

PEACEBUILDING AND BUSINESS:

FOSTERING COMMERCIAL CONTACT
BETWEEN GEORGIANS AND ABKHAZ



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The National Committee on American Foreign Policy was founded in 1974 by Professor Hans J. Morgenthau and others. It is a nonprofit, activist organization dedicated to the resolution of conflicts that threaten U.S. interests. Toward that end, the National Committee identifies, articulates, and helps advance American foreign policy interests from a nonpartisan perspective within the framework of political realism.

American foreign policy interests include:

- preserving and strengthening national security;
- supporting countries committed to the values and the practice of political, religious, and cultural pluralism;
- improving U.S. relations with the developed and developing worlds;
- advancing human rights;
- encouraging realistic arms control agreements;
- curbing the proliferation of nuclear and other unconventional weapons;
- promoting an open and global economy.

Believing that an informed public is vital to a democratic society, the National Committee offers educational programs that address security challenges facing the United States and publishes a variety of publications, including its bimonthly journal, *American Foreign Policy Interests*.



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ACRONYMS

Baku-Tbilisi-Ceyhan Pipeline (BTC)
Black Sea Infrastructure Development (BSID)
Commonwealth of Independent States (CIS)
Environmental Impact Assessment (EIA)
European Bank for Reconstruction and Development (EBRD)
European Neighborhood Programme (ENP)
European Union (EU)
European Union Monitoring Mission (EUMM)
Federal Security Service (FSB)
Foreign Direct Investment (FDI)
General System of Preferences (GSP)
Government of Georgia (GoG)
Gross Domestic Product (GDP)
Internally Displaced Persons (IDPs)
International Finance Corporation (IFC)
International Financial Institutions (IFIs)
International Olympic Committee (IOC)
North Atlantic Treaty Organization (NATO)
Organization of the Black Sea Economic Cooperation (BSEC)
Overseas Private Investment Corporation (OPIC)
Stabilization and Association Agreement (SAA)
United Nations Observer Mission in Georgia (UNOMIG)
United States Government (USG)
World Trade Organization (WTO)



INTRODUCTION

Background

Abkhazia is a territory located on the Black Sea in the northwest of Georgia, which broke away from Tbilisi's control after the conflict of 1992-93. The situation remained frozen until the Georgia-Russia War (August 7-11, 2008). Only Russia and three other countries have recognized and established diplomatic relations with Abkhazia. The United States, the European Union (EU), and other countries maintain a policy of non-recognition towards Abkhazia and South Ossetia, another breakaway region in Georgia.

This research report by the National Committee on American Foreign Policy (NCAFP) explores opportunities for mutually beneficial interaction between Georgians and Abkhaz. It is based on the premise that private sector representatives are well suited to take a cooperative approach to engagement. Even in the most intractable conflicts, the private sector is primarily interested in market access and a stable environment for doing business. There are many examples of commercial contact as a tool for conflict mitigation: the Southeast Europe Economic Cooperation Initiative promoted stability after Yugoslavia's breakup. The Greek-Turkish Business Forum catalyzed bilateral agreements on trade, tourism, maritime and environmental issues. And trade between China and Taiwan helps reduce tension across the Taiwan Straits.

Recommendations are offered to the Government of Georgia (GoG), de facto Abkhaz authorities (hereafter called "Abkhaz authorities"), the U.S. Government (USG), the Russian Government, other international stakeholders, and the private sector. Highlighting opportunities for economic cooperation between Georgians and Abkhaz, the report focuses on Abkhazia as there is greater opportunity for progress in Abkhazia than in South Ossetia. The report does not, however, address questions regarding the political status of Abkhazia nor does it explore security arrangements. Politics and security are considered only to the extent that they impact economic issues.

U.S. Interests

The United States has important strategic interests in Georgia. They encompass historical, commercial, political and security objectives.

The affinity between Georgia and the United States goes back to the period when Eduard Shevardnadze served as the Soviet Union's foreign minister. Shevardnadze attained iconic status in the West for his pivotal role managing the dissolution of the USSR, as well as negotiating German reunification. Shevardnadze served as President of Georgia from 1995 to 2003. Under his leadership, Georgia steered a pro-Western course, becoming both ally and friend of the United States.

Georgia's location makes it an important trans-Eurasia energy transit country. The East-West Corridor transports vital oil and natural gas supplies from the Caspian via Georgia to Western markets. The Baku-Tbilisi-Ceyhan pipeline (BTC) cost \$3.5 billion and now delivers a million barrels of oil each day to Western markets. The South Caucasus gas pipeline, which follows the same route, and the smaller Baku-Tbilisi-Supsa line are other Caspian pipelines not under Russia's control. Estimated to cost \$12 billion, the Nabucco pipeline will expand trans-Caspian projects by transporting natural gas from Azerbaijan and Turkmenistan through Georgia to Turkey. These supply routes are essential to diversifying energy sources for consumers in the West.

President George W. Bush and Georgia's President Mikheil Saakashvili developed a close relationship based on shared values and Georgia's support of Bush's Global War on Terror. Saakashvili embraced liberal democracy after the "Revolution of Roses," a popular movement that swept him to power in 2003. Representing the possibility of a democratic post-Soviet state outside of the Baltics, Georgia was heralded as a beacon of democracy. The United States led efforts to establish the Partnership for Peace Program between the North Atlantic Treaty Organization (NATO) and Georgia, and championed Georgia's NATO membership. The 2008 Bucharest Summit communiqué promised "eventual membership" for Georgia in NATO.

Georgia remains a staunchly pro-American bastion in the South Caucasus. When President Barack Obama

appealed for more troops in Afghanistan, Georgia quickly responded pledging approximately 1,000 troops. The southern line of the Northern Distribution Network supplying troops in Afghanistan runs through Georgia. The GoG also provides over-flight rights to NATO. Adopted in 2009, the “U.S.-Georgia Charter on Strategic Partnership” affirms support for Georgia’s “legitimate security and defense needs” as well as “regional peace and stability.” It does not, however, provide a U.S. security guarantee.

U.S.-Russia relations have rebounded since their low point during the Bush administration. Pressing the “reset button” has enabled the U.S. and Russia to work more effectively together on a range of issues, including non-proliferation as well as multilateral initiatives before the UN Security Council. The Strategic Arms Reduction Treaty was signed on April 8, 2010. A new cooperative approach to Russia will be announced at NATO’s Lisbon meeting in November 2010.

The Obama administration has assured the GoG that its rapprochement with Russia does not come at Georgia’s expense. But Georgia is concerned. During the Bush administration, Georgia fashioned itself as a “strategic partner” of the United States. While the strategic partnership endures, the U.S.-Georgia relationship is now more straightforward and based on strategic objectives. These include preventing conflict between Russia and Georgia that would put the U.S. in a position of having to take sides.

Executive Summary

The Russia-Georgia War of 2008 ended when France’s President Nicolas Sarkozy, on behalf of the EU presidency, negotiated a ceasefire on August 12, 2008. The ceasefire agreement required a withdrawal of forces to pre-war positions and access by humanitarian and monitoring missions to the conflict areas. Russia flagrantly violated the accord. Citing “new realities,” it recognized Abkhazia as a sovereign state on August 26, 2008. Russia subsequently signed a “bilateral military cooperation agreement” with Abkhazia leasing military bases and formalizing the deployment of up to 5,000 Russian troops. Prime Minister Vladimir Putin pledged \$470 million to support the Russian armed forces in Abkhazia and \$340 million for budgetary and social support, as well as stimulus for the Abkhaz economy.

Adopted in the immediate post-war crisis period, the GoG’s “Law on Occupied Territories” was seen by the GoG as the bulwark of its efforts to deter countries from recognizing Abkhazia and South Ossetia. The Law restricts commercial and diplomatic contact with Abkhazia and South Ossetia. It also restricts travel unless Abkhaz and South Ossetians use Georgian passports. The “State Strategy on Occupied Territories: Engagement through Cooperation” was announced on January 27, 2010. Rejecting violence as a tool for resolving conflict or addressing status issues, the State Strategy endorses interaction in order to improve socio-economic conditions and gradually build confidence on both sides. The GoG is on the verge of finalizing an Action Plan to implement the State Strategy. Realizing the Action Plan can be achieved through a more relaxed regulatory environment, which calibrates modifications in the Law on Occupied Territories with Sukhumi’s cooperation.

Engagement faces serious obstacles. The GoG wants to engage, but on its own terms. Abkhaz lack incentive to engage, especially with Russia providing funds and security. Russia opposes any step that diminishes its position in Abkhazia or hinders efforts to undermine Saakashvili and hasten regime change in Georgia.

Business may yet be possible despite the current climate of conflict and distrust. It is ultimately in the interest of both Georgia and Abkhaz to strengthen Abkhazia, thereby reducing the possibility of absorption by Russia. A self-confident and empowered Abkhazia would be more willing to entertain some kind of association with Georgia in the future. Russia’s assistance to Abkhazia is expensive and it comes at a time when Russia is hard hit by the global economic crisis. Though Russia wields a veto over Abkhazia’s affairs, it might be prepared to look the other way if there were savings or money to be made.

The GoG and Abkhaz authorities should take gradual and carefully calibrated steps that are in their own interests, as well as those of Russia. Identifying opportunities is the first practical step. To this end, the report describes mutually beneficial business arrangements. These involve power generation and transmission, tourism, and agro-industries. Preparation for the 2014 Sochi Olympics also represents an opportunity for economic cooperation.

The Enguri Sand and Gravel Export Project (and related activities) is a specific, private sector initiative that could be launched immediately as a win-win for Georgia, Abkhazia and Russia. Pending negotiations and agreement, the Project will produce raw material from the Enguri River, which will be loaded onto barges and transported to markets across the Black Sea. Sand and gravel are urgently needed by Russia for construction of the Olympic facilities. Abkhaz will receive royalties in exchange for guaranteeing security and safe passage. In addition to employment generation, Georgia will benefit from the developer's upgrading of roads, railways, and nearby bridges.

The Project also presents an opportunity for tourism and agro-industries. This report proposes an enterprise called "Black Sea Resorts and Family Entertainment Centers," which would build and operate a hotel, gaming and recreational facility at the site. As part of its cruise and tourism package, Black Sea Resorts would also develop facilities in Western Georgia and Russia that could be used for the Sochi Olympics.

With bridges and infrastructure facilitating contact between Georgians and Abkhaz, tea plantations in Gali could be restored with a tea collection and processing center on the east side of the Enguri. The same model could be explored for other agro-industries fostering contact between Georgians and Abkhaz (e.g. hazelnuts, tomatoes, citrus and apple products). The equivalent of a free trade zone, where commodities, machinery and equipment could be sold, would also be desirable.

The report also offers policy proposals promoting contact between Abkhazia and the international community, as well as between Abkhaz and Georgians. The Action Plan establishes priorities and strategic sequencing of activities. Interaction requires an effective coordinating mechanism exchanging information and assisting project development. To this end, the coordinating commission should be set up under UN auspices with international donor funds.

A role for Turkey is proposed. The GoG should waive customs requirements for Turkish cargo ships putting into Abkhaz ports and develop a notification protocol allowing their direct access to Abkhazia. In addition to opening a land route from Turkey to the Gali region, establishing commercial ferry service between Sukhumi and Trabzon would stimulate trade and tourism. Ankara should assure the GoG that direct contact between Turks and Abkhaz does not represent a process of "creeping recognition."

Civil society interaction can identify practical areas for cooperation. Donors should earmark funds for dialogue initiatives engaging Georgians and Abkhaz. In addition, the U.S. can help connect Abkhaz civil society with the international community via existing Fulbright scholarships, IREX university exchanges and participation in the State Department's International Visitors Program. Abkhazia's isolation would be further reduced through the participation of civil society representatives in the "Forum on Provincial Cities in the South Caucasus."

After the 2008 War, the U.S. committed \$1.06 billion for relief and reconstruction, including \$250 million for direct budget support. It also spearheaded a conference of donors at which \$4.5 billion in grants and loans were pledged. Largess at such level was born from crisis and will not continue. FY 2011 foreign aid should support activities that involve the private sector and civil society in regional cooperation. More than "strategic patience," the United States should be proactive in advancing its interests through vigorous engagement aimed at normal travel and trade in the South Caucasus.

RECENT HISTORY

Revolution of Roses

The 2003 "Revolution of Roses" brought Saakashvili to power and initiated a period of dramatic political and economic reform in Georgia. Saakashvili's pro-Western positions were anathema to Russia, which seeks to restore influence in its so-called near-abroad. Russia launched a propaganda and harassment campaign aimed at delegitimizing Saakashvili. It also sought to undermine Georgia's statehood by providing Abkhaz separatists with diplomatic and military support.

Russia was angered by the Bush administration's promotion of a NATO Membership Action Plan for Georgia

and U.S. support for Kosovo's independence. It withdrew from the 1996 CIS declaration banning military assistance and imposing sanctions on Abkhazia on March 6, 2008. The following month, it established legal connections between its ministries and their counterparts in Abkhazia and South Ossetia, opening fifteen new checkpoints along the cease-fire line between Georgia and Abkhazia. Tensions spiked when Russian fighter planes shot down an unarmed Georgian surveillance drone over the Gali district on April 20, 2008 and deployed 500 paratroopers armed with howitzers, SA-11 anti-aircraft systems, and other offensive weapons. Moscow insisted that its troop increases were proportionate to the GoG's deployment of additional police to North Kodori adjoining Abkhazia.

The Russia-Georgia War

War between Georgia and Russia erupted on August 7, 2008. In response to Russian and South Ossetian provocations, Saakashvili ordered the shelling and deployment of Georgian troops into Tskhinvali, South Ossetia's capital. By August 9, Russia's disproportionate land, air, and sea assault overwhelmed Georgia's armed forces. Operations extended from the port of Poti in the west to Gori just 40 km from Tbilisi. Russian forces occupied the Kodori Gorge, to the northeast of Abkhazia. Ossetian militias, often in collusion with the Russian military, burned and looted Georgian villages around Tskhinvali¹ and on the road to Gori.² Approximately 90% of villages in the buffer zone were damaged or destroyed.³

Georgia's military defeat was a serious setback. The Georgian army was destroyed, demoralized and disarmed. The war also took a human toll in lives lost and persons displaced. Civilian economic costs of the war are estimated at \$1.2 billion. According to Ghia Nodia, the former Education Minister, "We lost the illusion of rapid progress."⁴

International Response

On August 12, five heads of state from nations once controlled by the Soviet Union — Latvia, Lithuania, Estonia, Ukraine and Poland — joined a rally in Tbilisi's Freedom Square rebuking Russia for its aggression. The emotional gathering was symbolic of international solidarity with Georgia. Acting on behalf of the EU Presidency, Sarkozy negotiated a ceasefire on August 12. The agreement required a withdrawal of forces to pre-war positions and access by humanitarian and monitoring missions to the conflict areas. Russia repeatedly violated the ceasefire by, for example, refusing to withdraw troops or dismantle checkpoints and unilaterally establishing a 12 km buffer zone around South Ossetia.

The United States led international relief and reconstruction by committing \$1.06 billion.⁵ U.S. assistance made Georgia one of the largest per-capita recipients of foreign aid in the world. On October 22, 2008, the United States was joined by 38 countries and 15 international organizations at a conference of donors in Brussels at which \$4.5 billion in grants and loans were pledged over 3 years. The package consisted of \$2 billion in aid and \$2.5 billion in loans, including an 18-month stand-by agreement with the International Monetary Fund (IMF) worth \$750 million. Assistance helped bolster investor confidence, sustain private capital flows, and provide sufficient liquidity to the banking system. It also helped the GoG maintain a stable exchange rate and adequate level of international reserves.⁶

ENGAGEMENT STRATEGY

Georgia-Abkhazia

The GoG tried to isolate Abkhazia after the 1992-93 conflict. Today, however, the GoG is pursuing a policy of engagement aimed at addressing the humanitarian needs of Abkhaz and South Ossetians. Abkhaz are skeptical; they believe that engagement is a Trojan horse for advancing Georgia's long-term goal of "reintegration" and "de-occupation."

The GoG published its "State Strategy on Occupied Territories" on January 27, 2010. The State Strategy rejects violence as a tool for resolving conflict with Abkhazia and South Ossetia, or addressing status issues. Instead, it seeks to promote interaction aimed at improving the socio-economic conditions on both sides. The

State Strategy envisions the rehabilitation of infrastructure and freedom of movement. It emphasizes human rights, religious rights, and preservation of ethnic identity and cultural heritage, as well as the free flow of information. It further calls for the safe, orderly and dignified return of internally displaced persons, while reaffirming the GoG's commitment to international law and good neighborly relations.

The State Strategy includes practical recommendations such as:

- Providing financial incentives for increased trade.
- Creating dedicated funds for joint business activities.
- Establishing special economic zones for bi-communal contact and cooperation.
- Encouraging the sale of goods from Abkhazia to Georgia and internationally.
- Arranging technical support to collaborative enterprises (e.g. storage, processing and packaging facilities for agricultural goods).
- Refurbishing connective infrastructure (e.g. roads, waterways, utilities, and telecommunications).
- Facilitating freedom of movement through the issuance of ID cards and laissez-passer documents.

The GoG is proceeding in phases. It is currently finalizing an Action Plan focusing on implementation measures that advance the State Strategy including:

- Establishing a joint investment fund capitalized by donors and Georgian business.
- Launching a financing institution with some characteristics of a commercial bank to facilitate transactions between Georgians and Abkhaz.
- Creating a trust fund for NGOs to engage Georgians and Abkhaz in collaborative activities.
- Establishing a Cooperation Commission to twin Georgian and Abkhaz enterprises, and act as an information liaison.

GoG officials explain that the State Strategy and Action Plan provide a roadmap for implementing Georgia's "Law on Occupied Territories." Adopted on October 15, 2008, the Law is the primary bulwark supporting the GoG's policy of non-recognition towards Abkhazia and South Ossetia. The Law calls for implementation of the ceasefire agreement. It decries Russia's violation of the agreement, as well as impediments imposed by Russia to implementing other international arrangements. It criticizes Russia's refusal to extend the UN Observer Mission in Georgia (UNOMIG) and condemns the deployment of the Federal Security Service (FSB) along administrative dividing lines, which prevents the EU Monitoring Mission (EUMM) from fulfilling its mandate. The Law also regulates diplomatic contact, commercial activity, travel to the territories, and travel by Abkhaz and South Ossetians who do not use Georgian passports. It also limits visa opportunities for Abkhaz and South Ossetians who have been issued Russian passports.

The Law in Occupied Territories was first amended on February 26, 2010 to incorporate some revisions proposed by the Venice Commission of the Council of Europe. It is presently undergoing additional revisions. The newly amended Law is due during the summer of 2010. At its core, the Law is likely to remain unchanged.

The State Strategy mirrors the legislative intent of the Law on Occupied Territories. By mentioning "Occupied Territories" in its title, the State Strategy gives no ground on recognition. Its preamble states that the goal of the State Strategy is to "reverse the process of annexation by the Russian Federation." It states, "Georgia pursues these objectives in concurrence with the international community's adherence to the non-recognition policy toward Abkhazia and the Tskhinvali region/South Ossetia, and its support for Georgia's engagement policy."⁷

However, the State Strategy and the Law on Occupied Territories diverge in their objectives. The State Strategy seeks to engage Abkhaz and South Ossetians, while the Law is punitive in seeking to isolate them. The State Strategy is a political text prepared for multiple audiences:

- *Hardliners*: Many Georgians still want a military solution to restore Georgia's sovereignty in Abkhazia and South Ossetia. Though this is impractical given Russia's military presence and the condition of Georgia's armed forces, hardliners viscerally feel that what was taken by force should be regained using force. They reject conciliatory steps as undermining the non-recognition policy.
- *Directly affected parties*: Abkhaz and South Ossetians see ethnic Georgians as arrogant, aggressive, and

war-mongering. Their view contradicts Georgians' self-image of magnanimity and hospitality. To improve perceptions, the State Strategy recognizes the disadvantages resulting from isolation and seeks to address them in meaningful ways. It also shows humility by acknowledging that the GoG made mistakes and suggesting remedies.

- *International community*: Some diplomats believe that the GoG's isolation policy was to blame for hardening divisions and that reckless behavior caused the 2008 War. The GoG strongly disagrees. Nonetheless, it is trying to refurbish its image through a more benevolent approach. By involving the international community at each stage of drafting and dissemination, the GoG is encouraging countries to have ownership of the process. It hopes ownership will translate into material support.

Archil Gegeshidze, Senior Fellow of the Georgian Foundation for Strategic and International Studies, commends the State Strategy for "denying coercion and offering opportunities to engage in mutually beneficial projects." But he believes "[i]t is badly packaged." Gegeshidze notes, "The Strategy may impress the outside world but not the Abkhaz. Georgia needs to openly refrain from making claims on territory if it wants the Abkhaz to go along." The State Strategy was rolled out with much fanfare. Gegeshidze believes more discreet dissemination would enhance results.⁸ Buy-in by the Abkhaz authorities is critical to the success or failure of the Action Plan.

Temuri Yakobashvili, the GoG's State Minister for Reintegration, has successfully forged consensus within the GoG on the need for engagement. He has also been transparent in vetting ideas with the international community and Georgian civil society representatives like Gegeshidze. In addition, he has shown flexibility by discreetly reaching out to the directly affected parties and soliciting their input. Yakobashvili benefited from experts seconded by the U.S. Agency for International Development, the United Kingdom, Germany and others in preparing documents that are concise, innovative and professionally organized.

ECONOMIC CONDITIONS

Georgia's Economy

Georgia became an economic success story after the Revolution of Roses. The GoG sought to advance its goal of reintegration by making Georgia economically vibrant. It believed that Abkhaz and South Ossetians would be lured back by Georgia's prosperity.

In 2007, Georgia's positive macroeconomic trends included growth of 12% resulting from a boom in the telecom, construction, transport, financial and tourism sectors. Its trade turnover increased 39.9% between 2006 and 2007. Exports increased 32.5% and imports by 41% during the same period. Georgia also benefited from an overall improvement in macroeconomic indicators such as the gross domestic product (GDP) growth rate, fiscal balance, current account balance, and real exchange rate, as well as positive structural changes measured by improvements in the banking system, position of the central bank and increasing rates of tax collection. Foreign direct investment was \$1.8 billion in 2007, fueled by investors from Kazakhstan, Russia, Israel, and the Gulf States.⁹ This represented a 40% increase from the previous year, and 19.8% of GDP. Trade liberalization, privatization of small and medium-sized enterprises, and elimination of price controls and subsidies helped enhance Georgia's economic performance. Georgia became a WTO member in good standing.

Georgia also benefited from its location on the Eurasia Silk Road. The BTC oil pipeline and South Caucasus gas pipeline from Azerbaijan generate transport fees, as well as opportunities beyond the energy sector. The embargo by Turkey and Azerbaijan of Armenia has increased Georgia's strategic importance as a transit country not only for trade between Turkey and Azerbaijan, but also the movement of Turkish goods to markets in Central Asia.

The 2008 War adversely affected Georgia. It resulted in \$1.2 billion in damages to the civilian economy. Russia targeted both military and civilian infrastructure. It bombed the port at Poti on the Black Sea, the military airport near Tbilisi, and military bases across the country. The demolition of a bridge that spans the Mtkvari river about 40 km west of Tbilisi cut the main east-west rail link from Poti and Batumi to the Georgian capital, and beyond to Armenia and Azerbaijan.¹⁰ The conflict resulted in damages to roads (\$150

million), destruction of civilian infrastructure and private property (\$350 million), wasted crops and farmland (\$100 million), and environmental damage (\$200 million) from oil spills in the Black Sea and forest fires in the Borjomi-Kharagauli and Ateni Valley. Economic recovery was further hampered by increased shipping costs of \$100 million and loss of \$300 million in fiscal revenue (August-December 2008).

The 2008 War also created a crisis in investor and consumer confidence. Georgia's economic growth fell to 6% in 2008, half the rate of the 2009 expansion, and 50% less than originally projected.¹¹ Before the war, the GoG forecast \$2 billion in FDI for 2008.¹² After the war, FDI was less than \$200 million (August-December 2008) after reaching \$1 billion during the first half of 2008.¹³

Georgia's credit rating fell; stocks and bonds slumped. The Bank of Georgia, the only stock listed outside the country, tumbled 32%, the biggest monthly drop since it started trading in November 2006.¹⁴ Foreign currency reserves dipped 6.4% to \$1.3 billion as the Central Bank sold close about one eighth of its foreign reserves to cushion a decline in the value of its currency. Despite banking restrictions to prevent capital flight, reserves at the National Bank decreased by about 40% between August 8 and September 12, 2008.¹⁵

The U.S. responded quickly and comprehensively to cushion economic consequences, deepening its trade and investment ties with Georgia. The Bush administration announced plans to: broaden its Trade and Investment Framework Agreement with Georgia; explore an enhanced bilateral investment treaty; develop new legislation to expand preferential access to the U.S. market for Georgian exports; and provide trade-related technical assistance, including measures to help Georgia take full advantage of the Generalized System of Preferences (GSP). In addition, the Commerce Department expanded its assistance to American firms considering investment in Georgia and sponsored exchanges to enhance ties between the U.S. and Georgian business communities. The U.S. Overseas Private Investment Corporation (OPIC) expanded its support for private sector investment projects. Combined with the IMF package, U.S. assistance programs signaled a level of commitment by the international community that gave Georgia visibility and helped restore investor confidence.

Georgia nonetheless experienced a 3.9% contraction in 2009 due to a decline in trade, services and tourism. The reduction was compounded by the global economic crisis. Uncertainties resulted in stagnated economic activity, export slowdowns, and a credit crunch for businesses. FDI was only \$760 million.

Over the past year, Georgia has been digging itself out of the ditch. Average per capita income has increased to about \$2,500. Inflation has declined from its peak of 11% in 2007.¹⁶ The IMF projects 2-4% economic growth in 2010 based on first quarter results. Customs and tax revenues are also projected to increase this year, as well as banking deposits and credit portfolios. According to GoG statistics, the state budget increased by 12.1% and the deposit portfolio by 30.7% from the first quarter of 2009 to a similar period in 2010. Georgia ranked 11th out of 183 countries for ease of doing business by the IFC in 2010. It also ranked in the top ten in four important categories: starting a business, dealing with construction permits, employing workers and registering property.¹⁷

The Georgian Investment Group questions this data: "Georgian economic activity is stagnated and produces nothing ... exports are halted and imports reduced. The 4-5% growth forecast may come true only if the state takes new loans and makes artificial injections to the economy, however, it can give only short term results." Given Georgia's reliance on foreign aid for budgetary support and to bolster investor confidence, the Group describes Georgia as "a foreign debt dependent country," whose economy suffers from too much governmental control.¹⁸

Abkhazia's Economy

Abkhazia is 8,700 km². According to the 1989 census, Abkhazia's population was 525,000 people, of which Georgians represented 45.7% and ethnic Abkhaz 17.8%. Other groups included Armenians and Russians. The 1992-93 conflict displaced 250,000 ethnic Georgians, dramatically affecting Abkhazia's demographics. Abkhazia's current population is about 180,000.¹⁹

Based primarily on tourism and agriculture, Abkhazia's economy is seasonal. Mild and sub-tropical, Abkhazia has more than 200 sunny days each year. These conditions are ideal for citrus, tea, and tobacco, which occupy

40% of the land under cultivation. Abkhazia is covered by forest with a variety of species such as chestnut, oak, box, and yew.²⁰

In the 1980s, Abkhazia's economy included 500 industrial enterprises, primarily power engineering and machine manufacturing.²¹ Gagra, with its beautiful white sand beaches, was a celebrated tourist destination. Other tourist spots included Sukhumi, Gudauta, Pitsunda, Lake Ritsa, and Novyi Afon, home to one of the world's most beautiful and historic monasteries. After the 1992-93 conflict, Sukhumi's hospitality industry virtually disappeared. Its storied seaside grew dilapidated, its coastline polluted, and infrastructure neglected. Many buildings, even those on the Black Sea, are still pockmarked from small-arms fire.

Abkhazia grew dependent on humanitarian assistance and subsistence farming. However, up to 60,000 land mines hampered agricultural production. Accelerated by the CIS embargo (1996-2008), its productive capacity collapsed. Industrial production decreased tenfold; underinvestment and neglect undermined Abkhazia's transport and energy infrastructure. The Gali, Ochamchira, and Tquarchal districts in Eastern Abkhazia had been largely populated by ethnic Georgians and became deserted. Citrus fruit production dropped from 100,000-120,000 tons/year to 30,000-33,000 tons/year. Tea production dropped from 100,000 tons/year to 6,000-7,000 tons/year. Tobacco production of about 10,000 tons/year completely disappeared. While Abkhazia had 23 tea-processing facilities before the conflict, only 9 functioned after the conflict.²² Agricultural productivity was affected by the lack of seed, fertilizer and mechanization. Industrial enterprises employing 30,000 people diminished fivefold, with industrial output decreasing to 5% of the pre-conflict total. Use of fuel wood to meet household energy needs resulted in deforestation and erosion of potentially productive agricultural areas. Hazelnuts were the only agricultural commodity where production stayed strong. Hazelnut production continued in the Gali region on properties owned by Georgians that were occupied after the conflict. Hazelnut farmers export to Sochi across the River Psou, as well as across the line of control in Zugdidi. Abkhaz authorities claim that Abkhazia lost \$13 billion as a result of the conflict.

Conflict helped fuel Abkhazia's grey economy. Organized crime also undermines legitimate economic activity. Smuggling is a major activity, including movement of goods to Georgia. Gangs smuggle cigarettes into Georgia and bring out foodstuffs. Rail links between Sukhumi and Sochi are used for contraband. Locally produced drugs, as well as narcotics from Latin America and Central Asia, are moved through Abkhazia to consumers in Russia and Europe. Weapons are also transported through Abkhazia to groups in the North Caucasus. Counterfeit Georgian products that are popular in Russia, such as wine and water, are smuggled across the River Psou. Criminal gangs working with local police impose unofficial taxes on hazelnuts sold in Gali. Russian border guards also take their cut. The Kodori Gorge, which was taken by Abkhaz in 2008, has a large criminal element. Rare and prohibited wood species are harvested for export. Abkhazia is also a point of origin and transfer area for human trafficking involving Russian girls and young women who are registered as "housekeeping staff" and transported to brothels in Istanbul.²³ Since 2007, there have been two known attempts to smuggle weapons grade material from countries in the former Soviet Union to Turkey via Abkhazia (Cesium 137 and yellowcake).²⁴

Despite the devastating effect of conflict on Abkhazia's economy and widespread criminality, Abkhazia is making a comeback. Per capita income increased to \$1,500 in 2009. Tax revenues doubled between 2008 and 2009. Other growth indicators include an average monthly salary increase between 1999 and 2008 of \$8.7/person to \$127.5/person. The number of imported vehicles grew from 104 in 1999 to 3,527 in 2008. As a result of economic links with Russia, annual real budget revenues grew from \$5.5 million in 2000 to \$65 million in 2008.

Russia is renovating Abkhazia's infrastructure by building roads, expanding the utility grid, and developing a water supply system. A new highway was recently built between Sukhumi and Southern Russia. Abkhazia has functioning ports: Sukhumi, Gagra, Gudauta and Ochamchira. Of these, Sukhumi has deep water of up to 7 meters. However, equipment for loading containers is in short supply and the railway connecting the port is in disrepair. Sukhumi's Babushera Airport has a 3,600 meter runway, but needs upgrading, as do most internal railways.

Regarding the hospitality industry, Abkhazia had 200 hotels, spas and resorts with 30,000 beds that serviced

1.5 million tourists yearly before 1992. Post-conflict, the number of facilities decreased to 67 with only 12,000 beds. After the 2008 War, however, Abkhazia's hospitality industry started a comeback. Though tourism increased in 2009, many visitors were day-trippers from Sochi. Abkhazia lacks the capacity for a large overnight population. Currently, for example, Gagra has only 9,500 hotel rooms. Two new hotels are under construction with a capacity of 1,600 rooms. These facilities are a step towards realizing the target of 60,000 hotel rooms. So far this year, 11 Austrian tourism companies have visited Abkhazia to explore work in the hospitality field. Abkhaz officials are confident that tourism will continue to grow as long as there are conditions of security.

Abkhazia also has natural resources. Coal from the Khudzga pit in Tkvarcheli represents a potential resource of 100,000 tons. Even larger reserves are estimated at the Dzहित deposit on Mount Khodza.²⁵ Oil reserves may be off the coast of Abkhazia. The authorities signed an agreement with Rosneft to explore and will consider extraction arrangements based on initial resource assessments. Abkhazia has the potential to produce 100,000 tons of tea each year. Logging is potentially a major enterprise. In addition to hazelnuts, persimmons and viticulture, kiwi has growth potential.²⁶

Laws are being developed regulating trade and FDI. As an unrecognized entity, however, Abkhazia cannot raise funds in capital markets and does not have access to funds from IFIs. Abkhazia lacks a legal infrastructure for economic development. For example, it has not promulgated a legal code on basic issues like state regulation, land tenure, the status of cooperatives and private ownership of property. Land is owned by the state and leased to individual homeowners and businesses. Ethnic Abkhaz living in Russia have invested in joint ventures, primarily in agriculture and the food-processing industry.²⁷ Efforts are being made to identify new business partners in Eastern Europe, especially Romania. In addition, Turks are exploring construction and commodity sourcing opportunities. According to Nadir Bitieff, National Security Adviser to the Abkhaz President, "The Law [on Occupied Territories] slows down investments, but they will come."²⁸

ECONOMIC OPPORTUNITIES

Sectors

Following are examples of mutually beneficial economic activities for Georgians and Abkhaz.

- The Enguri Hydroelectric Power Station generates 1.3 million kw from the Enguri River, which marks the administrative border of the conflict zone. The reservoir, with a capacity of 1,100 million square meters, is located in Georgia while the plant and distribution transformer is in Abkhazia. 60% of the electricity goes to Georgia with the balance transmitted to Abkhazia. The 410 meter dam irrigates 20,000 hectares in the Gali District. The dam also manages flooding from the Enguri and Eristqali rivers.²⁹ According to the EC, the HPP "demonstrates that even in the context of an unresolved war, economic and security considerations can force parties to collaborate."³⁰ Georgian and Abkhaz engineers recently worked together to implement a €40 million renovation financed by the EBRD. In December 2009, InterRao, Russia's state energy company, signed an agreement with Georgia to jointly operate the facility. Abkhazia rejected the deal, offering Russia a lease of up to 10 years instead.
- The Khudoni Dam and Hydro Station is located 40 km upriver from the Enguri Dam. Started in the 1980s by the Soviets, construction is about 30% complete. The estimated cost to finishing construction is \$2 billion. The World Bank is currently supporting an Environmental Impact Assessment (EIA) looking at the impact on local communities. Next steps involve completing the EIA, arranging a finance package, and negotiating a market contract with Russia. Given the site location and steps to develop a high voltage transmission system, it is envisioned that most of the generated electricity would be transmitted to Krasnodarsky Krai, a region in Russia with Sochi as its capitol, or to Turkey.
- The Enguri Sand and Gravel Export Project has been undertaken by Black Sea Infrastructure Development (BSID). The project will dredge the dry-bed of the Enguri River at a site 62 km from Anaklia and 40 km upstream from the Khudoni site. Up to 500 million cubic meters of product will be immediately loaded onto barges and transported downriver, bound for markets across the Black Sea. The developers plan to upgrade roads, railways, and nearby bridges. In addition to creating 250 jobs, other benefits include flood plain safety below the dam as well as an additional deepwater port and deepwater fuel depot for the Eastern Black Sea. An economic development zone and potential marina and resort

facilities could be established near the site. The project will be financed by private investors with support from IFIs. Eight months are needed from approval to the start of gravel production. Before starting, however, the project needs a detailed EIA that will consider the effect of gravel removal on siltation patterns in the Black Sea.

- Black Sea Resorts and Family Entertainment Centers could play a leading role in expanding hotel capacity in Georgia and marketing tourism packages with stops in Abkhazia (e.g. Gagra) and Russia (e.g. Sochi). Tourism packages will be attractive for Russian and Western tourists due the natural beauty of these hospitality destinations and the allure of cultural heritage sites throughout the region. Plans may also integrate casinos and other gaming industry recreational activities. The marina near the Enguri Sand and Gravel Project is envisioned as a hotel property.
- Suitcase trade of commodities and agricultural goods is conducted by many of the 1,800 persons who cross the Enguri River each day. Medical equipment and pharmaceuticals are also procured in Georgia for sale in Abkhazia. As a member of the WTO, Georgia imports goods at a much lower cost than Russia does. The costs of commodities in Sukhumi are three times greater than in Zugdidi. Absent a legal framework for trade, Abkhaz traders have to pay “customs” when they bring goods across the Enguri. “Transit fees” are collected at checkpoints by Abkhaz police working in close cooperation with Abkhaz gangs and FSB border security. The sale of agricultural commodities from Abkhazia in Georgia is hampered by the GoG’s refusal to recognize certificates of origin issued by Abkhaz authorities.
- Tea plantations existed for 200 years across Western Georgia, including Abkhazia. 96% of the tea consumed in the Soviet Union originated from Georgia. During the Soviet period, production was dominated by small cooperatives. Tea bushes were harvested manually using pruning machinery manufactured in Georgia. Tea production all but ended as a result of the conflict. Going forward, capital investment is needed to rehabilitate the untended and overgrown organic tea plantations. The immediate market is in Georgia itself, which currently relies on imports for almost all of its tea consumption. Tea plantations will not only create employment, including jobs for displaced ethnic Georgians returning to work in their villages of origin. They will also motivate tea producers in Abkhazia to sell their product at processing centers on the eastern side of the Enguri, thus catalyzing both social and economic interaction.
- Agro-enterprise zones, including tea processing facilities, could be established for agricultural commodities grown in Gali and processed at facilities in Zugdidi. For example, tomatoes could be canned as tomato sauce, citrus products bottled as juice, and apples turned into a variety of products including juice and pectin. Hazelnuts are another in-demand commodity, as demonstrated by Ferrero’s efforts to capture market share. While enterprise zones would engage Georgian, Abkhaz, and international private sector representatives, international donors can assist through project financing, loan guarantees, and risk insurance. The GoG can also support agro-enterprise zones by training employees and offering other benefits such as health care. Issues include quality control and certificate of origin labeling.

While this report is hopeful, its approach is steely-eyed. Collaborative activities can only go forward with concurrence by the GoG and Abkhaz authorities. Commercial contact will not occur in the current climate unless both sides make a strategic decision that it is in their interests to allow it.

Civic Initiatives

People-to-people activities – also called “track two activities” – represent a form of cooperation engaging business representatives and other non-governmental actors. People-to-people activities create space for civic engagement while building bridges through practical forms of cooperation that, based on dialogue and joint analysis, derive mutual benefit. They can also help transform conflict conditions through confidence building by reducing misperceptions and combating negative stereotypes that undermine mutual understanding.

People-to-people activities are not a substitute for official diplomacy, but they can change the climate in which diplomatic efforts occur. They can also add value by developing innovative policy initiatives based on common approaches to shared problems. While it may be possible to measure small steps in project development, it is much more difficult to quantify changed behavior and attitudes, or to affect the climate for political interaction.³¹

Numerous initiatives have been undertaken to bridge divides between Georgians and Abkhaz. The UN established the Coordinating Council in 1997 with working groups on security, humanitarian issues and IDPs,

and economic cooperation. With UNOMIG as the overall lead agency, both Georgian and Abkhaz representatives participated; Russia served as facilitator and countries in the Group of Friends functioned as observers. Within the framework of the Geneva process and under the auspices of the UN, Confidence Building Measures were discussed at meetings in Athens in 1998, Istanbul in 1999, and Yalta in 2001. Both sides agreed to undertake a long list of activities in a variety of fields which would involve implementing partners from different sectors and with complementary competencies. Projects were discussed involving youth, students, scientists, psychologists, writers, librarians, political circles, war veterans, and invalids. Joint cultural and economic activities were envisioned in a variety of fields, including winemaking. Plans were made to establish a database tracking activities. Beginning in February 2006, UNOMIG operated a shuttle bus crossing the 800-meter bridge over the Enguri River.³² On rare occasions, officials and political leaders also got together informally. Many of the commitments in the Yalta Declaration were never fulfilled and UNOMIG, as the implementing mechanism, no longer exists.³³

Georgian-Abkhaz people-to-people activities depend on international intermediaries as well as foreign donors.³⁴ The most effective endeavors are those of Conciliation Resources and the Berghof Center. International Alert has constructively focused on interaction around economic issues. The so-called Schlaining Process has involved more than 100 Georgian and Abkhaz officials, politicians, and civic leaders. When NGO counterparts meet — usually in Istanbul or elsewhere in Europe — they tend to avoid hot-button issues. Activities usually occur in parallel rather than in tandem. Training seminars have provided a useful framework for interaction and overcoming psychological issues. Participants have taken part in study tours to Northern Ireland, Scotland, and Cyprus to examine conflict and governance issues.

Several obstacles, however, have limited the impact of people-to-people activities. Difficulties result from the lack of resources, as well as failures by both the Georgian and Abkhaz sides to create a permissive environment for interaction. Abkhaz are especially adamant in their opposition to activities that can be manipulated to advance reintegration. Bitterness on both sides impedes trust and reconciliation.

Going forward, the GoG is exploring innovative ways to facilitate freedom of movement. It plans to issue laissez-passer travel documents and identification cards to Abkhaz. The documents will make travel easier and allow Abkhaz to benefit from social services available in Georgia, such as health care and education, which are of higher quality and lower cost than in Abkhazia.

Abkhaz civil society representatives believe that the GoG's efforts are too politicized and have little chance of occurring. They prefer regional frameworks for cooperation on business and environmental issues such as the BSEC and the Caucasian Forum on Provincial Cities in the South Caucasus.³⁵ Previous efforts to foster regional economic integration have all failed. The Soviet Transcaucasus Federation of 1922 was short-lived. Mikhail Gorbachev's proposal for a common "Caucasian home" was never achieved. Russia's proposed 3+1 formula was undermined by conflict in Chechnya. Benefits from broader regional groupings, such as GUAM (Georgia/Ukraine/Azerbaijan/Moldova), have not materialized.

Sochi Olympics

The Sochi Olympics are in trouble due to construction delays and cost overruns. A debacle would be a major embarrassment to Putin who has staked his personal prestige on successful Games.

Originally budgeted at \$8-13 billion, the current cost is estimated at \$37 billion. There are serious obstacles to building facilities for the Games. Since the Sochi area lacks raw materials, barges are bringing sand and gravel from Turkey. Russia has tried to build a port at Sochi, but has encountered engineering difficulties. Even when raw materials are available, laborers are in short supply. Transport and hospitality infrastructure are also major problems. Sochi lacks a major airport, but because Sochi is just 35 km from Abkhazia, Russia hopes to use Sukhumi's Babushera Airport as a transport hub. However, the GoG has protested to the International Civil Aviation Organization. Russia has proposed to the International Olympic Committee (IOC) splitting sporting events between sites in Sochi and near Moscow. With estimated hotel capacity downsized from 56,000 to 42,000, Russia wrote the IOC to propose that athletes stay on boats on the Black Sea.

The Olympics present both opportunity and peril for Abkhazia. Many Abkhaz are concerned about the surge

of up to 50,000 foreign workers, who will be employed to build the Olympic Village and related facilities. They are also worried about the ecological impact of a huge Russian cement plant under consideration for Abkhazia at a cost of \$170 million.³⁶ Groups like the Center for Humanitarian Issues in Sukhumi are concerned about the environmental impact to Abkhazia's coastline. Abkhaz civil society organizations have protested major deforestation and soil erosion from construction of a major highway through scenic gorges linking Sukhumi to Russia.

Some GoG officials and Abkhaz authorities are considering how to profit from building the Olympic facilities and meeting service requirements during the Games. Russia may need Georgia to provide sand, gravel and electricity. According to Yakobashvili, "Why not make money from the Olympics?"³⁷

Georgia abandoned initial efforts to orchestrate an international boycott of the Sochi Olympics (just 35 km from Abkhazia). However, the Circassian Diaspora, based mostly in Turkey and Jordan, is meeting with Members of the U.S. Congress and European Parliament to promote protests during the Sochi Olympics. Circassians seek acknowledgement of the Circassian Genocide in the 19th century, when Czarist forces killed more than a quarter million people and expelled many from Sochi, the historic Circassian capitol.

STAKEHOLDERS

The United States

Georgia emerged as a high-value ally after the events of September 11, 2001. Bush and Saakashvili developed a close personal relationship based on shared values and Georgia's embrace of Bush's war on terror. Though less ideological, the Obama administration also strongly supports Georgia. In his address to the parliament, Vice President Joseph R. Biden, Jr. affirmed: "We, the United States, stand by you on your journey to a secure, free and democratic, and once again united, Georgia."³⁸

Regarding security cooperation, the Pentagon launched a 20-month, \$64-million Train and Equip Program to enhance Georgia's counter-terrorism capabilities on April 29, 2002. The Georgia Sustainment and Stability Operations Program immediately followed, lasting 18 months and costing \$60 million. Georgia was one of the first countries to join the multinational force in Iraq. In response to Obama's appeal for more forces in Afghanistan, Georgia pledged approximately 1,000 troops. The Northern Distribution Network runs through Georgia and is used to send supplies to troops in Afghanistan. Georgia also provides over-flight rights for NATO transport.

The United States led efforts to establish the Partnership for Peace Program between NATO and Georgia. The Bush administration also championed Georgia's NATO membership. A decision on MAP for Georgia was deferred at NATO's Bucharest Summit on April 4, 2008. However, the final communiqué affirmed, "We agreed today that these countries [Georgia and Ukraine] will become members of NATO." Though the Obama administration continues security cooperation with the GoG, it declined Georgia's request for assistance in rearming. Instead, it is working with Georgia to modernize its military, focusing on training, planning, and organization of Georgian forces to be deployed in Afghanistan.³⁹ The U.S. offered \$1.06 billion after the 2008 War. However, the package will be spent out this fiscal year.

The U.S.-Georgia Charter on Strategic Partnership was adopted in 2009. It formalizes the pre-NATO relationship by affirming U.S. support for Georgia's "legitimate security and defense needs" as well as "regional peace and stability." In addition to security cooperation, the Charter affirms cooperation on energy and economic trade, advancing democracy and the rule of law, and strengthening cultural ties. The Charter includes working groups, but its emphasis is more on process than product. Critics say the Charter is a consolation prize for NATO's decision to withhold MAP from Georgia.⁴⁰

After the Revolution of Roses, Georgia was heralded by the Bush administration as a beacon of democracy that represented the possibility of a democratic post-Soviet state outside of the Baltics. Since 2007, however, Georgia has struggled to consolidate its democratic development. Biden called for "significant, concrete steps that need to be taken to deepen democracy." He added, "Your Rose Revolution will only be complete when

government is transparent, accountable, and fully participatory; when issues are debated within this chamber, not on the streets; when you fully address constitutional issues regarding the balance of power between the parliament and the executive branch, and leveling your electoral playing field; when the media is totally independent and professional, provide people with the information to make informed decisions, and to hold their government accountable for the decisions it makes; when the courts are free from outside influence and the rule of law is firmly established; and when the transfer of powers occurs through peaceful, constitutional, and democratic processes, not on the street.”⁴¹

Georgia straddles the East-West Corridor that transports oil and natural gas supplies from the Caspian via Georgia to western markets. The BTC pipeline cost \$3.5 billion and now delivers a million barrels of oil each day. The Erzurum gas pipeline, which follows the same route, and the smaller Baku-Supsa line are other Caspian pipelines not under Russia’s control. The proposed Nabucco pipeline, whose construction is estimated at \$12 billion, will expand trans-Caspian projects by transporting natural gas from Azerbaijan and Turkmenistan through Georgia to Turkey. These supply routes are essential to diversifying energy sources and lessening U.S. dependence on suppliers from the Persian Gulf.

U.S.-Georgia relations are increasingly defined by strategic interests. A Georgian official warned that the perception of U.S. power in the Caucasus would collapse if Russia were allowed a free hand. He cautioned that countries will think twice before relying on the West to guarantee their interests when it requires standing up to Russia.⁴² Georgians have a simmering resentment of the U.S. for abandoning them in their hour of need. The GoG is concerned by U.S. overtures to Russia. Pushing the reset button established improved relations with Russia as a foreign policy priority for the Obama administration. But Georgians fear that improvement will come at their expense.

U.S.-Russia relations have rebounded from their low point during the Bush administration when Putin likened the United States to the “Third Reich.” In addition, Russia suspended its commitment to the Treaty on Conventional Forces in Europe; denounced U.S. plans for a missile defense system in Poland and the Czech Republic; and suggested that Russia would consider withdrawing from the 1987 treaty on intermediate-range nuclear missiles.

The Obama administration has taken steps to systematically repair relations. The United States and Russia work together when cooperation advances their respective national interests. Russia plays a critical role when it comes to negotiations of sanctions on Iran, as well as other multilateral initiatives before the UN Security Council. In addition, the United States and Russia have a shared strategic interest in standing together against Islamic extremist organizations worldwide and in the North Caucasus.

Obama has made non-proliferation his administration’s signature issue. After dropping plans for the missile shield in Poland and the Czech Republic, Obama and President Dmitri Medvedev signed the New Strategic Arms Reduction Treaty in Prague on April 8, 2010. The Obama administration is looking to revive the Treaty on Conventional Forces in Europe, from which Russia withdrew in 2007 in part to protest the Bush administration’s support for Georgia’s NATO membership. Plans are underway for NATO to reduce some of its tactical nuclear weapons, and to invite Russia to join the anti-ballistic missile shield. The U.S. and NATO are developing a new approach to Russia that will be announced at NATO’s Lisbon summit in November 2010.

Despite cooperation with Russia on non-proliferation issues, the Obama administration still maintains a strategic partnership with and strongly supports Georgia. According to Biden, “We stand against the 19th century notion of spheres of influence ... We will not recognize Abkhazia and South Ossetia as independent states. And we urge the world not to recognize them as independent states. We call upon Russia to honor its international commitments clearly specified in the August 12 ceasefire agreement, including withdrawal of forces to their pre-conflict positions, and ultimately out of Georgia.”⁴³

Russia

The relationship between Georgia and Russia is highly personalized and emotional. Putin’s goading of Saakashvili provoked the 2008 War. Russia’s aggression and disproportionate response are documented in the EU report prepared by Ambassador Heidi Tagliavini.

The August 12 ceasefire agreement required Russia to withdraw its forces to pre-war positions, guarantee humanitarian access, and permit monitoring missions to the conflict areas. It also called for a diplomatic process on the future status of Abkhazia and South Ossetia. However, Russia cited “new realities” and established diplomatic relations with Abkhazia as a sovereign state on August 26, 2010. Putin proclaimed that “[Abkhazia] doesn’t need to be recognized by any country other than Russia.” However, Nicaragua, Venezuela, and Nauru followed Russia’s lead, establishing diplomatic relations with Abkhazia.⁴⁴ Every other country in the world views Abkhazia and South Ossetia as parts of Georgia.

Russia signed a “bilateral military cooperation agreement” with Abkhazia formalizing the deployment of 3,800 Russian troops and 1,000 FSB members on the administrative border.⁴⁵ In addition, Russia and the Abkhaz authorities signed a 49-year lease for the naval base at Ochimchira, where naval/coast guard forces will be stationed, and for the Bombora Air Base at Gudauta where 1,700 troops will be posted. Beginning in August 2009, the Sevastopol-based Russian Navy started patrolling the Black Sea to prevent Georgian Coast Guard vessels from interdicting Turkish ships putting into port absent GoG authorization.

On his first post-war trip to Abkhazia, Putin pledged \$470 million to support the Russian armed forces in Abkhazia and reinforce the administrative dividing line at the Enguri River. Putin also announced \$340 million for social support and as stimulus for the Abkhaz economy, including \$65 million in direct budgetary support in 2009 and a slightly higher amount in 2010. In addition, Russia agreed to pay \$17 million in pensions to Abkhaz holding Russian passports.⁴⁶ Russia has provided assistance despite the global economic crisis and decline in energy prices.

Russia is dominant force in Abkhazia’s economy. Approximately 80% of all goods consumed in Abkhazia come from Russia.⁴⁷ Russia is financing the set-up of Abkhazia’s banking system. Russia’s state railway is leasing the Abkhaz railroad. Negotiations are underway for Russia to assume operation of the airport and a port near Sukhumi.⁴⁸ Major Russian television stations are broadcast in Abkhazia and Internet access in Abkhazia is provided via Russian Internet service providers.

All property in Abkhazia is technically owned by the state. However, long-term leases are allowed. Non-citizens of Abkhazia were previously blocked from owning private property; Russians who wanted to acquire assets had to become Abkhaz citizens, a process that takes ten years, or work through an Abkhaz partner. However, recent legislation allows Russian citizens to lease homes in Abkhazia. Prominent Russians have acquired properties on the Black Sea coast, including the oligarch Oleg Deripaska and Moscow’s Mayor Yuri Luzhkov, who built a mansion on a spectacular bluff in Gagra. The sale of properties belonging to Georgian IDPs in the Gali region is especially egregious to the GoG.

Though Abkhaz welcome their strategic partnership with Russia, they also have a long history of resisting Russian imperialism. Abkhaz want independence. They do not want to be assimilated or annexed by Russia. The Russian State Duma passed a resolution on February 17, 2010 heralding “the 200th anniversary of Russia’s patronage over Abkhazia.”⁴⁹

Russia’s relations with Georgia remain tense and acrimonious. Georgia and Russia severed diplomatic relations after the 2008 War. Georgia maintains an interests section at the Swiss embassy in Moscow and Russia has an interests section at the Swiss Embassy in Tbilisi. However, the absence of a Georgian consulate creates problems for an estimated half million ethnic Georgians living in Russia, as well as Georgians with dual citizenship. The GoG maintains it cannot resume relations until Russia abides by ceasefire commitments. Russia’s disparaging of Saakashvili also impedes resuming relations. According to Medvedev, Russia will eventually restore relations with Georgia, but not until Saakashvili leaves office.⁵⁰

Despite acrimony, Russia remains a major investor in Georgia. Through subsidiaries, the Russian state-owned VTB Bank owns a majority stake in Energy Invest and provides electricity to Tbilisi. Electricity supplies continued even during the war. VTB also owns Rustavi Chemical and power-generating facilities.⁵¹ Most Georgians want the GoG to take a different approach towards Russia. A public opinion poll conducted by the Caucasus Resource Research Center on April 11-26, 2010 found that 52% of those surveyed disapprove of Georgia’s current policy towards Russia; 82% support a resumption of direct flights between Tbilisi and

Moscow.⁵² The GoG adamantly insists that it will not agree to restore full diplomatic or consular relations until Russia rescinds its recognition of Abkhazia and South Ossetia and withdraws troops from these territories. The GoG believes that normalizing relations would send the wrong signal to countries it is lobbying to hold the line on non-recognition. Georgia and Russia are at loggerheads; Moscow has no intention to compromise.

Russia's approach to Abkhazia is part of a broader strategy to reassert its sphere of influence in the near-abroad where Russia empowers its allies and befriends those who oppose its opponents. Russia supported Ukraine's Viktor Yanukovich, indicating that his election would usher in a new period of cooperation with Moscow, including increased trade and inexpensive natural gas. After Kyrgyzstan's President Kurmanbek Bakiyev took a bounty from Russia and then extended a lease with the United States for the Manas military base, Russia sheltered Kyrgyz opposition leaders and supported Bakiyev's ouster. Belarus' President Alexander Lukashenko has also fallen from favor for sheltering Bakiyev and demanding rent for Russian military bases. Recalling protests that deposed Bakiyev, pro-Kremlin Duma deputy Sergei Markov says that Moscow is planning a "second Bishkek" to realize regime change in Georgia. Saakashvili is reviled by Putin for his pro-Western positions and stands in the way of Russia's efforts to control of the East-West energy corridor.⁵³ Russia's control of Georgia is essential to projecting and consolidating its interests in the Black Sea, the southern Caucasus, Central Asia, and beyond.

Turkey

Turkey has extensive ties to Russia, with which it shares strategic interests and extensive commercial contact. Medvedev and Turkey's President Abdullah Gül signed 17 cooperation agreements on May 12, 2010. As a result, bilateral trade volume currently valued at \$30 billion is expected to surpass \$100 billion. Most of the increase will come from the energy sector via a pipeline from Samsun on the Black Sea to Ceyhan on the Mediterranean. "South Stream" and other types of economic cooperation deepen Turkey's dependence on Russia while consolidating Russia's energy influence in Eurasia. This also advances one of Moscow's strategic objectives: an outlet to the Mediterranean via Turkey.

Among the cooperation agreements signed in May, Turkey and Russia agreed to work together on nuclear power, with Russia agreeing to build a nuclear power station in Mersin. Turkish construction workers are employed across Russia, and Turkish construction companies were contracted to build Russia's military bases in Abkhazia. The Trabzon-Sochi maritime link is important commercially. About 5.5 million Russian tourists visit Turkey each year; tourism will increase with plans to lift visa requirements for visits of less than a month.⁵⁴

As part of Turkey's "Zero Problems with Neighbors Policy," Gül visited Moscow and Tbilisi several times in 2010 to try to mediate a rapprochement. Though Turkey's proposal for a South Caucasus Stability Pact floundered, Turkey believes it is well positioned to act as mediator given its close ties with both Russia and Georgia.

Georgia is Turkey's window to the Caucasus and the Caspian countries. Turkish hubs on the Black Sea coast are linked to Batumi, a former Ottoman province now serving as the primary East-West route from Turkey to Central Asia. The Sarpi/Batumi border in Adjara was opened in 1988. A second post in Turkgozu was opened in 1994 and a third in Cildir-Aktas is planned. Failure of Turkey and Armenia to normalize relations has hindered implementation of the EU's Transport Corridor Europe-Caucasus-Asia Programme, thereby heightening the importance of Georgia for surface transport.⁵⁵

Turkey is one of Georgia's top trading partners. Trade volume was \$1 billion in 2009. Turkey ranks second in FDI valued at \$165 million in 2008. Turkey is Georgia's largest export market, accounting for 17.6% of exports in 2008. The value of goods imported from Turkey by Georgia is 14.9% of total imports.⁵⁶ The two countries signed a Free Trade Agreement and cooperate militarily via weapons sales from Turkey to Georgia and training of Georgian military personnel.

At least 300,000 ethnic Abkhaz, even more ethnic Georgians, and untold numbers of North Caucasians (mostly Circassians) live in Turkey.⁵⁷ This Diaspora helps make Turkey Abkhazia's second largest trading partner behind Russia. Turkish freighters supplied Sukhumi despite efforts by Georgia's Coast Guard to impose a maritime blockage. The Georgian Coast Guard arrested three ships by mid-2009 carrying goods between Turkey and Abkhazia.⁵⁸ On August 8, 2009, the Georgian Coast Guard seized the **Buket**, a Turkish freighter,

which failed to notify the GoG that it was transporting 2,800 tons of fuel to Abkhazia. The ship was confiscated and sold at auction in Batumi. Under the Law on Occupied Territories, her captain was sentenced to 24 years in prison but his sentence was suspended after Turkey's Foreign Minister Ahmet Davuto lu personally intervened.

European Union

Georgia currently participates in the EU's Eastern Partnership Initiative (as does Ukraine, Armenia, Azerbaijan, Moldova and Belarus). Georgian passport holders benefit from a Visa Facilitation Regime with the EU. A Visa Liberalization Dialogue is also underway. Georgia also enjoys GSP+ (General System of Preferences), allowing it to export without tax or quota to EU Member States.

Additionally, Georgia is negotiating a Comprehensive Free Trade Agreement with the EU. It has already adopted 28 conventions (e.g. biodiversity and environmental protection). The Agreement will be finalized when the GoG addresses performance shortfalls in a few areas such as food safety and labor rights. Though the Free Trade Agreement will have negligible impact in the short term, its advantages are mostly political, sending a positive signal to the IFIs and private investors. In May, the EC issued a directive allowing the start of negotiations on a Stabilization and Association Agreement (SAA) for all countries in the South Caucasus "when conditions are correct." Georgia is at the head of the queue.

Russia resents the EU's involvement in Georgia and its staunch non-recognition policy towards Abkhazia and South Ossetia. Russia impeded deployment of the EUMM with FSB forces. The EU participates diplomatically as a co-chair of the Geneva process. Russia is suspicious of the EU. It sees the Eastern Partnership Initiative as a way of weaning countries from its influence. If Georgia gets an SAA, then Russia's efforts to assert control over its near abroad will be further undermined.

ABKHAZ PERSPECTIVE

Peace and progress are unattainable without mutual understanding: it takes two to tango. The Abkhaz perspective cannot be ignored.

This section of the report describes Abkhaz perspectives. It is based on the author's meetings in Sukhumi with Abkhaz authorities, members of parliament, and civil society. While the author does not necessarily associate himself with the statements in this section, they are provided so that the reader may have a fuller understanding of the divergent views of Georgians and Abkhaz.

Abkhaz authorities, including Prime Minister Sergey Shamba, are deeply resentful of Georgia's Law on Occupied Territories. Shamba maintains that the GoG does not accept "new realities." Abkhaz authorities complain about Georgia's efforts to block air, land, and sea access, and its lobbying of Western countries to prevent visas from being issued to Abkhaz with Russian passports. They maintain that Abkhazia's law on dual citizenship was adopted in order to get around resulting travel restrictions.

Abkhaz are also upset by the GoG's efforts to disrupt commercial contacts. By way of example they note Nokia's aborted business with Abkhazia's mobile phone service, which was suspended when the GoG appealed to the Government of Finland, citing violations of Georgia's Law on Occupied Territories (which is deeply resented by the Abkhaz authorities and civil society alike). In addition, Benetton opened a retail outlet in Sukhumi but was forced to close under pressure from the GoG.

Confidence-building measures are dismissed as unrealistic. In addition to condemning the Law on Occupied Territories, Abkhaz authorities criticize the State Strategy for referring to "occupied territories" in its title and discussing "de-occupation" and "non-recognition" in its preamble. According to Shamba, the State Strategy is "a device to bring Abkhazia back to Georgia." Bitieff maintains: "If Abkhazia is built and then decides to rejoin Georgia, so be it. But that won't happen. It's too late."

Distrust is rooted in historical memory. According to Shamba, "We barely survived. Georgians stole

everything – cars, factory equipment, furniture in houses – after attacking us in 1992.” Abkhaz authorities seek a bilateral agreement with the GoG on the non-use of force, which Abkhaz authorities see as a first step to restoring trust. They have proposed it during the Geneva process. However, the GoG has rejected Abkhaz overtures. It believes that entering into an agreement with the Abkhaz authorities implies recognition. The GoG has countered by offering to sign a non-aggression pact with Russia, but only after Russian troops withdraw from occupied territories. Russia has repeatedly rejected Georgia’s overture. The GoG considers that it already made a commitment on non-use of force when it agreed to the French-brokered ceasefire and follow-up in August and September 2008.

Regarding Russia’s role, Shamba adds: “Why engage [with Georgia] when we have a strategic partnership with great and huge Russia? We are ready for relations with all countries except Georgia.”⁵⁹ He points out, “By isolating us, the international community creates the situation where we are dependent on Russia and then criticizes us for being a puppet regime.”

Shamba welcomes “breathing space” provided by the presence of Russian troops. “The constant threat of war forced us to spend all our resources on security. Now people have confidence for the future. They know aggression will be prevented.” Regarding “bilateral agreements” allowing Russian bases in Abkhazia, “We had very tough arguments with Russia and always tried to defend our national interests.” He says wryly, “We have a long history of fighting foreign domination. Maybe that is why there are only 100,000 of us.”

Batal Tabagua, head of the Central Election Commission, represents Abkhaz hardliners with deep antipathy towards the West. “The United States is our main enemy,” he says; “Everybody is afraid of the U.S., so it thinks it can do what it wants. It threatens countries that want to recognize us.” Shamba tried to temper Tabagua’s comments, adding, “There is no hatred at the societal level. We have very good attitudes towards the American people and culture.”

Shamba explains, “Our priorities are security and economic development.” He describes the presence of Russian troops as an additional opportunity for economic development. “Help, tourists, television all come from Russia.” He adds, “We are making progress with tourism and agriculture such as wine, kiwi and citrus, but we need storage facilities and access to new markets.”

Turkey is discussed as both an alternative and additional partner to Russia. Turks currently come to Abkhazia via Sochi. Abkhaz authorities want direct ferry service between Trabzon and Sukhumi. Shamba plans to set up a special ministry to encourage repatriation of the Abkhaz Diaspora, most of whom reside in Turkey. He expressed keen interest in Israel’s “Aliyah” policy, and wants to replicate Israel’s approach.

Abkhaz leaders feel that time is on their side. They believe that international recognition is inevitable. They plan to study how other non-recognized states have gained credibility by opening trade and cultural liaison offices.

Bitieff acknowledges that communications are the key to better understanding. “We want Georgia to recognize us. That would allow refugees to come home or get compensated.” He also believes that normalizing relations with Georgia would be a boon for business. “The more money comes, the stronger our civil society.” With pride he adds, “It’s more free here [than in Georgia]. Abkhazia is an open society that wants to interact with the world. Georgian society is more like Russia’s — Bolshevik and imperial.”

RECOMMENDATIONS

Georgia’s engagement policy is the right approach. Engagement addresses immediate basic human needs, while potentially reducing tensions. It can also potentially diminish the distrust and acrimony that pervades relations between Georgians and Abkhaz, thereby setting the stage for long-term rapprochement. Practical benefits of the State Strategy can be maximized by depoliticizing it and by emphasizing regional cooperation.

Engagement is a difficult balancing act that must take into account intractable, core positions of both sides. Georgia wants to engage without legitimizing the Abkhaz authorities or seeming to support Abkhazia’s goal of independence. Abkhaz will only engage if engagement does not undermine their goal to gain greater global

recognition as an independent and sovereign State.

Progress requires a flexible, long-term and realistic approach. It must be based on the GoG's recognition that Georgia's interests are best served when Abkhaz prosper via commercial contact with Georgians as well as through regional links in the Caucasus and with littoral states of the Black Sea. Adamant about non-recognition, the GoG will only pursue this course if it believes that infrastructure and regional economic development do not advance recognition efforts by the Abkhaz authorities.

Russia is indispensable to Abkhazia. It provides security, funds, and access. While Abkhaz recognize Russia's indispensable role, they are wary of being annexed by Russia or having their identity overwhelmed by Russians. It is in the interest of both Georgia and Abkhaz to strengthen Abkhazia, thereby reducing the possibility of absorption by Russia. A self-confident and empowered Abkhazia may be more willing to discuss some kind of association with Georgia in the future.

There is not a lot of common ground. The delicate balance between Georgian and Abkhaz interests could easily be upset without gradual and carefully calibrated steps that benefit all parties, including Russia. Even when everyone benefits, there is a question that hangs over cooperation between Georgia and Abkhazia: does Russia have incentive to allow it?

Business proposals

Business is the common language. There are several opportunities with the potential to derive mutual benefit. Most noteworthy is the Enguri Sand and Gravel Export Project (and related activities). This private sector initiative can be launched immediately as a win-win for Georgia, Abkhazia and Russia.

Pending negotiations and agreement with affected parties, the Project will produce raw material urgently needed by Russia for construction of the Olympic facilities. Abkhaz will receive royalties in exchange for guaranteeing security and safe passage of barges down the Enguri to the Black Sea. Georgia will benefit from the upgrading of roads, railways, and nearby bridges by the developer. In addition to creating 250 jobs, the Project also presents an opportunity for tourism and agro-industries.

This report proposes an enterprise called "Black Sea Resorts and Project Entertainment Centers," which would build and operate a hotel, gaming and recreational facility at the site. As part of its cruise and tourism package, Black Sea Resorts would also develop facilities in Western Georgia and Russia, including locations that could be used for the Sochi Olympics.

Bridges and infrastructure near the dredging area will facilitate commercial contact between Georgians and Abkhaz. Restoring tea plantations in Gali and setting up a tea collection and processing center on the east side of the Enguri would facilitate interaction. The same model could be explored for other agro-industries linking Georgians and Abkhaz (e.g. hazelnuts, tomatoes, citrus, and apple products). In addition, it would be desirable to establish the equivalent of a free trade zone nearby where other commodities, machinery, and equipment could be sold. Consistent with the GoG's Action Plan, a vocational training institute is also envisioned.

Realization of the Project would be a cause for celebration. On this occasion, Yvgeny Yevtushenko could participate in a collaborative cultural event such as a "poetry concert" for an audience of Georgians and Abkhaz. Yevtushenko is revered as an artist and moral icon by Georgians and Abkhaz alike. Now 80 years old, he has ties to Abkhazia, where he kept a home that was destroyed during the 1992-93 conflict.

Policy Proposals

The following policy proposals promote contact between Abkhazia and the international community, including Georgia.

- *Upgrade the Action Plan:* The GoG should emphasize priorities and strategic sequencing. The donor community can assist by establishing an "Action Plan Affinity Group" offering resources to private sector initiatives in the form of project financing, loan guarantees, risk insurance, and grants for worker training and other benefits. The Action Plan can best be achieved through a more relaxed regulatory environment

which calibrates modifications in the Law on Occupied Territories with Sukhumi's cooperation. Without a quid pro quo, the United States could provide Georgia with a Free Trade Agreement as incentive to modify the Law on Occupied Territories.

- *Empower the Coordinating Commission:* A reliable communications and liaison channel exchanging information and assisting project development is essential to implementing the Action Plan. Led by a Special Representative on Shared Interests, the coordinating commission should have the tacit approval of both the GoG and Abkhaz authorities. However, it must not accept funds from either side lest financing from one compromise its credibility with the other. The cost of staff and facilities should be fully covered by a member of the international donor community, such as the EU, that has experience funding activities in Abkhazia. To ensure the Commission's independence, it could be established under UN auspices.
- *Enhance freedom of movement:* It would be best if the Abkhaz authorities had "no objection" when Abkhaz travel in Georgia or internationally using laissez-passer documents issued by the GoG. As a fallback position, the GoG and Abkhaz authorities could allow mutual recognition of civil documents, such as birth certificates, driving licenses, and professional degrees, to allow freedom of movement and facilitate commercial contact between Abkhaz and Georgians, including those displaced by the conflict.
- *Reduce the isolation of Abkhaz:* Civil society interaction can identify practical areas for cooperation, thereby building confidence. Donor funds should be allocated to dialogue initiatives engaging Georgians and Abkhaz. In addition, the U.S. can help connect Abkhaz civil society with the international community via existing Fulbright scholarships, IREX university exchanges, and participation in the State Department's International Visitors Program. Abkhazia's isolation would be further reduced through the participation of civil society representatives in the "Forum on Provincial Cities in the South Caucasus."
- *Expand Turkey's role:* The GoG should waive customs requirements for Turkish cargo ships putting into Abkhaz ports. Rather than requiring them to dock first in Poti or Batumi, a notification protocol could be developed informing the GoG of their cargo and route. Links between Turks and Abkhaz would also be enhanced by developing a direct land route from Turkey to the Gali region, as well as via restoration of the Vesylloe-Enguri railway linking Russia, Abkhazia, and other parts of Georgia. Opening commercial ferry service between Sukhumi and Trabzon would stimulate trade and tourism. Ankara should assure the GoG that direct contact between Turks and Abkhaz does not represent a process of "creeping recognition."

Conclusion

It would be wrong to underestimate Russia's role in fomenting conflict and sustaining divisions. But just as Russia is a source of the problem, it can also contribute to progress. Improved Georgia-Abkhaz relations can be achieved by improving relations between Georgia and Russia.

The GoG currently rejects cooperation until Russia rescinds recognition of Abkhazia and South Ossetia and withdraws forces from occupied territories. Georgia should adopt a more non-confrontational approach. When Russia lifts its boycott of Georgian water, wine and other goods, Georgia should support Russia's WTO membership. Russia's membership is also in Georgia's interest as it will require Russia to abide by WTO regulations and provide a forum to redress trade embargos. Georgia could also support Russia's membership in the OECD. Normal travel and trade between Georgia and Russia can be enhanced by resuming direct flights between Tbilisi and Moscow. Georgia must not let its national pride interfere with its national interests.

As Georgia's strong supporter, the United States is best placed to counsel Georgia on ways to mitigate conflict and move forward. More than "strategic patience," the United States should proactively promote peace and progress in Georgia and the region. Anything less could be interpreted as abandoning Georgia to Russia's sphere of influence, which would be detrimental to both Georgia and the United States.

Methodology

This research report highlights key issues and trends. Information was derived from a variety of primary and secondary sources, including interviews in Tbilisi with GoG officials, representatives of the international community, Georgian scholars, NGOs, and media representatives. The author also visited Sukhumi for discussions with Abkhaz authorities, members of parliament, and civil society representatives. Secondary source materials included reports of in-country NGOs, documents prepared by the EU, UN, Organization for Security and Cooperation in Europe, and the USG, as well as press reports. This report also draws on the

author's previous reports: "Restoring Georgia's Sovereignty in Abkhazia" (Atlantic Council of the United States, July 2008) and "Post-Conflict Georgia" (Atlantic Council of the United States, September 2008). The author is grateful to colleagues who participated in peer review from the Harriman Institute and the School of International and Public Affairs at Columbia University, the Carnegie Endowment for International Peace, American University in Washington, D.C., and the Georgia Foundation for Strategic and International Studies, as well as representatives of the private sector.

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