

Economics of Conflict: Core Economic Dimensions of the Georgian-South Ossetian Context

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Abstract—This article presents SWOT analysis for Georgian - South Ossetian conflict. The research analyzes socio-economic aspects and considers future prospects for all sides including neighbor countries and regions. Also it includes the possibilities of positive intervention of neighbor countries to solve the conflict or to mitigate its negative results. The main question of the article is: What will it take to award Georgians and South Ossetians with a peace dividend?

Keywords—Conflict economics, Georgian economy, international organizations, peace building, S. Ossetian economy.

I. INTRODUCTION

GEORGINA-S. Ossetian (to be more correct - Georgian-Russian) armed conflict of 1991-1992 and 2008 years, left thousands dead on both sides of the conflict and tens of thousands displaced ethnic Georgians into other parts of Georgia – primarily to Shida Kartli region [1]. Unfortunately, that was not the only price Georgians and S. Ossetians paid for the provocations from Russian Federation and their military forces. Unfortunately, along with the physical elimination, smashed infrastructure, destroyed personal connections between people and many other extremely negative effects, Georgian-S. Ossetian conflict (however, as we already said, it is more correct to use term - Georgian-Russian Conflict) also put its extremely harmful impact on the financial prosperity of both sides, however in some special cases it also had some positive financial effect for the Georgian and S. Ossetian economies.

II. ACHIEVEMENTS OF CONFLICT AFFECTED SIDES

It is obvious that Georgian economy is progressing non-stop for the last quarter century. Advancements could be seen in all aspects of socio-political and economic aspects, excluding conflict territories. It is important to underline that Georgian development is proved by the different international organizations and their indexes:

- In 1995 GDP per capita in Georgia was less than 600 USD, which increased more than 6 times for less than a quarter century and hit 3.8 thousand USD in 2015 [2].
- One of the most important elements of country's financial stability - assets of banking sector has increased approximately 90 times up to 24.4 billion USD [3].
- Foreign Direct Investments increased from 3.7 million USD in 1996 to 1.56 billion USD in 2015 [4].

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- An average wage increased 60 times from 13.5 GEL in 1995 to 818 GEL in 2014. The same period saw drastic growth of the volume of export (20 times) from 155 million USD to 2.9 billion USD [5].
- In 2003 Georgia was 124th-129th among 133 countries in the rating of perceived corruption alongside with Cameroon, Angola, Tajikistan and Azerbaijan. By 2015 it had moved up to 48th place out of 168 countries [6].
- Georgia took unprecedented scale of fight against criminal and created the best police force in the region, with trust of above 80 per cent among local population. According to Safety Index, Georgia is number 3 and only Singapore and South Korea are ahead, according to 2016 results [7].
- According to the Frazer Institute's Economic Freedom of the World: 2016 Annual Report Georgia got 5th place for the Economic Freedom Ratings [8];
- Georgia is number 24 according to the World Bank's doing business 2016 ranking [9];
- Georgia hit the list of countries with economic freedom compiled by Heritage Foundation – number 12 out of 43 European countries and 23rd internationally) [10].

These and other achievements have contributed to Georgia's leap to a dimension drastically different from that of the 1990s. At the same time, South Ossetian economy with a minimum level of development within production and service sectors has remained largely the same for the last 20 years. The level of salaries and public savings is insignificant while tourism and agriculture sectors remain underdeveloped. The investment volume (which is transferred only from Russia) is minimal. Finding extremely poor jobs with low salaries at Russian military bases is the only remedy to pervasive unemployment. Without financial support of the Russian Federation, South Ossetian economy is critically fragile.

Although some indicators suggest that the problem also exists in Georgia to some extent; however, it is evident that economic cooperation between South Ossetia and Georgia will provide both sides with the opportunity to overcome a series of social-economic problems. However, problem here is not only in Georgian-S. Ossetian conflict, but in Russian participation, which prevents this sort of partnership by annexing S. Ossetia by all means (please see Table I).

III. COST OF CONFLICT (GEORGIA)

A. Expenditure on Defense

Georgian government has spent up to 7 billion USD for the last 10 years (2006-2015). It means that in average Georgia was spending on defense the amount money which is equal to

5.3% to the country's GDP. At the same time during some years, Georgia was spending even more: in 2007 – 9. %, 2008 – 8.5%, 2009 – 5.6% [11]. While an average expenditure on defense in European countries in 2014 was equal to 1.5% of GDP (Austria – 0.7%, Germany – 1.2%, France – 2.2%).

Taking into account Georgia's relatively moderate capacity as opposed to the western European countries (expenditures on defense in 2007 – 40% of the state budget) [12], the rate of spending is unjustified. Consequently, if Georgia's expenditure on defense is to be gauged for the last 10 years, the cost of conflict amounts to at least 5 billion USD (if Georgia's defense expenditure would equal to standard European average – 1.5% of GDP instead of 5.3%).

TABLE I
SWOT ANALYSIS – COST OF CONFLICT FOR GEORGIA

| Strength | Weaknesses |
|---|---|
| <ul style="list-style-type: none"> - Financial assistance of the international community, - The presence of respective missions of the UN and EU taking into account Georgia's interests. | <ul style="list-style-type: none"> - Costs of military actions and mitigation of their effects, - Severe socio-economic conditions, - Disempowered economy and limited opportunities for its development, - Problems related to NATO and EU integration, - Damaged investment climate. |
| Opportunities | Threats |
| <ul style="list-style-type: none"> - Visa liberalization with EU member states, - Free trade regime with EU and other countries and regions, - Special treatment from international community. | <ul style="list-style-type: none"> - Risk related to potential escalation of new conflicts as a consequence of the existing geopolitical reality, - Long term instability and insecurity, - Deterioration of social-economic imbalance with the rest of the world, - Decrease of the national security potential. |

B. Bureaucracy

Duplication of the same duties between different state agencies and ministries, which finally causes misunderstanding and lack of coordination. Sometimes causing competition between state organizations and their heads. After all making a huge press on state budget.

Short overview is enough to understand how complicated and duplicated the problem is. The list of organizations dealing with the conflicts directly or indirectly is: Office Of The State Minister of Georgia for Reconciliation and Civic Equality (40 people employed, budget – 1.6 million Gel); Ministry of Internally Displaced Persons from the Occupied Territories, Accommodation and Refugees of Georgia (308 employees, budget – 70 million Gel); Administration of S. Ossetia (Budget 3.5 million Gel), Temporary Commission on Territorial Integrity, National Security Council, National Security Agency, and many others, not to mention such obvious institutions as Ministry of Defense, Ministry of Interior Affairs and so on.

C. Loss of Internally Displaced People (Private Sector)

By the end of 2013 International Displacement Monitoring Center estimated that Europe homed 2.2 million displaced people [13]. As a result of several waves of conflicts, mostly in 1992-1993 and 2008, the number of internally displaced persons in Georgia amount to 450 thousand, which would have been a huge challenge not only for small Georgia but also for any larger European state. As a result of Russian-

Georgian war, which (officially) even experts failed to predict [14].

The UN data suggest that the number of IDPs from South Ossetia totals 20 thousand (15 thousand out of whom from 2008 war while 5 thousand from the conflict in 1990s). If property of households is to be estimated (considering there are 4 members in an average household) 20.000 USD, it appears that the loss sustained only by the private sector of Georgia's IDPs amounted to 100 million USD and even partial compensation of this sum costs the Georgian state lot more. If putting together all the losses sustained by all IDP households in Georgia, the cost if these losses will be estimated - 2 billion USD.

D. Destroyed Infrastructure (Government Sector)

It is almost impossible to make a detailed calculation for the infrastructural damage, however according to the author's calculations, the loss for infrastructural damage such as: roads, bridges, water and electricity communications, governmental buildings and so on, are equal to hundreds of millions of US dollars [15].

E. Accommodation for IDPs

According to data available in March 2015, the country had 263 598 IDPs (7% of total population) with 122 383 males and 141 215 women. Most of these IDPs reside in Tbilisi (39%) and Samegrelo-Zemo Svaneti region (32%) [16]. There are 2000 compact settlements in Georgia the largest being Tserovani with 6421 settlers, followed by Batumi (2231) and Poti (2145) new districts [17].

Taking into account that Georgian government is giving only 10 000 USD or specially constructed houses per IDP family for housing compensation, providing the IDPs with accommodation will cost the Georgian government additional 100-150 million USD. However, it is worth noting that this kind of compensation is a far cry when compared with losses sustained by the internally displaced persons.

F. Social Assistances for IDPs

Pursuant to the Law of Georgia on Persons Displaced from the Occupied Territories, every IDP is eligible to the monthly allowance of 45 GEL (provided that a person's monthly salary does not exceed 1250 GEL). Though increased to compare with monthly 28 GEL allocated in previous years, the allowance is far from being sufficient. Up to 600 million GEL has been paid to the IDPs as monthly allowance. However, it is worth noting that the monthly amount is 4 times less than Georgia's living minimum totaling 160 GEL per capita. If taken separately, total amount of money spent on providing monthly allowance for IDPs from South Ossetia has totaled \$15 millions.

IV. "BENEFITS" OF CONFLICT (GEORGIA)

A. Grants and Loans from International Organizations

At a flash appeal conference held in 2008, 67 countries and members of the international community expressed their commitment to provide assistance to Georgia and pledged 4.5

billion USD for the next 3 years (USA – 1 billion USD, International Monetary Fund - 750 million USD, EU Commission - 650 million USD, Japan - 200 million USD...). The assistance was expected to improve social-economic standards of IDPs as well as to address the needs of the banking sector, contribute to effectiveness of infrastructural projects and stabilize the state budget. It is worth noting that 60 per cent of the assistance (2.5 billion USD) is a loan given at concession which Georgia is responsible to return after certain period of time. The remaining 40 per cent (2 billion USD) accounts for grants. Therefore, it can be assumed that 2 billion USD is a 'benefit' which Georgia received as a result of the conflict.

B. International Organizations and Projects.

From 1992 to 2008 before the closure of the international observer mission under the aegis of UN (United Nations Observer Mission in Georgia – UNOMIG) by Russia, the mission had spent 397 million USD [18]. The biggest share of this sum was spend on accommodating the needs of the mission itself rather than on direct interventions aimed to improve the quality of lives of internally displaced persons. However, apart from financial assistance, the mission had rendered a very strong support to Georgia, in particular at the initial stage of state building.

On October 1, 2008, aftermath the closure of UNMIG EU monitors (EUMM counts approximately 200 monitors as of today) opened their office in Georgia under the legitimating of all EU member states [19]. Even though, it is widely perceived that EUMM failed to fully replace UNMIG, according to data provided by the European Commission, the mission has already spent approximately 150 million EURO (approximately 200 million USD) on the needs of the project in Georgia which, in turn, has had a positive impact on Georgian economy.

V. COST OF CONFLICT (S. OSSETIA)

After all, in real numbers the loss and expenditures of S. Ossetia is not so high and in US dollars is approximately equal to several dozen millions. However, we have to take into a consideration what is the real economic capacity for this region. Instead of progress and development the war has taken almost everything and left local people with no opportunity for the robust economic development during last 25 years, as well as for unforeseen future. So called "financial support" from Russian Federations is not for everyone, but only for chosen ones. Financial disproportion among locals is huge, but that is not the only problem; even more problematic is the lack of availability of high level educational institutions for younger generation and training centers for older ones. Moreover, unlike to Abkhazian region trade links are extremely poorly developed with the Georgian side [20], which makes prices on the local market extremely high and almost unaffordable for locals to improve their life standards, especially taking into a consideration the massive unemployment factor (please see Table II).

TABLE II
SWOT ANALYSIS – COST OF CONFLICT FOR S. OSSETIA

| Strength | Weaknesses |
|--|--|
| <ul style="list-style-type: none"> - Financial support provided by the Russian Federation, - Employment opportunities on Russian labor market, - Protection under the Russian Federation | <ul style="list-style-type: none"> - Deterioration of socio-economic conditions, - Possibility to be mixed within the Russian culture and to lose S. Ossetian identity, - Worsening relations with the potentially most valuable partner – Georgia, - Massive unemployment. |
| Opportunities | Threats |
| <ul style="list-style-type: none"> - Visa free regime with the Russian Federation, - "close" cooperation with Nicaragua and Venezuela, - attracting Russian investments. countries and regions, | <ul style="list-style-type: none"> - The recognition of 'independence', - Constant exposure to a social-economic trap, - Exposure of the local communities to the risk of becoming ethnic minority as a result of the replacement of those who has left the region with representatives of other ethnic groups; - Transfer of governing mechanisms to the Russian Federation.-economic imbalance with the rest of the world, |

VI. "BENEFITS" OF THE CONFLICT (S. OSSETIA)

A. Financial Assistance from the Russian Federation

According to Russian sources, from 2008 to 2015 Russia has transferred around 100 million USD to South Ossetia on an annual basis. In 2016 financial transaction from Russia hit 8.7 milliard rubles (approximately 130 million USD). In other words, for the past ten years South Ossetia has received financial support approximately 1 billion USD which, in light of the size of population not exceeding 30 000 residents, accounts for more than 30 000 USD per capita. However, even it seems surprising, lives of ordinary residents of South Ossetia have remained largely unchanged for the past ten years. It does not take a genius to analyze that money laundering is one of the key attractions for local leaders to maintain the status quo.

B. The Cost of Independence

It has been long recognized that the war of 2008 served as grounds for recognizing the independence of South Ossetia and Abkhazia by the Russian Federation which was later joined by few countries such as Nauru (which shortly after revoked the recognition), Nicaragua and Venezuela. It is evident that prospects of the partnership with any of these countries except for Russia are almost infeasible. Subsequently, signing agreements on visa liberalization, opening representations and high level meetings are futile efforts leading to wasting of resources and nothing more. Moreover, so called recognition of S. Ossetia on international level by the Russian Federation on one hand, is continued by massive invasion of Russian Federation into the S. Ossetia, by controlling its borders, customs duties, armed forces and the whole government.

VII. FUTURE PROSPECTS FOR BOTH SIDES

A. Transit Trade SGS (Société Générale de Surveillance)

In the beginning of the 1990s, after losing its control over Tskhinvali and Sukhumi, Georgia had no valid mechanism to

calculate movement of goods to and from South Ossetia and Abkhazia. However, in 2012 Georgia got such possibility through SGS mechanism. But unfortunately it is not implemented yet and the Russian Federation is already taking the control over S. Ossetian customs house. On the other hand, there is still a possibility for joint cooperation in terms international transits, trade and tourism, which will help S. Ossetia to overcome its financial problems [21].

B. Visa Liberalization

It is evident that under no circumstances do Georgia's territorial issues have a direct influence on its prospects for visa free regime and free trade with the EU. However, for the EU this is an apparent chance to make its own positive contribution for the Georgian state. Visa free regime with the EU will not allow Georgian citizens to work in the EU countries. However, this arrangement will certainly serve as an incentive for both businessmen and ordinary Georgian citizens.

C. Free Trade with the EU

Signing the Agreement on Deep and Comprehensive Free Trade Agreement with the EU gives Georgia an opportunity for improving social-economic effects [22] contributing to increased income and technological progress. In a long run Georgian GDP is anticipated to increase to 4.3 per cent, export is expected to reach 7.5 per cent and salaries - 3.6 per cent. On the other hand, the arrangement is expected to contribute to cutting back of consumers' costs to 0.6 per cent [23]. Under constructive cooperation, these results will positively influence both Georgia and South Ossetia.

D. Foreign Direct Investments

Georgia is one of the good performers worldwide in terms of FDI attraction in absolute terms and per capita [24]. Since independence in the beginning of 90's Georgia has attracted more than 15 billion foreign direct investments and 41% of all those investments came from EU [25]. FDIs are essential element for Georgia's successful economic development, affecting not only different industries and improving employment rates, but what is even more important positively influencing local currency stability, which is the core element for long term comprehensive economic development [26].

Georgia is taking all possible steps to attract as much FDI as possible, but the conflicts on its territory are hindering the process. On the other hand, making a final peace could positively affect S. Ossetian region to attract international investments all over the world as a part of Georgian Economy.

VIII. CONCLUSION

Conflicts are always a good mechanism for money laundering and in many case that's why they are lasting for decades. Taking into consideration all negative and potentially positive effects (international aids), we can say that Peace and possibility for sustainable economic, socio and political development are always the best ways. As we see losses which Georgia and S. Ossetia took on both sides much higher than

those "benefits". The problem is even worse when the influential neighbor is coming on state, to prevent conflicts peaceful resolution.

Despite the problems already faced and negative personal stories brought by war on both sides, peace is one of the core elements which guarantees the comprehensive economic development. Losses already seen on both sides will only increase the day after day, postponing prosperity for the future and predestining enchanted circle. On the other hand, there are enough possibilities for cooperation, which should not be wasted.

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