

Opinion and Analysis

NINE HARD TRUTHS ALONG THE CASPIAN MIDDLE CORRIDOR:

**Critical Factors facing the Caucasus
and Central Asia**

By Dr. Eric Rudenshiold

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NINE HARD TRUTHS ALONG THE CASPIAN MIDDLE CORRIDOR:

Critical Lessons for the Caucasus and Central Asia

By Dr. Eric Rudenshiold

The word is out. The eight, energy-rich Caucasus and Central Asian countries are joining together along a newly invigorated Middle Corridor trade route that is increasingly proving a competitive alternative to Russia's northern transit corridor. This expanding, Trans-Caspian, east-west trade passage is catching global attention and attracting significant investments from international donors and partners. Spurred by Russia's war in Ukraine, the Caucasus (Armenia, Azerbaijan, Georgia) and Central Asia (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan) have tacitly agreed to reduce their economic reliance on neighboring Russia and China, by cooperating with each other and collectively pursuing global engagement and investment.

Formerly mistrustful competitors, the Central Asians have recognized the opportunity to diversify economic, security, and other partnerships, due in large measure to Russia's preoccupation with Ukraine, as well as the economic risk of secondary sanctions, by maintaining Russia as their

largest economic partner. Divided by a multitude of conflicts, both resolved and frozen, the Caucasus are likewise revisiting their historic differences and seeing Moscow's divided attention as a potential prospect to reconnect, expand and transform their economies. Growth over the last several years in trade along the Middle Corridor is quite remarkable, as trade volumes have risen significantly and are expected to triple to 11 million tons in 2030 with operational improvements.

And the world is responding by beating a path to this centrally located but remote region of Asia that is again becoming a trade and transit crossroads for the north, south, east, and west. Tens of billions of Dollars, Euros, Yuan, Dirham and other currencies have been committed to regional and bilateral development projects in the greater Caspian region over the last two years. But previous international outreach and development efforts in the broader region have at times proven unsuccessful; and current efforts could likewise falter. Apart from sales of hydrocarbons and other extractive commodities, many international

business partnerships and engagements in the 1990s and the late 2000s were ineffective in integrating the region's economies into the global market. Reasons for these disappointments were varied: Many past failures can be attributed to Moscow's efforts to maintain an economic neighborhood where it could play an outsized and pivotal role. In some instances, regional leaders and officials may have signed agreements without understanding the implications of the fine print. At times, investors simply held unrealistic expectations. If investments now are expected to continue to proliferate and economies to grow in the Caspian region, a number of domestic constraints, as well as intra- and inter-regional impediments, still exist and need to be addressed during the current, massive growth period. The following nine hard truths were derived from development observations gleaned across the last three decades from countries along the Middle Corridor:

- 1. Agreements signed are not enough.** It is easy for governments and financiers to make promises, when commitments of funds are made at high-level ceremonies. But regional officials know that pledges don't always materialize, or at least not in the amounts promised. International financiers, donors, and industries have specific expectations regarding a business climate, even when making allowances for a developing economy.

When the senior officials leave and those responsible for realizing the agreements show up, cooperation, authorization, and facilitation are needed for implementation. Enforceable contracts, property rights, and titles; reliable banking systems; and accountable civil

servants and uncorrupted and transparent court systems are but some of the requisite factors in ensuring smooth working conditions for international investors.

All of the Caucasus and Central Asian countries have problems addressing corruption and energizing their slow-moving, risk-averse bureaucracies. Progress is being made in many of these countries, as evidenced by improving scores in Transparency International's Corruption Perceptions Index, but the gap between expectations and reality can be significant. Poor or slow execution of agreement provisions can quickly lead to the erosion of confidence in a country and in the perception of its ability to meet terms and conditions.

Unimplemented or slowly executed reforms can be a severe constraint to positive perceptions of a country's progress. The international finance community is a relatively small one and impressions are shared quickly, particularly if they are negative. No institution wants to see its investments at



Uzbekistan and Qatar sign bilateral documents to develop cooperation.

risk. Attention to detail is vital. Managing expectations and clearly communicating about issues as they arise is also requisite for maintaining confidence. These practices need to be inculcated into regional practice at all levels.

2. Absent Baku, there is no Middle Corridor, as currently envisioned.

Much of the attention for the Middle Corridor's development rightfully is focused on Central Asia and the need for harmonized transport systems, digitalization of documentation, improved transport, and other infrastructure needs, as well as addressing efforts to heighten intra-regional cooperation. However, the

Central Asia. Roll-on roll-off freight capabilities, investments to increase operational efficiency, and a host of soft and hard infrastructure needs for Central Asia should be coordinated with Azerbaijan and Georgia, if efficiencies are to be improved and transport costs lowered.

Baku is both the lynchpin and chokepoint for trans-Caspian trade (as well as for much of the cargo from the emerging, trans-Caspian, North-South Corridor that links Russia to Iran). The European Union's Global Gateway Initiative has largely promoted investment in Central Asia, by mobilizing €10 billion for the improvement of transport linkages

across the five Central Asian republics.

However, these efforts need to be funded and coordinated across the Caucasus countries as well or risk missing the opportunity to ensure synchronized development and economies of scale.

While Baku is engaging closely with Astana, Tashkent, and the other regional capitals, many in the international community are not holistically viewing or

investing in the entire corridor.

Governments and development organizations usually split the Caucasus and Central Asia into different departments or bureaus which are operationally and financially separate and tend not to coordinate with each other. For the multi-modal Middle Corridor to deliver



The Port of Baku sits at the crossroads of the east-west Middle Corridor and the North-South Corridor.

most efficient route to Europe along the Middle Corridor goes through Baku—the only port on the western side of the Caspian Sea. Improved freight capabilities in Central Asia will not enhance the Middle Corridor's effectiveness, if the Port of Baku is not in sync with other modal networks from

expectations of doubling and tripling low-cost capacity along its comparatively shorter and potentially faster route, investment and coordination between governmental and international financiers and donors, as well as the private sector, is vital. At the axis of the region's trade routes, Baku becomes the central element of the region's diversifying trade alliances and passageways, before routes move on to Georgia, Türkiye, and Europe.

3. **Absent Yerevan, the Middle Corridor will run at half capacity.** The current routing of east-west trade along reconstituted Silk Road connections in Central Asia and across the Caspian Sea through Azerbaijan and Georgia to the Black Sea is not living up to the Corridor's full potential. The on-going implementation of peace negotiations between Armenia and Azerbaijan open up the prospect of a refurbished rail line from Azerbaijan through Armenia to Türkiye and the Mediterranean Sea.

While the final disposition of the rail line has not yet been agreed to, a 2020 agreement between Armenia, Azerbaijan, and Russia laid the groundwork for a reconstituted link between the two Caucasus countries and then onward to Türkiye. Azerbaijan's rail operator, with the assistance of Turkish construction companies, have improved and updated railway lines almost up to the Armenian border, looking to replace sections

destroyed during the conflict in the region. Pending a final agreement between Baku and Yerevan, the proposed 43-kilometer route through Armenia's Zangezur region would create an uninterrupted rail connection from the Caspian to the Mediterranean Sea.

Armenian Prime Minister Pashinyan's Crossroads for Peace plan is based on the notion of reconstituting connectivity between Armenia, Azerbaijan, Türkiye, and Iran, and includes rail, road, pipeline, and energy transmission lines. Türkiye's President Erdogan has called for creating "new roadmaps" between Armenia and the rest of the region. Azerbaijan's President Aliyev has expressed strong interest in the rail corridor that would link Azerbaijan with its Nakhchevan exclave and onward to Türkiye. Though many in the international community are skeptical about resolving differences between the two countries, many historic red lines between the two have already been redressed, with progress continuing.



The May 10, 2024, meeting between the Foreign Ministers of Armenia and Azerbaijan was hosted by Kazakhstan in Almaty.

The prospect of building out a second major rail transit across the Caucasus is a major incentive for the region's economies, as well as for Central Asia. The engagement of Kazakhstan's leadership as a neutral broker between Armenia and Azerbaijan is potentially a very positive step in the peace process, particularly since all Central Asian countries have transit interests that would benefit from increased connectivity to Türkiye and beyond.

4. Russia and China's woes are deep.

With the possible exception of Georgia, the other Caucasus and Central Asian nations have sought to varying degrees to reduce their economic dependence on Russia, to avoid the impact of secondary sanctions, and to develop trade alternatives, as Moscow remains preoccupied by its war against Ukraine. The exodus of foreign investments and businesses from Russia is also an ominous indicator for future growth or investment in the militarized Russian economy. Further, Russia's dependence on China for revenues and commodity imports is another concern shared by Central Asian specialists wary of becoming too deeply engaged with Beijing.

In interviews, pundits from the region candidly see Russia as weakened economically, politically, and militarily by the war in Ukraine. Even Moscow's leverage of hosting large numbers of labor migrants from its near abroad has been reduced considerably after the Crocus City Hall terror attack, because

would-be "guest workers" are being discouraged to travel to Russia by their own capitals. While remaining an important trade partner, Moscow is largely seen across the Middle Corridor as a less-attractive source of investment and regional development.

China also suffers economically, with a widespread property sector crisis, the lack of a vigorous COVID recovery, a shrinking and disillusioned labor force, inflation, and falling demand for China-produced goods in international markets, all carefully watched by Central Asian leaders. While Belt and Road Initiative investments are still important to Middle



The Taliban's acting Deputy Prime Minister Mullah Abdul Ghani Baradar met with a Kyrgyz delegation in 2022.

Corridor countries, as is trade with China, Beijing's development legacy in the broader region is mixed, with past investments proving less advantageous than originally forecast.

Nevertheless, China is also an important trading partner to the broader region, competing with Russia for influence, particularly as investments from the West and Middle East are increasingly

offered in both the Caucasus and Central Asia. While the Caspian region countries will continue to trade with their large neighbors, they will also continue to seek opportunities to trade elsewhere and reduce dependencies on Moscow and Beijing.

- 5. The Taliban mean business.** Initially a source of security concern, the Taliban regime has become a growing source of engagement for Central Asia in the last two years, especially as the region's capitals seek a rail passage to the south and connectivity with Pakistan, the Red Sea, and India. Promoting increased bilateral trade with Afghanistan, the Central Asians are offering food, energy, and other commodities, as they court the once-feared Taliban for transit options. While denying *de jure* recognition of the government in Kabul, trade expansion discussions, railway proposals, as well as cooperation on water and energy sharing, are a *de facto* acknowledgment by Central Asian capitals that the Taliban are open for business and a potentially strategic transit partner.

Successive delegations between the regions have sought greater bilateral engagement and ways to address mutually concerning water and energy needs. Central Asia's leaders were deeply apprehensive over the prospects of terrorism and violence spilling northward upon the withdrawal of U.S. forces from Afghanistan, but since that time a growing recognition that there are gains to be made from positive regional relations has supplanted initial fears.

Increased rail connectivity through Afghanistan would be a significant

boon to the Middle Corridor's trade capacity and flexibility by adding South Asian port and market options, as well as building relations with a fragile southern neighbor. Cargo transit by road from Central Asia through Afghanistan has grown in quantity and reliability but is still insufficient to provide cost-effective volumes. In addition to promoting cooperation, trans-Afghanistan rail development would present significant opportunities for regional inter- and intra-regional trade. Qatar and other investors appear to be helping make this multi-year effort a strong possibility, though security questions for any cargo routing through Afghanistan remain.

- 6. Cooperation over competition.** Less than a decade ago, Central Asian leaders did not meet with each other, let alone discuss issues of mutual concern. Caucasus countries were divided by conflicts and relations with Moscow. However, since Russia's 2022 invasion of Ukraine, these eight, near-abroad countries have found new ways to work



Official photo of the 2023 Annual Summit of the five Central Asian Presidents that included the President of Azerbaijan for the first time.

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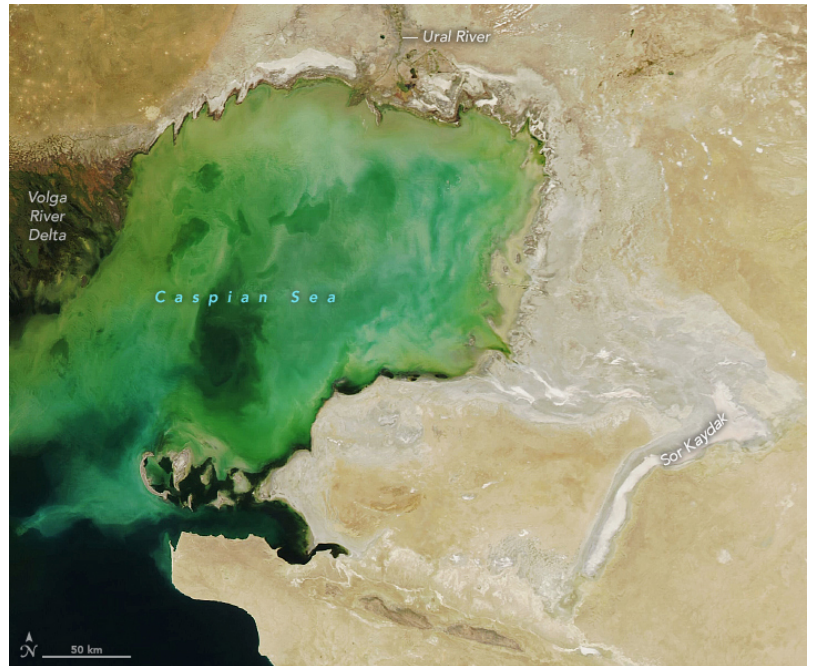
together, even on formerly taboo issues, have discovered elements of common ground, and have cautiously explored opportunities for joint collaboration. On some levels, with Russia out of the driver's seat, greater pragmatism is entering intra-regional relations. For international investors, this is a paradigm shift.

Whereas in the past Kazakhstan and Uzbekistan might compete against each other for the same bilateral investments as a matter of national pride, both could wind up missing out if they fail now to cooperate. As a bilateral partner, neither country enjoyed a sizable enough market in some sectors to be fully attractive to international business. However, when combined – and adding other countries in the region – Central Asia becomes a market of 80+ million people which is a significant size for international investment. As Caucasus countries become more engaged with Central Asian business and investment, another 20 million people can be added to the overall regional market.

By working jointly, as opposed to separately, the countries of the region stand to gain greater dividends. The entire region can benefit and share use of super-sized industrial facilities, even developing a hub-and-spoke set-up, as opposed to trying to reproduce the same facility in multiple countries. Economies of scale across the Caspian region are starting to take hold, but national pride needs to be accompanied by the benefits of regional cooperation.

- 7. Weather will impact the efficiency of the Middle Corridor.** Environmental change in the Caspian region is a serious

reality, with extended droughts, historic floods, and an overall decline in the region's water reservoirs becoming a new norm. The Caspian Sea, for



NASA photo from 2022 showing declining Caspian Sea levels that complicate shipping lanes.

instance, is experiencing a historic decline in water levels, causing increased dredging in Caspian Sea ports and the need to shore up transit and petroleum-related infrastructures. This need to deepen shipping channels and stabilize pipelines is adding expense to the Middle Corridor and creating logistical difficulties for the transit of cargo.

Increasing temperatures across Central Asia and the Caucasus are tied directly to weather anomalies that are bursting dams, crashing power grids, and threatening the region's aging infrastructure. The multi-modal Middle Corridor depends upon seamless connectivity to be reliable, fast, and competitive for moving cargo. While

unlikely to approach the shipping volumes associated with Russia's rail-dominated Northern Corridor, the multi-modal nature of the Middle Corridor makes it more vulnerable to weather-related disruptions which will need to be factored into current and future normative transit planning.

8. **Traveling at the speed of reality.**

While development investments and commitments are pouring into the Caspian region, and political will appears to be green-lighting cooperation, many changes and improvements will take significant time. Hard infrastructure, such as widening two-lane roads in and out of border crossings to speed transit, addressing regional differences in rail gauges that produce bottlenecks as containers are shifted, and adding larger cranes at ports, is easy to target but involve widespread problems that will not get resolved immediately. Changing multiple time-worn practices for handling and processing freight and business arrangements are some of the many institutional chokepoints that impinge on the Middle Corridor's effectiveness and require changes to bureaucratic culture.

Collectively, there are many significant limits to institutional capacity in this region, including limits to absorb and administer the new funds, as well as



City of Bukha after Russian troops were driven out by Ukrainian forces.

limits on governments, local partners, and individuals to adopt change. Training customs officials, for instance, to adopt soft infrastructure changes and unified procedures will require harmonization agreements, digitalization, and coordination that is not yet in existence.

Financiers and businesses need to recognize these challenges to creating and strengthening modern institutions and procedures from the outset, setting realistic expectations. Development efforts need to include training and capacity building across numerous key sectors, with schools and vocational efforts adapted to actual needs in each of the region's eight countries.

9. **War in Ukraine won't last forever.**

The prospects for the Middle Corridor countries created by the war in Ukraine, Russia's war-dominated economy, and the imperative to diversify their

economies and trade away from sanctions-restricted cargoes are unique and opportune. The Caucasus and Central Asian countries are exploring new markets and partners. The confluence of a rising and more worldly generation into positions of power and influence across the region, along with geopolitical opportunity, are also catalysts fed by international financial support and investment. However, the key driver for this cascade of changes is a war that will at some point end.

Russia's devastated war economy will need to reboot and seek to redevelop trade. In 2023, westward trade along Russia's Northern Corridor was down over 50 percent from 2022 volumes, due to the declines in western trade. This decay in European trade will very likely result in Russian pressure on southern neighbors to reconstitute pre-war trade routes and relationships that favored Russian logistics and infrastructure. Moscow could easily add further inducements such as lower freight rates and nuclear power plant construction.

Labeled by many now in the west as a pariah state, it is unlikely that Russia will see a rapid and full return of its old business partners in the immediate post-war aftermath, particularly as over 1000 companies have curtailed or permanently closed operations in Russia. Nationalization and the recent confiscations of western businesses assets, added to reputational concerns for doing business in Russia in the foreseeable future, could easily contribute to a more difficult environment for western businesses.

As a result, Russia will continue to depend upon its energy sector for future revenues, but it will need to pursue

alternative and non-aligned partners in order to try to redevelop its broader economy.

The Caucasus and Central Asian countries will continue their trade with Russia, a neighbor and important trade partner. However, the Caspian region's new connectivity and partnerships could be at risk, if targeted by Russia.

The countries of the Caucasus and Central Asia have seized the moment to develop a new business and trade corridor, as well as have attracted significant investments and partnerships from global partners. However, today's honeymoon period of billions in investment funds pouring into the region could easily dry up, as happened in the past, if international expectations sharply outpace the reality of the region's development speed. Likewise, prospects to constructively bridge the Caspian and optimize connectivity through Baku, Tbilisi, and eventually Yerevan can realize a significant increase in trans-regional cargo traffic, reducing transit times, and reducing overall costs.

A similar opening to connect to the global south through Afghanistan reinforces the importance of the Middle Corridor as a network of road, rail, and sea transit routes that can join the eight, individual Caspian countries in Central Asia and the South Caucasus into something much greater. The sum of the parts can elevate the entire region from what was once a comparative trade dead zone into a bustling and diverse transit hub that capitalizes on its central location.

China's trans-regional trade is already a major and growing contributor to the Middle Corridor's viability. Rare earth interests and investments will likely produce major corridor clients. Increased connectivity is

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already adding impetus for business within the Caucasus and Central Asia to export their own goods and wares.

Breaking the region's de facto dependence on Russia and China's economies, the Middle Corridor offers remarkable opportunities for trade development and integration with Türkiye, Europe, and global markets. As Russia's war in Ukraine has provided an impetus for trade and transit diversification, so too can the end of that war pose challenges for the Caucasus and Central Asia, if their reforms and innovations are not institutionalized in improved market practices, cost-effective and reliable shipping options. This large region has seen partners come and go over the last three decades, but there has never

been as significant a moment where the international community is paying the region such deserved attention—and where Russia has comparatively less to offer.

While significant challenges for the Middle Corridor exist, the potential for this new transit route to transform trans-Eurasian trade is significant. The new cooperation and investments being made by countries in the region themselves demonstrate that the Middle Corridor's Caspian countries appreciate the historic opportunities and are all in. Transcending current realities to achieve a stable and sustainable role in global trade will require concerted cooperation on their part and on that of global financiers, as well as the ability to capitalize on hard truths.

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