

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

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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.

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.

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.

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.

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