REGIONAL ECONOMIES

RUSSIA AND THE SOUTHERN CAUCASUS: REALITY AND ECONOMIC COOPERATION STRATEGIES

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The Southern Caucasus is one of the most important geopolitical and geo-economic CIS zones in Russia's sphere of vitally important interests. One of the main reasons for this is Russia's close historical, geographical, economic, political, and strategic ties with this region's countries—Azerbaijan, Armenia, and Georgia. However, the instability in this potentially conflict-intensive region is having a strong impact on the situation in the Northern Caucasus and on the security of the Russian Federation as a whole. The South Caucasian vector is the "hottest" area of Russian foreign policy. It is characterized by dynamic, complicated, and urgent problems, which have geostrategic dimensions.

The geo-economic significance of the Southern Caucasus for Russia is defined by many factors. The region has large promising supplies of hydrocarbons (in the neighboring Caspian zone), as well as deposits of polymetallic ores (manganese, copper and molybdenum concentrates, and so on). Its strategic value as a transit territory is also growing, through which gas and oil pipelines linking Europe and Asia are beginning to be built.

The South Caucasian states are also interested in close cooperation with Russia. They are tied to their northern neighbor by a common history, as well as cultural and human relations. What is more, these countries are very economically dependent on the Russian Federation. They depend on Russian deliveries of energy resources, metals, lumber, and products of the machine-building and chemical industries, as well as foodstuffs for ensuring their normal functioning, on the one hand. While on the other, Russia is an attractive and receptive sales market for the traditional products of the agroindustrial sector of these countries: tea, tobacco, vegetables, citrus fruit, cotton, wines, as well as industrial commodities and raw materials. What is more, the tension which arose on the labor market due to the lingering conflicts, economic crisis, unemployment, and social instability in these countries has largely been defused by labor migration to the Russian Federation. In the past ten years, labor migration alone has resulted in the departure of an average of 20-25% of the titular nation from the South Caucasian republics.[1] According to the available assessments, the amount of foreign currency legally exported from Russia by the South Caucasian diasporas amounts to approximately 5-7 billion dollars a year. It is these transfers that fill the family budgets of much of the South Caucasian population and prevent a drop in the standard of living below the mark conducive to political destabilization.[2]

But despite the favorable prerequisites, in the post-Soviet period, relations between Russia and these states have developed laboriously and contradictorily, which was due to the ambiguous and inconsistent policy of the leaders of these newly independent states, as well as to the severe socioeconomic situation in the region, the unresolved ethnopolitical conflicts, and the opposition of some Western states to rapprochement among the former Soviet republics.

The difficult economic situation of the latter compelled them to look for solutions to the economic crisis in the "far abroad." The situation was aggravated by the Russian Federation's economic weakness, due to which it could not render the necessary economic assistance to its South Caucasian partners or become a driving force propelling them out of their quagmire. The faux-pas made by the Russian leadership in its relations with these governments also played a negative role.

[1] See: *Rossia i Zakavkazie: realii nezavisimosti i novoe partnerstvo*, Finstatinform, Moscow, 2000, p. 124.

[2] See: *Iuzhny flang SNG. Tsentral'naia Azia-Kaspii-Kavkaz: vozmozhnosti i vyzovy dlia Rossii*, Logos, Moscow, 2003, p. 18.

Foreign Economic Potential of the Region's Countries

The South Caucasian republics established their sovereignty while profound changes were going on in their economies. The transition to a market economy aggravated the breakdown in economic ties with the former Soviet republics, which manifested itself in an abrupt reduction in industrial and agricultural production and a drop in the standard of living among most of the population. Several specific circumstances had a negative effect on these changes: the ethnic confrontation in Georgia, the Karabakh conflict in Azerbaijan, and the economic and transport blockade in Armenia, which caused political instability in Azerbaijan and Georgia. What is more, the South Caucasian states differ immensely from each other in terms of production potential.

By 1995, Azerbaijan's GDP abruptly fell to 42.1% of the 1991 level, Armenia's to 59.8%, and Georgia's to 35.8%. In subsequent years, the economies of these countries gradually recovered. But the 1998 financial crisis had a negative effect on the situation in Russia, as a result of which in 2000, Azerbaijan's GDP amounted to 59.3% of the 1991 level, Armenia's to 76.9%, and Georgia's to 47.5%.[3]

The situation in the production sphere in these countries shows the virtual loss of their industrial and agrarian status. The drop in production in the key branches of industry is having a particularly negative effect on the prospects for economic revival. The industrial production volume in 1995 amounted to 33% of the 1991 level in Azerbaijan, 50% in Armenia, and 18% in Georgia. By 2000, the situation had not changed much. The industrial production volume amounted to 35% in Azerbaijan, 56% in Armenia, and 24% in Georgia.[4] Large foreign investments were the only thing that saved Azerbaijan from a slump in the oil industry (oil production even increased from 11.7 million tons in 1991 to 14.1 million tons in 2000). In contrast to Azerbaijan, Armenia does not have large supplies of energy resources. Oil deposits were found in Georgia, on the Black Sea shelf, but their prospects have not yet been determined, and the fields currently under development (annual production exceeds 100,000 tons) are not enough to cover the country's domestic needs. So in the foreseeable future, Armenia and Georgia will feel an acute shortage of energy resources.

[3] See: *10 let SNG (1991-2000). Statsbornik (Statistics Reference)*, Moscow, 2001, p. 18.

[4] Ibid., p. 46.

The ruling circles of the South Caucasian republics tried to avoid an abrupt drop in agricultural production, understanding that this could lead to food shortages in the cities. In 2000, the indices in these spheres (in terms of the 1991 level) amounted to 64% in Azerbaijan, 112% in Armenia, and 90% in Georgia,[5] which were largely achieved due to the significant increase in the number of people employed in agriculture. On the whole, over a span of ten years, grain production grew by 16% in Azerbaijan, while it dropped by 22% in Armenia, and by 13% in Georgia, which shows a tendency toward increased dependence of the latter two countries on import. During the same period, grape harvesting significantly decreased: in Azerbaijan 15-fold, in Georgia 2.5-fold, and in Armenia almost 2-fold. In these countries, grapes are the raw material for producing traditional wines, which are largely exported. What is more, the cotton harvest dropped almost six-fold in Azerbaijan.

The crisis situation in the economy also predetermined the reduction in the foreign trade potential of these countries. For example, compared with the 1991 level, the volume of export-import transactions in 2000 amounted to 25% and 20% in Azerbaijan, 11% and 21% in Armenia, and 10% and 18% in Georgia, respectively.[6] Their commercial operations with CIS countries have dropped dramatically, falling to 3-10% during the indicated period. In 2000, the percentage of reciprocal trade among these countries amounted to 20.9% of the total foreign trade turnover volume in Azerbaijan, 20.8% in Armenia, and 36.7% in Georgia.[7] At the same time, the export-import operations with third countries increased.

In international labor division, the states of the region act as exporters of raw goods, unprocessed and semi-processed materials, a few foodstuffs, and raw agricultural products. The percentage of equipment, machinery, and transportation means in the total volume of deliveries to the foreign market is not high, but these products constitute a significant part of their import, mainly from the West. In this respect, in the near future, the foreign currency revenue received by the South Caucasian states from export of their products will lag behind their import expenses. And only Azerbaijan will be able to balance commerce with its Western partners (by means of an increase in oil deliveries), while there is a negative balance in trade exchange with CIS countries.

The positive economic dynamics designated in the region's republics on the threshold of the new century indicated that the initial stage in the transition to a market economy was over and that they had affirmed themselves as independent states after the collapse of the U.S.S.R. (see the table).

The relatively high GDP and other macroeconomic index growth rates in recent years are largely explained by the low base for comparison and are still not enough to fully compensate for the severe economic drop noted at the beginning of the 1990s. Only Armenia managed to raise its GDP to 108.2% (of the 1991 level) in 2003, in Azerbaijan this index was 80.1%, and in Georgia, 57.1%. But enormous resources are needed to bring the industrial production volume back up to the level of the beginning of the 1990s. (In 2003, the industrial production volume in Armenia amounted to 77% of the 1991 level, in Azerbaijan to 40%, and in Georgia to 27%.)

In recent years, the investment growth rates in basic capital surpassed the GDP growth rates. But the volume is still insufficient to ensure a stable upswing in the economy. While the possibilities for raising production using morally and physically outmoded and worn-out fixed assets have essentially been exhausted.

The diversification of foreign economic ties achieved in the South Caucasian countries is creating certain prerequisites for expanding their participation in international labor division, but due to their limited foreign trade potential, they do not have sufficient conditions either for comprehensive production modernization, or for creating competitive high-tech systems. In 2002, the ratio of export and import to the GDP amounted to 43.8% and 51.2% in Azerbaijan, 29.6% and 47.2% in Armenia, and 27.4% and 39.1% in Georgia.[8]

The improvement in the macroeconomic situation helped to increase the foreign trade turnover of these states. But in the mid-term, their overall economic situation is unlikely to seriously change (with

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[5] See: *10 let SNG (1991-2000). Statsbornik (Statistics Reference)*, Moscow, 2001, p. 46.
[6] Ibid., p. 8.
[7] See: *Vneshniaia torgovlia stran SNG*, Moscow, 2003, p. 25.
[8] See: *Vneshniaia torgovlia stran SNG*, p. 25.

Macroeconomic Indices of the South Caucasian Countries
(*in % of the previous year*)

	2000	2001	2002	2003	2003 (1991=100)
Gross Domestic Product					
Azerbaijan	111.1	109.9	110.6	111.2	80.1
Armenia	105.9	109.6	112.9	113.9	108.2
Georgia	101.8	104.8	105.5	108.6	57.1
Industrial Production Volume					
Azerbaijan	107	105	104	106	40
Armenia	106	105	115	115	77
Georgia	111	95	107	111	27
Investments in Basic Capital					
Azerbaijan	103	121	184	171	790
Armenia	127	106	145	141	—
Georgia	97	111	118	168	54

Source: *CIS in 2003. Statistics Reference*, Moscow, 2004, pp. 25, 36, 47.

respect to a qualitative improvement in production and foreign trade potential), unless the leaders of these countries make radical adjustments to the economic development strategy.

State of Reciprocal Trade

Despite the increase in foreign trade of the region's countries in recent years, their percentage in the total volume of Russia's goods turnover is extremely modest. In 2003, it amounted to a mere 0.5%, and to 3.1% in the Russian Federation's total volume with the CIS countries. In Russia's trade with the South Caucasian countries in 2003, Azerbaijan accounted for 50.2%, Armenia for 28.5%, and Georgia for 21.3%, while bilateral goods exchange was not balanced. In 2003, Russia's positive trade balance with Azerbaijan amounted to 235.7 million, with Armenia to 113.2 million, and with Georgia to 74.2 million dollars.

In the foreseeable future, the region's countries will urgently need to maintain a high level of goods exchange with their northern neighbor, since Russia is still their most important trade partner. In 2003, goods turnover with Russia in the total trade volume amounted to 10.2% in Azerbaijan (in exchange with all the CIS countries—44.9%), to 15.5% and 69.3% in Armenia, and to 15.0% and 39.3% in Georgia, respectively. Although the economy of the South Caucasian republics is still closely tied to the Russian economy, they are not nearly as interdependent as they were at the beginning of the 1990s.

The economic trade ties between Russia and Azerbaijan developed under conditions of an acute economic crisis and negative factors in bilateral political and economic relations. In particular, the latter included the Baku leadership's displeasure with official Moscow's stance on the Karabakh problem and with the close cooperation between Russia and Armenia, the closing of the Russian Federation's border with Azerbaijan during the Chechen war, and Baku's striving to expand ties with Western countries and establish strategic partnership with the U.S., the EU countries, and Turkey. This had a negative effect on economic cooperation between Russia and Azerbaijan and on goods exchange between them.

In 2003, Russia's percentage in Azerbaijan's export amounted to 10.2% and to 14.6% in its import. Approximately 40% of Russia's deliveries to Azerbaijan consist of foodstuffs and the raw material for their production (grain, flour, and cereals), 16% of machinery and equipment, 12% of lumber and lumber products, and 9% of ferrous and nonferrous metals.

Foodstuffs predominated in Russia's import from Azerbaijan: tobacco, fruit, alcoholic beverages—52%, cotton, cotton fiber, and yarn—8%, and petroleum products—12%. In compliance with a bilateral contract on oil transit (signed on 18 January, 1996), Azerbaijan is pumping oil via the Baku-Novorossiisk route (in 2003, 2.7 million tons). The Russian Itera and Transneft companies deliver natural gas to Azerbaijan (in 2003, around 5.5 billion cubic m, in 2004, according to preliminary data, 4.5 billion cubic m).

The transport factor is having a negative effect on the development of trade between Armenia and Russia, as a result of which even traditional ties are at times economically inexpedient. The Karabakh conflict has deprived Armenia of its rail communication with Turkey and Azerbaijan. At present, almost 90% of Erevan's foreign freight is transported by Georgian railroad, as well as via its Black Sea ports of Poti and Batumi. High transportation costs make many Armenian goods uncompetitive on the foreign markets. In 2003, Russia's percentage in Armenia's export amounted to 13.9% and to 16.4% in import.

Machinery and equipment occupy 38.4% in Russia's deliveries to Armenia, metals and metal products to 19.1%, foodstuffs and raw agricultural products to 12.0%, and chemical industry products to 9%. What is more, energy resources, raw diamonds, and equipment for the Armenian nuclear power plant constitute the lion's share. Foodstuffs and raw agricultural products account for 70% of Armenia's deliveries to Russia, including 62.1% in hard liquor, 10.8% in unprocessed aluminum, 5% in machinery, equipment, and transportation means, and 3.7% in mineral products.

Moscow managed to settle the problem of Erevan's state debt taking over five of the country's enterprises. But debts on gas delivered by the Itera Company (23.8 million dollars at the beginning of 2004), goods from the Roskontrakt Company amounting to 28.28 million dollars, and products from the Almaziuvelirexport Company of 1.6 million dollars have still not been settled.

The development of cooperation between these countries is promoted by the favorable political climate and the largely homogeneous economic environment. But their economic trade relations lag behind the high level of political cooperation between the partners.

Georgia's trade with Russia is seriously aggravated by the absence of direct transportation routes, which is explained by the unsettled conflicts in Abkhazia and South Ossetia. The only railroad and the one highway which link these countries pass through Abkhazia and are not currently open, while cargo is shipped by means of the Batumi-Poti-Novorossiisk ferry or by rail through Azerbaijan. This raises transportation costs and ultimately leads to an increase in the price of the exported goods. Russia's percentage in Georgia's export in 2003 amounted to 17.2%, and in import to 14.6%. The following goods form the basis of Russian deliveries: natural gas—around 1 billion cubic m a year, electricity—around 110 million kW/h, wheat and flour—33%, chemical industry products—12%, machinery, equipment, and transportation means—14%, and ferrous metals and their products—5%. Import from Georgia consists of 39% in wines, 21% in mineral water, 11% in hard liquor, 6% in machinery, equipment, and transportation means, 5% in citrus fruit, 3% in ores, including manganese concentrates, and 3% in ferrous alloys.

Tbilisi's debt to Moscow under state loans was 156.8 million dollars in 2003. At Georgia's request, Russia agreed to restructure this debt within the framework of the Paris Club. What is more, Georgian consumers owed Russia around 170 million dollars for natural gas and electric energy.

The cutback in reciprocal trade is leading to a decline in Russia's economic presence in the region. This trend is especially dangerous at present, when new economic structures and markets are intensively forming in the Southern Caucasus, as a result of which the vacant production and commercial niches are passing into the hands of foreign companies. And while competition on these markets is still rather feeble, it will soon toughen up, so Moscow should take the initiative now before it is too late.

Production and Investment Cooperation

An important factor of economic cooperation between Russia and the South Caucasian countries is the production and investment relations with industrial associations and companies. But the investment activity of Russian capital in the Southern Caucasus is much lower than in other countries. It is mainly manifested in the economic trade complex. For example, LUKoil is exploring and developing oil fields on the Azerbaijani shelf of the Caspian, Gazprom is the main supplier of natural gas, and RAO "EES Rossii" is not only exporting electric energy, but is generating and operating the energy networks of these states. Unsettled conflicts, transportation, trade, and legal barriers, the breakdown and reorientation of economic ties, the growing competition from Western companies, and the weakness of Russian companies due to their limited investment potential are preventing the development of production cooperation.

Around 300 companies with a share of Russian capital operate in Azerbaijan today. By the beginning of 2001, the Russian Federation occupied fifth place in investment volume in the Azerbaijan economy (229 million dollars), behind the U.S. with 1,248.2 million, Turkey with 691.6 million, Great Britain with 678.8 million, and Norway with 275 million dollars.[9] With the intention to continue in his father's footsteps, the country's president, Ilkham Aliev, is in favor of preserving and strengthening ties with Russia. Baku's striving to modernize its industry will make cooperation with Moscow all the more important, whereby not only in producing and transporting Azerbaijani oil. Cooperation in machine-building, building the North-South rail transportation corridor, and expanding agricultural export in the Russian Federation are also significant factors. Azerbaijan is willing to meet Russia half way in defining the status of the Caspian Sea and is delivering oil via the Baku-Novorossiisk pipeline.

As we have already noted, Azerbaijan's largest Russian partner is LUKoil, which is exploring and developing offshore oil fields on the Caspian shelf (the percentage of its share in the Shakh Deniz project is 5%). Along with the State Oil Company of the Azerbaijan Republic, this concern began geological survey work in 1997 on the D-222 unit, which is part of the Ialama-Samur structure. (In 2003, LUKoil increased its share in this project from 60% to 80%.)

Gazprom is supplying natural gas. Azerbaijan has this commodity, but there is still a long way to go before serious development of the shelf fields begins, while the country's annual demands amount to 12-14 billion cubic m, half of which are delivered by the RF. Cooperation between RAO "EES Rossii" and the AO Azerenerzhi Company only takes the form of energy exchange and parallel operation of the energy systems of both countries. Baku is still not ready to take this further, fearing for its energy safety.[10]

Economic ties are being restored between individual industrial structures in both countries. Russian enterprises have begun building ships and train carriages (for the Baku metro) for Azerbaijan. Joint production of freight trucks has been organized. The KamAZ and GAZ automobile companies are operating successfully in Azerbaijan.

Within the framework of the North-South international transportation corridor (ITC) (India-Persian Gulf-Iran-Russia-Europe), Russia, Azerbaijan, and Iran have created a consortium for building a new railway branch passing through Iran and Azerbaijan with access to Russia. The project for building the Anzali-Astara railroad is evaluated at 350 million dollars. In so doing, Moscow has expressed its willingness to invest half of this amount.[11] Implementation of this project will strengthen Russia's economic and geopolitical position and its relations with the Persian Gulf and Indian Ocean countries.

In compliance with an agreement between Rostelekom and Aztelekom, optical fiber communications between Russia and Azerbaijan are being established, which is laying the foundation for creating a ring circuit around the entire Caucasus. And the Russian Metal Pipe Company (MPC) has come to terms with the Western Targol Company, which owns the Azerbaijani Azerbor pipe-rolling plant, on manufac-

[9] See: M.E. Guliev, *Ekonomicheskie sviazi Azerbaijana s Rossiei: problemy, prioritety, perspektivy*, St. Petersburg, 2002, p. 13.

[10] See: *Nezavisimaia gazeta*, 25 May, 2004.

[11] See: *Zerkalo* (Azerbaijan), 13 April, 2004.

turing pipes from the steel delivered by Russia (based on joint investments of 30 million dollars). This will make it possible to raise their output to 150-200,000 tons a year. Azerbor's products will not only meet the demands of the domestic market. They will be exported to Iran, Iraq, Turkmenistan, and the Arabian countries.[12]

Broader participation of Russian capital in the Azerbaijan economy is needed to further develop economic cooperation based on creating financial industrial groups and assisting in the construction, modernization, and operation of the republic's enterprises. Implementation of the measures envisaged in the Program of Bilateral Economic Cooperation until 2010, which stipulates cooperation in specific industries, as well as systemic measures relating to the establishment of customs regulations and procedures, the harmonization of legislation, the creation of free trade conditions, and the expansion of interregional and border relations will help to achieve the designated goal of increasing reciprocal goods turnover from 513.9 million dollars in 2003 to 1 billion dollars annually.

As for investments, Russia still occupies one of the leading places in the Armenian economy. In terms of volume, its share exceeds 30% of the accumulated foreign investments. Between 1992 and 2002, they amounted to 217 million dollars, about 30 million of them were invested in 2002. In terms of this index, the Russian Federation yields only to Greece (245.4 million dollars). Today, there are 2,608 enterprises with a share of foreign capital in Armenia, 625 of which have Russian capital (around 24%).[13] These funds were invested primarily in the fuel and energy complex, ferrous metallurgy, the chemical, food flavoring, and confectionary industry, and in the banking sector.

While implementing its policy, the Armenian leadership is manifesting complementariness, pragmatism, and flexibility, and is combining integration processes within the framework of the CIS with cooperation with Western structures. In relations with NATO, official Erevan is demonstrating equilibrium and trying to build them taking into account its strategic partnership with Moscow.

The most promising sphere of bilateral economic ties is the fuel and energy complex. The main target of cooperation is the Armenian nuclear power plant, which produces more than 40% of the republic's electric energy. In September 2003, the plant was transferred to the trust management of the INTER RAO EES Company for five years with the right of extension. An agreement was also reached on the purchase by RAO "EES Rossii" of the Sevano-Razdan hydropower cascade (costing 25 million dollars) by way of settling part of Erevan's debt on the nuclear fuel delivered.

Around 40% of Armenia's electric power is produced by thermal power plants which operate on natural gas supplied by Gazprom and the Itera Company. The Russian-Armenian ZAO ArmRosgazprom Company created in 1997 is the main seller of blue fuel on the Armenian domestic market (in 2002, deliveries amounted to 1.4 billion cubic m). This enterprise owns the republic's entire gas transportation system, which in future is to be used to transit natural gas to third countries. Along with the Armenian side, Gazprom is reviewing the conditions of its participation in building the Iran-Armenia pipeline, with its possible use for pumping natural gas from Turkmenistan to Armenia.

The Armenal joint venture, created in 2000 on the basis of the Kanaker Aluminum Plant, is also operating efficiently. In 2000-2002, the Russian RusAl Company invested 41.3 million dollars in Armenal, thanks to which this enterprise produced 5,372 tons of aluminum foil in 2002, almost twice as much as in 2001. The percentage of Armenal production amounted to 7-8% of the country's export (46 million dollars). In 2003, the entire enterprise was transferred to the Russian Aluminum Company, the directors of which began its modernization, planning to spend up to 32 million dollars on this.

Around 70% of the shares of the Armavia structure belong to the Russian Siberian Airline Company. On the decision of official Erevan, the routes of the Armenian Airline state structure were also transferred under its management, as a result of which it became the first Russian company to be a national air shipper for another country.

ZAO Rosaviaspetskomplekt, which belongs to the RASKO concern, purchased 100% of the shares in the Armenian ZAO Orbit plant in 2003, which puts out night vision equipment and other special tech-

[12] See: *Zerkalo*, 9 April, 2004.
[13] See: *Nezavisimaia gazeta*, 5 March, 2004.

nology. RASKO is the main founder of the ZAO International Business Center (IBC) joint venture, and the owner of the Armenian Almaz and Aragats plants (producers of synthetic diamonds). Also in 2003, IBC became owner of the Erevan Araks plant, on the basis of which the manufacture of new types of instruments made from synthetic diamond powder is being organized, as well as the Karatmeken plant in Giumry, which supplies stone-cutting lathes.

Russian banks are becoming more active in Armenia's banking sphere. Their share in the authorized capital of the republic's banking system is approaching 20%. Among them are Unibank (authorized capital of 5 million dollars), Areximbank (3.8 million dollars), and Ardshininvestbank (5 million dollars). Russia's Runabank invested 2 million dollars in restoring synthetic rubber production at the ZAO Nairit-1 chemical plant. Renaissance Capital investment bank is also showing an interest in the Armenian financial market. In order to assist the work of large Russian companies, Russia's Vneshtorgbank (ATB) purchased 70% of the shares of Armenia's Armsberbank in 2004. It intends to increase its authorized capital five-fold and expand the range of services offered, primarily for stimulating investment programs, intensifying bilateral economic trade ties, and improving its services to the population.

The advance of Russian capital onto the Armenian market depends on settlement of the Nagorny Karabakh conflict and normalization of Georgian-Abkhazian relations. Failure to resolve these questions has led to a breakdown in communications and an increase in the influence of the transportation factor on the foreign economic ties between Moscow and Erevan. Difficulties in this sphere have also been caused by insufficient harmonization of regulatory acts, particularly those affecting the protection of investments, tax and customs legislation.

The low level of investment cooperation between Russia and Georgia is largely explained by the political-economic and financial situation of the latter, which in terms of many indices is viewed as a high risk zone for large investments. So until recently, Russian capital has not been particularly active with respect to the industrial facilities privatized in Georgia either, since many of them have accumulated debts and the state of their fixed assets requires significant financial outlays. On the whole, the volume of Russian business lags behind the funds offered by investors from the "far abroad." For example, it accounts for 1.5-2% of the total volume of investments in the republic (in third countries this index is almost 34%). More than 200 joint enterprises with a share of Russian capital operate in Georgia, but most of them are small intermediary and trade companies.

The development of bilateral economic relations is promoted by cooperation in power engineering and the gas industry. The INTER RAO EES Company mentioned above delivers electric energy to Georgia, and the GruzRosenergo joint venture ensures the operation of power transmission lines in the border regions. After purchasing 75% of the shares of the Tbilisi Telasi Electric Company, two energy units of the Tbilisi State Regional Power Plant with a capacity of 300 MW each and the right to manage (for 25 years) the Khrami-1 and Khrami-2 hydropower plants with a capacity of 100 MW each, RAO "EES Rossii" controls about 30% of the generation and approximately 60% of the sales of electric power in the country. The agreements reached at a trilateral meeting of the presidents of Russia and Georgia, along with a delegation from Abkhazia (Sochi on 6-7 March, 2003), will further increase this Russian structure's niche on the electric power market. This meeting focused particular attention on the problems of modernizing the Ingur hydropower plant cascade. The energy holding company is planning to invest enormous funds in restoring and developing Georgia's energy system. Joining the energy networks of the Caucasian countries into an integrated system will greatly promote the further development of cooperation in this sphere, as well as an increase in export of electric energy to Turkey and Iran.

In 2003, an agreement between Gazprom and the Georgian Ministry of Fuel and Energy on strategic cooperation (for 25 years) came into force, which reinforced position of this Russian company. In correspondence with this document, Gazprom will export natural gas to the republic, participate in its sale to end consumers, engage in the operation, reconstruction, and expansion of Georgia's gas pipelines, and develop joint projects on the use of the gas transportation system's transit capacities and the delivery of the necessary equipment. It intends to enlist the help of its branch institutes to resolve the problems in this industry. There are also plans to form the GruzRosgazprom joint venture, which will be entrusted with creating capacities for transporting blue fuel through Georgia to the consumers of other South Caucasian states and to countries further away, as well as with operating this system. But these plans are being hindered by the failure to introduce addenda into Georgia's legislation permitting the privatization of major gas pipelines.

The percentage of natural gas in the republic's energy balance is around 24%. In 2003, its deliveries amounted to approximately 1 billion cubic m, including 257 million cubic m under contracts with Gazexport, and 752 million cubic m with Itera. In 2004, the Gazexport Company, a subsidiary of the Gazprom structure, met the full demand (almost 1 billion cubic m).

Quite a number of problems have accumulated between Moscow and Tbilisi. Among them are the procedure and deadlines for withdrawing Russian military bases from Georgia, the visa regime, and the status of the Georgian autonomies. Due to the slump and stagnation in the republic's industry, the collapse in its agriculture, its total dependence on deliveries of energy resources, and corruption, there is little hope for a rapid solution to the crisis. The country's new president, Mikhail Saakashvili, is taking steps to restore friendly relations with Russia. His willingness to turn a new leaf was met with understanding in Moscow. It agrees to guarantee deliveries of energy resources, restructure debts, and help rebuild the economy by making investments and participating in the privatization of Georgian enterprises.

Russian investors, who have long had their eye on Georgian enterprises, were given ironclad guarantees by the new Georgian leadership that their capital would be protected. The Russian Federation was inclined to believe these assurances after K. Bendukidze, a prominent Russian businessman became head of the republic's Ministry of Economics, and the country's prime minister, Z. Zhvania, offered the Russian side a set of investment projects costing several billion dollars. The main investment areas in the republic are power engineering, agriculture, the food and processing industry, tourism, and the development of the transportation infrastructure.[14] Along with this, there are plans to create a joint Russian-Georgian enterprise for exporting gas to Turkey.

Russian businessmen assess all of these proposals as promising. In particular, the Industrial Investors Holding intends to invest up to 200 million dollars in the republic's economy over the next three years and take part in privatizing the Georgian ports, Poti and Batumi. The holding also acquired blocking parcel of shares of the Zestafon Ferro ferroalloy plant and is conducting talks with the country's government on the purchase of the Chiaturmarganets enterprise, which supplies manganese concentrate to the Ferro plant.[15] Aeroflot bought the Air Zena—Georgian Airline company. The question of creating a production unit in the republic for assembling Russia's sport-utility vehicle, the Niva, is being actively discussed. This make of car is very popular in the country due to the state of most local roads. The possibility is also being reviewed of incorporating Russia's Vneshtorgbank into the capital of Georgia's Joint Bank.

The country's new leadership is hoping that the radical reforms and attracted investments will revive the national economy. Minister of Economics K. Bendukidze, mentioned above, believes that a threefold increase the republic's GDP in ten years is a realistic goal, but this will require ultra-liberal reforms. Official Tbilisi decided not to object to Russia joining the WTO, both sides signed a protocol (on 28 May, 2004) on completing negotiations on the conditions for the Russian Federation's membership in this organization. Tbilisi hopes that in response Moscow will agree to restructure Georgia's debt, which has reached 320 million dollars. Further development of bilateral economic cooperation largely depends on settlement of the Abkhazian and South Ossetian conflicts and on creating a climate of trust and good neighborly relations.

Possible Cooperation Strategies

At the turn of the century, the geopolitical situation in the post-Soviet space as a whole, and in the South Caucasian countries in particular, radically changed. The newly independent states in the region

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[14] See: *Svobodnaia Gruzia*, 29 May, 2004.
[15] See: *Nezavisimaia gazeta*, 9 June, 2004.

became a "bone of contention" and an arena of world strategic rivalry among the main international economic centers and geopolitical blocs interested in taking control over raw materials and energy resources, as well as over the transportation routes.

Today, actors whose intentions do not coincide with Russia's historically developed geopolitical interests are making concerted efforts to gain a lever of influence on the South Caucasian countries. For example, the U.S. considers this region a zone of Washington's strategic interests, the European Union is interested in acquiring its own influence on it, and Turkey also wishes to have levers of influence on these states. So it is trying to make maximum use of its transit geographical location, while Iran, which has significant supplies of hydrocarbons in the Caspian, is attempting to gain access to the world energy resource market through the Southern Caucasus.

On the whole, the policy of the western states in the region is aimed at ousting Russia from the scene. This is particularly obvious in the struggle for access to Caspian oil and for control over its transportation routes. The situation is aggravated by the fact that the leaders of the South Caucasian states are strategically oriented toward the United States and NATO, hoping that they will help them to resolve their security problems and revive their economies.

All of these factors have perceptibly changed the situation in the Southern Caucasus and led to a decrease in Russia's influence in the political, economic, and military sphere with a simultaneous increase in the presence of the U.S., the NATO countries, the EU, Turkey, and Iran. The long-term influence of these factors on development of the situation in the South Caucasian countries is forcing official Moscow to reconsider its strategy regarding the South Caucasian segment of the post-Soviet space. Russia's "withdrawal" from the Southern Caucasus is fraught with serious future complications.

In terms of globalization, the Russian Federation must analyze those development aspects which will allow it to gain a better understanding of the available opportunities and challenges. The matter concerns the development of a new strategy based on the principle of viewing the Southern Caucasus as an integrated geo-economic zone with Russia's Northern Caucasus. On the one hand, this approach will allow the Russian Federation to concentrate its efforts on implementing large transborder projects which have something in common with and are of key significance for the South Caucasian countries, as well as ever-growing significance for Russia. This includes, for example, the international energy resource production and transportation projects on the Caspian shelf and building the North-South and TRACECA Eurasian transportation corridors. Implementation of these plans could significantly change the geopolitical situation in the region, turning it into a communication junction of global significance. On the other, it will promote a rise in the efficiency of bilateral relations between Russia and each of the South Caucasian countries, as well as the use of a differentiated approach reflecting the specifics of the political and economic interrelations in order to resolve specific questions. Thanks to Russian companies, including banks, pooling their efforts, common development problems in the economies of the South Caucasian republics can be efficiently overcome, which the Russian Federation is also interested in.

The necessary prerequisites for carrying out these tasks have already come to a head, and the conditions for cooperation have significantly changed. Trends have been designated in the South Caucasian countries toward an improvement in the situation and a solution to the crisis. The governments of these states are designating programs aimed at further economic development. Their implementation requires not only material resources, but also a sales market for their products. After encountering serious difficulties in attracting investments and barriers on the way to reorienting economic relations toward the Western markets, these countries are convinced of the practical need to expand export beyond the CIS, since their products are largely non-competitive. They all admit that there is great potential for promoting the development of relations with other republics of the Commonwealth, primarily with Russia. This largely explains the noticeable increase in their trade volumes with Russia in recent years.

In order to gain a stronger economic foothold in the Southern Caucasus, Russia should take more advantage of the potential of the Chamber of Commerce and Industry, and unions and associations of industrialists and businessmen. In order to coordinate the work of these structures, it would be useful to create a Business Council for the Caucasus, within the framework of which it would be possible not only to discuss, but also to draw up alternatives for uniting efforts and resources to participate on this region's market, in particular regarding projects to coordinate and develop a raw material base and production capacities and to privatize industrial facilities. To support the most significant projects for developing cooperation in these and other spheres, a special Investment Fund should be formed on the basis of state and private financial resources, primarily of Russia's South Federal District, the South Caucasian countries, and neighboring states. Contacts with South Caucasian partners should be encouraged by creating business cooperation associations and holding economic forums and conferences at the regional level. In order to carry out these tasks, favorable international and legal conditions should be created, national legislation harmonized (particularly in terms of investment protection, tax, customs, and banking activity), information support rendered, and the development of interregional and border relations promoted.

Efforts should be made to remove the barriers hindering economic cooperation, as well as the formation of a free trade zone and ultimately a common Caucasian market. All of this will promote an upswing in the economies of the region's republics, an increase in their mutual trust, and strengthening of good neighborly relations.

So Moscow's long-term strategy regarding the South Caucasian states should focus on their close cooperation ties with the Russian Northern Caucasus. In the future, this approach will facilitate a stable strategic partnership for forming an integrated economic and, especially, defense space, which is extremely important for ensuring security on the CIS's southern borders.

Only this will help to make the geopolitical and geo-economic situation in the Caucasus more predictable and mutually controllable both in relations among the South Caucasian states themselves and between each them and Russia. This also applies to their relations with the U.S., NATO, the European Union, Turkey, Iran, and other countries of the world. Russia's task is to find a common language, primarily with the leaders of the South Caucasian states.