

# BAKU DIALOGUES

POLICY PERSPECTIVES ON THE SILK ROAD REGION

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# Development or Regression?

## Eurasia's Investment Attractiveness

*Stanislav Pritchkin*

In 2021 the countries of Central Asia and the South Caucasus—some call it Eurasia, other the Silk Road region—will celebrate thirty years of independence. Theoretically, this period should have provided sufficient time for each to have formed a new economic model, set and at least partially attain long-term development goals, and developed a foreign policy model for optimal interaction with investors, including foreign ones. However, the experience of the post-Soviet republics under consideration in this essay, which does not aspire to be comprehensive but should rather be considered a preliminary assessment, indicates that independence is neither a prerequisite for successful development nor one that centers of achieving a sustainable increase in popular welfare.

Despite the fact that in 1991 standards of living and educational and economic attainment in the Soviet republics that are examined in this essay were approximately similar, after three decades of independent development the countries under consideration have been significantly stratified in terms of national wealth, types of political and social systems, and the specifics of their economic activities. Former fraternal republics look today as if they are countries from different continents. Since the breakup of the Soviet Union, some have done very well, others less so.

In considering the economic dimension of independent development, we can assert that, with a few exceptions, these countries have not managed to seriously reform the model inherited from the USSR. Instead of rebuilding their

economies so as to integrate them into global production chains, a majority of them have squandered the industrial potential built during the Soviet era. Consequently, the overall investment attractiveness of these countries remains at a suboptimal level.

Two markers or indicators stand out as effective tools to analyze the systematic work of a state as a responsible actor in domestic economic policy and in penetrating foreign markets: its investment attractiveness and the responsibility of its approach in working with non-state internal and external players.

Unfortunately, it can be stated that, again with a few exceptions, the countries of the Silk Road region have not been able to achieve serious success in creating a competitive, diversified, and open economies with effective systems for protecting private property and investors' rights. Moreover, most Eurasian countries have not even officially set such a goal for themselves. Given contemporary global conditions, characterized by a cutthroat international economic

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environment, none of the states in question can expect high-quality development and improvements of their respective socio-economic situations without building the capacity to attract

foreign investment on the basis of international best practices and a focus on harnessing the latest technologies.

That being said, the growth of investors' interest in the countries of Central Asia and the South Caucasus continues to be facilitated by the systematic development of regional integration projects, as well as transport infrastructure within a number of major projects, such as the Belt and Road Initiative, the Eurasian Economic Union (EAEU), the Southern Energy Corridor, TRACECA, and so on. A final determination to direct investment into a country made by a series of important factors, some of which are featured in an April 2020 report on the investment attractiveness of the countries of Central Asia and the South Caucasus issued by a team of analysts at the Moscow-based ECED Expert.

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The purpose of that study, as well as this essay, is to rank the countries of Central Asia and the South Caucasus by ordering those that are, in the view of this author, the most promising and potentially profitable for investors and safe from the point of view of doing business and protecting property rights. In this case, investment attractiveness was assessed on the basis of an analysis of the development of the region's countries, considerations involving the stability of political institutions, an evaluation of economic potential, and the openness and hard to quantify "friendliness" of each country towards domestic and foreign investors.

The first section of this essay consists of a brief discussion of each of the countries belonging to the core of the Silk Road region, in alphabetical order. This is then followed with a list rank-ordering them in terms of investment attractiveness, with brief explanations provided.

In making my determinations on the positions of countries in the region, I have had recourse

to the macroeconomic stability indices provided by three leading rating agencies—Fitch, Moody's, and Standard & Poor's—as these form the basis for decisionmaking about investments for many investors. The countries with the best and most stable financial systems in the region—namely Kazakhstan and Azerbaijan—have the highest recommended investment ratings of the region's countries. Among the other countries, Georgia and Uzbekistan form a second-highest cluster. The obvious weak participant is Turkmenistan, which has not been included on the lists of ratings agencies for a decade due to a judgment made that the statistics provided by the country are unreliable.

I have also made use of criteria found in the World Bank's annual "Doing Business" flagship reporting series. There we can see that the countries of the region are working to improve their rankings by improving their respective business environments. This work has brought results. Over the past several years, some of the Silk Road

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region countries have significantly increased their presence at the top of the ratings list. Georgia became the region's undisputed leader in the latest report, taking seventh place overall in the global ranking. However, progress in other countries is also impressive. On the World Bank's list of top 40 ease-of-doing-business countries from the Silk Road region we see (in addition to Georgia) Kazakhstan and Azerbaijan. Armenia is in 47th place, which is at first glance impressive but for the fact that only a few years ago it was in 35th place. Uzbekistan is rapidly improving its business environment, moving from 150th place in 2016 to 76th in the latest World Bank report. Kyrgyzstan has fallen in the rankings whilst Tajikistan has moved up quite impressively.

It is also critical to note in this introductory section that political stability, continuity of economic and investment policies, and stability of foreign policy contacts with key trade partners are also important parameters of investment attractiveness for any country. The Central Asia and the South Cau-

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casus countries are largely states in political transition from a socialistic political model. Therefore, the impact of political processes on investment attractiveness is very high. In this regard, the current political situation in all selected countries needs to be taken into account with regards to stability and vulnerability to destabilization; potential foreign policy risks were also reviewed.

All this being said, we can now turn to an examination of each of the countries that make up the core of the Silk Road region, in alphabetical order.

### Azerbaijan

In general, the situation in the country is quite stable: President Ilham Aliyev's team controls the situation in the republic, and the pro-government party has a stable majority in the parliament after its latest electoral victory in February 2020. The main challenge for the political system is managing the ongoing large-scale renewal of the political elite due to the

departure of the older generation of politicians who worked under Heydar Aliyev, the country's former president and father of the current one.

The formation of a new balance of power in the Azerbaijani political system may be associated with the emergence of points of tension between different political groups within the elite. At the same time, the authority and political weight of the president in many ways enables him to effectively stop intra-elite conflicts in time and prevent such internecine episodes from adversely affecting the system as a whole.

The main military and political challenge for the country remains the problem of Nagorno-Karabakh, whose sovereign ownership the republic defends in a long-standing dispute with Armenia. The November 2020 tripartite ceasefire that brought back most of the occupied lands under the direct control of Baku marks an important turning point, but it is not a peace treaty.

On the scale of internal political stability, Azerbaijan is a very stable state, which means that a balanced

political system has been formed in the country, which implies a fairly balanced power vertical, a stable socio-economic situation, and broad electoral support for the country's leadership.

From the point of view of the foreign policy model, Azerbaijan has a pragmatic approach to building relations with major regional players. At the same time, Baku is trying to build equidistant relations with key global centers of power, while having intensive economic ties with all of them. The existence of the conflict with Armenia for Nagorno-Karabakh has been a long-term challenge for consolidating the conditions for the establishment of a healthy investment climate, as each new escalation could have resulted in military risks

for Azerbaijan's energy, industrial, and transport infrastructure. However, the Second Karabakh War has largely mitigated this threat: it brought about not only a military victory for Azerbaijan but also opened new in-

vestment opportunities for internal and foreign businesses. The newly-liberated territories represent new

areas for massive construction and economic development. Meanwhile, in political terms the November 2020 victory against Armenian forces strengthened drastically Aliyev's authority and credibility at home and abroad, making him the most respected leader in Eurasia.

## Armenia

In contrast to Azerbaijan, Yerevan's defeat in the Second Karabakh War brought the political situation in the country to the brink of disaster. Before the start of the war, the internal political situation in the country has gradually stabilized after the revolutionary changes that took place in April 2018. By and large, the team led by prime minister Nikol Pashinyan had never held high positions in government before, although in the wake of popular street protests and with unusually high public support his team quickly gained almost complete control over Armenia's political system (the same could not be said, however, with respect to the military and the civilian security sectors).

The results of the Second Karabakh War, including the terms of the tripartite agreement ending it, were considered disastrous in

many Armenian circles. Immediately after the announcement of the signing of a truce with Azerbaijan with the mediation of Russia, protests began in Yerevan demanding Pashinyan's resignation. With ebbs and flows, these have continued until the present day. An early election has been called, and the prime minister's political future remains uncertain. Armenia continues to face months of political turbulence, with ambiguous prospects for stabilization. Coupled with battlefield and diplomatic losses due to the war, the investment and economic situation in Armenia will remain extremely negative in the medium term.

The border with two of its four neighbors (Azerbaijan and Turkey) remains closed in the aftermath of the Second Karabakh War, although that may change in the time ahead. Relations with its other two neighbors (Iran and Georgia) are not exactly smooth, since Iran itself is under sanctions and cooperation with it does not sufficiently compensate for the closed borders with Azerbaijan and Turkey. Ties with Georgia are also uneven due to the complex nature of relations between Tbilisi and Yerevan's main geopolitical partner, Moscow. Given that only through the territory of Georgia can Armenia trade with Russia and other partners in the EAEU, the country's difficult geopolitical position is obvious.

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## Georgia

The internal political situation in Georgia is currently quite unstable. The positions of the ruling “Georgian Dream-Democratic Georgia” coalition remains vulnerable, despite having a majority in the legislative chamber as a result of recent elections. Over the past few months, the Georgian opposition has organized mass protests, boycotting the work of the parliament, and organizing what it has called “corridors of shame” for members of the ruling elite. A key demand of the opposition is to switch to a proportional electoral system that would allow it, so it says, to compete on more even terms with the ruling coalition. The authorities are not ready to grant this and other concessions. Georgia’s Western partners—the EU and the United States—have so far been entirely unable to break the impasse.

Georgia is also characterized by a difficult socio-economic situation, which is manifested in a sharp depreciation of the national currency, a state budget deficit, and a drop in the standard of living of the general population. The government’s anti-crisis measures do not correspond to the scale of problems in the economy and may be ineffective due to a lack of available material resources. It seems that a high level

of political tension will remain the prevailing reality. The situation may develop according to the most negative scenario, including some sort of revolutionary change of power. Thus, the country’s political stability assessment continues to be very low.

The foreign policy situation for Georgia is no less complicated and tense. The key conflict factor is the loss of Abkhazia and South Ossetia and the support both breakaway territories continue to receive from Russia. This configuration creates long-term foreign policy tension for Georgia, which has to deal with the reality of having a constant conflict with a key economic partner, namely Russia. For the moment, Tbilisi has no choice but to live with this contradiction, putting its political posture above its prospects for economic stability and development goals. In such circumstances, potential economic projects have a significant risk of foreign policy destabilization.

## Kazakhstan

In March 2019 the country’s first and only president since independence, Nursultan Nazarbayev, announced his resignation as head of state and proposed his longtime associate, Kassym-Jomart Tokayev,

to become his successor. (This was later formalized in an election.) Thus, the first ever transition of power in the history of the republic was launched. However, a genuine transfer of power and resulting movement to a post-Nazarbayev era has not yet occurred. Nazarbayev remains at the helm of the country’s ruling party and chairs the state’s Security Council. Kazakhstan thus maintains a sort of dual power situation. On the one hand, Tokayev is the formal president and head of state, but Nazarbayev’s ambitions, political weight, and constitutional powers make him the de facto head of state.

Such a dual power arrangement is quite risky, especially for the political class of Kazakhstan, as it allows different groups to play on the contradictions and differences in the approaches of the two leaders to achieve their particular goals. Moreover, given the presence of several centers of power, Tokayev’s political weight is at a suboptimal level: he has been unable to consolidate his authority sufficiently to fully control all the levers and mechanisms of government necessary for effective leadership. The transition remains ongoing.

In general, Kazakhstan has a stable electoral situation, and the weakness of the opposition assures

it cannot become a serious destabilizing factor. The main risks come from the uncertainty surrounding the final transition of power and the presence of a hidden split in the political elite, hidden tensions in society due to socio-economic problems, and a complex ethnic situation.

The foreign policy model of Kazakhstan, built on the principle of a balanced multi-vector approach, reflects the pragmatic interests of the republic as much as possible. The country remains an important part of key regional integration projects like the EAEU and the Collective Security Treaty Organization (the CSTO), while actively developing relations with other leading centers of power in China, the United States, the EU, and others.

## Kyrgyzstan

The key event in the recent political life of the country took place in October 2020 with the annulment of the parliamentary elections as a result of opposition protests and allegations of vote rigging. The incumbent president, Sooronbay Jeenbekov, resigned after appointing a prime minister who was acceptable to the opposition. After a period

of uncertainty, Sadyr Japarov was elected president in January 2021, equipped with enhanced executive powers endorsed by a constitutional referendum.

The political elite remains divided along regional and clan lines, and the difficult socio-economic situation in the country is such that the new leadership will have trouble stabilizing the political one.

Taking into account the country's socio-economic crisis, one can conclude that there may be a rise in national populism in public policy characterized in part by calls to squeeze out foreign investors and conduct a policy of nationalization. Japarov came to public prominence a decade ago through a lively campaign to re-nationalize the massive Kumtor gold mine, and since becoming president has been sending mixed signals on the issue. Moreover, while Kyrgyzstan is unlikely to withdraw from the EAEU, the possibility of torpedoing some of the country's obligations to the Union remains actual.

Kyrgyzstan's foreign policy model assumes a strong orientation towards the Russian Federation for reasons having mainly to do with economic interests and security issues. At the same time,

Bishkek has relatively stable relations with other world power centers, notably China and the United States. It is also important to take into account the country's high external credit debt, most of which is owed to China. Meanwhile at the regional level, Kyrgyzstan regularly has border disputes with Tajikistan and trade disputes with Kazakhstan, which seriously affects the country's overall investment climate.

### *Tajikistan*

Presidential elections were held in Tajikistan in fall 2020. The country's leader since 1994, Emomali Rahmon, was re-elected yet again. The March 2020 parliamentary elections were also carried out under full control of pro-government parties.

Despite the ruling elite's continuing success in consolidating power, Tajikistan remains a country with a fairly high risk of political instability. This is due to a number of factors, the most important of which are: unresolved economic problems (lack of jobs, a high level of real unemployment, rising import prices against the background of the fall in the national currency, the continuing outflow of Tajik migrants from

Russia); gradual archaization and degradation of the administrative state apparatus, high level of corruption, and links with organized crime; dissatisfaction of regional and clan groups with Rahmon's policies and the unavailability of serious channels for the authorities to receive feedback from society; and the ongoing Islamization of parts of society driven by the possible infiltration of radical Islamist elements from neighboring countries (Afghanistan) and the Middle East (Syria, Iraq).

Tajikistan's foreign policy model is generally quite balanced, with smooth relations with all partners, but sometimes foreign policy factors have an impact on the economic situation and the position of investors. The risk of state insolvency is not just a theoretical possibility. A potentially worrisome precedent was the transfer of rights to a gold mine project to China in the face of the Dushanbe's inability to repay previously received loans.

### *Turkmenistan*

Due to the country's rigid presidential model, the political situation remains relatively stable even in the face of difficulties in the socio-economic sphere. At the same time, the further

deterioration of the economic situation in the context of reduced hydrocarbon export revenues, overborrowing, and the possibility the government will be unable to meet its social obligations may prompt the Turkmenistani authorities to invite new investors and open some sectors of the economy (gas production, in particular), but without changing the conditions for foreign investment. The recently signed agreement with Azerbaijan to jointly develop Caspian Sea hydrocarbons could become an economic game-changer.

The country also faces a complex set of military and terrorist threats related to the situation in Afghanistan. The long, weakly protected border with an unstable country as well as the appearance of Islamic State emissaries in the border areas with Turkmenistan creates a whole range of new risks for Turkmenistan.

Its foreign policy of official neutrality should ideally guarantee the republic equal relations with all foreign policy partners, but in reality the situation is more complicated. Isolation, weak involvement in regional projects, and the insecurity of the long border with unstable Afghanistan do not create the most positive background for investment projects in the country.

## Uzbekistan

The political situation in Uzbekistan remains stable five years after the transition of power and the arrival of Shavkat Mirziyoyev as president. The president confidently controls the administrative apparatus and remains the most influential player in the political system, even in the conditions of liberalization of political and social processes in the country. Thanks to systematic work on reform that are in many ways transformational, Myrziyoyev has a high level of support and approval from the population. The parliamentary elections held at the end of December 2019 showed that despite the presence of five parties, each of which won seats in the legislative chamber, they all occupy their own niches in the existing political system whilst all support the president.

Uzbekistan is becoming a Central Asian success story and is inching towards Kazakhstan. Perhaps the most efficient reference point to gain further details on the achievements of its ongoing transformation, especially with regards to its foreign policy, is to refer the reader to the interview with its foreign minister, Abdulaziz Kamilov, published in the previous edition of *Baku Dialogues*. Here it

is sufficient to underline that trade turnover in terms of volume and geography, as well as investment inflows, have been growing rapidly in recent years.

## Rank Ordering

With this we can now come to rank-ordering the countries that make up the core of the Silk Road region. The country that tops this list is Kazakhstan. Its confident pole position demonstrates that even against the background of the current power transition, the country is developing quite successfully with respect to its neighbors, using geographical transit opportunities and natural resources to nearly optimal advantage.

The country has serious economic potential, a large domestic market of 19 million people coupled with the markets of the EAEU countries, rich reserves of natural resources, a legislative framework focused on attracting investors, a set of programs for the development of a non-resource economy, and, accordingly, the existence of favorable conditions for investors in these areas.

Meanwhile, political risks associated with the uncertainty surrounding the transition of power, the presence of

intra-elite conflict potential, corruption risks, and a complex inter-ethnic situation are relatively low.

Coming in second and third, respectively, are Azerbaijan and Uzbekistan. Virtually tied with respect to the number of points in the aggregate analysis of most parameters, Azerbaijan holds a slight lead due to the duration of its domestic stability and its recent battlefield and diplomatic triumphs. That being said, all three of the Silk Road region's leading states (Kazakhstan, Azerbaijan, Uzbekistan) have a fairly large market, natural resources, and sustainable political models that allow them to realize their economic and investment potential.

In the case of Azerbaijan, positives include: significant resource potential; political continuity and stability; good transport accessibility and developed transit opportunities; a relatively large market (10 million people); an economic policy focused on the admission of foreign investors; streamlined administrative services; and measures to reform the economy, diversify

it, and increase its attractiveness to investors. The main minus is the monopolistic, semi-closed nature of the non-oil economy dominated by major domestic players, but also a high degree of state regulation of the economy.

In the case of Uzbekistan, the positives include a large domestic market (over 34 million people); a diversified economy; the availability of its own resource base;

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political stability; and ongoing efforts to systematically reform the country's economy and create favorable conditions for investors. Disadvantages include: strong state intervention in the economy; a weak financial system; corruption and a burdensome bu-

reaucracy (especially outside the capital); the presence of social contradictions; low purchasing power of the population; and low qualification of labor resources.

Fourth place goes to Georgia, thanks to its past reform successes and the fact that it managed to maintain a high level of transparency and attractiveness to

foreign institutions. Domestic political turbulence has not fundamentally changed this situation, which is all the more impressive given that the country neither has significant natural resources nor a capacious internal market.

Advantages include: favorable conditions for doing business; favorable transit location; relatively diversified economy; and ongoing efforts to strengthen economic and migration ties with the European Union. Disadvantages include: deep structural problems in the economy due to the breakdown of relations with traditional economic partners (e.g., Russia); unresolved foreign policy disputes and secessionist threats (e.g., the conflict with Russia and the situation in Abkhazia and South Ossetia); seemingly permanent political instability; and risks of social protests.

Fifth, sixth, and seventh place go to Kyrgyzstan, Armenia, and Tajikistan, respectively. These three former Soviet republics each offer an inexpensive labor force, limited but important mineral reserves, and a favorable climate for the development of agriculture. At the same time, they are each characterized by underdeveloped infrastructure, a narrow domestic market, corruption and burdensome bureaucratic procedures, state intervention in the

economy, and the lack of real mechanisms for entrepreneurs to protect their rights.

In the case of Kyrgyzstan, specific advantages include: relatively liberal legislation; the work of the authorities to create favorable conditions for investment; an inexpensive labor force; favorable conditions for the development of agriculture; developed light industry and a healthy tourism sector; and the country's participation in the work of the EAEU. Disadvantages include: state interference in the economy; a number of serious precedents pointing to difficulties faced by foreign investors in implementing projects in the country; repeated revisions of previously reached agreements with foreign investors; lack of continuity of the political course; high risks of political instability; spread of Islamist ideology; narrowness of the domestic market; and low qualification of the labor force.

In the case of Armenia, advantages include: a relatively diversified economy; a skilled workforce; and a relatively favorable investment climate. Minuses include: a high risk of political destabilization; a transport blockade; an insignificant resource base; the presence of social contradictions; and psychological issues as a result of losing the Second Karabakh War.

In the case of Tajikistan, advantages include: a low-cost labor force; availability of a number of minerals; and a favorable climate for the development of agriculture. Disadvantages include: poor infrastructure; a narrow domestic market; high risks of political destabilization; corruption and heavy bureaucracy; state interference in the economy; and a lack of real mechanisms for entrepreneurs to protect their rights.

Eighth place goes to Turkmenistan. Despite the presence of large hydrocarbon reserves and the state's enormous transit potential, Ashgabat still has not realized its great economic potential due to its tight political model, which implies serious control over all economic activity in the country.

Advantages include: the presence of large hydrocarbon reserves; high transit potential; political stability and continuity of the economic course; and the adoption of measures by the authorities to reform the economy and maintain stability in society. Disadvantages include: total control of the country by a tight-knit group centered on the head of state over the economy; lack of protection of property rights; high corruption and bureaucratic inefficiency; the danger of the Islamization of society; risk of destabilization due

to the crisis in Afghanistan; and over-dependence on hydrocarbon exports to China for state revenues.

### *Reflecting on the Top Three*

When speaking about the future development of countries, it is important to take into account those that are most important in terms of the readiness of a given state to improve its business environment, namely assessing its development programs and investment policies. These areas—in contrast to the availability of natural resources and the geographical location of the country—are changeable: they can be improved if there is sufficient political will and a corresponding desire to develop properly.

With respect to the countries of the Silk Road region we see that, with rare exceptions, a systematic approach to national development and the setting of long-term goals for economic growth is lacking. The same is true for their respective investment policies. While each of the countries discussed try to nominally have progressive laws protecting the rights of investors at the level of legislation, in practice businesses and foreign investors usually have virtually no real mechanisms and institutions to protect their interests before the state authorities.



According to this important criteria, among the countries of Central Asia and the South Caucasus, at present only three—Kazakhstan, Azerbaijan, and Uzbekistan—are carrying out systematic, comprehensive work to develop their economies and create favorable and comfortable policies for investors. Moreover, while Kazakhstan has traditionally been singled out in the post-Soviet space for its numerous ambitious development programs, Uzbekistan has made a rapid breakthrough in the development and successful implementation of a whole range of industry-specific growth and development programs, which are generally included in its five-year structural strategy.

The ambition and scale of Azerbaijan's economic development programs has been boosted since the announcement of various economic initiatives in the wake of the Second Karabakh War. This gives hope to foreign investors that it may further climb

up the ranks of various surveys in the years to come—but it is simply too early to make definitive predictions. Rising population growth, job creation, and economic diversification remain challenges that, in some ways, Georgia has exceeded in overcoming in comparison to its eastern neighbor, notwithstanding the paucity of its natural resource base.

Here it seems appropriate to say a few additional words about Azerbaijan. In order to realize its investment potential, the

country will need to launch a systematic effort to promote its economy through the organization and participation of investment fora both within the country and abroad. At the same time, Azerbaijan already has extensive experience in holding such events, and it is recommended to focus on attracting medium-sized foreign businesses to targeted areas that have the greatest potential for development: tourism, agriculture, construction, and so

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on. In this regard, one of the most underreported but potentially game-changing factors involves a joint Italian-Azerbaijani initiative that first arose in February 2020 during Aliyev's state visit to Italy to establish an innovative academic consortium spearheaded by the institutional home of Baku Dialogues, ADA University.

With an anticipated program portfolio comprised of applied hard sciences, information technology and computer sciences (including big data analytics), business and engineering, design, food science and agrotech, and

management as well as entrepreneurship, such a flagship project could catapult Azerbaijan to the very top of regional rankings. By combining world-class academics with hands-on tech labs, fabrication facilities, a business incubator, and similar ready-for-the-real-world curriculum innovations, such a project—if successful—would go a long way towards demonstrating Baku's fundamental commitment not just to providing a world-class university education but also to advancing sustainable economic diversification plan and, in turn, help Azerbaijan move up the global value chain. **BD**

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