

# Trade as a Confidence-building Measure

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## ***Introduction***

Developments in Crimea and Eastern Ukraine over the past two years, the recent surge in violence in the Nagorno-Karabakh conflict, and the lack of substantial progress in resolving protracted ethno-territorial conflicts in Georgia and Moldova indicate the limited utility of existing approaches to conflict settlement in these cases. Confidence-building measures used hitherto have not resulted in opening a credible path towards conflict settlement. At best, they have stabilised, but arguably also entrenched, an existing status quo. This does not render them useless or counter-productive, but calls for alternative, innovative (even non-conventional) approaches to how security and cooperation could be (re-)built and encouraged in zones of protracted conflict in the OSCE region.

Areas of economic engagement, one of the three baskets of the 1975 Helsinki Final Act, are among a number of avenues that can usefully be explored in the search for measures through which confidence can be built among parties. It can be viewed as a first step on a path toward a settlement as opposed to a temporary 'fix' of an acute problem. Trade—the focus of our working paper—features prominently in the so-called second basket of the Helsinki Final Act, entitled “Co-operation in the Field of Economics, of Science and Technology and of the Environment”. In particular, the participating States recognise “that trade represents an essential sector of their co-operation” and acknowledge “the importance of the contribution which an improvement of business contacts, and the accompanying growth of confidence in business relationships, could make to the development of commercial and economic relations”.<sup>1</sup> Translated into the context of confidence-building, we can thus assume that trade can contribute to confidence-building across current divides in the conflict zones. Based on prior experience, we have identified five particular reasons why this might be the case:

- Trade establishes and sustains relationships across dividing lines: traders become partners in a system of agreed rules by which they abide, and this, in turn, strengthens confidence in each other and in a system of rules and can serve as an example in other types of relationships.
- Trade benefits people by providing access to goods (and services) and creating and sustaining markets: it thus strengthens economic development and contributes to maintaining and improving livelihoods.
- Trade therefore creates communities of stakeholders that rely on each other and benefit from cooperation and from continuing and expanding relations.
- Similarly, one can also expect spill-over effects from trade: in order to sustain and expand trade, it needs to be facilitated, including in relation to transport, finance, development of common standards, dispute resolution, etc.: the more trade there is, the more spill-overs are likely, and the more stability and confidence across more sectors can be achieved.
- The relationship between trade and confidence is not necessarily one-directional: trade is likely to require some pre-existing confidence, but it can enhance what exists and sustain it: trade and the confidence it helps to build and sustain can

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<sup>1</sup>See: <<http://www.hri.org/docs/Helsinki75.html>>

bridge confidence gaps in other areas and create opportunities (and necessities) for confidence-building elsewhere.

Put differently, trade is one area in which self-interested elites can see opportunities for constructive engagement that does not immediately threaten an established status quo and can generate gains in terms of social and political stability (and thus for regime security). Yet, at the same time, and following the logic outlined above, facilitating trade offers the international community an opportunity to contribute not only to confidence-building and improving the livelihoods of the people affected by these protracted conflicts but also to building a foundation upon which comprehensive conflict resolution in the future might be possible: the approximation and harmonisation of legal and regulatory frameworks across a variety of sectors that would be required for, and a consequence of, expanding trade can facilitate, and ease fears about, re-integration of the conflict zones.

Examining past and present efforts of trade facilitation in three of the original four protracted conflicts in the region concerned (Transnistria, Abkhazia and South Ossetia), the main purpose of our investigation is to establish a robust evidence basis for constructive recommendations to the OSCE Chairmanship about the role the international community could play in facilitating meaningful and purposeful engagement between the conflict parties through trade. In the next section, we first define what confidence-building measures entail and briefly outline available scholarly literature on the relationship of trade interdependence and conflict. We then turn to a discussion of the cases concerned: Georgia-Abkhazia, Georgia-South Ossetia and Moldova-Transnistria, and analyse trade-focused confidence-building initiatives. In the final section, we offer a summary of our findings based on a comparative assessment of what accounts for the successes and/or failures of these initiatives and conclude with a number of policy recommendations.

### **Confidence-Building**

The term 'confidence-building' first entered the diplomatic repertoire in the mid-1970s describing various tools of conflict prevention and conflict resolution. However, it was only in the post-Cold War period that the term, and its practice, considerably gained in traction and were considered the 'fastest growing business' in diplomacy. During the Cold War, the employment of confidence-building measures (CBMs) was rather limited, mainly to the military domain, and concerned with concrete issues such as arms control (Desjardins, 2014, p.4).

Over the past two decades, however, their use in diplomacy has grown (and changed) significantly across a whole array of issues that concern inter- and intra-state relations alike. Although they are not meant "to deal with the root causes of conflicts" as such (Desjardins, 2014, p.4), CBMs are to lessen fear and suspicion among conflicting sides "by making the parties' behaviour more predictable" (Maiese, 2003). In fact, as some have argued, CBMs

are often viewed as "the first step in turning hostile relationships into more accommodating ones" (Desjardins, 2014, p.4).

### **Trade and Conflict**

Trade generally falls into the category of economic CBMs. According to the "OSCE Guide on Non-Military Confidence-Building Measures (CBMs)", economic CBMs bring different states and communities together through economic cooperation including "cross-border and inter-community trade". In this way, it is largely argued that trade provides a basis for dialogue and has far reaching consequences that often go "beyond the economic domain" (OSCE, 2012, p.9).

In the scholarly literature on this subject, the role of trade has generally been analysed through the lens of the so-called democratic peace theory which posits that liberal democracies are less likely to engage in military confrontations with one another (Doyle, 1983). In a similar manner, proponents of the interdependence-conflict theory have emphasised the pacifying effects of trade interdependence. Their general argument is that the broader, deeper, and more intense inter-state and inter-community trade relations are, the lower is the likelihood of these states and communities fighting each other (Oneal, 2003; Liberman, 2004, p.139). The World Trade Organisation takes a similar stance by pointing out that "sales people are usually reluctant to fight their customers" (WTO, 2003, p.2). When translated in the context of this paper, questions regarding the trade-peace and trade-conflict relationship are of particular interest to us, and in order to establish the viability of trade as a CBM in the protracted conflicts in the OSCE region, we focus on three such conflicts and on the relations between communities rather than states.

While most work on trade concerns the role that trade interdependence plays in conflict reduction (or peace promotion) in general, recent research conducted by Lee and Rider (2016, p.1) re-tests the 'trade-reduces-conflict' hypothesis by focusing on a particular type of conflict, namely conflict 'over high-salience issues' such as territory. Their results are in line with the established 'liberal peace' consensus on this issue: trade "interdependence decreases the incentives for trading partners to engage in militarised conflict" (Lee and Rider, 2016, p.2, 4-5).

However, liberal claims about the trade-conflict (trade-peace) interrelationship have not gone unchallenged. Keshk, Pollins and Reuveny (2004), for example, maintain that trade relations are intrinsically affected by political relations and "when this effect is [adequately] accounted for, the apparent [positive] impact of trade on conflict disappears". They refer to this phenomenon as the 'primacy of politics' (Keshk, Pollins & Reuveny 2004, p.1176) – a view shared by some of our respondents, too. In the context of CBMs, Desjardins (2014, p.5), among others, has also argued "that in nearly all cases, CBMs are only as strong as the

fundamental political will for compromise in any successful negotiations" and has cautioned that "[t]hey are not cost-free and do not only bring positive results".

Keshk, Pollins and Reuveny (2004, p.1176) have proposed that the scholarly debate on trade should be framed in the context of 'when' and 'how' trade promotes peace rather than 'whether' it does so or not. This is the approach we adopt in this paper as well as we seek to uncover ways in which trade could facilitate the rapprochement of conflict parties and the ways in which the international community could facilitate such an outcome.

## *The Case of Georgia*

### **Georgian-Abkhaz Trade Relations**

On 27 May 2016, after four years of an Abkhaz boycott, a meeting of the Incident Prevention and Response Mechanism (IPRM) took place in Gali.<sup>2</sup> On top of the agenda was a tragic occasion – just days earlier, a 30-year old ethnic Georgian internally displaced person (IDP) from Abkhazia had been gunned down in broad daylight in the Tbilisi-administered territory near the so-called Administrative Boundary Line (ABL) with Abkhazia.<sup>3</sup> Subsequent media reports suggested that the reason for the shooting was an altercation between the victim and one of the 'customs officers' from the Abkhaz side. The victim was allegedly trying to negotiate the amount of bribe to be paid in order to transport food to a relative's funeral in Gali (The Clarion, 26 May 2016).

As was expected, this incident sparked a public outcry in Georgia. Once again, questions were raised regarding Tbilisi's conciliatory policy towards Abkhazia and South Ossetia (and Russia) pursued by the Georgian Dream coalition since 2012. The previous government's aggressive rhetoric against Russia was significantly tempered down, the use of the word 'occupation' by some of the senior government officials was also limited, and Georgia renewed trade talks with its northern neighbour. Concerning Abkhazia and South Ossetia, this policy manifested itself in an easing of the security measures on the ABL by reducing manpower and dismantling some of the checkpoints (The Clarion, 26 May 2016).

Despite public concerns after the above incident, government officials were adamant that this policy would not change. Prime Minister Giorgi Kvirikashvili condemned the incident but expressed hope that the ongoing confidence-building process would continue. Likewise, President Giorgi Margvelashvili stressed that Tbilisi would continue pursuing its so-called "policy of 'strategic patience', aiming to eventually bring Russia to 'rational dialogue'" (The Clarion, 26 May 2016). What this incident highlights, however, is how fragile security remains alongside these ABLs and that years of confidence-building measures can be undermined significantly by single events. At the same time, the Georgian government's reaction to this event also indicates their openness to dialogue. This current, more flexible approach should be taken as an opportunity to engage in a constructive dialogue rather than be considered as a "series of pointless concessions" (The Clarion, 26 May 2016).

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<sup>2</sup> IPRM meetings, set up in 2009, were one of the most substantial outcomes of the Geneva international discussions which bring the conflicting sides to the discussion table after the 2008 Russo-Georgian war. IPRM meetings in Gali had been suspended since 2012 due to the Abkhaz side's refusal to allow the EU Monitoring Mission (EUMM) commander at the time into the territory of Abkhazia allegedly because of his pro-Georgian stance on the issue (The Clarion, 26 May 2016).

<sup>3</sup> Village Khurcha where the incident took place, is close to one of the crossing points that links Gali district of Abkhazia - a predominantly ethnic Georgian-populated region - and Zugdidi district of Samegrelo region in western Georgia (The Clarion, 26 May 2016).

### Trade across the ABL

At present, Abkhaz authorities maintain that any movement of commercial goods to and from the Georgian side is illegal.<sup>4</sup>From the Georgian perspective, the situation is not so straightforward: on the one hand, movement of goods on the territory of Abkhazia is viewed as 'a domestic turnover' in Georgia; on the other hand, the Law of Georgia on the Occupied Territories, which was adopted in the aftermath of the August 2008 war, declares all economic activities, including trade, on the territory of both Abkhazia and South Ossetia—considered as territories occupied by the Russian Federation – as illegal, a few exceptions to one side (Caucasus Business Week, 14 Dec. 2015). Nevertheless, informal trade (or rather, smuggling) between the two sides continues, and according to 2013 estimates is thought to be around \$15 million per year (Mirimanova, 2015, p.3). As one official from the European Union Monitoring Mission in Georgia (EUMM) observed, "if you were to stand by the crossing points at Enguri river, you will see that there is always some small scale trade going on"(interview with an EUMM official, June 2016).<sup>5</sup>

The main transit route for goods and people between the Georgian and Abkhaz sides is the Enguri river which provides access to the Gali district in Abkhazia. The so-called trans-Enguri trade is carried out through one official and a number of unofficial routes (Caucasus Business Week, 14 Dec. 2015).<sup>6</sup> Throughout the 1990s, contraband trade across the Enguri grew significantly, and according to some analysts reached especially high levels in the period of 1998-2003 (which followed the deterioration of the security situation in the region and the escalation of violence in May 1998) (Kukhianidze *et al.*, 2004, p.5, 15).<sup>7</sup> According to some estimates, before summer 2006 (which saw another phase of escalation of violence in the Tbilisi-controlled Kodori gorge in Abkhazia), the turnover of goods between the conflicting sides was \$10–15 million annually (even under the conditions of unofficial trade). Moreover, while it has mainly been ethnic Georgians from Gali participating in this trans-border trade, by 2005–2006 there were cases of some ethnic Abkhaz (including from western Abkhazia) also travelling to Georgia. In the aftermath of summer 2006, however, the unofficial 'border' between the two sides was closed, which made smuggling even more difficult and the turnover of goods between the two sides reportedly shrunk 'more than ten-fold' (Baratelia, 2011, p.14). This had a negative impact on cross-border inter-community

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<sup>4</sup>This has been largely the case since 2007 when *de facto* President of Abkhazia Sergei Bagapsh signed a decree on this issue amidst security concerns in the region (Caucasus Business Week, 14 Dec. 2015).

<sup>5</sup> According to Abkhaz sources, there were 1,1 million 'border' crossings at Enguri last year alone (interview with an EUMM official, June 2016). However, these numbers are disputed by the Georgian side and international observers who argue that the real number is likely to be much lower as *de facto* authorities in Abkhazia continue to clamp down on freedom of movement across Enguri (authors' interviews with an EUMM official, June 2016 and with a Georgian government official, May 2016).

<sup>6</sup> The official route goes across the Enguri Bridge which is the main bridge over the river Enguri that links Georgia and Abkhazia. According to recent reports, goods turnover through this route is 80% and people turnover is 75%. In addition to this, the so-called upper zone provides about 5% of goods and people turnover. There is also the so-called lower zone with 15% goods and 20% people turnover (Caucasus Business Week, 14 Dec. 2015).

<sup>7</sup>Gali's private sector at the time consisted of "large-scale smuggling of scrap-metal, petrol and cigarettes" (Mirimanova, 2006, p.526), as well as log and timber, stolen cars, drugs and weapons (Kukhianidze *et al.*, 2004, pp.31-48; see also Reliefweb, 31 July 2004).

trade relations, especially in light of the slow but steady progress that had been made in the region over the preceding years.

A study published at the time by International Alert highlighted the potential positive impact that local, Gali-based small-business entrepreneurs might have on bridging the gap between Abkhaz and Georgian communities and potentially change conflict dynamics and perceptions. Some ethnic Georgians from Gali were even open to the prospect of engaging in joint business ventures with Abkhaz from other regions (such as Gudauta or Sokhumi/Sukhum) (Mirimanova, 2006, p.526-527). In their interviews, they talked about the need for (and importance of) peace and trade to re-build relationships between the two sides: "We need to restore relationships between the Abkhaz and Georgians in Abkhazia. Nothing can do it better than joint business" (cited in Mirimanova, 2006, p.529). People on the ground, thus, seemed to echo the proponents of the "trade-causes-peace argument", arguing that the more people engaged in business, the lesser would be the chances of renewed hostilities. As one of the respondents of the study put it at the time, "[p]eople who have got a business are neither angry nor aggressive. They want to expand their business, and another war would mean losing everything again" (cited in Mirimanova, 2006, p.529).<sup>8</sup> Moreover, some ethnic Georgians in Gali even favoured the status quo: "[l]et 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" (cited in Mirimanova, 2006, p.529).

A practical example of how such sentiments can be supported externally and contribute to confidence-building are some of the activities of the Abkhaz Union of Women Entrepreneurs – an NGO founded by Abkhaz businesswomen and based in Sokhumi/Sukhum. Providing training and material support to ethnic Georgian entrepreneurs from Gali, their projects were conducted in partnership with a number of international donor organisations such as International Alert, the UK Department for International Development, the Swiss Agency for Development and Cooperation, Swedish NGO Women to Women (*Kvinna till Kvinna*), UNHCR and UN Volunteers (Mirimanova, 2006, p.527-528). The importance and utility of such externally supported interactions on the ground between business people from the two communities was repeatedly emphasised by officials from the Ministry of Foreign Affairs in Tbilisi as well who suggested that the international community could implement more programs targeted at fostering cross-border, inter-community trade rather than focusing too much on inter-community trade within Abkhazia (interviews with Ketevan Chumbadze, Counsellor at the Political Department, Ministry of Foreign Affairs of Georgia and David Dondua, Deputy Minister of Foreign Affairs of Georgia, June 2016).

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<sup>8</sup>While not representative of an entire IDP population of Georgia, of course, these viewpoints seem to be different from a segment of the IDP population outside of Gali. Some of the interviews conducted in Tbilisi in 2011, for instance, highlighted the skepticism towards trade links as a viable mechanism for a long-term stability and conflict-resolution tool in the region, emphasising instead the supremacy of political means (authors' interviews in Tbilisi, 2011).



Other relatively successful examples of this approach to confidence building include Conciliation Resources' attempts to facilitate business connections between the conflict parties in the South Caucasus, including through organising, since the early 2000s, a number of study visits to the UK for Georgian and Abkhaz representatives; the creation of the Caucasus Business and Development Network (CBDN) by International Alert which brought together "business people, civil society activists and academics, all working towards peace in the region" (Klein and Pentikainen, 2012, p.224); and the establishment of the Economy and Conflict Research Group of the South Caucasus (ECRG) which was focused on exploring "new insight[s] into the inter-linkages between economy and conflict – in particular, the positive role that business could play in peacebuilding processes" (Klein and Pentikainen, 2012, p.236). By 2005-2006, this project in particular had some very positive outcomes. As some of its organisers pointed out,

[i]t had found a niche and introduced some new thinking into peacebuilding and conflict resolution discourses. We were being heard by the international community, donors were excited and the future financial support seemed to be in place. Therefore, the future seemed bright – except it wasn't. While the process was reaching a pinnacle, the exact opposite happened on the funding front. Iraq and Afghanistan were eating into much of the donor money. Moreover, our big plans, if not shelved, became more of a topic for academic discussion than implementation (Klein and Pentikainen, 2012, p.237).

Others involved also echoed this sentiment. Jonathan Cohen, Director of Programmes at the Conciliation Resources at the time, noted that

[w]ith other international priorities taking precedence, the external sponsors drifted in and out of modes of urgency. Generally, they were comfortable to maintain what was perceived as a stable status quo (allowing the misconstrued notion of 'frozen conflict' to take root – the conflict was not frozen, the process to find peace was) (Cohen, 2012, p.66).<sup>9</sup>

At the same time, changes in Georgia's internal politics began to affect the wider conflict dynamics. In late 2003, the 'Rose Revolution' brought about the peaceful change of government in Georgia from Shevardnadze to Saakashvili—a change in more than just generational terms. While there was a sense during Shevardnadze's rule, especially in the early years, that Russia could be engaged in the conflict settlement process in support of Georgia, increasingly Saakashvili's government distanced itself from this view. In fact, it viewed Russia as the main obstacle to conflict settlement and pursued a policy of internationalising Georgia's conflicts in order to secure more substantial Western support. In this way, emphasis was put on framing the conflict as Georgian-Russian rather than Georgian-Abkhaz. However, this approach also led to a deterioration of the relations with the

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<sup>9</sup>Interestingly enough the same view was voiced by a representative of one international organisation based in Chisinau, questioning the idea of 'protracted conflicts' when we explained the idea behind this paper and the upcoming OSCE workshop. According to them, "there is no protracted conflict [in Moldova] but protracted conflict settlement process" (authors' interview, June 2016).

Abkhaz who perceived it as a strategy to further isolate them (Cohen, 2012, p.66). This left little room for Georgian-Abkhaz dialogue. Tbilisi viewed civil society processes and initiatives as largely unproductive and, therefore, less welcome (Cohen, 2012, p.71; see also interview with Giorgi (Goga) Khaindrava, June 2016).<sup>10</sup>

Nonetheless, and despite at times tense relations between the conflict parties, there had been a number of attempts during Saakashvili's period to engage with the Abkhaz side, and in particular to create a legal framework to regulate economic interactions across the ABL. Most notably, in 2008, proposals were made to turn the Gali and Ochamchire districts in Abkhazia into 'special' or 'free economic zones' as a way of building confidence.<sup>11</sup> However, negotiations on this issue eventually ground to a halt as a result of the subsequent Russo-Georgian war (RFE/RL, 17 July 2008).

### Enguri Hydropower Station

One notable exception to an otherwise dismal track record of economic cooperation is the operation of the Enguri hydropower complex, partly borne of the necessity to manage a situation in which the actual power station is located in Abkhazia while the reservoir is on Georgian-controlled territory. The protocol of 1999<sup>12</sup> and further agreements, such as the March 2003 tripartite agreement between the Georgian, Abkhaz and Russian representatives, have enabled the conflicting sides to ensure the uninterrupted functioning and rehabilitation of the station (Mirimanova, 2013a, p.57). According to these agreements, Abkhazia receives 50% of the electricity generated by the power plant (Caucasus Times, 23 July 2003). The management of the hydropower station sits in Zugdidi in the Samegrelo region of Georgia and has a representative branch in Tbilisi. The wages as well as all associated maintenance costs are paid by the Georgian government (Basaria, 2011, p.18). Both the Georgian and Abkhaz sides often declare their indisputable right to operate and own the Enguri station; yet despite such mutually exclusive claims, the station has continued to operate without any disruption. Ethnic Georgian employees of the station unanimously agree that "for the whole duration of the post-war period, there were no conflicts between them and the few Abkhaz working at the station. Everyone has a clear understanding of their responsibility to ensure the smooth running of the plant" (Basaria, 2011, p.21). While there are some justifiable claims that this need not be a 'unique' case and that many aspects of this particular example of inter-ethnic cooperation could be exported at a smaller scale as well into other economic

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<sup>10</sup>Almost a decade later, another change of government in 2012 created a renewed opportunity for dialogue to resume, including through civil society, with the new State Minister for Reconciliation and Civic Equality, Paata Zakareishvili, for instance, having been actively involved in civil society initiatives before assuming government office.

<sup>11</sup>This idea was voiced by then President Mikheil Saakashvili in March 2008 as part of his government's new peace plan for Abkhazia. Economic relations were also an important part of the second stage of the three-phase peace plan proposed by German Foreign Minister Frank-Walter Steinmeier during his visits in Tbilisi, Sokhumi/Sukhum and Moscow in July 2008. However, exact details of the latter proposal were not disclosed publicly (RFE/RL, 17 July 2008).

<sup>12</sup> Adopted at the Istanbul Statement of the Georgian and Abkhaz Sides on Confidence-Building Measures in June 1999.

projects (Basaria, 2011, pp.18, 21), it is not clear what the actual confidence-building effects beyond this case are.

### Railway Links

The Transcaucasus Railway, the first railway in the Caucasus and the only railway linking Georgia and Russia is another issue of contention, but also potentially a possible issue of cooperation, between the conflicting sides. It was built by Tsarist Russia and expanded during the Soviet times as a strategic railway link that allowed Russia broader access into the Caucasus region. After the dissolution of the Soviet Union, the railway was taken over by the respective entities in the region. While the Tbilisi-Baku section of the railway was rehabilitated, the Tbilisi-Sokhumi/Sukhum section ceased operation in the early 1990s as a result of the Georgian-Abkhaz conflict (Railinform, n.d.). Several attempts were made since then to restore railway tracks between Georgia and Abkhazia. In 2005, the parties agreed that a research group consisting of Georgian, Abkhaz and Russian experts would visit Zugdidi, Gali and Ochamchire to study the issue first-hand. However, negotiations stalled due to the Abkhaz side refusing to take on board what they claimed were 'additional political demands' from the Georgian side who argued in favour of the possible return of some of the IDPs to Abkhazia as part of the deal (Reliefweb, 27 July 2005).

In 2012, the new Georgian government re-opened the issue of restoring this railway link that would connect Russia to Armenia via Abkhazia and Georgian-controlled territory (The Jamestown Foundation, 12 Nov. 2012). In 2013, *de-facto* deputy foreign minister of Abkhazia, Irakli Khintba stated that the regime in Sokhumi/Sukhum had not yet estimated the economic costs and benefits of this project in order to assess its value to the Abkhaz side. His main issue, however, seemed to be Tbilisi's insistence on negotiating with the Russian side on this issue while the Abkhaz would not entertain anything less than unchallenged control of the segment of the railway which lies within the territory of Abkhazia (Abkhaz World, 28 Aug. 2013). That same year, International Alert published a study detailing potential costs and benefits of re-opening the railway line and concluded that, because of the associated costs of conducting the repair work, the project would not be able to return on the investment required, estimated at \$277.5 million (Mirimanova, 2013b, p.3).

Beyond the issue of cost, there is also a significant, and not entirely positive, regional dynamic: a complete restoration of the railway link would extend benefits to many South Caucasus economies, including, and perhaps most of all, Armenia, which, in turn, has raised concerns (and criticism) in neighbouring Azerbaijan and Turkey.

Nonetheless, the issue of the railway link has been raised again at the meeting in early 2015 between Zurab Abashidze, the Georgian Prime Minister's Special Representative for Matters

of Relations with Russia, and Grigory Karasin, Russia's Deputy Foreign Minister.<sup>13</sup> This issue was raised within the framework of the WTO agreement that Russia and Georgia signed back in 2011. The trade deal effectively opened doors for Russia's accession to the WTO after 18 years since it made its application (Georgia had been a member since 2000). The agreement, brokered by Swiss mediators, established three 'trade corridors' at the Georgian-Russian border, two of which run through Abkhazia and South Ossetia. Geneva-based company SGS was to be contracted by both the Georgian and Russian sides to regulate customs and carry out the monitoring (*Vestnik Kavkaza*, 19 Feb. 2015; Civil Georgia, 18 Nov. 2011; 17 Feb. 2015). However, at the time the deal had little practical implications due to non-existent trade (or diplomatic) relations between the two countries.<sup>14</sup> Since then, the situation has somewhat improved as Russia lifted some of the bans it had imposed since 2006 and in 2013 started re-opening its market to some Georgian products. In the case of Abkhazia, in order for Georgia and Russia to start implementing the 2011 WTO agreement and start using this territory as a "'corridor' for mutual trade", the issue of the restoration of the railway links automatically props up again (*VestnikKavkaza*, 19 Feb. 2015). However, while this issue remains open, due also to the above sensitivities involved in relation to Azerbaijan and Turkey, there could be a room here for further talks and rapprochement between the conflicting sides.<sup>15</sup>

### **Georgian-Ossetian Trade Relations**

Unlike Abkhazia, where there were territorially concentrated pockets of ethnic Georgians and ethnic Abkhaz in various parts of the region (with the exception of big cities such as Sokhumi/Sukhum), South Ossetia is an area of mixed settlement with no clear dividing line between ethnic Georgians and ethnic Ossetians. This has contributed to the preservation of a much higher degree of socio-economic links between the two communities in the region (Mirimanova, 2006, p.533).<sup>16</sup>

As in Abkhazia, the seemingly 'frozen' nature of the conflict served as a convenient tool in the hands of various organised crime groups developing illegal schemes for smuggling goods, drugs, weapons and people along the Transcaucasian highway (ICG, 2004, p.9). Illegal trade was thriving because neither Georgian nor South Ossetian sides were willing to cooperate on regulating it under any legal framework. On the one hand, South Ossetia would not let Georgian customs officials on its territory, claiming being an independent state, and on the other hand, Georgians would not set up customs control checkpoints on

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<sup>13</sup> The two countries have no diplomatic relations since the war in 2008; however, the so-called Abashidze-Karasin format of the Georgian-Russian dialogue was set up after the new government came in power in Tbilisi in 2012.

<sup>14</sup> Since 2006 Russian market has been closed to Georgian products after it imposed ban on Georgian (and Moldovan) wine and mineral water.

<sup>15</sup> In Moldova, railway links through Transnistria for goods and then passengers were restored after several years of negotiations between the parties in 2011.

<sup>16</sup> One such example was a village of Khetagurovo, which was divided into two parts after the early onset of violence in the early 1990s. With the intention to keep the source of income, Georgian and Ossetian villagers decided to exchange the arable land between themselves so that in case of the encounter with the militia they could show that 'Georgian' land was, in fact, farmed by Ossetians and vice versa (Mirimanova, 2006, pp.537-538).

their side in order not to grant any legitimacy to the Ossetian *de facto* authorities (ICG, 2004, p.10). Moreover, according to a number of reports, authorities on both sides as well as Russian troops stationed in South Ossetia profited significantly from smuggling operations (Kukhianidze, *et al.*, 8, 27, 38; ICG, 2004, 10), which further limited any incentives for formal trade regulation.

#### Ergneti Market

Located on a highway which links the Georgian town of Gorito Tskhinvali in South Ossetia, Ergneti Market was one such place where illegal trade was taking place. It gained particular prominence after 1999 when smuggling alcohol from Georgia to Russia became less profitable and instead people started smuggling cigarettes, petrol, stolen cars, agricultural and industrial products into Georgia via Ergneti, while Georgian agricultural produce would end up in Russia through the Ergneti route (Mirimanova, 2006, p.535). Since the goods were not taxed, prices for them were some of the lowest in the region. As a result, Ergneti market quickly turned into "a price-setting mechanism for the entire region", providing a rather "reliable source of income for thousands of Ossetians and Georgians" (Mirimanova, 2006, p.535). People from both sides of the conflict unanimously praised Ergneti market and talked about its alleged benefits. As one analyst put it,

[m]ost 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 (Mirimanova, 2006, p.536).

In other words, it was largely perceived as "an important development mechanism in South Ossetia, with significant peacebuilding implications"; in fact, even authorities in Tbilisi and Tskhinvali acknowledged "that the organisation of Ergneti market had been their main achievement" (Mirimanova, 2006, p.535).

According to some estimates, goods turnover at Ergneti market was between \$101 million and \$133 million per year (Mirimanova, 2006, p.535; Kukhianidze, *et al.*, 2004, p.19) which reportedly cost Georgia's state budget \$120 million annually in customs revenues (Civil Georgia, 2 Sept. 2004). While there had been numerous raids against illegal trade in Ergneti, these were largely believed to have been a means to solicit and collect bribes rather than being genuine anti-smuggling operations (Ossetia-info, 2003; Kukhianidze, *et al.*, 2004). However, after the 2003 'Rose Revolution', the Georgian government took the issue of illegal smuggling more seriously and by early June 2004 Ergneti market had been closed down. While Georgian customs reportedly claimed a fourfold increase in revenue (ICG, 2004, pp.10-11), relations between ethnic Georgians and Ossetians in the conflict zone further deteriorated (eventually resulting in the brief outbreak of violence over the summer 2004). Livelihoods of the local population (on both sides of the conflict) were also negatively

affected as their only source of income evaporated. More importantly, however, "the market was a means for average Georgians and Ossetians to meet, build contacts, and identify common interests after the war years" (ICG, 2004, p.10-11).<sup>17</sup>

At the time as well as since then, many have criticised the decision by Saakashvili's government to close this market down. Goga Khaindrava who served as Georgia's State Minister on Conflict Resolutions in 2004-2006<sup>18</sup> maintains that this was a mistake:

Reportedly up to 3,000 people, both ethnic Georgians and Ossetians were involved in this market one way or another – this is a huge number for such a small region as South Ossetia. It served as a place of inter-ethnic mixing through trade. The Russians do acknowledge the power of inter-community trade in bringing people closer to one another and this is partly why they are building fences now (authors' interview, June 2016).

The importance of the Ergneti market was also recognised by Bidzina Ivanishvili during the 2012 parliamentary election campaign as he pledged to re-open it (Eurasianet, 14 March 2013). However, even though ordinary people in South Ossetia seemed to be open to this idea, the authorities in South Ossetia were less enthusiastic. Boris Chochiev, South Ossetia's *de-facto* prime minister at the time, claimed that restoring cross-border trade in the Georgian-controlled territory "would bring 'great harm to the republic of South Ossetia'" (cited in Eurasianet, 14 March 2013). By 2014, however, and after a change of government in South Ossetia, the new leadership under Leonid Tibilov seems to have softened its stance on the issue. Similarly, Georgian State Minister Paata Zakareishvili noted that there is indeed "a political will to discuss the issue on the expert level", but cautioned that "[i]n its direct sense, restoration of the Ergneti market is not planned. The discussion is about opening trade centres in the direction of Abkhazia and Tskhinvali" (Georgia Today, 1-7 Aug. 2014).

In early 2016, one such trade centre opened in the Georgian village of Rukhi located by the Enguri bridge near Abkhazia. According to Natia Turnava, the Deputy Executive Director of the state-owned company in charge of this project, the expectation is "that customers of this centre will be not only the people living near the dividing line, but also people living in the region of Abkhazia" (cited in Accent, 26 Feb. 2016). This issue was pointed out in many of the interviews we conducted with the representatives of the Georgian government as well. As Marina Salukvadze from the State Ministry for Reconciliation and Civil Equality<sup>19</sup> pointed out, "before, there were organised shopping tours from Abkhazia to Lilo market [near Tbilisi] in which many Abkhaz also took part, but now it will be much easier for them to do the shopping closer to home" (authors' interview, June 2016). In other words, despite

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<sup>17</sup>After the 2008 Russian-Georgian war, the village of Ergneti was divided. One part now serves as a 'buffer zone' between the Georgian and Ossetian sides while the other part is situated on Ossetian-controlled territory (Agenda.ge, 28 Dec. 2014).

<sup>18</sup>Khaindrava also was the State Minister on the Abkhaz Affairs in 1992.

<sup>19</sup>Salukvadze is the Head of Unit of Autonomous Republic of Abkhazia and Former Autonomous District of South Ossetia at the Ministry and used to be a regular participant of the IPRM meetings.

political problems, human relations on the ground have been maintained, especially in the socio-economic and cultural spheres. For instance, due to the demand and "the steady flow of patients" who come to the Georgia-controlled territory from Abkhazia for treatment, a medical centre is also being built in Rukhi (Natia Turnava cited in Accent, 26 Feb. 2016). According to Zviad Zviadadze, also from the State Ministry for Reconciliation and Civil Equality,<sup>20</sup> "last year alone, up to 1800 people sought medical treatment in Georgia from the break-away regions" (authors' interview, June 2016).<sup>21</sup>

Further, Georgian sources point to the need for a Rukhi-type shopping centre near South Ossetia as well. Products in Gori (on the Georgian side) are reportedly up to three times cheaper than the same products in Tskhinvali (on the South Ossetian side). Moreover, the Ossetian population of Tskhinvali largely depends on imported products from Georgia, especially during the harsh winter period when the Roki Tunnel connecting South Ossetia to the Russian Federation is often closed. However, as Deputy State Minister for Reconciliation and Civil Equality Ketevan Tsikhelashvili points out, "trade relations are often directly linked to the freedom of movement and in light of the current 'borderisation' in South Ossetia carried out by the Russian forces stationed there, it makes it even harder for the local population on both sides of the 'dividing line' to engage in cross-border inter-community trade" (authors' interview, June 2016). This is where she sees a need for more active involvement, and engagement, of the international community as well.

The EUMM also points to the challenges it faces in regards to the freedom of movement issue. "People are used to living together", said one EUMM official (authors' interview, June 2016). However, the wired fences that have been erected since 2012-2013 (and that shifted the demarcated 'boundary lines' between South Ossetia and the Georgian-controlled territories) significantly hinder the freedom of movement of local populations. Currently, only some 4,000 people with permanent residence in the Akhalkalaki<sup>22</sup> region are allowed to cross into Georgian-controlled territories and even they have to operate within the imposed limit of 50 kilograms per person on goods they can transport back to South Ossetia. As officials point out, the situation in this regard is not improving, in fact, it is probably getting worse with more detentions along the ABLs happening each month (authors' interview, June 2016).

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<sup>20</sup>Zviadadze heads the Department of Autonomous Republic of Abkhazia, Former Autonomous District of South Ossetia and Civil Integration at the Ministry.

<sup>21</sup>Ministry of Labour, Health and Social Affairs of Georgia has allocated annual budget of 10 million GEL for this purpose alone. For the patients from Abkhazia and South Ossetia it is free to get medical treatment in the Georgia-controlled territory up to 20,000 GEL (interview with Zviad Zviadadze, June 2016).

<sup>22</sup>Akhalkalaki is an ethnic-Georgian town in South Ossetia which was under Tbilisi control after the initial outbreak of violence in the early 1990s. However, it has been under the control of *de facto* South Ossetian authorities since the August war of 2008.

## ***The Case of Moldova***

### **Moldovan-Transnistrian Trade Relations**

Since breaking away from Moldova in the early 1990s, Transnistria has often been described as "Sheriff Republic", "black hole", "Smirnov & Son Co."<sup>23</sup> and over the years many have indicated that the very roots of the Moldovan-Transnistrian conflict could be traced back to economic interests. While ethno-linguistic factors cannot be discounted altogether, as some have pointed out, they were further aggravated by "the marked differences in [Chisinau's and Tiraspol's] approach to economic reform" (World Bank, 1998, p.i; see also, CISR, n.d.).

Back in 1989-90, even before the dissolution of the Soviet Union, the idea was put forward to turn the cities of Tiraspol and Bender/Bendery<sup>24</sup> into free economic zones in order to establish the so-called regional self-financing for the Left Bank Region – a model popular during *perestroika* in the Baltic states (CISR, n.d., pp.1-2; CISR, 2003, p.3). The rationale behind this idea was Transnistria's overall standing in the economy of the Moldovan Soviet Socialist Republic (MSSR) – with a territory of only 12.4% and the population of 15.2% of the MSSR, by 1990 Transnistria and Bender/Bendery accounted for about 40% of the country's gross national product. This was largely due to the region's strategic geographic position, having access to a number of important trade routes that provided transport links to Ukraine's sea port of Odessa and the Donetsk-Dnieper region (CISR, n.d., p.2). In this way, Transnistria "has always been a natural hub for Moldova's trade with the east in respect to both land transportation and energy pipeline connections" (World Bank, 1998, p.i). Moreover, the region also boasted "large-scale multi-sectoral industry" as well as housing the largest hydro-electric power station responsible for 85-90% of Moldova's electricity. Its overall agricultural production was also six times higher than the entire Soviet Union's (CISR, n.d., p.2; World Bank, 1998, pp. i, 3). As a result, Transnistria's secession significantly affected the rest of Moldova not only politically but also economically. Already one of the smallest economies in the former Soviet Union (FSU), Moldova's economy was now split "into two even smaller economies" and the country experienced "one of the steepest economic declines among the FSU countries" (World Bank, 1998, pp.3-4).

After *de facto* seceding from Moldova in the early 1990s, Transnistria embarked on the path of decoupling its economic institutions from the rest of the country. It established its own central Transnistrian Republican Bank, issued separate currency and set up separate customs services by introducing its own customs control posts along river Nistru/Dniester. As is the case in Georgia, Transnistria treats trade relations with Moldova as foreign trade, while for Moldova this is considered as internal turnover of goods (World Bank, 1998, p.i).

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<sup>23</sup>Referring to *de facto* President of Transnistria Igor Smirnov (in office 1991-2011).

<sup>24</sup> City of Bender/Bendery is located in the so-called buffer zone but under *de facto* administrative control of Transnistria.



This ambiguity, coupled with lack of structural reforms has created fertile ground for shadow economy to emerge on the territory of Transnistria. Especially during the 1990s, much of the trade there was unregulated and the region was a place for "unrecorded foreign trade, tax evasion, and smuggling". This was also due to lack of control over the region's eastern border with Ukraine, which effectively remained out of Chisinau's control (World Bank, 1998, p.4). This undoubtedly further affected already strained economic relations between Moldova and Transnistria, however, as many acknowledge, "the level of integration prior to the conflict was so high [between these entities] that trade links have been partially maintained despite all the difficulties, and the exchange of goods remain[ed] rather intensive" throughout much of the 1990s (World Bank, 1998, p.6). As Yurii Ganin, Head of the Tiraspol-based working group of the Transnistrian Investment Forum pointed out, "we had a war but we still had [inter-community] trade. War stopped and trade continued" (authors' interview, June 2016).

One such sphere of integration that could not be easily detangled was energy, which became one of the main spheres of coordination (and cooperation) between the two sides after the initial outbreak of violence. Moldova depends heavily on the energy it imports from Russia and all its major pipelines go through Transnistria. As is the case with Georgian-Abkhaz cooperation in regards to the Enguri hydroelectric power station, Moldova and Transnistria also managed to find the common ground when it came to operating the country's largest power plant – Moldovskaya, situated in Transnistria. After the conflict, electricity infrastructure continued to function as a single entity, controlled administratively from Chisinau and relations between Moldovskaya and MOLDENERGO, the electricity company situated in the west bank, were kept strictly commercial. Half of the electricity produced at the plant still went to Moldova (World Bank, 1998, pp.3, 6).

Moreover, in the mid-1990s in particular, there were some further attempts from Tiraspol to try and reintegrate Transnistria's economy with Moldova's economic system. This could also be attributed to the shift in Russian foreign policy towards more diplomacy in order to advance its national security and economic interests (ICG, 2004, pp.5-6). As a result, a number of agreements were signed between Chisinau and Tiraspol, including an agreement on regulating the monetary and credit systems. As part of this agreement Moldova opened a branch of its National Bank office in Tiraspol. This was followed by a custom's agreement a year later which resulted in abolishing customs posts between the west and east banks. Instead, joint customs posts were established at the border with Ukraine. Furthermore, in order to regulate, and standardise Moldovan and Transnistrian customs relations, Moldova also shared its customs stamps and seals with Tiraspol (ICG, 2004, p.15; World Bank, 1998, pp. ii-iii). However, instead of achieving its goal and producing "a common customs space", this initiative enabled further lucrative deals to take place in and via Transnistria. Since

Transnistrian enterprises were now no longer required to pay taxes to the Moldovan authorities, internal border between these entities turned into a place of uncontrolled 'legal' smuggling with vested interests from various business circles not only in Transnistria and Moldova but also in Ukraine and Russia. As was the case in Georgia, this "created a powerful network" in and around Transnistria that had more interest in maintaining status quo than trying to find solutions to the conflict (ICG, 2004, p.15). In fact, some would argue that such a 'network' of status quo supporters in the region exists up to present time. As one EU official put it, the current situation in Transnistria is "one of a 'comfort' rather than a conflict. There is nothing to fight about. All there is, is vested economic interests" (authors' interview, June 2016).

As a result of these unintended consequences of the above-mentioned agreement, the five-year period of 1996-2001 could be considered "the most successful for the Transdnestrian [*sic*] economy" (ICG, 2004, p.15). However, this situation began to change from 2001 onwards. As the newly elected president, Vladimir Voronin (in office 2001-2009) had an initial 'honeymoon' period with Transnistria, but soon reversed course and resorted to using political and economic pressure to coerce Tiraspol into a settlement, additionally hoping for parallel Russian pressure on Transnistria in the context of the so-called Kozak plan (Beyer and Wolff 2016). As this initiative faltered in 2003 in the wake of Western pressure on Voronin and his own fears of losing power given the popular discontent with the settlement proposed in the Kozak plan (Hill 2012), Voronin's 'European turn' facilitated further measures that increased economic pressure on Transnistria. The first step in this direction was the introduction of new customs stamps and seals in line with the WTO standards (ICG, 2004, p.7). This was followed by the signing of a number of Protocols between Moldova and Ukraine in 2003, which demanded that goods to be transported through the Ukrainian-Moldovan border, including at its Transnistrian segment, required official customs documents issued by Chisinau (CISR, 2003, p.10; see also, Government Portal, 16 May 2003). In accordance with this new rule, Transnistrian enterprises could, however, register with the Moldovan State Registration Chamber and receive certificates of origin from the Chamber of Commerce and Industry of the Republic of Moldova (CISR, 2003, p.10).<sup>25</sup> In 2005, a number of further agreements were signed. On 7 October 2005, the Memorandum of Understanding between the European Commission and the Moldovan and Ukrainian Governments established the legal basis for the EU Border Assistance Mission to Moldova and Ukraine (EUBAM)<sup>26</sup> which was launched later that year (Eubam.org). This was followed by another agreement between Chisinau and Kyiv on 30 December 2005 "on normalizing the

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<sup>25</sup> According to Iulian Groza, an independent expert and policy moderator at the Chisinau-based think tank Institute for European Policies and Reforms (IPRE), since then over 1000 Transnistrian companies have registered in Moldova (authors' interview, June 2016).

<sup>26</sup> Its current mandate runs until 30 November 2017 (Eubam.org).

trade regime" on the border between the two countries (Socor, 8 March 2006).<sup>27</sup> These moves had further serious implications for Transnistria's economy, which by then had already suffered for several years.<sup>28</sup>

However, despite tense relations over the years, "traditional trade relations and personal contacts between the economic entities" continued (CISR, 2003, p.10); moreover, they acquired a whole new dimension as Chisinau intensified its efforts to establish stronger relations with the EU. As is the case in Georgia, in Moldova as well, there is a strong belief that closer ties with the rest of Europe will help transform the country into a more attractive entity (both politically and economically) for the residents in break-away region. Thus, European integration is also seen as "the necessary precondition for the country's sustainable reintegration" (Groza, 2015, p.5; see also interviews with Groza (Moldova) and Marina Salukvadze (Georgia), June 2016).

An important step in this direction was the launch of the EU's Eastern Partnership (EaP) program which targeted countries in the 'Wider Europe', such as Moldova and Georgia (alongside Belarus, Ukraine, Armenia and Azerbaijan) by promoting and strengthening democratic institutions in these countries "through political association and economic integration" with the EU (Mikhnovets, 2015, p.1). An important part of the EaP is the Association Agreement (AA) and the related Deep and Comprehensive Free Trade Area (DCFTA). The AA involves a number of reforms targeting countries' legislature and aimed at improving human rights situation and the rule of law. The DCFTA, on the other hand, implies "a wide range of economic reforms" and provides "an increased opportunity for economic integration, trade, [and] investments" with the EU (Mikhnovets, 2015, p.1).

### **The DCFTA Negotiations**

Moldova and the EU started negotiations about the AA and the DCFTA in 2010 and 2011 respectively and *de facto* authorities in Tiraspol were also included in this process as observers. For Chisinau it was of course important to apply the AA throughout the entire country, including Transnistria (Groza, 2015, p.5). The negotiations were completed in 2013, and in June 2014 Moldova and the EU signed the AA, the application of which, together with the DCFTA, provisionally started from September 2014 (as was the case in Georgia too). By that time, in 2013 the EU Council had made a decision to extend the Autonomous Trade Preferences (ATPs) offered to Moldova since 2008 until the end of 2015 when the ATPs were to be replaced by the DCFTA (from 1 January 2016) (Groza, 2015, p.4;

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<sup>27</sup> After initially suspending it in January 2006, the Ukrainian government started implementing the agreement in March that year (Socor, 8 March 2006).

<sup>28</sup> For instance, already in 2002, the total export of goods from Transnistria had already reduced by 35.6% in comparison to the previous year, while the export of goods to Moldova declined by 39%. Transnistrian imports of goods also shrunk by 16.9%, including a decline of imports from Moldova by 30.2%. According to Transnistrian officials, the region's losses from this 'economic blockade' amounted to \$167.8 million over the course of 2002 and first quarter of the 2003 fiscal year (CISR, 2003, p.10).

Calus, 2016). Transnistria had been part of the ATPs as well and thanks to this scheme both Moldova and Transnistria "could export certain quotas of their goods to the EU market without paying customs fees" (Calus, 2016). Already in 2015, for instance, Transnistria's exports to the EU was 30%. As some have pointed out, "the economic interest of the Transnistrian region is linked, with over 70%, to the Western economic space" and that without the DCFTA Transnistrian budget "could lose about 50 million USD, which would represent about 5% of the GDP" (Groza, 2015, p.6; see also Calus, 2016). However, despite economic rationality seemingly pointing towards Transnistria participating in the DCFTA too, its authorities continuously insisted on the region's economic and trade links with the Russian Federation and the Russia-backed economic space of the Eurasian Economic Union (EEU) (formerly Customs Union). In fact, as one official argued, "the extension of the implementation of the Association Agreement into the Transnistrian region would be part of a geopolitical war against Transnistria" (quoted in Groza, 2015, p.6).

Thus, it seemed that Transnistrian authorities were not willing to make any concessions on this issue and were to miss out on having access to the European markets from the year 2016. Initially, in the early period after the EU and Moldova started negotiations on the AA in 2010, the Transnistrian side generally did not seem to appreciate the potential magnitude of the (negative) impact of being left out of a DCFTA with the EU. This was recognised by the UK and, starting in 2010, the British Embassy in Chisinau began to organise and deliver a number of training events to raise awareness of DCFTA with the Transnistrian business community (primarily involving the TN Chamber of Commerce). In 2010/11 these were delivered in cooperation with Sweden and Finland, but thereafter solely by the UK. Over time, capacity building was intensified especially at the level of working jointly with the Moldovan and Transnistrian chambers of commerce on trade relations more generally and the impact of the DCFTA in particular (see also below). This created both greater awareness on the Transnistrian side of the challenges and opportunities presented by DCFTA implementation and helped to put into place a broader coalition of actors on the left bank willing to reach a compromise with the EU. Thus, following intensive negotiations between Brussels and Tiraspol, a deal was reached in December 2015 under which the EU accepted the inclusion of Transnistria into the application of the DCFTA for Moldova as of 1 January 2016. (Personal communication from UK diplomat, June 2016)

While Tiraspol is strengthening its ties with the EU, even if rather unwillingly, there is hope in Chisinau (and also in Brussels) that this might, eventually lead to strengthening of ties with the Moldova controlled territories as well. However, the above change in Transnistria's economic policy does not necessarily indicate its willingness to reintegrate with Moldova. On the east bank of the Nistru/Dniester, there is widespread acknowledgement that "the EU is an important trading partner" they cannot afford to lose (interview with Yurii Ganin, June

2016). Indeed, Transnistria's exports to the EU countries have overtaken its exports to the Russian Federation and the rest of the EEU countries (Belarus, Armenia, Kazakhstan and Kyrgyzstan). According to *de facto* authorities in Tiraspol, in the first three months of 2016 alone, 58% of its exported goods made it to the EU while the number for the EEU was only 6%. In 2015, 27% of its reported \$189 million in exports went to the EU, while exports to Russia declined by almost 7% to 7.7% (Eurasianet, 4 May 2016).

However, despite this seemingly declining Russian stake in Tiraspol's trade relations, many continue to emphasise their links with "mother Russia" (personal communication with Anatolii Dirun,<sup>29</sup> June 2016). Some in Transnistria are well aware of the potential contradictions in Tiraspol's policies. As Yurii Ganin pointed out, "on the one hand we want to have free trade with the EU which implies harmonisation of our legislature in accordance with the EU standards, but at the same time we are intrinsically linked with Russia and the EEU. We see Moldova as a bridge between us and the West. So we have to balance all this" (authors' interview, June 2016). In fact, Ganin talks about the so-called two-bridge theory where Transnistria acts as a 'big bridge' with the West and a 'small bridge' with Moldova (authors' interviews).

### **The Future of the DCFTA in Transnistria**

Analysts have hailed the DCFTA deal with Transnistria as Brussels' (and Chisinau's) great achievement. While most don't expect any solution on the political status of Transnistria in the short to medium term, almost everyone seems to agree that the new deal "bring[s] the two territories closer together, mitigating against future conflict" and that unlike Ukraine, "Moldova uses trade to ease relations and build bridges"(De Waal, 2016).

But does money really talk louder than politics and does trade indeed transcend geopolitical divides? Many in both Georgia and Moldova would argue that it does, but only to a certain degree. In Georgia, for instance, views similar to the ones expressed by de Waal and others are often met with certain scepticism (and cynicism). In informal conversations many point to the "naivety of the West" in this regard. Even in Brussels, some have cautioned about unrealistic expectations often associated with the DCFTA. As one source in Brussels pointed out, "there seems to be a lot of excitement about the DCFTA and a desire to copy it in other cases but there are a lot of strings attached to it which makes it quite a fragile 'tool'. Moreover, Transnistria is a very unique case and therefore the DCFTA deal there is not repeatable any time soon anywhere else" (interview with an EU official, June 2016). So what makes Transnistria such a unique case then?

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<sup>29</sup>Dirun is a scientific coordinator and a 'candidate' of political sciences at the Tiraspol School of Political Research.

Transnistria's economy almost entirely depends on trade. Tiraspol uses income from exports (rather than taxes) to generate money for the budget, which makes them much more vulnerable to external pressures (interview with an EU official, June 2016). Due to a number of factors, in recent years its economy has gone from 'bad to worse' and as one analyst put it, "Transnistria faced the threat of economic catastrophe" (Calus, 2015; see also interview with Tatyana Laryushin,<sup>30</sup> June 2016). Due to its landlocked geographic position it has also been particularly affected by the ongoing conflict in Ukraine which has been an important transit country for Transnistria. Devaluation of the national currencies of its main trading partners (Moldova, Russia, Ukraine) has also played its role. Weaker economic standing of Russia, due to Western sanctions and the falling oil prices also meant that the financial support from Moscow was gradually decreasing (Calus, 2015; see also interview with Yurii Ganin, June 2016). In the midst of the upcoming *de facto* Presidential elections in Transnistria, current *de facto* President Yevgeny Shevchuk also was under a lot of pressure, especially from the Transnistrian business community, to accept the deal (Calus, 2015; see also interview with Dirk Schuebel, May 2016).<sup>31</sup> In fact, as Tatyana Laryushin points out, at a recent business forum in Chisinau, some businessmen from Transnistria were openly talking about the dire economic situation in the region and were urging the Ministry of Economics of Moldova that something needed to be done, that Transnistria was getting poorer and poorer (authors' interview, June 2016).

However, probably the biggest surprise has been Russia's reaction to Transnistria's rapprochement with the EU by allowing Tiraspol to sign the new DCFTA deal. As de Waal (2016) points out, firstly, "Moscow has so far gone along with the deal because it knows its influence in Transnistria is largely unaffected". Indeed, Moscow does not really lose anything by this move: it maintains the status quo whereas Transnistrian businesses continue to access the EU market "without the need for any concessions and without the need to integrate with Moldova and the EU" (Calus, 2016). In fact, many of these Transnistrian businesses are owned by Russian conglomerates. For more than a decade now authorities in Tiraspol have actively engaged in a process of privatisation and many of the "strategic industrial assets located inside Transnistria, such as steel, cement and hydroelectric plants, for instance, are now under the control of Russian big businesses (Chamberlain-Creanga and Allin, 2010: 333).

On the other hand, others have questioned whether the EU could have acted any differently other than agreeing to engage Transnistria in the DCFTA. Many agree, both in Chisinau and Brussels, that "Moldova had nothing to gain from it [the DCFTA deal with Transnistria] economically. There were only political gains" (authors' interview with an EU official, June

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<sup>30</sup>Laryushin is a Chisinau-based economic expert at the Institute for Development and Social initiatives (IDIS).

<sup>31</sup>Schuebel is the Head of Division for bilateral relations with the Eastern Partnership countries in the European External Action Service.

2016). As Calus (2016) points out "[t]he EU's decision was most likely driven by a fear of potential reaction from Moscow". If the socio-economic situation in Transnistria were to deteriorate further, Russia could have portrayed the situation as an 'economic blockade' of the region and declared a 'humanitarian crisis' there demanding access via Ukraine which would further heighten the security situation in Transnistria and the wider region (Calus, 2016). More importantly, however, there is the issue of financing – "Russia cannot afford to bail out Transnistria", at least not under the current political and economic conditions. On top of Abkhazia and South Ossetia, it "also has to foot the bill in Crimea" now (De Waal, 2016).

Whether Tiraspol delivers on its promises regarding the DCFTA and whether this model works in the long run is yet to be seen (Calus, 2015, 2016; De Waal, 2016), but the current economic situation and diminishing Russian financial assistance in Transnistria might indeed prove to be that rare opportunity for the international community to try and 'push' Tiraspol towards closer political and economic engagement with Chisinau (Calus, 2015).

While much attention has been paid to the track-one negotiations between Tiraspol and Brussels, there were also important track-two initiatives. For example, the UK's Conflict, Stability, and Security Fund supported a project on developing cross-river trade relations that ran in parallel to official negotiations on the DCFTA. Bringing together some twenty officials and experts from both sides, as well as two international experts,<sup>32</sup> the project focused on jointly identifying problems and solutions in trade relations, eventually producing a series of recommendations on how Transnistria can gradually transition to full compliance with DCFTA requirements. The report notably concluded that "in order to achieve long-term economic stability in the region, it is necessary to formulate and implement specific measures of economic, legal, and political character for the creation of a strong basis for business with a priority on the depoliticisation of trade relations."<sup>33</sup>

Are there any lessons to be learnt from the way in which Brussels, Chisinau, and Tiraspol dealt with the DCFTA issue that could be applied to Georgia? The two cases are, of course, very different. Unlike in Transnistria, it is more difficult to use trade as a leverage in Abkhazia and South Ossetia (authors' interview with an EU official, June 2016). These are not industrial places like Transnistria and rich businessmen there are all closely linked with Russian business (and political) circles (authors interview with the Georgian MFA representative, June 2016). They are also not landlocked and are adjacent to Russia. Nevertheless, some common trends can still be observed between these cases. *De-facto* state budgets of these regions are almost entirely subsidised by Russia. In Abkhazia, for

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<sup>32</sup>One of the co-authors of this report, Stefan Wolff, served as one of the international experts on this group, together with Natalia Mirimanova.

<sup>33</sup>Yuri Ganin, personal communication, 11 February 2002.

instance, budget in 2011 amounted to 3,875 billion roubles (\$114 million) (at the time Georgia's state budget was \$3.6 billion). Since then the numbers have grown considerably and reached 11.8 billion roubles in 2015 (\$180 million) (Georgia's state budget in 2015 was \$4.2 billion). However, according to local residents, only small proportion of these funds reach people on the ground and according to some sources, unemployment levels are as high as 70% (Caucasus Business Week, 14 Dec. 2015). In South Ossetia as well, people make similar complaints. Furthermore, as is the case in Transnistria, devaluation of the Russian Rouble since 2014 has had a significant impact on Abkhazia and South Ossetia as well. In fact, according to recent estimates by the IMF, the Russian economy will continue to shrink in 2016 (VestnikKavkaza, 22 June 2016).

There have been some other contributing factors too. Tourism has always been the driving force of the Abkhaz economy ever since Soviet times. However, annexation of Crimea is also likely to have negative impact in this regard. It is more likely for Russian tourists now to vacation in Crimea (where tourism also plays a big role in the region's economy), where infrastructure for tourism is much more developed than in Abkhazia. Thus, some experts point to the dire conditions of the Abkhaz economy (Caucasus Business Week, 14 Dec. 2015). The situation is of course no less dire in the case of South Ossetia which has traditionally faced even more severe economic problems. This uncertain economic situation in these regions undoubtedly creates tensions within their societies. Thus, some have argued that like in Transnistria, this could be a good "precondition for negotiations with the Abkhaz party" in particular to try and find ways of minimising Russian trade influence there (Caucasus Business Week, 14 Dec. 2015). The Georgian side seems to be aware of this opportunity, however, as one government official pointed out to us,

if you look at the numbers, we still cannot match up with what Russia is offering these regions financially. What we need to do instead is become financially more stable ourselves. We need to make our economy stronger and healthier. That is how we can win the Abkhaz and Ossetians over. When they look at a local resident in Zugdidi (adjacent to Abkhazia) and see that s/he lives in much better conditions than they will start thinking about certain issues differently as well and may reconsider their current stance (authors' interview, June 2016).

And the only way to do it, according to the Georgian side, is through closer ties with the EU, through the DCFTA and through visa liberalisation.



## ***Conclusions and Recommendations***

### **Preliminary Considerations**

The brief discussion of the cases of Abkhazia, South Ossetia, and Transnistria has highlighted a number of issues that can inform the approach the OSCE is taking to confidence-building in its region's protracted conflicts. The following set of conclusions and recommendations must be seen in this context of relatively limited empirical evidence and thus a consequently slim basis for broad generalisations. Yet, combined with our own practical experience in the region and elsewhere, and analytical insights gained from studying similar processes in other conflict situations, we feel there is a sufficient basis for offering specific insights into the dynamics of successful confidencebuilding and making some concrete suggestions for future confidence-building measures.

Successful confidencebuilding has three dimensions: the context in which it occurs, its content, and the process through which it is realised. Put differently, CBMs should be seen as part of an adaptable strategy of conflict resolution rather than as a one-off 'crisis' management effort or an opportunistic response to a particular opening. CBMs, in this sense of transitional or change mechanisms, can counter-act the entrenchment an existing status quo. This requires principled, transparent engagement with key actors on all sides, through formal and informal channels, supported by neutral expert advice.

Such an approach is predicated on a theory of change (i.e., not the prolonging or merely incremental improvement of an existing situation) that seeks to identify key actors and considers how to change their capacities and interests as well as the structures in which they work so that they can genuinely buy into, and implement, sustainable confidence building.

This leads to some further general points on the conditions that are likely to facilitate successful confidence building, including the need for sustainable, predictable external funding for long-term engagement with local partners (i.e., a focus on strategic programmes rather than ad hoc projects) and consequently a related need to invest in current and future leaderships on both sides of the divide. In the context of a theory of change, this addresses the issues of capacities, interests, and structures in the long term, while simultaneously building confidence into the process of CBMs and its external funders—provided that the objectives and associated timeframes reflect local understandings of need and are based on realistic expectations of what can be achieved, by whom and how fast. Long-term engagement, in addition, also creates opportunities to revisit adopted strategies and adapt them based on problem-driven analysis and responses.

### **Case-specific observations**

There is clearly a benefit in trade across conflict lines, and our case studies illustrate the overall stabilising, violence-reducing effects of such economic relations. Moreover, these benefits are broadly recognised across the region as well: on the ground among the people and businesses directly affected, as well as among elites keen to increase linkages between divided communities (and those afraid of the undesired consequences of potentially improved confidence).

While one could take the view that any form of trade is better than no trade, it is important to note several significant caveats that arise when taking a long-term view. Unofficial, unregulated economic activity limits the potential for confidence building and for leveraging and strategically locking in confidence gains. It can provide examples of the possibility of inter-ethnic and cross-community collaboration, but it also creates and entrenches constituencies with little interest in moving beyond the status quo, precisely because they benefit from the unregulated nature of their activities. This may decrease the likelihood of a resurgence of violence, but it simultaneously blocks meaningful progress towards conflict settlement, while also entrenching bad practices of governance. The case of Ergneti market indicates the stabilising effect of 'any' trade relations: while there were no major violent incidents involving South Ossetia after the initial violence in the early 1990s, the market's forced closure in June 2004 was followed by a major resurgence of violence the following summer. The subsequent recognition of the importance of places of trade as places of contact, and thus potentially confidence building, by leaders on both sides has led to new initiatives, such as for the establishment of so-called trade centres near the ABLs in Georgia. In other words, disbanding rather than tolerating unregulated trade is potentially counter-productive unless alternative and sustainable arrangements are put in place.

Our cases also indicate that confidence building, or more precisely confidence maintaining, is possible, even in the context of otherwise deteriorating relations. Concrete, individualised, 'pre-existing' links, such as those in relation to the Enguri hydropower station in Georgia-Abkhazia and the Moldovskaya power station in Moldova-Transnistria, have survived the ups and downs of relations between the conflict parties over more than two decades of 'frozen' conflicts in Moldova and Georgia. Yet, at the same time, such localised solutions are often just that and spill-over effects limited or non-existent.

The feasibility and viability of confidence building is highly contingent upon the context in which it happens, and success in one case is not necessarily transferable to another one. This is particularly obvious in relation to the EU-Moldova DCFTA and its application, since 2016, to Transnistria. There was a clear Transnistrian interest (to retain the ability to export goods to the EU and to avoid a deeper economic crisis), a similarly clear Moldovan interest

(to avoid a formal internal economic boundary), and a clear EU interest (to prevent further political and economic destabilisation in the region). Moreover, as these interests partially overlapped, i.e., were shared among some or all actors, finding a solution was possible. Equally importantly, there was an inclusive process of finding this solution, and one at that which was not blocked by Russia. Replication of this deal to Georgia is unlikely for the time being, given the very different circumstances there: direct access to and from Russia, significantly lower importance of trade with Georgia and the EU, a lower density of pre-existing linkages across the divides, and arguably a different level of geopolitical stakes on both sides. Put differently, the balance of power between coalitions for and/or against change in the case of Transnistria was very different from the situation in Abkhazia and South Ossetia.

That said, previous experience in Georgia with track-two focused engagement on economic issues and the specific efforts, funded by the UK, to establish a cross-river expert group on trade, also underline the importance of confidence-building beyond officials—not as replacement or substitute, but as a well-coordinated complement to these efforts that can broaden and strengthen existing coalitions for change and contribute to the effective and legitimate implementation of necessary reforms.

A final observation extends beyond trade and points to the importance of considering the underpinning infrastructure for trade in a broad sense: regulation and transportation. Our cases indicate, first, that there is a need, and to some extent appetite, for the regulation of economic relations. This is most obvious in the case of the application of the DCFTA to Transnistria, but also apparent in recent efforts in Georgia to establish trade centres at the ABLs. Transportation, both in the sense of physical infrastructure of roads, railways, and border crossings, and in terms of associated regulation, such as the recognition of number plates, is equally important. Agreements in these areas, for example on passenger and goods traffic on a railway link between Chisinau, Tiraspol, and Odessa, facilitate trade and thus create positive, mutually reinforcing spill-over effects, whereas protracted failures to reach, or implement, agreements, such as on Transnistrian number plates and the restoration of landline telephone connections, or the restoration of railway links across the Caucasus have the opposite effect.

### **Some Concrete Recommendations**

Building on the analysis and comparison of trade-related confidence-building efforts in three of the protracted conflicts in the OSCE region—Transnistria, Abkhazia, and South Ossetia—we end our working paper with a series of recommendations. As noted earlier, successful confidence building has three dimensions: context, content, and process.

While it is trivial to emphasise that CBMs can only be successful if they are developed and implemented on the basis of a comprehensive understanding of the conflict, it is perhaps less trivial to note that establishing such an understanding should be part of confidence building. However, we are not advocating a soul-searching exercise with the parties on what their respective conflicts, underlying causes, and possible solutions are. Rather our first process-focused suggestion is more limited in scope. Taking the case of the UK-sponsored expert group on cross-river trade barriers in Transnistria as an example, we recommend that future confidence-building measures should start with a joint and comprehensive problem definition led by local experts and assisted as appropriate by neutral, international advisors. External funding of such initiatives could open opportunities for bottom-up initiatives, that, while perhaps very localised in their focus, may trigger the productive engagement of individuals and communities that can enhance confidence between the parties more generally. The really critical issue, in our view, would be a locally-led, inclusive process for identifying a problem, examining its causes, and developing its solutions. International assistance would be required to finance such a process and to support the implementation of its outcomes.

While some confidence building can be locally driven, it should not be seen as replacing internationally-led initiatives. What would be crucial, however, is how such initiatives are carried out. One useful approach, and our second process-focused recommendation, is the use of scenario planning as a technique of identifying different possible 'futures' and the pathways leading there. This is not about predicting any specific future, but can be used to develop strategies that help the parties to avoid undesirable futures and attain desirable ones. Even where strategy development may not be immediately possible, scenario planning is extremely useful in establishing common understandings of problems and heightening parties' sensitivity to the fact that the future is not a foregone conclusion but can be shaped (positively) by their actions. There is a strong tradition of the use of this approach in business, and it could easily lend itself to confidence building measures in relation to trade and related issues. Its very success depends on an inclusive process, it fosters peer learning and joint problem solving, helps to anchor international partners and builds local capacity.

In terms of content-related recommendations, our first proposal is to revive, albeit in somewhat modified form, an earlier initiative implemented by the OSCE Mission in Moldova which looked at the issue of past agreements between Chisinau and Tiraspol. By various counts, upwards of 170 such agreements had been concluded over the years but many of them were of questionable legal status, had been not, or not fully, implemented, and/or superseded by subsequent agreements. Co-sponsored by the US, Germany, and the UK, three international experts were tasked to review agreements and offer suggestions for

concrete implementation steps.<sup>34</sup> Based on the preferences of the parties, this review was undertaken in the fields of education, transport, and law enforcement cooperation, and while relevant reports were produced, no concrete steps on implementation were taken. A new initiative of this kind focused on existing economic agreements and involving experts from the parties alongside international advisors from the very beginning could be an extremely productive approach that responds to a concrete need in the context of the DCFTA application to Transnistria. Supported by the international community, such an initiative would not be particularly resource or time-intensive, but could make a very significant contribution to facilitating compliance with DCFTA requirements in the context of the agreement achieved last year.

An initiative on past agreements in the economic sphere would also contribute to a perennial problem that has marred relations between Chisinau and Tiraspol for a long time, the absence of effective implementation mechanisms and guarantees. Related to this, our second content-related proposal is focused on this particular issue, namely how to build confidence between the parties into their reciprocal ability and willingness to implement any future agreements on trade-related issues and beyond. So far, work on guarantees was either done at the international expert level (e.g., a UK-sponsored project in 2011/12) or involved ‘unilateral’ proposals by the parties or mediators (e.g., a recent Russian ‘non-paper’ on the issue). It might be useful, therefore, to convene a joint expert group of the parties, assisted by international experts, to identify the critical gaps and issues in relation to the current lack of trust in this respect, to review existing proposals and establish areas of existing consensus, and to elaborate a framework of implementation mechanisms and guarantees that addresses all stakeholders’ concerns and can serve as the basis for enhancing confidence of the parties in each other and in their negotiations on all three baskets of the 2012 Vienna Agreement on the agenda for the Transnistrian settlement talks.

A focus on implementation mechanisms and guarantees might also be a useful approach to take in relation to other protracted conflicts in the OSCE region. It could be scaled up to the level of a comprehensive agreement (e.g., in the case of the Nagorno-Karabakh conflict) or scaled down to very specific, sectoral or local agreements (such as in Abkhazia, South Ossetia, or Donbas). The benefit of either approach is that such discussions would be status-neutral, they would demonstrate parties’ willingness to engage with each other and demonstrate good faith ahead of future more substantive settlement negotiations, and they would, critically, enhance confidence in an actual negotiation process and firmly anchor its international partners in a future settlement.

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<sup>34</sup>The expert team consisted of a former Head of the OSCE Mission to Moldova, William Hill, a former Deputy Head of the Mission, Gottfried Hanne, and one of the co-authors of this report, Stefan Wolff.

In terms of content-related recommendations in regards to Abkhazia and South Ossetia, as one EU official pointed out, “we need to start from the basics here and think about restoration of some basic relations. .... Motivation of every business is to make money so as long as there is safe environment to do this, the opportunity of re-building economic links (and potentially restoring good neighbourly relations between communities) is already there actually” (authors’ interview, June 2016). Both at the MFA in Tbilisi as well as Brussels officials emphasised the importance of such initiatives in bringing members of the private sectors together and giving them a chance to talk to each other. One of the acute problems that the conflicting sides often face is "isolation from knowledge ... which sometimes leads to paradoxical policies"(authors’ interview with an EU official, June 2016). More committed engagement is, thus, needed from the international community, including the OSCE, to help all sides involved to have access to adequate sources of information (authors’ interview with an EU official, June 2014). In this regard, business forums and dialogues held on neutral territories and facilitated by international mediators could provide an opportunity to get some insight about how business communities on the 'other' side operate as well as to get adequate information on how issues such as Georgia's visa liberalisation (currently at the final stages of discussion at COREPER<sup>35</sup>), for instance, or the AA (expected to enter fully into force on 1 July 2016) and the DCFTA might impact Abkhazia and South Ossetia. Existing formats within the so-called London Process, initiated and facilitated by Conciliation Resources, could be used, and expanded even further. This is an informal Georgian-Abkhaz dialogue process that started in 2012 and brings together civil societymembers and authorities from both sides of the conflict to discuss issues that vary from education and healthcare, culture and history to freedom of movement, as well as more politically charged issues such as the status of Abkhazia's ethnic Georgians (see Covcas bulletin, 22 Aug. 2014). This platform (of using a neutral territory- in this case the UK) could be used to bring together business communities too (including small- and medium-sized enterprises) and could be expanded to include South Ossetian stakeholders as well. Such meetings do occur occasionally, but a more systematic approach would certainly benefit the process of rapprochement. Similarly, the platform provided by the Caucasus Business and Development Network, initiated by International Alert in 2005, could, and should, be utilised more actively.

### **Concluding Comments**

We are aware that much in the foregoing discussion is framed in rather hypothetical language of ‘may’, ‘could’, ‘might’, etc. This is partly a necessity arising from the fact that the empirical basis on which we drew our conclusions is admittedly slim, but it also reflects a deliberate choice of seeking to emphasise that confidence building in relation to trade and beyond is ultimately a question of political will. This political will is often lacking. Yet, as we

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<sup>35</sup>Committee of Permanent Representatives in the European Union.

noted with reference to our underpinning theory of change, it can be fostered by focussing on the capacities and interests of the relevant actors on both sides of a divide and on the structures in which they operate. Our various recommendations above in terms of the process and content of future confidence-building measures recognise the primacy of politics and thus reflect this need to build capacities, re-orient interests, and create structures that enable confidence building as a foundation for feasible and viable conflict settlements.

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