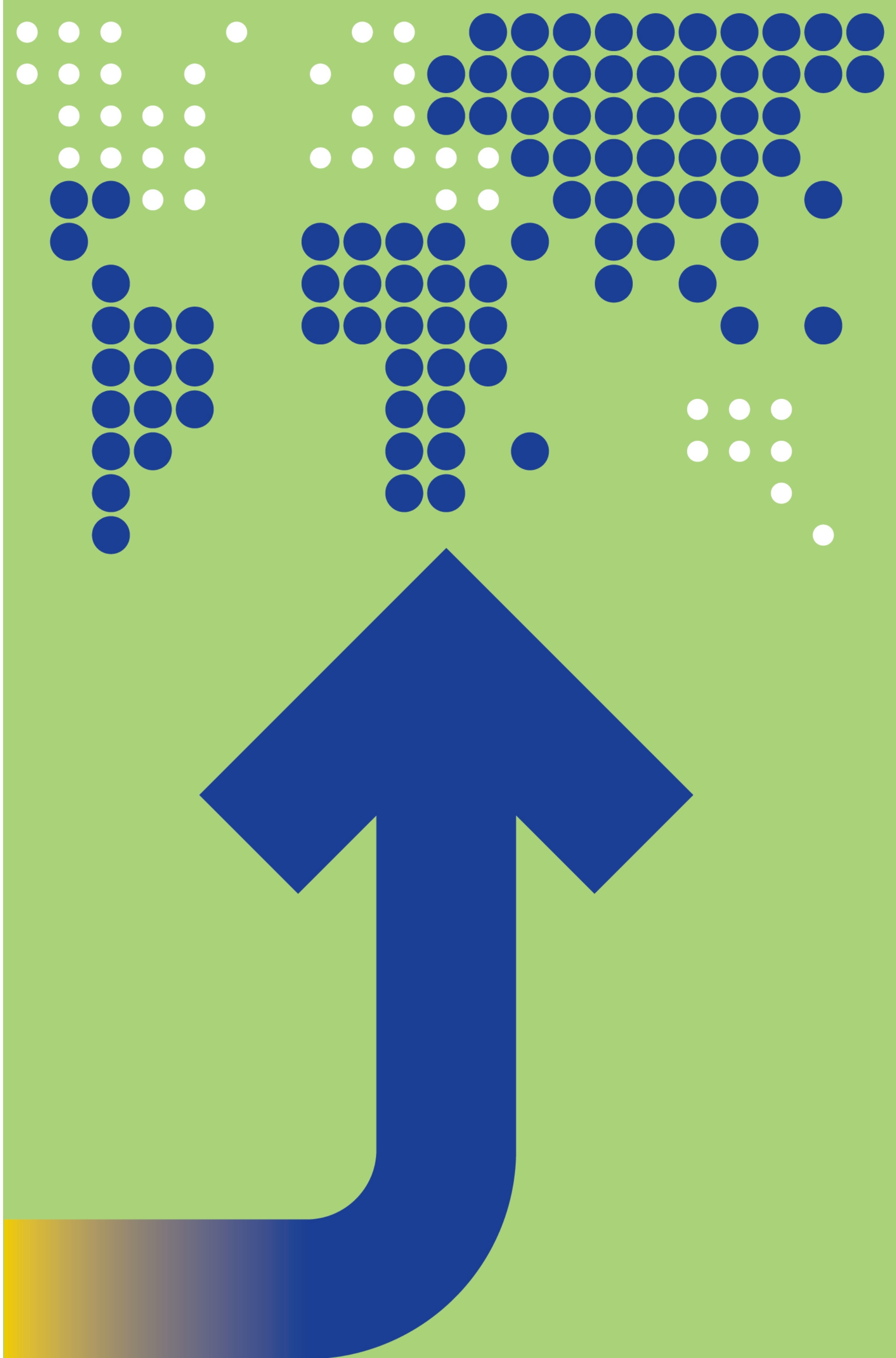

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EMERGING MARKETS FORUM

2019 Eurasia Meeting

The Impact of the Belt and Road Initiative in Central Asia and the South Caucasus: "Inside-out" Perspectives of Experts from the Region

Aktoty Aitzhanova, Rustam Aminjonov, Rezo Beradze, Irakli Gabriadze, Bahodir Ganiev, Giorgi Khishtovani, Matin Kholmatov, Roman Mogilevskii, and Mariam Zabakhidze

Background Paper

Emerging Markets Forum
A nonprofit initiative of the Centennial Group

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Preface

Johannes F. Linn and Leo Zucker

The Belt and Road Initiative (BRI) is a development program undertaken by China, beginning in 2013, with a global reach and potentially far-reaching economic and geopolitical implications. Much has been written about various aspects of the BRI since its inception, with a lot of speculation on China's motives in launching the initiative, its current and expected future scale, and its possible impact on participant countries. Most of the literature on this topic has been contributed by experts and journalists from industrialized countries and based on the limited information available on the BRI at a global level. Little has been written by experts from the participating countries based on country- and region-specific information; an "inside-out" view of the BRI is needed.[1]

The Emerging Markets Forum, with financial support from the Swiss National Bank, has undertaken a study of the BRI's impact on the eight countries of the Central Asia and South Caucasus (CASC) region with the goal of filling this gap. It has commissioned country notes prepared by five experts in the region. Each author was asked to respond to a structured set of questions about the scope of the BRI activities in her or his country (or countries, in the case of the South Caucasus), their terms of financing, the potential benefits and risks associated with the initiative, and relevant issues that warrant future research. All countries in the region, except Turkmenistan,[2] are covered by the five notes: four notes cover Kazakhstan, the Kyrgyz Republic, Tajikistan and Uzbekistan, respectively, in Central Asia, and one note covers Armenia, Azerbaijan and Georgia in the South Caucasus. These notes are compiled in this Working Paper.

We are very grateful to the authors of these notes for contributing their expert insights to this study. The papers differ in the extent to which they provide in-depth data on BRI activities given considerable differences in availability of information across countries. They do, however, show the great variation of the extent of engagement with the BRI in the CASC region to date and shed new light on the scope of the BRI and on its potential benefits and risks.

The Emerging Markets Forum has also commissioned a set of five background notes on the perspectives of five outside powers (China, Russia, the European Union, India and the United States of America) on the BRI in the CASC region. These background notes have been compiled in a separate Emerging Markets Forum Working Paper.

Based on these ten background notes and on additional research, we have prepared an overview paper which provides an assessment of what we know about the BRI in the CASC region, including its potential benefits and risks (as seen from the perspectives of participating countries), how outside partner countries are likely to engage with it, what policy responses are appropriate, and what issues could be usefully addressed by future research.

1. See the comprehensive annotated bibliography compiled for this current study: http://www.emergingmarketsforum.org/wp-content/uploads/2018/10/BRI-Annotated-Bibliography-2018-10-19.pdf

2. We did not commission a note on Turkmenistan since we could not readily identify an independent local expert and also judged the likelihood of accessing usable information as very low.

The Belt and Road Initiative in the South Caucasus Region

Giorgi Khishtovani, Mariam Zabakhidze, Irakli Gabriadze, and Rezo Beradze

1. Executive Summary

The Belt and Road Initiative (BRI), according to Chinese officials, intends to improve connectivity through Asia, Europe and Africa. The BRI is seen as a game-changer, as it promises to have an impact on more than 4 billion people in more than 65 countries across Asia, Europe and Africa (Tung 2016). The South Caucasus region, at the crossroads between Europe and Asia, certainly comes under the focus of the BRI. This country note evaluates the potential outcomes/impacts of the BRI on the South Caucasus region by reviewing the current political and economic situations of Armenia, Azerbaijan and Georgia and outlining their current and future engagement in the BRI.

Armenia, Azerbaijan and Georgia share many similarities as former Soviet Union countries who regained their independence in the early 1990s. Russia's occupation of two Georgian regions and the conflict between Armenia and Azerbaijan over Nagorno-Karabakh makes the region politically complex. Having advanced relationships with Azerbaijan and Turkey as well as with Armenia, Georgia plays a pivotal role in regional connectivity and coordination. Moreover, among the three countries of this region, Georgia is the most politically stable, with the highest position in the Ease of Doing Business Index, Index of Economic Freedom and Corruption Perception Index. However, Azerbaijan, having by far the largest economy in the region (bigger than the economies of Armenia and Georgia combined) due to its oil and gas reserves, also plays an important role in the region.

What all three countries in the South Caucasus region share is the need to modernize their infrastructure and boost trade opportunities. Long before the BRI, hard infrastructure connectivity had been prominent on the regional agenda. Relevant projects have been initiated as part of two major infrastructure development trajectories in the region: (1) the Asian Development Bank-initiated Central Asia Regional Economic Cooperation (CAREC) Program, launched in 1997; and (2) the EU-led link between the South Caucasus and Central Asia (TRACECA), launched in 1993. More recently, completion of the Baku-Tbilisi-Kars (BTK) railway, and developments along the Trans-Caspian International Transport Route (TITR), linking Kazakhstan, Azerbaijan, Georgia and Turkey, have been considered as contributing towards the China-Central Asia-West Asia corridor under the BRI. In addition, the first phase of the Anaklia Deep-Sea Port in Georgia and the renovation of Alat Port in Baku are also labeled as BRI projects in the South Caucasus. Major pipelines such as the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the Baku-Tbilisi-Erzurum (BTE) pipeline, also referred to as the South Caucasus pipeline (SCP), are already operating across the region and could also fall into the BRI narrative. Furthermore, in this context, the Trans-Anatolian Natural Gas Pipeline Project (TANAP) is also relevant and has attracted interest from China. Most recently, the AIIB approved its biggest loan so far for the construction of a gas pipeline connecting Azerbaijan with Turkey and Southern Europe.

Due to its land borders being closed with Azerbaijan and Turkey, Armenia's regional connectivity is quite limited. A multimodal transport corridor, the Persian Gulf-Black Sea corridor, is one of the very few options available for Armenia to become involved in the Initiative. This corridor envisages connecting Iran with Europe via Armenia and Georgia.

Although there are some projects that can be linked to the BRI, it is still difficult to evaluate the impact of the Initiative on the South Caucasus region. Nonetheless, this report has identified that for the South Caucasus region the Belt and Road Initiative can serve as a means of:

- Diversifying economic activities;
- Improving coordination between projects and perhaps harmonizing them under one umbrella (one aim);
- Catalyzing better regional coordination and attracting more investors; and
- Focusing on the region not only as a transit corridor but also as an economic corridor by making greater use of relatively cheap labor and other resources

coupled with establishing closer ties with the EU and other markets such as the Eurasian Economic Union (EAEU).

However, to build on the incentives coming from the BRI, the countries of the South Caucasus need to achieve better coordination to make the region more attractive and competitive. Due to the political tension between Armenia and Azerbaijan, it is not particularly likely that the South Caucasus countries will adopt a common coordinated policy approach towards the BRI; however, bilateral cooperation (Georgia-Azerbaijan; Georgia-Armenia) has been proven possible given the already existing activities. In this regard, apart from hard infrastructure projects, countries should focus on soft infrastructure tools like unified tracking and tracing systems.

Furthermore, as Armenia, Azerbaijan and Georgia cannot afford financing large investment projects by themselves, they have to take into consideration the associated risks. Thus, the fiscal flexibility of these countries makes a significant difference. In particular, it is important to assess the risks South Caucasus countries are facing by increasing their levels of indebtedness.

Based on the analysis, it is clear that the BRI is still unfolding and, due to its scale, it is somewhat difficult to pin down. The main concern related to the BRI is unpacking what are likely to be the real objectives behind the Initiative. Would investment and trade be driven by market-based transactions, or would they be a form of foreign aid that is not based on economic gains and losses? Which of the numerous countries in Asia, Europe and Africa along the Belt and Road will likely be the Initiative's core targets of economic cooperation?

This paper evaluates the potential outcomes/impacts of the BRI on the South Caucasus region. The first chapter briefly presents country profiles of Georgia, Armenia and Azerbaijan, followed by an evaluation of the current level of engagement of these countries in the BRI. The potential outcomes/impacts are presented in the following chapter. Lastly, based on the analysis, gaps and areas for future research are identified, along with some recommendations for the governments of the South Caucasus countries, for investors/donors, for the Chinese government, and for private entities.

2. South Caucasus Region: Overview

The South Caucasus (SC) region (Armenia, Azerbaijan, and Georgia), situated at the crossroads between Asia and Europe, is geopolitically significant and politically complex. The importance of the region is amplified by the existence of gas and oil reserves in the Caspian Basin and neighboring Central Asia. Apart from natural resources, improved infrastructure is anticipated to make it easier to transport goods from East Asia to Western Europe, leading to larger trade/cargo flows through the region. However, the need for better connectivity is hindered by some critical obstacles. For example, Georgia, due to its NATO and EU aspirations, is opposed by Russia at various levels, with this tension exploding into armed conflict in 2008, as a consequence of which Russia now occupies two Georgian regions[1]. In addition, the conflict between Armenia and Azerbaijan over Nagorno-Karabakh has resulted in the closing of borders between both Armenia and Azerbaijan and Armenia and Turkey (Azerbaijan's close ally). Armenia keeps close ties with Russia, which has a large military base located in the country. Having advanced its relationships with Azerbaijan and Turkey as well as with Armenia, Georgia plays a pivotal role in regional connectivity and coordination.

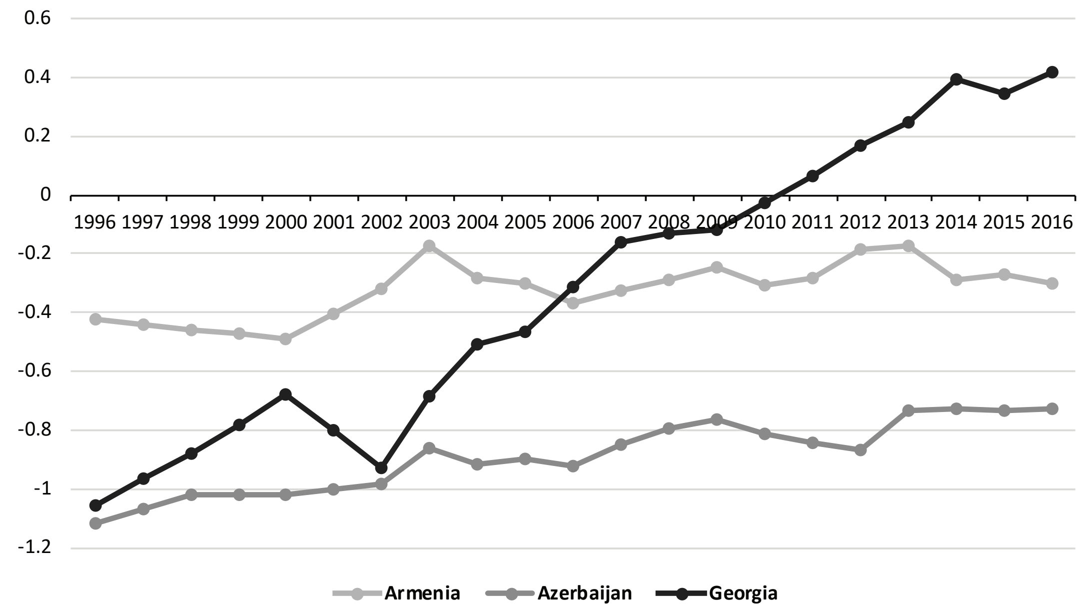
In the SC region, Azerbaijan's economy is by far the biggest, greater than those of Armenia and Georgia combined. With a population of over 9.9 million, as of 2017, the total GDP of Azerbaijan was around US$40.5 billion, while Georgia (population 3.7 million) and Armenia (population 2.9 million) recorded US$15.2 billion and US$11.5 billion respectively (World Bank 2018a).

In terms of political stability and transparency, Georgia ranks highest among these three countries. According to the World Bank's World Governance Indicators (WGI), Georgia has the highest average institutional quality (see Figure 1).

A similar trend is observed when it comes to freedom and democracy. According to the Freedom House Index, Georgia and Armenia are partly free, with scores of 64 and 44 out of 100, respectively. Meanwhile, Azerbaijan is currently classified as not a free country, scoring only 12 points (Freedom House 2018). Nonetheless, although Georgia ranks 9th in the world in the Ease of Doing Business Index and 16th in the Index of Economic Freedom, high unemployment and challenging socio-economic conditions are dominant features of its current economic environment. Those challenges are similar in Armenia, which is ranked 47th in the latest Ease of Doing Business Index and 44th in the Index of Economic Freedom. As for Azerbaijan, the main challenge for its economy is its high dependency on natural resources. In terms of international rankings, Azerbaijan has the least favorable results among

1. Formally, Russia recognized the independence of Abkhazia and South Ossetia, the regions of Georgia accounting for 20 percent of the country's territory.

Figure 1: Average Institutional Quality (unweighted average of six WGI indicators)



Source: World Bank (2018)

Table 1: Key indicators for Armenia, Azerbaijan and Georgia

Indicator	Armenia	Azerbaijan	Georgia
Population (million)	2.9	9.8	3.7
GDP, 2017 (US$ billions)	11.5	40.7	15.2
GDP per Capita, 2017 (US$)	3,860	4,140	4,090
GDP per Capita PPP, 2017	9,480	17,530	10,740
Freedom House Index, 2018 (Score)	44	12	64
Ease of Doing Business, 2018 (Rank)	47	57	9
Index of Economic Freedom, 2018 (Rank)	44	67	16
Corruption Perception Index, 2017 (Rank)	107	122	46

Source: IMF, World Bank, Freedom House, Heritage Foundation, Transparency International

the SC countries, as the country ranks 57th and 67th in the Ease of Doing Business Index and the Index of Economic Freedom, respectively (Heritage Foundation 2018, World Bank 2018b). In terms of good governance, Azerbaijan faces the most challenging situation in the region, with the lowest score in Transparency International's Corruption Perception Index, ranking 122nd out of 180 countries, whereas Armenia holds 107th place and Georgia is 46th (Transparency International 2017). Table 1 summarizes the main indicators for SC countries.

Even though the SC countries have made significant progress, they still face serious socio-economic problems. Decades of hardship have affected the living standards of much of the population of Georgia, 21 percent of which still lives below the poverty line (ADB 2017b). Unbalanced economic growth and a weak export structure[2] coupled with regional political and economic fluctuations have all resulted in relatively slow economic growth. The main sources of growth have been the service sector (including tourism, transport, real estate and finance) and construction, with the economy now significantly dependent on these areas. In the SC region, Georgia is regarded as an open economy, having signed several strategic trade agreements including the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, free trade agreements (FTAs) with CIS countries, Ukraine, Turkey and EFTA Countries, and most recently a free trade agreement with China (including Hong Kong). All of these could potentially

2. Due to its weak industrial and agricultural sectors, Georgia's export portfolio is not particularly diversified. Most of its exported goods are commodities with low added value, and these are highly vulnerable to volatile world-market prices.

support export diversification and increase FDI flows into the country, which in turn would require better connectivity.

Armenia's economic integration in the SC is limited due to its closed borders with Azerbaijan and Turkey. Today, Armenia has open borders with two countries, Georgia to the north and Iran to the south. Furthermore, Armenia is highly dependent on Russia economically (its top trading partner) as well as politically. In January 2015, Armenia became a member of the Russia-led Eurasian Economic Union (EAEU), which gives Armenia access to a single Eurasian economic market of 180 million people (KPMG 2016 in Inan & Yayloyan 2018). However, as Armenia does not share a border with any of its member countries, to benefit from the agreement the country needs better connectivity with neighboring Georgia, which is the main transit country for Armenia's exported and imported goods. On 24 November 2017, Armenia and the EU officially signed the Comprehensive and Enhanced Partnership Agreement (CEPA), giving the country a GSP+ trade regime and the potential to increase its trade volume with the EU.

Azerbaijan's political and economic development has been heavily dependent on its natural resources, particularly its oil and gas reserves that, according to UNCTAD data of 2017, accounts for 90 percent of the country's total exports (UNCTAD 2018a). According to an IMF report, Azerbaijani oil reserves will last for another 15-20 years, highlighting the fact that Azerbaijan's "oil dependence and fiscal vulnerabilities are rapidly increasing" (Albino-War & Quillin 2013). Therefore, to reduce this dependence, Azerbaijan has made substantial investments in the Trans-Caspian trade corridor and has signed multiple agreements relating to the Trans-Caspian transport network[3]. However, in 2014, when Georgia signed an Association Agreement (AA) with the EU, Azerbaijan rejected the EU's offer to do likewise. Meanwhile, the country has also not expressed an interest in joining the EAEU as it tries to keep a balance between Russia and the West.

Based on the discussion above, it is apparent that all three countries need better connectivity to overcome their

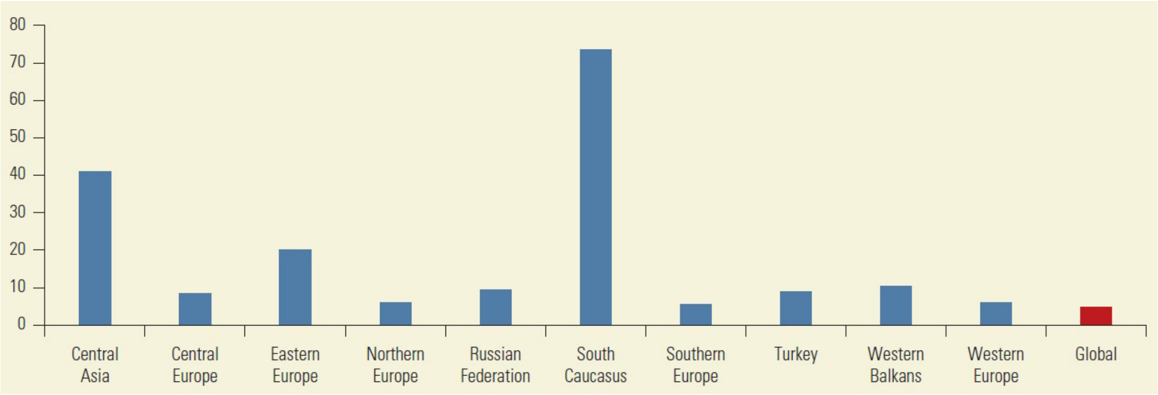
3. For instance, the TITR project, which is an extension of TRACECA, could be regarded as an attempt by the railway and port authorities of Azerbaijan, Kazakhstan, and Georgia to address tariff issues.

Table 2: Multidimensional Connectivity Indices (on a per capita basis; lowest means best)

Country	Multi-dimensional connectivity	Trade	FDI	Migration	ICT	Airlines	Portfolio Flows
Western Europe	6	6	6	9	9	15	19
Turkey	56	55	57	39	76	62	85
Eastern Europe	62	59	60	81	54	57	76
Central Asia	94	99	93	101	101	103	101
South Caucasus	104	104	102	64	104	104	93
Georgia	84	102	65	63	98	99	90
Armenia	87	90	70	77	89	79	81
Azerbaijan	106	106	107	87	103	93	106

Source: World Bank
Note: FDI = foreign direct investment; ICT = information and communication technology

Figure 2: Growth in Connectivity (percent), 2000-14



Source: World Bank

economic challenges. Considering the regional context, it is difficult to find ways to improve connectivity, but there is some potential. The room/need for improvement in terms of connectivity in the region is apparent from Table 2, which depicts World Bank's Multidimensional Connectivity Index for the SC region and neighboring regions. According to the index, Western Europe has the best Connectivity Index and the SC region has the worst. Among the SC countries, Georgia has the best connectivity, followed by Armenia and then Azerbaijan.

However, it should also be mentioned that, during 2000-2014, the SC region has increased connectivity by nearly 75 percent, which is by far the best result across all regions. This improvement in connectivity in the SC region has been driven by a number of external actors, such as the EU, Russia, the USA, Turkey, and China, all of which have their own interests in the region. This has been embodied in different projects, including the EU-led Transport Corridor Europe-Caucasus-Asia (TRACECA), the Asian Development Bank-led Central Asia Regional Economic Cooperation (CAREC) Program, and most recently the China-led Belt and Road initiative (BRI). In the following section, these overlapping projects will be discussed in more detail, with a particular focus on the BRI.

3. The BRI in the South Caucasus Region: Current Involvement

It is challenging to identify the specific date on which the BRI landed in the SC region. However, a range of events have contributed to the current state of engagement of the SC countries in the Initiative. This section outlines the current level of involvement of SC countries in the BRI by focusing on the main areas of BRI engagement (transport connectivity and trade). However, so far there has been no direct Chinese investment in the ongoing projects, even though the corridors they support are very much part of the corridors envisaged by the BRI.

3.1. Infrastructure Connectivity

Hard infrastructure connectivity has been prominent on the agenda in the SC region for more than two decades. Since long before the announcement of the BRI, two countries of the SC (Georgia and Azerbaijan), together with Turkey and two countries of Central Asia (Kazakhstan and Turkmenistan), have been working towards the improvement of regional connectivity. Moreover, relevant projects have been initiated as part of two major infrastructure development trajectories in the region: (1) the Asian Development Bank-initiated Central Asia Regional Economic Cooperation (CAREC) Program, launched in 1997; and (2) the EU-led links between the South Caucasus and Central Asia (TRACECA), launched in 1993 (Table 3 provides more detailed information about these initiatives). However, as myriad studies show, the region is still lagging behind in terms of infrastructure connectivity, mainly due to deficiencies such as gauge size differences, tariffs and border-crossing variances (Inan & Yayloyan 2018, World Economic Forum 2014).

Oil and Gas Pipelines

Historically, outside interest in the SC region has been mainly driven by the rich oil reserves of the Caspian Sea. Thus, some major pipelines such as the Baku-Tbilisi-Ceyhan (BTC) oil pipeline[4] and the Baku-Tbilisi-Erzurum (BTE)

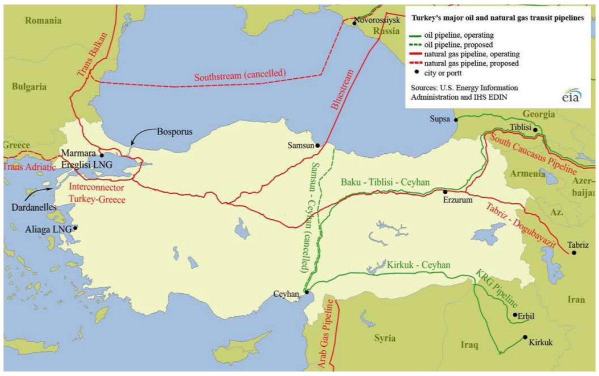
4. Backed by Western companies led by BP, the BTC pipeline became operational in 2005. It serves as Azerbaijan's main export pipeline.

Table 3: Initiatives Involving the South Caucasus Region

Initiative/ Project Name	Launch date	Short Description	Financed by	Countries Involved	Status
TRACECA	1993	TRACECA is an internationally recognized program aimed at strengthening economic relations, trade and transport communication in the regions of the Black Sea basin, South Caucasus and Central Asia owing to active work based on political will and common aspirations of all member-states.	European Commission and various IFIs (EBRD, ADB, EIB).	Azerbaijan, Armenia, Georgia, Iran, Kazakhstan, Kyrgyz Republic, Moldova, Romania, Tajikistan, Turkey, Ukraine, Uzbekistan	Ongoing
CAREC	1997	The CAREC Program entails the partnership of 11 countries and development partners working together to promote development through cooperation, leading to accelerated economic growth and poverty reduction. It is guided by the overarching vision of "Good Neighbors, Good Partners, and Good Prospects."	Asian Development Bank and various IFIs (EBRD, IMF, ISDB, UNDP, World Bank)	Afghanistan, Azerbaijan, People's Republic of China, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Pakistan, Tajikistan, Turkmenistan, Uzbekistan	Ongoing

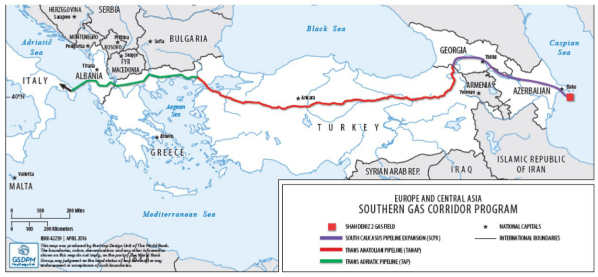
Source: TRACECA (2018), CAREC (2018)

Figure 3: Major Oil and Gas Pipelines in the South Caucasus Region



Source: U.S. Energy Information Administration and IHS EDIN

Figure 4: Southern Gas Corridor Program



Source: GSDPM

pipeline, also referred to as the South Caucasus pipeline (SCP)[5], are already operating across the region.

Furthermore, due to growing interest from Europe in becoming less dependent on Russian energy, the building of alternative pipelines through the SC region has been ongoing for some time. For example, despite constant opposition from Russia, the Trans-Caspian energy corridor from Turkmenistan and Kazakhstan to Turkey via Azerbaijan and Georgia has been around since the 1990s (Wheeler 2013). In this context, the Trans-Anatolian Natural Gas Pipeline Project (TANAP) is also relevant. Most recently, the AIIB approved its biggest-ever loan for the construction of a gas pipeline connecting Azerbaijan with Turkey and Southern Europe. Azerbaijan received US$600 million designated for the TANAP which, when completed, will transport natural gas from fields in Azerbaijan via Georgia across Turkey and then onward to markets in Southeastern Europe (Suokas 2016).

Railway

Part of the BRI (or the "Belt," also referred to as the concept of the "Silk Road Economic Belt" [SREB]), aims

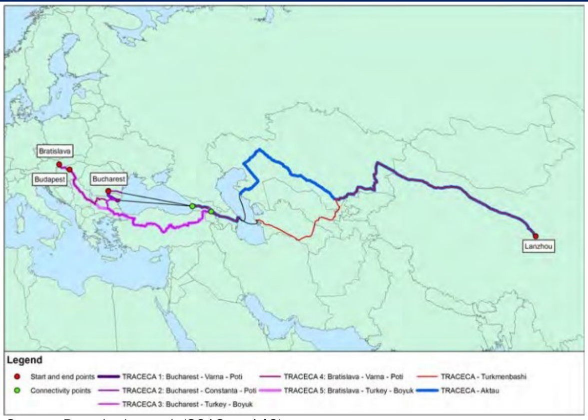
5. Connects Azerbaijani Shah Deniz fields with Erzurum in Turkey through Georgia.

Table 4: Summary of Oil- and Gas-related Projects in the South Caucasus Region

Initiative/ Project Name	Launch date	Short Description	Financed by	Countries Involved	Status
Baku-Tbilisi-Ceyhan (BTC) oil pipeline	2005	The pipeline carries oil from the Azeri-Chirag-Deepwater Gunashli (ACG) field and condensate from Shah Deniz across Azerbaijan, Georgia and Turkey. Its length is 1,768km in total: 443km in Azerbaijan, 249km in Georgia, and 1,076km in Turkey. The Azerbaijani and Georgian sections of the pipeline are operated by BP on behalf of its shareholders in BTC Co., while the Turkish section is operated by BOTAS International Limited (BIL).	British Petroleum holds the majority of shares (30.1%) followed by AzerBTC limited (25%) and Chevron (8.9%)	Azerbaijan, Georgia, Turkey	Operational
Baku-Tbilisi-Erzurum gas pipeline	2006	The South Caucasus pipeline (SCP) was built to export Shah Deniz gas from Azerbaijan to Georgia and Turkey. The pipeline starts from the Sangachal terminal near Baku. It follows the route of the Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline through Azerbaijan and Georgia to Turkey, where it is linked to the Turkish gas distribution system. During the first half of 2018, SCPX activities continued successfully along the pipeline route across Azerbaijan and Georgia. All infrastructure across Azerbaijan and Georgia required to support the first commercial gas deliveries to Turkey were completed on schedule and were ready to operate before commencement of export on 30 June 2018.	BP, operator (28.8%), AzSCP (10.0%), TPAO (19 %), Petronas (15.5%), Lukoil (10 %), NICO (10%) and SGC Midstream (6.7%).	Azerbaijan, Georgia, Turkey	Ongoing
Trans-Anatolian Natural Gas Pipeline (TANAP)	2015	TANAP, combined with the SCP and the Trans-Adriatic Pipeline (TAP), forms the Southern Gas Corridor. It aims to transport gas from Azerbaijan's Shah Deniz II field in the Caspian Sea, as well as from other fields from the south of the Caspian Sea, to Turkey and Europe.	Multiple IFIs, including the World Bank, AIIB	Turkey, TANAP; Georgia and Azerbaijan, SCP	Ongoing

Source: BP (2018), TANAP (2018)

Figure 5: TRACECA Corridor



Source: Davydenko et al. (2012, p. 140)

to build railway and road infrastructure linking China to Europe though Central Asia, Russia and the SC. It is not yet possible to exhaustively list all possible routes and trade corridors connecting China to Europe. However, one of the anticipated trade corridors is "China-Central Asia-West Asia," covering several countries and potentially encompassing the Transport Corridor Europe Caucasus Asia (TRACECA), connecting China, Kazakhstan, Azerbaijan, Georgia and Turkey, and ultimately Europe by railway.

This corridor presents numerous opportunities for the SC region; however, there are a number of obstacles to be overcome. Apart from the need to modernize and develop hard infrastructure, a range of challenges come from a lack of soft infrastructure tools. For instance, while examining the efficacy of the road connection between Xinjiang province in China to the port of Poti in Georgia, going through Kazakhstan and Azerbaijan (part of the Trans-Caspian International Transport Route [TITR]), it was revealed that railway cargo loaded in China on 29 January 2015 arrived in Georgia on 6 February 2015. The analysis showed that usually almost a third of the transit time was spent undergoing bureaucratic procedures (Grey 2015). Moreover, the corridor is facing competition from other major corridors connecting hinterland China with Europe, such as the Trans-Siberian and Central Kazakhstan corridors. Therefore, improvements in soft infrastructure across the region will greatly contribute to the increased competitiveness of the corridor passing through the SC region.

Furthermore, the competitiveness of the corridor passing through the SC region is largely linked with Turkey's historical position as a land bridge between Asia and Europe. To strengthen this connectivity, Turkey has been actively investing in domestic and transnational projects such as the Baku-Tbilisi-Kars (BTK) railway (Reconnecting Asia 2018a). The project began in 2007 with the signing

Figure 6: Turkey's Vision of Being a Land Bridge between Europe and Asia

Source: CSIS

of an agreement between Turkey, Georgia and Azerbaijan. Azerbaijan is a main investor in this railway scheme and approved a loan of US$770 million to Georgia for the construction of the missing Akhalkalaki-Kars section and for rehabilitation of the existing route through Georgia.

Despite the Baku-Tbilisi-Kars railway having been completed in 2017, there are still several obstacles to overcome before it becomes fully functional. First, Turkey lacks an effective railway network linking Kars to western Turkey and then on to the EU. In addition, Central Asian and SC countries use a 1.520m gauge, while China, Turkey and EU countries use a 1.435m gauge, known as the standard gauge. Non-harmonized tariff and border-crossing procedures also contribute to increasing costs (Inan & Yayloyan 2018).

In general, Armenia seems to have been left out of the regional mega-infrastructure projects due to its tense relations with Turkey and Azerbaijan. However, the ongoing north-south corridor development, connecting the Indian Ocean and the Persian Gulf to the Black Sea through Iran, Armenia and Georgia, should be noted here. The Chinese Ministry of Commerce has stated that the latter could serve as a key commodities transit corridor, carrying oil from Iran to Europe over Armenia and Georgia and across the Black Sea (MOFCOM 2017). At the same time, Azerbaijan is also making substantial efforts to redirect the north-south corridor in its direction. Accordingly, this proposed US$3.2 billion link with Armenia is under threat due to the commitment Iran has made to work on the Rasht (Iran)-Astara (Azerbaijan) railway linking the rail networks of Iran, Russia, and Azerbaijan (Inan & Yayloyan 2018). In turn, Baku has offered Iran a US$500 million loan for the completion of this railway (Valiyev 2016). This line would enable Russian goods to reach the Persian Gulf and, perhaps more importantly, it would facilitate trade between Russia and India via the Indian Ocean.

Ports

Another project that can be related to the BRI in the SC region is the Anaklia Deep-Sea Port (Georgia). Anticipated to serve as the main gateway for imports for approximately 17 million inhabitants of SC and Central Asian countries, it is also expected to provide critical supply routes for nearly 146 million people living within near reach of the port. The ultimate goal is to embrace trade opportunities emerging from the New Silk Road trade route between China and Europe. Set to be operational in 2021 (after the first phase is finished), the US$2.5 billion project is being constructed in nine phases. The port will be 16 meters deep, thus enabling it to handle various vessel types, such as Panamax, Handymax, and Aframax, with capacities of up to 10,000 TEUs. Phase 1 of the project includes the construction of a container terminal with a capacity of 900,000 TEUs and a dry bulk cargo facility with a capacity of 1.5

Table 5: Summary of Railway-related Projects in the South Caucasus Region

Initiative/ Project Name	Launch date	Short Description	Financed by	Countries Involved	Status
Baku-Tbilisi-Kars Railway	2007	The BTK railway is a regional rail link that connects Kars in northeast Turkey to the Georgian capital of Tbilisi and Baku, Azerbaijan's capital city. Its purpose is to increase the flow of both passenger and freight traffic between all three participating nations, as well as increase political and societal cooperation between them. Experts forecast that the BTK railway line will transport a million passengers and 6.5 million tons of cargo in its initial stage. By 2023, this railway line is forecast to carry an estimated 17 million tons of cargo and about three million passengers.	Azerbaijan, Turkey	Azerbaijan, Georgia, Turkey	Finished
Trans-Caspian International Transport Route (TITR)	2013	In November 2013, as part of the II International Transport and Logistics Business Forum "New Silk Road" in Astana, the leaders of the JSC "National Company Kazakhstan Temir Zholy," CJSC "Azerbaijan Railways," and JSC "Georgian Railway" signed an agreement on the establishment of the Coordination Committee for the development of the TITR. In December 2016, the participants of the Coordinating Committee for the Development of the TITR—Kazakhstan, Azerbaijan, and Georgia—decided to establish the International Association "Trans-Caspian International Transport Route." Participants predict that the TITR in its initial operations will be able to transport up to 5.5 million tons of cargo annually, rising to 13.5 million tons per year by 2020.	Countries involved via IFIs	Kazakhstan, Azerbaijan, Georgia, Turkey	Ongoing

Source: Kenderdine (2018), Shahbazov (2017)

Figure 7: Major Ports in the South Caucasus Region

Source: China National Development and Reform Commission

million tons. Its final capacity is expected to reach 100 million tons. The Anaklia Development Consortium, a joint venture between US-based Conti International and Georgia-based TBC Holding, is implementing the project. In addition to the port infrastructure, the consortium is developing a Special Economic Zone in this area. As for the Chinese involvement in this project, it should be noted that due to the limited shipping capacity of the trans-Siberian railway, China is interested in exploring opportunities presented by the Anaklia Deep-Sea Port via the trans-Caspian trade route, especially given the recent completion of the BTK railway. This could explain China's interest in investing in the port. Indeed, Shanghai Zhenhua Heavy Industries (ZPMC) has committed to investing US$50 million in the project and to providing the project with various types of equipment needed to control a modern container terminal (Shah 2018).

Another BRI-relevant port, Baku International Sea Trade Port, is currently under construction in Alat settlement. With a total investment of US$540 million, three phases of construction are anticipated. The first phase aims to bring capacity up to 10 million tons of cargo and 40,000 TEUs, whereas the second stage entails raising this to 17 million tons of cargo and 150,000 TEUs. Once the

Table 6: Summary of Port-related Projects in the South Caucasus Region

Initiative/Project Name	Launch date	Short Description	Financed by	Countries Involved	Status
Anaklia Development Consortium (ADC)	2015	ADC is developing the Anaklia Deep-Sea Port and the Anaklia City/Special Economic Zone. Anaklia Deep-Sea Port is a greenfield PPP project between Anaklia Development Consortium LLC (ADC) and the Government of Georgia to develop, construct, operate and transfer a deep-sea port on the east coast of the Black Sea. JSC Anaklia City intends to develop the city-scale Special Economic Zone (SEZ) adjacent to Anaklia Deep-Sea Port with about 2,000 hectares of development territory. Development of the port will take place over 9 phases. Phase 1 of construction will be completed in 2021, and the cost of development and construction will be US$540 million.	Out of a total value of US$2.5 billion, the Georgian government has offered US$110 million. The rest has come from the Anaklia Development Consortium LLC.	Georgia	Ongoing
Alat Port Azerbaijan	2013	The new port in Alat is a transportation hub linking west, south and north. It will also increase Azerbaijan's connectivity as an efficient hub and thus increase the volume of cargo being handled. In addition, the new port's location is linked to existing highways and railways, connecting the port to the inland regions of the country. There are three international rail routes into Azerbaijan, which all converge at Alat: (1) to the northwest, passing through Baku to Russia; (2) to the west, passing through Georgia to the shores of the Black Sea and Turkey; and (3) to the south and to the border with Iran.	Azerbaijan	Azerbaijan	Ongoing

Source: Shah (2018), Shepard (2016)

third phase has finished, a capacity of up to 25 million tons of cargo and 1 million TEUs is anticipated (Shepard 2016).

Roads and Highways

In terms of road connectivity, it is important to highlight the network of highways crossing the SC region from east to west and south to north. However, many parts of the highways are under construction and still need a significant amount of funding before being completed. In this regard, there are several projects that can be associated with the BRI.

In June 2017, Georgia signed a loan agreement during the second annual meeting of the Board of Governors of the AIIB (a financial institution directly associated with the BRI) for a US$114 million loan for the construction of approximately 14.3 km of modern highway bypassing the port city of Batumi on the Black Sea coast. This segment is part of the East-West Highway of Georgia (currently under construction) which is connecting the east of the country to the west. Elsewhere on the highway, there is one significant part in the center of the highway around Rikoti mountain pass that still requires significant investment (AIIB 2017). Recently, the Government of Japan devoted US$340 million to the construction of this part (ADB 2018).

To improve Georgia-Armenia transit options, the Armenia-Georgia Border Road (M6 Vanadzor-Bagratashen) rehabilitation project has to be noted. The project aims to improve the strategic regional link between Armenia (Vanadzor) and the Georgian border (Bagratashen), one of the busiest roads in Armenia for internal and external trade. The rehabilitation and upgrade of 51.5 km of the two-lane M6 highway from Vanadzor to the border with Georgia at Bagratashen is to be supported by the EIB (US$56.4 million) and the ADB (US$50 million) (Reconnecting Asia 2018b).

In addition, the Meghri-Yerevan-Bavra highway, another north-south connection, linking Armenia's southern border with Iran to its northern border with Georgia, financed by the Armenian government as well as through loans from the ADB and the EIB, is seen as a potentially time-efficient route that boosts the Iran-Armenia connection. It takes less time to ship goods from any port in China to Yerevan via the Iranian port of Bandar Abbas than to ship to Georgian ports (Inan & Yayloyan 2018). This corridor, also known as the Persian Gulf-Black Sea Corridor, is a multimodal transport corridor which envisages connecting Iran with Europe via Armenia and Georgia.

Another corridor is of interest to Azerbaijan. The International South-North Transport Corridor includes India, Iran, Azerbaijan and Russia. This route would enable Indian cargo to head to the port of Bandar Abbas in Iran and then

Table 7: Summary of Road- and Highway-related Projects in the South Caucasus Region

Initiative/ Project Name	Launch date	Short Description	Financed by	Countries Involved	Status
Batumi bypass highway (Georgia)	2017	The objective of the Batumi Bypass Road Project is to improve regional connectivity in Georgia and to improve efficiency for road transport along the East-West Highway. The project will construct a new two-lane 14.3 km highway to provide a bypass to Batumi (the second largest city in Georgia). The road would pass through a number of mountainous settlements. Due to the hilly nature of the terrain, this stretch of road requires the construction of five tunnels and 19 bridges over rivers and valleys.	AIIB (36.15%), ADB (36.15%), Georgia (27.7 %)	Georgia	Ongoing
Lapis-Lazuli Transport Corridor	2017	This corridor aims to enhance regional economic cooperation and connectivity between Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey, and expand economic and cultural links between Europe and Asia.	Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey	Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey	Ongoing
Persian Gulf-Black Sea Corridor	2015	A multimodal transport corridor which envisages connecting Iran with Europe via Armenia and Georgia. Iran, Armenia, Georgia, Greece, and Bulgaria are key members of the project. One of the key issues in this project is the modernization of transport infrastructure connecting Armenia with Iran and Georgia.	Countries involved via IFIs	Iran, Armenia, Georgia, Greece	Ongoing
International North-South Transport Corridor		The International North-South Transportation Corridor (INSTC) is an India-driven initiative connecting India with Russia and Europe via Iran. This is claimed to be a connectivity initiative parallel to China's One Belt One Road strategy.	Countries involved via IFIs	Azerbaijan, Iran, India, Russia	Ongoing

Source: Daly (2017), Inan & Yayloyan (2018) overland by road and/or rail through Azerbaijan and on to Russia and beyond.

Another recent development occurred at the 7th Regional Economic Cooperation Conference on Afghanistan (RECCA-VII) when Turkey, Afghanistan, Turkmenistan, Azerbaijan and Georgia signed an agreement providing for a major international trade and transport corridor stretching from Turkey to Afghanistan via the post-Soviet Central Asian republics, named the “Lapis Lazuli Corridor” (Daly 2017).

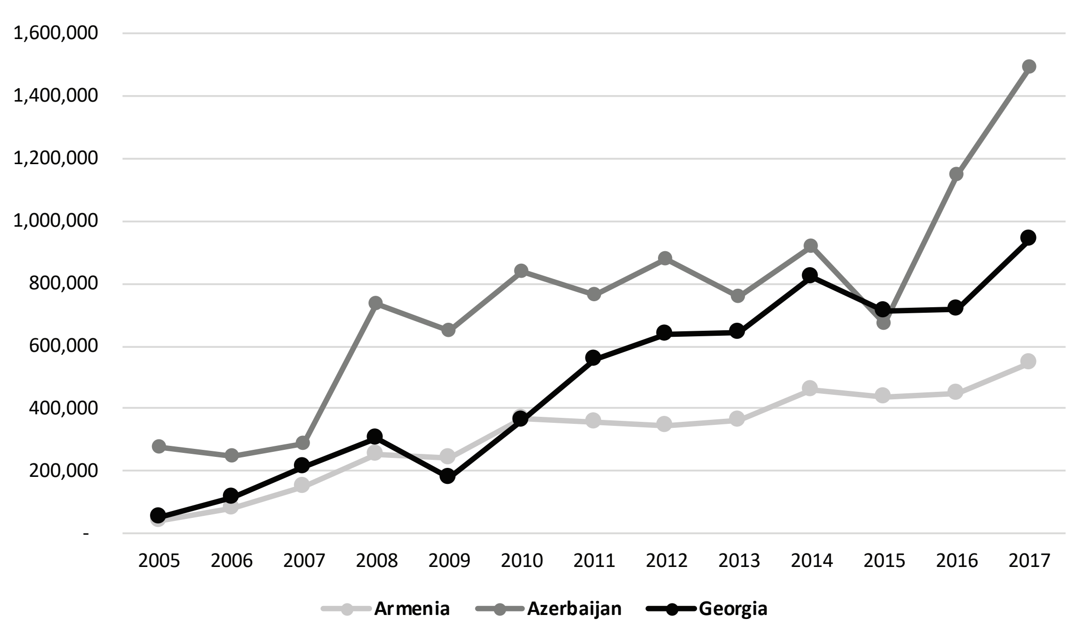
3.2. Trade Facilitation: China’s Trade Relations in the South Caucasus Region

Investment and trade cooperation under the BRI should improve the investment and trade system, and remove investment and trade barriers to enhance business opportunities within the region and for all related countries. In addition, it should ensure that the WTO Trade Facilitation Agreement takes effect and is implemented. It is estimated that in 2020, 80 percent of the world’s population will be living in developing countries, many of which are part of the BRI. This section provides an overview of the trading partnerships that SC countries have formed and how each country has seen its trading relationship with China develop.

Armenia and Georgia have been members of the WTO since 2003 and 2000 respectively, while Azerbaijan is still in the accession process. The trade relationship between Armenia and Azerbaijan is non-existent due to the ongoing conflict, however Georgia enjoys close trade relationships with both countries. As of 2017, Azerbaijan and Armenia ranked 4th and 6th respectively among Georgia’s biggest trade partners, while China was 3rd (8.8 percent of total trade turnover). Over the past decade, Georgia has increased its cooperation with China. For instance, bilateral trade between the two countries in 2002 amounted to around US$10 million, whereas by 2017 it reached US$940 million. Excluding the EU, China is the third largest export destination for Georgia, accounting for 7.9 percent of total exports (National Statistics Office of Georgia 2017). In 2017, Georgia signed an FTA with China (effective as of 1 January 2018), putting Georgia in a unique position of having an FTA with China and having a DCFTA with the EU.

Similar trends in terms of trade with China have been observed in Azerbaijan and Armenia as well. Azerbaijan’s trade turnover with China increased by 30.4 percent to US$1.49 billion in 2017. Armenia’s trade turnover with China is also on the rise: trade between the two countries increased by 21.0 percent in 2017 over 2016 levels. It is also worth mentioning that Armenia is a member of the

Figure 8: Trade Turnover with China (US$ thousands)



Source: UNCTAD

EAEU, which gives Armenia access to a single economic market of 180 million people (Inan & Yayloyan 2018).

3.3. Financial Integration: FDI in the South Caucasus Region

All three countries in the SC region see FDI as a means of boosting their economies. The chart below shows FDI net inflows as a percentage of GDP for each SC country.

In 2016, Azerbaijan had the largest FDI inflow among the SC countries (see Figure 9). The largest investor in Azerbaijan is the UK, constituting 50 percent of Azerbaijan's FDI inflows between 2003 and 2014 (largely due to investments made by British Petroleum). However, Baku also maintains close ties with Russia, its second-largest FDI investor (UNCTAD 2018b)[6].

Georgia is also significantly dependent on FDI inflows, which constituted approximately 12 percent of its GDP over the last couple of years. In 2017, the largest investor in Georgia was Azerbaijan (25 percent)[7] (mainly because of the building of a new pipeline), followed by the Netherlands (19 percent) and the UK (13 percent). China held 10th place with 2 percent. The main investment sectors are transport and communication, energy, real estate and the financial sector. Over the period of 2002-2017, the net inflow of China's investment into the country was US$590 million (3.3 percent of total investments over the same period) (GEOSTAT 2018).

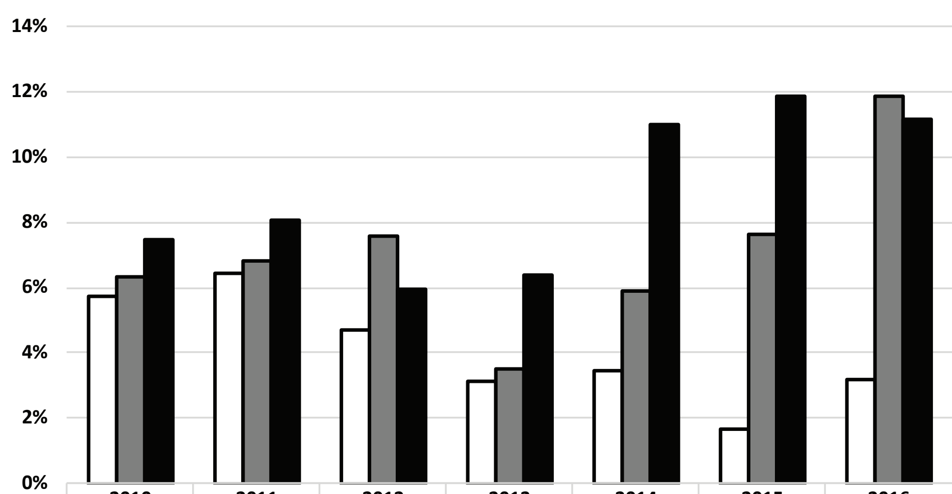
Reportedly, Chinese investments in Georgia target agriculture, banking, telecommunications, infrastructure, hospitality and light industry. Since 2007, the Chinese company Hualing Group has made an approximately US$500 million investment in Georgia, half of which has been devoted to Free Economic Zones (Tskhovrebova 2016). One such zone is near Kutaisi, which is approximately 120 km from Anaklia Deep-Sea Port. Furthermore, the China Energy Company Limited (CEFC) purchased 75 percent of shares in the Poti Free Industrial Zone located in Poti port (CEFC China 2017).

Armenia has the lowest share of FDI to GDP in the region and has seen no significant investments from China over the course of the last two decades. Armenia's main investor country in 2017 was Germany. In Armenia, Chinese activity is less evident than in the other SC countries. The most notable activity has been China's interest in connecting the Black Sea and the Persian Gulf. In this regard, China Communications Construction Company carried out a feasibility study for the construction of the Southern Armenia Railway project to connect the Black Sea and the Persian Gulf.

Overall, according to World Investment Report 2018 (UNCTAD 2018b), China is becoming an important investor in transition economies (including SC countries). China's

6. Information regarding FDI flows from China to Azerbaijan is not available.
7. Azerbaijan traditionally is one of the largest investors in Georgia.

Figure 9: Foreign Direct Investment (net inflows, percentage of GDP)



	2010	2011	2012	2013	2014	2015	2016
Armenia	5.72%	6.44%	4.68%	3.11%	3.48%	1.69%	3.20%
Azerbaijan	6.34%	6.80%	7.60%	3.53%	5.89%	7.63%	11.89%
Georgia	7.47%	8.08%	5.95%	6.37%	11.01%	11.86%	11.18%

Source: World Bank (2018)

FDI stock in this region increased from US$8 billion in 2011 to US$23 billion in 2016, making it the fourth-largest investor country for transition economies.

3.4. Policy Coordination

Policy coordination is regarded as an important guarantee of the BRI's implementation, thus this section outlines the extent to which BRI investments are integrated with the national plans of the SC countries' governments.

Georgia

Initially, in 2013, Georgia was not part of the BRI. However, it has gradually become a valuable and reliable partner for China in general. As a result of increased cooperation since 2017, Georgia has repositioned itself, hosted two international forums—one in 2015 and another in 2017—dedicated to the BRI, and signed an FTA with China (Ismalov & Papava 2018).

Currently, the Government of Georgia (GoG) uses two guiding strategy documents to tackle economic challenges. A social and economic development strategy "Georgia 2020," announced in 2012, is a broad guiding document directed at the long-term growth of most economic sectors beyond 2020. Boosting the private sector's competitiveness, developing human capital and improving access to finance are the three main areas on which the document focuses (Government of Georgia 2013). More recently, in 2016, the GoG announced a "4-point plan" focusing on four pillars, one of which is economic development. Both documents emphasize infrastructure modernization as a key precondition for Georgia to position itself as a transit hub and to unlock trade opportunities. Furthermore, both documents mention Anaklia Deep-Sea Port, the East-West Highway and the BTK railway as pivotal projects in achieving those goals (Gabekhadze 2016).

In terms of advanced manufacturing and transport, in 2016, Georgian Railway signed an agreement with China's CRRC to build a new factory in Tbilisi and to purchase 28 freight locomotives. The agriculture sector has also received attention, as an MoU was signed to support the revival of tea plantations in Georgia. Cooperation in tourism and cultural exchanges have also risen. For instance, talks are ongoing between the two countries about visa-free travel opportunities for tour groups (agenda.ge 2016). The JSC Partnership Fund, a state-owned investment fund, has also established several MoUs, including one with Chinese engineering company SEDIN Engineering Co to assist with the industrialization process (JSC Partnership Fund 2017a). Box 1 below provides more details about JSC Partnership Fund's engagement with Chinese partners.

Furthermore, since 2016, the Georgian Chamber of Commerce and Industry (GCCI) has been a member of the Silk Road Chamber of International Commerce (SRCIC), a Hong Kong-based entity focusing on the development of

Box 1: JSC Partnership Fund and the BRI

At the Belt and Road Forum for International Cooperation held in Beijing on 14 May 2017, CEFC China Energy Company Limited signed two important cooperation agreements with the GoG: a Memorandum of Understanding on the Joint Establishment of the Georgian Development Bank; and a Strategic Cooperation Framework Agreement on the Joint Establishment of the Georgian National Construction Fund. These documents were signed by Dimitri Kumsishvili, then Georgia's First Deputy Prime Minister and Minister of Economy and Sustainable Development, and David Saganelidze, CEO of the JSC Partnership Fund. The overarching aim of these agreements is to further advance strategic cooperation between CEFC China and the GoG, as well as to build the planned "Silk Road Common Market Zone," which is intended to accelerate the development of an innovative Belt and Road trade model. Furthermore, these agreements state that CEFC China will work with the GoG to set up the Georgian Development Bank. This bank will be controlled and operated by CEFC China and, in order to boost bilateral economic and financial cooperation, emphasis will be placed on RMB-denominated financial services and cross-border RMB settlement services (CEFC China 2017). Despite having a range of important MoUs, it is worth mentioning that currently there is no single overarching document regarding the BRI, as all of them are project/sector-specific.

Cooperation between the JSC Partnership Fund and Chinese partners goes beyond industrial sectors, as in 2017 the Fund signed a framework agreement with Baima Wine City Industrial Co Ltd to support Georgian wine export to China (JSC Partnership Fund 2017b). This is in line with an increasing trend in wine export. Back in 2016, Georgian Wine House was opened in China, in Jiangxi province (Ministry of Agriculture of Georgia 2016). In 2017, wine exports to China increased by 43 percent over 2016 levels, and according to export data for 2018, after analyzing the first six months, China is the third-largest importer of Georgian wine (data.gov.ge 2018).

the BRI and seeking to advance its members' growth and prosperity by offering trade and investment opportunities.

Azerbaijan

Similar to Georgia, Azerbaijan has a guiding strategy document "Azerbaijan 2020: The Look into the Future," which also presents modernization of transport infrastructure as one of the country's main areas of focus. In order to boost the country's competitiveness in the Europe-Caucasus-Asia and north-south transport corridors, some specific BRI-linked projects have been mentioned, such as an international sea trade port in Alat and the BTK railway (Government of Azerbaijan 2012).

Azerbaijani-Chinese cooperation has been driven by the deepening of economic and trade relations dating back to before the BRI. For instance, in 2005, when Azerbaijani President Ilham Aliyev visited China, an Azerbaijani-Chinese business forum took place with representatives of 40 Azerbaijani and 400 Chinese companies. Among the 20 contracts signed by businesses at the forum, one agreement established a base in Azerbaijan for developing Chinese know-how in the manufacturing of fiberglass cables, mobile drilling rigs used in the oil and gas industry, materials for storage/packaging of agricultural products, and computer technology (Babayan 2014). Ten years later, in 2015 Azerbaijan signed a MoU on construction of the Silk Road Economic Belt, focusing on securing a series of deals in areas including trade, judiciary, civil aviation, education, transportation and energy (Xinhuanet.com 2015).

Armenia

The Armenia Development Strategy for 2014-2025 outlines the general trajectory of Armenia's development vision. However, following the recent political shift in Armenia, the current administration is working on a new strategy document entitled "Armenia Development Strategy 2030" (Government of Armenia 2018).

Currently, compared with the other SC countries, Armenia has the least formalized cooperation with China under the BRI and the developments under this flagship initiative somewhat reflect the general China-Armenia relationship. Moving forward, it will be interesting to follow how cooperation with China will develop under the new administration in Armenia.

4. The BRI and the South Caucasus: Future Outcomes/Potential Impacts

The countries of the SC region have increasingly vulnerable economies due to their high degree of dependence on certain factors (for instance, Azerbaijan is heavily dependent on oil and gas, Armenia on remittances from Russia, and Georgia on FDI inflows and regional political stability). Thus, for the countries of the SC, the opportunities presented by the BRI could be summed up as follows:

- Diversify economic activities;
- Improve coordination between a wide spread of projects under one umbrella (one aim);
- Enhance regional coordination and utilize the strength of the region to attract more investors; and
- Strive to become more than just transit countries by offering skilled and relatively cheap labor and relatively cheap resources coupled with closer ties with the EU and other markets such as the EAEU.

Due to political tension between Armenia and Azerbaijan, it is not likely that the SC countries will adopt a coordinated policy approach towards the BRI; however, bilateral cooperation (Georgia-Azerbaijan; Georgia-Armenia) has already proven possible.

Among the SC countries, Armenia, having closed border crossings with Azerbaijan and Turkey, should be the most interested in boosting its share of global trade by positioning itself in the BRI. Armenia could leverage its EAEU membership together with closer ties with the EU, Iran and Georgia to transit cargo from south to north. Thus, as part of the BRI, Armenia could consider a south-to-north highway from the Iranian border to the Georgian border as being key for its involvement. Nonetheless, the success of this is likely to be hindered by Azerbaijan's efforts to divert south-north transportation from Iran via Azerbaijan (Inan & Yayloyan 2018).

In terms of future possible impacts, we may consider the corridor approaches and their different stages. Thus, we can assume that the SC region, as a part of the corridors connecting Asia to Europe, will experience varying impacts in terms of integration at various stages.

According to the ADB (2011), the region can be considered as comprising five stages: transport corridor (stage 1), logistics corridor (stage 2), transport and trade facilitation corridor (stage 3), economic or growth corridor (stage 4), and development corridor (stage 5). The countries in this region are at stage one: 'Transport corridors generally refer to the infrastructure dimension that provides physical links to an area in a country or region that previously lacked connection' (ADB 2011).

It could be argued that focusing on soft and hard infrastructure, improved regional ties and communication could serve as a pathway to reach stage five. In this regard, the

BRI could serve as an incentive for SC countries to move forward from stage 1. The journey from stage 1 to stage 5 could bring more cargo and FDI across borders and enable conducive conditions for innovation. As a result, healthier and more developed economies could emerge.

Furthermore, future potential outcomes/impacts could be anticipated by looking at the BRI from a broader regional perspective. According to a recent ADB report, to maintain the regional growth trajectory, eradicate poverty, and respond appropriately to climate change in Asia, infrastructure investments of US$26 trillion from 2016 to 2030, or US$1.7 trillion per year, are needed (ADB 2017a). One can argue that the BRI is expected to contribute greatly to narrowing the infrastructure financing gap in Asia. In addition, improved connectivity is expected to enable more favorable conditions for boosting trade. Notably, China and Europe represent the geographic and political ends of the "Belt and Road" for the Eurasian continental part of the initiative, thus BRI-related expectations are linked to their increasing cooperation. Looking at trade between China and Europe, which accelerated after 2001 when China became a member of the WTO, in 2017 it reached US$573 billion (Fardella & Prodi 2017). In terms of modes of transport, until recently almost 99 percent of the cargo moving from the Asia-Pacific region to Europe and vice versa was transported by sea (European Commission 2018). However, the value of goods shipped by railway increased from €1.6 billion in 2011 to €10.2 billion in 2016 and the value almost doubled from 2015 to 2016, with Germany, Poland and the Czech Republic accounting for 80 percent of total European railway trade with China (source: Eurostat). This analysis is crucial when looking at the possible impacts of the BRI from SC countries' perspectives, as according to the OECD (2011), in 2050 Europe-Asia railway routes will be able to absorb between 0.5 and 1 million TEUs out of a total of 20 million in the world, or 2.5-5 percent of total shipments. In addition, a simulation by Garcia Herrero & Xu (2016, p. 6) using a gravity model revealed that as far as trade flows between BRI countries are concerned, "a 10 percent reduction in railway, air and maritime costs increases trade by 2 percent, 5.5 percent and 1.1 percent respectively." Considering the potential benefits of an efficient railway corridor for the BRI, individual countries and corridors are engaged in intense competition.

Development of the information and communication technologies (ICT) and digital technologies sector could be seen as one of the key areas to be indirectly affected by the Initiative. As China has been vocal about building a "Digital Silk Road," this could also offer potential for the countries of the SC to engage. For instance, ICT remains one of the fastest-growing sectors in Armenia. According to the Enterprise Incubator Foundation (2015), total revenue from the ICT sector grew by 17.7 percent in 2014, reaching US$559.1 million in 2015. Furthermore, more than 450 ICT companies operate in Armenia, with average annual growth of 10 percent. However, it should be noted that more skilled human capital is needed. The lack of a skilled workforce is also noted in neighboring Georgia, where there are ongoing capacity building programs funded by the World Bank aimed at the development of an innovation-driven and knowledge-based economy through the advancement of IT skills in Georgia (World Bank 2016). In addition, the existence of fiber optic networks and the affordability of broadband networks and services are extremely important. The Trans-Eurasian Information Super Highway (TASIM) is a fiber-optic route spanning from Hong Kong to Frankfurt in Germany, with an estimated length of 11,000km. This route will pass through China, Kazakhstan, Azerbaijan, Georgia, Turkey and Germany. Currently, the TASIM is still under construction, and its potential to improve ICT connectivity across Eurasia should be noted (ESCAP 2017).

5. Risks along the BRI

Although initially the BRI had been regarded as a domestic development strategy aiming mainly to boost China's underdeveloped western provinces, gradually it has gained global recognition and is currently viewed as one of the most significant global development initiatives of the 21st century (Szczudlik-Tatar 2013). Risk management, as a key part of economic development, is especially relevant to large-scale infrastructure investments, which are inherently risky due to weak governance or poorly-executed rule of law and corruption. Countries of the SC are not immune to these political, geopolitical, economic, financial, regulatory, social and environmental risks (Sheng 2018). Therefore, this section reviews BRI-related risks relevant to the SC region.

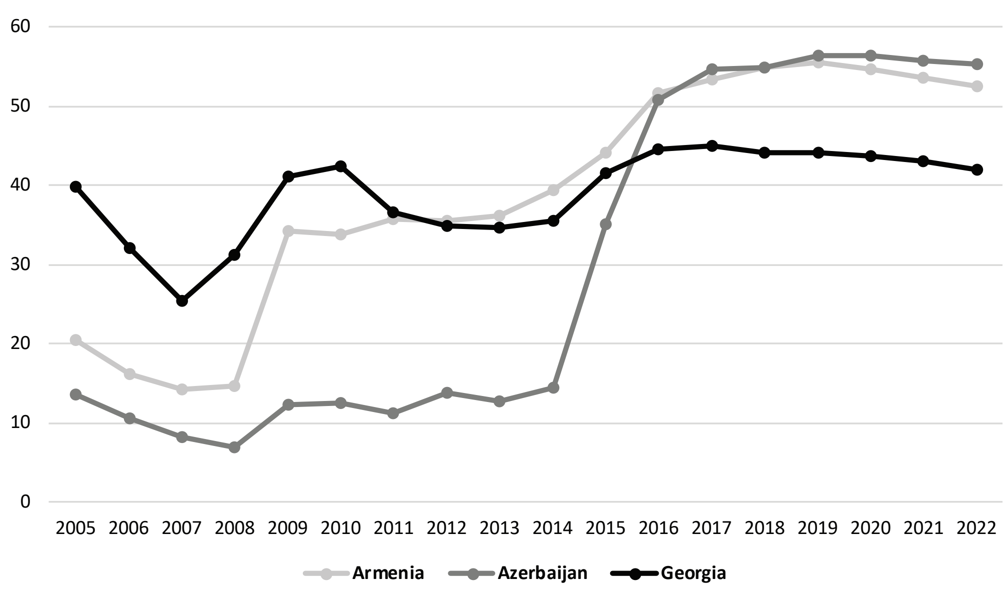
Factors such as political stability, government effectiveness, and rule of law, coupled with democratic accountability and control of corruption, underpin political and geopolitical risks. However, as BRI-related infrastructure projects are interdependent, regional and country-specific internal instability poses a major threat to them. For instance, as noted earlier, the political tension between Armenia and Azerbaijan has been evident in the competition regarding the International North-South Transport Corridor and Persian Gulf-Black Sea routes. Azerbaijan and Armenia are both seeking improved connectivity with Iran (Sheng 2018). In addition, given Russia's longstanding view of post-Soviet countries as falling within its geographic sphere of influence, China's targeting of the region as a focus of its Silk Road initiative has received a largely negative reaction in the Kremlin (Wilson 2016).

As for the economic and financial risks directly or indirectly threatening the completion of BRI-related projects, many BRI countries adopt foreign exchange control or capital control policies. A paper by the Center for Global Development assessed the likelihood of debt problems in the 68 countries identified as potential BRI borrowers. Eight countries[8] have been identified as being at particular risk of unsustainable debt based on an identified pipeline of project lending associated with the BRI. Based on analysis of 68 BRI-related countries, the study revealed low, significant and high-risk countries from a debt sustainability perspective. Armenia was found to be at significant risk, while Georgia and Azerbaijan were found to have low debt sustainability (Hurley et al. 2018). It is worth mentioning that increasing debt and China's role in managing bilateral debt problems have already been seen as problematic. For instance, in Sri Lanka, citizens have on a regular basis protested against police over a new industrial zone surrounding Hambantota port. Meanwhile, in Pakistan, Chinese officials have openly appealed to opposition politicians to embrace the construction of the China-Pakistan Economic Corridor (CPEC), which is among the BRI's flagship projects and has also been the subject of protest (Sheng 2018).

When it comes to the need to increase connectivity in and around the SC region, the need for a significant amount of investment in infrastructure is apparent. Countries in the SC region cannot afford to finance large investment projects by themselves and thus have to borrow. On the one hand, the origin of borrowed money is important (will it be China or other international institutions?), but on the other hand the fiscal space these countries have makes a significant difference. In particular, it is important to assess the risk SC countries are facing by increasing their levels of indebtedness. Figure 10 depicts the current levels of indebtedness for each of the SC countries. Figure 10 shows that external general government debt increased significantly from 2014 to 2016. This is partly caused by the devaluation of the local currencies against major international currencies to which the debt is converted. Since external debt makes up a relatively high share of these countries' debt structures, it caused an increase in the share relative to GDP. According to the IMF, this share should remain relatively stable over the next four years but, as the currency crisis in 2014 showed, these countries should be relatively cautious when considering taking new loans.

8. These countries are Djibouti, the Kyrgyz Republic (Kyrgyzstan), the Lao People's Democratic Republic (Laos), the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan.

Figure 10: General Government Gross Debt, Percentage of GDP (IMF WEO)



Source: IMF (2018)

Assessment and management of social and environmental issues can be critical in infrastructure and energy projects and can serve as important drivers of public opinion and attitudes. These issues include, but are not limited to, labor and working conditions, labor strikes, pollution prevention and abatement, demolition and relocation, biodiversity conservation and ecological protection, indigenous people, and cultural heritage (Sheng 2018). The countries of the SC region have different regulatory frameworks handling social and environmental issues related to infrastructure. For instance, in 2018 Georgia adopted the Environmental Assessment Code[9], including the Environmental Impact Assessment and Environmental Strategic Assessment, whereas Armenia and Azerbaijan rely on international conventions and the internal policies of the funding financial institutions (Parliament of Georgia 2017, United Nations Development Programme 2016). Nonetheless, the enforcement mechanism still needs to be improved. Even before the new legal framework was adopted, the Tbilisi Bypass Railway project[10], led by China Railway 23rd Bureau Group, experienced some challenges. Operating under the 1999 FIDIC Yellow Book conditions, which gives the contractor the right to hire labor according to its own considerations, the company had no obligation to employ a local workforce. Furthermore, some officials from Georgian Railway stated that the style of Chinese management was different from that of Western companies. While the latter concentrate on procedures, careful planning and safety matters, Chinese companies were more concerned with hard results (Zhou 2012). More recently, the same company faced a protest from local Georgian employees working on another railway project in western Georgia. The workforce expressed dissatisfaction with the working conditions and the local population protested against vibrations caused by the construction work, which endangered their houses.

9. This commitment implies adoption of the environmental assessment code that will envisage the requirements of the convention "on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters" (hereafter, Aarhus Convention) in issues of environmental protection and will ensure public participation in the decision-making process in relation with effects on the environment, particularly: to bring potential negative impacts of high-risk activities on the condition of the natural environment, as well as on human life and health, under the environment assessment regulation, in compliance with the requirements of EU directive 2011/92/EC "on the assessment of the effects of certain public and private projects on environment."

10. Construction of the Tbilisi Bypass Railway project started in 2010. Tbilisi has been one of the key junctions within the national and regional junctions; in particular, railway lines leading to Azerbaijan, Armenia and Georgia's Black Sea ports converge in Tbilisi. Due to these major international lines leading to Europe via Turkey, railways in Tbilisi also form part of the east-west transport corridor, which now could be linked to the BRI. Thus, the main reason for this project was to address the growing city's size, population, and traffic flows (Babunashvili 2018).

In terms of dedicated freedom of information legislation, all three countries have provisions in place applicable at the national, regional and local levels. However, the provisions for accessing information vary. Some investment documents, due to their confidentiality, are not open for public viewing. Therefore, it goes without saying that more in-depth and case-by-case research is needed to have more information about the involvement of wide stakeholders into the decisions-making.

From a more global perspective, several studies have been carried out to assess the level of risk associated with BRI-related projects. For instance, the Economist Intelligence Unit (EIU) conducted a study titled "Prospects and Challenges on China's "the Belt and Road": A risk assessment report." The study is based on risks across 10 categories (security, political stability, government effectiveness, legal and regulatory environment, macroeconomic risks, foreign trade and payment, tax policy, labor market, financial risk, and infrastructure), and revealed that most of the BRI countries have high operational risk (Economist Intelligence Unit 2015). Positively for Georgia, it was given the lowest risk level in the SC region. Another study initiated by ACCA and the Shanghai Stock Exchange (SSE) produced the Belt and Road Country Cooperation Index (BRCCDI). This index is calculated by dividing a country's cooperation level by the level of the operational risk. The average score was set at 1.02, with Kazakhstan and Turkey scoring 1.38 and 1.22 respectively, Georgia scoring 0.88 and Azerbaijan scoring 0.68 (The Association of Chartered Certified Accountants 2017).

6. Recommendations

Based on the analysis, it is clear that the BRI is still unfolding and, due to its scale, it is somewhat chaotic. The main concern related to the BRI is ascertaining the real objectives behind the Initiative. Would investment and trade be driven by market-based transactions, or would they be in the form of foreign aid that is not based on economic calculations of gains and losses? Which of the 65 or so countries in Asia, Europe and Africa along the Belt and Road are likely to be the Initiative's priority targets for economic cooperation? This section provides some recommendations for BRI stakeholders and tries to identify gaps where further research is needed.

6.1. For the Governments of South Caucasus Countries

In general, SC countries should seek better regional coordination (highlighted in more detail in a previous study by PMCG)[11] in order to increase the competitiveness of the trade routes passing through them. The strengths and weaknesses of each corridor need to be examined very carefully. When doing so, focus should be placed on studying already-existing hard infrastructure, its improvement and further steps for improving soft infrastructure in order to increase the competitiveness of the corridors. Countries can use the incentives arising from the BRI to deepen regional economic ties that, in turn, will give the SC region more comparative advantages and allow the region to gain more attention and investments from China. Several particular steps could be helpful here.

Firstly, the simplification of border crossing procedures is of great importance. It is also strongly advised to create a soft infrastructure tool at the regional level, such as a unified tracking and tracing system, while the countries along the corridor should manage an efficient electronic data flow and run scheduled train operations. These steps are all necessary to increase the reliability of the corridor, to significantly reduce the time spent crossing borders, and to minimize cargo delays and theft risk.

Secondly, while investigating the TRACECA corridor, it was identified that tariffs are highly volatile, making it nearly impossible to make any reliable price forecasts. Despite the fact that the parties within TRACECA have signed a number of documents relating to certain benefits and reduced tariffs, in practice little has been accomplished in this direction.

However, as already mentioned above, due to the complex political context and existing regional conflicts, it would be impossible for the countries of the SC to have a joint approach. Therefore, further research is needed to identify regional cooperation options for the countries of the SC. As several BRI-related infrastructure projects have already raised some questions regarding debt sustainability, apart from policy coordination, governments should also be cautious about increasing their debt portfolios.

BRI-related projects have the potential to enable the creation of job opportunities; however, governments should ensure that local human capital development is properly integrated into any such processes.

6.2. For Donors/Investors

In 2016, the net total of official development assistance (ODA) was US$868 million in the SC region (Georgia, US$463 million; Armenia, US$327 million; and Azerbaijan, US$78 million) and most of the funding was aimed at social and economic infrastructure (OECD 2018). In addition, major international financial institutions, such as the EBRD[12] and the ADB[13], have significant portfolios in the region. Having the BRI in the SC region could bring new donors/investors. For instance, Georgia and Azerbaijan have already received loans from the AIIB. The key challenge for donors would be to ensure coordination on a greater scale. Therefore, further research on finding common ground and developing a coordination mechanism would be helpful.

6.3. For Private Entities

Although the BRI is currently a government initiative, its future success depends on interest from the private sector. This has been reflected in a study by Baker McKenzie, in which BRI projects linked to China were assessed to be worth US$350 billion over the next five years. Most opportunities, as suggested, are unlocked for private companies operating in sectors such as: technology; media and telecommunications; consumer goods and retail; industry; manufacturing and transportation; financial institutions; energy; mining; and infrastructure. In addition, companies providing professional services are critical to mitigate risks, due to the necessity of due diligence, business structuring, contract negotiation, labor and tax regulations, and insurance requirements as part of a firm's successful offshore activities (Baker McKenzie 2017).

However, international companies might face some challenges arising from the lack of knowledge of the local context and the low level of human capacity of the local workforce, as well as complex legal regulations or power structures. Therefore, more insights into the local business environment would be essential for private entities to enter new markets.

In general, it can be argued that there are three main challenges facing the Initiative: selection of appropriate projects; implementation of the projects; and separate political and economic matters. Thus, moving forward it will be important to address the following questions:

- Will the Initiative contribute to stability, or will it fuel power dimensions in countries along the Belt and Road?
- What will the BRI do for regional cooperation and how will it enhance regional connectivity?

11. Zabakhidze, M., and R. Beradze (2017). "Georgia as a Transit Hub and its Increasing Potential in the Implementation of the Belt and Road Initiative." PMCG.

12. Current portfolio in Georgia, Azerbaijan and Armenia as of July 2018 was €789 million, €1,426 million and €312 million, respectively.

13. As of 2016, active portfolio in Georgia, Azerbaijan and Armenia was US$1,021 million, US$2,791 million and US$804 million respectively.

- Will the BRI advance China's soft power and will the BRI give China a greater role in the global governance architecture?
- What will be the role of non-BRI countries in shaping the Initiative?
- What will be the role of new and old financial institutions in the realization of the BRI?

7. Conclusion

This country note has analyzed possible outcomes and impacts of the BRI on the countries of the SC region. Currently, Armenia, Azerbaijan and Georgia are facing socio-economic challenges that can be addressed by infrastructure modernization and enhanced regional cooperation. According to Chinese officials, the BRI is aimed at unlocking new markets, promoting trade, and facilitating investment, consumption, job creation and people-to-people exchange. Therefore, the BRI narrative and the common objectives of the countries of the SC appear to be a natural fit.

Due to the complex political framework and existing regional conflicts, it is impossible for all of the SC countries to have a joint approach. However, Georgia, having good relations with Azerbaijan as well as Armenia, plays an important role in regional cooperation. Thus, bilateral cooperation between countries of the SC has proven possible. The TANAP, for example, showcases cooperation between Georgia and Azerbaijan. The TANAP, combined with the SCP and the Trans-Adriatic Pipeline (TAP), forms the South Natural Gas Corridor that aims to transport gas from Azerbaijan's fields in the Caspian Sea like Shah Deniz II to Turkey and Europe. In a similar manner, the TITR, linking Kazakhstan, Azerbaijan, Georgia and Turkey, and the BTK railway project could also be considered examples of regional cooperation.

Armenia, having just two open borders (one with Georgia and one with Iran), should be particularly interested in boosting its share of global trade by positioning itself in the BRI. Therefore, a south-to-north highway from the Iranian border to the Georgian border can be seen as a key project to ensure its involvement in the BRI. Nonetheless, the success of this is likely to be hindered by Azerbaijan's efforts to divert south-north transportation from Iran via Azerbaijan.

However, while there is some potential to further improve regional connectivity, it should also be mentioned that Georgia, Armenia and Azerbaijan differ greatly in terms of their foreign policies. Georgia, with its NATO and EU aspirations, seeks closer ties with its western allies. Meanwhile, Azerbaijan is trying to keep a balance between Russia and the West, and Armenia is a member of the Russia-led EAEU. Therefore, given these geopolitical considerations, further research is needed to identify regional cooperation options for the countries of the SC. In addition, as several BRI-related infrastructure projects have already raised some questions regarding debt sustainability, apart from geopolitical peculiarities, governments should also be cautious about increasing their debt portfolios.

In conclusion, the BRI is a priority on the policy agenda of China, with numerous existing and planned projects in and beyond the SC region. However, it is still uncertain as to how this Initiative will be implemented. While synergies could be observed between the BRI and current infrastructure development needs in the countries of the SC region, cooperation is still limited due to a lack of policy coordination, financial risks and concerns about the transparency and fairness of the BRI.

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The Watergate Office Building, 2600 Virginia Avenue, NW, Suite 201

Washington, DC 20037, USA. Tel:(1) 202 393 6663 Fax: (1) 202 393 6556

Email: info@emergingmarketsforum.org