

## The New Silk Road Initiative

### ARE ITS ECONOMIC UNDERPINNINGS SOUND?

PONARS Eurasia Policy Memo No. 384

August 2015

Sebastien Peyrouse<sup>1</sup>

*The George Washington University*

In 2011, then U.S. Secretary of State Hillary Clinton rolled out a plan for Central and South Asia:

“Let’s work together to create a new Silk Road. Not a single thoroughfare like its namesake, but an international web and network of economic and transit connections. That means building more rail lines, highways, energy infrastructure....”

Unfortunately, the logic of the U.S. government’s New Silk Road (NSR) Initiative is not convincingly based on the realities of regional trade between Central and South Asia. The principal narrative of the NSR is that Central and South Asia have complementary economies. While this may appear to be true on paper, it does not adequately reflect regional economic and trade dynamics. Building or rehabilitating transportation infrastructure does not necessarily result in trade development; this requires genuine regional integration, good governance, and functioning transport services and customs procedures. More measured projects, such as the development of small local transportation networks, would probably be more effective, including by allowing some isolated regions to improve local trade.

#### **Established Commercial Flows: Russia and China Dominate**

Any new project concerning Central Asian trade routes must take into account existing trade flows, which Russia and China currently dominate. It is not clear whether these flows can be redirected, or whether the states of the region are even interested in doing so, as it would require them to abandon the prerogatives in which they have invested – both politically and economically – for more than a decade.

---

<sup>1</sup> [Sebastien Peyrouse](#) is Research Professor of International Affairs at the George Washington University. This paper is part of a project co-authored with Gael Raballand (World Bank).

Russia's economic interests in the region are on the rise and now rank as one of the most important drivers of its influence in Central Asia. After a decline in the 1990s, Russia regained its important, though no longer monopolistic, economic position in the region. By 2013, commercial exchange between Russia and the countries of Central Asia reached almost \$22 billion, making Russia the region's third-largest trading partner behind China and the European Union. In addition, the creation of the Eurasian Economic Union in January 2015 sent a clear political message that the Kremlin seeks to create a few joint supranational mechanisms in areas of economics and finance that would ensure greater integration between Russia and some of its closest Central Asian neighbors.

China's role and growing influence in regional trade must also be considered. As in other regions of the world where Beijing is asserting itself, China is advancing its geopolitical influence in Central Asia by creating economically-based good-neighborly relations. In just a few years, China has succeeded in improving its reputation through soft-power diplomacy while drastically changing the economic and strategic dynamic in Central Asia. It has positioned itself as the second most influential external actor in the region generally and has surpassed Russia in economic influence in particular. The Central Asian market is important to China both as a new market for Chinese products and as a conduit that could open up access to markets in Russia, Iran, and Turkey.

### **Trade Prospects between Central Asia and Afghanistan/South Asia**

In light of the already established commercial flows to and from Central Asia, the NSR envisages making Kabul, the current missing link between Central and South Asia, the heart of its development strategy.

An increase in trade between Central Asia and Afghanistan would provide the economic rationale for this strategy. Although there has been some growth, however, the numbers remain low. As in most regions with poor, developing countries, regional integration and trade growth is hampered by a lack of economic structures and low levels of development. Currently, Afghanistan trades only marginally with Central Asian states. Trade in semi-finished and intermediate products—the most lucrative type of trade—is virtually nonexistent between Central Asia and Afghanistan. As a result, regional integration is unlikely to grow rapidly and will remain low, most probably for years to come. Instead, Central Asian economies need what the “Chinese global workshop” has to offer: investment in transportation infrastructure and energy production, as well as cheap goods that fit in with the region's low standard of living.

Despite growing political relations since the fall of the Soviet Union, economic and trade relations between Central and South Asia have barely taken off. So far, all major projects aimed at linking the two regions by transport (the Central-South Asia Transport and Trade Forum and the Karakoram Highway) have failed or have had very little impact.

India's economic presence in Central Asia is minimal. Accounting for only about 0.25 percent of total Indian trade, the Central Asian market is insignificant and unlikely to increase by more than 1 percent irrespective of developments. For the Central Asian markets, Delhi represents only about 0.4 percent of foreign trade, ranking only between 14 and 21 on the list of largest trading partners for each state.

India's economic presence and trade with Central Asia is hampered by several factors. With the exception of Kazakhstan, Central Asian interest in India as the "world's back office" is limited, as the countries of the region are not yet at the level of development to require such services. Moreover, because the majority of India's trade is conducted by cheaper and more efficient sea routes, its trade relations are developing primarily with South Asia, Europe, and the United States. In addition, the Indian economy is now largely privatized, and the state no longer provides major business incentives. Delhi cannot force its businessmen to invest in an area they deem unattractive or unstable, particularly if the state does not establish support mechanisms that would offset such risk-taking.

Pakistan, too, is a very remote economic actor in Central Asia, positioned only about sixteenth in terms of trade. Pakistani businessmen are active mainly in purchasing cotton, particularly from Uzbekistan.

### **The New Silk Road Initiative's Economic Limitations**

Beyond competition with already existing economic flows, there are several unanswered questions concerning the viability of the NSR. What types of evaluations have been made to assess the amount of goods transported to date? How has the potential for trade development been calculated? How have the security risks and costs of transport been assessed?

#### *Traffic*

So far, the growth of trade between Central Asia and Afghanistan/South Asia has been due mainly to the transport of military equipment, which cannot be compared to regular commercial trade. To support the economic justification of the NSR, Washington policymaking circles have [used](#) NATO data from 2009 to 2012 on traffic flows along the Northern Distribution Network (NDN). Although this data suggests that traffic along the New Silk Road is well established and will surge in upcoming years, using the number of trucks crossing the borders daily does not really support the portrayal of the NDN as particularly successful. [According](#) to the U.S. State Department, in three years, more than 58,000 containers transited to Afghanistan through the NDN, an average of almost 400 container trucks per week, which is equivalent to less than 30 trucks a day (or less than one loaded train per day). This figure raises two concerns. First, to economically justify road rehabilitation, a general rule of thumb is that traffic should be

above 150 trucks a day in landlocked regions. Moreover, transit of 30 trucks a day consists of military, not commercial, traffic.

### *Security*

There also are security issues that would need to be addressed. The NATO convoys have provided their own security, while commercial traffic would not enjoy a similar benefit or would have to secure it at high cost. Therefore, the current or even expected level of military traffic is not really a reliable indicator of what the level of commercial trade will be.

### *Maritime Trade*

In addition, the concept for the NSR suffers from a lack of consideration of business perspectives. Drawing a road on a map does not mean that there will be a corresponding increase in trade on the ground. Proponents of the project have generally focused on infrastructure development, which is only one factor in the success of commercial transportation. For an importer and exporter (or freight forwarder), route selection ultimately depends on the cost ratio between the price of the product and how much it costs to transport it. Businesses make their route selection based on factors such as cost, effectiveness of transport services and regulation, attractiveness of markets, and reliability and functioning of border crossings. The NSR focuses more on distance than on reliability and predictability. Among traders, however, the latter are much more decisive factors.

World trade today is largely based on shipping: ninety-five percent of commodities circulating between Asia and Europe take maritime routes, leaving only about 1 percent of trade to overland continental routes. It is highly unlikely that this trend could be altered much. Maritime transport offers many advantages. The level of service is superior, since it avoids the innumerable hazards linked to multiple border crossings and the potential for corruption in transit countries. And even where there are well-functioning border and customs procedures, it is more complex to dissociate the procedures of customs formalities, border crossings, and final customs clearances in continental trade than it is to carry out these operations simultaneously in the ports for maritime trade. Although transport time may be longer by sea than by a continental route, it can be guaranteed, making it more attractive than road or rail transport.

### *Governance and Corruption*

The NSR also does not take into account poor governance and poorly managed border agencies, which make the route economically problematic. In fact, some border officials and government authorities maintain a personal interest in slow, tight borders. Bolstering economic regionalism involves increasing economic liberalization that in turn

can adversely affect the interests of leaders in the region. Indeed, Central Asian presidents have opposed promoting economic regionalism that would threaten either their personal and family fortunes or their clients' economic interests. In this regard, Uzbekistan has regularly increased transit fees, which has made regional integration more difficult and expensive. The OSCE and the EU have advocated for simplification of procedures at borders in Central Asia for several years but with relatively limited impact.

## Conclusion

Promoters of the NSR have overlooked certain underlying economic elements that could affect the viability of the initiative. First, the Central Asian economic space is largely already occupied by other actors, whose ambitions and interests largely diverge from Western designs. Second, the project is based on principles that are, to a large extent, contested by transport economists: the construction or rehabilitation of roads does not create traffic per se nor does the increase of military traffic in connection with Afghanistan signify any potential for long-term trade. Distance is secondary to transport security, predictability, and reliability, which are by no means assured given the potential and real political instability in Afghanistan and Central Asia. There are also corruption and embezzlement risks that loom over the transport of goods with every border crossing.

All that said, there do remain benefits to improving the infrastructure between Central Asia and Afghanistan as such. It can present important opportunities in terms of development at the local level. Central Asia is much more than just a transit point for Afghanistan. The three border states of Turkmenistan, Uzbekistan, and Tajikistan, as well as Kazakhstan, all play an important role in providing economic and reconstruction aid to Afghanistan. Moreover, local areas near the borders (particularly if relations between various Central Asian governments improve) would benefit from better road and railway links. By engaging in more measured, less costly projects (and ones less likely to be beset by corruption), the NSR may still be able to contribute effectively to the development of these states.