

## **Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector**

### **Case study South Caucasus\***

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## South Caucasus

# Between pragmatism and idealism: businesses coping with conflict in the South Caucasus

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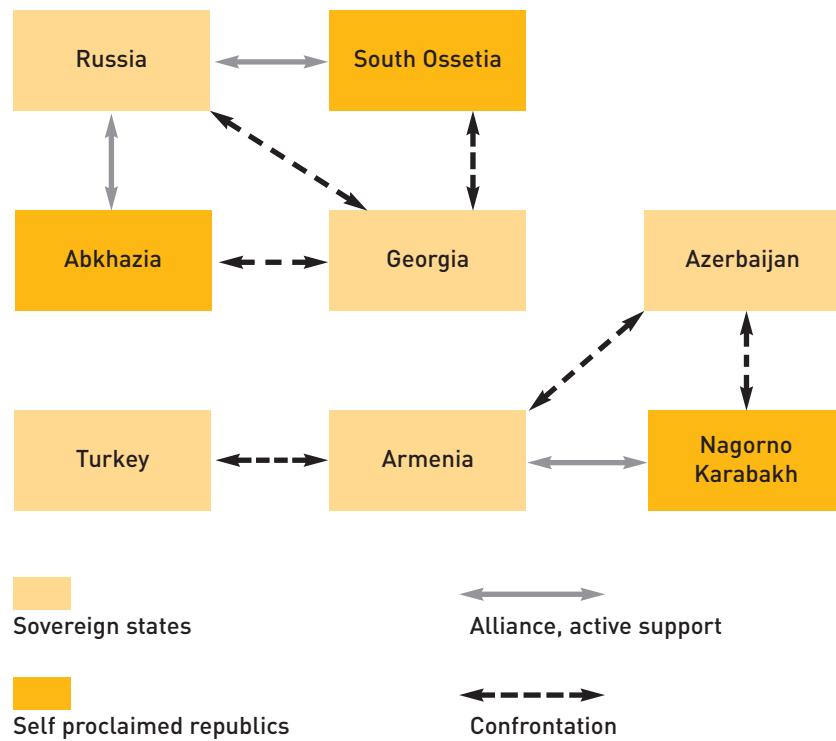
This report explores the role that local private sector activity can play in addressing the conflicts of the South Caucasus. It is based on qualitative interviews conducted with a range of entrepreneurs, both formal and informal, carried out in 2005. It embraces three unresolved conflicts: the conflict between Armenians and Azeris over Nagorny-Karabakh; and the conflicts over Abkhazia and South Ossetia that challenged Georgia's territorial integrity.<sup>1</sup>

All three resulted from the break-up of the Soviet Union. Despite its peaceful dissolution, the newly independent states in the South Caucasus all experienced some degree of violence. The turmoil in Georgia was linked to the escalation of internal conflicts with the autonomous regions of Abkhazia and South Ossetia, while the unilateral secession of Nagorny-Karabakh – a predominantly Armenian region in Azerbaijan – sparked a war between the latter and Armenia. An overview of the conflicts is provided below, together with an outline of the current political context and the private sectors. These are followed by examples of local business activities that have the potential to contribute to peace in the region. A schematic map of the region showing conflict dynamics is presented as Figure 1.

### Economic impacts of post-Soviet conflict and transition

The armed conflicts born from the collapse of the Soviet Union were accompanied by looting, robbery and arms trade profits, but by and large they were not profit-motivated. However, the post-conflict 'prolonged ceasefire' situations, accompanied by economic blockades on the non-recognised entities by the recognised states, created

**Figure 1 – Conflicts in the South Caucasus region**



an environment conducive to the growth of semi-legal business activities. These in turn became a serious obstacle to conflict resolution, as this report explores in detail.<sup>2</sup>

After the collapse of the Soviet system, the successor states underwent hasty privatisation processes that were non-transparent and ultimately predatory. The spoils of the most profitable industrial and mineral extraction enterprises were divided among top-level bureaucrats and associated mafia groups. Large businesses were concentrated in the hands of the few and remained profitable throughout the armed phase of the conflicts and even afterwards.

With regard to smaller businesses, while the private sector had not officially existed in the Soviet Union, entrepreneurial spirit thrived underground, manifesting itself in the small-scale production of clothes, shoes, private medical services and trade. Its informal character had implications for the ways in which it was able to adapt to the post-Soviet environment.

Small businesses suffered throughout the ‘hot’ and ‘frozen’ stages of conflicts as military escalation, the closure of trade routes, inflation, corruption and an unfavourable investment climate affected their operations. The state failed to adopt an active role in safeguarding emerging small and medium private sector businesses in both the recognised and self-proclaimed republics. On the contrary, state institutions – customs, border guards, police and other layers of bureaucracy – all sought to extract bribes, deterring entrepreneurs by perpetuating an atmosphere of lawlessness and mafia rule. The lack of domestic and external investment into small and medium enterprises (SMEs) compounded the constraints imposed by this environment.

The costs of prosecuting the conflicts led to economic crises on all sides. Armenia’s GDP decreased by approximately 60 percent from 1991-93,<sup>3</sup> and in Azerbaijan it fell by 63 percent between 1989-95.<sup>4</sup> There are no reliable statistics on the economy of Abkhazia but GDP in 1994 was assessed at 14 percent of the pre-war level.<sup>5</sup> Georgian economist experts estimated Abkhazia’s GDP in 2001 as 10 percent of the pre-war level.<sup>6</sup> Georgia experienced immense economic hardship, galloping inflation and high unemployment rates along with dramatic declines in the quality and reach of social services. On the outbreak of war in 1992, Georgia’s GDP had already declined by 40 percent and in 1994 it was assessed at 23.4 percent of the pre-war level.<sup>7</sup>

### Economies of the non-recognised entities

Following ceasefire agreements across the region, the non-recognised states fell significantly behind the sovereign states in economic development, largely as a result of their isolation. The World Bank, European Bank for Reconstruction and Development (EBRD) and International Monetary Fund (IMF), for example, being mandated to deal only with internationally recognised states, actively assisted Georgia, Armenia and Azerbaijan with funds and advice regarding economic transition, but left the unrecognised states to their own devices. Abkhazia and South Ossetia received support from Russia, which helped to rebuild their banking systems and currencies;<sup>8</sup> Nagorno-Karabakh, which shares the same currency as Armenia, developed its own distinct economic laws and regulations, and receives support from the Armenian diaspora.

In the current context of unresolved conflict, interaction between businesses in non-recognised entities and those in recognised states has a strange ‘semi-legal’ status that is peculiar to the region. What is legal under the codes of the unrecognised states may be illegal in the states from which they have seceded. For example, trade across the disputed border of South Ossetia qualifies as smuggling in Georgia, while it is defined as legal international trade for the breakaway enclave. In Nagorno-Karabakh, cross-border trade with Azerbaijan is non-

existent because it is a high-risk enterprise, but Azeris and Armenians trade with one another in Georgia.

Despite their isolation from international institutions, the economies of the *de facto* states are developing along their own course. Nagorno-Karabakh presents a vibrant economy that thrives despite its unrecognised status. Private companies from the Armenian diaspora are actively investing in industry, services and agriculture. The volume of industrial production grew by 15 percent in 2002 and 38 percent in 2003, while increases in agricultural production exceeded 26 percent in the same year.

Meanwhile tourism in Abkhazia has been going through a modest renaissance. The quality of services is well below the level of Soviet times, but the inflow of low to middle-range tourists from Russia is growing fast. Russian and Turkish businesses have renovated hotels on the coast, and Turkish firms are engaged in the export of timber and scrap metal. International organisations are now beginning to explore the possibility of contributing in the realm of economic development. UNDP recently published an assessment of the prospects for introducing micro-finance as a means of fostering SMEs in an environment where – despite Russian and Turkish investment – the banking system is not well developed, interest rates are high, government support is minimal and personal savings are non-existent.<sup>9</sup>

South Ossetia remains the poorest of the breakaway republics with no sizeable investments at all. GDP per capita in South Ossetia is \$250.<sup>10</sup> Customs duties on the import and export of goods to and from Russia make up 90 percent of the republic's budget,<sup>11</sup> and Russia pays pensions and provides other social subsidies to the population.

### Economies of the recognised states

Economic development in the recognised states is more visible, though it relies on currency flows from the oil sector in the case of Azerbaijan; grants and credits from the US in the case of Georgia; and inputs from the diaspora in the case of Armenia. All three are members of the World Trade Organization and the World Bank is present through its Poverty Reduction Strategy.

Azerbaijan's oil sector provides 39.4 percent of the country's GDP. The key internal stakeholders are the state and the big Azeri businesses politically allied with it, which means that the sector is concentrated in the hands of the ruling elite. There are few incentives to make oil revenues transparent or to use them for sustainable economic growth and poverty reduction.<sup>12</sup>

Azerbaijan experienced 9.9 percent growth in 2001 and 11.2 percent in 2005. The non-oil sector has the potential to create jobs (the oil sector currently employs only

1-1.5 percent of the economically active population),<sup>13</sup> with agriculture, trade, construction and transport primarily in the hands of the private sector.<sup>14</sup> However, the non-oil sector lacks economic and political influence. The Asian Development Bank recently identified ‘weak protection and enforcement of property and contractual rights, cumbersome licensing procedures, corruption, and limited access to, and high cost of, bank credits’ as key obstacles to expansion.<sup>15</sup>

Armenia’s economy has similarly been characterised by high growth rates in the past few years: 13.9 percent in 2003 and 10.1 percent in 2004. Agriculture, industry and construction remain the lead sectors in the composition of Armenia’s economy.<sup>16</sup> GDP per capita grew from \$740 in 2002 to \$1,104 in 2004, but the gap between earnings in the capital, Yerevan, and at the periphery has increased over the same period. A large number of Armenians seek employment in Russia, and their remittances account for a significant share in the country’s income structure. Remittances accounted for 6.7 percent of annual economic growth between 1994 and 2002, according to official data.

GDP per capita in Georgia has increased from \$410 in 1995, to \$692 in 2000 and \$927 in 2003. Corruption and the shadow economy were major obstacles facing the economy under the post-war presidency of Edvard Shevardnadze. The new government of President Mikhail Saakashvili enjoys substantial financial support from the US and international donors. Georgia’s current spending priorities are the armed forces and the energy sector, while privatisation of large state-owned enterprises is high on the economic agenda.

### Overview of private sector engagement in peacebuilding in the South Caucasus

The cases presented in the following sections are mainly of micro to small and medium businesses, as well as informal economic actors, such as market traders. Many of these are based in border regions, meaning they are closer to ‘the other side’. Their size and proximity to the ‘front line’ holds dangers as well as opportunities since they are most exposed to immediate conflict impacts. Due to their location and size, they have no access to policy makers in the capitals to communicate their concerns. It also holds opportunities, as due to their vulnerability to conflict, these entrepreneurs feel an urgent need to address conflict issues, such as socio-economic inequalities.

Their location has led them to maintain contacts with ‘the other side’ out of sheer socio-economic necessity. However, material motivation was not always the sole driving force. Many demonstrate tolerance towards those who used to be their neighbours and ended up on the ‘wrong side’ of the conflict. The convergence of business and human dimensions ensured surprising sustainability of their risky

enterprises. While national-level discourses in the political sphere and the media on ‘the enemy’ continue to fuel the conflict, their day-to-day contacts have provided for continuity in pre-war relations and interactions that yield a ‘win-win’ situation for all involved. The final section presents some recommendations as to how such contacts can be strengthened to further promote peace in the region.

## **Georgian entrepreneurs in Gal/i:<sup>17</sup> seeking cooperation with the Abkhaz private sector**

### **Georgian-Abkhaz conflict overview**

The history of the Georgian-Abkhaz conflict is one of competing nationalisms. Economic grievances were not the driving force, but were woven into nationalist aspirations. The Abkhaz claimed to be economically disadvantaged, believing Georgians reserved the best jobs, while central government failed to invest in Abkhazia’s industrial development. Similarly, Georgians in Abkhazia were upset at what they saw to be the disproportionately high quotas of jobs given to Abkhaz in the ministries and other institutions.<sup>18</sup>

The rise to power in Georgia of the ultra-nationalist Zviad Gamsakhurdia in 1990 and the measures he adopted, such as a decree that Georgian would be the only official language, were deeply threatening to the minorities in both Abkhazia and South Ossetia. In August 1990, the Abkhaz Supreme Soviet declared Abkhazia’s sovereignty in the absence of ethnic Georgian parliamentarians. Street protests, some marked by violence, indicated an emerging conflict throughout 1991. In March 1991, the Abkhaz voted in favour of preserving the Soviet Union in a Soviet referendum that Georgia boycotted, opting instead for independence.

Abkhaz demands for equality within a federal state met with Georgian resistance despite some concessions. The Abkhaz leadership launched a campaign to remove ethnic Georgians from positions of authority against a backdrop of mounting hostility between the two camps backed by armed groups, one of which was Gamsakhurdia’s personal guard. Gamsakhurdia was ousted in January 1992 by warlords with whom he had reportedly failed to make a deal. Shevardnadze, an agreeable figure for both Moscow and the emerging Georgian National Guard, was granted the presidency without a popular vote.

Following three years of increased tensions between Georgians and Abkhaz in relation to the Georgian Independence Movement and the break-up of the Soviet Union, in August 1992 open hostilities broke out when the Georgian National Guard entered Abkhazia. The resulting war was devastating to all communities in

Abkhazia. In 1993, supported by volunteers from the North Caucasus and by Russian heavy weapons, the Abkhaz drove the Georgian forces and the remaining ethnic Georgian population across the Inguri River.

Several ceasefire agreements failed until November 1993 when the two sides signed a Memorandum of Understanding in Geneva. A Commonwealth of Independent States (CIS) peacekeeping contingent consisting of Russian blue berets was deployed to the conflict zone. In 1994, the governments of Georgia and the Abkhaz authorities signed an agreement on the Voluntary Return of Refugees and Displaced Persons under the auspices of the UN, Russia and the UNHCR.

Since then several armed skirmishes and hostage-takings have occurred in Gal/i district, an overwhelmingly Georgian-populated part of western Abkhazia. Georgian paramilitaries and Abkhaz gangs that neither government effectively controls continue to be the major threat to security in Gal/i.

Russia's economic influence is abundantly apparent in Abkhazia. Moscow has issued passports to the majority of Abkhazia's people and funds social welfare expenditures. Together with Turkey, it is the only importer of Abkhazia's timber, citrus and wines. Russian private and state-affiliated capital has a substantial presence in Abkhaz tourist resorts and wine production. Georgia regards this as unfriendly behaviour since the CIS approved an economic blockade of Abkhazia in 1996. Russia was the first member state to violate the blockade.

The Georgian-Abkhaz peace process has been diverse, involving various international NGO and inter-governmental organisations, an international peacekeeping contingent, the governments of the conflicting sides and third parties, local NGOs and community groups. Dialogue and problem-solving workshops have continued under the aegis of various US and European academic institutions, involving youth, academics, women, environmental activists, journalists and ex-combatants.

In 1997, the UN facilitated the establishment of a Coordinating Council as a forum for negotiation between the two sides. Chaired by the Special Representative of the UN Secretary General (SRSG) to Georgia, it consists of three working groups dealing with security, IDPs and refugees. Assistance with social and economic issues is also on the agenda and a few projects were implemented with international or bilateral funds. The SRSG mainly provides 'good offices' and communication channels for officials from Georgia and Abkhazia to meet and talk.

The official peace negotiations have not yielded any significant rapprochement. Abkhazia insists on full sovereignty and international recognition, while Georgia offers membership in a two-member federal state, but without a separate army.<sup>19</sup>

These two approaches are incompatible. Throughout negotiations the Abkhaz leadership attempted to impose a piecemeal approach by discussing economic issues, such as energy and transport, before going on to address the core issues of the status of Abkhazia and the return of Georgian IDPs/refugees. Re-opening the railroad from Russia, via Abkhazia and Georgia, to Armenia, is top of the Abkhaz agenda and economically vital to Georgia as well, but talks have idled because Georgia insists on the return of IDPs as the priority issue. The IDPs from Gal/i strongly opposed Georgia's engagement in the railway negotiations before the issue of their safe return had been resolved.<sup>20</sup> Abkhazia resists this approach because it fears that any return to the pre-war demography, when ethnic Georgians significantly outnumbered Abkhaz, would skew the popular vote in any referendum on Abkhazia's future status. A UN Needs Assessment Mission to Abkhazia in 1998 came to the conclusion that the CIS blockade of Abkhazia had a negative impact on the peace process by solidifying the political positions of both sides.

In 2004 a document was submitted to the National Security Council of Georgia that outlined a federal solution to the conflict in which Abkhaz residents would be granted joint Abkhaz and Georgian citizenship, but Abkhazia would not be recognised internationally.<sup>21</sup> The plan foresees a quota for ethnic Abkhaz in the Georgian parliament that would assure equal representation. Abkhazia would set its own taxes and duties, but would pay certain revenues to the Georgian exchequer. Special bank notes of Georgian currency, bearing Abkhaz symbols, would circulate in both Abkhazia and Georgia. Georgian IDPs would be free to return and the international community was invited to assist in a resettlement programme. Abkhazia rejected the proposal and still insists on full independence.

At the end of 2004 a group of Georgian civil society leaders presented a proposal to transform the Georgian-Abkhaz conflict by creating a special economic zone stretching 30 km along both sides of the Inguri River, the *de facto* border between the conflicting sides.<sup>22</sup> The zone would be managed by a joint Georgian-Abkhaz administration and monitored by representatives of the international community. If implemented, the measure would boost revenues for both sides by opening the trade routes from Turkey and Iran to Russia, which currently form part of the shadow economy. Although the proposal has not been rejected outright, Georgian and Abkhaz politicians have not considered it formally.

With the accession to power in Abkhazia of Sergey Bagapsh in January 2005, Georgia anticipated some change of direction. However, President Bagapsh recently reiterated Abkhazia's aspiration to become an 'associate member' of the Russian Federation and the population is likely to be awarded Russian citizenship in the near future.<sup>23</sup>

## Economic links despite the ‘frozen’ conflict

All economic cooperation between Georgia and Abkhazia takes place in the realm of the shadow economy. The only exception is the Inguri hydroelectric complex, which was split down the middle at the end of the armed conflict with the plant in Abkhazia and the dam in Georgia. Both are heavily dependent on Inguri for electricity and so, of necessity, they agreed a project for joint management of the facility. In October 1998, the EBRD allocated \$38.5 million to finance reconstruction of the Inguri complex. As a condition, it required Georgia and Abkhazia to sign a Memorandum of Understanding and to allocate management positions equally between both sides. Observers have noted the peacebuilding potential imbued in this kind of cooperation: “Engineers and managers working on the Inguri complex, and politicians believe that this joint management effort is leading the peace process, not following it, and could become a model for cooperation in rebuilding railway, communication and transport ties, but to date there has been little tangible influence on other areas of cooperation.”<sup>24</sup>

Despite the ongoing sensitivity to discussing the other critical opportunity for cross-territorial cooperation – the railway from Russia to Georgia through Abkhazia, which also connects Armenia – the Georgian government has finally put economic interaction with Abkhazia on its agenda. After years of opposition to the restoration of the Sukhum/i-Tbilisi rail link, Georgia has decided to enter the railway talks.<sup>25</sup>

## Conflict consequences in Gal/i district

Over 250,000 Georgians were displaced from Abkhazia during the armed phase of the conflict, with Georgians from Gal/i district constituting around one third. Georgians were an overwhelming majority in Gal/i prior to the war (93.8 percent in 1989). In 1998, long after the military phase ended, 30-40,000 Georgians still remained, soon to be joined by a spontaneous return of IDPs. These returnees were labelled ‘traitors’ by the Abkhaz ‘government in exile’, which consists of ethnic Georgians from Abkhazia and is influential in Georgian politics. At present the number of Georgians in Gal/i is estimated at around 50-60,000.<sup>26</sup>

Georgians in Gal/i complain of Abkhazia’s discriminatory educational policy and their limited participation in political affairs. Crime, the lack of basic security and minimal income-generating opportunities underpin daily life. The authorities cannot alleviate conditions because the scale of poverty is wide and resources scarce. There has been zero investment due to a volatile criminal situation in which the identity and affiliation of the gangs that terrorise Abkhaz and Georgian alike are rarely clear. As one interviewee recounted: “If it is known that a father has received a parcel from his son who’s working in Russia, burglary is almost inevitable. It’s usual that the entire harvest is taken from the peasants.”

Nonetheless, the new president, Sergey Bagapsh, declined a proposal by the SRSG to open a UN human rights office in Gal/i, claiming that the Abkhaz enforcement agencies were already working to combat crime.<sup>27</sup> However, the government clearly lacks the resources to improve security significantly or, many believe, any motivation to re-integrate returnees into Abkhazia's politics, economy and culture. A law in October 2005 effectively denied citizenship to Gal/i Georgians by setting five years' unbroken residence as its main condition.<sup>28</sup> This excludes a significant number of returnees and all IDPs in Georgia. For those who do qualify, Abkhazia permits dual citizenship only with the Russian Federation so ethnic Georgians have to abandon their Georgian citizenship to qualify.<sup>29</sup> Currently, a quarter of the residents of Gal/i hold Abkhaz IDs, which are basically old Soviet passports with a special form attached. Most also hold Georgian passports, though this is rarely publicised. As a result, under Abkhaz electoral law, only a quarter of Gal/i Georgians can vote and the remainder is disenfranchised.

### Gal/i entrepreneurs: a bridge between Georgia and Abkhazia?

In Soviet times, Gal/i was a flourishing district, with industry and a developed agricultural sector. There were canneries, a tea factory, poultry farms, a timber factory employing 2,000 people and the Inguri hydroelectric plant. Residents also grew fruit and vegetables and Gal/i was an important regional food supplier, accounting for more than 50 percent of Abkhazia's total agricultural output before the war.

Gal/i's private sector at present is a peculiar combination of large-scale smuggling of scrap-metal, petrol and cigarettes with Georgia, and small-scale trade across the Inguri River.<sup>30</sup> Under Georgian law, it is illegal for goods to cross the border so traders are required to bribe gatekeepers on the Georgian side. Abkhaz customs officials and border guards also take advantage of traders' vulnerability to line their pockets every time they cross the river.

Gal/i, along with Ochamchira and Tkvarcheli districts, is the most underdeveloped part of Abkhazia despite its long tradition of superb agriculture. However, agricultural equipment has either been destroyed or stolen since the war, or simply worn out. Farmers have no transport to take their crops to market, even to the nearby city of Gal/i.

Residents of Gal/i admit that the private sector is at a primitive stage of development. The majority survives on whatever their gardens, woods and pastures provide – dairy produce, vegetables, fruit, nuts and honey. They receive little assistance aside from humanitarian aid from the Georgian government and directly from international organisations, and even this is far from stable or sufficient.<sup>31</sup> Georgia receives substantial assistance for IDPs who live in western Georgia, but

returnees to Gal/i and Georgians who never left receive no help for their reconstruction needs or business activities.<sup>32</sup> The small proportion of Gal/i residents who teach or work in the city administration receive ludicrously low wages from the Abkhaz government. The business community in Gal/i district does not qualify as small, but rather as micro-business, as the businesspeople themselves admit. The private sector does not generate much employment, with the number of hired personnel rarely exceeding a handful per business.

Gal/i holds a twice-weekly market, but most farmers cannot sell their produce due to lack of transport. Instead, they sell to wholesalers who profit from the higher margins. Re-selling agricultural crops is the most popular business in the district, but farmers are so preoccupied with survival – and so suspicious of one another – that cooperation does not yet appear an option. Other private sector activities in Gal/i are bakeries and mini-shops. Most goods and non-agricultural products are bought in Georgia for resale in Gal/i. Occasionally Gal/i farmers take nuts, honey or pork to sell in Georgia where they receive a higher price than in Abkhazia.

One group of Gal/i Georgians is keen to do joint business with Abkhaz from other regions. Gal/i Georgians, who have received support from the Abkhaz Union of Women Entrepreneurs, are among those eager to expand their business activities beyond Gal/i region. They had practical suggestions in interviews: “Let’s make our internal cooperation a reality and only then look outwards and create business links with Georgians who reside in Georgia”; and “We could reconstruct the cannery [that’s been abandoned] and start a mini-cannery together with [Abkhaz] entrepreneurs from Gudauta or Sukhum/i.”

#### The Abkhaz Union of Women Entrepreneurs

A group of Georgian small enterprise owners from Gal/i district were at the early stage of starting businesses at the time of the research, having received preliminary training and financial assistance from the Union of Women Entrepreneurs, a Sukhum/i-based NGO that runs a grant programme for small business projects in Gal/i.

The Union of Women Entrepreneurs was founded in April 2002 by a group of enthusiasts led by an Abkhaz businesswoman, and involves successful entrepreneurs, mostly women, but also men. Their businesses include hotels, farms, construction companies, trade and others. Since its inception, the organisation has developed into a resource centre and a business incubator for SMEs in Abkhazia.

The Union’s aim is to assist women entrepreneurs with training and low or no-interest credits and grants for business start-ups. To date, it has implemented

projects in partnership with the UK Department for International Development, International Alert, the Swiss Agency for Development and Cooperation, the Swedish NGO *Kvinna till Kvinna*, UN Volunteers and UNHCR. So far, several training courses and 15 small businesses have been the outcomes of these projects.

The organisation is one of a few prominent Abkhaz NGOs, and is staffed by ethnic Abkhaz. However, it is committed to SME development throughout Abkhazia and across ethnic divisions. The head of the Union of Women Entrepreneurs was the driving force behind an initiative to involve Georgian returnees in Gal/i, Ochamchira and Tkvarchal/i districts, where poverty levels and war devastation are the highest in Abkhazia. The widening gap between the rich and poor, and between the regions, creates a potential for violence. The divisions between haves and have-nots coincide with ethnic division, which is dangerous in a society that has been through violent conflict.

The project pioneered a series of trainings and a grant competition for start-up entrepreneurs in Gal/i. Their first trainees included owners of a small gift shop, a tailoring business, a bakery, a small poultry farm and a centre offering free and paid training courses. The pilot training and grant competition project were started with finance from members of the Union with no external assistance.

It is the first and only Abkhaz initiative to try to generate business activity in a district with a Georgian population, and where there is no other private sector input or development. Leaders of the Union say their motivation is the development of an independent private sector in Abkhazia, because they believe that private initiative, hard work and enhanced skills will provide affirmation and hope to entrepreneurs. It is their hope that these entrepreneurs will become the pioneers who break the cycle of hardship and helplessness, and ensure a breakthrough in the Abkhaz economy.

Ethnic Georgian entrepreneurs have a variety of motives for creating joint ventures with Abkhaz businesspeople. First, they do not see Georgia as a profitable or safe market. Since the closure of Ergneti market at the border with South Ossetia in September 2004, the largest source of smuggling, Georgia has tightened its border with Abkhazia.<sup>33</sup> Small traders and food producers barely cover their subsistence needs after paying bribes to customs officials on both sides of the Inguri River. “It is other people who are welcome in Georgia: they transport metal and gasoline to Georgia, they have their people helping them. Our profits are nothing compared to theirs,” said one Gal/i entrepreneur. In the view of another: “They are the business people, who form part of the corrupt networks that embrace the authorities and criminal circles.” Interviewees did not believe that ordinary Abkhaz or Gal/i

Georgians could do business with Georgian entrepreneurs. “The main reason is that our [Abkhaz] government prohibits this.” This belief persists regardless of the fact that no explicit law forbids trade with Georgia.

Local entrepreneurs were acutely aware of the need to maintain peace: “We need to restore relationships between the Abkhaz and Georgians in Abkhazia. Nothing can do it better than joint business.” According to another interviewee: “Many of us have lost our property, the houses were burnt down. But there is no war anymore, and this is what matters the most. We will rebuild our houses.” Another said: “Let the ‘frozen’ conflict persist rather than have another war. When there is peace and people are not dying, we’ll always find a way to survive.” They are confident that the greater the number of people engaged in the private sector, the less the chance that war will resume. “People who have got a business are neither angry nor aggressive. They want to expand their business, and another war would mean losing everything again.”

Thirdly, if a Georgian starts a business, it stirs suspicion among his Abkhaz neighbours and the authorities. A joint business initiative between a Gal/i Georgian and an Abkhaz from Sukhum/i, for example, would be better received. Gal/i Georgians are afraid to travel to Sukhum/i to sell their products, particularly young men who fear indiscriminate violence or military conscription. Partnerships with Abkhaz businesses would help Gal/i farmers access more profitable markets in Abkhazia without actually going there.

Gal/i entrepreneurs also feel their experience resonates better with Abkhaz business people than with Georgians. Because Abkhaz business has been left to its own devices, it has had to invent models that fit the particular environment of restricted trade, lack of currency and licences, and low investment rates. Purchasing power is much lower than in Georgia, and the scope of goods and services on offer is correspondingly narrow. Gal/i entrepreneurs, therefore, seek to cooperate with Abkhaz businesses first, and only then to turn their attention to Georgian businesses across the river.

Gal/i entrepreneurs feel marginalised by both Georgia and Abkhazia. The Georgians who never left Gal/i had been waiting for the situation to improve and now find they have been forgotten by Abkhaz business and the Abkhaz authorities. They expect greater responsiveness from the private sector in more developed regions of Abkhazia.

But Georgian returnees also see themselves as mediators between Abkhaz and Georgian. “When we go shopping or selling in Georgia, we tell them how we, the returnees, are being treated by the Abkhaz population. These stories also serve peacebuilding.” In the words of another interviewee: “If Georgian-Abkhaz business relations were established within Abkhazia, then the Abkhaz might be able to better understand Georgians from Georgia.” The first attempts are being made to offer spaces to Abkhaz and Georgian businesspeople to come together and ‘talk business’ (see below).

It is clear that integrating ethnic Georgian entrepreneurs from Gal/i into Abkhazia's private sector, and the kinds of joint ventures envisaged by people interviewed for this report, could have benefits for wider peacebuilding efforts in the region, including:

- Joint reconstruction of livelihoods
- Promotion of greater economic equality among ethnic groups, including those who ended up on the 'other side'
- Confidence building
- Prejudice reduction
- Reconciliation
- Institutionalisation of cross-conflict economic ties.

#### **Abkhaz and Georgians: talking business and peace**

In 2002, the UK-based peacebuilding NGO Conciliation Resources (CR) began a series of study visits to London for Georgian and Abkhaz politicians, officials and civic figures, to understand the experience Northern Ireland. The first visit focused on the economic sphere, and explored the ways that economics and business impact on a peace process and can contribute to the dynamics of conflict transformation.

After the visit, one participant, an ethnic Georgian factory director in pre-war Abkhazia who had been displaced to Georgia, made efforts to keep in touch with the Abkhaz participants. He asked CR to facilitate a further meeting in Gal/i. An informal meeting of businesspeople, officials and politicians was arranged under CR's auspices (the NGO's involvement lent the meeting an international context and provided participants with whatever political cover they might need, but CR was not present at the meeting). At that stage, the maintenance of relations and the discussion of possibilities were considered more important than putting any concrete business proposals on the table.

One of the practical outcomes of the meeting was a joint visit to a trade fair in Istanbul in May 2004, with the support from a group of Turkish businessmen. The initiative came from the Georgian and Abkhaz interlocutors, but CR issued the invitations, liaised with the Abkhaz and Georgian authorities, arranged travel through the UN assistance and co-funded the trip with the British Embassy in Georgia.

Regular communication and interactive analysis of the challenges and opportunities for building entrepreneurial bridges between the two private sectors was logistically difficult for the Georgians and the Abkhaz. In light of

this, all agreed that it would be useful to convene a meeting in Moscow in September 2005 as a means of analysing the underlying challenges and considering ways to move forward. CR also felt it was important to link this process to fellow peacebuilding NGO International Alert's more extensive work on business and conflict in the South Caucasus. The meeting was designed to explore the challenges and opportunities involved in economic cooperation in a context that circumscribes the room for legal economic endeavour.

In the Moscow meeting a mixed group of Georgian and Abkhaz business people, officials and politicians came to the joint conclusion that with the political process in deadlock, cooperation between businesspeople presented an opportunity to change the dynamic and, in the view of some participants, operating a parallel, economic approach can help unlock the political stalemate. Although the nature of trust is always disputed in a conflict environment, reliable patterns of behaviour promoted by shared economic goals can contribute to mutual trust. Despite the legacy of war, many factors provide encouragement for economic cooperation, such as the lower transport costs of working with those in close geographic proximity, as well as evidence of common attitudes.

The most obstructive impediments from the participants' perspective are groups who benefit from the current status quo through cooperation in the smuggling of illegal and legal goods. Other factors impact upon opportunities, notably the atmosphere of political deadlock, which leads to a lack of public optimism. Politicians compound this by engaging in war rhetoric, reinforcing each other's insecurity.

Although the meeting was not framed with a 'problem-solving' agenda, participants grappled with their real problems and made suggestions that could empower local businesspeople for future engagement. Among them:

- To establish a customs point on the 'shared' river, not to collect customs fees, but to monitor and register passing goods
- The Quadripartite Committee should be encouraged to elaborate a temporary legal framework for economic cooperation and sign a provisional agreement for transitional regulations of economic activities
- To create a free economic zone in Gal/i, financed by the Georgian and Abkhaz diasporas
- To create a joint, non-governmental economic forum to prepare concrete business proposals, as well as establish parallel mechanisms on both sides that would assess the political feasibility of potential business joint ventures and lobby for economic cooperation.

While some of these ideas might not be politically feasible at present, they reflect a willingness to think creatively. Six weeks after the Moscow meeting, CR and IA helped some participants and other businesspeople from both communities to travel to another trade fair in Turkey. Again a Turkish business association provided assistance. Those involved want to keep talking, but they also want to find the right framework in which to explore at what point they can begin to juggle the political and economic realities, and start doing business.

*This case has been written for Local Business, Local Peace by Jonathan Cohen and Diana Klein.*

## Georgia and South Ossetia: business cooperation across the dividing line

### Georgia-South Ossetia conflict overview

In the late 1980s South Ossetians became concerned that Georgian chauvinism threatened their identity and political rights. In January 1989, a popular front emerged whose goal was to secede and reunite with their kin in North Ossetia. Economic insecurity was one factor behind the South Ossetians' fears; its budget was the smallest in Georgia and scarcely met the population's basic needs. A series of provocations by Georgian activists strengthened support for the nationalist party. In November 1989 a moderate political force, the Soviet of National Deputies, called an emergency session and made an effort to upgrade South Ossetia's status to an autonomous republic, but the Georgian parliament responded by reducing the region to a 'cultural autonomy'. The leading Georgian nationalist party, *Mrgvali Magida* ('Round Table'), launched a march on Tskhinvali, to demonstrate its intention of keeping the subordination of ethnic groups in place. In September 1990, South Ossetia declared independence from Georgia after it declared independence from the Soviet Union. Georgian paramilitaries associated with the nationalist parties besieged Tskhinvali in early January 1991, forcing South Ossetia to mobilise.

President Gamsakhurdia introduced an economic and energy blockade of South Ossetia in early 1991 and maintained it throughout the winter. In March 1991 South Ossetia again voted to preserve the Soviet Union. Waves of Georgian attacks followed, but overall motivation was low due to the lack of lootable resources. Clashes occurred between Georgian and Ossetian regiments, along with vicious attacks on the civilian population. After Gamsakhurdia's regime was overthrown in early 1992, hopes blossomed for an end to the armed conflict, but the Georgian National Guard attacked again in June 1992 in order to achieve a strong position prior to the ceasefire negotiations.

On 24 June 1992, Georgia and South Ossetia signed a ceasefire agreement and a quadripartite Joint Control Commission, consisting of Russia, Georgia, South and North Ossetia, was set up to monitor it. A Russian peacekeeping force was deployed in the conflict zone.

One thousand South Ossetians died in the conflict, hundreds more were wounded and about 100 villages were burned and destroyed. Between 40-100,000 South Ossetians fled to North Ossetia (prior to the war about 100,000 Ossetians lived in Georgia) and 10,000 Georgians fled South Ossetia.<sup>34</sup> Both sides reported atrocities against civilians.<sup>35</sup>

The conflict zone is currently divided in two parts, one controlled by South Ossetia, the other by Georgia. Because Georgian and Ossetian villages in the zone are clustered as a mosaic, clear demarcation of the different spheres of control is impossible. This has shielded Ossetian and Georgian communities from total alienation and preserved inter-communal bridges. On the other hand, in an environment with no clear-cut front lines, armed violence can re-ignite, as occurred in summer 2004.

The conflict entered a new stage after Georgia's Rose Revolution in November 2003. One of President Mikheil Saakashvili's first pledges was to restore Georgia's territorial integrity. His first step towards that goal was an anti-smuggling campaign that targeted Ergneti wholesale market on the border between Georgia and South Ossetia. Losses in customs revenues due to smuggling from the market have been estimated at \$10 million per month.<sup>36</sup> The campaign was accompanied by an increased number of Georgian checkpoints in the conflict zone, which stirred the suspicions of the South Ossetians, and the commander of the Russian peacekeeping contingent responded by threatening to remove the Georgian military by force. Meanwhile, tensions peaked with shelling and killings. Seventeen Georgians and five Ossetians were reportedly killed in clashes in summer 2004.<sup>37</sup> Despite the optimism generated by the closure of Ergneti Market – the government immediately used the increased revenue to double pensions from \$7 to \$14 a month – some politicians conceded it had been a mistake not to offer traders an alternative space, or to legalise the transit of goods from South Ossetia.<sup>38</sup>

### **International assistance for economic rehabilitation**

Though the international community is present in the conflict zone, inter-governmental assistance is channelled directly to Georgia, the internationally recognised state. Any direct involvement by the EU, OSCE or UN in South Ossetia is controversial because they are perceived as Georgia's allies due to their adherence to the principle of the territorial integrity of states. South Ossetians fear they will be forced to give up independence in exchange for economic development and external support, and are deeply opposed to this option.

The amount of money allocated for the rehabilitation of the conflict zone in South Ossetia is substantial: \$948,000 for building houses for potential repatriates and \$1.54 million for renewing infrastructure. The restoration of mixed Ossetian-Georgian livelihoods, however, has largely failed. Refugees from both ethnic groups either would not move back, or would return only to sell the new houses built by the EU.<sup>39</sup> A further \$474,000 was allocated to the rehabilitation of infrastructure in the IDPs' temporary settlements and channelled through the Georgian government. Indirectly some help was channelled to South Ossetian communities through a series of EU projects focusing on economic rehabilitation with the participation of Georgian and Ossetian communities.<sup>40</sup> Translating small successes in cooperative economic rehabilitation at a community level into the political and economic spheres, however, remains a challenge.

The EU is prepared to fund programmes for the revival of economic links between South Ossetia and Georgia, including a joint Georgian/Ossetian customs collection mechanism and the re-opening of the transport route from Russia southwards. However, the funding invitation was on hold at the time of writing because the two sides failed to reach agreement on where the customs post should be located.<sup>41</sup>

The new Georgian government has recently begun to consider a programme to support SMEs in the Georgian sector of the conflict zone with help from the EC and OSCE. It also proposed funding economic revival in South Ossetia, but this was conditional on South Ossetia resuming its status as an autonomous republic within Georgia, which was not acceptable to its leadership.

Meanwhile, Georgian and South Ossetian farmers, traders and entrepreneurs have developed their own strategies for cooperation within the limits of the current security and economic conditions. These ensure a degree of secure income for both communities. Those who engage in them, however, receive no funding from international or domestic sources to expand their activities or to involve a greater number of people.

### Private sector in South Ossetia: resilience and a vision for change

Three modes of private sector response in South Ossetia to conflict were identified during the research for this report:

- **Escapism.** Entrepreneurs leave South Ossetia and do business elsewhere
- **Conformism.** Entrepreneurs participate in the corrupt networks that persist in the conflict situation and have no ambition to promote political and economic change
- **Resilience.** Entrepreneurs stay in South Ossetia by choice and try to bring about political and economic change.

This study focuses on cases in the third category, which demonstrate there is a group in the South Ossetian private sector with a vision and strategy to rebuild relations between Georgia and South Ossetia, and make cooperative initiatives sustainable.

The local private sector operates as a peacebuilding agent below or beyond the geo-political level where the interests of Georgia and Russia collide. The logic of the strategy is simple: eventually, the private sector will outnumber and overpower militants on both sides.

The private sector in South Ossetia developed out of a need to fill the void in services, goods and food supply created by the Georgian blockade. There was a boom in small restaurants, cafes and shops in the post-*perestroika* years, but this collapsed after the war. Representatives of what remains of the private sector are proud of staying afloat despite 15 years of conflict. One interviewee recounts: "Day after day, when there was a break in the shelling of the city, people would come out of their shelters and carry on renovating a small shop in the basement, or selling food and other basic items." Agriculture died out in the 'frozen' conflict because farmers could not afford new equipment and were regularly robbed of their herds or harvests by militia. However, entrepreneurs from both communities, including individuals from Georgia proper, managed to put aside their political differences and engage in trade, illustrating a range of models for private sector engagement in peacebuilding. The remainder of this section presents some examples.

### Ergneti market: a peacebuilding mechanism

Ergneti market became the most reliable source of income for thousands of Ossetians and Georgians after 1999 when it became less profitable to smuggle alcohol from Georgia to Russia. Petrol, cigarettes, food and industrial products from Russia were traded in Ergneti and smuggled to Georgia while a counter-stream of agricultural products from Georgia flowed north into Russia via South Ossetia. Ergneti market served as a price-setting mechanism for the entire region.

The volume of trade at Ergneti market was estimated as between \$101-133 million per year in 2004.<sup>42</sup> Theoretically, Georgia should have collected duties at the border with Russia, but this part of South Ossetia was not under its control. The establishment of customs posts at the *de facto* border with South Ossetia would have meant that Georgia had conceded the breakaway state's claim to sovereignty. Though opening the Transcaucasus railway to Russia remains of utmost importance to both Georgia and South Ossetia, the politics of the region has relegated pragmatic interests into second place.

The closure of Ergneti market in 2004 had a devastating impact on small traders, yet failed to halt the flow of contraband, which instead concentrated into the hands of a small number of players. In interviews conducted for this report, Ergneti was considered an important development mechanism in South Ossetia, with significant peacebuilding implications. Previous presidents of Georgia and South Ossetia have boasted to the OSCE that the organisation of Ergneti market had been their main achievement. One trader remembers: "People seemed to have put aside the violence, and traded and interacted in a friendly way regardless of their ethnic origin." Most small entrepreneurs at Ergneti market, Georgians and Ossetians alike, acted within an unwritten code of conduct – governing a space that could otherwise easily have become an arena of violent clashes. Conflicts between Ergneti actors only occurred when someone had violated the rules of business, rarely as a result of ethnic differences.

The closure of Ergneti market demonstrated that micro-businesses, no matter how numerous, have no influence on political decisions. In the words of one trader: "I traded at Ergneti market and about 30 people from the Georgian side were my partners. They helped with the transport. My customers were Georgians – I lost them. Our business and human communication was intense. I think if there were several Ergneti Markets, they could not have shut all of them as easily as they've done with this one." Women traders talked of their Georgian counterparts with empathy; they shared a common fate as hardworking, self-reliant and vulnerable entrepreneurs.

While all interviewees emphasised the SMEs' lack of influence on political decision-making, Georgian businesspeople did not voice their protests, though their circumstances have seriously worsened. Given that closure was 'good for Georgia' financially and a symbolic act to counter perceptions of corruption in Georgia, they may have felt inhibited at voicing any concern.

### Assistance to private sector development and peacebuilding

Bottling and selling of mineral water is an important sector in South Ossetia, with a large number of bottling companies competing in a small market. Those in the business are forced to stay in South Ossetia because they cannot go anywhere else. As a result, they have developed a high level of commitment to bringing about political and economic change, according to one owner interviewed for this research. An ex-combatant, he employs Ossetian and Georgian ex-combatants and is concerned about their re-integration into civilian life. However, his ability to provide jobs is limited due to a lack of development opportunities. He is convinced that business should be 'cosmopolitan', and that ethnicity and national aspirations should not intervene.

No one will invest in marketing and branding South Ossetian spring water due to the lack of a barcode; most South Ossetian water is exported for sale under a Russian barcode. While most bottlers would not consider selling water to Georgia, this businessman has a partnership with a Georgian in the border village of Avnevi who sells it into the Georgian market from where it is exported to Azerbaijan. Businesspeople with similar links are perceived as trading with the ‘enemy’ and are treated as pariahs.

By helping the South Ossetian private sector ‘spread its wings’, the businessman believes he is contributing to the emergence of a class of liberated, ‘thinking’ persons with the capacity to influence politics. This category of people barely survives in the suffocating political environment. In his view, the major problem is that people who are driven by personal greed have become politicians by accident and do not care about South Ossetia’s long-term prospects. All those interviewed think healthy SME activities are impossible in a conflict context, and would naturally be a voice for peace were they to gain political influence: “Had businesspeople on both sides been consulted [in peace negotiations], the conflict could have been settled quickly,” said one interviewee. In their view, a group of ‘resilient’, liberated, thinking entrepreneurs needs to be nurtured.

The interviewees emphasised that armed conflict could have been avoided if the private sector had been rich, cohesive and influential in the first place. “The conflict was an outgrowth of the political ambitions of the leaders; the people did not need it,” said one. Another’s view was that ‘business cannot survive in the atmosphere of mistrust’. “If I provide 20 people with jobs and income, and so do another dozen entrepreneurs, who would contemplate warfare?” Social tension and conflict are due to disparities between those with the opportunities to earn a living and those who had a hard time making ends meet.

Some interviewees did not think that the promotion of joint business initiatives with Georgians was a good idea because the initiatives were likely to cause social resentment. The development of local business on both sides separately was considered a more promising model. Eventually the links will be established – but only after the conflict is resolved.

#### **Co-operating for security across the divide: farmers in the conflict zone**

The village of Khetagurovo, at the heart of the conflict zone in Znaur region, was divided in two as a result of the 1991-92 war. The villagers decided to exchange lands with their neighbours so that today not a single plot is abandoned. Georgians cultivate land that was formerly South Ossetian, and vice versa. They also agreed to monitor the movements of paramilitary forces and to prevent their own from attacking their former co-villagers. One farmer recounts: “We decided that, in the event of conflict escalation, we would

demonstrate to the armed guys that the Georgians are working Ossetian land, and the other way round, to prevent shooting.” The driving force behind the agreement was the desire to preserve one’s business and network.

Among the peacebuilding elements in the above cases, the following patterns can be identified:

- Informal business across the front line
- Attempts by independent entrepreneurs to transform the domestic, political environment
- ‘Gentlemen’s agreements’ on the mutual protection of businesses across ethnic lines.

### Sadakhlo market: ignoring the war, building peace?

Sadakhlo, with a population of 13,000 Azeris, is situated in Georgia near the Armenian border. A market was established in the early 1990s that subsequently became the main source of income for tens of thousands of Georgians, Armenians and Azeris. Sadakhlo is adjacent to Kvemo Kartli region, which is populated by Azeris and Armenians. It is, therefore, a place where three countries meet. It is also on the true periphery of Georgia. While the poverty level in Georgia was 52.3 percent in 2004, the figure for Kvemo Kartli was 78 percent, of whom 30 percent live in extreme poverty.<sup>43</sup> Most Azeris in Sadakhlo do not speak Georgian and their chances of employment are light. In Soviet times the farmers’ dairy produce, fruit and vegetables were prized, but Georgia has since prohibited the purchase, privatisation or rental of land in the border regions, and Azeris and Armenians lost their access to soils and pasture.

Sadakhlo market has manifested the abyss that lies between the rich and poor in Armenia, Azerbaijan and Georgia. This inequality is so dramatic that ‘the conflict is not really between Armenia and Azerbaijan, but between a class of people who gain and a class of people who lose’, according to one trader. Even at the peak of the war between Armenia and Azerbaijan, ordinary Azeris and Armenians continued to trade at Sadakhlo.

A new phase in the history of Sadakhlo began with President Saakashvili’s recent anti-smuggling campaign. Though targeted at Ergneti market, other markets have felt a knock-on effect. In Sadakhlo, the campaign initially led to an increase in both fees and bribes, as well as streamlined customs procedures, including better storage facilities and refrigeration. Ordinary traders were not impressed. “We are told that the tax payment enforcement is for our own benefit,” observed the deputy governor

of Marneuli region. “But people in remote areas of the country do not feel it and would rather not be bothered by the state, but just take care of themselves.”

The market was until recently open daily. Armenian nationals reached it through a gate guarded by Armenian and Georgian customs officers and border guards. Traders from Azerbaijan entered Georgia via the Krasny Most ('Red Bridge') border checkpoint and took the bus to Sadakhlo. On a busy day there would be 5,000 people trading in Sadakhlo.<sup>44</sup> All 72 Azeri villages in Georgia were dependent on the trade.

Business at Sadakhlo market was regulated by informal agreements stronger than any written law, and Azeris and Armenians demonstrated surprising levels of trust. A Sadakhlo Azeri would act as a middleman between a Baku entrepreneur, who supplied Chinese-made clothes, and five wholesale customers from Armenia. He supplied the goods on credit because he knew they would pay it back: “We all know each other and reputation is our major asset.” Armenians used to rent apartments from Azeri families in Sadakhlo to avoid them having to travel back and forth in the trading season. Azeri teenagers found casual work carrying goods across the Armenian border. Azeri flour ended up in Armenia, while Armenian smoked river fish would be found on Azeri dinner tables. Sadakhlo traders participated in smuggling, but this was not perceived as reprehensible, just a normal exchange of agricultural products, wine, cattle, cheap industrial goods and clothes. According to local interviewees, large oil-product deals were rarely made in Sadakhlo, but relied on direct contact between business circles in Armenia and Azerbaijan.

One unspoken rule at Sadakhlo was always not to discuss politics. The issue of Nagorny-Karabakh was a no-go area between traders. “It wasn’t us ordinary people who started the conflict,” said one veteran Armenian trader, “so why should we stick our nose in it?” Most of those surveyed opted for a peaceful resolution of the conflict. However, one Azeri conceded a valuable insight: “If direct economic relations are restored between Armenia and Azerbaijan, we Sadakhlo traders will lose our jobs.” The statement was also indicative of the deep disillusionment with which traders see their rulers. They do not believe that resolution of the Nagorny-Karabakh conflict will bring about positive change in their societies, or that governments will ever focus on the needs of the poor.

Customs authorities in Georgia notified their Armenian counterparts of the final closure Sadakhlo market in mid-April 2006. All three governments had in fact been keen to close the market – considered by all three states as a hub for contraband and corruption at customs checkpoints, as well as a source of lost revenue.

Local Sadakhlo traders – ethnic Azeris – felt the heaviest blow as a result of the market’s closure. A few of them are now making ends meet by purchasing sugar from

Azeri wholesalers (Azerbaijan has recently launched sugar export to Georgia and Iran) and selling it on to Georgia. However, the majority are struggling to find a new source of income. It is likely that the loss of an opportunity to sell local produce will soon increase poverty in the region, and locals are doubtful that the Georgian state will help them.

The Sadakhlo phenomenon incorporated some peacebuilding elements. The operation of the market required humanisation of the relations between members of the warring parties. A younger generation in both countries has grown up with no direct contact with one another and is now involved in virtual war in internet chat-rooms characterised by xenophobia and hostility. Armenians and Azeris at Sadakhlo market, by contrast, never lost direct contact and this may have enhanced their conflict-free co-existence. But the actors involved are from the most disadvantaged categories of society, and have no influence in local politics, let alone nationally. Sadakhlo presents an example of spontaneous peacebuilding grounded in the apolitical pragmatism of trade.

Direct contacts between Armenian and Azeri traders have terminated with closure of the market. This had been the only place where representatives of the two nations at war with each other used to trade, ignoring the war. Restoration of trade and other economic relations between Armenia and Azerbaijan are now contingent on resolution of the Nagorno-Karabakh conflict.

## Conclusions

Most of the cases of business cooperation across the various conflict divides in the South Caucasus presented in this report were born out of socio-economic necessity. Continued business contact with ‘the other side’ also has a clear human dimension however, with businesspeople involved in it believing that they are holding a ‘fort of normality’ that may eventually show the way for broader peaceful relations between the countries. This is further evidenced by some of the examples above where businesspeople have made deliberate efforts to directly address conflict issues in ways that go beyond ‘just doing business’. The Abkhaz Union of Women Entrepreneurs and the Abkhaz-Georgian dialogue are cases in point. It is important to point out that the entrepreneurs who are engaged in trade or other business across the divide have never questioned the legitimacy of their side’s goal in the conflict, but throughout the conflict have challenged the idea of curtailing human and neighbourly relations with ordinary people who happened to belong to the rival side because of their identity, residency or family ties.

In the absence of formal peace between conflict actors, the ongoing reality of closed borders, and the residual threat that violence will resume, such economic contacts

happen in a ‘semi-legal’, legally insecure environment, as described above and as demonstrated by the recent closure of two key markets. This forces many activities that would be regarded as perfectly legal elsewhere into the shadow economy. Businesspeople risk hostility from their own government and society if business is carried out in an open and transparent manner. Yet these contacts do exist, and efforts at involving the business community in the region more systematically in peacebuilding should aim at strengthening pre-existing links. This means mechanisms and space need to be created allowing for such business activity.

Any cross-conflict private sector initiatives with peacebuilding goals need to avoid or mitigate both the potential threats to businesspeople emanating from what’s perceived as ‘cooperating with the enemy,’ and being confined to the shadows. Such initiatives can take various forms:

- A private sector institution that provides business to business diplomacy under the aegis of international organisations
- A private sector institution that operates within the same state’s (or entity’s) legal framework and territorial boundaries, and integrates the local minority community of the rival ethnic group
- Private sector institutions on both sides of the conflict pairing up with a private sector body from a third party, forming a tri-lateral business network or organisation. Business interaction at the regional level seems to provide a window of opportunity for the individual, conflict-party private sectors to get involved in commerce and production in partnership with the ‘enemy’ side, which otherwise is either impossible or highly problematic.

Irrespective of venue, any private sector institution involved in peacebuilding must be influential and strong. This means that the entire private sector needs to be strengthened. SME entrepreneurs can only develop into a peace constituency if they can break free from political pressure, and gain financial independence. Large businesses are in no position to challenge the *status quo* in South Caucasus because they are either too closely associated with government, or are actively profiting from the no-war-no-peace situation. SMEs need advocacy, public relations and lobbying skills, as well as investment and business training.

An environment more conducive for private sector involvement in peacebuilding needs to be fostered in the South Caucasus. New economic interaction mechanisms, embodied in joint ventures, the creation and promotion of regional and sub-regional brands (e.g. ‘Made in the South Caucasus’), free trade zones, and cooperatively guarded and managed trade routes and markets, need to be promoted if the economic reality is to change. The recent establishment of the Caucasus Business and Development Network, is one promising example in that direction. The closure of informal markets such as Ergneti and Sadakhlo has negative, economic impacts

not only on those who engage in them: it runs the additional danger of destroying the few forums that exist for peaceful interaction and rapprochement at the community level.

### The Caucasus Business and Development Network

The Caucasus Business and Development Network (CBDN) is a unique platform for dialogue and information exchange between business communities and other interested parties in the South Caucasus. Geographically, CBDN covers Armenia, Azerbaijan, Georgia and Turkey and includes Abkhazia, Nagorny-Karabakh and South Ossetia. It promotes economic cooperation in the region as a means of building confidence and lasting peace in the region, and encourages initiatives that have a positive impact on the conflict dynamics.

In early 2006 the network established a bilingual, Russian/English website. Among other services, it provides users with frequent electronic bulletin on the economies of the region, discussion forums and a business database. It can be accessed on [www.caucasusbusiness.net](http://www.caucasusbusiness.net)

Reconciliation dialogue and trainings in the South Caucasus have reached saturation in terms of the number of people who have already internalised reconciliation values and actively engaged in peacebuilding. But the societies are no closer to one another than before. Indeed, a contrary tendency of escalating ethnic hatred and animosity seems to be prevailing, particularly in the younger generations who have no memory of pre-conflict, inter-ethnic marriages, friendships, mixed workplaces, jazz bands and soccer teams.

Private sector cooperation may be a turning point in the reconciliation process between the conflict parties, offering the potential for participants to rediscover each other's humanity at the same time as investing in joint activities. Cross-conflict private sector initiatives, and even unilateral social investment by local private enterprises, would fit well within a joint reconstruction approach aimed at the depolarisation of peoples, economies and their visions of the future.<sup>45</sup>

## Acronyms

<b>CBDN</b>	Caucasus Business and Development Network
<b>CIS</b>	Commonwealth of Independent States
<b>CR</b>	Conciliation Resources
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EU</b>	European Union
<b>IDPs</b>	Internally Displaced Persons
<b>IMF</b>	International Monetary Fund
<b>GDP</b>	Gross Domestic Product
<b>OSCE</b>	Organization for Security and Cooperation in Europe
<b>SME</b>	Small and medium enterprises
<b>SRSG</b>	Special Representative of the UN Secretary General
<b>UNDP</b>	United Nations Development Program
<b>UNHCR</b>	United Nations High Commission for Refugees

## Endnotes

- 1 Both sovereign states and self-proclaimed republics have their own authorities, parliaments and presidents and define these as government. The use of this terminology in this report does not suggest any opinion on the status of a governed territory by the author and editors.
- 2 Any trade between parties in legal goods is still illegal since the non-recognised entities treat their frontiers with the recognised states as international borders, requiring customs, while the recognised states treat the same borders as administrative boundaries. The legality of economic relations is therefore a conflict issue.
- 3 USAID Armenia Private Sector Programme (Washington DC, US: USAID). [www.usaid.gov/am/private.html](http://www.usaid.gov/am/private.html)
- 4 IMF (2005) 'Republic of Azerbaijan: Ex Post Assessment of Longer-Term Program Engagement' *Country Report No. 05/59* (Washington DC, US: IMF). Available at [www.imf.org/external/pubs/ft/scr/2005/cr05259.pdf](http://www.imf.org/external/pubs/ft/scr/2005/cr05259.pdf)
- 5 Bargandzia, D. (1999) *Settlement of the Georgian-Abkhaz Conflict: Economic Aspects* (The Hague, Netherlands: Unrepresented Nations and Peoples Organisation).
- 6 Chkhartishvili, D., Gotsiridze, R. and Kitsmarishvili, B. (2004) 'Georgia: Conflict Regions and Economy' in Champain, P., Klein, D. and Mirimanova, N. (eds.) (2004) *From War Economies to Peace Economies in the South Caucasus* (London, UK: International Alert).
- 7 IMF op. cit.; Chkhartishvili et al. op. cit.
- 8 The Russian rouble is official currency in both *de facto* states.
- 9 Wilson, T. (2005) *Assessment of Opportunities for Developing a Micro-finance Project in Abkhazia* (New York, US: UNDP).
- 10 International Crisis Group (2004) 'Avoiding War in South Ossetia' *Report No. 159* (Brussels, Belgium: International Crisis Group).
- 11 Dzhikaev, V. and Parastaev, A. (2004) 'Economy and Conflict in South Ossetia' in Champain et al op. cit.
- 12 Asian Development Bank (2004) *Asian Development Outlook 2004*. Available at [www.adb.org/Documents/Books/ADO/2004/aze.asp](http://www.adb.org/Documents/Books/ADO/2004/aze.asp)

- 13 While the official unemployment rate is 10 percent, it soars to 47 percent among IDPs and refugees from Nagorny-Karabakh, Armenia and the other occupied territories, who account for 12 percent of Azerbaijan's population.
- 14 IMF (2004) 'Azerbaijan: Poverty Reduction Strategy Paper Progress Report' *Country Report No. 04/322* (Washington DC, US: IMF).
- 15 Asian Development Bank op. cit.
- 16 IMF (2004) op. cit.
- 17 Gal' is the Abkhaz spelling of the name of the district that Georgians call 'Gali'.
- 18 Kaufman, S.J. (2001) *Modern Hatreds: The Symbolic Politics of Ethnic War* (Ithaca, US and London, UK: Cornell University Press).
- 19 *Civil Georgia*, 30 May 2004. Available at [www.civil.ge/eng/detail.php?id=6979](http://www.civil.ge/eng/detail.php?id=6979)
- 20 *Rustavi 2*, 3 July 2005.
- 21 *Civil Georgia* op. cit.
- 22 *Caucaz: Europenews*, 14 September 2005.
- 23 *Nezavisimaya Gazeta*, 18 August 2005.
- 24 Garb, P. (1999) 'The Inguri Power Complex' in Cohen, J. (ed.) *A Question of Sovereignty: The Georgia-Abkhazia Peace Process Accord Series* (London, UK: Conciliation Resources).
- 25 *Civil Georgia*, 15 June 2005. Available at [www.civil.ge/eng/article.php?id=10155](http://www.civil.ge/eng/article.php?id=10155)
- 26 *Civil Georgia*, 8 August 2005; Baev, P., Koehler, J. and Zürcher, C. (2002): 'Civil Wars in the Caucasus' *Case Studies on the Politics and Economics of Civil War* component of World Bank project 'Economics of Political and Criminal Violence'. Available at [www.univie.ac.at/politikwissenschaft/Caucasus.pdf](http://www.univie.ac.at/politikwissenschaft/Caucasus.pdf)
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## Turkey and Armenia: encouraging business to enable peace

Natalia Mirimanova

The conflict between Turks and Armenians dates back to Ottoman times. Armenians claim that the Ottoman Turks committed genocide against its Armenian minority, chasing away the survivors and misappropriating their lands. Historic accounts of this episode remain vivid as they are passed from generation to generation and are now considered a building block of the Armenian national identity.<sup>1</sup> The Turks argue that the killing and exile of Armenians was nothing extraordinary in the era of World War 1 and that thousands of Turkish civilians were equally uprooted. Turkey tends to blame the Russian empire for the suffering of both ordinary Turks and Armenians, and rejects accusations that it committed genocide against the Armenians.

The conflict acquired a new dimension in the early 1990s after the newly independent state of Armenia refused to recognise the Treaty of Kars of 1921, which demarcated the Turkish-Soviet border. Diplomatic relations have been suspended ever since. In addition, Turkey allied itself with Azerbaijan over the Nagorno-Karabakh issue, introducing an economic blockade of Armenia, and closing its border for ground transport and trade. The Turkish-Azerbaijan alliance was not solely grounded in historic solidarity, but had an economic aspect in the Baku-Tbilisi-Ceyhan oil pipeline which runs from Azerbaijan to Turkey's Mediterranean coast.<sup>2</sup>

There is understanding between Turkish and Armenian business communities that both countries have sustained economic damage from the blockade of Armenia. The closure restricts Armenia's access to 44 percent of the regional market and Turkey is denied access to the most rational transportation routes to new markets in the South Caucasus and beyond. Re-opening the rail and road links across the Turkish-Armenian border is closely dependant on the issue of Nagorno-Karabakh; Turkey has long taken the position that it would make no move that would upset Azerbaijan. No official information has been released regarding the cost of the blockade.

### The Turkish-Armenian Business Development Council

The Turkish-Armenian Business Development Council (TABDC) was co-founded by an Armenian, Arsen Ghazaryan, and a Turk, Kaan Soyak, in May 1997 after the summit of the Black Sea Economic Cooperation Pact in Istanbul. The first legal link between Turkish (mainly Anatolian) and Armenian business

circles, the TABDC was envisioned as a bridge between the two societies, as well as a forum for hosting inter-governmental interactions. It is currently registered as an NGO in Turkey, Armenia and the USA, and recently opened a European branch. The TABDC initially grew out of personal contacts between Turkish and Armenian businessmen. Several successful business ventures helped to establish sufficient levels of trust and confidence, that they shared views on how to promote dialogue to overcome the deadlock between the two countries. The TABDC was founded to promote reconciliation by demonstrating the benefits of direct cooperation between the two private sectors.

Though rarely publicised, trade between Turkey and Armenia persisted throughout the years, though it was not secure and there is no legal protection for entrepreneurs involved. There is a shuttle bus service between Yerevan and Istanbul, as well as regular flights. But the bus companies are exclusively Turkish, since Armenia-registered buses are not allowed to enter Turkey.

The TABDC initially set itself the goal of helping Armenian and Anatolian Turkish businesspeople to communicate and streamline their operations. The co-founders' first principle was the creation of trust between Turkish and Armenian operators. They assisted in the creation of joint ventures in third countries and facilitated trade without violating the laws of either state. They encouraged direct communication between Armenian and Turkish entrepreneurs to nurture the spirit of direct business interaction, sponsoring trips by individual businesspeople and associations in both countries. The TABDC has used trade fairs as a forum for Turkish and Armenian entrepreneurs to meet and arrange deals; it also functions as a hub for the exchange of business information.

The TABDC formulates its mission as follows: "We hope to assist in finding peaceful means to historical problems. Our aim, by contributing to the development of Anatolia and Armenia, is to raise awareness of the diversity of Anatolia, to acknowledge the existence of an Armenian past in Anatolia, and to send positive messages to Armenia, Turkey and the diaspora."<sup>3</sup>

It was clear from the outset that the environment requires transformation if business is to flourish. The TABDC diversified its palette of activities to include music and dance festivals, and cultural exchanges. It became involved in the restoration of the Armenian Akhtamar Church on Lake Van, persuading the Istanbul Chamber of Commerce to sponsor the project, with consultancy services provided by the Armenian Union of Architects. The TABDC sponsors concerts by Turkish musicians in Armenia and Armenian musicians in Turkey. Ankara State University and Yerevan State University recently signed a joint cooperation agreement after the TABDC facilitated the contact.

Two factors have been crucial to the TABDC's successes. The first is the personalities of the co-founders, their enthusiasm, energy, business acumen and public relations skills. Secondly, the resources required to finance TABDC projects make it unique among the region's NGOs, which cannot normally sustain operations without external funding. At the same time, TABDC is not a business institution in any conventional sense because profit is a secondary yardstick of its performance.

Armenia extended support to the TABDC because its mission fits the government's agenda of lifting sanctions and opening the border. Yerevan welcomes foreign investment and trade. Turkish legislation, by contrast, consists of bilateral agreements with individual countries so that foreign companies do business in Turkey under different legal environments. As a result Armenians are not permitted to purchase land in Turkey, while other nationals are entitled to do so.

The TABDC's reception in Turkey has been somewhat different. Mr. Soyak put considerable effort into fostering favourable public opinion and extinguishing the hostility of Turkish nationalist groups. He presented Armenia as a gateway to Russia and Central Asia, and claims that, despite nationalist sentiments, no one in Turkey speaks openly against new possibilities for economic growth.

TABDC balances the idealism of its long-term vision of a free flow of people, goods, transport and money between Turkey and Armenia, with the pragmatic awareness that it needs to start small by assisting individual entrepreneurs from both sides to work with one another. All deals between Turkish and Armenian businesses must be arranged through a third party because of the blockade. Simultaneously, the TABDC has elaborated legal mechanisms for Armenian-Turkish business transactions to grow in number and is currently involved in around 70 percent of existing Armenian-Turkish transactions. Some projects, notably in trade, are implemented without a political solution to the deadlock. Others, such as banking or the creation of a free trade zone, cannot be carried out without first restoring diplomatic relations. However, the TABDC is already preparing for representatives of the banking sectors to meet.

The TABDC not only brokers business contacts between the Turkish and Armenian private sectors, it aims at systemic change in bilateral relations between the two countries in general. To achieve this, TABDC employs advocacy tactics, namely:

- Lobbying home governments and international business circles for the inclusion of Armenia in the South Caucasus oil pipeline routes, re-opening railway and road traffic from Turkey through Armenia etc.
- Raising awareness of peace dividends within society through press conferences, media interviews and public events

- Direct action via reconstruction of Armenian historic sites in Turkey, earthquake aid etc.
- Networking to expand the ‘peace constituency’
- Consolidating European and US political institutions’ support to peacebuilding between Turkey and Armenia through the promotion of the positive experiences of cooperation between the two countries’ private sectors and civil society sectors.

### Endnotes

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