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Peacebuilding in the South Caucasus:
What can the EU contribute?

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Understanding conflict. Building peace.

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Executive Summary

This paper is aimed at motivating and informing discussion within the EU institutions and Member States on the nature of their engagement in the South Caucasus.[1] It suggests priority areas for political dialogue and external assistance programming under the upcoming EC Country and Regional Strategy Papers. It argues that unless authorities and civil society in the region, supported by the international community, genuinely address the root causes of violent conflict, societal instability and distrust, then broad-based development and prosperity will remain beyond reach.

The finalisation of the European Neighbourhood Policy Action Plans in 2006, the elaboration of subsequent assistance plans and the continuation of political and economic dialogue offer a number of opportunities. For the authorities and people of the region, there is the potential to start to lay stronger foundations for sustainable socio-economic development and create better livelihood opportunities for more people. They can seize the chance to build on the benefits of the partnership in the European Neighbourhood. For the European Union, dialogue and monitoring on governance, security and economy issues, accompanied by well-targeted assistance, can help motivate greater interest in regional peace and co-operation, thus increasing the EU's own prosperity and security.

There are signs of progress

Measured on the basis of official declarations, some progress is discernable in the way that governments are seeking to engage with the international community over issues of governance and economic reform. EU Action Plan negotiations with Armenia advanced quite rapidly on the basis of a mutual interest in approximating legislation. The Government of Azerbaijan proposed that Azerbaijan add a ninth Millennium Development Goal (MDG) to 'establish and strengthen good governance'. In Georgia, a progressive vision was articulated by Prime Minister Nogaideli when he told the Directors of the US Millennium Challenge Corporation that the country had 'embarked upon the path of society-wide democratic transformation'. One part of this vision, as President Saakashvili put it in his summit speech in Vilnius on 4 May 2006, is that 'Georgia strives towards European values'.

...but building peace still needs to be embedded as the focus of a long-term strategy

The primary goal that still needs to be shared by the regions' leaders and its international partners is to establish a long-term peacebuilding vision. Peacebuilding is a continuing process – one which encourages the attitudes, the behaviours, and the structural conditions in society that lay the foundations for peaceful, stable and ultimately prosperous social and economic development. This means that all parties need to come to be convinced that they have shared interests in regional peace, co-operation and integration.

How might this happen? Above all, it requires building a full awareness of the costs of continued instability and conflict and a realisation of the opportunities that will emerge if peace can take root. The process takes time and it requires patience and determination on the part of those who govern,

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1   This paper reiterates a number of points and recommendations made in other documents. These include, inter alia, the Crisis Group publications on Georgia (2003), Armenia and Azerbaijan (both 2004), the DFID-commissioned Analysis of Incentives and Capacity for Poverty Reduction and Good Governance in Georgia, DFID 2002, and the report *The EU and the South Caucasus: Opportunities for Intensified Engagement* from the conference in the Hague in May 2004, as well as International Alert's *Corruption and Conflict in the South Caucasus* report (2006). It complements the Crisis Group report on *Conflict Resolution in the South Caucasus: the EU's Role* (March 2006) also produced under the Conflict Prevention Partnership.

as well as those who seek to contribute from outside. In terms of outside involvement, the nature and direction of political dialogue with the region's leaders, and above all the explicit and implicit approaches adopted by Russia and the United States, will be the most important determinants of the success or failure of peacebuilding efforts. For Georgia in the second half of 2006, for example, it will begin negotiations in NATO over its membership prospects that will impact most substantially on the government's motivation to take meaningful steps to improve governance. The EU Member States (old and new) will, therefore, have to be alive to the need for a coherent message as delivered by their NATO and their EU representatives. Decisions on NATO membership prospects, for example, must be based on meaningful governance reform and not political expediency.

Ultimately, peacebuilding needs to be demanded and driven by the region's people. It is the only sustainable force that can ensure and sustain the national will necessary to combat poverty, drive equitable development and protect fundamental rights and freedoms. It is a point that Javier Solana, EU High Representative for the Common Foreign and Security Policy, underlined at the 2006 Vilnius mini-summit when he emphasised that, 'When it comes to the future of the new democracies, the need to address frozen conflicts, or the efforts of building a meaningful partnership [with] the European Union, the mantra is always the same: success starts at home. The lead must come from the new democracies'.

Why is peacebuilding in the South Caucasus so important?

Poverty reduction in the region and the access of its people to globalised economic opportunities depend on whether they can drive a durable exit from instability and weak or poor governance. There are four types of costs if they cannot motivate change or are prevented from doing so by those with a vested interest in the status quo. The flip side of these costs would be the substantial economic and social benefits that would arise from progress with peace. While it varies who pays the costs and who is sensitive to them, their inter-relationship is key.

1. Economic
   a) *Markets:* The conflict divisions (geographically and socially) lead to fragmentation of markets, meaning that they function on a smaller scale and are less dynamic than their potential. Income from customs and business taxes, and thus overall government revenue, are accordingly reduced due to a lower volume of activity.
   b) *Infrastructure:* Regional infrastructure is distorted where tensions and hostilities result in missed opportunities and sub-optimal or duplicated measures to establish transport links and energy routes.
   c) *Foreign exchange:* Income of this kind is foregone due to the negative impacts on tourist numbers and foreign direct investment. Actual and perceived instability, corruption and violence prevent the full exploitation of the region's tourist potential
   d) *Unproductive spending:* In anticipation of worsening tensions, military spending increases. A heavy economic burden on budgets and a motivation to retain untransparent extra-budgetary funds, the primary effect of such spending is to absorb investment capacity. This risks slowing economic growth and diverting resources away from social sectors where they are desperately needed.

2. Governance
   a) *Corruption:* As recent research by International Alert has shown, the pervasive extent of corruption at all levels has profound negative effects on the way that divided communities perceive each other.[2] The tendency of people to perceive governing elites as corrupt undermines the legitimacy of each of the governments/authorities vis-à-vis its people, thus diminishing the prospects for public support for any future peace agreement. Entrenched in the system of politics and the provision of goods and services, it undermines the

2   See International Alert, *Corruption and Conflict in the South Caucasus* (2006).

development of a vibrant private sector and profoundly weakens the (potential) role that local businesses can play in building peace.

b) *Democratisation inhibited*: The real and perceived nefarious activities of neighbours and rivals can be used to justify or provide a rationale for oppression and/or limitations on democratic participation in political life and on the opening up of the media sector. Anti-democratic currents are most evident during elections but are consistently visible, to varying degrees, on all sides of conflict divides across the whole region.

c) *Key issues avoided*: The conflicts function as political alibis for governments to avoid addressing important issues of governance and socio-economic development. Not only can tensions be used and/or manipulated to deflect attention from failings in government in core areas of government responsibility (such as education, health and law and order) but they can obscure their involvement in corruption and links with other forms of criminality.

d) *Radicalisation of some social groups*: Where groups remain marginalised from participation in political decision making and fair access to economic opportunity, this can lead to their radicalisation. A more general danger of populism exists in the region due to susceptibilities to appeals based on a sense of victimisation or other grievances.

3. Regional security in the European Neighbourhood

a) *Spill-over*: The South Caucasus region is one of the most prominent venues in the world for the playing out of the geo-strategic interests of the great powers. These are principally driven by traditional and evolving Russian sensibilities, greatly increased American interest driven by upheavals in the Middle East, Central Asia and Afghanistan, as well as rising demand for hydrocarbons from Asian markets (particularly Chinese) and European markets.

b) *Turkey:* The opening of negotiations on Turkey's membership of the EU has significant implications for the wider region. Not only is prosperity (and political capital) being foregone by the continued closure of the border with Armenia, but the Armenia-Azerbaijan conflict helps maintain tension in the Armenia-Turkey dimension in regional relations. This has possible knock-on effects for Turkey's EU dialogue and for South Caucasian access to European markets. In addition, the activities of diasporas and businesses in Turkey have the potential to influence economic and political prospects in the Black Sea basin.

c) *Energy supplies:* The willingness of the EU to negotiate energy deals with Turkmenistan is symptomatic of Europe's dilemma when seeking to secure sources of energy for its markets and diminish reliance on Russia. This need, aggravated by tensions with Iran and the insurgency in Iraq, increases the temptation for Azerbaijan to use its leverage over oil and gas as a counter to democratisation pressure from the West. The bilateral relationship between Baku and Moscow can be pushed and pulled by either side to protect their respective politico-business interests from Western interference.

4. Human/Cultural

a) *Casualties and fear*: Continuing sporadic outbursts of low-level violence lead to widespread human suffering, population displacement and civilian casualties and trauma. This is accompanied by a fear of a worsening situation. The inability of pluralism and tolerance to take root is exacerbated through economic costs and overflows into other areas of life and politics. There is an added potential of reversing or undermining the benefits of development assistance.

b) *Image:* The damage done by conflict and instability is reinforced by negative perceptions that drive both dynamic individuals and capital away from the region, as well as deterring investment from the outside. The perceptions aggravate already adverse effects on production, investment, infrastructure, the environment and, therefore, livelihoods across the region.

Recommended steps for the EU

As is the case for all international actors, the EU cannot by itself put an end to instability and conflict in the Caucasus. It can, *however*, do more to orientate its engagement to help build capable, accountable governance which ensures the delivery of basic services and the protection of fundamental rights and freedoms for citizens. Taking a long-term vision, the primary focus of the EU's engagement should be to promote meaningful participation by citizens in political and economic life, focussing on the 'social contract' between authorities and the citizens that they serve. The implications for the EU are that:

- *There must be coherence among the EU's political dialogue, trade and economic incentives and development assistance under the European Neighbourhood Policy. They must together focus on helping to advance structural stability in the region.*[3] This means:
  - deepening dialogue with international partners, particularly Russia and the US, including the Millennium Challenge Corporation. Disbursements under Millennium Challenge Compacts in Georgia and, pending entry into force, Armenia, will significantly outstrip EU assistance over the coming four or five years;
  - ensuring a coherent message is delivered in EU and NATO which makes it clear that standards of governance (such as transparency and democratic oversight) will not be compromised on and will need to arise out of structural, and not superficial, change;
  - combining bilateral and thematic programmes in such a way as to balance government-defined assistance with support to civil society, the private sector and the legislature. This balance is needed to redress the current low level of citizen participation and empowerment.

- *Political dialogue, incentives, as well assistance programmes should together be orientated towards ensuring the effective implementation of commitments made under the Action Plans and in international conventions already in place.* The right kinds of areas for engagement (such as democratisation and the rule of law) have been identified and the ongoing negotiations should continue to clearly communicate the priority that will be given to implementation. The tone of the EU's political dialogue with authorities in the region should depend on whether the mechanisms for rigorous monitoring and assessment are robust and whether they are revealing the achievement of genuine progress. The EU must be clear that financial assistance will not be forthcoming where insufficient political commitment is preventing progress in the areas agreed under the Action Plans.

- *To ensure the effective implementation of these commitments, local civil society will need to be motivated and empowered to play a meaningful role in the monitoring and assessment.* This monitoring process should not be limited to government circles and the EU should clearly communicate that its attention is focussed on the freedom of civil society (including the media) to fulfil this role. While it is necessary also to pay close attention to the political interests of the diffuse range of civil society groups, it should be a priority to promote and sustain civil society monitoring processes in the short, medium and long term.[4]

- *Genuine progress will depend on how well reforms tackle deeply entrenched interests that attach to property, tradition, social and economic advantage and prestige.* EU spending should be targeted to ensure a meaningful separation of powers and a functioning system of checks and balances, where the executive and associated state agencies (such as the office of a Public Defender/Ombudsman), the legislature, judiciary

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[3]   'Structural stability embraces the mutually reinforcing goals of social peace, respect for the rule of law and human rights, and social and economic development. It is supported by dynamic and representative political structures, including accountable security services (and an independent justice system) capable of managing change and resolving disputes without resort to violence'. See the DAC Guidelines (2001) *Helping Prevent Violent Conflict.*

[4]   In Georgia, a process involving 76 Georgian NGOs and sponsored by the Eurasia Foundation, the Open Society Georgia Foundation and the Heinrich Boll Foundation is an important step forward and constitutes an opportunity to strengthen civil society's role in driving their country's progress towards the goals of the ENP Action Plans.

and civil society each can effectively fulfil its role. This will help underpin the second imperative for peace – equitable access to economic opportunity. Greater transparency, more legal certainty and an improved system of taxation would dramatically improve the economic climate and possibilities for trade and economic interaction across borders and conflict divides.

- *Laying the foundations for peaceful and stable development in the region will require more engagement with the non-recognised entities, expanding efforts to reduce their isolation.* Without implying sovereignty, more should be done to promote genuinely responsive and accountable governance in provincial districts, strengthen civil society and enhance meaningful interactions across divides.

- *Levels of staffing in Brussels and in the Delegations must correspond to the scale and complexity of the challenges faced.* Putting the fragility of the region, and the issue of poor or weak governance, at the heart of its engagement is an expert-labour intensive venture. Internal capacity to understand and tackle the complex and opaque forces at work in the region will be a key determinant of the EU's ability to better identify and promote positive forces in society and to monitor change.

Introduction

'Years of wars and turmoil have been followed by a period of continuing instability in the region; only limited progress in state building, democratisation, consolidation of the rule of law…has been made and the region continues to run the risk of becoming caught in a downward spiral of insecurity and conflict'[5]

Although there have been advances since this European Parliament resolution in 2004, there remains much that the EU can do to extend 'the benefits of economic and political cooperation to our neighbours in the East while tackling political problems there'.[6] In the coming months and years, the European Union has the opportunity to take a more strategic approach to building peace and stability in the region than in the past, improving its impact in the short, medium and long term.[7]

The rationale for a primary focus on peacebuilding is clear. As long ago as June 1999, the Communication on EU relations with the South Caucasus identified conflicts as lying at the root of the region's political, economic and humanitarian problems.[8] It was recognised that EU assistance could only be effective if the conflicts were settled and regional cooperation became possible.

Despite some significant shifts in the geo-political context and increased GDP growth rates, nearly seven years after the Communication, the resolution of the conflicts remains frozen and the region is still afflicted by the threat of a return to violence. Severe hostility and mistrust continue. Shadow economies that dominate the region perpetuate, and even increase, the severe income disparities and inequity that can, and do, drive instability. Negative attitudes across conflict divides remain entrenched, exacerbated by combative public rhetoric by leaders across the region, and flashpoint incidents such as the July 2006 deployment of Georgian troops into the Khodori Gorge.

Supported by concerted political dialogue, and with the right mix of geographic and thematic programmes,[9] the European Neighbourhood Policy Instrument (including the Action Plans elaborated under it) can be used to establish a common framework for engagement. This framework would serve to define and sequence a set of coherent and integrated activities to help lay the foundations of long-term peace and stability and would unlock the region's potential to feed into and be a transit point for North to South, as well as East-West, trade. For use by the European institutions and the Member States, it also would be a clear reference point for international partners, one upon which more mutually reinforcing engagement could be established.

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5   European Parliament resolution with a European Parliament recommendation to the Council on EU policy towards the South Caucasus 2003/2225(INI) 26 February 2004.
6   See the EU Security Strategy adopted in December 2003.
7   For overall figures for the financial and technical assistance provided, see Annex 1 to this paper. For more details, see the Crisis Group South Caucasus report (2006), p.12.
8   Communication from the Commission to the Council and the European Parliament – *The European Union's relations with the South Caucasus under the Partnership and Cooperation agreements*, COM(1999) 0272 final, 7 June 1999, (OJ C5/1999/116).
9   In January 2006 the Commission approved seven new thematic programmes (regrouping 15 previously). As of the spring 2006, the financial allocations for the new thematic programmes await final agreement.

Geo-strategic context

The overall ability of the EU to influence events and fulfil its peacebuilding aims will be conditioned, to a great extent, by how it engages with the other principal international actors impacting on the region. Given the stated priority of the EU to avoid creating new dividing lines,[10] it is essential that the EU frames its approach within the geo-strategic context. This general context is briefly sketched out here, with the emphasis on recent shifts in the picture.

Although the geo-strategic importance of the region is increasing for different actors for different reasons, common to all of them is their interest and involvement in the politics of energy. For the world's powers, economic growth has increasingly become linked with the ability to provide or secure supplies of hydrocarbons. They, therefore, have a stake in the future paths taken by the region's constituent societies – politically and economically. This prompts a sense that some of the rivalries of the Cold War are re-emerging and beginning to influence the thinking of leaders in the region. The competing interests of external actors threaten to deepen existing fault-lines, catalysed by the growing involvement of the West, particularly the United States, and the perception that it is trying to draw the region away from the historic influence of Moscow. The growing debate over the possibilities of accession into NATO epitomises this dynamic.

These issues are sharpened by the potential threats to the supply of Caspian oil and gas. The EU needs to pay close attention to the potential for internal unrest and/or for a political choice by the Azerbaijani government to look to the emerging great powers in the East for its preferred allies. In addition, there are considerable risks of terrorist targeting of the pipelines, which, given lack of infrastructure and difficult terrain along their route, are almost impossible to protect fully.

Europe

For Europe, 'pipeline politics' (and concerns about the powerful influence of Russia in the energy market) are motivating increased interest within foreign affairs ministries (and in the oil majors) in how to engage with governments in the region, particularly Azerbaijan. Other political motivations for the EU include concerns about trafficking, migration, money laundering and organised crime emanating from, or transiting, the region. It also has an interest in the secure disposal of Soviet-era military material and in eliminating the environmental risks posed by the Medzamor nuclear power station in Armenia.[11]

At the same time, there are considerable concerns that the enormous wealth that will come to Azerbaijan and, to some degree, Georgia, from the exploitation of hydrocarbon reserves, will act to counter motivations to reform and may, in fact, fuel instability.[12] In particular, there are serious concerns that, in the absence of proper public scrutiny of financial flows from the oil and gas, 'sovereign rents'[13] from these resources will be appropriated by elites, with negative impacts on governance standards. Moreover, there are rising expectations in these countries, often based on highly optimistic estimates of the extent of the reserves, that the *inevitable* consequence of the revenues and investment will be better lives for all.

It is highly possible that the real and perceived wealth from hydrocarbons, and the playing-out of US and Russian interests, will also work *against* the appeal of the Union and the economic appeal of attaining its norms and standards. This appeal has, to date, been one of the key levers for influence

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10   *A Secure Europe in a Better World*. European Security Strategy.

11   The ageing Medzamor nuclear plant produces 40 per cent of Armenia's electricity. It is in a highly seismic zone 40 kilometres from Yerevan and is considered by the EU to be a threat to the region. Russia's Unified Energy Systems Corporation manages the plant.

12   In 2003 Georgian-EU merchandise trade was dominated by energy products (with a significant Georgian surplus of €0.17 billion). Azerbaijan's exports to the EU amounted to €1.3 billion (€1.23billion of which were energy related), while imports reached €0.8 billion. For more detail on the EU's interaction with Azerbaijan, see the Crisis Group South Caucasus report (2006) p.10-11.

13   Collier, P., *'Is Aid Oil?'*, Working paper, 2005.

which the EU can exert in the South Caucasus.[14] Representatives in EU and NATO negotiating fora will need to take care that they deliver a coherent message that these standards will not be compromised on and will need to arise out of structural, and not superficial, change.

Russia

With a strong sense of what it sees as its own 'backyard', Russia will continue to be a 'key player with the ability to sabotage peace processes if not to resolve the conflicts'.[15] Its capacity to do so is occurring at a time when its leverage through supplies of energy is strong. Due to its economic interests (particularly export routes for the hydrocarbon resources of the Caspian region) and instability in the North Caucasus, the region remains one of Russia's main security priorities.[16] As a result, Russia wants to preserve its foothold beyond the Caucasus mountain range. One of the most striking characteristics of Abkhazia and South Ossetia is the enormous influence Russia has. As in the rest of the region, much of their population relies on remittances from family members working in Russia,[17] watches Russian television, and has instinctive bond with the traditional regional hegemony. In addition, Russia is seen as the historical protector and guarantor (of minority rights and autonomous status) as well as the sole benefactor. It provides the most affordable goods (despite the official embargo in Abkhazia), gives access to passports, pays pensions and funds salaries. In South Ossetia, this means that an external actor that is perceived to take a position running counter to Russia is generally seen as 'hostile'. In Abkhazia, Russian tourists are increasingly the lifeblood of a very weak and vulnerable economy, particularly now that sources for forestry exports[18] are declining.

Russia's relationship with Georgia is particularly fraught, driven and compounded by realities and perceptions of the conflicts in the two bordering non-recognised entities. The tension between Georgia and Russia has escalated recently through politically significant measures taken by each in turn. For example, the February 2006 resolution in Georgian parliament on reviewing the status of Russian Peacekeepers both in the Georgian-Abkhaz and the Georgian-Ossetian zones of conflict is one example of the willingness of the Georgian elite to confront the influence of the regional superpower. The strong anti-Russian statements of both the previous and the incumbent Georgian governments need to be viewed in the light of Russia's control of the energy infrastructure which may limit Georgia's ability to follow through on its rhetoric.[19] This position, however, is changing with the possible emergence of Iran as an alternative supplier of gas, implying the potential for more confrontation with Russia and for difficulties in Georgia's relationship with the United States.[20]

More than just a member of the 'Minsk Group', in Armenia and currently Nagorny Karabakh, Russia is seen, and holds itself out, as Armenia's protector. This is manifested, for example, in its military presence and role at Armenia's borders and the substantial investments (for example, in aviation, communications and utilities). Russia was recently estimated to own 5 per cent of Armenia's defence and power enterprises.[21] Tensions around the Nagorny Karabakh conflict are an opportunity to show its leverage and, by popular perception at least, to sell arms to both sides. As regards Azerbaijan, Azeri and Russian interests are more evenly balanced. In addition to the ties arising from the Azeri diaspora

14   1999 saw the ratification of the Partnership and Cooperation Agreements between the EU and each of the three countries. In the same year, Georgia became a member of the Council of Europe, followed by Armenia and Azerbaijan in 2001. All three countries have been involved in the NATO Partnership for Peace programme since 1994.

15   Russia operates as a facilitator in the UN- and OSCE-mediated peace processes (often being concerned to restrict or at least control international mandates), as a mediator in bilateral and trilateral relations with the parties, as a troop contributor to the Commonwealth of Independent States Peacekeeping Force and UN Observer Mission in Georgia (UNOMIG) in Abkhazia, and as a state seeking to promote its national interest. See Cohen, J., *Regional Introduction: Struggling to Find Peace*. 2002.

16   In addition to the on-going unrest in Chechnya and the threat of terrorist attacks, there are tensions with North Ossetia which was recently told to take back 8,000 Ingushetians expelled in 1991-1992.

17   The exact number of labour migrants from the Caucasus in Russia varies and is largely impossible to determine. It is, however, most likely to be no less than 2 million, but no more than 5 million.

18   Abkhazia's exports of timber to Turkey violates an international embargo and by unsustainably depleting its natural resources, severely damages its environment.

19   Almost the entire Georgian energy-distribution system has been sold to the Russian state-owned energy-consortium Gazprom.

20   The Armenian section of the new gas pipeline from Iran, which could potentially provide Georgia with another source of energy, is also Russian-owned, however.

21   See *Armenia: Internal Instability Ahead* - Crisis Group Europe Report (2004) p.22.

in Russia, the trade corridor to Iran (the Dagestan-Baku-Tehran railway) and investments in the energy sector, the two countries are acutely aware of the importance to Russia of the radar station in Gabala.

The United States

US engagement in the South Caucasus epitomises Washington's highly visible desire since 2001 to 'transform societies' in the interests of its own national security and democratisation agenda.[22] Following the military actions in Afghanistan and Iraq and the deterioration of relations with Uzbekistan, this desire is combined with American interests in guaranteeing friendly airspace and securing a staging post to the Middle East and Central Asia. Deeper US engagement in the military[23] and energy sector now goes together with new directions taken in development spending. USAID and Millennium Challenge Corporation (MCC) have both made economic growth central to the US Government development strategy, targeting trade capacity building, agriculture, investment in infrastructure, and 'microeconomic' reform. Much attention also is being given by USAID to some democratising civil society groups that promote political pluralism and to improvements to the civil service and justice system through training programmes.[24] Progress has been least visible, however, in efforts to promote the system of checks and balances, a robust separation of powers and a vibrant media sector.

The American agenda is most evident in Georgia where there is high profile involvement in politics and military assistance. Close relations have been epitomised by the visit of George W Bush in May 2005 to Tblisi and by the deployment of Georgian military to Iraq. An investment of around $295 million over five years by MCC to Georgia was approved in February 2006, with the Millennium Challenge Compact entering into force on 7 April 2006. The MCC also is preparing substantial investments in Armenia.

The decision by MCC to fund programmes in Georgia is based on the premise that the pre-conditions of 'ruling justly, investing in its people, and encouraging economic freedom' have been met. The Millennium Challenge Georgia can, therefore, 'move aggressively ahead to disburse funding and begin the programmes'.[25] With the aim of 'reducing poverty through economic growth', there are two components to the MCG's activities: Regional Infrastructure Rehabilitation and Enterprise Development. The first involves road building in the Samtskhe-Javakheti region, energy infrastructure rehabilitation, and regional infrastructure development to improve regional and municipal service delivery. The second will create an independently managed Georgia Regional Development investment fund (GRDF) to provide capital to, and further assist, SMEs primarily in the regions. A second project will aim to improve economic performance of agribusinesses.

In Armenia, which also made a symbolic deployment as part of the 'coalition of the willing' in Iraq, diaspora links to the US (epitomised by the investments of the Lincy Foundation[26]) as well as rivalries with Russia remain strong drivers of US involvement in the region.[27] As part of Washington's counter-terrorism agenda, in March 2002 Congress made the President's temporary waivers of Section 907 in the Freedom Support Act permanent by amending the International Traffic in Arms Regulations (ITAR). With this notice, Armenia[28] and Azerbaijan were officially removed from a list of proscribed destinations for the exports and imports of defence articles and defence services. The nature of the

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22 'Development abstracted from foreign policy concerns in the real world and the challenges it presents, is not likely to be sustainable over the long term' see Natsios, A., *Five Debates on International Development - The US Perspective*, 2005.

23 In March 2002 the US launched its 'Train and Equip' programme in Georgia, allocating an initial $64 million to train Georgian security forces in anti-terrorism and counter-insurgency measures. In July 2004, the US Congress approved $5 million in annual military aid each to Armenia and Azerbaijan.

24 The USAID budget for Georgia is about $8-14 million per year in each of the areas of economic growth, the social sector, energy, and democracy and governance. The US government is also involved through the FBI, Department of Justice, Department of the Treasury and US Customs. Author's interview, Tbilisi, February 2006.

25 Ambassador Danilovich, Chief Executive Officer of the Millennium Challenge Corporation on the announcement of the 'Entry into Force' of the Millennium Challenge Georgia's Compact, 9 April 2006.

26 The $160 million investment by the Lincy Foundation of Armenian-American millionaire, Kerk Kerkorian, was 30 per cent of the national budget. See Crisis Group Armenia report (2004), p.7.

27 It is generally considered that there are about 7 million Armenians worldwide. Petrosian, D., *Armenian Diaspora critical of Yerevan authorities*, IWPR, June 2002, www.iwpr.net.

28 As a result of the amendment, the 2003 foreign aid bill included a hard earmark for Armenia that guarantees a minimum of $90 million in assistance to Armenia, an additional $4 million in foreign military financing and $300,000 in military training.

relationship with Azerbaijan's Aliyev government is also driven by US energy supply priorities and the desire to establish a secure bridging post to Central Asia. This results in a dilemma for the United States (and Europe). On the surface, the vast wealth that Azerbaijan has begun to accumulate would justify a reduction or cessation of development activities and the government in Baku could make a strong case for its own capacity to deliver poverty alleviation. However, significant concerns remain over the vast disparities in wealth and over commitments to improve governance and tackle corruption. The continuation of negative popular perceptions diminishes prospects for peace in the region.

Iran

Iran has closer relations with Armenia than with Azerbaijan despite the religious characteristics of the three societies and has used its common interests with Russia (particularly demarcation of the Caspian and a difference of view with the West) to alleviate its diplomatic isolation. In Azerbaijan, Iran is seen as a 'historical overlord that is ambivalent about Azeri independence, while the issue of a substantial Azeri population in northern Iran, which prompted Azeri nationalists to call for a reunification of historic Azerbaijan in the early 1990s, cautions Iranian policy'.[29] Armenia has a small border with Iran but the economic relationship favours Tehran, which does not allow Armenian trucks to enter and enjoys a substantial trade surplus. However, the 100,000-strong Armenian diaspora in Iran enjoys legal and economic privileges, and the two countries share an interest in supplies of gas and electricity[30] and in transportation.[31] However, as Russia's energy policy in the region risks becoming more unpredictable, Armenia is increasingly looking towards Iran. Its energy policy currently is perceived as more reliable than that of Russia.

Turkey

In its policy towards the South Caucasus and Russia, Turkey 'is facing tough choices – economic, diplomatic or even moral'.[32] Business between Turkey and Russia is currently undergoing spectacular expansion, with Turkey selling consumer goods and construction services in return for Russian energy. Discussions are underway to export Russian and Kazakh oil through a pipeline from the Turkish Black Sea port of Samsun to Ceyhan (to add to one that carries Russian gas). However, there are significant historical rivalries and the strengthening of Turkey's relations with Azerbaijan and Georgia (arising, in part, from its role in pipeline routes) has prompted caution in Moscow. On the Turkish side, Ankara is not only conscious of the ramifications that an unstable neighbourhood could have on its peace and security, but is well aware that the continued closure of its border with Armenia is a major issue in its negotiations to join the EU. Armenian-Turkish relations are conditioned by Turkish support to Azerbaijan (and its interpretation of the Karabakh conflict) as well as by the ongoing genocide debate.

Yet, Turkey's economic policy in the region seems to be less of a calculated strategy, than a result of the fact that Turkish enterprises are culturally and geographically well positioned and are willing to take risks in areas where many other Western companies will not. The completion of the Nabucco gas pipeline, as well as the routes for oil and gas which arrive at Turkish Mediterranean ports clinches Turkey's role as a energy conduit between east and west. The Black Sea has the potential to see far greater flows of exports from and imports to the region. Already, for example, despite the official embargo on trade with Abkhazia, goods and services flow in both directions, with much of Abkhazia's forestry exports arriving in Turkey. In Georgia, Turkish companies are increasingly involved in the construction sector. An additional dynamic is the presence of large regional diasporas in Turkey. In Turkey, for example, there are estimated to be around 800,000 Abkhaz. The desire of the Abkhaz authorities to persuade these native Abkhaz speakers to return to their homeland and safeguard the Abkhaz language and culture is a factor driving greater interest in improving governance and economic life in the entity.

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29   See Cohen (2002).
30   Iran has loaned Armenia $30 million to complete its 40 km stretch of the gas pipeline due for completion in 2007. This will supply one third of Armenia's needs. The level of Iranian investment is estimated at $15 million, mostly in the energy sector. See Crisis Group Armenia report 2004 p.25.
31   20 per cent of Armenia's land trade is with Iran, amounting to $140 million in 2003. Trade is expected to increase with the opening of a new tunnel in the southern region of Kajaran. Ibid.
32   See Linking hands across the Steppes in the Economist, 3 June 2006.

Context in the region

Political dynamics

In the region, the formal structures of democratic systems (presidents, parliaments, courts of first and final instance, and multipartyism) have been put in place. However, below this veneer of democracy there is little to convince that there is meaningful public participation in political life. Personalities and not policies are at the heart of politics[33] and patron-client ties structured by clan affiliations infiltrate all areas of governance. Real power is negotiated and exercised by informal, personalised networks, which determine levels of access to wealth, education and status and determine the ownership and rent of land where there is money to be made.[34] The probity and transparency of public financial management continues to be questioned, due, in part, to the continued existence of extra-budgetary funds which are not subject to democratic oversight. Combined with action against freedom of speech and association, the effect is a pervasive disillusionment among citizens about their ability to change the system of decision-making and to hold officials accountable for their actions and for money spent.

Legislatures, and the other institutions that check and balance power in the region, are relatively weak in the face of strong presidential systems. Although general and local elections have been, and continue to be held, they have been flawed by interventions by the authorities in power, tampering and, in some cases, outright manipulation.[35]

Crude censorship of the media is not frequent, but there is generally little need for official censors to act. Political interests have bought up or strongly influence the main media outlets and there is little money available or committed for investment in a campaigning, balanced and independent media (such as through advertising revenues). Censorship is 'very internalized, done in a subtle way, and difficult to pin down, but people know exactly where to stop in their investigation'.[36] Broadcasting and other media licences are, to varying degrees, closely controlled by the authorities, often motivated by concerns over the interests and manoeuvrings of rivals and former overlords. The effect is to drive down standards of openness and independence that would be expected in a European context.

Despite the proliferation of NGOs and the range of their activities, their influence remains, to varying degrees, quite limited. Their activity has been confined primarily to cities and rarely spreads to rural communities. Although some progress in this area can be seen,[37] the sector remains highly politicised and, in Azerbaijan, for example, rifts between the NGOs basically are congruent with the rifts between the political parties. There are few NGO activists who defy the official line and are ready for direct contacts with Armenians, but they face harassment at home.

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33   See Cohen (2002).
34   While at the everyday level, ordinary people attach 'great significance to family networks for the procurement of work, revenue and other social goods, a more generalised 'clan' politics is present at every level of society. A 'clan' denotes an informal network united by a common patron, control over a particular resource base, a regional or ethnic identity.' In Georgia, for example, 'while clan networks are omnipresent, they grow in salience and political influence with distance from the centre' (such as in Samegrelo and especially in Svaneti). See *Analysis of Incentives and Capacity for Poverty Reduction and Good Governance in Georgia*, DFID Drivers of Change document 2002.
35   For example, the OSCE stated that the Azerbaijani parliamentary elections in 2005 did not meet international standards, and assessed the count as 'bad or very bad' in 43 per cent of places observed.
36   In Armenia, for example, 'business elites have invested massively in media and control many television stations. Some small stations that initially were reluctant to sell to big business interests have been forced to do so after pressure was put on advertisers to boycott them - a very effective practice across the former Soviet Union.' Crisis Group Armenia report p.15.
37   See the statement by the Azeri Minister of Foreign Affairs in late 2005, that 'Azerbaijan side supports calls of the international community vis-à-vis setting up direct contacts between the communities and carrying out comprehensive confidence-building measures with a view to overcome hostility, achieving stability and mutual understanding'.

In Georgia, the Rose Revolution lead to many of the most dynamic members of civil society entering government and subsequent dynamics have politicised the activities of the leading non-governmental organisations and have begun to undermine the ability of civil society as a whole to play the role of neutral 'watchdogs'. In Armenia, 'the lack of objective and full information is cited as the main hindrance to public participation in decision making and the main cause of corruption. Without public pressure and scrutiny, officials have little incentive to clean up their acts'.[38] More generally, the vulnerability of NGOs to the funding limitations of external donors is exacerbated by the fragility of democratic institutions and shortcomings in the willingness and commitment of donors to press for, and protect, the right of NGOs to operate without fear of oppression or harm.

In terms of the conflicts, civic actors who are striving for peaceful solutions are politically weak and their capacity to address the issue is far from developed. Instead, education systems and media propagate negative images and reinforce animosities. There is little public information and debate about progress in or constraints on negotiation processes, and communities have been 'mobilized by war and rendered passive by the socioeconomic burdens of transition. The majority of the regions' population is grappling with economic hardship rather than political change.'[39]

Opinions are divided as to the intentions of those holding formal political power. On the one hand, it is held that 'Western-leaning' leaders are constrained by political realities in a changing society (and, perhaps, the weakness of their own political positions) to risk pushing forward compromises (involving perhaps IDP return, processes of self-determination or demilitarisation) that would be rejected by the country's elite.[40] Unable to sell such compromises back home, they would be opening themselves up to the potential for regime change where an angry population backs the rise of hardliners – some of whom hold senior government positions.[41] This is a very real risk because, for more than a decade, media and education has reinforced beliefs that make it likely that citizens would instinctively reject compromise. In Azerbaijan and Georgia, for example, the agenda has largely been the restoration of territories lost in the post-independence wars while Armenians have tended to deny the very existence of the conflict and portray Azeris as Turks (with all the historically negative perceptions that such an attitude entails). On the other hand, it is contended that political rulers manipulate this perception for their own ends, perpetuating varying degrees of domination by the central executive. This can undermine the efforts of external actors to assist regional reconciliation and integration processes, exemplified with the open hostility of the Georgian government to the European Union's efforts to engage in Abkhazia in 'decentralised co-operation' on human rights, civil society development and economic rehabilitation issues.

Although the opacity of the political context in the region means that real power and influence are hard to identify, concerns remain that, on the one side, the faces in the system have changed but that the system has not.[42] Question marks also continue as to whether the most significant structural issues are being properly tackled with a coherent and sustainable strategy.[43] In any event, it can be said with certainty that there have been few signs of statesmanship or the promotion of reconciliation within societies (let alone with regard to the so-called enemies).

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38   See Crisis Group Armenia Report (2004) p.16.
39   Cohen (2002).
40   In April 2005, the then Minister of Defense Giorgi Baramidze (now Minister for EU integration) urged 'everyone to join the Georgian army, defend Georgia, join the people who are ready to spill blood for their motherland. This time has come'. (Georgian Imedi TV, 6 April 2005).
41   In Azerbaijan, for example, it remains to be seen to what extent political cracks in the ruling elite may unfold. See *Azerbaijan: Turning Over a New Leaf?* Crisis Group Report N° 156 – 13 May 2004, pp. 19-22. In Armenia, 'Pro-government and opposition parties compete to appear the most patriotic, looking for opportunities to accuse the other of having betrayed Nagorno-Karabakh.' See *Armenia: Internal Instability Ahead* - Crisis Group Europe Report N°158, 18 October 2004, p.6.
42   In Azerbaijan, it remains to be seen what the impact of recent changes at the head of certain ministries (including Customs, Social Protection, Sports and Youth) will be, and what motivated those changes.
43   'The successive governments of independent Armenia have failed so far to identify the country's priorities and development strategies in all spheres'. *UNDP in Armenia - Democratic governance*' www.undp.am.

The combined effect across the region is to give an impression of 'decorative democracy' rather than democratic legitimacy. Even in Georgia, praised for its democratic revolution in November 2003, the sweeping nature of Mikhail Saakashvili's victory in the January 2004 presidential elections (96 per cent) and of his National Movement has, in practice, set the scene for the emergence of a powerful executive in the absence of robust separation of powers. Loyal MPs dominate parliament and historical divisions among the opposition mean that unity calls risk being scarcely credible to the electorate. The electoral and recruitment processes for the Tbilisi city authorities and the design of local election legislation epitomise the preference for state strength rather than steps towards genuine democratic governance. Hampered by weak capacity and corruption, the justice system is not yet effective in playing its role of ensuring the Rule of Law. The creation and gradual strengthening of the office of the Public Defender of Georgia (Ombudsman) is, however, a positive step in the direction of offering protection against abuses of power and should be extended in Georgia and replicated across the region.

Economic systems

The economies of the region are labelled as transition economies, although they can be best characterized as a mixture of 'war', 'shadow' and 'coping' economies. Despite the flourishing of some economic sectors, such as diamond polishing in Armenia and hydrocarbon exploitation in Azerbaijan, they remain characterised by 'porous borders allowing influxes of cheap and illegal goods, monopolistic restrictions, additional costs and transactions required by corrupt practices and poorly enforced regulatory frameworks. These conditions continue to severely compromise local industrial activity, and privilege short-term investments over mid- to long-term commitments'.[44] A lack of understanding from international actors, as well as deficient tools to address many of the basic issues hamper efforts to promote economic development.

Powerful members of business, political and military elites are able to derive relatively substantial wealth from this economic context. They are able to do so because of the continuing and entrenched informality of the clan-based political and social system and the weak capacity and authority of governance institutions. In particular, the Rule of Law (in terms of norms and structures) is too superficial to effectively counter either their vested interest in the current system or the corruption that is pervasive at all levels. Whereas the post-independence decade was characterised by ad hoc sporadic corruption, corruption has now become an entrenched system for politics and the provision of goods and services. It has become so systematic that, according to an observer, 'people see not corruption but where to find the money for the bribe as the problem. Corruption is so entrenched, people expect officials to ask for money and propose it themselves, thinking it will accelerate the process'.[45] Although it is a relatively predictable feature of the system, its effect is to undermine the development of a vibrant private sector, and to profoundly weaken the (potential) role that local businesses can play in building peace.[46]

To varying degrees in the region, governments are driving economic growth and market liberalisation. In Georgia, there have also been moves to remove environmental regulations that 'hinder' businesses (partly because they are seen not to be realistically enforceable) and to crack-down on the informal economy.[47] The liberalisation is viewed favourably by some external actors (notably the United States) who prioritise economic growth as the primary factor in driving development. However, too hasty a drive towards liberalisation, privatisation and formalisation in the region actually risks destabilising and even sweeping away the long-standing informal

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44 DFID Drivers of Change document on Georgia 2002.
45 Crisis Group Armenia report 2004.
46 See Banfield, J., Gunduz, C. and Killick, N. (eds.) *Local Business, Local Peace: The Peacebuilding Potential of the Domestic Private Sector*, International Alert, London (2006).
47 Although there are locally led drives to increase revenues, as the recent efforts in Georgia demonstrated, these are counterproductive in other areas: the closure of the Ergneti market increased the state budget, but escalated the conflict in South Ossetia. The closure of the Sadakhlo market, yielded similar results, but virtually shut down cross border agricultural trade with Azerbaijan and ended small-scale trade between Azerbaijani and Armenian communities.

socio-economic system on which, in the absence of effective formal state institutions, large segments of the population depend.[48] With the lack of alternative livelihood opportunities and social safety net, this risks increasing poverty and driving instability.

Comprising unrecorded and unregulated small-scale activities (the extent of which remains substantial yet ill-defined), the informal economy, along with remittances, mitigates the impact of unemployment and the lack of livelihood opportunities. Many people are forced to participate in it in order to scrape a subsistence living to survive.[49] This, in turn, perpetuates problems of revenue collection and the creation of formalised economic systems. Moreover, the closure of borders and the imposition of certain customs policies blocks trading routes (see below on the conflict zones) causing highly negative impacts on the development of small- and medium-sized businesses. For example, the decision by Russia in December 2005 to ban Georgian agricultural produce (and, later, wine) on the grounds that it failed to meet health standards severely impacted on the South Ossetians who earned relatively significant income from transit fees. In addition, the current Georgian customs policy vis-à-vis agricultural produce from Azerbaijan effectively prevents cross-border trade between Azerbaijan and Georgia by small farmers. This has caused a collapse of many agricultural enterprises in Western Azerbaijan. An additional effect of these policies is to severely constrain the legal flow of goods so that incentives increase for customs to be a source of corruption and pushes Abkhazia and South Ossetia further under Russian influence.

Across the region, despite the continuing inadequacies of social services[50] and the lack of infrastructure[51] necessary for the emergence of a prosperous formalised economy, government funds for military spending are increasing. For example, in Armenia's budget for 2006, out of expenditure of about $1 billion, $166 million is earmarked for the military, a 21 per cent increase over 2005.[52] In Azerbaijan, despite his stated commitment to a peaceful resolution to the Nagorny Karabakh conflict, President Aliyev describes the Azerbaijani army as able to take back the territory by force. On 17 September 2005, he announced that Azerbaijan's defence spending amounted to $175 million in 2004, increased to $300 million in 2005, and will reach $600 million in 2006. Moreover, there seems to be a growing sense within Azerbaijan that the wealth derived from hydrocarbon exploitation will deliver the country victory over Karabakh. Even if greater professionalism and capacity of the armed forces is a common (and justifiable) mark of statehood, it is also the case that rhetoric on 'protecting territorial integrity' and/or on 'patriotic interests' serves to distract attention from shortcomings in the provision of government services and the inequity within political and economic systems.

The conflict zones

Efforts to resolve the conflicts come up against the enormous complexity of the context and are undermined, in particular, by vested interests in the status quo and by the significant asymmetry in the engagement of external actors in the region.

On the emotional level, perceptions of historical 'truth' come through an opaque layer of subjectivity and are characterised by allegations, mistrust and misconception. Real and perceived corruption on either side of the conflict lines serves to delegitimise governmental institutions in the eyes of the public, undermining their potential to one day achieve buy-in for

48   Although there are conceptual and methodological problems with the data, the 2002 census of Georgia suggested that 'Only 0.75 per cent [of the 40.1 per cent of Georgians that are employed] received income from enterprises they own. 57.7 per cent of all employed received their income from land and almost 9/10 of these living from agricultural activities said that they receive their income from 'private subsidiary plots of land' i.e. were not commercial farmers. See the DFID Drivers of Change analysis, 2002.

49   Taking Georgia as an example, official estimates for 2002 suggested that the informal economy represented 35-40 per cent of GDP, possibly an under-estimate, and is especially active in urban contexts.

50   For example, only about 1 per cent of Georgian GDP goes into the health system.

51   A recent expert estimate for the rehabilitation of the electricity network in Gali, Georgia, alone, was put at $850 million.

52   RFE/RL Newsline, 29 September 2005.

53   *Corruption and Conflict in the South Caucasus*, International Alert, 2006.

a peace agreement which requires a compromise.[53] At the same time, negative perceptions of the 'other side' are manipulated to justify hard-line positions on conflict resolution processes. The imposition of blockades and trade restrictions as crude means of leverage fuels antagonisms and prevent alternative approaches that could be of mutual interest across the conflict divides.

Politically, the parties to the conflicts over Abkhazia, South Ossetia and Nagorny Karabakh have entrenched their positions. For example, despite an outline government plan for a peaceful resolution of the Georgian-Ossetian conflict[54] and its very real economic interests in more open land borders for exports to Russia, the continuing anti-Russian virulence of the Georgian government does little to convince that serious efforts are underway to resolve the conflicts in the region.[55] For its part, Russia is also playing its part in the current escalation by imposing the above mentioned ban on Georgian agricultural imports and wine. Georgia responded in February 2006 by demanding visas from Russian peacekeeping forces in South Ossetia.

In these conflict zones, complex informal networks which overlie ineffective governance structures sustain the status quo. In a 'shadow economy' context (often obscured by the broader discourse over identity and sovereignty), there are groups who benefit from the largely unregulated nature of the local economies and who do not want to see changes which would affect this position.[56] The same groups are also connected to 'business partners' across the conflict divides. In South Ossetia and Abkhazia, these networks connect also the Russian political, military and business elite, reinforcing the bonds with the northern power[57] (see the section on Russia above). Duties imposed by the current authorities in Abkhazia on trade in local produce would seem more suited to the interests of Russian businesses active there, rather than those of ordinary Abkhaz business men and women. In the continuing stale-mate over Nagorny Karabakh, meanwhile, a perhaps under-estimated factor is that the political elites of Armenia and Azerbaijan have no real or perceived economic interests in either escalating or resolving the conflict.

Civil society dynamics in the three non-recognised entities are determined by their geographic and political isolation as well as their prior status as part of the Soviet Union. This means that few people have had direct contact with Western institutions and experiences of Western-style economic and social development. Although the civil societies of the non-recognised entities want to see a widening of civic space and participation, and a peaceful resolution to conflicts, this does not mean that they are willing to compromise on their political aspirations (i.e. secession). Because external actors have rarely included the non-recognised entities in any substantial governance programmes (due to sensibilities that may be interpreted as support to state-building), this has reinforced the problem of asymmetry in their engagement in the region.

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54   On 26 January 2005, while addressing the Parliamentary Assembly of the Council of Europe, President Saakashvili unveiled the South Ossetia Peace Initiative, a proposal for re-integration on the basis of broad autonomy. http://www.georgiaemb.org//Print.asp?id=376.

55   The attitude of the Georgian government (with a few exceptions) is as Saakashvili put it: 'There is no conflict at all. [South Ossetia] is an ordinary region of Georgia'. åËı‡ËÎ ë‡‡Í‡¯‚ËÎË: 'Ç ûÊÌÓÈ éÒÂÚËË ÌÂÚ ÌËÍ‡ÍÓ„Ó ÍÓÌÙÎËÍÚ‡', in Kavkazskii Uzel, March 2004.

56   'Economic and ethnic relationships…are blurred when profits are to be made, whether this relates to Abkhaz and Georgians trading across the Inguri River or Armenians and Azeris meeting in the Sadakhlo market in Georgia.' Cohen (2002). For example, the closure of the Rocky Tunnel in South Ossetia and Abhaz routes to Georgian goods benefits those with a stake in the port at Poti.

57   In South Ossetia, Russia is engaged to build another gas pipeline into the entity, is giving $600,000 in agricultural loans, and has financed a raise in the salaries of teachers, the police and armed forces.

What can be done (and what is already being done)

Governance and participation

'EU assistance and deepened cooperation should be clearly linked with progress in key areas such as conflict resolution, respect for fundamental rights, the rule of law and democratic values, and progress measured against clear benchmarks'.[58]

International assistance, and the diplomacy that backs it up, need to be formulated so as to generate positive interest in regional peace, co-operation and integration. This means furthering **structural stability and meaningful citizen participation in political and economic life**. The goal is to help the recipient society establish and sustain the social contract between authorities and the citizens they serve. On the one hand, this means strengthening government capacity in service delivery (in terms of financial management and budgeting as well as the quality of actual delivery in the areas of health, education, housing, infrastructure and a social safety net). On the other, citizens must be able and empowered to demand accountability and responsiveness from those that govern them at the local and national level. Human security (freedom from want and freedom from fear, including fear of abuses of power) depends on the proper functioning of this 'deal'.

It is because 'support for country-defined strategies'[59] often comes to mean support for '*government-defined*' priorities that it is particularly vital to find the right balance between working with governments, civil society and the private sector. The sustainability of progress will, to a great extent, depend on the ability of a strengthened and motivated civil society to hold governments to account on their commitments and responsibilities. Strengthened institutions of the Public Defender (Ombudsmen) will also play an important role in this regard. Where oversight mechanisms are insufficient, the effectiveness of the spending can be thrown into question.[60] As always, co-ordination (to ensure genuine coherence of the international effort) is also vital, particularly now that project implementation units are being phased out as part of agreed aid effectiveness 'best practice'. Misdirected assistance, aid that does not account for its political dimensions, and political incoherence can all have highly negative effects on incremental social processes to improve governance and participation.

Capable and accountable government institutions

To varying degrees in the region, there has been some progress in drafting public sector reform strategies and poverty reduction plans.[61] Yet despite millions spent by the EU and other donors, there still remains an urgent need to improve policy-making and implementing processes across government.[62] Priority areas continue to be building the capacity of public institutions to deliver for the citizens they serve and ensuring the political commitment for them to be subject to public scrutiny.[63] This contrasts with a marked preference among government partners to receive

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58   European Parliament resolution with a European Parliament recommendation to the Council on EU policy towards the South Caucasus 2003/2225(INI) 26 Feb 2004.
59   See the 2005 Paris Declaration on Aid Effectiveness taken up in the European Consensus on Development.
60   For example, in Georgia, the recent $5 million health sector project in Georgia funded by the UK, EU and USAID.
61   In Georgia, about $14 million has been pooled international by the Dutch, Swedish, British and World Bank for public sector reform. With the commitment of the Ministry of Finance, a Public Sector Financial Management Reform Strategy is in place to begin the process of improving public financial management. For example, a single Treasury account has recently been created and medium-term planning framework is in place. In Armenia, Sweden and the UK are helping put in place a MTEF. In Azerbaijan, a new Human Development and Poverty Reduction plan is being drawn up by the government, with World Bank assistance.
62   TACIS spending amounted to EUR 326.5 million from 1991-2004. See Annex.
63   Challenges remain in tackling 'autocratic management, weak delegation of authority, poor communication with the general public, incomplete execution of functions, weak horizontal links between the public institutions, orientations less to do with solving current problems of public importance and more related to the implementation of particular interests'. DFID Drivers of Change analysis, 2002.

equipment rather than use assistance to drive changes in the quality of governance. They tend to seek the economic package without committing to, and driving, concrete political change that establishes a robust separation of powers and a system of checks and balances, which together underpin democratic legitimacy and the Rule of Law.

The implementation of reforms remains one of the most difficult challenges, particularly as regards to the civil service. Progress in this area depends on sufficient will from inside government assisted by pressure from outside it, applied through political dialogue and related to negotiations on economic and security incentives. Twinning projects[64] and the provision of technical assistance through consultants can help but are insufficient in themselves. The EU needs to make a more concerted push in this area through all aspects of its engagement, whether diplomacy or assistance.[65] One obstacle that it will have to overcome is the trend of largely unpredictable personnel changes within governing structures which undermine continuity in negotiations on the provision of assistance and make it very difficult for sustaining the implementation of any initiatives.[66]

Security and justice sector institutions (including customs)[67]

Despite the fundamental importance of what is interchangeably called Security Sector Reform[68] or Rule of Law[69] (or both), international engagement in the region to date reflects the common flaws in approaches to this area. There is a tendency for security sector-related and other rule-of-law assistance to focus too heavily on formal institutions of the executive and on short-term law and order concerns (often misnamed 'security reform'), rather than on key norms and principles of rule of law. It is also symptomatic of an approach in which initiatives are not sufficiently coherent with each other and seem not to be connected to a broader strategy for security-system reform (which, under the OECD DAC definition, includes the criminal justice sector). In Azerbaijan, for example, multiple separate projects are starting up. The Council of Europe is about to initiate a prison reform programme. The OSCE is engaging (at least in the short term, pending funding) on improving the police school, professionalising traffic police and piloting a community policing project in the 'model' town of Mingechevir. The US is running work to improve drug investigations and the EU has just contracted work on customs (under the TACIS Action Plan 2002) and building capacity in the bailiffs and ushers system. There are also activities to monitor trials and open access to the Bar.

The EU has been engaged in the region through both the Community 1st pillar and inter-governmental 2nd pillar. From early 2004 in Georgia, the Commission allocated €4.65m from the Rapid Reaction Mechanism for the rehabilitation of one prison and work on the probation system. €Five million euros out of €27 million in the 2004 TACIS plan was allocated to support the penitentiary services and to assist the Ministry of Internal Affairs on human resources policy relating to the police. In July 2004 the ESDP EUJUST Themis mission in Georgia was initiated (at the request of the Georgian authorities) to assist the reform process in the criminal justice sector. Ten international civilian experts (including judges, prosecutors and penitentiary experts) were deployed, reporting to the SG/HR Solana through the EUSR. The EU also is involved in the region in the justice sphere and in some aspects of police professionalisation (in addition to police work done by the OSCE).

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64   Twinning is used particularly in relations with Azerbaijan which has now prioritised it in the area of transport in order to develop a national transport strategy.

65   In Azerbaijan, in the Tacis Action Plan for 2004 that is currently getting underway, 2 million euros is allocated to institutional development and policy planning out of a total of 15 million.

66   The problem is particularly damaging where changes are political and little attention is paid to the actual capacity of individuals to fulfil the particular function. Discontinuity in negotiation processes was particularly marked in Georgia following the Rose Revolution. The new government, for example, restarted discussions on the Criminal Procedure code which had been running since 2001.

67   The security system includes the justice and penal sectors, customs, police, and military, as well as institutions and mechanisms for control, oversight and accountability. See the OECD DAC Guidelines on Security System Reform and Governance (2005) www.oecd.org/dac/conflict/ssr. See also the SSR concepts agreed by the EU in June 2006.

68   SSR seeks to increase partner countries' abilities to meet security needs in their societies in a manner consistent with democratic norms, human rights and sound principles of governance, transparency and the rule of law. Ibid.

69   There is no internationally agreed definition of rule of law, but the concept first and foremost seeks to emphasize the necessity of establishing a rule-based society in the interests of legal certainty and predictability. The rule of law also operates so as to prevent any abuse of the state's monopoly on legitimate use of force. The basic rule is that public authorities can interfere with citizens' rights only if duly and legitimately authorized to do so.

The EU has, in particular, invested significant energies and funds in the sphere of border management (including customs procedures in line with EU standards).[70] It rightly recognises that improving the legitimate movement of goods and people across borders, and curbing illicit flows, are key to improving regional stability and promoting economic development. However, measures taken must be sensitive to the livelihood needs of the many thousands of people who rely on small-scale cross-border trade to survive. All activities in the area of border management will need tp be conflict and gender sensitive (see www.conflictsensitivity.org), accompanied by poverty reduction programmes for the communities affected, and co-ordinated with the other donors (particularly the United States – USAID, FBI, US Customs etc.).

More generally, a much more concerted, well-funded, and sustained engagement in security system reform (and particularly access to justice) is necessary in order to close the yawning gap between the changes in the legal system on paper, on the one hand, and their actual and perceived enforcement on the other.[71] This means ensuring equality before the law (procedural rules allowing for real and genuine equal access), but also equality in the law (substantive rules allowing for and ensuring non-discriminatory outcomes). Even if the law enshrines the key freedoms, rights and judicial independence that define a liberal democracy,[72] the political will and operational capacity must exist in the security system institutions to enforce it.

The transformation of the security (and justice) system is very difficult to achieve because it will entail changes in key power structures (ministries, police, judiciary, etc.). It affects the distribution of power among key political and law enforcement institutions, both formal and informal, as well as among individuals and groups. However, in the absence of broader structural reforms aimed at the *governance* of the security system (including its financial management), projects to strengthen operational processes, disciplinary measures and individual competencies will only have marginal impact[73] Progress needs to be underpinned by building not only capacity but also integrity in the relevant institutions as well as by reinforcing the interest and capacity of parliament and civil society actors to oversee the sector and articulate people's security needs.[74] If achieved, it will lead to increased trust towards government and civil servants, and confidence in due process under transparent rules and procedures, that is the lynchpin and catalyst for economic activity. It also would permit the more effective delivery on other governance responsibilities, ranging from the protection of citizens and property to the enforcement of environmental regulations and pollution control.

Effective parliaments and other oversight bodies

Engagement in this area is occurring through relatively small-scale capacity development projects, although question marks remain over their ability to effect real changes to current

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70   Border mentoring programme in Georgia involves the deployment of a team of border experts attached to the office of the EUSR who work with the [relevant government ministry] to improve border management. CFSP financing increased from €0.3m in 2003 to €3m for 2005 in view of this deployment. Funds also were made available under 2002 Tacis plan to improve the border management faculty within the police academy, although the overall objective suffered when the Georgian government decided to reduce its operating budget for the police academy.

71   'In Armenia, as in many former Soviet republics, rule of law on paper seldom translates into implementation. Courts act mostly as an extension of the executive…Respect for human rights is equally ambiguous…An activist summarised 'The main problem of human rights here is that there is no justice, and as long as we don't have an independent justice system, we cannot talk about human rights. Violations are usually not of minorities - ethnic,religious but of most of the citizens of this country''. See Crisis Group Armenia Report (2004) p.14-15.

72   The Georgian Constitution, adopted in 1995 (subsequently amended following the Rose Revolution), for example, defines fundamental human rights, including basic freedoms of equality and speech in accordance with international legal standards (articles 12-47). The state undertakes to guarantee equality of development between the different ethnic groups inhabiting Georgia (article 38). Judicial power is formally independent and court proceedings are held in public (articles 82-91). See the DFID Drivers of Change Analysis 2002.

73   OECD DAC Issues Brief on Equal Access to Justice and the Rule of Law www.oecd.org/dac/conflict/issuesbriefs.

74   In Azerbaijan, the OSCE has seen some success from its programme to increase NGO monitoring of trials and, as regards the Collegium (the Bar), the UK and US have sought to pressurise the government into running an entrance exam in order to open up the institution and ensure the access of qualified candidates. The 2006 TACIS plan for Georgia is 20 million euros of which half is going to national border management and work on the procuracy and Ministry of the Interior, and half is going into the health sector and legislative approximation.

systems and practice. Moreover, there is no guarantee that the involvement of Parliament in the early stages of a project will mean that its legislating and oversight roles are reinforced as a characteristic of the political system. For example, while the interaction of the EC with the Georgian government over the criminal justice reform plan involved the legal committee of the parliament in the steering committee, parliament was not involved in approving the strategy nor in the implementation plan.

There is also a risk that, despite laudable moves on paper to establish and strengthen oversight watchdogs (such the donor programme regarding the Chamber of Control in Georgia), such bodies will be used as a tool for the executive to manifest and communicate its power. Equally, these moves must be analysed in full to verify whether or not the 'watchdog' has teeth, and whether the personnel who lead them are afforded the political space in which to carry out their functions effectively.[75] The same is true of the Office of Public Defenders (Ombudsmen) that have emerged in Georgia and Armenia. In the former, the Government has made welcome moves to increase the operating budget and, in June 2006, to involve the Public Defender in an initial investigation into allegations of human rights abuses by Georgian security forces. Some evidence also exists of a desire to give a provincial dimension to this important institution. In Armenia, the optimism which followed a number of initial investigations was stymied by government intervention and the political battle over the post in early 2006.

Strong civil society able to freely voice its views

'Through its actions and priorities, the EU can signal the importance it gives to strengthening civil society. It can signal this through direct consultation and engagement with CSOs in the region, through its policies and programmes, and by the standards it promotes.'[76] The existence of the European Initiative for Democracy and Human Rights (EIDHR), and its use in the South Caucasus, shows that the EU does recognise that it should support the development of a strong and engaged local civil society but it does not yet do so on a scale that reflects civil society's importance (even allowing for the diffuse nature of civil society in the region). Assistance tends to be piecemeal and ad hoc, perpetuating a weak civil society system in which NGOs are often simply small (perhaps one or two person) project implementation agencies. To send the right message, the EU will need to press for an improvement on the low level of civil society engagement that was secured in the negotiation of the Action Plans.[77]

The EU, and other international actors, also needs to clearly communicate their willingness and commitment to press for, and protect, the right of NGOs to operate without fear of oppression or harm. This is particularly critical where NGOs are operating in conflict zones. The responsibility to do so arises not least from the fact that NGOs are often implementing donor-funded projects. Experience, for example, in Georgia has shown that partner ministries can be highly critical of financing that flows directly to local and international NGOs even where the funding stream (Decentralised Co-operation) is ring-fenced away from Commission to Government engagement or where it has come through TACIS funds in support of a peace-process.

In addition, the strengthening of civil society is also one way to help increase public understanding of the EU and improve its credibility among the populations of the region. As the Crisis Group report (2006) argues, engagement in this area will help increase knowledge of the EU institutions and instruments as well as buy-in to its values.

Capable and accountable local self-government

As highlighted at the 2004 Hague conference, local government is an important connection

75 In Armenia, for example, in 2003 the government created the Council on Combating Corruption, headed by Prime Minister Markarian and composed of several ministers, including the justice minister, but it has no right to conduct investigations, and its transparency and efficiency are already being questioned. No serving high-rank official has been prosecuted for corruption.' See Crisis Group Armenia report p.17.

76 See *European Union and Southern Caucasus – Opportunities for Intensified Engagement*, Outcomes and recommendations from a policy dialogue seminar hosted by the Netherlands Ministry of Foreign Affairs & European Centre for Conflict Prevention, 24-26th May, The Hague, The Netherlands.

77 See the Crisis Group report (2006) p.22

between the grassroots and the political elite. Programmes with municipalities should aim to build their capacity to deliver basic services and produce realistic and realisable administrative and operating parameters for local-level economic development. Through municipal development councils, an interest can be built up in policy-making and the motivations necessary to insist that administrations are responsive to needs. Engagement in this area (and the phasing out of the two tier system in line with Council of Europe commitments) needs, however, to be handled with care. Because of the risk that the flaws of the executive committees (which are closely tied to the centre by political and financial commitments) will be transferred to the emerging municipal councils, it must not be rushed.

Although they can be expensive, difficult to implement and occur in a two tier system of centrally appointed executive committees and locally elected municipalities, constructive efforts are underway in the region to engage in this area. For example, in Azerbaijan there are currently a small number of programmes which seek to increase interaction between municipal councils and citizens. In Georgia, a decentralisation process is formally occurring so that village consortiums can elect representatives (although the legislation needs to be closely monitored and its practical extent assessed) and, in an example of an externally funded local governance project, DFID, the EC, UNDP and government are initiating a three-year project in Javakheti to assist local government in evidence-based planning and strategising (with community participation). If it properly accounts for and addresses its political and social impacts, the Millennium Challenge Georgia also has the potential to drive improvements in this area through all the provincial development activities in which it is engaged. In Abkhazia, with EC and Norwegian funding, the UNDP's engagement across the conflict divide seeks to engage local authorities in defining and elaborating strategies for rehabilitation and reconstruction and in developing competences in technical areas such as the management of water systems. The follow-up to the 2006 Needs Assessment on South Ossetia and action subsequent to donors' conference in Brussels also should be orientated towards community-empowerment objectives, which aim to close the gap between local political decision-making and needs and concerns of local communities.

Conflict transformation and resolution (in the conflict zones)

To guard against forum shopping by the conflict parties, the EU should strengthen and support existing processes rather than taking a role as a new mediator. Its role should be 'to support the processes of longer-term transformation and proactively help create conditions that facilitate a political resolution of the conflicts'.[78] The key to this will be to generate a sense of common interests and security across the region's conflict divides.

The principal activities in the conflict zones have so far included (i) support of 9.4m euros to the rehabilitation of the Enguri power complex, shared between Abkhaz and Georgian control, (ii) two phases of economic rehabilitation assistance for Georgia/Abkhazia to be spent over two years, 50 per cent on infrastructure and 50 per cent on capacity development, training and public awareness (iii) three phases of small-scale rehabilitation programmes in South Ossetia, (iv) support to the Joint Control Commission (since April 2001) that runs the Russian-led peacekeeping operation in the conflict zone (and in which the Commission is an observer) and a contribution to the recent OSCE Needs Assessment study, and (v) a declared readiness to support large-scale rehabilitation in the case of a settlement over Nagorny Karabakh and a withdrawal of Armenian forces.[79]

Without equating to recognition, the focus of EU support should be on drawing communities on either side of the conflict divides into constructive relationships[80] through, for example, business-to-business contacts (see below) and municipal-level political interactions (as noted above). A shift in approach would allow more to be done to strengthen the ability of citizens' groups to

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78   See the Hague Conference report (2004).
79   See the website of the European Commission delegation to Georgia and Armenia for more information on EC Assistance in Abkhazia and South Ossetia. Assistance to Abkhazia since 1997 amounts to around 25 million euros. Assistance to South Ossetia since 1998 totals 7.5 million.
80   Suggestions from the 2004 Hague conference included educational initiatives, supporting the exchange of information and upholding international standards relating to the media, economic development assistance and trade initiatives, and support for civil society organisations (within their communities and in cross-border activities). p.21.

demand that authorities are responsive to their needs, generating more positive perceptions of living and governance standards across conflict divides and a sense of common interests (such as over a shared environment).[81] The EC's external assistance aimed at addressing certain structural political and economic challenges in South Ossetia and Abkhazia are a laudable effort to tackle these issues. Programmes have begun which aim to improve the accountability and responsiveness of district level governance and increase access to information enjoyed by citizens. With a long-term horizon, it will be important for the international community (notably the EU and the US) to bolster this kind of work (and to safeguard it through the delivery of clear political messages in Tbilisi, Tskhinval/i and Sukhum/i).

Experience suggests that, given current difficulties encountered in official negotiations over status (epitomised at the Rambouillet summit in February 2006 over Nagorny Karabakh), this positive dynamic is most useful when created at the local level and can be more cost-effective than large-scale infrastructure rehabilitation.[82] Experience also suggests that, because women are less often perceived as being threatening or as being potential combatants, they are often able to work across conflict divides and have increased ability to manoeuvre in deeply divided societies.

International governmental and non-governmental organisations can take the lead in improving the understanding and capacity of local authorities so that they can respond better and more equitably to local needs. They can work to facilitate people-to-people contacts and interactions, such as over common environmental, economic or social concerns. They also can help ensure that the voice of groups that may otherwise be marginalised is heard. Examples of constructive engagement by international organisations include the efforts to bring Karabakh IDPs/refugees into dialogue processes (as through the Consortium Initiative)[83] or business women from either side of the Abkhazia/Gali conflict divide (through the Abkhaz Union of Women Entrepreneurs).[84] In Abkhazia, there seems even to be an emerging interest in European values which could be built on through cultural and educational visits. This stems, in part, from some concerns among ethnic Abkhaz about how to maintain the predominance of their language and culture as Russian influence grows. Civil society organisations, working within their communities and across conflict divides, can increase the awareness of a shared future and mutual self-interest. As noted above, particular attention needs to be given in these contexts to the vulnerability of NGOs, and the projects that they implement for donors, to incidences of violence, threats and the abuse of power. This does not, however, diminish the need for the EU's engagement to be transparent to the recognised governments in the region.

Economy and improvements in the business climate

The second broad priority area for engagement is support for economic development and diversification, especially support to small- and medium-sized enterprises.[85] Even where substantial resources are about to come on-line from the exploitation and transit of hydro-

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81   For example, EIDHR micro-projects targeted towards the Abkhaz conflict zone amounts to 200,000 euros over two years beginning in June 2005. It comprises funds (a) to create an inventory of minority rights and (b) to train young lawyers to monitor court cases with the aim of protecting human rights. Additional small-scale projects are implemented using Decentralised Co-operation (0.95m euros starting in 2006).

82   While a laudable goal, large infrastructure projects across conflict divides (such as the Inguri power station) often require long periods of negotiation. They must also secure a strong sense of local community ownership in order to avoid problems such as the theft of construction materials and a lack of integrity in the provision of rehabilitation materials.

83   The Consortium Initiative is a coalition of three international non-governmental organisations (Conciliation Resources, International Alert and the London Information Network on Conflicts and State-building). It was established to address the conflict between Armenians and Azerbaijanis over Nagorny Karabakh and seeks to put this conflict into a regional framework, locating it in the wider dynamic of the South Caucasus. www.consortium-initiative.org.

84   The Abkhaz Union of Women-Entrepreneurs was founded in April 2002 and is the first and only locally driven initiative to generate business activity in Gali, Ochamchira and Tkvarchali districts. Abkhaz entrepreneurs (mostly women, but also men) work across ethnic divides to provide training and low- or no-interest credits and grants for business start-ups. See the forthcoming publication by International Alert *Local Business, Local Peace: The Peacebuilding Potential of the Domestic Private Sector*.

85   This was also a recommendation of the Hague conference 2004.

carbons, there is an unavoidable need to establish sustainable economic growth. Oil reserves pumped through the BTC pipeline, for example, are expected to last only around 20 years.

Local trade and economic interactions

The EC has made quite significant investments in economic development through TACIS programmes (for example, supporting a 3.5 million euro economic development project in Azerbaijan as well as a two year Caspian littoral business development initiative). This is also an area included in the ENP Action Plans to parallel government initiatives[86] and is the focus of Millennium Challenge programmes in Georgia (and potentially Armenia). However, such investment will be unlikely to have a sustainable peacebuilding impact unless it is (a) implemented using a conflict-sensitive approach (with a full understanding of the fragility, inequity and complexity of the societies in which they take place)[87] and (b) backed by sufficient will and capacity in government (nationally and locally) to ensure that it is sustainable over time (such as the ability to maintain roads and other physical infrastructure once they are built). The extent of MCG disbursements in Georgia and the complexities of the operating environment in South Ossetia make it all the more important for the relevant external funders to apply conflict sensitivity to the design and implementation of development and rehabilitation efforts.

The Caucasus is not a transition economy as we know it and so there is a need to deepen understanding of the distinctive nature of the local economy and separate out those factors that negatively impact on economic development and the overall business climate. Efforts in this area should be accompanied by an increase in social protection,[88] which is largely non-existent for the vast majority of the population (although, as noted above, the shadow economy mitigates the impact of unemployment and the lack of livelihood opportunities). Key issues include:

- *Monopolies:* the EU needs to work with partner governments on this issue which is currently one of the most serious impediments of economic development in the region - 'All the business is controlled by clans, no newcomer has any chance to break in, and the struggle is for huge monopolies, which of course have the support of customs and thus of the state'.[89] The predatory nature of these monopolies, coupled with their political backing, prevents fair competition and further increases the gap between rich and poor. Although anti-monopoly laws are a good start, the benefits flowing from their implementation will be undermined by the absence of measures to generate alternative sources of income or provide adequate social safety net for the people affected.
- *Domestic revenue collection:* Even if incapacity to collect taxes continues to be a significant problem, great care is needed in efforts to tackle it. There are multiple major difficulties with tax revenue collection: inadequate prediction of tax revenues expected, the narrow tax base institutionalised in the tax regime itself and the impunity with which transgressions of the system are tolerated.[90] Taxation changes must not, however, penalise lower-income earners relative to higher earners. Help could be offered to establish taxation regimes that generate economic activity and benefit poor communities rather than benefit specific sectoral interests in the economy who have lobbying power. For example, the internal Georgian anti-corruption/taxation initiative aimed at increasing revenues is currently being met with public protests, as it is impacting first and foremost the poorer population, while failing to tackle corruption amongst the elite.

86   The Baku government has a regional development plan for 2005-2008 in which provincial secretariats will provide business advice to local citizens. It also is looking to promote FDI through an export and investment promotion agency. A Human Development and Poverty Reduction Plan is in the pipeline drawing on World Bank expertise.

87   On the one hand, the actions of external actors of all types challenge existing power structures and impact on societal relations at multiple and overlapping levels. On the other, the democratic and economic processes that they trigger are themselves shaped by an array of context-specific factors which are linked to formal and actual power structures as well as societal relations, cultures and values.

88   The system needs to be overhauled if a viable social safety net is to be created. Reform of pension systems is a priority, while unemployment benefits need to become more easily accessible to justify the small benefits available.

89   See Crisis Group Armenia report (2004) p.16.

90   For a detailed discussion of these problems see United Nations Development Programme, Human Development Report. Georgia (Tbilisi, 1999), pp.25-36.

- *Banking system:* Government initiatives, notably in Georgia and Armenia, and activities by external actors such as the EBRD and the IFC have led to some improvements in the banking sector. However, the development of small- and medium-sized businesses is still impaired by difficulties experienced in accessing credit. Although the transfer of remittances mitigates the problem to some extent, high interest rates and inefficient banking procedures act as a major hindrance to the productive capacities of the sovereign republics and the unrecognised entities. This problem is exacerbated by political events, such as the imposition of sever obstacles to small scale cross-border trade which can rapidly lead to borrowers defaulting on their debts.
- *Regional co-operation:* Proposals for deepened multilateral cooperation are periodically made and formally welcomed, but are undermined by opposing political priorities in the region.[91] To secure continued economic growth, more cross-border economic interaction is desperately needed. Yet, since December 2005, regional economic cooperation has declined further and the engagement of external actors in this area is not yet proportionate to its importance.[92]

International trade

Through the Partnership and Cooperation Agreements with the EU, which also eliminate trade quotas and provide for the protection of intellectual, industrial and commercial property rights, the parties have accorded each other Most Favoured Nation (MFN) treatment. The countries of the Southern Caucasus also benefit from the EU's Generalised System of Preferences (GSP) or GSP Plus. Through the GSP system all three countries can export certain commodities to European markets either duty-free or with reduced tariffs. The PCAs also contain provisions on the elimination of quantitative restrictions and other trade-related matters, including competition and state aids. In respect of Armenia[93] and Georgia,[94] the EU has explicitly recognised the progress of their economies by including them into the category of transition economies. As transition economies, Armenia and Georgia may benefit from a special ad hoc 'market economy treatment'. Georgia is already pressing to start consultations in 2006 on the possibility of a future Free Trade Area agreement with the EU. Azerbaijan has not requested the EU to grant it a 'transition economy' or market economy status in Trade Defence Instrument (TDI) investigations.[95]

The low level of trade will benefit from the EU's initiatives on energy supply and transport routes, Transport Corridor Europe Central Asia (TRACECA) and the Interstate Oil and Gas to Europe (INOGATE).[96] However, for Armenia, there is a real danger that it will remain outside the main economic and trade routes under development in the Caucasus. The blockades imposed by Azerbaijan and Turkey on its eastern and western borders limit access to global markets and make it reliant on the Yerevan-Tbilisi-Poti railway, and the roads north to Georgia, which are Armenia's only access to the Black Sea, Russia and Europe. The dependency is aggravated by the conflicts in South Ossetia and Abkhazia which make train communications with Russia impossible.[97]

91   In attempting to contain their internal conflicts Georgia and Azerbaijan champion the principle of territorial integrity, deploying blockades (on Abkhazia/South Ossetia and Armenia respectively) to support their cause. However, Armenia has a diametrically opposed view on territorial integrity in view of its engagement in Nagorny Karabakh, and both historically and today looks upon Russia as its most important regional guarantor against Turkish aggression. [DFID Drivers of Change analysis, 2002]

92   GTZ is formally still running a regional economic cooperation project in the Red Bridge border regions, but with the decline in trade, the cooperation is not functioning and the work will be phased out by the end of 2006. On-going projects include the OSCE's Environment and Security Initiative supporting regional co-operation on environmental issues (such as its river monitoring programme) and International Alert's Economy and Conflict project.

93   EU trade with Armenia remains limited; in 2003 exports and imports to Armenia amounted to €0.2 billion and €0.3 billion respectively. Armenia's share in the EU's external trade is relatively insignificant: 0.02 per cent in imports and 0.04 per cent in exports (2003). Armenia has been a member of WTO since 2003.

94   Trade between Georgia and the EU remains at a very low level; in 2003 Georgian imports and exports amounted to €0.4 billion and €0.3 billion respectively. In 2003 Georgia's share in the EU's exports and imports was 0.04 per cent and 0.03 per cent respectively.

95   Azerbaijan is the EU's largest trading partner in the Caucasus due to its energy exports. Azerbaijan has an observer status in WTO, and applied for membership in 1999; the EU is giving assistance to help prepare for membership under Tacis.

96   The TRACECA programme is designed to support economic independence (mainly from Russia) for the three South Caucasian states, by creating alternative transport routes and improving existing transport infrastructure, as well as customs procedures, to improve access to European and world markets. The INOGATE programme works towards the regional integration of pipeline systems to facilitate oil and gas transport through NIS states, enhancing safety and security of these networks and supporting the convergence of regulatory frameworks of participating countries to those of the EU. These improvements are meant also to make the region more attractive for IFI and private sector funding.

97   About 80 per cent of Armenian land trade and transportation goes through Georgia, see Crisis Group Armenia report (2004).

How might it be done?

The EU currently has a significant opportunity to establish a coherent and integrated approach to peacebuilding.[98] It has three primary types of influence in its relationship with the South Caucasus: *policy dialogue*, both with governments and other key actors inside and external to the region; *incentives*, such as closer co-operation, preferential access to EU markets or support for loans and investments; and *budget lines* to provide technical assistance and aid for humanitarian and development purposes. It also has less tangible influence through the aspirations of leaders and people of the South Caucasus to be closer to Europe and to the community of values and prosperity it represents. The fundamental question is how these levers can be combined to lay the foundations for long-term peace and stability in the region - respect for democracy (both the structures and mechanisms, such as elections), human rights and market economy principles.[99]

Focussing on its core competencies (and expanding out from them), the EU can use the ENP instrument to engage more strategically on a range of structural issues, strengthening incentives for change and going beyond vague commitments to 'look for further ways in which it could support efforts to prevent and resolve conflicts as well as in post conflict rehabilitation in Southern Caucasus'.[100]

Whether affected through a geographic or thematic approach, assistance to support reform in sensitive areas of national policy (such as rule of law and political participation) depends for its effectiveness on sustained political support from the EU. It should also complement with EU Member State efforts (and vice versa) as well as be joined up with the work of the Council of Europe (including the Venice Commission), NATO (particularly as regards the Individual Partnership Action Plans), OSCE (including its Minsk Group) and the UNOMIG in Georgia. Above all, all eyes need to be trained on progress in *implementation*.

Political dialogue

'*Donors must condition their aid very strongly to real institutional changes, and not to the current cosmetic changes we see today*'.[101]

As noted at the conference hosted by the Dutch Government in the Hague in 2004, 'Although funding is an especially tangible instrument, many of the recommendations and strategies explored here are more reliant on sustained policy dialogue and diplomacy'.[102] The provision of technical equipment and piecemeal interventions in certain parts of the government administration and security (including justice) system will be unlikely to motivate the governance and capacity changes that are required in the region. High-level talks as well as in-country discussions need to pursue these points, with the aim of improving coherence in approaches.

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98   Although negotiations on the European Neighbourhood Policy (ENP) country Action Plans are advancing, the Partnership and Cooperation Agreement (PCA) framework and existing Country and Regional Strategies (CSP/RSP) will continue to structure the EU's relations with the region for at least another three years. Whilst budget envelopes for European Neighbourhood and Partnership Instrument (ENPI) are being finalised, funds can continue to flow to the region because contracts under TACIS and other EC instruments can still be signed until the end of 2007 for implementation until 2008 or 2009.

99   These are the essential elements of the Partnership and Cooperation Agreements, activated in 1999, with each of the three countries of the South Caucasus. For more detail on co-operation steps, see the Crisis Group South Caucasus report (2006).

100   Armenia country strategy paper 2003-2006.

101   See Crisis Group Armenia Report (2004) p.14.

102   See the Hague report (2004) p.17.

Political dialogue is one area where there is clear potential for improved engagement because of the prestige that comes to governing elites in the region with high-level political engagement and the attainment of international standards. For the time it takes for the fragile societies in the region to embed the social contract (of course, this is a *process* and cannot be imposed), this political dialogue should be used to emphasise that:

- Assistance is conditional on the elaboration of and adherence to a credible, coherent and realisable strategy by each government to establish and enforce the principles of accountability and responsiveness and to meet the country's international commitments to democracy, human rights and fundamental freedoms.
- Attention will be consistently maintained at all levels to *adhere* to this strategy.
- Adherence will be assessed not only on the formulation of legislation but also the demonstrable will to implement a strategy to enforce it - identifying and working on the areas where more capacity is needed. Transparency and tolerance of criticism will be important touchstones of progress in this regard.
- Considerable resources will be dedicated ensuring more monitoring, deeper assessments and greater will to sanction non- or cosmetic implementation.[103] The Council Committee on Eastern Europe and Central Asia would need to be fully engaged in pushing the emphasis on monitoring implementation.

One option that is available to the EU is to pursue the same strategy as has been employed in respect of the Ukraine. Here, the Council conclusions of February 2005 established an Action Plan *Plus*, for which the High Representative for the Common Foreign and Security Policy, Javier Solana, and External Relations Commissioner, Benita Ferrero-Waldner, were given a mandate to add extra measures to reinforce the agreed Action Plan. A process was established to do more than simply 'monitor' AP implementation but also to conduct a joint assessment of progress after one year.

Meanwhile, the EU Special Representative should make full use of his mandate[104] and carry this message to the authorities in the region and in dialogue with external partners. He also should ensure that it is effectively communicated to, and through, the region's press and civil society on either side of the conflict divide so as to galvanise internal momentum for progress. The EU must aim to be highly transparent about both what it does and why it chooses to do it that way. One fundamental political message is that local governance and citizen participation needs to be strengthened in *both* the recognised states and the unrecognised entities and that the EU sees the improved performance of local structures and the sustained engagement of civil society as a vital part of the peace process.

Bilateral dialogues with external partners

Russia: As recommended by the 2006 Crisis Group South Caucasus report, the EU should seek to expand its Common Space of Co-operation in the Field of External Security with Russia beyond 'practical co-operation on crisis management in order to prepare the ground for joint initiatives'. It should urge Russia and Georgia to engage in dialogue over common interests such as border control and the environment and to facilitate, not hamper, commerce and investment in the region. EU support to poverty reduction and confidence-building programmes in the North Caucasus could assist Russia in stabilising the situation in the North Caucasus and would help prevent a possible spill-over to the South Caucasus.

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103 The Crisis Group report (2006) also recommends 'clear benchmarks to measure progress; a comprehensive monitoring mechanism established and monitoring reports made public' [p.4]. The Hague conference recommended that 'A rapporteur on democracy and rule of law could be appointed to monitor the situation in the region' and feed into the production of the assessment reports [p.18].

104 Following on from the work of Heikki Talvitie, Peter Semneby was appointed in February 2006 to be the new EU Special Representative to the region. His mandate includes furthering the EU policy objectives of (i) assisting Armenia, Azerbaijan and Georgia in carrying out political and economic reforms, notably in the fields of rule of law, democratisation, human rights, good governance, development and poverty reduction; (ii) preventing conflicts in the region and contributing to the peaceful settlement of conflicts, including through promoting the return of refugees and internally displaced persons; and (iii) encouraging and supporting further cooperation between States of the region, including on economic, energy and transport issues.

USA (including the Millennium Challenge Corporation): Dialogue between the EU and the United States should highlight the potential problems that certain aspects of US assistance in the region could inadvertently cause to the objectives that they both share in the region. In Georgia, for example, the commitment of nearly three hundred million dollars through the Millennium Challenge Account is a particular concern where, despite the laudable intentions and double mechanisms for fiscal control, the receipt of such a large sum (dwarfing other donor aid) risks destabilising a delicate process to establish responsible budgeting and expenditure through a medium-term government plan. Out of a total of $297 million, none of the $168 million allocated to the Regional Development Fund for two infrastructure projects (road and pipeline rehabilitation) nor Rural Enterprise Venture Capital Fund is on budget. The former will, at least, be implemented by a government body (the Municipal Development Fund chaired by the Prime Minister) supervised by the World Bank. The latter fund (worth $35-40 million), however, is effectively a project implementation unit implementing a concept (venture capital) that is, to date, unknown in the country.

The primary concern is that the pursuit of economic development objectives, in the absence of a fuller analysis of the political and social dimensions of MCC disbursements, risks exacerbating problems of governance in Georgia (and, if its Compact is agreed, Armenia). In the South Caucasus, the flow of such large sums of money cannot be removed from the context - where patronage politics and personal relations predominate over transparent rules and procedures, and the already-substantial gap is widening between the wealthy and the poor and marginalised. Large-scale spending will not achieve 'transformational development'[105] without highly robust structures and mechanisms for monitoring and assessment. Currently the rule of law and the voice of civil society seem too weak for these kinds of control to be exercised over the spending. It is, therefore, essential that the EU works with the MCC and its in-country officers in order to mutually reinforce the shared and complementary objectives. The conflict sensitivity of these initiatives is vital in order to maximise positive effects and mitigate potential negative impacts.

Turkey and Iran: The opening of the border with Turkey would have substantial economic importance for the region. It would both assist the traditionally underdeveloped eastern parts of Turkey and provide new markets in the Caucasus for Turkish goods. According to a World Bank study, Armenian GDP, for example, would increase 14 per cent and its export costs to Europe would be cut by 30 to 50 per cent. The EU can use its negotiations over Turkish accession to the EU to push its regional co-operation and regional integration priorities. As regards Iran, once relations begin to allow dialogue on issues other than nuclear proliferation, talks should seek to engage on how to facilitate north-south and east-west trade in the region.

Combining geographic and thematic approaches

The Action Plans
By and large, the broad objectives (such as democratisation and rule of law) of the Action Plans are the right ones, although they need to be pursued vigorously in practice, going beyond the existence of 'codes' and conventions on paper.[106] Genuine progress will depend on how well international actors help address deeply entrenched interests that attach to property, ideas, social advantage, prestige, and traditional ways of doing things. Because activities under the Action Plans are negotiated with the state authorities and assessed in partnership with them,[107] this may open up difficulties where the focus area is politically sensitive and targets the status quo pattern of political and economic power and influence.

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105   See *Five Debates in International Development*, Andrew Natsios (2005).
106   These are to provide support and expertise in the preparation and implementation of key reforms in the areas of democratisation (e.g. electoral laws, decentralisation, strengthening of local administrative capacity), rule of law (reform of penal and civil codes, codes of criminal procedure, strengthening the efficiency of judicial administrations, elaboration of strategies in the fight against corruption), and human and fundamental social rights (legislations protecting human rights and fundamental freedoms, enforcement of international conventions, fight against racial hatred and xenophobia, human right training, enforcement of international conventions on social and labour rights). See the Communication to the Commission [SEC(2005) 1521] from Benita Ferrero-Waldner on 22 November 2005 on Implementing and Promoting the European Neighbourhood Policy.
107   See the Crisis Group report (2006) p.15-17 for more information on the Action Plan process.

Every effort must be made to prevent the parties from paying lip service to the reform priorities. This is because the real test is the degree to which the positive pledges outlined in the Action Plans are actually implemented. Success will depend on the knowledge of the context[108] and how well donors play to the strengths of multiple partners within recipient countries. 'Not all, by any stretch, are found in government. Many are found in civil society, in religious institutions, farmer's cooperatives, and non-governmental organisations'.[109]

- **Capable and accountable government institutions**

  In consultation with existing international actors, and as appropriate in each of the countries in the region, the EU should look to engage and assist in the following areas which are selected from the Drivers of Change analysis in 2002.[110] Research suggests that they remain just as relevant in the region as a whole four years later. Their implementation would require strong political will from the top leadership of the country. Improvements in this area would help to bring an end to the brain drain both from the countries to the West, as well as from governmental institutions to the private sector or international actors (such as development agencies or multinational corporations).

  1. Establish a unified system of civil service personnel management. Laws should be put in place to require civil service employee ranking increase the role of the Civil Service Bureau, and mandate that it coordinate and monitor personnel departments at various state agencies. (In Georgia, an existing donor programme has begun to put in place an electronic system for tracking personnel and their performance and, this can be built on here and elsewhere.)
  2. Optimise the number of civil servants so that it is sustainable in the national budget. This should serve to increase efficiency and create a possibility for increasing salaries. A universal percentage reduction criteria should be avoided. Better budgeting will require an end to the use of 'closed' extra-budgetary funds.
  3. Improve the qualifications of civil servants. Low professionalism and lack of skills are seen as one of the factors driving corruption. It is recommended to elaborate a long-term program with the aim of creating highly qualified public servants.
  4. Institute rules for the recruitment and promotion of civil servants in order to increase public trust and professionalism. Strict procedures for job competition processes should be mandatory, replacing a system where recruitment and promotion are at the discretion of empowered individuals. Vacancies and promotions of civil servants should be published on the internet. Important posts should be advertised in the press. A professionalised Civil Service Bureau (CSB) should have more competences in monitoring promotions which should depend on achieving higher standards.
  5. Establish and enforce standards of behaviour (Ethical Code) of civil servants. Norms of behaviour for civil servants, penalties for violations, and procedures for internal inspections should be laid down and made available to the public.
  6. Raise the status, salaries and guarantees to civil servants in order to increase the attractiveness of the civil service as a career. The firing of civil servants should only be allowed for concrete and proven violations. As far as possible, in-line with public financial management targets, the system of salaries should be improved, such as by placing professional responsibility (and thus career progress) on those whose actions create wage arrears.
  7. Allow secondary employment where this would not counter-act laws on conflicts of interests and corruption.
  8. Improve the verification of financial disclosures and establish penalties for submitting incomplete information.

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108 A framework for Country Conflict Assessment has been developed to guide the setting of strategic priorities and areas of intervention within individual CSP/RSPs. All Commission assistance also should adhere to the commitment to conflict prevention and mitigation which is a cross-cutting objective of all Commission assistance COM(2001) 211, 11th April 2001.
109 *Five Debates in International Development*, Andrew Natsios, Development Policy Review, 2006, 24 (2): 131-139.
110 DFID Drivers of Change Analysis, 2002.

- **Security and justice sector institutions (including customs)**[111]

To sustain progress towards Action Plan objectives (such as strengthening respect for human rights and fundamental freedoms, improving the business climate, combating corruption and fraud or protecting the environment), the EU should seek to forge an integrated approach toward reform of the security (including justice) sector.

Going beyond piecemeal activities on border guards, police or prosecution service, the design and implementation of programmes must be co-ordinated to take into account the inter-linkages among the institutions. Given the gap between laws on paper and enforcement, *the primary focus must be on strengthening the governance of the security institutions (and oversight of their finances)* so that the security service institutions are accountable for their actions and heavily sanctioned for any abuses.[112] The task of professionalising the security services remains extremely important but will not contribute to structural stability in the absence of proper oversight and accountability mechanisms.[113]

One entry-point that could usefully be supported is a consultation process and broad public dialogue framed as a review of the main security fears felt by citizens in their day-to-day life. It would capture, also, their assessment of the ability of current structures to mitigate those fears. Although such a review would be difficult to navigate through the hostilities and negative perceptions evident in nationalist rhetoric, it would act to catalyse reforms and sustain them over time, providing a basis for the development of an overarching national security policy that has political, institutional and public support.

Measures that are needed as part of an integrated strategy (driven by a committed government) co-ordinated by the EU and supported by all external actors are set out in work involving donors in the OECD DAC.[114] Particular emphasis should be given to strengthening structures and mechanisms for holding the security system to account, procedurally and financially. Internally within the security services, this may focus on (i) transparent and equitable disciplinary procedures; (ii) a code of ethics; (iii) mechanisms through which public complaints can be made and effectively dealt with (e.g. Police Complaints Authorities). Another priority will be to provide help for the development of the legal framework and independent capacity to ensure that laws are created, applied and enforced fairly, uniformly and efficiently, according to international standards, to both public officials and ordinary citizens. Better protection from crime and from abuses of state power also will depend on a more effective and professional legal and justice system and increased citizens' knowledge of their rights under law.

It must be noted that, in many cases, work on one institution will not succeed unless complementary work is carried out on others (such as between police and prosecution services, or justice and prison systems). Wherever these links exist, it is imperative to join up the reforms in each area of engagement. In addition, improved salaries will be likely to be an essential component of any activities undertaken and thus require co-ordination with work on public financial management and budgetary oversight.

All assistance in this area should account for the need to build, through the relevant thematic programmes, the ability of civil society to fulfil its 'watchdog' and 'policy advocacy' roles. Progress will depend on how well co-ordinated the international community is in pushing for

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111   For more information on implementation of an integrated approach to SSR, please refer to the OECD DAC guidance currently under development. The conceptual background is available at www.oecd.org/dac/conflict/ssr.

112   This would be in line with the Commission's Communication on Conflict Prevention which pledged to make security sector governance a major plank of its promotion of security and stability on and around its borders.

113   'Control over and support from them rules out serious challenges from other political forces. As an observer told Crisis Group, 'parliamentary and other state structures are only decorative…in comparison to the security structures'…The internal security forces form the other pillar of the Karabakh clan's power'. See Crisis Group Armenia report (2004) p.11.

114   See the OECD DAC Issues Brief on Security System Reform (2006) and ongoing work on the SSR Implementation Framework.

change and how successfully national reformers (including from civil society) have been engaged in the negotiation process.

- **Effective parliaments and other oversight bodies**

The EU can provide support for properly elected and properly functioning legislatures by supporting capacity-building. This might include training MPs and parliamentary staff, developing parliamentary committees, libraries and research services and training parliamentary journalists.[115] The aim is to strengthen the legal framework, within which government institutions (including those in the security sector) operate so that it is in line with democratic norms and procedures and to increase its role in holding to them to account, procedurally and financially.

- **Improving the economic climate**

The economic isolation of the unrecognised entities in the region seems to serve largely to catalyse greater reliance on illegal trafficking and various forms of unregulated exploitation of resources that benefit mafias more than people or ecologies. EU assistance should seek to reverse this tendency for vested interests in the status quo to outweigh pressure for change. This might involve two tracks: (i) greater public awareness of the costs of conflict and the mutual advantages that could be gained from peace (ii) incremental steps to facilitate legal economic interactions including across the conflict divides (such as through access to information on the law, prices etc - see, for example, www.caucasusbusiness.net).

Local private sector interactions (among both men and women) have significant peacebuilding potential - not merely to support the delivery of specific poverty-reducing services but also to engage in advocacy and policy advice.[116] Aspirations to run a successful business increases interest in sustaining peace because the resumption of conflict would risk losing the money and effort invested. It also creates ambitions to access a wider market of potential consumers and catalyse economic cooperation across conflict divide. In addition, joint business initiatives (such as between a Gali Georgian and an Abkhaz from Sukhumi) may operate more easily than a mono-ethnic enterprise. Transparency with authorities as regards the non-political purposes of increased business-to-business contacts will help avoid politicisation. Business associations and resource centres have good potential to be self-sustaining over time. This, of course, is dependent on the conflict sensitivity of the initiative (for example, GTZ experience in the border area of Georgia in areas populated by ethnic Azeris encountered the difficulty that business advisors tended to be ethnic Georgians whom Azeris communities did not wish to access for assistance).

Thematic programmes

To balance out the predominance of states in its outreach to the Neighbourhood, the EU must target its thematic instruments towards ensuring greater public participation in how they are governed and how social services are delivered.[117] The new thematic programmes,[118] agreed by the Commission on 25 January 2006, will be absolutely vital to achieving the (non-geographic) policy objectives of the Union that are not adequately addressed through the geographic aspects of ENPI. These programmes can be used where the goal cannot be fully achieved through the Action Plans that have been agreed bilaterally. They might include, in particular, the programme on Human Rights and Democracy, on 'Investing in People', on Environment and Sustainable Management of Natural Resources, including Energy and on Non-state actors in Development.

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115 See the Hague conference report (2004).
116 See Banfield, J., Gunduz, C. and Killick, N., eds. (2006).
117 Similarly, Crisis Group report (2006) recommended that the EU 'increase public ownership and awareness. Engage civil society in Action Plan finalisation and monitoring – particularly in Azerbaijan. Organize conferences, seminars, and media events. Strengthen parliaments and local authorities' involvement' p.5.
118 Previous programmes included rehabilitation, macro financial assistance, food security, NGO co-financing, aid to uprooted people, and the European Initiative for Democracy and Human Rights.

- **Strong civil society able to freely voice its views**

  It is important that the relevant thematic instruments are carefully combined so as to provide civil society organisations with a reasonable prospect of developing their capacity over time to play more of a role in the elaboration, implementation and oversight of policies.[119] The purpose of doing this is to promote, fertilise, and enable the growth of a vibrant independent non-state sector (including the media) that is able to hold governments accountable to their citizens for their actions and, in the short to medium term, to play the role that the opposition plays in mature democracies. Mechanisms for needs assessment and implementation can be developed with international NGOs in an intermediary function, where necessary.

  Even if NGO assistance needs to be handled with care (as civil society is a product and reflection of the societies in which they function), the EU should provide a channel for multi-year core funding of NGOs with a good track record of achievement and these should be encouraged to bring in other groups and to form alliances.[120] Within conflict-sensitive frameworks that are grounded in an understanding of local actors and power dynamics, the EU needs to:

  a) Move beyond the provision of only piecemeal single year/single ad hoc project assistance to civil society groups. Such assistance must be given enough time to take effect.
  b) Ensure engagement outside the capital and some major cities so that local-level groups can push for more responsive and accountable local administrations.
  c) Pay special attention to ensuring that the voice of women is heard and really listened to. Experience in numerous fragile societies has shown that women's groups can be powerful positive forces for intra-community co-operation. In the Caucasus, there is strong potential to build on the traditional Soviet-era mediation role played by women and harness the logic and political weight that lies behind Security Council Resolution 1325.

  With regards to the follow-up to the Action Plan commitments, there would be significant value in mobilising and empowering civil society to monitor and assess progress, perhaps submitting an annual report on some of the priority areas. Civil society would be supported so as to publicise the benchmarks as well as to consider and communicate the government's progress towards meeting them. The aim would be to generate public pressure for change. This process has been begun in Georgia with an initiative sponsored by the Eurasia Foundation, Open Society Georgia and the Heinrich Boll Foundation, and it should be expanded and reinforced across the region.

  As regards the conflict zones, and in addition to the civil society strengthening and people-to-people contacts outlined above, significant value could added by establishing a mechanism that makes information available on what projects are being implemented. This would help ensure that they reinforce, and do not duplicate, one another.

- **Supporting independent media**

  Only by ensuring public awareness of their government's progress and by generating interest in holding it accountable, will the gap be closed between commitments on paper and the reality experienced by millions of individuals. This is the driving force behind the 2004 Hague conference recommendation that the EU support the establishment of an independent broadcasting regulator in the three countries. It would have the responsibility to 'ensure a pluralistic output of political coverage and transparency in the funding of media outlets,

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119   See the OECD DAC Issues Brief on Civil society, www.oecd.org/dac/conflict/issuesbriefs. The OSCE-funded publication of the Association of Young Economists in Georgia, '*How to cross the state borders of Georgia*', is an example of this kind of useful approach.
120   For example, in the past and in the absence of a EC delegation in Azerbaijan, access of Azerbaijani NGOs to funding from micro-projects of the EIDHR has been greatly restricted. The NGOs that do exist and obtain funding are often more like to be 'one or two person' implementing consultancies.

particularly television stations'. It also could support an independent regional media centre to promote cultural exchanges and people-to-people contacts. In addition, independent media in the NREs are usually more difficult to sustain due to a smaller resource base, although their presence is equally, if not more, important.

- **Capable and accountable local government**

  Governance that is responsive to citizens' daily needs can be pushed from the bottom-up using the 'Non-state actors in development instrument'. Low-visibility engagement with local administrations can gradually be reinforced with a concrete transferral of some power from the centre. Even if certain commitments have been made by governments in the region to move away from a two-tier system of ex-Commissars and municipal councils, this change needs to happen slowly and gradually. The new structures and attitudes need time to develop before expectations and political attention damages their emergence.

  The EU should support gradual, but steady reforms in local authorities' management, including promoting good governance through educational programms. The latter also can allow it to introduce democratisation measures to the non-recognized entities, as local self-government will be needed regardless of the political outcome of the conflicts.

Rapid Reaction/Stability Instrument

The Stability Instrument that will be available for use in the 2007-2013 financial perspective can act, like the RRM, as an emergency instrument in its own right, and as a bridge to longer-term assistance. It can leverage the main EC co-operation instruments with flexible short-term finance from a dedicated budget line. It will be a useful tool to allow rapid mobilisation of Community Funds in the event of a breakthrough in official talks on the status of the non-recognised entities.

Conclusion

Geo-politics, the current state of governance systems, and continuing high levels of public distrust mean that the odds are, unfortunately, stacked against the achievement of maximum positive peacebuilding impacts by the EU. For the EU, the complexity of the context and the breadth of the challenges mean that it must use the principles of the European Neighbourhood Policy to construct a well-crafted, coherent, balanced and sustained engagement in the region.

Geopolitically, the EU's engagement is just one part of a complex picture of international interests and approaches, one which is dominated by issues of energy security and the dynamics of the relationship between the United States and Russia. The former is working towards the objective of 'transformational development' driven by democratisation and economic progress. It also is pursuing national security interests that focus on reinforcing stability and the counter-terrorism agenda in the region. Taking a long-term view, these are not always easy to align. Russia's engagement is determined by its role as a historic regional superpower and its perceptions of how that role should be played. Political, security and economic priorities motivate a desire to strengthen its already substantial influence in the region and exercise its power in the politics of energy. In addition, Turkey is emerging as politically pivotal and increasingly active economically, and this has important implications as regards EU membership negotiations and in the potential position taken by NATO vis-à-vis the region. Iran remains highly influential as a trading partner, and an alternative supplier of energy, and as a consequence of the numbers of ethnic Azeris living within its borders.

Despite some progress and a greater amount of rhetoric, governance in the region continues to justify its characterisation as a place of 'decorative democracy'. There is very little meaningful public participation in policy-making and implementation and there are few signs of commitment or concrete measures to embed a robust separation of powers and ensure a system of checks and balances on the power of strong executives. Political power is exercised by elites and, within an opaque arena, political decision-making is seen to be influenced by powerful business elites. For most ordinary people, however, life involves a struggle to survive, and to work within an economic system that is a combination of 'war', 'shadow' and 'coping' and which is afflicted by systematic corruption. The Rule of Law is too weak or skewed to counter those with vested interests in the status quo, and social safety nets are not in place to protect people from the vagaries of the political and economic system.

One of the consequences of the continuing problems of governance and inequitable access to economic opportunity is that negative perceptions are entrenched across conflict divides. Media coverage and education systems perpetuate these attitudes, and even the most progressive civil society groups are wary of, or hostile to, 'threats' to their political aspirations. Meanwhile, emotions are subject to manipulation by those interested in the status quo, and authorities justify military spending over social spending (sometimes outside of the government budget) in order to counter the perceived threats posed by the other side and their backers.

To counter these root causes of fragility and the risks of a recurrence of violent conflict, international actors will need to work with stakeholders in the region to address deeply entrenched interests that attach to property, ideas, social advantage, prestige and traditional ways of doing things. They need work to change perceptions and to affect system-wide change, politically and economically over the long term. Across conflict divides, people-to-people interactions and economic exchanges can help generate more positive attitudes and drive

prospects for peace. Without implying sovereignty, greater levels of government commitment and external assistance to these processes will help lead to greater prosperity for the region as whole over the long term.

The primary focus of this engagement needs to be the 'social contract', closing the gap between ordinary citizens and the ministries and agencies of the executive. Supported by the delivery of a clear political message on the importance of this objective, development assistance needs to focus on improving the institutions of governance, including those that are part of the security and justice sector, and those at the local level. As much as ministries need to be effective, so too must parliaments and oversight bodies be able to fully carry out their functions ensuring that government is held to account for its actions and fundamental freedoms are protected. Civil society must be free to voice its views and carry out its functions as watchdogs of government actions and advocates of public concerns. Improved governance and improved security (including from abuses of power) will help underpin increased economic activity, locally and nationally, and higher flows of foreign investment into the region. To drive these changes from the bottom-up (as well as the customary top-down), engagement in local-level processes will need to be extensive and sustained.

In engaging in these processes, the EU has at its disposal three principal tools: political dialogue, economic incentives, and external assistance programming. These can be combined to ensure an approach which drives progress towards a number of the core goals which can be discerned in the Action Plans – towards better, more democratic governance, towards the Rule of Law and towards economic development. The sustainability of progress will depend on genuine implementation by the governments concerned. Robust monitoring will, therefore, be vital. Assessment of progress should not just be carried out by the State officials but also by parliament and civil society (including the media). They should be assisted in its efforts to do so and this will mean using thematic instruments to deliver deeper and more sustained support for non-state actors to play their roles. European officials will need to consistently reinforce these peacebuilding efforts through high-level political dialogue. Coherence in the delivery of that message – in the region, in Brussels, in other international for a such as NATO, and with other external partners – will be necessary to ensure that the message is not lost in the web of other negotiations, such as on counter-terrorism, organised crime and energy supplies.

Annex

EC Assistance in the South Caucasus 1991-2004

	Armenia	Azerbaijan	Georgia
EC Assistance 1991-2004	€380m	€400m	€420m
-TACIS	€100m	€116.5m	€110m
-Food Security Programme	€100m	€57m	€70m
-Humanitarian (ECHO and Food aid operations through European Agricultural Guarantee and Evidence Fund)	€120m	€76.2m (including rehabilitation of war damaged areas)	€160m
-Macro-Financial Assistance (balance of payments and budget support)	€28m loans €30m grants		€100m loans €55m grants
CSP priorities to end 2006	€20m for period 2004-2006 Food Security Programme ?21m 1. Support for institutional, legal and administrative reform 2. Addressing social consequences of transition	€30m for the period 2004-2006 1. Poverty reduction 2. support for institutional reform 3. private sector development	€137m for the period 2004-2006 1. rule of law, good governance, civil society 2. poverty reduction 3. confidence building measures aimed at conflict prevention and settlement Commission decision, following a donor conference co-chaired by the World Bank on 16-17 June in Brussels, to double its assistance to Georgia with a pledge of €125 million for the period 2004-2006.
Regional priorities	TACIS regional programme in support of regional transport and maritime initiatives, energy, environment and Justice and Home Affairs (fight against drug trafficking)		
EIDHR	Activities in support of NGOs in Armenia launched 2003 aimed at conflict prevention and resolution.		Civil Society EC-Council of Europe programme judicial reform
Rehabilitation			Abkhazia and S. Ossetia. The EU is the largest international donor in both conflict zones.
CFSP Joint Action			Support to Georgian border guards and Joint Control Commission of the Georgian-Ossetian conflict[121]
RRM			2004 Presidential and Parliamentary elections reform of judicial and rule of law sectors capacity building including Georgian Parliament

121   OJ L 157, 26.6.2003, p.72. Council Joint Action 2003/473/CFSP, 25/06/2005 regarding a contribution from the European Union to the conflict settlement process in Georgia/South Ossetia. Updated