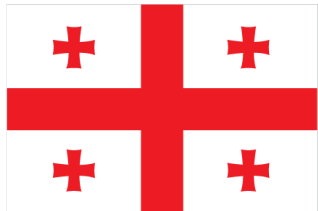


# EU's Trade Policy towards its Eastern Neighbors: The Case of Georgia

## Attracting Investments, not Subsidies



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# Main Topics:

- What was Georgia before
- Why revolutionary changes
- What were the achievements
- What Georgia is seeking
- The Study and Future of the DCFTA
- Economic and Political Consequences (Cost and Benefits of DCFTA)

# Georgia during the USSR – **BLACK MARKET**

- Colonial economy – **100% dependent** on central authorities in Moscow, developing of the sectors of economy answering only to internal demands of the SU
- Command economy – **wasteful and inefficient**
- No economic rights, **no legal** entrepreneurship
- Bad **quality** of goods
- High level of **Corruption**
- **Black market**
- **Common currency**, common economic policy, common market but ongoing debates, disputes

# Economy of Georgian SSR

- **More than 900 industrial factories** – both of heavy and light sectors: there were 3 factories of more than 10 thousands of workers, at least 5 factories of more than 5 thousands of workers, and up to 20 with 1,000 workers.
- Georgian agriculture sector was producing up to **90% of consumed in the SU tea; 98% of citruses**, half of **wine**, up to 40% mineral water etc.
- **No unemployment...** 😊

# Union of SSR

**Common currency**, common economic policy, common market but ongoing debates, disputes:

- *Russia blamed other republics – **in feeding of them***
- ***Which republic was contributing more**, which - net beneficiary, which - subsidized, etc.*
- *Most of the higher quality industries were **concentrated in the center**, in the periphery industries were old and of low quality*
- *Similarly, skills of work force were **higher in the center** - education quality was the same*
- ***Interrelationship** between different republics **was not possible** – everything was decided in the **center - Moscow***

# Georgia after the SU: therapy without anesthesia

- a) Immediate lost of **market and demand**
- b) **Collapse of all industries** – lack of market, low quality of goods and the global tough competition
- c) Declining of the **quality of work force**
- d) Lack of trade – very **small internal market**
- e) Lack of **skills in business** management
- f) Problems of **property rights**, investment climate
- g) Widespread **corruption**, mismanagement and political abuse
- h) **Energy supply** shortages
- i) **Unemployment** reached the level of 50% in the middle of 90s

# Unemployment – main reasons

- Lack of **investments**
- Lack of qualifications to fit the **world market** standards
- **Disadvantageous profile** of work force
- **Lack of practice** for long years – further decline of quality, low productivity
- **Restricted trade** with the developed nations – no markets for Georgian industrial goods
- No participation **in global division of labor**
- **Underdeveloped labor market**
- Lack of **experience** in global economic relations, trade, pushing of country's interests
- **Disoriented** educational system

# Underdeveloped Labor Market

- Market prices of the labor didn't reflect **neither real quality nor cost of labor** causing managerial mistakes
- Any obstacles to manage human resources flexible way was **increasing costs of the labor**
- **Wrong** prices on labor also have brought into confusion foreign and (even) local investors
- Supply and demand of labor were shifted towards **wrong point of equilibrium**
- No access to **foreign markets**
- **Productivity was lower** than price demand



# Problematic Geopolitical Environment

- Permanent threats and **ongoing conflicts in the region**, started in 1989
- **Energy blockade** by Russian Federation - from 1991
- **No big natural resources** but **transit** opportunities of energy from the East to the West made country sphere of interest of big politics
- **Neighboring** countries – low level of **competitiveness**, few investment opportunities
- **Ban from the biggest export market** of Georgian agriculture goods – the Russian Federation, from 2006

# Main challenges for foreign investors in Georgia in 2003

- Wrong **Business climate**
- Problematic **region**
- Weakly protected **property rights**
- **Lack of high quality work force** and underdeveloped labor market
- Widespread and rampant **corruption**
- **Small market** and low **purchasing power** of local consumers
- **Crime**
- **International Aid**

# Problems of Business Climate

- Lots of **unnecessary regulations**, licenses and permits
- High pressure of the **various inspections**
- **Barriers** to enter into a certain sector of economy
- Uneasy **to start and run** a business
- **Barriers to trade abroad**
- High **import tariffs**
- Heavy **tax burden**
- **Lack of trust** in public institutions, the register of real property, etc
- Political pressure, **power abuse**, corruption, shadow economy

# Trade problems and consequences

Trade barriers and artificial political **obstacles affected Georgian market very harmfully:**

- Small market gave no chances **to reduce per unit cost** – therefore all the industries failed, were destroyed and sold out as scrap metal – which had been a main export sector for years
- **Labor degraded and lost competitiveness** – especially after new leaders of trade appeared in the world
- Emigration of the best representatives of the labor force – **around half of the urban labor force left the country**, the proportion of them who are getting the nationality of other countries, is increasing every day (from 1m to 1.5 m people left, by different estimations, official number of population is 4.6m which reflects the number of Georgians who remain citizens of Georgia, even many of them have lived long years abroad).
- Country **trade imbalance reached proportion of 1/4** (1 - export and 4-import)

# A CHOICE - 2003

- **RADICAL CHANGES OR FURTHER DECLINE**
- HIGHER EFFECTIVENESS OF PUBLIC SECTOR OR TOTAL COLLAPSE OF THE STATE
- FIGHTING CORRUPTION OR FURTHER DEEPENING IN THE MARSH
- IMPROVING OF BUSINESS CLIMATE OR FURTHER SHRUNK OF THE ECONOMY
- FREE TRADE OR PROTECTIONISM
- DEMOCRATIZATION OR FURTHER STEPS TOWARDS AUTHORITARIANISM

# Georgia reforms 2004-2010

- Reorganization of the **Police**
- **Tax cuts** 2005-2007
- Improving of **business climate** -  
**deregulation** of business activities,  
**liberalization** of economy, new wave of  
**privatization**
- Improved **public services**, **downsized**  
agencies

# Business climate improvements

- One of the **lowest** tax rates
- Lowest **Import** duties
- **Fewest** number of taxes
- Improved procedures for **tax payment and declarations/returns**
- Improved **customs'** procedures
- Simplified **registration** and **entrance** to a market
- Eliminated of **800 unnecessary licenses** and permits
- Simplified and secured real **estate register**
- **Import tariffs** (actual) decreased close to the level 0%

# Some Results of the Reforms

- Volume of deposits in banks increased **8 times**
- Number of registered cars increased **4 times**
- GDP per capita increased **more than twice**
- Liberalization and deregulation of energy sector – resulted in complete supply *and net positive balance of electricity trade*
- **But** State revenues increased more *than six times*
- Public services – **confidence** into which cardinally improved (police, public registers, business registration, etc) from almost 0% to *up to 95%* of population
- Decreased level of **corruption**



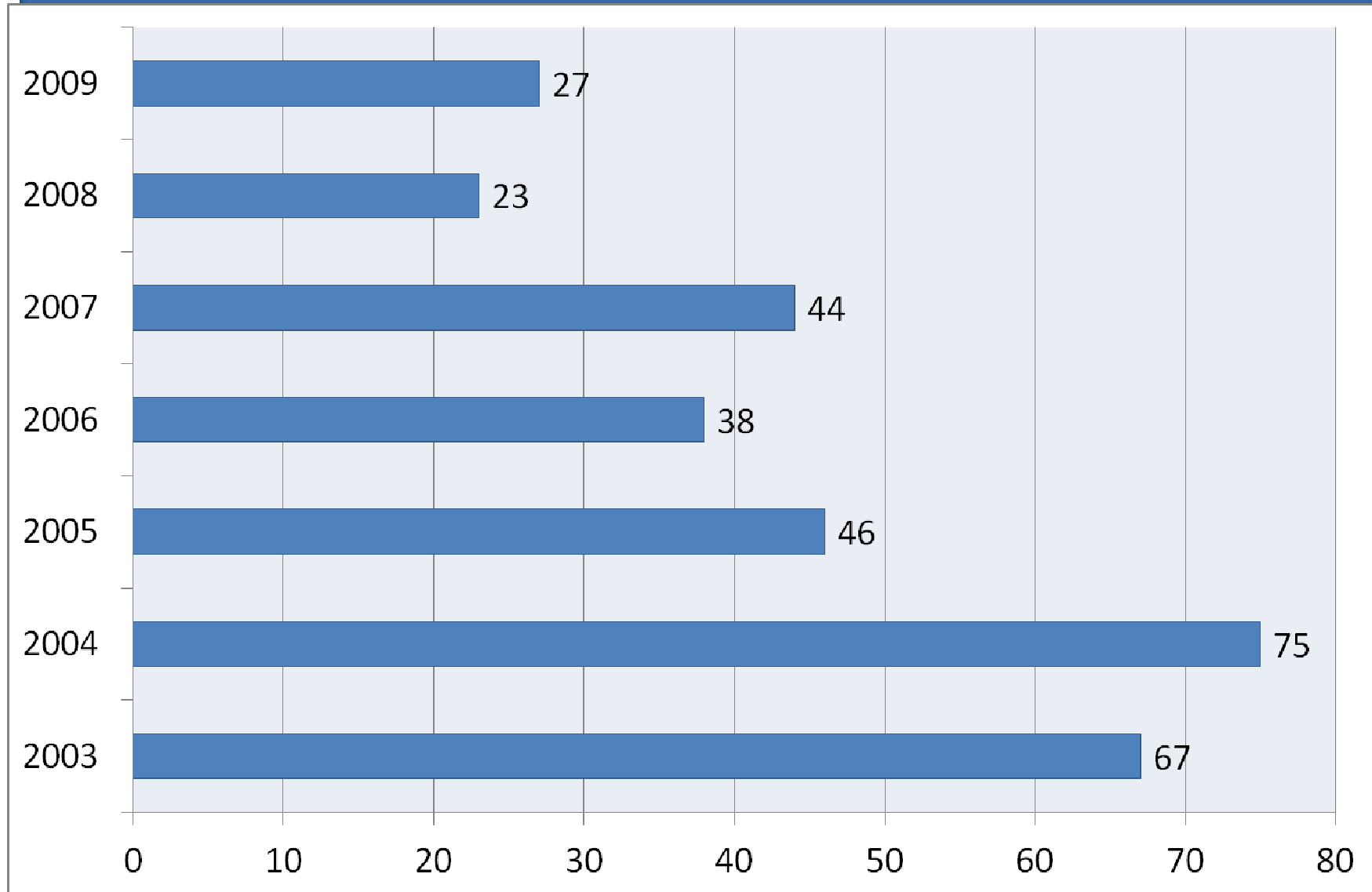
# Evaluation of Georgia's performance

- Heritage Foundation Index of economic Freedom: from 91<sup>st</sup> to 29<sup>th</sup> place in the world
- Fraser Institute from 121<sup>st</sup> to 27<sup>th</sup> place in the world (2011)
- Doing Business of the World Bank Survey: 12<sup>th</sup> place
- Global competitiveness index - 93<sup>rd</sup> place
- Transparency international from 131<sup>st</sup> to 68<sup>th</sup> place

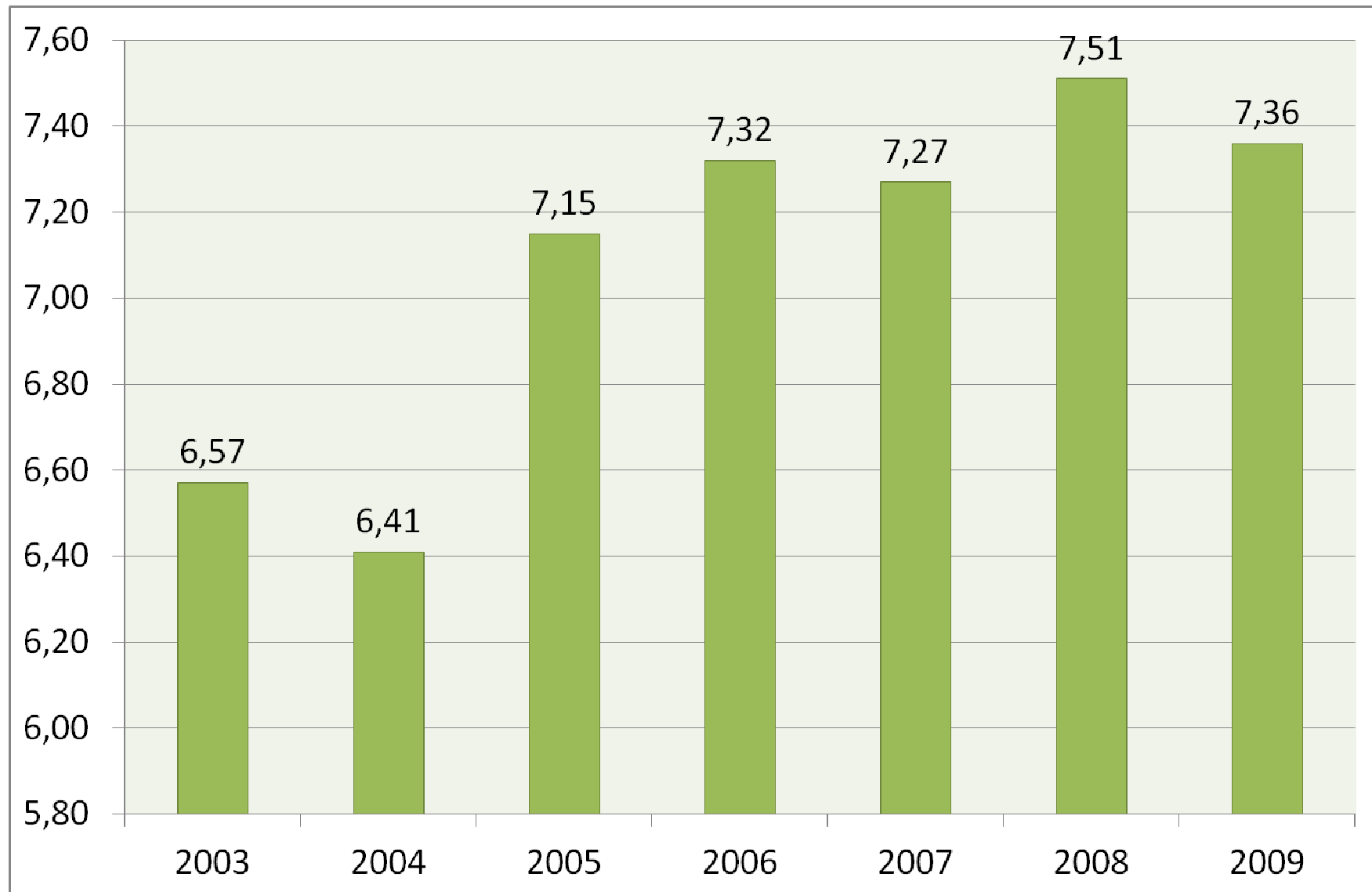
# INVESTORS CAN CONSIDER

- HERITAGE FOUNDATION: LABOR FREEDOM-  
**93.7%** (5<sup>th</sup> place in the world, 2011)
- FRASER INSTITUTE: BUSINESS REGULATION:  
**7.3** (1<sup>st</sup>, 2010)
- WB: STARTING OF BUSINESS: **8<sup>th</sup>** (2011)

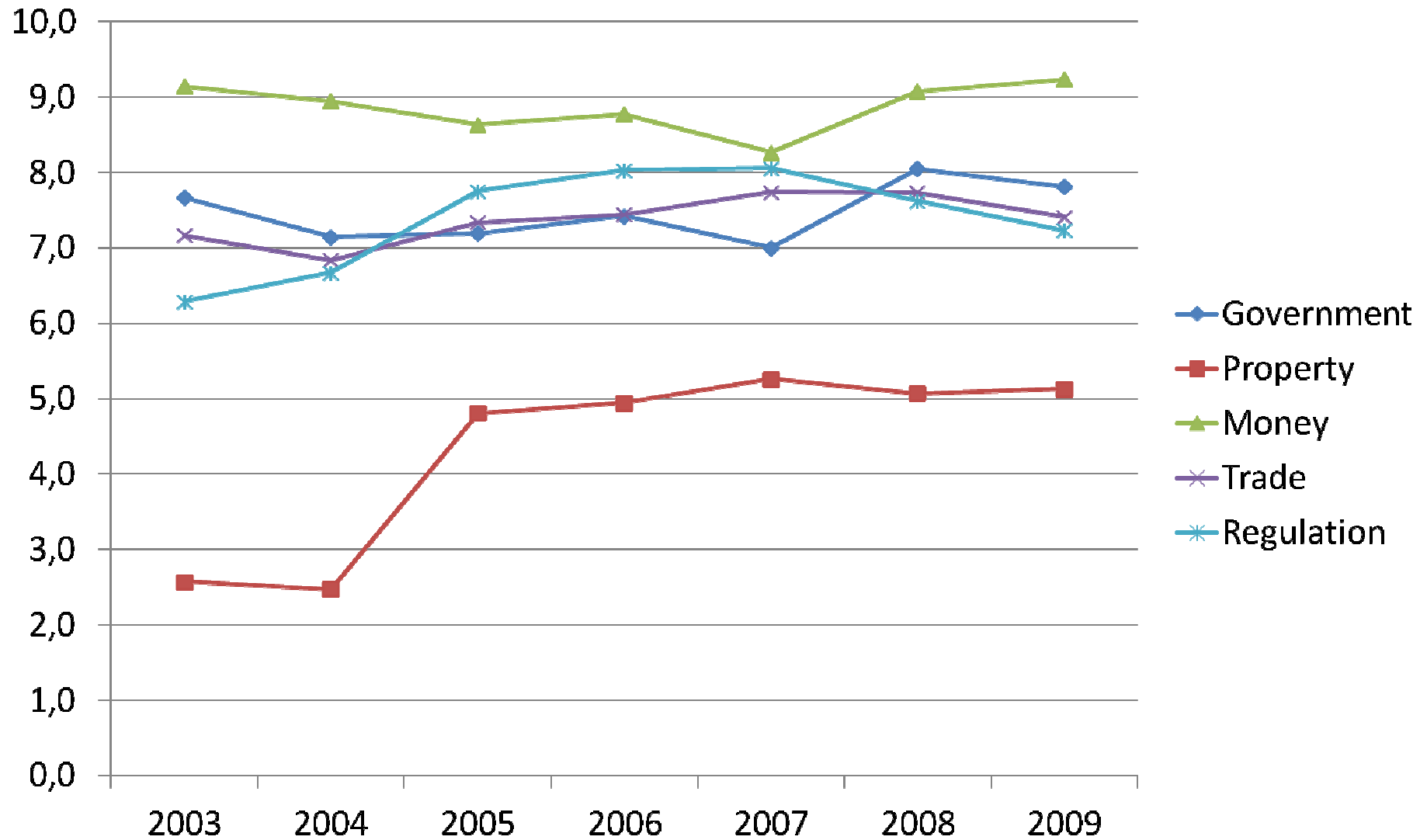
# GEORGIA EFW - Rank



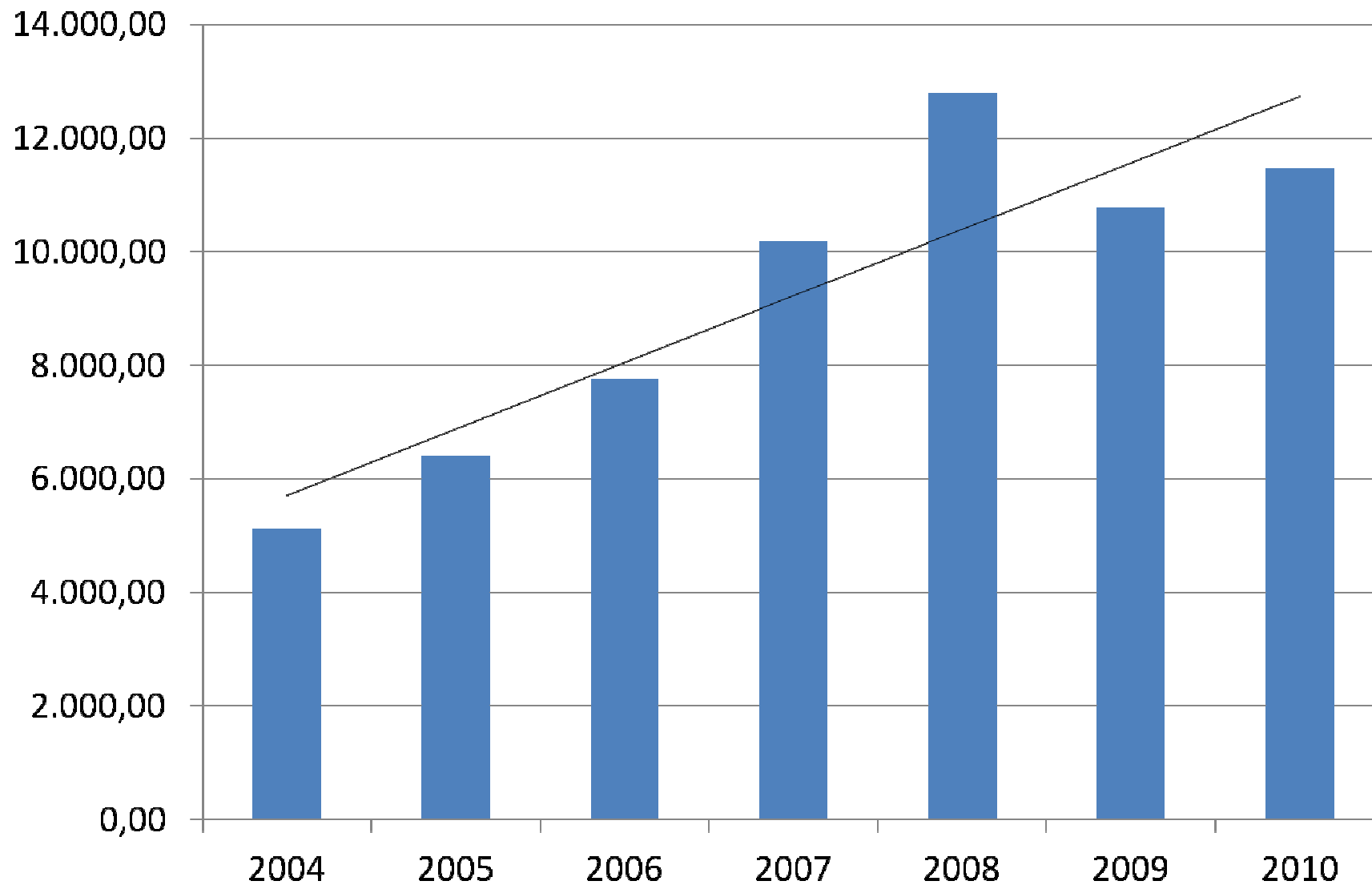
# Georgia – EFW - Score



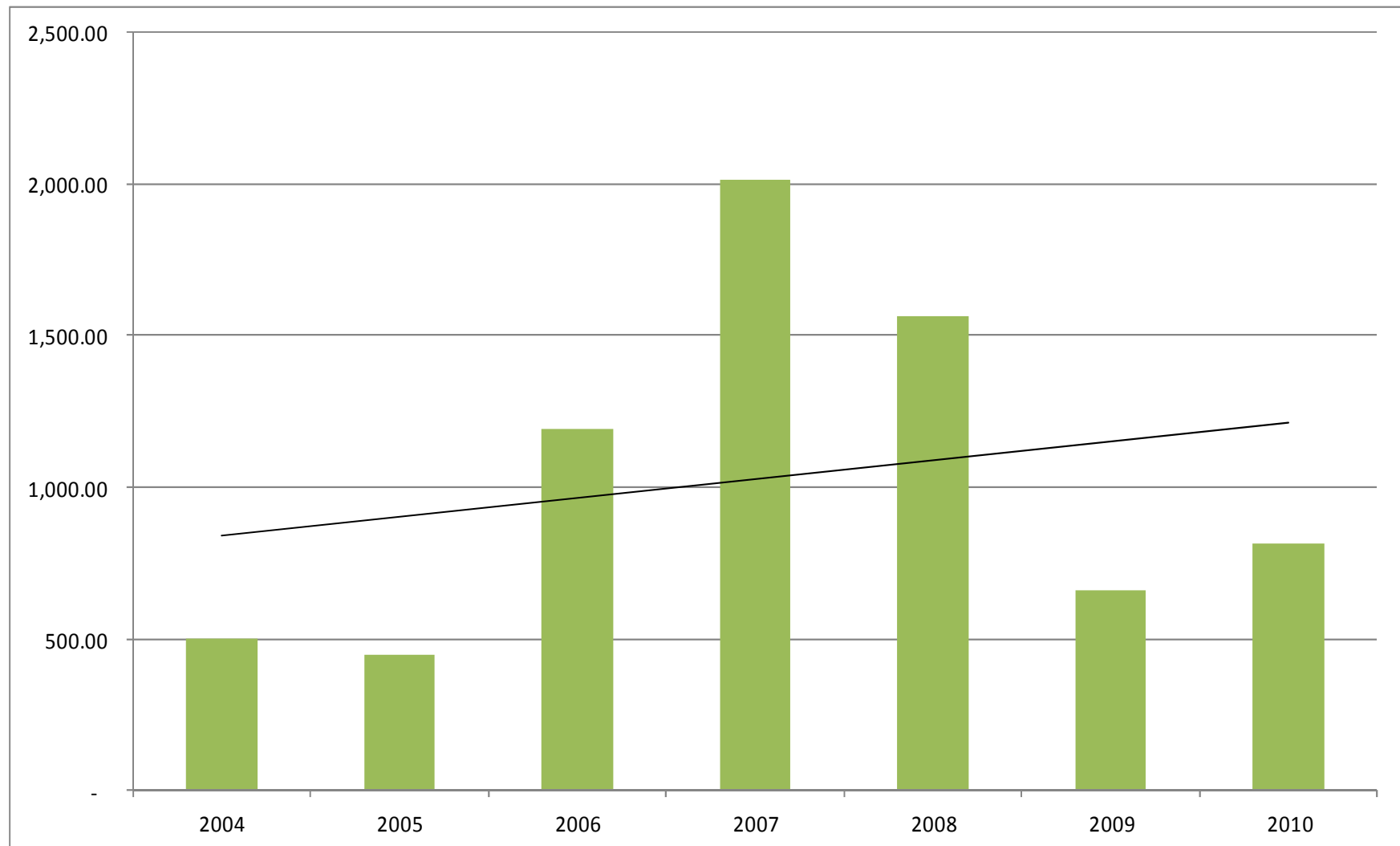
# Georgia's EFW Progress by Components



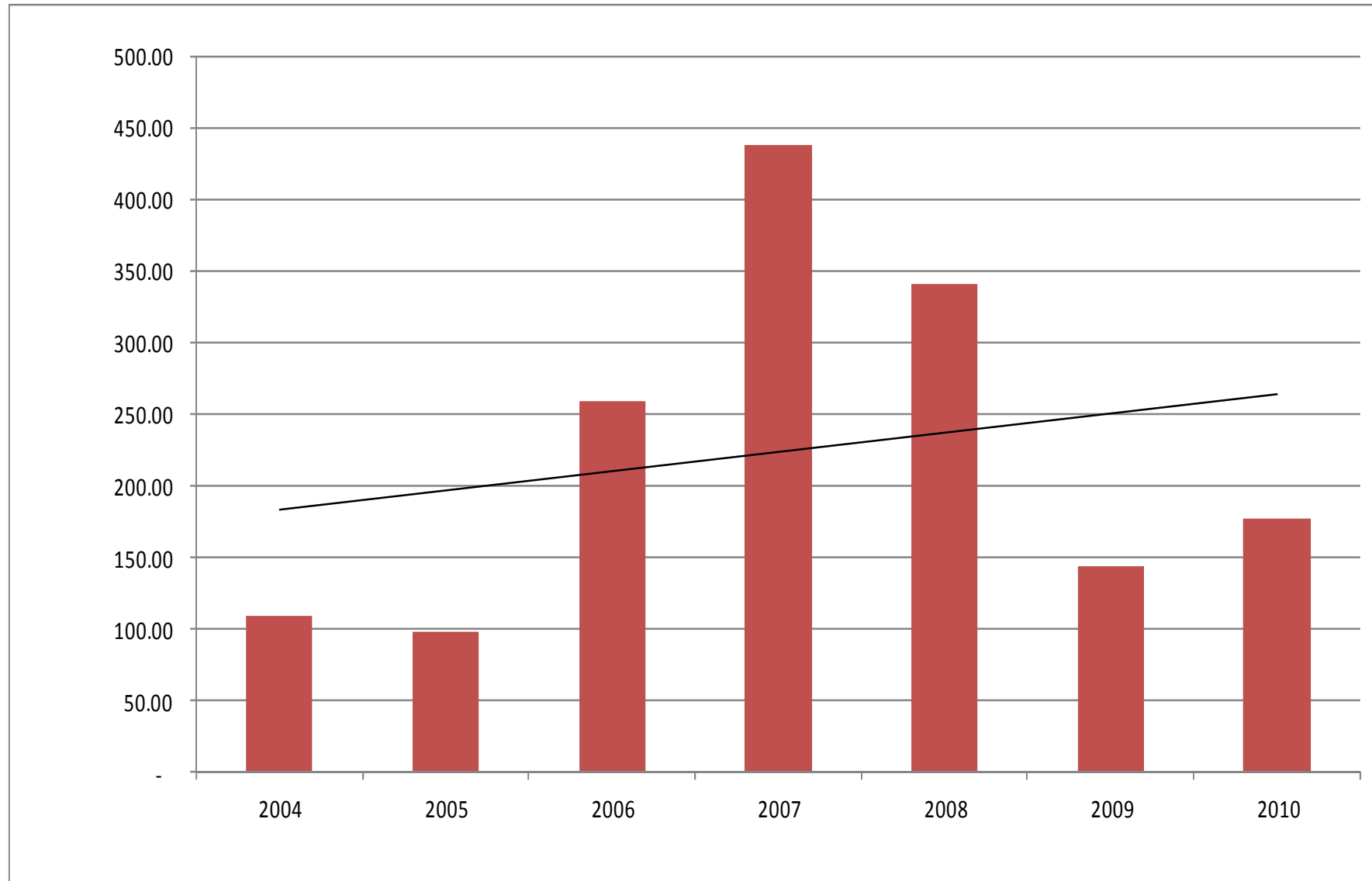
# GEORGIA GDP (USD, GeoStat)



# FDI in Georgia (Geostat m.USD, 2004-2010)



# FDI per capita (USD, Geostat)





# Trade Between Georgia and the EU

(Geostat, th. USD 2004-2010)

		2004	2005	2006	2007	2008	2009
EXPORT	WORLD	<b>646,903</b>	<b>865,454</b>	<b>935,992</b>	<b>1,232,371</b>	<b>1,495,457</b>	<b>1,130,555</b>
	EU	<b>128,204</b>	<b>216,756</b>	<b>225,354</b>	<b>268,530</b>	<b>335,154</b>	<b>237,547</b>
	SHARE	<b>20%</b>	<b>25%</b>	<b>24%</b>	<b>22%</b>	<b>22%</b>	<b>21%</b>
IMPORT	WORLD	<b>1,845,555</b>	<b>2,489,953</b>	<b>3,676,969</b>	<b>5,214,883</b>	<b>6,304,557</b>	<b>4,369,496</b>
	EU	<b>657,248</b>	<b>740,323</b>	<b>1,104,127</b>	<b>1,538,905</b>	<b>1,756,450</b>	<b>1,305,489</b>
	SHARE	<b>36%</b>	<b>30%</b>	<b>30%</b>	<b>30%</b>	<b>28%</b>	<b>30%</b>

# Trade Policy Improvements

- Georgia, **a member of WTO** from 2000; declared unilateral decrease of import tariffs from 2006
- Georgia has **FTA** with Turkey, Azerbaijan, and with almost all the CIS countries (except the RF)
- Georgia has one of the **lowest import tariffs** (1.3 % of average)
- **No barriers** for **Foreign Investments**
- Unilateral recognition of **OECD standards**, and simplification of imports from OECD countries
- Georgia made easy visa procedures for most of the nationalities of the world and **no visa for OECD, CIS** and other nationalities.
- *But Georgia seeks more trade with the EU, the USA, China, India, etc*

# Disadvantages and Advantages for Investing in Georgia

<b>DISADVANTAGES</b>	<b>ADVANTAGES</b>
<b>Regional security problems</b>	<b>Liberalized and deregulated market</b>
<b>Small scale market</b>	<b>Easy to start and organize business</b>
<b>Low quality of labor force and underdeveloped labor market</b>	<b>Cheap labor and low costs on procedures</b>
<b>Difficult access to the best foreign markets</b>	<b>Easy to enter to local markets</b>
<b>Low purchasing power of local consumers</b>	<b>Low tax rates and number of taxes (<i>0% VAT on exports</i>)</b>
<b>Global competition</b>	<b>Openness of the economic borders</b>

# Georgia needs Free Trade

- Access to the more and **higher purchasing power** consumers
- Use of **economy of scale**
- Attract **foreign investors**
- **Improve quality** of goods to satisfy the EU markets and consumers
- Bring **international experience**, skills and quality *including to the labor market*
- **Increase competitiveness of** local entrepreneurs and local production
- Better protection of **Georgian brands**
- Better use of advantages **of geographic location**

## **Four Freedoms** of the EU – Georgia and Georgians are attracted with:

- *Free movement of goods*
- *Freedom of movement for workers*
- *Free movement of capital*
- *Freedom of establishment and  
Freedom to provide services*

# What can be **interesting for the EU** in signing FTA with Georgia

- Better use of the **transit corridor**
- Access to **new markets**
- Finding new opportunities for **investing, employment**
- Finding **new partners**
- Ensuring **peace** in the neighborhood

# FTA Talks - Process started in 2006

## Requirements for DCFTA (Matrix Sent to the GoG in March 2008):

- 1. Overall coordination negotiating mechanism
- 2. Tariff and non-tariff barriers (NTBs)
- **3. Technical barriers to trade (TBT)**
- **4. Sanitary and phytosanitary measures (SPS)**
- 5. Trade facilitation and customs administration
- 6. Rules of origin
- 7. Services and investment
- **8. Intellectual property rights**
- 9. Public procurement
- **10. Competition**
- 11. Sustainable development (social and labor issues; environment).

# DC FTA – Pre-negotiation Requirements

- Georgia works to fulfill certain requirements **to start negotiations** *four before and seven after starting of official negotiations*, among which:
  - *Improvement of **food safety** through development of **sanitary and phitosanitary** institutions*
  - *Adopting of the **EU technical standards***
  - *Implementation (back) of **antitrust institutions***
  - *Protection of **intellectual property rights***





# DCFTA - Costs and Benefits for GE

<u>COSTS</u>	<u>BENEFITS</u>
Temporary lost of local consumers, increase of costs due to new regulations	Wider market, economy of scale, chances to decrease unit cost
Production quality improvement measures	Attracting more foreign investments
Management skills have to be developed further, logistics, packing, etc	Studying of better business management, Improved skills of labor, employing more people
Understand local (of EU nations) procedures for import	Returning back of skillful workers from developed nations
Private firms for certification and consumer protection	Protected and satisfied consumers, more demand for local goods
<b>Small business</b> can be kicked out from markets	Overcoming global competition, expanding production and exports

# GEORGIA AND THE EU

(CIA World-fact-book)

	EU 	GEORGIA 	Comparison
Population	492,387,344	4,600,825	107
Territory	4,324,782	69,700	62
GDP (MUSD, 2009 est.)	16,210,000	10,750	1508
GDP per capita (USD, 2009, est)	32,921	2,337	14
Labor Force (millions)	225,500	1,900	119
Exports (MUSD, 2009 est)	1,952,000	1,893	1031
Imports (MUSD, 2009 est)	1,690,000	4,293	394
Budget Revenues (MUSD)	7,194,793	3,152	2283
Budget Expenditures (MUSD)	8,243,793	4,137	1993
Electricity Consumption (mKW2007-8 est)	2,906,000	6,902	421

# The Study

- Financed by PASOS, LGI, OSI
- Four researchers: P.Messerlin, SciencePo, M.Emerson, CEPS, A.Vernoy, SciencePo, G.Jandieri, NESG,
- Evaluation of the process of discussions and DCFTA itself
- Evaluation of readiness of Georgia
- Calculation of costs and benefits to both side
- Elaboration of recommendations

# Main findings – the process

- From 2006 to 2010 the EU Commission was working with Georgia with “open-ended” language *preconditions, sufficient progress, adequate system, effective and proper implementation*
- There is **no clear definition** what is DCFTA
- Pre-requirements to Georgia are **higher than to EU membership access ones**
- Pre-requirements to Georgia are stricter than for others, some of the nations who *are the member now*
- Georgia fulfilled most of the trade-related requirements
- Showed **the EU as an aggressive and careless neighbor**, not as an anchor

# Main findings – **Readiness** of Georgia

- Georgia's reforms of last years made it a leader as the **DB report** illustrates *“scores higher in WB Doing Business survey than a number of old and new EU MS in terms of regulatory quality”*
- Business environment **and economic freedom** indices of GE are high and improving, *illustrating its desires and understanding of the momentum.*
- **GE has very moderate tariffs** in agriculture, (4.6%) *low tariffs in industry (0.3%), no barriers to FDI.*
- GE made **“unconditional mutual recognition of technical norms of all OECD** countries – reforms EU has not yet achieved”.

# DCFTA

- “The DCFTA negotiations lack elementary fairness and transparency because the Commission has never clearly defined what a DCFTA is to be.
- As a result, DCFTA negotiations consist of an unpredictable, open-ended journey during which the Commission shows little sign of valuing efforts made by the EU negotiating partners.”

# TBT

- “It should be added that the Commission has chosen two products (lifts and cable cars) **which are not produced at all in Georgia**. Interpreting such a surprising choice is difficult.”
- “All these requirements are quite unprecedented. The most recent FTA often qualified as ‘deep and comprehensive’ by Commission’s **officials—the EU-Korea FTA—does not include such an agenda**. It would be interesting to hear why such a harmonization is not required in a trade agreement with a large, fully industrialized and very competitive economy such as Korea whereas it should be a precondition for negotiating a similar agreement with a small, lowermiddle income country having a very limited industrial sector, such as Georgia.”

# Openness of borders

	Applied tariffs (%)			WTO notifications			Services
	all goods	agriculture	industry	antidumping	antisubsidy	safeguard	under GATS
<b>Europ. Community</b>	<b>5.9[a]</b>	<b>13.5[a]</b>	<b>4.6</b>	<b>144</b>	<b>10</b>	<b>0</b>	<b>115</b>
<b>Countries under accession negotiations</b>							
<b>Croatia</b>	<b>4.9</b>	<b>10.7</b>	<b>4.0</b>	<b>–</b>	<b>–</b>	<b>0</b>	<b>126</b>
<b>Turkey</b>	<b>9.7</b>	<b>42.9</b>	<b>4.8</b>	<b>110</b>	<b>1</b>	<b>9</b>	<b>77</b>
<b>Macedonia</b>	<b>7.3</b>	<b>13.4</b>	<b>6.4</b>	<b>–</b>	<b>–</b>	<b>0</b>	<b>115</b>
<b>Countries with signed or ongoing DCFTA negotiations</b>							
<b>Korea</b>	<b>12.1</b>	<b>43.6</b>	<b>6.6</b>	<b>43</b>	<b>–</b>	<b>0</b>	<b>98</b>
<b>Ukraine</b>	<b>4.6</b>	<b>9.7</b>	<b>3.8</b>	<b>19</b>	<b>0</b>	<b>1</b>	<b>137</b>
<b>Countries willing to open DCFTA negotiations</b>							
<b>Armenia</b>	<b>2.8</b>	<b>6.8</b>	<b>2.2</b>	<b>–</b>	<b>–</b>	<b>0</b>	<b>106</b>
<b>Georgia</b>	<b>1.3</b>	<b>7.7</b>	<b>0.3</b>	<b>–</b>	<b>–</b>	<b>0</b>	<b>125</b>
<b>Moldova</b>	<b>4.6</b>	<b>10.7</b>	<b>3.7</b>	<b>–</b>	<b>–</b>	<b>1</b>	<b>147</b>



# Easy to make business

	Ease of doing business 6	Starting a Business 51	Dealing with Con- struction Permits 52	Registering Property 53	Getting Credit 54	Protecting Investors 55	Paying Taxes 56	Trading Across Borders 57	Enforcing Contracts 58	Closing a Business 59
<b>EC cohorts</b>										
EC-1958	38	59	112	65	46	72	92	83	48	105
EC-1973	6	18	54	26	28	70	44	17	27	62
EC-1980s	63	118	21	43	11	14	12	14	30	7
EC-1995	20	65	102	77	11	44	118	78	71	93
EC-2004a	50	67	87	58	49	80	99	60	69	45
EC-2004b	21	59	53	109	60	79	64	31	37	29
EC-2007	51	44	70	79	75	97	73	55	55	30
<b>Countries under accession negotiations</b>										
Croatia	84	56	132	110	65	132	42	98	47	89
Turkey	65	63	137	38	72	59	75	76	26	115
Macedonia	38	5	136	69	46	20	38	66	65	116
<b>Countries under DCFTA negotiations</b>										
Ukraine	145	118	179	164	32	109	181	139	43	150
<b>Countries willing to open DCFTA negotiations</b>										
Armenia	48	22	78	5	46	93	159	82	63	54
Georgia	12	8	7	2	15	20	61	35	41	105
Moldova	90	94	159	18	89	109	106	141	20	92

## Experience of others:

*number of companies before and after implementing EU food safety regulations*

- In Poland from 5,000 to 500,
- In Hungary from 2,000 to 400, and
- In Romania from 11,000 to 700, from which only 52 were approved for trade with the EU.

# Increased costs of living:

1. Food of 12 categories, price increase only for poorest part of the population will be around **GEL700 m, or around 3% of GDP**
2. **Social security expenditures** of the government to be increased around the same volume of GEL700 m
3. Total burden of the reform can be **up to 15% of GDP**

# Economic Growth – 5 scenarios

YEARS	growth	2%	5%	7%	10%	12%
	EU	GEORGIA				
0	34,000	2,500	2,500	2,500	2,500	2,500
10	41,446	3,047	4,072	4,918	6,484	7,765
20	50,522	3,715	6,633	9,674	16,819	24,116
21	51,533	3,789	6,965	10,351	18,501	27,010
30	61,586	4,528	10,805	19,031	43,624	74,900
31	62,818	4,619	11,345	20,363	47,986	83,888
40	75,073	5,520	17,600	37,436	113,148	232,627
41	76,575	5,631	18,480	40,057	124,463	260,543
50	91,514	6,729	28,668	73,643	293,477	722,505

# Full use of the DCFTA aquis – some predictable results

- Will **slow down** the growth of the economy 3-5%
- Will **rise the prices** on food and other useful goods up to 90%
- Will **double the social expenditures** of the Government and increase the number of vulnerable population by 50%
- **Discourage use of computers and the Internet** by poor population
- Will increase number of inspections and inspectors, **rise the probability of corruption, increase of black markets**

**AND...**

Please don't **Greek** us!

Or

Don't parasitize,  
Invest and don't subsidize!

# Without...

- without full access to the EU markets (very limited access to EU agricultural markets),
  - without full access to EU aid, and
  - without voting rights in the EU decision-making.
- 
- This is clearly not a sustainable approach.

# Main Conclusions:

current approach of the EU is:

- A bad development policy for GE
- A bad commercial policy for the EU.
- A bad foreign policy for the EU



Thank you!

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