

# **Challenges of Integration into the World Economy and Development**

## THE IMPACT OF ASEAN - CHINA FREE TRADE AGREEMENT ON EUROPEAN ECONOMY

**Andrea MANTOVANI**

*University of Bologna*

*45 Maggiore St., 40125, Bologna, Italy*

*a.mantovani@unibo.it*

**Abstract.** *ASEAN members initiated ASEAN Free Trade Area (AFTA) both to increase trade among them and to create an integrated market, thus exploiting the comparative advantage that may come from producing and exporting products like palm oil and biodiesel. Following the rise of China and its increasing trading opportunities, ASEAN members and China itself acknowledged that the best way to develop and promote growth in their countries was through a Free Trade Agreement (FTA). Through the ASEAN-China FTA (ACFTA), not only tariffs and barriers considerably reduced, but a higher level of economic integration was achieved. This was expected to boost the economies of the countries involved and attract foreign investments into the area. Of particular interest for the present study is the case of Indonesia, the largest economy of ASEAN, and an attractive destination for investors from China due to its richness in raw material resources. However, China and Indonesia (together with Vietnam) recently experienced the attempt by the EU to limit trade through the imposition of antidumping duties. Specific case studies that will be treated in this paper are related to: Chinese and Vietnamese shoe production; Chinese solar panel; Indonesia biodiesel. In all these cases, the EU imposed anti-dumping duties that raised much criticism and provoked serious trade retaliation (e.g. China imposed similar duties on the entrance of Bordeaux wine). The lack of political cohesion has so far reduced the effectiveness of the counter measures adopted by Asian countries. This paper suggests that things may rapidly change, as the higher level of economic integration reached through the ACFTA will progressively reinforce the ability of both ASEAN countries and China to respond to the protectionist policies adopted by the EU. To this regard, this paper evaluates the impact of trade retaliation on some specific European industries. In particular, it focuses on the solar panel industry and on the biodiesel industry and highlight their connection to the 20-20-20 plan (20% increase in energy efficiency, 20% reduction of CO2 emissions, and 20% increases in renewables by 2020) set by the EU. It argues that, in order to achieve its ambitious environmental goals, the European government should avoid unnecessary protectionist measures and collaborate more extensively with ASEAN nations and China.*

**Keywords:** *ASEAN Free Trade Area; China; European Union; trade retaliation; 20-20-20 Climate and Energy Package.*

### Introduction

The Association of South East Asian Nations (ASEAN) was established in 1967 with the aim to strengthen the economic, social and cultural development of Southeast Asia. ASEAN members initiated ASEAN Free Trade Area (AFTA) in order to increase trade among themselves and to create an economic community. Member countries made significant progress in lowering intra-regional tariffs. Furthermore, following the European example, they pursued further economic integration and the creation of a proper common market (Plummer, 2006). The emergence of China as a global player contributed to changing the scenario. As a result, increased negotiations between ASEAN and China led to the formation of the ASEAN-China Free Trade Agreement (ACFTA), a free trade area among the ten member states of the ASEAN and the People's Republic of China.

Even though China had already established economic trade with individual South East Asia countries throughout the course of history, it did not pursue official relations until the 1990s. In 1991, at the 24th ASEAN Ministerial Meeting, China officially initiated to build relationships with ASEAN. The ASEAN members welcomed China's interest. Soon afterwards subsequent formation of committees on different areas such as science, technology, security, and trade followed. A major breakthrough was the signing of the Framework Agreement on a Comprehensive Economic Cooperation in 2002,

which laid the foundation for ACFTA. Further developments on this agreement occurred in 2004 with the signing of the Framework Agreement on Trade in Goods by ASEAN and China. The six original ASEAN countries (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) agreed with China on the elimination of tariffs on 90% of their products by 2010, while the less developed ASEAN countries were given time until 2015 to implement such measures.

In terms of consumer market size, ACFTA is now the biggest Free Trade Area in the world. The end goal of having a Free Trade Agreement is to improve national prosperity for each of its members. Park (2007) examined whether ACTFA would be potentially beneficial for both sides, and concluded that both economic and non-economic factors were in favor of a positive answer. However, at the global level, the scenario that recently emerged proved not to be that simple. The entrance of China into the WTO in 2001 altered not only the delicate equilibrium in the Asian region as a whole, but also at a world level. Many industrialized countries adopted safeguard measures against relatively cheap products coming from Asia. In particular, the Anti-Dumping regulation simultaneously reinforced in the '90s in both the US and the EU reflected the need to defend local markets against the entrance of low-cost products coming from Southeast Asia, in particular from China. In the EU, for example, new Anti-Dumping regulations came into force on January 1, 1995, updated by Regulation 1225/2009. They targeted in particular dumped imports that caused significant injury to European producers. In order to apply such duties, the EU investigation on anti-dumping claims must demonstrate that: (i) there exists dumping by the exporting producers in the country/countries concerned; (ii) material injury has been suffered by the Community industry concerned; (iii) there is a causal link between the dumping and injury found. Such measures were recently adopted more extensively than in the past, raising criticisms and concern. However, as I will argue, the higher level of economic and political integration achieved in Asia following ASEAN-China Free Trade Agreement has substantially changed the effectiveness of such policy instruments, and provoked trade retaliation.

Not only China, but also many other ASEAN countries, like Indonesia and Vietnam, have been highly affected by the Anti-Dumping regulation implemented by the European Union. For example, Indonesia was imposed an additional duty of on average 18.9% for the biodiesel exported to the EU. This, together with a similar duty of an average of 47.7% for Chinese exporters of solar panels, raised two main issues. First, trading partners responded by restricting the import of certain products from the EU. Some European producers, especially in luxury sectors, recently experienced such trade retaliation measures. Second, and more important for the aim of this paper, such trade policies may prove to be in sharp contrast with important initiatives within the environmental policy framework strongly supported by the EU. Case in point, the price for alternative sources of energy may indeed increase because of such forms of protectionism, thus reducing the possibility to achieve the ambitious goals set at the EU level in terms of environmental protection.

This paper explores the effect of the deeper level of integration of Asian countries with the EU economy, with a particular focus on the difficult relation between trade policy and environmental policy. In particular, the success of the EU environmental policy crucially depends on the possibility to complete its climate and energy targets by 2020. The aim of the so-called 20-20-20 integrated plan is to simultaneously obtain: (i) a 20% reduction in EU greenhouse gas emissions; (ii) an increase in the share of EU energy consumption produced from renewable resources to 20%; (iii) a 20% improvement in the EU's energy efficiency. I will argue that the EU should reduce the level of protectionism towards Asian countries if it wants to achieve such ambitious goal. The reason is simple. The EU needs alternative affordable sources of energy coming also from the exploitation of biodiesel and solar power, for example, and this is possible only by opening up trade with those countries where they are cheaply produced. This is even more necessary as Asian economies are becoming deeply integrated because of ACFTA. Therefore, their ability to effectively respond to European protectionist measures is going to increase in the following years. In fact, this reality has already played out. In order to support my thesis, I will consider relevant case studies that show the impact on the European economy of different strategies respectively adopted by China, Vietnam and Indonesia. Such responsive strategies cover a time span of almost a decade and show that a progressively higher level of economic integration not only within ASEAN but also between ASEAN

and China has significantly increased the level of effectiveness of the responses adopted by Asian countries.

### **The impact of ACFTA on the European Economy**

As I introduced above, apart from China, in my analysis I also focus on Indonesia and Vietnam as two interesting cases of recent integration in the Asian market as well as examples of countries subject to anti-dumping duties levied by the EU. Starting from Indonesia, 16% of its GDP is still provided by the agricultural sector that also employs 45% of the labor force. The potential advantages of such a country are represented by perfect climate for agriculture, fertile volcanic soil, abundance of water, and plenty of arable land. Today Indonesia is the world's largest producer of palm oil as well as a leading global producer of other high value commodities such as cocoa, rubber and coffee. Focal industries such as fisheries and agri-food, consumer electronics, furniture, and natural cosmetics have huge potential in the EU market. Demand for imports of focal products is projected to grow by nearly 7 percent a year over the medium term. Recently, the EU demand for agri-food imports has been strong, particularly in response to changes in consumer incomes. As an example, over the last four decades, the palm oil industry has expanded dramatically. The share of palm oil production has increased by 16.8 percent, from only 4 percent in 1962 to 20.8 percent in 2002. This shows the competitive advantage of crude palm oil (CPO) as one important source of Indonesia's export incomes. In addition to raw materials for cooking oil, palm oil is used to make margarine, soap, oleochemicals and now also for *biofuel*, therefore touching upon one of the most important points of this paper. However, as we have already discussed, the European Union applies precise rules for exporters willing to enter its market. Under Common Commercial Policy (CCP), for example, it controls the minimum standard quality items from Indonesia. Even though Indonesia and EU have a bilateral agreement under WTO, some industries are subject to specific quota barrier or standard quality barrier. This is not the only trade barrier, as it will be shown below. Protectionist measures such as antidumping duties have been recently employed towards biodiesel from Indonesia to the European market, thus reducing its import.

Let me now consider Vietnam. In the past years, Vietnam's economy has grown exponentially; its GDP has increased by 10.3%, resulting in considerable expansion of its middle class and increased purchasing power. The implementation of new regulations, more privatization, and a reduction of restrictions for foreign ownerships has attracted numerous foreign investors. The reconstruction of its economy, together with ASEAN economic integration and free trade agreements, helped Vietnam to improve trade with other countries in the region. Indeed, Vietnam's trade with other ASEAN members has increased to 20%, the biggest surge in the whole region. Vietnam has also strengthened its relations with the neighbors through cooperation, equality, mutual benefit and non-interference into other country's internal affairs. ASEAN membership has also given Vietnam the opportunity to reinforce external relationships with non-ASEAN member countries and to actively participate in international cooperation meetings. In addition, Vietnam joined the regional road, electricity, and fuel networks. In short, Vietnam promoted its image as a dynamic country with a foreign policy characterized as independent, self-reliant, politically stable, cooperative and developed. Vietnam has also worked hard to attract foreign investors, creating an appealing and attractive business atmosphere for foreign investors by continuously improving its legal framework and institutes associated with business and investment. If one compares Indonesia and Vietnam in terms of exports, Vietnam has surprisingly outperformed Indonesia in the clothing and footwear industry due to its cheaper labor force and strategic location, which is comparable to China. ASEAN is also pushing Vietnam to become more liberal and open to the other countries, making it possible to build multilateral agreements in trading with ASEAN and non-ASEAN members.

Overall, the strengthening of ASEAN's integration process brought a significant improvement in the socio-economic conditions of Indonesia and Vietnam. It provided these countries easy access to other ASEAN countries as well as China, a higher availability of different products, markets that are more heterogeneous, reduced tariffs, and bigger chance of investments between ASEAN member or other

countries in Asia region. Although today Indonesia maintains a stronger economic position, Vietnam is quickly catching up thanks to skilled but still cheap labor cost, political stability, and a more transparency towards foreigner investors. Once again, thanks to ASEAN and ACFTA.

Turning to China, with more than 1.4 billion people it is currently twice as populated then the entire ASEAN-10 and 6 times more populated than Indonesia. Following the data gathered by Jiang and Li (2013), China's total exports to the six ASEAN members, Singapore, Malaysia, Indonesia, Vietnam, Thailand and Philippines amounted to 193.701 billion USD in 2013. The authors also report evidence of a significant increase as compared to 2011, especially in China's exports to Malaysia (31% more than the previous year). In contrast, total export from China to Myanmar, Cambodia, Brunei and Laos had decreased. However, total exports to Vietnam was USD 34.21 billion in 2012, with an increase of 17.6% over the previous year, accounting for 16.75% of total exports China to ASEAN, exceeding Thailand and Philippines ranked in fourth place. In January 2010, when ACFTA was fully established, ASEAN-China two-way trade grew by 10.9% to 443.6 billion USD in 2013. China's export to ASEAN reached 244.1 billion USD, while ASEAN's export to China reached 199.5 billion USD. Nowadays, China is ASEAN's largest trade partner, and ASEAN is China's 3rd largest trade partner. ASEAN-China bilateral investments increased, amounting to 12 billion USD from January to November 2013, in which China's investment to ASEAN reached 4.52 billion USD while ASEAN's investment to China were 7.53 billion USD. These data show greater economic integration in the Asian region. It means, also, a higher degree of political cooperation also in front of other free trade areas and customs unions like the EU.

The dynamism of China's economy, as well as ASEAN countries has revealed the importance of establishing stable economic, political and social relations. Growing economic ties between ASEAN and China reflect their vibrant economies, their respective trade connections and complementary economic structures. Trade statistics (see Chandra & Lontoh, 2011, among others) showed that Indonesia is the ASEAN member with closest trade relations with China, especially after the entry into force of the ASEAN-China trade agreements FTA. Linked to our previous focus on Indonesia, China is one of Indonesia's major trading partners after ASEAN. The total value of trade between Indonesia and China reached USD 36.2 billion (2010) and the amount is 12.4% of the total trade between Indonesia (see ICRA, 2011). Meanwhile, the trade between the two countries during the period 2006-2010 recorded economic growth on average by 30%.

The previous analysis revealed a greater level of economic integration between Asian countries. This also implies an increase in the political integration and a common commitment to play an even bigger role at the world level. The implications for the European Union are clear: protectionist measures adopted by the EU government may backfire. Moreover, the ambitious environmental policy pursued at the EU level may be hindered if protectionist trade policies reduce the free flow of those goods and services that may facilitate the adoption of alternative sources of energy. In the following analysis, I propose three examples of antidumping duties that generated economic and political tension between the EU and three different Asian nations.

The first case analyzed is the tariffs on Chinese and Vietnamese footwear import imposed by the EU in 2006. The then EU Commissioner, Peter Mandelson, announced that evidence had been found of anti-competitive practices on the part of Chinese and Vietnamese footwear manufacturers. Consequently, a decision was made to impose a duty on shoes imported from these regions over a period of five months. The duty started in April 2006 at a rate of 4%. By October of the same year, the rate had risen to 19.4% for China and 16.8% for Vietnam. Following the EU investigation, evidence showed that the Chinese and Vietnamese shoe manufacturing sectors had benefited from state-backed cheap financing, non-market land rents, tax holidays and improper asset valuation. This allowed Chinese producers to export shoes to the European market at a price lower than that was much lower than under proper competitive market circumstances. Hence, the EU claimed it had evidence of illegal dumping. The Commission also estimated that the resulting tripling of imports from the two countries over the past four years has caused the closure of 1000 footwear companies, the loss of 40,000 jobs, and a drop in production of 30%. Material injury for European producers was then evident. Commissioner Mandelson claimed that the antidumping duties were not protectionist

measures. He added that China and Vietnam were free to exploit the natural competitive advantages of their cheaper labor cost. However, they were not entitled to distort free trade through anti-competitive practices. "Defense against unfair trade is specifically sanctioned by the WTO. I do not use trade defense instruments lightly or casually," he said. Nonetheless, the Chinese government reacted by stating that the Commission had insufficient evidence to back such claims, and that Chinese shoe exporters were not dumping goods into the EU. In that case, however, the reactions by Chinese and Vietnamese governments were not aligned, as they individually responded to the accusations brought up against them. Furthermore, the other ASEAN countries were never involved in the dispute. As a result, EU footwear manufacturers took advantage from the lower competitive pressure from Asia, with no repercussions on other European industries. The only tangible drawback was imposed on final customers. In fact, the Federation of European Sporting Goods Industry (FESI) estimated that European consumers would end up paying the cost of the antidumping duty, as shoe prices increased by 25% on average.

The previous example is related to a sector that is not directly connected to environmental policy. Moreover, as I argued above, the EU did not suffer any form of trade retaliation neither from China nor from Vietnam. However, in 2013, the outcome of a similar protectionist measure was notably different. In November of that year, in fact, the EU imposed tariffs of as much as 42.1 percent on solar glass from China to curb import competition for EU producers. The duties were the preliminary outcome of an investigation opened in February 2013 after a dumping complaint was filed by a European group of producers who made up more than a quarter of EU production of solar glass (the EU solar-glass market was valued at least 200 million EUR). The European Commission found that Chinese exporters were selling the glass used in solar panels at below-cost prices thanks to government-backed subsidies. China's expansion into the European solar glass market caused again material injury for EU producers, given that Chinese exporters increased their share of the EU market from 6.2% in 2009 to nearly 30% in 2012. Consequently, a substantial number of European solar glass producers were forced to either cease production or sell off their manufacturing facilities. John Clancy, the EU Trade Spokesman, said that the Commission's investigation "has demonstrated the existence of dumping from the People's Republic of China that causes injury to the Union industry, and that the imposition of provisional measures is not against the Union interest."

However, this time the response from the Chinese government was more aggressive. The Chinese premier, Li Keqiang, had warned the European Commission that the case would have hurt EU-China trade relations. François Godement, head of the China program at the European Centre for Foreign Relations, had predicted that China would have retaliated, and the French government was against the imposition of such measures. Why did France take this position? The reason is simple. In June 2013 the Chinese government began an inquiry into the import of EU wines at the request of Chinese wine makers. The Chinese Commerce Ministry received an application from the domestic wine industry, which accused wines imported from Europe of entering China's market by use of unfair trade tactics such as dumping and subsidies. As a consequence, China, together this time with other ASEAN countries, decided to restrict the import of Bordeaux wine (China was the primary destination market for Bordeaux wine, as Chinese consumers were ready to pay very high prices for such a luxury wine). This affected not only French producers of wine, which were obviously against such anti-dumping measures, but also the purchasing power of many European consumers willing to buy relatively cheap solar panels produced in China. Therefore, in addition to harming this time a specific European industry (wine), the response by the Chinese government caused a negative ripple effect that spread to the European environmental policy, as it reduced the effectiveness of the 20-20-20 plan.

The last case analyzed connects trade policy and environmental policy even more directly. In July 2013, the EU started applying provisional anti-dumping duties on biodiesel imports from Indonesia, following an investigation that started in April of the same year. In November 2013, the EU voted in favor of introducing definitive anti-dumping duties against biodiesel imports from Indonesia and Argentina. However, due to the simultaneous reinvigoration of the EU environmental policy through the 20-20-20 plan, the demand of biodiesel in the EU continued to rise, despite supply still heavily depended on imports from those countries subjected to the imposed tariff, Indonesia *in primis*. The EU relied on the amiss assumption that they would have been able to easily substitute the cheap

biodiesel from Indonesia with that of other Asian countries, such as Malaysia and South Korea. However, in light of the increasing cooperative effort pursued among ASEAN members, these countries began to systematically reduce the export of biodiesel to EU. Hence, this is a prime example of how the establishment of strong economic collaboration between Asian nations can pose additional challenges not only to EU trade policy, but also to stifle the effectiveness of other interdependent policies, in particular EU environmental initiatives such as the 20-20-20 plan.

### Conclusions and implications

The presence of ASEAN and the economic integration achieved following ASEAN-China Free Trade Agreement (ACFTA) has brought substantial changes not only within the Asian continent but also at the global level. In particular, the goal of this paper was to analyze how this may have influenced not only the trade policy adopted by the European Union, but also its environmental strategies. We initially highlighted the cases of Indonesia and Vietnam, which benefited from ACFTA in terms of availability of goods, reduced tariffs, and increased levels of investments. Together with China, they represented an interesting case study to test the implications for European trade policy. In particular, I argued that the deeper level of integration reached by Asian countries has contributed to accelerate two problems faced by the European Union. First, restricting trade against such countries may backfire, as they can now respond by reducing the import of European products, as in the case of Bordeaux wine. Second, the ambitious environmental goals set by the EU, which require the substitution of polluting energy production with green alternatives, relies on the possibility to find economically feasible sources of energy. Case in point, the effective use of photovoltaic systems and the reduction of diesel fuel crucially depends on the respective availability of solar panels and biodiesel at competitive prices. Nonetheless, recent trade policy measures implemented by the EU caused a decrease in the import of cheap solar panels from China and biodiesel from Indonesia! This goes against the ambitious environmental policy promoted by the EU through the 20-20-20 plan. A better coordination between environmental policy and trade policy at the EU level is therefore necessary to fight pollution without spoiling international relations with trade partners that are becoming not only more powerful, but also more aware than in the past of their influence and strategic economic strength as a single entity promoted through ACFTA.

### References

- Association of South East Asian Nation. FTA Agreements - ASEAN. ASEAN Secretariat. Retrieved from <http://www.asean.org/asean/external-relations/china/item/asean-china-free-trade-area>.
- Booth, A. (2011). *China's Economic Relations with Indonesia: Threats and Opportunities*. SOAS, University of London.
- Chandra, A., and Lontoh, A.Z. (2011). *Trade Relations: The deepening of economic integration amid uncertainty?*. International institute for Sustainable Development. Retrieved from [http://www.iisd.org/tnk/pdf/indonesia\\_china\\_relations.pdf](http://www.iisd.org/tnk/pdf/indonesia_china_relations.pdf).
- Clancy, J. (2013). EU imposes maximum 42.1% anti-dumping tariff on Chinese solar glass exporters. Retrieved from [http://m.pv-magazine.com/news/details/beitrag/eu-imposes-maximum-421-anti-dumping-tariff-on-chinese-solar-glass-exporters\\_100013572/](http://m.pv-magazine.com/news/details/beitrag/eu-imposes-maximum-421-anti-dumping-tariff-on-chinese-solar-glass-exporters_100013572/).
- Council Regulation (EC) No 1225/2009 of 30 November 2009 on protection against dumped imports from countries not members of the European Community. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2010/april/tradoc\\_146035.pdf](http://trade.ec.europa.eu/doclib/docs/2010/april/tradoc_146035.pdf).
- Euractiv (2006). EU announces tariffs on Chinese and Vietnamese shoes, 24/02/2006. Retrieved from <http://www.euractiv.com/trade/eu-announces-tariffs-chinese-vietnamese-shoes/article-152925>
- European Commission (2013). Directorate General for Trade. EU imposes definitive measures on Chinese solar panels, confirms undertaking with Chinese solar panel exporters, Brussels, 2 December 2013. Retrieved from [http://europa.eu/rapid/press-release\\_IP-13-1190\\_en.htm](http://europa.eu/rapid/press-release_IP-13-1190_en.htm).
- European Commission, Directorate General for Trade. *EU to impose definitive anti-dumping duties on biodiesel from Argentina and Indonesia*, Brussels, 21 November 2013. Retrieved from

- [http://europa.eu/rapid/press-release\\_IP-13-1140\\_en.htm](http://europa.eu/rapid/press-release_IP-13-1140_en.htm).
- European Union Trade Policy. Retrieved from <http://ec.europa.eu/trade/policy/>.
- ICRA Indonesia (2011). The Impact of ACFTA to Indonesia China Trade. Retrieved from <http://icraindonesia.com/uploaded/The%20Impacts%20of%20ACFTA%20020511.pdf>.
- Jiang, J., and Li, C. (2013). Analysis of Trade Development between China and Association of Southeast Asian Nations. *Journal of Behavioural Economics, Finance, Entrepreneurship, Accounting and Transport*, 1(1), 15-20.
- Losari, J.J., and Koesnaldi, J.W. (2015). Is Indonesia up for the ASEAN economic community 2015?. *Asian International Economists Network*. Retrieved from <http://www.aienetwork.org/blog/38/is-indonesia-up-for-the-asean-economic-community-2015>.
- Mandelson, P. (2006). Statement to the Press: Anti-dumping investigation into Chinese and Vietnamese leather shoes, Brussels, 23 February 2006. Retrieved from [http://europa.eu/rapid/press-release\\_SPEECH-06-119\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-06-119_en.htm).
- Park, D. (2007). The Prospects of the ASEAN–China Free Trade Area (ACFTA): A Qualitative Overview. *Journal of the Asia Pacific Economy*, 12(4), 485-503.
- Plummer, M. (2006). ASEAN-EU economic relationship: Integration and lessons for the ASEAN economic community. *Journal of Asian Economics*, 17(3), 427-447.
- Thangavelu, S., and Findlay, C. (2011). *The Impact of FTA on Foreign Direct Investment in the Asia-Pacific Region*. Economic Research Institute of ASEAN and East Asia. Retrieved from [http://www.eria.org/publications/research\\_project\\_reports/images/pdf/y2010/no29/Ch4\\_The\\_Impact\\_of\\_FTA.pdf](http://www.eria.org/publications/research_project_reports/images/pdf/y2010/no29/Ch4_The_Impact_of_FTA.pdf).
- The Telegraph (5 June 2013). China responds to European solar panel dispute with wine probe that hits vineyard owning EC trade chief. Retrieved from <http://www.telegraph.co.uk/finance/globalbusiness/10100058/China-responds-to-European-solar-panel-dispute-with-wine-probe-that-hits-vineyard-owning-EC-trade-chief.htm>.



## NEW FORMS AND TRENDS OF INTERNATIONAL TRADE AMID THE GLOBAL CRISIS

**Tamta MIKABERIDZE**

*Ivane Javakhishvili Tbilisi state University  
3 University St., Tbilisi, Georgia  
mikaberidzetamta@gmail.com*

**Abstract.** *The present paper aims to discuss and to investigate the importance and impact of new theories of international trade, new forms and trends, technical instruments and facilities of the international trade on the background of trans-nationalization and integration in the global economy. In the present work, the existing studies on a new theory of the intra-industry trade (Balassa, 1967; Krugman, 1979; Helpman, 1998; Hamelss, 1995; Levinson, 1995; Fontagne, 1997; Freudenberg, 1997 and others), its role and the reasons of emergency are mostly developed in the line with the new forms of international transactions and technical instruments. The analysis is based on the WTO statistical data. In the global trade, the focus from the “money transactions” is carried over to the “transactions not involving money”. This process has provided the rapid expansion of buy-back transactions. This is largely due to the global crisis and certain transformation of the international economic environment. The findings have been made on how the compensation transactions promote the maintenance of the trade relations between the developed countries with the countries which are in the difficult economic situation, how the compensation transactions provide for the security and stability of the supply of raw materials. Why those transactions are the mutually beneficial instrument both for developed and developing countries? The role of the industrial product in compensation arrangements may be played by the joint development projects and cooperation in techniques and technology. Compensation arrangements in industrial products have emerged as a response to the international trade complications. Today it may be the way out from periodically rising crises. Largely, the Western technology and equipment gain access to the Eastern markets mainly through compensation transactions. The development of relations between the countries of the North and the South and search for the opportunities of industrial cooperation is carried out based on compensation and countertrade transactions. This paper emphasizes the importance and advantages of use of new opportunities of trade system and new trade forms and facilities for countries with small open economies (including Georgia), especially amid the integration in the modern global economy and the global downturn.*

**Keywords:** *Intra-Industry trade; compensation transactions; trade technologies; trans-nationalization; counter trade.*

### Introduction

The development of the world economy amid the global crisis is characterized by a rise in the integration (as indicated by the processes related to NAFTA, MERCOSUR, the European Union and now the Eurasian Union as well). Depending on such processes, the developing countries require special support and development of international trade in order to save their economies.

At the modern stage of the world economy's development, a growing number of countries are expanding the scale of their participation in the world integration processes by means of foreign trade. The evidence of that is the statistical data of WTO: Since 1990, South-South trade – that is, trade among emerging and other developing economies – has grown from 8 per cent of world trade in 1990 to around 25% today, and is projected to reach 30% by 2030. Trade corridors between Asia and North America, and between Asia and Europe, now surpass the old transatlantic trade corridor, while trade corridors between Africa and Asia or Latin America and Africa are growing in importance. Even as the South's share of world trade expands, world trade as a whole continues to grow, meaning that developing countries have ever-richer and more diverse markets for their exports.

Participation in the international trade gives the countries (especially the developing ones) an opportunity to effectively use the resources possessed by them, develop the priority sectors, adopt the world scientific and technical achievements (since overcoming of socio-economic and production-technical backwardness is only possible by means of intensification of partner relations with the developed countries). In the process of formation of an open economy strengthening of economic ties takes place, which is an intensive factor of economic growth and structural rearrangement, it accelerates formation of market institutions and mechanisms in the country, etc.

The process of globalization of the world economy has resulted in major changes in the international trade and its participants and in the emergence of new trends therein. Therefore, the analytical review of the new theories of the international trade, especially of the intra-industry trade theory (Balassa, 1967), their importance and impact of the new forms and trends in international trade, technical instruments and facilities on the background of the trans-nationalization and integration in the global economy is very important.

The research of the new forms and trends of international trade is especially relevant for the countries with small open economies, such as Georgia. In September 2014 Georgia signed the EU Association Agreement (DSFTA), which regulations have been already entered in force. Consequently, the study of capabilities of new structure and directions of trade flows shall become the benchmark for the further economic development of the country.

### **Research methods**

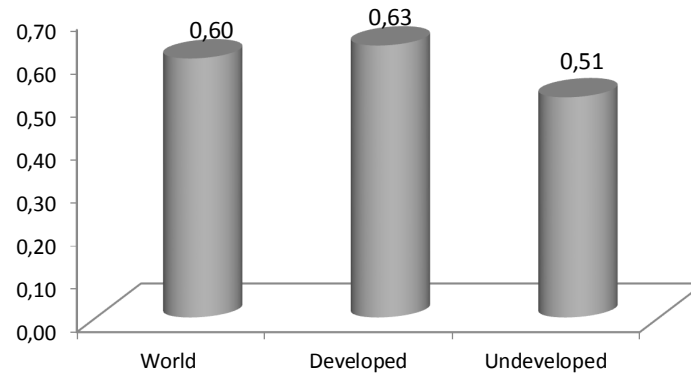
Analysis and synthesis, abstraction, deduction, induction and statistics methods have been used in the process of scientific research. The theoretical basis of the research consists in the existing studies on a new theory of intra-industry trade (Balassa, 1967; Krugman, 1979; Helpman, 1998; Hamelss, 1995; Levinson, 1995; Fontagne, 1997; Freudenberg, 1997 and others), the product life cycle theory (Vernon, 1969), their role and the reasons of emergency are mostly developed in the line with the latest foreign trade technologies, new forms of international transactions and technical instruments, the countertrade and barter transactions which have developed since the '80s. The WTO and OECD statistical data have been used for the analysis.

### **Conceptual issues of intra-industry trade**

In the modern theories which propose the alternative interpretation of the international trade we can distinguish the theory of neo-technological directions: Posner's technology gap theory (1961); Kemp's scale effect theory (1964); Krugman's theory of imperfect competition (1979); Balassa's theory of intra-industry trade (1967); Vernon's theory of product life cycle (1969); Porter's theory of the competitive advantage of nations (1986), which in turn explain the nature and trends of the intra-industry trade (Balassa, 1967; Krugman, 1979; Helpman, 1998; Hamelss, 1995; Levinson, 1995; Fontagne, 1997; Freudenberg, 1997 and others).

The rise in the share of the global turnover mainly comes to the intra corporate trade (within the transnational corporations), the so-called intra-industry trade – the growth of the counter supply of similar (homogenous) industrial goods between one and the same industries of different countries, the increase in trade between the countries with similar resources etc.

The trend of growth of the intra-industry trade share has been increased over time. For example, in the UK it was 53.2% in 1970, 74.7% - in 1980, and in 84.6% - in 1990. The same trend in Germany was 55.8; 56,6 and 72,2% accordingly (Helpman, 1998, p.20). Later on, the review of the EU data has shown that the share of intra-industry trade is rather high and according to the Grübel-Lloyd index looks like this:



**Figure 1. Average Grubel-Lloyd indices for European Union (27) across selected economies 2011**

The chart shows that for 1996-2011 a trend of intra-industry trade growth in the EU, which reflects the close correlation with the change of the market situation; we have witnessed the trend of a steady growth of the intra-industry trade, which has been strengthening during the crisis.

As it is, the intra-industry trade theory has emerged from the rejection of the traditional trade theory (because traditional theories failed to explain some of the economic events of the second half of the XX century). However, in time they tried to integrate these two theories into one model.

According to the economists Fontagne (1997) and Freudenberg (1997), three models of the international trade are: the inter-industry trade, intra-industry trade with horizontally differentiated products, and the intra-industry trade with vertically differentiated products (Fontagne & Freudenberg, 1997). The horizontal differentiation of products means that there are different kinds of roughly similar products on the market (with similar quality and price), but the products may be differentiated not only horizontally (based on secondary signs), but also vertically (by quality and price). These differences may be related to the amount of the costs for the scientific research, conducting experiments and design, workforce qualification, advertisements and so on. Basis of specialization of the intra-industry trade with horizontally differentiated products is differences in quality of products, and costs related to the distribution of resources are potentially significant (in the level of income among the countries in connection with the possible differences). Basis of specialization of intra-industry trade with vertically differentiated products is the variety of products with similar attributes. Costs related to distribution of resources are insignificant (Fontagne & Freudenberg, 1997).

Several reasons explain the intra-industry trade in differentiated products:

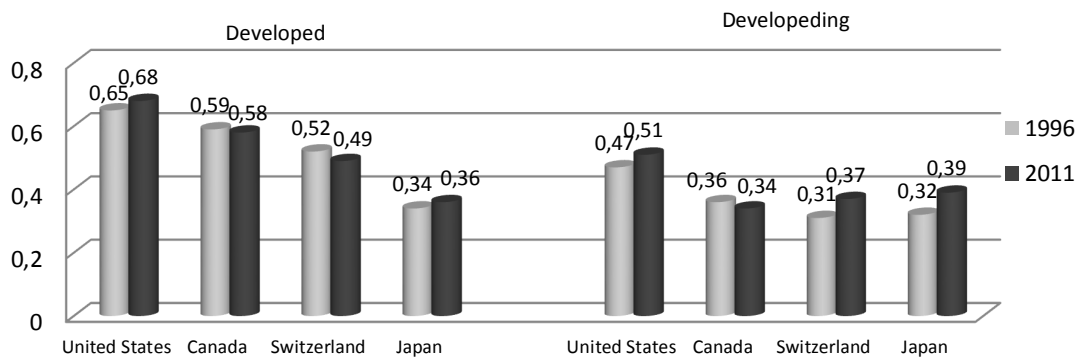
- *The different taste of consumers* who want to have a great choice of products within one commodity group (Ballasa, 1967);

- *Overlapping demand* (Linder, 1961) in particular the country's export those industrial products for which there is a capacious internal market; as in the countries of about the same income level the consumers have similar taste, for each country it is easier to export goods, in the production and trade of which it has accumulated a great experience in the domestic market;

- *Scale effect* (Krugman, 1979). With the increase in the scale of production, which usually takes place in the framework of monopolistic competition, the production costs for each unit are declining. Therefore, for those countries there becomes feasible to specialize in the production and turnover of technologically homogenous, but differentiated products (the so-called intra-industry trade). For example, we may bring the trade in motorcars between the countries producing them.

Studies prove that the share of intra-industry trade will be higher when the trade partners are highly developed countries and have about the same level of development and when the trade partners have large territories and do not substantially differ in size.

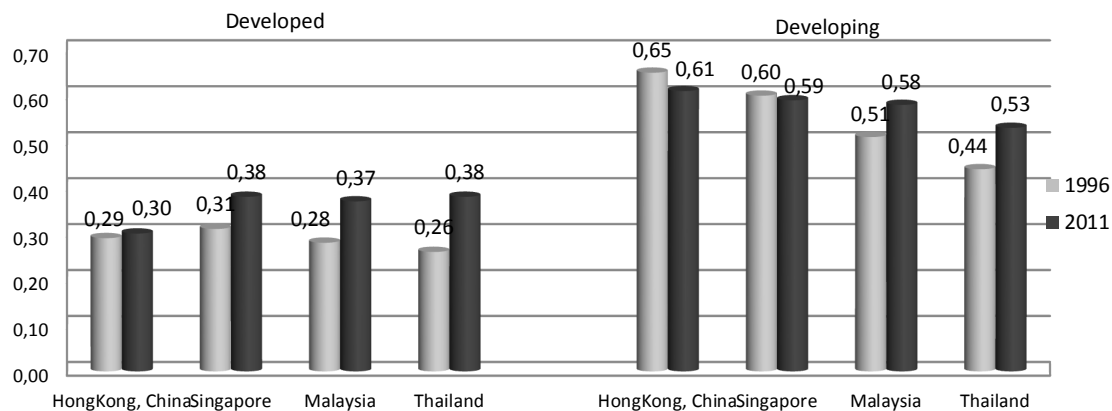
The above reasoning is confirmed by the WTO modern research concerning the average rate of GL (Grubel-Lloyd) index (determining the intra-industry trade value) in the developed and developing countries in the years 1996-2011 and, hence, participation of the countries in the intra-industry trade (WTO, 2013, p.70). The study has found out that in the developed countries (the US, the EU, Canada and Switzerland) and rapidly developing industrialized countries (Hong Kong, China, Singapore, Malaysia and Thailand) the trend of involving in the intra-industry trade is more pronounced, while in the developing resource-rich countries (Algeria, Nigeria, Venezuela) and least developed countries (Central African Republic, Niger, Madagascar) a relatively less share comes to the intra-industry trade. There is a slight change in the GL index from 1996 until 2011.



**Figure 2. Average Grubel-Lloyd indices for the European Union (27) across selected economies 2011**

The chart shows a rapid growth of the intra-industry trade in the developed homogeneous economies (the US, Japan), which is less manifested in Canada and Switzerland, which economy is not of strongly expressed homogenous nature. At the same time, the high rate of the intra-industry trade is observed between the developed (the US, Switzerland, and Japan) and the developing countries, which we believe can be explained according to the product life cycle theory.

The countries with developed economies like the US and the EU are involved in trade with other developed countries, while the developing countries, such as Malaysia and Thailand, have the intra-industry trade with other developing countries. Although China and the Republic of Korea are considered emerging economies, they are structurally closer to the developed economies, as they have succeeded in the economy, in contrast to other poor and resource-rich countries. Consequently, in recent years the intra-industry trade share of those two countries has been increasing as compared to the developing countries.



**Figure 3. Average Grubel-Lloyd indices for four industrializing developing countries across selected economies, 1996-2011**

Noteworthy is that the intra-industry trade growth in the countries with rapidly developing markets (Hong Kong, China, Singapore, Malaysia, and Thailand) is mainly associated with the production of small appliances. In some cases, the reduction of intra-industry trade of the said countries with economically less developed and developing countries is associated with the growth of intra-industry trade between the countries with fast-growing markets.

The GL Index of Japan compared to other developed countries is smaller than that of developing countries. This is because Japan is poor of natural resources and mainly imports raw materials. Its high GL Index compared to the Asian developing economies stems from its geographic proximity, as well as from the fact that the majority of those allegedly developing countries are actually the developed industrialized countries. This analysis is based on the statistical data on the intra-industry trade index published in 2013 by the World Trade Organization (WTO, 2013, p.70), however, it should be mentioned that WTO has not differentiated developing countries that complicates the research process.

Subject to the foregoing, we conclude that the intra-industry trade trend is increasing in most countries in 1996-2011 in spite of two world crises in 1998 and 2008.

The technological trend of the trade theory is characterized not only by the development of new theories and emergence of transnational corporations, but also by significantly changing of the structure of international markets, which of course should meet the new forms of economic relations. This issue is of particular importance also in terms of the international trade development, because the development and expansion of the economic potential of emerging economies stands on the agenda of overcoming the global crisis by the world economy. The review of the intra-industry trade theory and matching new forms of economic transactions related to it with the modern challenges will contribute to the reduction in losses arising from the inefficient use of financial, natural resources and human factor.

That is why we need to study comprehensively the forms and trends in international trade, technical tools and facilities against the background of trans-nationalization and integration in the global economy.

### **New technologies of international trade**

Trans-nationalization of modern economies, development of the interrelated trade and transfer of pricing policies in the framework of corporations have ultimately had the essential impact on the organizational forms of international trade operations, international trade structure and, therefore, the international competition forms. In particular, all possible forms of compensation transactions have been developed. In the international activity, the compensation transactions are also called turnover operations, or the counter trade. There are many forms of counter trade classification and typology points. One feature is common to them; they represent a form of exchange of goods and services that are less dependent on the formation of demand and supply in international markets.

The counter trade includes:

a) commercial-compensation - trade operations, in framework of which the counter purchases mainly relate to goods and services. Hence, here we do not take into consideration the transfer of technology and techniques for export compensation. These operations are rather quickly realized and the terms of transactions rarely exceed 2-3 years.

The commercial buy-back has the following varieties:

*Barter* - natural exchange of one goods for another without using money. The barter trade also includes the binding (completed in financial terms) sales and purchases. For example: compensation of the exporter's raw materials through the supply of equivalent resources.

*Offset transactions* (commercial), which have common features with the natural barter (for example, execution of a transaction under one contract), and also have distinctive features. So, for example, there can take place the unsettled balance of the mutual supply and financial regulation of offset transactions. Two types of offset transactions have been extended in the world practice: the export settlement through the natural counter purchases (barter modification) and individual payments for export and counter offsets.

*Counter purchases* - operations, as a result of which the exporter is obliged to purchase (or to facilitate the purchase of) during a certain time period the product manufactured by the importer in the quantity which makes up a certain percentage ratio to the cost of sale (contract). To fulfill such obligation the exporter concludes (beyond a major export contract) one or more buy-back contracts. Payments, which are derived from the basic contract and the counter purchase contract are performed separately.

b) buy-back transactions of industrial products (or buy-back transactions mainly based on the industrial cooperation) are formally similar to counter purchases but mainly they are related to the export of machinery and industrial equipment in exchange for the purchase of equivalent goods manufactured with this equipment. Unlike the previous buy-back trade forms such transactions can be carried for quite a long time (15-20 years), and the counter purchase amount may exceed the amount of the originally supplied equipment.

There are two main forms of compensation transactions of industrial products: the counter industrial purchases, which represent the buy-back type of operations and offset trade. In case of the counter industrial purchases, the equipment supplier (exporter) undertakes to acquire the products that are manufactured on the specified industrial equipment, or the products manufactured simply on the same enterprise.

The essence of the offset contract is the liability, which is beneficial for the importer, which means that the exporter takes part in the assembly of equipment, supply of materials, acceptance of subcontract, or in the joint production process. The offset trade has developed in specific areas of business where the production cost is very high, for example: civil and military aircraft industry, airspace engineering and aeronautics.

Sometimes the compensation arrangements of industrial products include the requirements of importing countries that the importers should use the defined (minimum) share of local parts and assemblies or other local products. The industrial compensation transactions may involve an intermediary. In this case, the exporter will assign the risk related to the performance of counter-purchase obligation to the special company-intermediary (or compensation enterprise), which receives a certain bonus (discount) for the risk.

The varieties of technical instruments of the international trade in the global market are based on the support provided by the countries to the transnational companies. The expansion of the global market will lead to the sustainable strengthening and development of the economic functions of the countries. As for the compensation trade volume, it is difficult to bring the real figures, which will evidence the growth of its share in the global trade. According to the international statistics, this share varies from 5% to 40% (Wash.: Govt. 1991/102 ICT p.52).

More evident is the specialist's opinion that over the last 15-20 years the amount of compensation transactions has been increasing rapidly. Initially, such transactions were typical only for the "East-West" trade. However, thereafter the principle of compensation extended to the "North-South" and "South-North" trade. Dozens of countries transferred to the compensation regime after the first oil crisis (1972-1973), and many of them are still regularly apply the practices of reciprocal state procurements. Counter purchases are a more or less common form of commercial compensation, but the barter trade also continues to exist. It is relatively common in emerging and transitional economies, which have accumulated large foreign debts, and therefore have limited financial capabilities. The production buy-back is common in China, because the actual capabilities and domestic market size of this country are enormous. At this time, the counter industrial purchases and offset trade are more typical for those countries, which have the industrial and technological boosts (know-how), which are necessary for this type of transactions. Hence, the place and role of new forms of the global trade, are largely caused by the trans-nationalization of the world economy and trade.

It should be noted that the current mechanisms of foreign trade transactions become more complex and sophisticated. Even the Eastern and Southern African countries have begun to use the multilateral compensation system.

Noteworthy is the tripartite financial compensation practices, under which the payment to a country-exporter by the importer is made in the form of transfer acceptable to it (by foreign exchange credit or products), through a third country. Another novelty is the issue of so-called compensation bonds. This mechanism was used for the first time in Indonesia and Australia.

Therefore, in the global trade the focus from the "money transactions" is carried over to the "transactions not involving money". It is this process that has provided the rapid expansion of buy-back transactions. This is largely due to the global crisis and certain transformation of the international economic environment, which characteristics are:

*Trade slowdown and instability; increasing instability of the raw materials and semi-finished products market.* The compensation regime of trade allows the raw materials exporting country to mitigate the effect of the decline in the supply and to maintain the volume of raw materials export. Thus, at the end of the 1970-s 14% of oil exports of OPEC countries was the object of compensation transactions. (Helwin, 1995, pp.1031-1036).

*Instability of exchange rates.* Compensation trade allows countries which are more or less dependent on foreign trade to limit the risk of foreign exchange rate fluctuation;

*Growth of neoprotectionism in the global trade.* The policy, which is aimed at balancing the international trade relations and allows to mitigate different measures restricting the trade;

*High amount of debt in some developed countries and many developing countries, the Eastern Europe and the CIS countries.* Compensation agreements allow those countries to promote their imports in spite of the lack of foreign currency resources and problems with the foreign credit availability.

*For developed countries, the buy-back transactions serve as a facility to maintain trade relations with the countries that are in the difficult economic situation.* In this case, developing countries manage to overcome the double resistance from the side of their insolvency and instability of their currencies.

*The compensation transaction system provides the security and stability of supply of raw materials.* It is a mutually beneficial tool for both developed and developing countries.

*For the companies that deliberately carry out an aggressive policy on the world market, the buy-back transaction conditions provide a serious advantage in the competitive struggle.* The western technology and equipment gain access to the Eastern markets mainly through the compensation transactions. The development of relations between the countries of the North and the South and search for the opportunities of industrial cooperation is carried out on the basis of compensation transactions.

In the global downturn conditions it is impossible to carry out the anti-inflation (strict monetary) policy because of the interdependence of the economic agents of the world market in the commerce, foreign exchange and banking areas. The message “No currency, no contract” is outdated for today, and the business and governments of developing countries should change it with the slogan: “Agree to buy when you want to sell”.

The relationship based on compensation transactions provides stabilization of the primary raw materials market. Harmonization of interests of all market participants proceeds not only from the prices, but also from the volume of realized products and profitability of the transaction. At the same time, the instability in those markets largely characterizes the volume of supply (rather than price dynamics).

## **Conclusions**

The role of the industrial product in compensation arrangements may be played by the joint development projects and cooperation in techniques and technology. Compensation arrangements in industrial products have emerged as a response to the international trade complications. Today it may be the way out from periodically rising crisis. The compensation transactions have significantly changed the international trade scheme. More extensively, the international trade and international competition under the impact of compensation transactions have undergone such structural changes that have penetrated the depths of the modern world economy structure. On the background of the integration of the developed economies, the national sovereignty of countries has limited and the effectiveness of national regulation policies has declined. For the international aspect, this has not caused disintegration, but on the contrary, has led to an increase in the interdependence through the changing role of the individual states in the global economy. The countertrade and barter transaction technologies have further strengthened the intra-industry trade and interdependence between companies and sectors as well.

The transnational economy is without doubt the oligopolistic system of conflicts and strong dictates. It creates the world of coalition relations. The situation makes the international trade a foothold for a collision of strategic alliances and the politics. In this processes, the only way for developing countries with small open economies (including Georgia) to maintain the economic sovereignty and political independence is to ensure the fast economic development and to find out and to establish a small (even microscopic, invisible) own niche in the international market. All these objectives cannot be achieved without an effective foreign trade structure and right long-run trade policy.



In our opinion, in this process Georgia is trying to make the right choice to form the efficient foreign trade structure and effective target-oriented trade policy

In our opinion, in this process Georgia is trying to make the right choice to form the efficient foreign trade structure and effective target-oriented trade policy where the countertrade and barter transaction should play an important role. In the conditions of the current global crisis and subject to the geopolitical considerations, Georgia has no way other than the regional associations and integration with the world trading system, that will be greatly promoted by the introduction of the advanced trading technologies. We believe that this trend will be accelerated by the Association Agreement (DSFTA), which is the free trade growth promotion factor in Georgia. However, it should be also noted that the implementation of this Agreement will be much more difficult due to the conflict of economic interests, but we hope that this problem is solvable by joint efforts.

## References

- Balassa, B. (1970). Growth Strategies in Semi-Industrial Countries. *The Quarterly Journal of Economics*, 84(1), 24-47.
- Balassa, B. (1986). Intra-Industry Specialization: a Cross-Country Analysis. *European Economic Review*, 30(1), 27-42.
- Bernard, A.B., Jensen, J.B., Redding, S.J, and Schott, P.K (2007). Firms in International Trade. *Journal of Economic Perspectives*, 21(3), 105-130.
- Brown, R.H. (1995). The national export strategy. *Third annual report to the United States Congress. Business America*, 116(1110), 1-145.
- Fontagne, L., and Freudenberg, M. (1997). Intra-Industry Trade: Methodological Issues Reconsidered. CEPII Working Paper No. 97-02.
- Grubel, H., and Lloyd, P.J. (1975). *Intra-Industry Trade, the Theory and measurement of International Trade in Differentiated Products*. London: McMillan.
- Gvelesiani, R., and Gogorishvili, I. (2012). *Economic Policy*. Book II. Tbilisi: Universali Publishing House (in Georgian Language).
- Hellwin, L. (1995). Trade policy and distortions in intra -Asian trade. *Economics*, 27(11), 1031-1036.
- Helpman, E. (1987). Imperfect Competition and International Trade: Evidence from fourteen Industrial Countries. *Journal of the Japanese and International Economics*, 1(1), 62-81.
- Helpman, E. (1998). *The Structure of Foreign Trade*. NBER Working Paper No.6752, Cambridge.
- Hummels, D., and Levinsohn, J. (1995). Monopolistic Competition and International Trade: Reconsidering the Evidence. *Quality Journal of Economics*, 110(3), 799-836.
- Linder, S. (1961). *An Essay on Trade and Transformation*. New York: John Wiley and Sons.
- World Trade Organization (2011). News items, Economic Research and Analysis. Retrieved from [https://www.wto.org/english/news\\_e/news11\\_e/rese\\_03oct11\\_e.htm](https://www.wto.org/english/news_e/news11_e/rese_03oct11_e.htm).
- World Trade Organization (2013). World Trade Report. WTO, Factors shaping the future of world trade. Retrieved from [https://www.wto.org/english/res\\_e/booksp\\_e/world\\_trade\\_report13\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/world_trade_report13_e.pdf).
- World Trade Organization (2014). World trade report. Trade and development: recent trends and the role of the WTO. Retrieved from [https://www.wto.org/english/res\\_e/booksp\\_e/world\\_trade\\_report14\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/world_trade_report14_e.pdf).

## CLUSTER AS A TOOL FOR THE CHALLENGES OF DEVELOPMENT

**Ineza GAGNIDZE**

*Ivane Javakhishvili Tbilisi State University  
4 Vani St., Tbilisi, Georgia  
ineza.gagnidze@tsu.ge*

**Abstract.** *In this paper we discuss the cluster as a tool for the Challenges of Development. Our opinions are based upon the conclusions of the EU Commission Communications, scientists and research organizations. It is well known that economic prosperity among the regions of Europe is linked to the degree of cluster strength. Regions with a higher share of employment in industries that belong to strong clusters are generally more prosperous. Clusters are part of Microeconomic Competitiveness. Cluster is a system supporting the business management improvement. Clusters may embody the characteristics of the modern innovation process: they can be considered as “reduced scale innovation systems”. The cluster activities and initiatives help establish interdisciplinary teams on special thematic fields, which jointly initiate novel ideas and innovative products. In cultural and creative industries, clusters are vertically disintegrated networks of production units that can function flexibly when faced by high levels of instability and the risk that prevails in the production and consumption of cultural goods and services. Cluster’s ten emerging industries cover more than 45 million employees in Europe, which corresponds to 22% of all European employment and 35% of European payroll. Clusters and, more generally, regional agglomerations are often at the core of innovative development. Clusters help to develop a special form of thinking. It can direct the policy towards different directions, namely: development of science and technologies, education and vocational training, export and foreign investments. Clusters provide the welfare, that is, a result of country’s competitiveness. Cluster-based approaches could become a core tool for a “new industrial policy”.*

**Keywords:** *cluster; innovation; competitiveness; emerging industries; cluster policy.*

### Introduction

Clusters are linked with generally recognized successful cases in the world economy. Cluster-based approach is unique and universal. It means that the competitiveness of developed country’s economy is more increased by clusters while the economy is developed synergistically in the condition of developing economy.

In this paper, we discuss about the cluster as a supporting factor of microeconomics competitiveness. As a system, it encourages innovation, the emergence of new sectors, acts synergistically and provides the increase of competitiveness of the region. We will prove our position based on the works of the European Commission communication, staff working documents, reports of recognized research organizations and famous scientists.

Marshall (1890) first introduced clusters as part of an economic analysis. “He described the advantages of agglomeration of economic activities in terms of availability of a qualified workforce and specialization. Similarly, Schumpeter (1939) referred to the “swarming” or clustering of industry. Based on Alfred Marshall’s concepts, Becattini raised the issue of the importance of place-based economic development with the notions of external economies that changed the approach to industrial policy. More recently, the concept of clusters has been popularized and implemented by Porter (1990)” (COM, 2008, p.7).

“More recent research on clusters indicates that even within a given field there is room for many different successful clusters, each taking a unique, individual role. Clusters are differentiated by their specialization in a particular stage of their field’s value chain, by their focus on specific geographic areas, or by targeting selected customer needs or market segments” (Ketels, 2003, p.4).

While analyzing the Cluster, as a supporting factor of microeconomics competitiveness, we used the World Economic Forum's Global Competitiveness Reports. For cluster, as seen through this prism, is characterized by invisible supporting effects of development, which we presented in the paper. Together with these effects, we discussed on emerging industries. These ten industries contribute efficient functioning of the cluster and they themselves develop better.

In the review of Cluster as a system, we took the system characteristics from several studies (Laszlo & Krippner, 1998; Laszlo, 2011; Morin, 2014). Then we analyzed the cluster and came to the conclusion that the cluster was a system. We think that the cluster's systematicity stipulates that the cluster is a universal tool for the challenges of development.

The Clusters success gave a big impulse for Cluster Initiatives (CIs) in many developed as well as developing countries. "CIs in developing and transition economies are considerably younger than in advanced economies. This reflects the fact that cluster based development projects became popular in advanced economies as early as the mid-1990's, while CIs were not adopted in developing and transition economies on a larger scale until after the year 2000. In developing economies 55% of CIs were started in 2003 or later. For transition economies that share is even higher, 72%, while the corresponding share for advanced economies is only 28%" (Ketels Lindqvist & Solvell, 2006, p.13). For interested readers in further study of CIs, the same group of scientists submitted "The Cluster Initiative Greenbook 2.0" (Lindqvist, Ketels & Solvel, 2013), that describes: "what they do, how they operate, how they perform; The analysis is based on data from 356 cluster organizations in 50 countries world-wide, primarily in OECD countries".

There are lots of literature on the efficiency of clusters and Cluster Initiatives in economy, the partly analysis of which is sustained in this paper format. So we would like to mentioned that we fully agree with Ketels (2015, p.28), who, based upon the many authors' work (Aiginger, 2006; Aghion et al., 2011; Rodrik, 2004; Stiglitz et al., 2013; Warwick, 2013), argues that "cluster-based approaches could become a core tool for a "new industrial policy".

## **Methodology**

For the preparation of this publication, we reviewed the literature for the clusters, systems, innovations and competitiveness. Data, reports and surveys were analyzed in detail, in order to create a clear picture related to research topics. In this study, we focus on analyzing visible and invisible sides of clusters. To test these hypotheses we use the case study as an analytical tool, also synthesis, analogy, correlation and systemic approach.

## **Cluster – part of the Microeconomic Competitiveness**

"An industrial cluster is an agglomeration of companies, suppliers, service providers, and associated institutions in a particular field. Often included are financial providers, educational institutions, and various levels of government" (WB, 2009, p.11). The concept of clusters is very similar to the concept of "open innovation" which is nowadays broadly accepted. Similarities also exist with the concept of "triple helix".

The World Economic Forum's researchers in their report wrote, "The New GCI framework distinguishes two broad areas of microeconomic competitiveness (Figure 1): the sophistication of company operations and the quality of the business environment. A third category - the state of cluster development (agglomeration economics) - is conceptually distinct, but data limitations preclude independent measurement. Cluster variables are included as part of the business environment" (GCR, 2008-2009, p.48).

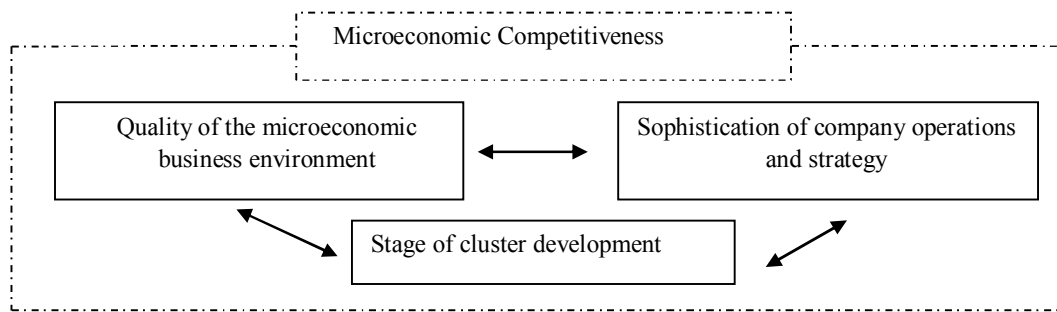


Figure 1. Microeconomic Competitiveness by the World Economic Forum

Besides the above-mentioned importance of a cluster, we would like to highlight the invisible effects of clusters that many scientists write about. They are as follows:

- “Clusters affect competition in three broad ways: *first*, by increasing the productivity of companies based in the area; *second*, by driving the direction and pace of innovation, which underpins future productivity growth; and *third*, by stimulating the formation of new businesses, which expands and strengthens the cluster itself. A cluster allows each member to benefit *as if* it had greater scale or *as if* it had joined with others formally—without requiring it to sacrifice its flexibility” (Porter M., HBR, 1998);
- “Although cluster firms and cluster organizations compete against each other - in particular those which belong to the same sector of activities - there are many reasons justifying competition and cooperation at the same time. There is scope for further strengthening cluster excellence through trans-national cluster cooperation at business level” (COM, 2008, p.7);
- As members of clusters, they have sense of “civil responsibility” which makes them to think broader than just from the point of view of private-ownership interests. The result is effective owner. Clusters also completely answer the modern opinions regarding the social responsibility;
- The speed of cluster formation depends and is determined by the processes that are taking place beyond the clustering scheme. Different processes are taking place, such as: organizing and activation of copyright protection and patent activities, transfer of technologies, development of international scientific and educational links that promote processes of integration, etc.

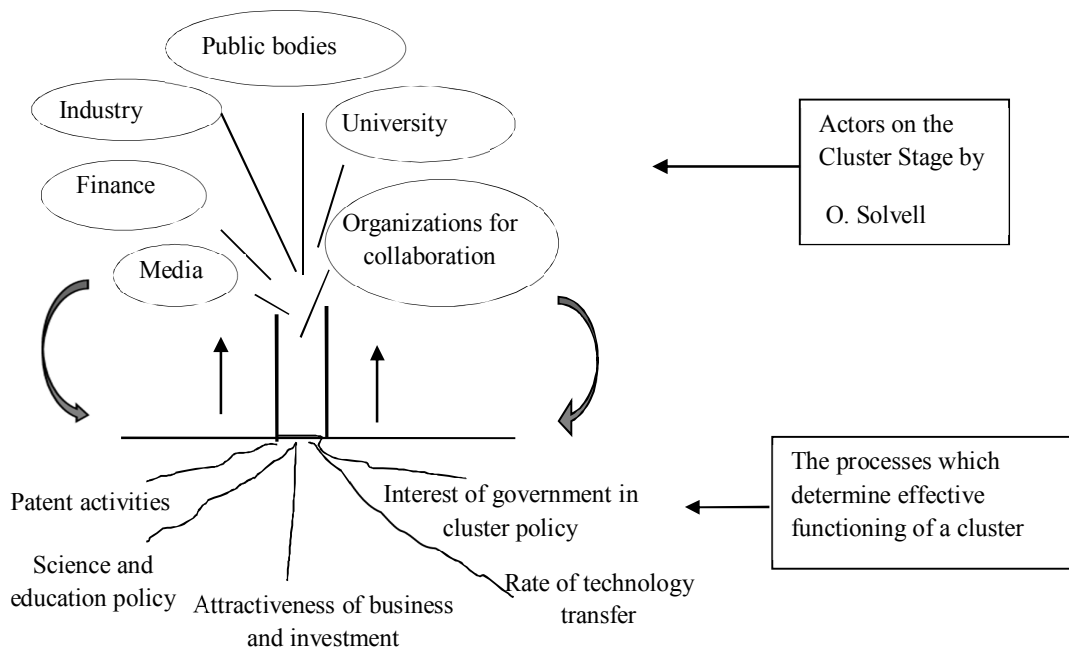
At evaluating the Cluster-based economic policy, the worldwide recognized researchers point out that “Cluster-based economic policy suggests a different perspective: First, all clusters are important, not only traded or high-tech sectors. The productivity across all of them determines the standard of living a country or region can sustain. Second, cluster efforts are not about targeting - they are a tool that, in principle, is open to all clusters in a region. Third, cluster efforts are directed at improving the underlying conditions for higher levels of productivity and innovation, not the outcomes in terms of market share or employment directly” (Ketels, 2003, p.16).

For the extension of the above mentioned, we think that the cluster of education and science must be granted the most important role among any valid clusters in economics. This cluster is “the heart” of system and promotes the innovation and competitiveness in the developed countries. Cluster formation in the economy of developing country is the shortest way of development. We will try to explain the reasoning and opinions and expressed schematically the invisible effects of education and science cluster on transition economies (Gagnidze, 2013, p.3) on Figure 2.

For analyzing the cluster of education and science, we applied the list of the main participants of the cluster from the work by Solvell. In his book he has “identified six main types: firms, financial actors, public actors, universities, organizations for collaboration and media”(Solvell, 2009, p.16).

We consider that frequency of branches of the “cluster tree” presented on Figure 2 is determined by “fertility” of the ground on which this tree grows. As for the fertility of the ground, it’s determined by intensity of the processes going on beyond the cluster participants, namely: interest of government in cluster policy, attractiveness of investment environment, rate of technology transfer, formation and

effective functioning of corresponding institutions, development of new educational and vocational programs, creation and generation of new knowledge, enforcement of intellectual property law, promoting development of close integration processes based on long-term scientific and educational links, etc.



**Figure 2. Visible and invisible sides of the education and science cluster**

The overground and underground parts, given on Figure 2, with close relation to each other create continuously updated and effective system. The frequency of branches of the cluster tree is too high in the economy of developed countries. This is hard to say on the Developing Country where the desirable effective links are weak and their results are less impressionable. We wish to mention convincingly that the education and science cluster is really “Perpendo Mobile” for the development of any economy. The difference is only among the “Power” of this engine. We should search its reason in Gap Model. It has been “identified seven gaps of innovation in clusters. There are five internal gaps and two external gaps (Sölvell & Williams, 2013, p.23).

If we describe the characteristics of the “ground” for clusters to grow presented on Figure 2 in Georgia, it can be said that the previous government of the country didn’t show much interest in developing cluster promoting policy. The surveys prove that Georgia and Belarus were the only ones among the countries of Eastern Partnership in which there were no discussions about cluster policy on the government level let alone the European countries, where there are over 2000 Cluster Initiatives nowadays.

### Clusters and innovations

Economic prosperity among the regions of Europe is linked to the degree of cluster strength. Regions with a higher share of employment in industries that belong to strong clusters are generally more prosperous (COM, 2008, p. 28). 78% of the innovative companies working in a cluster introduced new or significantly improved products compared to the 74% of the 2004 Innobarometer. Similarly, 63% of the innovative cluster companies introduced innovative production technology, compared to the 56% that the Innobarometer found amongst innovative European Union enterprises two years ago. These results suggest that innovation is indeed spurred by clusters (SEC, 2008, Annex, p.20, 23, 27).

In proving the mentioned, we focus on to two facts: *First*, the World Economic Forum's researchers write in their reports on evaluating the content of "Twelfth pillar: Innovation": "it means sufficient investment in research and development (R&D), especially by the private sector; the presence of high-quality scientific research institutions that can generate the basic knowledge needed to build the new technologies; extensive collaboration in research and technological developments between universities and industry; and the protection of intellectual property" (GCR, 2014-2015, p.9). *Second*, the named Twelfth pillar with others includes the following indicators: Quality of scientific research institutions; Company spending on R&D; University-industry collaboration in R&D; Gov't procurement of advanced tech products; Availability of scientists and engineers; PCT patents. It is clear that all the above-mentioned characteristics in any country's economy are improved with the existence of cluster (the more powerful the cluster is, the more it's improved). Once more, it points out the universality of the cluster approach.

It is mentioned in the statistical analysis and overview of current policy done in many countries that "Innovation is increasingly characterized as an open process, in which many different actors - companies, customers, investors, universities, and other organizations - cooperate in a complex ways. Ideas move across institutional boundaries more frequently. The traditional linear model of innovation with clearly assigned roles for basic research at the university, and applied research in a company R&D center, is no longer relevant. Innovation can benefit from geographic proximity, which facilitates the flows of tacit knowledge and the unplanned interactions that are critical parts of the innovation process. This is one of the reasons why innovation occurs locally whereas its benefits spread more widely through productivity gains (Innovation Clusters in Europe, p.5).

The University is granted the special role for effective operation of clusters. The necessity of their modernization is mentioned in the documents of the Commissions. "The Council stresses the vital role of higher education and lifelong learning in supporting innovation. The Council supports the conclusion of the Commission's Communication "Delivering on the Modernization Agenda for Universities" that universities in Europe must be reformed and modernized. It also agrees that the priority areas for reform are improving governance, developing new partnerships with business, increasing and diversifying sources of funding and extending opportunities for higher education and lifelong learning to support the innovation capacity of the labor force" (2769<sup>th</sup> C/06/337, 2006, p.5).

The strong interdependence between the Clusters and Innovations is also confirmed by that Innovation clusters are determined in the latest documents of the Commission, namely: "Innovation clusters means structures or organized groups of independent parties (such as innovative start-ups, small, medium and large enterprises, as well as research and knowledge dissemination organizations, non-for-profit organizations and other related economic actors) designed to stimulate innovative activity by promoting sharing of facilities and exchange of knowledge and expertise and by contributing effectively to knowledge transfer, networking, information dissemination and collaboration among the undertakings and other organizations in the cluster" (SWD, 2014, p.10).

### **Clusters and Emerging Industries**

Cluster's ten emerging industries (Advanced Packaging, Biopharmaceuticals, Blue Growth Industries, Creative Industries, Digital Industries, Environmental Industries, Experience Industries, Logistical Services, Medical Devices, and Mobility Technologies) cover more than 45 million employees in Europe, which corresponds to 22% of all European employment and 35% of European payroll (Ketels & Protsiv, 2014, p.4). "Emerging industries" are either new industrial sectors or existing industrial sectors that are evolving or merging into new industries. They are most often driven by, needs, key enabling technologies, new business models such as innovative service concepts, and by societal challenges that industry must address as a matter of survival (EFCEI, 2013, p.9).

There are indicated in the documents of the European Commission that "Clusters should be open, flexible and attractive to the best talent and expertise available worldwide. Efforts at regional, national

and EU level should facilitate the establishment of closer and more efficient linkages between clusters as well as with leading research institutes within Europe and abroad. At the same time, cluster organizations are invited to improve their support services and better integrate innovative SMEs into clusters (COM, 2008, p.9). Researchers of emerging industry pointed out that, “Small firms playing a disproportionately large role in the development of emerging technologies. In fact, despite accounting for a more 8% of all patents in the database, small firms contributed 24% of the patents of U.S. firms in emerging industry clusters” (Monfardini et al., 2012, p.20).

A key role for a cluster organization is therefore to facilitate the creation of new value chains by connecting companies from different sectors and sub-sectors that have a need to move up in the new value chain. “A very good example of such a sophisticated strategy can be found at the management organization of the German cluster supported under the Leading Edge-Cluster Programme of the Federal Ministry of Education and Research (BMBF). The cluster is regarded as a pioneer for Industry 4.0 and gathers 174 companies, research institutes and organizations from various industries such as mechanical engineering, automotive components, agricultural machinery, industrial laundry technology, electronics and ICT. At its core are more than thirty cross-sectorial innovation projects that are combined with so-called “sustainability initiatives” to ensure technology transfer among cluster participants and commercialization of the new products at the global market (Lämmer-Gamp, Kergel & Nerger, 2014, p.29). The same we can say about Chemical Cluster of Bavaria.

We can discuss another good example for combining services following a strategy that aims at the promotion of cross-sectorial fertilization is provided by the Greek Corallia – Hellenic Technology Cluster Initiative. Corallia host three different clusters: gi-Cluster (Innovative Gaming Technologies and Creative Content cluster), mi-Cluster (Nano/Microelectronics-based Systems and Applications Cluster) and si-Cluster (Space Technologies and Applications Cluster). Thus, the cluster is a strong tool for the development of related and new branches for the country on any level of development.

### Cluster as a system

The word “system” derives from the Greek “synhistanai” which means “to place together”. The scientists write about the system that “A system is a set of interconnected elements which form a whole and show properties which are properties of the whole rather than of the individual elements (Laszlo, 2011). In its broadest conception, a “system” may be described as a complex of interacting components together with the *relationships* among them that permit the identification of a boundary-maintaining entity or process (Laszlo & Krippner, 1998, p.47). The claim that a system is more than the sum of its parts is very well known, and indeed was already made by Aristotle, and it encapsulates a very interesting point, namely that a system has certain qualities and properties that we cannot find in the parts by themselves. These qualities come from the *organization* of the system (Morin, 2014, p.15). Within clusters, these entities can operate more efficiently and *can share* common technologies, infrastructure, pools of knowledge, and demand.

Therefore, the system characteristics are: proximity of the constituent elements, interrelationships of separate and one whole, dynamics, mutual influence, synergy. These features are characteristic for clusters, for which we can conclude that cluster also is a system (Gagnidze, 2015, pp.2-3), namely:

1. As ineffective activity of one of clusters major players (“firms, financial actors, public actors, universities, organizations for collaboration and media” (Solvell, 2009, p.16) will cause damage not only him but to all of them and vice-versa, the success of one will support all of them. *Interaction* is too high;
2. The system is characterized by *synergy*, the same may be observed on Cluster and its component firms. Cluster firms are more innovative than non-cluster firms. “63% of the innovative cluster companies introduced innovative production technology, compared to the 56% that the Innobarometer found amongst innovative European Union enterprises” (COM, 2008, p.20);

3. Cluster creates *an unified system of interests*, namely: a) the interest of science is research, creation of new knowledge and offer of new products to the market; b) the interest of education is to master and transfer new knowledge; c) the interest of businesses is to offer new products to the market and make a profit; d) the interest of State is local economic development and the raise of welfare. Such convergence of interests is an indisputable guarantee of success;
4. Cluster is *not a closed system*, so it brings out the best potential of the region over time. “38% of all European employees work in enterprises that are part of a cluster. In some regions, this share goes up to over 50% while in others it is only about 25%” (COM, 2008, p.27);
5. Cluster system is characterized by *dynamics*, since it forms sub-clusters. As a result, it’s renewable and meets the increased and new requirements. Over time, the clusters can change their profile and specialization, which has happened in several large clusters. “One example for such evolutionary process is the Humber seafood cluster in the UK, which transformed from a commodity producer within an increasingly competitive global frozen seafood industry to a leading value-added fresh/chilled fish hub serving Europe” (COM, 2008, p.9);
6. Cluster is an *extendable system*. On one side, it improves the separate firm's management and economic indicators and on the other, with this process it encourages to strengthen the chain of firms and business environment improvement in whole. The World Economic Forum’s Global Competitiveness Report confirms this. In this report, the clusters are considered as part of Microeconomic Competitiveness and the state of cluster development is as one of the indicators of “Business Sophistication” pillar. Other indicators of this pillar also focus on cluster, these are: Local supplier quantity, Local supplier quality, Nature of competitive advantage, Value chain breadth, Control of international distribution, Production process sophistication, Extent of marketing, Willingness to delegate authority (GCR, 2014-15, p.105). Let us remember what we have already mentioned above that the cluster supports the improvement of the indicator of the same report “Twelfth pillar: Innovation”.

## Conclusions

Generally, high quality of life in the developed countries provides the desire to preserve its achievements even in long-term. It is possible to reach the mentioned by inherent benefits for clusters that is described in a brief summary of cluster policies in 31 European countries, namely: the benefits of a cluster come in three dimensions:

- Firstly, companies can operate with a higher level of efficiency, drawing on more specialized assets and suppliers with shorter reaction times than they would be able to in isolation;
- Secondly, companies and research institutions can achieve higher levels of innovation. Knowledge spillovers and the close interaction with customers and other companies create more new ideas and provide intense pressure to innovate while the cluster environment lowers the cost of experimenting;
- Thirdly, the level of business formations tends to be higher in clusters. Start-ups are more reliant on external suppliers and partners, all of which they find in a cluster. Clusters also *reduce the costs of failure*, as entrepreneurs can fall back on local employment opportunities in the many other companies in the same field (Cluster policy in Europe, 2008, p.5).

Therefore, we conclude that the cluster is one of the best tools for the challenges of development.

## References

- Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions (2008). Towards world-class clusters in the European Union: Implementing the broad-based innovation strategy. SEC (2008), 2637, Brussels, 5.11.2008, COM(2008), 652 fin/2, 7-9.
- Commission Staff Working Document SEC (2008). The Concept of Clusters and Cluster Policies and their Role for Competitiveness and Innovation: Main Statistical Results and Lessons Learned. Annex to the Communication from the Commission “Towards world-class clusters in the



- European Union: Implementing the broad-based innovation strategy” COM(2008)652 final of 17.10.2008, Europe Innova/PRO INNO Europe paper N° 9, 24-27.
- Commission Staff Working Document (2008). Annex to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, The concept of clusters and cluster policies and their role for competitiveness and innovation: Main statistical results and lessons learned, COM(2008) 652 final, Brussels, 17.10.2008, SEC (2008) 2637, 5-7. Retrieved from <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52006DC0502&from=EN>.
- Cluster Management Excellence. Volume II: Sustainability and Effectiveness of Clusters and Networks, 84-85. Retrieved from [www.bmwi.de](http://www.bmwi.de).
- Cluster policy in Europe (2008). A brief summary of cluster policies in 31 European countries, Europe Innova Cluster Mapping Project, Oxford Research AS January, 2008, 3-5.
- Council on Competitiveness (COC) (2007). Cluster-Based Strategies for Growing State Economies, National Governors Association, Innovation America, 3-5. Retrieved from <http://www.compete.org/publications/all/211>.
- Council of the European Union (2006). 2769<sup>th</sup> Council meeting, Competitiveness (Internal Market, Industry and Research) Brussels, 4 December 2006, Council Conclusions on a Broad-Based Innovation Strategy: Strategic Priorities for Innovation Action at EU Level, Council of the European Union, C/06/337, 15717/06 (Press 337), 3-5.
- Creative Economy Report (2013). Widening Local Development Pathways, UNESCO, 2013 Special Edition, 27-29. Retrieved from <http://www.unesco.org/culture/pdf/creative-economy-report-2013.pdf>.
- European Commission (2014). Communication from the Commission, Framework for state aid for research and development and innovation, SWD (2014) 163, SWD (2014) 164. Brussels, 21.5.2014, C (2014) 3282,7-10.
- European Forum for Clusters in Emerging Industries (EFCEI) (2013). Extension of the European Cluster Observatory: Promoting better policies to develop world class, Policy Roadmap Actions for new linkages needed, 6-9.
- European Commission (2007). Innovation Clusters in Europe: A Statistical Analysis and Overview of Current Policy Support, DG Enterprise and Industry Report, DG Research, DG Regional Policy.
- Gagnidze, I. (2013). *Regarding Invisible Effect of Education and Science Cluster in Transitional Countries*. Paper presented at The International Symposium the Economic Crisis: Time for a Paradigm Shift – towards a Systems Approach, Valencia, Spain, January 24-25, 2013.
- Gagnidze I. (2013). *Membership of Cluster – One of the Ways to Business Management Improvement*. Paper presented at 3rd Business Systems Laboratory International Symposium, Perugia, January 21-23, 2015.
- Innovasjon Norge (2010). Intellectual Property Rights for clusters, NCE and Arena (NCE/Arena), Project report 3-5. Retrieved from [www.innovasjon Norge.no](http://www.innovasjon Norge.no).
- Ketels, Ch. (2015). *Competitiveness and Clusters: Implications for a New European Growth Strategy*, Working Paper no 84, Welfare, Wealth, Work for Europe, 25-28.
- Ketels, Ch. (2003). *The Development of the cluster concept* – present experiences and further developments, Prepared for NRW conference on clusters, Duisburg, Germany, 5 Dec 2003, 2-4. Retrieved from [http://www.clustermapping.us/sites/default/files/files/resource/The\\_development\\_of\\_the\\_cluster\\_concept\\_-\\_present\\_experiences\\_and\\_further\\_developments.pdf](http://www.clustermapping.us/sites/default/files/files/resource/The_development_of_the_cluster_concept_-_present_experiences_and_further_developments.pdf).
- Ketels, Ch., Lindqvist, G., and Solvell, O. (2006). *Cluster Initiatives in Developing and Transition Economies*. Stockholm: The Cluster Initiative Greenbook.
- Ketels, Ch., and Protsiv, S. (2014). *European Cluster Panorama 2014*. European Cluster Observatory, Report, Center for Strategy and Competitiveness Stockholm School of Economics, 2-4. Retrieved from [www.clusterobservatory.eu](http://www.clusterobservatory.eu).
- Laszlo, A., and Krippner, S. (1998). Systems Theories: their Origins, Foundations, and Development. In J.S. Jordan (Ed.), *Systems Theories and A Priori Aspects of Perception* (pp. 47-74). Amsterdam: Elsevier Science. Retrieved from <http://webcache.googleusercontent.com/search?q=cache:http://terras-altas.net.br/MA->

- 2013/statistics/Systems%2520Theories/SystemsTheory-Alexander%2520Laszlo%2520and%2520Stanley%2520Krippner.pdf.
- Laszlo, K.C. (2011). *From Systems Thinking to Systems Being*. Retrieved from <http://www.saybrook.edu/rethinkingcomplexity/posts/07-24-11/systems-thinking-systems-being>.
- Lämmer-Gamp, Th., Kergel, H., and Nerger, M. (2014). Cluster organizations in Europe – insights from Bronze and Gold Label assessments. European Secretariat for Cluster Analysis (ESCA), Input paper for the workshop “Moving forward the EU policy agenda on cluster excellence”, Brussels, September 23, 2014, 5-6.
- Lindqvist, G., Ketels, Ch., and Sölvell, O. (2013). *The Cluster Initiative Greenbook 2.0*. Stockholm: Ivory Tower Publishers.
- Monfardini, E., Probst, L., Szenci, K., Cambier, B., and Frideres, L. (2012). *Emerging industries report* on the methodology for their classification and on the most active, significant and relevant new emerging industrial sectors. European Union, July 2012, 20-22.
- Porter M.E. (1998). Clusters and the new economics of competition. *HBR*, November-December Issue. Retrieved from <https://hbr.org/1998/11/clusters-and-the-new-economics-of-competition>.
- Sölvell, O. (2009). *Clusters - Balancing Evolutionary and Constructive Forces*. Stockholm: Ivory Tower Publishers.
- Sölvell, O., and Williams, M. (2013). *Building the Cluster Commons – An Evaluation of 12 Cluster Organizations in Sweden 2005 - 2012*. Stockholm: Ivory Tower Publishers.
- The Global Competitiveness Reports (2008-09; 2014-2015). Retrieved from [www.weforum.org](http://www.weforum.org).
- Case studies of clustering efforts in Europe: Analysis of their potential for promoting innovation and competitiveness, Europa INNOVA, cluster mapping. Preliminary draft version for distribution in the European Presidential Conference on Innovation and Clusters, Stockholm 22-23 January 2008, 2-4.

Websites:

<http://www.gi-cluster.gr/el/>

<http://www.corallia.org/el/clusters/mi-cluster.html>

<http://www.si-cluster.gr/el/>

## PREFERENTIAL TRADE REGIMES AS TOOLS FOR INTEGRATING SMALL COUNTRIES INTO THE WORLD TRADING SYSTEM (CASE OF GEORGIA)

**Marine TAVARTKILADZE**  
Tbilisi State University  
2 University St., Tbilisi, Georgia  
mtavartkiladze@imedil.ge

***Abstract.** This paper deals with the opportunities of using preferential trade regimes by transitional economies and their expected results. Effects of the use of these regimes in terms of optimal integration into global economy are assessed on the example of such a small open economy as Georgia. The paper has been prepared by applying deduction, induction, analysis and synthesis, abstraction and statistical methods of research. The first part of the paper contains an analytical overview of the essence of preferential trade regime. This paper provides an analytical comparison of some aspects of foreign trade regimes of the European Union. It underlines current trade priorities of developing countries among which the important ones include: the easing of promotion of agricultural production, the restriction of tariff rates, the effective use of Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU. The second part of the paper analyses one of the aspects of the application of trade preferences on the example of a small economy - Georgia; In particular, it assesses the effect of EU-Georgia DCFTA on the trade in agricultural goods as this sector is of special social and economic importance to the country. This part of the paper discusses the trends in agricultural trade (primary production, processed goods); analyses factors impeding agricultural trade in view of existing tariffs and non-tariff barriers; provides the information in the context of DCFTA, thereby enabling to analyze possibilities of the development of Georgia's trade potential in agricultural production. Conclusions are made on the basis of the research as to how preferential trade regimes assist small countries in entering markets of developed countries; what benefits can be derived from the engagement in these schemes, which translate into increased trade indicator, boosted confidence of investors and the establishment of more predictable legal environment; how customers benefit from better quality products at lower prices, the development of market, benevolent effects on innovations (protection of intellectual property), the reformation and modernization of the country, et cetera. Problems are identified on the basis of the research and corresponding recommendations are provided including such important recommendations as to devise export promotion measures; to organize training courses for economic agents; to develop concrete measures of approximation with standards of industrialized countries through establishing corresponding organizations. Moreover, recommendations are provided on the ways of effective use of preferential treatments.*

**Keywords:** GSP; DCFTA; small-size country in global trade; international trade in agricultural production.

### Introduction

Regional and foreign aspects of trading policy of developed countries refer to the problems of economic development, as well as the problems of integration of the countries with small opened economy into the regional unions. In this respect, the evaluation of the possibilities of preferential trading regimes and their prospective outcomes are distinguished by actuality.

Effects of the use of these regimes in terms of optimal integration into global economy are assessed on the example of Georgia and European Union. Due to the events in neighbor countries, geographical location and neighborhood policy the way to integrate into the regional unions and World Trading System is without alternative for Georgia.

## **Research methodology**

The paper has been prepared by applying deduction, induction, analysis and synthesis, abstraction and statistical methods of research. Georgia's export-import database released by National Statistics Office of Georgia was used for ascertainment consistent patterns between analytical and statistical assessments. One of the aspects of utilization of trading preferences was analyzed, in particular, evaluation of the impact of Agreement on Deep and Comprehensive Free Trade Area (DCFTA) between Georgia and its largest partner – European Union on trading in agricultural products. The paper analyzes the role of preferences in the sustainable development of the country. Conclusions are made based on research results and relevant recommendations are provided.

## **Analytical consideration of preferential trade regimes**

The majority of countries engaged in international economic relations, including highly developed countries, have various trade regimes established with their partner countries. The nature of those regimes may depend on economic and political interests of those countries, their participation in regional and global economic unions and organizations, programs of assistance to weaker economies, etc.

In terms of trade in goods and services, one can distinguish basic, most-favored-nation and preferential regimes. Preferential regimes, as the name of the concept implies, envisage the trade on preferential terms. By the rule of their application, there are two types of preferential regimes: symmetric and asymmetric. The symmetric preferential trade regime between countries envisages bilateral establishment of preferential trade terms/tariffs, whereas the asymmetric regime, preferences are unilateral and no reciprocity is demanded from the country enjoying those preferences. The most common forms of symmetric preferential regimes are duty-free/free trade and customs unions. Asymmetric preferential trade regimes are established between the countries with different levels of economic development. Developed countries grant such regimes to relatively weaker partner economies, which envisage the granting of unilateral customs and tariff benefits (without demanding the reciprocity) and represent one of the forms of economic assistance. Tariffs established for (beneficiary) countries enjoying asymmetric preferences are lower than the tariffs under the MFN regime and often involve the full exemption of products from customs duties. Developed countries grant asymmetric preferential regimes of various levels to countries grouped by different categories (level of development, geographical location, degree of observance of requirements of international conventions, et cetera).

One of wide spread forms of asymmetric preferential trade regimes is the Generalized System of Preferences – GSP. The purpose of the mentioned regime is to support exports from developing and less developed countries.

The GSP program was first launched by the European Economic Community (EEC), which later became the European Union (EU), in 1971, followed by Japan in the same year. The United States then authorized its GSP program in 1976 by title V of the trade act of 1974 (Graham, 1978)

There are currently 13 countries granting GSP preferences: Australia, Belarus, Bulgaria, Canada, Estonia, EU, Japan, New Zealand, Norway, The Russia federation, Switzerland, Turkey, United States of America. Currently, there are more than 200 beneficiary countries from GSP program in total. Although dozens of countries enjoy the Generalized System of Preferences (GSP), one can still observe controversial opinions in describing the effects of GSP on the welfare of developing countries. While in their works Grossman and Sykes (2005) and Pomfret (1986) speak about positive effects of GSP regimes, many other researchers question them. Limao (2006), and Caglar Ozden and Eric Reinhardt (2003) provide empirical evidence of GSP donor countries disproportionately replacing tariff restrictions on GSP-sensitive goods with non-tariff barriers.

During the description of preferential regimes, the schemes (GSP, GSP+) of European Union should be underlined. Pursuant to the referred schemes, while trading with European Union the countries make use of zero or lower tariff in comparison with MFN rates. As a result, European Union uses the MFN tariff only in regard of few countries of WTO.

Under GSP preferences (Council Regulation (EC) No 732/2008 rolled over by Council Regulation (EC) No 512/2011) 176 countries and overseas territories were divided in 3 groups:

- Everything But Arms (EBA) – duty-free quota-free access to the EU market for all products from the 49 least developed countries;
- GSP+ – deep tariff cuts for countries which ratified and implemented international conventions relating to human and labor rights, environment and good governance. The first 10 GSP+ countries are: Armenia, Bolivia, Cape Verde, Costa Rica, Ecuador, Georgia, Mongolia, Paraguay, Pakistan and Peru;
- GSP general arrangement for all the other beneficiaries.

According to the new GSP scheme of the EU countries are divided into following groups:

- 89 countries which need GSP trade preferences the most (49 least developed countries under EBA and 40 Low income' and lower middle income countries, as classified by the World Bank) may benefit from standard GSP and/or GSP+
- *Partners that are no longer eligible* - 33 overseas countries and territories (already have access—do not need GSP)
- *Partners which no longer benefit:*
  - 34 Partners that have been granted preferences through other tracks (e.g. bilateral agreements, autonomous arrangements - do not need GSP).
  - 20 High income or upper middle income partners, as listed by the World Bank (these more advanced developing countries no longer need preferences to export; in fact, continuing to provide preferences to them increases the competitive pressure on exports from LDCs and other poor countries, which lag behind).

Main Objectives of new GSP scheme are:

- Focus the preferences on those most in need—Least Developed Countries and other poor economies with no other preferential channels to access the EU market. Reflection of different trade, financial and development needs of countries;
- Enhance GSP+ as a tool to support partners that are serious about implementing international conventions;
- Make the system more transparent and predictable for economic operator;
- Adapt to Lisbon procedures—enhanced role for the European Parliament.

The European Union Trade with GSP in 2014 is presented in table 1.

**Table 1. European Union Trade with GSP**

Indicator	Unit	Period	Imports	Exports	Total trade	Balance
Last year	Million euros	2014	997,235	792,764	1,789,998	-204,471
Share in the EU trade	%	2014	59.4	46.6	52.9	
Annual growth rate	%	2013 - 2014	-1.5	-1.9		
Annual average growth rate	%	2013 - 2014	2.9	5.9		

*Share:* share in Total with Total defined as all products

*Growth:* relative variation between current and previous period

Source: European Commission, European Union, Trade in goods with GSP. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147291.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147291.pdf).

Imports and exports in 2014 by product groups are presented in table 2 and 3.

**Table 2. The European Union Trade with GSP (Import by product groups, 2014)**

Product Value	Value (Million €)	Share %
Agricultural products	71,544	7.2
Fishery products	12,135	1.2
Industrial products	913,555	91.6
TOTAL	997,235	100.0

*Share: share in Total with Total defined as all products*

*Source: European Commission, European Union, Trade in goods with GSP. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147291.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147291.pdf).*

**Table 3. The European Union Trade with GSP (Export by product groups, 2014)**

Product Value	Value (M€)	Share %
Agricultural products	61,939	7.8
Fishery products	2,233	0.3
Industrial products	728,591	91.9
TOTAL	792,764	100.0

*Share: share in Total with Total defined as all products*

*Source: European Commission, European Union, Trade in goods with GSP. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147291.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147291.pdf).*

GSP and GSP+ schemes of the European Union enable the entrepreneurs to import more than 7200 types of production of their origin to the EU market with zero rates, thus increasing competitiveness of national products and providing support for national export.

An extension of the EU GSP program DCFTA promotes to establish Corresponding institutions. Basic requirements are: 1. Technical Barriers of Trade (TBT); 2. Sanitary and Phytosanitary barriers (SPS); 3. Antimonopoly law legislation According to EU recommendations; 4. Protecting intellectual property.

### **Possibilities for optimal use of the EU preferential trade regimes**

Let's consider the effects of the use of the EU preferential trade regime for optimal integration into the world trade system on the example of such a small open economy as Georgia.

Over the past few years, Georgia has been heading towards the integration into the world economic area. Since 1997 year, after joining the World Trade Organization (WTO), the application of Generalized System of Preferences in trade with developed countries, which was later complemented with GSP+ trade regimes, made the terms of foreign trade more favorable for Georgia and encouraged the increase in its exports. Over the past decade the total volume of export increased four times. After the enactment of Eastern Partnership Initiative in 2009, the relations between Georgia and the European Union entered a new phase. The Eastern Partnership Initiative envisages the deepening of relations in three main directions - the Association Agreement (AA) which also includes the Agreement on Deep and Comprehensive Free Trade Area (DCFTA), and visa facilitation and readmission agreements. However, the liberal trading regime resulted in a higher increase of imports than exports which, in turn, led to an unprecedented increase of deficit in trade balance, thereby giving policy-makers serious food for thought. It should be noted that according to the data of National Statistics Service of Georgia [1] the gap between import and export, against the backdrop of their increasing indicators, has been gradually narrowing over the last few years. In 2013 year, the export amounted to 36% of total foreign trade turnover.

According to the evaluation of the use of the EU trade preferences as of 2010, Georgia had a very high indicator of the use of preferences (92.52%), which means that more than 90% of trade turnover was implemented at a zero-rate tariff [1]. EU scheme enables Georgia to export products whose total value does not exceed EUR 6000 only by using invoice declaration. For the rest of products the *ad volarem* taxes decreased by 3.5%.

After the ratification of the Agreement on Deep and Comprehensive Free Trade Area with the European Union the GPS+ regime was annulled and it will be replaced by DCFTA ensuring bilateral and gradual annulment of barriers impeding the access to the market. Georgia's access to market will be "comprehensive" because it will cover a wide array of trade-related issues and it would be "deep" because it aims at eliminating: behind the border" obstacles to trade [iii]. The agreement envisages the removal of up to 95% tariff and total liberalization of trade in industrial commodities. As regard the trade in agricultural products, a significant liberalization will also affect it save a range of exceptions.

After the enactment of DCFTA a number of tariffs will be annulled, but they will be reduced at various rates depending on the categories of production. For example, with regard to agricultural production – a tariff rate quota will extend to garlic whereas market entry (initial) prices will be maintained on other products.

In 2013, Georgia did not export any of the products of the abovementioned category to the EU. However, last year Georgia exported 400 tons of garlic to Armenia, which means that it will be difficult to maintain the established upper limit of 220 tons. The reason of establishment of this limit on this commodity category is that China produces 80% of world garlic production.

According to the information provided by the Information Unit of Export Issues of European Union, the list also includes some types of products which currently enjoy GSP+0 tariff preferences and consequently, the entry price still applied to them (Table N4).

**Table 4. List of products with ordinary tax rate under GSP + scheme**

Code	Product	EU ordinary tax rate (%)
08061010	Table grapes	20
08092100	Sour cherries, fresh	12
08093010	Nectarine	17.6
08094005	Plums	6.4
08091000	Apricots, fresh	20
2009	Different varieties of fruit juice	22.4

*Source: Information Unit of Export Issues of European Union. Tbilisi, Georgia*

The European Union is the second largest partner of Georgia after Commonwealth of Independent States (CIS). Georgia has the lowest tariffs for the EU production - 5.57% for agricultural products, 0.45% for industrial products. [iv] In 2013, the gap between exports and imports narrowed due to decrease in imports and increase in exports. In 2012, 20% of the total agricultural exports were sent to EU countries; in 2013, the corresponding indicator increased to 23%. In total, agricultural products comprise 26% of Georgian exports, which is 30% of trade turnover with the EU.

Among the agricultural produce exported to EU countries, fresh and dry nut is an unchallengeable leader. This category amounts to 64% of total agricultural exports to the EU and 65% of total exports in this specific category. Leading categories of exported agricultural production in 2013 year were nuts, natural grape juice and mineral waters. Although the leading categories of exported agricultural production do not significantly change by countries, the production is less diversified by EU countries. The latter is caused by the fact that almost all export products intended for EU countries enjoy GSP+. As it was already mentioned, Georgia intensively uses GSP+ regime and it should be noted here that in 2013, some 60% of goods exported under this regime was the agricultural produce, which is the 10% increase on the 2012 indicator.

Georgia is the so-called net importer country, which means that the larger share of the demand for food products (approximately 80%) is met by imports [v]. According to statistical data Georgia depends on the import of the following products: wheat, tobacco products, meat products and vegetable oils, also food products from processed cereals. The growth of above listed production requires huge land resources and a high level of mechanization, which do not represent Georgia's competitive advantage.

Increase of agricultural export potential is limited due to the fragmentation of farms and land parcels. It will be more difficult for individual farmers than cooperatives to meet the EU standards and certification requirements as well as to take risks associated with the entry of new markets and export of their products considering the high competitiveness of the EU markets. Currently, the primary production dominates the agricultural sector of Georgia. Farmers produce products mainly for personal consumption or for trade in a chaotic manner. Thus, without the establishment of a complex value chain it will be difficult to fully utilize potential benefits of DCFTA in terms of agricultural exports.

The highest growth is expected in breeding cattle and meat production (more than 60%) and cultivation of vegetables, fruit, nuts and oily grains (more than 20%). The current structure of husbandry is represented by many individual farmers producing products for their personal consumption; also, a small number of commercialized family farms and large enterprises. To stimulate the development of the sector, it is necessary, for the beginning, to establish main institutions such as commodity registry and veterinary service. Special emphasis must be placed on the improvement of production technique, cattle breeding, fodder and in general, animal health protection.

Agreements reached between Georgia and the EU and especially steps taken within the framework of DCFTA create favorable conditions for the increase in Georgian exports to EU market, but one of the significant obstacles for the Georgian side is the satisfaction of international and EU standards. Moreover, a trend that has been observed worldwide, especially after the crisis, imply the increase in nontariff barriers which include various standards and occupy a large share in actively applied nontariff barriers which remains one of the most difficult and insurmountable problems for Georgia. The reason of utilization nontariff barriers may be economic, environmental, social, political or combined. Nontariff barriers may also be used as the tool to impede trade - by heightening standards or posing additional technical requirements. Although Georgia assumed the obligations to improve its standards and approximate the standards with those of the EU, it still fails to fulfill corresponding measures.

Georgia lacks laboratories of international standards. Georgian entrepreneurs have to travel to laboratories of neighboring countries to obtain corresponding certificates.

Two significant types of barriers can be singled out from nontariff limitations:

- Technical (TBT);
- Sanitary and phytosanitary (SPS).

Developed countries have high standards for production quality, which serve the aim of protecting local consumers and environment. Meeting high standards is a serious problem for developing countries because this requires additional costs. Technical barriers related to technical peculiarities of production are also important.

### **Conclusions and recommendations**

DCFTA will be beneficial for the increase of welfare of those citizens of Georgia who will have access to the better quality products on the local market and in the longer term, who will find increase in revenues due to the new business opportunities and economic growth resulting from European integration. The past experience of the use of preferential trade regimes shows that trade clearly favors those products that enjoy mentioned preferences. In order to mitigate possible by-effects and challenges caused by the enactment of DCFTA, the following recommendations should be taken into account:

- To develop medium- and long-term strategies for agricultural sector, evaluating its export potential and identifying those sectors in which Georgia may have the competitive advantages;
- To develop targeted sector programs and initiatives for increasing export potential in specific fields;



- To assist in certification procedures for the fulfillment of requirements specified by nontariff measures, to conduct consultations, to enhance the role of training centers and houses of farmers;
- To develop a manual for producers providing trade-related information;
- To form certain activities for the approximation to the standards of developed countries (ISO, IEC, CEN, CENELEC) on the basis of establishing targeted organizations.

Development of new standards and technical regulations, and corresponding legislative framework of Georgia will positively affect agricultural sector because the agricultural industry will be orientated on producing goods in accordance with those standards, which will have prospects of sale on the markets of European Union and other developed countries and at the same time, high standards will limit the import of low quality products to Georgia. . This will open up new opportunities not only in EU-Georgia trade, but in Georgia's trade with the rest of the world, given the worldwide recognition of EU norms and standards. The application of these standards will bring significantly more choice and higher quality products to Georgian consumers and make Georgia a more attractive place for foreign investors. The most sensitive sectors will benefit from long transitional periods to ensure the smooth adaptation of Georgia's economy.

Overall, preferential regimes support small countries to enter the markets of developed countries. The benefit of involvement into the mentioned scheme may translate into the increase in trade, higher degree of confidence among investors and support in the formation of more predictable legislative environment, the benefit to customers – better products at lower price, development of market, positive impact on innovations (protection of intellectual property), reformation and modernization of the country, etc.

## References

- Bagwell, K., and Staiger, R.W. (1999). An Economic Theory of GATT. *American Economic Review*, 89(1), 215-248.
- Baldwin, R.E., and Murray, T. (1977). MFN Tariff Regulations and Developing Country Trade benefits under GSP. *The Economic Journal*, 87(345), 30-46.
- Beruchashvili, T., Karaulashvili, A., and Mshvidobadze, M. (2006). *Georgia and the European Union*. Tbilisi, Georgia: Department of State Bureau of Educational and Cultural Affairs.
- Brown, D.K (1989). Trade and welfare effect of the European Schemes of the generalized System of Preferences. *Economic department and Cultural Change*, 37(4), 757-776.
- Clark, D.P. (1991). Trade versus Aid: Distributions of Third World development Assistance. *Economic development and Cultural Change*, 39(4), 829-837.
- Clark, D.P., and Zarrilli, S. (1992). Non-Tariff Measures and Industrial Nation imports of GSP-Covered Products. *Southern Economic Journal*, 59(2), 284-293.
- Gogorishvili, I. (2009). National Economic Interests in Conditions of Globalization of Georgia's Economy. In *Proceedings of Globalization and Prospects of Sustainable Development of Georgian Economy* (pp.36-46). Tbilisi: Universal Publishing House.
- Graham, T.R. (1978). The US Generalized System of Preferences for Developing Countries: International Innovation and the Art of the Possible. *The American Journal of International Law*, 72(3), 513-541.
- Grossman, G.M., and Sykes, A.O. (2005). European communities-Conditions for the Granting of tariff preferences to developing countries. The American Law Institute. Retrieved from [www.ali.org](http://www.ali.org).
- Gvelesiani, R., and Gogorishvili, I. (2012). *Economic Policy*. Book II. Tbilisi: Universali Publishing House (in Georgian language).
- Kaglar, O., and Reinhardt, E. (2003). The Perversity of Preferences. The Generalized System of Preferences and Developing Country Trade Policies, 1976-2000. The World Bank, Development Research Group Trade.
- Krugman, P., and Obstfeld, M. (2000). *International Economics: Theory and Policy*. Tbilisi: Open Society Georgia Foundation.

- Limao, N.M. (2006). Are Preferential Trade Agreements with Non-trade objectives a Stumbling Block for Multilateral liberalization?. Working Paper 02-02. University of Maryland, Department of Economics, Centre for International Economics.
- Pomfret, R. (1986). The effects of Trade Preferences for developing countries. *Southern Economic Journal*, 53(1), 18-26.

Websites:

<http://eeas.europa.eu>

<http://www.economy.ge>

<http://exporthelp.europa.eu/thdapp/index.htm>

<http://unctad.org>

<http://www.usitc.gov>

## PROSPECTS TO IMPROVE THE TOURIST MARKET OPERATION IN GEORGIA

**Marina METREVELI**

*Georgian Technical University  
77 Kostava St., Tbilisi, Georgia  
marinametreveli@yahoo.co.uk*

**Irina GOGORISHVILI**

*Ivane Javakhsishvili Tbilisi State University  
2 University St., Tbilisi, Georgia  
irinagorisi@yahoo.com*

**Abstract.** *The tourism economic policy is to be developed based on the systemic approach and on the concept of sustainable development, meaning the improvement of the efficiency of the use of the existing potential, i.e. intense branch development. As for the development of the tourism market of Georgia, it should be noted that the empirical materials needed by the scientists and economic policy-makers are quite scarce and unsatisfactory. Despite the bodies charged with collecting and treating these materials, the statistics of tourism as that of an economically important branch, is beneath criticism. It is impossible to obtain the materials about the kinds, quantities, quality, jobs, growth trends, investment efficiency or prices of the tourist products offered by tour companies, value of such products or other features to be used to develop both, micro-economic and macro-economic policy. The goal of our study is to describe the Georgian tourism market, its developmental level and trends of its sustainable development by using the existing possibilities (we mean the lack of information and reliability about the study object). The methods of the study are the following: systemic approach to the evaluation of the results of the branch expansion and induction, deduction and statistical methods. For this study, we used the materials provided by the National Statistics Office of Georgia and individual tour companies. The paper gives evidence for the following trends in the Georgian tourism market: the number of the tour and travel agencies operating in 2013 decreased by 9% as compared to 2011, the most successful year for tourism in Georgia (the number of large companies did not change, the number of medium businesses decreased by 9 and that of small businesses decreased by 27); the high rate of increase in the turnover of the companies operating on the Georgian tourism market is typical to medium and small businesses (the turnover with large companies in 2013 as compared to 2006, increased by 130%, while the same indicator amounted to 248% for medium businesses and 1575% for small businesses); rapid and advantageous development of small businesses was the case after the military actions in Georgia in 2008 and is mostly caused by the changes in the Georgian tourism market and low risks as compared to large and medium businesses.*

**Keywords:** *tourism; competitiveness; economics; policy; product.*

### Introduction

The tourism economic policy is to be developed based on the systemic approach and on the concept of sustainable development, meaning the improvement of the efficiency of the use of the existing potential, i.e. intense branch development. These processes may inflict serious damage to the environment resulting in the conflicts between the goals of the tourism development policy and goals of protecting the nature. Such a conflict between these goals will ultimately hamper the development of both policies. To avoid such processes, the micro- and macro-aspects of the tourism market must be thoroughly studied and the economic-political decisions must be made.

As for the development of the tourism market of Georgia, it should be noted that the empirical materials needed by the scientists and economic policy-makers are quite scarce and unsatisfactory. Despite the bodies charged with collecting and treating these materials, the statistics of tourism as that of an economically important branch, is beneath criticism. It is impossible to obtain the materials about the kinds, quantities, quality, jobs, growth trends, investment efficiency or prices of the tourist

products offered by tour companies, value of such products or other features to be used to develop both, micro-economic and macro-economic policy.

**The tourist market operation in Georgia**

The Hague Declaration on Tourism recognizes the new special role of tourism in improving the standard of life and material well-being of the people of the world. At the same time, it should be noted that in respect of establishing the international peace and in globalization of cultures, tourism is an effective force, which with its developmental outcomes, is unique and irreplaceable by any branch of the world economy (Metreveli, 2011, pp.371-377).

It should also be noted that tourism as a branch of economy and important element of the field of service is not closely associated with the safety status or the level of economic development in the country. In order to make this opinion clearer, we would like to inform you that the situation in the country (level of economic development, safety status, political stability, etc.) mostly affects the development of mass tourism. As for the development of other kinds of tourism, the supporting factors and risk factors for the tourism development must be considered depending on their sustainability.

Supporting are the following factors: tourism infrastructure, which is quite diversified, industrial factors existing in the country in general and (particularly) specific factors. Among the specific factors, the ones, which may seem limited at the first sight, such as a system of values of the country social medium immediately associated with the cultural and socio-ecological issues, are emphasized. Generally, together with the traditional approaches, there has been a quite important new approach used recently in the exploration of the questions of tourism implying all-inclusiveness. In this instance, we mean the increased role of the questions not traditionally associated with tourism.

Since the 1990s, a new approach has been introduced to the management theory, the so-called marketing management, which considers meeting the demands of the tour product consumers as the major goal of the microeconomic policy in the business engineering of the tour product companies.

Based on the concept of marketing management, we can present the marketing management plan of the causal effects of the process of manufacturing and realization of the tourist product by a tour company operating on the market (Figure 1).

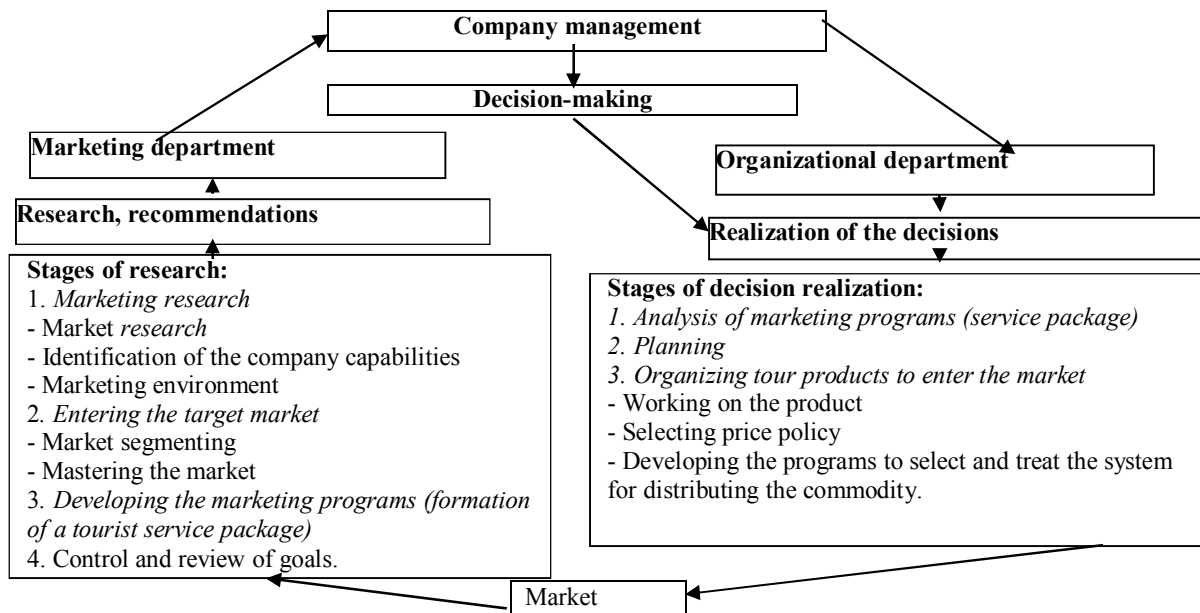


Figure 1. Marketing management plan of a tour company (Metreveli, 2002)

The plan shows the prospect of continuous turnover of a touristic product by the companies as the tourist business develops. The plan shows the directions of a tour product or its components at each stage of the turnover with arrows (causal effects) (Metreveli, 2002).

The first stage in the left part of the plan depicts the marketing research, which is an important part in developing the system to enter the market. The major objective of the marketing research is the identification of the real capabilities of the company on the tourist service market. These real capabilities are determined by the situation established on the market (conjuncture) on the one hand and by technological, financial, staff and organizational potential of the company on the other hand. The goal of the market research is to study of the typical requirements for the tourist product interesting to the company. In addition, it is important to identify not only the level and demand effective by the moment of the research, but also to forecast these indicators with the future perspective. An important problem occurring at the beginning of the conjuncture activity is the information support, data about the tourism market, price levels, etc.

The information important for improving the competitiveness of the branch of tourism in Georgia is gained by calculating the travel and tourism competitiveness index. The indicators and characteristics to fix this index are provided by the international organizations operating in Georgia. Surely, such state of affairs is not a bit satisfactory, as the participation of the Georgian specialists and experts in this process is much limited.

The analysis of the present state of the Georgian tourism market evidences the sustainable expansion of the Georgian tourism market (if not considering the years of 2009 and 2012). The tables given in the paper, based on the results of the data analysis, show the following trends in the Georgian tourism market:

1. There are 42 large, 22 medium and 313 small tour companies operating in the Georgian tourism market in 2013. In 2013, the number of the tour and travel agencies decreased by 9% as compared to 2011, the most successful year for tourism in Georgia (the number of large companies did not change, the number of medium businesses decreased by 9 and that of small businesses decreased by 27). (The data are calculated based on the data of Table 1).
2. The high rate of increase in the turnover of the companies operating on the Georgian tourism market is typical to medium and small businesses (the turnover with large companies in 2013 as compared to 2006, increased by 130%, while the same indicator amounted to 248% for medium businesses and 1575% for small businesses).

In other words, despite the absolute reduction in the number of businesses, as the declared data suggest, the total turnover increased by 13% yielding the difference of 36,4 million Gel (as compared to 2011) (as calculated by using the data of Table 2).

**Table 1. Number of operating tour and travel agencies according to the agency size (2006-2013)**

Years	Travel agencies		Large businesses			Medium businesses			Small businesses		
	Total No.	Change as compared to 2006, %	No.	Change as compared to 2006, %	Change since the previous year, %	No.	Change as compared to 2006, %	Change since the previous year, %	No.	Change as compared to 2006, %	Change since the previous year, %
2006	114	100%	25	100%		14	100%		75	100%	
2007	124	9%	26	4%	4%	22	57%	57%	76	1%	1%
2008	137	10%	30	20%	15%	22	57%	0%	85	13%	12%
2009	248	118%	28	12%	-7%	32	129%	45%	188	151%	121%
2010	351	141%	30	20%	7%	35	150%	9%	286	280%	52%
2011	413	262%	42	68%	40%	31	121%	-11%	340	353%	19%
2012	361	216%	35	40%	-17%	32	129%	3%	294	291%	-14%
2013	377	231%	42	68%	20%	22	57%	-31%	313	316%	6%

Source: The table is drafted by the authors by using the materials of GEOSTAT of 2013

**Table 2. Volume of turnover of the tour and travel agencies (declared data), mln. Gel**

Years	Volume of turnover of tourist businesses			Large businesses			Medium businesses			Small businesses		
	Mln. GEL Total	Change as compared to 2006, %	Change since the previous year, %	Mln. GEL	Change as compared to 2006, %	Change since the previous year, %	Mln. GEL	Change as compared to 2006, %	Change since the previous year, %	Mln. GEL	Change as compared to 2006, %	Change since the previous year, %
2006	116,8	100%		104.7			9.6			2.4		
2007	160,0	37%	37%	139.3	33%	33%	14.3	49%	49%	6.4	167%	167%
2008	165,1	41%	3%	137.8	32%	-1%	22.3	132%	56%	5.0	108%	-22%
2009	147,5	26%	-11%	116.6	11%	-15%	22.0	129%	-1%	8.9	271%	78%
2010	173,9	49%	18%	121.9	16%	4,5%	32.0	233%	45%	20.0	733%	125%
2011	277,6	138%	60%	198.6	90%	63%	48.5	405%	52%	30.4	167%	52%
2012	257,4	120%	-7%	191.5	82%	-3%	41.4	331%	-2%	24.6	925%	-19%
2013	314	169%	22%	240.3	130%	25%	33.4	248%	-19%	40.2	1575%	63%

Source: The table is drafted by the authors by using the materials of GEOSTAT of 2013

In 2011, Georgia ranked the 73<sup>rd</sup> among 139 world countries with its index of competitiveness, and has a better indicator than its neighboring countries of Azerbaijan (ranking the 83<sup>rd</sup>) and Armenia (ranking the 90<sup>th</sup>), but falls back Russia (the 59<sup>th</sup>) and Turkey (the 50<sup>th</sup>). As per the data of 2013, Georgia, with its index of competitiveness, ranked the 66<sup>th</sup> among 140 countries, while Azerbaijan was the 78<sup>th</sup>, Armenia was the 79<sup>th</sup>, Russia was the 63<sup>rd</sup> and Turkey was the 46<sup>th</sup> (as calculated by using the data of Table 3).

**Table 3. Travel and tourism index of competitiveness (2011 and 2013)**

Countries	2011	2013	
	Rank/among 139 countries	Rank/among 140 countries	Point
Georgia	73	66	4.10
Azerbaijan	83	78	3.97
Armenia	90	79	3.96
Turkey	50	46	4.44
Russia	59	63	4.16

Source: The Table is drafted by using the data of "The Travel & Tourism, Report 2013".

Aiming at improving its competitiveness as compared to its neighboring countries, Georgia has to orient its tourism policy on the tourism market and analyze the existing problems, what, on its turn, will help stimulate the travel industry.

The data given above are clear evidence of the prospects of tourism in Georgia - to be more competitive than the neighboring countries; however, the processes below occurring on the background of 14 travel industry indices are not a bit soothing, as the expansion and development of the tourism market is possible through the scientific studies of the 14 indices of the travel industry and study data suggested at the World Economic Forum (The Travel & Tourism Competitiveness Report, 2013) in Georgia.

**Table 4. State of the tourist business in Georgia by 14 characteristics (World Economic Forum, 2013)**

<b>pillar</b>	<b>Characteristics</b>	<b>Rank</b>	<b>Point</b>
1 <sup>st</sup>	Policy rules and regulations	4.8	40
1.01	Prevalence of foreign ownership	3.9	118
1.02	Property rights	3.1	128
1.03	Business impact of rules on FDI	4.8	50
1.04	Visa requirements, no. of countries	159	6
1.05	Openness bilateral ASAs (0–38)	6.8	118
1.06	Transparency of government policymaking	4.8	36
1.07	No. of days to start a business	2	2
1.08	Cost to start a business, % GNI/capita	3.8	45
1.09	GATS commitment restrictiveness (0–100)	52.9	7
2 <sup>nd</sup>	Environmental sustainability	4.5	74
2.01	Stringency of environmental regulation	3.4	94
2.02	Enforcement of environmental regulation	3.6	69
2.03	Sustainability of T&T industry development	4.8	47
2.04	Carbon dioxide emission, million tons/capita	1.2	41
2.05	Particulate matter concentration, µg/m <sup>3</sup>	54.1	106
2.06	Threatened species, %	5.6	80
2.07	Environm. treaty ratification (0–25)	5.6	80
3 <sup>rd</sup>	Safety and security	5.1	51
3.01	Business costs of crime and violence	5.1	54
3.02	Reliability of police services	5.1	37
3.03	Road traffic accidents/100,000 pop.	16.8	74
3.04	Business costs of terrorism .	5.5	79
4 <sup>th</sup>	Health and hygiene	6.0	37
4.01	Physician density/1,000 pop.	4.8	3
4.02	Access to improved sanitation, % pop.	95.0	52
4.03	Access to improved drinking water, % pop.	98.0	52
4.04	Hospital beds/10,000 pop.	31.0	60
5 <sup>th</sup>	Prioritization of Travel & Tourism	5.5	17
5.01	Government prioritization of the T&T industry	6.3	16
5.02	T&T gov't expenditure, % gov't budget	n/a	n/a
5.03	Effectiveness of marketing to attract tourists	4.9	50
5.04	Comprehensiveness of T&T data (0–120)	65.0	70
5.05	Timeliness of T&T data (0–18)	16.5	17
6 <sup>th</sup>	Air transport infrastructure	2.5	101
6.01	Quality of air transport infrastructure	4.3	82
6.02	Airline seat kms/week, dom., millions	0.2	93
6.03	Airline seat kms/week, int'l, millions	33.1	103
6.04	Departures/1,000 pop.	1.4	92
6.05	Airport density/million pop.	0.7	66
6.06	No. of operating airlines	17.5	87
6.07	International air transport network	4.2	94
7 <sup>th</sup>	Ground transport infrastructure	3.9	61
7.01	Quality of roads	4.4	56
7.02	Quality of railroad infrastructure	4.0	34
7.03	Quality of port infrastructure	4.3	65
7.04	Quality of ground transport network	4.3	65
7.05	Road density/million pop.	29.0	75
8 <sup>th</sup>	Tourism infrastructure	3.3	82
8.01	Hotel rooms/100 pop.	0.3	78
8.02	Presence of major car rental co. (1–7)	3	97
8.03	ATMs accepting Visa cards/million pop.	373.6	54

9 <sup>th</sup>	9th pillar: ICT infrastructure	3.0	75
9.01	ICT use for B-to-B transactions	n/a	n/a
9.02	ICT use for B-to-C transactions	n/a	n/a
9.03	Individuals using the Internet, %	36.6	76
9.04	Fixed telephone lines/100 pop.	31.1	38
9.05	Broadband Internet subscribers/100 pop.	7.5	66
9.06	Mobile telephone subscriptions/100 pop.	102.3	79
9.07	Mobile broadband subscriptions/100 pop.	21.3	52
10 <sup>th</sup>	Price competitiveness in T&T ind.	4.7	52
10.01	Ticket taxes and airport charges (0–100)	74.9	86
10.02	Purchasing power parity	0.6	53
10.03	Fuel price, US\$ cents/liter	3.9	36
10.04	Extent and effect of taxation	113.0	76
10.05	Hotel price index, US\$	135.1	66
11 <sup>th</sup>	Human resources	5.1	40
	Education and training	4.6	77
11.01	Primary education enrollment, net %	99.6	7
11.02	Secondary education enrollment, gross %	86.2	79
11.03	Quality of the educational system	3.0	113
11.04	Local availability specialized research & training	3.3	118
11.05	Extent of staff training	3.6	99
	Availability of qualified labor	5.7	9
11.06	Hiring and firing practices	5.0	9
11.07	Ease of hiring foreign labor	5.4	5
11.08	HIV prevalence, % adult pop.	0.1	12
11.09	Business impact of HIV/AIDS	5.2	74
11.10	Life expectancy, years	73.3	75
12 <sup>th</sup>	Affinity for Travel & Tourism	4.8	53
12.01	Tourism openness, % of GDP	8.1	30
12.02	Attitude of population toward foreign visitors	6.5	33
12.03	Extension of business trips recommended	5.6	50
12.04	Degree of customer orientation	3.9	118
13 <sup>th</sup>	Natural resources	2.7	119
13.01	No. of World Heritage natural sites	0	79
13.02	Quality of the natural environment	4.6	59
13.03	Total known species	395	101
13.04	Terrestrial biome protection (0–17%)	3.6	114
13.05	Marine protected areas, %	0.1	82
14 <sup>th</sup>	Cultural resources	2.0	84
14.01	No. of World Heritage cultural sites	4	63
14.02	Sports stadiums, seats/million pop.	49,392.1	56
14.03	No. of int'l fairs and exhibitions	3.3	111
14.04	Creative industries exports, % of world total	0.0	106

The results of the study reported at the World Economic Forum evidence the urgent necessity for the thorough transformations and reforms in the complex development of the branch of tourism in Georgia (Table 4).

The review of the indices and characteristics of tourism competitiveness evidences a much unfavorable situation in Georgia in respect of the level and prospects of the tourism market development. In this connection, we mention that out of 140 states, Georgia has a problem with the indicators immediately associated with and directly affecting the successful development of tourism, with the following indicators worth mentioning: 1.02; 1.05; 2.01; 2.05; 5.02; 6; 6.01; 6.02; 6.03; 6.04; 6.07; 8; 8.02; (*tourism infrastructure*); 9.01; 9.02; 11.03; 11.04 (level and quality of education); the indicator of the client orientation (12.04), making Georgia the 118<sup>th</sup> in the world is particularly



worthwhile. It is regretful to note that as this study suggests, with its indicators of 13; 13.03 and 13.04, Georgia is considered a country with scarce natural resources. Consequently, worth of attention is the development and promotion of cultural tourism in Georgia, what is not the case unfortunately. Despite the fact that Georgia, notwithstanding its small size, with its indicator of the number of world cultural heritage (14.01), ranks the 63<sup>rd</sup>, this position looks weak anyway, further evidenced by the indicator of the number of fairs and exhibitions (14.03) and percentage of export of the products of creative branches in the world export of 14.04.

We emphasize the indicators of human (labor) resources, in particular, the quality of the enlightening system (11.03) and availability of specialized studies and training (11.04) making Georgia the 113<sup>th</sup> and 118<sup>th</sup> among 140 world countries, respectively. Such state of affairs casts a doubt to the prospects for training the qualified labor resources to develop tourism.

As per the studies of the World Economic Forum, the prospect for the tourism development in Georgia is quite vague, and unless there are thorough and crucial measures are planned, Georgia will fail to reach even those quite low indicators fixed in 2013-2023.

The share of the tourism market product value of Georgia in GDP is 15,9% and must be increased by 4,8% in perspective. Such state of affairs will either hamper the GDP growth, or ignore the priority of the branch of tourism (if the branch structure is not changed, See Table 5). The real picture of the share of the value of the touristic product market in 2013 changed much (by 5.2%). If considering that the share of tourism industry in GDP changed from 4.5% in 2012 (Tourism's Direct Contribution to GDP) to 5.4% in 2013 (i.e. slightly changed), the mentioned trend is difficult to explain.

**Table 5. Travel and tourism indicators, 2012**

Countries	Contribution of travel and tourist industry/whole branch to GDP, mln. USD	Contribution of travel and tourist industry/whole branch to GDP, %	Growth perspective of travel and tourist industry/whole branch in 2013-2022, %-8o	Jobs in travel and tourist industry/whole branch (1,000 positions)	Share of jobs in travel and tourist industry/whole branch in employment, %	Prospect of future growth of jobs in the travel and tourist industry/whole branch in 2013-2022, %
Georgia	700 / 2500	4.5 / 15.9	4.8 / 4.8	67.9 / 243.2	4.0 / 14.2	0.6 / 0.6
Armenia	214.5/838	2.0 / 7.6	0.9 / 1.5	18.9 / 75	1.7 / 6.8	-3.7 / -3.2
Azerbaijan	1101.4 / 4116	1.9 / 6.9	7.5 / 7.5	73.3 / 277	1.7 / 6.3	2.7 / 2.6
Turkey	33,520.3 / 86,436.0	4.2 / 10.9	2.9 / 3.0	532.2 / 2,004.0	2.2 / 8.2	2.6 / 1.4
Russia	27071 / 110623	1.5 / 5.9	3.9 / 3.8	981,3 / 3,933	1.4 / 5.5	0.4 / 0.1

Source: Drafted by "The Travel & Tourism Report. Reducing Barriers to Economic Growth and Job Creation. Insight Report" and data in p. 9.

The Travel & Tourism Competitiveness Report. Reducing Barriers to Economic Growth and Job Creation. The data of Georgia of 2012 are not included in page 172 of the Insight Report for some uncertain reasons. At the same time, the prospect for future growth is given for 2013-2022, while WTTC Travel & Tourism Economic Impact 2013 considers the period of 2013-2023. Georgia has not provided this international organization with the data of the following indicators: 5.02 (percentage of state costs of the state budget (%)), 9.01 (using information computer technologies in B-B deals), 9.02 (using information computer technologies in B-to-C deals).

In addition, we would like to note that the data allowing holding the studies are particularly important in developing the reasonable policy in travel and tourism. Unfortunately, we have no access to such prospects (evidenced by the indicator of 11.04 of "The Travel & Tourism Competitiveness Report 2013"). The data above were provided to the World Economic Forum by the International Finance Corporation (IFC) using the materials of the International Monetary Fund in Georgia (IMF).

The analysis of the studies gives an impression of the tourism policy developers tending to ignore and failing to analyze the studies of the said issues provided by the international organizations. Besides, the official statistics of Georgia has failed (since the tourism development was declared a priority in Georgia) to gather the important data and characteristics of tourism.

Breaking the old stereotypes in tourist industry is much important, particularly, on the background of the problems caused by climatic changes. As suggested by the Kyoto Protocol of Climate Change Frame Convention (1992, the UNO Climate Change Frame Convention of Rio de Janeiro), not only the countries and branches, but also every industry must be put to the mode of adaptation (Gvelesiani & Gogorishvili, 2010, pp.137-142).

## Conclusions

In Georgia, the tourism, in addition to the mode of adaptation having become necessary due to the climatic change, is forced to offer the consumer diversified products, as a tourist of the XXI century now mostly prefers non-organized tourism, i.e. travels without the help of travel agencies (Metreveli, 2011, pp.133-137). In order to rescue the established situation, the travel agencies have to make innovative changes to their tour packages and services to realize cognitive, and entertainment arrangements. At the initial stage, it is sufficient to employ the scientific-educational staff in our country (attracting even the retired or temporarily unemployed lecturers or young specialists, or trainees). Let us recall the immortal work “The Magic Mountain” by Thomas Mann, the great German writer and Nobel Prize Laureate, where the writer tells us about a lecturer’s arriving at the sanatorium in Switzerland delivering the lectures to the students about love. Such a practice existed in foreign countries as early as at the beginning of the XX century.

Planning and organization of the touristic products manufacturing must include the mechanisms affecting the potential buyers’ demands developed based on the non-material components of human development, e.g. the stimuli of joy, participating in the nature protection, helping the helpless, charity and the like and increased importance of a tourist’s personality. Such an approach is widely spread in Australia, where the tourists (the youngsters from other countries and anyone concerned) are allowed to take care of or treat the animals at a certain cost.

The stability of the fundamental universal values results in the variety of the religious, cultural, economic, philosophical and moral creed being the basis and result of the responsible tourism. Sustainable responsible tourism must become the major qualitative characteristic of the tourism market of Georgia resulting in the high efficiency and great success.

## References

- Gvelesiani, R., and Gogorishvili, I. (2010). *Economic Policy, book II*. Tbilisi: Universali Tbilisi Publishing House.
- Metreveli, M. (2002). Modern state of tourism and prospects for its development in Georgia. Unpublished dissertation, Tbilisi, Georgia (in Georgian language).
- Metreveli, M. (2011). *Environment and Ecotourism Management*. Tbilisi: Favoriti Printi Publishing House.
- Metreveli, M. (2011). *Tourism Economics and Policy*. Tbilisi: Favoriti Printi Publishing House.
- Metreveli, M., and Timothy, D. (2010). Effects of the August 2008 War in Georgia on Tourism and Its Resources. In I. Kelly (Ed.), *Tourism, Progress and Peace* (chapter 9). University of Western Australia.
- Metreveli, M., and Timothy, D. (2010). Religious heritage and emerging tourism in the Republic of Georgia. *Journal of Heritage Tourism*, 5(3), 237-244.
- UNWTO World Tourism Barometer (2013). Retrieved from <http://mkt.unwto.org/barometer>.

World Economic Forum (2013). The Travel & Tourism Competitiveness Report. Retrieved from [http://www3.weforum.org/docs/WEF\\_TT\\_Competitiveness\\_Report\\_2013.pdf](http://www3.weforum.org/docs/WEF_TT_Competitiveness_Report_2013.pdf).

Websites:

<http://wttc-infographic.org/>

[http://www.economy.ge/uploads/meniu\\_publicaciebi/ouer/GEORGIAN\\_TOURISM\\_IN\\_FIGURES\\_2013.pdf](http://www.economy.ge/uploads/meniu_publicaciebi/ouer/GEORGIAN_TOURISM_IN_FIGURES_2013.pdf).

[http://www.geostat.ge/cms/site\\_images/\\_files/georgian/bop/FTrade\\_January\\_%20March\\_2014\\_GEO.pdf](http://www.geostat.ge/cms/site_images/_files/georgian/bop/FTrade_January_%20March_2014_GEO.pdf).

<http://www.GNTA.ge>.

## **INTEGRATION WITH THE EU: PROSPECTS FOR FOREIGN TRADE OF EASTERN PARTNERSHIP COUNTRIES**

**Eka SEPASHVILI**  
*Tbilisi State University*  
 2 University St., Tbilisi, Georgia  
 eka.sepashvili@tsu.ge

***Abstract.** In the article, the author discusses the process of integration taking place in the Eastern neighborhood of the EU, namely the cooperation within the EU initiative Eastern Partnership. However, the issues of integration are discussed from the point of current economic globalization and political developments. The Author stipulates modern concepts of security and economic cooperation, which profoundly changed their meanings and lay down the basis of cooperation within Eastern Partnership. The main pillars of EaP are argued and the perspective offered by these cooperation, achieved progress, current challenges and future prospects are discussed. The article stresses the issues dealing with prospects of establishing the free trade area in the region. For this purpose the dynamics of foreign trade flows among EaP countries and with the EU are analyzed as well as agreements on Deep and Comprehensive Free Trade Area between the EU and 3 EaP partner countries, namely Georgia, Moldova and Ukraine, are stipulated. Wide spectra of data on foreign trade are presented and correlation between the development of cooperation within the EaP format and increased trade flows are studied. At the same time some data on changing pattern of foreign trade are considered.*

***Keywords:** European integration; DCFTA; Eastern partnership; Georgia.*

### **Introduction**

In modern reality during the international division of labor, it is impossible to live on your own. Thus, nowadays the key words are the interdependence of nations and the imperatives that a global system imposes on national economies. The main problem is that majority of states are focused on national interests' strategies caused by country's social-economic needs. However, ignorance of globalization or not adequate recognition of its importance is likely to lead to missing the chance of participation via international relations in globalized economy and gain profits.

Globalization of the world economy often goes through regional integration, which used to be started with broader and deeper economic relations. Today the EU remains a "classic model" of successful regional integration, which positively influences the economic development of the member-states as well as neighboring countries. The primary objectives of regional policy are to reduce negative phenomena arising from natural conditions, geographical location or economic processes, and to create as favorable conditions as possible for closing the development gap and for encouraging innovative economic activity.

The new regionalism is quite different from the process taking place in the 50s-60s of the 20<sup>th</sup> century. Contemporary regionalism includes economic, political, social and cultural aspects, and goes far beyond the free trade. All EaP partner countries are actively involved in this process.

EaP countries are in dual transition towards the development and enhancement of democracy and establishment of a market economy to create a basis for self-sustained economic and social growth.

### **The political economy of integration in Europe**

The process of integration European nations begun in the beginning of 20<sup>th</sup> century and went through several legislative agreements and by the beginning of the 21<sup>st</sup> century turn into one of the major

player of the global system, which dictates further development and trends of evolution of surrounding area (Sepashvili, 2013, p.109). Because towards the end of the 20<sup>th</sup> century the process of globalization has gained the new stage of development, the EU took additional steps and in 2004 enlargement of the EU occurred.

The questions that one may ask hearing about European Union enlargement are: *why did this enlargement happen? Or what are the consequences for this extension?*

Over the history of its existence the EU went through *Deepening* the integration from Free Trade up to Single Market and Common currency (EURO) and five stages of *Enlargement* beginning with 6 states and ending so far with 28 states.

Despite the crisis of 2008 and skepticism arising in the EU on its further expansion, economic pragmatism does dictate that expansion of the EU is to be continued. Number of Politicians from member states argues that best reaction to the crisis is to pursue further and deeper economic integration (Cameron, 2010, p.2). The EU actively tries to establish harmonized space on its borders for long-term goal of expansion. The policy tends to transform partner countries through its foreign political instrument: intergovernmental agreements, common strategies and joint actions. Recently, European Commission issued joint consultation paper "Toward a new European Neighborhood Policy" (European Commission, 2015) debating the lessons learned and prospects for further advancement of more tailored cooperation to cope with raised challenges and move forward.

Theoretically, implementation of the intergovernmental agreements, that the EU offers, might enable any country to achieve such level of development that it would be enough to become the member of the EU. In early 90th number of so-called European agreements were signed with central and Eastern European countries. The articles of these agreements proved the EU aspiration to prepare these countries for membership. 2004 year was marked by great enlargement when 10 CEE countries became the member of the EU, and later in the beginning of 2007 two more countries joined the big family of Europe, and just recently in July, 28<sup>th</sup>, 2014 one more member was joined the Union. Nowadays, the process has been weakened but not stopped: The EU actively continues working on more cooperation and deeper integration with surrounded neighborhood, which appeared to be divided by two clusters of countries, Mediterranean and Eastern regions.

*What are the pragmatics that lays down the foundation of the aspiration of nations to join the EU and willingness of the EU member states to tolerate emerging countries wishing to accept complicated and rather difficult EU rules and regulations?*

In the beginning of the 21<sup>st</sup> century, some of traditional concepts are needed to be revised due to the new solid arguments that enable the concepts to gain a new, contemporary meaning. I'd like to draw the attention to two concepts which profoundly changed their meaning and that I think, explains above mentioned question and is determining the goals of development the EU Neighbor countries (including Georgia) and their international relations. There are the following:

- The new concept of security;
- The new concept of economic cooperation.

A new concept of security suggests us to use such a structure of economic cooperation, which is based on the balance of interests of the states, and secures the most stable political climate in the region instead of measuring the security by the quantity of arms and ammunitions (Sepashvili, 2013, p.112).

As for the new concept of economic cooperation, it is no longer treated as "hostage" of political tension. Just the vice-versa, it is through active economic cooperation that various political conflicts can be solved. Even if the solutions are not easy to reach, the proper atmosphere for it is being created, which earlier or later, would inevitably bring the expected results.

These two new concepts of security and economic cooperation define the basic philosophy of the development and evolution of the new economic and political links and relations among the states.

Georgia is still in period of a great political and economic transformation. The country faces numerous sources of challenges and uncertainties. Thus, to rely on above-mentioned new paradigm some sort of cooperation among challenging sides has become necessary to utilize the economic opportunities. In this regard Georgia's integration into the huge region of Europe is very important. Sides should try to find common interests and thus, gain maximum profit from the cooperation.

So far, expansion process of EU seems to be continued despite the weak vivid evidences. The EU actively tries to establish harmonized space on borders for long-term goal of extension. The policy tends to transform partner countries through its foreign political instrument: intergovernmental agreements, common strategies and joint actions (Cameron, 2010, p.3).

This short overview shows that the Eastern Partnership region countries: Azerbaijan, Armenia, Belarus, Moldova, Georgia and Ukraine have to become the part of global society. Nowadays major players of the world focus rather on regions than single countries. After the gaining of independence, all these six countries began to build new political and economic relations with each other and surrounding world, becoming the members of various international or regional organizations. In this context, the moving of the region towards the Europe seems quite natural. All six countries took similar steps to get closer to the EU.

### **Eastern Partnership partner countries relations with the EU**

In 1999 all six countries (The European Union has concluded nine partnership and cooperation agreements with countries of Eastern Europe and Central Asia) sign PCA<sup>vi</sup>, which represented the basis for relations with the EU and separate countries. The other and stronger instrument for creation fertile environment around the EU for enlargement (though in long term future) is European Neighborhood Policy (ENP), that the EU offers its neighbor countries. ENP covers 16 countries, which as it was mentioned above were separated into two big regions: Mediterranean and Eastern in order to better tailor approaches and face the challenges of differentiation.

This format of cooperation for Eastern Region countries was reinforced in 2009, when the EU's new Initiative - Eastern Partnership<sup>1</sup> - was launched by adopting Joint Declaration at the Prague Summit on May 7. Initiative represents eastern dimension of the ENP, where six eastern European neighbors of the EU – Armenia, Azerbaijan, Belarus, Moldova, Georgia and Ukraine – are participating. This new partnership is intended to turn into an effective mechanism bringing Eastern European countries to functional arrangements with the EU in all directions based on tailor-made approaches and ensuring the possible highest degree of integration with the EU.

The main principles and perspectives offered by the initiative for Georgia, which are reflected in the Commission Communication on Eastern Partnership (of December 3, 2008) and EaP Joint Declaration (of May 7, 2009) as well as Warsaw Joint Declaration in 2011 and Vilnius Summit Joint Declaration are mainly not only in line with Georgia's priorities but with other partners needs and goals.

Eastern Partnership's bilateral format defines concrete goals for partner countries: conclusion of an Association Agreement, creation of a free trade area, gradual visa liberalization, energy security, economic and social convergence with the EU and etc. Meanwhile multilateral format of cooperation within EaP offers participant countries different mechanism, such as thematic platforms, panels, and different Flagship initiatives, to develop joint projects affecting regional development.

Despite the fact that over the past decades significant political and economic development take place in the region leading to more turbulences and instability, EaP managed to meet some of its goals: three countries (Moldova, Georgia and Ukraine) out of six signed Associate Agreements<sup>vii</sup> with the

---

<sup>1</sup> Retrieved from [http://eeas.europa.eu/eastern/index\\_en.htm](http://eeas.europa.eu/eastern/index_en.htm).

EU and thus, created realistic prospects for free trade in the region; Mobility Partnerships with Georgia, Moldova, Armenia, Azerbaijan, Ukraine are in place alongside with visa free regime with Moldova and visa liberalization dialog with Georgia and Ukraine.

The civil society developed a tool to monitor the process of European integration for EaP countries - The European Integration Index for Eastern Partnership Countries (EaP Index). The index measures countries' track towards the EU integration. It contains on three main dimensions: 1. deep and sustainable democracy; 2. cross-sector picture of a country in a comparative manner and 3. independent analysis of country report. The Index 2013 shows the positive advancement of all six EaP countries towards the European Union, with a few exceptions. The countries rank did not change in 2013 and 2014 and were as follow: Moldova, Georgia, Ukraine, Armenia, Azerbaijan and Belarus.

### **EU Trade with Eastern Partnership Region Countries**

The one of significant indicators of changes in regional organization levels are statistical data on countries' export. Export indicators are fairly used to estimate regional organization level. They strongly reflect the reconstruction taking place among countries. Export indicators exactly show economic aspects of regional level changes (Ruggie, 1993, p.125). It is regarded, that how much more is the value of interregional export, the better relations are established among neighbour countries, and consequently, the level of organization is growing. The showings on EaP countries' trade data evidently confirm the changes and growing dynamics. The obvious increasing tendency of trade volumes predicts for further success in the future after the DC FTAs are enacted fully for some countries and/or other trade facilitation measures are utilized fully for others.

EU trade arrangements with the neighboring countries differ from the general framework of the EU regional trade agreements (RTAs) to the EU Free Trade Agreements (FTAs). However, in EaP region the EU negotiated new generation of trade agreements known as Deep and Comprehensive Free Trade agreements, but only with some countries, namely Ukraine, Moldova and Georgia. Growing benefits which are anticipated after DC FTAs will fully realized, are assessed and significant growth or GDP and welfare level is researched (Ecorys & CASE, 2012).

The trade policy impact though the ENP's action Plan implementation success differ country to country. Consequently, the EU trade with its immediate neighbors is notable by its non-homogeneous nature due to the fact that surrounded countries vary according their economic performance. As some author distinguishes, (Liargovas, 2013, p.4) the EU has four groups of neighboring countries:

- Developed countries (wealthier than the most EU member states – Norway, Switzerland, Iceland and Israel);
- Emerging upper middle income countries (with \$4 000 – \$10 000 GDP per capita – alongside with other countries this group includes Belarus and Ukraine, with \$6 202 and \$3 971 GDP per capita correspondently in 2012<sup>viii</sup>);
- Hydrocarbon countries (producers and exporters of Hydrocarbon group includes Azerbaijan together with Russia, Syria, Algeria, etc.);
- Lower middle (with income levels less than half of some EU member states - e.g., Bulgaria with \$14 234.572 in 2012<sup>ix</sup> ; the group includes Armenia, Georgia, and Moldova together with Egypt and Morocco).

And therefore, there is substantial difference between economic indicators of EaP countries. The factors and motives which comprise the basis of regional unification have vivid political character. But this doesn't mean that affords of states, that are now based on political consideration, will have no results. The classic scheme, that B. Balassa had been suggested (Balassa, 1961), distinguishes between cooperation and integration. Thus, EaP region process can be determined as the process of integration and not the state of integration.

**Table 1. Some Trade Related Data on EaP Partner Countries**

Country	GDP per capita	Average annual GDP growth	Average applied tariff		Total number of services with GATS commitments in WTO
			Agriculture	Manufacturing	
Belarus	6,202.0 (current USD 2012)	7.0 (% 2000-2012)	15.2 (2011)	9.0 (2011)	N/A
Ukraine	3,971.2 (current USD 2012)	4.7 (% 2000-2012)	9.5 (2011)	3.8 (2011)	137
Azerbaijan	7,226.6 (current USD 2011)	12.5 (% 2000-2012)	14.1 (2011)	8.2 (2011)	N/A
Armenia	3,135.0 (current USD 2011)	7.80 (% 2000-2010)	6.8 (2010)	2.2 (2010)	106
Georgia	3,513.6 current USD 2011)	6.40 (% 2000-2010)	7.2 (2010)	0.7 (2010)	125
Moldova	2,135.9 current USD 2011)	5.10 (% 2000-2010)	10.5 (2010)	3.7 (2010)	147

The table above indicates quite varied picture of the countries.

Belarus and Ukraine have higher average import tariffs on both manufactured goods and agricultural products. Belarus service sector is less open than that of the EU's. Ukraine will have free trade of service as the Associate agreement will fully enters into force, as the Deep and Comprehensive free trade area agreement is the part of it. However, dues to the Russia's claims, Ukraine have postponed this process until January 1, 2016.

The trade liberalization between EU and *Belarus* is not foreseen as the Belarus became the member of Russian-leading Eurasian Custom Union making impossible for the country to be engaged in trade liberalization talks with the EU or other EaP countries (Ukraine, Moldova, Georgia) which have the DC FTA with the EU. Moreover, in June 2007 the EU removed the Generalised System of Preferences (GSP) system of trade dues to the negligence of core principles of the International Labor Organization by Belarus. Since 2010, Belarus was charged unilateral import quotas on textile and clothing products. However, one third of Belarus trade turnover comes on trade with the EU. Meanwhile, Russia represents the most importuned trade partner for Belarus. Belarus' exports to the EU includes mainly mineral fuels alongside with chemicals, chemicals, agricultural products, machinery and textiles, which have much lower volume. The main items of the EU's export to Belarus are mainly machinery, transport equipment and chemicals to Belarus (European Commission, Trade policy.)

**Table 2. Trade Dynamics of Belarus**

year	Belarus			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Belarus (mln €)
2004	13,141	11,055	24,196	5,344
2005	13,430	12,842	26,271	6,687
2006	17,793	15,711	33,504	8,891
2007	20,936	17,713	38,649	9,254
2008	26,775	22,145	48,920	11,114
2009	20,479	15,258	35,737	7,591
2010	26,314	19,072	45,386	9,303



2011	32,873	29,755	62,628	11,566
2012	36,118	35,825	71,943	12,465
2013	32,990	28,474	61,464	12,012
2014				10,893

Source: *Statistics of Countries and Regions; European Commission. Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>*

Ukraine's trade, like Belarus, with the EU comprises about one third of its total trade. Ukraine exports iron, steel, mining products, agricultural products, and machinery to the EU. The country's trade is liberalized due to the GSP, which was granted by the EU since 1993. Ukraine has the highest level of efficiency usage of the GSP among EaP countries which enjoy the same trade regime.

**Table 3. Trade Dynamics of Ukraine**

year	Ukraine			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Ukraine (mln €)
2004	23,310	26,235	49,545	19,105
2005	29,060	27,303	56,362	22,018
2006	35,809	30,358	66,167	28,235
2007	43,833	35,934	79,768	34,915
2008	58,154	45,474	103,628	39,801
2009	32,595	28,552	61,147	21,934
2010	45,817	38,797	84,614	28,959
2011	59,344	49,146	108,490	36,435
2012	65,892	53,557	119,449	38,507
2013	59,017	48,546	107,562	37,782
2014				30,903

Source: *Statistics of Countries and Regions; European Commission. Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>*

The trade between the EU and Azerbaijan mainly includes oil and gas directed to the EU, and manufactured goods and agricultural products directed from the EU. This trade is closely connected with political and security of supplies problems. Azerbaijan has relatively high average import tariffs on manufactured goods and significant level of protectionism in the services sector. The high level of corruption significantly harms country.

99.5% of total exports of Azerbaijan to the EU consist of oil and gas. EU's main export items to Azerbaijan are machinery and transport equipment (47.6%), miscellaneous manufactured articles (20.1%) and manufactured goods (14%). Azerbaijan benefits from the EU's GSP+ trade regime since 1 January 2009.

**Table 4. Trade Dynamics of Azerbaijan**

year	Azerbaijan			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Azerbaijan (mln €)
2004	2,827	2,904	5,731	2,538
2005	3,385	3,494	6,879	4,003
2006	4,195	5,075	9,270	7,404
2007	4,169	4,420	8,589	8,944
2008	4,875	32,469	37,344	12,724
2009	4,390	10,540	14,930	9,148
2010	4,979	16,112	21,091	12,394
2011	7,009	19,088	26,097	18,344
2012	7,513	18,608	26,121	17,282
2013	8,214	18,385	26,598	18,099
2014				16,641

Source: *Statistics of Countries and Regions; European Commission. Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>*

Moldova, Georgia and Armenia are countries with very small economies. The main exports of these countries to the EU are agricultural products, while import from the EU includes industrial goods and agricultural products. Armenia, Georgia and Moldova due to their size are not under key trade interest for the EU. Their trade policies are liberalized and they have low tariffs. Their services trade regime is as open as the EU's. According to Messerlin et al. (2012), Georgia is fully open to FDI and recognizes the technical standards of the EU and of other trading partners. The EU offers these countries trade preferences under the GSP+. Moreover, last year, Association Agreements with Moldova and Georgia was signed on 27 June, and the DC FTA, which is the part of this agreement, went into force.

The EU is *Moldova's* main trading partner, trade turnover with the EU stand more than 40% of Moldova's total trade. The followed by biggest trading partners are Russia and Ukraine. However, overall trade with Moldova as well as with Georgia, accounts for only 0.1% of EU's overall trade. EU exports to Moldova mainly machinery, transport equipment, chemicals, fuels, mining products and agricultural products. EU imports from Moldova mainly agricultural products, clothing, textiles and machinery.

**Table 5. Trade Dynamics of Moldova**

year	Moldova			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Moldova (mln €)
2004	1,422	792	2,213	1,445
2005	1,843	876	2,719	1,521
2006	2,142	834	2,976	1,705
2007	2,689	973	3,662	2,228
2008	3,325	1,074	4,399	2,469
2009	2,346	917	3,263	1,765
2010	2,908	1,163	4,071	2,148
2011	3,722	1,590	5,312	2,709
2012	4,047	1,680	5,727	2,982
2013	4,199	1,861	6,059	3,242
2014				3,514

Source: *Statistics of Countries and Regions; European Commission. Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>*

The *EU-Armenia* bilateral trade relations are currently regulated by a Partnership and Cooperation Agreement, which is in force since 1999. The negotiations on Association Agreement were launched in July 2010, which also included trade part - Deep and Comprehensive Free Trade Agreement – but was interrupted as Armenia expressed its willingness to join Eurasian Customs Union. About one third of Armenia's trade comes on the EU. Armenia imports machinery and transport equipment, miscellaneous manufactured articles, chemicals and foods; and exports manufactured goods; crude materials and transport equipment.

**Table 6. Trade Dynamics of Armenia**

year	Armenia			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Armenia (mln €)
2004	1,086	581	1,667	586
2005	1,448	783	2,231	934
2006	1,745	785	2,530	818
2007	2,384	841	3,225	960
2008	3,009	719	3,728	988
2009	2,369	500	2,869	696
2010	2,828	785	3,613	816
2011	2,977	959	3,936	967
2012	3,319	1,112	4,431	958
2013	3,433	1,135	4,568	978
2014				990

Source: Statistics of Countries and Regions; European Commission. Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>

Currently, Georgia has shown impressive progress in all directions: country signed an Association Agreement including Deep and Comprehensive Free Trade Area (DC FTA) (EPRC, 2014) which was ratified by Georgian Government last year and went into force since September 1, 2014. Upon its entry into force, the Association Agreement will replace the EU-Georgia PCA. Pending its entry into force, since September 1, 2014, approximately 80% of the Association Agreement is being applied on a provisional basis.

Over the past decade, Georgia's foreign trade has increased six times. Country's trade balance has constant deficit, but during few years this deficit has declined and in 2013 it constituted just 36% of total foreign trade. The European Union is the Georgia's biggest trade partner, which covers about 30% of total trade. So far Georgia was EU GSP+ beneficial country, but this is to be re-placed by DC FTA regime.

Currently, Georgia has the lowest import tariffs on the EU products (agricultural 5.57% - industrial 0.45). In 2012, Georgia's total foreign trade turnover grew by 10.5% compared to the previous year, exports grew by 8.6% and imports grew by 11%. Among the top 10 trade partner countries of Georgia there were three EU member states: Germany (5th place), Bulgaria (8th place) and Italy (10th place) in 2012.

**Table 7. Trade Dynamics of Georgia**

year	Georgia			
	Imports (mln €)	Exports (mln €)	Total Trade (mln €)	EU Trade with Georgia (mln €)
2004	1,485	518	2,004	926
2005	2,002	684	2,686	960
2006	2,925	775	3,700	1,404
2007	3,808	902	4,710	1,571
2008	4,286	1,017	5,304	1,996
2009	3,105	807	3,912	1,457
2010	3,966	1,265	5,231	1,795
2011	5,070	1,573	6,643	2,224
2012	6,104	1,850	7,954	2,653
2013	6,038	2,228	8,266	2,698
2014				2,569

Source: Statistics of Countries and Regions; European Commission, Retrieved from <http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>

According different estimations (CASE 2012), the agreement will increase trade diversification and reach around 6,5% of GDP due to the considerable declining of trade barriers, both tariff and non-

tariff, and opening new opportunities for Georgian firms by giving free and simplified access to the 500 mln consumers EU market, the biggest market of the world, as well as creating favorable environment and attractive climate for foreign and domestic investments. predictions argue that in middle term period, over the next 5-6 years Georgia's' export will increase by 13,5% while in long term period this increase will reach about 12%; and import will rise by 7,5%. According to the study, chemicals, rubber and plastic output and export potential are to be increased by 60%. The predictions note also 60% growth of livestock and meat production and 20% growth for vegetables, fruits, nuts and oilseeds production.

Thus, overall realization of DC FTA will benefit improvement of welfare for the citizens of Georgia. Better access to high quality products on domestic markets, ensured food safety and potential of higher income generating from new business opportunities and economic growth are among main gains and benefits arising from deeper and broader European integration.

Alongside with the uncountable political meaning, Association Agreement has tremendous economic benefits for Georgia's economy. It is expected that the DCFTA, which is an integral part of AA, will open the EU's internal market, which is the biggest market of the world dues to its approximately 500 mln population with the highest purchasing power. As it was already shown, the Georgian export and import to and from the EU are characterized by growing dynamics, which is expected to continue increasing over the time, especially after DCFTA requirements are fully met. Georgia has implemented wide range of reforms to improve Food Safety and Consumer Protection. An important package of legislative changes aiming at harmonization of the national labor legislation with the international standards elaborated in close cooperation with the ILO experts and civil society has been adopted. Special attention is paid to effective anti-monopoly policy and harmonization of technical regulations. The Government's efforts are focused to ensure favorable business environment, with strong guarantees of private property rights (Sepashvili, 2014); all these actions facilitate Georgian companies to produce higher standard products that will lead to more competitiveness of Georgian producers<sup>2</sup>.

## **Conclusion**

Today the EU remains a "classic model" of successful regional integration which positively influences the economic development of the member-states as well as neighboring countries. Nowadays, we are witnessing dramatic changes occurring in the region, which gives start to the new developments closely connected with gradual integration of the EU's Eastern neighbors into European Economic space. The impact of integration on economic growth and the means and ways of implementation of integration assumes greater importance for EaP region countries over the development.

After almost the hundred years, the primary objectives of regional policy is still the same: to create as favorable conditions as possible for development, for achieving democracy, respect for human rights, rules of law, for encouraging innovative economic activities. As a whole, the success of integrated groups in significant degree depends on elaboration such motivating forms of political and economic relations, that most of all appropriates specific features of concrete region and nation. These aspect are the main basis for EaP regional integration process.

The short overview presented in the article showed that the Eastern Partnership region countries have to become the part of global society. EaP countries are in dual transition towards the development and enhancement of democracy and establishment of a market economy to create a basis for self-sustained economic and social growth. As trade data on EaP countries' showed, increased level of regionalization and integration in the EaP region has clear evidence.

---

<sup>2</sup> For more information see reports at [www.eu-nato.gov.ge](http://www.eu-nato.gov.ge).

## References

- Balassa, B. (1961). *The Theory of Economic Integration*. Homewood: Richard D. Irwin Inc.
- Cameron, F. (2010). The European Union as a Model for Regional Integration, European Policy Centre, Hertie School of Governance, Berlin, September 2010. Retrieved from <http://www.cfr.org/world/european-union-model-regional-integration/p22935>.
- Ecorys and CASE (2012). Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova. 2012. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc\\_149666.pdf](http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc_149666.pdf).
- Eastern Partnership Index (2013). International Renaissance Foundation in cooperation with the Open Society Foundations and Eastern Partnership Civil Society Forum. Retrieved from [http://www.eap-index.eu/sites/default/files/EaP\\_Index\\_2013\\_0.pdf](http://www.eap-index.eu/sites/default/files/EaP_Index_2013_0.pdf).
- Eastern Partnership. European Union External Action. Retrieved from [http://eeas.europa.eu/eastern/index\\_en.htm](http://eeas.europa.eu/eastern/index_en.htm).
- European Commission. Trade policy. Retrieved from <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/belarus/>.
- European Commission. Toward a new European Neighborhood Policy. Retrieved from <http://eeas.europa.eu>.
- Economic Policy Research Center (EPRC). European Union's Association Agreements. Retrieved from <http://eeas.europa.eu/association/>.
- Economic Policy Research Center (EPRC) (2014). European Union's Agreement on Deep and Comprehensive Free Trade Area and Georgia. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2012/november/tradoc\\_150105.pdf](http://trade.ec.europa.eu/doclib/docs/2012/november/tradoc_150105.pdf).
- International Monetary Fund (2012). World Economic Outlook Database. October, 2012.
- Liargovas, P. (2013). EU Trade policies towards Neighboring Countries. European Commission, WP2/01 Search Working Paper, January, 2013.
- Ruggie, J.G. (1993). *Multilateralism Matters: The Theory and Practice of the Institutional Form*. New York: Columbia University Press.
- Sepashvili, E. (2013). Georgia's Economic Integration into European Space: Challenges and Prospects. Paper presented at the Tbilisi State University, May 2013.
- Sepashvili, E. (2014). Political and Economic Aspects of Security policy in Relation to Eastern Partnership-Georgia, EU Eastern Partnership. Paper presented at Jean Monnet Conference, University of Latvia, Riga, 11-13 June 2014.
- The National Statistics Office of Georgia. Foreign Trade. Retrieved from [http://geostat.ge/index.php?action=page&p\\_id=137&lang](http://geostat.ge/index.php?action=page&p_id=137&lang).

## Websites:

[www.easternpartnership.org](http://www.easternpartnership.org)  
<http://ec.europa.eu/trade/policy/countries-and-regions/statistics/>

<sup>i</sup> [http://geostat.ge/index.php?action=page&p\\_id=136&lang=geo](http://geostat.ge/index.php?action=page&p_id=136&lang=geo)

<sup>ii</sup> Mid-term Evaluation of the EU's Generalised System of Preferences, 2010, [http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc\\_146195.pdf](http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146195.pdf)

<sup>iii</sup> Georgia: Moving Towards DCFTA

[http://eeas.europa.eu/delegations/georgia/documents/eu\\_georgia/dcfta2012\\_01\\_en.pdf](http://eeas.europa.eu/delegations/georgia/documents/eu_georgia/dcfta2012_01_en.pdf)

<sup>iv</sup> CASE network. Studies and Analysis. EU-Ukraine DCFTA: the Model for Eastern Partnership Regional Trade Cooperation, 2012, [http://www.case-research.eu/sites/default/files/publications/CNSA\\_2012\\_445.pdf](http://www.case-research.eu/sites/default/files/publications/CNSA_2012_445.pdf)

<sup>v</sup> Food and Agriculture Organization of the United Nations. Eastern Europe and Central Asia Agro-Industry Development Brief, Georgia, 2012year

[http://www.fao.org/fileadmin/user\\_upload/Europe/documents/Publications/AI\\_briefs/AI\\_briefs2012/fao\\_georgia.pdf](http://www.fao.org/fileadmin/user_upload/Europe/documents/Publications/AI_briefs/AI_briefs2012/fao_georgia.pdf)

<sup>vi</sup> EU-Belarus PCA has been frozen in 2007 due to the political reasons.

<sup>vii</sup> The European Commission, Retrieved from: <http://eeas.europa.eu/association/>

<sup>viii</sup> Source: International Monetary fund, World Economic Outlook Database, October, 2012.

<sup>ix</sup> Source: International Monetary fund, World Economic Outlook Database, October, 2012.