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Prospects for Foreign Investments and Strategic Economic Partnership in the Caucasus

The economy of the former Soviet Union was characterized by a high degree of integration of the economies of all of the Union republics, and was based on an explicit nationwide division of labor. This explains why the existence of the entities of the Union in a unified nation for seventy long years has left a profound imprint on their economic systems, which were formed with an orientation toward a unified economy; after the breakup of the USSR, all of the newly formed nations effectively faced the necessity of forming their independent national economic systems all over again, each representing individual elements of a previously unified complex interconnected in structure, disposition of productive forces, technologies utilized, and principles for the organization of production.

The situation that took shape after the breakup of the USSR was aggravated by the circumstance that the still essentially Soviet economy encountered a global crisis that visibly revealed the sluggishness of the command-administrative structures, which proved unable to react quickly and efficiently to innovations. The prolonged mobilization of natural, labor, and capital resources on an extensive basis, along

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with the growing foreign economic burdens and the associated constant decline in the efficiency of the economy, led in the 1980s to a situation where it was necessary to increase the share of accumulation even just to support zero growth. The preconditions for destabilization and crisis in the financial situation were formed during this same period. The crisis processes were advanced by political factors during 1989–91 as well. As a result, the drop in production and investment activity, destruction of business ties among enterprises, collapse of the financial system, loss of control over the monetary and credit sphere, bankruptcy in foreign policy and currency, and collapse of state political and economic structures were apparent by the time of collapse of the Union.

Moreover, the diversity of natural and climatic conditions, the high level of sufficiency of natural and human resources, and a number of external factors conditioned the relatively self-contained nature of the economy of the USSR in relation to the world economy. The material and technical base of the economy of the USSR was functionally outmoded compared to progressive international standards as a whole. A situation was created after the collapse of the unified economic system and the appearance of financial difficulties, both at the level of the newly created nations and at the level of the individual enterprises, wherein the intrinsic capabilities for technological renewal proved to be paltry in practice.

As a result, functionally outdated equipment was physically depreciated as well. This, in turn, is the main reason for the fact that most of the goods produced in the post-Soviet countries proved not to be market competitive (owing to their poor quality and/or high production costs), making it impossible to penetrate world markets and actively integrate into the world economic system.

All of the aforementioned pertains in one way or another to all of the former entities of the Union, and to the Caucasus region in particular.

Three sovereign nations of the Transcaucasus and ten entities of the Russian Federation (including Chechnya), inhabited by representatives of more than fifty nationalities and ethnic groups, are located on the comparatively small territory of the Caucasus, which is distinguished by great diversity of terrain and natural and geographical conditions. The Caucasus has always been a conglomerate of contradictions and is even more so today. This has been confirmed in recent years by the

political processes that have been taking place in the region, and by the number of nationality and ethnic conflicts that periodically break out, fade away, and then worsen again in various corners of the Caucasus. These problems of the social and political life of the peoples of the Caucasus are so global in significance that they should be relegated not only to the political, social, and moral planes, but also, to no less a degree, to the economic plane. The military operations and the destruction, casualties, and social problems they cause, owing to the presence of a large number of refugees and the blockade of transport arteries, cannot fail to have a substantial impact on the economic situation and the realization of production capabilities in the nations and administrative territorial formations of the Caucasus.

As a result of the effect of these political, economic, and other factors, virtually all of the subjects of the Caucasus have been drawn to one extent or another into a profound crisis that encompasses all spheres of their vital activity, and has led to drastic declines in production, a high level of inflation, and a drop in the population's standard of living. For example, in Georgia, the production volume of the gross domestic product declined by 4.5 times during 1989–94, inflation reached 68 percent a month, the percentage ratio of the minimum wage and the subsistence level was not more than 2 percent in 1994, and the country's total foreign debt exceeded U.S. $1 billion.[1] The production volume of GDP in Azerbaijan in 1996 was 42 percent of the 1990 level[2]; oil production dropped sharply after 1991; agricultural production dropped to minimal levels; and prices for agricultural products had increased by 566 times in 1996 compared to 1992, and for material and technical resources by 976 times.[3] The economy of Armenia was in collapse until 1994, with GDP in 1993 at one-third of the 1989 level, about 80 percent of the population of the republic living below the poverty line, and foreign debt estimated at approximately U.S. $550 million.[4]

Since 1994–95, thanks to the active pursuit of a policy of reform, a trend toward the stabilization and resurgence of the economy has been observed in the nations of the Transcaucasus, but the consequences of the crisis are so profound that overcoming them could take many long years and will not be managed without the implementation of a radical, constructive domestic economic policy, an optimal combination of the interests of the state and territorial formations of the region, and the active involvement of foreign investment.

The development of the economy of one or another country depends largely on the extent to which foreign economic factors are borne in mind in the formation of intrinsic economic policy. Taking the principal trends in international relations into account and finding one's own place in the world economic system have particular significance. This tenet should be a fundamental one in determining the strategic directions of economic development and the priority aspects of economic reform in the countries of the Caucasus.

The economic progress of the nations of the Transcaucasus and the entities of the Russian Federation located in the North Caucasus will be predetermined to a significant extent by the extent and pace of their integration with the civilized world. Taking into account the contemporary state of the economy and the production potential of the state and territorial formations of the Caucasus, the task of integrating cannot be considered to be among those easily accomplished. The truth must be told that, despite the political complexities that exist here, the Caucasus region is not at all isolated from the rest of the world. First, it is a constituent entity of the Commonwealth of Independent States [CIS]; second, Azerbaijan, Armenia, Georgia, and the Russian Federation are members of the Black Sea Economic Alliance; and third, all three nations of the Transcaucasus virtually simultaneously signed agreements on collaboration and partnership with the European Union, and are setting up bilateral trade and economic relations with many of the nations of the world community. All of these directions of international integration, however, cannot be perceived as the sole necessary and sufficient condition for the region to join the world market. The Commonwealth of Independent States is currently experiencing a certain stagnation of integration processes, and, for well-known reasons, it is moreover unable to provide for the incorporation of international production standards; on the contrary, it is limiting integration processes to the boundaries of the CIS by analogy with the self-contained production cooperation that was characteristic of the economic system of the Soviet Union. Although it has great prospects and thus requires particular attention, the Black Sea Economic Alliance is nonetheless a comparatively new international regional formation, and does not yet possess the requisite degree of integration and vigor in its mutual relations to have a marked influence on the economic development of its member nations. Collaboration with the European Union and the economically developed European nations is not being implemented on

principles of equal partnership today. What is taking place here is more a process of assistance in the assimilation and adoption of democratic principles for the structuring of social and political life and market mechanisms for economic management. Moreover, the advanced countries of the world are still taking a wait-and-see attitude, watching the course of development of events in the Caucasus. From their point of view, the Caucasus is still a "hot spot" that does not possess sufficient political and economic stability to actively attract economic partners.

At the same, one also cannot fail to take into account that the relatively small size of the countries of the Transcaucasus and the administrative and territorial entities of the North Caucasus also determines the correspondingly small size of their markets. If we were to extrapolate from the prevailing conflicts in the Caucasus region and consider, at least theoretically, the possibility of the existence of a unified market in the Caucasus, the size of such a market, even an idealized one in that case, would remain small, and would not be very attractive to the "high and mighty."

All of this testifies to the need for interaction among the entities of the Caucasus region to create the preconditions for the rapid and steady development of their economies, and to deepen economic partnership in the Caucasus. Joint efforts will also make it possible to compensate for the "harm" caused by the aforementioned "unattractiveness" of the region to foreign partners, and to find new opportunities to attract foreign investments.

Judging by the data of recent years, the Caucasus region is far from distinguished in investment activity, either from the standpoint of the intrinsic investments of the entities in the Caucasus or on the plane of investing by foreign companies.

Some data reflecting investment activity in the countries of the Transcaucasus are given in Table 1.

These data testify both to the extremely low investment activity and to the unsatisfactory state of the economy of the states in the Transcaucasus region as a whole. The structural changes—characterized by the decline in the share of the production of goods, the rise in the share of services, the decline in the share of sectors with a high degree of product processing, and the rise in the proportionate share of sectors of a raw-material and semi-raw-material nature, and, finally, the reduction in the share of accumulation compared to the share of

Table 1

Investment Activity in Countries of the Transcaucasus, 1995–96 (as %)

	Georgia	Azerbaijan	Armenia
Proportionate share of all capital investment in volume of GDP (1996)	3.0	23.0	7.0
Level of investments in fixed capital (1996)	5.0	93.0	No data
Share of investments made in social infrastructure (1995)	56.9	44.7	55.7
Proportionate share of resource-producing sectors in the overall volume of industrial investments (1995)	77.2	90.0	99.0
Proportionate share of all resource-conserving sectors in overall volume of industrial investments (1995)	22.6	4.6	0.9

Source: "Strukturnye izmeneniia v ekonomikakh gosudarstv—uchastnikov SNG v 1991–1996 g.g. (analiticheskii doklad)," International Economic Committee of the Economic Union of the CIS, Moscow, 1997.

consumption in the utilization of GDP—are eliciting particular concern.

All of this confirms once again the necessity of increased economic collaboration among the state and territorial formations of the Caucasus, and their finding of common spheres for the attraction of foreign investments to the region.

The data on Georgia's trade with Azerbaijan and Armenia given in Table 2, for example, testify to the mutual vested interest of the nations of the Transcaucasus in the development of economic relations among themselves.

With regard to the question of attracting broad-scale investment to the Caucasus region, the chief problem here is to reduce the high risk of long-term investments, owing to which investment activity in the Caucasus remains fairly unattractive. At the same time, there are areas in the region that could be of special interest to foreign investors. In this connection, it is sufficient to mention the oil of the Caspian basin and the Transcaucasus transport corridor linking Europe and Asia to conclude that the Caucasus is acquiring a special function, and that "cementing" their presence in this region will become a strategic

Table 2

Georgia's Trade with Azerbaijan and Armenia, 1995–97
(millions of U.S. dollars)

	Azerbaijan			Armenia		
	1995	1996	1997	1995	1996	1997
Import of goods into Georgia	47.7	71.2	105.9	11.1	15.7	20.8
Export of goods from Georgia	12.7	24.8	25.1	18.9	20.5	18.9

Source: "Sotsial'no-ekonomicheskoe polozhenie Gruzii," *Statistical Collections of the State Department of Statistics of Georgia*, 1995, 1996, 1997.

task for many nations and leading companies of the world.

An increased rate of economic growth in Azerbaijan could be chiefly conditional upon an increased volume of petroleum production and the development of the petroleum refining industry. This is confirmed at least by the fact that the increase in Azerbaijani exports to U.S. $850 million (in 1996) was achieved for the most part thanks to petroleum exports, while direct foreign investments in the Azerbaijani economy, which have reached U.S. $1 billion, have been intended by and large for the development of the petroleum industry.[5]

At the same time, both the problem of the development of the oil industry and the future economic development of the entire Caucasus region depend largely on setting up the transport arteries of the "Europe–Caucasus–Asia" transit corridor. The practical realization of this plan began with the implementation of the project known as TRACECA (Transport Corridor Europe–Caucasus–Asia), with the European Union as its principal ideologue and sponsor.

TRACECA is today considered to be a transit corridor that will supplement and develop already existing routings, first and foremost European ones. In this regard, opportunities will arise to unite the transport systems of the Black Sea, and the Caspian, Adriatic, and Mediterranean seas. Speaking in favor of the attractiveness of the TRACECA project is the fact that the development of thirty-five specific programs is currently underway within its context. The total cost of the programs with the participation of Georgia alone, of which there are sixteen, exceeds 500 million ECU, including 176 million ECU for the

development of the maritime port of the city of Poti. The general TRACECA project also includes programs for the rehabilitation of highways in Armenia, and for the upgrading of the port of Baku, the port of Turkmenbashi, and the port of Aktau in Kazakhstan, and others.

No less important is the resolution of the issue of the transmission of energy resources by oil pipeline. In particular, the Azerbaijani–Georgian transport routing for [Iranian] oil is one of the priority large-scale projects in Georgia, attracting considerable foreign investments. At the same time, the realization of this project will create the preconditions for more active investment in other spheres of the economies of Azerbaijan and Georgia. The cost of the project on the territory of Azerbaijan and Georgia as a whole is roughly U.S. $350 million. The work, subject to implementation on the territory of Georgia, includes: the rehabilitation of the existing petroleum pipeline; the replacement of damaged sections; the construction of a new section of pipeline (39.5 kilometers); the rehabilitation and construction of pumping and pressure-reduction stations; the construction of a terminal in Supsa; and the creation of a maritime off-loading installation.

It must generally be noted that the state of the fuel and energy complex is a very important measure of the production capabilities of any nation. In this regard, the combination of efforts of the entities in the Caucasus aimed at the integration of their energy systems seems most topical. The nations of the Black Sea basin have now realized the practical necessity of the joint resolution of the energy problems of the region, and they unequivocally support the concept of a unification of the power systems of the member nations of the Black Sea Economic Alliance, the realization of which will make it possible to utilize the energy resources of the nations in the basin, to increase the reliability of the energy supply, and to carry out both mutually advantageous exchanges between neighboring power systems and transit cross-flows to other countries. The creation of a new electric power association within the framework of the international project "The Unification of National Power Systems of the Countries of the Black Sea Region," as well as the Energy Assembly of the countries of the Black Sea basin, is proposed for the realization of this concept.

Considering various aspects of the economic development of the whole geographic region and the mutual relations of the state and territorial formations located in it, we also need to touch on the question of the emergence of economic rivalries between individual entities

in the region. The theory of multilateral competition knows various levels of manifestation, at the level of firms, industries, countries, and regional formations. Competitors, as a rule, should be characterized by more or less identical economic might and identical directions in the selection of strategic interests, which defines the intersection of their economic pretensions as well.

The competitive ability of a country depends first and foremost on how productively national natural, labor, material, and financial resources are utilized. At the same time, any competition is an incentive to improve to a certain extent. The level of productivity in each individual country would effectively not depend on the conditions in other countries were there no international competition, while international flows of goods and capital are an opportunity to enhance productivity in the utilization of the resources of a country, to eliminate the necessity of independently producing all of the goods and services, and to specialize in those sectors of the economy and market segments where the country is relatively more competitive. Proceeding from this, the conclusion may be drawn in practice that some entities in the Caucasus region are not strategic competitors on an economic plane. For example, Azerbaijan has oil, while Georgia has maritime access to the ocean; both countries are on the "right-of-way" of the Transcaucasus corridor; and each possesses its own, in a number of cases unique, production potential. All of this determines the postulate that Azerbaijan and Georgia cannot be considered competitors; they are more likely to be economic partners.

Georgia has a vested interest in seeing that Caspian oil (and not just Caspian oil) be transported to the West across its territory, which is simultaneously in the economic interests of Azerbaijan as well, because in that case all possible freights from East to West and vice versa would pass across its territory as well.

The lack of economic competition between the countries of Georgia and Azerbaijan cannot be perceived in any way as the cause of the lack of market incentives for development; these countries have other competitors as well, and they themselves taken together should be regarded as economic partners in interregional competition. The economic partnership of Azerbaijan and Georgia could become (and, as practice shows, is indeed gradually becoming) a "magnet" for attracting the other entities of the Caucasus as well.

The processes of economic integration in the Caucasus region have

enormous significance for the active inclusion of the economies of each of the entities of the Caucasus in the regional, and then the world, market system. The principal directions of economic partnership in the Caucasus should be the establishment of stable cooperative ties in the fuel and energy complex, machine building, the food supply, the production of consumer goods, and the transport sphere; the application of joint efforts toward the rational utilization of the advantages of the geopolitical situation in the Caucasus and its economic potential; the convergence of the principal conditions of market activity in the region; the creation of a model for a regional economic system; and the formation of an efficient system for regulating integration processes. The Caucasus region as a whole is to a certain extent a unique territorial and production complex, and possesses significant potential for making it possible to solve the problem of its economic development; the further economic progress of all entities in the region thus largely depends on the collaboration of the state and territorial formations of the Caucasus.

Notes

1. According to data of the State Department of Statistics of Georgia.

2. "Osnovnye makroekonomicheskie pokazateli stran SNG 1990–1996" [The Principal Macroeconomic Indicators for the CIS Countries for 1990–1996], *Statisticheskii sbornik Mezhgosudarstvennogo statisticheskogo komiteta SNG* [Statistical Collection of the International Statistical Committee of the CIS]. Moscow, 1997.

3. "O khode ekonomicheskikh reform v gosudarstvakh—uchastnikakh SNG" [The Course of Economic Reforms in the CIS Member Nations], *Analiticheskii doklad Mezhgosudarstvennogo ekonomicheskogo komiteta Ekonomicheskogo Soiuza SNG* [Analytical Report of the International Economic Committee of the Economic Union of the CIS]. Moscow, 1997.

4. "Dresdner Bank ob ekonomicheskom polozhenii Zakavkazskikh respublik" [Dresdner Bank on the Economic Situation in the Transcaucasian Republics], *Biulleten' inostrannoi kommercheskoi informatsii NII kon"iunkturnykh issledovanii Rossiiskoi Federatsii* [Foreign Commercial Information Bulletin of the Scientific Research Institute for Competitive Market Studies of the Russian Federation], no. 23, February 26, 1998.

5. Ibid.