

PRESS RELEASE

Economic consequences of the Georgian-Russian conflict

Executive summary

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The conflict in **Georgia** over the two separatist provinces **Abkhazia** and **South Ossetia**, their declarations of independence and the official recognition by Russia led to a sharp deterioration of the Russian relations with the West. The **economic** consequences will be serious, impacting not only the Caucasus region proper but likely far beyond. **Georgian** economic growth is likely to suffer, at least in the short run. Overall economic losses, including the damaged infrastructure, loss of output, FDI, lower remittances and exports can be estimated at around **EUR 2 bn**. The speed of recovery will depend largely on the political stability – which is by far not guaranteed. **Abkhazia** has around 340 th inhabitants and was not directly affected by the latest military conflict. The country will benefit from the forthcoming Russian investment and the construction boom in the Sochi region, and her tourism and agricultural potential should help it to sustain as an independent country. A formal accession to Russia at some later point cannot be ruled out either. The tiny newly independent republic **South Ossetia** (with a population of less than 70 th people) has no viable resources to speak of and its chances for the economic sustainability as an independent state are slim - despite Russian assistance. Given the non-viability as an independent country and its possible annexation by Russia (and/or its de facto unification with Russia's North Ossetia), this could lead to further conflicts in the Russian part of Caucasus, in particular owing to Ingushetia (and possibly also Chechnya and Dagestan).

Russia could well be the main medium and long-term loser of the Georgian conflict – although the direct costs of the August war were marginal. The chances for a successful economic diversification and a switch to innovation-based development have now definitely diminished. The main concern is that the recent sharp deterioration of Russian relations with the West will lead to serious repercussions for the future path of Russian economic reforms. The delayed WTO accession will represent an important setback for Russian reforms, also the postponing of negotiations of a new EU-Russia Partnership Agreement will further weaken the position of liberal reformers in Russia. EU-Russia economic relations are dominated by energy: the EU depends on Russian energy deliveries and

Russia is dependent on the EU market for her exports. **South Ossetia** and **Abkhazia** *per se* are unimportant for the world energy markets, yet Georgia proper is an important corridor for energy transit from the Caspian basin bypassing Russia. The conflict might have negative implications for the prospects of Georgia consolidating its role as an alternative (to Russia) corridor for the transit of Caspian oil and gas to Europe. The latter applies first of all to the planned Nabucco gas pipeline. Potentially even more importantly, with the balance of power in the region after the recent conflict seemingly shifting in Russia's favour and given Russia's strong opposition to Nabucco, Turkmenistan may become even less willing to be involved in the project. In a similar vein, Kazakhstan may become less willing to ship its oil via the Southern Caucasus.

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