

The European Union and Transcaucasus (South) Countries: On a Cross-road

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Abstract

This study is an attempt to analyze EU policies towards the Southern Caucasus that deals basically with the changes in EU policies from 1999 to date. The EU policy towards the region can be analyzed in two phases. First, the study will discuss the EU support during the 1990-1999 phase in relation to the economic and technical aid offered to the region. Second, the study attempts to analyze the EU's active policies since 1999 in terms of changes in EU policies as well as the causes of this change and the importance of the region for the EU. The study will conclude by asserting that political and economic stability cannot be reached without solving the problems in the region. In this context, the importance of the EU in the establishment of peace and stability in this framework are also discussed.

ევროგაერთიანება და ტრანსკავკასიური ქვეყნები გზაჯვარედინზე

მუნირ ჰუსეინი

ნაშრომი წარმოადგენს ევროგაერთიანების პოლიტიკის ანალიზს სამხრეთ კავკასიასთან დაკავშირებით. კვლევა მოიცავს პერიოდს 1999 წლიდან დღემდე. ევროგაერთიანების პოლიტიკა მოცემული რეგიონის მიმართ შესაძლოა განვიხილოთ 2 ფაზაში: პირველ ფაზაში წარმოდგენილია აღნიშნული რეგიონის მიმართ ევროგაერთიანების ტექნიკურ-ეკონომიკური დახმარება, 1990-1999 წლებში. მეორე ფაზაში განხილულია ევროგაერთიანების პოლიტიკა 1990 წლიდან, ევროგაერთიანების პოლიტიკის ცვლილების, ცვლილებათა მიზეზების კვლევისა და ევროგაერთიანებისათვის კონკრეტული რეგიონის მნიშვნელობის თვალსაზრისით. აღსანიშნავია, რომ სამხრეთ კავკასიის რეგიონში პოლიტიკური და ეკონომიკური სტაბილურობა რეგიონშივე არსებული პრობლემების მოგვარების გარეშე შეუძლებელია. აღნიშნულ კონტექსტში, ნაშრომი განიხილავს ევროგაერთიანების როლს მშვიდობისა და სტაბილურობის დამყარებაშიც.

This study is an attempt to analyze EU policies towards the Southern Caucasus. The EU's interest in the region in the wake of independence remained basically in the economic sphere, limited especially to economic aid, since economic aid was thought to be sufficient for the solution of the region's problems. With the Partnership and Cooperation Agreement concluded in 1999 in Luxembourg, the EU interest in the region has changed, as the EU has decided to enhance its political profile in the region in addition to its economic interests. This study deals basically with the changes in EU policies from 1999 to date.

The EU policy towards the region can be analyzed in two phases. First, the study will discuss the EU support during the 1990-1999 phase in relation to the economic and technical aid offered to the region. This part focuses on the EU's choice to take a backseat in issues relating to the solution of regional problems and to the establishment of stability in the region. Second, the study attempts to analyze the EU's active policies since 1999 in terms of changes in EU policies as well as the causes of this change and the importance of the region for the EU. In this context, the impacts of the EU policies on South Caucasia are also within the context of this discussion. The study will conclude by asserting that political and economic stability cannot be reached without solving the problems in the region, and instability will eventually threaten European security and stability in the long run. In this context, the importance of the EU in the establishment of peace and stability in this framework are also discussed.

What the South Caucasus region is?

Before going into detail South Caucasus we have to know slightly geography of Caucasus or Caucasia. This is a region in Eurasia bordered on the south by Iran, on the southwest by Turkey, on the west by the Black Sea, on the east by the Caspian Sea, and on the north by Russia. The Caucasus includes the Caucasus Mountains and surrounding lowlands.

The Caucasus Mountains are commonly reckoned as a dividing line between Asia and Europe, and territories in Caucasia are variably considered to be in one or both continents. The northern portion of the Caucasus is known as the Ciscaucasus and the southern portion as the Transcaucasus. The highest peak in the Caucasus is Mount Elbrus (5,642 m) which, in the western Ciscaucasus in Russia, is generally considered the highest point in Europe.

The Caucasus is one of the most linguistically and culturally diverse regions on Earth. The nation-states that compose the Caucasus today are the post-Soviet states Georgia, Armenia, and Azerbaijan; and various parts of Russia and Iran. The Russian divisions include Krasnodar Krai, Stavropol Krai, and the autonomous republics of Adygea, Kalmykia, Karachay-Cherkessia, Kabardino-Balkaria, North Ossetia, Ingushetia, Chechnya, and Dagestan. Three territories in the region claim independence but are not generally acknowledged as nation-states by the international community: Abkhazia, Nagorno-Karabakh and South Ossetia (Wikipedia, Caucasus).

South Caucasus, also referred to as Transcaucasia or Transcaucasus, is the southern portion of the Caucasus region between Europe and Asia, extending from the Greater Caucasus to the Turkish and Iranian borders, between the Black and Caspian Seas.

The area includes the Colchis Lowland, Kura Lowland, Talysh Mountains, Lenkoran Lowland, Caucasus Minor, and Javakheti-Armenian Uplands.

All of Armenia is in Transcaucasia; the majority of Georgia and Azerbaijan, including the exclave of Naxçivan, fall within this area. The countries of the region are producers of oil, manganese ore, tea, citrus fruits, and wine.

In Western languages, the terms Transcaucasus and Transcaucasia are translations of the Russian *zakavkazje* meaning “the area beyond the Caucasus Mountains”, i.e., as seen from the Russian capital (analogous to the Roman terms *Transalpine* and *Transpadania*).

The region remains one of the most complicated in the post-Soviet area, and comprises three heavily disputed areas - Abkhazia and South Ossetia in Georgia, and Nagorno-Karabakh in Azerbaijan (Wikipedia, South- Caucasus).

Burning Issues of South caucasia and their background

In early 1990s the South Caucasus states Armenia, Azerbaijan and Georgia gained their independence and sovereignty. Since then these states have chosen the path of democratic governance (adoption of Constitution, division of powers, etc.), civil society (development of the NGO sector and independent mass media) and liberal economy (free market). However, currently Armenia, Azerbaijan and Georgia are in an acute period of political, economic, social and cultural readjustment. There have been enormous qualitative and quantitative

changes in society since early 90s due to several key factors, such as:

- < Inevitable but still severe post-Soviet social-economic collapse related with wide-spread corruption;

- < Armed conflicts between Armenia and Azerbaijan over Nagorno Karabakh, and in Georgia (Abkhazia and South Ossetia), which reached high-intensity stage and later grew into a protracted “frozen” stage;

- < Humanitarian crisis characterized by the vast flow of refugees and IDPs in the aftermath of regional conflicts as well as the exodus of population (including intellectual capital) to abroad for better opportunities and life conditions;

- < Process of democratization and institutional reforms of political, military, economic and social systems in compliance with international standards and their gradual integration into the international community;

- < Development of various strategically important economic projects with vast international assistance and support. The projects based on the region's key strategic location (Transport Corridor Europe-Caucasus-Asia) and energy resources (oil/gas resources along with pipeline routes, such as BTC and SCP).

The issues discussed above are, the most arduous challenge appeared to be armed conflicts that took up enormous amount of national human and economic resources, on one hand, and aggravated number of socio-economic and political hardship, on the other. After the ceasefire agreements over the conflicts were reached (over Nagorno Karabakh in May 1994; over Abkhazia in July 1993 - yet broken in September 1993 and regained in April 1994, and over South Ossetia in June 1992), much effort has been spent by the international community towards the final resolution of the conflicts, which mainly faced the hard-edged and polarized approaches of the conflicting parties. Also, these conflicts have had their deep impact on the societies awaking latent negative feelings, strengthening existing negative stereotypes and nationalism in general.

As a result of Azerbaijani-Armenia conflict over Nagorno Karabakh, Georgian-Abkhazian, and Georgian-South-Ossetian conflicts the following issues have become key factors for the development of South Caucasus states:

- Unresolved conflicts still decisively influence the political life of Armenia, Azerbaijan and Georgia and hamper the process of their further democratization; military structures have gained an influential role in Armenian society, pushing back other democratic institutions and negatively affecting the country's democratization process in general;

< The regions uncontrolled by federal authorities have provided a solid ground for corruption, lack of transparency and isolation of civil control over the decision making process;

< The conflicts in Georgia have hardened the relations with Russian Federation. Unresolved conflict over Nagorno Karabakh breeds tensed relations between Armenia and Turkey, which altogether seriously slows down the process of integration in the region;

< Hundreds of thousands of refugees and IDPs flown from the conflict zones, and the issue of their resettlement are still a serious social problem (GPPAC, “Regional_Action_Agendas”).

EU Interests in Caucasus stability

There are a few reasons why the South Caucasus has special importance for the EU.

EU's growing interest in diversification of the energy supplies, first of all gas, pushes it towards closer cooperation with the Caucasus. In the coming decade the region will experience major changes coming from the significant oil and gas production and transportation. In Azerbaijan the expected revenues from the fields in the Caspian according to estimates, in the next few years, with peak of production in 2012, will amount to 160-180 billion dollars (compare to the current state budget of 4 billion dollars). The oil pipe-line Baku-Tbilisi-Jeyhan, construction of which was completed in 2005 started to deliver “big oil” from the major offshore field Azeri-Chirag-Guneshli from the Caspian to the European markets. The gas from the field Shahdeniz in the Azerbaijani sector of the Caspian is expected to be delivered to the European consumers upon the construction of the pipe-line Baku -Erzerum in 2006, thus contributing to the diversification of the energy supplies for Europe, who has been strongly dependent on Russian gas supplies. The convenient geographic location on the cross roads of major East-West transportation routes is making the Caucasus attractive in trade, military and communication terms. Azerbaijan and Georgia, connecting exits to two seas - Caspian and Black Sea provide a convenient transit from the Central Asia oil and gas resources in Kazakhstan, Turkmenistan to Europe.

On the other hand, the Caucasus states, previously being weak and unstable, are now capable of providing security through cooperation with their European and American partners in the joint programs on fight with terrorism, trafficking, in peacekeeping. All this justifies EU greater involvement in the region. For the EU the main rationale

behind the European Neighborhood Policy (ENP) is in development of the “zone of prosperity and a friendly neighborhood - a “ring of friends”, with whom the EU enjoys close, peaceful and cooperative relations”. The Strategy of European Neighborhood Policy says, that “the European Union has a strong interest in the stability and development of the South Caucasus”.

Definitions, made mainly in the terms of real interests, however, often put some limitations of the understanding of the significance of the region and lead to underestimation of the degree of closeness between the EU and South Caucasus. The Caucasus has common borders with influential regional powers, such as Russia and Iran, who are in the focus of the international attention. The South Caucasus as a historical bridge between the cultures and civilizations and promoter of modernization farther to the East and the South bears no less significance for EU, than as an energy producer or military hub. Azerbaijan, the country with pre-dominantly Muslim population, has demonstrated a unique example of modernization, caused by the development of industrial capitalism in the 19th - early 20th centuries. The latter promoted transformation which resulted in political pluralism, development of liberalism and creation of the first democratic republic in the Muslim world in 1918, the reform influence of which extended to Iran, Ottoman Empire, Central Asia. The institutions of the pre-Soviet period appeared to be strong enough to survive totalitarianism, while the liberal traditions nowadays continue to survive post-Soviet autocracy in the form of political opposition, plurality of media and civil society. This indicates presence of a significant reform potential in the South Caucasus societies, which, if developed, can have a considerable influence on geographical areas extending the borders of the region and lead to the greater ring of friendly states with enduring and democratic stability (Alieva, 2006).

Instability in the South Caucasus is a threat to EU's security. Geographic proximity, energy resources, pipelines and the challenges of international crime and trafficking make stability in the region a clear EU interest. Yet, the unresolved Nagorno-Karabakh, Abkhazian and South Ossetian conflicts have the potential to ignite into full-fledged wars in Europe's neighbourhood. To guarantee its own security, the EU should become more engaged in efforts to resolve the three disputes. It can do so by strengthening the conflict resolution dimension of the instruments it applies. As the EU is unlikely to offer membership to Georgia, Armenia and Azerbaijan even in the medium term, it must identify innovative means to impose conditionality on

its aid and demonstrate influence. This is a challenge that Brussels has only begun to address (Europe Report, 2006).

The Southern Caucasus has severe problems waiting to be solved. First of all, the region is crowded with external actors. The region witnesses the conflicting interests of the neighbouring countries on the one hand and of the external powers on the other hand, thus making it even harder to establish stability in the region. Its geographic location makes the region a natural conduit for trafficking, smuggling and all kinds of organised crime. In this respect, any kind of destabilisation in the region may have an impact on the security of the European Union. Also, the continuation of the 'frozen conflicts' in South Caucasia jeopardises Caucasian security, prevents a unified response from regional states against outside threats (Svante, 1999,p.103), and prevents the development of prosperity, democracy, peace and stability. The EU and its member states seek economic objectives in the South Caucasus. The South Caucasus represents a micro region of the broader Caspian region and can consequently be considered an important area for the EU facing new energy needs, with a view to attempt to diversify its energy supplies.

Due to its geographic location, at the extreme edge of Europe, the South Caucasus could assume a key role of an energy corridor and direct trade channel between the East and West. Therefore, resolution of frozen conflicts can be seen as a prerequisite for securing energy export routes ("Caucasian Preconditions for the development of an integrated European Policy Towards the South Caucasus", 2004).

Georgia and Azerbaijan are willing to integrate with the West. Georgia's new leader, and its Prime Minister Zurab Zhvania, have expressed their wish to enter the EU on various occasions (Mikheil Saakashvili, 2004, p. 47; Zhvania, June 16). Georgia has a long way to go for EU membership. Azerbaijan and Georgia cannot fulfil the requirements of rapprochement with the West without solving the problems of Karabakh and of South Ossetia and the Abkhazia problems, respectively. Also, solving these problems will improve the integration of the regional states, the opening of borders, and possibilities for cooperation.

Democracy and human rights should be promoted. Eradicating corruption, strengthening the rule of law and human rights, alleviating poverty, are the directions toward which the countries need to channel their attempts. A compulsory condition for ensuring stability in the South Caucasus is the promotion of co-operation between the states of South Caucasus. Within the framework of the question, what can the EU do to promote cooperation in the region? (Demira, 2004 – 2005)

EU-South Caucasus: On a cross-road

The EU appeared on the South Caucasus scene in the early 90s. In the wake of the Rome Summit of December 1990, the EU launched the TACIS (Technical Assistance to the Commonwealth of Independent States) programme to sustain the economic reform and development process in the CIS countries and to support their integration to the world economy. After the summits held in Luxemburg on 28-29 June 1991, 9-10 December 1991 in Maastricht, and 25-27 June 1992 in Lisbon, more emphasis was put on the development of relations with the former Soviet republics. In this context, TRACECA (Transport Corridor Europe-Caucasus-Asia) and INOGATE (Interstate Oil and Gas Transport to Europe) were initiated under the TACIS programme. TRACECA (TRACECA; INOGATE), launched in 1993, aims at facilitating the countries' access to world markets by developing a transport and transit corridor. It is in fact the revitalisation of the ancient Silk Road.

In 1998, within the TRACECA framework, 12 states signed a multilateral treaty in Baku, regulating international transportation of people and goods (United States Energy Information Administration, 1998). For the countries within the programme, the TRACECA Project provides an alternative to the traditional and widely used Moscow route and hence bears strategic importance to present an alternative transportation route to Europe. Moreover, agreement was reached for the transportation of heavy-duty material through the TRACECA route and it was emphasised that this corridor is the shortest, fastest, and cheapest route from Asia to Europe. The technical support to be provided within the Programme was also sustained by the IMF, the EBRD and the World Bank (IBRD). INOGATE, launched in 1995, aimed to create a favourable environment for attracting private investment in the field of oil and gas and facilitating their transportation through the provision of technical assistance. A special emphasis was put on the rehabilitation of existing infrastructure (INOGATE Newsletter, 1999, p.1-2). At its first summit in 1999, an Umbrella Agreement was signed on the development of hydrocarbon transportation networks between the Caspian Basin and Europe across the Black Sea region. The agreement allows countries not covered by EU's TACIS programme to join infrastructure projects, and has so far been signed by 21 countries, including all the BSEC members except Russia. A secretariat for INOGATE was set up in Kyiv in November 2000 (Aydin, M).

Since 1992, the EU has provided just over a billion euros in assistance to the three states of the South Caucasus, distributed through a range of programmes as described above.

From 1992-2000, the EU allocated 317.78 million in grants to Georgia, as summarised in Table I. The EU has supported Georgia through a range of instruments such as the TACIS programme, ECHO Humanitarian Assistance, Food Aid Operation, Food Security Programme, Exceptional Humanitarian Assistance.

EU Relations to South Caucasus Countries

1. EU-Armenia Relations

The Partnership and Cooperation Agreement (PCA) with Armenia, initially signed in April 1996, has been the legal framework for EU-Armenia bilateral relations since it entered into force at the start of July 1999. In this context, respect for democracy, principles of international law, human rights, and the principles of the market economy are the essential elements on which the EU-Armenian partnership is based. The PCA provides a framework for wide-ranging cooperation in the areas of political dialogue, trade, investment, economic, legislative, and cultural cooperation.

The various joint institutions set up under the PCA (Cooperation Council, Cooperation Committee, Subcommittee on Trade, Economic and Related Legal Affairs, as well as the Parliamentary Cooperation committee) have functioned smoothly and have ensured a regular political dialogue. Cooperation Councils have been held annually since 1999 (the latest in Brussels in September 2004), whilst the latest bilateral meeting between the two sides was an informal EU Troika Meeting with Armenia on 13th December 2005.

In July 2003, bilateral relations between the EU and the dialogue between the two sides were further strengthened by the appointment of Ambassador Heikki Talvitie as the first EU Special Representative for the Southern Caucasus. His mandate includes assisting the EU in developing a comprehensive policy towards the region, and supporting the conflict prevention and settlement mechanisms currently in operation there.

The decision taken by the European Council on 14th June 2004 to incorporate the countries of the Southern Caucasus into the framework of the European Neighbourhood Policy, is indicative of the EU's willingness to extend cooperation with Armenia beyond that provided for under the existing framework of the PCA. Armenia is

invited to enter into closer political, economic and cultural relations with the EU, to enhance cooperation, and to share responsibility for conflict prevention and resolution in the surrounding region. The Union offers the prospect of a stake in its internal market, of heightened bilateral trade, and of further economic integration.

As a first step in this direction, a country report assessing current progress in Armenia towards political and economic reform, was published on 2nd March 2005, highlighting areas in which bilateral cooperation could feasibly and valuably be strengthened. Since then, work has begun on drafting the ENP Action Plan for Armenia, which sets jointly defined priorities in selected areas for the next five years. Formal consultations on the Action Plan were opened in Yerevan on 28th November 2005 and are currently ongoing (European Commission External Relations, October 27, 2008).

Political relations:

The EU has an interest in Armenia has developed in the context of a politically stable and economically prosperous Southern Caucasus. In this respect, the conflict with Azerbaijan over Nagorno-Karabakh (NK) remains the major impediment to development in the country and contributes to regional instability. It is also hoped that the opening of EU-Turkey accession talks will help to facilitate a rapprochement between Turkey and Armenia, ultimately leading to a reopening of the border between the two countries.

In the context of the European Neighborhood Policy, the EU is committed to developing an Action Plan in consultation with Armenia which both reflects the specificity of the country, and contains concrete goals and actions to be achieved in the short and medium term.

Trade

The EU is Armenia's primary trading partner, accounting for 38.7% of Armenian exports and 34% of its imports in 2004, around three times higher than US-Armenia trade. In absolute terms, however, bilateral trade between the two is extremely limited, amounting to just €474 million in 2003. It is also extremely concentrated and dominated by the trade in precious stones which are imported, polished, and subsequently re-exported to the EU. These account for 63% of EU imports from Armenia, and 34% of EU exports to the country. The EU

also imports base metals, whilst its exports are dominated by machinery, equipment, and vehicles.

Assistance

EC assistance to Armenia since 1991 amounts to more than 380 million. Humanitarian assistance (notably ECHO and Food Aid Operations through the European Agricultural Guarantee and Guidance Fund, EAGGF) has accounted for nearly €120 million and has contributed to alleviating the very severe humanitarian situation in the mid-1990s. TACIS national allocations and the Food Security Programme each represent around € 100 million.

TACIS Programme

With the approval of the Country Strategy Paper in December 2001, TACIS assistance to Armenia in the period 2002-2006 is focusing on continued support for institutional, legal and administrative reform as well as on support in addressing the social consequences of transition. TACIS is providing essential assistance to the implementation of Armenia's Poverty Reduction Strategy approved in 2003. The 2002-2003 Action Programme (€ 10 million) is currently being implemented. The 2004-2005 Action Programme (also 10 million) has recently been agreed.

Armenia also participates in Tacis regional programmes like TRACECA, INOGATE and the Regional Environmental Centre for Southern Caucasus, based in Tbilisi, Georgia.

Macro financial assistance

In December 1998, Armenia settled the remaining amount of its debt to the Community. The country subsequently benefited from a new Macro Financial Assistance package of a €28 million loan and a total grant of €30 million to be disbursed over the period 1999-2005, subject to macro-economic performance and structural reforms. In the context of the IMF-supported economic programme, this assistance has contributed to the sustainability of Armenia's external debt.

Food Security Programme (FSP)

The Food Security Programme (FSP) has provided significant budgetary support to key agricultural and social sectors in Armenia and has thus played an important role in tackling poverty in Armenia,

notably through its support for family allowances and child care. The combination of budget support and technical assistance through FSP (with complementary TACIS technical assistance) has also enabled significant reforms to be made in the field of land reform and public finance management. Implementation of FSP has been very successful and further such support is envisaged for 2005-2006 (€ 21 million) notably to assist Armenia in continuing to implement its Poverty Reduction Strategy.

Humanitarian Assistance (ECHO)

ECHO has been present in the NIS region since the early 1990s, in accordance with its core mandate (humanitarian assistance in response to natural or man-made disasters). From 1993 to 1999, ECHO's operational funding in the southern Caucasus has been considerable, with € 64.255 million of humanitarian aid going to Armenia, € 83.34 million to Georgia and € 82.96 million to Azerbaijan.

ECHO's withdrawal from post-emergency programmes in southern Caucasus started in 1996 and was completed in 2000 with a last allocation of € 3.855 million for the three countries. In 2000 and 2001 ECHO provided a total € 1.5 million as contribution to alleviating the consequences of the drought in Armenia. European Initiative for Democracy and Human Rights (EIDHR)

The EC European Initiative for Democracy and Human Rights (EIDHR) Programme launched its activities in support of NGOs in Armenia in 2003 with the objective of promoting and protecting human rights and democratization as well as conflict prevention and resolution.

Table 1

Total EC grants to Armenia since 1991 (in addition to the figures below, Armenia benefits from grants under the TACIS Regional Programme)

	1991-1993	1994	1995	1996	1997	1998	1999	2000	2001	2002-2003	2004-2006	Total M €
Tacis National Allocations	28.90	-	6.00	14.00	-	10.00	-	10.00	-	10.00	20.00	98.90
Nuclear Safety	-	-	-	10.00	10.00	-	-	11.00	-	-	7	29.00
ECHO	10.40	19.90	23.96	4.97	1.96	1.60	2.30	1.10	2.10	0.5	-	68.79
EAGGF	-	-	34.00	13.20	-	-	-	3.00	-	-	-	50.20
FSP	-	-	-	13.00	6.00	12.00	10.00	10.00	10.00	20.30	21.00	102.30
Macro financial assistance (disbursed)	-	5.70	-	-	-	8.00	4.00	-	-	11.00	7.00	35.70
Aid against effects of Russian financial crisis	-	1.50	-	-	-	-	-	-	-	-	-	1.50
Total M €	38.30	25.60	63.96	55.17	8.96	31.60	17.80	35.10	12.10	41.80	55.00	386.39

Selected economic and social indicators

General

Area: 29,700 km²

Population: 3,000,000 (World Bank, 2004)

Life Expectancy (2003): 75 years (WB, 2003)

Population growth rate: -1.2% (1999), -0.6% (2002), -0.4% (2003)

Population below poverty line: 32% (2003)

Economy

Nominal GDP 2003 (US\$): 2 billion

GDP per capita 2003: € 797

GDP Breakdown by sector value added (2002):

Agriculture: 26,2 %

Industry: 36,8 %

Services: 37 %

Real GDP growth rate: 2002:12.9%, 2003:13.9%, 2004: 10.1%

Inflation: 2002: 1.1%, 2003: 4.8%, 2004: 7.0% (European Commission External Relations, October 27, 2008).

2. EU - Relations with Azerbaijan

EU-Azerbaijan Trade Relations

Azerbaijan is the EU's largest trading partner in the Caucasus although this primarily relates to cotton, oil and gas. Since 1993 total trade with the EU has grown steadily. In contrast trade with the CIS states has fallen over the past years. Large scale privatisation is required and further economic diversification is essential. Azerbaijan holds a strategic location between the EU and Central Asia. Development of the TRACECA trade route will provide a cornerstone for future economic growth. The EU helped prepare the multilateral transport agreement which was signed at the Baku Summit in September 1998. Trade in textiles is covered by a specific agreement although the volume of trade with the EU is currently negligible.

A high-level dialogue on energy and transport in the Black Sea and Caspian Sea was launched at the Commission's initiative with the November 2004 Baku Ministerials, aimed at the development of a regional energy and transport market and its progressive integration with the EU market.

The fifth meeting of the Trade, Investment and related legal issues sub-committee was held in April 2005, where there was a substantive dialogue allowing an open and frank exchange of views. On 11 February 2005 the first meeting of the new sub committee on Energy and Transport was held in Brussels; its creation was a confirmation of the importance paid by both the EU and Azerbaijan to such strategic issues.

See for further information on bilateral trade the Commission's external trade website.

EU-Azerbaijan Political Relations

The Summit held in Luxembourg on 22 June 1999 marked the entry into force of the Partnership and Cooperation Agreement. At that occasion it adopted a Joint Declaration on relations between the EU and the Caucasus countries including Azerbaijan. The PCA covers cooperation in all non-military areas and its main elements are:

- < Elimination of trade quotas and provision of most favoured nation treatment
- < On investment: provision of MFN or national treatment to companies and freedom of capital movement
- < Protection of intellectual, industrial and commercial property rights
- < Yearly political dialogue at ministerial, parliamentary and/or senior official levels
- < The first Cooperation Council was held in Luxembourg on 12 October 1999 and the first Cooperation Committee was held on 27 March 2000. In total six Cooperation Councils have been held.
- < The latest bilateral meeting between the two sides was the EU Troika meeting with Azerbaijan, which took place on 13th December 2005 in Brussels.

In July 2003 the EU appointed a Special representative to the Southern Caucasus whose mandate is to (a) to assist the countries carry out political and economic reforms, notably in the fields of rule of law, democratisation, human rights, good governance, development and poverty reduction; (b) in accordance with existing mechanisms, to prevent conflicts in the region, to assist in the resolution of conflicts, and to prepare the return of peace, including through promoting the return of refugees and internally displaced persons (IDPs); (c) to engage constructively with key national actors neighbouring the region; (d) to encourage and to support further cooperation between States of the region, in particular between the States of the South Caucasus, including on economic, energy and transport issues; (e) to enhance EU effectiveness and visibility in the region.

Since its independence Azerbaijan has benefited a total of 399 Million of EC assistance, principally in the form of:

- < Humanitarian aid taking the form of feeding programmes, shelter for IDPs and refugees, medical programmes.
- < Food aid and budgetary food security assistance in the form of direct food aid and financial assistance to ensure food supplies

< Exceptional assistance for budgetary relief funding existing budget commitments to infrastructure investments that have close links to Tacis activities including energy projects, transport, nuclear safety and - Rehabilitation of territories damaged in the Nagorno-Karabakh conflict, including the rehabilitation of a railway line to Fizuli, electricity supplies, drinking water and irrigation and the reconstruction of schools.

The Tacis programmes since 1998 have concentrated on public sector reform and since 2002/3 put a stronger emphasis on poverty reduction following the adoption of a Poverty Reduction Strategy by Azerbaijan in late 2002. Below you find a table showing the main themes of the Tacis programmes for the period 1998-2006.

With the entry into force of the PCA and the improvement of the economic situation in the country the focus of EC assistance is shifting from humanitarian aid to rehabilitation, reconstruction and the promotion of trade and investment ties in between EC and Azerbaijan. EC assistance will also be used increasingly to reduce tensions resulting from the Nagorno-Karabakh conflict by supporting regional cooperation, post-conflict rehabilitation and by linking assistance levels to progress in conflict resolution.

EU feels strongly that the Minsk Group (OSCE) offers the best mechanism for the settlement of the Nagorno-Karabakh issue and fully support the efforts made by the Azeri Government and the Armenians to improve dialogue in recent months. Until progress is made over Nagorno-Karabakh regional stability will continue to be threatened and development stifled.

INOGATE (cross border energy initiative funded by Tacis) started the implementation of cross border small scale investment projects as a follow up to the Umbrella Agreement. Projects for the three Caucasus countries, such as improving cross border metering are included.

Future of EU-Azeri relations

The European Neighbourhood Policy marks a significant step forward in relations between the EU and Azerbaijan. Following a recommendation made by the Commission, the Council on 14 June 2004 decided to offer Georgia, Armenia and Azerbaijan to participate in the European Neighbourhood Policy. The Country report for Azerbaijan, assessing progress made by Azerbaijan with regard to political and economic reforms, was released on 2 March 2005. The European

Neighbourhood Policy builds on the existing Partnership and Co-operation Agreement but at the same time goes beyond it to offer the prospect of an increasingly close relationship with the EU, involving a significant degree of economic integration and a deepening of political cooperation. The ENP Action Plan for Azerbaijan which sets jointly defined key priorities in selected areas for the near future is in the process of being discussed, and the formal consultations on the Action Plan opened on 12th December 2005. The new assistance instrument ENPI (European Neighbourhood Partnership Instrument) will replace Tacis in 2007.

The continued development of the market economy is important and the creation of a business climate that is attractive to investment particularly from the EU is a key priority. In the wider social and political sphere, the strengthening of democracy and the respect for human rights remain of paramount importance.

General Data:

Official name: Azerbaijani Republic

Geography: area: 86.600 km²

Capital: Baku

Population: 8.3 million (2005 est.)

Ethnic groups: 90% Azeri, 3.2% Dagestani Peoples, 2.5% Russian, 2.3% Armenian

Religions: 93.4% Muslim, 2.3% Russian Orthodox, 2.3% Armenian Orthodox

Official Language: Azeri

Table 2
Political System

Constitution:	adopted 12 November 1995. Amended by referendum on 24th August 2002.
Legal system:	based on civil law system
Suffrage:	18 years of age; universal
Executive branch:	<p>chief of state: President İlham ALIYEV (since 31st October 2003)</p> <p>cabinet: Council of Ministers appointed by the president and confirmed by the National Assembly</p> <p>elections: president elected by simple majority vote to a five-year term; election last held 15 October 2003 (next to be held NA October 2008); prime minister and first deputy prime ministers appointed by the president and confirmed by the National Assembly</p> <p>election results: İlham ALIYEV elected president; percent of vote - İlham ALIYEV 76.8%, İsa GAMBAR 14%</p>
Legislative branch:	<p>unicameral National Assembly or Milli Mejlis (125 seats; members elected by first-past-the-post system to serve five-year terms)</p> <p>elections: last held 6th November 2005</p> <p>election results: Yeni Azerbaijan (New Azerbaijan) Party: 56, Popular Front: 1, Musavat: 5, Independent: 40, Ana Vata (Motherland): 2, Vətəndaş Hamraylıy (Citizens' Solidarity): 2, Others: 9</p> <p>The main opposition parties are given in bold. The results in 10 of the 125 constituencies have been invalidated by the Central Election Commission. Reruns will take place on 13 May 2006.</p>
Judicial branch:	Supreme Court

Economy:

Currency: Azerbaijani Manat (AZM) [New Manat as from 1 January 2006]

Total GDP: \$8.5 billion (World Bank, 2004)

GDP per capita: \$ 950 (World Bank, 2004)

GDP real growth rate: 10.6% in 2002, 11.2% in 2003, 10.2% in 2004

Real per capita income : purchasing power parity - \$3,390 (2003 est.)

Inflation rate (consumer prices): 6.7% (World Bank, 2004)

For a fuller set of social and economic indicators, please consult the World Bank page for Azerbaijan (http://devdata.worldbank.org/AAG/aze_aag.pdf)

Table 3
TACIS-Priorities since 1998:

Tacis Priorities	1998/99	2000/01	2002/03	2004/06
Institutional, legal & administrative reform	PCA	PCA	PCA	PCA
Originally Infrastructure Networks	Ministry of Transport	Ministry of Transport		
	Ministry of Fuel and Energy	Ministry of Fuel and Energy	Ministry of Fuel and Energy	
		Pay policy reform		
		Cabinet of Ministers reform		
	Social targeting of assistance			Social targeting of assistance
				Border guards and anti people traffic
	Customs	Customs	Customs	Customs
	Statistics	Statistics	Statistics	Statistics
				Ministry of Ecology
				Institution Building partnership incl. Civil society
Private sector & assistance for economic development.	SME Development	SME Development	SME Development	SME Development
	Rural Credit	Rural Credit		
			Ministry of Tax	Ministry of Tax
		Securities market		
		International accounting standards		International accounting standards
				Vocational training strategy
		MTP Tempus	MTP Tempus	MTP Tempus
Tacis Total	16.0 m	14.0m	14.0m	30.0m

Table 4
EC-assistance to Azerbaijan (€ million):

	1992-1994	1995	1996	1997	1998	1999	2000	2001	2002-2003	2004-2006
Tacis National Allocations	20.50	6.00	8.00	8.00	8.00	8.00	7.00	7.00	14.00	30.00
Exceptional Assistance					10.00	10.00	10.00			0
ECHO	31.09			28.82	7.70	6.10	4.10	3.36	1.5	0
FEOGA		43.0	22.65							
Food security			15	16	14.0	12.0			20.0	(30.0)
Rehabilitation			3.0	4.0	4.5	3.2	3.674			
Exceptional Humanitarian Aid		8.0						1.5		
Total	59.59	77.82	56.35	34.1	40.6	38.06	22.17	7	34	30 + (30)

Total 1992-2006: Million 399.674

(429.694 m if potential Food Security Allocations are included (European Commission External Relations, October 27, 2008).

3. EU-Georgia Relations

General

Based on the Partnership and Cooperation Agreement (PCA) entered into force on 1 July 1999, the EU's cooperation objectives are to build a relationship with Georgia in which the respect of democratic principles, the rule of law and human rights, as well as the consolidation of a market economy are fostered and supported. The PCA provides for trade liberalisation and cooperation in a wide range of areas. Tacis is the main financial instrument supporting the implementation of the PCA and providing grant assistance for projects in priority areas that are defined on a biannual basis.

The EU has an interest in Georgia developing in the context of a politically stable and economically prosperous southern Caucasus. In this respect, the conflicts in Abkhazia and Tskhinvali region/South

Ossetia remain a major impediment to development in Georgia and contribute to regional instability. The EU supports the principle of Georgian territorial integrity. The decision by the Council of Ministers in 2001 with respect to conflict resolution in the southern Caucasus has intensified the EU's political commitment to the region in the following years. EU's involvement is yet limited to the South Ossetia conflict where the EU provides support to the Joint Control Mission but it stands ready to look for further ways in which it could contribute to conflict resolution, as well as post-conflict rehabilitation.

The appointment in July 2003 of a European Union Special Representative for the South Caucasus (the Finnish diplomat, Amb Heikki Talvitie) was a further step in the deepening of relations with Georgia and the other two countries of the region, Armenia and Azerbaijan. It is however Georgia's "Rose Revolution" in November 2003 which has opened up new perspectives for EU-Georgia relations. The EU has offered its political support to the new regime in Georgia through declarations and visits. President Prodi met interim President Nino Burjanadze in December 2003, HR Solana visited Georgia on 14-15 January 2004, Irish Foreign Minister, Brian Cowen, attended Saakashvili's inauguration on 25 January, and EU SR Talvitie has visited Georgia on numerous occasions often accompanied by high level Commission officials. He visited both Abkhazia and South-Ossetia and went to meet Ajara's leader, Aslan Abashidze, before as well as after the parliamentary election on 28th of March.

The Commission is preparing a recommendation on the relationship of the 3 South Caucasus countries with the European Neighbourhood Policy (ENP). The Council will discuss the issue in June 2004.

Besides, the Commission is co-chairing with the World Bank a Donors Conference for Georgia in Brussels on 16-17 June 2004.

Trade

Georgian trade with the EU is covered under Title III of the Partnership & Cooperation Agreement (PCA). Georgia benefits from the EU's General System of Preferences (GSP) and its economic status as Most Favoured Nation (MFN) put down in the PCA.

Nevertheless Trade between Georgia and the EU have yet remained at very low levels - in 2002 accounting for only 0.03% of the EU's external trade (with EU imports amounting to € 266 million and EU exports amounting to € 287 million). Conversely, trade with the EU amounted to about 26% of Georgia's imports and 43% of Georgia's exports. Georgia joined the WTO in 2000.

Assistance

The new Country Strategy Paper 2004-2006

In the light of the serious problems of governance in Georgia, highlighted in 2002 by kidnapping cases, the Commission decided to review the Country Strategy Paper (CSP) for Georgia, outside the regular cycle of CSP adaptations. A new CSP for Georgia was therefore prepared, together with a new Indicative Programme for 2004-2006. These were adopted by the Commission on 23 September 2003. The main lines of the CSP revision are that EU assistance should reach its objectives, including through:

- < significantly strengthening “conditionality” of assistance
- < more strongly focusing assistance on the most promising reform programmes

- < providing much stronger support to civil society

Thematic priorities for EU assistance 2004-2006 (all instruments):

- < Rule of law, good governance, human rights and democratic institutions

- < Fight against poverty

- < Conflict prevention, conflict settlement and post-conflict rehabilitation

The Commission has responded to the “Rose Revolution” by providing some immediate assistance and by examining how its instruments can best be mobilised in the new situation including the possible allocation of additional resources. In December 2003 the Commission decided to provide € 2 million from the Rapid Reaction Fund for support, via the UNDP, for the Presidential and Parliamentary elections (4 January and 28 March respectively) and to rapidly disburse € 5 million from Georgia's Food Security Programme as budgetary support during the winter months.

Georgia will also benefit from the continuing assistance provided under the Tacis Regional Cooperation Programme (Interstate programme).

Past assistance

Since 1992, the EU has supported Georgia through a range of instruments. The main instruments have been: ECHO humanitarian assistance: (92 million 1992-2002); Food Security Programme (59 million 1992-2002); Tacis National Programme (84 million 1992-

2002). Total EU assistance has amounted to 370m (not including Tacis Regional or member states' assistance).

Tacis Programme

The 2000-2001 Tacis National Action Programme (AP, total 15 million) concentrated on three priority areas, namely: (1) support for institutional, legal and administrative reforms; (2) support to the private sector development and assistance for economic development and (3) development of infrastructure networks.

In 2002-2003 Tacis, with an indicative budget of € 14 million, was focusing on support for institutional, legal and administrative reform, as well as on support in addressing the social consequences of transition. This included continued support to the approximation of legislation for the implementation of the PCA. Support in addressing the social consequences of transition was targeting the health sector, including investments to support the primary healthcare restructuring programme.

Georgia also participates in Tacis regional programmes like Traceca, Inogate and the Regional Environmental Centre for Southern Caucasus, based in Tbilisi.

Exceptional financial assistance

In July 1998, Georgia settled the remaining amount of its arrears towards the Community (€ 131 million). The country subsequently benefited from a new assistance package consisting of a loan of € 110 million and a total grant amount of € 65 million that was to be disbursed over the 1998-2004 period.

Food Security Programme (FSP)

Over the period 1996 to 1999 the FSP disbursed € 24 million to Georgia. Since 2000, the FSP has partially reoriented the support in favour of a complementary poverty alleviation component through the social safety net in the form of: (a) allocation of resources and further targeting of the family poverty benefit; (b) institutional care. € 13 million has been disbursed in the period 2002-2003.

Rehabilitation

EU assistance to Georgia under the rehabilitation programme concerned both the Tskhinvali region (South Ossetia, SO) and Abkhazia (Enguri hydropower plant and dam). In 1997, the EC proposed to grant 5 million for the rehabilitation of infrastructure in the post conflict area of SO, and in order to stimulate the peace-process between SO and Tbilisi. In 1999 the EC proposed a new grant of € 2.5 million, upon the approval and fulfilment of conditionalities. Given the dynamics created by its programme, the EC has provided financial assistance for and participated in the Joint Control Commission (JCC) on SO since April 2001. This quadripartite body (with Georgia, SO, North Ossetia, and Russia) is conducted with the OSCE.

Enguri. In 1997, the EC proposed to grant € 10 million for urgent repairs at the Enguri hydropower plant and dam (repair of generator Nr. 3 and provision of stop log at the dam), in two tranches of € 5 million and under its rehabilitation budget. This assistance was complementary to the rehabilitation program of Enguri financed from an EBRDR loan of some € 44.5 million.

Humanitarian Assistance (ECHO)

ECHO has been present in the NIS region since the early 1990s, in accordance with its core mandate (humanitarian assistance in response to natural or man-made disasters). From 1993 to 1999, ECHO's operational funding in the southern Caucasus has been considerable, with € 64.255 million of humanitarian aid going to Armenia, € 83.34 million to Georgia and 82.96 million to Azerbaijan.

ECHO's withdrawal from post-emergency programmes in southern Caucasus started in 1996 and was completed in 2000 with a last allocation of € 3.855 million for the three countries. In 2000, 2001 and ECHO provided a total € 2.35 million as a contribution to alleviating the consequences of the drought in Georgia.

Support to the Georgian Border Guards

Through a Joint Action in the framework of Common Foreign and Security Policy, the EU provided equipment worth € 1.045 million to the Georgian Border Guards (GBG) in 2000 and 2001, aimed at protecting the unarmed OSCE monitors at the border between

Georgia and the Chechen Republic of the Russian Federation.
European Initiative for Democracy and Human Rights (EIDHR)

With an allocation of € 1.9 million Georgia was a focus country for the EIDHR in 2002.

Table 5

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Total M €
Humanitarian Aid: ECHO		11.78	17.81	27.45	10.20	5.80	6.41	6.93	2.62	1.05	2.00	2.20	94.25
FEOGA				41.0	21.55								62.55
Exceptional Humanitarian Aid		6.0											6.0
Aid against effects of Russian Crisis								4.0					4.0
Food Security Programme					18.25	16.0		12.0		13.00*			59.25
TACIS National Allocations	9.0	4.0	4.0	6.0	8.0	8.0	8.0	8.0	11.0	4.0	14.0**		84.0
Rehabilitation in Conflict Zones						3.50	6.50	7.50		10.0			27.5
Exceptional financial assistance (disbursed)							10.0	9.0		6.0			25.0
CFSP									1.09	0.25	0.1	0.16	1.60
EIDHR										0.23	2.5	2.82	5.55
RRM												2.00	2.00
Total M €	9.00	21.78	21.81	74.45	58.00	33.30	30.91	47.43	14.71	34.53	16.1	7.18	369.43

* Disbursed

** Allocation for 2002-2003

4. Basic Data

Independence: 9 April 1991 (from Soviet Union)

Constitution: adopted 17 October 1995 (amended on 4 February 2004)

Legal System: based on civil law system

Suffrage: 18 years of age: universal

Executive Branch: President Mikheil Saakashvili (elected as president on 4 January, inaugurated on 25 January 2004) The president is elected for a five-year-term and is both the chief of state and head of government; Prime Minister: Zurab Zhvania; Cabinet: Cabinet of Ministers

Legislative Branch: unicameral Supreme Council (235 seats, members are elected by popular vote to serve four-year-terms); Speaker of Parliament: Nino Burjanadze; last elections held on 28 March 2004

Government type: republic

Capital: T'bilisi

Population: 4,934,413 (July 2003 est.)

Population growth rate: -0.52% (2003 est.)

Birth rate: 11.79 births/1,000 population (2003 est.)

Death rate: 14.71 deaths/1,000 population (2003 est.)

Life expectancy at birth: total population: 64.76 years male: 61.33 years, female: 68.36 years (2003 est.)

Net migration rate: -2.3 migrant(s)/1,000 population (2003 est.)

Ethnic groups: Georgian 70.1%, Armenian 8.1%, Russian 6.3%, Azeri 5.7%, Ossetian 3%, Abkhaz 1.8%, other 5%

Religions: Georgian Orthodox 65%, Muslim 11%, Russian Orthodox 10%, Armenian Apostolic 8%, unknown 6%

Languages: Georgian 71% (official), Russian 9%, Armenian 7%, Azeri 6%, other 7%: Note: Abkhaz is the official language in Abkhazia

GDP - purchasing power parity : \$16.05 billion (2002 est.)

GDP - real growth rate: 5.4% (2002 est.)

GDP - per capita: purchasing power parity - \$3,200 (2001 est.)

Population below poverty line: 54% (2001 est.) (European Commission External Relations, October 27, 2008).

Conclusion

According to Borut Grgic, Director, Institute for Strategic Studies, Ljubljana Some South Caucasian countries, such as Azerbaijan are rich in oil and gas, while others, Georgia and Armenia can serve as effective transit routes for Russian and Central Asian energy to the EU, namely, gas. With the increased energy consumption and dependence on imports, the EU could engage the countries of the South Caucasus to import the CIS energy. The South Caucasus also provides access to Central Asia, which is important to the EU in order to push reforms and check the influence from neighboring Russia, China and Iran (and possibly India) on the region.

EU's relationship with the South Caucasus has been weak due to two reasons. First, the EU's internal crisis over the constitution and lack of leadership are impacting its longer-term vision over the South Caucasus. This situation sets back the relations with Armenia, Azerbaijan and Georgia and gives an upper hand to Russian influence. Second, because the bureaucracy in Brussels drives the EU's relationship with the South Caucasus, it is quite insensitive to the day-to-day problems of the region. Therefore, certain venues of reforms and bilateral relations are not pursued, while Russia is able to take advantage of the situation and fill the vacuum. For example, Russia is more actively getting involved in the resolution of the Nagorno-Karabakh problem since the EU is staying out of it. Because of this complexity, the EU's influence on the region is weakening.

There are plenty of champions within the EU making the South Caucasus a priority but no significant progress is visible because of lingering bureaucratic stagnation. Without changing its political stance to the South Caucasus, the EU would not be able to maximize its influence on the region and will miss its opportunity to other regional players. EU needs to provide more political commitment to the region, which means stop treating it as a Brussels issue and start thinking of the future accession plans of Armenia, Georgia and Azerbaijan. EU should also provide more commitment to reforms. These actions will be timely when the EU is increasingly dependent on energy imports and is seeing the rising powers of other Eurasian players that may increase their leverage both on the South Caucasus and Central Asia.

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