Discussion paper

Connecting Eurasia Dialogue

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On 15 March 2019, the first "Connecting Eurasia Dialogue: From the Atlantic to the Pacific" was held in Brussels, at Europe's political heart. The event was organized by the Roscongress Foundation and the Conoscere Eurasia Association with the support of the Association of European Businesses and the Belgian-Luxembourg Chamber of Commerce.

Amid the current political cooldown, this was a unique gathering, enabling a high-level dialogue on trade, economic, and integration issues among stakeholders from the wider Eurasian space, including the European Union (EU), the Eurasian Economic Union (EAEU), and China. The focus of high-level policy makers and top business executives attended the Dialogue was on challenges and opportunities of the EU's engagement with the EAEU, harmonization of soft infrastructure to enhance trans-Eurasian connectivity, and the EAEU's single pharmaceutical market. This IIASA discussion paper provides a summary of the deliberations, supported by research from inside and outside the Institute.

***Conclusions*:**

- An alternative to further non-engagement between the EU and the EAEU could be the initiation of a dialogue based on the spirit of German *Ostpolitik* of the 60s and 70s – *Wandel durch Annäherung* (Change through Rapprochement).

- Bottom-up trust-building through enhanced dialogue across business and expert communities is needed, complemented by continued technical-level talks between the European Commission and the Eurasian Economic Commission. Informal but systematic meetings could cover four practical issues: i) alignment of technical regulations and standards; ii) mutual facilitation of customs procedures and creation of "green transit corridors" between Europe and China through countries of the EAEU; iii) coordination of digital agendas; and iv) a coordinated stance toward China's Belt and Road Initiative. If successful, this would lay the foundation for shifting the dialogue to a higher level.

- Enhanced coordination in the area of soft infrastructure would foster adoption of the EU regulations and standards on investment, labor, environment, and other areas as a model for a common connectivity framework with the rest of Eurasia, which has proven to be effective in supporting business and welfare of citizens.

EU–EAEU economic ties

Opportunity costs of non-cooperation

Due to the crisis around Ukraine and the tensions between Russia and the West, relations between the European Union and the Eurasian Economic Union have not had a chance to further. Despite the Eurasian Economic Commission (EEC) having repeatedly stressed its interest in deeper cooperation with its partner to the west, the European Commission has not engaged in official talks and has not publicly recognized the EAEU's international legal personality. Not only have there been no official diplomatic contacts between the two unions, but economic relations have also deteriorated. Many countries of the Western world and Russia have imposed sanctions and counter-sanctions on each other.

The total trade turnover between the EU and EAEU countries decreased from US$461.3 billion (bn) in 2012 to $287.3 bn in 2017. Thus, because of sanctions, the fall in oil prices, and the economic decline in the Eurasian region – all of which can be attributed to political factors – *the two sides arguably have, together, lost out on $174 bn in foregone trade*.

From 2010 to 2017 most investments in Russia, the country, which accounts for 87% of the EAEU's GDP, originated from European countries. During that period, Cyprus, Ireland, the Netherlands, and the United Kingdom together contributed 48% of foreign direct investment (FDI) in Russia. Investments by Asian economies were less significant; for example, Singapore contributed 6% and China 1% of FDI flows to Russia. In 2016 FDI stocks from the EU28 to Russia amounted to €84.9 bn ($93.39 bn, average 2016 exchange rate). The Bank of Finland recently highlighted that, due to the sanctions, European investments of $10 bn in the EAEU were not realized in the period from 2014 to 2017. In particular, Italian FDI flows to the EAEU decreased from $2.86 bn in 2012 to $0.70 bn in 2017. At the same time, the total FDI stock from China to Russia rose from $1.09 bn in 2014 to $1.49 bn in 2017.

To make up for reduced trade and investments, and also to balance relations with its western partners, Russia stepped up cooperation with some Asian countries – sometimes referred to as Moscow's so-called *Turn to the East*. While the total trade turnover between the EAEU and Asia (China and ASEAN) also decreased from $234.3 bn in 2012 to $202.3 bn in 2017, it rose again by 22% in 2018, reaching $222 bn.

The EU still remains the EAEU's most important trade and investment partner. However, its role has diminished and continues to do so, contrary to the trend involving Asian countries. According to UN Comtrade, from 2012 to 2017 the share of imports coming from the EU dropped from 36% to 32%, while the share of imports from Asia increased almost symmetrically from 27% to 32% during the same period. The EEC reports slightly different data, but the trend is the same: the share of EU imports to the EAEU decreased from 44% in 2012 to 40% in 2018. Due to Western sanctions and the regional economic downturn, unemployment in the EAEU rose by 6.68% in the crisis period between 2014 and 2015.

Box 1. EAEU in 2019 in brief

The Eurasian Economic Union (EAEU) is a trade and economic bloc that aims to create a common internal market based on free movement of goods and services, labor, capital, and enterprise.

Founded on 1 January 2015, it comprises Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Russia. In 2017 its nominal collective GDP was $1.8 trillion, its population was 183.75 million (m).

The EAEU is both supranational and intergovernmental in nature. Its key bodies and their responsibilities are:

- Supreme Eurasian Economic Council (heads of state) – strategic decision making;
- Eurasian Intergovernmental Council (heads of government) – coordination of national policies;
- Eurasian Economic Commission (located in Moscow)
    - Council of the Commission (deputy heads of government) – decision making and oversight
    - Board of the Commission (10 supranational ministers) – main executive body and day-to-day implementation;
- Court of the EAEU (located in Minsk) – arbitration and interpretation of EAEU legislation as set out in the Treaty of the EAEU (2014) and in the acts of the Commission;
- Eurasian Development Bank and Eurasian Fund for Stabilization and Development (located in Almaty) – investments in infrastructure and integration projects, support of macroeconomic stability;
- Financial regulator of the EAEU (to be created by 2025 in Astana) – control of the common financial market.

Decisions falling under the EAEU competency are made by consensus or by a qualified majority. Each member state has an equal voice, independently from its GDP or population size.

The EAEU has declared a purely economic agenda, namely, national political matters are "none of its business". In December 2018, the Supreme Eurasian Economic Council adopted the "Declaration on the further Development of the EAEU", which proposes an extension of integration between member states to humanitarian aspects such as cooperation in scientific research, education, tourism, and sports.

Main achievements and prospects of the EAEU:

- Customs union, including a new customs code
- Common technical regulations and standards for 70% of goods
- Common labor market, including healthcare and pensions
- Single market achieved for 55% of all services
- Common pharmaceutical and medical equipment market (see page 9)
- Common electricity market by 2019
- Common oil and gas market by 2025
- Common financial market by 2025
- Digital agenda until 2025 (initiated in 2016)

EAEU international cooperation:

- Free Trade Agreement (FTA) with Vietnam (2015)
- Interim FTA with Iran (2018)
- Non-preferential Agreement on Trade and Economic Cooperation with China (2018)
- Observer status of Moldova (2018)
- Memorandum of Understanding (MoU) with the Commonwealth of Independent States (CIS) (2018)
- MoU with Association of Southeast Asian Nations (ASEAN) (2018)
- MoU with the Southern Common Market (MERCOSUR) (2018)
- FTA negotiations ongoing with India, Israel, Serbia, Singapore, and others.

Relations of the EAEU member states with the EU:

- Armenia: Eastern Partnership member (2009), Comprehensive and Enhanced Partnership Agreement (2017), Generalized Scheme of Preference Plus (GSP+) status
- Belarus: Eastern Partnership member (2009)
- Kazakhstan: Comprehensive and Enhanced Partnership Agreement (2015)
- Kyrgyzstan: Partnership and Cooperation Agreement (1999, updated in 2017), GSP+ status
- Russia: Partnership and Cooperation Agreement (1997)
- EAEU: Joint Declaration on Cooperation with Greece (2017), MoU with standardization systems of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC) (both 2017)

Why cooperate?

At the event “Connecting Eurasia Dialogue: From the Atlantic to the Pacific”, EUROCHAMBRES (the Association of European Chambers of Commerce and Industry) spoke in support of lifting Western sanctions against Russia and of initiating official EU–EAEU cooperation. In fact, from Europe’s viewpoint there are several convincing reasons for deeper trade and economic cooperation with its eastern counterpart. *The EAEU is the third-largest EU trading partner* after the USA and China. In 2017 it made up 9% of total EU imports, mainly duty-free energy resources, and 5% of total EU exports.

There is strategic *factor compatibility* between the EAEU and the EU. The EAEU provides to the EU industry with a relatively cheap and stable supply of energy carriers and raw materials. In 2016, 37% of crude oil and 40% of natural gas imports to the EU came from Kazakhstan and Russia. Concurrently, EAEU economy represents a market of 172 m people for European cars and machinery and equipment, and other value added goods. In 2017, 74% of the EAEU’s exports to the EU were mineral fuels, while another 16% were metals, stone, glass, ceramics, and chemicals. European exports to the EAEU mainly consisted of machinery (31%), transport equipment (15%), and chemical products (21%).

Some experts estimate that the *EU may face shortages of high-skilled workers* by 2025, which *can be fulfilled by a labor force from the EAEU*, which, in comparison to other regions with developing economies, *is well-educated and professional.* For example, tertiary education rates are higher in this region than in the EU (31% vs. 28%).

Another favorable factor is *geographic proximity*. For example, the distance from Washington D.C. to Brussels is 6,215 km, whereas the distance from Moscow to Brussels is only 2,256 km. A cargo shipment by maritime freight from Rotterdam to New York takes approximately six days, twice as long as from Rotterdam to Saint Petersburg. Train freight from Duisburg to Moscow takes less than a day. Moreover, the creation of a single transport space in the EAEU, with common rules and less red tape, could facilitate trade and logistics between Europe and the growing Asian markets.

From 2012 to 2030, the EU's share in the global GDP is expected to shrink from 23% to 16%. Together, the points mentioned above indicate that a *deeper economic cooperation with the Eurasian Economic Union could provide an important additional factor in keeping European industry competitive* in the global markets.

One of the arguments as to why there is no official cooperation between the EU and the EAEU is that the European Commission is not convinced that the EAEU is indeed a supranational organization or that its decisions are binding on its member states. Adherents to this view refer to many existing barriers holding back the EAEU's internal market and also the EEC's lack of competence in many economic spheres as an obstacle to deeper interaction between the EU and the EAEU. Yet, at the same time the EU is planning to sign an Association Agreement with MERCOSUR by the end of 2019. In many ways, however, the EAEU can boast deeper integration in comparison to MERCOSUR. While internal trade in both organizations is relatively low (about 13~15% of total trade), the EAEU has achieved deeper integration with fewer national tariff exemptions.

Inspired by the European experience, the EAEU is autonomously implementing union-wide technical regulations and industrial product standards, which for the most part are much the same to those of the EU (from 60~95% depending on sector).

It is often said that any cooperation between the EU and the EAEU would be possible only when the political relations between the EU and Russia regarding the crisis around Ukraine are settled. However, as the EAEU is an economic organization, some event participants suggested that an alternative to further non-engagement could be to *initiate a dialogue between the two unions based on the spirit of traditional German Ostpolitik – Wandel durch Annäherung* (Change through Rapprochement).

Box 2. The Central Asian thaw: Reforms and new openness of Uzbekistan

Uzbekistan's new president Shavkat Mirziyoyev, who took office in December 2016, has enacted wide-ranging economic, legal, and administrative reforms (Development Strategy for 2017-2021). This modernization has led to a significant change in the business climate; the country opened up, and new opportunities arose for investors.

Uzbekistan is a big labor market due to its young and growing population (32 m inhabitants, of which 19.4 m are of working age).

In 2017 Uzbekistan was the fourth-largest economy in the CIS (85th in the world), measured by GDP in real terms: $47.9 bn GDP per capita at current prices was $1,490 ($6,930 based on PPP). The country shows confident real GDP growth at around 5.5% annually.

There has been considerable progress in the World Bank's "Ease of Doing Business" ranking, with country moving to 76th place in 2019 from 87th in 2016.

The country currently stands on five economic pillars: gold exports, agriculture, textile production, automotive industry, and remittances from labor migrants (mainly from Russia).

In 2017 direct foreign investment amounted to \$4.2 bn – an increase of \$500 m year to year. Key foreign investors include Germany, Japan, Russia, South Korea, Turkey, and USA. The European Bank for Reconstruction and Development (EBRD) committed to investing \$10 bn, and the European Investment Bank (EIB) announced its intention to open a representative office in Tashkent. In March 2019 Uzbekistan issued its first-ever batch of eurobonds on the London Stock Exchange worth \$1 bn.

The local currency is now tradable and its control has been liberalized. A reduction in import duties is being implemented, with the establishment of an average customs tax rate of 6.45%. Uzbekistan's main trading partners are China, Kazakhstan, Russia, and Turkey. In 2018 the trade turnover between Russia and Uzbekistan increased by 20%. Switzerland is Europe's main export destination for Uzbek goods (mainly gold), and Germany is the main European importer.

In 2018 the European Union and Uzbekistan started negotiations for an Enhanced Partnership and Cooperation Agreement (EPCA). At the same time, Uzbekistan considered becoming an observer state with the EAEU.

Where and how to cooperate?

Many participants of the event strongly supported the idea of the European Commission engaging with the Eurasian Economic Commission as soon as possible to discuss possibilities for deep and comprehensive trade and economic cooperation. The ultimate goal would be to sign an *(asymmetric) free trade agreement* together with bilateral agreements (EU–Armenia, EU–Belarus, etc.) in various other areas of interest, as the EEC's negotiation power to date has mainly been limited to trade and technical regulations matters. However, normalization of relations between Russia and the West, together with mutual lifting of sanctions, remains a pre-requisite for this process.

Participants encouraged the approach of step-by-step trust (re-)building in a bottom-up way involving expert, business, and policy communities, starting from the least politicized matters. First, *dialogue should be enhanced across business and expert communities*. Second, *dialogue at the technical level between the European Commission and the Eurasian Economic Commission*, which began in November 2017, should be continued. Systematic meetings could aim at the following areas:

- *Further alignment of technical regulations and standards* of the EAEU along the lines of European and European-like international models.
- *Mutual facilitation of customs procedures* and the *creation of "green corridors"* for trade between Europe and Asia through the customs territory of the EAEU.
- In the information economy of the future, common coding methods, cyphers and regulations will be equally as important as common technical standards are for trade in goods. The European Union has adopted its "Digital agenda for 2020" (2010) and "the Single digital market strategy" (2015). After the European Parliament elections in May 2019 the renewed European Commission is likely to set up a new digital strategy for 2030. In 2016 the Eurasian Economic Commission, with the aid of the World Bank Group, initiated the EAEU's "Digital agenda for 2025." The EU and the EAEU could benefit from *exchanging experience and coordinating their respective digital agendas*.

Enhancing Connectivity in Greater Eurasia

China's new Silk Road in Central Eurasia

Another central theme of the event was the promotion of increased transport connectivity in the wider Eurasian space. Participants focused on benefits and challenges of China's Belt and Road Initiative (BRI), in particular those concerning the land-based "Silk Road Economic Belt".

From 2012 to 2016, *rail cargo flows from China to Europe through the EAEU countries doubled every year*, although from a low base, to reach around 97,000 containers. IIASA research has argued that this *explosive growth in container traffic is likely to continue for a few years* and in order to make this development sustainable a further decrease in freight rates backed by investment in physical infrastructure, together with alignment and facilitation of soft infrastructure between the EU, EAEU, and the People's Republic of China, is necessary.

Box 3. Soft infrastructure

In the transport sector "soft infrastructure" can be understood as the entirety of customs procedures, cargo documents, digitalization, single windows, technical regulations and standards, investment rules, licensing, export loans, insurance, etc. The term is used in contrast to "hard infrastructure" which includes roads, railways, ports, warehouses, etc.

Leading global and regional development banks share the view that *enhancement and alignment of soft infrastructure is at least as important as investments in hard infrastructure*.

In 2019 IIASA is to conduct a research project on "Improving soft infrastructure connectivity between the EU, the EAEU, and China" as part of its broader research program (#InEurasia).

Currently, *about 98% of mutual EU–China deliveries are conducted via maritime shipping*. At the same time, the *Belt and Road Initiative promises greater openness, inter-regional connectivity, and economic growth to the land-locked countries* of Central Eurasia. For example, currently it takes 22 days to deliver cargo from Uzbekistan to a nearest seaport. A Chinese railway corridor through Afghanistan and Pakistan under construction can decrease the required time tenfold to only 2~3 days. Another planned corridor would connect Urumchi in China to Tashkent via southern Kyrgyzstan.

In Kazakhstan, the Silk Road Economic Belt is estimated to create 20,000 new jobs. The bulk of Chinese direct capital investments in the EAEU is concentrated in Kazakhstan, with the FDI stock reaching $21.5 bn in 2016. In the coming years, Kazakhstan is expected to attract another $7 bn in Chinese investment. In parallel, as part of its "Nurly Zhol" (Bright Way) program, the Kazakh government has invested $9 bn in the country's transport infrastructure. Additional investment of $15 bn is planned, with $8.5 bn of this to be invested by 2020. Russian researchers estimate that the implementation of the transcontinental transit project "Western China–Western Europe" could bring the Russian regions situated along the corridor additional gross regional product (GRP) growth of 6~9%.

In its "Main directions of economic development until 2030" (adopted in 2015), the EEC expressed its wish to make the EAEU more than a mere "transit drawbridge" between Europe and the Asia-Pacific. By 2030, coordination of transport policy in the EAEU is set to increase freight turnover in Russia by

1.5%, in Kazakhstan by 11%, and in Belarus by 14%. This coordination is greatly needed. Kazakhstan has already opened "Western China–Western Europe" section, while construction of the Russian segment has not finished.

In 2015 in Moscow, a joint declaration "On the conjunction of the EAEU and the Silk Road Economic Belt" was signed. It was under this umbrella, three years later, that China and the Eurasian Economic Union signed a non-preferential trade and economic cooperation agreement.

Remaining a rule maker: Europe's approach

In response to China's Belt and Road Initiative, the EU has a major interest in developing its own approach to connectivity in the wider Eurasian space. *In Brussels, there seems to be a growing concern that Beijing is using the BRI as a geopolitical tool* to restrict free trade that can also tolerate the use of unfair and unhealthy business practices which can contribute to indebtedness of smaller economies, and to give Chinese companies subsidies and other preferences. Furthermore, there are *concerns that Chinese might try to take advantage of the intra-European disagreement* on the appropriate speed and format of engagement with the Belt and Road Initiative. The "16+1" sub-regional cooperation format, a Chinese initiative aimed at intensifying and expanding cooperation with 11 EU member states and 5 Balkan countries, is one example of this. Another is the signing by Italy of an MoU with China on the BRI, the first Western European country to do so. Italy wishes to enhance its "Made in Italy" brand through increasing trade – especially in the form of exports – to China. The BRI is seen as a vehicle for achieving this. Italy offers goods (in particular luxury goods and foodstuffs) that are attractive to China's growing middle class. Beijing is also interested in investing in Italian firms. Even more importantly – Italy's infrastructure can be key to enhance the transport and trading network of the BRI, giving it strategic access to Europe. Currently less than 2% of goods coming to Italy by sea originate in China, hence there are substantial prospects for its increase.

Despite their differences, the EU and Chinese approaches to connectivity are complementary, rather than competing. Europe does not have the same financial resources to invest in infrastructure as China does (overall financial commitments to the BRI, according to different sources, vary from $500 bn to $1.4 tn), but it does have considerable expertise in the establishment of strong investment, labor, and environmental standards. *Through enhanced coordination in the area of soft infrastructure, the EU could foster the adoption of its regulatory practices and principles as a model for a common connectivity framework with the rest of Eurasia* (see Box 4). This interest could best be served by initiating cooperation with the Eurasian Economic Union. First, as already mentioned, *the EAEU has stated its willingness to learn from European models, rules, and standards*. From the long-term perspective, it may be unwise to drive a regional bloc covering 1/7 of the earth's landmass into using Chinese/BRI standards instead of European ones due to European non-engagement. Second, *Europe's engagement with the EAEU could lead to the notion of a coordinated stance towards the BRI.* This, of course, would include the need for compromise, taking into account national interests of all parties involved. Third, *better relations with the EAEU could help the EU balance its relations with China*.

Box 4. EU Strategy on Connecting Europe and Asia

In late 2018–early 2019, the European Union published three key documents outlining Brussels' view on better connectivity in the wider Eurasian space:

- Connecting Europe and Asia: Building blocks for an EU (European External Action Service, EEAS)
- The "European way to connectivity" (European Parliament)
- The EU's new Central Asia strategy (European Parliament)

Key elements:

Comprehensive: The term "connectivity," as described in the documents, includes not only i) transport and logistics, but also three other important sectors that go hand in hand with it: namely, cooperation in ii) energy systems, iii) the digital economy and iv) the human dimension (education, research, innovation, culture, and tourism).

Sustainable and fair: Cooperation in the four above-mentioned fields should be conducted with an eye to the environment and the well-being of future generations. This aspect includes: transparency, non-discriminatory market practices, a level playing field for businesses, high environmental and social standards benefiting local communities, and the fiscal and financial sustainability of infrastructure projects.

Common rules and standards: Connectivity initiatives in the wider Eurasian space should be based on European and internationally recognized practices, rules, conventions, and technical standards, thus forming a common soft infrastructure, which, moreover, would be advantageous for European companies.

Smarter investments: The European Commission has proposed to increase the EU's external action budget to €123 bn for the period 2021–2027. Included in this proposal is an investment framework for external action up to €60 billion. The European Fund for Strategic Investments (EFSI) seeks to mobilize €500 bn in investment by 2020, having met its target of €315 bn in July 2018. Until now, 21% of this investment has gone to energy, 11% to digital, and 8% to transport.

Poster child: EAEU Common Pharma Market

The creation of a common pharmaceutical and medical equipment market in the Eurasian Economic Union (2017) can be regarded as a good example of: i) how integration within the EAEU is beneficial for European producers; and ii) how the EAEU adopts regulations based on European models. A representative of the European Federation of Pharmaceutical Industries and Associations (EFPIA) called this endeavor *"a great success story"*.

A common pharmaceutical market of the EAEU facilitates both exports and local production by the European pharma industry in the following ways.

First, the harmonization of *intra-EAEU standards, together with mutual recognition* of "Good Manufacturing Procedures," "Good Documentation Procedures," clinical trials and medicine assessment, the creation of a regional pharmacopeia, as well as the uniformity of the "Common

Technical Document" dossier all mean that, a European medication registered in one EAEU member state can now be freely circulated in all other EAEU member states.

Second, all above-*mentioned regulations and standards are up to 95% aligned with their European and European-like international analogues*, including EU "good practice" quality guidelines and regulations (GxP) and the guidelines from the "International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use" (ICH). For example, the EAEU Rules for registration and analysis of medical products for human use were developed based on EU Directive 2001/83/EEC, and the EAEU Good Manufacturing Practice complies with the GMP EU, revised in 2015.

Such harmonization ensures: i) high-quality drugs and faster access to innovative medicines for patients, ii) clarity and certainty for international and domestic companies, and iii) efficiency gains for regulators (e.g., they can now focus on where the need for control is the highest). The scale effects of having a common market of 183.75 m people should also lead to cost reductions (e.g., in testing and certification).

Coordination between the EU and the EAEU in the pharma sector would be advantageous for both sides and is relatively easy to achieve. Medicines are exempt from current sanctions and counter-sanctions, and the size of the EAEU medical market is estimated at more than $25 bn (2016). Pharmaceuticals and biotechnology are one of the world's most innovative industrial sector, ranking first in 2017 R&D intensity (16%; R&D as percentage of net sales; according to OECD). It is also investment-driven and based mainly on global value chains. Here the common pharma market of the EAEU could provide incentives for significantly increasing backward and forward linkages (albeit from a low starting point).

Participants highlighted that another important aspect is the digitalization of the market, which creates opportunities – as well as challenges – for example, for the creation of a common IT platform in April 2019. Russia's plan to implement digital tracking of medicine products using advanced QR-codes could be very burdensome to European producers. Furthermore, there are questions as to the exact content of the regulatory data protection alignment in the EAEU. This once again indicates that *coordination of digital standards is becoming more and more important* to avoid new technical barriers to trade.

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