



# GEORGIA'S CONVERGENCE WITH THE EUROPEAN UNION: EXPORT CHALLENGES

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**Abstract:** *The paper aims to identify Georgia's export challenges in the context of Deep and Comprehensive Free Trade Area (DCFTA) and to present the theoretical findings for the assessment the results of the Georgia's convergence to the EU under the free trade conditions. In order to assess its impact on export, the paper provides a comparative analysis of the results of the sociological survey of Georgian exporters conducted in 2016 and 2022 and also, an experimental study on the impact of institutional distance on export. Among the important findings are: exporters with more than 5 years of experience (mostly considering sanitary and phytosanitary standards) were positively affected by institutional proximity and export flows are in positive correlation with the state effectiveness (according to the WGI) in partner countries.*

**Keywords:** *Trade Policy, Institutional Distance, Regional Integration, EU-Georgia Trade, DCFTA.*

**JEL:** *F13, F14, F15, O43.*

## 1. Georgia's Progress in Institutional Harmonization and Export Challenges

The Deep and Comprehensive Free Trade Area between the European Union and Georgia as the principle pillar of the EU-Georgia Association Agreement (AA) defines regulatory alignment with EU rules in trade-associated issues. AA signed in June 2014 and it entered into force in July 2016 (Chronology of major events of EU-Georgia cooperation).

It should be noted that the DCFTA was the main trade-related component of the European Neighborhood Policy (ENP) and its preparation, ratification and implementation were preceded by in-depth reforms such as changes implemented in standardization, accreditation, conformity assessment, technical regulation and metrology and in various directions:

- Technical and construction supervision agency was established;
- Code on product safety and free movement of goods was adopted;

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- Thousands of international and European standards were adopted, and hundreds of standards were removed from the register of Georgian standards, some of which contradicted European standards; Internationally recognized metrological services and services of European certification bodies became available;
- A comprehensive strategy of competition policy was developed and a competition agency was established;
- A new customs code was developed and many changes were implemented, including information technology development projects, implementation of trade facilitation and integrated border management systems (NCTS computer program) and others.
- Significant changes were made in the direction of intellectual property protection etc.

A number of institutional reforms have continued and are being implemented within the framework of the Association Agreement (in detail see DCFTA, Georgia's Action Plans and Annual Reports, 2015-2022).

According to the implemented action plan of 2022, the field of trade statistics was improved, specific steps were taken in the direction of diversification of export products in the territory of the European Union (promotion of Georgian companies in international events, exhibitions and trade missions). A universal industrial program was developed and support for small and medium enterprises in terms of access to finance and/or technical support was increased; The training of export managers of small and medium-sized businesses is underway; the participation of entrepreneurs in the European Entrepreneurs' Network (EEN) is stimulated; the Trade with Georgia platform has been launched. The legislative and institutional sphere in the field of technical barriers to trade has been brought closer to the relevant legislation and best practices of the European Union, including the development of technical regulations on radio equipment, medical devices, electromagnetic compatibility, construction products and others. A risk assessment system was implemented for the market supervision agency; An electronic information system on dangerous products was created; introduced in the Standards Department in accordance with ISO 9001:2015; Work is underway to offer services in accordance with SO 17034:2016; new methods of laboratory diagnostics were introduced in the sanitary and phytosanitary direction; The scope of accreditation has been expanded; In the fields of telecommunications, e-commerce and postal services, a legal framework corresponding to European best practices was developed and the development of the postal market was promoted; The unified electronic system of state purchases (e-Procurement) and others were introduced.

According to the Association Implementation Report on Georgia (12 August 2022) the process of aligning national law with EU law as part of the DCFTA is well on track. All core institutions in charge of the DCFTA's implementation in Georgia are in place and operational.

Despite the progressive implementation of the planned measures, envisaged by the AA /DCFTA, there are a number of challenges for Georgian exports to enter the EU market.

Institutional harmonization plays an important role in the process of rapprochement between Georgia and the European Union, but the growth of Georgian exports to the EU market is modest.

Researchers give different assessments of the weak growth of Georgian exports to the EU market. For example, some of them (Akhvlediani et al. 2022) point out that trade flows between



the EU and Georgia have remained largely unchanged since the provisional entry into force of the DCFTA. They explain the given circumstance by the fact that Georgia has traditionally had a very low overall trade barrier. This implies that the liberalisation of trade barriers on the Georgian side should also not be expected to have a significant impact on Georgia's imports from the EU.

Georgia's export prospects require proper assessment in order to implement the right policy; also, the study of the issue is interesting from the theoretical point of view to assess the consequences of free trade agreements.

In order to identify barriers of Georgia's trade with the European Union, we conducted sociological studies of the Georgian exporters twice in 2016 (Papachashvili et al. 2016) and in 2022<sup>4</sup> based on the specially designed questionnaires. More than two hundred exporters participated in-depth interviews. So, *Methodology* covers analysis of appropriate scientific literature, statistical analysis based on the relevant national and international databases, and the survey of Georgian exporters on the basis of a questionnaire on non-tariff barriers. Comparative analysis is given on the bases of the results of the survey of Georgian exporters, and also, an experimental study is represented on the impact of institutional distance on export.

## 2. Exporters' Survey Results

According to the data of the National Statistics Service of Georgia in 2020, the export of Georgia amounted to 3,344.5 million dollars, and the share of the European Union is 21.5%. Representatives of the main export sector participated in our research. We mainly interviewed exporters of the following products: grape and wine products, fruit and vegetable processing, pharmaceutical products, metals, non-alcoholic and alcoholic beverages, tea, production of spices and seasonings and others.

The respondents participating in the research were quite familiar with the export process and related procedures, due to the fact that they have been exporting their products to different countries for years. According to the majority's assessment, the export of Georgian products is proceeding without interruptions, although certain difficulties have been identified, among which it should be noted: ensuring the continuity of the supply of products; difficulties in meeting EU technical requirements and certification; low awareness of Georgian products, transparent system of customs brokers, more electronicization of services related to export and others.

The study revealed that there is positive progress in meeting sanitary and phytosanitary measures. Only 16% of exporters (24% according to the previous survey) believe that these requirements are either hindering or prohibitive. 75% of the respondents indicate that their biggest costs in fulfilling the requirements related to sanitary and phytosanitary measures are: time, financial costs and costs related to complex regulations. Given the circumstances that 75%

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<sup>4</sup> The scientific research is being carried out by the Institute for Development Studies at Sulkhani-Saba Orbeliani University, Georgia, 2022.



of the surveyed exporters are small and medium enterprises, it is more difficult for them to comply with sanitary and phytosanitary measures.

8% of respondents (16% as of 2016) believe that the measures defined by technical standards (bans, authorization delays, registration requirements, other prohibitions/restrictions) are hindering or prohibitive. There is also a positive trend in the mentioned indicator compared to the results of the previous research. 52% of the exporters state that they have to meet the standards related to product identification, packaging and marking mostly from the technical standards.

8% of the surveyed exporters were subjected to retaliatory measures from the EU, among which the most prominent were: anti-dumping measures, countervailing duties, special agricultural protection measures. This indicator is also improved compared to the previous survey (12%).

Despite a number of reforms and the simplification of procedural standards, 47% of exporters (according to the 2016 survey - 65%) cannot meet any international or EU standards, nor do they possess relevant certificates. 18% of exporters have ISO 22000 (food product safety), and 20% have HACCP system (sanitary and phytosanitary norms).

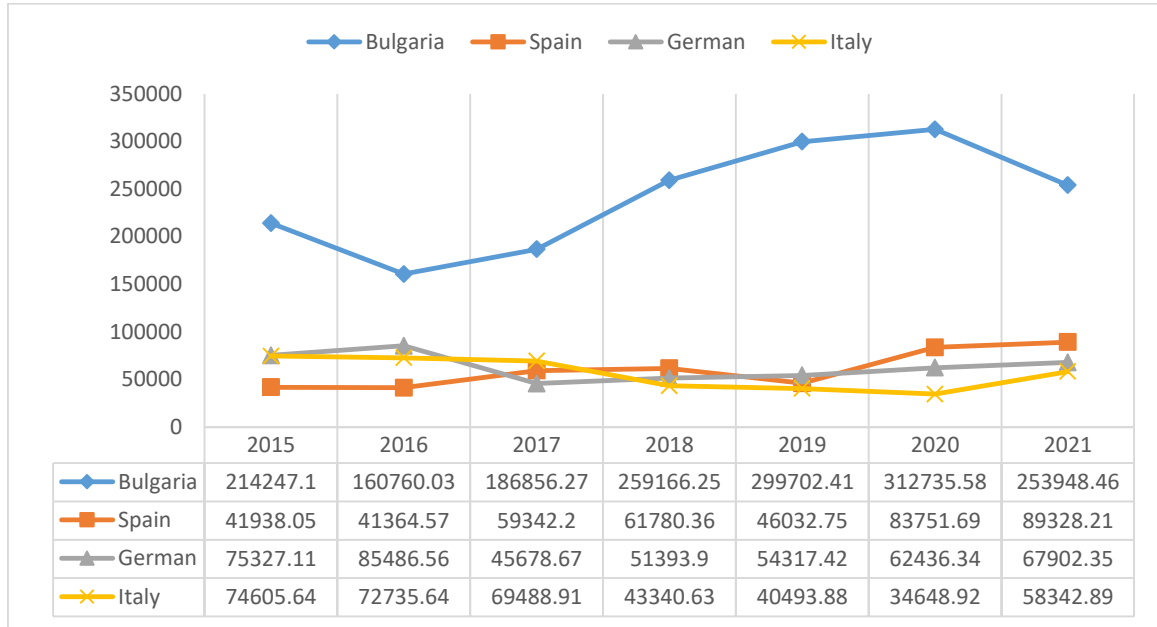
99% of respondents benefited from state programs, exporters' guides and/or various measures designed to bring them closer to the European Union. They mostly participate in events organized by state agencies; in grant and export promotion/stimulation programs; fair-exhibitions; with the events of the branch association. It should be noted that some measures are associated with financial costs, which creates an additional obstacle for exporters.

### **3. Experimental Assessment of the Institutional Approximation Impact on the Export Flows**

Among the countries of the European Union, Bulgaria, followed by Spain, Germany and Italy stand out in terms of the value of the export flows from Georgia.

In 2016-2020, exports to Bulgaria were growing noticeably. In 2021, it decreased sharply. Exports with the other three countries are stable and characterized by a slightly increasing trend.

**Table 1. Dynamics of Georgia's Export Flows in Selected Countries, 1000 USD**



Source: National Statistics Office of Georgia.

We suppose that the dynamics of the country's State Efficiency Index may have some correlation to the export flows insofar as it reflects the overall institutional orderliness. For example, in table 2, in which the State Efficiency Indices are given, we see that in 2020, Bulgaria's state efficiency index has suddenly dropped sharply, from 0.26 to -0.07. It is highly likely that this is what caused the sharp drop in exports from Georgia to Bulgaria in 2021.

In Spain, Germany and Italy, these indices show a decreasing trend in 2015-2020, although we do not have sharp fluctuations, as in the case of Bulgaria. Export flows in the direction of these countries are also stable.

**Table 2. State efficiency index**

Country	2015	2016	2017	2018	2019	2020
<b>Georgia</b>	0.40	0.52	0.58	0.61	0.83	0.79
<b>Bulgaria</b>	0.11	0.21	0.19	0.20	0.26	-0.07
<b>Germany</b>	1.69	1.70	1.65	1.56	1.53	1.36
<b>Italy</b>	0.52	0.58	0.53	0.44	0.48	0.40
<b>Spain</b>	1.19	1.13	1.04	1.00	1.00	0.89

Source: The Worldwide Governance Indicators.

We believe that the index of Georgia's rapprochement with the European Union may have a significant impact on export flows. The dynamics of index values in 2015-2021 are given in Table 3.

**Table 3. Index of Georgia's Approximation to the European Union**

Index	2015	2016	2017	2018	2019	2020	2021
Approximation	0.67	0.67	0.64	0.98	0.98	0.65	0.65

Source: Eastern Partnership Index.

Among the selected indicators, let's evaluate the Pearson correlation coefficient, in particular, between the state efficiency index of Georgia, the total value of exports to the mentioned four EU countries and the approximation index of Georgia to the European Union.

**Table 4. Pearson Correlation Coefficients Among State Efficiency, Export Value and Approximation Index**

Correlation coefficients	Efficiency	Export	Approximation
efficiency	1.00	0.70	0.44
export	0.70	1.00	0.22
approximation	0.44	0.22	1.00

We found that the correlation coefficient is high between the efficiency index of the state and the total value of exports. Let's check its statistical significance.

$t = 1.9351$ ,  $df = 4$ ,  $p\text{-value} = 0.1251$

alternative hypothesis: true correlation is not equal to 0

95 percent confidence interval: -0.2667258 0.9633024

sample estimates: cor. = 0.695355

The coefficient is statistically significant. This gives us the opportunity to deepen the research in the direction of searching for a cause-and-effect relationship between Georgia's state efficiency and export flows. Also, this fact supports the assumption that when the country's state efficiency index falls, its trade reputation is significantly damaged and the volume of trade flows with the country decreases, and vice versa.

*Limitation of the study:* Obviously, we are aware of the limitation of the time interval and therefore the results of the given study. However, we think that this experimental approach has a perspective from a methodological point of view. Time series data retrieval is limited not only for Georgia, but also for a number of post-socialist countries. It should be noted that the identification of relevant long-term observation variables to assess the institutional effect by economic sectors is a future task. Nevertheless, it is clear that there is a gap between the planned transposition of the European regulations and the actual effects.

#### 4. Conclusions:

Based on the analysis of the research results, we can formulate certain conclusions:

- The deep and comprehensive free trade agreement promotes the growth of Georgian exports in the European Union through the institutional harmonization, but the results of export growth is modest;
- General institutional arrangements have an impact on export flows;



- Deep and Comprehensive Free Trade Agreement is an additional tool for trade promotion;
- For Georgia's export growth, it is important to find sources of its development beyond institutional harmonization;
- Full access to the EU market is possible through the harmonization of non-tariff regulatory instruments, but compared to tariffs, their change is gradual, which suggests that trade policy reform is still an unfinished process;
- On the one hand, institutional differences in the business environment are reduced, which should reduce informational asymmetries and transaction costs for economic agents, and on the other hand, have a positive effect on the quality and awareness of export goods;
- Companies with long-standing partnerships with the EU find EU non-tariff measures less of a hindrance.

Based on the results obtained, we consider it important to consider the following recommendations:

- Development of medium and long-term strategies for each sector by assessing its export potential and determining the sectors in which Georgia may have a competitive advantage;
- Development of targeted sectoral programs and initiatives in fields with competitive advantages;
- Assisting in certification procedures for meeting the requirements established by non-tariff measures, conducting consultations, increasing the role of farmers' houses, training centers, etc.;
- Formation of specific measures of convergence with the standards of developed countries (ISO, IEC, EN, ENELE) on the basis of the formation of targeted organizations;
- Creation of partnership funds of entrepreneurs, which will replace the ring of intermediary companies.

The creation/development of the relevant legislative base of Georgia's international standards and technical regulations will have a positive impact on Georgian exports in the sense that companies will be focused on the production of products with standards that will have sales prospects on the markets of the European Union and other developed countries, and at the same time, high standards will limit low-quality imported products into Georgia.

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