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# IMPACT OF REGIONAL INTEGRATION ON TRADE AND ECONOMIC COOPERATION - A KEY STUDY OF GEORGIA AND AZERBAIJAN

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## **Abstract:**

The South Caucasus is a unique, small, and densely populated region in the southern part of the Caucasus. It consists of three independent states—Georgia, Azerbaijan, and Armenia. Georgia is actively engaged in the Peaceful Neighborhood Initiative in the South Caucasus and strives to deepen political and economic relations with the countries in the region based on sovereign interests. In these processes, strengthening mutually beneficial, trust-based cooperation with the Republic of Azerbaijan is of special interest to Georgia. After the collapse of the Union of Soviet Socialist Republics (USSR) and the regaining of independence by Georgia and Azerbaijan, a completely new phase of diplomatic relations began between the two countries, which grew into a strategic partnership. Territorial proximity and the establishment of diplomatic relations have prompted the dynamic development of trade and economic relations between the two countries, which increases the urgency of the study. The paper focuses on the priority areas of trade and economic cooperation between Georgia and Azerbaijan. However, at the present stage, economics and politics are so closely interrelated that it is impossible to draw a line between them. Therefore, in order to achieve the purpose of the paper, the first chapter focuses on the development of diplomatic relations between the two countries, while the following chapters study trade and economic cooperation between Georgia and Azerbaijan and analyze the development of bilateral cooperation in trade in services; in addition, the trade intensity index is calculated, the importance of investments from Azerbaijan in the Georgian economy is assessed, transnational energy and transport projects proposed by the Georgian and Azerbaijani governments are discussed, and the growing role of Georgia as a trade and transport hub in the Caucasus, in both the offshore and onshore components of these projects, is evaluated. It is noted that trade and economic relations show growing dynamics and readiness to further develop cooperation. In addition, several suggestions that may help Georgia increase the scale of cooperation with Azerbaijan and assist in deepening the involvement of the two countries in global integration processes are proposed. The paper is expected to enhance further research and discussion on trade and economic cooperation between Georgia and Azerbaijan and, most importantly, support this kind of cooperation.

## **Keywords:**

Georgia, Azerbaijan, export, import, investments, transit projects.

**JEL Classification:** F10, O10, O11

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## Introduction

Georgia and Azerbaijan gained independence in 1991 after the collapse of the Soviet Union. Since then both countries have become full-fledged players of world politics and economics and have been actively involved in international relations. The ongoing changes in the post-Soviet space and the treaty of century on the development of Caspian oil (Azeri-Chirag-Gunasli field) have led to the necessity of re-examination of their foreign policy and economic relations. Due to its unique geopolitical location and role, Georgia has become a major transit hub for supplying oil and gas from Azerbaijan to the West since the 1990s. While Azerbaijan supplies Georgia with energy resources and helps the country diversify its oil and gas imports.

The strategic cooperation between the two countries is developing successfully in politics, trade, economic, energy, transport, and cultural sectors (MFAG, n.d.). High-level visits, business forums, cultural events and other activities take place regularly. These relations are based on trust and mutual respect, promoting peace and stability in the region, ensuring the well-being of our people, and enhancing energy security of Europe. These are the reasons determining the importance of this paper.

## Research Methodology

The aim of the paper is to study the current state of trade and economic cooperation between Georgia and Azerbaijan, to identify priority areas and to develop recommendations for the deepening and development of this cooperation. Based on the aim of the paper, the following main tasks were determined: to study the Georgian-Azerbaijani diplomatic relations and geopolitical factors; to analyze the current state of trade and investment cooperation and identify the main directions of this cooperation; to assess the current state of energy cooperation between these two countries in the South Caucasus, taking into account globalization, regional integration and national interests, and to identify transit opportunities of Georgia.

In order to achieve the aim of the paper, we used international and national normative and legal acts, research papers and policy documents on the issues of cooperation between Georgia and Azerbaijan prepared by Georgian and foreign researchers, assessments and statements by officials of both countries. In addition, key international indexes and statistical materials that reflect the indicators of strategic cooperation between the two countries over the last few years are used in the paper. We used historical, logical, analysis, comparison, synthesis, grouping, graphic representation, and other economic and statistical methods in the processing of the above studies and statistical materials for the purpose of the paper.

### 1. Diplomatic relations between Georgia and Azerbaijan (brief overview)

Protocol on the Establishment of Diplomatic Relations signed between the Republics of Georgia and Azerbaijan on November 18, 1992 is the basis for close cooperation and mutual understanding between the two countries. Since the establishment of diplomatic relations, the cooperation between the countries has been actively developing and is of bilateral and multilateral character. For strengthening these relations more than one hundred agreements have been signed that led to the development of normative legal basis for cooperation between the states of

Azerbaijan and Georgia (MFAG, n.d.). The Declaration on Peace, Security and Cooperation in the Caucasus Region of 8 March 1996 signed by the Presidents of Georgia and Azerbaijan is one of the guarantors of peace, security, and cooperation between the two countries. After the signing of the document, at the press conference with the President of Georgia Eduard Shevardnadze, the President of Azerbaijan Ilham Aliyev stressed the sincere friendly relations between the two countries and noted: We feel at home, next to our brothers here. We arrived here with these feelings, and the hours spent in Tbilisi, in the Georgian land fully justify our feelings and hopes. (HEYDAR ALIYEV HERITAGE. INTERNATIONAL ONLINE LIBRARY, 1996). Traditional friendly relations between Georgia and the Republic of Azerbaijan existing for decades became the basis for addressing a number of issues mutually and active cooperation in the international sphere. For enhancing and deepening diplomatic efforts and economic cooperation between the countries the Embassy of Georgia opened in Baku in February 1995 and the Embassy of Azerbaijan opened in Tbilisi in March 1996. Later, the Consulate of Azerbaijan opened in Batumi (Aslanli & Isayev, 2017).

The cooperation between Georgia and Azerbaijan is strengthened by the involvement of both countries in a number of programs such as the NATO program "Partnership for Peace," GUAM, Black Sea Economic Cooperation (MFAG, n.d.) and the Azerbaijan-Georgia-Turkey trilateral format. Trabzon Declaration signed in 2012 as part of a trilateral format, focuses on the strategic nature of relations. The Trabzon Declaration covered all the major areas of cooperation between the three countries (MFAG, 2012). "The trilateral relationship was further enhanced by the agreement on strengthening the military partnership in May 2017, including joint military training and cooperation between the General Staffs of the Armed Forces of the three countries" (German T. , 2018,). As the government of Georgia declares, the strategic partnership between the three countries "is of great importance for the security of the region, the well-being of our people and the development of the defense forces" (Civil.ge, 2021). Georgia is interested in strengthening peace, stability and security in the Caucasus and is ready to implement its peacekeeping mission for long-term peace and stability through reasonable policy. It is important to note that after the aggravation of the situation between Azerbaijan and Armenia in recent years, Georgia has assumed the function of a mediator, honorably played its non-aligned role in the region, resulting in numerous positive reviews from the West and Turkey, as well as from the conflicting parties (EUROPE TIME, 2021). (Samadbegishvili S. , 2020) The Government of Georgia is ready to continue its role as an active mediator in rebuilding trust between Azerbaijan and Armenia, which is important for the whole region.

## **2. Development of trade relations**

Since the establishment of diplomatic relations, the governments of Georgia and Azerbaijan "strive to promote trade and economic cooperation on the basis of equality and mutual benefit" (Legislative Herald of Georgia, 1996). There has been a free trade regime between Georgia and Azerbaijan since 1996, which is legally regulated within both bilateral and multilateral (within GUAM) formats (MFAG, n.d.). This agreement contributes to enhancing the bilateral trade and creates the conditions needed for economic growth.

Trade turnover between Georgia and Azerbaijan is quite high. Goods worth of USD 5.1 billion were exported to Azerbaijan in 1995-2019 and the country was ranked the first position. Imports

worth of USD 8.7 billion were also imported in the same period. In total, the trade turnover amounted to USD13.8 billion. The highest export (USD 710 million) was observed in 2013, which was equal to 24.4% of total exports for the year. After that, from April 2014, Azerbaijan banned the import of cars produced before 2006, and from 2015 the excise tax on new cars was increased, which was added by economic problems in both countries. In 2016, exports decreased 4.6 times compared to 2013 and amounted to USD 153 million (PIA.GE, 2020).

From 2017, the export of passenger cars from Georgia to Azerbaijan started to increase again and according to official statistics, in recent years Azerbaijan steadily occupies the third or fourth position in the top ten trading partner countries of Georgia. In 2017, Georgia's exports to Azerbaijan amounted to USD 274,224.08 thousand, which accounts for 10% of total exports; in 2018 export amounted to USD 507,644.44 thousand, which is 15% of total exports. In 2019, with 13.4% of total exports (USD 508,680.84 thousand) Azerbaijan ranks first among the largest trading partners of Georgia in terms of exports; in 2020 it took the second position with 13.2% (USD 441,293.17 thousand), and in 2021 the third position with 12.8% (USD 488,292.63 thousand). The figures show that after several years of failure, Azerbaijan has become an important market for Georgian exports, which would have been impossible without a steadily growing trade relations. Table 1 shows the export-import structure of Georgia and Azerbaijan.

**Table 1. Georgian exports and imports of goods to and from Azerbaijan (thousand USD)**

	Imports	% in total imports	Exports	% in total exports
2008	607,396.1	9.6%	203,930.30	13.6%
2009	410,124.36	9.2%	165,633.80	14.6%
2010	484,829.92	9.3%	256,241.83	15.3%
2011	636,253.66	9%	425,907.05	19.5%
2012	703,803.67	8.7%	626,913.94	26.4%
2013	655,871.97	8.2%	709,919.20	24.4%
2014	640,323.00	7.5%	544,447.87	19%
2015	538,638.37	7.4%	240,869.55	10.9%
2016	492,567.87	6.8%	152,719.40	7.2%
2017	567,110.86	7.1%	274,224.08	10%

2018	592,761.83	6.4%	507,644.44	15%
2019	558,771.77	5.9%	508,680.84	13.4%
2020	513,206.92	6.4%	441,293.17	13.2%
2021	509,000.86	5.6%	488,292.63	12.8%

**The table is compiled based on the data provided by the National Statistics Office of Georgia.**

It is important to note that despite the growth of exports, Georgia has a negative trade balance with Azerbaijan. Imports from this country are mainly represented by oil gases, gaseous hydrocarbons, electricity, oil, and oil products. According to researchers, hydrocarbon fuel cannot be directly replaced at the expense of local production. However, if an oil refinery plant, new hydro and other renewable energy facilities are built, it will be possible to reduce the cost of imports (and not only from this country) (Gaganidze & Ramishvili, 2018). It should be mentioned that the geographical location of the country, the increase in local hydrocarbon extraction, oil and gas pipelines, railways and seaports provide good opportunities for the construction and functioning of a regional oil refinery in Georgia.

Foreign trade balance of Georgia with Azerbaijan is positive for the trade in agri-food products. Azerbaijan is the third country following Germany and Turkey where the export of agri-food products from Georgia has significantly increased in recent years. According to official data, exports of agri-food products to Azerbaijan increased by 14% in 2020 compared to 2019, and with 11% (USD 100 million) the country took the second position in the total exports of agri-food products of Georgia. Export of agri-food products mainly include frozen meat and butter (however, these products were mostly re-exported), as well as live cattle, sheep, nitrogen fertilizers, alcoholic carbonated beverages, and citrus (MEPAG, 2021).

When analyzing trade relations between Georgia and Azerbaijan, it is interesting to assess Georgia's revealed comparative advantage (RCA) over Azerbaijan based on export commodity groups. Table 2 provides the indicators of comparative advantage of Georgia over Azerbaijan by export commodity groups. The table shows that Georgia, in general, has a comparative advantage over Azerbaijan ( $RCA > 1$ ) for certain commodity groups, such as Food Products, Intermediate goods, Minerals, and Chemicals. While Azerbaijan has a comparative advantage ( $RCA < 1$ ) for Hides and Skins, Transportation, Mach and Elec, Capital goods, Wood, Consumer goods, Textiles and Clothing, Fuel, and Vegetables. In addition, for some commodity groups, Georgia's comparative advantage over Azerbaijan has varied over the years. In particular, in 2000-2009, Azerbaijan had a comparative advantage in Metals. However, the situation changed after 2010 and Georgia's comparative advantage over Azerbaijan is observed. In 2004-2014 comparative advantage in Plastic or Rubber was held by Azerbaijan, while in 2015-2019 it was held by Georgia. Azerbaijan had comparative advantage in Raw materials in 1997-2007; while since 2008 comparative advantage of Georgia for this product has been observed.

The free trade agreement between Georgia and Azerbaijan provides stimulus for further development of trade in services. Involvement of Georgia in the Bologna Process led to the enhancement of bilateral relations between Georgia and Azerbaijan in the field of education. According to official statistics, 12,448 citizens of Azerbaijan studied on undergraduate, graduate, doctoral and one-step medical programs in Georgia in 2015-2020 (MESG, 2021), accounting for 22% of the total number of foreign students enrolled in Georgian higher education institutions. We believe that low tuition fees, high quality and variety of study programs, easy rights and low costs of living in the country will further increase the number of Azerbaijani students willing to study in Georgian universities. The researchers consider that "Georgia has the potential to become the hub of educational space in the near future due to the immigrant's effective policy and high quality of education" (Kumari, 2021).

**Table 2. Revealed comparative advantages of Georgia with respect to Azerbaijan, by product group and index, 1996-2019 (WITS, n.d.)**

Product Group	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Food Products	0,17	0,22	1,16	1,1	6,85	2,14	4,27	3,72	6,41	5,26	1,04	0,66	1,44	1,5	2,49	2,08	1,21	1,24	1,3	2,84	1,43	1,88	2,36	2,31
Intermediate goods	2,38	2,12	1,67	2,73	1,84	3,31	2,45	1,45	2,58	3,84	3,35	3,43	3,2	2,53	1,86	2,72	2,36	1,7	2,4	2,16	1,35	1,87	1,16	1,16
Miscellaneous	0,03	0,58	0,08	0,16	1,16	0,21	0,04	0,09	0,01	0,01	0,06	0,19	0,08	0,06	0,21	0,32	0,24	0,37	0,17	0,06	0,25	0,09	0,04	0,31
Hides and Skins								0,01		0,07	0,1	0,73	0,29	0,77	1,38	0,12	0,05	15,31	3,59		0	0,05	0,03	0,02
Stone and Glass	0,92	0,23	0,15	4,29	3,88	9,8	0,48	2,59	5,71	0,37	1,18	0,59	0,95	0,79	0,27	1,61	0,6	0,04	0,3	0,39	0,42	0,64	0,12	0,03
Minerals	0,8	0,13	0,49	5,17	1,74	7,93	0,26	1,05	12,92	13,45	19,52	21,58	20,52	17,26	4,87	12,17	15,94	15,1	15,48	1,07	0,48	0,77	1,16	1,91
Animal	0,11		0,08	0,19	0	0,01	0,46	0,72	0,09	0,01	0,03	0,06	0,9	0,42	0,31	2,02	2,16	3,17	2,76	5,66	4,04	5,05	11,84	13,1
Transportation	0,08	0,86	0,91	0,07	0,49	0,06	0,58	2,49	0,39	1,67	1,29	0,72	0,07	1,79	0,24	0,01	0,49	0,13	0,05	0	3,06	0,02	0	0
Metals	4,46	4,34	2,09	1,33	0,83	0,68	0,28	0,36	0,32	0,09	0,11	0,1	0,41	0,43	2,61	3,15	1,44	1,62	2,8	2,41	1,84	2,47	2,2	2,51
Plastic or Rubber	0	0,01	0,01	0,5	1,71	2,99	2,78	1,34	0,26	0,32	0,04	0,02	0,07	0,15	0,04	0,09	0,19	0,38	0,72	1,27	1,5	2,02	2	1,63
Mach and Elec	0,22	0,5	1,19	0,33	0,15	0,07	0,08	0,2	0,06	0,02	0,02	0,02	0,08	0,02	0,03	0,09	0,39	0,1	0,06	0,1	0,1	0,04	0,04	0,05
Capital goods	0,22	0,57	1,07	0,3	0,25	0,07	0,07	0,95	0,11	0,03	0,52	0,28	0,07	0,11	0,03	0,06	0,45	0,11	0,05	0,05	0,92	0,01	0,02	0,04
Raw materials	1,21	0,02	0,14	0,9	0,43	1,71	0,31	0,81	1,29	0,42	0,5	0,24	1,58	3,26	2,51	1,01	0,62	1,02	1,08	1,79	2,1	4,06	6,5	4,5
Wood	0,11	0,02	0,02	0,48	0,72	0,26	0,56	1,38	0,19	0,19	0,13	0,03	0,1	0,15	0,13	0,21	0,09	0,11	0,08	0,31	0,06	1,25	0,13	0,2
Consumer goods	0,21	0,35	0,57	0,46	1,76	0,54	0,84	0,73	0,8	0,81	0,24	0,35	0,68	0,91	1,11	1,05	0,83	1,4	0,79	1,02	0,57	0,73	0,69	0,75
Chemicals	2,22	1,49	1,71	1,24	2,74	8,18	2,64	4,74	4,83	1,85	0,93	2,14	1,08	1,71	0,89	1,36	1,01	3,31	1,15	1,44	0,56	0,68	0,81	1,77
Textiles and Clothing	2,47	0,52	0,01	0,01	0,16	0,28	0,01	0	0	0,01		0,07	0,11	0,22	0,41	0,62	0,08	2,04	0,42	0,06	0,07	0,07	0,12	0,27
Fuels	3,2	0,53	1,49	5,87	0,04		2,39	0,48			0,14	1,88	0,56	1,83	0,18	0,81	0,38	0,25	0,19	0	0,21	0,04	0,23	0,43
Vegetable	0,89	0,33	0,12	0,04	0,19	0,06	0,22	0,35	0,34	0,41	0,21	0,12	0,74	1,66	2,15	0,34	0,12	0,28	0,25	0,1	0,78	1,67	1,47	0,7
Footwear					0,01	0	0					2,49	6,9	9,1		1,67	0,18	7,28	1,85		0	0,01	0,01	3,28

Cooperation between Azerbaijan and Georgia in the tourism sector is important. From 2015 to 2019, Azerbaijan was steadily ranked the first or the second in the top ten countries by the number of visitors to Georgia. 9,357,964 visitors arrived in Georgia an 2019, most of them (1,526,619 visitors) were from Azerbaijan. 7% (USD 231 million) of tourism receipts were generated from Azerbaijani visitors the same year. In 2020, the number of visitors to Georgia decreased by an unprecedented 80.7% from Azerbaijan compared to 2019 and amounted to 295,175 visitors

(GNTA, 2020). In the post-pandemic period (2021) tourist destinations in Georgia and Azerbaijan are becoming popular. Active efforts are directed on the development of Combined Tourism Package of Georgia and Azerbaijan, which aims to offer a joint tourism package to the representatives of the third countries. This package will help the parties to attract more representatives of the third country, arriving from Georgia to Azerbaijan and vice versa. The researchers who study tourism consider, that as the demand for so called co-tours (visiting several countries) has recently increased, the development of a joint tourism package by the two countries will significantly help the citizens of these countries to travel more, attract tourists from other countries and receive economic benefits (Gelashvili, 2021). PCR test is another factor that will help us attract tourists from Azerbaijan in the post-pandemic period.

Azerbaijan is in the list of the countries whose citizens are allowed to enter Georgia through the air border without a PCR test. As for the vaccinated visitors, they will be able to enter Georgia without any problems if at the border they present a document confirming the full course of covid vaccine. As we see, the views of researchers on the recovery of tourism are optimistic, although it should also be noted that, as yet the pandemic remains an unresolved problem for the tourism sector. Tourism accounts for over 70% of our country's service exports. Naturally, optimistic forecasts of tourism recovery will help increase the country's export potential and reduce trade imbalances with Azerbaijan, along with other sectors of the economy.

As Azerbaijan is one of the most important trade partners of Georgia, we considered it reasonable to evaluate the trade relations between the two countries through the trade intensity index.

The trade intensity index is calculated using the following formula (Gaganidze & Ramishvili, 2018):

$I_{ij} = (X_{ij}/X_i)/(M_j/M)$ , where

$X_{ij}$  – i export of the country, j - country;

$X_i$  – i total exports of the country;

$M_j$  – j total imports of the country;

$M$  - world import.

The trade intensity index can take values from zero to infinity. If the value obtained is over 1, then the trading partner is much more important for the given country than vice versa. If the obtained value is equal to one, the export potential of the given and partner countries is adequate, and if it is less than 1, the export potential of the given country is not properly utilized (Gaganidze & Ramishvili, 2018). The trade intensity index according to the trade data of Georgia and Azerbaijan is given in Table 3.

**Table 3. Trade Intensity Index according to trade data between Georgia and Azerbaijan for 2008-2020 (thousand USD)**

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Georgian exports to Azerbaijan (Xia)</b>	203,930	165,634	256,242	425,907	626,914	709,919	544,448	240,870	152,719	274,224	507,644	508,681	441,293
<b>Total Georgian exports (Xi)</b>	1,495,345	1,133,630	1,677,307	2,186,421	2,376,635	2,910,315	2,861,045	2,204,189	2,117,149	2,745,744	3,379,732	3,798,394	3,343,443
<b>Total Azerbaijani imports (Mn)</b>	9,723,548	8,591,593	9,098,405	14,404,242	14,547,451	16,316,832	14,207,962	14,510,515	12,660,428	12,773,292	17,206,501	20,469,873	15,860,684
<b>World imports (M)</b>	16,079,717,595	12,375,452,301	15,160,923,659	18,073,303,526	18,068,903,760	18,504,822,695	18,549,078,001	16,176,398,129	15,776,742,244	17,620,453,934	18,875,211,883	18,449,266,347	17,706,134,564
<b>Ian=</b>	226	210	255	244	328	277	248	122	90	138	165	121	147

**The data are taken and processed from WITS (WITS, n.d.) and Geostat (GEOSTAT, 2020).**

Table N3 shows that in the reporting period (2008-2020) the trade intensity index between Georgia and Azerbaijan is always significantly higher than 1, which indicates that trade between the two countries is quite intense. The index substantiates our view that Azerbaijan is a strategic trading partner of Georgia and trade between the parties has great prospects in the context of economic globalization. It is necessary to utilize trade opportunities with one of Georgia's main trading partners fully and effectively as well as to reduce artificial barriers to trade between the countries and improve the competitiveness of products and services produced in Georgia. The table also shows that the share of exports to Azerbaijan in total exports of Georgia is significantly higher than the share of goods imported by Azerbaijan (exported to Azerbaijan) in world imports.

As an interim conclusion, it can be said that from the perspective of trade relations, Azerbaijan occupies one of the most important places among Georgia's business partners. With the growing dynamics of trade relations, the two countries are promoting peaceful regional cooperation, attracting foreign investment, and implementing strategically important projects. Strategic cooperation between the two countries is also important for Azerbaijan, as this cooperation allows the country to access the large European market through Georgia.

### 3. Foreign direct investment

Attracting foreign investments is extremely important for the economy of Georgia as it is one of the main foundations of the country's socio-economic development. The Republic of Azerbaijan is among the top ten countries investing in Georgia. The investment cooperation between the two countries was facilitated by the favorable investment and business environment of our country.

According to the National Statistics Office of Georgia, after the global financial crisis and the Russia-Georgia war of 2008, investments in Georgia were increasing in 2010-2014 and began to decline in 2015-2016, followed by a peak investment rate in 2017 amounting to almost USD 2 billion, which is the historical maximum for Georgia and was mainly due to the investments made from Azerbaijan for the construction of the Shah Deniz gas pipeline. In 2018-2019, the volume of investments decreased again and amounted to much less than in 2014 (GEOSTAT, 2018). The inflow of investments was negatively affected by coronavirus pandemic in 2020 and 2021. The volume of foreign direct investment in Georgia in 2020 decreased by 57.2 percent compared to 2019 and amounted to USD 572 million US dollars. According to official sources, the main reasons for the decline are equity reduction, transfer of ownership of several enterprises to Georgian residents and repayment of loan liabilities (GEOSTAT, 2020). According to preliminary data for the three quarters of 2021, investments decreased by 54.5 percent compared to the same period of 2019 and amounted to USD 728.4 million (GEOSTAT, 2021). Investments in the sectors with the highest investment potential for Georgia (tourism and transport) especially decreased (Civil.ge, 2021), which, should be considered possible due to the pandemic situation, as the reduction did not occur only in Georgia.

It should be noted that from 2013 to 2019, Azerbaijan was ranked first in investments, and "in 2013-2019, most of the investment in Georgia (USD 2.3 billion) came from Azerbaijan, followed by the Netherlands with USD 1.5 billion and the United Kingdom with USD 1.4 billion. All the three countries participated in the construction of the Transcaucasian Pipeline" (Namchavadze, 2020). In 2019-2020, investments in Georgia from Azerbaijan decreased significantly (Table 4). The main reason for the reduction was the completion of the Shah Deniz construction project of the main gas pipeline, which is an important factor for the reduction along with the reasons of investments mentioned above by official sources (Khorbaladze, 2021). Given the fact that new large investment projects have not been launched in the country and due to the spread of the pandemic, the economy can not grow at a pace to attract additional investment, so we received a reduction in investment both from Azerbaijan as well as other countries (Konrad Adenauer Foundation (KAS) and (EPRC) Economic Policy Research Center, 2020).

**Table 4. Direct investments from Azerbaijan to Georgia (thousand USD)**

Period	Total FDI	FDI from Azerbaijan	The share of Azerbaijan in total FDI
2008	1,575,243.2	23,371.9	1.5
2009	666,774.6	29,923.3	4.5

<b>2010</b>	<b>865,637.7</b>	62,859.6	7.3
<b>2011</b>	<b>1,133,971.1</b>	69,454.6	6.1
<b>2012</b>	<b>1,048,227.0</b>	61,287.4	5.8
<b>2013</b>	<b>1,039,174.2</b>	84,620.4	8.1
<b>2014</b>	<b>1,836,980.0</b>	340,549.8	18.5
<b>2015</b>	<b>1,728,758.1</b>	581,739.1	33.7
<b>2016</b>	<b>1,653,993.4</b>	555,138.2	33.6
<b>2017</b>	<b>1,980,773.3</b>	460,500.8	23.2
<b>2018</b>	<b>1,317,071.4</b>	246,692.9	18.7
<b>2019</b>	<b>1,335,810.6</b>	38,879.0	2.9
<b>2020</b>	<b>571,963.3</b>	-16,382.7	-2.9
<b>I qtr. 2021*</b>	<b>131,696.9</b>	-6,256.9	-4.8
<b>II qtr. 2021*</b>	<b>297,699.0</b>	590.4	0.2
<b>III qtr. 2021*</b>	<b>299,020.3</b>	2,993.8	1.0

**The table is compiled based on the data provided by the National Statistics Office of Georgia.**

"Investment resources are declining around the world currently, and the Georgian government will have to take radical and innovative steps to reverse this trend and improve declining investment activities of the country (khorbaladze, 2021)." Considering these circumstances, demonstrating the right message by the government of the country to foreign investors should be a priority. Participation of the Georgian delegation at the official opening of the Azerbaijan-Georgia-Turkey business forum held in Baku in December 2021 can be considered as such a message, as it was clearly stated that Georgia, Azerbaijan and Turkey have been historically united by strategic, regional, logistics, energy projects, which is a precondition for the security and economic cooperation of these countries. At the forum Georgia was represented by current businesses with investments from Azerbaijan or Turkey and the businesses wishing to establish new relationships, be it trade or investment ties. "It is very important that the region is now experiencing economic recovery, overcoming pandemic crisis, especially Georgia, which offers businessmen its double-digit economic growth and a stable macroeconomic environment and is considered by both countries as an investment platform (MESDG, 2021). The government program Produce in Georgia

is actively involved in attracting investments from Azerbaijan (and not only) as the Program is a kind of mediator between foreign investors and the Government of Georgia (Enterprise Georgia, 2020).

Favorable geopolitical location of Georgia creates a significant opportunity for attracting investments. "The country has the potential to become a major transport logistics hub in the Caucasus and Central Asia, which is one of the key factors for increasing its competitiveness. The transport and logistics potential of the country is not fully utilized at this stage. These two factors are critical for attracting investments" (Konrad Adenauer Foundation (KAS) and (EPRC) Economic Policy Research Center, 2020). Rankings of international organizations is another factor that increases investment attractiveness of Georgia. Doing Business and Heritage Foundation Rankings are some of the most important ones. According to the Heritage Foundation Economic Freedom Index of 2020 Georgia's rating score was 77.1 points, a historical maximum for the country, and it ranked 12<sup>th</sup> in the world (MESDG, 2020). In 2020, in Doing Business Ranking Georgia took the 7<sup>th</sup> position among 190 countries. Starting a business is the area where Georgia has the best result (2<sup>nd</sup> position) in this ranking, while the worst result (64<sup>th</sup> position) is observed in resolving insolvency. In 2020 Georgia's position in the ease of doing business rankings was significantly higher compared to other Eastern Partnership countries and was the only country among them to take position in the top ten (Georgia in the world rankings, 2021). "Despite its positions in the rankings of international organizations, still there are significant problems in attracting investment in our country; these are: ensuring free competition, protection of property rights, the rule of law, strong judicial system, the issues related to the protection of democracy, education, as well as a number of problematic issues related to insolvency, resolution of commercial disputes and doing business" (Sikharulidze & Charaia, 2018). Resolving the above problems requires much effort and long time; however, it will make our country more attractive and interesting for Azerbaijani investors (and not only). The main thing is that "the state takes effective steps to eliminate the existing shortcomings and maintain a stable attractive entrepreneurial and investment environment in the long run. The main thing needed is that "the state should take effective measures to eliminate the existing shortcomings and maintain a stable attractive entrepreneurial and investment environment in the long run" (Georgia G. o., 2020). In this regards Georgia faces the challenge in ensuring stability of institutions, one of the primary factors influencing FDI (Cermakova, 2020) and trade (Ouechtati, 2020) in general. The comparative advantage of Georgia in this regards consists also in availability of real estates, representing, apart from wafe level (Jasova, 2016) another prerequisite for FDI inflow, as confirmed by Hromada et al., 2021. Foreign direct investment causes an increase in the costs associated with housing, whether it is owner-occupied housing or rental housing (Horak et al., 2021). Foreign direct investment then causes an increase in property and income inequality between individual regions (Machova et al., 2022), so creating a stable and balanced growth oriented economic environment is crucial for all economies under any kind of economic integration and closer cooperation.

#### **4. Energy and transport corridors**

Considering the geopolitical factors, relations between Georgia and Azerbaijan - the two countries of the South Caucasus - provide a clear example of regional integration. Azerbaijan is a monopoly supplier of natural gas to Georgia at an affordable price, while Georgia's geographical location is crucial for Azerbaijan in exporting hydrocarbons from the Caspian region to Europe. "Georgia has

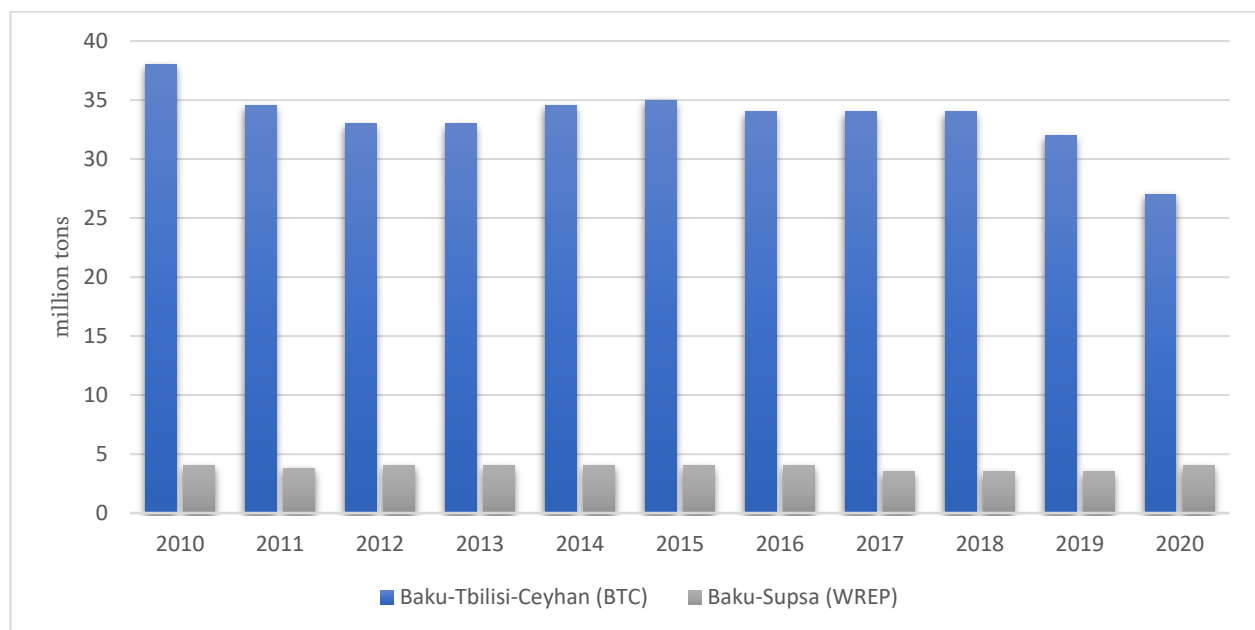
strategic cooperation with Azerbaijan and Turkey, which has an ambition to become an energy center in the region. The main goal of the strategic cooperation of the three countries is to strengthen the transit function of the South Caucasus between the East and the West" (German T. , 2018,). All the three countries have so far met all the expectations in line with the national interests. Affordable energy represents an important advantage for economic stability, stability of prices and competitiveness of the region (Bednar, 2022).

Since the 1990s, Russia has been trying to do everything to influence the development of transit function of the South Caucasus region to reduce the ability of creating alternative routes for the transportation of energy resources. Russia uses the conflicts in Nagorno-Karabakh, Abkhazia and Samachablo as its main tool in these efforts, showing energy-consuming countries that the South Caucasus region is not stable and cannot provide safe transportation of gas and oil outside the region for a long time (Patariaia, 2015). Despite these efforts by Russia, Azerbaijan, and Georgia, together with Turkey, showed an excellent example of trilateral regional cooperation, and in the late 1990s they laid the foundation for energy and transport projects through the support of the United States and the European countries, thus helping Europe to reduce energy dependence on Russian oil and natural gas. This allowed to "launch two large regional oil pipelines, such as the Baku-Supsa (WREP), and the Baku-Tbilisi Ceyhan (BTC) pipelines and the first South Caucasus gas pipeline Baku-Tbilisi-Erzurum (SCP) (Shah Deniz) going to the West (Business and Economics Center (BEC), 2017), which is important not only for the Georgian and Azerbaijani people, but also for the socio-economic development and stability of the regions.

Cooperation between Azerbaijan, Georgia and Turkey began with the "Deal of the Century", which allowed 10 Western multinational companies to evaluate and exploit the Caspian energy resources. Under the agreement, Azerbaijan and Georgia became important transit countries for the transportation of these energy resources (Gogolashvili, 2017). Since 1999 oil extracted from Chirag field in the Caspian Sea has been flowing through the Western Route Export Pipeline (WREP) known as Baku-Supsa Pipeline to the Supsa terminal in western Georgia (GOGC, n.d.), then oil is supplied to the West via tankers through Turkish Straits (Kadagishvili, 2020). Due to this project, Georgia returned to the world map as a major historical transit country, providing the best transit route from east to west and from north to south. The implementation of the Baku-Supsa project created the basis for the implementation of the Baku-Tbilisi-Ceyhan Main Export Pipeline (BTC) and the Baku-Tbilisi-Erzurum South Caucasus gas pipeline (SCP) projects in Georgia. From a geopolitical point of view, the main aim of the Baku-Tbilisi-Ceyhan project was to transport Caspian oil to the world market independently of Russia. This was the first project within the CIS which led to the limitation of Russia's political and economic interests and the participation of the United States and the United Kingdom in the project played a crucial role. The launch of the pipeline has increased the role of the Caspian Basin resources in the world commodity market and shortened the scope of Russia's influence in the region. The Baku-Tbilisi-Ceyhan (BTC) pipeline, the basis of the East-West Corridor of the modern South Caucasus, connects the Sangachal terminal in Azerbaijan with the Turkish port of Ceyhan. It is 1768 kilometers long, including 443 kilometers passing through the territory of Azerbaijan, 249 kilometers - through Georgia, and 1076 kilometers through Turkey (bp Georgia, n.d.)". The Baku-Tbilisi-Ceyhan pipeline is the "deal of the century" as Azerbaijani President Aliyev called it. With this deal, Azerbaijan took the first step towards active integration into the world economy (Aras, Suleymanov, & Mammadov, 2016). The pipeline capacity is 1.2 million barrels per day and it transports oil not only from Azerbaijan, but also from Turkmenistan and Kazakhstan. Turkmen and Kazakh oil is transported by tankers to the Caspian

Sea and loaded on the Baku-Tbilisi-Ceyhan pipeline at the Sangachal terminal. At the other end of the Baku-Tbilisi-Ceyhan pipeline, oil is loaded into tankers again to be supplied to Western markets (Smith David J., 2014). Like in case of the Baku-Supsa oil pipeline, BP is the management company of this project. "Its partners in the project are - SOCAR, MOL, INPEX, Equinor, ExxonMobil, TPAO, ITOCHU, ONGC Videsh Limited (OVL). On behalf of its partners BP is proud to announce that by September 18, 2021 the field marked 4 billion barrels of oil" (bp Georgia, 2021). "At present, BP is one of the largest investors in Georgia, having invested over USD 4 billion in infrastructure and social development projects" (bp Georgia, n.d.). From 2006 to 2021, the pipeline carried 455 million tons (3.41 billion barrels) of oil, while according to the 10 months data of 2021 it carried 174,220 million barrels. Figure 1 shows the loading of the Baku-Tbilisi-Ceyhan and Baku-Supsa pipelines in 2010-2020.

**Figure 1 Load of Baku-Tbilisi-Ceyhan and Baku-Supsa pipelines in 2010-2020**

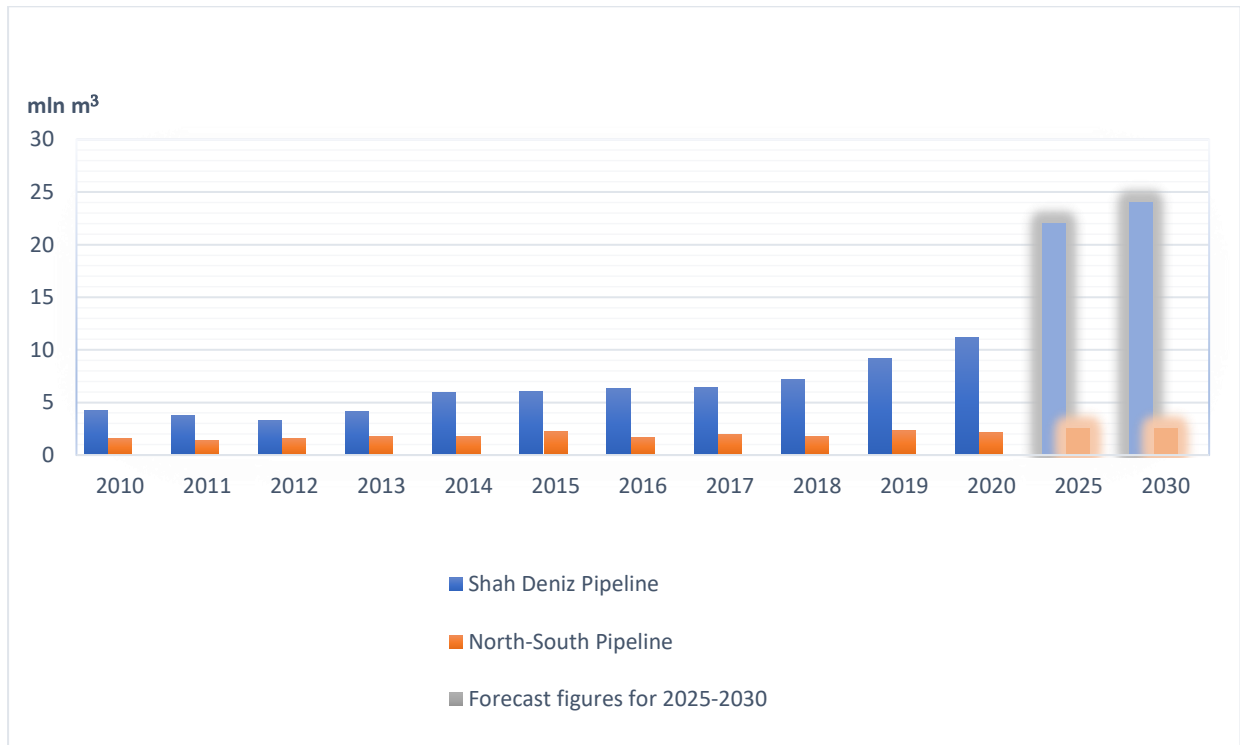


Source: <https://www.gogc.ge/ka/statistics/years/>

Along with the Baku-Tbilisi-Ceyhan oil pipeline, the South Caucasus gas pipeline runs through a common corridor on the territory of Georgia (bp Georgia, n.d.). The South Caucasus Gas Pipeline or the Azerbaijani Shah Deniz gas pipeline (SCP) is connected to the USD 7 billion worth, 2,000-kilometer long Trans-Anatolian Pipeline (TANAP), which in turn connects with the Trans-Adriatic Pipeline (TAP) at the Turkish border (German T. , 2018). The Trans-Adriatic Pipeline crosses Greece and Albania, from where it flows to southern Italy through a pipeline at the bottom of the Adriatic Sea. The total investment for this route is USD 40 billion, with a length of 3,500 kilometers (Pipeline, n.d.). The actual annual load of the SCP gas pipeline in 2014-2017 was about 6 billion m<sup>3</sup> on average, in 2018 it reached 7.1 billion m<sup>3</sup> and in 2019 - 9.2 billion m<sup>3</sup>. In 2020 the volume of natural gas carried by the pipeline reached a record high of 11.1 billion m<sup>3</sup>, which is naturally due to the transition to the active phase of the TANAP project. For 2025-2030, it is planned to grow the transit to 22-24 billion m<sup>3</sup> (GOGC, 2020). As the figures show, a significant increase in the transit

of natural gas through the South Caucasus gas pipeline is expected in the long run, which will lead to the reduction of dependence of the West on Russia, which is the main global mission of the pipeline. It should be mentioned that "another North-South (NSGP) gas pipeline passes through the territory of Georgia, which transports Russian gas to Georgia and Armenia. The Georgian part of the NSGP is 234 km long and has a projected capacity of 12 billion cubic meters per year (GOGC, n.d.). Figure 3 shows the load of Shah Deniz Pipeline and the North-South Pipeline in 2010-2020 and the forecasts for 2025-2030 (GOGC, 2020).

**Figure 2 Transit of natural gas, mln m<sup>3</sup> a year**



Regarding the oil pipelines, Georgia only acts as a transit country and receives revenue from transit. This benefit increases in the case of the South Caucasus pipeline, Georgia receives 5% of the transported gas in the form of transit tax and the country can buy an additional 0.5 billion m<sup>3</sup> of gas annually (Komakhia, 2017). In addition, natural gas imported to Georgia is almost entirely supplied by SOCAR, the State Oil Company of Azerbaijan, which helps our country to reduce pressure from Russia.

Here, we should definitely mention the involvement of Georgia and Azerbaijan in the Silk Road Economic Belt Project, the development of this project is facilitated by the Baku-Tbilisi-Kars railway line, the so called "intermediate section" of the Silk Road. This is the easiest and cheapest route between Europe and Asia. The Baku-Tbilisi-Kars railway connects Europe with China with the Turkish railway through Georgia, Azerbaijan, Turkmenistan, and Kazakhstan (Papava, 2017). The construction of the railway was carried out with a loan provided by the State Oil Fund of the Republic of Azerbaijan, which will be paid back by the Marabda-Kartsakhi railway from its net profit. Its

potential is 6.5 million tons, which will be gradually increased to 17 million. The project also includes providing service to 1 million passengers (GBC, 2019), which is an important factor for the development of tourism industry in Georgia, as the Iron Silk Road will allow tourists from Asia and Europe to travel cheaply to Georgia. This all will contribute to the employment of the population and increase their income, which is one of the best tools of the country's economic development (Kadagishvili, 2020).

Georgia offers both land and sea routes to Azerbaijan. Georgian Railway transports dry and liquid cargo from Azerbaijan, Kazakhstan and Turkmenistan to the Black Sea ports (Batumi, Poti and Kulevi), from where cargo is transported directly to the ports of Bulgaria, Romania, Ukraine, Russia and Turkey (Business and Economics Center (BEC), 2017). Georgia's Black Sea ports provide access to the Mediterranean Sea via the Bosphorus (Curtis, 1995).

Thus, international strategic projects and corridors with significant investments are another area that unites Georgia and Azerbaijan and creates the prospect for further development of their political and economic cooperation. "The active political and financial support of the Trans-Caspian pipeline projects by the United States, the European Union and its individual members will be crucial for the implementation of the perspective (Komakhia M, 2017)". This kind of support will guarantee stability and peace in the South Caucasus, strengthen the transit potential of the region, and contribute to its socio-economic development.

## Conclusion

The scientific literature analyzed in the paper, reports statistical materials by governmental and non-governmental institutions, national and international organizations provide the basis for the following conclusions:

1. Diplomatic cooperation between the two countries is based on the sovereignty of states, protection of territorial integrity and commitment to the principles of inviolability of borders;
2. Trade and economic relations have growing dynamics and show readiness to further develop cooperation; Georgia can play the role of an economic hub in development of this relationship, as the country already has free trade regime with the European Union, EFTA (European Free Trade Association) and is the first country in the region which signed a free trade agreement with China in 2017. This provides an opportunity for Azerbaijan and Georgia to integrate into the largest markets of the world in a bilateral format by combining local resources. In addition, "it would be desirable if Georgia becomes the initiator of the projects, which cover not only bilateral (Georgia-Azerbaijan, Georgia-Armenia), but also trilateral (Georgia-Azerbaijan-Armenia) formats. The time for reconstruction and launching economic projects is coming and Georgia should be in the center of these processes not only geographically but in terms of content as well (Samadbegishvili S. , 2020)".
3. Investment cooperation is explained by the high level of relations and the expectation about its recovery provide reasons for optimism. It is logical to assume that a very favorable geopolitical location of Georgia, good positions in international rankings and free trade in various directions will contribute to the growth of investments from Azerbaijan in the real sector of the country's economy. The main thing now for Georgia is to "avoid dangers between geopolitical players through maneuvering wisely" (Kadagishvili, Leila, 2015)" and to suggest the international community,

together with Azerbaijan, mutually beneficial projects based on equal partnership which will enhance the involvement of the two countries in global processes.

4. With its geostrategic location and role Georgia has successfully served as a transit hub for many years, transporting Caspian hydrocarbons from Azerbaijan and Central Asia to the West through Turkey, thus, despite the security risks in the South Caucasus, Georgia is creating opportunities for further development of this potential, opening the way for a number of countries from the Far East to the West to consume hydrocarbons from the Caspian Sea. Georgia, for its part, benefits from transit tariffs that contribute to the country's economic development. Georgia has an ambition to become a land transit corridor between Europe and Asia through the Baku-Tbilisi-Kars railway line, which connects the country with Azerbaijan and Turkey. In these processes, it is important for Georgia and Azerbaijan to contribute to regional peace and cooperation by maintaining strong, friendly relations, and to present themselves to the world as countries in the South Caucasus region attractive for investment and international projects.

Finally, the current trade and economic relations between Georgia and Azerbaijan and the jointly implemented transnational projects in the field of energy and transport are proof of the mutually beneficial interdependence of these two countries. This factor largely determines the positive perspective of this relationship in the future and the representation of the region on an international map.

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