

# European Integration and Business Environment in Georgia

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## Abstract

Paper analyzes the impact that the process of Georgia's European integration have had on country's business environment. A significant changes have occurred in Georgia in the last decade, which had an influence on the status of the current business environment. Especially, it is worth to mention the aspiration of the country for European Integration. Georgia has carried out a number of recommendations and requirements set by the European Union, on the way to this goal, which has changed the country's business environment.

The negotiations between the EU and Georgia about the "Deep and Comprehensive Free Trade Area (DCFTA)" was officially opened on 28th February, 2012. Prior to the opening discussions about "DCFTA", the European Commission singled out four main areas of country's economy, where conducted fundamental reforms became precondition to open diplomacy. These sectors were: technical barriers related to the EU trade regulations, sanitary and phytosanitary measures, intellectual property rights and competition policy. In addition, the European Commission together with the International Labour Organization asked for changing of the Labour Code and directly linked implemented reforms to progress, which should be reached during the talks with Europe about "DCFTA".

*Key words: Business environment, European integration, DCFTA, reforms.*

## 1. Introduction

The business environment, which includes financial, legal, political and other systems of the country, undoubtedly has a significant impact on companies' activities. The favorable business environment mostly determines the economic development of the country. Also, many other factors have impact on the attractiveness of the business environment.

We all agree that business is a complex process, which is not working in vacuum. Both, internal and external environment of the firm affects on its' activity. All of the factors which has a direct or indirect impact on business transactions are components of business environment (Pujari S.). It is widely recognized, that the business environment has a significant impact on activities of the firm.

Business environment mostly determines the pace of economic growth in the country. Some important indicators are used to assess it including: the World Economic Forum's "Global Competitiveness Index", the World Bank's "Ease of Doing Business Index" and the Heritage Foundation's "Index of Economic Freedom". All of them assesses business environment, but only with different angles and methodology. The declared political course of Georgia is an integration with the European Union. Certainly, the business

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environment and its' components are influenced by the process of European Integration. It should be noted, that economic integration with EU can be achieved by harmonization of our business environment with its' requirements.

The relations between Georgia and European Union started in 1991-1992, after the Soviet Union collapsed and Georgia was established as an independent state. Since 1995, Georgia benefits from the EU's Generalised System of Trade Preferences (GSP), but since 2005 it was the EU's Generalised System of Preferences (GSP + trade regime) and now, country benefits from Deep and Comprehensive Free Trade Agreement (DCFTA) that was officially signed in 2014.

On 22th April of 1996, the European Union and Georgia signed a Partnership and Cooperation Agreement (PCA), in Luxemburg. On September 1, 1997, in accordance with the decision of the Parliament our country started harmonization of legislation according to the EU's demands.

On 14th June of 2004, Georgia joined the European Neighborhood Policy after the EU Council decision.

European Neighborhood Policy, which began after EU enlargement, was developed in 2004 and aims to support harmonization of political, economic and cultural process between the EU and its neighboring countries. With this program, the EU tries to promote democracy, stability and prosperity around its' borders. European Neighborhood Policy spreads on Georgia, Armenia and Azerbaijan since 2004, after well-known "Rose Revolution" in our country.

European Neighborhood Policy aims to harmonize standards and rules, which should contribute to the improvement and approximation of business legal environment with the EU standards.

One of the main aim of the EU is to create basis for free movement of human resources and legal migration. A lot of young people are given the opportunity to continue their studies abroad, improve their knowledge and skills, which provides highly qualified personnel for Georgian business.

Within the framework of the European Neighborhood Policy it is important to strengthen cooperation, in order to improve security and fighting against corruption. The European Union is actively involved in conflict resolution and crisis management situations. All of this contributes to the formation of a stable political surroundings in the partner country and plays an important role in moulding favorable business environment.

The EU also pays a great attention to cooperation in the field of human rights protection and culture. One of the key issues in this direction is the Labor Code. Considering EU requirements in this issue, ensures the improvement of the labor code and creates worthy working conditions. There are lot of questions raised about the Labor Code in our country. The European Union offers recommendations in this field, in order to harmonize our legislation to EU standards, which will positively impact on business environment in a legal point of view.

European Neighbourhood Policy contributes to the integration of involved countries in European transport, energy and telecommunication networks, as well as scientific research. These contributes to the adoption and implementation of modern technologies in Georgia and has a beneficial impact on business technological environment. It has

created the possibility for Georgian scientists to take part in research and innovation projects and companies have an opportunity to enjoy the benefits that using modern technologies allow.

Georgia joined “Eastern Partnership” (EP) initiative in 2009. EP proposal, as a new format of the EU's eastern neighboring countries (Azerbaijan, Belarus, Moldova, Georgia, Armenia, Ukraine) firstly was developed by Sweden and Poland. This program offers maximum opportunities to partner countries considering its existing political and economic situation, as well as the intensity of reforms.

The Eastern Partnership is based on shared commitment to the following principles: the rule of law; good governance; respect to human rights; respect and protection of minorities; market economy; sustainable development. Achieving all of these guarantees forming peaceful and secure environment, which is very attractive for business.

Some projects are done within the framework of Eastern partnership, which will contribute to the improvement of our country's business environment. In this regard following can be noted:

- Competition Sphere - A legislative base was formed by establishing structure, which theoretically is equipped with the necessary rights. In this field, the authorized body, that has privilege of protection and fulfillment of the requirements of normative acts is an independent legal entity called “Competition and State Procurement Agency”, which was founded in 2013 after the native resolution of our government. Also, on 31th March of 2014, Competition Agency was established after the changes in the Georgian Law “On Free Trade and Competition”. It is an independent regulatory authority and its effective functioning should become the main premise of improving the competitive environment in Georgia.
- Food Safety Sphere - In close cooperation with the European Commission a food safety strategy and a harmonization program of legislation in this field was prepared; Started operating the suspended articles of the law about "Food Safety". It is likely that companies will pay more attention to product safety and quality of products produced in our country.
- Intellectual Property Sphere - Independent research was carried out in fraud and counterfeiting. At the same time our government is working on implementation of the EU recommendations. A relevant legislation related to the intellectual property is received. In order to favor and protect copyright Coordinating Council of Copyright Protection Agency was established. Intellectual property protection will make business profitable in many directions. For instance, workers in the music business will be insured from fraud and loss of income from their composed product.

This ambitious and pioneering Agreement represents a concrete way to exploit the dynamics in EU-Georgia relations, focusing on support to core reforms, on economic recovery and growth, governance and sector cooperation in areas such as, for example, energy, transport, environment protection, industrial and small and medium enterprise cooperation, social development and protection, equal rights, consumer protection, education, training and youth as well as cultural cooperation (European Commission, 2014).

Once signed and implemented, concrete benefits can flow from the Agreement. Examples include the better protection of consumers through the higher quality and improved safety of locally-grown agricultural products; better business opportunities for small- and medium-sized enterprises through the opening of markets; better access to improved health services; and energy savings thanks to more efficient use of energy

resources and the development of renewable energy sources; a better functioning judiciary and thanks to the strengthened rule of law, demanding accountability rules for public decision-makers and increased transparency (European Commission, 2014).

Some important aspects of DCFTA are given below to show how this agreement can affect on Georgia's business environment.

Market access for goods - All customs duties on goods with minor exceptions will be removed as soon as the AA enters into force. Ultimately, Georgia and the EU will eliminate duties on 100 % and 99.9 % (in trade value) respectively of their imports from the other party. For industrial goods the DCFTA involves the immediate removal of import duties on both sides. Trade in agricultural products will be also fully and immediately liberalised, but with the exception of trade in garlic imports, for which a duty-free tariff-rate quota is established.

Technical barriers to trade – it aims to reduce 'technical barriers to trade' (TBT), i.e. technical regulations, standards, conformity assessment procedures and similar requirements applying to industrial goods.

Sanitary and phytosanitary (SPS) measures - aims to facilitate trade in animals and plants, and products of animal and plant origin, while ensuring that the parties' level of protection is maintained. Georgia will bring its SPS legislation in line with the EU's (which is based on internationally recognised sanitary and phytosanitary standards) and in the selected sectors of interest to Georgia's economy.

Customs and trade facilitation – it seeks to enhance cooperation in customs and customs-related matters and simplify customs requirements and formalities while at the same time preventing customs fraud, e.g. through incorrect declarations of product origin. Current payments and movement of capital – The provisions on free movement of capital represent standard safeguards, including the possibility of taking measures to ensure the stability of the financial system.

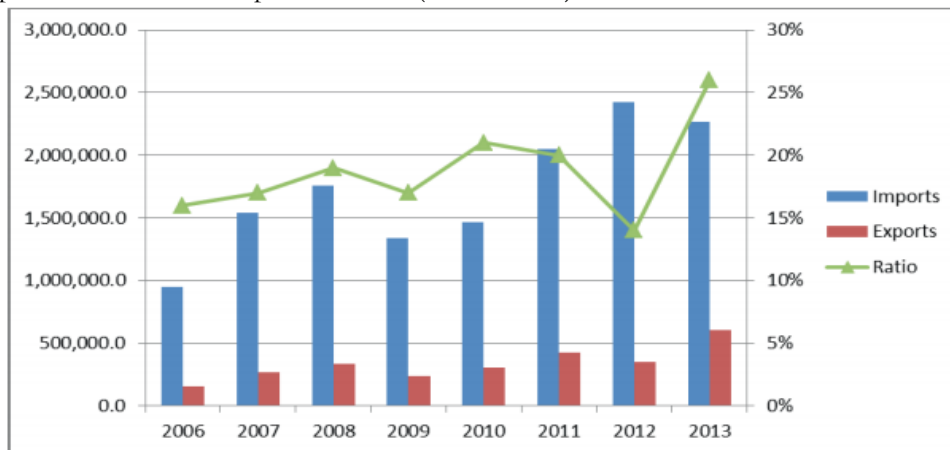
Transparency - contains basic transparency provisions applying to bilateral trade relations and trade-related policy making in the EU and Georgia. It aims to ensure that all stakeholders (governmental decision-makers, businesses and exporters, investors, civil society organisations and civil society at large) have access to information on the implementation of the EU-Georgia free-trade area and are consulted or otherwise involved in the decisions taken.

Dispute settlement - is based on the WTO Dispute Settlement Understanding, but involves a faster procedure, the first step of which is consultation between the parties with a view to reaching a solution (European Commission, 2014).

The EU is the second largest trade partner for Georgia after the Commonwealth of Independent States (CIS) countries. Over the course of the past few years (f.1), the trade turnover with the EU countries has been on the rise, both exports and imports have been steadily increasing, except for drops in 2009 and 2010. Georgia has the lowest import tariffs on the EU products (agricultural - 5.57%, industrial - 0.45) (CASE Network, 2012). In 2013, the export/import gap has converged due to both decrease in imports and increase in exports. Out of total agricultural exports in 2012 – 20 percent was directed to the EU countries, this indicator increased to 23 percent in 2013<sup>1</sup>.

<sup>1</sup>Information Received from the National Statistics Office. Letter dated March 7th, 2014.

Overall, agricultural export comprises 26 percent of total exports of Georgia, and 30 percent of total EU export turnover (EPRC, 2014).



**Figure 1.** Georgia EU trade tendencies in thousand USD

Source: National Statistics Office of Georgia

When it comes to the types of agricultural products exported to the EU countries, nuts (fresh and dried hazelnuts, walnuts) are absolute leaders; this category comprises 64 percent of total agricultural export to the EU and 65 percent of total exports in this particular category. In case of overall agricultural exports leader categories in 2013 were nuts, natural grape wines and mineral waters. Even though the top agricultural export categories do not vary greatly among different country groups, diversification of products is less in case of the EU countries. The latter is caused by the fact that almost all top export products directed to the EU countries are using the preferential treatment under GSP+. As mentioned earlier in the paper, Georgia has a high utilization rate of the GSP+ as a matter of fact up to 60 percent of exports under this treatment were agricultural products in 2013, a ten percent increase as compared to 2012. Product diversification in terms of varieties is not very broad. Around 50 types of products have entered the EU market in the years of 2012-2013. It is noteworthy that new products have emerged in 2013, especially processed and frozen vegetables are to be noted, also frozen fish, oils, vegetable saps and extracts. To conclude, it seems that elimination of import duties under the GSP+ treatment has boosted exports in the product categories covered by the trade regime. Generally, it is arguable how much tariffs actually matter, substantial number of empirical works suggest that tariff barriers explain only about one percent of the variation in trade turnover (Isakova, Koczan, Plekhanov, 2013). As a matter of fact other barriers to trade, especially technical, non-tariff hindrances might have larger effect.

The positions of Georgia are very high in "Doing Business" ranking, as can be seen from the proposed diagrams of the paper. Also, the country has a high rate according to the index of "Economic Freedom". It has a fairly liberal laws regarding doing business. This factor is one of the most important contributor to the flow of investments in our state. However, the lack of a stable political environment remains as a problem, and also there

are a number of recommendations in terms of improving the legal environment. At the same time, less developed technological environment of business creates troubles and additionally, there are many problems in the social sphere. All of these, hinders flow of investments in Georgia.

In general, it should be noted that the development of business environment is characterized by a positive trend in Georgia, which is mainly caused by reforms implemented during the European integration process.

It is not a strange that Georgia, which has small history of market economy, is characterized by relatively low entrepreneurial skills. Georgian entrepreneurs will have a better opportunity to master modern methods and technologies of doing business, during the deep cooperation with the European Union.

An essential problem is that on the one hand, there is a high level of unemployment and on the other hand the lack of highly qualified staff. The lack of highly qualified local staff can be considered as one of the obstacles of FDI inflows. Without them it would be impossible to fully utilize the benefits from free trade regime with the European Union. Deepening relations with the European Union gives an opportunity to more young people to continue their studies abroad, which provides highly qualified personnel for Georgian business. Also, trainings for the entrepreneurs funded by the EU, encourages our owners to raise their skills and manage business better.

For the country it is very important to fully utilize the potential of export, in which DCFTA has big role to play. Probable positive effects are: export growth, improvement of the potential of export, improvement of Georgian product quality and awareness, investments in the country, increasing competition on the market, reduction of unemployment, implementing modern technologies in Georgian companies and others. All of these, will make business environment more attractive for both, foreign and local investors.

Georgia will have to comply the recommendations given by the EU during European integration process, which should become a premise to improve investment, legal and social environment, also to make a political environment more stable. All of these, has to provide a more favorable environment for investments in our country.

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