

## FEATURES OF ECONOMIC DEVELOPMENT IN THE SOUTH CAUCASIAN COUNTRIES, CURRENT STATE AND PROSPECTS OF REGIONAL ECONOMIC RELATIONS

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### Abstract

*The current level of territorial - economic relations and production capacities of the South Caucasus countries has become one of the important factors for strengthening and deepening the integration process. The dynamics of globalization necessitates efficient use of the favorable geographical position of the Caucasus Region, as well as, its socio-economic and transit potential.*

*The article analyzes the economic development features and regional economic relations of the South Caucasian countries with the help of key macroeconomic indicators. The research shows that Azerbaijan has formed a strong economy in the region, and the region's transit potential and regional relations are poorly used. The article gives substantiated proposals for increasing the transit potential of the Caucasus region and raising the level of regionalization.*

**Keywords:** South Caucasus countries, regional economic relations, infrastructure index, logistics effectiveness index, the level of regionalization.

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## 1. Introduction

We cannot speak about the region's present and future without having a single idea on the economic potential and development prospects of the Caucasus region. The most notable three countries in the South Caucasus are Azerbaijan, Armenia and Georgia. The collapse of the USSR and the independence of these republics radically changed the nature of mutual relations and economic development. Developed European countries, mostly the United States had a strong influence on the region's economy. There are many common features in the development of Azerbaijan, Armenia and Georgia at the modern phase. At the first glance, their way is similar: gaining independence, systematic change and market reforms, free selection of economic partners, however, these countries experience this in a different way. For a number of reasons, the socio-economic development of the countries in the region, compared to other countries of the post-Soviet space, occur at difficult and complicated circumstances.

We should take the South Caucasus region as a part of the world's economic system, the territorial segment in the world and an important region of the world's economic space. At the modern phase when the world economy is globalized and the development gets a new nature, the comprehensive assessment of the economic potential of the South Caucasus region and bringing it to action has a principal importance. Natural production conditions of the region conditioned the complexity of each country's economy to this or that extent and the relatively high level of qualification and centralization created an objective basis for the deepening of integration processes.

The fact that Azerbaijan has high energy resources and favorable geostrategic conditions has caused the increase in the interest of the West, primarily the United States. In addition, Azerbaijan's proximity to the West's strategic partner and favorable geostrategic position has also played an important role. Therefore, special attention is paid to Azerbaijan among

the South Caucasian countries. Thus, the South Caucasus is a remarkable region in the development of new economic and social relations based on free market law, market relations and competition, and processes related to the formation of civil society.

## 2. Preliminaries

Among the economies in the South Caucasus, the weight of the Azerbaijan economy is high and it is developing more dynamically. There are numerous causes of the country's leading position and the formation of a strong economy in the region (rich natural resources, complex and successful economic reforms, the planned exploitation of oil and gas resources, flexible co-ordination of raw materials' export volumes with world conjugation, etc.).

Azerbaijan is a country with a developed manufacturing sector focused on highly developed industries, multi-faceted agriculture and export. Important areas of Azerbaijan's economy are oil and gas extraction and processing, chemical, mechanical engineering, ferrous and non-ferrous metallurgy, light industry and agrarian sector.

From 1991 to 1995, the country's GDP dropped to 60% of the level in 1991 and only in 1996, the economic situation stabilized. If the GDP decline in 1995 was 11.8%, in 1996, the dynamics improved and the growth was 1.3%. In 1997 the situation improved and the GDP growth was 5.8%, and in the subsequent years, the dynamic growth continued to increase.<sup>1</sup>

In the next stage of the development of the transformed economy of Azerbaijan, that's, in 2000-2008, though the elimination of the critical tendency in the industry, a new problem of inflation arose. This was due to the lack of strict fiscal and monetary policy in the country. In 2000, the price index of consumer goods and services was 2%, in 2005 – 10%, in 2006 – 8%,

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<sup>1</sup> See K. Kh. Zoidov; Z.K. Zoidov; "Evolution of the transformational economic systems of the countries of the South Caucasus under the conditions of integration and global instability", in *Regional problems of economic transformation*, No. 9, 2014, p. 188. <http://www.econjournals.com/index.php/ijefi/article/view/2530>.

in 2007 – 17%, and in 2008 - 21%.<sup>2</sup> However, the scale of the country's economy has expanded compared to the previous years and a steady increase was observed in the dynamics of some macroeconomic indicators. Thus, the GDP of the country in 2015 will be approximately 4.5 times more than the level in 2000, the volume of funds directed to the fixed capital - 15.3 times, the volume of industrial production - 3.1 times, the volume of agricultural products - 2 times, and the volume of freight forwarding (excluding pipelines) - 2.5 times (Table 1).

Table 1

Dynamics of some macroeconomic indicators of Azerbaijan<sup>13</sup>, %

Years	Azerbaijan				
	Physical volumes index of GDP	Volume index of funds directed to fixed capital	Volume index of industrial products	Volume index of agricultural products	Freight volumes index (except for pipelines)
2000	100	100	100	100	100
2005	188,3	596	163,0	140,4	168,7
2010	402,5	1007	326,2	158,2	205,8
2012	411,8	1519	302,8	178,4	235,0
2013	435,7	1748	308,3	187,2	245,8
2014	447,8	1718	306,1	182,3	246,5
2015	453,0	1527	313,4	194,3	248,1

In the framework of the Azerbaijan's anti-crisis program, it is possible to distinguish the basic provisions, such as amending the directions of the activity and nature of Azerbaijan's FM (Financial Market) in order to solve problems such as a moderate conservative politics, comprehensive support of strategically important enterprises in the real sector, as well as, the provision of the liquidity of the financial system in the

<sup>2</sup> Statistical indicators of Azerbaijan, *Statistical Summary*, SSCAR: Baku, 2016, p. 42.

crisis, preservation of its stability and stimulation of aggregate demand in terms of regulating the activity of financial institutions.

Despite the positive dynamics of Azerbaijan's socio - economic development after the known global financial crisis, its growth rate also slowed down. This is due to the significant changes in the structure of production growth since 2010. In other words, the non-oil sector acts as the driving force of the economy in the background of the slowdown in hydrocarbon production.

The volume of GDP in the country in 2011 increased by 0.1% and reached \$ 66 billion in comparison with 2010; in 2012, it increased by 2.2% and reached 68.8 billion manat compared with 2011, and in 2013, it increased 5.8% and reached 73.5 billion dollars compared to 2012. Compared to 2013, GDP volume in 2014 increased by 2.8% reached 75.2 billion dollars. While in 2014, it increased by 1.1% and reached 53 billion manat in 2015. The special weight of industrial sectors in the GDP structure was 46.3%, social and other services - 14.7%, construction - 11.8%, trade and services - 7.1%, taxes on imported goods - 6.4%, transport and storage - 4.8 %, agriculture, forestry and fishing - 5.3%, housing services - 1.8%, and information and transport sector - 1.8% .<sup>3</sup>

Another important indicator in terms of eliminating the consequences of the crisis is the amount of capital investments. Over the last decade, this figure has increased steadily. In the global financial crisis, compared to 2007, the amount of capital investments in the country increased by 31.8% in 2008.<sup>4</sup>

In 2013 compared to the previous year, investment in fixed capital on all funding sources increased by 15.1% and reached 22.8 billion dollars. 76.7% of all investments, that's, 17.5 billion dollars fell to the share of the domestic source, and 23, 3%, that's, 5.3 billion dollars fell to the share of foreign investment. As it is seen from Table 1, the total amount of investments

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<sup>3</sup> Statistical indicators of Azerbaijan, *op. cit.*, p. 382.

<sup>4</sup> K. Kh Zoidov; Z.K. Zoidov, *op. cit.*, p. 189.

directed to fixed capital in 2015 was about 42 times more than the level in 1991 which shows that the country's economy has a great potential for strengthening the innovation orientation and expanding regional economic cooperation.

Significant changes have taken place both in the amount and structure of the investment directed to the economy on all sources over the past period (Table 2). The amount of investments directed to the economy of Azerbaijan on all sources has increased almost 4 times in 2014 compared to 2005 and about 3 times in comparison with 2015. During this period, the trend towards a steady increase in investment dynamics in the economy has been clearly demonstrated by the linear graphics (Figure 1). The amount of investments directed to the economy by all sources in 2014 is 27.9 billion dollar which is 11.7 billion dollars of it (41,9 %) falls to the share of foreign investments and 16.2 billion. dollars (58.1 %) to the share of domestic investments. In 2015, these indicators were estimated as 19.5 billion dollars, 10.7 billion dollars (54.9%), and 8.8 billion dollars (45.1%).

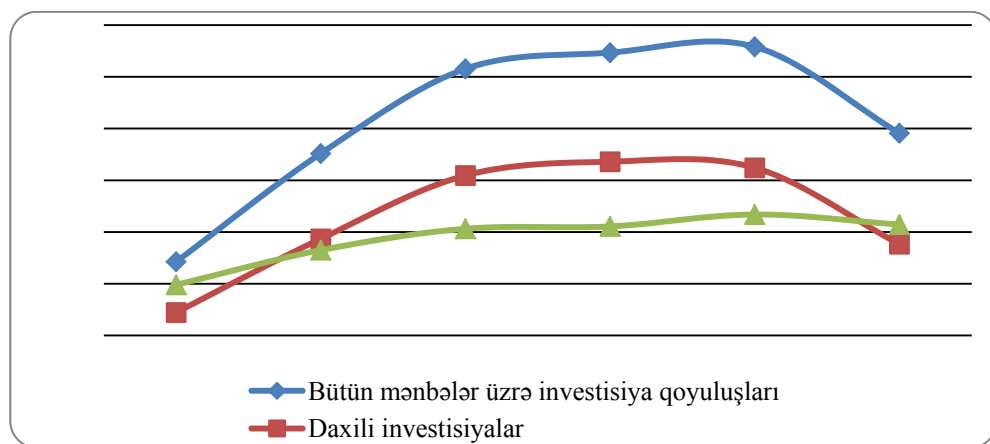
In 2005, foreign investment directed to the economy was about 4.9 billion dollars, but it rose to \$ 10.7 billion in 2015, that's, it increased by 2.2 times.

**Table 2**

Investment directed to Azerbaijan's economy in 2005 – 2015<sup>13</sup> (mln. USD)

	2005	2010	2012	2013	2014	2015
Investments from all sources, including:	7118,5	17591,4	25777,8	27340,0	27907,5	19547,2
Domestic investments	2225,3	9343,6	15463,8	16799,1	16209,8	8828,1
Foreign investments, including:	4893,2	8247,8	10314,0	10540,9	11697,7	10719,1
Financial Loans	698,4	3405,9	3135,5	2655,8	1880,6	2210,2

Direct Investments	4030,4	3614,9	5382,3	5976,2	8049,2	7483,1
Including:						
Oil sector	3799,9	2955,3	4287,8	4935,2	6730,7	6622,7
Non-oil sector	230,5	659,6	1094,5	1041,0	1318,5	860,9



**Figure 1.** The amount of investments directed to Azerbaijan's economy in 2005 – 2015 (billion USD) Investments from all sources, Domestic investments, Foreign investments

During this period, direct investment in the structure of foreign investment played a leading role, which had a positive impact on the development of the country's economy, its regional economic relations and investment opportunities, increase in the technological level of production, and attracting advanced technologies to the country. 4030,4 billion dollars, that's, 82.4 % of 4893,2 billion dollars foreign investment directed to economy in 2005, and 7483.1 billion dollars, that's, 69.8 % of 10719,1 billion dollars foreign investment in 2015 fell to the share of direct investments. In this period, direct investments in the non-oil sector along with oil sector are clearly visible.

Thus, the dynamics of the investment directed to the economy in the last decade has gradually increased, both foreign and also domestic sources have played an important role in the formation of such a trend, and also direct investments comprised most of the attracted foreign investment.

The sectoral structure of employment is dominated by the service sector (52.6 %), agriculture, forestry and fishing (32.1 %) and industry (15.3 %).<sup>5</sup>

The role of the non - government sector in the country's economy is great. Thus, if the share of the non - government sector in GDP in the country in 2005 was 77.8%, in 2014 it was 81.9%, and in 2015 - 81.2%. The role of the non - governmental sector in separate fields is more important.

of the main macroeconomic indicators of Azerbaijan, taking into consideration In 2015, the share of non – governmental sector in the industry was 83 %, in construction - 84.5 %, agriculture, forestry and fishing - 99.8 %, transport and warehouse - 81.7 %, information and communication - 81 %, and social and other services - 57.8 %.<sup>6</sup>

This increase in the dynamics even the impact of any global financial and economic crisis, shows the sustainable development of the national economy in the present stage and in future, and significant resources for the status of the leading and strategic country of regional economic cooperation. In addition, according to the Global Competitiveness Index in 2016, Azerbaijan is on the 35th place, moving up to 2 levels in comparison with 2015.<sup>7</sup> This shows that Azerbaijan has the most competitive economy in the region, the favorable business environment for investors, the complex nature of reforms in the country's economy, and also the availability of effective economic development opportunities based on quality factors.

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<sup>5</sup> *Ibidem.*

<sup>6</sup> Statistical indicators of Azerbaijan, *op. cit.*, p. 383.

<sup>7</sup> World Economic Forum, *Global Competitiveness Report, 2015-2017*, <http://reports.weforum.org/global-competitiveness-index-2015-2017>, pp. 65-67.



Thus, summarizing the priorities of the Azerbaijani government's strategic development concepts and programs, the main characteristics of the modern model of economic development of the country can be given as follows:

- formation of a fully - socially oriented economic system - independent national economy based on market relations and capable of self-development,
- natural-economic, production-technical and scientific-technical potential of the country, as well as active involvement of foreign investment into economic turnover,
- ensuring the effective integration of the national economy into the global economic system.

Another country in the South Caucasus region is Armenia. Until 1991, when the country gained its independence, the country's economic development was largely based on industrial-chemical, mechanical, light, non-ferrous metallurgy industries. The agrarian sector comprised about 20% of the economy.<sup>8</sup>

After the collapse of the USSR, a large part of industrial enterprises stopped their activity. In 1990-1993, the GDP in the republic dropped dramatically, i.e. to 53% of the level in 1991.<sup>9</sup> The reason for this situation was the decline in railroad operations, the interruption of inter-business relations, and the deep energy crisis.

In 1994 there was a positive growth dynamics in this country and other macroeconomic indicators continued in 2000-2008.

In 1996, GDP volumewas 63% of the level in 1991. In 2001-2008, the average annual GDP growth of this country was 11.9%. Such a growth rate was provided in the background of currency and inflation stability that did not exceed the level of 5-6%. Compared to 2007, Armenia's economic growth in 2008 was 6.8%. Under the influence of the global financial crisis, the rate of economic growth has slowed down almost twice.

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<sup>8</sup> K.Kh. Zoidov, Zoidov Z.K., *op.cit.*, p. 193.

<sup>9</sup> 10 years of the CIS (1991-2000): stat. Sat. / MSK CIS. - M., 2001.

Compared to 2012, GDP in 2013 increased by 3.5 % and reached 10.5 billion dollars. The share of industry in the structure of total value added was 18.9 %, agriculture, forestry and fishery - 21.2%, construction - 11.6%, services - 48.3%. Armenia has been ahead of Georgia for more than 20 years of GDP per capita, but is far behind by Azerbaijan.<sup>10</sup>

Due to the global financial and economic crisis, investment activity in Armenia declined in 2010-2015. Investment in fixed capital declined from 366% to 301% of the level in 2000 (Table 2).

**Table 2**

Dynamics of some macroeconomic indicators of Armenia<sup>13</sup>, %

Years	Armenia				
	Physical volumes index of GDP	Volume index of funds directed to fixed capital	Volume index of industrial products	Volume index of agricultural products	Freight volumes index (except for pipelines)
2000	100	100	100	100	100
2005	178,0	351	153	155	202
2010	214,8	366	160	149	264
2012	241,0	325	199	186	237
2013	250,0	300	212	199	302
2014	258,0	300	218	212	233
2015	...	301	229	237	238

The decline in industry has been widespread throughout the industry's all structure practically by types of economic activity. This impact has affected mostly mechanical engineering and light industry. In 2015, the volume of industrial production was restored by 229% compared to the level in 2000. In the period compared, the volume index of

<sup>10</sup> K.Kh. Zoidov, Zoidov Z.K., *op.cit.*, p. 193.

agricultural products and freight (excluding pipelines) was 237% and 238% respectively. Moreover, in many respects the crisis has forced the competition mechanism to improve, moderate and optimize, and apply new technologies. Thus, it is necessary to significantly improve the logistic conditions of industrial development in the country for the future technological growth. From this point of view, the formation of the "Northern – Southern" transport corridor that connects Georgia and Iran via Armenia can play an important role. As a result of this corridor, Armenia may partially reduce the transit risk of economic development.

In Georgia, among the republics of the former Soviet Union, GDP has dropped dramatically. In 1992, the physical volume index of GDP dropped from 55.1 % of the level in 1991 to 34.9 % in 1994.<sup>11</sup>

In 1995, the government directed all debts given by International Monetary Fund to reduce inflation and to stabilize the financial sector to remove the economy from the crisis. Prices for wheat and grain products were released, an agreement was signed on the construction of the pipeline from Georgia, the law on commercial banks was adopted, land, agrarian and tax reforms were implemented. The introduction of new monetary units and the relative balance of the state budget in October 1995 had a positive impact on the economy.

In 1995, serious measures were adopted to regulate the banking system, as well as, the accounting system was renewed according to the international accounting standards. As a result, GDP grew by 11% in 1996. More than 30,000 enterprises were registered in transport, service, construction and food industries. The private sector gives 50% of GDP. The dynamic growth in Georgia's economy started only in 2001.<sup>12</sup>

The Georgian government has succeeded in overcoming the budget crisis, wages and pensions were regulated, and also a number of anti-corruption measures were implemented. Already in 2004, the currency

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<sup>11</sup> 10 years of the CIS (1991-2000): stat. Sat. MSK CIS. - M., 2001.

<sup>12</sup> K. Kh. Zoidov, Zoidov Z.K., *op.cit.*, p. 197.

reserves of the Georgian CB were doubled. Despite the sharp decline in taxes, budget revenues have increased by 5 times. The passage of the Baku-Tbilisi-Ceyhan oil pipeline through this country has made it an important transit country. Oil shipment is also carried out through the Georgian Railway. In addition, in 2006 Baku – Tbilisi - Erzurum transit gas pipeline which the release capacity is 6.6 million cubic meters per year was put into operation.<sup>13</sup>

During 1991-2009, there was no improvement in the real sector of the Georgian economy. The volume of industrial production continued to decline and in 2009 it amounted to nearly 39% of the level in 1991. The sharp decline in the volume of industrial production took place in 1992-1995. The average rate of decline in this period was 34%.<sup>14</sup>

Since 2010, the economic growth has been restored. Compared to 2009, the country's GDP growth was 6% in 2010 and 5% in 2015 compared to 2014.<sup>15</sup> After this period, the provision of economic growth is largely due to restoration of export growth and a sharp increase in the private sector lending. Further development of the Georgian's economy will be related to attract indirect foreign investment, policy aimed at expanding export potential, as well as transit potential of the country.

A significant dynamics indicator of economic transformation and development is the foreign economic relations, reflecting changes both in the structure of the national economy and also in the interaction with separate countries.

Significant changes in the geographical structure of foreign trade took place in the period of 1995-1999, on the conditions of the deepening of economic decline and the break of regional co-operation. The special weight of the CIS countries in the total trade turnover of Azerbaijan has

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<sup>13</sup> K. Kh. Zoidov, Durandin, O.G., "On the problem of the formation of innovative economy in the countries of the post - Soviet space under the conditions of modernization", Part I - III in *Regional problems of economic transformation.*, 2011. № 4; 2012. № 1-3.

<sup>14</sup> K.Kh. Zoidov, Zoidov, Z.K., *op.cit.*, p. 198

<sup>15</sup> Statistical indicators of Azerbaijan, *Statistical summary*, SSCAR, Baku, 2016. p. 824.

dropped sharply, from 39.3% to 27.3%, including export from 44.7% to 22.7%. The decline in Armenia was 53.3% - 23.4%. There has been no pragmatic change in Georgia and remained at the level of 39 – 40%.<sup>16</sup>

In 2016, 25.3 % of Azerbaijan's import operations were accounted by the Independent Societies Union, 26.0 % by the European Union, 38.8 % by the Black Sea Economic Cooperation Organization, 17.6 % by Economic Cooperation Organization, 19.7 % - by Islamic Cooperation Organization, 42.3 % - by Asian-Pacific Economic Cooperation Organization and 52.4% - by Economic Cooperation and Development Organization.<sup>17</sup> Compared to 2012, the special weight of the Commonwealth of Independent States, the Black Sea Economic Cooperation Organization and the Asia-Pacific Economic Cooperation Organization has increased in imports in 2016.

In 2016, 43.2 % of Azerbaijan's export operations were made by the European Union, 22% by the Black Sea Economic Cooperation Organization, 15.2% by the Economic Cooperation Organization, 19.3% by the Islamic Cooperation Organization, 20.3% by Asia-Pacific Economic Cooperation Organization and 60.9% by the Economic Cooperation and Development Organization [12, p.35]. In comparison with 2012, the special weight of the Commonwealth of Independent States, the Black Sea Economic Cooperation Organization, the Economic Cooperation Organization, the Islamic Cooperation Organization and the Organization for Economic Co-operation and Development (ECOD) increased in 2016. In general, 95.9% of Azerbaijan's exports, 90.8% of imports fall to the share of geographical region of Europe and Asia.<sup>18</sup>

Diversification of external demand for traditional goods and industrialization, hesitations in the world's fuel and raw material market, the exploitation of large infrastructure facilities, the increase in the domestic

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<sup>16</sup> L.B. Vardomsky, Pylin A.G., Sokolova T.V., *The countries of the South Caucasus: peculiarities of development and regional interaction*, - M.: Institute of Economics, Russian Academy of Sciences, RAS, 2014. p. 35.

<sup>17</sup> Foreign trade of Azerbaijan, *Statistical summary*, Baku: SSCAR, 2017, p. 33.

<sup>18</sup> Foreign trade of Azerbaijan, *op. cit.*, pp. 36-37.

demand for high quality imported goods, the liberalization of foreign trade, the structure and dynamics of the foreign trade relations of the South Caucasian countries in the background of the development of regional economy related to Georgia and Armenia's joining to the WTO have undergone serious changes in 2000 - 2015. (Table 3).

The highest growth rate of foreign trade in this period was recorded in Azerbaijan, and the lowest in Armenia. The rapid growth of foreign trade in Azerbaijan was primarily caused by the production of hydrocarbon resources and the rise in their world prices in the second half of 2000. Compared to 1999, the foreign trade turnover of Azerbaijan increased by 48.4% in 2000, and compared to 2007, it increased by 5 times in 2008. Compared to 2012, the growth was 6.3% in 2013. In recent years, the dynamics of this indicator has been diminished. Compared to 2000, the value of exports in 2008 increased about 28 times in value, and compared to 2009, an increase was approximately 2.1 times in 2014.<sup>19</sup>

**Table 3**

Dynamics of foreign trade of the South Caucasus countries in 2000 -2015<sup>12</sup>  
(billion USD)

Countries / indicators	2011	2012	2013	2014	2015
<i><b>Azerbaijan</b></i>					
Export	<b>26,6</b>	<b>23,9</b>	<b>24,0</b>	<b>21,8</b>	<b>12,7</b>
Import	<b>9,8</b>	<b>9,7</b>	<b>10,7</b>	<b>9,2</b>	<b>9,2</b>
Foreign trade turnover	36,4	33,6	34,7	31	21,9
Difference (+;-)	<b>16,8</b>	<b>14,2</b>	<b>13,3</b>	<b>12,6</b>	<b>3,5</b>
<i><b>Armenia</b></i>					
Export	<b>1,3</b>	<b>1,4</b>	<b>1,5</b>	<b>1,5</b>	<b>1,5</b>
Import	<b>4,1</b>	<b>4,3</b>	<b>4,4</b>	<b>4,4</b>	<b>3,2</b>
Foreign trade turnover	5,4	5,7	5,9	5,9	4,7
Difference (+;-)	<b>-2,8</b>	<b>-2,9</b>	<b>-2,9</b>	<b>-2,9</b>	<b>-1,7</b>
<i><b>Georgia</b></i>					

<sup>19</sup> Foreign trade of Azerbaijan, *Statistical summary*, SSCAR, Baku, 2017, p. 13

Export	2,2	2,4	2,9	2,9	2,2
Import	7,1	8,1	8,0	8,6	7,3
Foreign trade turnover	9,3	10,5	10,9	11,5	9,5
Difference (+;-)	-4,9	-5,7	-5,1	-5,7	-5,1

Compared to 2011, the volume of foreign trade turnover of Azerbaijan in 2014 amounted to 36.4 billion dollars from 31 billion dollars and the volume of export declined to 21.8 billion dollars from 26.6 billion. However, despite the high volume of export operations, the country's foreign trade balance was positive.

The high share of import transactions in the foreign trade of Armenia and Georgia led to their foreign trade balance to be negative. The positive trade balance of Azerbaijan is 6.1% of the country's GDP, the negative trade balance of Armenia and Georgia is 16 % and 36.4 % of their GDP, respectively.

In Georgia, the increase of import in value comprises 11.1 times. This led to considerable liberalization of foreign trade policies. In June 2000, Georgia joined the WTO. In 2007, the new Customs Code started functioning.<sup>20</sup>

Another factor of the rapid growth of this country's import operations is the strengthening of the national currency in the context of a large-scale flow of foreign capital.<sup>21</sup> Finally, the third factor of increasing imports is the broad application of re-export of goods in Georgia. A number of sectors of Georgia's economy have been oriented towards the import and re-sale of foreign products.<sup>22</sup>

The increase in imports and exports in Armenia was less significant and increased by about 5 times. Like Georgia, Armenia has substantially

<sup>20</sup> L.B. Vardomsky, Pylin A.G., Sokolova T.V., *The countries of the South Caucasus: peculiarities of development and regional interaction*, M.: Institute of Economics, Russian Academy of Sciences, RAS, 2014, p. 36.

<sup>21</sup> See A. Pylin., "The Economics of Post - Soviet Georgia: Trends and Problems", *The Russian Economic Journal*, 2013, No. 1. pp. 86-95.

<sup>22</sup> L.B. Vardomsky, Pylin A.G., Sokolova T.V., *op. cit.*, p. 36.

liberalized its foreign trade policy. In February 2003, Armenia joined the WTO. The import customs tariffs applied in this country are the lowest among WTO member countries and the tariff quota is not used in the country.<sup>23</sup> One of the major factors that hinders the active growth of foreign trade in Armenia is high transport and logistics costs.<sup>24</sup>

Despite the fact that in recent years, the three countries have a high rate of economic growth, raw material orientation in their export has clearly shown itself.

The diversity of foreign trade dynamics and the scale of the economy have created differences in the foreign trade openness. Thus, the quota of external debt turnover in 2015 was 40.6% in Azerbaijan, 67.9% in Georgia and 44.3% in Armenia. The indicator of Georgia and Armenia's foreign trade deficit is substantially lower and it is determined by export in Azerbaijan.

The South Caucasus countries have significant transit potential. It is necessary to have favorable transportation and logistics conditions in the form of relevant institutions and modern vehicles for the development of transit traffic, income generation and transit costs reduction. The emergence of new international relations has been one of the key areas of transformation of the South Caucasus region.

The transit potential of Azerbaijan is determined by the fact that it is neighbor to Russia from the north, to Iran from the south and to Turkey from the west. Georgia has great transit potential, which is conditioned by its geographical location in the Black Sea with neighboring countries such as Azerbaijan, Armenia, Russia and Turkey. Through its territory, Caspian hydrocarbons are transited to Turkey and the Europe, and Russian gas to Armenia. The development of transit potential of Armenia slowed down by the war conditions actually related to Armenia's invasion of Azerbaijan's lands and the lack of access to the sea. Among the South Caucasus countries,

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<sup>23</sup> Armenia and the Customs Union: assessment of the economic effect of integration. CIS EDB. Report No. 20. 2013. p. 8.

<sup>24</sup> Vardomsky L.B., Pylin A.G., Sokolova T.V., *op. cit.*, p. 37.



Georgia uses more than others its transit potential (transport services comprise 5 - 6% of export GDP). In Azerbaijan and Armenia, this indicator is 1 - 2%, which is mainly explained by the fact that Azerbaijan is on a large scale in the economy and Armenia is out of the process.<sup>25</sup>

It is necessary to improve the quality of transport infrastructure, establish a modern logistics center and develop border checkpoints in order to increase the transit potential of the South Caucasus countries. In the modern world, regional states differ in the level of transport infrastructure development. According to the information given by the World Economic Forum, the rapid development of transport infrastructure has been observed in Azerbaijan (55th among 148 world countries) and Georgia (58). Armenia is still far behind this indicator (67)<sup>26</sup>.

According to the results of 2016, Azerbaijan ranks in the 51st place according to the infrastructure index, including, for the quality of roads – 36th, railway infrastructure – 20th, port infrastructure – 40th, air transport infrastructure – 24th and power supply – 50th. Armenia ranks in the 80th place for the index of infrastructure, including, for the quality of roads – 85th, railway infrastructure – 64th, port infrastructure – 125th, air transport infrastructure – 52th and power supply – 77th. In this rating, Georgia ranks in the 69th place for the index of infrastructure, including, for the quality of roads – 82th, railway infrastructure – 39th, port infrastructure – 69th, air transport infrastructure – 69th and power supply – 68<sup>th</sup>.<sup>27</sup> The future development of the transit potential of the region will contribute to the construction and modernization of the new transport infrastructure.

The countries of the region are far behind in the development of trade and logistics environment and border checkpoints system. In 2010, Azerbaijan ranked relatively high in the rating of the World Bank (LPI index) on the efficiency of logistics (89th among 155 countries in the world). Georgia ranked in the 93rd and Armenia in the 111th place respectively.

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<sup>25</sup> Vardomsky L.B., Pylin A.G., Sokolova T.V., *op. cit.*, p. 26.

<sup>26</sup> Global\_Competitiveness\_Report\_2015-2016.pdf, p.58, p.67.

<sup>27</sup> Global\_Competitiveness\_Report\_2017-2018.pdf, p. 393.

According to the results of 2016, Armenia ranks in the 141th place and Georgia in the 130th place. The main challenges in the region are low reliability and quality of customs and border control, and logistics.

### **3. Main results**

Thus, the strong development of the oil and gas industry and complex economic reforms in Azerbaijan during the period studied have dramatically increased its economic weight in the South Caucasus. In this regard, the socio-economic differentiation of the region has increased. The growth of oil and gas production in Azerbaijan, the creation of an international pipeline network, and the development of other types of transport have sharply expanded the transit function of Azerbaijan and Georgia. Relationships established and being formed allow for the development of mutual trade. Two places that characterize a very high level of interaction of national economies in the South Caucasus - Azerbaijan – Georgia and Georgia – Armenia, as well as, integration unions have been formed within the composition of Azerbaijan, Georgia and Turkey.

The main criteria showing the image of Azerbaijan in the world are related to its being a stable country, reliable energy supplier and having extensive transit opportunities, favorable geographical location, space industry, the South Caucasus's most developed economy and rapid development of the economy. The Davos Economic Forum's being held in Baku on the "Strategic Dialogue about the Future of the South Caucasus and Central Asia" on April 7-8 is not accidental. By organizing this forum, our country didn't just approved that is a leading country in the region in terms of economy, but also Azerbaijanis a decisive country in the integration of South Caucasus and Central Asia. At the same time, on September 14, 2017, the extension of the term of Agreement on joint development and production sharing for the Azeri and Chirag fields and the Deep Water Portion of the Gunashli field in the Azerbaijani sector of the Caspian Sea until 2050 at HeydarAliyev Center will play a key role in the economic development of the country and the region in the coming decades.

Finally, Azerbaijan's declaration on its achievement of a great progress in social and economic spheres, its important role in global energy market, acting as a guarantor of energy security for many countries in the world, as an important oil and gas supplier in international markets, Azerbaijan's being persistent in the completion of the project "Southern Gas Corridor", one of the largest infrastructure projects in the world, together with its international partners and making big investments in East- West and North- South transport corridors at the 72<sup>nd</sup> session of the UN General Assembly on 20 September 2017 once more proves that our country has a strong economic and political potential in the South Caucasus region, and Azerbaijan will play an important role in the development of region's natural resources, transport, infrastructure, agriculture, mining, telecommunications and finance sectors and regional economic relations, future strategic planning, and improvement of regionalization level.

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