Georgia positions itself on China's new Silk Road: relations between Tbilisi and Beijing in the light of the Belt-and-Road Initiative

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Georgia Positions Itself on China's New Silk Road

Relations between Tbilisi and Beijing in the Light of the Belt-and-Road Initiative

Franziska Smolnik

China's importance and presence in Georgia are growing. The Belt and Road Initiative, Beijing's vision of a new Silk Road, has met with active approval here – in contrast to a number of West European capitals, where the project is instead increasingly viewed with reservations or scepticism. The government in Tbilisi is carefully positioning Georgia as an essential part of the south Eurasian corridor. In order to profit from future trade flow between China and Europe, it has implemented a series of measures. In 2017, it became the first country in Eurasia to conclude a free-trade agreement with China. Large infrastructure projects are being carried out to facilitate transit. Georgia is also using formats such as the Tbilisi Belt & Road Forum to promote its location. However, whether the new Silk Road will be a purely win-win situation for the country, still remains to be seen.

In autumn 2013 the Chinese government announced its concept of a new Silk Road, which now operates under the designation of the Belt and Road Initiative (BRI). It intends to build and/or expand a multi-layered network of sea and overland routes in the coming years and decades, along which regional and supra-regional cooperation can prosper. The Initiative is less a fully worked-out foreign-policy plan, more a framework or superstructure. It also subsumes existing traffic routes and infrastructure plans. Despite its rather hazy outline – or perhaps because of it – the BRI seems to be successful in inspiring visions for the future in the southern Caucasus.

The BRI and National Development Strategies

Georgia's leadership sees China's initiative as confirmation of its own foreign-policy goal of establishing the country as a transport hub between Europe and Asia. It expects improved regional connectivity to lead to both increased transit and a marked upturn in its domestic economy. According to the government's discourse, it is above all Georgia's strategically important geographical location that predestines it as a hub: not only do its Black Sea ports offer Central Asia's landlocked countries access to European markets, but for China and the EU the route via Georgia complements

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northern Eurasian overland routes through Russia. The government in Tbilisi also foregrounds the country's political order, pointing to its democratic reforms and high level of economic liberalisation. It has sought to put itself on the map as an attractive business location through such events as the Tbilisi Belt & Road Forum, which was organised with Chinese partners in 2017 for the second time and is meant to be a "mini Davos". Associating its own development strategies with the "BRI" label is also intended to boost Georgia's image abroad.

To establish itself as a hub linking East and West, Georgia is primarily banking on two series of measures: creating a network of free-trade agreements, most recently through the agreement with China; and expanding infrastructure, in particular through the Baku–Tbilisi–Kars railway route and the deep-sea port at Anaklia. However, these measures will only take full effect in several years' time. Whilst this is in keeping with expectations in Georgia, it does make it difficult to gauge their success (or otherwise). This is reflected in the ambivalence characterising the debate in Georgia, as the author discovered in conversations in Tbilisi.

Economic and Political Objectives

In Tbilisi, close relations with China are seen as an essential factor for increasing trade flow along the southern Eurasian route and helping to realise the goal of Georgia becoming a transport hub. Georgia's vision is to act as a bridge between East and West. In this context, Georgia-China relations do not rival but complement the country's Euro-Atlantic orientation and its ongoing integration into European structures.

The Georgian leadership primarily views expanded relations with China in terms of economic gains. However, it also hopes for an important synergy effect of economic cooperation and increased economic interests, namely security guarantees and a counterweight to its neighbour to the north, Russia. Extensive Chinese economic interests in Georgia should prevent Russia from using military aggression against the country – at least that is the idea – since Moscow will take care not to endanger Chinese investments. According to local observers, Georgia's cooperation with China also sends a crucial message to Moscow that alternative markets exist – and that potential export losses from renewed Russian sanctions against Georgian products could easily be recouped.

The Development of Bilateral Economic Relations to Date

Economic cooperation between Georgia and China has developed rapidly in the past few years. There are ever more meetings between Chinese entrepreneurs and Georgian government officials and business representatives with the aim of further expanding relations. In the 1990s, the two countries' trading volume was negligible. According to Georgia's statistical agency, until 2000 annual imports from China came to under US$3 million; Georgian exports to China did not even reach US$1 million. This changed dramatically in the first decade of the new century, when trading volumes rose more than a hundredfold. This increase was primarily driven by the enormous growth in Chinese exports and underpinned by China's changed foreign policy, proclaimed by Beijing in the early 2000s under the motto "Going Out". During the late 2000s, several larger commissions for infrastructure development in Georgia, such as bypasses, tunnels and railway lines, went to Chinese companies. Trade between the countries continued to increase sharply in the following years. In 2017 Georgian exports to China amounted to over US$207 million; imports from China to Georgia were valued at over US$732 million.

However, these figures reveal not only the strong growth in bilateral trade relations. They also highlight a trade deficit on the part of Georgia, which, with its not even 4 million inhabitants, is a tiny country compared to China. There is also an imbalance in the range of traded goods. Whilst China sells a range of goods to Georgia, the latter's exports to China are not very diversified. Ores, copper and copper products predominate alongside alcoholic drinks, especially wine. In contrast to the wide portfolio of exported goods from China, little diversification exists in Chinese foreign direct investment (FDI) in Georgia. One company in particular, the Hualing Group, looms large – inter alia as operator of a duty-free industrial zone in Georgia's Kutaisi. The Hualing Group's investments pushed China's FDI to its peak of nearly US$218 million in 2014. However, the dominance of a single investment source carries with it a risk of fluctuation. Thus, in 2016 China's direct investments were only about US$26 million. In 2017, FDI increased again, though far below 2014 levels.

Free Trade with China from 2018

This is the backdrop against which Georgia's leadership judges its free-trade agreement with China, which entered into effect on 1 January 2018, to be a real success. The agreement is seen as paving the way for further development of economic relations and Georgia's future as a hub between East and West. Import duties have been removed on both sides for over 90 percent of export categories. The government in Tbilisi assumes that Georgia in particular will profit from the agreement since most imports from China were already exempted from customs duties before the agreement, a sign of the liberalisation of Georgia's economy. A feasibility study carried out in the run-up to the negotiations came to a similar conclusion. For instance, the agreement stipulates that China will remove customs duties from alcoholic drinks, including wine. Previously these were as high as 20 percent for Georgian wines. Tbilisi therefore expects this export hit to further establish itself on the Chinese market. China is already the second-biggest market for wine from Georgia, after Russia – although the total volume of bottles sold to Russia is still about six times greater.

The agreement was negotiated relatively quickly. Its advocates see this as proof of Beijing's interest in Georgia. However, sceptics – including many representatives of Georgia's business world – feel the hasty agreement reflects the asymmetry between the two economies and inadequately protects Georgia's own market against China's economic might and its affordable products. They have numerous unanswered questions, in particular how domestic production and the local workforce might profit from the agreement. One challenge for Georgia's economy is the frequently low competitiveness of local products. Despite positive dynamics, its industrial sector is neither well-developed nor productive. Georgia's stumbling block, however, continues to be its agricultural sector. The national development strategy "Georgia 2020" concedes that the country's export potential is generally low. For sceptics, these conditions will make it challenging to diversify the country's exports and therefore difficult to make extensive use of the customs exemption on Georgia's side. Furthermore, the growth of promising and export-orientated sectors of the economy often founders due to a lack of qualified labour in the country.

The Free-Trade Network as a Competitive Advantage

The free-trade agreement with China completes a whole series of comparable agreements concluded by Tbilisi. Georgia also has free-trade agreements with the CIS countries Ukraine, Belarus, Moldova, Kazakhstan, Kirgizstan, Uzbekistan and Turkmenistan; its neighbours Armenia, Azerbaijan and Turkey; the EFTA states Switzerland, Iceland, Liechtenstein and Norway; and, via the Deep and Comprehensive Free Trade Area (DCFTA), the EU member states. It also enjoys preferential trade rules within its relations with the USA, Canada and

Japan; negotiations for a free-trade agreement with India are planned.

This network of customs-exempt trade has enabled Georgia to grow its own market exponentially, according to Georgian government officials. They point out that, with existing free-trade agreements alone, the country can offer Chinese companies access to a market of more than 800 million people. This, they believe, is one of its fundamental advantages as a business location in the competition not only for transit flows from East to West but also for attracting Chinese companies to transfer production to Georgia. However, a precondition for using Georgia as an export platform for the EU market is that it fulfils or implements the DCFTA requirements on rules of origin as well as product-safety, hygiene and social standards. To date, Chinese investment focuses mostly on non-tradable goods, and investment in Georgia's export-orientated sectors is extremely low, according to two studies made in 2017 by the Georgian Foundation for Strategic and International Studies.

Expanding Infrastructure

Alongside its free-trade extension, the Georgian government is also making efforts to expand the country's road, rail and sea traffic infrastructure. Its aim is to markedly increase the attractiveness of both Georgia's location and the route from China to Europe through the southern Caucasus.

Currently, the southern route is still overshadowed by the northern routes via Russia, which handle the large majority of overland (rail) transit between China and Europe. Two infrastructure projects in particular now aim to change that: the new, or rather modernised, Baku-Tbilisi-Kars (BTK) rail link connecting the neighbouring countries of Azerbaijan, Georgia and Turkey; and the mega project at Anaklia, a deep-sea port on Georgia's Black Sea Coast, estimated to cost US$2.5 bn.

Rail Traffic: Baku–Tbilisi–Kars

Although the Baku–Tbilisi–Kars rail link was conceived, and work begun, long before BRI, it is now seen in Georgia as a central component of the southern Eurasian route. After a decade of construction and several delays, the physical infrastructure has been completed. On 30 October 2017, the line was inaugurated in Baku by the heads of state or government of Azerbaijan, Georgia, Turkey, Kazakhstan and Uzbekistan. Once the railroad has become fully operational, it is expected to be able to carry up to 17 million tonnes of freight and three million passengers annually. Currently, its capacity is still substantially below those levels, at around five million tonnes of freight and one million passengers. The first test run was carried out as long ago as December 2015 from Lianyungang, a town in northeast China, via Kazakhstan, the Caspian Sea to Azerbaijan and Georgia to Turkey – with the last leg again by ship from the Georgian port of Poti, rather than by train. The journey time of 15 days became the benchmark for those involved; in Georgia this figure was also used to herald its arrival as a competitor to the northern routes via Russia.

Despite the importance accorded to the BTK route for the southern Eurasian corridor by the initiating countries, no Chinese, European or international investors participated in its financing. From early on, actors such as the World Bank, the Asian Development Bank or the European Bank for Reconstruction and Development favoured a connection that included Armenia. Due to the conflict over Nagorno-Karabakh, however, this was not an option for Azerbaijan or Turkey – the two countries' borders with Armenia are closed. The BTK railroad was therefore sponsored by Turkey and Azerbaijan. The latter co-financed the Georgian section of the link through two loans from the state energy company, totalling approximately US$775 million. It is likely that the government in Baku also secured itself some control over the terms of use for the Georgian section. It has already announced that Armenia would only be allowed to use the BTK to transport its own freight if progress was made in the Nagorno-Karabakh conflict.

Sea Traffic: Anaklia Deep-Sea Port

Georgia plans to use the deep-sea port at Anaklia to decisively strengthen the maritime component of this southern route. The two Georgian Black Sea ports which currently handle most of the traffic are Poti and Batumi, further south. Their shortcoming is insufficient depth for container ships of the Panamax class. Freight coming from or going to Georgia therefore has to be transferred to other ships in Istanbul or Constanta (Romania), leading to delays. The deep-sea port at Anaklia is meant to remedy this.

Anaklia is viewed as a once-in-a-century project – "a new Georgia is being born", according to Prime Minister Giorgi Kvirikashvili. Its construction in several phases is projected to take the next few decades. The first operational phase is expected to start in 2020 with a capacity of 900,000 TEU (standard containers) per year – more than half of what the port at Poti can currently process.

China was initially not involved in this mega project, whose first phase of construction began in December 2017. A Georgian-Chinese consortium had submitted a bid to the government for building the deep-sea port, but the contract was ultimately awarded to a Georgian-American joint venture, to the surprise of many. The leadership in Tbilisi sees this choice not least as a confirmation of the country's Euro-Atlantic orientation and shared values with the West. As well as offering better terms, the Georgian-American concept distinguished itself by planning to employ as much Georgian labour as possible. This choice also reflects the scepticism of parts of Georgian society towards increasing Chinese commitments in the country. Many specialists and workers on infrastructure projects conducted by Chinese companies so far have come from China. This has been particularly true for projects not financed by the state and therefore less closely regulated. Georgian financial analysts argue that Chinese companies draw on Chinese employees not least because of the shortage of skilled labour in Georgia. However, the wider public tends to be critical of growing labour migration from China; fears of foreign domination increasingly play a role in Georgia's social discourse.

Although the Georgian-American bid was awarded the contract for Anaklia, Chinese commitment was welcomed from the outset to position the project within the BRI context. Since early 2018, the Chinese company Zhenhua Heavy Industries Co. (ZPMC) has been involved in the project, providing US$50 bn. It is also expected to find further source of investments for Anaklia in China.

Challenges beyond the Physical Infrastructure

Despite its optimism regarding opportunities for Chinese-Georgian cooperation, the leadership in Tbilisi is not solely banking on bilateral relations with Beijing. It is also making efforts to expand regional cooperation, for instance as part of the BTK. Its relations with Azerbaijan and Turkey are already close. Georgia cooperates with these two countries mainly economically, but increasingly also in security and military matters. Recently, there have been attempts to resuscitate the GUAM Organisation for Democracy and Economic Development, whose members are Georgia, Ukraine, Azerbaijan and Moldova. Last year, the organisation's first high-level meeting since 2008 was held under a Georgian presidency. It agreed to strengthen the economic aspects of cooperation. Georgia is also working with Ukraine, Azerbaijan, Kazakhstan and Turkey within the framework of the Trans-Caspian International Transport Route (TITR).

This multilateral approach makes sense. Transport experts believe that the southern Eurasian route suffers from a competitive disadvantage because it crosses so many countries. Another test run, also in 2015, from Xinjiang in western China to the Georgian Black-Sea port of Poti only took nine days, but by all accounts almost a third of that time was lost to administrative hurdles. To make the southern corridor truly competitive, substantial adjustments will be required in terms of prices/fees, customs, operation, and work processes – for instance when changing means of transport to cross the Caspian and Black Sea, in itself a weakness of that route compared to the entirely overland routes via Russia. Regulations in the countries involved must also be harmonised, which requires close cooperation of all stakeholders along the entire transport chain. Such is the conclusion of a study commissioned by the International Union of Railways, published in October 2017.

Georgia has already successfully implemented several reforms, for instance by introducing integrated border management and making customs clearance more efficient. However, in Georgia as well "soft" infrastructure could still be improved. Its officials rightly assert that the country scores well in international governance and business rankings. However, where the preconditions for creating a transport hub are concerned, individual indicators can give a more nuanced picture. The latest Enabling Trade Index (2016), published by the World Economic Forum, ranks Georgia 41st and thus the best in Eurasia. However, it slides further down the table in sub-indices such as availability and quality of transport infrastructure, and availability and quality of transport services (76th and 98th out of 136). In the Doing Business Ranking 2018 Georgia made the global top ten with an impressive ninth place, but in the Trading across Borders category it did less well, coming 62nd. Meanwhile, in the World Bank's latest Logistics Performance Index (2016), Georgia only reaches 130th out of 160 – which puts it mid-table among comparable Eurasian countries. Given the interdependencies in the transit sector, unilateral Georgian efforts to improve soft infrastructure will not be enough, however. The efforts would have to be reciprocated and also met with the corresponding political willingness by the other countries along the route.

Route Competition – Even within Georgia?

The inclusiveness of the Belt and Road Initiative is often cited as one of its central characteristics. There are no fixed routes, only sketched-out corridors. On a much smaller scale, Georgia has a similarly web-like structure. Improvements to the sea route via the Black Sea, the rail link towards Turkey and the road network are meant to help the country benefit as much as possible from the flow of goods between China and Europe. However, analysts and those involved in expanding the transit route raise the question of whether the planned capacities will really be fully utilised. The operator of the port at Poti, no doubt inter alia with an eye on future competition from Anaklia, has announced an expansion of that port as well. A 2015 World Bank report on Georgia's transport and logistics strategy did acknowledge that the existing Georgian Black-Sea ports are operationally limited, but also stated that their capacities corresponded to both current demand and the projected demand for the next few years. Moreover, the completion of the BTK rail link has also connected Turkey's Mediterranean and Black-Sea ports to the southern Eurasian route via Georgia. These might also compete with Anaklia. In conversation, local and international experts point out that, at least for the moment, the growth rates on which planning for Anaklia was based have not been realised.

On this point, the above-mentioned International Union of Railways study stated that overland transport by rail between Asia and Europe was growing quickly and would continue to grow. Nonetheless, its share of total trade is expected to remain small compared to sea freight. Experts calculate that rail freight is around three times quicker than the sea route, but also three to three-and-a-half times more expensive. It is therefore best suited, they say, to high-cost goods where quick availability is a priority and additional costs are less important. Moreover, they say, the greater share of the goods will still travel on the northern routes via Russia. According to projections for 2027, only three percent of the Eurasian rail traffic will go on the southern routes, meaning both the line via Georgia and those via Central Asia, Iran and Turkey which circumvent Georgia.

Analyses by the ISET Policy Institute in Tbilisi reveal that freight transport on Georgia's railways has been declining in recent years, dropping from 22 or 23 million tonnes in 2007-2008 to under 12 million tonnes in 2016. The analyses found a reduction particularly in transit, even though a large share of it remained on the southern route and merely moved to roads. Some freight, however, also migrated to the northern routes. Figures from the Georgian Finance Ministry and the national statistics agency similarly show that freight has declined overall in recent years.

Experts in Georgia largely welcome the government's initiative to turn the country into a transport hub. However, some question whether Georgia is not better suited to being a hub for regional trade between the states of the southern Caucasus and Central Asia than a hub for international trade between China and Europe. Many agree that Georgia will have to acquire noticeably more trade to realise its potential as a transport junction, and not only trade from China or from East to West, but also in the opposite direction. Having the physical infrastructure is a necessary but not sufficient condition for this.

To increase transit volumes, Georgia is also gambling on geopolitics. Russia's ongoing embargo on certain European and Ukrainian food stuffs, as well as the constraints imposed on Ukrainian goods transit via Russia to China, could benefit the southern route. After all, China is an increasingly important buyer of Ukrainian agricultural products. And the fact that China is eyeing Georgia's ports in particular can be seen not just in Anaklia but Poti as well: in 2017, CEFC China Energy acquired 75 percent of the tax-exempt industrial zone there.

Conclusion and Outlook

China's Belt and Road Initiative has hit a chord with the Georgian government. It is compatible with the government's own attempts to establish Georgia as a transport hub and to capitalise on its geographical position between Europe and Asia. To make the country attractive as a regional and inter-regional hub, Tbilisi is counting in particular on a network of free-trade agreements as well as the expansion and upgrade of its infrastructure. The fact that, in 2017, Georgia was one of the first countries ever to receive a credit from the Beijing-initiated Asian Infrastructure Investment Bank (whose founding members include Georgia) is seen as proof, along with the free-trade agreement, of Georgia's significance for the Chinese.

As a trade hub, Georgia wants to profit from more than just transit. It also intends to further boost its domestic economy. When the first building phase of the deep-sea port at Anaklia was launched in December 2017, Prime Minister Kvirikashvili said the project would turn Georgia into a "logistics and industrial development hub". As an export platform, Georgia wants to attract foreign companies that will relocate their production or processing facilities so as to benefit from the DCFTA with the European Union or the free-trade agreement with China for goods "made in Georgia". Whether these plans will be realised remains to be seen. Georgia certainly requires further measures to harmonise with European standards and regulations so as to profit comprehensively from the DCFTA. It will also need to make greater efforts to train skilled labour so as to strengthen the export-orientated sectors of its economy.

Not least of all, Georgia's very active integration into the Belt and Road context shows the independent-mindedness of its foreign policy. While that policy continues to be primarily orientated towards the West, it is increasingly open towards the East. How far Georgia's agency (both financial and political) will go given the huge asymmetry between China's economy and its own is an open question. So far, the Georgian government has emphasised the economic importance of the new Silk Road and its associated Chinese commitments in the region. Georgia's geopolitical considerations mainly concern Russia – whether they be opportunities for fencing in its neighbour to the North by increasing Chinese economic interests in Georgia, or positioning the southern Eurasian route as an alternative to the northern routes dominated by Moscow.

Tbilisi stresses that its relations with the West and China complement each other. In several West European capitals, however, there are growing doubts as to whether the Belt and Road Initiative as promulgated by China will be equally profitable for all sides. Instead, suspicions are that the Initiative is a Chinese geostrategic project. For Georgia, this means that the extent to which its two foreign-policy orientations can be reconciled will only be proved in practice.

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