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## REGIONAL SECURITY

**REGIONAL SECURITY MECHANISMS  
IN CENTRAL ASIA:  
DEVELOPMENT TRENDS**

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*Introduction*

**S**ecurity regionalization is one of the most striking features of international relations in a world where the formerly clear boundaries of national security are rapidly disappearing. The region is developing into an important factor of universal peace and stability. This, in turn, is largely changing our traditional ideas about the means and methods of national security as a sine qua non of sovereign states' stability.

Security regionalization is itself a direct outcome of such visible trends in the contemporary world as *much more frequent cases of "humanitarian interference" in the internal affairs of states; diminished pertinence of traditional armed conflicts against the background of much more frequent armed conflicts inside states; much higher significance of peacekeeping efforts and the "human security" factor, etc.*

These trends pushed the idea of regionalism to the forefront, demonstrated to all that the so-called sovereign answer to contemporary challenges is ineffective, and put a "collective (regional) response" to such challenges on the agenda.

It is commonly believed that in the 21st century no state can rely on its own forces alone, which means that "collective strategies, collective structures, and an awareness of collective responsibility have become absolutely indispensable."<sup>1</sup>

In this context, the regional mechanisms and institutions of states are treated as effective international legal instruments of peace and security.

<sup>1</sup> "Bolee bezopasny mir: nasha obshchaia otvetstvennost'. Doklad Gruppy vysokogo urovnia po ugrozam, vyzovam i peremenam. Reziume (Ó/59/565)," available at [<http://www.un.org/russian/secureworld/>].

Their usefulness is ensured mainly by internal structuring and the availability of means and mechanisms of conflict settlement (either inter-

state or domestic). These mechanisms and institutions are useful in settling local disagreements in full conformity with the U.N. Charter.

## Central Asia: Regional Security Mechanisms, Their Development and Classification

The death of the Soviet Union, which destroyed the bipolar system of international relations, put an end to the single defense and security system.

It was replaced by a “security vacuum”<sup>2</sup> in which the old security system was either already nonexistent or ill-suited to the new realities, while a new one had not yet been created. The Central Asian countries had to act fast in the new conditions: they badly needed effective institutional and legal security frameworks to be set up as promptly as possible. This meant that the Central Asian states had to cope with the dual task of preserving (or adjusting) some of the old security elements and setting up a qualitatively new security system in the region.

This institutionalized security at two interconnected and mutually complementary levels: post-Soviet and regional (Central Asian), thus enforcing the international legal and organizational relations between the states.

The Commonwealth of Independent States (CIS) ushered in an era of sovereign states. One of the basic documents, the agreement which set up the CIS, said that “*the Union of the S.S.R. as a subject of international law and a geopolitical reality has ceased to exist.*”<sup>3</sup>

Until the mid-1990s, when other regional inter-state structures came into being (the Central Asian Union [CAU], the Partnership for Peace NATO Program, the Shanghai Five, etc.), the CIS was the only “security umbrella” for Central Asia.

The CIS can be described as a unique alliance of states: elsewhere in the world “commonwealths” were set up as “informal clubs” of former colonies based on shared interests.<sup>4</sup>

The Alma-Ata Declaration that created the CIS says that the new structure “is open to all Soviet successor states.”<sup>5</sup> The CIS founders deemed it necessary to point out that “the Commonwealth is neither a state nor a supra-state structure.”<sup>6</sup>

This and similar alliances are loosely subordinated; there are no obligations among them stemming from agreements or other documents; their cooperation is not very structuralized, while decisions are taken by consensus. The CIS organizational structure is much more ramified than that of similar alliances and, as distinct from them, it is a regional agency, that is, a regional arrangement set up in conformity with Chapter VIII of the U.N. Charter.

<sup>2</sup> The term, as a rule, was used to describe the situation in post-bipolar Europe, from which the enemy image disappeared together with the U.S.S.R. and the Warsaw Treaty Organization.

<sup>3</sup> “Soglashenie o sozdanii Sodrzhestva Nezavisimykh Gosudarstv,” available at [<http://www.cis.minsk.by/webnpa/text.aspx?RN=N09100001>].

<sup>4</sup> The British Commonwealth of Nations is an alliance of independent sovereign states which emerged from the ruins of the British colonial empire. Today, it comprises 49 states.

<sup>5</sup> “Alma-Atinskaia deklaratsia Sodrzhestva Nezavisimykh Gosudarstv,” available at [<http://www.cis.minsk.by/main.aspx?uid=178>].

<sup>6</sup> Ibidem.



The CIS is obviously important for regional stability and security; it ensured mutual recognition of the member states and helped them confirm their international-legal status as Soviet successor states on the world arena. It contributed to the international legal foundation of both the post-Soviet and regional security system in Central Asia.

This means that the CIS

- ensured continuity in the field of security and defense;
- prevented a post-Soviet crisis similar to that in Yugoslavia;
- determined the fate of the Soviet nuclear potential;
- put the former Union republics' administrative borders into the international legal context, etc.

Collective structures were a logical response to the regional countries' objective need for *mutual security*. On the one hand, these institutions spoke of regional stability and consistently progressing inter-state relations in Central Asia. While on the other, they were the only correct and necessary step designed to protect the region against the globalization-induced threats and challenges.

The Central Asian states created the institutional foundations of regional security within a fairly short period of their independence and functioning as subjects of international relations.

Today, the region has practically all the necessary multisided security institutions: inter-governmental structures; cooperation programs; contact groups and consultative structures directly related to the collective security and defense systems; pluralist communities; and mechanisms for security dialogs and conflict management. More often than not, such mechanisms are described as either collective security, collective defense, or cooperative security systems as far as their purposes, aims, and tasks are concerned.<sup>7</sup>

For academic purposes, these institutions can be described as traditional and non-traditional regional and other collective arrangements designed to ensure regional security.

Today, the regional agencies with normatively specified aims and ramified organizational structures can be described as the most adequate international-legal security instruments. The Central Asian states regard their involvement in them as one of their foreign policy priorities and one of the main instruments of their integration into the world community.

Practice has shown that international and interstate organizations set up by the regional countries have proven to be the most effective in the regional security sphere.

Security globalization is moving toward integration of non-regional states into the regional security systems; this has been gradually developing into a norm. Regional organizations often move beyond the geographical boundaries of their responsibility to ensure the security of their member states.

This means that the regional security organizations operating in Central Asia can be divided into *intra-regional, mixed, and extra-regional* depending on whether one of the regional states founded the interstate organization, was one of its members, or was involved in any of such organizations.

There are two legal points related to the *intra-regional organizations*: first, such structures are set up by regional states; second, the sphere, scope, and target of direct legal impact are limited to the security issues of the Central Asian countries. The following structures belong to this category: the Central Asian Cooperation Organization (CACO), which merged with EurAsEC in 2006, and the International Fund for Saving the Aral Sea (IFAS).

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<sup>7</sup> See: A.J.K. Bailes, A. Cottee, "Regional Security Cooperation in the Early 21st Century," available at [<http://yearbook2006.sipri.org/chap4>]; B.L. Job, "'Alliances' and Regional Security Developments: The Role of Regional Arrangements in the United Nations' Promotion of Peace and Stability," in: *New Millennium, New Perspectives: The United Nations, and Governance*, ed. by R. Thakur, E. Newman, United Nations University Press, 2000, Tokyo, New York. Paris, and others.

As the only structure set up by all the region's five states, which are still members of it, the IFAS is unique, even though it cannot be described as a regional security institution in the classical sense. In fact, the regional security concept is much wider than the military-political dimension proper, which means that the IFAS can be described as one of the key security agencies of Central Asia. Moreover, it is not merely concerned with the Aral Sea (that is, with regional environmental security); it is also a collective mechanism for settling water-related issues in Central Asia.

The former is undoubtedly an urgent international legal problem of interstate cooperation which directly affects the region's security and stability.

The *mixed regional organizations* form the largest group; they are very important because the Central Asian countries are either among their founders (such as the SCO, CSTO, and CIS) or are officially represented in them (OSCE). Their considerable potential allows this group to remain the most active security agent in Central Asia.

The international legal status of some of these structures is fairly specific in the sense that fighting security threats and challenges in Central Asia is either their main function (CSO) or one of their priorities (CSTO). In other words, from the very beginning these organizations intended to operate in Central Asia.

*Extra-regional organizations* form the third group, in which the regional states are neither founders nor official members.

This does not prevent them from being actively involved in ensuring regional security in Central Asia. The regional activities of the European Union and NATO in the region (in Afghanistan, among other places) are a pertinent example.

## Specifics and Development Trends of Regional Organizations Today

The regional Central Asian organizations have traveled far: in 2001, the Shanghai Five was transformed into the SCO, while the Central Asian Economic Community (CAEC) set up in 1998 on the basis of the CAU was transformed in 2002 into the multifunctional CACO. This shows that the regional security system in Central Asia has reached a new stage in its development.

This has been a progressive phenomenon since, as distinct from their predecessors concerned with individual aspects of regional realities (territorial disputes, border security, and economic cooperation), the CSO and CACO were set up as collective security institutions concerned with the entire range of regional security issues.

The CACO Treaty described the following as its major objectives:

- active cooperation in the sphere of regional security and stability;
- mutual support in preventing threats to the independence, sovereignty, and territorial integrity of the states;
- fighting regional and trans-national crime (drug trafficking, organized crime, illegal migration, and terrorism);
- coordinated and concerted actions in the sphere of rational and mutually advantageous use of water and energy resources;
- cooperation in other spheres of mutual interest.

The SCO and CSTO have gained much more weight, which was promoted by the following events: the merging of the CACO with EurAsEC in 2006<sup>8</sup>; ramification of the SCO's institutional structure by setting up a Regional Anti-Terrorist Structure (RATS) in 2004 and the SCO-Afghanistan Contact group in 2005; Uzbekistan's return to CSTO in 2006, etc. China plays first fiddle in the SCO; this organization is growing even more important because of the Xinjiang Uighur Autonomous Region of China. This region largely affects Beijing's Central Asian policy, which is explained by its common borders with Turkestan and the local people's common ethnic, cultural, and religious roots.

According to statistics, the numerical strength of the Uighurs (the "titular nation" in the Autonomous Region) amounts to between 8 and 10 million. Over 350 thousand Uighurs live in the Central Asian countries (there are 300 thousand Uighurs in Kazakhstan and 50 thousand in Kyrgyzstan).<sup>9</sup> This explains why the SCO as the only regional institution with Chinese presence is regarded as China's main (or even only) international legal instrument in Central Asia.

An analysis of the SCO's development and its basic documents describes it as a Central Asian project.

The Shanghai Five, the SCO's predecessor, played the key role in settling the frozen territorial disputes between China and the former Soviet republics and in formulating the legal security framework in the transborder regions. The following treaties can be described as the major achievements of the Shanghai Five: On Greater Confidence in the Military Sphere in Border Areas (1996) and On Mutual Reduction of Armed Forces in Border Areas (1997), which the parties described "as good experience in strengthening regional and global security and cooperation."<sup>10</sup>

These documents are especially important in the context of regional security because they, first, allowed the Shanghai Five to expand its sphere at the regional level and marked a new stage in its development into a multifunctional regional organization. Second, these documents set up a system of organizational and legal measures designed to reduce military threats and build up confidence.

Confidence-building measures as effective international legal instruments of military-political security were first registered in the CSCE Final Act of 1975. The above-mentioned agreement registered an entire range of confidence-building measures: exchange of observers at military exercises; information about military activities and large-scale troop movements; exchange of information related to armed forces and border guards, etc.

The SCO rests on "two whales"—the economy and security—which can be described as its greatest advantage. The structure operates on the organizational and legal basis of regional economic cooperation. On 14 September, 2001, three months after the SCO Declaration had been adopted, the member countries signed a Memorandum on the Basic Goals and Directions of Regional Economic Cooperation and Launch of Process on Creating Favorable Conditions in the Field of Trade and Investments. There is the Program of Multilateral Trade and Economic Cooperation among the SCO Member States for the next 20 to 25 years adopted in 2003 and the Realization Plan dated to 2004. The Organization has a Deputy Executive Secretary for Economy, a Business Council, an SCO Inter-bank Association, etc.

The Central Asian countries are especially concerned with alternative transport routes within the SCO. Today, Kazakhstan and China are engaged in 12 projects intended to augment their transportation potential; the highway between Tajikistan and China and 600 km of the highway between Andijan and Kashgar (which passes through Osh, Sarytash, and Irkeshtam) have been completed. There are also plans to build a railway along this route.

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<sup>8</sup> Turkmenistan is the only Central Asian state which remained outside the EurAsEC. In October 2008, Uzbekistan suspended its EurAsEC membership.

<sup>9</sup> See: "Troubles across Turkestan," *The Economist*, 18-24 July, 2009, p. 58.

<sup>10</sup> "Sovmestnoe zaiavlenie uchastnikov Alma-Atinskoy vstrechi," 3 July, 1998, available at [<http://russian.china.org.cn/russian/43089.htm>].

The SCO economic dimension obviously meets the national interests of the Central Asian countries.<sup>11</sup>

China is interested in developing an integrated transport system of the regional states; its objective interest is raised not only by possible economic dividends, but also by the desire to preserve stability in politically volatile Xinjiang.

China extended its technical support to the preliminary cost estimate of the Uzbekistan-Kyrgyzstan-China railway. The 974-km long Korla-Kashgar stretch (1996-1999) is the first step toward the more ambitious railway project. The Committee for the Reforms in the Xinjiang Uighur Autonomous Region decided to go on with the railway project as part of the 11th five-year plan (2006-2010).<sup>12</sup>

The military-political aspect of regional security remains the centerpiece of the CSTO responsible for all of its activities; it is building up its anti-terror and anti-extremist components. The objectives are matched by the Collective Rapid Deployment Force of the Central Asian region (CRDF); the Collective Operational Reaction Force (CORF) is being formed; a regional group of armed forces<sup>13</sup> and a single air defense system are planned.

The Collective Rapid Deployment Force of the Central Asian region was set up by a Decision of the Collective Security Council of 25 May, 2001; it is staffed with military units from Kazakhstan, Kyrgyzstan, Tajikistan, and Russia. A military air base was opened in the fall of 2003 in the city of Kant in Kyrgyzstan. In 2004, the Rapid Deployment Force began carrying out annual command post exercises code-named Rubezh.

Back in 2005, the Russian Federation put forward an idea about the CSTO CORF as another step in the same direction. The armed conflict between Russia and Georgia in August 2008 added vigor to the idea and its realization.

In February 2009, a meeting of the CSTO heads of state passed a decision on drafting corresponding documents. Kazakhstan, Kyrgyzstan, Russia, and Tajikistan signed an agreement on the Collective Operation Reaction Force at a regular session of the CSTO Collective Security Council held on 4 June, 2009. Uzbekistan was the only CSTO member that steered away from the agreement with a Special Opinion on the issue.

The CORF pursues at least four major aims: protection of sovereignty and territorial integrity; fighting terrorism, extremism, and drug trafficking; special operations against organized crime; prevention and liquidation of the consequences of natural and technogenic disasters.<sup>14</sup>

A closer look at the above suggests questions about their regional future and implementation.

- The major tasks of the collective forces and the planned regional group of armed forces in Central Asia look similar, which creates certain international legal problems. Both structures are intended, first and foremost, to protect the local states' territorial integrity and sovereignty, which means that their functions are duplicated. We all know that external military threats remain the main threats to territorial integrity and sovereignty, while armed force remains the traditional means of defense.

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<sup>11</sup> According to some analysts, this is a sign that China is seeking economic domination in the SCO expanse, while its policies are described as "aggressive and selfish" (A. Lukin, "The Shanghai Cooperation Organization: What Next?" *Russia in Global Affairs*, No. 2, July-September 2007). There is also the opinion, however, that the SCO's economic importance is an objective trend (see: V. Frolenkov, "Kollektivnoe ekonomicheskoe sotrudnichestvo stran-chlenov ShOS: nachal'ny etap stanovleniia," *Problemy Dal'nego Vostoka*, No. 2, 2007, p. 84).

<sup>12</sup> See: "Novy stary Shelkovy put'," 5 July, 2007, available at [<http://newspaper.kz/print.asp?aid=93202>].

<sup>13</sup> Similar groups have been set up in the European and Caucasian sectors: the Russian-Armenian coalition forces were created in 1996; the Russian-Belarusian, in 1999.

<sup>14</sup> See: N. Bordiuzha, "Finansirovanie chastey KSOR, ikh osnashchenie i snabzhenie budet osushchestvliat'sia..." (interview), available at [[http://www.mamf.ru/odkb\\_mamf/pr/kzv.php](http://www.mamf.ru/odkb_mamf/pr/kzv.php)].

Uzbekistan, one of the main CSTO members, described its position in the Special Opinion, which stems from the CSTO's international legal status as a military-political alliance. The Foreign Ministry of Uzbekistan pointed out in its press release that the CORF, as the CSTO's military component, should be used to repulse external military threats alone.<sup>15</sup>

- Second, CSTO Secretary-General Nikolai Bordiuzha said that the CORF would be used "to localize armed and *border conflicts* (italics mine.—*I.B.*)."<sup>16</sup> This means that it would be used to settle interstate disputes. From this it follows that this does not suit, for objective reasons, the long-term interests of the regional countries: they have not yet completed demarcation of state borders and delimitation of their territories.

There are many other issues, some of them conflict-prone, which require adequate regional handling.

These areas of interstate cooperation might develop into the "Achilles' heel" and create conditions in which some states might meddle in the domestic affairs of their regional neighbors. The CORF is obviously ill-suited to deal with interstate disputes.

Uzbekistan has voiced its disagreement and pointed out that it wants to be sure that the CORF will never, even hypothetically, be used to settle regional disputes.<sup>17</sup>

It should be said that, according to the international legal doctrine, the "collective security" system should deal with both external and internal challenges and threats. However, as distinct from the collective security mechanisms, military-political alliances (the CSTO in this case) cannot be involved in conflict settlement inside the system.<sup>18</sup>

- Third, the CORF's powers overlap those of other CSTO structures; in 2005, all the Central Asian CSTO members became involved in the Coordinating Council of Heads of Competent Authorities on Illicit Drug Trafficking Counteraction of the member states of the CSTO; since 2006, they have been contributing to operative preventive measures to identify the channels of illegal migration and intercept the activities of transborder criminal groups.

In 2003, Operation Channel designed to check illegal drug trafficking became an annual feature within the CSTO. There are plans to transform Operation Channel into a permanent regional anti-drug operation within the CSTO.<sup>19</sup>

- Fourth, to be endorsed by the national parliaments of the member countries, the Agreement should be discussed separately. Under the Law of the Republic of Uzbekistan On International Treaties, agreements related to the country's defense capability need parliamentary approval. The deputies of the Oliy Majlis discussed the Special Opinion of the Republic of Uzbekistan and disagreed with the Agreement's provision that permitted its temporary application even before it was ratified in full conformity with the national procedures.<sup>20</sup>

<sup>15</sup> See: Press release. "K itogam uchastia Prezidenta Respubliki Uzbekistan I.A. Karimova v sessii Soveta kollektivnoy bezopasnosti ODKB i zasedanii Soveta glav gosudarstv ShOS ot 18 iyunia 2009 goda," available at [<http://www.uzbekistan.pl/index.php?goto=985>].

<sup>16</sup> N. Bordiuzha: "Eto budet piatistoronniaia gruppirovka dlia bolshey voyny" (interview), *Kommersant*, 29 May, 2009.

<sup>17</sup> See: Press release of the Foreign Ministry of the Republic of Uzbekistan, available at [[http://mfa.uz/rus/prensa\\_I\\_media\\_servis/press\\_reizi/180609u\\_7.mgr](http://mfa.uz/rus/prensa_I_media_servis/press_reizi/180609u_7.mgr)].

<sup>18</sup> At one time, U.S. Secretary of State Dulles offered the following comment about the role of NATO (an organization close in nature to the CSTO) in dealing with disagreements among its members: "NATO cannot undertake pacific settlements of disputes amongst its members" (*The Department of State Bulletin*, 34/884 (4 June, 1956) 925-26). Quoted from: A. Abass, *Regional Organisations and the Development of Collective Security*, Hart Publishing, Oxford and Portland, Oregon, 2004, p. 38).

<sup>19</sup> See: "Ezhegodny doklad General'nogo Sekretaria Organizatsii dogovora o kollektivnoy bezopasnosti," in: *Dokumenty po voprosam formirovaniya i funktsionirovaniya sistemy kollektivnoy bezopasnosti gosudarstv-chlenov ODKB*, Issue 9, Moscow, 2008, p. 63.

<sup>20</sup> See: "O zasedanii Zakonodatelnoy palaty Oliy Mazhlisa Respubliki Uzbekistan," available at [<http://uza.uz/ru/politics/7009/>].



More than that: this violates the rule of consensus decision-making within the Collective Security Council of the CSTO: under Art 12 of the CSTO Charter, the decisions (except those related to procedure) of the Collective Security Council, the Council of Foreign Ministers and Defense Ministers, and the Committee of the Secretaries of the National Security Councils are made by consensus.

The CSTO is obviously seeking monopoly in dealing with border security; so far only Tajikistan and Armenia have agreements on joint border-guarding with the Russian Federation. All the other members guard their borders independently.

It should be said that there are parallel structures dealing with border issues in the CIS, CSTO, and EurAsEC: the Council of the Commanders of Border Guards of the CIS (set up in 1992) and the Council on Border Issues of the EurAsEC. The CSTO leaders deemed it expedient to transfer the powers related to “collective security in the border sphere” from the EurAsEC to the CSTO.<sup>21</sup>

The CSTO is a collective defense institution; as a military-political alliance it is intended to defend its members against external military threats and oppose the challenges and threats of the day, which means that military force is its main instrument.

As distinct from the CSTO, the SCO is a traditional multi-purpose regional structure; as a collective security system it promotes “more efficient common use of the emerging possibilities and counteracting new challenges and threats.”<sup>22</sup>

The SCO Charter and other founding documents regulate interstate relations in opposing trans-border and other contemporary challenges to security. The SCO jurisdiction is related to the military-political sphere, however its founding documents do not register the right to collective self-defense, that is, the mechanism of the use of force to repulse armed aggression as registered by Art 51 of the U.N. Charter. SCO and CSTO officials respond to suggestions to merge the SCO and CSTO with references to the difference in “their functional tasks.”<sup>23</sup>

At the same time, in view of the current reality, the SCO members are discussing the possibility of joint use of their armed forces to oppose terrorism, extremism, and separatism. There are plans to use armed forces to jointly rebuff large armed bands of international terrorists if they cross into any of the member states.<sup>24</sup> Between 9 and 17 August, 2007, the joint military exercises Peaceful Mission-2007 were carried out in the territories of Russia and China; the exercises intended to create unified methods for dealing with crises, ensuring regional security, and testing whether the armed forces of both countries were ready to carry out these tasks.<sup>25</sup>

The NATO military contingent in Afghanistan (over 90 thousand) which moved into the country in the wake of 9/11<sup>26</sup> can be described as an important element of regional security of Central Asia; today, everything related to the security issues in Afghanistan belongs to the Alliance’s responsibility sphere.

Since 2003, the International Security Assistance Force in Afghanistan set up in December 2001 under a SC U.N. mandate has been under NATO command.

<sup>21</sup> See: “Ezhegodny doklad General’nogo Sekretaria Organizatsii dogovora o kollektivnoy bezopasnosti,” p. 68.

<sup>22</sup> Khartia Shankhaiskoy organizatsii sotrudnichestva, available at [[http://russian.china.org.cn/international/txt/2002-06/12/content\\_2033359.htm](http://russian.china.org.cn/international/txt/2002-06/12/content_2033359.htm)].

<sup>23</sup> “My vziali kurs na transformatsiu ODKB iz voenno-politicheskoy struktury v mnogofunktsional’nuu organizatsiu,”—N. Bordiuzha,” available at [<http://www.kisi.kz/site.html?id=3938>].

<sup>24</sup> See: *Analiticheskie doklady Nauchno-koordinatsionnogo soveta po mezhdunarodnym issledovaniyam MGIMO (U) MID Rossii*, Issue 3 (18), May 2007. Subject: “Shankhaiskaia organizatsia sotrudnichestva i sovremenny mir,” p. 49.

<sup>25</sup> The joint military exercises of the SCO members involved over 6,500 military and 80 aircraft; they were carried out on two terrains: the testing ground of the 34th motor rifle division in the town of Chebarkul in the Volga-Urals Military District (the RF) and in Urumqi, the administrative center of the Xinjiang Uighur Autonomous Region (China).

<sup>26</sup> See: “British Forces in Afghanistan,” *The Economist*, 18-24 July, 2009, p. 26.

This speaks of NATO's growing role in Afghanistan as an important Central Asian security factor. In the other Central Asian countries, NATO completely relies on the Partnership for Peace Program as its main foreign policy instrument. It involves all the Central Asian countries, including Turkmenistan with its "positive neutrality" principle. Tajikistan was the last regional country to join the program in 2002.

According to the Foreign Ministry of Uzbekistan, the republic has already been involved in over 400 events within the program; over 100 scientific and technical projects have been implemented in the republic.<sup>27</sup>

In 2004, NATO created the post of Special Representative for the Caucasus and Central Asia, which was filled from the start by Robert F. Simmons.

Political scientists regard the OSCE as a result of a consensus between the East and the West during the Cold War era<sup>28</sup> and as an important security institution in Central Asia which strives to universalize the goals and tasks of international and regional security.

Together with the IFAS and CIS, the OSCE is one of the three regional structures in which all the regional states are represented. The principles and rules of regional and international security elaborated by the OSCE are registered in international legal documents.

The European Union is the only interstate organization involved in the Central Asian regional institutions system, in which the regional countries are not represented as members.<sup>29</sup>

The European Union maintains its presence in Central Asia mainly in the form of various programs and projects covering a wide range of regional issues. This is, in fact, the cornerstone on which the EU programs rest.

Since 1992, the EU's regional programs have been implemented within the *Technical Assistance to the Commonwealth of Independent States Program* (TACIS); the regional states are involved in the following EU programs: Border Management Program in Central Asia (BOMCA); the Central Asia Drug Action Program (CADAP); Transport Corridor Europe-Caucasus-Asia (TRACECA); Interstate Oil and Gas Transport to Europe (INOGATE), as well as specialized programs for education (TEMPUS) and science (INTAS).<sup>30</sup>

The BOMCA and CADAP programs are the centerpieces of the regional security efforts. The former contributes to the system of border management in the region, while the latter helps coordinate the efforts to curb drug trafficking; its special representative set up his office in Tajikistan.

On the one hand, these programs are intended to consolidate regional stability; while on the other, they help neutralize the challenges to the EU members by creating a security belt of sorts. This means that both are important instruments designed to prevent or, at least, reduce the security risks emanating from Central Asia.

The European leaders are fully aware of the region's importance for ensuring and maintaining stability in the European Union in the long-term perspective. Peter Struck, former Defense Minister of Germany, pointed out: "Germany is also being defended at the Hindu Kush."<sup>31</sup>

<sup>27</sup> [[http://mfa.uz/rus/pressa\\_i\\_media\\_servis/news/040408r\\_5.mgr](http://mfa.uz/rus/pressa_i_media_servis/news/040408r_5.mgr)].

<sup>28</sup> See: E. Chung, "Multiple Regional Security Frameworks for Central Asia," p. 292, available at [[http://www.sejong.org/Pub\\_st/PUB\\_ST\\_DATA/kst005-09.pdf](http://www.sejong.org/Pub_st/PUB_ST_DATA/kst005-09.pdf)].

<sup>29</sup> The European Union is a regional association of European countries set up in 1993 on the basis of the European Communities, an alliance of three formally independent yet interconnected regional economic organizations: the European Coal and Steel Community (ECSC) set up in 1951; the European Atomic Energy Community (Euratom); and the European Economic Community (EEC) set up in 1957.

<sup>30</sup> In 2007, the Central Asian countries were involved in the Development Cooperation and Economic Cooperation Instrument, which replaced TACIS as a result of the reform of external cooperation of the EU Commission and its new Regulation for the period 2007-2013.

<sup>31</sup> [<http://www.spiegel.de/international/germany/0,1518,630090,00.html>].

Table

## The Main Regional Organizations

Organization	Organizational and Legal Status	Regional Affiliation	Membership of the Central Asian States	Foundation Date
CIS	Collective security organization	mixed	All the Central Asian states are founders* (11 members in all)**	1991
CSTO	Collective defense organization	mixed	Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan are founders <sup>32</sup> (7 members in all)	In 1992 CST; since 2002, CSTO <sup>33</sup>
SCO	Collective security organization	mixed	Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan are founders (6 members in all)	In 1996, The Shanghai Five; since 2001, the SCO
OSCE	Cooperative security organization	mixed	All the Central Asian states belong to it (56 members in all)	In 1975, CSCE; since 1994, OSCE
EU	Collective security organization	extra-regional	The Central Asian countries do not belong to it (27 members in all)	1993
NATO	Collective defense organization	extra-regional	All the Central Asian states belong to the Partnership for Peace program (20 partner-states in all)	1949 NATO set up its Partnership for Peace program in 1994
IFAS	Ecological security organization	intra-regional	All the Central Asian states are founders	1993

\* Turkmenistan did not sign the CIS Charter and remained its associated member.  
\*\* Georgia officially suspended its CIS membership.

<sup>32</sup> In 2006, Uzbekistan restored its CSTO membership. Today, it has joined the main documents out of the total 74 envisaged by the Protocol on Uzbekistan's Restored CSTO Membership.

<sup>33</sup> Turkmenistan is the only Central Asian state that remained outside the CSTO. The country's new Military Doctrine adopted in January 2009 bans membership in any military-political alliances. The country, however, is represented in CSTO events. In 2007, the republic's Ministry of the Interior participated, for the first time, in Operation Channel-2007.



## The Non-Traditional Institutions Factor

What place do non-traditional institutions occupy in the Central Asian security institutions?

Since 1994, the Central Asian countries have been involved in the *NATO Partnership for Peace Program*; there is a *Central Asia-Japan Dialog* or *6 + 1*, a format of cooperation at the foreign ministers' level.<sup>34</sup>

In 1997, Uzbekistan initiated *Contact Group 6 + 2* to settle the Afghan conflict.<sup>35</sup>

There is also the *Conference on Interaction and Confidence-Building Measures in Asia* (CICA), a structure patterned on the OSCE designed to achieve political stability in Asia.

This means that various collective structures differ from one another as far as their aims, potential, and the range of instruments designed to achieve regional security are concerned. Non-military, or "peaceful means" predominate: dialog, partnership, confidence, and transparency of military politics.

The absence of the component that presupposes the use of force should not be taken as a sign of inefficiency; this does not diminish the role of these organizations in maintaining peace in the region. In fact, the transborder and complex nature of the current problems and challenges presupposes new approaches: force can be combined with peaceful means.

This suggests that the advantages of these structures should be studied in detail. As a rule, the regional organizations are rooted in common values (as well as interests, problems, and threats); the absence of enmity in mutual relations attracts the states. As distinct from the regional organizations, this element is not an obligatory criterion of cooperation within the non-traditional mechanisms. For instance, India and Pakistan, two countries which since 1947 (the year of their independence) have been at war three times, are both CICA members even though their national security strategies described each other as the main security threat. Their nuclear status, the fact that they border on regional seats of instability, and their confrontation over Kashmir make these countries a security concern for the Central Asian states.

Their cooperation as CICA members is important for stability in South and Central Asia. The Declaration on Eliminating Terrorism and Promoting a Dialog Among Civilizations adopted by the first CICA summit in 2002, as well as the Catalogue of the CICA Confidence-Building Measures and creation of a Secretariat as the CICA's permanent administrative body point to its growing regional role.

These mechanisms are concerned with specific tasks, which can be described as their greatest advantage. The *6 + 3 Contact Group*, for example, is concerned with the Afghan crisis. In fact, Afghanistan's neighbors do not belong, as a group, to any of the regional organizations.

Pakistan and Iran, for example, hold an observer status in the SCO, which is concerned with Afghan settlement among other things.

Only two out of Afghanistan's six neighbors (Uzbekistan and Tajikistan) are members of the CSTO. NATO, in turn, has so far shown no intention of cooperating with the CSTO.

The Economic Cooperation Organization (ECO) does not include China; more than that: it is a trade-economic organization.<sup>36</sup>

In light of the above, the *6 + 3 Contact Group*, which includes all of Afghanistan's neighbors and the conflicting sides and power centers, such as NATO, the U.S., and Russia, looks like the mechanism best adapted to conflict settlement.

From the point of view of the Central Asian states, this mechanism has the following advantages:

- First, it is a Central Asian project designed to achieve peace in Afghanistan as the main regional value;

<sup>34</sup> Azerbaijan is an extra-regional member. The dialogue was set up in September 2004 on the initiative of Japan.

<sup>35</sup> In April 2006, President of Uzbekistan Karimov addressed the NATO summit with a suggestion to transform the *6 + 2 Group* into the *6 + 3 Group* and involve NATO in it.

<sup>36</sup> It is, however, becoming more politically involved. Its latest summit held in Tehran in 2009 discussed, besides economic issues, the Palestinian-Israeli conflict and foreign military presence in Afghanistan.

- Second, Afghanistan's neighbors can be directly involved in restoring regional peace and stability;
- Third, it is an alternative mechanism, which makes it possible to coordinate the efforts of America, China, and Russia in the Afghan direction.

### *In Lieu of a Conclusion*

We should all accept the fact that each of the regional states regards the acts (either cooperative or antagonistic) of its regional neighbors as important determinants of its foreign and security policies.<sup>37</sup>

Their closeness, that is, coexistence in the same region, offers the regional states a chance to establish close ties among themselves, which will lead to more frequent contacts, closer interpenetration and, hence, much more stable relations.

An analysis of contemporary interstate relations in Central Asia shows that regional security mechanisms occupy an important place in the regional context, while their role cannot be overestimated.

Today, the traditional institutions, such as collective security and collective defense structures, dominate the Central Asian security expanse.

The regional states, however, are fully aware of the need to set up a single mechanism of regional security, which means that cooperation in this sphere should be treated as a priority, while the number of members will increase.

It can be said that today the triad of mutually complementary mechanisms described above can offer reliable regional security in this strategically important area.

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<sup>37</sup> See: J.S. Nye, *International Regionalism*, Little, Brown & Co., Boston, 1968, p. vii.

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## AFGHANISTAN: ITS ROLE AND PLACE IN THE INTERNATIONAL SECURITY SYSTEM

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### *Introduction*

**F**or three decades now the country has been struggling for survival amid a never-ending armed conflict that makes a concerted foreign policy course impossible. This is fraught with a loss of statehood and is responsible for Afghanistan's role and place in the international relations system.

## Afghanistan and International Security

The military-political crisis in Afghanistan is echoing across Central and Southern Asia and is spreading its negative impact even further across the world.

Farkhad Tolipov, a political analyst from Uzbekistan, has rightly noted that strategic “friction” in Afghanistan is closely connected with the geopolitical reversal occurring in the Central Asian states. He has written that “friction” makes it much harder to pursue strategic and tactical aims and that, if they are achieved at all, the cost will be enormous. The Afghan crisis is largely responsible for the geopolitical instability in Central Asia, which affects its security.<sup>1</sup>

The foreign policy activities of the Central Asian states and the world community as a whole have to take the Afghan factor into account. President of Uzbekistan Islam Karimov has written: “The deepness and acuteness of the Afghan crisis and its obvious impact on the geopolitical processes at the regional and global levels allow us to describe this tragedy as the largest and the most dangerous regional conflict of our time. The military-political crisis in Afghanistan is inevitably affecting regional stability in Central Asia and Uzbekistan’s national security, in particular, in the most negative way.”<sup>2</sup>

The military-political developments in Afghanistan have deprived the Great Game term of its initial meaning.<sup>3</sup> In the 19th-the beginning of the 20th century, it was the British-Russian struggle; today the number of players has multiplied, while the threats the game produces affect the entire globe. “The game has become too deadly and has attracted too many players; it now resembles less a chess match than the Afghan game of *buzkashi*, with Afghanistan playing the role of the goat carcass fought over by innumerable teams. Washington must seize the opportunity now to replace this Great Game with a new grand bargain for the region.”<sup>4</sup>

What is going on in Afghanistan has already proven beyond a doubt that at the present stage of globalization no armed conflict of any noticeable duration in any state will remain limited to its borders. For several reasons, it will inevitably spread to create, sooner or later, numerous problems for its neighbors and destabilize the region. In these conditions, the attempts to set up and strengthen central power can hardly be consistent and systematic, while state-building efforts are limited both geographically and conceptually.

The above fully applies to Afghanistan: it is an object rather than a subject of world politics even though the world community has accepted it as an independent state with a seat in the U.N. and several other international structures. In other words, today the country is at best an eyewitness or a victim (to a great extent) rather than an active player on the world political scene. Indeed, the most important decisions relating to state-building and its foreign and domestic policies are made by others. All international conferences under the U.N. aegis on postwar settlement that produce agreements between Afghanistan and the world community are held outside the country, in Tokyo, Bonn, London, Paris, The Hague, etc. This testifies to the gravity of the situation inside the country. Any state wishing to establish and develop bilateral relations with Afghanistan has to look at Washington and the European capitals rather than at Kabul. Kabul, in turn, has to concentrate its foreign policy efforts

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<sup>1</sup> See: F. Tolipov, “Strategic Friction in Afghanistan and Geopolitical Reversal in Central Asia,” *Central Asia and the Caucasus*, No. 2 (56), 2009, p. 44.

<sup>2</sup> I. Karimov, *Uzbekistan na poroge XXI veka: ugrozy bezopasnosti, usloviia i garantii progressa*, Izdatelskiy dom “Drofa,” Moscow, 1997, pp. 20, 25.

<sup>3</sup> In the past Afghanistan was seen as a “geopolitical chessboard” of sorts with Russia and Britain moving the chessmen represented by Afghan leaders and groups.

<sup>4</sup> B.R. Rubin, A. Rashid, “From Great Game to Grand Bargain,” *Foreign Affairs*, November/December 2008, pp. 33.

on seeking foreign aid in the form of civilian and military equipment supplied by donor countries. Foreign companies are already involved in economic restoration. The country's numerous religious, ideological and political problems affect the international system on a global scale (illicit drug production and trafficking, illegal trade in weapons, etc.).

On many occasions in the past the conflict became uncontrollable and spread beyond the country to threaten its neighbors. The international community has somewhat remedied the situation and achieved relative stability in the north. In the south, however, the threat of a "spillover" is still real. The situation on the Pakistani-Afghan border creates conflicts between the two countries and leads to disagreements with the United States and other members of the antiterrorist coalition. This happened when the U.S. moved its troops, without consulting Islamabad, to carry out military operations on both sides of the Afghan-Pakistani border (on territory neither country controls).

## Seeking New Solutions

There are two aspects—internal and external—of the problem. On the one hand, the international coalition is still not completely united and stable, which cannot but affect the ISAF operations and the Operation Enduring Freedom; Afghan society is not united either. In September 2008, President of Pakistan Asif Ali Zardari spoke about this at the 63rd Session of the U.N. General Assembly. He pointed out that the scattered American operations in Pakistan were counterproductive and merely exposed all the representatives of the antiterrorist coalition to greater danger from terrorism. The Pakistani military believed that they were taking decisive enough steps to address the problem in the country's north and would cope with it in the next six months. Seen from Washington, however, the situation on the border is going from bad to worse, and there is an urgent need to track the fighters as far as their lairs, including on Pakistani territory.

Joint operations on both sides of the Afghan-Pakistani border (U.S.-Pakistani, Afghan-Pakistani, or U.S.-Pakistani-Afghan) are discussed as a way out of the current disagreements. However, some of the Pakistani military do not trust their Afghan colleagues, seeing them as representatives of the Pentagon and the CIA. On the other hand, certain members of the American and Afghan military establishment suspect that Taliban sympathizers in Pakistani intelligence are guilty of information leaks, which makes joint operations of the special services ineffective.

This means that no decision on joint military operations of the United States, Afghanistan, and Pakistan against the Taliban has been made, even though antiterrorist efforts go on unabated.

Uncontrolled drug trafficking, one of the greatest dangers, is spreading far and wide. According to the U.N., in 1999 Afghanistan accounted for 75 percent of the world's opium production<sup>5</sup>; nearly ten years later it accounted for 90 percent (8 thousand tons).<sup>6</sup> Neighboring territories serve as corridors of opium and heroin trafficking to the CIS countries, Asia, Europe, and North America. Today, drug money is used to pay the fighters, the greatest destabilizing hazard for Afghanistan and its neighbors.

The international coalition is deliberately avoiding the issue: opium poppy provides millions of Afghans with a means of subsistence. Hence the paradox: *the international forces are doing nothing to curb drug production, while this increases tension in Central Asia, which serves as a corridor for illegal trade.* This is driving the coalition's Central Asian allies into a corner: they refuse to accept

<sup>5</sup> See: *Vystuplenie Prezidenta Respubliki Uzbekistan Islama Karimova na sammite OBSE*, Istanbul, 18 November, 1999.

<sup>6</sup> See: *Vystuplenie Prezidenta Respubliki Uzbekistan Islama Karimova na sammite ShOS*, Dushanbe, August 2008.

the argument about drug-related revenue as indispensable for the nation's survival and cannot wait for alternative economic developments in Afghanistan.<sup>7</sup>

In recent years, the Afghan campaign has practically destroyed the country's poorly developed national economy and is interfering with economic contacts on a regional scale. No new transport lines can be laid to provide the Central Asian countries with access to the Persian Gulf and the Indian Ocean. This explains why the Central Asian coalition members want to finally settle the Afghan conflict.

Barnett Rubin and Ahmed Rashid have written: "Seven years after the U.S.-led coalition and the Afghan commanders it supported pushed the leaderships of the Taliban and al-Qa'eda out of Afghanistan and into Pakistan, an insurgency that includes these and other groups is gaining ground on both the Afghan and the Pakistani sides of the border." They deem it necessary to point out: "Al-Qa'eda has established a new safe haven in the Tribal Areas of Pakistan, where it is defended by a new organization, the Taliban Movement of Pakistan."<sup>8</sup> This means that a larger military contingent and more active antiterrorist raids by the Americans might end unpredictably. Many share the opinion that a wider international military presence is causing mounting indignation among the locals, on which the Taliban is capitalizing. This is true in principle, however the scale of "mounting indignation" is not in fact as great as it is made out to be.

I am convinced that this and similar friction situations should not invite a revision of the military presence conception.

In August 2009, the presidential election and its related campaign fanned domestic tension once more; the parliamentary elections scheduled for 2010 are fraught with similar complications.

Some of the world leaders, including U.N. Secretary General Ban Ki-Moon, voiced their concern about the worsening military and political situation in the country caused by the much more active involvement of the Taliban, al-Qa'eda, and other extremist structures. Repeated assassination attempts on Hamid Karzai, terrorist acts in Kabul and elsewhere, and the increased number of attacks on members of the U.N. humanitarian mission and NATO military speak of the mounting aggressiveness of the power-thirsty extremists.

This is a manifestation of another Afghan problem: some think an agreement with the moderate part of the Taliban is possible. If attempted, it will fall through and cause even more disagreements among the coalition members.

On 4 April, 2009, the NATO summit held in Baden-Baden, Cologne, and Strasbourg passed several decisions designed to regulate the situation in Afghanistan. President Obama stated, in particular, that his country would dispatch 17 thousand military to the country; the European leaders promised 5 thousand military, 3 thousands of whom would comprise highly mobile units to ensure the safety of the presidential election. The others would be engaged in training Afghan military and the police.<sup>9</sup>

Barnett Rubin and Ahmed Rashid, however, are convinced that better coordinated diplomatic efforts applied on a regional basis can be described as a much better strategy. The time has come to create a program designed to address several regional and global problems on a greater scale.

The authors believe that the new administration should defuse "the destructive dynamics" of the strategic and military-political rivalry between the world and regional powers over Afghanistan and the influence on the processes around it and that it should pursue its policy within the Contact Group under the U.N. SC aegis. They write that the Contact Group should consist of five permanent member

<sup>7</sup> This is one of the "friction" situations that negatively affect the Afghan campaign (see: F. Tolipov, op. cit.).

<sup>8</sup> B.R. Rubin, A. Rashid, op. cit., pp. 30, 31.

<sup>9</sup> "Summit Declaration on Afghanistan Issued by the Heads of State and Government participating in the meeting of the North Atlantic Council in Strasbourg / Kehl on 4 April, 2009, Press Release: (2009) 045, NATO 04 Apr. 2009," available at [[http://www.nato.int/cps/en/natolive/news\\_52836.htm?mode=pressrelease](http://www.nato.int/cps/en/natolive/news_52836.htm?mode=pressrelease)].

states of the U.N. SC and probably other actors (NATO and Saudi Arabia as a member of the Muslim world which has good contacts both with Pakistan and the members of all sorts of riot groups in Afghanistan), which will strengthen Pakistan's position. Experts are convinced that a constructive dialog in this format will allow the United States and NATO to use Iranian territory as a means of alternative access to Afghanistan in order to lessen their dependence on Pakistan in this respect. The Contact Group could explain to Afghanistan's neighbors that the West is determined to address not just extremism in the region, but also economic development, job creation, the drug trade, and border disputes. This dialog should be further backed by the obligation to promote regional economic integration, including a packet of long-term international aid to the regions that suffered more than others in Afghanistan, Pakistan, and Central Asia, particularly the border areas.

It seems that President Obama was duly impressed: he initiated an international contact group on Afghanistan and Pakistan under the U.N. aegis with the participation of the NATO and Central Asian states, Russia, China, India, and Iran.<sup>10</sup>

It should be said that the initiative did not come as a complete surprise.

In April 2008, speaking at the NATO/EAPC summit in Bucharest, President of Uzbekistan Islam Karimov clearly outlined his position on the issue.<sup>11</sup>

In August of the same year at the SCO summit in Dushanbe, the president of Uzbekistan reconfirmed and specified his position:

1. There is no military solution to the Afghan problem, which is recognized by a growing number of states.
2. The time has come to address the acute social ills, such as destitution and unemployment. Today, all social groups, the younger generation in particular, are seeking means of subsistence as fighters or drug pushers, etc.
3. The confessional and national specifics of the Afghans should be taken into account: this has already been confirmed by all sorts of wars waged by outside forces in this country in the past.

The revived 6 + 2 Contact Group for Afghanistan under the U.N. aegis that functioned in 1999-2001 should be expanded to include NATO, which is actively involved in Afghan settlement.

Meanwhile, old ideas still serve as a guiding light, at least for some experts. Gunter Knabe of Germany, for example, insists that the ethnically variegated country has always closed its ranks, and will close them in the future, against an external enemy. The world community should bear this in mind to prevent resistance to anything that looks anti-Islamic in the eyes of this rigorously devout nation.<sup>12</sup>

This can hardly suggest novel approaches to the old problem.

The international coalition entered a country torn by civil war, which explains why the nation hailed those who removed the Taliban.

It seems doubtful that all Afghans are demanding the withdrawal of the foreign occupants; the reference to the religious factor is not quite correct either: after all, the Taliban ideology proved alien to the traditional way of life. It was also denounced by the Muslim community, the OIC in particular.

This means that the key to Afghan settlement should be sought elsewhere.

<sup>10</sup> K. DeYoung, "Obama Outlines Afghan Strategy. He Pushes Stability and Regional Partnerships," *The Washington Post*, Saturday, 28 March, 2009, p. A01.

<sup>11</sup> See: *Vystuplenie Prezidenta Respubliki Uzbekistan Islama Karimova na sammite NATO/SEAP*, Bucharest, 4 April, 2008 (see also: I. Karimov, *Po puti modernizatsii strany i ustoichivogo razvitiia ekonomiki*, Tashkent, 2008, pp. 240-244).

<sup>12</sup> *Materialy mezhdunarodnoi konferentsii "Afghanistan: problemy stabilizatsii i perspektivy rekonstruktsii"*, Tashkent, 17-18 June, 2009.



*In Lieu of a Conclusion*

- First, we should keep in mind that no compromise on the key issues is possible. The operation seems to have slowed down because the United States, NATO, and the Afghan government tried to reach a compromise with the Taliban, which invariably declined similar approaches in the past.
- Second, the Afghans and the world community should see for themselves that Operation Enduring Freedom is a counterterrorist rather than an anti-Afghan effort. So far, it is simply impossible to wage this war with much better results, fewer losses and fewer mistakes than it is done today. It is much easier to face an enemy than to fight elusive terrorists. The war on terror requires that intelligence efforts be constantly improved and the Afghans offered new and more convincing propagandist arguments.
- Third, any concessions of the Kabul regime will trigger an offensive on all fronts—military, geopolitical, intelligence, ideological, psychological, etc.—which means that stemming the flow of volunteers wishing to join the terrorist ranks should be regarded as one of the central tasks.
- Fourth, S. Khan, a Pakistani analyst, was quite right when he pointed out that, in the eyes of the locals, the distinctions between the coalition forces and the Taliban are being gradually eroded. There is no Afghan administration to speak of at the district level in the south and southeast; the new police are corrupt through and through, while the legislative system is dysfunctional. To cope, the armed forces, meant to merely help the local civilian authorities, have to act instead of the local administrations and assist reconstruction.<sup>13</sup>

The above suggests that the peacekeeping operation of the international coalition in Afghanistan will not end soon. Hasty and rash decisions should be ruled out: the Taliban is capable of a war of attrition to wear down the coalition forces' morale. This means that the enemy should be defeated with a weapon of its own.

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<sup>13</sup> Ibidem.

## REGIONAL CONFLICTS

**GLOBALIZATION OF  
REGIONAL CONFLICTS:  
A FUTURE WAR  
FOR THE UPPER KARABAKH**

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*Introduction*

Globalization in international relations is perhaps best understood in terms of increased interdependence in the international system. This interdependence manifests itself in both economic and military affairs. Since World War II, the United States has been the leading force behind “globalizing” processes: as economic interdependence leads toward more open markets, and military interdependence makes global affairs more peaceful, it has been in the vital interest of Washington to rid the world of isolationist and militarily autarkic powers.<sup>1</sup>

<sup>1</sup> This, of course, includes America’s fights against Nazism and various forms of socialism/communism, as well as its more gentle push to get rid of the “friendly” empires of Britain, France, etc.

With increased interdependence regional conflicts also have become politically globalized. No regional conflict today remains isolated to a particular region despite the fact that very few of them directly affect power hierarchy in the international system. Regional conflicts in part acquire their global significance due to a spread of the phenomenon loosely understood as “soft power.”<sup>2</sup> Since the dominant powers in today’s world are either liberal democracies (the United States, the United Kingdom, France, etc.) or trying to play the democratic game (Russia, China, India, etc.),

<sup>2</sup> “Soft power” is best analyzed and explained in J. Nye, Jr., *Soft Power: The Means to Success in World Politics*, Public Affairs, New York, 2005.



the concepts associated with democratic ideals have become the major currency in soft power transactions. Therefore, regional actors have to pay attention to public opinion and cultural sensitivities prevalent in dominant global powers even though these powers may not be directly affected by regional conflicts. Soft power of public opinion and ideals of international justice and freedom may well push and/or allow hard power to step in to quell or mediate by force a protracted conflict, and this could have disastrous consequences for one or both parties involved in a regional dispute.

The rise of soft power has made such concept as “victory” and “resolution of conflict” more political rather than military phenomena. As the Bush administration found out in 2003, a proclamation of military victory may amount to little if it is not politically endorsed or acknowledged by the others who may have stakes in such an outcome. Substantial dissent in regional or global public opinion may well result in a protracted and rather costly conflict, especially if a proclaimed military victory does not look that decisive.

The “frozen” conflict of the Upper Karabakh between Armenia and Azerbaijan is not and cannot be isolated from globalizing trends. In fact, one could argue that the very fact this and other similar conflicts are frozen reflects the preferences of dominant global powers in the international

system. Violent regional wars go against the notions of global “security,” and “stability,” especially the latter, since it implies, to a large degree, preservation of a status quo. In this sense, national interests of those directly involved in the frozen conflicts may well contradict priorities and interests of those powers who prioritize “stability” in order to better promote interdependence in trade, and predictability in military affairs. Almost everywhere “frozen conflict” does imply closed borders and military stand-off, but even such circumstances would be preferable to damaging upheavals that accompany attempts to regain or conquer lost territories by force.

For better or for worse, the Karabakh conflict is part of the international system, although its eventual direct outcome may only influence power game at a regional level—in the Caucasus and/or Caspian Basin. However, if the parties to this conflict were to resort to military force to solve the Karabakh issue, regional (Turkey, Iran), and global (U.S., Russia) powers will not stay away as the fact of upsetting the status quo itself will affect their interests in some. On the other hand, the regional and global powers are interdependent through positive trade and alliance links or negative military stand-offs, and they will be tempted to gain the upper hand in some of the issues of their mutual interest through an expanded participation in a power game in the Caucasus.

## The International System, Its Complexity, and Interdependence

The international system is a complex system, with its structure and units. The structure displays variation as the interacting units engage each other with distinct patterns as great powers rise and fall, and world order experiences change. Globalization would be one of the many variations of international structure, which currently dominates world affairs, and as such it largely depends on the factor of growing interdependence among the main units of the system.

Kenneth Waltz has outlined the main characteristics of the international system, identifying the units as the nation-states, and distribution of power among them as system’s structure.<sup>3</sup> According to him, the units interact and thus form structure; and the units and structure comprise the system. The

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<sup>3</sup> See: K. Waltz, *Theory of International Politics*, McGraw-Hill, New York, 1979.

latter, however, also influences unit behavior. In other words, the units and the system mutually recreate each other with structure being intermediary; however, obviously they both cannot be the primary source of the other at the same time.

Waltz's explanation of international politics is, perhaps, one of the most advanced and distinct to the date; however, his point on how the system and the units influence each other represents a vicious circle as the system is explained/created by the units, while the system explains/creates unit behavior. In the international system, the idea of unit behavior is not exclusively ascribed to the legally recognized states alone, otherwise called "sovereign nation-states," but includes behavior of various "governments," government-like entities or "poles of power"—they deemed to be affecting structure of the system as well.<sup>4</sup> At the same time, "government" is frequently identified with "the state" as it is assumed that governments and those who speak for them uniformly and universally represent their respective states, and as such are identical with them.

Logic and evidence could suggest otherwise, especially in the times when more and more international issues and actors arise. There must be a distinction made between the state and government (and government-like entities). Such organizations as Hamas or Hizbollah, self-proclaimed entities like Upper Karabakh or Abkhazia, insurgent groups like those in Colombia, Afghanistan or Pakistan clearly are not nation-states, but their behavior in the system significantly affects other actors. In terms of their basic functions, such groups, whether they are terrorist organizations or multinational corporations, perform similar functions to governments—all of them have at least some degree of legitimacy, could exercise power, and conduct policies according to their preferences.

In short, the international system is better described as a unity of "governments" and structures, i.e. a set of organized power centers and distribution of power among them. The international system affects behavior of nation-states, most of which have their central governments as their seats of power, but some may have more than one centers of organized power. "Nation-states" clearly differ from "governments" as they possess recognized and defined international boundaries that contain human societies within them. Indeed, these nation-states represent the main preoccupation for all the "governments"—most of them want to preserve their own, others want to acquire them, still others want to destroy or dismember those headed by rival governments.<sup>5</sup> More often than not states do not act with one voice—that of their governments—and this is more pronounced in non-Western and developing regions of the world where some many national governments are openly challenged by alternative, separatist, rebel "governments" that often times work against interests of the state they are formally part of.<sup>6</sup>

Behavior of the main units of the system, governments, in the international system, thus, produces feedback loops. Often times, centers of organized power or governments act in order to change and/or affect others; however, some effects of their own actions are fed back to them in such a way that their own behavior or make-up could be altered. For instance, Afghanistan's Taliban government's decision to give sanctuary to al-Qa'eda within the geographic space they controlled, and allow them to operate autonomously, eventually resulted into a powerful feedback loop, which saw them deposed from power by the end of 2001.<sup>7</sup> Government leaders and policy-makers frequently consider feed-

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<sup>4</sup> F. Fukuyama, *State-Building: Governance and World Order in the 21st Century*, Cornell University Press, Ithaca, New York, 2004.

<sup>5</sup> See: W. Ettmayer, *Alte Staaten—neue Welt: Stabilität und Wandel in den internationalen Beziehungen*, Trauner Verlag, Linz, 2008.

<sup>6</sup> Such "nation-states" as the Democratic Republic of Congo or Somalia could serve as the best examples of these. In some, international organizations could have almost as much power as locally elected governments; this could be the case, for instance, in Bosnia and Kosovo (that is, if one recognizes Kosovo as an independent state).

<sup>7</sup> At that time, Afghanistan had three main centers of power or "governments": the Taliban regime, al-Qa'eda, and the Northern Alliance cornered by the former two into a northeastern part of the country.

back loops of their own international actions as most realistic people would avoid doing things that may harm themselves and their own groups in the states they are part of.

Feedback loops do not always work the same way, and very seldom they produce the same results. That is, actions by some governments may produce strong feedback against their states, and similar actions by others may not.<sup>8</sup> This suggests that the international system is a non-linear, non-deterministic one. Linear systems always produce effects that are directly proportional to their causes. This may look like a trivial statement, but some social theories, such as Marxism and fascism, assume linear nature of the international system, as well as various conspiracy theories. The international system is anarchic not only because of the absence of the overall system-wide authority, but also because of behavior of its units that defies deterministic logic. Future behavior in such a system could be predicted with a certain degree of accuracy; however, much like long-term weather predictions could be made with a certain degree of precision.

The international system as a complex system was created in mid 17th century Europe by warring princes affiliated with different denominations of the Christian church, but since its structure has evolved and has displayed numerous variations.<sup>9</sup> Governments in charge of nation-states have remained dominant units of the system, but structure of the system or distribution of power has exhibited change and adaptation. The Cold War witnessed structural bipolarity at the global level, preceded by less predictable multipolar arrangements in the international structure. The end of the Cold War and the disappearance of a global rivalry between the Soviet Union and the United States once again gave rise to a multipolar world power structure.<sup>10</sup> The emergence of new multipolarity has coincided with the increased significance of energy resources in international politics, as all wealthy and growing economies are highly oil and natural gas dependant while the world crude oil supplies continue to get diminished.

The international system is an open system as it needs close interaction with and support by other systems, most importantly by natural environment. To sustain or increase states' wealth and power, societies need to extract the necessary resources from the natural environment, and subsequently dump byproducts and refuse of the economic production cycle into the same environmental system. This close and necessary interaction of the international system with natural environment furthers depletion of resources, damage to the environment, and fosters competition for diminishing natural resources among governments. The existing structural arrangements in the international system currently manifest in globalizing trends assume the possibility of and encourage unlimited economic growth, while the natural energy reserves cannot possibly provide unlimited supplies. The contest for limited and diminishing resources coupled with unlimited growth goals also attracts global attention to such seemingly remote and seemingly insignificant conflicts as the Upper Karabakh.<sup>11</sup>

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<sup>8</sup> For instance, in 1995, Croatia was successful at retaking by force its breakaway provinces without much damaging feedback against the Croatian state, while similar attempts by the government of Georgia in 2008 triggered de facto dismemberment of the Georgian state.

<sup>9</sup> R. Gilpin, *War and Change in World Politics*, Cambridge University Press, Cambridge, 1981.

<sup>10</sup> Discussions of a "unipolar world" that occasionally have occurred since the early 1990s do not make sense, just like a notion of a piece of magnet with only one pole does not. Analytical concept of "poles of power" only makes sense if there are at least two of them in active or potential opposition to each other (for instance, see: C. von Clausewitz, *On War*, Princeton, Princeton University Press, New Jersey, 1976, Book I, Chapter 1, or any other authoritative edition of the volume).

<sup>11</sup> Data on world and regional oil and gas production and consumption is frequently published by professional journals, such as *World Oil* [<http://www.worldoil.com/>] and *Oil & Gas Journal* [<http://www.ogj.com/>], governments, such as the U.S. Energy Information Administration [<http://www.eia.doe.gov/>], and those who worry about diminishing supplies drum alarm (see: The Oil Drum, "World Oil Production Forecast—Update May 2009," available at [<http://www.theoil Drum.com/node/5395>]).

## Parochial Interests of International Actors

The Caucasus could be analyzed as an international subsystem. This designation is, of course, theoretical and requires a degree of abstraction in order to consider a collection of units (governments or organized centers of power) as a coherent whole somewhat abstracted from the larger international system.<sup>12</sup> Three sovereign governments, those of Armenia, Azerbaijan, and Georgia, as well as three self-styled entities, Abkhazia, South Ossetia, and the Upper Karabakh comprise this subsystem due to many centuries-old shared history and geography.<sup>13</sup> Since the end of the 18th century, the Caucasian subsystem has been an arena of competition among the three dominant neighboring states, Iran/Persia, Turkey/the Ottoman Empire, and Russia/U.S.S.R. Occasionally, throughout history great global powers have managed to find their way into the regional game, for instance, the British after World War I, and the Americans after the collapse of the Soviet Union.

Few regional processes/phenomena give the Caucasus its global significance.

- First, crude oil reserves found in Azerbaijan designate the subsystem as significant in the context of global energy supplies.
- Second, the Caucasus holds strategically significant location between the Black and Caspian Seas providing the only alternative land-bridge from Europe to Central Asia and back bypassing Russia and Iran. Oil and natural gas fields of Kazakhstan and Turkmenistan add to this strategic and economic significance of the subsystem.
- Third, the frozen/protracted conflicts around Abkhazia, South Ossetia, and the Upper Karabakh globalize regional processes by getting a variety of international players involved.

Those engaged in the region are not limited to world governments, but include international organizations (the U.N., EU, NATO, CIS, OSCE, etc.), a plethora of non-governmental organizations, and international corporations (mostly attracted by oil and gas business). Vast majority of the international actors involved in the Caucasus are more interested in the preservation of the status quo and “stability” than they are in “resolution” of the regional conflicts even though many of them have been sent to the Caucasus with some kind of “conflict resolution” mandate.<sup>14</sup>

Obviously, the international actors in the Caucasus are connected to their respective capitals, most of which are found in the West, and these capitals do carry their own interests and priorities in international relations. Therefore, it should not be unnatural to allow that, to some degree, the internationals involved in the Caucasus are defended by their respective capitals and public opinion, and vice versa, organizations originating from the local societies respond to their respective interests and priorities. Since, no Western capital faces critical circumstances in the Caucasus threatening their own survival or well-being, they generally should be willing to play along with their nationals in the region, the parochial interests of whom should lay in the preservation of the status quo, especially if the existing and future jobs and trade issues are to be upset by a potential conflict. Naturally, one should

<sup>12</sup> For more on the Caucasus as a region comprised of three nation-states, see: L. Tchantouridze, “The States of the Caucasus and their Neighbours,” in: *Coming Together or Falling Apart? Regionalism in the Former Soviet Union*, ed. by S.N. MacFarlane, QCIR, Kingston, 1997; De Ya. Breault, P. Jolicoeur, J. Lévesque, *La Russie et son ex-empire: reconfiguration géopolitique de l’ancien espace soviétique*, Presses de Sciences Po, Paris, 2003.

<sup>13</sup> In addition, one could specifically consider economic links as contributing factor of regional formation (see: V. Papava, *Central Caucasus-Asia (Essay on Geopolitical Economy)*, Siakhle, Tbilisi, 2009, in Georgian; E. Ismailov, “New Regionalism in the Caucasus: A Conceptual Approach,” *The Caucasus & Globalization: Journal of Social, Political, and Economic Studies*, Vol. 1 (1), 2006).

<sup>14</sup> See: O. Ramsbotham, T. Woodhouse, H. Miall, *Contemporary Conflict Resolution*, Polity Press, Cambridge, UK, 2009.

expect much outcry and criticism to be directed against the side to a military conflict, which would be the most likely benefactor of war, and a real or perceived disturber of “stability.” Georgia’s case provides a good example—the European Union sponsored commission essentially blamed Tbilisi for August 2008 war, although the country was invaded by a more powerful neighbor, Russia, and parts of its territory were seized as a consequence.<sup>15</sup>

Similarly, it would be unreasonable to expect Baku to be supported by any significant international actor if it were to try regaining the Upper Karabakh and other lost territories by force. Unless the actors are connected with hard core interests with a potential success by Azerbaijan, even brotherly nations, such as Turkey, are likely to look the other way. Ironically, globalization of a regional conflict also makes it an international business, and as international business benefits more from the preservation of status quos, interests of international actors do not coincide with those of regional players directly involved in the conflict.

## A Future War for the Upper Karabakh

The war for the Upper Karabakh fought between Armenia and Azerbaijan resulted into a self-styled “independent” Upper Karabakh entity with the capital in Stepanakert (Khankendi). Although de facto the Stepanakert region is not distinguishable from Armenia proper, as it has no distinct foreign and defense policy of its own, it still potentially impacts the international sub-system of the Caucasus through its mere presence, and its potential to become a de facto independent entity from Armenia. If future events were to lead to the direction of separation of foreign and defense priorities between Erevan and Stepanakert, Baku will likely benefit from it. On the other hand, if Stepanakert were to remain strictly under Erevan, it could potentially be used by the latter to manipulate its future relations with Azerbaijan and/or other neighbors, which most likely would trigger more hard-line policies from Baku.

Complexities of a tripartite relationship around the Karabakh would be more apparent if military activities to resolve the frozen conflict were to be renewed. In the case of war, the leadership in Stepanakert would be more hard-line than that in Erevan, as they would be the chief recipients of the enemy’s missiles and bombs. They are also more likely to lose if Baku prevails, more than the leadership in Erevan—a protracted war with Azerbaijan would see well-being of their families and supporters erased, not to mention human casualties. Accordingly, the leadership in Stepanakert would be more committed to military defense of their region at all costs than the leadership in Baku would be committed to its recovery as their fortunes will not be threatened as dramatically if Azerbaijan’s offensive fails. The ordinary Armenian inhabitants of the Upper Karabakh would also be more passionate in their opposition to Azerbaijan, and more dedicated to defend their self-styled republic than ordinary Armenians in Armenia proper or Azeris would be willing to sacrifice themselves in the effort to bring the break-away region back. In a future war, Stepanakert’s self-defense forces most likely will be outgunned and dwarfed by Azerbaijan’s armed forces, except that they will most likely receive major help in both manpower and arms from Armenia proper, and other supporters, such as Russia and Iran. Stepanakert and Erevan are more on the same page and rather inseparable when it comes to military forces (unlike their leaderships and population), as without Erevan’s help

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<sup>15</sup> Independent International Fact-Finding Mission on the Conflict in Georgia [<http://www.ceiig.ch/Report.html>]. The title of this commission itself is biased as it does not imply an interstate war between Georgia and Russia, but “conflict in Georgia.”



the self-styled republic's armed forces are not likely to survive the Azeri assault, and the defenses of Armenia proper will become exposed and vulnerable, if the self-styled republic were to collapse dramatically.<sup>16</sup>

No doubt, a renewed war for the Upper Karabakh will find reaction in public opinion and political leaderships around the world. As the Armenians in the self-styled republic will be essentially fighting for their survival, chances are very good that public opinion will sway in their favor, especially if the war drags on, as public opinion generally favors the underdog and sympathizes with those under attack. The political leaderships in both Erevan and Stepanakert will also better manage public relations campaign through separate or joint appeals for help, assistance, peace, ceasefire, etc. than the government in Baku. Stepanakert and Erevan will be better positioned to get support from their traditional allies, Moscow and Tehran, than Baku will get from its only true ally, Ankara. Such support of the Armenian forces would be even more forthcoming and substantial were the Azeri forces to achieve success at initial stages of their campaign.

When it comes to global great powers, especially the United States, they will not likely get involved in the conflict, unless it goes out of control and spreads beyond the issue of the Upper Karabakh, which is a highly unlikely scenario. However, public opinion in the United States will most likely support the Armenian side. Not only the Armenians have a well-established and better organized ethnic lobby in the United States only second to the Jewish lobby, they are also more likely to generate opinions favorable to their cause through their numerous Armenian studies university-based centers, programs, scholars, think tanks, publications, and Armenian-oriented NGOs.

If public opinion in the U.S. and other Western democracies sways in favor of the Armenian side, Baku may well forget about private assurances of help and promises of support routinely made in Washington and other Western capitals. In cases of war, public opinion is the king in Western democracies and very few politicians will risk voicing support for those whom public opinion does not approve.<sup>17</sup> Many may sympathize with the Azeri cause, but if a future military conflict between Armenia and Azerbaijan were to drag on, as it will inevitably do, Western opinion will be on the side of a more familiar party, moreover if it were to face some harsh measures through the conflict or in the aftermath.

It should also be noted that the conditions for a potential military solution of the Karabakh issue will be created by the overall international situation around the Caucasus. If Iran were to be weakened by U.N.-sponsored sanctions (or military reprisals by the U.S.), and/or Russian power undermined by its own domestic strife and/or poor economic, social or demographic conditions, the initial and decisive stages of war may witness larger and forceful involvement of Turkey. Either of these scenarios seeing Iran and Russia weakening dramatically is unlikely in the near future; however, quite possible in the long run: Tehran has not shown any signs of making concessions to the West, and structural weaknesses of the Russian Federation will one day yield their harmful effects on the country. If such circumstances were to arise, Erevan and Stepanakert will not be able to effectively counter a joint Azeri-Turkish onslaught, and that is probably why it is crucial for Erevan to find some kind of common language with Ankara sometime soon.<sup>18</sup>

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<sup>16</sup> When considering possibilities of a future war between Armenia and Azerbaijan, the study of their respective strategic cultures would be an important factor in estimating potential outcomes (see: J.S. Lantis, D. Howlett, "Strategic Culture," in: *Strategy in the Contemporary World*, ed. by J. Baylis, J. Wirtz, C.S. Grey, E. Cohen, Oxford University Press, London, 2007).

<sup>17</sup> Connections between public opinion and war have long been studied in the West. They deemed to be of significance even during less interconnected international structures (see: E. Luard, *Peace and Opinion*, Oxford University Press, London, 1962).

<sup>18</sup> The ongoing rapprochement between Ankara and Erevan has been rejected by some powerful voices in Armenia objecting to giving too many concessions to Turkey (see: "Oskanian Rejects Armenian-Turkey Protocols," *The Civiltas Foundation*, 22 September, 2009, available at [<http://www.civiltasfoundation.org/cf/discussions/227-oskanian-rejects-armenia-turkey-protocols.html>]).

In a new war to erupt around the Upper Karabakh, peacetime diplomatic orientation and activities of Baku, Stepanakert, and Erevan will likely continue only with a more urgent and energetic pace. Peacetime allows the participants of the “frozen conflicts” to adopt a wait and see approach, a luxury which cannot be imagined in wartime. If the Karabakh conflict were to reignite, there is no telling how rash and frantic policies by governments in Baku, Stepanakert or Erevan may influence their respective states (a state-like entity in Stepanakert’s case) and societies. Rash and unwise decisions made in the late 1980s and early 1990s by political leaders in Baku, Stepanakert, and Erevan eventually contributed to deaths of tens of thousands, displacement of more than a million people, and created two decades of abnormal economic conditions in both countries.

## Concluding Remarks— Complexity Remains

The case of the “frozen conflict” of the Upper Karabakh appears to be far from a simple diplomatic or military solution. The conflict has lasted too long, initially as an active military engagement, and then as a frozen one, to allow for a straightforward disentanglement of potentially explosive issues. Interests of international actors are powerfully entrenched in this region as well, and any attempt to forcefully change the status quo will trigger negative feedback loops, and public opinion outcries throughout the world. The Caucasus’ increased interdependence with the outside world plays into the hands of the Erevan/Stepanakert side, and Baku cannot possibly go against this dominant trend in world politics without incurring criticism and damages in the process.

The United States has consistently pushed for interdependence in trade (frequently and commonly dubbed as support for “free trade,” “open markets,” and opposition to protectionism, mercantilism, socialist or pro-Soviet minded governments), and for interdependence in security matters (support for global and regional military alliances, their enlargement, “coalitions of the willing,” etc.). An outbreak of hostilities in the Caucasus would be upsetting to such trends, especially at very delicate junctures in international affairs when the world is facing economic or financial crises or nuclear stand-offs with Iran and North Korea. Strategic significance of the Caucasus region, and the oil reserves that tie it with many threads to the larger international system create an inescapable conundrum for Azerbaijan, for which there is neither a quick answer nor an easy solution.

The satisfactory settlement of the Upper Karabakh issue will most likely be a lengthy and daunting process influenced by shifts in power balance both regionally and globally. Public opinion in Western states, and the ability of the parties involved to influence it, especially in societies of great powers, will also affect the conditions of a potential settlement scenario. There are no longer isolated conflicts or obscure and irrelevant wars in the world—at least for the time being, the world is deeply interconnected through both power relations and information noise.

**GEORGIA-SOUTH OSSETIA:  
A PRELUDE TO WAR**  
*Did Economic Assistance Strengthen  
Competing Spoilers  
in Georgian-South Ossetian Conflict?*

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## I. Introduction

Sixteen years after the Sochi agreements an uneasy truce between Georgia and South Ossetia gave way to renewed violence in August 2008. The protracted peace process with lengthy and futile negotiations led to few agreements between the conflicting sides, which were often faulted at the implementation phase. Material and human costs of a failed peace process were huge: hundreds of civilian deaths, thousands of wounded, tens of thousands of people displaced, and millions of Euros spent on rehabilitation projects by local and international actors vanished within days.

With millions of aid money poured into Georgia for conflict prevention purposes prior to 2008, it is only legitimate to ask whether aid could make things worse and contribute to renewed violence, or to a lack of the sides' interest in peaceful conflict settlement. Much has been written on political, geopolitical and military aspects of the Georgian-South Ossetian conflict and failed peace settlement that led to renewed hostilities in 2008. This article, however, looks at how aid (intentionally or unintentionally) contributed to dividing lines in the Georgian-South Ossetian conflict and strengthened competing spoilers in the settlement process. It argues that economic rehabilitation projects, supported by competing actors, in the conflict zone fed into the dividing lines between the local Georgian and Ossetian communities, and the international community failed to bridge the widening gaps between them.

With the ceasefire signed in the early 1990s and stalled peace talks, many observers have branded the Georgian-South Ossetian conflict as frozen. However, the August 2008 conflict between Russia and Georgia over South Ossetia once again demonstrated the importance of the consolidation of conflict settlement and necessity to deal with threats to peacebuilding.

Although the negotiation process has been halted since 2006, it would be a mistake to call the Georgian-Ossetian conflict a frozen one. Despite low level of violence and frequent security incidents in the conflict zone, the ceasefire largely held until the summer of 2004, when Tbilisi's anti-smuggling operation in the conflict zone led to dozens of casualties and stopped short of the real warfare. Since then Tbilisi has been trying to alter the status quo in the negotiations and peacekeep-

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ing formats, which it, not without merits, saw as disadvantageous. These efforts intensified with the Georgian leadership backing up an “alternative” de facto government of Dmitri Sanakoev in South Ossetia in November 2006. Tbilisi provided Sanakoev, who controlled Georgian enclaves in South Ossetia, with strong financial and political support, putting him in charge of a temporary administration established in May 2007. Attempts were made to include Sanakoev in the established negotiations processes.

Moscow’s interventions, however, increased with strong political and financial backing of Tskhinvali and its de facto president Eduard Kokoity. Both Tskhinvali and Moscow were against any changes of the negotiation and peacekeeping formats, and their insistence on maintaining them and Tbilisi’s refusal to put up with the existing status quo led to the deterioration of the situation and complete freezing of the talks.

With Moscow and Tbilisi investing in different projects, the two communities (Georgian and Ossetian) also became physically divided. The mutual infrastructural dependency, which the sides were able to more or less maintain despite the conflict in the early 1990s, was gradually disappearing with the sides further separating from each other. Tbilisi and Moscow invested heavily in separate infrastructure and economic projects, and international aid failed to bridge the increasing gap.

All international efforts to maintain peace were unsuccessful, and the deteriorating security situation on the ground grew into a full-fledged war in August 2008. Failure to bridge the divide and address the “spoilers,” that actively thought to undermine the conflict settlement through a variety of means or at least had no interest in long-term peace, brought the renewed warfare and loss of significant human and capital recourses invested in the conflict settlement.

### Defining “Spoilers”

The typology of spoilers was first introduced in Stephen Stedman’s *International Security* article, “Spoilers Problems in Peace Processes.” Stedman defined spoilers, as “those leaders and parties who believe that peace emerging from negotiations threatens their power, worldview, and interests, and use violence to undermine attempts to achieve it.”<sup>1</sup> However, this is a narrow definition of spoilers that involves violent obstruction of peaceful conflict resolution. Edward Newman and Oliver Richmond give a broader definition of spoilers, arguing that “any actors that are opposed to peaceful settlement for whatever reason” constitute spoilers.<sup>2</sup> They argue that such actors could be either within or outside the peace process and use violent or other means to disrupt the process in pursuit of their own goals, which could include gaining recognition and legitimacy, time or material benefits. Spoiling could also include actors, “which are geographically external to the conflict, but which support internal spoilers and spoiling tactics.”<sup>3</sup>

This article shows that the Georgian-South Ossetian conflict provided a rich context for a range of internal and external spoilers and spoiling behavior. All parties to the conflict at various stages had interest in renewed violence or maintaining status quo, and meddled in the conflict settlement process. This article pays particular attention to economic interests of different actors and how they initially contributed to frozen peace process from 1992-2004, and then to a growing gap between the Georgian and Ossetian communities, and renewed hostilities in the summer of 2008.

<sup>1</sup> St.J. Stedman, “Spoiler Problems in Peace Processes,” *International Security*, Vol. 22, No. 2, Fall 1997, p. 5.

<sup>2</sup> E. Newman, O. Richmond, “The Impact of Spoilers on Peace Processes and Peacebuilding,” *Policy Brief*, No. 2, United Nations University, 2006.

<sup>3</sup> Ibidem.

## II. Background to the Conflict

### 1991-1992 Conflict

South Ossetia was an autonomous region of the former Soviet Republic of Georgia, located along Georgia's northern frontier in the Caucasus Mountains, bordering North Ossetia within the Russian Federation, and surrounded on the south, east and west by Georgia proper. Prior to the August 2008 war the region had ethnically mixed population of some 70,000 people. Ethnic Georgians made up 20 to 30 percent of the population<sup>4</sup> and mostly lived in three valleys of Didi Liakhvi,<sup>5</sup> Patara Liakhvi and Proni, as well as a large part of the Akhagori District. The villages inhabited mainly by ethnic Georgians were administered by Tbilisi, while the Ossetian-inhabited villages were under the administration of the de facto South Ossetian authorities based in Tskhinvali.

The political cause of the conflict is the clash between the self-determination claims on the part of Ossetians and territorial integrity claims by Tbilisi. The conflict turned violent in December 1990, when South Ossetia sought greater autonomy from Georgia at the time of the collapse of the Soviet Union. The war lasted until June 1992 and had devastating consequences: some 1,000 dead, 100 missing, extensive destruction of property and infrastructure, as well as thousands of displaced people internally, but also to Russia's North Ossetia.<sup>6</sup>

The ceasefire was reached in Russia's city of Sochi in June 1992, when the then Georgian and Russian leaders, Eduard Shevardnadze and Boris Yeltsin, signed the *Agreement on the Principles of the Settlement of the Georgian-Ossetian Conflict*, also known as "Sochi Agreement."<sup>7</sup> South Ossetia de facto seceded from Georgia in 1992. The Sochi Agreement established: the Joint Control Commission (JCC), a body for negotiations with Georgian, Russian, North and South Ossetian representatives; and the Joint Peacekeeping Forces (JPKFs), a trilateral peacekeeping force with Georgian, Russian and Ossetian units.<sup>8</sup>

The peacekeeping and conflict settlement process evolved over the years, but negotiations were slow with lengthy periods of inactivity. No military confrontation occurred for twelve years. As explained below, the parties had vested economic interests in maintaining status quo, i.e. no war-no peace situation.

### 2004 Anti-smuggling Operation

In the late 1990s, negotiations in the JCC format led to some progress, particularly on issues of return, demilitarization and economic rehabilitation. However, no breakthrough in political negotia-

<sup>4</sup> See: "Facts about South Ossetia," *International Herald Tribune*, 8 August, 2008, available at [<http://www.iht.com/articles/ap/2008/08/08/news/Georgia-South-Ossetia-Glance.php>].

<sup>5</sup> The villages of the Didi Liakhvi valley were strategically placed along the TransCam road between Tskhinvali and Java. The villages Tamarasheni and Kekhvi mark the valley's boundaries, located one and eight kilometers north of Tskhinvali, respectively.

<sup>6</sup> On humanitarian law violations during the 1991-1992 conflict in South Ossetia, see: Human Rights Watch, "Bloodshed in the Caucasus: Violations of Humanitarian Law and Human Rights in the Georgia-South Ossetia Conflict," March 1992. Another conflict in Georgia was fought in the early 1990s in Abkhazia, a former Soviet Republic of Georgia located in northwestern Georgia between the Black Sea and the Caucasus Mountains. The 1992-1993 military confrontation there led to some 8,000 deaths, 18,000 wounded and the forced displacement of over 200,000 ethnic Georgians (see: Human Rights Watch/Helsinki, "Georgia/Abkhazia: Violations of the Laws of War and Russia's Role in the Conflict," Human Rights Watch Arms Project, Vol. 7, No. 7, March 1995).

<sup>7</sup> *Agreement on the Principles of Settlement of the Georgian-Ossetian Conflict*, 24 June, 1992.

<sup>8</sup> *Ibid.*, Art 3. The Organization for Security and Cooperation in Europe (OSCE) also participated in JCC meetings.

tions happened largely because of vested economic interest the political actors (spoilers) had in illegal trade. A large wholesale market was established on the administrative border of South Ossetia. Without any effective customs control the market quickly became a smuggling hub between Russia and the South Caucasus, Turkey and Iran.<sup>9</sup>

Hundreds of millions of U.S. dollars that exchanged hands at the Ergneti market provided strong interest for spoiling behavior. A number of law enforcement officials from South Ossetia and Georgia proper were believed to be participating in criminal economic activities.<sup>10</sup> The authorities on both sides cooperated to profit from illegal trade, as did Russian customs and peacekeeping troops.<sup>11</sup> Thus, smuggling and the illegal economy largely helped in maintaining the postwar status quo as potential spoilers had little interest in stopping the smuggling. Needless to say, they also had little incentives for conflict resolution.

After Georgia's 2003 Rose Revolution and Mikheil Saakashvili's coming to power, he made restoration of Georgia's territorial integrity one of his top priorities. Tbilisi's approach was to undermine vested economic interests by launching a large-scale anti-smuggling operation, thus hoping to crack down on major source of income, which benefited the spoilers to the peace process. Simultaneously Saakashvili intended to win loyalties of Ossetian people by a humanitarian aid "offensive."<sup>12</sup>

The anti-smuggling operation began in 2003 and was aimed primarily at closing the Ergneti market, followed by physically blowing up roads used for goods smuggled through South Ossetia and the market.<sup>13</sup> By June 2004 the market was closed and the Georgian police presence increased significantly in the region to conduct regular checking of vehicles for smuggled goods. Saakashvili's government also initiated economic and cultural projects, including an Ossetian language television station, pensions, free fertilizer and humanitarian aid.<sup>14</sup>

As part of the anti-smuggling campaign, in May 2004 several Georgian Ministry of Interior units landed by helicopter in the villages of Tkviavi, Pkhvenisi, Nikozi and Eredvi, adjacent to the South Ossetian administrative border, and proceeded to set up roadblocks that restricted traffic from South Ossetia. This move led to renewed hostilities in the following months that resulted in dozens of casualties, and narrowly escaped a full warfare.<sup>15</sup> Security situation on the ground, however, deteriorated since then and never recovered to the pre-2004 level.

The sides to the conflict agreed on a new ceasefire in August 2004, which formally held until the summer of 2008, however, the situation on the ground remained hostile, with frequent exchanges of fire and criminal incidents, including mutual kidnappings, detentions and occasional killings.<sup>16</sup>

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<sup>9</sup> The most lucrative trade was allegedly wheat flour (worth some \$130 million a year), dairy products (\$60.5 million), cigarettes (\$60 million), petrol (\$23.2 million) and kerosene (\$12 million) (see: A. Kukhianidze, A. Kapatadze, R. Gotsiridze, *Smuggling Through Abkhazia and Tskhinvali Region/South Ossetia*, Research Report for the American University's Transnational Crime and Corruption Center (TRACC), 2003).

<sup>10</sup> See: D. Darchiashvili, G. Tevzadze, "Ethnic Conflicts and Breakaway Regions in Georgia," *Building Democracy in Georgia*, Discussion Paper No. 9, May 2003, pp. 12-13.

<sup>11</sup> Three Georgian MPs and the deputy governor of the region were considered to control parts of the market from the Georgian side, and the son of former South Ossetian leader Chibirov was seen as playing a key role on the Ossetian side (see: M. Areshidze, *Current Economic Causes of Conflict in Georgia*, unpublished report for U.K. department for International Development (DFID), 2002).

<sup>12</sup> Crisis Group Europe Report No. 159, *Georgia: Avoiding War in South Ossetia*, 26 November, 2004.

<sup>13</sup> See: "Governor Blows up By-Roads to Prevent Smuggling," *Civil Georgia*, 28 December, 2003.

<sup>14</sup> *Ibidem*.

<sup>15</sup> See: "South Ossetia Crisis Abates," Institute for War and Peace Reporting (IWPR), Caucasus Reporting Service No. 236, 3 June, 2004; "South Ossetia Tensions Still High," IWPR, Caucasus Reporting Service No. 242, 14 July, 2004; "South Ossetia Conflict Heats Up," IWPR, Caucasus Reporting Service No. 246, 12 August, 2004.

<sup>16</sup> See: "Georgian Police Targeted on Smuggling Faultlines," *Civil Georgia*, 1 February, 2005; "Five Die in South Ossetia Shootout," *Civil Georgia*, 30 May, 2005.

### 2006 Bid to Alter the Status Quo

In another bid to alter the status quo peacefully, in late 2006, the Georgian government began supporting an alternative South Ossetian administration led by Dmitri Sanakoev.<sup>17</sup> Following parallel presidential elections in November 2006, two competing governments began to coexist in South Ossetia: the secessionist de facto government headed by Kokoity in Tskhinvali and a pro-Tbilisi government headed by Sanakoev, based in Eredvi.<sup>18</sup> The Sanakoev administration maintained authority over the ethnic Georgian villages in South Ossetia and Akhagori District, while Tskhinvali administered the rest of the region.

With the emergence of alternative leadership in South Ossetia, security situation on the ground remained hostile,<sup>19</sup> and the negotiations between Tbilisi and Tskhinvali within the JCC framework became deadlocked. The Georgian authorities pushed for a change in the negotiation format, as it saw the JCC as a “three against one” arrangement. They called for limiting Russia’s role and insisted on the OSCE, European Union and United States participation in the talks.<sup>20</sup> Tskhinvali had been against the format change and instead pushed for a formal agreement on the non-use of force.<sup>21</sup> Russia, for its part, considered itself a guarantor of stability in the region, and since August 2004, had also been emphasizing its obligation to protect a large number of Ossetians to whom it had given Russian passports beginning in the late 1990s.<sup>22</sup>

## III. Competing Economic Projects

While the sides failed to agree on a format change in the negotiation process, they continued to pursue separate aid projects in the conflict zone, which suited their narrow, often competing interests. Tbilisi, Moscow and international community have been investing in the economic projects and infrastructure rehabilitation in South Ossetia. Georgian and Russian projects were often competing with each other and contributed to further isolation of local communities on the ground. The OSCE and European Commission (EC) failed to bridge the growing gap between the communities, and although some efforts were made to involve both sides in economic rehabilitation projects, they proved unsuccessful.

The beginning of 2008 marked further deterioration of security situation on the ground. Kosovo’s independence recognition by the Western countries and Georgia’s continued bid for NATO membership caused Russia’s harsh reactions. Moscow increased its engagement with Georgia’s break-away regions and invested heavily in potential spoilers to the peace process. Frequent exchange of fire and mutual recriminations in summer led to renewed hostilities on the ground in August 2008, which quickly turned into the inter-state conflict between Georgia and Russia. Although open hostil-

<sup>17</sup> See: “Staging ‘Alternative Choice’ for South Ossetia,” *Civil Georgia*, 7 November, 2006; “Signs of Status Quo Change in South Ossetia,” *Civil Georgia*, 14 November, 2006. Dmitri Sanakoev served in the previous Tskhinvali administration of de facto president Ludvig Chibirov (1996-2001).

<sup>18</sup> See: “Simultaneous Polls in South Ossetia,” *Civil Georgia*, 12 November, 2006.

<sup>19</sup> See: “Four Die in South Ossetia Skirmish,” *Civil Georgia*, 8 September, 2006; “Two Die in South Ossetia Shooting,” *Civil Georgia*, 25 March, 2007.

<sup>20</sup> See: “Tbilisi Proposes New Negotiating Format for South Ossetia,” *Civil Georgia*, 1 March, 2008.

<sup>21</sup> “Tskhinvali Insists on Talks in Frames of JCC,” *Civil Georgia*, 24 July, 2008.

<sup>22</sup> See: Ministry of Foreign Affairs of the Russian Federation Press Release, 30 July, 2004; “Russian Foreign Minister Warned Tbilisi Against Attempting on Russian Peacekeepers’ Lives,” *Regnum*, 20 July, 2006 (see also: P.A. Goble, “Russian ‘Passportization,’” *New York Times*, 9 September, 2008).

ities lasted for less than a week, consequences were devastating, and prospects for peaceful conflict resolution in the near future vanished. Millions of dollars invested in infrastructure and economic rehabilitation projects were completely lost.

Up until 2006 economic rehabilitation was pretty much the only field where Tbilisi and Tskhinvali cooperated. Since 1999 the European Commission had been investing in cross-community projects implemented by the Organization for Security and Cooperation in Europe. A large economic rehabilitation program was launched by the OSCE after the winter 2005-2006 needs assessment. However, this cooperation broke down as Tbilisi and Moscow invested greater sums in competing projects outside of the OSCE implemented ones. While the OSCE tried to promote confidence building through ethnic cooperation, the unilateral Georgian and Russian programs competed for loyalties, contributing to further division of local communities.

### Tbilisi's Economic Projects

Tbilisi began to heavily invest in Sanakoev's administration in order to make itself more attractive to South Ossetia's population by dramatic improvement in conditions in the zone of conflict under its control. The authorities believed that the investments in Georgian-controlled areas would demonstrate to Ossetians what they could gain by shifting loyalties to Tbilisi.<sup>23</sup>

In February 2007, the Georgian authorities allocated six million Georgian lari (app. \$3.5 million) for direct budget support to the three municipalities under Georgian control in South Ossetia: Kurta, Eredvi, and Avnevi.<sup>24</sup> After Sanakoev's appointment as a head of the temporary administration of South Ossetia, Tbilisi announced allocating further 12 million lari (app. \$7 million) for the region.<sup>25</sup> With further budgetary amendments Tbilisi invested in total over 30 million Georgian lari in Sanakoev's administration and unilateral projects in the region.<sup>26</sup> Considering the size of the territory and population under Sanakoev's control, Tbilisi's investments were huge. The money was mostly spent for infrastructure projects, including the construction of gas pipeline to the villages in the Didi and Patara Liakhvi valleys. The money was also used for renovation of schools, improvement of water infrastructures, construction of sports facilities, and lights for village streets.<sup>27</sup>

Although the villages under Tbilisi administration benefited greatly from those unilateral expenditures and progress was indeed visible on the ground, this one-sided approach to the rehabilitation and economic projects also led to a widening gap of the ethnic divide. In fact, such steps also contributed to physical separation of the sides, gradually reducing infrastructural interdependency that existed in the region from Soviet times. Geographic peculiarities of the region used to facilitate cooperation between the communities. Ossetians had to pass through the Georgian villages of the Didi Liakhvi valley in order to reach further northern Ossetian enclave of Java, and Georgians needed to go through Tskhinvali in order to get to the Didi Liakhvi valley. However, with sides investing in separate by-pass roads, this interdependency was significantly reduced. The electricity networks were also separated.

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<sup>23</sup> See: International Crisis Group, "Georgia's South Ossetia Conflict: Make Haste Slowly," Europe Report No. 183, 7 June, 2007.

<sup>24</sup> See: "Government Unveils South Ossetia GEL 6 mln Investment Plan," *Civil Georgia*, 24 February, 2007.

<sup>25</sup> See: "Finance Minister Meets S. Ossetian Administration Chief," *Civil Georgia*, 22 May, 2007.

<sup>26</sup> According to a June 2008 budget amendment, GEL 19 million was allocated to the temporary administration headed by Sanakoev in 2008, whereas it was GEL 13 million in 2007 (see: "Defense Spending to Go Up by GEL 295 mln," *Georgian Times*, 24 June, 2008).

<sup>27</sup> Crisis Group report No. 183, p. 22.

### Moscow's Economic Projects

In parallel to Tbilisi's investments in the zone of conflict, Moscow also implemented unilateral projects in support of Tskhinvali administration. At a donor conference in June 2006, Russia pledged some 3 million Euro, but continued to implement projects separately without coordination with the OSCE and the Georgian side. Moscow directly financed seven projects completed by the end of 2006.<sup>28</sup>

In the past, Tbilisi and Moscow have signed two agreements on economic rehabilitation of the conflict zone in 1993<sup>29</sup> and 2000.<sup>30</sup> While the 1993 Agreement was partially implemented, the 2000 one was never materialized. Moscow asserted that its unilateral economic assistance was within the framework of the above-mentioned agreements, however, those treaties envisaged joint implementation under the JCC's supervision. Russia chose instead to disburse the money at its own will. In late 2006, Gazprom announced the construction of a gas pipeline across the Caucasus range, linking North and South Ossetia, yet another step to decrease the region's dependency on Georgian infrastructure.<sup>31</sup>

Russia's aid to South Ossetia included not only economic rehabilitation projects, but also military, budgetary and education support. Moscow has also directly appointed Russian personnel to the de facto Ossetian authorities.

Moscow's unilateral support for Tskhinvali can be viewed in the frames of supporting the spoilers in the conflict. Russia's "investments" backed up South Ossetia's leadership leaning toward Moscow and prevented the prospect for confidence building between the communities and the impeding potential for possible conflict resolution. By attaching South Ossetia's economy to Russia, Moscow was further alienating the breakaway region's population from Georgia, thus increasing the gap between the ethnic communities.

### International Economic Projects

International aid to the conflict zone intensified after the 2004 summer hostilities following Tbilisi's anti-smuggling operations. In November 2004, the then Georgian Prime Minister Zurab Zhvania and South Ossetia's de facto President Eduard Kokoity met in Russia's city of Sochi and agreed that confidence building and economic rehabilitation could give an impetus to further negotiations and ultimate conflict resolution. They agreed that the JCC should examine economic projects that would be of mutual interest to the sides and submit them to the European Commission for funding.

The OSCE led a Needs Assessment Study in the zone of conflict in December 2005-April 2006 and identified projects for infrastructure rehabilitation (social facilities, energy supply, and roads) and economic development (agriculture, business, and finance).<sup>32</sup> Following this study, the JCC agreed on a list of priority projects worth of 10 million Euro and its implementation mechanism.<sup>33</sup> The approved projects were to contribute to the negotiation process by rehabilitation of basic infrastructure, economic development, and confidence building.

<sup>28</sup> These included the reconstruction of a secondary school, dental clinic, hotel, concert hall, sports hall and hospital lab in Tskhinvali and construction of a road (see: Crisis Group report No. 183, p. 23).

<sup>29</sup> See: *Intergovernmental Agreement between Russia and Georgia on Economic Rehabilitation in the Georgian-Ossetian Zone of Conflict*, 14 September, 1993.

<sup>30</sup> See: *Georgian-Russian Economic Agreement on Rehabilitation in the Zone of Conflict and on the Return and Integration of Refugees*, 23 December, 2000.

<sup>31</sup> See: "Russia: Ossetia Pipeline Adds Fuel to the Georgia Fire," *RFE/RL*, 6 November, 2006.

<sup>32</sup> See: Crisis Group report No. 183, p. 21.

<sup>33</sup> See: *JCC Meeting Protocol*, Tskhinvali, 11-13 May, 2006.



The OSCE chairman-in-office hosted a donors conference in Brussels in June 2006 that pledged almost 10 million Euro for the implementation of agreed projects.<sup>34</sup> Tbilisi pledged to provide a matching contribution, but allocated 50,000 Euro by the fall of 2007 and an additional 250,000 Euro since then.<sup>35</sup> In parallel, the Georgian authorities invested much more in the Sanakoev administration and in the development of Sanakoev-administered areas in South Ossetia. Moscow, on the other hand, pledged some 3 million Euro at the donors conference, but it proceeded to fund and implement projects separately and unilaterally, outside of the JCC agreed mechanism.<sup>36</sup>

Although the OSCE-led multi-donor projects were intended to build trust between the communities and contribute to confidence building and therefore to political negotiation processes, the international community failed to press the sides for continued cooperation and prevent an increasing gap resulting from unilateral programs, drifting the communities apart. Political stand-off between Tbilisi and Moscow and Sanakoev and Kokoity worsened dramatically, contributing to further deterioration of security in the zone of conflict, and leading to complete stalling of the political negotiation process.

Considering how small the territory of South Ossetia is and also relative smallness of its population, economic rehabilitation worth of millions of Euros had a significant potential of confidence building if implemented jointly. However, aid quickly became politicized competing for local loyalties and feeding into the greed of potential spoilers to the peace processes. Political hostility, deteriorated security, militarization, and a physical separation of conflicted communities led to renewed hostilities in the summer of 2008.

## IV. August War

Clear signs of rapid deterioration of security situation in the conflict zone were visible months prior to the armed hostility. Georgian and South Ossetian forces engaged in violent attacks and mutual recriminations.<sup>37</sup> The situation further deteriorated with Kosovo's independence recognition by Western countries and Georgia's continued bid for NATO membership. This led to Russia's deepening its ties with Georgia's breakaway regions and increased cooperation.<sup>38</sup> Military exercises conducted by Georgian and Russian forces in summer further escalated the tensions.<sup>39</sup>

Violent incidents between the Georgian and Ossetian forces intensified by the end of July. The sides exchanged mutual recriminations on opening fire on 29 July.<sup>40</sup>

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<sup>34</sup> The pledges were: the European Commission (two million euros), the United States (two million U.S. dollars), Sweden (one million euros), Belgium (one million euros), Germany (500,000 euros), the Netherlands (500,000 euros), Norway (about 250,000 euros), Spain (200,000 euros) and Finland (200,000 euros). Estonia, Turkey, France, Hungary, the United Kingdom, Lithuania, Italy, the Czech Republic, Croatia, Poland and Andorra pledged amounts of up to 150,000 euros (see: "Donors Pledge EUR 10 mln for S. Ossetia Rehabilitation," *Civil Georgia*, 15 June, 2006).

<sup>35</sup> See: "Georgia Pledges More Aid to Promote South Ossetia's Reconstruction," *Eurasia Insight*, 5 November, 2007.

<sup>36</sup> See: "Russia's Separate Funding for S. Ossetia Angers Georgia," *Civil Georgia*, 17 June, 2006.

<sup>37</sup> See: "EU Calls for Calm After Clash in Georgia Rebel Region," Reuters, 4 July, 2008, available at [[http://uk.reuters.com/article/homepageCrisis/idUKL04712416.\\_CH\\_.242020080704](http://uk.reuters.com/article/homepageCrisis/idUKL04712416._CH_.242020080704)].

<sup>38</sup> See: *Information for the Media: About the President's Orders to the Government of the Russian Federation in Relation to Abkhazia and South Ossetia*, Ministry of Foreign Affairs of the Russian Federation, 501-16-04-2008, 16 April, 2008.

<sup>39</sup> The Georgian army conducted a joint exercise with the U.S. forces near Tbilisi on 15 July; and the same day Russian military launched Caucasus-2008, a military exercise not far from the Roki tunnel connecting Russia and South Ossetia (see: "U.S. Troops Start Training Exercise in Georgia," Reuters, 15 July, 2008; "Kavkaz-2008, a Major Joint Exercise, Started in the North Caucasus Military District, Ministry of Defense of the Russian Federation News Release, 15 July, 2008).

<sup>40</sup> See: "M.I.A.: Five Policeman Injured in S. Ossetia Blast," *Civil Georgia*, 1 August, 2008.

The security situation further deteriorated in the beginning of August with frequent exchange of fire between the sides. On 7 August, 2008, the Georgian forces launched an artillery attack on Tskhinvali, claiming that they did so in response to the Ossetian side firing mortars on villages inhabited by ethnic Georgians. Russia's military response began the next day, with the declared purpose of protecting the Russian peacekeepers stationed in South Ossetia and the Russian citizens in South Ossetia.<sup>41</sup> However, Moscow's response was clearly disproportionate as it went far beyond South Ossetia and its forces occupied Georgia proper around the conflict zone and western Georgia, destroying military and civilian targets throughout the country.<sup>42</sup> The Georgian troops retreated on the morning of 10 August.<sup>43</sup> On 16 August, a new ceasefire was brokered by the French presidency of European Union.<sup>44</sup> Tbilisi lost control of the territories it had previously controlled in the conflict.

Political, economic and humanitarian consequences of the short war were devastating and will be felt for generations to come. Some 192,000 people from both sides were displaced at the peak of the conflict<sup>45</sup> and some 20,000 ethnic Georgians remain in displacement. Hundreds of people, including civilians, were killed from both sides. War, as well as looting and burning, perpetrated mostly by the Ossetian militia after the active fighting, caused extensive damage to infrastructure and houses. Ethnic Georgian villages in South Ossetia were practically raised to the ground.<sup>46</sup>

On 26 August, the Russian authorities recognized the independence of Abkhazia and South Ossetia<sup>47</sup> and announced its intentions to keep a total of 7,600 troops in Georgia's breakaway regions.<sup>48</sup> Diplomatic relations between Tbilisi and Moscow are down to minimal. Late October, Georgia passed a law on occupied territories calling the Russian troops occupational forces and imposing restrictions on any engagement with the breakaway regions, specifically prohibiting any property and business transactions.<sup>49</sup>

## V. Conclusions

The unresolved Georgian-South Ossetian conflict provided a rich context for a range of internal and external spoilers and spoiling behavior. At any stage of the conflict resolution process, all parties, including Tbilisi, Tskhinvali and Moscow, had interest in maintaining status quo or renewed hostilities, thus undermining conflict settlement through a variety of means. This article looked at one—economic factor, and more specifically—aid, and how it can intentionally or unintentionally make things worse if it serves vested interests, rather than confidence building on the ground. I argued that the economic rehabilitation projects in the conflict zone, supported by the competing actors with competing interests, fed into the dividing lines between the local Georgian and Ossetian communities, physically isolating the two and contributing to renewed hostilities in the summer of 2008.

<sup>41</sup> See: *Up in Flames: Humanitarian Law Violations and Civilian Victims in the Conflict over South Ossetia*, Human Rights Watch Report, January 2009, p. 5.

<sup>42</sup> See: "Russian Invasion of Georgia, Facts and Figures," Government of Georgia Update, 1 October, 2008.

<sup>43</sup> See: "A Two-Sided Descent into Full-Scale War," *The Washington Post*, 17 August, 2008.

<sup>44</sup> See: "Medvedev Signs Ceasefire," *Civil Georgia*, 16 August, 2008.

<sup>45</sup> See: "Revised Figures Push Number of Georgia Displaced up to 192,000," on UNHCR website, 12 September, 2008.

<sup>46</sup> For more, see: Human Rights Watch Report, January 2009.

<sup>47</sup> *Statement from the Ministry of Foreign Affairs of the Russian Federation*, Ministry of Foreign Affairs of the Russian Federation, 26 August, 2008.

<sup>48</sup> See: "Russia Plans 7,600 Force in Georgia Rebel Regions," *Reuters*, 9 September, 2008.

<sup>49</sup> See: "Bill on Occupied Territories Signed into Law," *Civil Georgia*, 31 October, 2008.



With political negotiations stalled, economic rehabilitation was pretty much the only field where Tbilisi and Tskhinvali cooperated up until 2006. Since 1999 the European Commission had been investing in cross-community projects implemented by the OSCE. A large economic rehabilitation program was launched by the OSCE after the winter 2005-2006 needs assessment. However, this cooperation broke down as Tbilisi and Moscow invested greater sums in competing projects outside of the OSCE implemented ones. The unilateral Georgian and Russian programs competed for loyalties and contributed to further division of local communities. With economic cooperation breaking down and isolated infrastructure, conflict prevention mechanisms also broke down and together with many political and geopolitical factors led to renewed hostilities in the summer of 2008.

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## REGIONAL ECONOMIES

**ARMENIA:  
THE CRISIS AND  
FUNDAMENTAL  
ECONOMIC PROBLEMS**

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The world crisis interrupted the stable economic growth Armenia had been enjoying for the past fifteen years. Progressive development began in 1994, whereby between 2001 and 2007 the growth indices reached double digits. In 2008, the increase in GDP came to a halt due to the Russian-Georgian war and amounted to only 6.8%.<sup>1</sup>

And as early as the first six months of 2009, the GDP began to decrease, dropping as low as 16.3% compared to the same period of the previous year, which is one of the worst indices for the entire

CIS.<sup>2</sup> In July, the drop in GDP amounted to 18.7%, which encouraged people to think that the crisis had bottomed out.

The Armenian government took measures that reduced the negative impact of the crisis to a minimum. This was mainly assisted by financial aid from the outside. However, both independent observers and government representatives admit that the crisis only aggravated the problems that already existed in the country's economy. While there are others who believe that the crisis will be conducive to radical restructuring that will make the economy more efficient and competitive.

<sup>1</sup> For more detail, see: H. Khachatrian, "Armenia: Economics," in: *Central Eurasia 2008*, CA&CC Press®, Sweden, 2009.

<sup>2</sup> Main macroeconomic indices of the CIS countries (January-June 2009 compared to January-June 2008), available at [www.cisstat.com], 20 August, 2009.

## Anticipation of the Crisis and the Government's Anticrisis Campaign

From the very beginning, it was clear that Armenia, with its small domestic market, would be dealt a severe blow by the crisis that began beyond its borders since it was bound to affect the countries to which the republic exports goods and services and which make investments in Armenia.

Nonferrous metals (copper, molybdenum, and aluminum) constitute about half of Armenia's export. In recent years, the pricing environment has been shaping up favorably, and the export earnings have noticeably grown. But it was obvious that the crisis threatened a cutback in the consumption of nonferrous metals and a drop in prices, particularly for copper, which is used in large amounts in construction. It is worth recalling that it was precisely a decline in construction that triggered the world crisis.

The export of manpower is another important article of Armenia's revenue. After the collapse of the U.S.S.R., between 600,000 and 800,000 Armenians (15-20% of the population), according to some sources, left the country in search of a way to earn a living. Approximately 60,000 periodically leave to work at seasonal jobs. It goes without saying that the remittances labor migrants and members of the Armenian diaspora send to their relatives in Armenia constitute the republic's revenue from this "export." In 2008, the noncommercial bank transfers amounted to 1 billion \$630 million, which is more than 10% of GDP and almost 48% of the domestic trade turnover.

In actual fact, the inflow of money is much greater, although it is impossible to determine the true amount of this revenue, since a large portion of the money bypasses the banking system. Revenue from the export of manpower depends on the demand for it in those countries where labor migrants live and work. Eighty percent of the money comes to Armenia from Russia, so there is close economic interaction between these countries. The state of the Russian economy is primarily determined by the world oil prices and this is another important factor that affects Armenia.

The decrease in inflow of foreign investments, primarily into the construction business, is the third important way the world crisis is having an impact on Armenia. It began to dwindle as early as the end of 2008 as a result of the Five-Day War between Russia and Georgia.

During 2009, all the above-mentioned factors had an immense effect on the republic's economy. In particular, as early as the end of 2008, world copper and molybdenum prices fell by half (compared to the beginning of the same year), and the volume of their export from Armenia significantly dropped. As for remittances (commercial and noncommercial), during the year their inflow shrank by 34% (as of July 2009).

As early as November 2008, Prime Minister Tigran Sargsian presented the National Assembly with the main provisions of the government's anticrisis program. It included a standard set of measures: increasing government expenditures to raise demand (numerous infrastructure projects), streamlining local production units, and stimulating export.

In particular, potentially productive local manufacturers were to be offered preferential loans and loan guarantees. There were plans to create particularly lucrative conditions for small and medium businesses, since they offer the largest number of jobs. There were no plans to lower tax rates since, in April-May 2008, the government announced its strategic goal to be the opposite task, that of reducing the shadow economy sector, i.e., increasing the amount of tax collected. The program did not plan on allotting special financial resources from the state budget. It was decided not to cut back the state budget initially offered for 2009 that envisaged GDP growth of 6-8%. The government planned on making up for the shortage of funds by increasing external borrowing. International financial organizations—the IMF, World Bank, and Asian Development Bank—were considered as potential lend-

ers. These calculations could have fully justified themselves: Armenia had a sufficiently low level of external debt—14% of GDP (at the end of 2008).

These expectations were justified, even though America's Millennium Challenge Corporation announced the partial curtailment of its programs due to the violation of democratic freedoms in Armenia (meaning the events relating to the presidential election on 19 February, 2008). This shortage of funds amounted to around \$75 million, but it was amply compensated for by loans from the IMF (more than \$800 million, \$400 million of which were received before May 2009),<sup>3</sup> as well as by Russia's interstate loan of \$500 million dollars, which was issued at a LIBOR+3 rate and for a term of 15 years.<sup>4</sup>

In addition, on 2 June, 2009, the government passed a law through the National Assembly according to which the upper threshold for the state budget deficit was raised from 5.0% to 7.5% of GDP. This permits the government to borrow a total of 230 billion drams (\$640 million) to cover the budget deficit in the event the annual GDP falls by 15%. And even in that case, budget assignments (940 billion drams) will be fully activated, including for wages, pensions, and benefits. It should be noted that the necessary borrowed funds are already available.

This does not exhaust the list of borrowings. In March, the World Bank made a decision to grant Armenia four loans (totaling \$85 million), including one for \$35 million, which will immediately be spent on creating new jobs. The Asian Development Bank also allotted \$47 million; in the future, the government hopes to receive quite a large loan from it (see below).

One of the goals of the anticrisis program is attracting the funds of the Armenian diaspora into the banking system. The matter concerns not only the deposits of large investors (several banks fully or partially belong to large private owners from the diaspora), but also an attempt to increase the relatively small revenues from Armenians living abroad by turning the republic into a serene harbor: the growing bank crisis has essentially not affected Armenia.

In order to execute the intended plans, a law was adopted at the beginning of 2009 on founding an All-Armenian Bank, but further steps in this direction have not been taken.

## Impact of the Crisis

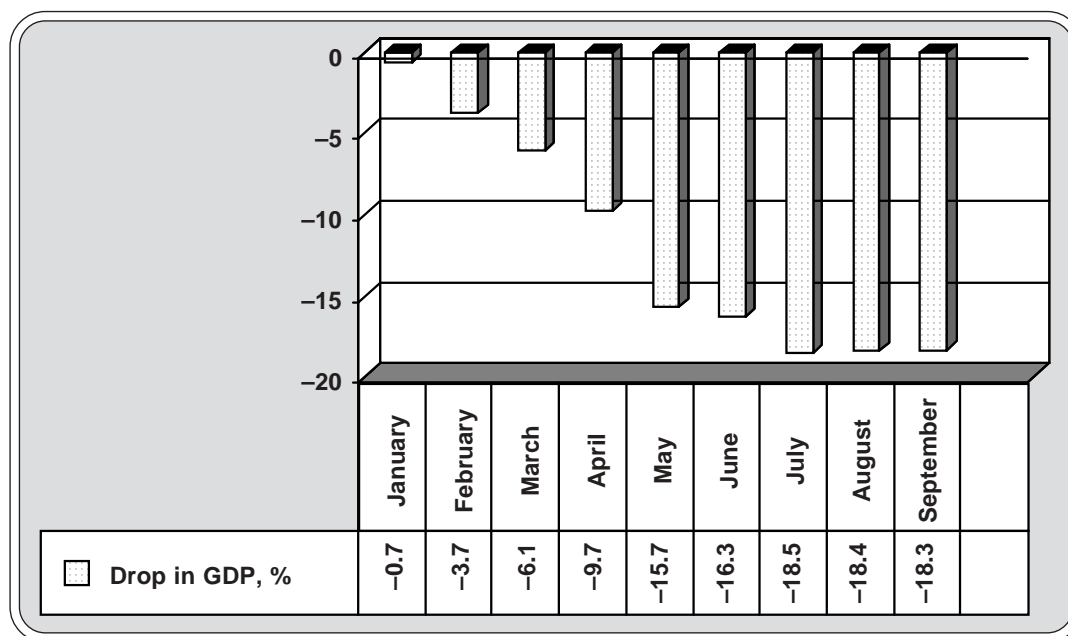
According to the Armenian National Statistics Board, in January-July 2009, the country's GDP amounted to 81.5% compared to the same index for the previous year.

As Figure 1 shows, two phases can be identified in the dynamics of change in GDP over the year—an abrupt drop and relative stabilization. The first phase continued until July: after a relatively small decrease in the first months of the year—6.1% in the first quarter, there was an abrupt acceleration in the drop to 16.3% in the first six months, which continued to a low of 18.5% in July (as noted above, this was the worst index for all the CIS countries). In the next two months, the drop came to a halt, and the economy even recovered its losses somewhat: in August and September, this index rose slightly to 18.4% and 18.3% compared to the same periods of the previous year, respectively. This created grounds for cautious optimism: the government announced that the economy had begun to stabilize, and by the end of the year the drop would constitute “a mere” 15% of the previous year's level.

<sup>3</sup> For more on the IMF Council's decision, see: [<http://www.imf.org/external/np/sec/pr/2009/pr09228.htm/>].

<sup>4</sup> At the end of June, the government of Armenia adopted a decision, according to which in 2009 only about \$245 million of this amount would be spent. The rest would be saved in the stabilization fund.

Figure 1

Dynamics of Change in Armenia's GDP  
in 2009

The data presented in the table on p. 46 confirm these estimates. The table shows that the most abrupt drop in production output was seen in construction; by July the volume had dropped by almost half. The output of industrial production fell by 12%, while the decrease in agricultural production was less. For the abovementioned reasons (decrease in nonferrous metal prices), there was a sharp drop in export in terms of value, by almost half. In so doing, in July, the import volume was 4.57-fold higher than the export volume. In the following two months, a slow improvement in almost all the mentioned parameters was seen, which is clear from the data presented in the table. The recovery in the construction industry and increase in export—in September it increased by 26.5% compared with August—are particularly encouraging factors from the government's viewpoint. Evidently, the government's anticrisis measures played a certain role in these processes, which will be discussed below.

The crisis also aggravated problems in lending. By May 2009, bank lending rates, which were high anyway at 16% per annum, had increased by more than two percentage points; it became more difficult for businessmen to obtain loans; and consumer lending had stopped entirely. In so doing, the banks had surplus liquidity, that is, they issued fewer loans than they could have. The corresponding parameter N2 (ratio of the volume of highly liquid assets to overall assets), which, according to Central Bank regulations, should have been equal to 15%, amounted to an average of 23.85% in December, later reaching 30.74%, while the volume of free monetary resources increased from December to May from 41.6 billion drams to 54.09 billion (\$146 million).

In order to lower lending rates, the Central Bank decreased the refinancing rate from 7.75% to 5.00% (March-September), whereby the low inflation rate (2-3%) made it possible to do this without any alarming repercussions. In addition, approximately \$60 million were pumped into the banking

Table

**Change in Armenia's Macroeconomic Parameters  
in January-September 2009  
(in percentages of the same period for 2008)**

	January-July	January-September
<b>Gross domestic product</b>	<b>81.5</b>	<b>81.7</b>
<b>Output of industrial production</b>	<b>88.0</b>	<b>88.6</b>
<b>Output of agricultural production</b>	<b>97.9</b>	<b>98.7</b>
<b>Volume of construction</b>	<b>55.0</b>	<b>56.2</b>
<b>Volume of retail trade</b>	<b>100.1</b>	<b>100.8</b>
<b>Volume of services</b>	<b>99.5</b>	<b>98.8</b>
<b>Average nominal wages</b>	<b>111.3</b>	<b>112</b>
<b>Export</b>	<b>55.5</b>	<b>58.5</b>
<b>Import</b>	<b>70.5</b>	<b>72.1</b>

system thanks to foreign aid and Russian loans. However, it has still not been possible to achieve a decrease in the lending rates.<sup>5</sup>

It should be noted that the first phase of the world economic crisis, which began in September 2008, had essentially no impact on Armenia—it did not have a developed financial system and its interaction with other countries in this sphere was minimum. In particular, the republic's banking system did not have any ties with financial institutions abroad, apart from its own parent banks or international organizations (for example, the HSBC-Armenia bank with its parent British HSBC bank). These circumstances, as well as the extremely strict control exercised by Central Bank, led to the fact that Armenia proved to be the only country in the CIS that did not need financial aid to support its banking system, which, on the whole, remained profitable.

All the same, problems with state finances arose. In the first six months of 2009, due to the economic slump, state budget revenues were 12.9% lower than the index for the previous year. Whereby, according to the budget plan, revenues should have increased on average over the year by 14%. In addition, as already noted, remittances from abroad during the same period decreased by 34%. The government managed to fulfill its main fiscal commitments only with the help of unprecedented borrowing, as mentioned above. Against the background of these troubling figures, it is surprising that the volumes of retail trade and services essentially remained the same. In other words, the country has not suffered from any abrupt drop in the standard of living. This is explained by the fact that, despite the crisis, wages continue to increase in the country (see the table), whereby in the state sector they are even higher (118.1%) than in the private. In previous years, the exact opposite trend was typical.

<sup>5</sup> By the end of August, the amount of loan deposits increased slightly compared to June by approximately 5% after a drop of the same amount in the previous three months. This is possibly the beginning of a revival in active lending.



## The Government's Anticrisis Measures

List of main anticrisis measures of the Armenian government:

- The activity of five mining companies producing copper and molybdenum has fully recovered. Around 6,000 jobs were retained, which were particularly important for Siunik marza (a province in the south of the country). Some enterprises were offered subsidies and loans totaling \$60 million; they again became relatively profitable thanks to the partial restoration of the former world price level. Two enterprises upgraded their equipment.
- The assistance was rendered to several local companies that a special government commission evaluated as potentially productive. The assistance took various forms: loans, loan guarantees, and the purchase of some shares. In so doing, the range of activity of those enterprises that received assistance is extremely wide: food processing, the production of environmentally pure products, textile production, software manufacture, machine-tool production, and so on. By the end of October, 44 companies had been allotted aid totaling more than 30 billion drams (\$80 million).
- Attempts are being made at the same time to give a new boost to the soft financing of small and medium businesses. In particular, the World Bank issued a loan of \$50 million in March and, on 1 April, a corresponding program was launched. But the lending rates in the country are still very high.
- A decision was made to grant loan guarantees to developer companies in order to stimulate the completion of facilities, the construction of which had halted due to the crisis (providing these facilities were already more than halfway built). Such guarantees, totaling more than \$10 million, were offered to five companies. In July-August, it was not possible to activate the construction industry. However, a slight increase in construction began in September (see the table).

## Monetary Policy

As already mentioned, the world financial crisis essentially caused Armenia no direct harm due to its insufficient integration into the world financial system. All the same, the inflow of funds from abroad has been dwindling (since the fall of 2008). In addition, the demand for American dollars has increased in the republic, just as it has in Russia. The dram exchange rate remained at 305 drams to the dollar for quite a long time. Armenian officials chose conservative tactics to combat the growing demand for U.S. currency, trying to maintain the previous exchange rate. Often more than \$60 million a day would be sold on the exchange market, which is ten times higher than the average level.

As a result, from October 2008 to March 2009, the Central Bank of Armenia spent approximately \$600 million (one third of its foreign exchange reserves) on exchange market interventions, and the percentage of dollar deposits rose from 40% to 70%. In other words, the de-dollarization of the economy accompanied by an increase in the dram exchange rate that occurred between 2004 and 2006<sup>6</sup> was reversed.

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<sup>6</sup> See: H. Khachatryan, "Armenian Currency: The Drama of the Dram," in: *Central Eurasia: National Currencies*, ed. by E.M. Ismailov, CA&CC Press®, Stockholm, 2008.

Finally, on 3 March, 2009, the Central Bank announced that it was curtailing its efforts to support the dram exchange rate, that is, it was returning to a floating exchange rate policy, although it had technically never renounced it. The exchange rate of the national currency instantly fell from 305 to 370 drams to the dollar.

The events of the following months confirmed the forecasts that the band the dram is allowed to trade within in the future would amount to 360-380 to the dollar. As of August 2009 (when this article was written), no upheavals had occurred in the exchange market.<sup>7</sup> It is believed that the financial structures were able to make adjustments to the exchange rate incurring the least losses for the population and banks (there was no outflow of deposits). Thanks to this, the IMF offered Armenia a Stand-by loan without delay. As already mentioned, on the whole, the banking system ended the first six months of the year in the black.

## Construction

From the very beginning, particular importance was placed on building infrastructure when elaborating the anticrisis measures. The country was in great need of an improved infrastructure network, and this would also ensure the creation of new jobs.

The government began unfolding an extensive plan for modernizing rural roads and also began developing a project for building a new international highway linking Iran with the Georgian port of Batumi by the shortest route (Meghri-Erevan-Gumri-Akhalkalaki-Batumi). Armenia and Georgia were counting on receiving a loan from the Asian Development Bank, but it would most likely not be issued before the end of 2009, which would be too late to assuage the crisis phenomena.

The same also applied to two other projects: the Iran-Armenia railroad and the Tabriz-Ararat pipeline for transporting petroleum products. In mid-August, the government announced that due to the situation in Iran the launching of another Armenian-Iranian project—building a hydropower plant on the border river Arax—would be postponed. Iran promised to grant a total of \$400 million to infrastructure projects in Armenia, but not one of them has been launched yet.

The government is also putting great store by growth of the construction industry, since in the past five years it has proven to be the driving force behind the economy, and its growth rates have been amounting on average to more than 20% a year. As a result, by 2008, construction ensured 27% of Armenia's GDP, whereas in 2002 it provided only 6.6%. So, as of today, this industry accounts for the lion's share of the economic slump.

In January-May 2009, the share of construction in GDP abruptly dropped compared to the same period for 2006 (see Fig. 2),<sup>8</sup> and the government is exerting great efforts to retain this important sector of the economy.

The government's plans placed special focus on construction in the Spitak earthquake zone, where approximately 7,000 residents still do not have a decent roof over their heads since the disaster occurred in 1988. There were plans to allot approximately 70 billion drams (\$190 million) from budget and borrowed funds for this purpose. Real revival of construction work in this zone did not begin until September.

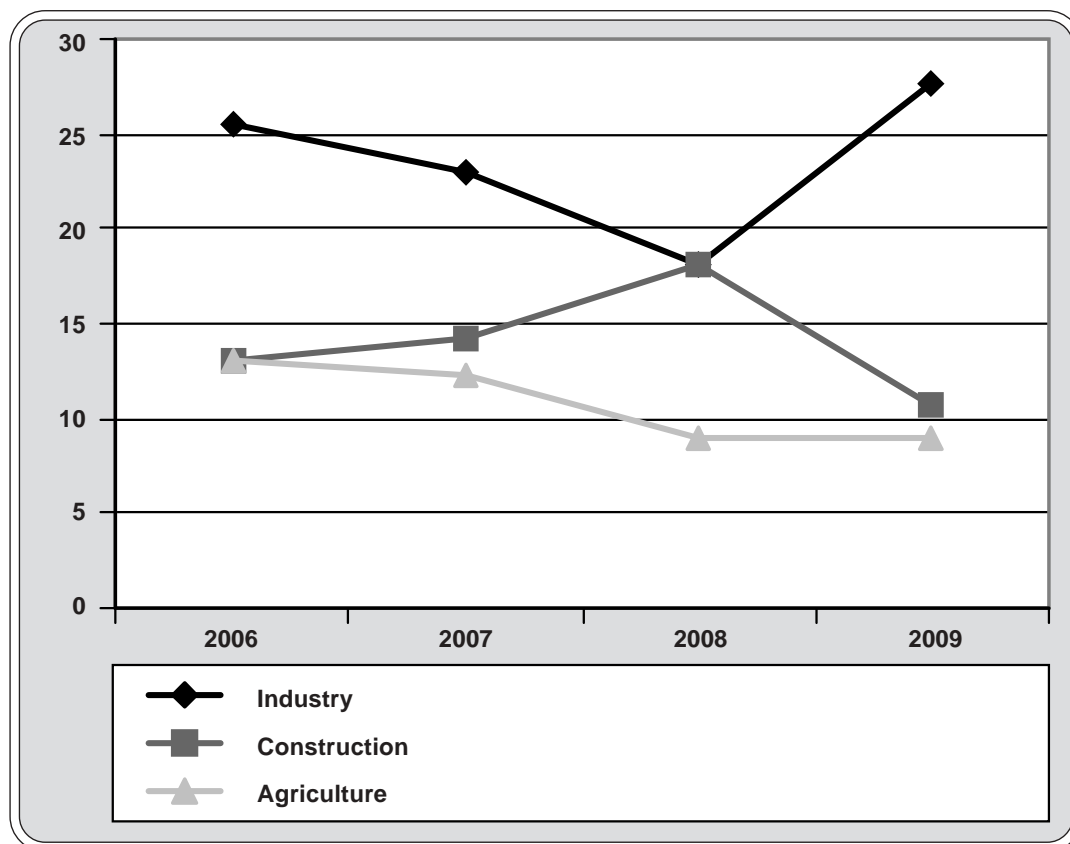
The government is also planning to step up private demand for construction which, during the boom years in the construction industry, provided 90% of the revenue into this sphere. There are plans

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<sup>7</sup> Fluctuations in the dollar exchange rate did not go beyond the above-mentioned band right up until January 2010, the time this article underwent its final revision.

<sup>8</sup> The figure shows the data for January-May of the past four years. The share of construction in GDP at this time was much lower than on average for the year due to the seasonal dependence of the parameters being studied.

Figure 2



to stimulate mortgage loans for this. Another step in this direction was taken in June 2009. A National Mortgage Company (NMC) was created to refinance mortgage loans of commercial banks.

By this time, mortgage loans totaling 87 billion drams (\$235 million) had been issued, but the country still needs another \$150 million in such loans. The initial capital of the NMC amounted to 17 billion drams and the Central Bank of Armenia is its only property owner, but in the future the authorities are also hoping to attract private investors to the NMC.

## Measures to Improve the Business Sphere

Government representatives have repeatedly emphasized that the anticrisis program is nothing more than a way to soften the blow dealt by the world crisis, whereas it will take radical economic reforms to achieve the formation of a competitive economy. This means not only so-called “second generation reforms,” which were mentioned at the beginning of the 2000s and which never came to fruition.

Tigran Sargsian’s government, which began working in April 2008, designated several primary measures: improving the tax administration, cutting back the shadow economy, fighting monopolism,

and creating a contemporary information society, that is, promoting the penetration of information technology into every sphere of life.

There are many obstacles in the way since the ruling Republican Party of Armenia largely depends on oligarchs who occupy a monopoly position in various branches of the economy and make use of unofficial privileges in the tax and customs spheres.

President Serge Sargsian, who is the government's only political bastion, has apparently found himself between a rock and a hard place, since he also happens to be the leader of the "oligarch" RPA that is resisting the reforms.

One way or another, however, the government has managed to achieve some success in the struggle to improve the business climate and create equal conditions for all:

1. A decision was made to grant a three-year deferment for paying value added tax when importing equipment.
2. The regulations in customs and tax payments and accounting for small and medium businesses have been simplified. This is just part of the program calculated for three years to carry out reform of the tax administration.
3. Some improvement has been achieved in tax revenue, that is, the shadow economy is being cut back. The authorities claim that this is what is creating the paradoxical phenomenon of a decrease in GDP without the same drop in retail trade. A campaign has begun in the country aimed at issuing checks to customers in stores, without which it is impossible to determine the true volume of trade turnover. Moreover, the tax department announced that between January and June 2009, it managed to raise the share of profits tax to 16% of the total tax collections instead of the 11.5% achieved in 2008. This is another phenomenon that in no way fits the picture of an economic slump. Consequently, there are positive changes in the taxation sphere.
4. In October, the National Assembly finally adopted a set of amendments to the tax legislation, according to which tax representatives should be on permanent duty at dozens of large enterprises to monitor the amount of goods dispatched and the prices for them. The government first presented this set of amendments in May of 2009 and it was met with great resistance in the parliament: it was not adopted until the third attempt, whereby in a version that was perceptibly "softer" than the original one. Nevertheless, its adoption could become the beginning of the government's noticeable victory in the fight against monopolism and tax privileges.

So it follows from the above that the government is continuing its efforts to create a contemporary and effective business environment, as well as a highly efficient economy on its basis. Focus points are being created in promising spheres for attracting the funds of private investors.

The first series of facilities is already functioning: an industrial park in the city of Gumri, a Center of International Tourism on the grounds of the Tatev medieval monastery complex, a free trade area near the airport of Zvartnots, a nuclear medicine center at the Erevan Institute of Physics, and so on.

## *Conclusion*

The world economic crisis revealed two main reasons for the weakness of the Armenian economy: its permanent need for remittances from abroad and its great dependence on the state of certain spheres of the economy (construction and metallurgy).

The government has so far managed to prevent any negative social consequences of the crisis, while it is also trying to create conditions for developing a more diversified and efficient economy.

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## THE PROBLEMS OF STATE REGULATION OF SMALL BUSINESS IN GEORGIA

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### *Introduction*

The former Soviet republics, including Georgia, achieved their state independence, which brought with it a multitude of problems. The former economic ties broke down and there was not enough qualified personnel to promote the development of a market economy, so many enterprises ceased to exist, and the country's economy collapsed. The main task was to restructure the national economy.

The republic's government did all it could to form a market economy in the country, but these

attempts were not crowned by success. The population spontaneously launched into small business, but nor did this do anything to improve the economy.

World experience shows that small business can play a significant role in resolving many problems; it plays a vital part in reducing unemployment and strengthening economic stability as a whole. At the stage of the post-communist transformation the advantages of small business are most important and can be enhanced with the help of a streamlined mechanism of state support.

### **The Role and Importance of Small Business**

Small business is important due to the influence it has on macroeconomic indices (GDP, employment, budget revenues and expenditures, import, export, inflation, and so on). Small business is

one of the main sources for developing and stabilizing the economic system as a whole. It also provides a quick return on money invested. In developed countries, almost half of the able-bodied population is employed in small business; it accounts for approximately 50% of all the products manufactured in the country.

According to American specialists,<sup>1</sup> small business is so vitally important for the economy because it creates jobs, introduces new technology and services, meets the needs of large corporations for specialized products and services, and creates a high level of specialization and cooperation among enterprises, as well as a highly efficient production climate. As practice shows, small businesses help to promote the introduction of innovations into the economy. This all clearly shows that small business is conducive to the wide-scale activation of labor resources in the economy. And this is the crux of its social role as a powerful means of macroeconomic stabilization.

There is an objective need for integration between small and big business in a market economy. In developed countries, the main forms of their interaction are as follows: leasing, subleasing, franchising, license agreements, and venture capital financing. Cooperation and competition with small companies help to increase the maneuverability of large companies and stimulate them to introduce the latest technology.

*In the structure of market mechanisms*, the role of small business is manifested in its ability to fight monopolism, since it is able to react quickly to changing public demand due to its flexibility.

*In the public sphere*, small business gives people a sense of their capacity as property owners and of their ability to make independent decisions; that is, it encourages people to fully realize their potential.

*In the social sphere*, small business helps to form the middle class, which today constitutes the main component in a market society.

*In the creation and preservation of a competitive environment*, small business can have a strong impact on large enterprises and stimulate their innovative activity.

Small business has the following competitive advantages: a high level of efficiency in decision-making, rapid movement of capital, a low level of irretrievable losses, a low demand for capital, the ability to quickly change the range of manufactured products, a short technological cycle, rapid resource turnover (which increases revenue, shortens reimbursement time, and lowers the level of economic risk), small overhead expenses, stable product sales, rapid adaptability to changes in market demand, and rapid information exchange which gives small companies the opportunity to react quickly to any change in competitive conditions.

Small businesses are able to exist and develop even during economic crises.

## Small Business Development Trends in Georgia

The collapse in the Soviet economic structure brought up new and multifarious problems.

At the end of the 19th century, Georgia shifted from the feudal system to capitalism, while in the 1990s, it shifted from the communist economy to market relations. The latter transformation is unique in the world economy.

At the beginning of the 1990s, privatization of state property (issuing vouchers to the population) began in Georgia (as it did in other former Union republics); the employees of the privatized

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<sup>1</sup> See: D. Rechmen, M. Meskon, K. Bouvi, D. Till, *Modern Business*, Textbook, in two volumes, Respublika, Moscow, 1995 (in Russian).



enterprises had the advantage in this process, and “associations,” “cooperatives,” and “joint-stock companies” began cropping up.

Rural residents were given plots of land free of charge, and city residents became the owners of communal apartments with the right to later privatize them. Cooperative apartments (paid in full) went to their owners. At the same time, prices and international relations underwent liberalization.

Due to the difficult economic situation, the population was forced to return to forms of home-based business, crafts, and commerce. In large cities, huge numbers of vending kiosks and stalls, beauty salons, small retail stores, and handicraft enterprises, etc. appeared. Thus, a large part of the population was engaged in life-saving small business. It was precisely during these years that Georgia began enjoying the benefits of small business and social and economic stabilization began, which helped the population to find jobs.

The formation of small business in Georgia was also promoted, in addition to everything else, by the fact that small-scale enterprises remaining from the Soviet era were the first to be privatized. In 1993, they constituted 98.4% of the total number of privatized facilities.

On the basis of the Law on Privatization of State Property, the Provision on Privatization of State Property in the Form of Tenders, Auctions, Contract Purchase, Direct Sale, and on the Transfer of the Right to Manage Shares Owned by the State in the Form of Tenders was adopted. The most popular way of carrying out privatization was through auctions.

Until 1993, laws and government resolutions were adopted in the republic that helped to form the private sector in the country and promote business development. Among them special mention should be made of the Law on the Fundamental Principles of Business Activity (1991) and government resolutions On Approval of the Provision on State Enterprises (1992), On Approval of the Temporary Provision on Securities (1992), On Approval of the Provision on Individual Business and Individual Production Units (1993), and On Approval of the Provision on Societies with Limited Liability (1993).

The formation of small business has been stymied in the country by the fact that there were no laws on small businesses until 1999.

According to the State Statistics Department, until 1999 businesses were assessed as small depending on the number of their employees and the specifics of their operation. Industrial, agricultural, and transport enterprises with up to 50 employees, construction companies with up to 35 employees, companies engaged in medicine and education with 30 employees, wholesale and retail trade companies with 20 employees, and other organizations with 20 employees were classified as small businesses.

On 23 July, 1999, the Law on Support of Small Businesses came into force, according to which businesses were classified as small, in addition to the number of employees, by the annual turnover. For industrial enterprises, the criteria were 40 employees and 500,000 lari; for construction 20 employees and 300,000 lari; for transport and communications 20 employees and 200,000 lari; for agriculture 20 employees and 150,000 lari; for wholesale and retail trade 10 employees and 50,000 lari; in the educational, public health, and cultural spheres 25 employees and 60,000 lari; and in other spheres of economic activity 15 employees and 100,000 lari.<sup>2</sup>

Three years later, amendments were made to this law, according to which enterprises with no more than 20 employees and an annual turnover of 500,000 lari were defined as small.

It should be noted that the definition of the threshold size of small businesses envisaged in the law does not always correspond to reality, since statistics provide a very different picture. The real size of small businesses is perceptibly lower than that envisaged in the law—3-4 employees, and the annual turnover is 40-50,000 lari. This shows that the criteria were established without taking account of or analyzing the actual situation in the country. Nevertheless, we need to realize that the criteria for

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<sup>2</sup> See: Georgian Law on the Support of Small Businesses, *Advokat*, Nos. 37-38, 2006, appendix.

small businesses should fluctuate depending on the change in the level of the country's economic development.

An analysis of these data shows that the situation relating to small business in the country (both in terms of types of economic activity and in terms of its distribution around the country) does not look particularly favorable. In terms of types of economic activity, most small businesses are engaged in wholesale and retail trade, car repair, household goods and personal items—42.9% (2007), whereas in the regional structure (Tbilisi), this index amounts to 28.7%.

In the next few years, special attention should be focused on forming small business in agriculture. This conclusion can be drawn from taking a look at the volume of products put out by small businesses—in 2005-2007, agriculture, hunting, and forestry accounted for only 2%, the mining industry and quarry development for 1.6%, and electric power, gas, and water supply for 0.6%. In 2007, Tbilisi<sup>3</sup> alone accounted for 52.2% of the total volume of products generated by small businesses.

It follows from the above that the development level of small business is low (in 2007, small business output amounted to only 5-6% of the total amount of goods and services produced in the republic), which is due to the almost total absence of state support.

The economic and legal foundations for developing and supporting small business in Georgia were set forth in the law of 23 July, 1999 On Support of Small Businesses. Until it was adopted, a Small Business Development Support Fund functioned under the Ministry of Economics, which was eliminated by this law. Subsequently, a small business development and support center was instituted responsible for drawing up and implementing government policy in this sphere. This center was a legal entity of public law and had regional offices throughout the country. Its activity was controlled by a small business coordinating council which consisted of representatives from 13 different state governing institutions: ministries of economics, finance, commerce, and foreign economic relations, industry, agriculture, labor and employment, the state chancellery, and the national bank, as well as the coworkers of regional organizations. The president approved the candidacy of the director and members of the council (for a term of two years).

The Law on Support of Small Businesses granted small businesses the right to create unions and funds in order to solve tasks related to state support and development.

The Law on Support of Small Businesses helped to clarify the criteria for small businesses, although it was unable to meet the demands of the times. This required making amendments to it (by means of a law adopted in 2002); the criteria for small businesses were defined by new parameters and statistical values. But this law did not meet the expectations either with respect to the further development and support of small business.

In 2006, the Georgian parliament cancelled this law (instead of improving it), and a new one has still not been adopted. At the same time, the small business development and support center was abolished. It can be said that as of today Georgia has neither a legislative framework for regulating small business, nor a body for regulating its macroeconomic development.

## Theoretical Model of Macroeconomic Small Business Regulation

The mechanism of macroeconomic small business regulation is a complex system. It is called upon to enhance the benefits of small business in the country's economy and promote its optimal

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<sup>3</sup> See: *Business in Georgia*, Statistics Department of the Georgian Ministry of Economic Development, 2008 (in Georgian).

development. The purpose of forming such a system is to remove the detrimental macroeconomic or microeconomic aspects that have a negative impact on the development of small business. The mechanism of macroeconomic regulation is a unified system that ensures the normal development and functioning of small business in a competitive environment and reinforces its place in the country's economic system.

By its nature small business needs comprehensive support. Financial resources must be found, information structures launched, the network of marketing services expanded, efforts made to ensure the training of qualified personnel, and so on. Small business also needs support because it has a low level of production diversity, a small amount of authorized capital, and insufficient resources; management is rather poorly developed in this sphere, and it is very sensitive to changes in the market situation.

The development of small business is particularly important in countries with a post-Soviet economy; here it is a vital means for eradicating unemployment and forming business skills. However, a multitude of obstacles stand in its way here (the high level of corruption, the mistakes committed when carrying out reforms, difficulties encountered during the reforms in general, and so on).

So rendering support to small business should be one of the important areas of state economic policy. In this respect, the system of methods and tools for carrying out legislative, executive, and monitoring measures aimed at the macroeconomic regulation and development of small business must be improved. Only this will make it possible to achieve stabilization of the entire economy and its subsequent development.

The mechanism of macroeconomic regulation of small business development should contain the following elements: legislative support, a system of regulation indicators; a set of regulation methods and tools; a macroeconomic infrastructure of support; state entrepreneurship; regulation of the receipt of international assistance; risk-based security; regulation control; and regulation structures (see Fig. 1).

*Legislative and regulatory support* implies adopting laws and regulatory acts that define the status of small business in the economy and promote its further development.

*The system of regulation indicators* comprises all those indices on the basis of which it is possible to study the overall situation existing in small business, as well as eliminate the difficulties and shortcomings arising during regulation.

*The system of regulation measures* primarily implies defining a small business development strategy and drawing up macroeconomic policy, as well as all the measures that must be implemented to achieve the set goals.

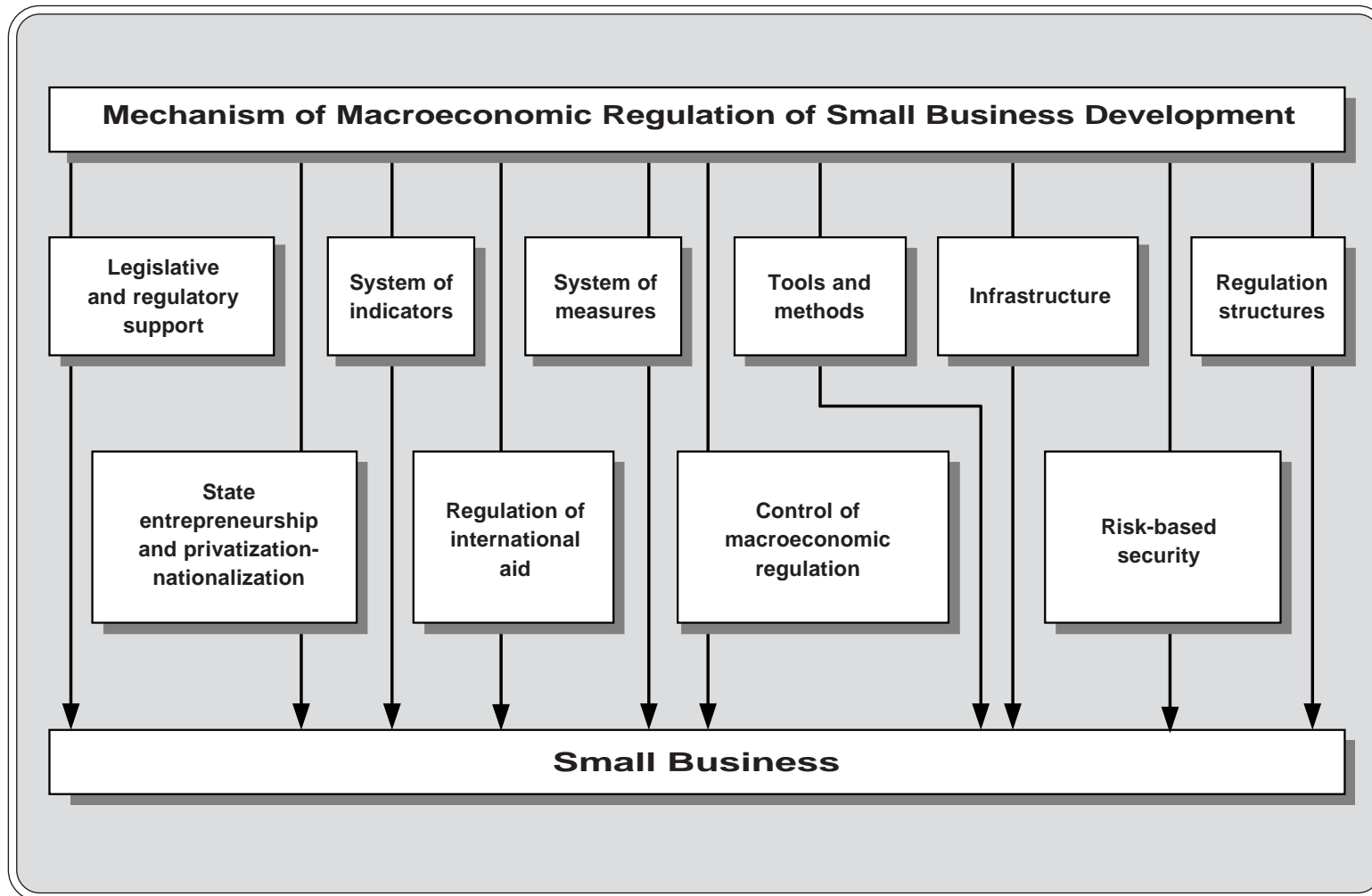
Administrative and economic tools can be singled out among *the tools of macroeconomic regulation*. The first include licensing, registration, antimonopoly prohibitions, quoting, environmental bans, and so on. The economic tools include forecasts, plans, programs, standards, regulations, tariffs, state investments, discount rates, reserve rates, loan privileges, tax rates, customs fees, tax breaks, government procurement, subsidies, compensations, fiscal, monetary tools, and so on. These tools do not entail direct warnings, but act based on the interests of the object of regulation.

Economic regulation of small business development can be carried out by means of direct and indirect methods. Direct methods are aimed at rendering comprehensive assistance to the development of small business, which should be carried by means of state subsidizing, implementing state programs, and developing state entrepreneurship.

One of the elements of macroeconomic regulation of small business development is *state entrepreneurship in small business*. This implies the operation of small enterprises (which are directly owned by the state) that are unable to operate in the private sector at a particular stage.

*Regulation of international aid* implies that the state is responsible for monitoring the receipt of international aid to ensure its further efficient use. This is carried out by the structures that directly control small business.

Figure 1



*Regulation control* implies identifying (based on an analysis of the corresponding indicators) the existing shortcomings and determining ways to eliminate them or make adjustments to the management mechanism, as well as guaranteeing risk-based security of small business.

*Structures that control the regulation of small business development* include all three branches of state power—legislative, executive, and judicial.

The mechanism of macroeconomic regulation of small business development is a system of closely interrelated elements. All the elements (subsystems) of the model presented have undergone constant changes, additions, and clarification, since small business is regarded as a dynamically developing entity.

As already noted, all the above problems are particularly pertinent today for the post-Soviet countries, since the market economy is still being formed in them. Small business, as the primary source for enhancing competition and forming and ensuring the stability of big business, is a powerful means for overcoming economic backwardness.

So forming a mechanism of macroeconomic regulation of small business development support and its smooth functioning is a necessary prerequisite for improving the market economy.

## **Main Areas in the Macroeconomic Regulation of Small Business in Georgia**

We believe that the following set of laws should be prepared for improving the legislative base of small business development in Georgia: a Law on Small Business, a Law on Mutual Protection Associations for Small Enterprises, a Law on the Innovation Activity of Small Enterprises, a Law on Regulation of Contractual Relations in Small Business, and a Law on State Support of Small Business.

The Law on Small Business should set forth the essence of small business, criteria for assessing and determining the size of small enterprises, organizational and legal forms, registration conditions, simplified bookkeeping procedures, its organizational structure, a mechanism for transforming small businesses, the appointment of experts, public information and confidentiality.

The mechanism of macroeconomic regulation will not be effective if, first, criteria for assessing the development of small business and the size of small businesses are not determined. Whereby the country should not be guided by indices characteristic for other states—the situation existing in Georgia should primarily be taken into account.

Relying on the studies carried out, the following criteria should be adopted for evaluating the development of small business in Georgia: annual volume of products sold; number of employees; total number of small businesses; number of residents per small enterprise; number of small enterprises per 1,000 residents; average monthly salary of people employed in small business; and the percentage of small business (in GDP, in the total number of employees, and in the total number of enterprises).

As for the criteria for defining whether an enterprise can be classified as small, the dimensions of the country's economy and its level of development should be taken into account. In particular, the values of the indices (according to our suggested criteria) for operating enterprises should be calculated. Those enterprises that have values lower than the average should be classified as small, those with average indices as medium, and those with indices higher than the average as large enterprises.

Based on the analysis conducted and in the short-term perspective, those businesses with no more than ten employees and with an average annual turnover of no more than 150,000 lari should be classified as small.

The Law on Mutual Protection Associations for Small Enterprises should define the functions of a Union of Creditors. It should operate under government control and serve small businesses, issuing them the necessary loans (for developing enterprises, for raising the qualifications of the union members, for putting their children through school, and so on). This same law should envisage insurance against possible risks with the possibility of their redistribution to insurance companies.

The Law on the Innovation Activity of Small Enterprises should determine those spheres that belong to innovation activity—scientific research, R&D, invention, education, and so on. Methods for encouraging and stimulating innovation activity in small business should also be determined.

The law should set forth principles for the operation of technoparks, joint venture companies, a national investment agency, and state enterprises for encouraging investors in innovative small business.

The law should envisage venture (risk) activity; innovation companies willing to allot capital should be engaged in this. It should also envisage the main types of activity of a venture fund, the main entities of venture activity, and small innovation companies. They should form a link between the scientific sphere and production.

Small innovation enterprises act as the consumers of scientific production for the scientific sphere and as a means of commercialization of scientific results. Small innovation enterprises act as a supplier of goods and services and one of the main sources for raising competitiveness and for modernizing production in the production sphere. The law should also define the types of small innovation companies.

It is impossible to imagine the business activity of small enterprises without the existence of a *Law on Regulation of Contractual Relations in Small Business*. The market economy relies on unions of free entrepreneurs and they, as a rule, are formed by contracts between market entities. The law should establish the legal regulations of contractual relations between small businesses and other market entities (large businesses, state institutions, credit institutions, and so on), in particular, leasing, franchising, venture, and contractual agreements.

The *Law on State Support of Small Business* should define the functions of small business development support funds and centers, as well as a system and infrastructure of state support of small business; and a United Small Business Development Fund of Georgia should be created. State support of small business should be envisaged not only by specific laws, but also by other laws that apply to the entire economy.

Quantitative and qualitative development indices can be included in the *system of indicators* of macroeconomic regulation of small business development. The quantitative indicators include: volume of manufactured products, number of employees, number of small enterprises and their density, and the percentage of small business in the gross domestic product.

The qualitative indices include: the branch structure of small business, the percentage of innovation enterprises in the total number of small businesses, the regional structure, average salaries, productivity, capital intensity, capital productivity ratio, and length of working week in small business.

*The system of measures* of macroeconomic regulation of small business development, as mentioned in the theoretical model, implies defining a development strategy and drawing up a corresponding macroeconomic policy. The main area of development of small business at the current stage should be raising the percentage of small business based on an increase in the number of enterprises and their qualitative improvement. Particular importance should be placed on development in the innovative sphere.



The legislative, executive, and judicial bodies are the *regulation structures* of small business in Georgia. The parliament adopts corresponding specific and general economic laws that define the rules of the game in small business. The executive bodies define the development strategy for small business and draw up a corresponding policy and system of measures. Both the parliament and executive power monitor how the adopted laws are put into practice. The judicial bodies protect small business, as well as other economic entities, from lawlessness and injustice, which promotes their enhancement.

A distinction should be made between specific and non-specific structures of macroeconomic regulation of small business development.

It seems expedient to create a specialized state independent structure under the cabinet of ministers of Georgia called *the Small Business Development Administration* for rendering assistance to small business in free competition conditions. Its functions should include the following: determining state policy in the development of small business; preparing corresponding laws; developing a state financing program for small business with its further submission to the parliament for approval; analyzing the activity of small business; developing corresponding programs and carrying out corresponding measures for its stimulation; organizing the establishment of contacts between small and big business; defining and coordinating small business infrastructure; information support; rendering assistance (in the form of guarantees) for obtaining loans; and attracting investors.

The Small Business Development Administration should be financed by the state.

Economic ministries (in particular, the Ministry of Economic Development) should act as non-specific structures for regulating small business.

The Ministry of Economic Development should:

- (1) Develop a small business development strategy and state economic policy.
- (2) Closely study the acts drawn up by the Small Business Development Administration and submit them to the legislative body.
- (3) Define the areas of small business development in priority branches.
- (4) Assist the financing of R&D in small business, as well as introduce the latest technology.

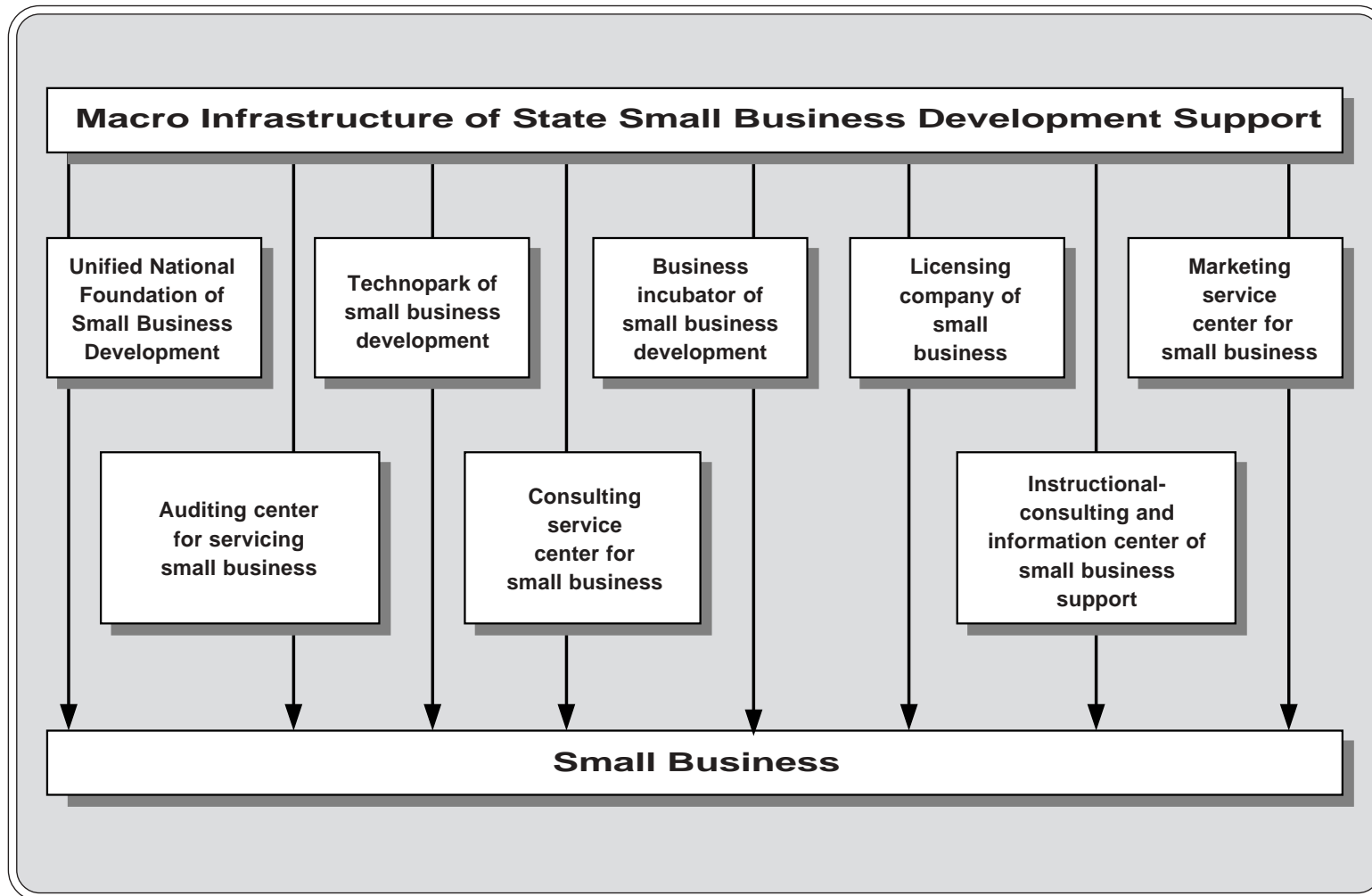
The existence of a *macroeconomic infrastructure of small business support* is one of the most important links in the regulation mechanism. A macrostructure of small business support should be created under the Small Business Development Administration (see Fig. 2).

*The National Fund of Small Business Development* should find financial resources and make efficient use of them, provide small business employees with high-quality financial servicing, and issue preferential and interest-free loans to enterprises that operate in spheres that are of state priority.

*The technopark of small business development* should create conditions that promote the development and activity of small innovation companies, carry out rapid commercialization of the results of R&D and encourage scientists, promote the development of science-intensive production units, hold seminars and consultations on the problems of innovative activity for the employees of small companies, help small businesses to participate in exhibitions of high technology and ensure them access to the international market, develop and implement small business personnel training projects in management and marketing, set up (for example? in Rustavi, Kutaisi, Zugdidi, and Telavi) equipment for innovation enterprises and permit them temporary use of laboratories and industrial facilities.

*The business incubator of small business development* should create the conditions necessary for developing small businesses (from the moment they are founded to the time they achieve full financial independence), provide small businesses with production and office space, render professional servicing, and take part in developing various innovation programs.

Figure 2



*The licensing company of small business* is responsible for introducing efficient leasing of moveable property and real estate, providing small businesses with equipment, facilities, and so on, creating a pool of secondary equipment in order to lease it, providing small business entities with specialized equipment (for example, transportation means, road-building equipment, special machinery and plant, and so on), providing small business with short-term rental of equipment and small-scale mechanization facilities (along with service personnel), and creating an information base for small business.

*The marketing service center for small business* ensures the output of products that enjoy the greatest demand among the population, assists in developing a certain segment of the market (at the lowest cost) and in determining solvent demand, defines additional products that could be offered to an existing client, identifies new customers who will purchase the existing range of products, and helps to create new types of products. The center should carry out corresponding marketing in compliance with the industrial profile of the small enterprise.

*The auditing center for servicing small business* that exists under the Georgian Small Business Development Administration is responsible for auditing small business entities to ensure they are observing the legislative and regulatory acts and carrying out correct bookkeeping procedures, as well as for providing legal consultations on civil, economic, labor, customs, and tax law.

*The consulting service center for small business* is responsible for drawing up a business plan to justify the feasibility of forming a small business, providing legal assistance during registration, forming an authorized fund and registering documents, defining sources (national and international funds) from which small businesses can obtain financial aid, and gathering information on the infrastructure that influences its development.

*The auxiliary instructional-consulting and information center for small business support* is intended for filling in the growing gaps in different spheres (information, marketing, business activity), raising the professional level of enterprise employees, and training professional personnel, consultants, and government officials for small business.

All the organizations in the designated infrastructure will at the first stage exist at the macro level and be financed from the state budget; it would be expedient to draw funds from big business and international aid. As the market economy and small business develop, a particular organization may become redundant at the macro level and it can be joined to the market structure. The Small Business Development Administration should ensure organization and coordination of this infrastructure.

Several funds and sponsor organizations are operating in Georgia in order to assist the formation of a market economy and develop business, such as the Eurasia Fund, World Bank, World Vision (which has micro-credit activities), and the European Bank of Reconstruction and Development (EBRD).

The Open Society-Georgia Fund has elaborated an economic development program for 2006-2008, which envisages small business support.

Small businesses engaged in material production and innovation activity must be created in the state sector.

At the current state of Georgia's economic development, the main obstacles in the enhancement of small business can be considered the low level of economic and technological development, the low qualification of blue- and white-collar workers, the absence of a developed small business development support infrastructure, the low average wages, the insufficient development of management and marketing, the underdevelopment of the economic reforms, the slow rate at which market relations are forming, the low level of investment activity, the unsophisticated taxation system, inefficient use of foreign loans, the burgeoning external debt, the outmoded import-export structure, lack of protection of the domestic market from low-quality and fake products, the low level of customs con-

trol, backwardness in the service sphere, in the economy of the regions, and in the insurance sphere, and so on.

The following can be singled out among the internal non-economic dangers: violation of the country's territorial integrity (a large number of displaced persons); the problematical demographic situation; regional separatism; deterioration of the environmental situation, and natural disasters.

Among the external economic dangers, the financial crisis, increase in fuel prices, and others should be mentioned.

External non-economic dangers include the deterioration in the international and regional political situation.

In order to assess the level of security, we should take a look at the corresponding indices, for example, the percentage of small business in GDP, small business structure (branch and regional), volume of investments (foreign and domestic), the level of wages, and the percentage of small business (in terms of number of employees).

Today small business in Georgia is operating at high risk, so enterprises should make use of the possibilities offered by the insurance system.

The marginal risk should be estimated in order to ensure the security of small business development in Georgia.

So we can say the development of small business is under threat today in Georgia and requires active support from the state.

The parliament, which should monitor the performance of the laws adopted, the government, and the judicial power hold the prime responsibility for *monitoring macroeconomic regulation of small business development*. Control functions should be carried out on the basis of an analysis of the corresponding indicators with subsequent development of measures for correcting the mistakes.

It is vital to raise not only the quantitative but also the qualitative level of small business. Special tax measures should be adopted to meet these requirements. The current Tax Code does not envisage any special benefits for small business. The Law on Entrepreneurs envisaged simplified bookkeeping procedures for small business, but this provision was eliminated by the amendments made to this document in 2006. It would be expedient to create special tax legislation; for this purpose, a separate section called "Taxes on Small Enterprises" should be introduced into the Tax Code. This requires adopting special tax breaks for small businesses in those regions or branches that are of prime significance for the country's economy. For example, small business can be enhanced in such regions as Mtskheta-Mtianeti, Samtskhe-Javakheti, Zemo Svaneti, Racha-Lechkhumi, Tskhinvali, and Abkhazia; the most promising branches are the processing industry, agriculture, fishing, tourism, etc.

Small business needs to be protected from dumping, unhealthy competition, bad advertising, and other phenomena of the "bureaucratic market" that prevent the normal functioning of the market mechanism; the state should ensure fair competition.

The Small Business Development Administration should resolve all of the above-mentioned problems.

The low popularity of small business in Georgia today is also due to the fact that the population does not show any particular interest in it. So the Small Business Development Administration should help to boost its popularity through the mass media. In addition, this problem should be resolved with the assistance of the entire small business support infrastructure.

The Small Business Development Administration and Unified National Fund of Small Business Development should provide for preferential loans to be issued to small businesses.

A method for encouraging enterprises oriented toward high-quality, competitive, and innovative production should be applied to raise the qualitative level of small business. Such enterprises should be granted tax breaks and enjoy zero customs fees, and various ways of accelerated depreciation should

also be used. Fifty percent of the basic cost of fixed assets that have served for more than three years should be written off. Special attention should be focused on selecting those branches that will ensure an increase in production volume and revenue into the state budget.

The small enterprises of these branches should also be able to replace import with locally manufactured products. This primarily relates to enterprises of the light and food industries.

Structural improvement of rapidly developing small business should be carried out, and it should be rendered all kinds of support, particularly those enterprises that are mastering the latest technology; within two years they should be made exempt from all types of taxes. They should also be issued preferential loans.

### *Conclusion*

The study carried out shows that the level of small business development in Georgia is low, which is due to the country's low level of economic development, on the one hand, and the weak regulation of small business by the state, on the other; there is almost no corresponding legislative framework, regulation mechanism, state support infrastructure, and so on.

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## THE WORLD ECONOMIC CRISIS AND ITS IMPACT ON THE SOCIOECONOMIC SITUATION IN KAZAKHSTAN

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The world financial crisis, which began with the collapse of the U.S. credit pyramid, is known to be the biggest crisis since the Great Depression.<sup>1</sup>

The first signs of the crisis appeared in the U.S. mortgage market in 2006<sup>2</sup> (housing loans were not being repaid), and shortly afterwards this market collapsed, triggering a global liquidity crisis.<sup>3</sup>

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<sup>1</sup> [[http://www.ipd.kz/index.php?option=com\\_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru](http://www.ipd.kz/index.php?option=com_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru)], 15 June, 2009.

<sup>2</sup> [[http://akmolinka.narod.ru/n161\\_16\\_12/actual.htm](http://akmolinka.narod.ru/n161_16_12/actual.htm)], 15 June, 2009.

<sup>3</sup> In the early 2000s, American lobbyists from Wall Street developed a mortgage loan scheme for borrowers with a less than perfect credit history. Such loans came to be known as "subprime loans"; active lending in this segment began in

Housing prices in the U.S. plummeted, investments in housing construction fell, and the liquidity of the mortgage derivatives market began to decline. All of this took place against the background of a jump in credit spreads in money markets; the stocks of international companies plunged, and stock indexes fell significantly<sup>4</sup> due to the bankruptcy of major financial institutions, primarily investment banks.<sup>5</sup>

Against the background of rising unemployment and tightening credit, the increase in U.S. consumer spending ceased in the second quarter of 2008 (for the first time since 1991).<sup>6</sup>

In the third quarter of 2008, investors withdrew \$20 billion from investment funds in developing countries for fear that the crisis might cause a recession in these countries.<sup>7</sup>

The U.S. economy's failure to cope with the escalating financial crisis was probably caused by the specific features of this economy:

- (1) issue of dollars not backed by international reserves;
- (2) issue of debt not backed by real assets (a gap between the financial and real sectors of the economy: pre-crisis world GDP stood at \$64-65 trillion, while the value of all obligations, including cash and financial instruments, was about \$500 trillion<sup>8</sup>); this resulted in a "bubble" that was further inflated by factoring (sale of accounts receivable to third parties). As a result, the right to receive payment from borrowers became a separate and quite independent asset;
- (3) organization of an unwarranted inflow of electronic money into the economy;
- (4) rapid growth of U.S. external debt (its annual increase is comparable to half of U.S. GDP);
- (5) use of dollars not backed by international reserves in the stock market;
- (6) excessive financial liberalization; credit (mortgage) policy was beyond the government's control and, in effect, beyond the law (long period of low interest rates, low savings rate, highly speculative stock market, etc.);
- (7) unjustified absence of strong government regulation of the financial market and industry (the U.S. insisted on the need to refrain from any kind of government intervention); the unfolding crisis only confirmed the concerns about the liberalization of the economy.<sup>9</sup>

Kazakh economist A. Essentugelov associates the specific features of the American model with the transition of developed countries from the industrial to the post-industrial socioeconomic order in the context of rapid globalization (1980s).<sup>10</sup> In industrial society, the source of growth was industrial capital. Economic growth was achieved by increasing the scale of production and reducing unit costs. Large industrial enterprises with a considerable number of employees operated in the economy. They depended only weakly on bank credit; rather, it was the other way round.

Gradually the situation began to change. Economic growth slowed because it required increasing amounts of resources, which were limited a priori. This paved the way for innovations in the econ-

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2003, and in the first three years loans were offered on easy terms. In 2006-2007 payments increased; coupled with an increase in unemployment this led to mass eviction of people from their homes because of bankruptcy. To this was added a sharp drop in the value of derivatives backed by these loans due to mass bankruptcies of borrowers. The crisis was in full swing [http://www.utro.ru/articles/2009/02/09/796535.shtml], 25 June, 2009.

<sup>4</sup> [http://economyclub.info/upload/Jakupova.doc], 15 June, 2009.

<sup>5</sup> [http://bb.f2.kz/ru/economic/vliyanie-mirovogo-krizisa-sentyabrya-2008-na-kazahstan-t408.html], 15 June, 2009.

<sup>6</sup> [http://economyclub.info/upload/Seytkasimov.doc], 29 June, 2009.

<sup>7</sup> Ibidem.

<sup>8</sup> [http://economyclub.info/upload/Kuchukova.doc], 29 June, 2009.

<sup>9</sup> [http://www.washingtonpost.com/wp-dyn/content/article/2008/10/09/AR2008100903425.html], 16 June, 2009.

<sup>10</sup> [http://economyclub.info/upload/Essentugelov.doc], 16 June, 2009.



omy in the form of new technologies that made it possible to produce the same (or larger) amounts of finished products at a lower cost. Thus, economic development became less dependent on invested capital than on the human factor (people's knowledge and abilities). Active work got underway to develop and implement innovations and to improve technologies; the role of the mass media increased, helping to create a qualitatively new economy.

The role of large enterprises as the main business entities gradually passed to small and medium enterprises, which were quicker to respond to changes in the market by using the achievements of scientific and technical progress.

The active innovation process required increasing investments: in human capital, R&D, testing, manufacture of high technology products, etc. At the same time, small and medium enterprises (accounting for 90% of GDP in the U.S., 80% in Germany, and 70-80% in other developed countries)<sup>11</sup> lacked the necessary financial resources and were badly in need of credit. This led to the modernization of the financial system and to the appearance of new financial instruments for investing capital. Money became an asset that could be used to make large profits without providing services to the real sector of the economy. That is why the actively developing financial sector tended to become increasingly autonomous.

Thus, there was a transition from the industrial to the post-industrial socioeconomic order. With an increase in the role of the human factor, industrial capital as an engine of economic progress gave way to financial capital, which provided new opportunities for development.

The transition to the post-industrial order went hand in hand with globalization, which served to increase the interdependence of once economically unrelated countries. It should be noted that globalization affected both sectors of the economy: real and financial. It created favorable conditions for the movement of goods, services, capital and labor. The boundaries between national financial systems began to erode as they merged into a single global system.

Using the latest achievements of information and communication systems, the financial sector developed rapidly with a reduction in transaction costs. It became possible to take part in market operations through the Internet, to purchase real and financial assets, speculate and make profit.

The rejection of the old (Bretton Woods) monetary system and the switch to a new, floating exchange rate system completed the formation of the modern U.S. economic model; that was also when the U.S. began to issue large amounts of dollars not backed by international reserves.

As an argument, A. Essentugelov quotes R. Dornbusch,<sup>12</sup> who wrote at the turn of the century: "Even with all the US prosperity, the world today has had an overdose of finance and hence it is far more likely that a serious accident can happen." The U.S. became the issuer of a de facto global reserve currency, the dollar, the demand for which kept increasing due to globalization and to the strength of the American economy.

From the 1970s on, the world economy as a whole successfully developed for quite a long time. Living standards in the U.S. were improved by means of strong credit and budget expansion, and consumption grew rapidly. Due to the soundness and profitability of the U.S. economy, many countries invested their surplus funds in the United States by acquiring treasury securities, while the U.S. government borrowed funds from these countries to cover its growing budget expenditures. The informal sector in many countries used the dollar as a medium of exchange.

Hence the stock of dollars circulating in the world economy in the early 21st century already exceeded the actual amount of produced goods and services. The "soap bubble" in the financial market swelled.

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<sup>11</sup> [<http://economyclub.info/upload/Essentugelov.doc>], 16 June, 2009.

<sup>12</sup> *Ibidem*.

Whereas in industrial society the economic system is expressed by the formula “enterprise-market (trade)-consumer,” in post-industrial society it looks as follows: “enterprise-market (trade)-consumer; enterprise-profit-interest-dividends on shares-insurance of shares-loans to insurers-...”

All of this together resulted in a financial crisis. In industrial society, crises are caused by over-production, and in post-industrial (today’s) society the crisis began with excessive consumption of money (in the financial sector).

Low lending rates combined with diverse financial innovations and inadequate risk assessment led to a housing boom and to a critical situation in the housing market.

Given a very low savings rate and a high rate of consumption (with weak government regulation), global imbalances worsened and dependence on the outside world increased.<sup>13</sup>

The U.S. mortgage market expanded in large part due to sophisticated financial instruments, which is why the crisis that started in this market developed into a financial crisis. The development of many countries is connected with the U.S. economic and financial systems and, in fact, there are no boundaries between national banking systems,<sup>14</sup> so that the financial crisis has spilled over into virtually all other countries and turned into a global one.

Kazakhstan was one of the first countries in the world to feel the effects of the 2008 wave of the global crisis,<sup>15</sup> which hit it exactly a year earlier than other countries in the world.<sup>16</sup> This is because, in the first place, the country’s economy is sufficiently deeply integrated into international markets.<sup>17</sup> Due to its developed banking and financial systems, Kazakhstan turned out to be more vulnerable to the impact of the world financial crisis than other Central Asian countries (Uzbekistan, Tajikistan and Kyrgyzstan).<sup>18</sup>

The first signs of the world financial crisis appeared in Kazakhstan in early 2007, when the U.S. encountered the problem of subprime loans.<sup>19</sup> At that time, construction in Kazakhstan was developing rapidly. For fear of another mortgage crisis (like the one in the U.S.), foreign banks stopped lending to Kazakh banks. Since foreign loans were the main source of funds,<sup>20</sup> second-tier Kazakh banks were unable not only to continue providing credit to the construction industry and other sectors of the economy, but also to meet their foreign obligations; their shares began to fall.<sup>21</sup>

Total banking sector debt soon rose to \$40 billion.<sup>22</sup> In order to repay their external debts, banks cancelled all loans, and growth in the construction sector slowed significantly. The reduced opportunities of domestic banks to attract external financial resources curtailed credit to the domestic economy; there was a continued trend toward a reduction in banking system liquidity, compounded by large debts.

Sharp price changes in the world food market<sup>23</sup> led to a considerable increase in inflationary pressure on the economy.<sup>24</sup> Thus, the global liquidity crunch began to have a significant impact not only on the banking sector of the republic’s economy, but on its real sector as well.

<sup>13</sup> [<http://economyclub.info/upload/Jakupova.doc>], 15 June, 2009.

<sup>14</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>15</sup> [[http://www.ipd.kz/index.php?option=com\\_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru](http://www.ipd.kz/index.php?option=com_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru)], 24 June, 2009.

<sup>16</sup> [<http://economyclub.info/upload/Seytkasimov.doc>], 29 June, 2009.

<sup>17</sup> [[http://akmolinka.narod.ru/n161\\_16\\_12/actual.htm](http://akmolinka.narod.ru/n161_16_12/actual.htm)], 15 June 2009.

<sup>18</sup> [<http://economyclub.info/upload/Fam%20Ti%20Chan.doc>], 24 June, 2009.

<sup>19</sup> *Ibidem*.

<sup>20</sup> [[http://www.kazpravda.kz/index.php?uin=1151984397&act=archive\\_date&day=26&month=8&year=2008](http://www.kazpravda.kz/index.php?uin=1151984397&act=archive_date&day=26&month=8&year=2008)], 26 June, 2009.

<sup>21</sup> [[http://akmolinka.narod.ru/n161\\_16\\_12/actual.htm](http://akmolinka.narod.ru/n161_16_12/actual.htm)], 15 June, 2009.

<sup>22</sup> [<http://economyclub.info/upload/Fam%20Ti%20Chan.doc>], 24 June, 2009.

<sup>23</sup> [<http://www.polit.nnov.ru/2008/03/12/crisisdate/>], 24 June, 2009.

<sup>24</sup> [<http://ru.government.kz/documents/govprog/27>], 24 June, 2009.

This vulnerability of the Kazakhstan economy is probably explained by the following peculiarities:

- (1) Increasing raw material orientation of exports, primarily due to oil and gas. Under favorable global market conditions (high raw material prices), the national economy not only obtained sufficient funds for active development, but also became heavily dependent on global demand for oil.<sup>25</sup> The pre-crisis economic growth was the result of favorable external economic conditions and growing raw material exports.<sup>26</sup> The annual drop in oil prices<sup>27</sup> has naturally reduced export earnings, posing a threat to the republic's National Fund and the state budget. This may result in a devaluation of the tenge,<sup>28</sup> wage cuts, etc.
- (2) Open markets, growing imports and free importation of goods were a disincentive to the development of the real sector of the economy (noncompetitiveness of local products). Growth in imports coupled with a rise in average contract prices, a decline in labor productivity growth rates and a number of other factors fueled inflation in the country in May 2008.<sup>29</sup>
- (3) The established trend toward an inflow of foreign loans and poor banking regulation. The inflow of loans accelerated, including due to tax breaks. Under the republic's Tax Code that operated until 2009, financial institutions and construction companies were exempt from VAT, and this played a significant role in the collapse of the real estate market in late 2008.<sup>30</sup>
- (4) The sharp reduction in the flow of credit from abroad and the world liquidity crisis hit the country's construction industry; in the first half of 2008, investments in housing construction fell by 2.3%, and the volume of newly constructed housing decreased by 7.7%. Before the crisis, many banks made wide use of borrowed funds (in 2008, the share of external borrowings exceeded 50%) to provide credit to construction market players. They were involved in speculative financing of the economy through resale of low-interest loans (obtained at 5% per annum) in the domestic market (at interest rates of 12-15%),<sup>31</sup> often to borrowers that were inherently incapable of repaying these loans and applied for new ones in order to refinance existing debts.<sup>32</sup>
- (5) At the start of the crisis, in August 2007, Kazakhstan's external debt was \$96.4 billion (in 2001-2007, it increased 8-fold), while its GDP was just over \$100 billion.<sup>33</sup> In 2008, the country's total external debt was virtually equal to GDP, exceeding \$105 billion; of this, the external debts of commercial banks exceeded \$45 billion.<sup>34</sup> In eight years, total banking sector assets increased 21.7-fold, and credit to the economy, 21.8-fold.<sup>35</sup> In 2009, Kazakhstan was due to repay \$11 billion of external debt, and this creates problems with credit to the economy and further economic growth.<sup>36</sup> In other words, ineffective banking regulation has led

<sup>25</sup> [<http://economyclub.info/upload/Seytkasimov.doc>], 29 June, 2009.

<sup>26</sup> Ibidem.

<sup>27</sup> Kazakhstan President Nursultan Nazarbaev's 2009 Address to the Nation [[http://www.akorda.kz/www/www\\_akorda\\_kz.nsf/sections?OpenForm&id\\_doc=73738D165C03D67D062575710070A04F&lang=ru&L1=L2&L2=L2-22](http://www.akorda.kz/www/www_akorda_kz.nsf/sections?OpenForm&id_doc=73738D165C03D67D062575710070A04F&lang=ru&L1=L2&L2=L2-22)].

<sup>28</sup> [<http://economyclub.info/upload/Alpyspaeva.doc>], 24 June, 2009.

<sup>29</sup> [<http://economyclub.info/upload/Iskakova.doc>], 29 June, 2009.

<sup>30</sup> [<http://souz-atameken.kz/rus/pressfile/?cid=30&rid=6590>], 29 June, 2009.

<sup>31</sup> [<http://economyclub.info/upload/Seytkasimov.doc>], 29 June, 2009.

<sup>32</sup> Ibidem.

<sup>33</sup> Ibidem.

<sup>34</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>35</sup> Ibidem.

<sup>36</sup> Ibidem.

to over-accumulation of external debt coupled with poor risk management in the financial sector itself.

- (6) As a result of the third peculiarity, issued credit was concentrated in the construction sector and the real estate market, which currently have a significant amount of delinquent loans.
- (7) The flow of capital into Kazakhstan unbalanced the exchange rate and created opportunities for exposure to risks (devaluation, liquidity and credit); such risks appear when the flow of capital reverses direction.<sup>37</sup>
- (8) Low rates of labor productivity growth lead to the conclusion that little importance is attached to this factor even though it is the basis of economic growth.<sup>38</sup>
- (9) There is no effective economic diversification mechanism; the economy is unbalanced, while the level of raw material processing is low.<sup>39</sup>

Consequently, as a result of the world financial crisis in Kazakhstan:

- (1) export prices declined significantly, so that budget revenues fell while expenditure items remained intact; at the same time, domestic prices for oil products changed very little; unemployment increased<sup>40</sup>;
- (2) the inflow of foreign investment shrank because the main funding sources were blocked and foreign lenders began to call in loans; there was a rapid outflow of speculative capital<sup>41</sup>; opportunities for refinancing the external debt of the national banking system worsened sharply, and economic growth began to slow<sup>42</sup>;
- (3) banking system liquidity began to decline; domestic bank shares slumped;
- (4) a credit default crisis started in the real sector of the economy; activity in the construction sector declined sharply; specialized debt collection agencies appeared in the country;
- (5) real problems in two sectors (banking and mining) led to panic in other sectors; aware of the shortage of funds at large and powerful corporations, players in these markets feared that problems might appear in their own activities as well. Companies concluded short-term (instead of long-term) contracts, stopped investing, cut their staffs, wound up entire lines of business and banned new projects. It should be noted that the perceived threats were often nonexistent, while the consequences of such decisions are unpredictable;
- (6) expectations of a “rainy day” have spread to consumers as well. They also tend to reduce their spending, are reluctant to invest in time deposits and to repay loans, while consumption declines.

Today we can identify five global market trends associated with the crisis and posing a threat to the Kazakhstan economy<sup>43</sup> (see Table 1).

<sup>37</sup> [<http://economyclub.info/upload/Seytkasimov.doc>], 29 June, 2009.

<sup>38</sup> [<http://www.zakon.kz/our/news/news.asp?id=30081515>; [http://www.akorda.kz/www/www\\_akorda\\_kz.nsf/sections?OpenForm&id\\_doc=5995684C07768CD1462572340019E67F&lang=ru](http://www.akorda.kz/www/www_akorda_kz.nsf/sections?OpenForm&id_doc=5995684C07768CD1462572340019E67F&lang=ru); <http://www.nomad.su/?a=4-200605060004>], 29 June, 2009.

<sup>39</sup> [<http://economyclub.info/upload/Seytkasimov.doc>], 29 June, 2009.

<sup>40</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>41</sup> Ibidem.

<sup>42</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>43</sup> [<http://economyclub.info/upload/Alpyspaeva.doc>], 24 June, 2009.

Table 1

**Global Crisis: Worldwide Market Trends and  
Threats to Kazakhstan**

<b>Trend</b>	<b>Source</b>	<b>Challenge to Kazakhstan's Economy</b>
<b>Cyclical slowdown in the world economy (decline in global demand)</b>	<b>Characteristic of many world markets</b>	May lower demand for export products (oil, gas, metals and grain <sup>44</sup> ) and so reduce export earnings going into the National Fund of Kazakhstan and the state budget, which will have a negative effect on public investment and consumption, lead to a devaluation of the tenge, to wage cuts, etc. In the recent past, a drop in demand for steel caused a temporary decline in production at Arcelor Mittal in Kazakhstan, and this in turn had an effect on coal producers, mining and other related industries. As a result, the incomes of thousands of families in Kazakhstan declined.
<b>Limited sources of financing</b>	<b>Conditions at international financial institutions</b>	The significant reduction in external sources of financing for the banking system limits opportunities for providing credit to the economy.
<b>High price volatility in world commodity markets</b>	<b>World commodity markets</b>	A sharp drop in prices will have the same effect as the trend toward a cyclical slowdown in the world economy. The trade balance may worsen, and this may have a negative effect on the current account: Kazakhstan's external position will weaken. The greatest danger is a protracted decline in world oil prices below the threshold level of \$60 per barrel. This may lead to a decline in industrial production, higher unemployment, inflation, and lower consumption. According to some forecasts, <sup>45</sup> the drop in oil prices may be postponed until the global crisis enters the phase of an industrial slump. The crisis in financial markets stimulates speculative investments in oil purchase and sale transactions, which are believed to be more reliable. Active speculation leads

<sup>44</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>45</sup> [[http://www.ipd.kz/index.php?option=com\\_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru](http://www.ipd.kz/index.php?option=com_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru)], 25 June, 2009.

Table 1 (continued)

Trend	Source	Challenge to Kazakhstan's Economy
		to the formation of a price bubble in the oil market. This trend appears favorable, but in the long term it provides grounds for preserving the existing parameters of the natural resource-based economy without an effective mechanism for redistribution into the manufacturing sector and innovations.
Global stock market meltdown	World stock markets	Leads to a sharp drop in the value of Kazakhstan company shares.
Panic in financial markets, bankruptcy of large investment banks, sharp rise in Libor rates	World financial markets	Significantly limits foreign liquidity markets, creating difficulties for external debt refinancing by banks and corporations. Rising Libor rates may lead to delay in repayment of foreign loans by banks due to specific credit terms: many loans were issued at a floating Libor-based rate.

When the first signs of the crisis appeared in Kazakhstan, according to some experts, there were two possible development scenarios.<sup>46</sup>

The first scenario envisaged a contraction in the economy.

- First, it was possible to ensure, through administrative measures, a decline in the prices of produced goods (by reducing the prices of productive resources). For example, cuts in oil prices would have lowered the price of oil products (primarily gasoline); at the same time, this would have reduced transportation costs, with an appropriate effect on pricing.
- Second, it was possible to reduce the cost of infrastructure projects: roads, electric power plants and pipelines.
- Third, it was possible to review some items of government expenditure where costs far exceed benefits.

The choice of this scenario could have resulted in an immediate decline in GDP growth rates (even to the point of negative growth). But it could have provided an opportunity to maintain real living standards in the country and prevent a severe budget deficit.

The second scenario was designed to maintain the size of the economy. This was possible given a replacement of foreign loans and natural resource revenues by an alternative financing source. The National Fund could become such a source (given a reduction in reserve requirements for second-tier banks), so enabling the republic to expand its economic capacity.

The government of Kazakhstan chose the second scenario: money from the National Fund was channeled into banking, construction, infrastructure and industrial projects.

<sup>46</sup> [<http://www.dialog.kz/site.php?lan=ru&id=92&pub=1467>], 25 June, 2009.



Kazakhstan Prime Minister Karim Masimov told the Senate of the country's Parliament in November 2008 that "we should use the current situation to the best advantage so as to emerge from the crisis with a stronger and more competitive economy. As historical experience shows, the cyclical development of the world economy is a natural process, and recessions are always followed by recoveries. The eventual economic recovery will lead to a significant increase in world consumption, and we should be ready to take advantage of the opportunities offered by an improvement in global market conditions. That is why even today we should focus on creating export-oriented competitive lines of production and on developing infrastructure and human resources."

The main instruments adopted by Kazakhstan to mitigate the effects of the global financial crisis are monetary control and anti-inflation policy.<sup>47</sup>

It was decided to limit external borrowing, lower reserve requirements for banks, and provide the necessary assistance (monetary and administrative) to the worst affected areas of the economy: shared housing construction, small and medium business, and the agro-industrial complex.<sup>48</sup> Measures are being taken to ensure food security and improve export-import operations.

As part of the chosen course, the government, the National Bank and the Financial Supervision Agency have adopted a Joint Action Plan to stabilize the economy and the financial system for 2009-2010. Allocations under this plan total \$15 billion (\$10 billion from the National Fund, and \$5 billion from the budget and pension savings), or 20% of GDP.<sup>49</sup>

This amount is distributed as follows:

- \$4 billion to ensure the stability of the financial sector;
- \$5 billion to stabilize the real estate market;
- \$1 billion to support small and medium business;
- \$1 billion to boost the development of the agro-industrial complex;
- \$4 billion to implement breakthrough innovative, infrastructure and industrial projects.

The main operators appointed to implement the Joint Action Plan (on behalf of the government) are the Sovereign Wealth Fund (SWF) Samruk-Kazyna and the KazAgro holding company. They obtain loans from the National Fund by issuing bonds.

In order to ensure financial sector stability, work is underway to improve the payment system, provide the necessary amount of credit to the real sector of the economy on reasonable terms, and create conditions for maintaining the level of investment activity. Banks will be provided with additional sources of liquidity. The National Bank has lowered reserve requirements for second-tier banks from 2% to 1.5% for domestic liabilities and from 3% to 2.5% for other liabilities.<sup>50</sup>

On the whole, the government has set three tasks before banks:

1. to increase credit to the economy;
2. to continue financing projects in the area of industrialization and innovations;
3. to continue lending to small and medium businesses.<sup>51</sup>

A whole package of measures is being implemented for this purpose:

— steps are being taken to recapitalize four systemically important banks;

<sup>47</sup> [[http://akmolinka.narod.ru/n161\\_16\\_12/actual.htm](http://akmolinka.narod.ru/n161_16_12/actual.htm)], 26 June, 2009.

<sup>48</sup> Ibidem.

<sup>49</sup> [<http://news.kkb.kz/news/show.asp?no=1165776>], 26 June, 2009.

<sup>50</sup> [<http://www.aktau-business.com/2009/03/04/nacionalnyjj-bank-kazakhstana-snizil-normativy.html>], 26 June, 2009.

<sup>51</sup> [<http://economyclub.info/upload/Nesternko.doc>], 29 June, 2009.



- the level of bank deposit guarantees for retail deposits at second-tier banks has been raised (to 5 million tenge);
- the activities of the Distressed Assets Fund operating in the country are geared to improve the loan portfolios of domestic banks through the purchase of doubtful debts and their subsequent management (so as to increase investor confidence in the banking sector); the Fund is a market institution that performs a stabilizing function as a guarantor of financial stability;
- the range of instruments accepted as collateral for repo transactions is expanding;
- national companies, joint stock companies, state-owned enterprises and legal entities (with a government stake in authorized capital), and also state organizations whose assets are managed by the National Bank place their temporarily idle funds on deposit with second-tier banks;
- the government guarantees all pension payments;
- measures are being taken to attract pension assets for financing priority investment projects in order to diversify the investment portfolios of retirement savings funds;
- under the stabilization program, the government and akims (regional governors) are authorized to take measures to increase employment and raise household incomes by implementing various additional investment and regional programs.

As part of the efforts to stabilize the real estate market in Astana and Almaty, work is in progress to launch a program for mortgage lending and for developing the housing sector. This program is intended for citizens whose residential floor area does not exceed 120 square meters. Mortgage loans are to be issued for terms of up to 15 years at an interest rate of 10.5-12.5% per annum (with the right to prepay) and only for housing projects under construction.

Another measure to stabilize the real estate market is work to set moderate prices for new housing in the Astana and Almaty markets. The akimats (regional governments) are entitled to purchase, at moderate prices, apartments in completed housing projects or projects nearing completion.

Funds are being allocated for the construction of rental housing under a program run by the Samruk-Kazyna Real Estate Fund, a subsidiary of SWF Samruk-Kazyna; this will make it possible to build an additional 265 thousand square meters of housing. All these projects will be sold through the housing savings system, which will enable government and public sector employees and young families to obtain bridging loans at no more than 4% per annum.

In addition, measures are being taken to prevent another shock in Kazakhstan's construction market. More stringent requirements have been imposed on potential real estate developers and credit institutions in the "shared construction" market in order to enhance the protection of its participants.

The authorities continue to provide financial support and to lower administrative barriers for small and medium business. Most of the allocated funds are used to refinance current projects, and the rest, to implement new ones. Loan programs are operated by banks; steps are being taken to resolve the issue of stabilizing fee rates at no more than 14%.

Previously adopted programs of support for small and medium business are being reviewed so as to determine the effective rate. The DAMU Entrepreneurship Development Fund is introducing a loan guarantee mechanism.

The Samruk-Kazyna Fund is developing a microcredit program for entrepreneurs from rural areas.

Small and medium businesses have been given access to contracts awarded by government agencies, national and holding companies (in the past, their participation was contingent on a certain amount of working capital); preference in choosing suppliers will be given to domestic companies. In the purchase of large lots of imported equipment, a necessary condition is its assembly, repair and maintenance within the republic.

Apart from that, the new Tax Code (effective from 1 January, 2009) provides for a number of tax breaks associated with the implementation of investment projects by enterprises.<sup>52</sup> The rate of corporate income tax has been cut from 30% to 15%; VAT has been reduced to 12%<sup>53</sup>; and other fiscal measures have been taken.<sup>54</sup>

To accelerate the development of the agro-industrial complex, the state channels investments into the modernization of existing and the development of new export-oriented sectors. Priority is given to the grain, meat and dairy, and fruit and vegetable sectors. It is planned to expand fruit and vegetable production using drip irrigation techniques, greenhouses, vegetable storage facilities, poultry plants, commercial dairy farms, feedlots, modern meat packing complexes, plants for the production and deep processing of fine wool, agricultural machinery assembly lines, and Agrotech markets.

Special emphasis is placed on the development of export infrastructure. Regional buffer stocks of grain and flour have been created, and multilateral agreements have been concluded between regional akimats, grain producers and milling companies on stable grain and flour supplies to regional markets.<sup>55</sup>

The government continues its active work to implement innovative, infrastructure and industrial projects. It has taken a decision on large-scale construction and modernization of the country's infrastructure so as to resolve systemic problems in the economy, including the problem of employment. Work is underway to implement a program called 30 Corporate Leaders of Kazakhstan.

In order to modernize the electric power industry and enhance its investment appeal, it is planned to limit tariffs for various groups of energy producers (for a term of at least 7 years), with periodical adjustments based on the previous year's inflation rate. Tariffs will include an investment component, while the electricity connection fee will be abolished.

It is planned to implement a set of measures in saving energy and using renewable energy sources. New power stations will be built on Lake Balkhash and in the Kostanay Region, and the Ekibastuz GRES power plants will be renovated.<sup>56</sup>

Work is in progress on direct budget financing of 19 most promising investment projects (8 energy, 5 transport, 3 oil and gas, etc.), which are to help modernize and maintain the competitiveness of the economy in the post-crisis period.<sup>57</sup>

An inventory of projects ordered by President Nazarbaev has resulted in a list of 45 breakthrough projects (28 production and 17 infrastructure) at a total cost of about \$54 billion.<sup>58</sup>

The government is developing a five-year plan for the country's accelerated industrial-innovative development, which is to include an industrialization map for 2010-2020 and a scheme of rational distribution of production facilities. These efforts are to be focused on seven selected areas: the agro-industrial complex and agricultural processing; construction; oil refining; metallurgy; chemical industry and pharmaceuticals; energy; transport and telecommunications infrastructure. Work to select other areas is still in progress.

The industrial development plan will take effect from January 2010.<sup>59</sup> (Its final version had to be presented on 1 August, with final approval on 1 December, 2009).<sup>60</sup>

The so-called Roadmap<sup>61</sup> adopted in pursuance of the tasks set by the head of state in his 2009 Address is already being put into effect. It is designed to implement a strategy for regional employ-

<sup>52</sup> [<http://bb.f2.kz/ru/zakon/skachat-nalogovyj-kodeks-respubliki-kazahstan-2009-goda-t639.html>], 29 June, 2009.

<sup>53</sup> Ibidem.

<sup>54</sup> [<http://www.minplan.kz/economyabout/247/5898/>], 30 June, 2009.

<sup>55</sup> [[http://akmolinka.narod.ru/n161\\_16\\_12/actual.htm](http://akmolinka.narod.ru/n161_16_12/actual.htm)], 15 June, 2009.

<sup>56</sup> [[http://www.samruk-kazyna.kz/page.php?page\\_id=19&lang=1&article\\_id=235&parent\\_id=15](http://www.samruk-kazyna.kz/page.php?page_id=19&lang=1&article_id=235&parent_id=15)], 29 June, 2009.

<sup>57</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

<sup>58</sup> [<http://economyclub.info/upload/Nurmaganbetov.doc>], 29 June, 2009.

<sup>59</sup> [<http://v.zakon.kz/140325-gotovimsja-k-industrializacii.html>], 30 June, 2009.

<sup>60</sup> [[http://www.kazakistan.kz/rus/news/economy/2009\\_06\\_02\\_19\\_30\\_00](http://www.kazakistan.kz/rus/news/economy/2009_06_02_19_30_00)], 30 June, 2009.

<sup>61</sup> [<http://mirtv.ru/content/view/66468/86/>], 30 June, 2009.

ment and personnel training, accelerated development of the agro-industrial complex, implementation of the second section of the 30 Corporate Leaders program, industrial and infrastructure projects.<sup>62</sup>

The Roadmap covers several areas:<sup>63</sup>

1. Development of the housing and public utilities system.
2. Repair and construction of roads.
3. Repair of schools, hospitals and other social facilities.
4. Repair and renovation of priority social and cultural facilities in towns and cities, settlements, auls (villages) and aul districts.
5. Increase in social employment and youth training programs.
6. Expansion of opportunities to use social employment and youth training programs with due regard for regional demand for jobs.
7. Training and retraining of personnel.

As part of personnel training and retraining, summer schools (functioning during the three summer months) open to all comers (from 18 to 50 years) will provide free training in trades that are most in demand in the labor market. These include hairdressers, flower growers, welders, drivers, tailors, cooks, etc. Each participant in this program will receive a monthly allowance of \$50 and will subsequently have an opportunity to get a job under ongoing investment projects.

Employment agencies will select specialists from among people registered as unemployed and assign them to jobs (according to the needs of investment projects).

Participants in the Roadmap project will be recruited to work in reconstructing and developing various vital infrastructure sectors: housing and public utilities systems (water supply and sewerage, heating and power supply); repair and thermal insulation of schools, hospitals, etc.; repair, renovation and construction of local roads; social projects in towns and cities, settlements, auls (villages) and aul districts.<sup>64</sup>

For graduates of universities, colleges and lyceums, the project envisages practical training for terms of up to 6 months and with a salary of at least 15,000 tenge, whereupon they may get a full-time job.<sup>65</sup>

Today the country has completed the first stage of the Kazakhstan-2030 Strategy.

Due to changes in domestic and foreign market conditions, the government is working, by order of the president, on a socioeconomic development strategy until 2020, which will be adapted to the new stage in the country's development to the maximum extent and will help to meet today's economic and political challenges.<sup>66</sup>

Thus, measures are being taken and improved in the country to revive the economy and mitigate the effects of the crisis (GDP growth in 2008 slowed by almost two-thirds from the previous year to 3.0%).<sup>67</sup>

<sup>62</sup> [<http://www.khabar.kz/index.cfm?id=76139>], 30 June, 2009.

<sup>63</sup> [<http://dorkarta.enbek.gov.kz/>], 30 June, 2009.

<sup>64</sup> [[http://209.85.129.132/search?q=cache:kpAF7qKvc98J:www.yujanka.kz/economics.php%3Fsubaction%3Dshowfull%26id%3D1241417811%26archive%3D%26start\\_from%3D%26ucat%3D2%26+%D0%93%D0%BE%D1%81%D0%BF%D1%80%D0%BE%D0%B3%D1%80%D0%B0%D0%BC%D0%BC%D0%B0+%C2%AB%D0%94%D0%BE%D1%80%D0%BE%D0%B6%D0%BD%D0%B0%D1%8F+%D0%BA%D0%B0%D1%80%D1%82%D0%B0%C2%BB+%D0%B2+%D0%9A%D0%B0%D0%B7%D0%B0%D1%85%D1%81%D1%82%D0%B0%D0%BD%D0%B5&cd=3&hl=ru&ct=clnk&gl=ru](http://209.85.129.132/search?q=cache:kpAF7qKvc98J:www.yujanka.kz/economics.php%3Fsubaction%3Dshowfull%26id%3D1241417811%26archive%3D%26start_from%3D%26ucat%3D2%26+%D0%93%D0%BE%D1%81%D0%BF%D1%80%D0%BE%D0%B3%D1%80%D0%B0%D0%BC%D0%BC%D0%B0+%C2%AB%D0%94%D0%BE%D1%80%D0%BE%D0%B6%D0%BD%D0%B0%D1%8F+%D0%BA%D0%B0%D1%80%D1%82%D0%B0%C2%BB+%D0%B2+%D0%9A%D0%B0%D0%B7%D0%B0%D1%85%D1%81%D1%82%D0%B0%D0%BD%D0%B5&cd=3&hl=ru&ct=clnk&gl=ru)], 30 June, 2009.

<sup>65</sup> *Ibidem*.

<sup>66</sup> [<http://eng.minplan.kz/2020/>], 30 June, 2009.

<sup>67</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

As a result of the implementation of the anti-crisis Joint Action Plan, real GDP growth in 2009 will be in the range of 1-3%;<sup>68</sup> unemployment in 2009-2010 will not exceed 8.0%; and inflation at the end of 2009 will be 11.0%.<sup>69</sup>

Despite the crisis, pensions, wages and student grants in 2009-2010 will increase by 25%, and in 2011 by another 30%.<sup>70</sup> Thus, the state's social spending will double by 2011.<sup>71</sup>

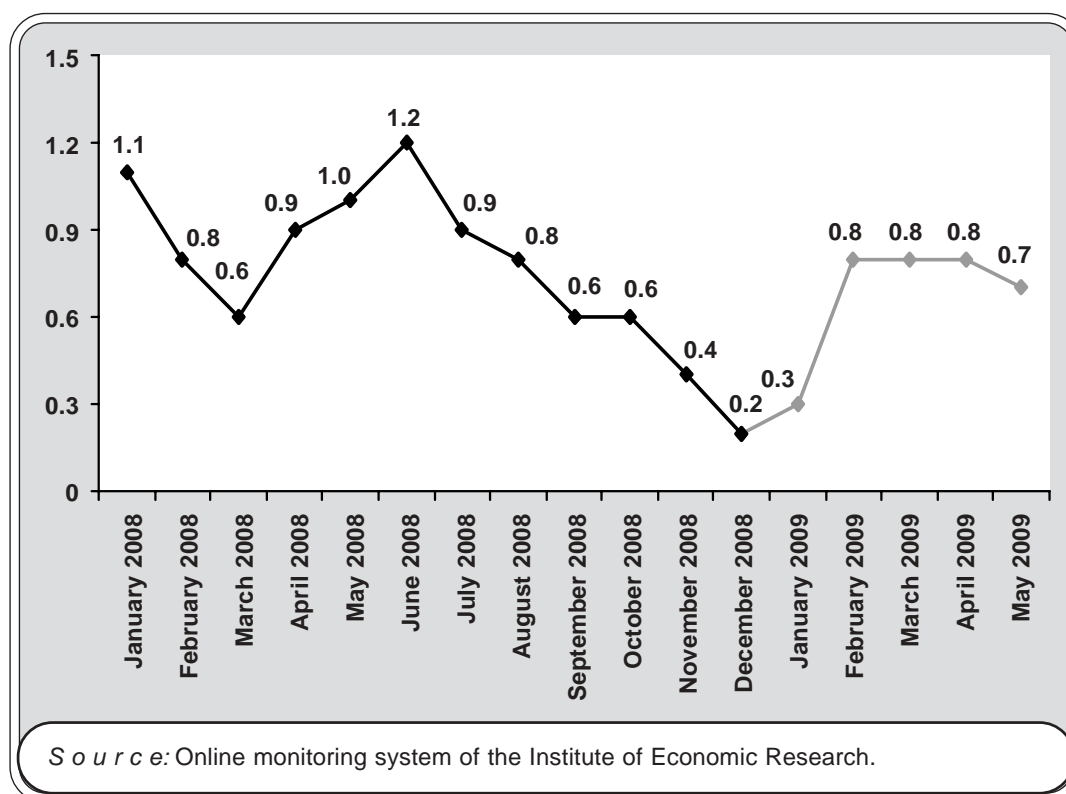
In the first quarter of 2009, GDP fell by 2%, whereas in the fourth quarter of 2008 it increased.<sup>72</sup>

In May 2009 (compared to April), the index of industrial production was 100.7%. According to the Statistics Agency, inflation in May 2009 over December 2008 was 3.5%, or 1.0 percentage point lower than in the same period of the previous year (4.5%).

In annual average terms, inflation in January-May 2009 over the same period of the previous year was 8.7%, compared to 19.0% in January-May 2008 (see Fig. 1).

Figure 1

Inflation in 2008-2009  
(month-on-month, %)



<sup>68</sup> [<http://ru.government.kz/documents/govprog/27>], 30 June, 2009.

<sup>69</sup> [<http://economyclub.info/upload/Kuchukova.doc>], 29 June, 2009.

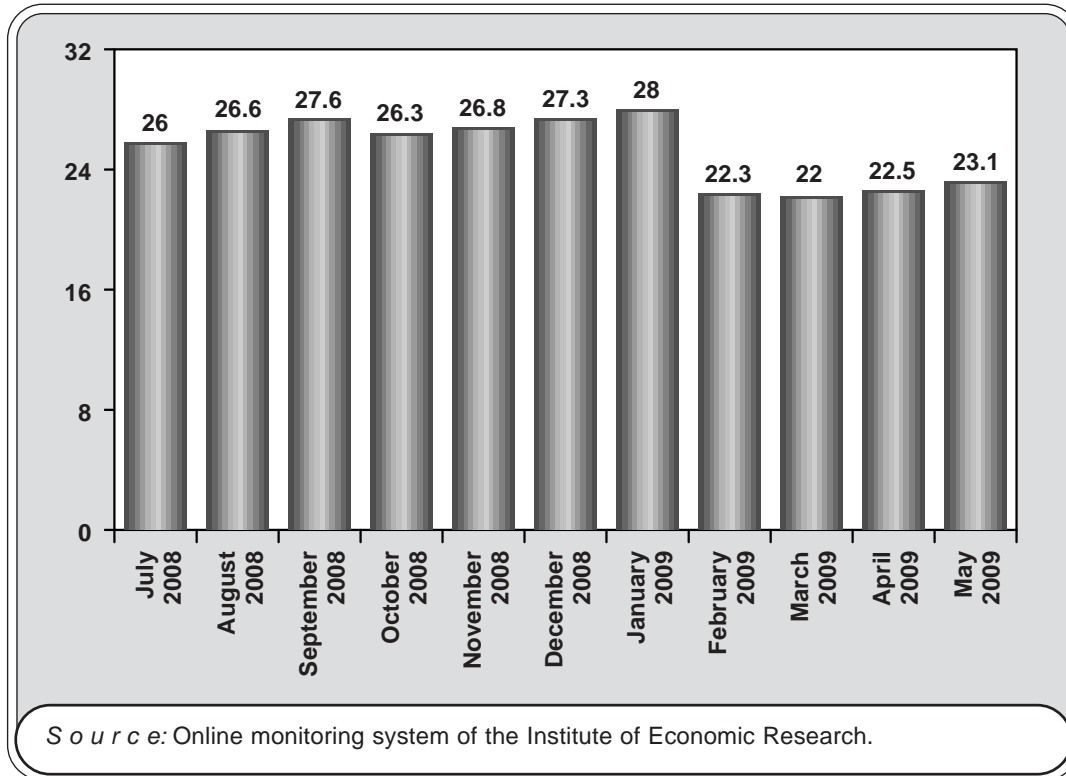
<sup>70</sup> [[http://www.ipd.kz/index.php?option=com\\_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru&limitstart=3](http://www.ipd.kz/index.php?option=com_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru&limitstart=3)], 29 June, 2009.

<sup>71</sup> [<http://www.automan.kz/57443-raskhody-gosudarstva-na-vyplatu-pensij-i.html>], 30 June, 2009.

<sup>72</sup> [<http://www.inform.kz/ShowArticle?id=234389>], 29 June, 2009.

Figure 2

**National Fund of the Republic of Kazakhstan  
(billions of dollars)**



According to the online monitoring data of the Institute of Economic Research of the Kazakhstan Ministry of Economy and Budget Planning, unemployment in the first quarter of 2009 was 6.9%.

Despite difficult economic conditions, the republic has mainly retained its reserves. As of 30 June, 2009, its total international reserves and National Bank assets exceeded \$43 billion (see Figs. 2 and 3). If the situation worsens, they will help the government to implement its stabilization measures.

As regards forecasts, the Ministry of Economy and Budget Planning<sup>73</sup> predicts GDP growth of 1% in 2009, 3.0% in 2010, and up to 4.3% in 2013. The surge in inflation to 11% at the end of 2009 is to give way, as a result of the devaluation of the tenge, to a gradual decline in inflation rates to 5.5-7.5% at the end of 2013.<sup>74</sup>

In 2010-2013, investments are expected to increase at a rate of 4.4-5.3%, and this will ensure a sufficiently high rate of capital formation allowing active technological modernization. Consumption in 2010-2013 is to increase at 2.7-3.5% (see Table 2), with public consumption growing faster than household consumption.<sup>75</sup>

<sup>73</sup> [<http://www.minplan.kz/economyabout/247/5898/>], 30 June, 2009.

<sup>74</sup> Ibidem.

<sup>75</sup> Ibidem.

Figure 3

International Reserves of the Republic of Kazakhstan  
(billions of dollars)

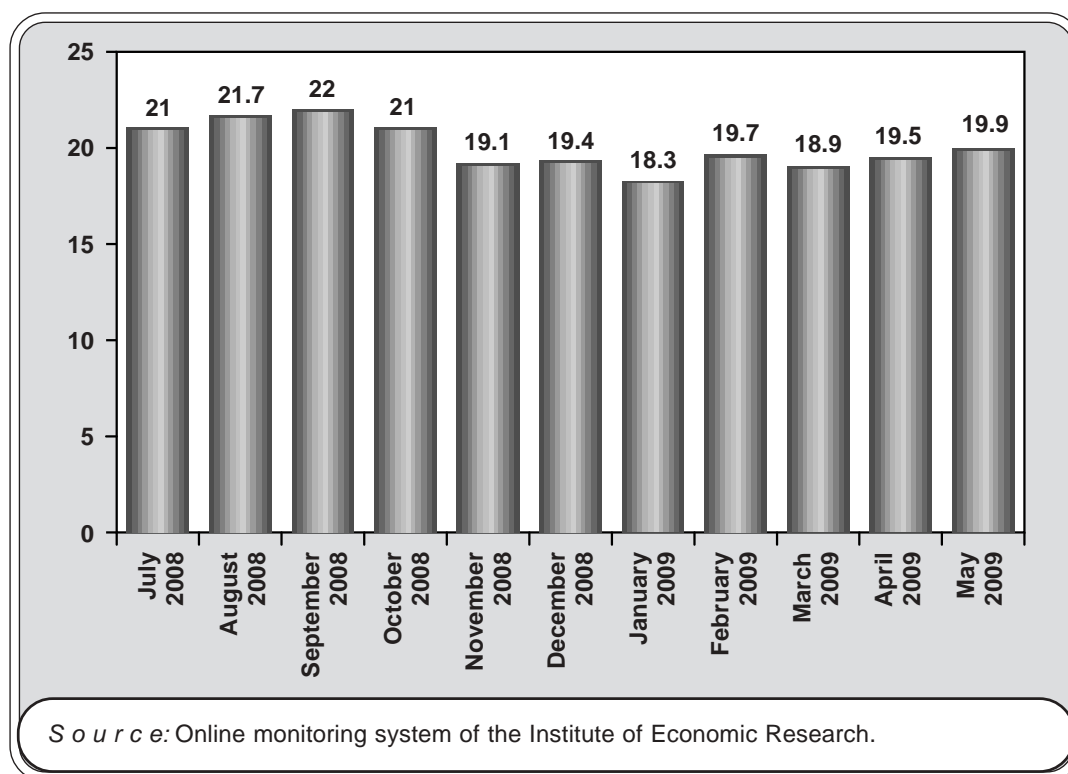


Table 2

Indicators of Economic Growth for 2009-2013  
(year-on-year, %)<sup>76</sup>

Indicators	2009	2010	2011	2012	2013
Consumption	0.3	2.7	3.1	3.3	3.5
including: private	-0.2	2.2	2.5	2.7	3.0
public	3.0	4.4	5.0	5.2	5.3
Investments	0.0	4.2	4.6	5.1	5.3
Exports of goods and services	2.0	3.1	2.0	2.3	3.2
Imports of goods and services	0.4	3.7	1.1	1.5	2.7

<sup>76</sup> [<http://www.minplan.kz/economyabout/247/5898/>], 30 June, 2009.

The Ministry of Economy and Budget Planning expects a decline in unemployment from 7.4% in 2009 to 6.8% by 2013.<sup>77</sup>

Thus, the world crisis is yet another endurance test for Kazakhstan. It has created the prerequisites for improving the economic system and has enabled banks to group together and get down to restructuring their loan portfolios built up in the pre-crisis period. Consequently, there is every reason to say that Kazakhstan now has all the prerequisites for continued stability and economic recovery.

As for the prospects of global economic development, the peak of the crisis is expected in 2009-2010, followed by a depression in 2010-2013 with a subsequent restructuring of the world economy for new development.<sup>78</sup>

According to the IMF, the economic crisis in Europe will probably last until the second half of 2010.<sup>79</sup> But it may last even longer unless the governments of European countries combine their efforts in implementing an anti-crisis policy and provide serious support to unstable financial institutions.

In 2009, the IMF<sup>80</sup> expects the economies of 16 eurozone countries to shrink by 4.2%. Their position will improve only in 2010 (when the decline will be no more than 0.4%).

In emerging market countries, GDP in 2009 is expected to decline by 4.9%, whereas in 2010 their economies will grow by 0.7%. And according to the World Bank, the world economy in 2009 will shrink by 3%.<sup>81</sup>

Chairman of the U.S. Federal Reserve System Ben Bernanke<sup>82</sup> said that the American economy should start growing in 2009, so stabilizing the development of countries dependent on it.

Measures to overcome the consequences of the global financial crisis are being taken throughout the world; the only thing now is to wait for the results.

Unemployment in the U.S. and Europe is currently around 10%.<sup>83</sup>

In the U.S., the quarterly decline in GDP was 5.7%, and industrial production in the euro area in April 2009 was down 21.6% from the same period of 2008.

Chinese exports in May fell by 26.4% (year-on-year), with similar figures for imports.

In 2008 and early 2009, there was a whole series of international summit meetings aimed at developing measures to overcome the global economic crisis.<sup>84</sup> These include the G2 Summit (Washington, U.S., 15 November, 2008), a forum of the Asia-Europe Meeting (ASEM), the New World, New Capitalism Conference (Paris, France, 8-9 January, 2009), the World Economic Forum (Davos, Switzerland, 28 January-1 February, 2009), the 2nd Astana Economic Forum (Astana, Kazakhstan, 11-12 March, 2009), and others.

These measures demonstrate the desire of nations to solve the common problems facing the world through joint efforts. Hopefully, mankind will overcome the crisis and continue its development.

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<sup>77</sup> [<http://www.minplan.kz/economyabout/247/5898/>], 30 June, 2009.

<sup>78</sup> [[http://www.ipd.kz/index.php?option=com\\_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru](http://www.ipd.kz/index.php?option=com_content&view=article&id=278%3A2008-11-01-07-20-06&catid=80%3A2008-09-06-10-05-09&Itemid=31&lang=ru)], 15 June, 2009.

<sup>79</sup> [<http://www.kazks.kz/article/163.html>], 15 June, 2009.

<sup>80</sup> *Ibidem*.

<sup>81</sup> [<http://www.kabmir.org/news/1324-svobodnoe-padenie-mirovoy-ekonomiki-prodoljaetsya.html>], 30 June, 2009.

<sup>82</sup> [<http://www.kazks.kz/article/163.html>], 15 June, 2009.

<sup>83</sup> [<http://www.kabmir.org/news/1324-svobodnoe-padenie-mirovoy-ekonomiki-prodoljaetsya.html>], 30 June, 2009.

<sup>84</sup> [<http://www.economyclub.info/>], 30 June, 2009.



## KAZAKHSTAN'S ECONOMY IN THE GRIPS OF THE WORLD FINANCIAL CRISIS

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During the past two years, the world economy has been functioning in the conditions of a global financial crisis that is having an impact on the economic development of almost every country in the world. The republic of Kazakhstan, which succeeded during the years of its independence to occupy a dignified place in the world economy, is no exception. It was the first CIS country (and one of the first in the world) to become caught in the grips of the financial crisis.

It should be emphasized that the current crisis has primarily affected highly developed countries. Beginning in the U.S., it quickly pulled Germany, France, Japan, Great Britain, and other countries into its orbit. Although in terms of its main economic indices, Kazakhstan lags far behind these countries, there were many reasons why it followed right behind the U.S. and fell victim to the crisis earlier than many others. The first signs of the crisis phenomena appeared in this country as early as the end of the summer of 2007.

It stands to reason that all the aspects of the global financial and economic crisis will become a target of comprehensive scientific study, from which the necessary practical conclusions will have to be drawn. Today it is too early to talk about the possible results of these studies, but some reasons for what is going on are already obvious. The main one seems to be that the theoretical concepts prevalent in world economic science over the past decades have proven untenable.

In the second half of the 20th century, particularly after the collapse of the world socialist

system, most countries took a so-called neo-liberal approach to economic development problems. This approach espouses the principle of liberalism (free market relations in the economy) and the concept of monetarism (amplification of the role of financial capital in economic development). In compliance with this, free market relations are viewed as the only possible regulator of the development of national economies and the world economy as a whole, while the state is allotted the role of passive observer. But when national banks and corporations found themselves on the brink of bankruptcy, it was the governments of the largest capitalist countries that had to fork out huge amounts of money from the treasury to help them avoid collapse of their financial and economic systems. So the theory of liberal monetarism as a universal mechanism of economic regulation has not justified itself.

At the beginning of April 2009, a meeting of the leaders of the twenty largest nations of the world was held in London to look for ways out of the crisis. Several decisions were adopted that essentially meant a rejection of the neo-liberal theory. However, President of Kazakhstan Nursultan Nazarbaev had been questioning its validity even earlier. At the beginning of March 2009, he realized that it was wrong for the republic's economy to be oriented solely toward market relations and said that the economy should be "hand-steered," which undoubtedly implied intensifying the government's role in the country's economic life.

## Economic Boom of the Beginning of the Century (the Kazakhstani Miracle)

The first years of this century were marked by high growth rates in Kazakhstan's national economy. For seven years (2000-2006), the annual real growth in the gross domestic product (GDP) did not drop below 9%. Sometimes it even exceeded 10% (in 2001, it reached 13.5% and in 2006, 10.7%). On the whole over the indicated period, the total GDP growth in constant prices, without taking account of the rise in hydrocarbon prices, amounted to 99.0%, that is, the GDP essentially doubled.<sup>1</sup>

In 2005, the republic's GDP amounted to \$56.8 billion, which was higher than the indices of all the Central Asian and Caucasian states (Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan, Azerbaijan, Georgia, and Armenia) put together.<sup>2</sup>

In 2006, the country's GDP in current prices amounted to as much as \$81 billion, while in 2007 it topped \$100 billion (\$104.85 billion) for the first time.

And whereas in 2000, Kazakhstan's per capita GDP was only \$1,229, by 2007 this index had risen by more than five-fold, reaching \$6,772.<sup>3</sup>

Industry has been developing in leaps and bounds; in 2000, industrial production rose by 15.5% compared to the level of the previous year, in 2001 it increased by 13.8%, in 2002 by 10.5%, in 2003 by 9.1%, and in 2004 by 10.4%.

In subsequent years, the industrial production growth rates dropped slightly, but still amounted to 5-7% per annum.<sup>4</sup>

Such rapid growth in GDP, industrial production, and other macroeconomic indices at the beginning of this century prompted journalists and experts to call what was happening a "Kazakhstani miracle."

But the growing global financial crisis shed light on many secrets of this "miracle." It turned out that it was mainly based on "two whales": priority development of the oil-and-gas sector aimed at promoting a constant increase in the export of energy resources and the rapid increase in hydrocarbon prices in the world energy markets.

The vast oil and gas supplies on Kazakhstan's territory and the shelf of the Caspian Sea contiguous to it (along with their relatively low domestic consumption) also encouraged the government to concentrate on turning the oil-and-gas industry into a driving force behind the national economy.

In his annual message to the nation in February 2005 entitled *Kazakhstan on the Road to Accelerated Economic, Social, and Political Modernization*, President Nazarbaev openly admitted that "today the main source of economic growth is exploitation of the country's raw material potential."<sup>5</sup>

The favorable situation that developed in the world energy markets, as well as the extensive use of foreign direct investments for accelerating the development of the oil-and-gas sector yielded good results.

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<sup>1</sup> See: *Kazakhstan za gody nezavisimosti (1991-2007)*, Republic of Kazakhstan Statistics Agency, Astana, 2008, pp. 75-76.

<sup>2</sup> See: V. Babak, "The Oil and Gas Sector in Kazakhstan," in: *Central Asia and the Caucasus*, No. 4 (40), 2006, p. 47. Incidentally, data published later and evidently revised give a slightly higher figure. For example, the report of the Republic of Kazakhstan Statistics Agency *Kazakhstan za gody nezavisimosti (1991-2007)* (In the Period of Independence [1991-2007]) already cited gives a figure of \$57.1 billion.

<sup>3</sup> See: *Kazakhstan za gody nezavisimosti (1991-2007)*, p. 74.

<sup>4</sup> See: *Ibid.*, p. 10.

<sup>5</sup> *Kazhkhstanskaia pravda*, 11 March, 2005.

Since 1995, oil production in the country has been on the constant rise. For example, in 1995, 20.6 million tons of oil and gas condensate were produced in the country, while in 2000 this index reached 35.3 million tons, that is, over five years, liquid fuel production rose by more than 71%.

As a result, in 2000, the percentage of oil production in the total volume of the country's industrial production amounted to 39.9%, that is, almost 2/5.<sup>6</sup>

In the new century, oil and gas condensate production has continued to rise at a steady rate, while liquid fuel is still being exported to the world markets. In 2007, oil production had reached 67.5 million tons, while in 2008, it reached the 70-million-ton mark, which is 1.8% of world oil production.

In recent years, approximately 90% of all the oil produced in the country has been going to export. For example, in 2007, 60.8 million tons of the total 67.5 million tons of oil and gas condensate produced were exported. Compared with 1999, the physical volumes of oil export increased 2.57-fold.

There has also been rapid growth in natural gas production. Between 2000 and 2007, natural and casing-head gas production increased from 8.9 to 29.2 bcm a year, which is a by almost 3.3-fold increase.<sup>7</sup>

In 2006, the share of the oil-and-gas industry in the country's GDP amounted to 14.7%, and to 66.3% in export.

In other words, two dollars out of every three that Kazakhstan earned in the export markets came from the sale of oil and gas.<sup>8</sup>

The share of the gas sector has been relatively small compared to oil export.

In 2007, Kazakhstan exported 15.2 bcm of natural gas totaling \$648.2 million, while more than 60 million tons of oil totaling \$28.13 billion were exported. It is interesting to note that since 1999, the physical volumes of oil export have increased 2.57-fold, while export earnings from its sale have increased 13.59-fold, which shows the rapid rise in oil prices in recent years.<sup>9</sup>

The constant rise in the volumes of oil production and increase in oil prices in the world markets were the main reasons for the rapid increase in Kazakhstan's export. In 2003, it amounted to \$12.9 billion, in 2004 to \$20.1 billion, in 2007 to \$47.8 billion, and in 2008 to as much as \$71.2 billion.<sup>10</sup>

It goes without saying that import volumes also constantly rose, but to a much lesser extent. So in recent years the republic has had a high positive foreign trade balance (in 2005 it amounted to \$10.5 billion, in 2006 to \$14.6 billion, and in 2007 to \$15.0 billion).

The enormous earnings from hydrocarbon export made it possible for Kazakhstan to create a special National Fund in August 2000 to accumulate tax payments from raw material enterprises that obtained super profits from the export of raw materials and other receipts.

According to its founding documents, the purpose of creating this fund was to stabilize the socioeconomic situation, accumulate savings for the future generations, and reduce the economy's dependence on the negative influence of external factors.

The fund consists of two components: stabilization and savings (the Stabilization and Savings funds, respectively). It should be noted that Kazakhstan was the first CIS country to form such a financial structure called upon to ensure the creation of favorable conditions for further economic development.

Although the National Fund did not begin functioning until 2001, by the end of 2006 it had accumulated \$14,039.1 million. A year later this sum had reached \$21,045.5 million, and by the end

<sup>6</sup> See: *Kontinent*, 27 December, 2000-16 January, 2001, p. 19.

<sup>7</sup> [<http://www.rusoil.ru/opinions/o06-58.html>].

<sup>8</sup> *Ibidem*.

<sup>9</sup> Calculated according to: V. Babak, *op. cit.*, pp. 43, 45 and [<http://lider-invest.com.ua/news/2008-02-14-1961>].

<sup>10</sup> See: *Kazakhstan v 2008 godu*, RK Statistics Agency, Astana, 2009, p. 12.

of 2008 it was as much as \$27,334.2 million, which was almost 1.5-fold more than the international reserves of the National Bank at the end of 2008 (\$19,396.2 million).<sup>11</sup>

Significant positive changes have also occurred in the social sphere. Personal incomes have rapidly risen—wages, work pensions, various social benefits, and so on. For example, in 2004, per capita monetary income amounted to 12,817 tenge (a month), in 2005, it was 15,787 tenge, in 2006, 19,152 tenge, in 2007, 25,226 tenge, while in 2008, it had reached 30,509 tenge.<sup>12</sup> The nominal average monthly wage in 2004 amounted to 28,329 tenge, in 2006 to 40,790 tenge, and in 2008 to as much as 60,734 tenge (\$526).<sup>13</sup>

Between 2004 and 2008, state budget expenditures increased from 1,323.8 to 3,394.1 billion tenge, which is more than 2.5-fold.

During this time, the amount of residential space put into service increased from 2.6 to 6.8 million sq. m.<sup>14</sup>

In 2007, the republic's government promulgated a three-year socioeconomic development program for the country for 2008-2010. It stated that "the main goal of the country's socioeconomic policy in 2008-2010 was to create favorable institutional and economic conditions for raising Kazakhstan's international competitiveness and the standard of living of its citizens."<sup>15</sup>

The high indices of the republic's socioeconomic development inspired the president to put forward the ambitious goal of achieving Kazakhstan's entry into the club of the fifty most economically developed and competitive countries of the world.

## Development of the Financial Crisis

The first signs of the financial crisis in Kazakhstan, as already noted, appeared as early as the end of the summer of 2007. It was then, according to press reports, that some of the largest banks began to feel a liquidity shortage. At that time, due to the unfolding crisis, foreign creditors not only stopped lending money to customers abroad, they also demanded the return of previous debts. Kazakhstani banks were some of the first to fall victim to the crisis due to the enormous amounts of debt they had already accumulated to foreign creditors.

For example, on the eve of the crisis, by the end of 2006, more than half (52%) of their liabilities constituted foreign borrowing. It is interesting to note that in 2004 the share of foreign borrowing amounted to 38%, that is, in just two years, this index rose by more than 1/3.<sup>16</sup>

It should be stressed that it was precisely the enormous amounts of foreign financial borrowing and not the drop in hydrocarbon prices that was one of the main, if not the main, reason for the crisis in the country: it began when the oil and gas prices in the world markets reached record levels and continued to grow, with export earnings rising close on their heels.

The rapid growth rates of the national economy, the vast natural resources, and the national banking system that functioned in compliance with international standards augmented Kazakhstan's

<sup>11</sup> See: *Kapital kz*, No. 38, 16 October, 2008, available at [<http://news.finance.ua/ru/-/2/0/all/2009/02/05150897/printable>].

<sup>12</sup> See: *Sotsialno-ekonomicheskoe razvitiie Kazakhstana v 2008 g. (predvaritelnye itogi)* (Kazakhstan's Socioeconomic Development in 2008 [preliminary results]), RK Statistics Agency, Astana, 2009, p. 7.

<sup>13</sup> *Ibidem*.

<sup>14</sup> *Ibid.*, p. 8.

<sup>15</sup> "Srednesrochniy plan sotsialno-ekonomicheskogo razvitiia Respubliki Kazakhstan na 2008-2010 gody," *RK Collected Acts of the President and the Government*, No. 32, 2007, p. 354.

<sup>16</sup> See: O. Skvortsov, "Finansovyy krizis: zarubezhnyy opyt (na primere Iaponii i Kazakhstana)," available at [<http://www.klerk.ru/columnists/skvortsov/?130694>].

role in the world financial system. Suffice it to say that it was given rather a high sovereign credit rating (in particular, BBB+ from Standard&Poor's, an international rating company).

In turn, the high rating the republic was given by prestigious world agencies helped to attract foreign investments and loans. The country's commercial banks had the green light to borrow large amounts of money from abroad and often on extremely preferential terms. This made it possible to lend out the money received under much higher interest rates in the domestic market—"reselling" money became an extremely profitable business.

By the beginning of the crisis, the loans received by commercial banks abroad amounted to the colossal sum of \$45 billion, that is, about half of the country's GDP in 2007. The commercial banks' use of borrowed foreign capital became a topic of discussion in the national parliament.

In April 2007, members of the Majilis (the lower house of parliament) finances and budget committee held a meeting with the heads of commercial banks at which they expressed their "concern about the rapid and accelerating increase in bank assets compared with their own capital." It was noted at the meeting that "in the past two years, the ratio of bank assets to Kazakhstan's GDP had more than doubled from 48.5 to 101.7%." In so doing, it was noted that the rapid growth in the banks' loan portfolio was a risk factor.<sup>17</sup>

The main recipients of loans from commercial banks were those branches of the national economy that guaranteed the highest profit (housing construction, commerce, and the non-production sphere). Unfortunately, only 1/10 of the funds received was used in industry.

As for the enormous inflow of foreign direct investments into the country, which amounted to \$166 billion between 1993 and 2008,<sup>18</sup> something the republic's leadership showed particular pride in, the large foreign investments were mainly used to develop the primary sector, which was supposed to ensure increased volumes of oil and gas production.

In this way, despite the generally positive influence of foreign capital on economic growth (in recent years up to 80% of its growth was ensured by means of foreign borrowing),<sup>19</sup> it also played a negative role, since it encouraged the national economy to focus predominantly on development of the oil-and-gas-producing industry. This branch of the national economy has been evolving at a rapid rate, while other branches (in particular, the processing industry) have been developing much more slowly; and this disproportion has been increasingly growing.

This situation could have been anticipated. As early as 2001 I wrote: "More or less easily earned petrodollars deprive other branches of attention. The strategy is perpetrating technological backwardness and will turn the country into a raw material appendage of the developed world. There is a real threat that oil will not take Kazakhstan into the future but slow down its economic advance."<sup>20</sup>

Unfortunately, the worries voiced eight years ago proved to be true. According to official statistics, in the first quarter of 2009, Kazakhstan imported not only machinery, equipment, metals, and items made from them, but also petroleum products that the country is still unable to fully provide itself with. Various commodities are still being imported that could quite easily be manufactured in the republic itself.

The newspaper *Delovaia nedelia* writes: "The production volumes of non-food consumer and investment commodities in the country are incredibly small, the production dynamics of many food-stuffs noticeably lags behind demand, which is making Kazakhstan extremely dependent on the import of these commodities."<sup>21</sup>

<sup>17</sup> See: K. Sagadiyev, "Mirovaia ekonomika perezhivaet rubikonnoe vremia," *Delovoi Kazakhstan*, 6 March, 2009.

<sup>18</sup> See: *Kazakhstansko-britanskaia Torgovo-promyshlennaia palata. Perspektivy kazakhstanskoi ekonomiki* (Kazakh-British Chamber of Commerce. Prospects of the Kazakh Economy), available at [<http://kbcc.org.uk/ru/business-info/kazakhstan-economy-outlook/>].

<sup>19</sup> See: A. Kurtov, "Tsentralnaia Aziia—ispytanie krizisom," available at [<http://www.centrasia.ru/newsA.php?st=1234569780>].

<sup>20</sup> V. Babak, "Kazakh Oil: Economic Booster or Dead Weight?" *Central Asia and the Caucasus*, No. 3 (9), 2001, p. 45.

<sup>21</sup> N. Ramazanov, "Rost smenilsia padeniem," available at [<http://www.dn.kz/main/bank01.htm>].

Most of the funds Kazakh banks received were used, as mentioned above, for construction, as well as for issuing consumer and mortgage loans.

For example, five of Kazakhstan's largest commercial banks, which account for 70% of the assets of the national banking system, increased the volume of their loans to construction companies in just 2.5 years (from the end of 2004 to April 2007) from \$1.6 billion to \$10.4 billion.<sup>22</sup> The share of loans issued to construction companies (taking into account mortgage loans) amounted to 30%.<sup>23</sup>

It should be noted that the constantly growing earnings from oil and gas condensate export (due to the rapid increase in hydrocarbon prices in the world markets and increase in its production volumes in Kazakhstan) reached the colossal sum of \$28 billion in 2007. The above-mentioned foreign borrowing by Kazakh banks was another important source of foreign exchange receipts. A combination of these two factors caused "overheating" of the national economy.

The favorable external situation did not have a significant impact on the development of most production branches: the construction industry and the banking sector being the indisputable favorites.

The high earning power of the construction business and the shortage of housing, which has existed since as early as Soviet times, as well as the essentially unhindered opportunity to obtain mortgage loans stimulated a real building boom in the country which was accompanied by a speculative increase in housing prices. Between 2000 and 2007, housing prices increased by 1,780% in the secondary market and by 775% in the primary. While the amount of new housing put into service increased four-fold.<sup>24</sup>

The loan crisis of 2007 dealt a severe blow to the construction business in Kazakhstan—bankers were forced to tighten up loan-issuing conditions and many building projects were frozen; construction became an unprofitable business. An outflow of capital from the construction industry began. Many investors, unable to find use for their capital in the country, turned their sights abroad. The demand for foreign real estate dramatically rose.

The deterioration in the capital inflow and outflow balance that began several years previously continued with a vengeance. As early as 2005, the net capital outflow was expressed in quite a high negative value (−\$4.97 billion). In 2006–2007, this index continued to deteriorate (−\$8.49 and −\$10.95 billion, respectively).<sup>25</sup>

The loan crisis dealt a hard blow to small and medium business. Many small-scale and medium-sized enterprises, deprived of access to loans, began to close down. For example, according to the official data as of 1 January, 2008, approximately 1.4 million people were employed in small and medium business, but by the fall of the same year this figure had dropped by half.<sup>26</sup>

As a result, the ranks of the unemployed greatly swelled and revenue into the state budget correspondingly fell.

In recent years, wages have rapidly grown in the country, as well as pensions and other social benefits, which has promoted an increase in domestic consumer demand. Since this growth was much higher than the increase in labor productivity, it resulted in an increase in inflation. At first it was moderate, reaching 7.7% in 2005 and 8.4% in 2006, whereas in 2007 it had risen as high as 18.8%.

The growing financial crisis significantly worsened the country's macroeconomic indices. The GDP growth rates slowed: in 2006, they were 10.6%, in 2007, 8.7%,<sup>27</sup> and in 2008, only 3.2%. The

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<sup>22</sup> See: *Program Statement of the Socialist Resistance of Kazakhstan about the crisis and measures for overcoming it...* available at [[http://www.kazakhstan.socializm.ru/ideology/program/antikrizis\\_econ\\_program\\_2009](http://www.kazakhstan.socializm.ru/ideology/program/antikrizis_econ_program_2009)].

<sup>23</sup> *Ibidem*.

<sup>24</sup> [[http://www.zakon.kz/our\\_news/news\\_asp?id=30176764](http://www.zakon.kz/our_news/news_asp?id=30176764)].

<sup>25</sup> See: P. Svoik, "Ekonomika Kazakhstana na fone mirovogo krizisa: chto my sozdali i s chem ostaemsia?" available at [<http://www.centrasia.ru/newsA.php?st=1225058400>].

<sup>26</sup> See: D. Satpaev, "V Kazakhstane zatiagivaiut poiasa," RIA Novosti (Moscow), 14 October, 2008.

<sup>27</sup> See: *Kazakhstan za gody nezavisimosti (1991–2007)*, p. 11.



industrial production growth rates also perceptibly dropped. In 2006, its growth amounted to 7.2%, in 2007 to 5.0%, and in 2008 to only 2.1%. Compared to the 2007 level, agricultural production dropped by 5.6%, although in previous years stable growth was seen in the agrarian sector: in 2005—4.6%, in 2006—4.5%, and in 2007—8.9%.<sup>28</sup>

As for the growth rates in the country's foreign trade turnover (export and import), they depend on the influence of two factors at once: the impact of the crisis on the demand for goods and services and the change in prices. The republic's high export growth rates were explained by the increase in price for the country's main export commodities (hydrocarbons, metals, and wheat) and the increase in their physical volume. For example, in 2006 export rose by 37.3% compared to the previous year, in 2007, by 24.8%, and in 2008, by 49.1%.

In 2008, the increase in oil prices continued, compensating for the negative effect of other factors. But at the end of the year, there was a landslide in the prices for Kazakhstan's export commodities, and in the first quarter of 2009, the picture dramatically changed. According to the data of the National Statistics Agency, during the first three months of 2009 export decreased by almost half (49.2%) compared with the first quarter of 2008 and amounted to only \$8.02 billion. At the same time, import decreased by only 15.8% and amounted to \$5.99 billion. In this way, the surplus in Kazakhstan's foreign trade balance in the first quarter of 2009 amounted to only \$2.03 billion, which is over four-fold less than during the first quarter of 2008, when the positive balance reached \$8.7 billion.<sup>29</sup>

If this trend continues, it will have a negative effect on settling of the external debt. The problem of paying off the country's growing external debt existed even before the onset of the world financial crisis. For example, in just two years (from 2004 to 2005), this debt almost doubled. By the end of 2005, it had reached the sum of \$43.4 billion, which was approximately 75% of the GDP.<sup>30</sup>

Kazakhstan came close to the critical mark when its gross external debt amounted to 80% of the GDP. But as early as 2006, the republic crossed even this boundary: in just a year the external debt rose to \$74 billion, which was more than 90% of the GDP (\$81 billion).

In 2007-2008, Kazakhstan's gross debt continued to rise: by the end of 2008 it was already as high as \$107.8 billion, although its share in GDP terms dropped to 81.5%.<sup>31</sup>

At present, the increase rate in the gross debt amount has dropped, but its relation to the GDP is still above the critical mark.

So-called second-tier banks have a particular role to play in this rapid increase in the country's gross external debt. By the end of 2007, their total external debt had reached almost \$46 billion, which amounted to 47.4% of the country's gross external debt. In 2008, these banks were supposed to pay off \$14.1 billion, in order to do which they had to resort to new loans (totaling \$7.4 billion). Nevertheless, they managed to reduce their debt to \$39.2 billion.

In 2008, the situation became much worse. Due to the inability of banks to independently pay off their debts, Kazakhstan lost several potential creditors. In addition, the worsened liquidity situation in the world markets dramatically limited the possibility of receiving foreign loans for settling the existing debt. Interest rates in the world credit markets noticeably increased.

In addition, the drop in prices for the country's main export commodities (oil, gas, metals, and grain) in 2008 significantly reduced state revenues.

The state still has the capacity to support the banking sector, but is unable to assist all private enterprises.

<sup>28</sup> Ibidem.

<sup>29</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-April 2009*, RK Statistics Agency, Astana, May 2009.

<sup>30</sup> See: N. Ramazanov, "Dolgovaia iama vse glubzhe," *Delovaia nedelia*, 10 April, 2009.

<sup>31</sup> Ibidem.



The external debt of Kazakhstan enterprises (without taking into account inter-company debts and bank debts) at the beginning of 2008 amounted to approximately \$35 billion, while the assets of the National Fund were evaluated at \$27.3 billion.<sup>32</sup>

Despite the fact that in 2008, there was limited access to foreign credit markets, the country's gross external debt continued to rise and by the end of the year had increased by another 11.2%, reaching a total amount of \$107.8 billion.

But it should be noted that in 2008, the national debt, as well as debts for which there are government-guaranteed obligations, increased by only \$68 million. At the same time, the external debts of the private sector increased over the year by more than \$10.8 billion.<sup>33</sup>

In 2008, Kazakhstan paid off the enormous sum of \$31.3 billion on its external obligations (including costs relating to paying off and servicing the national debt, as well as settling the external debts of the private sector). It was able to cope with this difficult task due to the enormous positive foreign trade balance that had developed because of the high hydrocarbon prices in the world markets and by means of new foreign borrowing. Despite this, as already mentioned above, the total amount of the Kazakhstan's gross external debt increased again, and by the end of 2008 each of the country's residents accounted for approximately \$6,800 of the external debt.

## Anticrisis Strategy

Despite the fact that the first symptoms of the crisis in Kazakhstan's banking system were noticed as early as the beginning of the second half of 2007, the country's leadership was long unable to define its anticrisis strategy. Naturally, it took several measures to remove the difficulties that arose in the country's fiscal system and to stabilize the situation in general. But this was more of a response to certain problems in the banking system than a well-thought-out anticrisis program.

For example, when capital began to stream out of Kazakhstan, and national commercial banks had limited access to the foreign capital markets, the country's leadership began to take steps to correct the situation that developed. But at that time it was unable to fully assess the dimensions of the crisis that had already begun. The authorities evidently viewed the situation that developed as merely a temporary liquidity shortage in second-tier banks and limited themselves to providing them with the necessary short-term liquidity.

According to Vice President of the country's National Bank Daniar Akishev, in the second half of 2007, the total amount of government assistance to commercial banks amounted to some \$40 billion. In addition, President Nazarbaev instructed that another \$4 billion be allotted to support the country's banking system.<sup>34</sup>

It was presumed that the measures adopted would be enough to remove the banks' temporary liquidity problems and that the situation would quickly recover. When speaking at a round table discussion in September 2008 in Moscow on the problems of the global financial crisis organized by the Russian Information Agency, Novosti, Daniar Akishev also said that the situation in Kazakhstan's banking system had dramatically improved by the end of 2007 and so the world financial crisis that developed in 2008 was not having any noticeable influence on the banking system of his country.<sup>35</sup>

Unfortunately, as often happens in countries with a high level of state corruption, the situation in the financial sphere developed contrary to the scenario designated by the government. After receiv-

<sup>32</sup> See: N. Ramazanov, "Dolgovaia iama vse glubzhe."

<sup>33</sup> Ibidem.

<sup>34</sup> See: RIA Novosti (Moscow), 24 September, 2008.

<sup>35</sup> Ibidem.

ing \$4 billion in 2007 to support small and medium business and construction, Kazakhstan banks were in no hurry to use it for its designated purpose. As a result, Prime Minister Karim Masimov was forced to recall some of the money the banks had still not used, hinting that this money was obviously being put on the float.<sup>36</sup>

As early as October 2008, less than a month after the victorious reports of National Bank Vice President Mr. Akishev in Moscow, the second wave of the financial crisis dealt Kazakhstan a severe blow. This time, the republic's leaders reacted quite promptly to the aggravated situation.

In October 2008, President Nazarbaev made a decision to create a National Prosperity Fund called Samruk-Kazyna, a kind of anticrisis headquarters. A total of \$10 billion was allotted to it from the stabilization part of the National Fund. Four billion of this sum was intended for four of the country's strategic banks (Alliance Bank, BTA Bank [Turam-Alem Bank], Narodny Bank, and Kazkommertsbank), as well as to support several other sectors of the national economy.

A total of \$3 billion was allotted to support the construction industry and mortgaging; \$1 billion was intended to support the agro-industrial complex, and the same amount was allotted to save small and medium business. In addition, \$1 billion was to be used to implement various production and infrastructure projects.

The government's anticrisis program adopted in November 2008 proposed, in particular, that the Samruk-Kazyna holding created by the government join the capital of the four above-mentioned strategic banks; it was presumed that it would become their co-owner.

In other words, Kazakhstan largely undertook the same measures to save its banking system that were undertaken in the U.S., Germany, and Great Britain.

In addition, in order to reduce the negative effects of the world financial crisis to a minimum, high export fees and a new tax on mineral production were introduced. With these measures the government showed its willingness to take active steps to settle the crisis situation in the economy and finances.

According to Dosym Satpaev, director of the Risk Assessment Group, governmentalization of the economy is going on in Kazakhstan, whereby not only in the financial sphere, but also in other important sectors, such as the energy industry, the mining industry, and others.<sup>37</sup>

At the end of November 2008, the president gathered local investors together at a special meeting. He expressed his concern that over the past year approximately \$52 billion had been exported from the country and asked the businessmen to share their opinions on the problem of loss minimization. But according to press reports, this idea was not supported and the talks failed. It is possible that the businessmen did not like some of the head of state's proposals. The president stated in particular that the state would allot \$3 billion to support the construction business, but believed that "the time had gone when a square meter of housing cost \$5-6,000 and construction companies enjoying state support should assume some of the losses themselves and sell housing at a lower price than previously. Those companies that objected would have to face bankruptcy."<sup>38</sup>

Nazarbaev also suggested that the money accumulated in the pension funds be used to recapitalize commercial banks; after stabilization of the financial situation this money should be returned.<sup>39</sup>

At the end of 2008, the republic's government, National Bank, and Financial Inspection Agency adopted a joint action plan for 2009-2010 aimed at stabilizing the economy and financial system, which envisages a whole series of measures for a quick exit from the crisis. According to this document, the state was to render financial support to banks by purchasing their shares and issuing them subordinated loans.

<sup>36</sup> Ibidem.

<sup>37</sup> See: RIA Novosti (Moscow), 14 October, 2008.

<sup>38</sup> V. Panfilova, "Nazarbaev meniaet ekonomicheskuiu strategiiu," *Nezavisimaia gazeta*, 25 November, 2008.

<sup>39</sup> Ibidem.

In order to receive this assistance, the banks are supposed to raise their own capital by means of their shareholders. It is presumed that as the global financial crisis abates and access is gained to the international capital markets, the state (in the form of the Samruk-Kazyna fund) will gradually cease its participation in the banks' capital.

There are also plans to create a distressed assets fund using revenue from the republican budget, the activity of which should be aimed at improving the quality of the banks' loan portfolios. In 2009, it was to have 122 billion tenge (approximately \$1 billion) at its disposal. The fund's main obligation will be to purchase doubtful bank assets and subsequently manage them.

In January 2009, the government rendered emergency assistance to Kazkommertsbank and Narodny Bank by depositing \$1 billion each in them. The following month, the same measures were also undertaken with respect to two other large banks, BTA and Alliance Bank; and a decision was made to purchase their shares.

The pumping of government resources into the banking system made it possible to maintain the banks' liquidity at a satisfactory level. The share of liquid assets compared to the total as of 1 March, 2009 amounted to 16.4%. But the quality of the loan portfolio was extremely unsatisfactory: almost 2/3 of the loans qualified either as doubtful (55.2%), or as unrecoverable (7.2%).<sup>40</sup>

In addition, \$5 billion was allotted to activate the real estate market in Astana and Almaty (by means of the Samruk-Kazyna fund). There are also plans to launch a special program of mortgage lending and housing development. Funds to implement it should come from resources borrowed from the National Fund and accumulative pension funds.

The plan also envisages rendering support to small and medium business. For this purpose, there were plans to allot \$1 billion in 2009. Second-tier banks are to be the operators of all the lending programs for small and medium business. The limit on financing of each project is being increased from \$3 to 5 million.<sup>41</sup>

The document also envisages several measures for developing the agro-industrial complex and implementing innovation, industrial, and infrastructure projects.

The International Monetary Fund (IMF) assessed the anticrisis measures adopted by the Kazakhstan government as positive. During a meeting with the republic's Prime Minister Karim Masimov, head of the IMF mission in Kazakhstan Tim Callen noted that "the policy of the Kazakh government shows that the country is doing the right thing to extricate itself from the current situation." In particular, the IMF representative very much approved the government's decision to recapitalize banks at the government's expense.<sup>42</sup>

At the beginning of February 2009, the country's leadership adopted a decision to greatly devalue the national currency, as a result of which the value of one dollar increased from 122.3 to 144.0 tenge (from 4 to 5 February). This measure was called upon not only to raise the competitiveness of domestic products in the world markets, it was also designed to put an end to the huge amounts the National Bank was spending to maintain the exchange rate of the national currency.

The National Bank made the sum it was spending to maintain the national currency public for the first time—between the fourth quarter 2008 and 4 February 2009, it spent \$6 billion. In January 2009 alone, maintenance of the previous tenge exchange rate cost \$2.7 billion.<sup>43</sup>

It should be noted that devaluation of the national currency was carried out in Kazakhstan much later than in many CIS countries, whereby its dimensions were much smaller than in other countries.

<sup>40</sup> See: N. Ramazanov, "Zhestkaia posadka," available at [<http://www.dn.kz/main/bank01.htm>].

<sup>41</sup> [<http://www.zakon.kz/our/news/news.asp?id=30369373>].

<sup>42</sup> See: *Kazakhstan segodnia*, 19 November, 2008.

<sup>43</sup> [<http://news.finance.ua/ru/-/2/0/all/2009/02/05/150897/printable>].

Devaluation of the tenge was a compulsory measure. The National Bank was faced with a dilemma: either to continue spending its own international reserves to maintain the exchange rate of the national currency, or to devalue it. The country's authorities understood that this would have ambiguous economic and social consequences for the country. But in the end the fact that devaluation could promote the expansion of export was evidently the clincher. And in the crisis conditions, this was extremely important for the country.

## Short-Term Prospects

Economic forecasting is usually a thankless task. Even during times of long economic stability it is accompanied by significant difficulties and depends on many factors of social life—psychological, legal, public, and so on, that do not have a quantitative expression and so can only be accounted for approximately.

In the conditions of an economic crisis, forecasting is complicated by the unusualness of the situation. So in this case it is not a matter of forecasts for the next 1-2 years as such, but rather prepositions based on already designated trends and expert opinions.

According to IMF experts who visited the country in mid-June 2009, the republic's GDP would decrease by more than 2%. But according to the forecasts of the republic's cabinet of ministers, economic growth in 2009 would continue, although its rates would slow down to 1%.<sup>44</sup>

Preliminary data of the RK Statistics Agency for the first quarter of 2009 show that the republic's GDP in January-March 2009 decreased to 2.2% compared to the same period for the previous year.<sup>45</sup>

In January-May 2009, industrial production dropped by 4.6% compared to the same period in 2008. Judging from the first intermediate data, the IMF's forecast might prove to be more precise than the forecast of the Kazakh cabinet of ministers.

Kazakhstan was one of the first countries to enter the financial crisis and, according to the available statistics, has a real chance of withdrawing from it before the rest, since the republic has managed to avoid a severe drop in GDP and volumes of industrial production.

Despite the fact that the government was slow on the uptake at the beginning of the crisis, the measures it subsequently implemented have yielded positive results. A total of \$19 billion have been allotted to carrying out anticrisis measures, which corresponds to 14% of the country's GDP.<sup>46</sup>

The funds invested in infrastructure, transportation, and social facilities have made it possible to create approximately 100,000 new jobs and, in so doing, partially resolve the employment problem.

According to the president, unemployment has come to rest at a level of 7.2%, and there is reason to believe that it will not go any higher than this mark.<sup>47</sup>

The government has succeeded in stabilizing the foreign exchange reserves (\$43 billion as of June 2009); the increase in oil prices that has begun gives rise to the hope that this trend will continue.

Despite the severe blow dealt to the banking system, it was able to withstand it thanks to government intervention.

In the first four months of 2009, the credit investments of second-tier banks in various branches of the economy decreased compared to the corresponding period in 2008 by only 9.3%,<sup>48</sup> showing

<sup>44</sup> See: *Press Dossier of the Kazakhstan National Economic Chamber "Soiuz Atameken,"* 16 June, 2009.

<sup>45</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-May 2009*, RK Statistics Agency, Astana, June 2009.

<sup>46</sup> [<http://www.centrasia.ru/news/A.php?st=1244816640>].

<sup>47</sup> See: RK Statistics Agency, available at [[http://www.stat.kz/news/Pages.n2\\_01\\_07\\_2009.aspx](http://www.stat.kz/news/Pages.n2_01_07_2009.aspx)].

<sup>48</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009*, RK Statistics Agency, Astana, June 2009.

that the banking system in general has nevertheless retained its capacity to contract. In all likelihood, it can be assumed that in the near future it will be able to renew lending to the economy in the necessary amounts.

The state budget for 2009 formed taking account of the devaluation in the tenge forecasts an annual inflation of 11%. The cumulative inflation for January-June 2009 (3.9%)<sup>49</sup> is a positive sign that this task has been successfully dealt with. It is also possible that the annual inflation rate will be lower than the figure planned in the budget.

Regardless of how prices form in the world markets, oil will continue to be the country's main export commodity. In the first quarter of 2009, despite the increase in the physical volume of oil and gas condensate sales (by 63.3% compared to the same period for 2008), the earnings from their export decreased by 27.4% compared to the same period of the previous year.<sup>50</sup>

The increase in hydrocarbon prices makes it possible to count on a significant surplus in the republic's foreign trade balance in 2009 too, although it will undoubtedly be much lower than in 2008. The main reason for the decrease in surplus is that the average price of a barrel of oil in the world markets in 2009 will be much lower than the previous year.

The measures taken by the government to render assistance to small and medium business (al- lotting \$2 billion, introducing a new tax code, and so on) helped to revive it. According to state statistics, as of 1 June, 2009, 290,025 legal entities were registered in the country, which is 5.2% more than the previous year. The number of enterprises belonging to small business, that is, those with less than 50 employees, also rose by 5.5%.<sup>51</sup>

In 2009, corporate income tax was lowered by 1/3 and currently amounts to 20%. In 2011, the government plans to further lower this tax to 15%. The value added tax rate was lowered to 12%.<sup>52</sup> Many administrative barriers have been removed.

All of these measures are designed to revive and promote the successful development of small and medium business in the country in the near future. As mentioned above, the first positive shifts in this direction have already been designated.

Positive changes are also expected in the development of the agro-industrial complex. The state has allotted more than \$2 billion to the development of the agrarian sector. This made it possible to carry out spring sowing in full. In addition, in 2009 the amount of cultivated area was increased by 1.6 million hectares. Between January and May 2009, the volume of gross agricultural produce rose by 3.1% compared to the same period in 2008.

In May, Standard&Poor's raised its forecast of Kazakhstan's sovereign rating to "stable." This could stimulate the inflow of foreign investments, which essentially dwindled to nothing during the crisis.

During its years of independence, Kazakhstan has succeeded in attracting more than \$90 billion in foreign investments (in addition to \$140 billion in domestic assignments), which has promoted a 2.5-fold growth in the country's economy since 2000. Unfortunately, all of these funds mainly went to development of the oil and gas industry, the export of the production of which, as in other countries of the third world, is given primary significance.

But it should be noted that since approximately 2004-2005, most of the investments have been going to the construction and banking sectors, the share of which significantly rose in the country's GDP growth, although this could not change the raw material preponderance of export.

According to the republic's president, "the crisis has once again proven the need to diversify our economy. This is the only correct path of post-crisis development capable of ensuring the stable and

<sup>49</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009*.

<sup>50</sup> See: N. Ramazanov, "Rost smenilsia padeniem."

<sup>51</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009*.

<sup>52</sup> *Message of Kazakhstan President Nazarbaev to the Nation*, 6 March, 2009.

long-term prosperity for our citizens.”<sup>53</sup> In saying this, he essentially admitted the error of the previous investment policy.

In addition, in 2010, a ten-year plan will begin (consisting of two five-year plans) designed to accelerate the country’s industrial-innovation development.

Priority development of the following sectors of the national economy is envisaged:

- the agro-industrial complex,
- construction and construction materials,
- oil refining and services,
- metallurgy,
- chemicals and pharmaceuticals,
- the energy industry and infrastructure.<sup>54</sup>

It can be presumed that despite the president’s recent (June 2009) appeal to foreign investors and informing them of the impressive plans for developing the national economy, we cannot expect an inflow of monetary resources into the country in the previous amounts.

- First, although the banking sector has managed to withstand the crisis thanks to government support, its reputation has been greatly shaken.
- Second, the crisis forced foreign investors to choose the countries and facilities for their investments more carefully.
- Third, the drop in world energy resource prices is in no way helping to attract foreign investments into the oil and gas branch of the country’s economy.
- Fourth, the republic’s leadership is tightening up the legislative conditions for the operation of foreign companies in Kazakhstan and demanding a larger share of their profits, which will also hamper the inflow of funds into the country’s economy.

Despite the crisis, the country’s leadership is guaranteeing performance of its obligations to increase social payments and wages. In his message to the nation of 6 March, 2009, President Nazarbaev promised that, as planned, the salaries of budget employees and stipends would be raised, while at the same time the average amount of pensions would also be increased (in 2010 by 25% and in 2011 by another 30%).

The state plans to issue an additional 11,000 grants and 40,000 loans to help students who have been unable to pay their tuition because of the crisis. The data for January-April 2009 confirm the reality of the leadership’s promises. For example, according to the RK Statistics Agency, in April 2009, the average monthly salary in the country amounted to 64,730 tenge. Compared to April 2008, nominal wages rose by 11.8%. Real wages increased by 2.8% during this time.<sup>55</sup>

All of this shows that the Kazakhstan leadership is indeed striving to alleviate the negative impact of the global financial crisis and create favorable conditions for raising the nation’s standard of living.

\* \* \*

Specialists can still not agree on whether or not the economic crisis has reached its peak. But one thing is clear—sooner or later it will come to an end and become a topic of discussion and study throughout the world, including in Kazakhstan.

<sup>53</sup> N. Nazarbaev, “From a Speech to an Assembly of Investors,” 12 June, 2009.

<sup>54</sup> Ibidem.

<sup>55</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-May 2009*.



Both interior and exterior factors play a certain role in this kind of crisis, but most important is the correlation between them.

In the globalization era, it is essentially impossible to avoid the impact of external factors on a country's economic development. Kazakhstan, as other countries, must strive to alleviate the impact of internal factors of crisis phenomena. For example, the diversification program adopted is designed to eliminate the national economy's biased orientation toward priority development of the oil and gas industry.

This program will not be easy to implement. After the crisis, the world economy will begin to recover. The consumption of energy resources and their prices will grow throughout the world. This could give rise to the temptation to try and gain enormous profits from the sale of liquid fuel and "easy" oil money could again put the brakes on real diversification of the national economy.

World economic crises are inevitable. And the more successfully the diversification program is carried out, the better prepared the country will be for another disaster in the world economy.

Nor should we forget that reserves of energy resources, no matter how great they are, are nevertheless finite. And the economic life of society must go on even after the last barrel of oil is extracted from the subsurface.

So we need to learn some lessons from the current financial crisis and draw the appropriate conclusions.

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## UZBEKISTAN IN THE CONTEXT OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

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### *Introduction*

The most urgent tasks of the present day are to make an objective assessment of the reasons for the emergence of the global financial and economic crisis that broke out in 2008 and draw up a program of measures for overcoming its negative consequences.

As world experience shows, crises inevitably give rise to political instability and an increase in crime and corruption throughout the world (for example, the 1847-1849 crisis led to revolutions in many European countries, while the Great Depression of 1929 generated Fascism). Moreo-



ver, such conditions may cause an abrupt change in the functioning of political institutions and push to the foreground aggressive forces that used to be considered secondary and marginal (anarchism, Nazism, neo-Fascism, and racism). The elections held recently in the European countries (including to the European Parliament) are clear

proof of the real possibility that such threats may arise.

But during the first weeks of 2008, essentially all international experts regarded the situation in the world economy as favorable. Society did not take the warnings of some analysts about the impending crisis seriously.

## The National Economy Before and in the Midst of the Crisis

Keeping in mind the growing integration of Uzbekistan's economy into the global financial and economic structures, it stands to reason that the crisis could not help but have a negative impact on the republic.

It should be noted, however, that in recent years a sufficiently stable resource base was created in Uzbekistan conducive to the smooth functioning of the financial-economic, budgetary, and banking systems, as well as of different branches of the national economy.

The macroeconomic situation in Uzbekistan in recent years has been enjoying the following attributes: continued economic growth, low inflation rates, higher real personal monetary incomes and employment, higher foreign trade volumes, and dynamic development of small business, entrepreneurship, and home jobs (see Table 1).

Table 1

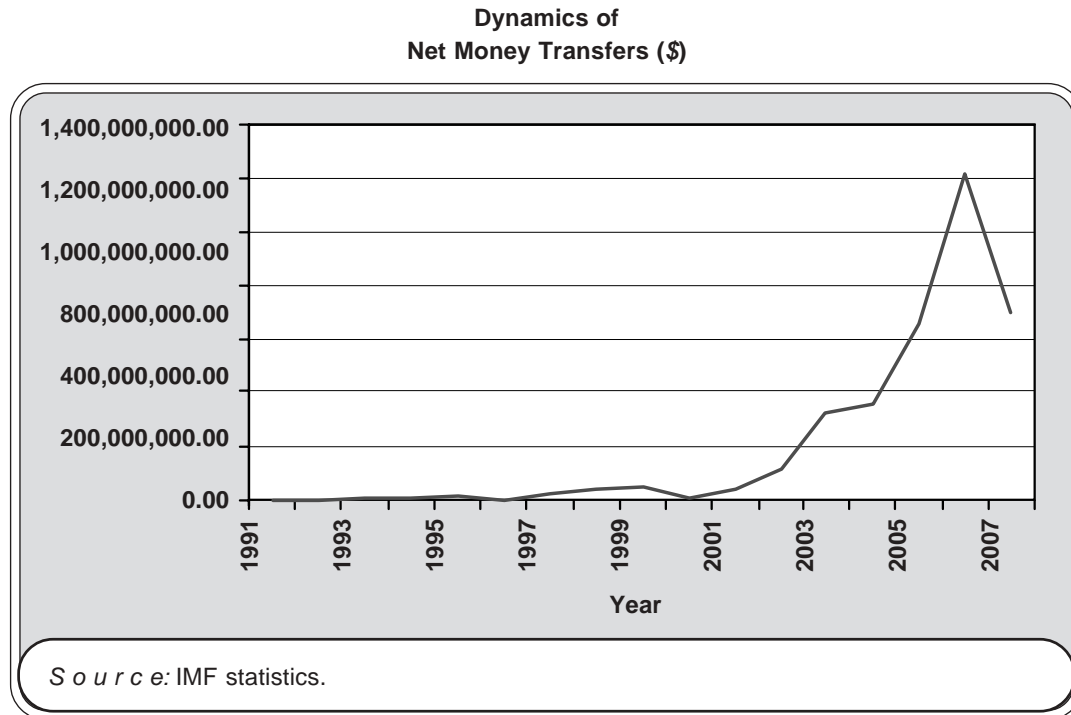
Key Economic Indices of the Republic of Uzbekistan  
(% of the previous year)

Indices	2005	2006	2007	2008	2009 (predicted)
Gross domestic product	107.0	107.3	109.5	109.0	108.0
Budget revenues (% of GDP)	21.2	21.6	21.8	23.8	22.2
Deficit/surplus (% of GDP)	0.3	0.5	0.5	1.6	1.0
Industrial production	107.2	110.8	112.1	112.7	109.3
Agricultural production	106.2	106.2	106.1	104.5	105.0
Investments in basic capital	105.7	111.4	122.9	128.3	118.0
Inflation (CPI)	7.8	6.8	6.8	7.8	7-9
Soum/dollar exchange rate (at the end of the period)	1,174.02	1,240.00	1,290.00	1,393.00	1,456.0
<i>Source:</i> Data of the State Statistics Board of the Republic of Uzbekistan.					

At a presentation of the EBRD's annual report *Transition Report 2007*, it was noted that over the past seven years, the economic growth rates in Uzbekistan amounted to an average of 5.4%, while in 2007, this index equaled 9.3%.

The high world gold and raw hydrocarbon prices, as well as the large money transfers into the country, which amounted to 7% of the total GDP volume<sup>1</sup> (see Fig. 1), have had a positive impact on the republic's economic growth.

Figure 1



This figure clearly shows that in 2001-2007 the volume of transfers was on the rise, that is, over these six years the amount of net money transfers rose by 1,600% and amounted to almost 7.2% of GDP; the increase in this index in 2005-2007 was much higher than in 2001-2007. We can see from these data that migration from Uzbekistan has intensified over the past three years. World practice shows that this process is having a positive effect on the country's development since, in the future, it could promote an increase in investments and a rise in the country's foreign trade turnover. On the other hand, in the context of the global financial and economic crisis, stable development of the national economy is being disrupted.

According to experts, the world financial and economic crisis could spread to the Central Asian region as early as 2009. The impending disaster was demonstrated by the reduction in remittances after 2007, the decrease in foreign investments, and the reduction in demand for local products.

In addition, the crisis could have a negative impact on the financial sphere (lending and foreign investments) and import. In this respect, most countries of Central Asia (CA) intended to put tight restrictions on state spending, lower the inflation rate, and halt the outflow of foreign currency; this, in turn, could lead to a reduction in import (in order to support national manufacturers).

<sup>1</sup> See: *Vesti* (Uzbekistan), 10 December, 2007.

Over the past two decades, the efforts of the IMF and WB leave much to be desired with respect to conducting reforms in countries with a transition economy. While carrying out their economic reforms, the CA republics encountered a whole slew of problems. For example, Western countries and international financial institutions were not willing to issue these republics large loans; nor did their closest neighbors (Turkey and Iran), which were pursuing their own interests, render the necessary financial assistance. The crisis showed again that the activity of international financial institutions must be improved and comprehensive relations developed with Third World countries.

Due to the aggravated financial and economic situation in the CA republics, selling large industrial facilities to foreign investors became very popular. Kazakhstan is a good case in point, where foreign capital took over some of important industrial facilities, such as Ekibastuz GRES-1 (America's AEC), the Ermakov power plant (Japan Chrome Corporation), the Karaganda metallurgical combine (America's Ispat International), the Vasilkovskoye Gold Mine (a Canadian-British-Dutch financial industrial group), the Chimkent lead factory (an Australian company), the Zyrianovsk lead and Ust-Kamenogorsk lead and zinc combines (Ridder Invest Company), and the Bakyrchik Gold Mine (Britain's Bakyrchik Gold and Canada's Indochina Goldfields); Balkhashmed was taken over by a Western company, while the main chromium fields went to Turkish companies, and so on.<sup>2</sup>

I would like to draw special attention to the fact that the ill-conceived policy of many states with respect to foreign borrowing has placed their economies in a difficult position by making them overly dependent on external factors. As for Uzbekistan, even though it encouraged the receipt of foreign investments, it was against hasty liberalization of the economy and privatization of strategic facilities. At the initial stage, Uzbekistan largely retained state control over the economy and carried out a socially oriented domestic policy, focusing explicitly on protecting the socially vulnerable strata of the population.

The republic never pursued a policy of obtaining short-term speculative loans and attracting foreign loans on a long-term basis at preferential interest rates (see Fig. 2).<sup>3</sup> The republic's government has repeatedly rejected proposals to provide loans for certain projects, since it had no reliable guarantee of their timely servicing. Uzbekistan's aggregate external debt as of 1 January, 2009 amounted to 13.3% of GDP and is classified by international rating agencies as "less than moderate."<sup>4</sup>

According to foreign economists, countries that are mainly oriented toward export and have large external debts will suffer the greatest losses, and those countries that adopted timely measures to re-tool production, develop new technologies, and produce competitive products at the lowest costs will suffer the least. (Given the current world economic system, the external debt should not exceed 50% of GDP, while before the crisis it amounted to 60%.)

Figure 3, which features such indices as the GDP dynamics and the dynamics of foreign trade as a whole, as well as of export and import, can be used to determine the scope of the impact of the world financial and economic crisis on Uzbekistan's economy.

This figure clearly shows the interaction between the annual GDP growth and the volume of annual foreign trade growth, that is, it determines how integrated the republic is in the world community. For example, the financial crisis in Southeast Asia in 1997, as well as the collapse of the Russian stock market in 1998 had a negative impact on foreign trade growth, but these events did not have a significant influence on the republic's GDP growth.

In 1993-1997, the import growth rates were much higher than the export rates since a policy was pursued that provided the population with all its basic necessities (due to the low level of restrictions

<sup>2</sup> See: V. Vovk, N. Kharitonova, "Vneshnepoliticheskie priority stran Tsentral'noi Azii," available at [[http://www.ia-centr.ru/public\\_details.php?id=137](http://www.ia-centr.ru/public_details.php?id=137)].

<sup>3</sup> See: I.A. Karimov, "Mirovoi finansovo-ekonomicheskii krizis, puti i mery po ego preodoleniiu v usloviakh Uzbekistana," Uzbekiston, Tashkent, 2009, p. 9.

<sup>4</sup> Ibid., pp. 25-26.

Figure 2

Dynamics of the External Debt of Several Countries of the World (% of GDP)

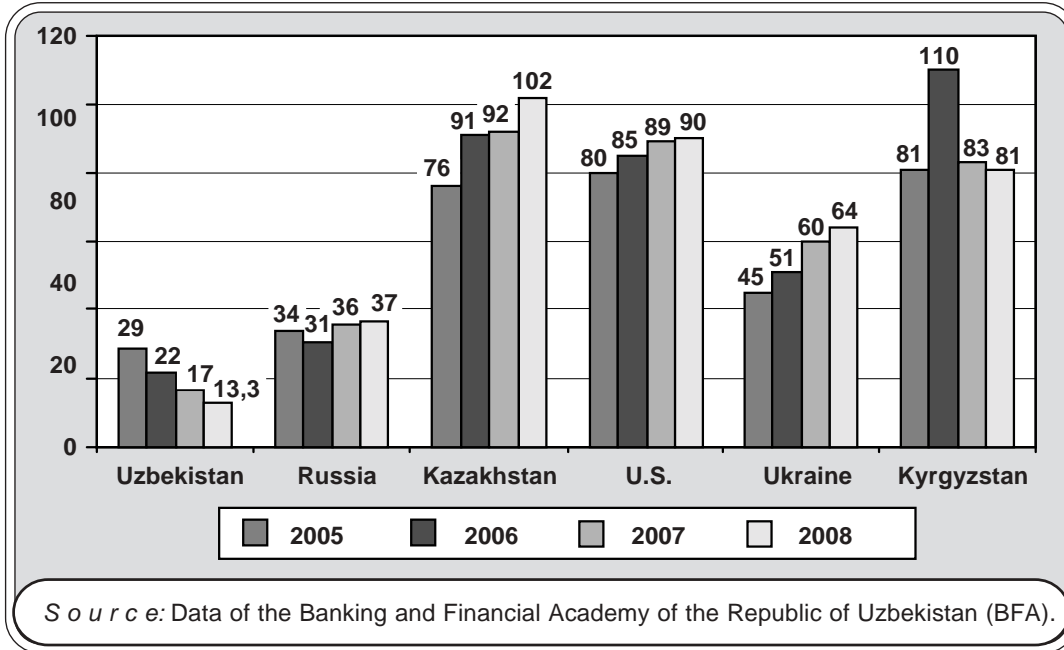
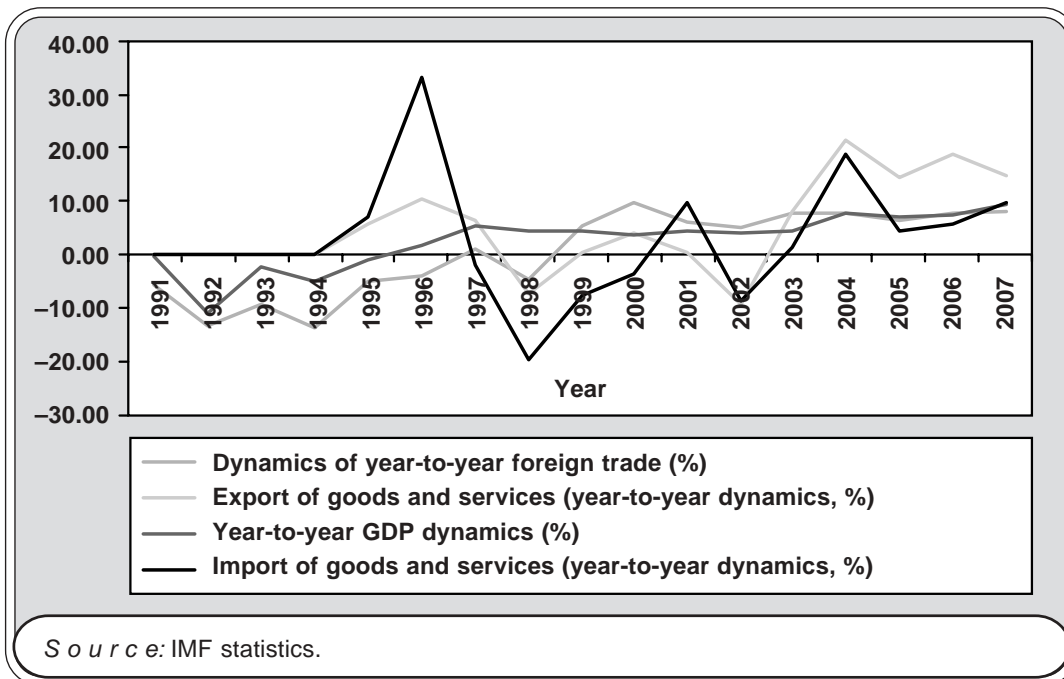


Figure 3

Dynamics in GDP Growth and Foreign Trade Increase



on import and low customs fees). In 1997, the republic began conducting a policy aimed at supporting local manufacturers; they enjoy favorable conditions in the internal and external markets.

Tariff regulation in 1999-2008 led legitimately to exports soaring ahead of imports. This was largely due to the increase in world ginned cotton, gold, and ferrous metal prices (the republic's main export commodities).

## The Government's Anticrisis Policy

Uzbekistan continues to enjoy relatively sophisticated mechanisms for producing and selling goods in the internal market; all they require is more stimulation in order to alleviate, albeit to some extent, the consequences of the crisis.

Implementing joint investment projects in the infrastructure branches is one such measure designed to soften the blow of the world financial crisis. In the crisis conditions, the sources for financing and providing loans to the republic's infrastructure branches abruptly shrank.

The government of Uzbekistan is carrying out measures to further diversify foreign trade relations, primarily with the countries of Asia and the CIS (including with Russia), in order to ensure dynamic and balanced economic growth.

Due to the declining demand in the world market, the prices for the products exported by Uzbekistan (precious and ferrous metals, cotton, uranium, petroleum products, mineral fertilizers, and so on) are dropping. This in turn is leading to a decrease in export revenue for economic entities and is affecting their profitability, and, ultimately, the growth rates and macroeconomic indices. In addition, purchasing power is dropping in the world, which could have a negative effect on the country's payment balance and on production as a whole. Ninety-two percent of international payments for goods and services is carried out in U.S. dollars, and the exchange rate of this currency greatly fluctuates.

Meanwhile, the Central Bank's monetary policy and the economy's stable position giving no reason for concern. However, Uzbekistan, as part of the global economic expanse, is increasingly feeling the negative consequences of the world crisis. So carrying out the anticrisis program for 2009-2012 is still an important priority in the republic's socioeconomic development for 2009. The Uzbekistan government is posing itself the following tasks in order to ensure dynamic and balanced economic growth.

- *First*, continuing the structural reforms and diversification of the economy is the most important priority of the economic program for 2009.
- *Second*, keeping in mind the food crisis and possible inflow of migrants, the government declared 2009 to be The Year of Development and Improvement of the Village.
- *Third*, development of the service and small business sphere is regarded as the most important factor in providing employment and raising the population's standard of living. These measures include both tax and loan benefits, as well as further intensification of institutional reforms in order to create a more favorable business climate for developing private business.
- *Fourth*, further improvement of the production and social infrastructure is a vital factor in the country's modernization and in raising employment.

- *Fifth*, in 2009, further improvement in banking performance remains a priority task; the population and economic entities are still being encouraged to deposit their free funds in commercial banks.

On the whole, all these measures are aimed at creating additional jobs keeping in mind the possible inflow of migrants and at satisfying the population's growing demands. The main emphasis is being placed on the agricultural sector; there are also plans to expand the scope of contractual work on the major repair, reconstruction, and building of housing.

On the whole, it can be said that the anticrisis program is targeted toward those spheres of the economy that do not require large investments but, in so doing, generate the largest number of jobs.

Special mention should be made of the fact that Uzbekistan, in contrast to other raw material export countries (which are dealt the main blow), has every opportunity to avoid the destructive consequences of the crisis. This requires reorienting the national economy toward accelerated technological development.

On the whole, the following conclusions can be drawn with respect to the impact of the world economic crisis on Uzbekistan's economy:

- The crisis is still having a minimal impact on the economy and mainly affects branches that produce export commodities.
- The republic's economy continues to grow, but the consumer market is shrinking (due to inflation); the volume of remittances is decreasing.
- It is highly likely that the crisis in Uzbekistan will take its toll later than in other countries of the region, since the republic's economy is more sustainable, stable, and diversified.
- The global crisis in Uzbekistan will have severe consequences due to the economy's export and raw material orientation.
- The crisis could lead to a revival of the protectionist policy, which will become a powerful tool in the import-substitution policy.
- The country's withdrawal from the crisis will be accompanied by structural changes in the economy. The anticrisis program, which is aimed at modernizing production and reducing production costs by means of technological improvement, will ensure the country's future competitiveness in the world markets.

The global financial and economic crisis has essentially had no effect on the securities market, but there are still high inflation risks, and there may be a change in foreign investors' targets, whose stock exchange share amounted to more than 30% of the total securities turnover.

It should also be noted that the collapse in the mortgage market in the U.S., which set the crisis off, did not have an effect on the mortgage system emerging in Uzbekistan. This is explained by the fact that it relies on internal sources of financing.

## Possible Pluses of the Crisis

When analyzing the situation in countries affected by the crisis, the appropriate lessons should be learned when forming and developing the mortgage and securities market in the future.

In addition to the possible negative consequences, the current crisis could also have positive effects. In the European countries and the U.S., investors are dispensing with assets and getting rid of shares. This is releasing resources for further investment, which will encourage a search for new alternative markets.

In contrast to Western markets, the markets of developing countries are showing sustainable growth dynamics. So it is highly likely that many investors will set their sights on Uzbekistan's market, since the country is enjoying a stable situation and economic growth.

Moreover, the world financial crisis could have a positive effect on the republic's economy. This requires pursuing a balanced fiscal and monetary policy aimed at stimulating export potential, diversification of the economy, differentiation, and correct positioning of export commodities.

For example, the world financial crisis is increasing the demand for gold, which is one of the republic's export items, thus generating a rise in its price in the near future. The same can be said for other raw mineral resources produced in the country.

In addition, whereas Uzbekistan used to deliver fruits and vegetables to Russia and Kazakhstan, the demand for these products is also growing at present in European and Asian countries.

However, large European commercial companies make very specific demands on the quality of these products, and their production in the republic must meet these demands. This requires motivating the producers (dehkan households and farmsteads) and creating a network of services for them; in the final analysis, this will lead to a rise in competitiveness of the fruit and vegetable industry.

Uzbekistan's neighbors became convinced even more that they were right to choose a multi-vector foreign policy. At present, they heavily depend on the financial and political support of the world nations. Meanwhile, the economic slump could lead to a sociopolitical crisis, which not all countries will be able to deal with. So it is a little risky to count on stable financial and political support from the world community.

In addition to everything else, the crisis is creating a new and, most likely, the last opportunity for Uzbekistan to reinforce its leading position in the Central Asian region. Uzbekistan is trying to reactivate the collective tools of its influence, that is, it is quite capable of playing a leading role in regional integration and realizing its long-cherished dream of creating a single country and nation ("Our common home Turkestan").

But the activity of the integration structures largely depends on the internal prosperity of the republic itself, which increases its economic appeal.

## *Conclusion*

Keeping in mind the growing integration of Uzbekistan's economy into the world economic and financial structures, the global crisis had and is continuing to have a negative impact on it. This is particularly clear in the export-oriented branches and production units related to them; demand has dramatically dropped in the world market and the prices for the republic's most important export commodities have decreased. This, in turn, is having a negative impact on the balance and efficiency of the economy as a whole and is creating many problems in implementing the envisaged projects and reaching the set goals.

Despite the negative influence of the global financial and economic crisis, in 2009 Uzbekistan not only enjoyed stable functioning of its economy, but also achieved high and stable growth rates and developed a whole set of effective measures, primarily an anticrisis program and the mechanisms for introducing it. Its implementation will make it possible to withdraw from the crisis with



a stronger, more stable, and balanced economy, which will ensure the republic a worthy place on the world arena.

Moreover, the crisis could help to enhance the production of goods meant for internal consumption, which in the future will ensure dynamic economic growth and promote a further rise in the standard of living.

So the government of Uzbekistan should conduct a policy aimed at rendering additional assistance to the banking and financial structures and supporting business activity and the enterprises and companies of the real sector of the economy. Additional tax benefits and preferences must be granted to raise the profitability of production and export possibilities, and other large-scale projects must also be elaborated and implemented.

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## NATION-BUILDING

**THE POLITICAL REGIME  
IN KAZAKHSTAN:  
ITS CURRENT STATE AND  
POSSIBLE FUTURE**

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Political science defines “political regime” in a variety of ways, yet only two of the definitions are commonly accepted. One of them relies on the political and legal, or institutional, approach, while the other is based on sociology. However they agree when it comes to an understanding of the diverse relations between the government and society.

Those wishing to define any specific political regime should proceed from its institutional design and corresponding political practice (observance of constitutional norms, freedoms and rights); the degree of public involvement in decision-making at the state level; the degree and possibility of competition between the government and the opposition; and the role of open coercion and enforcement in state governance.<sup>1</sup>

The majority of Russian political scientists, studying the transformations in the post-Soviet expanse, concentrate on political *actors* and *institutions* and the mode of their interaction responsible for the structure of power relations.

V. Ghelman, for example, who identifies actors, institutions, resources, and strategies as the main independent variables, has described a political regime as the “sum-total of actors involved in a polit-

<sup>1</sup> For a more detailed analysis of all interpretations of the “political regime” concept in contemporary political science, see: A.P. Tsygankov, *Sovremennyye politicheskie rezhimy: struktura, tipologiya, dinamika*, Interpraks, Moscow, 1995.

ical process, institutions of political power, and the resources and strategies used to gain and retain power.”<sup>2</sup>

R. Turovskiy seems to agree with the above. He describes a political regime as the “sum-total of political actors (including their methods of governance, resources, aims and strategies) and institutions (interpreted both as organizations and the norms and rules of the game) operating on a certain territory.”<sup>3</sup>

The subjects of social action—various elite groups with resources and strategies of their own—can be described as actors. *Resources* are an attribute (a circumstance or a boon), the possession of which makes it easier to influence society. *Strategies* are the nature of actions some actors undertake in relation to others (force, compromise, or a combination of the two).<sup>4</sup> *Institutions* are the sum-total of formal and informal “rules of the game” which impose limitations on the political actors or create incentives to political action.<sup>5</sup>

This definition contains the concept of *dominating actor* used to describe a subject (a strong leader, a ruling party, or the ruling clan, etc.) able to rule beyond any meaningful cooperation with others.<sup>6</sup>

The concepts of formal and informal “actor” and “institution” suffice to describe any political regime as a functional sphere of a political system which, in turn, can be described as a method of cooperation within the formal and informal institutions of the sum-total of actors in the political process who rely on various resources and strategies to gain and retain power.

V. Ghelman has pointed out that the formal description of the political regime created for the purposes of analysis of regime changes allows one to draw a line between competitive and uncompetitive regimes. In the latter case, the dominating actor is all-important, while the others have no significant roles to play.<sup>7</sup>

Before analyzing the political regime in Kazakhstan, it should be noted that by 1995 the country acquired objective conditions conducive to stronger presidential power. This power was represented by Nazarbaev, who had acquired far greater political resources than his opponents.

Electoral support, which the president used to strengthen his legitimacy and improve the referendum strategy, can be described as one such resource. His unrivalled authority, likewise, was another important factor. It had been earned much earlier, during the last years of Soviet power when Nursultan Nazarbaev, a flexible politician, demonstrated his no mean talent for compromises with various social groups and his ability to formulate balanced centrist positions and earn popular support. According to the all-Union poll the *Dialog* journal conducted in 1991, 40 percent of the respondents pointed to Nazarbaev as the “politician of the year” (36 percent selected Boris Yeltsin as the “man of the year”). In May 1991, the Obshchestvennoe mnenie Foundation obtained similar results.<sup>8</sup>

Presidentship completed Nazarbaev’s symbolic resources with institutional resources that expanded his influence not only in the political but also in the wider (social) sphere, which translated into curbing the political parties’ and media’s freedom of action.

The president showed a lot of skill when handling the results of economic restructuring to obtain, apart from the symbolic and institutional recourses, the most important, economic, resource.

This cemented his dominance to the extent that neither the differentiated interests of the elite and the rest of society caused by the economic reforms, nor the exacerbated contradictions created by

<sup>2</sup> *Rossia regionov: transformatsia politicheskikh rezhimov*, ed. by V. Ghelman, S. Ryzhenkov, and M. Bri, Moscow, 2000, pp. 19-20.

<sup>3</sup> R.F. Turovskiy, “Regional’nye politicheskie rezhimy v Rossii: k metodologii analiza,” *Polis*, No. 2, 2009, p. 78.

<sup>4</sup> See: *Rossia regionov: transformatsia politicheskikh rezhimov*, pp. 19-20.

<sup>5</sup> See: V.Ia. Ghelman, “Iz ognia da v polymia? (Dinamika postsovetskikh rezhimov v sravnitel’noy perspektive),” *Polis*, No. 2, 2007, p. 82.

<sup>6</sup> See: *Ibid.*, p. 86.

<sup>7</sup> See: *Ibidem*.

<sup>8</sup> See: *Kazakhstanskaia pravda*, 17 August, 1991, p. 1.

the clan nature of the Kazakh ethnos (the division into *zhuzes*) undermined President Nazarbaev's influence.

The regime, which survived the challenge of the young national bourgeoisie led by former Prime Minister Kazhegeldin during the 1999 presidential campaign and the so-called elite riot of 2001-2002, demonstrated its sustainability.<sup>9</sup>

An analysis of post-Soviet (after 2003) political developments in Kazakhstan leads to the conclusion that new influential political actors are unlikely to come to the fore in the near future.

We can say that in 2003 the post-Soviet regime entered a stage of consolidation.

The electoral cycles of 2004-2005 and 2007 confirmed that the government's domination was absolute and that society was withdrawing its support of the opposition.

The 2004 parliamentary elections brought victory to the pro-presidential parties, which retained their grip on the legislature. The latest presidential elections, which took place in 2005, were fairly peaceful for the powers that be and could be described as the incumbent's triumph: he gained 91.1 percent of the votes, leaving barely 10 percent for Zh. Tuyakbay, the presidential candidate for the For a Fair Kazakhstan opposition movement.<sup>10</sup> This means that President Nazarbaev will remain at the helm till at least 2012.

In 2003 the political regime in Kazakhstan obviously achieved its stability and acquired distinctive features and specifics.

Within V. Ghelman's classification, the post-Soviet regime in Kazakhstan can be described as *monocentric* with one dominating actor who relies on formal and informal institutions.<sup>11</sup>

Within R. Dahl's model,<sup>12</sup> which defines regimes according to two criteria—the competitive power struggle and the degree of public involvement in governance—the regime in Kazakhstan can be defined as a *competitive oligarchy*.

To clarify the essence of the political regime that has taken shape in Kazakhstan and reveal its specific features, we should identify its social basis and the methods of its functioning.

The regime can be described as *authoritarian* since the range of the president's power and domination of the executive branch registered in the 1995 Constitution narrow down, to the greatest degree possible, the polycentric nature of the political system. There is no democracy to speak of; this much is confirmed by the public structures engaged in monitoring democratic developments across the world.

Freedom House, one of the international NGOs, calculated the general index of democratic development in Kazakhstan in 2008 as 6.39, which can be described as essentially the absolute minimum.<sup>13</sup>

Since it boasts several parties and formal pluralism, the republic cannot be described as a totalitarian state either, yet the president has monopolized decision-making on all important issues, while the power elites function outside public control.

Power and property in Kazakhstan have merged to the extent that they cannot be separated from each other. This is the main feature of the country's political regime, which rests on the personal cap-

<sup>9</sup> For more detail, see: S. Markelov, O. Petrovskiy, *Kazakhstan 2001-2002gg.: politicheskiy krizis*, Kania, Novosibirsk, 2002.

<sup>10</sup> See: A. Terentiev, "Vyborny v Kazakhstane: ukroshchenie 'oranzhevoy' volny," *Mirovaia ekonomika i mezhdunarodnye otnosheniya*, No. 5, 2006, p. 33.

<sup>11</sup> See: V. Ghelman, "Transformatsii i rezhimy: neopredelennost' i ee posledstvia," in: *Rossia regionov: transformatsia politicheskikh rezhimov*, ed. by S. Ryzhenkov, G. Liukhterkhandt-Mikhaleva (with participation of A. Kuzmin), Moscow, St. Petersburg, 2000, p. 34.

<sup>12</sup> See: R. Dahl, "Polyarchal Democracy," in: R.A. Dahl, I. Shapiro, J.A. Cheibub, *The Democracy Sourcebook*, The MIT Press, Cambridge, Massachusetts, 2003.

<sup>13</sup> See: Nations in Transit — Kazakhstan (2008), available at [<http://www.freedomhouse.org/template.cfm?page=47&nit=477&year=2008>]. The Freedom House rating is scaled from 1 to 7 where 1 stands for maximum development of democracy, 7 for minimum.

ital accumulated by Nazarbaev's clan ("the family") and on the money donated by big business, which depends on the government.

- Thus, first, this ensures political control over the most important resources.
- Second, big business is used to liquidate or neutralize disloyal subjects, manipulate public opinion, and accumulate symbolic resources by putting pressure on the media.

The *bureaucratic machine* alone (the power-wielding and civilian departments and ministries) is capable of preserving political power merged with property. The presidential administration, the core of the republic's bureaucratic structure, transfers political aims and tasks to the lower levels. The system will survive and will remain efficient as long as the president retains his legitimacy and wide popular support.

Contradictions and squabbles at the top are not excluded, however the dominating actor has enough resources to restore consolidation through "imposed consensus."

In Kazakhstan, bureaucracy is based on the *clan system*, a throwback to the clan and tribal past. The slowly changing structural limitations cannot be lifted all at once, which inevitably affects political transformations. In a loosely consolidated society living under the spell of its patriarchal past, any reform affects the clans and their interests; the clans, which ensure support of the president, should be rewarded with privileges.

Once consolidated, the regime did nothing to wipe out the clan system; it became even more widespread, with relatives and supporters replacing the rivals removed from official posts. The "family" enhanced the regime's stability and made the president its hostage of sorts: if other clans start pressing for power his position will be questioned.

This means that the regime in Kazakhstan can be tagged as *clan-bureaucratic authoritarianism* under which the interests of the head of state and clan bureaucracy balance each other out and are legitimized through the formal institutions of imitation democracy.

Formally Kazakhstan is a state ruled by law, while in actual fact the functioning of the formal democratic procedures and institutions is grossly distorted, and the law serves as an instrument of power. This is amply confirmed by the use of court procedures to isolate the most prominent opposition members (such as A. Kazhegeldin) during the election campaign; the media were functioning under administrative pressure; and criminal proceedings were instituted against disloyal politicians (G. Zhakiyanov and M. Abliazov). Laws and even the Constitution are frequently changed.

The above suggests that the political regime in Kazakhstan can be described as *clan-bureaucratic authoritarianism with elements of imitation democracy*.

An analysis of empirical data shows that with no political forces able to launch a regime change in sight the regime will retain its sustainability in the near future.

At the same time, power transfer is the headache of all patrimonial regimes of the monocentric type (in which decision-making belongs to one person while his power rests on patron-client relations with the elites).

In 2005, when Nursultan Nazarbaev was reelected president, the final decision on a successor was postponed until 2012; his age, however (he will be 72 in 2012), does not permit procrastination.

This means that the political regime's possible development trends have become especially important. There are three options: first, preservation of the status quo; second, moving back to traditions and limited democratic developments; third, the regime's limited modernization. The third option is the most desirable and the most probable.

Let us discuss the above in greater detail.

1. *Preservation of the status quo*. This is possible if the president is reelected for another term or if Operation Successor follows the Russian pattern. To preserve the status quo, the new

president should follow the old “imposed consensus” strategy to keep the elites consolidated and to retain his dominance.

This looks possible, however the choice of successor might prove a problem. In contrast to Russia, in Kazakhstan, where the clans enjoy power, political problems might be aggravated by psychological difficulties. Nursultan Nazarbaev has no sons, which means that his elder daughter Dariga or his second daughter’s husband Timur Kulibaev might claim presidency (the chances of the latter are more likely).

2. *Moving back to traditions.* The least plausible variant, but still a possibility. Formulated in 2006 by one of the most influential presidential claimants—Rakhat Aliev, ex-husband of Nazarbaev’s elder daughter—it is still popular among certain elite groups.

In 2006, Aliev published an article “Respublikostan ili Kazakhskiy Sultanat. Kakoy vybor my sdelaem?” (Republic-stan or a Kazakh Sultanate: Which is Better for Us?) in which he wrote: “The republic is an alien form of government that reached the Kazakh steppes straight from the head of fiery revolutionary Vladimir Ilyich Lenin. The monarchy, on the other hand, goes well with the Kazakh clan traditions and world experience, especially with the British experience. Indeed, Britain does not hesitate to accept that the nation is divided into commoners and lords and that this is reflected in its parliament.

“The Kazakh parliament, on the other hand, is a sad sight. Since we have no lords, who occupies the seats in the upper chamber? Are they respected people? Let us imagine for a moment that the seats are filled with members of real, clan and national, social groups. The monarchy is in general a reliable, convenient, and democratic form of government as distinct from the republic, which breeds corruption and dictators. By the logic of the nature of his power, the monarch is able to guarantee social stability for a long stretch of history—a luxury the president does not enjoy.”<sup>14</sup>

In 2007, the president decided to neutralize his too active son-in-law: criminal charges were instituted against him on 23 May. He was accused of hostage-taking,<sup>15</sup> in 2008 he was sentenced in absentia to twenty years in prison;<sup>16</sup> he absconded abroad; his wife had no choice but to divorce him.<sup>17</sup>

Still, continued public legitimization of clan nobility can be described as an objective prerequisite for a Sultanate in Kazakhstan.

On the other hand, fairly large groups of the republic’s population are modernized enough to make a monarchy unacceptable. The foreign factor is no less important: the Western countries with strong lobby groups in the republic will never permit a totalitarian form of government as hazardous for the money they invested in the power complex. The second variant depends on the successor’s personal preferences and political convictions. In other words, this variant, to a great extent, depends on a procedure.

This makes the third variant the most probable of the three.

3. *Modernization of the political regime.* No democratic regime will appear in the country in the near future, however it may acquire conditions conducive to democracy in the more distant future. I have in mind the greater political role of formal institutions and the much lesser impact of informal traditional relations.

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<sup>14</sup> R. Aliev, “Respublikostan ili Kazakhskiy Sultanat. Kakoy vybor my sdelaem?” *Karavan*, 25 August, 2006, p. 1.

<sup>15</sup> See: N. Tishchenko, “Vysokie otnoshenia,” Internet-gazeta “Lenta.ru,” available at [<http://lenta.ru/articles/2007/05/25/case/>], 25 May, 2007.

<sup>16</sup> See: “Rakhata Alieva prigovorili k 20 godam za popytku sverzhenia Nazarbaeva,” Internet-gazeta “Lenta.ru,” available at [<http://lenta.ru/news/2008/03/26/aliev/>], 26 March, 2008.

<sup>17</sup> See: N. Tishchenko, “Byvshiy ziat’,” Internet-gazeta “Lenta.ru,” available at [<http://lenta.ru/articles/2007/06/13/divorce/>], 13 June, 2007.

This may take the form of more rational policies (according to M. Weber), that is, a competent bureaucracy playing a greater role and clan and tribal relations having less influence.

Modernization spells a divorce with monocentrism, which means redistribution of power in favor of the legislature. This will boost the role of the political parties and of the nation's political involvement.

Nursultan Nazarbaev's recent decisions suggest that Kazakhstan will follow the third road: in 2002 the government began reforming the party system and raising the status of the political parties, in particular through the Law on Political Parties adopted in the summer of 2002, which envisaged reregistering all the political parties of Kazakhstan.

It was not a democratic law: members of the public and international organizations never hesitated to criticize it in the most vehement way. The new registration order drew a lot of critical comments: the law envisaged that parties should have at least 50 thousand members in all the regions and no fewer than 700 members in Astana and Almaty.

This provision can hardly be described as democratic since it infringes on the right of citizens to form alliances; the new law merely copied the RF Law on Political Parties adopted a year earlier. In fact, in view of the different population size of the two republics (140 million in Russia and 15.2 million in Kazakhstan), the number of party members looks grossly inflated. Nevertheless, the very fact that the status of political parties in Kazakhstan was raised means that the political process is moving in the direction of a greater role for the formal institutions, which is a sign of political modernization.

The president introduced a few more recent political novelties.

In 2003, the nature of interaction between the state and the public structures began to gradually shift toward an institutionalized dialog on a national scale in the form of a permanent conference between the political forces and the government which brought together members of political parties, parliamentarians, and other public and political figures. The opposition parties chose to ignore the new structure because at the initial stage the president was not personally involved.

In 2006, the forum was transformed into the State Commission on Drawing Up and Specifying the Program of Democratic Reforms under the Kazakhstan president—GKVD; President Nazarbaev's personal participation in the work of the GKVD raised the dialog platform to the highest level of national debate, giving it a status of state importance."<sup>18</sup>

In 2006-2007, the Commission met six times; it elaborated practical steps in all fields of political modernization.

Speaking at its closing session, President Nazarbaev said: "The time has come to discuss the possibility of the prime minister being supported by the parliamentary majority party. This is done all over the world and we should follow world practices."<sup>19</sup>

Early in 2007, the president first discussed the candidate for prime minister of a new Cabinet with Nur Otan, the parliamentary majority party.<sup>20</sup> This launched a new political practice.

The initiative suggested by the incumbent ready to quit can be described as a trend toward de-personalization of power: the greater role of the parliament and political parties in appointing the prime minister is an important factor in redistributing powers from the presidential administration to the legislature. Personal monopoly on decision-making is gradually being replaced with collective decision-making, an obviously progressive practice.

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<sup>18</sup> L. Karmazina, "Institutionalization of the Party System in the Republic of Kazakhstan: Past and Present," *Central Asia and the Caucasus*, No. 5 (53), p. 49.

<sup>19</sup> Vystuplenie N.A. Nazarbaeva na VI zasedanii Gosudarstvennoy komissii po razrabotke i konkretizatsii programmy demokraticheskikh reform 19 fevralia 2007 g. Official site of the President of the Republic of Kazakhstan [www.akorda.kz], 20 February, 2007.

<sup>20</sup> See: A. Shomanov, S. Konovalov, "Republic of Kazakhstan. Politics," in: *Central Eurasia 2007, Analytical Annual*, CA&CC Press®, Sweden, 2008, p. 150.



These initiatives, however, did not infringe on the monopoly of the ruling elites: the pro-presidential parties gradually merged into a single party of power, Nur Otan. In 2006, the newly united party boasted nearly one million members, an unprecedented situation in independent Kazakhstan.<sup>21</sup>

It should be said that in Russia the 2003 parliamentary elections brought the government absolute domination in the State Duma for the first time; very soon in Kazakhstan people started talking about “the revived C.P.S.U.” and the advent of a “one-party epoch.” The 2007 parliamentary elections in Kazakhstan produced a one-party parliament, which, however, had certain positive results.

The emergence of a dominant party of power increased the role of the formal institutions and contracted the field of informal practices. The party of power could create a new system for balancing the interests of the elite groups. In the past, it was the president who was the key factor in this balance—today it is determined by the degree of the “group’s” loyalty to the party and its integration into the party’s structure. The elites have to act together; their relations must become institutionalized, more formal and less dependent on the clans.

In 2007, the president’s ideas about the political reforms were supported by the parliament and implemented in one more constitutional reform.<sup>22</sup> The parliament adopted over 60 constitutional amendments, the most important of them were considered those which widened the powers of the legislature and raised the status of the political parties. Some experts described this as a step toward a presidential-parliamentary republic.<sup>23</sup>

While the parliament strengthened its position, the president lost some of his prerogatives; his term was reduced from 7 to 5 years (Art 41.1), the amendment being applied to the president elected after 4 December, 2005 (Art 94.1).

Nazarbaev was immune to the ban on more than two successive terms as president, the amendment being initiated by parliamentarians who stressed “the first president’s historic role.”<sup>24</sup> This means that the president preserved his special powers while cutting back the prerogatives of his successor.

An analysis of President Nazarbaev’s latest initiatives and the constitutional reform of 2007 suggests that the country will opt for modernization even if democracy is still far away.

So far, the role of the formal institutions, the political parties in particular, will be enhanced; monopoly on decision-making will be reduced while the political course will be implemented through the parliament and its greater powers.

By moving in this direction the president is trying to resolve the power continuity problem. He knows that the legitimacy of his successor might be much weaker than his own, which means that, deprived of this symbolic resource, the monocentric regime might lose some of its stability and consolidation.

He opted for depersonalization of power; split the decision-making function between the president and the parliament; used his personal authority to boost the legitimacy of the party of power in the hope of reducing the elite and clan squabbles that might flare up once he leaves his post to inner party rivalries.

By limiting the clan struggle to formal institutions, Nazarbaev hoped to prevent a “riot of elites” (similar to that of 2001-2002). He is convinced that these conflicts should be resolved not by the new president (whose powers will be fairly limited anyway), but by the parliament and the ruling party on the basis of relative polycentrism and consensus.

No additional institutional measures designed to suppress possible flare-ups of non-formal clan and tribal relations have been introduced so far, but gradual movement in this direction suggests

<sup>21</sup> See: L. Karmazina, *op. cit.*, p. 47.

<sup>22</sup> See: V. Vorobiev, “Glava Kazakhstana podelilsia vlastiu,” *Rossiiskaia gazeta*, 17 May, 2007, p. 2.

<sup>23</sup> See: A. Shomanov, S. Kononov, *op. cit.*, p. 151.

<sup>24</sup> S. Maslov, “Nazarbaev podpisal sebe tretiy srok,” *Rossiiskaia gazeta*, 23 May, 2007, p. 3.

that the political relations in the country might become more rational and better suited to the modern times. The same is true of an even more important goal: a democratic society in the true sense of the word.

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## LEADER IDEOLOGY IN POST-SOVIET TAJIKISTAN

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### *Introduction*

Ideology is one of the foundations of authoritative regimes and forms the image of their leaders. Using Uzbekistan as an example, A. March comes to the conclusion that the ideological system imposed by the state has a tangible impact on society, even one that has already lived at one time under the communist ideology.<sup>1</sup> Based on an analysis of several special features of the development of the post-Communist countries (and several others), the conclusion is drawn that during a political regime change, the population can be ideologically “reset.” After a new ideology has been repeatedly fed to the people over the span of several years, it becomes a conscious or subconscious element of society’s mindset.<sup>2</sup> Thus ide-

ology plays a significant role in state- and nation-building, particular after the formation of new states or territorial units.

The new system forms in several interdependent dimensions. The first, chronologically, is historical ideology. The existence of a historical past that goes back into antiquity sets a nation or nationality above others (usually its neighbors). Research studies in this area are leading to the rapid development of archeology and myth creation about antiquity. Another goal of historical ideology is searching for the most significant periods in history of a certain territory (or nation) which are frequently associated with certain outstanding personalities: “great” nations are regarded as the predecessors of present-day territorial units, and heroes are associated with the leaders of the most recent times (presidents or monarchs),

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<sup>1</sup> See: A. March, “From Leninism to Karimovism: Hegemony, Ideology, and Authoritarian Legitimation,” in: *Post-Soviet Affairs*, Vol. 19, Issue 4, 2003, p. 309.

<sup>2</sup> Ideological frameworks also exist (albeit in vaguer form) in the so-called democratic regimes of Europe. Examples are a certain kind of anti-Islamic ideology, advancing the ideology of a democratic society, and so on. In demo-

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cratic countries there is usually no single ideological system that might be spread by monopolized mass media, as is the case in authoritarian regimes.

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which largely determines the ideology of modern states.

As early as Soviet times, studies of the ancient historical past turned into a “struggle over the oldest settlement” in this or another Central Asian republic, whereby the number of celebrations in honor of “the founding of a City” has only increased in the post-Soviet era. In this way, based on the “latest studies,” the history of several towns proved older than people thought.

Building a modern nation is the second dimension of the ideological system (based on its national and territorial past), which frequently leads to denial of the previous regime. In this way, such “modernization” in post-Soviet countries is turning into denial of the Soviet regime and is manifested differently in each of them. Attempts are being made to introduce modern power institutions and advanced technology (often at any cost), rebuild cities (mainly capitals), democratize society (keeping in mind local national traits), and incorporate other innovations; the regime strives to become “modern.”

These ways of forming a new system lead to the people identifying the presidents of the new states with historical heroes and sometimes idolizing them (as in the case of the first Turkmen presi-

dent).<sup>3</sup> Presidents become the guarantors of contemporary development and stability, which in the conditions of the authoritarian regimes of Central Asia (CA) promotes the emergence of personality cults.

This article will take a look at these phenomena (the personality cult and its development) based on the example of Tajikistan. An analysis will be conducted of the political portrait of Tajik President Emomali Rakhmonov (Rakhmon) drawn by his ideologists and “court” journalists on the pages of official publications. Particular attention will be given to his ancestry and a description of his personality and activity during his time as a statesman. Running ahead, it can be noted that a certain idealized virtual portrait of president Rakhmon has been created in the sources used.

<sup>3</sup> See my previous works on Turkmen ideology: S. Horák, S. Riazanova, “Mifologičeskoe i religioznoe v ideologii postsovetского Turkmenistana,” in: *Politeks*, No. 2, 2006, pp. 323-331; S. Horák, “Mify velikogo Turkmenbashi,” in: *Vestnik Evrazii—Acta Eurasica*, No. 2 (28), 2005, pp. 105-133; Idem, “Portret prezidenta Turkmenbashi kak osnova turkmenskogo rezhima,” in: *Vestnik Evrazii—Acta Eurasica*, No. 3, 2007, pp. 139-165. For more on the ideology of post-Niyazov Turkmenistan, see S. Horák, J. Šír, “Dismantling Totalitarianism? Turkmenistan under Berdymuhammedov,” in: *Silk Road Studies Paper. Central Asia and The Caucasus Institute — Silk Road Studies Program*, Washington, Stockholm, March 2009, pp. 32-43.

## The Ancestry and Personal Traits of Emomali Rakhmon

The formation of Rakhmon’s present-day image is closely associated with his legendary predecessors. The future president grew up in a peasant family that lived a simple life. Many people in Dangara (Rakhmon’s home town) recall those times, so the many “glorious” stories are often not so much about him as about his ancestors, which makes it even more difficult to distinguish the truth from fiction.

Ancestry plays an important role in the life of well-known people. The legend about the president’s ancestors has it that they were from Samarkand and were forced to hide from the Manghud warriors of the Manghit dynasty (that is, Uzbeks), who ruled at that time in Bukhara.<sup>4</sup> Evidently the roots of the present-day ideological and political struggle between Tajikistan and Uzbekistan go back to this period.

<sup>4</sup> See: S. Mirzoshov, Sh. Khanif, *Mirotvorets*, Adib, Dushanbe, 2004, pp. 21-22.

The president's grandfather is also mentioned in this connection as a renowned and respected *ishan* and *mawlawiyah*, which emphasizes Rakhmon's religious Muslim roots.

According to this version, the president is a *seyid* (descendent of Ali) from the illustrious family of Khoja Yusuf Khatloni.

So the president associates his post with the status of a descendent of a saint, which gives him the right to possess the spiritual power characteristic of many rulers and privileged people from Central Asian history.<sup>5</sup> Just as interesting is the legend about the president's father, who became acquainted with his future wife in rather storybook circumstances. According to the story, he happened to meet a young and beautiful widow, the mother of two children, by a well and fell in love with her at first sight.<sup>6</sup>

Rakhmon's father is described as an ordinary hard-working man who was not any different from anyone else. It should be noted that mention of the president and his family's lower-class background has become one of the distinguishing features in all the publications about him.

Rakhmon's father was a common collective farm laborer, his mother, being a very wise woman, helped people with her advice. The birth of the future president, Emomali Sharifovich Rakhmon, blends harmoniously into this picture of an ideal family. For giving birth to a son, his mother received a swath of silk from her husband as a gift, which in those days was extremely rare.<sup>7</sup>

Emomali's childhood is described in a whole series of idealized stories that happened to him in his home town of Dangara and its environs.

It is interesting that in contrast to the description of the youth of other current presidents of Central Asia (for example, the Turkmen president), Rakhmon's childhood is described in positive terms, which is remarkable if we keep in mind the ideological system of post-Soviet Tajikistan; the Soviet leadership is not presented as an oppressor of the people of Tajikistan (in contrast to Uzbekistan, Turkmenistan, or to a certain extent Kazakhstan).<sup>8</sup>

Judging from its description, Dangara was full of hard-working people who strove for the common good; the same picture is also drawn in Soviet Tajik literature of socialist realism.

Emomali himself is described as a man of labor who (in contrast to his brother Nuriddin) did not have the opportunity to enjoy children's games.<sup>9</sup> All the same, as in any ideological biography, love plays a significant part. Rakhmon had a favorite teacher, Alla (a symbol of knowledge), who even used to appear in his dreams.

The fact that Rakhmon came from an ordinary family later served to bring him closer to the common people. He is described as having the characteristics inherent in Tajiks—wisdom, honesty, flexibility, democratic character, kindness, perseverance, and inquisitiveness. These are the traits the Tajik people expect in a leader, and Emomali Rakhmon certainly fits this mode.<sup>10</sup>

In the 1980s-1990s, Rakhmon worked as the director of a collective state farm and according to his ideologists and biography writers his revolutionary approach to management became one of the main prerequisites for his further climb up the political ladder. He permitted the farm workers to use

<sup>5</sup> For more on Rakhmon possibly coming from a family of saints and on the reasons for looking for saints among the renowned people of Central Asia in general, see: S. Abashin, "Potomki sviatykh v sovremennoi Srednei Azii," in: *Etnograficheskoe obozrenie*, No. 4, 2001, pp. 62-83 (see also: V.I. Bushkov and D.V. Mikulsky, *Anatomiia grazhdanskoi voiny v Tadjikistane*, RAS Institute of Ethnology and Anthropology, Moscow, 1997, pp. 138-139).

<sup>6</sup> See: S. Mirzosh, Sh. Khanif, op. cit., pp. 25-28.

<sup>7</sup> Ibid., p. 32.

<sup>8</sup> Some Tajik political scientists and historians do not fit the official historiographic mold, nor do they always uphold the official viewpoint on the Soviet period (see, for example: A. Mamadazimov, *Politicheskaia istoriia Tadjikskogo naroda*, Donish, Dushanbe, 2000). Due to the periodical aggravation in Russian-Tajik relations, articles also appear that accuse Soviet policy of colonialism in order to find favor with the president and condone his current policy.

<sup>9</sup> See: S. Mirzosh, Sh. Khanif, op. cit., p. 31.

<sup>10</sup> See: S. Fattoev, "Prezident Emomali Rakhmonov," in: *Emomali Rakhmonov: nasha tsel'—edinstvo, soglasie, sozidanie*, Irfon, Dushanbe, 2000, pp. 112-113.

part of the fields for their personal needs, which allowed them to make extra earnings.<sup>11</sup> Such innovations later formed the basis for the agrarian reforms in independent Tajikistan; which his former coworkers, who praise the president's wisdom, take great delight in recalling.

The best source of information about this period is the small Rakhmon museum located in his former office in the administration building of the state farm in Dangara. The room has a desk, a television from the 1980s, a safe, and a few shelves and tables where photographs and documents signed by Rakhmon are kept.

The fact that the museum operates unofficially shows that the personality cult has not really taken off the ground in the republic. In addition, Dangara is not an ideological center and many people outside the region do not know the museum exists.

But the president's popularity is much higher in his home town than it is in the capital (Dushanbe), although his fellow townsmen still live a rather impoverished life.

This positive attitude of the residents of Dangara toward the president's activity was formed under the influence of the republican mass media and ideological literature (the image of a president-peacekeeper, the custodian of national independence). In this context, people are simply repeating what they have heard and accepting it as their own.<sup>12</sup> But the main reason for this veneration of the president can be considered to be the sense of community that is felt among fellow countrymen, which plays a huge role in Tajikistan, particularly in forming the national elite.

Changes in the outer appearance of Dangara are given as another reason: the repaired streets, new buildings, schools, museum, railroad (not far from the town), building of an airport, and so on.

In this case, his peasant ancestry becomes intertwined with his lower-class background; in articles on the president's frequent trips to Tajikistan's regions, the official press constantly focuses attention on these factors, particularly emphasizing how well Rakhmon is informed about what is going on in the country, his ability to socialize with the people, and his ongoing concern about the common people.

An example of his socialization with the people is given in a story about how Rakhmon gave an old man and his grandson a ride. The old man did not recognize him, although he thought his face was familiar. Later, when all was revealed, the old man compared Emomalijan with saint Khizar, who appeared before them.

Despite the fact that this is a typical Tajik expression, it nevertheless elevates the president, just as does the old man addressing him as "padishah" (a superlative royal title in the Tajik language, roughly equivalent to "the Great" or "Great King").<sup>13</sup>

Another story describes a walk the president took incognito. But it should be stressed that all the president's trips to the Tajik regions are planned in advance and the local authorities prepare for them with immense care to ensure that the president is happy and the local officials are not reprimanded.<sup>14</sup>

Among Rakhmon's other characteristics, mention is often made of his innate intelligence, thirst for knowledge, and thoughtful analysis of the texts he reads; such qualities are ascribed to all the leaders of the Central Asian countries.

The president is idealized as a young and talented leader; all his positive qualities go back to his childhood. His physical strength and athletic spirit are particularly noted. These qualities enhance the president's image as a symbol of justice who protects the weak from the strong.<sup>15</sup> However, keeping in mind the increasing corruption and tyranny of the president's family, the people are skeptical about these characteristics.

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<sup>11</sup> See: S. Mirzosh, Sh. Khanif, *op. cit.*, p. 39.

<sup>12</sup> Interviews in Dangara in July 2006 and February 2008.

<sup>13</sup> See: S. Mirzosh, Sh. Khanif, *op. cit.*, p. 106.

<sup>14</sup> Interview with former official in Kulob, July 2006, interview with former high-ranking official in Dushanbe, July 2006.

<sup>15</sup> See: S. Mirzosh, Sh. Khanif, *op. cit.*, p. 36.

## Rakhmon's Political Career

Rakhmon's political image is also enforced thanks to the many photographs that illustrate all the publications about him.

Photographs usually show the president in three main circumstances.

First, there are photographs that show phenomena typical of Tajikistan. All the Central Asian leaders try to show respect for their elders (*aksakals*). This is why elderly people are often appointed as the heads of district, regional, and local administrations. Photographs also show Rakhmon meeting with his parents (in the Dangara museum there are many such photographs). Photographs of historical monuments are also traditional; they often depict the president's visits to archeological digs in Penjikent, the *sadak* at the site where poet Rudaghi's tomb is presumed to be, and so on.<sup>16</sup>

The modernizing aspect of ideology can be clearly seen on the photos depicting the president's visits to large building sites or his attendance at their official openings.

The photographs primarily show current infrastructure facilities, such as new highways (the Kulma pass on the Chinese border—Pamir-south Tajikistan-north Tajikistan) and tunnels (in particular the Istiklol tunnel under the Anzob pass).

In the context of the republic's modernization, the president often appears at the opening ceremonies of new schools. Since all authoritarian regimes declare education and science as the most important priorities (although these spheres are in fact undergoing degradation), there are always photographs of pupils, students, and scientists in the president's albums.

Emomali Rakhmon, like all the Central Asian presidents, often has his photo taken with young people ("the country's future"). Such meetings are frequently accompanied by presenting gifts of modern equipment, often computer technology.<sup>17</sup> These acts are described by the mass media as a sign of the country's modernization. Despite this, the technology often spoils over time or is not used due to lack of heating, because the teachers themselves do not know how to use computers, or simply because there is often no electricity.<sup>18</sup> Representatives of the arts are also considered to be a valuable contribution to the radiant future.<sup>19</sup>

The last category of photographs serves to legitimize the president in the eyes of the people and the outside world and create his image as an outstanding international statesman. They are mainly devoted to Rakhmon's speeches at the U.N. and other international forums and meetings with the official leaders of Russia, the EU, U.S., and Asian and other countries.

The president is shown on these photographs as a political and national leader who is recognized and respected by the world community and, of course, by his own people. They often show protocol meetings and his addresses at formal summits, which are presented as key speeches. Here the point is to accentuate the significance of the president's international activity.

This "collection of souvenirs" presents the president as a national hero who has an influence on world history, that is, a parallel is drawn with the outstanding personalities of the Tajik people.

The photographs of all three categories present Rakhmon as a national leader and father of the nation and raise his political status. The president's activity on the world arena and his constant concern about his people reinforce his image as the state's head. This also enforces the idea of the permanency of the head of state.

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<sup>16</sup> See, for example: A. Dostiev, *Sitorai Golib*, Matbuot, Dushanbe, 2006; *15-bakhorii Istiklol (nasr va azm)*, Adib, Dushanbe, 2006 (see also: E. Rahmonov, *The Tajiks in the Mirror of History*, Volume One, *From the Aryans to the Samanids*, River Editions, London).

<sup>17</sup> See: V. Gaffori, Z. Saidov, *Vdokhnovitel' national'nogo renessansa*, NIAT Khovar, Dushanbe, 2007, p. 37.

<sup>18</sup> Interview with a school director in the Sarvod Region, July 2003.

<sup>19</sup> See: A. Sharipov, "Emomali Rakhmonov. Prezidenti mo! Our President! Nash Prezident!" Manuscript from the website [<http://www.president.tj>], p. 143.



After the 2003 referendum, amendments were made to the constitution of Tajikistan. They legally extended the president's term in power, which corresponds to the region's patriarchal tradition (the leading role of the head of the family or patron).

All the above-mentioned methods for forming the leader's image are not only used in the CA countries, but also in all authoritarian regimes, as well as in the memoirs of prominent political figures. Tajik and Central Asian practice as a whole borrows Soviet Central Asian traditions in this respect.<sup>20</sup>

### ***The Beginning of Rakhmon's Political Career***

Rakhmon's advent to power is considered a key event in the history of the Tajik people. As we know, he was elected president in November 1992 at the 14th session of the Tajik Supreme Soviet in the palace of Arbob in Khujand (which was still Leninabad at that time).

This event can in fact be considered an auspicious occasion in Tajikistan's most recent history, although many publications describe it differently. The president's supporters write about the exclusively legal and fair election of the president, which is also reflected in the protocol of the Supreme Soviet session.<sup>21</sup>

Other sources, particularly from the opposition camp, talk about a controlled process, influenced by the main warlords at that time, S. Safarov and S. Kenjaev.<sup>22</sup> They claim that Rakhmon's candidacy was proposed out of the blue. According to the Russian military, Rakhmon was considered a person of little influence in the Dangara region by that time.<sup>23</sup>

The organization of the so-called *oshi oshti* ("food of conciliation") is considered one of Rakhmon's first contributions to national conciliation (immediately following the 16th session of the Supreme Soviet). This act is advertised by the president's supporters as one of the first steps the new leader took as president toward conciliation.<sup>24</sup> But, as ethnographers and historians note, this "tradition" was rather an artificial invention and could not have a serious effect on further conciliation.<sup>25</sup>

The "court" ideologists relate Rakhmon's advent to power to different legends.

The story of Rakhmon's neighbor, who had a dream several days before the session in Khujand about a golden apple flying over Dangara, the surrounding hills, and the *mazar* (tomb) of a local saint, Mavlano Tojiddin, deserves special attention. People tried to catch the apple, but only Emomali was able to do it. According to popular belief, the owner of a golden apple is destined for great things.<sup>26</sup>

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<sup>20</sup> See, for example, publications about the first secretary of the Uzbek Communist Party Sharaf Rashidov, who is described and shown on photographs as an outstanding Central Asian leader, a resolute and beloved politician: S. Rizaev, *Sharaf Rashidov, Shtrikhi k portretu*, Ezuvchi-Nur, Tashkent, 1992.

<sup>21</sup> See: S. Mirzoshoh, Sh. Khanif, op. cit., pp. 64-67 (also see the memoirs of the then deputy and later deputy chairman of the Supreme Soviet Abdumajid Dostiev: A. Dostiev, op. cit., pp. 50-53).

<sup>22</sup> See: M. Isin, "Geopolitika odnogo kontsa. Tsentral'noaziatskie anomalii," 18 February, 2002, available at [<http://www.nomad.su/?a=2-200202180100>].

<sup>23</sup> See: S. Kolosov, "Vostok—delo tonkoe. Tadzhijskie zametki komandira otriada," available at [<http://www.agentura.ru/library/spetsnaz50/vostok/>]. This fact is confirmed in an interview with a former member of the president's entourage, July 2006.

<sup>24</sup> See: S. Nazarov, "Retsept mira" *nachali iskat' v Khudzhande*, NIAT Khovar, 13 November, 2007, available at [[http://www.toptj.com/ShowNews.aspx?news\\_id=6898E423-302E-471D-90D4-1A9BF31F77D7](http://www.toptj.com/ShowNews.aspx?news_id=6898E423-302E-471D-90D4-1A9BF31F77D7)].

<sup>25</sup> See: V.I. Bushkov, D.V. Mikulsky, op. cit., p. 137.

<sup>26</sup> See: S. Mirzoshoh, Sh. Khanif, op. cit., p. 54. The following work was used for questions of oneirology: B. Ostřanský, "The Art of Medieval Arab Oneirology," in: *Archiv Orientální* (Prague), No. 4, 2005, pp. 407-428.



The events in Khujand in November 1992 are also associated with unusually clear and warm weather, which set in precisely after the news was received of Rakhmon's election as president; there was no more cold weather until the end of the winter and no snow fell at all in Dushanbe, which many refugees had been worried about.<sup>27</sup>

But after November 1992, a civil war began in the country, and a state leader with little political experience could hardly have been capable of reconciling the fighting sides at that time.

However, after almost five years, Rakhmon was able to achieve peace with the opposition. The official press emphasizes this as a unique event in history, and the president himself is considered a talented self-taught person who was able to quickly comprehend the basics of politics himself.<sup>28</sup>

Thus Rakhmon became the nation's savior and a symbol of its sovereignty.<sup>29</sup>

The president's resolve and steadfastness are characterized by the expression frequently cited by his ideologists: "on the path to peace and consent I will either die fighting or achieve my goal!"

### Peacekeeper

Peacekeeping has become the springboard of President Rakhmon's nascent personality cult; however, despite the high praise, this part of his ideology is relatively weak. It primarily emphasizes the actual achievement of peace agreements.

The merits of the president himself come to the forefront without drawing attention to the merits of other people, particularly leaders of opposition.<sup>30</sup>

It should be noted that special efforts were not required to achieve the population's approval of this aspect of the president's activity. All the people wanted was for the fighting to stop, and anyone who could cope with the situation was considered a real peacekeeper. And despite the participation of the opposition in state governance, Rakhmon kept a firm grip on the main levers of influence (including ideological).

The role of chief peacekeeper ensured Rakhmon the support of most of the population; although in 2005-2006 it significantly flagged.

In official publications, Rakhmon is described as a strong personality with extraordinary governing abilities. It should be admitted that not every president could stay in power during and after a civil war. Much attention is focused on promulgating the president's decisiveness after his advent to power in November 1992. It was precisely his words and orders, it seems, that forced the state officials to return to Dushanbe.<sup>31</sup> At that time the Tajik capital was considered a dangerous place to be and outside government control.<sup>32</sup> Propaganda emphasizes the unassertive conditions in the head of state's main camp at that time.<sup>33</sup>

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<sup>27</sup> See: Sh. Zukhurov, *Prezidenti Khalk—Prezidenti man. Emomali Rakhmonov: "Vakhdat, sulkh va bunedkori maromi most!* Irfon, Dushanbe, 2000, p. 61.

<sup>28</sup> See: *Narodnaia gazeta*, 4 October, 2006.

<sup>29</sup> See: S. Fattoev, *op. cit.*, p. 105.

<sup>30</sup> In this respect, Tajik political scientist Abduvani Mamadazimov, who essentially places the leaders of the opposition on essentially the same level as Rakhmon, upholds a more well-balanced approach (see: A. Mamadazimov, *op. cit.*, pp. 325-326).

<sup>31</sup> See: S. Mirzoshov, Sh. Khanif, *op. cit.*, p. 71.

<sup>32</sup> Despite Rakhmon's ideological heroism, the capture of Dushanbe began at this time during a session of the Supreme Soviet in Khujand, i.e. Rakhmon went to regions already occupied by the National Front forces that supported Rakhmon under the command of people from Kulob and Tajikistan. It was at this time that persecution began in Dushanbe of people from the "opposition" regions of the country (Karategin, Pamir, and so on) (see: V.I. Bushkov and D.V. Mikulsky, *op. cit.*, p. 65).

<sup>33</sup> See: S. Mirzoshov and Sh. Khanif give the example of the reception of a delegation of elders and askakals from Khissor (see: S. Mirzoshov, Sh. Khanif, *op. cit.*, p. 74).

Rakhmon's biographers frequently point out the president's inner strength honed by his farm work and service in the Pacific fleet.<sup>34</sup>

In addition to decisiveness, Rakhmon (as his biographers note) is distinguished by immense courage. This fact is usually proven by the new head of state's move to troubled Dushanbe.<sup>35</sup>

Rakhmon's activity during the war (according to his ideologists) was an endless series of important talks and meetings; the president is depicted as a national hero.

To confirm the president's personal courage, his official biographers give the example of how he visited the leaders of the opposition in the borough of Khosdek in Afghanistan in December 1996.<sup>36</sup> Historians and political scientists who are not pro-Rakhmon also indicate the critical significance of this moment.<sup>37</sup>

Special emphasis is placed on the president's unbending will, who was not afraid to attend a meeting in the opposition camp on Afghan territory, something that was considered extremely dangerous. As official publications emphasize, this makes Rakhmon not only a peacekeeper with respect to Tajikistan, but to Afghanistan as well.<sup>38</sup>

There is also frequent mention (as an example of the president's courage) of two more significant events that augment his image of an intrepid man.

- The first was in Rushan when the opposition attempted to halt the president's cortege and local representatives tried to persuade Rakhmon not to participate in a meeting with the population, but the president would hear nothing of it.<sup>39</sup> According to official sources, this event shows Rakhmon's support by the people who forced the "disturbers of the peace" to open the road to the president. Whereby Rakhmon asked the journalists present not to cover this event so as not to arouse a negative response in the people of Pamir and eastern Tajikistan. So this event also showed the president's political qualities in addition to his courage.
- The second case is related to an assassination attempt on Rakhmon in Khujand. The president's wife (Azizamokh) dreamt that she saw herself dancing alone, which according to popular belief precedes mourning and nostalgia for a person who is no longer with us.<sup>40</sup> But Rakhmon, even after the attack, from which he escaped with a few injuries, did not decline from meeting with people among whom there might also be terrorists.<sup>41</sup>

In addition to his decisiveness and courage, Rakhmon's penchant for hard work also helped to settle the conflict in Tajikistan. According to official sources, thanks to his tireless labor, the president was able, in addition to entering a peace treaty, to achieve success in resolving two more important problems.

In the post-war period, Rakhmon has raised the standard of living more than any other leader in the previous 70 years.<sup>42</sup> After the war, he was able to remove the local warlords,<sup>43</sup> in particular those who could undermine his position or simply knew too much about him.

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<sup>34</sup> See: V. Vorobiev, "Sem' let prezidenta," in: *Emomali Rakhmonov: nasha tsel'—edinstvo, soglasie, sozidanie*, p. 119 (see also: S. Mirzosh, Sh. Khanif, op. cit., p. 17).

<sup>35</sup> See: S. Mirzosh, Sh. Khanif, op. cit., pp. 68-69.

<sup>36</sup> Ibid., pp. 152-168.

<sup>37</sup> See: A. Mamadazimov, op. cit., p. 327.

<sup>38</sup> An example of this peacekeeping is Emomali Rakhmon's speech from the U.N. rostrum (see: A. Sharipov, Z. Sirodzhov, 2005—*God kul'tury mira*, Davashtich, Dushanbe, p. 8).

<sup>39</sup> See: S. Mirzosh, Sh. Khanif, op. cit., pp. 145-146.

<sup>40</sup> Ibid., p. 184.

<sup>41</sup> See: S. Fattoev, op. cit., p. 107.

<sup>42</sup> Ibid., p. 118. This assertion can be challenged keeping in mind the catastrophic socioeconomic situation in the country, which only partially improved after the war and is maintained largely by migrant workers.

<sup>43</sup> See: A. Dostiev, op. cit., p. 52.

In June 1997, a peace treaty was signed in Moscow that ultimately gave the president of Tajikistan the image of peacekeeper.

To be objective, it should also be noted that Rakhmon's ideologists gave the same assessment of the role of Said Abdullo Nuri, who signed the treaty on the part of the opposition. All of these events are used as an example for schoolchildren.<sup>44</sup>

Thus, Rakhmon's role (for the future generations) is emphasized as a national hero and the founder of political culture in Tajikistan based on peace and understanding.<sup>45</sup>

### **Emomali Rakhmon as a Politician**

Rakhmon has been honed by the hardships he endured during his peacekeeping mission, and, without losing the dignity and honor he inherited from his great grandfather and the father of his great grandfather, he has become the leader of the country just like a commander at the head of his troops, carefully calculating each step forward.<sup>46</sup>

Despite the obstacles already mentioned associated with the fact he does not have an intellectual background, the president has been able, according to his ideologists, to occupy a dignified place among the top world leaders and also become a symbol of independent Tajikistan.<sup>47</sup>

In the context of the elevation of Ismoil Somoni, as a founder of the predecessor state of present-day Tajikistan, Rakhmon is presented as his heir. Both leaders took upon themselves the arduous task of forming the Tajik nation.<sup>48</sup> Both are regarded as unifying factors of their nation, who also held out their hands to their opponents, calling on them to work toward strengthening their countries.<sup>49</sup>

Some authors also try to compare Emomali Rakhmon with Abraham Lincoln, who united the Americans. Rakhmon also succeeded at one time in preserving the state and the country's territorial integrity.<sup>50</sup>

The postwar era has not called for heroic deeds, so propaganda has been concentrating on the image of an intelligent and kind president who gives all kinds of good advice.

Two interesting examples can be given.

When visiting a beekeeping farm, the president gave some intelligent advice on how first-class honey could be made and exported abroad. The minister of agriculture was instructed to draw up a strategy for supporting beekeepers.<sup>51</sup> The president also showed how well informed he was in maternal and child health issues. At a meeting, "the president gave some good advice and enlightened the audience in family planning and how to bring up healthy and educated children."<sup>52</sup> In this respect, it is interesting to note that the president recommended that women wait three years between the birth of each subsequent child.<sup>53</sup>

Rakhmon's positive traits stand out even more vividly against the background of his enemies.

<sup>44</sup> One of the teachers I interviewed showed me essay topics for upper-classmen that were related to this period. By way of example, the following topics can be given: "The President's Courage During the Civil War," "Path to Peace in Tajikistan and President Rakhmonov." Interview with a primary school teacher in Dushanbe, July 2006.

<sup>45</sup> See: *Narodnaia gazeta*, 21 June, 2006.

<sup>46</sup> See: S. Mirzosh, Sh. Khanif, op. cit., p. 83.

<sup>47</sup> See: S. Fattoev, op. cit., p. 106.

<sup>48</sup> See: S. Mirzosh, Sh. Khanif, op. cit., p. 67.

<sup>49</sup> See: V. Vorobiev, op. cit., p. 120.

<sup>50</sup> See: S. Fattoev, op. cit., p. 111.

<sup>51</sup> See: *Narodnaia gazeta*, 9 September, 2005.

<sup>52</sup> *Narodnaia gazeta*, 11 October, 2006.

<sup>53</sup> See: "Semia—osnova i opora gosudarstva," in: V. Gaffori, Z. Saidov, op. cit.

A case in point is the former warlords, although some of them greatly assisted the president during the civil war. Subsequently criminal cases were instigated against them (as soon as they began to get stronger); and the official press and mass media were invited to cover the court cases.

This is how the president's main opponents, Ia. Salimov and G. Mirzoev, were dealt with. During the civil war and after it many warlords adopted impermissible methods and committed unjustified actions.

It was these two who were declared enemies of the state, as criminal and corrupted elements. This method has been systematically used in authoritarian regimes with low information pluralism to denounce unfavorable elements. In the official press, the president is presented as a "good/kind leader" as opposed to the "bad commanders."<sup>54</sup>

Against the background of the universal corruption in Tajikistan, the president looks like the most honest person, who is fighting bribe-taking and clannishness in the political elite (despite his control over the most important branches of the economy). It is precisely the governing and foreign policy methods Emomali Rakhmon uses that are studied in state institutions to educate new officials.<sup>55</sup>

Great attention is focused in the Tajik mass media on covering the president's activity in traditional neighborly mutual assistance (*khashar*) or at voluntary work; he is frequently presented as a protector of the ordinary people, who are exploited by "evil" officials.

An example is an incidence that happened during Rakhmon's trip to the Ishkashim region. An old woman came up to him and asked for help finding her son, who was killed during the war. The president began to cry (a sign of sensitivity), and then promised to find and punish those who rendered her no assistance (the president's justice and decisiveness).<sup>56</sup>

The president again demonstrated his sense of justice during a trip to the Kulob region. Rakhmon visited one of the enterprises and was very displeased with the owner when he found out how much the workers were actually paid (30 somoni, approximately \$10 a month). The president ordered the owner to immediately raise salaries and hire new workers (reduce unemployment) by cutting back on the owner's income.<sup>57</sup> The Tajik official press also shows examples of how the president's instructions and assignments are carried out.<sup>58</sup>

The mass media regularly highlight the progressive changes that occur in the country's regions after the president has visited. An example is the president's second visit to the village of Puli Sangin, in which, after his first visit, wages were raised, even to as high as \$150 for one dairymaid.<sup>59</sup>

Ideologists describe the president as a generous person who gives out money, whereby, as it is emphasized, from his own pocket. An example is the description of a meeting at a school in Garm-Chashma in Pamir, during which the president personally gave the school director money to buy clothes and shoes for the children.<sup>60</sup>

## Conclusion

All of the above-mentioned signs of idealization of the president do not go beyond the bounds of the Central Asian traditions of political culture. All the presidents of the region are depicted by

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<sup>54</sup> S. Mirzoshlo, Sh. Khanif, op. cit., pp. 117-119.

<sup>55</sup> See: *Narodnaia gazeta*, 26 December, 2007.

<sup>56</sup> See: S. Mirzoshlo, Sh. Khanif, op. cit., p. 143.

<sup>57</sup> See: *Narodnaia gazeta*, 30 August, 2005.

<sup>58</sup> See: *Narodnaia gazeta*, 23 August, 2005.

<sup>59</sup> See: *Narodnaia gazeta*, 4 December, 2006.

<sup>60</sup> See: S. Mirzoshlo, Sh. Khanif, op. cit., pp. 136-138.

ideologists as leaders of the nation and good and kind rulers who fight against the enemies of the people (including bureaucrats).

The presidents are described as wise, well-bred people who are respected in their country and abroad; whereby their many photographs do not differ in theme from the former photographs of general secretaries and first secretaries.

However, the activity of the president of Tajikistan (or of the other presidents of the CA countries for that matter) cannot be underestimated, although nor can it be called genuine concern for the people, as official sources try to insist.

The corruption that corrodes all the Central Asian states cannot leave their presidents with entirely unscathed personalities.

Manifestations of the personality cult are also similar in all the CA countries: photographs of presidents in public places and their numerous sayings constantly cited in the press and textbooks, not to mention the multitude of books supposedly written by them.

All the above-mentioned signs are a traditional feature of authoritarian regimes (both pre-revolutionary and Soviet) and their corresponding leaders.

The main thing that distinguishes Rakhmon from the other CA presidents is his peacekeeping activity and unaffected manners. Rakhmon must be given his due; he has exerted a great deal of effort to establish peace in the republic, although, more than ten years later, people are gradually beginning to forget about this.

On the whole, all the presidents of the Central Asian countries are presented as caring “fathers” and nation-builders.

It should be noted that, in contrast to his colleagues, President Rakhmon does not focus attention on the level of his education, as the president of Kazakhstan does, for example (his dissertations), or on titles and awards.

Rakhmon projects the main traits of the nation onto himself, emphasizing his common birth. He, in a certain sense, is the “bobo” (father, elder) of the entire state, although he did not reach the age of an honorable aksakal (by CA standards) until recently.

The people like the image of an ordinary man he has created (“one of us”). In addition, there is limited access in the republic to foreign information (for example, the RTR television channel was closed down in the spring of 2009), which makes it possible to reinforce his image as an upright “father of the nation.”

The ideological effect greatly slows down the reassessment of values, and the country’s new leader (after Rakhmon steps down), no matter who it is, will have to uphold this ideological system, adjusting it to his own image.<sup>61</sup>

But it should be noted that many people who are attentively watching the processes going on in the country and abroad and have access to different sources of information are quite critical about the president’s idealized image.

His authority as an honest leader is also undermined by information that leaks through about the whims and fancies of Rakhmon and his family.

The president’s popularity (even among the ordinary people) declined somewhat after he made several curious decisions. Among them we can mention, for example, the Tajikization of names; the president shortened his name to Rakhmon (in March 2007).

Holding traditional ceremonies has been restricted by the law, which did not interfere with holding grandiose celebrations on the occasion of Rakhmon’s election as president in 2006.

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<sup>61</sup> The ideological resetting in Turkmenistan after the death of first president Saparmurat Turkmenbashi could serve as an example. Although the content changed when creating the new image of a leader, the form remained almost the same and led to a new personality cult in the country (see: S. Horák, J. Šír, *op. cit.*).

Many of the above-mentioned decisions are essentially demagogic in nature and frequently avoid resolving the problems that exist in Tajikistan.

The increasing decline in Rakhmon's authority is making it incumbent on his administration and "court ideologists" to increasingly mythologize his personality.

In 2006, a concept of Rakhmon was developed in foreign policy as a leader of the Aryan civilization.<sup>62</sup>

The idea is being promulgated that in the conditions of the economic crisis that is reaching its peak, the president could save the nation from its dire consequences. But this, again, is nothing more than ideological speculation.

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<sup>62</sup> See: *Narodnaia gazeta*, 27 June, 2006.

## REGIONAL POLITICS

ONE OF  
THE LIMITROPHE TERRITORIES  
OF THE GLOBAL WORLD  
*(Transformation of the States  
of the Baltic-Black Sea Region  
in the 21st Century)*

## Part II

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Early in the 21st century, the effects of the Soviet Union's disintegration are only just starting to come to the fore, but I am convinced that the old world order is already dead.

Indeed, deprived of an external threat, the United States has been gradually losing its former role as global hegemon, while liberal democracy has proven unable to maintain its former Great Power status. The fear of the "red plague" in the East disappeared together with the Soviet Union; the old ideological bonds have slackened, while a new ideology is being formulated on the basis of particular interests. The political elite is still clinging to its imperial ambitions, however its social support is dwindling.

*Continued from No. 4-5, 2009.*



The Americans are losing their former patriotic zeal: "Recent trends in public opinion suggest that the U.S. electorate is even less ready to sacrifice blood and treasure in foreign fields than it was during the Vietnam War."<sup>1</sup>

America's obsession with global domination died on the ruins of the bipolar system of international relations; the Soviet Union's disintegration destroyed its "environment" and opened up wide vistas for the new rival geopolitical actors.

The imperial U.S.-dominated global system of international relations of the past became a mirage before our eyes, while the milieu in which confrontation with the Soviet Union demanded concentrated efforts was replaced with the competitive environment of states of the same economic formation.<sup>2</sup>

Professor of Economic History at Harvard University Niall Ferguson has written in this connection: "We tend to assume that power, like nature, abhors a vacuum. In the history of world politics, it seems, someone is always the hegemon, or bidding to become it. Today, it is the United States; a century ago, it was the United Kingdom. Before that, it was France, Spain, and so on. The famed 19th-century German historian Leopold von Ranke, doyen of the study of statecraft, portrayed modern European history as an incessant struggle for mastery, in which a balance of power was possible only through recurrent conflict.

"The influence of economics on the study of diplomacy only seems to confirm the notion that history is a competition between rival powers."<sup>3</sup>

The Soviet Union's withdrawal from history echoed at the regional level as well: Russia not only lost its geopolitical impact, but also its political, military, and economic control over large territories in Europe and across the former Soviet Union. According to Brzezinski, today "the space occupied for centuries by the Tsarist Empire and for three-quarters of a century by the Soviet Union was now to be filled by a dozen of states, with most (except for Russia) hardly prepared for genuine sovereignty." He adds: "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 the simultaneous attempt to undo the old Soviet socioeconomic model."<sup>4</sup>

It should be said that the reforms undertaken by Mikhail Gorbachev were possible because of the high level of social guarantees in the Soviet Union. He opened Pandora's Box and imposed religion, nationalism, and social and political disputes on the nation while wielding the old totalitarian instruments, which, according to the American analyst, was dangerous for the unity of the Soviet Union itself.

In 1988, Zbigniew Brzezinski published *The Grand Failure: The Birth and Death of Communism in the Twentieth Century* in which he predicted the Soviet Union's most probable future as prolonged disorder, which would not bring any positive results, as well as further concessions and ill-considered changes which would bring the coming political crisis closer. The reforms indispensable for economic health would probably deprive the Soviet workers of the main boons offered by the current system: employment and wages unrelated to labor productivity. They would have nothing in exchange.<sup>5</sup>

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<sup>1</sup> N. Ferguson, "A World without Power," *Foreign Policy*, July/August 2004, available at [<http://www.mtholyoke.edu/acad/intrel/afp/vac.htm>].

<sup>2</sup> See: A. Gat, "The Return of Authoritarian Great Powers," *Foreign Affairs*, No. 4, July/August, 2007.

<sup>3</sup> N. Ferguson, op. cit.

<sup>4</sup> Z. Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives*, Basic Books, New York, 1997, p. 89.

<sup>5</sup> See: Z. Brzezinski, "Bolshoy proval: rozhdenie i smert kommunizma v XX veke," in: *Obshchestvennaia zhizn za rubezhom*, Issue 9, Moscow, 1990, pp. 12-15. (*The Grand Failure: The Birth and Death of Communism in the Twentieth Century*, Charles Scribner's Sons, New York, 1989.)

So far, no complete assessment of what the Soviet Union's disappearance from the map meant for Eastern Europe and the world is possible.

The replacement of global bi-polar confrontation with ethnic pushed the Baltic-Black Sea Region at least four centuries back. By the same token, Russia, a former world communist empire, was transformed into a "torn" state. (Samuel Huntington has offered an apt description of "torn" states: "Torn countries are identifiable by two phenomena. Their leaders refer to them as a 'bridge' between two cultures, and observers describe them as Janus-faced. 'Russia looks West—and East.'"<sup>6</sup>)

The Russians experienced a historical shock of sorts: they tried to adjust themselves to the new realities and a dim and unpredictable future.

Vladimir Lukin, the first ambassador of post-communist Russia to the United States, offered the following comment: "In the past, Russia saw itself as being ahead of Asia, though lagging behind Europe. But since then, Asia has developed much faster..." and "we find ourselves to be not so much between 'modern Europe' and 'backward Asia' but rather occupying some strange middle space between two 'Europes.'"<sup>7</sup>

With no Soviet Union in sight the geopolitical landscape of Europe changed beyond recognition. Until recently a great power and the leader of satellite states with territories stretching to the heart of Europe (or, at one time, to the South China Sea), Russia, the legal heir of the Soviet Union, became a state with no geographic access to the outside world; it was weakened by the never-ending conflicts on its western, southern, and eastern borders. Even its northern territories covered with ice the year round and therefore ill-suited for human habitation are geopolitically vulnerable because of their geological value.

American political scientist Parag Khanna has described new multi-polarity as a world dominated by the American, European, and Chinese "empires" with a "world of second order," the countries of which "can be described as the key bearing points of the multipolar world because their decisions can tip the global balance of forces;" this "world of second order" can be described as a "global middle class if such existed at all."<sup>8</sup> Russia is one such country.

Empires and their global geopolitical interests are the main players on the "world chessboard." Today, only the United States and China can be described as "generalized empires." Regional alliances such as the European Union also create imperial structures and should, therefore, be regarded as main world players.

Samuel Huntington, Zbigniew Brzezinski and many other analysts agree that for the first time in the last 200 years Russia has lost its imperial status. In *The Clash of Civilizations*, Huntington described the change of geopolitical priorities on the World Island in the following way: "While the Soviet Union was a superpower with global interests, Russia is a major power with regional and civilizational interests."<sup>9</sup> However it can no longer affect the policies pursued by the countries of the Baltic-Black Sea Region which have joined NATO and the EU; its grip on Ukraine and Belarus has weakened.

To my mind, this happens because, in pursuance of its nationalist and selfish interests, Russia is pushing the Slavic states out of its sphere of influence by political, economic, ethnic, and other methods. The objective international circumstances have nothing to do with this.

British historian Arnold Toynbee believed that at all times civilizations had been born to respond to challenges. Their growth can be described as a new script of the Challenge and Response drama; each turn produced a new script, while the Challenges and Responses were nothing more than repeti-

<sup>6</sup> S.P. Huntington, *The Clash of Civilizations and the Remaking of World Order*, Touchstone Books, New York, 1998, p. 139.

<sup>7</sup> V. Lukin, "Our Security Predicament," *Foreign Policy*, No. 88, 1992, p. 60.

<sup>8</sup> V. Inozemtsev, "Mechty o mnogopoliusnom mire," *Nezavisimaya gazeta*, 18 September, 2008.

<sup>9</sup> S.P. Huntington, op. cit., p. 164.

tions of the old plot. Seen as mathematical progressions of sorts, the repetitions can be formulated as: a challenge that received an adequate response led to a new challenge followed by an adequate response until the continuity snapped. The following describes progressive disintegration: a challenge with an inadequate response leads to another challenge and another inadequate response and so on until complete disintegration ensues.<sup>10</sup>

The twenty-year long history of the newly independent states can be described as a chain of challenges and inadequate responses with not much sense in them. In the majority of cases this happens because the selfish interests of the quasi-elites prevail over national interests. And, in particular, the last two decades have demonstrated to one and all that the Russian elite is unable to respond to the global challenges.

Disintegration of the Soviet Union affected the national (cultural) sphere and badly hit the Baltic-Black Sea Region.

Cultural distinctions were successfully suppressed first by the Russian Empire and then the Soviet Union in which the militant Marxist-Leninist ideology replaced the monarchy as the main pressure instrument. Once the Soviet Union disintegrated these distinctions sprang back to life.

It should be said that the structure based on the national rather than territorial principle is a “delayed action mine” which made it next to impossible to address these problems. The Soviet nationalities policy added urgency to the problems in the course of the changes in social and political conditions.

National-cultural progress was an illusion based on “the tenacity of the belief in the immortality of universal states with their impressiveness rooted in the “Time of Troubles” and symbolizing a revival of the degrading society. A universal state captivates hearts and minds because it is the embodiment of a rally from the long-unhaulted rout of a “Time of Troubles.” Politically, a universal state is the highest expression of a rally, a psychological product of social disintegration. A feeling of unity and universality is typical of all universal states.”<sup>11</sup>

Communist ideology, which was easily grasped by the masses, replaced religion and culture; Marxism-Leninism explained the problems of human beings in simple terms.

The Soviet Union could offer totalitarianism and nothing else. In his book, *The Grand Failure: The Birth and Death of Communism in the Twentieth Century*, Brzezinski described communism as the most unusual political and intellectual delusion of the 20th century. He goes on to say that the doctrine elaborated by an obscure German Jewish immigrant librarian and enthusiastically embraced by an equally obscure Russian political scribbler became the most attractive theory of the century because it explained the meaning of life in comprehensive and, most important, simple terms. The Stalin system survived because of the personality cult and mass extermination of objectionable people. It went on living because the masses had no idea about any other alternative.<sup>12</sup>

Neither the Russian Empire nor the Soviet Union created conditions needed to overcome the national and cultural disarray; in fact, the political elite concentrated on deepening the gap.

More often than not, wrote Toynbee, the level of human prosperity is measured by power and wealth; this means that common consciousness looks at the already read chapters of tragic history of public decline as periods of amazing rally and prosperity. This sad delusion might go on and on for ages, but sooner or later it ends. Enlightenment dawns when the terminally ill society begins a war against itself. This war engulfs resources and depletes vitality, which causes society to devour itself.<sup>13</sup>

<sup>10</sup> See: A. Toynbee, *Postizhenie istorii* (A Study of History), Progress Publishers, Moscow, 1991, p. 475.

<sup>11</sup> See: *Ibid.*, p. 499.

<sup>12</sup> See: Z. Brzezinski, “Bolshoi proval,” pp. 12-15.

<sup>13</sup> See: A. Toynbee, *op. cit.*, p. 335.

Map 1

## Split of Civilizations



Huntington describes the majority of the Baltic-Black Sea Region's countries as cleft countries in which "major groups from two or more civilizations say, in effect, 'We are different peoples and belong in different places.' The forces of repulsion drive them apart and they gravitate toward civilizational magnets in other societies."<sup>14</sup>

Today, like many years ago, the spilt runs across the territory of the so-called Baltic-Black Sea Arc which comprised parts of contemporary Russia and the Baltic countries, Belarus, Ukraine, Moldova, Rumania, and Bosnia. It is clearly shown in Huntington's *The Clash of Civilizations*<sup>15</sup> (see Map 1).

It should be said that this is a unique situation unknown in the world.

The states of the Baltic-Black Sea Region considerably differ because of their culture and history. Some of them were able to integrate into the European Union fairly easily (the Baltic countries, Poland, the Czech Republic, Slovenia, and Hungary).

Kievan Rus and Muscovy had little contact with Western European societies. Russian civilization developed as an offspring of Byzantine civilization and then for two hundred years, from the mid-thirteenth to the mid-fifteenth centuries, Russia was under the suzerainty of the Golden Horde. Russia had no or little exposure to the defining historical phenomena of Western civilization: Roman Catholicism, feudalism, the Renaissance, the reformation, overseas expansion and colonization, the Enlightenment, and the emergence of the nation state. Seven of the eight distinctive features of Western civilization—religion, languages, separation of church and state, rule of law, social pluralism, representative bodies, individualism—were almost totally absent from the Russian experience.<sup>16</sup>

The Slavic states that had checked the Asian onslaught on Europe underwent serious social and political changes that affected not only their statehoods but the ethnos as a whole, its mentality and psychology in the first place.

This means that the statehood of Eastern Slavs was formed under an alien yoke—the process that could not be described as natural. A special type of relations

<sup>14</sup> S.P. Huntington, op. cit., p. 138.

<sup>15</sup> See: Ibid., p. 159.

<sup>16</sup> See: Ibid., p. 139.

between the elite and the class it ruled (G. Mosca)<sup>17</sup> took shape: the national elite pressed harder than the foreign invaders to preserve its domination. “The appanage princes who obeyed the ‘czar of Russia’—the Tatar khan—had never been independent autocrats; they kept their possessions because the conquerors let them. Russians were ruled from the Golden Horde and, according to Fletcher, the Moscow czars were forced to perform a humiliating rite: every year in the Kremlin they fed oats to the khan’s horse from their caps.”<sup>18</sup>

The Mongol suzerainty widened the cleft between the elite and the masses, with the former being nothing more than a puppet handled by the conquerors. The cleft meanwhile was steadily widening under the pressure of the highly imperfect spiritual sphere.

Czar Peter tried to reform the Church according to the Western pattern by handing all the key posts in the Russian Orthodox hierarchy (which had traditionally belonged to Great Russians) to priests from left-bank Ukraine conquered in the course of the Russian-Polish war of 1667.

Under the strong influence of Roman Catholicism, the Ukrainian Orthodox clerics (irrespective of their acceptance or rejection of Romanization) had to study Roman theology. As a result, they were oriented, to a certain extent, toward Western world outlook.<sup>19</sup>

In the course of history the elite became totally alien to the people, who never looked at their betters as part of the nation. This is confirmed by almost all Russian 19th-century writers.

The elite, therefore, had to look for patrons abroad: in Byzantium, the Golden Horde, Europe (France and Germany) and the United States; the nation alienated from power had been living in internal deportation and accepted, without murmur, alien ideas imposed on it by the coup of October 1917.

Machiavelli believed that the concept of “monarchy” had nothing to do with the form of government in Russia. It “acquired a different meaning interpreted as independence of absolute monarchic power or unlimited power rather than independence from external power.”<sup>20</sup>

Well-known Russian academic A. Panov is convinced that “...in Russia the process of self-destruction of the country as a national-political and state structure is underway. This is officially confirmed: the autochthonous population has detached itself from power because power does not express its interests.”<sup>21</sup>

In his “*Left-Wing Communism: An Infantile Disorder*” written in 1920, Lenin wrote: “It is only when the ‘lower classes’ do not want to live in the old way and the ‘upper classes’ cannot carry on in the old way that the revolution can triumph.”<sup>22</sup> This profound remark indicates the deepness of the national cleft.

The October coup of 1917 in Russia was carried out according to a foreign script and with foreign interference. A new, ethnically vague political elite replaced the old national elite. Zbigniew Brzezinski described the results in the following way: “One cannot overstate the horrors and tribulations that have befallen the Russian people in the course of this century. Hardly a single Russian family has had the opportunity to lead a normal civilized existence.”<sup>23</sup>

The seventy years of communist rule in the Soviet Union merely widened the gap between the ruling part and civil society. In actual fact, Gorbachev’s “perestroika” did not mean reforms since he

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<sup>17</sup> See: G. Mosca, *The Ruling Class*, edited and revised, with an introduction by Arthur Livingston; Transl. by Hannah D. Kahn, McGraw-Hill, New York, 1939.

<sup>18</sup> V. Khalifov, *Nauka o vlasti. Kratologia*, Os-89, Moscow, 2008, pp. 282-284.

<sup>19</sup> See: A. Toynbee, op. cit., p. 497.

<sup>20</sup> Quoted from: F.F. Kokoshkin, *Russkoe gosudarstvennoe pravo*, Moscow, 1908, p. 123.

<sup>21</sup> A.I. Panov, “Politicheskiy pluralizm v sovremennoy Rossii,” Academy of Political Science. Department of Political Science and Political Governance, Academy of Civil Service at the RF President, Chelovek i kariera Publishers, Moscow, 2001, p. 98.

<sup>22</sup> V.I. Lenin, “*Left-Wing Communism, An Infantile Disorder*,” Resistance Books, Sydney, 1999, p. 83.

<sup>23</sup> Z. Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives*, p. 90.



and his “loyal” cronies (Eduard Shevardnadze, Alexander Yakovlev, and other prominent party functionaries) spared no effort to ruin the state. His “new political thinking” and “openness” were nothing more than a new form of Western suzerainty.

In 1999, speaking at the American University in Turkey, Mikhail Gorbachev said: “Destruction of communism was the aim of my life. To achieve this I used my position in the party and country...”

The moral degradation of the Soviet nomenklatura requires no proof—this is an axiom confirmed by what Shevardnadze had to say about Stalin: “...as I plunge deeper into the material I become more and more convinced that Stalin was a rock unique in human history.”<sup>24</sup>

The geopolitical changes that left their imprint in the Baltic-Black Sea Region were not caused by global economic processes. They were caused by the political (elite) sphere of international relations; they are civilizational changes determined by the historical conditions in which the Slavic states acquired their statehoods. The process went on by recruiting the political national elite and was determined by ethnic and cultural specifics acquired in the course of social evolution.

This process can be described as mutual alienation of the quasi-elite and civil society, which developed into antagonistic contradictions under the pressure of historical circumstances (the Mongol invasion, emergence of monarchy and serfdom, World War I, the coup of October 1917, the Stalin terror, the period of stagnation, and the rule of Mikhail Gorbachev).

In fact, these were centuries-old antagonist contradictions between the ruling class and the ruled rooted in violence as the major instrument of governance.<sup>25</sup>

The history of East Slavic civilization abounds in facts of genocide of the Slavs. Witness the following: according to the report by O. Shatunovskaia, member of the Party Control Committee at the C.C. C.P.S.U. and the commission set up to investigate Sergey Kirov’s assassination and the political processes of the 1930s, “between 1 January, 1935 and 22 June, 1941, 19,840 thousand ‘enemies of the people’ were arrested; 7 million of them were executed; the majority of the rest perished in the camps.”<sup>26</sup>

The same thing is going on today: in 1998, there were 64,545 criminal deaths in Russia, while 81,565 were injured in criminal incidents.<sup>27</sup> In 2002, Colonel-General Leonid Ivashov wrote: “In 2001, 83 thousand were killed, tens of thousands died of injuries in hospitals, and about 70 thousand disappeared without a trace.”<sup>28</sup> This policy created conditions for the “biological damage on the Russian people;” this is what Brzezinski writes about in clear terms in his *The Grand Chessboard*.<sup>29</sup>

The country can be described as a “cleft country” because its leaders have their sights set on another civilization and are prepared to place their stakes on separatism to reach it: “‘The strongest tendency of the late [twentieth century],’ writes Jacques Barzun in his history of the West, *From Dawn to Decadence*, ‘was Separatism... It affected all forms of unity... The ideal of Pluralism had disintegrated and Separatism took its place; as one partisan of the new goal put it, ‘Salad Bowl is better than melting pot.’”<sup>30</sup>

Separatism in the post-Soviet part of the world, in the Slavic states in particular, is of an elite nature because the quasi-elite is formed according to nationalities and fights for its interests by contending (in latent forms) with the autochthonous population living in an eternal state of inner deportation.

<sup>24</sup> *Bulvar Gordona*, No. 41 (181), 14 October, 2008.

<sup>25</sup> See: G. Mosca, op. cit.

<sup>26</sup> *Argumenty i fakty*, No. 33 (514), 18-24 August, 1990.

<sup>27</sup> See: S. Kara-Murza, *Sovetskaia tsivilizatsia*, Book 1, Eksmo Publishers, Moscow, 2008, p. 215.

<sup>28</sup> *Zavtra*, No. 45, 2002, p. 1.

<sup>29</sup> See: Z. Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives*, p. 89.

<sup>30</sup> Quoted from: P.J. Buchanan, *The Death of the West. How Dying Populations and Immigrant Invasions Imperil Our Country and Civilization*, 1st edition, Thomas Dunne Books, St. Martin’s Press, New York, 12 December, 2001, available at [<http://thelandofintellect.org/readings/DeathOfTheWest.txt>].

Over time, the elite's Western orientation took a novel form of mondialism; separate negotiations of Soviet leaders with the West became a precedent. The leaders of the countries of the Baltic-Black Sea Region, of the Soviet Union in particular (Gorbachev, Shevardnadze, Yakovlev, Yeltsin, Kravchuk, and Shushkevich), preferred the Kemalist strategy. They believed that Western culture was their own option for the sake of which they were destroying their own civilization.

In 1991, the quasi-elite pushed the Baltic-Black Sea Region back into the 17th century in the geopolitical sense. Later, the states that had long remained within the field of attraction of the European civilization joined the EU and NATO (the Czech Republic, the Baltic countries, Poland, etc.). Others, such as Belarus and Ukraine were split. Today America is interested in them to a certain extent.

V. Kolosov, director of the Center of Geopolitical Studies at the Institute of Geography (RAS), and R. Turovskiy, senior fellow at the Research Institute of Cultural and Natural Heritage, have written: "Encouraged by the West official Kiev is trying to become a geopolitical alternative to Moscow. Recent experience has shown that in Eastern Europe the idea of an alliance of any configuration without Russia is usually spearheaded against it. This means that the state should be concerned about the possibility of a medieval Baltic-Pontic belt ('sanitary cordon' along Russia's western border)."<sup>31</sup>

Zbigniew Brzezinski has written: "Most painful of all, Russia's international status was significantly degraded, with one of the world's two superpowers now viewed by many as little more than a Third World regional power, though still possessing a significant but increasingly antiquated nuclear arsenal... Russia's social condition was, in fact, typical of a middle-rank Third World country."<sup>32</sup>

These processes were generated by the national elites first of the Soviet Union and then of the newly independent states that, since the mid-1980s, had been living under latent Western patronage.

It should be said that the national elites of the Eastern Slavs at all times looked at Western Europe and the United States as the only pattern for Russia. The interest of the liberal-democratic states is heated by the readiness of the post-Soviet political elites to support their geopolitical interests.

To my mind, Gorbachev's rule should be taken as the starting point of disintegration of Soviet power; he tended to ignore laws and abuse power. "The deliberately friendly posture adopted by the West, especially by the United States, toward the new Russian leadership was a source of encouragement to the post-Soviet 'westernizers' and reinforced their pro-American inclinations. They were flattered to be on a first-name basis with the top policy makers of the world's only superpower, and they found it easy to deceive themselves into thinking that they, too, were the leaders of a superpower... The problem was that it was devoid of either international or domestic realism. While the concept of 'mature strategic partnership' was flattering, it was also deceptive. America was neither inclined to share global power with Russia"<sup>33</sup> nor could it, even if it had wanted to do so.

It looks as if Alexander Rutskoy, former vice-president of Russia, offered the most apt description of the processes underway in the Baltic-Black Sea Region: "It is apparent from looking at our country's geopolitical situation that Russia represents the only bridge between Asia and Europe. Whoever becomes the master of this space will become the master of the world."<sup>34</sup>

This puts the new geopolitical trends in the Baltic-Black Sea Region and in Eurasia (Russia) in a nutshell. Because of the disintegration that took place in the region in the late 20th century, the lim-

<sup>31</sup> V.A. Kolosov, R.A. Turovskiy, "Geopoliticheskoe polozhenie Rossii na poroge XXI veka: realii i perspektivy," *Polis (Politicheskie issledovaniya)*, No. 3, 2000.

<sup>32</sup> Z. Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives*, pp. 89-90.

<sup>33</sup> *Ibid.*, pp. 99-100.

<sup>34</sup> *Ibid.*, p. 111 (see also: S.P. Huntington, *op. cit.*, pp. 165-168).



itrophe civilization changed its geographic outlines. The unipolar world based on the United States is gradually losing its self-regulating ability, however the United States will remain one of the world's poles together with Europe and rapidly developing China.

Director of the Center for Studies of Postindustrial Society Vladislav Inozemtsev has written the following: "In the emerging world, the influence of the 'power centers' will be determined by four factors: first, the scale and degree of diversification of the national economy; second, the intensity of financial and economic cooperation with the other poles; third, the size and combat-worthiness of conventional armed forces (nuclear potential is mainly used for containment); and fourth, by the ability of the great powers to integrate their 'near abroad.'

"Alas, Russia, despite its 'rising up from its knees' over the last ten years, cannot claim the status of one of the poles: its economy wholly depends on oil and gas exports; its financial wellbeing depends, to a great extent, on the West; its army is not ready to maneuver far from the state borders, while its integration efforts on CIS territory cannot be called anything other than a complete failure."<sup>35</sup>

Having lost its influence in the countries of the Baltic-Black Sea Region, Russia created conditions in which Europe ceased to be a limitrophe zone wedged between the poles of the bipolar world of the Cold War era to become one of the power centers of the global world.

Having lost its imperial status (which it enjoyed for 300 years), Russia became a limitrophe zone in the sphere of the geopolitical interests of the global players (America, Europe, and China).

The demographic situation in the East Slavic states aggravates the situation, while the Russians in Russia can be described as an internally deported nation. In addition, "some 20 million Russian-speaking people were now inhabitants of foreign states."<sup>36</sup> "Russia's birthrate had already plummeted. Its population had fallen to 145 million; one of the estimates had it headed to 123 million by 2015. 'If you believe the forecasts made by serious people who have devoted their whole lives to studying this question,' warns President Putin, 'in 15 years' time there will be 22 million fewer Russians. Just think about that figure—it is a seventh of [Russia's] population. A loss of 22 million Russians in fifteen years would be greater than all the Soviet Union's losses in the Hitler-Stalin war,' Putin went on to add ominously, 'If the present trend continues, there will be a threat to the survival of the nation.'<sup>37</sup>

Russia is again (it did this in 2004) cutting down its army and navy: before 2012 the land forces will be reduced by 90 percent; the air force by 48 percent; the navy by 49 percent; strategic rocket forces by 33 percent; aero-space forces by 15 percent; and airborne troops by 17 percent.<sup>38</sup>

Ten years ago, in an interview to the *Vremia-MN* newspaper, Zbigniew Brzezinski said in particular: "A restored union with Moscow as the center is a chimera. It seems that some time would pass before the Russian elite woke up to the newly independent states as a new reality."<sup>39</sup>

Early in the third millennium, the limitrophe zone shifted from the Baltic-Black Sea Arc to the Eurasian territories (Russia). Today, the East Slavic states are classical "corrupt" states very much in line with what Machiavelli wrote several centuries ago: "The city ran great risk of losing its freedom through civil discord; that its original institutions are no longer adapted to a city that has become corrupted, is plainly seen in two matters of great moment, I mean in the appointment of magistrates and in the passing of laws."<sup>40</sup>

<sup>35</sup> V. Inozemtsev, op. cit.

<sup>36</sup> Z. Brzezinski, *The Grand Chessboard. American Primacy and Its Geostrategic Imperatives*, pp. 89-90.

<sup>37</sup> P.J. Buchanan, op. cit. (see also: A. Gentleman, "Wanted: More Russian Babies to Rescue a Fast Dying Nation," *London Observer*, 31 December, 2000; R. Legvold, "Russia's Uninformed Foreign Policy," *Foreign Affairs*, September/October, 2001, p. 63).

<sup>38</sup> See: *Rossiiskaia gazeta—Federalny vypusk*, No. 4772, 15 October, 2008.

<sup>39</sup> Z. Brzezinski, "Rossiiskim rukovoditeliam pora by protrezvet," *Vremia-MN*, 1 November, 1999.

<sup>40</sup> N. Machiavelli, *Discourses on the First Decade of Titus Livius*, Transl. from the Italian by Ninian Hill Thomson, M.A., Kegan Paul, Trench & Co., 1, Paternoster Square, London, 1883, available at [<http://www.gutenberg.org/dirs/1/0/8/2/10827/10827.txt>].

These countries present a hazard for the liberal democracies and the totalitarian empires of our days. The quasi-elites have not abandoned their parasitic habits based on total violence, the masses' genetic fear of the powers that be, corruption, juggling with values, and lies.

Functionally, the post-Soviet quasi-elites differ from the national elites of liberal democracies: protected by the Western umbrella the former obey commands from the West and serve Western interests; the latter serve civil society. In Russia, the phobocratic traditions going back to the Mongol yoke are still very much alive.

This evolutionary form corresponds to the conception of "imposing" (according to Karl-Schmitter) and "revolution from the above" (according to Munk-Leff)—a situation in which the leading (old and new) elite groups resort to force to achieve political stability. This can be seen both in Russia and Ukraine.

The post-Soviet quasi-elite is the main instrument which destroys statehoods. In his *The Road to Serfdom*, F.A. von Hayek, a well-known German political scientist, economist, and sociologist, explained this phenomenon and demonstrated that in contemporary mass society the political elite "is not likely to be formed by the best but rather by the worst elements of any society."<sup>41</sup>

Even those who dedicated their lives to the struggle against the Soviet Union were caught unprepared. Brzezinski has described the near future of the newly formed limitrophe zone: "The Russian elite will have to wake from its dreams in which Russia is still a world power. It should merely lead the country away from the unfavorable geopolitical situation created by the following.

"China, Russia's eastern neighbor, has a population of 1.2 billion and an economy 4 times larger than the Russian; the Japanese economy is 5 times larger than Russia's. There are 300 million Muslims to the south of Russia whose enmity is heated up by Russia's policies. To the West, there are 360 million Europeans with an economy which is 11 times larger. There is America across the Atlantic, the economy of which comprises twelve Russian economies. The time has come for the Russian leaders to sober up."<sup>42</sup>

A world of three poles is one of many probabilities of future developments. This is the closest, but not the final, prospect. America, China, and Europe are not the whole world. There are other important players—India, Japan, Russia, Brazil, Pakistan, Iran, and the Arab countries—which in the near future will be kept on the back seat; this means that conflicts and a struggle for zones of influence should not be ruled out.

In the 21st century, the current deficit of resources will transform the limitrophe territory, which due to globalization now covers the whole of Eurasia (Russia), into an object of the geopolitical and geo-economic interests of the main world players.

Niall Fergusson, for example, believes that "the alternative to unipolarity would not be multipolarity at all. It would be apolarity—a global vacuum of power. And far more dangerous forces than rival great powers would benefit from such a not-so-new world disorder."<sup>43</sup> "Today nobody knows what resources will be in greatest demand in 40 or 50 years and what will trigger the main conflict," writes Vladislav Inozemtsev. "It seems that the multipolar world will not enjoy peaceful cooperation of the poles. It will rather become a system of seigneur-vassal relations between the poles and their 'near periphery.' The great powers and the hatching power centers might cause conflicts on the borders of the peripheries. The multipolar world of the 21st century will be a world of violence and wars—it will never be stable."<sup>44</sup>

<sup>41</sup> F.A. Hayek, *The Road to Serfdom*, University of Chicago Press; 50 Anv edition, 15 October, 1994, p. 142.

<sup>42</sup> Z. Brzezinski, "Rossiiskim rukovoditeliam pora by protrezvet."

<sup>43</sup> N. Ferguson, op. cit.

<sup>44</sup> V. Inozemtsev, op. cit.

Destruction of the bipolar system of international relations not merely pushed the Baltic-Black Sea Region back into its natural state of a limitrophe zone on the “World Island” between Europe and Eurasia. Globalization and the emergence of new power centers have changed the geographic outlines of the limitrophe zone.

The radical change of the balance of power in the globalized world created new global players with different spheres of geopolitical and geo-economic interests. They have already turned their attention to the territory of the East Slavic states, Russia in particular, which, under the pressure of circumstances, became a limitrophe zone of the globalized world.

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## CENTRAL ASIA AND THE CAUCASUS: POST-CRISIS ANALYSIS OF THE STATE AND SOCIETY

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On the whole, little or no attention is paid to the forecasts of post-crisis development in Central Asia and the Caucasus that are scattered among the publications on the post-crisis world. Indeed, so far these regions essentially remain outside the global industrial market, while the raw-material orientation of their economies allowed practically all eight of them to avoid serious socioeconomic upheavals. It is impossible, however, to supply an exhaustive forecast of the crisis' economic, political, cultural, demographic, and other impacts.

Kazakhstan was the first among the Central Asian (and the post-Soviet countries in general) to face the crisis. This happened in the fall of 2007 when the oil reserve fund was opened and the state tried to stifle the crisis by urgently pumping state money into the republic's economy.

This means that the numerous official statements, expert assessments, and constructive sug-

gestions coming from the Kazakhstan opposition should be regarded as belonging to the so-called inertia model of social and economic development promoted in the republic for many years.

The international conference held in Bishkek in March 2009 and the International Conference on the Social Impact of the Economic Crisis in Eastern Europe, Central Asia and Turkey held in December 2009 in Almaty pointed out that the countries for which “Russia remains a main trading partner and a major source of remittances” suffered more than many of the others.<sup>1</sup>

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<sup>1</sup> For more detail, see: “Gosudarstva Kavkaza i TsA zhdet rezkoe padenie tempov ekonomicheskogo rosta,” 6 March, 2009, available at [www.un.org]; “V Almaty otkrylas' Mezhdunarodnaia konferentsia po antikrizisnoy politike v stranakh Vostochnoy Evropy i Tsentral'noy Azii,” available at [www.un.org] (see also: D. Jardaneh, “Crisis Brings Reversal of Fortune to Caucasus and Central Asia,” 10 March, 2009, International Monetary Fund. Middle East and Central Asia Department, available at [www.imf.org]).

This means that all the academic publications relating to the prospects for state and social development should be associated with the countries that have economies closely tied to Russia.

The post-crisis development of Turkmenistan and Azerbaijan, which still rely on the production and transportation of energy resources, while the most important political and economic decisions still hinge on increasingly greater oil and gas export, looks different.

International organizations are actively involved in elaborating long-term strategies for the two countries; their small populations create a relatively smaller number of problems.

The post-crisis strategy of Uzbekistan can be put in a nutshell as “tapping the anticrisis measures to the full for the positive development of the state and society.”

In 2009, the republic launched a state program called The Year of Development and Improvement of the Countryside, which opened a new stage of reforms. The country’s leaders plan to extend the state social programs designed to further promote human rights and freedoms and move closer to a civil society.

The Georgian model of post-crisis development deserves special mention: according to Mikhail Saakashvili, “We said that instead of reg-

ulated economy we would choose the way of liberal economy.” The Georgian president insists that this model rests on the “values and works of Ilia Chavchavadze, ... the first Georgian libertarian with his economic philosophy,”<sup>2</sup> rather than on the Western theories based on the Anglo-Saxon tradition.

“Despite many social problems, unemployment, poverty, and the political unrest, the society understands that we need to carry out the process by means of dialog.”<sup>3</sup> According to the Georgian leaders, their “last hope always was a foreign assistance and international finance organizations.”<sup>4</sup>

I have undertaken a comparison and analysis of the possible post-crisis development of eight countries (Azerbaijan, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan) and of the future of their state institutions and civil societies.

<sup>2</sup> M. Saakashvili, “The President of Georgia Presented Economic Package to the Parliament of Georgia,” 6 October, 2009, available at [<http://www.president.gov.ge/?l=E&m=0&sm=3&id=3052>].

<sup>3</sup> M. Saakashvili, “The President of Georgia Met with the Members of the Anticrisis Council,” 8 November, 2008, available at [<http://www.president.gov.ge/?l=E&m=0&sm=3&st=30&id=2775>].

<sup>4</sup> M. Saakashvili, “The President of Georgia Presented Economic Package to the Parliament of Georgia.”

## The State Initiates, Carries Out, and Guarantees the Post-Crisis Reforms: Necessary Theoretical Digressions

The state should not be carried away by “financial algorithms” of post-crisis development (which might push social interests to the backburner). Complex anticrisis measures should be sought and elaborated. One of today’s politicians has described the measures designed to preserve the state’s regulatory role as an “eternal historic task.”<sup>5</sup>

<sup>5</sup> F. Fillon, *Un Etat moderne dans une économie de marché responsable*, 16 septembre 2009, available at [[www.blog-fillon.com](http://www.blog-fillon.com)]; *Prime Minister Francois Fillon’s speech at a Conference in Yaroslavl*, available at [[www.yaroslavl-2009.ru](http://www.yaroslavl-2009.ru)].

Some experts insist that the world crisis has “restored” the state; others are convinced that the crisis was triggered not by an imagined “absence of state regulation” but by the state’s active interference in the economic sphere, excessive patronage of other spheres of life, and the cult of power.<sup>6</sup>

It should be said that quality is more important than quantity. When talking about the “size of the state” economists refer not to its territory and population strength but to the share of financial resources in its GDP redistributed through the national budget (the so-called extended government budget) and the scale of the state’s direct interference in the economy through all sorts of bylaws, which make possible “state regulation,” and through the interference of executive structures in the form of “economic management by hand.” Mikhail Saakashvili has pointed out in a similar context: “Freedom [is] expressed in minimal number of the government body, low taxes, in the minimal involvement of the state and in the maximal freedom of an entrepreneur and citizen from bureaucratic ties.” The Georgian leader believes that during the world crisis the public became extremely disoriented by socialist and populist slogans about the greater role of the state. This pattern should be destroyed.<sup>7</sup>

Let us take a closer look at the role of the state in post-crisis society.

President of Kyrgyzstan Bakiev is convinced that “the entire society should pool its efforts” to fight the crisis. This calls “for a new ideology and new organizational forms” because “there are prerequisites of real changes.” This means that “a reasonable balance between novelties and traditions should be maintained to make it possible to capitalize on our heritage, actual experience, and technological achievements.”<sup>8</sup>

President of Armenia Sargsian deemed it necessary to describe the changing role of the state as follows: “There is a misunderstanding which I want to discuss now. Some think that the crisis is limited to the financial and economic spheres, its social dimension being the result of the former. The global crisis is a great challenge to the political sphere, the system of values, and morality.”<sup>9</sup>

The Armenian leaders believe that the post-crisis strategy should have a political aspect as well.

The above suggests that the ruling elites of Central Asia and the Caucasus are convinced that the traditional ways of social progress should acquire a new theoretical interpretation.

## After the Crisis: State-Society Relations

The leaders of the Central Asian and Caucasian countries are equally concerned about post-crisis development. Witness the following:

President Karimov: “We should think about post-crisis development.”<sup>10</sup>

President Nazarbaev: “Crises come and go yet the general vector of our movement toward a successful and prosperous society remains the same.”<sup>11</sup>

<sup>6</sup> See, for example, works by Deepak Lal, a prominent economist and professor at the University of California in Los Angeles.

<sup>7</sup> M. Saakashvili, “The President of Georgia Presented Economic Package to the Parliament of Georgia.”

<sup>8</sup> K. Bakiev, “Vystuplenie na zasedanii Zhogorku Kenesha KR,” 1 September, 2009, available at [www.president.kg].

<sup>9</sup> S. Sargsian, “Vstupitel’noe slovo na tematicheskome soveshchanii s predsedateliami politicheskikh partiy “Vsemirny finansovo-ekonomicheskii krizis i Armenia,” 20 March, 2009, available at [www.president.am].

<sup>10</sup> I.A. Karimov, *Mirovoy finansovo-ekonomicheskii krizis, puti i mery po ego preodoleniiu v usloviyakh Uzbekistana*, Uzbekiston, Tashkent, 2009.

<sup>11</sup> N.A. Nazarbaev, “Obrashchenie po sluchaiu Natsional’noy perepisi naselenia,” 24 February, 2009, available at [www.akorda.kz].

President Sargsian: "Economic and other crises are temporary phenomena."<sup>12</sup>

President Bakiev spoke about the "mechanism of long-term changes as the president's course in the conditions of the problems created and exacerbated by the world financial crisis"<sup>13</sup> and called on the nation "to be prepared for further development," to carry out "resetting," and to "renovate the approaches and formats of interactions inside the administrative system and with other social groups."<sup>14</sup>

President Saakashvili: "In a word: Reform. Reform. Reform. This is the only path to transforming Georgia into a trustworthy partner for our allies."<sup>15</sup>

As early as in February 2009, President Nazarbaev formulated the task of the ruling Nur Otan Party, the government, the presidential administration, and the parliament as drafting a Plan of Kazakhstan's Renovation in the Post-Crisis Period.<sup>16</sup>

The republic has already identified seven trends of its industrial and technological development: modernization of the agrarian sector; development of the construction industry, oil refining, and infrastructure of the oil and gas sector, metallurgy and production of finished metal products, as well as accelerated development of the chemical, pharmaceutical, and defense industries, electric power production; and the transport and telecommunication infrastructures.<sup>17</sup>

President Bakiev identified four key trends of his country's mid-term development: movement toward a real multiparty system and adequate conditions for constructive opposition activities; a dialog and cooperation with the institutions of a civil society; reform of the state administration system to involve broad social groups into decision-making; and correct and well-considered cultural policies.<sup>18</sup> It should be said that the leaders of Kyrgyzstan are relatively more concerned about meeting the daily needs of the public.

Armenia is no less concerned about post-crisis developments. President Sargsian: "Topic No. 1 of all our discussions is unquestionably new trends in our progress... To overcome the crisis imposed on us we should intensify the reforms to the maximum rather than postpone them."<sup>19</sup>

This means that a wider range of social and economic reforms and their acceleration look like the intention of all.

In the summer of 2009, Ashgabad hosted an international symposium called Shaping the Post-Crisis World: Regional Implications and Coordinated Responses by Member Countries (of the Islamic Development Bank—IDB) which discussed "how to mitigate the impact of the global financial crisis on their economies."<sup>20</sup>

It was at the same time that the leaders of Turkmenistan identified their main strategy as trade in energy resources.

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<sup>12</sup> S. Sargsian, "Pozdravitel'noe slovo po sluchaiu 18-oy godovshchiny nezavisimosti," 21 September, 2009, available at [www.president.am].

<sup>13</sup> K. Bakiev, "Kurs na obnovlenie strany," 24 March, 2009, available at [www.kyrgyzembassy.ru].

<sup>14</sup> K. Bakiev, "Vystuplenie na vstreche s molodymi gossluzhashchimi i biznesmenami," 12 March, 2009, available at [www.president.kg].

<sup>15</sup> M. Saakashvili, "Address to the Parliament of Georgia," 20 July 2009, available at [http://www.president.gov.ge/?l=E&m=0&sm=3&id=2988].

<sup>16</sup> See: N.A. Nazarbaev, "Zakliuchitel'noe vystuplenie na rasshirennoe zasedanii Biuro Politsoveta partii," 12 February, 2009," available at [www.akorda.kz].

<sup>17</sup> See: N.A. Nazarbaev, "Interview korrespondentam agentstva 'Khabar' and TRK 'Kazakhstan,'" 20 May, 2009, available at [www.akorda.kz].

<sup>18</sup> See: K. Bakiev, "Obrashchenie 'Kurs na obnovlenie strany,'" 24 March, 2009, available at [www.kyrgyzembassy.ru].

<sup>19</sup> S. Sargsian, "Privetstvennaia rech k uchastnikam s'ezda Soyuzha promyshlennikov i predprinimateley," 13 May, 2009, available at [www.president.am].

<sup>20</sup> "Ashkhabadskiy summit IBR: novaia strategiya sotrudnichestva," 2 June, 2009, Electronic newspaper *Turkmenistan: The Golden Age*, available at [www.turkmenistan.gov.tm].



## Protection of Human Rights: Prosperity or Law?

In the final analysis, the impact of the crisis will depend on the degree to which the state has developed a civil society and its institutions. So, the world crisis will hardly reduce to naught everything that has been done to protect human rights and ensure the rule of law and is unlikely to interfere with the reforms in the judicial sphere.

Experts from the leading international organizations are convinced that “additional measures should be taken to protect the rights of vulnerable groups and individuals, especially women, children, migrants, refugees, autochthonous peoples, the disabled, and senior citizens.” “Xenophobia in relation to migrant workers might increase.”<sup>21</sup>

Members of international organizations who visited Uzbekistan approved of what had been done to improve the conditions in prisons and extend the Program of the Red Crescent International Committee; they also added: “We urge Uzbekistan to continue looking to ODIHR for guidance in areas such as enhancing legislation on human rights, fighting trafficking in persons, and raising public awareness of human rights.”<sup>22</sup>

The president of Georgia, likewise, confirmed in front of the parliament: “I repeat today my personal commitment to introducing popular jury trials in our judiciary system.”<sup>23</sup>

The international community has described Kyrgyzstan’s priorities as “ensuring a role for civil society oversight of police activity, protection of human rights in detention centers, and a strong and independent judiciary.”<sup>24</sup>

In 2007, Tajikistan adopted a Program of Judicial Reform to strengthen and improve the judicial power; the country’s leaders insist that the reform is being implemented step by step.

The leaders of Kazakhstan call on structures “to increase the faith of the people in the judicial system in particular through its transparency and efficiency as well as through the courts’ strict abidance to the laws.”<sup>25</sup>

In Central Asia and the Caucasus everything said about human rights hinges on the “rule of law.” What does the term mean? Without going into detail and in the context of the already proclaimed priority of the economy over politics, this means, primarily, that the state power structures should not discriminate among those involved in economic activities.

## Job Security: Uses and Dangers of Unemployment

Opinions about employment differ from one Central Asian and Caucasian country to another.

Tajikistan, for example, where the employment problem is probably the most acute, is carrying out a wide range of anticrisis measures designed to achieve macroeconomic sustainability and stabili-

<sup>21</sup> Human Rights Council Tenth Special Session: “The Impact of the Global Economic and Financial Crises on the Universal Realization and Effective Enjoyment of Human Rights”, Statement of Ms. Navanethem Pillay, United Nations High Commissioner for Human Rights, available at [<http://www.unhcr.ch/hurricane/hurricane.nsf/view01/A7A2CA2316182115C12575630035ED9F?opendocument>].

<sup>22</sup> U.S. Mission to OSCE on Human Rights in Uzbekistan, 17 September, 2009, available at [<http://www.america.gov/st/texttrans-english/2009/September/20090917165922eaifas0.8082653.html&distid=ucs>].

<sup>23</sup> M. Saakashvili, “Address to the Parliament of Georgia,” 20 July, 2009.

<sup>24</sup> “Response to Kyrgyzstan Minister on Advancing Democracy. U.S. Welcomes Kyrgyzstan’s Actions to Reform Law Enforcement, Judiciary,” 1 October, 2009, available at [[www.america.gov](http://www.america.gov)].

<sup>25</sup> N.A. Nazarbaev, “Vystuplenie na otkrytii III sessii Parlamenta RK chetvertogo sozyva,” available at [[www.akorda.kz](http://www.akorda.kz)].



ty of the real economic sector and to encourage the private sector. Labor migrants are actively involved in the labor market, and social support of the population is realized.<sup>26</sup> It seems that the problem of new jobs in the republic will remain topical.

In Uzbekistan, a job-creation program is being implemented together with encouraging outworking based on cooperation with industrial enterprises. In 2008, the outworkers produced \$25 million-worth of products and services.<sup>27</sup>

The state encouraged cattle breeding in private and dehkan households to increase employment, particularly in the countryside.

Some think that after the crisis a certain level of unemployment should be preserved so as “to rescue the normal world with an innovation economy based on a high level of human capital and training.”<sup>28</sup>

The above cannot be accepted as true in the Central Asian and Caucasian countries because of their demographic status, the level of social protection of the unemployed, the local mentality, the “register of material costs,” and potential new jobs.

The president of Armenia has offered the following: “The process should look like a two-way street: the crisis should not be used to justify the distortions in the reform process accompanied by statements that this has improved the business climate.”<sup>29</sup> Potential economic advance should be followed by stabilized work hours, restored paid administrative leave, and liquidation of the wage arrears. The Armenian president also spoke about social responsibility of the businessmen, even though some of the economists reject this opinion: they describe this as a charity that “shifts the burden to the shareholders.”

## Reducing Poverty: Where is the Boundary between Moderation and a Threat?

The world crisis cut down financial receipts (the states are receiving fewer taxes, money transfers, and loans); according to the World Bank, it has reduced to naught everything that was accomplished in the last 10 years to reduce poverty<sup>30</sup> (in Azerbaijan the poverty level dropped from 49 to 16 percent in 2004-2008).<sup>31</sup>

These negative trends might trigger social tension, lead to extremism, and bring the reforms to a standstill.

To avoid this and withdraw from the hazardous zone, the state should provide greater state incomes for spending in the social sphere (higher pensions, allowances, and social aid).

In other words, stronger social policies are very much needed; they should develop the market economy and create a stronger state. This is possible only in a state where power is consolidated,

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<sup>26</sup> See: “Tadzhikistan priznatelen OON za podderzhku v preodolenii global’nykh krizisov,” 29 June, 2009, available at [www.un.org]; “Vystuplenie Sirodzhidina Aslova, Postoiannogo predstavitelia Respubliki Tajikistan pri OON,” New York, 29 June, 2009, in: *U.N. Conference on the World Financial and Economic Crisis and Its Impact on Development*, available at [http://www.un.org/ru/ga/econcrisissummit].

<sup>27</sup> See: “Uluchshenie polozhenia zhenshchin—prioritet gosudarstvennoy politiki Uzbekistana,” 19 March, 2009 [www.un.org].

<sup>28</sup> “Bezrobotitsa—odna iz samykh tiazhelykh sostavliayushchikh ekonomicheskogo krizisa,” available at [www.svobodanews.ru].

<sup>29</sup> S. Sargsian, “Privetstvennaia rech k uchastnikam s’ezda Soyuzya promyshlennikov i predprinimateley.”

<sup>30</sup> See: *Europe & Central Asia Poverty Team Newsletter*, Issue 27, April 2009, available at [www.worldbank.org].

<sup>31</sup> See: I. Aliev, “Interview agentstvu ‘Interfaks-Azerbaijan,’” 20 March, 2008, available at [www.interfax.az].

the social institutions demonstrate efficiency, while society observes the norms of morality and the laws.

In a poor country, democracy is poorly developed, which means that the aid should be fairly distributed, something which applies in particular to Tajikistan. The World Bank believes that state finances should acquire a special system of administration which would distribute the available means in the most effective way and ensure their rational and transparent use to reduce poverty and achieve macroeconomic sustainability.<sup>32</sup>

The West believes that its aid (designed to promote economic growth and fight poverty) should be limited to the countries which pursue the “right” policies to develop and consolidate the civil society institutions. There is also a different opinion among economists: aid should be extended to all states irrespective of their policies; it should stimulate economic growth and should not punish people for the errors and blunders of the ruling elite.

In fact, in the absence of control over international organizations and objective assessments of their activities, everything done to extend financial aid to countries proved ineffective. Instead of giving the citizens of Third World countries maximum freedom and assistance to move them closer, to a certain degree, to well-being in the market economy, they are invited to get out of the poverty trap according to a unified plan concocted by international experts.<sup>33</sup>

## Fighting Corruption: “Much Depends on Our ‘No’”

The U.N. term “post-crisis setting” is used to envisage a wide range of measures designed to ensure observance of ethical norms and the anticorruption struggle in the public and private sectors. The banking secrecy principle should no longer interfere with the efforts to recover stolen assets.

Within the much-publicized Stolen Assets Recovery Initiative, the states should be actively assisted in their efforts in this direction. The U.N. Secretary-General has pointed out that corruption “weakens democratic institutions, undermines the rule of law and enables terrorists to finance their nefarious work.”<sup>34</sup>

President of Kazakhstan Nursultan Nazarbaev deemed it necessary to stress that “fighting corruption is not a short-term campaign—it is one of the country’s important priorities. We should, at the same time, prevent account squaring under the guise of the anticorruption struggle.”<sup>35</sup> He believes it necessary to “submit to the Parliament, on a priority basis, drafts on scientific tests of all laws and by-laws, which should include their potential corruptibility.”<sup>36</sup>

It should be said that these and other statements by the leaders of Soviet successor-states followed numerous similar statements made by President of Russia Dmitry Medvedev.

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<sup>32</sup> See: “Vsemirny bank vydellil Tajikistanu \$5 mln. na uluchshenie sistemy upravleniya gosudarstvennymi resursami,” 15 May, 2009, available at [www.un.org]; M. Brownbridge, S. Canagarajah, “How Should Fiscal Policy Respond to the Economic Crisis in the Low Income Commonwealth of Independent States? Some Pointers from Tajikistan,” June 2009, available at [www.worldbank.org].

<sup>33</sup> [http://www.inliberty.ru/library/study/352; http://www.inliberty.ru/library/authors/William\_Easterly].

<sup>34</sup> Ban Ki-moon, *Secretary-General’s Message on International Anti-Corruption Day*, New York, 9 December, 2008, available at [www.un.org].

<sup>35</sup> N. Nazarbaev, “Vystuplenie na otkrytii III sessii Parlamenta RK chetvertogo sozyva.”

<sup>36</sup> N. Nazarbaev, “Zakliuchitel’noe vystuplenie na rasshirennom zasedanii Biuro Politsoveya partii,” 12 February, 2009.

It is commonly believed that in countries with a low level of economic freedom, corruption interferes with economic growth: wider corruption means limited competitiveness, which causes production decline.

From this it follows that wider economic freedom is the best and shortest road to bridling corruption. According to Ella Paneyakh, sociologist, Director of the Institute of the Rule of Law, European University at St. Petersburg, public organizations claiming to be civil society institutions “develop into phantoms designed to pump out money from foreign donors rather than from the budget.”<sup>37</sup>

## Introducing Innovations: “New Inventions Will Pull the World Out of the Crisis”

To close the gap that separates Central Asia and the Caucasus from Western Europe, America and Southeast Asia, the Central Asian and Caucasian countries should actively promote knowledge and novel approaches to R&D in the high-tech sphere.

Nobel laureate and futurist Alvin Toffler has the following to say about the future: because of the unlimited nature of knowledge, the state in a postindustrial society is merely unable to cover all spheres. The human brain and new inventions, rather than the economy, will pull the world out of the crisis.<sup>38</sup>

President Nazarbaev has pointed out that to be efficient industrial policies “should rest on innovations and the latest knowledge and technologies. This means that we need a new Law on Science to formulate the principles according to which science will develop in Kazakhstan.”<sup>39</sup>

He has specified that “technology can no longer assure the prosperity of any country or of the world as a whole—the countries with highly developed technologies have become the main source and the key cause of the global crisis.”<sup>40</sup>

Some people in Uzbekistan are convinced that the country should “introduce the latest innovation technologies”<sup>41</sup> based on the already elaborated strategic program for 2009-2014. The projects comprise about 450 investment documents related to the fuel and energy sphere, chemical, metallurgical, light and textile industries, and other economic branches totaling over \$24.0 billion; about \$18.5 billion of the total will be spent on new facilities, while about \$6.0 billion will cover the cost of modernization, reconstruction, and technical and technological retooling.

President of Kyrgyzstan Bakiev has pointed out: “Those who manage to master the innovation model of post-crisis development better and faster than the rest will win.”<sup>42</sup>

President of Tajikistan Rakhmon believes that “the time has come to change the education system.” He suggested that “starting in September 2014, all secondary schools should be transferred to a new general education system in order to join the global general education sphere.”<sup>43</sup> The Tajik pres-

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<sup>37</sup> E. Paneyakh, “Resursnoe gosudarstvo” Simona Kordonskogo: zametki na poliakh,” 5 March, 2009, available at [<http://www.liberal.ru/articles/cat/4212>].

<sup>38</sup> See: “Novosti konferentsii,” 17 September, 2009, available at [[www.yaroslavl-2009.ru](http://www.yaroslavl-2009.ru)].

<sup>39</sup> N. Nazarbaev, “Vystuplenie na otkrytii III sessii Parlamenta RK chetvertogo sozyva.”

<sup>40</sup> N. Nazarbaev, “Piaty put,” *Izvestia*, 22 September, 2009.

<sup>41</sup> I.A. Karimov, op. cit.

<sup>42</sup> K. Bakiev, “Reforma obrazovania natselena na ukreplenie nezavisimosti i budushchee strany,” 10 June, 2009, available at [[www.president.kg](http://www.president.kg)].

<sup>43</sup> E. Rakhmon, “Poslanie Majlisi Oli,” 15 April, 2009, available at [[www.president.tj](http://www.president.tj)].

ident is convinced that exact sciences, thinking in technical terms, high technology, and an informational world outlook have become the factors that move the economy and shape the future.<sup>44</sup>

Investments should obviously be channeled into the cities that have specific technical and technological potential.

In Kazakhstan, for example, Almaty is the most promising city, though in the future Kostanay, Pavlodar, and Karaganda may also become fairly attractive. There are plans to set up technopolises, free scientific zones, bio-agro ecolises, etc.

## **Farmers: A Halleluiah rather than an Epitaph to the Middle Class**

In the future, Uzbekistan is resolved to realize a “wide range of long-term and closely related measures designed to radically improve the standard of living and image of the countryside; to develop the social and production infrastructure on a priority basis; to revise in the most radical way the status, role, and importance of property owners, entrepreneurship and small businesses; and to extend all types of support to farmers.” The republic is busy “upgrading the sustainability and, most important, efficiency of farmsteads,” since “weak farmsteads are unable to acquire the necessary machinery or be sufficiently liquid; they cannot be described as solvent and, most important, they are unable to cover their expenses and create profits to become a reliable source of growing profits.”<sup>45</sup>

According to the president of Tajikistan, the country should “master the latest achievements of science and technology on a great scale and in all fields; start using arable land as rationally and efficiently as possible, and take all possible measures to grow and store high-grade seeds of high-yielding plants, wheat in particular.”<sup>46</sup>

In the other Central Asian and Caucasian countries, agricultural reforms are coordinated with their industrial development.

The middle class has grown poorer—this is described as one of the negative impacts of the global financial and economic crisis. One of the documents of the International Red Crescent says: “[A] sizable number of people in the middle class within the European Union and Central Asia are struggling to meet life’s basic needs.”<sup>47</sup>

This means that after the crisis the middle class—entrepreneurs and farmers—should become the main target of socio-economic reforms.

## **General Strategy for the Post-Crisis World: “Harmony is the Key to Prosperity”**

According to the U.N., there are several major elements in the common strategy to overcome the crisis and shape the post-crisis world. They are:

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<sup>44</sup> See: E. Rakhmon, “Televizionnoe obrashchenie ko dnu gosudarstvennoy nezavisimosti,” available at [www.president.tj].

<sup>45</sup> I.A. Karimov, op. cit.

<sup>46</sup> E. Rakhmon, “Obrashchenie k zemledeltсам I narodu strany,” 27 July, 2009, available at [www.president.tj].

<sup>47</sup> *The Economic Crisis and Its Humanitarian Impact on Europe*, Testimonies from the Red Cross Red Crescent, October 2009, available at [www.redcross-eu.net].

- making responsible and sustainable use of limited natural resources;
- putting the economy back in its proper place in society;
- spreading democracy to all social relations and institutions;
- building a minimum ethos on the basis on multicultural exchange and the philosophical and religious traditions of peoples; strengthening a spiritual vision of the world.<sup>48</sup>

In one of his speeches President Rakhmon rightly pointed out that “a new fair arrangement of the contemporary world can be achieved not on the balance of power but on the balance of interests; not by seeking profits at the expense of others but seeking balance and consensus; not through unilateral claims and arbitrary rule but through mutual respect. These are the principles easily grasped by all reasonable people on the strength of experience accumulated throughout centuries.”<sup>49</sup>

President of Turkmenistan Berdymukhammedov believes that “there are no and should be no barriers where factors of good-neighborliness, territorial proximity, and spiritual affinity are complemented with honesty, straightforwardness, common sense, and transparent intentions, in short everything that has become especially precious during the world crisis and joint efforts to find a way out.”<sup>50</sup>

Some people in Central Asia believe that cooperation with and aid to the developing countries, “especially to the land-locked countries, should not add to their debt burden but, on the contrary, help them achieve sustainable development and strengthen their national potential to stand opposed to this and similar crises.”<sup>51</sup>

The fact that the Central Asian and Caucasian leaders involve experts in the public discussions can be described as highly positive. On the one hand, this invites the creative forces of civil society to provide an adequate response and thus be involved in a dialog; on the other, this is a channel through which political leaders can communicate with the nation in an emotional way.

The leaders of the Central Asian and Caucasian countries agree that in the new, post-crisis world, egoism and greed should be replaced with solidarity; the leaders of many other smaller countries, especially in Eurasia, agree with this.

To achieve a qualitatively new stage, that of “ethics of common good” based on respect for each and every individual, responsibility, and cooperation, the global economy should be enriched with universal ethical norms.

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<sup>48</sup> See: *United Nations Conference on the World Financial and Economic Crisis and its Impact on Development, New York, 24-26 June, 2009. Opening Session Address of H.E. Miguel D'Escoto Brockmann, President of the United Nations General Assembly*, available at [www.un.org/ga/econcrisissummit].

<sup>49</sup> E. Rakhmon, “Vystuplenie na 15-m zasedanii glav gosudarstv i pravitelstv stran Dvizhenia neprisoedinenia,” 16 July, 2009, available at [www.president.tj].

<sup>50</sup> “K itogam visita Prezidenta Turkmenistana v Iran,” 7 February, 2009, Electronic newspaper *Turkmenistan: The Golden Age*” available at [www.turkmenistan.gov.tm].

<sup>51</sup> “Kazakhstan prizval likvidirovat' bariery na puti tovarov gosudarstv, otrezannykh ot moria,” 20 October, 2009, available at [www.un.org].

## ON THE APPLICABILITY OF THE *UTI POSSIDETIS JURIS* PRINCIPLE DURING DELIMITATION OF THE CASPIAN SEA AMONG THE LITTORAL STATES

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### *Introduction*

One of the Caspian region's most problematic issues is determining the legal status of the Caspian Sea. The status of the Caspian Sea was first enforced in two agreements entered between Russia and Iran in 1921 and 1940. But the collapse of the U.S.S.R. and, as a result, the appearance of newly independent states on the Caspian coast (Azerbaijan, Kazakhstan, and Turkmenistan) led to a change in the existing legal, as well as political, positions in the region. This was partially reflected in U.N. documents.<sup>1</sup> The regime established as early as Soviet times no longer met the interests of the littoral states, particularly with respect to use of the economic resources of the Caspian's seabed and its contiguous waters, which made re-examination of the issue obligatory.

At present, the countries of the region are divided on this issue, upholding two radically opposing viewpoints.

<sup>1</sup> See: P. Tavernier, *Le statut juridique de la mer Caspienne: mer ou lac? La pratique des États vue à travers les docu-*

Iran's position, and to some extent Russia's, is based on the fact that the Caspian Sea is a lake, the legal status of which was defined by the agreements of 1921 and 1940 which should be considered valid until new agreements are entered on this issue (the condominium thesis). However, the new littoral states (Azerbaijan, Kazakhstan, and to a lesser extent Turkmenistan) refer to the legal mechanisms of territorial inheritance of the states based on the so-called *uti possidetis, ita possideatis* principle (as you possess, so may you possess), that is, the principle of succession of territories and boundaries.<sup>2</sup> It enforces the state's right to inherit the administrative borders they held at the time the colonial or totalitarian predecessor state collapsed.

In this article, we shall try to offer a legal analysis of the two above-mentioned positions, as well as examine the applicability of the *uti possidetis juris* principle to the littoral states.

*ments publiés par les Nations Unies, 1999, available at [http://www.ridi.org/adi/199910a1.htm#n2#n2], 11 February, 2007.*

<sup>2</sup> *Ibid.*, § 14.

## The Legal Status of the Caspian Sea: Past and Present

First it would be expedient to take a closer look at several basic geographical parameters of the Caspian Sea. It is located between 36°34' and 47°13' N and 44°18' and 52°24' E. It is divided into three



main basins: the first is the Northern Caspian with a depth of less than 100 meters and is part of the Volga Plain; the Middle Caspian, the so-called small Caucasian Depression, between 40° and 44° latitude, where the depth varies from 500 to 800 meters; and the Southern Caspian with a depth that reaches 1,000 meters. Due to the coastline vagaries, which depend on the changes in sea level, the area of the sea's surface fluctuates from between 380,000 to 430,000 sq. km. The average width amounts to 200 nautical miles, apart from the northern zone, which is more than 300 miles. The main activities in the sea are fishing and oil and gas production. The Caspian Sea serves as a direct communication network for some of the littoral states. For example, it is linked to the Black Sea by the Volga-Don Canal and to the Baltic via the Volga-Baltic Canal.<sup>3</sup>

Most researchers in the international law of the sea believe that from the legal viewpoint the Caspian is a lake and not a sea. For example, renowned French specialist in this sphere, Gilbert Gidel, believes that for the status of such water areas to be regulated by the international law of the sea, they must be freely and naturally connected with each other all over the globe. In so doing, the salt water basin called the Caspian Sea may be an entity of international relations since its coast is shared by several political regimes; however, it is not automatically governed by the regulations of the international law of the sea since it is not connected to the oceans.<sup>4</sup>

At the same time, the historical and, to a greater extent, oceanographic aspects, as well as the salt water composition and type of fauna and flora of the Caspian, reinforce the viewpoint of those experts who claim that this body of water is a sea.<sup>5</sup> Gilbert Gidel had the following to say about this: "...International law may only be applied by the tacit consent or a formal agreement among the littoral states which are essentially the only possessors of the right to dispose of these waters."<sup>6</sup>

The practice of delimitation in bodies of water shows that in the past it has been based on the consideration of common interests, which requires joint participation among the states involved in the use of mineral and fish resources, or carried out in compliance with the principle of fair division of their use. In the latter case, delimitation was carried out on the basis of a so-called equidistant median line. In so doing, the littoral states were to observe precautionary measures in order to protect each other's interests. Such an agreement could also include provisions that permitted only the littoral states to engage in free shipping, as well as provisions on establishing international cooperation in the border zones.

The status of the Caspian Sea is still undetermined and unrecognized by the littoral states and by the international community as a whole.<sup>7</sup>

## The Age of the Russian Empire

On 13 February, 1729, the Russian Empire and Iran signed the Treaty of Resht, which regulated their relations in the Caspian. It demarcated and ceded to Russia some Persian territories, and provided for freedom of commerce and navigation on the Caspian and the Araks and Kura rivers.

<sup>3</sup> See: D. Allonsius, *Le régime juridique de la mer Caspienne. Problèmes actuels de droit international public*, L.G.D.J., Paris, 1997.

<sup>4</sup> See: G. Gidel, *Le droit international public de la mer*. Tome I. Chateauroux: Etablissements Mellottée, 1932, p. 40.

<sup>5</sup> See: E. Franckx, "Maritime Delimitation in the Caspian Sea: Legal Issues," *China Oceans Law Review* 2006, No. 1, p. 2.

<sup>6</sup> G. Gidel, *op. cit.*, p. 48.

<sup>7</sup> See: R. Meese, "La Mer Caspienne: Quelques problèmes actuels," *Note d'actualité*, RGDIP 1999/2, p. 5, available at [<http://members.aol.com/Rmeese75/Caspiennefinal.htm>], 11 February, 2007.

The rise in the Russian Empire's economic and military might in the 17th century disrupted the balance between these Caspian nations. After nine years of uninterrupted wars, Russia gained control over Northern Persia. In compliance with the treaties of Gulistan and Turkmanchai signed in 1813 and 1828, Russia retained the exclusive right to navigation of its military fleet in the Caspian. The Treaty of Turkmanchai determined the land boundaries between the two countries, as well as the ownership of several disputed islands in the Caspian. It also granted both Russia and Iran equal rights of navigation of their commercial fleets and reiterated Russia's earlier right to sail its military fleet in the Caspian Sea.<sup>8</sup>

## The Age of Azerbaijan's Independence (1918-1920)

When examining the historical context of this problem, some authors tend to overlook the period of independence of the Azerbaijani Democratic Republic (ADR) in 1918-1920. In 1920, it was occupied by Soviet Russia and after 1922, when the Soviet Union was formed, the second colonial period began.

From this it can be concluded that during its albeit short existence at the beginning of the 20th century, the ADR, in compliance with the *uti possidetis juris* principle, took advantage of its right to possess the sea and land territories defined by the previous boundaries between the Russian Empire and Iran established by a decision of the 1881 border commission (the Russian-Iranian boundary in the Caspian joined the end points of the land borders of the Russian Empire [later the Soviet Union] and Iran contiguous to the sea, that is, in the city of Astara from the eastern and in Gasan-Kuli from the western part of the sea).<sup>9</sup>

We will remind you that this principle was first applied during the decolonization of Central and South America. For example, the states that formed there after decolonization adopted the administrative boundaries (i.e. the boundaries of the vice kingdoms and provinces) that previously existed between the Spanish colonies. For South America these were the boundaries established in 1810, and for Central America the boundaries of 1821.<sup>10</sup>

The *uti possidetis* principle, which was later also applied to the African countries, referred to land borders. But its legal sphere also includes islands, seas, and, what is most interesting, internal water bodies and lakes.<sup>11</sup> For example, this principle was first used to determine maritime boundaries in the decision of the Hague court regarding the Guinea against Guinea Bissau case of 1985 (delimitation in the Sea of Alcatraz), as well as in the court decision regarding the Salvador against Honduras case of 1992 (delimitation in the mouth of the Goascoran River).<sup>12</sup>

<sup>8</sup> See: E. Franckx, A. Razavi, "The Problem of Delimitation in the Caspian Sea," in: *Proc. of Int. Symposium on the Problems of Regional Seas, 12-14 May, 2001, Istanbul-Turkey*, p. 2.

<sup>9</sup> See: R. Meese, op. cit.

<sup>10</sup> See: J. Salmon, *Droit des Gens*. Tome II. Édition partiellement revue par E. David, Bruxelles: Presses Universitaires de Belgique, 20ème édition, 2006-2007, p. 256.

<sup>11</sup> See: Nguyen Hong Thao et Préface de Laurent Luccini, *Le Vietnam et ses différends maritimes dans la mer de Bien Dong (Mer de Chine Méridionale)*, Paris: Editions A. Pedone, 2004.

<sup>12</sup> See: *Collection of Decisions of 1992 of the International Hague Court—C.I.J., Affaire El Salvador/Honduras*, fond, 11 Septembre 1992, Recueil 1992, p. 558, par. 333, p. 559, par. 385, p. 598, par. 400; R.G.D.I.P., 1985, § 40, p. 503, la sentence arbitrale du 14 février 1985 dans l'affaire de la Délimitation de la frontière maritime Guinée/ Guinée Bissau.

## The Soviet Age

According to the Moscow Treaty of 26 February, 1921 between Iran and Soviet Russia, the latter declared the conventions and treaties signed between the czarist regime and Iran null and void. At the same time, a decision was made to retain the Russian-Persian boundaries (both land and sea) established by the decision of the 1881 commission.

It was precisely during re-examination of the Moscow Treaty that experts first became extremely interested in the legal status of the Caspian Sea. The third article of this treaty reads: "Talks at the highest level led to the boundary determined by the border commission of 1881 being accepted by both sides, that is, by Russia and Iran, as the maritime boundary between the two states. This boundary must be protected and be inviolable." Here we are talking specifically about the Astara–Gasankuli boundary.

The treaties On Commerce, Navigation, and Regulation and On Commerce and Navigation signed in 1940 also confirmed that the Caspian Sea belonged to the Soviet Union and Iran.

Between 1921 and 1991, the Soviet Union and Iran regarded the Caspian as a lake, the legal status of which was regulated by the above-mentioned agreements, as well as by the internal legislation of these countries. Correspondingly, its resources were recognized as the exclusive property of these countries.

## The Collapse of the Soviet Union and Formation of New States

After the collapse of the Soviet Union in 1991, the number of Caspian states increased from two to five (Azerbaijan, Kazakhstan, Iran, Russia, and Turkmenistan). Russia and Iran recognized the existence of the community of littoral states as the basis for present and future legal settlement of the Caspian question. At that time, they adhered to the condominium principle, recognizing the legality of all the treaties signed between them prior to the signing of new ones.

Russia's position was clearly set forth in a letter by Russian Permanent Representative to the U.N. and now Russian Minister of Foreign Affairs Sergey Lavrov to the Secretary General of 1994, which was published as a United Nations document: "The Caspian Sea lacks a natural link to the world's ocean and seas and is thus a land-locked body of water. The norms of international maritime law, particularly those pertaining to a territorial sea, exclusive economic zone and continental shelf, are not applicable to it. There is thus no basis for unilateral claims relating to the establishment of zones of this type in the Caspian or for the introduction of elements of their regimes..."<sup>13</sup> It should be noted, however, that the geopolitical and economic processes in the region had made radical adjustments to this position by the end of the 1990s.

Azerbaijan, Kazakhstan, and Turkmenistan note in their letters to the U.N.<sup>14</sup> that the Russian-Iranian agreements do not apply to them, but that a qualified interpretation of these agreements could

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<sup>13</sup> Letter from Permanent Representative of the Russian Federation at the United Nations of 5 October, 1994 to the Secretary General. Numbered A/49/475, available at [<http://daccessdds.un.org/doc/UNDOC/GEN/N94/386/79/PDF/N9438679.pdf?OpenElement>].

<sup>14</sup> Letter from Kazakhstan and Turkmenistan to the U.N. numbered A/52/93 of 17 March, 1997, available at [<http://daccessdds.un.org/doc/UNDOC/GEN/N97/072/44/PDF/N9707244.pdf?OpenElement>]; also letter from Kazakhstan numbered A/52/424 of 3 October, 1997, available at [<http://daccessdds.un.org/doc/UNDOC/GEN/N97/262/63/PDF/N9726263.pdf?OpenElement>], etc.

be adopted. The position of these countries is based on the right of the states to territorial succession based on the principle of continuity of territorial inheritance—*uti possidetis*. This was followed by intensive talks at the bilateral and multilateral levels during which many documents were signed,<sup>15</sup> which however did not lead to establishing a balanced legal regime in the Caspian basin.

## Applicability of the *Uti Possidetis* Principle to the Newly Independent Caspian States

So, according to the indicated principle “*uti possidetis, ita possideatis*” (as you possess, so may you possess, that is, succession, continuity of the right to territorial property),<sup>16</sup> the colonial borders must be respected and preserved even after new states acquire their independence. In the classical interpretation it applies to the demarcation of land borders. Later, this principle was also applied to other spheres, such as islands and seas.<sup>17</sup> But the most interesting thing is that the principle was also later successfully applied to internal waterways and lakes, such as the Caspian.<sup>18</sup>

We will note that in contrast to most of the classical situations, the appearance of new states after decolonization is usually a disruptive rather than smooth process with respect to inheriting the obligations adopted by the predecessor state. In other words, in this situation, the principle of discontinuation sooner predominates, or the so-called “*tabula rasa*” principle. This means that the successor state is not the successor of the predecessor state since the latter continues to legally exist, that is, the successor state must begin everything from scratch. Nor does the successor state hold responsibility for treaties signed by the predecessor state, apart from those that it accepts of its own accord.<sup>19</sup>

As of today, the *uti possidetis juris* principle is based on a solid legal foundation. The applicability of this principle and of colonial law is determined by the situation that has developed at the time the colonial state collapses. “International law, and correspondingly the *uti possidetis* principle, is applied to the new state from the moment of its formation as a state and does not have an inverse effect. The *uti possidetis* principle freezes the territorial status, just as a clock stops time from moving forward.”<sup>20</sup> In other words, the countries that have become independent establish their borders on the

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<sup>15</sup> The Agreement on the Division of the Contiguous Areas of the Caspian Sea Signed between Azerbaijan and Russia on 23 September, 2002; The Agreement on the Division of the Ground of the Caspian Sea signed between Azerbaijan and Kazakhstan on 29 November, 2001 and the Protocol of 27 February, 2003 Applied to It; The Agreement on the Division of the North Part of the Caspian Sea Signed between Russia and Kazakhstan on 6 July, 1998 for the Application of the Sovereign Rights in the Utilization of the Ground of the Sea and the Protocol of 13 May, 2002 Applied to It; The Agreement on the Intersection Point of the Division of the Contiguous Areas of the Caspian Sea Signed between Azerbaijan, Kazakhstan and Russia on 14 May, 2003; The Framework Convention on the Environmental Protection of the Caspian Sea Signed in Tehran on 4 November, 2003; The First Meeting of the Caspian States on the Development of the Draft Protocol on the Protection of the Caspian Sea from the Pollution from the Onshore Establishments and Activities of the Framework Convention on the Environmental Protection of the Caspian Sea was Held in Ashgabat on 24-25 January, 2005, available at [<http://www.cpf-az.org/cgi-bin/e-cms>].

<sup>16</sup> Nguyen Hong Thao et Préface de Laurent Luccini, op. cit., p. 162.

<sup>17</sup> See: *Collection of Decisions of 1992 of the International Hague Court—C.I.J., Affaire El Salvador/Honduras*, fond, 11 septembre 1992, Recueil 1992, p. 558, par. 333, p. 559, par. 385, p. 598, par. 400.

<sup>18</sup> See, for example: Nguyen Hong Thao, op. cit.

<sup>19</sup> See: J. Salmon, op. cit., p. 347.

<sup>20</sup> *Collection of Decisions of the International Hague Court of 1986—C.I.J., Affaire du différend frontalier Burkina Faso/Mali*, fond, 22 décembre 1986, Recueil 1986, p. 568, par. 30.

basis of those that existed at the time the colonial state collapsed. Moreover, the “*uti possidetis* principle is not a ‘panacea from all ills,’ applicable in all circumstances that develop on the border line.”<sup>21</sup> It does not exclude changes in boundaries in those places where they were undefined or in those cases when both sides are in agreement. We will note that the application of *uti possidetis* should correspond to general principles based on the fact that a legal event should be viewed through the prism of the legal regime in effect at the time the event occurred.<sup>22</sup> In other words, *uti possidetis* should be interpreted within the framework of intertemporal law (*le droit intertemporel*.—Fr.), that is, the correct interpretation of administrative colonial acts, for example, should be adhered to.

As noted, signing of the Moscow Treaty of 1921 between Iran and the R.S.F.S.R. led to the set of agreements and conventions signed during the czarist age being declared null and void. All the same, the sides reached a mutual agreement on retaining the boundaries (both land and sea) established in 1881. The Treaty on Commerce and Navigation signed between the two countries on 25 March, 1940 in Tehran did not even mention borders. This document envisaged the right to transit of those commodities that crossed Iran or Russia and were intended for third countries, as well as the right to navigation of the military and commercial fleets of both countries. In addition, these countries pledged to prohibit use of the sea by third states and their subjects. So a maritime boundary between the Soviet Union and Iran has always existed. And this is the boundary Azerbaijan and Turkmenistan inherited in 1991 on the basis of sectoral delimitation.

So we can conclude that the delimitation of administrative and territorial boundaries established in the Caspian in 1970 by a decision of the U.S.S.R. Ministry of the Petroleum Industry according to the median line principle based on the method of equidistance and forming the corresponding sectors of the sea for the littoral states—Kazakhstan, Azerbaijan, Russia, and Turkmenistan—shows the legality of applying the *uti possidetis* principle to the U.S.S.R. successor states and even Iran, due to the tacit consent of the latter. We will remind you that Iran has never objected to the median line principle the Soviet Union officially offered it in 1970.

The practice of Soviet-Iranian relations in the Caspian after division of its northern sector according to the median line principle in 1970 clearly shows that these countries were happy with the existing situation, had no objections and disputes, and cooperated very closely with each other right up to the collapse of the Soviet Union.

Even after decolonization, all the successor states accepted the previous administrative and territorial boundaries established according to the median line principle. This conclusion can be drawn on the basis of the Joint Communiqué of 27 February, 1997, in which Kazakhstan and Turkmenistan declared that until a corresponding convention on the status of the Caspian Sea is entered, they will accept administrative and territorial division of the boundaries according to the median line principle.<sup>23</sup> Azerbaijan also suggested that, in the meantime, exclusive zones be created in the Caspian for each of the littoral states, and that the space beyond these zones be considered common property.

On 6 July, 1998, keeping in mind that the existing legal status of the Caspian does not meet the emerging needs and does not allow for precise regulation of relations among the littoral states, the Russian Federation and Kazakhstan signed a treaty on division of the seabed in the northern sector in order to fully realize their rights to use of its mineral resources. *This treaty on division was the first to recognize the demand of one of the newly formed independent states to part of the Caspian Sea, with respect to which it can be concluded that from this time on the thesis of equal division of all the Caspian’s resources (which was referred to in the Soviet-Iranian agreements) among the littoral states*

<sup>21</sup> M.G. Kohen, *L’uti possidetis revisité: l’arrêt du 11 septembre 1992 dans l’affaire El Salvador/Honduras*, RGDIP, 1993, p. 942.

<sup>22</sup> See: *International Law Reports*, 1951, p. 161 et s. ICLQ, 1952, p. 247.

<sup>23</sup> See: Letter from Kazakhstan and Turkmenistan A/52/93 (of 17 March, 1997), sheet of documents distributed in the U.N.

can by right be considered invalid. It clearly distinguished between issues relating to dividing the Caspian's subsoil and to determining its legal status.

According to this treaty, the bed of the northern part of the Caspian and its subsoil shall be divided among the sides in compliance with the median line principle, which with the mutual consent of all sides was modified on the basis of equidistance. Joint use of the surface waters guarantees the freedom of navigation, adherence to fishing regulations, and protection of the maritime environment.<sup>24</sup> The document clarifies several technical specifications for drawing the modified median line, for example, depending on the water level in the Caspian. It also envisages those cases when the modified median line crosses potential deposits, as well as cooperation in developing export oil pipelines and the use of river routes. Its conclusion notes that questions relating to free navigation of the sea's waters and flights over it, the laying and use of cables and underwater pipelines, as well as all other means of use of the Caspian Sea, will be regulated by bilateral and multilateral treaties between and among the littoral states based on the Convention on the Legal Status of the Caspian, when such is adopted.

### *Conclusion*

At present, the sovereign rights of the littoral Caspian states are still undetermined, which not only hinders use of the Caspian's natural resources and the subsequent economic development of the littoral states, but could also cause acute regional conflicts.

The actual activity of the Caspian states over the past 20 years, as well as the fact that the condominium thesis Iran insists on is no longer the best alternative for resolving issues not regulated by historical agreements,<sup>25</sup> make it possible to conclude that the *uti possidetis juris* principle can legitimately be applied to sectoral division of the sea.

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<sup>24</sup> See: *Documents d'actualité internationale* n° 19. 1<sup>er</sup> octobre 1998, pp. 746-747.

<sup>25</sup> See: E. Franckx, *op. cit.*, p. 37.



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