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# ANALYSIS

## POTENTIAL FOR SINO-EUROPEAN COOPERATION IN CENTRAL ASIA AND THE SOUTHERN CAUCASUS

### Introduction

Central Asia and the Caucasus are lands of great potential. This is particularly the case from the perspectives of China and the European Union (EU), which could see the region as the link between their two markets. Those two economic giants traded at a level of about 1.5 billion Euros a day in 2019, a volume that has stayed stable for several years.<sup>1</sup> However, the Great Caspian Sea region is still held back by other elements. International relations are still, at least partially, based on the assumptions of a zero-sum game that characterized the Cold War era. This has led to diplomacy being more confrontational than necessary in some cases. This causes potential partners to adopt stances of mutual opposition to each state's interests instead of using their resources toward an outcome that would be optimal for all. In Central Asia, scholars have described the hypothesized competition between great powers for the control of the region's resources as the "New Great Game."<sup>2</sup> This concept can also be expanded to cover the South Caucasus, which, if anything, has seen more direct intervention from great powers in support of potential allies.

This confrontational stance has not been without consequences; instability deters investment. Despite such a limitation, the sheer quantity of resources in the region, especially in the energy sector, has attracted investors. However, stabilization has the potential to attract them even more. Furthermore, the region, especially Azerbaijan and the Caspian Sea, has seen a significant military buildup that has drained funds that could have been used to prepare the region's countries for the post-hydrocarbon period.

This begs the question: How can Europe and China engage in productive cooperation in Central

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<sup>1</sup> European Commission, "China," accessed February 3, 2021, <https://ec.europa.eu/trade/policy/countries-and-regions/countries/china/>; Gabor Braun, "Azerbaijan at a crossroads: The Europe - South Caucasus - Asia logistics nexus - European perspective," in *The South Caucasus-centred Transport Hub: The Crossroads of the East-West and the North-South Corridors*, edited by Mahir Humberov (Budapest: Institute for Foreign Affairs and Trade and Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2017): 33.

<sup>2</sup> Qamar Fatima and Sumena Zafar, "New Great Game: Players, Interests, Strategies and Central Asia," *South Asian Studies* 29 (2) (2014): 628.

Asia and the Southern Caucasus? A potential avenue would be by centering their relations on common interests, such as the extraction of natural resources, transportation of goods between the two regions, and the expansion of a consumer market in the region.

Such goals would have to orbit around two goals. First, collaboration between domestic and international actors is needed in order to develop the region's infrastructure to increase the existing capacity for trade between the two ends of the trade route, even if rival states tried to leverage concessions by halting the transportation of trade goods. Second, the regions should provide credible security guarantees that would allow funds to be used for development instead of military buildup. If peace between regional actors and with their powerful neighbors was to be secured, several hurdles for the maximization for the trade potential of the region would be overcome, which is in the best interests of all the actors involved.

For such projects to be feasible, the states of Central Asia and the Caucasus also have important roles to play to facilitate such cooperation. The bureaucratic hurdles faced by foreign investors have to be drastically reduced and the impacts of "iceberg costs," additional costs experienced after the exploitation of resources,<sup>3</sup> have to be limited. Those states also need to develop larger domestic consumer markets, thereby making the trade route more attractive compared with the sparsely populated Trans-Siberian Railway system<sup>4</sup>. Finally, cooperation from other states in the region on both security and economic issues is necessary to make the trading hub both stable and competitive.

### **Investment in infrastructure**

Investment in infrastructure has been one of the major developments of the last few decades in Central Asia and the South Caucasus. While these investments are not in the interests of established actors such as Russia, which acted as a resource hub during the Soviet period and aims to maintain its power in the region,<sup>5</sup> the relative geographical position of Europe makes clear that collaboration has the potential to have more pros than cons. This can be achieved by investing in three aspects of infrastructure. Two, extraction and transportation, are based on local investments; the last one is linked to developing the respective export markets. The result will be economic expansion.

The states of the region have generally made significant progress in the establishment of infrastructure dedicated to resource extraction. Both Kazakhstan and Azerbaijan have installed significant infrastructure in their respective oil fields. However, more challenging exploitation sites, such as Kashagan in northern Kazakhstan, would profit from foreign investment. In that specific site, the Italian-based firm Eni owns the rights to exploit the fields, but is slowed down by logistics and ecological concerns.<sup>6</sup> Nevertheless, more dangerous is the resource nationalism enacted by Kazakhstan. Recent pressures have led the Eni consortium to agree for the Kazakh ownership share of

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<sup>3</sup> R. Dornbusch, S. Fischer, and P.A. Samuelsson, "Comparative Advantage, Trade, and Payments in a Ricardian Model with a Continuum of Goods," *The American Economic Review* 67 (5) (1977): 829.

<sup>4</sup> Morten Anker et al., *The Caspian Sea Region Towards 2025: Caspia Inc., National Giants or Trade and Transit?* (Delft: Ebulon, 2010): 50.

<sup>5</sup> Diana Szoke and Zoltan Egeresi, "Azerbaijan at a crossroads: The Europe - South Caucasus - Asia energy nexus," in *The South Caucasus-centred Transport Hub: The Crossroads of the East-West and the North-South Corridors*, edited by Mahir Humbatov (Budapest: Institute for Foreign Affairs and Trade and Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2017): 15.

<sup>6</sup> Maria Sangermano, "Reshaping the Energy Balance: the Caspian Chessboard," in *Caspian Security Issues: Conflicts, Cooperation and Energy Supplies*, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 139.

the fields to double.<sup>7</sup> While this could increase state revenues for this particular site and, thus, be profitable in the short term, it could endanger long-term overall revenues. This is because foreign investments are doomed to be lower if they are at risk of political pressure. This would not be a problem if the only interest of Kazakhstan was in the development of the Kashagan fields, but if the country wants to become a major actor in global trade, it will need its investors to trust the government to respect negotiated agreements. Furthermore, bureaucratic hurdles making investments more difficult, which are common in the region,<sup>8</sup> need to be reduced for foreign direct investment to intensify. The necessary reforms are already under way in many countries, which are either in the process of or, in the case of Kazakhstan, have negotiated Enhanced Partnership and Cooperation Agreements (EPCA).<sup>9</sup> Such a step, if successful, would be interesting for Azerbaijan and Georgia to follow.

Even without such an agreement, Azerbaijan has seen significant progress in this aspect in recent years. According to Doing Business, the country ranks 34<sup>th</sup> in the world, a commendable score, similar to Kazakhstan's 25<sup>th</sup> and Georgia's 7<sup>th</sup>, which would make the trade corridor very competitive. However, the "Trading across Borders" category remains one of the weak points for all three countries.<sup>10</sup> However, in the case of Azerbaijan, its score is mostly brought down by the subcategory "Cost to export: Documentary compliance." If we look at the category as a whole, time demands for trade meet the standards for the region "Europe & Central Asia," while cost of trade lags slightly behind.<sup>11</sup> However, Azerbaijan has been taking measure to address some of these issues in recent years and has become a leader in other categories, such as "Getting Credit," in which the country ranks first in the world.<sup>12</sup> In fact, the 2019 report ranked Azerbaijan as one of the countries having improved their trade system the most compared with their previous report.<sup>13</sup>

However, trade costs in Azerbaijan, Georgia, and Kazakhstan are not the most pressing issue concerning resource extraction in Central Asia and the South Caucasus. More problematic is the situation in Turkmenistan, whose immense natural gas reserves are underexploited, in part owing to its hesitation to allow foreign investors into the country.<sup>14</sup> While it is able to extract gas from its inland fields, the country faces more challenges concerning its offshore exploitation opportunities. However,

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<sup>7</sup> Anker et al., *The Caspian Sea Region Towards 2025*: 37.

<sup>8</sup> Mahir Humbatov, "Europe -South Caucasus - Asia transport, investment and logistics nexus: Perspectives, challenges and implementations," in *The South Caucasus-centred Transport Hub: The Crossroads of the East-West and the North-South Corridors*, edited by Mahir Humbatov (Budapest: Institute for Foreign Affairs and Trade and Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2017): 69.

<sup>9</sup> European Commission, "EU and Kyrgyz Republic initial Enhanced Partnership and Cooperation Agreement," Countries and Regions, last modified July 6, 2019, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=2046>; European Commission, "Kazakhstan," Countries and Regions, <https://ec.europa.eu/trade/policy/countries-and-regions/countries/kazakhstan/>, accessed on November 4, 2020; European Parliament, "Enhanced Partnership and Cooperation Agreement (EPCA) with Uzbekistan," EU texts, accessed on November 4, 2020, <https://www.europarl.europa.eu/delegations/en/enhanced-partnership-and-cooperation-agr/product-details/20200406DPU25171>.

<sup>10</sup> Doing Business, "Rankings," accessed February 2, 2021, <https://www.doingbusiness.org/en/rankings>

<sup>11</sup> World Bank Group, "Doing Business 2020: Economy Profile – Azerbaijan," accessed February 2, 2021, <https://www.doingbusiness.org/content/dam/doingBusiness/country/a/azerbaijan/AZE.pdf>.

<sup>12</sup> Doing Business, "Doing Business in Azerbaijan," accessed on February 2, 2021, <https://www.doingbusiness.org/en/data/exploreeconomies/azerbaijan#>.

<sup>13</sup> World Bank Group, *Doing Business 2019: Training for Reform* (Washington: International Bank for Reconstruction and Development/The World Bank, 2019): 1.

<sup>14</sup> Sangermano, "Reshaping the Energy Balance: the Caspian Chessboard": 134.

Ashgabat has shown itself more cooperative concerning those reserves.

Nevertheless, it would be an error to limit our attention solely to hydrocarbon resources. The Great Caspian Sea region is host to some of the largest reserves of many minerals on Earth.<sup>15</sup> Uzbekistan has one of the largest reserves of gold on the planet,<sup>16</sup> which could act as an accessible source of this metal for China to use in producing electronic components. Kazakhstan hosts the largest chromium reserves, the second-largest barite reserves, and the third-largest uranium reserves in the world.<sup>17</sup> The latter could be of particular interest as the world is looking for renewable energies to produce electricity and nuclear energy is an obvious contender.

Staying on the subject of electricity production, the region could also profit from producing solar energy in the semi-arid areas of Kazakhstan, Uzbekistan, and Turkmenistan.<sup>18</sup> Meanwhile, the high mountains of the Caucasus, the Tian Shan and Pamir ranges, could be used to produce hydroelectricity.<sup>19</sup> A major hurdle to that goal was cleared when Uzbekistan, under the new leadership of Shavkat Mirziyoyev, allowed Tajikistan to go ahead with its plan for finalizing the Rogun Dam, which will, once completed, be the highest dam in the world.<sup>20</sup>

However, resource exploitation does not end at extraction. If anything, the transportation of those resources to their final destinations has been more of an issue in Central Asia due to the landlocked nature of the countries. In 2015, Mazhikeyev and colleagues found that the transport of goods by rail through Central Asia could increase the cost of trade by up to 60%, mainly due to the cost of crossing multiple borders.<sup>21</sup> Therefore, the problem is twofold: China and Europe need to help countries in the region to develop their infrastructure; meanwhile, the countries of the region need to come to agreements in order to reduce the “iceberg costs” plaguing local trade.

As the infrastructure situation currently stands, four main pipelines, of varying capacities and conditions, head westward from Baku; three oil pipelines head, respectively, to ports in Turkey, Georgia, and Russia; meanwhile, one natural gas pipeline heads to Turkey and, since last December, to the Adriatic Sea.<sup>22</sup> Progress is also visible on the subject of maritime transport, as the Caspian states have been expanding their port capacities with impressive projects in Aktau, Alyat, and Turkmenbashi.<sup>23</sup>

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<sup>15</sup> Anker et al., *The Caspian Sea Region Towards 2025*, 15.

<sup>16</sup> *Ibid.*: 38.

<sup>17</sup> *Ibid.*: 38.

<sup>18</sup> Bahtiyor Eshchanov et al., “Solar Power Potential of the Central Asian Countries,” *Central Asia Regional Data Review* 18 (2019): 1-7.

<sup>19</sup> Anker et al., *The Caspian Sea Region Towards 2025*: 38-40.

<sup>20</sup> BBC, “Tajikistan’s Rogun: Building the world’s tallest dam,” last modified November 13, 2016, <https://www.bbc.com/news/world-asia-37929367>; Reuters, “Uzbekistan drops objections to giant Tajik hydro project,” last modified March 9, 2018, <https://www.reuters.com/article/tajikistan-uzbekistan-hydro/uzbekistan-drops-objections-to-giant-tajik-hydro-project-idUSL5N1QR4CD>.

<sup>21</sup> Arman Mazhikeyev, T. Huw Edwards, and Marian Rizov, “Openness and isolation: The trade performance of the former Soviet Central Asian countries,” *International Business Review* 24: 945.

<sup>22</sup> Benjamin K. Sovacool, “Reconfiguring territoriality and energy security: global production networks and the Baku-Tbilisi-Ceyhan (BTC) pipeline,” *Journal of Cleaner Production* 32 (2012): 211-213.

<sup>23</sup> Humbatov, “Europe -South Caucasus - Asia transport, investment and logistics nexus: Perspectives, challenges and implementations,” 85-86.

Furthermore, the Baku–Tbilisi–Kars railway opened in 2017, which could facilitate rail transportation of goods between the Black and Caspian seas.<sup>24</sup> Nevertheless, Azerbaijan still lags behind the world average in railway density,<sup>25</sup> and infrastructure on the other side of the Caspian, and especially in Turkmenistan, is lagging behind.<sup>26</sup> Furthermore, both ends of the region connect to less developed areas, which also demands increased infrastructure investments.

Concerning the pipeline situation, the Central Asian and South Caucasian states face different challenges. On the western shores of the Caspian Sea, Azerbaijan already has many pipelines connecting their hydrocarbon resources to either the Mediterranean or the Black Sea. The two main pipelines currently being developed are Baku–Tbilisi–Ceyhan (BTC) and the South Caucasus Pipeline (SCP). Europe already has its eyes set on those pipelines. The recent transformation of the SCP into the Southern Gas Corridor (SGC) stands as one of the most ambitious projects in recent years. The SGC is a project to integrate the large gas reserves of the Great Caspian Region to the European Market by an extension of the SCP into a system of pipelines that would reach Greece and then the Adriatic Sea.<sup>27</sup> The project was completed in December 2020; therefore, it is too early to draw conclusions about its consequences for trade between the Southern Caucasus and Europe. However, the inauguration marks a new era of opportunity for closer economic ties in the future. While we tend instinctively to think of Turkmenistan when talking about gas exports from the region, the Shah Deniz gas field of Azerbaijan is also an attractive deposit. It is expected that the field will export 10 bcm of gas annually toward the European continent.<sup>28</sup> The project has seen significant support from both the European Union and the United States since its inception due to the commercial advantages linked to it and its capacity to diminish Russian leverage over Europe.<sup>29</sup> The success of such a project could lead to further investment in similar proposals in the future.

However, the significant developments of the BTC and SGC left alternative routes with little attention. While Europe has little or no interest in modernizing the existing pipeline connecting Baku to Novorossiysk, a connection to a Georgian port on the Black Sea, with or without a pipeline project linked to it, could be of interest. Such a project would have the potential not only to involve the export of oil and natural gas (which will nevertheless remain a major part of the trade from Central Asia and the Caucasus toward Europe), but also of goods originating from China if the development were to be designed to be adapted to more traditional trade cargo. A potential supplementary link between the Southern Caucasus and Europe already exists in the Baku–Supsa Pipeline. However, its development has slowed owing to two issues. First, most modern oil tankers are not only too large to pass through the Turkish straits but also would be too numerous.<sup>30</sup> Second, plans to lay a pipeline at the bottom of

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<sup>24</sup> Ibid.: 61.

<sup>25</sup> Ibid.: 56.

<sup>26</sup> Paolo Sorbello, “Turkmenistan’s Ongoing Gas Quandary,” *The Diplomat*, last modified April 25, 2017, <https://thediplomat.com/2017/04/turkmenistans-ongoing-gas-quandary/>.

<sup>27</sup> Marco Siddi, “The EU’s Botched Geopolitical Approach to External Energy Policy: The Case of the Southern Gas Corridor,” *Geopolitics* 24, (1) (2019): 129.

<sup>28</sup> Yahoo! Finance, “BP Delivers Gas From Shah Deniz to Europe, Boosts Competition,” last modified January 3, 2021, <https://finance.yahoo.com/news/bp-delivers-gas-shah-deniz-145402163.html>.

<sup>29</sup> Siddi, “The EU’s Botched Geopolitical Approach to External Energy Policy,” 130-131.

<sup>30</sup> Kamer Kasim, “Azerbaijan-Turkey-Turkmenistan Triangle: an ideal model of cooperation,” in *Trilateral Dimension of Azerbaijan’s Foreign*

the Black Sea have been judged either too costly or not interesting enough and have seen declining interest.<sup>31</sup> However, investment in a Black Sea port and a European counterpart could reap some benefits, despite the large initial investment. Similarly to the connection between Alyat and either Aktau or Turkmenbashi, which connects Central Asia to the Caucasus, investment into Black Sea terminals would connect the Southern Caucasus with Eastern Europe.

Instead of seeing it as a rival to the Turkish terminal, such a project should be considered as a second link between the two regions that would reduce the pressure on each terminal. Obviously, this would throw a wrench into the Turkish aspiration of being the regional resource hub.<sup>32</sup> However, it would still benefit greatly from hosting not only the largest terminal but also the one handling the most valuable resources and also serving the richest countries in Europe, as the previously mentioned limitations of the Turkish straight would leave it with a mandate for the Mediterranean. Meanwhile, a more modest port on the Black Sea could cover the demand for Chinese goods in Eastern Europe via the Black Sea. This would also have the added advantage for Europe of giving the two poorest states in the EU, Bulgaria, and Romania,<sup>33</sup> large infrastructure projects that could improve the local economy. Overall, a third connection via the Black Sea is not essential for Sino-European trade but could be beneficial by reducing pressure on the other nodes and providing Eastern Europe with direct access to the trade corridor.

On the eastern shores, the issue stands less in the connections with China than the quality of the infrastructure in place to get products out of the country. That issue is particularly great in Turkmenistan, a country has already seen large investments from China,<sup>34</sup> but for which the initial hopes were scaled back when Beijing cut its demand for natural gas after Ashgabat failed to deliver on its promises, mainly owing to poor infrastructure.<sup>35</sup> However, as established before, Turkmenistan has been more than reluctant to let foreign actors have access to the country. The participation of Turkmenistan is nonetheless essential as its immense natural gas reserves will inevitably attract more investors to the overall project.

In the case of Kazakhstan, infrastructure is overall of better quality. Its connection to both China and the Caspian reduces transport costs as no borders need to be crossed for that portion of the road. This could make the port of Aktau a better long-term investment for the transport of goods in the Sino-European trade. Furthermore, the mineral reserves of Kazakhstan are of the greatest interest for China considering its current industrial composition.<sup>36</sup> However, one issue is found on the other side of the

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Policy, edited by Farhad Mammadov and Fuad Chiragov (Baku: Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2015): 68.

<sup>31</sup> Ibid.: 76.

<sup>32</sup> Anker et al., *The Caspian Sea Region Towards 2025*: 75.

<sup>33</sup> CIA, "Central Asia: Bulgaria," accessed on December 1, 2020, <https://www.cia.gov/library/publications/the-world-factbook/geos/bu.html>; CIA, "Central Asia: Romania," accessed on December 1, 2020, <https://www.cia.gov/library/publications/the-world-factbook/geos/ro.html>.

<sup>34</sup> Matteo Verda, "Landlocked Caspian States and the Access to International Energy Markets," in *Caspian Security Issues: Conflicts, Cooperation and Energy Supplies*, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 122.

<sup>35</sup> Paolo Sorbello, "Turkmenistan's Ongoing Gas Quandary," *The Diplomat*, last modified April 25, 2017, <https://thediplomat.com/2017/04/turkmenistans-ongoing-gas-quandary/>.

<sup>36</sup> Jennifer C. Li, "China's Rising Demand for Minerals and Emerging Global Norms and Practices in the Mining Industry," Working Paper

Sino-Kazakh border: The current policies that can be described at minimum as major human rights abuses in the Xinjiang region of China make any investment riskier as it would entail significant potential for domestic backlash.<sup>37</sup>

Concerning the “iceberg costs” associated with trade in Central Asia and the Caucasus, the states of the region have been making some progress in recent years. Overall, the cost of rail transport will always be greater than transport by sea. However, this mode of transportation is significantly faster, especially in the case of trade between China and the EU.<sup>38</sup> Central Asian states, once so unwilling to integrate their economies, have been taking giant steps toward that aim in recent years. Before the pandemic halted international travel, the region was planning to introduce a “Silk Visa” giving access to up to four of the five Central Asian states (excluding Turkmenistan) with the explicit aim of creating a local equivalent to the Schengen Zone.<sup>39</sup> This could be very significant in states like Uzbekistan that used to base their economies on protectionist principles.<sup>40</sup> However, the sincerity of those claims and how the ongoing COVID-19 pandemic will affect these goals is still to be seen.

Furthermore, the region has been successful at improving its trade relations with the EU via the previously mentioned negotiations of EPCAs with Kazakhstan, Uzbekistan, and Kyrgyzstan. If Azerbaijan and Georgia were to go in the same direction, trade between China and the EU would be more uniform than ever, which would drastically reduce the bureaucratic cost of trade.

Nevertheless, trade tariffs will still make trade costlier in the region, especially considering it has more borders to negotiate than the Russian route, which borders both China and the EU directly.<sup>41</sup> However, it would be unreasonable for the transit states to completely give up on those revenues that form one of the most important short-term revenue sources for those countries. Nevertheless, to be competitive, the total tariffs need to be not significantly larger than the total Russian tariffs.

However, this alternative route has another potential advantage. In contrast to the Trans-Siberian railway, this new Silk Road is home to a large population of potential consumers for both European and Chinese goods.<sup>42</sup> However, in order to tap its full potential, investment needs to be made in the local economies to increase the population’s capacity to consume those products. Thankfully, several of those countries have received significant amounts of revenues linked to the hydrocarbon trade in recent decades; these are being reinvested for diversifying their economies once these resources become less profitable.<sup>43</sup>

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No.2 (2006).

<sup>37</sup> Sharon Braithwaite and Lindsay Isaac, “UK to fine companies that fail to disclose imports tied to China’s Xinjiang region,” CNN Business, last modified January 12, 2021. <https://www.cnn.com/2021/01/12/business/uk-xinjiang-supply-chain/index.html>.

<sup>38</sup> Braun, “Azerbaijan at a crossroads,” 35.

<sup>39</sup> Khamza Sharifzoda, “Can a ‘Silk Visa’ Boost Tourism in Central Asia,” The Diplomat, last modified January 15, 2019, <https://thediplomat.com/2019/01/can-a-silk-visa-boost-tourism-in-central-asia/>.

<sup>40</sup> Arman Mazhikeyev, T. Huw Edwards, and Marian Rizov, “Openness and isolation: The trade performance of the former Soviet Central Asian countries,” *International Business Review* 24: 935.

<sup>41</sup> Anker et al., *The Caspian Sea Region Towards 2025*: 50.

<sup>42</sup> Ibid.

<sup>43</sup> Indra Overland, “Petroleum Revenue and Caspian Security. Conflict Driver or Means of Conflict Resolution?” in *Caspian Security Issues*:

This is one of the main reasons why foreign investment is necessary in the previous two sectors despite some of those countries having wealth of their own. It is both in Europe's, China's and the region's interest for these countries to fully focus on developing diversified economies that would create an attractive market with the infrastructure already in place to respond to their demand. Among the most promising projects are the large ports in Aktau and Alyat that will not only bring significant revenues but also provide long-term employment to their respective regions.<sup>44</sup> Each of these infrastructure projects, and many other ports in the area, are accompanied with special economic zones meant to attract industries in exchange for special tax rates and other benefits. While the Aktau zone proved to be more successful, the Alyat zone was originally held back by legislative issues.<sup>45</sup> This led the Azerbaijani parliament to review the law in 2018;<sup>46</sup> this new version of the Free Economic Zone was then placed under temporary administration until an authorized body took over in May 2020.<sup>47</sup> These are encouraging developments for the success of the project.

Overall, infrastructure investment has been one of the aspects of Europe–Caspian–China relations that has been most developed. However, it has often been used more as a connection between the region and one of the two other actors than as a way to connect all three regions into one trade corridor that would be profitable to all involved. By coordinating their efforts, the full potential of the region could more easily be achieved.

### **Stabilization of the region**

The security aspect of the issue can itself be separated into two different categories. First is the need for security for the states of the region. This includes both regional or domestic rivalries, most notably challenges to territorial integrity in Azerbaijan and Georgia, with the former being settled only last November. Second is both protection from, and the non-antagonization of, actors foreign to the region.

Concerning the need for national security, it is well known that insecurity makes investments less attractive.<sup>48</sup> That is particularly the case when talking about infrastructure that is difficult to move, such as pipelines. Before Azerbaijan liberated its occupied territory, the strategic pipelines connecting the region to the Black and Mediterranean Seas were within striking distance of an Armenian offensive.<sup>49</sup> Furthermore, a small portion of the Baku–Supsa pipeline is currently under the control of

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Conflicts, Cooperation and Energy Supplies, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 156.

<sup>44</sup> Braun, Azerbaijan at a crossroads, 44-45.

<sup>45</sup> Humbatov, "Europe -South Caucasus - Asia transport, investment and logistics nexus: Perspectives, challenges and implementations," 90-93.

<sup>46</sup> AzerNews, "Azerbaijani parliament adopts law on FEZ in Alyat settlement," last modified March 6, 2018, <https://www.azernews.az/business/128365.html>.

<sup>47</sup> Mushvig Mehdiyev, "Azerbaijan Creates Free Economic Zone Offering Competitive Advantages," Caspian News, last modified May 26, 2020, <https://caspiannews.com/news-detail/azerbaijan-creates-free-economic-zone-offering-competitive-advantages-2020-5-26-29/>.

<sup>48</sup> Anker et al., The Caspian Sea Region Towards 2025, 9.

<sup>49</sup> Overland, "Petroleum Revenue and Caspian Security," 166.



the separatist republic of South Ossetia-Alania.<sup>50</sup> The possibility of such a link, especially one transporting strategic resources, being interrupted owing to war makes it a dangerous strategy for states to depend on. This is particularly relevant as one of Europe's motivations for assisting in the Caucasus is to avoid dependence on Russia, Armenia and South Ossetia-Alania's ally, for such resources.<sup>51</sup>

Thankfully, one of the potential conflicts, and the one involving the most actors, was resolved in 2018 when the coastal states of the Caspian Sea agreed on a legal status for the body of water that includes Article 14.1, which allows states to lay pipelines at the bottom of the sea, and Article 10.2, which guarantees free access for the member states' fleets to its surface.<sup>52</sup> Such a development is particularly relevant owing to the increasing militarization of the sea before the deal was struck.<sup>53</sup>

However, security concerns are not limited to the region. Russia's desired control of the territories of the former Soviet Union might stand as one of the main challenges to the success of a Sino-European trade corridor through the Caspian region. Such fears were increased not only by the Russian intervention in South Ossetia and Eastern Ukraine, but by the refusal of the West to act on its promises to protect those countries.<sup>54</sup> This comes on top of years of the United States and its allies acting in ways that were seen as disrespectful by many states of the region, in particular Azerbaijan and Uzbekistan.<sup>55</sup>

This situation creates volatile relations with those countries in search of security but also leads to increased military spending by those countries. This is particularly the case for Azerbaijan,<sup>56</sup> which faced both intra-regional concerns with Armenia and extra-regional tensions with Russia and Iran.<sup>57</sup> The main issue with such a situation is that the resources spent on the military could have been of better use in diversifying the economy and investing in the country's infrastructure. As a comparison, Kazakhstan, which only faced tension with Russia, was able to invest significantly more of their revenues toward that goal.<sup>58</sup>

Such relations with Russia and, in a lesser measure, Iran bring another challenge for the trade

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<sup>50</sup> Margarita Antidze, "Georgia just accused Russia of slowly eating away at its borders," Business Insider, last modified July 13, 2015, <https://www.businessinsider.com/georgia-accusing-russia-of-taking-territory-2015-7?r=UK>.

<sup>51</sup> Szoke and Egeresi, "Azerbaijan at a crossroads," 19.

<sup>52</sup> Convention on the Legal Status of the Caspian Sea (2018). <http://en.kremlin.ru/supplement/5328>.

<sup>53</sup> Azad Garibov, "Caspian Naval Build-up: Militarization and Arms Race," in *Caspian Security Issues: Conflicts, Cooperation and Energy Supplies*, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 85.

<sup>54</sup> Heydar Mirza and Igor Korobov, "Pragmatic Policies and Interplay of Forces - Azerbaijan's foreign policy amidst Turkey and Iran," in *Trilateral Dimension of Azerbaijan's Foreign Policy*, edited by Farhad Mammadov and Fuad Chiragov (Baku: Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2015): 87-89.

<sup>55</sup> Mirza and Korobov, "Pragmatic Policies and Interplay of Forces," 86; Aleksandr Pikalov, "Uzbekistan between the great powers: a balancing act or a multi-vectorial approach?" *Central Asian Survey* 33 (3) (2014): 297-311.

<sup>56</sup> R. Craig Nation, "Protracted Conflicts in the Caucasus," in *Caspian Security Issues: Conflicts, Cooperation and Energy Supplies*, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 42.

<sup>57</sup> Richard Weitz, "Caspian Triangles: Azerbaijan's Trilateral Diplomacy-A New Approach for a New Era," in *Trilateral Dimension of Azerbaijan's Foreign Policy*, edited by Farhad Mammadov and Fuad Chiragov (Baku: Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2015); 10, 15.

<sup>58</sup> Overland, *Petroleum Revenue and Caspian Security*, 156.

corridor: its strategic significance. Ironically, what makes this corridor so attractive to Europe and China in a security perspective is also what makes it so dangerous for the countries of the region: it enables alternative trade routes that circumvent Iran and Russia, thus reducing their power to leverage concessions from Europe.<sup>59</sup> Therefore, it is important that development be done in a way that is not seen as a threat to Russian interests. This is where the traditional multi-vectorial diplomacy that defines most of the region<sup>60</sup> could prove effective. More specifically, the triangular diplomacy used by Azerbaijan could be raised from a national to a regional scale. In such a scenario, the China–South Eurasia–Europe route would be only one of many trade corridors traversing the region. Examples of other corridors include the existing Iran–Caucasus–Russia corridor (assuming that relations between the United States and Iran warm with the new administration taking office).<sup>61</sup> Other potential partners include South Asia, which could be connected through Central Asia.

Inclusion of other actors in a way that makes it also profitable for them makes it less likely that they will intervene against the trade corridor. The Southern Caucasus in particular would otherwise be vulnerable to intervention by Russia, which traditionally has a military presence in Armenia and the separatist republics in Georgia. While Azerbaijan used to not have any such presence,<sup>62</sup> the monitoring of the Lachin corridor following the 2020 Nagorno-Karabakh war reintroduced the Russian military to the country.<sup>63</sup>

### **Domestic participation**

As a final and shorter point, the countries of Southern Eurasia need to increase collaboration in order to lead such projects to fruition. In their 2010 book, Morten Anker and colleagues predicted that, if the South Caucasian countries failed to collaborate, the trade corridors would have to bypass them, which would cause their isolation and near collapse.<sup>64</sup> Thankfully, such an apocalyptic scenario is unlikely considering the friendly relations that Azerbaijan and Georgia have cultivated,<sup>65</sup> and the fact that Armenia, with which Azerbaijan has tense relations, is not needed to connect the two seas. Furthermore, the recent conflict pushed the line of conflict away from the pipelines, which makes the related security concerns less relevant. Finally, recent developments have opened the door for more

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<sup>59</sup> Weitz, “Caspian Triangles,” 9; Szoke and Egeresi, “Azerbaijan at a crossroads,” 19; Stephen Blank, “The Geopolitical Significance of the Caucasus: An American View,” in *Caspian Security Issues: Conflicts, Cooperation and Energy Supplies*, edited by Marco Valigi (Novi Ligure: Edizioni Epoké, 2014): 57.

<sup>60</sup> Szoke and Egeresi, “Azerbaijan at a crossroads,” 14; Aleksandr Pikalov, “Uzbekistan between the great powers: a balancing act or a multi-vectorial approach?” *Central Asian Survey* 33, (3) (2014): 297-311.

<sup>61</sup> Gulzar Salimova, “International North-South Transport Corridor: South Caucasus-centred approach,” in *The South Caucasus-centred Transport Hub: The Crossroads of the East-West and the North-South Corridors*, edited by Mahir Humberov (Budapest: Institute for Foreign Affairs and Trade and Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2017): 101.

<sup>62</sup> Verda, “Landlocked Caspian States and the Access to International Energy Markets,” 125.

<sup>63</sup> “Russia deploys peacekeepers to Nagorno-Karabakh after ceasefire deal,” *France 24*, last modified November 11, 2020. <https://www.france24.com/en/europe/20201111-russia-deploys-peacekeepers-to-nagorno-karabakh-after-ceasefire-deal>.

<sup>64</sup> Anker et al., *The Caspian Sea Region Towards 2025*, 123-124.

<sup>65</sup> Carlo Frappi, and Marco Valigi, “Patterns of cooperation in the Southern Caucasus area,” in *Trilateral Dimension of Azerbaijan’s Foreign Policy*, edited by Farhad Mammadov and Fuad Chiragov (Baku: Centre for Strategic Studies under the President of the Republic of Azerbaijan, 2015): 31-59.

cooperation between Azerbaijan and Armenia in the transport sector. In January 2021, coordinated statements from Armenia, Azerbaijan, and Russia opened the door to future talks about cooperation in regional transport.<sup>66</sup> The first of these discussions was held the next month; the participants agreed to form expert subgroups.<sup>67</sup> This could enable the creation of a significantly shorter railway connection between Turkey and Azerbaijan by transiting through Armenia via the Azerbaijani exclave of Nakhichevan.<sup>68</sup>

Most other elements linked to domestic participation of regional actors have been addressed. Bureaucratic hurdles are slowly being addressed and “iceberg costs” are going down with regional integration and improved infrastructure. The resolution of the Caspian Sea status is an important step toward long-term stability in the region. Nevertheless, many countries in the region, such as Uzbekistan, have a history of regularly rebooting their diplomatic relations<sup>69</sup> and, if a confrontational stand was to be adopted by multiple states of the region, it could endanger the prospects for a new Silk Road to appear.

## Conclusion

In conclusion, cooperation between Europe and China in Central Asia and the Southern Caucasus is not only possible, but also profitable for all actors involved. Such cooperation would have to be based on two axes: investment and stabilization. However, the states of the region also have a role to play in making such relations possible. They need to reduce the barriers to trade and maintain stable and cordial diplomatic relations with their neighbors.

Foreign investments need to be focused on three elements: improving resource extraction, improving goods transportation, and bolstering the local consumer markets. Meanwhile, stabilization efforts need to focus on resolving conflicts within the region, which are particularly numerous in the Southern Caucasus, and to secure the region from hostile interventions undertaken by other actors such as Russia and Iran.

While such cooperation is possible and profitable, it does not mean that it will be adopted by the involved states. A Cold War mentality in which diplomacy is necessarily a zero-sum game could hinder any attempt to collaborate with a rival power.<sup>70</sup> Furthermore, some of the infrastructure needed for projects to be successful has a high initial cost but will only bring profits in the long term.

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<sup>66</sup> Azertac, “Russian President, Azerbaijani President and Armenian Prime Minister made press statements,” last modified January 11, 2021, [https://azertag.az/en/xeber/Russian\\_President\\_Azerbaijani\\_President\\_and\\_Armenian\\_Prime\\_Minister\\_made\\_press\\_statements\\_VIDE\\_O-1685479](https://azertag.az/en/xeber/Russian_President_Azerbaijani_President_and_Armenian_Prime_Minister_made_press_statements_VIDE_O-1685479)

<sup>67</sup> Mushvig Mehdiyev, “Azerbaijan, Armenia and Russia Hold First Meeting to Restore Regional Transport Links,” Caspian News, last modified February 3, 2021, <https://caspiannews.com/news-detail/azerbaijan-armenia-and-russia-hold-first-meeting-to-restore-regional-transport-links-2021-2-3-0/>.

<sup>68</sup> Orkhan Baghirov, “The Nakhchivan corridor will boost connectivity in the Caucasus,” EURACTIV, accessed on February 3, 2021, <https://www.euractiv.com/section/azerbaijan/opinion/the-nakhchivan-corridor-will-boost-connectivity-in-caucasus/>.

<sup>69</sup> Aleksandr Pikalov, “Uzbekistan between the great powers: a balancing act or a multi-vectorial approach?” *Central Asian Survey* 33 (3) (2014): 297-311.

<sup>70</sup> Kasim, Azerbaijan-Turkey-Turkmenistan Triangle, 61.

Governments under pressure to reap immediate results might be put off by such projects. However, if a project was to come to fruition, the whole region could fulfill the enormous potential it has been denied for so long.

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*The views expressed in the writings belong to the authors and do not necessarily reflect the editorial policy of the AIR Center*