Keywords
Belt and Road Initiative, European Union, EU's Eastern Neighborhood, South Caucasus, Baku-Tbilisi-Kars Railway, Connectivity Strategy

Towards Greater Connectivity: The South Caucasus as a Railway Hub between the EU and China

Executive Summary
Since its unveiling in 2013, China’s Belt and Road Initiative (BRI) has clearly manifested itself as one of China’s highest priorities. The mere size and ambition of the BRI, to which Beijing has already committed massive financial and diplomatic resources, could render it one of the defining economic and political projects of the first half of the 21st century.

The European Union (EU) and its eastern partners have found themselves at the center of the BRI. For Europe, China’s engagement in the EU’s Eastern Neighborhood presents both massive opportunities and serious challenges. Just recently, the EU has adopted its own Connectivity Strategy portrayed as the EU’s answer to BRI. Both these initiatives open up new opportunities for cooperation and rivalry between the two powers, especially in the Eastern Neighborhood. It remains to be seen, however, how far these initiatives can go and whether they will be able to impact the regional geostrategic landscape. If they unfold as Beijing and Brussels hope, the ramifications would certainly be far-reaching.

Since the South Caucasus offers the shortest rail route from China to Europe, the countries expect to gain from increased connectivity between Europe and China by leveraging their positions as transit hubs. In this context, the newly established Baku-Tbilisi-Kars (BTK) railway line is a major item in Azerbaijan’s and Georgia’s foreign policy agendas of transforming their countries into a connectivity hub between Europe and Asia. China and the EU themselves stand to benefit politically as well as economically if this route becomes competitive to Northern routes going through Russia. The success of the transit hub that Azerbaijan and Georgia seek to create in the South Caucasus depends on several factors: the optimization of traffic capacity of rail infrastructure and roads, a favorable regulatory framework and price regime adjusted to the needs of intermodal transport, preferential customs clearance procedures, and the adoption of effective regulations for e-commerce.
Introduction

Despite the declared end of geographical boundaries, globalization and the digital revolution did not render distance obsolete. On the contrary, with old geopolitical rivalries returning to the spotlight as an increasingly important driver of global market movements, geography matters now more than ever. However, new geopolitical rivalries are taking place not over territory but over connectivity. Connectivity has become a crucial driver in establishing physical networks with infrastructure alliances stretching psychically across borders as a global good. China with its relentless pursuit of supply chain partnerships through the Belt and Road Initiative (BRI) is a major player in this global paradigm shift.

Under the BRI, China intends to build a new commercial superhighway by shifting the focus from primarily maritime routes to more dynamic trade routes based on the land-sea combination, which will link China to Europe. Intended to galvanize economic development by drastically boosting regional interconnectivity, the BRI’s land component – the so-called ‘Silk Road Economic Belt’ – seeks to interconnect the Eurasian landmass through a concentrated network of both ‘hard’ and ‘soft’ infrastructure materialized around dynamic transport corridors.¹


Intercontinental rail has become a defining feature of the BRI’s land component and the project has been a particularly strong driver behind the upgrading of existing and developing new Eurasian rail routes. The major element of these transport corridors is the development of the EU-China rail networks. A decade ago, regular direct rail freight links from China to Europe were virtually non-existent. Today, there are more than 12 train lines connecting Europe with China. In 2017 alone, 3,673 new freight trains were launched between China and the EU.

The massive effort and enormous resources China has committed to the BRI – arguably the largest investment drive ever launched by one single country – generated greater attention in Europe to its underlying rationale and potential strategic implications. On October 15 2018, the European Union (EU) adopted its own strategy on connecting Europe and Asia. Under this new connectivity initiative, the EU intends to build its own dynamic superhighway based on the combination of rails, roads, and maritime networks.

Although the strategy has been widely portrayed as Europe’s response to China’s Belt and Road Initiative, the EU was quick to point out that ‘the European Union and China share an interest in making sure that
our respective initiatives work well together, despite the differences in approach and implementation'.

Commenting on the EU’s new connectivity strategy, Federica Mogherini, High Representative of the Union for Foreign Affairs and Security Policy, also noted that ‘our approach is confident enough, I would say, not to measure our proposals as reactions to others.’

It is not inevitable that the EU and China should necessarily be rivals when it comes to connectivity projects. While the Sino-European partnership is far from an alliance and contains elements of deep disagreements, closing the infrastructure gap and boosting the connectivity across Eurasia is equally important for China and for the EU. Meeting all of Asia’s infrastructure needs requires $26 trillion in investments, particularly in the fields of energy and transport infrastructure, which is the challenge that cannot be tackled effectively by one country alone. Since both Beijing and Brussels share similar development strategies based on interconnectedness, there is plenty of room for cooperation to bridge the gaps and boost connectivity across Eurasia. This particularly rings true when it comes to establishing new and developing existing rail connections between the EU and China, the biggest strength of which is being faster than maritime and cheaper than air shipping.

The countries of the South Caucasus, especially Georgia and Azerbaijan, recognize both China’s BRI and the EU’s new connectivity strategy as overlapping with their own foreign-policy agenda of transforming their countries into full-fledged connectivity hubs between Europe and China. Since the South Caucasus offers the shortest rail route from China to Europe, Georgia and Azerbaijan expect to gain from increased connectivity between East and West by leveraging their positions as transit hubs. In this context, the newly established Baku-Tbilisi-Kars (BTK) railway line might significantly boost connectivity across Eurasia and broaden the possibility for EU-China cooperation in the region.

The Current State of EU-China Rail Connections

Since 2008, when the first train arrived from Xiangtan to Hamburg, China-Europe railway services have seen dramatic growth not only in terms of origins and destinations but also with regard to cargo type, volume, and overall competitiveness. And the pace of growth is only starting to accelerate. Although it is still unclear how much trade rail freight services will be able to capture, their share of cargo by value is already

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2 Ibid.

3 Since Armenia has for the most part been excluded from participating in important transportation projects in the region due to the embargo imposed by Turkey and Azerbaijan in the wake of the Nagorno-Karabakh conflict, this paper solely focuses on transportation projects developed by Georgia and Azerbaijan. Nevertheless, Armenia hopes to join the BRI by pushing for the development of the “Persian Gulf-Black Sea” transportation corridor that would connect Iran with Europe via Armenia and Georgian Black Sea ports. However, due to financial constraints and geopolitical obstacles, the project does not seem feasible at the moment.
growing fast. According to the International Union of Railway, cargo traffic flows between China and Europe by rail could double over the next decade. However, there are also substantial challenges and difficulties for EU-China rail connections lying ahead. Despite strong development, rail transport still has a low intermodal market share of around 1% in the trade between Asia and Europe. Currently, 93% of the 15 to 17 million TEU in Chinese container cargo bound for Europe moves by sea, with the remaining 7% split between air and rail.

The major challenge facing EU-China rail connections is structural shortcomings of Europe’s rail networks, especially in Eastern Europe. The pace of growth in containerized cargo volumes riding the rails between China and the EU has strained infrastructure and causes bottlenecks. The key challenge is upgrading rail terminals, particularly those at change-of-gauge stations. It is true that the EU is investing in its cargo rail connections by creating common standards for the interoperability of rail networks through the Trans-European Transport Network (TEN-T) initiatives. However, while there are many highways and roads getting built through the EU Cohesion Fund, the economic impact of which is dubious, there are not nearly enough cross-border railways getting built in Eastern Europe using TEN-T funds.

What is more, since most of Europe’s railway system is older than China’s, this creates capacity constraints. Delays, often generated by lengthy customs procedures, security checks and necessity to meet differing rail gauge standards cause a massive waste of time. According to Richard Griffiths, up to 80% of the travel time from China to Europe consists of delays. In 2017 alone, China-Europe trains experienced delays of up to six days. Delays are the major factor why customers still prefer maritime shipping over rail services and why ocean shipping still accounts for more than 90% of cargo traffic flows between China and Europe.

The South Caucasus as a Transit Hub: The Case of Baku-Tbilisi-Kars

Although Beijing was until recently a minor player in the South Caucasus, with the launch of the Belt and Road Initiative, the region has gradually become an area of great interest for China. As China aims to diversify its trade routes, South Caucasus offers an alternative and shorter route to conduct part of its trade. In May 2017, Tbilisi concluded a free trade agreement with Beijing which made Georgia the only post-Soviet country that has concluded such a deal with both the EU and China. For the EU, Beijing’s growing presence in the region covered by the Union’s Eastern Partnership (EaP) policy presents both opportunities and challenges. The EU’s 2016 China strategy explicitly states that ‘[i]t is in the EU-’s interest to work with China to ensure that any Chinese involvement in the EU’s Eastern and Southern

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4 R. Griffiths, *Revitalizing the Silk Road: China’s Belt and Road Initiative*, Leiden, HIPE Publication, 2017
neighborhoods helps reinforce rules-based governance and regional security.\(^5\)

On 30 October 2017, Azerbaijan and Georgia together with Turkey officially launched an 826-kilometer long Baku-Tbilisi-Kars railway line. With the initial capacity to transport 5 million tons of freight a year and just 14 days to reach destination, the BTK offers a significant shortcut in comparison to alternative rail routes. Currently, the Northern freight routes via Russia and Kazakhstan are the most used transport corridors between Europe and China. These routes have fewer customs borders to pass than alternative routes, as Russia and Kazakhstan are part of the Eurasian Customs Union, which means the train only has two borders to cross, that of China-Kazakhstan, and Russia-EU. However, these routes experience both capacity and political constraints and take longer than the BTK to reach the destination. In the long run, the BTK could assist China to gain a competitive edge in the high value goods market (for instance, electronic devices) since it gives Chinese manufacturers an opportunity to organize faster and cheaper deliveries to the EU.

The BTK also offers the potential to access new markets and bypass capacity or political constraints of the Northern routes running through Russia. The chronic imbalance in trade between the EU and China heavily tilted in favor of Beijing means that most trains go back to China empty. The cost of moving these trains are primarily covered by Chinese provinces, which raises the question of the long-term profitability of these connections. Only one third of all westbound trains carry goods back to China. One major business segment that might potentially make these rail connections more profitable is the export of premium food products from Europe to China, high profit margins of which could offset the high shipment cost. The Russian import ban on EU products prohibits premium foodstuff like French cheese and Dutch veal from entering or even transiting through Russian territory offers a real competitive edge for the BTK over the Northern rail routes.

Moreover, Baku-Tbilisi-Kars has the potential to be popular with manufacturers of products that tend to be highly seasonal such as the clothing sector. The apparel business is a classic example of a seasonal industry which operates under tight timeline in order to keep up with deadlines for launching new fashion collections while trying to avoid exorbitant transportation costs. Moreover, the BTK might gain competitive advantage in those manufacturing sectors that require expeditious deliveries but cannot afford the shipment costs of air freight due to a low profit margin.

Given the geostrategic significance of the BTK, the Central Asian countries also have expressed their interest in participating in the BTK. The launch of the BTK and the ongoing construction of Baku International Sea Trade Port, the biggest and multi-purpose port in the Caspian Sea, serve to boost the capacity and attractiveness of the Trans-Caspian International Transport Route (TITR), which could help landlocked Central Asian countries to become land-linked. Under the BTK project, after departing China, trains will cross into Kazakhstan at the Khorgos Gateway before being transported to Baku by ferry across the Caspian Sea and then head towards Europe via Georgia and Turkey.

On November 5, 2017, the first train cargo from Kazakhstan arrived in the Turkish port of Mersin via the BTK route. The first successful transit of goods was received very positively in Kazakhstan resulting in a very optimistic stance on the future benefits of the BTK and the possibility of reviving the TITR. In April 2018, Georgia’s Economy Minister Dimitry Kumsishvili and Chinese Minister of Transport Li Xiaopeng reached an agreement over China helping Georgia to upgrade its portion of the TITR. In parallel, the landmark Caspian Sea Convention signed by five littoral states – Iran, Russia, Kazakhstan, Turkmenistan and Azerbaijan – on August 12, 2018 might also enhance the development of Trans-Caspian transportation projects.

Unlike the Southern Gas Corridor, the transportation corridor through the South Caucasus based on the Baku-Tbilisi-Kars rail route has not been a prominent feature of the EU’s foreign policy agenda until recently. However, it seems like this is starting to change. The EU, commenting on the launch of the BTK railway line stated that ‘[it] welcomes the new rail corridor which, coupled with investments, improved infrastructure and logistics coordination will provide better connectivity, new business opportunities and increased trade. This is at the heart of its Eastern Partnership as well as of its Central Asia strategy.’

The Commission’s joint communication on the new connectivity strategy also revealed that the EU recently agreed to extend its Trans-European Transport Network (TEN-T) to the Eastern Partnership countries.

Policy Recommendations

While the BTK holds a great potential to offer a competitive alternative to other routes, it is still too early to make predictions about its future. The corridor still has a number of gaps to bridge to allow a convenient service. It is currently facing several

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challenges concerning transport time, reliability and operating costs due to numerous border crossings and changes in transport mode. Additional limitations include the relative lack of “soft” infrastructure, such as simplified customs procedures.

Since establishing new routes and making them competitive requires substantial transformations in operations, pricing, and customs, much work still needs to be done by the countries of the South Caucasus to improve the interoperability and harmonize technical standards across the region. Georgia and Azerbaijan should make more efforts to reduce the red tape around border clearances, create unified regulations and technical standards, and optimize operational efficiency along the corridor. Creating a favorable regulatory framework and price regime adjusted to the needs of intermodal transport coupled with automation of customs procedures could produce fast improvements along the BTK and thus offer a competitive option over the Northern routes.

However, more than the regional countries, it will ultimately be up to the EU and China whether the promises of connectivity in the region are actually realized. To make its ambitious connectivity agenda work, China clearly needs the EU. However, the EU has its own concerns about China’s connectivity agenda stemming from the perception that sometimes Chinese connectivity projects do not adequately reflect principles on which Europe’s approach to connectivity is based. Those principles include, among others, sustainability, market principles, and transparency. To achieve a higher level of integration between its own Belt and Road Initiative and the EU’s connectivity strategy, particularly the EU’s TEN-T policy, China should mitigate those concerns by promoting the principles of transparency and sustainability in its connectivity projects. Without adhering to these principles, Beijing will simply not be able to convince Brussels that it is a credible partner on connectivity.

At the same time, while with its new connectivity strategy the EU is starting to play a more active role in shaping the rules around the connectivity in the Eastern Neighborhood and beyond, the strategy will not achieve the intended results if it does not include tangible financial commitments. If the EU wants its own approach to connectivity to work in practice, scaling up financing mechanisms for connectivity while specifying how exactly those financial commitments would be operationalized is absolutely essential. Otherwise, the approach will lack credibility and fall short of convincing the EU’s Eastern partners that it has the potential to deliver on connectivity.
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