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## **Historical determinants of the economic relations of Georgia and the European Union**

### **Historyczne uwarunkowania stosunków gospodarczych Gruzji i Unii Europejskiej**

**Abstract:** Currently, the European Union holds a significant position in the ongoing integration and globalization processes. The EU has always played an outstanding role in the foreign economic relations of Georgia. Cooperation between the parties is gradually deepening. The present paper discusses the historical, as well as recent aspects of the development of this cooperation.

**Keywords:** The European Union, Georgia, deep and comprehensive free trade, Association Agreement, export

**Streszczenie:** Współcześnie Unia Europejska zajmuje szczególną pozycję na świecie, jeśli chodzi o procesy globalizacji i integracji. Pozycja oraz rola Unii Europejskiej w zewnętrznych stosunkach gospodarczych Gruzji zawsze była znacząca. Współpraca między stronami znacząco się pogłębia. W artykule omówiono historyczne i aktualne aspekty współpracy.

**Słowa kluczowe:** Unia Europejska, Gruzja, pogłębiona i wszechstronna strefa wolnego handlu, umowa stowarzyszeniowa, eksport

#### **Introduction**

Georgia is one of the main centres of ancient civilization. Early human fossils found at an archeological site near Dmanisi (Georgia) represent one of the earliest known human presence in Europe. The geographic location and resources of Georgia are outstanding as well. The country is a connecting bridge between Europe and Asia and this increases its trading, economic and political importance in global trade and economic relations.

Integration in the European Union is one of the key priorities of Georgia's foreign policy. At the beginning of the 21st century, the EU is the most developed regional integration with its trading, economic and political (and not only) potential. National, trading and economic interests of Georgia push the country towards European integration. From the strategic standpoint, under globalization processes, further deepening of trading, economic, financial and technical relations of Georgia with the European Union and attraction of foreign investments is of the utmost importance as it is one of the key prerequisites of the country's socio-economic development, growth of export and integration in the global economy.

As soon as Georgia regained independence, the EU expressed support for Georgia's orientation to the market economy and development of democracy in the country. On March 22, 1992 the EU recognized the independence of Georgia and development of political, trading and economic relations with the EU began. Since that time, the EU has been supporting Georgia. On the other hand, relations between Georgia and some of the EU countries began to develop many centuries ago<sup>1</sup>.

## **Legal Basis of Trading and Economic Relations between Georgia and the EU**

The EU was one of the first to recognize the independence of Georgia in 1992; in 1995, the European Commission opened a representative office in Georgia<sup>2</sup>.

On April 20, 2000 the Parliament of Georgia ratified the WTO Accession agreement and Georgia is a full member of the WTO since July 14, 2000. It's notable, that on May 31, 1999 bilateral negotiations with the EU on the conditions of market access ended.

**Agreement on Trade in Textile Products.** Agreement between the European Community and the Republic of Georgia on trade in textile products is one of the first agreements between the EU and Georgia, which was valid from January 1, 1993 until December 31, 1999. Terms of the partnership and cooperation agreement defined for trade in goods didn't apply to the agreement on trade in textile products. According to the Agreement, export of textiles and clothes from Georgia to the EU market would be subject to quotas if the volume of export from Georgia to the EU market increased compared to the previous year and exceeded a specific volume of the total export. After Georgia's accession to the WTO, all quantitative restrictions on the export of textiles and clothes were gradually removed.

It's notable, that there were no textiles and clothes in Georgian export (including to the EU market), consequently, Georgia couldn't get any benefit from the Agreement on Trade in Textile Products.

**Agreement on Partnership and Cooperation.** The Agreement on Partnership and Cooperation between Georgia and the EU<sup>3</sup> was signed in Luxembourg on April 22, 1996 and came into force on July 1, 1999. The drive of the agreement was a wish to establish and develop close relations between parties based on existing historical relations and mutual values. The agreement was signed for ten years and it will be automatically extended unless the parties decide otherwise.

The Agreement on Partnership and Cooperation provided regulations for the agreement not only between Georgia and the EU, but also between Georgia and all the EU member countries. The agreement supported further development of the cooperation between Georgia and the EU. It aimed to promote trade, in-

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<sup>1</sup> R. Putkaradze, *Trade and Economic Relations of Georgia: Problems and Perspectives*, Universali, Tbilisi 2010, p. 10.

<sup>2</sup> [http://eeas.europa.eu/delegations/georgia/index\\_en.htm](http://eeas.europa.eu/delegations/georgia/index_en.htm)

<sup>3</sup> [www.delgeo.ec.europa.eu/en/pca/EURO\\_G.pdf](http://www.delgeo.ec.europa.eu/en/pca/EURO_G.pdf);

[http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21999A0804\(01\):DE:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21999A0804(01):DE:NOT)

vestments and economic relations between the parties and help Georgia to comply with European standards. In 1997 the Georgian government made an additional agreement to make Georgian legislation closer to the European legislative standards.

The major objectives of the Agreement on Partnership and Cooperation were (Article 1): a) to provide an appropriate framework for political dialogue between Georgia and the EU allowing the development of political relations; b) to support Georgia's efforts to consolidate its democracy and to develop its economy and to complete the transition into a market economy; c) to promote trade and investment and harmonious economic relations between the parties and so to their sustainable economic development; d) to provide a basis for legislative, economic, social, financial, civil, scientific, technological and cultural cooperation.

The Agreement was imbued with the wish and responsibilities of both parties to promote development of democracy and market economy, which will enable the parties to strengthen political, trading, economic and cultural relations and to make way for trade and economic integration.

The Agreement is based on three key principles: respect for democracy, principles of international law and human rights and the principles of the market economy. Let us briefly discuss major directions of the Agreement on Partnership and Cooperation.

**European Neighbourhood Policy**<sup>4</sup>. The 2004 enlargement of the European Union made it possible for this union to take significant measures to promote stability and security on the continent. The EU is determined to avoid new dividing lines in Europe and to promote prosperity and stability within and beyond the new borders.

In March 2003, the EU presented a new document *Wider Europe - Neighbourhood: A new Framework for Relations with Eastern and Southern Neighbours*, which was approved by the European Council and regarded as an appropriate platform for defining political directions to address new neighbours.

On June 14, 2004 the European Council approved the European Neighbourhood Policy – Strategy Paper prepared by the European Commission. Based on that document, three South Caucasian states were included in the European Neighbourhood Policy.

On November 14, 2006 the European Neighbourhood Policy: Action Plan for Georgia was signed at the EU-Georgia meeting. The Action Plan sets out major fields for cooperation. The Action Plan covers a timeframe of five years. Implementation of the Action Plan will help fulfill the provisions of the Partnership and Cooperation Agreement and contribute to the development of closer relations with the EU. Implementation of the Action Plan will significantly advance the approximation of Georgian legislation, norms and standards to those of the European Union.

Action Plan of the European Neighbourhood Policy sets out strategic objectives, priorities and tasks of the cooperation between Georgia and the EU. Despite its title – Action Plan, it doesn't include a detailed schedule or plan for implementation, that is characteristic for an action plan. Action Plan of the European Neighbourhood Policy might be regarded to be a more strategic document,

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<sup>4</sup> [http://ec.europa.eu/world/enp/index\\_en.htm](http://ec.europa.eu/world/enp/index_en.htm); <http://www.enp.ge>

which generally covers cooperation in different priority areas. The key objective of the Neighbourhood Policy is to turn Europe into a zone of stability, prosperity and security.

The European Neighbourhood Policy had far-reaching goals based on commitment to shared values and effective implementation of political, economic and institutional reforms.

**Eastern Partnership**<sup>5</sup>. In May 2009 Eastern Partnership (EaP) summit took place in the Czech Republic (27+6 countries) where a joint declaration was adopted. The European Commission published the communication on Eastern Partnership on December 3, 2008 and it was approved on March 19, 2009. Eastern Partnership, initiated by the EU member states Sweden and Poland, is a new form of cooperation with the eastern neighbours (Ukraine, Moldova, Georgia, Azerbaijan, Armenia and Belarus) of the EU.

Eastern partnership can't be seen as future membership perspective; however, it will encourage both bilateral and multilateral integration processes. It will provide Georgia with an additional opportunity to get closer to the EU. The Partnership is to provide the foundation for new Association Agreements between the EU and eastern partner countries, as well as for a free and comprehensive free trade and a simplified visa regime.

It should be noted that Eastern Partnership wasn't an alternative of the EU membership perspective, but encouraged deeper integration of the partner countries in the EU, spreading of shared values, strengthening of security in the region and economic development through regional and bilateral cooperation.

According to the European Commission, the key objective of the initiative is to support implementation of the European Neighbourhood Policy; however, the initiative goes further and provides partner countries with definite perspectives to get closer to the EU.

The document of the European Commission suggests development of cooperation in the context of bilateral and regional cooperation. While the ultimate objective of bilateral cooperation is creation of a wide political framework, which will deepen cooperation of partner countries with the European Union, regional cooperation should encourage development of cooperation of the European Union with the region and integration processes in the region through deepening cooperation in the areas of common interest (security, migration, trade; implementation of joint programmes in transportation, energy and other areas).

Thus, the major objectives of the Eastern partnership are: 1. Bring partner countries closer to the European Union; 2. Encourage stability and economic development in partner countries and gradual integration of 6 eastern European partner countries in the EU.

**Association Agreement and its Significance for Georgia.** Georgia has made significant progress with the European Union recently. The EU-Georgia Association Agreement was signed on 27 June 2014. Therefore, currently Georgia faces qualitatively new perspectives and challenges.

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<sup>5</sup> [http://ec.europa.eu/external\\_relations/eastern/index\\_en.htm](http://ec.europa.eu/external_relations/eastern/index_en.htm)

<sup>0</sup>[http://eu-integration.gov.ge/?que=geo/georgia\\_and\\_the\\_eu/east\\_partnership](http://eu-integration.gov.ge/?que=geo/georgia_and_the_eu/east_partnership)

Eastern Partnership. The European commission's recommendations to the European Parliament and the European Council. Brussels, European Commission 2008.

The deep and Comprehensive Free Trade Agreement (DCFTA) is the most important part of the Association Agreement, as the DCFTA includes the mechanism for trade and economic integration in the EU and opens the EU single market with its 505 million consumers for Georgia. On the other hand, the EU market is one of the largest in the world in the context of purchasing power. Carrying out reforms in different areas becomes essential for the country. Unlike the trade agreements which mainly aim to reduce and eliminate trade barriers, the present agreement has other objectives as well.

Introduction of the EU standards in Georgia will encourage improving effectiveness of investment attractiveness of the country, deepening of the country's trade relations with the EU and socio-economic development of the country in general.

The DCFTA provides an opportunity for Georgia to benefit from three out of four freedoms of the EU – free movement of goods, services and capital. Considerable progress might be achieved from the point of the fourth freedom, encourage visa liberalization process.

The agreement is qualitatively different from the other free trade agreements signed by Georgia. The DCFTA includes trade liberalization for both goods and services. In addition, the DCFTA covers a wide range of trade-related issues (e.g. food safety, competition policy, intellectual property protection, financial services, etc.) and includes gradually bringing trade legislation of Georgia closer to the EU legislation. These issues and bringing Georgia closer to the EU is within the interests of the country.

Implementation of the DCFTA will open the largest market for Georgian goods and services in the event they meet EU requirements. Georgia will become an attractive country for investors, which will result in the increase of investments and creation of new jobs. The DCFTA will encourage opening new factories to export to the EU market, providing Georgian consumers with safe products, development of state organization bodies in accordance with the best European practice. All this is positively reflected on the country's socio-economic development.

It is very important that the agreement includes establishing a national food safety and quality system infrastructure of European level, which will contribute to free access of Georgian agricultural and industrial production to the EU market and on the other hand, providing the domestic market with safe and high-quality products. Legislative approximation to the EU state procurement rules is also very important. It is also planned that an intellectual property protection system and customs regulations will be brought in compliance with the European one.

As declared, the European Union is based on the values of human dignity, freedom, democracy, equality, protection of human rights, gender equality, etc. Consequently, the country trying to integrate in the European structures should share these values. On the other hand, it's in the interests of each democratic state to share and respect these values.

The positive effect of the DCFTA is the reduction of non-tariff barriers, which will result in changes in sanitary and phytosanitary measures, technical barriers of trade, protection of intellectual property, protection of competition and in other areas.

These changes will be effective not only from the point of an increase in foreign trade between the parties, but more sanitary and phytosanitary measures

will ensure safety of food products as well, which, first of all, is in the interests of Georgian consumers. In addition, protection of intellectual property and encouraging competition will have only positive implications. Approximation of foreign trade regulations with the EU standards will result in the increase in trade between the EU and Georgia, as well as in the investments from the EU, which will be followed by closer economic integration.

According to the results of the studies, economic outcomes of the DCFTA are quite significant for Georgia. It is notable that due to the DCFTA export from Georgia to the EU it will grow by 9% in the short term and by 12% in the long term; import will correspondingly increase by – 4.4% and 7.5%. The average salary is expected to grow by 3.6% and consumer prices to decline by 0.6%. As a result, the DCFTA will contribute to the growth of the purchasing power of Georgian citizens, especially in the medium and long term<sup>6</sup>. Due to the DCFTA, GDP of Georgia is expected to grow by 4.3%. Reduction of non-tariff barriers in the medium and long term is one of the most important outcomes of trade liberalization. On the other hand, implementation of the terms of the Association Agreement is connected with certain expenses. However, the ultimate benefit exceeds all the expenses several times.

The DCFTA, as a part of the Association Agreement will provide the necessity for regulatory reforms in the country, which, in turn, will lead to changes in such areas, as sanitary and phytosanitary, technical barriers to trade, intellectual property, competition and customs regulations. The benefit of these processes will be not only access to the EU and other markets, but better sanitary and phytosanitary standards, which will ensure food safety; better protection of intellectual property, which will contribute to innovations; better competition policy, which will contribute to price reduction.

### **Trade and Economic Cooperation between Georgia and the EU (brief review)**

The deepening of trade and economic, financial and other types of relations with the EU is of utmost strategic importance for Georgia, as sharing European values and best practices and getting closer to the EU are priorities of the foreign policy of Georgia<sup>7</sup>.

It should be taken into consideration, that an increasing negative trade balance is the major problem for Georgia. The growth rate of Georgian export in recent years is lower compared to the import growth rate. In 2003 the negative trade balance of Georgia amounted to 679.7 million USD, in 2005 it totaled 1.5 billion USD, in 2008 – 4.8 billion USD, in 2010 – 3.58 billion USD, in 2013 – 5.1 billion USD and in 2014 – 5.7 billion USD. The trade balance of Georgia with the EU is negative as well.

Foreign trade turnover of Georgia amounted to 11 457 million USD in 2014 – 5 percent higher compared with the previous year. The share of export amounted

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<sup>6</sup> Research by ECORYS and CASE, *Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova* 2012. [http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc\\_149666.pdf](http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc_149666.pdf)

<sup>7</sup> R. Putkaradze, *Traded and Economic Relations of Georgia: Problems and Perspectives*, Universali, Tbilisi 2010.

to 2861 million (1.6% higher accordingly) and import amounted to 8596 million USD (7% higher)<sup>8</sup>.

Trade relations between the parties have been intensifying recently. In 2008, foreign trade turnover of Georgia with the EU exceeded 2 million USD – export amounted to 335.2 million USD and import amounted to 1 665.5 million USD; thus, import exceeded export five times. The share of the European countries in foreign trade turnover of Georgia amounted to 26.5% - 22.4% in export and 27.5% in import.

In 2014, foreign trade turnover of Georgia with the EU countries amounted to 2990 million USD – export amounted to 621 million USD and import amounted to 2369 million USD; thus, the share of the European countries in foreign trade turnover of Georgia amounted to 26 - 22% in export and 28% in import.

It's notable, that comparison of the data provided by National Statistics Office of Georgia and by Eurostat shows quite different, wide-scale cooperation between the parties, which is a subject of a separate study, especially regarding Georgian export. According to the Eurostat, Georgia ranks 67<sup>th</sup> position among the countries exporting to the EU, 85<sup>th</sup> place among importers and 76<sup>th</sup> by trade turnover<sup>9</sup>. As Eurostat data shows, the EU accounts for 20.8% of Georgian export, 28.8% - of Georgian import and 26.7% - of foreign trade turnover. Georgia accounts only 0.1% of the EU export and even less of the EU import<sup>10</sup>.

The EU is the largest trade partner of Georgia. Bilateral trade is developing quite dynamically. The following products are leading in the export structure of Georgia: fresh and dried nuts, mineral waters, fertilizers, copper ores and concentrates, raw and semi-processed gold. As for the import, dominant place is held by cars, medicines, sugar, oil and oil products, computers, etc. Trade relations between Georgia and the EU has good potential of development, realization of this potential mainly depends on the full utilization of the opportunities offered by the agreement<sup>11</sup>.

Diversification of export is very important for Georgia. The EU market is one of the main priorities from this point. In our opinion, a precondition of the socio-economic development of Georgia is realization of the country's export potential, including on the EU market, which will become a basis for high economic growth rates. As the official EU website (europa.eu.int) says "Despite the growing tendency, trade turnover between the EU and Georgia is small and not sufficiently diversified, especially Georgian export to the EU...".

Deepening of cooperation between Georgia and the EU and active involvement of Georgia in the trade and economic area of the EU will contribute to improving competitiveness of agricultural, banking, light and food production and other sectors, as well as attracting investments from Europe and will ultimately support the socio-economic development of Georgia, creation of new jobs and increase in budget revenues.

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<sup>8</sup> Foreign Trade of Georgia, National Statistics Office of Georgia 2014.

<sup>9</sup> European Union, Trade in goods with Georgia, European Commission 2015.

<sup>10</sup> European Union, Trade in goods with Georgia, European Commission 2015.

<sup>11</sup> M. Kaulia, *Strengthening of Bilateral Trade*, the European Neighborhood Policy and Georgia, Analysis of independent experts (Friedrich Ebert Fund), Tbilisi 2007, p. 104.

## Summary

Trade and economic relations between Georgia and the EU are widening gradually. The Georgia-EU Association Agreement is of the utmost importance for Georgia. Georgia should go on the European way. There will be new challenges and barriers in this way, however, the history of the economy of the EU, experience and economic development of the new and old EU member countries, as well as of the EU candidate countries (Iceland, Montenegro, Serbia, Macedonia, Turkey, Albania, Bosnia and Herzegovina, Kosovo) prove that accession to the EU is beneficial for a country, especially for a small country, like Georgia. Consequently, Georgia should successfully implement the terms of the Association Agreement and support gradual integration of its economy (and not only) in the EU economy.

It's necessary to share the European experience in the economic reforming process. In addition, it's essential to follow the EU recommendations and support the European integration process in the country. It's advisable to reduce the negative trade balance (including with the EU) of the country gradually, to increase the volume of export and Georgian export to the EU.

Finally and most importantly, further gradual integration of the Georgian economy to the EU should continue.

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