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**Economic Connectivity
in the South-Caucasus: A Post-Conflict Economic Scenario**

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**July 1st, 2016
Vienna, Austria**

Importance of the Research

- Building a **post-conflict** economic scenario
- The future of the region without **Nagorno-Karabakh conflict**
- **Quantifying** benefits of the resolution of Nagorno-Karabakh conflict
- **First** econometric modeling on the subject

Benefits of the Single Market

- Attractive ground for Foreign Direct Investment (FDI)
- Free labour movement in the region
- Free capital movement in the region
- No import/export tax
- Caspian Sea ports linked to Black Sea ports

Research Design

- Econometric Modeling
- **Two stage Least Squares Regression (2SLS) Analysis.** Widely used to analyse the feedback loops (bilateral relations) rather than the unilateral relations among variables. by applying two **consecutive OLS methodologies**, estimates two-way impact among variables, after considering the impacts of control variables.
- Main indicators: **GDP** and **FDI**
- Additional indicators: **Labour force**, **Export**, **Domestic investment**.

Research Design

- The regressions are estimated with following specification and by applying STATA:
- $GDP = \text{Intercept} + b_1 * FDI + b_2 * \text{Domestic Investments} + b_3 * \dots$
- $FDI = \text{Intercept} + b_1 * GDP + b_2 * \text{Exports} + b_3 * \dots$

Research Design

- Regression estimates are tested for (1) **normality**, (2) **multicollinearity**, (3) **heteroskedasticity**, and (4) **serial correlation**, to estimate reliability of the regression results
- Normality tests have been conducted via the **Shapiro-Wilk** and **Jarque-Bera** tests
- The model was run for all three countries separately

Benefits for Georgia

- Low volume of the investment from **outside** of Caucasus
- Azerbaijan is one of the **biggest investors** in the last three years
- Liberal **economic policies** (compared to Azerbaijan and Armenia) – attracting more investment from outside in case of the single market

Benefits for Georgia

- In line with the theory, GDP and FDI in Georgia are **bilaterally related**
- A dollar increase in FDI increases GDP by **11 USD**, and one dollar increase in GDP increases FDI by **0.05 USD**.
- Impact of GDP to FDI is **significant** at 90% and 95% confidence intervals, insignificant at 99% confidence interval. Nevertheless, FDI-GDP relation is significant at 99% confidence interval

Benefits for Georgia

```
. reg3 (gefdi gegdp gedomi gelab) (gegdp gefdi gecapu geex gelab)
```

```
Three-stage least-squares regression
```

Equation	Obs	Parms	RMSE	"R-sq"	chi2	P
gefdi	40	3	80.43699	0.6940	85.58	0.0000
gegdp	40	4	893.1862	0.6411	159.79	0.0000

Benefits for Georgia

```
-----  
              |      Coef.   Std. Err.      z    P>|z|      [95% Conf. Interval]  
-----+-----  
gefdi        |  
    gegdp    |   .0538881   .0259226     2.08   0.038     .0030807     .1046954  
    gedomi   |   1.65e-07   3.71e-08     4.45   0.000     9.24e-08     2.38e-07  
    gelab    |  -342.331   43.81007    -7.81   0.000    -428.1971    -256.4648  
    _cons    |   21479.95  2733.547     7.86   0.000    16122.3      26837.6  
-----+-----  
gegdp        |  
    gefdi    |   11.15379   1.914315     5.83   0.000     7.401802     14.90578  
    gecapu   |  -1.10e-06   3.42e-07    -3.21   0.001    -1.76e-06    -4.26e-07  
    geex     |   .0009818   .0006659     1.47   0.140    -.0003233     .0022869  
    gelab    |   3816.301   484.5884     7.88   0.000    2866.525     4766.077  
    _cons    | -239431.5   30579.24    -7.83   0.000  -299365.7    -179497.3  
-----  
Endogenous variables:  gefdi gegdp  
Exogenous variables:   gedomi gelab gecapu geex  
-----
```

Benefits for Azerbaijan

- Cheap workforce from Georgia and Armenia
- Less military spending
- New safe areas for investment
- Increase of transportation from Russia to Armenia via Azerbaijan

Benefits for Azerbaijan

- A dollar of attracted FDI increases GDP of Azerbaijan by **0.11 USD**
- The increased GDP attracts **5.94 USD** FDI per one dollar increase.
- The relations are significant at **99% confidence interval**. The significance holds even stronger, once model accounts the control variable.

Benefits for Armenia

- Economic Integration with Azerbaijan & Turkey
- Flow of investment from Azerbaijan and Turkey
- Less economic dependency on Russia
- Less dependency on Georgia for transport routes

Benefits for Armenia

- A dollar of attracted FDI increases GDP of Armenia by **0.07 USD**
- The increased GDP attracts **4.06 USD** FDI per one dollar increase.
- The relations are significant at **99% confidence interval**.

Shortcomings

- Shortage of the data
- Shortage of the trustable data
- A lot of political influence on the economic decisions in three countries
- Lower correlation between GDP and FDI, than was expected

Conclusion

- Single Market followed by Free Trade Zone
- Creating economic incentive for sustainable peace
- Politically more united Caucasus

Thank you

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