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Georgia's Economic Role in the South Caucasus

The economy of the former Soviet Union was characterized by a high degree of integration of the economies of its union republics, and was based on a clear union-wide division of labor. This explains why the coexistence of these republics in a common economic space, the “unified national-economic complex” for seventy long years left a deep impression on their economic systems. After the breakup of the Soviet Union, all of the newly established states had to set up independent national economic systems practically from scratch, and each of these economic systems represented an individual element in the formerly unified complex.

This disintegration after the breakup of the Soviet Union was exacerbated by the crisis that had already befallen the Soviet economy, whose administrative command structures proved themselves incapable of quick and efficient response to innovations. By the late 1980s, the steady decline in economic efficiency led to a situation in which the savings rate had to be increased just to maintain zero growth. The prerequisites for destabilization and crisis of the financial system took shape during this period. Crisis processes were also set in motion by political factors in

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1989–91. As a result, by the time the Soviet Union actually collapsed it was in the midst of a decline in production and investment activity, disintegration of economic ties between enterprises, a breakdown of the financial system, loss of control over the monetary sphere, foreign-policy and currency bankruptcy, and the dissolution of state political and economic structures.

The diversity of natural and climatic conditions, a high level of self-sufficiency in regard to natural and human resources, and a number of external factors made the Soviet economy relatively closed in relation to the international market. After the breakup of the unified economic system and the coming of financial difficulties at the level of the newly established states as well as individual enterprises, prospects for technological modernization and renewal were poor. As a result, obsolete equipment was also worn out. This, in turn, is the main reason why most of the goods produced in post-Soviet countries were not competitive (due to the low quality and/or high costs of production), which makes it impossible to penetrate international markets and actively integrate into the international economic system. This appreciable component of the post-Soviet economy is essentially a corpse, and it only “functions” by mechanisms of necroeconomics.¹ All of this applies in one way or another to all of the former Soviet republics and particularly to the South Caucasus region.²

The comparatively small territory of the South Caucasus (186,100 square kilometers) is notable for its highly diverse landscape, natural, and geographic conditions. The Caucasus as a whole and the South Caucasus in particular have always been and now have become even more a conglomeration of contradictions. This is apparent in the political processes occurring in the region, and in ethnic conflicts. These problems in the socioeconomic life of the peoples of the South Caucasus have such large-scale significance that they should be classified not only as political, social, and moral phenomena, but also as economic ones.³ Military operations (including those in the North Caucasus, particularly the war in Chechnya, which has an especially adverse effect on Georgia), the destruction caused by such hostilities, their victims, the social problems associated with the presence of large numbers of refugees and the blockade of transportation arteries inevitably have a significant influence on the economic situation and the realization of production potential in the South Caucasus.

As a result of these political, economic, and other factors, almost all

of the states of the South Caucasus have found themselves more or less plunged into a deep crisis that encompasses all spheres of their vital activity and has led to a steep drop in production, high inflation, and a decline in the standard of living. For example, in Georgia the GDP fell by 72 percent in 1989–94; in Azerbaijan, GDP in 1996 was 42 percent of the 1990 level; and the economy of Armenia was in serious condition up until 1994, with GDP in 1993 at one-third of the 1989 level. Starting in 1994–95, a trend toward stabilization and economic recovery has been seen in the states of the South Caucasus, thanks to an aggressive reform policy, but the consequences of the crisis were so profound that it may take years to overcome them. This cannot be done without pursuing radical and constructive domestic economic policies, along with an optimal combination of the interests of all states in the region and the active attraction of foreign investments.

Economic development depends largely on the extent to which a particular country takes into account *foreign economic factors* in setting its own economic policy. Considerations of basic trends in international relations and finding one's own place in the international economic system are especially important. This should be the basic premise for determining the strategic directions of economic development and reforms in the South Caucasus.

The economic progress of the states of the South Caucasus will be determined primarily by the degree and pace of their integration with the civilized world. Considering the current state of the economy in the states of the South Caucasus, the task of integration cannot be classified as easy. Nevertheless, it is important to note that the South Caucasus region, in spite of its present political difficulties, has not been isolated from the rest of the world. First of all, it is a component of the Commonwealth of Independent States [CIS]. Second, Azerbaijan, Armenia, and Georgia are members of the Black Sea Economic Alliance. And third, all three states of the South Caucasus signed cooperation and partnership agreements with the European Union almost simultaneously, and bilateral trade and economic relations are also being set up with many countries of the international community. However, all of these directions of international integration are not sufficient for the region's entry into the international market.

In the opinion of critically disposed experts, intra-CIS integration processes are now experiencing certain difficulties,⁴ and for well-known reasons some countries favor keeping integration processes within the

framework of the CIS, analogous in a sense to the closed cooperation that characterized the economic system of the Soviet Union.⁵ The Black Sea Economic Alliance, although it has great prospects and therefore deserves special attention, is nevertheless still a comparatively new interstate regional organization whose degree of integration is not yet significant.⁶ At present, cooperation with the European Union and economically developed European states cannot be realized on a footing of equal partnership. Rather, the EU is assisting the introduction of democratic principles for the construction of sociopolitical life and market mechanisms.⁷

In many cases, the leading countries of the world are taking a wait-and-see position, watching to see how events unfold in the South Caucasus. There is a widespread belief that, even though the conflicts there are presently frozen, the South Caucasus is still a hot spot that does not have the political and economic stability needed to actively recruit economic partners.⁸ Likewise, the relatively small size of the countries of the South Caucasus (their combined population is not more than 17 million) makes their markets accordingly small. Setting aside the significant conflicts in the region and looking, at least theoretically, at the possibility of a unified market in the South Caucasus, even in this idealized case the market is still not very big and can be covered by investments made by either Russia or Turkey.

All of this points to the need to find opportunities for interaction between economic agents from the states of the South Caucasus, in order to create the prerequisites for their rapid and sustainable development. Ideally, this would mean setting up a strategic economic partnership (not simply cooperation) in the South Caucasus.⁹ Joint (if initially informal) efforts are needed to the attraction of foreign investments for the region.¹⁰ The main problems here lie in the current high risk of long-term investments, which is why investment activity in the South Caucasus is still not very attractive. Still, there are spheres in the region that could be particularly interesting for foreign investors: this is apparent in the oil of the Caspian Basin,¹¹ or the Euro-Asian Transportation and Communication Corridor [EATCC] linking Europe and Asia through regions of Central Asia and the South Caucasus.¹² For these reasons, the South Caucasus are acquiring a special importance, and for many states in the region and leading companies in the world staking their claim in this region is becoming a strategic objective.

The increased economic growth rate in Azerbaijan may be mainly

15. The transportation artery linking Russia with countries of the South Caucasus, which is slightly used at present (due to blocking of the Russia–Georgia–Armenia rail link) can be considered an integral part of the North–South transportation corridor in the future (if the conflict in Abkhazia is resolved) (A. Mukhin and V. Mesamed, “Mezhdunarodnyi transportnyi koridor ‘Sever-Iug’: problemy i perspektivy” [The North–South International Transportation Corridor: Problems and Prospects], *Tsentral’naia Aziia i Kavkaz*, 2004, no. 1).

due to increased oil production and development of the oil refining sector. At the same time, the problem of development of the oil sector as well as the future economic development of the entire South Caucasus largely depend on setting up the EATCC transportation arteries. Practical realization of this plan began with the implementation of the widely known Transport Corridor Europe Caucasus Asia [TRACECA] project. TRACECA is presently seen as a transit corridor that will supplement and develop existing routes, primarily European ones. This will create possibilities for joining together the transportation systems of the Black, Caspian, Adriatic, and Mediterranean Seas.

Resolving questions of pipeline transport of energy seems equally important. The Azerbaijan-Georgian oil transport route has become a priority large-scale project in Georgia that is attracting significant foreign investment. The realization of this project is also creating prerequisites for more active investment in other sectors in Azerbaijan and Georgia, not to mention increasing the level of security in this region.¹³ On the other hand, this project would have no future if the project for transporting oil from Azerbaijan through Russia were not also in operation, since in conflict conditions, when oil pipelines run through or near hot spots, the existence of alternative pipelines is of decisive significance. In the transport of early oil not only are Azerbaijan and Georgia strategic economic partners, but Georgia and Russia may also be seen as such (although, unfortunately, Russia has almost never acknowledged this).¹⁴ Implementation of the projected transport corridor through Georgia, Armenia, and Iran is especially important for the economies of Georgia and Armenia and of fundamental significance for the development of a strategic partnership between Georgia and Armenia.¹⁵

The above suggests that Georgia is a country with every opportunity to promote the future formation of an economic system in the South Caucasus, in close partnership with Russia.

Questions of the beginnings of competition between individual countries in the region should also be raised. Market competition can manifest itself at various levels: at the level of firms, sectors, countries, and regional entities. A country's competitiveness depends primarily on how productively it uses its natural, labor, material, and financial resources. At the same time, any competition is, to a certain extent, motivation for improvement. Without international competition, productivity levels in each individual country would not depend on the situation in other

countries, while international flows of goods and capital are an opportunity to increase the productivity by which a country's resources are used, eliminating the need to produce all goods and services independently and specialize in those sectors of the economy and market segments where the country is relatively more competitive.

These considerations suggest that, economically, Azerbaijan and Georgia are not strategic competitors. Azerbaijan has oil and gas, while Georgia has an outlet to the ocean and is directly adjacent to Turkey. Both countries are on the EATCC route, and each of them possesses its own, in a number of cases unique, production potential. Azerbaijan and Georgia are more likely to be strategic partners than competitors. It is in Georgia's interest that Caspian oil and gas (and more) be transported through its territory. This is also in the economic interests of Azerbaijan, since in this case all kinds of freight from East to West and back will also pass through its territory. At the same time, the absence of economic competition between Georgia and Azerbaijan should not be perceived as a lack of market stimulus for development: these countries have other competitors, and they themselves, taken together, should be regarded as economic partners in interregional competition. The economic partnership of Azerbaijan and Georgia can become a magnet to attract other entities not only of the South Caucasus, but of the entire Caucasus (although, unfortunately, not all of them recognize the advantages of such a strategic economic partnership in the region).

In conclusion, we will emphasize, in particular, that strategic economic partnership is the foundation on which the economic system of the South Caucasus can and should be built.

Notes

1. V. Papava, "Necroeconomics: The Theory of Post-Communist Transformation of an Economy," *International Journal of Social Economics*, 2002, vol. 29, nos. 9–10.

2. A.A. Adamesku and E.D. Silaev, eds., *Zakavkazskii ekonomicheskii raion* [The Transcaucasian Economic Region] (Moscow, 1973).

An interesting approach involving use of the concept of "Central Caucasus" instead of "South Caucasus" in the scholarly literature. In this interpretation, "South Caucasus" includes the northern regions of Turkey and Iran, the way "North Caucasus" includes the southern regions of Russia north of the Caucasus Mountains (E. Ismailov, "O geopoliticheskikh predposylkakh ekonomicheskoi integratsii Tsentral'nogo Kavkaza" [Geopolitical Prerequisites for Economic Integration of

the Central Caucasus], *Izvestiia AN Gruzii—seriia ekonomicheskaiia*, 2002, vol. 10, nos. 3–4; E. Ismailov and Z. Kengerli, "Kavkaz v globaliziruiushchiesia mire: novaia model' integratsii" [The Caucasus in a Globalizing World: A New Model of Integration], *Tsentral'naia Aziia i Kavkaz*, 2003, no. 2.

3. For example, M. Maksoev, "Nekotorye ekonomicheskie problemy Kavkazskogo regiona" [Some Economic Problems of the Caucasian Region], *Obshchestvo i ekonomika*, 1998, no. 2; R. Asatiani, "Issues of Economic Development of the Caucasus," *Caucasica. The Journal of Caucasian Studies*, 1998, vol. 1.

4. For example, L.P. Kozik and P.A. Kokhno, *SNG: realii i perspektivy* [The CIS: Realities and Prospects] (Moscow, 2001); *10 let Sodruzhestva nezavisimykh gosudarstv: illiuzii, razocharovaniia, nadezhdy* [Ten Years of the Commonwealth of Independent States: Illusions, Disappointments and Hopes] (Moscow, 2001); V.A. Shul'ga et al., *Ekonomika SNG: 10 let reformirovaniia i integratsionnogo razvitiia* [The Economy of the CIS: Ten Years of Reform and Integration Development] (Moscow, 2001); N. Shumskii, "Obshchee ekonomicheskoe prostranstvo gosudarstv sodruzhestva: optimal'nyi format" [The Common Economic Space of Commonwealth States: Optimal Format], *Mirovaia ekonomika i mezhdunarodnye otnosheniia*, 2004, no. 2.

5. For example, M.B. Olcott, A. Åslund, and S.W. Garnett, *Getting It Wrong. Regional Cooperation and the Commonwealth of Independent States* (Washington, DC: Carnegie Endowment for International Peace, 1999).

6. For example, N.N. Constantinescu, ed., *History of Economic Cooperation in the Black Sea Area During the 20th Century* (Bucharest, 1997).

7. For example, A.M. Gegeshidze, "The South Caucasus: Getting Close to Europe?" *Marco Polo Magazine*, 1999, no. 1.

The possibilities of expanding cooperation of the countries of the South Caucasus with NATO are no less important in this regard (see F. Kune [Coene], *NATO i Iuzhnyi Kavkaz* [NATO and the South Caucasus] [Tbilisi: Kavkazskii institut mira, demokratii i razvitiia, 2003]).

8. For example, *Iuzhnyi Kavkaz—nestabil'nyi region "zamorozhennykh" konfliktov. Materialy mezhdunarodnoi konferentsii po Kavkazu Fonda Fridrikha Eberta, Berlin, 26–27 noiabria 2001 g.* [The South Caucasus: An Unstable Region of "Frozen" Conflicts. Materials of the Friedrich Ebert Foundation's International Conference on the Caucasus, Berlin, November 26–27, 2001] (Tbilisi, 2002); T. de Vaal [de Waal], "Ugrozy bezopasnosti na Iuzhnom Kavkaze" [Threats to Security in the South Caucasus], *Vestnik Evropy*, 2003, nos. 7–8; A. Rondeli, "Iuzhnyi Kavkaz i Rossiia. Vzgliad iz Tbilisi" [The South Caucasus and Russia. The View from Tbilisi], *Vestnik Evropy*, 2003, nos. 7–8; A. Iazykova, "Gosudarstva Iuzhnogo Kavkaza v novom geopoliticheskom izmerenii. Vzgliad iz Moskvy" [States of the South Caucasus in the New Geopolitical Measurement. The View from Moscow], *Vestnik Evropy*, 2003, nos. 7–8; V. Keshelava, ed., *Rossiisko-gruzinskie otnosheniia. Abkhazskii rakurs* [Russian-Georgian Relations. The Abkhazian Perspective] (Tbilisi, 2004); T. de Waal, *Black Garden. Armenia and Azerbaijan through Peace and War* (New York: New York University Press, 2003).

9. V. Papava, "O formirovanii ekonomicheskoi sistemy na Iuzhnom Kavkaze" [Formation of the Economic System in the South Caucasus], *Obshchestvo i ekonomika*, 2002, no. 1; V. Papava, "O kharaktere i perspektivakh razvitiia strategicheskogo partnerstva na Iuzhnom Kavkaze" [The Nature and Prospects for Development of

a Strategic Economic Partnership in the South Caucasus], in *Tsentral'naia Aziia i Iuzhnyi Kavkaz. Nasushchnye problemy* [Central Asia and the South Caucasus. Urgent Problems], ed. B. Rumer (Almaty, 2002); V. Papava and V. Kakabadze, "Strategicheskoe ekonomicheskoe partnerstvo na Kavkaze" [Strategic Economic Partnership in the Caucasus], *Caucasica. The Journal of Caucasian Studies*, 1998, vol. 2; V. Papava, "On the Possibilities and Prospects for the Formation of an Economic System in the Southern Caucasus," in *Central Asia and South Caucasus Affairs*, ed. B. Rumer and S. Y. Lau (Tokyo, 2002); V. Papava and N. Gogatadze, "Prospects for Foreign Investments and Strategic Economic Partnership in the Caucasus," *Problems of Economic Transition*, 1998, vol. 41, no. 5, pp. 79–88.

10. Iu. Iudanov, "Zakavkaz'e: otsenki investitsionnoi privlekatel'nosti" [Transcaucasia: Assessments of Investment Attractiveness], *Mirovaia ekonomika i mezhdunarodnye otnosheniia*, 1999, no. 11.

11. For example, F. Asadov, "Neftianye karavany XXI veka na Velikom shelkovom puti: perspektivy Azerbaidzhana i Kazakhstana" [Twenty-First Century Oil Caravans on the Great Silk Route: perspectives of Azerbaijan and Kazakhstan], *Tsentral'naia Aziia i Kavkaz*, 2000, no. 6; Z. Tevzade, "Eksportnye marshruty i problemy transportirovki kaspiskoi nefti" [Export Routes and Problems of Transporting Caspian Oil], *Tsentral'naia Aziia i Kavkaz*, 2004, no. 1.

12. A. Gegeshidze, "Eshche raz o Velikom shelkovogo puti" [Once Again About the Great Silk Route], *Tsentral'naia Aziia i Kavkaz*, 1999, no. 3 (4), p. 172; G. Goshadze and O. Sharadze, "Evraziiskii transportnyi koridor" [The Eurasian Transportation Corridor], *Obshchestvo i ekonomika*, 1998, no. 2; A. Martirosian, "Velikii shelkovyi put': etapy vosstanovleniia" [The Great Silk Route: Stages of Reestablishment], *Tsentral'naia Aziia i Kavkaz*, 2000, no. 6; V.G. Mitiaev, "Gruzii na Velikom shelkovom puti" [Georgia on the Great Silk Route], in *Gruzii: problemy i perspektivy razvitiia* [Georgia: Problems and Prospects of Development], ed. E.M. Kozhokin (Moscow, 2001), vol. 1.

13. For example, V. Maisaia, *The Caucasus-Caspian Regional Security Agenda in the 21st Century: Caspian Oil Geopolitics and Georgia* (Tbilisi, 2002).

14. For more on the significance and possibilities of partnership between Russia and the countries of the South Caucasus, see, for example, *Rossia i Zakavkaz'e: realii nezavisimosti i novoe partnerstvo* [Russia and Transcaucasia: The Realities of Independence and a New Partnership], ed. R.M. Avakov and A.G. Lisov (Moscow, 2000), pp. 171–207; *Ekonomicheskie strategii stran SNG i Rossia* [The Economic Strategies of CIS Countries and Russia], ed. A.N. Barkovskii (Moscow, 2003).

Against the background of causality of Georgia's economic relations with Russia (see E.M. Ivanov, "Ekonomicheskie otnosheniia Gruzii c Rossiei" [Georgia's Economic Relations with Russia], in *Gruzii: problemy i perspektivy razvitiia*, pp. 176–82), the significance and possibility of partnership between them take on special urgency.

It must be noted that the possibilities of strategic partnership in the region largely depend on "equalizing" the investment climate in Russia (Z.B. Marshall, "Russia's Investment Outlook," in *Russian-Eurasian Renaissance? U.S. Trade and Investment in Russia and Eurasia*, ed. J.H. Kaliski and E.K. Lawson [Stanford: Stanford University Press, 2003]) and in countries of the South Caucasus, as well as in countries of Central Asia (S.F. Starr, "The Investment Climate in Central Asia and the Caucasus" in *Russian-Eurasian Renaissance?*).