

Study of Economic Relations Between Georgia and Armenia:
The Development of Regional Trade Related Growth in Samtskhe-Javakheti

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Prepared for UNDP by the Caucasus Research Resource Center – Georgia
Tbilisi, Georgia
(September 2007)

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Acknowledgement

This project was undertaken for UNDP Georgia to support their Cross-Border Cooperation Project between the regions of Samtskhe-Javakheti in Georgia and Shirak in Armenia. The project is jointly implemented by UNDP and the Norwegian Government.

The project was coordinated by the Caucasus Research Resource Center (CRRC) – Georgia and Eurasia Foundation Representative Office in Georgia. The research team was led by Dr George Welton. Senior researchers included Giorgi Pertaia from American Chamber of Commerce – Georgia, and David Narmania and Giorgi Tsimitia from the Association of Young Economists of Georgia (AYEG). Field research was conducted by Aleksandre Elizbarashvili and Giorgi Batisashvili. Additional research and support was provided by Susan Smith, Arpine Porsughyan and the CRRC team. The team would like to thank Dr. Hans Gutbrod and Aaron Erlich of CRRC for editing drafts and providing critical feedback.

Executive Summary

Geographic proximity, cultural connections and similarity in marketplaces would seem to make Armenia and Georgia natural trading partners. With borders to Azerbaijan and Turkey closed, Georgia has become the main transit route for Armenian goods heading to Turkey, Europe and the world. Georgia benefits from preferential access to Armenian markets and makes money from the transportation of Armenian goods and oil across its territory. As a result, trade between the Georgian region of Samtskhe-Javakheti and the neighbouring Armenian region of Shirak should provide a natural basis for development in both regions. This is not happening. The main border crossing point in the Samtskhe-Javakheti (Samtskhe-Javakheti) region, close to the Georgian city of Ninotsminda, is under-utilised and trade is not creating stimulation for growth in either region.

The reasons for this failing *seem* obvious. The Armenian border with Samtskhe-Javakheti has always been disconnected from the rest of the Georgian transport infrastructure. Roads on the Georgian side have, until recently, been in such a complete state of disrepair that travel times to the Georgian port towns of Poti or Batumi or to the Turkish border have been quicker when goods come through the more southerly Sadakhlo checkpoint. There is no direct train link between Samtskhe-Javakheti and Shirak. The checkpoint itself is totally under-resourced and customs laws and border regulations have traditionally been extremely cumbersome. At the same time, the region has been extremely under-productive with a destroyed irrigation system, farm machinery and transportation system removing the means or the incentives for improvement.

However, transport infrastructure, the legal environment and level of development are changing rapidly. Roads are already dramatically better than they were two years ago and by 2010 Ninotsminda, the closest city in the region to the Armenian border, will have a direct road link to Tbilisi. By the end of 2008, the border crossing at Ninotsminda will be rebuilt and, soon after, another border crossing with Turkey will be opened at Kartsakhi, far closer to the Armenian border.

In Georgian legislation, driven by an economically liberal government and facilitated by World Trade Organization (WTO) and European Neighbourhood Policy (ENP) membership, significant reforms to the customs law have taken place. These have streamlined government administration of the tax system, simplified procedures and decreased import tariffs. Finally, development projects in the region are encouraging agricultural productivity, the development of new products and improved market readiness.

The main aim of this research is to support the UNDP Project, *Cross Border Cooperation between the Shirak Region, Armenia and the Samtskhe-Javakheti Region, Georgia*. The main goal of this project is to help improve socio-economic development in the region by encouraging economic cooperation and trade between the two areas. Three of the main ways the project hopes to do this are; to help remove hurdles to cooperation and trade across the border between the two regions, to improve border management and to support small regional business initiatives.

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This research will support these goals and offer recommendations on how to achieve them. Its purpose will be to ask three main questions. First, why is so little trade taking place over the main Ninotsminda checkpoint? Second, what legislative and procedural changes could make this trade easier? Third, particularly in the light of the large changes in physical infrastructure, legislation and development, in what areas are opportunities likely to open up for cooperation in the future.

In order to answer these questions the research project concentrated time and resources on field interviews with tradesmen on the Ninotsminda border as well as local businessmen and locally experienced experts in Samtskhe-Javakheti and Tbilisi.

There were four reasons for focusing our own research on locally gathered information rather than national economic statistics. First, the current situation between the two countries generally tells us little about the likely opportunities for trade and cooperation in these regions. There is almost no trade taking place at the moment between the two regions, the situation in Samtskhe-Javakheti is highly particular, and the broad infrastructural and institutional context is changing so fast that it makes simple extrapolation from the current situation impossible. Second, we benefited from seeing the outline of the Armenian UNDP research team project and knew that we would be able to draw on their broad economic analysis, where necessary, for our own. Third, understanding the local situation directly allowed us to avoid some of the problems of depending on unreliable Government statistics. Finally, investigating the situation directly allowed us to get a broader picture of what is happening locally, to draw on the knowledge and experience of local stakeholders and the development community, many of whom have been looking for years for answers to the questions we are asking.

Before summarising the main report, it is important to be clear that this research *is not* a development evaluation of the region and neither is it a feasibility study of the various agricultural businesses that are emerging there. While it is our hope that the analysis and insights of the research may be useful for the UNDP and other organisations, either as background information or as the basis for future development and research ideas, its understanding of the Samtskhe-Javakheti market is indicative rather than exhaustive.

Particularly for evaluating cross-border trade, our biggest hurdle was the fact that the research was almost exclusively limited to the Georgian side. Trade is based on *comparative* advantage. Therefore, before it would be possible to evaluate the viability of any particular industry for support, it would be necessary to evaluate both sides of the border. Realising this, we attempted to supplement our original plan with limited Shirak-based research, but far more still needs to be done.

The following research report is made up of four sections. The first section is based upon field research we undertook at the Ninotsminda and Sadakhlo borders. It will describe the lack of activity we saw there and will provide a detailed description of customs processes on the Georgian side, and the practical barriers they create to trade. This section will explain that the current situation is a result of a perfect storm of administrative and

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infrastructure problems. However, while the infrastructure problems are being removed, the complicated and sometimes unnecessary procedural hurdles will remain unless steps are made by government to take account of Samtskhe-Javakheti's particular situation

The second section will look at the national customs environment, recent legislative changes and likely changes in the future. While the importance of this high level analysis may be less immediately apparent than the on-the-ground research of the first section, it is necessary to understand the changing institutional and legislative environment if one is to lobby for change effectively or predict likely changes. For example, we identified one discussion currently underway that might exclude the possibility of agricultural trade over the Samtskhe-Javakheti/Shirak border. This would clearly be disastrous for any cooperation plans, and UNDP should seek assurances that this will not happen before any investment in cross-border development is undertaken.

The third section will look at changes in the transport infrastructure. The quality of roads and the disconnectedness of the region is clearly one of the reasons why local efforts at development have been stifled and why any Georgian – Armenian trade has transited through Sadakhlo. The road program that should be completed in 2010 and the railway that is also being rehabilitated will connect the region to the rest of Georgia. This section will consider how this is likely to change transport patterns and economic development and, in particular, whether this is likely to make Samtskhe-Javakheti an alternative Georgian transit route.

We conclude that while the economic benefits to be gained from agriculture will be significant, its likelihood to be a regional transit hub is more difficult to discern. It seems unlikely that the road will create an alternative route to existing transit traffic, even if it is coming from or going to Turkey. The railway could be more significant, dependent on its year-round reliability, but Armenia's use of this route will probably be made difficult by continuing political tensions with Azerbaijan.

The fourth section will analyse the market environment in Samtskhe-Javakheti in light of the general background provided by the other three sections. It will try to evaluate if current changes in the region are likely to open up new opportunities for trade and cooperation. To do this, the section will look in detail at the operation of the main local agricultural businesses. It will evaluate the hurdles they face and the development currently going on in the region to see if these changes are likely to open up any other prospects for cross-border trade and cooperation.

We found that on the Georgian side the businesses in Samtskhe-Javakheti that are beginning to develop, whatever may be said by donors, are primarily focused on import substitution in the Georgian market. It also seems as though packing and processing, while slowly developing in the region, will be unlikely to look for inputs from Armenia (except perhaps construction materials) anytime soon. That said, comparative advantages seem to exist between the primary products of Georgia and its neighbouring market in Armenia. Also, Armenian markets enjoy seasonal advantages in certain agricultural products, and Georgia may be developing an advantage in potatoes and potato seeds.

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Given the strong cultural connections between the two regions, better customs procedures and transport infrastructure should create considerable opportunities for improvements in trade in the future.

Recommendations

Customs

While infrastructure may be improving in the region, both in terms of road, rail and irrigation, the customs system is extremely discouraging to trade. Small traders (importing less than 700 GEL of goods) need to:

- Gain documents of origin to receive the zero customs tariff rating (Georgians need to go to Tbilisi to get this and Armenians find it hard to attain in Armenia)
- Armenians need to gain an import license from Tbilisi.
- Armenians need to go to Ninotsminda to pay their import charge, their customs tariff and VAT and then return to the border with the receipt from this transaction before they can clear goods. This process can take up to three hours.
- Owing to an unreliable computer system, clearing customs into Georgia is subject to delays.
- Georgians exporting to Armenia have to pay significant charges to take goods into the country.

Larger importers into Georgia also need to:

- Customs clear goods at the Vale checkpoint rather than allowing clearance near the Ninotsminda border. This encourages them to take goods through the Sadakhlo checkpoint even if they are intended for the Samtskhe-Javakheti market.
- Gain a customs guarantee in Georgia.

Recommendations:

- Ensure that the new checkpoint at Ninotsminda has phytosanitary capacity (without which the transport of produce over this border will be impossible).
- Provide information on the new customs procedures for import/export in Russian and Armenian on both sides of the border, on a notice board and in a leaflet that is easily obtained in both regions. Ensure that both sides know that with the appropriate documentation taxes for import tariff should not be necessary for produce originating in Georgia/Armenia.
- Ensure appropriate equipment at the Ninotsminda checkpoint (even before the new checkpoint is completed). In particular assess the connection to the customs computer system and the power supply situation to see if these can easily be improved.
- Encourage a review of the procedures.
 - At a minimum make all licenses, permits and certificates necessary for import/export available in the region, as close to the border as possible.
 - Make banking services available at the Ninotsminda border or develop a system so that the border police can take small sums of money at the checkpoint.

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- Make it possible for local Government to provide documents showing customs origin or ideally find a way to organise a reciprocal agreement, for the Ninotsminda border, that removes the need for a proof of origin on locally produced goods.
- Make sure that customs clearing is available at either the new customs checkpoint at Ninotsminda or the new checkpoint to be opened in the region at the completion of the new road.
- Abolish the need for a customs guarantee or make sure that the process for obtaining one is clear, well understood, simple and cheap.
- Encourage Georgia and Armenia to adopt the same procedures for their customs processing wherever possible. This should go beyond the level of ‘coordination’ suggested by the *European Neighbourhood Policy*.
- Encourage the Georgian and Armenian Government to accept invoice prices as the basis for customs valuations (as far as can be done without encouraging fraud).
- UNDP and Georgian/Armenia Government should investigate the problems for Georgians who are trying to export into Armenia at the Ninotsminda checkpoint and work out a strategy for resolving them.
- Georgian Government should clearly announce that they do not plan to unilaterally remove customs tariffs on agricultural goods from Turkey into Georgia but also advertise at the border that with the appropriate paperwork customs tariffs should not be made on imported/exported goods.

Developing market opportunities

- Develop or support a business advisory service to assist local businesses. This should
 - Help them to develop business plans.
 - Develop relationships with the donor community and sources of finance to help connect donor money to well evaluated and developed projects.
 - Provide information and assistance to those who want to export to Armenia/Turkey.
- Conduct cross-border pricing analysis to see where opportunities might exist for encouraging industries with comparative advantage. After an initial assessment of market opportunities, if considerable opportunities exist then, UNDP could conduct a regional development plan.
- Identify particular industries likely to emerge in the aftermath of the Baku-Akhalkaki-Kars rail network, new road to Tbilisi and new customs points near Akhalkalaki and Ninotsminda are completed.

Background

As neighbouring countries on the South Caucasian periphery of Europe, Armenia and Georgia have many opportunities for trade and partnership. From a Georgian point of view, Armenia offers a useful additional market, as well as a land route to Iran and the Middle East. For Armenia, Georgia is vital as its link to the outside world. Both the Azerbaijani border and the Turkish border have been closed to Armenia since Armenian independence.¹ As a result, although direct flights persist to Russia, Europe and the world, the only land route from Armenia to Turkey, Russia, Europe and beyond, is to go through Georgia.²

In addition to the hard geo-strategic and economic reasons for cooperation, there are also many 'soft' reasons. People from Armenia and Georgia are extremely familiar with one another's economy, culture and history. Armenians have historically played a significant role in the Georgian business community³ and business links remain strong. At the same time, both countries offer similar business environments with equivalent levels of economic development and many of the same hurdles to business development. All of this is further helped by linguistic connections. In addition to the large Armenian language community in Georgia, business is facilitated by the ease with which both sides speak Russian.

Samtskhe-Javakheti

The region of Samtskhe-Javakheti is located in the South West of Georgia bordering Armenia and Turkey and totals 64,000km². At the time of the 2002 census its population was 55% Armenian. The current population is 209,000.⁴

The region is economically agrarian and can be divided into Javakheti and Samtskhe. Javakheti, made up of the Ninotsminda and Akhalkalaki districts, and Samtskhe, which includes the districts of Adigeni, Akhaltsikhe, Aspindza and Borjomi. Javakheti is generally higher and colder (though many villages in Samtskhe are also high and isolated) and because of altitude can experience -40 degrees Celsius in the winter and be

1 In 1991 Turkey originally refused to recognize and trade with Armenia because of its conflict in Nagorno-Karabakh but recent discussions have also focused on the issue of the recognition of the Armenian Genocide as a continuing source of tension between the two countries.

2 There is some suggestion that even the status of the Turkish-Armenian border might change. According to a recent *Eurasianet* article, the new Turkish Government might be more open to the idea of opening the border than any Government since Armenian independence. This change will not be considered in this research project. See Christoph Peuch, 'Armenia/Turkey: Economic Necessity Pushing Yerevan, Ankara Closer', *Eurasianet.org* (26th July 2007), <http://www.eurasianet.org/departments/insight/articles/eav072603.shtml>.

3 Ronald Grigor Suny, *The Making of the Georgian Nation*, Indiana University Press (1994), p88

4 Department of Statistics, *Number of Population by Large Administrative-Territorial Units* (January 2006), <http://www.statistics.ge/main.php?pform=47&plang=1>.

become physically cut off from the rest of the country.⁵ Because it is closer to the border, Javakheti has an Armenian concentration over 90%.⁶

Employment by Activity in Samtskhe-Javakheti, 2005

Total No Employed Persons	103, 900
	%
Industry	1.6
Agriculture and Forestry	78.9
Construction	1.9
Transport and Communication	1.3
Trade	3.1
Social Sector	8.2
Public Administration	2.6
Other services	2.3

Source: UNDP Armenia, *Armenia and Georgia Economic Relations: Unrealised Opportunities* (Draft, August 2007), p49.

The majority of farms plots, which measure between 0.5-1.5 hectares of land,⁷ provide subsistence for a family and an income from marketable excess.⁸ Historically returns from Samtskhe-Javakheti land have been low, perhaps producing as little as 300-600 USD per hectare. However, irrigated land Samtskhe-Javakheti can produce a reasonable income for a successful farmer of up to 4-6,000 USD per hectare for potatoes alone if he is using the right seed, fertiliser and farming practices (Appendix 2 and 3).⁹

An average family in Javakheti will grow potatoes and keep two or three cattle for milk, meat and cheese. An average Samtskhe family will have a similar profile (though usually a smaller land plot), but because of the lower altitudes may supplement their harvest with some fruits and a wider range of vegetables. There is very little industry or effectively organised tourism in the region, apart from Borjomi.¹⁰ In terms of income, according to a recent CARE/DFID survey at 398 GEL (240 USD) per month the average income is almost 100 GEL (60 USD) per month higher than the equivalent agrarian family

5 Akhalkalaki in the south of the Region is 1,750m above sea level and some of the villages around Ninotsminda are over 2000m.

6 Census, State Department of Statistics of Georgia (2002).

7 The average for Samtskhe is estimated at 0.93 hectares according to recent done by CARE. Georgian Opinion Research Business International (GORBI), *Status of Social and Economic Conditions in Selected Villages of Samtskhe-Javakheti*, Prepared for CARE/DFID, Tbilisi, (2006)

8 Although specific figures for Samtskhe-Javakheti are not available, the average farming family produces for themselves 58% of the food they eat (by value). Department of Statistics, *Food Security Situation: Trends in Figures* (April, 2007).

9 This figure was calculated by the UNDP/CRRC Research Team in consultations with agricultural experts at UNDP in Akhalkalaki and CARE in Akhaltsikhe. Independently of one another they calculated income/cost summaries that fairly closely matched (see Appendix 2).

10 Borjomi National Park, which includes the valley of Borjomi itself and Bakuriani summer/ski resort have a significantly different profile to the rest of the region. It is warmer and considerably more economically diverse. It has a population that is less than 10% Armenian (according to the 2002 census) and it is closer to Tbilisi. It does not have particularly strong links with Armenia and will not, therefore, form a focal part of this research.

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elsewhere in Georgia, although according to the same survey, the extreme poverty level is also higher than the national average at 22%. Employment, at 85% is roughly in line with the rest of the country.¹¹

Since the 2003 *Rose Revolution* the region has been a priority for both the Georgian Government and the international community. There are three connected reasons for this interest. First, it has been historically isolated. During the Soviet Union, the region was never seriously developed. Following the collapse of the Soviet Union, the situation worsened as naturally difficult topography was made more problematic by a crumbling road system. As Hedvig Lohm from ECMI says, the region became ‘virtually isolated from the rest of Georgia in terms of transport infrastructure and economic ties’.¹²

Second, and perhaps most importantly, the ethnic dimension of the region has given it political significance in a range of ways. As members of the Council of Europe and signatories to the *Framework Convention for the Protection of Minority Rights* and the *European Language Charter*, the Georgian Government has undertaken specific legal obligations to protect the rights of minorities.¹³ At the same time, in light of the conflicts in South Ossetia and Abkhazia, which were partially ethnically motivated, the Government of Georgia and the international community have seen the need to focus on developing and integrating the region into the rest of Georgia proper in order to avoid potential problems in the future.¹⁴ The Government of Georgia is, therefore, currently trying to navigate the difficult political terrain which allows political and cultural rights while encouraging integration with the rest of Georgia.

Third, the international community was concerned about how the isolation and ethnic tensions might worsen in the light of the Russian base closure that was finally completed in June of this year. Because of the region’s close proximity to NATO member Turkey, the south of the region had been dominated by the 62nd Russian Divisional Base in Akhalkalaki. The military base, which had previously employed 1,500-2,000 people, had been the main employer in the Akhalkalaki area, and the impact of its closure has been

11 Georgian Opinion Research Business International (GORBI), *Status of Social and Economic Conditions in Selected Villages of Samtskhe-Javakheti*, Prepared for CARE/DFID, Tbilisi (2006) p27-8 This research polled 600 families in Samtskhe (but not in Javakheti) and compared its findings to control groups in other agricultural regions of Georgia.

12 Hedvig Lohm, *Javakheti after the Rose Revolution: Progress and Regress in the Pursuit of National Unity in Georgia*, ECMI Working Paper No 38 (April 2007), p6.

13 While the *Framework Convention on the Protection of National Minorities* was ratified in 2005, the *European Language Charter* has yet to be ratified. For an evaluation of the success of their application in Georgian Law and state policy, see, Johanna Popjanevski, *Minorities and the State in the South Caucasus: Assessing the Protection of National Minorities in Georgia and Azerbaijan*, Central Asia Caucasus Institute, Silk Road Studies Program (September 2006), p31.

(<http://www.silkroadstudies.org/new/docs/Silkroadpapers/0609Popjanevski.pdf>)

14 This is commonly understood motivation behind the Millennium Challenge Georgia (MCG) road and the stated reason for AgVantage and Mercy Corps’ interest in the region. UNDP/CRRC Research Team Interview with Richard Hurelbrink, Director, AgVantage, (20th August 2007) and UNDP/CRRC Research Team Interview with Julie Burch, Regional Representative for the Caucasus, Mercy Corps, (23 August 2007).

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estimated at 300-600, 000 USD per month.¹⁵ Developmental organisations saw the potential economic and political consequences of these changes and were encouraged to step in.¹⁶

As a result of these motivations, this historically isolated region is seeing considerable sums of international organization and local government money spent on developing the transport infrastructure in order to connect it to Georgia proper, rebuild the infrastructure of utilities necessary to facilitate (particularly agricultural) production and create the right form of incentive structures to develop sustainable agribusiness.

For the most part, this development work has focused on import substitution or export to Western markets, but as as Julie Burch, from Mercy Corps points out,

In Akhaltsikhe there is strong cultural capital with Armenia so that the local farmers there would often rather be doing business with Armenia than with the rest of Georgia. Even with the infrastructure changes taking place, it is unclear how easily this will change.¹⁷

Ninotsminda and Akhalkalaki, in particular, are predominantly Armenian speaking with strong cultural and economic ties to Yerevan and strong distrust towards the Tbilisi authorities.¹⁸ As long as this continues, the desire to trade with Armenia will remain strong even if there are hurdles.

15 Hedvig Lohm, *Javakheti after the Rose Revolution: Progress and Regress in the Pursuit of National Unity in Georgia*, ECMI Working Paper No 38 (April 2007) p10.

16 AgVantage, for example, was asked to start undertaking work in the region, at the suggestion of their funders, USAID, as a direct reaction to the Russian base closing. UNDP/CRRRC Research Team Interview with Richard Hurelbrink, Director, AgVantage, (20th August 2007).

17 UNDP Research Group Interview with Julie Burch, Regional Representative for the Caucasus, Mercy Corps, (23rd August 2007).

18 Hedvig Lohm, *Javakheti after the Rose Revolution: Progress and Regress in the Pursuit of National Unity in Georgia*, ECMI Working Paper No 38 (April 2007), p40.

1. Field research into existing cross-border activity at Ninotsminda

Introduction

The principle purpose of this overall research project is to encourage the development of cross-border trade. In order to do this, it is clearly necessary to understand what is happening at the border now, not just the volume and type of trade, but the practical difficulties for it. The border checkpoint at Ninotsminda, located on the main Akhalkalaki – Ninostminda – Gyumri – Yerevan highway has the potential to be a major regional crossing point. However, it is extremely under-utilised and the volume of the goods moving through it is negligible.

The goods, which are mainly related to agriculture and construction, are carried by motor cars as well as semi-trucks and trucks with no seals.¹⁹ The agricultural goods are seasonal with variations in harvest time across the border driving some of the trade.²⁰ For example, apricots come into season in June in Armenia and in the middle of July in Georgia, and for that six week period there is trade over the border in apricots. Imports from Armenia may include early season potatoes and seed potatoes, cabbages, apricots, peaches, grapes, milk products and meat. Additionally, there are some construction materials including tuff stone and cement.

In order to find out the impact of customs formalities on the trade development between the regions, the field researchers conducted a thorough study of the border-customs checkpoint of Ninotsminda; the infrastructure problems including the physical state of the border checkpoint, the road quality to Ninotsminda, the banking facilities and the physical distance to the nearest Turkish checkpoint and clearing depot at Vale.

In summary, customs procedures make it extremely difficult to transit any quantity of goods over the Ninotsiminda border. The technical limitations of the border make all imports potentially erratic. The absence of documents of origin mean that practically all imports will be taxed (even though goods from Armenia or Georgia should be exempt), and the infrastructure limitations make payment of these charges time consuming and difficult. The requirement of import licenses also force the importer to take a trip to Tbilisi once a year. For larger shipments, because there is no customs clearance point near the border, the entrepreneur has to transit an additional 150 km to Vale to clear their

19 Trucks that contain over 700 GEL of goods are sealed until they move to a custom depot, where the goods are assessed formerly and charges are levied. This will be discussed in detail in section 1.

20 In some parts of Georgia, the early Georgian season is seen as offering large market opportunities, since it would allow Georgia to provide Eastern Europe with fruits early in the season. However, the altitude in Samtskhe-Javakheti results in a short season so that the seasonal variation usually works to the advantage of Armenia. UNDP/CRRC Research Team Interview with with Richard Hurelbrink, Director, AgVantage, (20th August 2007).

goods. If the goods are intended for the Akhalkalaki market, this would involve a 250km round-trip. Importers also have to obtain customs guarantees.

Many of these problems are in the process of being resolved already. The new checkpoint is currently under construction and is due to be finished by the end of 2008. At the same time, improvements to the road have already dramatically cut the time to Vale and the reconstruction of the road from the border to the city of Ninotsminda should be completed as part of Millennium Challenge Georgia's (MCG) road building project by 2010. A new customs checkpoint and customs depot only 37 km outside of Akhaltsikhe (approximately 70km from the Ninotsminda border) should open at about the same time.

All of that said, this new infrastructure will not be in place for a several years, and it is worth encouraging new trade before its completion. In addition, even with the new infrastructure, problems with the customs procedures will continue to hamper regional trade. Therefore, as the first step of this research paper we will elaborate the situation at the border and the regulatory and infrastructural problems to trade.

Field research conducted at the Ninotsminda border

During implementation of our study we sent two field researchers to spend two weeks in Samtskhe-Javakheti looking at the border and local market, and then the same two researchers spent two weeks at the Sadakhlo border crossing with Armenia near to Tbilisi.

In the Samtskhe-Javakheti region (30th June 2007 to 14th July 2007) they interviewed 57 people, this number included all of the 28 traders who came over the border 29 local business people, from the Akhalkalaki market and the surrounding area.²¹

An average of 2.5 vehicles a day passed over the border during our research period and the largest single product being imported was tuff stone (13 vehicles), after that were potatoes (6 vehicles), rock salt and cabbage (3 trucks each). One large truck passed over the border carrying cement valued at 20,000 GEL. Excluding this, the average value of the goods coming over the border was 395 GEL. The average value of agricultural products (including salt) was 288 GEL and the average value of the non-agricultural products (excluding the 20,000 GEL load) was 480 GEL.

As we have already mentioned these figures are probably not a good sample for estimating traffic since agricultural products are seasonal and we only spent two weeks at the border. The border guards explained that the range of imports is certainly wider over the course of a year, including potatoes (both seed and normal), cabbages, apricots, peaches, grapes, dairy products, meat products, tuff stone, cement and construction materials. However, according to customs officials working at Ninotsminda no more than 10 vehicles go through their checkpoint in a day at any time of the year.

²¹On top of this the field researchers conducted interviews with another 40 or so individuals in the region and ran two stakeholder meetings, one in Akhaltsikhe and the other in Akhalkalaki.

The type of goods traded over the border changes according to the season and also varies depending on the crop yield for the given year (e.g. if there is a bumper harvest of potatoes in Armenia and bad harvest in Georgia, Armenian imports will increase). During the period of our research there *was no* export from Georgia to Armenia at all. One person did try to take potatoes from Georgia to Armenia but came back complaining that he had been asked to pay too large a bribe.²² Below we will discuss the border formalities for importers into Georgia before explaining the difficulties that our research suggested these formalities create.

Formalities related to border crossing

(For summary of time delays over the Armenian/Georgian border for Armenian exporters please see Appendix 1)

The import of goods into Georgia requires three stages, 1) departure from Armenia, 2) border formalities in Georgia and 3) customs formalities in Georgia. Our research suggests that exiting Armenia and clearing border formalities into Georgia (stages one and two) usually took 40 minutes in total.

Customs formalities present the largest hurdle to imports and depend upon the volume of goods imported. There are three categories of goods.

1. No customs tax
 - Agricultural products up to 50 GEL or 5 kilograms
 - Non food products up to 300 GEL
2. Less than GEL 700
 - The Ninotsminda customs checkpoint is allowed to customs clear the goods after a person pays relevant customs duties. This requires the importer to travel to Ninotsminda and pay money at a bank before coming back to the border to clear goods.
3. Exceeds 700 GEL
 - The Ninotsminda customs checkpoint is not allowed to customs clear the goods. After sealing the goods, customs official will issue a registration certificate of the goods and they must be moved to a customs depot.

As a rule, the owners of the goods do not have any invoice or contract with which to demonstrate the value of the goods, and since the checkpoint does not have a scale, both weight and price need to be estimated. This often leads to conflict between border guards and importers.

²² The UNDP/CRRC Research Team did not undertake this kind of research on the Armenian side of the border and so were not able to substantiate any of the claims made about the prevalence of bribery in the Armenian customs system. However, it is certainly clear that many of the traders we interviewed claimed that corruption was high on the Armenian side.

Procedures

If the goods have a value of less than 700 GEL (or in the case of produce, less than 50 GEL) the customs clearance (including inspection and assessment of value should take ½ an hour).

If the goods have a value of more than 50 GEL (assuming agricultural goods), then the importer must declare their goods and the information about them must be entered into the customs' computer system.²³

After the presentation of a declaration the applicable customs duties are paid. Customs duties are:

- a. Customs fee – 5 Euro equivalent in GEL, in cases where the customs value of goods is less than 300 GEL; otherwise a 60 Euro equivalent in GEL.
- b. Customs duty – 0%, 5% or 12% depending on the type of goods²⁴
- c. Excise – movement of excise goods through the Ninotsminda customs checkpoint is prohibited
- d. Value Added Tax (VAT) – 18%.

Infrastructure difficulties

The pictures below show were taken in May by the field researchers. On the left is the checkpoint, the right shows the road from the checkpoint to Ninotsminda.



As one can see, the checkpoint is in very bad state so the first problems relate to the checkpoint itself which does not have reliable electricity or water and possesses old

²³ Georgian customs law requires that the declarant fill out the necessary declaration but at the Ninotsminda checkpoint the border guards input the information into the computer system directly.

²⁴ Note that this charge should not be due on goods that can demonstrate they originated in Armenia. However, since few people can prove that their goods are from Armenia, most of them pay this fee.

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technical equipment. Since goods need to be declared before they can be cleared, if the equipment, the electricity or the computer network should fail, then importers have to wait for it to be fixed or come online again.

In the process of our research, a number of cases occurred where due to different problems, it was impossible to fill in the declaration or registration certificate. These problems were usually technical in nature. In one case, the breakdown of the customs network required the owners of the goods to wait for an entire day and finally leave their goods and come back the following day when the computer had been repaired.

The second infrastructure difficulty relates to banking services. At many Georgian border crossings, bank branches or payment centres are located near the border to facilitate small payments. There are no such facilities at Ninotsminda. The lack of banking facilities is exacerbated by the road conditions and transport facilities to Ninotsminda. First, if payment is to be made at Ninotsminda, then the goods must be left at the border until the importer returns with a receipt from the bank. Since importers usually only possess one vehicle in which their goods are located, they have to secure transit to the city with a different vehicle. This is not easy since traffic is so light and can be expensive. While the UNDP research team was present, an entrepreneur importing tuff stone (with a customs value of 560 GEL) needed six hours to pay customs duties.²⁵

Furthermore, although it is only 23km to Ninotsminda from the checkpoint, the road is in such a state of disrepair that this can take 1-1½hrs each way, so that the return trip can take 3 hours (also depending on the time spent at the bank).

Leaving perishable goods in the open air at customs also present a risk to importers. According to the customs officials, two months previous to the visit of the UNDP research team an Armenian entrepreneur presented ice cream for import. By the time the entrepreneur had paid the customs duties (4 hours), the ice-cream had melted.

If the goods are valued at over 700 GEL, then the individual must have his transport sealed and clearance must take place at a Customs depot. The closest current depot is Vale. In cases where an individual might want to sell his or her goods in Ninotsminda, even though the goods would normally only have to be carried 23km over the border, the owner of goods is obliged to take them 150km to Vale, the nearest customs clearance point in order to customs clear the goods. Even though the quality of the road (after Ninotsminda) has improved dramatically, this is still time consuming and expensive.

²⁵ Payment of customs duties includes three stages 1) journey to Ninotsminda 2) payment of money at the bank 3) return journey.

Inability to obtain documents

Proof of origin

Georgia and Armenia have concluded a free trade agreement, according to which import of Armenian goods is free of customs duty (12% of customs value for majority of the agricultural products). However, none of the producers made use of this right.

The majority of interviewed entrepreneurs believed that obtaining a certificate of origin to be more time consuming and expensive than payment of customs duty in Georgia. The same problem occurs for those wishing to export from the region since the certificate of origin can only be obtained in Tbilisi.²⁶

Import license

According to the *Law of Georgia on Licenses and Permissions*, all vegetables imported into Georgia require permission issued by the National Service for Food Safety, Veterinary and Plant Protection of the Ministry of Agriculture in Tbilisi. Animal and meat products require a different permission (issued by the same organization). Georgian Customs obliges the person intending import of goods to Georgia to present this permission in advance.

Customs guarantee

In addition to this, again commensurate with the Georgian customs legislation, if goods need to be customs cleared then a bank guarantee (valuing 40,000 Euros) issued by the resident banking institution of Georgia must be presented to the customs depot before they can release the goods. Ordinarily, this is provided in the form of an insurance document. Smaller traders find the concept difficult to grasp and the document hard to obtain.

Because of many of these difficulties, which are present at Ninotsminda but not at Sadakhlo, the majority of importers prefer to bring the goods though the Sadakhlo customs checkpoint, place them under customs procedure of import in Tbilisi and only after this bring them to Ninotsminda.

Non-availability of information

During interviews it became clear that traders in the region lack information on the correct procedures for importing/exporting goods. Of the 54 traders and business people interviewed 65% did not even know what duties need to be paid on different goods. More

²⁶ The certificate of origin – “CT 1” is issued by the Chamber of Commerce of Georgia. This organization does not have a branch in Samtskhe-Javakheti region. So in order to obtain the certificate the goods must be brought to Tbilisi.

significantly, 80% did not know that as Armenian producers they should not pay the tariff (upon presentation of the relevant certificate of origin). People do not have information about customs regimes and other formalities or their rights and obligations when dealing with customs.

This is created by two factors. First, the majority of the population do not speak Georgian, and second, the legislation is continually changing. There is no information board or leaflet containing current information about customs formalities and duties at the border.

The lack of information has two main consequences. First, it creates conflict between importers and officials. Second, it undermines trust in the authorities. During the project, we contacted a range of people who have dealings with customs, as well as traders in the region who do not. The majority of the people we interviewed have tried to avoid contact with customs because they believe that the process is overly complicated and continues to be corrupt.²⁷ One Armenian cheese manufacturer described the importing environment as follows:

You have to have a special document to be able to pass the cheese through the customs, or you have to pay big bribes to both Armenian and Georgian customs officials. Getting that document also costs big money, excluding bribes.²⁸

Corruption

Since 2003, Georgia has implemented important changes that were intended to target corruption (see previous section). At this stage, the level of corruption in customs is generally considered lower. The decline in corruption is partly demonstrated by the conversations we had with active business people. Approximately 85% of those interviewed stressed that corruption was not a problem. 15% said that there was, 'of course', corruption but did not say that they had experienced it themselves or knew anyone directly who had.²⁹ That said, one cannot afford to be complacent. Problems do persist and just after we finished our research, in mid-July, five customs officers at Sadakhlo were arrested and charged for taking bribes and are currently awaiting trial.

That said, in Armenia the perception remains that all customs officials are always corrupt. One monthly exporter to Armenia said that if his permits are not correct there is

27 Interviews we carried out with about 20 farmers and small traders in Gyumri (who do not import/export with Georgia) revealed that they were still highly suspicious of Georgian customs officials believing corruption to be rife – even though no one we interviewed who engaged in trade found corruption to be a problem. UNDP/CRRC Research Team Interview, Gyumri (June 2007)

28 UNDP/CRRC Research Team Interview with Armenian Cheese Producer from Ashotsk Cheese Factory, (June 2007).

29 The sense this gave to the interviewers was that these individuals, who usually did not engage in trade, worked on the assumption that nothing changes.

fixed bribe in amount of 100 USD. This perception is common-place.³⁰ Ironically some of the business people we spoke to said that they would prefer to pay a small bribe than to go through the current, extremely expensive and time consuming administrative procedures. According to some, bribes are more efficient, cheaper and more reliable than bureaucracy.

Georgian trade with Armenia

Clearly since there was no export occurring from Georgia on this border while we were there, it was difficult to obtain specific information on the nature of the difficulties Georgian exporters faced. As we have suggested already there was a common consensus amongst many of the stakeholders that we talked to, that trade with Armenia was dogged by high costs and that, in the specific industries we will discuss at the end, price differentials across the two markets was rarely enough to justify trade. One large cheese producer, for example, pointed out that he could sell his cheese to Tbilisi for 6.5 GEL per kilo or sell in Gyumri for 7 GEL. The market differential was not enough to justify the difficulties of export, even though he bought a lot of his imports from Yerevan.³¹

In addition to this we did a survey of 29 traders in the Akalkalaki market and asked them what their main hurdles were to trade (we did not specify trade with Armenia). Of the respondents, 66% cited road rehabilitation, 52% of them cited high customs taxes and 17% cited distance to the customs terminal. These results seem to suggest that problems with procedures and charges may exist on the other side of the border as well.

Research on the Sadakhlo Border

The twelve days the researchers spent on the Sadakhlo border were far less concerned with administrative and logistical issues, mainly because all of the importing traffic was valued over 700 GEL and, therefore, required to be custom cleared at the Natakhtari Customs Depot just outside of Tbilisi.³² At the border the registration and sealing of these trucks took approximately 20 minutes. If the truck is transiting the country then it remains sealed until reaching the border. If it is destined for Georgia then it has to be cleared in the Customs Depot, a process that can take 1 ½ to 5 days depending on the goods.

One significant difference between Ninotsminda and Sadakhlo is that at Sadakhlo they are not allowed to customs clear goods at all, even if they are in quantities of between 300-700 GEL. This creates a significant disincentive for small volumes of goods to cross

30 Other traders suggested that bribes vary according to the weight of imports; 1 tonne – 100 USD, 3 tonnes – 200 USD, etc.

31 UNDP/CRRC Research Team Interview with Ninotsminda milk and cheese producer, 11th May 2007.

32 One significant difference between Ninotsminda and Sadakhlo is that at Sadakhlo they are not allowed to customs clear goods at all, even if they are in quantities of between 300-700 GEL. This creates a significant disincentive for small volumes of goods to cross the border and may partially explain why no small trade was observed while we were there.

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the border and may partially explain why no small trade was observed while we were there.

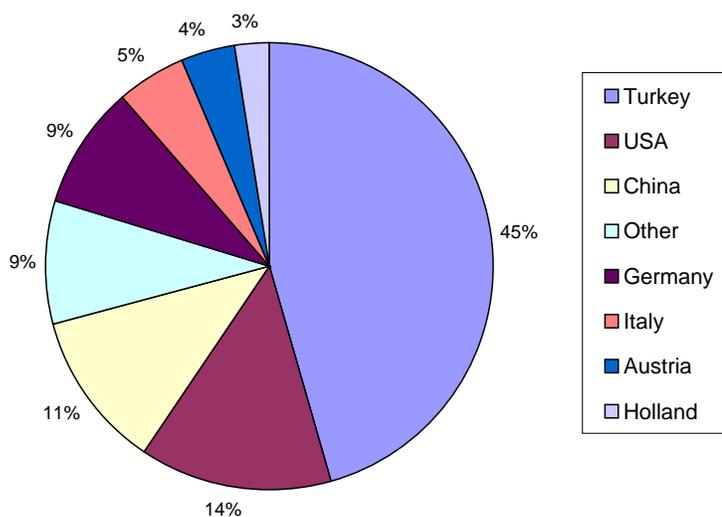
In the 12 days we spent on the border (18-30th June) we saw 128 trucks pass over the border, an average of 10.7 per day. Out of these 40 were coming from Armenia into Georgia only 6 were exports and only three of those were importing to Georgia

Table 1.1 Trucks Moving over the Sadakhlo border from Armenia

No of trucks	Destination	Goods
3	Georgia	2 carbide, 1 electronics
42	Turkey	All empty trucks
3	Russia	Cognac

Of the 80 trucks coming going into Armenia the origin was diverse (Table 1.2) and most of the containers were simply marked 'mixed' so their contents are hard to establish.

Table 1.2 Origin of Goods Crossing Sadakhlo Border
(18-30 June 2007)



Since this information represents two weeks research it cannot be taken as exhaustive, however, it does allow us to make a couple of interesting observations. In particular, there are no goods exported from Georgia to Armenia in this time and there are no goods exported from Russia to Armenia.³³ There are no agricultural goods at all (though 3 trucks of cognac did export to Russia) in our sample. Also interestingly for our analysis

³³ Although these figures would not include any Russian cars that might be imported since the researchers were only tracking trucks and the import of cars is usually done by simply driving them over the border after they arrive at Poti.

of possible changes in the transportation system later (see section 3), all of the goods transiting through the country, even those destined for Turkey, transited through Poti, which strongly suggests that any Turkish goods originate in the West of the country and are therefore less likely to use land transport to get to Armenia.

It is also interesting to note, that while Armenian consumers are clearly eager to buy Turkish goods,³⁴ Turkey does not seem to reciprocate. Not only were Armenians not exporting to Turkey over this border, but all of the trucks destined back to Turkey were empty. This means that Armenian goods do not export to Turkey even where effectively free transport exists.

Conclusion

In conclusion, while corruption no longer seems to be a problem on the Georgian side of the border, the current system of administrative requirements makes even small scale trade difficult over the Ninotsminda border. Technical limitations at the checkpoint create uncertainties and can lead to long delays and poor roads to Ninotsminda combined with lack of banking facilities require large investment of time, even for small traders. The absence of documents of origin mean that practically all imports will be taxed and acquiring import licenses takes time.

On top of this larger shipments have to be cleared in Vale so have to travel 150 km (plus whatever distance they have to come back if they are intended for local markets). They also have to obtain customs guarantees that will require additional preparatory work in Georgia or time travelling to Vale. Interviews conducted by us reveal that in order to avoid customs clearance procedures individuals will routinely travel to the border with friends and family so as to divide the value of the goods and bring it below the customs clearance limit. This is clearly not a good solution.

Building the new checkpoint should help to alleviate the technical problems and a customs clearance point near to Akhalkalaki would made other procedures less prohibitive, but this will not resolve the ineffectiveness of the so-called Georgia-Armenia free trade area. Export licenses and proof of origin needs to be made easier to obtain. Ideally, a list of particular goods such as local potatoes, cheese and cattle should be agreed upon where proof of origin is not required.³⁵

On top of all this, failure to provide information, in the relevant languages, misses an opportunity to facilitate trade over the border and to build trust with the customs officials. This is important not only because it undermines regional trade and development but also because it perpetuates the suspicion in the local community about the reliability and good

34 Also see, Agence France Presse (AFP) 'Armenians gobble up Turkish goods', (10 September, 2007).

35 The one concern for abolishing the 'documents of origin' rule is that it would allow goods coming from other countries to circumvent tax payments. However, given that particular breeds of potatoes and cattle that are grown locally and the fact that Georgian/Armenian cheeses are also fairly distinctive, it should be possible to develop a system where at the very least these three main products could be traded without proof of origin.

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faith of state officials. Actively working to resolve these issues, even if it means altering the general rules for the Ninotsminda border, would therefore create both developmental and political benefits.

2. Analysis of customs legislation and governance

Introduction

The previous section discussed the impact of customs legislation on the border checkpoint at Ninotsminda, which is clearly important for understanding current developments in Georgia. This section will look at the general customs environment that has emerged following the Rose Revolution.

This investigation is relevant to our analysis for three reasons. First, the process of change is on-going and discussions regarding changes to customs legislation across the country will inevitably affect Ninotsminda. For example, it became apparent during our research that the Government is considering reducing the number of customs checkpoints that will allow agricultural products across them.³⁶ If agricultural products were not permitted to cross at Ninotsminda, then it would practically destroy any prospect for trade between Samtskhe-Javakheti and Shirak.

Second, part of this project will involve advocacy for change in the customs system. Such advocacy is more likely to be successful if the advocates understand the broad patterns of change taking place and the structure of the institutions they are occurring in.

Third, the situation at the Ninotsminda border is being significantly changed to bring it up to national standards and to remove some of its infrastructural limitations. Understanding the broad pattern of changes taking place in the Georgian customs system will allow us to better understand the likely hurdles to trade that may remain even after these reforms have taken place.

Reforms to the custom system in Georgia

Before the Rose Revolution the Georgian customs system was famously inefficient and corrupt. After 2003, the new Georgian Government, therefore, prioritized the reform of the customs service. Customs reforms took three forms, 1) changes to the institutions of customs control, 2) changes to the procedures for customs clearance and 3) changes to the values of tariffs charged.

Reforms to the customs system started with the development of the *Customs System Development Strategy*, which led to a new regulatory system and structure for the Customs Department that entered into force in August of 2004. This new regulatory

³⁶ According to the Head of Phyto-Vetinary Control at the State Revenue Service, this would be in line with European Neighborhood Policy recommendations for phytosanitary control. However, while it is true that the ENP encourages that Phyto-Vetinary Control is targeted to specialised border, it is not true that ENP requires or encourages closing small borders to agricultural products.

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system dramatically reduced the number of the customs staff.³⁷ More recently, in April 2007, the functions of the Tax Department and the Customs Department and Financial Police were combined into a new State Revenue Service under the Ministry of Finance. This was intended to streamline the administrative operations of the two departments and to ensure better information sharing.

Many of these changes have been aimed at producing a ‘one-stop’ customs clearing system. Under the old system, customs clearance required the physical movement of the importer through a number of time-consuming and cumbersome stages.³⁸ The ‘one-stop-shop’ in a customs context envisages a ‘one-window-checking’ system which would combine all of these functions in one place. This system was officially implemented in 2006, though it is inconsistently applied at the moment.³⁹

The physical structure of the tax and customs system is also in a state of flux. Checkpoints are being renovated and decisions are being made about the location of customs clearing depots and their respective specialities.⁴⁰ In July 2007, then Minister of Finance, Aleksi Aleksishvili, and Head of the new State Revenue Service, Mindia Gadaevi, announced that in addition to tax service centres, renovated customs points would be open at Lagodekhi, Kazbegi, Poti, Ninotsminda and Sadakhlo no later than the end of 2008.

In terms of legislation, the new customs legislation (which came into force from January 1, 2007) has been adopted with the intention of simplifying procedures for businessmen, filling in gaps of the old system and harmonizing Georgian practices with the EU. Key elements of the reformed code include the reduction of customs regimes from 15 to seven, the incorporation of all procedures into one code, increased freedom for cargo in the country and improvements in the methods of goods valuation

Finally, there have been reductions in import duties. According to the Georgian State Minister for European and Euro-Atlantic integration, Giorgi Baramidze, ‘Georgia’s tariff rates are among the lowest worldwide, with custom duties for up to 90% of goods at 0% rate and rest at 5% or 12%’.⁴¹ The Government of Georgia has, at various points,

37 The number of staff has been reduced from 2,000 in 2003 to approximately 1,100 now. UNDP/CRRC Research Team interview with Roman Chkhenkheli, Head of Phyto-Vetinary and Special Control Unit in the State Revenue Service, Tbilisi, 21st August 2007.

38 For instance, importers would have to go to one room to fill out the goods declaration, have the goods accepted in a second room, undergo phytosanitary checks in a third room, checking documents in a fourth room, etc. And, of course, in each room there were particular procedures and new queues.

39 Under the current system, the most effective application of the ‘one-window-checking system’ occurs in the Customs clearance of imported cars. These are cleared through police stations and do not subscribe to ordinary customs procedures. Sadakhlo can be expected to apply this principle following the completion of their new facilities.

40 It has been suggested by the Government that there should be a reduction in the number of checkpoints able to make phytosanitary checks on the border. I will discuss this later.

41 Presentation by Giorgi Baramidze, Vice Prime-Minister and State Minister for European and Euro-Atlantic Integration to the NATO Parliamentary Assembly, Economics and Security Committee, (26th May 2006).

announced its intention to reduce tariff rates through 2007 and to completely eliminate duties on all products imported to Georgia by 2008.

Agricultural goods are an exception to this trend and are likely to remain so. Most agricultural goods produced in Georgia, including meat, potatoes, tomatoes, onions, cucumbers, carrots and cabbage have the highest tariff rate of 12%, and only cheese has the intermediate rate of 5%.⁴²

There has been some discussion about removing these tariffs but members of Government and Parliament insist that this is unlikely. Teimuraz Kopaleishvili, the Head of Staff of the Parliamentary Budget and Finance Committee, points out that, 'Last year we had an initiative to reduce customs tariffs to zero on all products, but then we decided against it. We maintained tariffs on agricultural products because there are so many hidden subsidies in the Turkish market, the EU and America that it would be unfair to expect our producers to compete'.⁴³

Strengths and limitations of the new system

The two main benefits of the new system are their impact on corruption and business efficiency. One of the core objectives of the post-Revolution Government has been the fight against corruption.⁴⁴ And by the accounts of most international observers, the battle has been extremely successful.⁴⁵ Our survey (to be discussed later) can give additional weight to this well established trend. While suspicion clearly remains in Armenia about the potential for Georgian corruption, there seems to be little evidence for significant corruption on the Georgian side.

The other main objective of the customs reform was the desire to increase efficiency and transparency so as to make business in and through Georgia cheaper and more predictable. Already, by 2006, Georgia had made significant strides in improving its customs procedures and was both significantly cheaper and quicker to import into/export

<http://www.eunato.gov.ge/admin/uploads/speech%20giorgi%20baramidze%20at%20the%20esc%5B1%5D.doc>

42 UNDP/CRRC Research Team Interview with Teimuraz Kopaleishvili, Head of Staff of the Parliamentary Budget and Finance Committee (17th August 2007).

43 UNDP/CRRC Research Team Interview with Teimuraz Kopaleishvili, Head of Staff of the Parliamentary Budget and Finance Committee (17th August 2007).

44 In 2005, the National Security Council of Georgia developed and approved the National Anti-corruption Strategy of Georgia. The strategy is targeted at developing an effective government system, activating legal and civil measures to fight against corruption and preventing corrupt practices in governance.

45 The World Bank hails Georgia as the top anticorruption performer in its 2006 "Anticorruption in Transition-3" (ACT3) report. The World Bank and European Bank for Reconstruction and Development (EBRD) reports that the percentage of firms that identified corruption as a significant obstacle fell from 60% to 39% from 2002 to 2005, and the percentage of firms that paid bribes during tax collection fell from 44% to 11% from 2002 to 2005. The Millennium Challenge Corporation's 2007 eligibility indicators for Georgia indicate that Georgia now satisfies the indicator regarding "Control of Corruption". 95% of Georgians surveyed said they had not paid a bribe to receive a public service in the last 12 months according to a February 2007 International Republican Institute poll.

out of, than the regional average.⁴⁶ This is further substantiated by the opinion of business people in the region. President of AmCham – Georgia, Esben Emborg (who is also a representative of *Nestle* for the South Caucasus), argued that Georgia has made massive improvements in its Customs environment between 2004 and 2007 and that it is now vastly easier to import into Georgia than Armenia or Azerbaijan.⁴⁷

While the objective of our research is fairly specific, it is worth considering the general weaknesses of this system since it will allow us to understand the likely problems that regional cooperation may face, even after proposed current changes have been implemented.

The main problems for the customs institutions are professionalism in the organization, confusion created by rapid change and failure to communicate with the end user. The professionalism of the new staff, using new legislation and with limited job security has led to excessive scrupulousness in decision making, particularly amongst lower ranking staff.

As Georgian President Mikheil Saakashvili said in an interview,

Lower-level employees are often afraid to make decisions because of a lack of competence, and they think that postponing any decision is the best way out of the situation. In most cases the fiscal institutions blame each other for their inaccuracies, which results in the delay and complication of procedures. In the end, entrepreneurs are the ones who suffer the most⁴⁸

Like other fiscal agencies, customs units have monthly collection targets that encourage officers to impose high sanctions and penalties on inspected businesses. This has been particularly problematic recently when customs officials, unsure of the new legislation themselves, have believed the prudent course is to offer fines when uncertain.

Legislative reforms

Legislative reforms have, again, certainly reduced the administrative and logistical burden on traders, however, there are several aspects of the old system which continue in spite of pressure for change. First, a system of ‘reserve pricing’ continues to be commonly used. Under this system, unit prices for most typical products imported into Georgia are defined not by the accompanying invoice, but by a government-ordained price list.

Within the existing customs clearance procedure, reserve valuation is believed to be the most widespread injustice. This drastically reduces the incentives for traders to seek out cheaper imports since cheaper goods will be priced at historic levels. Markets with fast-

46World Bank, *Ease of Doing Business Report: 2006*

<http://www.doingbusiness.org/ExploreEconomies/?economyid=74>

47 Esben Emborg, in an interview with GHN News Agency, (18th July 2007).

48 Mikheil Saakashvili, in an interview with *Civil Georgia* (21st February 2007).

changing prices are the most damaged. One example conveyed to the team was a Georgian importer who had found unbranded flat-screen TVs from China at 1/4 their 'listed' price at the time. Since he would be required to pay tax on the listed price (or 48% mark-up on the actual price) the import was made unprofitable.⁴⁹

The reduction in tariff levels also has clear benefits in terms of allowing international access. However, since the tariff on agricultural goods remains in effect generally, access to the Georgian market remains limited. This creates two concerns. First, as we mentioned in the previous section, both Georgians and Armenians, finding it hard to get Proof of Origin documents, are not gaining their legally sanctioned preferences. Second, many of the people we talked to continue to be concerned that the Government may abolish customs taxes on all agricultural products.

The European Neighbourhood Policy and the World Trade Organization

European Neighbourhood Policy

In May 2007, the Government of Georgia adopted the *European Neighbourhood Policy Action Plan Implementation Strategy*. A similar document exists for Armenia.⁵⁰ As had already been stated in the Government's broader policy reform strategy, the ENP remains one of the key elements of their developing policy agenda.⁵¹ One of the main reasons for implementing this policy is the primary benefits it affords in terms of potential access to the common market, technical assistance and aid. However, as the *Georgian-European Policy and Legal Advice Centre* has argued, 'the indirect benefits of the ENP are... "even larger" than the direct benefits ... that is, an alignment with the EU economic pattern brings investment and sustainable economic growth to the partner countries'.⁵²

As signatories to the ENP in both countries have stated, they desire to harmonise and simplify their procedures with each other and the EU and to fight corruption. The ENP offers a framework within which that can happen. By connecting their different reform processes to the common objectives of the EU, Georgia and Armenia will naturally become more coordinated in their policy as their reforms progress, even if their progress occurs at different rates.

The World Trade Organization

Georgia has been a member of the World Trade Organization (WTO) since June 2000, and Armenia has been a member since February 2003. The WTO obviously offers a

49 UNDP/CRRC Research Team Interview with Customs Expert, (April 2007).

50 http://ec.europa.eu/world/enp/pdf/action_plans/armenia_enp_ap_final_en.pdf

51 Georgian Government Document, *Basic Data and Directions 2008-2011*, (2007) p5 see: <http://www.imf.ge/aattach/285.pdf>

52 Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends: Quarterly Review* (July 2007), p7.

structure and incentives for removing customs quotas and reducing tariffs. However, more important for the customs reforms taking place in Georgia, the WTO offers considerable expertise in relation to the development of specific customs regulations.

Consideration of the role of the WTO and ENP

Both the WTO and the ENP offer opportunities and incentives for customs reform. However, their organizational structures and the skill sets of their specialists differ. The aspirations of the ENP are more precise than the WTO, since not only do they want efficiency and transparency in customs regulations, they also want those regulations to coordinate with EU legislation.

While the objectives of the ENP offer a general direction for reform, they do not prescribe the legislative solutions and allow considerable latitude to their members. For example, in the most recent European Neighbourhood Action Plan, the EU lists its priorities for Georgian customs reform, which include full adoption of the 2006 Customs Code, the simplification of procedures, consultation with the business community and the strengthening of administrative capacity.⁵³ However, very little direction is given as to the exact way in which these aims should be achieved. The closest the document comes to technical advice is to say,

Strengthen the overall administrative capacity of the customs administration, in particular to increase transparency of customs rules and tariffs, to ensure the correct implementation of customs valuation rules, to implement the principles of risk based customs control and post clearance control; provide the customs administration with sufficient internal or external laboratory expertise as well as sufficient operational capacity in the IT area.⁵⁴

The WTO on the other hand offers particular solutions and best practices on determination of customs valuation, rules of origin and pre-shipment inspection (PSI) regulations. For example, it offers six different acceptable systems for customs valuation. Nonetheless, both the WTO and the ENP aim to create coordination and not uniformity, and it would clearly make sense for the Armenian and Georgian governments to ensure that they select exactly the same system of valuation.

The one big concern with the adoption of ENP provisions, in terms of customs, is whether it is always appropriate for a country at Georgia's level of development to accept a system for organizing customs that was mainly designed by and for Western Europe. One particular example of this is the issue of phytosanitary provisions. Suggestions for reform of the customs system currently under review would include the reduction of the number of customs checkpoints that provide phytosanitary checks. The reason for this

53 *European Neighbourhood Policy Action Plan*, adopted by Georgian Government (May 2007), p6. (http://ec.europa.eu/world/enp/pdf/action_plans/georgia_enp_ap_final_en.pdf).

54 *European Neighbourhood Policy Action Plan*, adopted by Georgian Government May 2007. p6 (http://ec.europa.eu/world/enp/pdf/action_plans/georgia_enp_ap_final_en.pdf)

suggestion is that both equipment and expertise for these checks is expensive and limited. Therefore, it is argued, it is better to offer a professional and comprehensive review in fewer places, rather than partial and perhaps amateurish review in many.

As a result of the ENP provisions, the Georgian State Revenue Service is considering excluding phytosanitary checks from Ninotsminda checkpoint. This would exclude agricultural products from moving over this border and would require them all to route through Sadakhlo. Given that the two regions are predominantly agricultural, this would destroy the possibility of a much of regional trade and integration that the current changes in infrastructure make possible.⁵⁵ UNDP should make every effort to secure assurances that this will not happen, before investing heavily in trying to foster cross-border trade at this particular crossing.

Conclusion

In conclusion, the reforms to the customs legislation have clearly generated impressive improvements in efficiency, and seem to have largely dealt with the issue of corruption. However, problems persist, either because of continuing legislative omissions or a failure to effectively implement the reforms that are in place. The reforms to the Customs Department (now part of the State Revenue Service) have created a far more streamlined institutional environment, but without stability, development of the human resources and a clear communications strategy, the institution will continued to be dogged by overly costly procedures, and will be hard to understand for the end user.

Similarly, while legislative reforms and changes to tariffs have been welcome, and again, have helped to reduce the costs to importers, there are still factors which make life difficult for the small agricultural business. The system of customs valuation still encourages confusion. In addition, the sheer volume of legislative changes have made communication problems more vital. With so many changes, it is not clear where an importer would go to (particularly if they do not speak Georgian or English) for a detailed account of the new system and the rights and responsibilities it produces. This is particularly problematic in our case, but needs to be addressed generally.

⁵⁵ UNDP/CRRC Research Team Interview with Roman Chkhenkeli, head of Phyto-Veterinary and Special Control, State Revenue Service (21st August 2007).

3. Changes to Transport Infrastructure and Trade in Services

Introduction

Until recently the border districts of Akhalkalaki and Ninotsminda have been effectively cut-off from trade with the rest of Georgia. Physical geography, combined with collapsed roads and a very ineffective train system meant that connections to the main markets of Tbilisi and even Akhaltsikhe were extremely problematic. Even the relatively short (in distance) trip to the border is extremely time-consuming.

The poor quality of the roads was the most commonly cited problem facing the region in the stakeholder interviews we conducted and in the large needs assessment that Mercy Corps conducted in Akhalkalaki in 2006.⁵⁶ Poor transport infrastructure not only made connections to markets difficult, they also increased the price of inputs like seed and fertilizer and made cooperation and processing very difficult to manage. As we have already discussed, combined with the organization of the customs legislation the poor road conditions have made Ninotsminda practically irrelevant to regional trade.

This is already changing. The road from Akhaltsikhe to Akhalkalaki is already largely repaired, allowing travel along the old route from Tbilisi to Ninotsminda (though not to the border) in 3½hrs-5½ hours (rather than the previous 7½ hours). Road repair work that should commence next spring (and hopefully finish in 2010) will further shorten travel time by creating a direct link from Ninotsminda to Tbilisi that may take as little as 2½ hours. Also, an additional road to the Turkish border that is 37km from Akhaltsikhe, and renovation of the existing road to Ninotsminda will create a dramatic short-cut to Turkey from Armenia. Finally, a new train originating in Baku and travelling via Tbilisi and Akhalkalaki to Kars in Turkey will provide another connecting line to Tbilisi, to Turkey and to Europe.

All of the changes in infrastructure will create two kinds of improvements. First, eased transit of goods will allow the region to connect physically to national and international markets, to buy inputs less expensively and sell outputs to more lucrative markets.

Second, the changes may allow the south of the region in particular to provide an alternative transit route through Georgia. Currently, Georgia makes a considerable income as a transit country, moving goods, oil and gas to/from Armenia, Azerbaijan and Russia (and through them the Middle East and Central Asia) to Turkey, the Black Sea and beyond. Georgia's highest value service export is transportation. At the present time, there is only one viable route for these goods, straight through the centre of the country to the Black Sea ports of Poti and Batumi, and then on by sea to the rest of the world, or by road to Turkey. If the region can gain a small proportion of this transit, or if cross-border

⁵⁶ Mercy Corps, *Akhalkalaki District: Participatory Assessment and Survey Results*. (June 2006)

trade is stimulated by increased transit access to Turkey and Europe, then the benefits could be considerable

Definite conclusions on the possible size and impact of these changes are hard to make, since they not only depend upon calculations of time savings from particular renovations, but they also depend upon how those pieces of infrastructure connect to wider networks and require a great deal of information about the destination of current and likely future road users. This information is rarely recorded at this time. The difficulties of calculations are compounded by the fact that large infrastructure projects usually have complicated political implications, and who is allowed to benefit from them is not necessarily a matter of simple economics.

This section will, nonetheless, try and lay out some of the likely possible alternatives, since, even if one is not sure of the eventual outcomes, this should help planning around and advocating for, particular uses.

The physical transport infrastructure of Georgia

There are roughly 20,250 km of operational motorways in Georgia and 1,550 km of railways. Annually, roughly 24.5 million tonnes of freight are transported over roads, compared to 16.3 million tons by rail. Unsurprisingly, passenger travel also heavily favours the roads, with 257 million person trips on the roadways compared to 2.2 million on the railways.⁵⁷

Both road and rail travel are rebounding from the collapse following the economic downturn of the early 1990s. Traffic and freight levels are climbing back to pre-collapse levels, but the road and rail networks are ill-suited to manage the increasing load, as a decade without maintenance has left much of the infrastructure in advanced stages of disrepair. In recent years, the Georgian Government has steadily been repairing heavily used motorways to improve transit, but much more time and investment are necessary before the situation is normalised.

The current state of transport infrastructure in Samtskhe-Javakheti

The current road system in Samtskhe-Javakheti is changing rapidly. The one existing (reasonably) high quality road between Tbilisi and the region goes South-West from Tbilisi through the district capitals of Borjomi, and Akhaltsikhe. Akhaltsikhe is about 200km from Tbilisi and takes approximately 3½ hours to reach. From there you can go 30km to the Turkish border at Vale or head South-East towards the Armenian border, passing through Aspindza, Akhalkalaki and Ninotsminda. Akhaltsikhe to the border at Ninotsminda is about 110km and takes 3 hours to reach.

⁵⁷ Assistance in Assessing the SJRR Project, Draft Final Report, The Louis Berger Group (April 2005)

Most of this route is now reasonable quality road. The South-East route from Akhaltsikhe to Akhalkalaki and then on to Ninotsminda has improved dramatically recently and is now about 90% good.⁵⁸ However, as has already been mentioned, the last 23km to the border is still a disaster and can take over an hour.

As an alternative route from Samtskhe-Javakheti to Tbilisi there is a direct 167km road, which lies at a high altitude and is in an almost complete state of collapse and extremely hard to pass. In the summer it takes 6-7 hours to reach Akhalkalaki but is impractical for most commercial travel and completely impassable from January to April for normal cars. The daily traffic counts along this alternative direct road are very low⁵⁹, and seasonally variant. Along a similar route there is a train line from Tbilisi to Akhaltsikhe, though this currently only operates in the summer.

Infrastructure improvements

Perhaps the most significant regional infrastructure developments likely to impact cross-border relations between Georgia, Turkey, and Armenia are the Kars-Akhalkalaki-Baku rail link and the *Samtskhe-Javakheti Roads Rehabilitation Project* (SJRR).

As part of its compact with the Millennium Challenge Corporation, Millennium Challenge Georgia (MCG) will undertake the rehabilitation of the 167km direct route from Tbilisi to Ninotsminda in Javakheti.⁶⁰ The project also aims to repair the 43km link from Akhalkalaki through Ninotsminda to the Armenian border (the first half of which has now been done), and the 33km link between Akhalkalaki and Kartsakhi at the Turkish border. The Government of Georgia also committed to repair the road from Akhalkalaki to Akhaltsikhe, which has been largely completed.⁶¹

The aim of these improvements is to enhance highway connections between Javakheti and Tbilisi, and to improve international links with Turkey and Armenia to stimulate economic integration and development.

At the time of writing (September 2007), MCG is preparing the procurement and bidding documents to select a contractor/contractors for road construction. After successful bidders are identified, the contractor(s) will begin mobilization. Given the severe winter climatic conditions of Javakheti, mobilization will not likely begin in the winter of 2007 on the segments in that region. It is unlikely that construction in Javakheti will commence

58 This is based upon estimates made by the UNDP/CRRC Research Team driving to Akhalkalaki (29th August 2007).

59 Both the Louis Berger Group and Kocks Consult GmbH measured the Average Annual Daily Traffic Count to be under 100 vehicles per day.

60 MCG has, in fact, only committed to rehabilitating 153km of this road, but the rest of the road from that point into Tbilisi is already in good condition.

61 When the CRRC Research Team first visited the border in May the road from Akhaltsikhe to Akhalkalaki was in about a 70% state of disrepair and took the researchers over 2 hours. At the end of August, when the same trip was taken again, the road was only about 20% damaged and the trip took 1 hour and 20 minutes (though an average Georgian car or small van driver would certainly take longer).

before the spring of 2008. Feasibility studies for the project estimate that construction should take approximately two years to complete. Therefore, one can tentatively conclude that (barring possible mishaps) the MCG road should be completed by autumn of 2010.

The main intention of the new road will be to decrease the travel time to Tbilisi from its current time of six hours to approximately four hours, though the travel time may be even lower.⁶² This will clearly create incentives for greater integration with the rest of Georgia.

Increased traffic loads on the completed project road will result from a combination of the natural traffic growth rate, traffic generation, and traffic diversion from alternative routes to the new route. Growth rates for vehicular traffic along the project road were recently calculated by Kocks Consult GmbH in their feasibility report for the SJRR project. They estimated that by 2029 the traffic load from the south of the route will have increased by 10 or 11 times to an AADT (Annual Average Daily Traffic) of 1000-1100 cars.

The vast majority of these diverted trips are expected to have their origin in the Akhalkalaki-Ninotsminda region and their destination in Tbilisi. According to this assessment, the new road is unlikely to create significant traffic transfer from the rest of Samtskhe-Javakheti.⁶³

Border Crossings

The MCG road rehabilitation project also intends to improve the road to the Armenian border near Ninotsminda and create a new border crossing to Turkey at Kartsakhi. The road between Akhalkalaki and Ninotsminda has already been repaired. Once the additional roads are repaired it will create a potentially vastly shorter trip from the Armenian border to the Turkish border. The trip from the Ninotsminda checkpoint to Vale is currently about 150km, however, the trip to Kartsakhi will be only 80km. Currently, there is no active border crossing to Turkey at Kartsakhi, although facilities (currently abandoned) have been constructed on the Turkish side.

Rail rehabilitation

On the 2nd July 2007, the 'Tbilisi Declaration' on the common vision between Turkey, Azerbaijan and Georgia, celebrated the commencement of the Baku-Tbilisi-Kars railway project.⁶⁴ The Georgian section of the railway is being constructed and renovated with a 200 million USD loan from the Azerbaijani Government at a 1% interest rate to be repaid

62 This estimate seems conservative since the distance from Ninotsminda to Tbilisi is 167km so that a 60kph average would only take 3 hrs. However, given the altitude of the road, significant seasonal differences may apply. *Samtskhe-Javakheti Roads Rehabilitation Project, Final Feasibility Study Report*, Kocks Consult GmbH (February 2007).

63 Ibid, 36 and 39.

64 'The Tbilisi Declaration' on Common Vision for Regional Cooperation, *Civil Georgia* (7th February 2007). (<http://www.civil.ge/eng/article.php?id=14588>)

in 25 years.⁶⁵ The intention of this rail link is to give Azerbaijan and Georgia a direct rail connection to Turkey and, through Turkey, the European rail system.

Economic Impact of the new Infrastructure

There are two kinds of impact that the various forms of rehabilitation could have on trade from the region and trade across the Ninotsminda border with Armenia. The first is the direct impact on market opportunities that the rehabilitation of roads in the region and particularly the rehabilitation of the Ninotsminda-Tbilisi road will create. The second impact is the consequence of the different transit routes that will be created between Armenia, the area's bordering regions and the rest of the world.

Impact of the Road and Rail Rehabilitation for Samtskhe-Javakheti directly

We surveyed 29 traders in Akhalkalaki market, and one of the questions we asked them was the benefits of improved infrastructure. The results were as follows:

Table 3.1 Ways that improved infrastructure will help business in the region.

<i>How will the road repairing benefit on your business? Routes?</i>	Domestic products	Vegetables	Dairy	Fruits	Other	Total
The products will not be damaged	4	8		2		14
Cheaper transportation	4	9	2	1	7	23
Car will not be damaged					1	1

Source: UNDP Field Researchers, Akhalkalaki (June-July 2007)

In their feasibility analysis Kocks Consult GmbH provided some estimates on the likely commercial impact of the new road for Samtskhe-Javakheti. They estimate the following increase in volumes moving from Ninotsminda and Tbilisi by 2013.

Direct Economic Impact of the Trade between Ninotsminda and Tbilisi

Potatoes: 22,805 tonnes

Milk: 5,594 tonnes

Other Products: 1,250 tonnes

Total: 29,649 tonnes

According to their estimations, at 12 tonnes per vehicle and approximately 120 USD savings (in petrol, time, damage to vehicle and damage to goods) per trip this represents a 591,000 USD savings per year.

65 'Saakashvili Speaks on Regional Railway, as Deal Signed', *Civil Georgia*, (7th February 2007).

There are no publicly available figures on the likely impact of either the border crossing or the new rail link. At the very least, we can assume that, along with changes to the customs checkpoint, they will encourage more trade between the two regions, particularly between the west of Armenia and Georgia.

Changes to transit patterns

Georgia as a transit country

Georgia's potential as a 'silk road' transit country has been widely discussed and impacts Government policy on trade in a range of ways. In particular, it is stated Government policy to develop Georgia as a transit route for goods and services coming from the Middle East, Azerbaijan, Central Asia and further East. The most obvious form of this policy can be seen in the *Tbilisi Declaration*, which listed the large energy projects agreed between Turkey, Georgia and Azerbaijan. As the declaration states:

With three successful energy infrastructure projects, the Baku-Supsa export oil pipeline; Heydar Aliyev Baku-Tbilisi-Ceyhan (BTC) export oil pipeline; and the South Caucasus gas pipeline (Baku-Tbilisi-Erzurum) our cooperation has established a vital and secure new source of energy for Europe.⁶⁶

The same declaration announced the commencement of the Baku-Tbilisi-Kars railway project and 'a new electricity transmission line from the Republic of Azerbaijan through the territory of Georgia to the Republic of Turkey'.⁶⁷

Georgia also offers favourable discounts on tax charges to railway transit from Azerbaijan, providing a 50% discount on the freight transit tariff to Azerbaijan, as against 24% discount on petroleum products from Armenia and a 17% discount for other cargo.⁶⁸ In addition to these discounts, there has been considerable investment in the infrastructure necessary to develop Georgia as a transit country for the transportation of goods from China and Central Asia to the West. The aspiration to become a premier transit country has impacted on Georgia in a range of ways and has resulted in low tariff rates, considerable interest in developing its Black Sea ports and a successful focus on the development of physical transport infrastructure.⁶⁹

66 'The Tbilisi Declaration' on Common Vision for Regional Cooperation, *Civil Georgia* (7th February 2007). (<http://www.civil.ge/eng/article.php?id=14588>)

67 'The Tbilisi Declaration' on Common Vision for Regional Cooperation, *Civil Georgia* (7th February 2007). (<http://www.civil.ge/eng/article.php?id=14588>)

68 Armenia UNDP Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities Draft Report* (July 2007), p16.

69 This will be discussed further in the next section.

Transport services and Armenia

Transport services

Transport services are the largest category of Georgian service trade, making up 49% of exports and 55% of imports in the last quarter of 2006.⁷⁰ As one would expect of a transit country, Georgia gains from sale of transport services to Armenia. One 20' sea/land container will cost 522 USD by rail for the trip Poti-Yerevan-Poti. By truck, the same trip will cost 1357 USD.⁷¹ Unsurprisingly, as a result, the bulk of transport travels out of the country by train (74% in 2003). In 2006, Armenia exported 3.1 million tonnes through Georgia, which the UNDP research team in Armenia estimated to be worth 100 million USD.⁷²

At the present time Samtskhe-Javakheti makes approximately 1% of Georgia's earnings from transport.⁷³ However, the crucial question for us is whether any of these general trade patterns are likely to be re-routed through/to Samtskhe-Javakheti as a result of the infrastructure changes that are taking place.

The MCG Road, the improved roads in Javakheti and the new customs checkpoints (see Appendix 5, 6 and 7 for appropriate maps of the region)

One question about all the new roads heading to and through Javakheti is whether they will replace the more northerly route that goes from Sadakhlo and exits Georgia at Poti, or Sarpi.. First, it seems unlikely that the Sadakhlo-Ninotsminda-Kartsakhi route will replace Sadakhlo-Tbilisi-Sarpi since the current route from Sadakhlo-Tbilisi-Vale is only about 50km shorter and has failed to do so.⁷⁴ Equally, most of the Turkish goods moving to Armenia, as we observed in the first section, exit through Poti, suggesting they originate in the West of Turkey and would therefore be badly suited to road transport.

However, if the Armenian trucks cross into Georgia through the Ninotsminda crossing, the picture is somewhat different. On the face of it, improving the transport links and ease of navigating the customs point at Ninotsminda, would seem to offer vastly shorter routes for Armenian goods to Turkey and through Turkey, to Europe. If we just consider some distances on the Armenian side of the border, from the West of Armenia to the West of Georgia or Turkey, travel times are far quicker through Ninotsminda.

70 Georgian-European Policy and Legal Advice Centre (GEPLAC), *Georgian Economic Trends, Quarterly Review* (July 2007), p39.

71 By truck the bulk of these charges go to the transporter (1100 USD for truck and 280 USD for rail) and Transport Handling Charge at the port (215 USD in either case) Armenian UNDP Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities Draft Report* (July 2007), p31.

72 Armenian UNDP Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities Draft Report* (July 2007), p31.

73 Armenian UNDP Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities Draft Report* (July 2007).

74 Also, the speed of the vale route is probably quicker and the Ninotsminda route, even if well repaired, will involve some high passes and winding roads.

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Even from Yerevan, travel times are faster to Ninotsminda than to Sadakhlo. If we imagine a situation where problems with customs organization (discussed above) and road conditions were improved one would expect considerable increase in traffic volumes – particularly heading to Turkey.

Table 3.1

Route	Distance	Time for average car
Yerevan to Ninotsminda border	178 km	2.30 –3 hr
Yerevan to the Sadakhlo border	225 km	4 hr
Gyumri to Nintotsimda border	48 km	45 min (maximum)
Gyumri to Sadakhlo border	171 km	3.30 hr

Source: UNDP/CRRC Research Team member based in Shirak

An improvement in access to both border crossings has the potential to make Javakheti a vital transport link between Armenia and Turkey, given the efficiency of this shorter route compared to the long road through Sarpi. However, simply looking at the transit routes from one country to another may not give a very clear picture.

Even though the current route from Sadakhlo to the Sarpi border is approximately 480km and takes almost 7½ hrs, while the current route through Vale is about 320km and takes no more than 5½ hrs, of the two border crossings, Sarpi is by far the preferred crossing point, with an average annual daily traffic (AADT) count⁷⁵ on the Sarpi-Batumi road segment of 717 vehicles in 2006, of which 221 vehicles were freight carriers. Vale, on the other hand, had an AADT of 48 in 2006, of which six vehicles were freight bearing.⁷⁶ This can be partially explained by the fact that the Vale route is less reliable. However, perhaps more importantly, exiting Vale leaves you less well connected to the Europe-bound Turkish roads than Sarpi.

Similarly, while the Kartsakhi route gives even more dramatic connections to Turkey from Gyumri (1 hour rather than 7½ from Sadakhlo-Sarpi) the calculation will be dependent upon where the goods are heading after that and travel times in Turkey. On the Turkish side of the border, Çıldır is the nearest city and is not integrated into the Turkish highway system as well as the route through the Sarpi border crossing. However, if you add the additional saving of 2¾ hours from Gyumri to Ninotsminda (rather than Sadakhlo) it becomes difficult to believe that wherever you were going in Turkey/Europe the alternative route would be better. Therefore, it seems reasonable to conclude that for road-based traffic heading to the West of Armenia the Kartsakhi-Ninotsminda route will be better than Sarpi-Sadakhlo route.

⁷⁵ The average annual daily traffic count is converted from the average daily traffic count to create an annual average that accounts for seasonal variations.

⁷⁶ *Samtskhe-Javakheti Roads Rehabilitation Project Final Feasibility Study Report*, Annex 2-3-4 “Traffic Modeling Scenarios”. Kocks Consult GmbH (February 2007)

Baku-Akhalkalaki-Kars Railway

In a similar fashion, the degree to which the railway through Akhalkalaki will supplant the more northerly road and rail routes is probably most significantly dependent on where the traffic is ultimately going. The more northerly rail route does continue to look more attractive to international investors, who have given it almost all of their attention. There are two reasons for this. First, this route will connect to the Black Sea and, therefore, will be better suited to transportation to global markets. Second, the more southern Akhalkalaki route, which will involve several high mountain passes, may not be as reliable year around.

For these reasons, Central Asian investors have focused almost entirely on the more southerly route and considerable investment has gone into the rail service and the ports it serves. Kazakh investors are putting nine million USD into the construction and re-equipment of the Port of Poti through 2008, and this investment will include the refurbishment and re-equipment of a wheat terminal which will be used for processing wheat before export to Europe.⁷⁷ In May 2006, *Green Oak Group* won a 92 million USD management contract for the Port of Batumi⁷⁸

Armenian exports currently mainly use the Black Sea ports as their means of transit. This makes some sense. If we look at the way in which Armenian goods transit through Georgia, we see that more than 75% of goods transited through Georgia from Armenia move through the Port of Poti, mainly arriving at the port on railway containers. Most of this transportation is organized by Georgian representatives of Maersk Sealand and Hapag-Lloyd (Maersk Georgia and Catoni Georgia).

One significant question for our purposes is also whether the new train system will be able to connect to the Armenian network. Armenian freight could connect to the network in one of three ways, by using the existing Yerevan-Tbilisi train route and then heading South-West directly to Turkey rather than heading West to Poti and the Black sea transit. Second, if the rail line between Shirak and Samtskhe-Javakheti were renovated this would allow for a direct link. Both of these options (particularly the second) could be politically problematic for an Azerbaijani funded railway link, not only because it would help Armenia, but because it would specifically help Armenia transit its goods to Azerbaijan and Turkey. More likely is the possibility that goods would travel by road from Armenia to Akhalkalaki where they would be loaded onto railway trucks. Again, political problems might make it necessary to package, repackage or process the goods first so that their origin does not create problems. This could itself create opportunities.

77 <http://www.maf.ge/eng/> (Bulletin from 18th June 2007)

78 'GreenOak pays 92 million USD for Batumi Port', *Civil Georgia*, (12th May 2006)

Conclusion

The infrastructure changes will obviously create great opportunities for improving Samtskhe-Javakheti's market access. The exact nature of the benefits this creates will depend upon the extent to which it motivates the local economy to increase productivity and whether it encourages new industry in the region, but the benefits could be considerable. It will certainly increase the market value of goods produced locally and decrease the cost of inputs.

Whether it turns the region into an alternative transit route through Georgia to Turkey, will depend on the nature of the goods and their intended destination. It seems likely that the road will be an alternative route to Turkey from the West of Armenia and possibly from Tbilisi (and everywhere to the East) for the South of Turkey. However, it seems unlikely that it will replace the main route through Tbilisi for most transited goods, since the majority of these find cheaper access to European and Russian markets by sea out of the Port of Poti.

The benefits of the new rail link will depend upon two considerations. First, whether it is reliable all year round for heavy goods transit. Second, whether it is of particular use for Armenian goods transiting to Turkey will depend on political considerations and the extent to which Armenian exporters are allowed to use it. Estimating answers to this question are little more than speculation.

Whatever the political outcomes, the new routes will be useful and could produce growth in both goods traded and income from transport services. However, the exact nature of these benefits will probably not be clear until the routes have been in place for a couple of years.

4. Trade in goods: sectoral and regional analysis

Introduction

The primary focus of this research project is cross-border cooperation from the perspective of Samtskhe-Javakheti. While we have already made clear that this is not a development assessment or a feasibility study for different industries in the region, it is clear that even a partial analysis of the prospects for cross-border trade must include some aspect of both. Therefore, this section will evaluate the market in three main ways. First, it will consider the general national trends for trade in goods. The purpose of this is to see if any of the information available at a national level can help us to understand why there is so little trade going on in the region we are studying and also if the existing trends offer any insights into likely areas for development. Generally speaking, we find this information can offer limited insights.

The second part of the analysis will consider the agricultural sector and its development in Samtskhe-Javakheti. Since Samtskhe-Javakheti is over 80% rural,⁷⁹ an understanding of the economy of the region is essentially dependent on an understanding of the agriculture sector. By looking at the evolution of farming in Georgia and talking to a range of local farmers, traders, politicians, and development professionals we have developed an overview of the challenges and opportunities that agricultural development faces in the region.

We conclude that even though the analysis of the problem is superficially similar with all parties highlighting infrastructural problems, technical deficits and lack of inputs, there is still fundamental disagreement between groups as to how the problems should be resolved. As a result, while the farmers are usually unaware of this themselves, one area in continued need of support is business planning. There is a great deal of international money in the region and the country as a whole for well thought out agricultural development projects. The problem continues to be for farmers to develop those project plans and present them in the right way to access these funds.

In terms of cross-border trade specifically, we looked at the functioning of the various markets, and the development activities of a range of international organizations. We found that very little of the development work at the moment is focused on cross-border trade (even if it says that it is). What other opportunities might exist is hard to assess within the context of this research project. Our research was only intended to look at the Georgian side of the border. While we briefly consider some basic facts of the situation in Shirak, clearly a more detailed attempt to look for particular cross-border trade opportunities needs to spend more time looking at the markets on both sides of the border. Since this was never intended to be the purpose of this research, our analysis on this can only be suggestive.

⁷⁹ Georgian Department of Statistics (provided July 2007).

Georgia-Armenia trade

We can see the country breakdown of imports and exports to/from Georgia in table 4.1 below. Exports to Armenia are a significantly higher percentage of the total than Armenian imports to Georgia.

Table 4.1 Export and Import Percentages, First Quarter 2007

Import	Percentage	Export	Percentage
Russia	16.1	Turkey	15.9
Turkey	13.0	Azerbaijan	9.8
Ukraine	8.8	Armenia	9.5
Germany	8.3	Ukraine	7.5
Azerbaijan	7.3	Russia	5.9
UAE	4.1	Germany	5.2
Others	42.4	Others	46.2

Source: Georgian-European Policy and Legal Advice Centre, *Georgian Economic Trends* (July 2007).

The main agricultural exports from Georgia to the world in 2006 were fruit at 61.7 million USD (mostly hazelnuts), sugar at 18.8 million USD and wheat at 6.6 million USD. Wine exports have fallen to half their 2005 level at 41.9 million USD and vegetables are a barely noticeable at 1.2 million USD.⁸⁰

Looking at the trend of imports and exports to and from Armenia (Table 4.2), one can see that the general pattern is one of growth. Trade between the two countries was six times higher in 2006 than it was in 2000. In 2006, more than 4% of Georgian exports went to Armenia and Georgia maintained a positive trade surplus of 39.3 USD million in 2006.

Table 4.2 Georgian foreign trade with Armenia 2000-2006(ML. USD)

Years	2000	2001	2002	2003	2004	2005	2006
Export	13.8	12.5	21.6	42.7	57.8	39.7	73.6
Import	13.4	4.7	7.5	6.4	83.5	39.3	40.2
Balance	0.4	7.8	14.1	36.3	-25.7	0.4	33.4

Source: Ministry of Finance of Georgia, Revenue Service, Provided to Project Researchers, June 2007⁸¹

The composition of these imports in 2006 is somewhat idiosyncratic. At 15.6 million USD, cement is the main export to Georgia from Armenia, followed by 7.9 million USD

⁸⁰ Department of Statistics, *Food Security Situation: Trend in Figures* (April 2007).

⁸¹ The most obvious fact to observe from these figures is the dramatic increase in trade that occurred between 2003 and 2004 (an increase of more than 12 times) and the significant decline (still 7 times the 2003 level) that followed thereafter. One explanation for the erratic figures is that the changes that took place in the aftermath of the Rose Revolution dramatically decreased the shadow economy. As a result, in 2004 reported imports rose. UNDP/CRRC Research Team Report Interview with Roman Chkhenkeli, Head of Phytosanitary Control Unit, State Revenue Service, Tbilisi, (21st August 2007).

of vegetable products, mainly coffee, with some prepared and preserved meat contained in the same figure.⁸²

Exported goods have shown a far more dramatic increase, doubling in 2001/2 and maintaining fairly rigorous growth thereafter. Sugar and fertilizers show the largest volumes and significant growth⁸³ Also, for our purposes, wood at 3 million USD and maize at 4.5 million USD could have regional relevance as they are both locally produced.⁸⁴

In addition to these findings, one interesting conclusion of the Armenian UNDP research team is that Georgia's import of Armenian goods contains a negative income elasticity of demand so that as Georgian income goes up, Georgians will generally substitute higher quality imports from the rest of the world for the Armenian imports they have traditionally bought.⁸⁵

This kind of national level analysis has some value. Knowing that Georgia exports fertiliser to Armenia and that Shirak is largely agricultural seems to offer an opportunity for transit traffic through the region. Also, knowing that Armenia's main export is cement seems to offer the same opportunity the other way around.

Beyond that, the benefit of analysis of the national and historic data is limited. The reason for this is that the potential numbers for regional cooperation and trade we can realistically expect are probably too small to register nationally. Added to this, our analysis starts from the premise that there is currently no activity. The whole point is to build from a very low base. In this situation, it is unlikely that the current trade patterns are going to tell us much about future trends.

The agriculture sector in Georgia

The end of the Soviet Union created considerable difficulties for Georgian agriculture. The system of production and distribution upon which the collective farms (*kolkhoz*) had operated ceased to function. Ironically, the collectivist system seems to have left farmers with no idea how to organise collectively. A state apparatus that required cooperation was not replaced with a commercial understanding of the benefits of specific collective efforts, so coordination in both buying, producing and selling has not emerged naturally.

82 UNDP Armenia Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities* (Draft, August 2007), p29.

83 Note that there are some discrepancies between this information and the information offered by the Armenian team. According to the Armenians, 11.8 million USD of sugar was exported from Georgia (a 2.5 times increase on 2005) – this is a relatively recent addition. After that they have fertilizer (9.5 million up from 5.2), which, unlike sugar, has a long history as an export commodity. The third thing they list is wood (5 million USD in 2006 – a 1.8 fold increase). UNDP Armenia Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities* (Draft, August 2007), p28.

84 Ministry of Finance of Georgia, Revenue Service, (Provided to Project Researchers, June 2007)

85 Armenia UNDP Research Team, *Armenia and Georgia Economic Relations: Unrealised Opportunities*, (Draft, July 2007) p7.

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In the first instance, lack of centralised planning led to the destruction of the technical base and infrastructure on which the system depended. With farmers no longer able to get replacement parts for their machines, many were sold for scrap. In the absence of clearly defined private ownership of land, overgrazing became commonplace and both milk and meat yields plummeted. Without responsibility for irrigation systems or local roads, the infrastructure necessary for growing food or getting it to market fell into disrepair.

However, clearly the end of communism cannot be entirely blamed for the collapse of agricultural productivity that occurred in the early 1990s. For a start, even during the old system there had been private agricultural production. As Fidas and McNicholas from the IBRD (World Bank) point out,

In 1990, the private sector contributed 46 percent of gross agricultural output, and private productivity averaged about twice that of the state farms. Under the state system, designated plots were leased to farmers and town dwellers for private crop and livestock raising. As during the Soviet era, more than half of Georgia's meat and milk and nearly half of its eggs come from private producers.⁸⁶

Therefore, it was not the end of the Soviet system which alone precipitated agricultural collapse, but the way in which that transfer was (mis)managed. In particular, land reform, which started in 1992, and which was solidified by the 1996 *Law on Private Ownership of Agricultural Land*, parcelled out small plots of land but made the registration and sale of that land so difficult that no market in land was able to arise. Reforms after the *Rose Revolution* quickly changed this situation but a property market is only now beginning to develop. As a result, even now, of the (approximately) 656,000 farms in Georgia, the vast majority have land-plots of less than 1 hectare, and less than 16,000 farms have plots of more than 4 hectares.⁸⁷

This has been exacerbated by infrastructure concerns and while the major transportation issues look set to be solved (discussed above) and the irrigation system is gradually being repaired, both remain in a state of disrepair and the timeline for their completion continues to be unclear. Finally, if supply has been historically problematic, generation of demand became a lot more difficult when Russia banned Georgian agricultural products in December 2005 and Georgian wines and brandies in March 2006.⁸⁸

However, the agricultural dependency of the country as a whole and the believed potential productivity of the land, have left many encouraged that there is potential for

86 Penelope Fidas and Jim McNicholas, 'Need Land Administration Reform: Start a Revolution', *Celebrating Reform, International Bank for Reconstruction and Development* (2007), p38. (<http://www.reformersclub.org/documents/reform/FullSetOfCaseStudies.pdf>)

87 UNDP/CRRC Research Team Interview with Richard Hurelbrink, Director of AgVantage (20th August 2007)

88 In December 2005, the Russian Ministry of Agriculture placed 'temporary' restrictions on agricultural products imported from Georgia. See 'Russia restricts import of agricultural products from Georgia', *Civil Georgia* (20th December 2005). This was followed by the restriction of Georgian wine on grounds of 'hygiene'. See 'PM: Russia's ban on Georgian wine import unfair', *Civil Georgia* (30th March 2006).

developing agribusiness as a key to development more broadly. This continues to be driven by the realisation that agriculture forms the financial basis for the livelihoods of most of the Georgian population and while agriculture's share in GDP is decreasing (from 17.3% of Nominal GDP in 2000 to 14.6% in 2006),⁸⁹ its role in employment remains strong with as much as half the Georgian workforce engaged in agriculture.⁹⁰

The hope for growth lies in a combination of import substitution and export promotion strategies. A belief in the possibility of import substitution is driven by the realisation that 50% of the food and beverage market is made up of imports.⁹¹ As a result, it has been widely suggested that agribusiness, and in particular secondary food processing, should be a natural area for import-substituting growth.⁹² In addition, if arranged appropriately it is thought that the geographic location and productivity of the soil could make Georgia a considerable exporter of agricultural products. This has been a focal point for the involvement of many international donor organisations.

Analysis of Agricultural in Samtskhe-Javakheti

Table 2.1 shows the composition of agricultural production across the different districts of the Samtskhe-Javakheti region. As we can see, across the region as a whole potato, milk and meat production are the three biggest products in terms of value.⁹³

89 Georgian-European Policy and Legal Advice Centre (GEPLAC), *Georgian Economic Trends, Quarterly Review* (July 2007), p13.

90 AgVantage Draft Report, *The Georgian National Food and Agriculture Strategy: 2006-2015*, (Sept 2006)

91 Vakhtang Burkadze, 'Structural Adjustment of the Georgian Agricultural Sector', printed in *Georgian Economic Trends, Quarterly Review*, , Georgian-European Policy and Legal Advice Centre (GEPLAC), (July 2007), p58-73.

92 UNDP/CRRC Research Team Interview with senior international financier, Tbilisi (June 2007).

93 It is worth noting that these figures are formulated using a statistical sampling system applied by the Department of Statistics, rather than a collation of actual numbers. There are some good reasons for this, since it captures grey and non-marketed production. However it creates its own problems since it entirely depends upon the appropriateness of the sample chosen. It seems unlikely, for example, that Borjomi produced no fruit in 2005.

Table 2.1 2005 Agricultural Production in Samtskhe-Javakheti (percentages of total market value)

	Akhalsikhe	Adigeni	Aspindza	Borjomi	Akhalkalaki	Ninotsminda	Total
Potatoes	32%	32%	14%	34%	48%	24%	36%
Grain	8%	8%	8%	4%	12%	7%	9%
Vegetables	13%	14%	11%	13%	6%	2%	8%
Fruits	4%	4%	7%	0%	0%	0%	2%
Meat	20%	21%	31%	25%	10%	19%	17%
Milk	21%	19%	26%	22%	22%	45%	27%
Eggs	2%	2%	3%	3%	1%	2%	2%
Wool	0.01%	0.01%	0.04%	0.02%	0.03%	0.06%	0.03%
Total	100%	100%	100%	100%	100%	100%	100%
Value (000s USD)	15,019	11,042	5,959	5,798	38,535	18,832	95,185

Source: UNDP Research Team Interview with Shalva Kavelidze, Advisor to the Gamgebeli of Samtskhe-Javakheti.⁹⁴

1 USD – 1.7 Lari

The average plots of land in Samtskhe-Javakheti do not deviate significantly from the national account suggested above. According to a recent survey conducted amongst 600 households in Samtskhe (the whole region apart from Ninotsminda and Akhalkalaki), the average area of cultivated land across the region is 0.92 hectares.⁹⁵

The three main industries all enjoy opportunity for profitability, but are mostly under-utilising this opportunity. This is significant for our purposes because it impacts on their long-term viability and their likelihood as potential exporters. For this reason we will consider the three industries below.

Potato production

Potatoes are the only produce grown and sold in significant quantities in Samtskhe-Javakheti. Potato production in the region is almost exclusively done on small plots of land, between 0.5 and 1.5 hectares. Potato production is suited to the climate in Samtskhe-Javakheti because the crop is susceptible to infection that is less prevalent at high altitudes. This is particularly useful for seed multiplication because the initial investment in the seed is considerably higher than for producing eating potatoes, and because the highest quality seeds are more susceptible to infection. The higher investment requires that the farmers make even greater efforts to limit risk.⁹⁶

Yield for potato production has been low in Samtskhe-Javakheti since the early nineties. This is the result of a number of factors; the collapse of the irrigation system, poor roads

⁹⁴ Note that Mr Kavelidze admitted that he got his numbers from the Department of Statistics and that the Department of Statistics gained their figures by statistical sampling of the community.

⁹⁵ Georgian Opinion Research Business International, *Status of Social and Economic Conditions in Selected Villages of Samtskhe-Javakheti*, Prepared for CARE/DFID (Tbilisi, 2006) p27-8

⁹⁶ We will explain this further below.

pushing up the price and pushing down the availability of inputs like high quality seed and fertiliser. According to a recent report for MCG the yield for farms in Georgia was about 15 tonnes per hectare in 2006, but this could go as high as 40 tonnes if the appropriate irrigation, seed and fertiliser was used.⁹⁷

At the low level of production, the likely income from potatoes is extremely poor. Both AgVantage, UNDP and CARE estimate that at the 15 tonne level incomes may be as low as 500-1000 GEL per hectare per year. However, at the higher level, incomes can be 5,000-8,000 GEL, or even higher, depending on price level.⁹⁸ (See Appendix 1 and 2 for our income and cost estimates).

Potato production is sensitive to a number of variables. Obviously revenue is the result of price and volume produced, and while improvements in volumes can be secured by improvements in irrigation, the use of inputs like seeds and fertiliser, and production techniques (barring disease or natural disaster), price is a different matter. Price varies throughout the year so storing potatoes can ensure a higher return but beyond that, until production and packing standards reach international level, price will be limited by the demands of local and, at best, regional markets. If productivity in the region goes up dramatically, either price will have to go down or new export markets will have to be found.

In terms of cost, the highest priced input is seeds. Potato seed comes in a range of grades. The highest, 'Super Elite' seed (which is usually imported from Germany or Holland) is principally used for growing more seeds, so called 'seed multiplication'. Potato seed is essentially just high grade potatoes (sorted from each crop every year) but each generation we move away from 'Super Elite', the productivity of the resulting seed-potato declines. Usually, if one starts with the next generation after 'Super Elite' one can use some of the product to reseed, repeating this without input of new seed will kill productivity in three or four years. Therefore, an average producer will ideally input three or four tonnes of new seed every year, to be mixed with seed he retains, in order to maintain high productivity.

In the past, most of the seeds for Georgia came from Armenia. These would come from one of approximately ten large seed producers in the country. The largest of these, *Agrico* is a Dutch firm that imports 'Super Elite' seeds into Armenia (ironically, through Georgia) before multiplying them on its 120 hectares of land and selling them regionally. Of the 3000 tonnes *Agrico* produces annually (2400 tonnes seed and the rest eating potatoes) it sold approximately 1000 tonnes to Georgia, of which 100 tonnes, they

97 Kocks Consult GmbH, Samtskhe-Javakheti Roads Rehabilitation Project Final Feasibility Study Report, (February 2007) p224. The reason for the large range is price.

98 The reason for the significant difference in income is that Kocks Consult GmbH uses historic prices to estimate future market price at 0.3 GEL per Kilo. The estimates produced by CARE and UNDP base their estimate on last year's price which, which is historically high at 0.6 GEL per kg. They are convinced this can be sustained. UNDP/CRRC Research Team Interview with CARE agronomists, 30th August 2007 and UNDP/CRRC Research Team Interview with UNDP Agronomist (31st August 2007). See Appendix 1 and 2 for profit and loss estimates.

estimated, would go to Ninotsminda. Producers would collect the seed potatoes themselves so the farmers took responsibility for transit and customs clearance. Some of these seed would then be also be resold to Azerbaijan.⁹⁹

Cattle for meat

The production, or specifically, the fattening of cattle for slaughter, seems to be a highly lucrative activity already. Cattle that are fattened in the summer are purchased as winter raised calves in the spring (March-May) and sold in October after spending the summer on grazing pastures.

Given our cost calculations (Appendix 3) in six months, it is possible to make a return of 1,852 GEL on an initial investment of 4,500 GEL (an 82% annual return).¹⁰⁰ If a farmer borrowed 3,500 GEL then his return would drop to 1,537 GEL (original less interest) but his return on his investment (his investment is now a lot lower at only 1000 GEL) would be over 300%. The fact that most buyers do not do this is a clear indication that it is not the availability of financing that created the problem for local farmers but the lack of understanding of it.¹⁰¹

Milk and cheese

The vast majority of milk production is currently done by small producers and transformed into cheese by them personally. Milk and cheese currently produce low revenues, according to our calculations creating a profit of 258 GEL per cow per year (Appendix 4). This low revenue is largely the result of low milk yield of the short-horned cow (maximum of 1200 litres per cow).¹⁰²

The situation is different for large producers. One unusually large producer we talked to said that his hundred head of cow produced 1500 litres of milk per year, or between them, 20 tonnes of cheese per year and that he was able to sell this on the Tbilisi market at 6.5 GEL per kilo. He also said that the price for cheese is approximately the same in Gyumri as it is in Tbilisi so there is little motivation for sale in Armenia (even though he goes to

99 UNDP/CRRC Research Team interview with Kamo Zakaryan and Gevorg Gevorgyan, seed producers and stock holders of Agrico, Gyumri (11th July 2007).

100 UNDP/CRRC Research Team Interview with CARE agronomists (30th August 2007).

101 To put this another way, if one were to use the 3,500 GEL left over to buy (with loans) another 35 cattle on the same terms, the return on the same 4,500 GEL would be 6,917 GEL instead of 1,852 GEL. Of course, there may be other limiting factors, like the availability of grazing, but this is not considered in our calculations.

102 Note that this yield estimate was provided by CARE agronomists in Akhaltsikhe. In Akhalkalaki we were consistently told that yield was closer to 1,500 Litres, though these were larger producers who were probably using better techniques. There have been attempts to use alternative breeds of cattle. The *Shikvi* cow has been tried in the region (this cow can produce 5000-7000 litres per year), but the cow finds the climate difficult to survive. There are currently experiments taking place to assess the viability of this breed and cross-breeds. UNDP Field Researcher Interviews with Dairy Farmers (June 2007). It has also been suggested that the yield of the current herd could increase dramatically if fed and housed properly. One expert even suggested that yield could be as high as 4000 Litres, CRRC Research Interview (17th February, 2007). <http://crcc-caucasus.blogspot.com/2007/02/cows-in-caucasus-overgrazing-underfed.html>

Yerevan to buy cheese producing inputs). In Ninotsminda, he said that there are approximately ten farmers with 60-120 cows and 40-50 farmers with between 10-40 cows (as we can see, Ninotsminda's largest output by far is milk).¹⁰³

Developmental Problems

On the face of it there is considerable agreement concerning the problems that agricultural producers and traders face in Georgia generally and Samtskhe-Javakheti in particular. When Mercy Corps questioned 882 respondents from 64 villages of Akhalkalaki to assign urgency to the problems facing their town (on a 1-5 scale with 5 the most urgent) the top 11 problems were:

Table 4.1 List of Stakeholder self-identified problems in Akhalkalaki district

Problem	Roads	Fuel Price	Russian Base Closure	Price of Fertilisers	Medical Centres	Sale of Farm Products	Seeds	Jobs	Irrigation	Gas	Schools
Mean	4.8	4.5	4.5	4.4	4.4	4.4	4.2	4.2	4.1	4.1	4.1

Source: Mercy Corps, *Akhalkalaki District: Participatory Assessment and Survey Results* (June 2006), p24

However, the difference in results could simply be the result of the fact that over one third of them were not involved in agricultural production.

The farmers we spoke to in the region generally agreed with the results of Mercy Corps Survey. International commentators and local stakeholders highlight physical infrastructure, low technical development and low levels of inputs as key hurdles to development. Yet observers usually see deeper problems that are rarely highlighted by local stakeholders. Policy makers and development workers (both in the region and outside of it) are more likely to identify poor credit facilities and poor management and financial expertise as key problems.

Physical Infrastructure

Probably the two most commonly cited developmental hurdles in the region are transport infrastructure and irrigation. We have already discussed transport at length above. For some commentators like Deputy Governor of Samtskhe Javakheti, Samvel Oveyan the importance of irrigation cannot be overstated. 'Before the irrigation system is repaired' he argues, 'there is no-sense in speaking about regional development'.¹⁰⁴

The irrigation system that operated under the former Soviet Union depended upon 318 deep wells and a number of shallow water wells, 25 reservoirs, as well as a large system of irrigation channels and pumping stations to get water to higher elevations.

103 UNDP/CRRC Research Team Interview with Ninotsminda milk farmer and cheese producer in Akhalkalaki(11th May 2007).

104 UNDP/CRRC Research Team interview with Samvel Oveyan, Deputy Governor of Samtskhe Javakheti (26th June 2007).

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A report by AgVantage offers a summary of the problem,

In 1988 386,000 hectares were still under irrigation with 291,000 of this being with gravity systems and 95,000 relying on 120 pumping stations lifting water from rivers. In 2005 it is estimated that there were 150,000 hectares¹⁰⁵ of gravity irrigation, less than 40 percent of 17 years ago.¹⁰⁶

For high-altitude locations like Samtskhe-Javakheti the problem was even worse, partly because these areas generally have lower rainfall and partly because the system was in even worse disrepair. The AgVantage report continues,

The decline for lift-irrigated area is even more pronounced. From the 95,000 hectares in 1988, this had declined to less than 1,000 hectares in 2005 supplied by only 6 pumping stations.¹⁰⁷

Irrigation is important because better irrigated fields are more productive, as Deputy to Ninotsminda Gamgebeli, Jumber Gelashvili, argues ‘improvements in irrigation would make Akhalkalaki and Ninotsimnda fields twice as productive as they are now’.¹⁰⁸ But perhaps more importantly, irrigation is a protection against drought. Droughts occur every three or four years in Georgia and without protection from drought it is extremely hard to persuade farmers to invest in more productive methods, seeds or machinery, since a drought will effectively destroy an investment that might require return over many years.¹⁰⁹ Poor irrigation can also have political consequences when locals ‘even cancel the water flow for each other because of bad relationships between villages’.¹¹⁰

As a researcher from ECMI has said, and most commentators seem to agree, ‘the irrigation system is improving’.¹¹¹ This has occurred as the result of the efforts and money from many sources. The World Bank has been financing the renovation of the irrigation system (32.8 million USD) in a project that has lasted 6 years and has already provided irrigation for 46,000 of a projected 110,000 hectares, aimed at helping 80,000 homes

105 Of these 150,000 hectares, however, it is estimated that approximately half are not operating at full capacity due to the lack of adequate funds for operation and maintenance see AgVantage Draft Report, *The Georgian National Food and Agriculture Strategy: 2006-2015*, (Sept 2006), p70.

106 AgVantage Draft Report, *The Georgian National Food and Agriculture Strategy: 2006-2015* (Sept 2006), p70.

107 AgVantage Draft Report, *The Georgian National Food and Agriculture Strategy: 2006-2015* (Sept 2006), p70.

108 UNDP/CRRC Research Team interview with Jumber Gelashvili, First Deputy of Ninotsminda Gamgebeli (4th June 2007).

109 This is particularly clear for potato production. As stated above, since it is not necessary to buy new seed every year, investment in seed requires a return over 3-5 years. In this situation, a drought is not just destroying earnings for one year, but is destroying the basis for earnings over several. In this risky situation, it makes more sense to buy cheap, less productive seed.

110 UNDP/CRRC Research Team interview with David Kipiani, representative of Mercy Corps (22nd May 2007).

111 European Centre for Minority Issues, Javakheti after the Rose Revolution: Progress and Regress in the Pursuit of National Unity in Georgia, ECMI Working Paper No 38 (April 2007), p6

across the country.¹¹² Similarly, many of the local NGOs are offering, or have offered, grants for local irrigation repair in Samtskhe-Javakheti including UNDP, CARE and Mercy Corps.

Technical Equipment and Inputs

In addition to the poor infrastructure, poorly available or overpriced machinery and inputs are also cited as a big problem. Shalva Dalalishvili, a Deputy of the Akhaltsikhe Gamgebeli argues that ‘since 1989 there was no new technology bought in [the agricultural] sector’.¹¹³ Similarly, farmers will routinely complain about the over-pricing of necessary inputs like seed and fertiliser. As a Deputy of the Akhalkalaki Gamgebeli put it, ‘The main obstacle for farmers appears to be the lack of new seeds and pesticides’.¹¹⁴

However, while new technology, cheaper inputs, pesticides and chemicals are commonly the main demand from farmers, they are rarely understood as private investments to form part of a business plan, but rather, as inputs that should be provided to the farmers and traders by government or the international community. Therefore, the provision of these inputs, by itself, is rarely sustainable.

For the same reason, while the banking system is routinely cited as a problem area for developmental efforts it was never mentioned by the farmers when we asked them the problems they faced.

Larger land plots would help commercial viability. It is the stated policy of the Government of Georgia that, ‘if there is a possibility to choose the right of holding, priority shall be given to private ownership’.¹¹⁵ However, only about 17% of the 400,000 hectares of agricultural land in Samtskhe-Javakheti is privatized. This is mainly arable.¹¹⁶ Of the non-privatised land, 8%, designated for hay-making, is in the process of being privatized. However, 70% of the public land is pasture land and is not currently being considered for privatization.

The land issue in the region has two separate components. The first is the question of whether grazing land should be privatised. The lack of land privatisation continues to encourage over-grazing, since there is no incentive for any one farmer to restrict use of one piece of land in order to increase the feed provided to a smaller herd. However,

112 World Bank, ‘Restoring Irrigation and Revitalizing Agriculture in Georgia’s Villages’, (Reviewed 25th August 2007) at:

<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/GEORGIAEXTN/0,,contentMDK:20207398~pagePK:141137~piPK:141127~theSitePK:301746,00.html>

113 UNDP/CRRC Research Team Interview with Shalva Dalalishvili, Deputy to the Akaltsikhe Gamgabeli (4th June 2007)

114 UNDP/CRRC Research Team, Interview Simon Manainan, Deputy of Akhalkalaki Gamgebeli (4th June 2007)

115 Georgian Government Document, *Basic Data and Directions 2008-2011*, (2007) p5. (<http://www.imf.ge/aattach/285.pdf>)

116 Based on figures provided by the Samtskhe-Javakheti Municipal Authority (June 2006).

privatising the land in a situation where so many people depend upon open access would be socially and politically difficult.

The second issue is the lack of a market in land. This cannot be blamed on privatisation since most of the arable land is privately held but is, again, the result of having few alternative employment opportunities in the region. As long as most people depend on the produce of their small plots to survive and produce an income, they will have no incentive to sell and the consolidation of farming into more commercially viable plots will not take place.

One attempt to create commercial sized agriculture is the Government's plan to sell 100 plots of 400 hectares each at 20% of their market price with the requirements that the land is used for agriculture and that the purchaser sets up a processing factory. Saakashvili stated that, 'receiving a lot of money from the sale of land is not the priority now. The priority is to produce jobs.'¹¹⁷ Though an interesting idea, this will hardly change the structure of agricultural property ownership in the country. In the meantime the only possibility for consolidation is to encourage collective activity of different kinds, particularly in buying and selling the already existing produce. This is already underway and will be vastly improved by the road reforms that are taking place.

Lack of commercial orientation cannot be entirely blamed on the size of land-plots. A consensus also seems to exist between development experts that most farmers simply do not assess their businesses as commercial enterprises and this undermines their ability or incentives for longer-term planning and investment. One solution to this may be to help farmers with basic business planning. As Gocha Atoshvili from the Akhaltsikhe Business Centre argues,

most farmers demand new technology, seeds and pesticides. However, consultancy service for farmers would be better in the long run. This service will assist the farmers to plan their revenues to invest in technology or other useful arrangements and provide professional advice on planting, harvesting and general agribusiness management.¹¹⁸

The point is that while the local community usually sees technological deficits as a problem of lack of money, a more accurate characterisation would be to see it as a failure of organisation, credit facilities or business planning. AgVantage, for example, attempted to respond to the problem of technical underdevelopment with an equipment leasing service, but it did not work because, when presented in market terms, the technology that farmers demand proved too expensive.¹¹⁹

117 'Government Lays Out Plan for Agro-Business Development', *Civil Georgia*, (25th July 2007) (<http://www.civil.ge/eng/article.php?id=15494>)

118 UNDP/CRRC Research Team interview with Head of Akhaltsikhe Business Centre Gocha Atoshvili (26th June 2007)

119 UNDP/CRRC Research Team Interview with Director of AgVantage, Richard Hurelbrink, (20th August 2007)

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International organizations are already heavily involved in the provision of consultancy services, though these tend to focus on technical advice rather than business planning. Mercy Corps has a regional agricultural centre in Akhalkalaki that offers advice, new agricultural ideas, technical equipment for leasing and seed for sale. CARE started a rural advisory centre this year but they currently only offer technical advice. Finally, MCG is offering grants to set up rural service centres, which (it is imagined) would provide the same set of services.

The difficulties that some of the international organizations have experienced when they offer funding are also illustrative of the same problem. AgVantage, funded by USAID, for example, started with an expectation that their work would be largely demand side, working on marketing strategies and identifying export markets. As Richard Hurelbrink Director of AgVantage, agrees, ‘When we first started we didn’t even have a “production” unit but we soon realised that, the issue here [in Georgia] is not markets, the issue here is supply. Georgia is not a reliable supplier of agricultural products’.¹²⁰

Hurelbrink continues,

Georgia farmers do not engage in the kind of commercial planning and contracted relationships necessary to supply export markets. Even in Moscow [a less Westernized market space] there are only 5 or 6 major retailers, and they want suppliers who can provide reliable products year round – and they are pretty vicious in pricing. Georgia is just not able to provide them the quality and consistency of product they demand.¹²¹

A lack of market orientation in the agribusiness sector has also been at the centre of MCG’s difficulties in developing good projects. The MCG Agribusiness Development Assistance (ADA) Grants have been offering grants of varying size to ‘primary producers’ (farmers), ‘service centres’ (providing equipment, wholesale inputs and expertise) and ‘value chains’ (financing a collection of components that take a product from field, through packing and processing, to market).¹²² MCG’s projects required some level of matched funding, but farmers only have to offer one third of the money for any proposed project. The applications, MCG says, were ‘a disaster...they [the farmers] routinely had no financials and no marketing plan. They completely failed to understand what we were looking for’.¹²³

The reason, MCG will admit, is that they have practically no money for helping these farmers to develop business plans. As a result, since they lack local connections, they

120 UNDP/CRRC Research Team Interview with, Richard Hurelbrink, General Director of AgVantage (20th August 2007).

121 UNDP/CRRC Research Team Interview with, Richard Hurelbrink, General Director of AgVantage (20th August 2007).

122 The notion of ‘value chains’ in particular seem to be significant in the contemporary NGO work, and is at the centre of the World Bank, AgVantage and MCG’s methodology. It finances a business plan that includes all of the production, processing and distribution elements.

123 UNDP/CRRC Research Team Interview with, Rusudan Kacharava, Director of Agribusiness Development Assistance Program of Millennium Challenge Georgia (28th June 2007).

have no way of assessing the viability of the projects or encouraging good projects to apply. The farmers in the region we spoke to, as a result, complained that no-one they knew had received an MCG grant. But when asked what these grants were for, they seemed to think they were simply intended to subsidise existing farming operations, helping to buy new machinery and inputs.¹²⁴

This offers opportunities for more locally embedded organizations since they could help businesses put together plans that can take advantage of money that is already available.¹²⁵ This kind of cooperation is already happening. AgVantage has helped the company *Herbia* to prepare a research proposal for MCG's Agricultural Development Assistance and, with considerable money available for agricultural development projects, it seems like the best added value that small projects can provide is local assistance in using these resources.

Market Opportunities

The objective of this research was to identify hurdles to cooperation between Samtskhe-Javakheti and Shirak, and not to identify market opportunities. However, in the process of the research the research team has spoken to a very wide range of stakeholders and they have offered their insights into the different opportunities in the region. We will discuss these below. We have also noticed a few areas, in the process of our research, that might be interesting for UNDP to investigate further, but these ideas are merely suggestive and would need further research before they are pursued.

Suggested market opportunities are wide ranging in Samtskhe-Javakheti and most of the main agricultural industries are being tried by one or more of the developmental agencies. Encouraging potato seed production is one clear ambition for many. For this reason Mercy Corps, CARE, the United States Department of Agriculture (USDA) and AgVantage have offered money to help farmers set up cooperatives for purchasing seed potatoes or have bought the potatoes themselves. AgVantage has also set up a potato storage facility, since if potatoes can be sold later they can gain a higher price.

Milk has been generally encouraged through assistance in producing cheese (see below). Amongst the other suggested opportunities we were told, honey¹²⁶, cabbages and fruits¹²⁷, fishing, beer¹²⁸, cauliflower, juice, berry and herb collection.¹²⁹

124 UNDP/CRRC Research Team Interview with local business people in Akhalkalaki (11th May 2007).

125 According to some commentators we spoke to there is resistance to this kind of cross-agency support in the development community, since most of the organizations working locally have small business grants to allocate themselves and like to use their local networks to find good projects to fund themselves. In the competitive world of international NGOs 'success stories' are the key to future grants, and in Samtskhe-Javakheti the competition for them is fierce.

126 UNDP/CRRC Research Team, Interview Simon Mananyan, Deputy of Akhalkalaki Gamgebeli (4th June 2007), Shalva Dalelishvili, Deputy of Akhaltsikhe Gamgebeli (26th June 2007), and CHF Central Georgia Regional Coordinator, Nana Berdzenishvili (29th August 2007)

127 UNDP/CRRC Research Team interview, Shalva Dalelishvili, Deputy of Akhaltsikhe Gamgebeli (26th of June 2007), also Gocha Atoshvili, "Akhaltsikhe Business Centre" (26th of June) emphasized fruits.

Processing

Processing of agricultural products is seen by some as the key to agribusiness development in Georgia, since it is the main manner in which agricultural products can gain high value-added in the region. AgVantage has spent 450,000 USD helping to develop two new industrial cheese producing factories in the villages of Orlovka and Spasovka in Javakheti. These factories were intended as a demonstration of the possible prospects for these industries across the rest of the region. However, they are more about 'food security' than agricultural development (since they will largely substitute Georgian goods).¹³⁰

Other secondary production is routinely suggested as an avenue for growth including packing centres and tinning. However, the old factories that do exist are extremely out of date and, according to many of those we spoke to, are incapable of guaranteeing production of quality finished goods.

Also, for reprocessing and tinning to work commercially the farming community needs to understand their operations in different commercial terms. Richard Hurelbrink, Director of AgVantage, says,

Georgians don't seem to understand that processing plants don't pay the same money for inputs as the fresh produce market. So, for example, they expect to be paid the same for tomatoes that are going to be processed into tomato paste as they get for fresh tomatoes. But it is a different market. Producers who provide goods for processors use different production techniques with higher yields and there is still money to be made, but it is a different business.¹³¹

That said, some new processing is being developed in the region. Herbs are largely grown wild and collected by farmers outside of their usual busy seasons. CHF is helping to set up drying centres so that these herbs can be sold in bulk to local pharmaceutical companies and one small meat processing factory is being developed with Israeli money to produce sausage.¹³²

128 UNDP/CRRC Research Team interview with Jumber Gelashvili, First Deputy of Ninotsminda Gamgebeli (4th June 2007).

129 UNDP/CRRC Research Team Interview with Shalva Dalalishvili, Deputy to Akhaltsikhe Gamgebeli (4th June 2007). Berry production was also highlighted as a growth area in UNDP/CRRC Research Team Interview with, Richard Hurelbrink, Director of AgVantage (20th August 2007) and herb collection and drying for pharmaceutical products is being developed by CHF. UNDP/CRRC Research Team interview with Nana Berdzenishvili, CHF Central Georgia Regional Coordinator (29th August 2007).

130 Since this facility will have the capacity for making hard cheeses, there is some hope that it might aim for the export market in the future, but for the time-being, its focus is substituting lower quality locally produced cheese.

131 UNDP/CRRC Research Team interview with, Richard Hurelbrink, Director of AgVantage (20th August 2007).

132 UNDP/CRRC Research Team interview with Nana Berdzenishvili, CHF Central Georgia Regional Coordinator (29th August 2007).

The carrot and stick of cooperation - infrastructure and health and safety changes

Arguably the biggest changes to agriculture over the next few years in the region will be associated with the new road and the changes in Georgian health and safety legislation. At the moment, most of the region's milk is processed into cheese by small groups of farmers in each region, and often on a household-by-household basis. In a similar way, at the moment, there are few large meat processing plants in the region and meat is butchered using small local slaughterhouses.

In two years time, new health and safety legislation will come into effect. This legislation will make it more difficult for small groups to produce cheese legally for the market and slaughterhouses too will become more strictly regulated. However, at the same time, the new roads will make it a lot easier for the products to be collected and sold in commercial volumes for processing. *Sante Ecofood* and *Soplis Naboti* are planning to set up milk collection points in Ninotsminda and Akhalkalaki so that they can use the milk produced locally for production of cheese in factories near to Tbilisi. Similarly, the meat company *Nikora* plans to buy cattle locally for slaughter and processing. Most of these products will be intended for the domestic market.¹³³

This clearly creates risks and opportunities for local farmers. By allowing them to connect to the main markets, it creates opportunities for selling their products at higher market price. For milk producers it allows them to sell raw milk to the market for the first time. At the same time, since the market will be effectively controlled by a few main buyers, the risk is that they will seek to drive that price down over time.

CHF has analysed the income implications of this change for local milk producers and believe that the shift from sale of cheese to sale of raw milk will leave their income largely unchanged, but will leave them a lot more time to focus on other revenue producing activities.¹³⁴

Opportunities for trade

Even though the international organizations often highlight their desire to encourage exports, most of the support that has been suggested so far has been for products intended for the domestic market. This makes sense because, as Hurelbrink again says, 'we started out aiming at export markets but then we realised that even the goods that you export are 85% consumed at home. You can't do export without doing the domestic market'.¹³⁵

133 UNDP/CRRC Research Team interview with Nana Berdzenishvili, CHF Central Georgia Regional Coordinator (29th August 2007).

134 UNDP/CRRC Research Team interview with Nana Berdzenishvili, CHF Central Georgia Regional Coordinator (29th August 2007).

135 UNDP/CRRC Research Team interview with, Richard Hurelbrink, Director of AgVantage (20th August 2007).

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Particularly in terms of export to Armenia, almost no-one we spoke saw this as an avenue for significant growth in the region. As Patrick Sommerville from CHF explained, ‘encouraging trade with Armenia is a blind alley, the big prospect for the region is that it might become a regional packing and processing location for transport of goods to Turkey’.¹³⁶ One obvious reason why there are so few opportunities is the similarity of products and their prices across the two regions.

Price Comparison for Commonly Produced Goods and Basic Inputs 2007

Product	Price in Akhalkalaki	Price in Gyumri
	June 2007	June 2007
	1USD=343.25 Dram	1USD=1.67 Lari
Potatoes (per kg)	0.5-0.6	0.80 – 1.20
Tomatoes (per kg)	1.5 (Turkish)	1 - 1.5
Apples (per kg)	1.5 (Turkish)	1.7 – 2
Cheese (per kg)	4.2-4.8	3 - 4.5
Beef (per kg)	3.6-4.2	4.5 – 5
Electricity (KwH)	0.08-0.1	0.07
Manual labour (weeding)	6-7	\$5.90 per day
Land	162 (newly privatizing)	600-700 per hectare
Rent	4.80	8-10 per hectare

Source: UNDP Research Team Field Researchers in Akhalkalaki and Gyumri June 2007

Where goods have major price differentials, this will clearly create incentives for trade. Equally, if inputs are significantly different, then it will create incentives for production to take place in a particular location. For example, if gas or electricity prices were far higher in one place then production needed heated green-houses or production needing intensive refrigeration might favour one region.

Prices are similar in most of the products surveyed.¹³⁷ The one significant price differential is in potatoes which are 80-100% more expensive in Gyumri than Ninotsminda in our brief survey. In addition, it is worth noting that if there is significant increase in productivity (as suggested by the analysis above), then we can expect there to be some reduction in the prices listed here for Georgia, which are historically high

136 UNDP/CRRC Research Team interview with Patrick Sommerville, CHF (30th May 2007) and with Shalva Dalalishvili, Deputy of Akhaltsikhe Gamgebeli (4th June 2007).

137 As already stated, these prices are based upon one comparison between two markets on one date. It is intended to be suggestive and need not necessarily reflect major trends. Further cross-market research would have to be done to identify where true comparative advantage exists in the two regions.

anyway. As a result, one would expect the pressure to export potatoes into Armenia from Georgia would increase.¹³⁸

A connected field where increased productivity is already leading to an increase in exports from the region is seed potatoes. The few Armenian potato producers we interviewed in Gyumri had purchased their potato seeds in Georgia this year, since Armenia prices were high.¹³⁹ In the past, according to Georgian farmers we spoke to, this had worked the other way around.¹⁴⁰ Given the existing trade and the rapid increases in Georgian productivity in this area, it certainly seems like an area that might be worth targeting in terms of trade between the two regions. However, investigation is necessary before this is done because it is entirely possible that the seed that has been imported by AgVantage, USDA, Mercy Corps and CARE may be creating market distortions, allowing Georgians to currently sell their seed at an unsustainably low level.

Another alternative that has been suggested to stimulate trade is collective processing. The idea is that opportunities might exist for transferring inputs into Georgia, which would then be processed, perhaps along with Georgian inputs, for the Georgian or export markets. This is an interesting idea, particularly given Georgia's location, the new infrastructure and Turkish attitudes towards Armenian goods. However, it will probably not work in any goods that Samtskhe-Javakheti already produces in large volumes (for example cheese, potatoes or meat) since currently increasing productivity will probably mean that local inputs can provide any new processors for the time being. Added to this, given the inevitable hassles of importing inputs (even in a significantly improved regime), Armenia is only likely to persuade producers to look outside the Georgian market for inputs if it has a particularly convincing value-adding case.

Even if there are not major differences in prices, this does not rule out the possibility of some trade taking place. For a start, like a lot of agricultural trade, seasonality differs and this allows goods to be traded over the border if they grow earlier in one place than another. Quality of harvest may also differ so that if the Armenians have a bad potato harvest then Georgia is likely to export to Armenia and if Armenia has a bad harvest then the reverse will happen. Also, as Julie Burch from Mercy Corps points out, 'the cultural connections encourage trade. Farmers from Samtskhe-Javakheti may be more familiar and comfortable with Armenian breeds of animals than they are with Georgian and so they may want to trade with them. This happened to us when we were buying pigs for breeders in Akhaltsikhe'.¹⁴¹

138 Of course, this is largely speculative and is not based on a detailed understanding of the historic comparisons between the two countries. Clearly, this price differential might be an aberration, but we know that Georgian prices are historically high.

139 Our interviewer spoke to ten farmers in one impromptu focus group. UNDP/CRRC Research Team Interview, Shirak, (10th July 2007)

140 UNDP/CRRC Research Team interview with potato farmers, Akhalkalaki (11th May 2007).

141 UNDP Research Group interview with Julie Burch, Regional Representative for the Caucasus, Mercy Corps (23rd August 2007).

CHF, which has also been engaged in regional agriculture development, feel that in the past Samtskhe-Javakheti has been so keen to trade with Armenia that it has disadvantaged local farmers. As Central Georgia Regional Coordinator, Nana Berdzenishvili states,

Our experience is that our people would far rather sell their stuff to Armenia or locally but they have been losing a lot of money by not selling to local markets [markets in Georgia but outside Samtskhe-Javakheti].¹⁴²

Therefore, even though there are few markets where we can, at this time, make a clear and unequivocal case for cross-border opportunities, it is clear that there remains motivation to look for them. And particularly if UNDP is able to encourage both Governments to make trade easier, and offer some support in terms of information provision, it is this good-will and cultural connection that could, more than anything, maintain the likelihood of cross-border trade growth in the future.

Conclusion

While national statistics are unlikely to provide us with many insights for likely areas of cross-border trade, a clear understanding of the differences in the two markets will. This analysis was focused on the Georgian side of the border, so its conclusions are partial. If similar research could be undertaken in Armenia, then the results would be far more powerful.¹⁴³

The discussion of the market in Samtskhe-Javakheti was a clearly partial start. The focus on agribusiness is a common and understandable focus for developmental organisations, particularly in a country like Georgia and a region like Samtskhe-Javakheti where agriculture remains the largest employer. Significant infrastructure problems have existed in the region making productive development and access to markets difficult or impossible. Many of these problems are being corrected with the help of international donors.

These efforts will open up opportunities in a wide range of areas, and, while potato is the one example where our research seemed to suggest a comparative advantage (on both seed and eating potatoes), there are almost certainly others.

Since trade is dependent on differentials in price, developments which increase productivities and allow farmers to specialise will encourage it. Our tentative research suggested that potatoes are a potentially lucrative market and meat already is one. However, getting farmers to capitalise on their advantages continues to be a challenge.

142 UNDP/CRRC Research Team interview with Nana Berdzenishvili, CHF Central Georgia Regional Coordinator (29th August 2007).

143 While the Armenia UNDP Research Team offered an analysis of the available statistical information on structures of production in Armenia, without an analysis of comparative costs and prices it is hard to establish where opportunities might exist.

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Consensus seems to exist amongst observers, even if it is not recognised by the traders themselves, that a lack of commercial orientation is likely to continue making development difficult. Some international organizations are working on this, but the coverage is still patchy.

In addition to general market planning, two areas could particularly help development and trade with the neighbouring region. First, any business advisory service should specifically help farmers who want to export to Armenia or Turkey deal with the difficulties of this process. Second, it should work to help local producers connect to other international donors by identifying the sources of funds and facilitating the development of business plans. There is no shortage of money for development work in Samtskhe-Javakheti, improving the way it is spent would probably be the biggest added value of all.

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Appendix 1 Delay times for Armenian exporters at the Ninotsminda border

	Export formalities at Armenian customs	Border formalities in Armenia	Border formalities in Georgia	Customs formalities in Georgia	Total border crossing time (both sides)	Comments
Goods are Free of Charge	20 minutes	10 minutes	10 minutes	20 minutes	1 hour	
Customs Value < 700 GEL	20 minutes	10 minutes	10 minutes	Min 3 hours. (payment in Ninotsminda)	3 hours 40 min. (Minimum)	The owner of the goods is obliged to make payment of customs duties in Ninotsminda (20km) and come back (this time does not includes the time caused by obstacles mentioned in the report)
Customs Value > 700 GEL	20 minutes	10 minutes	10 minutes	From 1 day to 2 days.	From 1 day to two days	Georgian customs procedure starts at the border and finishes at the customs terminal (nearest – Vale Customs clearance depot). See relevant Chapter

Source: UNDP Research Team Field Research at the Ninotsminda Border (30th June to 14th July 2007)

Appendix 2a Agricultural Profit and Loss Estimations (Akhalkalaki)

Income	Quantity	Unit Price	Total		
Harvest	25000				80% farmers plant between .3-1.5 hectares of potato
Price GEL	0.6				20% farmers plant 1.5-more hectares
				15000	
Costs (per hectare)					
Seed	3500	1.5	5250		
Plough		Autumn	125		
		Spring	125		
Cultivation	2	100	200		
Harrowing	3	50	150		
Sowing			100		
chemical fertiliser			250		
chemical treatment/pesticides	85	3.5	297.5		
Herbicide			274		
Hilling			110		
irrigation 2	2	185	370		cost of getting the water 1t 150 and 35 for labour
Harvest			525		cost of tractor - 125 and people are 13.3 for one tonne
Transportation	8	30	240		
sorting of potato	8	30	240		
				8256.5	
Total income per year				6743.5	

There are about 50 people with more than 10 hectares but about 80% in this region sow approximately one hectare
Source UNDP Research Interview with UNDP Agronomist, Akhalkalaki, 31 September 2007

Appendix 2b: Potato Production (Akhaltzikhe)

Income (per hectare)	Volume	Price (EEL)	Total	
Harvest	25000	0.6	15000	Volume also can vary enormously and this volume assumes the best use of fertilisers with good seeds and technology.
				Prices can vary. In 2000-2005 0.35 lari, in 2006 0.7 (because a low harvest). The price is also an estimated average of the cost of seed potatoes (the most expensive), eating potatoes (mid-range) and potatoes for cattle.
Total revenue				15000
Costs (per hectare)				
Seed	3000	1.2	3600	Seed can cost between 1-2.5 lari depending on quality. The most expensive seed is only really appropriate for seed multiplication processes. The seed was 2.2 last year. This is based on b-class potatoes.
Plough			120	The hiring of technology from the village tractor owner
cultivation and plant			400	This includes farmers labour, hired labour. Seasonality and availability. Unit price is highly variable
Fertilisers and pesticides			700	Tre-planting
seed transport to plot			20	
chemical treatment			150	Tost planting fungicides
Irrigation	2	150	300	The irrigation at altitude requires pumping and so there is the need to have the irrigation agreed upon within the community.
Harvest			600	
Transportation			50	
sorting of the seeds				This is mainly done by the household
Total costs				5940
Total profit per year				9060
Average farmer has 1/2 hectare potato land				4530

Given the variability of the revenue it is worth considering how variations will affect the cost.

At this volume of production the break-even sale price is 24 tetri.

At this sales price, break-even production is 8485kg

Appendix 3: Meat Production Akhaltsikhe

Most meat production is the fattening of winter raised calves in summer pasture. Bought March-May and sold in October. 2/3 people per village so 300 per municipality. 10 cows to a buyer

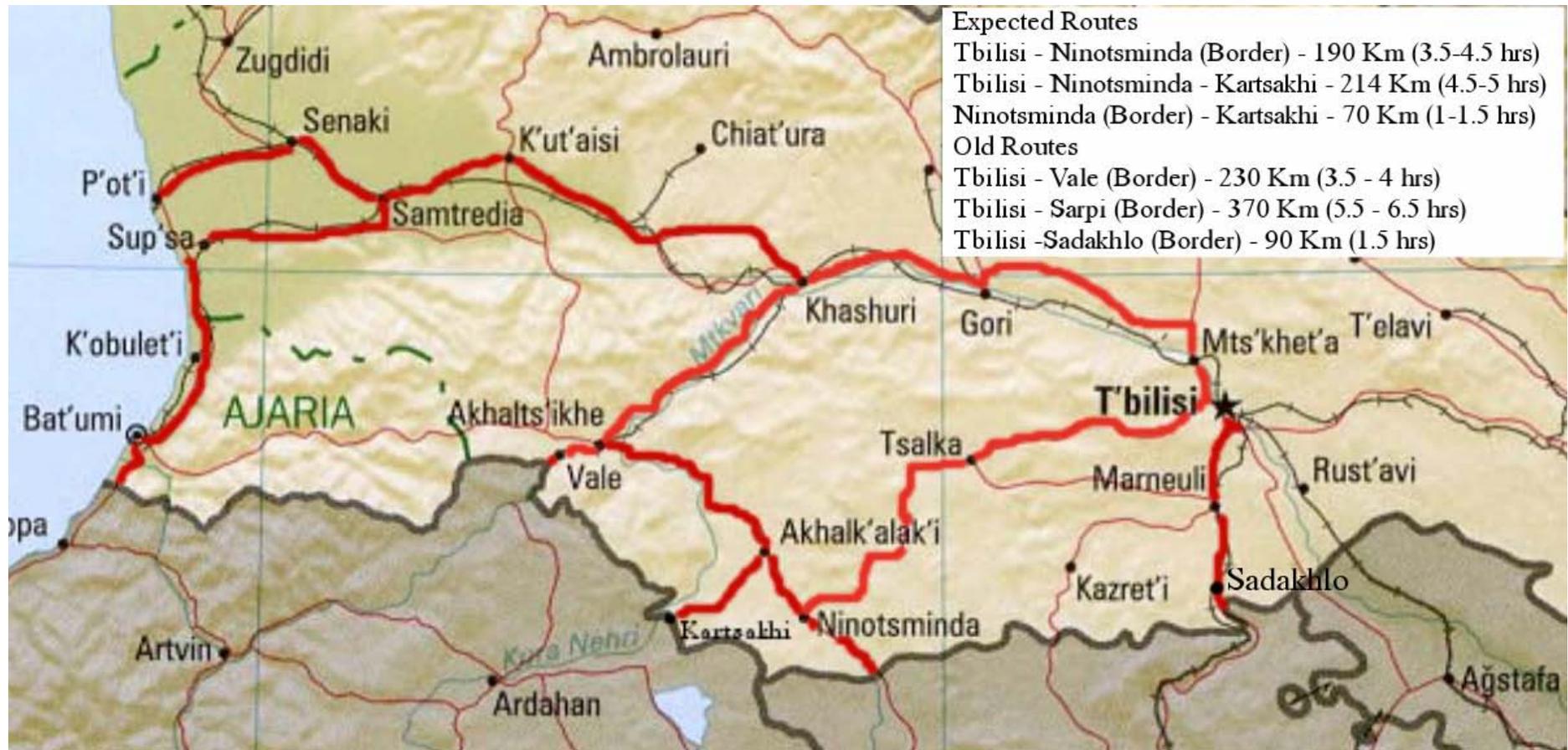
Profit and Loss Estimate						
October sales price		10	450		4500	
Purchase Price		10	250	2500		this can be purchased for credit at Constanta at 18% but most people will use there own money.
	Hayland	4	2	8		2/3 cows per hectare
	Veterinary			100		
	Shepherd	5	8	40		5 lari per month for 8 months
Total costs					2648	
Total profit					1852	

Appendix 4: Small Milk Production in Akhaltsikhe

Income

Cheese (110 kg and 3.5 GEL)	385		Almost all milk is made into cheese or sold for cheese. 800/1200 liters of milk per year and 7/8 litres per kg of cheese
Calves (sold after one month)	100		this might be low, since some calves kept to replace cows and some wintered for spring sale.
Total income		485	
Costs			
Winter feed	180		60 bales for the winter (150 days) at average of 3 lari per bail (4 to buy and 2 if collected oneself)
Shepherd	35		
Veterinary	12		average cost of 3 GEL per bale
Total costs		227	5 lari per cow per month - 7 months)
Total income one cow		258	
Total income three cows		774	

Appendix 5: Map of the south of Georgia showing main transit routes from Armenia



Source: Based on a map found at the University of Austen, Texas, Map Collection, Sept 2007
http://www.lib.utexas.edu/maps/commonwealth/georgia_rel99.jpg



Appendix 6: Map of Armenia showing main transit routes through Ninotsminda and Sadakhlo

Source: Based on a map found at the University of Austen, Texas, Map Collection, Sept 2007
http://www.lib.utexas.edu/maps/commonwealth/georgia_rel99.jpg

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Source: Based on a map found at the University of Austen, Texas, Map Collection, Sept 2007 http://www.lib.utexas.edu/maps/commonwealth/georgia_rel99.jpg