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**THE CENTRAL CAUCASUS**  
ESSAYS ON GEOPOLITICAL ECONOMY

Foreword by  
*S. Frederick STARR*

# **THE CENTRAL CAUCASUS:**

## **ESSAYS ON GEOPOLITICAL ECONOMY**



**Eldar ISMAILOV  
and  
Vladimer PAPAUA**

# **THE CENTRAL CAUCASUS: ESSAYS ON GEOPOLITICAL ECONOMY**

Foreword by  
***S. Frederick STARR***

**CA&CC Press® AB  
STOCKHOLM**

**THE CENTRAL CAUCASUS:  
ESSAYS ON GEOPOLITICAL ECONOMY**

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# LIST OF ACRONYMS

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ADB	Asian Development Bank
AIOC	Azerbaijan International Operating Company
APEC	Asia-Pacific Economic Cooperation
APR	Asia-Pacific Region
ASEAN	Association of South East Nations
BAM	Baikal-Amur Mainline
BP	British Petroleum
BSECO	Black Sea Economic Cooperation Organization
BTC	Baku-Tbilisi-Ceyhan Oil Pipeline
CAEC	Central Asian Economic Community
CACO	Central Asian Cooperation Organization
CBC	Caucasian Business Council
C.C. C.P.S.U.	Central Committee of the Communist Party of the Soviet Union
CCM	Caucasian Common Market
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
CTC	Caucasian Transnational Corporations
CUE	Caucasian Universal Exchange
EurAsEC	Eurasian Economic Community
EATCC	Euro-Asian Transportation and Communication Corridor
EBRD	European Bank for Reconstruction and Development
ECO	Economic Cooperation Organization
EFTA	European Free Trade Association
EU	European Union
FDI	Foreign Direct Investment

GDP	Gross Domestic Product
GDR	German Democratic Republic
GUAM	Georgia-Ukraine-Azerbaijan-Moldova
GUUAM	Georgia-Ukraine-Uzbekistan-Azerbaijan-Moldova
IDB	Islamic Development Bank
IFI	International Financial Institutions
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas Transport to Europe
MASSR	Mountain Autonomous Soviet Socialist Republic
MERCOSUR	South American Common Market
NAFTA	North American Free Trade Agreement
OPEC	Organization of the Petroleum Exporting Countries
RF	Russian Federation
SCO	Shanghai Cooperation Organization
SCP	South Caucasus Pipeline
SFDRF	Southern Federal District of the Russian Federation
SPECA	U.N. Special Program for the Economies of Central Asia
TDFR	Transcaucasian Democratic Federative Republic
TNC	Transnational Corporations
TRACECA	Transport Corridor Europe-Caucasus-Asia
TSFSR	Transcaucasian Soviet Federative Socialist Republic
U.S.	United States of America
U.S.S.R.	Union of Soviet Socialist Republics
WB	World Bank
WTO	World Trade Organization

# FOREWORD

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To understand today's world requires both analytic skills and imagination. The authors of this book—Eldar Ismailov and Vladimer Papava—are well supplied with both, which is fortunate, since they set for themselves a task that has defied most social scientists and analysts. Their goal is to look afresh at the Caucasian region and to determine whether it, or some part of it, has the potential of becoming a new economic space, or economic spaces and, if so, of what sort. In other words, they set out to do nothing less than to re-conceptualize the Caucasus as a region.

Immediately they encounter intellectual landmines in the form of words and geographical terminology we have long accepted as obvious. They quickly dispense with the old Russian imperial term “Transcaucasus” as taking its reference not from the Caucasus but from Russia. Then they ask whether the commonly accepted term “Southern Caucasus” has any relevance to the task at hand. They argue convincingly that it does not. In its place, they boldly propose two new terms: “Central Caucasus,” which consists of the new states of Armenia, Azerbaijan, and Georgia, and a new “Southern Caucasus,” which is comprised of an eastern and western part ruled respectively by Iran and Turkey. Our authors leave intact our present understanding of the “Northern Caucasus,” although even this they rework somewhat when they consider it in the context of the larger region.

In a few paragraphs these two senior economists from the Caucasus have redrawn our mental map of the region! This is no casual game on their part, even though they both have a good sense of humor. Instead of simply dropping these definitions on us as *obiter dicta*, they then proceed to analyze carefully each of these three regions from the standpoint of their politics, resources, economic capacities, and human resources. The picture they paint is an intriguing one. The Northern Caucasus may embrace

over half the total territory of the Caucasus but it gets low marks on account of its ethnic and political fragmentation, isolation, and persisting high level of conflict. The (new) Southern Caucasus fares even worse, for it has remained a region of stunted development.

Is it an accident in terms of their delayed development that self-government exists in neither the Northern nor Southern Caucasus? Professors Ismailov and Papava think not. They argue convincingly that self-government (which they equate with the idea of democracy) is essential not only to economic and social development but to the prevention of corruption, which is widespread in all three zones. Stated differently, they consider that “foreign” rule, whether from Russia, Turkey, or Iran, is incompatible with the emergence of a vital economic zone in the Caucasus. This leaves the authors no choice but to concentrate their further analysis on the Central Caucasus, i.e., Armenia, Azerbaijan, Georgia.

At this point, our intrepid explorers encounter a second intellectual landmine, this one in the form of the region’s history. This may be the toughest part of their task, not simply because the history of the region is incredibly complex, but because the same evidence has been used over and over in support of wildly incompatible theses. Thankfully, they pass over rather lightly the millennia prior to the eighteenth century. Had they attempted to sort out this confusing skein of empires, states, and fortified districts you would not be holding their book today.

The question that Ismailov and Papava pose to the historical record is the right one: when, if ever, were integrative tendencies evident in the Caucasus and in its constituent parts? Naturally, they pause on Sheikh Shamil, who between 1834 and 1859 attempted in vain to integrate the Northern Caucasus on the basis of ethnicity and religion. Equally problematic is the halting integrative trend to be detected in the Southern Caucasus under the nineteenth century emirs. Inevitably, the authors slide over the rest of that century and even the brief Transcaucasus Federation of 1922 before focusing on the late Soviet period and the first years following the Soviet breakup. These passages are full of interest, however, and the reader will doubtless be intrigued by the authors’ comments on the informal understandings between the U.S.S.R., Turkey, and Iran that condemned the region to being divided among these three poles for a further three-quarters of a century.

Taken together, the historical experience provides scant encouragement for those favoring some form of regional or even sub-regional integration today, and especially integration that arises from within rather than from without. Acknowledging this, the authors turn their attention to the three countries that today constitute the core of the region which has been renamed the Central Caucasus. In what is bound to be judged as some of the most controversial passages of the book, they argue, in essence, that Armenia has for two decades isolated itself within the Central Caucasus and all but forfeited its chance of being part of the new centripetal force that is steadily but decisively reshaping the region. This was already evident when Armenia's policy effectively scuttled Gorbachev's last-ditch attempt to advance the notion of a common "Caucasian Home." When Armenia attacked the Azerbaijan province of Karabakh and went on to occupy a fifth of Azerbaijan's territory, and when it lent support to ethnic Armenian separatists in the Georgian region of Samtskhe-Javakhetia, the die was cast. Down to the present, Ismailov and Papava argue, Armenia has been "isolating itself from the integrative process in the Central Caucasus."

The new centripetal force in the region arises, our authors suggest, from the perceived common interests between Azerbaijan and Georgia. Never mind, they imply, that Georgia boasts one of the oldest national Christian churches anywhere, and that Azerbaijan is the place from which all Iran was converted to Shi'a Islam. Forget whatever you may have heard about national and religious identities as the main source of conflict in this region, with its patchwork of ethnicities and religions. In the Central Caucasus today, economics and common interests trump ethnicity and religion.

The progress of amity and cooperation between Azerbaijan and Georgia is impressive by any measure. No less striking, however, is the extent to which Armenia's policies have pushed it to the back of the economic train in the Central Caucasus. True, the Armenian economy has many strengths, especially its strong natural and human resources. But measured by gross domestic product or either total or per capita foreign direct investment, Armenia lags its neighbors and the gap is widening. Georgia's economy suffers from a staggering range of pathologies that are well known to the investment community, but for only one year since 1996 has

Armenia surpassed Georgia in foreign investment. It is often claimed that Armenia's unique asset is the wealth and commitment of the Armenian Diaspora in the Middle East, Europe, and North America. The evidence provided in this book does not support this contention.

The central concern of this study is whether the Central Caucasus (preferably with Armenia, but, if necessary, without) can become not only the "core" of the region, which it is by definition, or a "node" of trade, but an economic "hub." A "hub", the authors contend, combines in one place or region the junction of a series of transportation arteries, major financial institutions, and significant institutions in the spheres of science, technology, and education. Azerbaijan and Georgia show increasing signs of meeting this definition. Absolutely central is the fact that, even without Armenia, these two countries command major east-west and north-south arteries of continental transport and trade. With Armenia, the organizing and integrative energy of the Central Caucasus would be greater still.

This book details the workings of these emerging arteries of transport and trade, and shows convincingly that they are destined to play critically important roles in the lives of the region's immediate neighbors—Russia, Turkey, Iran, and Central Asia—and also of lands as distant as Western Europe, China, and the Indian sub-continent.

With so much at stake, it is inevitable that various powers would seek to organize the Central Caucasus from without or, better, to absorb it into some larger entity that is under the control of an interested neighbor. The systematic review of the Central Caucasus' relationship with the Black Sea Economic Cooperation Organization, GUAM, the Economic Cooperation Organization, the Collective Security Treaty Organization, NATO and other international groupings may not be the most exciting part of this book. But it is essential to form a comprehensive understanding of the range of political and economic forces acting on the region. Again, the authors are forcing us to look on the map in many different ways, some of which present challenges to the others.

Russia emerges as the greatest threat to the aspirations of those who would like to see the Central Caucasus establish itself as a regional hub. Professors Ismailov and Papava do not hide their view that Russia still seeks to restore its empire. They see Anatolii Chubais' talk of a "Liberal Empire" as mere rhetoric. They are convinced that while Russia may op-

pose the use of military force in the formation of a new Liberal Empire, it would not hesitate to use it as necessary in its day-to-day functioning, once such an empire is established. They are equally skeptical about Iran, which they see as posing a threat to both Azerbaijan and Georgia. This prompts them to treat with caution the propose Russia-Iran trade route passing through both Georgia and Armenia, and generally to favor somewhat the east-west connections that would link the European Union with China and India. But one might reasonably ask whether Russia and Iran, as major gas producers, are not in the end competitors, and whether this might eventually prevent them from taking decisive combined action against the Central Caucasus hub.

Vladimer Papava, a widely known and respected Georgian economist and former Minister of Economics in Tbilisi, and Eldar Ismailov, an equally distinguished economist from Azerbaijan and a star of Baku's academic life, are enthusiastic over the prospects of the Central Caucasus but they are not naïve. They know that both their countries, as well as Armenia and all the Russian-ruled Northern Caucasus, suffer from the massive corruption and what the economist Adam Lipowski has termed "misdevelopment" that is the heritage of Soviet rule. Papava has even written an impressive book on the subject aptly entitled *Necroeconomics*.<sup>1</sup>

The authors' prescription for turning these denuded and disinvested economies into "vita-economies" is active civic participation through the functioning institutions of democracy. They make a convincing case for this, and are utterly clear-eyed in identifying the impediments that stand in the way of achieving this goal. The obstacles are by no means trivial. Indeed, they are so serious that one involuntarily asks, "What happens if the states of the Central Caucasus fail to build democratic institutions?" Being optimists at heart, Professors Ismailov and Papava do not directly answer this question. But the evidence they provide suggests that the alternative is to return to age-old cycles of external rule, fragmentation, corruption, and under-development. Such an outcome would be bad for the neighboring countries that might otherwise appear to reap short-term

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<sup>1</sup> Vladimer Papava, *Necroeconomics: the Political: Economy of Post-Communist Capitalism*, New York, iUniverse, 2005.

benefit from expanding their geographical control and hegemony. Such a failure would be equally bad for the European Union, China and Southeast Asia. If anything were to thwart the development of the Central Caucasus as the continental hub described so vividly on these pages, it would deny to these global economic centers a continental land-bridge spanning all Eurasia. The opportunity cost of such a failure would be incalculable.

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# INTRODUCTION

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*Eldar Ismailov and Vladimer Papava*

Just recently a part of the Soviet Union's unified political space, the Caucasus is now an arena for playing out diverse geopolitical and economic interests [Degoev, 2001a; Dugin, 2000; Gajiev, K., 2003; Kuliev, 1999; MacFarlane, 2004; Yalowitz and Cornell, 2004]. In contrast to the other regions which separated from the U.S.S.R.—the Baltic countries, Central Asia, the West Slavonic part of the U.S.S.R.—the legal and political status of the various Caucasian countries vis-à-vis the world community is heterogeneous [Starr, 1994]. The Caucasus has lost its political-legal and socio-economic integrity: the Northern Caucasus is under the jurisdiction of the Russian Federation, while the three republics, which acquired state independence, Armenia [Curtis, 1995; Dudwick, 1993; Gajiev, K., 2003, pp. 120-140; Hovannisian, 1994; Hunter, 1994, pp. 22-57; Lang, 1988; Libaridian, 1999, 2004; Libaridian (ed.), 1991; Matossian, 1962; Suny, 1993; Walker, Ch., 1990], Azerbaijan [Akiner, 2000; Alijarly, 1996; Altdstadt, 1992; Eivazov, 2004; Gajiev, K., 2003, pp. 98-119; Goltz, 1998; Guluzade, 1999; Hunter, 1993; Hunter, 1994, pp. 58-96; Nichol, 1995; Swietochowski, 1994, 1995; Swietochowski and Collins, 1999] and Georgia [Allen, 1971; Coppieters, 1998a; Coppieters and Legvold (eds.), 2005; Gachechiladze, 1995; Gajiev, K., 2003, pp. 141-171; Gegeshidze, 2002; Hunter, 1994, pp. 110-141; Jones St., 1993; Lang, 1962; Metreveli, 1995; Slider, 1995; Suny, 1998; Waal, 2005], are experiencing different fates. The first has enjoyed the greatest support from Russia from the very beginning, while the other two, which are oriented toward the West, have been drawn into ethnopolitical conflicts in which ethnic minorities are taking advantage of the former metropolis' patronage.

The multi-vector nature of the Caucasian political space [MacFarlane, 2004; Yalowitz and Cornell, 2004], the significance of the region as a treasure-house of hydrocarbon resources and as a transportation corridor for exporting Central Asian oil and gas to the world market, and the ardu-

ous nation-building period the region's countries have been going through are all drawing the attention of both the scientific community and politicians to the Caucasus [Mardanov and Ismailov (eds.), 1998]. The struggle for control over the energy resources of the Caspian Sea Basin has been going on for more than two hundred years [O'Hara, 2004]. Each country with interests in the Caucasus (Russia, Turkey, Iran, the U.S., the European and Asian states, and others) is developing its own views on this region and the prospects for its development [Ahmady, 2001; Baev, 2004; Cherniavskiy, 1998a, 1998b; Cornell, 1998, 2001b; Grabbe, 2004; Hale, 1996; Jaffe, 2001; Jones Sc., 2000; Kalicki and Lawson (eds.), 2003; Larrabee, 2004; Light, 1996; Mohsenin, 2001; Nahavandi, 1996; Naumkin, 2001; Pauw, 1996; Riabtsev, 1999; Trenin, 1996; Zubarevich and Fedorov, 1999; Yaz'kova, 2002].<sup>1</sup>

No matter what the differences in opinion or the approaches to the current situation and the prospects for developing the integration processes in the Caucasus,<sup>2</sup> the key question of whether the traditional—primarily Russian—factors defining the problematic destiny of the Caucasus are still pertinent, or whether the future lies in the new strategic priorities gaining momentum makes it possible to consider these approaches from two perspectives. We can either look at the future of the Caucasus as a new modification of the old integration model, or we can entertain the so-called idea of a United Caucasus as a new political system of relations.

Frequently, the new strategic priorities imply that one traditional priority factor of influence (the Russian) is replaced by others (the Western, Turkish, and so on). This dichotomy is often described as replacing one Big Brother with another.

It is obvious that this bipolar systemization of the integration processes in the Caucasus appears overly simplified. In this book, we are putting forward a principally new view on the integrity and regional structure of the Caucasus.

In order to understand the current situation in the Caucasus, as well as develop principles and the main areas for forming a regional integrated community, it is important first to comprehend and summarize the main economic development trends both throughout the Caucasus as a whole, and in the region's individual countries.

Each country in the region is fulfilling its own unique function, which requires special research. An analysis of the current state and prospects for developing interrelations among these countries deserves particular attention.

Many of today's researchers of the Caucasus focus in particular on analyzing ways to achieve peaceful settlement of the conflicts in the Caucasus, while only a few publications are devoted to the state of economic interrelations in the region and their development prospects [Champain, 2004; Champain, Klein, and Mirimanova (eds.), 2004; Herzig, 1999].

Based on the current state of each individual country in the region and particularly on their interrelations,<sup>3</sup> any analysis of the prospects for Caucasian integration is to a certain extent tentative. In so doing, at least partial recognition of the inexpediency of this kind of analysis,<sup>4</sup> in our opinion, would mean accepting the current situation of isolation and rivalry which is characteristic of several entities of the region. And this is not only undesirable in the globalizing world, particularly in the long term, it is also essentially impossible: the Caucasus cannot and should not remain isolated from the global integration processes. Nevertheless, we strongly believe that integration into the world economy requires comprehending the intra-regional integration possibilities.

The goal of this book is to reconsider the views that have formed about the Caucasus and analyze the main geopolitical and geo-economic problems of the integration prospects of the region. What is more, research of the Caucasus within the framework of geopolitical economy<sup>5</sup> is also acquiring special significance due to the energy resources of the Caspian Sea Basin [Aliev, Il., 2003; Guseinov, 2002; Zhiltsov, Zonn, and Ushkov, 2003].<sup>6</sup>

Well aware that readers may not always agree with the authors' interpretations of several of the issues considered here, we welcome a substantiated debate on this topic and further discussion of the problems raised in this book.

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### NOTES

<sup>1</sup> See also: A. Maleki, *Iran and Turan. A Note for Iran's Relations with Central Asia and Caucasus Republics*. Available at [http://www.caspianstudies.com/Irans%20neighbour/central%20Asia/iran\\_and\\_turan.htm](http://www.caspianstudies.com/Irans%20neighbour/central%20Asia/iran_and_turan.htm).

- <sup>2</sup> Views on the current situation and the development prospects for Caucasian integration range from totally pessimistic [Kazarian, 1999] to extremely optimistic [Gasanzade, 1999].
- <sup>3</sup> It must be admitted that even between Azerbaijan and Georgia, the regional interests of which largely coincide, there is, unfortunately, far from always complete mutual understanding, which is manifested particularly clearly with respect to the conflict zones [Welt, 1999].
- <sup>4</sup> If the idea is upheld that integration of the Caucasus (even of any of its parts) is only wishful thinking, since there has never been any political or cultural integrity in Caucasian history [Chikovani, 2005], this will lead to historical determination of the social processes, the inconsistency of which has been repeatedly proven by history itself. Even the most extreme viewpoint on complete isolation of the Caucasian people during their multi-century history does not exclude in the least the essential possibility of rapprochement, or even coincidence, of several deep-rooted interests of the countries and peoples of the region, which cannot be considered surprising in today's globalizing world.
- <sup>5</sup> Geopolitical economy expands the framework of political economy by drawing geographical and historical aspects of the topic under study into the analysis [Reifer, 2005, pp. 195-196].
- <sup>6</sup> It is no accident that one of the most pertinent topics of contemporary geopolitical economy is an analysis of the rivalry among different states for control over energy and other resources, which at times escalates into war [Le Billon, 2004].

# Essay 1 | ON INTEGRATION AND THE CONCEPTION OF THE CENTRAL CAUCASUS

---

*Eldar Ismailov*

## 1.1. Prehistory

At the end of the 18th century, another active round of integration began in the Caucasus in light of the Russian Empire's expansionist policy [Breyfogle, 2005], which led to a prolonged Russian-Caucasian war in which the numerically small peoples of the Northern Caucasus were forced to unite in a joint struggle for independence [Kokiev, 1929; Narochnitskiy, 1998; Piotrovskiy (ed.), 1988; Romanovskiy, 2004, pp. 3-279]. The first widespread attempt to achieve this goal was the movement begun by Sheikh Mansour in 1785, which, incidentally, could not consolidate the Caucasian peoples into a stable integrated formation [Skitskiy, 1933; Smirnov, 1950]. Later, Sheikh Shamil was the only person who managed to create a stable integrated community in the Northern Caucasus based on the ethnic-religious principle—the Imamate, which existed from 1834 to 1859 [Degoev, 2001b; Gammer, 1998; Magomedov, 1939].

When the Russian Empire collapsed at the beginning of the 20th century, integration processes in the Northern Caucasus began to intensify again. Their legitimate consequence was the creation of an independent Mountain Republic in 1918-1920, which united many peoples of the Northern Caucasus [Shafir, 1972]. At this time (April 1918), in the southern part of the Greater Caucasus, a Transcaucasian Democratic Federative Republic was created for the first time. This integrated formation existed for just one month and then split into three independent states—the Azerbaijan Democratic Republic, the Georgian Democratic Republic, and the Republic of Armenia.<sup>1</sup>

When Bolshevik (Communist) power took hold in Russia, the integration processes in the Caucasus assumed new features. In particular, in

1922, an integrated union formed on the political-ideological principle—the Transcaucasian Soviet Federative Socialist Republic (T.S.F.S.R.), comprised of Azerbaijan, Georgia, and Armenia, which were already Soviet republics. The T.S.F.S.R. as an integrated formation within a larger union—the U.S.S.R.—was essentially only an interim mechanism ensuring more efficient governance by the Center (Moscow) of this turbulent region. After fulfilling its main functions of smoothing out the ethnic confrontations, creating the base for economic integration between the Transcaucasus and Russia, and so on, the T.S.F.S.R. was abolished in 1936 [Azizbekova, Mnatsakanian, and Traskunov, 1969; Sidamonidze, 1972].

After abolishment of the Mountain Republic and the Transcaucasian Soviet Federative Socialist Republic, the main economic and legal mechanisms were oriented toward integrating the autonomous republics of the Northern Caucasus into a single North Caucasian economic region [Khmelevskiy, 1976], and the Union republics of the Transcaucasus [Mints, 1969] into a single Transcaucasian economic region [Adamesku and Silaev (eds.), 1973], as well as integrating these regions among themselves and with the Center. They continued to function within the U.S.S.R.'s unified national economic complex as integrated regions right up until the collapse of the Soviet Union.

After the collapse of the U.S.S.R. [Lundestad, 2002], once again, as at the beginning of the 20th century, three independent states formed in the southern part of the Greater Caucasus—the Azerbaijan Republic, Georgia, and the Republic of Armenia. While in the Northern Caucasus, integration processes were activated for joining forces in the fight for independence. Chechnia, after declaring its independence in 1992, headed this movement [Dunlop, 1998; Gall and Waal, 1998; Lapidus, 1998; Nukhaev, 2002a, 2002b, 2002c, 2002d].

Thus, this brief historical review of the integration processes in the Caucasus shows that they occur in cycles and are directly associated with the appearance of extreme situations in Russia. Under these conditions, strengthening of the integration processes in the Caucasus led to the formation of fragile communities which disintegrated after the situation in Russia stabilized and it consolidated its power over the region.

Due to the new extreme sociopolitical situation that arose at the end of the 20th-beginning of the 21st centuries, the Caucasian state formations

acquired their first opportunity to integrate into a single socioeconomic union which met the essential interests of the region's development as a whole and each of its components individually. This task could only be realized by developing a realistic model of Caucasian integration.

### 1.2. Models of Caucasian Integration

At present, there is no shortage of conceptual models of Caucasian integration—Caucasian Home, Caucasian Common Market, United States of the Transcaucasus, and others. The number of countries participating in them varies from two—Azerbaijan and Georgia—to eight—Azerbaijan, Georgia, Armenia, Turkey, Russia, Iran, the U.S., and the European Union. The combination and sequence of the participation of the individual states in these models vary, and each of them is aimed at carrying out particular tasks.

The idea of a Caucasian Home put forward immediately after the collapse of the U.S.S.R. [Aliiev, R., 1997; Khaladdin, 1997; Mamedov, 1997] was essentially the successor of the idea of a Free Caucasus and is its modernized version adapted to the new geopolitical reality and aimed at achieving peace, stability, and prosperity in the Caucasus.<sup>2</sup>

The first step in this direction was the creation of the Assembly of Mountain Peoples of the Caucasus in 1989, which was transformed in 1991 into a Confederation uniting the Chechens, Kabardins, Adighes, Abazins, Abkhazians, and other peoples of the Caucasus [Yandarbiev, 1997].

At the initial stage, the idea of a Caucasian Home aroused a broad response among the North Caucasian peoples, who saw regional integration as unification of only the Northern Caucasus. But the absence in the autonomous North Caucasian formations of several necessary prerequisites (state sovereignty, sufficient resources, and so on) made it impossible to achieve the set goal. Later, as these realities were comprehended, North Caucasian politicians began to recognize all the more clearly the need for expanding cooperation with their immediate southern neighbors—Azerbaijan and Georgia.

Subsequently, after Moscow reinforced its power over the autonomous formations of the Northern Caucasus, it became clear that their independ-

ent participation in Caucasian integration would have to be postponed until some much later date. On the other hand, Armenia's policy in the region made participation of this country in Caucasian integration essentially impossible in the near future. In this way, although the idea of a Caucasian Home gradually acquired widespread regional significance, in reality it could not be put into practice.

Just as unrealistic in the present circumstances was the model of Caucasian integration in which Azerbaijan, Armenia, and Georgia would act together [Goble, 1997]. It cannot be realized due to Armenia's occupation of part of Azerbaijan's territory [Ismailov, M., 1996]; nor should we ignore the problems periodically provoked by the Armenian separatist forces in Samtskhe-Javakhetia in Georgia [Darchiashvili, 2000; Metreveli, E., 2004; Young, 2006]. It is obvious that Azerbaijan objectively cannot be interested in establishing economic cooperation with Armenia.

One of the versions of this model is the idea of creating a United States of the Transcaucasus (U.S.S.T.) [Teiub ogly, 2000], or a United States of the Caucasus (U.S.C.) [Guliev, 2003], which for a start presumes uniting Azerbaijan and Georgia, with Armenia possibly joining later. According to the author of this idea, this approach will help to resolve the problem of separatism, which is the main hindrance in the development of Azerbaijan and Georgia, by Abkhazia, South Ossetia, and Nagorno-Karabakh joining the U.S.S.T. as federal lands, but without the right to secession.

Another version of Caucasian integration is the 3+1 model proposed by Russia, which was publicized at the Kislovodsk summit in 1996. At the meeting, in which, in addition to representatives of Azerbaijan, Georgia, Armenia, and Russia, the leaders of the autonomous formations of the Northern Caucasus (apart from Chechnia) also participated, the Russian side repeatedly talked about Russia's interests in the Transcaucasus and that the Caucasus cannot be geopolitically separated from Russia. The 3+1 conception of Caucasian integration proposed by Russia, which reflected by and large the interests of one side and did not fully correspond to the goals of the independent Caucasian states, could not advance past the draft stage.

Along with this, the models of sub-global integration called upon to accelerate implementation of the Caucasus' planetary function as a center



linking the major regional systems (for example, the European Community and the Asia-Pacific Region) should also be singled out. One of these models is the 3+3+2 project—Russia-Turkey-Iran+Azerbaijan-Georgia-Armenia+the U.S.-European Union—discussed at the Istanbul summit of the OSCE member states in 1999.

Thus, an analysis of the existing models of Caucasian integration makes it possible to single out the following main groups:

- The Caucasian Home models, incorporating the autonomous republics of the Northern Caucasus (there is also the viewpoint that these autonomous republics should participate in this integration model as independent states), and independent Caucasian states;
- Models uniting the independent Caucasian states—Azerbaijan, Georgia, and Armenia;
- The 3+1 model, uniting the independent Caucasian republics and Russia;
- Sub-global models, incorporating the three independent Caucasian states, three contiguous states, and other world nations (3+3+2).

There are interesting aspects in all of these projects, and the authors' arguments in favor of the viability of their projects look extremely convincing. But they are all still abstract models, and are not being implemented for various objective and subjective reasons, although the idea of Caucasian integration is actively supported by the world community. It is presumed that all of these models suffer from one common shortcoming which does not allow them to become a full-fledged conceptual basis for practical action in launching a socioeconomic integration mechanism. And this shortcoming is an *inadequate vision of the entire problem of Caucasian integration, its structure, mechanisms, and initializing nucleus*.

To draw up a realistic model of Caucasian integration on which practical action could be based in this direction, we need to define the place and role of the Caucasus in the global political space, taking into account global and regional changes [Kovalskiy, 1999], as well as to rethink the concept of and overcome the stereotypical political-geographical division of the Caucasus.

### **1.3. On the Concept “The Caucasus”**

The contemporary content of the geopolitical concept of the Caucasus goes back to the 18th-19th centuries—to the period when Russia conquered the Caucasus. This was when the Caucasian region began being divided into the Caucasus and the Transcaucasus (beyond the Caucasus) [Gamkrelidze, 1999]. Later, the concept of the Northern Caucasus was introduced to designate the territory to the north of the conquered Transcaucasus.

It goes without saying that the term “the Transcaucasus” was a product of Russia’s foreign policy conception, which reflected the metropolis’ attitude toward the political-administrative division of the conquered region. Of course, in so doing, the interests of the peoples of the region, as well as the economic, cultural, and other relations which historically developed in the region, were frequently sacrificed to the interests of the Russian Empire. What is more, the term “the Transcaucasus” latently presumed that the territory to the south of the Great Caucasian Mountain Range did not belong to the Caucasus proper, was on the other side of it and so outside it. In so doing, this term was essentially an expression of and to some extent a means for achieving the Russian Empire’s political goal in the Caucasian region—division of the local peoples living in the northern and southern parts of the conquered Caucasus.

There is no doubt that the term “the Transcaucasus” not only had a geographical, but also a geopolitical meaning. This is clear at least from the fact that the Transcaucasus only stretched to the southern state frontiers of the Russian Empire in the Caucasian region and altered in size along with its changes. For example, at the end of the 19th century, after the Kars Region of the Ottoman Empire was conquered by the Russian Empire, it was considered a component of the Caucasus. But after Russia lost Kars, Ardahan, and Bayazeh, they were no longer mentioned as Caucasian in the Russian political and historical documents. After declaring their independence, these areas created a state in November 1918—the Southwestern Caucasian (Kars) Democratic Republic [Gajiev, A., 1992, 2004; Tagieva, 2005].

Since it reflected the existing geopolitical reality and, in particular, Russia’s absolute domination in the Caucasian region, the term “the Transcaucasus” was used right up until the beginning of the 1990s.

The first attempt to reject the Russian model of geopolitical division of the region was to replace the term “the Transcaucasus” with the more correct term “the Southern Caucasus,” which includes all the same republics—Azerbaijan, Georgia, and Armenia.

It should be emphasized that the concept “the Southern Caucasus,” just as the category “the Transcaucasus” before it, has a “Russian” geopolitical meaning, since it designated the part of the Caucasian region that has achieved its independence from Russia, unlike the Northern Caucasus which remained part of the Russian Federation. The division of the Caucasus into these two parts is carried out again in correspondence with the borders between Russia and the independent Caucasian countries. It is no coincidence that the term “the Southern Caucasus” went into circulation and was endorsed as soon as the U.S.S.R. collapsed. In so doing, the category “the Southern Caucasus” reflected an important aspect of the new geopolitical situation in the Caucasus—the emergence of three independent states there.

The historical significance of this event cannot be overestimated in the further fate of the peoples of the entire Caucasus, since it laid down the foundation for building a United Caucasus in the future by granting the largest Caucasian nations their own statehood and opening the way for their consolidation.

In this respect, the meaning of the concept “Caucasian state” should be clarified. First, like any, this state should possess the necessary attributes of statehood. Second, it should be territorially located in the Caucasus. At present, only Azerbaijan, Georgia and Armenia correspond fully to the listed conditions. As for Russia, this state can be considered contiguous, since only a small part of its territory belongs to the Caucasus.

In light of this, another semantic load of the concept “the Southern Caucasus” can be singled out. This is possibly a not fully recognized striving to underline the Caucasian nature of the three South Caucasian states in counterbalance to Russia, which is constantly claiming the status of a Caucasian state with a certain geopolitical undertone.

Nevertheless, the term “the Southern Caucasus” in its present meaning, in our opinion, does not entirely adequately reflect the changes in gist and content of the geopolitical processes going on in the Caucasus. The mechanical exchange of one concept for another is essentially taking place

within the framework of the former Russian model for structuring the Caucasus, dividing it into the Northern and the Southern (the Transcaucasus) within the post-Soviet space. This model suffers in our opinion from two main drawbacks. First, it has outlived itself, since its foundation has disappeared—the geopolitical reality of Russia’s monopoly domination in the Caucasus. Second, this model is based on an incorrect reflection of historically developed socioeconomic, sociocultural, and ethnic parameters of the Caucasus. The matter concerns the unjustified shrinking of these parameters due to the fact that the northeastern regions of Turkey (the Kars, Ardahan, Artvin, Igdyr, and other *ils*) and the northwestern regions of Iran (the East Azerbaijan and West Azerbaijan *ostans*) are not included in the Caucasian region. Many centuries before Russia conquered the Caucasus, these regions were part of the same socioeconomic and ethnocultural area, where even today Caucasian peoples mainly live, which makes it possible to consider them “Caucasian” regions of these countries, like the Caucasian region of Russia (the Northern Caucasus).

The fact that Armenia, which is indisputably considered a Caucasian state, just like the aforementioned regions of Turkey and Iran, is located beyond the Greater Caucasus can also be presented in favor of this argument. What is more, both Armenia and the northeastern regions of Turkey (Kars, Igdyr, Ardahan, and others) are equidistant from the Greater Caucasus and are partially located in the Lesser Caucasus.

Based on the above, we offer the following way of structuring the Caucasian region [Ismailov, E., 2002; Ismailov and Kengerli, 2003]:<sup>3</sup>

1. *The Central Caucasus*, including the three independent states—Azerbaijan, Georgia, Armenia;
2. *The Northern Caucasus*, consisting of the border autonomous state formations of the Russian Federation;
3. *The Southern Caucasus*, including the *ils* of Turkey bordering on Azerbaijan, Georgia, and Armenia (*Southwestern Caucasus*) and the northwestern *ostans* of Iran (*Southeastern Caucasus*).

In our opinion, the offered version for defining the parameters of the Caucasus and dividing its socioeconomic space most fully and precisely reproduces current geopolitical reality in the region, encompasses all its

components (countries, regions, and autonomous formations), and takes into account the historically developed specific features of the Caucasus as a sociocultural formation.<sup>4</sup> What is more, division of the Caucasian region into its central, northern, and southern parts makes it possible to designate essentially new and realistic ways of developing the integration processes in the Caucasus.

### **1.4. Political Prerequisites of Economic Integration in the Central Caucasus**

In contrast to the traditional approaches encompassing only the territory of the post-Soviet space (the Northern Caucasus and the Transcaucasus), the offered methodology for determining the parameters and structure of the socioeconomic space of the Caucasus also presumes inclusion of the northwestern regions of Iran and the northeastern regions of Turkey. At first glance, this may seem to complicate even more the already extremely complicated geopolitical picture of the region. But precisely this posing of the question makes it possible to replenish the integrity of the Caucasus with its missing elements and, in so doing, achieve dynamic, stable, and systemic development of the integration processes throughout the entire region. In other words, we are proposing a 3+3 Caucasian integration model which unites the independent states of the Central Caucasus (Armenia, Azerbaijan, and Georgia) and the regional states (Iran, Russia, and Turkey).

An analysis of the contemporary geopolitical picture of the Caucasus within the framework of the proposed model makes it possible to precisely define the sociopolitical prerequisites for integration of the entire region, as well as identify the essential socioeconomic relations among its components.

The Caucasus as an integrated socioeconomic region was and still is in the sphere of special interests of the regional nations—Iran, Russia, and Turkey [Avakov and Lisov (eds.), 2000, 2002; Kajaman, 2004; Nahavandi, 1996]. Each of these countries has its own interests in this region and its own idea of its integrity and has influenced and is still influencing integration of the Caucasian state formations and the rates of their develop-

ment using its own political-legal and economic levers. What is more, the correlation of forces of the regional nations periodically changed and, as a rule, each time only one of them had monopoly domination in the region. The last such monopolist was Russia.

Taking into account the contemporary geopolitical trends and the three former “Transcaucasian” republics gaining their independence, a situation is currently developing for the first time in which all the regional powers, due to their border regions’ participation, have equal opportunities for simultaneous involvement in the Caucasian integration processes. This, in the final analysis, is helping to turn the Caucasus from a bone of contention into a region where the interests of all the regional powers can be coordinated. In so doing, a real opportunity is appearing for settling the existing conflicts and problems in the Caucasus. As a result, the likelihood of realizing the essential interests of the region as a whole and of each of its parts individually is becoming much greater.

During the last decade, the biggest changes have occurred in the Central Caucasus. Only in this part of the Caucasus did Caucasian states—Azerbaijan, Armenia, and Georgia—arise and reinforce their independence, the sovereignty of which allows them to independently define their own geostrategic reference points. A priority area of Azerbaijan’s and Georgia’s foreign policy is rapprochement with the West and Turkey, and these countries are more or less successfully moving along the designated path. Armenia, on the other hand, is still oriented toward Russia, while also carrying out a policy of rapprochement with Iran. In this way, it can be said that the Central Caucasian states are headed in different geostrategic directions, which is prompting the formation of different political alliances in the region (Turkey-Azerbaijan-Georgia and Russia-Iran-Armenia).<sup>5</sup> This is precisely why there is a high level of ethno-political conflict in the Central Caucasus, where two states—Azerbaijan and Armenia—are in a state of war, and Georgia is being pounded from within by several separatist movements (Abkhazian and South Ossetian) [Darchiashvili, 2000; Diasamidze, 2002; Gogueliani, 2003].

When focusing attention on the common features of Azerbaijan’s and Georgia’s geostrategic reference points, it should be noted that they are helping to strengthen the economic and political ties between these countries. On the other hand, Armenia’s expansionist policy toward Azerbaijan

(at the beginning of the 1990s, 200,000 Azerbaijanis were deported from Armenia, who are its indigenous residents, and approximately 20 percent of the territory of the Azerbaijan Republic was seized) is giving rise to many of the present breakdowns in socioeconomic relations and transportation communication lines in the Central Caucasus.

In essence, due to its policy toward Azerbaijan, Armenia is isolating itself from the integration processes in the Central Caucasus: the transportation arteries going through the Caucasus bypass Armenia. What is more, due to Armenia's geographical location, economic ties can essentially be established among the Central, Northern, and Southern Caucasus without it. The common borders (Azerbaijan has a border with Turkey, Russia, Iran, and access to the Caspian Sea, and Georgia has a border with Russia, Turkey, and access to the Black Sea) are promoting activation of economic ties both between each of these countries, and between the Caucasus as a whole and other economic regions. According to this principle, the so-called planetary function of the Caucasus from the transportation-geographical viewpoint can essentially be implemented regardless of Armenia's participation in regional integration. What is more, it should be acknowledged that this state's policy, primarily toward Azerbaijan, is leading to an increase in tension and instability in the region.

The Northern and Southern Caucasus are under different (compared with the Central Caucasus) sociopolitical conditions of participation in regional integration. Being part of Russia, Turkey, and Iran, these areas of the Caucasus objectively do not have the possibility of independently participating in the Caucasian integration process. Therefore, when establishing relations with the Central Caucasian states, they are acting within the framework defined by the policy and legislation of their states. At the same time, there are also differences between the political statuses of the Northern and the Southern Caucasus: the Northern Caucasus is represented by the autonomous republics of the Russian Federation, while the Southern Caucasus consists of regions of the unitary states of Iran and Turkey, which do not have political autonomy. In other words, the Northern Caucasus has relatively broader political and legal opportunities for establishing economic, political, and cultural contacts with the Central Caucasian countries. From the viewpoint of the region's

integration prospects, the Northern Caucasus also has the advantage over the Southern Caucasus of recently being part of the U.S.S.R.'s unified national economic complex along with the Central Caucasus, and now being part of a state which belongs, along with the Central Caucasian states, to the CIS. What is more, the Southern Caucasus is divided by the state border between Turkey and Iran, which are traditional rivals. This border creates certain hindrances to integration of its eastern and western parts.

On the other hand, the Northern Caucasus, in contrast to the Southern, is a high conflict-prone and instable zone. After the disintegration of the U.S.S.R., the local peoples began a movement for independence which in certain cases turned into ethnopolitical conflicts. The most acute of them—the Russian-Chechen—is having a destabilizing effect on the entire Northern Caucasus and partly on the Central Caucasus. The consequences of this conflict are having a detrimental effect on the functioning of economic relations and the transportation communication channels between the North Caucasian regions, as well as between them and the Central Caucasus.

So an analysis of the sociopolitical processes going on in the Caucasus today shows that this region is a heterogeneous geopolitical and socioeconomic space characterized by:

1. unequal political-legal opportunities for its parts to participate in regional integration (in the Central Caucasus—independent states, in the Northern Caucasus—autonomous state formations, in the Southern Caucasus—administrative regions);
2. different geostrategic directions of its parts, and this gives rise to the current high level of the region's ethnopolitical conflict-proneness, the breakdown in intra-regional economic relations, the splits in the information and communication space, and so on.

The current situation throughout the Caucasus does not favor achieving regional integration. Nevertheless, *we are proceeding from recognition of the essential possibility and inevitability of integration of the entire Caucasus, since the historically socioeconomic ties between its peoples have promoted the formation of an interrelated regional economy, common Caucasian values, and a common Caucasian mentality.* Along with



this, the idea of regional integration is currently prevalent in the public opinion of most of the Caucasian states, which is reflected in the statements of the leaders of the Caucasian nations about the need to form a common Caucasian Home in the region.

Despite the historical inevitability and huge potential integration possibilities of the entire Caucasus, we must keep in mind that this process is distinguished by extreme contradictoriness, complexity, and duration, and presumes singling out the following main levels:

- Integration of the Central Caucasian countries;
- Integration of the Central Caucasus with the Northern and Southern Caucasus within the existing borders and with the inviolable sovereignty of all the states of the region.

At the current stage, regional reality as the logical and historical first step presumes establishing integration relations between the Central Caucasian states [Deklaratsia (Declaration), 1997], because this is where the Caucasian states are located which are capable of independently drawing up and implementing their own development strategy. What is more, the world community is interested in the peaceful coexistence of the Central Caucasian countries, since this region is a central junction in the system of transportation arteries connecting the West with the East and the North with the South. These conditions are making it possible for the Central Caucasian countries to act as the initiators of regional integration. As for Caucasian integration, that is, integration of the Central Caucasus with the Northern and Southern Caucasus, the achievement of this goal is only possible in the distant future and exclusively with the simultaneous involvement of Russia, Turkey, and Iran in the integration processes.

As noted above, the Central Caucasus is the initializing nucleus of regional integration. We mean Azerbaijan and Georgia, since only these states have all the necessary prerequisites for laying down a solid foundation for a United Caucasus. The main ones among them can be singled out:

- Throughout history, the Azerbaijani and Georgian people have lived in peace without ethnic conflicts or any obvious contradictions; for many centuries and today, Azerbaijanis live peacefully in Georgia and Georgians in Azerbaijan;

- The main natural-geographical and social-demographic parameters of Azerbaijan and Georgia (territory, population, and so on) are approximately the same;
- Azerbaijan and Georgia are headed in the same direction in their geopolitical development strategies;
- Azerbaijan and Georgia constitute the main transportation corridor between the Caspian and Black seas, the significance of which is dramatically growing in view of implementation of the TRACECA project;
- Joint participation of Azerbaijan and Georgia in regional political and economic unions;
- Joint participation of Azerbaijan and Georgia in building and carrying out regionally significant projects: the Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline;
- The Declaration on Peace, Security, and Cooperation in the Caucasian Region adopted jointly by Azerbaijan and Georgia in 1996 is the foundation for creating and developing economic relations between them.

The above is confirmed again by the fact that despite the existing conflicts, integration processes in the Central Caucasus are gaining momentum due to the growing cooperation between Azerbaijan and Georgia [Mollazade, 1999]. Strategic partnership between Azerbaijan and Georgia is developing on this fertile ground [Papava, 1998; Papava and Gogatadze, 1998], which is an objective basis for beginning movement toward economic integration [Papava, Vladimer, 2002b, 2002c].

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#### NOTES

<sup>1</sup> See: “Zakavkazskiy Seym” (Transcaucasian Diet). In: [SIE, 1964, pp. 599-600].

<sup>2</sup> It should be noted that the current idea of a Caucasian Home, excluding the dominating role of any one state [Aliiev, R., 1998], significantly differs from the model that arose as early as the 19th century in Great Britain aimed at raising Turkey’s role in the Caucasus [Avetisian, 1998].

<sup>3</sup> See also: [Beridze, Ismailov, and Papava, 2004, Ch. 1].

- <sup>4</sup> It should be noted that recently the term “Central Eurasia” is becoming increasingly popular, which implies all the countries of Central Asia and the Southern Caucasus (Armenia, Azerbaijan, and Georgia) [Fairbanks, Nelson, Starr, and Weisbrode, 2001]. Consequently, linguistically too, the concept “the Central Caucasus” is more in tune with Central Eurasia and Central Asia than the concept “the Southern Caucasus.”
- <sup>5</sup> Among the multitude of publications on the common interests of Russia, Iran, and Armenia, we particularly single out [Cornell, 1998, Petrossian, 1999].

Certain superficial symptoms of a rapprochement of Russian and Turkish interests in the Caucasus have appeared recently (for example, Turkey’s consumption of Russian gas, or the identical approaches to territorial integrity, taking into account the Chechen and Kurdish problems, respectively, which in no way means profound trends in the rapprochement of these interests, as some experts seem to think [Hill and Taspinar, 2006].

# Essay **2** | ON THE INTEGRATIONABILITY OF THE CAUCASUS

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*Eldar Ismailov*

## **2.1. A Short Excursion into History**

The formation of a system for governing the “United” Caucasus has a long history. As a component of different empires throughout history, this system underwent significant modification every time. In so doing, it stands to reason that imperial systems left their mark on the integrationability of the Caucasus. On the whole, they (as entities of governance) played a consolidating role with respect to the Caucasus (as an object of governance). Under this influence, the object itself became integrated, although at certain times in history, which we will talk about below, the centralized administration of the Caucasus was extremely fragile.

In order to substantiate this, we will take a short excursion into history. At the beginning of the 16th century, independent state formations existed in the Northern Caucasus, the most significant of which were the Avarian Khanate, the Daghestani Shamkhalate, and several others [Piotrovskiy (ed.), 1988, pp. 292-294]. By the mid-16th century, all of these independent feudal dominions were under the protectorate of the Ottoman Empire, although they retained their own system of governance and local currency.

Things were a little different in the Central Caucasus. As a result of the collapse of the united Georgian state in the 15th century, which had existed since the 12th century [SIE, 1963, pp. 812-814], in the western part of the Central Caucasus, three independent czardoms arose at the same time—Imereti, Kartli, and Kakheti—and one principedom—Samtskhe. In the eastern part of the Central Caucasus, the ancient Azerbaijani state of Shirvanshakhs, which arose in the 9th century [Velikhanly (ed.), 1998, p. 296], and the Shekinskoe dominion were on their last leg.

As for the Southern Caucasus, this region was divided between two powerful neighbors—the Sefevid and Ottoman empires.

The long confrontation between the Sefevid shahs and the Ottoman sultans led to an abrupt change in the situation throughout the entire Caucasian region. As a result of the Amasiiskiy Peace Treaty entered between the sides sparring for the Caucasus in 1555, the Imereti Czardom [SIE, 1964, p. 804] and Samtskhe Princedom [SIE, 1969, p. 524] were subordinated to the Ottoman Empire for more than two centuries. In 1628, the Akhaltsikhe pashalik was created in the Samtskhe-Saatabago Princedom by the Ottomans [Berdzenishvili (ed.), 1961, p. 142]. At the same time, the entire eastern part of the Central Caucasus, including the Georgian czardoms of Kartli and Kakheti, territories of the already former Shirvanshakh state (abolished in 1538), and the Shekinskoe feudal dominion (abolished in 1551), was subordinated to the Sefevid Empire. The mentioned lands were part of three beylerbeyliks (the Shirvan, Karabakh, and Chukhursaad). The Sefevids created an Azerbaijani (Tabriz) beylerbeylik in their part of the Southern Caucasus (the southeastern part). Administration was under the strict control of the shah's court, and Sefevid currency—the *ab-basi* (*abaz*)—was in circulation there.

It stands to reason that the Ottoman system of governance was widespread in the mountainous area of the Northern Caucasus and the western parts of the Central and Southern Caucasus, which were under the powerful influence and, most important, part of the Ottoman Empire. In these regions of the Caucasus, the standard Ottoman currency—the *piast* (*ku-rush*)—was in circulation.

This situation in the Caucasian region, with a few insignificant changes one way or the other (between the Ottomans and the Sefevids), remained right up until the first quarter of the 18th century, when the Russian Empire became actively involved in the struggle for the Caucasus [Breyfogle, 2005]. Even before its final establishment in the Northern and Central Caucasus, czarism began deliberately and consistently to form a new administrative-territorial structure in the region. It introduced the Russian model of governance and the principles of territorial division of the Caucasian region, and it also established interrelations with the region's former independent state formations. By 1844, the Russian Empire had created an integrated regional system of governance of the conquered

region for the first time—the Caucasian vicegerency. Gubernias, oblasts, and okrugs were created, which were supervised by Russian bureaucrats. A czarist vicegerent, who lived in the city of Tiflis (this is how the name of the Georgian capital of Tbilisi became Russified), headed the central body of coordination and control over all socioeconomic life in the Northern and Central Caucasus.<sup>1</sup> In this way, the first Russian unified administrative system of governance was introduced in the Caucasus (Northern and Central). Czarism also began to actively introduce its own currency—the ruble—in the obedient Caucasus.

In keeping with the chosen course, the czarist government carried out administrative reform in the Caucasus in 1846. Six gubernias were created in the Central Caucasus—Shemakha (after 1859, the Baku gubernia), Tiflis, Kutaisi, Irevan, Elizavetpol, and Black Sea. As early as 1844, due to Shamil's increasingly frequent uprisings, the Dzharo-Belokan oblast was transformed into a military district of the same name, the head of which was endowed with the rights of a governor. In the Northern Caucasus, in addition to the existing Astrakhan gubernia, in 1846-1847, the Derbent and Stavropol gubernias were created (see Table 2.1).

Table 2.1

**Administrative-Territorial Division of the Caucasus  
in the Russian Empire: 1721-1917**

Division Region	Gubernias		Oblasts		Okrugs	
	Name	Years	Name	Years	Name	Years
<b>Northern Caucasus</b>	Astrakhan	1715- 1785, 1796	Astrakhan	1785- 1796		
	Caucasian	1785- 1822	Caucasian	1822- 1847		
	Stavropol	1847- 1917				
	Derbent	1846- 1860	Daghestan	1860- 1917		

Table 2.1 (continued)

Division Region	Gubernias		Oblasts		Okrugs	
	Name	Years	Name	Years	Name	Years
			“Don Cossack Host Region” Terek	1786- 1917  1806- 1917		
			Kuban	1860- 1920		
	Black Sea	1896- 1917			Black Sea	1867
<b>Central Caucasus</b>  <i>Georgia</i>      <i>Azerbaijan</i>						
	Georgian	1801				
	Georgian- Imereti	1841- 1846				
	Tiflis	1846- 1917				
	Kutaisi	1846- 1917				
			Batumi	1878- 1917	Sukhumi	1866- 1917
	Shemakha	1846- 1859	Caspian (from Derbent to Astara)	1722- 1735		
	Irevan	1850- 1917	Dzharo- Belokan	1830- 1844	Dzharo- Belokan Zakataly	1844- 1860 1860- 1917

Table 2.1 (continued)

Division Region	Gubernias		Oblasts		Okrugs	
	Name	Years	Name	Years	Name	Years
	Baku	1859-1917	Caspian (Northern Azerbaijan)	1840-1846		
	Elizavetpol	1868-1917				
Southwestern Caucasus			Kars	1828-1917		
			Akhalsikhe	1878-1917		
Southeastern Caucasus			Caspian (from Astara to Resht)	1722-1732		

The czarist authorities in the Caucasus completely eradicated the remnants of independence to which the local state formations still clung. For example, in the 1860s, the Daghestani khanates (Kyurin, Mehtulin, and Avarian) and shamkhalate were abolished. In the Central Caucasus, during the same years, Abkhazia (Abkhzeti), Megrelia (Samegrelo) and Svanetia (Svaneti) were deprived of the remnants of their autonomy [Gaprindashvili and Zhordania (eds.), 1990, pp. 165, 167-168].

In the Southern Caucasus, both in its southwestern and southeastern parts, including the Kars pashalik (part of the Ottoman state) and Azerbaijani (Tabriz) beylerbeylik (part of Iran), the former systems of governance of the corresponding state centers, as well as their currency, were still in place in the mid-19th century.

As a result of the Russian Empire's victory in the war with the Ottoman state, the Kars pashalik (Southwestern Caucasus) was transferred to the czarist authorities' control in 1878. Here a Russian system of governance was also established, the Kars oblast was created in the Caucasian vicegerency and the Russian ruble was put into circulation.



In this way, beginning in 1878, almost the entire Caucasus—Central, Northern, and Southern (without the southeastern part, which belonged to Iran)—was included in the sociopolitical space of the Russian Empire and functioned as a single, integrated socioeconomic and financial-institutional system—the Caucasian vicegerency.

Only after the collapse of the Russian Empire in February 1917 was the vicegerency in the Caucasus abolished. In 1918, independent republics and integrated state formations emerged in the Caucasian region.

For example, in the piedmont of the Northern Caucasus, the Don, Terek, Kuban, Black Sea, and other Soviet republics arose and existed for a while [SIE, 1964, p. 305; 1965, p. 241; 1975, pp. 199-201]. In 1918, some of these new state formations became integrated into the North Caucasian Soviet Republic (it included the Kuban-Black Sea, Terek, and Stavropol Soviet republics) [SIE, 1969, p. 671].

The same situation developed in the Central Caucasus, where on the basis of the former Transcaucasian gubernias, an integrated state arose in 1918—the Transcaucasian Democratic Federative Republic (T.D.F.R.) [Aliev, Ig. (ed.), 1995, pp. 350-351; Berdzenishvili (ed.), 1961, pp. 294-297; Nersisian (ed.), 1980, pp. 280-281]. After existing for just over one month, it broke down into three independent, democratic states: the Azerbaijan Democratic Republic [Dokumenty [Documents], 1998], the Ararat Republic [Sarkisian, Khudaverdian, and Iuzbashian, 1998, pp. 217-234], and the Democratic Republic of Georgia [Dokumenty [Documents], 1919, pp. 332-338].

The same thing can be seen in the Southern Caucasus. The Southwestern Caucasian (Kars) Democratic Republic and the Araz-Turkic Republic arose in the southwestern part, and the Republic of Azadestan and the Soviet Gilian Republic in the southeastern part.

After reinforcing their position in the 1920s, the authorities of Russia, Iran, and Turkey began to conduct a coordinated policy in the Caucasus (Northern, Central, and Southern) aimed at abolishing the local independent state formations. Gradually all the independent Caucasian states were abolished. In Iran and Turkey, they were transformed into administrative-territorial units—*ostans* and *vilayets*, respectively. In the former Russian Empire (Northern and Central Caucasus), first Soviet republics were created (on new principles—socialist), which were later

integrated into a single state formation with their own regional financial-institutional systems of governance and currency: in the Northern Caucasus—into the Mountain Autonomous Soviet Socialist Republic (M.A.S.S.R.), and in the Central Caucasus—into the Transcaucasian Soviet Federative Socialist Republic (T.S.F.S.R.). As the governance system of the socioeconomic processes in the Soviet state developed, these regional party-legal and financial-economic institutions were abolished—in 1924 and 1936, respectively.

Nevertheless, the main institutions of regional governance were retained: military-strategic and political—the Transcaucasian and North Caucasian Military and Border districts, the Transcaucasian and North Caucasian railroad, the Transcaucasian and North Caucasian Energy System, the Transcaucasian Higher Party School, and so on; and economic—corresponding structures in the central (Union) bodies of state administration of the economy (of the Transcaucasian and North Caucasian economic regions). The mentioned institutions functioned right up until the collapse of the U.S.S.R. in 1991.

So, during the past five centuries, the Caucasus has been in and out of various imperial systems of governance: the Ottoman, Sefevid, Iranian, Russian, and Russian-Soviet. The most complete and integrated was the governance system of the Russian Empire in the form of the Caucasian vicegerency, which at certain times included almost the entire Caucasus (apart from the southeastern subregion, although its Caspian part, Gilian, belonged to the Caspian region of Russia in 1722-1732).

When independent republics formed in the Central Caucasus in the 1990s, the single sociopolitical and economic space of the Soviet Caucasus disintegrated and each country, based on its own specific features, began to create its own political-legal and financial-economic institutions. This, in turn, presumes their coordination aimed at accelerating the socioeconomic development of the entire region.

As in Soviet times, the Northern Caucasus (the North Caucasian economic region) remained part of a single political and economic space. In 2001, it was incorporated into the Southern Federal District of the Russian Federation which formed at that time. This presumes greater integration of the Northern Caucasus with Russia's other southern regions, while in the

recent Soviet past, the economy of the Northern Caucasus was more integrated with the Transcaucasian economic region.

In the Southern Caucasus, the systems of governance and currency of the Turkish Republic and the Islamic Republic of Iran are still in place in its southwestern and southeastern parts, respectively.

During the past two centuries, integration in the Caucasus took shape and was supervised mainly by the Russian (in 1785-1822, the Caucasian vicegerency in the Northern Caucasus with its center in Ekaterinograd, and in 1844-1917, it subsequently included the Northern, Central, and Southwestern Caucasus with its center in Tiflis) and the Soviet empires (M.A.S.S.R., 1920-1924 and T.S.F.S.R., 1922-1936). In addition to this, the Center (Moscow), shifting from the political-economic principle of governance to the party-economic, created the C.P.S.U. Central Committee Bureau for the Transcaucasus and, in keeping with this, identified the Transcaucasian and North Caucasian economic regions as independent units within the single national economic complex of the country and the Russian Federation, respectively (1954-1991). Between 1844 and 1917, the Northern, Central, and Southwestern (since 1878) Caucasus, belonging to the Caucasian vicegerency of the Russian Empire, were governed from a single regional center by the czarist vicegerent in the Caucasus with its headquarters in Tiflis. In the Soviet Empire, the governance systems of the Northern (M.A.S.S.R. and Daghestan A.S.S.R., later the North Caucasian economic region) and the Central Caucasus (T.S.F.S.R., Transcaucasian economic region, C.P.S.U. Central Committee Bureau for the Transcaucasus) were divided and coordinated by Moscow.

Nevertheless, it should be noted in particular that even during the periods of their independence, the Caucasian peoples also created their own integrated state formations and, correspondingly, regional economic-financial and legal institutions of governance. For example, the Imamate of Sheikh Shamil (1835-1856) and the Mountain Republic (1920-1924) formed in the Northern Caucasus, as well as the Transcaucasian Democratic Federative Republic (April 1918) in the Central Caucasus.

So this short excursion into the history of sociopolitical and economic life in the Caucasus showed that, despite its history saturated with contradictory trends, integrated formations (governance systems) formed in this region. This was observed both during periods of independence of the in-

digenous peoples of the Caucasus, and during periods when they belonged to various imperial systems of governance, which shows the existence of objective trends toward regional integration.

## **2.2. The Contemporary State of Caucasian Integrationability**

Before turning directly to an analysis of the contemporary integration processes in the Caucasus, it would be wise to make a short detour to clarify the meaning of the term “integration.” In our day and age, this term has become extremely widespread and is frequently used to describe phenomena which are very different from each other.

First, cooperation at the global level is called integration (for example, when talking about a country’s integration into the world financial system, integration of world markets, or integration between Europe and America). Second, there is the persistent concept of regional integration among the independent states (along the lines of the European Union, NAFTA, ASEAN, and so on). Third, there has recently been frequent talk about integration among the regions or markets of the same state.

We will note that all of these three phenomena are totally different in essence and are developing in keeping with their own specific laws. Here we will talk about integration in its original and most widespread understanding—regional integration among individual countries. In so doing, economic integration should be especially singled out, which is qualitatively the higher level of cooperation, whereby intrinsic coordination is achieved in carrying out the reproduction process in individual countries. Given their sovereignty and market relations, coordinated development of interstate cooperation and exchange is of immense significance.

At the turn of the 21st century, as a result of the formation of independent states in the Central Caucasus, the region’s countries acquired another opportunity to become integrated into a single economic union meeting the essential interests of the region’s development as a whole and each of its components individually. But this task can only be carried out if a realistic model of Caucasian integration is developed.

The short historical review of the system of governance in the Caucasus in the 18th-20th centuries showed that the peoples of the region, both during periods of dependence on regional powers, and during the years of independence, strove for integration. As a result, in the end, different types of integrated state formations emerged with their own special government and financial-institutional structures and common currencies. These integrated state formations largely appeared in Russia's geopolitical space, that is, in the Northern and Central Caucasus. As for the Southern Caucasus, parts of which belonged and still belong to Turkey and Iran, independent state formations did not appear and, correspondingly, their integration was impossible. In these areas, either independent state formations appeared only sporadically, or they were drawn into the sociopolitical and economic life of the Caucasus, which was part of the Russian Empire.

In keeping with the political principles in effect in the former Soviet Union, before the collapse of the U.S.S.R., the Southern Caucasus was behind the Iron Curtain. For the reasons already mentioned, integration processes largely developed between the Northern and Central Caucasus, and the southern part of the Caucasus remained outside general Caucasian integration. The same can be said for the integration processes between the parts of the Southern Caucasus, that is, between the Southwestern and Southeastern Caucasus.

As of today, the Northern Caucasus, which consists of eight republics (Adigey, Dagestan, Ingushetia, Chechnia, Kabardino-Balkaria, Karachaevo-Cherkessia, North Ossetia-Alania, and Kalmykia) and four administrative units (the Krasnodar, Stavropol, Rostov, and Astrakhan regions), belongs to the Southern Federal District of the Russian Federation.<sup>2</sup> In the Northern Caucasus, as during the Soviet era, a common currency is still in circulation—the ruble, as well as integrated organizational-legal institutions and financial mechanisms of regional integration.

Under current conditions, each of the entities located in the Central Caucasus independently establishes financial-institutional ties with each other, whereby the degree of independence of these ties differs and the relations between the countries are developing differently.

After acquiring their independence, the republics of the Central Caucasus joined several regional associations—the ECO, CIS, BSECO, GUUAM (later GUAM), and others—although they have still not gleaned

any significant benefits from this participation. In our opinion, there are objective reasons for this. One of them is the politicization of the mentioned associations, another lies in the fact that they have only just formed and have not yet accumulated sufficient experience of cooperation under the new conditions. For example, the ECO is a club of Muslim countries demonstrating their solidarity and uniting countries of different orientation from a large region, beginning with Islamist Afghanistan and ending with secular Azerbaijan. There are also significant differences in the goals, principles, methods, and forms in which they function, which, of course, predetermined the areas and rates of economic development of the components of this regional union.

In the economic space of the former U.S.S.R., steps are also being taken to form a regional integrated association, but at present, due to a whole slew of objective reasons, they have not yielded the anticipated results. A graphic example of this is the significant political difficulties in creating the CIS in 1991. In addition to this, at present, 27 tariff and approximately 200 non-tariff customs restrictions exist among the CIS countries, which there are plans to gradually abolish over the next ten years. The economic goals set in GUAM are also being implemented slowly. Cooperation among the countries belonging to the BSECO is developing more dynamically. It should be noted that only Azerbaijan and Georgia of the Central Caucasian countries participate in the ECO and GUAM, while Armenia participates in the EurAsEC as an observer. These countries are all members of other regional associations (the CIS and BSECO) (Table 2.2).

Table 2.2

**Participation of the Central Caucasian Countries  
in Regional Associations**

<b>Associations Countries</b>	<b>CIS</b>	<b>EurAsEC</b>	<b>BSECO</b>	<b>GUAM</b>	<b>ECO</b>
Azerbaijan	+	—	+	+	+
Georgia	+	—	+	+	—
Armenia	+	+	+	—	—

At the beginning of the 1990s, the possibilities of expanding foreign trade with neighboring states helped to accelerate the formation of these regional associations. The Central Caucasian countries believed that the benefits from this cooperation could more likely be realized if there were integration among countries with different, but mutually complimentary production possibilities in the most profitable industries, and that integration itself would be accompanied by a significant reduction in tariff restrictions and the granting of extremely moderate regional preferences. In practice, however, the entities of regional associations were not guided by the aforementioned considerations in their activity, so the effect from it was insignificant.

Let's take, for example, the plans to put the Rustavi Metallurgical Combine back into operation. In Soviet times, this enterprise put out millions of tons of steel and pig iron every year, and the ore for production was delivered from the Azerbaijani town of Dashkesan. At present, due to unsuccessful attempts to find a major investor, the combine has long been standing idle. This and other similar examples are hindering the revival of economic integration between Georgia and Azerbaijan to a certain extent.

The level of integration in the systems of governance is also acquiring vital importance. For example, the CIS was considered the best formed integration union, while GUAM is only just beginning this process. Along with this, attention should be focused on the fact that the benefits of integration are determined not only by measures of foreign trade policy, but also by joint efforts to improve the infrastructure and service sphere. For example, such regional unions as the BSECO and ECO have a powerful banking structure, while the CIS and GUAM are making their first attempts to create a common interstate bank.

In the 20th century, a system of international regulation of economic exchange formed in the world.<sup>3</sup> At present, the standards and rules for carrying it out are coordinated multilaterally within the framework of specialized international institutions, such as the IMF, WB, WTO, and others. The Caucasian countries are members of the IMF and WB and directly cooperate with these organizations. On the whole, their share in the total volume of credits allotted to the Central Caucasian republics by international financial institutions (IFI) amounted to 33.9 percent and 56.2 percent, respectively.

As the data of Table 2.3. show, in 1995-2003, the WB granted Azerbaijan credits amounting to 544.8 million USD (33.0 percent of this organization's total index for the Central Caucasus) and the IMF allotted 486.3 million USD (48.9 percent); these same organizations granted 511.1 million USD (31.0 percent) and 304.1 million USD (30.6 percent) to Georgia, and 593.0 million USD (36.0 percent) and 203.7 million USD (20.5 percent) to Armenia, respectively. In terms of the credited funds they have allotted, the mentioned financial institutions predominate in the Central Caucasian countries. They account for 43.7 and 39.0 percent of all the credited funds allotted to Azerbaijan by IFI; 59.6 and 35.5 percent of the funds allotted to Georgia, and 71.4 and 24.5 percent of the funds allotted to Armenia, respectively.

The EBRD is stepping up its activity, particularly in recent years, which is most clearly seen in Azerbaijan. It was allotted 148.0 million USD, which amounts to 2/3 of the total amount of investments in the Central Caucasian countries. The ADB and IDB are also intensifying their activity in Azerbaijan (see Table 2.3).

Table 2.3

**Credits Allotted to the Central Caucasian Countries  
by International Financial Institutions (as of 1 July 2003)**

Countries Creditors	Azerbaijan		Georgia		Armenia		TOTAL	
	Million USD	Percent	Million USD	Percent	Million USD	Percent	Million USD	Percent
<b>IMF</b>	486.3	48.9	304.1	30.6	203.7	20.5	<b>994,1</b>	<b>100</b>
<b>WB</b>	544.8	33.0	511.1	31.0	593.0	36.0	<b>1,648,9</b>	<b>100</b>
<b>EBRD</b>	148.0	66.0	41.7	18.6	34.6	15.4	<b>224,3</b>	<b>100</b>
<b>ADB</b>	5.9	100	—	—	—	—	<b>5,9</b>	<b>100</b>
<b>IDB</b>	61.8	100	—	—	—	—	<b>61,8</b>	<b>100</b>
<b>TOTAL</b>	1,246.8	42.5	856.9	29.2	831.1	28.3	<b>2,935,0</b>	<b>100</b>

Georgia and Armenia are members of the WTO, while Azerbaijan is holding talks about joining it.



### 2.3. Types of International Integration and the Caucasus

At the contemporary stage of globalization, the following main types (stages) of international integration can be singled out: free trade zone, customs union, common market, economic union, and political union. They have both features in common (among the countries joining a particular type of integration structure, bureaucratic barriers are largely removed in foreign economic relations) and their own specific traits.

For example, under conditions of a *free trade zone*, the countries voluntarily reject protection of their national markets in relations with their partners in this union, whereas in relations with third countries, they act individually rather than collectively, that is, they retain their economic sovereignty. Each participant in a free trade zone establishes its own tariffs with third countries. This type of integration is in effect between the countries of EFTA, NAFTA, and other integration groups. The agreement on a free trade zone can potentially be only the first step and serve as a boost for full-fledged integration processes. The most promising in this respect, in our opinion, could be economic interests associated with the creation of international transportation communication channels and the formation of conditions for their efficient operation.

Within the framework of a *customs union*, the foreign trade ties of its members with third countries are determined collectively. The participants in the union jointly establish a common tariff barrier to be used with respect to third countries. This provides the opportunity to more reliably protect the integrated regional economic space being formed and act on the international arena as a consolidated trade bloc. But in so doing, the participants of this integration union lose some of their foreign economic sovereignty. This type of integration was carried out, in particular, within the EU.

In the case of a *common market*, all the conditions of a customs union are still pertinent. What is more, restrictions are removed on the movement of various production factors, which increases the economic interdependence of the member states of the particular union. In so doing, free inter-country movement requires a higher organizational level of interstate coordination of economic policy. Decisions on this method of governing in-

tegration processes are made at regular assemblies of the heads of state and government of the member countries.

A common market cannot be considered the final stage in development of international economic integration. Freedom of movement of goods, services, capital, and labor across state borders alone is not enough to form a mature common market space. According to European experts, the following measures are required for this [Semenov, 2001, pp. 22-23]:

- equal tax levels;
- elimination of budgetary subsidies to certain enterprises and entire industries;
- removal of differences in national labor and economic legislation;
- unification of national technical and sanitary standards;
- coordination of national financial institutions and social security systems.

The implementation of these measures, accompanied by further coordination by the participants in integration of tax, monetary, antimonopoly, industrial, agrarian, and social policy, leads to the creation of a common inter-regional market of economically united countries. This stage of integration is usually called an *economic union*. At this stage of its development, the need arises in the uniting countries for regional management structures capable not only to supervise and coordinate their economic activity, but also to make efficient decisions in the name of the entire integration bloc.

Practice has shown that among the existing integration groups, the formation of an economic union progresses much slower than in the case of a customs union and common market. As an economic union develops, prerequisites are formed in these countries for a *political union*, which is the highest rung of regional integration and presumes the transformation of a mature common market space into an integrated economic and political organism. When transferring from an economic to a political union, the mutual foreign economic relations of the countries participating in it shift to interstate relations. In this case, within the framework of this region, the problem of international economic relations ceases to exist.

The institutional structure of potential political unions is still not sufficiently clear. It can be presumed with great certainty that it will have many

different aspects, depending on the historical, social, and political conditions of a particular region. But in the most general terms, the matter concerns the emergence of new multinational entities of world economic and international political relations, which act from a common economic and foreign political perspective and express the interests and political will of all the members of these unions. The formation of new vast states has essentially begun.

As already mentioned above, the state formations of the Northern and Central Caucasus in the past already enjoyed higher stages of integration, that is, both an economic and a political union. At present, they continue to exist only in the Northern Caucasus—the economic and political unions between the republics and regions of the Northern Caucasus within the Russian Federation. After the collapse of the U.S.S.R., the constituents of the Northern Caucasus remained within the Russian Federation and raised their political status (from autonomous republics to republics within the RF). They sort of “renewed” the former treaty with Soviet Russia (within the framework of the U.S.S.R.) at the same high level of integration (both political and economic). But this subregion did not acquire its geopolitical function and so could not independently integrate into the world economy, that is, execute its geo-economic function.

The Southern Caucasus has hardly changed in the geopolitical respect. The Southwestern and Southeastern Caucasus still belong to Turkey and Iran as their northeastern and northwestern parts. So today, the Southern Caucasus, like the Northern, cannot independently integrate into the world community.

Only the republics of the Central Caucasus, which have obtained political independence, have renewed their geopolitical functions once more, and in so doing have gained the opportunity to independently and fully integrate into the world economy, that is, to execute their geo-economic function.

What is more, it should be noted that the Central Caucasus is still a zone of geopolitical interests of both world and regional powers. This largely explains why this region is shaken by ethnopolitical and military conflicts [Goldenberg, 1994].

Consequently, for full integration of the Caucasus into the world community, it is primarily necessary to define and coordinate the interests of the components of the three regional powers—Russia, Turkey, and Iran—in terms of the Central Caucasus’ execution (or non-execution) of its geo-

political function. For five centuries now, these regional powers (Iran, Turkey, and Russia), believing they have the exclusive right to possess the entire Caucasus, are directly and severely clashing with each other with the constant and indirect participation of the Euro-Atlantic powers, which is naturally making it more difficult for the Caucasian region to carry out both its geopolitical and geo-economic functions.

At the same time, at the beginning of the 21st century, the foreign situation in the Central Caucasus radically changed. Whereas in the Soviet era, a high level of integration existed between the Central and Northern Caucasus and they practically had no relations with the Southern Caucasus, under the new conditions, the relations of the Central Caucasian republics both with the Northern and Southern Caucasus essentially reached the same level, whereby without any limitations.

The situation within the Central Caucasus can be characterized as heterogeneous. A military conflict has been going on for more than ten years now between Azerbaijan and Armenia. At the same time, both economic and political relations have been actively built and developed throughout this period under new principles between Georgia and Azerbaijan, which is creating real prerequisites for achieving the highest levels of integration. As for relations between Armenia and Georgia, they are developing relatively slowly and cautiously.

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## NOTES

- <sup>1</sup> Between 1882 and 1905, the position of general manager was introduced instead of vicegerent in the Caucasus (see: [Velikhanly (ed.), 2000, pp. 117, 196; 2001, p. 98]).
- <sup>2</sup> In addition to the Northern Caucasus, the Southern Federal District of the Russian Federation also includes the Volgograd Region.
- <sup>3</sup> It should be noted that extremely interesting processes having been going on in this sphere in the past decades. According to the data of experts of the Institute of German Economics (Cologne), until the mid-1980s, the volumes of international trade and foreign direct investments increased at approximately equal rates, by 7 percent a year. After 1988, the rates began to significantly differ: foreign investments increased twice as rapidly as trade. Whereas the increase in world trade during this period amounted to 10 percent a year, foreign direct investments increased annually by 19 percent [Mitra, Selowsky, *et al.*, 2002].

## 3.1. Globalization and Regionalism

An analysis of the Caucasus' geohistory shows that the socioeconomic space of this region at different stages in its history executed both a geopolitical and a geo-economic function. The correlation between them changed depending on the stage of historical development: whereas during the years of complete dependence, that is, when the region belonged to a particular empire, the entire Caucasus or its individual parts could not carry out any geofunction, during periods of varying degrees of dependence, it carried out one or the other geofunction, and during periods of independence, it executed both of the above-mentioned functions at the same time.

For example, after the Russian Empire conquered the Caucasus and during the time of the Soviet Empire, the region was a component of Russia and the U.S.S.R., respectively, and so it could not fulfill either the geopolitical or the geo-economic function.<sup>1</sup> At present, when the countries of the Central Caucasus have acquired their independence, both of the mentioned functions—geopolitical and geo-economic—are being revived. In so doing, it should be noted that at this stage, the region's geo-economic function must undergo more intensive development.

But geopolitical predilections, along with extreme enthusiasm about the national idea, in the Central Caucasus are continuing to have a strong influence on the formation and development of the geo-economic function, which in turn presumes an active search for and the drawing up of a new concise and balanced geo-economic strategy. In this respect, in the 21st century, the countries of the Central Caucasus themselves should primarily strive to ensure that geo-economic, rather than geopolitical, func-

tions dominate in the region. If the region finally begins to carry out its geo-economic function in a balanced way and can consistently develop it, this will make it possible to develop and fulfill a coordinated geopolitical function in the future, from which both the countries of the region and the world economy as a whole will benefit. Only by predominantly strengthening the geo-economic function can the Caucasus become a single, integrated, and effective functional component of the globalizing world.

World history is an endless train, kaleidoscope, of changes, where space and the components filling it (political, economic, social, power-related, and so on) are squeezing up against specifically defined geographic landmark-boundaries. In the end, new landmarks appear, the old space is renewed, and one set of states collapses to give rise to others with a different appearance. But, despite all these political transformations, the development trends of the world economy have always been oriented toward attracting and establishing efficacious interaction among its components, that is, toward forming a single global economic system. This is fully manifested at the current stage of human development too. The centripetal forces in the world dramatically intensified during the second half of the 20th century, which was reflected in such processes as regionalism and globalization, and in the creation of integrated interstate unions on every continent [Ismailov and Kengerli, 2002].

Indeed, at present the world economy is a dynamic, constantly changing, and disproportionately developing structure, which is integrating into a single whole consisting of approximately 200 national-state formations. The interrelations and interdependence among these formations is asymmetrical: diverse groups of countries, the opportunities of which are significantly differentiated, are drawn into the global integration processes to different degrees. At the same time, it goes without saying that not one country is able to efficiently exist and ensure its dynamic vital activity under conditions of economic self-sufficiency.

The former Soviet Union republics and the former countries belonging to the socialist camp encountered difficulties with adapting to the rapidly changing conditions of the world economy during the formation and development of their national economies. And in actual fact, never feeling themselves to be independent participants in the global system when they belonged to the Russian and Soviet empires, they were not ready to per-

form the role of a full-fledged world player able to defend itself independently from possible adverse influences, new global challenges, and threats. This is why an adaptable, searching economic strategy is needed which will allow each country to restructure itself on time and develop in a balanced way within the framework of regional development. After all, the global economic system is not a mechanical sum of national economies, but an integrated, self-sufficient, self-developing “population” with its own geo-economic and geofinancial laws, that is, a mobile economic and financial global structure [Kochetov, 1999, p. 214].

Under the conditions of the development trends of deep-cutting changes in the nature of relations between states associated with the substitution of system-forming factors of international economic relations, introduction of the concept “geo-economy” into circulation in the 1990s is indicative and was intended to reflect the new quality of the processes of economic development and economic integration [Gajiev, K., 2003, p. 86]. A new world economic system is forming, within the framework of which several stable socioeconomic areas are developing. These areas are emerging on the basis of structure-forming algorithms for building economic practice and fundamental competitive advantages which are being realized in the system of world labor division and which, consequently, have their own system of political and economic priorities.

During the establishment of the world economic system, the integration of individual national economies is being carried out in different ways. The main way is to form integration unions of countries located in the same geographical space and at approximately the same level of development, that is, regionalism of the world economy.<sup>2</sup>

### **3.2. Regionalism in the Post-Soviet Space**

The new era in the formation of regional unions in the world economy began with the collapse of the integrated socialist system, the Council for Mutual Economic Assistance (CMEA) [Fadeev, 1974; SEV [CMEA], 1972] and, primarily, its organizer and fulcrum, the U.S.S.R. The disappearance of opposite development trends in the two sub-global integrated formations—capitalism and socialism—ultimately promoted the appear-

ance of cardinally new laws governing global and regional integration [Portnoi, 1997]. As a result of this, socioeconomic expediency, rather than political-ideological need, was endorsed as the fundamental principle of global integration processes.

After the collapse of CMEA, qualitatively new vectors of regionalism began to arise in the space it had occupied, which can be grouped as follows:

- the revival of integration relations between the former CMEA member states and an already developed integration structure—the EU;
- the formation of integration blocs uniting the former Union republics within the post-Soviet space;
- the joining of individual post-Soviet states into integration unions with countries bordering on the former U.S.S.R.

The disappearance of CMEA—an integration formation built on a political-ideological foundation—made it possible for the East European states of the former socialist bloc (the GDR, Czechoslovakia, Hungary, Poland, and so on) to become integrated into the European Community, an age-old socioeconomic and spiritual space for them. The gathering up of individual East European countries, as well as the Baltic republics of the former U.S.S.R., into the bosom of European integration is an entirely legitimate phenomenon, since they are returning to their historical and geographical homeland. Nevertheless, other former Union republics are also striving to join the EU: this is most clearly and consistently manifested in Ukraine, Georgia, and Azerbaijan.

With the collapse of the Soviet Union, the world political community gained fifteen new state entities, each of which is facing the urgent problem of precisely defining its niche and its vector in the world integration processes [Illarionov, 1992]. As already noted above, in the footsteps of the East European states, some of the former Union republics also began steering a course toward entry into the EU. But, in contrast to the first, rapprochement with the West was in no way the main vector of the post-Soviet republics' (the Baltic states being an exception) integration into the world community. For all of them, integration opportunities appeared and continue to exist within the framework of various regional unions, and in other integration vectors.



In so doing, an important place is given to processes aimed at integration among the post-Soviet states themselves. During their few years of independence, the former Union republics have created several regional unions, which shows that the post-Soviet space still retains its necessary (although headed in different directions) integration potential (different peoples and religions). This potential is based on the common historical past of the peoples of the post-Soviet countries, and on their prolonged coexistence within the Russian Empire and the U.S.S.R., which has given rise to close economic, technical, cultural, and other relations still retained to this day.

It is important to note that during the first years of independence of the former Soviet republics, initiatives were seen which tended toward forming unions along ethnic and religious principles—the Union of Slavonic States, the Community of Turkic States, the Union of Russian Orthodox States, and so on. But none of these initiatives led to the creation of efficient integrated formations, and were limited at best to expanded cooperation in the cultural sphere. This fact convincingly shows that at the regional level, efficient integrated relations are being established exclusively on the basis of the socioeconomic principle [Ismailov and Kengerli, 2002, p. 25].

The first attempt to retain the integration space formed by the Soviet Union was the accelerated creation on Russia's initiative of the CIS as the successor of the U.S.S.R. Although this Commonwealth continues to function by momentum mainly on the old political-ideological mechanisms, an intensive search is presently underway for ways to transform integration relations aimed at preserving and developing the post-Soviet integration space, but instead on principles of socioeconomic expediency [Abbasov, 2002; Friedman, 1996; Pirozhkov, 2001; Reznikova, 2000; Shmelev, 1999].

The more than ten years of the CIS's existence [Artsishevskiy and Promskiy, 2001; Grinberg and Vardomskiy, 2001; Grinberg, Zevin, *et al.*, 2001; Isingarín, 2001; Konstantinov, 2002; Krotov, 2001; Nekipelov, 2002; Pokrovskiy, 2002; Shul'ga (head of the authors' team), 2001; Shumskiy, 2001, 2003] have shown that the arising socioeconomic principle is still not as effective an integration basis for the entire post-Soviet space as the political-ideological principle was at one time. In keeping with the latter, all the existing contradictions among the components of the former U.S.S.R. have mainly been resolved by the forceful, administrative-command method. It is precisely for this reason that the many ethnic and ter-

ritorial conflicts have still not been resolved in the CIS to this day [Coppieters, Zverev, and Trenin (eds.), 1998; Ehrhart, Kreikemeyer, and Zagorski (eds.), 1995; Kremenjuk, 1994], which began and are manifesting themselves in the most acute forms in the Caucasus [Goldenberg, 1994]. Apparently, under current conditions, integration in the post-Soviet space can be carried out most effectively in the form of separate regional unions with a relatively narrow circle of participants.

After the creation of the CIS, the first organization of this kind was the customs union between Russia and Belarus (the ethnopolitical principle), which was later joined by Kazakhstan, Kyrgyzstan, and Tajikistan. In 2000, this organization was transformed into the EurAsEC [Cherkassov, 2003; Kononovich, 2004]. Another similar union is GUUAM [Burkinskiy and Stepanov, 2001; Kurbanov, 2005; Matiichik, 2004; Nasirov, 2002]<sup>3</sup>—an organization founded by Georgia, Ukraine, Azerbaijan, and Moldova, which was later temporarily joined by Uzbekistan. In May 2005, GUUAM was reorganized into GUAM after Uzbekistan withdrew from it. One of its main goals is to create a new transportation-energy corridor in the republics of the former U.S.S.R.

Among the regional unions in the post-Soviet space, the Central Asian Economic Community (CAEC) can also be singled out, to which Kazakhstan, Uzbekistan, and Kyrgyzstan belong since 1994, and Tajikistan since March 1998.<sup>4</sup>

Along with this, in the past decade, essentially all the former U.S.S.R. republics have been participants in various regional integration unions which encompass the border territories of the disintegrated Soviet Union. The following can be singled out:

- the ECO [Esil'baev, 1996], the participants of which are Muslim countries, along with post-Soviet (Azerbaijan, Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan, and Turkmenistan), contiguous states also participate (Turkey, Pakistan, Iran, and Afghanistan);
- the BSECO [Borisenko, 1999; Goncharenko, 2001],<sup>5</sup> within the framework of which post-Soviet republics (Russia, Ukraine, Azerbaijan, Georgia, and others) and contiguous states (Turkey, Rumania, Bulgaria, and others) cooperate;
- the SCO [Arunova and Goriunkov, 2004; Glumskov, 2005; Grigorieva, 2000; Reutov, 2000; Strokan', 2001], the participants of

which are Kazakhstan, Kyrgyzstan, China, Russia, Tajikistan, and Uzbekistan.

In this way, regional integration processes, by erasing the borders of the post-Soviet space and gradually drawing republics of the former U.S.S.R. into their orbit, are helping them to enter into the world economy, on the one hand, and are leading to an increase in the influence of world and regional geopolitical and geo-economic centers in this space, on the other.

At present, it can be ascertained that there is a multitude of different vectors and regional islands of integration in the post-Soviet space. Each country, based on the vision of its place and role in this multifaceted spectrum of integration areas, as well as its ideas about how to join the “global community,” is striving to choose the optimal alternatives for itself and, correspondingly, is searching for allies and partners [Cheshkov, 1999; Efimova and Alaev (eds.), 1999; Shul’ga (head of the authors’ team), 2001].

This analysis of the integration processes in the post-Soviet space has shown that all the Caucasian states are participating in regional integration formations created on socioeconomic principles. All the regional formations to which these states belong can be considered long-range and strategic, complementary, and promoting an acceleration of their development. Caucasian integration has the highest priority, is vitally important, and allows the national interests of the region’s states to be realized to the greatest extent, the naturalness and inevitability of which has been predetermined by previous historical evolution [Ismailov, E., 1998]. Not only are the Caucasian states themselves interested in inter-Caucasian regional integration processes, but also the world community as a whole, since only an integrated Caucasus free from internal conflicts is capable of efficiently carrying out its planetary function as a bridge connecting the West and the East, as well as the North and the South, and thus of promoting globalization.

### **3.3. “New Regionalism”**

After territorial policy in the world stabilized in the 1980s, signs of significant regional activity began to appear. The main factors stimulating this activity were the functional changes in the economy combined with the

new forms of political mobilization and reconsideration of the territory's social and economic significance. In so doing, the changing context was clearly visible, which was specified not only by the state, as before—during “old regionalism,”<sup>6</sup> but also by the transforming international market and arising international regimes.

The thing is that under the unfolding conditions of spatial planning, regionalism, which blends magnificently into this process, could no longer be controlled by the outmoded mechanisms of territorial deployment and exchange. The state itself has been modified and, in the process, it has largely lost its former ability to control spatial changes and development. The state's power functions and its authority have become eroded under the impact of three vectors: internationalization (from above), regional and local challenges (from below), and the development of a market and civil society (from the side). As a result, the role of the state has weakened in governing the economy, social development, institutional structure, culture, and so on.

The elements of contemporary regionalism, which is marked by a departure beyond the boundaries of the national state, an increase in the competitive struggle in the national division of labor, a striving for change, and the absence of strict adherence to traditions, also began to arise in the same progression. Nevertheless, despite the essential changes, “old” and “new” regionalism continue to coexist, searching, in an uncomfortable tussle, for a new synthesis of the general and the specific [Keating, 1998].

“New regionalism” is inherent in the international relations of the end of the 20th-beginning of the 21st centuries.<sup>7</sup> The ideas which it formulates forms today the basis of the sociopolitical life of essentially every country and continent of the world. The significance of this phenomenon dramatically grew after the collapse of the world socialist system.

“New regionalism” is based on the choice of individual trade partners and sectors of the economy subject to be opened, and promotes the use of several bilateral agreements aimed at forming strategic trade relations under preferential conditions with important markets, regardless of their location. Understood as a complex sociopolitical and economic phenomenon, new regionalism is transnational in nature. Under present-day conditions, it is integrative in nature: subnational entities, which for many different reasons become stifled within the boundaries of their own country,

sooner or later begin to look for a place for themselves in a broader geopolitical and geo-economic space. Establishing their relations with their mother state anew, these entities simultaneously create more complex relations with neighboring territories. The new georegional picture of the world, which is taking shape as a result, is a combination of transnational alliances of different degrees of solidarity and formalization. This lay of the land, in turn, gives rise to great scientific interest in analyzing this relatively new phenomenon and prompts reconsideration of many conceptions of contemporary international relations.<sup>8</sup>

The transnational nature of “new regionalism” is raising fundamental questions about how state structures should adapt to the era of globalization and interdependence. It is liberal in nature and tries to make the difference between insiders and outsiders less significant. It can also be interpreted as a tool, with the help of which some countries, geographically remote from the decision-making centers, avoid potential transformation into the sociocultural and political periphery. In some cases, a “soft” division of spheres of influence among several countries takes place, each of which at one time initiated the formation of some regional union.

This “new regionalism,” which in no way can be identified with the “revised” version of trade protectionism and regional economic blocs, is acquiring a mass nature at the present stage of implementation of the world economic processes. It differs from “old regionalism,” as defined by Professor Björn Hettne, in its greater multidimensionality, which includes a wide range of trade and financial, sociopolitical, military, environmental, and other dimensions [Hettne, 1999, pp. 7-8]. The concept of new regionalism is also characterized by several other special features, which define its specificity:

- it is developing as a contemporary version of multipolarity, that is, simultaneously at the macro- and micro-regional level, and is not restricted to the boundaries of the national state, increasingly erasing state borders and projecting local features directly on to the global world;<sup>9</sup>
- is being implemented, as a rule, from below, and not from above (due to which elements of spontaneity and autonomy are manifested in this process), includes economic issues and the problems

associated with them (environment, security, and so on), and presumes the participation, in addition to states, of nongovernmental and subnational entities;

- is searching for optimal ways for states entering regional agreements to integrate into the world global processes, as well as for specific local resources (physical, intellectual, and so on) capable of giving a new contemporary boost to the development of each country with comprehensive use of the potential it has already accumulated;
- as a multi-level concept, it is encompassing large and diverse regional macro-structures (the EU, APEC, NAFTA, and so on), diverse interregional relations, and the internal structure of each individual regional formation;
- implementing the idea of “open regionalism” is prevalent, which directly overlaps with economic interdependence.

Under present-day conditions, it is integrative in nature: subnational entities, which for many different reasons become stifled within the boundaries of their own country, sooner or later begin to look for a place for themselves in a broader geopolitical and geo-economic space. At the present stage, states with a similar level of development have been integrating within the regional framework, since under present-day production conditions, which differ in complexity and breadth of nomenclature, the domestic markets, even those of large countries, are insufficient for their optimal development. The enlargement of spheres of economic relations is promoting more successful development of the country's economy, and raising its competitiveness on the world market. In the common regional economic spaces which have developed, not only are internal barriers being removed in establishing foreign economic relations (due to the joint customs policy being conducted), but other areas of economic policy are also being coordinated—structural, monetary, energy, transport, social, and so on. In so doing, zones of integration are forming with special preferential conditions for the economic entities belonging to the particular regional union. The most favored country treatment is usually applied to enterprises, companies, and firms of other states in the territory of integration unions.

The configuration of “new regionalism” is becoming increasingly reinforced in world politics and economics. During the past 50 years, several successful geo-economic areas, regional integration coalitions, and groups have formed in the world. They include NAFTA, the EU, APEC, ASEAN, MERCOSUR, and others. They are becoming increasingly firmly established as unified socioeconomic complexes and are characterized by the great similarity of the goals and interests of the states belonging to them. And this process is continuing.<sup>10</sup> All these unions, although they noticeably differ with respect to a whole series of parameters—dimensions, degree of maturity, level of blending of their national economies, and so on, are to a certain extent autonomous regional economic spaces, in which interaction between the economic entities of the countries belonging to them is developing the most intensively. The foreign economic relations of the member states of the integrated groups are oriented primarily toward their partners in the community. For example, in the mid-1990s, export within the boundaries of the region itself accounted for 60 percent of the total export volume of the EU countries. A similar index for the NAFTA countries amounted to 47 percent, for ASEAN to 22 percent, and for MERCOSUR to 20 percent [Semenov, 2001].

“New regionalism” is based on the ties between the region and international (including European, Asian, and so on) order, whereby the regions are striving to find their place in the state, on the continent, and on the international markets. In this sense, it is entirely in keeping with globalization (since it creates stimuli for the participation of countries and regions in the integration processes), and more precisely, with its local version, which is an alternative to the world mechanism of trade liberalization (like the WTO). Each regional organization forms its own consensus regarding its recipe for economic success and focuses its activity within the framework of the organization. In so doing, “new regionalism” is intensifying the competitive struggle between regions, and is not providing new roles in the national division of labor.

It should be noted that regionalism is leading to a certain isolation of individual national economies from the major, structure-forming trends in forming the world economic system, on the one hand, and to stronger coherence of individual national economies, their blending into a single economic organism, and the creation of consolidated reference points for

globalization trends, on the other. In other words, regional integration is the necessary level of development of globalization. These interrelated processes are going on at the same time and presuppose coordination of the contradictions arising between current group (regional) and long-term (planetary) interests.

International experience of regional integration shows that countries with a dynamic production sector, the products of which were competitive on the world markets, were able to make full use of the potential of regional unions. On the contrary, in countries with a narrow product range and no competition or experience of operating under market conditions, the benefits gleaned from participation in regional integration proved much lower. This also applies to a certain extent to the Central Caucasian countries: their economies, which are poorly integrated into the international division of labor, are increasingly acquiring features of a peripheral economy oriented toward the export of fuel and raw materials and the import of high-tech engineering products and ready-made consumer goods. It is for this reason that trade in natural resources is a passive geo-economic niche, which is extremely sensitive to the country's status in the world community and to influence from outside [Neklessa, 2000].

In this way, within the framework of a single, but non-homogeneous global micro-economy, the contours of socially and culturally primordial "large spaces" can clearly be seen, the members of which are united by common socioeconomic interests and goals. In so doing, the formation of macro-regional geo-economic spaces is realistically going on in the world against the background of its socioeconomic stratification. These spaces to a large extent are the concentration of political and economic forces and are oriented toward the outside world and open to foreign markets. This is the gist of "new regionalism."

### **3.4. The Central Caucasus in the World Economic Community and Prospective Areas of Regional Integration**

The Caucasus as an integral socioeconomic entity is a transportation and communication corridor connecting Europe and Asia. What is more, this



region possesses vast hydrocarbon, natural, and human resources, due to which it is currently in the sphere of special interests of the so-called world government.<sup>11</sup> Each of the entities of the latter has its interests here and its own idea of Caucasian integrity, whereby it uses its financial and power levers to have a bearing on the integration of the Caucasian state formations and the rates of their development.

What is more, the correlation of forces among the entities of the “world government”—Eurasian and Euroatlantic powers—periodically changes. This, in turn, leads each time to a transformation in the region’s integrity, the interstate relations among the Caucasian components, and the rates and forms of their movement.

The revival of the statehood and sovereignty of the Caucasian republics, their transfer from a planned management system to a market economy, as well as their participation in various international economic and financial blocs and organizations are all impossible without the development of essentially new socioeconomic relations built on parity and a mutually advantageous basis. This implies that the partners are free to choose how and on what basis their interrelations will develop.

In the 21st century, the Caucasian state formations gained the opportunity for the first time to become integrated into a single economic union which meets the urgent development interests of the region as a whole and each of its components individually. The Caucasian states, which are in favor of ensuring smooth entry of their national economies into the system of world economic relations, believe it necessary to participate in international economic and financial unions and organizations belonging to different regional economic sub-systems.

The dynamic development of the Caucasian states goes hand in hand with their fundamental entry into the world economic community. This is manifested primarily in their socioeconomic integration with their closest neighbors (for example, GUAM, the CIS, BSECO, and others), as well as in the active establishment of relations with other regional economic unions (for example, the EU, CAEC, APEC, NAFTA, and others).

What is more, the absence of a global system of economic cooperation is making it difficult to develop national and regional mechanisms to achieve an optimal balance of interests among all the entities of the region. What is more, we must realize that the most important and efficient aspect

of all the regional unions in terms of harmonious development of the Caucasian entities is their socioeconomic union with each other, which presumes joint and comprehensive resolution of the entire range of economic, social, and environmental, and other problems experienced by the Caucasus as a whole.

A mandatory condition of regional integration is to have a policy coordinated by all its participants in various spheres of the economy, in legal regulation, in the formation of a regional information network, and so on. This gives rise to the need to create and put into operation corresponding development mechanisms for the integration processes in the Caucasian region.

Such branches of the economy as transportation and communication, oil production and oil refining, power engineering, agriculture and the processing of agricultural produce, trade, environmental protection, public health and pharmaceuticals, tourism, and so on should be among the priority areas of Caucasian integration. In addition to this, it is expedient to develop cooperation in such extremely important aspects of activity as eliminating the consequences of natural disasters and technogenic catastrophes and accidents, as well as fighting terrorism, drug trafficking, organized crime, and the laundering of dirty money.

As mentioned above, the most promising areas of cooperation are transportation and communication. Their successful advance in the region is of strategic importance for the development of production cooperation, trade, tourism, and other types of services. Implementing projects in the mentioned branches of the economy will help to fulfill the task of creating an efficient and reliable system of transport communication channels and supply lines in the region in the future. These channels are vitally important arteries of the entire communication mechanism within the framework of the economic space of the Caucasus. If this task is not carried out, it will be impossible to achieve tangible results in any of the other spheres of cooperation and realize the potential possibilities for economic development of the region.

What is more, the significance of the system of vitally important transportation and telecommunication arteries which the Caucasus has at its disposal due to its geographical location goes beyond the regional level. For example, the specific importance of Azerbaijan's and Georgia's freight

and shipment market lies in the high level of interest foreign countries are showing in the transit of cargo through their territory (including sea ports). This interest is manifested to the greatest extent with respect to the Central Caucasian countries through geo-economic factors,<sup>12</sup> which gives reason to confirm the geo-economic importance of developing cooperation in this area.<sup>13</sup>

This infrastructure will not only assist integration of the Caucasian countries, but will also incorporate them into the trans-European communication network and will help to implement the global project of an Eurasian transportation corridor, thus ensuring enormous flows of freight (including raw material) in the West-East and North-South directions. In this respect, the viewpoint of Azerbaijan and Georgia, which are giving priority importance to the TRACECA project, is clear—they are interested in assimilating international transportation routes connecting Europe, the Caucasus, and Asia.<sup>14</sup>

The thing is that the existing transportation network of the Central Caucasus is just a fragment of the communication channels enjoyed by the former U.S.S.R., and there are essentially no modern express lines here. For this reason, it is imperative to form a communication network which meets the changed geostrategic status of the region. The future of both Azerbaijan and Georgia will to a significant extent be determined by the carrying out of geo-economic functions on the West-East and North-South communication axes, that is, both in the latitudinal and longitudinal directions. This will allow them to more fully realize their geo-economic capabilities by fulfilling the function of a transportation-communication bridge in the mentioned directions.

The high dynamics of trade development between the APR countries and Europe is also making a safe and efficient Europe-Caucasus-Asia transportation-communication corridor vitally important. In this respect, the greatest advantages—additional jobs, profit, investments—will be enjoyed by countries which can draw transit Eurasian freight flows to their transportation communication lines. This is why many countries, regional unions, branch associations, and international financial institutions have allotted long-term loans for building roads. For example, with respect to Azerbaijan alone, as of mid-2004, the following statistics can be presented: WB—40 million USD; EBRD—41 million USD; Iran—40 million

USD; the Kuwait Foundation—47.5 million USD; IDB—44.4 million USD; ADB—38 million USD; Saudi Development Foundation—15 million USD; the Abu Dhabi Foundation—10 million USD; OPEC—6 million USD; and the EU—1.5 million USD.<sup>15</sup>

Based on this, Georgia and Azerbaijan are placing great hopes on the major upgrading of the region's transit-service function, believing it to be of benefit to them.<sup>16</sup> However, despite the general acceptance of this situation, at times curious arguments, to put it mildly, are encountered, according to which this function is fraught not only with ultimately dashing all hopes of creating a self-sufficient economy (at least of the agrarian-industrial type), but also with destroying culture and the traditional behavior stereotype [Mouradian, 2000].

A graphic result of the cooperation among Azerbaijan, Georgia, and Turkey in the transport sphere are the Baku-Supsa and BTC oil pipeline projects, which have already been implemented, and the Baku-Tbilisi-Erzurum gas pipeline project, which is underway. Precisely these projects have a magnetic attraction, which will generate the interest of strategic investors in the region and particularly in Azerbaijan.

The first realistic projects have already essentially been carried out in the communication sphere. They include, for example, the laying of the TransAsiaEurope optical-fiber cable. This kind of project is providing new types of communication services among a whole series of countries, both within the region and beyond it. The most promising among them are projects for creating optical-fiber communication lines: transregional—Palermo-Istanbul-Odessa-Novorossiisk,<sup>17</sup> and regional—Varna-Odessa-Novorossiisk-Poti.

Energy issues are one of the key concerns, including the transit of energy resources. This last question could become an economic boost to integration, since transit can only be efficiently regulated on a multilateral basis. Here we should primarily single out the project aimed at uniting the electric power systems of the region's countries. The importance of this project is increasing due to the fact that it will also become a reliable springboard for beginning promising development of a united Eurasian electric power system. Along with this, energy resource transportation projects are acquiring particular importance from the viewpoint of activating the Caucasus' geo-economic function.

Trade, which serves as one of the main driving forces of economic development of the Caucasian countries, is becoming an important strategic vector in the expansion and intensification of regional cooperation. The building up of mutual trade and economic relations in the region is making the question of gradually removing the barriers in this sphere all the more urgent, as well as of simplifying and correlating the national customs and transit procedures. An important component of this process is taking comprehensive account of the positive experience accumulated in other regional unions.

Today, in light of the liberalization of world trade and the intensified creation of regional and bilateral free trade zones, which is being most actively carried out in Europe, America, and the APR, the Caucasian countries are showing great interest in organizing such zones in the near future. What is more, among the reasons hindering the development of trade in the region, the following should be singled out:

- The low level of correlation among customs procedures and of the regulation of transport relations;
- Tariff and non-tariff barriers of the region's states;
- Long and wearying customs and other border inspection procedures;
- Incompletely drawn up rules for carrying out foreign trade and transit in the Central Caucasus;
- High transportation costs related to the geographical location of the region and the worn-out transportation infrastructure.

Promising areas of Caucasian integration are creating conditions for expanding socioeconomic ties between cities—financial and industrial and trade centers, as well as stimulating the development of border trade between regions.

During recent years, interest has significantly grown in cooperation in the tourist industry. Many countries of the region have a vast recreation potential, with respect to which tourist services are viewed now as a vital sector of the economy. Regional cooperation, both on a bilateral and multilateral basis, could have a positive effect on the development of the tourist industry.<sup>18</sup>

The market orientation of the region's countries is giving rise to the need for a favorable investment climate, development of private business, increased activity of small and medium enterprises, and the establishment of business contacts in the region. Along with this, joint activity in such areas of cooperation as statistics, scientific and technical developments, and the law (in particular fighting organized crime, terrorism, illicit arms trade, smuggling, drug trafficking), and so on, is considered very beneficial.

The environment is one of the region's most urgent problems. Here it is important to focus attention on the uniqueness of the Caucasus' natural environment. Under globalization conditions, that is, with respect to fulfilling the geo-economic function, we should keep in mind the immense burden imposed on the environment, flora, and fauna of the region and take steps to minimize them. The main tasks in this area are searching for ways to neutralize sources of pollution on the shores of the Caspian and Black seas, and along the Kura and Araks (Araz) rivers, to prevent technogenic consequences of the global projects being carried out in the region, as well as to resolve other problems in the use of natural resources. The question of ensuring technogenic safety and carrying out environmental protection measures along the route of the Baku-Tbilisi-Ceyhan export pipeline has recently become extremely urgent. This particularly applies to its Georgian section (the Borzhomi Gorge) and the Azerbaijani section (the Gobustan Preserve). Today, measures are already being taken here to reduce the technogenic environmental risk to these territories. In other words, despite today's realities characterized by the overwhelming importance of current economic interests, the identification and mobilization of ways to implement efficient environmental protection and technogenic emergency monitoring mechanisms in the region continues to be a central concern.

The monetary system occupies an important place in implementing Caucasian integration projects. The main designation of this system is to provide financial resources for joint regional projects and the creation of a contemporary capital market in the region. The following projects requiring joint financing can be singled out:

- Reconstruction of the Khashuri-Batumi pipeline for transporting Azerbaijani petroleum products for export via the port of Batumi;

- Expansion of oil terminals at the ports of Batumi and Poti in anticipation of additional volumes of petroleum products;
- Construction of infrastructure facilities for storing and transshipment of freight at the ports of Batumi and Poti;
- Creation of a joint construction company (with the participation of Azerbaijan, Georgia, and one foreign side) in Supsa for developing the Baku-Supsa oil infrastructure;
- Creation of a consortium within the North-South corridor international transportation project, which will design, build, and operate the 355km Kazvin (Iran)-Astara (Azerbaijan) railroad;
- Implementation of the Kars-Akhalkalaki-Tbilisi international railroad project;
- Formation of a network of consignment customs terminals;
- Investment in the energy system of the Azerbaijan Republic for building up its capacities;
- Development of the export capacities of the agroindustrial sector of the Caucasian economy, in particular, the canned food industry, wine-growing, the production of cotton, silk, nuts, and so on;
- Investment in the building industry and real estate.

These and other extremely promising projects confirm the thesis that, with respect to cooperation development, questions of investment attractiveness are acquiring priority importance in the region.

Taking into account their geographical location, the countries of the Central Caucasus, in addition to cooperation with the Northern Caucasus (Russia) and the Southern Caucasus (Turkey and Iran), are just as interested in developing integration with the countries of Europe, America, the Greater Middle East, and the APR.

At present, as already mentioned, the most intensive shoots of integration in the Caucasus are appearing in interrelations between Azerbaijan and Georgia. All the other areas are, in our opinion, prospective in nature, and will require a relatively long time to develop, as well as the creation of corresponding prerequisites encompassing an entire range of integration problems. At the same time as Caucasian integration, integration process-

es will progress between Central Asia and the Central Caucasus, which constitute the nucleus of the Eurasian space.

Incorporation of the national economy into the integration process requires the ability to direct the form of the unions, ensure their flexible flow from one state to another, create new alliances, and use different forms of international economic communication. In this respect, a program of gradual integration of the Caucasus into the world community is needed, based precisely on the geo-economic function.

At present, it is important for the Caucasus to become incorporated into the world economic system, proceeding not only from current interests, but also taking into account the future trends of the dynamically developing world economic system. It must become the “nodal point” of its movement, pre-empt events and, in particular, be willing and capable of ensuring the movement of commodity, financial, and human flows along the West-East and North-South axes. In other words, the Caucasus must expediently create favorable geo-economic situations using a broad range of methods and means of strategic maneuvering.

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## NOTES

- <sup>1</sup> Only during isolated short periods of history, in particular during the transformation of the Russian Empire into the Soviet, was the Caucasus involved in a big geopolitical game (World War I). In so doing, during this period, this region began to carry out a geopolitical function, while its geo-economic function could not be engaged. As the Center’s (Moscow’s) powers and absolute domination over the region intensified, its geopolitical function ceased to be effective.
- <sup>2</sup> For more on the interrelations between globalization and regionalism in the Russian context, see: [Medvedkov, 2003].
- <sup>3</sup> See also: S. I. Pirozhkov and B. A. Parakhonskiy, *Formirovanie modeli regional’nogo sotrudnichestva v sisteme GUUAM (Formation of a Regional Cooperation Model in the GUUAM System)*. Available at [http://www.niurr.gov.ua/ru/conference/sevastopol\\_conf/pirozhkov\\_parahonsky.htm](http://www.niurr.gov.ua/ru/conference/sevastopol_conf/pirozhkov_parahonsky.htm). From 2006 GUAM has been in the process of transformation into formal regional organization (GUAM Transforms into Formal Regional Organization, *Civil Georgia, UNAG online Magazine*, 23 May 2006. Available at <http://www.civil.ge/eng/print.php?id=12624>), and it was re-named the Organization for Democracy and Economic Development—GUAM (Socor, 2006b).



- <sup>4</sup> On 28 February 2002, the CAEC was transformed into the Central Asian Cooperation Organization (CACO), which Russia also joined on 18 October 2004. On 6 October 2005, a decision was adopted at a CACO meeting on its merging with the EurAsEC [Kurtov, 2005].
- <sup>5</sup> See also: A. Yaz'kova and B. Kuprianov, "Chernomorskiy uzel" (Black Sea Junction), *Federal Information-Analytical Journal "Senator."* Available at <http://senat.org/integ4/txt8.htm>.
- <sup>6</sup> The following mainly apply to the main features of "old regionalism:" existence under the conditions of bipolarity; formation primarily from above, under the control of two rivaling superpowers; protectionist nature; precise orientation toward resolving either economic problems, or security problems; development of relations exclusively among sovereign states.
- <sup>7</sup> For more details on the interpretations of the phenomenon of modern regionalism by different scientific schools studying international relations, see: [Makarychev, 2000, pp. 6-7].
- <sup>8</sup> This trend regarding the study of regional problems, which intensified in the 1990s, was called the "second wave" of international regionalism.
- <sup>9</sup> "New regionalism" is analyzed in depth in the book by Ohmae [Ohmae, 1995]; it describes the establishment and development on many continents of special economic zones uniting regions which legally belong to different states, but are essentially much more strongly related to each other. The author focuses attention both on the tempestuously developing space of Southeast Asia, and on the domination of this process in "old Europe."
- <sup>10</sup> For example, in December 2004, the leaders of 12 Latin American countries (Argentina, Bolivia, Brazil, Chili, Columbia, Ecuador, Guyana, Paraguay, Peru, Surinam, Uruguay, and Venezuela) signed an agreement on the creation of an economic and political union—the South American Community of Nations (SCN), similar to the European Union. It is presumed that in the future the new bloc could compete both with the EU and the U.S. There will be 360 million citizens in this community, and its total GDP could reach almost 1 trillion USD. (For comparison: the population of the EU was calculated in January 2004 at only 300 million people, although of course its GDP is much higher.)
- <sup>11</sup> In this case, we mean a united community of the most developed nations on the planet (with their politics, ideology, levers of influence, and so on) which directly or indirectly (by means of supranational organizations) carries out global governance of the world and the processes going on in it.
- <sup>12</sup> In general, geo-economic factors should be understood as the manifestation of primarily external influences (from outside the Central Caucasus) on the scope of

business activity of the market entities of a particular region. It should also be noted that geo-economic influences are manifested not on any sphere of the regional economy, but only on those which are of significant interest to foreign states. In so doing, levers of influence are not limited to only economic measures. The matter concerns, as a rule, the comprehensive influence, with elements of foreign political and other types of influence on the situation.

- <sup>13</sup> This is why the Europeans are interested in creating guarantees of security and stability in the Central Caucasus, and in not allowing Azerbaijan and Georgia to be drawn into severe geopolitical opposition, in particular, into a zone of tense opposition with Russia.
- <sup>14</sup> The matter concerns, on the whole, the formation of a regional zone of economic cooperation as a fundamental component of the system of international division of labor and the creation of a contemporary version of the Great Silk Road. One of the main designations of TRACECA is to ensure reliable delivery of energy resources from the Central Asian and Caucasian countries via the Caspian and Black seas to Europe and create an East-West axis with intensive operation of rail, road, and sea communication routes. Apart from the countries of the mentioned regions, China is also showing great interest in this project.
- <sup>15</sup> This information was obtained from the Azerbaijan Ministry of Transportation, the Azerbaijan Ministry of Economic Development, the Azerbaijan Ministry of Finance, as well as corresponding international organizations.
- <sup>16</sup> This primarily concerns Georgia, which is giving this function “driving-force” significance [Papava, 2005a].
- <sup>17</sup> This communication line, which is designated to incorporate all the region’s countries into the present-day telecommunication channels, was hooked up to the optical-fiber cable running from Japan through South Korea and the Russian cities of Khabarovsk and St. Petersburg to Denmark.
- <sup>18</sup> It should be noted that in many countries of the world with similar resort and recreation resources as the Caucasian countries, profit from tourism is one of the main revenue articles in the state budget.

## 4.1. On the Caucasian Economic Space

All the participants in Caucasian integration would like to see the economic space of this region streamlined and unified, rather than fragmented, which means that the same game rules must apply at every level—production, financial, commercial, customs, investment, environmental, information, and so on. Otherwise difficulties will arise in organizing and regulating the region's economic system, additional risks will appear, costs will increase, and the competitiveness of each of the Central Caucasian states will deteriorate. At present, the Caucasian economy has gained the opportunity to become fundamentally integrated into the world economy, which gives rise to the need to systemically comprehend its parameters. With these parameters in mind, answers can be found to the following fundamental questions: will the Caucasian economy wed with the system of global economic relations, and, if so, what parameters will be paramount and play a determining role?

The Caucasian region possesses extremely rich natural raw material, energy, and recreation resources. Among them we can single out oil, gas, manganese, molybdenum, and iron ores, nepheline, copper, zinc, lead, gold, iodine, bromine, raw perlite, building materials, and so on. The Caucasian countries engage in agriculture, producing cotton, tobacco, raw silk, grapes, rareripes, subtropical crops, wine and cognac, canned fruits and vegetables, fish, sturgeon caviar, and so on.

The total territory of the Caucasus covers 907,000 square kilometers, the size of its population amounts to 51.7 million people, and the average population density is 57 people per square kilometer (see Table 4.1). The per capita GDP of the Caucasus amounts to over 851.0 USD. Each of the

Caucasian sub-regions differs in terms of its natural, ethnodemographic, and sociopolitical parameters and indices of economic development.

Table 4.1

## Main Indices of the Caucasian Region as of 2002

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<b>The Caucasus, total</b>	<b>907.0</b>	<b>100</b>	<b>51.7</b>	<b>100</b>	<b>44.0</b>	<b>100</b>
<i>Northern Caucasus (part of the RF Southern Federal District)</i>	<i>475.3</i>	<i>52.4</i>	<i>20.1</i>	<i>38.9</i>	<i>17.1</i>	<i>38.8</i>
Mountainous Area	111.8	12.3	6.6	12.8	2.9	6.6
Piedmont	363.5	40.1	13.5	26.1	14.2	32.2
<b>Central Caucasus</b>	<b>186.1</b>	<b>20.5</b>	<b>16.6</b>	<b>32.1</b>	<b>12.0</b>	<b>27.3</b>
Azerbaijan	86.6	9.5	8.2	15.9	6.2	14.1
Georgia	69.7	7.7	4.6	8.9	3.4	7.7
Armenia	29.8	3.3	3.8	7.3	2.4	5.5
<b>Southern Caucasus</b>	<b>245.6</b>	<b>27.1</b>	<b>15.0</b>	<b>29.0</b>	<b>14.9</b>	<b>33.9</b>
<b>Southeastern Caucasus (northwestern ostans of Iran)</b>	198.9	21.9	13.3	25.7	13.5	30.7
<b>Southwestern Caucasus (northeastern ils of Turkey)</b>	46.7	5.2	1.7	3.3	1.4	3.2

The largest region in the Caucasus is the Northern Caucasus, which accounts for 52.4 percent of the territory, 38.9 percent of the population,

and 38.9 percent of the GDP of the entire Caucasus. The next largest in terms of territorial size and GDP is the Southern Caucasus—27.1 percent and 33.9 percent, respectively, and in terms of population, the Central Caucasus—32.1 percent.

## 4.2. The Central Caucasus

The countries of the Central Caucasus, which comprise a relatively smaller part of the region, have a much higher population density and are distinguished by a more developed scientific and technical potential. Three independent states—Azerbaijan, Armenia, and Georgia—belong to the Central Caucasus. A comparative analysis of the economies of these countries shows that the largest state in terms of territory (46.5 percent), population (49.4 percent), and GDP (51.7 percent) is Azerbaijan, followed by Georgia, and then Armenia (Table 4.2).

Table 4.2

Main Indices of the Central Caucasus as of 2002

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<i>Central Caucasus</i>	<i>186.1</i>	<i>100</i>	<i>16.6</i>	<i>100</i>	<i>12.0</i>	<i>100</i>
Azerbaijan	86.6	46.5	8.2	49.4	6.2	51.7
Georgia	69.7	37.5	4.6	27.7	3.4	28.3
Armenia	29.8	16.0	3.8	22.9	2.4	20.0

The republics' capitals are the largest cities in the Central Caucasus: Baku (1.84 million residents), Tbilisi (1.07 million residents), and Yerevan (1.10 million residents).

The territory of the Central Caucasus covers 186,100 square kilometers, its population amounts to 16.6 million people, its GDP to 12.0 bil-

lion USD, and export to 3.0 billion USD. The largest state of the region is Azerbaijan with a population of 8.2 million people, followed by Georgia with 4.6 million people. In terms of per capita GDP, Azerbaijan (880 USD) and Georgia (877 USD) are ahead of Armenia (873 USD). The largest regional exporter is Azerbaijan, which delivers 2.3 billion dollars' worth of goods and services to the world markets.

An analysis of the main macroeconomic indices in Table 4.3 shows the positive trends in economic development observed in all the Central Caucasian republics. In so doing, Azerbaijan has the highest GDP indices, as well as the largest total volume of industrial and agricultural produce. Georgia's economy, in turn, has been manifesting higher dynamics of these indices in recent years. On the whole, the positive picture which has taken shape in Azerbaijan and Georgia was promoted to a certain extent by their mutually advantageous and close cooperation.

Table 4.3

**Main Indices of Economic Development of  
the Central Caucasian Countries**

<b>Indices by country</b> \ <b>Years</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>GROSS DOMESTIC PRODUCT</b>						
a) in million USD:						
— Azerbaijan	4,447	4,584	5,273	5,708	6,236	7,138
— Georgia	3,608	2,838	3,046	3,206	3,399	3,995
— Armenia	1,892	1,845	1,912	2,117	2,376	2,805
b) in percentages of previous year:						
— Azerbaijan	110.0	107.4	111.1	109.9	110.6	111.2
— Georgia	103.1	102.9	101.8	104.8	105.5	111.1
— Armenia	107.3	103.3	105.9	109.6	113.2	113.9

Table 4.3 (continued)

<b>Indices by country</b> \ <b>Years</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
c) per capita USD:						
— Azerbaijan	571	583	665	715	775	880
— Georgia	763	605	654	694	741	877
— Armenia	499	486	503	557	740	873
<b>INDUSTRIAL PRODUCTION</b>						
a) in million USD:						
— Azerbaijan	3,328.6	3,499.8	4,067.3	4,047.1	4,134.6	5,024.2
— Georgia	875.8	869.8	971.0	1,006.5	1,066.4	1,180.7
— Armenia	517.3	529.7	557.1	557.2	594.9	732.1
b) in percentages of previous year:						
— Azerbaijan	102.2	103.6	106.9	105.1	103.6	106.1
— Georgia	98.5	104.8	106.1	98.9	104.9	110.6
— Armenia	97.9	105.3	106.4	105.3	114.6	114.9
<b>AGRICULTURAL PRODUCTION</b>						
a) in million USD:						
— Azerbaijan	1,142.9	1,148.8	1,198.7	1,286.4	1,325.9	1,411.2
— Georgia	1,363.1	1,032.9	919.1	995.0	982.3	1,153.3
— Armenia	796.4	582.5	521.2	632.1	658.7	708.6
b) in percentages of previous year:						
— Azerbaijan	106.2	107.1	112.1	111.1	106.4	105.6
— Georgia	93.4	106.9	88.0	108.2	98.9	110.5
— Armenia	113.1	101.3	97.5	111.6	104.4	104.3

The objective nature of the trends prevailing in the relations between these two states is obvious: it reflects their growing interest in making the greatest use of the advantages of international division of labor, complementarity, and cooperation in production and mobilization of financial and material resources for implementing joint projects.

Compared with neighboring countries, the investment index for the Azerbaijani economy is extremely impressive: in 2001, it was 1.6 billion USD; in 2002, 2.8 billion USD; and in 2003, 4.0 billion USD. In other words, during the past three years, investments have increased 2.5-fold. In 1996-2003, Azerbaijan received 10.4 billion USD in foreign direct investments (FDI) (Table 4.4). By mid-2003, the country had received and used approximately 1.78 billion USD in other long-term loans and credits (approximately 272.0 million USD of them have been repaid).

Table 4.4

**The Dynamics of Foreign Direct Investments  
for the Central Caucasian Countries  
(in million USD)**

<b>Countries Years</b>	<b>Azerbaijan</b>	<b>Georgia</b>	<b>Armenia</b>
<b>1996</b>	519.0	45	18
<b>1997</b>	1,111.0	243	52
<b>1998</b>	1,404.0	265	232
<b>1999</b>	754.9	82	135
<b>2000</b>	692.0	131	125
<b>2001</b>	899.8	110	77
<b>2002</b>	1,811.9	165	152
<b>2003</b>	3,060.3	338	157

For a more detailed analysis of FDI in the Central Caucasian countries, it is expedient to follow the changes in the average index of the per



capita investment volume (Table 4.5). We will note that in 2003, the highest level, which reached 369 USD, was achieved in Azerbaijan.

*Table 4.5*

**Volume of Per Capita Foreign Direct Investments  
for the Central Caucasian Countries (*in USD*)**

<b>Countries Years</b>	<b>Azerbaijan</b>	<b>Georgia</b>	<b>Armenia</b>
<b>1996</b>	67.9	9.7	4.7
<b>1997</b>	143.9	53.6	13.7
<b>1998</b>	182.3	59.1	61.2
<b>1999</b>	96.0	18.4	35.6
<b>2000</b>	85.4	29.7	32.8
<b>2001</b>	112.6	25.1	20.0
<b>2002</b>	221.0	37.9	46.5
<b>2003</b>	369.0	73.4	49.0

For attracting FDI, the following three main factors must be taken into account [Ozawa, 1992]:

- The country should remain open to the outside world and, in particular, to FDI from transnational corporations, which significantly supplement state support.
- A rational policy should be drawn up with respect to attracting FDI to accelerate economic development.
- The economic development generated by FDI in the leader-country could have an impact on neighboring countries, particularly during coordination of their activity in this area.

These theoretical postulates are confirmed in the Central Caucasian countries as well, for example, Azerbaijan's development in the produc-

tion and transportation of oil and gas is having a direct positive effect on the economic growth rates of neighboring countries: to a greater extent on Georgia and Turkey, and to a lesser on Iran and Russia (which partly borders on Azerbaijan).

Nevertheless, the countries of the Central Caucasus do not yet pragmatically correlate with the objective criteria used for their evaluation and for defining their place in Europe (political and economic reforms, investment conditions, business opportunities). These states are not self-sufficient, and they do not have the necessary international reserves to fully finance imports [Gorovoi and Omel'ianchik, 2001]. At the same time, its industrial and agricultural sectors are favorable targets for attracting investments.

In the near future, Azerbaijan will continue to act as leader-country in attracting FDI into the Central Caucasus, and this is entirely understandable: the production and transportation of oil and gas are the main sources of the region's investment attractiveness.

### **4.3. The Northern Caucasus**

The North Caucasian region, which administratively belongs to the Russian Federation, consists of the Piedmont and Mountainous Areas (Table 4.6).

The territory of the Northern Caucasus covers 475,300 square kilometers, the size of population amounts to 20.1 million people, and the GDP to 17.1 billion USD (see Table 4.6). The most populated territories are: in the Piedmont Area—Krasnodar Territory (5.1 million people) and the Rostov Region (4.4 million people), and in the Mountainous Area—Daghestan (2.6 million people). They also lead in the region in terms of amount of GDP—6.1 billion USD, 4.2 billion USD, and 1.1 billion USD, respectively.

The Krasnodar and Stavropol territories, Rostov and Astrakhan regions, and the Republic of Kalmykia belong to the Piedmont Area of the Northern Caucasus.

The Mountainous Area is comprised of seven North Caucasian republics: Adigey, Daghestan, Ingushetia, Chechnia, Kabardino-Balkaria, Karachaevo-Cherkessia, and North Ossetia-Alania.

Table 4.6

## Main Indices of the Northern Caucasus as of 2002

No.	Indices Regions	Territory		Population		GDP	
		Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<b>1.</b>	<b><i>Northern Caucasus (part of the RF Southern Federal District)</i></b>	<b>475.3</b>	<b>100</b>	<b>20.1</b>	<b>100</b>	17.1	<b>100</b>
<b>1.1</b>	<b><i>Piedmont Area</i></b>	<b>363.5</b>	<b>76.5</b>	<b>13.5</b>	<b>67.2</b>	<b>14.2</b>	<b>83.0</b>
1.1.1	Krasnodar Territory	76.0	16.0	5.1	25.4	6.1	35.6
1.1.2	Stavropol Territory	66.5	14.0	2.7	13.4	2.4	14.0
1.1.3	Rostov Region	100.8	21.2	4.4	21.9	4.2	24.4
1.1.4	Astrakhan Region	44.1	9.2	1.0	5.0	1.2	6.7
1.1.5	Republic of Kalmykia	76.1	16.1	0.3	1.5	0.4	2.3
<b>1.2</b>	<b><i>Mountainous Area</i></b>	<b>111.8</b>	<b>23.5</b>	<b>6.6</b>	<b>32.8</b>	<b>2.9</b>	<b>17.0</b>
1.2.1	Republic of Adigey	7.6	1.6	0.4	2.0	0.2	1.2
1.2.2	Republic of Daghestan	50.3	10.6	2.6	12.8	1.1	6.2
1.2.3	Republic of Ingushetia	6.3	1.3	0.5	2.5	0.2	1.2
1.2.4	Chechen Republic	13.0	2.7	1.1	5.5	—	—
1.2.5	Republic of Kabardino-Balkaria	12.5	2.6	0.9	4.5	0.7	4.3
1.2.6	Republic of Karachaevo- Cherkessia	14.1	3.0	0.4	2.0	0.2	1.2
1.2.7	Republic of North Ossetia-Alania	8.0	1.7	0.7	3.5	0.5	2.9

The Mountainous Area is less developed and with 23.5 percent of the territory and 32.8 percent of the population, it produces 17.0 percent of the GDP of the Northern Caucasus. Rostov-on-Don (more than 1 million residents) and Krasnodar (692,000 residents) are the largest cities in the Piedmont Area, and Makhachkala, Vladikavkaz, and Nalchik are the largest cities in the Mountainous Area.

In terms of level of economic development, the Northern Caucasus occupies the last place in the Russian Federation: per capita GDP production here amounts to only 47 percent of the corresponding average index for Russia. The maximum values of this index (61-56 percent) are observed in the Krasnodar and Stavropol territories, while Daghestan and North Ossetia (not including Ingushetia and Chechnia) have the minimum levels (28-30 percent) [Kistanov and Kopylov, 2003, p. 430]. On the whole, the Northern Caucasus accounts for 2.8 percent of the territory, 14.0 percent of the population, and 5.7 percent of the GDP of the Russian Federation, which are without a doubt low indices (Tables 4.7 and 4.8).

Table 4.7

**Share of the Northern Caucasus  
in the Economy of the Caucasus and Russia  
(in percentages)**

<b>Region Indices</b>	<b>The Caucasus— total</b>	<b>Including the Northern Caucasus</b>	<b>Russia—total</b>	<b>Including the Northern Caucasus</b>
Territory	100	52.4	100	2.8
Population	100	38.9	100	14.0
GDP	100	38.9	100	5.7

This region belongs to the densely populated regions: the average population density index amounts to 50 people per square kilometer [Kistanov and Kopylov, 2003, p. 422].

The economy of the Northern Caucasus is an industrial-agrarian complex. It has extremely favorable natural-climatic conditions for human activity, a developed resort industry, and produces fuel, metal, and engineer-

Table 4.8

**Main Indices of the Northern Caucasus  
in the Russian Economy as of 2002**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<b>Russian Federation</b>	<b>17,075.4</b>	<b>100</b>	<b>143.1</b>	<b>100</b>	<b>299.9</b>	<b>100</b>
<i>Northern Caucasus (part of the RF Southern Federal District)</i>	<i>475.3</i>	<i>2.8</i>	<i>20.1</i>	<i>14.0</i>	<i>17.1</i>	<i>5.7</i>
<i>Piedmont Area</i>	<i>363.5</i>	<i>2.1</i>	<i>13.5</i>	<i>9.4</i>	<i>14.2</i>	<i>4.7</i>
Krasnodar Territory	76.0	0.4	5.1	3.6	6.1	2.0
Stavropol Territory	66.5	0.4	2.7	1.9	2.4	0.8
Rostov Region	100.8	0.6	4.4	3.1	4.2	1.4
Astrakhan Region	44.1	0.3	1.0	0.7	1.2	0.4
Republic of Kalmykia	76.1	0.4	0.3	0.2	0.4	0.1
<i>Mountainous Area</i>	<i>111.8</i>	<i>0.7</i>	<i>6.6</i>	<i>4.6</i>	<i>2.9</i>	<i>1.0</i>
Republic of Adigey	7.6	0.05	0.4	0.3	0.2	0.07
Republic of Daghestan	50.3	0.3	2.6	1.8	1.1	0.4
Republic of Ingushetia	6.3	0.04	0.5	0.3	0.2	0.07
Chechen Republic	13.0	0.08	1.1	0.8	—	—
Republic of Kabardino-Balkaria	12.5	0.08	0.9	0.6	0.7	0.2
Republic of Karachaevo- Cherkessia	14.1	0.09	0.4	0.3	0.2	0.07
Republic of North Ossetia-Alania	8.0	0.06	0.7	0.5	0.5	0.2

ing products (mainline electric locomotives, steam boilers, press-forging plant, combine harvesters, and so on), as well as agricultural produce (grain, sunflower seeds, sugar beets, canned food, and granulated sugar). The Northern Caucasus has a well-developed port industry on the Black and Caspian seas, as well as close communication ties both with the Central Caucasus and with Central Asia.

After the collapse of the Soviet Union, ethnic contradictions became acutely aggravated, and centrifugal trends intensified. The armed conflict in Chechnia destabilized the situation throughout the Northern Caucasus and the overall socioeconomic situation greatly deteriorated. For example, relatively recently, its fuel and energy industry accounted for almost 1/10 of the entire production volume of Russia's fuel industry and power engineering [Kistanov and Kopylov, 2003, p. 423]. After satisfying its own local fuel needs, the Northern Caucasus delivered a large amount of coal, oil, petroleum products, and natural gas to other regions of the country. But during the past 10-12 years, the delivery volumes of energy resources have noticeably dwindled due to the abrupt drop in gas production in the Krasnodar and Stavropol territories related to the exhaustion of its supplies, the halt in oil production in Chechnia due to the hostilities, and the drop in coal production in the Rostov Region in light of a reduction in profitability. The electric power industry, the significance of which goes beyond the boundaries of the region, is represented by several hydropower stations, thermal power stations, and the Rostov atomic power station.

The most important economic indices, with the exception of agriculture, are the lowest for Russia. In the Piedmont Area of the Northern Caucasus, industry is represented by enterprises of the oil- and gas-producing, coal, machine-building, chemical, light, and food industries, and in the Mountainous Area by oil production and oil refining, ferrous metallurgy, and the food and light industries. The absolute scale of annual oil production has stabilized at a level of 3-4 million tons (at the end of the 1980s—10-11 million tons), coal production at 10-12 million tons (compared with 29 million tons in 1990), and gas generation at approximately 3.5 billion cubic meters, which is several times lower than in the mid-1970s, when the region produced 1/5 of the Union-wide index [Kistanov and Kopylov, 2003, p. 424].

The largest industrial regions are the Rostov Region and the Krasnodar and Stavropol territories, which account for almost 90 percent of the

total volume of production in the Northern Caucasus [Kistanov and Kopylov, 2003, p. 427]. But even in these industrially developed regions, income per capita does not exceed 65-75 percent of the corresponding average Russian index, and in Ingushetia and Dagestan, these figures amount to only 34-37 percent. The regions with the lowest incomes are Dagestan and Ingushetia [Kistanov and Kopylov, 2003, pp. 430-431].

The Northern Caucasus belongs to the largest farming and cattle-breeding regions of Russia. On the whole, farming is more productive than cattle-breeding. The production of grain (wheat, corn), industrial crops (sunflower, sugar beets), fruit, grapes, and tea predominates. The percentage of potatoes, melons and gourds, and fodder crops is very high. Rice, tobacco, castor-oil plant, and essential-oil-bearing plants are also grown. Cattle-breeding is represented by fine- and semifine-wool sheep-breeding, milk-and-meat and meat-and-milk cattle-breeding, pig-breeding, and poultry farming.

In the Northern Caucasus, all types of transportation and communication routes are very developed. In so doing, all kinds of transportation and communication arteries (beginning with pipelines and ending with high-voltage lines) link the Northern Caucasus with the countries of both the Central Caucasus and Central Asia.

Taking into account the size, development level, and territorial remoteness of the Northern Caucasus from the other regions of Russia, as well as its many centuries of socioeconomic ties with the Central Caucasian states, cooperation between the Northern Caucasus and the latter should become more efficient and economically expedient than its cooperation with Russia's remote regions, for example, the Far East.

### **4.4. The Southern Caucasus**

The South Caucasian region is composed of the northwestern regions (ostans) of Iran and the northeastern regions (ils) of Turkey (Table 4.9).

The territory of the Southern Caucasus covers an area of 245,600 square kilometers, it has a population of 15.0 million people, and the GDP amounts to 14.9 billion USD. The largest areas in terms of all the indicated parameters are the ostans of Iran: Eastern Azerbaijan—47,800 sq. km, 3.3 million people, and 5.2 billion USD, and Western Azerbaijan—43,700 sq. km,

Table 4.9

**Main Indices of the Southern Caucasus  
as of 2002**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<b>Southern Caucasus</b>	<b>245.6</b>	<b>100</b>	<b>15.0</b>	<b>100</b>	<b>14.9</b>	<b>100</b>
<i>Southwestern Caucasus (northeastern ils of Turkey)</i>	<i>46.7</i>	<i>19.0</i>	<i>1.7</i>	<i>11.3</i>	<i>1.4</i>	<i>9.4</i>
Agry	11.5	4.7	0.5	3.3	0.3	2.0
Artvin	7.4	3.0	0.2	1.3	0.3	2.0
Kars	10.1	4.1	0.3	2.0	0.2	1.3
Van	9.3	3.8	0.4	2.6	0.4	2.7
Ardahan	4.8	1.9	0.1	0.7	0.1	0.7
Igdyr	3.6	1.5	0.2	1.4	0.1	0.7
<i>Southeastern Caucasus (northwestern ostans of Iran)</i>	<i>198.9</i>	<i>81.0</i>	<i>13.3</i>	<i>88.7</i>	<i>13.5</i>	<i>90.6</i>
Western Azerbaijan	43.7	17.8	2.5	16.8	3.9	26.2
Eastern Azerbaijan	47.8	19.6	3.3	22.0	5.2	34.9
Khamadan	20.2	8.2	1.7	11.3	1.0	6.7
Ardebil	18.0	7.3	1.7	11.3	0.8	5.4
Zanjan	39.4	16.0	0.9	6.0	0.4	2.7
Kazvin	15.0	6.1	1.0	6.6	0.6	4.0
Gilian	14.8	6.0	2.2	14.7	1.6	10.7



2.5 million people, and 3.9 billion USD, respectively. In so doing, the Iranian part, that is, the Southeastern Caucasus, accounts for 81.0 percent of the territory, 88.7 percent of the population, and 90.6 percent of the GDP of the Southern Caucasus.

The northwestern ostan of Iran are agrarian-industrial. The largest city of the Southeastern Caucasus is Tabriz with a population of approximately one million people. The trans-Iranian railroad and a network of highways pass through the territory and connect the Southeastern Caucasus both with the border areas of Turkey (Southwestern Caucasus) and Azerbaijan (Central Caucasus) and with the center of Iran.

The most economically developed areas are the ostan of Western and Eastern Azerbaijan. Their total share of Iranian territory amounts to 5.6 percent, population to 9.0 percent, and GDP to 8.8 percent (Tables 4.10 and 4.11).

Table 4.10

**Main Indices of the Southeastern Caucasus  
in the Iranian Economy as of 2002**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<b>Iran</b>	<b>1,648.0</b>	<b>100</b>	<b>64.5</b>	<b>100</b>	<b>103.4</b>	<b>100</b>
<i>Southeastern Caucasus (northwestern ostans of Iran)</i>	<i>98.9</i>	<i>12.1</i>	<i>13.3</i>	<i>20.6</i>	<i>13.5</i>	<i>13.1</i>
Western Azerbaijan	43.7	2.7	2.5	3.9	3.9	3.8
Eastern Azerbaijan	47.8	2.9	3.3	5.1	5.2	5.0
Khamadan	20.2	1.2	1.7	2.6	1.0	1.0
Ardebil	18.0	1.1	1.7	2.6	0.8	0.8
Zanjan	39.4	2.4	0.9	1.4	0.4	0.4
Kazvin	15.0	0.9	1.0	1.6	0.6	0.6
Gilian	14.8	0.9	2.2	3.4	1.6	1.5

Table 4.11

**Share of the Southeastern Caucasus  
in the Economy of the Caucasus and Iran  
(in percentages)**

<b>Region Indices</b>	<b>The Caucasus— total</b>	<b>Including the Southeastern Caucasus</b>	<b>Iran—total</b>	<b>Including the Southeastern Caucasus</b>
Territory	100	21.9	100	12.1
Population	100	25.7	100	20.6
GDP	100	30.7	100	13.1

In the ostan of Western Azerbaijan, machine-building, the petrochemical industry, and the food and light industries are well developed, while in Eastern Azerbaijan, the steel and mining industries predominate. In the Southeastern Caucasus, agriculture is ubiquitously practiced—wheat, oats, potatoes, onion, almonds, and subtropical crops are grown.

The southwestern part of the Southern Caucasus is the smallest (Table 4.12), constituting 19 percent of its territory, 11.3 percent of the population, and 9.4 percent of the GDP. Its share of the indices for the Caucasus as a whole is even lower.

Table 4.12

**Share of the Southwestern Caucasus  
in the Economy of the Caucasus and Turkey as of 2002  
(in percentages)**

<b>Region Indices</b>	<b>The Caucasus— total</b>	<b>Including the Southwestern Caucasus</b>	<b>Turkey—total</b>	<b>Including the Southwestern Caucasus</b>
Territory	100	5.2	100	6.0
Population	100	3.3	100	2.4
GDP	100	3.2	100	1.1

The northeastern ills of Turkey make up a very insignificant part of the country's economy (Table 4.13). It should also be noted that they are economically poorly developed (GDP—1.4 billion USD) and are the peripheral agricultural regions of Turkey.

Table 4.13

**Main Indices of the Southwestern Caucasus  
in the Turkish Economy as of 2002**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
Turkey	74.8	100	69.6	100	123.9	100
<i>Southwestern Caucasus (northeastern ills of Turkey)</i>	<i>46.7</i>	<i>6.0</i>	<i>1.7</i>	<i>2.4</i>	<i>1.4</i>	<i>1.1</i>
Agry	11.5	1.5	0.5	0.7	0.3	0.2
Artvin	7.4	1.0	0.2	0.3	0.3	0.2
Kars	10.1	1.3	0.3	0.4	0.2	0.2
Van	9.3	1.1	0.4	0.6	0.4	0.3
Ardahan	4.8	0.6	0.1	0.1	0.1	0.08
Igdyr	3.6	0.5	0.2	0.3	0.1	0.08

## 4.5. Comparative Analysis of the Parameters of the Caucasian Economic Space

As follows from the above-mentioned, although each of the areas of the Caucasus essentially has the resources necessary to be a self-reproducing entity, nevertheless, their full-fledged execution of the geo-economic function presupposes economic integration of the region's components.

The following questions naturally arise. Should an independent regional union be created in the Caucasus for carrying out the geo-economic function? If yes, according to which principles and which type? Will this boost accelerated economic development of the region's countries? To provide an exhaustive answer, a comparative analysis must first be made of the main parameters of the Caucasian economic space and its structures with respect to other regional unions.

A comparison of the main indices characterizing the socioeconomic potential of the entire Caucasus (including the Central Caucasus), on the one hand, and of the current integration groups (the CIS, GUUAM, CAEC, EU, APEC, NAFTA, MERCOSUR, and so on), on the other, shows their lack of comparability in terms of amount of territorial, human, and production resources (Tables 4.14 and 4.15).

Table 4.14

Main Indices of Regional Unions and the Caucasus as of 2002

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
The Caucasus	907.0	100	51.7	100	44.0	100
GUUAM	1,242.7	137	89.6	173	59.6	135
CAEC	3,995.8	440	56.0	108	38.5	87
CIS	22,114.6	2,438	278.6	538	453.2	1,030
EU (15)	3,232	356	372.6	720	8,093	18,393
NAFTA	19,522	2,152	401	775	9,371.2	21,298
MERCOSUR	11,893	1,311	213	411	1,048.7	2,383
APEC	62,012.5	6,837	2,513.7	4,862	17,924	40,736

For example, compared with GUUAM, the Caucasus is 1.4-fold smaller in terms of territory, 1.7-fold in terms of size of population, and 1.4-fold in terms of GDP. The difference between GUUAM and the Central Cauca-

Table 4.15

**Main Indices of Regional Unions  
and the Central Caucasus as of 2002**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
The Central Caucasus	186.1	100	16.6	100	12.0	100
GUUAM	1,242.7	668	89.6	540	59.6	497
CAEC	3,995.8	2,147	56.0	337	38.5	320
CIS	22,114.6	11,883	278.6	1,678	453.2	3,777
EU (15)	3,232	1,737	372.6	2,245	8,093	67,442
NAFTA	19,522	10,495	401	2,416	9,371.2	78,093
MERCOSUR	11,893	6,394	213	1,283	1,048.7	8,739
APEC	62,012.5	33,339	2,513.7	15,143	1,7924	149,367

sus is even more noticeable—6.7-fold, 5.4-fold, and 5.0-fold, respectively. The comparative indices of the Caucasian region with respect to other integration groups are much lower than those presented for GUUAM.

If we keep in mind that after Uzbekistan withdrew its membership from GUUAM in May 2005, this organization, now GUAM, is somewhat smaller, the comparative indices with respect to the Caucasus and the Central Caucasus look as follows: in terms of territory, GUAM accounts for 88 percent of the Caucasus, although it is 1.25-fold larger in terms of population; at the same time, GUAM is 4.3-fold larger than the Central Caucasus in terms of territory, and 3.9-fold in terms of population.

In this way, the Caucasus (and particularly its central part—Azerbaijan, Armenia, and Georgia) cannot be compared in size to any of the above-mentioned world integration groups. If we proceed from the simple notion that the larger the integrating component, the more difficult it is for it to become incorporated into the integration processes, we can see how the relatively small size of the region under review makes it potentially

conductive to integration both on a global scale and at the regional (and sub-regional) level.

Integration of the Caucasus into a single integral region was prompted not so much by its potential, market capacity, that is, trade and investment possibilities and attractiveness, as by the functional significance of its unique territorial location at the crossroads between Europe and Asia, the Christian and Islamic civilizations, the historical Great Silk Road [Elisseff, 2000; Foltz, 1999; Liu, 1998; Petrov, 1999] and the Volga-Caspian Trade Route [Akhmedov, 1972] and their contemporary modifications—the West-East and North-South international transportation-communication corridors. In other words, at the beginning of the 21st century, the principles, forms, and methods of Caucasian integration, as well as type of regional union, should be largely determined based on its transportation-communication significance for the world economy.

#### **4.6. The Caucasus in the System of Transportation-Communication Corridors**

During the Roman Empire (1st century B.C.), the trade routes connecting Rome with Shanghai passed through the Caucasus. But after the Mongol Conquest in the 13th century, the Silk Road went into decline and the Volga-Caspian Trade Route acquired priority significance, that is, the West-East trade route was replaced by the North-South. When the Caucasus became part of the Russian Empire, land communication routes between Europe and Asia (West-East) were partially laid through the Piedmont Area of the Northern Caucasus and Siberia. During the Soviet era, a railroad was built which connected Eastern Europe, the Northern Caucasus (Rostov-on-Don), Siberia, and the Far East (BAM) with the APR countries.

Today, there are plans to restore the New Silk Road<sup>1</sup> on the basis of three main industrial springboards: power engineering, a transcontinental transportation system, and telecommunications. The fulcrum of this project, which is simultaneously accumulating global, regional, and local interests, should be development of natural resources not only of the Caucasian region, but of the entire Caspian zone in its broadest sense, that is,

including the natural riches of the Central Asian countries. Actualizing the raw material potential of Central Asia and, primarily, its large oil and gas fields, will make it possible to increase the Caspian countries' economic dynamism, and ensure large importers of hydrocarbons stable supplies of raw material.

An important springboard for reviving the Silk Road is also the transportation infrastructure. Control over this area is one of the main geopolitical and geo-economic issues. As the rich factual data of world history show, if control is lost over the transportation infrastructure, a country would begin to lose its spheres of geopolitical and geo-economic influence and its position as leader, and would also lose control over the regional markets and financial flows [Polterovich, 1998].

In this respect, the experience accumulated while carrying out a U.N. Special Program for the Economies of Central Asia (SPECA)<sup>2</sup> is very interesting, within the framework of which the Action Program for Transit Transport Cooperation of the SPECA member states was drawn up.<sup>3</sup> Its main priorities are to create the most acceptable, safe, and competitive sub-regional and transborder transportation routes and transit conditions as prerequisites for economic development and access to foreign markets. Along with the development of the Eurasian Transportation Routes (including the trans-Siberian mainline, TRACECA, the southern mainline, and the North-South mainline), this project aims to extend the European transportation corridors to the East, as well as link important communication lines with the Asian highways and trans-Asian main railroad.

Azerbaijan's active participation in the SPECA transportation project and fuller implementation of the potential of the latter could yield real results and tangible advantages for the Caucasian region. This, in particular, could be manifested in assisting the integration of its countries into the world economy, supporting the integration processes at regional and sub-regional levels, raising the efficiency of road transportation, as well as helping them to join the U.N. Trans-European North-South Motorway (TEM) and Trans-European Railway (TER) projects, and to become involved in joint U.N. and SCO initiatives for simplifying transportation operations. This cooperation will ultimately become a means for developing efficient, unified, and safe transportation systems in the region and incorporating regional regulating documents within the framework of Europe-

an and international regulations. It will also serve as an important stimulus for Caucasian integration into the global systems of transportation-communication routes.

Taking into account the growing cooperation with the Central Asian region, it would be wise to present a brief socioeconomic description of this area.

The territory of Central Asia covers an area of 3,995,800 square kilometers, its population amounts to 56 million people, its GDP is 38.5 billion USD (see Table 4.16), and export reaches 16.2 billion USD.

The population of the largest state in the region—Uzbekistan—amounts to 25 million residents, followed by Kazakhstan with 15 million people. The size of the population in Tajikistan, Kyrgyzstan, and Turkmenistan reaches approximately 4-6 million people. In terms of GDP, Kazakhstan leads in the region, followed at a short distance by Uzbekistan. In Turkmenistan, Kyrgyzstan, and Tajikistan, the GDP does not exceed 3 billion USD. The largest regional exporter is Kazakhstan, which delivers goods and services amounting to 9 billion USD to the world markets.

Table 4.16

**Main Indices of the Central Asian Countries  
as of 2000**

Indices Regions	Territory		Population		GDP	
	Thou. sq. km	Percent	Million people	Percent	Billion USD	Percent
<i>Central Asia— as a whole, including</i>	<i>3,995.8</i>	<i>100</i>	<i>56</i>	<i>100</i>	<i>38.5</i>	<i>100</i>
Kazakhstan	2,717.3	68.0	15	26.9	15.6	40.5
Kyrgyzstan	199.9	5.0	5	8.9	1.6	4.2
Tajikistan	143.1	3.6	6	10.7	1.8	4.7
Turkmenistan	488.1	12.2	5	8.9	2.7	7.0
Uzbekistan	447.4	11.2	25	44.6	16.8	43.6



Specialists' forecasts give reason to believe that in the 21st century, Central Asia will become one of the important raw material and energy storehouses of the world [Makhmudov, 2002]. The explored reserves of oil and natural gas in Kazakhstan amount to 2.2 billion tons and 2.5 trillion cubic meters, respectively. Reserves of natural gas in Turkmenistan reach 2.9 trillion cubic meters, and in Uzbekistan, they amount to 1.9 trillion cubic meters. The hypothetical reserves in Kazakhstan, taking into account the deposits on the Caspian shelf and in the basin of the Aral Sea, have reached a level of more than 13.0 billion tons of oil and 6 trillion cubic meters of natural gas, in Turkmenistan, they amount to 6.3 billion tons and 15.5 trillion cubic meters, and in Uzbekistan to 0.3 billion tons and 2.0 trillion cubic meters, respectively. Taking into account the data presented, we can presume that the Caspian region will occupy a place on the market similar to the one currently occupied by the North Sea (Norway). It is also important to keep in mind the fact that the Central Asian countries have, in addition to oil, significant supplies of strategic raw minerals: uranium, gold, polymetallic and iron ores, and so on.

At the beginning of 1994, Kazakhstan and Uzbekistan agreed to create a regional economic cooperation organization. In April of the same year, Kyrgyzstan joined them, and in March 1998, Tajikistan came on board. The main goal of the Central Asian Economic Community (CAEC) was to achieve economic integration of the member states of this regional union.

It should be emphasized that the CAEC, even at the regional level, is not one of the most important integration formations. We will remind you that Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan are members of the CIS. What is more, these independent states, with the exception of Uzbekistan, belong, along with Belarus and Russia, to the customs union.

What is more, until May 2005, Uzbekistan was a member of GUUAM, while Turkmenistan, which declared a policy of state neutrality, is not integrated into any group. Nevertheless, for each of these countries, the significance of economic cooperation with Russia cannot be compared with the weak mutual cooperation within the framework of the CAEC.

It should be noted that despite the proven and hypothetical reserves of oil and gas, the participation of the Central Asian republics in the international division of labor as large deliverers of these raw materials is com-

plicated by certain circumstances. There are many reasons for this, the main one being the acute geopolitical struggle unfolding for control over the region's resources and their transportation to the world markets. The problem is also aggravated by the fact that all the Central Asian states are so-called land-locked countries, that is, they do not have direct access to the World Ocean and so are cut off from the main trade routes. Due to these geographic and political factors, integration of the region into the global economic space is quite difficult, as a result of which the prospects for developing all five countries of the region are limited to one extent or another.

The North-South corridor is another transportation-communication route passing through the Caucasus. Its passage from Russia through the Caucasus and western part of Iran (and not through Central Asia) and on via the Persian Gulf to the Indian Ocean is due to the presence of a developed transportation-communication infrastructure there.

Based on everything said above, an acute need is arising for real economic integration of the Caucasian countries. Broadly speaking, the countries of the Central Caucasus (Azerbaijan, Georgia, and Armenia) and three contiguous regional territories (border regions of Russia, Turkey, and Iran) can be drawn into this integration, while if we take a narrower view, only Azerbaijan and Georgia can be integrated at the initial stage.

In summary, it can be said that the socioeconomic space of the Caucasus is small in size and heterogeneous in nature. The rates and reference points of economic growth of the Caucasian sub-regions and their interaction with each other are different, which, in the final analysis, will make it difficult for the region to carry out its geo-economic function in a comprehensive way with all the ensuing consequences.

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## NOTES

- <sup>1</sup> The EU came forward with the initiative to revive the Silk Road in 1993 (the TRACECA project), followed by the U.S. in 1999 [Act, 1999].
- <sup>2</sup> This program was adopted in the Tashkent Declaration signed in March 1998 by the presidents of Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan. In September of the same year, Turkmenistan officially supported this Declaration and expressed its willingness to participate in SPECA. In November 2002, Azerbaijan joined SPECA. The priority areas of cooperation are: the development of the

transportation infrastructure and simplification of border-crossing procedures; the rational and efficient use of energy and water resources; holding an international economic conference on Tajikistan in the regional context of Central Asia. In February 2004, the U.N. Secretary-General in his letters to the presidents of the five Central Asian countries and Azerbaijan confirmed the goals and importance of SPECA and the U.N.'s adherence to its implementation. Available at <http://www.unece.org/speca/transp/pro-pwg-t40400ru.htm>.

- <sup>3</sup> Several U.N. organizations, the EU, IFI, and international and nongovernmental organizations participate in the mentioned Action Program. Its main elements were included as a regional contribution to the Almaty Action Program approved at the international conference at the level of transit-transportation cooperation ministers (Almaty, August 2003). At present, a discussion is being held about ways to ensure efficient measures to implement the results obtained and render the SPECA member states assistance in carrying them out.

### **5.1. On the Nature of the Post-Communist-Type Economy**

Economies which function on market principles have been studied in sufficient depth. The economic theory reflecting their development has also been elaborated at the proper level. Despite this, current reality and primarily the post-communist economic transit have brought up several unresolved issues [Papava, 2000; Papava 2005c, pp. 12-27; 2005d].<sup>1</sup>

The economy of the former U.S.S.R. was characterized by a high degree of integration of the economies of the Union republics belonging to it and was based on a precise Union-wide division of labor. This explains the fact that the coexistence of these republics in a unified economic space—a single national economic complex—for seventy long years made a deep imprint on their economic systems, which were formed with an integrated economy in mind. After the collapse of the Soviet Union, all the newly formed states essentially had to create their independent national economic systems anew, each of which represented separate elements of what used to be a single complex, interrelated in terms of their structure, the distribution of their productive forces, the technologies they used, and the principles of their production organization.

The situation which developed after the collapse of the U.S.S.R. was also aggravated by the fact that the economic system essentially encountered a crisis while still in its Soviet phase. The foot dragging of the command-administrative structures which proved incapable of rapidly and efficiently reacting to innovations became blatantly obvious. The continuous

mobilization of natural, labor, and capital resources on an extensive basis, the rising exogenous load, and the constant decline in efficiency of the economy associated with all this led in the 1980s to a situation where the share of savings had to be raised to maintain even zero growth. This was the harbinger of destabilization and a crisis in the financial system. The crisis was also aggravated by the political factors plaguing the years between 1989 and 1991. As a result, by the time the U.S.S.R. collapsed, the slump in production and investment activity, the breakdown in economic relations among enterprises, the disintegration of the financial system, the loss of control over the monetary system, foreign political and foreign currency bankruptcy, and the collapse of the state-political and economic structures were clearly manifest [Easterly and Fisher, 1994].<sup>2</sup>

What is more, the diverse natural-climatic conditions, the high level of provision with natural and human resources, as well as several external factors gave rise to the relative closed nature of the U.S.S.R. economy with respect to the world market. The material and technical base of the Soviet economy compared with the advanced international standards as a whole was obsolete. After the disintegration of the unified economic system and the emergence of financial difficulties both at the level of the newly formed states, and at the level of individual enterprises, a situation was created in which the region's own potential for technological regeneration was essentially non-existent. As a result, the obsolete equipment also became physically the worse for wear. And this in turn was the main reason for the non-competitiveness of most of the goods produced in the post-Soviet countries (due to their low quality and/or high production costs), which is making it impossible to gain access to the world markets and actively integrate into the world economic system.

This situation requires a non-standard approach to comprehending the nature of the economy of the U.S.S.R. and East European countries (as well as China, Mongolia, and Vietnam), which hereafter will be called the communist-type economy [Papava, 2000; Papava, 2005c, p. 17; 2005d].

As we know, by nature, the communist-type economy (which is frequently called the command economy in the literature) fundamentally excludes competitive relations in all their forms. Most countries with this kind of economy were united into a single economic space. The most graphic example of this was the Council for Mutual Economic Assistance (CMEA),

which existed for approximately forty years and within the framework of which a single coordinating body functioned. As for economic cooperation with countries with a market economy, it was carried out on a limited scale and regulated exclusively at the intergovernmental level.

Repudiation of competition in the command economy destroyed the only effective stimulus of economic development, as a result of which low-quality products were invariably manufactured, the price of which was artificially reduced due to subsidies from the state budget. The main source of government revenues in the U.S.S.R. were sales of alcohol, and essentially the only way to obtain stable foreign currency was through the sale of raw material (primarily oil) to countries with a developed market economy.

Based on an analysis and synthesis of the main features of the economic system which formed during the communist regime in Poland, Adam Lipowski comes to the conclusion that when the entire world is divided into developed and developing countries, countries with a command economy cannot belong to either category; he describes them as “misdeveloped” countries. In them [Lipowski, 1998, p. 9]:

- the share of industry in the gross domestic product is extremely high due to the low percentage of domestic and foreign trade and services;
- the manufacture of means of production accounts for a significant part of industrial production due to the low volume of production of consumer items;
- the volume of production of products which are competitive at the international level is extremely low;
- products not required for consumption are produced in large amounts;
- the percentage of production of outmoded products in industrial production is extremely high.

The overthrow of the communist regime and collapse of the command economy “denuded” the economy of the post-communist countries before the world market: with some exception (in particular several hydropower facilities, oil and gas production, and the primary processing of raw mate-

rial), the products in these countries, due to their low quality and/or high price, were uncompetitive by international standards. There is no market for these products, and there essentially could be none. An economy of this type, in our opinion, can be called “dead,” that is, a *necroeconomy*, and the theory for studying it can be called a *necroeconomic theory*, *necroeconomics* [Papava, 2001, 2002a, 2005c]. It should be noted that the “closest” concept to “necroeconomy” is the concept “virtual economy” [Gaddy and Ickes, 1998, 2002; Woodruff, 1999a, 1999b].

Lipowski uses the term “divestment” (an antonym of “investment”) to describe the above-mentioned “denuding” of the command economy [Drucker, 1985; Taylor, 1988], which implies “removal” from the post-communist-type economy of the mentioned pathologies of the “misdeveloped” economy [Lipowski, 1998, pp. 31-32] which give rise to a necroeconomy.

In this way, it can be maintained that the economy of post-communist capitalism [Papava, 2005c; Papava and Beridze, 2005] differs from the economies of other models of capitalism [Brown M., 1995, pp. 15-177; Gwynne, Klak, and Shaw, 2003] precisely due to its necroeconomic part.

It goes without saying that when some part of an economy is “dead,” the rest of it will be “viable,” which we will provisionally call the *vital economy*, or *vitaconomy*, and the theory for studying it, *the vitaeconomic theory*, *vitaconomics*, which in content is nothing other than economic theory, economics, in the generally accepted understanding. It should be noted that in a market economy which does not have the phenomenon of a necroeconomy, the vitaconomy is called the economy, or, in other words, the market economy is essentially the vitaconomy.

The first question to be answered is what do a necroeconomy and vitaconomy have in common and how do they differ.

In a necroeconomy, just as in a vitaconomy, a product can be produced, that is, *supply* is provided, but in contrast to the product produced in a vitaconomy, there is no *demand* for the product produced in a necroeconomy due to its low quality and/or high price. Consequently, *the necroeconomy excludes any rational purchase-and-sale act*, nor is there any such thing as an equilibrium price.

If a certain segment of the economy is “dead” (that is, it cannot be revived), this should not create any problems either: logically, a “dead”

economy cannot have any influence on its “live” part. Under the conditions of a market economy, this is precisely how it works: uncompetitive production “disappears,” so essentially does not create any problems for the rest of the economy. This is why research into economic theory is “limited” to the problems of the market economy, since it does not have a necroeconomy as such.

The situation is dramatically different in countries going through the post-communist transit. *In them, the necroeconomy was formed on the basis of technical furbishing of the command economy.*

To show how the necroeconomy and vitaeconomy have an influence on each other, the post-communist economy can be presented as follows:

1. The necroeconomy in the state sector;
2. The vitaeconomy in the state sector;
3. The privatized necroeconomy;
4. The privatized vitaeconomy;
5. The vitaeconomy created by new private investments.

Large and medium industrial enterprises usually belong to the first group, which, based on the designation of the types of products produced in them, are evaluated as strategic, although due to their non-competitiveness, these enterprises are “dead” under market conditions.

The basis of the vitaeconomy in the state sector is mainly formed by power engineering (particularly the production and transmission of electric power, the production and supply of oil and gas), transportation, and communication enterprises. If they are privatized, they move into the fourth group—into the privatized vitaeconomy. This group can also include several medium and primarily small industrial enterprises (until they are privatized).

Enterprises of the first group move into the third group after their privatization. A change in form of ownership in itself in no way means that idle enterprises are automatically brought back to life, for the state of being a “corpse” does not change depending on its owner—the state or a private company. *Ignorance of this fact is the main reason why privatization is somehow discredited*, when, particularly at the initial stage, irrespective of and isolated from the investment process, it is imputed with bringing



idle enterprises back to life, regardless of whether each specific enterprise was “dead” or “alive” to begin with.

The last, fifth, group encompasses the most “healthy” part of the post-communist economy, which is recreated according to the principles of the market economy by means of private investments. Despite this, there are certain problems here which merit adequate consideration. In particular, the matter concerns certain foreign investments by means of which not the newest, but used and relatively outmoded (to be more precise, obsolete by world standards) technologies are being attracted in the post-communist countries. In our opinion, such investments can at best be called “*second-hand investments*,” the products produced with their help are competitive only within the framework of “emerging markets,” and only for a limited amount of time—until competitive commodities by world standards penetrate these markets.

The next question which is important to discuss is what causes the stable existence of a necroeconomy in post-communist capitalist countries?

In our opinion, the answer to this question can be found within the context of the evolutionary theory of economic changes [Nelson and Winter, 1982]. The main tool of this theory is the concept “routine,” which means formed regulations and codes of company conduct which regulate its reproduction [Murrell, 1992a, 1992b].

It is precisely the “routine” which formed over many decades in the depths of the command economy that is the main factor compelling “dead” enterprises *to work under the already non-existent conditions of the command economy*, as a result of which their storehouses are full of uncompetitive products. What is more, since they are essentially impossible to sell, insurmountable debts to the state budget, social funds, energy sector, and other enterprises are accumulated. As a result, a confused network of reciprocal enterprise indebtedness is created [Åslund, 1995, Ch. 6].

According to the traditions established in the command system, when an enterprise has accumulated debts (including deliberately), its director in the higher state bodies (in the leading structures of the communist party, State Planning Committee, Ministry of Finance) raised the question of writing them off, and usually managed it. Based on this, providing there was an essentially unlimited (to be more precise, guaranteed) opportunity

to write off debts, enterprise directors did not see their accumulation as dangerous. *This mechanism of writing off debts is that inbred “routine” which is unfortunately manifested from time to time in post-communist capitalist countries in different forms of “tax amnesty”* [Nikolaev, 2002; Shul’ga, 2002].

There is no doubt that the necroeconomy has a detrimental influence on the development of post-communist countries. Consequently, a mechanism must be identified and put into action which will resolve the problems of “dead” enterprises “automatically,” which is characteristic of the market economy. In other words, this mechanism should ensure the ubiquitous dissemination of market principles of economic system. The key to resolving the problem lies in the above-mentioned evolutionary theory of economic changes.

The fifth group of companies of the post-communist economy—the private sector created exclusively by means of private investments—requires particular attention from the state. The state should assist its reinforcement and enlargement, concern itself with creating that stable political and macroeconomic environment in which new companies will arise from private investments. It must be kept in mind that the “routine” formed in this group of companies will by nature be market-oriented and, in so doing, not pose any necroeconomic danger to society.

The main priority of the economic policy of a post-communist state should be narrowing down the areas of the first and third groups by ubiquitous enlargement of the fifth group. Despite the natural unattractiveness of those companies from the fifth group which were created by means of “secondhand investments,” providing there is a reliable legislative base, they cannot give rise to a necroeconomy since they are formed according to the principles of the market economy. This means that should a company become uncompetitive, its corresponding “routine” will ensure that it “leaves the scene,” since it is subordinated to market mechanisms.

As for the second and fourth groups, regardless of whether a specific enterprise still belongs to the state or is privatized, it urgently needs to attract new investments [Papava and Meskhia, 2002] by selling a corresponding portion of its property or at least by transferring the right to long-term management of these enterprises to a strategic investor. Otherwise, it

will be much more likely that a vitaeconomy from the second and fourth groups will grow into a necroeconomy in the first and third groups.

As noted above, privatization in itself does not automatically lead to destruction of a necroeconomy. Consequently, to ensure the functioning of strategic enterprises from the first group, the state has only one option: to hold an open (including international) tender with the objective of identifying a strategic investor to whom a specific “dead” enterprise (or to be more precise, the right to begin corresponding production, which is strategic for the particular country, within the “dead” enterprise) will be transferred with the right to long-term management. It is possible that this step will not be enough for the strategic investor, which means the state will have to sell the facility to him, even at a symbolic price, for a “dead” enterprise cannot be expensive.

The third group—privatized necroeconomy—has absolutely no prospects.

The technical base of a necroeconomy can only be correctly described as scrap metal. Consequently, destruction (in the direct sense) of a necroeconomy is possible by engaging in the direct sale of scrap metal, including by means of export, since export generates revenue in hard currency for the owner, which essentially can be used to create a vitaeconomy (although on a downgraded scale).

The “routine” of the command economy is retained, since people are slow to catch on that “dead” machinery and equipment is only scrap metal. Ignorance of this fact interferes with, and at times prohibits, the sale of this “scrap metal,” particularly since it involves its export. This ultimately prolongs the existence of a necroeconomy.

It is theoretically obvious that an efficient mechanism for destroying a necroeconomy is directly related to legislation on bankruptcy.

Eradicating a necroeconomy is only possible by creating institutions which assist democratic transformations. A sure indicator of the end of the post-communist transit, or in other words, the end of the economy of post-communist capitalism, is abolishment of the very phenomenon of a necroeconomy. And this opens the doors of the EU for post-post-communist capitalist countries [Papava, 2003b].

All that was said above about the communist-type economy applies to all the former U.S.S.R. republics and, in particular, to the Central Caucasian countries.

## 5.2. On the Economy of the Central Caucasian Countries

The relatively small area of the Central Caucasus (186,100 square kilometers) is distinguished by its extremely diverse landscape and natural-geographical conditions. This, as well as the interests of territorial distribution of production in the former U.S.S.R., helped to form the special features of economic development in the Central Caucasian countries [Adamescu and Silaev (eds.), 1973; Gachechiladze, Nadzhafaliyev, and Rondeli, 1984; Herzig, 1999; Schroeder, 1996].

The economy of Soviet *Armenia* was characterized by the products of the chemical industry, ferrous metals, machine-tools, precision tools, textiles, clothing, leather footwear, and so on. Particular mention should be made of electric power generation and of the atomic power station, which was and still is the only one in the entire Central Caucasus. Cognac production in the food industry still occupies a special place in the Armenian economy.

The economy of Soviet *Azerbaijan* was characterized by a sufficiently developed industrial base. This primarily applies to oil production and oil refinery, while metallurgy and the production of mineral fertilizers, fuels, lubricants, herbicides, and synthetic rubber were also of great importance. Cotton-, wool-, and footwear-manufacturing plants should be singled out among the enterprises of the light industry. As for agriculture, its produce was consumed not only in Azerbaijan, but also in other regions of the former U.S.S.R.

A sufficiently developed industrial base was also characteristic of the economy of Soviet *Georgia*—metallurgy, the production of ferrous alloys, machine-building (agricultural machinery industry, aeronautical engineering, shipbuilding) and machine-tool industry, and the chemical industry. The agricultural produce and foodstuffs (primarily wine, mineral water, tea, and citrus fruit) was mainly exported beyond Georgia and was in demand essentially throughout the former U.S.S.R.

The collapse of the communist system in the Soviet society and the disintegration of the U.S.S.R. led to a breakdown in cooperative relations among the enterprises of the former U.S.S.R. and the disappearance of the system for supporting the consumption of these enterprises' products. The question of reorienting foreign trade [Kaminski, 1996] became urgent. Most

enterprises of the Central Caucasian countries (as of the whole of the former U.S.S.R.) were incapable of meeting the demands of international competition. As a result of the above-mentioned divestment process, the economy of each of these countries could not avoid the trend toward de-industrialization. Unfortunately, this process was exacerbated even more by conflicts.

The Caucasus as a whole, and the Central Caucasus in particular, was always and is still today a conglomerate of contradictions. In recent years, this was manifested in the political processes and the ethnic conflicts going on in the region [Antonenko, 2005; Birch, 1996; Chorbajian, Donabedian, and Mutaftian, 1994; Coppieters, 2001, 2003; Coppieters, Darchiashvili, and Akaba (eds.), 2000; Cornell, 2001c, 2002; Croissant, 1998; Dragadze, 1999; Fairbanks, 1995; Herzig, 1999, pp. 44-83; Hewitt, 1996; Hunter, 1994; Khaindrava, 2002; King, 2001b, 2005; Lynch, 2004a; Nodia, 2000, 2005, pp. 44-60; O'Ballance, 1997; Panico and Rone, 1994; Sorcor, 2004; Waal, 2003; Walker, E., 2000; Wright, 1996; Zverev, 1996].<sup>3</sup> These problems in the sociopolitical life of the peoples of the Central Caucasus are so great in significance that they should be classified not only as political, social, and moral phenomena, but also as economic [Asatiani, 1998; Maksoev, 1998; Nakahira, 2004; Papava, 2005a]. In aggregate, all the problems boil down to the one overall problem of security in the region [Aves, 1995; Coppieters, 1996; Coppieters and Legvold (eds.), 2005; Craft, 2000; Ebnöther and Gustenau (eds.), 2004; Eivazov, 2004; Kanet, 1998; Nodia, 2004; Rondeli, 2000; Waal, 2002]. At the same time, the problem of security in the Central Caucasus largely depends on the economic aspects of the development of the region's countries [Becker, 2003; Maisaia, 1999; Maksoev, 1999].

The hostilities (including in the Northern Caucasus, and particularly in Chechnia [Cornell, 2005; Dunlop, 1998; Gall and Waal, 1998; Kashnikov and Coppieters, 2002; Lapidus, 1998; Oliker, 2001; Sakwa, 2003], which have had a particularly negative effect on the situation in Georgia), the destruction, the victims, and the social problems generated by the large number of refugees, as well as the ensuing blockade of transportation arteries cannot help but have a significant impact on the economic situation and on the realization of the production potential in the Central Caucasian states.

As a result of these political, economic, and other factors, essentially all the Central Caucasian states have found themselves to one extent or

another in a profound crisis which encompasses all spheres of their vital activity and is leading to an abrupt slump in production, a high level of inflation, and a decline in the standard of living [Curtis (ed.), 1995, pp. 41-57, 115-129, 190-206; Gurgenzidze, Lobzhanidze, and Onoprishvili, 1994; Khaduri, 2005]. The conflicts have had an especially negative effect on the economy of the Central Caucasian countries, as a result of which they have lost their potential for economic development [Polyakov, 2000].<sup>4</sup>

For example, in 1996, *Azerbaijan's* GDP amounted to 42 percent of the 1990 level [Samedzade, 2004, p. 463]; the volume of production and industrial output significantly decreased—in 1995 it was 72 percent of the 1990 level [Gajiev, K., 2003, p. 104]. Before 1994, the economy of *Armenia* was in a depressed state, in particular, economic potential decreased by almost 90 percent, the GDP dropped ten-fold, and the volume of industrial production by 80 percent [Gajiev, K., 2003, p. 125]. In *Georgia*, the GDP for 1990-1994 dropped by 72 percent, and the volume of industrial production by 84 percent [Papava and Beridze, 2005, p. 162].

Beginning in 1994-1995, thanks to actively carrying out a reform policy, trends toward stabilization and improvement of the economy were observed in the Central Caucasian states [Herzig, 1999, pp. 119-146],<sup>5</sup> but the consequences of the crisis were so profound that it will take more than one year to overcome them. What is more, success will be contingent on a radical and constructive domestic economic policy, as well as on an optimal combination of the interests of all the states of this region and the active attraction of foreign investments [Reznikova, 2003; Starr, 2003; Yudanov, 1999].

Taking into account that the economic reforms in the Central Caucasian countries are being carried out with the direct participation of the IMF<sup>6</sup> and WB, it is not surprising that these reforms themselves are by nature essentially of the same type. Here it should be noted that Azerbaijan, with significant hydrocarbon supplies, did not hurry to actively cooperate with the international financial institutions. As a result, it was a little later with its market reforms than Armenia and Georgia. What is more, not all the reforms conducted by these countries according to the single scenario of the so-called Washington consensus can be called justified [Cheru, 1999; Gomulka, 1995; Stiglitz, 2002].

The significant role played by the Armenian Diaspora in essentially all the spheres of Armenia's development should be particularly emphasized

[Kotchikian, 2003; Libaridian, 1999, pp. 119-148; Suny, 1993], primarily in rendering economic aid and in investments in the national economy [Freinkman, 2001; Khachatrian, A., 2004, pp. 203-206].<sup>7</sup>

The current stage of reform of the national economies of the Central Caucasian countries and cooperation with international financial institutions and donor countries in this sphere is going on within the framework of poverty reduction and economic development programs [Gelbard, McHugh, Iradian, Beddies, and Redifer, 2005].<sup>8</sup>

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### NOTES

<sup>1</sup> Transfer to a market economy is an integral part of the broader process of post-communist transformation of the whole of society, as a result of which the problem of market formation is not only economic [Kennedy, 2002].

<sup>2</sup> By the time the U.S.S.R. collapsed the economic difficulties had become exacerbated by the mounting national and ethnic problems [Tuminez, 2003].

<sup>3</sup> See also: *The Southern Caucasus is an Instable Region of "Frozen" Conflicts. Documents of an International Conference on the Caucasus of the Friedrich Ebert Stiftung, Berlin, 26-27 November 2001*. Tbilisi: Friedrich Ebert Stiftung, 2002.

<sup>4</sup> See also: *Lost Potential in the South Caucasus: Aspects of Interstate Trade*. Yerevan, Baku, Tbilisi: ANTARES, 2003.

<sup>5</sup> See also: [Åslund, 2003; Beridze and Papava, 2003; Egiazarian, 2003; Khachatrian, 2002; Papava, 1995, 1996; Papava and Chikovani (eds.), 1997; Rasulov, 2003].

<sup>6</sup> For more on the nature of the IMF programs in post-communist countries (using the example of Georgia), see: [Papava, 2003a].

<sup>7</sup> See also: Victoria Minoian and Lev Freinkman, "Diaspora's Contribution to Armenia's Economic Development: What Drives the First Movers and How Their Efforts Could Be Scaled Up?" *Knowledge for Development Program*, The World Bank. Available at <http://info.worldbank.org/etools/docs/library/152388/victoriaminoian.pdf>.

<sup>8</sup> See also: *Economic Development and Poverty Reduction Program of Georgia*. Tbilisi: Government of Georgia, 2003; *Poverty Reduction Strategy Paper*. Yerevan: Information Analytic Center for Economic Reforms, 2003; *Poverty Reduction Strategy Paper (Interim Report)*. Baku, 2001. Available at <http://www.imf.org/external/NP/prsp/2001/aze/01/053001.pdf>; *State Program on Poverty Reduction and Economic Development 2003-2005 (Final Draft)*. Baku, 2003. Available at <http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN016805.pdf>.

# Essay **6** | **ECONOMIC INTERRELATIONS IN THE CENTRAL CAUCASUS**

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*Vladimer Papava*

## **6.1. Opportunities for Strategic Economic Partnership in the Caucasus and Prospects for Forming a Regional Cluster**

The development of the economy of a particular country largely depends on the extent to which *foreign economic factors* are taken into account when forming its economic policy. It is particularly important for a country to keep in mind the main trends in international relations and find its own place in the world economic system. This situation should prevail when determining the strategic directions of economic development and the priority aspects of the economic reforms in the Central Caucasian countries.

In light of the small size of their economies, economic progress in the Central Caucasian states will primarily be predetermined by the degree of openness of the latter and the rate of their integration into the civilized world [Connolly and Melo (eds.), 1994; Dornbush, 1993].

Taking into account the present state of the economy (in addition to other things) and nation-building in the Central Caucasian countries [Coppieters and Legvold (eds.), 2005; Cornell, 2001a; Fairbanks, 2004; Freese, 2005; Hunter, 1994; King, 2001a, 2004; Lynch, 2006; Miller, 2004; Rondeli, 2004a; Rutland, 1994],<sup>1</sup> integration is not an easy task to carry out. Admittedly, it cannot be said that the Central Caucasian region, despite the political difficulties it is encountering, is isolated from the rest of the world. First, it is an integral part of the CIS,<sup>2</sup> second, Azerbaijan, Armenia, and Georgia are members of the BSECO, and third, all three Central Caucasian states signed agreements with the EU on cooperation and partnership at the same time. What is more, bilateral trade and economic inter-



relations are being established with many countries of the world community. But all these areas of international integration cannot be considered sufficient grounds for the region's debut onto the world market.

According to many experts, the CIS today is experiencing certain difficulties with integration [Friedman, 1996; Grinberg, Zevin, *et. al.*, 2001; Kozik, Kokhno, 2001; Shul'ga (head of the authors' team), 2001; Shumskiy, 2004], and what is more, for well-known reasons, it is doing its best to keep the integration processes within the framework of the CIS, along similar lines to the close production cooperation characteristic of the Soviet economic system [Coppieters, 1998b, pp. 194-197; Olcott, Åslund, and Garnett, 1999].

Based on the current economic relations of the Black Sea Basin countries [Constantinescu (ed.), 1997], the BSECO, although it has great prospects and so requires special attention, is nevertheless still a relatively new interstate regional formation and does not yet have the necessary degree of integration and level of interrelations to make a significant impact on the economic development of its member states.

Cooperation with the EU and the economically developed European states cannot be carried out today on equal partnership terms. It is more a matter of the developed states assisting the Central Caucasian countries to introduce democratic principles aimed at forming market mechanisms for managing the economy and building their social and political life [Alieva, 2004b; Gegeshidze, 1999b; Japaridze and Rondeli, 2004; Papava and Tokmazishvili, 2006; Shugarian, 2004].<sup>3</sup>

What is more, the advanced countries of the world are often playing the wait-and-see game, preferring to sit on the fence and observe the development of events in the Central Caucasus. There is the popular opinion that the Central Caucasus is a "frozen," although "hot," spot [Antonenko, 2005; Birch, 1996; Chorbajian, Donabedian, and, Mutafian, 1994; Coppieters, 2001, 2003; Coppieters, Darchiashvili, and Akaba (eds.), 2000; Cornell, 2001c, 2002; Croissant, 1998; Dragadze, 1999; Fairbanks, 1995; Hewitt, 1996; Hunter, 1994; Khaindrava, 2002; King, 2001b, 2005; Lynch, 2004a; Nodia, 2000, 2005, pp. 44-60; O'Ballance, 1997; Panico and Rone, 1994; Socor, 2004; Waal, 2003; Walker, E., 2000; Wright, 1996; Zverev, 1996],<sup>4</sup> which does not have enough political and economic stability to actively attract economic partners. This is not at all surprising if we

keep in mind that conflict zones directly become not only a stronghold for terrorists and a refuge for drug traffickers and drug dealers, but also zones for laundering dirty money, kidnapping hostages, and trading in people [Yaz'kova, 2005, pp. 57-58].

Moreover, we must also keep in mind that the relatively small size of the Central Caucasian countries, where the population does not exceed 17 million, also determines the correspondingly small size of their markets. The conflict zones are creating serious obstacles to forming a Central Caucasus common market, as a result of which, all other things being equal, large investors prefer to make investments either in Russia, or in Turkey, and develop the fragmented markets of the Central Caucasian countries from there, rather than investing in this region directly.

As globalization spreads, the size of the corresponding market for the successful development of any country, including small countries, becomes less important. Globalization promotes the unification of markets and, if a country is sufficiently open, regardless of the size of its territory and population, the market of that country can become part of these united markets [Alesina, 1998].<sup>5</sup>

Due to the underdevelopment of the national economies of the Central Caucasian countries and, consequently, their low competitiveness on the international markets, it is particularly important to find ways for the economic entities of these states to interact in order to concentrate joint efforts on creating prerequisites for these countries' rapid and sustainable development. In other words, ways to establish strategic economic partnership (and not simply cooperation) in the Central Caucasus are becoming of paramount importance [Papava, 1998, 2002b, 2002c; Papava and Gogatadze, 1998]. Only joint efforts (even if they are informal at first) will make it easier to find common areas in which the region can attract foreign investments [Papava and Gogatadze, 1998; Reznikova, 2003; Starr, 2003; Yudanov, 1999].

As for attracting large-scale investments in the Central Caucasian region, the main thing is to reduce the high risk of long-term investments, which is making investment activity in the Central Caucasus unattractive. At the same time, the region has areas which are of special interest to foreign investors. In this respect, it is enough to mention the oil of the Caspian Basin [Gökay, 1999; Croissant and Croissant, 1999; Karl, 1998; Mah-

novski, 2003; Roberts, 2001; Rosenberg and Saavalainen, 1998; Tsalik, 2003] and the EATCC, which links Europe and Asia via Central Asia and the Central Caucasus [Chebotarev and Bondartsev, 1999; Gegeshidze, 1999a; Goshadze and Sharadze, 1998; Martirosian, A., 2000; Mitiaev, 2001], in order to conclude that the Central Caucasus is acquiring a special function. What is more, many states and leading companies of the world are making it their strategic task to stake out a claim for themselves in this region.

Azerbaijan could increase the rate of its economic growth by raising the volume of oil production and developing the oil refining industry.

Both development of the oil industry and the future economic development of the entire Central Caucasus largely depend on streamlining the transportation arteries of the EATCC. Practical implementation of this plan began with the widely known TRACECA project [Shevardnadze, 1999].

TRACECA today is considered a transit corridor for supplementing and extending already existing routes, primarily, European. In this respect, opportunities are appearing to unite the transportation systems of the Black Sea, Caspian, Adriatic, and Mediterranean seas.

It is just as important to resolve the problem of transporting energy resources via pipelines [Asadov, 2000; Chase, 2002; DeLay, 1999; Kalicki, 2001; Müller, 2000; Rondeli, 2004b; Starr and Cornell, 2005; Starr and Cornell (eds.), 2005; Tevzadze, 2004]. In particular, the Azerbaijan-Georgian route for transporting early oil became the first priority large-scale project in Georgia to attract significant foreign investments. What is more, implementation of this project created prerequisites for more active investment in other spheres of the economy of Azerbaijan and Georgia, not to mention raising the level of security in this region [Maisaia, 2002].

On the other hand, launching the project for transporting early oil from Azerbaijan via Russia was of immense importance in implementing this project, for under conflict conditions when oil pipelines pass through or close to hot spots, the existence of alternative pipelines makes all the difference. Consequently, this example shows that when it comes to transporting early oil, not only are Azerbaijan and Georgia strategic economic partners, but Georgia and Russia, as well as Azerbaijan and Russia (although unfortunately Russia has never really admitted this) can also be considered such.<sup>6</sup>

The following pipeline projects laid the foundation for economic partnership between Azerbaijan and Georgia in the post-Soviet period: the Baku-Tbilisi-Supsa and BTC oil pipelines, as well as the SCP pipeline for transporting gas from the Shah Deniz offshore field. Turkey is directly involved in implementing the last two projects [Caglayan, Mamedov, Medz-mariashvili, *et al.*, 2003].

A further step in strengthening economic partnership between Azerbaijan and Georgia, as well as in involving Turkey in this process, could be building and operating the Kars-Akhalkalaki-Tbilisi-Baku rail system. A 68-kilometer section connecting Turkish Kars with Georgian Akhalkalaki must be built in order to implement this project (according to a preliminary evaluation, it will cost around 300-500 million dollars) [Ziyadov, 2005].

All of these projects (pipeline and railroad) are graphic examples of the coincidence of economic interests between the two Central Caucasian countries (Azerbaijan and Georgia) and Turkey, the northern regions of which, as noted above, represent the Southwestern Caucasus.

The operation of a transportation corridor through Georgia, Armenia, and Iran<sup>7</sup> is of particular significance for the economy of Armenia and Georgia. It can be seen as an integral part of a larger project—the North-South transportation corridor [Mukhin and Mesamed, 2004].

Due to the conflicts in the Caucasus, we can see that the implementation of many regional projects is essentially impossible without the participation of Georgia. Consequently, Georgia is acting as a link both within the Central Caucasus and throughout the Caucasus as a whole. The efficiency of these projects largely depends on a constructive policy (including economic) on Russia's part [Rondeli, 2002a, 2003].

When reviewing different aspects of economic development of the entire geographical region and the interrelations among the states located in it, we should also mention the emergence of economic competition between individual countries of the region.

The theory of market competition sets forth different levels of its manifestation, at the level of industries, at the level of countries, and at the level of regional formations. As a rule, the competitors should have more or less the same economic strength and the same areas of strategic interests, which will ensure the overlapping of their economic aspirations. A country's competitiveness depends primarily on how productively national nat-

ural, labor, material, and financial resources are used. At the same time, any competition encourages enhancement to a certain extent. If there were no international competition, the level of productivity in each individual country would essentially not depend on the situation in other countries. On the other hand, international flows of goods and capital make it possible to raise the productive use of a country's resources, remove the need to independently produce all goods and services, and allow the country to specialize in those branches of the economy and segments of the market in which the country is relatively more competitive.

Based on this, the conclusion can be drawn that in the economic respect, Azerbaijan and Georgia, for example, are not strategic rivals. This is explained by the fact that Azerbaijan has oil and gas and Georgia has sea access to the Ocean and direct proximity with Turkey, both countries are on the EATCC route, and each of them has its own and, in some cases, unique production potential. All of this means that Azerbaijan and Georgia cannot be viewed as rivals, rather they are strategic economic partners.

At the same time, the absence of interstate economic competition between Georgia and Azerbaijan in no way means that these countries have no market stimuli for development: these countries have other rival countries, and they themselves, taken together, should be evaluated as economic partners in interregional competition. Economic partnership between Azerbaijan and Georgia can be (and this is confirmed to a certain extent by practice) a magnet for attracting other entities not only of the Central, but of the entire Caucasus (although, unfortunately, not everyone recognizes the advantages of strategic economic partnership in the region).

What is more, it should be emphasized in particular that a strategic economic partnership is the foundation on which the economic system of the Central Caucasus can and should be built.

In this context, the question arises of the possibilities of creating an interstate cluster from these two countries, which would help to increase their joint competitiveness on the world markets.

According to the cluster theory,<sup>8</sup> geographically contiguous and inter-related companies, firms, or organizations act together in a particular sphere (which forms the cluster), which significantly raises their joint competitiveness. Based on this, it is not surprising that under conditions of the globalization of competition, localization of competitive advantages

takes place [Enright, 1998], as a result of which an analysis of the experience of certain countries acquires special significance [Brown R., 2000; Enright, and Roberts, 2001; Jensen, 2004; Møller-Pedersen, 2003; Wolfe, 2003] for drawing up a corresponding regional policy [Raines, 2001].

As we know, the geographical dimensions of the cluster can vary and embrace either one city, or an entire country, and even neighboring countries as well.<sup>9</sup>

Despite a certain amount of skepticism relating to the existence of a single streamlined theory of clusters per se,<sup>10</sup> the existence of several schools is currently recognized [Pilipenko, 2005]:

- the American, which is oriented toward the competitive development of nations with different standards of living;
- the British, which focuses attention on the role of transnational corporations (TNCs) in the international division of labor in the competition processes, and
- the Scandinavian, which consists of four groups—the Danish, Finnish, Norwegian, and Swedish, which to one extent or another focus attention on systems of innovations, the historical evolution of competitiveness, and the special features of market organization.

Ways to form and develop clusters in the Central Caucasian countries can most likely best be studied within the framework of the American school of the cluster theory. In so doing, based on the fact that Azerbaijan has oil and gas, use of the Norwegian experience with respect to the formation and operation of an oil cluster [Steensnæs, 2002]<sup>11</sup> is without doubt promising for the entire Central Caucasian region (not only for Azerbaijan), taking into account the comprehensive approach for developing and using all types of energy resources (not only in Azerbaijan, but also in other countries of the region), based on the application of environmental technologies.

It should be noted that in the future, providing the conflict in Nagorno-Karabakh is settled, Armenia will also occupy its due place in the Central Caucasian cluster.

This approach will not only increase the joint competitiveness of these countries on the world markets, but also strengthen the strategic partnership relations in the region.

## 6.2. The Central Caucasus as a Transportation-Energy Hub

In the present-day world, the globalization of trade, markets, the financial system, and business as a whole [Beck, 1999, Ch. 7; Dolgov, 1998; Gorbachev, M. S., *et. al.*, 2003; Held, Goldblatt, McGrew, and Perraton, 1999, Ch. 3-5; Hirst and Thompson, 1999; Stiglitz, 2002] has raised the question of a principally new understanding of space and spatial organization of the economy [Castells, 1996, Ch. 6].

It should be noted that despite intensifying globalization, economic development has not become geographically unified [Scott, 2000, p. 133]; what is more, the geographical factor is becoming increasingly significant in the competitive advantage of particular countries [Enright, 1998, p. 6].

Along with the traditional approaches, regional economics and spatial economics are enhanced by many contemporary views and theoretical elaborations [Armstrong and Taylor, 2001; Fujita, Krugman, and Venables, 2001; Granberg, 2004; Krugman, 1993, 1997].

Scientific research of the regional problems of economic development makes wide use of the concept “hub.”

The term “hub” is most frequently used in relation to computers and contemporary information technology; in particular, “hub” implies a certain bloc connecting all its other parts into a unified technical system and, in so doing, ensuring operation of the entire system as a whole. Economists use this meaning of the term “hub” for designating the key part of a certain territorial system, which ensures the functioning of the latter [Sergeev, 2001]. In an attempt to find a more general approach, the concept of hub is understood as the most perfect principle for organizing management [Viskovic, 2004].

Despite the widespread use in the economic and geographic literature of the term “hub,” it unfortunately does not have a precise definition. It is frequently identified with the term “node” [Felsenstein, Schamp, and Shachar, 2002; Schamp, Rachor-Hagelueken, and Grimm, 2002] or “junction” [Fujita, Krugman, and Venables, 2001, pp. 129-131], or even with “transport junction” [Sergeev, 2001].

For the sake of clarity in our further discussion, we will try to draw a line between the concepts of “hub” and “node, junction.”

Node and junction imply a territorial combination of facilities located, as a rule, in an area of direct contact, which defines the development of the particular landscape [Alaev, 1983, pp. 55-56]. The term “node” presumes constant interaction with companies, households, and so on, and most important, the significance of a node is defined by its interrelations with other nodes [Felsenstein, Schamp, and Shachar, 2002, pp. 2-3].

The more specific term “industrial node” means a combination of industrial enterprises (one or several population settlements) along with common production and social infrastructure facilities, which in so doing are located within a compact area (Granberg, 2004, p. 27]. According to another approach, this definition corresponds to the concept of “economic knot,” whereas “industrial node” is only a bloc of industrial enterprises with production relations among them. What is more, the term “integrated node” is used which, in addition to “economic knot,” also includes meliorants (that is, means for improving the environmental situation) [Alaev, 1983, pp. 96, 220].

The concept “transport junction” is also widely used as the interception of transport communication lines which are usually combined with a concentration of production and population [Granberg, 2004, p. 27]. Based on the simpler definition of “transport junction,” it is a point where no fewer than two lines of different, but interacting, means of transport meet [Alaev, 1983, p. 215].

In contrast to these economic interpretations of “node,” the concept “hub” implies both the concentration of certain interrelated economic functions in a certain territory, and the mandatory presence of channels of interaction among the economic entities within or beyond this territory. In this way, the term “hub” was formed as a generalization of the term “transportation hub” [Herzog, 2000]. It is no accident, when emphasizing this special feature of “hub,” that the term “hub-and-spoke” is often used in the scientific community [Armstrong and Taylor, 2001, pp. 296-297; Sergeev, 2001].

According to a wider interpretation of hub, it is a combination of transport junction, financial center, center of scientific studies, center for producing high-tech products and, educational center [Sergeev, 2001].

In the scientific literature, different territorial formations are viewed as “hubs,” including individual countries [Lee, 2004; Philips, 1999, 2004]. What is more, a relatively large union of states can act as a hub, and indi-



vidual states, or their smaller unions, as the spokes. The most vibrant example of this is the EU, which acts as a hub, and the countries of Eastern Europe until recently outside the EU, which act as spokes (meaning individual countries), or block-spokes (meaning a union of countries) [Adam, Kosma, and McHugh, 2003; Benedictis, Santis, and Vicarelli, 2005; Enders and Wonnacott, 1996; Wonnacott, 1996].

Based on the special features of the above-listed characteristics of hub, we can ask which of its versions best applies to the Central Caucasus.

Azerbaijan has essentially already secured its image of the main regional transportation hub [Derr, 1998], and is making serious claims to becoming a hub in banking activity, business services, the light industry, warehouse storage, and agriculture [Escudero, 2002]. At the same time, Baku's new airport is also claiming to be a transportation hub for the entire Caspian region [Escudero, 2002]. It is justifiably considered that Baku could carry out the function of a central hub in this region and become the next Dubai [Escudero, 2001].

Georgia is interested in Caspian oil and gas (in addition to other resources) being transported to the West through its territory, which is also in Azerbaijan's economic interest, for, in this case, this route is acquiring special importance. All kinds of shipments (not only oil and gas) will also pass through its territory from East to West and vice versa. The transportation of Caspian oil and gas through Georgia to Turkey is enhancing Turkey's role as an energy transportation hub [Boucher, 2005]. Continuing this thought, the BTC oil pipeline is giving the Caspian region the function of a new European energy transportation hub [Yevgrashina, 2002].

What is more, Georgia's geographical location along the transportation corridor connecting Europe with Asia via the Caucasus has endowed this country with the function of a so-called transit hub [Ivakhnenko, 2005].

Here we should stipulate that in many of the references to the literature presented here concerning the transportation hub of an individual Central Caucasian country, or the entire region, the term "hub" is unfortunately used more as a tribute to fashion, and from the scientific viewpoint, it would be much more correct to use the term "transport junction."

The possibility of activating Armenia as a transportation hub largely depends on the peaceful settlement of the conflicts in Nagorno-Karabakh and Abkhazia: the first will facilitate operation of the Azerbaijan-Arme-

nia-Turkey route, and the second, formation of the Russia-Georgia-Armenia-Iran transportation axis. In addition to the mentioned conflicts, other obstacles stand in the way of implementing these projects, among which the growing danger coming from Iran should be mentioned in particular. This casts aspersions on the expediency of more intensive involvement of this country in economic (and other) interrelations of the Central Caucasian countries.

Based on the generalized definition of hub and taking into account the conflict between Armenia and Azerbaijan, Georgia has to fulfill the function of “regional hub” in the Central Caucasus: any political, environmental, cultural, scientific, and other relations and meetings in this region of the Caucasus, providing all three countries of the region participate, are essentially only possible in Georgia.

The formation of a full-fledged economic hub in the Central Caucasus is still a long way off, but if the conflicts are resolved and all of the region’s potential opportunities are used correctly, and if foreign investments are targeted toward developing the contours of a transportation-energy hub, there is every reason to believe that the Central Caucasus can gradually become an extensive “hub-and-spoke” system.

### **6.3. The International Factor in the Economic Development of the Central Caucasus**

In the contemporary globalizing world, the international economic function fulfilled by a particular country is of special significance for its development. The formation of this function primarily depends on the comparative advantages of a particular country, the use of which also defines its place in the world economy. What is more, a great deal also depends on the international relations of this country both with its immediate geographical neighbors, as well as with countries defining the main areas in world politics. There are often cases when a particular country cannot make full use of the comparative advantages it has, if its international relations do not promote this.

International relations of the Central Caucasian countries are largely defined by their historical roots, which have a significant influence on the

formation of the main areas of foreign policy in these countries [Adalian, 1995; Alieva, 1995; Curtis and Suny, 1995, pp. 64-70; Hovannisian, 1994; Hunter, 2000; Jones St., 2003; Kukhianidze, 1998; Nichol, 1995, pp. 138-141; Nodia, 1998; Slider, 1995, pp. 219-225].

Of the Central Caucasian countries, Azerbaijan, which is rich in hydrocarbon resources, clearly has a definite comparative advantage. To this can be added its convenient geographical location, which promotes its use as a transportation hub.

Based on the special geographical features of the Central Caucasus, the use of Azerbaijan's transportation potential largely depends on the other countries of the region, Georgia and Armenia.

Georgia's main comparative advantage is its geographical location along the transportation corridor connecting Europe and Asia, which also defines the international economic function of this Central Caucasian country [Papava, 2002d]. Georgia also has the potential to become a significant transportation link joining Russia with Armenia and further with Iran.

Armenia is also characterized by a potential transportation function both in the West-East direction (Turkey-Armenia-Azerbaijan), and in the North-South direction (Russia-Georgia-Armenia-Iran).

For Armenia, just as for Georgia, the West-South (Georgia-Armenia-Iran) transportation corridor, which joins the Black Sea to the Persian Gulf, is also of special importance.

The problem lies in the extent to which the international relations of the Central Caucasian countries help to use their comparative advantages.

Oil and gas occupy an important place in the contemporary world economy and politics, which largely defines the attitude of many states toward the Central Caucasus. Based on this, it is not surprising that Azerbaijan's hydrocarbon resources and their transportation routes, which are of immense geostrategic importance [Cornell, Tsereteli, and Socor, 2005], conditioned the positive and negative effects both for this country and for the entire region from the very beginning [O'Hara, 2004].

The positive effect is largely associated with Western countries, which are interested in having as many alternatives for obtaining oil and gas as possible, and therefore, from the very beginning, have been extremely interested in assimilating Azerbaijani energy resources and creating alternative pipelines for their transportation. And this, in turn, ensures the inflow

of significant foreign direct investments both into Azerbaijan and into other Caucasian countries (Georgia and Turkey) where the pipelines run.

As for the negative effects, they proceeded primarily from the regional oil- and gas-production and transportation competitors—Russia and Iran, which, with all the means at their disposal, tried to gain control over the use and particularly the transportation of Azerbaijani hydrocarbon resources.

The common ethnic, cultural, and linguistic traits it shares with Turkey are of special significance for Azerbaijan, which gives rise to common viewpoints on many international issues. This, as should be expected, also came into play when defining the route for transporting oil and gas.

Despite the fact that the shortest route linking Azerbaijan with Turkey passes through Armenia, the choice of this potential transportation route, which is the best from the economic viewpoint, was undermined by the relations that developed between these countries.

First, the conflict between Armenia and Azerbaijan over Nagorno-Karabakh, and the seizure by Armenian armed forces of Azerbaijani territory beyond this conflict region, not to mention the breakdown in railroad communication between Azerbaijan and its autonomous district—Nakhichevan—unequivocally determined Azerbaijan's negative attitude toward the use of Armenian territory as a transportation corridor.

Second, Turkey, in turn, in support of Azerbaijan, has also blocked transportation communication lines with Armenia.<sup>12</sup>

Here it should also be mentioned that Armenia has its claims against Turkey with respect to the latter's nonrecognition of the Armenian genocide of the beginning of the 20th century. What is more, the fact that Armenians often identify Azerbaijanis with Turks is the reason why the Armenians also perceive the Azerbaijanis as accomplices in the "Armenian genocide" [Hunter, 2000, p. 30].

The case of Armenia is a graphic example of how use of its comparative advantage as the shortest route linking Azerbaijan with Turkey is being hindered by the conflict relations which have developed with these countries [Aras and Foster, 1999, p. 236; Dikbas, 2005; Harutyunyan, 2004].<sup>13</sup>

Here it is expedient to note that the absence of official, including economic, relations between Armenia and Azerbaijan does not mean that no illegal trade, although on a relatively small scale, is carried out by means

of transit through Georgia. Despite the demands of the Azerbaijani side not to permit the shipment of goods through Georgia from Azerbaijan to Armenia, the Georgian side, referring to the fact that Georgia and Armenia are members of WTO, does not always fulfill these demands, which is creating certain difficulties in Azerbaijani-Georgian relations too [Alkha-zashvili, 2006].

It is important to note that Russia has been on Armenia's side from the very beginning in the Armenian-Azerbaijani conflict. Here we will emphasize that by directly and openly supporting the separatist movements in Abkhazia and South Ossetia, Russia has also set itself against Georgia.<sup>14</sup>

As a result, the military-political union between Armenia and Russia was registered as a strategic partnership between these countries. By recognizing Russia's advanced defense function in the Central Caucasus,<sup>15</sup> Armenia acquired the status of Russia's outpost in the Caucasus, not an entirely flattering position for a sovereign state to be in [Cameron and Domański, 2005; Liloyan, 2004].<sup>16</sup>

The exclusion of the Armenian route for transporting oil and gas from Azerbaijan to the West has helped to increase the expediency of using the Georgian vector [Croissant, 1999], which was in fact put into practice.

Geopolitically, Georgia has a key position in the Central Caucasus, particularly keeping in mind the conflict between Armenia and Azerbaijan. Georgia must carry out the function of the region's link. What is more, essentially immediately after restoration of its state independence, Georgia made its strategic, pro-Western, choice [Rondeli, 2001].

As a country with high systemic risk factors, primarily due to the high level of corruption [Brzezinski and Bell, 2003], Georgia's investment attractiveness is low, although implementation of the BTC oil pipeline project [Papava, 2005e] and the projects related to it are opening up new opportunities for expanding investments beyond the energy sector [Starr, 2003, p. 87]. This situation greatly improved after the Rose Revolution [Ascherson, 2004; Baran, 2004b; Fairbanks, 2004; Jones St., 2006; Karumidze and Wertsch (eds.), 2005; King, 2004; Miller, 2004; Welt 2004], since trust grew in a country which had officially declared the priority of democratic values in post-revolutionary changes [Papava, 2005b].

From the very time the idea arose of transporting Caspian oil to the West and building the BTC oil pipeline (bypassing Russia and Iran) for

this purpose, Azerbaijan [Cornell and Ismailzade, 2005; Nassibli, 1999], Georgia [Croissant, 1999; Papava, 2005e], and Turkey [Aras and Foster, 1999; Baran, 2005] essentially represented one team<sup>17</sup> with significant support from the U.S. [Kalicki, 2001, p. 122; Mahnovski, 2003, pp. 116-117]. This fully met the main goals of the U.S. in the region aimed at isolating Iran; preventing the restoration of Russia's monopoly position in the region; supporting Turkey's increasing influence in the region; and encouraging American companies to make investments in the region [Müller, 2000, p. 189].

Another goal was added to the aforementioned after the tragic events of 9/11, that is, the U.S. was interested in promoting development in the region's countries, which would help to reduce the risk of new terrorist acts and bring the war on terrorism to its successful conclusion [Gati and Christiansen, 2003].<sup>18</sup>

What is more, we must also keep in mind that the U.S. administration placed top priority on achieving national energy security, within the framework of which the U.S.'s international energy policy is acquiring special significance, in particular in the Caspian region [Kalicki, 2001, p. 120]. The U.S.'s strategy in the region can be paraphrased as one of "multiple pipelines," which means adding new pipelines to the existing ones [Pamir, 2000].

All the same, the U.S.'s interests in the region are not limited to energy alone [Jaffe, 2001].

The U.S.'s task is to help the former Soviet republics of the region to eradicate the remnants of the Soviet economy, to develop a market economy and private sector, to achieve robust foundations for economic growth, to establish the rule of law, to resolve social and environmental problems, and to avail themselves of the benefits of energy development and extended export routes [Mann, 2003].

It is no accident that the U.S.'s Caspian policy aimed at preventing restoration of Russia's monopoly in the region is perceived as a policy aimed against Russia itself. In actual fact, this is not so [Baran, 2004a], and according to the U.S.'s official position, Caspian energy is an arena for potential cooperation with Russia [Larrabee, 2004; Mann, 2003, pp. 152-153]. Along with this, cooperation potential between the U.S. and Russia also encompasses such spheres as enhancing the economic development of

the region's states and preventing religious and political extremism and international terrorism [Chufrin, 2001].

It is cooperation and partnership, and not a conflict of interests between the U.S. and Russia [Naumkin, 2001], that can help to achieve the most positive results in use of Caspian energy.

Implementing principles of cooperation and partnership between the countries of the regions can also ensure that their interests are met; unfortunately, understanding and carrying out these principles in practice in the region is the most difficult thing for the Russian side [Papava, 1998; Papava and Gogatadze, 1998]. What is more, certain so-called "frozen conflicts" in the Central Caucasian countries are making it difficult to develop economic (and other) cooperation between them [Yunusov, 1999], although this certainly does not mean the countries cannot look for ways to carry out this cooperation [Champain, 2004; Champain, Klein, and Mirimanova (eds.), 2004].

Recently, the EU has been focusing greater attention on the Black Sea countries [Grabbe, 2004; Lynch, 2004b]. Here it should be emphasized that the TRACECA and INOGATE projects are most in harmony with the European view of Central Caucasian development [Rondeli, 2004b, p. 52]. Implementation of the BTC oil pipeline is viewed as an important component of Europe's energy security [Chase, 2002]. What is more, the system of Black Sea oil pipelines can be used as a significant component of the EU's "Wider Europe" strategy, and in this respect, the significance of Georgia and Azerbaijan, which are potential contenders for membership in the European and trans-Atlantic structures, is very important [Baran, 2004a, p. 120].

Caspian energy resources cannot only be of benefit to the Central Caucasus, but might also pose a threat to the countries of this region, which is predetermined by Russia's fear about the increase in the West's influence on the region, which is supposedly creating a danger for its national security and contradicts its interests [Rondeli, 2002b].

What are Russia's main economic interests in the Caspian energy region? They can be formulated as follows: the development of mutually advantageous trade and economic relations with the region's countries; the use of their transport capacities; and participation in the production and shipment of energy resources [Naumkin, 2001, p. 122].

We must also keep in mind the fact that Russia receives roughly 50 per cent of the country's total hard currency revenues from the export of oil and gas [Pamir, 2000, p. 34].<sup>19</sup> It goes without saying that Russia is not interesting in losing control over the revenues of other countries from Caspian energy.

According to Russian experts, the construction of the BTC oil pipeline contradicts Russia's interests [Zagashvili, 2000]. To be fair, it should be noted that some Western experts are coming out in support of the Russian stance and voicing anti-American criticism with respect to the oil pipeline projects [Colon, 2000], although this in no way reflects a realistic view of the processes going on in the region and, particularly, the West's official position.

Russian politicians are still holding onto the idea of restoring the empire,<sup>20</sup> at least in its modernized form, which was reflected in the conception for creating a so-called Liberal Empire [Chubais, 2003].<sup>21</sup> In accordance with this conception Russia, by means of economic expansion,<sup>22</sup> can and should restore its economic influence throughout the entire post-Soviet space.<sup>23</sup>

Russia began implementing a plan for incorporating the Caucasus into the Liberal Empire being formed with its strategic partner in the region—Armenia: at the end of 2002, a Russian-Armenian agreement called a “debt-for-equity” swap was implemented.<sup>24</sup> According to it, Russia obtained enterprises from Armenia, the total cost of which was enough to fully cover Armenia's \$93-million debt to Russia. Russia's activity in Georgia in this area, which began even before the Rose Revolution, significantly increased after the revolution [Papava and Starr, 2006], which the Georgian leadership also assisted. It should be noted that in the case of successful implementation of the Russian Liberal Empire plan in Georgia, it will be easier to draw Azerbaijan into this imperial scheme as well, since all of its main transportation and communication arteries, including the main pipelines, run through Georgia.

Based on the above, it is not at all surprising that the Russian side not only was not interested in developing a transportation corridor through Georgia and, in particular, in building pipelines passing through its territory, it also made use of all the possible mechanisms to hinder the implementation of these projects [Rondeli, 2002b].

According to the widespread view of Russian experts, public opinion in Georgia seems to be exaggerating Russia's role in destabilizing the po-



litical situation in Georgia in order to halt construction of the oil pipelines linking Baku to the Black Sea and the Mediterranean Sea. However, these experts admit there are facts confirming Russia's negative actions toward Georgia [Zubarevich and Fedorov, 1999, pp. 138-139].

In this context, it is interesting to note the view that the West's future relations with Russia are predetermined by the outcome of Russian-Georgian relations: what will Russia prefer—to have Georgia as a prosperous and stable neighbor, or to keep it “a prisoner of its imperial past” [Baran, 2004b, p. 118].

According to Russian experts, Iran and Armenia are Russia's strategic partners in the opposition to a Europe-Caucasus-Asia transportation corridor [Zagashvili, 2000, p. 188].

Both Russian [Malysheva, 2000] and Iranian [Maleki, 2003/2004] experts emphasize the coincidence of several Russian and Iranian interests in the region [Cornell, 2001b, pp. 85-88; Freedman, 1997], and specifically with respect to Caspian energy (among other things). They are essentially unanimous in their skeptical assessments of economic (among other) aspects of the BTC oil pipeline project [Entessar, 1999, pp. 173-174; Maleki, 2003/2004, p. 56; Zagashvili, 2000, pp. 193-194]. This position is also shared by several Western experts [Sherman, 2000; Stauffer, 2000].

Iran was particularly vexed about its exclusion, at the U.S.'s insistence, from the projects for developing and transporting Azerbaijani energy resources [Entessar, 1999, p. 171; Freedman, 1997, p. 107].

There is a substantiated opinion that Iran is at a geographic disadvantage, since the main consumers of Caspian energy resources are more interested in the east-west infrastructure than in transporting more oil through the Persian Gulf [Müller, 2000, p. 192].

In this respect, it is important to note that Iran has a real interest in Georgia. Georgia forms a significant section of the transportation corridor linking Iran to Europe [Malysheva, 2000, p. 67].

What is more, surprise is aroused by arguments that oil and Caspian energy resources as a whole should become the basis of advancement of the region's countries, and that the U.S.'s approach regarding Iran's exclusion from the oil pipeline network is supposedly delaying this process [Mohsenin, 2001, p. 176]. First, the experience of a large number of countries shows that oil and other energy resources far from always ensure their

advancement [Karl, 1997; Karl and Gary, 2004], which was briefly noted above. Second, it cannot be considered substantiated that Iran's exclusion from the oil pipeline routes and the inclusion of new countries in them interferes with the progress of the latter.

It should be noted that Iran welcomes regional cooperation as a tool of peace and stability in the region [Mohsenin, 2001, p. 174], which is a positive thing in itself.

Above it was noted that implementation of the transportation corridor project through Georgia, Armenia, and Iran is of special significance for the Georgian and Armenian economy, which can be considered a component of a larger project—the North-South transportation corridor [Mukhin and Mesamed, 2004]. This project, however, has its difficulties.

The North-South transportation corridor naturally implies Russia's participation and the activation of Russia-Georgia-Armenia-Iran transportation ties.<sup>25</sup> This problem is directly tied both to launching a ferry service between the Georgian port of Poti and the Russian port of Kavkaz, and to restoring rail communication between Russia and Georgia, to be more precise, the Abkhazian section of the Georgian railroad. Movement along this section was halted in August 1992 after the beginning of the armed conflict in Abkhazia.

Restoration of this railroad communication is primarily in the interests of the strategic partners—Russia and Armenia [Atshemian, 2005; Volkhonsky, 2005].<sup>26</sup> For Georgia, without realistic progress in the peaceful settlement of the conflict in Abkhazia, this project could lead to the loss of a more or less effective mechanism in the talks with Russia. The main thing is not to hinder the process of Georgia's territorial reintegration, even in exchange for the revival of rail communication with Armenia [Katcharava, 2003, 2006].<sup>27</sup> In so doing, it should not be forgotten that the possibility of peacefully settling the conflict in Abkhazia will create a precedent which could have a negative international effect for Armenia regarding the future status of Nagorno-Karabakh. What is more, it must be kept in mind that even if the Abkhazian section of the railroad is not restored, the interests of the Armenian side are still being taken into account in the railroad-ferry service between the ports of Poti and Kavkaz [Pachkoria, 2005].

The urgency of this problem will increase if we take into account that official circles in Armenia are considering several projects (assessed at be-

tween 700 million and 1 billion dollars) for building a railroad to Iran.<sup>28</sup> Particularly since these projects are being viewed in the same context as the possibility of reviving rail communication with Russia via Georgia.<sup>29</sup> In so doing, some think that opening the Abkhazian section of the railroad will intensify the Russia-Armenia-Iran coalition opposing Georgia [Melia, 2005a, 2005b] and will lead to forming a Russia-Armenia-Iran axis [Cornell, 1998, pp. 62-64] and weakening the U.S.'s influence in the region [Martirosian, S., 2003], which is one of the main tasks of Russo-Iranian cooperation [Cornell, 2001b, p. 86].

Theoretically, the Russia-Georgia-Armenia-Iran railroad should help to reinforce economic interrelations among these countries, but keeping in mind the rising dangers for the entire civilized world coming primarily from Iran, the dubious expediency of rail communication between it and its open partner, Russia, is obvious.

The fact that Armenia and Georgia cannot use the comparative advantage of the potential North-South transportation corridor testifies again to the economic losses being endured by the region's countries due to the political difficulties throughout the entire Caucasus.

The future of the Central Caucasian countries largely depends on settling the conflicts in the region and achieving a fundamental change in the approaches of the Caucasus' neighbors toward these countries. Armenia, Azerbaijan, and Georgia should be perceived not so much as objects in their spheres of influence, but as partners in regional economic (among other) projects. Then the economic significance of both the Central Caucasus and of the Caucasus as a whole will increase even more, as a result of which the interest of international investment community in the region will significantly promote its economic development.

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### NOTES

- <sup>1</sup> The problem of nation-building is acquiring special importance under contemporary conditions, since weak and failed states are usually sources of many global dangers (for example, AIDS, the drug business, terrorism) [Fukuyama, 2004].
- <sup>2</sup> In the spring of 2006, Russia, on the pretext of fighting against falsified consumer products, put a ban on the imports of Georgian wines to Russia, even though it is a common knowledge that the most of falsified Georgian wines have been produced outside Georgia [Anjaparidze, 2006a; Tsereteli, 2006]. Furthermore, Russia ac-

counted for more than 70% of Georgia's wine exports. Other Georgian goods also faced the problem of expulsion from the Russian market [Parsons, 2006]. As a result Georgia does not have any economic interests to be in the CIS [Anjaparidze, 2006b, Mackedon, 2006; Socor, 2006a].

<sup>3</sup> In this area, it is just as, if not more, important that the Central Caucasian countries expand their cooperation potential with NATO [Alieva, 2004a; Anderson, 2000; Asmus and Jackson, 2004; Blandy, 2004; Cornell, 2004; Cornell, McDermott, O'Malley, Socor, and Starr, 2004; Hiscok, 2004; Johnson, 2004; Kune, 2003; Nuriyev, 2000; Rumer, and Simon, 2006, Skonieczka, 2004].

<sup>4</sup> See also: *The Southern Caucasus is an Instable Region of "Frozen" Conflicts. Documents of an International Conference on the Caucasus of the Friedrich Ebert Stiftung, Berlin, 26-27 November 2001*. Tbilisi: Friedrich Ebert Stiftung, 2002.

<sup>5</sup> The problem of the influence of a country's size on its economic development, taking into account the level of democratization, as well as political, religious, ethnic, and other factors, is the topic of a separate study [Alesina and Spolaore, 2005].

<sup>6</sup> For more on the significance and possibilities of partnership between Russia and the South Caucasian countries, see: [Avakov and Lisov (eds.), 2000, pp. 171-207; Barkovskiy (ed.), 2003; Papava, 1998; Papava and Gogatadze, 1998].

It should be noted that the possibilities of strategic partnership in the region largely depend on a fundamental improvement and leveling-out of the investment climate in Russia [Marshall, 2003] and the Central Caucasian countries [Starr, 2003]. In this context, the Russian factor in the West's strategies toward the Central Caucasus and the Black Sea Region is acquiring special significance [Larabee, 2004].

<sup>7</sup> It should be noted that transportation communication between Armenia and Azerbaijan is impossible until peaceful settlement of the conflict in Nagorno-Karabakh is achieved.

<sup>8</sup> Fundamental publications on the cluster theory are [Porter, 1990, 1998].

<sup>9</sup> The problem of spatial borders of a cluster is the topic of an independent study [Belussi, 2004; Enright, 1996, 2000].

<sup>10</sup> Denial of the existence of a single cluster theory in no way excludes the presence of numerous theories and ideas shedding light on its (the cluster's) content and logic of formation and functioning [Feser, 1998].

<sup>11</sup> Here it is necessary to emphasize that the Azerbaijani oilfield in the Caspian Sea (the Azeri, Chirag, Gunashli (ACG) field) is classified as a cluster (see: "Baku-Tbilisi-Ceyhan (BTC) Pipeline Open Yesterday," *Scandinavian Oil-Gas Maga-*

zine, 26 May, 2005. Available at [http://www.scandoil.com/moxie/news/fd\\_news/bakutbilisiceyhan-btc-pip.shtml](http://www.scandoil.com/moxie/news/fd_news/bakutbilisiceyhan-btc-pip.shtml); M. Townshend, "BTC Section—Between Two Seas. Progress on the BTC Pipeline Project," *Azerbaijan International*, No. 10.3, 2002. Available at [http://www.azer.com/aiweb/categories/magazine/ai103\\_folder/103\\_articles/103\\_btc.html](http://www.azer.com/aiweb/categories/magazine/ai103_folder/103_articles/103_btc.html).

- <sup>12</sup> It should be noted that despite the existing problems in interrelations between Armenia and Turkey, economic contacts between the representatives of these countries are nevertheless taking place [Soyak, 2004, pp. 59-62]. In so doing, the annual trade turnover between these countries is estimated at 100 million dollars [Hill and Taspinar, 2006, p. 16].
- <sup>13</sup> It is important to note that improving interrelations with Azerbaijan and Turkey by finding a common language to achieve peaceful settlement of the Karabakh conflict is gradually becoming one of Armenia's economic interests [Khachatryan, A., 2004, pp. 222-227].
- <sup>14</sup> The conflict between Armenia and Azerbaijan and their support by Russia and Turkey, respectively, as well as Russia's combat action against Chechnia, can in no way be interpreted as a standoff between the Christian and Muslim religions in the Caucasus [Huntington, 1996]. Orthodox Christian Russia has essentially occupied the territory of Orthodox Christian Georgia in Abkhazia and South Ossetia, while Muslim Iran is supporting Christian Armenia, and not Muslim Azerbaijan, in the Armenian-Azerbaijani conflict [Cornell, 2001c, pp. 47-51].

A certain rapprochement of interests between Russia and Turkey in the Caucasus also refutes the concept of a standoff between the Christian and Muslim religions in the Caucasus [Hill and Taspinar, 2006]. What is more, it is important to note that the presence of certain superficial coincidences of interests, in our opinion, in no way means an alliance between Russia and Turkey in the near future.

- <sup>15</sup> Based on the fact that Armenia is carrying out Russia's advanced defense function in the Caucasus, the entirely irrational conclusion is drawn that this is supposedly restricting Russia's direct presence in the region [Sarksian, 1999]. Reasoning in this context could bring us to the conclusion that if Armenia did not execute Russia's defense function in the Caucasus, it (Russia) would have to begin combat action in order to establish its direct presence in the region.

It is important to note that Armenia, just like Russia, is not interested in the possible deployment of NATO or U.S. military bases in Georgia and Azerbaijan [Darbinian, 2004]. However, Armenia is in no way excluding cooperation with NATO [Blandy, 2004, p. 70; Yaz'kova, 2005, p. 60]. Despite the fact that due to its dependence on Russia, Armenia is also refraining from membership in NATO [Asmus and Jackson, 2004], this is not preventing it from intensively working toward integration into European organizations [Minasian, 2005].

- <sup>16</sup> In this context, it is worth taking note of the fact that according to the current opinion, Iran is hoping that Russia might yield its outpost in the Caucasus to it, and that Armenia will be transformed from a Russian into an Iranian outpost (see: Media Review, U.S. Embassy, Yerevan, *Daily Media Reviews*, 9 December 2005. Available at <http://www.usa.am/mediareviews.html?d=9&m=12&y=2005>).
- <sup>17</sup> Joint action by Azerbaijan, Georgia, and Turkey to build and operate the BTC pipeline has made it possible for these countries to gain an effect much superior to the direct economic effect from implementation of this project [Elkind, 2005], which primarily consists of a significant expansion in cooperation in many spheres between these countries [Starr, 2005].
- <sup>18</sup> It should be noted that after the events of 9/11, the Caucasus has moved in the priorities of U.S. international policy from the category of “threat to interests, but not an immediate threat to security” to the category of “imminent threat to security and interests” [Foster, 2004].
- <sup>19</sup> It should be noted that Russia is in no way interested in reducing the export of oil and gas to countries of the post-Soviet space [Korchemkin, 1996]. This might lead not only to a reduction in direct revenue from the sale of energy resources, but will also cause a serious reduction in the degree of dependence of former Soviet states on Russia’s goodwill to deliver them these energy resources at prices acceptable to them.
- <sup>20</sup> It should be noted that in Russia the idea of restoring the empire has always (even right after the disintegration of the U.S.S.R.) been particularly pertinent [Dawisha, 1995; Smith, 2004, pp. 3-4], which was primarily manifested in retaining the institution of Russian citizenship in the former Soviet republics [Simonia, 1995, p. 22].

Of essential importance is also the fact that it is precisely the temptation to restore the empire that largely determines Russia’s conduct in the Caspian-Caucasus region as a whole, as well as with respect to the production and transportation of energy resources of this region [Shoumikhin, 1999, pp. 136-139].
- <sup>21</sup> It should be emphasized that the idea of a Liberal Empire itself, following Yuri Krupnov’s justified comment [Krupnov, 2005], is not Russia’s, and that it was first put forward as early as the second half of the 19th century in Great Britain [Matthew, 1973], was elaborated at the end of the 20th century [Reiff, 1999] and increasingly acquired a clearly American hue [Farrell, 2005].

What is more, in all likelihood, we should agree with the opinion that acceleration of the formation of the Russian version of a Liberal Empire was given a particular boost [Torbakov, 2003] by the U.S.’s combat action in Afghanistan and Iraq as the possibility of forming an American Democratic Empire [Kurtz, 2003].
- <sup>22</sup> According to its architects, a Liberal Empire should be created not by forced armed occupation of former Soviet republics, but by gaining control over the main eco-

conomic facilities (by means of acquiring and developing assets) located in their territory. An essentially universal analysis of Russian investments in the CIS countries is presented in an article by [Crane, Peterson, and Olikier, 2005].

It is also important to note that in the Russian idea of a Liberal Empire, its developers and executors imply nonmilitary methods of creation in the word “Liberal,” and not of the functioning (which they don’t mention at all) of this “Empire,” which is essentially not surprising if we keep in mind the far from democratic and liberal nature of the regime in Putin’s Russia [Åslund, 2005; Trenin, 2005].

Here we should note the interrelation in Russian policy in the post-Soviet space of Energy Dependence and Political Independence, whereby when the first increases, the second weakens [Smith, 2004, pp. 5-8]. It is no accident that for Russia, along with the formation of a Liberal Empire, a targeted advance toward creating an Energy Empire is of particular importance [Hill, 2004].

- <sup>23</sup> It should be noted that the idea of creating a Liberal Empire is largely related to the idea of Russia’s Eurasian mission [Dugin, 2005], which has deep historical roots in Russia [Gloveli, 2000].
- <sup>24</sup> See: *Armenia: Economic Highlights*, July 2002. Available at <http://www.bisnis.doc.gov/bisnis/bisdoc/020809ARHaiLights.htm>.
- <sup>25</sup> It should be noted that transportation communication between Russia and Armenia via Azerbaijan is impossible until peaceful settlement of the conflict in Nagorno-Karabakh is achieved.
- <sup>26</sup> What is more, the Russian side is raising the question of handing management of the Abkhazian section of the Russian-Georgian railroad over to Armenia (see: “Abkhazskuiu zheleznuiu dorogu predlagaetsia peredat’ v upravlenie Armenii” (Management of the Abkhazian Railroad is to be Handed Over to Armenia), *Armianskaia gazeta*, 24 May 2004. Available at [http://www.yerkir.am/rus/index.php?sub=news\\_arm&day=24&month=05&year=2004&id=653](http://www.yerkir.am/rus/index.php?sub=news_arm&day=24&month=05&year=2004&id=653)).
- <sup>27</sup> We should pay attention to the fact that the post-revolutionary leadership in Georgia is positive about restoring the Abkhazian section of the railroad [Anjaparidze, 2005] (Abkhaz Railway Consortium Set up. *Civil Georgia, Tbilisi*, 5 May 2006. Available at <http://www.civil.ge/eng/detail.php?id=12496>).
- <sup>28</sup> See: “Armenia i Iran obsuzhdaiut vozmozhnosti stroitel’sтва zheleznoi dorogi” (Armenia and Iran Discuss the Possibility of Building a Railroad), *Day.Az: Novosti Armenii*, 16 December 2005. Available at <http://www.day.az/news/armenia/37247.html>; *Rassmatrivaitsia proekty stroitel’sтва zheleznoi dorogi Iran-Armenia* (Iran-Armenia Railroad Construction Projects are Being Reviewed). Available at [http://scripts.online.ru/money/news/98/07/10\\_551.htm](http://scripts.online.ru/money/news/98/07/10_551.htm)).

The project for a gas pipeline connecting Iran and Armenia is arousing particular interest in the economic interrelations between these countries [Chitchian, 2001; Shahabi, 2001].

- <sup>29</sup> See: “Armenia namerena postroit’ novuiu zheleznuiu dorodu v Iran” (Armenia Intends to Build a New Railroad in Iran), *webargo.net*, 28 September 2005. Available at <http://www.webagro.ru/news.php?id=14896>; “Economic News in Brief,” *Iran News*, 28 September, 2005. Available at [http://www.iran.ru/eng/iran\\_news.php?act=news\\_by\\_id&news\\_id=19667](http://www.iran.ru/eng/iran_news.php?act=news_by_id&news_id=19667); “Iran, Armenia to Work on Joint Railway Project,” *IranMania*, 29 September, 2005. Available at <http://www.iranmania.com/News/ArticleView/Default.asp?NewsCode=36090&NewsKind=Current%20Affairs>.



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In this notable book, Ismailov and Papava attempt at no less than a redefinition of the Caucasus as a geographic region, adopting a novel geo-economic approach. Aiming to redefine the region away from the Soviet era, they discuss in great detail the advantages of integrating the former Soviet Caucasus with neighboring regions of Turkey and Iran. Refreshingly unconventional, this book provides many new insights into the politics and economy of the Caucasus and its place in the world.

*Dr. Svante Cornell, Research Director, Central Asia-Caucasus Institute, Johns Hopkins University-SAIS*

The two authors show, with tables, figures, and theoretical insight, the economic paths of Armenia, Azerbaijan and Georgia since independence, and their prospects for integration into the global economy. Reconceptualizing the Caucasian economic space, they show how the Caucasian economies are linked to one another, to regional powers and associations, and to the broader global markets in Europe, Asia and the United States. They investigate the prospects for a common Caucasian regional economic space and looking at the Caucasian economies since independence, remind us that no economy can be isolated, not even small and peripheral economies like those in Caucasia. They illustrate the critical role the region is beginning to play in global energy markets and as a transport hub between Asia and Europe. This is the first book in English to explore the geo-economics of Caucasia. The authors should be commended for bringing together such detailed analysis and information into one book.

*Dr. Stephen F. Jones, Professor of Russian and Eurasian Studies, Mount Holyoke College*

A book on geopolitical economy of the Central Caucasus provides a principally new vision of geo-political and geo-economic problems of the Caucasus. Proceeding from a new approach to the Caucasus regionalizations, the authors of the book have been successful in creating an original model of the involvement of Central Caucasian countries into globalization processes. The book raises many disputable issues and is informative enough to be of use not only for experts in the Caucasus but also a broader range of readers showing interest in the problems of the region.

*Dr. Akira Matsunaga, Professor of Eurasian Studies, The Sasakawa Peace Foundation*