

# Economic Cooperation in the South Caucasus and the Wider Region: Gained Losses, Lost Benefits

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The past two and a half decades in the South Caucasus leave little hope to entertain for the eventual integration of the region. The different integrational processes and transnational alliances that the South Caucasus countries have engaged in surely contribute to the creation of new spaces for cooperation, but also to the perpetuation of the conflicts in the region. In fact, often conflicts have been defining the design and implementation of these transnational alliances and integrational processes. With this reality, regional transnational integration as an avenue for conflict resolution seems to be part of a vicious circle since conflict resolution is often seen as a precondition for regional integration.

This paper aims to explore economic options for inserting a wedge in this vicious circle. Convinced that regional economic cooperation could be an important step towards conflict transformation in the South Caucasus, this paper suggests that the prospects of such integration be considered. Be it in the form of exploring opportunities in the different integrational paths that the countries of the South Caucasus have taken or challenging the isolationist economic policies that have outlived their goals and utility, this paper offers all stakeholders to look at economic cooperation *with* rather than *against* each other as the option that could lead to the resolution of conflicts in the region.

## Introduction

Today, two and a half decades after the Belavezha Accords, discussions about the disintegration of the common Soviet space often evolve around the range of losses suffered and the depth of different fractured ties – cultural, infrastructural, and economic. As the authors of this paper, we focus on the concrete economic gains emerging from transnational cooperation – and the losses due to the absence of such cooperation – in the post-Soviet space and beyond the borders of the former Union of Soviet Socialist Republics (USSR). More specifically, we analyze the potential socio-economic benefits of regional cooperation and the related lost opportunities for post-Soviet Armenia, Azerbaijan, and Georgia as well as in the wider context regarding Russia, Turkey, and Iran.

We depart from the premise that disintegration and integration are ongoing parallel processes: new alliances are created on the ruins of old ones. The new ones – that is the post-Soviet economic and political unions or forms of regional and transnational cooperation – can be either narrower or wider in both geography and scope than the previous ones. The Eurasian Economic Union (EAEU), the Eurasian Economic Space and the Eurasian Customs Union, the Organization for Democracy and Economic Development (GUAM), and the Commonwealth of Independent States (CIS) often are not only amorphous, but also narrower than the Soviet Union, and much narrower than the Eastern Bloc and the Council for Mutual Economic Assistance (CMEA). However, many post-Soviet countries cooperate with and join different, often very wide alliances – the Brazil, Russia, India, China and South Africa (BRICS) association, the North Atlantic Treaty Organization (NATO), the EU, the World Trade Organization (WTO), the Organization of Islamic Cooperation (OIC), and others. The South Caucasus countries also enter these types of relations that are often intersecting or even mutually exclusive. The instances of such cooperation point out to another effect of the collapse of the Soviet Union: one set of opportunities has been replaced with another, and options and forms of transnational and economic cooperation, perhaps, have become even more diverse.

This paper discusses the current situation, as well as the prospects for regional cooperation and integration in an environment where many conflicts rend the South Caucasus region contributing to the popularity of isolationist policies and often determining the principles of economic cooperation. Under the concept of regional integration, we imply a process in which states voluntarily come together for an institution that provides economic, political, social, and security

benefits, and the integration level can range from a simple free trade agreement to a full political union. While the benefits and motivations can vary in different contexts, we underline the possible contribution of economic integration to conflict transformation in the South Caucasus. This stand can be traced back to Kant: economic interdependency between countries is effective for preventing conflicts and might contribute to conflict resolution (Domke 1988), (Polachek and McDonald 1992), (Oneal and Russett 2000).

Not surprisingly, our analysis shows that the South Caucasus countries together with their neighbors Turkey, Russia, and Iran are not moving in the direction of voluntary integration. Most transnational projects implemented after the collapse of the Soviet Union have been focused not only on the creation of new spaces for economic cooperation, but also on serving conflicts. Conflicts have been defining the principles of implementation and the design of regional projects. The majority of the implemented or envisioned transnational projects are perpetuations of conflicts through economic means. They entail not only cooperation “with” but also cooperation “against” others. In our opinion, two and a half decades during which the main criteria for economic cooperation were often determined by conflicts show that this approach is not conducive to conflict resolution or transformation in the region.

Instead of conflict transformation, we have been observing a dynamic wherein conflicts deepen and become ingrained due to decreased pragmatic economic interest toward neighbors. Besides, the quality of life of a significantly large portion of the South Caucasus population remains disappointingly low. In the meantime, resources needed for socio-economic development are spent on carrying out policies of economic isolation of the “enemies,” and thus the cost of the economic projects increases.

The governments of the South Caucasus countries<sup>1</sup> pay far more attention to the development of the “defense” industry that is serving conflicts than to health care, education, or the creation of sustainable systems of social guarantees. The militarization of the region is growing at the expense of quality of life, because cooperation in the military sphere and trade in arms absorb significant financial resources. At the same time, conflicts remain unresolved, while the resources needed for their transformation are running out.

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<sup>1</sup> In a sense, this statement can also be attributed to Russia, Turkey, and Iran, with a caveat of significant differences among these countries.

<sup>2</sup> We used quotation marks for this term simply because the “defense” industry is easily transformed into a system that serves offensive, and even expansionist goals.

We acknowledge that regional integration as an avenue for conflict resolution seems to be part of a vicious circle since often conflict resolution is seen as a precondition for regional integration. The history of the past two and a half decades makes us think that integration for the South Caucasus is impossible in the near future due to the conflicts within and among the states, along with complex and sometimes strained relations with the big neighbors – Turkey, Iran, and Russia. Convinced that regional economic cooperation could be an important step towards conflict transformation, we suggest that the prospects of such integration be considered. Therefore, what follows is an attempt to assess the current situation, identify the most problematic and most promising areas of economic cooperation, and offer some recommendations.

## **Socio-economic and conflict context: After the USSR collapse**

Following the dissolution of the Soviet Union, the South Caucasus experienced a full economic fragmentation. The cooperation chains of enterprises and people-to-people contacts dramatically decreased not only between faraway regions of the former Soviet Union but also between neighboring republics, in which the political elites were vigorously engaged in building ethnically-defined nation-states and the struggle for domination over the economic resources of the newly independent states. In the South Caucasus, these processes were exaggerated by nationalistic rhetoric and policies that led to violent conflicts.

One of those conflicts has been over the Nagorno-Karabakh region between Armenia and Azerbaijan, as a consequence of which the borders between the countries were sealed off in the early 1990s. Turkey closed the rail and air connections with Armenia and halted the transit of humanitarian aid through its territory to Armenia in 1993.<sup>3</sup> Today, Armenia has two “gates” to the world – Georgia to the north and Iran to the south. These “gates” are largely inappropriate for the establishment of regional economic cooperation and the implementation of transnational projects. Out of the 1,500 kilometers of land

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<sup>3</sup> Prior to this and also in the Soviet period, Turkey and Armenia were connected only through the Kars-Gyumri railroad; the land border was generally closed. In early 1993, Turkey allowed the transit of international humanitarian aid to Armenia through its territory at the Doğu Kapı-Akhourian crossing (Gültekin Punsmann, Simão and Tavitian, *The Closed Armenia-Turkey Border: Economic and Social Effects, Including Those on the People; and the Implications for the Overall Situation in the Region* 2007).

border that Armenia shares with its four neighbors, only about 250 kilometers are open for transnational economic relations. All parties involved in this conflict have demonstrated commitment to practicing political and cultural isolation of the neighbors for more than twenty years now. The readiness of political regimes in Azerbaijan, Turkey, and Armenia to live with closed borders outweighs the desire to find mutually acceptable avenues for conflict resolution or transformation. Hence, Armenia was excluded from large transnational projects, and the desire of each party to unilaterally get what they want particularly using economic leverages was put above the obvious prospects for effective regional economic cooperation.

Armenia has well-established relations with Georgia and their current economic ties are crucially important for Armenia, as Georgia is the main transit country for Armenia. Iran and Armenia have developed energy and trade cooperation even though Armenia's major trade and economic partners for either state or private business actors are Russia, the EU, the US, and Turkey. With an active flow of remittances and investments from Russia, its role in Armenia's economy is major. Recently Armenia deepened its economic integration with Russia within the framework of the EAEU along with Belarus, Kazakhstan, and Kyrgyzstan. In this context, Armenia could potentially benefit from new opportunities gaining access to the EAEU markets. On the other hand, Armenian businesses have almost one-sided economic relations with their Turkish counterparts. Goods from Turkey enter Armenia, but no major trade flows are going from Armenia to Turkey.

Azerbaijan borders Kazakhstan and Turkmenistan via the Caspian Sea and it has land borders with Georgia, Russia, Iran, Armenia, and Turkey. Azerbaijan has the richest hydrocarbon reserves in the region and therefore plays an important role in major energy projects. Access to these resources explains the Azerbaijani regime's claim for a leading role in the South Caucasus and its attempts to influence the policies of the big neighbors, particularly those of Turkey. Its share in the cumulative gross domestic product (GDP) indicators of the South Caucasus countries in 2015 was 74.2 percent (Central Intelligence Agency 2015). Although the drop in oil prices in 2015 and the devaluation of the national currency had an impact on these figures, the economic weight of Azerbaijan in the South Caucasus remains significant.

Azerbaijan's cooperation with Georgia and Turkey is focused on natural resources and excludes Armenia due to the Nagorno-Karabakh conflict. The closed borders also have an inverse effect on Azerbaijan. Its border with Armenia is one of its longest and constitutes an easy and the most economically

viable route to Turkey – its biggest political and economic partner. The impact of conflicts and geopolitics on the economy was clearly reflected on the largest transnational economic project of the post-Soviet period – the Baku-Tbilisi-Ceyhan (BTC) oil pipeline running from Baku, bypassing both Russia and Armenia, via Georgia to Turkey. The option to have the pipeline run through Iran, which was “the most economically effective,” was not seriously considered due to strained relations between the United States (US) and Iran (Starr and Cornell 2005). In addition, the impermeable border between Armenia and Azerbaijan is the biggest obstacle for communication with the Nakhchivan Autonomous Republic – Azerbaijan’s enclave sandwiched between the borders of Armenia, Iran, and Turkey.

One would assume that the conflict between the neighbors and, as a result, the closed borders with Armenia, as well as the complex geopolitical relations among the US, the EU, Russia, and Iran, would put Georgia in a preferential position. Indeed, Georgia plays an important role in the socio-economic relations of the South Caucasus since it is the transit country for regional transport and energy projects. Currently, Georgia has substantial socio-

economic cooperation with all neighboring countries, even Russia. However, Georgian external economic relations are strongly affected by the Abkhazian and South Ossetian conflicts and political confrontation with Russia that intermittently result in closing the lucrative Russian market for Georgian products. In addition,



another source of constant tension is that part of the Baku-Supsa oil pipeline passes in the immediate proximity to the boundary line with South Ossetia established after the August 2008 war. Consequently, conflicts and complex geopolitical relations have a significant impact on the implementation of economic projects in Georgia as well. They are a serious obstacle to the development of both the country and regional cooperation.

Turkey conceives the South Caucasus as an energy-rich region, which also provides access to new markets including those in Central Asia. Turkey needs the energy resources of the region to meet its growing demand. Its contribution to the international projects is significant for the South Caucasus countries and

includes opening the Caspian energy reserves to the West<sup>4</sup>. Turkey is also a major trade partner for all countries in the region. Turkey's relations with Armenia and the future of the borders depend on the progress of the Nagorno-Karabakh peace process and relations with Azerbaijan. Turkey recently engaged in a confrontation with Russia stemming from their conflicting policies in Syria, and this tension is thus a negative factor hindering regional cooperation.

Russia also influences the establishment of transnational economic ties. Russian experts and policy-makers traditionally consider the South Caucasus as a geo-strategically critical region for defending the country's southern borders from security threats derived as both direct and side effects of the dynamics in the Middle East and in global politics. Russia's corresponding securitization policies have determined its keen attention to the political and economic developments in the South Caucasus republics as well as in Turkey, a neighboring political power with its own strategic considerations towards this region. In addition to the efforts aimed at maintaining its military and political presence, Russia strives to preserve and possibly enlarge its economic influence on all three ex-Soviet republics in the region. At the same time, Turkish-Russian, as well as Russian-Iranian, relations have their own dynamics that do not always consider the developments in the South Caucasus, but they certainly and greatly affect them.

The Russian military industry gets significant dividends from the Nagorno-Karabakh conflict by supplying weapons to all political actors involved. In a period of high oil prices, Azerbaijan even became one of the largest buyers of arms in Europe. Moreover, conflicts have pushed the South Caucasus republics to actively participate in "the politics of sanctions and blockades." In many cases, the local regimes were the initiators of such policies in the early 1990s in order to oppose each other in the conflict dynamics. Thus, the political elites who control the South Caucasus republics show no desire to create a common regional economic space. Twenty-five years since gaining independence this policy has demonstrated its inadequacy, assuming that the main goal of all the actors involved was the resolution or transformation of the conflicts. In that case, counterproductively, conflicts in the region were not resolved and deepened even further.

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<sup>4</sup> Reference to such civilizational constructs as "East" and "West", the authors do not seek to reproduce orientalist categories, but only refer to the vocabulary of certain economic projects, as used by the actors engaged in their implementation.

Against this backdrop, we analyze the main areas of cooperation, the challenges and the suggestions for solutions. We believe that the potential socio-economic benefits of regional cooperation, and the actual losses without them, might be valuable incentives for regional integration attempts by the South Caucasus countries to prevent further conflicts and resolve the existing ones. In the following section we analyze the main cooperation areas in the region – trade and investments, energy and transportation projects, education, tourism, agriculture, and defense industry. In the final sections, we make recommendations to advance the cooperation.

## **Cooperation ‘with’ and ‘against’: Main transnational cooperation areas in the region**

### **Trade and investments: Despite conflicts and because of them**

Despite the declining economic and political influence on the regional processes after the dissolution of the Soviet Union, Russia remained actively involved in the conflicts in the South Caucasus as a key broker between the conflicting parties. The gradual return of Russia’s economic power to the region began with the recovery after the devastating crisis in the 1990s thanks to the new economic policies underpinned by high prices on energy resources. At the same time, Russia’s private and state-run corporations managed to acquire considerable shares in some vital sectors of these countries’ economies.

Armenia is a salient example of Russia’s widespread economic presence in an ex-Soviet republic. Russia is Armenia’s main trade partner: in 2014, the foreign trade turnover between the two countries amounted to \$1.43 billion, of which \$1.12 billion were from Russia’s exports and \$308 million were from Russia’s imports (National Statistical Service of the Republic of Armenia 2015). Armenia’s membership in the EAEU came into force on January 2, 2015, and the possible benefits to trade relations between Russia and Armenia resulting from this development are yet to be seen. The EAEU became a key factor of economic relations for Armenia with any non-EAEU country. Now, Armenia must follow the EAEU rules when developing any relations, especially trade-related ones, and the Armenian legislation is being reformed to correspond to the EAEU regulations.

Russian companies are the main foreign investors in Armenia. The Russian state-run corporations such as Gazprom and, until recently, Inter RAO UES,



have dominated the energy sector of the country's economy. In 2014, Gazprom purchased the remaining 20 percent of shares of ArmRosGazprom and became the sole owner of the company. Eventually, Gazprom Armenia grew into a backbone energy organization in Armenia. In addition to energy distribution, Gazprom is involved in the reconstruction of the Armenian energy facilities. A similar situation is present in the sectors of telecommunications, banking, transportation, and heavy industry. Russia's VimpelCom took possession of all assets of the national communications operator ArmenTel; VTB Bank took over Armsberbank, one of the country's leading banks; Russian Railways is conducting concession management of Armenian Railways; and the Russian aluminum company Rusal runs one of the largest industrial enterprises in Armenia, Rusal Armenal, which is the only producer of aluminum foil in the Caucasus and Central Asia (Ministry of Economic Development of the Russian Federation 2015).

Although there are no diplomatic relations between Armenia and Turkey and the borders are closed, Turkish businesses are important trade partners for their Armenian counterparts. The imports from Turkey to Armenia were at \$232 million in 2014 according to Armenia's official statistics (National Statistical Service of the Republic of Armenia 2015). Because of the closed borders, trade, which mainly means imports to Armenia from Turkey, is happening through Georgia and Iran. There is no embargo on Turkish goods in Armenia so the rules of demand ensure the flow of goods to Armenia. Turkish businesses became the fourth trade partner of their Armenian counterparts in terms of imports to Armenia in 2014 (National Statistical Service of the Republic of Armenia 2015).

Imports from Armenia to Turkey are low and are conditioned by the absence of a trade agreement between Turkey and Armenia, which would allow Armenian trucks to unload in Turkey without special permits. Since no diplomatic relations exist, requesting such permits is not possible. An alternative way would be a direct request from Armenia's Ministry of Transport and Communications to the Ministry of Transport, Maritime Affairs and Communications of Turkey (Turkish-Armenian Business Development Council 2013). However, such a request has not been placed perhaps because of Armenia's reluctance to reach out in the absence of proper diplomatic relations. At the same time, the Armenian Customs Service data and Armenia's official statistics demonstrate that in 2014 goods were exported from Armenia to Turkey in the amount of \$1.5 million via Georgia or Iran (National Statistical Service of the Republic of Armenia 2015) (Customs Service of the Republic of

Armenia 2015). In addition to the impediments and the blockade, the basic cause of the narrow flow of Armenian products to Turkey is the limited range of export products that the Armenian economy has to offer.

The obstacles to trade between Armenia and Turkey are usually ascribed to the legal framework, despite the trade between Armenian and Turkish businesses. However, the legal grounds for obstruction are also loose. The decision to close the border between Turkey and Armenia was taken on October 3, 1993 by a decree of the Turkish government. This decree does not refer to trade relations in general; it only mentions that Turkey will halt the transit of humanitarian aid across its territory to Armenia. Thus, the obstruction is bigger than what the law requires and a de facto embargo is in place (Turkish-Armenian Business Development Council 2013).

Russia is the main foreign trade partner of not only Armenia, but also Azerbaijan. The trade turnover between the two countries in 2014 reached \$4 billion. While the volume of exports from Russia to Azerbaijan was \$3.37 billion, the volume of exports from Azerbaijan to Russia amounted to \$634.9 million (Ministry of Economic Development of the Russian Federation 2015). However, the presence of Russian business capital in Azerbaijan's economy is less significant than in Armenia's economy. In 2014, the largest shares of foreign investments into Azerbaijan's economy were from the United Kingdom (UK), Norway, Turkey, the US, and France. Russia's proportion in foreign investments in Azerbaijan was 6.1 percent, which means that Russian investors rank sixth among the top investors in Azerbaijan. This rank is shared with Iran (Ministry of Economic Development of the Russian Federation 2015).

Foreign investments in Azerbaijan are flowing mainly into the energy sphere, notably gas production in the Shah Deniz gas field in the Caspian Sea, which is considered a founding link for the Southern Gas Corridor aiming to reduce the EU's and Turkey's dependence on Russian gas supplies. Lukoil, Russia's second largest oil company, is developing the Shah Deniz gas field and has invested about \$700 million since the project started (Ministry of Economic Development of the Russian Federation 2015).

The economic relations between Turkey and Azerbaijan are multi-dimensional and extensive. Since 1992, agreements to intensify economic relations, especially concerning the export and marketing of Azerbaijan's oil and gas, have greatly evolved due to Turkey's role as an energy corridor. The trade volume between the two countries, which was \$278 million in 1996, increased to \$2.13 billion in 2015 (Turkish Statistical Institute 2016). In 2014, the amount

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of investments of about 2,600 Turkish companies in Azerbaijan reached \$9 billion while the total amount of investments by Azerbaijani companies in Turkey was \$4 billion (Türkiye Cumhuriyeti Dışişleri Bakanlığı 2014). Azerbaijan is investing in the energy sector and the construction of ports and refineries in Turkey. The Petkim factory in Izmir is one example. The largest investor is the State Oil Company of Azerbaijan Republic (SOCAR) with \$2.4 billion (Karimova 2015). Since 2010, Turkey stands among the top five countries of Azerbaijan's imports list (Observatory of Economic Complexity 2015). Officials in Baku state that the existing potential is worth \$20 billion, though only a fraction of it is realized (Turkishnews.com 2012).

The Russian-Georgian economic cooperation has substantially suffered from the turbulences in the political relationship of the two states during the last decade. The policies of confrontation resulted in Russian sanctions against Georgian products and in severed diplomatic relations between the two countries. Even though the sanctions were lifted following the change of the political elite in Georgia in 2012, diplomatic relations remain halted as the Georgian government continues opposing Russian cooperation with South Ossetia and Abkhazia.

Nevertheless, in 2013 the trade turnover between the two states returned to the position prior to the August 2008 war, and in early 2015 Russia was Georgia's third largest trade partner after China and Turkey (National Statistics Office of Georgia 2016). Despite these positive dynamics in trade, in 2015 the share of the Russian capital in Georgia's total foreign investment stock remained at \$49 million, making Russia the seventh major investor in Georgia (National Statistics Office of Georgia 2016). Some Russian companies, however, have been successful in the Georgian market, especially in the energy and telecommunications sectors. To give just a few examples, Lukoil-Georgia through its largest chain of gas stations holds one quarter of the retail diesel and petrol market; Inter RAO UES owns 75 percent of the shares of Telasi, which is the leading electricity distribution company in Tbilisi; and Vimpelcom owns 51 percent of the shares in Mobitel and thus controls about 13 percent of Georgia's telecom market (Zavyalova 2014).

The development of Turkish-Georgian economic relations began in 1988, when the Sarp-Sarpi border crossing between Artvin and Batumi was activated. At that time, the border checkpoint enabled crossing from Turkey to the Soviet Union. Since 1991, it became an important connection link not only between Turkey and Georgia, but also between Turkey and the Caucasus by turning into a busy border crossing point for suitcase trade after the dissolution of the Soviet

Union. While there were only 808 people crossing the Sarp-Sarpi Border in 1988, this number increased to 5,997,000 in 2013 (Deniz and Aslan 2014).

The main progress in economic relations between the two countries was realized in 2007 when the Free Trade Agreement was signed (Türkiye Cumhuriyeti Dışişleri Bakanlığı 2015). This progress, which was followed by the abolishment of visas and granting of passage without passport control, made Turkey the most important trade partner of Georgia. According to official data, the trade turnover, which was \$753 million in 2006, has increased to \$1.67 billion in 2014 (Türkiye Cumhuriyeti Dışişleri Bakanlığı 2015).

Georgia has active trade relations both with Armenia and Azerbaijan. According to the official data of the National Statistics Office of Georgia, from January 2012 to December 2015, exports from Georgia to Azerbaijan amounted to \$2.12 million and to Armenia just over \$1 million. Georgia imported goods in the value of \$2.52 million from Azerbaijan and \$634,000 from Armenia between January 2012 and December 2015 (National Statistics Office of Georgia 2016). In addition to direct trade relations, re-export to Azerbaijan and Armenia from Georgia is considerably large. As Georgia is the transit country between Armenia, Azerbaijan, and Turkey, it exports the imported goods to other countries. According to the official data received from the National Statistics Office of Georgia, from January 2012 to July 2015 re-export from Azerbaijan amounted to \$1.35 billion, from Armenia to \$584 million, and from Turkey to \$41 million.

The South Caucasus does not play that much of a significant role in Russian-Turkish economic cooperation as it could, and Russian and Turkish companies do not implement any major joint projects in the region. The South Caucasus is rather a field for economic confrontation of the two regional powers promoting rival pipelines for energy supplies and routes for transit of Asian goods to Europe. Nevertheless, the region is still an important transit hub between Russia and Turkey. Georgia especially has benefited from the increased trade turnover between the two countries, which tripled in 10 years from \$10.9 billion in 2004 to \$31.2 billion in 2014 (Ministry of Economic Development of the Russian Federation 2015). Moreover, small and medium-sized Turkish businesses operate very comfortably in Georgia and Azerbaijan, while large companies chiefly represent the Russian business sector in these countries (and also in Armenia).

Recently, though, the “era” of mounting Russian-Turkish economic cooperation has been turned around by Russia’s sanctions against Turkey after

the downing of a Russian warplane by Turkish air forces in November 2015 and Turkey's retaliatory policies toward Russia. According to some media reports, the Russian economic sanctions have already affected the crossing of the Russian-Georgian border checkpoint in Lars where trucks registered in Turkey are swarming on Georgian territory. This situation creates problems to Georgian exporters, and, if continued, it may bring significant financial losses to them (Dzhorbenadze 2015). Georgia may suffer even more losses from the ceased transit if the Russian and Turkish governments do not agree on the extension of permits for the transport companies in 2016, which expired on February 1, 2016. Since then, Turkish and Russian trucks have not been allowed to transport goods into Russia and Turkey, respectively (Fokht 2016).

Abkhazia also joined the Russian sanctions against Turkey, though Turkey is one of the few countries that has informal trade relations with Abkhazia. The Abkhaz diaspora in Turkey has contributed to building these business relations, and the trade turnover between Turkey and Abkhazia is estimated to be second after Russia and Abkhazia (Milliyet 2016). With the sanctions, these situations are expected to decrease and leave Russia as Abkhazia's only important trade partner.

Economic migrants also play a significant role in the relations between and among the countries of the South Caucasus and the larger region. After the dissolution of Soviet Union, many Azerbaijanis, Armenians, and Georgians went to work abroad due to the poor economic situation in their home countries. Most of the migrants went to Russia, and hundreds of thousands of Azerbaijanis, Armenians, and Georgians – not taking into account those who are citizens of Russia – live in Russia, according to unofficial figures. Throughout the 2000s Azerbaijan, Armenia, and Georgia were among the top ten countries that received significant remittances from Russia. According to the Russian Central Bank data, in 2014 remittances from Russia amounted to \$1.55 billion to Armenia, \$1.31 billion to Azerbaijan, and \$813 million to Georgia (Central Bank of the Russian Federation 2016). In 2015-2016 these figures fell as a result of the Russian economic crisis.

Thus, despite the impenetrable Armenian-Azerbaijani border, the conflict-ridden relations between Georgia and Russia, and the tensions in relations between Turkey and Armenia, money and trade still flows across the problematic borders. In many cases pragmatism, mutual interest, and benefits of cross-border relations prevail over conflict disengagement.

## **Energy projects: New alliances and protracted conflicts**

The energy projects in the region evolved from Azerbaijani hydrocarbon resources fueling the interest of big actors such as the US, the EU, and Russia. Azerbaijan developed its energy strategy towards the South Caucasus on the basis of its own energy security and the export of oil and natural gas resources of the Caspian Basin to international markets through routes bypassing Russia. While Kazakhstan is rich in oil resources and Turkmenistan is rich in natural gas resources, Azerbaijan has rich reserves of both oil and gas. Azerbaijan has a strategic position for Turkey in terms of transporting its own energy resources as well as transporting Kazakhstan's oil and Turkmenistan's gas to Turkey and Europe. Turkey, therefore, has actively cooperated with Azerbaijan in the energy sector, and this cooperation has strengthened their strategic partnership. The cooperation for energy resources between the two countries led to projects like the Baku-Supsa oil pipeline, the BTC oil pipeline, the Baku-Tbilisi-Erzurum (BTE also known as the South Caucasus Pipeline) natural gas pipeline, the Trans-Anatolian Pipeline (TANAP, natural gas), and the Trans-Adriatic Pipeline (TAP, natural gas). Georgia takes part in all those projects except for the TAP as a transit country. So, a steady energy partnership has been established between Turkey, Azerbaijan, and Georgia. Thus, the design of energy projects has secured the division of the region with this partnership on the one side and Russia, Armenia, and Iran on the other side, where Iran tries to play by its own rules.

It is worth noting that Azerbaijan, in an attempt to claim the role of the strongest regional player, also uses all these energy projects for the economic blockade of Armenia. The official political rhetoric is constructed in a way as to emphasize the continued success of this policy. Meanwhile Azerbaijan, relying on the European Union (EU) and the US interests in oil and gas, hopes to gain their further support in resolving the Nagorno-Karabakh conflict in its favor. While the large energy projects remain relevant, the fragmentation of the South Caucasus – a potential regional common economic space – into different blocks is the only reality.

The Baku-Supsa oil pipeline was the first pipeline to help deliver Azerbaijani oil to Turkey and Europe. The pipeline, dating from the Soviet era, was launched with improvements in 1999 following the agreement signed in 1996 between Georgia, Turkey, and Azerbaijan. Via the Baku-Supsa line, Azerbaijani oil is transported to the Georgian port of Supsa, and from Supsa it is transported to Turkey and Europe (Azerbaijan.Az n.d.).

Following the opening of the Baku-Supsa oil pipeline, the BTC oil pipeline project was put on the agenda. Initially intended to pass from Baku through Nagorno-Karabakh and Armenia to Ceyhan and dubbed as the “peace pipeline,” it eventually circumvented Nagorno-Karabakh and Armenia. In 1998, Turkey, Azerbaijan, and Georgia agreed in Trabzon to carry out the project, and in 1999, the presidents of the three countries signed an agreement at the summit of the Organization for Security and Co-operation in Europe (OSCE) in Istanbul. The BTC oil pipeline project with a cost of \$4 billion was completed due to the political determination of the three states. The 1,768-kilometer-long pipeline became operational in 2006, and a 1,076-kilometer-long section passes through Turkey. About 1 million barrels of Azerbaijani oil a day are supplied to the world market through the pipeline to the port of Ceyhan. Despite the opposition of Russia and Iran, the pipeline was built with investments from the US and Western European companies and with the support of their governments. The BTC oil pipeline has strengthened Azerbaijan’s positions internationally, while providing Turkey with a strategic stance in the energy market.

The BTE natural gas pipeline, which transports Azerbaijan’s natural gas resources to Turkey, is significant in the Azerbaijan-Georgia-Turkey energy cooperation. The construction of the 970-kilometer-long BTE natural gas pipeline started in 2002 and was completed in 2006. The BTE natural gas pipeline has been supplying natural gas to Turkey from the Stage 1 bed in Azerbaijan’s Shah Deniz gas field. Turkey and Azerbaijan have also agreed on delivering natural gas extracted from the Stage 2 bed in the Shah Deniz gas field through the same pipeline to Turkey and then from Erzurum to other domestic pipelines and to Europe (Starr and Cornell 2005).

In addition to the BTE natural gas pipeline, the Nabucco natural gas pipeline was discussed between Turkey, Azerbaijan, and Georgia in the 2000s. Proposed by the US and the EU, this project would ensure that gas be extracted from the Shah Deniz Stage 2 bed and transported to Europe. However, Azerbaijan did not show a decisive approach in this project, making perhaps a strategic decision in order to keep its relations with Russia balanced. Russia explicitly opposed this project since it would undermine the Nord Stream project and could significantly reduce the Russian share in the European energy market. As a result, both Russia’s opposition and the global financial crisis that negatively affected the European economies made the realization of the Nabucco natural gas pipeline impossible.

Nevertheless, the failure to implement the Nabucco natural gas pipeline prepared ground for the TANAP and the TAP that Turkey and Azerbaijan agreed on in 2012. Turkey and Azerbaijan signed an agreement related to the TANAP in June 2012 whereby 16 billion cubic meters of natural gas extracted from the Shah Deniz Stage 2 bed would be delivered to Turkey and Europe through this pipeline. The TANAP, at an estimated cost of \$7 billion, is expected to transport 6 billion cubic meters of natural gas per year to the Turkish domestic market and 10 billion cubic meters to the European market. The total gas volume to be transported with this line as a joint project of Azerbaijan's SOCAR, Turkey's Petroleum Pipeline Corporation (BOTAŞ), and UK's British Petroleum (BP), is aimed to reach, together with additional resources such as those from Turkmenistan, 23 billion cubic meters by 2023 and 31 billion cubic meters by 2026. Turkey has taken a successful step in supplying natural gas to Europe with the TANAP, and the Azerbaijan-Georgia-Turkey route gained importance in supplying natural gas to Europe (Sandıklı, Gafarlı and İsmayılov 2014).

The TAP is different from other projects because it does not represent a geopolitically sensitive alternative to Russia's Nord Stream and is supported by the EU. The TAP is 450 kilometers shorter than the Nabucco natural gas pipeline and less costly. It does not target Central and Eastern Europe directly – something that differentiates it from the Nabucco natural gas pipeline and is less alarming for Russia. As of December 2015, the TAP's shareholding is comprised of the UK's BP, Azerbaijan's SOCAR, and Italy's Snam S.p.A. having 20 percent each, Belgium's Fluxys with 19 percent, Spain's Enagás with 16 percent, and Switzerland's Axpo with 5 percent of the shares (Trans Adriatic Pipeline 2015). The TAP practically provides an extension to the TANAP into Europe, and together with the BTE natural gas pipeline they connect the Caspian Basin to Europe, materializing the Southern Gas Corridor that is Europe's guarantee for the security and diversity of its energy supplies.

However, Iran's and Turkmenistan's gas have great importance for the implementation of the TANAP and the TAP, as Azerbaijan's natural gas alone is not enough to practically implement the projects (Gafarlı 2015). The projects also provide an opportunity to reduce the tension between Azerbaijan and Iran and to develop energy relations. With the lifting of sanctions against Iran, the discussions of new energy projects in both North-South and East-West directions have intensified.

As a whole, Azerbaijan meets 20 percent of Turkey's natural gas needs. The volume of the Shah Deniz gas bed is calculated to be 1 trillion cubic meters and



is expected to meet 30 percent of Turkey's needs in the future. However, it is not the only benefit that Turkey gets from these energy projects. They also provide an opportunity for Turkey to create its own energy policy and security. Energy efficiency, new energy sources, and an important role for the European energy security are other potential benefits. Energy is among the core issues in the Turkey's EU membership negotiations and the above-mentioned projects improve the country's position as a candidate state (Ministry of Foreign Affairs of Turkey 2015).

As a transit country, Georgia also receives considerable benefits from the pipelines. For example, the BTC oil pipeline brings Georgia an estimated profit of \$50-70 million per year. Georgia is also a transit country for Russian gas to Armenia. The North-South Gas Pipeline (NSGP) has been in operation since the 1980s. This is the easiest and the cheapest way to transport gas from Russia to Armenia (Gochitashvili 2014). According to official statistics, 2.1 billion cubic meters of gas was transported from Russia to Armenia in 2014. For the transit of Russian gas to Armenia, Georgia receives 10 percent of the gas per year, which is currently 200 million cubic meters. If Georgia expands this agreement, then it would receive 10 percent of the expanded volume of the gas transit (Gochitashvili 2014).

## **Transportation projects: Old and new lines of connection and disconnection**

Since the collapse of the Soviet Union, transportation projects in the South Caucasus have been influenced by the conflict context and also served to sustain the conflicts. The Nagorno-Karabakh conflict and the closed Turkey-Armenia borders have reinforced progress for an East-West route via the Turkey-Georgia-Azerbaijan axis and a North-South one via the Armenia-Iran axis.

Azerbaijan, Turkey, and Georgia reached a final agreement for the construction of the Baku-Tbilisi-Kars railway project in 2007, although the idea had emerged immediately following the 1993 closure of the Kars-Gyumri-Tbilisi railway passing through Armenia. As of February 2016, the Baku-Tbilisi-Kars railway is deemed to become functional by 2017. The proposed and much-awaited railway project will give an important impetus for the development of Northeastern Anatolia. In 2008, the Mayor of Kars Naif Alibeyoğlu said the new railway would become a crucial lifeline for the city – one of the poorest towns in Turkey. In his opinion, this line would also demonstrate that Kars is a natural bridge between the two geographical zones – Turkey and the Caucasus

Economic Cooperation in the South Caucasus and the Wider Region: Gained Losses, Lost Benefits (Dikkaya and Özyakışır 2008). Many other cities located along this transportation line would benefit similarly from this transportation project.

Iran and Armenia have an agreement of their own on the Southern Armenia Railway project connecting the Black Sea to the Persian Gulf – a link in the North-South Transport Corridor project that will ensure connection between India and Europe. This project, however, under current circumstances will connect only to the Georgian Black Sea ports since both a functional intersection with the Baku-Tbilisi-Kars railroad and a route following on to Russia from Georgia seem implausible given the conflict context. There have been plans to revive a Russia-Georgia railway through Sukhum/i, Tbilisi, and Yerevan. Although Abkhazia and Armenia support this project, so far it has not been welcomed by Georgia, which has been trying to isolate Abkhazia. An alternative North-South plan, which would pass through the Caucasus but bypass Armenia and accommodate the conflicts, would be the modernization of the railways passing from Russia to Azerbaijan and Iran.

On a more global scale, initiatives that evoke the Silk Road have set the stage for new transportation routes passing through the South Caucasus. In 1993, an agreement was reached to establish the Transport Corridor Europe-Caucasus-Asia (TRACECA) to create a major link between different countries. The agreement was reached in Brussels with the participation of ministers from Azerbaijan, Armenia, and Georgia from the South Caucasus and Kazakhstan, Kyrgyzstan, Turkmenistan, and Uzbekistan from Central Asia. The aim of this project is to integrate the European, Caucasus, Central and South East Asian markets developing transport and trade. The TRACECA is expected to ensure transport infrastructure and security of the East-West transportation through sea, air, and ground accelerating the inclusion of the South Caucasus into the global markets. The TRACECA is also expected to develop transportation between Turkey-Georgia-Azerbaijan and to increase Turkey's effectiveness in the South Caucasus markets (Sandıklı, Gafarlı and Ismayilov 2014).

Prospective transportation cooperation is crucial for Armenia, which exports its goods to the EU and the US mainly through Georgia. Currently, products loaded on trucks are transferred to ships in Batumi and Poti. Since Armenia became a WTO member in 2012, its exports have been increasing yearly. However, Armenian producers are not very competitive compared to Turkish, Georgian, or Mediterranean producers, mainly due to transportation costs. In the case when the destination is Russia, the efficiency is higher: trucks pass through Georgia and unload their cargo in their destinations in Russia. Transport and communication comprised 4.8 percent of the GDP of Armenia in

Economic Cooperation in the South Caucasus and the Wider Region: Gained Losses, Lost Benefits 2015 (National Statistical Service of the Republic of Armenia 2016). By comparison, the same indicator for Georgia, that does not have such severe issues with its borders, is at 10.7 percent (National Statistics Office of Georgia 2016).

Despite the absence of diplomatic relation between Turkey and Armenia, transport routes function through Georgia and Iran. There are regular bus routes through Georgia, travel tours from Armenia to Turkey, and several direct flights per week between Istanbul and Yerevan. A comparison between air and ground transportation presents a curious case of the possibilities of the two countries. Similar to ground transportation, air connection also requires bilateral agreements between countries. Despite the absence of an air transport agreement between Turkey and Armenia, flights take place through permits renewed for every flight happening through the H50 air corridor, which was closed in 1993. The reopening of this air corridor in May 1995 was requested by the Azerbaijani civilian aviation authority since Armenia and Azerbaijan have access to each other's air space for civilian aviation (Gültekin Punsmann and Gevorgyan, Review of Legal Issues Between Armenia and Turkey 2012). The precedent of air connection between Turkey and Armenia could be used to expand ground transport as well.

In the future, the South Caucasus countries may have an important role as a transit route between Iran and Russia and the North-South line in general since the sanctions against Iran were lifted. However, Armenia's inclusion in the East-West route between Azerbaijan, Georgia, and Turkey is not on the agenda, and the Kars-Gyumri-Tbilisi railway remains closed.

Even though closed borders hinder interstate communication and trade, in some cases such as Turkey and Armenia or Russia and Georgia, the borders are not impenetrable and alternative access points are available. At the same time, the most efficient routes of communication between Azerbaijan and Turkey, Georgia and Russia remain blocked because of the conflicts. In the post-Soviet reality, the newly emerged dynamics in the regional cooperation are characterized by both attempts to implement large-scale projects (such as the revived Silk Road) and efforts to cease previous communications due to multidimensional confrontational policies.

## **Education: As business, soft power, and mechanism of conflict protraction or resolution**

The systems of higher education in the South Caucasus faced an ambiguous situation after the collapse of the USSR. A sharp decline in quality has been visible in many areas of education, which led to a brain drain from the region with opportunities for getting high-quality education in the EU, the US, and elsewhere becoming available. Locally, the marketization of the education systems created possibilities for the development of the business sector in providing paid private education, especially at the higher education level. Providing services in this area became a very profitable business all over the South Caucasus as a significant part of the population strives to get higher education by all available means. However, it is hard to say how successful this experience has been. Although in each country the situation and progress has been different, a cautious evaluation suggests that the emergence of private education institutions have not significantly improved the quality of education.

As in the other areas of cooperation or lack of it, the patterns of student mobility in the South Caucasus also reproduce the political-economic unions and preferences conditioned by conflicts. At the state level the educational system is regarded as an instrument of influence – a soft power. A similar approach or pattern can be traced to the international level. Education is a dynamically developing sector between Armenia, Azerbaijan, Georgia, Turkey, and Russia in different flows of students and educational services. Some of the educational agencies primarily use their resources in order to attract students from countries with which they have formed alliances, aiming to maintain or increase their influence in those countries or seeing greater opportunities.

The Russian government supports programs that admit students from the South Caucasus to ensure a stable student flow to Russia. In 2010-2011 about 4,166 students from Azerbaijan and 1,964 students from Armenia studied at Russian universities. As a result, Azerbaijan and Armenia were number 6 and 12, respectively, on the list of top 15 countries with the largest number of students that went to study in Russia. Georgia was not on that list (Arefyev 2012).

In parallel, there is also an “export” of educational services to the region. There are eight branches of different Russian universities in Armenia. Azerbaijan has five including a branch of Moscow State University, which is the main Russian university (Ministry of Education and Science of the Russian Federation 2016). This “export” of educational services has largely bypassed Georgia, where a

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now defunct branch of the Moscow State University of Economics, Statistics, and Informatics was operating.

Many Armenian students study in Turkish and Georgian universities. Yet, beginning in 2016, the number of students studying in Georgia may decrease because the US State Department decided to cut the financing for Armenian students studying at the Georgian Institute of Public Affairs (GIPA). This opportunity used to be a platform for joint learning for Armenian, Georgian, and Azerbaijani students. There were 922 students, mainly Georgian citizens of Armenian background, from Georgia studying in Armenian educational institutions in 2014 (National Statistical Service of the Republic of Armenia 2015). In 2014 there was only one Turkish citizen studying in Armenia (National Statistical Service of the Republic of Armenia 2015).

The Turkish government and some Turkish private foundations continue providing educational services in Azerbaijan. Today tens of Turkish-initiated colleges and universities provide education to students in Azerbaijan, and 6,901 Azeri students studied in Turkish universities in 2014 (Erdoğan 2014). The Turkish Qafqaz University is currently considered one of the most prestigious universities in Azerbaijan providing students with the highest quality of education.

Opportunities for regional educational exchanges both for students and academics might be a valuable contribution to the prevention and transformation of the regional conflicts by facilitating interpersonal contacts and conducting joint academic activities, such as research and conferences. The existing mobility in this area demonstrates the younger generation's ability to ignore conflict ideologies and find common ground. At the same time, the attractiveness of studying abroad and the governments' support of mobility for education demonstrate the openness of the South Caucasus societies to the outside world.

Nevertheless, the South Caucasus governments increasingly attempt to control their students abroad. Students are viewed as some sort of a political resource, a solidarity group, which can be mobilized for the broadest possible representation of conflict positions. This leads to the trans-nationalization of local conflicts and their export into third countries in the region and beyond. Thus, not only big players, but also the smaller South Caucasus republics can and do use educational mobility as an instrument for soft power.

## **Tourism: Vacation space as a platform for contacts**

Some of the most obvious long-term prospects for the region's economic development lie in the tourism industry. The potential here is not only in infrastructure projects that are implemented in order to transform the South Caucasus into a transit corridor but also in projects that could turn the region into a harbor of tourist destinations. In addition, the recent fall in oil prices, which inflicted a serious blow on Russia's and Azerbaijan's budgets, suggests that the low cost of energy resources is the reality for the next several years. The tourism industry has strongly been affected by the economic crisis, and the fall in energy prices has limited investment capabilities for tourism projects in the South Caucasus.

The South Caucasus borders Turkey, which has one of the most developed and attractive tourism industries in the world. Therefore, for the South Caucasus countries, the actual and potential development of this sector lies with internal tourism and visitors from neighboring post-Soviet countries, as well as from Turkey (mostly to Georgia) and Iran (mostly to Azerbaijan and Armenia). The development of the tourism industry is regional in nature and dependent on average income levels.

Georgia is the most attractive country for tourism in the South Caucasus. The tourism boom started in recent years continues as hundreds of thousands of Armenian, Azerbaijani, Turkish, Russian, Ukrainian, and other tourists travel to Georgia, especially to the Black Sea resort towns for summer vacations and ski resorts for winter vacations. According to the Georgian national tourism administration 1,468,888 Armenians, 1,393,257 Azerbaijanis, 1,391,721 Turks, 926,144 Russians, and 141,734 Ukrainians visited Georgia in 2015 making the list of the top 5 countries whose citizens visited Georgia in the last few years (Georgian National Tourist Administration 2016).

In 2015, Georgia had almost 6 million visitors. Even though only part of them came to Georgia for tourism purposes and stayed more than two to three days, these numbers are impressive since the population of Georgia is less than 4 million people.

For many years now Georgia has been the physical space where citizens of Armenia and Azerbaijan (and more broadly Armenians and Azerbaijanis) continue making contacts in many different spheres. Visitors from conflicting countries come to Georgia for various activities, meet each other, and have the opportunity to hear the other side's point of view. A similar though a far less prominent role of a neutral meeting space has been acquired by Armenia in the

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context of Georgian-Abkhazian and Georgian-South Ossetian relations and by Turkey in the context of Armenian-Turkish and other regional relations.

At the same time, tourism in the region generally increases the interest level of people in each other enhancing the mobility of the populations and the diversity of contacts. Accidental and simple encounters between people vacationing in the same location also facilitate informal contacts allowing people from other parts of the region to meet for the first time. Conflicts are humanized and informal meetings show that sharing common space does not necessarily lead to conflict.

Tourism is identified as one of the most important areas that can be developed between Turkey and the South Caucasus countries (Türkiye Ekonomi Politikaları Araştırma Vakfı (TEPAV) 2015). Tourism is important for developing contacts between Turkey and Armenia who share a conflict relationship. In addition to seasonal vacations, health and sports tourism, cultural-historical tours of Armenian historical sites in Turkey, such as the ancient city of Ani, have an important potential to be explored. The development of tourism between these countries would also contribute to the personal interactions between societies.

Georgia's attractiveness for tourists also creates some positive prospects for Azerbaijan and Armenia. There is a growth of interest towards this relatively small region. Many tourists that visit Georgia also try to visit all three countries (at least the capital cities) in order to form an opinion about the region. The geography of the region allows doing so relatively quickly and in the future tourism could become a powerful incentive for abandoning the policy of closed borders. The regional diversity, the richness of local cultural contexts together with geographic proximity, clearly demonstrates the great potential of regional cooperation in the tourism industry and at the same time the losses that this sector continues to incur due to conflicts that disintegrate the South Caucasus space. As this paper argues, all sectors of the regional economies suffer constant and permanent losses, and among them the most important one is the agricultural industry in the region.

## **Agriculture: Traditional and new markets**

After the collapse of the Soviet Union, the economy of the South Caucasus states suffered the same fate – a total collapse. In the post-Soviet era, the exit from the economic breakdown and the development of the republics was uneven and could not be otherwise. However, the preconditions that would allow the restoration of at least part of the old capacity were never re-established. The

industrial factories (petrochemical industry, machinery, and others) that provided a huge number of permanent jobs for qualified staff disintegrated due to the breakup of a great many regional relations and the interconnectedness as a result of the emergence of conflicts, among other factors. Agriculture also suffered a huge blow due to the breakup of regional relations. With a constant shortage of food during the Soviet years, the Russian market brought the local entrepreneurs and speculators operating in the shadow tremendous profits. During all the post-Soviet years, agriculture has been rebuilt and restored. However, the usual additional income is no longer available to producers, despite the variety of manufactured products.

Agriculture could be a sector wherein the South Caucasus countries could develop cooperation very productively, especially for the use of new technologies and techniques. For example, both Armenia and Georgia have many competitive advantages and traditions in the cultivation of certain types of fruits and vegetables. Armenia is experienced in the cultivation of apricots, grapes, peaches, apples, pears, tomatoes, and cucumbers. Georgia has very developed traditions in cultivating grapes, persimmons, kiwis, citrus fruits, and a long-standing winery sector. This complementarity can serve to both countries and contribute to the development of agriculture, not excluding each other and making use of each other's accumulated experience and expertise (Karapetyan 2015). Another area of cooperation could be the greenhouse business. While this is a new trend in the Armenian economy, Georgia already has a good tradition in greenhouse establishment and development. Many foreign companies, especially from Israel, are involved in greenhouse development in Georgia. A wide variety of fruits and vegetables traditionally are grown also in Azerbaijan. For example, in recent years the volumes of grape production, as well as of pomegranates, and the export of pomegranate juice are being rapidly restored.

In general, agricultural development is one of the priority areas in the region and to a greater extent than tourism, it demonstrates the need for regional cooperation. The geography itself encourages the cooperation of all South Caucasus countries in this area.

Russia plays a significant role for the sector of agriculture in the South Caucasus. In fact, for all three countries the northern neighbor is the only large and vital market for fruits and vegetables sales. The situation is complicated by Russia's willingness to apply restrictive measures and sanctions for political reasons yet with pretexts of unmet sanitary standards and health concerns against some of the South Caucasus producers, first and foremost hitting the



agriculture sector. In addition, the agricultural production of the South Caucasus had to survive competition from such agricultural giants as Turkey and Iran, a situation that changed following the recent Russian sanctions against Turkey that opened new opportunities for the South Caucasus producers.

Regional cooperation is critically important for the development of a modern type of agriculture. The market division of manufactured products and avoiding excessive competition with each other is only one aspect of the process. The availability and rational use of water resources, the rehabilitation of abandoned conflict territories, and strict environmental control are impossible without broad regional cooperation. In order to go beyond being a poorly-developed agricultural “appendix” for the Russian market, there is a need to develop modern methods of farming taking into account environmental concerns. It is unlikely that a major breakthrough in this area is possible in the current situation of the regional fragmentation and permanent conflicts.

## **The defense industry and the militarization of the region**

The South Caucasus conflicts contribute to the development of military enterprises producing weapons, ammunition, and other military attributes, the disproportionately large armies of the South Caucasus states, and the significant growth of interest toward arms procurement. The 2000s were a period of rapid militarization of the republics.

First of all, militarization impacted the state budgets with Azerbaijan registering the most massive increase. Azerbaijan’s 2014 military budget was \$3.8 billion, an increase from \$3.6 billion in 2013 and \$3 billion in 2012. In comparison, Armenia’s 2013 defense budget was \$447 million (Daly 2014). In both countries military expenses are significant portions of state budgets, which during those years averaged slightly over \$23 billion in Azerbaijan, and \$3 billion in Armenia. To comprehend the scale of this increase over years, we can compare for example the 2004 Azerbaijan spending of around \$150-170 million for its military needs and Armenia spending of around \$100 million in 2005 (Ziyadov 2005). The growth of military spending coincided with a general increase in income but regardless of this increase, throughout the 2000s it was an important part of the budgets of the two countries. The current trend is that military spending will decrease in Azerbaijan due to the decline in oil prices, but it certainly will still be quite significant.

After Mikhail Saakashvili came to power, Georgia started to increase military spending. In 2003, the military budget was \$30 million, and by 2007 the

spending rose to a \$1 billion. Prior to the August 2008 War, the military spending reached 8 percent of the state GDP. After the war, it has declined and Georgia's military budget for 2013 did not exceed \$400 million (Simonyan 2014). Despite this sharp decline in the defense budget, as compared with the beginning of the 2000s, military spending remains high.

A number of European countries and the United States are among the countries supplying arms to the region. However, Russia remains the main arms supplier to Azerbaijan and Armenia. Ukraine supplied Georgia before the August 2008 war. Among the biggest contracts in the post-Soviet years have been the Russian arms sales to Armenia of more than \$1 billion in 1996-1997 and to Azerbaijan since 2011 for over \$4 billion.

The militarization of the region brought attempts to recreate the defense enterprises locally. Azerbaijan, whose Ministry of Defense Industry was created in 2005-2006, leads in this sphere. According to the Head of Ministry Yaver Jamalov, "The diversity of production increases every year" (Radioazadlyg 2014). Azerbaijan inherited from the USSR two dozen different military production companies that did not survive the collapse of the Soviet Union. Currently, the companies operating under the Ministry of Defense Industry are engaged in the production of various types of small arms, ammunition, as well as modernization and repair of equipment.

In contrast, Armenia and Georgia have not inherited significant military-industrial enterprises from the Soviet Union. However, attempts to start some type of production were undertaken in these republics as well. Georgia achieved more significant results creating, in cooperation with Israel, aircrafts, "Didgori" armored vehicles, the "Lasik" infantry fighting vehicle, small arms, and other military attributes.

It is obvious that the high militarization of the region leads to considerable financial costs. However, it is unlikely that attempts to create different types of weapons as part of their defense industry will turn Azerbaijan or Georgia into significant arms exporters. Militarization keeps all the societies under constant pressure and is the most visible symbol of regional fragmentation. The maintenance of large armies and the large-scale procurement of arms are likely to lead to new conflicts and wars and do not contribute to the visions of peaceful transformation of conflicts in the region.

## **Main challenges and windows of opportunity**

The processes that hinder regional cooperation in the South Caucasus are all linked to the conflicts within and around the region. Comprehensive and inclusive cooperation is hardly possible when the Nagorno-Karabakh conflict continues, Armenia is blockaded by Azerbaijan and Turkey, and South Ossetia and Abkhazia are recognized by Russia and treated as occupied territories by Georgia, the US, and the EU. The snowballing crisis in the Russian-Turkish relations brings further negative dynamics to the economic and political environment in the South Caucasus.

The anxieties in the South Caucasus countries are increasing also because of the greater geopolitical confrontation between the US with its allies, including Turkey on the one hand and Russia on the other, and it is certainly not conducive for shaping the South Caucasus as a transit hub between East and West as well as South and North. Now, all projects in the region are set to be reweighed by regional and global powers from the perspective of compliance of these initiatives to their own geostrategic considerations, and those seeming to be “rival” are proactively opposed. The lack of trust between the South Caucasus republics, even in the face of shared global threats, does not contribute to regional cooperation either.

Moreover, the economic crisis is observable to some extent in all these countries. Oil prices have plummeted since 2014. As the Azerbaijani and Russian economies are oriented towards exports of energy resources, they were greatly hit by this sharp decline in their export revenue. The high inflation rate, the devaluation of the national currencies, and the decline in GDP growth are common problems also for Turkey and Georgia. The financial resources to invest in large infrastructure projects in the region have become limited. The declining purchasing power of the populations in these countries and, especially in Russia as the biggest market for the South Caucasus agricultural and other products, affects local producers and exporters.

All in all, the worsening socio-economic situation leads to growing public discontent across the region. Still, despite apparent threats such as violent unrests, this situation opens a window of opportunity for the South Caucasus countries to launch proactive and flexible economic policies that would include constructive and pragmatic business cooperation with the neighboring countries. In this context, both challenges and opportunities emerge for the further cooperation in the region.

## **Amidst confrontations and separated by unions**

The sharp deterioration of relations between Turkey and Russia at the end of 2015 defied the predictions of many analysts of a further rapprochement between the two countries and even the emergence of a Russian-Turkish alliance (Alaranta 2015). Indeed, the conservative, traditional, and anti-Western rhetoric of the political leadership of the two states as well as some of their coinciding economic interests for years prevailed over various disagreements they had on regional politics. The two states succeeded in avoiding confrontation over such sensitive issue as the Ukrainian crisis, and especially the Crimea events of March 2014. Even the Syrian crisis did not rock the ground under the rapidly intensifying economic cooperation between the two states for almost five years until finally the securitization policies based on geostrategic considerations overcame the economic rationale.

Only two months before the November 2015 crisis, Turkish President Recep Tayyip Erdoğan in a meeting with Russian President Vladimir Putin held in Moscow stated that the trade turnover between the two countries was expected to reach a figure of \$100 billion by 2023 (President of Russia 2015). Furthermore, until recent times the governments in Ankara and Moscow actively discussed different formats for establishing a free trade zone between Turkey and Russia (Sputnik 2014) (Kazimirko-Kirillova 2015). Should the bilateral relations between Turkey and Russia improve and the announced ambitious plans be implemented, their realization would contribute to the role of the South Caucasus as a transit region. However, the growing degree of the confrontation leaves little hope for this scenario. In these political circumstances, the South Caucasus republics are left with only short-term advantages and situational opportunities, such as substituting the banned Turkish agricultural products in the Russian market by their own exports.

When it comes to the official integrational projects that Turkey and Russia each offer to the South Caucasus countries, the difference is that the Turkish approach to regional cooperation is to bypass Armenia at least while the Nagorno-Karabakh conflict is not resolved, while for its geostrategic considerations Russia cannot completely ignore any of the South Caucasus states including Georgia despite the tense relations between them. The rapidly deteriorating relations with Russia induce Turkey to intensify the implementation of its main infrastructure projects in the region – the TANAP, and the Baku-Tbilisi-Kars railway. The frequent visits of the Turkish officials to Azerbaijan following the worsening relationship with Russia demonstrate the

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serious attitude of Turkey in bringing these “projects of the century” to their completion (Vestnik Kavkaza 2015).

The approach of the policy-makers in Russia to regional cooperation in the South Caucasus is based on the promotion of cooperation with the EAEU. With Armenia joining this integration project, a new possible platform for dialogue between Armenia and Azerbaijan may appear. In Russia, some experts and policy advisors believe in the idea of peace between Armenia and Azerbaijan through economic cooperation within the framework of the EAEU (Romashov 2015). Although Azerbaijan is cautious about Russia-dominated integration initiatives in the post-Soviet space and puts forward the resolution of the Nagorno-Karabakh conflict in its favor as a precondition for the accession (Ponomareva 2015), Russia consistently works on persuading Azerbaijan to participate at least in selected areas of cooperation under the EAEU. Hypothetically, at some juncture, Russia’s efforts may succeed. The Azerbaijani government, which is facing a worsening economic situation in the country because of the decreasing revenues from the oil and gas exports, may become more willing to engage with Russian initiatives if they appear to be profitable.

Another piece in this puzzle is Georgia with its pro-Western orientation and without diplomatic relations with Russia. Thus, the involvement of Tbilisi into the Eurasian project is out of Russia’s short-term reach. However, the policy choices towards constructive dialogue with Russia made by the Georgian government led by Irakli Garibashvili brought some positive dynamics to the cooperation with Russia, including expanding trade and liberalization of the visa regime. If the Russian-Georgian relations continue their positive development under Giorgi Kvirikashvili’s government, tensions in the region might considerably reduce. Eventually, this development could ameliorate the environment for regional cooperation, which prospectively might include the resumption of railway communication between Russia and Georgia via Abkhazia, and break a brick in the wall of the Armenian blockade.

## **Embedded opportunities in two different paths of integration**

Regional integration between Armenia and Georgia has been complicated because of the different economic integration vectors of the two countries. Georgia signed the Association Agreement with the EU, and Armenia is a member of the EAEU. Engagement with two different customs unions may also hinder direct cross-border trade relations between Armenia and Georgia. However, this development can be seen as an opportunity. Access to the EU

market may be attractive for Armenian businesses that want to export products and are also interested in investing in the Georgian economy. Similarly, the EAEU market can be attractive for Georgian businesses and trigger Georgian investments in Armenia.

For example, Georgian producers could export their goods to Armenia as semi-finished products and export them to the EAEU member states of Russia, Belarus, Kazakhstan, and Kyrgyzstan as a “Made in Armenia” brand. This type of cooperation now exists between Armenia and Iran. Armenian producers import large amounts of crawfish from Iran, keep them for a period in special pools in Armenia, then export them to Russia as a product of Armenia. This is a real opportunity as the Russian food safety body announced recently that it will give a green light to more meat and fish producers from Armenia (Federal Service for Veterinary and Phytosanitary Surveillance 2015).

Azerbaijan is the only country in the South Caucasus that has not been integrating into the European or the Eurasian Union. However, this situation also provides an opportunity for Azerbaijan. The establishment of mutually dependent economic relations between Azerbaijan and Georgia gives hope for Azerbaijan to be closer to the EU. For further integration into the western economies, Azerbaijan needs to improve the relationship with the WTO, including the issue of its membership. Azerbaijan’s integration into the WTO will provide its companies with access to the world market.

## **The Turkish-Armenian border: Still valid**

In 2009, Armenia and Turkey were very close to opening the border. Both Turkish and Armenian governments started preparations: the roads were renovated, the railroad was upgraded, the road signs were updated and cleaned. While the normalization efforts between Turkey and Armenia eventually failed and the border remains close, opening it still has valid benefits for both sides (Schmidt 2011).

First of all, Turkish exports to Armenia are expected to at least double with the opening of borders (Jrbashyan, et al. 2005). Secondly, Armenian producers would have direct access to the Middle East and the EU markets; they can use the alternative port of Trabzon in Turkey to decrease export costs, as using the Georgian ports of Batumi and Poti is very expensive due to the distance between them and Armenian producers. Thirdly, an open border would contribute to the drastic development of bordering regions both in Turkey and Armenia. Turkey’s border regions consider the closed border as isolation for themselves, too, and the open border would make this region “the starting point

Economic Cooperation in the South Caucasus and the Wider Region: Gained Losses, Lost Benefits of Turkey, not the end” (Hrant Dink Foundation 2014). The trade between border cities would inevitably increase. Also, new infrastructure would be created such as hotels, guesthouses, restaurants, trade centers, and markets. Armenia would have an opportunity to export electricity to the bordering regions. Moreover, it would significantly contribute to the development of tourism and the establishment of small and medium-sized enterprises. Also, an open border would significantly cut the transportation costs between the two countries. Lastly, more interpersonal contacts would be made and reconciliation between the societies would start gaining ground.

The opening of the border seems to have drawbacks as well. Some Armenian experts have concerns, predicting that Turkey would start to invest considerable amounts in bordering Armenian regions leading to demographic and economic security problems in the future. As an example Chairman of Regional Development Foundation of Armenia Varazdat Karapetyan brings the Georgian experience (Karapetyan 2015). Turkish economic intervention in Adjara is very high and almost every significant business or construction is owned or run by a Turkish company (Regnum 2013). However, even with closed borders over 20,000 trucks with Turkish goods come to Armenia every year according to unofficial sources (Turkish-Armenian Business Development Council 2013).

Finally, if the changes in the context of the Nagorno-Karabakh conflict are not happening to incite changes in the Turkish-Armenian border opening, then a reverse cause and effect logic might work: the opening of the Turkish-Armenian border could lead to changes in the situation around the Nagorno-Karabakh conflict. Such a shift in the situation could push all sides to search for solutions more actively.

## **Recommendations and Conclusion**

Speaking at the opening of the fourth Global Baku forum on March 10, 2016, the Azerbaijani President said, “Sometimes the questions related to energy security are being unnecessarily politicized, we are against this. Politics and energy must be separate from each other; energy should not be used as a political tool. At the same time, political instruments interfering into business development also sometimes create complications” (Official web-site of President of Azerbaijan Republic 2016). However, large transnational projects are not only economic in nature, but also political. That is the reality, and the future depends on political preferences and choices. Politicians representing all sides of conflicts in the South Caucasus have repeatedly stated their commitment to

peaceful resolution. Economic cooperation is one of the most effective ways for this type of resolution. Even so, little to nothing has been done yet to advance in this direction.

On the contrary, voices that are highly skeptical of the possibility of such cooperation are the loudest. However, we believe that it might be possible. There are important precedents, perhaps most prominently the creation of the EU. “The solidarity in production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible” (Schuman 1950). This is how Robert Schuman summarized his intentions to create the European Coal and Steel Community (ECSC) with the Schuman Declaration on May 9, 1950. By pooling the two vital materials causing conflicts – coal and steel – and creating economic interdependency peace was reached in Europe after centuries of devastating conflicts and wars. The ECSC paved its way to the EU in the following decades, and despite all of its problems, it achieved one of its main goals of guaranteeing peace among its members. There has not been any armed conflict between the EU member states since its establishment in 1951. This is one of the most important reasons why it was awarded the Nobel Peace Prize in 2012. Another example of successful regional integration for conflict resolution is the Association of the Southeast Asian Nations (ASEAN). The ASEAN was established in 1967 with one of its aims being to curb potential inter-state conflicts in Southeast Asia. Having so far realized this aim, it has also developed into an economic body that has been contributing to the development and wealth of its members.

Kanchan Chandra explains how this process might work in India among Hindus and Muslims, “Wherever Hindus and Muslims are dependent upon each other in the local economy, local Hindu and Muslim economic actors will co-operate to prevent violence in order not to incur economic losses on both sides. In such towns, if political entrepreneurs choose to play a polarizing strategy, Hindus and Muslims tied to each other in the local economy will resist. Over time, faced with resistance from these interdependent economic actors, political elites should switch to moderate strategies” (Chandra 2001). While conceptual problems for defining what type of “interdependence,” “economic relations,” or “conflict” should be taken into consideration (Crescenzi 2005), actors who run the risk of facing losses in a possible conflict would pressure politicians for less conflictual policies. Although mainly the material benefits are mentioned in this example, the effect of inter-societal communication



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derived from ongoing cooperation between the actors should not be underestimated.

We believe that equitable regional economic cooperation among the countries of the South Caucasus, while maintaining a balance in the system of influences of the big neighbors, is an alternative to permanent conflict. Business always strives for the best possible conditions that bring profit. However, in the context of the South Caucasus, business currently does not play an independent role and is closely intertwined with political power. At the same time, political will dominates the definition of the transnational goals and not vice versa. In order to change the situation, it is necessary to support independent business organizations and entrepreneurs. The more entrepreneurial pragmatism there is in the region, the more opportunities for conflict transformation will appear.

For example, the creation of a transnational regional bank that could finance regional projects with an equal participation of the South Caucasus countries could be such a step. It can start at least with the participation of Azerbaijan, Georgia, and Turkey, but be open to Russia, Armenia, and Iran. New transnational associations of entrepreneurs and transnational entrepreneurial projects could be created, primarily in agriculture with a profitable division of production, and in tourism, by establishing schools of tour guides for cross-border trips, organizing regional festivals, and making other steps towards popularizing the region as a tourist destination.

Finally, it is crucial to maintain and develop the discussions and policy debates in the form of research, open public forums, publications exposing how much all the societies lose because of the policies of economic isolation, what the price of these policies is, and what the prospects of overcoming them are.

The biggest challenge is that conflicts become permanent and contribute to the acceptance of and adaptation to the policies of isolation and blockade. The conflict becomes the norm. Politicians, businessmen, and ordinary people can no longer build a vision for potential cooperation. Opportunities for cooperation fade away in the eyes of the citizens of the South Caucasus countries. Yet, it is obvious that the future of the region lies in the development of regional transport infrastructure, agriculture, and tourism. All these spheres suffer massive losses from the region's fragmentation and can gain a lot from regional cooperation. We believe that with closer cooperation and even integration among the South Caucasus countries, Russia, Turkey, and Iran might contribute to the resolution of the conflicts in the region.

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