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# Opening the 'Ingur/i gate' for legal business

Views from Georgian and Abkhaz private companies



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Views from Georgian and Abkhaz private companies

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# Contents

<b>Executive summary</b>	<b>4</b>
<b>1. Introduction</b>	<b>6</b>
<b>2. Research framework and methodology</b>	<b>8</b>
<b>3. Main findings</b>	<b>9</b>
3.1 Political considerations	9
3.2 Business considerations	11
<b>4. Conclusions</b>	<b>16</b>

## Map of region



# Executive summary

Where conflicts persist, political peace processes stagnate, and ties between peoples disintegrate, opening business channels across a conflict divide can change the reality on the ground. It builds trust and enhances mutual security, whilst also boosting the economy and facilitating communication between people. However, if business relations transcend a conflict divide, but are illicit or criminal, they are unlikely to bring about a lasting transformation of the conflict or open up avenues for dialogue on hitherto contentious issues. Some special form of legalisation of cross-conflict business relations is particularly necessary when the status of one of the parties means that the rules of international trade cannot be applied. The regulation of private business activities across the conflict divide may be a first tangible step towards building trust between the two sides, showing credibility to the outside world and each other, and introducing institutional and normative links, thus paving the way for a more sustainable political solution.

International Alert carried out research to find out whether there were pragmatic drivers for cooperation across the Georgian–Abkhaz conflict divide. A series of studies of illicit trans-Ingur/i trade demonstrated that it was regulated more by market forces than by political or security factors. However, its illicit nature meant that it could not contribute to sustainable conflict transformation. Therefore, a Track 1.5 Georgian–Abkhaz format was designed to search for a provisional normative framework that would make economic activities across the conflict divide regulated and transparent. This study analyses attitudes, business considerations, and counter-proposals by private companies on both sides of the Georgian–Abkhaz conflict. The following conclusions were drawn:

- **Politics trumps profit, but in different ways on the Georgian and Abkhaz sides of the conflict**

Both Georgian and Abkhaz businesses regard their side's political position on the status of Abkhazia as final. The prevailing thinking is that political decisions carry more weight than economic ones. Therefore, Georgian entrepreneurs welcome business with Abkhaz private companies largely on the grounds of de-occupation and the restoration of the integrity of the country on a new integration basis, while Abkhaz businesspeople regard business with Georgian partners as an integral part and a consequence of the improved political relations with the neighboring state.

- **A zero-sum approach to the conflict impedes 'outside the box' thinking**

Businesses usually take a zero-sum approach. Few Georgian companies think 'outside the box' on potential economic gains from the legalisation of interaction with Abkhaz businesses while the status of Abkhazia remains contested. Abkhaz companies were more imaginative, but regard business relations with Georgian companies within an equal status framework as the point of departure.

- **Legality and legitimacy of business engagement with the opposite side are key**

Neither side rules out special laws enabling business relations across the conflict divide. Legality is the key factor for Georgians; for the Abkhaz, the moral aspect of business relations is paramount.

- **Private business on both sides is affected by the conflict in different ways**

Georgian entrepreneurs do not see the conflict as a major issue, while Abkhaz businesspeople view lack of recognition as a significant hindrance, meaning that there is more of a sense of urgency to find access to international financial and banking options as well as new markets and suppliers on the Abkhaz side.

- **There are alternatives to doing business across the 'Ingur/i gate' and these matter**

As long as existing alternatives to doing business with the opposite side are sustainable, while resources for investment and innovation remain limited, companies are unlikely to explore new and risky opportunities.

- **Some business sectors would gain from the opening of the 'Ingur/i gate' for legal business more than others**

Among the businesses who will benefit from the opening are transport and logistics companies, certain services and exporters on both sides, and importers, retailers and businesses that need modern equipment and technologies on the Abkhaz side. Overall, Abkhaz companies are interested in the opening of the routes and markets across Ingur/i, while Georgian companies regard Abkhazia as an insignificant market with a criminalised business culture and are more interested in its transit capacity.

- **Size and geography matter**

Small companies close to the conflict line are the most enthusiastic about the possibility of expanding their customer base and buying supplies more cheaply.

- **Risk-to-profit calculations differ on the two sides, intermediaries are indispensable**

Abkhaz companies see the business environment in Georgia as safe, but entrepreneurs may not be comfortable engaging with Georgian counterparts personally, while Georgian companies list crime as the key feature of the business environment in Abkhazia. Companies on both sides would therefore prefer to deal with their counterparts via intermediaries.

# 1. Introduction

Protracted conflicts are characterised by a lack of vitality in the peace process, on the one hand, and – in the absence of an imminent security threat to either side – by an acceptable status quo on the other. A specific challenge in this case is to encourage the two sides to change the status quo in such a way that their positions will not necessarily be strengthened, but will not be weakened either. Moreover, some conflict-related issues such as economic development, isolation, living conditions of the borderland population and minorities, environmental challenges, freedom of movement and the like may be alleviated and even solved.

The economy in the context of conflict is heavily affected by political and psychological factors that may outweigh business calculations and lead to business decisions that may appear poorly grounded, short-sighted and even irrational. The task of de-coupling political inhibitors from economic enablers is challenging, yet proven to be worthwhile as a strategy to achieve conflict transformation. It helps with building relationships and trust and enhancing mutual security, as well as boosting business activities and incomes.<sup>1</sup> The link between revitalisation of economic relations and political concessions, however, is not evident and may not be immediate or causal. For example, regardless of the active economic exchange between China and Taiwan, Taiwanese professionals and businesspeople moving to China on long-term contracts, and mutual investments, politically, Taiwan retains its independence course.<sup>2</sup> Turkish Cypriots are still divided on conditions for unification, just like Greek Cypriots, and politics and security maintain the division, although businesses freely and legally trade in goods and services.<sup>3</sup>

In cases where the two sides are in a deadlock on the issue of the status of a particular territory and peoples, inhibiting development and growth, and where relationships between the sides in the conflict are strained or non-existent, starting business relationships serves the purpose of changing the reality on the ground. It stimulates contacts between people, helps the conflict sides discover each other's humanity, and establishes communication channels, which increases the chances of success for dialogue on the most difficult and contentious issues. Engaging in business relations is a matter of choice and decisions are made on the basis of calculating the risk to benefits ratio.

International Alert has pioneered an analytical approach to the cross-conflict illicit economy in the context of the Georgian–Abkhaz conflict through studying qualitative and quantitative aspects of trans-Ingur/i<sup>4</sup> trade in view of eliciting pragmatic and voluntary drivers for cooperation. This research has demonstrated that illicit business-to-business operations across the Ingur/i conflict divide are a clear market phenomenon, since trade has persisted throughout various phases of the conflict, and economic factors, such as price gradient and supply-demand composition, are more important regulators of trade than political or security factors. On the other hand, there is sufficient evidence that illicit grassroots or lucrative criminal cross-conflict business cooperation does not lead to enduring transformation in relationships between societies and polities, at best conforming to the status

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1 N. Mirimanova (ed.), *Regulation of trade across contested borders: The cases of Taiwan/China, Kosovo/Serbia and Cyprus*, London: International Alert, 2015, <http://www.international-alert.org/publications/regulation-trade-across-contested-borders-en>

2 N. Smith, Taiwan is suffering from a massive brain drain and the main beneficiary is China, *TIME*, 21 August 2017, <http://time.com/4906162/taiwan-brain-drain-youth-china-jobs-economy>

3 J. Galvanek and H. Giessmann, *Everyday resistance to conflict resolution measures and opportunities for systemic conflict transformation*, in J. Burges, O. Richmond and R. Samaddar (eds.), *Cultures of governance and peace: A comparison of EU and Indian theoretical and policy approaches*, Manchester: Manchester University Press, 2016, pp. 159–160, <http://www.manchesteruniversitypress.co.uk/9780719099557>

4 The Ingur/i river is a natural divide between Georgia and Abkhazia.

quo.<sup>5</sup> Furthermore, reversal to hostility happens immediately after the shadow business collapses.<sup>6</sup> Based on these two empirically backed propositions – that trans-Ingur/i illicit trade is economically expedient and that its illicit nature makes it unfit to become a game changer in conflict transformation – a three-dimensional Track 1.5 process interlinking a dialogue platform comprised of Georgian and Abkhaz stakeholders in their expert capacity, research and political advocacy was set up. This was designed to facilitate a joint search for a provisional legal framework that would make economic activities across the conflict divide regulated and transparent.

Private business companies are key stakeholders with regard to the opening of the 'Ingur/i gate' for legal business. This study reveals a spectrum of attitudes, business considerations and counter-proposals with regard to boosting legal business across the current conflict divide by private Georgian and Abkhaz companies.

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5 N. Mirimanova, *Between pragmatism and idealism: businesses coping with conflict in the South Caucasus*, in J. Banfield, C. Gündüz, N. Killick (eds.), *Local business, local peace: The peacebuilding potential of the domestic private sector*, London: International Alert, 2006, <http://www.international-alert.org/publications/local-business-local-peace>; U. Joras, *Companies in peace processes: a Guatemalan case study*, Bielefeld: Transcript-Verlag, 2007; S. Abboud, *Disrupting conflict economies*, Beirut: Carnegie Middle East Center, 2015, <http://carnegie-mec.org/2015/05/19/disrupting-conflict-economies-pub-60224>

6 For the case of the Ergneti wholesale market on the Georgian-South Ossetian divide see T. de Waal, *The Caucasus: An introduction*, Oxford: Oxford University Press, 2010, pp.199–202

## 2. Research framework and methodology

The objectives of the study were as follows:

- To identify sectors that expect profits from the opening of the 'Ingur/i gate' for legal business
- To carry out a cost-benefit analysis on the basis of the perceptions of the companies on both sides (qualitative assessment) and lay the groundwork for a future micro- and macro-economic assessment of the peace dividend<sup>7</sup> arising from a hypothetical regulatory framework (quantitative assessment, modelling)
- To evaluate the relative weight of business and political considerations as part of the assessment of doing business across the conflict frontier
- To evaluate the challenges envisaged by companies in the application of a regulatory framework as well as specific aspects of business operation that ought to be covered in the regulatory framework in order for it to be relevant and facilitative

In-depth, structured interviews with the owners and managers of 24 Georgian and 14 Abkhaz private companies of varying size and geographic locations on both sides of the Georgian–Abkhaz conflict divide were conducted in November–December 2017.

The sectors included agriculture, tourism, transport and logistics, and retail. More specifically, they included car dealerships, education, business consultancy, trading on the stock exchange, accountancy, construction, and various services (tailoring, wedding salons, cosmetic surgery).

We used a qualitative methodology to learn more about attitudes towards the profitability of a regulated trans-Ingur/i business environment. In assessing this hypothetical opportunity, tendencies across sectors and geography were observed.

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7 A. Rettberg, Exploring the peace dividend: Perceptions of armed conflict impacts on the Colombian private sectors, London: International Alert, 2007, <http://www.international-alert.org/publications/exploring-peace-dividend-perceptions-armed-conflict-impacts-colombian-private-sectors>

## 3. Main findings

### 3.1 Political considerations

#### **Political imperative sets limitations on business opportunities, inhibits 'outside the box' thinking**

First and foremost, imagining a situation where cross-Ingur/i business relationships become legal, although the two sides have still not reached an agreement on the status of Abkhazia, was a challenge for all surveyed, but particularly for Georgian companies, which struggled to envisage any possibility of conducting legal business with an illegal entity. Political views, together with seemingly insurmountable legal impediments, plus the inability to reflect on Abkhazia as anything but an occupied territory, prevented Georgian businesspeople from thinking 'outside the box'. None of the Georgian companies were familiar with existing cases of regulated economic relations in the absence of a peace agreement between conflict sides (Cyprus, Taiwan–China and Kosovo–Serbia) except one company that happened to be a branch of a Taiwanese firm.

The Abkhaz companies surveyed were equally unfamiliar with these cases, but had less difficulty imagining business relations with Georgian companies, partly because the question of political status is resolved in their view – they invariably referred to their country and to the rational need to build normal neighbourly relationships with Georgia. Although political and emotional factors are still not favourable for engaging in business with Georgians, Abkhaz companies can see the economic benefits of the 'Ingur/i gate' opening up. Besides, illicit trade across Ingur/i and other business connections with Georgian counterparts is a known fact in Abkhazia, while the majority of Georgian entrepreneurs, except those living in areas adjacent to the divide, are not aware of this trade.

#### **Affirmation of status versus relationship-building as a starting point**

Both the Abkhaz and Georgian entrepreneurs surveyed regard their side's political position on the status of Abkhazia to be final and non-negotiable. Any further deliberations concerning the possibility of interim facilitation of doing business across the conflict divide are viewed through this prism. None of the companies on either side would consider engaging in cross-conflict business activities unless they received a 'green light' from their respective authorities – except for the very few adventurous ones already involved in illicit trade and the equally few opponents of dealing with the other side in any way. Attitudes towards the possibility of engaging in business across Ingur/i ranged from non-objection to active welcoming, given that clear permission from the authorities was granted.

Among those in Georgia that support decriminalisation and facilitation of business-to-business links across Ingur/i before a final political agreement are companies that are geographically close to Ingur/i and that have customers from Abkhazia. However, even Georgian entrepreneurs who support a softening of the Law on Occupied Territories (which prohibits any commercial activity in Abkhazia and South Ossetia including Georgian–Abkhaz interaction) favour the Law's restrictions on doing business in Abkhazia and by Abkhaz companies outside Georgia.

Georgian companies were more conservative in their assessment of this business opportunity and prioritised full legality and security over profits and people-to-people contacts.

The companies ready to engage in business with the other side were nevertheless reluctant to deal directly with individuals and firms, at least at the initial stage, and stated that they would solicit assistance from intermediaries.

### **Georgian and Abkhaz businesspeople regard economic opening in the absence of a political agreement differently**

Georgian entrepreneurs view the benefits of beginning legal business relations across the divide predominantly in the light of the re-integration of Abkhazia as an entity, but also as a way to welcome Abkhaz businesspeople into politically reformed and economically advanced Georgia, a country that may not be familiar to most Abkhaz. The prospect of political re-integration is a motive for some companies to seek closer economic and human links with breakaway Abkhazia. This prospect also makes others resist any rapprochement before the conflict is resolved, meaning that territorial integrity is restored.

Abkhaz entrepreneurs view the benefits which may result from the launch of legal business relations across the divide in the light of business advantages as well as the restoration of secure neighbourly co-existence.

### **The unresolved conflict affects businesses on the two sides differently**

Georgian entrepreneurs do not see the conflict as a source of impediments for their business and list internal legislative and financial obstacles instead. Abkhaz entrepreneurs regard non-recognition as a significant hindrance in the development of their business. Isolation and severely restricted possibilities for investment, banking and entering external markets are listed as consequences of the hardline policy of Georgia and a major impediment for businesses in Abkhazia.

The Russian presence in Abkhazia, both in terms of provision of opportunities for local businesses and influencing the Abkhaz authorities, is believed by the Georgian interlocutors to undermine any rapprochement with Georgia. This is identified by Georgian entrepreneurs as the main obstacle in the way of Abkhaz–Georgian business-to-business cooperation.

### **Abkhaz and Georgian entrepreneurs have different feelings about reaching out to the other side**

Emotional unease and peer pressure are the key disincentives for Abkhaz entrepreneurs. Some think that doing business across the conflict line may defuse hostility and enable society to regard pragmatic and beneficial exchanges favourably. However, for this to happen, doing business across the conflict line needs to be legitimised by society and by the authorities.

For the average Georgian company, the issue of the legality of doing business with Abkhaz companies or in Abkhazia is intrinsically linked to patriotism, and any breach in the law is equivalent to a breach of national interest and sovereignty. Georgian entrepreneurs unanimously subscribe to the state's legal and political framework of non-recognition and de-occupation. Doing business with Abkhaz companies or in Abkhazia in the current legal circumstances is therefore equated with undermining the national interest. This does not preclude, however, a special set of rules and norms enabling business relations with private Abkhaz businesses being made part of the normative space in Georgia.

However, *legality is the main imperative*, which explains why Georgian companies do business with Russian companies and Russian investors are treated like any other investor in Georgia, despite the fact that Russia is an occupying country and that diplomatic relations have been cut off. Doing business with Russian companies

is profitable and legal. On the contrary, doing business with Abkhaz companies is illegal and profits may not be substantial or immediate.

Thus, for Georgian companies, political and administrative factors are dominant in the search for legality and legitimacy when engaging in business with their adversary. For Abkhaz companies, meanwhile, social and ethical factors are more important.

## 3.2 Business considerations

Politics aside, the economic rationale for trans-Ingur/i business-to-business relations does exist on both sides. However, private companies differ with regard to their interest in the possibility of opening the 'trans-Ingur/i gate' for legal business.

Some see this as an opportunity to boost profits, while others do not think this is possible. Another group would rather keep the 'trans-Ingur/i gate' closed in order to prevent unwanted competition. Two factors were definitive in the assessment of the 'trans-Ingur/i gate' as potentially profitable: *new business opportunities* (new markets, possibility for innovation, new suppliers) and the *risks* involved in the exploration of new business (the quality of the business environment).

### Degree of businesses' interest in opening the 'Ingur/i gate' varies across sectors

*Transport and logistics* companies and those that need to expand to currently inaccessible markets and suppliers on both sides have a clear economic incentive. Cargo from Russia may be transported by land to Georgian ports to avoid frequent delays at the Russian port of Novorossiysk. Abkhazia becoming a legal transit territory is of clear interest to Georgian transport and logistics companies. Cargo from Turkey to Abkhazia and from Abkhazia to Turkey could also pass via Batumi and Sarpi.

It has become lucrative for Abkhaz farmers to sell their *hazelnut* crop to their Georgian counterparts after Georgian hazelnuts were allowed onto the EU market, which includes 500 million consumers with high purchasing power in a stable environment.<sup>8</sup>

Abkhaz and Georgian companies that operate in the *retail trade* sectors, selling cars and spare parts, flowers, and agricultural products, where Georgian suppliers have a clear advantage, are interested in mutually beneficial business links. Georgian retailers are competitive suppliers in the Abkhaz market, offering a better quality-price ratio compared to offers from Russia and even Turkey due to the costly and irregular transport options.

New tomato and cucumber businesses in Abkhazia cater to local consumers and upscale hotels on the Abkhaz Riviera as well as Russian supermarket chains. There are cheaper and lower quality Turkish tomatoes and cucumbers entering Abkhazia directly from Turkey and via Georgia across Ingur/i, and they have their market as well. Since the tomato market is at the early stage of diversification, new farmers are aware of the potentially detrimental impact of an unrestricted flow of Georgian tomatoes and think that a possibly temporary protectionist policy may be required, but in the long run they think the market will stabilise. At the same time, since Abkhazia itself does not produce sufficient volumes of *agricultural products*, such as cheese and other dairy products, fruit, and vegetables, like potatoes, the demand for Georgian products remains at its highest during the summer months, when over a million Russian tourists visit Abkhazia.

8 In June 2014, Georgia signed an Association Agreement introducing a Deep and Comprehensive Free Trade Area agreement with the European Union and with the EFTA countries (Switzerland, Norway, Iceland and Lichtenstein). For more information, see <http://ec.europa.eu/trade/policy/countries-and-regions/countries/georgia>

Among those in Abkhazia that support the idea of legal business-to-business links across Ingur/i are service companies that require affordable new technology, professional training and equipment for innovative business development. Plastic surgery clinics, beauty salons, dressmakers, wedding boutiques, construction services and florists are some of the sectors that indicated their interest in linking up with Georgian counterparts to receive training in new skills and obtain technology and supplies.

Service providers from Georgia (education and professional training, trading on the stock exchange, accounting and auditing) could easily, and at a minimal cost, gain new customers even without setting up an office or physically crossing the divide, by setting up online courses, virtual trading and occasionally sending individuals to give lectures or courses.

There are also companies on both sides that do not see any positive impact of the opening on their businesses. For Georgian companies, Abkhazia is an insignificant market and its business environment is regarded as criminalised. The risks therefore outweigh the potential profits. Interestingly, a company that supplies agricultural products exclusively to the Russian market via the only open land connection at the Upper (Verkhny) Lars checkpoint did not express interest in exploring hypothetical transit via Abkhaz territory and instead suggested improving the road network, by building more tunnels, for example. This response was indicative of the choice in favour of difficult but familiar conditions versus possibly less difficult but unexplored conditions for operating one's business.

Abkhaz companies that enjoy a dominant position on the market because of their exclusive relations with suppliers from third countries that send their goods via Russia oppose the idea of letting Georgian companies operate in Abkhazia, because they fear counter-supplies of identical products (international brands) or more competitive goods originating from Georgia. The market in Abkhazia is small, but not saturated with goods and services. Therefore, a supply of cheaper goods from the Georgian side would break monopolies and lower prices, while the possibilities for Abkhaz companies to manoeuvre, lower prices, invest in new kinds of business or improve the quality of their products are extremely limited due to unaffordable bank loans, limited access to external markets and lack of investment.

The competition that opening up the 'Ingur/i gate' would introduce is regarded as potentially destructive by companies that have carved out their niche in Abkhazia's tourist industry and which cater to a particular category of Russian customers who are satisfied with the price and quality of service. They fear that hotel chains and better quality services would squeeze them out.

### **Proximity to the conflict divide and size of company matter**

Georgian companies residing in the regions adjacent to the conflict divide, some of which already have Abkhaz customers, express strong interest in legal expansion into Abkhazia in order to withstand strong competition at home. Companies from the regions close to the Ingur/i divide see business opportunities for themselves, but also for the ethnic Georgian population in Abkhazia. Abkhaz companies in the areas adjacent to the Ingur/i divide are also more willing to engage with their Georgian counterparts.

Small companies on both sides which have a low turnover and struggle to sustain competition, when loans are inaccessible and the purchasing power of customers they cater to is low, regard the possibility of expanding their customer base and receiving cheaper supplies as beneficial.

## Alternatives to doing business across the 'Ingur/i gate' matter

Neither side appeared desperate to engage in trans-Ingur/i business relations, because both have developed viable business alternatives.

Georgia trades with the world, and is an open economy. It ranks 16th in the 2016 World Bank's Ease of Doing Business index, 13th in the 2017 Economic Freedom Index, and 59th out of 128 global economies in the Global Competitiveness Report.<sup>9</sup> This creates favourable conditions for importers (90% of goods enter Georgia with zero customs duty). Georgia has concluded Free Trade Agreements with all its major trade partners, including with the EU and EFTA, Turkey, Armenia and most recently China.<sup>10</sup> The main obstacles to improving the profitability of private businesses in Georgia are unaffordable loans, competition in some sectors with foreign business companies that enjoy privileges over local firms, and a lack of professionally trained staff, especially in technology, IT, and engineering.

Abkhazia's isolation was eased after a series of agreements<sup>11</sup> between the Russian Federation and Abkhazia came into force. Russia recognised Abkhazia as an independent state in August 2008, which provided a legal framework for Abkhaz companies to sign official contracts with Russian companies, including distributors of some global brands, and eliminated customs duties.<sup>12</sup>

Improved opportunities to trade and do other business with or via Russian companies has significantly expanded the horizons of Abkhaz companies, giving them a new sense of the possibilities ahead. Business relationships between Russia and Abkhazia did not change immediately after the 2008 recognition of Abkhazia as an independent state by Russia. Various barriers for doing business across the 'Psou gate' (at the Psou border crossing with Russia) remained in place until 2013. Russian customs officers had been deployed as mobile inspection teams in Abkhazia to monitor the operation of Abkhaz customs in 2009. They left in 2013 after professional relationships improved and a sufficient level of trust was established between the two customs bodies. Besides, with Russian assistance Abkhaz customs managed to make progress in modernising its operation, both in terms of technology and professional discipline. Corruption, which had been the major impediment for Abkhaz companies who wanted to take goods and supplies across the Psou border, decreased after the abolishment of customs payments, hence the procedure where a paying party was in direct contact with the collecting party was not in place anymore.<sup>13</sup> Processing of the paperwork accompanying goods in the port of Novorossiysk destined for Abkhazia accelerated significantly after a special team of brokers was assigned by Russian customs to deal with cargo going to Abkhazia.

Importing goods from third countries and the distribution of some international brands in Abkhazia became possible via Russian companies or branches of international brands registered in Russia. Cargo for Abkhazia arrives at the sea port of Novorossiysk, while the final destination is marked as 'Russia, Sukhum' or 'Russia, Abkhazia' and then transits Russia to Abkhazia. This is in compliance with Russian legislation and in contradiction with Georgian legislation. Joint Russian–Abkhaz companies encounter even fewer hurdles in doing business with counterparts outside Abkhazia.

9 World Bank Group, *Doing business 2017: Equal opportunity for all*, Washington DC: World Bank Group, 2017, <http://www.doingbusiness.org/reports/global-reports/doing-business-2017>; T. Miller, A. Kim, *2017 Index of economic freedom*, Washington DC: The Heritage Foundation, 2016, <https://www.heritage.org/international-economies/report/2017-index-economic-freedom-trade-and-prosperity-risk>; K. Schwab (ed.), *The global competitiveness report 2016–2017*, Geneva: World Economic Forum, 2016, <https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1>

10 Georgia, China sign historic free trade agreement, *Agenda.ge*, 13 May 2017, <http://agenda.ge/news/79386/eng>

11 Stronger strategic partnership with Russia crucial for Abkhazia-Khadjimba, *Interfax*, 20 December 2017, <http://www.interfax.com/newsinf.asp?y=2009&m=12&d=9&pg=4&id=799336>

12 Not all customs duties were abolished. See the 2012 agreement between Abkhazia and Russia on the mode of trade in goods, [https://docs.wixstatic.com/ugd/789eb6\\_b5844c3d8d284032b5c50a1b742a4328.pdf](https://docs.wixstatic.com/ugd/789eb6_b5844c3d8d284032b5c50a1b742a4328.pdf)

13 As per the agreement on zero customs duties between Russia and Abkhazia. The Chamber of Commerce and Industry of the Republic of Abkhazia: *Treaty between the Russian Federation and the Republic of Abkhazia on trade regime*, 2015, <http://www.tppra.org/en/documents/treaty-between-russian-federation-and-republic-abkhazia-trade-regime>, accessed 8 February 2018

Improvements in the organisation of the crossing of Russian tourists to Abkhazia has led to an increased flow of customers for Abkhaz hotels and tourist companies.

However, regardless of the obvious progress, Abkhaz companies do not regard the situation at the Russian border as fully satisfactory and report arbitrariness and corruption at the customs offices. And the high customs duties that Russia levies on imports inflate the final prices of supplies and goods originating from third countries that Abkhaz companies purchase in Russia and bring across Psou. The opening of the 'Ingur/i gate' would create an alternative to the 'Psou gate' and provide Abkhaz companies with supplementary transit routes and cheaper supplies from third countries.

Delays of shipments from Turkey remain a big problem for Abkhaz companies, since direct connections with Abkhaz ports are illegal according to the Georgian Law on the Occupied Territories. This means journeys are irregular and risky and that it is hard to predict arrival dates. This creates major problems for retailers and local courier companies.

The main obstacles to the development of business in Abkhazia, especially outside the retail trade, were identified as lack of access to affordable new technology, expertise, lack of access to loans and other financial resources and the need to purchase supplies and services on a full pre-payment basis.

Overall, economic incentives to do business across Ingur/i are stronger among Abkhaz companies than among their Georgian counterparts. Georgian companies' interest is invariably described in abstract and general terms. This could be attributed to their low interest in exploring Abkhazia as a new business destination and the fact that they enjoy a range of legal, safe and lucrative alternatives. In contrast, Abkhaz entrepreneurs tend to be better informed about business opportunities that would emerge across the conflict line should the necessary legal framework be built. Dependence on Russia as a market, source of supplies, political ally and guarantor of security, on the one hand, and Georgia's persistent non-recognition policy on the other limit knowledge, innovation and investment – and hence impede the development of businesses in Abkhazia.

### **Risks relative to profits are asymmetric on both sides**

Abkhaz entrepreneurs regard the Georgian business environment as stable, transparent, and low-risk. Some of the Abkhaz entrepreneurs surveyed used to do business with Georgian partners or are currently engaged in illicit trans-Ingur/i trade, and are ready to restart this work on a legal footing. In contrast, Georgian entrepreneurs assess the Abkhaz business environment as criminalised, unstable, and high-risk. Transport companies and suppliers from Georgia are concerned about guarantees, including the insurance system on the other side, and the physical security of people and cargo.

Georgian companies think that Russian influence on the Abkhaz authorities and the Russian military presence in Abkhazia make potential trans-Ingur/i business links vulnerable. In their view, Russia's decision with respect to the possibility of business activities across the conflict divide as well as on the conflict overall is key, but hard to predict.

### **Key issues affecting the model of legalisation of trans-Ingur/i business-to-business relations**

The companies surveyed raised the following issues that need to be factored into a potential regulatory framework for doing business across Ingur/i:

- How can an Abkhaz company be incorporated as a client into the Georgian payroll/payment system, and how can it be proven that the money is transferred for services provided?
- What authority should issue certificates of origin, and how should place of origin be named ('Made in Abkhazia', 'Made in Georgia' or something else)?
- How can the freedom of movement of people, goods, and capital be implemented?
- If there is to be asymmetric access (i.e. protectionism in certain sectors), who will regulate this and how?
- How can security of investment be guaranteed?
- How will insurance of goods and cargo be provided?

## 4. Conclusions

### **Politics trumps profit, but in different ways on the Georgian and Abkhaz sides of the conflict**

All businesses regard their side's political position on the status of Abkhazia as final and non-negotiable. With few exceptions, no company would engage in cross-conflict trade without permission from their authorities. In both cases, the most popular line of thought is that politics comes before the economy, and business follows political decisions.

Georgian entrepreneurs see the benefits of legal trade with Abkhazia as advancing the re-integration agenda and as a way of welcoming the Abkhaz people into a reformed Georgia. Abkhaz entrepreneurs, on the other hand, see the benefits more in the light of business advantages and the restoration of good neighbourly relations.

### **A zero-sum approach to the conflict impedes 'outside the box' thinking**

Businesses are not familiar with ways of regulating economic relations in the absence of a political settlement around a contested entity. Therefore, they tend to take a zero-sum approach: any deviation from the political position is tantamount to a concession.

Few Georgian companies were interested in – or capable of – thinking 'outside the box' on potential economic gains from the legalisation of business interaction with Abkhaz businesses while the very status of Abkhazia remains contested. On the other hand, Abkhaz companies were more imaginative, not least because they appeared to be following developments in the business environment and were better informed about business opportunities in Georgia. However, they regard business relations with Georgian companies within an equal status framework as the point of departure.

### **Legality and legitimacy of business engagement with the opposite side are key**

Neither side rules out special laws enabling business relations across the conflict divide. Legality is the key factor for Georgians, whilst for the Abkhaz, the key factor is whether they have moral objections to doing business with Georgians. Political and administrative factors are dominant for Georgian companies, while Abkhaz companies are more inclined to take account of social and ethical factors.

### **Private business on both sides is affected by the conflict in different ways**

Georgian entrepreneurs do not see the conflict as a major problem for their business, listing legal and financial obstacles instead. However, the Abkhaz regard lack of recognition as a significant hindrance to the running of their businesses, due to lack of investment, few banking options, and limited external markets. Therefore, there is more of a sense of urgency to find new markets and suppliers on the Abkhaz side.

### **There are alternatives to doing business across the 'Ingur/i gate' and these matter**

Access to alternative markets, suppliers and sources of investment will affect the readiness of companies to explore new and potentially risky cross-conflict business opportunities. Security of investment, access to affordable loans, and a stable income are valuable because companies on both sides have limited room for

manoeuvre when exploring new business ventures. As long as existing alternatives to doing business with the other side are at least sustainable, while resources for investment and innovation remain limited, companies are unlikely to explore new and risky opportunities. There is a general lack of long-term planning on both sides, especially in Abkhazia.

### **Some business sectors would gain from the opening of the 'Ingur/i gate' for legal business more than others**

Companies involved in transport, agricultural production, the retail trade and the service sector see a clear economic incentive in terms of market access, shorter routes to market, more competitive prices, and access to technology. But other companies currently dominant in their sector oppose the inevitable increase in competition. Overall, Abkhaz companies are more interested in opening up routes and markets across Ingur/i, while Georgian companies regard Abkhazia as an insignificant market with a criminalised business culture, but regard its transit capacity as valuable.

### **Size and geography matter**

On both sides, small companies close to the conflict line that struggle to compete on the market are the most enthusiastic about the possibility of expanding their customer base and buying supplies more cheaply. They have a clear advantage in terms of a shorter crossing distance and familial ties across the conflict divide.

### **Risk-to-profit calculations differ on the two sides, intermediaries are indispensable**

Attitudes towards the possibility of doing business across the divide ranged from non-objection to active welcoming, if clear permission from the authorities was granted. Business thinking and risk-to-profit calculations are coloured by perceptions. Whilst Abkhaz companies see the business environment in Georgia as orderly and safe, the idea of direct business dealings with Georgians is assessed with caution. Georgian companies, on the other hand, list crime as the pervasive characteristic of the business environment in Abkhazia. Thus, private companies on both sides would prefer to deal with their counterparts via intermediaries.

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