

## B/ORDERS AND ECONOMIC INTEGRATION PREFERENCES: THE CASE OF GEORGIA

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### Abstract

*B/orders are multidimensional phenomena studied by various social disciplines. In the present paper b/orders are dealt with in cross-country economic cooperation context. Post-Soviet space is one of the most interesting cases for b/order studies, because of the complex re-territorialization processes that have taken place there since 1990s along with deep economic and political transformations.*

*In Georgia b/ordering processes are affected by country-specific features (such as small size, geopolitical characteristics) and general region-wide forces (its strong European integration aspirations, Russia's dominant role in the region). The analysis of the formal institutional basis for Georgia's cooperation with these important economic partners and the dynamics of economic activities (cross-border flows of goods and production factors) enable to assess the role of b/orders, recent developments in b/ordering and their economic consequences.*

*The research shows that in Georgia b/orders are under the influence of alternative external economic integration forces (from EU and Russia) and the process of internalization of the external influences by the private agents and the government, as well as their readiness, involvement and cooperation during b/order related reforms.*

**Keywords:** *b/orders, European integration, institutions, economic cooperation*

**JEL Classification:** *F15*

### I. INTRODUCTION

According to the famous border scholar, Paasi borders and boundaries are context-dependent, therefore contextual approach is inevitable in research (Paasi, 2005). Border studies based on cases help to better understand social meaning, functions and construction of borders in a concrete economic and political space. Post-Soviet space is one of the most interesting cases of bordering due to complex re-territorialization processes that have taken place there since 1990s, along with deep transformations of economic and political systems.

In our analysis the understanding of b/orders go beyond the geographical limites of states and involve construction of borders through various social practices carried out by state and non-state agents. The term „b/order“ covers the institutional nature of borders and the endless process of inclusion and exclusion through the institutions.

Borders and b/ordering practices are involved in the debates about the role and position of EU in its eastern neighborhood, and the role of Russia as the main regional player. These debates involve issues like trade cooperation, energy and economic security, political and social changes and ultimately affect the way b/orders are conceived, re-considered and re-interpreted. At present Georgia's political and economic reality is formed under the influence of strong geopolitical forces such as Euro-Atlantic aspirations of the country, mutual border with Russia, existence of conflict regions in its territory, etc.

There are state-centric and post-modern philosophy traditions in border theory (Kolossov, 2010). The first approach considers borders the essential element of states and international order, while the latter is mainly focused on borders as social constructs and man-made institutions. These theoretical models are applied to the Georgian case, by analyzing both the role of government in determining economic integration goals and the interplay of formal and informal institutions that shape the framework conditions for economic integration.

B/ordering process is affected by the possible conflict between the desired economic integration directions. All else equal, economic cooperation on transparent and non-discriminatory basis is beneficial for any country. Cross border economic cooperation among states is not a zero-sum game and each participant can gain from it, therefore from pure economic perspective Georgia's economic cooperation with EU on the one hand and with Russia on the other are not mutually exclusive. The same is declared by the national security concept of Georgia. Despite this these two directions of economic integration are very often discussed (mainly by political scientists) as conflicting. Some of the explanations of why Georgia's choice of European integration inherently implies conflict with Russia (Kakachia&Minesashvili, 2015) are: unacceptability of social, and hence, the economic model of Russia; Russia's power in Post-Soviet space and efforts to maintain it; regulatory competition between EU and Russia in the fields, where incompatibility of interests is prominent (Buzogany, 2015); discrepancy in the EU and Russian approaches towards regional security in their neighborhoods (Delcour,

2011). Whatever the reasons behind the incompatibility of interests, the consequences are inevitably related to b/orders in terms of either direct conflicts or differences in rules and institutions, what hinders flows of goods, people and information.

The analyses of the formal institutional basis for Georgia's cooperation with EU on the one hand and Russia on the other and the dynamics of economic activities (cross-border flows of goods and production factors) enables to assess the role of b/orders, recent developments in b/ordering and their economic consequences. The paper is organized as follows: first we discuss some theoretical background for the role of b/orders in economic integration; then we analyze b/orders in the context of Georgia's economic cooperation with the EU taking into consideration both external and internal drivers of changes; the third section deals with b/order dynamics determined by the mix of conflict and cooperation with Russia.

## **II. B/ORDERS IN INTERNATIONAL ECONOMIC COOPERATION: THEORETICAL BACKGROUND**

It is widely accepted that borders create (or reflect) difference and constitute the separation line between states and geographical spaces (Newman, 2006), or groups of people. The simplest understanding of borders is how they make distinctions among countries, separating internal economic systems or environments from the external ones. Economic integration is a strong mechanism to overcome various forms of separation and reduce border-related barriers and uncertainty, but at the same time b/ordering based on the principles of economic integration is highly selective. Open border today are not universal, rather they are permeable with regard to only certain flows and transactions or certain countries and regions. For example, developed countries do not welcome inflows of unqualified labor force, but are more open for high-skilled labor. Today „selective openness“ is an accepted form of interaction between national borders and global flows of goods and production factors. Because of the selective nature of borders economic integrations and even those at the highest level of development are incomplete. Historically within EC internal market was hindered by nuisance barriers to trade supplemented by differences in regulations and more subtle government policies that discriminated in favour of national products (Krugman, 1991) and contemporary preferential trade agreements (PTAs) give even stronger evidence for selectivity. The differentiation and filtering functions of borders come to the forefront within PTAs as they discriminate against non-member states (Jamagidze, 2016). Rules of origin have the central role in identifying goods that come from the countries eligible to preferential treatment. Policy differences and institutional heterogeneity hinder economic integration. They further accentuate the significance of borders as differences and create specific forms of exclusion and inclusion. Therefore countries within PTAs can achieve deep integration only by removing “behind-the-border” barriers. Thus harmonization of economic policies and institutions is also highly selective around the world. Under the circumstances borders gain new roles and functions. They should provide effective connections and help states to mediate between national markets and global and regional markets, as well as national policy-making and global and regional rules.

Since gaining independence and expression of its desire to control its borders on its own, economic border redefinition has been an important objective in Georgia. It has been affected by the state's economic policy choices (internal driver) and regional economic integration forces (external determinants). The latter can be discussed in two main context: 1) developed within regional integration and 2) developed on bi-lateral basis.

Regional integration in Post-Soviet space has had little success so far and therefore little influence on b/ordering practices. In 1990s several groupings were formed, such as CIS, BSEC, GUAM but they could not eliminate barrier role of borders even in trade among member states as the agreements did not cover trade in services and contained provisions on contingent protection measures and other restrictions applied by parties unilaterally. Today Georgia's foreign economic ties are managed more on bi-lateral rather than on regionally integrated basis. As the country was in need of greater openness to the external world, access to technologies, capital and other resources and the regional blocks mentioned could not offer it sufficient degree of openness, cooperation and diversification, European integration became the key instrument of managing external dependencies.

## **III. B/ORDERS IN THE CONTEXT OF GEORGIA'S ECONOMIC COOPERATION WITH THE EU**

EU not only creates and establishes its rules, institutions and governance system inside it, but also exports these institutions outside its external borders (Shimmelfennig, 2009; Boerzel, 2010). The process of Europeanization is based on the general EU principles of market economy and liberal democracy, which are exported to the neighboring countries. However in the neighboring region and in Georgia too Europeanization is selective and bounded in the sense that it does not lead to membership, rather it represents the alternative to membership. External governance of EU to avoid “new dividing lines” (EU Commission, 2003), together with Georgia's internal willingness to reform affects b/orders by transforming their functions. The accession process, participation in neighborhood policy and in Association agreements involves transformation of economic and political institutions so as to achieve greater convergence with EU. Since its start in 1992 Georgia-EU

cooperation has been developed step by step and involved trade facilitation as well as deeper institutional reforms. The most important recent developments were conclusion of The Association agreement and the positive decision on Visa liberalization (Figure 1).

**Table 1 - Short Chronology of Georgia-EU Cooperation**

1992	Recognition of Georgia's independence and start of cooperation
1995	GSP conferred to Georgia
1999	Partnership and Cooperation Agreement enters into force
2003	Appointment of EU Special Representative for the South Caucasus
2004	Georgia is included in European Neighborhood Policy
2005	GSP+ conferred
2008	Creation of EUMM; Geneva Negotiation Format launched;
2010	The Agreement on Unified Airspace between the EU and its Member Countries was concluded on December 2, 2010 in Brussels between Georgia and the EU.
2011	The Visa Facilitation and Readmission Agreements between Georgia and the EU entered into force on March 1, 2011.
2011	The Agreement on the Protection of Geographical Indications of Agricultural Products and Foodstuffs was concluded between Georgia and the EU on July 14, 2011 and entered into force on April 1, 2012.
2012	Dialogue on Visa free Mobility launched
2013	Association Agreement and DCFTA initialed at Vilnius Summit
2014	Association Agreement and DCFTA ratified
2015	Positive report on Visa liberalization published

Source: Office of the State Minister of Georgia on European and Euro-Atlantic Integration

In political discourse as well as in public debates European integration is always considered the only unquestionable path of economic development. It is also discussed in identity context. As declared by Georgia's National Security Strategy, European aspirations are based on the unity of national values. "...fundamental national values are rooted in European values and traditions... Georgia aspires to achieve full-fledged integration into Europe's political, economic and security systems... „Georgia aspires to return to its European tradition and remains an integral part of Europe” (National Security Concept of Georgia). Obviously, Georgia strives to identify itself as the part of European space, what can be interpreted as a manifestation of its expectations for full integration in the future. We can say that this path was also expressed in the everyday process of b/ordering through ideology, symbols and institutions that have been explicitly directed at reducing the divide between EU and Georgia (for example, use of EU flag along with national symbols in every public agencies in Georgia).

At the same time European orientation was regarded the only context in which realization of Georgia's geopolitical functions could be possible. In general the geopolitical dimension is one of the most significant in Georgia's national b/order construction. Georgia is the only country among eight South Caucasian and Central Asian countries with direct entrance into the world Ocean. It represents the most suitable transit country for the transportation of the Caspian basin oil and natural gas to Europe. Georgia is at the intersection of Russia-Georgia-Armenia-Iran-Arabian and Europe-Georgia-Azerbaijan-Central Asia-China routes (Bondyrev et al, 2015). At the same time Georgia has got common border with Russia, South Caucasus countries and Turkey what strengthens its central role in the region. From this point of view Georgia represents a certain divide, watershed or border between North and South, on the one hand and between West and East, on the other. Historically it was the place of meeting and space of contact of diverse cultures, people and trade flows. This function was lost during Soviet times, and was brought high on economic development agenda after gaining the independence. Now Georgia's geopolitical reality represents an opportunity for establishing intensive economic cooperation among diverse economic agents from West and East or from North and South. This function is especially important for the movement of energy commodities.

Geopolitical location is a strong supportive factor to become an economic and transportation hub, but there are political, commercial and technical barriers, as well as conflict of interests which have an adverse affect on full realization of this potential. Very often the North-South and East-West transport corridors are considered as contradictory, because of Russian factor. Pro-Western politicians and experts regard Georgia's participation in North-South projects detrimental to its energy security and the European integration path. Although Georgia as a small country with scarce market and resources has little to offer EU economically, but it can perform the

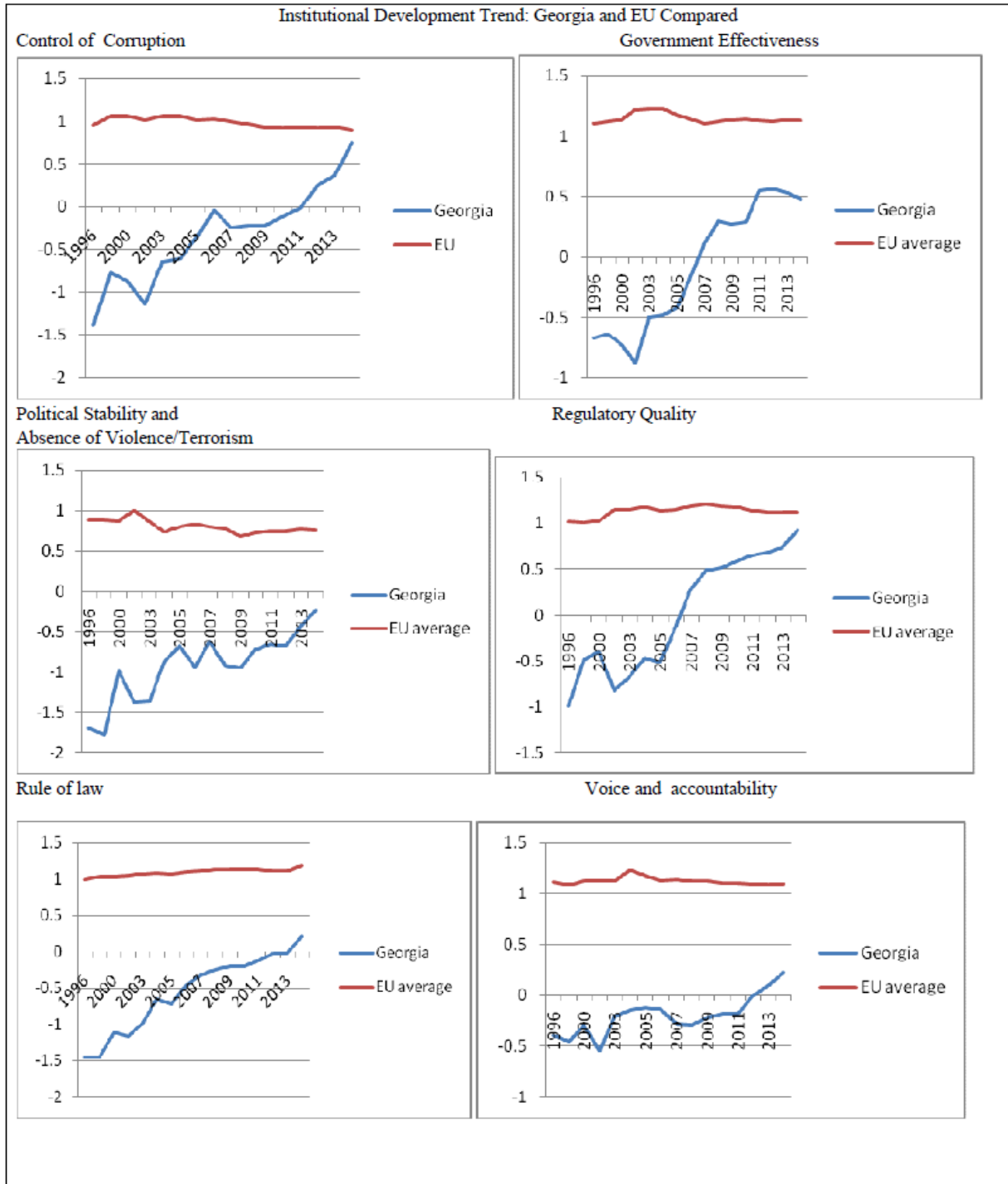
bridging and communication function in EU's access to Caspian Basin resources and Asian markets (Meister, 2010). Conflicts in South Caucasus region extremely weaken this function borders. EU supported transportation projects (such as TRACECA, INOGATE) enable the participants to enhance their capacities to access world markets through alternative routes and encourages deeper regional integration. Since 1993 Georgia has participated in 28 technical support programs and 7 investment programs within TRACECA with total budget of 25 million Euros and benefited from 36 INOGATE projects.

The most important b/ordering instrument is ENP in which Georgia was included in 2004. It aimed at phasing down the political, security, economic and cultural demarcation lines through increased cooperation between the enlarged Europe and its neighbors. ENP and later Eastern enlargement were to avoid new dividing lines in Europe by promoting stability and prosperity within and beyond the Union's old and new borders (EU Commission, 2003). They also promoted to export EU institutions and values, enhance specific reforms (trade facilitation, export promotion) and create grounds for DCFTA.

ENP as a tool to export internal institutions and practices from EU to Georgia can be characterized a b/ordering process which brought new dimensions in Georgia's social and institutional development. Sectoral reforms undertaken within EPN framework and steps taken towards legislation convergence with EU *acquis* diminish institutional distance with EU, and hence the barrier function of border. But at the same time because it was offered as an alternative of membership, it further emphasizes the difference between member and non-member states (Scott, 2009). EU enlargements brought the borders of the EU closer to Georgia and other former Soviet countries. These changes (decrease in physical and institutional distance) are supportive factors for more intense economic cooperation.

Taken together neighborhood countries represent a large adjacent market for the EU and reduction of social contrasts around the external borders is also major concern for the EU. From the perspective of its influence on borders, ENP and later DCFTA help the country to overcome barrier function and enhance the bridging function of borders, by offering conditional preferential economic and political relations in exchange of the recipient countries' adherence to the ENP principles. In particular, the EU pursues tailor-made agreements and conditions aiming at bringing the EU neighbors gradually closer to the Single Market. Under DCFTA three out of four freedoms on are realized and goods, services and capital will move freely between Georgia and the European Union. Georgia and the EU will eliminate duties on 100% and 99.9% (in trade value), respectively, of their imports from the other party. For industrial goods, the DCFTA involves the immediate removal of import duties on both sides. Trade in agricultural products will be also fully and immediately liberalized with minor exceptions (EU-Georgia DCFTA Reading Guide).

However, elimination of barriers directly related to border-crossing will not automatically remove all barrier functions of the borders. Progressive liberalization of trade and further reforms in the areas of competitiveness, enforcing investors' protection, strengthening the role of small local producers, raising production standards and consumers' safety are still at the agenda. Georgia has to implement over 320 directives and regulations in the next few years, effectively restructuring the economy (Kapanadze, 2014). EU provided substantial assistance to Georgia which has significantly increased in the period 2014-2017, with up to €410 million available to support the political, legal and economic reforms envisaged in the Association Agreement (EU-Georgia Trade Insight, 2015).



**Figure 1 \_ Variable Trend in 1996-2013**

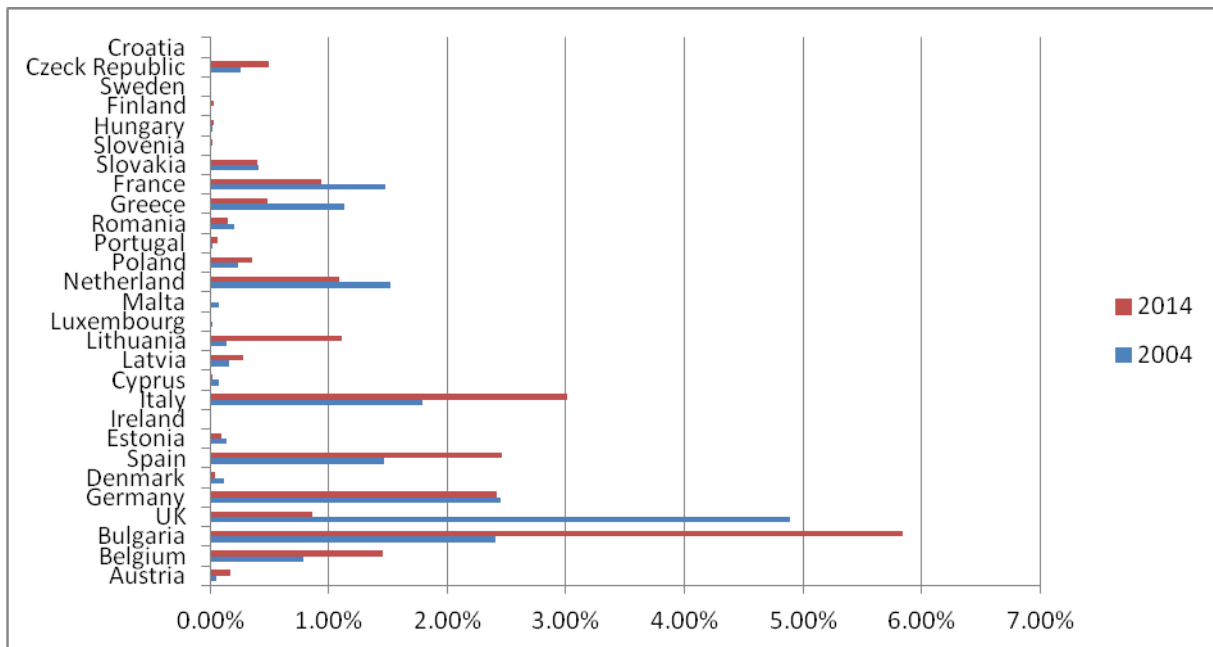
*Source: Worldwide Governance Indicators*

Greater permeability of borders requires that reforms go beyond tariff and non-tariff liberalization and cover specific trade facilitation measures. At present experts argue that effective bi-lateral cooperation is needed in the areas of technical regulations, metrology, market surveillance, accreditation, conformity assessment procedures, food safety standards, customs procedures, rules of origin, anti-circumvention mechanisms and other technical areas which are related to the movement of cross-border flows of goods and services. Thus, the realization of bridging function of borders depend on progress in harmonization of not only trade-related institutions, regulations and practices and but also the reduction of the institutional distance in a broader sense by means of policy convergence.

Georgia is taking costly and difficult steps towards greater harmonization with EU. Actually the comparison of institutional development levels between EU and Georgia shows convergence trend (figure 1).

At macro level this leads to improved business environment, less uncertainty and lower transaction costs, while at micro and industrial level it may create additional dividing lines between those who gain access to large EU market and those who cannot modernize themselves and adequately respond to the EU regulations and standards. This may lead to trade re-orientation from EU. Thus the b/ordering mechanisms can create differential effects in terms of opportunities for economic agents in Georgia. Expected benefits/costs may create grounds for mobilization of interests and affect the adherence to the agreed policy path. The example can be EU competition policy, which creates externalities outside EU and pertain all firms interested in EU market (Lavenex & Schimmelfennig, 2009).

Georgia exports mainly labor-intensive and resource-based commodities, and there is little improvement in the structure of trade over time. For instance, EU imports of services from Georgia equals 0,2 billion euro through 2010-2013, and exports has increased inconsiderably from 0,3 billion in 2010 to 0,4 in 2013. If the overall EU-level bilateral trade with Georgia is compared with bilateral trade with other countries EU is Georgia’s largest trade partner. Such an approach is used by most experts and state agencies when analyzing the trade data. The reason behind is that trade flows which enter any EU country is subject to common treatment. Such a common treatment does not exist with other trade partners and regulation is carried out on bilateral basis. However if we disaggregate total trade data at the country level, we will see, that leading positions are taken by non-EU countries. The geographical orientation of trade, measured by the share of Georgia’s exports to an EU country in Georgia’s total exports shows an uneven development of trade ties.



**Figure 2 - Shares of Georgia’s exports to an EU country in Georgia’s total exports**  
 Source: Author’s calculations based on the data obtained from [www.geostat.ge](http://www.geostat.ge)

Only Bulgaria appears among top ten trade partners during 2004-2014 and only a few of export destination countries reach 3% share in Georgia’s total export. And if discussed at the regional level, CIS region is the leading in Georgia’s total trade turnover. EU’s share is stable, as it has not increased during the last five years. In exports EU is the second largest export partner taking 30% share. The first place as an export partner is occupied by CIS region with 36%. Obviously the geographical proximity with this region as well as historically established trade and economic ties play an important role here.

A generalized evaluation given in most Official Statistical Reports, expert evaluations and official documents is the emphasis on EU, as Georgia’s first trade partner. They are manifestations of „emotional b/ordering“, related to the desirability of more intensive trade relations with the EU, as well as attempts at homogenization of attitudes through public opinion formation about EU as a leading trade partner. The comparison of Georgia-EU trade data with those of other neighboring countries shows that Georgia is still less important trade partner for the EU, as it takes share of 0,1% in EU’s total trade and ranks as 76th trade partner, compared with Azerbaijan 35th rank, Ukraine \_ 25th and Moldova – 68<sup>th</sup> (EU Commission Trade Portal). The economic capacity of Georgia should adequately respond to the institutional arrangements for greater border permeability with EU as low level of economic interdependence affects it adversely.

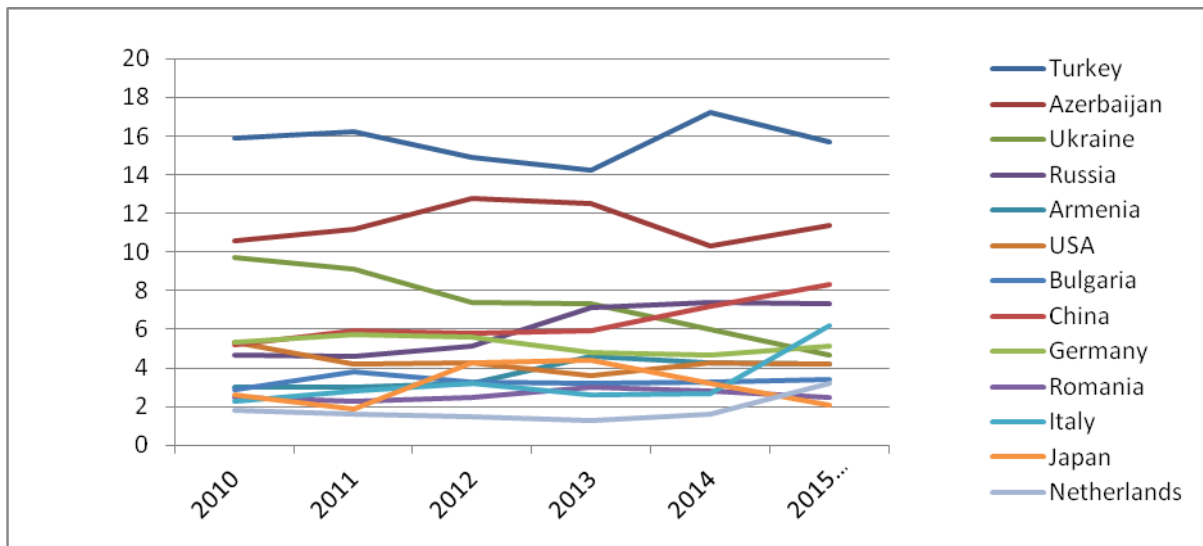
**IV. B/ORDER DYNAMICS IN CONFLICT AND COOPERATION WITH RUSSIA**

From external drivers of b/order permeability point of view Russia can be considered an alternative source of institutions. Its competition with EU as well as its influence on economic integration preferences of the national agents and interest groups is important. Because border related policy is undertaken by power elites (Newman, 2003), decisions on more open or more closed borders significantly depends on the preferences of the power elites with regard to economic partners and foreign economic policy priorities. As a result of Rose Revolution the government in Georgia was formed by ostensibly pro-Western elite. The reforms undertaken involved openness towards Euro-Atlantic structures in economic, political and socio-cultural sense. These processes went in parallel to the deterioration of relations with Russia.

Currently one of the obvious characteristics of Russia-Georgia relations is political tension on the one hand and attempts at maintaining and developing economic relations on the other. The course of economic cooperation with Russia can be divided into three stages (Jamagidze, 2013): 1) the period of active cooperation (1992-2005) – open borders; 2) the period of disintegration (2006-2012) - closed borders 3) the period of re-bordering (present)

At the first stage the legal basis for bilateral cooperation was created. Georgia concluded a number of international agreements with Russia including the Agreement of the Development of Trade and Economic Relations (10.05.94); Free Trade Agreement (10.05.94); Convention on Avoiding Double Taxation (which did not enter into force). Until 2005 Russia was the main trade partner of Georgia taking about 14-% in total trade turnover.

The second stage was marked with growing political and economic tension. As a result of Russian 2006 embargo on Georgian exports and 2008 Russian-Georgian war the share of Russia in Georgia’s total trade turnover dropped considerably (from 16,3 to 3,7 %) in 2006 (Figure 3).



**Figure 3 \_ Partner's share in Georgia's Total trade turnover**

Source: [www.geostat.ge](http://www.geostat.ge)

Until 2012 Russia did not appear at all among the ten leading export partner countries of Georgia, which took 74% of total Georgian exports. In 2006 the ban was imposed on selected products notably on Georgian wine, bottled spring water and agricultural commodities—fruits, nuts and vegetables. The next step taken towards closed borders was shutting down the only legitimate border checkpoint between Georgia and Russia at Zemo Larsi and ceasing the banking transfers of the remittances by Georgian migrant workers in Russia. In October, 2006 Russia restricted all land, air, and sea communications. Permissions for flights into Russian airspace were stopped for Georgian air-companies. Because of this Russian air companies (Siberia, Aeroflot) also stopped flights to Georgia. Russia banned traffic even for those Georgian transporters, who had permissions for international logistic from ECMT (European Conference of Ministers of Transportation). Postal connections between Georgia and Russia have been revoked as well. 80 percent of the total post sent from Georgia was going through the Russian Federation. Finally, an important part of sanctions was increase in prices for Russian energy resources imported by Georgia. These sanctions forced Georgia to seek markets elsewhere, and Georgian producers took active steps towards diversification of trade geography. The Russian embargo did not have substantial negative effect on aggregate economic indicators. Georgia’s trade turnover continued to grow and its share reached 65 percent of GDP in 2012 (it was 40 percent of GDP in 2005). In contrast, Russian-Georgian war in 2008 had substantial negative effects as it raised political risks of Georgia’s business environment and the attraction of Georgia as a place to invest has been damaged.



During the years of Russian embargo and in the absence of official diplomatic relations, Georgia's economic cooperation with Russia decreased considerably, but later on there was a slight increase in trade and investment flows (Figure 4).

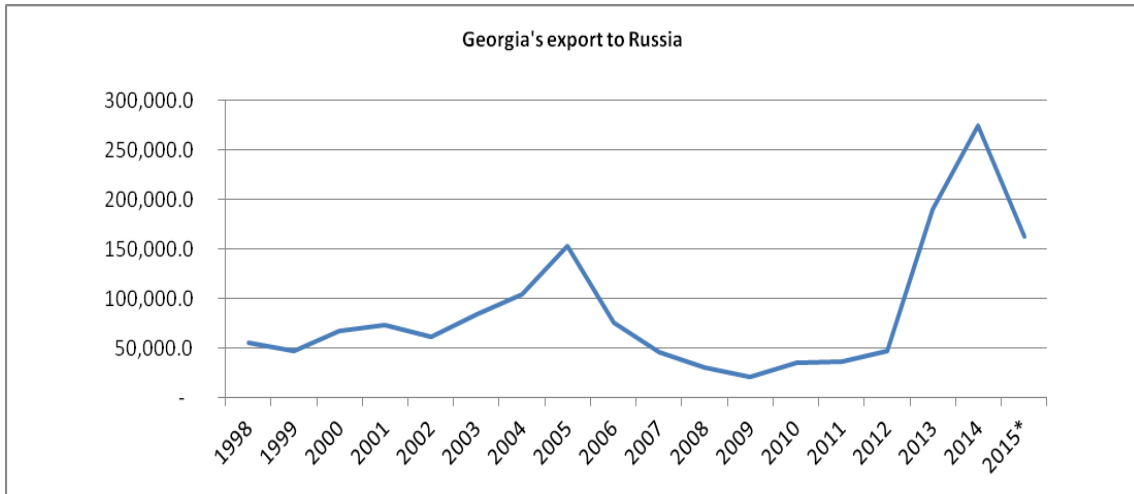


Figure 4 - Variable Trend in 1998-2015

Source: www.geostat.ge

This indicates to the existence of private actors who are interested in and have influence on the development of Georgia-Russia economic relations.

At the third stage of cooperation steps have been taken to re-establish bilateral economic cooperation. Changes in b/ordering processes may take place along with the changes of power elites. That was the case in Georgia. The new government since 2012 re-evaluated the existing b/ordering practices, what involved delinking economic and social issues from political and security ones. Georgia expressed readiness to accept more open economic borders with Russia. In December 2012 the Russian government also acknowledged that economic relations should be depoliticized. Against the background of changed political landscape in Georgia, both parties decided that it was in their economic interest to open borders. Russia has gradually reopened trade in agricultural products (notably wine) and mineral water. As a result Russia has reappeared as the fourth trade partner taking more than 7% in Georgia's total trade.

As for the other forms of economic cooperation, since 1996 Russian investments have accounted about 10 percent of Georgia's total FDI. The proportion has sharply decreased to 2 percent in 2012. That year FDI inflow in Georgia was about \$911.6 million in total, and about half of that came from the EU member states (\$440 million).

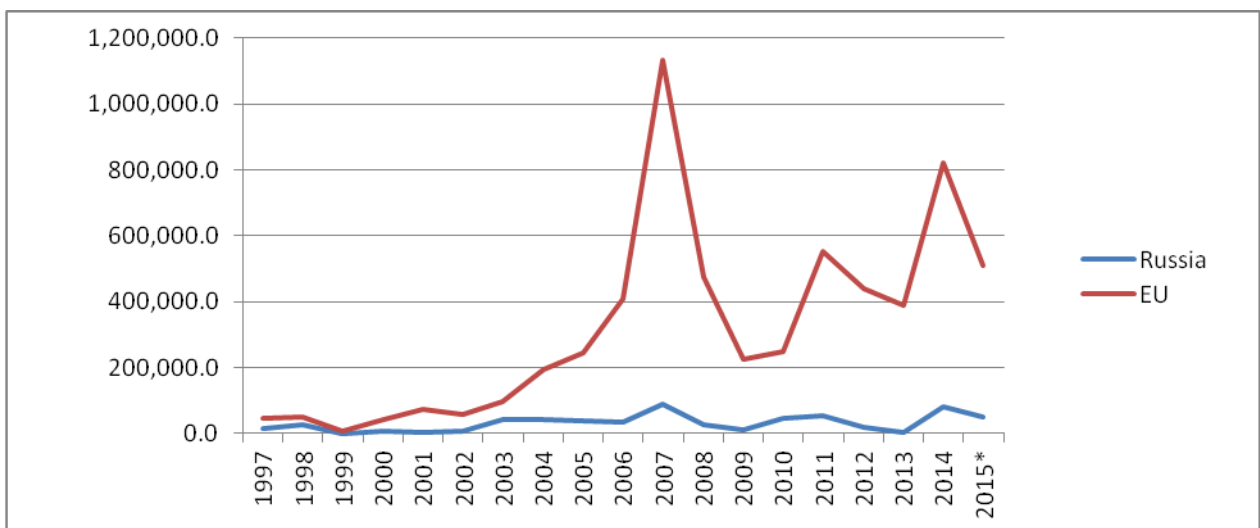


Figure 5 - Variable Trend in 1997-2015

Source: www.geostat.ge

Figure 5 compares FDI inflows from EU and Russia and illustrates that although the amount was almost the same in 1990s, now EU investors are much more active in Georgian economy.

Economic relations with Russia are under the strong influence of political decisions. This leads to the volatility in economic flows and increases the transaction costs. The critical issue with Russia is b/ordering in



political and physical-geographical sense with its serious economic consequences. Russia demarcates and to reinforces borders between Abkhazia and South Ossetia regions and the rest of Georgia which were not originally part of the breakaway regions. Russia uses two explicit types of unilateral ‘borderization’, such as passportization (giving Russian citizenship to local population) and the erection of fences. This is the case of external determination of borders using power (Scott, 2015). The fixed borders are designed to exclude interaction between two sides of the de facto boundary, not only in physical-geographical sense, but also in economic and legal sense.

Disputed borders involve huge losses in terms of human capital and financial, economic and social costs. In Georgia they create torn away parts from the internal market, which are heavily dependent on Russian economy. Russian companies are the leading economic agents and Russia is the main trade partner of Abkhazia region. Trade volume amounted 11 610 million Rubles in 2014 (Integrated Foreign Economic Information Portal of Russian Federation). South Ossetia region depends on Russia to a greater extent: 90% of imports come from Russia. The negotiated agreements with Abkhazia and South Ossetia regions on deeper economic, security and budgetary integration strengthen Russia’s control over their economic policies and make the regions even stronger dependent on Russia. These unsettled borders stand in the way of further development of economic integration and alienates Georgia from EU as it contradicts the goals of security and prosperity along its external borders. They also represent the main obstacle to Russian-Georgian normalization policy. Under the circumstances economic cooperation with Russia appears less important objective, as the main problem is that of disputed borders.

## V. CONCLUSION

Through the development of Georgia-EU cooperation b/ordering has aimed at elimination of barrier function of borders by removing trade barriers and reducing institutional and regulatory gap. It has involved use of not only economic policy measures, but also ideas, symbols and public opinion formation. The physical-geographical and the institutional distances with EU are gradually decreasing, but the economic ties are still weak. Georgia’s European course is widely approved and accepted. At the same time the process of elimination b/orders through several legislative, institutional and administrative reforms involve high transaction costs in the short run and benefits in long-term perspective.

B/ordering with Russia goes hand in hand with political conflicts. Under the circumstances borders first of all have the function of protection from external expansion. The experience of using b/ordering practices towards economic flows as a political instrument increases the uncertainty and unreliability of economic transactions with Russia and implies high transaction costs, even under the absence of direct border barriers.

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