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**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION
DIRECTORATE B
- POLICY DEPARTMENT -**

NOTE

ON GEORGIA: POLITICAL AND ECONOMIC SITUATION, EU-RELATIONS

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I. GEOGRAPHY AND HISTORY¹

Georgia has a population of some 4.5 million and a surface area twice that of Belgium. About 15% of the territory is, however, not under government control. There are three main geographical regions: the Caucasus mountain range in the north, which stretches from the Black Sea to the Caspian Sea and forms a natural border with Russia; the plains in the south, which also extend into Turkey and Armenia; and the Central Georgian basin area which borders on Azerbaijan to the east and the Black Sea to the west.

As in most other parts of the Caucasus, the ethnic and linguistic diversity is huge. There are Azeri, Armenian, Abkhaz, Ossetian and Kist minorities (commented upon further down in this note). Megrelians and Svans in western Georgia are much closer to the dominating Georgian group. The inhabitants of Adjara, in the southwest, are Georgians, but some of them are Muslims, as a lingering consequence of Ottoman rule in the past.

The Georgian language belongs to the Kartvelian (also called South Caucasian) family of languages, which is distinct from the Indo-European, Semitic and Ural-Altai families. The alphabet and literature date back almost two thousand years. Georgia was Christianised in the fourth century. Its fertile soils and strategic position have made it a constant target for its neighbours. The capital Tbilisi has been destroyed 26 times (with invasions by Romans, Byzantines, Russians, Persians, Arabs, Mongols and Turks).

In 1783, King Irakli II put Georgia, then under threat from both the Ottoman Turks and the Persians, under Russian protection. In 1801, Tsar Paul I annexed Georgia. The monarchy was abolished and the Orthodox and autocephalous Georgian church was placed under the authority of the Russian Synod. However, it took more than sixty years to conquer the Caucasus. At the end of the nineteenth century, the Tsarist regime intensified its policy of russification. Russian became the official language and Georgian a foreign language. This policy provoked a strong nationalist reaction.

The fall of the Russian Empire enabled Georgia to proclaim its independence in 1918. However, threatened by the Turks, White Russian armies and the Bolsheviks, Georgia could not resist for long. The Red Army entered Tbilisi in early 1921. The (Menshevik) government went into exile and Georgia became a Soviet Socialist Republic.

The Soviets created several autonomous entities based on ethnic origin between 1921 and 1924. The demarcation of these entities and the way that they were interwoven were designed to avoid the formation of potentially dangerous groupings of mountain peoples and to weaken subjects that were regarded as unreliable, such as the Azeris and the Georgians. In 1921/22 three autonomous republics on Georgian territory were created: Abkhazia, Adjara and South Ossetia.

Georgia proclaimed itself independent on 9 April 1991, exactly two years after a nationalist protest in the capital Tbilisi had been brutally repressed by the Soviet

¹ See also the map and basic country data in the annexes I and II.

authorities. The following month, a leading figure in the nationalist opposition against the Soviet rule, Mr Zviad Gamsakhurdia, was elected President. The nationalist movement was, however, deeply split and Gamsakhurdia soon lost control of the National Guard. In December 1991, he was overthrown and Eduard Shevardnadze, who had been Foreign Minister in the Soviet Union under Gorbachev and before that leader of the Communist Party in Georgia for many years, was made chairman of a transitional government. Mr Gamsakhurdia did, however, mount resistance in western Georgia with the help of units that remained loyal to him.

In parallel with the developments just mentioned, and to a great extent in reaction to the Georgian nationalist mobilisation, nationalist sentiments grew also in the autonomous regions of South Ossetia and Abkhazia. Wars were fought and lost by the central government. They produced hundreds of thousands of refugees and internally displaced persons, with Georgians forced to leave Abkhazia representing the biggest group.

Although a clash between Georgian nationalist ambitions and activities of paramilitary organisations on the one hand and Ossetian and Abkhazian nationalist ambitions on the other was the cause of the conflicts, Russia had - and continues to have - an important role. Nationalists in both regions sought and obtained Russian support, although there are conflicting accounts of the more precise nature and extent of that support. In Abkhazia, volunteers from the Northern Caucasus recruited with the help of the Confederation of Mountain Peoples of the Caucasus² also joined the Abkhazian fighters.

Weakened by the defeat in Abkhazia and facing a military threat from Gamsakhurdia, Shevardnadze opted for cooperation with Russia. This enabled him to consolidate his grip on power, but at a considerable price: accepting Russian military presence in Abkhazia and South Ossetia (as peacekeepers effectively hindering new attempts by the central government to gain control), accepting Russian bases elsewhere in the country and agreeing to Georgia joining the Commonwealth of Independent States (CIS).

The accommodation with Russia, together with abstention from major reform projects and from attacks on corruption that would challenge the domestic elite, made it possible to achieve a modicum of stability. Making progress in state-building and halting the economic decline were, however, difficult under these circumstances. Moreover, Russia relations remained very uneasy.

The bloodless Rose Revolution in November 2003 ended President Shevardnadze's rule. Faced with massive and sustained demonstrations against the official results of parliamentary elections, an invasion of protesters when he was to address the new parliament during its opening ceremony, a threat to have his own residence invaded, vanishing support from the security apparatus and not only American, but with great likelihood also Russian advice to him to resign, Mr Shevardnadze finally did so. Fresh presidential and parliamentary elections were held in the beginning of 2004 and recognised by international monitors as essentially free and fair.

² An insurgent political movement which later played a role in Chechnyan resistance against Russia.

II. POLITICAL SITUATION

Internal political situation

The presidential election in January 2004 and the parliamentary election two months later made the opposition leader Mikheil Saakashvili President³ and gave Georgia a Parliament totally dominated by supporters of the new President. The two other main ex-opposition leaders, Mr Zurab Zhvania and Ms Nino Burjanadze, supported Mr Saakashvili in the presidential election. Mr Zhvania became Prime Minister and Ms Burjanadze kept her post as Speaker of the parliament.

The new government launched a very comprehensive reform programme and scored some remarkable early successes, not least in fighting tax evasion and corruption which had almost bankrupted the country. Some methods used in order to achieve quick results have, however, been criticised, not least by the Parliamentary Assembly of the Council of Europe. This applies inter alia to a system of so called plea bargaining, whereby persons suspected of having committed illegal acts can escape pre-trial detention and/or being convicted by pleading guilty and making a payment.

Mr Zhvania died from gas poisoning in February 2005 said to have been caused by a faulty heater. He was widely believed to exercise a balancing influence on the young (now 38 years) President Saakashvili, who is often characterised as somewhat impulsive and populist. The current absence of a political leader with a stature comparable to that of Mr Zhvania gives rise to concern, not least when the Defence Minister, Mr Okruashvili, makes statements on the breakaway regions which depart from the officially espoused policy of confidence-building.

There are question marks in relation to the consolidation of the democratic system. The total dominance in Parliament of the pro-presidential party is anomalous, although it is the result of a free and fair election. According to various reports, pluralism is limited also by reluctance within the media to antagonise the President.

In October 2005, President Saakashvili dismissed the Foreign Minister (and former French Ambassador to Georgia, remarkably enough) Ms Salome Zourabichvili after the parliament had accused her of underperforming and called ever more loudly for her to be sacked. Ms Zourabichvili claimed that she was targeted because she hindered continuation of corrupt practices within the Foreign Ministry. She rapidly managed to mobilise many thousands of demonstrators in the capital and later went on to found the political party 'Georgia's Way', which may become a significant political force. Local elections which will be held in the end of 2006 will be a test of the potential of this and other opposition parties, as well as of the general development of the democratic system.

In spring 2006, the murder of the banker Sandro Girgvliani by personnel of the Ministry of Interior threw fresh doubt on the actual state of the rule of law in the country. There

³ Official biography: www.president.gov.ge/?l=E&m=1&sm=3

were various rumours on high-level involvement in the crime and pressure for an independent inquiry, as well as for the dismissal of the Interior Minister, Mr Merabishvili. Neither was achieved, however.

Human rights NGOs say patterns of torture and ill-treatment established before the Rose Revolution have not been broken. They call for comprehensive measures to ensure that this really happens and for measures to strengthen democracy and the rule of law⁴. The Parliamentary Assembly of the Council of Europe (PACE) recently made the following analysis of developments as regards democracy, human rights and the rule of law:

The authorities are continuing to demonstrate a clear resolve to build a stable and modern European democracy (...). The post-revolutionary euphoria has given way to more pragmatism; the hasty, sometimes even chaotic initial approach to reforms is very gradually being replaced by a clearer focus on priorities and by a better-defined strategy. However, most reforms are only at their very beginnings and major challenges still lie ahead. The ambitious work which has been undertaken in order to bring legislation in line with European standards still has to produce concrete results in most areas.

(...) the strong system of government is not accompanied by efficient checks and balances (...).

Most reforms appear to be carried out by a narrow circle of like-minded leading politicians, rather than by a broad configuration of people reflecting all the rich potential of the nation.

(...) any failure to deliver on promised reforms can easily result in mistrust and questioning of these same reforms.⁵

The President, Government, Parliament and local government

The Constitution, adopted in 1995 and amended in February 2004, grants the President extensive powers. Elected for a five year period and not eligible for more than two terms, the President *shall lead and exercise the internal and foreign policy of the state*. The President appoints the Prime Minister, gives his consent to the Prime Minister's appointments of other Ministers, can dismiss the Ministers of Internal Affairs, Defence and State Security and dissolve the Government. The President can also dissolve the Parliament if certain conditions are met.

Mr Mikheil Saakashvili was elected President in January 2004. He was the joint candidate of the main opposition parties, his own National Movement and the United Democrats, which later merged to form the National Movement - Democrats.

⁴ See for example the website of the World Organisation Against Torture (OMCT): www.omct.org/base.cfm?cfid=3887835&cftoken=24599094&page=omct&consol=OPEN&kwrd=OMCT

⁵ Resolution 1477 (2006), adopted on 24 January 2006; <http://assembly.coe.int/Documents/AdoptedText/ta06/ERES1477.htm>;

Prime Minister is Mr Zhurab Noghaideli, former Minister of Finance who earned much credit for a dramatic improvement in the public finances during his time in that job. By letting Mr Noghaideli inherit the post from Mr Zhvania, President Saakashvili saw to that it stayed in the hands of a member of the Democrats wing of the merged party. Saakashvili's National Movement wing is, however, believed to strengthen its influence and there is speculation that this could lead to increasing tensions within the party.

The Parliament (Sakartvelos Parlamenti) is unicameral and has 235 members elected for a term of four years, 150 of whom are elected on party lists (election held in March 2004) and 85 in single mandate constituencies (November 2003). The President of the Parliament, Ms Nino Burjanadze, also belongs to the Democrats wing of the ruling party. A number of opposition MPs conducted a boycott of the parliament in spring 2006 after an MP in their ranks had been stripped of his mandate. He had continued to be actively involved with his company, which is prohibited by both the constitution and the election law, although the prohibition is rarely enforced.

The threshold for gaining seats through a party list is 7% of the votes. Only the National Movement - Democrats and the pro-business New Rights Party managed this in the last elections. The latter suffered in the elections from having taken a neutral stance during the Rose Revolution. Some MPs who made their way to the Parliament through single mandate constituencies belong to other parties. There have also been some defections from the National Movement - Democrats.

The Parliament has approved changes to its composition that will come into effect following the next parliamentary elections, in 2008. It will then have 150 members. 100 MPs will be elected by proportional representation in a nationwide constituency; the remaining 50 in 19 constituencies in each of which all the seats will be filled by candidates from the list that gets the highest number of votes - a highly unusual and controversial 'winner takes it all' system.

The Parliament has also passed legislation that will reorganise local government. The new system will come into effect at local elections in late 2006. Based on the current districts in the country, 65 new councils will be formed. The previous system of district and village councils will be abolished. Elections to the councils will be direct, although the head of the council or mayor will be elected from among the new council members. The indirect election of mayors, including of the mayor of the capital Tbilisi, has caused controversy with the main opposition parties, which have pushed for direct elections.

The Georgian government resists calls for greater responsibilities for the regional and local levels. Whether centralism helps to contain centrifugal tendencies or rather increases grievances and causes growing tensions is moot. In any case, the absence of a tried and tested system of power-sharing between Tbilisi and regional or local entities complicates the task of convincing Abkhazia and South Ossetia that such power-sharing is indeed workable and will be respected.

South Ossetia

South Ossetia borders on North Ossetia, in the Russian Federation. The Ossetian language belongs to the Iranian group. Most Ossetians are Orthodox Christians, but there is a Sunni Muslim minority.

The region broke out of Georgia as a result of fighting that started in January 1991 and claimed about 1 000 lives. Some 60 000 Ossetians and 10 000 Georgians became refugees or internally displaced persons (IDPs)⁶. The *Sochi Agreement*, ended the fighting in 1992. A Joint Control Commission (JCC) made up by Georgian, South Ossetian, North Ossetian and Russian representatives was put in place and a Joint Peace Keeping Force (JPKF) with the same composition was created. The JCC should also work on conflict settlement. Being isolated there, the Georgian government is pursuing a wider format for efforts at ending the conflict.

Fighting occurred in the summer of 2004. After having succeeded in unseating the leader of the breakaway region Adjara, President Saakashvili tried to apply pressure and raise support from the population of South Ossetia. He totally failed in this and changed tack.

The Georgian government presented a peace plan for South Ossetia to the UN General Assembly and to the OSCE in the autumn of 2005. A statement by the OSCE Ministerial Council in Ljubljana on 6 December 2005 supported this plan. The peace plan describes a process which should lead to the conclusion of an agreement on South Ossetia's status within Georgia. Comprehensive autonomy would be granted and a number of linguistic, educational and other rights would be guaranteed together with representation in central governing and judicial bodies.

In parallel with negotiations on the status agreement, a host of aid and integration measures on the ground should be prepared and implemented. Integration should include joint policing as well as joint control of the Roki tunnel at the Russian border. Through this tunnel, big volumes of goods are smuggled and income from this traffic is believed to sustain the South Ossetian *de facto* authorities. As a basis for humanitarian and rehabilitation aid, the OSCE has carried out a needs assessment. At a donors' conference in Brussels 15 June 2006, pledges of a total of € 10 million were made by the EU, the USA and a number of European states. Russia has indicated that it may provide € 3 million. It apparently prefers to channel its aid directly to the South Ossetian *de facto* authorities, while minimising international coordination and avoiding giving a role to Tbilisi.

As confidence-building measures and part of the re-integration of the region into Georgia, the payment of pensions should be resumed and arrears settled. The issue of property restitution, which is critically important in the context of refugee and IDP return,

⁶ Estimates given in *Georgia-South Ossetia: Refugee Return the Path to Peace*, International Crisis Group briefing; <http://www.crisisgroup.org/home/index.cfm?id=3380&l=1>

should also be dealt with. The plan envisages the creation of a Joint Georgian-Ossetian Rehabilitation Fund, with donor support from the EU, Russia and the USA.

The *de facto* President of South Ossetia, Mr Kokoity, in December 2005 outlined a process with similar contents, but with the crucial difference that South Ossetia's status and related issues would not be dealt with in parallel, but after the region had benefited from large-scale aid. Very little progress in attempts to launch a peace process in South Ossetia was made in the first half of 2006.

Abkhazia

The Abkhazian language belongs to the northern Caucasian group and has official status within the region, under Georgian law. Abkhazians are predominantly Orthodox Christians. Abkhazians made up only 18% of the population at the time of the declaration of independence. Many Abkhazians, in particular Muslims, departed to Turkey after a failed revolt in 1866 following the imposition of tsarist rule. Many Georgians, Russians and Armenians then moved in.

It is estimated that around 10 000 people lost their lives in the war with Georgian government forces in 2003 and that 300 000 became IDPs. The ceasefire was formalised in 1994 in the *Moscow Agreement*. This also provides the basis for a CIS peacekeeping force - effectively a Russian force - of around 1 800 troops patrolling a buffer zone along the Ingury river, which separates Abkhazia from the rest of Georgia.

The population of Abkhazia is now about 300 000, a fifth of whom are Armenian. Little has changed on the ground since the end of hostilities. The return of IDPs, in particular to the Gali district in western Abkhazia, is a major issue. Anxious to avoid a return to the earlier demographic situation in the region, the Abkhaz side is very uncooperative. Opening of a UN-OSCE human rights office in the Gali district has so far been possible.

A UN Observer Mission in Georgia (UNOMIG) monitors the ceasefire on the ground. It is led by the UN Secretary-General's Special Representative for Abkhazia, currently Ms Heidi Tagliavini. A 'Group of Friends of the Secretary-General' consisting of Russia, France, Germany, the United Kingdom and the USA met on 2-3 February 2006 with representatives of the Georgian and Abkhaz sides.

The Georgian government in June 2006 outlined a plan for broad internal sovereignty for Abkhazia within a federalised Georgia. The Abkhaz *de facto* authorities kept refusing to discuss any plan without independence as the ultimate objective. The two sides, Russia and Armenia have, however, agreed to rehabilitate a railway that crosses Abkhazia.

Other ethnic minorities

Approximately 150 000 ethnic **Armenians** live in Javakhetia in the south, on the border with Armenia. Few of them speak Georgian. Many consider that the Georgian government cares little about the difficult socio-economic situation in the region and

some call for arrangements for self-government. Tensions could rise if the socio-economic situation should further deteriorate, re-integrated breakaway regions be granted real and effective self-rule and the same be denied to Javakhetia.

A Russian military base in the biggest city in Javakhetia, Akhalkalaki, will be closed by 2008 (see Russia and the CIS, below). This will aggravate the big unemployment problem in the region. Plans for a railway line between Akhalkalaki and Kars, in Turkey, meet criticism, since relations between Armenians and Turkey for historical as well as contemporary motives are very difficult. Armenia ensures the supply of electricity to Javakhetia, but avoids giving support that could strain Armenian-Georgian relations.

In Kvemo Kartli on the border to Azerbaijan, ethnic **Azeri** constitute a high proportion of the population, but there are no demands for autonomy, let alone independence. As in Javakhetia, Georgian is rarely spoken.

In the Pankisi gorge on the border to Chechnya, there are both long-since established Chechens, called **Kists**, and newly arrived refugees from the war-torn neighbouring republic. Russia has accused Georgia of tolerating the presence of Chechen fighters in the gorge (see also Russia and the CIS, below).

International relations⁷

Georgia's foreign policy largely reflects the country's security predicament, with the breakaway regions, Russia's ambiguous policy in relation to the territorial integrity and sovereignty of the Georgian state and risks of serious spill-over effects on Georgia of further strife and upheavals in the neighbourhood as main elements⁸. Making the USA and the EU ever more engaged is a major objective. This translates inter alia to a pursuit of NATO membership and various requests to the EU (see EU-Georgian relations below).

The Rose Revolution did not fundamentally change Georgia's foreign policy, but made the country much more attractive to the West. It suddenly seemed very possible that Georgia could go through a transition to democracy and market economy and that this could stimulate a broader development in this direction in the region. A big rise in foreign aid and lending by international financial institutions followed.

Georgia's efforts to further engage the USA and the EU are also helped by the rapidly growing exploitation of energy resources in the Caspian region and a strong western interest in constructing and protecting pipelines through Georgia that avoid both Russia and Iran⁹. However, the US and EU energy interests make them put a big premium on stability and unwilling to support risky moves in relation to Abkhazia and South Ossetia.

⁷ See also membership of selected international organisations, annex III.

⁸ These and other security issues are comprehensively dealt with in Coppieters and Legvold (ed): *Statehood and Security. Georgia and the Rose Revolution* (available in the EP library).

⁹ A Baku-Tbilisi-Ceyhan (BTC) oil pipeline recently became operational and a Baku-Tbilisi-Erzurum (BTE) gas pipeline is nearing completion

While seeking to capitalise on an image of Georgia as a new champion of democracy, the Georgian government in fact has other priorities as far as its neighbours Azerbaijan and Armenia are concerned. These include avoiding destabilising developments that could spill over. Deepening economic relations, in particular with Azerbaijan and Turkey, makes it possible to somewhat limit the huge dependency on Russia.

Russia and the CIS

As already touched upon, Russia's role in relation to the breakaway regions is highly problematic. Russian peacekeepers are widely perceived as partial and the Georgian parliament has called for their departure. Russia has imposed a visa regime on Georgia, but exempted the inhabitants of Abkhazia and South Ossetia, to whom Russian citizenship is offered.

Russian-Georgian tensions in relation to the situation in the Pankisi gorge intensified in 2002 but later eased. Russia accused Georgia of failing to take action against trafficking of weapons to Chechnya and allowing Chechen terrorists to mix with Chechen refugees and Kists. A series of violations of the Georgian airspace occurred and a bombing was allegedly carried out. Encouraged by the US doctrine on pre-emptive strikes, President Putin and the Russian Defence Minister Ivanov have repeatedly claimed that Russia has a right to carry out such strikes outside its territory.

Sections of the Russian-Georgian border were monitored by an OSCE mission until the end of 2004, when Russia refused to agree to a prolongation of the mandate. Russia still has two military bases in Georgia (outside the breakaway regions), but agreed, in May 2005, to close them by 2008. Russia has sought guarantees that Georgia will not host any American base and vehemently opposes the idea of Georgian membership of NATO.

Georgia is highly dependent on energy imports from Russia. Interruptions in both gas and electricity supplies occurred in January 2006, according to Russian explanations because of attacks against relevant infrastructure on the Russian side of the border. President Saakashvili expressed doubts on these explanations. A hardening of Russia's trade policy towards Georgia (higher energy prices, bans on Georgian wine, brandy, fruit and mineral water) in the beginning of 2006 prompted President Saakashvili to question the case for continued Georgian membership in the CIS.

Mr Saakashvili and Mr Putin met on 13 June in St Petersburg. The atmosphere was reportedly strained and there was apparently no approximation of positions.

Armenia, Azerbaijan and Turkey

Georgia provides a crucially important path for Armenia's foreign trade and other contacts with the world since Armenia has no other open border than that with Iran. At the same time, Georgia participates in the build up of a Baku-Tbilisi-Turkey transport corridor which circumvents Armenia and increases its isolation. The almost diametrically

opposed nature of the two countries' Russia relations in the security field also limit the scope for cooperation. For Armenia, keeping Russia engaged is an important objective.

Relations with Azerbaijan are increasingly focused on energy transit, which generates important revenue and energy supplies, which could reduce the Georgian dependency on Russia.

Turkey is a very important trading partner and in the last years, limited security cooperation has been developed. The completion of the oil and gas pipelines from Azerbaijan via Georgia to Turkey may be followed by other infrastructure projects, e.g. construction of an Akhalkalaki-Kars railway stretch that would make possible the opening of a Baku-Tbilisi-Kars (Turkey) axis. Armenia demands the reopening of an existing Turkey-Armenia-Georgia railway instead, but Turkey is not willing and continues to keep its border with Armenia closed.

The USA and Nato

The US role prior to the Rose Revolution is a matter of debate (for example, the ousted President Shevardnadze at one point claimed that the USA engineered the revolution). It is anyway clear that the shift to the US educated and strongly western-oriented Mikheil Saakashvili suited US interests. On the ideological level, the Rose Revolution provided a rare marketable example of a 'regime change' which President Bush exploited when appearing, in May 2005, on a podium in Tbilisi together with President Saakashvili. Bush promised that *'as you build a free and democratic Georgia, the American people will stand with you'*.

The USA was a big donor of aid to Georgia already before the Rose Revolution and has since then further increased its contributions. Much aid is channelled through the Millennium Challenge Corporation¹⁰. Already in 2002, a 'Train and Equip' programme for the Georgian military was launched. This programme was ostensibly aimed at making the military capable of dealing with terrorist threats, which helped to make it (just about) acceptable to Russia. It could, however, prepare the ground for more comprehensive security cooperation.

Georgia's strong interest in engaging the USA ever more closely on its side in the dispute with Russia over the breakaway regions and other issues is far from fully matched by a corresponding US interest. Nevertheless, the USA pressed for the closure of the Russian bases in Georgia and would clearly welcome a resolution of the South Ossetia and Abkhazia conflicts.

Georgia is an active participant in NATO's Partnership for Peace programme and is energetically pursuing NATO membership. The US President Bush expressed support for Georgian NATO membership when receiving President Saakashvili in Washington on 5 July 2006. Georgia is increasing its military expenditure and participates in the US-led coalition forces in Iraq.

¹⁰ <http://usinfo.state.gov/ei/Archive/2005/Sep/13-306443.html>

III. ECONOMIC SITUATION¹¹

The rapid disintegration of the Soviet economic system in Georgia's case coincided with a descent into civil war, producing an exceptionally steep economic decline. GDP contracted on average 11.7% per year 1990-1998. The economic transition process largely failed, corruption and smuggling thrived, tax revenues shrunk to very low levels and salaries and pensions were often not paid. Towards the end of President Shevardnadze's rule, economic growth resumed, but the state finances were in a miserable condition and international financial institutions and the very few western investors who had shown an interest in Georgia tended to give up hope and disengage.

Georgia is now the second poorest country in Europe, after Moldova¹². The external debt is high and the physical infrastructure is in urgent need of huge investment. Economic growth is, however, strong: 7.7% in 2005, according to the International Monetary Fund. The IMF predicts a slight decline in 2006 and 2007, as two huge pipeline construction projects are concluded. Agriculture represents about 20% of the GDP. Recent Russian bans on Georgian wine, brandy, fruit and mineral water (purportedly for public health reasons) present these important sectors with an urgent challenge to find new export markets. The bans may reduce the GDP figure for 2006 by 1%.

The government's economic strategy emphasises privatisation, attracting foreign investment, anti-corruption measures and lean government. Mart Laar, who as Prime Minister of Estonia in the 1990s successfully implemented a 'shock therapy'-type economic reform programme, is special advisor to President Saakashvili. Coordinating economic reforms is otherwise the task of Kakha Bendukidze, a Russian oligarch of Georgian origin who after the Rose Revolution was invited to join the government.

Privatisations are normally carried out through auctions, without imposition of specific conditions. As Georgia is still perceived as risky for investors and skill in handling post-Soviet conditions may be crucial, western investors are difficult to attract but Russian firms less so. Some see a danger in an increased role of Russian firms, which may well take their cue from the Russian government. Ms Zourabichvili, leader of the party 'Georgia's Way', expressed a different view when visiting the European Parliament in January 2006. She felt that Russian pursuit of influence through the Georgian economy was preferable to Russian support to the breakaway regions and exploitation of Georgia's dependency on Russian energy. A bigger Russian stake in the Georgian economy could mean a clear Russian interest in that it develops well, according to Ms Zourabichvili.

The EU is by far the most important source of imports, followed by Russia and Turkey. Georgian exports go mainly to Turkey, Turkmenistan, the EU and Russia (each with a share of about 17%). Metals give an important contribution to Georgia's export earnings¹³. Georgia is a member of the World Trade Organisation (WTO) since 2000.

¹¹ See also annex II: basic country data.

¹² Based on GDP at purchasing power parity figures given in the UNDP's 2005 *Human Development Report*.

¹³ For further trade data, see http://trade.ec.europa.eu/doclib/docs/2006/may/tradoc_113383.pdf

IV. EU-GEORGIA RELATIONS

Georgia and the South Caucasus earlier attracted relatively little EU interest, but this is no longer the case. After a troika visit to the three countries of the region in early 2001, the Council stated that the EU was willing to play a more active political role and that it would look for further ways in which it could support efforts at conflict prevention and resolution (while clearly not envisaging any EU involvement in mediation). Since 2003, the EU has a Special Representative for the South Caucasus (currently Mr Peter Semneby). Since 2004, the three countries are included in the European Neighbourhood Policy (ENP). EU aid to Georgia has been doubled and there is a clear trend towards further development of the EU's engagement, not least in relation to conflict resolution.

There are several reasons for the increasing EU interest. As the Member States give the EU a growing role in security matters and regional conflicts are identified as a key threat¹⁴, overlooking the conflicts in the Caucasus becomes difficult. EU enlargement reduces the geographical distance to the region and has brought in new members who because of their own recent history tend to understand and identify in particular with Georgia much more than older EU members states do. And not least important, the EU's new interest in diversifying its energy supply leads it to eye ever more keenly the resources in the Caspian basin and transit possibilities in the South Caucasus.

At the same time, some Member States (not least France) are very reluctant to let the EU get deeply involved. The European Security Strategy only notes 'the problems of the Southern Caucasus', although it elsewhere explicitly mentions the conflicts in Kashmir, the Great Lakes Region, the Korean Peninsula and, indeed, the Middle East. The South Caucasus was originally excluded from the ENP. The new prospects opened up by the Rose Revolution no doubt helped the European Parliament to convince the Council that the region should be included. The EU maintains a distance to core Georgian security issues. Significantly, in early 2005, intense internal EU discussions on a proposed EU mission to monitor the Georgian-Russian border ended with a decision to provide very small scale assistance to Georgian border monitors instead. The background was that Russia had vetoed a continuation of an OSCE border monitoring mission¹⁵.

The EU's main objectives for its policy on Georgia are to stimulate continued political and economic reforms, contribute to the settlement of conflicts and facilitate implementation of such settlement, support regional cooperation in the South Caucasus and generally develop EU-Georgia relations.

A Partnership and Cooperation Agreement (PCA)¹⁶ is the legal basis for the relationship. It was concluded for an initial period of ten years and expires on 1 July 2009, unless there is an agreement to extend its period of application. The PCA is very similar to those with other countries in the region. It states, in the preamble, that support for the independence,

¹⁴ In particular in the European Security Strategy; <http://ue.eu.int/uedocs/cmsUpload/78367.pdf>

¹⁵ A recent International Crisis Group report discusses the EU's role in conflict resolution in the South Caucasus in its entirety: <http://www.crisisgroup.org/home/index.cfm?id=4037&l=1>

¹⁶ http://ec.europa.eu/comm/external_relations/ceeca/pca/pca_georgia.pdf

sovereignty and territorial integrity of Georgia will contribute to the safeguarding of peace and stability in Europe. The articles provide for trade liberalisation, economic cooperation and cooperation in various other areas, including prevention of crime and illegal migration. Joint bodies set up on the basis of the PCA include a Cooperation Council at ministerial level and the Parliamentary Cooperation Committee.

The core element of the ENP is bilateral Action Plans. A draft such plan, prepared by the Commission in cooperation with the Council and based on a country report¹⁷, is now being discussed (effectively negotiated) with Georgia. Adoption, together with Action Plans for Armenia and Azerbaijan, is foreseen in autumn 2006.

Georgia wants a strong focus on conflict resolution. The EU currently provides assistance for economic rehabilitation in South Ossetia and Abkhazia, with a view in particular to facilitate the return of refugees and internally displaced persons. Georgia is looking for further EU assistance in this regard and for financing of measures foreseen in the government's peace plan for South Ossetia. More controversially, Georgia also wants the EU to put pressure on Russia to cooperate in efforts to achieve settlements that respect the territorial integrity of Georgia and lead to reintegration of the two regions.

The EU wants to focus on continuation of the political and economic reform process in Georgia, strengthening the respect for the rule of law, consolidating a democratic system of government, improving the business climate and reducing poverty.

The Country Strategy Paper which guides EU assistance to Georgia identifies support for institutional, legal and administrative reform and support for addressing the social consequences of transition as the most important tasks. EU aid to Georgia in 2004 was in the order of € 50 million (including macro-financial assistance, but not grants from multi-country programmes). Neither Georgia or the other countries of the South Caucasus are included in the external lending mandate of the European Investment Bank (EIB), but the Commission has proposed inclusion in the next such mandate (which the European Parliament has called for).

The EU provided advice on reform of the judiciary through the 'rule of law mission' EUJUST THEMIS¹⁸ after the Rose Revolution. This was a new type of CFSP mission at the time. Under its CFSP, the EU is also providing financing for the Joint Control Commission for South Ossetia mentioned above.

The role of the European Parliament

The EP observed and criticised the conduct of the November 2003 parliamentary elections. It congratulated the people of Georgia on the 'Rose Revolution'¹⁹ and observed

¹⁷ This and other Commission documents on Georgia and the ENP are available at http://ec.europa.eu/world/enp/partners/enp_georgia_en.htm

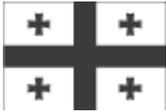
¹⁸ <http://www.consilium.europa.eu/showPage.asp?id=701&lang=en>

¹⁹ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P5-TA-2003-0602+0+DOC+XML+V0//EN&language=EN>

also the fresh elections in the beginning of 2004. A resolution on the South Caucasus called for the inclusion of this region in the ENP and reiterated an earlier idea to develop a Stability Pact²⁰, without elaborating. Later, Parliament deplored Russian statements about the use of pre-emptive strikes, requested the Georgian government to define its commitment towards the autonomy of Abkhazia and South Ossetia within a reunited Georgia, rejected 'presidential elections' in Abkhazia as illegitimate and called for an EU willingness to mediate in the conflicts in the South Caucasus²¹.

²⁰ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P5-TA-2004-0122+0+DOC+XML+V0//EN&language=EN>

²¹ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2004-0023+0+DOC+XML+V0//EN&language=EN>



MAP OF GEORGIA



South Caucasus:
Basic country data

	Armenia	Azerbaijan	Georgia	source:
Population (million)	3.0	8.4	4.5 ²²	UNFPA
Ethnic composition	Armenians 98% (2001)	Azeris 90.6% (1999)	Georgians 83.8%, Azeris 6.5% Armenians 5.7% (2002)	censuses
Official language (and other)	Armenian (Russian)	Azerbaijani (Russian)	Georgian, in Abkhazia also Abkhazian (Russian, Armenian, Azeri, Ossetian)	various, incl US State Dept
Currency	Dram (AMD)	Manat (AZM)	Lari (GEL)	
President	Robert Kocharian	Ilham Aliyev	Mikheil Saakashvili	
Next (and most recent) presidential election	2008 (March 2003)	Oct 2008 (Oct 2003)	2009 (Jan 2004)	EIU and other
Next (and most recent) parliamentary elections	2007 (May 2003)	Nov 2010 (Nov 2005)	2008 (March 2004)	EIU and other
GDP per head 2003 (USD at purchasing power parity)	3.671	3.617	2.588	UNDP
Real GDP growth rate (%) 2005	13.9	24.3	7.7	IMF
Projected real GDP growth rate (%) 2006 and 2007	7.5 6.0	26.2 22.9	6.4 5.0	IMF
Transition indicator ²³	3.11	2.67	3.04	EBRD
Human development rank ²⁴ /177 countries studied	83	101	100	UNDP
Corruption rank /158 countries studied	88	137	130	TI

Explanation of sources:

EBRD European Bank for Reconstruction and Development, fact sheets on the respective countries, accessed at www.ebrd.com on 14 June 2006.

EIU The Economist Intelligence Unit, country reports 2006; <http://db.eiu.com/index.asp> (click on 'Enterprise client access' - not accessible for free outside the EP)

IMF International Monetary Fund, *World Economic Outlook*, April 2006; www.imf.org/external/pubs/ft/weo/2006/01/index.htm (statistical appendix, p 21)

TI Transparency International, Corruption Perception Index rank in 2005; www.transparency.org/news_room/in_focus/2005/cpi_2005#cp

UNDP United Nations' Development Programme, *Human Development Report 2005*; http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.PDF

UNFPA United Nations' Population Fund, *State of the World Population 2005*; www.unfpa.org/swp/2005/images/e_indicator2.pdf

²² Does not include the inhabitants of the breakway regions Abkhazia and South Osetia

²³ Scale from 1 to 4.33 measuring economic transition. 1 indicates no or little progress, 4.33 means standards similar to advanced economies. Lowest value: Turkmenistan (1.29), highest: Hungary (3.93).

²⁴ Human Development Index (HDI) rank in 2005. The HDI provides an indication of the living conditions which is less rough than the GDP per head, since it also includes life expectancy at birth, literacy and school enrolment.

South Caucasus countries:
 Membership of selected international organisations
 and participation in certain multilateral cooperation

	OSCE	CoE	EBRD	ECT	CIS	CSTO	PfP	GUAM	BSEC	WTO	World Bank PRS
Armenia	X	X	X	X	X	X	X		X	X	X
Azerbaijan	X	X	X	X	X		X	X	X		
Georgia	X	X	X	X	X		X	X	X	X	X

OSCE	Organisation for Security and Cooperation in Europe; www.osce.org
CoE	Council of Europe; www.coe.int/
EBRD	European Bank for Reconstruction and Development; www.ebrd.org
ECT	The Energy Charter Treaty (X indicates ratification); www.encharter.org/language.jsp
CIS	Commonwealth of Independent States; www.cis.minsk.by/ ; in English: www.cis.minsk.by/main.aspx?uid=74
CSTO	Common Security Treaty Organisation (other members: Russia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan); http://194.226.82.50/eng/events/articles/2006/06/107615/107619.shtml
PfP	The Partnership for Peace Programme created by NATO (None of the countries is a NATO member, but Georgia is actively pursuing NATO membership); www.nato.int/issues/pfp/index.html
GUAM	Organisation for Democracy and Economic Development - GUAM (other members: Ukraine, Moldova); www.nrcu.gov.ua/index.php?id=148&listid=28905
BSEC	Black Sea Economic Cooperation (other members: Albania, Bulgaria, Greece, Moldova, Romania, Russia, Serbia, Turkey, Ukraine); www.bsec-organization.org/
WTO	World Trade Organisation; www.wto.org
World Bank PRS	Cooperation with the World Bank that includes a Poverty Reduction Strategy; www.worldbank.org