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TOWARD THE GREAT OCEAN 4: TURN TO THE EAST

PRELIMINARY RESULTS AND NEW OBJECTIVES

VALDAI DISCUSSION CLUB REPORT

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To our readers

Address by the Chairman of the Board of the Foundation for Development and Support of the Valdai Discussion Club

THE FUTURE UPON US

As many believe, the Russian soul is first and foremost a restless soul torn between the West and the East. Russia, accordingly, is a bridge of sorts linking the “true” Europe with the “true” Asia. Viewed from this angle, Russia’s entire history is in its geography and no matter how huge its territory, it is still a kind of an “in-between” space.

This topic has been discussed for a long time, but it is hard to pinpoint the exact date when it all began. Was it the coming of the Rurikids, or the baptism of Rus, or the slaughter of Mamai?

One way or another, debates on Russia’s “European” or “Asian” nature were a key component of the Russian political and philosophical discourse throughout the 19th century. These altercations have generated an entire line of thought (albeit an extremely controversial one), the Eurasianism, which is still in existence and continues to gain popularity. In recent times, it has even acquired a practical aspect seeking to predict how Eurasia and Russia as its part will advance.

But before we come to this point, it is worthwhile to dwell on its composition. The huge Eurasian continent – the biggest of all continents, accounting for 36 percent of the world’s landmass and approximately 75 percent of the world population – is highly heterogeneous. It includes Western Europe, Hindustan, China, the troubled Middle East, and more. Let me repeat: the continent is immense and its centerpiece is a vast territory

measuring thousands of kilometers both west to east and north to south. We can call it Central Eurasia: it lacks precise borders and includes many countries, wholly or in part. One of its key nations, Russia, can be said to form it, although it stretches far beyond its geographical limits.

Until quite recently, it was Eurasia’s outlying littoral areas – the Middle East, the Mediterranean basin, China, Western Europe, etc. – that propelled its advancement. But for all of Central Asia’s occasional prosperity, what we can describe as Central Eurasia has never been a source of development or a productive civilization.

It would, of course, be an offensive simplification to reduce the region’s role to that of a bridge but, no matter how you look at it, the Silk Road was just a road from one point to another. Characteristically, the road became pitted as trade between China and West Europe grew slack.

But let us return to Russia. At least for about 400 years, it sought – partly consciously, partly unconsciously – to transform the “road” into “territory,” a settled productive civilization. It was the Russian Empire that in its heyday built part of Central Eurasia, depending on how we understand the geography of this region.

Both the Eurasian disputes and the “restless soul” talk are largely associated with this factor. Much of Russian classical literature is about discussing whether there is a specific Eurasian identity. Other related questions are whether Russia can or cannot engender a

special Eurasian civilization, going beyond a national culture, and whether this civilization can exist at all? Who, aside from Russia, can be involved in shaping this civilization? What relations should exist between the major countries, Russia and China? And so on and so forth. There are many questions and still many more answers.

What is even more important, as all of them are relevant today. New technologies, a comparatively long period of peace, and the lack of grave conflicts inside of the Central Eurasian region have generated a good opportunity for development. The nutrient broth is starting to boil, and it is high time we put in the needed ingredients.

Therefore, this is the moment of truth for all countries in the region, primarily Russia and China. The main parameters have been determined: it was decided to develop the region. Now it is time for specific decision-making but, as we know, the devil is in the detail.

There are numerous details of this kind related to many aspects of practical cooperation between the key Central Eurasian players, primarily the relationship between political and purely economic issues. The thing is that, in a sense, Eurasian history displays the same

intentions as the widely-discussed trans-Pacific and trans-Atlantic projects. All of these address development in an environment rife with national jurisdictions that are offset by the universal international nature of modern business. What will regulation be like in the big, multi-state regions? Who will carry it out and on what terms? What will be the role of national governments?

The current debates on these points are of an entirely practical nature.

Russia, whether it wants to or not, should reply to these and many other questions.

For Russia, developing Eurasia, particularly its central part, is of key importance. Tapping the regions between the Urals and the Pacific, and encouraging their economic growth is Russia's formula for success.

Therefore, the said "restlessness" under modern circumstances has an entirely practical aim to coordinate the Russia-Eurasia development strategy. The future will soon be upon us and we'll have to face challenges.

The intellectual task facing the Valdai Discussion Club is to analyze these challenges and understand the meaning of developments.

Andrey Bystritskiy

INTRODUCTION

Today's Russia has all but completed its turn toward Asia. However, it remains to be seen how far-reaching and successful it will be, and in what specific areas it will evolve and what will be its content, benefits, and costs. This features three key elements highlighted in three reports released by the Valdai Discussion Club between 2012-2015. Some of the provisions and ideas put forward by the authors of these reports made their way into Russia's public policy and paved the way to concrete political decisions. The first of these three reports, titled *Toward the Great Ocean, or the New Globalization of Russia*, highlighted new opportunities for Russia and, most importantly, for Russia to the east of the Urals, against the backdrop of accelerated development of Asian countries. The report called for making use of these opportunities. The second report, titled *Toward the Great Ocean – 2, or Russia's Breakthrough to Asia*, focused on opportunities for cooperation in specific areas and proposed new frameworks for initiatives of this kind to succeed. The third report, *Toward the Great Ocean – 3: Creating Central Eurasia*, was aimed at building a new system of international relations within the greater Eurasia area and explored opportunities for facilitating substantive cooperation and aligning the Eurasian integration processes and China's Silk Road Economic Belt project.

Dozens of experts took part in writing these reports with a view of devising recommendations that would help create favorable external conditions for Russia's development, its presence in Asia and Eurasia, whilst also facilitating regional trade and economic cooperation for Siberia and the Russian Far East. The latter objective has been equally important, if not more important, than the former. It is obvious that attracting massive investment flows from Asian countries and Europe, and providing as much freedom as possible to local business initiatives is the only way for Siberia and the Russian Far East to foster development.

Siberia and the Russian Far East have received strong competitive advantages on the back of the recent changes in the global markets. The first advantage has to do with the production of water-intensive goods, such as food, paper pulp, and synthetic fibers for the Asian markets that almost universally suffer from a shortage of water for industrial, agricultural, as well as personal use. The possibility of producing energy-intensive goods is another competitive advantage. With some creativity, even cold weather can be a competitive advantage, for example, in the case of data storage.

These and other industries are based on high technology and contribute to its development. The numerous experts who wrote on the rise of Siberia and the Russian Far East pointed to the need to promote innovations in this region and called for a new industrialization. It should be noted, however, that an industrial boom has already taken place in Asia. For this reason, the main challenge is not so much to create research and industrial clusters in or near Novosibirsk, Tomsk, Krasnoyarsk, and Komsomolsk-on-Amur, but to determine their target markets and specifics.

Research has been undertaken on this issue, dozens of case studies were conducted, and articles and reports released. Serious challenges had to be overcome on the way. We had to answer point-blank questions for ourselves and society in general. The research team has grown over the years, focusing on the key economic developments in Asia. It came up with a very important conclusion. The economic rise of East, Southeast, and South Asia was attributable to their global exports, but now they are refocusing their trade, investment, and financial flows on markets within Asia. They are moving from the Asia for the World to the Asia for Asia model. This is a major economic and geopolitical shift, and we have yet to grasp its consequences. But one thing was certain several years ago: China seemed to be poised for a westward shift towards Central Asia,

Europe, and thus Russia. This shift has now taken shape in the concept and project of the Silk Road Economic Belt (SREB).

Research into the logistics of Russia's Asian turn showed that in the new environment traditional transport routes fail to satisfy the development needs of Russia's Trans-Urals region. They could not overcome the so-called "continental curse," i.e. the remoteness of the markets of Central Siberia, one of Russia's most advanced regions in terms of industrial development and human capital. Plans to increase trade flows from the Pacific Ocean to Europe and back were also mostly outdated and did not correspond to the market needs. As it turned out, the main infrastructure deficiency to the east of the Urals was the lack of a vertical, meridian component, in the form of railways or roads connecting Siberia and the Russian Far East with China and its immense markets, and potentially with Iran, India, and Pakistan.

With the development of the logistics strategy and its promise of overhauling the transportation network in Siberia and the Far East, as well as taking into account other geographic, economic, and geopolitical factors in Asia, it seems probable, and advisable that Central Eurasia be designated as a new development region. It could be based on the interaction between the Eurasian Economic Union (EAEU) and the SREB initiative. This could lead us along with our Chinese and Kazakh colleagues and experts from other countries to provide a rationale for aligning the EAEU and SREB projects.

Apart from the economic agenda Russia should also be proactive in its efforts to facilitate crises settlement in the Pacific. Having been the center of gravity in economic, political, and military and strategic processes for the last several centuries, the Atlantic is about to be replaced by the Pacific in this capacity. Russia should be proactive in setting the region's agenda and participating in the work of this new center of

gravity, regardless of whether it becomes an arena for escalating regional competition or tilts toward closer cooperation.

Russia's standoff with the West in 2013–2014 has accelerated its economic turn to the East. This move is no longer viewed as pragmatic economics, but acquires geopolitical and civilizational traits. From the outset, we have sought to emphasize in our papers that it would not only be disadvantageous, but also dangerous for Russia to choose between Europe and Asia. Russia is moving toward becoming a great Eurasian Atlantic-Pacific power, while remaining part of the European civilization.

It seems advisable for efforts to form the Greater Eurasian Community to carry on so that a new economic and political space open to everyone emerges. It should include Europe as the western part of the continent. After all, this would greatly benefit Europe, since it is now going through a crisis period and has to adapt to the new reality. The very idea of the Greater Eurasian Community is based on the assessment of long-term global development trends, such as the counterattack by the ailing West, the rise of China, India, Iran, and opportunities for countries in between to develop, drawing South Korea, Japan, and European countries into the orbit of the new development center. In this vision China becomes an economic leader as the strongest macro-regional economy, but not a political hegemon, since this role would be contested by other countries.

In terms of Russia's long-term relations with China, there is a need for more certainty. The ideas of aligning the EAEU and SREB projects, strengthening the SCO's regional role, promoting mutually beneficial economic cooperation, and political partnership are all becoming a reality before our very eyes. It is now crucial to consolidate this success and give new momentum to its steady advancement.

Sergei Karaganov

1. RUSSIA AND ASIA PACIFIC IN THE 21ST CENTURY

1.1. Reasons Behind the “Turn to the East”

The turn to the East was long overdue in Russia's foreign and domestic policies. The first steps in this direction were made in the 1990s, when the Russian government tried not just to develop bilateral relations with Asia Pacific countries, but also to become established in many regional organizations, such as APEC and ASEAN-centric organizations. But the inconsistency of those actions and the economic challenges Russia was facing at the time prevented it from formulating an effective strategy of cooperation in Asia Pacific (APR). Russia was closely connected to Europe and pursued a clearly pro-European policy, and the Russian elite had little interest in Asia. But the gradual deterioration of relations with the West these past few years and the futile attempts to become part of Europe encouraged Russia's turn to the East.

Many Asian countries saw that cooperation with Russia as limited to trade in natural resources. The region was politically stable, and most regional countries were developing dynamically. Over time, their view of Russia changed. They began to expect it to play a bigger role, including in the field of security. As if living up to their expectations, Russia worked actively at the six-party talks on the North Korean nuclear weapons program, joined the East Asia Summit and redoubled its efforts in the APEC framework.

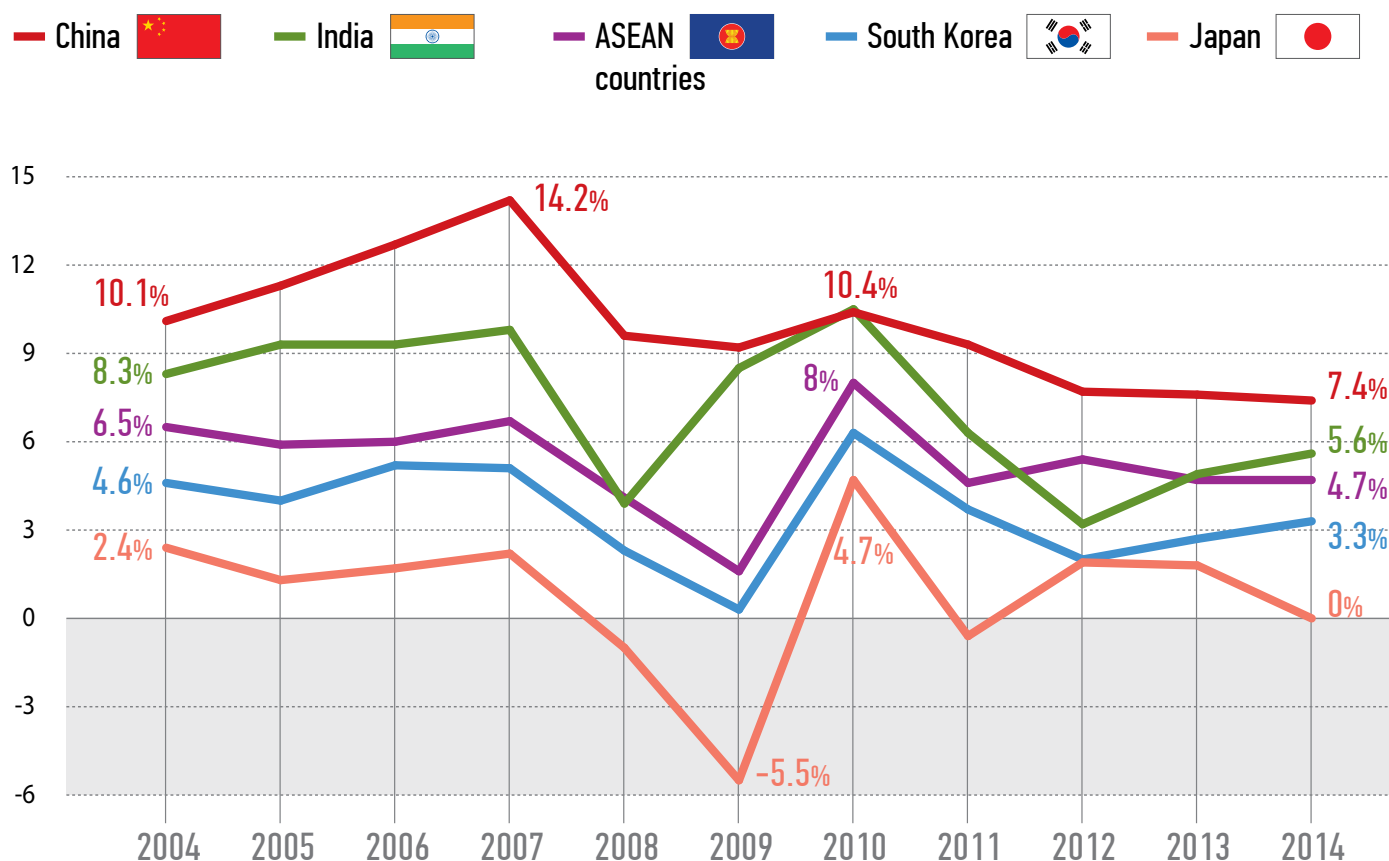
However, Russia's policy in Asia was fragmented and the country did not develop a coherent Asian strategy until the late 2000s. The first elements of this strategy formulated at the turn of the 2010s, even though they started out as a framework philosophy and general aspirations, were fundamentally different from Russia's Asian policy of the past. Russia's new Asian policy is not perfect yet, as we will see below, but it is a coherent

strategy, and a group of like-minded people within the Russian elite is actively promoting the country's eastward turn.

Another new element is that the Asian countries' “demand” for Russia has increased over the past five to seven years when the international political standing of the Asia Pacific region deteriorated. In that period, US-Chinese differences grew stronger, while small and medium-sized countries tried to overcome their one-sided alignment with either China or the United States, and to balance China's growing power. Russia's position is unique in that it has friendly relations with China and so cooperation with Russia is not perceived as a threat to Chinese interests. The economic attractions include Russia's transit potential and its possible participation in dealing with global and regional challenges, considering its energy supplies, its contribution to food security in Asia, and the huge potential of Siberia and the Russian Far East as the last frontier of Eurasia.

Furthermore, the so-called Asian paradox provides conditions for the growth of Russia's presence in the region. Broader economic interaction, rapid economic growth (in 2000–2013, GDP increased by 6.7 percent in the ASEAN+3 countries and India, the biggest nations of Asia Pacific, whereas the EU's GDP increased by only 0.9 percent and the US' GDP, by 1.9 percent), and the signing of additional economic cooperation agreements have not improved the region's security. The level of mutual distrust is very high, and the arms race continues unabated. The four leading Asian powers – China, India, Japan and South Korea – together accounted for about 20 percent of global military spending in 2014. China's military budget reached \$216 billion in current market value, or over half of

GDP GROWTH RATE* IN ASIA PACIFIC



* in 2004-2014 (current market value)

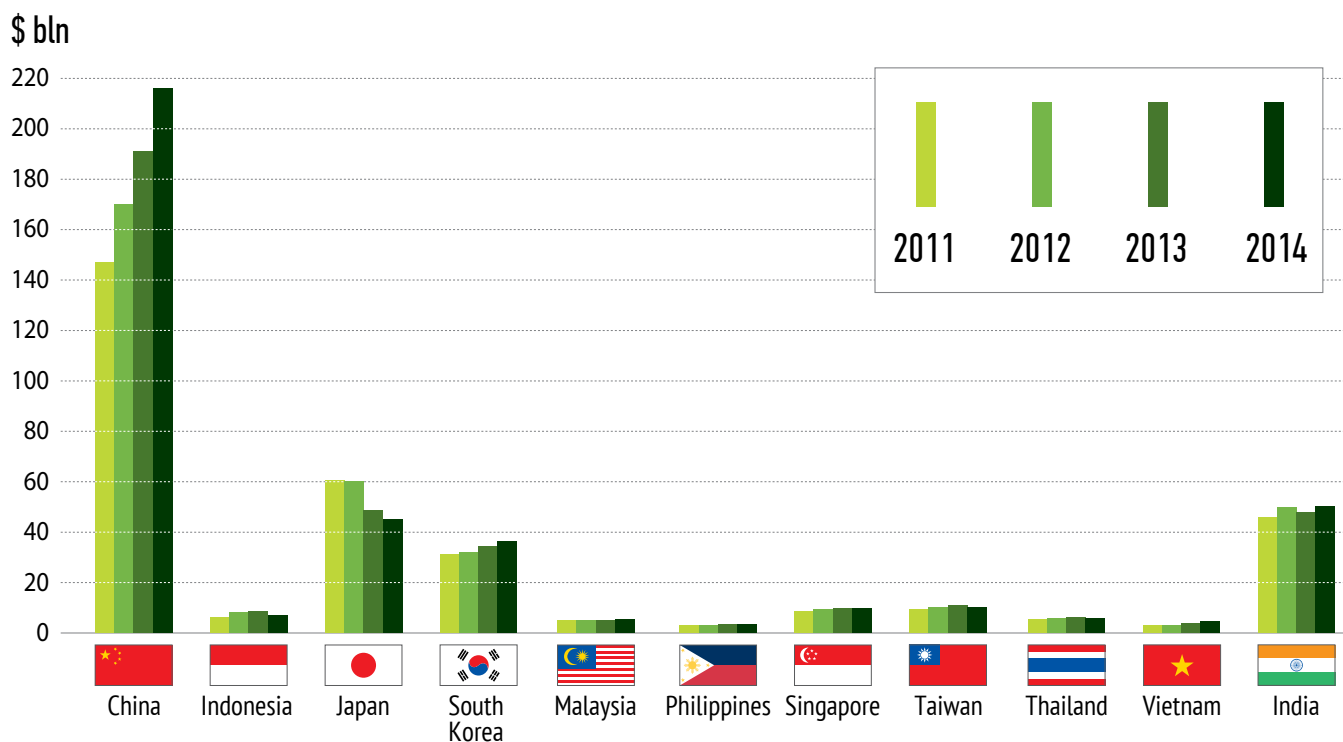
Source: Euromonitor International

the above four countries' combined military spending. The growing military component can be explained by the periodic flaring up of territorial disputes, the North Korean nuclear weapons program, and the growth of non-traditional security threats.

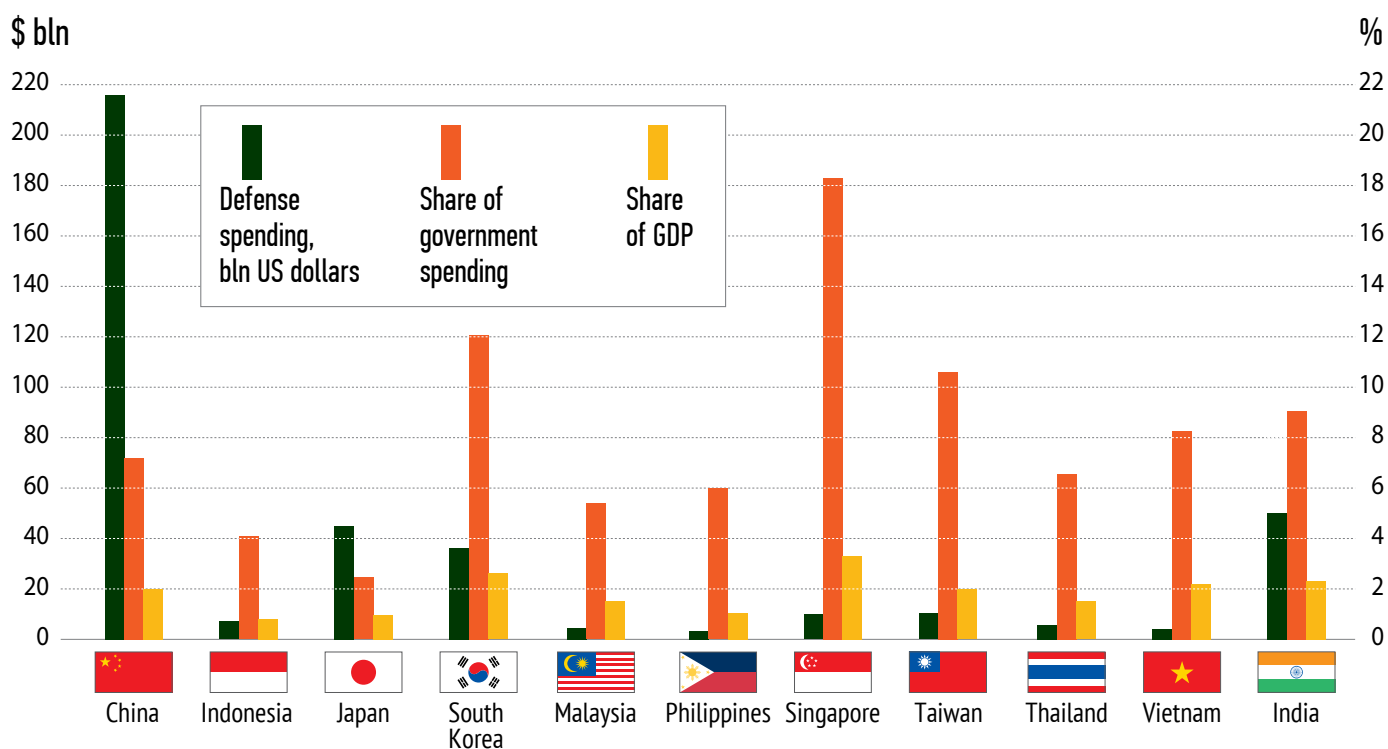
The unbalanced architecture of Asia-Pacific security is coming into stark contrast with economic regionalization and growing economic relations between regional countries. The Asia-Pacific military alliances are set for confrontation and deterrence and are closed to

new power centers. At the same time, the new power centers, primarily China, increasingly actively demand a reform of the security and international economic governance systems. It has been proposed that an all-inclusive international security organization be created for Asia and Asia Pacific, and that a soft system of Eurasian cooperation and security be created and kept open to Europe so as to ease the neighbors' fears regarding China and to cushion their resistance to China's peaceful economic expansion.

ASIAN COUNTRIES' MILITARY EXPENDITURES

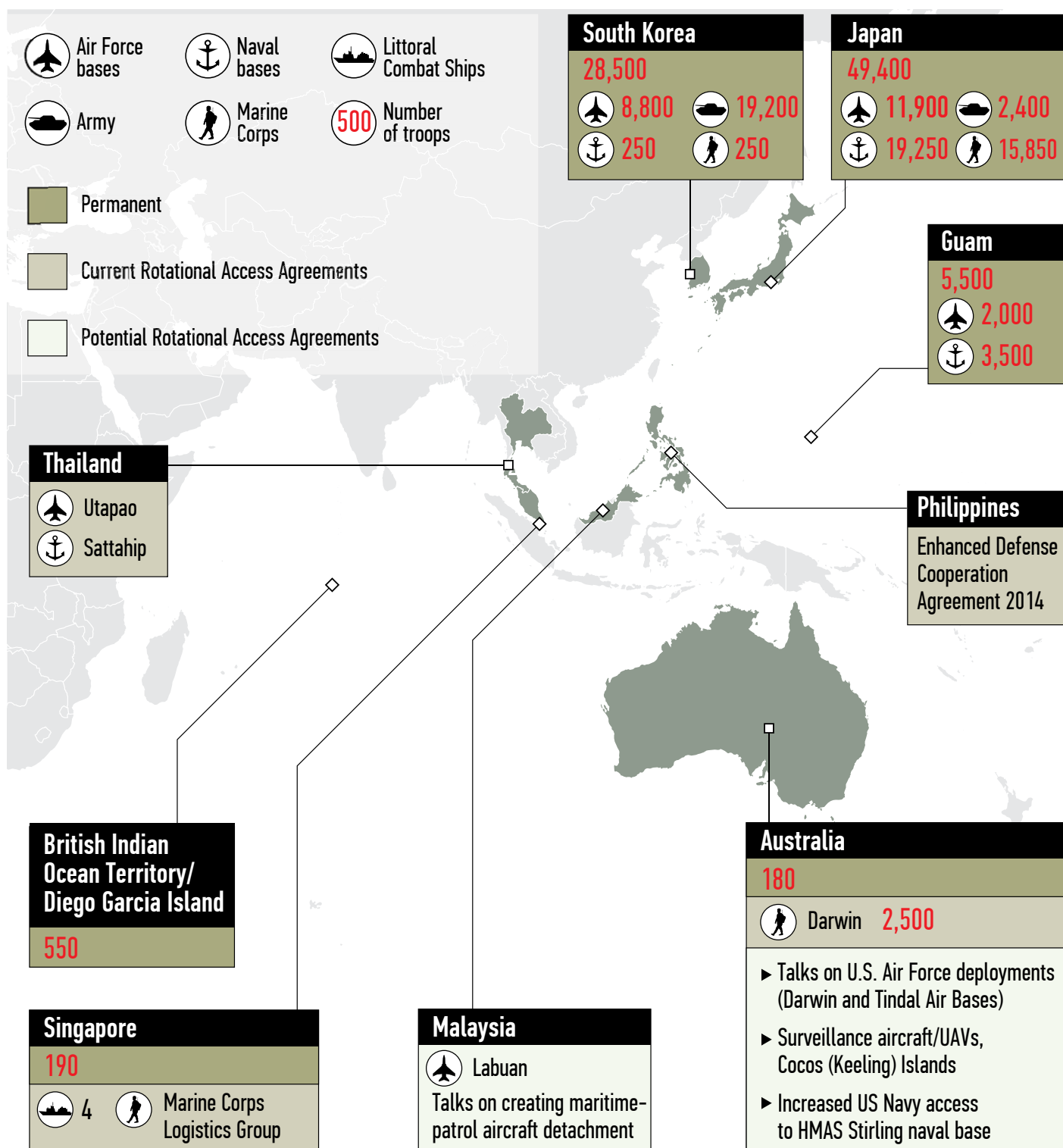


Defense spending (total, share of GDP and government spending)



Source: The Military Balance 2014, IISS

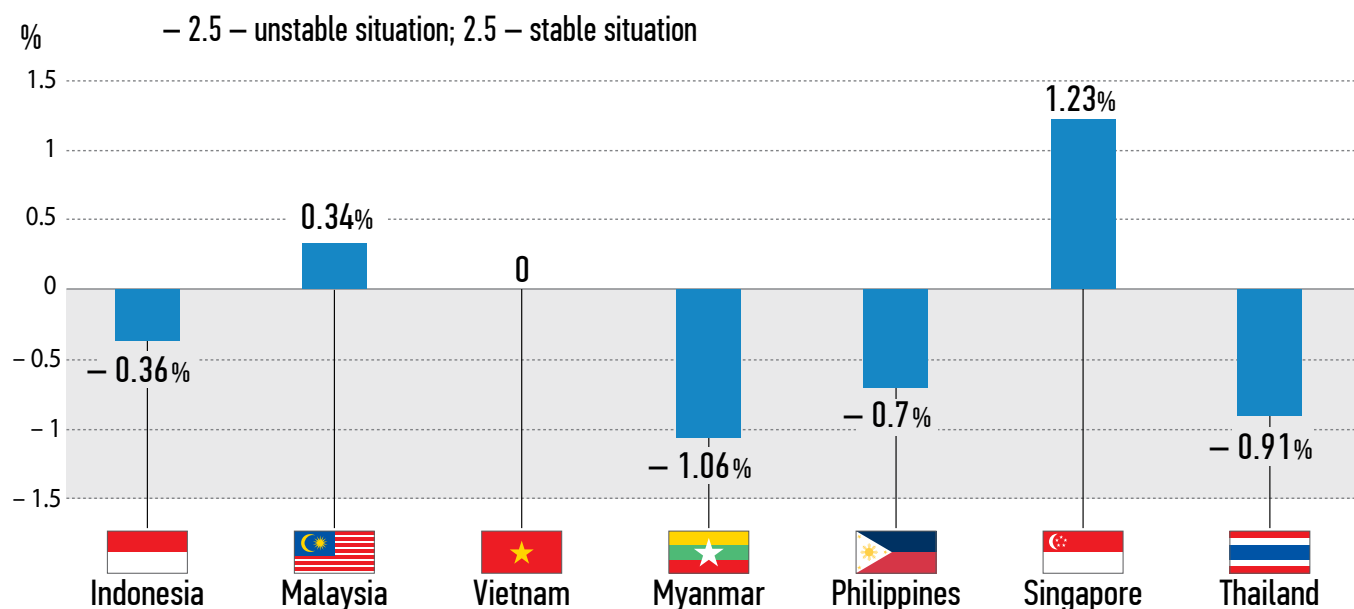
U.S. MILITARY FORCES DEPLOYED IN THE WESTERN PACIFIC *



* as of December 2014

Source: The Military Balance 2015. IISS

POLITICAL STABILITY INDEX IN SOUTHEAST ASIAN COUNTRIES IN 2014



Source: The World Bank

The potential for deepening integration, primarily in the framework of ASEAN, and for promoting political cooperation between its economies has been largely exhausted. There are no all-inclusive institutions of international security in Asia such as the OSCE, which unites the majority of European countries, whereas such organizations could be more effective in Asia than they are in Europe. The reason for this is that there are no military or economic blocs in Asia such as NATO and the EU in Europe, where the united stance of the member countries and their striving and ability (by virtue of numbers) to suppress the non-members and block the OSCE and the Council of Europe's work on key issues. Maybe it's time to apply the Helsinki Process to Asia and Eurasia, for example in the form of a Eurasian Cooperation, such as the Development and Security Forum, as has been

proposed at the level of experts. This format could help settle the problem of the European security impasse on a larger scale.

The Trans-Pacific Partnership (TPP) comprising the United States and several large regional economies, which was created in 2015, is designed to play a special role in the political and economic development of the region. The TPP aims to create new international trade and investment rules that would gradually replace the WTO. The TPP is a new challenge to Russia (to a limited extent) and such leading regional countries as China (to the greatest extent), India, and South Korea. Some ASEAN economies (Vietnam, Singapore, Malaysia, and Indonesia) have decided to join the TPP, while others (Laos and Cambodia) opted against this. China is pondering a difficult choice: either to join the TPP and so accept the rules that have been formulated without China's participation (these

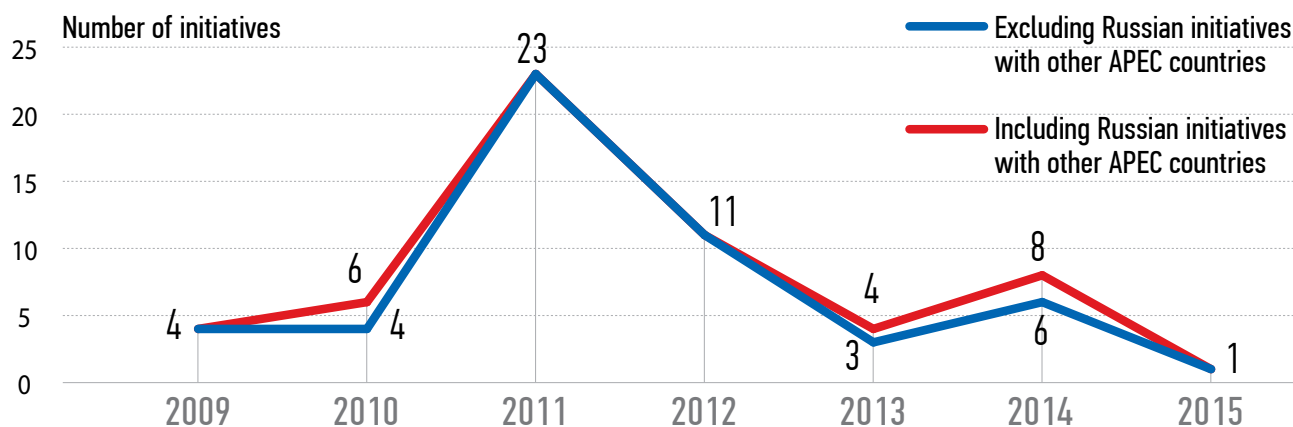
rules can presumably be adjusted, but this won't change the fundamental principles such as a ban on "forced technology localization"), or to create alternative economic governance organizations. This division, as well as rising tensions, many of them fuelled deliberately, are objectively increasing the medium-sized parties' interest in involving Russia as a positive balancer.

Over the past two or three years, Asian countries have gained considerable weight on Russia's foreign policy agenda. The number of exchange visits by Russian and Asian leaders has increased perceptibly, although Russia-Asia systemic political cooperation is so far unbalanced. A glance at the number of Russia's initiatives at APEC shows that it grew for several years before the APEC Leader's Week in Vladivostok and plunged after it. Meetings between top Russian authorities, Asian business leaders, and potential investors were cancelled without good reason. In light of their specific political culture, Asian countries see Russia's absence at summit meetings as evidence

that Russia does not regard them as priority cooperation venues.

Russia's attendance at the APEC leaders' meetings and EAS as well as top-level Russian visits to Asian countries have been irregular. For example, Russia was represented at the APEC Leaders' Week in 2015 by the prime minister rather than the president. Russia worked hard for several years to gain access to the East Asia Summit, but was only granted head-of-government level of participation in 2014, partly because Russia is not facing any threats similar to European ones in the East. In fact, it sees no threats in the East at all, and so thinks it deserves less attention at the top level. Russia, which has been working hard to repel the threat from the West, should use the absence of threats in the East to gain a stronger footing. This implies hard work too, starting with regular attendance of international Asian forums by top Russian leaders.

CYCLES OF RUSSIA'S ACTIVITY WITH APEC BY THE NUMBER OF PROPOSED COOPERATION PROJECTS (2009–2015)



Source: Official APEC website

1.2. Russia in Regional Affairs

The US-Chinese geostrategic rivalry is the most important factor capable of determining the future of Asia and the APR. This rivalry has deepened in recent years and the efficiency of Russia's policy will depend on how well its relations with each of these partners develop. Japan and many European countries demonstrate that as America's allies they cannot display independence in mapping out their foreign policy.

The complications in Russia-US relations can affect cooperation with US allies in the APR. Small and medium-sized APR states are apprehensive that Russian-American tensions will be projected to relations in Asia. Moreover, given close economic ties between the PRC and the US, Russian-Chinese cooperation is also likely to face certain problems (even today it is rumored that many Chinese banks are feeling US pressure and therefore refrain from cooperating with Russia).

So far, it is hard to characterize with certainty the results of efforts to build new types of relations between the China and the US. On the one hand, constructive rhetoric aimed at promoting relations is still in place. On the other, there is an indirect clash of interests. The US vigorously objects to Chinese policies in the South China Sea and the East China Sea and is strengthening its systems of alliances. In September 2015, Japan amended its Constitution (approving a package of 11 laws) and as a result is now in the position to render the US logistic and rear support all over the world.

Russia is not involved in either the TPP or the China-supported Regional Comprehensive Economic Partnership (RCEP). Neither is it directly involved in the PRC-US rivalry. At the same time, Russia has limited opportunities for influencing regional processes or taking part in shaping the agenda, the rules, or even the norms of cooperation.

Its chances of helping to develop technical standards are also limited.

Moscow has been an active participant in efforts to build a new financial architecture in the region. It is one of the founding countries of the Asian Infrastructure Investment Bank (AIIB). The agreement on the bank's establishment was signed on June 29, 2015. Russia is also a member of the BRICS' New Development Bank, which was designed, among other things, to finance infrastructure projects (the agreement was ratified on February 20, 2015). But so far Russia has not been very active in proposing its own projects requiring financing by the AIIB or the Silk Road Fund. In part, this is explained by the fact that it doesn't see itself as predominantly a transit power or a bridge between Europe and Asia. Our main interest is internal development and investment in our domestic economy.

Russia has been successful as an Asian supplier in the area of emergency relief and in the services sector (where it accounts for 5 percent of the total APR services market, focusing on business services, transportation, computer and information services, and a number of others).

One of the most important achievements of Russia's SCO presidency in 2014-2015 was the beginning of India and Pakistan's accession into the organization. SCO expansion provides member-countries with new opportunities for cooperation, including in the larger Eurasian format. This may help to promote both the fight against the terrorist threat and a more efficient Afghanistan policy. But the acceptance of India and Pakistan generates a number of problems as well. It is feared that Indian-Pakistani contradictions can reduce the organization's efficiency. It would appear that Russia and China, as the SCO leaders, will have to work together to smooth over these contradictions, by dissolving them into the SCO's positive, forward-looking agenda.

Eurasian and Asian development and Russia's policy to diversify cooperation with its Asian partners have found their expression in the launching of the EAEU-Vietnam project. The agreement embraces a broad range of issues concerning bilateral cooperation, from tariffs and dispute resolution mechanisms to intellectual property protection. Vietnam accounts for about 1 per cent of the EAEU imports from countries outside of the

former USSR. This is anything but a potent economic effect from cooperation and many commodities are on a sensitive items list. But this agreement is a political breakthrough for the EAEU and boosts its international legal standing. It also makes it possible to strengthen the basis of economic cooperation between Russia (as part of the EAEU) and ASEAN, blazing the way for an EAEU-ASEAN free trade area.

1.3. Relations with Key Regional Partners

The Russia-China honeymoon is not over yet. Our leaders demonstrate similar views on the current world order, as they did during the Victory Parades in Moscow on May 9 and in Beijing on September 3, 2015. But Russian-Chinese economic cooperation is rather limited, with Russia mostly exporting raw materials to and importing value-added consumer goods from China. For this honeymoon to become "happily-ever-after," they need a common agenda and clear plans.

The crises of 2009 and 2014-2015 showed that mutual trade tended to fluctuate dramatically. The falling prices of commodities, primarily oil, greatly weakened the ruble and delivered a double blow to mutual trade (cheap raw materials combined with a decline in the solvent demand for Chinese goods). Russia-China trade was \$63.6 billion in 2015, down from \$88.35 billion in 2014, this in spite of increased trade volume between the countries. But the worst part is that Russia-China trade and economic relations in their current form do not serve to create a reliable foundation for future relations, one that would not depend on changes in domestic policy, ideology, or foreign policy goals.

Relations between Russia and Japan

have greatly changed since the start of the Ukrainian crisis, largely because Tokyo has supported Western sanctions against Russia. Moreover, Japan views some elements of Russia-China rapprochement as anti-Japanese (for example, Russia's participation in the Victory Parade in Beijing on September 3, 2015). However, economic cooperation between Russia and Japan keeps growing, although bilateral trade in 2015 was only \$21.3 billion, a decrease of 31 percent, down from \$30.8 billion in 2014.

Energy cooperation is one of the most promising spheres. Japan traditionally imports energy resources from Russia, specifically liquefied natural gas from Sakhalin and oil via the East Siberia-Pacific Ocean (ESPO) pipeline. At the same time it increased imports of Russian coal by 20 percent, up to 9.66 million metric tons in 2014. Japan heavily depends on coal imported from Australia, which accounts for 74 percent of Japanese imports, and therefore would like to diversify its coal supplies. Meanwhile, Russia's coal exports to China plunged by over 40 percent in the first few months of 2015. Japan obviously wants to strengthen relations with Russia in order to counterbalance the effects of Russia-China rapprochement. This

promises the possibility of breakthrough agreements.

Trade between Russia and South Korea amounted to \$18 billion in 2015. Their political relations will depend on Russia's reaction to North Korea's growing international activity.

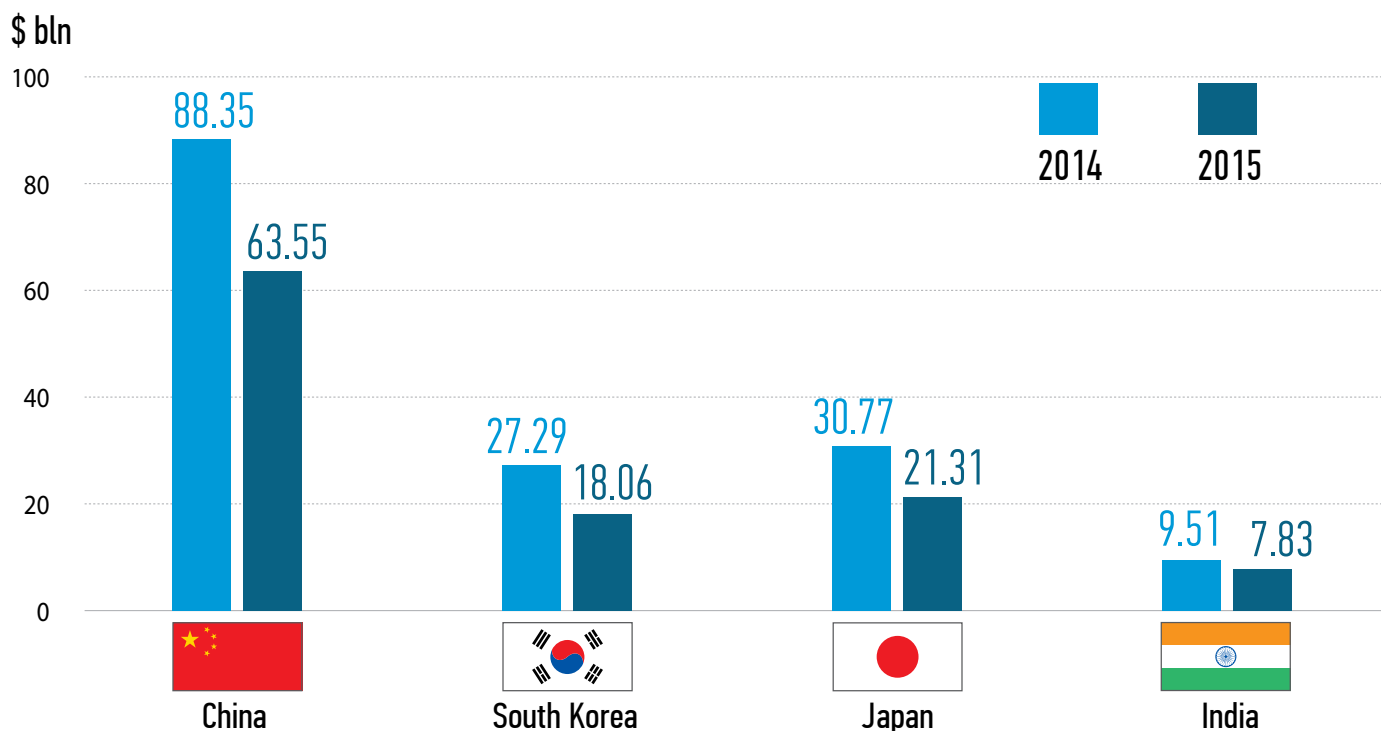
On January 6, 2016, North Korea held its fourth nuclear bomb test. On February 7, it said it had launched a satellite into space. The UN responded on March 2 by approving sanctions against Pyongyang, a move that China supported after negotiations with the United States. Overall, Russia can easily develop bilateral relations with South Korea and also cooperate with it in the Eurasian format, considering Seoul's interest in

Russia's assistance in finding a solution to the North Korean problem.

Russia would like India to become more deeply involved in the creation of a common Eurasian cooperation space. Russia-India trade volume was \$7.8 billion in 2015, down from \$9.5 billion in 2014, with Russian exports standing at \$6.3 billion and India's exports to Russia at \$3.2 billion. Over the past few years, India has climbed up on the list of Russia's largest trade partners. Cooperation with other regional partners is growing too.

Russia-Vietnam cooperation has grown, including bilateral trade, which has increased nearly sevenfold over the past 10 years, from \$400 million to \$2.76 billion. The goal is to increase bilateral trade to \$10 billion by 2020.

RUSSIA'S TRADE WITH CHINA, SOUTH KOREA, JAPAN AND INDIA IN 2014 AND 2015



Source: The Federal State Statistics Service of Russia

Russia's military cooperation with Asian-Pacific countries is a major component of regional relations. On February 16, 2016, Russia and Myanmar signed several contracts for the repair of Russian-made Mi-8 Hip multipurpose helicopters. At the same time Indonesia is planning to buy 10 Su-35 fighter jets. Military cooperation features prominently in Russia-India relations and is evidence of the high level of trust between the partners, even though India is also actively cooperating with the United States in this sphere. In general, Russia's military technical cooperation with Asian countries can play a positive role in the regional balance of power and in strengthening stability.

Energy is another traditional sphere of cooperation. In 2015, Russia became a major oil supplier to China, delivering 16 million metric tons of oil, more than Saudi Arabia did. Energy cooperation is a highly promising sphere for promoting Russia's interests in Asia Pacific. According to forecasts, energy consumption in the region will grow by over 60 percent by 2035. Energy requirements are expected to grow by 31 percent in China and by 11 percent in Southeast Asian countries.

Russia's full-scale operation in Asian gas markets can change the balance of forces, increase competition, and lower prices and this will decrease the attractiveness of LNG supplied by other countries to the Asian-Pacific market. The changing energy balance in the region obviously favors Russia. Over the past 10 years, Russia's energy exports to the Asia Pacific region have increased 15-fold, and the share of the regional countries in Russia's aggregate energy exports reached 24 percent. Crude oil and oil products dominate Russia's energy exports to Asia Pacific (64 percent and 21 percent, respectively).

The biggest obstacles to the development of economic cooperation in this region are Russian and Asian businesses'

lack of information about each other's opportunities, the underestimating of Russia's industrial capabilities, insufficient use of financial mechanisms, and instruments for encouraging cooperation. The creation and improvement of these instruments would create a firm basis for interaction amid Western sanctions against Russia and should become a priority in Russia's relations with its regional partners.

Russia's turn to the East is an accomplished fact in terms of foreign policy, but it needs to be given legs. The priority in this sphere is cooperation with China, on which Russia can rely politically in difficult times but with which economic relations are not satisfactory. So far, Russians don't see the advantages of rapprochement with China. In order to give substance to these new relations, the authorities should compile a list of common goals and develop investment and industrial cooperation. Russia and China need not seek conflict-free relations, which are nearly impossible between two equal powers. Instead, they should create architecture of stability and strengthen their cooperative environment.

At the same time, Russia should also develop relations with the other large Asian partners, gradually involving them in Russia-China cooperation thereby reducing anxiety in Russia and in the regional countries. Some of these countries have the technology and investment resources that can be put to use in Russia in order to boost the production of commodities for export to Asian, primarily to Chinese, markets. Joint efforts in the sphere of international security should promote the understanding that Russia-China rapprochement is not spearheaded against any country in the region. Russia must respond to the Asian countries' demands and weave them into its overall contribution to regional stability.

2. TURN TO THE EAST: THE RISE OF RUSSIA'S SIBERIA AND FAR EAST

Stepping up political and economic cooperation with Asian countries is not only important and needed in its own right, but is also a tool and driver of accelerated socioeconomic development of Russian territories to the east of the Urals, i.e. Siberia and the Far East. The rapid economic growth of Asian countries has created real development opportunities for Russia's Siberia and Far East. Without a new federal and local governance model these opportunities don't have much of a chance to materialize. Russia had better set its sails in order to catch the wind of Asian growth.

This process started back in 2012 with the establishment of the Ministry for the Development of the Russian Far East, which was tasked with coordinating public policy regarding eastern territories. Over the three years that have elapsed since then, the minister has changed, the regional development model was revised, and many new tools for implementing it were developed and launched. It is now time to sum up the preliminary results and highlight the most important developments for Russia to the east of the Urals and the integration of these territories into the APR economic space.

The institutional framework for the turn to the East was developed in 2015. This effort included the selection of the first nine priority development areas in Russia's Far East. Three of them have already been launched: Komsomolsk, specializing in aircraft parts manufacturing and timber processing; Khabarovsk with metal works, an agricultural greenhouse complex, a warehousing transport and logistics complex and an airport; and Nadezhdinskaya with a transport and logistics complex, a confectionery plant, and enterprises specializing in processed food production.

A list of investment projects has been established. By the end of 2015 it included six initiatives, and three more were added in February 2016. Development institutions were created and are now up and running, including the Far East Development Fund, the Far East Development

Corporation, the Agency for the Development of Human Capital in the Far East, and the Far East Agency for Investment Promotion and Export Support. Vladivostok received free port status.

Although these institutions are still in their early days and it is too early to evaluate their performance, the investment climate in the region has already started to improve. Russia's Far East has not been immune to national economic woes. However, as the country in general slid into recession, the region has been able to maintain positive momentum in terms of investment and industrial growth. The next step would be to align plans and projects of national and international development institutions.

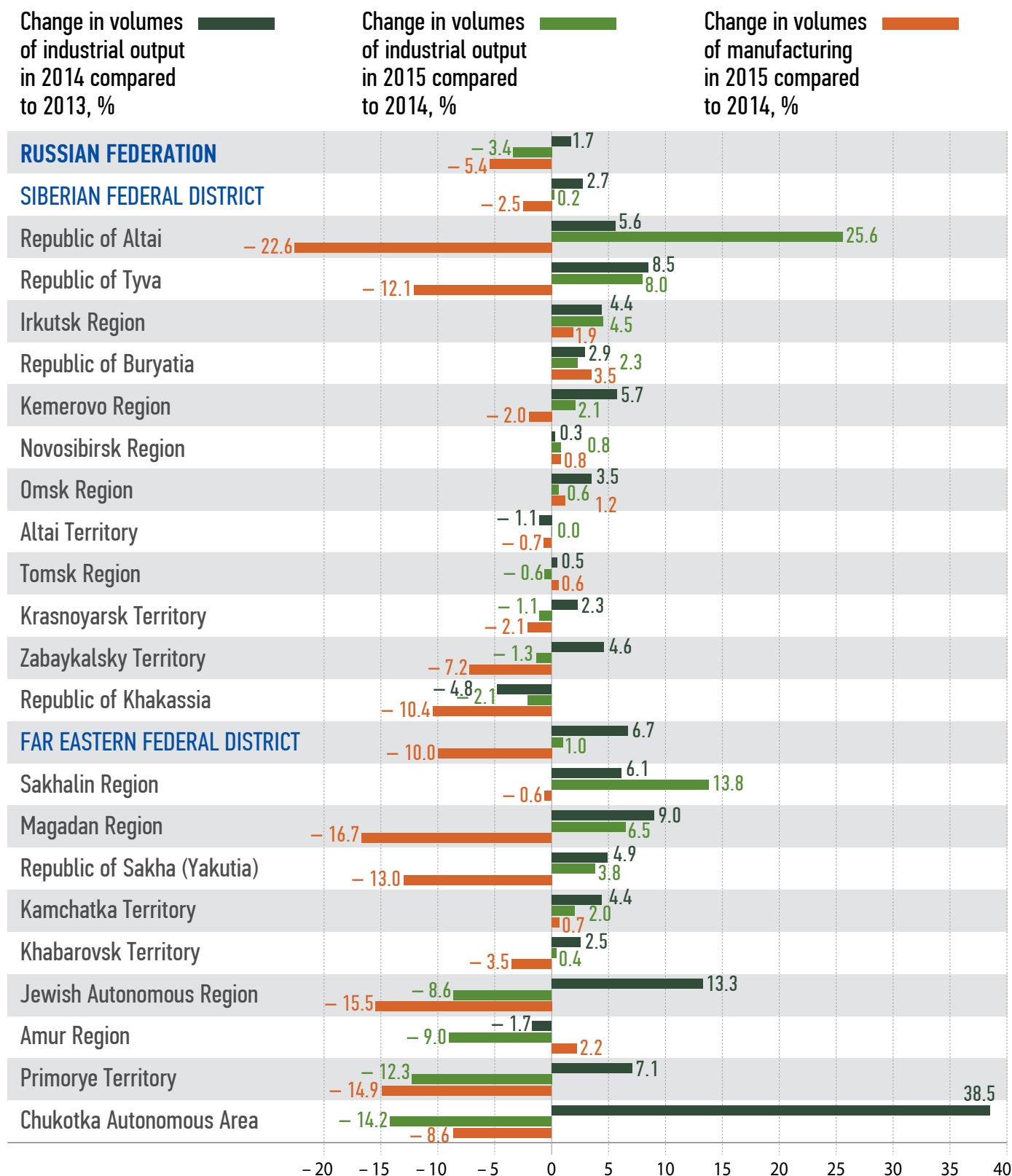
Russia's turn to the east has reached a crucial point. It could be tempting to stop there, since the region has now a new governance structure, so why not stand back and wait for results. This would be a mistake.

First, while social and economic development indicators for the Far East are relatively positive, they conceal substantial disparities. The Sakhalin and Magadan regions are rapidly developing, but the two biggest constituent entities in the region, the Primorye Territory and Khabarovsk Territory, are on a downward trend, on par or even lagging behind the national average. Even regions that posted an increase in their industrial production index have seen only a modest uptick or an outright decline in manufacturing volumes (Fig. 1).

There are also disparities in terms of investment. Investment in Russia's Far East has been growing, but this increase is attributable to higher investment in the Amur and Magadan regions, while in other regions the situation is less favorable (Fig. 2).

Second, the structural challenges facing the Far East are still there: its economy is still based exclusively on commodities, foreign capital is nowhere to be seen, and people continue to leave the region. Unless all these issues are resolved, the region is unlikely to become a long-term economic growth driver for Russia.

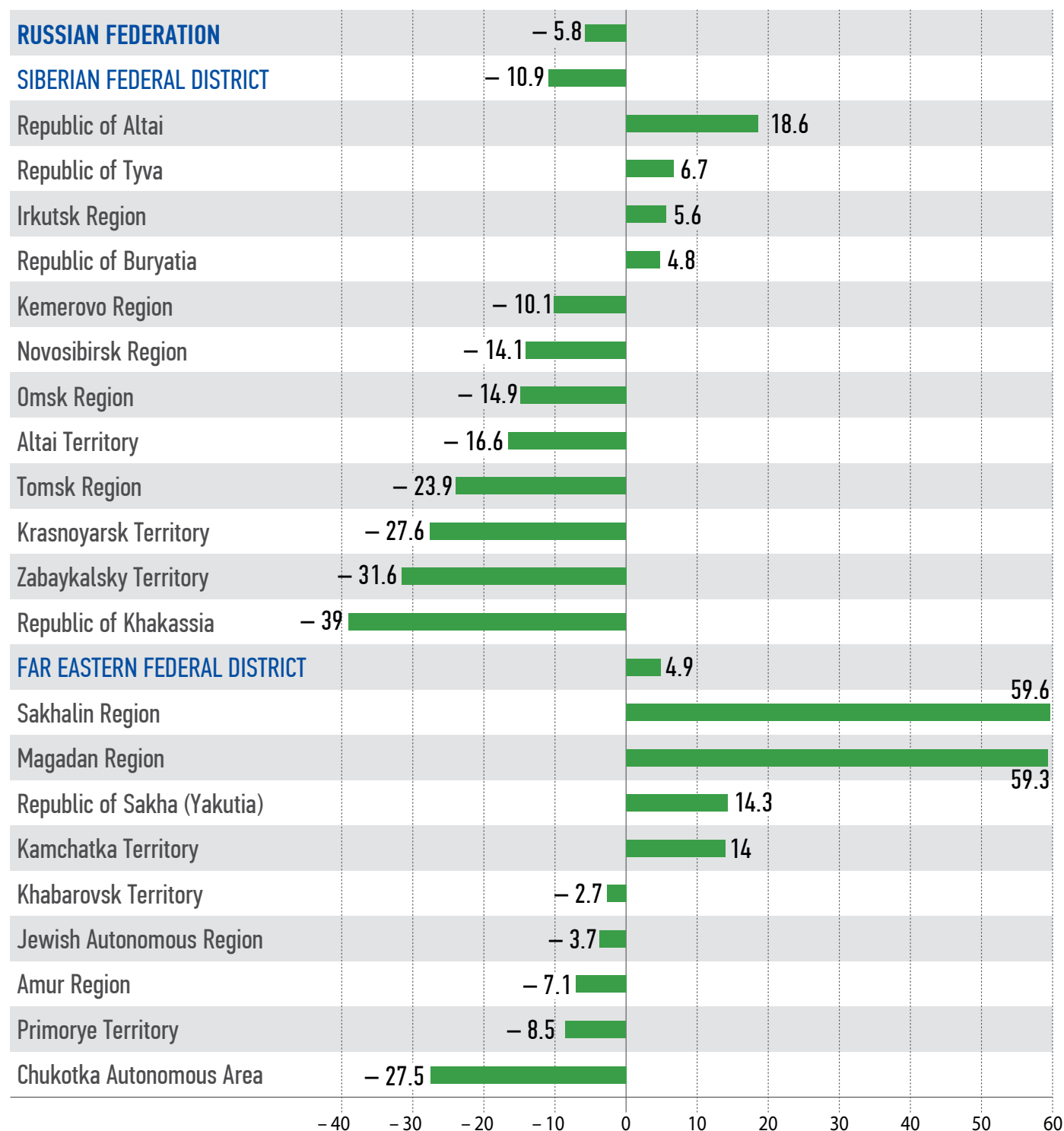
INDUSTRIAL OUTPUT AND MANUFACTURING



Source: The Federal State Statistics Service of Russia

FIXED CAPITAL INVESTMENT

January-September 2015 compared to the same period of 2014, %



Source: Russian Federal State Statistics Service

Third, the outside environment has changed radically since policies to promote the development of Russia's Far East were launched. So far, expectations of a massive inflow of foreign investment have failed to materialize. Only one foreign resident has been registered in priority development areas that were designed as a platform for attracting foreign investors. Other projects are at the preliminary stage. Asian banks and investment funds view Russia as a high-risk destination against a backdrop of global economic uncertainty, political risks, and sanctions. In March 2016, Bank of China granted a EUR 2 billion loan to Gazprom, the biggest borrowing the Russian gas giant has ever tapped from a single lender. However, among Chinese financial institutions, development institutions, and the Silk Road Fund, not private banks, have so far been active in Russia. In addition, loans are mostly provided at quite unattractive rates. The situation has been made even worse by the slowing Chinese economy, instability in its financial markets, and a campaign to crack down on corruption, which has scared off the Chinese elite from engaging in any risky undertakings.

China's turn toward the West is another important trend, as will be discussed in more detail in the next section of this report. In fact, China is trying to keep up the momentum of its extensive economic growth model by accelerating the development of the underdeveloped inland territories, reaching out to Central Eurasian countries, paving the way for future expansion toward the southwest and Europe, as well as diversifying export risks as its competition with the US on the sea becomes more strained.

The current development model for Russia's eastern territories consists of setting up export-oriented manufacturing and attracting major foreign players. The priority development areas are viewed as a key tool. They offer deregulation and massive tax incentives, both of which are intended to lure in foreign investors. The main selection criterion was the demand among such

investors for locating investment projects in specific territories. Priority development areas are supposed to be on par with the leading APR country in terms of investment and business climate indicators. For instance, profit tax should be as low as in Hong Kong, customs clearance as simple and straightforward as in Singapore, obtaining a connection to the power grid as quick as in South Korea, etc.

Unfortunately, this development model for Russia's eastern territories was born in and tailored to suit a different international environment. Without adjustments it would be unable to adapt to new risks and exploit these emerging opportunities.

First, this policy never became part of a system-wide effort, remaining a set of useful, but poorly connected measures. But there's more to it. It is simply impossible to foster economic activity and attract investors by simply passing a few pieces of legislation, especially into a region that has been struggling with this issue for the last quarter of a century. It is not enough to call Russky Island a priority development area and expect an investment boom to follow, or to build a university campus in anticipation of a rapid improvement in human capital, or to give Vladivostok free port status and expect its cargo turnover to surge. There is also no reason to expect that a dozen priority development areas, even if they reach their intended success, would radically change eastern Russia. What should follow are other, more radical initiatives that would not boil down to additional subsidies, since there is less and less funding available anyway, requiring a rethink of the regional economy.

Siberia and the Far East should become a territory of economic liberty. Formal and informal barriers should be removed in order to attract investors to all projects, with the exception of strategic national defense projects. There is a need for an all-out effort to root out corruption, especially in the key and the most criminalized industries, such as fisheries and forestry. Key

industries, primarily those related to infrastructure and mineral extraction should be liberalized. Measures should be enacted to attract skilled workers to the region and create incentives for people to move from remote territories of the northwest to the south.

State corporations should move their headquarters to Russia's Far East. In early 2014, the Prime Minister Dmitry Medvedev voiced this proposal, which however did little to persuade major companies to relocate to the territories where their key production facilities operate. It seems that the time has come for the state to intervene directly. This idea should be followed by legislative action targeting at least state corporations, and possibly specific private companies generating super profits in the region. This should be accompanied by gradual tax decentralization. The current relationship between the federal center and Russia's East is based on quasi-colonial principles and should be changed. The first step would be to change the funding model of the Far East Development Fund, which now gets part of its resources from regional taxes. Other initiatives to this effect should follow.

There is also a need to promote the Far Eastern agenda on regional integration platforms and become more actively involved with Asian development institutions (Asian Infrastructure Investment Bank, Silk Road Fund), as well as develop and improve the Eastern Economic Forum with a view of transforming it into one of the key business forums in Asia Pacific. Serious efforts should be undertaken to improve the Far East's positioning, branding, and online footprint. For now, priority development areas don't even have a Russian website.

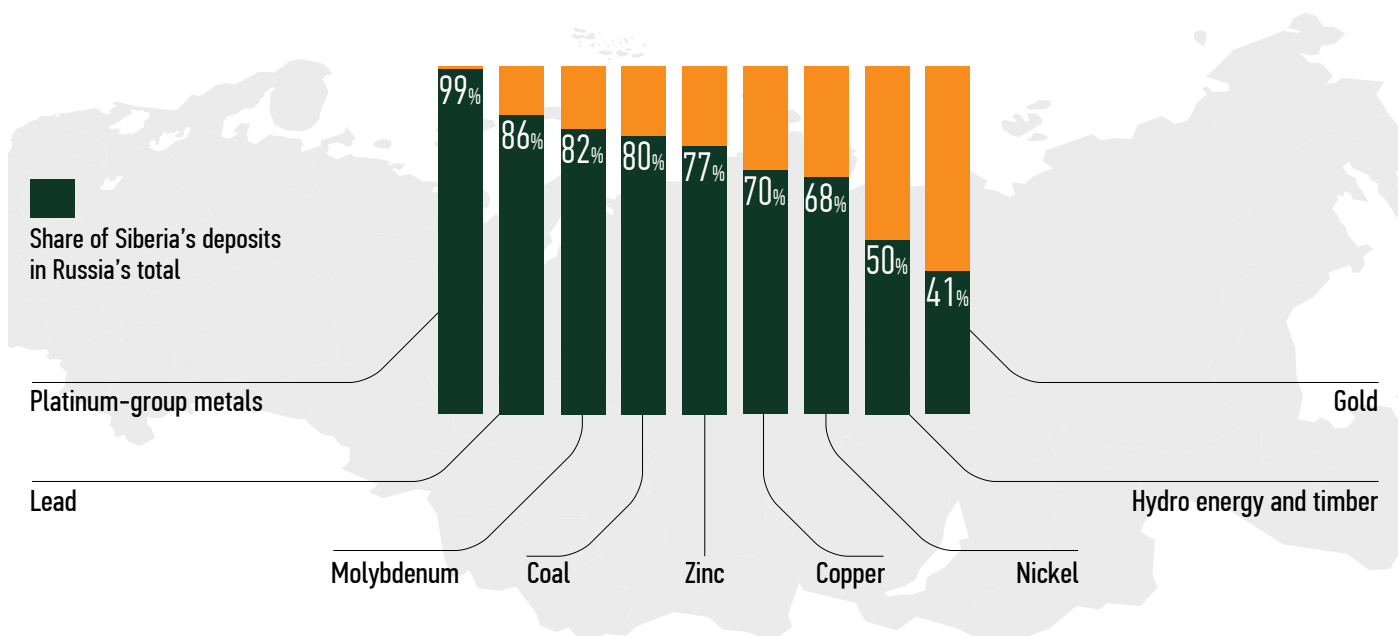
Second, an integrated approach to managing Siberia and the Far East is not simply desirable, but should actually be a requisite in this new environment. It is rooted in the initial idea of turning toward the East. Specifically, in 2012 the current Minister of Defense Sergei Shoigu proposed an ambitious project to set up a State

Corporation for the Development of Siberia and the Far East. In his 2013 Address to the Federal Assembly, President of Russia Vladimir Putin called developing Siberia and the Far East "a national priority for the entire 21st century." After that Siberia to the west of the Far Eastern Federal District was forgotten. In his subsequent addresses to the Federal Assembly the President mentioned only the Far East, and the ministry that was created to this effect was limited in its geography to Russia's Far East.

However, Siberia and the Far East are integral parts of a single macro-region. They have historical ties: since the times when these territories were discovered by Russian pioneers, the word Siberia referred to the territory from the Ural Mountains all the way to the Pacific Ocean. This wider region has a specific identity, symbolized on the national emblem by the right head of the two-headed eagle. Siberia and the Far East maintain close economic and human contacts that are sometimes more active than those with Moscow. Finally, they are interlinked on the infrastructural level by the Trans-Siberian Railway and the Northern Sea Route.

Siberia outweighs the Far East in terms of its overall economic potential. In fact, the Siberian Federal District has a population of 19.3 million, and the Far Eastern Federal District has only 6.2 million, while covering a larger area. The Siberian Federal District is rich in such natural resources as oil and gas, coal, uranium, ferrous, non-ferrous and rare-earth metals, precious metals, timber, water and hydro energy resources. Siberia accounts for 80 percent of the total coal deposits in Russia, as well as 70 percent of copper, 68 percent of nickel, 86 percent of lead, 77 percent of zinc, 82 percent of molybdenum, 41 percent of gold, 99 percent of platinum-group metals, and over 50 percent of the country's total hydro energy resources and timber. The region has also abundant croplands, while it also benefits from a more favorable climate compared to the Far East. Its main feature, however, is that Siberia offers extensive

SIBERIA'S NATURAL RESOURCES



Source: sfo.gov.ru/okrug/ekonomika/strategiya/

opportunities for developing high value-added manufacturing. It has also high human potential, since the top 20 Russian universities include five Siberian universities and not a single institution of the Far East.

Siberia's main curse is its location deep inside the continent, far from the key markets, a predicament made even worse by the poor development of the transport infrastructure. China's Silk Road Economic Belt project creates new opportunities. If Siberia succeeds in becoming part of the emerging Central Eurasian transport and industrial cluster, it could give it new wind, transforming its disadvantageous geographical location into an advantage.

Pushing for accelerated development of the Far East while leaving Siberia behind would inevitably make the continental curse even worse by clogging the transport infrastructure. The development of the Far East should produce the opposite effect by making Siberia closer to foreign markets. However, it would be unfair to demand that the Ministry for the Development of Russia's

Far East embark on this activity, since Siberia is not part of its responsibility.

The Arctic part of Russia faces similar issues. Its division into the Siberian and Far Eastern parts is artificial and underpinned by purely bureaucratic logic. This should not stand in the way of coordinating infrastructure development projects, since to a large extent they cover several regions, as is the case of the Northern Sea Route.

Now that the development institutions for the Far East are up and running, the next important step in terms of accelerating the development of Russia's eastern territories would be to coordinate the development of the Far East with that of Siberia. This should be accompanied by an effort to devise specific mechanisms for aligning Eurasian integration with the Silk Road Economic Belt project. The Asia Pacific Region and Central Eurasia are rapidly changing, and it is very important for Russia to keep up with these changes, if not lead them. Russia's turn to the East is a decade behind Asia's rapid economic growth. It is now important not to repeat the deficiencies of the past.

3. GREATER EURASIA: YESTERDAY, TODAY, TOMORROW

3.1. Alignment: From an Idea to a Strategy

Aligning the development of the Eurasian Economic Union and the Silk Road Economic Belt is one of the most forward-looking concepts for cooperation among a big group of states. Its aim is creating a synergy between the two projects and organizing a new co-development area around Eurasia's transport and logistical framework. This synergy should result in the world's biggest cooperation region located in and around Central Eurasia. But as we move towards Greater Eurasia's new community, we should address a number of institutional issues, determine industry-specific priorities for trans-border cooperation and rules of the game, and gauge up each partner's benefits and contributions.

This cooperation is based on an understanding that none of the discussed differences between the leading states in Central Eurasia is profound, let alone antagonistic. Russia, China, Kazakhstan, the former Soviet Central Asian states, Iran, and Mongolia are facing common external, and in a number of cases, internal challenges. These are religious extremism, environmental threats, water shortages, drug trafficking, and negative impacts of policies pursued by certain non-regional power centers. They need greater socioeconomic stability and growth rate sustainability. All of them need a bridgehead for more staggered policies to preclude the destabilization of Afghanistan and the spread of instability from the Middle East. It is necessary to consolidate the region's development agendas and to strengthen international security cooperation between the local states.

Eurasian integration is the flagship project that Russia and its partners have

mapped out for the next few decades. Launched on January 1, 2015, the Eurasian Economic Union (EAEU) is laying the foundation for legal frameworks enabling a joint breakthrough. It is also creating a tool for preventing and settling interstate disputes. The EAEU has been established to enable comprehensive modernization, cooperation, and greater competitiveness of national economies. The union is also meant to create conditions for stable development and better living standards in the member-states. Accordingly, the EAEU provides for free movement of goods, services, capital, and workforce and works to coordinate and synchronize economic policies in different areas. Thanks to the EAEU, there is just one customs border left between China and the EU.

Added to the common customs office, the EAEU's main achievement to date, are common phytosanitary norms. These legal and bureaucratic instruments can create huge practical opportunities for border trade within the EAEU and on its external borders. But for this to materialize, we should expedite the development of a unified EAEU-China agenda. The EAEU Treaty offers a roadmap for progress towards a common market and possible exemptions. It is planned to consolidate regulation of pharmaceutical industries in 2016, to create a common power and energy market in 2019, to institute common financial mega-regulators in 2022, and to form a common market for oil, gas and petroleum products between 2024 and 2025. This in itself will facilitate the development of related clusters in Eurasia.

The SREB initiative was announced by PRC President Xi Jinping at Nazarbayev University in Astana in September 2013. Its

aim is not only to solve China's domestic economic problems but also to ensure regional political and economic stability on the basis of large-scale investment and infrastructure projects and a policy to include the region's countries in common production chains.

The SREB is not just a transit and transport project. It is an offer of economic development for a number of states, complete with numerous infrastructural production, trade, and services projects. If implemented, this will make it possible to provide a stable and secure environment for the development of both western China and the whole of Central Eurasia by unlocking its full potential. But despite the clarity of objectives, the Chinese idea was initially devoid of specifics, something that led to its controversial interpretations by other players.

Conscious that coordination affords a lot of opportunities for Greater Eurasia as a potentially advanced region in many respects – industrial, technological, logistical, and cultural – the leaders of Russia and the PRC signed, on May 8, 2015, a joint declaration on cooperation in aligning the development of the Eurasian Economic Union and the SREB. The declaration was joined by Armenia, Belarus, Kazakhstan, and Kyrgyzstan. Along with creating mechanisms facilitating bilateral trade between the EAEU and China, the sides expressed readiness to promote cooperation with reliance on the SCO, the Asian Infrastructure Investment Bank, and the Silk Road Fund.

Despite an initial acceleration, cooperation subsequently slowed down. In this connection, the Supreme Eurasian Economic Council, at its meeting in October 2015, decided to draft a roadmap for EAEU-China cooperation. Put in charge of the project, the Eurasian Economic Commission (EAEC) at first stage seemed to remove itself from the effort. Thus, after the intellectual work reached a new level, it is important to infuse it with the necessary practical tempo, which means creating institutional mechanisms for daily practical cooperation between the EAEU and China. This should include cooperation between state authorities, the EAEU supranational institutions, cooperation between development institutions (Silk Road Fund and Eurasian Development Bank), and dialogue between businesses, experts, and civil societies.

To reiterate, the potential for intensified interstate and inter-regional cooperation in Central Eurasia is not only and not so much a transport project as a co-development project involving countries in the region. This macro-region possesses a huge potential based on its economic vigor, rich mineral resources, Chinese investments, and common institutional and legal projects like the EAEU, the SCO, and the CSTO. All of this creates prerequisites for the revival of the original Silk Road as a continental belt of trade, economic, and cultural cooperation between adjacent states, which enables them to gain wealth and prosperity.

3.2. The Interests Involved

Alignment is not only (and not so much) about transport infrastructure development or institutional cooperation between the EAEU and China. It is a large-scale project emphasizing co-development in the entire Central Eurasian region and as such is an extremely timely initiative for all of its current and potential participants. Russia will be in a position to approach the potential of Siberia and the Russian Far East from yet another angle and the competitive advantages of these areas on the Asian market will increase manifold owing to the possibility of developing water- and power-intensive industries. Russia's interest is also explained by the need to develop north-south longitudinal transport routes to Iran and India.

The investment and infrastructural coordination programs promise Kazakhstan and the Central Asian countries economic development and additional financial resources that are badly needed by these republics as they try to cope with a crisis in the economy. The Central Asian states have faced economic problems in the wake of the falling oil prices and the weakening of the Russian economy. Like Russia, practically every republic is witnessing a dramatic devaluation and volatility of its national currency, inflation growth, and economic decline. Accordingly, the proposed infrastructural and investment projects will encourage production in Kazakhstan and the Central Asian republics and strengthen social and political stability.

Russia, China, and the Central Asian states are equally concerned with assuring stability and security in the region and preventing its fragmentation. By virtue of internal instability factors (irremovable political elites, fewer opportunities for generous social policies in a crisis, etc.), the countries in the region prove extremely vulnerable to external threats such as radical religious ideas, terrorism, and drug trafficking.

Alignment is currently central for the EAEU because it needs to strengthen its institutional component and test integration in practice. The lack of interstate institutions makes it impossible to discuss crucial issues at a lower level and leads to a situation where the Five have to coordinate their positions on cooperation with China mostly in a bilateral format, something that puts integration at risk. There is a demand for a mechanism that would enable maximal coordination of national interests and delegation of powers to supranational institutions.

Further cooperation with China matched by the EAEU's own simultaneous development will facilitate gradual approximation of technological guidelines and standards in the five countries and the emergence of a single approach to trade and economic relations with a third side. In turn, this means not only better negotiating positions but also a higher degree of protection against intense rivalry on Asian markets. With economies in decline, further simplification of business-related legal proceedings can substantially revitalize investment in the region.

The EAEU-SREB alignment project should give a new impetus for development to the Shanghai Cooperation Organization as an important platform for regional cooperation and international security. After the accession of India and Pakistan and an expansion of cooperation with Iran, Mongolia, Afghanistan, and potentially the Republic of Korea, the SCO can aspire to the role of the most effective institution for international cooperation at the macro-regional (Eurasian) level. Russia (as the strongest military power in the region) and China (as the economic leader, albeit not the hegemon) can and must be central to this cooperation. Prospectively the SCO's positive experience of cooperation and resolution of complicated issues may well form the foundation of the emerging Greater Eurasian Community.

3.3. From a Eurasian Bridge to a Common Development Space

Eurasia offers unique opportunities for developing transport and logistics corridors and hubs, including air cargo traffic, for matching Europe's and Asia's manufacturing and consumption potentials. For this reason, expanding the transport and logistics infrastructure in Central Eurasia is both a main prerequisite for and a trend in its future development. The SREB project, once implemented, would make transport routes from West China shorter compared to when delivered via the Suez Canal. This will be an 8,400 kilometer route. Of this total, 3,400 kilometers have already been built on Chinese territory, and Kazakhstan and Russia are about to either build or renovate another 2,800 and 2,200 kilometers, respectively.

There are currently several transit corridors for delivering goods from China to Europe. In 2015, freight turnover on the sea route from China to Europe was equal to 11.2 million TEUs and 4.5 million TEUs in the opposite direction.

- *42,000 TEUs – overall transit through Kazakhstan, Orenburg, and Saratov regions;*
- *200 TEUs – the cargo turnover along Urumqi – Almaty – Saksaulskaya – Aktau – Makhachkala – Novorossiysk – Constanța route;*
- *3,000 TEUs – overall transit along the Urumqi – Almaty – Saksaulskaya – Aktau – Teheran route.*

Cargo transit from China through Kazakhstan has the potential of reaching 200 TEUs, while freight traffic from China to Iran via Saksaulskaya and Aktau could reach 150,000 TEUs. So far, this seems to be a distant possibility. While the Trans-Siberian Railway has a total transit capacity of 1.2 million TEUs per year, in 2015 container

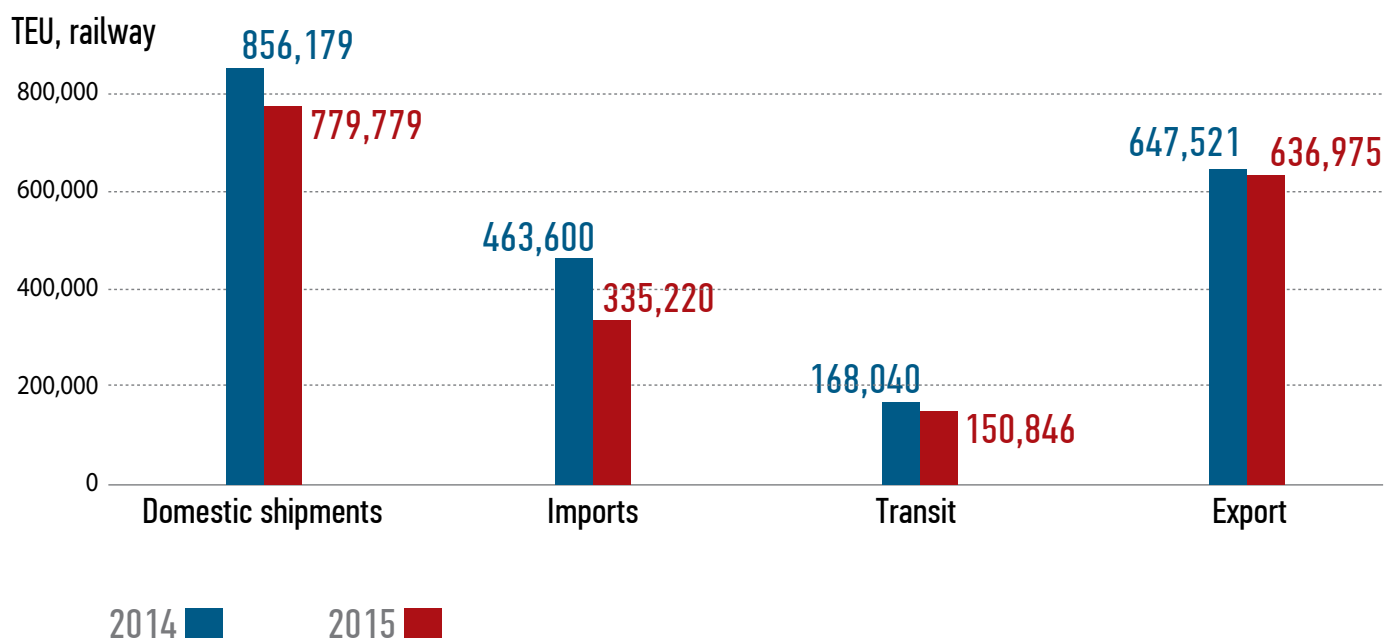
shipments along this route were only slightly higher than 700,000 TEUs. Of this total, only 450,000 TEUs traveled the whole distance from Vladivostok to the terminal point of the Trans-Siberian Railway.

The Trans-Siberian Railway has the potential for increasing its transit capacity. Unlike the Baikal – Amur Mainline, it is double tracked and fully electrified, which means that it won't require substantial investment in upgrading it in the near future. Nevertheless, the Trans-Siberian Railway has several bottlenecks (sections, hubs, stations, etc.) that slow down cargo turnover. If all the necessary initiatives are implemented, such as adding tracks in some sections, crossing loops, interchange yards, improving maintenance, this could add 10%-15% to its transit capacity.

Many elements of the EAEU transportation infrastructure are underdeveloped, undermining cooperation in the transportation industry. For instance, the Almaty cargo port in Kazakhstan is not as well equipped as the Urumqi inland port in China, which affects service quality and timeframes.

This situation could be explained in the following manner. While it is true that land routes linking Europe and Asia provide for shorter transit times compared to shipments by sea at 14 days to 30-35 days, respectively, transportation by land is much more expensive. Consequently, it is used only by few market segments, where the speed of delivery really matters. This could be goods with high added value per kilogram of weight, specific types of food products, and premium textiles. However, transportation rates for sea and land routes, for example the Shanghai – St. Petersburg – Moscow and the Shanghai – Russia's Far East – Moscow routes have been recently converging. This inspires hope that in the future transportation by land could become competitive.

RAILWAY TURNOVER OF LOADED CONTAINERS OF EAEU



Source: Calculations by InfraNews.ru information portal based on open quotes by Transcontainer, Russkaya Troyka, Kazakhstan Temir Zholy.

All in all, transcontinental transportation corridors are important to Russia not so much as a source of revenue from transit operations, but rather as a possibility to develop domestic traffic between regions, which could foster industrial development at destination points. In this regard, it is important to develop north-south transport routes while creating trans-border development and investment clusters.

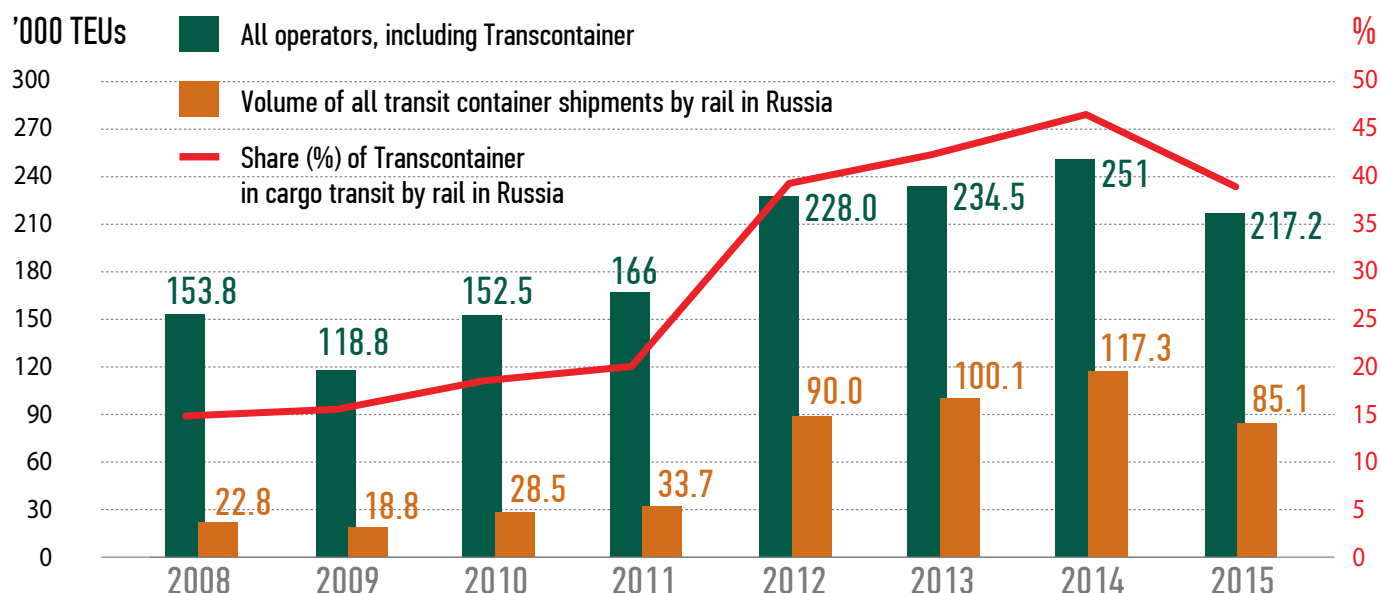
However, the Greater Eurasia cannot be merely a transport and logistics project. It should be about expanding trade and economic ties within the region, including between Russia and China. So far, the situation in this area has been ambiguous. On the one hand, huge resources are available and there is a great potential, while on the other hand, existing disparities have to be recognized. That said, Russia and the EAEU's trade with China is more diversified than with any other trade

partner. On top of hydrocarbons and coal, EAEU members supply to China equipment, uranium, timber, petrochemicals, and almost all customs commodity codes, except for silk and cotton.

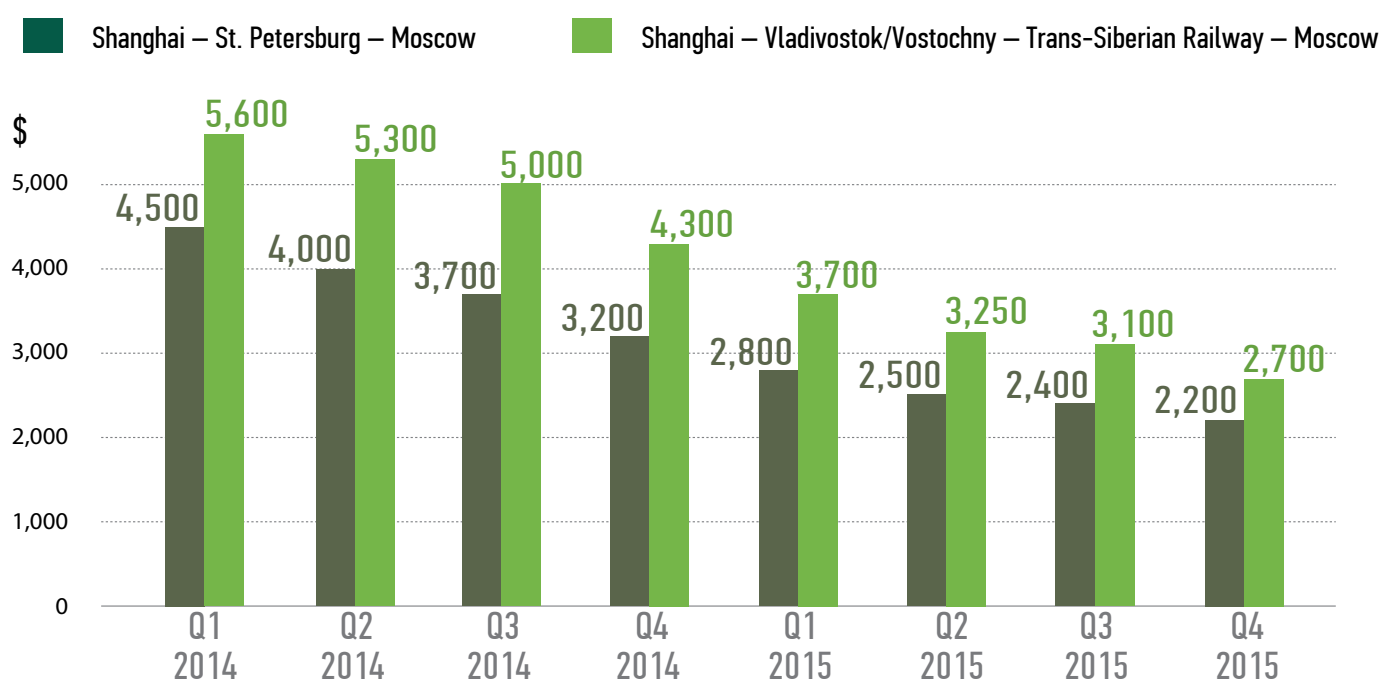
There is some ambivalence in the EAEU's current trade relations with China. On the one hand, trade between EAEU members and China dropped sharply in dollar terms in 2014-2015, even though its physical volumes inched up. This is largely attributable to the depreciation of the national currencies in Russia and Kazakhstan, the two EAEU majors.

On the other hand, it should be taken into account that the decline was due not to lower supply volumes, but to lower prices of goods, parts, and raw materials. In terms of foreign trade volumes there were actually some positive trends: some of the EAEU countries (Armenia and Belarus) were able to expand their trade with China in 2014-2015. Russia is

TRANSIT CARGO TURNOVER ON RUSSIAN RAILWAYS

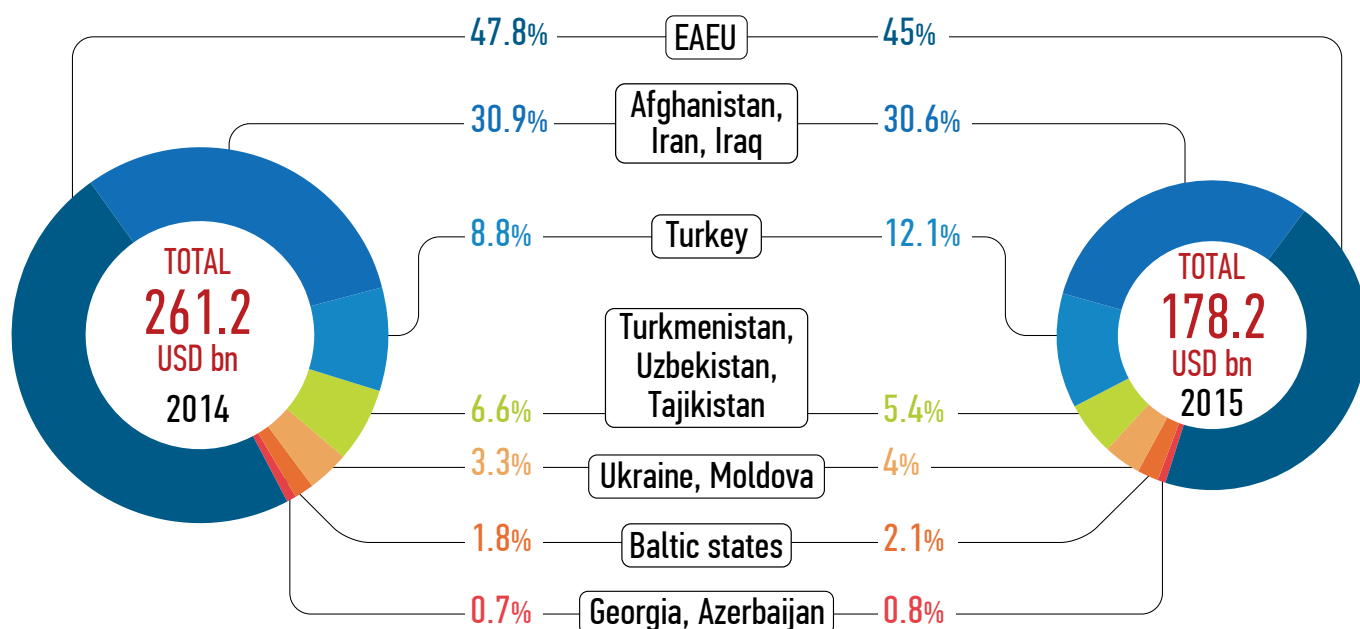


Average rates to deliver one TEU to Moscow by sea via St. Petersburg versus the Trans-Siberian Railway

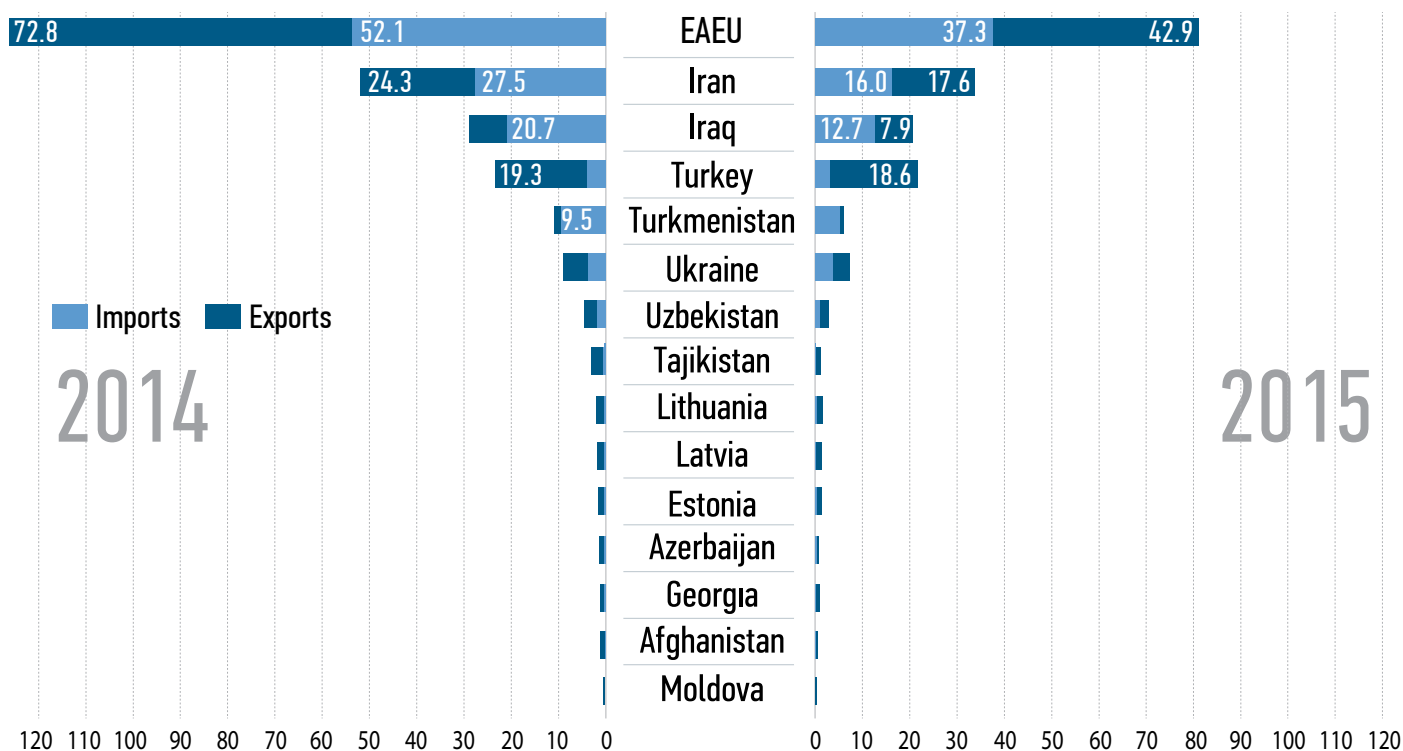


Source: Calculations by InfraNews.ru information portal based on open quotes by Transcontainer, Russkaya Troyka, Kazakhstan Temir Zholy.

TRADE TURNOVER WITH CHINA



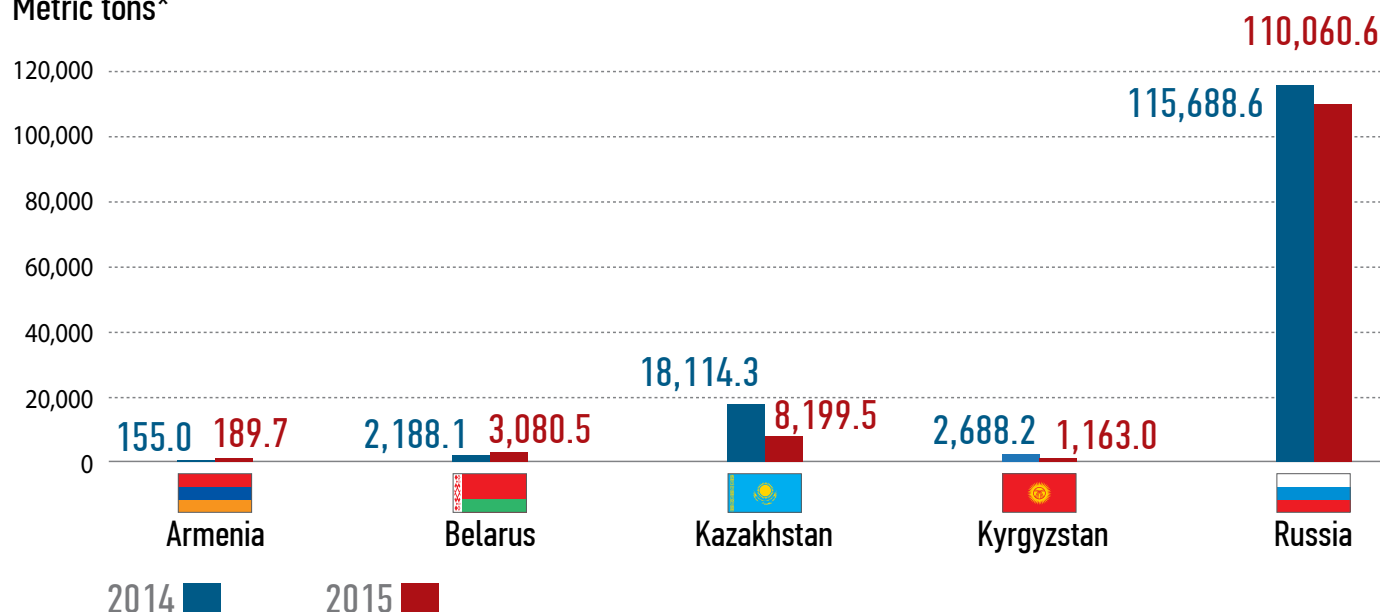
Foreign trade turnover between China and participating SREB countries, USD bn



Source: General Administration of Customs and National Bureau of Statistics of People's Republic of China.

TRADE BETWEEN CHINA AND EAEU MEMBER STATES

Metric tons*



*with possible margin of error, since not all product categories are measured in metric tons

Source: Federal Customs Service of the Russian Federation, National Bureau of Statistics of People's Republic of China.

still ahead of other EAEU members in terms of trade volumes with China, while Armenia and Kyrgyzstan are on the lower side of the spectrum.

Apart from developing trade, it would be advisable for Central Eurasian countries to establish a framework for trans-border economic cooperation. Energy cooperation seems to show great promise since a common energy market is expected to be created within the EAEU by 2019. Bigger coverage area, more generating capacities and their interconnectivity would enhance the market's efficiency. If on top of that the issue of winter and summer power supply in Central Asia is resolved by leveraging hydro power and nuclear energy, the prospects are extremely encouraging. Even at this early stage it could make sense to explore whether, and if yes, how western China with its population of 22

million could be connected to this common market.

The balance between north-south and the prevailing east-west route will play a key role in determining whether and to what extent different territories within this vast region would be able to develop concurrently. Anyway, the Silk Road was initially designed as an east-west route bypassing Siberia on the south and reaching Russian territory only near Orenburg or Saratov. This is the way it will be. For this reason, Russia needs to develop transportation links not only, and maybe not so much for Europe-bound transits, but primarily for strengthening economic and social ties of Russia's Siberia with trans-border regions in Central Eurasia, and integrating Siberian innovative, industrial, and agrarian clusters into the bigger Eurasian economy. In this context, it would be crucial to add virtually

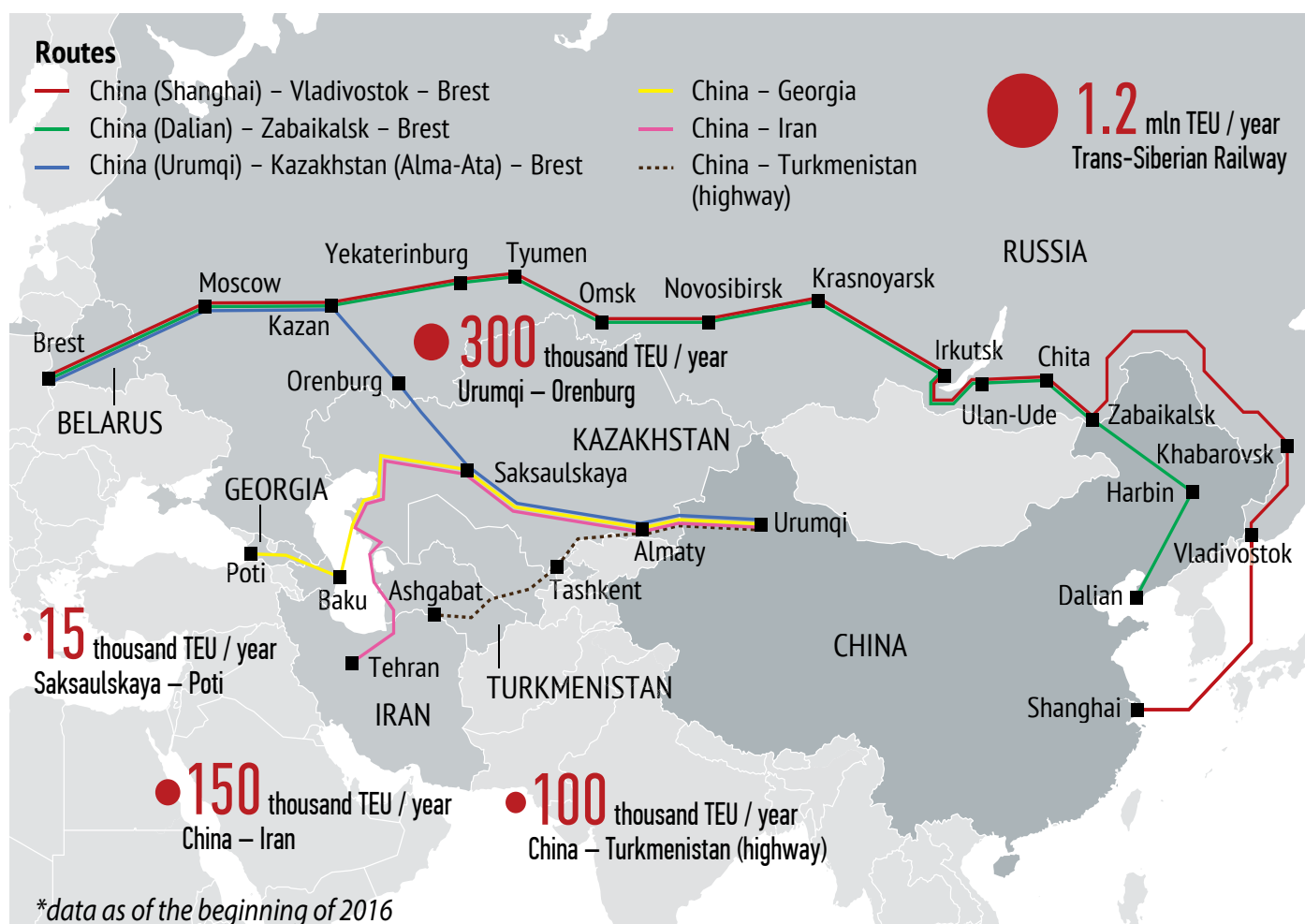
non-existent north-south routes to the current transportation infrastructure, which is dominated by east-west routes.

It is also vital not just to develop transportation links between Russia's Siberia and other regions in Central Eurasia, but also to offer Russian industrial, agricultural, and intellectual products and services that would be complementary for this regional market in terms of its structure and trade turnover. In this vein, Moscow could contribute to the

development of Central Eurasia by offering to use the potential of the abovementioned Siberian clusters to the benefit of the trans-border regional economy. This could, among other things, make Russian exports within this macro-region less commodity-oriented by offering not just oil, natural gas, power, coal, and timber, but also a wide range of agricultural and industrial products and services.

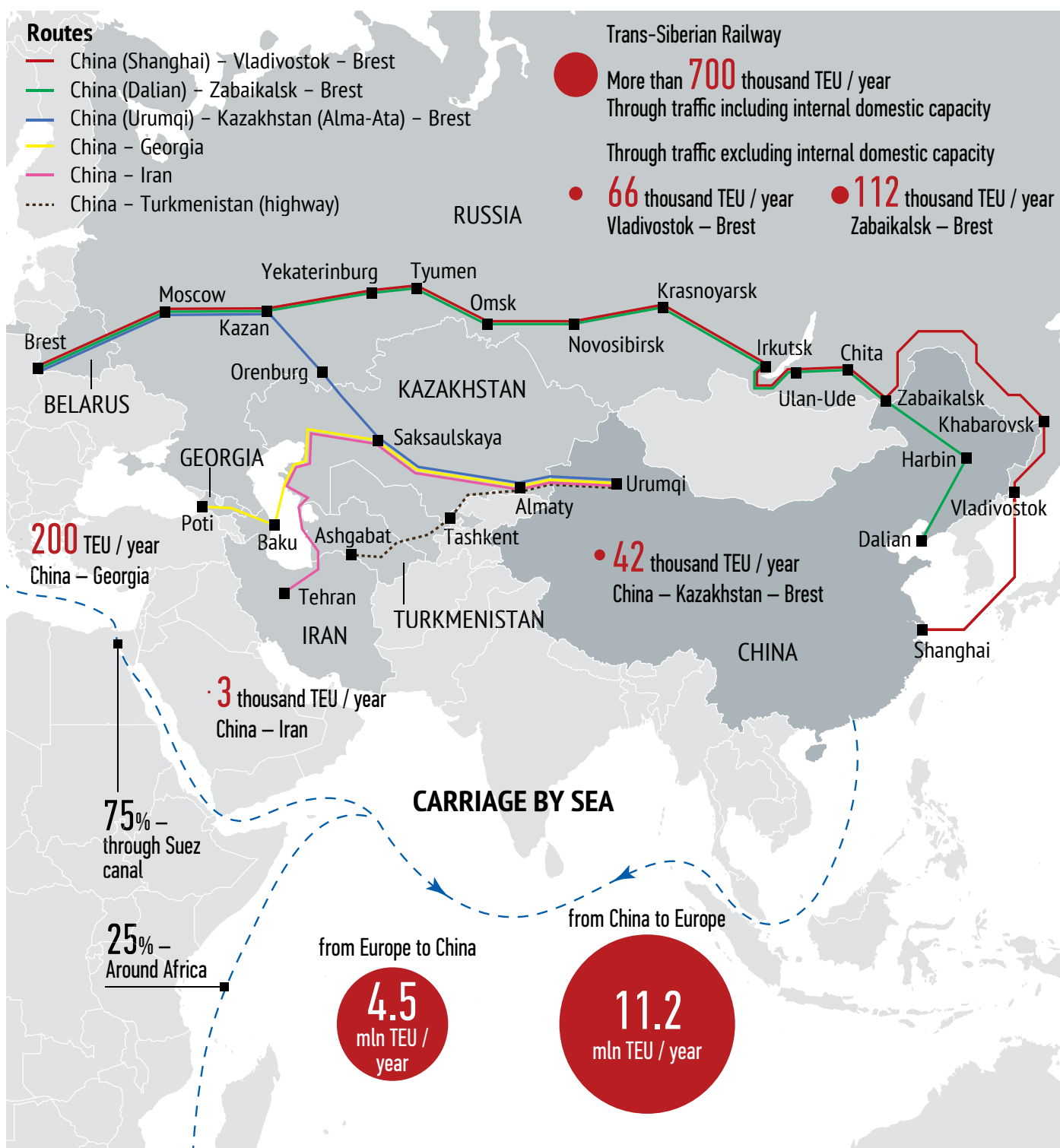
In addition, Siberian clusters benefit from their inherent competitive advantages

CAPACITY OF RAIL AND AUTO ROUTES FROM AND TO CHINA*



Source: calculations from the information portal InfraNews.ru based on tender offers of "TransContainer", "Russkaya Troyka", the Republican State Enterprise "Kazakhstan temir zholy"

TRANSIT OF GOODS FROM AND TO CHINA IN 2015



Source: calculations from the information portal InfraNews.ru based on tender offers of “TransContainer”, “Russkaya Troyka”, the Republican State Enterprise “Kazakhstan temir zholy”

such as abundant power supply, mineral, fuel, and water resources, as well as vast croplands, all of which when combined make investing in energy and water-intensive manufacturing attractive. This would pave the way for a more harmonious and streamlined division of labor within Central Eurasia with Russia's Siberia, on the one side, and regions of China, Kazakhstan, Iran, and India on the other. This approach would make Siberian clusters more attractive to foreign investors from both the Asia Pacific region, including South Korea, Japan,

Singapore, and Europe, as well as to Russian investors.

It is also crucial to strengthen cooperation within value chains between Russia and Kazakhstan. The southern Urals metals industry could play a key role in this respect, since it has a long and successful track record of working in close cooperation with commodity producers from Kazakhstan. The metals industry could also gain a foothold in the expanding markets in the south of Eurasia.

3.4. Agenda

Institutional differences between EAEU and SREB projects could become one of the obstacles to their future alignment. A common platform should be created in order for them to be able to work out their shared vision. The Eurasian Economic Commission (EEC) has been quite passive in conducting talks with China due to the fact that the EEC's authority is limited solely to the drafting of a non-preferential trade treaty with China. Expanding the EEC's authority to investment and transportation makes sense, since it would create conditions for developing a single approach among participating countries to all issues related to the alignment initiative, preventing member countries from embarking on any projects with China separately. The need to strengthen the EEC's role in the transportation industry is also driven by the aspiration to deeper transport and logistics cooperation between EAEU countries and other states (as per Par. 1 and 2, Article 114 of the Treaty), as well as to promote Eurasian integration in this sector. The Commission should also play a bigger role in promoting investment cooperation in order to address issues related to protecting the rights

of investors and guaranteeing the security of their investments.

The delegation of more authority to the Eurasian Economic Commission should be accompanied by the creation of a separate permanent intergovernmental committee within the EAEU as a negotiating platform and a body that would address all technical issues related to cooperation with China. This framework could operate at the level of deputy prime ministers, who would be tasked with Eurasian integration. It could also be advisable to think about the creation of a permanent structure that would bring together officials of the rank of ambassadors who would be in charge of coordinating key aspects of integration.

Establishing a common structure is also important because aligning EAEU and SREB projects entails not only trade cooperation, but also various infrastructure and investment programs. Ideally, this initiative should pave the way toward harmonizing legislation regarding technical regulations and mutual recognition of technical standards. This calls for addressing regulations and the issue of investment protection, labor migration, as well as social

security with a view of facilitating mobility, which could ultimately lead to the creation of a new arbitration institution. This agenda is multifaceted, which means that it cannot be rolled out without thorough preparation, and a technical foundation and coordination of the parties in terms of their capabilities. It is these issues that the institutional framework for aligning EAEU and SREB projects is designed to address.

The best solution in terms of international law would be to have the EAEU member states enter into a grand agreement with China. This would guarantee that the interests of each of the five EAEU countries are taken into account to the maximum extent, while expanding EAEU-China cooperation in areas that so far were beyond the reach of supra-national bodies. Institution-wise, it seems advisable to create a joint EAEU-China advisory body for discussing the key issues related to aligning EAEU and SREB projects and devising recommendations for their governments.

Decisive action is needed since India, Iran, Pakistan and other countries within the region are eyeing SREB with growing interest. For this reason, institutionalizing the interaction between the EAEU and SREB would provide EAEU a competitive edge with respect to Chinese projects, while also attracting investment from other regional players. The first meeting of the working group on devising proposals on joint transport and infrastructure projects as part of the effort to align EAEU and SREB projects was held in early February 2016. The main outcome of the meeting was the decision to draw a list of priority infrastructure projects by early March 2016 taking into account the interests of EAEU countries. This document would serve as a foundation for developing a roadmap to promote cooperation between the EAEU and China. Facilitating greater cooperation of EAEU and Chinese

development institutions should be the key priority regarding the implementation of large-scale infrastructure projects.

After addressing the institutional deficiencies inherent to the EAEU and the effort to align it with the SREB project, it will then be necessary to identify the subject matter of the EAEU's cooperation with China. Joint projects would enjoy maximum success if the barriers related to the movement of capital, services, goods and labor mobility were lowered or even removed. Developing an international program Eurasian Verticals, i.e. strengthening north-south trade and economic ties, in cooperation with partners from China, Kazakhstan, Central Asia, Mongolia and Iran, would provide an additional advantage. Setting up an EAEU-SCO free-trade area and possibly reaching out to other Asian integration bodies, primarily ASEAN, as part of the effort to align the EAEU and SREB projects would be a separate issue.

All these organizational and institutional decisions should be aimed at creating an integral and open space of concurrent development in Eurasia. Eurasia has been the cradle of many nations and civilizations, a place where many empires were born and triumphed, including Chinese, Persian, Mongolian empires, the Timurid Empire and that of Alexander the Great, the Ottoman Empire, and the Russian Empire. However, Eurasia was not a single political and economic space, before the 21st century. Being torn apart by Europe and Asia, it was relegated to the backseat and had to give way to a global economic system dominated by maritime powers. Eurasia lacked an identity of its own and was regarded as a tangle of competing interests of great powers. This situation is beginning to change. Russia is turning toward the east, while China is looking to the west. By creating a space of concurrent development these and other countries could carve a path to the emergence of an independent center of sustainable growth and political stability.

CONCLUSION: THE TURN IS JUST BEGINNING

Russia's true turn to the East is just beginning. It focuses on creating new internal (organizational and legal) conditions for the accelerated development of Siberia and the Russian Far East, imparting new qualities to the Russian presence in the Asia Pacific region, building up trade, economic and political ties with countries in Asia, and organizing a new co-development space in Eurasia. The turn is a three-pronged process, with each of the prongs needed for successful development of the other two. The turn is not a U-turn away from Europe but a pragmatic orientation to new opportunities and Russia's striving to be up to the modern world's requirements.

There are objective conditions and prerequisites for a turn to the East, which is likely to benefit all regional players. If successful, Russia and its regional partners will bring more peace and prosperity to Asia and Eurasia. And none of the contradictions referred to in the context of this turn is objective. The biggest Eurasian powers – Russia and China – are moving towards each other and seek to coordinate their regional projects. In effect, this means that they are sponsoring the emergence of a new community in Eurasia.

At the same time, the turn to the East has been met with both external and internal opposition. Players outside of the region view Asia and Eurasia as an arena of struggle, where they can try to pit Russia and China against each other and exploit their alleged antagonisms. They seek to keep Asia split with the help of a system of bilateral military alliances and obstruct the emergence of an inclusive security community in the APR. The West felt a real shock watching Moscow and Beijing make strides in their political relations in 2014 and 2015. Today, however, our Western partners tend to focus on the fact that China was not ready to clearly declare in public that it was willing to support Russia economically when the sanctions war was declared.

The military and political crises in Europe and the Middle East have been distracting Moscow from the strategically more important Eastern vector. As it was mentioned in the first part of this report, Russia is still inconsistent in its cooperation with international political formats in Asia; often it does not come where it is expected. Every opportunity must be used to communicate with regional political and business leaders. We should understand what the “demand for Russia” is all about and what benefits we can derive from it.

Russia is not doing enough to turn Siberia and the Russian Far East into a territory where foreign investors feel more comfortable than elsewhere. Yet, important steps have been made in this regard and positive dynamics have emerged. The important thing is not to pause and instead persist in informing our Asian partners about new opportunities. A crucial domestic policy task is the need to extend the successful Far Eastern business practices to Siberia. This is of particular importance in view of the need to involve Russia's Siberian regions in co-development projects in Central Eurasia. The regional authorities in centers like Tyumen, Krasnoyarsk or Novosibirsk should roll-out their own trans-border cooperation projects with the participation of leading development institutions.

The behavior of Russia's key partners in the region – China, Japan, and the Republic of Korea – also displays inertia and a bent for only reaping short-term benefits. Fears and uncertainty persist. Russia fears that China will turn toward the US. In China many are afraid that Russia will cave in under the weight of its geostrategic commitments and revert to a quasi-colonial status in relations with the West. Despite the historically unprecedented scale of political trust, the point of no return has not yet been passed.

Our aim is to make the strategic rapprochement and unprecedented trust

between Russia and China irreversible. Our relations must become more transparent and their cooperative philosophy more mature. They should assume a long-term strategic nature and rest on a firm institutional foundation. It is also necessary to prevent external forces from being able to kindle distrust between Russia and China. Citizens of both countries need to expand contacts and this can be accomplished by introducing visa-free travel. This will make it possible, as early as in the mid-term, to come close to establishing in Eurasia a new international political entity based on common interests and many shared values. This will rally Eurasia and make it an independent center of power and influence on a global scale.

Russia and the PRC's shared interest in preventing Kazakhstan and Central Asia from relaying instability to their territory has led them to choose cooperation over a model of competition. Potential instability in Central Eurasia is an ideal challenge of sorts for Russia and China, one that can only be met with the help of a positive-sum rational game.

The effort to stabilize the region is likely to be a rallying factor for Moscow and Beijing in the context of general global affairs. Reconfiguring international economic governance is

irreversible. Major transcontinental associations are emerging and the two most important Eurasian powers obviously have no alternative to further rapprochement.

Our task for now is to determine what institutional forms would be optimal to make the emergence of a community of interests and values in Central Eurasia irreversible. These institutional forms should be comprehensive and inclusive, combining politics and economics as well as "soft" and "hard" power. They should also be palatable for the great, mid-sized, and small powers. We hold in our hands potentially excellent institutions for international cooperation and development: Eurasian integration, financial institutions of the Silk Road and the Asian Infrastructure Investment Bank, the Shanghai Cooperation Organization, ASEAN multilateral formats, and much else. We should work to improve them and make them mutually complementary. And, most importantly, the SCO's development and institutionalization are likely to result in an umbrella for a Greater Eurasian Community of Development, Cooperation and Security, which will be certainly open to the western part of the continent – Europe.

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