



International North–South Transport Corridor and Transregional Integration Scenarios

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With the signing of an agreement between Iran, Russia, and India in September 2000 to initiate the International North–South Transport Corridor (INSTC), it seemed that the regional geopolitical landscape in Eurasia would be spared any further significant changes while trade and the economic activity were expected to gain positive traction. However, subsequent developments have proven this view to be exceedingly optimistic, marked by several minor economic nosedives, the US intervention in Afghanistan and Iraq, the expansion of China's influence in Central Asia and the emergence of the Belt and Road Initiative (BRI), as well as the revival of economic sanctions against Iran and the start of a large-scale trade war against Russia. All these developments also undermined trade, in addition to decreasing the role of the INSTC. As we approach the 20th anniversary of the agreement between the three countries to launch this trade corridor, it has to be recognised that few steps were taken to make this project a reality, despite the assurances by Iranian, Russian, and Indian politicians on the need to promote the INSTC.

All the more, it has to be noted, at this stage the project does not require substantial investment. In fact, the INSTC already exists in the shape of a number of sparse transport infrastructure fragments with its capacity ranging from 5 million tons (for Iran's and Azerbaijan's railways) all the way to tens of millions of tons per year for Russian and Iranian seaports, as well as the high throughput capacity of Belarussian railway network as part of the Trans-European Transport Networks. INSTC also relies on a dense network of motor roads of varying quality and significance, as well as the possibility to ship goods through the Caspian Sea ports. That said, the project can hardly aspire to become a key transport corridor and an economic development driver (de facto offering a regional integration platform) unless it can acquire two key elements: robust trade that would attract new flows and the corresponding investment and industrial complexes along the transport corridor.

The Quest for Mutual Interest

Transport routes are like rivers, where water always finds a way to continue its flow. It is not a coincidence that transport routes are often referred to as arteries. But what comes first – a riverbed or the water, the first representing the strategic will of states and the second the contents, i.e. goods resulting from the balance of interests between businesses and consumers?

Global trade routes such as the North–South Project can be viewed as social and economic phenomena largely shaped by the political will of the countries that promote these trade corridors based on their understanding of common interests. The Suez Canal, for example, was built as part of a state-run project and owes its creation to French geopolitical considerations. Now, however, it is an organic and integral part of global trade and belongs to everyone in the sense that the canal affects everyone involved in global

trade, and only historians remember the original intent behind its creation. Moreover, initiatives to develop transport corridors can be entirely ideologically driven. For example, 18th century reformer Henri de Saint-Simon used the construction of the Suez and Panama canals as arguments underpinning his theories of the equality and unity of the people around the world. In fact, all these inclusive and unifying projects are always driven by shared pragmatic interest.

The INSTC and China's BRI can hardly be imagined separately

It may seem like a paradox, but the INSTC was heralded back in the 1930s by a British project to build a Trans-Iranian highway to ensure the military containment of Russia. But after a railway linked, in 1939, Bandar Torkaman, a Caspian port, to Bandar-e Emam Khomeyni on the Persian Gulf, it was used to deliver US aid to the Soviet Union during the Second World War. Now, almost a century later, the INSTC project has come a long way from colonial games to emerge as a development corridor.

When the INSTC project took shape within the Russian government at the turn of the 21st century, it absorbed all these motives, including taking advantage of the flow of Chinese goods to Europe by moving some trans-Eurasian shipments from the sea routes to the continent through Iran, the Caspian states, and the south of Russia, as well as giving an impetus to regional development in Central Russia, along the Volga and near the Caspian Sea by expanding related sectors and services along the international transport corridor. There was also the idea of adding a new and attractive proposition to Russia's relations with Europe to emphasise the actual potential of Russia and its neighbouring countries as a bridge between Asia and Europe. Naturally, it was not clear from the outset how long it would take for this idea to materialize. The route and its infrastructure can only be regarded as viable when the business community gets behind this macroeconomic concept, which sometimes takes decades.

The Institute of Economic Forecasting of the Russian Academy of Sciences has shown in its analysis that infrastructure investment in today's Russia produces a multiplier effect that exceeds 2 points. In other words, for every rouble invested in infrastructure the national economy gets more than a rouble in additional revenue in related sectors. For example, Russian Railways intends to invest RUB 7.2trn in railway infrastructure development until 2025, which is expected to generate approximately RUB 20trn in additional revenue for the Russian economy, or roughly 18% of Russia's annual GDP.

In today's world, the trans-regional transport infrastructure is a combination of multiple interests with dozens of major international trade operators serving a multitude of smaller ones, with hundreds of logistics

operators in various sectors. It does not make any difference whether we are dealing with motor highways, railways, sea routes, or air service. Any project to develop a transport artery implies some reciprocal interaction: its establishment is predicated on an expected surge in the movement of goods, and further investment in expanding the shipping route and improving logistics follow these interests. It is for this reason that no major impetus for developing a route can be expected before a business-friendly infrastructure is created. This is clearly illustrated by the strategic outlook for the INSTC: its capacity was scaled down by the 2010s to about 15 to 20 million tons per year, while its capacity at launch was revised down to 5 million tons per year.

After the idea of an alternative trans-Eurasian logistics route linking China to Europe took shape in the form of the INSTC project as we know it, its architecture and purpose have changed considerably. Its primary purpose was initially described as an alternative to the Suez Canal, although in the 2000s INSTC's projected annual capacity of 30 to 50 million tons could hardly be regarded as a viable alternative to the canal that handles roughly 1 billion tons per year. Decelerating growth in China dealt the heaviest blow to the INSTC project. In fact, Chinese goods were expected to form the project's core until a sustainable flow of shipments would start from India's industrial regions. From 1986 to 2000, a 1% increase in GDP led to an increase in international trade of 2.2%, but in the 13 years that followed, this indicator fell to just 1.3%. China's annual exports grew by as much as 24% in peak years, while imports climbed 20%.

China's economy generated growth rates that were well above the global average for over four decades, which enabled the country to emerge as the world's largest economy in terms of GDP by purchasing power parity by 2014 and the second-largest economy (second only to the US) in terms of nominal GDP. During the economic downturn in 2008 and 2009, China saw slightly slower growth rates, while avoiding any strong decline in its macroeconomic indicators. Its growth decelerated from 10.8% in 2000s to 7.9% in 2011. However, this was followed by a major slump with export growth shrinking to just 5.5% in 2018, which naturally did not spare global trade. Annual trade growth in the 3% or 4% range has become a new normal, which hardly encourages INSTC's development.

Against this backdrop, what can drive INSTC development? Considering the lack of investment and limited demand, the best results could be achieved by having neighbouring countries streamline their coordination and work together within integration projects. In this context, enhancing the connectivity of the national transport systems turned out to be the only viable solution for transport and logistics development. Essentially, this is not so much about

enhancing connectivity between international corridors as it is about promoting regional links between national systems. This in turn affects regional economic integration and sometimes even drives it.

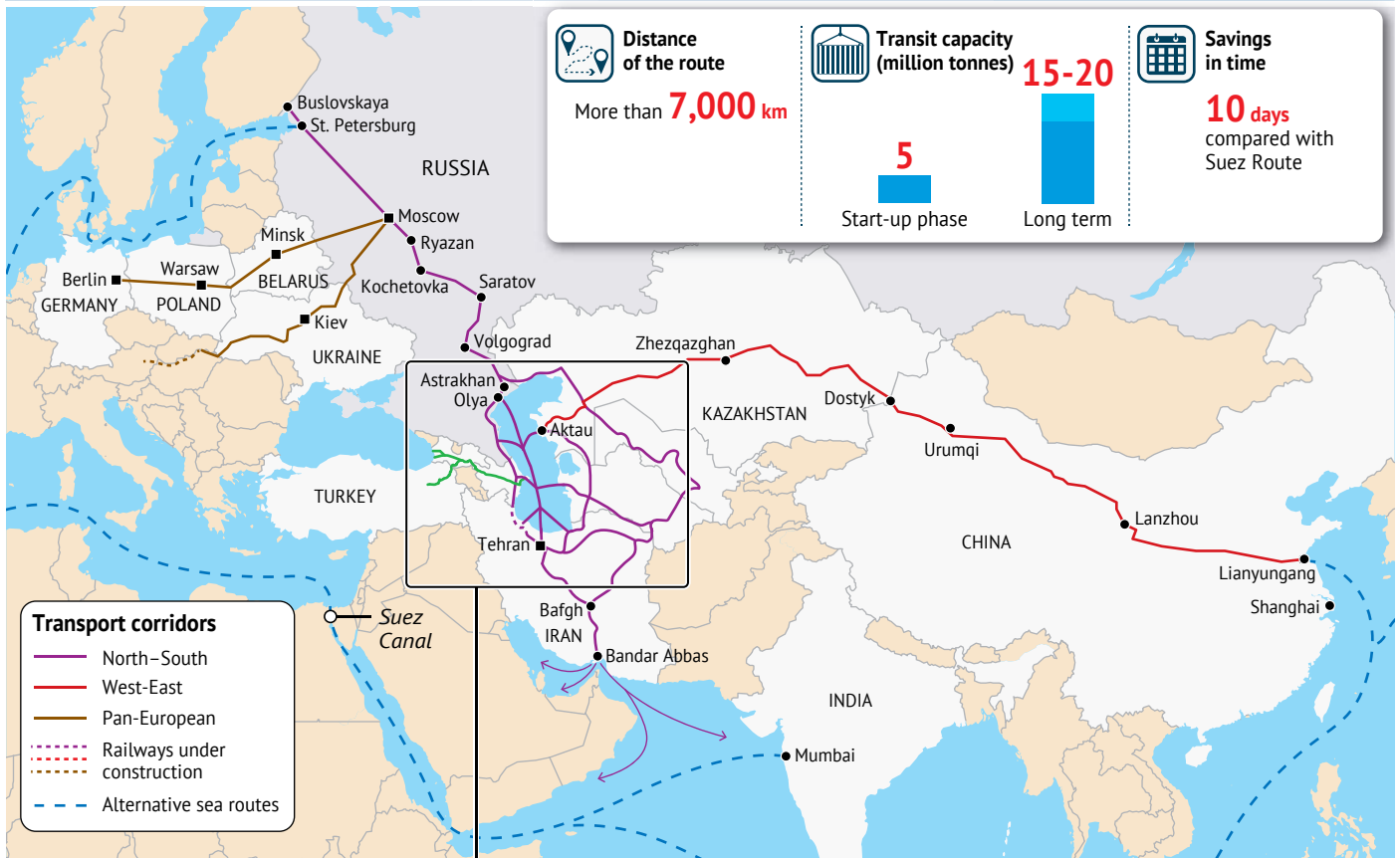
This begs a conclusion that may sound like a paradox: the INSTC and China's BRI can hardly be imagined separately. An objective look at transit flows, trade, and geography suggests that China's interests and east–west transport flows can be seen in every major hub along the INSTC. The opposite is also true. This becomes apparent at Caspian ports, including in Russia, as well as the INSTC's eastern pillar along the Caspian coast where the China–Kazakhstan–Iran (CKI) transport corridor and the INSTC basically form a single network. In the western section Azerbaijan's transport hub was initially seen as an intersection of north–south and east–west trade and investment flows. An intermodal transport route was launched through Bandar-e Anzali in 2018. It starts in Eastern China's Jiangsu province (Lianyungang), runs to Western China in Xinjiang (Urumqi), and then goes into Kazakhstan at Dostyk and on through Zhezkazgan–Beyneu railway reaching the Aktau seaport. There, cargo is loaded on ships and delivered to Bandar-e Anzali in Iran. This port is expected to get a railway link as part of the INSTC project, which would be a great boost for its competitiveness.

INSTC is a reciprocal projection of mutual interests of Russia and its partners

Thus, the INSTC currently presents a mosaic of transport and economic links that differ in terms of infrastructure development and that offer a broad diversity of political relations with Russia and other partner countries. It would not be an exaggeration to suggest that the INSTC is a reciprocal projection of mutual interests of Russia and its partners. Transport interconnected infrastructure is shaped for decades to come. It is for this reason that from Moscow's perspective the INSTC is a promising macroeconomic structure that is linked to a multitude of related sectors, including the downstream sector, electric power, communications, and tourism.

The Eurasian Economic Union (EAEU) plays a key role in shaping the legal and technological platform for ensuring connectivity within the INSTC. Countries within the Commonwealth of Independent States Free Trade Area (Azerbaijan, Uzbekistan) further enhance the corridor within their respective segments that reach Turkey through the South Caucasus. Cooperation among the five Caspian states creates a combination of sea and land projects along the western and eastern coasts, offering two major pillars in Iran: one reaching Oman (Persian Gulf countries) and the other stretching towards India. There is also an additional Caucasian segment of the INSTC where post-Soviet conflicts set the agenda. Finally, the INSTC's economic might is determined by two major factors: Russia's relations with the EU and with India.

INTERNATIONAL NORTH-SOUTH TRANSPORT CORRIDOR



North-South Transport Corridor

Transcaspian route

- ▶ **Russian ports**
Astrakhan, Olya, Makhachkala
- ▶ **Iranian ports**
Anzali, Nowshahr, Amirabad
- ▶ **Kazakh ports**
Aktau, Kuryk
- ▶ **Turkmen ports**
Turkmenbashi
- ▶ **Azerbaijani ports**
Baku (Alyat)

West route

- ▶ Astrakhan, Makhachkala, Samur, Baku, Astara, Rasht, Qazvin

East route

- ▶ Astrakhan, Atyrau, Makat, Beyneu, Mangystau, Zhanaozen, Bereket, Ak-Yayla, Gorgan

West-East transport corridor

Baku–Tbilisi–Kars transport corridor

Source: Russian Railways, open sources.

The Russian Node

The INSTC pales in comparison to Russia's other transport corridors such as the major transshipment routes along the Baikal-Amur Mainline and the Trans-Siberian Railway, the longest in the world. These two railways handle transits in the millions of tons, and apart from routine shipments some 13 regular container trains operate between China and Russia along various routes. In particular, there is a rail link between Nahodka-Vostochnaya station and Martsevo that was launched specifically for delivering car parts for Hyundai Motors Co. from Busan to an auto assembly plant in Taganrog. Another regular train on the Trans-Siberian Railway serves Central Asian transport hubs in Kazakhstan and Uzbekistan.

There are no projects of this magnitude along the INSTC. However, this route's main advantage compared to other routes and above all sea shipments through the Suez Canal is that it reduces transit times (by as much as 10 days for certain destinations). It also offers the economic benefit of using a trans-Caspian multimodal route, which so far is undermined by the need to operate multiple intermodal exchanges.

The advantages become even more obvious if we compare the two routes: the sea route that dominates trade between Russia and Iran, and the continental route of INSTC. The average container shipment from St. Petersburg to Bandar Abbas takes between 25 and 28 days, requiring at least two transshipments: usually one in Rotterdam or Hamburg in the North Sea, and one in La Spezia in the Mediterranean. Under this routing, it takes from 38 to 42 days for a container to travel from Pervouralsk (Sverdlovsk Region) to Bandar Abbas. However, when shipped through Caspian Sea ports from Pervouralsk to Bandar-e Anzali, the same container will reach the destination in just 20 to 25 days at a comparable cost. Statistics show that 12% to 16% of containers shipped to and from Russia and Iran go through Caspian ports, while there are almost no transited containers from India, for example, in the region so far.

Statistics show that 12% to 16% of containers shipped to and from Russia and Iran go through Caspian ports

Although the INSTC has to be regarded as a network of interconnected motor roads, railways, ports, and even aviation hubs, it is the railways that form the route's core. The fundamental documents setting forth the strategy for the Russian rail transport include Russian Strategy for Developing Rail Transport

until 2020 and up to 2025, the Transport Strategy of the Russian Federation until 2030, and the Comprehensive Plan for Upgrading and Expanding Core Infrastructure (as a separate national project). These instruments provide for developing rail infrastructure through a series of stand-alone measures designed to increase throughput capacity within specific segments (double tracking, building and restoring switching tracks, improving right-of-way power distribution, electrification of specific segments, automatic block signalling, expanding receiving-and-departure yards, and upgrading terminals), as well as comprehensive investment projects.

The following key initiatives are expected to be carried out through 2025 on five of the 16 Russian railway lines within the INSTC:

- launching of high-speed passenger service between St. Petersburg and Buslovskaya;
- integrated reconstruction of the Northwestern Railway on the Mga–Gatchina–Veimarn–Ivangorod section with rail links to ports along the southern coast of the Gulf of Finland;
- development of the Moscow railway hub;
- reconstruction and electrification of the Rtishchevo–Kochetovka section, building a bypass for the Saratov railway hub, a new bridge over the Volga, and launching the electrified section from Rtishchevo to Kochetovka;
- integrated reconstruction of the Akhtub–Trubnaya–Verkhny Backunchak–Aksarayskaya section, including a railway bridge over the Akhtub River that is expected to open in 2019, and modernization of a locomotive maintenance facility at Aksarayskaya station.

All in all, some RUB 15 to 18bn will be invested in these initiatives until 2023.

The Volga Railway, a major Russian Railways affiliate, is the INSTC's main node in Russia. It covers the Saratov, Volgograd and Astrakhan regions, as well as portions of the Rostov Region and Kazakhstan. Despite these ambitious plans mentioned above, Russian Railways is consistent in its efforts to expand capacity along this line. In 2017, rail shipments in this section increased by 13%, and added another 15% in 2018. By 2025, this indicator is expected to increase by 20%.

The INSTC has a critical role to play in developing adjacent Russian regions. The Volgograd Region is a case in point. Its exports increased by 5% in 2018 and most of them, dominated by petroleum products, food, and chemicals, went to the five Caspian countries. Kazakhstan remains a key partner for the region, accounting for \$78.8m in exports, followed by Azerbaijan with \$37.9m, Iran with \$15.5m, and Turkmenistan with \$780,000 worth of exports.

This is a telling example since any effort to assess the role of Russian regions in the pre-Caspian economy is usually limited to the Astrakhan Region and Dagestan, while other Russian regions are also involved in Caspian cooperation initiatives.

The Caspian Arch

The INSTC sea section and its coastal pillars are formed by a number of routes.

- The **Transcaspian route** includes Russian seaports Astrakhan, Olya, Makhachkala, and Iranian ports Bandar-e Anzali, Nowshahr, and Amirabad.
- The corridor's **West route** includes a direct rail link through the Samur (Russia) and Yalama (Azerbaijan) crossing points, extending into Iran through the transborder section between Astara (Azerbaijan) and Astara (Iran).
- The corridor's **East route** includes a direct rail link through Kazakhstan, Uzbekistan, and Turkmenistan reaching Iran's rail network at border-crossing points Serakhs (Turkmenistan)–Sarakhs (Iran) and Ak-Yayla (Turkmenistan)–Incheboron (Iran).

Russian Railways believes that the timeframe for launching a new rail line linking Rasht–Astara (Iran)–Astara (Azerbaijan) will play a major role in developing the INSTC in the medium term, since it is the last missing link for establishing direct rail service along the western section of the INSTC.

The Astara–Rasht–Qazvin railway was supposed to link the existing railway networks of Azerbaijan, Iran, and Russia, and a three-party agreement to build it was signed by the presidents of the three countries back in 2005. Under the agreement, Iran was to build 350 km of track on its territory, and Azerbaijan was to build another 8.5 km to link Astara to the border with Iran, as well as rebuild the existing mainline on its territory. It took Iran 10 years to complete the Rasht–Qazvin section, and the line was inaugurated on March 6, 2019, in the Gilan Province as part of INSTC's Qazvin–Astara segment. The new line includes 53 tunnels totalling 22 km. It also has the longest railway bridge in Iran that is 1,430 m long, and the Manjil dam (Sefid Rud dam). Qazvin now has a rail link to Tehran, as well as to the Iranian ports Bandar Abbas in the Persian Gulf and Amirabad on the Caspian coast.

Since early 2010s, Kazakhstan has been proactive in promoting transit shipments, which affected other Eurasian countries

Since early 2010s, Kazakhstan has been proactive in promoting transit shipments, which affected other Eurasian countries. Railway construction projects in Kazakhstan were built as part of an effort to create the Trans-Asian Railway's northern corridor (China–Kazakhstan–Russia–Belarus–EU) and the East–West corridor (China–Kazakhstan–Aktau and Kuryk ports–Baku (Alyat)–Georgia–Turkey–EU, with a Turkmenistan–Iran–Turkey diverging branch line). Projects in Turkmenistan further enhanced Kazakhstan's potential within the INSTC. Three links to Iranian railways have been built there in the post-Soviet era. The new railway line from Gyzyletrek on Turkmenistan's border with Iran to Bereket and then on to Kazakhstan's Zhanaozen (2009–2014) paved the way to a new railway route as part of the INSTC along the eastern coast of the Caspian Sea linking Russia, Kazakhstan, Turkmenistan, Iran, and the Gulf countries. This railway can be used to deliver cargo from the Siberian regions in Russia and China's western regions to Iran and other countries in western Asia.

It is telling that the topics discussed at interagency talks among international participants in both north–south and east–west projects in international transport corridors almost coincide in terms of their reach and sophistication, focusing on through rates, terms for national shipping operators, as well as technical terms on information exchange between customs agencies on goods and means of transport. Therefore, these developments can hardly be viewed as one line getting the upper hand in a competitive struggle as seen by leaders in Baku and Nur-Sultan, which has been a matter of geopolitical speculation. On the contrary, the international transport corridor in Azerbaijan and Kazakhstan is viewed as a network that depends on global indicators (macroeconomic growth rates in China and India, as well as commodity prices). Both countries seek to promote connectivity on north–south and east–west routes, as well as their integration into their agricultural and industrial economies (developing industrial zones and agriculture parks along these routes).

Regardless of global developments, the INSTC's prospects for making steady progress in Azerbaijan are primarily predicated on the growth of local and cross-border shipments and the expansion of the national economy's trade and export potential. As part of a national economic policy, Baku seeks to address a number of interrelated problems:

- to stabilize the decline in cargo volume caused by shrinking transit shipments and exports of oil and petroleum products;
- to develop the transport infrastructure while also expanding new manufacturing capacity (setting up regional special economic zones and technology parks along international highways);

- to maintain a quality logistics infrastructure and intermodal connectors in ports (build the second phase of the Baku International Sea Trade Port, and new infrastructure to link Baku–Alyat highway (Baku port) with Georgia);
- to carry out administrative and management reforms in order to ensure an appealing environment for international transport and logistics operators. This effort also includes system-wide governance reform consisting of disbanding the Transport Ministry and transferring some of its functions to the Ministry of Transport, Communications and High Technologies, as well as establishing the Coordinating Council on Transit Freight, setting up an agency for road maintenance and development, and supporting state-owned conglomerates (Caspar, AZAL, Azerbaijan Railways).

It is too early to say whether this policy will be effective. Nevertheless, measures have been taken to reduce transiting rates, make logistics more time-efficient, and minimize paperwork for export and import transactions. For example, Azerbaijan Railways has been offering a 50% discount since May 2016 on rail shipments to Astara on the border with Iran, from which freight is delivered to Iran by road.

One of the purposes behind these initiatives is attracting international and domestic investment to the INSTC and related systems. In fact, Azerbaijan has been the main investor in Baku–Tbilisi–Kars railway (a \$775m loan was granted in two tranches in 2007 for the construction of the Georgian section), as well as in the Iranian section of the INSTC western section between Rasht and Astara. A €500m loan agreement was signed in November 2017 but has yet to be carried out due to the revival of anti-Iran sanctions that make bank-to-bank transfers impossible.

One of the main issues in INSTC's development in Azerbaijan and Kazakhstan is to understand how much investment is actually needed and then to attract it. In the summer of 2017, the Central Asia Regional Economic Cooperation (CAREC) teamed up with the Asian Development Bank to present a railway development strategy for Central Asia and the Caspian Region in 2017–2030. The document was to earmark investment for specific implementation stages and offered a list of additional projects that included the East–West and North–South international transport corridors. CAREC concluded that

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railways are the best transport solution for the entire Central Asian region in terms of their speed, affordability, accessibility, and simplicity. In fact, this document can be viewed as a long-term railway development policy for CAREC member countries. The authors believe that improving the railway and multimodal infrastructure as well as placing railways on a commercial footing and reforming them would generate trade flows and facilitate regional economic development.

In view of the 2016 results, the CAREC Secretariat adjusted an earlier version of the document that covered a period until 2020. The new strategy includes promising railway infrastructure projects in the participating countries, including the INSTC. According to the new estimates, Kazakhstan and Azerbaijan needed \$4.61bn to fund this sector. The enormous scale of investment is due to the need to modernize the rail system and introduce digital controls, as well as the fact that railway projects have yet to attract private capital, while national railway companies depend on government support.

Judging by official statements, Azerbaijan plans to complete both transiting lines within the country by the end of 2020. Initially, all the funds went to the western section of the Baku–Tbilisi–Kars railway towards Georgia with a \$1.6bn grant from the World Bank. These funds aimed enhancing the performance of Azerbaijan Railways, including optimizing its staff, drafting a business plan, and developing a new financial model for the company. By early 2018, Baku decided on the mechanism and the funds required for completing another INSTC segment connecting Sumqayit to Yalama on the Russian border. The Asian Development Bank Board of Directors approved two loans to Azerbaijan Railways for a total of \$400m. The first \$250m loan is expected to go towards reforming Azerbaijan Railways, which, according to the Asian Development Bank, would greatly improve the company's financial standing. The second \$150m loan will go towards upgrading the rail line. This effort will include restoring 441 km of track, as well as introducing computer controls for managing freight shipments. The line's current capacity is less than 5 million tons of cargo per year, but it is expected to reach 10 to 15 million tons eventually. Achieving these goals would require a number of technical improvements to ensure compliance with safety regulations.

It is telling that Baku is trying to attract funding for the INSTC anywhere it can. Specifically, during a meeting of the Azerbaijan–Hungary Intergovernmental Commission on Economic Cooperation in 2017, Hungary's Eximbank offered a loan to this end against the promise to enable Hungarian

companies to join the project on the design or construction phase. Baku has even succeeded in drawing France into the INSTC. In March 2019, a bilateral convention was signed in Paris at the ministerial level for the reconstruction of the Sumqayit–Yalama rail line of the INSTC as part of the programme to develop the railway sector.

Anticipating a surge in transit along the INSTC, Baku upgraded its rolling stock by signing a major contract with Russia's Uralvagonzavod. In 2015, Azerbaijan Railways received 3,100 freight cars, including 600 tank cars for oil products, 400 boxcars, 400 flat cars, and 200 container platforms, as well as 1,000 open hoppers, 300 covered grain hoppers, 100 other covered hoppers, and 100 cement cars. Azerbaijan Railways also has an option to purchase another 14,000 freight cars of various kinds from Uralvagonzavod. In addition, Russian Railways and Azerbaijan Railways have reached a preliminary agreement on a container transshipment rate along an India–Iran–Azerbaijan–Russia routing (Mumbai–Moscow), with rates for a 40-foot container not exceeding \$3,000.

Infrastructure development brings about enhanced connectivity and creates new development spaces and opportunities, while also reducing transport costs and facilitating people-to-people relationships. This, in turn, adds momentum to socioeconomic development for all areas along the INSTC, and also generates higher growth rates. At the same time, any decline in economic activity affects volume since one of the inevitable characteristics of the transport system is its dependence on the state of exports and imports.

**Anticipating a surge
in transit along the INSTC,
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stock**

The Iranian Platform: Working with the EAEU amid Sanctions

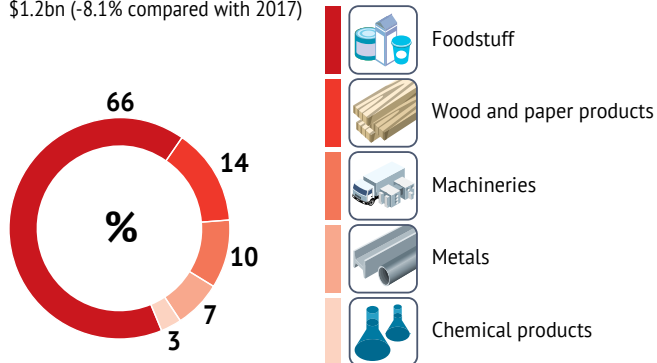
In terms of politics and economic strategy, the oil-for-goods deal is the INSTC's main development driver in Iran. However, its implementation will require a broad range of measures. Most importantly, Russia needs to find a stable market for Iranian oil outside of Russia and develop complex clearing mechanisms so that Iranians can pay for goods acquired by Russian companies abroad using funds they keep, in particular, in China, South Korea, Japan, and about 20 other countries. Iran could then receive the goods it needs from Russia.

TRADE IN GOODS BETWEEN RUSSIA AND IRAN IN 2018



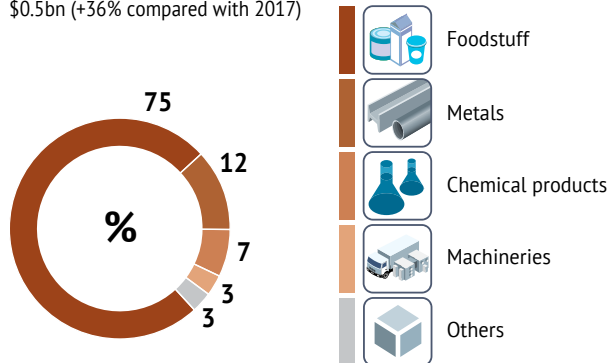
Russia's exports to Iran

\$1.2bn (-8.1% compared with 2017)



Russia's imports from Iran

\$0.5bn (+36% compared with 2017)



Source: Federal Customs Service.

In addition, there are a number of factors that are objective, negative and would have a system-wide effect. These include the tightening of US economic sanctions, efforts to move away from the US dollar in trade, Iran's protectionist policies (mandatory 4% tariff on all imports), and objective infrastructure deficiencies. Rail accounts for just 2% to 3% of cargo shipments in Iran, while inefficient diesel trucks, over 30 years old, account for more than half of the freight transport mix. Iran's downstream operations are structured in such a way that the country has a shortage of light petroleum products and has to cover the deficit with imports. Thus, only a new rail network from the Indian Ocean to Russia and Turkey can save Iran's economy from suffocating. To these ends, Moscow and Tehran reached a final agreement in 2019 to extend a Russian loan to Iran in euros for an amount equivalent to \$5bn to be invested in 35 priority projects in energy, construction, seaports, electrification, railways, etc.

Signed in May 2018, the Interim Agreement enabling formation of a free trade area (FTA) between the EAEU and Iran has provided a major impetus to promoting the INSTC. This instrument offers Iran the possibility of expanding the export of goods and a labour force, as well as developing transiting operations. The EAEU countries committed themselves to lowering import duties on 502 types of goods, primarily pistachio nuts, dates, figs, raisins, shrimp, confectionary products, tableware, cleaning solutions, carpets, and plastics. Iran, in turn, undertook to lower import duties on 864 types of goods. Duties on meat products will be reduced from 26%

to 5%–10%, duties on bean cultures will fall to the same level, down from 55%, vegetable oil duties will drop from 20% to 10%, pasta and confectionary duties will be subject to duties ranging from 14% to 20%, down from 55%, and rolled steel will be taxed at 15% instead of 20%. Duties on rail track components will drop from 5% to 4%, accumulators will be subject to a 10% duty instead of 32%–55%, and pipes and reinforcement metal will benefit from a 4% tariff instead of 32%. These items currently account for more than half of the total exports from Kazakhstan and Russia to Iran. This FTA is the first step in expanding cooperation in other sectors, including tourism, investment, research, technology, and transport.

It is still early for EAEU–Iran full-scale cooperation. Iran's share in Russian foreign trade is almost negligible at 0.4% (comparable to Armenia), while Russia commands a much larger share of Iran's foreign trade at 4.2%. In 2016, according to Russian Export Center statistics, the EAEU's exports to Iran increased by 48% to \$2.6bn, with Russia accounting for \$2.2bn. Trade was somewhat stagnant in 2018. Russian Export Center experts believe grain, vegetable oils, power equipment (including grid equipment), rail components and machinery, manufacturing equipment, and timber processing products to be the most promising product categories in terms of exports to Iran. This trade, however, is largely headed one way. Exports from Russia, including automobiles, trucks, other equipment, food products, and metals totalled \$1.9bn, while imports from Iran stood at \$300m and mostly consisted of food products. That said, a number of Russian exports to Iran are critical to export companies. Some of the most striking examples include trailers: which accounts for 58% of overall exports from Russia. The same indicator for wide rolled alloyed steel is 22%, power generating units – 19%, rolling mills and cast rolls – 19%, barley – 15%, and corn – 13%.

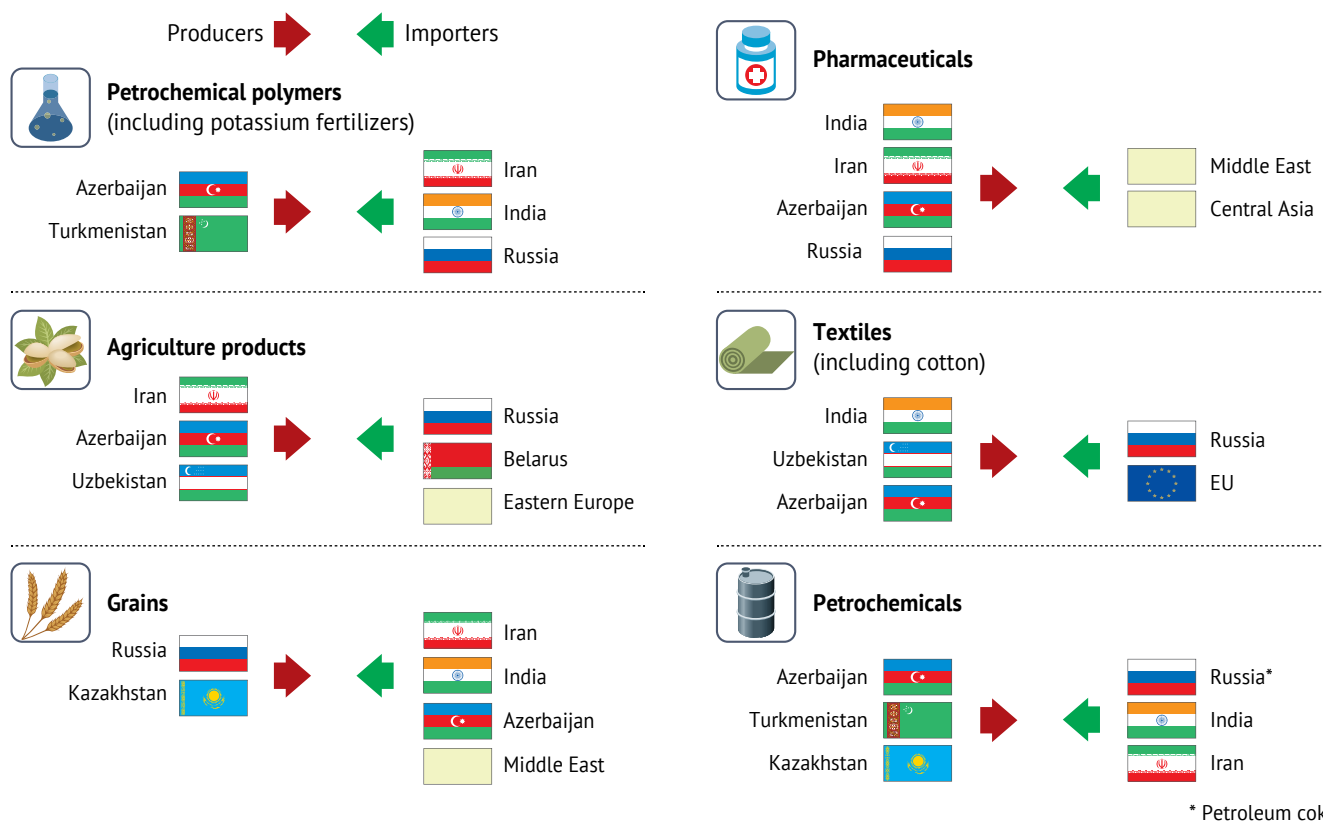
Only a new rail network from the Indian Ocean to Russia and Turkey can save Iran's economy from suffocating

According to an analysis by the Eurasian Economic Commission (EEC), Russia is expected to benefit the most from the FTA with Iran in terms of GDP growth with an effect of \$1.3bn compared to \$500m for Kazakhstan, \$78.6m for Belarus, \$27m for Armenia, and \$12 million for Kyrgyzstan. The EEC forecasts that EAEU exports to Iran will mostly focus on non-agricultural sectors, accounting for 83.1% of the overall increase in exports. This would include medicines, surface-active substances, paper, clothing, steel products, various kinds of mechanical and electric equipment, vehicles, etc. Overall exports could surge by as much as 73%.

Anchor Projects

Coal is the core revenue driver for most trans-Eurasian international transport corridors. Unfortunately, INSTC routing lacks this valuable resource. Oil and gas transported in tank cars account for a substantial part of the shipments along this route, but an excessive focus on this segment could be a barrier for the development of other projects and make the entire route dependent on the extremely volatile prices on hydrocarbons. The transport sector is an important revenue driver that has the potential to evolve into a powerhouse, but only if specific conditions for developing the industrial economy in general are met. INSTC participants can benefit in several ways from transiting and manufacturing opportunities along various segments of the route.

MAIN GOODS TO BE TRANSPORTED ALONG NORTH-SOUTH CORRIDOR



The first tier of benefits consists of fostering the development of services. Shopping centres, gas stations, car-care centres, motels, cafes, and tourist centres are expected to pop up along the route. Considering the responsiveness of road construction companies along the INSTC, several thousand new jobs could be created in each of the participating countries

(anywhere from 15,000 to 25,000 depending on the scale of road upgrades). A number of INSTC key road segments lack side railing, or any residential or office buildings around them. There is also a deficit of recreational areas, parking, very few filling stations, cafes, bathrooms, etc. All these shortcomings prove that there is potential for developing services.

The second tier of benefits consists of developing national and cross-border logistics. Specifically, one of the most urgent problems for the North–South vehicle corridor is the delivery of consolidated cargo from several customers in a single container. There are about three dozen companies operating between Russia and Europe that provide such services. However, this service is still almost nowhere to be found in shipments between Tehran and Moscow. A dozen new logistics centres are expected to be created in order to realign cargo traffic patterns, carrying the promise of increasing revenue from transit. These new logistics centres could emerge around agricultural parks where agricultural products are processed into final value-added goods.

The third tier of benefits consists of the opportunity to build toll roads, which is new for the Caspian region. Offering two alternatives within a single road infrastructure with a toll highway and a network of regional roads could also give a substantial boost to the economy. Kazakhstan intends to convert 7,000 km of roads into toll roads by 2022.

Russia is expected to benefit the most from the FTA with Iran in terms of GDP growth with an effect of \$1.3bn compared to \$500m for Kazakhstan

On the Way to a Transregional Partnership

Infrastructure connectivity between regions covered by the INSTC is essential for ensuring security and political stability in the participating countries. However, geographical and infrastructure connectivity does not necessarily translate into compatibility. This calls for an institutional and contractual framework as part of one or several interconnected integration projects such as the EAEU, the Shanghai Cooperation Organization (SCO), and ASEAN, as well as a social and political environment conducive to cooperation. In other words, compatibility is determined not only by the physical availability of communications (such as roads, logistics centres, etc.), but also by offering a variety of users the possibility to freely use this infrastructure. It has to be understood to what extent national laws and international treaties provide for

the unhindered cross-border movement of goods, services, capital, and labour between various integration groups and to what extent business can take advantage of these opportunities at various levels.

In terms of developing the INSTC, a deliberate regional integration policy will be needed to deliver on this objective by building agile partnerships along the following lines. First, it demands creation of a **permanent institution (mechanism) for promoting inter-regional cooperation** in the form of a flexible organization similar to Asia Dialogue. To establish such a body, Iran, Russia, China, and India could become the four founding countries for discussing economic, political, cultural, and security matters at the first stage. These talks could take place both at the expert level and the level of officials from the corresponding ministries. Making this organization a permanent institution would enhance its appeal in the eyes of other Asian countries.

It has to be understood that a forward-looking approach would be needed in all sectors for the INSTC project to materialize. Interagency entities that currently oversee dialogue on international transport corridors must serve as a foundation for joint committees that will be tasked with devising scenarios and preparing short-term (until 2025), medium-term (until 2035), and long-term (until 2050) projections. This would be a good way to foster cooperation. We need medium-term projections for new joint projects to develop within various INSTC segments in polymer chemistry, engineering, machine tools, automotive and aerospace industries, professional equipment, and the creation of new polymer and composite materials.

Second, creation of a **common currency market** is needed. This usually requires a high level of integration that is difficult to achieve in real life. However, the idea of forming a currency union as a way to move away from trading in US dollars is a recurrent subject for the EAEU, the SCO, and the D-8 Organization for Economic Cooperation (an organization regrouping eight of the most developed countries in the Islamic world established by the OIC in 1997).

Third, **uniform business and trade conditions** have to be ensured. Promoting exports by small and medium-sized companies (through infrastructure banks, national export agencies and other institutions) is a way to increased regional integration.

Fourth, **promoting tourism and visa-free travel** is a no less important measure. Basically, this is the key prerequisite for creating a common labour market. Russia has set an ambitious objective to attract as many working age people from its neighbouring countries as possible (both as new Russian nationals and as labour migrants). The country's population is expected

to increase by 5 million people based on efforts to liberalize migration policies and streamline access to citizenship, and the INSTC crosses a region that has the biggest potential in terms of attracting labour resources.

Fifth, **export of services and digitalization** are to be promoted. This is a key priority for Russia, India, Iran, and Belarus. The market for the industrial Internet of Things and artificial intelligence is growing in Eurasia. According to the Russian Federal State Statistics Service, the share of digital goods and services exports in Russia's GDP increased from 0.5% to 1% in 2018 (compared to 5.8% in China and 2.5% for the EU). There is also a series of projects to create clusters of pharmaceutical manufacturing facilities and rehabilitation clinics in India, Iran, Azerbaijan, and Russia.

India's Interests in the INSTC: The Caspian Sea and the Central Asia 'Channel'

For India, the INSTC is above all a factor for expanding exports and accessing the raw materials in Central Asia that are needed for its booming economy. In its plans to promote cooperation with Central Asia, India emphasizes that its national companies would benefit from accessing mineral deposits, including uranium, copper, titanium, yellow phosphorus, iron ore, liquefied gas, coal, etc. When Indian delegations hold talks with Kazakhstan, they always stress Delhi's commitment to contribute to Kazakhstan's goal of increasing non-oil exports by 50% by 2025. In turn, Kazakhstan Temir Zholy (KTZ; national railway company of Kazakhstan), Kazakhstan's leading logistics operator, has expressed interest in building a terminal at Mundra Port, Gujarat.

The INSTC also plays a decisive role in a Russian-Indian project by SIBUR and Reliance Industries to build a butyl rubber plant in India with the main raw material, isoprene, for the Jamnagar plant to be delivered from Togliatti. The INSTC's export potential is also critical for future investment in this project to have small and medium-sized companies produce and sell consumer goods, including products from plastic, elastomers, and organic synthesis materials.

Over the past 20 years India has emerged as a top-three global economy, creating a new reality not only for Russia but

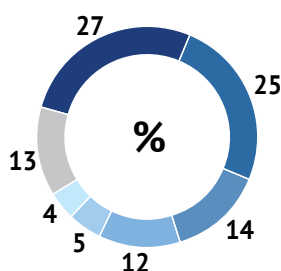
**For India, the INSTC
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TRADE IN GOODS BETWEEN RUSSIA AND INDIA IN 2018



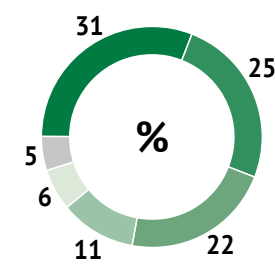
Russia's exports to India

\$7.8bn (+20% compared with 2017)



Russia's imports from India

\$3.2bn (+11% compared with 2017)



Source: Federal Customs Service.

primarily for Central Asia. Interestingly, Delhi expressed interest in the INSTC in the early 2000s, which coincided with the release of the Vision 2020 national development strategy, which outlined growth factors for the Indian economy. These include steady expansion of exports, the availability of developed port infrastructure, a developed financial sector, a flexible regulatory framework, and a state lending system. Taken together, these factors are viewed as prerequisites for making India a potential global development leader. India's accession to the Customs Convention on the International Transport of Goods under Cover of TIR (Transports International Routiers) Carnets was a major achievement in terms of its efforts to make a foray into foreign logistics markets.

According to World Economic Forum's (WEF) forecast, over the next decade India will have an annual growth rate of 7.5%. Currently ranked the world's sixth largest economy with a nominal GDP of \$2.6trn, India is set to become the third largest economy by 2030 with a GDP of \$6trn at official exchange rate. The Analytical Center for the Government of the Russian Federation noted that India's economy grew by 230% between 2000 and 2017, which means that the country's real GDP grew by an average of 7.1% per year, while its contribution to the global GDP by purchasing power parity in 2017 reached 7.4%, with only China and the United States ahead.

Standard Chartered Bank released another positive long-term forecast on India. It is based on the assumption that India's youth will play an increasingly active role in the economy, which could sustain consumption growth and create demand for employment. Under these projections, about 100 million new jobs are expected to be created by 2030 in the manufacturing and services sectors

alone. Today, the median age in India is 28, and by 2030 this indicator is expected to be 31 years, compared to 40 in the US and China. In addition, household consumption accounts for 60% of India's GDP, compared to 40% in China. According to WEF's report *Future of Consumption in Fast-Growth Consumer Markets: India*, fast growth will transform the income of India's households so that the country will no longer be viewed as a bottom-of-the-pyramid economy. In ten years, the share of high-income families will more than double from 3% in 2018 to 7% in 2030, while the share of middle-income households is set to grow from the current 54% to 78% by 2030. By this time, the share of low-income households will decrease more than three times from the current 43% to 15%. The expansion of the middle class will lift almost 25 million households out of poverty. Understandably, expectations for a consumer boom in India will drive international trade growth, which will not fail to affect the INSTC.

India's main trade partners currently include China, the US, the UAE, Saudi Arabia, Singapore, and the UK, which could create a problem in terms of India's participation in the INSTC project. In fact, in 2015–2017, the US and the UAE were the leading markets for Indian goods, accounting for over a quarter of all Indian exports in terms of value, while China was the leading exporter to India in recent years. All in all, in 2018, India's exports totalled \$216bn, of which the EAEU accounted for \$4bn, and imports reached \$337bn, of which the EAEU accounted for \$8bn. Accordingly, there is a clear need to create incentives not only for promoting transits of Indian goods along the INSTC, but also for drawing India into manufacturing and investment projects in participating countries along this corridor. This strategy would also promote competition with Chinese influence in the region by reducing the imbalance from China's economic expansion.

There is a clear need to create incentives not only for promoting transits of Indian goods along the INSTC, but also for drawing India into manufacturing and investment projects

The fact that Delhi's interest in the INSTC is limited to developing its own trade logistics, mostly consisting of transits through Afghanistan and on to Uzbekistan and Central Asia in general, is another challenge. This could be attributable to the fact that India views the INSTC primarily as a means for delivering raw materials from Central Asia. At the same time, a direct backbone route from the Indian Ocean to Europe has yet to be created. This is why Delhi has been backing the development of its own segment within the INSTC in the hope of forming a consortium of stakeholders. Despite efficient logistics and the relatively favourable location of the Iranian Persian Gulf ports of Bandar Abbas and Bandar-e Emam Khomeyni within the INSTC, India has placed its bets on its own project in Iran's Chabahar Free Trade-Industrial Zone, from where India intends to develop rail traffic towards Iran's border with Afghanistan.

Under a 2016 trilateral transit agreement between India, Afghanistan, and Iran, India is to launch two terminals and five berths at Chabahar port, as well as be in charge of cargo handling within 10 years. The port's transshipment capacity is expected to be 10 million tons per year in Phase 1, and could reach as high as 82 to 85 million tons once all the berths are added.

This project for Delhi is what Gwadar port in Pakistan is for China, i.e. the possibility to establish a foothold in a potentially beneficial export/transit route and expand regional influence. Although China's Gwadar port and India's Chabahar port projects are comparable in terms of initial investment, Delhi has been reluctant to announce any further plans for Iran, while China has signed a series of agreements valued at \$46bn and covering several decades to promote the China–Pakistan Economic Corridor. It has to be noted that existing Indian ports and the state of Gujarat with its strong economy (it accounts for approximately 20% of India's exports) provide a starting ground for India's project in Iran, as well as for the INSTC in general, while China's projects along the Pakistani corridor were launched only recently.

India had succeeded in securing a \$500m credit line before Iran was slapped with a new round of sanctions and bought heavy lift cranes and other equipment in Germany. It is telling that China has also expressed interest in this project with its Shanghai Zhenhua Heavy Industries Co., Ltd (ZPMC) on track to deliver four transshipment cranes to serve large container ships. Apart from the port project, India has an even more ambitious plan to create a new trans-Iranian railway by building over 2,000 km of new track and upgrading old lines. However, this initiative faces a number of technical and financial challenges.

Phase 1 construction as financed by Delhi consists of building a single-track railway line linking the Chabahar port to Iranshahr and then on to Zahedan, an Iranian city near the border of Afghanistan and Pakistan (with a rail branch to Pakistan). Zahedan is also expected to provide a link to the existing Iranian railway system, offering the possibility of delivering freight to both Azerbaijan and Turkmenistan on the opposing sides of the Caspian Sea. Delhi is also planning a second phase to continue the railway to Iran's northeast to Mashhad with its major hub and running a separate line to Haf in the direction of Herat, Afghanistan. Here, it can be connected to the Soviet-era railway that stretches across Turkmenistan (Mary), and reaches Tashkent, Bishkek, Almaty, and on to the main trans-Eurasian corridors.

Finally, the third phase would be the construction of a Mashhad–Gorgan line where the Indian project will be connected to the INSTC's eastern branch through the Incheboron crossing between Iran and Turkmenistan. This refers

to the Kazakhstan–Turkmenistan–Iran railway project regarding the Zhanaozen–Bolashak–Bereket–Gorgan line that opened in late 2014. Russian Railways signed a €1.2bn contract on March 28, 2017, to electrify the Iranian section of this railway from Garmsar to Incheboron, as well as branches to Iran’s Caspian ports of Amirabad and Bandar Torkaman. It should be noted that the Indian project is aligned with the initiative by Uzbekistan and Afghanistan to link Mazar-i-Sharif to Herat. O‘zbekiston Temir Yo‘llari, Uzbekistan’s national railway operator, announced plans to add 100 km to this line every eight months, if some \$2bn are invested in the project.

All this leads to the conclusion that there is a need to coordinate efforts in all segments of the INSTC, especially within the Iranian and Caspian sections. A consortium of stakeholders could be created to develop logistics and manufacturing along the corridor. This consortium could be tasked with assessing the required infrastructure investment, attract and capitalize external funds, and coordinate the overlapping strategies of its participants. While the exact composition of INSTC’s corporate participants may vary, the following combinations could emerge in core areas:

- **Investment:** credit lines from the Asian Development Bank, the banks of Japan and Russia, including Gazprombank, VTB and Sberbank, as well as regional state-owned infrastructure development banks in India and Iran.
- **Construction** of rail tracks, hubs, bogie exchanges, and electrification: Russian Railways, KTZ, Islamic Republic of Iran Railways, Uzbekistan Railways and Azerbaijan Railways.
- **Logistics:** introducing management mechanisms for multimodal container shipments and digital upgrades for the logistics space – Transcontainer, Russian Railways, Avtodor, RT-Invest Transport Systems LLC, Container Corporation of India Ltd, AzRusTrans (joint venture formed by Azerbaijan Railways and Rusagrotans), KTZ.
- **Cooperation among industrial clusters and special economic zones (SEZ)** along the transport corridor: manufacturing centres in India’s Gujarat state, Iran’s Chabahar and Bandar-e Anzali (Caspian) SEZs, Alyat SEZ (Azerbaijan), Aktau SEZ (Kazakhstan), and Lotos SEZ (Astrakhan).

Finally, an agreement on a free trade zone between India and the EAEU would create strong motivation for corridor development by offering incentives for the unhindered circulation of goods along ‘green corridors’ on the border and attracting capital and technology. Optimistic forecasts claim that regular traffic along the INSTC would help expand Russian-Indian trade from the current \$6bn to as high as \$30bn over the next 10 years.

An agreement on a free trade zone between India and the EAEU would create strong motivation for corridor development

Interests of Persian Gulf Countries

Oman is de facto the only Arab country that has signed the INSTC agreements. However, other regional countries are becoming increasingly interested in this corridor as they expand their ties with the main stakeholders of the INSTC.

The 2,100 km Trans-Arabian Railway connecting Saudi Arabia, Bahrain, Kuwait, Oman, Qatar, and the UAE (Gulf Cooperation Council project) is among the projects that will indirectly affect the corridor's potential. Russia has already expressed interest in joining this project by taking part in building and equipping the railway, as well as delivering rolling stock (Uralvagonzavod, Sinara-Transport Machines, United Wagon Company, and Transmasholding). This railway is designed to divert 40% of air traffic within the Arabian Peninsula and is expected to increase overall regional passenger traffic by 10%. In addition, the railway would help promote economic integration among the Arabian monarchies.

Apart from passenger traffic, freight volumes along the INSTC should also expand. The Russian Direct Investment Fund and the Kuwait Investment Authority are working on several dozen joint projects worth about \$200m. The following companies are interested in projects related to electric power, water supply, and equipment manufacturing: Power Machines, Technopromexport, Gazprom, NOVATEK, Zarubezhneft, and Inter-RAO Engineering. And KamAZ is interested in selling trucks and specialized equipment to Kuwait. The UAE is a leading trade and economic partner for the EAEU and the CIS in the region, besides from being Russia's number one trade partner in the Gulf region with \$1.7bn in trade in 2018. This ranks the UAE third by this indicator in the wider group of Arab countries after Algeria and Egypt. Over 3,000 Russian companies operate in the UAE. Along with the Russian Direct Investment Fund, UAE's Mubadala Investment Company invested some \$1.4bn in more than 40 Russian projects ranging from the oil industry to sport. Mubadala has plans to acquire 49% of Gazpromneft-Vostok that develops brownfields in the Tomsk and Omsk regions. The deal could be valued at over \$300m.

Uzbekistan is also proactive in expanding its ties with the UAE with more than 100 companies of UAE capital operating in the country. During his recent visit to the UAE, President of Uzbekistan Shavkat Mirziyoyev agreed to over \$10bn worth of projects in finance, renewable energy resources, infrastructure, and agriculture. These deals have yet to be formalized

in contracts, but some details have already seeped out. Mubadala agreed to explore the possibility of working with Uzbekistan on generating electricity from renewable resources, as well as developing new oil and gas projects. In addition, UAE investors are also interested in Uzbekistan's textile, construction materials, canned food, services, and tourism industries. Bilateral trade between the UAE and Uzbekistan totaled \$400 million in 2018, and the two countries plan to expand this to \$1 billion in the years to come. It is obvious that projects to expand communications between the UAE and Uzbekistan through Iranian ports will provide additional impetus to their joint undertakings.

Finally, the UAE has expressed interest in developing Caspian transport links. DP World (Dubai Port World), the world's third largest port operator in terms of transshipment volumes, said it is interested in the Alyat (Azerbaijan) and Aktau (Kazakhstan) ports. In particular, DP World drafted a master plan for the Alyat Free Trade Zone in Azerbaijan, and also provided consulting services on the draft law to create the free trade zone and conducting a feasibility study. Industry experts believe that the Alyat Free Trade Zone project could attract as much as \$1bn in investment over the next few years. Seeking to expand its business opportunities in regional trade, DP World acquired a 51% stake in Khorgos SEZ on Kazakhstan's border with China, as well as a 49% stake in Aktau SEZ.

The presence of a leading international operator in the Caspian region could pave the way for an increase in shipping volume for its ports. The emergence of smooth container transshipment mechanisms to and from rail and sea, the most vibrant segment that is growing at an annual pace of about 12%, will have a positive effect on shipment volumes along the INSTC.

Looking beyond the Horizon

We live in an era where trade wars coexist with integration processes within the same socioeconomic spaces, which creates special challenges as well as opportunities for the International North–South Transport Corridor over the next decade.

- **Digitalization.** In addition to business operations, many aspects of public life have been digitalized. Machine learning (AI) solutions for logistics and transport sectors are around the corner. This could produce an economic effect of \$16trn by 2030, and 200 of the 500 largest companies are expected to leave the market or merge with others.

- **Energy revolution.** By 2017, renewable energy use has increased 13 times over. Electric vehicles will change our strategies regarding natural resources – they will no longer be a source of massive profits. This promises a decline in volume for one of the commodities transported along the INSTC.
- **Rapid population growth around the world.** Life expectancy has increased tremendously, leaping from 48 to 71 years within the last 30 years. A longevity industry has emerged as an essential sector covering healthcare, healthy nutrition and lifestyle. Feeding a population of 10 billion would require 60% more food. Agriculture must evolve into a high-technology sector and double its labour efficiency.
- **Urbanization.** Population agglomerations are growing along the Caspian coast and the INSTC. Baku has already exceeded 2 million residents, and a number of million-plus cities are developing in Kazakhstan, including Almaty, Nur-Sultan and Shymkent. This is accompanied by social and economic tension and higher unemployment.
- **The labour market is changing.** Robots are gradually replacing physical labour. What matters now is a skilled workforce rather than labour costs. Manufacturing is moving back from the developing to the developed countries, which promises changes in education system. Instead of simply passing down knowledge it will prioritize the ability to find information and develop creativity. This will have a direct bearing on the interaction between the INSTC countries in higher education and vocational training.

By promoting neighbourly relations and relying on the Eurasian partnership (EAEU FTA), as well as expanding symbiotic economic ties in bilateral and multilateral relations, Russia has created a network of more or less reliable allies and partners that serve as a stability cushion. According to the International Monetary Fund's forecast, Russia's real GDP will increase 1.8% in 2019, compared to a 7.5% increase in India, 3.6% in Iran, 3.1% in Kazakhstan, 5% in Uzbekistan, 3.1% in Belarus, 3.6% in Azerbaijan, 4.8% in Armenia, and 4.8% in Georgia. According to the Institute of Economics of the Russian Academy of Sciences, by 2028, prospective joint value chains in manufacturing and trade could accelerate Russia's forecasted growth by additional 3% of GDP.

These are the advantages and challenges of the quasi-integration project centred around the International North–South Transport Corridor.

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