Russia and Georgia
The Ways Out of the Crisis

George Khutsishvili and Tina Gogueliani
(Editors)

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Post-Soviet Economic Relations between Georgia and Russia: Reality and Development Potential

Georgia-Russia economic relations became controversial already after the disintegration of the USSR. They are even more difficult at present.

After the five-day Georgia-Russia war in August 2008 and the recognition, by Moscow, of Abkhazia and South Ossetia independence, Georgia-Russia relations deteriorated a lot: Diplomatic relations have been terminated and top officials in both states refrain from holding a dialogue. This has, of course, influenced Georgia–Russia economic relations.

The purpose of this article is to investigate the nature of the main problems in the economic relations of these two countries and define, wherever possible, the ways of their improvement.

History in Brief

In the former USSR, economic relations between Russia and Georgia were built as a constituent part of the Soviet State, i.e. within the framework of integrated national economy. From the perspective of the Soviet Union’s administrative division, Georgia,

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like many other relatively small Soviet republics, was perceived as a part of the Transcaucasian economic region, rather than an independent entity. After the collapse of the USSR and the centralized economy, followed by breaking up of established production relationships between individual economic subjects, the enterprises in the post-Soviet space had to find a market to sell one’s own products. This turned out to be quite a difficult task given international competition, low quality of products and/or high production costs.

One of the first mistakes made by the Georgian authorities at the beginning of the 90s, was imposing economic blockade against Russia. Georgians blocked the Samtredia railway junction, as a result of which the existing production relationships between Georgia and Russia (and not only Russia) broke up earlier than in other post-Soviet republics. Thus, the first economic losses in Georgia-Russia relations were caused by the Georgian government.

The Commonwealth of Independent States was formed immediately after the collapse of the Soviet Union. All the former Soviet republics joined the CIS except for the Baltic states. According to a number of experts, the CIS has been experiencing certain difficulties with integration almost since the moment of its existence.

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5 Georgia joined the CIS later, at the end of 1993. This happened after the Georgian military forces, fighting for territorial integrity, had to leave Abkhazia, which resulted in a wave of thousands of internally displaced people. Hoping to regulate relationship with Russia, the government of Georgia took a decision to join the CIS to make Moscow benevolent. It has to be noted that Russia supported, from the very beginning, separatist movements not only in Georgia, but also in the other former Soviet republics. (See, Crossroads and Conflict: Security and Foreign Policy in The Caucasus and Central Asia, Gary K. Bertsch, Cassady Craft, Scott A. Jones, and Michael Beck, eds. New York: Routledge, 2000; Dov Lynch. Engaging Eurasia’s Separatist States.Unresolved Conflicts and De Facto States. Washington, D.C.: United States Institute of Peace Press, 2004).
of the main reasons is putting limitations on the integration processes by keeping it within CIS limits and making it similar to the industrial cooperation characteristic of the closed Soviet economic system. Russia’s military aggression against Georgia and unilateral recognition of Abkhazia and South Ossetia independence by Moscow questions the advisability of the existence of this organization, which only formally declares the inviolability of its member states’ borders. After the Russian aggression Georgia left the CIS, which, in addition to other problems, made the organization’s future even more questionable.

Already before the Georgia-Russia war in August 2008 that is in the year 2006 Russia punished Georgia for its western orientation by closing the Russian market for Georgian wines, mineral waters and agricultural products, in general. This was explained by low quality of Georgian products. However, high quality products were


not allowed to enter the Russian market, either. This served as a serious stimulus to start searching for other new markets.\(^{14}\) Although Moscow made a purely political decision to use economic measures to punish Georgia, this does not justify the insulting comments made by some of the high ranking Georgian officials.\(^{15}\) By doing so they insulted their own people, in the first place.

At present, an opinion prevails that just like official diplomatic relations; economic relations have been also cut between the two countries. This is not true, since Georgia ‘exports’ its labor force to Russia and Russia is one of the biggest ‘importers’ of investments into Georgia.

Despite quite limited external trade transactions, trading relations have not been cut between the two countries. According to the official statistics, the share of Georgian exports into Russia within the total volume of Georgian exports dropped from 17.8\% in 2005 (i.e. one year before Russia banned imports of food products from Georgia) to 2.0\% in 2008,\(^{16}\) and constituted 2.5\% for ten months in 2009.\(^{17}\) The same trend is observed in the reduction of the share of Russian imports into Georgia: In 2005, import from Russia into Georgia made up 15.4\%, in 2008; this showing decreased to 6.7\%,\(^{18}\) and constituted 6.4\% for ten months in 2009.\(^{19}\)

Many citizens of Georgia as well as ethnic Georgians, who have managed to receive Russian citizenship and are now residing in Russia,\(^{20}\) send some part of their


\(^{20}\) “Georgian Imports by Countries, 2009. External Economic relations”. Department of
earnings to the relatives living in Georgia. Introduction by Russia of visa regime with Georgia, the 2006 persecution of the ethnic Georgians (including Russia’s citizens) living in Russia, and a parallel development of the banking system, increased the use of bank channels for money remittances, which replaced the previously existing Soviet practice – delivering money to relatives via acquaintances returning to the home country.

This practice was not influenced even by Georgia-Russia war of August 2008. In particular, a total of 403 mln USD was transferred to Georgia in 2005, i.e. one year before Russia’s persecution of the Georgians. Out of this amount, over 240 mln USD was transferred from Russia, which made up 59.6% of the total of all the money remittances. Already in 2008, this figure increased 2.5 times as compared to the year 2005 and made up 1002 mln USD. Remittances from Russia increased 2.6 times and made up almost 634 mln USD or 63.3% of the total transfers. Due to the global financial crisis, remittances to Georgia in the first ten months of 2009 constituted 84% of the remittances in the first ten months of 2008. Remittances from Russia were even smaller and constituted only 72.4%, which can be mainly explained by the severity of the economic crisis in Russia.

As for Russia’s investments into Georgian economy, the statistical information is so incomplete (not only on Russian investments, by the way) that it does not allow making conclusions about the actual situation. This is primarily caused by the fact that many companies working on direct investments are registered in offshore zones, due to which it is impossible to trace back the origin of their money. Despite this, the problem with Russian investments in the post-Soviet space (and not only there) is related to the concept of ‘Liberal Empire’ which has been implemented since 2002.


Ibid
The Concept of ‘Liberal Empire’ and Georgia

Restoration of the empire even in a modernized form is always on Russian politicians’ mind,\textsuperscript{25} which has found its reflection in the concept of ‘Liberal Empire.’\textsuperscript{26} This concept implies that through economic expansion\textsuperscript{27} Russia can restore its influence in the entire post-Soviet space.\textsuperscript{28} It has to be noted that Chubais’ concept of ‘Liberal

\textsuperscript{25} It has to be noted that the restoration of empire has always been a topical issue for Russia (even immediately after the dissolution of the USSR) (Karen Dawisha. “Imperialism, Dependence, and Interdependence in the Eurasian Space”. In Adeed Dawisha, and Karen Dawisha, eds., \textit{The Making of Foreign Policy in Russia and The New States of Eurasia}. Armonk, M. E. Sharpe, 1995). This was primarily manifested in the preservation of the institute of Soviet citizenship in former Soviet republics (Nodari A. Simonia. “Priorities of Russia’s Foreign Policy and the Way It Works”. In Adeed Dawisha, and Karen Dawisha, eds., \textit{The Making of Foreign Policy in Russia and The New States of Eurasia}. Armonk, M. E. Sharpe, 1995, р. 22).


\textsuperscript{27} According to its architects’ plan, ‘Liberal Empire’ has to be formed through the ownership of the main economic objects (through the acquisition and development of assets) located on the territories of the former Soviet republics, rather than the occupation, by force, of these republics (Keith Crane, D. J. Peterson, and Olga Oliker. “Russian Investment in the Commonwealth of Independent States”. \textit{Eurasian Geography and Economics}, 2005, Vol. 46, No. 6).

Empire’ was especially popular in 1998-2005. 29

Russia started implementing its plan for the involvement of the Caucasus into the forming ‘Liberal Empire’ together with Armenia – its strategic partner in the region. The Russian-Armenian agreement ‘Property in exchange for debt’ was signed at the end of 2002. 30 Under this agreement Russia received from Armenia enterprises the value of which (93 mln USD) turned out to be enough to fully repay Armenia’s debts to Russia. At present, Armenia’s economy is fully absorbed by the Russian “Liberal Empire.” 31

Russia’s liberal-imperial plans in the Caucasus could be well illustrated by the following fact: Armenians transferred to the Russian monopolist ‘Russian railways’ (100% state owned) the management rights for the Armenian railways. These rights have been transferred for 30 years and can be extended for another 20 years after the initial 20 year operation period. This has been implemented through setting up a 100% daughter company ‘South Caucasus Railways.’ 32 The name of the latter reveals Russia’s intention to own not only Armenian, but also Azeri and Georgian railways.

Russia’s second move to restore its empire in the Caucasus implies the integration of Armenia and Russia into single economic space. Since Georgia’s geographic location impedes the accomplishment of this objective, Russia had to deal with Georgia in the first place. It should be emphasized that in case the ‘Liberal Empire’ plan is successfully implemented in Georgia, it will be easier to involve Azerbaijan, as all of its main transport and communication arteries (including the most important pipelines) run through Georgia.

The first attempt to involve Georgia into the ‘Liberal Empire’ was made in 2003, when Chubais’ RАО EES bought stocks and other assets of the American company ‘AES33- Silk Road’ – the owner of Tbilisi electricity distribution network, as a result

33 American Electrochemical Society
of which RAO EES managed to control 75% of the country’s electricity network.34

After the Rose Revolution the privatization price of many state owned companies was much higher than the price paid for the assets during Shevardnadze’s period, but due to the lack of transparency, Russian companies and their daughter companies, registered in third countries, managed to buy most new offers. The Russian holding company ‘Industrial investors’ is one of them. It managed to get the main gold mine and then half of the factory producing gold alloy.35

The main instrument for Russia’s foreign policy is Gazprom – the gas monopoly controlled by the state. Gazprom aimed at controlling not only Georgia’s gas industry, but also the only gas pipeline which carries Russian gas to Georgia and Armenia. If the US had not interfered in the negotiations between Georgia and Gazprom on the sale of the pipeline to the latter,36 the pipeline would be in Gazprom’s hands.37

Gazprom is not the only judicial person implementing the Russian policy in the Caucasus. In 2004, Russia’s state owned Vneshtorgbank bought controlling stake in the Armenian Armsberbank.38 Next year, the Vneshtorgbank bought controlling stake in the privatized United Georgian Bank, the third biggest bank in Georgia.39 Actually, the Vneshtorgbank nationalized the United Georgian Bank, but in this case its new owner became the Russian state.

As we see, this type of Russia’s activity in Georgia that started even before the Rose Revolution significantly intensified after the revolution,40 which was favored

by the Georgian Government.\textsuperscript{41}

Having said this, the idea that Georgia was considered to be totally lost for Russia does not seem to be correct.\textsuperscript{42} Neither does it seem to be true that Georgia and Armenia are not economically very attractive for Russia,\textsuperscript{43} since through involving these countries into the ‘Liberal Empire’ it becomes possible to involve also Azerbaijan, which is rich in carbohydrate resources.

Due to the above said, it is not at all surprising that the Russian side was not interested in developing a transport corridor through Georgia, or in constructing a pipeline, in particular. Moreover, it used (and still uses) any means to hinder the implementation of these projects.\textsuperscript{44}

**From the Pipeline ‘Cold War’ to ‘Pipeline Harmonization’**

It has to be noted from the outset that in the Russian policy implemented in the post-Soviet space there is a certain interrelatedness between ‘Energy Dependence’ and ‘Political Independence’, i.e. the growth of the former reduces the latter.\textsuperscript{45} It is not at all accidental that along with building the ‘Liberal Empire’ it is very important for Russia to form an ‘Energy Empire’ and steadily move in the direction of this objective.\textsuperscript{46} This is largely grounded on Putin’s myth about transforming Russia into an ‘Energy Superpower’.\textsuperscript{47} As a result, the energy policy of Moscow favors the formation of ‘New Economic Imperialism,’ extending not only to the outer world, but also to

\begin{itemize}
  \item Сергей Лунев. “Центральная Азия и Южный Кавказ как геополитические регионы и их значение для России”. *Центральная Азия и Кавказ*, 2006, № 3 (45), с. 26.
  \item Ibid.
\end{itemize}
Russia itself and its domestic economy. In this context, the Russian energy strategy needs to be considered also in relation to Europe.

At present, Russia, driven by the so-called ‘energy egoism,’ which is a constituent part of its nationalist view of the world, does its best to reach a dominant position in the Caspian basin.

Implementation of the cooperation and partnership principles in the Caucasus might guarantee that their interests will be met. However, unfortunately, it is just Russia that finds it most difficult to understand and follow these principles. For example, even Russian experts admit that Iran and Armenia are Russia’s strategic partners in opposing the creation of the Europe-Caucasus-Asia transportation corridor. Both Russian and Iranian experts emphasize that Russia’s and Iran’s interests in the region overlap with each other. This, especially, concerns Caspian energy resources (but not only). Russian experts also admit that Russia is waging ‘energy war’ with some

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of the former Soviet republics, including Georgia and Azerbaijan.\textsuperscript{56}

Appropriateness of such an evaluation of the Russia’s position on the transportation of Caspian energy resources via Georgia became evident during the Russian-Georgian war of August 2008, when the Russian aviation bombed, among other things, the pipelines running via the territory of Georgia.\textsuperscript{57} These pipelines are located far from South Ossetia, the protection of which was claimed to be the reason of the war. This made questionable the security of the transport corridor through which the pipelines run on the Georgian territory.\textsuperscript{58} In addition, this contributed to the increased danger of losing economic independence by Azerbaijan.\textsuperscript{59} Luckily, it did not take too long to rebuild trust regarding the transportation of energy resources through Georgia.\textsuperscript{60} The fact that Moscow did not manage to exercise control over these pipelines through military means,\textsuperscript{61} that is to fully monopolize the routes for the transportation of energy resources running from the former USSR in the direction of the West, even more


It should be noted that raising doubts about the security of the pipelines running through Georgia was one of the aims of the Russian aggression (Pierre Hassner. “One Cold War Among Many?”. Survival, 2008, Vol. 50, No. 4, p. 250).


encouraged Americans and Europeans to take efforts and search for alternative ways of gas and oil transportation. At the same time, the strengthening of the security of the existing pipelines on the territories of Azerbaijan and Georgia is becoming a topical issue for Ankara, Brussels and Washington. It is no less important that Kazakhstan, which has close ties with Russia, is also quite interested in the security of the transport corridor running through Azerbaijan in the direction of Georgia. The Caucasian energy corridor is becoming one of the major issues for the US administration. At the same time, many states interested in the diversification of the pipeline network are also making serious efforts.

All the above said shows the importance of new approaches to the diversification of the pipeline network, which has to be based, in the first place, on the replacement of the established paradigm of the so-called ‘alternative pipelines.’

Nowadays, the carbohydrate resources of the Caspian basin are regarded as alternatives to Russian carbohydrate resources and the pipelines transporting oil and gas (at present or in the future) from the Caspian basin to western markets bypassing Russia are considered to be ‘alternatives’ to the pipelines running through Russia’s territory. The term ‘alternative’ implies Russia’s confrontation with other countries. In other words, what we have is ‘pipeline confrontation’ or pipeline ‘cold war’ between Russia, on the one hand, and the West together with the transit states, on the other.

The examples of the Baku-Tbilisi-Supsa and Baku-Tbilisi-Ceyhan oil pipelines as well as of the South Caucasian gas pipeline illustrate the artificial character of such understanding of pipeline network development. In particular, the oil transported through these pipelines constitutes only 10% of Russian oil exports and the


gas transported through the South Caucasian pipeline – 2% of Russian gas exports. Given the proportion between the amount of oil transported by these pipelines and the total volume of Russian exports, the named three pipelines can hardly play the role of ‘alternative’ pipelines in relation to Russia. In reality, the three pipelines together with those running through Russian territories supplement each other. It is important, indeed, to have independent pipeline systems to ensure continuous gas and oil supply to customers even in unforeseen situations (e.g. malfunctioning for some technical reasons).

Therefore, it is necessary to shift from the ‘alternative pipeline paradigm’ to the ‘mutually supplementary pipelines’ or ‘pipeline harmonization’ paradigm. The latter is based on the partnership mechanisms interrelating those subjects who deal with gas and oil extraction, transportation and use. It is just consensus between all the parties that serves as a basis for ‘pipeline harmonization.’

It is very important to consider already discussed projects (White stream, Nabucco, North stream, South stream) within the ‘pipeline harmonization’ paradigm. For this purpose it is extremely important that all the interested parties take a decision to cooperate with each other so that the users are provided with an uninterrupted energy supply.

The Kremlin’s dualism or two different approaches applied to the same country

Russia applied to Georgia two approaches even before the Russia-Georgia war in August 2008. It would be enough to recall the following: The visa regime introduced by Russia for Georgian citizens did not apply to the Georgian citizens residing on the Abkhazian and South Ossetian territories. Later, Moscow initiated a free distribution of Russian passports to the residents of the named regions to strengthen Russia’s position, i.e. Russia could justify any military action by the protection of its own citizens.


The war in August 2008 fully fits into this scheme.

Having recognized the independence of both separatist regions, Moscow found itself in a paradoxical situation: It recognized the independence of two territorial entities the population of which was mainly represented by Russian citizens. Although the Kremlin likes to draw a comparison between Kosovo and Abkhazia-South Ossetia, we should keep in mind that before recognizing Kosovo’s independence, neither the US nor any other country encouraged the residents to accept their citizenship.69

Moscow’s decision to ban Georgian agricultural products in Russia was not applied to Abkhazia70, although that time the Kremlin was too far from recognizing its independence. Following Russia, Abkhazia also banned Georgian wines and mineral waters.71 At the same time, Moscow took a totally different decision regarding Abkhazian wines.72 All this was taking place long before the Russia-Georgia war in August 2008, not to mention the recognition of independence of the two Georgian regions.

At the same time, Moscow was not very much concerned about the fact that the conflict territories actually in the entire post-Soviet space, including the Caucasus, were developing not only into the stronghold of terrorism and a shelter for criminals in drug trafficking and drug trade business, but also into the zones for money laundering, kidnapping and human trafficking.73 In parallel, Russia threatened Georgia with war because of the Pankisi George long before the beginning of actual military actions.74

In other words, Moscow has been applying to Georgia two models of economic (and not only economic) relations for a long time, now. One of the models is meant for the separatist regions, the other – for the rest of Georgia.


This tendency has been naturally maintained since Moscow recognized Abkhazia and South Ossetia independence. By the way, the part of the world that supported Moscow’s initiative can be hardly called a progressive part of world civilization. By recognizing the independence of Abkhazia and South Ossetia, Russia even more reinforced their economic (and not only economic) integration into Russia. Nowadays, these separatist regions, like other regions in Russia, openly receive financial aid from Russia’s federal budget. For example, according to the information from the Ministry of Finance of the Russian Federation, the amount of financial aid to South Ossetia and Abkhazia in 2010-2011 will make up no less than 5.16 billion rubles.

Unofficially, Abkhazia and South Ossetia have the same legal status as the residents of Russian autonomies. As citizens of Abkhazia and South Ossetia they can take part in local elections; as the citizens of Russia they can elect the President of Russia and Parliament. To go abroad, the residents of Abkhazia and South Ossetia can use their Russian passports.

In addition to the above said, these regions are being militarized. This is an intense process which is implemented through setting up Russian military bases.

Here is a scenario that is quite likely to take place in the future: After making the right pause, the Kremlin will give an assignment to the puppet governments of Abkhazia and South Ossetia to hold a referendum on joining the Russian Federation. It is not difficult to predict referendum outcomes. We can also expect that Moscow will offer some artful justification of this kind of annexation. It might declare, for example, that since the international community (except for Russia and several less respectable countries) is still slow to recognize Abkhazia and South Ossetia, the only thing their population can do is to become a part of Russia. In other words, the Kremlin will try to put all the blame on the West, which, due to its reluctance to recognize the independence of Abkhazia and South Ossetia, will ‘force’ Russia to make these two territories into its members.

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75 Following Russia, the independence of Abkhazia and South Ossetia was recognized by Nicaragua, Venezuela and Nauru


78 Владимир Папава. “Россия: железная хватка Кремля”.
In the situation like this, the normalization of economic relations between Georgia and Russia (along with other issues, of course) does not seem to be easily achievable. The real solution of this problem is only possible in case the Kremlin stops applying dual approach to Georgia.

**Conclusion**

The analysis of the past economic relations between post-Soviet Russia and Georgia points to a number of problems. The fact that these problems have not been solved yet does not actually hinder the export of labor force from Georgia into Russia and the import of Russian capital into Georgia. In addition to this, these relations are not always identically perceived by Georgian and Russian communities: Russians are concerned about high number of labor migrants (coming not only from Georgia), whereas Georgians are scared of Russian investments perceived as a means to involve Georgia into the ‘Liberal Empire.’

Confrontation between Russia and the West regarding the provision of uninterrupted gas and oil supply (also bypassing Russia) has lasted for many years. As a result, Georgia, as a transit state, has many times found itself in a difficult situation. It’s time to radically change approach to the transportation of energy resources. In particular, it is necessary to shift from the ‘alternative pipeline’ paradigm, which is the basis of pipeline ‘cold war’ to a new paradigm – ‘pipeline harmonization’ paradigm, which implies cooperation in the development of a pipeline network. Such cooperation will involve not only producers and users of energy resources, but also all the transit countries.

The Georgia-Russia war in August 2008 and Russia’s recognition of Abkhazia and South Ossetia in the status of independent states largely deteriorated Georgia-Russia relations. Unfortunately, there is no doubt that among other things Moscow applied two models of the economic approach to Georgia. One of them was meant for Abkhazia and South Ossetia, the other—for the rest of Georgia. Such a dual approach was even more reinforced after Russia’s recognition of Abkhazia and South Ossetia. At the same time, less aggressive economic policy towards Georgia (we know that Russia’s economic aggression resulted in banning Georgian products, cancelling flights between the two countries, etc)\(^79\), will not dramatically change their relationship without

restoring Georgia’s territorial integrity (the territorial integrity required by Georgia is not an extraordinary, because for Russia the problem of the territorial integrity is doubtless). It would be also a mistake to wait until Russia changes its previous decision on the recognition of independence of the two regions (which would mark the beginning of their integration into Georgia) and not to make any efforts to more or less normalize relationship between the residents of Russia and Georgia, irrespective of their citizenship. Establishing basic interpersonal and economic relations is not something you can put on the shelf.