

## **The Political Economy Approach to the study of Armenia-Turkey Cross-Border engagement**

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**Abstract:** *The paper examines the propensity of cross-border engagement in Armenia, which is defined as the willingness and capacity of such engagement within the public, private and the NGO sectors of Armenian state and society. The study indicates that there is little support for Turkish-Armenian engagement within the government, and the positions of the Ministries on the issue are at times contradictory. On the contrary, the business sector is overall supportive of such engagement, with the dominant majority of the respondents calling for unconditional liberalization of border management between the two countries. Contrary to these “absolutists”, the “relativists” support engagement if proper administrative reforms within Armenia (for example, strengthening quality control agencies and customs reforms) are carried out in beforehand. Lack of such reforms, they argue, unnecessarily increases the costs of production in Armenia, making Armenian products less competitive in regional and global markets. “Isolationists” calling for no engagement with Turkey were dwarfed in comparison to the “absolutists” and “relativists”. Regardless of the level of support within the public, private and the NGO sectors, there is an overall lack of capacity of efficient cross-border governance and engagement. The paper also highlights the importance of the administratively strong local levels of government as active agents of ‘micro-diplomacy’ and the development of ‘proto-regions’ in border areas. The latter is the core developmental value for Armenia in engagement with Turkey, with the development of the peripheralized border areas as its core objective. The paper concludes with policy recommendations.*

JEL Classification: Z

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## INTRODUCTION

Borders represent the political organization of a territory. They demarcate the boundaries of statehood, the concept of states being conceived in the 17<sup>th</sup> century as an effective approach for economic organization. In the past two centuries, globalization of economic forces has accelerated, exposing the inherent contradiction between the logic of an outward-oriented capitalist economic system and territorially confined nation-states. In contemporary global economy, labor, capital and production are decoupled from their territorial basis, giving rise to what some claim to be a 'borderless economy' (Ohmae, 1995). Mobility of capital and labor have enabled more fluid patterns of production, heightening the pace of competition between states for foreign direct investments, capital inflow, and human capital. Yet, borders remain and still demarcate the political boundaries of states, and serve as territorial fixtures of state sovereignty.<sup>1</sup> The spread of regionalism and micro-regional arrangements in border areas serve as transnational 'fixes' in reconciling often contradictory outward oriented economic and inward-oriented political forces (Sparke, 2002).

The Turkish-Armenian border (TAB), along with other regions such as the Balkans for example, expose the limitations of much of the current discourse, which is built around neat categories and tidy analytical divisions. The cross-border engagement of market forces in both the Southern Caucasus and the Balkans is largely contingent on the administrative capacities of the public sector both at local and central levels of governance. Therefore, the effective utilization of cross-border engagement and regionalism is a good indicator of the international dimension of state capacities. Those depicting market forces as 'untamed tigers' ready to transcend borders and boundaries assume a passive state reacting primarily to their respective business sectors. Such conceptualizations are quite limiting within the context of both TAB and southeastern Europe, where the institutional strengths of the business sector are quite weak, a shortage of information (particularly business information) exists, and governmental and non-governmental support mechanisms for international business engagements are rudimentary.

Much of the literature on regionalism leverages the concept of micro-regions, which reflects the notion of aggressive and proactive business sectors ready to take on neighboring economies. Micro-regions are said to develop naturally, being highly contingent on the drive of private actors and territorially cross-cutting dense linkages between private and public sectors on both sides of the border. Instead, within the TAB context I replace the concept of 'micro-regions' with 'proto-regions'. 'Proto-regions' recognizes the centrality of the public sector in building and developing such cross-border economic zones and considers the need for specifically tailored policies in managing such regions. As such, proto-regions are able to capture the issue of public capacities, which is a theme that becomes diluted within a discourse centered upon the concept of micro-regions.

The role of the public and private sectors in promoting cross-border regionalism varies from region to region, and the degree of their involvement is highly contingent on the internal political systems of the countries under considerations. Established democracies tend to be more entrepreneurial and innovative in terms of cultivating cross-border institutions. The creativity of international engagement evidenced by such states reflects their internal administrative prowess. Within the transitioning economies of post-Communist world, (Armenia and the Balkans being good examples) such innovative institutional engagements at the regional level have been slow to develop.

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<sup>1</sup> At times such clearly defined positions of the economic and political forces concerning border management can be deceiving, considering the existence of protectionist forces, which under some circumstances, have been able to mobilize state support for their economic preferences. Champions of impermeable borders can also be found within the economic sphere as well.

This paper touches on several patterns of regionalism as practiced worldwide, and aims to demonstrate the variance of institutional patterns of cross-border engagement and to illuminate the importance of management of such cross-border links. Many such inter-state arrangements, such as the European Union, the North American Free Trade Agreement region, the Association of South East Asian Nations, among others, illustrate that contemporary borders are indeed fluid. Borders are permeable. And borders are *manageable*. Therefore, cross-border governance and management is an essential tool of modern statecraft for effective utilization of regionalism and realization of cross-border economic trade and production, which large number of states increasingly practice, both within industrialized as well as in developing countries. As such, borders are neither obsolete, nor intact in their dominance. Their utilization has been simply transformed.<sup>2</sup>

Border management, in terms of its developmental value, consists of two primary dimensions. First, border management can be carried out for the purposes of borderland community development, which is the case in much of Western Europe, and this practice is being reinforced in South Eastern Europe as well. The Basel metropolitan area, which is a tri-national region of France, Germany and Switzerland, is an excellent example of regional planning and trans-frontier cooperation (Briner, 1986). Secondly, border management can be carried out for purposes of national development in general. Here discussions focus on issues of trade policies, negotiating regionalist arrangements, tariffs and quotas, financial regulation, and quality control, among others. It is these two dimensions, local and national, that are the main focal points in this study. Cross-border management is an important instrument both for realizing local as well as national levels of development which cross-border governance offers.

While this research does not directly address the present state of diplomatic relations (or lack thereof) between Turkey and Armenia, it does recognize the political complexity of promoting proto-regions in this area. This paper introduces a tri-sectoral approach to cross-border engagement from the perspective of Armenian society. Specifically, it identifies the business sector, the public sector and the civil society as direct stakeholders of open border engagement with Turkey. The public sector is a stakeholder both at the local and central levels of government. The practice of industrialized and developing nations demonstrates that active local levels of government (sub-national levels of government) can play an important role in using cross-border engagement for the development of their communities in border areas. The so-called micro-diplomacy, while highly contingent on the support of central levels of government, has been a prerequisite for border communities to reap the benefits of cross-border engagement around the world. Central governments are essential in providing for the public goods necessary for the realization of benefits of cross-border engagement with any country. Transportation, bridges, roads, efficient taxation and customs, information, and border security are some of the public goods provided by governments in cross-border areas, as well as generally.

Civil society and the NGO sector can facilitate the Turkish-Armenian border relations by establishing links and building networks around specific issue areas. In the specific contexts of Turkish-Armenian border engagement, a strong NGO sector is essential to further Second-Track Diplomacy projects, which so far have been very few, partly due to the weak NGO structures in Armenia (Anonymous Interview, 2006). Moreover, while micro-regions are governed by the members involved, they still represent transnational political and economic spaces, and NGOs can be essential tools for representing the interests of various social groups in such spaces.

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<sup>2</sup> The changing role of borders and territoriality is best captured in accounts of the Rhine Basin in Europe, which at times is referred to as “the boulevard of multinational capitalism, for which borders no longer exist” (Aycoberry and Ferro, 1981). Citing the previous animosity and the conflict-ridden nature of the Rhine Basin, Quintin asks whether the younger generation will be able to understand how the French and the Germans considered the Rhine to be a ‘Great Divide’ in light of its current unparalleled success as a pole of development (Quintin, 1973 in Matthew Sparke, 1998).

The business community is also a direct stakeholder. Some industries and sectors are strongly interested opening the Turkish-Armenian border, while others are fearful that if left unregulated, low quality and inexpensive Turkish products would flood the Armenian market and hurt local, more expensive industries in the country. Reduced transportation costs, access to ports, established business cycles for introducing a product in foreign markets, and reduced costs of production technology as imported from Turkey were some of the benefits cited by respondents. There were also others within the business sector who highlighted issues of border control and quality control licensing by the government as necessary prerequisites in order to stop “cheap, low-quality products from being dumped” on the Armenian market, so a line of argument posited.

Examining the propensity of cross-border engagement from the Armenian side is the core of this research. Two dimensions of propensity are examined: attitudes/willingness of engagement and capacities of cross-border engagement by the public and private sectors and civil society. The research questions this study addresses are the following: (1) Is there willingness for cross-border engagement and cross-border governance? (2) What is the institutional capacity for cross-border engagement and cross-border governance? The current paper starts out by presenting key concepts, themes and debates pertaining to the political economy of border politics and regionalism. This will be followed by a discussion of the Research Design of the study. The paper will then focus the discussion on the Balkan region of southeastern Europe, and will introduce results of interviews carried out with representatives from the Stability Pact for South Eastern Europe as they pertain to the Armenian-Turkish case. The empirical material on Turkey-Armenia border issue gathered in Armenia will follow this section. The paper will conclude with a section on policy implications and a discussion of future research areas.

## **1. ON BORDERS AND REGIONS**

### **1.1. Borders**

“I do not view the border opening as an economic category. I view it as a political category. Economic actors are able to cut through and transcend borders.”

*President of a medium-Size Manufacturing and Exporting Enterprise, Yerevan, July 24, 2006*

Such positions and sentiments have fueled spirited debates among academics, development practitioners and businesspeople. As discussed in the previous section, the supporters of such arguments point to the dynamism and dominance of economic forces, which are able to bypass the border and escape territorially confining state boundaries. Ohmae’s arguments on this issue are perhaps the most vocal and best known articulations supporting the power of economic forces. Ohmae argues that the nation-state undergoes erosion when faced with globalizing forces and growing trends towards regionalism worldwide. Borderless economies have brought an end to the nation-state and its attendant territorial demarcation on the ground, the argument goes (Ohmae, 1995; Sparke, 1998). Ohmae asserts that state-centrism is becoming obsolete due to the globally organized nature of capitalism which empowers individual corporations and consumers at the expense of states, governments and democracies (Ohmae, 1995; Sparke, 1998). Ohmae introduces the concept of ‘region-states’, which may lie entirely within or across the borders of a nation-state, demonstrating the size and scale as generated by market forces and natural businesses within the global economy. In this framework the state is a mere historical accident (Ohmae, 1995). Ohmae goes so far as to argue that the borderless economy has deteriorated and finished the nation-state and its territorial demarcation (Ohmae, 1995). Similarly, Anderson and O’Dowd assert that territorially bounded units are diminishing in their significance as a result of increased flows of capital, commodities, information and people across borders. They argue that state borders and border regions are being re-made, re-negotiated and managed (Anderson and O’Dowd, 1999).

In contrast, Luttwak insists that the state and its territoriality are intact, and that the logic of inter-state conflict is 'vectored through the grammar of commerce'. In this approach geopolitics is replaced with 'geo-economics', where 'the authority of state bureaucrats can be asserted anew, not in the names of strategy and security this time, but rather to protect "vital economic interests" by geo-economic defenses, geo-economic offensives, geo-economic diplomacy, and geo-economic intelligence' (Luttwak, 1993). The effects of borders are most directly felt by landlocked countries, which are generally singled out for the lack of access to coasts and navigation. They are handicapped by their heavy dependence on passage through a sovereign transit country. Their structural dependence on their neighbor's infrastructure, sound cross-border political relations and neighbor's administrative practices are some of the most dominant constraints which landlocked countries face (Faye, et. al., 2004).

Some of the regions of China, India and Russia lie further from the coast than many landlocked countries like Azerbaijan and Moldova. While these inland subnational regions indeed face great distance-based cost disadvantages relative to their maritime counterparts, they do not have to face the challenges of border crossing (Faye, et. al., 2004, 32).

The case of the Turkish-Armenian border vividly illustrates that both positions are extreme in their analysis. The economic forces on both sides have been quite active, but they have also been unable thusfar to pressure political forces for greater engagement with their neighbor. Similarly, while the political forces and political boundaries have been persistent between the two countries, they have been too weak to prevent cross-border trade, which predominantly has taken the form of imports from Turkey into Armenia. In a more moderate position, Sparke argues that borderland transformations are messier than either Ohmae's or Luttwak's assertions would assert. Such borderland transformations fail to reflect any persistence of borders as Luttwak insists, nor do they indicate the eclipse of borders by economic forces as argued by Ohmae (Sparke, 1998). Sparke identifies the process of re-definition and reconstruction of the state in the context of globalization and regionalism (Sparke, 1998). This approach to the significance of borders in contemporary global economy insist on continuous validity of borders, but cautions that borders tend to hinder trade thus depriving the development of a nation (Sparke, 1998).

While economic forces may be more dominant in some regions, their power in shaping state policies can be muted in others. Both sides of the debate tend to view the state (the public sector) and economic forces as static constructs, ignoring the rich diversity of relationships between the public and private sectors that varies from state to state. Utilizing cross-border engagement for developmental purposes by a state requires entrepreneurship by the civil servants and institutional sophistication within the governmental structures. Both of these attributes are characteristic to established democracies, and they will take time to develop in transitioning economies, including in the Balkan regions and in Armenia.

## **1.2. Regions, Micro-regions and Proto-Regions: Their Developmental Value for Developing Countries**

The relationship between the public and the private sectors also determines the mode of regionalism as practiced by a given state, and eclipsing political borders is not always the end result of economic regionalism. The *raison d'être* of cross-border regions is to overcome the national borders which divide them (Anderson and O'Dowd, 1999). They are constructed around a territorial divide while their own boundaries are more fluid and imprecise. These regions stand out with formal institutional and informal links, all built around inter-personal and inter-organizational networks. These networks operate as open structures defined mainly through their functions and communication flows (Eger and Langer, 1996).

The developmental value of regionalism has been changing over time, and such fluctuations have been largely due to the significance of state borders attached by scholars and practitioners when discussing economic development of border regions as well as among countries in general. For instance, Martinez argued in 1978 that boundaries between nations are obstacles to development, and that ‘regions situated at or near borders generally develop at a slower rate than comparable interior areas, and no significant development occurs along boundary lines’ (Martinez, 1978, 5). Such pessimism concerning the developmental potential of borderline communities is also shared by practitioners and policy-makers, and relatively recent examples are taken to substantiate such claims. For example, the border between East and West Germany created an area largely unattractive for businesses from either side. There was very little development in that region during the Cold War. After the collapse of the Berlin Wall the border areas of West and East Germany instantaneously became the central regions of unified Germany. Currently these former border areas have been transformed into rapidly economically developing regions (Kühne, 2006).<sup>3</sup> The relatively open border arrangements between Poland and Ukraine also have been facilitating border-area economic activities, which were nonetheless disrupted after Poland joined the European Union (EU), and the Poland-Ukraine border became EU-Ukraine border, which was more strictly managed and became harder to cross (Kühne, 2006).<sup>4</sup>

The Turkish-Armenian border region lacks any substantive inter-organizational and inter-personal business and/or civil society networks, with the exception of Armenian traders traveling from Armenia to Turkey to return with textiles and other consumer goods for sale in Armenia. Most such contacts, while providing livelihoods to many, offer limited prospects for Armenia’s long-term development and the modernization of its business sectors. In this study, this border area is referred to as a proto-region, due to the low levels of formalization of such links and their disconnection from any systematic developmental policies put forth by the Armenian government.

One could argue that increased organizational flexibility of business enterprises and production as well as rapidly developing communication technologies offset the geographical isolation of border communities, thereby muting the negative impact which borders can have on the development of borderland communities. Specifically, a typical large corporation may try to offer the most profitable mix of products or services by producing or assembling many of them, but also subcontracting numerous functions (Hansen, 1983). Indeed, some of the biggest producers in Armenia, in construction materials and food processing, for example, have avoided creating their brand-name stores in the regions in Armenia. Instead, they form contracts and arrangements with other shops that are spread around the country, which then re-sell and distribute their products. “This strategy has enabled us to build a wider network in Armenia and sell more in the regions, than we would have otherwise been able to if we have tried to sell our products through our brand-name stores” (Anonymous Interview, 2006).<sup>5</sup> By extension, those seeing little developmental value in promoting proto-regions will point to this organizational flexibility of businesses arguing that they eventually will invest in the border areas at a greater rate, thereby bringing the much needed development to border communities without necessitating external cross-border engagement.

Perhaps the ability of private actors to spread throughout local regions, including border areas, is heightened in the contemporary conditions of global economy, but this should be viewed in relative terms. Globalization is unfolding in an uneven pace, giving rise to dynamic centers of international economic development, world cities, financial centers (such as New York City, London, Frankfurt and Tokyo) (Sassen, 1991;) and transnationalized regions (Mathias and Brock, 1995-1996; Duchacek, 1984). This uneven globalization around the world accentuates the need

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<sup>3</sup> Personal Interview with Björn Kühne, Senior Political Adviser, Stability Pact for South Eastern Europe, Brussels, Belgium. Interview with the author. June 28, 2006.

<sup>4</sup> Björn Kühne, *ibid.*

<sup>5</sup> Anonymous Interview, President, Large Enterprise/Production, July 24, 2006, Yerevan, Armenia.

for a “new localism,” (Johnson, 1994; Mathias and Brock, 1995-1996): some locations are more successful in attracting global investment than others, hence the crucial need of strong local levels of government and their administrative competency in utilizing globalization for their local developmental needs.

The developmental value of the Turkish-Armenian proto-region can be approached from both of these perspectives. One may argue that engagement with Turkey would add little to regional development because the task can be accomplished by Armenian businesses. Moreover, as the empirical section will illustrate, some within the policy-making elite argue for Armenia’s integration with European markets, and for the importance of developing sectors that are not dependent on Armenia’s location or limited resource endowments. The development of the Armenian information technology sector was a frequently cited example by governmental officials used to argue that Armenia is not dependent on economic engagement with Turkey.

### **1.3. Modes of Regionalism and Cross-Border Engagement**

Cross-border engagement is one of the central elements of regionalism, and together they can vary in two dimensions: (1) the degree of formalization; and (2) the mode of development. In terms of the first dimension, regions can range from being highly institutionalized, managed and regulated by inter-state agencies and international organizations on the one hand, and weakly institutionalized on the other hand. In the latter case regionalism is largely sustained by informal links and contacts between the business sectors of countries involved as well as the NGO sector. In terms of the second dimension, the regionalism can be advanced through bottom-up or top-down measures. The business sector is the initiator of regional arrangements throughout the bottom-up mode of regionalism, and international organizations and state-level institutions are the key actors in top-down mode of regionalism.

An example of a top-down mode of regionalism is South Asia. Here regionalism is orchestrated by political leaders, ministers and officials in the respective member states (Abonyi, 1994; Grundy-Warr and Perry, 1996; Grundy-Warr, 2002). The Association of South-East Asian Nations (ASEAN) is the main regional body, where the major decision-making involves key political leaders, ministers and officials from the respective members states. Contrary to European regions, intra-regional cooperation in South East Asia is orchestrated by central levels of governments, which take the lead in building ‘growth triangles’, such as arrangements among Indonesia, Malaysia and Singapore, the ‘northern triangle’ involving northern Malaysia, southern Thailand and parts of Sumatra (Indonesia) and the ‘East ASEAN growth area’ incorporating parts of Sabah (Malaysia), Brunei, Kalimantan (Indonesia) and the southern Philippines. Some of the projects involving such top-down initiatives of regionalism include building a large industrial estate in Batam island (Indonesia), and a tourist resort complex in neighboring Bintan island. These initiatives have become enclave developments involving high level political approval and a high input of political capital from the respective central states (Grundy-Warr, 2002).

Aside from cultivating growth triangles, the cooperation in South East Asia has also been evolving around issues of sustainable development and shared resource utilization. Joint development zones for offshore hydrocarbon sharing in disputed maritime border areas involving relevant state agencies and corporate partners is one example. This has involved Thailand and Malaysia in the Gulf of Thailand (Forbes, 2001; Grundy-Warr, 2002). Another example of cross-border cooperation around environmental issues and sustainable development is the project in the lower Mekong River Basin under the ‘Agreement on the Cooperation for the Sustainable Development of the Mekong River basin’ signed in April 1995 by Vietnam, Cambodia, Thailand and Laos, involving the intergovernmental Mekong River Commission in various policy recommendations, monitoring and consultative tasks (Grundy-Warr, 2002). In all of these efforts the central government is the primary stimulus for cross-border cooperation. Cross-border

governance institutions are cultivated from the center, which ends up producing cross-border arrangements that are heavily reliant and responsive to concerns of national sovereignty which the central governments frequently emphasize.

Contrary to the 'Asian Way' of highly controlled regionalism, the cross-border arrangements in Europe are institutionally much more complex and multi-layered. They involve top-down initiatives from European programs, as well as local projects of cooperation in cross-border areas. O'Dowd argues that the Council of Europe first became an initiator of transfrontier regionalism. It introduced new legal instruments and used frontier regions as illustrative laboratories for the problems and potential of European integration. Such top-down measures were built around local initiatives of cross-border cooperation by local and regional authorities (Strassoldo and Zotti, 1982; Anderson and O'Dowd, 1999).

Perhaps the most intense transborder cooperation has been developed in the Rhine basin, involving municipalities, universities, private sector interests and consultative committees of central and local governmental officials (Anderson and O'Dowd, 1999). Local authorities here were particularly important, as they initiated much of the cultivation of cross-border regions. The collaborations were project-specific, focusing on such issues as industrial decline, pollution, transfrontier workers and land-use planning (Anderson and O'Dowd, 1999; Mestre, 1992). The degree of dense cross-border cooperation in Rhine basin has not been replicated anywhere else, partly due to the unique features of the region. However, the Rhine basin example still offers many lessons for building cross-border governance institutions, some of which are relevant to the Turkey-Armenia border regions.

The specificities of the Rhine basin are several. First, it was the core of the European integration. Second, the population in the border area was densely settled and the level of economic activity was quite high. The nature of existing regional institutions also contributed to such an outcome. Specifically, many local authorities in Germany, Switzerland, and the Benelux countries were characterized by strong local levels of government and devolved power. The local chambers of commerce, trade unions, banks and universities, provided a solid institutional structure for cross-border cooperation (Anderson and O'Dowd, 1999). In short, multi-level institution building has been a key feature of cross-border regionalism in Western Europe. It has involved intergovernmental planning commissions in border regions as well as locally based structures – 'Euro-regions'.

Western Europe and South East Asia represent opposite poles of cross-border cooperation and regionalism. The importance of the local level actors is much more prevalent and present in the case of Western Europe than it is in South East Asia. The institutions of cross-border governance are also more evolved and multilayered in Western Europe than they are in South East Asia. Yet, the member countries in South East Asia have more control over cross-border activities. The administrative management of cross-border activities in South East Asia also reflects the internal top-down and state-driven pattern of internal development within many countries of South East Asia. In this respect, the internal governance characteristics of the members states will be reflected in the cross-border institution building in the region. Therefore, when discussing cross-border governance and institution building between Turkey and Armenia the internal governance structures of both countries will emerge as key determinants.

#### **1.4. Conclusion**

This section introduced some of the dominant debates surrounding regionalism and its developmental value for countries involved. It pointed out the centrality of public sector of a given state in terms of its institutional strength and ability to utilize regionalism for the development of a given country. It reviewed some of the existing patterns of regionalism which

differ in terms of the degree of formalization (high or low institutionalization) and the direction of regionalism (top-down and bottom-up) as practiced by countries involved. This section also situated these debates within the context of Turkish-Armenia Border arguing that existing economic links are sporadic and ad hoc, being poorly integrated into any systematic efforts of development of border areas. Due to the paucity of cross-border links, organizations and networks, this particular border area is referred to as a proto-region. Despite the rarity of systematic transactions between the two countries, there is sufficient ongoing trade which can serve as a basis for more systematic efforts at building and cultivating a micro-region around the Turkey-Armenia border.

## **2. RESEARCH DESIGN, METHODS AND INSTRUMENTATION**

### **2.1. Research Questions**

This study is built around the issue of propensity of cross-border engagement and cross-border governance between Armenia and Turkey, being developed within the tri-sectoral approach of business-government-NGO sector relationships. The propensity is operationalized as the *willingness* and *capacity* of cross-border engagement within and between various sectors of the society. Such propensity in border engagement around the world tends to be fueled via two routes: (1) ‘from above’, being driven largely by international organizations and global business actors; and/or (2) ‘from below’, being driven largely by local actors from the government as well as from the local businesses. While in the first case the international actors seek to modify and adjust political borders to accommodate economic actors, in the second case the cross-border links add up to economic proto-regions, which tend to transcend political borders. In both cases regionalism becomes the shared framework of analysis concerning cross-border engagement between two countries.

Toward these ends, two research questions are explored in this study. The first research question is of an *interpretive* nature, and the second one is *descriptive* (Maxwell, 1996):

- (i) Is there willingness for cross-border engagement with Turkey within the business sector, the government and the NGO sector of Armenia?
- (ii) What is the institutional capacity for cross-border engagement in the business sector, the government and the NGO sector in Armenia?

### **2.2. Research Design, Methods, Sampling and Instrumentation**

To explore these research questions cross-case comparative method and single case study methods have been used, and two levels of analysis are employed.

**First level of analysis/Inter-regional analysis:** Constant Comparative Method of Qualitative Research has been used for cross-case comparison of South Eastern Europe on the one hand, and South Caucasus/Turkey-Armenia border region on the other hand. This is a technique to carry out Grounded Theory Method and is an important component of the latter method (Glaser and Strauss, 1967). Contrary to most of the methods of qualitative and quantitative research, there is an interplay between data collection and analysis in the Grounded Theory Method. In utilizing the Constant Comparative Method, the researcher systematically compares newly gathered data with already existing data with the purpose of developing categories. This method also examines the cases against the theoretical assumptions widely shared in the relevant theoretical literature and theoretical models, which in this study evolve around regionalism and the political economy of state borders.

Using the Grounded Theory Method I have chosen South Eastern Europe and have compared that region with the Turkey-Armenia border region and the South Caucasus. To this end, I have carried out expert-interviews with policy-makers and practitioners from the Stability Pact for South Eastern Europe, which is an umbrella organization for donors and nation-states in the region in promoting regionalism and building Euro-regions in South Eastern Europe. Seven members of the Stability Pact have been interviewed by the author through structured and semi-structured interviews. These interviews have enabled to develop categories of operationalizing the propensity of cross-border engagement. These categories have enriched the research component carried out in Armenia in the Summer of 2006.

The inclusion of the South Eastern Europe in this study has been justified on the following shared similarities with Armenia:

- The countries of South Eastern Europe as well as Armenia are post-Communist countries, therefore, although with some variance, do exhibit overall similarities in center-periphery relations. Specifically, weak local levels of government are present both in South Eastern Europe as well as in Armenia.
- The countries of South Eastern Europe as well as Armenia are situated in politically charged neighborhoods. They all face regions fragmented with conflicts and interstate tensions.
- Some of the countries of South Eastern Europe as well as Armenia are landlocked, highly dependent on their neighbors for transit routes.
- The countries of South Eastern Europe as well as Armenia have small size economies, being highly dependent on the nearby countries with large economies (Europe, Russia, Turkey).

The major difference which these countries/regions have is the membership status (or lack thereof) and proximity to European Union. European institutions are deeply involved in promoting regionalism in South Eastern Europe. Their role of international actors in promoting cross-border ties in South Caucasus is very limited.

**Second level of analysis/Intra-regional analysis:** The single case study method is used in assessing the propensity of cross-border engagement between Armenia and Turkey.<sup>6</sup> Kaarbo and Beasley (1999) in a review of the literature on the case study method has categorized case studies into four groups: atheoretical, “disciplined-configurative” or “interpretive”, “hypothesis-generating” or “heuristic”, and “plausibility probe”. In interpretive case studies the researcher deploys certain theoretical frameworks to explain concrete cases. The focus remains on the case, rather than on theory (Kaarbo and Beasley, 1999). This is the method utilized in this research in order to assess the propensity of cross-border engagement in Armenia.

Operating within the tri-sectoral framework, taking the government, the business sector and the NGO sector as key stakeholders, respondents from all sectors were selected. Within the government, *purposeful* sampling has been carried out, which is defined as selecting only those respondents which are uniquely positioned to answer the questions. Put differently, no other respondents could illuminate the issue (Maxwell, 2005). Governmental officials indeed are uniquely positioned to articulate the position of the Armenian government on the issue as well as to provide macro-level analysis pertaining to the Armenia-Turkey border management. Four senior members and five mid-level members of Armenian government were interviewed. Their interviews are used in an anonymous manner in this study. Structured interviews have been the instrument of choice in this component of the study.

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<sup>6</sup> Only the Armenian side is examined in this work.

Within the business sector, using *purposeful* sampling, eight in-depth interviews with heads of private enterprises have been carried out. Five of these interviews were with large enterprises from the production, trade, and services sectors. One interview was with the president of a Medium Size enterprise in food production. Another was with a representative from a Medium Size freight company, and the third was with the head of a small enterprise specializing in shoe production and trade. In addition to these in-depth interviews, sixty-six phone interviews were carried out with small, medium and large enterprises from trade (19), services (26) and production (24) sectors. Twelve of these companies have between 150 to 600 employees.

Sixteen in-depth interviews were carried out within the NGO sector. The NGOs were selected based on the relevance of their organizational issue concentration on cross-border engagement issues. A focus-group was carried out with six members of the Research Triangle International/Local Government Project in order to investigate the state of local level governance in Armenia. In total, one hundred and eleven structured and semi-structured interviews were carried out in the course of this study.

### 2.3. Conclusion

The research design of the study was presented in this section, and the methodology of the research was introduced. Below is a box which summarizes the number and types of interviews carried out for this study. Research questions were presented in this section and key concepts were operationalized.

Table 1: Summary of Data Collection

<b>FIRST LEVEL: INTER-REGIONAL ANALYSIS</b>		
<b>Stability Pact for South Eastern Europe</b>	7 interviews	In-depth semi-structured
<b>SECOND LEVEL: INTRA-REGIONAL ANALYSIS</b>		
<b>Armenian Government</b>	9 interviews (of which 4 with senior and 5 with mid-level governmental officials)	In-depth structured
<b>Armenian Business Sector</b>	74 interviews (of which five heads of large enterprises (up to 2000 employees) from production, services and trade, and three heads of SMEs in food, freight and shoe production; 12 of the 66 telephone interviews were with large enterprises with between 150 and 600 employees)	In-depth structured (8) and phone (66)
<b>NGO Sector</b>	16 interviews	In-depth structured interviews
<b>Research Triangle International</b>	6 interviews	Focus group
<b>Total</b>	112 interviews	

### **3. FIRST LEVEL/INTER-REGIONAL ANALYSIS: SOUTH EASTERN EUROPE AND SOUTH CAUCASUS/ARMENIA-TURKEY**

#### **3.1. Incentives and Obstacles for Trans-frontier Cooperation**

Inter-regional analysis has been carried out using the Structured, Focused Comparative method developed by Alexander George (George and Bennett, 2004). It entails applying the same framework of analysis and same set of questions and categories to both cases under investigation. An analysis carried out by the EastWest Institute has focused on regional and transfrontier cooperation in South East Europe. In terms of *weaknesses* of cross-border cooperation within the region, the following factors were highlighted:

- Political problems impeding cooperation
- Unstable or less stable economies
- Lack of cooperation structures
- Lack of powerful International Communication Technology systems
- Lack of modern infrastructure at the borders
- Untrained staff at the border crossings

The South Caucasus region and the Turkey-Armenia border area share some of the strengths and weaknesses that are prevalent in South East Europe. Political problems are central in impeding cross-border cooperation, and perhaps their effect is even more acute, considering the lack of an experience with a systematic cooperation between the two countries over the past century. Most of the informal trade (largely imports from Turkey) have been focused on the major metropolitan areas in Turkey, and have had little direct impact on the border areas within Turkey.

Isolating political factors from economic considerations is quite challenging. The third senior governmental official interviewed for this study highlighted that the Baku-Ceyhan oil pipeline has already bypassed Armenia, further isolating the country geo-politically. Therefore, he pointed out, even if the border opening negotiations start now, the bargaining positions of the two countries would be highly asymmetric (Anonymous Interview, 2006), with Turkey holding more advantage and negotiation power than Armenia. The respondent then proceeded to reflect the concerns echoed by many, which revolve around issues of information shortage and a lack of understanding of the Turkish economy.

As in South Eastern Europe, in Armenia as well the structures of a market economy are still developing. The organizational density of the private sector is still not sufficiently significant to penetrate the regions within Armenia. Most of the economic activity is centered in Yerevan. The development of financial services in rural areas is largely absent, which is a characteristic which Armenian banks share with other regions around the world. The high costs of credit provision in rural areas necessitate the subsidizing of credit provision (Anonymous Interview, 2006).<sup>7</sup> An example of such a strategy that is currently active will be presented later in this paper.

The lack of cooperation structures is considered problematic in South Eastern Europe by the EastWest Institute (EastWest Institute, 2003). The lack of cooperation structures is even more acute in Armenia/South Caucasus than it is in South Eastern Europe. The diplomatic tensions and conflicts between Armenia and Turkey have limited any regional contacts between them to the Black Sea Economic Cooperation (BSEC) organization based in Istanbul. Additional informal contacts have been largely of a non-governmental nature, involving NGOs and businesspeople from both sides (Poghosyan, 2006). A lack of donor commitment to sustain these projects has been limiting the impact of these 'Track Two' diplomacy initiatives, curtailing their 'spill-over'

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<sup>7</sup> Anonymous Interview, Senior Governmental Official, July 25, 2006, Yerevan, Armenia.

effects into the society at large (Garaseferyan, 2006; Ohanyan, 2005).<sup>8</sup> As a result, such efforts have failed to translate into stable and recurring structures and forums of cooperation. In this respect, the presence of the Stability Pact for South Eastern Europe as a formal mechanism of donor cooperation and promotion of cross-border regionalism in the region is a significant boost for member countries and their cross-border governance capacities. The Stability Pact for South Eastern Europe ensures sustained donor commitment to cross-border governance issues within this region, and equivalent institutional structures to facilitate cross-border engagement between Turkey and Armenia are non-existent. Non-governmental organizations, such as the International Center for Human Development, the Turkish-Armenian Business Council, the regional cooperation programs carried out by the Eurasia Foundation and a tourism project developed and implemented by the Academy for Educational Development (Garaseferyan, 2006)<sup>9</sup> are select visible initiatives which serve as rudimentary cooperation outlets in the region.

The lack of powerful infrastructure at the border area, combined with untrained staff at border crossings, has been a major obstacle in building effective cross-regional institutions in Armenia.

Even though the level of customs duties does not constitute a major obstacle for the development of regional trade, the corruption and the situation of infrastructure strongly restrict the volume of exchanges. Absence of clarity in customs procedures represents a considerably high cost. Corruption does not affect all the importers equally. They are divided into three categories: some of them pay official customs tariffs; others have to bribe and pay a little amount of the customs duties while a third group gives only the bribe (Turkish-Armenian Business Development Council, 2002).

Aside from these shared weaknesses impeding cross-border cooperation in South Eastern Europe and South Caucasus, there are range of context-specific ramifications in the South Caucasus. The international environment in the region is markedly different. Specifically, Armenia has developed several coping mechanisms as a result of blockade (Beilock, 2005; Garaseferyan, 2006),<sup>10</sup> along with stakeholders benefiting from the blockade. This is somewhat reminiscent of the political economy of war and the stakeholders of war which emerged during the Balkan wars in the 1990s and which impeded the resolution of the conflict in the region (Andreas, 2004).

Also, cross-border regionalism within South Eastern Europe is between economies of comparable sizes. The picture is different between Armenia and Turkey. Countries of South Eastern Europe do have Western Europe as a neighboring large economy, but Europe has vested interests in seeing South Eastern Europe develop economically. As part of such an ambition, Europe has allowed some of the countries of South Eastern Europe to protect themselves while providing them with easy access to European markets (Kühnee, 2006).<sup>11</sup>

In terms of *strengths* in cross-border cooperation in South Eastern Europe the following factors are highlighted by the 2003 EastWest Institute ETF report (EastWest Institute, 2003):

- Sufficient size – critical mass of population
- Substantial mineral wealth
- Rich and similar cultural heritage
- Greece's EU membership

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<sup>8</sup> Personal Interview with the author, Karen Garaseferyan, Program Specialist, USAID Contractor, Academy for Educational Development, July 11, 2006, Yerevan, Armenia;

<sup>9</sup> Interview with the author, Karen Garaseferyan, Program Specialist, USAID Contractor, Academy for Educational Development, July 11, 2006, Yerevan, Armenia.

<sup>10</sup> Personal Interview with the author, Karen Garaseferyan, Program Specialist, USAID Contractor, Academy for Educational Development, July 11, 2006, Yerevan, Armenia

<sup>11</sup> Personal Interview with the author, Björn Kühne, Senior Political Adviser, Stability Pact for South Eastern Europe, June 28 and June 29, 2006, Brussels, Belgium.

- Exception case of multinational borders within the lakes region
- Cooperation at an experts' level
- Good experience of cooperation between businesses
- Support from the Council of Europe

Here, the picture in South Caucasus and Turkey-Armenia border region also differs in terms of strength. Armenia and Turkey have had very little systematic business cooperation, most of which has been limited to imports from Turkey into Armenia. There is no expert level cooperation, even around such transnational issue areas as environmental protection (Ghazaryan, 2006).<sup>12</sup> Cooperation between businesses has been rudimentary, and as the interviews of this study indicate, public relations on the Turkey-Armenia issue are not dealt with to any substantial degree. Aside from clusters within the NGO sector to foster Track Two Diplomacy projects, there is very little capacity towards that end, a point which also will be expanded upon in the next section.

However, the importation of products from Turkey to Armenia has created some basis of cooperation between the business sectors of both countries. The eastern parts of Turkey are largely peripheralized, as are the border areas of Armenia. Some point out that Armenia would not gain much in terms of economic development of its border areas because the border areas of Turkey are under-developed and villages are geographically isolated and far from one another (Anonymous Interview, 2006).<sup>13</sup> Others refer to their conversations and talks with Turkish counterparts and point out that Turks view Yerevan as the closest major metropolis for them, which can offer a well-developed medical infrastructure and medical services to communities in Eastern Turkey. Moreover, according to some unofficial accounts, the local levels of government in Eastern Turkey view the opening of the border as a potential boost for the development of their communities, despite strong resistance coming from the center (Poghoasyan, 2006; Garaseferyan, 2006).<sup>14</sup>

The economy in Kars area is highly polarized, which is also true for Turkey as a whole. There are very poor and rich people. Those who have capital will be interested in investing in Armenia... The mayor of Kars [Turkey] is interested in opening the border. This was in 2004. He is very interested for his community. He thinks that his state will benefit from it greatly. He does not see any negative consequences from open borders (Garaseferyan, 2006).<sup>15</sup>

The Deputy Mayor of Gyumri, Mr. Mazmanyanyan, has also indicated the potential of developing the agricultural sector in Shirak Marz were the border to open (Mazmanyanyan, 2006).<sup>16</sup> Food processing, and exporting of lamb in particular, is one area which he mentioned as potentially interesting for the eastern and peripheralized parts of Turkey.

In most of the regions trying to promote transfrontier cooperation and cross-border governance, the local levels of government are generally in support of such projects, while the central levels of government are in opposition. Maintaining full control over the country and the border areas in particular is one of the most frequently voiced concerns by governmental officials resisting

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<sup>12</sup> Personal Interview with the author, Hovhannes Ghazaryan, The Regional Environmental Centre for the Caucasus Armenian Branch Office Coordinator, July 24, 2006, Yerevan, Armenia

<sup>13</sup> Anonymous Interview with the author, senior governmental official, July 25, Yerevan, Armenia

<sup>14</sup> Personal Interview with the author, Tevan Pogosyan, Executive Director, International Center for Human Development, July 12 and July 16, 2006, Yerevan, Armenia; Personal Interview with the author, Karen Garaseferyan, Program Specialist, USAID Contractor, Academy for Educational Development, July 11, 2006, Yerevan, Armenia

<sup>15</sup> Personal Interview with the author, Karen Garaseferyan, Program Specialist, USAID Contractor, Academy for Educational Development, July 11, 2006, Yerevan, Armenia

<sup>16</sup> Personal Interview with the author, Mr. Mazmanyanyan, Deputy Mayor of Gyumri, June 19, 2006, Gyumri, Armenia.

opening of borders. Yet, the local levels of government tend to view border opening as a community development opportunity, and the degree of their freedom from the central levels of government as well as their entrepreneurship in lobbying the center for open borders become important variables in changing the dynamics of border politics between any two countries. In short, in any cost-benefit analysis of border opening the potential developmental value of border opening for peripheralized border communities is an important factor to be considered.

Cross-border engagement is a good instrument of economic development and as well as decentralization- putting some competencies at the local levels... Also important is the promotion of capacities in tourism, infrastructure and other areas of economy through cross-border engagement (Stojović, 2006).<sup>17</sup>

### **3.2. Capacity and Preparedness in Cross-Border Engagement**

There is no issue of preparedness when it comes to the Armenia-Turkey border opening issue. Our task is simply to improve the quality of governance and management of private enterprises.

Respondent, Senior Governmental Official, RA, July 20, 2006, Armenia

We are not prepared [for open engagement with Turkish economy]. The issue of quality control of products coming in from Turkey has to be dealt with before any talk of open borders with Turkey can take place... Certificates of quality control are issued, without proper analyses of incoming goods being carried out.

Respondent, Businessperson, President of a Large Manufacturing/ Exporting Enterprise, Yerevan, July 25, 2006

Is there an issue of preparedness when it comes to Armenia-Turkey border opening? The above two quotes represent two opposite poles of this debate. At one end of the spectrum the opening of the Armenia-Turkish border is viewed in primarily neo-liberal terms, leaving very little room for governmental involvement and regulation of business transactions between the two sides. Business should be free to operate as it wishes, with little, if any, governmental involvement, so the argument goes. As it appears, the shedding of state functions in the aftermath of the Soviet collapse and the resultant liberalization of Armenian statehood is understood as reducing state capacities as well. In very few interviews with the business sector representatives did the respondents mention the provision of certain public goods as way of state support towards the business environment and operation. The second quote does raise the issue of state capacity in managing the cross-border engagement, upon which the business sector is highly dependent upon.

Turkey-Armenia border opening is about capacities and administrative management. It is about reform. If we want to talk about Armenian development, we should be concentrating on such administrative issues instead of opening the Turkey-Armenia border issues (Anonymous Interview, 2006).<sup>18</sup>

If the border is opened, the public administration system will be strengthened. There will be more business contacts, which will generate pressure on the administrative capacities of the state (Anonymous Interview, 2006).<sup>19</sup>

The first quote presented above is reflective of a similar debate raging within academic and policy-making circles in Armenia. Freinkman et. al. have argued that Armenia should be focusing on improving its internal business climate and administrative reforms, instead of investing time

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<sup>17</sup> Personal Interview with the author, Dragan Stojović, Stability Pact for South Eastern Europe, Working Table II – Economy, June 29, 2006.

<sup>18</sup> Personal Interview with the author, Senior Governmental Official, July 25, 2006, Yerevan, Armenia.

<sup>19</sup> Personal Interview with the author, Regional Director, International Private Consulting Firm, July 13, 2006, Yerevan, Armenia.

and resources in improving its relationship with Turkey to gain access to their markets (Freinkman, et. al., 2004). The supremacy of institutional variables in determining the income and trade levels has been an important theme in their analysis. Beilock has challenged such analysis pointing out the complexity of assessing the indirect and direct costs of the blockade. Towards this end, Beilock has asserted that the blockades and international crises in general are conducive to authoritarianism and opaqueness in government, and hence to poor business environment (Beilock, 2005).

The second quote presented above illuminates another possible causality between cross-border engagement and administrative prowess. It reminds the reader that open borders, while being highly dependent on the administrative efficiency of the Armenian state, can also potentially serve as triggers and stimuli for institutional development and reform within the administrative structures at the local and/or national levels in Armenia. Cross-border engagement, the argument goes, can generate more complex business environments, and hence, yield increased pressures for enhanced administrative performance, creating incentives and a critical mass of actors needing and demanding a more responsive and effective administrative statehood. The relationship between the ‘administrative efficiency of Armenian statehood’ and ‘the cross-border engagement and regionalism’ is not as direct as many researchers and policy-makers would claim. The relationship between the two is multi-dimensional, and eludes neatly defined models and linear causality.

Applying the Grounded Theory Method to the experience of the Stability Pact for South Eastern Europe, as well as consulting the relevant literature on cross-border engagement, the following categories of administrative capacities were developed:

- Local democracy
- Center-periphery relations
- Network development around distinct issue areas
- Transnationalism and the development of the international administrative prowess of the state
- Building policy and administrative clusters around issue areas throughout cross-border regionalism
- The top-down mode of institution building carried out by donor structures.

### **Local Democracy and Center-Periphery Relations**

Dynamic center-periphery relations are essential ingredients of strong administrative capacities for cross-border engagement. However, the perceived interests of local and central levels of government in cross-border engagement tend to differ dramatically. Hansen argues for the distinction between economically-oriented efficiency values and politically-oriented sovereignty values (Hansen, 1983). While economic efficiency may entail cross-border economic transactions, political efficiency may discourage such contacts, primarily on grounds of maintaining full control and national sovereignty. Whether a border region will be developed through cross-border links or not becomes determined by the dominance of the efficiency or political sovereignty values. Local levels of government, if administratively strong and accountable to their communities, tend to be carriers of efficiency values, while central governments, in general, tend to be more concerned for national sovereignty. These dual sets of values can be negotiated between local and central levels of government. Provided that the local levels of government are sufficiently administratively evolved, they will be more effective in facilitating cross-border governance and promoting the efficiency values by generating political support for such border and regional planning at the central level. As such, the cross-border engagement can become a regional developmental instrument and an outcome of such bargaining and adjustment between efficiency and national sovereignty values.

While the administrative strength of local governments and their relationships with the center is an important determinant of their role in promoting cross-border regionalism, their immediate international and geo-political surrounding is also influential. In Western Europe local levels of government have been largely empowered by international bodies and international legal tools, as well as active business sectors. In South Eastern Europe these elements are rudimentary, and in the South Caucasus they are practically non-existent. For example, in Western Europe, working through the Council of Europe, local and regional authorities from regions and national ministers responsible for regional planning jointly developed a European Outline Convention on Transfrontier Cooperation. It was endorsed in 1979 by the Council of Europe's Parliamentary Assembly. Since that time it has been signed by Austria, Belgium, Denmark, France, Ireland, Italy, Luxemburg, The Netherlands, Norway, Sweden, Switzerland, and West Germany (as it was at the time). This transboundary cooperation document allows a range of cross-border activities, which can vary from highly informal contacts and consultations to complex and concrete arrangements and institutions (Hansen, 1983). The document has strengthened the position of the local levels of government in promoting cross-border regionalism, thereby strengthening the efficiency values while guaranteeing the protection of national sovereignty. Subsequently, building on this Convention, the European Charter of Local Self-Government was ratified by many countries (including Turkey), and was later on augmented by two additional Protocols (1995 and 1998). This Convention in South Eastern Europe has been ratified by Albania, Bulgaria, Croatia, Greece, Hungary, Moldova, Romania, the former Yugoslav Republic of Macedonia, and Turkey.

Also, within the Western European context, the initiative for such a measure was largely "home-grown". In contrast to Western Europe, such measures are being introduced 'from above' in South Eastern Europe. In South Eastern Europe there is very little local good will for cross-border engagement, as the wounds of war are still very much at the fore. In contrast to the South Caucasus, however, international institutional structures are quite evolved in South Eastern Europe, which poses new problems and offers new opportunities for the quality of local governance. Despite the heavy presence of international institutions in the region of South Eastern Europe, the lack of sufficient political willingness for cross-border regionalism manifests itself in variety of ways.

To try and solve the political problems through cross-border engagement is a mistake. One needs to have a political solution first. Cross-border engagement and regionalism can be facilitators (Cvijic, 2006).

In this respect, the degree of support for or opposition toward cross-border governance is not uniform. There is a divergence between the local levels and central levels of government, the political and economic sectors as well. The international community responds to such diversity by working at various levels within the affected states in South Eastern Europe. A senior level governmental official in Armenia pointed out that in the case of Turkey and Armenia, a political solution has to be found before any type of formal economic engagement takes place, even though various levels of government in Turkey are supportive of having formal relationships with Armenia (Anonymous Interview, 2006).

### **Network Development and Transnationalism**

The multi-layered approach to the promotion of cross-border regionalism best describes the strategy which the European Union has adopted towards South Eastern Europe. The respondents from the Stability Pact have pointed out that they work with governmental Ministries, and that their work with the local levels of government is largely on a project-basis. The dependence of the local levels of government on the legal framework as developed by the center has also been a

factor affecting the work of the Stability Pact in South Eastern Europe. However, the Stability Pact, due to its power of access to donors, has been able to activate the local levels of government by linking them with various associations and donor structures. As a result, local levels of government have found themselves in global diplomatic structures, which is a process referred to as ‘micro-diplomacy’ or ‘trans-governmentalism’ (Slaughter, 2004). Björn Kühne of the Stability Pact noted that the Stability Pact works with local levels of government on a project basis, which primarily involves linking local level governmental officials from one country with their counterparts in another country on the same issue (Kühne, 2006).

I am not sure how much we have achieved in empowering local levels of government. In many areas it was possible to take a specific issue. You mentioned earthquake. We have a disaster preparedness project to build capacities in reacting to natural disasters. These projects are also creating cross-border links between agencies in those issue areas. It is always very issue specific that we try to build institutions across regions. Strengthening local authorities are achieved indirectly. You create a network of people on the same issue, across issues, that can work together without necessarily going through their central governments. A police commissioner can link up with a police commissioner in other counties. Creating networks on issue areas, dispersing information, addresses problems more quickly than going through the center (Kühne, 2006).<sup>20</sup>

The local levels of government in South Eastern Europe have a unique access to International and European donor structures, which makes them a participant in global policies developed for the region. Yet, the abilities of international donors in local democracy projects is generally developing within the confines of the central authority. In South Eastern Europe, strengthening local levels of government has also created a problem of promoting separatism, which some of the respondents have brought up as an important issue to consider in such settings (Kühne, 2006).<sup>21</sup>

The interviews also revealed that the issue of capacity is problematic not only at the local levels of government, but also at the central levels of government as well in South Eastern Europe. The lack of administrative capacities has been noted as problematic, both in terms of institutions as well as skills (Kühne, 2006).<sup>22</sup> For example, some politicians do indeed see themselves as conduits of local interests and as representatives for local concerns at the center. Such politicians know the problems of their communities and they try to work at the center by changing the legislation. Yet there are many more politicians, who do not see themselves as representing or being accountable to anyone at the local level.

The relationship of administrative capacities and cross-border regionalism in South Eastern Europe is quite direct. The multi-layered approach of cross-border governance promotion by the Stability Pact places a heavy emphasis on building trans-governmental networks at both the local and central levels of government. As such, the instruments and mechanisms at the disposal of the Stability Pact offer little by way of conducting direct administrative reform inside the countries under consideration. Instead, the administrative capacities in member countries are dealt with indirectly. The network-building and development around specific issue areas strengthens the international administrative dimension of the member states, without necessarily tackling such internal problems as corruption, bureaucracy and inefficiency of business organization within these countries.

This international administrative dimension of the member states in the region is indeed a crucial one. Srdjan Cvijic of the Stability Pact notes:

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<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

It is possible to get them interested by showing how certain projects can bring political gains for the politicians. Politicians are less prone to cooperate with neighbors. They are less willing to cooperate with “enemies” not to estrange voters... Overall, if the atmosphere at the central level is not good, there is little the local level of government can do. The decentralization is largely a mirage. With “democratic change” and the break-up of Yugoslavia, again a centralization of authority took place. Only now these states are being slowly decentralized through EU efforts. Countries themselves are also engaged in this process of decentralization (Cvijic, 2006).<sup>23</sup>

By building trans-border inter-organizational networks, international actors such as the Stability Pact are in a way challenging the central authority by breaking the institutional isolation of distinct agencies inside the government. By building these networks, the sovereignty of the central authority is being limited through indirect measures. At the same time, if such measures translate into greater economic development, then the same international actors are also strengthening the target state as well as its sovereignty.

Overall, the study of the Stability Pact for South Eastern Europe reveals that the promotion of cross-border regionalism, particularly in settings with a heavy presence of international organizations and their active involvement, can help to strengthen the international dimension of the administrative state. This effect is manifest when local levels of government are activated (‘micro-diplomacy’) or when distinct issue-specific trans-governmental networks are built across borders. In such processes state sovereignty is transformed, redefined and renegotiated. Therefore, within the debate linking the state of administrative structures to cross-border governance the international dimension of state administration is an important variable to consider. The mobilization of trans-governmental networks by the Stability Pact has been the key mechanism activating the international administrative dimension of the nation-states within the region.

**Energy.** Within the context of Turkish-Armenia border politics, energy can potentially be used as an issue area around which transnational networks can be constructed. Cooperation around energy within South Eastern Europe is considered one of the prerequisites for the economic development of the region as a whole. A lack of energy markets discourages efficient production and use of energy, generating frequent power cuts and unreliable power supply, thus becoming a major obstacle in attracting investors to the region (Elst, 2006).<sup>24</sup> Therefore, the international policy-making community considers the creation of energy markets as an important step towards reviving the region as a whole. A major backdrop for this position is the cooperation of post-Second World War Europe around energy policy, which eventually extended to numerous other areas. For such extensions to occur, proper institutions have to be created, according to Renaud van der Elst of the Stability Pact for South Eastern Europe (Elst, 2006).<sup>25</sup>

Within South Eastern Europe energy markets are being created, ‘unbundling’ being the primary strategy of this effort. ‘Unbundling’ refers to the separation of power generation, transmission and distribution, which introduces competition into the energy markets. The privatization of companies operating within these stages of energy production and the distribution cycle also facilitates competition in energy production, transmission and distribution (Vardanyan, 2006).<sup>26</sup> Unbundling creates a basis for various interest groups to form around energy cooperation, which are then ready to link various countries with one another. Ironically, the inter-state cooperation as driven by private actors and international organizations, such as the Stability Pact for South

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<sup>23</sup> Personal Interview with the author, Srdjan Cvijic, Stability Pact for South Eastern Europe, June 28, 2006, Brussels, Belgium.

<sup>24</sup> Personal Interview with the author, Renaud van der Elst, Stability Pact for South Eastern Europe, June 29, 2006, Brussels, Belgium.

<sup>25</sup> Ibid.

<sup>26</sup> Personal Interview with the author, Levon Vardanyan, Ministry of Energy, Republic of Armenia, August 2, 2006.

Eastern Europe, is mistaken by some within the region as an attempt to “put Yugoslavia back together again”. To illuminate the value of such new models of integration, as exemplified within the energy sector, Renaud van der Elst points out that Italy will become the primary customer of the energy as produced within the region. Overall, creating energy markets and increasing the efficiency of production, distribution and consumption of energy within the region is also spearheaded by European Union institutions, as any such efforts are slow in forthcoming from the member states themselves.

The financing mechanism has been another powerful tool utilized by the Stability Pact within the region, aside from the issue-specific cross-border network mobilization discussed above. Dragon Stojović of the Stability Pact argues that there would be very little, if any, cross-border engagement without the various mechanisms (including the financing mechanism) of the Stability Pact and other international institutions operating in the region (Stojović, 2006).<sup>27</sup> These financing mechanisms are available specifically for cross-border projects. Although such financing mechanisms are largely decentralized by design, their implementation outcomes are often limited and challenged by weak capacities at the local levels.

I think it is up to the government as to how they will present these. It is the obligation of the local government to present this [EU funding] to their communities. It is up to the government in bringing these projects and informing their communities... There is still large level of conservatism at the local levels. They complain for lack of information... There is also lack of energy. All these projects are available for everyone. There is a gap; on the one side you have a conservative structure at the local levels, on the other hand at the center you have lack of capacities in presenting these projects. There is poor communication in both directions. If you would like some good local point within the communities, then you have to read lot of CVs. It is hard to find people who speak the languages of both sides of the borders and English, and who are also qualified in these issues, writing reports and evaluations (Stojović, 2006).<sup>28</sup>

In sum, the promotion of cross-border governance and regionalism in South East Europe is largely internationally-driven, and very much dependent on donor financing. Financial as well as institutional support in the region adds up to strengthen the international dimension of the member states in South Eastern Europe. These instruments link various governmental agencies with their counterparts from other states in the region, thereby transnationalizing these states while also integrating the local levels of government to global policy structures. In short, the significance of international actors working on the promotion of cross-border regionalism rests with targeting local and central levels of government and transnationalizing the member states in these regions. At the same time, the study of the Stability Pact also revealed that such international structures are also highly affected by the high level of centralization and lack of capacities and willingness of cross-border engagement within the member states.

The study of the Stability Pact as well as the rich experience and history of Western Europe in cross-border engagement illuminates a variety of lessons for utilizing cross-border engagement for developmental purposes. When contrasting the Turkey-Armenia case to the current developments in South Eastern Europe, the lack of international support structures and financing mechanisms quickly become apparent. Such a comparison also reveals that administrative capacities can also be addressed through cross-border regionalism promotion, and that international engagement can be utilized for activating the local levels of government.

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<sup>27</sup> Personal Interview with the author, Dragon Stojović, Stability Pact for South Eastern Europe, June 29, 2006, Brussels, Belgium.

<sup>28</sup> Ibid.

In general, local structures in Armenia are quite weak, which limits the prospects of using cross-border engagement and regionalism for developmental purposes in Armenia. A senior level governmental official has pointed out that both Armenia's and Turkey's local levels of government are weak. It was estimated that their involvement in micro-diplomacy would not transpire for another twenty-thirty years (Anonymous Interview, 2006).<sup>29</sup>

### **3.3. Conclusion**

The work of the Stability Pact in South Eastern Europe was introduced in this section, and the incentives and obstacles for the cross-border cooperation prevalent in the region were examined. These factors were then discussed in the context of Turkish-Armenia border. Questions of local democracy and center-periphery relations, mechanisms of cross-border, issue-based network development were examined as dimensions of capacity and preparedness for cross-border engagement.

## **4. SECOND LEVEL/INTRA-REGIONAL ANALYSIS: ARMENIA-TURKEY**

The purpose of this section is to examine the intra-regional propensity of cross-border engagement from the Armenian perspective. To reiterate, the propensity is operationalized as willingness and capacity of cross-border engagement, which in this study is addressed within a tri-sectoral framework. This qualitative study has focused on the government, the private sector and the NGO sector (comprising the three sectors), also placing a heavy emphasis on the engagement among these sectors. The first interpretive research question at this level of analysis inquires about the willingness of cross-border engagement with Turkey within the three sectors of the Armenian state and society. The second descriptive research question asks about the existing capacities of cross-border engagement within all three sectors under investigation.

### **4.1. The Government**

#### ***Willingness***

Overall, there were several themes which were shared by all of the interviewed respondents within the government. Specifically, all of the respondents highlighted the importance of transit routes which Armenia could gain as a result of opening the border. However, the significance attached to this factor was not uniform. Two of the respondents pointed out that Armenia has already adapted to the closed frontier on the Turkish side. They argued that the closed border has served as a stimulus for Armenia to look for alternative ways of connecting with European markets, instead of trying to integrate into the regional markets.

Another mid-level governmental officials presented the following argument:

Armenia's geography of foreign relations has evolved greatly from 1990s, when the blockade was a matter of life and death. Today the blockade continues but Armenia has other options. Let's not forget the Iran factor. Let's not forget our increasingly growing FDI levels; and that we moved away from purely assistance-based foreign relations to mutually beneficial industrial economic links (Anonymous Interview, 2006).<sup>30</sup>

One of the respondents indicated his concern that the attempts at integrating with the Eastern regions in Turkey, which he characterized as largely peripheralized and under-developed, would drag Armenia down economically and slow down its own development (Anonymous Interview,

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<sup>29</sup> Personal Interview with the author, Senior Level Governmental Official, August 6, 2006, Yerevan, Armenia.

<sup>30</sup> Personal Interview with the author, Mid-level Governmental Official, July 17, 2006, Yerevan, Armenia.

2006).<sup>31</sup> Analogous sentiments were also argued by others within the context of South Eastern Europe. In the case of South Eastern Europe, the member countries are also trying to integrate with European markets and have EU membership as their incentive. To this end, some of their officials actively resist European pressures for regionalism and regional integration for fear that this mode of development would slow down their pace of European integration.

On a similar note, a mid-level governmental Armenian official expressed confidence that Armenia would be able to compete with Turkish products inside Armenia as well as in global markets. The respondent expressed concern that Turkey is promoting poor quality products in Armenia within the context of officially closed borders from the Turkish side. The respondent argued that the closed border does not hurt the Armenian economy overall. In this argument, the respondent pointed to increasing agricultural production domestically. The respondent also asserted that Armenia was able to avoid the Asian bird influenza pandemic largely due to the closed border with Turkey. Moreover, this individual argued that after the Asian bird flu scare, poultry prices were high in the region for a while, and Turkey could have imported poultry from Armenia if the border was open on the Turkish side.

If the border opens we expect another strong partner with whom our cooperation should be on equal footing. We speak about the exchange of goods. Turkey is going to utilize only a small portion of its economic potential in Armenia. We have all the basis to be on equal footing only with this segment. Today we cooperate with Iran, and we do not see a threat in this relationship. This relationship has enabled us to buy technologies and address gaps in our agriculture. We realize joint projects... Currently we do not need the Turkish economy, because cooperation on their side has been only at the level of a small trade and imports into Armenia. Turkey does not care for our needs, especially when it comes to realizing the poor quality Turkish goods (Anonymous Interview, 2006).<sup>32</sup>

Moreover, one of the senior-level governmental officials interviewed for this study has also argued that even if the border were open and there were cross-border economic transactions, the overall value of such activities for the development of Armenia as a whole would be very limited. Buying a few products for few cents less would do little for the overall development of Armenia, so the argument went. Regarding the question concerning the prospects of cross-border engagement for the development of border communities, the respondent asserted that the issue is a matter of administrative reform, and not one of opening the border.

With respect to the willingness of engagement, one of the respondents expressed a frequently voiced concern pertaining to the difficulty of separating political issues from economic ones:

Right now we can't exclude politics, because the Baku-Tbilisi-Ceyhan pipeline has isolated Armenia. If the railways also isolate Armenia, then there will be little negotiation room left for Armenia. In this case cooperation will be one-sided; it should be two-sided. They [Turkey] have already excluded us from many projects. So even if we start now, we are already on the losing end. So the relationship is asymmetric, and it is hard to isolate politics from economics surrounding this issue. Again, by isolating us they diminish our room to maneuver... Also, we do not have any experience of working with Turkey. We do not know what to expect, what we could import and export (Anonymous Interview, 2006).<sup>33</sup>

It appears that the willingness to cooperate is largely conditioned by fears of imbalanced and unequal bargaining power. This sentiment, however, was not shared by all senior governmental

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<sup>31</sup> Personal Interview with the author, Senior Governmental Official, July 25, 2006, Yerevan, Armenia.

<sup>32</sup> Personal interview with the author, Mid-level governmental official, July 17, 2006, Yerevan, Armenia.

<sup>33</sup> Personal interview with the author, senior governmental official, July 17, 2006, Yerevan, Armenia.

officials interviewed for this study, and the fears of the Turkish economy slowing Armenian development reflects this. The currently ongoing trade (imports from Turkey) was a factor highlighted by most governmental officials in order to argue that Armenia is already exposed to the Turkish economy and that opening the border would add little to already existing trade levels. The issue of accessing new markets was mentioned in passing by one of the respondents, but a greater emphasis was placed on directly integrating with European markets which, was argued, should be the primary developmental goal for Armenia. The same respondents, despite overall skepticism concerning the developmental value of open Turkey-Armenia borders, also highlight the possible capital inflow, access to ports, and increases in services as areas in which Armenia would gain from open borders with Turkey.

### *Capacities*

The issue of administrative capacities of Armenian statehood is a topic which has been widely covered in variety of forums, national and international. This study approached the issue from a more focused perspective, emphasizing areas which are directly affected by cross-border engagement with any country. Specifically, the ability of the state at various levels to foster an environment supportive of the business sector is an important ingredient for a strong statehood, as well as effective cross-border engagement.

The inter-regional cooperation between Marzes is poorly developed, which will affect the development of our relations with Turkey. In many Marzes there is little, if any intra-Marz transport. The physical infrastructure is poorly developed, which leads to many problems. There are many cycles of business-starting, many have problems, but those that are strong they are able to work things out somehow. The process of registration is effective. Registering a business is efficient. However starting a business is a different matter. They have little assistance – mechanisms are poorly working. There is a large difference in business activity among the various marzes (Petrosyan, 2006).<sup>34</sup>

The weak inter-regional cooperation between and among Marzes prevents the development of regional markets at a greater rate. The cooperation between the local levels of government and businesses in the region is also weak. Two of the SME Presidents interviewed for this study pointed out that they do not expect anything from the government, including at the local levels. The frequent and unnecessary checks and visits by Armenian taxation agencies were noted both by the SME sector as well as by one of the senior level governmental officials included in the study as detrimental to development.<sup>35</sup> The provision of public goods is very weak in the regions, particularly the quality of the transportation infrastructure. The lack of partnerships between government and business in addressing some of the social problems in these communities was notable. One of the SMEs that has created 30 jobs in a borderland community village and was on its way to expand to 180 employees had never been contacted by local level government, with the exception of election campaigns and a request to mobilize voters in support of the incumbent candidate (Anonymous Interview, 2006).<sup>36</sup>

The strength of the banking sector is another important prerequisite for businesses to compete successfully globally, regionally as well as locally. And it is a strong banking sector which affects the volumes of exports, and the price of such exports in global markets. Specifically, the lack of capital which is not prohibitively expensive and has maturity periods responsive to the production cycles, is one of the most frequently voiced concerns within the business sector; many

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<sup>34</sup> Personal Interview with the author, Gegham Petrosyan, Deputy Director, Small and Medium Entrepreneurship Development National Center, July 12, 2006, Yerevan, Armenia.

<sup>35</sup> In many cases the respondents from the SME sector were apprehensive in informing about the number of employees they have, fearing that such an information can be passed down to taxation agencies.

<sup>36</sup> Personal Interview with the author, SME President, July 19, 2006, Shirak Marz, Armenia.

respondents argued access to such capital would enhance the ability of Armenian companies to compete with Turkish products in Turkey and/or in Armenia.

A president of a large private enterprise argued that the cost of their products abroad is higher relative to the same products exported from China, for instance, and that this is partly due to the high interest rates and short maturity periods of loan products in Armenia. Another entrepreneur also heading a large company argued that banks are unable to meet the needs of his company. The span of economic activities which some of the enterprises have achieved transcends the financial capabilities of Armenian banks. One of the presidents of a large company in the production sector pointed out that several banks have to join forces in order to satisfy the needs of his company. The prevailing prudential norms limit individual loan exposure to 20% of capital, which directs most banks to small and medium enterprises (Anonymous Interview, 2006; Borish, 2005).<sup>37</sup> To this end, international capital is being used to some extent to fill this gap. For example, the European Bank for Reconstruction and Development has emerged as a key source of capital in the South Caucasus region. An entrepreneur leading a small company in the production sector also pointed out that interest rates for credits are very high, and the maturity periods are too short. The short maturity periods do not coincide with the longer business cycles in the production sphere, although they may meet the interests of a trading company.

All of these issues, as brought up by entrepreneurs, have been and continue to be studied carefully and systematically by researchers and policy-makers. The Special Issue of the Armenian International Policy Research Group publication of 2005 presented range of informative articles pertaining to the financial sector. As noted by some observers therein, some of the challenges which currently the banking sector faces include, but are not limited to: (1) the small size of the banks; (2) the limited array of services; (3) low productivity; and (4) limited access to financial services outside Yerevan (Borish, 2005).

The organizational strength and flexibility of the financial sector and the provision of public goods by the government are particularly consequential for the borderland communities in Armenia. As discussed earlier, the financial sector is poorly represented in the regions of Armenia away from Yerevan. The high costs of credit delivery in rural areas make it extremely expensive for banks to operate in these regions, thereby necessitating subsidized credit delivery schemes by the state (Anonymous Interview, 2006).<sup>38</sup> Therefore, the prospect of using cross-border governance for the development of borderland communities is dependent on creative financial arrangements of credit provision for these areas. One such scheme is currently active in the regions inside Armenia; I discuss that program in a subsequent section of this paper.

One of the challenges which the banking sector faces is the lack of trust between private businesses and banks (Two Anonymous Interviews, July 20<sup>th</sup> and July 25<sup>th</sup>, 2006).<sup>39</sup> Despite rapid reform in the financial sector and major advances in its governance and transparency, a large level of economic activity remains in the form of cash exchanges, some of it comprising an opaque, shadow economy. Some economic activity is not reported by private enterprises for taxation related issues, further pushing some economic activity underground. The current state of Turkey-Armenia economic transactions, which are primarily in the form of imports into Armenia, is largely unregulated with the exception of customs duties paid at the border. Provided that these activities would be more regulated and formalized if economic relations between the two countries were normalized, this would facilitate the further strengthening of the banking sector: a greater level of activity would likely be pushed into the formal sector, which would then can be captured by the banks.

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<sup>37</sup> Personal Interview with the author, President, Large Enterprise/Production, July 24, 2006, Yerevan, Armenia.

<sup>38</sup> Personal Interview with the author, Senior Governmental Official, July 25, 2006, Yerevan, Armenia.

<sup>39</sup> Personal Interview with the author, Senior Governmental Official, July 25, 2006, Yerevan, Armenia; Personal Interview with the author, Senior Governmental Official, July 20, 2006, Yerevan, Armenia.

The institutional links between public and private actors within the financial sector is particularly crucial when trying to enhance financial intermediation and the deepening of financial markets. Expansion of financial services into the regions in Armenia is also a task beyond the capacities of the financial sector alone (Anonymous Interview, 2006).<sup>40</sup> However, one initiative of institutional cooperation between the public and private sector as promoted by the government is applicable to the issue of cross-border engagement under investigation, namely the Small and Medium Entrepreneurship Development National Center of Armenia.

### **Small and Medium Entrepreneurship Development National Center (“SME DNC”)**

The relevance of the SME sector for the Turkey-Armenia Border management is direct. Earlier in this paper I identified two developmental dimensions of cross-border engagement: (i) development of borderland communities and (ii) national development. The relevance of the SME sector is quite pertinent to the former. In 2004, SMEs constituted approximately 38.6% of the GDP in Armenia, with 58.4% of it being in trade, followed by construction (43.1%), services (34.1%), transport and communications (33.3%) and industry (29.7%). In 2004, 39.6% of total Armenian SME activity was in marzes, with the remaining 61.4% being concentrated in Yerevan (Logicon Development and SME DNC, 2005).

Also, the share of SMEs in export in Armenia in 2004 was 15.7%, the remaining 84.3% being generated by large enterprises. Share of SMEs in import was much higher hovering around 34.8%. In Armenia the share of the labor force employed in the SME sector relative to the total labor force of the country was 32.9% as of 2004, which is significantly lower than in Slovenia (62.6%), Croatia (65%), Latvia (69.3%) or Lithuania (70%). Interestingly, Armenia is second only to Croatia within transitioning post-communist economies in terms of share of private ownership (84%) (Logicon Development and SME DNC, 2005).

This brief overview reflects the scope of the economic activity as generated by the SME sector in Armenia. It illustrates a heavy concentration of the economic activity in Yerevan, as well as the little integration of the SME sector into the foreign markets. Therefore, the Turkish-Armenia border politics can be viewed as an opportunity for the further development of the Armenian SME sector, and one possible impact area is the expansion of the market size in the borderland communities where some of the SMEs are active.

One of the currently ongoing initiatives which seeks to deepen financial markets in Marzes by linking the SME sector to commercial banks through governmental support is the Small and Medium Enterprise Development National Center (SME DNC). SME DNC has been created by the government of Armenia, and comprises a fund which is overseen by a Board of Directors. The Minister of Trade and Economic Development of the Republic of Armenia is the Chairman of the Board of Trustees. Other members of the Board of Trustees represent Deputy Ministers from Ministries of Agriculture, Finance and Economics, other mid- and senior level governmental officials, as well as leaders from business associations and an NGO. As such, the agency is quasi-governmental in terms of its governance structure. It performs several functions in assisting SMEs and those seeking to start an SME. Provision of technical assistance, lobbying the government, organizing the SMEs as a sector, and most importantly, providing loan guarantees are some of the key functions of the SME DNC. The provision of loan guarantees by the SME DNC enables those entrepreneurs who lack necessary collateral to obtain credit lines from commercial banks. The fund of the SME DNC provides up to 70% of the bank collateral for the SME, which then releases the credit to the entrepreneur. The fund has established partnerships with the ACBA Bank, Anelik Bank, Ardshininvest Bank, Inekobank and Unibank. According to Gegham Petrosyan, 80% of the

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<sup>40</sup> Personal Interview with the author, Senior Governmental Official, July 25, 2006, Yerevan, Armenia.

SME DNC loan guarantee scheme has been implemented in the rural communities of Armenia. SME DNC has ten branch offices in Armenia which have been established to enhance the capacity of the center in servicing the rural communities in the marzes. For the period January to June 2006, the fund within the framework of its Loan Guarantee Program had provided loan guarantees to 38 SMEs totaling 131.4 mln AMD, which produced loan packages from the partner banks totaling 263.1 mln AMD. The regional distribution of the loans, in number of loans, was as follows: Lori – 9, Tavush – 5, Shirak – 3, Syunik – 2, Kotayk – 3, Gegharkunik – 13, Aragatsotn – 1 and Armavir – 2.(SME DNC, 2006).

Two SME founders who were assisted by the SME DNC fund have argued that the interest rates were too high and the maturity period was short, which did not allow much time for production and business activity to take root. These same arguments have been raised by other SME leaders who have not been covered by the SME DNC. In this respect, these particular respondents point to the challenges which the banking structure faces, and which by extension is the larger systemic environment in which the SME DNC operates. The added value of the SME DNC is the deepening of the financial markets and the linking of the banking structure to the rural areas. This quasi-governmental agency has added flexibility to the financial system, and has provided an institutional link between the financial sector and some small businesses. This initiative stands out as an overall positive case of engagement between the government and the private sector. This particular public-private partnership fills an important gap within the financial sector, namely deepening the financial market and providing access to rural areas, including the borderland communities.

Gegham Petrosyan of SME DNC was highly supportive of having open borders with Turkey, highlighting tourism, increased competition within Armenia and enhanced business attitudes combined with the development of organizational structures within the emergent SME sector as obvious benefits. Agricultural development in particular was emphasized by Mr. Petrosyan, who pointed out that SMEs are very active in this sector. This sentiment has been shared by many respondents of the study, as I discuss later in this paper.

## **4.2. Private Sector**

### ***Willingness and Capacities***

When assessing the issue of preparedness within the governmental sector, the analytical and actual/political separation between the willingness and administrative capacities of cross-border engagement was possible. Such distinction is harder to achieve when addressing the private business sector. The prevalent theme within the business sector interviews was support for opening the Turkish-Armenian border ('willingness'), provided that effective cross-border and internal administrative reforms of the public sector ('capacities') are implemented. The ability of the business sector to compete effectively with Turkish companies in Armenia as well as in Turkey was a common theme in interviews carried out with private business entrepreneurs.

According to Gagik Makaryan of UMBEA, competitiveness should be assessed based on price and quality (Makaryan, 2006).<sup>41</sup> According to the study presented by Joseph Prokopenko at the First National Symposium on Productivity and Competitiveness held in Armenia (February 17-18, 2006 in Yerevan), on a recent international business competitiveness index scale for 2005, the US holds the top ranked spot, with Turkey's at number 51, and Armenia's business competitiveness rated in 88<sup>th</sup> place. In terms of more specific competitiveness indicators for 2005, the quality of the market in the US is ranked the highest, with Turkey at 50<sup>th</sup> place on the same indicator and Armenia at the 110<sup>th</sup> spot. The quality of management/reliance on professional management is

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<sup>41</sup> Personal Interview with the author, Gagik Makaryan, Executive Director, UMBEA, July 17, 2006, Yerevan, Armenia.

ranked as 1st in the US, 66th in Turkey and 111th in Armenia. In terms of investments in staff training, Turkish companies placed in 42<sup>nd</sup> place, and Armenia was a laggard in this respect as well, occupying the 90<sup>th</sup> spot in 2005. In terms of business sophistication, Japan was ranked first, US was the third, Turkey was 41st, and Armenia was 81<sup>st</sup>. In terms of business innovation, US was first, Turkey was 51<sup>st</sup>, and Armenia was 73<sup>rd</sup>.

With the backdrop of these statistics, the responses from interviews for this study related to the issue of competitiveness were quite diverse. Some respondents were concerned that Turkish businesses have larger scales of production and more diverse suppliers of raw materials, which will strain the Armenian business sectors when entering into the same competitive environments. The ability of local producers to compete with Turkish products was a concern among such respondents. Two of the senior governmental officials, as reported earlier, fear that economic interaction with Turkey will slow down the economic development of Armenia. As such, however, they do not view the Turkish businesses to be a threat to Armenia, but rather a diversion from Armenia's integration with European structures.

Yet another group of respondents offers more balanced perspectives on the topic, arguing that the Turkish imports have already established themselves in the Armenian market, and that the Armenian producers have been able to adjust to the presence of Turkish products (Bekirski, 2006).<sup>42</sup> Such respondents do recognize possible adjustments that will happen within the Armenian economy, and accept some short-term losses, in the case of open borders. However, such respondents were largely confident that in the long-run the engagement with Turkey will strengthen the competitive capacities of Armenian businesses. For instance, Mr. Gagik Makaryan of UMBEA argues that there will be few changes in terms of imports, so the competition internally will not change very much. And any of the changes which would happen should be considered adjustments, which will in the long-run improve the overall strength of the economy and improve the competitiveness of Armenian businesses. Mr. Souren Bekirski, the President of TOSP Large Manufacturing Company also argues that Turkish imports have already established themselves in the Armenian market and that the competitive environment for Armenian businesses inside Armenia would not be drastically different with open borders; however he is quite cautious in his assessments regarding the prospect of Armenian companies entering the Turkish market:

Turkey has succeeded in using foreign capital and markets. Foreign Direct Investments in Turkey have been used more effectively than in other countries. In 15 years they, from zero, created a stunning industry, both in textiles, machinery, chemistry and tourism. To talk about competition in their country, I doubt it... The labor costs in Turkey varies from region to region. In western regions [of Turkey] labor is more expensive; in eastern parts the pay is lower but it still is more than it is in Armenia. They do have high productivity, which is explained by their modern equipment and machinery, and effective management (Bekirski, 2006).<sup>43</sup>

With respect to the willingness of engagement, the respondents from the private sector can be divided into three groups. The first, which I term "absolutists", insist on open borders without any preconditions or prerequisites. Such observers view the private sector to be highly self-reliant, and have little, if any, expectations from the government. "We have cut through the blockade in those difficult years, so we have learned to be independent and do not expect anything from the government." (Anonymous Interview, 2006).<sup>44</sup> Twenty-eight respondents expressed such support

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<sup>42</sup> Personal Interview with the author, Souren Bekirski, President, TOSP, Large Manufacturing Company, July 24, 2006, Yerevan, Armenia.

<sup>43</sup> Bekirski, *ibid*.

<sup>44</sup> Telephone interview with the author, Haytransarakogh, July 12, 2006, Yerevan, Armenia.

for open borders without necessarily raising issues of preparedness and expressing concern for various public service reforms inside Armenia, or at the border.

A second group, termed “relativists”, express their willingness and confidence in being able to compete with Turkish products inside Armenia, provided that the necessary public administrative reforms be carried out. Simplifying taxation, cross-border customs issues, export related paperwork, and strengthening quality control measures are among the areas which these entrepreneurs specify. This is the conditional approach to cross-border governance. Thirty of the phone interviewees and two of the in-depth interview participants from large businesses can be categorized in this group.

The third group, which was a minority among the respondents, sees very little, if any, benefit from engaging with Turkish economy more systematically and comprehensively. There were seven of these “isolationists” among the sixty-six respondents. Interestingly, all of these seven companies but one target primarily local markets. Two of them also operate within the regional market. Only one of seven mentioned Russia as a market of operation. Two of the companies specialize in food production, target local and regional markets and employ fifty-five and one-hundred people respectively. Another one employs sixty-four people and specializes in services, targeting the Russian market. Four out of seven companies employ less than ten people and work primarily within the local market.

Some of the trends reflected in the data reveal a close inter-relationship between the willingness and capacities of the organizations considered in this study. Those organizations with an established engagement with global markets were generally more eager and open to cross-border engagement with Turkey. Those that target the local market primarily and are poorly integrated with the global economy do not project global integration, and do not see Turkey as a market for their products and services. Once again, the willingness and capacities of cross-border engagement may be inter-related.

The in-depth interviews with large company representatives from the production sector indicated their overall support for opening the border, which likely reflects their desire for access to new markets. One of the respondents from a large company with enterprises in several sectors (production, trade, services) pointed out that opening the border would accelerate their cycles of production, which currently are choked by transportation gridlocks.

Every new channel of communication will be beneficial for our economy. We can transport our products quicker and the overall economic cycle of our companies will be facilitated (Anonymous Interview, 2006).<sup>45</sup>

Large company representatives which expressed support for open borders with Turkey (termed an ‘offensive’ approach to cross-border engagement) tended to be highly integrated in local, regional and global markets, particularly having a strong presence within the Russian market. It appears that globally integrated companies have developed specific skills and organizational capacities of negotiating access abroad, and it is such companies which consider an open border with Turkey as an opportunity, and not a threat. Those large companies which were more defensive towards engagement with Turkey tended to be more concentrated within the local and regional market. Open borders were perceived in terms of heightened competition and did not place any emphasis on the prospects of accessing Turkish markets. Companies from the food production sector were more concerned and fearful of heightened competition within the Armenian market and were fearful of the inflow of low-quality and/or cheap Turkish products. Those companies which were

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<sup>45</sup> Personal Interview with the author, Executive Director, Large Enterprise/Production, Trade, Services, July 28, Yerevan, Armenia, 2006.

more multifaceted including food production and services, for instance, were more eager to access new markets and were quicker in seeing the international dimension of the issue.

The heads of the large manufacturing companies pointed out that Russian market is full and highly competitive. The market in Iran, by contrast, is protected. Moreover, some argued that transporting products to far-removed regions is unreasonable, which makes Turkey, which is geographically closer, a more sensible choice. For some of the small and medium size companies in the borderland communities easy access to Turkey is also highly supported. Reduction in the costs of machinery and equipment of production is the main incentive for many (Anonymous Interview, 2006).<sup>46</sup> Currently, these small and medium enterprises purchase equipment, machinery and raw materials from Yerevan, where they are sold as Turkish imports. The added transportation costs and the increased chain between the producer and the consumer (the SME) increase the costs of production for the SME. Interestingly, an SME in the Shirak Marz working in shoe and footwear manufacturing similarly pointed out his dependence on the trader of leather, which is purchased from Turkey:

I am wholly dependent on these traders. But they are not professional shoemakers themselves, and they rarely meet my expectations in terms of the quality of leather that I need. If there was easy access, I would have purchased it myself, and the quality of my end product would have been higher (Anonymous Interview, 2006).<sup>47</sup>

Virtually all of the enterprises raised the issue of inadequate capitalization. Large companies highlighted that banks are small and with little capital. Moreover, the lending cycles and interest rates offered by local banks are satisfactory for those in trade, but not for those in production. In this respect, while some of the limitations which currently the banks face is problematic for more effective business engagement with Turkey, opening the border and the possible entry of Turkish banks into the Armenian market could provide new financial instruments and channels for Armenian businesses. Smaller businesses also insisted that the interest rates are too high and the maturity periods are too short. Lack of capital was also cited as a major limitation by such enterprises. The possible entry of Turkish banks and other foreign banks may heighten the competition within the financial sector and push local banks towards more creative areas of investment, branching out on the services offered by also achieving greater specialization.

As it appears, the majority of the businesspeople expressed strong support for opening the border between Armenia and Turkey. Among some of the more specific areas of opportunity as identified by respondents were reduced transportation costs, access to ports, reduction in prices of goods originating in Turkey, and reduction of materials costs (such as machinery and production equipment, leather, among others) which could eventually bring down the cost of the production. The potential impetus given to agriculture and developments in tourism were also noted quite frequently. Expanded opportunities for banks and additional circulation of capital were also noted. One of the respondents highlighted that certain products cannot be exported to Europe for variety of reasons, but they could be exported to Turkey due to its proximity and fewer controls and regulations relative to Europe. Having an alternative market to Russia was cited as a factor in negotiating better terms of trade within the Russian economy.

In terms of fears, perhaps the biggest concern was the inflow of cheap and low quality products from Turkey, which many surmised may hurt local producers. At the same time, entrepreneurs with such concerns consistently specified their ability to compete with Turkish products if quality control measures were instituted at the border:

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<sup>46</sup> Personal Interview with the author, Director, SME/Production and Trade, July 19, 2006, Shirak Marz, Armenia.

<sup>47</sup> Personal Interview with the author (2), Director, SME/Production and Trade, July 19, 2006, Gyumri, Armenia.

Our governmental quality control agencies do not have the necessary equipment to check the quality of incoming products. They issue quality certificates without doing the necessary analyses, and they also issue low customs tariffs to these goods... Ecologically unhealthy products are entering Armenia, and because they are cheaper, people tend to buy those without having the necessary information pertaining to the risk posed to their health by these products (Anonymous Interview, 2006).<sup>48</sup>

Another respondent highlighted that the possible inflow of low quality products is contrary to the consumer rights. Therefore, the argument goes, the government is responsible for instituting adequate quality control measures before engaging with the Turkish economy in a more formalized and systemic level. Such measures, the argument goes, will control the low quality-low cost products into Armenia, and Armenian enterprises can compete with higher quality and higher cost Turkish products.

Another issue pertaining to the administrative capacities of the public sector is the level of bureaucratization and inefficient public administration, which slows down the business cycles and the pace of exportation as carried out by private businesses. Specifically, a businessperson leading a large company engaged in production and trade pointed out the following:

I do want to emphasize that there are many bureaucratic hurdles during export. You have to pass through many agencies in order to export. It has to be more efficient. For example, right now we are in the process of exporting to Georgia and it has been three days that we have not received the necessary paperwork. Our pace is much faster than theirs (the government). Our volume of production is increasing rapidly, but the government is still slow... If something is too complicated then there is room for corruption (Anonymous Interview, 2006).<sup>49</sup>

According to a previous study carried out by UMBEA (Union of Manufacturers and Business Employers of Armenia), 59% of respondents noted bureaucratic gridlocks, unnecessary checks and paperwork as the main obstacles within the business environment of Armenia. Lack of clarity and stability within the legal framework was listed as an obstacle by the 44% of respondents. Corruption was mentioned by 43% of the respondents. Interestingly, 39% of the respondents highlighted the lack of access to foreign markets and 35% argued that the level of monopolization within the internal market is too high (Makaryan, 2006).

### **4.3. Civil Society and the NGO Sector**

The relevance of the NGO sector for cross-border engagement is two-fold. Internally within states, it has a domestic significance in cultivating closer *institutional* and *formal* links and generating forums of engagement for the government and the business sector. Externally, the NGO sector and other civil society organizations offer important channels of Second Track Diplomacy, particularly in regions where cross-border engagement is complicated by political problems and diplomatic hurdles.

The ability of the NGO sector to cultivate links between the public sector, the private sector and the civil society contributes to the national preparedness to engage effectively in regional economies, including developing cross-border links. Unfortunately, within the context of liberalizing statehoods in transitioning and developing countries such as Armenia's there is little basis for such an institutional dialogue between the public sector, the businesses and civil society. The lack of such an institutional dialogue is correlated with the consolidation of non-formal institutions in Armenia, which entails significant costs for economic development in the country

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<sup>48</sup> Personal interview with the author, President, Large Enterprise/Production, July 24, 2006.

<sup>49</sup> Ibid.

(Jrbashyan, 2006). Ironically, the liberalization of the Armenian economy and political structures in the transition period has been concurrent with the retreat of governmental structures from the economic sphere. Liberalization of economic and political structures is interpreted as reduction in governmental capacities as well. The weakness of formal and institutionalized links between the private and public sector is one such manifestation.

In Armenia the cross-sectoral dialogue seems to be increasing with the formation and consolidation of professional and business associations.<sup>50</sup> Here some of the professional associations have started to emerge, and the Union of Manufacturers and Business Employers of Armenia (UMBEA), the Foreign Investors' Association, the Green Lane Agricultural NGO and the Protection of Consumer Rights are some examples. UMBEA is non-profit organization, established in 1996. Large, medium and small entrepreneurs for the membership of UMBEA, and it functions to influence economic legislation, to protect the interests of manufacturers, to develop international business contacts with the Armenian businesses and to foster relationships within the Armenian business sector as well as abroad. One of the major functions of UMBEA is "...to establish continuous and constructive dialogue with the Government and the Legislative body of the country, to bring to the notice of respective governmental instances problems and issues which touch upon the group interests of businessmen." (Union of Manufacturers and Businessmen Employers of Armenia, 2006) UMBEA represents the seeds of potential public-private partnerships, but its main function is advocacy and skill-building within the business sector. Within the UMBEA framework the ability of accessing foreign markets is largely viewed as the sole responsibility of the business sector, a view which is also widely shared among the business-sector respondents in this study.

Overall, Armenian NGOs are criticized for being donor-driven and exhibiting little responsiveness to the public. Various studies have pointed out that only two-thirds of the NGOs registered in Armenia are active. Margarit Piliposyan also highlighted that the NGO sector capacities are weak in Armenia, particularly in the border areas:

NGO skills of initiating and negotiating can be somewhat lacking due to weak capacities on the Armenian side. I am not sure that we have strong professional NGOs on our side. We would need to do capacity building to prepare them towards that end. Probably opening resource centers, information centers, training centers would be one way of addressing the problem (Piliposyan, 2006).<sup>51</sup>

The external significance of the NGO sector rests with cultivating cross-border links with NGOs on the Turkish side. Such engagement would most likely be issue-specific, mirroring the issue-based network mobilization as practiced by the Stability Pact in South Eastern Europe. Moreover, NGO cross-border engagement also falls into the category of Second Track Diplomacy Projects, which are essential in facilitating and building on cross-border activities.

Sixteen NGOs have been included in this study. Five in-depth interviews were supplemented with eleven telephone interviews. In-depth interviews were conducted with those NGOs which were determined to have had the most interaction and projects with Turkey. The respondents for telephone interviews were included based on the issues which are most closely related to cross-border governance. Specifically, NGOs working on transnational issues were targeted. Environmental protection and sustainable development, women's rights, law and order, and

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<sup>50</sup> On August 1, 2006, in an interview carried out with the author in Yerevan, Margarit Piliposyan, the President of the NGO Center highlighted that currently there is a draft legislation on lobbying which requires the use of professional lobbyists. The NGO sector is quite concerned fearing that such an initiative would curtail the work of the NGO sector in effectively representing various social groups within the policy making structures in Armenia .

<sup>51</sup> Personal Interview with the author, Margarit Piliposyan, President, NGO Center: Civil Society Development Organization, August 1, 2006, Yerevan, Armenia.

consumer rights are among the issues represented within the sample. All of the respondents, with the exception of two, were very supportive of opening the border. Some of the opportunities which NGO sector representatives highlighted included (1) greater control over transnational problems, such as human trafficking, human rights violations, environmental protection and quality control measures; (2) utilization of the Armenian healthcare system by the population of eastern Turkey; and (3) offering transit routes to Turkey to connect with Central Asia, among others. Some of the reservations and concerns expressed by the respondents included (1) the projected cultural change in Armenia due to the inflow of high number of Turkish nationals; (2) higher inflow of low quality goods from Turkey, which, if left unregulated and poorly managed, would raise public health problems in Armenia; (3) heightened competition to Armenia's agricultural sector; (4) overall change in the competitive environment within Armenia; and (5) the availability of globally connected capital in Turkey and a modernized business class.

The overall capacities of the NGO sector is very uneven in Armenia. Most of the NGOs are concentrated in Yerevan, and there is little NGO presence in the borderland communities. Some of the NGOs are more embedded in transnational structures than others. Some have more resources than others. Those NGOs that have been started by transnational parent NGOs and international organizations tend to have more resources both in terms of finances as well as organizational skills. I have reviewed the NGO sector in Armenia elsewhere (Ohanyan, 2003). At this point it suffices to say that there are several NGOs around which Track Two Diplomacy initiatives can be built. Currently an interesting model of NGO activity used for the promotion of cross-border regionalism is utilized by the Danish Refugee Council. This project targets the NGO sector within the South and North Caucasus. The network of organization mobilized around this project is represented by 60 organizations. The main mechanism utilized within the network is the availability of grants for cross-border activities, involving at least three countries and/or unrecognized republics within Caucasus (Piliposyan, 2006).<sup>52</sup>

The International Center for Human Development (ICHHD) is one of the few NGOs which has been extensively involved in Track Two Diplomacy projects with Turkey. Tevan Poghosyan of IHCD has argued that having open borders with Turkey will not automatically translate into development for Armenia. Such cross-border management will be beneficial for Armenia if it effectively managed.

Opening the border may help us in trade, but today the open borders will not mean as much because we do not have a strong theme to negotiate appropriate arrangement for us. And I am confident that they [Turkey] are able to do that once the borders are open. Unfortunately, we are not getting ready to prepare [in Armenia] (Poghosyan, 2006).<sup>53</sup>

While highlighting the role of public preparedness for cross-border engagement, Tevan Poghosyan has listed several areas of possible engagement with Turkey. For instance, he pointed out that Antalya is a tourist destination, and many souvenirs for that market can be made more cheaply in Armenia. Exporting Armenian beer to Turkey, opening Armenian hospitals to Eastern Turkey, which are removed from major Turkish cities, establishing joint ventures were some of the areas that Tevan Poghosyan has mentioned.

Tevan Poghosyan has also brought up the issue of poor engagement between the business sector and the public sector, arguing that the European Neighborhood Policy will open many doors, but that the business sector has no awareness of such prospects and that they do not speak with the

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<sup>52</sup> Personal Interview with the author, Margarit Piliposyan, President, NGO Center: Civil Society Development Organization, August 1, 2006, Yerevan, Armenia.

<sup>53</sup> Personal Interview with the author, Tevan Poghosyan, Executive Director, International Center for Human Development, July 12 and July 16, 2006, Yerevan, Armenia.

government on such issues (Poghosyan, 2006).<sup>54</sup> The lack of effective cooperation with Georgia was also noted by Tevan Poghosyan who expressed his disappointment that there is little understanding of regional issues. This can be problematic now that the European Neighborhood Policy entails negotiations with Armenia, Georgia and Azerbaijan. According to Tevan Poghosyan, Europeans are expecting an understanding of shared interests among the members in the Caucasus, and are hoping to negotiate with them as a region.

In terms of existing Track Two Diplomacy Projects, Mr. Poghosyan has highlighted that ICHD has been at the center of many such initiatives. One of these projects was funded by the American University Center for Global Peace which also generated the TARC (Turkish-Armenian Reconciliation Commission) program. ICHD has assisted the Center for Global Peace by providing them with ideas and proposing possible initiatives of engagement. Some of the projects were good, and some were bad, he argued. However, all of these projects generated partnerships and networks.

Tevan Poghosyan has expressed his strong support for Track Two Diplomacy projects, asserting that “Track Two will say things, which Track One will not”. Conducting parallel projects and prioritizing socio-economic and political issues were mentioned by the respondent. Specifically, starting from socio-economic projects was highlighted as a base for both sides to move towards political discussions. Long-term donor commitment was emphasized as an essential ingredient for such Track Two Diplomacy projects to have ‘spill-over effects’.

The role of the NGO sector is equally valuable both during a Track Two Diplomacy Project, as well as throughout the cross-border engagement process between two countries. Any cross-border engagement of border communities entails enhanced transnationalism of a given state. In cross-border engagement the borderland communities involved find themselves in transnational spaces which, although continue to remain within the jurisdiction of the respective states, are characterized by a high degree of dispersion of authority. NGOs can be crucial in such settings to maintain a spotlight on the interests, needs and positions of various social groups which may be negatively affected (directly or indirectly) by transfrontier cooperation and cross-border regionalism.

The same issue of preparedness examined within the context of the public sector and the government plays out in the NGO sector as well. While the engagement areas for the NGO sector both before and after establishing cross-border links are quite wide, the lack of capacities complicates the issue. Despite the overall organizational weakness of the sector, there are several strong NGOs around which some Second Track Diplomacy Projects can be built. If cross-border regionalism takes root, it will strengthen the capacities of the NGO sector in the border areas. Margarit Piloposyan’s idea of creating training and resource centers in the border areas is quite valuable. Also important is the committed donor funding to sustain cross-border links in civil society. To reiterate Tevan Poghosyan’s point articulated earlier in this paper, a lack of donor commitment can undermine the potential of Track Two Diplomacy Projects. Procuring funding from the business sectors of both sides for Second Track Diplomacy projects can be utilized as an alternative, and perhaps more sustainable, source of funding.

## **5. POLICY RECOMMENDATIONS**

### **5.1. Coping with Globalization and Cross-Border Engagement**

How should developing, small countries treat cross-border engagement in light of economic globalization, considering the following?

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<sup>54</sup> Poghosyan, *ibid.*

- (1) Globalization spreads unevenly across regions.
- (2) Urban areas and large cities boast heavy concentration of multi-national companies and financial markets.
- (3) Highly sophisticated business actors with evolved governance structures are the 'heavy hitters' of economic globalization.
- (4) Such globally active businesses enjoy deep integration with global financial markets.
- (1) Economic logic orients foreign direct investment to countries with abundant labor forces and large markets with well-developed physical infrastructure (roads, railroads and bridges) and institutional resources (courts, police, banks); the latter is equivalent to evolved administrative structures of the FDI recipient state.
- (2) Global actors favor political stability.

Three possible policy responses can be identified which, however, are not mutually exclusive. A first response is one of *mobile globalizing*, which refers to transcending borders and accessing markets in Europe, North America, Eurasia and East Asia. This approach attaches little significance to geography and borders, assuming the possibility of developing industries that are flexible and invulnerable to the constraints of geography and borders. In Armenia this approach was favored by the two senior governmental officials interviewed in this study who broadly argued that Armenia has little to gain from engagement with Turkey and that it should focus on its continuing efforts of integrating with global markets within Europe. Development of the Armenian information technology sector was a frequently cited case to support this position.

A second possibility is *regional globalizing*, which is defined as the joining of multiple states into regional formal arrangements and trade blocs. Creation of the European Union and its structures, the North American Free Trade Organization, the Association of South East Asian Nations, and others, are examples of this approach. Some observers argue that such economic regional blocks are protectionist measures, as they help to temper fierce global competition. Others insist that economic regionalism enables and facilitates greater integration of member countries into the structures of global economy (Larson and Skidmore, 2003).

The third policy option, *local globalizing*, is the practice of cultivating cross-border links and institutions in an effort to transcend the small market size of a given country. Some of these arrangements can be more formal than others. Some cases of local regionalism are more managed and regulated than others, and the specific conditions are highly contingent on the administrative capacities and administrative resources of the states involved. For example, European integration received a significant boost from post-war transfrontier developments, a prominent case being the Rhine Basin (Anderson and O'Dowd, 1999), which started as a local regional project and eventually stimulated a process of global regionalism within Europe. In other cases, local regionalism can be weakly administered, regulated and managed, an example of which is the current trade between Turkey and Armenia, which is largely an importation of goods from Turkey into Armenia. Overall, the main incentive for promoting cross-border governance in Armenia is to induce foreign direct investment within a given region and offset the small size of the market of a given country. Open borders would create favorable conditions for multi-national companies operating in Turkey to extend their business into Armenia as well.

The practice of building cross-border regions around the world is viewed by member states as a tool to moderate the global competition that they face. Those promoting regionalism and cross-border engagement see such arrangement as shortcuts to accessing global markets. Globalization advances unevenly, and geography still matters in shaping access to global markets. As was illustrated in this study, countries in South Eastern Europe, with the support and assistance from European Union institutions, are progressing in the direction of facilitating cross-border links among the member countries, despite the bitterness of the Balkan wars of the 1990s. Making borders more flexible for businesses and less fragmented in South Eastern Europe is the main

strategy that is currently advanced by national and international policy-makers there, in an attempt to attract foreign direct investment into the region and promote political stability.

The small size of the economies in South Eastern Europe is addressed by establishing free trade zones and making borders more flexible and transformed. The economies which had been fragmented by political divisions in the region have made for unattractive foreign direct investment destinations. Increasing the flexibility of borders and easing cross-border movement of capital and production has been used as an important incentive to attract foreign direct investment (FDI). While FDI may not be attracted to a market of a few million people, it will be much more interested in a market of a few tens of millions. “Countries individually are small; they need to be promoted together” (O’Mahony, 2006).<sup>55</sup> To move towards such a goal, the Stability Pact has been pushing countries in South Eastern Europe to negotiate bi-lateral agreements, and thirty-one such agreements have been negotiated to date with the support of the Stability Pact. Currently, the Stability Pact is also in the process of promoting negotiation toward a single free trade zone, which is viewed as a ‘practicing ground for EU membership’ - a major carrot in promoting cross-border regionalism in South East Europe (O’Mahony, 2006).<sup>56</sup>

In the context of Armenia and the Turkish-Armenian border issue, the two senior governmental officials interviewed for this study emphasized the first approach, i.e. transcending borders and accessing European markets, as defined above. Therefore, it is important to point out that Armenia should continue to access European markets, as the governmental officials argue, without necessarily underestimating the value of regional development in border areas. The perceived need for the Armenian state and economy to bypass its regional markets and transcend its challenging geographical surroundings does not need to come at the expense of regional development, which at the moment can be best advanced through the third policy option approach of coping with globalization (‘local globalizing’ as defined above).

## **5.2. Short-term versus Long-term Policy Implications**

The realization of all three policy avenues discussed above is highly contingent on the administrative power of Armenian state, and the modernization of the Armenian business sector. As many would claim, it is consequently not an issue of opening the border, but one of internal administrative reforms. As was articulated in the previous sections of this paper, cross-border engagement can be viewed as a tool to enhance the administrative capacities of the state at the local levels, particularly in border regions. Greater interaction would generate more demand for competent performance of local institutions. At the same time, the benefits of cross-border engagement can be more effectively realized if local levels of government in borderland communities adopt a proactive and entrepreneurial posture.

A summary of long-term and short-term policy implications are presented below. Some of these suggestions are dependent on a political solution with Turkey, while others should be viewed as instruments of Track Two Diplomacy. In the proposed framework, the strengthening of administrative structures at local levels and the institutions of border control are recognized as long-term initiatives. The enhancement of links between the public and private sectors is also an example of such long-term engagement, which in general would strengthen the cross-border engagement capacities of Armenian state.

Organizational changes within governmental agencies to enhance the cross-border engagement capacities of Armenian statehood is also a recommendation with a long-term significance. Here the emphasis goes beyond Turkey, to include Armenia’s engagement with other countries within the region as well. In this respect, facilitating greater inter-agency dialogue within the Armenian

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<sup>55</sup> Personal Interview with the author, Mary O’Mahony, June 30, 2006, Brussels, Belgium.

<sup>56</sup> O’Mahony, *ibid.*

government is essential. To increase Armenia's exports within regional markets public-private partnerships need to be strengthened, as discussed above. However, such partnerships can be best utilized if appropriate Ministries and governmental agencies coordinate their policies more intensively and effectively. In terms of cross-border engagement, inter-agency dialogue and policy coordination between the Ministries of Trade and Economic Development, Foreign Affairs, Agriculture, Transport and Communication, Finance and Economy, Territorial Administration, Defense and State Customs Committee is essential. Creating a specialized agency for cross-border engagement or regional economic development to oversee such inter-agency policy coordination can be an effective tool in strengthening Armenia's capacity of utilizing its economic ties within the region. Such horizontal coordination has to be coupled with vertical coordination between the central and local levels of governance in Armenia, but the weakness of local levels of government is a major challenge towards this end.

The proposed specialized agency for cross-border engagement or regional economic development can:

- initiate public-private partnerships;
- organize trade and business visits to neighboring countries;
- conduct research on regional trade patterns and its prospects;
- study the experience of other countries in engaging regionally;
- negotiate with banks to and the government to create specialized loan programs targeting border communities;
- study the potential of cross-border engagement for agricultural development in rural areas, particularly those along border areas;
- provide information to local businesses in terms of business contacts and market conditions in neighboring countries;
- provide information on Armenia's business environment and Armenia's business contacts to interested parties in neighboring countries.

The short-term policy prescriptions proposed in this study are more specific. The experience of the Stability Pact for South Eastern Europe has demonstrated the value of building cross-border cooperation around distinct, and at times highly technical, issue areas. More formal institutions to support such cross-border cooperation generally follow. Within the context of the Turkey-Armenia border, three issues are particularly attractive in the short term: human trafficking, environmental protection and the energy sector. All three issue areas stand out as highly technical, and therefore, are somewhat easier to decouple from the larger political context surrounding the severed diplomatic links between the two countries.

***Human Trafficking and Transnational Organized Crime.*** Turkey has been at the forefront in efforts to combat transnational crime within international forums, such as the United Nations. According to the General Assembly Resolution A/55/383, Turkey's approach to combating transnational organized crime is proactive because Turkish officials link the issue of transnational organized crime with transnational terrorism. According to this same resolution, the link between transnational organized crime and terrorism has been established at the World Ministerial Conference on Organized Transnational Crime, which was held in Naples, Italy, in 1994. In short, human trafficking is framed as a transnational criminal activity by the Turkish side, which therefore, casts the issue in the realm of 'high-politics' of national security.

The problem of transnational organized crime as experienced from the Armenian side is one of human trafficking. Armenia is a major source and transit route for women and girls trafficked for sexual exploitation to the Middle East, Turkey and elsewhere. Traffickers route the victims to Turkey through Georgia via bus. According to the U.S. State Department 'Trafficking in Persons Report' of June 2006, the profits derived from the trafficking of victims through Armenia have reportedly increased compared to previous years (U.S. Department of State, 2006).

Public health problems, such as infectious diseases, reproductive health problems, substance abuse, mental health problems and violence, are directly associated with human trafficking, and thus are serious concerns for both countries (U.S. Department of State, 2006). Without belittling the importance of these issues in their own right, their possible contribution to producing cooperation in economic issue areas should be recognized. Specifically, countries which remain in Tier 3 (see note below) three years in a row can lose all non-humanitarian aid from the US government (Congressional Quarterly, 2004). While it is true that neither Armenia nor Turkey are considered in this category, the US government could take a more active stance in encouraging Turkey and Armenia to cooperate in combating the human trafficking that occurs between the two. Cooperation around this issue area will help both countries manage substantial public health problems. At same time, it can be utilized as a bridge towards cooperation in other issue areas between the two countries.

***Environmentalism.*** Northeastern Turkey and Armenia are part of the Caucasus Ecoregion, which is one of the most biologically rich regions on Earth, and is among the planet's 25 most diverse and 'endangered hotpots' (Williams, et. al., 2005). Policy-makers identify logging, overgrazing, poaching, infrastructure development and pollution as key causes driving the loss of biodiversity in the South Caucasus. The growing incorporation of the countries in the region into the structures of global economy has accelerated the pace of environmental damage, illegal timber export being among the most visible example of such activities.

There are a variety of areas around environmental protection of the South Caucasus Ecoregion which are in need of transborder cooperation between the member countries. Unsustainable logging and fuelwood is one of the environmental problems affecting both Armenia and Turkey. According to the Ecoregional Conservation Plan for the Caucasus as developed by governmental officials from the region as well as the international donor community, the Greater Caucasus Mountain Range and the Lesser Caucasus Mountain Chain (including the Dogu Karadeniz mountain in northeastern Turkey, the Meskheta and Trialeti ridges in Georgia, the Shakhdag, Sevan or Areguni, Pambak, Khalal, Ijevan, and Zangezur mountain ranges in Armenia, and the southern Zaqnqezur Range in the Nakhichevan (Azerbaijan) and the Talish Mountains are the most impacted by unsustainable logging and fuelwood (Williams, et. al., 2005). Forest inspection agencies play a crucial role in combating illegal logging and trade. Transboundary cooperation and NGO participation in monitoring the timber trade in the region are cited as important potential steps towards preventing illegal logging.

The utilization of the freshwater ecosystem in the Caucasus is another issue areas that is highly contingent on the cooperation of the countries within the region. The Javakheti-Asia Minor-Lake Sevan Region and Kura-Araks Basi can potentially contain protected areas and linking corridors, but the creation of these is dependent on transfrontier cooperation. All of these possible environmental programs need the proper organizational support, as noted by the participants of the Nature Protection in the Caucasus Ministerial Conference held in March 2006, in Berlin. Some of the policy recommendations as introduced by the authors of the "Ecoregional Conservation Plan for the Caucasus" document include, but are not limited to, the following:

- Organize a well managed protected area network across the Ecoregion;
- Encourage collaborative management through involvement of all stakeholders, from national governments to NGOs and local communities;
- Conserve and restore endangered species;
- Promote transboundary cooperation;
- Restore degraded ecosystems;
- Harmonize legislative and policy frameworks;
- Coordinate specific research and monitoring across the Ecoregion (including on indigenous knowledge and local communities);

- Increase environmental education and raise public awareness on biodiversity conservation (Williams, et. al., 2005).

To reiterate, environmental protection is a highly technical issue and therefore it is more amenable to being de-politicized. As such, it can be used as an effective tool of Second Track Diplomacy projects between Turkey and Armenia.

**Energy.** Within the Turkish-Armenia border the energy resources have so far been used as instruments of conflicts and bargaining chips, with oil pipelines and key transport routes bypassing Armenia. Such developments, however, do not preclude the possibility for energy policy to be used as one area around which cooperation and proto-regions can be constructed. According to Levon Vardanyan of the Ministry of Energy in Armenia, Europe is attempting to integrate the region with European energy markets, which is also a trend within the context of the South Eastern Balkans. Such preferences indeed strengthen the energy positions of Western Europe, but also contribute to the increased efficiency and distribution of energy resources within the regions under consideration.

Levon Vardanyan pointed out that an unbundling of energy production, transmission and distribution has already taken place in Armenia (Vardanyan, 2006).<sup>57</sup> Liberalization of energy policy and market structures in this issue area also were noted by the respondent. In the post-communist context Armenia is considered an energy producing as well as a transit country, which are important assets in a variety of forums. A report prepared by the International Center for Human Development has examined the current efforts at creating a unified power system within South Caucasus, where Armenia maintains centrality within the Unified Power System of South Caucasus (International Center for Human Development, et. al., 2004) The same report also highlights Armenia's role as the training center for human resources within the South Caucasus Unified Power System. Armenia's arrangements with Iran are noteworthy in this regard, as they enable seasonal trading of energy resources between the two countries; Armenia exports electricity to Iran in summer, importing it from Iran during the winter. Armenia also provides some electricity to Georgia. (Energy Charter Secretariat, 2004).

Despite such efforts at creating integrated energy markets in South Caucasus, the region remains fragmented and has failed to realize the full potential of cooperation around energy policies. There are few transmission lines to neighboring areas which are currently in use, due to persistent conflicts within the region. Specifically, there is the possibility of the integration of the power grids of Turkey and Azerbaijan. There is a transmission line from Armenia to Turkey that stretches for 74 km on the Armenian side, with 340 MW capacity and 220kV. According to Levon Vardanyan the line on the Armenian side is very well kept and requires little investment for its utilization. Levon Vardanyan also pointed that if Armenia sells electricity to eastern Turkey, this would free Turkish resources in supplying eastern Turkey instead selling it to Western Europe. Levon Vardanyan also indicated that an interested group from Turkey arrived in Armenia several years ago, expressing strong interest in buying electricity from Armenia, but that these initiatives faltered as the issue reached the central government of Turkey.

While prospects of exporting electricity from Armenia to Turkey may be encouraging, one should remember that Armenia's ability to export energy is largely explained by drastically reduced rates of internal consumption. At the moment, the consumption is approximately one-third of the levels of late 1980s and future export of electricity can be realized only if major investments in generation are carried out in Armenia (Energy Charter, 2004).

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<sup>57</sup> Personal Interview with the author, Levon Vardanyan, Ministry of Energy of the Republic of Armenia, August 3, 2006, Yerevan, Armenia.

The experience of South Eastern Europe and the Stability Pact also reveals the effectiveness of issue-based network development. “We do not let created institutions float in an open space. We build them around specific issue areas around which there is cooperation on both sides,” states a senior advisor to the Stability Pact (Kühne, 2006).<sup>58</sup> Issue-based network development can be applied both in cultivating engagements between the two countries and generating a willingness to construct micro-regions, as well as in following up on such measures and ensuring successful implementation. Building issue-based networks entails developing cross-border institutions of governance, which are needed for both countries to engage more constructively while also trying to deal with common transnational problems affecting the area. The three issue areas covered above present good starting point for such network development in the Armenian-Turkish context.

## CONCLUSIONS

The motivation of extending globalization to a given region or country has been the main impetus supporting the practice of constructing regionalist arrangements and cross-border micro-regions around the world. Globalization advances unevenly however, and geography still matters in shaping access to global markets. Political boundaries, while being more flexible in advanced economies, are less so in developing counties. At the same time, transcending borders and accessing global markets is indeed an ambitious goal for Armenia, one that is dependent on significant investments within the appropriate economic sectors. In short, those promoting regionalism and cross-border engagement generally see such arrangement as shortcuts to accessing larger global markets.

Cross-border engagement is one instrument among many which can be applied for the development of border areas in Armenia. Providing one or two policy tools specifically targeting the capacities of the border communities to reap the benefits of regionalism does not necessarily require the transformation of Armenia’s entire administrative apparatus. The preferred approach to regionalism, which I refer to as *clustered development*, is a flexible approach which provides an external avenue for strengthening public administration at the local levels. Opening the border will necessarily generate pressure on local levels of government to modernize and increase their responsiveness in addition to becoming more entrepreneurial in developing their communities.

In a more specific sense, capacity building is a prerequisite for effective cross-border engagement, and for development of institutions of cross-border governance, and all sectors studied in the present research have major gaps. Prioritization, therefore, is a first step in capacity building towards strengthening cross-border governance on the Armenian side. Within the public sector, macro-level reforms in the fields of quality control, efficiency of border management and its professionalization are the most frequently highlighted areas both by some governmental officials and by the vast majority of the respondents surveyed within the business sector for the present study. The lack of such reforms adds unnecessary costs to the unit of production, thereby hurting the competitiveness of Armenian enterprises. Similarly, local levels of government are the frontlines of cross-border engagement. Their professionalism and the skills of micro-diplomacy are important prerequisites for these border areas to realize the developmental potential of cross-border engagement. And lastly, the NGO sector in Armenia is also currently insufficient to serve effectively both as a Track Two Diplomacy tool, as well as a strong pillar of civil society in prospective emergent transnational spaces.

In sum:

- Transcending Armenia’s borders to access European markets should not replace the promotion of regionalism as an over-riding objective of economic globalization by Armenia.

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<sup>58</sup> Personal Interview with the author, Björn Kühne, Senior Political Adviser, Stability Pact for South Eastern Europe.

- Capacity-building within the public sector (particularly at the local level), business and the NGO sectors is essential, but so is prioritization among these areas. To this end, clustered development of regionalism should be promoted.
- Issue-based network development and creation of transnational links in these issue areas between governmental officials from both sides of the border is needed. This is trans-governmentalism, which is heavily reliant on micro-diplomacy at the local levels of government.
- Cooperation around human trafficking, environmental protection and energy generation and distribution are promising technical issues which offer possibilities of decoupling political issues from socio-economic ones. These issue areas offer the most promise for constructing Track Two Diplomacy projects between Turkey and Armenia.
- Donor commitment and patience will ensure the sustainability of the process, providing sufficient time and space for Second-Track Diplomacy projects to mature.
- A specialized agency for the promotion of cross-border engagement and regional economic development is proposed as a vehicle to enhance the capacities of Armenia's state in utilizing the potential of cross-border engagements more effectively.

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