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- Energy Policy and Energy Projects in Central Eurasia
- Regional Centers of Power and their Policy in Central Eurasia
- Central Eurasia: Politics Today

**ENERGY POLICY AND
ENERGY PROJECTS****IRAN'S GEOPOLITICS
IN THE MIDST OF
THE U.S.-RUSSIA-CHINA ENERGY
SECURITY STRUGGLE
FOR GEOSTRATEGIC CONTROL
OVER EURASIA****Thrassyvoulos (Thrassy) N. MARKETOS**

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Introduction

For reasons of both world strategy and control over natural resources, the U.S. administration is determined to secure a dominant role in Eurasia for itself. The Eastern Caspian

shore of the Central Asian states of Kazakhstan and Turkmenistan is crucial to oil and gas flow control, because determining which one, or both, of the two major projects—the Trans-Caspian

Corridor plus the Nabucco pipeline or the Caspian pipeline plus the South Stream pipeline—will reach the European or Asian market will in effect determine which major power, the U.S., Russia, or China, will gain geostrategic control over Eurasia.

The important geographical location of Central Asia (CA) with respect to the transport and communication networks in the West-East and North-South directions, concentration of the sizable fuel reserves there, as well as its vulnerability to the problems of the neighboring regions of South Asia and the Middle East has revived the ideas of the “Heartland” and “Eurasian Balkans” with the emphasis on the specific role and significance of CA in world politics.

The struggle of the leading world powers (U.S., Russia, and China) for geopolitical and geo-economic domination in the Caspian region is explained first by their geostrategic aspirations for leadership in the post-Cold War world order, as well as by the necessity to solve various regional and global security problems, many of which are linked with the Islamic Republic of Iran.

This paper argues that the key to this equation is Iran. In fact, how Moscow proceeds with the reconfiguration of Russo-Iranian relations could well form the centerpiece of the geopolitics of energy security in Eurasia.

Moscow can be expected to make vigorous efforts to coordinate with Iran over its oil and gas output and exports. The rationale for such a coordinated strategy involving Iran is very obvious. First, Moscow is intensely conscious of the West’s awareness of Iran’s enormous untapped hydrocarbon reserves as an alternative to Russian supplies. Russia will strive to stay ahead of the European, and eventually American, overtures toward Iran. Second, the hydrocarbon sector in Iran is firmly under state control and Moscow and Tehran are in harmony in this regard. Third, the two countries will be coordinating their energy policies for wider geopolitical purposes within the broad framework of their strategic cooperation. Furthermore, market forces dictate the rationale of Russia-Iran cooperation. Moscow would simply like to avoid competing with Iran as a major oil and gas route connect-

ing the Caspian and Central Asian energy-producing countries. Russia and Iran control roughly 20% of world’s oil reserves and close to half of the world’s gas reserves, and it makes good sense to accommodate each other.

Iran is indeed an important energy partner for Russia for many reasons. Russian oil companies, flush with funds, are keen to invest abroad. The Iranian upstream oil and gas sector and Iran’s energy ventures, such as pipeline projects, offer an attractive proposition for Russian investment. Again, Iran’s geographical location is ideal as an export outlet for expanding Russian energy exports, especially its ambitious developing liquefied natural gas (LNG) industry. Besides, Iran is an influential member of the Organization of Petroleum Exporting Countries, the decisions of which have a bearing on price stability and Russian export volumes.

But the most important consideration for Russia will be that Iran’s energy policy should not come into conflict with Russia’s interests. Once the U.S.’s engagement of Iran commences, Tehran will have plenty of choice while accessing foreign capital and advanced upstream oil and gas technology.¹ Iran is bound to probe gas markets such as Turkey, the Balkans, and Central and Eastern Europe. Also, Iran is keen to develop a new LNG industry. Moreover, Iran could well end up competing with Russia as a major oil and gas route connecting the Caspian and Central Asian energy producing countries.

Cooperation with Iran is no less important for Russia in terms of Caspian Sea issues. True, the two countries have divergent views on how the Caspian Sea should be divided. Russia prefers a median line solution, whereas Iran has insisted on an equal share (20%) solution for each littoral state regardless of the length of coastline. All the same, Russia and Iran are in profound agreement in their opposition to the U.S.-led Trans-Caspian pipeline projects.

Russia’s number one priority in energy cooperation with Iran will be for upstream partici-

¹ See: M.K. Bhadrakumar, “Russia, Iran and Eurasian Energy Politics,” *Japan Focus*, available at [<http://www.japanfocus.org/products/topdf/2613>].

pation by Russian companies. Gazprom has had some limited participation so far in the early phases of Iran's massive South Pars gas fields with an estimated aggregate cumulative production range of a stunning 13 trillion cubic meters. Moscow will be keen to promote greater involvement. Gazprom has shown an interest in the Iran-Pakistan-India pipeline project not only as a contractor but also as an investor.

But the big-ticket item will be the future development phases of South Pars, which Tehran has earmarked as feedstock for producing and exporting LNG for the European and Asian markets. Without doubt, Moscow will be keen to develop a role in Iran's nascent LNG industry so that it doesn't end up competing with Russia's own LNG industry.

On top of this, Moscow would be pleased at the present orientation of Iranian energy exports toward the Asian market. On the one hand, this would ease the competition from China for gaining access to Central Asian energy producers and, on the other, it reduces the likelihood of Iranian energy flows to Europe, which may otherwise cut into Russia's market share.

Equally, Russia would actively promote an Iranian gas pipeline to China via Pakistan and India. But the project is stalled due to U.S. pressure on India. By opposing the Iran-Pakistan-India gas pipeline, the U.S. is principally trying to deny China easy access to Iranian energy reserves.

To be sure, Moscow began anticipating several months ago that with the inevitable collapse of the United States' policy of containment of Iran and with Iran's ensuing arrival as a gas-exporting country, an altogether new scenario would shape up on Eurasia's energy map.

Beijing too is highly interested in the future orientation of the Iranian hydrocarbons. First, we should bear in mind that China, according to the country's declared security concept, seeks to create a worldwide atmosphere of mutual trust, mutual benefit, equality, and collaboration. It is willing to implement its previously elaborated principle of refraining from any pressure on smaller countries and interference in their internal affairs, to implement policies aimed at

demonstrating to the world community its fundamental position of great power, to explain the main content of China's foreign policy, which is focused on friendly relations and partnerships with a wide range of states, and to convince the world community that it is actively fighting for peace, equal rights, and justice, and is trying to dissociate itself from the "thesis on the Chinese threat."

It is in that sense that Beijing approaches questions referring to hydrocarbon export from the landlocked countries of CA. China's proximity to Central Asia permits it to quickly build oil pipelines from Kazakhstan to Xinjiang. The joint construction of a Sino-Central Asian gas pipeline is still underway. In 30 June, 2008, the first phase of construction of a gas pipeline from Uzbekistan to China began, a project with a total value of over 2 billion dollars. According to a previously signed agreement between the oil and gas companies of Uzbekistan and China, Chinese companies refine oil and gas reserves in Uzbekistan, and they have preferential access to wells once drilling is complete. These projects will give China direct access to oil and gas deposits in Uzbekistan and Turkmenistan, in addition to Azerbaijan and Iran, and will meet these countries' willingness to sell their energy directly to China regardless of Russia. Therefore at present, China is intensifying its investments for the exploration and exploitation of new oil and gas fields in Kazakhstan, Uzbekistan, and Turkmenistan, as well as building infrastructure to deliver energy to its maritime regions.

Thus, Tehran's choice to cooperate in the energy sector with Russia and China against the U.S. and EU interests in CA, or with the one power against the other, or even aligning itself with America's energy security policy in Central Eurasia, may define the world order of the 21st century.

This paper, following the principles of the neo-realist school of thought in geopolitics, is organized in three sections. Firstly, we shall examine the way in which tension in Iranian-U.S. relations stimulates the CA states to maneuver within the limits of the Iran-U.S.-Russia triangle. In the second part, we shall define the reason why

the development of Sino-Iranian relations over the past two decades is part of the steady expansion of ties between China and the wider Middle East, and more broadly, between the countries of East and West Asia. Finally, in the third part, we will shed light on the reason why many Chinese energy firms are increasingly shifting

their investments toward Africa and Central Asia, probably trying to diversify to the extent that is possible, and away from the Persian Gulf, and thus from the risks and uncertainties associated with the deeply entrenched U.S. military power, local instability, and maritime transportation of oil supplies.

Map 1

**Eurasia Energy Infrastructure.
Iran's Role in Existing and Projected Oil and Gas Pipelines**



Russian Energy Geopolitics in Central Asia: The Iranian Factor

Historically, “Big Iran” comprises the Middle East and part of CA (Tajikistan, Uzbekistan, and Turkmenistan), an Arab part of Western Asia and Egypt. In the 1990s, Tehran tried to take control over the former Soviet republics in CA and in the Gulf.

The essence of the Iranian foreign policy lies in the formation of a multi-polar world order under the aegis of the U.N., in which Iran and the other Islamic countries will represent one of the poles. At

the same time, Tehran regards CA as a continuation of the Persian Gulf region, which is a vitally important zone of Iranian economic interests as a whole. Therefore, the Islamic Republic traditionally defends projects of energy routes from CA states through its territory as the cheapest and most economically justified.²

However, the Soviet Union's collapse, the U.S. economic sanctions, Tehran's non-admission into the CA region energy projects, and the formation of Iran's negative image as a sponsor state of international terrorism, all hinder Iran's strategy to develop full-fledged relations with CA states. But, like Turkey, Iran failed to win a leading position in the region and in 2000 gave way to China. In the early 2000s, a sharp rise in oil prices, and most of all the U.S.'s mistakes in Iraq (toppling of Saddam Hussein), gave Iran an unprecedented opportunity to stand up against the U.S.

Tehran considers that Washington is still being hostile toward revolutionary Iran, aspires to world leadership, acts against Iran's economic goals in the CA region, and is conducting a propagandistic campaign against Iran. Moreover, it thinks that the U.S. military-technical cooperation with CA states and NATO's movement toward the East is an indication of America's desire to control and dominate in the Caspian region and part of the U.S. global efforts to surround and isolate Iran. In this sense, conflicts in Afghanistan and Palestine are also regarded by the conservative Iranian clergy as an "attack on the whole of the Muslim world."³ Tehran also regards the growing presence of Israel, a U.S. ally, in CA as a challenge to its national interests.

The anti-Iranian U.S. sanctions, and the Iranian-American dispute over CA, played such a decisive role in regional states economic strategy that the Caspian region's leading energy states, Kazakhstan and Turkmenistan, did not consider the mostly economically attractive transportation route through Iranian territory and restricted their cooperation with Iran to swap operations. Most importantly, the tension in Iranian-U.S. relations stimulated the CA states to maneuver within the limits of the Iran-U.S.-Russia triangle, a situation that promoted militarization of the Caspian Sea, which delayed development of the regional economy.

Speeding up of the armament race virtually put the Caspian states in the so-called "resource wars" stimulated by the American-Russian competition in the sphere of energy resources. Kazakhstan itself, having officially declared a multi-vector external relations strategy, considers the Iranian transit route to be a direct exit to the sea ports and hence the most realistic intermediate route of raw material supply to the markets of South Asia and Asia-Pacific states. Turkmenistan is also vitally interested in partnership with Iran, since for Ashghabad, the Iranian corridor means a possible liquidation of Russia's monopoly of its national gas reserves.

Factors like,

- (a) the traditional American approach connecting the problem of Islamic fundamentalism with the problem of human rights and development of democracy in CA,
- (b) the U.S.-CA states' discrepancies over the ways and methods to solve regional security problems,
- (c) the unsettled wars in Afghanistan and Iraq, along with
- (d) strengthening of the American-Iranian confrontation and
- (e) further consolidation of the Eurasian partnership within the framework of the Shanghai Cooperation Organization (SCO) and the Eurasian Economic Community (EurAsEC), distanced

² See: "New Regional Developments and National Security of the Islamic Republic of Iran," *An Iranian Quarterly Discourse*, Vol. 1, No. 1, Summer 1999.

³ G. Yuldaseva, "Geopolitics of Central Asia in the context of the Iranian Factor," *Caucasian Review of International Affairs* (CRIA), Vol. 2 (3), Summer 2008, p. 134.

the CA states from the U.S. in the advent of 11 September, 2001 and consequently invigorated Russian and Iranian positioning in the Caspian region.

It has become obvious that various anti-Iranian restrictions in the oil-gas sphere promoted by the West, as well as the continuing instability in Afghanistan and other countries adjacent to CA, have altered the external political preferences of most CA states in favor of Iran and Russia, both owing to economic and political motives that clearly contradict U.S. interests.

As far as Russia is concerned, it perceives its access to CA's energy resources and control over the transportation and communication corridors through the prism of its devotion to the idea of multi-polar approaches to international relations. However, Russia's Central Asian geostrategy presupposes political, economic, and social stability in a region fraught with Islamic extremism that threatens, above all, the stability of its own southern borders and territorial integrity. This geopolitical reasoning obliges Moscow to try and play an important role in Afghanistan's post-conflict stabilization.

Furthermore, while the U.S.-Russian rivalry is accelerating in Eurasia, and the U.S.-Iranian contradictions remain unsettled, Moscow is spending much of its political capital in building a cooperative relationship with Tehran as a counterweight to America's geopolitical and economic interests in CA. This is in fact the main stumbling block in Russian-American relations. The main condition for U.S.-Russian partnership is discontinuation of Russian-Iranian military-technical cooperation (including supplies of nuclear equipment). Of course, Moscow continues cooperating with Iran in its nuclear program, obviously convinced that Tehran's relations with Moscow are objectively strengthening the pragmatists' position on the Iranian domestic scene and neutralizing the radical Islamist approaches.⁴

Russia's stronger position there in the few last years may have forced the U.S. to try seeking decentralized pipeline networks, but Washington, nevertheless, insists that the pipelines bypass both Russia and Iran. For that reason, the pipelines which cross Azerbaijan and Georgia before reaching Turkey and the BTE gas pipeline are still the main instruments of geopolitical rivalry with Moscow. The future of many of these projects depends on the extent Kazakhstan and Turkmenistan, or even Iran, are prepared to use these lines.

It is noteworthy that Iran's outstanding gas reserves were essential to the early prospects for Nabucco. Iran has 28.13 tcm of natural gas reserves, accounting for 15.5% of the global supplies and ranking the country second in the world after Russia. These resources are both mismanaged and underexploited, so the huge 105 bcm/y output is not enough to meet domestic demand. As a result, Iranian gas is totally removed from the international markets, with the exception of a small amount (5.60 bcm/y) exported to Turkey.⁵ Several scholars consider Iranian gas as the only source able to meet Nabucco's needs⁶ to a twofold extent: on the one hand, obviously, the size of the reserves and the high reserves/production ratio. By exporting an additional 30 bcm/y to fill Nabucco, Iranian reserves are expected to last about 205 years. On the other hand, there is the country's strategic position, which makes Iran the most economically viable way to ship Turkmen gas beyond Gazprom's control. Unfortunately, Iranian gas exports suffer considerable setbacks as far as the systemic level is concerned. By limiting foreign investments in Iran's hydrocarbon sector to 20 million USD, the

⁴ See: G. Yuldaseva, "The Russian Factor in Central Asian Geopolitics in the Context of Iranian-American Contradictions," *Central Asia and the Caucasus*, No. 5 (47), 2007, available at [www.ca-c.org/online/2007/journal_eng/cac-05/04.shtml].

⁵ See: BP, "Statistical Review of World Energy", 2008, pp. 22-27.

⁶ See: G. Mangott, K. Westphal, "The Relevance of the Wider Black Sea Region to EU and Russian Energy Issues," in: *The Wider Black Sea Region in the 21st Century: Strategic, Economic and Energy Perspectives*, ed. by D. Hamilton, G. Mangott, Centre for Transatlantic Relations, Washington, 2008, pp. 147-176; F.F. Fee, "The Russia-Iran Energy Relations," *Middle East Economic Survey*, Vol. 59, No. 11, 2007, pp. 12-17.

U.S. Iran-Libya Sanctions Act (ILSA) seriously undermines Iran's appeal for Western investors. Despite the fact that most of the penalties harmed U.S. companies, such as ConocoPhillips, and no European company has been targeted so far, the threat of the sanctions, which are focused on credit access, prevented companies such as OMV and Shell from undertaking massive investments in the development of both Iranian upstream and domestic transport.⁷ As a result, given the political climate stemming from the Iranian nuclear issue, it seems to be considerably difficult for the EU to engage Iran in participating in the Nabucco project, whilst avoiding at the same time the emergence of disruptive effects on transatlantic relations. In other words, Nabucco turns out to be undermined by the U.S. sanctions more than by Russia's attempts to build alternative routes like South Stream. Other commentators are more dismissive about the need for Iranian gas. Their main argument is rooted in the poor Iranian infrastructural network, which is under massive strain because of growing domestic demand as well as the lack of investments aimed at upgrading the grid, notably the south-north trunk line which should ship gas from the giant South Pars offshore field. In other words, leaving aside the political consequences caused by Iranian involvement, the question of how Iran will ultimately be able to free up gas for export remains unresolved.

As for Turkmenistan, another most important gas supplier vital to the viability of any projected pipeline scheme, it has huge natural gas resources and a high level of production, but these resources need massive western investments to be developed. At the same time, Russia is apparently succeeding in strengthening its grip on the Central Asian infrastructural landscape.

The Nabucco pipeline needs to rely on Turkmen gas given the position of two other potential suppliers. Azerbaijan is the safest source, but it is still importing gas to satisfy its increasing domestic demand and the gas predictably coming from the giant Shah Deniz field is unlikely to fill Nabucco's double outlet. As a result, the participation of Azerbaijan alone seems to be unable to justify the huge investments required by the construction of Nabucco. Despite these misgivings, the Nabucco agreement was solemnly signed in Ankara on 13 July, 2009. It is worth mentioning here that the EU has invested its hopes in this project of disengaging from Russia in the energy sector, despite the many uncertainties regarding the states willing to fill the pipeline with gas.

In this regard, Iran has a huge amount of gas reserves at its disposal able to challenge Russia's dominance on the European markets. Unfortunately, the political climate is preventing Western companies from making investments aimed at developing Iran's gas upstream as well as its domestic grid, given the limited capacity of the south-north corridor.

Turkmenistan's engagement is needed to fill Nabucco in the short and medium terms, but several doubts arise concerning the available resources and the transit corridors. As far as resources are concerned, the EU should regard Turkmenistan gas as a "transitional source" while waiting for significant improvement of the political climate around Iran. However, Turkmenistan has committed itself to long-term agreements with Russia and China, with Europe losing its sole appeal, since Gazprom promised to raise the prices for Turkmenistan to the international levels. From a broad political perspective, Russia profited from the need of Turkmen President Berdymukhammedov to consolidate his power in the light of the regional context potentially sensitive to "destabilizing pressure" coming from the systemic level within the framework of the U.S.'s involvement in the "broader Middle East." Furthermore, given the unlikelihood of exporting Turkmen gas to Europe through Iran, Nabucco's prospects seem to be highly dependent on the TCP's prospects, which are turning out to be poor so far in the aftermath of the previous mid-2000s failure. However, the improvement of Azerbaijani-Turkmen relations, as well as a partnership between Turkmenistan and Russia, which is not as stable as it seems, leave some room for the EU and Western companies to maneuver.

⁷ See: P. Rivlin, "Iran's Energy Vulnerability," *Middle Eastern Review of International Affairs*, Vol. 10, No. 4, 2006, pp. 103-116.

Overall, Iran's involvement in the Central Asian region during recent decades has shown the inadequacy of efforts to limit the export of Islamic fundamentalism from Iranian territory by means economic sanctions and political isolation at the regional and global levels. This is why the Iranian vector in Central Asian foreign policies will steadily increase due to economic and political considerations, stimulated by de-ideologization of Iran's foreign policy. It is obvious that this cooperation would strengthen more under the new, moderate, and flexible Iranian regime. At the same time, Iran continues to be a potential competitor for the Central Asian states in the sphere of energy resources, which justifies the plurality of energy pipelines from the region.

However, the tough Iranian position on the nuclear issue and its inflexibility in solving regional security issues have brought Tehran to the brink of war with the U.S. Any military action under the above-mentioned circumstances would surely involve all the interested political parties, movements, and states in Central and South Asia, the Caucasus, and the Middle East and would have the potential of turning into another world war.

As a whole the positive dynamics of the geopolitical processes in the examined region will be dependent on well-defined constructive behavior by all regional "game" participants, including the U.S., the EU and Russia, Iran, as well as the states of Central Asia.

Meanwhile, it is worth taking the positive changes in Iran as an indication that Tehran is willing to moderate its position. It seems that with the advent of the new, more monolithic and united conservative cabinet in Tehran, the prospects for holding serious talks with the U.S. will grow. Especially if we take into account Iran's interest in "sincere cooperation" with Russia and the U.S. in the energy sphere and the possible development of new, positive approaches to the situation in the Caspian proceeding from this fact.

Balanced Eurasian-Atlantic cooperation in Central Asian region corresponds to the interests of the Central Asian states, which aspire to a multi-polar world order and a collective security system in Central Asia as the sole effective means of providing stability and development in the region. Moreover, constructive cooperation of the two main players in the region—the U.S. and Russia—could potentially restrict the growth of Iran's and China's regional ambitions and serve as the basis of stability for forming a Eurasian system of energy supplies and transport links.

In the new multi-polar architecture of international relations, with its various complex mechanisms of restraints and counterbalances, Iran, as well as other states with hegemonic intentions, could become a stable, but not dominant, player in Central Asia and the Caucasus.

Chinese Energy Geopolitics in Central Asia: The Iranian Factor

China is aiming to quadruple its per capita GDP to \$3,200 by 2020 from the \$800 attained in 2000. This would imply an average annual economic growth of 7.2% until 2020. In order to attain this, China will have to keep meeting the enormous appetite of its manufacturing economy for raw material and energy resources. On the other hand, it has to open up new markets for Chinese products while keeping the competitive economies of Asia and America at bay. This has to be driven by international relations backed by strategic defense capability. Conscious of these imperatives, China's international relations are developing on twin tracks: gaining sources of raw materials across the globe and increasing its strategic power projection. Beijing is on a fast track with respect to developing its missile capability and submarine fleet. Some analysts say that China will be able to match the defense capability of the U.S. by 2050.

Considering the above as an imperative, Beijing is rapidly opening up to South Asia. This region's geographic location, midway between the oil-rich Middle East and the South East Asian regions, borders on most of China's sensitive southern boundary. This gives China the strategic option of opening direct access through South Asia to the international sea lanes of the Indian Ocean. The Indian Ocean region has always been the scene of a power play among Russia, the U.S. and the West, and theocratic Islamic states like Iran, simply because 75% of global merchant shipping passes through it.

China has used Iran to bridge its connection to the Middle East. China and Iran are important geopolitical actors as well as major players in the global energy market.⁸ In recent years, Sino-Iranian relations have broadened and deepened. Energy cooperation is the main axis around which this partnership revolves. As a result, China is a stakeholder in the outcome of the diplomatic crisis that has been brewing over the Iranian nuclear program.

The development of Sino-Iranian relations over the past two decades is part of the steady expansion of ties between China and the wider Middle East, and more broadly, between the countries of East and West Asia. At the same time, Sino-Iranian relations have distinctive origins and characteristics, not to mention potentially far-reaching implications. The relations are rooted in shared historical experiences, in common outlooks and concerns about the current state of international and regional affairs, and in overlapping interests.

Energy cooperation is the backbone of Sino-Iranian economic relations, though economic ties have been forged in other areas as well. Trade in crude oil is the core of energy cooperation. In 2005, Iran was China's third leading foreign supplier, satisfying about 14% of its import requirements.⁹ In January 2006, Iran replaced Saudi Arabia as China's number one source of imported oil. With respect to the benefits accrued to China, it is worth noting that Iranian crude oil not only helps meet skyrocketing Chinese consumption needs, but also helps to contain the rising import costs through purchase of the relatively cheap, heavy (sulfur-rich) oil that is plentiful in Iran (and Saudi Arabia).

China's growing appetite for natural gas in the form of liquefied natural gas (LNG) has provided a second energy link with Iran, which has an estimated 15% of the world's natural gas reserves.¹⁰ In March 2004, the state-owned Zhuhai Zhenrong Corporation (a spin-off of NORINCO) agreed to import 110 million tons of Iranian liquefied natural gas (LNG) for over 25 years, a deal worth approximately \$20 billion. According to the terms of the Yadavaran project agreement, Sinopec has committed to the purchase of 10 million tons per year of liquefied natural gas (LNG) over a period of 25 years, beginning in 2009.¹¹ Iran's Deputy Oil Minister Hadi Nejad-Hosseini estimates that gas exports to China will gradually increase to 40 million tons per annum.¹²

A third area of cooperation in the energy sector is upstream and downstream development. Participation by Chinese companies in such projects is part of the internationalization of their business operations and part of their global effort to obtain equity stakes in production, thereby enhancing long-term energy security. In August 2000, CNPC won its first drilling contract in Iran (to drill

⁸ According to 'Ali Akbar Vahidi Ale-Agha, Deputy Managing Director of Petroleum Engineering & Development, an National Iranian Oil Company subsidiary, "China and Iran are perfectly matched for each other ... China has the world's biggest market of customers and no secure energy resources. We have a lot of energy, and we need foreign currency. And they have a lot of money to invest. It's a win-win situation" (V. Walt, "Iran Looks East," *Fortune*, 21 February, 2005).

⁹ See: "Iran's Crude Oil Sales to China," *Mehr News Agency*, FBIS-Near East and South Asia (hereafter FBISNES), 12 April, 2005.

¹⁰ See: *International Energy Outlook 2006*, U.S. Energy Information Agency, June 2006, Table 8, available at [http://www.eia.doe.gov/oiaf/ieo/nat_gas.html].

¹¹ See: *Associated Press*, 19 March, 2004; *The Asian Wall Street Journal*, 13 March, 2004.

¹² See: "Iran: Official Says Gas Exports to China To Start in 2009," *Mehr News Agency*, FBIS-NES, 5 July, 2005.

19 gas wells in southern Iran). The most significant breakthrough in this area is the widely reported preliminary agreement (reached in October 2004) between the National Iranian Oil Company (NIOC) and Sinopec to develop the Yadavaran oil field, whereby NIOC would sell 150,000 barrels per day (bpd) of crude oil to China at market prices over a period of 25 years when the field becomes fully operational.¹³

For Iran, engaging Chinese companies in these ventures stems from a mixture of motives. The main commercial objectives are access to much-needed foreign investment capital and technology. These objectives dovetail with the strategic imperative of locking in an economic partnership with a major world power that holds a permanent seat on the U.N. Security Council—a potentially useful lever in countering U.S. and Western pressure.

China and Iran have also found common ground in construction of oil and gas pipelines. Chinese companies are involved in projects that will enable Iran to augment the volume of its swap deals. The Neka-Sari pipeline, built by a consortium of Chinese companies led by Sinopec and CNPC (completed in 2003), carries Russian crude oil shipped from the ports of Astrakhan and Volgograd from the Iranian port of Neka further into Iran. Another pipeline being built with Chinese participation will carry oil from the Neka terminal to a refinery on the southern outskirts of Tehran in the municipality of Ray.¹⁴ China has an interest in expanding Iran's oil/gas pipeline network quite separate from whether or not its own firms help to build them. Consistent with its aim to develop alternative supply delivery networks,¹⁵ Beijing hopes to receive the necessary guarantees from Tehran to build an oil pipeline from the Caspian Sea, 386 km in length, to another pipeline in Kazakhstan that will be connected to China.

In addition, China and Iran have been working separately and jointly to augment their capacity to handle the increased volumes of oil, gas, and refined products moving from the Persian Gulf to East Asia. For example, in order to support the growth of LNG imports from Iran and other suppliers, China is building receiving terminals at Guangdong, Shanghai, and Fujian.¹⁶

All in all, whereas Iran seems determined to develop a full-blown strategic partnership, China appears primarily interested in commerce and limited political-strategic engagement. Foreign Minister Manouchehr Mottaki's statement reflects Iranian thinking: "China is seeking reliable energy and we are able to guarantee its supply. In fact, a strategic phase is now beginning in cooperation between the two countries."¹⁷ With Western pressure on Iran tightening, Iranian officials have, at every opportunity, sought to draw closer to China.

According to Ali Larijani, Secretary of Iran's National Security Council, China (along with Russia and India) "can play a balancing role."¹⁸ Similarly, President Ahmadinejad's statements at the SCO summit in Beijing in June 2006 are illustrative of the way in which Tehran has attempted to use its energy assets as a political lifeline. Echoing these statements, Dr. Ali Akbar Velayati, former foreign minister and now advisor to Spiritual Guide Ali Khamenei, referred to the SCO as a "political bloc."¹⁹

¹³ See: "China To Cooperate With Iran in Oil, Gas Sectors," *Islamic Republic News Agency* (hereafter IRNA), FBIS-NES, 27 December, 2004.

¹⁴ See: P. Hooman, "Russia Turns to Iran for Oil Exports," *Asia Times*, 11 February, 2003.

¹⁵ This is evident, for example, in the Chinese government's decision to finance about 80% of the estimated \$248 million cost of constructing the deep-sea port of Gwadar and thus move oil overland through Pakistan to western China.

¹⁶ Quoted from: IRNA, in: FBIS-NES, 14 October, 2005.

¹⁷ See text of interview with Islamic Republic of Iran Broadcasting (IRIB), IRNA, BBC-SWB-NES, 8 June, 2005.

¹⁸ B. Savadore, "Tehran Seeks Allies Through Energy Cooperation," *South China Morning Post* (Hong Kong), 16 June, 2006.

¹⁹ J. Calabrese, "China and Iran: Partners Perfectly Mismatched," *Middle East Institute*, 18 August, 2006, available at [<http://209.85.229.132/search?q=cache:Jcd2EWbqNpwJ:www.energiasportal.com/download/375/+Calabrese+John+South+China+Morning+Post&cd=16&hl=en&ct=clnk>].

Iranian officials appear, at times, to underestimate how much Sino-American relations means to China and perhaps overestimate how far Beijing might be willing to go to support Tehran. In addition, to the extent that the Iranian leaders are enamored by the “Chinese model” and determined to apply an Islamic version of it, they appear to have conveniently omitted from their frame of reference the fact that China’s success hinges on dynamic economic relations and a political *modus vivendi* with the West, particularly with the United States. Finally, by proclaiming China to be the “superpower of the new century” and implicitly tying Iran’s future to the latter’s coattails, Iranian officials run the risk of becoming prisoners of their own wishful thinking, while the Chinese leadership, keenly aware of its present limitations vis-à-vis the United States, has been quite careful to avoid stumbling or being dragged into a direct confrontation with Washington.

In that sense, it is also instructive to look at some of the shortcomings and uncertainties in the economic sphere. The mainstay of Sino-Iranian cooperation in the energy sector is the export of large and increasing quantities of Iranian crude oil to China. But the Iranian energy industry is badly in need of foreign investment and technology. To date, China’s investments are dwarfed by Iran’s investment needs. Furthermore, in an effort to diversify, Chinese energy firms are increasingly shifting their investments toward Africa and Central Asia, perhaps reflecting the need to diversify to the extent that is possible, and away from the Persian Gulf, and thus from the risks and uncertainties associated with the deeply entrenched U.S. military power, local instability, and maritime transportation of oil supplies.

Conclusion

Beijing’s efforts to connect itself to the Greater Central Asian region is restrained by the all pervasive American presence in Afghanistan. Even so, it is evident that Kabul remains a vital part of Beijing’s energy infrastructure, linking China with Pakistan, Iran, and the oil rich Central Asian countries. So it came as no surprise when China invested \$3.5 billion in the Aynak copper field project in the remote Logar province in May 2008. China also extended the Xinjiang railway up to Kashgar (via the Karakoram highway) about 500 km from the China-Pakistan border and is involved in the construction of a rail line to link Gwadar with the Pakistan-Iran railway.

China is taking advantage of its enormous cash reserves to buy up major energy assets in distressed countries like Afghanistan, thus securing for itself not just energy flows but key strategic advantages for years to come. Although most of its energy imports still come from the Middle East, Beijing is rapidly seeking to diversify its suppliers on a global basis: Venezuela, other Latin American countries, Africa, and Russia, as well as Central Asia. Furthermore, it has well-known strategic anxieties that the Strait of Malacca or other Indian Ocean waters may be closed to it during a time of crisis. Therefore, for geostrategic reasons, China seeks to avoid excessive dependence upon Middle Eastern and African producers. Most important, the geographic proximity of the greater Caspian Basin states, many of which border on China, and the lack of a strong U.S. military presence in CA, especially one that can counter Beijing’s massive land power, has made it an appealing source of energy in the eyes of Chinese planners. There would be no need for energy to be transported across the ocean, where China’s energy supplies would be vulnerable to potential maritime interdiction by the U.S. and Indian navies. Tehran is privileged in Beijing’s eyes since gas and oil can be shipped to it overland through the new pipelines that China is helping to build in Kazakhstan, Turkmenistan, and Uzbekistan and which could ultimately connect to Iran. The Atasu-Alashankou oil pipeline from Kazakhstan to China was opened as early as December 2005, and in 2006 Beijing announced its plans to also build a natural gas pipeline running parallel to it.

In addition, China is discussing prospective gas pipelines with Uzbekistan and Turkmenistan and Tajikistan that would link up with the projected gas pipeline scheduled for completion in 2009-2010.²⁰

In spite of these developments, Iran remains China's most important Caspian producer. In the first quarter of 2006 alone, China's oil imports from Iran increased by 25 percent in gross volume. Iran already supplies 15-17 percent of China's annual oil imports, and the interest in an overland pipeline from Iran to China makes it clear that Iran's role in Chinese energy policy will only continue to increase in the foreseeable future.²¹

In addition, Beijing is discussing its potential participation in the projected Iran-Afghanistan-Pakistan-India pipeline. Likewise, if the projected Turkmenistan-Afghanistan-Pakistan-India pipeline is implemented, it too will likely attract Chinese participation. Were energy relations between Pakistan and China to materialize, they would only heighten the existing nexus of energy, security, and maritime power projection exemplified by China's support of the construction of a major deep-sea port in Gwadar, Pakistan. Islamabad's role as an energy provider for China would certainly intensify Chinese efforts to help Pakistan remain secure, stable, and non-fundamentalist. It is noteworthy to mention here that according to a contract signed in May 2009, Iran will start exporting 21.5 million cu m of gas to Pakistan per day.

Tehran itself is betting on the total "interdependence of Asia and Persian Gulf geo-economic policies." In that context, Tehran has proposed the Asian Energy Security Grid and the \$7.6 billion Iran-Pakistan-India pipeline, both good examples of Iranian regionalization efforts, but doomed under great pressure from other actors, primarily the U.S.

In the meantime, Russia's and Iran's desire to oppose Washington's position to keep them away from Caspian energy transportation projects, the Iranian-American confrontation, and Tehran's doubts that Russian-American cooperation is viable are forcing the country's leaders to demonstrate more flexibility in regional policy and remain loyal to their alliance with Russia in the interests of their own security and as a possible counterweight to America's Central Asian policy. Moscow itself, in the context of bitter geopolitical and geo-economic rivalry with Washington in CA and the Middle East, finds cooperation with Tehran to be its only solution, even at the expense of a compromise in the Caspian Sea delimitation process or in Iran's nuclear program. So, Iran and Russia are joining forces to pull Central Asian states onto their side by implementing regional projects as the international transport North-South corridor, the North-South fiber optic communication line, and others which in the future might promote the economic integration of these states. Moscow is surely rewarded by acting as an intermediary between Iran and the West, and by Tehran's consent to Russia's intention to join the Organization of Islamic Council (OIC), as a counterweight to America's influence on the Islamic world in general and on the Muslim oil and gas exporters in particular.

The same scheme applies to China, another of Moscow's rival. In fact, since the mid-1990s Russia and China have been talking about building, together with Iran, the so-called pan-Asian continental oil bridge, a network of pipelines that will connect the Russian and Central Asian fuel energy producers with Chinese, and possibly also Korean and Japanese, customers. This idea has the potential of being realized, provided Tehran joins the Shanghai Cooperation Organization, in an energy security project binding actual SCO members (Russia, China and the Central Asian states) with Iran.

²⁰ See: St. Blank, "China's Emerging Energy Nexus with Central Asia," *Jamestown Foundation, China Brief*, Vol. 6, Issue 15, 19 July, 2006.

²¹ *Ibidem*.

Talking about the European Union, it is inclined to involve Russia and China in its Iranian projects, a tendency which contradicts U.S. interests in the region.²² We must bear in mind that Iran is already an energy exporter to Europe through Turkey, funneling through Turkmenistan's gas and swapping oil with Kazakhstan and Azerbaijan. Iran, Russia, and India have also conceived new areas of cooperation that connect northern Europe to the Indian Ocean via Iran and the Russian Federation. In that sense, the 25-year supply agreement, worth up to \$42 billion, signed between Iran and Switzerland, is only a prelude to what could follow if America does not find a more comprehensive way of dealing with Iran.²³

The EU is also in favor of Iranian participation in projects such as Nabucco, White Stream, and the Iranian-Turkish gas pipelines, with the possible inclusion of Arabian gas originating from Egypt or Syria.²⁴ These Iranian endeavors can reorient Central Asian energy routes through its territory and form a kind of "gas cartel" along with Russia and the CA countries, an idea put on the table recently by the Gulf Cooperation Council and approved by Tehran.

Of course, any thought about Tehran's possible inclusion in the Nabucco project produces strong American opposition, but both the EU and the U.S. are maneuvering new incentives for Iran to scrap its uranium enrichment program.²⁵

As for Turkey, in an effort to become the main energy corridor to Europe through the Trans-Caspian gas pipeline, it is not excluding the possibility of Iran's involvement. In fact, it is actively involved in the project for moving Iranian and Turkmenian gas to Europe across Turkey, which, it is convinced, will allow Europe to become independent of alternative gas suppliers. Provided that Washington's relations with Tehran improve, these geo-economic trends might come to the fore in U.S. Central Asian strategy. Such a thought sounded more realistic when the Bush administration no longer regarded Turkey as a reliable and acceptable partner when it comes to transporting energy resources to Europe.

The prospect of developing an alternative petroleum route from both the Caucasus and Central Asia to the Persian Gulf via Iran would be a wise foreign policy initiative in "realpolitik" terms. Iran has the potential of becoming an international petroleum port pumping station for its own petroleum resources, as well as that of the oil-rich Central Asian republics and the Caucasus. This would minimize Russia's influence and Europe's reliance on Russian energy and pipeline routes, while providing a greater sense of energy security for the industrialized world.

Iran clearly has the capacity for a Kazakhstan-Turkmenistan-Iran pipeline. The project, which is estimated at around \$1.2 billion, is currently being considered and may develop into a viable strategy and solution, pumping 1 million bbl oil per day from Kazakhstan and Turkmenistan to the Persian Gulf island of Kharg. Tehran is also supporting a projected Iran-Turkmenistan-Turkey-Europe gas pipeline which, covering a distance of 3,900 km, will supply up to 30 billion cubic meters of gas by 2010.²⁶

A cooperation context between Europe and Iran could include, apart of Iran's contribution of gas to the Nabucco pipeline project, the use of the Iranian grid for transporting natural gas from Caucasian and Central Asian producer states to the European market, as well as European investments in the Iranian energy sector.²⁷ It may look like a paradox, but Washington will not be able to reduce

²² See: "Shell, Repsol Wary of Iran Deal: Report," *Payvand News*, 3 May, 2008.

²³ See: "US Fearful of Iran-Europe Gas Deals," *Payvand News*, 3 May, 2008.

²⁴ See: D. Gollust, "Major Powers Make New Incentives Offer to Iran," *VOA*, London, 3 May, 2008.

²⁵ *Ibidem*.

²⁶ See: R. Molavi, M. Shareef, "Iran's Energy Mix and Europe's Energy Strategy," Durham University Centre for Iranian Studies, *Policy Brief*, 2008.

²⁷ See: I. Grigoriadou, "Evropaiki Energiaki Asfaleia—Ellhno-Tourkiki Synergasia" [European Energy Security – Greek-Turkish Cooperation], ELIAMEP, *Policy Brief*, No. 12, December 2008.

Europe's dependency on Russian gas without Iran's participation. As Russian analysts point out, it is up to Tehran to decide whether to gain access to the Western market through participation in the Nabucco project or join Russia, China, India, Pakistan, and some of the CA countries in implementing the "Energy of Asia" scheme. They also suggest that cooperation within the SCO appears to be the most convenient form of integration among Russia, Central Asian states, and Iran.²⁸

²⁸ See: V. Yurtayev, "Iran and Russia: New Start after 30-year Pause," *Strategic Culture Foundation*, available at [<http://en.fondsk.ru/print.php?id=1877>].

REGIONAL ECONOMIES

**MONETARY AND
BANKING SYSTEMS OF
THE CENTRAL EURASIAN COUNTRIES
IN THE CONTEXT OF
THE WORLD FINANCIAL AND
ECONOMIC CRISIS**

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Introduction

The financial crisis that has shaken the world dealt a rather hard-felt blow to the economy of the Central Eurasian countries, thus aggravating its weaknesses and ailments. Some countries in this group are keenly feeling the consequences, which are expressed primarily in imbalances in their monetary and banking systems, as well as in decreased trade, tougher conditions for acquiring funds in the world financial market, and so on. The independence of the market

economies of the Central European states has made it possible for different scenarios to be enacted for developing and integrating the above-mentioned systems in conditions of financial globalization. Various opinions are being expressed on this account, thus making this a pertinent research topic in the context of the growing dynamism of the processes designed to achieve closer cooperation in the financial and currency spheres.

The World Financial and Economic Crisis and its Manifestation in the Central Eurasian Expanse

Over the course of history, the world economy has periodically undergone financial upheavals. Between 1970 and 2007, IMF experts counted 124 systemic banking, 208 currency, and 63 debt crises accompanied by defaults on certified debts and affecting many countries. They have been covered in sufficient depth in the economic literature.¹ We will only list a few that have occurred in the past decade and encompassed entire groups of countries. For example, in 1992-1993, several countries of the European Union (Great Britain, Italy, Sweden, Norway, and Finland) experienced currency crises. In the past two years, a severe crisis, which began in Mexico, spread to other countries of Latin America. In 1997-1998, a global financial crisis began in the countries of East (Korea) and Southeast (Malaysia, Thailand, Indonesia, and the Philippines) Asia and later spread to Eastern Europe (Russia and several of the former Soviet republics) and Latin America (Brazil).

The crisis the global financial system is currently experiencing is one of the most serious and widespread of any that have occurred during the past few years. It differs from all the previous ones both in its severity and scope and perhaps for the first time since the Great Depression has encompassed the whole world. The uniqueness of the current financial crisis is manifested in different ways. First, we should stress its global nature: after beginning in the U.S., it spread rather rapidly to most other countries and became a global crisis, which distinguishes it from the above-mentioned crises. It is just as important to single out the scope of the crisis: it covers all spheres of the economy, not just its individual segments—financial, stock market, housing, and so on.

The crisis has proven extremely serious and arduous for the banking system and investment companies. It has caused an unprecedented collapse in stock markets and a very abrupt drop in prices for various kinds of raw materials, particularly oil (of almost three-fold) and metals (by one third). As early as its first phase in 2008, the crisis was accompanied by galloping inflation in the developed countries (2-3-fold) and its significant acceleration in the developing countries. Unparalleled resources within the framework of anti-crisis programs were required in order to alleviate its consequences—up to 10-15% of GDP in those countries most inflicted by these consequences and trillions of dollars in total. Forecasts told of the exceptional measures needed to fight the crisis and the enormous funds that this would require.

¹ See: D. Daianu, L. Lungu, "Why Is This Financial Crisis Occurring? How to Respond to It?," *TIGER Work Paper Series*, No. 113, Warsaw, July 2008; N.P. Goriunova and P.A. Minakir, *Finansovye krizisy na razvivaiushchikhsia rynkakh*. Nauka Publishers, Moscow, 2006; Z.F. Mamedov, *Anatomiia finansovogo krizisa*. St. Petersburg State University, St. Petersburg, 2005; A.G. Carstens, D.C. Hardy, C. Pazarbasioglu, "Avoiding Banking Crises in Latin America," *Finance&Development*, Vol. 41, No. 3, 2004, pp. 30-33; I.K. Kovzadadze, *Sistemnye bankovskie krizisy v usloviakh finansovoi globalizatsii*, ed. by V.I. Papava, Tbilisi University Publishers, Tbilisi, 2003; A.V. Anikin, *Istorii finansovykh potriaseniy. Rossiyskiy krizis v svete mirovogo opyta*, Olimp-Biznes, Moscow, 2002; C.P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, J. Wiley, New York, 2000; B. Eichengreen, A. Arteta, "Banking Crises in Emerging Markets: Presumptions and Evidence," *CIDER Working Paper*, No. 115, Center for International and Development Economics Research (University of California, Berkeley), 2000; S. Fischer, *The Asian Crisis: A View from the IMF*, Address by First Deputy Managing Director of the International Monetary Fund at the Midwinter Conference of the Bankers' Association for Foreign Trade, Washington, D.C., 22 January, 1998; A. Demirguc-Kunt, E. Detragiache, "The Determinants of Banking Crises in Developing and Developed Countries," *IMF Staff Papers*, Vol. 45, No. 1, 1998, pp. 81-109; J. Sachs, A. Tornell, A. Velasco, "Financial Crises in Emerging Markets: The Lesson from 1995," *Brookings Papers on Economic Activity*, 1996. No. 1, and others.

It was also predicted that recovery from this crisis would most likely be a long and drawn-out process. The measures needed to effect serious recovery and an upswing in the economy after the crisis cannot yet be implemented in the required way. The crisis could very easily slip into stagnation and some countries where high inflation remains can expect to encounter the extremely painful and destructive process of stagflation.²

On the whole, the world financial upheavals occurring at present have exceeded the most pessimistic expectations. These problems have also had a serious impact on the countries of Central Eurasia (CEA), which are becoming increasingly drawn into the world financial and economic system and actively integrating into the world financial markets with each passing year. It is these countries, particularly Central Asia and Central Europe, according to the World Bank, that have suffered more than other regions from the crisis.³ Admittedly, the main socioeconomic indices of the CEA countries during the current period of 2009, i.e. in conditions of the ongoing global financial crisis, are distinguished by significant differences.

Since many of the region's states proved vulnerable to the sudden outflow of capital and decrease in demand for export provoked by the crisis, the World Bank predicts an even more profound slump this year.⁴ Ukraine, for example, will experience the most serious economic difficulties, whereby its GDP will drop by 9%. GDP in Armenia, Belarus, Moldova, and Kazakhstan will decrease by 6.0%, 3.3%, 3.0%, and 1.5%, respectively, and the current account deficit will be huge: 12.1%, 7.8%, 12.1%, and 8.4%, respectively. The recovery of certain CEA countries from the crisis is being hindered by an abrupt drop in investments, particularly in Ukraine where they decreased by half.

The report also notes that in several states of the region, GDP will grow, although at more moderate rates than before the crisis. Azerbaijan's economy will increase by 3.3%. Uzbekistan will end the year with a 4.5% increase, and Georgia's GDP will grow by 1%. In 2010, the overall economic recovery will lead to all the region's countries "coming out in the black" (Table 1).⁵

The consequences of the economic slump are not the same across the board: the CEA countries are suffering from them to different degrees depending on the structure of their economy and their resistance to upheavals. A good case in point is the significant difference in the state of the economy and banking sector of Azerbaijan and Belarus. Azerbaijan sailed through the first stage of the crisis scotfree, without having to turn to any foreign financial sources and able to protect its independent position,⁶ while Belarus was forced to resort to IMF and Russian government loans, agreeing in the future to transfer to the Russian ruble. On the whole, sources of external financing have been exhausted for the CEA countries, as for other developing and transition countries, which was accompanied by a significant increase in extra risk charges and dramatically increased the cost of this financing. In turn, the sharp drop in investments is aggravating the countries' recovery from the crisis.

Along with this, some Central Eurasian countries (Kazakhstan, Ukraine) have stupendous debts on external loans, which, if not promptly paid off, will become much more expensive at the current

² For instance, the World Bank, compared to its previous report (see: *Global Economy Prospects 2009: Commodities at the Crossroads*, The International Bank for Reconstruction and Development / The World Bank, Washington, D.C., 20 November, 2008), gave worse forecasts of the slump in the world economy in 2009 from 1.7% to 2.9% and described the prospects for its development as extremely indefinite (see: *Global Development Finance: Charting a Global Recovery*, The International Bank for Reconstruction and Development / The World Bank, Washington, June 2009). Similar pessimistic statements are seen in the reports of the International Monetary Fund (see: *World Economic Outlook: Crisis and Recovery*, IMF, Washington, D.C., April 2009) and the Asian Development Bank (see: *Asian Development Outlook 2009*, Asian Development Bank, Manila, March 2009).

³ See: *Global Development Finance: Charting a Global Recovery*, pp. 110-118.

⁴ See: *Ibid.*, pp. 2, 9.

⁵ *Ibid.*, pp. 115, 117-118.

⁶ Attention is focused on this in particular in: N.A. Nikolaev, T.E. Marchenko, M.V. Titova, *Strany SNG i mirovoi krizis: obshchie problemy i raznye podkhody*, Analytical Report, FBK, Moscow, June 2009, p. 8.

Table 1

Central Eurasia
World Bank Forecast
(annual percent change)

Countries	2009	2010	2011	
Central Europe				
1 Belarus	GDP at market prices	-3.3	2.6	4.4
	<i>Current account bal/GDP</i>	-7.8	-5.7	-3.6
2 Moldova	GDP at market prices	-3.0	2.0	4.0
	<i>Current account bal/GDP</i>	-12.1	-10.1	-9.3
3 Ukraine	GDP at market prices	-9.0	1.0	3.5
	<i>Current account bal/GDP</i>	0.1	1.0	-0.8
Central Caucasus				
4 Azerbaijan	GDP at market prices	3.3	5.2	9.0
	<i>Current account bal/GDP</i>	10.3	15.5	19.0
5 Armenia	GDP at market prices	-6.0	-2.0	1.0
	<i>Current account bal/GDP</i>	-12.1	-10.3	-6.5
6 Georgia	GDP at market prices	1.0	2.0	4.0
	<i>Current account bal/GDP</i>	-19.6	-16.8	-15.5
Central Asia				
7 Afghanistan		n/a		
8 Kazakhstan	GDP at market prices	-1.5	1.5	3.0
	<i>Current account bal/GDP</i>	-8.4	-7.8	-6.3
9 Kyrgyzstan	GDP at market prices	0.5	2.5	3.5
	<i>Current account bal/GDP</i>	-6.0	-7.2	-7.8

Table 1 (continued)

Countries		2009	2010	2011
10	Tajikistan	n/a		
11	Turkmenistan	n/a		
12	Uzbekistan			
	GDP at market prices	4.5	5.0	6.5
	Current account bal/GDP	11.8	15.2	13.6

interest rates than at the interest rates that existed when the loans were initially issued. The drop in growth rates of export earnings is also having an impact on the acceptability of the level of their debts. Due to the fact that the main part of the external debt of these countries is redenominated in the leading reserve currencies, their ability to service their debts largely depends on the fluctuations in the foreign exchange rates. The deterioration in external conditions and increase in the U.S. dollar exchange rate in August 2008 have been creating downward pressure on the exchange rates of the national currency. Over the last year such countries as Kazakhstan, Ukraine, Tajikistan, and Armenia have been encountering a significant devaluation of their currencies. This drop in the exchange rate of their currencies has led to a significant increase in the cost of servicing the external debt when calculated in the national currency and is already having an impact on the state budgets and the budgets of companies. The indicated factors are creating a situation in which enormous debts have been generated in several CEA countries.⁷

The world monetary and banking system proved to be the most adversely affected by the crisis phenomena, which is generally recognized as being the main victim of the financial collapse. In so doing, according to international experts, in the next few years (until 2012), this system will undergo enormous changes. Certain problems have also arisen in the monetary and banking sector of the CEA countries, for example, in Ukraine and Kazakhstan. The banks of these countries have primarily been negatively affected by the high lending risk and liquidity risk in conditions of the deteriorating macroeconomic situation in these countries due to the faltering world economy, the difficult situation in the world banking system, and the sharp drop in access to external liquidity.⁸ Due to the outflow of foreign capital and the problems caused by this in the banking sector, the governments of the CIS countries have had to allot budget funds to support the national financial systems. As of today, the amount of direct assistance in Ukraine's and Kazakhstan's banking sectors reaches 5% of GDP, according to S&P's experts.⁹ Their national currencies were also unable to withstand the pressure of the financial upheavals and had to be devaluated.

The monetary and banking systems of other countries of this region were better able to cope with this crisis fever. This is partly explained by the underdevelopment of their financial institutions (banks, insurance companies, and so on), the low influence of the current situation in the

⁷ The report of U.N. Secretary-General Ban Ki-moon at a U.N. Conference on the Problems of the World Financial and Economic Crisis and its Impact on Development points out this trend (New York, 24-26 June, 2009) (see: *The World Financial and Economic Crisis and its Impact on Development*, Report of Secretary-General, pp. 5-6, available at [<http://www.un.org/ga/econcrisissummit/docs.shtml>]).

⁸ Standard & Poor's points this out in particular (see: "Kazakh, Russian, and Ukrainian Banks Face Another Tough Year of Poor Asset Quality and Thin Liquidity," *S&P*, 18 May, 2009, available at [<http://www.standardandpoors.ru>]).

⁹ See: "Russia, Kazakhstan, and Ukraine: Counting the Cost of the Crisis," *S&P*, 29 May, 2009, available at [<http://www.standardandpoors.ru>].

stock markets on the real sector of the economy, and the absence of a developed stock market infrastructure.

Such a differentiated reaction to the global financial and economic crisis also has a certain historical connotation. In this respect, the characteristics of the monetary and banking structures of the CEA countries during their independence is extremely interesting, which will make it possible to ensure an individual approach to their recovery in the context of the continuing cataclysms.

The Restoration of Monetary and Banking Systems in the CEA Countries: Common and Specific Features

An analysis of the collapse of the ruble zone—dissociation of the national currencies of the CEA countries from the Soviet ruble¹⁰—made it possible to identify common traits and specific features of the establishment of their monetary and banking systems.

During the first years of independence, the political and economic situation in the CEA countries was characterized as extreme, which in turn was aggravated by the undermining financial pressure applied by the Russian Federation which froze the foreign exchange accounts of physical and legal entities in all the post-Soviet republics. During this period the Soviet and then the Russian (federative) ruble circulated for a certain amount of time in the Central Eurasian countries. But Russia began to squeeze these countries out of the circulation sphere of its new currency—the Russian (federative) ruble. Due to the collapse of the clearing payment mechanism, not only external (Union-wide) but also internal economic and production relations began to fold up. Extensive salary arrears gave rise to a noticeable increase in social tension; industrial, agricultural, construction, trade, transportation enterprises and others either dramatically cut back their activity or were simply closed down. The main form of mutual settlement both within each CEA country individually and between them and the Russian Federation was barter. Under these conditions, in order to avoid general chaos, each country had to immediately create its own national currency and banking system.

The common features characterizing the formation of the monetary system of the CEA countries are: the absence of foreign exchange reserves and work experience in market conditions; a shortage of professional personnel; the extremely low level of the legal base; the functioning of a black currency market; an extreme increase in dollarization of the economy; and the absence of systemic relations with international financial institutions.

The following summary of the specific features of the establishment of national currencies in the CEA countries can be suggested:

- In some CEA countries (Ukraine, Belarus, Uzbekistan and Georgia) money substitutes, coupons, and checks, and in Tajikistan, the Russian ruble, were in circulation prior to the introduction of national currencies.
- Political and ethno-territorial conflicts had an influence on the intensity and efficiency of the formation of the monetary and banking systems. The conflicts occurred both within certain countries (the military confrontation of 1992 in Tajikistan that ended in national

¹⁰ For more on these processes, see: E. Ismailov, "National Currencies of the Central Eurasian Countries in the Context of Financial Globalization," in: *Central Eurasia: National Currencies*, CA&CC Press, Stockholm, 2008, pp. 17-20.

reconciliation in 2000, as well as the continuing problem of Georgia's¹¹ and Moldova's¹² territorial integrity) and between CEA countries (the Armenian-Azerbaijani Nagorno-Karabakh conflict, as a result of which Armenia occupied approximately 20% of Azerbaijan's territory).

- The monetary and banking system of Turkmenistan was formed apart, essentially under conditions of self-isolation and absolute presidential power that ignored objective market mechanisms and the integration trends in the world financial system. In 1990-2006, the Turkmen manat was essentially completely isolated from the international currency processes.
- In some countries of the region (Uzbekistan and Turkmenistan) there is still no free internal conversion of the national currencies, which means that illegal foreign exchange transactions continue to be carried out there at times.
- The large volume of raw hydrocarbon export, due to which the countries in question (Azerbaijan, Kazakhstan, and Turkmenistan) have achieved high economic growth indices in the past few years and formed large international reserves, is having a serious influence on the stabilization of their national currencies.

Let us now take a closer look at the dollarization phenomenon, which has become very widespread in all the CEA countries, although to varying extents (see Table 2).¹³

According to the evaluations of the rating compilers, the highest level of dollarization in the Central Eurasian region is seen in Tajikistan (13), and the lowest in Uzbekistan (5). Azerbaijan (6), along with Ukraine (8), Kazakhstan (7) and Uzbekistan, is in the group of moderately dollarized countries, while other countries of the Central Caucasus, Armenia and Georgia (9), are classified as highly dollarized. It should be noted that the IMF also placed the latter two Central Caucasian states in this group when evaluating the dollarization in developing countries in 1996-2005: according to it, dollarization in them, particularly in the past five years, was higher than 70% (in Georgia more than 80%). Diversification of assets, underdevelopment of the financial markets, and instability of the macroeconomic environment (primarily ongoing inflation and unstable dynamics of the exchange rate), due to which economic agents prefer foreign exchange holdings to national in order to avoid devaluation of savings and exchange risk, are some of the reasons for the rapid growth in the dollarization level in the national economies of these countries.¹⁴ The Asian crisis and economic up-

¹¹ With respect to the separatist policy of Abkhazia, South Ossetia, and Samtskhe-Javakhetia.

¹² With respect to the separatist policy of Transnistria.

¹³ The rating of developing countries and countries with a transition economy in terms of degree of partial dollarization was compiled by the Center of Economic Research of the Moscow International Institute of Econometrics, Information Technology, Finance, and Law according to the method of the U.S. National Bureau of Economic Research. In compliance with this method, the level of dollarization is determined by the percentage of household and company funds kept in international assets and how many loans the state and companies have in foreign currency. The summary index of dollarization is used to evaluate partial dollarization, calculated as the sum of three variables: (1) ratio of bank deposits in foreign currency to the broad money aggregate; (2) ratio of foreign debt to the country's GDP; (3) percentage of debt of the private sector in the country's total external debt. The data bases of Global Development Finance (World Bank), International Financial Statistics and World Economic Outlook database (IMF), and Joint OECD-BIS-IMF-World Bank Statistics as of March 2005 served as the initial data.

¹⁴ See: M. Savastano, "Dollarization in Latin America: Recent Evidence and Policy Issues," in: *The Macroeconomics of International Currencies: Theory, Policy and Evidence*, ed. by P. Mizen, E.J. Pentecost. Edward Elgar, Gloucestershire, 1996; T. Balino, A. Benett, E. Borensztein, "Monetary Policy in Dollarized Economies," *IMF Occasional Paper*, No. 171, 1999; J. Mongardini, M. Johannes, "Ratchet Effects in Currency Substitution: An Application to the Kyrgyz Republic," *IMF Working Paper*, WP/99/102, 1999; S.P. Moiseev, "Ekonomika dollarizatsii," *Digest-Finansy*, No. 10, 2000, pp. 9-13; I. Vetlov, "Dollarization in Lithuania: An Econometric Approach," *BOFIT Discussion Papers*, 2001/1; R.V. Piont-kovskiy, "Dollarizatsia, izmenchivost infliatsii i nerazvitye finansovye rynki v perekhodnykh ekonomikakh," in: *Konsortium ekonomicheskikh issledovaniy i obrazovaniya. Nauchnyy doklad No. 03/02*, EERC, Moscow, 2003, p. 7; S. Heyesen, "Dollarization: Controlling Risk Is Key," *Finance & Development*, Vol. 42, No. 1, March 2005, pp. 44-45.

Table 2

**Rating of Dollarized CEA Countries
(March 2005)**

Summary Index	Countries
Highly dollarized countries	
13	Tajikistan
11	Kyrgyzstan
10	Moldova
9	Armenia, Georgia, Turkmenistan, Belarus
Moderately dollarized countries	
8	Ukraine
7	Kazakhstan
6	Azerbaijan
5	Uzbekistan

heavals in Russia that followed (1997-1998) also helped to maintain the high level of dollarization in the CEA countries, thus giving rise to growing mistrust both in the Russian ruble and in the national currency, although in some of them it was manifested to a relatively lesser extent. The situation was aggravated by the increase in dollarization of the advances portfolio, which was related to receiving loans from international financial institutions for long-term economic development needs.

The measures undertaken in the past few years to improve the monetary and banking system have promoted a partial reduction in the dollarization level in the CEA countries, although the problem of optimizing this level is still pertinent.

So a brief review of rehabilitation of national monetary systems of CEA countries shows that:

- After the disintegration of the Soviet ruble zone new currencies in sovereign CEA states, in particular paper money of various denominations, small change, and jubilee and commemorative coins made from precious metals (platinum, gold, and silver);
- Whereas the security feature of the first paper money was not always satisfactory, subsequently its quality fully met international standards (this applies, in particular, to Azeri, Georgian, and Kazakhstan money)¹⁵;

¹⁵ The evolution of the national currencies in the CEA countries occurred in two stages. At the first stage, that is, during the first years after state independence was gained, full-fledged currencies were put into circulation in Afghanistan, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkmenistan, as well as intermediate currencies in Belarus, Georgia, Ukraine, Uzbekistan, and Tajikistan. They had a low degree of security and during the same period became extremely devaluated due to hyperinflation. The second stage is characterized by redenomination of the currencies, which promoted a qualitative improvement in the monetary economy. In the first group, redenomination was carried out in Afghanistan (October 2002) and Azerbaijan (January 2006), that is, old money was exchanged for new at a rate of 1,000:1 (afghani) and 5,000:1 (manat). In the second group, the first full-fledged national currency was issued in Georgia (September 1995), the lari, with a coefficient of 1,000,000:1, and in Uzbekistan (July 1994), the soum, at a rate of 1,000:1. In Belarus, where in

- As a rule, the names of currency denominations were printed on the banknotes in the national languages; excluding Kazakh tenge and Belarus rubles, where indications are in Russian as well as Georgian lari and Tajik somoni, using also English indications;
- The exchange rates were established with respect to the U.S. dollar; at the same time, other elements of the national monetary economy were introduced, including credit currency (bonds, checks, bills of exchange, etc.), and regulatory documents were adopted that envisaged the system and procedure for organizing and regulating money supply.

Consequently, the foundations for development of monetary and banking systems have formed in the CEA countries over the past seventeen years.

Development of Banking Systems of the CEA Countries Today

The functioning and development of the banking system in the Central Eurasian countries is intrinsically related to the establishment of their banking system. A two-tier model consisting of a central (national) bank (first tier) and commercial banks (second tier) was taken as the basis for creating the banking system. This structure was enforced in corresponding laws, which made it possible for the central (national) banks of the CEA countries to concentrate entirely on regulatory and supervisory functions, thus avoiding purely commercial functions.

The two-tier banking system¹⁶ formed in these countries after they acquired state independence was largely modeled on the standards generally accepted in international practice. This system ensures streamlined payments among all economic entities, redistributes temporarily free monetary resources, and provides an entire range of banking services by means of constant and close interaction in the market among themselves and with the outside world. These components form a single banking system intended for servicing national money circulation.

In order to accelerate the formation of a market banking environment in the CEA countries, the central (national) banks carried out an extremely liberal policy during the first years of independence. The mechanism for issuing licenses for banking activity, the requirements for the size of authorized capital, and the procedural formalities in general were extremely simplified, which promoted the creation of a large number of commercial banks within a short time in the Central Eurasian countries, most of which did not comply with even the elementary standards of banking activity, not to mention international standards. In subsequent years, due to the economic development of the region's countries, more stringent demands were made on local commercial banks, and so most of these banks, unable to withstand the new work conditions, folded up. The transformation and qualitative development of commercial banks is continuing, and as of the beginning of 2009, there were 448 banks in the CEA countries, while only in Azerbaijan and Ukraine in 1994 there were as much.

At present legislation has been drawn up in the CEA countries that determines the legal status of and regulates interaction among the banking system's main participants. The regulatory-legal acts that monitor its activity in the region apply,

1992-2000 20 types of banknotes in 18 denominations were issued, redenomination occurred twice: in August 1994 at a rate of 10:1, and on 1 January, 2000, at a rate of 1,000:1. And, finally, a new national currency was introduced in Tajikistan (October 2000), the somoni, which was converted in relation to the previous Tajik rubl at a rate of 1:1,000. In some CEA countries, the national banks (Georgia and Azerbaijan) introduced their currency in keeping with the concept "A single money family," which met international standards both in design and denomination.

¹⁶ Apart from Afghanistan.

- first, to the central banks,
- second, to the commercial banks and,
- third, to the various entities of the banking infrastructure.

During the years of sovereignty new laws have been adopted in many of these countries—on mortgage and bank deposit insurance—and amendments have been made to foreign exchange legislation aimed at its further liberalization. The laws and regulatory acts relating to banking activity have been drawn up on the basis of models accepted and functioning in Western countries keeping in mind the local specifics in each of the CEA countries. The only exception is Afghanistan, which plans to transfer to a monetary and banking system based on Islamic financing and lending principles. Throughout the entire transformation of the economic and legal foundation of the region's states, banking legislation has been modified and improved in step with the changes occurring in the economy. In many countries, it is no longer the early versions of the corresponding legislation that are in effect. A case in point is Azerbaijan, which has already amended its banking laws three times; in Belarus the first laws were adopted in December 1990, and on 25 October, 2000 they were incorporated into the Banking Code.

Table 3

**Banking Network
in the Central Eurasian Countries**

No.	Region Country	Number of Banks	Including:		Number of those with a share of foreign capital
			state- owned	private	
Central Europe					
1	Belarus	33	4	29	25
2	Moldova	16	1	15	15
3	Ukraine	185	2	183	54
Central Caucasus					
4	Azerbaijan	46	1	45	24
5	Armenia	22	—	22	12
6	Georgia	20	—	20	17
Central Asia					
7	Afghanistan	16	3	13	5
8	Kazakhstan	37	1	36	18
9	Kyrgyzstan	21	2	19	11

Table 3 (continued)

No.	Region	Number of Banks	Including:		Number of those with a share of foreign capital
	Country		state-owned	private	
10	Tajikistan	12	1	11	3
11	Turkmenistan	11	5	6	2
12	Uzbekistan	29	3	26	5
Total for the CEA:		448	21	427	191

S o u r c e: Data collected from the central banks of the CEA countries.

Today the central banks of the CEA countries largely ensure the internal and external stability of the national currency, a steady exchange rate, and development of the banking and payment systems, while they are also determined to prevent inflation upheavals. Along with this, they are engaged in more selective licensing, regulation, and control of the activity of commercial banks and are carrying out a flexible monetary and foreign exchange policy.

Commercial banks hold a special place among the credit institutions. As of the beginning of 2009, as mentioned above, there were 448 such banks, 23 of which are state-owned and 425 private, whereby 191 of the latter have a share of foreign capital (see Table 3).

Transformation of the banking sector in the CEA countries, which was being carried out keeping in mind national specifics and macroeconomic reality, has led to several positive results. The banking systems of most of these countries are playing an increasingly greater role in the national economy. Their commercial sector is characterized by accelerated development that outstrips overall economic growth, and in recent years there has been a significant increase in banking assets, deposits, and capital, as well as in lending in the non-financial sector and to the population.

These processes were being accompanied by enhancement of the institutional base of the CEA banking systems. The banks have begun introducing international standards of corporate management and accounting.¹⁷ The infrastructure of the banking system was being fortified at an accelerated rate: centralized credit registries, national card processing centers, national payment systems, mortgage funds, and bank deposit insurance funds have been created; foreign currency exchanges and stock markets, as well as national depository centers, are functioning; and the securities markets are consistently evolving. Increased attention is being given to the use of progressive information technology and bank management systems. Most Central Eurasian banks have become members of well-known international payment systems (Reuters and Europay International) and the Society for World Interbank Financial Telecommunications (SWIFT).

Nevertheless, at present, the banking systems in the CEA countries are rather fragmented and the level of their development, as well as the structure and volume of transactions they carry out, differ quite significantly and still lag far behind the European countries with transition economies, not to mention the developed countries. The assets of the CEA banking systems, the total size of which amounted to approximately 268.6 billion dollars at the beginning of 2008 (insignificant by world stand-

¹⁷ Apart from Afghanistan, Turkmenistan, and Uzbekistan, whose banking systems are closed in nature.

ards), are distributed unevenly among them and are characterized by a high degree of concentration. In this context Ukraine and Kazakhstan occupy a leading position, the shares of which are relevantly 44.2% and 36.2% of all the banking assets of the CEA countries. The banks of these CEA countries are consistently building up their financial potential: in terms of size of assets the largest of them are competing with the leading private banks in the post-Soviet and post-CMEA expanses. The banks of Azerbaijan and Georgia are on the up and up. The banking systems of some CEA countries are primarily characterized by a high share of state capital: Uzbekistan and Turkmenistan—more than 90%, Belarus—71.7%. A similar trend, although to a lesser extent, is also seen in Afghanistan. In Moldova, as in Kazakhstan, the largest banks were controlled by national private capital, while in Ukraine the arrival of foreign banking capital is an extremely tempestuous process—most of the largest banks were bought by transnational financial groups. Foreign banks predominate (approximately 50%) in Armenia and Kyrgyzstan. The banking system in Armenia is still very underdeveloped—its assets amount to less than 20% of GDP, which is one of the smallest indices in the CEA. Shares in Kyrgyzstan's leading banks were purchased by Kazakhstani banks, which boosted integration of the banking systems of these countries and promoted acceleration of their socioeconomic development. Due to the absence of a financial market, Tajikistan's banks are still not involved in financial transactions, although an increase has been noted in recent years, and their capital base constitutes a mere 5% of the republic's GDP. As a result, only five of the Central Eurasian countries are represented among the CIS's one hundred largest banks: 21 from Ukraine, 10 from Kazakhstan, 4 from Belarus and one each from Uzbekistan and Azerbaijan.

One of the main indices that is commonly used in international practice to evaluate the level of development of the national banking system with respect to the dimensions of the economy is the ratio of total assets of the banking system to GDP, which shows the level of financial intermediation in the country. An analysis of such coefficients for various CEA states according to the results of 2007 confirms the absolute leadership of Kazakhstan's (93.0%) and Ukraine's (84.1%) banking services in terms of support of the economy, which is much higher than the next two positions occupied by Armenia (67.0%) and Moldova (59.9%). Many Central Eurasian countries have the lowest capitalization indices in the world. The low level of financial intermediation,¹⁸ although it also shows its high growth potential, primarily indicates sluggish money flows, which is due to the informal economy, tradition of making payments in cash, and the population's low level of trust in banks.¹⁹ In other words, the banking systems of the CEA countries are still not performing their direct mission in full. However the ongoing reforms, although they have not raised the systems to a level comparable with the developed countries, are still opening up significant prospects for their growth.

The essential differentiation in the development level of the banking systems of the CEA countries is also manifested in their international rating assessments.²⁰ According to the data of the largest rating agencies, the risks of these systems are the highest in the world, which, in addition to the above-mentioned reasons, is due to the immense increase in the banks' loan debt and the low quality of the advances portfolio. According to the reports of Fitch Ratings,²¹ even the most advanced countries in this respect—Kazakhstan, Azerbaijan, and Georgia—have low macro-prudential indices. For example, in 2008, Kazakhstan was given one of the highest risk categories—MPI 3. In Fitch's Systemic

¹⁸ In several cases, as for example in Azerbaijan, the drop in the financial intermediation and capitalization index was due to the high economic growth rates.

¹⁹ See: "Banking Systems of the CIS Countries: Different Prospects, but the Same Risks," *S&P*, December 2004.

²⁰ For more detail, see: N. Muzaffarli (Imanov), *Reiting Azerbaidzhana v mezhdunarodnykh sravnitelnykh issledovaniakh*, Kavkaz, Baku, 2006, pp. 364-370; idem, "Comparative Economic Competitiveness of the Central Caucasian States," *The Caucasus & Globalization*, Vol. 1 (4), 2007, pp. 75-76.

²¹ See: *Bank Systemic Risk Report*, April 2008, Fitch; *Bank Systemic Risk Report*, September 2007, Fitch, available at [<http://www.fitchratings.com>].

Risk Matrix, it was classified as having a low level—D3 (the BSI D category). The dependence of Kazakhstan's banking system on foreign borrowing meant that it quickly felt the effect of the global credit crisis. A sharp slowdown in the growth of lending activity is currently observed, although thanks to strong government support, a systemic crisis was avoided. Azerbaijan has been placed in the weakest cell of the matrix MPI 3 and BSI E for several years now, although the agency's analysts say that the saving grace here is the low ratio of lending activity to GDP.²² Out of CEA countries Georgia is also in this category, although it is in a slightly stronger segment—MPI 2-BSI D. On the whole, the banking systems of these countries remain "unstable" or "very unstable," with a high level of vulnerability in terms of macro-prudential indices and a low ability to counteract the effect of macro-prudential stress factors.²³

Now it is obvious that in the context of the global financial upheavals the situation in the banking systems of the CEA will significantly change. The world crisis has led to an increase in the cost of funds in the international markets, thus making them out of bounds for many credit organizations. In these conditions, highly integrated systems will suffer the most, primarily Kazakhstan. International rating agencies have already lowered the sovereign rating of Kazakhstan, the banks of which were extremely dependent in their business on borrowing in the debenture markets. The banks of several other Central Eurasian countries (for example, Kyrgyzstan, Moldova, and Ukraine) were also forced to lower their development rates. Experts agree that credit institutions with state participation and a developed deposit base will suffer less from the crisis. However the leading Kazakhstan-Ukraine tandem may not remain a twosome for long since banks from other countries of the region, for example, Azerbaijani, Belarusian, and Georgian, may pull up their socks and reach the level of the CEA's leading credit institutions. The global crisis has had a significant impact on the sovereign lending ratings. Ukraine particularly felt this impact: since mid-2008, Standard & Poor's Credit Rating Service has lowered its rating twice and its forecast is still "Negative." Meanwhile, its forecast for Kazakhstan's ratings was recently changed to "Stable," which was largely explained by the assessment of the measures the Kazakhstan government adopted to limit the number of potential contingent liabilities associated with the problems in the banking system.²⁴

During institutionalization of the banking systems of the Central Eurasian countries, system-forming banks were singled out in the structure of each of them: The International Bank of Azerbaijan (Azerbaijan), VTB (Armenia), TBC (Georgia), Kazkommertsbank, BTA Bank (Kazakhstan), The National Bank of Uzbekistan (Uzbekistan), and others. These leading banks in their respective countries have been recognized by the foreign financial community, and their image is confirmed annually by nominations of the main analytical entities of the world banking industry (Euromoney, The Banker, Global Finance). It is precisely the system-forming banks that are first included in the ratings conducted by the main international rating agencies (see Table 4), in which they, as a rule, are given high ratings. In some cases (for example, the International Bank of Azerbaijan), these ratings could be even higher, but they are limited to assessments of the sovereign rating of the CEA countries.

An objective assessment of the economic conditions for running the banking business in the region in keeping with international standards is also presented in the World Bank's country report called

²² For more detail on international assessments of Azerbaijan's banking system, see: F. Murshudli, "Azerbaijan Banking System: Challenges and Prospects of Globalization," *The Caucasus & Globalization*, Vol. 2, Issue 2, 2008, pp. 79-87; idem, "Mezhdunarodnye otsenki bankovskoi sistemy Azerbaidzhana—vazhnyy indikator ee integratsii v mirovoi finansovyy rynek," *Banki i biznes*, No. 2, 2008, pp. 46-53; V. Fakhri, "Fitch Ratings: Azerbaidzhan vse eshche v spiske autsajderov mirovoi bankovskoi industrii," *Banki i biznes*, No. 2, 2008, pp. 42-45.

²³ See: *Bank Systemic Risk Report*, April 2008, Fitch; *Bank Systemic Risk Report*, September 2007, Fitch.

²⁴ For more detail, see: "Russia, Kazakhstan, and Ukraine: Counting the Cost of the Crisis"; "Kazakh, Russian, and Ukrainian Banks Face Another Tough Year of Poor Asset Quality and Thin Liquidity."

Table 4

**Activity of International Rating Agencies
in the Banking Sector of the CEA Countries²⁵**

No.	Region Country	Number of Banks Rated by:		
		Fitch	Moody's	Standard & Poor's
Central Europe				
1	Belarus	7	6	1
2	Moldova	0	0	0
3	Ukraine	18	34	6
Central Caucasus				
4	Azerbaijan	6	6	0
5	Armenia	2	4	0
6	Georgia	6	0	1
Central Asia				
7	Afghanistan	—	—	—
8	Kazakhstan	11	20	10
9	Kyrgyzstan	0	0	0
10	Tajikistan	0	0	0
11	Turkmenistan	0	0	0
12	Uzbekistan	4	3	0

Doing Business 2009, upon which the influential international investors rely. According to this research (see Table 5), in 2008, in terms of such an indicator of the business climate as accessibility of credit information, the best situation developed in Azerbaijan (12th place), followed by Armenia, Georgia, Kyrgyzstan and Ukraine (28th), Kazakhstan (43rd). Other CEA countries—Afghanistan, Tajikistan, Uzbekistan, Belarus and Moldova—lag noticeably behind them in this ranking.

So an analysis of the development of the monetary and banking systems in the CEA countries and the sophisticated assessments of the leading international rating agencies confirms that they have largely already passed through the initial stage of institutionalization, are ready for self-regulation and self-development, have a high growth potential, and are open to integration both within the region and into the global financial structure.

²⁵ See: [<http://www.fitchratings.com>]; [<http://www.moodys.com>]; [http://www2.standardandpoors.com/portal/site/sp/en/eu/page.my_homepage].

Table 5

**Ranking of CEA Countries
in Terms of Accessibility of Credit Information**

No.	Region Country	Ranking	Legal Rights Index	Credit Information Index	Coverage of Borrowers:	
					Public Registry Coverage	Private Bureau Coverage
Central Europe						
1	Belarus	109	2	5	2.4	0.0
2	Moldova	84	8	0	0.0	0.0
3	Ukraine	28	9	3	0.0	3.0
Central Caucasus						
4	Azerbaijan	12	8	5	3.1	0.0
5	Armenia	28	7	5	2.6	24.4
6	Georgia	28	6	6	0.0	4.5
Central Asia						
7	Afghanistan	178	1	0	0.0	0.0
8	Kazakhstan	43	5	6	0.0	25.6
9	Kyrgyzstan	28	7	5	0.0	3.7
10	Tajikistan	172	2	0	0.0	0.0
11	Turkmenistan	—	—	—	—	—
12	Uzbekistan	123	3	3	2.3	2.2

The Central Eurasian Region in the New Architecture of the World Monetary and Financial System

The evolution of the world monetary and financial system has created objective prerequisites for the appearance of new strong currencies that perform monetary functions not only at the national,

but also at the international level, as well as for the formation of various currency areas. These processes have led to structural changes in the world financial architecture, that is, to a transfer from the unipolar structure of the world financial system to a multi-polar model, which is the essential developmental characteristic in today's monetary relations. In the current situation, analyzing ways to integrate Central Eurasia's monetary and banking systems into the global financial centers is becoming very important. In so doing, the scenarios will become more diversified, particularly in the countries of regions such as CEA which are currently in search of efficient ways to incorporate into the global monetary and financial system.

Today's monetary and financial environment is also giving rise to very complicated, often contradictory, problems in the monetary and banking sphere which cannot be resolved without taking the new development trends in the world economy into account. The nature of these trends, namely, the increased integration of certain regions (particularly the countries of the European Union, the Persian Gulf, Southeast Asia, and others), as well as the promotion of this process in Central Eurasia, indicated that the dollar-based international monetary system evolving during the post-WWII period,²⁶ is set to develop toward the emergence of currency counterbalances.²⁷ The financial crises that have engulfed the world markets in recent years only made the expediency of these processes more obvious, since with the growing instability of the global economy it is better to have several points of reference and diversify investments and reserves.

In this respect, the problem of choosing the main vectors, principles, forms, and methods of interaction of the monetary and banking systems of the CEA states both among themselves and with similar systems of other countries is becoming particularly urgent. The attempts made by the monetary authorities of certain Central Eurasian countries to intensify monetary relations both within the region and with the countries of the EU, APR, South Asia, the Greater Middle East, as well as Russia and the U.S., show that the region's foreign exchange integration could develop in diverse ways. At present, the Central Eurasian states are being drawn very slowly into interregional interaction within the new architecture of the nascent world monetary system, while its geographic vector is still oriented toward the West. The practice of using the dollar and euro in international and partially in domestic payments does not fully meet the demands of sustainable development of the national economies of the CEA countries, increases the risks associated with the outside world, and lowers the effectiveness of foreign trade transactions, which, ultimately, slows down integration of the monetary and banking systems of the region's countries as competitive participants into international monetary relations.

Before moving on to an analysis of the possible scenarios of monetary integration within the CEA's financial and economic expanse, it is worth identifying from the viewpoint of the special development features of this region the main trends in the formation of a contemporary international financial architecture, that is, defining the structural ties and interaction dynamics of its system-forming elements—the leading currencies of the world, in the zone of influence of which are the monetary and banking systems of the Central Eurasian countries.

The globalizing economy and geopolitical expediency have led to the appearance of geo-economic prerequisites in the center of the Eurasian continent for the establishment of a new independent economic regional formation—Central Eurasia (CEA).²⁸ If we envision the continent in the form of an ellipse and Central Eurasia as its nucleus, it is easy to see that several nations and integration formations are putting financial and economic pressure on it. Diagram 1 shows clear ranking of the lead-

²⁶ The Bretton Woods currency system (1944-1978).

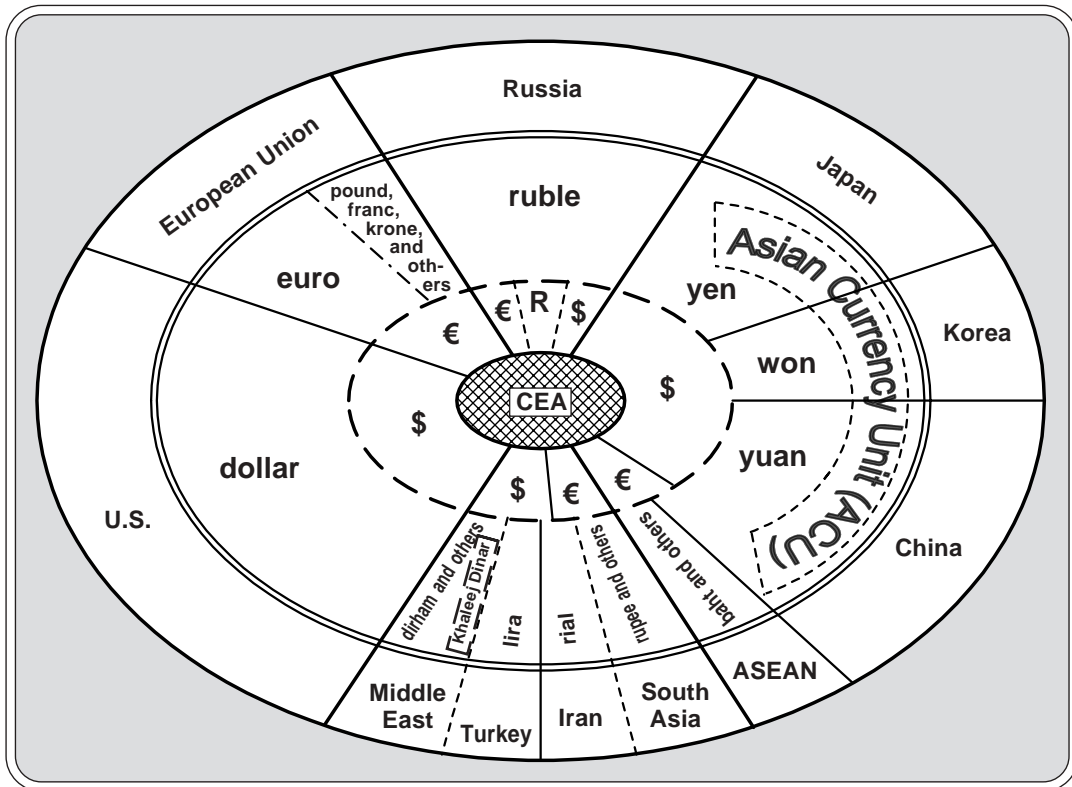
²⁷ This is particularly pointed out in: M. Ershov, *Ekonomicheskii suverenitet Rossii v globalnoi ekonomike*, Ekonomika, Moscow, 2005, p. 12.

²⁸ For more detail, see: E. Ismailov, M. Esenov, "Central Eurasia in the New Geopolitical and Geo-Economic Dimensions," in: *Central Eurasia 2005. Analytical Annual*, CA&CC Press, Sweden, 2006, pp. 11-43.

ing world currencies in terms of the degree and scale of their influence on the development of the foreign economic and foreign exchange activity of the CEU countries.

Diagram 1

The CEA Countries
in the Global Monetary Expans



The largest of these countries and unions, from which the strongest impulses also come, are in the West—in the Euro-Atlantic Region (the U.S., EU, and others)—and in the East—in the Asia Pacific Region (China, Japan, Korea, and others). Both impulses directly affect Central Eurasia. In addition, a local, but powerful, integration impulse is bearing down on the CEA from the north (Russia) and from the south (Iran, Turkey, India) due to their direct proximity and obvious geographical advantages. Along with this, financial and economic ties with the countries of the Middle East and ASEAN have been strengthening in recent years.

As the nucleus of the Eurasian expanse, this geographically united and historically interrelated region has been rapidly transforming and integrating into the global economy since the end of the 1990s. The CEA's advantages are its large supplies of natural riches (oil, gas, gold, and other ferrous metals), relatively well-developed infrastructure (common transportation routes, energy system, joint oil and gas-pipeline network inherited from the former Soviet Union), and human capital, as well as strategically important location at the crossroads between Europe and Asia.²⁹ It should be noted that

²⁹ After the collapse of the Soviet Union, the CEA states became an active hub at the meeting point of the three super civilizations (the Western-Christian, the Muslim, and the Chinese-Confucian) (see: S.P. Huntington, *The Clash of Civilizations and the Remaking of World Order*, Simon & Schuster, New York, 1996, 368 pages).

this region largely possesses the necessary resources and development potential to become a self-producing entity of the world economy. But full-fledged implementation of its planetary (geopolitical and geo-economic) function in the 21st century presumes the establishment of stable and efficient land ties both along the West-East horizontal and the North-South vertical.³⁰ In other words, the countries of the Central Eurasian region have been called upon to develop foreign trade and monetary and financial relations both latitudinally (with the countries of the Euro-Atlantic and Asia Pacific regions) and longitudinally (with Russia, Turkey, Iran, Pakistan, India, and the Middle Eastern countries).

At present, the Central Eurasian region has not reached the level of an independent object-subject of world finances nor has it clearly designated its own development trajectory in the geofinancial system of coordinates. The sociopolitical problems of most of its countries are still being resolved, and in geopolitical terms, the main political and financial players are still vying for their place in the balance of power. This continues to be a source of tension, not to mention the urgent problem of cooperation with the Central Eurasia's main economic partners—Russia, the U.S., the EU, China, Japan, as well as Turkey, Iran and India—whose interest in the region is primarily aroused by its geopolitical and geo-economic potential. The Central Eurasian countries are the main zones of their currency influence. Relations between the Central Eurasian countries and these nations are not equal due to the differences in territory size, geographic location, strategic and economic importance, development demands, political orientation, and interest in integration into the world economy, which have all caused a significant lack of coordination at the level of foreign exchange interrelations with entities of the world financial community.

The currencies, like commodities, are competing among themselves. When the movement of capital is liberalized, competition between currencies increases and the stronger currencies squeeze out the weaker ones, whereby not only from the global, but also from the regional market. More than that, the domestic foreign exchange market is protected to a certain extent by the policy of the monetary authorities. Due to the fact that the capacity of the world's currency markets³¹ is much higher than that of the commodity markets, the main competition between countries is played out precisely in the global foreign exchange market. So the foreign exchange market is not so much economics as geopolitics. This is why many regional and world states strive to predominate on the world monetary and financial expanse, including on the Central Eurasian.

It should be noted that for many centuries political, economic, and foreign exchange rivalry with respect to the region mainly developed longitudinally, that is, between Russia, on the one hand, and Iran, Turkey, and India, on the other. At the end of the 20th century, the U.S., China, Japan, Korea, and European Union, Middle East, and ASEAN countries joined them, which dramatically transformed the financial-economic expanse of the region and the principles of its functioning and integration.

Keeping in mind the multi-vector political and financial-economic cooperation forming between the CEA countries and the world and regional nations and unions, it is expedient to give a general financial-economic description of the Central Eurasian region. The CEA states have rich natural and human resources and a sufficiently large underdeveloped market, the consumer potential of which is steadily rising along with the simultaneous increase in foreign direct investments in the region's economy, which is indicative of the high attraction not only of its commodity and raw material, but also financial market.

³⁰ For more detail, see: E. Ismailov, "Central Eurasia: Its Geopolitical Function in the 21st Century," *Central Asia and the Caucasus*, No. 2 (50), 2008, pp. 7-29.

³¹ In 2007, the average daily turnover of exchange transactions in the world market topped 3.2 trillion dollars (see: "Triennial Central Bank Survey: Foreign Exchange and Derivatives Market Activity in 2007," in: *Bank of International Settlements*, December 2007, p. 4).

The CEA region, which is comprised of 12 states, covers an extensive territory—about 5.7 million sq. km. with a population of approximately 162.3 million people. In 2007, the total GDP in the countries of this region, keeping in mind the purchasing power parity (PPP), amounted to approximately 842.0 billion dollars, while foreign trade turnover reached 301.4 billion dollars. The foreign direct investment stock (FDI stock) in the region topped 110.6 billion dollars. The total external debt reached 203.7 billion dollars, while international reserves amounted to 78.6 billion dollars. Ukraine's economy appears to be the most developed and accounts for 38.2% of GDP (PPP), 36.5% of the foreign trade turnover, 34.4% of the FDI stock, and 41.3% of the CEA's international reserves. Then follows Kazakhstan with 20.0%, 26.7%, 39.2%, and 22.4%, respectively. Only Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan have a positive foreign trade balance. In terms of the per capita GDP (PPP) index, only four countries—Belarus, Kazakhstan, Azerbaijan and Ukraine—exceed its average regional level by 111.0%, 108.9%, 46.8%, and 34.3%, respectively. At the same time, Kazakhstan and Ukraine have a largest share in the region's external debt—47.3% and 33.9%, respectively.

A comparison of the main indices characterizing the socioeconomic potential of the CEA, on the one hand, and the global and regional nations and active integration groups, on the other, shows that this region lags significantly behind most of them in terms of its human, partially territorial, and particularly production resources (see Table 6).

So, Central Eurasia is 15.0-fold, 7.3-fold, and 57.6-fold larger in terms of territory and 1.3-fold, 2.4-fold, and 3.4-fold in terms of population than Japan, Turkey, and South Korea, respectively, although it lags behind them in terms of GDP (PPP) production 5.1-fold, 1.1-fold, and 1.4-fold, respectively. A perceptible unfavorable difference is seen in terms of GDP (PPP) between the CEA and the U.S., EU, China, Japan, India, ASEAN, Russia, and the Middle East.

Keeping in mind the main functions of international currency—payments in international trade transactions, international private investments, and the state's international reserves, it is worth analyzing the development trends in the foreign trade relations of the CEA countries, their investment interaction, as well as the structure of international reserves.

CEA's main trade partners are the EU, Russia, and China. The following three countries hold much less significant places—Turkey (4.7%), the U.S. (3.4%), and the Middle East (2.4%). The list of trade partners of significance is rounded off by Iran (1.9%), Pakistan (0.9%), Korea (1.2%), Japan (1.1%), ASEAN (1.1%), and India (0.9%). It should be noted that although the U.S.'s percentage in the region's international trade structure is insignificant, most of the foreign trade contracts (particularly the largest—oil) and settlements on export-import transactions are carried out in dollars (approximately 50%).³² A similar ratio is characteristic of the structure of foreign direct investment into the economy and of the international reserves of most CEA countries. Nevertheless, a somewhat different picture has emerged in certain states of the region. For example, the national banks of Kyrgyzstan and Kazakhstan have greatly diversified the structure of their foreign exchange portfolio of reserve assets: in 2005, in addition to the customary dollar (48.3% and 84.0%, respectively) and euro (16.5% and 6.3%), Swiss francs (3.7% and 1.0%), British pounds Sterling (3.3% and 2.5%), Australian (7.9% and 0.7%) and Canadian dollars (20.3% and 0.7%) were incorporated into it. In Azerbaijan and Georgia, a bicurrency basket of international reserves formed at the same time consisting of American dollars (85% and 75%, respectively) and euros (15% and 25%). In 2007, the percentage of dollar reserve assets decreased in Kyrgyzstan to 28.6%, whereas in euros and pounds Sterling it rose, vice versa, to 32.3% and 11.6%. In Azerbaijan, the international reserve portfolio was supplemented by a third currency

³² Exceptions are non-oil contracts with EU countries, as well as, partially, settlements with Russia. For example, according to experts of Dresdner Bank, the percentage of euros in servicing world export approximately corresponds to the export volume of the European Union countries in the total volume of world export (see: [http://www.dresdner-bank.de]).

Table 6

**Main Indices of CEA, World,
and Regional Nations and Associations,
2007**

Indices Regions	Territory ³³		Population ³⁴		GDP (PPP) ³⁵	
	thou. sq. km	percent	million people	percent	\$bn	percent
CEA	5673.2	100	162.3	100	842.0	100
U.S.	9,826.6	173.2	302.0	186.1	13,807.6	1,639.9
EU (27)	4,324.8	76.2	494.0	304.4	14,754.2	1,752.3
Russia	17,075.2	301.0	142.1	87.6	2,089.6	2,48.2
Japan	377.8	6.7	127.8	78.7	4,292.2	509.8
South Korea	98.5	1.7	48.5	29.9	1,201.9	142.7
China	9,597.0	169.2	1,321.1	814.0	7,034.8	835.5
ASEAN	4,495.6	79.2	574.6	354.0	2,585.5	307.1
India	3,287.6	58.0	1,169.0	720.3	2,996.6	355.9
Pakistan	803.9	14.2	158.2	97.5	410.3	48.7
Iran	1,648.0	29.1	71.7	44.2	757.5	90.0
Turkey	780.6	13.8	68.9	42.5	885.9	105.2
Middle East*	4,756.9	83.9	197.,6	121.8	1,925.4	228.7

* Without Iran.

and looked as follows: dollars—60%, euros—30%, and pounds Sterling—10%. Georgia still has a bicurrency basket, only the proportion of their distribution changed: dollars—65%, euros—35%. A total of 99.2% of the Belarus' structure of international reserves until mid-2006 consisted of the SDR³⁶ currencies (dollars—63%, euros—25%, other currencies—12%),³⁷ but during the later periods the assets in Russian rubles (since September 2006) and Chinese Yuan (since October 2007) were included therein.³⁸ As for FDI, a non-standard example can be given in the form of Kyrgyzstan, which received a few loans in yuan from China to implement several investment projects.

³³ See: *CIA-2008 The World Factbook*.

³⁴ See: *World Economic Outlook Database*, October 2008.

³⁵ Ibidem.

³⁶ SDR currencies: U.S. Dollar, Euro, U.K. Pound, Japanese Yen.

³⁷ See: [<http://www.president.gov.by/press24211.html>]. Acceptable technical deviations within 3%.

³⁸ See: [<http://www.nbrb.by/press/?action=search>].

So, the natural, human, and economic potential of CEA is already being actively tapped in the world trade and economic and monetary and financial processes. Nevertheless, the foreign trade and monetary turnover structures are extremely different. For example, in 2007 the EU (41.9%), Russia (30.1%), and China (10.3%) were the main foreign trade partners, and the U.S. accounted for only 3.4% (other countries for 14.3%), while the monetary turnover structure looks approximately as follows: dollars—50.0%, euros—40.0%, Russian rubles—9.0%, and other currencies—1.0%. Despite the fact that these ratios constantly change in one direction or the other, this variability is the basis of sustainable and long-term socioeconomic development of the region's countries and allows them to efficiently perform their geo-economic and geofinancial functions. Their implementation in the context of the increasing degree of openness of the economies and liberalization of monetary relations of the CEA countries, however slow the process may be, makes an analysis of the development potential of the leading international currencies and the dynamics of their interaction important for determining the vectors and principles of the integration of the national currencies into the global financial system.

Main Integration Axes in Monetary and Financial Space of CEA

As they developed, international currencies consistently strove to circulate in an increasingly extensive area and reinforce their position. As mentioned above, when the ruble zone fell apart, the currencies began to assimilate the newly formed and free monetary and financial expanse of the CEA countries. This process, in turn, had a perceptible impact on the existing interrelations among the leading international currencies in the global financial markets. They began to form their own currency configurations in these markets, that is, different correlations started to take shape among the world, regional, and local currencies. The weakest are the local currencies, which applies to the Central Eurasian countries. These currencies also proved to be the most vulnerable in the context of financial crises.

Due to the tough competition among the leading global currencies in both the domestic and the foreign markets, the monetary authorities of the CEA countries are faced with the difficult task of reinforcing the security of the newly formed national monetary and banking systems. Today foreign exchange integration is one of the most efficient and long-term ways to strengthen national currencies. An analysis of the integration processes in the global monetary and financial expanse with respect to the development interests of the CEA countries reveals four main foreign exchange areas. In two of them (along the main West-East axis) freely usable currencies and strong local currencies are in use, while in the other two (along the North-South axis) only currencies with restricted convertibility circulate.

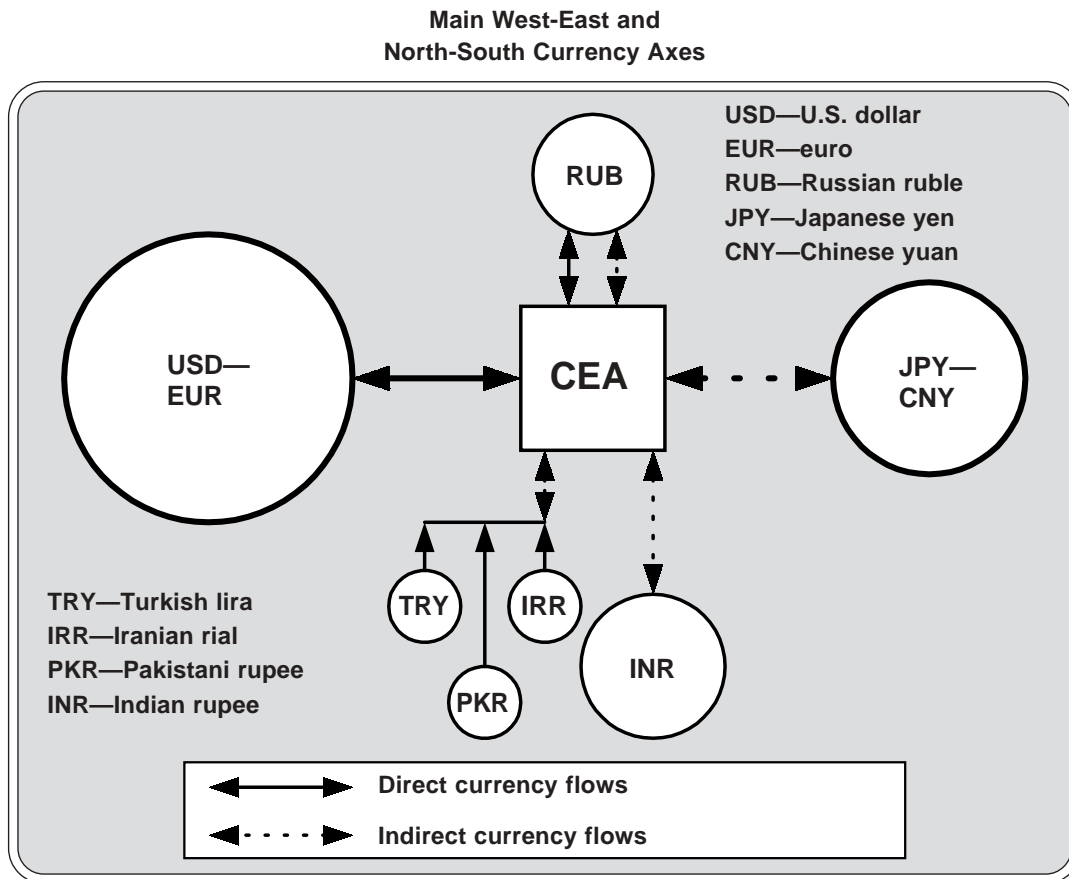
The integration processes in the Central Eurasian monetary and financial expanse are manifested in different vectors and are at different stages of development. It should be noted that the interregional monetary integration level is much lower than the external level. This is mainly due to the lack of coordination among the general country development objectives, the related economic interests, and the ways to achieve them on the basis of which the integration efforts of this group of states could be consolidated, although, as noted above, the region has all the objective prerequisites for this. The different ways to accomplish economic and monetary integration of the Central Eurasian countries are making it possible to diversify the scenarios for its implementation in today's conditions. Each of

these alternatives is self-sufficient and requires independent study. On the other hand, it should be kept in mind that in the context of financial globalization³⁹ and the membership of certain CEA countries in the WTO, their choice of the most attractive monetary poles on which to place the main stakes in foreign exchange relations is becoming extremely important.

A comparative analysis of the possible integration scenarios of the monetary and banking systems of the CEA countries leads us to conclude that they differ from one another in terms of objectives, prerequisites required for their formation, mechanisms, and sets of financial tools. Below we will take a look at the main tasks to be solved as the different vectors of foreign exchange integration are brought to fruition.

The national monetary and banking systems were established in the CEA countries under emergency conditions. As the situation stabilized, the monetary authorities began to develop their foreign exchange relations both within the region itself and along all the main axes in the latitudinal (West-East) and longitudinal (North-South) directions (see Diagram 2). This was because the region's countries wanted to realize their socioeconomic and political interests jointly and create conditions for the

Diagram 2



³⁹ In this case, we are regarding globalization as the *result* of the previous stages of the foreign economic activity of states, regions, and continents, on the one hand, and as a *specific phase* in the rapprochement and interdependence of national economies, on the other.

smooth and unproblematic integration of their national monetary and banking systems into the global financial space.

The gradual waning of the U.S. dollar's dominating role in the international financial architecture made it extremely pertinent to create monetary unions in certain regions of the world that encompass specific geographic areas within which one collective currency circulates in keeping with coordinated and unified regulations. These monetary unions can be joined into two different groups—national and international.⁴⁰ They differ in terms of the political and legal foundations on which the regional monetary and banking system functions. For example, whereas national monetary unions imply a single political-economic and foreign exchange expanse with a centralized monetary authority,⁴¹ international unions comprise of monetary and banking systems with their own national borders and commodity-money relations are managed in a decentralized way. In other words, in international monetary unions the central banks of the sovereign states jointly draw up monetary and foreign exchange policy.⁴²

The creation of a monetary union and corresponding common (collective) currency has always been accompanied by a large number of risks. According to R. Mundell's studies, if a monetary union is not created according to the principle of an "optimum currency area," the members of such a union could experience various economic upheavals, and some of them could even serve as the source of such upheavals.⁴³ A currency area is a group of two or more sovereign states with closed monetary relations that arose as the result of one of three forms of integration (monetary, financial, or political) or their combination. Within an optimum currency area, one collective currency or several national currencies are used as the common means of payment, the exchange rates of which are tied to one another under conditions of complete convertibility and fluctuate in a coordinated way in relation to the currencies of the other countries.

A systemic analysis of the integration processes in the CEA monetary and financial expanse presumes,

- first, identifying how ripe and economically expedient the situation is for creating a monetary union of Central Eurasian states,
- second, establishing the sequence, principles, and forms of participation of the region's countries in these currency areas located along the main axes, and,
- third, evaluating the advantages and disadvantages of such monetary unions for the CEA countries.

In order to determine the prospects for monetary integration within the Central Eurasian Region, it is important to establish how this group correlates to the requirements of an optimum currency area (OCA).⁴⁴ Although, as noted above, CEA in the 21st century is geopolitically and geo-economically ripe for an acceleration in interregional socioeconomic integration, including with respect to curren-

⁴⁰ See: M.D. Bordo, L. Jonung, *An Analysis of the Long-Run Behavior of the Velocity of Circulation*, Transactions Publishers, New Brunswick, London, 2003; idem, *Lessons for EMU from the History of Monetary Unions*, The Institute of Economic Affairs, London, 2000.

⁴¹ For example, the U.S.S.R. and the U.S.S.R. State Bank.

⁴² For example, in the Scandinavian Monetary Union the central banks of Sweden, Norway, and Denmark had a single currency unit—the Scandinavian krone, whereby each of them issued its own krone that freely circulated in the Union member states.

⁴³ American economist R. Mundell developed a theory of optimal currency areas at the beginning of the 1960s (for more detail, see: R.A. Mundell, "A Theory of Optimum Currency Areas," *American Economic Review*, Vol. 51, LI, 1961, pp. 657-665).

⁴⁴ The theory of optimum currency areas elaborated by R. Mundell was developed in the works of R.I. McKinnon, P. Kenen, E. Tower, T.D. Willet, *et al.* (see, in particular: R.I. McKinnon, "Optimum Currency Areas," *American Economic Review*, Vol. 53, LIII, 1963, pp. 717-725; P. Kenen, "The Theory of Optimum Currency Areas: An Eclectic View," in: *Monetary Problems in the International Economy*, University of Chicago Press, Chicago, 1969, pp. 41-60; E. Tower,

cy, the extent to which the development level of this group of countries corresponds to the necessary prerequisites and criteria for forming an OCA must still be assessed. If this assessment is positive, the principles and sequence of steps for moving in this direction must be identified.

Let us take a look at the main prerequisites of an OCA in the context of their applicability to the countries of the Central Eurasian region:

1. Mobility of production factors. Central Eurasia experiences significant restrictions on the movement of both manpower and capital. The border-crossing regimes, migration policy, and investment cooperation of the region's countries still fall far short of the requirements expected of state formations striving for economic and monetary integration. For example, it is impossible to move from one CEA country to another with an internal passport. The movement of capital does not enjoy any privileges either. The volume of mutual investment of the Central Eurasian countries constitutes a small percentage of the total foreign investment, although their absolute volume has significantly increased. For example, the share of Kazakhstan, the most active CEA country in terms of investment cooperation, in foreign investments in Azerbaijan's basic assets was a little bit higher than 0.04% in 2008.⁴⁵ This index for Georgia amounted to 4.4% of the total FDI in 2007, while the share in Azerbaijan's FDI in the Georgian economy constituted 2.1%.

Such passive cooperation of the CEA countries in the investment sphere is due to their low investment potential, on the one hand, and low profitability of the investment climate in some Central Eurasian countries, on the other, when potential investors encounter undeclared state protectionism. The low mobility of production factors in the region is a significant obstacle to creating a monetary union, since when the monetary authorities are unable to conduct an independent monetary and foreign exchange policy there is a sharp increase in the negative impact of asymmetrical shocks on the economy of the integrating countries. In recent years, interregional mobility of production factors has become more dynamic.

2. Development level of reciprocal trade relations. In most cases, this index is no more than a single digit, while in some (for example, export of the Central Caucasian countries to Uzbekistan and Kyrgyzstan, or of Tajikistan and Kyrgyzstan to the Central Caucasian countries) it amounts to tenths of a percent. In addition, bilateral trade is coming up against several reciprocal tariff and non-tariff restrictions. Throughout CEA as a whole, interregional foreign trade relations fall far short of the necessary requirements for an OCA. Nevertheless, in recent years, stable foreign trade relations have been developing at an accelerated rate between certain countries: for example, between Azerbaijan and Georgia (in 2007, 31.7% and 29.3% in export, respectively), between Armenia and Georgia (24.7% and 23.6%, respectively) and between Tajikistan and Uzbekistan (38.0% and 14.1%, respectively).
3. Similar institutional forms of management. The institutional lack of correspondence among the management mechanisms of the CEA countries, which is manifested in different approaches to the management of their national economies, is very evident. For example, whereas Belarus, Uzbekistan and Turkmenistan still maintain significant state control over the main sectors of production, in other countries of the region market methods prevail.
4. Diversification of production. The products of many branches are non-competitive in the world markets. The export of most CEA countries mainly consists of raw materials and is limited to a small range of commodities. The low diversification of the branch structure of production

T.D. Willett, *The Theory of Optimum Currency Areas and Exchange Rate Flexibility. Special Papers in International Economics*. International Finance Section, Princeton University, Princeton N.J., 1976).

⁴⁵ Calculated on the basis of the following data: *Statistical Yearbook of Azerbaijan 2007*, Sada, Baku, 2007, p. 495.

in the CEA countries makes them extremely vulnerable to outside shocks and aggravates the consequences that accompany them.

5. Financial integration. The development level of the integrated foreign exchange market in the CEA countries is extremely low, and it is also encountering several administrative restrictions. On the whole, the financial markets are underdeveloped and are characterized by a low level of liquidity. Interaction in the regional banking and stock markets, although it is growing, is still very low.⁴⁶ In turn, the insufficient liberalization of the foreign exchange market is limiting the possibility of liberalizing the trade and financial markets. For example, whereas in Kazakhstan, Armenia, and Kyrgyzstan, all restrictions on capital transactions have been removed, Turkmenistan and Tajikistan apply the strictest requirements to them; while in the other CEA countries a moderately liberal regime functions. Uzbekistan and Turkmenistan even still apply some restrictions to the current account convertibility.
6. Synchronicity of economic dynamics. The absence of a serious difference in the dynamics of GDP, inflation, and foreign exchange rates, and the level of financial interaction is one of the main quantitative parameters predetermining the prospects for a monetary union. An analysis of the synchronicity of economic dynamics in the 2000s shows that Azerbaijan is way ahead of the field in terms of GDP growth index,⁴⁷ followed at a good distance by Armenia and Kazakhstan. A similar situation has also developed with respect to industrial production growth rates, only Tajikistan takes the place of Armenia here. In terms of inflation rates (2001-2007; at the end of the period), Belarus (365%), Uzbekistan (253%), Tajikistan (224%), and Moldova (206%) are out in front, followed by a close-knit group consisting of Ukraine (184%), Kazakhstan (179%), Turkmenistan (174%), Azerbaijan (168%), Georgia (161%), Kyrgyzstan (152%), and Armenia (130%).⁴⁸ The differences in GDP and inflation rates increased in 2007-2008 due to the world financial crisis in keeping with how well the Central Eurasian countries are adapting to it. On the whole, the inflation rates are still relatively high here. There is also a significant difference in the dynamics of the real exchange rates of the national currency in relation to the dollar, which naturally complicates the transition to a common currency in the context of foreign trade dynamics. Whereas in Azerbaijan and Turkmenistan the national currency is steadily becoming stronger, in Tajikistan, Kazakhstan, Armenia, Ukraine and Belarus there was devaluation in 2009.
7. Level of political integration. In terms of monetary integration among the CEA countries, political will is extremely important in creating a monetary union. As R.S. Greenberg rightly notes, "political interest is manifested not only in the willingness to transfer to a common currency, but also in assuming the corresponding commitments."⁴⁹

In addition to the above-listed prerequisites for an OCA, the criteria of monetary integration are also important. Per capita GDP in terms of purchasing power parity is one of the particularly important criteria. For example, in 2007, there was a 5.9-fold difference between the maximum

⁴⁶ For more detail, see: A.A. Abalkina, "Bankovskoe vzaimodeistvie stran SNG," in: *Predposylki, problemy i perspektivy finansovogo vzaimodeystviia na postsovetском prostranstve*, The Center for Globalization and Integration Problems, Institute of Economics, Russian Academy of Sciences, Moscow, pp. 46-66; E.A. Kliushova, "Vzaimodeystvie uchastnikov i organizatorov fondovogo rynka v SNG," in: *Predposylki, problemy i perspektivy finansovogo vzaimodeystviia na postsovetском prostranstve*, pp. 67-90; E. Ismailov, F. Amirbekov, "Kavkazkaia universalnaia birzha: mekhanizm intergratsii Tsentralnogo Kavkaza," *Izvestia of the Georgian Academy of Sciences*, Vol. 11, No. 4, 2003.

⁴⁷ There are no corresponding data for Turkmenistan.

⁴⁸ IMF—*World Economic Outlook Database*, October 2008.

⁴⁹ R.S. Greenberg, "Perspektivy valiutnoi integratsii na postsovetском prostranstve," in: *Formirovanie integratsionnykh ob'edinenii stran SNG: finansovyy, valiutnyy, bankovskiy aspekty*, Finansy i statistika, Moscow, 2006, p. 179.

(Belarus—10,949 dollars) and minimum (Tajikistan—1,843 dollars) value of this index⁵⁰ in the region. Other criteria of regional conversion, in addition to the inflation factor mentioned above, should be singled out, i.e. budget deficit dynamics. The achievements of recent years have made it possible for several CEA countries (Azerbaijan, Moldova, and Kyrgyzstan) to reach a budget surplus. At the same time, in some other countries (Armenia, Georgia, and Tajikistan) a rather high budget deficit is seen.

All of this shows that the current situation in the Central Eurasian region does not in general correspond to the necessary prerequisites and criteria for creating an OCA. This process is still at the initial stage. But the positive trends observed in recent years in all the above-mentioned vectors give rise to the hope that in the long term an international monetary union could be created in the region among a few of its states.

When determining the priorities and sequence of steps to be taken in achieving monetary and financial integration we should proceed from the region's geo-economic and geopolitical function in the international financial and economic system. At the turn of the new century, the CEA countries acquired the opportunity, geopolitically, to establish their financial and economic relations along the main West-East and North-South axes at the same time.

An analysis has shown that the strongest magnetism for the Central Eurasian region comes from the currency area formed by the countries in the latitudinal direction: the main financial and investment flows in the CEA region are passing along the main West-East axis. It is precisely this axis that is the most promising from the viewpoint of monetary integration of the CEA countries into the global financial system. We know that the freely usable currencies in the Western area (the dollar and the euro) and the freely usable (the yen) and strong local currency (the yuan) in the Eastern area have competitive relations both between themselves and between their regional pairs—the dollar-euro⁵¹ and yuan-yen⁵²—which determine the main development trends of the current global monetary and financial system.

Along with its circulation in its own monetary and financial space, the dollar-euro currency tandem functions rather efficiently in all the other regions of the planet, while the yuan-yen tandem mainly functions in the East (APR). It should be noted that the financial and investment potential of the Eastern area is currently no less significant than the Western, and the growth rate of the Asian currency tandem in the world financial markets is higher than that of the Euro-Atlantic tandem. While the dollar and the euro were fortifying their position in the post-ruble zone, the yuan and yen were consistently squeezing them out of the APR, and today Japan and China have all the levers of influence on the region's financial flows and have created a financial and investment base for their subsequent advance into other regions, including into CEA. The leading countries of the Eastern area have already begun to act dynamically in CEA's economic space, but their currencies are still only indirectly related to the financial and investment activity of the region's countries. They are also jointly initiating the creation of a common collective Asian currency—the ACU.⁵³

⁵⁰ See: *CIA-2008 World Factbook*.

⁵¹ See: M. Chinn, J. Frankel, "The Euro May Over the Next 15 Years Surpass the Dollar as Leading International Currency," available at [[http://ksghome.harvard.edu/~jfrankel/EuroVs\\$-IFdebateFeb2008.pdf](http://ksghome.harvard.edu/~jfrankel/EuroVs$-IFdebateFeb2008.pdf)], 13 February, 2008; J. Frankel, "The Euro Could Surpass the Dollar within Ten Years," available at [<http://www.voxeu.org/index.php?q=node/989>], 18 March, 2008; V. Ya. Pishchik, *Evro i dollar SShA. Konkurentsiia i partnerstvo v usloviiakh globalizatsii*, Konsaltbankir, Moscow, 2002; R. Mundell, *The Euro and the Stability of the International Monetary System*, Columbia University, January 1999, § 6.

⁵² See: *Debating China's Exchange Rate Policy*, ed. by M. Goldstein, N.R. Lardy, Peterson Institute, Washington, 2008, 399 pp.; D. Burton, A. Zanello, "Asia Ten Years Later," *Finance & Development*, Vol. 44, No. 2, June 2007, pp. 22-25; N.G. Shchegoleva, R.G. Malsagova, *Kollektivnye valiuty: sovremennaia arkhitektura i tendentsii razvitiia*, Market DC, Moscow, 2006, 288 pp.; A. Prakash, "Envisioning a Single Asian Currency," *International Herald Tribune*, 28 March, 2006; H. Kuroda, *The Rises and Falls of Currencies*, Tokyo, 2005 (in Japanese); *Japan and China: Cooperation, Competition and Conflict*, ed. by G.H. Hilpert, M. Gurian, Palgrave Macmillan, Hampshire, 2002, 233 pp.; R. Taylor, *Greater China and Japan: Prospects for Economic Partnership in East Asia*, Sheffield Centre for Japanese Studies/Routledge Series, London, 1996, 228 pp.

⁵³ The possibility of creating an Asian currency unit was expressed by President of the Asia Development Bank H. Kuroda (see: H. Kuroda, op. cit). In his opinion, efforts should be made in this direction as the region moves toward eco-

The situation that has developed on the latitudinal axis of the foreign exchange markets is characterized by close interaction between the above-mentioned currency tandems, which, in turn, are regulating and controlling the integration processes in the foreign exchange markets of the West and East. Based on these fundamental trends of monetary integration, R. Mundell justified the need for creating a new international monetary system which should be based on an international monetary union in the West—the U.S. and EU—and in the East—Japan. Consequently, he offered a specific action plan for introducing a new Eurasian currency—INTOR—consisting of the dollar, euro, and yen,⁵⁴ which would give the world a new universal means of international price comparison and a world area of price and currency stability. In our opinion, taking into account China's current financial and economic potential, as well as its role in the Asia Pacific Region, the possibility of including the Chinese yuan in INTOR on a par with the Japanese yen should be considered.

Based on current monetary and financial relations, the countries of Central Europe and Central Caucasus are strongly drawn to the Western currency area, while Central Asia is under the influence of the Eastern. But since there is a tendency toward equalizing the gravitational pull of these currency areas and toward possibly creating an international monetary union between them with a common Eurasian currency—INTOR, integration of the CEA countries into the global financial space may be balanced in both directions.

The financial and investment potential of the areas located on the main North-South axis, although they are much smaller in size than the areas on the West-East axis, is nevertheless sufficiently high for the CEA countries. This is because for many centuries, right up until the end of the 20th century, they had direct developed commodity-money relations with the regional states in the south—Iran, Turkey, and India—and with Russia in the north.

Despite the fact that the financial and investment potential of the southern area is much higher than that of the northern, the integration impulses coming from the north are quite strong at present. Most of the CEA countries (apart from Georgia and Afghanistan) belong to the CIS, while Russia, after announcing its desire to achieve full convertibility of the ruble, is striving to recreate a national monetary union with the CEA countries. However, keeping in mind the active involvement of the CEA countries in the main West-East axis, the chances of recreating the ruble zone in the near future are very low, since the Russian ruble, which current reality shows, is under strong pressure from the currencies of the indicated areas.

The formation of three international currency areas can be seen in the south:

- 1) the Arab countries of the Persian Gulf⁵⁵;

conomic integration, including the establishment of a free trade area. This currency unit will be a currency index of 13 countries of the ASEAN+3 countries (member states of the ASEAN plus Japan, China, and South Korea). In addition to quotations, according to H. Kuroda, the index will express the GDP level, foreign trade volume, and level of participation in international settlements. As the countries of this group integrate (in the future Hong Kong and Taiwan may also join), the ACU will become a single Asian currency which could eventually become as strong as the euro (see: A. Prakash, op. cit.).

⁵⁴ See: R.A. Mundell, "The Case for a World Currency," *Journal of Policy Modeling*, Vol. 27, Issue 4 (June), 2005, pp. 465-475. This plan comprises three stages: 1) stabilization of the dollar, euro, and yen exchange rates (establishment of ceilings and floors on the exchange rates of these currencies in relation to each other); 2) strict fixation of the dollar, euro, and yen exchange rates, creation of a currency unit DEY (Dollar, Euro, Yen) and of a common central bank based on a basket of these currencies (with specified weights) in order to carry out a single monetary policy in the region aimed at achieving price stability, preliminarily coordinated with the FRS, European Central Bank, and Bank of Japan with respect to a common index for measuring inflation and a mechanism for distributing seigniorage; 3) introduction of a global currency (R. Mundell called it INTOR) that could be calculated on the basis of a world basket including several (but no more than five) of the world's leading and most stable currencies, in particular on the basis of the DEY unit, with the possibility of adjusting the composition of the currencies in it.

⁵⁵ See: M. Josh, "Gulf States to Adopt a Single Currency? Casting a Wary Eye at Europe, Members of the Gulf Cooperation Council are Moving forward Plans to Adopt a Common Currency," *Business & Finance*, May 2002, available at [http://goliath.ecnext.com/coms2/summary_0199-1685468_ITM]; *Ekspert Kazakhstan*, No. 16 (164), 21 April, 2008; *The Georgian Times*, 19 June, 2008.

- 2) the Economic Cooperation Organization (ECO)⁵⁶; and
- 3) based on the Indian rupee.

The most attractive option for CEA is the ECO international monetary union where some progress, although very insignificant, has been made. In particular, questions of monetary cooperation between the CEA countries and Turkey, Iran, and Pakistan are being actively discussed. However, participation of the CEA countries in this monetary union looks even less likely than restoration of the ruble zone.

* * *

So this analysis shows that during the CEA countries' sovereign development, stable national monetary and banking systems have formed that are actively interacting with the main monetary poles of the world economy located along the main West-East and North-South axes. Further study of the trends in monetary integration within this region will make it possible for the monetary authorities to choose an optimal development trajectory for their national monetary and banking systems in the context of world financial and economic crises.

⁵⁶ All the CEA countries, apart from Georgia and Armenia, belong to the ECO.

THE WORLD CRISIS AND THE RAW-MATERIAL ORIENTED TRANSITION ECONOMIES

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The world crisis, which naturally aggravated many problems, increased the raw-material dependence of the transition economies of at least some of the CIS countries.

A comparative analysis of the economic progress achieved in the last decades revealed that

natural riches slow down economic growth.¹ This

¹ See: R. Prebisch, *The Economic Development of Latin America and its Principal Problems*, Lane Success, New York, United Nations, 1950; A.O. Hirschman, *The Strategy of Economic Development*, Yale University Press, New Haven, 1958.

phenomenon, known as the resource curse, was accepted as a fact and became a subject of economic studies, especially after J.D. Sachs and A.M. Warner² published their articles dealing with the negative statistical dependence between natural riches and economic growth rates.

The authors, who looked at the “natural resources curse” as a factor of investments, corruption, the country’s openness, and trade conditions, agreed that natural riches should be described as a negative factor.

There are numerous examples confirming the above: between 1965 and 1988 the per capita GNP of the resource-dependent countries dwindled by approximately 1.3 percent every year, while in the countries with low and average incomes it grew annually by 2.2 percent.³

Nigeria, the oil-related income of which increased between 1965 and 2000 from \$33 to \$245 per capita in comparable prices while the GDP remained the same (\$325 in comparable prices), is one of the most striking examples among the OPEC countries.

Between 1970 and 2000, the share of the poor (with incomes below \$1 per day) in the country’s population increased from 36 to 70 percent.⁴

Many countries have been able to disentangle themselves from the natural resource curse and are demonstrating adequate development rates. Such are the United States and Botswana, among others.

The opinions about the fairly contradictory empirical regularities of the “natural resource curse” differ.

Theoreticians rely on an analysis of all sorts of economic and institutional aspects of what is known as Dutch disease (economic restructuring) caused by a country obtaining additional profits.

² See: J.D. Sachs, A.M. Warner, “The Curse of Natural Resources,” *European Economic Review*, Vol. 45, May 2001, pp. 827-838.

³ See: T. Gylfason, “Natural Resources, Education and Economic Development,” *European Economic Review*, Vol. 45, May 2001, pp. 847-859.

⁴ See: X. Sala-i-Martin, A. Subramanian, “Addressing the Natural Resource Curse: An Illustration from Nigeria,” *NBER Working paper* 9804, 2003.

In fact, Dutch disease (Dutch syndrome) is a wider concept than the “natural resource curse” since the money might not only come from the raw-materials sector or market fluctuations but also in the form of foreign aid.

Much has been written about Dutch disease.⁵ Most authors explain it by the contracting production of finished industrial goods responsible for external benefits. Others attach special importance to rent, economic policy mechanisms, and exchange rate fluctuations.

V. Matveenko,⁶ who has relied on the one-sector model to analyze the correlation between raw-material dependence and economic growth rates, and K. Kuralbaeva and O. Eysmont,⁷ who studied the dependence between the GDP growth rates of a resource exporter and the share of the resource sector in the economy using the two- and three-sector model, stand apart among the CIS authors.

The majority prefers simpler explanations: world oil and other raw material prices are never stable—the alternating booms and declines are fairly short. The volatility of the raw material markets is the main curse of raw-material exporters.

Everything that has been written today can be divided into two groups. One of them looks at the short-term consequences of the raw-material curse, the other at its long-term repercussions.

The transfer from a planned to a market economy has its specifics, and the symptoms of Dutch disease betray themselves gradually. This is why an adequate analysis is very hard to achieve.

Even before the crisis, CIS analysts spent much time talking about the resource curse and

⁵ The term is associated with the discoveries of vast natural gas fields in the late 1950s-early 1960s in the Dutch sector of the North Sea. In Norway, oil production grew almost 7-fold between 1970 and 1980; in the Netherlands 2.5-fold, and in the UK nearly 2-fold. The resultant upsurge of natural gas export made the natural currencies more expensive, which negatively affected the other export-oriented branches. Dutch disease is mainly associated with the growth of the real exchange rate caused by increased export in some branches, which negatively affects other branches and the economy as a whole.

⁶ See: V.D. Matveenko, *Resursozavisimost' i ekonomicheskoe razvitiye: primer Rossii*, St. Petersburg Economic-Mathematical Institute, RAS, 2005.

⁷ See: K. Kuralbaeva, O. Eysmont, “Istoshchenie prirodnykh resursov i dolgosrochnye perspektivy rossiyskoy ekonomiki,” *Nauchnye doklady EERC*, No. 99/07, 1999.

whether their countries were affected by it. Today the time has come to look at the roots of the countries' raw-material dependence in order to grasp the meaning of what is going on and address the short- and long-term tasks.

Several of the CIS countries, especially those rich in natural resources, are the largest exporters of mainly energy resources.⁸ They are Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan.

All of them (with the exception of Russia) belong to Central Asia and the Caucasus (the CAC

⁸ The aggregate energy potential of the CIS countries is about 11 percent of the world's proven oil resources; more than 41 percent of the world's natural gas resources (first place in the world) and 25 percent of the world's coal resources (first place in the world). Russia, with 77 percent of the CIS total oil extraction, Kazakhstan (11 percent), and Azerbaijan (about 9 percent) are the largest CIS oil producers. By 2008 Russia had moved into first place in the world in natural gas extraction (79 percent of CIS production); it is also the largest gas exporter. Turkmenistan, with 8 percent in the CIS, holds second place; Uzbekistan produces slightly less gas.

region). Three more countries export exchange goods: Armenia deals in copper; Georgia in ferroalloys and copper; and Tajikistan in cotton and aluminum. The raw-materials share in their export, however, is negligible.

During the crisis their incomes dropped; Kyrgyzstan is the only exception: gold, its main exchange commodity, is even more expensive than ever before.

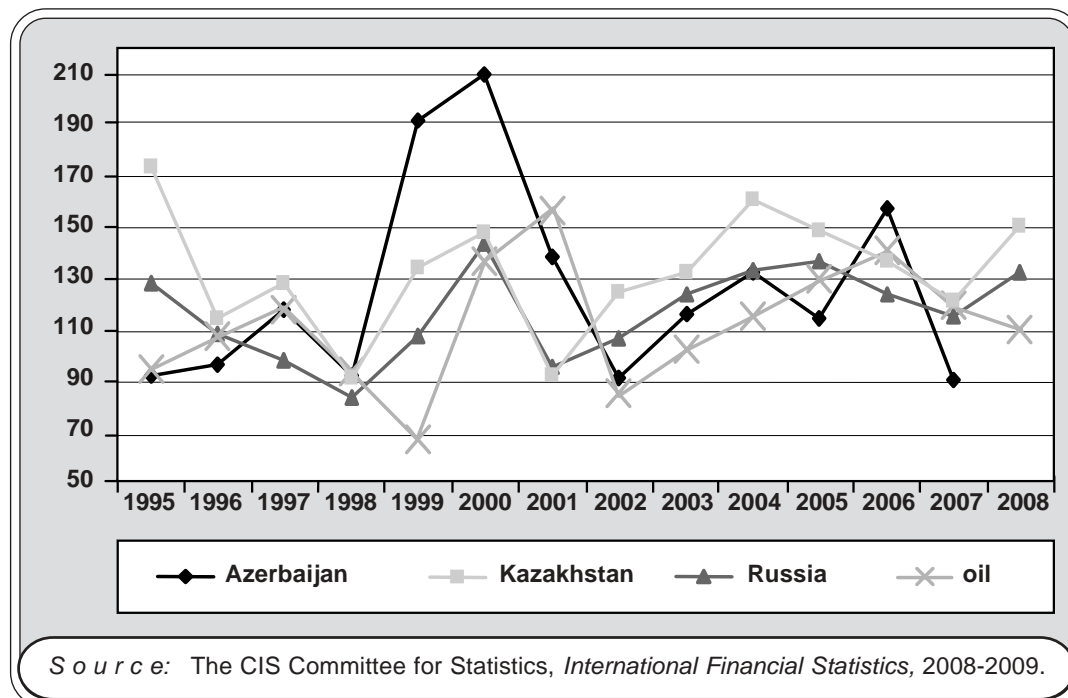
In fact, all the CIS countries depend on raw materials for their exports⁹; none of them managed to radically restructure their industrial production to export goods with high surplus value. Their finished goods are uncompetitive on the world markets.

For example, according to the RF Ministry of Economic Development, in 2008 fuel deliveries to the Far Abroad comprised 72.4 percent of Russia's exports.

⁹ Export of armaments, which is considerable in some countries (Russia being one of them), is beyond the scope of this article.

Figure 1

Dynamics of Export to the Far Abroad
(% of the previous year)



Azeri export is dominated by oil products (96 percent); energy resources account for nearly 40 percent of Uzbekistan's exports.¹⁰

The same is true of the other countries. The raw-material price fluctuations still strongly affect their basic macroeconomic indices.

During the global financial crisis of 1997-1998, when the raw material prices plummeted to an unprecedentedly low level, these countries showed the symptoms of Dutch disease, their dependence on raw materials making them especially vulnerable. Later, when the exchange prices on their main export items started climbing, they hastened to report high GDP and industrial production figures and export growth rates, thus demonstrating total oblivion of other development factors.

For the CIS countries, the present crisis has been a precise repetition of the situation when lower raw material prices caused an economic decline in resource-dependent countries.

¹⁰ [www.stat.uz].

This means that a very short period of the world's high and climbing raw-material prices caused the rapid economic growth in the raw-material exporters.

Statistics have demonstrated that in the countries mentioned above the high GDP and industrial production growth rates coincide with high raw-material prices, particularly for oil.¹¹

Figs. 2 and 3 illustrate the positive correlation between oil prices and macroeconomic indices.

The crisis revealed the strong and weak sides of the economic policy pursued by the raw-material exporters—Russia and the CAC. In some cases, Dutch disease alleviated the crisis-caused pains.

Table 1 shows some of the signs of the resource curse and Dutch disease which the crisis pushed to the fore.

¹¹ Natural gas and coal mainly follow the oil-price dynamics.

Figure 2

Dynamics of Growth
in GDP and Oil Prices
(% of the previous year)

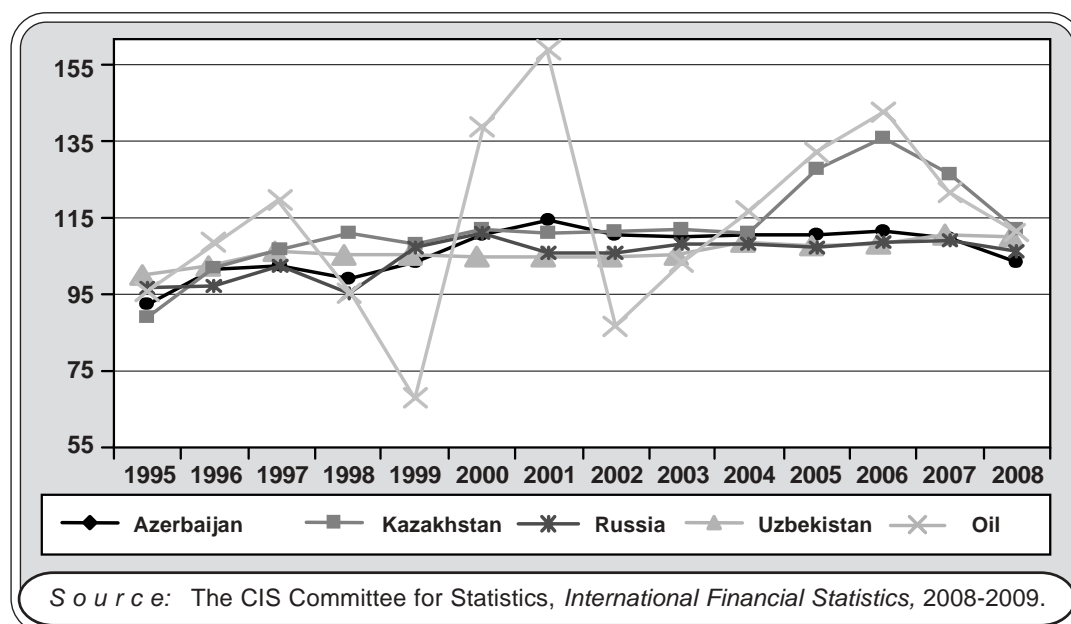


Figure 3

Dynamics of Industrial Production
(% of the previous year)

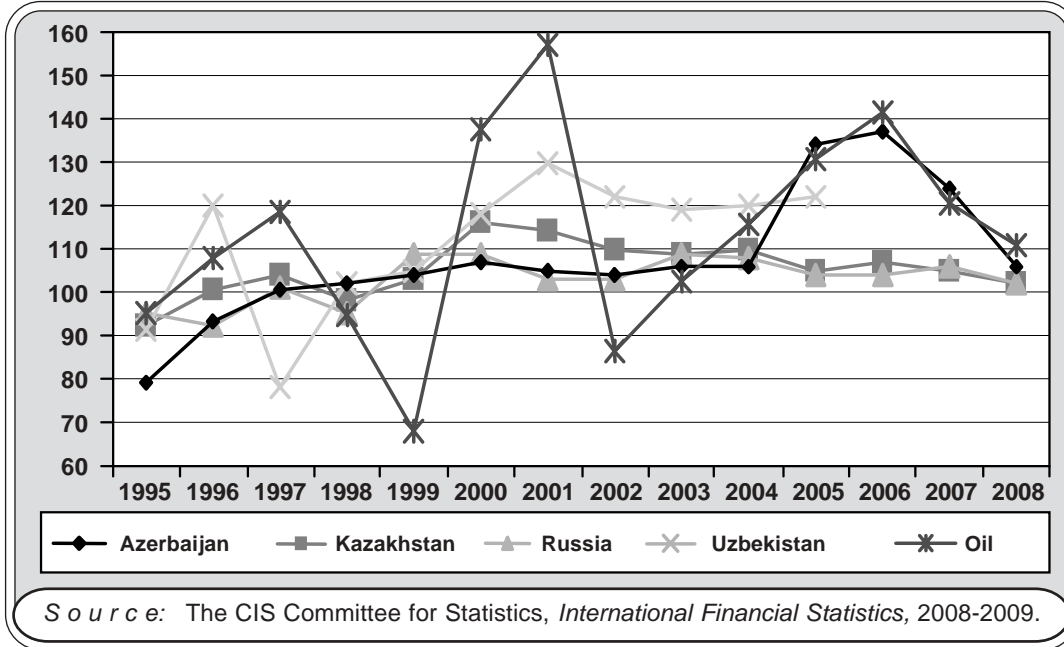


Table 1

Typical Symptoms of Dutch Disease and
Their Manifestations in the CAC

Typical Features of Dutch Disease	Manifestations	CAC Specifics
Slower economic growth that goes on for a long time	Negative statistical dependence between rich natural resources and economic growth rates	Hard to identify because of the short period of observation and the impact of the transformation-related decline
Production factors move over from the manufacturing sector to the resource and services sector	Marginal labor productivity and capital in these sectors overcome marginal labor productivity in the manufacturing sector	Rapid development of the services and construction spheres. Transfer of the workforce to the services sector. Including in the form of migration to other countries

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
Contraction of external benefits created by the manufacturing industries	Contraction of the scientific and R&D sectors	Fairly small amount of capital in the manufacturing sector and its low efficiency
De-industrialization	Contracting share of the industrial branches and the total number of jobs in the industrial sector. Investments in industry and its share in the GDP decrease	Industrial labor skills gradually disappear. The economy becomes mainly agrarian and raw-material. Formerly industrial regions become depressed while the workforce is concentrated in the services sector
Concentration of investments in the raw-material sector	Less money in the manufacturing sector negatively affects its profitability and competitiveness	Direct foreign investments are mainly intended for the extracting branches. The undeveloped economy negatively affects the market infrastructure
The exchange rate of the national currency becomes unstable	The position of both exporters and importers grows shaky. The manufacturing branches become less competitive	The national currency exchange rate is regulated. Monetary policy is toughened; import dues are raised
The gap between rich and poor widens	Wages are raised to different extents. Rent and the monopoly on strategic exports differentiate incomes even more	Decline caused by the transformations becomes more obvious. The shadow sector increases its money flows
Budget expenses are deliberately inflated	The surplus budget money dampens the state's initiatives in the sphere of institutional reforms	Inflated programs of budget and quasi-budget funding. Disguised funding of non-profitable enterprises
No stimuli for economic diversification	Fewer chances to be competitive in the world commodity market with a high share of added value.	Economic restructuring was never realized while China and other regional players increased their

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
	Protectionism toward national economy branches	demand for raw materials
Low asset turnover	The correlation between energy consumption and the GDP in the resource-dependent countries as a rule is much higher than in the developed countries	High energy-consumption of the GDP. High energy consumption of production is combined with inadequate domestic energy supplies
Undeveloped financial market	Since the resource sector has enough investment sources it becomes much harder to transform personal savings into investments. Savings are accumulated in foreign currency or are exported from the country	Banks are unwilling to lend money to the real sector. Companies have to invest their own profits, which are thus accumulated in the mining and raw-material exporting branches
Changeability	Wide cyclical vacillations caused by the instability of profit sources (resource prices, foreign loans)	Sharp decline of macroeconomic indices during a crisis
Squabbles over the rent and corruption	Concentration of political and economic power in the hands of small groups. Lower quality of social capital	Clans that control resources
Unjustified confidence in the future	Light-hearted treatment of the "easy money." Increased financial dependence	Large part of these incomes might be spent ineffectively. High external debts
Growing structural unemployment and migration	Interdependence between the practically undiversified economy that tends toward the resource sector and unemployment and workforce migration	Greater money flows from migrants and their effect in the form of a positive balance of payments
Worsened quality of human capital	Lower quality of education. Crisis of technical education. Additional income lowers the	Lower interest in education. General decrease in the

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
	demand for human capital. The educational system deteriorates	quality of human capital that was relatively high in the past
High volatility of trade balance	This creates a situation in which import decreases because of the drop in export	Dependence of many of the economic branches on import
Transformation into a raw-material appendage and a market not only for developed but also for developing economies	Trade between Russia and the CAC, on the one hand, and China, on the other, developed into a typically colonial structure: we sell them raw materials, they export their machine-building equipment to us	Chinese partners in fact impose their fuel and raw-material prices on the exporter companies

Certain Crisis Specifics in Russia and the CAC

Financial Resources

Crises assume special forms in developing countries that depend on exporting their raw materials. The large amount of taxes accumulated in special funds during the years of a favorable market situation keeps the economy afloat for some time since the funds effectively cushion the impact of the crisis.

Considerable banking assets absorb the shock and are used to continue funding facilities and projects no matter what is happening to the budget. In this case, weak Dutch disease symptoms create positive effects.

Crisis Asymmetry

In Russia and the CAC, which are rich in natural resources, the crisis mostly affected the raw-material and financial sectors because of the inertia of their economies and their lopsided integration.

The slowed-down economic advance of developing and transition economies during a crisis is explained by their "overheated" state on the eve of the stock market collapse caused by high raw-material prices. The following factors confirm this: high economic development rates; income growth; skyrocketing prices for real estate and other groups of products, and a loan boom.

Strong Institutions are Much More Important than Rapid Reforms

The expert community has agreed that during a crisis countries need tough and consistent state governance to ensure timely responses inside and outside the country and to coordinate the country's policies and its economic demands.

Back in the mid-1990s, when discussions about possible post-socialist development paths stirred up a lot of interest, renowned Polish economist Grzegorz Kolodko pointed out that a gradual transfer to the market without total destruction of the old economic institutions would help to avoid a slump.

The liberal economists insisted that shock therapy and their own market theory were the only alternative in the conditions of moving away from the communist paradigm.

It has become clear, however, that in a crisis those countries that preserved strong state institutions can rely on them for their stability.

Strong and Large Corporate State Sector

We all know that the private sector is dealt the heaviest blow in a crisis and that it is for the state sector to stabilize the situation. In the countries under review, the key economic centers were transferred under state control to avoid their precipitous collapse; more likely than not the state is a market player of sorts that supports consumers, producers, and investors.

Let us repeat: the state sector alleviates a crisis.

The CAC's Greater Geopolitical Role

Alternative fuel transportation routes and diversification of fuel consumers add weight to the CAC while its steadily growing export attracts larger foreign investments.

Asia (China, India, and some other countries in particular) will soon need a greater amount of hydrocarbon resources, which will push the CAC into the key geopolitical positions. Therefore the consumers want economic stabilization in the region as promptly as possible.

Monetary Policies

Russia's pre-crisis policy of strengthening the ruble considerably increased the volume of foreign currency loans in Kazakhstan: investors were encouraged by the high oil and other raw material prices. This created a money flow into liquid assets and, consequently, a loan boom. The resultant overheated economy, however, made the Russian and Kazakhstan banks and companies dependent on the money flow, which changes its direction during a crisis.

Openness or Isolationism

The liberal market economy favors an open economy, however in the post-Soviet countries liberalization boiled down to access to the external capital markets.

On the eve of the crisis, Kazakhstan and Russia were the two main rivals where economic openness was concerned. Much was said about integration into the international financial markets, which presupposed the active involvement of foreign capital.

A favorable situation in the commodities markets accompanied by the high growth rates of raw-material economies improves the country's image and its international rating even if its domestic accumulations remain negligible. This makes loans in the foreign markets especially tempting. As a result, the amount of money borrowed abroad reaches unbelievable proportions, both in the corporate and the banking sectors. Used as liquidity and involved in trade operations the borrowed money is never spent on serious restructuring.

In the past, the isolated nature of the CAC financial systems (of Uzbekistan, among others) was often criticized; examples of other countries' experience were used as an argument.

The situation is far from unambiguous: pre-crisis "minuses" turned out to be crisis "pluses." Indeed, the banking system of Uzbekistan with its very limited volume of foreign loans and total reliance on its own accumulations remained afloat and avoided shocks.

None of the developing or post-crisis economies can close the development gap and move forward without external borrowings: their effective use, though, is a much more challenging task.

Inertia of the Social Response

The social response to the crisis and its consequences differ from one CIS country to another. In Central Asia, for example, people trust the authorities much more than in Russia and the other Soviet-successor states in the European part of the former Soviet Union. This has been confirmed by statistical studies that involved 14 post-Soviet states.

The factors that affect the people's subjective ideas about the authorities are numerous: the degree of information openness; the specifics of national mentality; society's psychological mood, etc. All of them help alleviate the shock of a crisis.

The Crisis Revealed that the Economies were Highly Interdependent

It turned out that the Russian and CAC economies were more closely tied to each other than was earlier believed. Trade turnover has slackened, but money transfers, migration, and unofficial shadow deliveries are still going on as an important part of economic cooperation. The crisis has made this even more tangible.

The oil and gas transportation and transit routes can be described as an important factor that continues attracting foreign money despite the crisis.

A Crisis of Genre? Recommendations from International Institutions

What the heads of the international financial institutions have to say about the crisis in the CIS countries sounds ambiguous. Today, the IMF, the U.N., and the WB agree that the CIS economies

should have been diversified; that the CIS countries should have been more cautious with respect to foreign borrowing; that they should have moved away from resource export; and that they should have kept their financial sectors in check. This contradicts their earlier recommendations: openness and complete liberalization of the commodities and financial markets.

For a long time we were taught, in full accordance with the comparative advantage theory, that it was much wiser to buy cheap products in the world markets and sell what we had in (relative) abundance, that is, raw materials, mainly oil.

The crisis has taught us that economic stability is better than liberalization that brings about destabilization.

On the eve of the crisis, Russia and Kazakhstan, very much as usual, were offered as liberalization beacons for their less liberalized neighbors; their banks had higher credit ratings; the future was assessed in optimistic terms, etc.

Today, however, Uzbekistan is described as a country that has suffered less from the crisis than its CIS partners. On 19 July, 2009, IMF Managing Director Dominique Strauss-Kahn concluded his visit to Uzbekistan by pointing out “the economy’s resilience to the global crisis, which largely reflects the authorities’ prudent policies.”¹² He said further that Uzbekistan’s banking system, unlike those of the other countries, remained free from the negative impact of the world financial crisis and was working more effectively than ever before. The government, said the high-ranking international bureaucrat, had posed itself the task of ensuring even much higher growth rates. In any case, in 2009 the country’s economic growth would be one of the world’s highest, he concluded.

This leaves us wondering: Are strong institutions more important than precipitous reforms?

For a long time the Soviet-successor states shaped their economies under the strong influence of the Western liberal conservative economic school based, very much like the socialist theory, on fossilized dogmas: large-scale and hasty privatization; the a priori conviction that the state sector could not be effective by definition; minimal state interference; and the efficiency of the market’s invisible hand. Today, these postulates are criticized from all sides, including by the leading Western economists.

Today, both Russian and Kazakhstan experts have agreed: the countries need sovereign rather than “split” financial policies. China, which has realized its own, and highly original, conception of economic reforms, turned out to be less scarred by the crisis than many.

Uzbekistan is among the countries whose economy contains a certain share of raw-material branches. It even displays the symptoms of Dutch disease, which means that it should follow in the footsteps of those countries that have already overcome their backwardness through correct policies. We have in mind China, Indonesia, Malaysia, and certain others.

The above does not mean that rich natural resources interfere with economic advance, however they do create greater risks and call for more careful economic steering.

In fact, the resource-rich states can and should keep the potentially negative impact of their relative resource abundance on economic growth under control. Countries with an inefficient processing sector should not rely solely on the market mechanism, otherwise their future can be described as de-industrialization and slow economic growth.

This means that economic science and politics should address the numerous urgent tasks and rely on corresponding research.

¹² [<http://www.imf.org/external/np/sec/pr/2009/pr09221.htm>].

THE WORLD ECONOMIC CRISIS AND ITS IMPACT ON THE ECONOMIC DEVELOPMENT OF THE CENTRAL ASIAN COUNTRIES

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In the Central Asian (CA) countries, the world crisis has mainly had an impact on the financial and investment sphere. The region does not have enough of its own economic resources to overcome the consequences, so it will have to turn for the most part to influential neighbors.

The nature and manifestations of crisis phenomena depend on the level of development and integration of the economic systems of different states into the world economy.

Let's take a look at the situation that has developed in the CA countries under the influence of the world financial crisis, as well as at the possible ways to overcome it and the prospects for the region's further development.

Since the crisis began, there has been a significant drop in the growth rates of the macroeconomic indices in **Kazakhstan's** economy. The 2008 year-end results were not encouraging—the financial and economic spheres had obviously experienced a slump.

By the end of 2008, however, the powers that be had managed to halt the decline in financial indices. But it was the lower investment activity and difficult financial situation in the banking sector in 2007 that led to the economic crisis. This is confirmed by the data of Kazakhstan's Statistics Agency.¹

The GDP index for 2008 amounted to 103.2% compared to the previous year. Goods production accounted for 45% and services for 52.5%. The total production volume decreased by 2.2% (3,045.9 billion tenge) from January to June 2009 compared to the same period in 2008, giving rise to a corresponding change in the aforementioned indices—36.3% (goods) and 65.8% (services).²

The production branches—oil and mining—suffered the most from the crisis. The drop in growth rates in these branches corresponds to the downward trends in economies throughout the world. This reduction in production volume led to a change in the sectoral and geographic structures of the country's industry.

Box 1. Crude oil production increased in the Atyrau (by 20.6%) and Mangistau (by 2.0%) regions. In the Aktobe and Kzyl-Orda regions, it dropped by 2.6% and 3.7%, respectively. Gas condensate production increased in the Mangistau region 1.6-fold,

¹ Data of the Kazakhstan Statistics Agency, available at [<http://www.stat.kz/news/Pages/>].

² Data of the Kazakhstan Statistics Agency, available at [http://www.stat.kz/news/Pages/n_15_07_2009_3.aspx].

and in the West Kazakhstan region by 0.2%. In the Kostanai region, iron nugget production dropped by 18.9%. Copper ore production rose in the East Kazakhstan (by 68.1%) and Aktobe (by 14.3%) regions, while in the Karaganda region its production dropped by 0.8%. Steel manufacture rose in the Pavlodar (by 24.2%) and Kostanai (by 23.1%) regions, while in the East Kazakhstan and Karaganda regions, steel production dropped by 7.3% and 16.5%, respectively. The production of unwrought zinc increased in the Karaganda region by 5.1% and by 1.6% in the East Kazakhstan region. Refined copper production decreased in Almaty by 16.4% and in the Karaganda region by 0.9%. The greatest increase in energy production volumes was noted in the Zhambyl (by 40.5%), North Kazakhstan (by 20.0%), Almaty (by 11.9%), and Mangistau (by 11.1%) regions, as well as in Astana by 8.2%. The greatest decrease occurred in the Akmolinsk region (by 23.2%). The greatest increase in butter production was seen in the Zhambyl (by 3.9%) and Kostanai (by 1.2%) regions. At the same time, the largest drop in butter production was seen in the East Kazakhstan (by 28.8%) region and Almaty (by 24.9%). An increase in refined sunflower oil production was seen in the East Kazakhstan (by 29.2%) and Aktobe (by 1.2%) regions. A drop in refined sunflower oil production was noted in the South Kazakhstan (by 49.4%) region and in Almaty (by 39.9%). The production of fruit and vegetable juice increased in the Kostanai (by 13.8%) and South Kazakhstan (by 13.3%) regions. A drop in its production was seen in the Almaty region (by 71.6%) and in Almaty (by 23.9%).

(Data of the Kazakhstan Statistics Agency)

The year 2008 was marked by a sharp decrease in Kazakhstan's oil export revenues. The drop in world oil prices in 2009 prompted a decrease in oil production of 3 million tons, contrary to the government's official forecast (77 million tons).³ In addition, the Ministry of Economics is expecting a drop in production volume (of approximately 1%) in the metallurgical industry.

However in the first half of 2009, particularly in June, industrial production indices grew (see Figure 1); compared with May 2009, accelerated growth rates were seen in the mining (6.3%) and processing industries (9.9%). Crude oil and metallic ore production and the output of the machine-building, metallurgical, and food industries, including beverages and tobacco, increased.

The economic crisis in Kazakhstan is having a negative impact on the rise in the price index. By the end of 2008, prices reached an all-time high at every level. For instance, the consumer price index in December 2008 compared to December 2007 amounted to 109.5%. Food prices grew by 10.8%, non-food prices by 5.7%, and the cost of services by 11.4%. The prices for industrial products put out by manufacturing enterprises dropped by 18.6% in December 2008 compared to December 2007.⁴

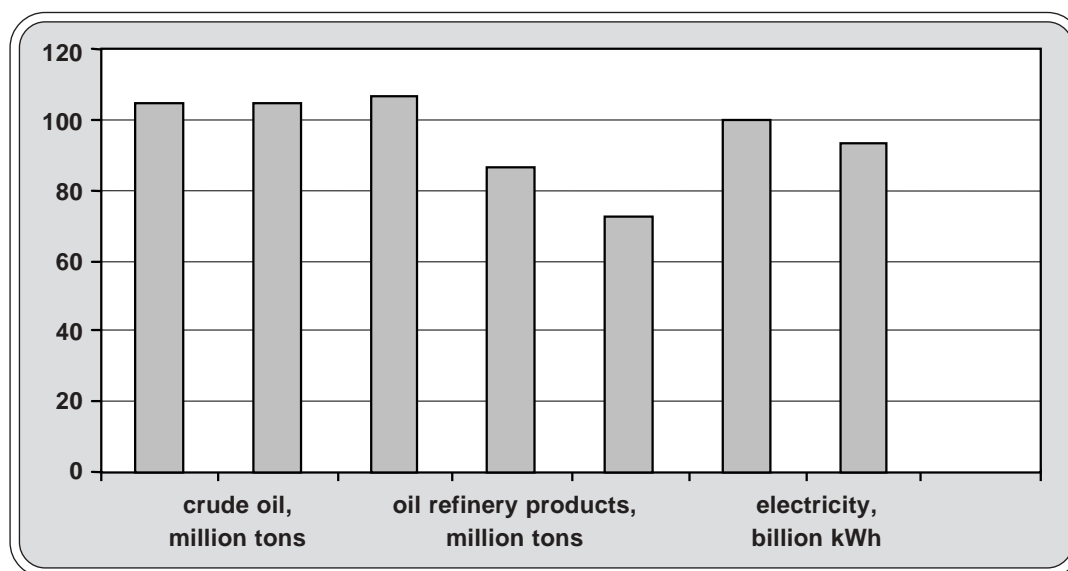
The situation improved slightly in the first half of 2009. In June 2009, the consumer price index amounted to 103.9% compared to December 2008. Food prices grew by 3.5%, non-food prices by 4.9%, and the cost of services by 3.3%. In June 2009, industrial product prices increased by 9.7% compared to December 2008.

³ According to the data of the State Statistics Agency, in 2008, 58,713,800 tons of crude oil and 12,024,100 tons of gas condensate were produced in Kazakhstan. This is 6.2% and 1.4% more, respectively, than in 2007. At a price of 40 dollars a barrel, it stands to reason that some fields can permit themselves a cutback due to a drop in profitability, available at [<http://regnum.ru/news/1112677.html>].

⁴ [http://www.stat.kz/news/Pages/n_17_03_09.aspx].

Figure 1

**Indices of the Physical Volume of Industrial Production
in Kazakhstan Compared
to the Corresponding Period of the Previous Year
(January-June 2009)**



During July 2009, food prices have increased by 0.2%, non-food prices by 0.6%, and the cost of services by 0.4%. But, according to many analysts, the decline in price growth rates was caused by the overall situation in the world, as well as the tight pricing policy conducted; this process will soon come to a halt.

The crisis has resulted in a significant drop in investment activity, both beyond the country and within it. The Kazakhstan government is resolving this problem by mobilizing large amounts of investment capital.

For instance, the Samruk-Kazyna Kazakhstan National Welfare Foundation is planning to attract additional funds (around 4 billion dollars) by floating the bonds of pension savings funds (PSF). There are plans to place the first tranche in March 2009 under the control of the government financial supervision agency (FSA). The average maturity of the bonds will be 15 years with a return on investment of 8.4% per annum, that is, "at the level of average return on investment of pension funds as of today."

The Kazakhstani government's anti-crisis program approved at the end of November 2008 presumes using the resources of the National Fund, budget, and pension funds. According to the FSA, pension savings accumulated in pension savings funds as of 1 November, 2008 amounted to one trillion 343.7 billion tenge (more than 11 billion dollars). At the end of 2008, 14 pension savings funds were functioning in the republic.

A decision was made to compensate for the shortage of financial resources by means of external acquisitions. Vneshekonombank of Russia will allot the Kazakhstan National Welfare Foundation up to 3 billion dollars for implementing several major projects.

In 2009, the government, along with business structures and foreign investors, began financing social projects; this step stabilized the situation in the financial market somewhat. According to the

results of the first half of 2009, the volume of investments in basic capital amounted to 1,794.1 billion tenge, which is 7.3% more than for the same period last year.

By the end of 2008, the economic and financial crisis in Kazakhstan had had such a strong impact on the national economy that it spread beyond the country's borders and affected its integration initiatives. In an attempt to resolve the domestic problems, the president of Kazakhstan came forward with an initiative to create a single world currency.⁵

Such worldwide integration initiatives do not provide real opportunities to use regional resources—currency integration is impossible even at the bilateral level.

In February 2009, the National Bank of Kazakhstan devaluated the local currency by 25%—to 150 tenge to the dollar against 120 tenge. The forecast of the Ministry of Economics and Budget Planning envisages further devaluation of the tenge—by 10% over an extended period.

Currency integration is only possible if there is a full-fledged common market of goods, capital, and labor, whereas Kazakhstan has still not reached that level. So its initiatives in this area can only be used piecemeal.

The 2008 year-end results are characterized by a drop in economic growth rates in the **Kyrgyz Republic**, although this drop was alleviated by an increase in GDP in the first six months. Real growth amounted to 7.6% or, not counting the enterprises engaged in developing the Kumtor field, to 5.4%. The per capita volume of GDP amounted to 35,100 soms (959 dollars) and increased by 6.8%.

In addition, the growing negative trade balance predetermined a deterioration in the indices of the balance of payments. According to the 2008 year-end results, Kyrgyzstan's negative trade balance amounted to 2 billion 416 million dollars.⁶

During 2008, industry manufactured products totaling 85.9 billion soms. In so doing, the growth rates compared to 2007 amounted to 114.9% or, not counting the Kumtor enterprises, to 97.9%. This situation arose for the following reasons.

First, the decrease in external demand for construction materials due to the world crisis had a negative impact on the development of industry. This resulted in a significant decrease in the growth rates of rubber and plastic goods production (78.3%) and the manufacture of other non-metal mineral products (88.2%) between January and December 2008.

As a result of the energy crisis due to wear and tear on the industry's fixed assets and the low level of water in the Toktogul reservoir, the growth rates in the production and distribution of electricity slowed down.

In particular, growth rates in the food industry enterprises slowed and amounted to only 101.1% in 2008 (105.2% in 2007). The same situation developed in the sewing industry. Whereas in 2007, the growth rates in this branch amounted to 145.6%, in 2008 they dropped to 115.7%.⁷

According to the National Statistics Committee, 481.0 million dollars in foreign direct investments were pumped into the economy in 2008 (compared to 324.4 million dollars in 2007).

There has also been a significant increase in the outflow of foreign investments, amounting to 287.6 million dollars (60% of the FDI invested), which is 2.1-fold higher than for the same period

⁵ Kazakhstan President Nursultan Nazarbaev believes that a single world currency should be created. According to the Kazinform Agency, the head of the Kazakhstani state said this at a business forum in Delhi. Whereby the head of Kazakhstan, who has previously made statements in favor of the idea of creating regional currencies, spoke against this initiative this time. According to him, such fragmentation could lead to "great chaos." "I think that the future measure consists in having an entirely fair world currency and not one issuer, as we have just now. This is an undemocratic, un-free, uncompetitive, and uncontrollable world currency. Instead of this, countries should come to terms on creating a world currency unit for exchanging goods that would be adopted by the U.N. and controlled by corresponding commissions, and we would have something to do with this currency," said Nursultan Nazarbaev, available at [<http://www.regnum.ru/news/1115303.html>].

⁶ The 24.kg IA presents these data with reference to the Kyrgyzstan National Statistics Board.

⁷ [<http://www.24.kg/economics/2009/25/01/107969.html>].

in 2007. This is explained by the consequences of the financial crisis. During 2008, when there was an acute shortage of funds, active attempts were made to raise the level of the country's investment appeal.⁸

These efforts resulted in a rise in Kyrgyzstan's rating. According to a report by the World Bank, it not only climbed up from 99th to 68th place in the 2009 rating, but was also included among the three countries considered to be advanced reformers. Measures will be carried out to implement the second stage of the Reforms for Business 2009 project, which will make it possible for the republic to raise its ranking even higher.

Kyrgyzstan occupies 7th place in the Free Trade category, 11th place in Investor Protection, 94th in Personal Freedom, and 115th and 117th in Innovations and Technology, respectively. In terms of corruption level, Kyrgyzstan ranks 123rd, with respect to bureaucracy 33rd, in the Tax Environment category it holds 107th place, and in Price Liberation 93rd. *Forbes* describes Kyrgyzstan as a poor mountainous country with a predominantly agricultural economy.⁹

The tight monetary and fiscal policy conducted in Kyrgyzstan kept the inflation rate below 20.0% from January to December 2008.¹⁰ The high inflation rates were caused by the increase in food prices during the second half of the year and the rise in prices for energy resources in the world markets during the first half.

Three factors had an impact on the slowdown in inflation rate—the drop in prices for agricultural products, the policy conducted by the government and National Bank, and the relative stability of the world economy at that time. In July, prices rose very slightly, and in August there was even negative growth.

Kyrgyzstan's financial system is quite stable due to the low level of integration of the country's banking structures into the world financial market. In so doing, it should be noted in particular that the negative impact of the crisis was manifested in a significant reduction in investment funds, since the main sponsors have external financing sources.

Kyrgyzstan's external debt, according to the Ministry of Finance, amounted to 2,076,850 million dollars at the end of December 2007, and 2,127,885 million dollars as of 31 December, 2008. So over the year, the state's external debt rose by 51 million dollars. Over the past four months, the debt has increased by 12 million dollars—in August 2008, it was equal to 2,115,906 million dollars. In December 2008, the Ministry of Finance spent 200 million soms (5 million dollars) to cover the external debt.¹¹

Kyrgyzstan lags behind the CIS countries in terms of investment growth rates in basic capital—the decrease in amount of deposits amounted to 5.4%.¹²

⁸ Within the framework of the New Economic Policy defined by the Kyrgyzstan president on 10 January, 2008, a Plan of Action for the country's government has been drawn up and approved for 2008, and a draft of its development strategy prepared (2009-2011). With the assistance of the Ministry of Economic Development, strategies and programs of socio-economic development of the regions for 2008-2011 have been prepared and approved in compliance with the new methodology and in keeping with the objectives and assignments envisaged in the draft of the development strategy renewed until 2011. In addition, the conception of a state regional policy has been drawn up that envisages accelerated development of the regions.

⁹ Ratings are compiled taking into account such parameters as human rights, democratic elections, freedom of speech, protection of minority shareholders, freedom of trade, low inflation, low profits tax, investment volume, and stock exchange indices. The top from *Forbes* is based on the assessments of the World Bank, Transparency International, World Economic Forum, Freedom House, the American Chamber of Commerce, the CIA, and several other organizations, available at [<http://www.24.kg/economics/2009/03/20/109765.html>].

¹⁰ The precise consumer price index for the year-end results of 2008 amounted to 20.1%.

¹¹ [http://www.madein.kg/ru/Finances/item1245_21012009].

¹² According to the CIS Statistics Committee, in 2008, the amount of investments in basic capital increased by 10% on average throughout the CIS compared to 2007. In some countries, a decrease in rates of 11% was noted. This is shown by the data of the Commonwealth's Interstate Statistics Committee. In the Commonwealth's other countries, the dynamics

In 2008, the inflow of direct investments into the country amounted to 580 million dollars. According to the 2008 year-end results, it rose in the World Bank's Doing Business rating to 68th place. The number of audits of economic entities in the republic has decreased by 28% and efforts are continuing to cut back on the licensing procedures. The volume of deposits in the country's banks has increased by 26%, while the inflow of loans into the country's economy rose by 20%.

The year 2008 saw a profound energy crisis, which was expressed in regular rolling black-outs for the population and corporations. But the government's main efforts were directed toward generating thermal energy, thanks to which there were no emergencies in the 2008-2009 cold season.

Migrants from Kyrgyzstan who work in Russia sent more than 870 million dollars home in 2008, which is almost twice as much as in 2007. According to the 2008 year-end results, the total amount of money transfers by labor migrants to Kyrgyzstan reached 1.2 billion dollars.

Kyrgyzstan has been focusing significant attention on economic security issues. In so doing, it also examined the financial and investment spheres, but in the context of the high inflation level particular attention was given to resolving food problems.

The official agencies have been reporting on the level of security reached for quite some time now. But the agrarian reforms of the 1990s basically resulted in a crisis in agriculture—local manufacturers could not compete with foreign companies and the rise in inflation essentially destroyed the domestic producers. All of this had a negative effect on the state of the agrarian sector.

This is mentioned in the draft of the republic's food safety conception for 2009-2013 drawn up by the Institute of Economics of the Kyrgyzstan National Academy of Sciences.¹³

The country's financial security is also threatened. According to the CIS Statistics Committee, a large part of investments came from foreign sources (30.6%).¹⁴

So the world financial crisis has aggravated the situation in the republic, but, on the other hand, it has also had a certain positive impact on the national economy.

Positive effects of the crisis:

- First, acute drop in outlays. All commodities that have an artificially high cost will drop in price (rent, real estate, logistics). Many medium-sized companies could become more efficient.
- Second, structural shifts in the economy. Inefficient and uncompetitive enterprises will go bankrupt, and the released resources can be used for other production units.
- Third, restoration and strengthening of sociopolitical stability; keeping macroeconomic sustainability under control, despite the galloping inflation and impact of the world crisis on the economy.
- Fourth, overcoming energy difficulties.
- Fifth, a drop in the total external debt as a percentage of GDP (from 80% to 46%) thanks to a correct strategy.

are positive. Tajikistan is the leader in terms of an increase in investments in basic capital for the second year running. This is associated with the construction of hydropower facilities. In addition to Tajikistan, the other members of the top three are Azerbaijan (34.3%) and Uzbekistan (22.4%). Among the outsiders, apart from Kyrgyzstan, are Armenia (growth at a level of 1.7%), Kazakhstan (4.6%), and Ukraine (4.7%) (see: [<http://www.cis/2009/02/12/106105.html>]).

¹³ [<http://www.24.kg/economics/2009/03/20/109731.html>].

¹⁴ According to this index, Kyrgyzstan ranks second in the Commonwealth after Tajikistan, where the percentage of foreign investments in the total amount of investments topped 70%. 28.8% of the investments in Kyrgyzstan were attracted in the form of household funds, 25.3% by means of enterprises' and organizations' own funds, and 11.5% in the form of budget investments.

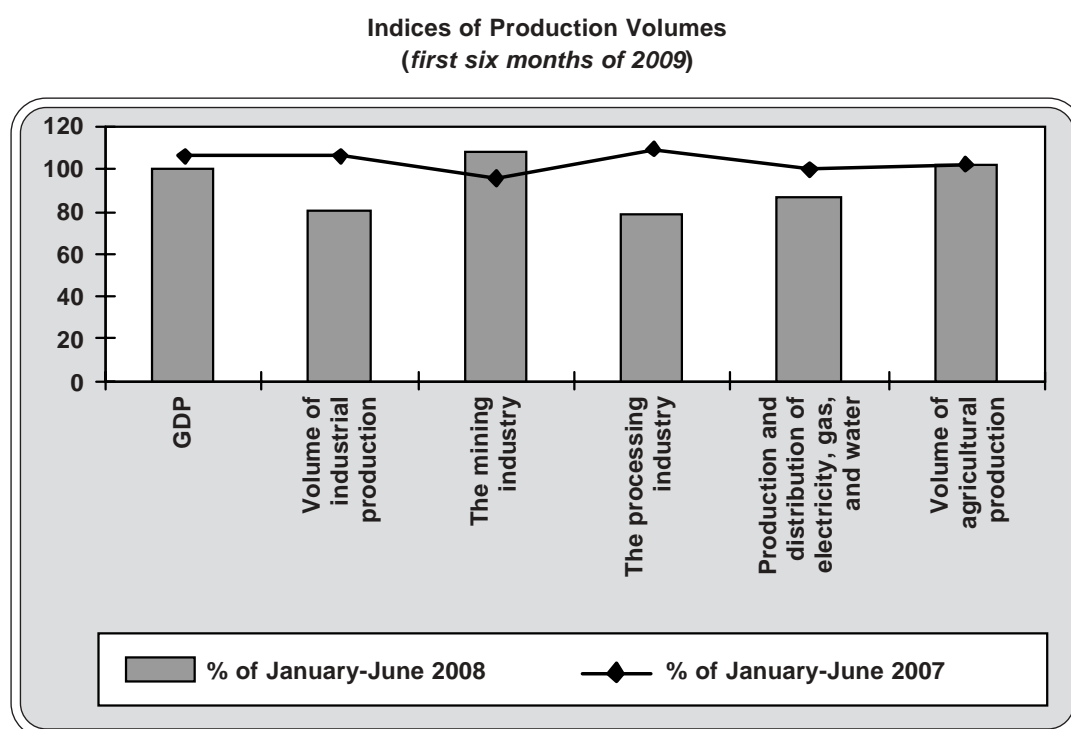
Negative effects of the crisis:

- Steady rise in production outlays and increase in prices for agricultural produce associated with the low demand for it and domestic manufacturers being pushed out by foreign companies.
- Abrupt decrease in funds allotted to agriculture from the state budget.
- Unsophisticated system for selling agricultural products, in which primary income is redistributed in favor of intermediaries.
- Absence of stable prices.
- Underdeveloped infrastructure of wholesale trade.
- Unequal competitive conditions with imported products.

In addition, a tight monetary policy, reform of the tax system, and the set of measures for activating state regulation of the economy in crisis conditions have yielded certain positive results. This is shown by the macroeconomic indices for the first six months of 2009. The volume of GDP in Kyrgyzstan for January-June 2009 amounted to 74,049 million soms, while the growth rates compared to the same period in 2008 reached 100.3% and 106.1%, respectively.¹⁵

Compared to 2007 (not counting the enterprises developing the Kumtor field), this index for the same period in 2008 was equal to 71,177.4 million soms, and the growth rates amounted to 101.3%. This was caused by a drop in demand for gold in the world markets and the delay in implementing the conditions of a contract with Canada's Centerra Company on field development.

Figure 2



¹⁵ Data of the Kyrgyzstan National Statistics Committee. Express information of 7 July, 2009, available at [<http://stat.kg/>].

The past period of this year was characterized by the negative impact of the world financial crisis on the main industrial branches; only four of them have positive physical volume indices: production of fuel and energy minerals (109.3%), production of other mineral resources (111.7%), manufacture of coke, petroleum products, and nuclear materials (3.8-fold), and manufacture of leather and leather goods (2.5-fold).

The percentage of industries that have not reached the corresponding physical volume index according to the results of the first quarter of 2009 amounted to 95.6%, and of the most backward to 95%.

The decrease in indices (not counting the Kumtor field) is associated with the worsened situation in the key branches of the economy: food production (94.7%), textile and sewing industry (57.8%), manufacture of building materials (36.7%), metallurgy and the production of metal goods (78.7%), and electricity production (84.8%). Their share amounted to 88.5%.

All the same, since March 2009, industry has been experiencing positive dynamics. The enterprises that came to a standstill due to the crisis have begun operating again, their numbers reaching 43.¹⁶

For instance, the Kant cement, the Kadamjai antimony, and the Khaidarkan mercury combines have resumed operation. However, due to the routine repairs being carried out, the Interglas factory in Tokmak for the manufacture of sheet glass is still standing idle. Special control is being maintained over the situation at the Mayлуу-Suuy electric lamp factory by the Kyrgyz Ministry of the Energy Industry. This factory is operating and putting out products, but the former owners left a multi-million debt.

In June, the consequences of the slump had still not been overcome. In the first half of 2009, the volume of industrial production dropped by 20%. A problematic situation has developed in the manufacture of building materials, due to which Kazakhstan has refused to purchase these products.

The consequences of the financial crisis are still having an impact on Kyrgyzstan's economic development. The drop in demand for the country's products from neighboring countries and the decrease in revenue transferred by labor migrants could lead to a deterioration in the stability of the balance of payments, which will have an effect on the som exchange rate.

In June, the National Bank of Kyrgyzstan continued conducting a policy aimed at preventing abrupt fluctuations in the exchange rate of the national currency, thanks to which stability is being retained.

According to the results of 2008, **Tajikistan** became part of a separate sub-group of the IMF known as "a low-income CIS country."

The real growth of the GDP in Tajikistan in 2008 amounted to 4.1%, while in 2009 IMF experts forecast an increase in this index to 7.0%.¹⁷

In the first half of 2009, Tajikistan's economy, as economies throughout the world, has been developing in a state of crisis. Tajikistan's economic growth is still at a rather low level—the increase in GDP for the first six months amounted to 2.8%, the gross agricultural product increased by almost 15%, and the domestic consumer demand for goods by 14%. In the first six months, compared to 2008, the GDP level rose by 5.8%.¹⁸

Due to the dynamic development in the service sphere, Tajikistan managed to keep up the GDP growth despite the significant drop in production, which amounted to 13.3% in January-June of this year (to 2 billion 558.9 million somoni). For the same period in 2008, this index was equal to 3.9%. The drop in manufacture of industrial goods is associated with the cutback in production of primary aluminum, which constitutes the basis of Tajikistan's export. Production in the fuel and energy industry compared to the same period last year decreased by 7% (365.9 million somoni). According to the Statistics Committee, Tajikistan was the only country in the CIS where such a drop in industrial production was registered.

¹⁶ [<http://www.24.kg/economics/2009/07/10/116023.html>].

¹⁷ Earlier, the IMF forecast an 8% increase for the country in 2008.

¹⁸ Data of the Tajikistan State Statistics Committee, available at [<http://www.state.tj>].

There is high social tension in the republic due to galloping inflation and the decrease in household incomes; money transfers from labor migrants have decreased.

There is an unfavorable business atmosphere in the republic, which is making investors less active. Tajikistan occupies 159th place out of 181 in the annual business freedom index of the World Bank. Enterprises are established with great difficulty in the republic, and the mechanisms for obtaining loans and managing international trade are not very effective.

The drop in prices for cotton and other exported agricultural crops has led to a decrease in foreign exchange receipts.¹⁹ In this situation, one of the priority vectors should be diversification of the agricultural sector.

At the end of 2008, the sharp rise in the dollar exchange rate with respect to the national currency (from 3.41 to 3.47 somoni to the dollar) led to an increase in inflation.²⁰ In January-June 2009, inflation rose by 2.8%, while for the same period of last year its increase amounted to 8.3%, which essentially brings up the low economic growth rates.

In January-June of this year, food prices grew by 2.1%, non-food prices by 2/4%, while the cost of services increased by 7.3%.

In so doing, according to experts, by the end of 2008 Tajik banks essentially had no foreign currency due a significant decrease in the transfers from abroad (including from labor migrants). In addition, the drop in prices and decrease in demand for Tajikistan's main export commodities—aluminum and cotton—played a negative role.

The direst consequence of the financial crisis was the cutback in revenues in 2008 from migrants and their return home. By the end of the year, this process had accelerated and in the first half of 2009 it speeded up even more. For example, 109 Tajik labor migrants were deported from Kazakhstan in 2008.

A dramatic slump is expected in the private sector due to the decrease in monetary transfers sent by migrant workers, and the consequences of this will be felt in the near future.

In the meantime, however, there may be some slight recovery, but this will be followed by an abrupt nose dive. Since the country is an oil importer, it will benefit in the near future from the dramatic drop in prices for energy resources. The same goes for the import of fertilizers and foodstuffs. The drop in prices will help to curb the burgeoning inflation.

This economizing will make it possible to buy raw materials (for example, for the aluminum plant in Tursunzade), but the effect will not be that significant since the prices for the goods produced, including aluminum and cotton (the main articles of the republic's export), are correspondingly dropping.

There is a real danger associated with money transfers. According to different sources, almost 1.5 million residents of Tajikistan's six-million population currently live and work outside the country, mainly in Russia and Kazakhstan. According to the statistics of the World Bank for 2008, migrant workers transferred 1.25 billion dollars home. According to unofficial data, this figure is much higher and could constitute up to 60% of the country's GDP. This makes the question of whether or not the workers living abroad can survive the world economic crisis rather important.

One of the main negative factors influencing the republic's economy is the drop in demand and decrease in world prices for the republic's main export goods—aluminum and cotton fiber. The cutback in trade operations has resulted in a noticeable drop in currency transfers and deterioration in the operation of these branches—during the first half of 2009, the drop in industrial production amounted to 13%.

In the first half of 2009, Tajikistan's foreign trade turnover shrank by 30.6% compared to the same period last year and amounted to 1 billion 615.8 million dollars, including electricity and natural gas, which is 30.6% (713 million dollars) less than the previous index.

¹⁹ Although the country is still mainly oriented toward growing cotton plant, this sector has been experiencing significant losses since the collapse of the Soviet Union in 1991. Between 2003 and 2007, when the prices in the world goods markets dropped, the percentage of cotton plant growing in the volume of the GDP decreased from 9 to 2%.

²⁰ On the National Bank's website, one dollar is equal to 3.4190 somoni.

A trade deficit (793 dollars) has developed, in particular, the deficit with the CIS countries amounted to 576.3 million dollars, and with the countries of the Far Abroad to 216.7 million dollars.

The volume of goods export for the period under report amounted to 411.4 million dollars, which is 380.4 million dollars (48%) less than for the same period of the previous year. The import of goods into the republic amounted to 1 billion 204.4 million dollars, which is 332.7 million dollars (21.6%) less than the January-June 2008 index for 2008. Compared to the previous month, export in June decreased by 3.2% and import by 9.9%.²¹

The situation in Tajikistan's hydropower sector is still complicated. It is associated not only with the insufficient volumes of electricity production, but also with the disagreements (with Uzbekistan) about building the Rogun GES.

Due to Tajikistan's debts (around 9 million dollars), Uzbekistan has cut back gas deliveries to the republic by 50%. At present, the country is receiving around 800,000 cu m of gas a day instead of the 1.65 million cu m that used to be delivered. The consumers' debt to Tajikistan's gas distributing company is around 18.7 million dollars, 10 million of which is owed by the population of the Tajik capital. As a result, the delivery of blue fuel to the TajikAzot and Tajiktsement enterprises has been completely halted.

Uzbekistan is the only exporter of natural gas to Tajikistan, which is unable to meet its needs by means of its own production, and the price of gas is set annually on the initiative of the Uzbek side.²²

In 2008, **Uzbekistan** maintained a stable position in the conditions of the international loan crisis and economic slump in the developed countries. The GDP growth rates in the republic amounted to 9%, there is a stable net surplus in foreign financial transactions and the budget, currency reserves continue to increase, and stability is being maintained in the banking system.

The increase in inflation has been curbed, although its rates are still high. Consistent execution of a rather tight monetary policy has made it possible to keep this process within the limits envisaged by the forecasts at a level of 7.8% per annum.²³

The growth rates in industry amounted to 112.7%; including to 117.7% in the production of consumer goods and to 21.3% in the service sphere.

Other important branches of the economy have also been developing at stable rates: construction has increased by 8.3%, transport shipments by 10.2%, and the trade sphere by 7.2%. In agriculture, the growth rates amounted to 104.5%; 3,410,000 tons of raw cotton have been prepared and 6,330,000 tons of grain have been produced, including 6,145,000 tons of wheat.

The state budget has exceeded the target—instead of the projected deficit, it recorded a surplus of 1.5% of GDP. Such are the data for the end of 2008.

In the first half of 2009, the indicated trends continued. According to the official data,²⁴ despite the world financial economic crisis, the socioeconomic policy pursued and the timely anti-crisis measures carried out ensured the stable, balanced, and sustainable development of the economy.

According to official statistics, in the first half of 2009, the increase in Uzbekistan's GDP amounted to 8.2%. The increase in industrial production reached 9.1%, in consumer goods 13.1%, in agriculture 4.6%, in services 18.5%, and in construction work 32.5%.

The state budget was executed with a net surplus of 0.3% of GDP, while the inflation level did not exceed the forecast indices. Real household incomes during the first half of the year grew by 25.9%.

²¹ Data of the Tajikistan State Statistics Committee, available at [<http://www.state.tj>].

²² The Uztransgaz Company informed the Tajik side that the price of the blue fuel to be delivered in 2009 would more than double—to 300 dollars per thousand cubic meters of fuel. This price did not suit Tajikgaz. Its representatives say that in the context of the global economic crisis the price of energy resources is dropping in the world markets. In 2008, Tajikistan imported gas at 145 dollars per thousand cubic meters from Uzbekistan, which was 1.5-fold higher than the price for 2007.

²³ Data of the official statistics, available at [<http://www.regnum.ru/news/>].

²⁴ From the speeches of officials, available at [<http://www.gazeta.uz/2009/07/18/gdp/>].

One hundred and forty-one billion soums have been invested in international and nationwide construction and road repair measures; and work totaling 61.1 billion soums has been carried out at meliorating and irrigation facilities.

The increase in amount of capital investments assimilated in the first half of the year amounted to 32.7%; while foreign direct investments grew 2.6-fold. Seventy-one point one percent of the total investments went to production needs.

Despite the worsening situation in the foreign market, the foreign trade turnover increased by 21.4% in 2008, whereby the export of goods and services rose by 28.7%. As a result, the positive balance in the foreign trade balance increased, which is a very important indication of the reliability of the balance of payments and stability of the economy as a whole.

Stable growth trends in the percentage of competitive production and a drop in the percentage of the deliveries of the raw material branches are clearly seen in the export structure. The production of non-raw material goods in 2008 amounted to more than 71%. In so doing, the export of cotton fiber traditional for Uzbekistan decreased from 20% (2003) to 12% (2008).

Last year, important decisions were made to raise the capitalization level of leading banks such as Uzpromstroibank, Asakabank, Pakhtabank, Gallabank, and others. A presidential decree was adopted on increasing the authorized capital of Mikrokreditbank, which is one of the main lending centers for financing small businesses and private entrepreneurs.

The inflow of additional resources resulted in the total capital of the republic's banks increasing compared to 2007 by 40%, and before 2010 this amount is predicted to double.

However, according to the forecasts for 2009, the slump in the world economy due to the drop in prices for exported goods in Uzbekistan's main trade partner countries will have an effect on the economic situation in the republic, and money transfers will also decrease.

But the country's economy is not integrated into the financial markets of the developed countries and is unlikely to be adversely affected.

"With its strong macroeconomic position, Uzbekistan has significant resources for financing a precisely targeted economic policy that will maintain growth. The task is to alleviate the impact of the world crisis on economic growth with the help of a timely and precisely targeted policy along with ensuring financial stability and a decrease in inflation," this is the official viewpoint, which is confirmed by the data of the republic's Statistics Committee.

All the same, crisis phenomena exist in the national economy. They are evidenced by the following parameters: the high level of inflation, the abrupt drop in the soum exchange rate, the growing level of unemployment, the increase in the number of labor migrants, and the low level of household incomes.

Special attention should be given to the fact that Uzbekistan's aggregate external debt as of 1 January, 2009 amounts to 13.3% of GDP and is characterized according to the international ranking system as "less than moderate."

The main economic regulation measures include an expansive fiscal policy, a tight monetary policy, currency restrictions, and restraining a drop in the soum exchange rate. It is also necessary to bolster trust in the banking system by freeing banks from functions that are not characteristic of them and helping them to acquire cash, as well as resolving issues relating to an increase in national revenues and price formation.

So the state of the economy of the region's countries (Kazakhstan, Uzbekistan, Kyrgyzstan, and Tajikistan) is characterized by an extremely unstable domestic political and economic situation: the state budget is being formed with a large deficit; pricing policy is not coordinated with the purchasing power of the population and the vendibility of the market; there is still high inflation and a crisis in the banking sphere; stagnation of the industrial sector of the economy is increasing, and there is a drop in the GDP growth rates.

Manifestations of the crisis in each of the countries depends on the specifics of branch development of the national economic systems and the level of market changes.

For example, Kazakhstan, which is characterized by a high level of development of market institutions, a powerful industrial complex, and a developed banking system, and which has large investment resources, suffered from the financial crisis more than other countries of the region.

The country's developed banking system, which is integrated into the world financial market, made active use of the contemporary forms of mortgage lending and investments in the securities market. As a result, it is currently dealing with serious problems associated with the lack of solvency and mass bankruptcy of borrowers and the depreciation of the capital being floated on the securities market.

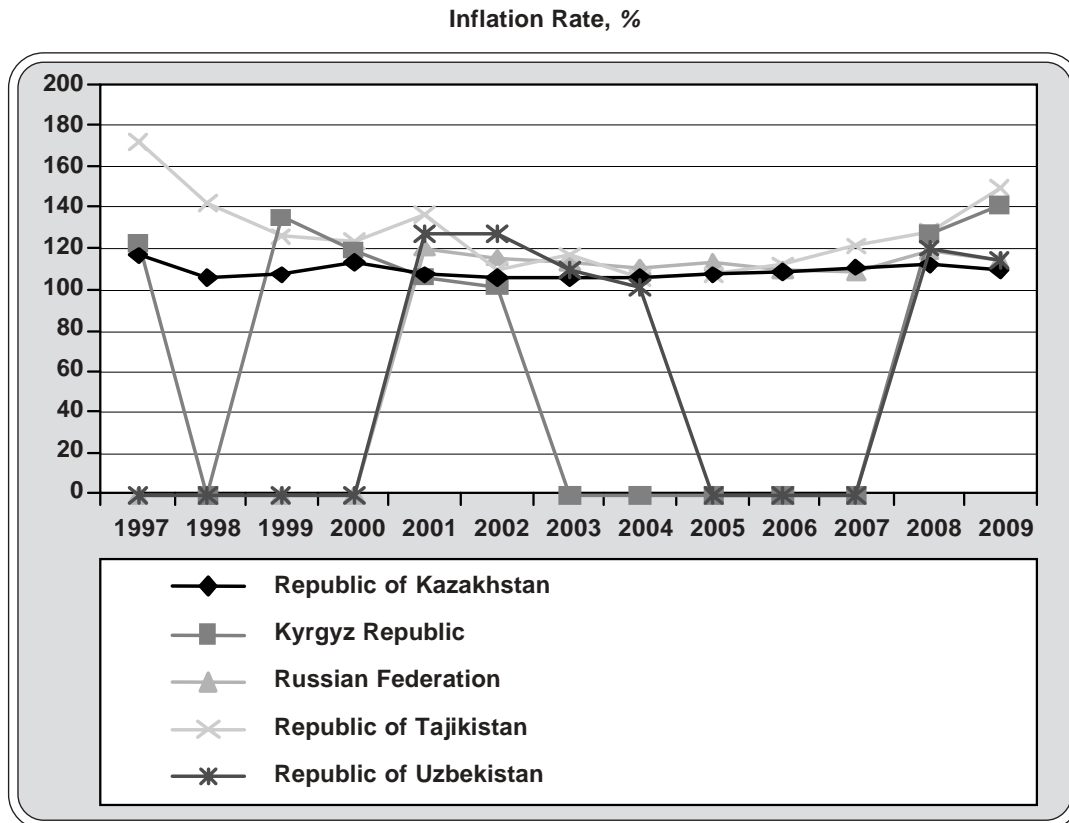
Uzbekistan did not have any particular problems, since the country's economy is the least integrated into the world financial markets ("a closed economy") and has a weak banking system. But this did not save the republic from inflation, a drop in the GDP growth rates, and a decrease in consumer demand.

A profound slump is seen in all branches of the economy in Kyrgyzstan and Tajikistan. These countries have the highest inflation rates—26.6% and 29.8%, respectively, and the lowest GDP growth rate (around 6%). These are the worst indices in terms of the 2008 results in the CIS countries (see Fig. 3), which shows the unsophisticated nature of their national economic systems and national markets.

Kazakhstan is showing the lowest inflation rate, which is approximately at the same level as the Russian Federation. This can be explained by the export resource of fuel and raw minerals. All the same, the republic is unable to help its regional neighbors fight inflation.

It should be noted that the increase in the GDP index shows the gross increase due to inflation and the increase in development rates in the trade and intermediary sectors of the economy. The industry of these countries is increasingly yielding the national market to imported goods.

Figure 3



Inflation on basic goods in Kyrgyzstan and Tajikistan is leading to the depletion of cheap goods, which primarily has an effect on the disadvantaged groups of the population and could lead to an increase in their discontent.

In Kyrgyzstan, inflation on food products has already led more than once to political instability. Today, this turn in events is extremely undesirable since it will deal a hard-felt blow to the faltering national economy.

According to official data, the GDP growth rates in almost all the countries of the region remain at the level of 7-8% a year, whereby the increase in industrial production amounts to 3-4% (see Fig. 4).

Uzbekistan is an exception—it is ahead of its neighbors.

But it should be kept in mind that the increase in GDP is determined taking into account the inflation index. On the whole, relying on the data presented below, the conclusion can be drawn that the CA countries do not have the necessary potential to independently overcome the crisis phenomena in their economies.

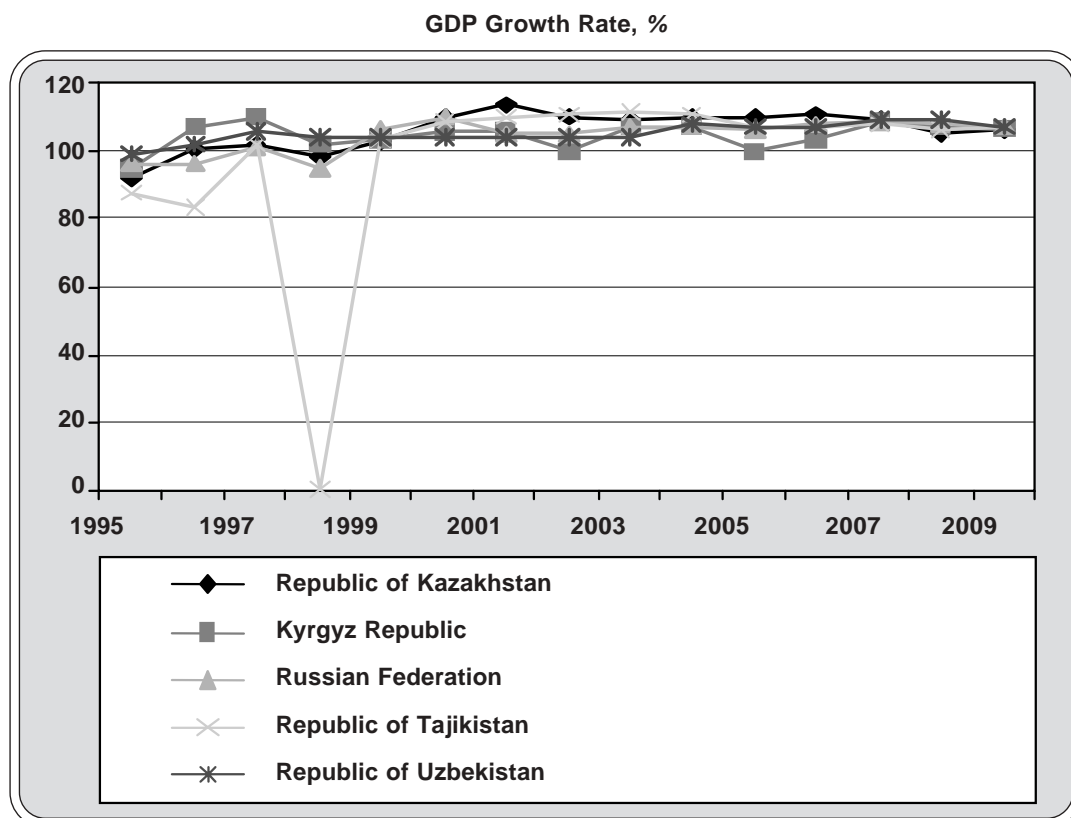
The situation is complicated in Kyrgyzstan and Tajikistan by the energy crisis and its consequences cannot be overcome without help from the outside.

The reasons for the economic instability existing in the republics vary.

The energy crisis in Tajikistan is the result of the civil war, irrational use of resources, and technological backwardness.

In Kyrgyzstan, there is a high level of wear and tear on the basic means of production and an unsophisticated system for using the country's hydro resources.

Figure 4



As early as 1995, specialists warned about the need for rational use of the hydro resources of the Toktogul reservoir; there was talk about the possibility of using different operational regimes for producing electricity and ensuring the needs of agriculture.

But instead of resolving the problems of domestic consumption, electricity manufacturers began orienting themselves more toward the foreign market, which indicates the absence of a balanced state approach to the use of the country's main strategic resource.

Probably the biggest mistake is that instead of mobilizing additional resources to reconstruct the branch, the government decided to raise its efficiency by means of privatization, that is, a change in owner. In the conditions of hydro resource shortage, this decision is absurd. And rolling blackouts are unlikely to resolve the problem, this will not increase the amount of water in the Toktogul reservoir by much.

Here are the main trends that have been seen in the CA countries' economy since the beginning of the world financial crisis.

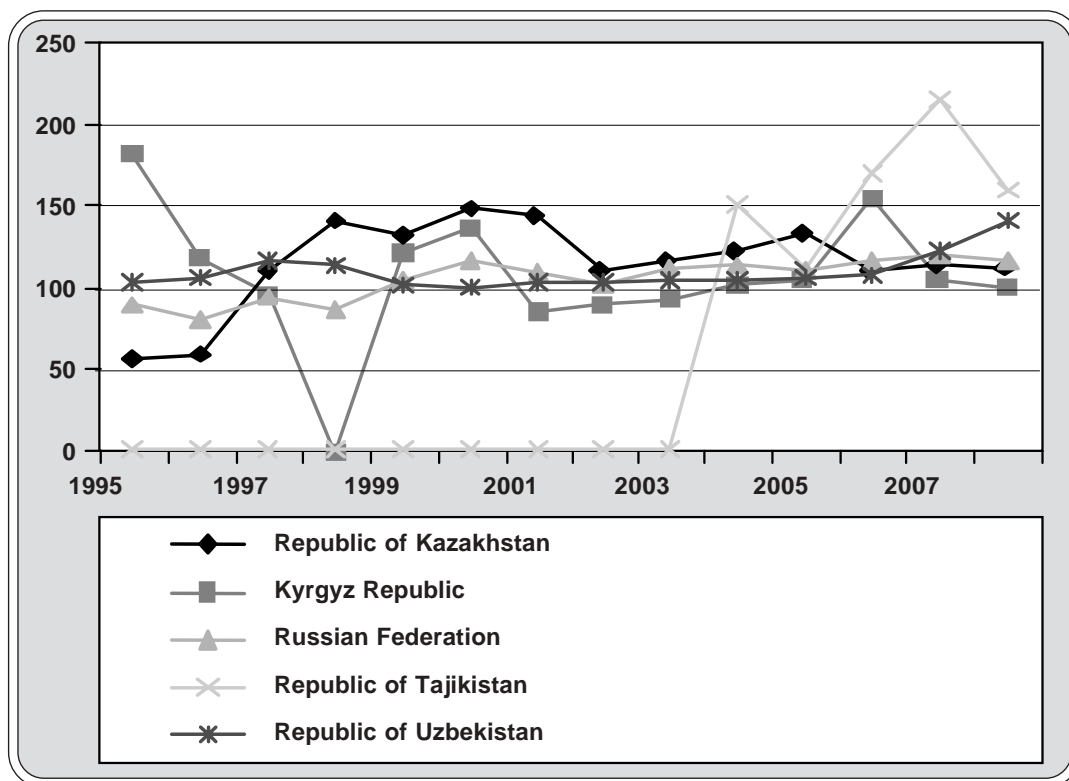
Since August 2008, there has been a sharp increase in inflation rates in essentially all the countries; it reached its peak at the end of September in Tajikistan (29.8%) and in Kyrgyzstan (26.3%).

By the end of the year, the inflation rates had dropped. There are the following reasons for this: the impact of the world economy, the anti-inflation policy conducted by the governments and national banks of the region's countries (drop in interest rate), and the decrease in prices for agricultural products (the region's economy is predominantly agricultural).

During the same period, there was a drop in investment activity due to the impact of the world financial crisis and the shortage of the republics' own financial assets.

Figure 5

Investment Growth Rate in Basic Capital, %



The volume of investments in 2008 compared to 2007 dropped by 2.2%. In Kazakhstan, this index increased by 8.2%, and in Uzbekistan by 19.8%.

The highest investment growth rate in the CIS has been registered in Tajikistan at 77.5%. This abrupt leap was due to the funds invested in the construction of the Rogun GES.

On average, however, the increase in investments in basic capital in all the countries amounted to 13% by the end of 2008, and in January-September 2007 to 21%. The increase in investments from states that are not members of the CIS or the EurAsEC was due to the decrease in investment activity.

Kazakhstan has the best indices in terms of investment growth rates in basic capital and amount of foreign investments. But it should be noted that funds came in spasmodically (see Fig. 5), and in recent years this inflow slowed down even more. This testifies to the republic's unstable financial market, which was confirmed by the 2009 banking crisis.

In recent years, the level of investments in Tajikistan has abruptly risen (almost half of them are Russian), which was promoted by the political stability in the country.

Other countries of the region are showing low investment activity, although in the 2009 forecast Uzbekistan plans to increase its efforts in this area.

On the whole, this indicates the low potential of economic growth in the region's countries.

The currency fluctuations in the exchange rates of the national currency were first characterized by their abrupt growth and then by a drop in the value of monetary units. In this respect, the following possible alternatives were discussed for recovering from the situation that developed: transfer of interstate payments to the ruble zone or transfer to payments using national currencies.

In all the republics, an increase in imports and decrease in exports is seen, which is leading to the formation of a negative trade balance and deterioration of the situation in the payment sphere.

The CA countries have a low export potential (the main index of competitiveness), which is expressed in a high level of raw material production. Despite the increase in the physical volume of export deliveries, the trade balance of the region's countries is worsening (see Fig. 6).

A positive increase in the export of finished products is seen only in Kazakhstan, but its percentage is very small and does not meet the demands of the world competitiveness standards.

From this we can conclude that the foreign trade potential of the CA countries will not allow the region to exist autonomously, that is, it needs help from the outside, which comes mainly from Russia.

The drop in consumer demand was caused by the decrease in the level of household incomes and decline in the profitability of enterprises. This trend is seen mostly in construction and in the service sphere.

All the above-mentioned factors are helping to develop the recession of the national economic systems, particularly in Tajikistan and Kyrgyzstan.

Essentially every country is pursuing a policy of additional capitalization of the banking sector due to the threat of a liquidity crisis. Kazakhstan is in the most difficult situation. Because of the relatively developed nature of its national economy, it has suffered most of all from the mortgage crisis, which created serious threats to the stability of the country's financial sector.

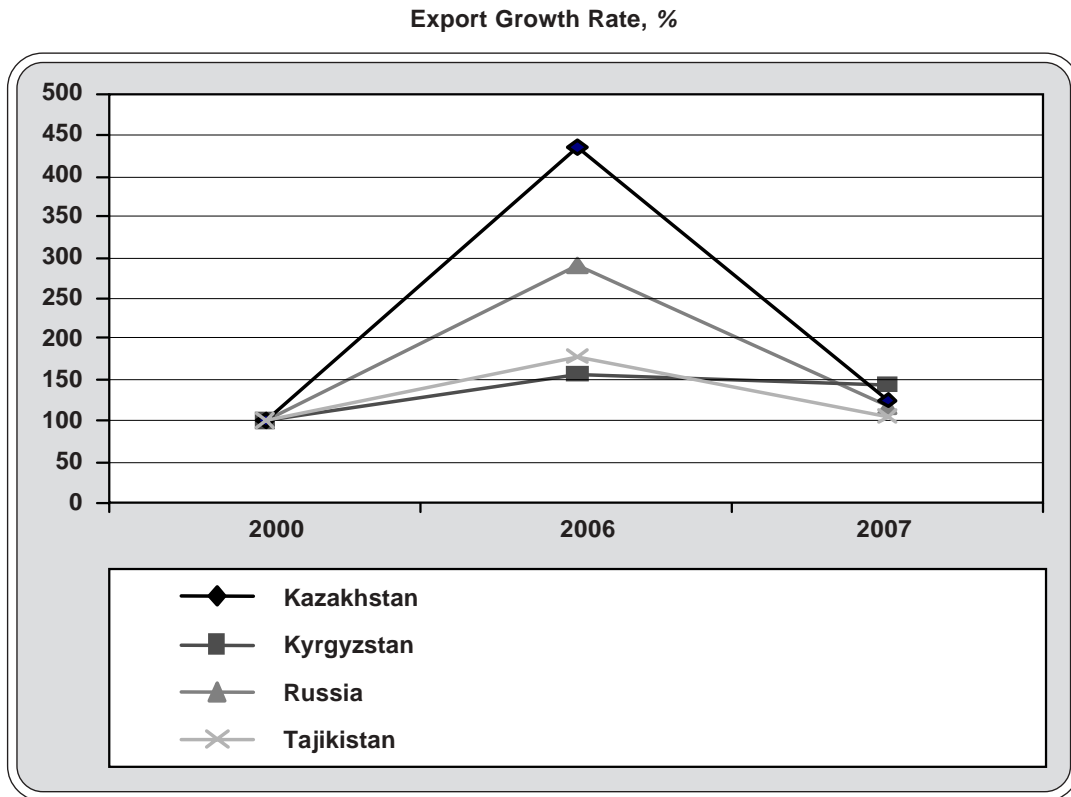
Measures were taken to ensure additional state lending to small and medium businesses, but in two months a positive result was not achieved. This failure is due to the fact that investment funds went into financial circulation, whereas they can only be effective if they are used directly by the state to finance business facilities at low interest rates.

The governments of all the countries of the region have officially recognized the problems their countries are facing and have begun to form a system of anti-crisis management measures, which should have been implemented at least six months ago.

State regulation measures are mainly ineffective, since they do not take into account the specifics of the countries' own economy, are populist in nature, and do not have smoothly operating mechanisms for carrying them out.

For example, state assistance to business in Kazakhstan (from the Kazyna Foundation) has not yielded positive results. Monetary resources transferred to the banking sector were mainly used to

Figure 6



strengthen the liquidity of the banks themselves, while the small amount that was intended for issuing loans became accreted with exorbitant interest rates, that is, state assistance did not reach its target.

In essentially all of the region's countries (with the exception of Kazakhstan), the world financial crisis only exacerbated the economic problems already existing there, sometimes transforming them into a systemic economic crisis.

In Kyrgyzstan and Tajikistan, the structural and energy crisis escalated into a systemic economic crisis, in Kazakhstan, the financial crisis entailed a drop in economic development growth rates (the first sign of an economic crisis); while in Uzbekistan, the structural crisis is acquiring the nature of an economic crisis.

The difficulty of the situation in the region's countries lies not so much in the fact that a crisis exists as in the fact that they do not have their own reserves to overcome it. They are copying the anti-crisis programs of the developed countries, which requires large financial resources and an efficient management system at all levels and also envisages a high level of market relations.

Not one of the CA countries has such resources. This is leading to an increase in financial dependence on external sponsors, that is, to a loss of independence in decision-making. The only solution to this situation might be to pool their own resources and overcome the current contradictions by means of integration both within the region and beyond it.

**AZERBAIJAN FINANCIAL AND
BANKING SYSTEM DURING
THE GLOBAL CRISIS:
SHIFT OF EMPHASIS
IN INTERNATIONAL COMPARATIVE
ASSESSMENTS**

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Introduction

The creation of a robust, innovative financial and banking system capable of meeting the needs of society is among the strategic tasks of the republic's economic policy aimed at ensuring the national sovereignty of this system as the country integrates into the global market. A sound financial system and increasing competitiveness of the banking sector are effective factors of sustainable economic growth making it possible to survive the global financial and economic collapse with relatively insignificant losses.

International comparative assessments are among the main instruments for analyzing the financial and credit strength and vulnerability of individual countries. At the same time, the realities of the global crisis show that the techniques, principles, emphasis and focus of these assessments in current conditions should change radically. Otherwise their objectivity and validity will be called into question, and this will in turn have a negative impact on the decision making process.

**Azerbaijan Financial and
Banking System
during Global Turmoil**

At the turn of the century, Azerbaijan entered a stage of active reform in all areas of social life, characterized by significant improvements in economic indicators and rising living standards. Today the country has one of the most dynamic economies in the world. In the last five years, the

country's economy grew 2.6-fold. And in 2008, faced with the challenges of the global crisis, our national economy demonstrated high stability and dynamism: in terms of GDP growth (10.8%), Azerbaijan ranked first among the CIS countries. It is interesting to note that non-oil GDP increased even faster: by 15.7%.¹ According to the International Monetary Fund (IMF), GDP (PPP) per capita increased 3.9-fold in 2000-2008 and reached a sufficiently high level for transition economies: \$8.6 thousand.²

The positive trend caused by the general economic recovery and rising household incomes in Azerbaijan in recent years has **strengthened the positive trends in the financial and banking sector**.³ Statistical data show that undeniable progress has by now been achieved in this sector in terms of its main quantitative and qualitative parameters.

In 2008, the republic's state budget revenues increased 1.8-fold, and their share in GDP rose by 4.5 percentage points. The consolidated budget surplus was 11% of GDP. In investment policy, priority is given to the use of domestic financial resources, whose share is now close to 75%. Moreover, Azerbaijan itself is gradually turning into an exporter of capital. In 2008, the current account of the balance of payments recorded a surplus of \$16.5 billion (35.6% of GDP). Total foreign assets, as a rule, far exceed foreign liabilities (at the beginning of 2009, 1.8 times). The country's net international investment position was positive at around \$11.9 billion.⁴ The manat exchange rate against the world's major currencies is strong and stable. Capital flows have been completely liberalized.

Total bank assets have grown, their structure and quality have improved, and the total amount of corporate and retail deposits has increased. The capital base of credit institutions has been strengthened, the supply of innovative banking products and services has increased, and the bank branch network has expanded significantly. The external liabilities of banks remain at a controllable level (as of the end of 2008, 23% of total bank liabilities). Due to the constructive activities of the Central Bank of Azerbaijan, significant successes have been achieved in arranging bank regulation and supervision and in bringing them into conformity with advanced international practice.⁵ In order to encourage recapitalization of the banking sector, since the beginning of 2009 retained earnings are exempt from tax. The legal and institutional frameworks for this sector of the economy have been improved, and its infrastructure has strengthened rapidly. More attention is being paid to the use of progressive technologies and the latest management information systems.

Azerbaijan's strategic international reserves—tangible evidence of the financial health of any state—have increased more than 12-fold in the last five years. In 2008 alone they increased by \$11 billion to a total of \$18.2 billion, which is almost 6 times in excess of the external public debt. In months of imports, foreign exchange reserves rose to 27 months, which is 3.4 times the figure for 2005.

Thus, despite the global liquidity crisis, **Azerbaijan's financial and banking system demonstrates sufficient stability in the face of economic upheaval in world markets thanks to ef-**

¹ See: *Statistical Bulletin of the National Bank of the Republic of Azerbaijan*, Baku, No. 5, 2009, p. 4.

² See: *IMF World Economic Outlook Database*, April 2009.

³ Current trends in Azerbaijan's financial and banking system are examined in greater detail in the scientific works of J. Hajiev, Chairman of the Board of the International Bank of Azerbaijan (see: (J. Hajiev, *The Monetary System and the International Bank of Azerbaijan*, CA&CC® Press AB, Stockholm, 2009, pp. 104-153); J. Hajiev, "Vremia—dumat o budushchem," *BDM. Banki i delovoi mir*, Moscow, No. 4, 2009, pp. 52-53), E. Ismailov, President of the Azerbaijan Banks Association (E. Ismailov, "National Currencies of the Central Eurasian Countries in the Context of Financial Globalization," in: *Central Eurasia: National Currencies*, CA&CC® Press AB, Stockholm, 2008, pp. 23-31) and Z. Mamedov, doctor of economics, professor at the Azerbaijan State Economic University (Z. Mamedov, "Denezhno-kreditnaia sistema Azerbaidzhana," *Obshchestvo i ekonomika*, No. 3, 2009, pp. 82-106).

⁴ See: *Statistical Bulletin of the National Bank of the Republic of Azerbaijan*, pp. 7-9.

⁵ This is indicated in a report by Standard & Poor's (see: *Bank Industry Risk Analysis*, S&P, 1 June, 2009).

fective measures implemented in recent years by the Ministry of Economic Development, Ministry of Finance and Central Bank of Azerbaijan. It is no accident that in contrast to similar systems in some other CIS countries it has avoided a heavy withdrawal of deposits and a large-scale outflow of foreign investments caused by panic after the outbreak of the world crisis.⁶ This is exactly why the republic today is not faced with the problem of overcoming the risks associated with such processes.

International Assessments of the Financial and Banking System: the Need for a New Paradigm

The process of integration and globalization of financial markets dictated the need for international assessments allowing a comparative analysis of certain sectors of the economy. The use of assessments (instead of precise measurements or calculations) of both individual parameters and integral characteristics of the objects under study is a generally accepted and time-tested method for creating and using scientific knowledge in economic research. In recent years, extensive use has been made of so-called ratings and rankings, which have proved to be a convenient and reliable instrument for reasoned economic decision making.

Ratings are universal: based on the construction of a composite indicator which makes it possible to assess both the quantitative and qualitative parameters of a given object, they have such properties as dynamism, predictability and adjustability. They are used by researchers and experts in conducting international comparative studies and in selecting “the only true” option from among numerous alternatives.⁷ In the modern sense, **ratings/rankings** are a comprehensive assessment of the state of the entity being analyzed, which makes it possible to classify it based on concrete parameters. In other words, the results of a study of the activities of economic entities are expressed by a combination of symbols used as a basis for clustering, which provides an opportunity for making current and comparative assessments.

Information obtained by means of ratings can be used by investors in operations with financial instruments and securities, in developing investment policy and in practical decision making.⁸ The

⁶ This circumstance is noted, in particular, by Standard & Poor’s (see: *Bank Industry Risk Analysis*).

⁷ See: B.G. Litvak, *Ekspertnye otsenki i priniatie resheni*, Moscow, Patent, 1996; idem, “Bankovskie reitingi,” *Biznes. Pribyl. Pravo*, No. 3, 1997, pp. 5-14; idem, *Ekspertnye tekhnologii v upravlenii*, Delo, Moscow, 2004, 398 pp.; N. Muzaffarli (Imanov), *Reiting Azerbaidzhana v mezhdunarodnykh sravnitelnykh issledovaniakh*, Kavkaz, Baku, 2006, pp. V-VIII, 1-9; A. Melville, “Rossia v mirovykh reitingakh,” *Ekspert*, No. 43, 20 November, 2006; V.T. Sevruck, “Znachenie reitingov dlia sravnitel'nogo analiza finansovykh pokazatelei stran SNG,” in: *Formirovanie integratsionnykh ob'edineni stran SNG: finansovyi, valiutnyi, bankovski aspekty. Nauchnyi almanakh fundamentalnykh i prikladnykh issledovani*, Finansy i statistika, Moscow, 2006, pp. 73-87; idem, “Mezhdunarodnye reitingi—indikator konkurentosposobnosti rosiiskikh uchastnikov mirovogo finansovogo rynka,” in: *Deiatel'nost bankov na finansovom rynke: rossiiskaia praktika i mirovoi opyt. Nauchnyi almanakh fundamentalnykh i prikladnykh issledovani*, Finansy i statistika, Moscow, 2007, pp. 138-152; M.G. Mironyuk, I.N. Timofeyev, Ya.I. Vaslavsky, “Universalnye sravnenia s ispolzovaniem kolichestvennykh metodov analiza: obzor pretsedentov,” *Politicheskie nauki. Sbornik nauchnykh trudov*, Issue 3, No. 5, 2007, pp. 43-76; A.A. Chaikovskiy, “Primenenie otsenok v ekonomike,” *Vestnik universiteta* (State University of Management), GUU, Moscow, No. 5, 2007; M.A. Sidorenkov, *Bankovskie reitingi*, available at [http://www.cfin.ru/finanalysis/banks/bank_ratings.shtml], 24 April, 2008.

⁸ For more detail, see: V.T. Sevruck, “Mezhdunarodnye reitingi—indikator konkurentosposobnosti rosiiskikh uchastnikov mirovogo finansovogo rynka,” pp. 139-147.

assignment of a rating offers a number of advantages to both the investor and the financial institution to which this rating is assigned. The main advantages are reflected in Table 1.

Table 1

Advantages of Having a Rating

ADVANTAGES	
For financial intermediaries	For investors
<p>Broad access to capital markets. A rated participant in the financial and banking sector in practice often enjoys better conditions of access to money and financial markets due to greater confidence in its debt instruments among investors and creditors. This can lead to a reduction in financing costs. Many institutional investors do not acquire debt instruments from unrated entities. Under growing financial globalization, international ratings have become guideposts helping issuers to offer their securities in world stock markets, thereby expanding the market for raising capital.</p> <p>Management of credit costs. A wider choice in capital markets results in a wider range of alternative sources of financing than for unrated banks. This enables financial and banking institutions to select more effective forms of borrowing and to optimize its cost.</p> <p>Structural significance. Greater customer confidence, expansion of niches occupied in the financial and banking markets, enhanced competitiveness and increasing returns on financial and banking activities make it possible to identify the strengths and weaknesses of the financial intermediary, and this in turn helps to determine where to focus attention in the near and distant future.</p>	<p>Opportunities for making a conscious investment decision. The rating assigned to a banking or other financial institution enables investors to assess whether the risk/return ratio is acceptable for investment and to compare it with alternative options. It is obvious that given equal risk/return ratios investors will choose a financial intermediary with a rating assigned by a leading international rating agency.</p> <p>Issuer's greater openness. As a rule, a rated bank has a higher level of information transparency. This is because during the preparation of a rating report and in its efforts to maintain the assigned rating the bank provides a larger amount of information to the rating agency than other companies, and this information is usually open to all potential investors.</p>

In this context, it is appropriate to examine the international assessments characterizing the development of Azerbaijan's economy and primarily its financial and banking system as one of the pillars of the country's sustainable socioeconomic development. For objective reasons, in recent years these assessments have been positive.

According to a joint study by the **Swiss Economic Institute and the Swiss Federal Institute of Technology**, in terms of the index of economic globalization Azerbaijan is in 76th place (with a score of 62.16 points out of a maximum possible 100 points) among 139 countries included in the rankings, and in the CIS it ranks fifth ahead of Ukraine, Russia, Belarus, and also of the Central Asian countries

(except Kazakhstan).⁹ Azerbaijan has fairly high sovereign ratings from **Fitch Ratings** (BB+), **Moody's** (Ba1) and **Standard & Poor's** (BB+). The list of domestic banks rated by these top three rating agencies is expanding steadily.

Budget plans for 2009 were recognized as feasible by international financial institutions. According to **Standard & Poor's**, which believes Azerbaijan's response to the world financial crisis to be quite adequate (especially regarding measures in the area of monetary policy and the financial system), in 2009 Azerbaijan's strong balance sheet should distinguish it from peers in the same rating category.¹⁰ In the **IMF's** opinion, "in contrast to other countries in the region, the solid foreign asset position of Azerbaijan and the expected overall fiscal position provide sufficient room to withstand a possibly severe economic slowdown."¹¹ According to the **World Bank's** cross-country report *Doing Business 2009*, which serves as a guide for influential investors throughout the world, in terms of such indicators of the business climate as "getting credit" and "protecting investors" Azerbaijan has the best position among CIS countries, ranking 12th and 18th, respectively, among 181 countries in the world.¹²

A study carried out by such an influential research agency as **The Economist Intelligence Unit jointly with Columbia University and the Columbia Law School (U.S.A.)** showed that in the near future Azerbaijan could be the region's leading destination for foreign direct investment due to its strong investment appeal.¹³

In 2007, the State Oil Fund of Azerbaijan (SOFAZ) won a **U.N.** award for ensuring transparency and accountability in the extractive industries, and at the **Extractive Industries Transparency Initiative (EITI) Conference** in Doha (Qatar) in February 2009 Azerbaijan became the first of 25 candidate countries to achieve EITI Compliant status.¹⁴

On the whole, according to the *Transition Report* of the **European Bank for Reconstruction and Development** for 2008, the world liquidity crisis has had little effect on Azerbaijan's financial system.¹⁵ The same conclusion is drawn by the **IMF**, which believes that "the ongoing global financial turmoil has so far had limited impact on Azerbaijan's financial sector."¹⁶

Of course, despite the prevalence of positive processes in Azerbaijan's financial and banking system, there are still some unresolved problems and bottlenecks in this area.¹⁷ Their existence either already has a negative effect or can eventually have such an effect on the stability of financial institutions and can slow down market transformation processes, which dictates the need for further reform.

These problem spots have become particularly evident during the current global financial crisis, which has gradually acquired clear, understandable contours: having started in the United States in August 2006, during 2007 and 2008 it gradually spread across the entire world economy. **This cri-**

⁹ See: *KOF Index of Globalization 2009*, Zurich, Swiss Economic Institute / Swiss Federal Institute of Technology, 27 January, 2009. In our opinion, the set of nine indicators used to compile the index of economic globalization is insufficient and it would make sense to add a number of indicators reflecting banking globalization, which would generally make these rankings more objective.

¹⁰ See: "How Azerbaijan Is Responding to the Global Economic Turmoil," *S&P*, 15 July, 2009.

¹¹ *Azerbaijan—Aide Mémoire for the 2008 IMF Staff Visit Discussions, 10-17 December, 2008*, Baku, 16 December, 2008.

¹² See: *Doing Business 2009. Country Profile for Azerbaijan*, The International Bank for Reconstruction and Development / The World Bank, Washington, D.C., 2008, pp. 26, 30.

¹³ See: *World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk*, The Economist Intelligence Unit / Columbia Program on International Investment, London, New York, 2007, p. 159.

¹⁴ See: Official website of the State Oil Fund of Azerbaijan [http://www.oilfund.az].

¹⁵ See: *Transition Report 2008: Growth in Transition*, EBRD, London, October 2008, p. 100.

¹⁶ *Azerbaijan—Aide Mémoire for the 2008 IMF Staff Visit Discussions, 10-17 December 2008*.

¹⁷ For a detailed SWOT analysis of the domestic banking sector see: F. Murshudli, "Azerbaijan Banking System: Challenges and Prospects of Globalization," *The Caucasus & Globalization*, Vol. 2, Issue 2, 2008, pp. 76-87.

sis has brought into sharp focus the need to change the philosophy of economic activity and to establish a new paradigm of economic thought; it has also clearly revealed the hidden defects of the methodology used to make international economic comparisons and assessments, which are in much greater demand since the turn of the century. In particular, the current global crisis has added urgency to the need to make significant changes in the criteria used to evaluate the soundness and stability of banking systems, and also the principles for measuring the success of their development.

In current conditions, these systems should break the spell of dubious international comparative studies and address the real challenges of our time. Indeed, the crisis had triggered the collapse of financial and industrial giants, major transnational banks and national banking systems only recently seen as models of economic success, and this provides convincing evidence that the existing methods for ranking them are no longer fully consistent with present conditions. That is why **the approaches to cross-country analytical comparisons for various sectors of the economy, including the banking sector, need a fundamental renewal.** In this context, it makes sense to examine the international assessments characterizing Azerbaijan's financial and banking sector as a mainstay of its sustainable socioeconomic development.

Indicators of Financial Market Sophistication: Hidden Defects, Contradictory Assessments

A detailed analysis of international assessments of the current state of Azerbaijan's banking system is made in the publications of one of the authors of this article.¹⁸ For this reason, **we shall focus on new cross-country comparisons made against the background of financial market instability.** Meanwhile, a study of this question has shown the contradictory nature of the indicators used to assess the financial and economic welfare of different countries.

Take, for example, the Global Competitiveness Index (GCI) developed as part of a wide-ranging and authoritative international comparative study conducted by the World Economic Forum (WEF). This index is based on 12 factors ("pillars"), including **financial market sophistication**, a factor of particular importance to us in the context of the problem we are dealing with. In 2007-2008, it was singled out into a separate pillar, which in turn consists of nine indicators. In the rankings for this pillar, the WEF's *Global Competitiveness Report 2008-2009* ranked Azerbaijan only 92nd among 134 countries.¹⁹ Although in this parameter the republic outranks most CIS countries, the assessment of its financial sector sophistication is obviously low.

As a notable competitive advantage of the republic's financial market, the report names only the legal rights index, whereas the list of its shortcomings and weak points includes eight items. Among these are financing through local equity market (rank 117), regulation of securities exchanges (115), restriction on capital flows and ease of access to loans (100), strength of investor protection (86), financial market sophistication (77) and venture capital availability (60). Among the most problematic

¹⁸ See: F. Murshudli, "Mezhdunarodnye otsenki bankovskoi sistemy Azerbaidzhana—vazhnyi indikator ieio integratsii v mirovoi finansovyi rynek," *Banki & Biznes*, No. 2, 2008, pp. 46-53; "Azerbaijan Banking System: Challenges and Prospects of Globalization," pp. 79-87.

¹⁹ See: *Global Competitiveness Report 2008-2009*, World Economic Forum, Geneva, 2008, pp. 16, 96.

factors for the country's financial market are access to financing and foreign currency regulations. It should also be noted that Azerbaijan has not been included among the top 100 countries with the soundest banking systems, occupying only 116th place in the WEF rankings for soundness of banks.²⁰ In this ranking, Azerbaijan was assigned a score of 4.7 points and was placed between Bangladesh and Taiwan.

Box 1. The world's soundest banking system is that of Canada with a score of 6.82 points. The top five countries also include Sweden (score 6.72), Luxembourg (6.71), Australia (6.70) and Denmark (6.68). The U.K. and U.S., which were among the top five in previous years, have lost their positions in the current rankings. For example, the U.K. has slipped to 44th place after a \$87 billion pledge by the government to bolster bank balance sheets. The U.S. ranks 40th, partly due to the bankruptcy of investment banks Bear Stearns and Lehman Brothers and the sale of Merrill Lynch.

(Global Competitiveness Report 2008-2009)

At the same time, in our view, **the WEF's financial sector rankings are not always objective and should be seen as somewhat conjectural.** Of course, Azerbaijan's financial market cannot be classified as a developed one, and some of its components (like the insurance and stock market) are significantly below the standards of the world's leading countries. But in the context of a dynamically developing national economy this gap is steadily narrowing. In our opinion, Azerbaijan's position in this GCI pillar, like that of other countries, is influenced by the specific procedure of its calculation.²¹ Doubts about the objectivity of the financial market sophistication pillar and its indicators arise after their comprehensive analysis. For example, according to the GCI rankings, Azerbaijan is ahead of such countries as China and Russia (even though they are BRIC countries with very dynamic growth of the equity market and strong investment appeal) and Argentina, and behind Zimbabwe, a country in the midst of a deep crisis with multi-digit inflation. Or take another example: the financial market of Italy (a G7 country with one of the world's strongest banking systems, a highly developed stock market and an S&P sovereign credit rating of A+) is only 91st in the WEF rankings, placed behind Bangladesh, The Gambia, Georgia, Costa Rica, Pakistan, El Salvador, Philippines, etc., whose financial institutions are little known on a global scale.

Apart from this, the inadequate positions of a number of countries can be explained by the specific composition of the indicators used to calculate this competitiveness pillar. The point is that only two of its component indicators—strength of investor protection and legal rights index—are based on generally accessible statistical data, while the other seven (including soundness of banks) are based on surveys of company executives and heads of financial and banking institutions. As we see it, possibly unreliable survey data may to some extent explain the very low positions of some countries (including Azerbaijan) and the overrated positions of other countries in these rankings; after all, in one indicator—the legal rights index, based on statistical data—Azerbaijan occupies a perfectly competitive position: rank 16.

²⁰ These rankings were compiled using data on bank accounts of different countries (hard data) and the results of a survey of top bank executives (survey data). As a result, banking systems were assigned scores of 1 to 7, where 7 means generally healthy banks with sound balance sheets, and 1, insolvent and may require a government bailout.

²¹ This is noted by other economists as well (see: V. Yu. Dodonov, *Konkurentosposobnost investitsionno-finansovoi sfery Kazakhstana v otsenkakh mezhdunarodnykh organizatsii*, available at [http://www.iwep.kz], 21 May, 2008; K. V. Shvandar, "Mirovoi krizis skvoz prizmu platiozhnogo balansa i konkurentosposobnosti," *Bankovskoye delo*, No. 5, 2009, pp. 54-60).

It should be noted, however, that the *Global Competitiveness Report* in question is based on data collected at the initial stage of the financial crisis, when its attendant effects were still barely discernible. Hence a contradiction between the assessments it contains and the actual state of affairs. This determines the urgent need to review the characteristics assessing the quality and the competitive advantages of a country's financial system as a whole, because these characteristics have proved to be invalid in the present conditions and have become obsolete overnight.

For example, the top ten countries with the most competitive financial systems as listed in the global competitiveness rankings for 2008-2009 included the U.K. (rank 5), Ireland (7), Sweden (8) and the U.S. (9). But the consequences of the crisis make it clear that these assessments of their financial systems, as well as those of other countries from the upper half of the rankings, are unjustified, considering that the current turmoil has had a very painful effect on them. The point is that WEF experts focused on such indicators as openness to world financial markets and ease of access to capital. As it turns out, however, countries that failed to meet these criteria entered the current crisis later than other countries and with less destructive consequences. In addition, the technique for measuring the competitiveness of the financial system does not include such important indicators as external debt or an assessment of the opportunities for servicing this debt, whereas the realities of the current crisis situation clearly demonstrate that a large debt hinders competitiveness, leading to its partial or total loss. Thus, **logic suggests that it is advisable to change the method for assessing the competitiveness of national financial systems.** In particular, the "soundness of banks" indicator should be retained, but the entire system for assessing their soundness should be seriously corrected, because otherwise the objectivity of the rankings will be called into question.

2009 World Financial Health Index: Shift of Emphasis

In the context of the current financial meltdown, rankings in which assessment procedures have changed radically during the crisis and are now based on principles fully reflecting the specifics of the situation are of particular interest. In our opinion, this includes the **2009 World Financial Health Index** (WFHI) compiled by *The Banker*, one of the most authoritative economic publications. It rates the ability of countries to weather the current crisis.²² It is surprising that this ranking, which is most instructive for transition countries, has escaped the attention of the country's economic agencies, Azerbaijani economists and usually meticulous journalists specializing in economics. Meanwhile, Azerbaijan's positions in this ranking (on both the overall index and its individual components) appear to be much better than in other international comparisons.

According to *The Banker*, **the financial crisis of 2008 has turned the world on its head, so that risks and the methods of their assessment have changed as well.** *The Banker's* latest rankings, which focus on low leverage, reveal some amazing results. As the authors of the study point out, in this brave new world the most developed economies—and those most dependent on credit—have suddenly become the ones most exposed to potential economic disaster.²³ Statistical data that until recently were used as a measure of economic performance (such as levels of bank lending) are now seen as the main indicators of financial risk. Unlike previous country rankings, where the most devel-

²² See: *The Banker*, London, Vol. 159, No. 995, January 2009, pp. 63-64, 66.

²³ See: C. Piggott, "Risers and Fallers," *The Banker*, January 2009, pp. 62-63.

oped financial markets were rewarded with high scores, *The Banker's* 2009 World Financial Health Index penalizes countries that rely too heavily on financial leverage.²⁴

An analysis of WFHI 2009 and its components has shown the following:

1. WFHI 2009 ranks 184 countries based on 25 indicators of financial and economic health grouped into four categories (economic stability, overall indebtedness, financial sector stability and government finances). With a score of 439.83 points (out of a maximum possible score of 1,000 points), **Azerbaijan is 39th in this ranking** (see Table 2).

According to *The Banker's* new financial risk model, Azerbaijan (like other post-Soviet countries: Russia, Moldova, Kazakhstan, Armenia, Georgia, Estonia and Belarus) is less likely to be affected by the current financial crisis than the U.K., Italy, Japan, France or Germany. These FSU countries may be poorer, but with a far lower reliance on credit and just a

Table 2

The Banker:
2009 World Financial Health Index²⁵

Rank	Country*	Indicators (maximum score)				
		Total score (1,000)	Economic stability (400)	Overall indebtedness (200)	Financial sector stability (200)	Government finances (200)
1	Norway	549.77	215.39	144.34	53.04	136.99
2	Russia	544.80	126.23	172.88	124.02	121.68
3	Kuwait	535.83	163.05	145.17	108.57	119.04
4	Singapore	516.63	159.20	126.62	98.37	132.44
5	Moldova	510.30	108.15	167.77	137.01	97.38
15	Kazakhstan	488.84	118.35	188.02	80.70	101.77
16	Armenia	487.25	122.99	120.55	145.91	97.80
20	Georgia	471.84	84.69	172.36	116.74	98.04
21	Switzerland	470.72	149.62	143.93	80.99	96.19
22	Estonia	468.89	94.86	160.62	106.67	106.74

²⁴ For a detailed discussion of the importance of a state's external debt as a criterion of its economic independence see: Sh. Hajiev, N. Muzaffarli (Imanov), *et al.*, "Economic Reform in Azerbaijan: Achievements and Problems," *The Caucasus & Globalization*, Vol. 2, Issue 4, 2008, pp. 52-53.

²⁵ See: *The Banker*, January 2009, pp. 64, 66.

Table 2 (continued)

Rank	Country*	Indicators (maximum score)				
		Total score (1,000)	Economic stability (400)	Overall indebtedness (200)	Financial sector stability (200)	Government finances (200)
27	U.S.	456.17	124.62	171.36	82.42	77.77
29	<i>Belarus</i>	453.85	127.84	111.16	114.78	100.06
35	China	446.59	146.05	145.56	56.60	98.37
37	Turkey	444.29	96.28	169.37	109.89	68.76
39	<i>Azerbaijan</i>	439.83	202.75	148.57	84.86	3.66
42	France	435.69	127.72	145.95	72.84	86.18
47	Germany	430.84	127.15	152.01	64.47	87.20
54	<i>Ukraine</i>	421.28	89.66	157.14	77.74	96.74
56	Italy	419.61	115.71	157.50	71.26	75.14
58	U.K.	418.84	122.00	134.53	77.51	84.80
59	<i>Lithuania</i>	416.80	85.76	151.93	82.17	96.93
63	<i>Latvia</i>	413.22	67.42	154.03	93.85	97.92
93	Kyrgyzstan	367.03	100.66	139.61	32.75	94.01
111	Japan	319.34	122.11	136.55	50.21	10.48
112	<i>Tajikistan</i>	316.55	108.93	97.58	32.34	77.70
124	<i>Uzbekistan</i>	281.69	128.13	145.03	—	8.53
166	<i>Turkmenistan</i>	171.47	117.07	49.97	—	4.43
182	Iraq	119.79	20.84	92.07	—	6.88
183	Mauritania	110.09	110.09	—	—	—
184	Zimbabwe	75.39	1.50	49.95	27.35	0.20

* Italics indicate post-Soviet (FSU) countries.

fraction of the leverage of rich developed countries they are evidently more insulated from financial meltdown than any of the latter.

Box 2. *In fact, not a single Group of 10 country makes it into the top 20 in The Banker's ranking. The highest ranked G10 country is Switzerland at 21, while Japan's beleaguered economy ranks at 111. Despite the crash in oil prices, the top three countries in the ranking—Norway, Russia and Kuwait—all have large reserves of oil or gas. Singapore, which has high levels of savings, low levels of government debt and huge foreign exchange reserves, ranks fourth. Moldova, a country with GDP per capita of just \$1,830, ranks fifth. Moldova has very low levels of debt (\$763 per capita, compared with the UK's \$171,000 per capita), and its banks have high capital-to-asset ratios (more than 17.0%) and low levels of lending (35.0% of GDP).*

(The Banker, January 2009, p. 64)

- In the first, most weighty component of WFHI 2009—“economic stability”** (a maximum score of 400 points)—Azerbaijan alone among the countries of Central and Eastern Europe and the CIS has made it into the top five, ranking fourth (202.75 points) behind Qatar (342.52), Luxembourg (220.50) and Norway (215.39).

Box 3. *This category includes 11 indicators: GDP growth forecast, 2009 (150 points); GDP per capita forecast, 2008 and 2009 (75 each); unemployment, %, 2008 (25); net national savings rates, % of gross national income (GNI), 2006 (25); current account balance forecast, % of GDP, 2008 and 2009 (15 and 10, respectively); foreign direct investment (FDI) inflow, % of GDP, 2007 (10); FDI inflow per capita, 2007 (5); FDI stock, % of GDP, 2007 (5); FDI stock per capita, 2007 (5).*

(The Banker, January 2009, p. 63)

It should be emphasized, in particular, that most developed economies have large trade deficits and suffer from faltering economic growth, while many developing countries enjoy trade surpluses and continued economic growth. For example, according to *The Banker*, **Azerbaijan ranks third in the world in terms of its current account surplus as a percentage of GDP.**²⁶

- In the second WFHI 2009 parameter—“overall indebtedness”** (a maximum score of 200 points)—Azerbaijan is in 51st position (148.57 points), outranking such European states as Austria, Belgium, U.K., Greece, Norway, Ireland, Luxembourg, Netherlands, Portugal, Finland, Sweden, Switzerland, and CIS countries: Armenia, Belarus, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

Box 4. *This component is based on 4 indicators: external debt, % of GDP, 2007; debt, per capita, 2007; public debt, % of GDP, 2007; gross external debt position, % increase Q2 2007 to Q2 2008 (50 points each).*

(The Banker, January 2009, p. 63)

Let us note that developed countries' overall indebtedness relative to GDP (including private sector borrowing) is several times the levels of many developing countries. The high-

²⁶ See: *The Banker*, January 2009, p. 67 (according to IMF *World Economic Outlook Forecast*, November 2008).

est level of government debt compared to any other developed country is recorded in Japan: 170.4% of GDP. Other highly leveraged countries in the ranking include Ireland and the U.K.: they have the highest external debt-to-GDP ratio of any country: 646% and 375% of GDP, respectively. In most developing and transition countries this indicator is several times lower. Even though household incomes remain lower in developing countries, they can take comfort from the fact that they were not part of the post-millennium credit boom. For example, Azerbaijan's external debt at the beginning of 2009 was 6.4% of GDP. It spent less than 1.1% of state budget revenue on debt service (interest payments), while Italy spent 11.9% for these purposes.²⁷ Low dependence on external borrowings and speculative operations is also characteristic of Azerbaijan banks, as confirmed, in particular, by Standard & Poor's ratings.²⁸ Such post-Soviet countries as Belarus, Ukraine, Georgia, Armenia, Russia and the Baltic states, on the contrary, have rapidly growing external debts, and in terms of this indicator (June 2007 to June 2008) they are among the world's top 20 countries.²⁹

4. **In the third WFHI 2009 parameter—“financial sector stability”** (a maximum score of 200 points)—**Azerbaijan is in 54th place (84.86 points)**, significantly ahead of the G10 countries (Switzerland, Canada, U.S., Sweden, Netherlands, France, Germany, Italy, U.K. and Belgium), the countries of Central Asia, and also such countries as Norway, Denmark, Austria, China, Argentina, Czech Republic, India, Lithuania, Latvia, Greece, Portugal, Ireland, Luxembourg and Japan.

Box 5. This parameter is based on 5 indicators: bank regulatory capital to risk weighted assets, 2008 (100 points); bank capital to assets, 2008; non-performing bank loans, 2008; bank provisions to non-performing loans, %, 2008; domestic credit provided by the bank sector, 2006 (25 points each).

(The Banker, January 2000, p. 63)

In Azerbaijan, one of the indicators constituting this parameter—domestic credit provided by banks—was only 18.4% of GDP in 2008.³⁰ Japan tops the ranking in this indicator: its banks have extended domestic credit equal to 308% of GDP, far higher than any other country in the world. In the U.S., domestic bank lending has exceeded 230% of GDP, nearly four times the world average.³¹ Until recently such high figures were regarded as a positive phenomenon, but an analysis of crisis realities has made it clear that credit resources three or four times in excess of GDP cannot be seen as a positive factor.

At the same time, strangely enough, in this segment of the ranking Azerbaijan is significantly behind its neighbors in the region: Georgia and especially Armenia. This is all the more surprising given that *The Banker* has included them among the world's 20 countries with the lowest level of bank stability (ranks 17 and 16, respectively):³² the percentage of non-performing bank loans in these countries was 54.4% and 53.8%, respectively.³³ In Azerbaijan,

²⁷ See: *The Banker*, January 2009, p. 63.

²⁸ See: *Bank Industry Risk Analysis*, p. 1.

²⁹ See: *The Banker*, January 2009, p. 68.

³⁰ Calculated based on data from: *Statistical Bulletin of the National Bank of the Republic of Azerbaijan*, Baku, No. 12, 2008, pp. 4, 19.

³¹ See: *The Banker*, January 2009, p. 63.

³² *Ibid.*, p. 68.

³³ See: *IMF Global Financial Stability Report*, July 2008.

this indicator stood at 3.8%, and despite its insignificant growth from the previous year, the situation in this area has stabilized.³⁴

5. **In the last of the four basic parameters of WFHI 2009—“government finances”** (a maximum score of 200 points)—Azerbaijan is in the worst position: rank 141³⁵ with an incredibly low score of 3.66 points.

Box 6. This parameter is based on 5 indicators: central government cash surplus or deficit, 2006 (80 points); central government debt interest, % of revenue, 2006 (80); reserves of foreign exchange and gold, % of imports, 2008 (20); reserves of foreign exchange and gold, % of GDP, 2008 (10); reserves of foreign exchange and gold, per capita, 2008 (10).

(*The Banker*, January 2009, p. 63)

Azerbaijan’s position in this ranking is questionable for several reasons.

- **First**, the initial indicator for the country’s reserves of foreign exchange and gold was taken from the *CIA World Factbook 2008*: \$8.5 billion (as of 31 December, 2008), whereas in actual fact, as noted above, with due regard for the resources of the Oil Fund of Azerbaijan the figure was \$18.2 billion.
- **Second**, government debt interest is insignificant because both government debt itself and the percentage of debt service (interest payments) are low, which has found its reflection in the second WFHI 2009 parameter (“overall indebtedness”). Consequently, in ranking Azerbaijan so low in this indicator the WFHI authors are contradicting themselves.
- **Third**, in recent years Azerbaijan has had a cash surplus, which should be generally seen as a positive factor, whereas Armenia and Moldova, for example, have recorded a cash deficit. But in this case the statistical source for WFHI 2009 was the World Bank’s database, *World Development Indicators 2008*, where the said indicator for Azerbaijan, in contrast to other countries, is absent for some obscure reason. And according to *The Banker*’s methodology, in the absence of data a country receives a score of zero.

Thus, despite the significantly better position in each indicator of government finances, Azerbaijan in this ranking is far behind (about 26 times) Georgia (whose score is 98.04 points), Armenia (97.80) and Moldova (97.38). This assessment can hardly be regarded as objective. Assuming a slightly higher score for the state of government finances in Azerbaijan than those of the above-listed countries (even if at least 100.00 points, a figure close to what it should be), **the republic would have been among the top three countries in the WFHI 2009 rankings** behind Norway and Russia.

Addressing the Crisis: Arguments for Financial Health

The latest reports of international financial institutions and rating agencies support our arguments for Azerbaijan’s financial health.

³⁴ In this context, we believe that Standard & Poor’s estimate of gross problematic assets in Azerbaijan’s banking system in the 35-50% range (see: *Bank Industry Risk Analysis*) is totally unjustified.

³⁵ This rank could have been even lower because the necessary data for many countries were unavailable.

For example, the **IMF** has included Azerbaijan in the group of countries whose economy is most immune to the crisis and least vulnerable to external factors.³⁶ Special note is taken of the banking system: according to IMF experts, serious steps have been taken in the republic in recent months to strengthen this system.³⁷ Somewhat earlier, an IMF mission that visited the republic in mid-December 2008 came to the conclusion that “Azerbaijan is expected to weather the short-term impact of the crisis relatively well under the current policy plans.”³⁸ That is why the IMF expects Azerbaijan in 2010 to show the highest real GDP growth among the countries of the Caucasus and Central Asia: 12.3% against a regional average of 5.0%.³⁹

The **World Bank**'s Country Economic Memorandum of March 2009 emphasizes that Azerbaijan (and its financial sector) is more immune than other countries to the effects of the global crisis.⁴⁰ In its *Global Economic Prospects 2009* report, the World Bank projected GDP growth in Azerbaijan at 10.4% in 2009 and 7.8% in 2010, the highest growth rates in the Europe and Central Asia region (19 developing countries).⁴¹ And although its annual report on the financial aspects of global development (*Global Development Finance: Charting a Global Recovery*) makes a less optimistic forecast (including for Azerbaijan), its experts say that in 2009-2011 Azerbaijan will be one of the countries in Europe and Central Asia with accelerating annual economic growth (3.3% in 2009, 5.2% in 2010, and 9.0% in 2011) and a double-digit current account surplus (10.3%, 15.5% and 19.0% of GDP, respectively).⁴² Real GDP growth in Azerbaijan is also projected by the **Asian Development Bank** at 8.0% in 2009 and 6.7% in 2010,⁴³ and by **Standard & Poor**'s at 4.0% and 5.4%, respectively.⁴⁴ **At a meeting of CIS finance and economy ministers and heads of national banks on 31 March, 2009, Russian Vice Premier and Finance Minister A. Kudrin** emphasized that Azerbaijan is least affected by the global crisis, sustaining high investment volume and economic growth.⁴⁵ According to **Standard & Poor**'s, “Azerbaijan is set in the medium term to take advantage of major opportunities that should support its sovereign credit ratings.”⁴⁶

The results of Azerbaijan's socioeconomic development in the first five months of 2009 with positive dynamics in all economic sectors without exception support the conclusions of influential international rating agencies and financial institutions on the minimal impact of the world crisis.⁴⁷ This is also evident from a study conducted by FBK, one of the leaders of the Russian professional services market, according to which Azerbaijan has the best socioeconomic indicators of all CIS countries for January-April 2009 (together with Uzbekistan) and is addressing the world economic crisis quite effectively.⁴⁸

³⁶ See: *World Economic Outlook: Crisis and Recovery*, IMF, Washington, D.C., April 2009, p. 84.

³⁷ See: *Regional Economic Outlook: Middle East and Central Asia*, IMF, Washington, D.C., May 2009, p. 30.

³⁸ *Azerbaijan—Aide Mémoire for the 2008 IMF Staff Visit Discussions, 10-17 December 2008*.

³⁹ See: *Regional Economic Outlook: Middle East and Central Asia*, pp. 25, 36.

⁴⁰ See: Statement by Azerbaijan Minister of Economic Development Sh. Mustafayev at a Cabinet meeting on the results of the country's socioeconomic development in the first quarter of 2009 (*Bakinski rabochi*, 24 April, 2009, p. 2).

⁴¹ See: *Global Economic Prospects 2009: Commodities at the Crossroads*, The International Bank for Reconstruction and Development / The World Bank, Washington, D.C., 20 November, 2008, pp. 151-152.

⁴² See: *Global Development Finance: Charting a Global Recovery*, The International Bank for Reconstruction and Development / The World Bank, Washington, June 2009, pp. 115, 117.

⁴³ See: *Asian Development Outlook 2009*, Manila, Asian Development Bank, March 2009, pp. 134, 296.

⁴⁴ See: *Azerbaidzhanskaia respublika—kreditnyi reiting*, Standard & Poor's, 24 February, 2009; *Bank Industry Risk Analysis*.

⁴⁵ See: Official website of the Russian Ministry of Finance [<http://www.minfin.ru/ru/press/speech/index.php?id4=7229>].

⁴⁶ “How Azerbaijan Is Responding to the Global Economic Turmoil,” S&P, 15 July, 2009.

⁴⁷ For more detail, see: F. Akhundov, “Rost ekonomiki Azerbaidzhana nagliadno demonstriruet minimal'noie vozdeistvie mirovogo krizisa,” available at [<http://www.day.az/news/economy/161888.html>].

⁴⁸ See: I.A. Nikolayev, T.Ye. Marchenko, M.V. Titova, *Strany SNG i mirovoi krizis: obshchie problemy i raznye podkhody. Analiticheski doklad*, FBK, Moscow, June 2009, pp. 8, 27.

One of the most visible expressions of a country's financial health is the existence of successful financial institutions. In Azerbaijan this includes, in the first place, the **International Bank of Azerbaijan** (IBA), the system core of the country's banking sector with a dominant position in the key segments of the domestic financial market. IBA plays the leading role in the development of the national banking system, in enhancing its competitiveness and stability. As a National Development Bank,⁴⁹ IBA also has a stabilizing effect on the state of the Azerbaijan economy as a whole. Well-established in the Caucasus region as one of its largest and soundest brand-name financial holding groups, IBA has the most advanced position in the republic in key banking indicators.

IBA's long positive experience and active involvement in innovation processes are the main factors behind its steadily growing reputation even during the active phase of the global financial crisis. For example, its main performance indicators in this contradictory period full of the worst expectations continued their positive dynamics. In April 2009, the Board of Directors of the European Economic Chamber of Trade, Commerce and Industry declared IBA the most stable credit institution in Europe at the time of the global financial crisis. That same month the Bank received awards from two leading global analytical magazines: from *Global Finance* (New York) as the best Azerbaijan bank in the Best Emerging Markets Bank category and from *Emeafinance* (London) as the best local bank in the Best Bank in CIS, Central and Eastern Europe category. In addition, at the 3rd Vienna Banking Forum (23-25 April, 2009) IBA Board Chairman Jahangir Hajiyev was named the best crisis manager of 2009 for the CIS, Central and Eastern Europe and was awarded the Platinum Key (the first international banking prize awarded by the Banking Association of Central and Eastern Europe) for his important contribution to the development of the national banking system.⁵⁰ Finally, in June 2009 Fitch Ratings affirmed IBA's long-term issuer default rating at "BB+" with a stable outlook.⁵¹

Overall, it should be noted that **timely preventive measures taken by the country's authorities have made it possible to minimize the negative impact of the crisis on its economy, particularly on its financial and banking sector, where this impact was barely noticeable, thereby promoting a further improvement in the state's financial health.** World practice in fighting the crisis shows that countries with significant gold and foreign exchange reserves coupled with a low level of external and internal debt—and Azerbaijan has a rightful place among these countries—can overcome the effects of global turmoil less painfully.

Post-Crisis Transformation Prospects: New Trends and Models

It should be noted that international experts **are expecting serious transformations in the post-crisis financial services market.** For example, a PwC publication entitled *The Day After Tomorrow*⁵² analyzes the new trends and models developing in the wake of the credit crisis and against the background of attempts by financial sector companies to adapt to the new business environment. The inevitability of transformations in the world banking system was also predicted by the top executives of

⁴⁹ For more detail, see: J. Hajiyev, "MBA—Bank Obshchenatsional'nogo Razvitiya," *Zerkalo*, 9 May, 2003; J. Hajiyev, "MBA—iadro bankovskoi sistemy Azerbaidzhana," *Zerkalo*, 12 November, 2005.

⁵⁰ Official website of the CIS Financial and Banking Council [<http://www.fbc-cis.ru/nws/news10.php>].

⁵¹ See: *Fitch Affirms International Bank of Azerbaijan at "BB+"*; *Outlook Stable*, 11 June, 2009.

⁵² See: *The Day After Tomorrow: A PricewaterhouseCoopers Perspective on the Global Financial Crisis*, PwC, February 2009, 24 pp.

a number of major Western banks who took part in a debate at the editorial office of *The Banker*.⁵³ In their opinion, this system will shortly undergo drastic changes: it should have a totally new face and be filled with new content.

A similar position is also clearly evident in the documents of authoritative and sufficiently effective world forums: the **G20 Leaders Summit on Financial Markets and the World Economy** (London, 1-2 April, 2009) and the **U.N. Conference on the World Financial and Economic Crisis and Its Impact on Development** (New York, 24-26 June, 2009). In particular, the G20 adopted a new concept (binding on all) of regulatory reform and financial recovery. It is important that this relates not only to banks, but also to financial companies. From now on, all financial institutions, instruments and markets systemically important to the world economy will be tightly regulated and controlled by a Financial Stability Board (FSB). In addition, the EU is insisting on the creation in 2010 of a new board to assess systemic risk headed by the European Central Bank, and the U.S. is urging the establishment of a new body to monitor systemic risk.⁵⁴ Progressive solutions for reform in the international financial system are contained in a speech by U.N. Secretary General Ban Ki-moon⁵⁵ at the above-mentioned U.N. Conference, and in the Report⁵⁶ and Recommendations⁵⁷ of the Commission of Experts.

Under the new rules of the game introduced in the world financial market, it is planned, in the first place, to change the behavior model of financial institutions: they will be responsible for performing financial analysis required to ensure loan portfolio quality, with tighter internal and government control. The main features of the new banking landscape will be a downsizing of the banking system with a simultaneous tightening of regulation and focus on a universal banking model. The banking model of the post-crisis world will be simpler, sounder, more transparent and geared to avert risk. Profit will fall, but risk-adjusted return will decline less sharply, because the level of business risk will decline as well.

One of the main conclusions is that financial institutions should not concentrate on current problems alone at the expense of long-term development. Most of the institutions now operating in the survival mode should already take decisions on how business will develop within two or three years. At the same time, they should adapt themselves to the realities of doing business in the world, where the interests of numerous stakeholders—the government and society as a whole—are increasingly important. This unquestionably competent opinion of leading international experts deserves close attention and study.

Consistent improvement in the indicators measuring the country's financial health will bring Azerbaijan closer to implementing the idea of its financial sovereignty, of turning its capital, Baku, into a powerful financial center of the Caucasus and achieving global competitiveness of national financial institutions. Compared to its neighbors, Azerbaijan is highly competitive in the struggle for the role of a regional financial center due to its undeniable advantage as the holder of significant gold and foreign exchange reserves coupled with a large energy potential. In the conditions of the current financial and economic crisis, Azerbaijan has every reason to be satisfied with its relatively stable monetary and banking system, which helps the economy to weather this global storm with relatively insignificant losses.

⁵³ See: C. Piggott, "FIG Chiefs Survey New Financial Landscape," *The Banker*, April 2009.

⁵⁴ See: *Declaration on Strengthening the Financial System*, London, 2 April, 2009, available at [<http://www.g20.org>]; *Global Plan for Recovery and Reform: the Communiqué from the London Summit*, London, 2 April, 2009, available at [<http://www.londonsummit.gov.uk>].

⁵⁵ See: *The World Financial and Economic Crisis and its Impact on Development*, available at [<http://www.un.org/ga/econcrisissummit/docs.shtml>].

⁵⁶ See: *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System*, available at [<http://www.un.org/ga/econcrisissummit/docs.shtml>].

⁵⁷ See: *Recommendations of the Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System*, available at [<http://www.un.org/ga/econcrisissummit/docs.shtml>].

Nevertheless, if Azerbaijan wants to aspire to the role of financial leader in the region, its economic agencies and financial institutions will have to do a great deal to create the necessary conditions for this purpose. Namely, **to anticipate the threats to the state's financial health and reputation, establish their sources, analyze the "anatomy" of each threat, try to understand their mechanics, nature and evolution, and most important of all, find appropriate mechanisms for blocking these threats and map the way to upgrade the entire financial and banking system, its institutional and staffing support in full accordance with current requirements.** In our opinion, it is only through such a consolidated effort that the domestic financial and banking markets can achieve quantitative optimization and make a qualitative breakthrough in the next 5 to 10 years, supply resources for the growing economy and for the development of the country's productive forces, ensure the necessary social stability and minimum social guarantees for the population, and provide the state with an effective tool for implementing macroeconomic decisions and strengthening Azerbaijan's geopolitical and geo-economic positions.

UZBEKISTAN'S BANKING SYSTEM AND ITS ROLE IN IMPLEMENTING THE ANTI-CRISIS PROGRAM

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1. Current State and Development Trends in Uzbekistan's Banking System

Uzbekistan currently has a dual banking system which consists of the Central Bank and commercial banks.

As of 1 January, 2009, Uzbekistan's banking system has 30 commercial banks, which include 3 state banks, 11 joint-stock commercial banks, 5 commercial banks with a share of foreign

capital, and 11 private banks (the share of physical entities in the authorized capital of these banks is higher than 50%).

During its first years of independence, Uzbekistan did not have a special law on the Central Bank. The banking system functioned in compliance with the Law on Banks and Banking Activity adopted on 15 February, 1991 (1 September, 1991 is the day the country gained its independence). This law was improved by introducing various amendments and addenda into it, thus creating a legal foundation for establishing the Central Bank of Uzbekistan (CBU) based on the regional division of the U.S.S.R. State Bank.

At the initial stage of the country's economic reform, the CBU performed such functions as servicing the government's accounts, controlling the activity of commercial banks, and organizing and managing the national payment system. But it did not issue money, since at that time Uzbekistan did not have its own national currency.

Introduction of the national currency, the soum, into circulation required conducting an independent monetary policy and presumed the need for intensifying the reforms in the financial sector. In addition, it became obvious that it was impossible to define the legal status, goals, and tasks of two entirely different institutions—the CBU and commercial banks—within the framework of one law. These factors made it necessary to regulate the activity of the CBU by means of a separate law.

Keeping in mind the proposals and recommendations of international financial institutions, foreign banks, and independent experts, the CBU drew up the draft of a Law on the Central Bank. This draft law was openly and extensively discussed by specialists, academic economists, and experts, who supplied numerous proposals and comments. Finally, on 21 December, 1995, at a regular session of the Oliy Majlis (the country's parliament), the Law on the Central Bank of the Republic of Uzbekistan was adopted.

According to Article 1 of this law, the CBU is a legal entity and all of its property is in federal ownership. This article also enforces its economic independence: "The Central Bank is an economically independent institution that shall cover its expenses with its own revenues."

According to Article 3, the main goal of the CBU is to ensure the stability of the national currency. The main tasks are:

- to form, adopt, and implement monetary policy and currency regulation policy;
- to set the rules to ensure an efficient payment system in the country;
- to license and regulate banking activity and the activity of credit unions and lombards, to supervise banks, credit unions, and lombards, and to license the production of certified securities;
- to keep and manage the country's official international reserves, including federal reserves by agreement;
- to manage, along with the Ministry of Finance, cash execution of the state budget.

It is important to emphasize that this law ensures the political and economic independence of the CBU. According to Article 6, the Central Bank shall independently make decisions within the limits of its competence. The state shall not be liable for the obligations of the CBU and the CBU shall not be liable for the obligations of the state.

It must be emphasized that certain factors interfere with the CBU performing its functions. For example, an increase in price for the products and services of natural monopolies promotes an increase in inflation and has a negative effect on the stability of the national exchange rate. This factor is not under the direct control and influence of the CBU.

The CBU draws up and carries out its own monetary policy. In compliance with Article 24 of the Law on the Central Bank of the Republic of Uzbekistan, the CBU may establish goals for changing one or several of the monetary indices.

The principal tools of the CBU's monetary policy are the following:

1. Refinancing policy.
2. Required reserves policy.
3. Open market policy
4. Monetary policy.
5. Deposit policy.

Within the framework of its refinancing policy, the CBU offers centralized loans to commercial banks secured against the following assets:

- gold, foreign currency, and currency and other valuables that belong to the category of international reserves;
- government liabilities and other debt instruments guaranteed by the government;
- assets deposited in the Central Bank and acceptable for its asset depositories that are permitted for buy-sale or other transactions of the Central Bank;
- commercial bills of exchange, the payment of which is under bank guarantee.

CBU loans are issued at discount rates. It independently establishes the interest rates for its transactions.

Until mid-1994, the credit policy of the CBU was relatively soft and centralized loans were used not only to create and develop vitally important branches of the economy, but also to provide state enterprises with circulating capital. In the second half of 1994, the nature of the refinancing policy changed. It was oriented toward maintaining the level of the monetary indices and achieving and maintaining macroeconomic stability.¹

Some of the acquired resources of Uzbekistan's commercial banks are kept in the CBU in the form of required reserves. The following types of acquired resources of commercial banks are not included in the required reserve ratio:

- interbank loans received;
- household deposits.

On 1 September, 2007, the required reserve ratio for deposits in the national and foreign currency were unified and established at a level of 13%. On 1 November, 2008 the standard required reserve ratio was raised by two percentage points.

Within the framework of the open market policy the CBU can buy and sell state securities in the open market, as well as the debt securities they issued themselves. But it cannot use operations in the open market for any level of budget financing, or buy state securities during their initial placement. The CBU board of directors determines the limit of open market operations.

At present, the CBU uses state securities (government short-term bonds and treasury notes) as the targets for open market transactions.

Since 2005, Uzbekistan's state budget has been executed with a surplus. Due to this, the amount of state securities issued remains insignificant. This keeps a control on the increase in number of open market transactions carried out by the CBU.

¹ M.B. Nurmurodov, *Monetarnaia politika i bankovskaia sistema Uzbekistana v usloviakh glubokikh strukturnykh preobrazovaniy. Makroekonomicheskie problemy perekhodnogo perioda v Uzbekistane. Problemye issledovaniia v ekonomike*, Mir ekonomiki i prava, Tashkent, 1998, p. 223.

Within the framework of the CBU's monetary policy, the following currency transactions are carried out:

- spot intervention;
- servicing the government's external debt;
- managing the official international reserves.

The U.S. dollar is a means of spot intervention. Spot intervention is carried out using the resources of the Consolidation Fund.

The government's main accounts have been opened on the CBU's balance. It services the government's foreign debt and carries out payments.

In most countries, reserves belong to the central bank, that is, they are reflected on its balance, and the final decisions on reserve management are made within its management structure. But there are several examples to the contrary (the U.S., Great Britain, and Japan), where reserves technically belong to the government and the final decisions on their management are also made by the government (usually by the Treasury or the Ministry of Finance).

For any country, a multitude of factors determine the choice between the two approaches. The current situation is possibly the most important of these factors: if the structure has already been formed and is working properly, there is no real need to change it. In addition, the main objectives for keeping reserves play an important role in determining the institutional structure. If reserves are largely used for monetary policy, it is expedient to transfer their management functions to the central bank. On the contrary, if they are kept primarily for hedging the government's obligations in foreign currency, the Ministry of Finance will claim the right to own these resources.

However, regardless of the right to own reserves, they are almost always controlled by the central bank either as the owner or as a government agent. An exception to this rule is when the reserves, or some of them, are part of an investment fund; in such cases, the authorities often prefer to create a specialized structure for managing them.

At the same time, the government usually makes the most urgent decisions concerning national currency (exchange rate policy, carrying out intervention, joining currency unions, and so on) directly related to reserve management. In such cases, the right to ownership of the reserves is considered less important than the need for a coordinated policy between the government and the central bank.

The CBU draws the temporarily free monetary means of commercial banks into its deposit accounts. In 2008, the average monthly volume of the CBU's deposit transactions amounted to 1,222 billion soums. In addition, it uses the balance on government accounts as a facility for its deposit transactions.

As we can see from the data presented in Table 1, in 2004-2006 the CBU's refinancing policy was expansionist in nature, that is, the refinancing rate tended to drop. This led to a decrease in the interest rate on commercial bank loans issued in the national currency. During this time, the average annual interest rate of short-term commercial bank loans in the national currency dropped by 1.8 percentage points.

In 2006-2008, the CBU refinancing rate did not change—it remained at a level of 14% per annum. This was due primarily to the need to keep the inflation rate within the range of 6-8% per annum.

The drop in interest rate on commercial bank loans within the period under review led to an increase in the volume of loan deposits. In 2008, commercial bank loan deposits increased by 178.4% compared to 2004.

As we can see from Table 1, in 2004-2007, there was a decrease in the required reserves rate of the CBU. This made it possible to increase the volume of acquired deposits. But at the end of 2008,

the required reserves rate rose by 2.0 percentage points, which could lead to a drop in bank liquidity and in interest rates paid on short-term and savings deposits.

In 2004-2008, due to the moderate monetary and fiscal policy, it was possible to reduce the government's external debt. The sum of the positive balance of foreign trade transactions also significantly increased. All of these factors are helping to swell the foreign currency supply in the internal market and lower the devaluation level of the national currency.

In compliance with the anti-crisis program drawn up in Uzbekistan on the initiative of the country's president and in the conditions of the falling demand in the world market, support of domestic

Table 1

**Dynamics of Monetary Indicators
in Uzbekistan²**

No.	Monetary Indicators	At the End of the Fiscal Year				
		2004	2005	2006	2007	2008
1	Annual inflation level, %	3.7	7.8	6.8	6.8	7.8
2	Annual refinancing rate, %	18.8	16.0	14.0	14.0	14.0
3	Required reserve rate on deposits in national currency, %	20.0	15.0	15.0	13.0	15.0
4	Government's external debt in relation to the GDP, %	37.3	31.3	23.1	17.0	14.8
5	Average annual interest rate on short-term loans in national currency, %	21.2	18.8	19.4	18.5	16.4
6	Average interest rate per annum on household short-term deposits in national currency	37.9	34.5	28.7	23.1	17.4
7	Nominal exchange rate of national currency in relation to 1 doll., in soums	1,058.0	1,180.0	1,240.0	1,290.0	1,393.0
8	Total volume of loan deposits of commercial banks, in billion soums	3,572.2	3,853.3	4,104.2	4,777.6	6,372.0
9	Total sum of commercial bank deposits, in billion soums	1,272.2	1,688.7	2,544.5	3,829.2	5,771.6

² The table was compiled by the authors on the basis of statistics of the Central Bank of the Republic of Uzbekistan.

producers by stimulating demand in the internal market was to play the key role in retaining the high rates of economic growth. In these conditions, monetary policy aimed at stimulating internal demand, in our opinion, requires the effective application of a cheap money policy. The relatively low and stable interest rates of bank loans are helping to increase the volume of commercial bank loan deposits in the real sector of the economy. This in turn is giving rise to the need to strengthen the resource base of commercial banks.

Since the first years of independence, a policy aimed at forming a dual banking system has been carried out in Uzbekistan that meets the demands and requirements of the market economy.

The banking system in Uzbekistan has undergone several stages of development during the years of independence.

- **The first stage lasted from 1991 until 1993** and was characterized by liquidation of the mono-bank system, formation of the CBU, and creation of a dual banking system. When the Law on Banks and Banking Activity (15 February, 1991) was adopted, a legal foundation for establishing a dual banking system was created in the country for the first time. Thanks to the law,
 - first, in the short period of time since declaration of the CBU's state independence, branches have been created that ensure the formation and implementation of a monetary policy; and
 - second, a system of commercial banks has formed as the second link in the national banking system.
- **The second stage covered 1994-1997.** During this period the national currency was introduced, a payment system was created that promotes integration into world settlement relations, and banking legislation is being improved (laws On the Central Bank of the Republic of Uzbekistan and On Banks and Banking Activity have been adopted). One of the priority tasks of reforming the banking sector was its de-monopolization.

At the initial stage this mainly happened by creating banks that specialize in servicing separate branches of the economy, such as Gallabank, Pakhtabank, Tadbirkorbank, Alokabank, and Asakabank.

On the basis of Resolution No. 362 of the Cabinet of Ministers of Uzbekistan of 13 July, 1994 (On Financial Support Measures for Developing the Banking System of the Republic of Uzbekistan), commercial banks were exempted from paying certain taxes, which made it possible to improve technical refurbishing and create a payment system.

- **The third stage lasted from 1998 until 2000.** At this stage, the state's policy was aimed at creating private banks; improving corporate governance in joint-stock banks; reforming bank supervision; and re-examining financial reporting in compliance with the IFRS.

One of the strategic areas in the changes was encouraging an inflow of private capital into the banking sector. This process was stimulated in 1997 when a presidential decree On Measures to Stimulate the Creation of Private Commercial Banks was issued that offered several benefits to banks established with a share of physical entities of no less than 50%.

- **At the fourth stage** a banking system reform program for 2000-2003 was adopted, the implementation of which resulted in a system of corporate governance being introduced into commercial banks. Specialized commercial banks, such as Pakhtabank, Gallabank, Asakabank, and Alokabank, were universalized. In addition, the government sets of shares of such banks as Tadbirkorbank, Savdogarbank, Trastbank, Uzprivatbank, and the Ipak Yuli bank were sold.

Resolution No. 195 of the Cabinet of Ministers of 19 May, 2000 On Additional Measures to Stimulate the Participation of Commercial Banks in the Development of Small and

Medium Business endorsed the creation in commercial banks of a concessional lending fund for increasing the access of small business entities to financial resources.

In order to raise the confidence in the banking system, laws On Banking Secrecy (2003) and On Guarantees for Protecting Household Deposits in Banks (2002) were adopted. A fund has been created for protecting household deposits in banks, to which all banks operating in the country belong. This guarantees the reliable protection of deposits, which has significantly increased the population's willingness to place their money in banks. It should be noted that in November 2008 a one-hundred-percent state guarantee was introduced for household deposits in banks regardless of the size of deposit.

The banking system reform program for 2003-2004 included: improving the tools of monetary policy and stimulating non-cash payments; developing retail services and consumer crediting system; raising the financial stability and capitalization of banks; improving the bank supervision system; raising the transparency of the banking system; integrating the financial system into the world economic community; and improving the interbank market.

In 2004, a credit history bureau was created in compliance with a government resolution in order to strengthen financial discipline, lower loan operation risks, and, based on international experience, provide information about potential borrowers. A National Institute of Credit Information of the Central Bank and Interbank Credit Bureau have been registered.

Another step toward increasing the efficiency of the entire banking system was introduction of the UZIBOR reference rate for interbank market deposits, similar to foreign reference rates such as Britain's LIBOR, Germany's FIBOR, France's PIBOR, and Russia's MosIBOR. This innovation, which came into force in October 2004, made it possible to profitably place the funds of commercial banks, raise the liquidity and turnover rate of the short-term money market, and adjust the interest rates of the interbank capital market. UZIBOR is an important benchmark for foreign investors when comparing Uzbekistan's earning power with other countries.

On 15 October, 2003, free conversion of national currency to foreign currency on current transactions of the payment balance was introduced in Uzbekistan. It is important to emphasize that Uzbekistan reached this goal without resorting to external hard currency borrowings. In so doing, it managed to retain the trend toward an increase in the country's international reserves. Over the past 5 years (2004-2008) they increased six-fold and amount to the equivalent of 1.5 annual imports.

The program for reforming and developing the banking sector for 2005-2007 includes: implementing specific measures for reinforcing monetary circulation; raising the stability of the national currency; stimulating an increase in household deposits; drawing large amounts of finances into banking circulation that remain beyond banking circulation; strengthening and raising the soundness of commercial banks; carrying out complete privatization of commercial banks; creating joint banks; developing different types of consumer loans and project financing; encouraging the active participation of commercial banks in the structural changes of the economy; and promoting significant expansion of their operations in the security market.

The program envisages a stage-by-stage increase in the authorized capital for newly created banks, thus bringing its volume up to 5 million dollars by 1 January, 2007 in soum equivalent for commercial banks and up to 2.5 million dollars for private banks. In order to raise the number of private shareholders and stimulate the creation of private banks before 1 January, 2010, the household income acquired as dividends on the shares of commercial banks was tax free.

Deposits in Uzbekistan's commercial banks are dynamically growing. This is partially explained by the increase in the total receipts in household deposits. As of 1 January, 2009, household deposits in the country's commercial banks amounted to 1,644.0 billion soums. In 2008, the increase in volume of household deposits compared with 2006 amounted to 242.4%. But the volume of transaction

deposits in 2008 compared with 2004 decreased. This can be associated with the adoption of a presidential resolution of 5 August, 2005 On Guarantees of Uninterrupted Provision of Cash Payments from Deposit Accounts in Banks.

The adoption of this resolution helped to increase the people's confidence in the banking system. From 2000 to 2005, a trend toward an increase in household deposits was seen. This is explained by the fact that, first, household cash revenues are rising and, second, commercial banks are paying reasonable interest rates. In order to stimulate the attraction of freely circulating household funds, reserve demands on household deposits were cancelled.

In 2005, the CBU undertook serious measures to execute the presidential resolution of 5 August, 2005. One such measure was full support of cash execution of the state budget.

In 2005, as a result of the measures undertaken by the CBU to reduce the amount of cash circulating beyond banks, the average monthly commercial banks' cash turnover increased by 49.7%. And the number of economic entities depositing cash through collection services increased to 7,962. As we know, one of the main ways to reduce the circulation of cash beyond banks is to ensure a stable increase in household deposits in commercial banks.

The data of recent years show the high level of liquidity of banks operating in Uzbekistan, particularly state banks.

There has been an increase in the absolute sum of aggregate capital of commercial banks. Whereas in 2000 this index amounted to 276 billion, in 2008 it reached 2,104.0 billion soums. This was promoted by measures aimed to raise the level of bank capitalization, which helped to fortify the capital base of banks and increase their solvency. In all of the country's large banks, the actual level of capital adequacy ratio (Basel 1) is higher than the standard level.

According to the 2008 year-end results:

- the aggregate current liquidity of the banking system amounts to an equivalent of more than 1.5 billion dollars, which is ten-fold higher than the volume of executory payments on external nongovernmental borrowings;
- the regulatory capital adequacy of Uzbekistan's commercial banks is almost three-fold higher than the international standards determined by the requirements of the international Basel committee on banking supervision;³
- the total assets of commercial banks is almost twice as high as the volume of acquired household and corporate deposits.

During 1995-2005, qualitative structural changes took place in the country's banking system. Whereas in 1995, the share of loans of Uzbekistan nongovernmental banks amounted to 18.8% of the total volume of bank loans, in 2005 this index was 31.1%.

In order to encourage the broad participation of commercial banks in the SME investment process, at the end of 1999-beginning of 2000, banks whose activity enjoyed concessional taxation were allowed to create a special concessional lending fund. The micro loans issued from this fund, as well as by means of lines of credit from extrabudgetary funds, have concessionary interest rates that are twice as low as the official CBU refinancing rate.

In 2008, Uzbekistan's commercial banks granted loans using all of their financing sources to small business and private business entities totaling 1,250.7 billion soums. This is 68.2% more than in 2007.⁴

³ I.K. Karimov, *Mirovoi finansovo-ekonomicheskii krizis, puti i mery po ego preodoleniiu v usloviakh Uzbekistana*, Uzbekistan, Tashkent, 2009, p. 24.

⁴ *Statbuletten Gosudarstvennogo komiteta statistiki Respubliki Uzbekistan*, Tashkent, 2009.

Attracting lines of credit from international financial organizations has made it possible for commercial banks to accelerate the financing of small business entities with respect to financial support of investment projects. Banks are closely cooperating with special extra-budgetary funds, as well as with international and foreign financial organizations that offer dedicated credit lines for developing small and medium business.

Commercial banks in Uzbekistan are active in the money transfer market. The Western Union money transfer system began operating in the republic in 2001. The first bank to introduce this system in Uzbekistan was Biznes Bank, a private joint-stock commercial bank. It was followed by the National Bank VED RU, ChAKB Khamkorbank, the People's Bank, GA Uzzhilsberbank, and others. Today, 14 banks in Uzbekistan offer transactions in the Western Union system. They have registered a total of 250 money transfer terminals, 170 of which are currently in operation (72 in Tashkent). In addition to the Western Union system, rapid money transfer services are offered by banks and other systems in the republic: Contact, MoneyGram, Anelik, Tezkor, MIGOM, and Bystraia Pochta. Only Uzprivatbank, which has opened three terminals in Tashkent, supports rapid money transfers in the Anelik system, the People's Bank in Tezkor, Uzpromstroibank in MIGOM, and Turonbank in Bystraia Pochta. In addition, Asaka Bank introduced its own money transfer system that has no analogs—Asaka VIP Money Transfer.⁵

According to the data of the Center of Economic Research, during 2002-2006 alone the inflow of official money transfers into the country increased more than five-fold, amounting to almost 1.4 billion dollars, or 8.2% of the GDP. Outgoing money transfers rose more slowly, increasing during the same period 2.6-fold and amounting to 226.7 million dollars at the end of 2006. Thus, Uzbekistan is a net recipient of money transfers, whereby the gap between inflow and outflow is increasing.⁶

In order to execute the Cabinet of Ministers resolution of 24 September, 2004 (On Measures for the Further Development of the Payment System Based on Banking Cards), the CBU and commercial banks undertook measures to expand the system of electronic payments using banking cards. For example, as of 1 January, 2006, 21 banks had issued 2,990,000 banking cards and the number of terminals for carrying out payments using banking cards reached 11,016.

The country's government has created the necessary conditions for developing banking card transactions. In particular, commercial banks were exempt until 1 January, 2005 from paying customs fees (apart from customs registration fees) during the import of banking tellers and other technological equipment used for making payments using banking cards. A decrease in the taxable base was established for commercial banks in the amount of the increase in the balance on household banking card accounts.

As of 1 January, 2009, the republic's banks have issued 4.5 million banking cards and set up 27,500 terminals. Large commercial banks account for the bulk of this issue: the National Bank VED RU, Uzpromstroibank, Pakhtabank, Uzzhilsberbank, and Asaka bank. The increase in number of banking cards in circulation will help to develop non-cash payments and expand their sphere of application. A single republic-wide processing center was also created which makes it possible to perform banking transactions in a single regime at all commercial terminals regardless of which bank services the trade organization or card holder.

As can be seen from the data presented, in 2004-2008 a trend was seen toward an increase in assets, loans, deposits, and the aggregate capital of Uzbekistan's commercial banks. In turn, the growth rates in their assets are explained by the increase in loans, since the latter occupy a relatively high percentage in the asset structure.

⁵ *Materialy nauchno-prakticheskikh issledovaniy Tsentra sotsialno-ekonomicheskikh issledovaniy*, Tashkent, 2008.

⁶ *Vliianie denezhnykh perevodov na ekonomiku Uzbekistana*, Center of Economic Research, Tashkent, 2007, p. 6.

In 2004-2007, by lowering the refinancing rate and required reserves standard, the CBU created favorable conditions for deposit-borrowing transactions of commercial banks.

Table 2

**Dynamics of Assets, Loans, Deposits,
and Aggregate Capital of Uzbekistan's Commercial Banks⁷**

	2004	2005	2006	2007	2008	In 2008 compared to 2004
Assets, billion soums	5,004.2	5,630.6	7,207.5	9,276.1	12,064.7	2.4-fold
Loans, billion soums	3,572.2	3,853.3	4,104.2	4,777.6	6,372.0	1.8-fold
Deposits, billion soums	1,272.2	1,688.7	2,544.5	3,829.2	5,771.6	4.5-fold
Total capital, billion soums	824.1	930.9	1,070.1	1,502.6	2,104.0	2.6-fold

These high deposit growth rates are explained by the following factors:

- household monetary incomes are on the rise (in 2008, the average salary in budget organizations increased more than 1.5-fold, while they rose 1.4-fold throughout the economy as a whole, real household incomes per capita increased 23% over the year);
- the volume of net profit of economic entities is increasing;
- a tax privilege was introduced on bank transactions with short-term household deposits (the taxable base of Uzbekistan's commercial banks is shrinking in the same amount as the increase in short-term household deposits).

Since 2005, the government and the CBU have been conducting a policy aimed at raising bank capitalization. As a result of this policy, in 2004-2008 the growth rates in the total capital of commercial banks increased 2.6-fold.

II. The Banking System's Role in Implementing the Anti-Crisis Program

The world financial crisis that began in 2008 led to a curtailment in the volume of investment activity, as well as an economic slump, a drop in demand, and a decrease in the international trade volumes. It also led to a drop in bank liquidity and solvency in many countries of the world.

⁷ The table is compiled on the basis of the statistics of the Central Bank of the Republic of Uzbekistan.

The following factors helped to soften the impact of the world crisis on Uzbekistan's banking system:

1. According to the results of 2008, the total current liquidity of the country's banking system is ten-fold higher than the volume of pending payments on external nongovernmental borrowings;
2. The actual total capital adequacy of Uzbekistan's banking system is almost three-fold higher than the regulatory requirement of the international Basel committee for the capital adequacy ratio of commercial banks.
3. In 2000-2008, the total volume of deposits in commercial banks increased more than 25-fold and reached a level of 15.8% of the GDP.
4. The percentage of problem loans in the gross assets of the republic's commercial banks did not exceed 3%.
5. The country's banking system refused to engage in external short-term speculative loans and its banks conducted a conservative credit policy.
6. Since 2005, the state budget has been executed with a positive balance.
7. Since the second half of 2003, the Uzbekistan government has completely given up the practice of taking out CB loans to cover the state budget deficit.

An Anti-Crisis Program has been drawn up in many countries of the world, including in Uzbekistan, the main component of which is a set of measures aimed at saving the banking system.

Within the framework of the Anti-Crisis Program for saving banks, the following measures were undertaken in different countries of the world:

1. Raising the Level of Bank Capitalization by Means of Additional Issuing of Shares and Offering Subordinated Loans

The state or Central Bank buys up the additional issue of shares. But their financial possibilities are limited. So this measure primarily affects system-forming banks, the bankruptcy of which could have a serious negative impact on the country's financial and economic situation. For example, in the U.S., the largest banks, G.P. Morgan Chase, Merrill Lynch, Morgan Stanley, and Bank of America, found themselves in a liquidity trap. So the U.S. Ministry of Finance had to buy their shares for 125 billion dollars. 125 billion of the 703 billion dollars of the U.S. anti-crisis program adopted in September 2008 were used to help small and medium banks.

The Swedish government decided to pump up to 50 billion kronas (6 billion dollars or 4.7 billion euros) into the country's banks. This step was instigated by the need to raise the banks' liquidity. In exchange, the government will obtain the right to purchase an additional issue of ordinary bank shares. The Swedish injections into the banking sector will be carried out through the stabilization fund, the decision to create which was approved by the parliament in October 2008. The Swedish financial system assistance plan adopted at that time envisages allotting the banks a total of 1.5 trillion kronas (more than 152 billion euros).⁸

In France and Russia, a method for granting subordinated loans was used to maintain the liquidity of large system-forming banks.

⁸ Data from the Internet site [<http://lenta.ru/news/2009/02/03/banks>].

Toward the end of 2008, the Society for Financing the French Economy granted leading French banks 10.5 billion euros in subordinated loans, including Crédit Agricole—3 billion, BNPP—2.55 billion, Société Générale—1.7 billion, Crédit Mutuel—1.2 billion, Groupe Caisse d'Épargne—1.1 billion, and Groupe Banque Populaire—0.5 billion euros.

In 2008, the three largest Russian banks—Sberbank, VTB, and Rosselkhozbank—were granted subordinated loans totaling 950 billion rubles with a 8% annual interest rate until 2020.

In Uzbekistan, the amount of authorized capital of six large system-forming banks was increased by means of state budget and Central Bank funds.

Table 3

**Volume of Funds Used
to Increase the Authorized Capital of Commercial Banks**

No.	Name of bank	Declared authorized capital, billion soums	Additional issue of shares					
			Total	Including				
				2008	2009	2010	2011	2012
1	Khalk banki	200	120	20	30	30	20	20
2	Asakabank	300	147	100	47	—	—	—
3	Promstroibank	100	65	63	2	—	—	—
4	Mikrokreditbank	150	72	54	18	—	—	—
5	Pakhtabank	100	50	22	28	—	—	—
6	Gallabank	50	36	13	23	—	—	—
Total		900	490	272	148	30	20	20

As can be seen from the data presented, until 2012 the amount of authorized capital of six of the country's banks will increase by 490 billion soums by means of state budget and CBU funds.

2. Nationalization of Banks

Due to the world crisis, many commercial banks lost their liquidity and found themselves on the brink of bankruptcy. For example, in the U.S., due to large debts and low liquidity, two of the largest mortgage banks—Fanny Mae and Freddie Mac—were on the brink of bankruptcy. The U.S. government had to completely nationalize them.

In the European Union, Great Britain and Germany are the leading countries with respect to bank nationalization level. In order to prevent the bankruptcy of the country's largest bank—the Royal Bank of Scotland—the British government purchased 58% of its shares. There are also plans to purchase Branford and Bringley.

In Germany, the government bought the shares of three banks. Banks are also being nationalized in other European countries. For example, in Iceland, two of the countries largest banks—Landsbanki and Iltner—have been nationalized.

3. Lowering the Refinancing Rates of Central Banks

In order to raise the liquidity of commercial banks and the accessibility of banking loans, central banks have been lowering their refinancing rates. In the U.S., the Federal Reserve System (FRS) reduced the refinancing rate to 1%, the European Central Bank to 2%, and the Central Bank of Japan to 0.3%.

In 2008, the FRS refinancing rate reached an all-time low in U.S. history of 5.25%. The drop in the Central Bank's refinancing rate corresponds to the increase in the current liquidity of the country's commercial banks. But maintaining relatively low interest rates on commercial bank loans could provoke inflation. According to several experts, maintaining the FRS refinancing rate at one percent for many months in 2002-2003 led to the current world crisis.

On 8 January, 2009, the Central Bank of England lowered its refinancing rate by half a percentage point to 1.5% per annum. This step was instigated by the need to maintain the banks' liquidity and stimulate the solvent demand of economic entities. But in conditions of the world crisis not all central banks are lowering their refinancing rates. For example, the Central Bank of Russia raised its refinancing rate twice in the last few months of 2008. And the refinancing rate of the Central Bank of Uzbekistan has remained unchanged over the past three years (2006-2008) at a level of 14% per annum.

It should be noted that with respect to the world financial crisis central banks have established a long list of securities to be used for guaranteeing centralized loans. For example, the European Central Bank has been accepting corporate bonds and the shares of several corporations nominated in euros since 2008 in order to guarantee the centralized loans offered to commercial banks. The Central Bank of England announced in April 2008 that it was going to offer commercial banks British treasury notes against securities, including mortgages.

For the first time in history, the U.S. FRS began buying government securities directly from the issuer. In addition, in October 2008, the FRS declared that it would directly support U.S. corporations by buying their short-term bonds.

4. State Guarantee of Household Deposits in Banks

The increased risk of liquidity and bankruptcy is lowering the people's confidence in banks. In such conditions, increasing the amount of secured deposits or a 100-percent government guarantee of household deposits are extremely important. For example, in Russia, due to the crisis, the amount of a secured deposit has been raised to 700,000 rubles, in the U.S. deposits of up to 200,000 dollars are secured. In some countries, the state guarantees all household deposits.

5. Government Purchase of Housing for the Poor and for Servicemen

Many banks found themselves on the brink of bankruptcy because they acquired mortgaged real property by means of short-term resources. When the price of real estate began to drop, they experienced a shortage of money since they had insufficient ways to refinance mortgage loans. In such cases, the state can help banks by purchasing housing for the poor and for servicemen.

6. Government Settlement of Residents' International Loans

In some countries of the world, including Russia, problems have arisen as the result of the global financial crisis associated with settling international loans. According to Russian analysts, "in past years these debts were returned by taking out more loans, whereby even in larger amounts than the initial debt. Now Western investors have significantly decreased the loans they offer to the organizations of other countries, particularly Russia. The conditions of these loans have become tougher and the interest rate has gone up. In addition, the dollar exchange rate has increased by 20%."⁹

Keeping in mind the difficulties in paying back international loans received by residents, the Central Bank of Russia allotted Vneshekonombank 50 billion dollars for servicing the international loans of resident companies.

In Uzbekistan, a set of measures was drawn up aimed at resolving the following key tasks:

1. Further accelerated modernization, technical and technological refurbishing of enterprises, and wide introduction of state-of-the-art flexible technology. This primarily applies to the basic branches of the economy, as well as export-orientated and localized production units.

There are plans to accelerate the implementation of branch programs for modernizing and technically and technologically refurbishing production, as well as transferring to international quality standards, which will make it possible to ensure stable positions both in the foreign and in the domestic markets.

2. Implementing specific measures to support export enterprises in order to ensure their competitiveness in the foreign markets in conditions of an abrupt deterioration of the current market conditions and creating additional stimuli for export, including:

- issuing them concessional loans for working capital financing for up to 12 months at a rate of no more than 70% of the refinancing rate of the Central Bank;
- extending, until 2012, exemption from all types of taxes and fees to the budget, apart from VAT, of enterprises with foreign investments specializing in the production of finished commodities;
- restructuring the amount of overdue and current debts on bank loans and writing off the penalty on payments to the budget, as well as offering other no less important privileges and preferences.

3. Raising the competitiveness of enterprises by introducing a tough economic regime and stimulating a decrease in production expenses and cost reduction. In 2008, the proposals of economic entities were approved for implementing measures aimed at cutting the production costs by at least 20 percent in the leading branches and spheres of Uzbekistan's economy.

There are plans to develop an efficient mechanism for encouraging directors and executives who achieve the designated parameters to lower production costs.

A mechanism has also been drawn up in the Anti-Crisis Program to limit any price increases in 2009 on all types of energy resources and main types of communal services to no more than 6-8 percent, with absolute provision of the profitability of their production.

4. Implementing measures to modernize the energy industry, reduce the energy-output ratio, and introduce an effective energy-saving system.

⁹ A.G. Aganbegian, "Rossiia v period globalnogo finansovo-ekonomicheskogo krizisa 2008-2009 gg.," *Bankovskie uslugi*, No. 1, 2009, p. 25.

5. In conditions of the falling demand in the world market, support of domestic producers by stimulating demand in the domestic market plays a key role in maintaining the high rates of economic growth.

An important element of this task is expanding the program of production localization, the volumes of which are to increase 3-4-fold.

The programs adopted for stimulating an increase in the production of food and non-food consumer goods envisage extensive stimuli for supporting domestic production enterprises. In particular, until 1 January, 2012, tax and customs benefits have been granted in the form of:

- lowering the single tax payment rate by 50% for micro companies and small businesses specializing in processing meat and milk, with targeted spending of the released funds on technical refurbishing and modernization of production;
- exempting enterprises specializing in putting out certain types of finished non-food items from paying profit tax and property tax and micro companies and small businesses from the single tax payment;
- adopting measures to lower the single tax payment rate for micro companies and small businesses from 10 to 8 percent, and beginning in 2009 to 7 percent and lowering the rate on household income with simultaneous improvement of its computation scale created powerful stimuli for developing business activity and small and private business.

In order to raise the country's competitiveness in the mid and long term:

- the implementation of several very important strategic projects was accelerated in the energy industry, the oil-, gas-, and chemical industry, and the metallurgical industry;
- another three big programs have been developed for modernizing rail transport, the energy industry, and the leather and shoe industry to begin in 2009;
- a program of technical modernization and production reconstruction for 2009-2014 has been adopted consisting of 852 projects totaling 42.5 billion dollars;
- a set of measures has been developed and is being carried out to expand cooperation with IFIs, international organizations, and funds with respect to co-financing large innovation projects, technical modernization projects, and production infrastructure projects;
- an energy-saving program has been developed that envisages the accelerated withdrawal and replacement of energy-intensive with energy-saving equipment, the complete automation of the accounting system, as well as the introduction of alternative sources of energy;
- measures are being adopted to expand the introduction of both domestic and foreign innovative developments into the economy and create a system promoting their active use not only at large, but also at small enterprises.

On the whole, the set of measures adopted and being carried out within the framework of Uzbekistan's Anti-Crisis Program, the sum of which amounts to a total of 3.9% of the GDP, is aimed at ensuring stability of the country's macroeconomic development.

**CIS, EURASEC, GUAM, AND
BSECO REGIONAL
ORGANIZATIONS: THEIR ROLE
IN THE INTEGRATION
PROCESSES IN CENTRAL
EURASIA**

**ONE OF THE LIMITROPHE TERRITORIES OF
THE GLOBAL WORLD
(TRANSFORMATION OF THE STATES OF
THE BALTIC-BLACK SEA REGION
IN THE 21ST CENTURY)**

P a r t I

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In recent years the academic community has become increasingly engrossed in the conceptions of the Baltic-Black Sea system (BBSS) of international relations. Closer inspection reveals three major approaches. The first approach envisages the conceptual mapping of Europe (an

idea suggested by Stein Rokkan)¹ and its application in the Vienna-Moscow-Istanbul triangle.

¹ See: S. Larsen, "Modelirovanie Evropy v logike Rokkana" (The Modeling of Europe in S. Rokkan's Logic), *Polis*, No. 1, 1995.

The second approach relies on the Cold War logic best described as conflicting interaction; it rests on the agency interpretation, which concentrates on military-strategic aspects and became especially obvious after the Russian-Georgian war of 2008. The third approach is best described as structural and interprets all changes as the geopolitical re-division of territories.

The BBSS problem is undoubtedly topical. It was Halford Mackinder who pointed to the region's geopolitical importance by tagging it as the World Island. It was pointed out long ago that the BBSS was formed by two continental rings, conventionally described as internal (formed by the East European and African-Arabian platforms) and external (formed, with a great degree of approximation, by the Hindustani, Chinese, and Siberian platforms).

Europe, as part of the World Island, is fringed by the Mediterranean basin in the south and a pseudo-Mediterranean basin of the Baltics in the north. There is a fairly wide strip of intermediate territory of the Black Sea and the Baltic runoffs between Europe and the Heartland (formed by Eurasia proper). This makes the BBSS a link between Europe and Eurasia proper.

Geographically we can identify a vast Baltic-Black Sea *Mezhdumorie* (inter-sea area) formed by two strips, one of them being part of the Baltic and the other of the Black Sea basins divided by the Carpathian Mountains that stretch meridionally between them. The river outflows of the Black Sea (the Dniester, Southern Bug, and Dnieper) are found to the east; they are adjacent to the rivers of the Baltic basin (the Nieman, Western Dvina, and the long rivers that flow

across lakes: the Velikaia, Narva, Lovat, Volkhov, and Neva). This is a smaller inter-sea area of sorts, the pied-Carpathian bridgehead of Eurasia.

The Danube basin, to the west of the Carpathians, latitudinally crosses the Small Carpathians (the Beskidy) to join the Vistula and Odra basins. From the geographical point of view, this much more complex and varied area falls apart into several interconnected territories and can be described as the Trans-Carpathian bridgehead of Europe.

Political and economic activities in both geographical niches create *mestorazvitia* (development areas) associated, according to Samuel Huntington, for historical reasons with European and Eurasian civilizational confrontation and development. In other words, the geopolitical self-determination of these places was conditioned by the interaction of two civilizational entities—Europe proper and Russia-Eurasia. This geographic expanse can be described as *mezhdumorie* (an interface of two civilizations according to S. Huntington) with two civilizational orders—the pro-Western that tends toward Europe and the Eastern, which is mentally closer to Eurasia, Russia.

On the whole, the BBSS can be described as a specific geopolitical entity at the junction of two vast geopolitical expanses—Western Europe and Russian Eurasia. It is wrong to think, however, that it tends either toward Europe or Eurasia. Throughout centuries this area acquired an intermediate civilization marked by a very specific mentality, culture, economic order, an undeveloped statehood, and the continuing efforts to find its place on the geopolitical map of Europe and the world.

The “Barrier Reef” between Western Europe and Northern Eurasia

Situated at the junction of civilizations, the inter-sea is a geopolitically fluid area. According to Samuel Huntington, Central and Southeastern Europe and the post-Soviet expanse are found at the junction of the Western Christian, Eastern Christian, and Muslim civilizations.² Hence its geopolitical fluidity is shown in two different ways.

² See: S.P. Huntington, *The Clash of Civilizations and the Remaking of World Order*, Touchstone Books, New York, 1998.

- First, for a long time it was deprived of a statehood of its own and remained part of various state formations (the Russian, Austria-Hungarian, and German empires).
- Second, the low level of legitimacy of the state borders, which were fixed under external pressure rather than by an agreement between the neighboring nations.

For a long time the Baltic-Black Sea region (BBSR) played a special role in the evolution of the European and Eurasian civilizations; it affected their development as well as the level of conflict. In the early period it served a natural barrier between the West and the East; it stopped the Mongols who were pressing into Europe.

A vast Mongolian Empire appeared on Eurasian territory in the 13th century. It was during the lifetime of Genghis Khan, its founder, that the Mongolian vanguard under Jebe and Subadai penetrated the Black Sea coastal area, the southern periphery of the Baltic-Black Sea inter-sea area. In 1223, they defeated the united Polovtsian and Russian forces at the Kalka.

In 1236-1242, Batu Khan, Genghis Khan's grandson, undertook a wide-scale and carefully prepared march to the "last sea" (the Atlantic) to create a great empire stretching from sea to sea. The Genghisids reached the European *Respublica Christiana*. The Mongols penetrated the western sector of the Baltic-Black Sea inter-sea area, besieged and captured Polish, Hungarian, and Czech towns and, after crossing Croatia and Serbia, reached the Adriatic. The behests of the founder of the empire and the first Eurasian civilization were thus fulfilled. On the way back the Mongols established their strict control over the Black Sea steppes and the Crimea.

Kievan Rus disappeared under the pressure of the Genghisids' Eurasian Empire. In 1236-1238, the Eurasian fringes (the Bulgars and the princedoms in the Volga and Don basins) were plundered; in 1240, Kiev and other southern princedoms were captured. The Galicia-Volhynia Princedom withstood the onslaught and checked it. Never captured, the north and the west of Kievan Rus became a buffer zone.

The Mongolian invasion created four territories that, in turn, shaped a new *mestorazvitie*:

- The East of the Eurasian zone became a feudalized periphery of the Golden Horde;
- The North (the Novgorod and Pskov republics), a geographic periphery, became de facto part of the Baltic periphery and, on the whole, matched these republics' geographic location in the Baltic-Black Sea inter-sea area. Having accepted its nominal vassal dependence on the Golden Horde, the North prevented German infiltration into the Slavic lands across the Baltic. The North became an object of expansion of two mutually exclusive cultures, which inevitably interfered with its *mestorazvitie*;
- The Greater Kiev and adjacent territories were depopulated and became politically disintegrated; this caused degradation of their statehood and invited the negative consequences of early colonialism;
- The West came to the fore as the core of new Baltic-Black Sea regional *mestorazvitie* (it included the Galicia-Volhynia Princedom which had lost control over the lower and middle reaches of the Dniester and Prut and survived in the basins of Dniester, Southern and Western Bug, and Dvina, as well as the upper reaches of the Dnieper that remained relatively independent in the context of the mounting feudalization. It was at that time that Galich and Vilnius, among other centers found in the so-called paradoxical periphery, claimed the leading role as a new power center in the BBSR.

It was only in the mid-13th century that Lithuania came forward as a new power center, having become consolidated under Mindaugas into a powerful autocratic state with power concentrated in the hands of the grand duke, who never tolerated rivals. The hegemony issue was radically resolved

when Poland and Hungary became involved to a much greater extent; in 1323 the influence of the Galich princely house was finally destroyed. As a result, Lithuania acquired Volhynia, Poland took Galich, while the southern Carpathian foothills were moved under power of the Transylvanian Rumanians dispatched there by the Hungarian kings. By the mid-14th century, the Rumanians had set up a Moldavian state on the eastern slopes of the Carpathians. The Horde's, essentially no-man's, land can be described as the fringes of the Dikoe Pole that stretched to the middle and lower reaches of the Dniester, Prut, and Siret. In the past there were Russian towns Maly Galich (Galats) and Belgorod (later Akkerman) here; the Crimean Khanate appeared further south.

By the very end of the 14th century a new *mestorazvitie* appeared in the Baltic-Black Sea inter-sea area, the center of which was divided into three peripheries: the Greater Duchy of Lithuania that united the greater part of the Western, Central, and Southern lands of Kievan Rus; the northern periphery with the Teutonic Order in Prussia and Livonia (a federation of one Order and four church possessions), as well as the Novgorod and Pskov republics. The southern periphery included the Moldavian State and the Crimean Khanate.

Throughout the 14th century a new core/periphery configuration of the Baltic-Black Sea area was taking shape; the limes appeared between the Golden Horde and Respublica Christiana. There also appeared the outlines of the BBSS proper formed by the limes, which incorporated the outside centers of power into the system. V. Tsymburskiy offered a highly apt description when he said that a belt of target territories appeared in the Baltic-Black Sea inter-sea area "to become the BBSS meridional axis (including Chersonesos and Tmutarakan) with the BBSS foci found on both sides of the axis."³

Stein Rokkan demonstrated that a periphery oriented toward the continent appeared on the conceptual map of Europe, in which buffer fringes of empires were formed.

The limitrophe role of the Baltic-Black Sea area created political and economic conditions conducive to the emergence of Muscovy, a new center of political power, in the east along the upper reaches of the Volga. This can be described as the main result of the structuring of the Baltic-Black Sea region. The new power center was gradually gaining strength to challenge the Golden Horde, thus assuming the role of a great Eurasian power in its dealings with the Respublica Christiana and intermediate limitrophe lands.

The BBSS created unique conditions for Europe and Eurasia and allowed them to remain mutually isolated for some time. Europe was developing within its own cultural environment untouched by the Asian Mongolian culture. Russia created a new European-Asian culture with the ideology that rejected the European road and yet was gripped by the desire to borrow European (French, German, and Jewish) values, thus rejecting not only its national traditions but also its national interests.

The Baltic-Black Sea Area as a Containment Factor for Europe's and Eurasia's Imperial Ambitions

The period that followed spanned the 16th-19th centuries. The five partitions of Rzech Pospolita, the Peace of Tilzit and the Vienna Congress that allowed Russia to engulf the BBSS can be described as its landmarks.

³ V. Tsymburskiy, "Kak zhivut i umiraiut mezhdunarodnye konfliktnye sistemy," *Polis*, No. 4, 1998, pp. 52-73.

The 16th and 17th centuries were marked by a struggle between Russia and Austria for control over the Baltic-Black Sea area. Russia joined some of the Ukrainian and Byelorussian lands it had had its eye on for a long time. The Austrian Empire acquired the Carpathian foothills to set up the so-called Kingdom of Galicia and Lodomeria on the lands of Galich Rus of the past, thus moving into a target territory long coveted by Hungary.

Prussia received Pomerania (with the exception of Gdansk) and a large part of Greater Poland. What remained of the Polish-Lithuanian state became part of the Baltic-Black Sea area. When partitioned, Poland, an imperial BBSS center, degenerated into a target territory, being replaced by Prussia.

The 18th century was filled with a struggle for control over the BBSS. In January 1793, Russia and Prussia signed an agreement on a new partition of Poland, under which the former acquired the Ukrainian and Byelorussian lands while Prussia moved into part of Greater Poland, Kuyavia, and Gdansk, thus replacing Poland in the BBSS.

In 1793, the Sejm had to accept the conditions of the Second Partition and ratify the corresponding agreements with Russia and Prussia. It also adopted a new Constitution that placed de facto the remnants of the Polish-Lithuanian state (the historical cores of two polities, Small Poland with Podlasie and Masovia, and Lithuania proper) under the control of the Russian Empire.

In 1795, the Courland nobles initiated the process of joining Russia; on 27 May of the same year, the Duchy became the Courland Gubernia of the Russian Empire.

The Fourth and Fifth Partitions took place in the early 19th century: the process proceeded in stages. Under the Peace of Tilzit of 1807 Prussia lost some of the Polish lands transformed into the Grand Principality of Finland (the Duchy of Warsaw was declared to be a constitutional monarchy); and in 1809 the Principality acquired Western Galicia and the Zamojski powiat under the peace treaty with Austria.

Poland was finally partitioned at the Vienna Congress. Earlier, in March 1813 while the war with Napoleon was still going on, Emperor Alexander I had appointed an interim government of the Duchy of Warsaw. At the Vienna Congress the Russian emperor insisted that the Polish state be restored as part of Russia. Some of the Polish lands were united with Russia as the Kingdom of Poland “inalienably connected with Russia under a Constitution” in the form of a union. The Russian emperor added the title of the King of Poland to his royal titles. This reduced Poland to the status of a target territory, which it remained until its statehood was restored after World War I.

The Russian Empire moved into the BBSS’s flanks—Finland and Eastern Moldavia (Bessarabia).

Integration of the Baltic-Black Sea lands was not a success despite certain progressive domestic political steps and the model of enclave modernization in the form of an autonomy for the Kingdom of Poland and the Grand Principality of Finland, which enjoyed the right to pursue their own domestic policies. The results cannot be described as a success despite the special regime in the Baltic-Black Sea area.

In 1816, Alexander I endorsed the liberation of peasants without land drafted by the Estland nobles. Similar laws were adopted in Courland in 1818 and, a year later, in Lifland. The national-liberation movements that swept the territories resulted in curtailed autonomy for Poland. In R. Dahl’s opinion, the Finnish experience was much more successful: the territory acquired a comparatively modern structure of political institutions which, by the end of the first decade of the 20th century, acquired the features of a polyarchy, that is, a democracy as we know it today.⁴

The target territories of the past were much more “European” than the rest of the empire and its standards. They were slowly but surely transformed into fertile soil on which the West-radiated de-

⁴ See: R.A.Dahl, “Polyarkhia, pluralism i prostranstvo,” in: *Antologia mirovoy politicheskoy mysli*, in five volumes, Vol. 2, Mysl Publishers, Moscow, 1997, p. 622 (Russian translation).

velopment impulses could flourish. There are numerous specific institutions and practices of dealing with everyday issues that can be described as grass-root politics still preserved in Ukraine and Byelorussia. Modernization processes were surging ahead in the Black Sea coast of Novorossia, the Crimea, Donbass and elsewhere.

Russia's policies on the newly acquired territories are best illustrated by the way the Crimean Tartars were treated once the peninsula became part of Russia. On 4 May, 1783, practically the day after the Crimea was joined to Russia, Grigory Potemkin, in his order to General Debalmen, wrote: "Her Imperial Majesty wishes that the troops treat the local people friendly without causing offense, ...those who violate this should be punished according to the law." Much attention was attached to religion: "Those who dare to treat their (the Crimean tartars.—*B.Z.*) holy places with disrespect and interfere with the Muslims' prayers should be treated with all possible cruelty as a rebel against the church." It was Grigory Potemkin who allocated money from the imperial budget to support the mosques and Muslim clergy.⁵

In 1936 Professor of Moscow University S. Bakhrushin wrote: "We should bear in mind that it was the nobility of the Crimean Tartars who profited in a very real way from joining the Crimea to Russia."⁶ Early in the 19th century the Tartar nobles owned 60 percent of the arable lands in the Crimea.⁷

The royal decrees of 19 October, 1794 and 17 September, 1796 fixed the rights and privileges of the Crimean Tartars, who became exempt from conscription, some taxes, and billeting; the peasants retained their personal freedom; the land and real estate could be inherited by Tartars of all social ranks and social groups.⁸

While the Crimean Tartars acquired freedom when the peninsula was joined to Russia, the Russian peasants remained serfs.⁹

The empire tried to strike root in the newly acquired territories, sometimes to the detriment of its own social standards; it proved unable to accept the new "European" ideas. The abolition of serfdom in 1861 came too late; this act merely tilled the soil for the 1905-1907 revolution.

The crisis of World War I stirred up revolutionary sentiments in Russia, which can be described as the second Time of Troubles. It should be said that the target territories of the BBSS (previously contested by Russia and Prussia) played a leading role in the revolutionary developments.

World War I created the Versailles-Washington system of international relations that destroyed the imperial German-Russian link. This allowed the temporarily forgotten Central and East European centers of power to come to the fore—this was a time of sanitary cordons. It proved to be short-lived, much shorter than any of Europe's political systems. In fact, by that time the continent no longer identified the BBSR as an independent power center.

In the first half of the 20th century, the evolution of the BBSR as an independent power center followed the common European patterns of totalitarian development: cooperation and confrontation between two totalitarian systems—national socialism in Europe and totalitarian communism in Eurasia (the U.S.S.R.). The geopolitical blunders of the British and French political elites in relation to the expanses to the east of the Odra allowed Germany and the Soviet Union to accumulate enough

⁵ E.I. Druzhinina, *Severnoe Prichernomorie v 1775-1800 gg.*, Moscow, 1959, pp. 93-94.

⁶ S.V. Bakhrushin, "Osnovnye momenty istorii Krymskogo khanstva," *Istoria v shkole*, No. 3, 1936, pp. 57-58.

⁷ A.A. Benningsen, "Ismail-bey Gasprinskiy (Gaspraly) i proiskhozhdenie jadidistskogo dvizheniya v Rossii," in: *Ismail-bey Gasprinskiy. Rossia i vostok*, Kazan, 1993, p. 81.

⁸ See: S.P. Deriy, "K voprosu o deiatel'nosti komissii po razresheniyu zemel'nykh sporov (1802-1810 gg.)," *MAIET*, Simferopol, Issue 3, 1993, p. 162.

⁹ See: B.V. Zazhigaev, *Evolutsia politicheskogo ustroystva v Respublike Krym v period 1989-1998 godov: Dissertatsia na soiskainie uchenoy stepeni kandidata politicheskikh nauk*, MGIMO (University) MID RF Press, Moscow, 2003.

potential for another clash to seize the continent with the BBSR as its restored epicenter. The Molotov-Ribbentrop Pact of 23 August, 1939 made World War II possible. It, in turn, became the apogee of the program of an imperial international communist system that engulfed the entire BBSR territory. The bi-polar Yalta-Potsdam system dominated the world. The Heartland of Mackinder finally became completely identified with the Soviet Union, while the Rimland of Nicholas Spykman with the Atlantic civilization headed by the United States as the guarantor of its continued existence.

The Soviet Union and the countries of the socialist camp imbibed the main political and economic traits of the cruelest totalitarian regimes in their extreme forms of tyranny camouflaged by the international proletarian quasi-ideology of communism. In his *The Grand Chessboard*, Zbigniew Brzezinski has provided an outline of its structure.¹⁰

Moscow and the territories of the first echelon of the Russian Federation that radiated its political and power impact onto the adjacent Union republics became the linchpin of the inner empire. The empire's external circles (the satellite countries) living behind the Iron Curtain that separated them from the rest of the world formed the second group; the third group included the geographically distant client states.

The moral degradation of the Soviet political elite killed the Soviet Empire; in the latter half of the 1980s its leaders abandoned the ideological values of Marxism-Leninism. In his *Democracy and Totalitarianism*, Raymond Aron predicted the inevitable collapse of the communist utopia: he was convinced that bit by bit the revolutionary enthusiasm would be dampened; after a long period the revolutionaries, or their sons, might become bourgeois.¹¹

Mikhail Gorbachev armed himself with "values common to mankind" to declare detente as the Soviet Union's foreign policy priority. The Soviet leaders were resolved to draw closer to the West under the slogan of a "common European home from the Atlantic to the Urals."¹² The system began to erode as soon as the Iron Curtain was lifted and the Marxist-Leninist ideology abandoned. Milovan Djilas, a Yugoslav political scientist, offered a highly interesting opinion. He said that professional revolutionaries occupied the posts in the East European countries, which ensured them all privileges, and that the communist upper crust had become bourgeois. The new regimes, he continued, which called themselves People's Democracies, were, in fact, oligarchic states in which a small privileged class exploited the popular masses.¹³

Communism gradually underwent a decline and the "empire of evil" began disintegrating between 1989 and 1991; the Soviet Union was no longer a centralized mechanism. The socialist camp in Eastern Europe was the first to fall apart.

In these conditions Russia, the legal heir to the Soviet Union, was kept busy by appropriating the Soviet Union's diplomatic missions and their property as well as finances and assets. It was Moscow that initiated the disintegration of the Soviet Union in 1991; it was the first to declare its independence and worked hard to pry the union republics away from their common state. The world was stunned by what looked like the speedy decline of the Soviet Union. The August 1991 putsch in Moscow paralyzed the central government.

During several short days in December 1991, the heads of Russia, Ukraine, and Byelorussia announced that the Soviet Union had been disbanded. Later it was officially replaced with a loosely connected structure called the Commonwealth of Independent States (CIS).

¹⁰ See: Z. Brzezinski, *The Grand Chessboard. American Primacy and its Geostrategic Imperatives*, Basic Books, New York, 1997, pp. 88-90.

¹¹ See: R. Aron, *Demokratia i totalitarizm*, Moscow, 1993, p. 127 (Russian translation).

¹² M.S. Gorbachev, *Perestroika i novoe myshlenie dlia nashey strany i dlia vsego mira*, Politizdat, Moscow, 1987, pp. 199-219.

¹³ See: M. Djilas, "Novyy klass (analiz kommunisticheskoy sistemy)" (The New Class: an Analysis of the Communist System), in: *Antologiya mirovoy politicheskoy mysli*, Vol. 2, p. 578.

“The collapse of the Soviet Union produced monumental geopolitical confusion. In the course of a mere fortnight, the Russian people—who, generally speaking, were even less forewarned than the outside world of the Soviet Union’s approaching disintegration—suddenly discovered that they were no longer the masters of a transcontinental empire but that the frontiers of Russia had been rolled back to where they had been in the Caucasus in the early 1800s, in Central Asia in the mid-1800s, and—much more dramatically and painfully—in the West in approximately 1600, soon after the reign of Ivan the Terrible.”¹⁴

Later, the feverish division of the post-Soviet legacy developed into a landslide, which in 1991 took the form of the “parade of sovereignties.” Zbigniew Brzezinski offered the following description of this: the territory “...was now to be filled by a dozen of states, with most (except for Russia) hardly prepared for genuine sovereignty and ranging in size from the relatively large Ukraine with its 52 million people to Armenia with its 3.5 million. Their viability seemed uncertain, while Moscow’s willingness to accommodate permanently to the new reality was similarly unpredictable.”¹⁵

The American political analyst looks at the CIS as a post-imperial structure in which the republics were moved away from the axis, the Russian Federation, to form a new outside empire (an autonomous shell or a new sanitary cordon).

It has deprived Russia of the possibility of exerting its political influence on the limitrophe territories of the past, which means that the disintegration of the Soviet Union had created a new geopolitical situation in the world. “The collapse of the Russian Empire created a power void in the very heart of Eurasia. Not only was there weakness and confusion in the newly independent states, but in Russia itself, the upheaval produced a massive systemic crisis, especially as the political upheaval was accompanied by a simultaneous attempt to undo the old Soviet socioeconomic model.”¹⁶

The seventy years of totalitarian regime destroyed all the prerequisites (including the genetic ones) needed to defend the Soviet Union by its citizens and to defend the CPSU by its members. “Three-quarters of a century of Communist rule had inflicted unprecedented biological damage on the Russian people. A very high proportion of its most gifted and enterprising individuals were killed or perished in the Gulag, in numbers to be counted in the millions.”¹⁷

It should be said that the nomenklatura (the Communist Party, Komsomol, and trade unions), as well as the KGB and its heirs in the form of the special services of the newly independent states were the main instrument that ruined and destroyed the Soviet Union. They used violence in its worst and most cruel forms rooted in the Stalin experience of the 1930s to impose their policies. Milovan Djilas wrote in his time that while in classical capitalism the hired worker and the capitalist were equal before the law even though in the material respect the former was the exploited and the latter the exploiter, in this case everything was absolutely different. With the legal equality in relation to material wealth (the nation was regarded as the formal owner) in fact a narrow circle of rulers profited from this material wealth using their monopoly on administration as an instrument. Any real demand for freedom under communism (this is what strikes communism at its very heart) in essence is reduced to a demand to correlate all relations (material and property) with the law.¹⁸

It was the form and causes of the disintegration of the Soviet Union that created a unique geopolitical situation in the region: “The disintegration late in 1991 of the world’s territorially largest state created a ‘black hole’ in the very center of Eurasia. It was as if the geopoliticians’ ‘heartland’ had been suddenly yanked from the global map.”¹⁹

¹⁴ Z. Brzezinski, *op. cit.*, p. 88.

¹⁵ *Ibidem*.

¹⁶ *Ibidem*.

¹⁷ *Ibidem*.

¹⁸ See: M. Djilas, *op. cit.*, p. 578.

¹⁹ Z. Brzezinski, *op. cit.*, p. 87.

It was as early as 1992 that Zbigniew Brzezinski put forward the Balto-Pontic doctrine—which was the term American political science used to describe, in the post-Soviet period, a possible alliance between Ukraine, Belarus, and Lithuania. The doctrine's author insisted that the United States needed the Balto-Black Sea Union as a belt that would lock Russia and its expansionist intentions in Asia.

The disintegration of the Soviet Union restored the BBSR to its natural state; today it occupies the historical place identified by Samuel Huntington as a barrier between Europe and Eurasia. In the globalized world, however, the BBSR cannot be regarded as an independent power center.

The Territory of Interlinking Civilizations

The present configuration of the BBSS was determined by the repercussions of the disintegration of the Soviet imperial expanse. The imperial counterpoint was simplified to the extreme; it is created by Moscow and Brussels; individual Western states, the United States especially, have certain roles to play in the process along with historical traditions. They make it possible to influence the former target territories (now independent states), as well as Germany, Sweden, Poland, and Hungary. Rumania, which controls Moldova, the western part of the target territory, and exerts influence on the divided state, is a special case.

The BBSS is formed by the RF's Kaliningrad exclave, Estonia, Latvia, Lithuania, Belarus, Ukraine, and Moldova and branches off to Finland and, in certain respects, to Poland.

The domestic arrangements of the independent states of the Baltic-Black Sea area are obviously stamped with their previous experience. For nearly five centuries they were target territories of Sweden, Prussia (Germany), Austria, the Sublime Porte, and Russia. The latter dominated them for quite a long time as the Russian Empire and the Soviet Union, a fact that helped the formula of state development created by the counterpoint of the national and imperial policies to take root there.

The dual position of the limitrophe territories of the Baltic-Black Sea zone contributed to the emergence of several common institutional traits caused by the hegemony of Poland, Sweden, and Germany, on the one hand, and Russia (the Soviet Union), on the other, in its northern part, and Austrian, Turkish and Russian hegemony in its southern part.

Let us look at the entire range of state forms in the Baltic-Black Sea area, albeit in general terms.

In the north Finland, which left the sphere of Russia's (the U.S.S.R.'s) imperial hegemony through a slow evolutionary process full of compromises, demonstrates sustainable development. This became possible due to its policy, which goes back to the early 19th century and can still be described as extremely useful to Finland and Russia (to a certain extent).

Estonia set up a classical parliamentary republic. In Latvia this state form demonstrates certain yet not entirely distinctive features. In both cases, however, statehood bears traces of the remnants of the autocratic syndrome; both states pursue highly nationalist policies that smack of apartheid. Lithuania is moving away from a parliamentary republic to the presidential-parliamentary system fraught with the danger of super-presidentialism, on the one hand, while it is encouraging pluralism and autonomy of the informal sectors of its polity, on the other. Both can probably be explained by traces of Russian and Polish traditions.

Belarus can be described as a super-presidential state, which is transforming into new "civilized" forms of authoritarianism. The state rests on the presidential-parliamentary system dominated by a policy that brings to mind Soviet practices. Today, the country needs imperial underpinning in the form of the Union State. Under certain conditions Warsaw, Brussels, and even Washington are pre-

pared to play this role, while Minsk has recently been demonstrating its readiness to accept this and received favorable signals.

Ukrainian statehood is very hard to interpret. The main problem is rooted in the Soviet past when a unitary state was set up to bring together different target territories. Those territories that are fairly close ethnically, culturally, and linguistically are still disunited by obvious, persisting, and fundamental differences. Ukrainian identity has existed for over a century and is still developing despite its contradictory nature. State development and nation formation within the only available framework of quasi-statehood Soviet style remain the main stumbling block. Even in much simpler contexts (Estonia is an ample example), life called for much more complicated and diverse institutional decisions. The Ukrainian political class, however, remains devoted to the “sacred cow” of unitarianism with the capital serving as the center and artificial administrative-territorial division. In fact, no productive and sensible state development in Ukraine is possible unless more complex forms of political organization are accepted, including the principles of territorial (federative or autonomous), con-social and corporative distribution of power. This calls for an account of the patchy historical past of the country’s political expanse, the varied nature of its population and its very different political cultures. This alone will transform the artificially created expanse into an integral state system.

In Moldova, parliamentarism is coupled in a very balanced and sustainable way with respected presidential power capable of national integration. The country still has its share of serious problems when it comes to state development and nation formation, but these problems can be resolved: under the pressure of the unfavorable conditions the political class and ordinary people are forced to seek agreement for the sake of small yet reliable results.

Moldova is a divided country, which interferes with its state development: Western Moldova belongs to Rumania; Bukovina is divided between Rumania and Ukraine, while the traditional Transnistrian core, the source of the country’s economic, cultural, and political progress, was separated from it and transformed into the Transnistrian Moldavian Republic.

Even a brief overview shows that in the presence of their different development patterns the Baltic-Black Sea countries are disunited by the recent systemic (communist) closeness. This means that many problems in the state development sphere (this is especially true of the CIS countries) cannot be shifted to the sphere of inter-state communication but are resolved along the old nomenklatura (mostly criminal) channels.

Mikhail Gorbachev, the last general secretary of the CC CPSU, is guilty of a geopolitical blunder or, rather, of betrayal of the Soviet Union’s national interests. This caused tectonic shifts on the Eurasian continent; the results are comparable with those of World War I and the October coup of 1917.

From the geopolitical point of view, these results can be divided into three levels.

Level One—global. The tectonic processes changed the entire structure of international relations. The bipolar system shaped by forty years of world history that helped mankind survive during the frightening years of “nuclear deterrence” has disappeared. With the disappearance of the Soviet Union, the world became unipolar.

The world with the only superpower, which emerged from the ruins of the old system in 1989-1991, did not stabilize the situation. The geopolitical global mosaic became different; the status of the states and their places in the system of international relations changed. The same applies to the regions, Europe in particular.

In the years of global confrontation between the Soviet Union and the United States, the two principle actors regarded Europe as a buffer zone. The two superpowers were readying for a thermonuclear war and were resolved to wage it in the Old World. In his interview to the *Kommersant-Vlast* journal (Russia) that appeared on 28 March, 2005, Colonel-General M. Burlakov, the last commander of the Western Group of the Soviet Armed Forces, said: “I frequently met Chairman of the NATO Military

Committee Klaus Naumann, who once told me: 'I saw the plans of the GDR army which you endorsed.' He agreed with our timetable which said that we could have reached La Manche in a week's time."²⁰

The post-Soviet global geopolitical landscape was absolutely different. During the Cold War, the United States was the center of attraction for a large varied and poly-civilizational group of countries tied together by a shared objective: containment of Soviet expansion. Colonel-General Burlakov's interview confirms this. The end of the Cold War spelled the end of this multi-national intercultural community; the West was no longer afraid of the Soviet Union. In fact, it was this fear that tightened the allied bonds in the sphere of military, economic, civilizational, and cultural interests.

Freed from the common threat, the European countries revised their interests and foreign policy priorities. European integration contributed to the separation of interests of the European states; they became potentially conflicting (especially in the economic sphere, energy resources in particular). Europe is no longer a buffer zone between two opposing superpowers of the bipolar world. It has developed into an independent geopolitical actor with global interests.

The trend toward America's waning hegemony on the international scene became clear in the 21st century. The Soviet Union ceased to exist—the cherished dream of Kissinger and Brzezinski came true; this was the beginning of the end of American world domination. In his interview to *Newsweek*, well-known American political scientist Francis Fukuyama said that America's strength in the world was waning mainly because other powers were getting stronger, which could be predicted.²¹

New giants are coming out onto the world area; they are getting stronger before our eyes. They are united Europe, with united Germany insisting on its leadership, and China. America is still an uncontested leader but the growing monsters are pushing it out, from both the political and economic arenas. They will continue doing this until they move it away first from their regions and zones of influence and later from all the other places.

Dr. Kenichi Ohmae, a Japanese economist, predicted that by the mid-21st century the Chinese economy would be 8 times bigger than Japan's. This will obviously change the format of Eastern integration: ASEAN + 3 will be replaced with China + 12. This is how the "Eastern wing" of Eurasia will look. Complete symmetry might be achieved: the United States of Europe in the West and, probably, the United States of China" in the East.²²

In his *The Tragedy of Great Power Politics*, John Mearsheimer, professor of Political Science at the University of Chicago, has written: "A rising China is the most dangerous potential threat to the United States in the early twenty-first century. ...the United States has a profound interest in seeing Chinese economic growth **slow** considerably in the years ahead." Prof. Mearsheimer has also written that China is not a single U.S.'s rival. He points to the European Union as another potentially formidable rival.²³

Professor of Economic History at Harvard University Niall Fergusson is convinced that power and force are not a natural monopoly; the power struggle is eternal and omnipresent. Unipolarity, writes Prof. Fergusson, a very popular topic of the early post-Soviet period, could not last long for the simple reason that history does not tolerate hyper-powers. Rivals that will appear sooner or later will bring the world back to the multipolar world of great powers.²⁴

In the post-Soviet world, Russia is no longer a pole of the bipolar world; the disintegration of the Soviet Union made it a fragment of the international relations structure. Russia's economy cannot be described as strong (its GDP comprises a miserly 2.4 percent of the global gross product); it has no

²⁰ M.P. Burlakov, "Interview," *Kommersant-Vlast*, 28 March 2005, available at [<http://vnr-su-army.narod.ru/interviu.html>],

²¹ See: "Francis Fukuyama: Back to the End of History," *Newsweek*, U.S.A., 29 September, 2008, available at [<http://www.inosmi.ru/translation/244157.html>], 8 June, 2009.

²² V. Konotopov, "Zakat imperii," available at [www.from-ua.com/politics/420b3bb377ba7], 8 June, 2009.

²³ J. Mearsheimer, *The Tragedy of Great Power Politics*, W.W. Norton, New York, 2001, pp. 362, 402, 386.

²⁴ See: N. Fergusson, "Mir bez gegemona," *Svobodnaia mysl'*-XXI, No. 1, 2005, available at [http://www.postindustrial.net/content1/show_content.php?id=119&table=free&lang=russian], 8 June, 2009.

serious army (its nuclear weapons are obsolete and cannot be used in local wars, particularly in Europe); its population is smaller not only than that of Brazil but also of Indonesia, Bangladesh, and even Nigeria. Russia lost its influence in the countries of the former socialist camp and in the Baltic countries. This context adds special importance to what Samuel Huntington has to say: "Overall Russia is creating a bloc with an Orthodox heartland under its leadership and a surrounding buffer of relatively weak Islamic states which it will in varying degrees dominate and from which it will attempt to exclude the influence of other powers. Russia also expects the world to accept and to approve this system. Foreign governments and international organizations, as Yeltsin said in February 1993, need to 'grant Russia special powers as a guarantor of peace and stability in the former regions of the USSR.' While the Soviet Union was a superpower with global interests, Russia is a major power with regional and civilizational interests."²⁵

The Soviet Union did not merely fall apart; its ruins buried the geopolitics of the strongest empire of the 20th century which had taken about 100 years to achieve its final shape. Throughout the 20th century Russia's geopolitics was shaken twice. This geopolitical collapse undermined trust in Russia as a partner in international relations. Today under certain conditions the Russian Federation might become one of the poles of the multipolar world but it is unlikely to impose its rules on others.

(To be continued)

²⁵ S.P. Huntington., op. cit., p. 164.

CENTRAL ASIA: REGIONAL RESPONSE TO A GLOBAL CHALLENGE

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What is the Global Challenge to Central Asia?

Central Asia should take up the challenge of globalization, hence the question: How should the Central Asian countries respond to it and what constitutes the challenge after all?

Globalization means that all sorts of international factors (economic, political, cultural, information exchange, etc.) have come to play an ever-increasing role in the social sphere

of various countries. To a certain extent this can be described as a “global challenge to Central Asia.”

Independence and sovereignty issues are two additional factors of the global challenge—this cannot be doubted or disputed. The new geopolitical Great Game has reached its culmination: indeed, the struggle for independence of the former Soviet republics did not end in 1991. It reached new heights in the early 21st century.

Throughout the period of their technical rather than real independence, the Central Asian countries were living, developing, and building their statehoods under permanent geopolitical stress. They failed to coordinate their foreign policies, thus burying the course toward integration formulated in December 1991 as a response to the Soviet Union’s disintegration.

There is another, no less important, aspect related to the essence of the budding world order and the countries’ attitude to it. The Central Asian countries, like all the other post-Soviet states, were carried away by the fictitious concept of the multi-polar world (an antinomy of the unipolar world theory) softly imposed on them.

The present system of international relations has two most important aspects **identified from the position of world order as a “regionalized and multi-sided world.” Regionalized should be interpreted as the world’s geographic regulation while “multi-sided” (but not multi-polar) describes entity regulation.**

At all times world order has been related to the problem of territorial control and the means and methods of administering it the controlling entities selected. During the Cold War period it was not the regionalization principle that was at play but rather the division into spheres of influence between the two powers. The resultant world order could be described as bipolar.

Today, the spheres of influence are replaced with regions while the entities of world order can no longer be described as poles but rather as various sides *involved*—states and international organizations. This means that the Central Asian countries should abandon the principles of the multi-polar world policies for the sake of regionalized and multi-sided relations.

Caught between Dependence, Independence, and Mutual Dependence

Regionalization is the right road toward the globalized world in which universal standards, forms, and rules of co-habitation on the planet Earth will gradually emerge and become accepted. Regional “re-division of the world” has nothing in common with imperialist re-division—it should be treated as the response of many countries to the challenges of globalization and a form of adaptation to it. This means that regionalism is the Central Asian countries’ road to independence.

Here is a question: why did the regional organizations (I have in mind the CIS, EurAsEC, and SCO), which operate in practically the same geographic areas, come into being? Could we limit ourselves to bilateral relations without developing regionalized international relations? Indeed, what is the purpose of many other similar structures set up in different corners of the world (the EU, NAFTA, MERCOSUR, ASEAN, ECO, and others)?

International regionalization is a sign that countries within certain zones have entered into special relations; they are mutually dependent to a very great extent; this helps them to develop, flourish, and ensure their safety.

It should be said that regionalization is not limited to places with geographically distinct regions—it also appears in areas with no identifiable regions.

This transforms regionalization from a purely geographic to a sociopolitical phenomenon created by human community rather than nature or a structure. It is a man-made creation. To borrow an expression from Benedict Anderson, it is an imagined community.

For this reason regionalization (the creation of a region of one's own) has become a typical feature of international relations today. This fully applies to the Central Asian region, which is a geographic expanse and a community at one and the same time.

Can any of the Central Asian states cope with the globalization challenge single-handedly? I doubt it: there is still no clear idea about dependence, independence, and mutual dependence in any of these states, which cannot yet select the best conception of world order (the multipolar conception turned out to be false). Hence their inability to identify *their own region*. M. Suiunbaev of Kyrgyzstan has rightly written: "The countries of our region have not yet achieved intellectual sovereignty and are not ready to undertake self-identification."¹

In fact, cooperation between the Central Asian countries and NATO, the CSTO, SCO, EurAsEC, and OSCE is geopolitically distorted: NATO and OSCE represent Western interests while CSTO and SCO oppose them.

Uzbekistan, for example, could have developed better relations with them had they been states rather than organizations.

Interstate relations differ radically from the relations inside organizations: the former are shaped in the context of national interests while the latter assume a supra-national context. In the first case, sovereignty is an absolute category, while in the second, it is relative.

As a member of international organizations Uzbekistan has failed to draw a line between its national and international, supra-national interests. As a member of international organizations it demonstrated obstinacy: the incident with the American base in Khanabad, the absolutely unfounded fears of a "color revolution," its repeated membership in the CST/CSTO and its policy in relation to GUUAM confirm this.

Hence the reversal nature of Central Asian foreign policy (geopolitics), which is explained primarily by the fact that the political elites are power thirsty: their policies have nothing to do with the classical laws of this type of relations.

This suggests the term "regime geopolitics," which manifests itself in attempts to add a geopolitical status to the regimes and, for this reason, as ad hoc reversal policies because of the lost political course.²

The so-called geopolitical America-China-Russia triangle proved to be the hardest test for the Central Asian countries. It largely warped the region's geopolitical configuration and political composition.

On the whole, the situation is as follows: Russia is using the mechanisms of the CIS, CSTO, and EurAsEC to pull the region northward; China is pulling it toward the East through the CSO, while the U.S. is exploiting the Greater Central Asian project to tie the region to the south.

In 1991 Uzbekistan came forward with the Turkestan is Our Common House conception and was one of the locomotives of Central Asian integration. This process was cut short in 2006 when the Central Asian Cooperation Organization (CACO) was united with EurAsEC under the false pretext

¹ M. Suiunbaev, "Problemy identichnosti, predelov tselesoobraznosti integratsii i neodnomernosti ee protsessa," in: *Proekty sotrudnichestva i integratsii dlia Tsentralnoi Azii: sravnitelnyi analiz, vozmozhnosti i perspektivy*, ed. by A.A. Kniazev, Bishkek, 2007, p. 46.

² I have already discussed the phenomenon of reversal policies in my article "Strategic Friction in Afghanistan and Geopolitical Reversal in Central Asia" that appeared in *Central Asia and the Caucasus*, No. 2 (56), 2009.

that they overlapped one another. In this way, the independence and mutual dependence regime was transformed into the dependence regime.

Nearly a year ago prominent American scholar and expert on Central Asian affairs Frederick Starr commented in an interview to the *Expert-Kazakhstan* journal on the New Great Game conception by saying that Russia alone was contemplating the situation in its context.

“I believe,” said he, “that this temporary situation is caused by the post-colonial syndrome which will finally go away. Neither the West nor America wants to make Central Asia part of their empire. This is absolutely impossible in practical terms and nobody has ever planned this. They want to help the region’s countries and nations live their own lives.”³

In the same interview Frederick Starr also said: “Recently, I met in Washington Chinese experts who told me that their country recognized the right of the Central Asian countries to set up regional organizations without interference or direct participation of other states, China included.

“Regrettably, Russia is convinced that this is impossible. It insists that the Central Asian countries have no right to set up their regional organizations without its participation or without China, America, India or Iran.

“Your countries have this right. I am convinced that later Moscow will change its approaches. This means that these countries are not threatened. If you have a self-governing region it will threaten no one. This will serve the cause of common security.”⁴ (Emphasis mine.—*F.T.*)

The concepts of independence, national interests, and security have changed—they are believed to belong to the sphere of activities of the political and business elite. R. Saifulin, an expert from Uzbekistan, has pointed out with good reason that these people “have already grown accustomed to the taste of their independence and are not prepared to sacrifice even part of it to integration.”⁵

This suggests that the foreign policies of the Central Asian countries, Uzbekistan in particular, have serious flaws that can be conventionally described as the “side effect of independence:” independence can be likened to an overdose of a low-quality medicine.

Central Asia-Pessimists vs. Central Asia-Optimists

The history of European integration included Euro-pessimists and Euro-optimists; the recent history of Central Asia has its share of both, however pessimists prevail.

Alexey Malashenko of Russia offered the most “systemic” definition of their contradictions: “Nobody has even doubted that Central Asia should be integrated. It is an axiom—on the verbal level. In practice the solution is steadily postponed and now looks hardly feasible.”⁶

To confirm these thoughts, the Russian expert offers arguments that to my mind are fairly contradictory and, therefore, not quite convincing, although fairly popular.

- The first argument: the region’s still vague definition. Dr. Malashenko reminds us all that in Soviet times the region had a longer name—“Central Asia and Kazakhstan.” The “and” con-

³ *Expert-Kazakhstan*, No. 4, 1 September, 2008 (see also: F. Starr, “Mnogovektornost—edinstvenno vozmozhny put dlia vsekh stran Tsentralnoi Azii,” available at [www.centrasia.org], 2 September, 2008).

⁴ *Ibidem*.

⁵ R. Saifulin, “Tsentralnoaziatskaia integratsiia: slozhnyi put ot deklaratsii k realiiam,” in: *Proekty sotrudnichestva i integratsii dlia Tsentralnoi Azii: sravnitelnyi analiz, vozmozhnosti i perspektivy*, p. 22.

⁶ A. Malashenko, “Tupiki integratsii v Tsentralnoi Azii,” in: *Proekty sotrudnichestva i integratsii dlia Tsentralnoi Azii: sravnitelnyi analiz, vozmozhnosti i perspektivy*, p. 16.

junction pointed out that the region was indivisible; its Soviet name, however, was obviously absurd: it never divided the region and failed to describe it as an entity.

- The second argument: the region is not homogenous; its population is divided into nomads and urban dwellers. For 100 years the nomads of the past (the Kazakhs and Kyrgyz) have been living in their own states (union republics and independent states) with developed industries. Kazakhstan, for example, has supported its leadership with a modern and even Westernized way of life.

Meanwhile the so-called urban nations (Uzbeks and Tajiks) were also nomads; this means that the distinction between the nomadic and settled peoples is a delusion.

- The third argument: the region is allegedly falling apart. Dr. Malashenko has written: "An analysis of regional developments has long become impossible without taking into account the Afghan elements and hence the events in Pakistan, etc. Everything going on in the 'far abroad' is much more important for Tajikistan, for example, than the squabbles in the ruling elite of Kazakhstan."

This does not hold water.

- First, the events in Pakistan and Afghanistan should be taken into account when we analyze the security issues of the European countries as well, but this should not cast doubt on the positive effects of their integration and does not speak of the region's disintegration.
- Second, the events in Afghanistan, and in the rest of the world, are the global challenges to be countered through regionalization.
- Third, the political developments in Uzbekistan are much more important for Tajikistan than everything that is going on in the far abroad.
- The fourth argument: the old border and water distribution problem. At first glance it disunited the region's countries and breeds mutual mistrust, yet the current disunity might create new mutual territorial claims and water-related conflicts. Those who speak about the Central Asian problems imply Russia's inevitable mediation.

We tempted to ask the great power whether it will perpetuate the current situation in the region for the sake of its continued mediation?

Joint administration of the region, that is, full-fledged integration, is the only answer to the territorial, water, and other problems. It has always been possible to carry out such a policy and today we can register very tangible results.

- The fifth argument: the Central Asian countries cannot close ranks to stand opposed to the security threats.

Alexey Malashenko has written: "Central Asian society is unlikely to close ranks for the sake of its joint opposition to the common external threat, coming, for example, from the reviving Taliban of Afghanistan. We should always bear in mind that Turkmenistan has been quite friendly with them."

For some reason the author of the above tends to ignore the concerted efforts of Kyrgyzstan, Tajikistan, and Uzbekistan which set up a headquarters in 2004 to coordinate their security structures in opposing the IDU fighters who crossed the border from Afghanistan. The joint military operation was a success.

We can also point to the Agreement on Joint Actions to Fight Terrorism, Political and Religious Extremism, Transnational Organized Crime and Other Threats to the Sides' Security and Stability the presidents of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan signed in April 2000.

The Central Asia-pessimists often contradict themselves without noticing it. They insist that the region's integration can be realized only as part of larger structures dominated by a great power; it is often said that Nazarbaev and Karimov mistrust each other and compete for regional domination.

If this is true will their countries' membership in the EurAsEC, CIS, or any other post-Soviet structure put an end to this rivalry? Indeed, if integration within any structure is possible why is it considered impossible in a narrower, Central Asian, context?

In other words, if there are insurmountable barriers to regional integration why are they expected to disappear within EurAsEC or the CIS while being prominent within the Central Asian region? It looks as if the hopes are being pinned on great power regulation.

Those who support SCO integration (the Central Asia-optimists) insist on this structure's numerous advantages: the geographic scope (from the Atlantic to the Pacific and from the Arctic to the Indian oceans); the members' combined GDP (\$2500 billion); population size (2.8 billion, or 45 percent of the world market); military might (supported by two nuclear powers); and natural riches (half of the world's oil and gas reserves).

These macro-statistics camouflage the micro-statistics and the Central Asian economic reality. These figures have nothing to do with territorial unity and open state borders (which can be said about the European Union); common foreign and defense policies, etc.

Behind these figures are the organization's conceptual deficiency and compositional incompleteness, as well as its inadequate ambitions.

The so-called Tajik Question is highly important for the pessimism vs. optimism discussions of Central Asian integration. I have in mind the way Tajikistan and the Tajiks treat the issue of regional integration within the Central Asian structure. Analysts stress the fact that the Tajiks who speak Persian will hardly be willing to integrate with the Turkic-speaking countries.

So far, this thesis has not been confirmed—what is more, it cannot be verified. There are several factors that speak of the opposite: Tajikistan and Uzbekistan are mutually dependent to a great extent, which has its positive and negative sides.

Late in June 1999, President of Uzbekistan Islam Karimov paid an official visit to Tajikistan where he laid on the table the following theory: the Tajiks and Uzbeks are one and the same people speaking different languages. The political effect was impressive, even though the theory had little to do with science. There was a lot of talk about the two countries resuming their friendship and even forming a union. Several days later the deplorable events in Batken drove the two states apart.

Today, relations between them are brimming with mutual suspicions and false stereotypes. Uzbekistan counted on its EurAsEC membership to defuse the tension caused by the Rogun Hydro-power Station project and was not supported, therefore it deemed it advisable to leave the structure in October 2008—this can be called the Uzbek demarche.

In January 2009, when visiting Uzbekistan, Russian President Dmitry Medvedev demonstrated his complete understanding of Tashkent's position by saying that the project should go ahead while the interests of all the sides should be taken into account. The Foreign Ministry of Tajikistan responded with a note to the Russian Federation.

President of Tajikistan Emomali Rakhmon is out to flaunt his independence by working on a political phantom of sorts—an alliance of the Aryan peoples with Iran and Afghanistan among its members. This utopian idea pales against the background of Tajikistan's membership in the SCO and EurAsEC.

Everything that looks like a weighty argument (the threat that the Tajik nation will be engulfed by its Turkic environment being one of them) should be used to prevent the country's integration in any structure.

Tajikistan is obviously being guided by geopolitics and nationalism when looking for a region suitable for integration.

Today the country has reached the stage when it must choose between a national state and a supra-national alliance. The discussion of Kazakhstan academics that was held in September 2007 and published by the *Megapolis* journal illustrated the dilemma in the best possible way.

Nurlan Amrekulov, a prominent political scientist, said: “To survive and preserve themselves, the Turks (the Central Asian Turks.—*F.T.*) will have to look for a road leading to integration among themselves in particular and with Russia as a nuclear power and guarantor of our sovereignty. There is another thing. I spoke to the Kyrgyz and their politicians. They all accept the integration idea, because they have no ambitions. Today they have to survive. In this context the Western categories by which we are still being guided are our worst enemies. **We are all prisoners of the myth about nation.**”

Journalist Seidahmet Kuttykadam offered a different opinion: “In a world ruled by cash survival depends on national identity. We could live without it in the past—today this has become impossible. Today we should work toward strong national and state consolidation.”

The discussion is significant: in the past, Kazakh and Kyrgyz political scientists tended to identify the region’s people as “nomads or settled peoples”—a mythical principle. Today, they are discussing a much more serious (yet unreal) “national state-integrated region” dilemma.

M. Suiunbaev has pointed out: “Sovereignty inflated nationalism and encouraged national myths (it created ‘micro-civilizations’). National ideologies of the Central Asian states act as disintegrating factors. Integration and the openness it implies might cause clashes of ‘micro-civilizations’ and myth destruction. This explains why the regimes which largely rely on these myths for their conservation are tending toward even greater closeness despite the resultant economic losses, which interferes with integration.”⁷

On the whole, an analysis of various opinions about the Central Asian regional integration suggests that the pessimistic approach is caused by the position of the political and business elites which want to preserve the status quo for their continued self-reproduction.

The optimist approach is fed by the position of the Central Asian nations, their expectations and hopes.

EurAsEC as a Region Alien to Central Asia

I have written a lot about the SCO’s problems; here I intend to dwell on certain conceptual problems of the EurAsEC in order to come back, via this, to the article’s central issue: a region within Central Asia.

When the Soviet Union disintegrated, it left behind the so-called post-Soviet expanse. This term is much more than a description of the territory occupied by the former Soviet republics—it describes all the geopolitical transformations going on there.

Today, the macro-region demonstrates a wide-scale geopolitical experiment described as “varied-speed integration.” EurAsEC is playing the main role; it fully supports Russia’s policy in relation to the former Soviet republics—the new independent states (NIS).

On 18 June, 2004, speaking at a EurAsEC summit, President of Russia Vladimir Putin called on the audience not to forget Russia’s role in ensuring Eurasian security. “I know,” said the Russian president, “that we can live according to the principle ‘the coachman knows the way,’ but a glance at the map will show you that Russia is situated in the very heart of Eurasia. I think there is nearly unani-

⁷ M. Suiunbaev, *op. cit.*

mous agreement that hardly any problem in Eurasia and on the global scale can be successfully addressed without Russia and beyond the role it plays in the world.”⁸

This created the impression that he had a new, mini-Soviet Union, in mind.

Certain politicians and experts (probably impressed by Europe’s results) were driven away by the idea of varied-speed integration.

For Russia this is an opportune slogan under which it can “gather the lands together”—the traditional method of empire-building. The very existence of the EurAsEC means that the NIS are inseparable from the RF; there is no democratic principle of unity within the CIS either.

Experiments in varied-speed integration might be acceptable were it not for the Commonwealth; stage-by-stage *reintegration* could have been explained if undertaken from scratch.

For over a century various integration structures existed, the latest being the Soviet Union; today, it is called the CIS.

The Soviet Union can be described as a political alliance that existed for a long time and then disintegrated. It was officially announced that it had disappeared as a state and as a geopolitical reality.

The geopolitically deficient EurAsEC cannot claim the role of a geopolitical reality: it covers part of Central Asia (an independent region with its traditional regional integration), on the one hand, and includes Belarus and Russia, a separate territory, on the other.

For this reason, the post-Soviet expanse can accept either a Soviet-patterned alliance or be geopolitically divided into independent parts.

I have already written that EurAsEC stands no chance of becoming one of these parts.

I should say that it is staffed with those NIS that look toward Russia: it comes as no surprise that Armenia, Russia’s permanent satellite, is involved as an observer. Uzbekistan, which joined the structure in 2006, left it in 2008.

Its existence cannot be justified and scientifically explained according to the principle of economic determinism.

Its summits discussed water distribution in Central Asia even though it does not cover the entire region; in fact, these problems cannot be successfully resolved without Turkmenistan—any attempt at this looks like deliberate ignoring of this country.

Speaking at the International Forum “Eurasian Integration: Present Trends and Globalization Challenges” held on 17 June in Astana, EurAsEC Secretary General Grigory Rapota said: “Energy and transport, two main infrastructural elements, can move forward the national economies and integration process within the EurAsEC.”⁹ In fact, it is electric power and, especially, transport that should move integration ahead within the CIS because these spheres of cooperation in the Heartland are of a transborder nature.

It is hard to comprehend how the same states that belong to several organizations can set up single customs expanses, free trade zones, economic regions, etc. within different structures. The CACO and SCO have put these questions on their agenda.

What can be said about the EurAsEC as the CACO and SCO’s rival?

It undermines the efforts to realize collective regional security across the post-Soviet expanse.

If it is a full-fledged integration system, we have the right to expect that its members would acquire a collective security system; but this is impossible since this structure is not a region with specific parameters.

Russia and Central Asia should look after their national security independently.

⁸ Replika na otkrytii mezhdunarodnogo foruma “Evraziiskaia integratsiia: tendentsii sovremennogo razvitiia i vyzovy globalizatsii,” available at [<http://2004.kremlin.ru/text/appears/2004/06/66021.shtml>].

⁹ “Rapota: EvrAzES iavliaetsia deistvuiushchei modeliu budushchego Evraziiskogo Soiuzu gosudarstv,” available at [<http://www.rian.ru/politics/20040618/614677.html>].

The Russian Federation is a strong power, but it should help its independent neighbors to strengthen their security not by attaching them to its territory with the help of the EurAsEC (or a similar structure) but by encouraging their independent regionalization. This process began in 1991.

None of the regional structures created by the former Soviet republics (such as the CACO) threatens Russia; they have been set up for the sake of their members' independence and regional development and are not aimed against the Russian Federation.

EurAsEC Secretary General Rapota is convinced that "the Eurasian Economic Community (EurAsEC) is a working model of the future Eurasian Union of States."¹⁰ Such a union would be better created within the CIS, out of *all* the former Soviet republics.

Experiments in varied-speed integration should be discontinued; what is needed is final and independent geopolitical delimitation.

How Should Central Asia Respond to the Global Challenge?

Developing and strengthening fully-fledged regional integration can be described as the only adequate answer. The local countries have covered part of the road; they have acquired some experience even though many of them have not yet appreciated this. Unfortunately, the process has not been without its drawbacks; the time has come to sum up the results and move on.

The following can be realized in the near future:

- A political alliance should be described as the highest aim of integration;
- A visa-free regime should be introduced among the Central Asian states;
- Foreign policies should be coordinated;
- Border delimitation should be suspended;
- The CACO should be restored;
- Ditto for the Central Asian Battalion;
- Ditto for the Central Asian Parliamentary Assembly;
- A regional referendum on a political Union of Central Asia should be held;
- The old functional structures should be restored and new ones created;
- A free trade zone should be set up;
- Ditto for a customs union;
- Ditto for a single economic expanse.

The present situation in Central Asia is the result of unfavorable subjective and objective circumstances, a combination in which the objective added to the subjective circumstances.

The heads of state and politicians are operating in far from ideal conditions: the situation inside and outside the region is far from simple.

Today, the situation is far from favorable: the great powers are stepping up their geopolitical rivalry (the Great Game) very much in line with the balance of forces principles.

¹⁰ Ibidem.

Central Asia is at a loss; the democratic process that had begun in Uzbekistan (and other countries) was frozen because of the errors committed by the people at the helm and the inevitable impact of the new world order.

The Central Asian developments are reflected in the domestic and foreign policies of the regions' states; it is part of the global process of world-wide restructuring.

The region needs its own Yalta to identify its post-Cold War status; it should answer the question: will the Central Asian countries develop into democratic states in the full sense of the word?

THE BSEC: ITS REGIONAL INTEGRATION PROSPECTS FOR ARMENIA

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Today the Black Sea Region must make a choice between developing internal integration in close relation with other structures and preserving the tension on its borders. The BSEC provides a good opportunity for further promoting mutually advantageous economic cooperation. The organization is primarily valuable in that it gives a boost to the development of production, rather than commerce. Today, along with Greece, Russia and Turkey are playing the main

organizational roles, striving to develop the BSEC as a structure equal in status to the EU.

Armenia has also been interested in implementing Black Sea integration programs, especially the building of the Black Sea Ring Highway (HWBSR). Making use of regional potential will promote a leap in economic development similar to the one Europe once made, although the world economic crisis may have a certain slowing impact on this process.

1. The BSEC and the Black Sea Region

1.1. The Organization of Black Sea Economic Cooperation

The Organization of the Black Sea Economic Cooperation (BSEC) was instituted in May 1999 on the basis of an Agreement on Black Sea Economic Cooperation entered in 1992. Eleven countries—Turkey, Greece, Armenia, Georgia, Azerbaijan, Russia, Ukraine, Moldova, Bulgaria, Rumania, and Albania—are the founders of the organization, Serbia joining them later. Hereafter, when referring to these countries, we will use the term “Greater Black Sea Region.”

The BSEC not only encompasses countries located in the littoral region of the Black Sea, but also those that do not have access to it. The organization has an institution of observers, they are rep-

representatives from European and Mediterranean countries, such as France, Germany, Austria, Egypt, Israel, Italy, Poland, the U.S., and others.¹ The BSEC also has the status of observer in the U.N.

The Council of Foreign Ministers is the organization's main working structure, which meets once every six months. There is also the BSEC Parliamentary Assembly, which represents the national parliaments of the member states and provides ongoing consultations.

The population of the BSEC countries amounts to 330 million people. It is one of the world's most dynamically developing regions in the economic respect. The organization's headquarters are in Istanbul, while the Bosphorus Strait provides a gateway to the Black Sea.

1.2. Member States

Most of the BSEC member states are at the transition stage in their development and lag economically behind the West European countries. In contrast to the Southeast Asian states—Japan, Singapore, and China—they are developing chaotically without any clear long-term plan.

The following table provides a better idea of the situation in the organization's member states:

Table

	Size of population (million), 2008 ²	Coastline (km)	GDP, \$bn, 2008 ³	PPP per capita	Average increase in GDP in 2006-2008 (%)
Azerbaijan	8.18	—	53.26	9,000	21.8
Albania	3.64	—	13.52	6,000	5.9
Armenia	2.97	—	12.07	6,400	11.5
Bulgaria	7.26	354	49.43	12,900	6.2
Greece	10.72	—	373.5	32,000	3.7
Georgia	4.63	310*	13.28	4,700	8.1
Moldova	4.32	—	6.2	2,500	5.0
Russia	140.70	475	1 757	15,800	7.3
Rumania	22.25	225	213.9	12,200	7.2
Serbia	7.38	—	52.18	10,900	6.1
Turkey	71.89	1,595	798.9	12,000	4.3
Ukraine	45.99	2,782	198	6,900	5.7

* 210 of them constitute the Abkhazian section.

¹ For a complete list of observers, see: [http://web.archive.org/web/20070928091304/http://www.bsec-organization.org/main.aspx?ID=About_BSEC].

² "The Demographic Status of the World's Population," *Geohive.com*, available at [<http://www.geohive.com/earth/world.aspx>].

³ *CIA World Factbook 2009*, available at [<https://www.cia.gov/library/publications/the-world-factbook/index.html>].

Although Armenia is the smallest country in terms of population, it outstrips Georgia, Albania, and Moldova with respect to standard of living, drawing almost level with Ukraine in terms of this index. As for its general economic potential, the country is only ahead of Moldova.

It is worth noting that the Turkish coast of the Black Sea is a very heterogeneous region. Its western part has a higher level of economic development on a par with Eastern Europe, while the eastern part consists of depressive regions, the population of which is declining due to emigration to the west of the country and abroad. This is generally typical of the entire Black Sea Region.

Another important factor is the extremely rapid economic growth of the countries of the region, which is one of the largest in the world. Whereas the average annual increase in the world economy reached 4-5% in recent years, in Greece it amounted to 3.7% and in Azerbaijan to 21.8%.

1.3. Special Features of the Black Sea Region: Domestic Political Crises in Turkey, Ukraine, Moldova, Armenia, and Georgia

It should be noted that almost all the countries of the region are currently experiencing a political crisis. In Turkey, the military and Islamists, who are currently the ruling party, have been locked in conflict for several years now.

Ukraine's political structure was formed during the Color Revolution of 2004; today it is undergoing a crisis. The country's president is weak and holds very little clout with the people, which has had an effect on all echelons of power. It is still not clear what this will lead to, while the future elections in 2010 might even aggravate the situation.

In April 2009, parliamentary elections were held in Moldova, which ended in victory for the communists. This generated an internal crisis—mass youth meetings were held and the parliament building was set on fire. The authorities soon took the situation under control, but the tension remained—relations with Rumania worsened.

There has been a stand-off for two years now between the authorities and opposition in Georgia, and after the country's defeat in the armed conflict with Russia in August 2008, the situation became even more aggravated.

Tension also continues in Armenia—after the elections in March 2008, acts of protest led to uprisings and the deaths of ten people. The situation has largely been normalized, but the crisis is still not over.

Instability in the region is the result of unequal, "catching up" development—there are no specific plans or the possibility of implementing them in any consistent manner. For example, in the countries of southeastern Asia everything is under the government's strict control.

The countries of the Greater Black Sea Region are attempting to link the democratic development process with economic growth, but this is only increasing the population's discontent since the results are not meeting its expectations.

1.4. Post-Soviet Chaos and Integration Possibilities

Another distinguishing feature of the Black Sea Region is the fact that the countries belonging to it do not regard it as united and independent. Until recently, most of the countries were orientated

toward the strong nations, maneuvering between their interests. Whereby, although the declarations have been loud, only lip service was and still is paid to democratic values.

After the collapse of the Soviet Union and destruction of the entire Eastern bloc, a new situation developed in the region—the independent states that formed looked for their own development model. But after almost two decades neither orientation toward the strong actors nor maneuvering between their interests have helped the countries to advance along their chosen path. The only solution is to develop interregional relations.

1.5. Georgia's Example

Georgia's example is worth our attention. Relying on a pro-Western policy, it expected integration support from the West both at the global and regional levels. And this support was forthcoming: the U.S., for example, called on other countries to support Georgia's entry into NATO; there were also plans for the state to join the European Union, which struck a debilitating blow at relations between Georgia and Russia. Now, after the war with the Russian Federation, Georgia's prospects for integration into NATO and the EU seem extremely illusive.

On the other hand, until recently Georgia has been participating in integration projects such as Eastern Partnership, but only as a mere formality in order to establish direct relations with the West. The country has still not recovered from the consequences of the war and has not yet determined its plans for the future. But, judging from the development trend in Armenian-Georgian relations, which Mikhail Saakashvili spoke about during his visit to Erevan, it can be presumed that the state will pursue regional integration, including within the framework of the BSEC.

1.6. Armenian-Turkish Relations in the Context of Regional Dynamics

We should also take a look at the normalization of Armenian-Turkish relations in this context, something which is very important for the region. Opening the border between these states will have a strong impact on all the countries: their economic projects will become more realistic and they will be able to emerge from their state of political confrontation.

In addition, the network of land transport routes, which has not been functioning for many years now, will be restored and prerequisites will appear for more stable economic growth.

All of these measures will help to improve the region's image in the eyes of the international community and to develop more harmonious interrelations, as well as promote peaceful conflict settlement.

1.7. Other Problems of the Black Sea Region

Ukraine also has problems in its relations with Russia, while it is also somewhat disappointed in the lack of specific integration results with the European Union.

Moldova's position is unclear, which is constantly fluctuating between a pro-Western and pro-Russian orientation. This is graphically illustrated by the republic's attitude toward GUAM—for two

years now the country's president has considered this organization unviable, but the state has not withdrawn its membership from it.

When talking about Bulgaria and Rumania, it is important to recall that these countries integrated into the European Union very recently but still lag greatly behind the countries of southern and western Europe (not to mention northern) in development. For example, in terms of parity purchasing power, Bulgaria's index amounts to only 40.1% of the average index for Europe (27), Rumania's to 45.8%, and Turkey's to 45.5%. (For comparison, in the U.S. it is 152.4% and in Norway 190%.⁴) Such disproportion will continue for quite some time to come.

On the other hand, a large part of the revenue supplementing the economy of Bulgaria, Rumania, and Turkey comes from tourism and the seaside resorts. The same can be said about Georgia.

For Russia, access to the Black Sea is important for other reasons—this is shown by the attempts to lay underwater pipelines, retain its fleet in Sevastopol, and other things.

As for Armenia, Azerbaijan, and Moldova, Black Sea integration is only advantageous for them economically, and it would be a mistake to exclude them from the region.

Armenia chaired in the BSCE from November 2008 to April 2009, handing over the chair to Azerbaijan⁵ (for the period from May to October 2009) at the April summit of foreign ministers of the organization's member states in Erevan. This important event confirmed the following: economic cooperation within the organization is capable of pushing political disagreements into the background.⁶

2. Organizations Functioning in the Region

The BSEC is not the only organization functioning in the region, the countries belonging to it also participate in other structures and programs.

A list of the relevant organizations and programs is presented below, and the similarities and differences between them and the BSEC are analyzed. Whereby these data do not reflect the goals they have declared, rather the role and area of their activity. The dynamism and competence of this organization is also interesting, since it, by encompassing many states, could well be an inefficient structure. Several conclusions about its role can be drawn on the basis of an analysis of these data.

In order to classify regional and global international organizations, it would be convenient to divide them into the following groups: economic, political, military, integration, and so on. But this is impossible.

- First, the declared goals and actual activity of the organizations may not coincide.
- Second, frequently the organizations that declare one sphere of activity function in several, that is, they are combined.

In addition, because of changes in the current situation, some of them change their sphere of activity or cease it altogether.

⁴ Eurostat. Table: GDP per Capita in PPS—GDP per Capita in Purchasing Power Standards (PPS) (EU-27 = 100), available at [<http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsieb010>].

⁵ "Armenii peredala predsdatel'stvo v OChES Azerbaidzhanu," available at [<http://www.regnum.ru/news/1152008.html>].

⁶ "...The heads of the Armenian and Azerbaijani delegations gave a good example to the other meeting participants yesterday in Erevan" (V. Vorobiev, "Bez shtorma. Chernomorskomu regionu propisali men'she politiki i bol'she ekonomiki," *Rossiiskaia gazeta*, 17 April, 2009, available at [<http://www.rg.ru/2009/04/17/vizit.html>]).

2.1. The CIS

The Commonwealth of Independent State was created at the end of 1991 along the lines of the British Commonwealth of Nations aimed at carrying out a “civilized divorce” among the states of the former Soviet Union. Over time, the CIS began to flag; only nine of the countries of the former union fully participate in it. As of today, the main functions of the Commonwealth are to preserve and strengthen the relations among the former union republics with the aid of various trade agreements and the holding of forums for discussing different issues.

The geographic factor has gradually been diminishing the pertinence of the first function, and history and politics are reducing the second to naught, since the organization is associated primarily with Russia. Of the countries in the Greater Black Sea Region, Azerbaijan, Armenia, Moldova, and Russia have the status of full-fledged members; Georgia completed its withdrawal from the Commonwealth in 2009, while Ukraine has not ratified the CIS charter and rather holds the status of an observer. The only thing that can realistically be said about the organization’s future is that it will continue to decline.

2.2. The CSTO

The Collective Security Treaty Organization was founded in 2002-2003 on the basis of the Collective Security Treaty entered as early as 1992. It is officially a military-political organization and designed to coordinate the self-defense efforts of its member states, as well as the fight against terrorism and other threats. But it is not very active and is a pro-Russian integration structure.

In 2009, Russia made several attempts to revive the organization, and an agreement on creating a rapid reaction joint force was signed. But all the decisions remained on paper. The CSTO is sometimes called “Russia’s pocket union,” but this statement is incorrect since its participants usually do not coordinate their positions. One of the organization’s spheres of activity was arms trade.

The leadership of the CSTO has been trying to draw Georgia and Azerbaijan into its ranks.⁷ This shows the absence of any ideology or political vector, but confirms the opinion that this organization is an integration structure. Only Armenia and Russia, of the countries in the region under review, currently participate in it. It is difficult to forecast the organization’s future, although the current situation, whereby the states do not interact with each other but only maintain relations with Russia, will in all likelihood continue.

2.3. GUAM

The organization’s name is an abbreviation and stands for its member states—Georgia, Ukraine, Azerbaijan, and Moldova. Turkey is an observer. All of them are currently members of the BSEC and several other regional and global organizations. In reality, GUAM can be called a political bloc that has attempted to integrate into the post-Soviet expanse (as an alternative to Russia). The organization, which was created in 1997-2001, was in opposition to Russia. It became active after the Color Rev-

⁷ See, for example: “Nikolai Bordiuzha: ODKB privetstvovala by vzaimodeistvie s Azerbaidzhanom po voprosam bezopasnosti,” IA Noyan-Tapan, Armenia, 23 March, 2009, available at [<http://www.noyan-tapan.am/news.php?p=0&c=0&t=0&r=0&year=2009&month=03&day=23&shownews=1013235&LangID=7>].

olutions in Georgia and Ukraine, while the collective vote made on the frozen conflicts was the basis for cooperation.

After Uzbekistan withdrew from the organization in 2005, GUAM gradually began to flag. As of today, it could be completely absorbed by Eastern Partnership and the BSEC.

2.4. NATO

The North Atlantic Treaty Organization is not new to the region. Turkey and Greece have been members of NATO since 1952, Bulgaria and Rumania since 2004, and Albania since April 2009. As for the talk about Georgia joining NATO, after the 2008 war with Russia this became a moot point. Ukraine's NATO membership has also been postponed.

The Partnership for Peace program functions in the region, in which Serbia, Azerbaijan, Armenia, and Moldova participate in addition to Georgia and Ukraine. In this way, in one form or another, the entire Black Sea Region is involved in cooperation with this organization.

Incidentally, Russia's participation is a mere formality: it perceives NATO as a remnant of the Cold War and has a very negative attitude towards many of its initiatives,⁸ particular toward its "extension to the East."

Russia-NATO relations are still extremely tense, but as the number of new members increases, the North Atlantic bloc is becoming less mobile, although it is still a dynamic and efficient military-political structure and will evidently remain so in the near future.

2.5. The EU

The European Union is a strong player in the Black Sea expanse. There are only three EU members among the countries of the Greater Black Sea Region: Greece (since 1981), Bulgaria and Rumania (both since 2007). Turkey has been trying to gain full-fledged membership in the union for many years now, the other countries of the union have also been showing an interest in this cooperation and participating in various special programs, such as Eastern Partnership.

The EU is a major economic organization—the sum GDP of all its members amounts to 18.85 trillion dollars, that is, around 30.3% of the world economy.⁹ It is a dynamically forming structure that is drawing more and more countries and regions into it and offering them large benefits and subsidies. The Union is one of the world's largest sales markets.

The Eastern Partnership Program envisages several types of benefits for post-Soviet countries. Ukraine, Belarus, Moldova, Armenia, Azerbaijan, and Georgia participate in it. Although there are people in Europe today who think that it was a mistake to grant Rumania and Bulgaria membership in the Union,¹⁰ the EU continues to expand and it is possible that other countries of the Black Sea Basin will join it. The quantity and quality of the region's economic and social contacts with Europe will rise in the next few years.

⁸ Russia was against NATO's military exercises in Georgia in May 2009 and expressed its discontent about certain countries participating in the exercises, as a result of which several countries, including Armenia, Switzerland, Kazakhstan, Latvia, Estonia, Moldova, and Serbia, refused to participate in them (see: Rogozin: Otkaz semi stran ot uchenii NATO v Gruzii—zasluga rossiiskoi diplomatii, available at [<http://www.apsny.ge/2009/mil/1244578558.php>]).

⁹ *CIA World Factbook. GDP (Official Exchange Rate) 2008*, available at [<https://www.cia.gov/library/publications/the-world-factbook/fields/2195.html>].

¹⁰ "Priniatie Rumynii i Bolgarii v ES okazalos' bol'shoi oshibkoi: interviu Vernera Vaidenfel'da," available at [<http://www.regnum.ru/news/1137772.html>].

2.6. The EurAsEC

The Eurasian Economic Community is another organization functioning in the region. Created in 2000-2001, the EurAsEC has not become an active player in the Black Sea Region: its sphere of activity embraces primarily Central Asia. Russia and Kazakhstan are the largest participants in the community; Armenia, Moldova, and Ukraine have the status of observers, whereby Armenia also participates in several other programs.¹¹ If it is put to use, the community's ten-billion reserve fund will be an effective step toward boosting the organization's activity, which, like the CIS, GUAM, and CTSO, has so far taken only passive part in the processes going on in the Black Sea Region.

2.7. Other Regional Organizations

A multitude of other organizations also function in the region, such as the Stability Pact for South Eastern Europe, the Central Asian Initiative, the Community of Democratic Choice, the Black Sea Forum for Partnership and Dialog, the Organization of the Islamic Conference, and others.

2.8. Special Features of the BSEC and its Prospects

Now we can compare the BSEC with the other organizations functioning in the region. The first difference is that the organization (in contrast to NATO and the EU) does not require its members to have any economic or political clout or that they declare any particular political form of activity (like NATO, the CSTO, and GUAM). In compliance with one of the articles of the BSEC's charter, any country can join the organization with the consent of its members.

In compliance with Article 4 of the charter, the main spheres of economic cooperation are: trade, finances, energy, transport, agriculture, health care, and tourism. The BSEC also declares the importance of cooperation between border posts, contacts between people, and fighting organized crime, illicit drug circulation, terrorism, and illegal migration.¹²

Despite certain political disagreements among its individual countries, the entire region is involved in the organization. The BSEC is also distinguished by its efficiency and relative efficacy. As of today, it is the only organization that is having any success in expanding the countries' internal contacts, while the other organizations listed link the region with other territories—Central Asia, Western Europe, Eastern Europe, the Middle East, or the North Atlantic expanse.

The BSEC is a convenient tribune for dialogue, a forum of sorts, where various projects are discussed. Any country, regardless of the size of its territory and GDP, can actively participate in it.

There appear to be two ways for the organization to develop in the future:

1. **The pessimistic scenario.** Gradual absorption by the European Union programs, such as Eastern Partnership, as well as other integration organizations. One of the factors for implementing the pessimistic scenario might be the failure of the region's countries to overcome their

¹¹ "Dogovor ob uchrezhdenii antikrizisnogo fonda EvrAzES budet podpisan pri uchastii Armenii, 9 June, 2009," available at [<http://www.armtown.com/news/ru/noa/20090609/42087206/>].

¹² See: *BSEC Charter*, available at [http://www.mintrans.ru/Pressa/BSEC/BSEC_Ustav.htm].

differences, primarily with respect to the Georgian-Abkhazian and Armenian-Turkish problems.

2. The optimistic scenario. Overcoming political discrepancies, settling conflicts, or separating political from economic issues. Independent development of the organization and region, right down to creating a structure reminiscent of the EU. Formation of a free trade zone and expanse for moving people and capital.

It cannot be said with any certainty at present which of the scenarios will ultimately be played out, since both are quite likely, and the region has still not re-examined its position on many issues (due to the economic crisis and the Russian-Georgian war). It is interesting that Russia, Bulgaria, and Rumania, as the most economically developed countries, were worried that Eastern Partnership would torpedo the Black Sea Economic Cooperation. This confirms once again their interest in the BSEC, not to mention that of other countries.

3. The Black Sea Ring Highway and Other Projects— A View from Armenia

The most serious BSEC project today is coordinating road development in order to build a Black Sea Ring Highway along the coast of the Black Sea. This idea was first voiced at the 15th BSEC summit in Istanbul in June 2007. Russia was the initiator of this construction project and, with its support, a memorandum of mutual understanding was signed last September in Sochi on its coordinated development.¹³

The project has aroused the interest of all the BSEC participants. According to Article 9 of the memorandum, the contract will last for five years and at the end of this term it will automatically be extended unless any of the sides raises an objection no later than one year before its termination: so far no such objections have been forthcoming.

The construction, use, and reconstruction of the highway will be financed from the budgets and investment funds of the BSEC member states, as well as with the help of the private sector.

According to BSEC Secretary General L. Chrysanthopoulos, implementing the project will help to develop trade in the region, join the road networks of Europe and Asia, and promote the development of tourism in the region's countries.¹⁴

3.1. Characteristics of the Black Sea Ring Highway

The Black Sea Ring Highway is a high capacity highway consisting of two thoroughfares each of which will have at least two lanes. The HWBSR is around 7,140 km in length and will pass through the following cities: Istanbul (Turkey)-Samsun (Turkey)-Trabzon (Turkey)/the Turkish part of the

¹³ Russian Ministry of Transport. Memorandum on Mutual Understanding on the coordinated development of a ring road around the Black Sea. Full text of the project is available at [http://www.mintrans.ru/press/BSEC/mem_rus.htm].

¹⁴ "Dva krupneishikh proekta OChES poluchili razvitie v period predsedatel'stva Rossii," *Kommersant*, 17 January, 2008, available at [<http://www.kommersant.ru/doc.aspx?DocsID=842696>].

highway coincides with the TRACECA route/-Batumi (Georgia)-Poti (Georgia)-Novorossiisk (Russia)-Rostov-on-Don (Russia)-Taganrog (Russia)-Mariupol (Ukraine)-Melitopol (Ukraine)-Odessa (Ukraine)-Kishinev (Moldova)-Bucharest (Romania)-Khaskovo (Bulgaria)-Edirne (Turkey)-Istanbul (Turkey)-Komotini (Greece)-Alexandropoulos (Greece)-Istanbul (Turkey).

3.2. The Abkhazian Factor

There are several issues of interest to Armenia here. It is obvious that the southeastern points of the highway are ports and the roads between them will pass along the coast of the Black Sea. As for the northwestern points, they penetrate somewhat deeper into the European continent, moving from Odessa to Kishinev and on to Bucharest, then returning to Istanbul. The link between the Batumi-Poti and Novorossiisk-Rostov-on-Don sections is not clear.

Keeping in mind breakaway Abkhazia, as well as the Russian-Georgian conflict, this issue has not been openly discussed so far. All the land links between Russia and Georgia have been severed. It was only very recently that the republic made a decision to open the checkpoint at Verkhniy Lars, which was voiced by President Saakashvili during his visit to Erevan at the end of June 2009.¹⁵

But it is unlikely that this part of the route can be used: in the winter it is impassible and it is economically unprofitable with respect to including it in the Black Sea Ring Highway, since it will increase its length by more than 500 km. What is more, Georgia is unlikely to approve the possibility of this highway being extended through Abkhazia.

So solutions to these problems must be found immediately by means of talks. A similar situation could also arise with respect to Transnistria and Moldova. And no one knows how events will further develop regarding the Georgian-Abkhazian conflict after the events of August 2008: Georgia has still not recovered and has not determined its new position. But talks on the highway are continuing, and this means that the issue is still on the agenda.

This situation is also having an impact on Armenia, since the severed communication with Russia, which has been going on for almost two decades now, is unwittingly leading to a continuation of the blockade. In other words, the republic is a hostage of the Georgian-Abkhazian and Georgian-Russian conflicts.

3.3. Additional Links for Countries that Do Not Have Access to the Black Sea

There is another important aspect of the building of the highway for Armenia. The BSEC member states that do not have access to the Black Sea and through which the new highway does not pass can join it by means of additional links.¹⁶ Erevan and Baku have also expressed an interest in joining the highway in this way.

Three of the eight additional links are associated with Armenian territory (two directly and one indirectly). One of them is the Georgian-Turkish road (reconstruction of the existing one)—Khopa (Turkey)-Artvin (Turkey)-Vale (Georgia)-Akhaltsikhe (Georgia)-Khashuri (Georgia).

¹⁵ "Gruziia gotova vesti peregovory s Rossiei ob otkrytii KPP 'Verkhniy Lars'—Saakashvili," available at [<http://www.arka.am/rus/economy/2009/06/24/15472.html>].

¹⁶ See: Appendix 1 to the Memorandum, available at [http://www.mintrans.ru/presa/BSEC/mem_app_rus.htm].

Another route, which leads directly to the republic, will sort of be its southeastern ring extension: Akhaltsikhe (Georgia)-Gumri (Armenia)-Erevan (Armenia)-Razdan (Armenia)-Tbilisi (Georgia). The length of this road is 525 km. The second route of the HWBSR system, which passes through Armenia, will encompass the northern regions of the country—Gumri (Armenia)-Vanadzor (Armenia)-Tbilisi (Georgia); it is 210 km in length.

Implementation of this project is extremely important for Armenia, both the building itself and its subsequent realization. Gumri, the second largest city in the republic, is currently undergoing a decline. During the past four years its population has shrunk by almost 2%. Whereas in 2004, 149,500 people lived here, in 2008, only 147,000 remained; the annual decrease in this index amounts to approximately 0.45%.¹⁷

This situation has been caused by the debilitating earthquake of 1988, the unfavorable situation in the Armenian provinces, as well as the proximity of the Turkish border (which is not functioning) and the Georgian border (which is not entirely functioning).

The other city in the north of the republic, Vanadzor, is only a little better off. Including it in the highway system will have a positive effect on its socioeconomic state.

3.4. Transborder Cooperation as a Way to Develop the Southern Regions of Georgia and the Northern Regions of Armenia

Building the road through the regions of Akhalkalaki and Ninotsminda, which are primarily populated by ethnic Armenians, will have a positive effect on employment in this area of Georgia and on its subsequent integration into the Black Sea Region.

Javakhetia, for example, was isolated during the entire existence of the Soviet Union. This situation continues today, which is causing constant emigration and an outflow of workers to Armenia and Russia.

So building a new road (or restoring the old one) between Georgia and Armenia through Javakhetia and Gumri fits in with the conception of a future regional transport structure. A decision has already been made despite the fact that this project is rather expensive—it will require approximately 170 million dollars to carry out.¹⁸ Implementation of this plan will take approximately two years; export and import to Armenia through Georgia will be much cheaper, while the Akhaltsikhe-Gumri road will make it possible to shorten the route and reduce transport costs by almost 20%.

As for Azerbaijan, it will participate in this project directly by means of the Poti-Tbilisi-Baku highway, and indirectly via the Rostov-on-Don-Volgograd-Astrakhan-Baku route.

3.5. Some Results

In light of the countries' economic backwardness, the highway in itself poses a bold challenge to the existing order throughout the entire region. So far the situation is not developing in

¹⁷ *Demograficheskiy sbornik Armenii*, 2008, Part 2, "Naselenie," p. 23, available at [http://www.armstat.am/file/article/demos_08_2.pdf].

¹⁸ "Gruziiia i Armeniia sozdatut konsortsium po stroitel'stvu avtomobil'noi magistrali mezhdu dvumia stranami," available at [<http://www.intermost.ru/news/117693/>].

the most propitious way: the Armenian-Turkish border is closed, the conflicts between Armenia and Azerbaijan, Georgia and Abkhazia, and Moldova and Transnistria have not been settled, and the Georgian-Russian border is also closed. Relations between Turkey and Greece also leave much to be desired.

For many years, certain difficulties in Javakhetia have been making building the highway in Armenia and Georgia difficult. In the event the Black Sea Ring Highway project and the building of additional links are realized, we will be dealing with a new reality in the region.

3.6. The Black Sea Bank of Trade and Development

Among the structures functioning within the BSEC, the Black Sea Bank of Trade and Development deserves special attention. The agreement to establish the bank was signed in 1997, but it did not begin functioning until 1999.¹⁹ Its headquarters are in Greece. Its official purpose is to promote private business, which it does by financing programs and lending money to banks and companies in these countries.²⁰ Moody's investment service assessed the bank's rating at BAA1 at the end of 2007.²¹

Greece, as the region's most economically developed country, plays the most active part in the bank's activity. A new financial structure was created—the Hellenic Development Fund. The BSEC, which is included in the official development assistance programs of the Organization of Economic Cooperation and Development, was able, with the new structure's help, to finance a program of economic cooperation and development in the region.

3.7. Other Initiatives of the BSEC

In 2007, the UNDP offered the Black Sea Trade and Investment Promotion Program aimed at developing commercial relations and investment policy among the BSEC member states. The program makes it possible for companies functioning in the Black Sea Region to take advantage of the trade and investment programs being carried out here. This is one more step toward creating a positive business environment in the region.

In addition, a development fund operates within the framework of the BSEC, the pool of which amounts to 660 million dollars. It was created in order to facilitate the drawing up and implementation of projects designed to promote the organization's regional cooperation and economic development, it renders financial assistance to various programs. It operates on the principle of voluntary donations from the BSEC countries, other organizations, observers, and third parties. Each contribution should be no less than 30,000 dollars or euros. The organizations of countries that invest this amount have the priority right to use the fund.

¹⁹ BSTDC. Key facts, available at [<http://www.bstdb.gr/keyfacts.htm>].

²⁰ In recent years the bank has made investments amounting to 2.1 million euros in OOO "Erevanskoe pivo," 23 million dollars in OOO "RusAl Armenia," and 3 million dollars in the ACBA Bank.

²¹ [<http://www.forbes.com/feeds/afx/2007/12/12/afx4429562.html>].

4. The BSEC and Armenia: Expectations and Possibilities

Armenia is a cofounder of the BSEC and has a representative office in Istanbul. It also participates in other structures and subdivisions of the organization. This will help to remove the economic blockade that has been in place for more than 15 years now, as well as enable the entire region to ultimately overcome the crisis caused by the collapse of the Soviet economy.

However, when listing all the things the republic can gain from the organization, we must ask: but what can Armenia give the BSEC? In addition to its official participation in all the organization's structures, the country put forward several initiatives during its chairmanship.

According to the republic's ministry of transport, Armenia's chairmanship in the BSEC has been very efficacious.²² In March 2009, a meeting was held of the ministers of the BSEC member states, which resulted in the adoption of the Erevan Declaration on the Prospects for Cooperation in Transport, one of the main points of which envisages building the Black Sea Ring Highway and simplifying the visa regime for professional drivers. Standardization of road legislation in the region's countries was also carried out.

The BSCE secretary general also agrees with the positive assessment of Armenia's chairmanship and he points out its other achievements during this time. This primarily applies to its mediation in the organization's contacts with Iran—it acquired a partner status in the organization.²³ The state can also act as a mediator between the BSEC and some of the Near and Middle Eastern states with which it maintains traditionally friendly relations.

Conclusion

So it can be said that the BSEC is merely a working form for organizing cooperation among the countries of the Black Sea Basin. How it will function depends only on its willingness to achieve mutual understanding. A foundation for launching bold projects has already been laid and their technical implementation has already begun, but everything will ultimately depend on the participants' ability to overcome the difficulties, of which there will be quite a few.

The organization is also a good forum for discussing various issues, and there are real possibilities for establishing strong internal ties in the region.

²² "Predsedatel'stvo Armenii v OChES bylo ochen' effektivnym: ministr transporta i sviazi respubliki," available at [<http://www.regnum.ru/news/fd-abroad/serbia/economy/1162092.html>].

²³ [<http://www.regnum.ru/news/1152008.html>].

COOPERATION AMONG THE SCO COUNTRIES IN THE HUMANITARIAN SPHERE: EXISTING PROBLEMS AND POSSIBLE SOLUTIONS

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Introduction

The humanitarian aspect is just as important as the economic and political components of the state's activity in terms of ensuring national interests at the international level. The concept "international humanitarian cooperation" includes interstate cooperation in cultural, scientific, information, sport, tourism, and other issues¹ and serves both individual and universal interests. No state can develop in an unfavorable environment without a high level of medical and educational development that guarantees people a dignified standard of living. Full-fledged humanitarian interaction can only develop in an atmosphere of trust and friendship among nations and helps, in turn, to gradually remove any negative perceptions of other national cultures from people's minds.

The culture of society as a whole and its tolerance toward other nationalities presuppose that a nation stands psychologically strong against such contemporary problems of mankind as terrorism and extremism and make it possible to resolve them by peaceful means.

Humanitarian cooperation is also of application-oriented relevance. For example, the

knowledge of language, culture, and traditions of another nation make it possible for states to interact more successfully in order to ensure security.

Recognizing the importance of humanitarian cooperation, national power structures and international organizations are investing large amounts of money in its development. Many states are practicing the policy of "cultural diplomacy," which envisages exporting their culture abroad, working with compatriots living in other countries, and hiring foreigners, thus pursuing the goal of creating a positive image for the country and raising its authority at the international level. For example, Germany allots impressive funds for this purpose—in 2008, 658.1 million euros, or 23% of the Foreign Ministry's budget, were spent to this end.²

Unfortunately, the Russian government underestimates the importance of this vector in the state's activity. When comparing the different approaches to the humanitarian sphere, we will take a look at the possible ways to raise efficiency and improve cultural cooperation within the framework of the SCO.

¹ See: *Tolkoviy entsiklopedicheskiy slovar'*, Norid, St. Petersburg, 2006, p. 485.

² See: N. Pavlov, 'Kultura-tretye izmerenie vneshnei politiki,' *Mezhdunarodnaia zhizn'*, Moscow, No. 8-9, 2008.

Cooperation among the SCO Member States in the Humanitarian Sphere

Cooperation in culture. Created in 2001, the SCO initially set itself the goal of developing cooperation among countries in the humanitarian sphere, which was set forth in its fundamental document—the Charter—and defined as one of its priority tasks. But no practical results were achieved in this vector until 2005. An expert group was created for cultural cooperation issues and a plan of multifaceted cultural cooperation between the Organization's member states for 2005-2006 was adopted.

In December 2006, this group held its first meeting. The experts approved the cultural measures to be carried out during the year in celebration of the Organization's fifth anniversary. Later, at a regular sitting of the ministers of culture, a plan of multifaceted cultural cooperation for 2007-2008 was passed that envisaged its further expansion.

The SCO Secretariat also makes a significant contribution to expanding humanitarian cooperation. In April 2007, at the summit in Bishkek, the agreement on cultural cooperation was signed. This event helped to bring the member states closer together. The number of undertakings carried out also increased. In particular, an album called "A Civilizational Dialogue" has been issued which contains an overview of the cultures of the SCO member states, and the Issyk Kul film festival and artistic forum in Hangchow were held.

In 2008, the ministers of culture adopted another cooperation plan for 2009-2011, and the expert group approved a unified Provision on Festivals, thus making this sphere of activity more streamlined and also improving its financial support.

Cooperation in education. On 26 October, 2005, the heads of government of the SCO states passed a decision to step up cooperation in education,³ which envisaged holding ministerial meetings and creating a permanent experts' working group. According to this agreement, the SCO member states shall enhance the integration process in education, assist mutual exchange among students, academics, and professors, exchange information on education issues, and encourage study of the languages, history, and culture of the Organization's states.⁴

At the 7th sitting of the Council of Heads of the SCO States, PRC Chairman Hu Jintao announced that 20 annual stipends for students studying in China had been instituted for each of the states. A Chinese-language study program has been launched in the Central Asian countries, which offers a teacher-training course at the Northwest University of China. Courses have opened at the University of Communications for training specialists from the SCO countries in telecommunications sponsored by the ZTE Company. On the PRC's initiative, in December 2006, advanced training courses were organized for businessmen and high-ranking officials in electronic machine-building.

In 2006, consultations were held for personnel services, educational institutions, and diplomatic academies of the SCO's foreign political departments. The Russian Foreign Ministry suggested creating a working group for jointly developing the Organization's personnel support principles in cooperation with the SCO Council of National Coordinators and Secretariat.

Many students from the SCO states study at MGIMO (Moscow State Institute of International Relations), the forging shop of the Russian Foreign Ministry. Other countries of the Organization have

³ Although practical cooperation was also realized earlier. For example, in May 2005, an Institute for the Study of the Chinese Language and Culture was opened in Tashkent. The same year, students from Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan began studying at the Northwest University of China.

⁴ Official website of the SCO [http://www.sectsc.org/redirect.asp?id=25&id_temp2=25&LanguageID=3].

taken the curriculum used at this higher educational institution as a basis for their educational programs. At present, Russia is aiming to bring its national educational standards into harmony with the European. But the orientation toward international standards should not undermine the national system of the Organization's member states.

It should also be noted that at first the SCO did not have any unified approaches regarding the export and import of educational services. Nor was there a single information center. In order to resolve these problems, in 2007 a special website was created and an information bulletin addressing cooperation in education began to be issued.

The SCO is also faced with the tasks of drawing up unified education standards and of ensuring the free movement of knowledge and specialists. According to Russian experts, "the resolution of these problems will provide greater opportunities for Russian higher educational institutions to render educational services to the citizens of SCO states, will make Russian education more competitive, and will increase the export of Russian educational services to the Asian mainland."⁵ Realizing the idea to create a SCO University expressed by Vladimir Putin in 2007 will also serve these goals.

On the whole, educational and cultural cooperation of the SCO countries is on the upward trend. In the Treaty on Friendship and Cooperation signed by the member states at the summit in Bishkek in 2007, the sides stated their intention to encourage and support the establishment of direct ties among cultural, educational, scientific, and research institutions, implement joint scientific research programs in personnel training, and carry out student, scientist, and specialist exchanges.⁶

China is the main recipient of the benefits of cultural cooperation being carried out within the framework of the Organization. Since 2005, targeted budget funds have been allotted to other member states for training 1,500 specialists in different spheres of cultural cooperation. More than 200 experts have already been trained for the SCO countries.⁷ Most of the cultural and art exhibitions organized by the SCO are held in the PRC. It has become the Organization's main concert and exhibition platform. International Chinese-language competitions are regularly held and the number of people wishing to study this language is growing.

Russia, on the other hand, is orienting itself more toward the CIS and EurAsEC with respect to cultural and humanitarian exchange since it has greater influence in these communities and can freely promulgate and spread the Russian culture there. The development of the SCO and its growing authority raise the question of the need to increase Russia's influence on the educational and cultural sphere of the Organization's member states.

Informational policy within the SCO. The Russian-Georgian war in August 2008 revealed serious shortcomings in the information coverage of these events within the SCO. At the summit in Dushanbe, Russian President Dmitri Medvedev had to explain the situation in the Caucasus to the leaders of the Organization's member states, as well as to observers. This shows that, first, not all the state leaders understood what was actually going on and, second, the level of Russian information policy leaves much to be desired. It is obvious that a unified information space has not been created yet within the framework of the SCO, neither with respect to television, nor to the press, nor to radio. And if the heads of states are not always sufficiently informed, we can see how much more difficult it is for the ordinary people to understand the gist of what is going on.

This is not only Russia's problem. Coverage of the events in Andijan, Tibet, Afghanistan, and Pakistan, as well as the situation involving Iran's nuclear program, has been distorted. Today, the

⁵ A. Vlasov, E. Poteeva, "Obrazovatel'nye reformy v stranakh ShOS," available at [<http://www.ia-centr.ru>].

⁶ See Art 19 of the Treaty on Friendship and Cooperation of the SCO Member States, Bishkek, 16 August, 2007.

⁷ [http://www.russian.xinhuanet.com/russian/2006-06/14/content_265844.htm].

interpretation of events aired by Western information services spreads much more quickly than the local version in the post-Soviet expanse.

A successful way to overcome this situation might be to create a unified information space, that is, open new television and radio channels (for example, Eurasia News along the lines of Euronews) or expand the broadcasting range of those channels already existing (Mir, the Golos Rossii radio station) in the SCO member and observer states. This requires adopting corresponding bilateral agreements that would provide information to Russian residents too. A press organ is also needed, for example, a daily newspaper covering social and business topics in all the languages of the Organization's countries.

So the creation of a unified information space should become one of the priority vectors in the SCO's activity.

Cooperation in public health. Since its establishment, the SCO has declared the need to cooperate in public health, but work in this area has been slow to get off the ground.

Not until the Shanghai summit in 2006 did the SCO express its willingness to make use of its opportunities in this sphere and take the situation under control. This was prompted by the disturbing statistics. For example, between 1990 and 2002, the use of opiates in the Central Asian countries rose 17-fold, which is a direct threat to the region's security.⁸ This was noted in the U.N. 2004 Report, which states that the cities located along the drug trafficking routes from Afghanistan to Russia account for the highest morbidity rate with respect to cases of HIV infection.

The prevalence of tuberculosis is growing, the number of victims doubled between 1990 and 2003. The situation is complicated even more by the low level of medical assistance and shortage of specialists, and in some rural areas of Central Asia it is simply impossible to receive any medical help at all. According to U.N. data, in 2006, 160,000 residents of the region required treatment, but only 21,000 actually received help,⁹ which requires the SCO's immediate intervention.

This state of affairs prompted examination of the question of cooperation in public health at the meeting of the Council of SCO Heads of State in 2006. The SCO Secretariat and experts were instructed to draw up a plan of further cooperation among the health care ministries and departments, as well as to form a permanent experts' group.

In the fall of 2007, Russian medical mobile groups stepped up their activity in the region, since statistics revealed that 40% of the population of Central Asian countries had no medical services. Teams of specialists were sent to Tajikistan and Kyrgyzstan and a mobile rail consultation-diagnostic center has been operating in Kazakhstan and will subsequently travel to each of the Central Asian countries in turn.

But the problem is that the country to which assistance is sent decides itself whether to accept this help or not. For example, Uzbekistan has not once shown an interest in this. So the measures carried out are not systematic.

In order to solve this task, Russia put forward the initiative to create a Shanghai Health Organization (SHO) along the lines of the World Health Organization (WHO). It is to be aimed at uniting the efforts of all the SCO countries to raise the quality of medical assistance. Within the framework of the SHO, there are also plans to provide practical courses and training for specialists and exchange advanced experience.

Another valuable contribution to raising the quality of health care could be implementing the proposal put forward by Russian expert E. Safronova to use the experience of international organiza-

⁸ Information from an international conference held on 5 October, 2005, Kazakhstan Institute of Strategic Studies under the President of the Republic of Kazakhstan, Almaty.

⁹ U.N. news website [<http://www.un.org/russian/news/fullstorynews.asp?newsID=5636>].

tions to carry out anti-epidemic training exercises.¹⁰ Similar maneuvers involving twenty-one countries have already been carried out by APEC. In Russia they were carried out in March 2006.

Keeping in mind that Asia has already been inflicted by a bird flu epidemic, the SCO countries could create a unified research center for developing vaccines against various viruses. National programs for their development already exist, but it is difficult to resolve this problem independently. Moreover, not one of the Central Asian countries, apart from Kazakhstan, is doing anything to rectify this problem.

Joint projects should also be drawn up that envisage the creation of a unified medical assistance and insurance system ensuring that citizens of the SCO countries, regardless of their whereabouts, receive high-quality medical services. Particular attention should be given to preventing and treating diseases that threaten to become pandemic, preventing new outbreaks of epidemics in the region, carrying out joint research studies under the guidance of the SCO, and disseminating advanced experience aimed at fighting infections. The people should also be provided with timely information about the danger of various infections.

Cooperation in dealing with emergencies. It is a well-known fact that the Central Asian region is periodically inflicted by natural disasters. The less developed countries of the region suffer the most from this. For example, Tajikistan periodically experiences earthquakes and extremely cold temperatures. In the winter of 2008, the country could not cope with the growing volumes of electricity consumption and found itself on the brink of disaster, plants and factories ground to a halt.

In 2002, the first meeting of the heads of the SCO countries' emergency ministries was held, within the framework of which a protocol was signed that envisaged developing cooperation to prevent and liquidate emergencies. In 2005, an Agreement on Cooperation and Assistance in Liquidating Emergencies was signed among the states' governments. The document envisages joint efforts for ensuring efficient and coordinated assistance to the people of the afflicted state.

However, the sides did not examine the question of establishing a permanent emergency control center in one of the SCO countries. Without such a center, the countries of the region have to ask for help from neighbors each time, which not only fails to resolve the problem, but also interferes with the development of national emergency services, the specialists of which do not receive the necessary training in the Central Asian countries and cannot appropriately deal with natural disasters, including technogenic catastrophes. The situation in this area is also complicated by climatic changes.

The second meeting of leaders of these departments of the SCO states was held in November 2006. It passed the Action Plan for Cooperation and Assistance in Emergencies for 2007-2008. Later, comprehensive exercises were held organized by the PRC Civil Administration Ministry, which again confirmed the need for a unified SCO center for natural disaster prevention and liquidation. This would help to better provide the region with technical means and raise the level of specialist training in this area. Keeping in mind the immense experience of the Russian Emergency Ministry, Russia could help to launch such a center and possibly head it.

Environmental cooperation. The drying up of the Aral Sea is one of the biggest contemporary environmental disasters and it has caused an abrupt drop in the standard of living of the people residing in the Aral Region. As of today, hundreds of thousands of people need help. The burial of radioactive wastes in the region of the Ferghana Valley is extremely dangerous. International organizations such as the UNDP, OSCE, EU, International Aral Sea Rehabilitation Fund, and others are en-

¹⁰ See: E. Safronova, *ShOS: k novym rubezham razvitiia*, RAS Institute for Far Eastern Studies, Moscow, 2008, pp. 161-184.

gaged in these and other environmental problems, as well as the countries of the region that are trying to carry out their own measures.¹¹

In 2004, an agreement was reached on developing cooperation with respect to enhancing environmental protection and preserving the environmental balance in the region, ensuring the rational use of hydropower resources, and preventing the desertification of land, as well as stopping other degrading processes.¹²

But cooperation in this sphere did not undergo further development until 2006 when regular meetings of the corresponding SCO expert groups began to be held. In 2007, two projects were approved: "Forecasting the Water Level of Cross-Border Rivers of the Aral Sea Basin" and "Expanding Cooperation in Environmental Protection and Environmental Rehabilitation of the Aral Sea Basin."¹³

According to Nursultan Nazarbaev, in addition to the Aral, the SCO could also solve other pertinent tasks of environmental safety, for example, rational use of the water resources of the Irtysh, Amu Darya, and Syr Darya, rivers.¹⁴ But it is still not possible to resolve all of these problems independently.

SCO Secretary General B. Nurgaliev has repeatedly noted that "only if U.N. institutions—the WHO, UNICEF, UPFPA, the World Bank, the Asia Bank, and other international institutions—join the efforts of the Central Asian States, as well as the SCO and EurAsEC, can progress be achieved in resolving the most acute social-environmental problems, in implementing projects to restore beneficial conditions for the vital activity of the people living in the Aral Region, and in protecting the health of the people and environment..."¹⁵ In this area the SCO is trying to establish regular cooperation with international structures, in particular with the U.N. Center for Preventive Diplomacy. Keeping in mind the SCO's growing authority, it is possible that in the near future, when cooperation with other organizations and countries develops, international projects could be carried out to improve the environment in Central Asia.

Basic principles need to be drawn up in natural disaster prevention and liquidation for carrying out joint rescue operations, as well as for training personnel in a unified method, keeping in mind the entire complex of necessary technical means. The SCO still does not have a separate structure responsible for preventing emergencies and providing urgent humanitarian aid.

Problems of Humanitarian Cooperation between Russia and Central Asian Countries and Possible Solutions

After re-examining and changing its foreign policy, Russia began actively focusing its attention on cooperation with the Central Asian countries. Integration projects related to this region began

¹¹ Kazakhstan is exerting efforts to rehabilitate the Small Aral, Uzbekistan, in order to rehabilitate the ecosystem in order to fixate the moving sands of the Aral's coastal plain.

¹² Joint communiqué of the Council of Heads of Government (Prime Ministers) of the SCO Member States. 2004.

¹³ Speech by B. Nurgaliev at a conference on the problems of the Aral Sea, Tashkent, 11-12 March, 2008, available at [<http://www.sectSCO.org>].

¹⁴ Nursultan Nazarbaev's speech at the Bishkek summit, 16 August, 2007, available at [<http://www.sectSCO.org/redirect.asp?id>].

¹⁵ Speech by B. Nurgaliev at a conference on the problems of the Aral Sea, Tashkent, 12 March, 2008.

to be put forward more frequently and Russian centers of science and culture are opening. In 2007, the Russkiy Mir (Russian World) Foundation was created that is called upon to promote the development of the Russian language. Cooperation is expanding with medical professionals, cinematographers, and artists.

A Kyrgyz-Russian university was opened in Bishkek, and a Tajik-Russian one in Dushanbe. The branches of some Russian higher educational establishments are being created in the countries of the region. The common history and traditional cultural ties between Russia and the Central Asian countries are having a positive influence on the further development of this cooperation. In order to further improve the above-mentioned statistics, broader use must be made of the possibilities of a unified SCO information sphere. This is also being enhanced by organizing seminars, conferences, Internet forums, and so on, which does not require much financing.

All these components of humanitarian cooperation are helping to strengthen comprehensive relations between the Russian Federation and Central Asian countries, raise mutual understanding among nations, and prevent intentional distortion of the contents of the SCO's policy by the press.

At the same time, several aspects should be noted that are making it difficult to create Russia's positive image in Central Asia and are preventing the establishment of relations between them.

One of the most important problems for Russia is **the drop in level of the use of the Russian language and Russian education** in the Central Asian republics. Many schools where the Russian language was previously taught have been closed and those remaining have as many as 50 students per class, which is a clear overload. This has been caused by objective difficulties involving their maintenance, so Russia must help to open new Russian schools. Moreover, keeping in mind the current migration situation, we should also think about opening Asian schools in Russia. But funding is so far lacking for this.

The shortage of Russian schools is aggravated by the shortage of teachers and their low qualification level. Schoolchildren who receive a secondary education in the Central Asian republics cannot compete with the graduates of local schools when applying to Russian higher educational institutions since they simply do not have the required level of knowledge. The introduction of the unified state exam (EGE) in Russian schools in 2009 and the need for students to present their results when applying to higher educational institutions are also creating an obstacle for applicants from other countries. There are not enough special Russian-language teaching centers in the Central Asian republics, they are not even always available in the large cities. Nevertheless, interest in Russian education is still high (see Table 1).

Table 1

**Would You Like to Receive an Education Abroad and
in What Country?**

Country	Yes, in Russia	Yes, in the EU	Yes, in the U.S.
Kazakhstan	18%	17%	14%
Kyrgyzstan	32%	17%	14%
Uzbekistan	—	—	—
Tajikistan	37%	12%	14%

Source: Non-commercial Partnership Eurasian Monitor, and Eurasia Heritage Foundation, October 2007.

And although the number of Central Asian students studying in Russian higher education institutions (apart from Kyrgyzstan) has not decreased over the past 12 years (see Table 2), the number of graduate students going to other countries, Pakistan, Saudi Arabia, Turkey, Iran, and Japan, has significantly increased. For example, whereas there are 2,300 Tajiks studying in Islamic countries,¹⁶ their numbers are much lower in Russia. This is explained by the fact that the governments of many of the indicated countries provide free education at their higher educational institutions.

However, as the Bolashak state program to assist Kazakh students wishing to study abroad shows, most applicants, given the choice, prefer to study at U.S. and European universities. For example, among those who received a Bolashak stipend in 2007-2008, 46.6% chose European countries, 29% the U.S., and 9.5% Russia.

Table 2

**Number of Students of
Central Asian Countries Studying
in Russian State and
Municipal Higher Educational Institutions**

Country	1995/96		2000/01		2006/07		2007/08	
	Total	inc. full-time	Total	inc. full-time	Total	inc. full-time	Total	inc. full-time
Kazakhstan	11,644	8,921	16,665	11,724	18,036	12,441	18,970	11,553
Kyrgyzstan	1,700	1,524	1,230	519	712	583	830	634
Tajikistan	738	642	324	221	1,135	647	1,234	742
Uzbekistan	3,176	2,735	3,221	1,162	5,287	2,092	4,614	2,088

Source: Russian Federal State Statistics Service.

Nevertheless, the Russian language is still a “ticket” to membership in the national elite in the Central Asian countries, as well as one of the main conditions for joining the middle class. The trends toward a cutback in Russian-language teaching caused by the desire to obtain a higher education in Western higher educational institutions are creating the need to improve study of the Russian language and prompting Russia to step up formation of its policy in this area. But Russia’s initiatives often come up against problems created by the local legislation and are sometimes perceived in certain circles as attempts to return to the educational traditions that existed in the Soviet Union.

Nevertheless, the experience of the work of branches of Russian universities in the region’s states shows an urgent need for expanding the network of secondary schools based on a Russian curriculum. The initial stage of this process could be offering Russian classes at national schools. The possibilities of extramural study in Russia should also be developed, as well as other mechanisms aimed at integrating schoolchildren from Central Asian countries into the Russian educational space. This will all make it possible to interest the most promising young people in studying in Russia. In so doing, the funds allotted for teaching students will be invested in Russian higher educational institutions and so

¹⁶ In Pakistan and Saudi Arabia there are approximately 1,500 students, in Egypt around 600, and in Iran around 70.

remain inside the country. In addition, by attracting students from the Central Asian countries, Russian universities raise their international rating and, consequently, the number of students from foreign countries will increase.

For those who study in their own countries, on the other hand, it is expedient to ensure the possibility of listening to lectures by Russian professors who are invited on sabbatical for several months (semesters). This could be resolved by special programs using grants or other state funds.

In order for the Central Asian population to study Russian in every large city of the region special courses should be offered as well as methods and tools applied for its independent study. It would be expedient to open retraining and advanced training centers in the capital of each republic for teachers at schools where the Russian language is taught. In this way, students will be able to continue their education at Russian higher educational institutions. This is shown by the data of a survey of residents of the Central Asian republics (see Table 3).

Table 3

**Should the Study of
the Russian Language be Expanded
in Your Country?**

Countries	Expand	Leave As Is	Cut Back
Kazakhstan	32%	53%	7%
Kyrgyzstan	61%	28%	4%
Uzbekistan	—	—	—
Tajikistan	89%	8%	1%

Source: Non-commercial Partnership Eurasian Monitor, and Eurasia Heritage Foundation, October 2007.

The level of **scientific cooperation** is still low. Moreover, the economic crisis has had a very negative impact on this sphere. State and private organizations are cutting back financing in this area. For example, exploration of uranium deposits in Tajikistan and Kyrgyzstan has been stopped. Apart from joint space projects with Uzbekistan and Kazakhstan, no other noticeable shifts are observed.

Joint developments in the humanitarian sciences are also few and far between. Russian funds are not showing much interest in developing scientific cooperation with the Central Asian countries. Only Russian-Kazakh scientific conferences are being systematically held, while such undertakings with other countries are episodic.

In order to correct the situation in this sphere, it would be expedient to:

- Ensure the creation of interstate research centers or mixed scientific groups for developing large joint projects in energy, transport construction, medicine, biology, and the environment;
- Interest Russian governmental and nongovernmental funds in helping to develop cooperation with Central Asian scientists, both in priority scientific spheres and in industry, and attracting funds from state corporations for this.

Systemize the holding of international scientific forums, conferences, and seminars on different scientific problems.

The SCO Forum created in 2006 has been called upon to play an important role in developing humanitarian cooperation. It carries out expert-analytical studies, draws up recommendations, and compiles forecasts. It primarily focuses on energy cooperation issues and defines the general criteria for accepting new members and determining the vectors of cooperation with other organizations.

Russia's opportunities in scientific development could be realized within the framework of the SCO University mentioned above with a unified curriculum for students from the member countries. Such higher educational institutions as Moscow State University, the Academy of the National Economy under the Russian Government, the Academy of Foreign Trade, and MGIMO have confirmed their interest in creating this University. At the initial stage, it could function as an advanced training center for state officials and representatives of commercial companies interested in accelerating the development of the six countries. In the future, study could be organized in such priority fields of specialization as transnational project management, international law, the fundamental principles of foreign economic activity in the region, and so on. As already noted, several scientific centers and groups could be created on the basis of the SCO University.

The expansion of scientific cooperation could also be promoted by the Kyrgyz idea of creating an Inter-Academic Scientific Council, which would help to intensify integration and promote more precise coordination of the intellectual efforts of scientific circles that are of practical interest for all the SCO countries.

Russia has very few **special support foundations of humanitarian cooperation with the Central Asian countries**. Although Roszarubezhtsentr exists, and in 2008 the Russkiy Mir Foundation appeared, this is clearly not enough.

The U.S., for example, has a multitude of such educational support mechanisms—scientific contacts, practical study courses, English courses, and so on. But in Russia neither the Russian Humanitarian Science Foundation nor Russkiy Ìir can assist in this. Nor are there nongovernmental organizations (NGO) in Russia that could function exclusively in the Central Asian region. On the other hand, the Conrad Adenauer, F. Ebert, McArthur, Carnegie, and Soros foundations are active there.... While Western and Eastern actors are pursuing their interests in Central Asia, Russia, lagging seriously behind them in level of activity, could lose its influence in the region in the future.

So it is necessary to promote the creation of domestic foundations and organizations, whereby especially for working in the Central Asian countries. Our own projects must be advanced, particularly in the humanitarian and social spheres. In addition, when drawing up and allotting grants it is expedient to involve experts from these countries and use the funds for Central Asian specialists to take practical study courses in Russia's scientific and state structures.

The problem of supporting Russian compatriots living in Central Asia consists primarily in the fact that their status in their countries of residence and the conditions for their entry into the Russian Federation have not been legally regulated and they are essentially equated with foreigners. The problem of dual citizenship has not been resolved yet, there is only a corresponding agreement with Tajikistan. This is making trips to Russia and entering various types of transactions very difficult. Adopting agreements on dual citizenship would make it possible to incorporate compatriots into the Russian legal field, as well as act as their guarantee in the event of emergencies.

Another problem for compatriots living in Central Asia is applying to Russian higher educational institutions, which is not supported by the Russian government free education quotas. In this sphere too they are equated with foreigners. They can study at Russian higher educational institutions on general terms, but, as already noted, students from Central Asia do not have the required level of knowledge for this. The only solution is paid education, and not everyone can afford it, so it is extremely important to allot funds for free education.

Another problem for compatriots is their low level of interaction at the interregional level. Insufficient information makes it more difficult for them to participate in various undertakings, so it is

important to create coordination councils that will join all or most organizations of compatriots in each country and consolidate their efforts to resolve the existing problems. Kyrgyzstan is a positive example where 63 organizations have joined to create this kind of council.

Corresponding information support is also needed, for example, the creation of a separate internet page or press organ, which will require the support of Russian state structures or foundations.

The difficult situation of migrants from Asian countries in Russia is one of the most important problems of cooperation in the humanitarian sphere. As we know, qualified personnel with a diverse range of skills is required to develop the Russian economy, but such personnel rarely comes from the Central Asian countries, mainly it is people without the proper training and education. They often do not even know where work hands are needed and if they are needed at all. They usually receive their information through friends and relatives who have already been in Russia. This provokes illegal migration and, consequently, no legal protection against employers who may wish to exploit them. Migrants usually choose large Russian cities, they are practically non-existent in medium and small towns. They usually go for any kind of work, so they often find themselves in criminal environment.

Legal relations with migrants contribute to the future of harmonious relations between Russia and the Central Asian countries. This requires creating favorable conditions. The workforce comes mainly from Kyrgyzstan, Uzbekistan, and Tajikistan, where there are not even any special Russian-language training centers, or the legal knowledge needed for Russia.

With knowledge of the Russian language and laws, it is easier for migrants to obtain legal protection. It would also be expedient to create a unified labor exchange, which would help them to find better jobs in Russia on a legal basis.

Central Asia's cooperation with other states and organizations is having both a positive and negative influence on Russia's interests. The humanitarian activity of states that are interested in the region is growing. The influence of the EU, NATO, OSCE, U.S., Iran, Turkey, and Japan is strengthening, which in some areas contradicts Russia's national interests. It should be noted that cooperation between the Central Asian countries and the indicated actors is being built exclusively on a bilateral basis. The region's countries act in most joint projects as sides receiving some kind of aid, which is largely carried out along "donor-recipient" lines, thus determining their interest, but on the other hand it increases their dependence on the donors.

The European Union countries are carrying out a more balanced and soft policy in Central Asia. Such EU programs as TACIS (a technical assistance program), TEMPUS (cooperation in higher education), COPERNICUS (exchange of scientific personnel), INTAS (cooperation among scientists), and Food Safety DIPECHO (disaster preparedness training) operate in the region. Bilateral cooperation programs are also being developed. Great Britain and Sweden are financing environmental protection, public health, the social sphere, and agrarian reforms; the Netherlands are helping to fight tuberculosis, and Switzerland is assisting in carrying out several water use projects.

In addition, in 2000, with the assistance of the EU, a Regional Environmental Center and a Coordination Center for Climatic Changes opened in Kazakhstan.

It should be noted that, when drawing up strategy with respect to Central Asia, the European Union countries take Russia's interests into account, clearly appreciating its traditionally high role in the region and drawing up their policy with this in mind.

The OSCE, which appeared in the region at the beginning of the 1990s,¹⁷ has made attempts to resolve several of the Central Asian states' environmental and health care problems, but a precise plan of action was not drawn up until 2000-2001. The OSCE Academy has opened and is functioning successfully in Bishkek.¹⁸

¹⁷ An OSCE center opened in Dushanbe in 1993, in Tashkent in 1995, and in Almaty and Bishkek in 1998.

¹⁸ In June 2003, it was transformed into the American University of Central Asia (AUCA).

Islamic organizations are also interested in the Central Asian countries. For example, in 2007, the International Islamic Organization for Education, Science, and Culture (ISESCO) of the Organization of the Islamic Conference (OIC) declared Tashkent to be the world's capital of Islamic culture.

The U.S., in contrast to the European Union, is trying to neutralize Russia's traditional influence in Central Asia, as well as the growing influence of the PRC, which it regards as its main strategic rival. The NATO countries are aiming to expand relations with the Central Asian states within the Partnership for Peace program (they began joining this program in the mid-1990s), designed to carry out joint work in different spheres. In 1998, Euro-Atlantic Disaster Response Coordination Center (EADRCC) was created for better coordinating activity, the purpose of which was to join efforts to render help during natural disasters to the member states of the Euro-Atlantic Partnership Council.

Over five years, beginning in 2003, financial aid to the Central Asian countries has increased 2.5-fold. Uzbekistan has received 266 million dollars from the Pentagon budget, Kyrgyzstan 146 million, and Tajikistan and Turkmenistan around 36 million each.

Turkey's humanitarian cooperation with the Central Asian countries is ambiguous. On the one hand, it upholds the geo-strategy of the West, striving to graphically show its loyalty to it and the expediency of its intermediary role in Central Asia while, on the other, it is promoting its own interests in the region.

The historical, cultural, and linguistic commonality with the Central Asian states and the pro-Western sentiments of this economically successful secular Muslim country, as well as U.S. support, are helping to expand Turkey's influence in the region. In the humanitarian sphere, Turkey's policy is directed at actively introducing a special educational system there.

As for Iran, there can be no doubt that it is tied by deep cultural and historical roots to Central Asia, which is an important region in the political and economic respect.¹⁹

At the beginning of the 21st century, Iran dropped the practice of exporting the idea of Islam to the Central Asian Region, since it understood that these states were interested in developing their own relations with other countries, primarily in the economic sphere, particularly when this cooperation promises investments. So contacts are primarily being established in this area.

Iran is also well aware that its presence in the region is closely tied to Russia's interests.

On the whole, the image of a country of "militant Islam" with claims to leadership among the Muslim states, excessive ideologization of foreign policy, and weak economic potential does not promote Iran's popularity in Central Asia.

Japan appeared in Central Asia's humanitarian space in 1991. It was precisely on its initiative that the Development Assistance Committee of the OECD (Organization for Economic Cooperation and Development) included the Central Asian countries on the list for receiving official aid aimed at improving and accelerating their development.

Since 1996, Japan has been holding culture days of its country in Central Asia, since 1999 it began granting stipends to Uzbek students studying at Japanese universities. More and more Japanese have begun visiting the region's countries.

In 2002, the Japanese government opened a Japanese Human Resource Development Center in Almaty which holds various cultural undertakings, organizes Japanese-language and management courses, and so on. The Japanese government has begun issuing grants aimed at developing cultural-educational and sporting institutions.

When analyzing the humanitarian cooperation of the Central Asian countries with third countries on the whole, the conclusion can be drawn that Russia's interests will be threatened (see, Table 4) if other countries, unfriendly toward Russia and pursuing goals that do not coincide with its interests, continue to increase the amount of their humanitarian aid to the Central Asian countries.

¹⁹ See: P. Goncharov, "Iran vozvrashchaetsia v Tsentral'nuiu Aziju," RIA Novosti, 25 August, 2006.

Table 4

**Influence on Russian Interests of
Humanitarian Cooperation between the Central Asian Countries and
Other States and Organizations²⁰**

Country/Actor in CA	Influence on Russia's Interests in Central Asia
EU	<i>positive influence</i>
NATO	<i>negative influence</i>
OSCE	<i>weak positive influence</i>
OIC, Iran	<i>weak positive influence</i>
U.S.	<i>negative influence</i>
Turkey	<i>negative influence</i>
Japan	<i>weak positive influence</i>

In order to avoid this Russia must increase its influence in all areas, including in the humanitarian sphere. This is all the more necessary if we keep in mind the willingness and greater inclination of almost all the Central Asian countries to cooperate with Russia than with Iran, Turkey, or the U.S.

Conclusion

On the whole, humanitarian cooperation within the SCO is developing in all vectors with varying success. It has become “one of the most important factors guaranteeing the Organization’s viability and could well play the role of a catalyst and example for inter-civilizational communication in the search for solutions to problems that are preventing harmonization of relations in the world.”²¹

The Russian Federation is trying to carry out a policy within the SCO aimed at strengthening all those cooperation vectors not receiving the proper development within the CIS. In so doing, the people of the Central Asian countries consider the Russian language and Russian culture to be part of their national history, continuing to use them for their further development. Quite a few Russians live in most of the region’s countries—approximately 20% of the population.

On the whole, the development of Russia’s humanitarian cooperation with the Central Asian countries is quite harmonious, the authority and influence of Russia and the Russian world have been preserved, and the region also keeps close tabs on its actions on the international arena.

So, by preserving the impressive results that have already been achieved, a strategy designed to intensify Russia’s influence in Central Asia must be continued.

²⁰ This scale does not reflect all the specifics of the factors of influence on Russia’s national interests, but it presents a general review of the influence of each of the countries.

²¹ Declaration of the Fifth Anniversary of the Shanghai Cooperation Organization, Shanghai, 15 March, 2006.

GUAM: OLD PROBLEMS AND NEW CHALLENGES

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Introduction

The post-Soviet states, which deemed it necessary to set up regional structures, have done and are doing their best to identify foreign policy priorities geared toward their national interests.

In fact, until the mid-1990s, when at least some of the states remained vague about their foreign policy orientations, no regional alliances were possible. For many reasons the Common Caucasian Home idea can be dismissed as still-born.

By the mid-1990s, most of the new independent states had formulated more or less clear foreign policy ideas and were prepared to ally with fellow thinkers. As a result several regional structures were set up.

In 1997, several countries intent on pursuing foreign and domestic policies independent of the Russian Federation set up GUAM.¹ While the situation remained stable, with Moscow retreating under Western pressure, the contradictions inside the organization remained dormant; after the war in South Ossetia, however, some mem-

bers deemed it necessary to readjust their regional priorities. The conflict laid bare the contradictions present in this structure (in fact no post-Soviet organization is free from them). Vladimir Papava has offered the following comment: "The fact that this structure has existed for many years shows that each country individually, as well as the organization they represent as a whole still have many unresolved problems."²

The war in South Ossetia bred pessimism about the future of GUAM in the expert community. At least some of its members, Modest Kolerov³ being one of them, doubted its chances for survival because of Russia's greater role. Those who asserted this proceeded from the fate of similar organizations.

Indeed, GUAM, like the Single Economic Expanse, the CIS, and certain other structures, has not avoided a great share of skepticism.⁴ Indeed, the diverging foreign policy interests of the Russian Federation and GUAM occasionally developed into open confrontation. On top of this, GUAM has enough inner ulcers of its own which have finally brought it face to face with the threat of de facto disappearance.

¹ It was set up on 10 October, 1997 at the Strasbourg Summit of the Council of Europe by the communique issued by the four members of the new structure (Georgia, Ukraine, Azerbaijan and Moldova.) It was a result of discussions on the flank agreements on conventional forces in Europe at the OSCE Permanent Council. The Strasbourg declaration was adopted as a final document.

Uzbekistan joined GUAM on 24 April 1999 at the Washington NATO summit which transformed the GUAM into GUUAM.

On 5 May, 2005, Uzbekistan left GUUAM, which forced the Kiev Summit of 22-23 May, 2006 to supply the structure with a new name, Organization for Democratic and Economic Development—GUAM (ODEC-GUAM).

² V. Papava, "On the Role of the 'Caucasian Tandem' in GUAM," *Central Asia and the Caucasus*, No. 3-4 (51-52), 2008, p. 47.

³ See: M. Kolerov, "Novyi Bolshoi Kavkaz: vzaimnoe sderzhivanie bez chuzhikh. Chego uzhe net i chto mozhet byt," available at [http: www.regnum.ru], 21 August, 2008.

⁴ See, for example: L.M. Grigoriev, M.R. Salikhov, *GUAM: piatnadsat let spustia. Sdvigi v ekonomike Azerbaidzhana, Gruzii, Moldavii i Ukrainy. 1991-2006*, REGNUM, Moscow, 2007; R.S. Grinberg, L.Z. Zevin et al., *10 let Sodruzhestva Nezavisimykh Gosudarstv: illiuzii, razocharovaniia, nadezhdy*, IMEPI RAN, Moscow, 2001.

GUAM: What Keeps It Together

Experts point to two major factors—regional and extra-regional—which created GUAM and keep it afloat.

D. Voronkova, for example, has pointed out: “Those who analyze international relations are convinced that the United States contributed to the emergence of GU(U)AM (Georgia, Ukraine, Uzbekistan, Azerbaijan, and Moldova) as a regional international organization. It was the U.S. that initiated GU(U)AM ‘to graft geopolitical pluralism to the post-Soviet expanse’ and ‘to contribute to stronger democracy and security in these countries’ (quoted from Steven Mann, Senior Advisor for Caspian Basin Energy Diplomacy, U.S. Department of State.”⁵

Another group of experts associated GUAM with the Union Treaty between Russia and Belarus signed in 1997 and the tension caused by the Black Sea Fleet issue and the Transnistria conflict.⁶

Whatever the case, the interest America, the European Union, and others showed in consolidating the future GUAM members was a determining factor—the states themselves wanted the same. Indeed, at first glance they were dealing with *similar problems*, namely, protecting their interests in ethnopolitical conflicts and pursuing a *mono-vector foreign policy* caused by their ardent desire to shake off Russia’s influence by setting up alternative energy and communication corridors, TRACECA being one of the relevant projects. The desire to join the Euroatlantic security system was another unifying factor of no mean importance.

This means that GUAM owes its existence to the identical geopolitical and geo-economic interests of the regional and extra-regional actors and shared approaches to their domestic problems. V. Mitiaev has offered the following comment: “The organization was built up as a political superstructure over the TRACECA transport project.”⁷

GU(U)AM’s fundamental documents registered the main development trends and goals that fitted the interests of its members.⁸

GUAM’s priorities survived, even if the accents were shifted to follow the political ups and downs that pushed different member states to the dominant positions.

In any case, the above factors coupled with the extra-regional actors’ interests are keeping the organization together.

⁵ D. Voronkova, “Etapy razvitiia GUUAM,” Part 1, available at [www.ia-centr.ru], 19 June, 2007.

⁶ Ibidem.

⁷ V. Mitiaev, “Gruziia na Velikom Shelkovom puti,” *Gruziia: problemy i perspektivy razvitiia*, Vol. 1, RISI, Moscow, 2001, p. 310.

⁸ The GUUAM presidents announced in Washington that the bloc had arrived at the following decisions:

“1. To strengthen and improve the mechanism of consolidation and coordination of actions within the framework of international organizations and to promote actively the practice of joint statements at various levels.

“2. To develop interaction within the framework of the Euro-Atlantic Partnership Council and NATO’s Partnership for Peace.

“3. To reaffirm the intention to intensify efforts to bring about peace on the basis of respect for the sovereignty and territorial integrity of the states concerned.

“...7. Pledge of cooperation in developing a Europe-Caucasus-Asia transport corridor on the basis of the results of the International Conference on the Restoration of the Historic Silk Road held in Baku in September 1998...”

GUUAM (GUAM) followed the above reconfirmed by all later documents (see: *The Washington Statement of the Presidents of the Azerbaijan Republic, Georgia, the Republic of Moldova, Ukraine and the Republic of Uzbekistan*, available at GUAM’s official sites [www.guam.org.ua] and [www.guam.org]).

The Roles and Interests of GUAM's Member States Outlined

I have already written that extra-regional factors coupled with shared approaches to the ethnopolitical conflicts in Nagorno-Karabakh, Transnistria, Abkhazia, and South Ossetia, as well as the desire to free themselves from their energy and energy-transportation dependence on the Russian Federation are the reasons the countries in question decided to set up GUAM. Periodically, the members closely scrutinized the reasons for their continued membership; from time to time their leaders deemed it necessary to revise the priorities to fit them to the national goals and tasks.

On 7 June, 2001 at the Yalta summit, President of Ukraine Kuchma suggested that the heads of state should discuss, on a priority basis, the development, efficiency, and security of the transportation issue on the territories of the GUAM members, including TRACECA. The Ukrainian president explained to the media that economic cooperation should be treated as a priority.

President Voronin of Moldova came forward with a statement that he expected political dividends from his country's GUAM membership.⁹

Azerbaijan and Georgia looked at their membership as a way to boost their foreign policy influence through alternative power transportation corridors; they also hoped to resolve the still unsettled conflicts and join the Euroatlantic security system.

Later, as cooperation went ahead the priorities changed to the extent that Uzbekistan left the structure.

In February-March 2005, the Orange Revolution in Ukraine jolted GUAM into greater activity.

The Kiev summit of 22-23 May, 2006 created the Organization for Democratic and Economic Cooperation—GUAM (ODEC-GUAM). Simultaneously, the relations of at least three members (Georgia, Moldova, and Ukraine) with the Russian Federation deteriorated. While in the past Ukraine served as the driving force behind GUAM, in 2005-2006, Azerbaijan, after avoiding a domestic crisis and preserving balanced relations with Moscow, gradually moved to the fore. Its new role was underpinned by its hydrocarbon wealth.

Much attention was attached to the Baku-Tbilisi-Ceyhan (BTC) oil pipeline that crossed the territories of Azerbaijan, Georgia, and Turkey. The post-Orange coolness between Ukraine and Azerbaijan disappeared—more evidence of Baku's new role.

On 7-8 September, 2006, President Yushchenko of Ukraine arrived in Baku on an official visit; the sides discussed wider cooperation in the energy sphere and the Odessa-Brody pipeline as a new power transportation route designed to bring Azeri and probably Kazakh oil to the West European markets.

Its key role in all sorts of projects made Baku one of the most significant GUAM members and pushed forward the issues of the unsettled conflicts.

The members' shared desire to unify their approaches to ethnopolitical problems pushed the conflict issue to the fore. When formulating the common approaches Azerbaijan relied on specific events and facts, such as Georgia's worsening relations with Russia; Ukraine's gas-related misunderstanding with the RF; dissatisfaction with Russia's peacekeeping mission expressed by Moldova and Georgia, etc.

From this time on the organization became more actively involved in the discussions of the unregulated conflicts. In fact, it was during the Kiev summit that some of the experts commented on the main reason Azerbaijan had joined GUAM and remained its member.¹⁰

⁹ See: D. Voronkova, op. cit., Part 2, available at [www.ia-centr.ru], 20 June, 2007.

¹⁰ See: "Expert: 'Tolko Karabakh derzhit Azerbaidzhan v sostave GUAM-a,'" available at [www.regnum.ru], 24 May, 2006.

Ukraine was more interested in cooperation in the energy sphere; it offered a conception of the Danubian Power Transportation Bridge that envisaged, among other things, transit of Caspian oil to the EU countries through the Odessa-Brody pipeline to be extended for this purpose to Gdansk in Poland.

Ukraine enjoyed the wholehearted support of Poland and the Baltic states; their far from simple relations with the Russian Federation forced them to look for alternative sources of power and transportation routes (the Black Sea-Caspian expanse was to be transformed into the Baltic-Black Sea-Caspian area). There was a lot of talk about extending the Odessa-Brody pipeline to Gdansk. Azerbaijan (and later probably Kazakhstan) was expected to be the main exporter; to reciprocate these countries were prepared to support Baku on vitally important issues.

On 19 June, 2007 President Yushchenko, speaking in Baku at the regular GUAM summit, pointed out that international transportation corridors were badly needed: "The Great Silk Road can be revived."

He also expressed his conviction that the governments and corresponding departments of the member states "will do their best" to ensure that the Ilyichevsk-Klaipeda railway and Ilyichevsk-Poti ferry would function smoothly and that cooperation in the energy sphere would be extended.

He went on to say that at the Krakow summit on 11 May, 2007, Azerbaijan, Georgia, and Ukraine, together with their partners (Poland and Lithuania), had suggested that a single fuel production and transit area should be set up. A workgroup had been created and began functioning. Simultaneously, an agreement on the Caspian pipeline was signed in Turkmenbashi.

The Ukrainian president said that his suggestion was based on the Eurasian Oil and Gas Transportation Corridor project with the already commissioned Odessa-Brody oil pipeline being its key stretch (to be extended to Poland). President Yushchenko described a free trade zone "without exemptions and limitations and in full accordance with the WTO norms" as another promising priority.

At the Vilnius jubilee GUAM summit, which also functioned as an energy conference, the Odessa-Brody-Płock-Gdansk pipeline was discussed in greater detail as part of the policy of drawing closer to the Baltic and EU countries. For the first time at the state level "the GUAM countries will join forces with Lithuania and Poland to realize this project," said Victor Yushchenko.

At the reception that marked the 10th GUAM jubilee, Lithuanian President Adamkus announced that his country was initiating Friends of GUAM in the EU Group and invited those EU members that supported the ODEC-GUAM to join it.

Azerbaijan, Georgia, and Moldova treat the unsettled conflicts as their priorities and used GUAM to double their initiatives. Starting in 2006 they jointly lobbied the related issues: one of the countries came forward with a resolution at a U.N. General Assembly while GUAM seconded it as a collective structure.

Different countries (all of them seeking membership in a security system unrelated to the Russian Federation) demonstrated their intention to integrate with the North Atlantic system differently: Georgia demonstrated this by its confrontation with Russia.

A peacekeeping contingent within GUAM was another important issue that has been discussed from the very first days. Its functions remained unclear: should the peacekeepers guard the pipeline or should they be involved in peacekeeping operations in the conflict zones? So far, the statements offered by the GUAM countries have not yet clarified the issue.

On 19 June, 2007, the Baku summit reached a preliminary agreement on setting up a peacekeeping battalion of about 500. Moldova's skepticism about the peacekeeping projects within GUAM deprives these decisions of any meaning.

The GUAM countries frequently discuss the possibility of inviting NATO to replace the peacekeepers in the zones of the Abkhazian, South Ossetian, Transnistrian and Nagorno-Karabakh conflicts. The North Atlantic Alliance has so far shown no interest in peacekeeping activities in the region in which Armenia, a CSTO member, is involved in many projects. Neither Azerbaijan, nor Georgia, nor Ukraine, nor Moldova managed to set up a common security system.

The GUAM countries are using the peacekeeping contingents issue to put pressure on Moscow. Tomas Valasek, senior European analyst at the Center for Defense Information in Washington, has pointed out: "Moreover, GUUAM members whose troops fought in conflict in Nagorno-Karabakh, Abkhazia and Transnistria are not in a position to provide truly neutral troops for peacekeeping in the same conflict area."¹¹ In any case, the issue of alternative peacekeeping forces has been and remains debatable.

On 1 July, 2008, the GUAM members met in Batumi for the third summit; on 8 August, the war in South Ossetia began. This forced them to readjust their policies in view of the fact that their common structure largely depends on what was going on elsewhere (independence for Kosovo) and on the bilateral relations among the members.

GUAM: From Integration to Possible Disintegration, or Old Problems and New Challenges

GUAM's internal problems are as old as the structure itself—the war in South Ossetia has merely added urgency to them. Indeed, at no time of its existence was its viability questioned as seriously as in August 2008. Today, the organization will feel more acutely than ever the burden of the unresolved problems. I have divided them, for the sake of discussion, into internal and external problems.

1. Problems in bilateral relations.

They are born by the still unresolved interstate problems and diverging national interests. The relations inside the bloc are far from ideal.

In August 2008, an oil terminal in Giurgiulești (Moldova) was commissioned—an event which did nothing to help Ukraine's geopolitical status. In fact, the new structure competes with Reni in Ukraine and Galați in Rumania as far as materials handling and the free economic zone are concerned.

Simultaneously, the 50-km long Cahul-Giurgiulești railway connected the port on the Danube with the Moldovan railway network. The republic acquired access to the European Union via Galați, which excluded Ukraine. After building a refinery of its own, Moldova fortified its position still further. Such are a few of the many more numerous examples of Ukrainian-Moldovan relations.

Georgia and Azerbaijan have their share of problems unrelated to their GUAM membership: there is the land issue in Kvemo Kartli and Baku's much more pronounced pragmatism in the energy transportation sphere. The list is much longer.

The KATB project is part of the Europe-the Caucasus-Asia corridor, but the United States and the European Union refused to fund the railway because Armenia was excluded from it. The future railway, geared at Ceyhan in Turkey, will decrease the role of Georgia's Black Sea ports. Tbilisi was forced to accept the project; this is shown by its economic indices and confirmed by what Georgian politicians and experts have to say (S. Zurabishvili, N. Oravelashvili, and others).

R. Ismailov has written the following: "For a long time Georgia remained undecided about the railway project. First it wanted compensation for the possible economic losses its two Black Sea ports (Batumi and Poti) might sustain because of the new railway. Turkey and Azerbaijan refused to pay. Under the pressure of the transportation blockade Russia instituted in 2006 Georgia had to retreat."¹²

¹¹ T. Valasek, "Military Cooperation between Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova in the GUUAM Framework," *Policy Brief*, No. 2, Caspian Studies Program, Cambridge, Mass., December 2000.

¹² R. Ismailov, "Azerbaïdžhan, Gruzii i Turtsiia: sozdanie transportnogo triumvirata?" available at [www.eurasianet.org], 8 February, 2007.

2. *Problems related to domestic policies and the socioeconomic context in the GUAM member states.*

Recently it has become obvious that politicians are acting and issuing statements under domestic rather than foreign political pressure. This is amply testified by the fact that President of Moldova Vladimir Voronin is drawing closer to Moscow. The republic can be described as GUAM's "weak link" for several reasons: its social and economic situation crippled by the ban on wine export to Russia (an important budget item); the conflict in Transnistria; problems with Rumania, etc. On top of this its territory has not been included in the GUAM's energy projects.

On 11 March, 2008, President Voronin gave an interview to *Kommersant* newspaper of Russia that caused quite a stir: there were rumors that Russia was prepared to guarantee the republic's restored territorial integrity in exchange for it remaining outside NATO.

In his interview Vladimir Voronin said: "At first GUAM posed itself different aims; much was said about the Odessa-Brody pipeline. A glance at the map convinced me that my country was left out of it."

When talking about the Russian peacekeepers, he said: "We do not want to replace these peacekeepers with anyone else."

About the future of GUAM: "The future is fairly dim. In the absence of economic interests we will not remain within it to serve as a counterweight to anyone."¹³

The republic's foreign ministry announced that it did not plan to leave GUAM, however the president's absence at three summits, the republic's lowered representation in it, and its refusal to discuss the military conflicts issue have convinced many in the expert community that Moldova is following in Uzbekistan's footsteps.

So far it is kept within the structure by conflicts that look similar to any outside observer and a unified approach to them rather than by any geopolitical considerations. Moldova, for example, abstained from voting on the refugees from Abkhazia issue.

The events of 7 April, 2009 in Chisinau laid bare the government's weakness and showed one and all that the danger of Rumania's interference in Moldova's domestic policies was very real. The Gagauz problem remains pending.

After the events of 9 April, Georgia, in turn, can no longer boost its prestige in GUAM.

The situation in Ukraine is very complicated, it seems that the country may split into the east and west; the parliamentary and government crises likewise do nothing to help the domestic policies.

The foreign policy problems are associated with Russia which, in turn, is pursuing its foreign policy in the following formats: the RF-U.S and the RF-Europe; there is also the U.S.-Europe aspect. Relations with Russia, the central actor in the CIS expanse, determine the attitude toward the unsettled problems among the GUAM members. In the fall of 2006 in Chisinau, GUAM's third parliamentary assembly refused to support Georgia and declined a special resolution on Georgian-Russian relations. V. Iovv, who represented Moldova and who was deputy of the republic's parliament, said that for different, including ethical, reasons other members of the same structure should not interfere in bilateral relations between states in or outside GUAM.¹⁴

The Moldovan deputy was obviously referring to Russian-Georgian relations.

Geopolitics and geo-economics have their share of problems and contradictions; in fact they stretch to the closest East European partners. Relations between Rumania and Moldova and between Rumania and Ukraine are brimming with mutual mistrust and mutual claims caused, among other things, by the recently commissioned navigable canal between Chernovoda and Constanța, which provided the

¹³ V. Voronin, "My s Vladimirom Putinyom davno poteriali vkus k sobstvennym khotelkam," available at [<http://www.kommersant.ru>], 11 March, 2008.

¹⁴ See: "Strany GUAM ne podderzhali Gruziiu," available at [<http://www.regnum.ru>], 16 October, 2006.

European countries along the Danube with a Black Sea outlet and deprived, by the same token, the Ukrainian ports of Reni, Izmail and Ust-Dunaisk of part of their business.

This casts doubts on President Yushchenko's statement made at the Baku summit to the effect that he would like to see Poland, Rumania, and Lithuania as potential GUAM members. Neither Poland nor Rumania want to add to the GUAM's geopolitical weight—they regard it as a handy anti-Russian forum. Poland needs the Odessa-Brody project as long as it is related to its interests; the planned oil pipeline from Azerbaijan to Europe via Ukraine will leave Lithuania out in the cold.

Russian diplomacy responded to the efforts of the GUAM members to draw closer to Poland and the Baltic countries with moving the contracts on oil and gas to the sphere of pure business, which badly hit some of the GUAM members. The pipelines under construction will leave some of the transit countries aside.

The alliance among Turkey, Georgia, and Azerbaijan is not free from geopolitical and geo-economic problems that should be resolved through bilateral agreements in various spheres of interstate cooperation. Pragmatism and the divergent interests of the countries involved breed contradictions related to the Eurasian corridor and to some of the joint projects. Turkey's desire to become the center of all the energy transportation routes is arousing concern in Georgia and in the West.

The Ukrainian Bely potok (White Stream) initiative is supported by Georgia while being totally ignored by Turkey.

On the whole, all GUAM-bred and promoted oil and gas projects look very fishy. The Odessa-Brody-Płock-Gdansk routes, as well as the GUEU (White Stream), compete with Turkey's policies and as such undermine its interests. The oil and gas projects of this structure are viewed as a rival to Nabucco, the BTC, the BTE, and the already functioning routes.

These plans raise numerous questions: Can they be realized at all? Will they repay themselves? How much will the fuel moved along them cost at the end? There are also objective geographical factors.

It should be said that the oil and gas projects put forward by GUAM contradict the interests of some of the member states at least.

The regular energy summits have done nothing to alleviate the contradictions; this means that GUAM can function as a full-blooded community of states based on an energy transportation corridor (alternative to the Russian one) only on the basis of Central Asian energy resources. For political reasons, this is hardly feasible.

The members have preserved their shared approaches to the ethnopolitical conflicts, but GUAM as a whole responds to them inadequately.

Unfortunately, their involvement in GUAM negatively affects the members' relations with their closest neighbors (Russia and Armenia).

In this way, the very much promoted regional integration has no firm foundation; some of the countries are dead set against new members with whom they have disagreements.

The situation in the Caucasus presupposes that Armenia should be actively involved; Georgia was prepared to invite it to participate in regional projects, but Azerbaijan cut short its intentions.

The unsettled conflicts issue is brimming with contradictions. At the bilateral level (Armenia-Georgia, Armenia-Ukraine, Armenia-Moldova), cooperation is going ahead while contradictions with certain other countries interferes with the process.

Kosovo's independence (a process that started on 17 February, 2008 on the initiative of GUAM closest allies) and the war in South Ossetia slowed down consolidation within GUAM.

This created the possibility of new geopolitical configurations and bred certain questions, one of them being Armenia's greater involvement in the regional processes. At first glance, Armenia alone profited from the open Armenian-Turkish border: for many years Armenia remained squeezed between Azerbaijan, Turkey, and unstable Georgia, Iran being its only outlet. Reality is not that simple.

The war in South Ossetia created numerous problems for all the countries, Turkey included. Security of the energy transportation corridors that connect it with the Caucasus and Central Asia was

threatened; this might have transformed it into another unstable partner of the West on a par with many post-Soviet countries.

The above suggests the following conclusion: disintegrating factors inside GUAM prevail over the integrating elements. Neither American aid, nor the EU Eastern Partnership project, nor the Black Sea Synergy can guarantee continued integration of the GUAM members and make the structure attractive for other countries.

C o n c l u s i o n

Today the future of GUAM, a product of political maneuvers of its members and outside forces, looks dim mainly because of the members' divergent interests, which is partly explained by their association with outside actors.

The smoldering conflicts are one of the main factors that keep Azerbaijan, Georgia, and Moldova in GUAM; Ukraine and Azerbaijan are joining forces in the hope of laying an alternative energy route to Europe. So far, the GUAM members agree on the conflict issue: recently they have promoted several resolutions of the U.N. General Assembly, yet mounting contradictions should not be ignored either.

We wonder how long their solidarity on the conflict issue will cement GUAM and its position? As long as they continue discussing joint fuel transportation projects (which involve Poland, the Baltic countries, and others), this organization will retain its importance.

When it becomes clear that the projects are unviable, the agreement on the conflict problem will disappear. In fact, Azerbaijan's greater role as a potentially main supplier of energy resources will hardly keep the structure together. In fact, throughout its lifetime it has not produced any more or less feasible conflict settlement project.

COOPERATION BETWEEN KAZAKHSTAN AND THE SHANGHAI COOPERATION ORGANIZATION AS A FACTOR IN THE DEVELOPMENT OF FOREIGN ECONOMIC ACTIVITY TODAY

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The Shanghai Cooperation Organization (SCO or Organization), which was created in order to strengthen regional security, enhance good-neighborly relations, and encourage multi-vector and multifaceted interaction among the member states, has become a major regional

structure with broad opportunities for establishing mutually beneficial relations in the commercial and economic sphere. The immense territorial, human, raw material resource, and transport-transit potential of the states participating in this Organization is an important factor of successful cooperation in this area. The SCO Secretariat and specialized economic institutions aim to promote cooperation in such vectors as foreign trade, investments, transportation and communications, energy, bank relations, agriculture, the environment, and the scientific-technical and social spheres.

Within the SCO, Kazakhstan has succeeded in achieving results that are promoting the development of the foreign sector of its own economy and its gradual integration into the world economy. However, there are several problems and unresolved issues in the Organization's activity that are hindering the development of foreign relations and putting the brakes on Kazakhstan's foreign economic activity. Keeping in mind that the development of relations with the SCO meets the country's interests and is extremely promising for its foreign economic activity, economic cooperation with the Organization must be strengthened.

I. Kazakhstan and the SCO: Main Results and Problems of Cooperation

When carrying out its foreign economic activity, Kazakhstan strives to present itself as an active and full-fledged member of the SCO. This is confirmed by the nature of its participation, position, and the results the country has achieved during the undertakings carried out by this Organization.

1. Kazakhstan's participation in SCO documents. Kazakhstan is party to the Organization's founding, program, and regulating documents.

1.1. The declaration on the founding of the SCO was passed by the heads of the member states on 15 June, 2001 in Shanghai. The Organization aims to enhance mutual trust and good-neighborly relations among its partner states, encourage effective cooperation among them in various areas, and promote joint efforts to maintain peace, security, and stability in the region. According to its Declaration, the Organization, enjoying immense potential and broad opportunities for advancing mutually beneficial cooperation among the member states, can ensure the development of cooperation in the commercial and economic sphere and its diversification on a bi- and multilateral basis.

1.2. The SCO Charter was signed in June 2002. This document, being the Organization's charter, sets forth its tasks: development and encouragement of efficient multifaceted regional cooperation, promotion of comprehensive and balanced economic growth and cultural development in the region, coordination of approaches during integration into the world economy, and development of relations with other states and international organizations.

In order to promote cooperation, the SCO countries shall not only exchange legal information, but also expand the sphere of interaction.

1.3. The memorandum on the main vectors of regional economic cooperation and on creating favorable conditions in trade and investments was signed at the first meeting of heads of government of the SCO states in Almaty in September 2001 and forms the basis for establishing its economic component. It stipulates that the development of trade and investments will be ensured by bringing the economies of the member states closer together on the basis of complementarity, as well as by carrying out cargo and passenger transport operations, including transit, developing checkpoint infrastructure, harmonizing technolog-

ical and commodity standards, exchanging regulatory and legal information, removing trade barriers, and attracting investments.

The protocol to the memorandum notes that strengthening commercial and economic cooperation will not only promote the economic development of the member states, but also, which is extremely important, maintain regional security and stability.

1.4. The program of multifaceted commercial and economic cooperation among the SCO member states was approved by the Council of Heads of Government in September 2003. The document envisaged the solution of several important tasks, including creating conditions for ensuring that all economic entities have equal opportunities and guarantees in production activity, drawing up joint programs in commercial and economic cooperation, creating a favorable investment climate, developing interbank cooperation and financial relations, further developing transportation and communication infrastructure, improving customs procedures, and rendering assistance in establishing contacts between economic entities in business. It should be noted that it was the Kazakh side that prepared the first version of this Program, which was taken as the basis for further examination.

1.5. The action plan for implementing the Program of Multifaceted Commercial and Economic Cooperation among the SCO Member States, passed in September 2004, was the logical continuation of the development of the Organization's contractual-legal basis. Within the framework of this plan, special working groups were created and began functioning to develop electronic trade, customs cooperation, cooperation in applying technical regulations and standards, transit potential, and investment interaction. In compliance with the economic cooperation priorities stipulated earlier, the document also envisaged more than 120 joint projects.

1.6. Declarations of the heads of states. The last one is the **Dushanbe declaration of the heads of SCO member states** adopted on 28 August, 2008 during the Organization's regular summit. The document notes that the SCO is in favor of broad cooperation in resolving resource support problems and achieving global development goals, overcoming the technological gap between countries, and eradicating poverty by providing all the states with equal access to the advantages of globalization.

Whereby in the conditions of the world financial and economic crisis, it is particularly important for the member states to carry out a responsible fiscal policy, exercise efficient control over the movement of capital on their territory, and ensure food and energy security.

1.7. Participation of Kazakh structures in drawing up documents determining the cooperation mechanism in the SCO. The participation of analytical and administrative structures in drawing up drafts and proposals for amendments and addenda to the provisions "Criteria for Accepting New SCO Member States," "On the Status of Dialogue Partner," and "On the Status of Observer" can be considered an important result of Kazakhstan's activity in the SCO. Such an important document as the Asian Energy Strategy was drawn up by the Kazakh analytical structure.

Kazakhstan has signed a total of more than 30 documents within the framework of the SCO.

2. Holding the Organization's summit in Kazakhstan. A meeting of the heads of the SCO member states was held in Astana in July 2005, during which it was decided to establish an institution of permanent representatives of the member states under the SCO Regional Antiterrorist Structure (RATS) and approve a Concept of Cooperation in Fighting Terrorism, Separatism, and Extremism and a Provision on Permanent Representatives of the Partner States under RATS.

At the end of the summit the Astana declaration of heads of state was adopted, which indicates that the SCO member states will consistently expand their cooperation in the economic vector in order to raise the potential of the fight against terrorism, separatism, and extremism, being guided in so doing by the Program of Multifaceted Commercial and Economic Cooperation.

3. **The activity of the Kazakhstan representative as SCO secretary general** is an important element of the country's active and full-fledged participation in the Organization. Since January 2007, the Kazakhstan representative has occupied the post of secretary general. During this time, two of the Organization's summits have been held: in Bishkek (2007) and Dushanbe (2008), a meeting of the Council of Heads of Government in Tashkent (November 2007), and several other planned undertakings, during which the Bishkek and Dushanbe declarations, joint communiqués, and an intergovernmental agreement on cooperation and mutual assistance in customs affairs were signed. Moreover, new structures and the staff members of the RATS Executive Committee were approved.
4. **Opening of the Khorgos International Center of Border Cooperation. The Khorgos International Center of Border Cooperation** (Khorgos ICBC), created in 2005 between Kazakhstan and China, plays an important role in commercial and economic cooperation among the SCO countries. According to experts, the ICBC will become one of the basic elements in the region's infrastructure in this sphere.
5. **Kazakhstan's participation in the SCO's economic institutions.** Kazakhstan is a member of the SCO's Business Council and Interbank Association.
 - 5.1. **The SCO Business Council (SCOBC)** was created in Shanghai in June 2006. It is supposed to perform expert work within the Organization and draw up recommendations in promising vectors of interstate commercial and economic cooperation.

Kazakhstan has been taking active part in the SCOBC's various undertakings. Mechanisms have been drawn up for regulating and coordinating commercial and economic cooperation and investment issues are regularly discussed.
 - 5.2. **The SCO Interbank Association** was created in compliance with an agreement on interbank cooperation signed in Moscow in October 2005 by authorized representatives of the banks of the SCO member states. It envisages interaction in financing and participation in investment projects. This form of cooperation is recognized to be the most effective and flexible.

However, there are several problems in Kazakhstan's foreign economic activity within the SCO.

1. **The Organization's internal contradictions** which hinder Kazakhstan's full-fledged cooperation with the SCO include:
 - Kazakhstan's uncoordinated cooperation with the SCO states;
 - differences in approaches and mechanisms for liberalizing foreign trade and investment activity;
 - the presence of EurAsEC and other integration economic structures in the region that undermine the SCO's influence in this sphere;
 - China's commodity expansion with respect to Russia and the Central Asian countries, which presents a threat to their economies;
 - the absence of balanced economic cooperation in the SCO countries.

These contradictions are generated by the political interests of the Organization's strongest member states and their unwillingness to compromise when resolving commercial and economic cooperation issues. So there is a greater danger of stagnation.

2. High differentiation of the level of economic development of the SCO countries.

An important factor undermining Kazakhstan's economic cooperation with the SCO countries is the different level of their development. The highest average annual rates of economic growth were noted in China where they reached more than 11%. Then come Kazakhstan and Russia with 10% and 8%, respectively.

Tajikistan, Uzbekistan, and Kyrgyzstan have the lowest indices with 7%, 6%, and 5%, respectively. This causes a shortage of goods in the markets, which has a negative effect on the countries' trade cooperation.

This situation is hindering integration on the way to achieving the economic level of the world market. So experts, considering it necessary to accelerate development of the infrastructure component, say that the efforts of such regional nations as Russia and China in the infrastructure development of their territories are expanding the domestic markets and markets for neighboring Central Asian countries (including those that do not have access to the sea), which are experiencing obvious difficulties in adapting to globalization. Large national companies and banks of Russia, the Central Asian countries, and China are capable of significantly enriching cooperation among the three sides. There is an obvious need for large collective infrastructure development projects. This requires a SCO bank of development, a joint investment committee, or something else along these lines.¹

3. Obstacles to the development of Kazakhstan's foreign economic relations with other SCO members. The situation that has developed in economic cooperation among the SCO countries can be examined on the basis of four main indices—the state of customs procedures, environmental protection, unification of standards, and mobility of business. It leaves much to be desired.

Several measures must be taken to correct the existing situation. For example, according to an expert forecast, increasing spending on improving customs affairs by only 10% will increase the trade volume among the countries by more than 10 billion USD.

There is also a great difference between the plans declared in the basic documents and their implementation in practice, which is hindering and complicating the development of the Organization's foreign economic relations. The cooperation mechanisms are still underdeveloped and need further work.

4. Kazakhstan's insufficient use of the region's transportation and transit potential. Kazakhstan is not using the region's transportation potential to its fullest benefit. Transit routes going to China's eastern regions and Russia's northern and western regions are not being used.

Several other factors also play a negative role:

- Kazakhstan's insufficient interaction with other countries of the region in raising the transit potential;
- cargo shipments around the region are very slow and poorly coordinated;
- incorrect tariff policy regarding cargo shipments;
- unsatisfactory technical state of transportation means;
- low technical level of railroads in the region.

¹ See: A. Sapitskiy, A. Salykova, *Ekonomicheskaya regionalizatsiya i problemy ShOS (teziy). ShOS: stanovleniye i problemy razvitiya*, Documents from an international conference, Institute of Management, Economics, and Forecasting, Almaty, 2005.

These factors are preventing Kazakhstan from enhancing integration of the region's transportation system and fully developing foreign economic activity.

5. Insufficiently efficient work of Kazakhstan's state structures in cooperation with SCO.

When evaluating the level of Kazakhstan's participation in the SCO, attention is drawn to the insufficiently efficient work of the country's state structures and their poorly organized activity with respect to implementing the adopted decisions and carrying out planned undertakings. The proposals and recommendations of the Kazakh side are not being clearly formulated in order to be submitted to the SCO Secretariat for further examination.

On the whole, these problems are hindering the development of Kazakhstan's economic activity in the SCO and slowing down diversification and an increase in competitiveness of the national economy. This requires defining the prospective vectors of development and the country's activity within the Organization.

II. Prospective Development Vectors of Kazakhstan's Foreign Economic Activity within the SCO

1. The prospects for Kazakhstan's further cooperation with the SCO should be examined from the viewpoint of the abovementioned cooperation problems and following strategic tasks:

1.1. Intensification of regional processes:

- stepping up regional integration processes as an important factor in undermining the negative manifestations of globalization;
- overcoming economic degradation, resolving social problems, and achieving social stability in the region's countries;
- helping to ensure regional security in Central Asia;
- observing national interests in cooperation with the leading countries in the SCO.

1.2. Raising Kazakhstan's role and place in regional economic cooperation with the SCO:

- preserving strategic partners in the SCO;
- raising economic potential and long-term mutually advantageous cooperation with the region's countries;
- carrying out a policy aimed at intensifying regional integration;
- attracting funds from other Organization member states for implementing economic projects in Kazakhstan.

1.3. Assisting sustainable economic growth and raising economic competitiveness:

- retaining stability in the region and assisting the politically weak SCO states, including in the economic sphere;
- fuller use of the country's potential by stepping up foreign economic activity;
- expanding Kazakhstan's participation in regional division of labor and cooperation by means of its diversification;

- protecting the SCO countries from the influence of foreign economic crisis phenomena, as well as their consequences;
- further strengthening of Kazakhstan's relations with the SCO countries and expansion of its participation in regional structures.

In August 2008, a summit was held in Dushanbe and in October of the same year a meeting of the SCO Council of Heads of Government in Astana. After these meetings, the most promising vectors in the republic's development listed below were defined.

1. Stepping up Kazakhstan's interaction in the transportation sphere. The growing role of the transportation sphere for the SCO is explained by the following factors:

- the activation of foreign relations and strengthening of the SCO states' economic interdependence;
- the increase in the volume of cargo shipments both to the domestic and to the foreign markets;
- the significant increase in the number of passenger transport operations due to the expansion of economic and cultural-humanitarian relations.

In order to further develop the country, it is extremely important to expand its access to the foreign markets, including to the SCO countries. This task can primarily be solved by means of more rational use of the region's transportation and transit potential and by forming a market of transportation services. This requires adopting the following measures.

1.1. Developing transit and transportation corridors. The most priority transit directions are the following:

- China-Kazakhstan-Russia-the EU countries;
- China-Kazakhstan-Uzbekistan-Turkmenistan-Iran-Turkey;
- Kazakhstan-Turkmenistan-Iran-Pakistan.

Putting each of these routes into operation will raise the diversification of transit flows and make it possible to increase the volume of freight and passenger movement through the republic, which promises great economic profit.

1.2. Carrying out a coordinated economic policy in transportation in the SCO region. In order to accelerate transport operations and lower their net cost, a coordinated policy must be drawn up in this area. This requires solving three important tasks.

1.2.1. A coordinated tariff policy in transport operations should be carried, that is, tariff rates must be lowered. It would be expedient to unify them and apply them throughout the entire transportation expense of the SCO.

1.2.2. With respect to customs relations, the procedure for crossing the internal borders of the SCO and registering documents for all types of transportation means should be made as simple as possible.

1.2.3. A unified taxation system for transportation means and services should be developed for increasing the efficiency of cargo and passenger transport operations.

1.3. Drawing up a SCO cooperation program in transportation. In order to form a unified market of transportation services in the SCO region an interstate cooperation program should be drawn up containing a set of different projects. This document should envisage:

- creating joint ventures for carrying out high-quality cargo and passenger transport operations;

- raising the level of vehicle service, primarily overland;
- introducing scientific-technical cooperation projects aimed at creating satellite and computer movement control systems and ensuring its security;
- organizing joint production of different transport means, as well as the spare parts for them on the basis of production cooperation;
- expanding transport cooperation on the basis of the latest scientific achievements.

This program should also envisage improving national legislation regarding transportation, as well as participation in it not only of the SCO countries, but also of other states.

- 2. Carrying out joint activity to protect the economy of the SCO countries from the influence of foreign economic threats and overcoming their consequences.** The crisis processes occurring in the European and American financial markets are dictating the need for adopting measures to combat them not only at the national but also at the supranational level. In this respect, the economic protection of the SCO countries must be ensured.

In order to accomplish this, the Kazakh side proposes creating a **Regional SCO Center for Monitoring the World Financial Markets and Macroeconomic Processes**. An important place in the activity of this center should be occupied by the development of financial assessment methods. Constant monitoring is required of the dynamics of change in the indices of economic cooperation and the state of financial indices in the stock markets.

This Center should draw up development forecasts both for individual markets and for the world economy. When an unfavorable forecast is obtained, the Center could make corresponding proposals and recommendations and compile joint action plans for protecting the economy of the Organization's countries from negative foreign influence and for overcoming the possible consequences. Moreover, it would be expedient to involve the analytical structures of other countries in this process.

- 3. Kazakhstan's participation in innovative and technological development projects.** Keeping in mind the leading role of innovative and technological development during diversification of the economy and an increase in its competitiveness, the country's foreign economic activity in scientific research must be stepped up.

In this respect, Kazakhstan is interested in carrying out joint Research and Development (R&D) with the participation of Russia and China, as well as in cooperating with them in the space research sphere.

- 3.1. Carrying out R&D.** Realization of this vector should begin with talks among the leaders responsible for scientific and innovative activity. A SCO Council for Scientific Research Cooperation should be created that will coordinate the efforts to create new scientific development and innovative technology to manufacture high-quality technical products.

These developments should promote not only an increase in the economy's competitiveness, but also the solution of many tasks in foodstuffs, energy, the environment, and so on.

- 3.2. Manufacturing high-tech products.** The manufacture of high-quality products must be streamlined by means of joint developments and technologies. For example, a joint Kazakh-Chinese-Russian venture for manufacturing sets of parts for microprocessor technology and complex electronics, including household appliances, could be opened on the basis of the existing Alatau information technology (near Almaty). This would provide the opportunity for creating new brands.

The volume and quality of the products manufactured should meet not only domestic demand, but also ensure the export of goods to Russian regions and Central Asian republics bordering on Kazakhstan.

3.3. Cooperation in space research. A qualitatively new and promising vector of Kazakhstan's activity in the SCO could be space research. In this case, not only traditional cooperation is important with Russia, but also with China—a space power with high potential.

Kazakhstan must also step up development of a **Program of SCO Cooperation in Space Research and Space Use**. Kazakhstan could already participate in such a program using the available potential in this sphere. In the future, it would be expedient for the Kazakh side to include the following tasks in the joint program.

1. Implementing a plan for creating a Kazakh satellite and carrying out a wide range of work in geophysical probing of the land surface of the SCO region.
2. Jointly creating contemporary communication and wide-range telecommunication satellites.
3. Participating in the commercial servicing of international satellite systems, including INMARSAT, NORD, and NAVSTAR.
4. Studying and using progressive world space monitoring technology for the region's natural and territorial complex.

4. Optimizing the functioning of the SCO. Intensifying cooperation in order to strengthen the SCO can be carried out in the following vectors.

4.1. Reducing contradictions and obstacles. Within the framework of this vector, the following questions must be resolved:

- carrying out monitoring in the development of economic relations (customs, business dynamics, coordination of standards, and so on);
- improving the mechanism of economic relations of the region's countries by precise state regulation of foreign economic activity;
- coordinating economic cooperation issues in close cooperation with other cooperation vectors;
- drawing up rules and provisions ensuring the adopting of decisions on the basis of the principle of consensus.

Due to the negative influence of the various contradictions and obstacles, optimization of the procedures and mechanisms of the SCO's activity deserves special attention.

4.2. Improving the control mechanism over the Organization's functioning. This process should be aimed at strengthening the planning, coordinating, and monitoring functions of the control mechanism.

- A) The plans for various undertakings must be approved as a mandatory procedure by competent structures of the member states, including by a joint group of experts of the SCO Secretariat.
- B) In order to strengthen the planning function of the control mechanism, the corresponding bodies and structures of the countries must be authorized to take control over determining the time limits for carrying out the undertakings, as well as allot the necessary funds for this.
- C) The Secretariat and other SCO bodies must be made responsible for coordinating the carrying out of undertakings and their results.
- D) The monitoring function of the Organization's control mechanism shall consist of monitoring during the carrying out of planned undertakings, analyzing possible mistakes,

and identifying their reasons. Expert groups, in turn, shall draw up efficient proposals for eliminating problem situations.

4.3. Expanding cooperation with international and regional organizations. Expanding and intensifying comprehensive relations with large international economic and financial organizations, as well as integration associations, such as the UN and its structures, the Islamic Development Bank, the Economic Cooperation Organization, the EurAsEC, and APEC, should play an important role in raising the efficiency of the SCO's activity. This was envisaged in Item 8 of the declaration of the heads of the SCO member states adopted in 2008 in Dushanbe.

In so doing, the SCO's cooperation with the indicated structures should be oriented toward their rendering financial assistance to the Organization's highest priority projects in different spheres. Efforts should also be joined to step up joint action to resolve social stability and economic development issues in the region.

5. Improving the activity of Kazakhstan's state structures participating in implementing cooperation with the SCO. The need for improving Kazakhstan's foreign economic activity requires that the country's ministries and other state structures raise the efficiency and coordination of their activity.

For this purpose, there are plans to create a special **Council for Developing Foreign Economic Activity** under the republic's government responsible for coordinating the activity of state structures and various interdepartmental commissions for commercial and economic cooperation with foreign countries and international organizations, including the SCO.

This Council should consist of the deputy heads of departments responsible for cooperation with the SCO or the heads of their departments, as well as experts, researchers, and specialists from other spheres. The Council should examine the entire set of issues: developing proposals and plans, carrying out undertakings, and control over their performance.

On the whole, the Council should ensure efficient and qualified development of this set of issues of Kazakhstan's foreign economic activity in the SCO.

In conclusion it should be noted that the development of the prospective vectors of Kazakhstan's interaction within the SCO examined in this article will make it possible to raise the efficiency and productivity of the country's foreign economic activity. This will promote the resolution of such important issues as making more efficient use of the region's transportation and transit potential, increasing stability in the economy in the conditions of the world economic crisis, developing pertinent vectors of scientific research, assisting innovative and technological development, accelerating diversification, and raising the international competitiveness of the country's economy.

REGIONAL POLITICS

**THE GEORGIAN ORTHODOX CHURCH
IN CURRENT GEORGIAN POLICY**

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For historical reasons the Georgian Orthodox Church (GOC) has always been a subject of Georgian policy despite its separation from the state registered in the country's Constitution. At all times religion not only confirmed and preserved the nation's spiritual values—it served the national and state interests. Today, rapidly unfolding globalization has posed the question of the future role of the church and religious values in general. This is especially important in Georgia where the Christian faith has been and remains one

of the components of national self-awareness. "Language-Motherland-Religion" is the linchpin of the national ideology that was revived when the country restored its independence.

In the years of Soviet occupation, the Communists either destroyed churches or used them for different purposes (they were turned into clubs, theaters, or storage facilities). In the very early years of Soviet occupation, a Council of Militant Atheists was set up to carry out anti-religious propaganda based on Lenin's ideas.

**The Age of Catharsis:
from Atheism to Concordat**

The Church regained its former influence along with the national-liberation movement that gained momentum in the 1990s. When the communist regime began loosening its grip, the GOC came to the fore. Church attendance increased; old churches were restored and new ones built. While the commu-

nist regime persecuted all faiths, in the 1990s the leaders of the Georgian independence movement encouraged religion. When the national government headed by Zviad Gamsakhurdia came to power, the GOC became an equal entity of the country's public life. Religious revival became irreversible to the extent that the Church preserved its role and even increased its influence under former communist Eduard Shevardnadze who replaced deposed Gamsakhurdia. During his years in power Shevardnadze openly demonstrated his religious feelings to push aside the earlier image of a communist. It was under him that many new churches were built. On the other hand, all sorts of religious sects, the relations of which with the GOC can be described as complicated, were mushrooming and consolidating their position at a catastrophic pace. The GOC never recognized them as religious minorities and accused them of blasphemy. This applied primarily to the Jehovah's Witnesses, the largest sect in Georgia. According to its ruling council, it has 16,900 followers in Georgia (a large figure for a country with a population of 4 million). In Russia, with a population of 145 million, there are 153 thousand Jehovah's Witnesses, in Armenia there are 10 thousand, in Azerbaijan, 799, and in Turkey, 1,000,¹ which means that in Georgia the situation is much more acute than in its neighbors. The GOC maintains positive relations with the traditional religions—Islam, Catholicism, and Gregorianism—with which it shares a common history. The oldest part of the Georgian capital is the best confirmation of this—1 sq km contains cultic buildings of all the traditional religions represented in the republic.

The general rejection of the Jehovah's Witnesses engaged in persistent proselytism took the form of fighting groups that physically attacked the unwelcome agitators, the scope of which aroused the concern of the U.S. Department of State. The country's pro-Western leaders brought to power by the Rose Revolution had to detain the priest who organized the fighters. Earlier, he was defrocked by the GOC for unsanctioned actions yet remained popular among the common people; for a long time after his arrest the opposition used this fact to accuse the government of fighting Christianity.

Significantly, under Shevardnadze, Georgian Orthodoxy acquired its legal status under Art 9 of the Georgian Constitution (1995), which said: "The state recognizes the special importance of the Georgian Orthodox Church in Georgian history but simultaneously declares complete freedom in religious belief and the independence of the Church from the state." While some political forces insisted on an official status for the GOC, the fundamental law was amended to point to its important role in Georgian history. This was done to take account of the interests of all the religious minorities living in the country. On the other hand, the Church had no legal power to restore the rights lost under the communists, including the right of ownership to the land confiscated during Soviet occupation. For this reason, in 2002 the state and the GOC entered a Constitutional Agreement known as the Concordat, a product of long discussions; on 22 October, 2002 the document was approved by the parliament.

Orthodox Christians comprise a large majority of the republic's population—the main reason behind the Concordat, which gave the Church the status of an historical "entity of public law," a legal entity with full rights, functioning in accordance with the canonical legal norms.²

Under the new document, the state was duty bound to compensate the material losses the Church had sustained under Soviet occupation.³ Under the Concordat, the Church restored its right to the religious attire kept in the state museum and regarded as religious and historical exhibits; this and other basic postulates were never implemented.

¹ News program of the Ertzulovneba TV Channel run by the Georgian Patriarchate, 12 March, 2009.

² Constitutional Agreement between the State and the Georgian Orthodox Church, 2002, Art 1.3.

³ *Ibid.*, Art 11.1.

The Age of Cosmopolitanism: the “Five-Cross Flag” Against the Church

The GOC lost some of its influence after the Rose Revolution: the ideologists of the “revolutionary” government were determined to breed new thinkers from the country’s population able to easily blend into the globalized world. They also shouldered the task of confirming the Christian symbols: in the 1990s independent Georgia restored the state symbols of the so-called First Republic of 1918. On 25 January, 2004 the new people at the helm hastened to replace the old symbols with new ones.

With their first decision they devised a new flag with five red crosses that came to be known as the “Five-Cross Flag;” the state symbol represents St. George, the patron saint of Georgia and the most popular among the Georgian saints. The fact that the Rose Revolution took place on 23 November, the Giorgoba (St. George) Day, supplied it with religious overtones. The event was commemorated by a statue of St. George erected in the very center of Tbilisi (against the GOC canons which ban statues of saints).

For political rather than religious reasons, the new government encouraged the use of religious symbols; the new state symbol was seen as a promotional banner of sorts to prove the country’s European provenance. As distinct from the previous regime, the new Georgian rulers moved away from the Church for reasons of their own.

The new people wanted all the power they could get: while they succeeded in controlling the media, NGOs, all the other institutions of civil society, the Church escaped their clutches. The fact that according to all the opinion polls the Church enjoyed more trust among the people than any of the state and non-governmental structures explains why the powers that be wanted to lay their hands on it. The Patriarchate did its best to avoid confrontation and went on with its traditional role of mediator during all sorts of crises. In the post-revolutionary period the tension between the Church and the government became tangible, which gave the opposition a chance to use religious rhetoric against the authorities.

Political-Religious Speculations

Under the previous president, religion and religious subjects were absent from political discussions; after the Rose Revolution, however, the situation radically changed. The opposition went to all lengths to exploit what it described as the new government’s anti-Christian nature. Its members organized a demonstrative collective prayer in a hospital (a former church) in Tbilisi’s center earmarked for an auction. None of the political forces are alien to religious speculations with political overtones. Indeed, there are at least two other churches, which have been turned into apartment blocks, in the capital’s center, however any commotion around them would not have brought political dividends. On the other hand, the intention to sell a hospital that was once a church under Soviet occupation is an opportunity not to be missed.

After several years in power the new leaders, after looking into the reasons for their plummeting rating, decided to put an end to their “anti-Christian” image. This became especially evident after the crisis of 7 November, 2007 when the government began encouraging the Church by distributing land, paying for a TV studio for the Patriarchate out of the state budget, etc.

These efforts notwithstanding, the opposition refused to remove the “anti-Christian” tag from the country’s authorities. It remained one of the most popular political topics; those politicians who in the past had not been known for their religiosity moved forward to defend religious values. Some of them even revived the previously buried fact that they had clergymen among their ancestors.

Two political entities—the Christian Democratic Alliance and the Christian-Democratic Movement—were set up for the latest parliamentary elections. The election campaign brimmed with religious rhetoric. The Christian-Democratic Movement built its platform on the demand to make Orthodoxy an official religion; it even gathered half a million signatures in support of its central election plank.⁴ Today, the Movement is classified as the official opposition; at the last parliamentary elections it scored 8.66 percent of the votes. Local experts, however, are convinced that it is a satellite of the government; in these conditions its demand cannot be described as utopian. The officials, however, while demonstrating their support of the Church, are not hastening to fulfill this demand. This is explained, to a certain extent, by the discrepancy between the positions of the political groups, the government, and the Church.

The GOC never actively supported the initiative; the Patriarchate limited itself to a single comment saying that it saw no reason to make Orthodoxy an official religion. The initiative looks more like a political speculation than anything else.

The Patriarch as a Charismatic Leader. Restoration of the Monarchy as One of the Ideas

The GOC’s influence on Georgian politics has recently become obvious. It was the Patriarch’s personal interference that ended the hunger strike of the opposition leaders during the political crisis that followed the events of 7 November, 2007. The opposition remained under the strong influence of the Church to the extent that the government was not loath to capitalize on it. The opposition leaders hurled accusations at the country’s leaders: “They are using the Patriarch’s authority to persuade the opposition to join the parliament”⁵ elected in 2008.

During the anti-government demonstration that took place in April 2009, more attempts were made to draw the Patriarchate into politics. On 8 April, 2009 the Patriarch issued a statement to the nation, which immediately stirred up political speculations. The opponents went out of their way to interpret it in their favor. “April 9 is a day that has been forever registered in our memory as the day of struggle for freedom and restored independence. Twenty years have passed. Times have changed and we are now facing different problems, but the danger remains. It is our duty to avert it. According to official statements, the government and opposition rule out violence: they are convinced that peaceful methods are their main weapon, however provocation should not be ruled out. I ask the powers once more to do everything to prevent the use of force against your people. I ask the opposition to keep within peaceful forms in your actions. I ask the law enforcers and the military—please bear in mind that you will stand opposed to your own flesh and blood.”⁶

⁴ Information supplied by Giorgy Targamadze on 22 May, 2008 during the Prime Time program of the Rustavi-2 TV Company.

⁵ Statement by David Gamkrelidze made on 25 May, 2008 in a program of the Rustavi-2 Company.

⁶ [<http://www.interpressnews.ge/ge/2009>].

This raised another wave of accusations: the opposition based them on the fact that the major power-controlled TV channels cut the Patriarch's address (they never broadcasted the parts in which the Patriarch addressed the law enforcers and the military with a request to avoid the use of force). These omissions were interpreted as a lack of respect toward the GOC and preparation to use force to resolve the crisis.

Significantly, another historic statement was made in small hours of 9 April, 1989. Speaking to the rally that demanded that Georgia should separate from the Soviet Union, the Patriarch said: "The danger is very real." Several minutes later Soviet troops launched an operation in which they used toxic gases and sapper shovels. When readying for the anti-government rally of 9 April, 2009, the opposition tried to attach sacral importance to the warning made twenty years ago.

On 19 April, 2009 the Patriarchate became actively involved in the political process with the Easter message of the Patriarch, which said in part: "For obvious reasons the government carries much more responsibility; it should ensure the country's territorial safety and protect and develop spiritual and national values. It should concern itself with the nation's material well-being, which means that it should address the social and economic problems. To a great extent, the country's prosperity depends on its relations with its neighboring state. We should develop our contacts with it by launching a dialog between cultures. The state should develop, while its ideology should be determined not by external geopolitical factors but by national interests. The government, political parties, NGOs, and the media should treat these interests as their priorities. We should protect our identity so as not to be turned into a blind weapon in alien hands. This is what guarantees the continued existence and development of any state."⁷ Significantly, the message, a product of consultations with corresponding experts, was presented as a document of fundamental importance for the state's development in the near future. This was not the first time that the Patriarchate, acting in ideologically deficient conditions, had offered its conceptual approach to the most urgent political issues.

At the very height of the political crisis, the Patriarch suggested that the Royal House, in the form of a constitutional monarchy, be restored in Georgia. This was expected to put an end to the prolonged discussions about the best state order. There is a gradually spreading consensus in the Georgian political community that the presidential form of government has proven deficient (the fact amply illustrated by the state's post-Soviet existence). The Patriarchate believed that the monarch could have shouldered the duty of mediator between the opposing sides. The idea was long discussed by the academic community and was dismissed as hardly viable for want of a suitable candidate. In February 2009, the Georgian media tagged the marriage between members of two branches of the House of Bagrationi "the marriage of the century."

The Georgian Patriarchate actively encouraged the marriage; according to Georgian historians, it put an end to the long squabble over the right to the Georgian throne among several branches of the Royal House of Bagrationi. There was a lot of talk in the Georgian expert community that a male offspring of the marriage would be the heir to the Georgian throne. Two months later that marriage was dissolved very much to the disappointment of the romantically-minded Georgian monarchists.

Significantly, the Patriarchate was convinced that the future monarch should be raised and educated in Georgia under the Church's patronage. The marriage triggered talks about an approximate date for establishing a constitutional monarch in Georgia: it was expected that after 20 years Georgia might become a monarchy, an event unprecedented in post-Soviet history. The Patriarchate did not limit its interests to Georgian politics: it also looked into social, economic, and demographic problems. The Patriarch promised to personally baptize each of the third and following children in every family.

⁷ [<http://www.patriarchate.ge> 2009].

This boosted the birth rate and revealed the extent of the Patriarch's charisma. On the other hand, some experts pointed to the danger of a theocratic state.

Theocracy or Secularism?

According to some Georgian experts, the Patriarchate is seeking stronger influence on society and even practices censorship. To prove this they point to the scandal caused by the TV show Ten Great Georgians run by the first channel of Georgian TV in which the audience was invited to identify ten Georgians who had played the greatest role in the country's history. Many of the potential candidates were religious figures, which gave rise to the Patriarchate's objections to the "rivalry of saints" as blasphemous.

This fact shed light on several problems: first, the disparity between the laws and the moral and religious values. The law on broadcasting bans any outside interference in editorial activities, yet the Patriarchate is duty bound to protect religious values. The Patriarch's Easter Message of 19 April, 2009 quoted above also said: "It is necessary to expand the Georgian business sector and set up a middle class. For objective and subjective reasons, the nation's absolute majority lives below the subsistence and poverty level. Meanwhile, Georgia's economic potential is great, especially for medium and small businesses. The global crisis has hit Georgian business and the people, which makes urgent efforts to stem redundancies an imperative. The state acted wisely in cutting down taxes in 2009, but it would be even better to announce tax amnesty for all physical and legal entities. Foodstuffs produced from environmentally sound agricultural products will bring in money—today the state should extend its assistance to their production in the form of subsidies and long-term loans."⁸

On 24 April, 2009 the government and the GOC drew up an unprecedented memorandum under which prisoners who had served half of their terms and who presented no danger to society would serve the rest of their terms in monasteries.

The Religious Factor in the Foreign Policy Context

In the post-Soviet period Russia has been actively exploiting Orthodox rhetoric to promote its geopolitical interests in Georgia: while referring to common Slavic roots when dealing with Ukraine and Belarus, Russia placed its stakes on their common religion when dealing with Georgia. The Russian Orthodox Church (ROC) has become part and parcel of Russia's foreign policy. After the Russian-Georgian war the ROC did not follow in the Kremlin's footsteps and reconfirmed the GOC's jurisdiction in Abkhazia and South Ossetia. This allowed the Georgian Patriarchate to communicate with the ROC while Russian bombers delivered strikes on Georgian cities and villages in August 2008. The Russian Patriarchate, in turn, declared that the religious and fraternal kinship of both peoples was all-important. The Russian political leaders consistently refused to talk to the Georgian leaders, which made the Georgian Patriarch the only person able to visit Moscow after the war and meet the Russian leaders. After these meetings the Russian troops left one of the occupied Georgian villages only to return the following day for unknown reasons. The very fact of acceptance of the GOC by Russia's religious and political leaders speaks volumes.

⁸ [<http://www.patriarchate.ge> 2009].

It is the close relations between the two churches that give certain Georgian observers the chance to accuse the GOC of pro-Russian orientation. "The Patriarchate has always objected to the state's pro-Western course. In its time it was dead set against a Papal visit to Georgia,"⁹ was how Georgian theologians commented on the close relations between the two churches. The war supplied them with additional arguments. On the one hand, "the Georgian state is seeking integration into Western society, while on the other, the Georgian Church still looks toward Russia." This can be frequently heard in certain quarters.

Conclusion

The GOC is gradually developing into an actor in the current political processes in Georgia: it is a mediator on the domestic scene and a distributor of political ideas and ideologies, conceptions and doctrines, while outside the country it has occupied the niche of people's diplomacy. Society's unbounded trust and support constitutes its main political capital and accounts for its strength. This allows it to show initiative and forces other political actors to take it and its interests into account. Politicians lend their ear to what the Patriarch has to say. On the other hand, Georgia's ill-wishers beyond its borders know that there is a lever that can be used to put a pressure on Georgia's policy, which threatens the country's national security and demands the Church's vigilance.

⁹ Comment offered by Beka Mindiashvili at the conference on Secular Society and Religious Nationalism organized by the Heinrich Böll Foundation, quoted by Iveria TV company on 12 April, 2008.

OPPOSITION IN KAZAKHSTAN: NAGGING PROBLEMS

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Today there are ten political parties in Kazakhstan but only one of them—the People's Democratic Nur Otan Party—supports the government. The rest are regarded as the opposition.

The Communist Party of Kazakhstan (CPK), the Communist People's Party of Kazakhstan (CPPK), the Azat Democratic Party of Kazakhstan, and the National Social-Democratic Party of Kazakhstan (NSDPK) can be described as the active opposition.

The camp of the moderate opposition is made up of the Ak Zhol Democratic Party of Kazakhstan, the Adilet Democratic Party, the Party of the Patriots of Kazakhstan (PPK), the Kazakhstan Auyl Social-Democratic Party, and the Rukhaniat Party.

The parties' relations with the government, their political views, their actions, and the tone of their statements divide the parties into active and moderate.

The moderate are critical yet, on the whole, constructive when it comes to a dialog with the other parties and the government; the active are mostly driven by the idea consolidating the opposition bloc into a united front to stand opposed to the ruling elite.

Heated polemics about whether or not the opposition in Kazakhstan meets the standards political science has established in the West have been going on for some time now. The analytical and expert communities have more or less agreed that the answer is "No."¹

This approach is based on the critical/loyal attitude toward the government or, rather, toward the president. Some people mistake oppositional sentiments for an anti-system stance.

Political science claims that a party becomes oppositional when either it has lost an election or fails to achieve a parliamentary majority thus standing no chance of acquiring a place in the cabinet. This means that the degree of involvement in executive state power is the main criterion.

Several parties may win an election and form a coalition government while opposition parties might acquire seats in the parliament to form a parliamentary opposition.

- The first side with the government, while the latter criticize it; they might, however, side with the authorities on individual issues. They are described as the opposition because they have been left outside the government.
- The second constitutional reform made it possible to take a scholarly approach to the concept of opposition: before that the parties were excluded from cabinet-forming. The first years of independence (1991-2007) created a non-classical approach to the phenomenon of the opposition: it is commonly believed that in Kazakhstan the opposition stands against the government rather than the ruling party.

Today Nur Otan is the ruling party, the rest belong to the opposition; none of them have factions of their own in the parliament. Indeed, the one seat held by the PPK in the Senate cannot be taken seriously because it opens no doors to the executive structures. Below I shall proceed from this.

The opposition in Kazakhstan appeared in the 1990s at the dawn of pluralism in the former Soviet republic. Independence and economic reforms brought to the fore an opposition that disagreed with the radical changes that removed the old values. They are the CPK before its registration; the Alash Party of National Freedom; the Kazakhstan branch of the All-Union Communist Party of Bolsheviks; the Solidarity Workers' Movement of Kazakhstan, and others. At the turn of the 1990s, ethno-political alliances—the Azat and Alash civil movements of Kazakhstan; the Zheltoksan National-Democratic Party of Kazakhstan; the Unity inter-national movement, and others. They were all actively involved in defending ethnic values and worked toward the revival of national self-awareness. In the 1994 parliamentary elections the opposition acquired about 40 of 176 seats in the Supreme Soviet of the 13th convocation.

The opposition forces gained more weight when a multi-party system appeared in the republic. Today many of the former top officials belong to the opposition: P. Svoik, M. Auezov, and G. Abilsi-

¹ See: "Partiia 'Ak Zhol': ravenstvo, trud, dukhovnost," *Materialy "kruglogo stola" diskussionnogo kluba "POLY-TON"* im. N. Masanova, 13 July, 2007, available at [<http://www.club.kz/index.php?lang=ru&mod=discuss&submod=large&article=24>]; "Pochemu my ne uchastvuem v vyborakh," *Materialy "kruglogo stola" diskussionnogo kluba "POLY-TON"* im. N. Masanova, 3 August, 2007, available at [<http://www.club.kz/index.php?lang=ru&mod=discuss&submod=large&article=25>].

tov belonged to the Azamat public movement (1995); A. Kazhegeldin and B. Tursynbaev (1998), the founders of the Democratic Choice of Kazakhstan (DCK, 2002), and Zh. Tuiakbai (2004).

In Kazakhstan, prominent politicians frequently move over to the opposition: because of their unbridled ambitions some of them fell out of favor; while others were pushed out because they scorned the ruling elites' unwritten laws. In some cases this was Ak Orda's deliberate strategy designed to stir up political rivalry.²

Prominent Russian political scientist A. Kurtov is convinced that the opposition in Kazakhstan should be described as a "sham:" "Several top officials who used to fill high posts in the state structures, including the presidential administration, were appointed leaders of the opposition parties. In this way the people's opposition sentiments were channeled in a direction controlled from above. Today, the political struggle in the republic is a mere imitation."³

This is hard to accept; the opposition in Kazakhstan was formed both from above and from below.

At first, the former variant prevailed. In 2001 the power establishment was stirred into action; the economic reforms divided the elite and pushed the "Young Turks" of Kazakhstan into politics. Driven by economic considerations and encroachments on the reformers' freedom to do business they wanted continued political reforms and modernization. They insisted on qualitatively new structural reforms in the legal sphere and culture; this frightened the old elite, which resorted to its traditional measures: threats, repressions, and dismissals from civil service.

In the early 21st century, the national elite split and a new opposition appeared with much better organizational abilities and money sources than the opposition of the early 1990s.

The DCK was the first step toward a counter-elite and a "systemic opposition" with good material, organizational, intellectual, and information resources (newspapers and web sites).

The opposition learned a lot from the election campaigns: it learned how to attract thousands of active supporters and how to keep the government on tenterhooks so that it would tap all its resources.

Since the early 2000s, the opposition has been receiving support from influential international organizations operating in the republic, the OSCE in particular, which became much more interested than before in the way human rights and freedoms were observed in Kazakhstan. The external factor became another of the opposition's important resources, which means that the opposition is growing more aware of its civil duties and becoming more responsible. With time this will help to create a legitimate mechanism of power change.

The entire history of the republic's opposition (which goes back to 1991) speaks of its fairly fluid nature: the Communist Party of Kazakhstan alone has survived since that time as an organizational structure. It too, however, split and produced a clone in the form of the Communist People's Party of Kazakhstan. Some other structures appeared, and became less active after a while, only to disappear under the pressure of the circumstances.⁴

At times the opposition seems to gain momentum but this is an illusion. Russian analyst A. Vlasov has aptly pointed out that "the Kazakhstan opposition thrives amid intrigues at the top;" instability inside the ruling elite creates the illusion of a strong opposition which disappears as soon as the opposition permits squabbles in its ranks.⁵

² See: S. Akimov, "Vlast i oppozitsiia v Gruzii i Kazakhstane," 1 April, 2009, available at [<http://ia-centr.ru/expert/4335/>].

³ A.A. Kurtov, "Kazakhstan: Kontrevolutsiia parlamenta, ili Kratkaia istoriia izgnaniia oppozitsii," 19 August, 2007, available at [<http://www.ferghana.ru/article.php?id=5295>].

⁴ See: "Politicheskii krizis kazakhstanskoi oppozitsii," *Materialy "kruglogo stola" diskussionnogo kluba "POLYTON" im. N. Masanova*, 25 February, 2005, available at [<http://www.club.kz/index.php?lang=ru&mod=discuss&submod=small&article=145>].

⁵ See: A.V. Vlasov, "Shansy kazakhstanskoi oppozitsii zavisiat ot voli vlasti," 26 June, 2007, available at [<http://www.easttime.ru/analitic/1/3/236.html>].

Prominent civil servants who drift over to the opposition are seen as a positive and partly negative factor. Today, they prevail among the opposition leaders; the so-called “common people” are outnumbered.

People in general mistrust former bureaucrats turned oppositionists: the most determined of them spent their lives strengthening the political system they now criticize; some of them belonged to the president’s closest circle before they decided to move over to the other side. Their reasons are not always clear which causes justified doubts about their sincerity.⁶ For this reason people mistrust the opposition as a whole.

Political scientists and analysts rightly noted that since the 2007 elections the opposition has been in a crisis. This opinion is substantiated by the round table of the POLYTON Discussion Club held on 24 October, 2008.⁷ The following confirms the crisis’ very real nature:

- First, nearly all the opposition parties are highly inconsistent in their actions because they lack clear strategies; they are meandering along with the changing political situation. For example, the NSDPK election program of 2007 looked more like a patchwork of populist, whereby highly attractive, slogans. Had the party carried out its promises an economic collapse would have followed;
- Second, the opposition lacks ideas to attract new supporters; its ideologists cannot cope with this task, which calls for creative minds;
- Third, the opposition is unable to respond to social developments and use them in its interests;
- Fourth, its contacts with the man-in-the-street cannot be called anything but inadequate;
- Fifth, inadequate self-positioning as a real alternative to the powers that be;
- Sixth, the new political leaders lack authority; today none of the opposition leaders can compete with President Nazarbaev.

NSDPK Chairman Zh. Tuiakbai became a politician in the parliamentary corridors and has never developed into a public figure. His very short term as deputy chairman of Nur Otan during the 2004 election campaign revealed that he was no orator and had no charisma, two shortcomings television made even more glaring. In 2005, as the single opposition presidential nominee, he was revealed as a man completely dependent on his closest circle.

A. Baimenov, who chairs the Ak Zhol party, is not a strong leader either; he looks more like a cabinet politician.

Azat Chairman B. Abilov is too emotional and eccentric.

S. Abdildin, the experienced head of the Communist Party of Kazakhstan, successfully ran against Nazarbaev in 1999; today he remains on the sidelines: the communist ideology is not that popular in the republic.

G. Zhakiiatov, the president’s most consistent and uncompromising opponent, has all the qualities of a public politician and is fairly popular among the people; for this reason he has been removed from active political activities.⁸

- Seven, for a long time the opposition remained disunited.

⁶ See: Ya. Butakov, “‘Troianskie koni’ oppozitsii,” 18 December, 2005, available at [<http://www.analitika.org/article.php?story=20051218225800313>].

⁷ See: “Demokraticeskaja oppozitsija: krizis ili izmenenie strategii?” *Materialy “kruglogo stola” diskussionnogo kluba “POLYTON” im. N. Masanova*, 24 October, 2008, available at [<http://www.alternativakz.org/index.php?go=mnenie&in=view&id=145>].

⁸ See: A.V. Vlasov, “Nuzhna novaia oppozitsija. Kazakhstan: rasstanovka sil posle vyborov,” 18 December, 2005, available at [<http://www.apn.kz/publications/article100.htm>].

“The opposition of Kazakhstan does not have a clear program of action and is organizationally disunited,” wrote one of the leading European analytical publications that covered Dick Cheney’s visit to Kazakhstan in 2006. The American diplomat suggested, in very moderate terms, that the opposition should create a program of real action and start looking for common points conducive to a dialog with the government.⁹

The opposition leaders admit that their ranks are disunited¹⁰ even though opposition parties regularly form coalitions and blocs: the Coalition of Social Protection (1992); Round Table of Political Parties, Public Associations and Trade Unions (1993); the Republic Coordination Council of Public Associations (1994-1997); the People’s Front of Kazakhstan (1998); the Forum of Democratic Forces of Kazakhstan (1999-2001); the Coordination Council of Democratic Forces of Kazakhstan (2004-2005); and the Bloc of Democratic Forces “For a Just Kazakhstan” (2005-2006).

They had their strong and weak sides but they all fell apart under the pressure of tactical disagreements and ambitions in the absence of a leader recognized by all the opposition forces. The opposition cannot agree on how to deal with various tasks or on how to change the political system and carry out democratic reforms.

A. Kozhakhmetov, a prominent oppositionist and head of the Shanyrak public alliance, promotes a most interesting system of views:

- (a) the “Westerners” are convinced that dictatorship cannot be defeated with domestic means and that foreign interference is needed;
- (b) those who describe themselves as close to the common people insist that the West is guided by the interests of big money and is, therefore, quite comfortable with the present regime. It is for the people themselves to remove it: they can and should do this;
- (c) those who believe that the regime can be talked into changes are out to prove that neither the West nor the people can change the present regime. It should be persuaded to start changing and will change after a while;
- (d) the “nihilists” reject everything and believe that nobody can do anything at all; everything will take its own course and arrive at the desired result. Everything that is or will be done, they argue, is nothing but petty intrigues that have nothing to do either with real changes or with the speed of the reforms.¹¹

The above calls for two additions.

1. While criticizing the government for its harsh pressure, the radical opposition repeatedly called on the people at the top to enter a dialog yet consistently ignored all the dialog alternatives suggested (a Permanent Conference, National Commission for Democracy, State Commission for Specifying and Programming Democratic Reforms, and a Public Chamber).

Not only the republic’s authorities (which could be described as prejudiced) but also independent Western experts are aware of the radicals’ hardly constructive approach. The foreign mission¹² that visited Kazakhstan on the eve of the 2005 elections minced no words when

⁹ See: A.V. Vlasov, “Pervye i vtoroye litsa kazakhstanskoy oppozitsii,” 23 May, 2006, available at [<http://www.analitika.org/article.php?story=20060523010547531>].

¹⁰ See: “Institut oppozitsii v Kazakhstane: realnost i perspektivy,” *Krugly stol v diskussionnom klube “Polyton,”* 26 January, 2007, available at [<http://www.club.kz/index.php?lang=ru&mod=discuss&submod=large&article=225>]; “Bulat Abilov: Nachnem peremeny s sebia. Vystuplenie na Forume demokraticeskoy oppozitsii Kazakhstana,” 11 April, 2009, available at [<http://ia-centr.ru/expert/4418/>].

¹¹ See: “Politicheskii krizis kazakhstanskoy oppozitsii...”

¹² The mission consisted of Gerald Frost, CIC General Director, Kenneth Minogue, an emeritus professor from London University, Prof. Dennis O’Keefe, a social scientist at the University of Buckingham, and David Ruffley, a Tory MP.

accusing the opposition leaders of their unwillingness to talk to the government and of their inability “to take the first step toward clearer ideological and political statements.” The foreign visitors pointed out that “the most vehement criticism of the government comes from former cabinet members still nursing their grudges.”¹³

It seems that the opposition does not merely respond to the “pressure the government puts on the opposition” with the alleged intention of creating “another valve to release the steam of public discontent.” The opposition refuses on principle to be involved in any dialog with the powers that be in order to avoid sharing the responsibility for important decisions. Even if the suggested dialog structures were intended “to release the steam of public discontent,” this might have been useful. The opposition involved in a dialog, on the other hand, could no longer exploit social discontent.

In exchange the opposition could have realized some of its suggestions; in fact, this already happened in the past. On 1 September, 2005, when speaking at the opening of the parliament’s second session, President Nazarbaev mentioned that he intended to set up, under his chairmanship, a State Commission for a Program of Democratic Reforms staffed with deputies and members of the presidential administration, the government, public associations, and NGOs; the most radical of the oppositionists were not forgotten either.

The president instructed his administration to come up with a program related to the country’s possible OSCE chairmanship in 2009. The government, ministries, and departments were expected to work in compliance with it. In fact, these initiatives were first formulated by head of the Ak Zhol party A. Baimenov in a statement known as Twelve Steps of the Government Toward the People of Kazakhstan dated 12 April, 2005.

Today it has become clear that nearly all the initiatives suggested by the DCK related to political reforms have been realized. The president is obviously prepared to take notice of all the constructive suggestions coming from the opposition and to realize those that will not undermine political stability and may prove useful in the long-term perspective.

It should be said that the government never refers to the sources of its initiatives, which allows the opposition to accuse it of “stealing” their slogans and inspiring ideas. First, the ideas have never and nowhere been a subject of laws protecting intellectual property; second, “true democrats” should be rejoicing that “their” ideas are being realized at the national level no matter by whom.

A. Baimenov’s position can be described as fair: “We have said many times that the realization of our ideas is more important than their source. We think it important to raise the nation’s standard of living, carry out economic reforms, and improve the political system; we want our ideas to work in the interests of all.”¹⁴ He confirmed his position by his contribution to the State Commission for Specifying and Programming of Democratic Reforms and as a Majilis deputy in 2006 and 2007. Much of what Ak Zhol had written became laws.

On the whole, however, a constructive approach is much weaker than a radical one even if it is much more promising. On the other hand, the radical opposition’s unyielding tactics hold no promise. Take O. Zhandosov, for example, one of the country’s most talented economists: his rich experience so far remains untapped.

2. Unwilling to be involved in a nationwide dialog with the government, the opposition leaders are seeking contacts behind the scene to obtain all sorts of preferences (the NSDPK and Ak Zhol).

¹³ A. Grozin, “Dialog vlasti i oppozitsii: neobkhodimoe uslovie stabilnogo razvitiia demokratii v Kazakhstane,” 10 January, 2006, available at [<http://www.analitika.org/article.php?story=20060110215722303>].

¹⁴ Ibidem.

“The specifics of the post-Soviet countries presuppose that any oppositionists, even those far removed from the system, are directly or indirectly connected with this or that ‘court’ group of influence.” The oppositionists themselves readily agree with this.¹⁵

Some of the opposition members are trying to join the power bandwagon no matter what (G. Kasymov, PPK). A. Chebotarev believes that “so far the opposition prefers to obey the rules the government has established for it and, strange as it may seem, is indulging in their criticism.”¹⁶ Some of the opposition leaders never bother to conceal the fact that this is a professional status which earns them their living and allows them to “haggle” with the government.

The government, in turn, demonstrates flexibility when dealing with the opposition: it flirts with some of the parties and their leaders. In 2006-2007, the president met the Ak Zhol and NSDPK leaders twice; no other parties or leaders were given this chance either before this period or later.¹⁷

This suggests that the government has also contributed to the weakness of the opposition.

We all know that the country’s leaders have never wanted a one-party system: its domination was never regarded as desirable. A two-party system looks preferable. A lot is said about an opposition that cannot be raised in a greenhouse but should take shape in natural conditions; the government, in turn, should assist this process.¹⁸

On the other hand, a civilized attitude (of the government in particular) toward the political opposition is just taking shape in the country. Today much is being done to present the opposition as a destructive or even extremist force; the opposition is not yet seen as an important guarantor of stability and the state’s sovereign democratic development.

The “opposition” concept should be specified together with its legal status, forms, and methods. This has been fully confirmed by foreign experience; in many countries the opposition, its status, and its rights are clearly outlined to ensure its continued activities. This can be realized either within stable political traditions (not all of them registered in laws) or within corresponding legal acts (the Constitution, laws, and rules of parliament).

Kazakhstan has not yet acquired the relevant traditions, therefore any law or new regulations in the already existing legislation (On Public Associations, On Political Parties, On Elections, On the Parliament and the Status of Deputies, and the rules of the parliament and its chambers) could speak volumes about society’s readiness to move forward toward even greater modernization of the political expanse. The people at the top agree that such a legal act is very much needed.¹⁹

The term “opposition” first appeared as an official term in the Conception of the Transfer to Sustainable Development for 2007-2024, in which the “political basis of Kazakhstan’s sustainable development” included efforts designed to foster the culture of political opposition, strengthen constructive opposition as a basis for competition among public figures and programs, and express the interests of all the public strata and groups.

¹⁵ See: A.V. Vlasov, “‘Ak Zhol’ pochti ne viden,” 3 September, 2007, available at [<http://www.ia-centr.ru/expert/132>]; idem, “Pervye i vtorые litsa kazakhstanskoi oppozitsii...”; “Institut oppozitsii v Kazakhstane: realnost i perspektivy,” *Krugly stol v diskussionnom klube “Polyton,”* 26 January, 2007; P. Danilin, “Kazakhstan: partii ‘vykhodiat iz pelenok,’” 12 December, 2005, available at [<http://www.analitika.org/article.php?story=20051218230359932>].

¹⁶ “Demokraticheskaiа oppozitsiia: krizis ili izmenenie strategii?” *Materialy “kruglogo stola” diskussionnogo kluba “POLYTON” im. N. Masanova,* 24 October, 2008, available at [<http://www.alternativakz.org/index.php?go=mnenie&in=view&id=145>].

¹⁷ See: A. Omarova, “A segodnia my dolzhny dvigatsia vpered,” *Megapolis,* No. 25, September, 2006.

¹⁸ See: D. Kaletaev, “Partiia dolzhna stat realnoi oporoi dlia svoego lidera,” 21 November, 2008, available at [<http://ia-centr.ru/expert/3027>].

¹⁹ See: “Kazakhstanu nuzhen zakon ob oppozitsii,” *31-i kanal,* 20 August, 2005.

This means that the republic has already acquired a foundation for social relations as an object of legal regulation.²⁰

In 2007 the NSDPK put on the table a draft law On Opposition Activities²¹ that cannot be described as a panacea; it might have proven useful as the start of a discussion on the place, role, and status of opposition activities. In Kazakhstan, where democratic legal development has its own specifics, this draft law can be regarded as a political education project for the people, and for the government and the opposition in particular.

This law would have given the opposition the legal status of an equal entity of social and political life in Kazakhstan; it would have created clear rules to be followed both by the government and the opposition. Any violation of them by any of the sides would have incurred sanctions against the culprit; the law would have offered the opposition wider and, most important, real possibilities to be involved in state governance.

The government preferred to ignore the draft law; in view of its habit of taking its time before responding to the opposition's initiatives the republic might acquire this law at some time in the future. Since 2005 the government has not only been accepting the opposition as a much needed element of political life but has also been striving to enter a dialog with it.

At the same time, the authorities deal harshly with the opposition when they feel this is appropriate; in favorable conditions, however, they refrain from intrigues. In 2005, for example, the favorable situation in the country and the hopes for a better future associated with the president made the administrative resource unnecessary: the turnout of Nazarbaev's supporters was very high.

Most of the time the government fights the opposition with all the means at its disposal: it keeps the political expanse under control, persecutes the leaders or bribes them, refuses to register disagreeable political parties, organizes information blockades, and uses the laws as it sees fit.

Analysts have concluded that the opposition in Kazakhstan "was set up under the constant control of the Ak Orda strategists and is managed within the limits set by the presidential administration."²²

It should be said that the mechanism of power change at the presidential level does not work in Kazakhstan; this is one of the reasons why the opposition remains weak.²³

It is thought that there are two reasons for the absence of a social base for the opposition. Two factors must be taken into account.

- First, in 2000-2007 society felt comfortable with the social and economic circumstances and felt no need for an alternative political and economic course.
- Second, the level of the nation's political culture and activeness remains too low to breed opposition sentiments.²⁴

The economic crisis of 2007 could have changed this; it gave rise to the "people's opposition": social actions of those who lost their money invested in housing projects, those who could not pay mortgage, and those who have no homes, as well as strikes at enterprises. Coupled with the mounting unemployment and crime this may increase social tension. The political opposition could have prof-

²⁰ See: O. Romaniko, "Pravovye osnovy oppozitsionnoi politicheskoi deiatelnosti v Kazakhstane," 24 March, 2008, available at [<http://suv-demokrat.csu.ru>].

²¹ See: "OSDP prezentovala obshchestvennosti razrabotannyi eiu proekt zakona 'Ob oppozitsionnoi deiatelnosti,'" *Panorama*, 13 April, 2007.

²² E. Kovel, "Teni zabytykh partii," 2 December, 2008, available at [<http://ia-centr.ru/expert/3095>]; A.V. Vlasov, N. Kharitonova, "Kazakhstan: rasstanovka sil posle vyborov," 12 December, 2005, available at [<http://www.analitika.org/article.php?story=20051218230359932>]; A. Nurmakov, "Gotovias k budushchei voine," 24 August, 2007, available at [<http://www.posit.su/site.php?lan=ru&id=100&pub=532>].

²³ See: A. Grishin, R.G. Abdullo, "Kazakhstan: ravnenie na fone ravnykh," 30 April, 2009, available at [<http://ia-centr.ru/expert/4548/>].

²⁴ See: "Pochemu my ne uchastvuem v vyborakh..."

ited from this by joining the protest movement or even heading it; the opposition leaders, however, let the chance slip through their fingers.

Disillusioned with its ability to ignite the nation with its liberal and democratic slogans, the opposition sided with the loosely structured national-patriotic movement which has an impressive grassroots following.²⁵ The opposition leaders showed each and everyone that they were unable to sustain sociopolitical ideas and remain within the Western political standards of public political polemics. In Kazakhstan the opposition is constantly swinging from nationalism to social-liberalism and back, from the right to the left; its involvement in obviously staged information campaigns does not improve its credibility.

For these reasons the institution of opposition in Kazakhstan is still undeveloped.

Today the opposition can be described as a loose and amorphous entity which limits itself to public statements and declarations on the web; it has neither a scientifically substantiated long-term program, nor an electorate to speak of, nor strong leaders able to claim presidency.

The opposition reached its peak in 2003-2004 and has been stagnating ever since. It became obvious after the 2005-2007 election cycle that it was being squeezed out of the political scene. This undermined its influence and badly affected its legitimacy. The opposition lost its chance to emerge as an alternative to the government; it proved too weak to sustain a prolonged political struggle, at least within the two-party system. Instead it preferred political propaganda.

All the analysts agree that the opposition forces should close ranks to form a common front in order to stand opposed to the ruling party and the regime. This would create a strong and politically active opposition. In fact, the ban on election blocs left the opposition with forming a common front as the only way of surviving as a political force.²⁶ So far there has been no progress in this direction.

In the last decade the opposition has formed all sorts of election alliances which fell apart once the elections were over. This is best illustrated by the NSDPK's failed attempt to set up, in January 2008, a people's coalition For Democratic Reforms by allying the Azat and Rukhaniat parties as well as the CPPK, CPK, Auyl, Ak Zhol, Alga, and the Civil Society foundation headed by G. Zhakiyanov.

The Khalyk Kenesi public parliament set up in May 2008 crumbled under the weight of the "negative consensus" very much typical of the Kazakhstan opposition when people prefer to join "against something" rather than "for something." The parliament set up to demonstrate that an efficient structure can be created confirmed the opposition's political insolvency.

In April 2009, at a forum of the democratic opposition, the NSDPK, Azat, and Alga parties, together with the Communist Party of Kazakhstan, made another attempt to consolidate their forces; they set up an organizing committee of their leaders expected to formulate the ideology and organizational principles of the new structure and carry out inter-party consultations with an eye to making use of the previous positive and negative experience. It was announced that the new structure would acquire a short-term program of action based on the parties' personal, financial, and media resources; specific actions were also mentioned.

This was the first time the opposition was so clear about its intention to form a single political party and took the first organizational steps in this direction. All previous attempts were limited to alliances of independent structures, while intentions to consolidate forces within a single party remained on paper.

This is true of the idea of a united democratic party voiced in the early 2000s by the Republican People's Party of Kazakhstan, the People's Congress of Kazakhstan Party, and Azamat and of the 2007 election "mergers" of the NSDPK with the True Ak Zhol party and the Ak Zhol party with the Adilet Democratic Party.

²⁵ See: B. Shamekenov, "Natsional-oranzhizm po-kazakhstanski," 19 September, 2008, available at [<http://www.posit.su/site.php?lan=ru&id=100&pub=14255>].

²⁶ See, for example: A. Nurmakov, *op. cit.*

In fact, the problems that interfered with the April merger strategy are numerous.

- First, it could hardly be expected that the rightist Azat party would be able to live side by side with the leftist NSDPK and CPK.
- Second, the opposition set about the business of sharing power even before it acquired it.²⁷

If the opposition comes to power any time soon its numerous leaders will clash over who gets the highest posts. There are ample examples of this: Victor Yushchenko and Yulia Timoshenko in Ukraine; Kurmanbek Bakiev and Felix Kulov in Kyrgyzstan; and Mikhail Saakashvili and the elite in Georgia.

To avoid this, the opposition needs a leader superior to the other presidential contenders. So far there is no figure able to unite the opposition and lead it. Today there can be no united opposition in Kazakhstan. Elusive absolute unity should be forgotten in favor of a new party or a much stronger old structure able to dominate the opposition.

This suggests that real tasks should be formulated and consistently addressed: a clearer ideology and more active work with those population groups that profited less than the others from the reforms. Equal access to the media is just as important.

Today there is no opposition of this kind in the republic. Members of the opposition (O. Zhandosov being one of them) are convinced that this situation will survive “as long as an authoritarian regime remains one of the key characteristics of our society. By distorting the views on life in many minds, and in the opposition in particular, it interferes with normal development.”²⁸

In view of the opposition’s numerous internal problems, however, this kind of statement seems very disputable.

²⁷ See: A. Shaigumarov, “Vozmemsia za ruki, družia, chtob ne propast po odinochke!” 15 April, 2009, available at [<http://ia-centr.ru/expert/4477/>].

²⁸ “Ob’edinenie demokraticheskikh sil: prichiny i perspektivy,” *Diskussiiia v klube “Polyton,”* 29 June, 2007, available at [<http://www.club.kz/index.php?lang=ru&mod=discuss&submod=large&article=246>].

ON THE RESULTS OF THE PRESIDENTIAL ELECTION IN KYRGYZSTAN

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By 18 May, 2009, 18 people had decided to run for president of the Kyrgyz Republic. Within five days, they were to submit all the necessary documents to the Central Elec-

tions Committee, gather at least 50,000 signatures in support of their candidacy, and pass a state language competency exam. At the beginning of the election campaign, there were six candidates left

in the running: current present Kurmanbek Bakiev, the only candidate from the opposition, leader of the Social-Democratic Party A. Atambaev, leader of the Ak-Shumkar party T. Sariev, head of the NGO and NCO Association T. Umetalieva,

leader of the Zhoomart movement N. Motuev, and well-known physician Zh. Nazaraliev.

On voting day (23 July), the majority of the republic's citizens voted for Kurmanbek Bakiev and he was re-elected president.

Situation Preview

It is commonly believed that there is a political standoff in Kyrgyzstan between the northern and southern clans or, to be more precise, families. This popular opinion, although it is not entirely true, does indeed reflect the actual state of affairs to some extent. First president Akaev is considered a "northerner," while Bakiev is a "southerner." Most of the posts in the current government and state institutions are occupied by southerners.

It was presumed that Bakiev would gather most of the votes in the country's south. And this is indeed what happened. In his birthplace (the Jalal-Abad Region), he received 78.2% of the votes, while in the Naryn Region (in the north) he only obtained 29.3%, that is, 2.5-fold less.

The concepts of "northerner" and "southerner" apply exclusively to the indigenous Kyrgyz population among whom kinship ties are still preserved and for whom place of birth and affiliation with a particular family are of immense importance. It is very difficult for the non-Kyrgyz to find a niche for themselves in the power structures. For example, the first government formed by Bakiev was entirely made up of representatives of the titular nation.

Amendments on not permitting other nationalities to occupy positions in the power structures were made to the constitutions adopted under Akaev and Bakiev. The provision on mandatory knowledge of the Kyrgyz language makes it impossible for the representatives of other nationalities to climb to the top. Whereas a person wishing to become a deputy used to be able to simply nominate himself, now he must play by the game rules and become a member of a particular party. And since all the members of political parties are Kyrgyz, it stands to reason that titanic efforts must be exerted for a person to distinguish himself among them and be nominated.

Presidential and parliamentary elections have always been accompanied by attempts to play up to the non-Kyrgyz electorate. The government and opposition suddenly remember that other nationalities exist. Numerous promises and assurances of upholding the spirit of internationalism are heard, since almost 40% of the voters are non-Kyrgyz. But this time it was perfectly clear that Bakiev already had his victory in hand.

The non-titular electorate mostly ignored the election. For example, the turnout was extremely low at polling stations with a predominantly Uzbek population.

During the years of independence, most of the country's non-Kyrgyz population, particularly Uzbeks (20%), have become convinced that elections are a purely Kyrgyz event and their results are the extension of a latent nationalistic policy. The Kyrgyz, who make up a little more than 60% of the population, traditionally uphold the principle of "collectivism," particularly in rural areas. Kindred relations are strong there and the people usually participate in such events en masse. So the ethnic factor was ignored this time: Bakiev was sure that he would obtain the necessary number of votes, and the other candidates understood from the beginning that the chances of taking the election to a second round were highly unlikely. So there were no traditionally aggressive agitation campaigns or a parade of live meetings with the voters.

Bakiev's victory came as no surprise. It could have been predicted long before the beginning of the election campaign as he had no worthy opponent and had the administrative resource, which

no one else controlled, at his disposal. Moreover, the opposition began the campaign in a state of disarray and with no firm legs to stand on, although the election was held ahead of time on its initiative.

One of the main reasons for Bakiev's victory was that long before the election he had debilitated the opposition by initiating court persecutions of the most prominent of its members. For example, a criminal case was instigated against I. Isakov, former defense minister and active participant in the Tulip Revolution. And the opposition was dealt a crushing blow when ex-minister of foreign affairs Jekshenkulov left the political arena. A criminal case was also instigated against him. He was considered the coordinator and "brain" of the opposition forces and he was able to cut short the internal discord by restraining the conflicting sides. When he left, the united opposition movement began to fall apart. Experts believe that only Jekshenkulov had the ability to direct the "untamed" political trends into a civilized channel. He would have under no circumstances permitted hostility between the candidates from the opposition, Atambaev and Sariev, something which was in Bakiev's interest.

The Social-Democrats and the Communists

As early as the end of last year, there was talk about the possibility of an early election. The Social-Democratic and Communist parties, whose factions sit in the parliament along with Ak Zhol, acted as though they had no major differences with the government. Debates in parliament focused on insignificant issues. But, as the question of an early presidential election was raised and opened to the floor, differences albeit emerged and burgeoned.

It was the Social-Democrat faction that initiated re-examining the question of an early election. The idea was to deprive Bakiev of any room for maneuver and force him to enter the battle unprepared.

The time for holding the next regular presidential election aroused dispute among all the opposition parties. According to the constitution, which was adopted after the so-called Tulip Revolution (March 2005), the next election was scheduled for 2010. But Bakiev became president while the old constitution was still in effect, according to which the election should be held in October 2009. The Social-Democrats, zooming in on this non-compliance, came forward with the initiative to hold an early election. The parliament decided to give the Constitutional Court the right to issue a verdict, which, basing its arguments on both the new and the old constitutions, determined that the election should be held before 25 October, 2009. The Zhogorku Kenesh (parliament) was to decide the actual date.

The deputies, most of whom were members of Bakiev's party, Ak Zhol, scheduled the presidential election for 23 July. They explained this decision by the possible need for a second round, which would require at least two months. In addition, time might be needed for court proceedings in the event the results were contested and for a decision to be issued. 23 July happened to fall on a work day, which did not suit the Social-Democrats. Moreover, they wanted to hold the election in the fall, when, in their opinion, more voters dissatisfied with the government would come to the polls.

Indeed, approximately 10% of Kyrgyzstan's able-bodied citizens (approximately 0.5 million people) live, although not permanently, outside the country, mainly in Russia. These are labor migrants. Approximately half of them leave the country to work in the spring and return in the fall. The opposition reckoned that the world crisis would also have an effect on the Kyrgyz migrant workers. Indeed, most of them were unable to find suitable jobs. So in this event it was logical that they would vote against Bakiev.

But the president foresaw this development of events. This was precisely why his pocket parliament scheduled the election for mid-summer.

Scheduling of the election on a work day (Thursday) gave rise to vehement disputes. This was also to Bakiev's advantage. He had the administrative resource at his disposal; he had the opportunity to manipulate those voters who were on the government budget and dependent on it (doctors, teachers, bureaucrats, and students). Only their bosses would permit them to take time off to go and vote, which they did. And it stands to reason that these "government" voters would vote for Bakiev, while those working in the private sector were not all given time off work to vote.

The calculations of the Social-Democrats and the opposition were not justified, and Bakiev and his team stepped confidently toward success. This was promoted by several important factors—the administrative resource, the availability of finances, the domestic political situation, and the economic circumstances. The other candidates were unable or did not want to make use of the opportunities they had.

The Communist party has the third largest faction in the parliament. The Communists did not have any major differences with the party in power, while there was some friction within the Ak Zhol party itself. When the date of the election became known, the Communists did not even announce whether or not their candidate would participate in the election.

As early as May it became known for sure that the Communists would not put forward a candidate. They said they would support Bakiev's candidacy and were entirely in agreement with his platform, although it had still not been publicized.

The reason for such a strange position was the Communists' desire to retain their seats in the parliament. They could lose them if they did not support the Ak Zhol party, so they preferred not to enter the fray, particularly since at the last parliamentary election the Communists acquired only 8 out of 90 seats. They were very well aware that their candidate could not contend for even second place.

The number of Communist deputies in the parliament graphically shows the breakdown in forces in the fight for presidency. During the election campaign, they occupied a neutral position, agitating neither for nor against Bakiev, and after the election they did not make a single statement about the voting results. The impression was created that for some time the Communist party had simply ceased to exist.

All of this shows that the Communists and the Ak Zhol party had most likely entered an unofficial "non-interference pact."

The Candidate's Chances

The election campaign launched by A. Atambaev, the main contender for the post of president after Bakiev, was boring and uninteresting, as, incidentally, were those of the other candidates. The press did nothing to inflate the mini sensations about the candidate being poisoned or a hex being put on him and so failed to pique the public's interest in Atambaev. Journalists and experts were expecting the election campaign to send sparks flying, but no sensational events occurred.

Even candidate N. Motuev, who had always been a central figure in scandals and the author of many a caustic statement, kept a low profile this time. His entire election campaign was built on making statements on TV in keeping with the election code, and he did not pay for extra airtime. Even before the election date was announced, he said that he would not be running for president, but would support Bakiev.

His comrade-in-arms and former ombudsman T. Bakir-uulu announced his desire to run for president, but soon gave up this idea when he was offered the position of ambassador to one of the

foreign countries. At the same time Motuev had a sudden change of mind and announced his decision to run for president. Evidently he had decided that he too might be offered a cushy post in the government or be sent to a prestigious country as ambassador.

Candidate T. Sariev conducted a very dull election campaign. He very rarely made statements; sometimes journalists had to go looking for him since he almost never invited them to his meetings with the voters. His election campaign was extremely uninspiring and insipid. Admittedly, a spark of interest was aroused by the fact that his representative, B. Zheenbekov, accused candidate Atambaev of making an assassination attempt on Sariev. Atambaev submitted a complaint to the Central Elections Committee, in which he wrote that Zheenbekov had accused him in the press of organizing an assassination. The scandal went no further than this.

Zh. Nazaraliev's election campaign was the strangest and most outrageous: he refused to meet with voters, preferring to communicate with them on the Internet, and announced that he wanted to turn the country into the largest legal producer of opium. He was called Mussolini for the image he projected in his agitation leaflets and posters.

As for candidate T. Umetalieva, her election campaign was the most passive. She did not meet with voters, did not make any sweeping statements, did not hold any debates with her rivals, did not criticize the president, and no one saw her agitation leaflets or posters almost right up until the election. She did occasionally appear on TV, but that was about all.

As for all the candidates and their election campaigns as a whole, journalists, analysts, and voters alike called them the most innocuous in the entire history of independent Kyrgyzstan. The impression was created that they had no intention of running for president and so there was no way they could even hope to win.

Atambaev went to the election knowing he would not win or even make it to the second round. He evidently hoped to be able to conspire with Bakiev to obtain certain economic or political advantages for himself, his closest supporters, and his relatives. Sariev's goal was to try his luck as candidate this time with his sights set on the next parliamentary, and then presidential, elections. It is possible that he also hoped to gain some favors from Bakiev. Nazaraliev's motives defy understanding. The successful physician and businessman, who is not associated either with the southern or the northern clans and who shocked the voters with his absurd statements, obtained no more than 3% of the votes. He claimed that it was his concern for the country and his native people that prompted him to run for president, but this did not really ring true. T. Umetalieva was easier to understand: she was simply confirming and enforcing her image as the only woman candidate for president and one of the leaders of the civil sector.

Untapped Potential

There was little to distinguish the presidential candidates' election campaigns. Nazaraliev's shocking proposal to make Kyrgyzstan a legal opium producer hardly counts. For the most part, the candidates did not put forward any precise programs either. They limited themselves to criticism of the powers that be and vague promises of a bright future—carrying out economic reforms, creating additional jobs, raising wages, lowering prices, observing human rights, providing free medicine and secondary education, and so on.

Initially, A. Atambaev, the candidate from the united opposition, had more chance than his rivals (not counting Bakiev). But his limp election campaign brought him only 8% of the votes, although he could have achieved a better result. This may have been because of the scandals associated with his

name, particularly when he appeared at meetings with voters either ill or with a hangover and gave his speech from behind the backs of two stalwart bodyguards.

None of the candidates took advantage of the errors of judgment and blunders the authorities made last year. For example, in the spring of 2008, the country was threatened with an energy crisis—there was not enough water in the reservoirs feeding the powerful hydropower stations not only to generate electricity for export, but even for domestic needs. The government introduced an electricity-saving regime. Even the country's capital (Bishkek) was left in the dark, not to mention the small towns and villages. The authorities said that climatic conditions were to blame for the water shortage. But most meteorologists, water engineers, and scientists believe that unskillful management of the country's hydropower resources was the core of the problem.

By the beginning of the election campaign the population had still not forgotten about the electricity problem that made life difficult for almost 10 months. But the opposition did not try to use the people's discontent as a trump card in the political game.

Nor were the candidates able to conduct a normal election campaign, since they were loath to spend money on it, believing it to be pointless. Bakiev's opponents could have also taken advantage of his unfulfilled promise to Russia in February to remove the American airbase, Manas, from the republic's territory. For changing his mind he received a two-billion-dollar loan for building hydropower stations and 150 million dollars in aid that went directly into the budget.

The impression is created that Kyrgyzstan is willing to become the ally of any state for money. And this does nothing for its international prestige.

Results

At the very beginning of the election campaign, Norma, an independent sociological service in Bishkek, carried out a voters' poll. Fifteen hundred respondents took part in the survey and it covered all the regions of the country. A total of 7.88% of the respondents voted for A. Atambaev as future president. His comrade-in-arms and at the same time rival within the opposition T. Sariiev gathered 6.08% of the votes. Physician Zh. Nazaraliev suited 1.5% of the respondents as head of state, while N. Motuev was in favor with only 0.5%. T. Umetalieva did not feature in the survey at all. And, finally, 61.5% of the voters were ready to vote for the current president, Kurmanbek Bakiev. Two point eight percent of the respondents voted against all.

On 27 July, the Central Elections Committee sent documents to the Constitutional Court of Kyrgyzstan on the election results. They were deemed legitimate. Seventy-nine point one percent of the voters (2,329,115 people) participated in the voting. The current head of state, Kurmanbek Bakiev, obtained 76.12% of the votes at the election. This result surprised even his supporters, they were counting on approximately 65%.

Second place went to the only candidate from the opposition, leader of the Social-Democratic Party, A. Atambaev, who gathered 8.41% of the votes. His "sworn friend," leader of the Ak-Shumkar party, T. Sariiev, obtained 6.74%. The only woman candidate, head of the NGO and NCO Association, T. Umetalieva, unexpectedly took an honorable fourth place with 1.14% of the votes. Leader of the Zhoomart movement, former coal king, N. Motuev, did not even gather 1% (0.93%). Physician Zh. Nazaraliev took up the rear with only 0.83% of the votes.

Quite a high percentage of the electorate, 4.66%, voted "against all."

It was clear even before the election that the opposition would try to declare the voting illegitimate, organize pickets and meetings, and lodge a complaint in court about Bakiev's use of the administrative resource. Western observers could have revealed serious violations during the election campaign.

What Will Happen Now

According to the constitution, Bakiev does not have the right to run for another term. It is still too early to tell how he intends to hold onto power: will he repeat the political move made by former Russian president Putin or will he think up something else? One thing is clear, the president is already beginning to prepare the ground for retaining control over the country after his presidential term ends. The question only remains—how?

Perhaps President Bakiev and his entourage will try to reinforce their achievements. Most likely there will be a gradual advance on the civil sector, human rights and nongovernmental organizations, and private mass media structures. Intensification of the authoritarian trends will be presented to the population as a necessary condition of survival in the conditions of the world crisis and political instability. At the same time, there will be an advance on the opposition. Those sanctions that were already applied to its leaders (arrests, exile from the country) may be supplemented by routing of the Social-Democratic Party or its gradual transformation into a pocket party. In the future, it may even occupy a liberal position with respect to the government.

Other opposition forces that united less than a year ago into the Oppositional People's Movement (OPM) to run for the election are unlikely to be able to remain united and will go their separate ways. The most radical of them (if they survive) might try and create a new, more consolidated bloc that will fight for seats in the parliament at the next election. This will require united opposition to the repressions that will most likely begin after a relatively quiet post-election period.

Preparations must be made for the next elections to the Zhogorku Kenesh. The Social-Democrats could become the second largest party in the parliament, but their position was severely undermined after the presidential election.

Until they started making statements in favor of an early presidential election, the leading party tolerated them and there were no particular differences between them, which cannot be said for Ak Zhol itself. Now, however, it is very likely that the members of another party will take the place of the Social-Democrats.

It is possible that some members of Ak Zhol, who are allegedly dissatisfied with the party's policy, will leave it and create a new political union which certain inactive oppositional and liberal organizations may join. This new formation may be able to replace the rebellious Social-Democrats. In actual fact, however, it will be a new, albeit pro-Bakiev "pet" or "pocket" party.

Another alternative is that T. Sariev's Ak-Shumkar party will take the place of the Social-Democrats. He did not criticize President Bakiev or the current authorities at the election. But by refusing to support Atambaev as the only candidate from the opposition and deciding to run independently he can hardly call himself a full-fledged oppositionist. Many believe that his passivity during the election campaign was prompted by his desire to find a niche for his party in the parliament. In five years' time, when Bakiev's term ends, he will most likely try to become president.

Whatever the case, Bakiev will form an obedient parliament and will not want to quit his position of power. In order to retain control over the country, he will need all the levers of power that can help him to solve this task. He is unlikely to try and remain president for a third term—the constitution prohibits this. But it is very likely that Kyrgyzstan will become a parliamentary-presidential republic in which the prime minister has great powers. Bakiev will most likely want to occupy this post and this will require obedient deputies in the Zhogorku Kenesh.

There are also other possible alternatives for the current president to hold onto power.

By all appearances, Bakiev's foreign policy will not change. He has become convinced that he can maneuver between the superpowers, managing to retain smooth relations with everyone. Today he is buoyed by the euphoria of having won the election.

In fact, some time must pass before it can be understood whether Russia has accepted the fact that the American base is still in Kyrgyzstan.

And how will China react, which is continuing to carry out a policy of non-interference and “smiling diplomacy”? So far this shows its tolerance and simple contemplation of what is going on. But we should not think that China liked how Bakiev, ignoring Russia, deceived his SCO colleagues by entering a new agreement with the U.S. on creating a Transit Shipment Center instead of the Manas airbase.

Before the election Bakiev declared a course towards retaining strategic partnership with Russia and supporting good-neighborly relations with neighboring states, particularly Kazakhstan, Uzbekistan, and Tajikistan. Specific statements have still not been forthcoming with respect to China’s relations with the West. There are no comments about relations with the U.S., nor have Moscow’s and Washington’s positions been determined.

Whatever the case, no abrupt changes should be expected in foreign policy. There will no strict orientation toward one country in particular. A multi-vector policy seems to be the optimal alternative for the government.

Normal relations with the U.S. and China are not as important for Kyrgyzstan as its relations with Russia. Bakiev was taking a risk when he decided to go for deceit with respect to the airbase, and it is still not clear whether Moscow has forgotten about it. Bakiev will most likely have to answer for this behavior at some point.

Bakiev should keep in mind that another false step could have serious consequences, because an unpredictable response from Moscow or Beijing could lead to serious problems.

Nor should we forget that 30% to 40% of the republic’s GDP is made up of migrant workers’ money transfers from Russia, while China accounts for 80% of the country’s foreign goods turnover. Sending work migrants home or clamping down on cross-border trade could lead to the economic and political collapse of the current regime. Kyrgyzstan, as the only post-Soviet member of the WTO, makes good earnings on the transit of cheap Chinese goods.

The Kyrgyz authorities have not been placing special importance on relations with the European Union so far, particularly since they are not as well developed as those with neighboring countries and Russia. But now, after the successful “transactions” with Moscow and Washington, Brussels may come up against uncompromising Bishkek, particularly with respect to observing democratic freedoms and human rights. Bakiev has already been humored by Washington choosing to ignore the strengthening of autocracy and flouting of democratic freedoms in the republic in exchange for deployment of the airbase. So it will be very difficult for Europe to hold talks with Kyrgyzstan.

REGIONAL SECURITY

THE GEORGIAN-RUSSIAN CONFLICT, ENERGY PROJECTS, AND SECURITY OF THE BLACK SEA-CASPIAN REGION

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The Russian-Georgian conflict of August 2008 should be regarded as part of the general geopolitical and geoenergy situation in the Caspian-Black Sea region, its causes and consequences being extremely important for many actors. Rooted in the past, it is closely connected with what was going elsewhere, Kosovo's independence proclaimed in February 2008 in particular.

I have written this article to offer my analysis of the 2008 events, reveal their impact on the energy situation and security in the Black Sea-Caspian region, and provide recommendations on how to diminish their negative impact on Ukraine.

I intend to discuss the causes that led to the crisis and its consequences.

I shall pay special attention to the positions of third sides and forecast possible developments.

The subject remains topical because the events of August 2008 directly affected the security of the Black Sea countries, their energy cooperation, and their relations with the European Union.

What happened in the summer of 2008 has become the subject of an academic discussion about the frozen conflicts in the Black Sea region which involves academics from post-Soviet states, Europe, and America.

Some of them are more interested in the causes and consequences; others in the roles of the third players in the region; while still others concentrate on individual aspects (ethnic, historical, military, political, etc.).

This subject remains inadequately studied, its discussion being limited to scattered comments and media reports even though the developments

in any of the GUAM countries are directly related to Ukraine's security.¹

The Caucasus Institute for Peace, Democracy and Development, the International Crisis Group, the Center for Civil Society Studies, the South Caucasian Institute of Regional Security,² and others have already produced well-founded analyses of their own.

The writings of those who look into the problem as part of the wider regional context of energy security inevitably affected by the conflicts in Georgia, Moldova, and Azerbaijan—S. Cornell, N. Kassenova, and T. Marketos—deserve special attention.³

Many in the expert community are convinced that the Russian-Georgian war and the 2009 gas conflict between Russia and Ukraine are interconnected as parts of Russia's larger plan to destabilize the region. Russia is determined to prevent NATO membership for Georgia and Ukraine, mar their image in the world, and promote energy transportation routes bypassing the two countries.

The impact of the Russian-Georgian confrontation on the energy-related Black Sea con-

text has two dimensions: transportation of Caspian energy resources across Georgia (the Odessa-Brody-Plock oil pipeline and the White Stream gas pipeline) and its influence on the Russian projects (the North Stream gas pipeline, the Burgas-Alexandroupolis oil pipeline, etc.).

The Russian Federation is deliberately misinforming the world about the Nabucco project in an effort to promote its pet South Stream project. In November 2008, Russian Ambassador to the European Union V. Chizhov said that, as distinct from the South Stream, Nabucco has no fuel sources.⁴

The disintegration of the Soviet Union made some of the former republics (Azerbaijan, Kazakhstan, and Turkmenistan) fuel-rich countries; they, however, have neither the transportation infrastructure to reach the world markets nor access to the open seas.

Transit across Russia was the only option. Foreign investments solved the problem because it was abundantly clear that politically these states depended for their sovereignty on access to the world markets.

The United States enthusiastically supported alternative gas and oil pipelines from the Caspian and Central Asia. Washington regarded them as an anti-monopoly rather than an anti-Russian effort which ensured fuel deliveries to Europe.

The Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline added vigor to the cooperation among Azerbaijan, Georgia, and Turkey involved in other infrastructure projects and boosted their economies. This created new alternatives for delivering fuel to Europe and gave Nabucco the chance of being further developed.

The BTC pipeline and the Nabucco agreement of 2006 designed to move Turkmenian and Azeri gas across Georgia and Turkey undermined Russia's monopoly in this sphere. The pipelines running outside Russia can be described as a challenge to its geopolitical ambitions.⁵

¹ See: G.M. Perepelitsia, *Genezis konfliktiv na postkomunistichnomu prostori Evropi*, Stilos—PP Foliant, Kiev, 2003 (in Ukrainian); H.A. Karasar, "Saakashvili Pulled the Trigger: Turkey between Russia and Georgia," *SETA Policy Brief*, No. 20, 2008; Z. Süslü, "Georgia at a Glance; Abkhazian and South Ossetian Conflict," *IBSU International Refereed Multi-disciplinary Scientific Journal*, No. 1, 2006; Y. Yakis, "The Black Sea and the Georgian Crisis," International Center for the Black Sea Studies, *Policy Brief*, No. 10, December 2008.

² See: *After August 2008: Consequences of the Russian-Georgian War*, The Caucasus Institute for Peace, Democracy and Development, September 2008; V. Kulik, "Konfliktogennyi potentsial Yuzhnogo Kavkaza kak sistemnyi vyzov natsionalnoi bezopasnosti Ukrainy," *Ukraina v mire. Ekspres-ekspertiza*, No. 5 (63), 2008; Yuzhnokavkazskii institut regionalnoi bezopasnosti, available at [<http://www.scirs.org/>].

³ See: S. Cornell, "Pipeline Power. The War in Georgia and the Future of the Caucasian Energy Corridor," *Georgetown Journal on International Affairs*, Winter/Spring 2009; N. Kassenova, "Kazakhstan and the South Caucasus Corridor in the Wake of the Georgia-Russia War," *EU-Central Asia Monitoring*, No. 3, January 2009, available at [<http://www.eucentralasia.eu/>]; T. Marketos, "Eastern Caspian Sea Energy Geopolitics: A Litmus Test for the U.S.-Russia-China Struggle for the Geostrategic Control of Eurasia Caucasian," *Review of International Affairs*, Vol. 3 (1), Winter 2009.

⁴ See: "Posol Rossii pri ES ne vidit istochnikov gaza dlia 'Nabucco,'" available at [<http://www.unian.net/rus/news/news-284159.html>], 13 November, 2008.

⁵ See: S. Cornell, op. cit.

The choice for the Central Asian and Caspian states is limited to the Georgian and Russian transits.

In January-February 2009 the expert community seemed to agree that the events in Georgia and the gas squabbles between Russia and Ukraine were interconnected.⁶ It was commonly believed that Russia was out to prevent European and Euro-Atlantic integration of Ukraine and Georgia and to demonstrate to the European Union that it was still in control in the Black Sea region.

⁶ See: "Gazovyi konflikt—eto prodolzhenie rossijsko-gruzinskoi voyny," available at [<http://www.unian.net/rus/news/news-295234.html>], 15 January, 2009.

Some Russian experts, V. Iakubian of the Kavkaz analytical center being one of them, think the same.⁷

They, however, blamed the two events on the United States which spared no effort to prevent greater regional roles for both the European Union and Russia.

In the security sphere, defrosting of the post-Soviet conflicts, inflated separatist sentiments, redistribution of the spheres of influence in the region, and the possibility that the territories of third countries might be used as a theater of war (the RF Black Sea Fleet problem) remain the main threats.

⁷ See: "SShA nachali rozygrysh ukrainskoi karty," available at [<http://vlasti.net/news/33443>], 8 January, 2009.

Going Back to the Roots. Why Did the Situation in South Ossetia and Abkhazia Become Exacerbated?

The Russian-Georgian confrontation goes back to the mid-1990s; since that time relations have been deteriorating for the following reasons:

- (1) the CIS "peacekeeping" contingent staffed with Russian military was never neutral and sided with the separatists;
- (2) it took a long time for Russia to remove the Soviet military bases from Georgia;
- (3) there were continuous clashes at the borders between Georgia and the separatist regions;
- (4) Russian passports were issued to people in Abkhazia and South Ossetia;
- (5) a railway between the RF and Abkhazia was built illegally;
- (6) a visa regime was introduced between the two countries;
- (7) numerous "spying" incidents were exposed;
- (8) the Rose Revolution broke out and support was rendered to the Orange Revolution in Ukraine;
- (9) Georgia favored an Euro-Atlantic orientation;
- (10) Russian citizens who served in the power-wielding structures were appointed to top posts in South Ossetia and Abkhazia;
- (11) economic sanctions and an embargo on export to the RF of Georgian agricultural products and wines were introduced and transport and postal communication was discontinued in 2006;

(12) alternative pipelines—the BTC, Baku-Tbilisi-Supsa, White Stream, Nabucco, etc.—were built.

Four key factors shape Russia's ideas of the post-Soviet expanse:⁸ NATO's eastward expansion; alternative fuel transportation routes; the Color Revolutions in Georgia and Ukraine, and Kosovo's independence.

On the eve of the NATO Bucharest summit in April 2008, the RF leaders made several statements to the effect that NATO membership for Georgia and Ukraine would threaten Russia's national security and that the RF was prepared to go to all lengths to prevent this.

This was registered in the Foreign Policy Conception of the Russian Federation issued in July 2008.⁹

Independence of Kosovo proclaimed in February 2008 stirred up the separatists in Georgia and Moldova. The "Kosovo precedent" was actively exploited to settle the frozen conflicts in the Black Sea region. Russia was dead set against Kosovo's independence, which makes its decision to recognize, in September 2008, the independence of Abkhazia and South Ossetia very strange indeed.

The West, which failed to substantiate the uniqueness of the Kosovo case (about which much was and is being said), allowed the Black Sea separatist areas to describe their situations as absolutely identical.

Certain elements of the international background of the Russian-Georgian conflict tuned down the international response and played into Russia's hands: high oil and gas prices which rapidly replenished Russia's stabilization fund, EU dependence on Russia's energy fuels, and Germany's active support of the North Stream project.

The talks on the Iranian nuclear file, in which France, the U.K., the U.S., the EU, and Russia are involved, can be described as another important factor. The sides failed to agree on the methods to be used; yet they, the United States in particular, wanted better relations with Russia.

The fact that Ukraine and Georgia were denied the MAP at the Bucharest summit in April 2008, mainly through Russia's diplomatic efforts, was important, as well as the political instability in these countries, the presidential campaign in the United States, which had reached its peak, and the opening of the Olympic Games in Beijing. They added more nuances to an already complex situation.

The events of August 2008 put the West in a quandary: it failed to act promptly and resolutely and to correctly assess what the Russian and Georgian leaders were doing.

On 6 March, 2008, the Russian Federation ignored the decisions passed by the CIS on introducing economic sanctions against Abkhazia and South Ossetia and instead deepened its cooperation with the two regions. In May 2008 and later, Russia carried out several military exercises in the Northern Caucasus, some of them close to the Georgian borders (Kavkaz-2008) and naval military exercises in the Black Sea.

South Ossetia was not a random choice; until 2008 the situation in Abkhazia was even worse. In 2007, however, Sochi (Russia), separated by 100 km from Sukhumi (Abkhazia), was selected as the venue of the Winter Olympics 2014. This meant that further exacerbation could cost Russia the Olympic Games, which might be moved elsewhere for security reasons. More than that: Russia's image would be tarred; it would be deprived of investments in infrastructure and the possibility of tapping Abkhazian resources. North Ossetia, part of the Russian Federation, was expected to extend its support.

⁸ See: *After August 2008: Consequences of the Russian-Georgian War.*

⁹ [<http://www.kremlin.ru/text/docs/2008/07/204108.shtml>], 12 July, 2008.

In March 2008, President Saakashvili offered Abkhazia another settlement alternative under which the breakaway region would enjoy wide autonomy inside Georgia, a free economic zone, and the right to veto the most important decisions and constitutional changes; it was planned to create a vice-presidency.

Sukhumi declined the plan; in July 2008, the leaders of South Ossetia, in turn, declined the offers extended by Foreign Minister of Germany Steinmeier to expand international involvement in the talks. In fact, this amounted to putting the brakes on the negotiations and on the quest for ways out of the frozen conflicts in Georgia.

In July 2008 Russia launched large-scale military exercises Kavkaz-2008 which ended on 2 August. The troops, however, were not returned to the places of their permanent garrisoning; they remained in North Ossetia. Early in August fire exchange was registered at the border between Georgia and South Ossetia that remained unexplained; this urged President Saakashvili to move troops into South Ossetia.

On 8 August Russia deemed it necessary to move its troops into South Ossetia under the pretext of defending its citizens. There is information, however, that its troops had entered the territory of Georgia a day earlier, on 7 August, which poses the question about who started the war. Several days later Russian troops entered Abkhazia.

The week of hostilities and the brokerage of the European Union represented by President Sarkozy ended with the signing of the 6 Points Agreement which envisaged: discontinuation of the hostilities; stationing of European observers on Georgian territory and Russian military bases on the territory of both separatist areas; and their independence recognized by Russia on 26 August, 2008.

It should be said that the agreements were repeatedly violated.

From the very beginning Russia, with no official evidence, accused Ukraine of extending military support to Georgia in the form of illegal weapon supplies. This provocation intended to undermine Ukraine's positive image in the international weapons markets; indeed, there were no bans on arms trade with Georgia, while its cooperation with Ukraine went on under officially signed contracts.

There are main versions of why the confrontation took place:

- (1) Russia wanted to stem NATO's eastward expansion and preserve its domination in the post-Soviet expanse.
- (2) Russia tried to undermine Georgia's role as a transit country for Caspian gas and oil and reduce to naught the efforts to set up alternative energy routes (BTC, Baku-Tbilisi-Supsa, the Baku-Tbilisi-Erzurum gas pipeline, and the White Stream project). This means that Russia is striving to establish its monopoly over fuel supplies to Europe.
- (3) Georgia's desire to attract the attention of the international community, NATO and the EU in particular, to the problem of the unsettled conflicts and "Russia's inadequate actions" in order to join NATO as promptly as possible.

An Analysis of the Main Dangers and Risks Created by the 2008 Russian-Georgian Crisis

There are obvious dangers and risks for the entire Black Sea region and for Ukraine as its part.

The region is running the risk of much more vigorous separatist activities in the breakaway areas of Moldova and Azerbaijan; there are security threats to the transportation routes and pipelines and even the danger of suspended fuel supplies from the Caspian.

Ukraine runs all these risks aggravated by the disagreements over the status of the RF Black Sea Fleet, the possibility that the South Ossetian plot may be used in the Crimea, the problems with the White Stream project, etc.

The Russian Federation spares no effort to denigrate Ukraine and Georgia as reliable transit countries for fuel deliveries to Europe by stressing both countries' inadequate actions in crises.

The Russian-Georgian conflict has bared the decision-making mechanism in Russia. I have in mind Premier Putin's leading role and his personal impact on the country's domestic and foreign policies. In fact, during the entire campaign Moscow denounced the president of Georgia, who it has been displeased with since the 2003 Rose Revolution, but never the country or the people

Early in September 2008, in his interview to the Italian RAI TV Channel, President Medvedev said that Russia believed that "the current regime was bankrupt; President Saakashvili no longer existed for Russia, he was politically dead."

The Russian-Georgian conflict affected the energy security of the Black Sea region as well.

The Russian army and its actions demonstrated that the infrastructure and transportation routes going across Georgia were very vulnerable. In the wake of the hostilities some of the investors withdrew from the Caspian fuel transportation projects, which slowed down Nabucco's progress.

In future, Kazakhstan and Turkmenistan can start exporting their fuel to China instead of Europe, which will increase Europe's dependence on Russian fuel export.

It should be said that America and Georgia intend to improve the security of energy transit to the European markets; they stated their intentions in the Strategic Partnership Charter the sides signed on 9 January, 2009 in Washington.

Positions of Third Sides

The fact that the CIS and SCO members did not support Russia's armed actions against Georgia and refused to recognize the independence of Abkhazia and South Ossetia is very important. It is even more important that Belarus, the closest post-Soviet ally and satellite of Russia, refused to act on Moscow's orders. More than that: from that time on Minsk began drifting toward the European Union.

Even though the final declarations of the Moscow CSTO meeting held on 5 September, 2008 supported Russia's actions against Georgia, the CSTO members refused to recognize the independence of the former Georgian regions.

The 2009 Russian-Ukrainian gas conflict was triggered by the inflated gas prices; earlier, in August and September 2008, Russia, which had been courting Turkmenistan and Uzbekistan, signed gas contracts with them based on European prices. It never expected them to go down by the end of 2008.¹⁰

Armenia, the key Russian partner in the Caucasus, found itself in a difficult situation. Isolated by its conflicts with Azerbaijan and Turkey from the rest of the world, it has to rely on Georgia for its

¹⁰ See: "Russia and Uzbekistan Agreed that Gas Prices Would Be on the European Level," *RIA Novosti*, 2 September, 2008.

contacts with other states. It had no choice but to supply materials and engineers to restore the railway bridge destroyed by Russian troops and to save its good relations with Georgia by refusing to recognize Abkhazia and South Ossetia.

The Russian-Georgian conflict bred fears that Russia might repeat the script in Moldova. In practical terms this is impossible because while South Ossetia borders on the Russian Federation, the Transnistria borders on Moldova and Ukraine. The latter supports Moldova's territorial integrity and will never let Russian troops across its territory. The South Caucasian variant can be used for political pressure.

Moscow might put pressure on Chisinau by insisting on the Kozak (or any other) Plan, which envisages that the Russian military contingent will remain in the region for the next 20 years.

It should be said that, contrary to the official position of its leaders, part of the Ukrainian population especially in the South and East approved of what Russia had done. This is primarily explained by the higher level of confidence in Russia's TV news; the political confrontation on home turf; and the pro-Russian parties that demonstrated much more activity.

The position of Turkey was not an easy one: on the one hand, it is connected with Georgia by oil- and gas-related projects. It invests heavily in Georgia's infrastructure and economy. On the other hand, it is one of Russia's most active partners both in the energy (the Blue Stream) and naval spheres (they prevented expansion of the NATO-led Operation Active Endeavor to the Black Sea).

In mid-August 2008, immediately after the South Ossetian events Premier of Turkey Erdoğan met Premier of Russia Putin and President Medvedev as self-appointed broker. He also met President Saakashvili who later said that "fraternal Turkey" had extended the largest share of humanitarian aid to Georgia and had promised to help restore Gori.¹¹

Having lost de facto the status of a peacekeeping country after the Georgian events, Russia demonstrated its involvement in other frozen Black Sea conflicts. On 2 November, 2008, the presidents of Armenia and Azerbaijan met in Moscow where they signed a declaration on peaceful settlement of the Nagorno-Karabakh conflict.

On 18 March, 2009, the president of Moldova met the head of Transnistria in Moscow; none of the sides wanted a compromise yet it was decided that the talks would be revived in a 5 + 2 format.

This means that Russia does not intend to retreat from its position in post-Soviet conflict settlement even though no results have been achieved so far. Russia wants to remain the only leader and is trying to keep the OSCE, the Minsk Group, Ukraine, and others away.

The Moscow declaration on Nagorno-Karabakh merely reconfirmed the earlier stated principles.

The Moscow meetings were accompanied by a well-orchestrated media campaign which stressed Russia's leading role and its successful peacekeeping and intermediary efforts.

The position of the European Union deserves special mention. This was the first time that Brussels paid attention to the Black Sea conflicts and became openly involved in them as an intermediary. It was as late as 2007 that the EU published its Black Sea Synergy, a document that paid little attention to the frozen conflicts and said that confidence-building measures should suffice to invigorate cooperation. The events of August 2008 demonstrated that defrosting is dangerous for Georgia and the region as a whole, as well as for the European Union.

France, which chaired the EU represented by its president, actively interfered; this showed the world that for the first time the EU had acquired a common foreign policy position in relation to the Black Sea region. At the same time it made serious concessions to Russia: the European Union feared its pressure in the energy sphere. This is confirmed by the fact that Russia never fulfilled the peace agreement and avoided sanctions.

¹¹ See: UNIAN [<http://www.unian.net/ukr/news/news-267261.html>], 14 August, 2008.

Forecasts for the Future

The situation around South Ossetia might develop according to two scenarios:

- (1) it might unify with North Ossetia to become part of the Russian Federation;
- (2) the situation in North Ossetia might be destabilized in order to tear it away from Russia and unify it with South Ossetia to form an independent state.

The second scenario looks very doubtful because power in Russia is highly centralized and the region's extremely low social and economic level will hardly allow it to form an independent unified state of the Ossets.

It seems that unification of both Ossetians, which will become part of the Russian Federation, looks realistic. Abkhazia might return to Georgia as an autonomy with the widest possible rights. This is possible for the following reasons:

- (1) ethnically South Ossetia differs from the rest of Georgia and is identical to North Ossetia;
- (2) the South Ossetian elite is controlled by Moscow which finances the state and its functions;
- (3) South Ossetia has never concealed its desire to join Russia;
- (4) South Ossetia does not have the resources, well-developed infrastructure, or economic prospects indispensable for an independent state;
- (5) Abkhazia never wanted to become part of the Russian Federation;
- (6) since Sochi is so close to Abkhazia Russia will do its best to avoid destabilization in Abkhazia;
- (7) before Russia's interference, the Abkhazian leaders were prone to accept wide autonomy;
- (8) the Abkhazians do not constitute an ethnic majority in the republic; with the return of the refugees Georgians will predominate.

The question of recognition of Abkhazia and South Ossetia as independent states is very important. Today Russia and Nicaragua (partly) have recognized them. This idea was suspended after the CSTO Moscow meeting in September 2008. There is the opinion that Russia is deliberately not insisting on their international recognition in order to preserve its monopoly and special relations with both republics.¹²

Conclusions

The Russian-Georgian crisis revealed the actual sides in the conflict; it shifted the talks from the Georgia-South Ossetia and Georgia-Abkhazia format to the Georgia-Russia format. This is confirmed by the fact that the European Union spoke to Moscow rather than to the heads of the unrecognized republics. Russia sent in its troops without the resolution of any international organization, which made it a participant in the conflict rather than an intermediary.

¹² See: "Nikolai Zlobin: Rossii ne nuzhno mezhdunarodnoe priznanie Abkhazii," *Ekho Moskvy*, available at [<http://www.echo.msk.ru/blog/nzlobin/547385-echo/>], 17 October, 2008.

August 2008 revealed the lengths to which Russia is prepared to go to prevent Euro-Atlantic integration of the Soviet successor states. In March-April 2008 it limited itself to sharp statements; in August it showed that it was prepared to act.

The European Union is out to play a more active role in the Black Sea region, but it is constrained by inner contradictions and its unwillingness to quarrel with Russia. This is partly confirmed by its prompt return to the talks on a new agreement suspended in August 2008; it failed to insist on placing its observers in Abkhazia and South Ossetia and on the strict adherence to the 6 Points Agreement.

In August 2008 it became clear that the struggle for the energy transportation routes from Central Asia and the Caspian might leave the limits of the economic sphere to assume political and even military dimensions which should be taken into account by those who are charting the routes.

MEDVEDEV-SARKOZY'S SIX POINTS: THE DIPLOMATIC ASPECT OF THE SOUTH OSSETIAN SETTLEMENT

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The August 2008 events in South Ossetia marked an important stage in the recent history of the Southern Caucasus: they changed the course of the region's sociopolitical life and have become the axis of the very complicated relations among the biggest international players.

The conflict settlement was achieved through a fairly long diplomatic struggle, which faithfully reflected the relations among Russia, the United States, and the European Union.

Below I offer an analysis of the diplomatic aspect of the South Ossetian settlement.

Mikhail Saakashvili's Stratagem

The tension between Tskhinval and Tbilisi, which cropped up early in 2008, had developed, by August, into a series of armed provocations and clashes. In a diplomatic effort to defuse the situation

Russia relied, very much as before, on the Joint Control Commission for the settlement of the Georgian-Ossetian conflict (JCC); Tbilisi, which refused to back off from its South Ossetian position, made these efforts futile.

Back in March 2008, Georgia, dissatisfied with the balance of votes in the JCC (one Georgian against three from the South Ossetian “lobbyists”) left the structure. This was obviously done to elbow Moscow out of the regional decision-making. This plan required a much worsened situation; Russia’s image as an intermediary should have been discredited. Between March and August 2008, Georgia consistently destabilized the situation in South Ossetia.

Late on 7 August, 2008, America’s interference somewhat stabilized the situation; the Georgian side announced a unilateral ceasefire.¹ Russian diplomats convinced the sides to meet for talks on 8 August outside the JCC on the condition that the Commission would remain the only negotiation format.²

Tbilisi, on the other hand, insisted that the negotiation format should be revised. Deputy Foreign Minister of Georgia G. Vashadze was expected in Moscow with an alternative crisis settlement. It looked as if the talks could be restarted.

At about 01:00 a.m. on 8 August, Tbilisi moved forward with a surprising statement that it had to abandon the ceasefire because of the shelling of Georgian villages from Ossetia. Simultaneously, Georgia responded with fire from its side of the border.

In September 2008, Dana Rohrabacher, deputy chairman of the U.S. House Foreign Affairs Subcommittee on International Organizations, Human Rights, and Oversight, said at the Congress hearings that, according to intelligence, Georgia had opened hostilities in South Ossetia.

Moscow, while fully aware of Tbilisi’s military preparations, was still caught unawares. Having agreed on talks with South Ossetia with Russia’s brokerage, Georgia detracted the attention of Russia’s leaders and its diplomatic service. Tbilisi obviously expected that the international community, whose attention was riveted on the Beijing Olympic Games, would be very slow to respond. The Georgian leaders sided with the West, which wrongly dismissed Russia’s military machine as weak and inefficient and its leaders as lacking determination. It seems that Georgia, which was actively seeking NATO membership and very aware of America’s support, expected to find itself under an unofficial security umbrella.

The military operation might also be provoked by certain American political circles out to test Russia’s military potential in the region.

Even if Tbilisi’s expectations came true, the Georgian army should have acted promptly, while the Georgian diplomats should have gained the support or at least the neutrality of the leading powers and international organizations. The blitzkrieg, however, failed: by 02:00 p.m. on 8 August only part of the planned operations had been completed. The morning raid by Russian aviation confirmed Russia’s intention to interfere.

Tbilisi was forced to move to the “humanitarian” stage of bringing constitutional law and order to South Ossetia: it announced that Georgia had allocated 50 million lari (over \$35 million) to implement humanitarian measures in South Ossetia.³

At 03:00 p.m., the Georgian authorities announced that they would cease fire if the Ossetian side lay down their arms before 06:00 p.m.; the Tskhinval population was invited to move toward Gori along a humanitarian corridor via Ergneti.⁴ By that time Georgia no longer controlled the situation.

¹ [<http://www.regnum.ru/news/1037918.html>].

² See: *Kommersant*, 8 August 2008.

³ [<http://www.regnum.ru/news/1038309.html>].

⁴ [<http://www.regnum.ru/news/1038398.html>].

The Georgian diplomats were much more successful: they ensured direct support from some of the Western countries and the neutrality of the rest. The U.S. Department of State promptly responded with a demand that Moscow put pressure on the South Ossetian leaders to make them cease fire in the conflict zone. Tbilisi was merely admonished to demonstrate restraint.

The European Union's response was more adequate: Secretary General of the Council of Europe Terry Davis pointed out that the number of casualties was increasing and called on the sides to cease fire.⁵ Georgia, however, was not condemned.

Russia's Foreign Ministry likewise tried to appeal to the international community in an effort to convene an extraordinary sitting of the U.N. Security Council. Moscow described Georgia's actions as "perfidious."⁶

For this reason the Russian leaders officially refused to talk to the president of Georgia; the RF Foreign Ministry still hoped that the UNSC would stop Tbilisi.⁷

The UNSC declined the Russian draft of the South Ossetian resolution: Georgia and the United States refused to accept the point that obligated the conflicting sides "to renounce the use of force." Russia's foreign partners preferred the wait-and-see policy, which would have allowed Georgia to complete its operation of bringing constitutional law and order to the breakaway republic.⁸

Russian diplomats avoided direct contacts with Tbilisi and remained engaged in talks with the United States. Vladimir Putin, who was attending the opening ceremony of the Olympic Games in Beijing, met with President George W. Bush to discuss the South Ossetian developments. The American president responded to the Russian premier's comment that "there is a war going on in South Ossetia" by saying that nobody wanted a war. The U.S. Department of State tried to move in as an intermediary.⁹

Tbilisi alone was quite satisfied with Washington's concealed intention to keep Russia away in order to permit Georgia restore its territorial integrity by force. In a series of telephone conversations with U.S. Secretary of State Condoleezza Rice, Russia's Foreign Minister Sergey Lavrov explained Russia's position in so many words: "In full accordance with the Constitution and the laws of the Russian Federation, President of Russia Dmitry Medvedev intends to defend the lives and dignity of Russian citizens."¹⁰ This undermined Washington's intended brokerage.

Russia launched its military operation in diplomatic isolation. Early on 8 August it became clear that the Russian peacekeepers had been fighting Georgian troops; this fact could not be ignored. About midday Russian aviation delivered the first strikes on Georgian territory, which demonstrated Russia's firm determination. At 03:30 p.m. the media published a statement President Medvedev made at a meeting of the RF Security Council: "We shall not allow our compatriots to be killed with impunity. Those who are responsible for that will be duly punished."¹¹ Russian units entered South Ossetian territory.

The Georgian leaders found themselves in a difficult situation, which called for a new strategy. Late in the evening of 8 August in his interview to the BBC, the president of Georgia, when asked whether he was prepared to withdraw from South Ossetia, answered: "Why should I withdraw troops from Georgian territory? This is our territory and we demand an immediate ceasefire. I want international mediation. I want delimitation of forces under international control."¹²

⁵ [<http://www.regnum.ru/news/1038344.html>].

⁶ [<http://www.kavkaz-uzel.ru/newstext/news/id/1226781.html>].

⁷ [<http://www.regnum.ru/news/1038051.html>].

⁸ [http://www.ng.ru/world/2008-08-08/100_nato.html].

⁹ [<http://www.nregion.com/txt.php?i=25419>].

¹⁰ [http://www.ng.ru/world/2008-08-08/100_dialog.html].

¹¹ [<http://www.vremya.ru/2008/143/52/209641.html>].

¹² [<http://www.regnum.ru/news/1038612.html>].

This clarified Georgia's tactics: while the military would be keeping the already gained positions at all costs, the Georgian diplomats would be trying to force Moscow, by hook or by crook, to halt and let the international intermediaries move in. Success would have allowed Georgia to change the line that separated the conflicting sides: it would have gone along the border between the Java and Znauri and Tskhinval districts; otherwise Russia could at least have been excluded from the talks.

On the diplomatic front Georgia was fighting for international, especially American, compassion. On 8 August, Mikhail Saakashvili made it clear by saying: "This is no longer Georgia's headache. This is closely related to America and its values. We are a freedom-loving nation that has been subjected to a military attack."¹³

The White House limited its support to a prompt relocation, by U.S. military transportation aircrafts, of Georgian units (about 2 thousand) from Iraq. The U.S. Department of State spared no effort to extend the widest diplomatic support to Tbilisi. As the hostilities unfolded, Russian-American relations rapidly dropped to their lowest point since the Cold War.

The European Union sided with the United States. The EU members demanded that the sides discontinue the hostilities and go back to the negotiation table, but none of them raised the issue of fundamental importance for Russia: the Georgian forces should be pulled back to the 7 August line. The Americans and Georgians, however, never managed to knock an anti-Russia coalition together. Germany and France had long been mutely displeased with Washington's foreign policy. The East European allies (Poland, Ukraine, Lithuania, Latvia, and Estonia), however, willingly joined the bandwagon. Their support, however, did not go further than anti-Russian invectives.

Under Western pressure the RF Foreign Ministry remained firm and continued calling on the international community to come up with an adequate assessment of Georgia's actions so that to force it to pull out and sign a non-use of force agreement.

The U.N. Security Council was the main battlefield; the tension reached its height on 10 August when the United States presented an anti-Russia resolution at the third sitting on the South Ossetian conflict. The resolution failed, but the world was able to watch a heated argument between the permanent representatives of Russia and the United States.

The EU Brokerage

On 9 August it became clear that Georgia was moving rapidly toward a military defeat. The West realized that Georgia could not resist Russia. In the evening of 8 August, the "shadow CIA" (Stratfor Intelligence Corporation) said that when Russia moved in, the rest of the world was left guessing as to where it would stop.¹⁴ On the other hand, nobody expected the Russian troops to move forward that fast and that far.

On 10 August the Georgians evacuated the Znauri and Tskhinval regions. The process was accompanied by talks between the two countries at the foreign ministry level, at which it was agreed to create two "humanitarian corridors" to allow refugees to leave South Ossetia.¹⁵

The Georgian side initiated a telephone conversation between Sergey Lavrov and Eka Tkeshelashvili on evacuation of the Georgian forces from the conflict zone.¹⁶

¹³ [<http://www.nregion.com/txt.php?i=25449>].

¹⁴ [<http://www.rian.ru/world/20080808/150215484.html>].

¹⁵ [<http://www.regnum.ru/news/1039028.html>].

¹⁶ [<http://www.regnum.ru/news/1039130.html>].

On the same day the representative of the RF embassy in Georgia was handed a note that said in particular: "The Foreign Ministry of Georgia announced that it is prepared to start immediate talks with the Russian Federation on discontinuation of the hostilities and ceasefire. All armed forces have been removed from the conflict zone."¹⁷

By that time the sides were no longer listening to one another, while the United States became a de facto side in the conflict. A mutually acceptable peace initiative was urgently needed.

France, which was chairing the European Union, shouldered the mission with a great chance of success since the U.S. Department of State had been unwilling to act as an adequate and impartial participant in the conflict settlement. The foreign policy ambitions of the French president promised success.

His plan consisted of three points: an immediate ceasefire; Georgia's complete territorial integrity, and a return to the 7 August line.

Moscow could hardly agree to this since Tbilisi had entirely lost its confidence. The RF Foreign Ministry responded with: "The current humanitarian catastrophe does not allow us to pull out the support units."¹⁸

However, the French president offered the best of the available Western alternatives. On 10 August the presidents of Russia and France spoke twice over the phone; it was agreed that President Sarkozy would come to Moscow. The Russian leaders' firmness bore fruit: it looked as if the settlement would take Russia's interests into account.

France was waging a complicated diplomatic game of its own. On 11 August the president of Georgia signed the peace agreement presented to him by foreign ministers of France and Finland B. Kouchner and A. Stubb. The document contained ceasefire provisions, demanded a pull out to the 7 August positions, and envisaged international presence in the conflict zone. In addition, it described Moscow as one of the sides to the conflict, and this could never be accepted by Russia. The document lacked Moscow's central demand: non-use of force, which Sergey Lavrov pointed out when talking to Alexander Stubb.¹⁹

On the eve of the Moscow talks, France was obviously out to deprive Moscow of a leeway. Moscow, however, refused to accept the document of 11 August as the final settlement; it was obviously not enough to keep Russia within the limits the European Union had tried to enforce on it. France made an attempt to push a three-point resolution through the UNSC: immediate ceasefire; immediate evacuation of the Russian troops; and Georgia's territorial integrity. Russia refused to accept the draft, which said nothing about the non-use of force.²⁰

To soften Russia's position the president of France had to publicly approve of Moscow's demands in a communique placed on the Palais Elysée website.²¹ President Sarkozy's efforts bore fruit: a peace settlement of 6 points was signed on 12 August:

1. non-use of force;
2. stop all military action;
3. free access to humanitarian aid;
4. Georgian troops return to their previous positions before the conflict;
5. Russian troops return to the lines they held before the start of the military operation and the Russian peacekeepers take on an additional security role until an international solution is reached;

¹⁷ [<http://www.nregion.com/txt.php?i=25524>].

¹⁸ [http://www.ng.ru/world/2008-08-09/100_putin.html].

¹⁹ [<http://www.regnum.ru/news/1039851.html>].

²⁰ [<http://www.kavkaz-uzel.ru/newstext/news/id/1227070.html>].

²¹ [http://www.ng.ru/world/2008-08-12/8_sarkozi.html].

6. An international discussion starts over the future status of South Ossetia and Abkhazia.²²

The French dropped the point that spoke of Russia as a side to the conflict, which can be described as a great success of Russian diplomacy. On 14 August the RF Foreign Ministry pointed out once more that the peace settlement of the Georgian-Ossetian conflict is a “Russian and French initiative;” the two capitals invited the sides to the conflict “which, as is generally known, are Georgia, South Ossetia, and Abkhazia,”²³ to support the settlement.

The document contained no reference to Georgia’s territorial integrity; instead it mentioned “an international discussion over the future status of South Ossetia and Abkhazia;” this was another diplomatic success for Moscow. The Russian side made it more or less clear that there could be no return to the past.²⁴

President Medvedev suggested that the Abkhazians and South Ossets should be given the right to decide where and how to live. He used the example of Kosovo to argue that sovereignty was much more important than unstable territorial integrity.²⁵

The president of France explained that he had to retreat on the issue because it was impossible to deal with all the issues together, some of which should be put away for future settlement.²⁶

This can be described as the first success of European diplomacy; it laid a document on the table to be discussed. From that time on the diplomatic struggle shifted to the legal sphere: one of the three alternatives—Russian, Georgian, or European—was to be accepted as legally binding.

The tug-o’-war began as soon as President Sarkozy arrived in Tbilisi. The words “an international discussion over the future status of South Ossetia and Abkhazia” were lost in the process while the accent was shifted to the international negotiations related to the regions’ security.²⁷

The presidents of Russia and France agreed on the changes over the phone while on 13 August Foreign Minister of Russia Lavrov pointed out that the “phrase about providing South Ossetia and Abkhazia with steadfast security means that it cannot be achieved outside the status context.”²⁸

While the sides went on with their comments on the agreement it became increasingly clear that they interpreted many of the points differently, the greatest controversy being caused by the format of the peacekeeping operation. The president of France insisted that the status of the Russian troops stationed in the conflict areas of Abkhazia and South Ossetia should be determined later while the other points should be immediately fulfilled. The European side hinted that it regarded Russia as a side to the conflict. On 13 August the foreign minister of Russia stated in no uncertain terms that Moscow would never alter the format of peacekeeping operations in Georgia as a matter of principle but was prepared to accept a wider international presence realized by U.N. and OCSE observers.²⁹

Accepted by the Russian and Georgian sides, the Medvedev-Sarkozy plan was passed on to the EU foreign ministers. From the start some of the EU East European members sided with Georgia and insisted on holding a special summit to “condemn Russia’s aggression.”

France, as the EU chairman, did not convene the meeting until Russia declared that the operation had been completed and the agreement approved. Lithuania, Latvia, Estonia, and Poland, supported by the UK, insisted that Russia should be punished for its “disproportionate use of force.” They

²² [<http://www.ccun.org/News/2008/August/>].

²³ [<http://www.vremya.ru/2008/147/52/210494.html>].

²⁴ [<http://www.vremya.ru/2008/146/52/210365.html>].

²⁵ [<http://www.regnum.ru/news/1040476.html>].

²⁶ [http://www.ng.ru/politics/2008-08-13/100_sarkozy.html].

²⁷ [<http://www.kavkaz-uzel.ru/newstext/news/id/1227152.html>].

²⁸ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1011126>].

²⁹ Ibidem.

remained in the minority. The majority sided with Alexander Stubb, who said that the meeting should concentrate on the EU peace mission.³⁰

As a result, the EU sent its observers rather than peacekeepers into the conflict zone. Bernard Kouchner frankly admitted that this was prompted by Russia's ensured agreement. The European diplomats treated the signing of the agreement and its fulfillment as their priority.

On 14 August, having approved the results of the meeting of the EU foreign ministers, Russia invited the presidents of South Ossetia and Abkhazia to Moscow to attend the signing procedure in order to confirm its status of intermediary. Tbilisi was satisfied with the EU's support of its territorial integrity and sovereignty and Brussels' readiness to revise the peacekeeping process.

On 13 August, however, a telephone conversation between the foreign ministers of Russia and Georgia revealed that Tbilisi refused to sign the document until it was approved by U.N. SC. Georgia was especially displeased with the point that said: "Until an international solution is worked out Russian peacekeepers are taking up an additional security role."³¹

At this stage the U.S. Department of State moved forward to take part in the process and caused havoc. The White House obviously intended to take revenge for its earlier diplomatic defeat that cost the United States a place at the negotiation table. By attacking Russia the U.S. intended to neutralize the possibilities offered by Point Five of the Medvedev-Sarkozy plan.

On 14 August, when on a visit to Paris, Secretary of State Condoleezza Rice suggested that the words "an additional security role" needed specification. The French explained that the Russian peacekeepers would control the territory of South Ossetia and patrol the adjacent strips of no more than 10 km in width. The U.S. Secretary of State agreed with this and deemed it necessary to stress that this should be a short-time measure.³²

Tbilisi was very much concerned with the changes in Point Six since the Russian side insisted that security of South Ossetia and Abkhazia was impossible without a final decision on their status. President Sarkozy and U.S. Secretary of State Rice joined forces to convince the Georgian side to sign the document, which, they argued, did not entail automatic recognition of the independence of the two breakaway republics. They both knew that Russia would not sign the agreement deprived of its Point Six. President Saakashvili was further convinced by the statement FRG Chancellor Angela Merkel made in Sochi during her meeting with President Medvedev; she confirmed her adherence to the principle of Georgia's territorial integrity.³³

On 15 August Condoleezza Rice personally brought the document that contained the six Medvedev-Sarkozy principles with her from Paris. Assured of the U.S.'s support, the president of Georgia signed the document; the next day it was approved by President of Russia Dmitry Medvedev.

On the Road toward Recognition

The diplomatic war unfolding around the Medvedev-Sarkozy agreement boiled down to a Russia-America duel in which the sides were pursuing different interests and nurtured different plans.

³⁰ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1011125>].

³¹ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1012528>].

³² *Ibidem*.

³³ *Ibidem*.

The American leaders, who had suffered an obvious defeat and had to listen to Tbilisi's reproaches of "perfidy," were determined to restore the 7 August status quo, which meant that Russia's peace-keeping efforts would be reduced to naught. Moscow was out to promote its interests and the results of the August events confirmed by the Medvedev-Sarkozy agreement.

The American leaders moved forward to threaten Russia with international isolation. On 13 August President George W. Bush declared that because of its actions in Georgia Russia risked being left out of the diplomatic, political, and economic international structures of the 21st century. The White House hinted that Russia might be elbowed out of the G-8 and the club of the industrially developed countries; it might remain outside the WTO and OECD, and the 2014 Winter Olympics in Sochi might be boycotted.³⁴ In connection with the South Ossetian events the U.S. Congress refused to annul the Jackson-Vanick Amendment and support an agreement that allowed cooperation with Russia in the sphere of civilian nuclear power production.³⁵

Simultaneously, America was obviously encouraging Georgia in the military-political sphere. On 13 August the U.S. president announced that his country had launched a humanitarian operation in Georgia with the use of military aviation and the Navy. He demanded that Russia leave the communication lines open for America to carry out its humanitarian projects.³⁶

From 19 August onwards American military transport aircrafts carrying humanitarian aid began landing in Georgia. The White House also announced that American warships loaded with humanitarian cargoes would enter the Black Sea. An attempt was also made by the White House to mobilize the NATO allies.

On 17 August, on board a plane leaving Tbilisi, U.S. Secretary of State declared that NATO would never allow Russia to triumph over Georgia and realize its strategic ambitious designs of undermining Georgia's democracy.³⁷

NATO deputy spokeswoman Carmen Romero promised that NATO would support Georgia and even assured it of NATO membership.

On 19 August the United States gathered the NATO foreign ministers in Washington for a special meeting to discuss the future of the Russia-NATO dialog.

However, the American hopes of the Alliance's concerted anti-Russian position proved futile. The foreign ministers found themselves divided into two camps. The United States, together with some of the Scandinavian countries and the absolute majority of the East European members, closed ranks over serious condemnation of Russia and promptly issuing Georgia the MAP. West European diplomats, the foreign ministers of France and Germany in particular, were dead set against this.

Four hours of heated debates produced a compromise: on the one hand, NATO was behind Georgia as far as its territorial integrity was concerned; on the other, it agreed that the guarantee of steadfast security for the two breakaway regions should be discussed at the international level. The document supported Georgia as a valuable partner and promised to restore its military infrastructure; it also set up a NATO-Georgia commission.

The document described Russia's actions during the conflict as disproportionate and unfit for a peacekeeper and concluded with a statement that the consequences of Russia's actions would be carefully analyzed; no sanctions, however, were mentioned. Nothing was said about a possible curtailment of cooperation within the Russia-NATO Council even though its work was suspended until Russia had fulfilled the Six Points. No exact dates for the MAP for Georgia were mentioned.³⁸

³⁴ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1011329>].

³⁵ [http://www.ng.ru/economics/2008-08-21/4_gazprom.html].

³⁶ [<http://www.regnum.ru/news/1041155.html>].

³⁷ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1013607>].

³⁸ Ibidem.

Despite the document's moderate nature, the promise to rearm Georgia showed that the United States and its NATO allies chose to ignore Russia's interests. Some of the planned joint Russia-NATO exercises had been annulled to let Russia contemplate the dangers of its cooler relations with the Alliance.

Moscow was left with only one option: taking a firm stance in its relations with the United States and NATO. In response to the resolution of 19 August, Russia's Foreign Minister Lavrov accused NATO of siding with an "aggressive and criminal regime" and made it clear that Moscow did not regret the suspension of the Russia-NATO Council.³⁹

The final accord sounded on 20 August when an agreement on the U.S. ABM system in Poland was signed. The RF Foreign Ministry responded with a harsh statement in which it expressed its complete mistrust of the United States as a partner.⁴⁰

On 21 August the NATO Headquarters received a letter from the RF Defense Ministry that informed the Alliance of a complete halt to military cooperation.

Meanwhile, Washington and Brussels needed the Russian Federation for their continued war efforts in Afghanistan. The leading American experts agreed that Moscow held a longer list of potential sanctions against NATO than the North Atlantic Alliance had against Russia.⁴¹

The United States endangered its strategically important cooperation with Russia. It seems that the White House was vexed by its diplomatic defeat while Moscow demonstrated that it could stand up for itself. On the other hand, Washington probably feared that Russia would not withdraw its troops from Georgia.

Meanwhile, Tbilisi and Moscow concentrated on getting confirmation of the Six Points from the UNSC. Georgia tried to shift the discussions onto the French settlement plan to insist on the point about its territorial integrity.⁴²

Russia, in turn, wanted the resolution to repeat the Medvedev-Sarkozy Plan word for word,⁴³ which would have allowed it to launch the Kosovo variant to achieve a new status for South Ossetia and Georgia. The task was not an easy one.

Moscow could count on Paris for support, although the French and their partners were very much concerned with Russia's pullout from Georgia.

On 17 August the French president declared that Russia should remove its troops from all large Georgian cities despite the Medvedev-Sarkozy point about the Russian peacekeepers' "additional security role."⁴⁴ The French Foreign Ministry leaked information into the media that on 17 August President Sarkozy had warned President Medvedev over the phone about the possible consequences if Russia failed to live up to its obligations under the Six Points Agreement. The Russian Foreign Ministry had to denounce this by saying that "Russia together with France is actively working toward a resolution of the U.N. Security Council that should fully register the agreements achieved in Moscow on 12 August." The U.S. and UK, said the statement, are "trying to distort post factum the content of these agreements."⁴⁵

The U.N. Security Council and the meeting of the NATO foreign ministers coincided, which affected the positions of the European allies. The Security Council was offered a resolution, which demanded that Russia should live up to its ceasefire and pullout obligations. Russia had to decline the draft: it insisted that the resolution contain the Six Points signed by Georgia and Russia with French

³⁹ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1013607>].

⁴⁰ [<http://www.regnum.ru/news/1044379.html>].

⁴¹ [http://www.ng.ru/world/2008-08-25/5_sanktsii.html].

⁴² [<http://www.kavkaz-uzel.ru/newstext/news/id/1227280.html>].

⁴³ [<http://www.nregion.com/txt.php?i=25646>].

⁴⁴ [<http://www.kavkaz-uzel.ru/newstext/news/id/1227342.html>].

⁴⁵ [<http://www.regnum.ru/news/1043211.html>].

brokerage. In an effort to return the U.N. Security Council to “earnest efforts to produce a fundamental resolution in support of the ‘six principles of Medvedev-Sarkozy’,” Russia urgently compiled and submitted its draft resolution, which was declined, in turn, on 21 August.

Russia’s European partners were irritated by the fact that Russian troops remained in control of part of Georgia’s territory. Western representatives arrived in Georgia to discover that Russian troops indeed controlled parts of Georgia beyond South Ossetia and the security zone. On 21 August representatives of the PACE and the French ambassador to Georgia were detained at the Russian checkpoint outside Gori; the incident stirred up passions. Instances of the destruction of Georgian military infrastructure after the end of the hostilities were interpreted as disturbing. Military equipment was removed from the republic, military bases destroyed, Georgian warships sunk—the Western states refused accept this as part of the mission of the Russian military formation that had arrived to support the peacekeepers in South Ossetia.

The West was especially irritated with the slow withdrawal of the Russian troops from Georgia, which was completed between 18 and 22 August, three days later than expected.

The European diplomats refused to include the Six Points in the U.N. resolution, and not only because of the slow pullout. The agreement of 12 August was a tactical gambit in a great diplomatic game designed to restore the prewar situation. The European Union needed a ceasefire and troop withdrawal more than anything else.

The fact that on 12 August, when in Moscow, the European diplomats had dropped the point on Georgia’s territorial integrity did not mean that they had abandoned it altogether. The Western partners could not allow Russia to launch the Kosovo variant in Abkhazia and South Ossetia. This left Russia with only one option: unilateral recognition of the republics’ independence.

This did not look tempting: after February 2008, when Kosovo had acquired its independence, Moscow gained a weighty argument in favor of independence of the two republics even though it was clear that none of the leading world players would follow suit. Georgia’s signature under the agreement on the non-use of force, confirmation in the U.N. of the status of the Russian peacekeepers, and an international discussion on the two republics’ political status were much more attractive options. However, these aims have not been achieved.

In fact, Russia was faced with a mission impossible: the European partners started talking about replacing the Russian peacekeepers with international servicemen. America and NATO resolutely promised Georgia that it would receive the MAP in the near future and that its military potential would be completely restored. Meanwhile, Tbilisi refused to adhere to the non-use of force principle, which allowed the West to annul the results of the August war from which Russia had, on the whole, profited.

Having moved Russian troops into South Ossetia and Abkhazia, the Russian leaders had to remain consistent and logical: they had to move on toward recognition of the independence of these states in order to create the legal basis for its continued military-political presence in the region.

While expecting that the international discussion of the future status of the two republics would gain momentum, Russia confirmed the peacekeepers’ positions on the strength of Point Five of the agreement. Moscow increased their numbers and announced that the security line established under the previous agreements had been restored.⁴⁶

On 17 August Russian peacekeepers moved into the Leningori District of South Ossetia previously under Georgian control. A security zone with two lines of checkpoints was organized along the South Ossetian administrative border: the first line ran slightly to the south of the border and had eight

⁴⁶ [<http://www.nregion.com/txt.php?i=25662>].

checkpoints used for observation and reconnaissance. The second line was located on South Ossetian territory; eighteen Russian checkpoints organized into two lines were placed along the border between Georgia and Abkhazia.

Under the pressure of its worsened relations with the U.S. and its NATO allies, Russia changed its intention about the length of the zone controlled by the Russian peacekeepers. On 22 August the RF General Staff extended it to the military airdrome in Senaki (35 km away from Zugdidi) and the southern part of Poti,⁴⁷ thus giving Russia another trump card in its game with the European partners.

On 23 August President Sarkozy thanked President Medvedev for the pullout of the Russian troops and raised the question of their presence in the Poti-Senaki area.⁴⁸ This opened another round of the diplomatic struggle.

The Last Round: The 8 September Agreement

The Western partners harshly responded to Russia's unilateral recognition of the independence of Abkhazia and South Ossetia, however the tension gradually subsided.

On 1 September Brussels hosted an EU summit which condemned Russia but refused to introduce sanctions against it. The EU leaders limited themselves to postponing the talks on a new strategic agreement until the troops were pulled out from Georgia to the 7 August line. This moderation is easily explained by the EU's fear of infringing on Moscow's interests on the eve of the talks about Russia's withdrawal from the buffer zone in Georgia.

On 8 September the talks in Moscow were crowned with a document entitled "Implementation of the Plan of Russian President Dmitry Medvedev and French President Nicolas Sarkozy," 12 August, 2008, which said in part: "Russia will withdraw all of its peacekeepers from the Poti-Senaki line within a maximum deadline of seven days and from the zones adjacent to South Ossetia and Abkhazia within ten days, following the deployment of international mechanisms in these zones, including at least 200 observers from the European Union;" the document also envisaged "the complete return of Georgian armed forces to their bases by 1 October, 2008."⁴⁹

Russia agreed to remove its troops in exchange for Georgia's consent not to use force against Abkhazia and South Ossetia. At the press conference that followed the signing of the document the French president announced that he had brought a letter with him from President Saakashvili that guaranteed the non-use of force.

The next day the EU delegates conducted talks in Tbilisi. The Georgian president agreed with the Moscow document; after signing the Implementation of the Plan, however, he made it clear that his interpretation differed from the Russian: "I have signed the document under which the Russian military will be replaced with international forces." A day later the Georgian Foreign Ministry published a declaration of the President of the European Council and President of the European Commission signed by President Sarkozy and President of the European Commission J.M. Barroso and passed on to President Saakashvili which said that the EU was prepared to deploy international observers on Georgian territory, including Abkhazia and South Ossetia.

⁴⁷ [<http://www.nregion.com/txt.php?i=25880>].

⁴⁸ [<http://www.kommersant.ru/doc-rss.aspx?DocsID=1016134>].

⁴⁹ [http://www.un.int/russia/new/MainRoot/docs/off_news/080908/newen.2.htm].

The situation looked even stranger when on 11 September Giorgi Bokeria, Deputy Foreign Minister of Georgia and an influential member of the Georgian president's closest circle, announced that Mikhail Saakashvili had not signed any other documents except the 12 August ceasefire agreement, also known as the Sarkozy Plan. It seems that the Georgians had fallen victim to Europe's diplomatic maneuvers.

The published declaration was the "carrot" which tempted the Georgian president to sign the agreement of 8 September. He signed a letter (if there was such a letter in the first place), which guaranteed the non-use of force against Abkhazia and South Ossetia. The point about the deployment of European observers across Georgian territory, including the two republics, meant nothing without Russia's signature. The Georgians, realizing that they had been tricked into signing, tried to beat a retreat.

Meanwhile, Russia offered its own explanations about the document signed in Moscow: on 9 September Foreign Minister of Russia Lavrov said that the European Union was the main guarantor of the non-use of force against Abkhazia and South Ossetia. Brussels offered no comment. Despite the obviously vague situation, the Russian troops were removed from the Poti-Senaki line by 13 September.

On 15 September the council of the EU foreign ministers set up an EU monitoring mission in Georgia of 350 people, including 200 observers. On 22 September it was announced that it would open its offices in Zugdidi, Poti, Gori, and Tbilisi. Simultaneously, Moscow confirmed its military-political presence in the region. On 9 September it established diplomatic relations with Sukhum and Tskhinval. On 17 September the sides signed agreements on friendship, cooperation, and mutual assistance.

Conclusion

The military operation Georgia launched on 8 August in South Ossetia upset the stability maintained since the 1990s. Under the pressure of American-Russian rivalry, the two largest players in the Southern Caucasus, the conflict assumed acute forms from the very beginning. Washington was out to deprive Russia of its peacekeeper status and legal justification of its continued military-political presence in the region. Moscow, in turn, fought to the end for status quo in the conflict zone as befitting its interests.

On the eve of the hostilities Russia had retreated on certain points to force Tbilisi and Tskhinval to start talking, which explains why Moscow regarded the war as perfidious and insulting. The attack made direct talks impossible. One of the large international players should have shouldered the task of brokerage; the United States moved in to claim the role.

However, Washington, as a de facto side to the conflict, failed its mission. Russia, which found itself in diplomatic isolation, decided to interfere in the conflict. The armed confrontation between Russia and Georgia was fraught with the region's complete destabilization, which forced the European Union, in turn, to interfere. President Sarkozy's foreign policy ambitions played a certain role too.

France's peace mission was crowned with the six principles of Medvedev-Sarkozy. This was an important step toward the final settlement since it helped to reach a ceasefire and stabilize the situation. The negotiations on the agreement revealed that the Russian and Georgian sides remained in an impasse. The Six Point agreement was adopted thanks to the skills of the European and Russian diplomats, who worded the document in a way that permitted different interpretations.

As soon as the document was signed, an even fiercer diplomatic struggle for legal confirmation of the results of the August conflict began.

The agreement can be described as a great success of Russian diplomacy while the U.S. Department of State suffered a defeat. In an effort to take revenge, Washington did not allow the U.N. SC to adopt the Six Points as part of its resolution. On the other hand, the European Union feared that Russia might launch an international discussion of the future political status of Abkhazia and South Ossetia according to the Kosovo variant. The Russian leaders were forced to unilaterally recognize the independence of the two republics in view of the promises of the U.S. and NATO to restore Georgia's military potential and extend NATO membership to it.

The Agreement of 12 August and Moscow's official recognition of the independence of Abkhazia and South Ossetia provided Russia with a legal basis for its military-political presence in the region.
