

March 2017



The EU, the Eurasian Economic Union and One Belt, One Road Can they work together?

By Ian Bond

The EU, the Eurasian Economic Union and One Belt, One Road: Can they work together?

By Ian Bond

- ★ There are three main integration projects in the Eurasian landmass: the European Union, the Eurasian Economic Union (EAEU) and China's 'One Belt, One Road' (OBOR) initiative. The EU is the largest economic bloc; the EAEU covers the largest area; OBOR covers the largest population.
- ★ These three projects spring from very different motives. The European Union is an institution which uses economic interdependence to preserve the peace in a part of the world where major wars have been the norm in history, and to make Europeans richer and freer (albeit with mixed results). The Eurasian Economic Union is Russia's latest attempt to reassemble as many as possible of the former Soviet states around itself, using economic leverage rather than military force. 'One Belt, One Road' serves a variety of purposes for China, including encouraging economic development in the west of the country and linking China to Europe by land as well as sea.
- ★ Geographically, the three projects overlap, with OBOR having the largest coverage but the lightest institutional architecture. Historically, if great powers had overlapping spheres of influence there would almost certainly be conflict between them. There are risks in the current situation.
- ★ But there is also an opportunity for the EU, EAEU and China to work together to avoid conflict and to look for synergies between their objectives. The EAEU and China have agreed to pursue convergence between OBOR and the EAEU; and the EU and China are major economic partners, and are looking for opportunities to work together in the countries involved in OBOR. The missing link is a relationship between the EAEU and the EU. The EU is rightly suspicious that the EAEU is more of a Russian geopolitical project than a genuine economic union between its members; but it should not dismiss it out of hand.
- ★ Relationships within and between these initiatives could easily go wrong. There are tensions between the EU and Russia, including over Russia's invasion of Ukraine and annexation of Crimea in 2014. There are tensions between countries along the 'Silk Road' from China to Europe. Russia is pursuing a strategic partnership with China at present, but their interests are not identical and nationalists on both sides occasionally voice suspicion or hostility to the other.
- ★ But there may be scope for an innovative approach to diplomacy and economic co-operation across a huge expanse and for the benefit of an enormous population. The approach would have to be incremental, starting with modest objectives and aiming to build confidence among the parties gradually, given the differences among them.

- ★ There are considerable obstacles in the way of working together. The EU is overwhelmed by internal and external challenges: the continuing problems of the eurozone; failure to control irregular migration from the Middle East and North Africa; tensions in the transatlantic relationship in the era of Donald Trump; and Russian mischief-making in EU countries as well as in Eastern Europe. Russia is economically weak (and will remain so as long as oil prices are relatively low), but compensating by being disruptive internationally, so that other powers are obliged to pay attention to it. China has proclaimed itself a champion of globalisation, but the playing field for foreign businesses in China is still far from level. The differences in values and political systems between the main powers in the region are enormous.
- ★ Nonetheless, Europe can no longer be certain that the US will protect the multilateral order, or that the Trump administration will see America's interests in Europe and Asia as similar to those of the EU and its member-states. There are shared economic and security interests in Europe and Eurasia that the parties could pursue, albeit with no guarantee of finding common approaches. But it is better for Europeans to try to find some common ground with the former Soviet states and China than to watch passively as the existing order is replaced by something much more hostile to the EU's values and interests.

When the Cold War ended with the collapse of the Soviet Union in 1991, it left many states on Russia's periphery detached from the empire of which they had formed part, in some cases for several centuries. Some of these states gravitated towards the West, ultimately joining the EU and NATO; some sought to remain under Russia's security and economic umbrella; some chose to remain neutral and to avoid being pulled into alignment with any of their neighbours.

The ascendancy of the Western political and economic model in Central and Eastern Europe coincided with the rise of China. Rapid economic growth and increasing integration into global trade allowed Beijing to lift hundreds of millions of people out of poverty, and to wield more influence in international forums. And as oil prices rose from 2000 onwards, Russia's leader, Vladimir Putin, began to rebuild his country's strength and to seek to reassert its influence in its former empire.

For almost two decades after the Cold War, countries wanted to converge (or at least to appear to converge) with the West, economically and politically. The free market capitalist economic model seemed to work, even if in its most primitive form it produced huge inequalities in society in countries like Russia. And most rulers concluded that it was in their interest to have the external trappings of democracy, or at least to look as though they were en route to becoming more democratic. The 2008-2009 financial crisis and subsequent economic

dislocation in developed countries jolted the post-Cold War international system. Even in the West, more and more people questioned whether the liberal international order and the process of globalisation were delivering economic benefits to them. Enthusiasm for taking more members into Western clubs waned. Russia and China found themselves in a position to increase their relative strength and their ability to shape the countries around them. They began to challenge Western models of economic and political integration.

The result is that in 2017 the landmass that includes the EU, the former Soviet Union and China is the object of three main regional integration processes, different in history, motivation and design but geographically overlapping. This policy brief looks at the nature and objectives of the three processes, the scope for them to complement each other and the benefits that would bring, as well as the risks of competition or conflict.

The EU, the EAEU and OBOR: Three models of integration

The EU has been a successful peace project in Europe, a region which had previously suffered a succession of large-scale wars between its major powers, culminating in the Second World War. It has used economic co-operation within a strong framework of rules to give its

members incentives to work together, and to reassure them that none of them can achieve dominance over the rest. As it celebrates the 60th anniversary of the signing of the Treaty of Rome in March 2017, the EU has grown from its original six member-states to 28, with seven

more countries at various stages of the formal accession process. It will lose one member, however, when the UK leaves in 2019 or later.

The EU is the world's largest single market, with almost 510 million people and a GDP of around €15 trillion. It is by far the most advanced of the three integration processes, with a wide range of institutions and significant supranational governance, including a single currency used by most of its member-states, and an elected parliament. But it is struggling with a range of internal and external problems. Economically, growth has been anaemic since the financial crisis, and Greece has teetered on the brink of default. Politically, the EU faces a challenge from populist parties that want to unpick or destroy the EU project. External crises have strengthened the populists: they have exploited the flows of immigrants both to attack the EU's institutions and to drive wedges between member-states.

“The EU's enlargement process, once its most powerful tool for encouraging neighbouring countries to reform, has stalled.”

At the same time, the EU's enlargement process, once its most powerful tool for encouraging neighbouring countries to reform, has stalled. Jean-Claude Juncker, the president of the European Commission, said in July 2014 that there would be no new enlargement in the next five years. The EU's European Neighbourhood Policy, designed to create stability, prosperity and good governance in the countries on Europe's periphery has been a near-total failure. The EU's Eastern Partnership, established in 2008, was supposed to produce “stability, better governance and economic development”. But four of the six former Soviet states in the Eastern Partnership are among the ten most corrupt countries in Europe and Central Asia.¹ The EU has never been able to agree whether the Eastern Partnership has a role to play in helping countries to prepare for accession to the EU, if that is what they themselves want. In any case, the six countries are divided in their own attitudes to the EU and Russia. Three of them want closer ties with Brussels and have signed association agreements with the EU, while two are members of the EAEU.

The EAEU grew out of a proposal by Kazakh President Nursultan Nazarbayev in 1994 for a Eurasian Union.² At that time Kazakhstan was a newly independent state with few international connections, and the bid to get back into Russia's economic and security orbit made good sense. In the intervening years, Kazakhstan has attracted large-scale investment in its oil and gas sector and built foreign relations with all the world's major powers. But over the same period, Russia's appetite for increasing its

influence in the former Soviet Union has also grown.

The EAEU has become the latest and so far the most institutionally sophisticated vehicle for Moscow to bring its neighbours back under its aegis. Its current members are Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia itself. Collectively, they cover an area of 20 million km², or a seventh of the land surface of the earth; have a population of about 180 million; and a GDP of around \$1.6 trillion in 2015. The economy of the EAEU may look small in comparison with that of the EU, but it produces an impressive amount of oil and gas (almost all of it from Russia and Kazakhstan): in 2014, EAEU countries produced more than 14 per cent of the world's oil and almost 20 per cent of its gas.³

The EAEU is loosely modelled on the EU. It has a Commission with representatives from each of the member-states. Unlike the EU, all the members of the EAEU have strong executive presidencies, with prime ministers having more limited powers; so rather than a single equivalent of the European Council the EAEU has a Supreme Council at head of state level and an inter-governmental council at prime ministerial level. An economic commission council (roughly corresponding to the Council of Ministers of the European Union) meets at deputy prime minister level. It also has a court, based in Minsk, and there are plans for a financial regulator to be established in Kazakhstan's financial capital, Almaty. The EAEU does not have a parliament, however, perhaps because most of its member-states have no tradition of democratically elected parliaments that can hold the executive to account.

The EAEU also copies the EU in aspiring to apply the ‘four freedoms’ (free movement of goods, services, labour and capital) across its member-states. The member-states have agreed to open their markets, though they are doing this gradually, both in terms of the sectors and the countries covered. Rather like the EU, the EAEU is finding free movement of goods and labour is easier to facilitate than free movement of services and capital. Because all the members of the EAEU were already members of the Commonwealth of Independent States (CIS) free trade agreement of 2011, most trade between them in goods was already tariff free, but non-tariff barriers remained; one of the goals of the EAEU is to remove these.

Free movement of labour is important both to Russia and to the poorer member-states of the EAEU, especially Armenia and Kyrgyzstan. Remittances from migrant workers in Russia made up more than 9 per cent of the GDP of Armenia and almost 20 per cent of the GDP of Kyrgyzstan in 2015. The need for remittances also explains why Tajikistan and (if its new pro-Russian president gets his

1: See ‘Communication from the Commission to the European Parliament and the Council: Eastern Partnership’, December 3rd 2008 and Transparency International, ‘Corruption Perceptions Index 2016’, January 25th 2017.

2: James Kilner, ‘Kazakhstan welcomes Putin's Eurasian Union concept’, *Daily Telegraph*, October 6th 2011.

3: Eurasian Economic Commission, ‘Energetika/Energy’ [Russian/English], 2015.

way) Moldova are interested in joining the EAEU: almost 22 per cent of Tajikistan's 2015 GDP consisted of remittances from Russia, and nearly 8 per cent of Moldova's.⁴

From January 2015, the EAEU liberalised trade in 43 service sectors including construction, engineering, agriculture, retail and wholesale trade and hospitality; but the opening was only partial. Belarus and Russia moved immediately to open their markets to engineering services (for example); Kazakhstan has until 2025 to follow suit.⁵ In addition, each member-state has derogations based on national legislation: Belarus, Kazakhstan and Russia all ban or restrict foreign ownership of land; while foreigners may not own businesses or open branches of their businesses in 'closed cities' (sensitive defence facilities) in Russia. Another 21 service sectors, including advertising and audiovisual services, are supposed to become part of the EAEU's internal market by 2025.

“China's OBOR is the most ambitious project in geographical scope and resources available, and the least institutionalised.”

Implementing the free movement of capital is likely to prove a problem both politically and technically. The scale of Russia's economy means it is by far the most significant EAEU investor in other member-states: 80 per cent of intra-EAEU direct investment (FDI) in 2015 came from Russia. The result is a highly asymmetric pattern of investment: more than half of Belarus's FDI stock is from other EAEU countries (above all Russia), while for Russia the figure is 0.5 per cent.⁶ For the non-Russian members of the EAEU, the prospect is that the most attractive parts of their economies will be bought up by Russian investors, many of whom (given the nature of the Russian economy) will be closely connected to the Russian administration. At the same time, Russia and Kazakhstan, with economies dominated by the hydrocarbons sector, are very vulnerable to the effect of oil and gas prices on their exchange rates. During 2014 and 2015 the Russian ruble lost more than half its value. Kazakhstan attempted to keep its currency, the tenge, more stable, but the effect of that was to make Russian goods more competitive on the Kazakh market; ultimately Kazakhstan

was forced to allow the tenge to float, which resulted in a steep loss of value.⁷

One important difference between the EU and the EAEU is that the latter is limited to the economic sphere: there is no common foreign policy and no equivalent of the EU's role in law enforcement, counter-terrorism or external migration. While Russia had ambitions to create a more comprehensive Eurasian Union, Belarus and Kazakhstan wanted to limit it to economic issues. When the treaty creating the Eurasian Economic Union was signed in May 2014, the first deputy prime minister of Kazakhstan, Bakytzhan Sagintayev, told the *New York Times*: “We are not creating a political organisation; we are forming a purely economic union. It is a pragmatic means to get benefits. We don't meddle into what Russia is doing politically, and they cannot tell us what foreign policy to pursue.”⁸ Kazakhstan has spent 25 years developing a successful 'multi-vector' foreign policy involving good relations with Russia, China and the West; it does not want to be forced to tilt too far in Russia's direction, particularly when China is a more important trading partner.

Of the three integration projects, China's OBOR is both the most ambitious in geographical scope and resources available, and the least institutionalised. One could even question whether it should be considered a single project at all. The Chinese president, Xi Jinping, set out the broad parameters of the initiative in two speeches in 2013: one in Kazakhstan, proposing a “Silk Road Economic Belt” from China through Central Asia to Europe; and one in Indonesia proposing a “Maritime Silk Road” from China via South-East Asia, South Asia and Africa to Europe.⁹ It was only after the two speeches that the Chinese Communist Party endorsed the idea of investing in infrastructure connecting China with its neighbours, and even then the initiative was given little or no publicity by the Chinese media.¹⁰ Yet since then OBOR has become the signature initiative of Xi's time in office, attracting international partners and featuring in innumerable statements by Chinese officials and experts overseas. According to an evaluation of OBOR by the consultancy company PwC, 66 countries from Lithuania to Indonesia are now part of the initiative.¹¹ For the purpose of this policy brief, however, the most relevant part of the initiative is the 'Belt', the (largely) overland route, or rather multiple routes, from China to Europe via Russia and other countries of the former Soviet Union.

4: World Bank data, 'Personal remittances, received (percentage of GDP)' and 'Bilateral remittance data', 2015.

5: Interview with the minister of the economy and financial policy of the Eurasian Economic Commission Timur Suleymenov in the newspaper *Kazakhstanskaya Pravda*, 'Eurasian integration is the most important factor in the stable development of our countries', Eurasian Economic Commission website [in Russian], January 30th 2015.

6: Tatiana Valovaya (editor-in-chief), 'Yevraziyskiy Ekonomicheskiy Soyuz: Novaya real'nost', novye vozmozhnosti' (Eurasian Economic Union: New reality, new possibilities [in Russian]), November 2016; Eurasian Economic Commission, 'Pryamye investitsii, eksport i import uslug v Yevraziyskom Ekonomicheskom Soyuze 2015 - Statisticheskii Byulleten' (Direct investment, export and import of services in the Eurasian Economic Union 2015 - Statistical Bulletin [Russian]), 2016.

7: Sergey Aleksashenko, 'Kazakhstan Floats The Tenge: Nothing personal, just business', Center on Global Interests, August 24th 2015.

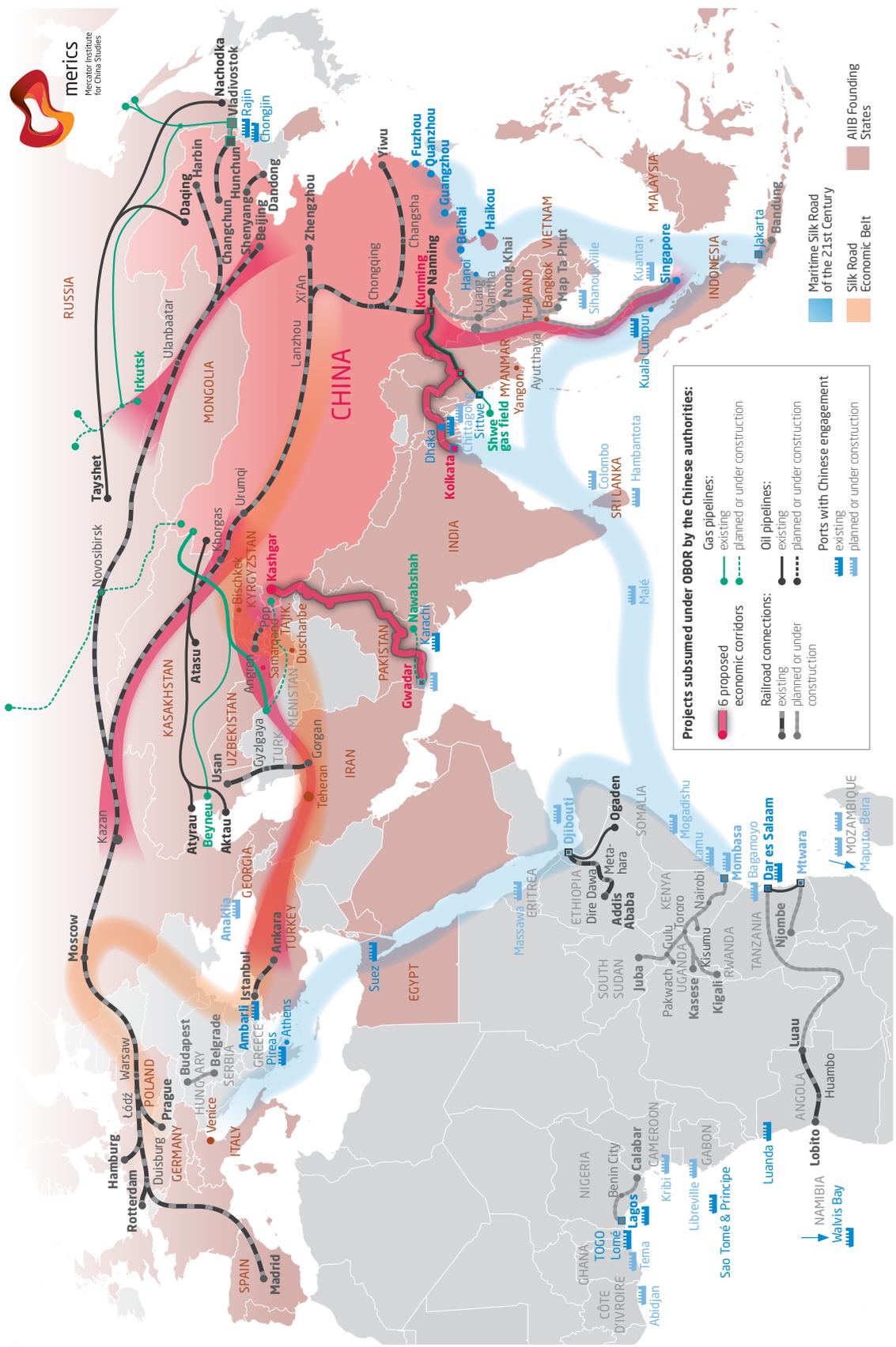
8: Neil MacFarquhar, 'Russia and two neighbours form economic union that has a Ukraine-size hole', *New York Times*, May 29th 2014.

9: 'President Xi Jinping delivers important speech and proposes to build a Silk Road Economic Belt with Central Asian countries', Ministry of Foreign Affairs of the People's Republic of China, September 7th 2013; 'Speech by Chinese President Xi Jinping to Indonesian Parliament', ASEAN-China Centre, October 2nd 2013.

10: For example, there is no reference to OBOR in the English-language summary of Xi's key reforms from the official Chinese news agency: 'Xi explains China's reform plan', *Xinhuanet*, November 15th 2013.

11: Gabriel Wong, Simon Booker and Guillaume Barthe Dejean, 'China and Belt & Road infrastructure: 2016 review and outlook', PwC B&R Watch, February 2017.

One Belt, One Road



Source: Mercator Institute for China Studies



In presenting OBOR to external audiences, China portrays the aims of the initiative in many different ways, offering its partners opportunities to see in the project whatever most interests them. In his speech in Kazakhstan, Xi Jinping described it as a step by step approach to regional co-operation. The first stage was to strengthen “policy communication” on national economic development strategies. Next would come road connectivity, creating a transport route from the Pacific to the Baltic and eventually a transport network connecting East, West and South Asia. The third element would be trade and investment facilitation. Fourth would be steps to increase financial resilience and make Central Asia more economically competitive in the world. Fifth would be people-to-people exchanges promoting understanding.

“The AIIB, with \$100 billion in capital, was designed to fill a real need for more investment in infrastructure in Asia.”

OBOR has an important geopolitical component for China: it increases China’s influence in many of the countries along the various routes. Indeed, one of the striking things about OBOR is that it is not one belt or one road, but many. In a positive sense, China is ensuring that many parties will benefit from the initiative and welcome Chinese influence in the world. More defensively, China is hedging its bets, providing itself with alternative connections in case any of the routes between Asia and Europe are obstructed. The leading Chinese scholar Wang Jisi of Peking University set out the case for this in an important article in 2012 (often quoted in meetings with Chinese experts), as a response to America’s ‘pivot to Asia’; indeed, his argument reads like the inspiration for Xi’s speeches in 2013. Wang argued that China needed to ensure that supply lines to the west of China remained open for oil and other commodities, via a ‘new Silk Road’ from China’s east coast cities through Central Asia and Europe to the Atlantic and Mediterranean.¹²

OBOR also plays an important internal role for China, in two ways. First, investment in infrastructure along the routes from China to Europe soaks up excess capacity in Chinese industries including steel and cement, keeping workers employed and staving off any social unrest at a time when domestic consumption of such commodities is growing more slowly. Second, building infrastructure

westwards is intended to benefit (among other places) the western province of Xinjiang, long troubled by ethnic violence; it will find itself on an important transport route to Europe rather than stuck at the end of the line. Beijing presumably hopes that economic development in Xinjiang will divert the Uighur minority who live there away from separatism and towards making money.

For the moment, OBOR has very little structure of its own; a number of Chinese ministries and agencies are responsible for carrying it forward.¹³ Beijing is working to give the initiative a more international character, to get away from the sense that this is a unilateral Chinese project. Wang Jisi identified the risk that other powers would label China as a neo-colonialist if it did not tread carefully. But at the same time, according to Chinese experts speaking privately, Beijing does not want to create a new international organisation with formal membership: China sees this as a move that might worry countries that were not included, including the US and (implicitly) Russia. Instead, China has made use of other organisations, such as the Shanghai Co-operation Organisation (SCO), to which Russia and all the Central Asian states except Turkmenistan belong. SCO presidents, meeting in Tashkent in June 2016, reaffirmed their support for the Silk Road Economic Belt “as one of the tools of creation of favourable conditions for the development of regional economic co-operation”.¹⁴ SCO prime ministers said in November 2016 that the Belt would “contribute to forming new models for international co-operation, strengthen partnership ties between countries, increase investment, and create new employment opportunities”.¹⁵

The SCO’s support, however, is more rhetorical than practical: the Central Asian states are not likely to be major investors in OBOR projects, though some of them may be major beneficiaries. The main vehicle for foreign investment in such projects is likely to be the Asia Infrastructure Investment Bank (AIIB). Xi proposed the establishment of the bank in the same speech in Indonesia in which he proposed the creation of the Maritime Silk Road. In part the proposal was an expression of frustration at the fact that countries including the US and Japan were blocking China’s efforts to increase its influence in traditional international financial institutions including the Asian Development Bank (ADB).¹⁶ But the AIIB, with \$100 billion in capital, was also designed to fill a real need for more investment in infrastructure in Asia, which the ADB alone could not meet. And because many Western powers, with the notable exception of the US, are

12: Wang Jisi, “Marching Westwards”: The rebalancing of China’s geostrategy, International and Strategic Studies Report, Centre for International and Strategic Studies, Peking University, October 7th 2013.

13: National Development and Reform Commission, Ministry of Foreign Affairs and Ministry of Commerce of the People’s Republic of China, ‘Vision and actions on jointly building Silk Road Economic Belt and 21st Century Maritime Silk Road’, *Xinhua*, March 28th 2015.

14: “The Tashkent declaration of the fifteenth anniversary of the Shanghai Co-operation Organisation”, Shanghai Co-operation Organisation website, June 24th 2016.

15: Joint communique: The fifteenth meeting of the SCO heads of government (prime ministers) council, Shanghai Co-operation Organisation website, November 3rd 2016.

16: Ian Bond, ‘Russia and China: Partners of choice and necessity?’, CER report, December 2016.

members of the AIIB, they give it an air of respectability and international buy-in for the projects it funds. As yet, however, the AIIB has only funded nine projects, and only two of them are in the former Soviet Union: one in Azerbaijan and one in Tajikistan. China's national Silk

Road Fund, with \$40 billion in capital, has also made only modest investments in Central Asia and the Caucasus since it started operations in 2014, though it has taken an equity stake in a Russian liquefied natural gas project on the Yamal Peninsula (in the Arctic Ocean).

Complementarity or competition in Eurasia?

There is considerable geographical overlap between the three integration processes. Two of the EU's Eastern Partners, Armenia and Belarus, are also members of the EAEU. But OBOR is the most comprehensive: according to PwC's list, all the countries of the EU's Eastern Partnership and all the members of the Eurasian Economic Union are involved, as well as a number of EU member-states. Even the UK can claim a small part of the Silk Road: a train from Yiwu in eastern China arrived in London on January 18th 2017, via Kazakhstan, Russia, a number of EU countries and the Channel Tunnel.

“Even the UK can claim a small part of the Silk Road: a train from China arrived in London in January.”

Though EU member-states are important trading and investment partners for Central Asia, the EU has been less politically visible in the region than China or Russia have been. All the Central Asian states bar Turkmenistan are members of the Shanghai Co-operation Organisation; Kazakhstan and Kyrgyzstan are members of the EAEU (with Tajikistan likely to join shortly). The EU has Partnership and Co-operation Agreements with all the Central Asian states except Turkmenistan; it adopted a 'Strategy for a new partnership' between the EU and Central Asia in 2007, which included a regional political dialogue, a regional energy dialogue and human rights dialogues with each of the states. When it reviewed this strategy in 2012, the EU congratulated itself on a "significant intensification of relations" with the countries of the region.¹⁷ In a further review in 2015, the EU claimed "substantial progress in developing relations" with the countries of the region.¹⁸ The evidence for this is generally hard to find, though the EU did sign an Enhanced Partnership and Co-operation Agreement with Kazakhstan in December 2015. This new agreement covers 29 areas of co-operation – mostly relating to trade in goods and services and removing barriers of various sorts, but with a brief section on foreign and security policy, including co-operation on promotion and protection of human rights and the rule of law. The

European Investment Bank has made loans in Kazakhstan, Kyrgyzstan and Tajikistan totalling over €500 million, mostly for energy and environmental projects.

There is plenty of scope for competition and suspicion between the three initiatives. Russia clearly sees the EU's Eastern Partnership as a geopolitical project; otherwise President Vladimir Putin would not have worked so hard with Armenia and Ukraine to thwart it. At least some Chinese scholars see it in the same light: Li Xin, director of the Centre for Russian and Central Asian Studies at the Shanghai Institute for International Studies, bracketed NATO expansion and the Eastern Partnership together and concluded that "the West extended its tentacles into the territory of the former Soviet Union".¹⁹

At the same time, despite the agreement between Xi and Putin in May 2015 to harmonise the development of the EAEU and OBOR, Russia has moved cautiously on linking together the two multilateral initiatives, and has instead emphasised its bilateral relationship with China. By spring 2016 the Eurasian Economic Commission still seemed in no hurry to start talks that might lead to a free trade agreement between the EAEU collectively and China. Chinese experts say privately that China is willing to be patient: OBOR is a long-term project, and Beijing recognises that it cannot be successful without Russia, or against Russia, because of Russia's influence in Central Asia. The Chinese also recognise that Russia and other members of the EAEU fear China's economic power, and that it will take time to overcome those fears: one former Chinese diplomat said that getting rid of stereotypes about China in the former Soviet Union would take a long time. China's carefully non-threatening approach seems to be paying off in Central Asia, where it has developed a symbiotic relationship in which Russia exercises local political influence by providing security, and China exercises it by providing investment.

In Eastern Europe, China has also avoided confronting Russia directly, while still to some extent undermining Russia's goals. It has not sided with Russia over the annexation of Crimea and it has become an important economic partner for Ukraine. As part of its strategy of having a wide range of routes to Europe, it has backed

17: Council of the European Union and European Commission, 'Progress Report on the implementation of the EU Strategy for Central Asia: Implementation Review and outline for Future Orientations', June 21st 2012.

18: Council of the European Union, 'Relations with Central Asia – Council conclusions on the EU Strategy for Central Asia', June 22nd 2015.

19: Li Xin, 'Chinese perspective on the creation of a Eurasian economic space', Valdai Discussion Club report, November 2016.

a Ukrainian plan to send goods by train and ship across the Black Sea, via Georgia and Azerbaijan, across the Caspian Sea and through Kazakhstan to China. Such a route, entirely outside Russia's control, would reduce the effectiveness of any future embargo on Ukrainian goods destined for Kazakhstan. It would also reduce transit times from Ukraine to China from about 40 days by ship to 14 days or less, making it possible for Ukraine to send perishable agricultural goods by the route.²⁰

China's approach to the EU has been a mix of constructive efforts to co-operate, and tactics that seem designed to weaken it. On the constructive side, China is keen to get the EU engaged in OBOR. The two sides agreed at a summit in 2015 to look for synergies between OBOR and the EU's Investment Plan for Europe (the so-called 'Juncker Plan', designed to encourage private investment in infrastructure). Since 1993 the EU has had a programme to develop a transport corridor from Europe to China via the Black Sea, South Caucasus, Caspian Sea and Central Asia (TRACECA), and there is clearly a logic in China and the EU combining their efforts as far as they can. The two sides have agreed to create a so-called 'connectivity platform' to improve infrastructure links and digital networks between the EU and China and in the countries along the way. From the EU side, the platform is also a way to get China to accept the EU's way of doing business in areas such as public procurement, competition policy and technical standards.²¹

“The missing leg of the triangle is a productive relationship between the EU and Russia.”

On the negative side, China has sometimes indulged in divide-and-rule tactics, playing off member-states against the Commission as it did in 2013, when it persuaded Germany to undermine the Commission's efforts to tackle unfair Chinese competition in solar panel production. From the Commission's perspective, the regular '16 plus 1' meetings that China holds with Central European EU member-states and countries in the Western Balkans risk creating a pro-Chinese 'lobby' in the EU through the promise of future investment, thereby making unified EU policy-making harder than ever.

Overall, there is potential for the EU and China to work together on OBOR, but as yet there are no concrete projects. The EU is keen to ensure that anything it does with China needs to meet European standards of transparency

and good governance, and that infrastructure is not built just so the Chinese can export over-production (as one EU official said privately). The European Commission is cautiously testing China's willingness to adapt to the EU's way of doing business, including rules on government procurement. The EU's 2016 strategy for China balances the areas where it sees China as needing to improve (a more level playing field for European businesses; less state subsidy for Chinese companies competing for business with European firms) and areas where it sees a common interest (peace and security in Africa, including anti-piracy operations off Somalia, in which the EU and China have both taken part).²²

The missing leg of the triangle, however, is a productive relationship between the EU and Russia. There are good reasons for the EU to take a firm line with Russia: politically, Russia's annexation of Crimea and invasion of eastern Ukraine challenge the norms of European security. EU member-states with memories of Soviet domination worry that Russia may see any sign of Western weakness as an opportunity to rebuild a sphere of influence in Central and Eastern Europe. Economically, Russia has been an extremely unco-operative partner since joining the World Trade Organisation in 2012: the EU has a number of disputes with Moscow, and no reason to believe that the EAEU will be any easier to deal with than the Russian authorities. So in its bilateral relations with Russia, the EU has little choice but to hold its ground and wait for better times. Both the EU and China, however, recognise that they cannot work together effectively along the Silk Road without taking some account of Russia and its historical links in the region.

The question is whether the EU's resolute approach to Russia has to extend to the EAEU. So far the EU has taken a largely negative approach to an organisation which it sees through the prism of Russia's political ambitions. It fears that rather than the EAEU serving as a vehicle for lowering barriers to trade with the rest of the world (as the EU itself has done), it will be a means for Russia to push the other members of the organisation to increase barriers, to the benefit of uncompetitive Russian firms and the detriment of more efficient European and Chinese enterprises. Indeed, the EAEU's common external tariff initially forced Kazakhstan to increase its own tariffs, though the Eurasian Economic Commission argues that tariff levels are now falling. European Commission officials do not want to give the EAEU legitimacy by dealing with it formally (as Russia would like), so limit themselves to informal contacts. But within those limitations, there is still some progress, for instance in harmonising EU and EAEU standards.

20: 'Feature: Ukraine-China cargo train on Silk Road opens up prospects for trade promotion', *Xinhua*, January 31st 2016.

21: Francesco Saverio Montesano and Maaike Okano-Heijmans, 'Economic diplomacy in EU-China relations: Why Europe needs its own 'OBOR'', Clingendael Netherlands Institute of International Relations, June 2016.

22: European Commission and High Representative for Foreign Affairs and Security Policy, 'Joint communication to the European Parliament and the Council: Elements for a new EU strategy on China', June 22nd 2016.

The European Commission and the European External Action Service do not like to think of the EU as a geopolitical actor, but both Russia and China see the EU in that light. Even so, it may be possible for the EU and China to work together, and to work with the EAEU. The Chinese are right to identify poor EU-Russia relations as a problem

for their ambitions for OBOR; and working through a multilateral organisation, even one dominated by Russia, may be a way to park some of the difficult issues in the relationship and at least try to find out whether there is any scope to make progress on trade and economic issues and reducing barriers between the parties.

Opportunities and risks of co-operation

The journey from Brussels to Beijing is a long one. The EU might take the view that it is China's business where it invests, and that as long as trade between Europe and China can travel by sea and air, the business case for creating rail and road infrastructure in Eurasia is weak. On the other hand, the EU has an interest, shared with China, in the stability and prosperity of the countries of Eastern Europe and Central Asia. Co-operation with China to create infrastructure around which, over time, new businesses might grow up may be one way in which the EU can make progress towards its objective.

“There is no basis for pursuing grandiose visions of a single economic space from Lisbon to Vladivostok.”

There are many reasons for pessimism about the chances of using the EAEU and OBOR to reduce regional tensions and promote economic development along the route from China to Europe, and few grounds for optimism. But there are good reasons to try something new. The EU-Russia stand-off in Eastern Europe shows no sign of improving, but the EU lacks the will to take decisive action to protect countries like Georgia that seek to integrate with the West. Over time the West's resolve to maintain sanctions against Russia is likely to erode. President Donald Trump's wish to 'get along' with Russia, though so far restrained by more Russia-sceptic members of his administration, could easily result in the US lifting sanctions at some point without Russia withdrawing its forces from Ukrainian territory. The effect of that would be to destabilise a region on Europe's borders. Russia does not (yet) judge that coercing more Eastern European states into its sphere of influence would be worth the pain of additional Western sanctions, but it is likely to exploit any opportunity that it sees to strengthen its presence in the politics and economics of the region.

The EU should certainly be on the look-out for Russia trying to use contacts between the Commission and the EAEU to legitimise Russian dominance of neighbouring states. The abortive trilateral talks between the EU, Russia

and Ukraine in 2014 and 2015, when Russia sought to redraft parts of Ukraine's association agreement with the EU, were an object lesson in the risks (though in the end the Commission rightly called a halt without conceding to Russia). Any decision to engage with the EAEU should only be taken after checking that other EAEU member-states were comfortable with direct EU contacts with the Eurasian Economic Commission. And any engagement must respect the fact that the EAEU is (thanks to Kazakhstan) only an economic union, without any foreign policy function.

The fact that the EAEU is institutionally limited to the economic sphere, and that OBOR is primarily a project for regional economic integration, makes it easier to justify practical co-operation. Trade between China, the EU and Russia is stagnating or declining. Growth in the EU is modest; Russia's growth will creep back above zero in 2017 after two successive years of contraction; and even China's growth, while above 6 per cent, masks a variety of economic problems. It is worth an effort to boost growth by reducing the barriers to trade between East and West.

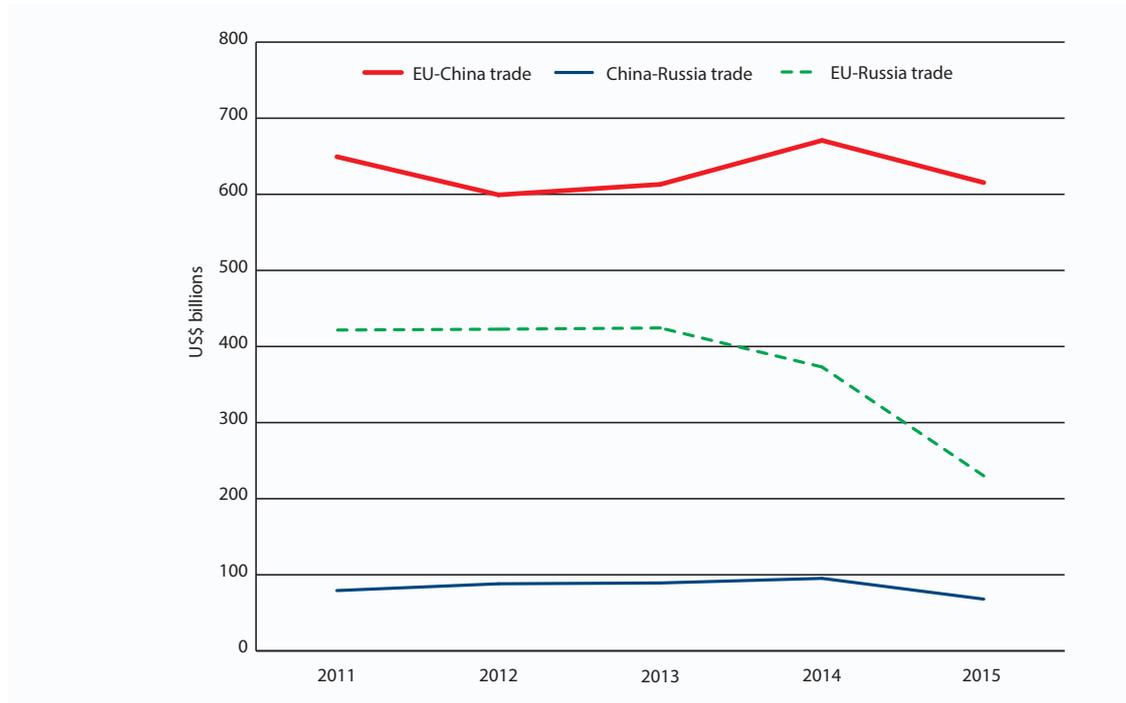
Engagement should be step-by-step. There is no basis at present for pursuing grandiose visions of a single economic space from Lisbon to Vladivostok, despite the interest of the Russian side in getting the EU involved in negotiations to that end. The EU should learn from past attempts to agree comprehensive programmes of co-operation with Russia: Moscow has implemented hardly any element of the ambitious 'Common Spaces' of 2003 (covering co-operation on freedom, security and justice; trade and the economy; foreign policy; and education, science and culture) or the 'Partnership for Modernisation' launched in 2010. Instead of looking for another large-scale initiative to announce, the EU should work quietly and incrementally with the Eurasian Economic Commission, the relevant Chinese agencies and the countries along the routes of the Silk Road Economic Belt. The goal should be to facilitate trade across the whole region, aiming gradually to reduce tariffs and remove non-tariff barriers, and to promote transparency, good governance and the rule of law, initially at least limited to the commercial sphere. In a 2016 report, the International Institute for Applied Systems Analysis outlined a possible 'mega-deal' between the EU and the

EAEU, involving trade agreements, removal of non-tariff barriers, the creation of integrated electricity markets and visa liberalisation.²³ But any idea of making such a deal an *a priori* political goal would be a mistake: better to start with more realistic expectations. In the long term, such

a gradual approach might create enough confidence for the three parties to work together on more ambitious ideas for free trade agreements; and it might open the way to extend the idea of 'rule of law' to include the legal framework for ensuring human rights.

Chart 1:
Trade between
China, the EU
and Russia

Source:
World Bank, *World
Integrated Trade
Solution*.



The EU, EAEU and China could all benefit from looking at the way in which the Conference on Security and Co-operation in Europe (the CSCE – often known as the 'Helsinki process') developed. It was a step-by-step evolution from the era of *détente*, when talks between the West, the Communist bloc and the neutral countries began in 1973, to the end of the Cold War in 1989. The precise design of the CSCE, with three 'baskets' of commitments relating to security, economic co-operation and human rights, could not be replicated (and almost all the countries along the Silk Road Economic Belt bar China are already participating states in the CSCE's successor, the Organisation for Security and Co-operation in Europe). But the process showed itself to be both flexible and resilient. It started out with a list of agreed basic principles of inter-state relations and relatively modest commitments in the three baskets, set out in the Helsinki Final Act of 1975. Through the ups and downs of East-West relations the participating states continued to meet, to review progress on previous commitments and to build on them (when they could agree) by adopting new ones.

Rather than aiming at distant and unrealistic goals, the EU, the EAEU and China could agree small steps to facilitate

trade and investment, review their implementation and then agree to more small steps. This would not preclude more far-reaching deals, but it might help to ensure that failure to conclude them did not mean no progress at all. The EU and China have been negotiating a Comprehensive Investment Agreement through 12 rounds of talks since 2013; an incremental process would not replace those negotiations, but might create a more positive atmosphere for them.

Even modest progress in increasing trade and investment and facilitating economic relations along the Silk Road would be a good thing. Despite the creation of the EAEU and OBOR, trade between the EU, China and Russia on the one hand and the former Soviet states along the Silk Road on the other has been dwindling. When the three big economies slow, the former Soviet states suffer along with their biggest trading partners. Trade between the former Soviet states on the one hand and China, the EU and Russia on the other has fallen significantly. The contraction in Russia's economy has probably been the most significant factor, not only reducing demand for exports from neighbouring states, but also hitting remittances from migrant workers.

23: Evgeny Vinokurov and others, 'Challenges and opportunities of economic integration within a wider European and Eurasian space', International Institute for Applied Systems Analysis, October 2016.

Chart 2a:
Trade between
Eastern Partners
and China, the
EU and Russia

Source:
World Bank, *World
Integrated Trade
Solution*.

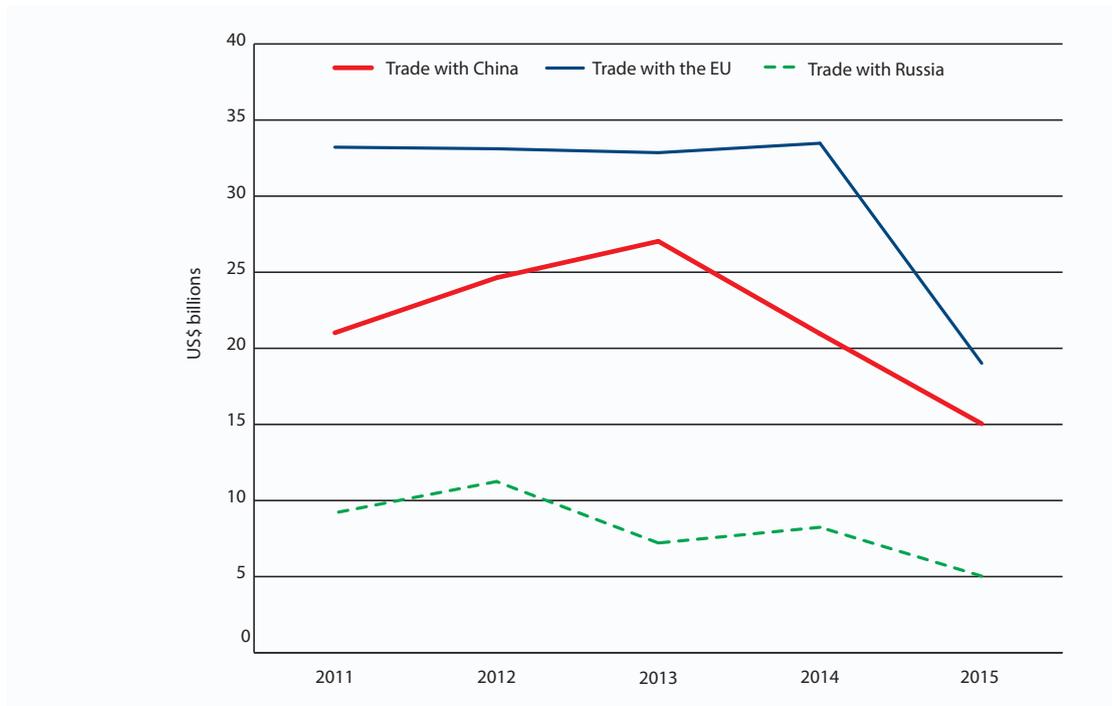
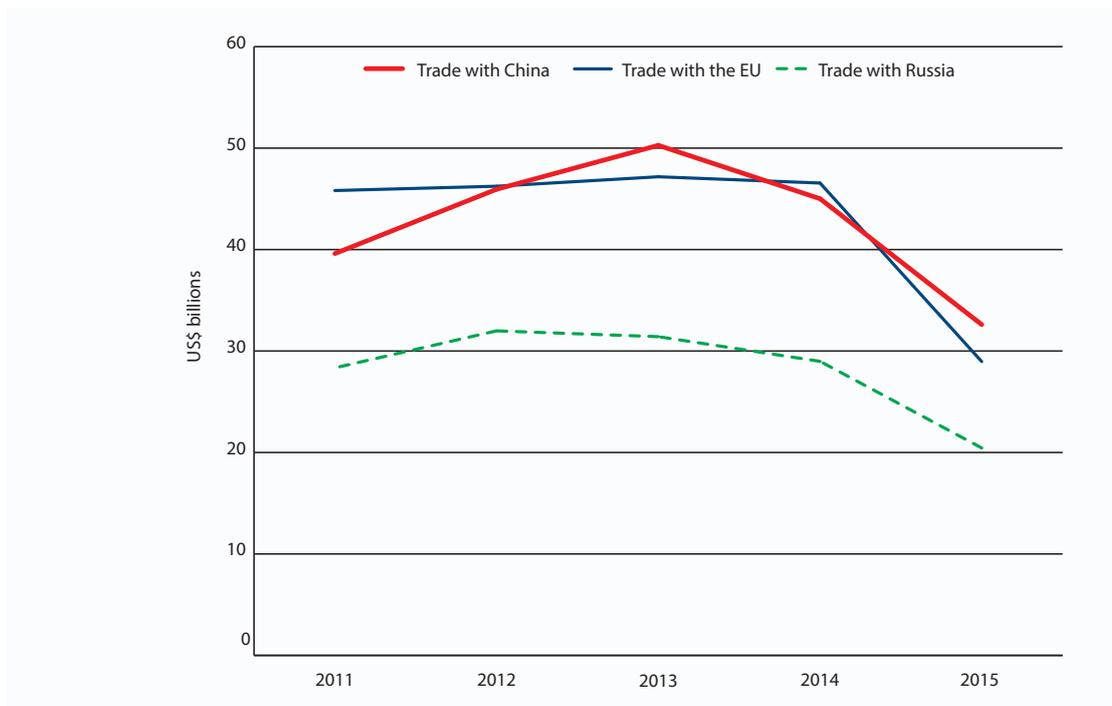


Chart 2b:
Trade between
the Central
Asian states and
China, the EU
and Russia

Source:
World Bank, *World
Integrated Trade
Solution*.



The structure of the trade between the 11 non-Russian states of the former Soviet Union (the six Eastern Partners and the five Central Asian states) on the one hand and the EU and China on the other shows that there is a degree of complementarity between their economies; but it also shows that the 11 still for the most part export agricultural and mineral commodities, and are not integrated into global manufacturing supply chains. China and the EU both import a lot of hydrocarbons from the region, and export mostly machinery and

manufactured goods. There should be scope for the former Soviet states to diversify and develop their economies as their physical connections to the rest of Asia and to Europe improve. Indeed, European and Chinese investment in infrastructure, provided that it responds to local needs as well as the interests of the EU and China, could do a lot to open up a region which has been on the margins of global political and economic progress for centuries.

Chart 3a:
Eastern
Partners' and
Central Asian
exports to
China, the EU
and Russia, by
category of
goods

Source:
World Bank,
World Integrated
Trade Solution
(categories based
on SITC Rev 4).

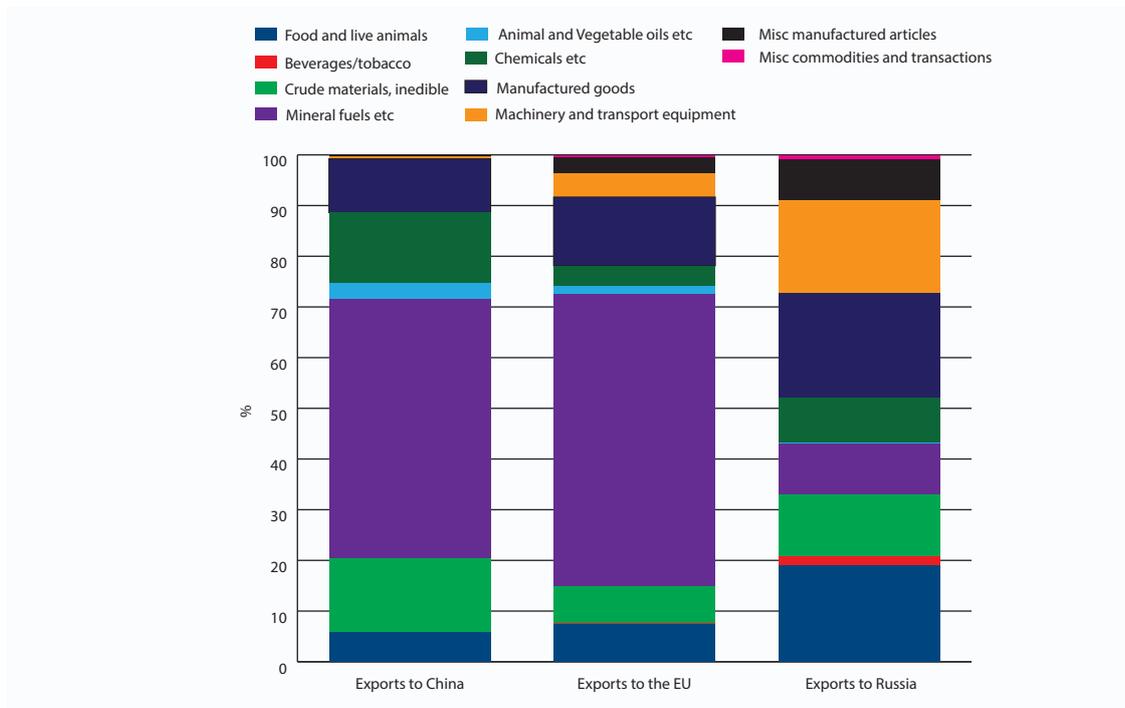
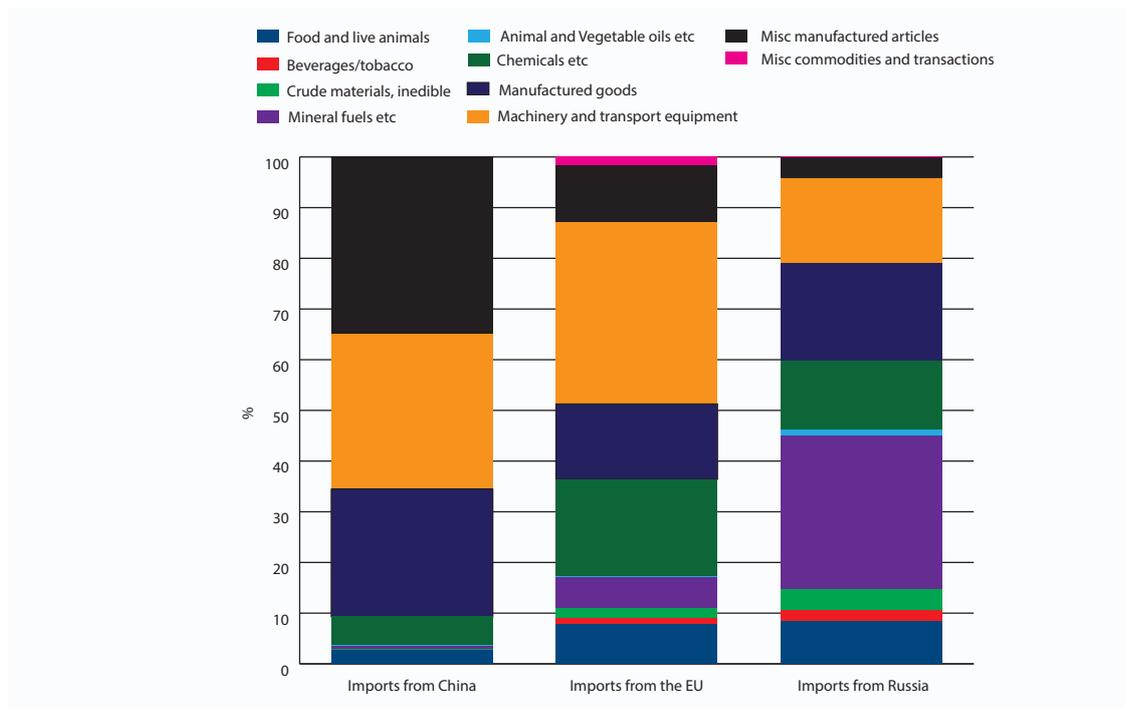


Chart 3b:
Eastern
Partners' and
Central Asian
imports from
China, the EU
and Russia, by
category of
goods

Source:
World Bank,
World Integrated
Trade Solution
(categories based
on SITC Rev 4).



It could easily turn out to be impossible to bring together three such disparate integration models, or to overcome stagnant trade resulting from internal economic difficulties in the region's biggest economies. The EU may find it too hard to think in strategic terms about its relations with former Soviet states (including Russia) and with China at a time when it is also trying to cope with internal and external challenges: Brexit; the continuing problems of the eurozone; failure to control irregular migration from the Middle East and North Africa;

and tensions in the transatlantic relationship in the era of Donald Trump. Putin may continue to compensate for economic weakness at home by muscle-flexing and causing mayhem abroad. China's commitment to globalisation and the rules-based system, as set out by Xi in his speech to the World Economic Forum in Davos, may turn out to be no more than window-dressing for a Western audience, while at home Xi pursues repressive policies that deter entrepreneurship.²⁴ The gap in values between an EU that bases almost all its activities on the

24: 'President Xi's speech to Davos in full', World Economic Forum, January 17th 2017.

rule of law, a Russia where the law is a flexible instrument for the regime and a China where the law is always subordinate to the will of the Communist Party may be so great that levelling the economic playing field proves to be impossible.

For any effort to build economic co-operation, even incrementally, to succeed, Russia would have to change its approach at least as much as China and probably more. The EAEU was not designed to make the former Soviet economies more open to the outside world. Russia, with its hydrocarbon-driven economy, thinks it has less to gain from globalisation and the easy movement of goods and services across borders than China, the EU or some of Russia's former Soviet neighbours. Given the state of the EU-Russia relationship, Beijing is likely to have to do more work to persuade Moscow that win-win economic relations are possible, and that a more open approach might help Russia to diversify its domestic economy and make it more resistant to the commodity price cycle.

“It is worth the EU making the effort to reach out to the members of the EAEU and to China.”

For all the foreseeable difficulties, however, it is worth the EU making the effort to reach out to the members of the EAEU and to China. The EU should certainly see whether China, which has an interest in the smooth flow of goods to and from Europe via Russia, can help to overcome Russia's suspicion of Western institutions and their intentions; and whether Beijing accepts that it has an interest in the survival of the liberal international order (even if it wants to modify it and ensure that China has more influence in it).

The EU needs to see whether it can make common cause with China because it can no longer be certain that it is on the same side as America when it comes to globalisation and free trade. Europe has been able to rely on the US

for the last 70 years, first to create and then to protect international institutions and international order, both economic and political. The Trump administration may undermine the multilateral organisations and ways of doing business on which international order has rested, if it turns the president's rhetoric into policies. Trump has shown over many years that he does not understand modern international trade; that he categorically believes that deficits are bad and surpluses are good; and that he does not like bodies such as the World Trade Organisation that can punish America for distorting trade.²⁵

Hopefully, the US administration will settle down and become more 'normal' in its trade policy; but there is no immediate evidence that it will; and Trump's inaugural address on January 20th 2017 and speech to Congress on February 28th were both protectionist in tone. The EU and its member-states should certainly try to persuade Trump to take a more traditional American stance. But they should also be prepared, in case he continues to behave in untraditional ways. They need to try to find common ground with other major trading partners, difficult though that may be, in order to maintain as much of the global trading system as they can. After the era of the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, when it seemed that the West would be able to set standards for international commerce for many years, the EU may find itself trying to negotiate common standards with China and the EAEU instead. It may well not succeed. The greater risk, however, is that the EU does not try, but leaves it to others to shape the future order, and ends up with something much more hostile to European values and interests.

This policy brief was written with generous support from the Open Society Foundations.

Ian Bond
Director of foreign policy, CER

March 2017

25: John Springford and Christian Odendahl, 'Trump, trade and the EU: Two wrongs don't make a right', CER insight, February 23rd 2017.