

EU's Trade Policy Developments and Economic Dimension of EU-Georgia Association Agreement

*Emir ETERIA**

Abstract

EU-Georgia Association Agreement (AA), with its integral part on Deep and Comprehensive Free Trade Area (DCFTA), has been regarded as the best opportunity for Georgia to promote exports to the EU and increase investment attractiveness of the country. Georgia's benefits from AA/DCFTA directly depend on consistency of reforms as well as on the speed and degree of legal approximation and regulatory convergence with the EU, which would support growth of Georgia's exports to the EU as well as attractiveness of Georgia for investments from the EU member states. However, after 5 years since the provisional application positive effects of the Association Agreement on trade and investment performance are not significant. As conducted study demonstrates, despite some encouraging developments in the EU-Georgia trade relations after enactment of the Association Agreement, in 2015-2018 (post-AA/DCFTA period) annual average growth rates of Georgia's exports to the EU and investments from the EU countries to Georgia compared to 2011-2014 (pre-AA/DCFTA period) decreased. It is clear, that already achieved progress in implementation of the Association Agreement is not sufficient for export and investment promotion and Georgia should continue reforms in all areas, envisaged by the Association Agreement. Moreover, it is high time to grant Georgia the EU membership perspective and/or advance Georgia towards membership of the European Economic Area (EEA), which will be additional incentive for the effective implementation of the European Integration related reforms.

Keywords: Association Agreement, Deep and Comprehensive Free Trade Area, EU, Georgia, Trade, Investments.

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* Emir ETERIA is associate professor at Caucasus University and Sokhumi State University, Tbilisi, Georgia. E-mail: eeteria@cu.edu.ge

1. Introduction

The European Union-Georgia Association Agreement (AA) came into force from July 1, 2016. However, many titles as well as annexes of the agreement, including Title IV (Trade and Trade-related Matters) have been provisionally applied since September 1, 2014. Therefore, after 5 years since provisional application of the agreement initial impacts of the AA on Georgia's investment and trade performance could be observed.

Noteworthy, that the EU alongside with Commonwealth of Independent States (CIS) is Georgia's one of the major trade partners and therefore, Georgia attempts to develop closer political and economic relations with the European Union. Accordingly, achieving political association and gradual economic integration with the EU, envisaged by the EU-Georgia Association Agreement are among the key priorities of Georgia's foreign as well as domestic policy agenda. It should be noted that the content of economic dimension of the Association Agreement with Georgia and other "Eastern Partnership" countries (Ukraine, Moldova) was largely influenced by recent transformation of the EU's trade policy, which became more focused on bilateral dimension of trade relations.

The aim of this article is to observe the EU's recent trade policy transformation and economic dimension of the EU-Georgia Association Agreement, as well as analyze recent key developments in Georgia's economic relations with the EU (trade and investments) in the light of the EU-Georgia Association Agreement. Therefore, the article is focused on economic dimension of the Association Agreement, namely on DCFTA part of the agreement as well as other parts related to the economic performance in general. Next part of this paper is devoted to review of the EU's trade policy transformation, especially the bilateral dimension of this policy. In the third part of the article, major peculiarities of the EU-Georgia Association Agreement are examined. In the final part, the EU-Georgia trade relations as well as movement of Foreign Direct Investments (FDI) from the EU countries to Georgia are analyzed. It should be noted that to evaluate initial impacts of AA/DCFTA on economic performance of Georgia trade and investment data for the period of 2011-2018 is analyzed. A study period is divided into two parts. The first period includes 2011-2014 or pre-AA/DCFTA period and the second, 2015-2018 or post-AA/DCFTA period. This division allows revealing new developments in Georgia's trade and investment performance during recent years.

2. A bilateral Dimension of the EU's Trade Policy

Noteworthy, that until 2006 the EU alongside with the USA and Japan was active supporter of multilateral trade liberalization. As Woolcock (2014) noted, "During the period 1999 to the mid-2000s, the EU focused on promoting a comprehensive, multilateral trade round" (p. 719). However, at the "Doha Development Round" achieving of genuine results matching with the EU's global trade interests were complicated. Besides, "There was also growing pressure from some EU businesses concerned that EU competitors were gaining preferential access to Asian markets in particular while the EU failed to act" (ibid, p. 722). Both above-mentioned developments on the global as well as the domestic level pushed the EU significantly modify trade policy priorities towards developing mutually beneficial bilateral trade relations. Moreover, it is worth noting that major economic powers (USA, Japan) also focused on developing bilateral trade relations and since 2000s world economy has been characterized by competitive liberalization among key players. As a result, in 2006 the EU ended moratorium on bilateral trade relations and designed the new trade strategy focused on developing bilateral dimension.

The EU's new trade strategy could be described as multidimensional trade strategy aimed at realization of the EU's commercial interests using various types of bilateral trade agreements. The EU's trade policy transformation towards the increased bilateral dimension was declared in the European Commission communication "Global Europe: competing in the world" (Commission of the European Communities, 2006). This communication could be seen as foundation of the EU's new trade strategy focused on challenges imposed by globalizing world economy, where competition and cooperation have been driving forces of economic development. In this regard, the abovementioned communication highlighted the EU's further commitment to multilateral trade liberalization. The EU's strategy of bilateral trade liberalization was based on belief, as it was declared later, that "bilateral is not the enemy of the multilateral. The opposite may hold truer: liberalization fuels liberalization" (European Commission, 2010, p. 3). However, it should also be noted that "Bilateral trade agreements offer the EU an easier and speedier way to advance European goals and project its values onto the global stage than multilateral forums" (Bongardt and Torres, 2018, p. 248). Moreover, the EU's new trade policy, according to the communication "Global Europe: competing in the world" is a main instrument to increase the EU competitiveness in the world economy. This communication underlines two major issues. The first, it

emphasized importance of open markets around the world and the second, it highlighted an increased role of reducing barriers to trade behind the border to the economic growth and job creation in the EU countries. Therefore, the EU admits the positive aspects of openness and economic globalization in general as well as major challenges created by global economic integration, where is no central government in order to regulate international economy.

In addition, Communication on “Global Europe: competing in the world” envisaged an extension of bilateral trade relations based on two considerations. First, according to communication the EU was willing to start negotiations with some countries based on the economic criteria, which was determined as the market potential (economic size and growth) and the level of protection against the EU export (tariffs and non-tariff barriers). As Woolcock (2014) noted, “The EU’s first preference was to negotiate a region-to-region agreement...Region-to-region agreements can be seen as an effort to exercise EU normative or soft power in shaping the international system (p. 722). Second, as stated in the communication, new free trade agreements in order to have positive impact on competitiveness, jobs creation and economic growth “must be comprehensive in scope, provide for liberalization of substantially all trade and go beyond WTO disciplines” (Commission of the European Communities, 2006, p. 8). Consequently, the EU’s new trade strategy incorporated two interrelated objectives. First, to expand free trade agreements on the bilateral level and the second, to broaden scope of free trade agreements via including issues, which were not agreed in the framework of WTO. Therefore, the new trade strategy envisaged the geographical expansion as wells as the broadening scope of FTA’s. Both objectives were not contradictory to multilateral trade liberalization as the bilateral liberalization and the expansion of scope of trade agreements, including issues “behind the border” is a major supporting factor for further multilateral liberalization. Accordingly, increased bilateral trade relations were seen as reinforcing instrument of multilateral trade liberalization. As it was stated in the communication “The EU's priority will be to ensure that any new FTAs, including our own, serve as a stepping stone, not a stumbling block for multilateral liberalization” (Commission of the European Communities, 2006, p. 8). As a result, the EU’s new trade strategy was oriented towards more open trade, which would be based on the agreed rules not only directly related to the trade, but also to other economic areas, which have impact on trade relations. Thus, recent changes in the EU’s trade policy and growing importance of bilateral trade relations was result of the less effective global trade system on the one hand and the increased competition in the world economy on the

other. As Gstöhl and Hanf (2014) pointed out “...the EU has increasingly come under pressure to reconcile the requirements of free trade with requests for guarding non-trade concerns related to public health, labour and environmental issues or intellectual property rights” (p. 747). Consequently, rising economic globalization based on the increased competition was major cause for changes in trade policy.

Noteworthy, that the EU’s neighbouring countries, especially “small” ones, were not priority countries to start negotiations on the new agreements. However, in 2007 the Commission of the European Communities elaborated Communication on “A Strong European Neighborhood Policy” (Commission of the European Communities, 2007), which was focused on neighbouring countries and along many areas of cooperation it also included trade related issues. Regarding the trade related issues, this communication replicated the EU’s general approach underlined in the EU’s global trade strategy and at the same time, was focused on conditionality and differentiation as the foundation for the development of trade relations with different countries in the region concerned.

It is clear, that the EU’s trade policy towards European Neighborhood Policy (ENP) countries, especially eastern neighbors, mostly was based on political considerations, rather than economic criteria underlined in the communication “Global Europe: competing in the world”. According to the communication on “A Strong European Neighborhood Policy”, “Spreading peace and prosperity across the borders of the EU prevents artificial divisions and creates benefits for the ENP partners and the EU alike” (Commission of the European Communities, 2007, p. 1). In addition to that, political considerations also incorporated some eastern neighbor countries’ (Ukraine, Moldova and Georgia) aspirations to achieve a deeper political and economic integration with the EU. These countries also expressed readiness to implement far-reaching reforms in many trade-related areas envisaged by the new agreements. As a result, priorities of the EU’s transformed trade policy coincided with eastern partner’s political and economic interests. Accordingly, despite that some eastern neighbor countries share in the EU’s total trade were not significant (less than 1%), the EU offered to these countries to conclude DC FTAs in order to promote their gradual economic integration with the EU. As a result, DCFTAs “... developed along with the European Neighbourhood Policy (ENP) and enhanced following the Eastern Partnership (launched in 2009), is indicative of the political considerations underlying the EU’s trade policy in its neighbourhood” (Manoli, 2013, p.52). In addition, the EU was willing to support an increased economic integration among partner countries. This approach “... of promoting regional integration in partner regions is reflected in the use of diagonal

cumulation (Woolcock, 2014, p. 724). Therefore, Deep and Comprehensive Free Trade Agreements (DCFTAs) in contrast to the EU's other trade agreements were driven mostly by geography and politics (geographical proximity and stable neighborhood), rather than economic considerations. Nevertheless, it is clear, that the EU's Association Agreements with the eastern neighbouring countries will provide favorable conditions for the EU countries investments and exports. In general, "The EU thus aims to combine economic interests, political values and other norms in its external relations, yet without indicating any prioritization among these objectives" (Gstöhl and Hanf, 2014, p. 736). Moreover, Association Agreements will promote eastern partners gradual economic integration with the EU as well as facilitate integration among neighbouring countries and their economic development. In this regard an idea of "Wider European Economic Area" (WEER), which should include EU, European Economic Area/European Free Trade Area, Balkan non-EU states and East European countries with Association Agreements with the EU, deserves special attention (Emerson, 2018).

Noteworthy that "...multilateralism and the idea of international trade as a win-win situation received another severe blow when the current US administration shifted to an "America First" stance with a bilateral, zero-sum perspective on and approach to extracting benefits from trade (Bongardt and Torres, 2018, p. 245). However, this could be seen as the possibility to increase the EU's role in the international trade in general and namely, in multilateral trade negotiations. Accordingly, the gradual evolution of the EU's bilateral trade policy priorities from simple FTAs to the comprehensive FTAs, which include many economic areas, clearly demonstrates the EU's effort to achieve its global economic goals by expansion of different types of bilateral trade agreements.

3. Major peculiarities of economic dimension of the EU-Georgia Association Agreement

The EU-Georgia Association Agreement includes many provisions, which have direct or indirect impact on EU-Georgia economic relations and economic development of Georgia in general. As Gstöhl and Hanf (2014) pointed out "Association agreements typically include preferential market access, various types of economic, financial or technical cooperation, and a political dialogue"(p. 738). It should be noted that the economic dimension of the Association Agreement is associated with Title IV - Trade and Trade Related Matters. However, other parts of the agreement, especially Title V- Economic Cooperation and Part VI - Other

Cooperation Policies also include provisions that have impact on economic performance of Georgia as well as further development of economic relations between the EU and Georgia.

As mentioned before, the part of Association Agreement, which is directly related to economic relations between the EU and Georgia, is DCFTA. In general, DCFTA is a new type of the EU trade agreement and, in contrast to a Free Trade Agreement (FTA), goes beyond the reduction/elimination of tariffs and covers a broad range of economic issues. Moreover, DCFTA includes so-called “Singapore issues” (trade and investment, trade and competition policy, transparency in government procurement, and trade facilitation). As Woolcock (2014) pointed out “the EU has generally succeeded in including the Singapore issues in the PTAs it negotiates with middle-income and developed economies” (p.727). Noteworthy, that “Singapore issues” were one of the main reasons of a disagreement at “Doha Development Round”. It is obvious, that insertion of these issues in AA adds difficulties to the implementation process of the agreement. As a result, DCFTA part of EU-Georgia Association Agreement could be seen as a reflection of the EU’s trade policy transformation during past several years.

An economic dimension of the Association Agreement based on conditionality is comprehensive and multipart. In general, economic dimension of the Association Agreement could be divided into two parts. First part is directly related to export-import of goods and access to the market. In Addition, agreement envisages adding of an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) as a protocol to this Agreement (Association Agreement, article 48) after Georgia’s relevant sectoral legislation will be fully approximated with the EU legislation. This part reflects external aspects of economic dimension of the AA. The second part of the economic dimension of the AA could be described as not directly related to the export of Georgia’s products to the EU market, but which envisages regulatory convergence in many areas and has an impact on trade relations as well. Therefore, this is the internal aspects of the economic dimension of the AA. It should be noted that the external and internal aspects of the economic dimension of the AA are closely interrelated influencing each other.

Noteworthy, that the DCFTA part of the AA envisages the regulatory convergence and legal approximation in many areas of the economy, such as intellectual property rights, sanitary and phytosanitary measures, customs legislation, trade in services and electronic commerce, public procurement, technical barriers to trade, standardization, metrology, accreditation and conformity

assessment, competition policy, etc. In addition to that other parts of Association Agreement (Title V- Economic Cooperation and Part VI - Other Cooperation Policies) also foresee regulatory convergence and legal approximation in areas such as taxation, public finances and financial control, financial services, environment, transport, energy, company law, industrial and enterprise policy, accounting and auditing, consumer policy, employment, social policy, etc. As a result, “Altogether the regulations are also aimed at liberalisation, approximation to the standards of the EU under monitoring of the joint committees with the final objective to arrive at a more Europe-like regulatory environment in the DCFTA countries” (Adarov and Havlik, 2016, p. 23). Moreover, the AA also envisages dynamic approximation of legislation of Georgia with those of the EU (Association Agreement, article 418) and therefore, Georgia should “... undertake any action needed to reflect the developments in EU law in its domestic legislation ...” (European Commission, 2017a, p.3). The concept of dynamic approximation makes implementation of the EU-Georgia Association Agreement even more complicated and challenging process.

Taking into account all abovementioned peculiarities of the EU-Georgia Association Agreement and difficulties related to the legal approximation and regulatory convergence, there are various analysis on impact of the Association Agreement on economic performance of Georgia. Several studies conducted before signing the Association Agreement envisaged DCFTA’s positive impact on economic growth in Georgia, especially in the long run (UNDP, 2007; Case/Global Insight, 2008; Ecorys/CASE, 2012). According to the abovementioned studies, Georgia will benefit from the increased trade opportunities and investment attractiveness and therefore, the AA would support economic growth in Georgia. While external aspects of the economic dimension (increased trade and investment opportunities) of the Association Agreement are positively assessed, there are studies (Messerlin, Emerson, Jandieri, and Le Vernoy, 2011; Dreyer, 2012) criticizing internal aspects of the economic dimension of the AA, because of Association Agreement and namely, DCFTA envisaged regulatory convergence and legal approximation in many areas. Therefore, according to the above-mentioned studies impact of AA/DCFTA foreseen legal approximation and regulatory convergence on the Georgia’s export promotion and investment attractiveness of the country is vague, especially in short run.

Noteworthy that according to Association Implementation Reports on Georgia, prepared by European Commission, in 2015-2018 Georgia’s efforts to implement respective AA/DCFTA commitments, had been positively assessed

(European Commission, 2016; European Commission, 2017b, European Commission, 2019).

4. Recent developments in the EU-Georgia economic Relations: trade and investments

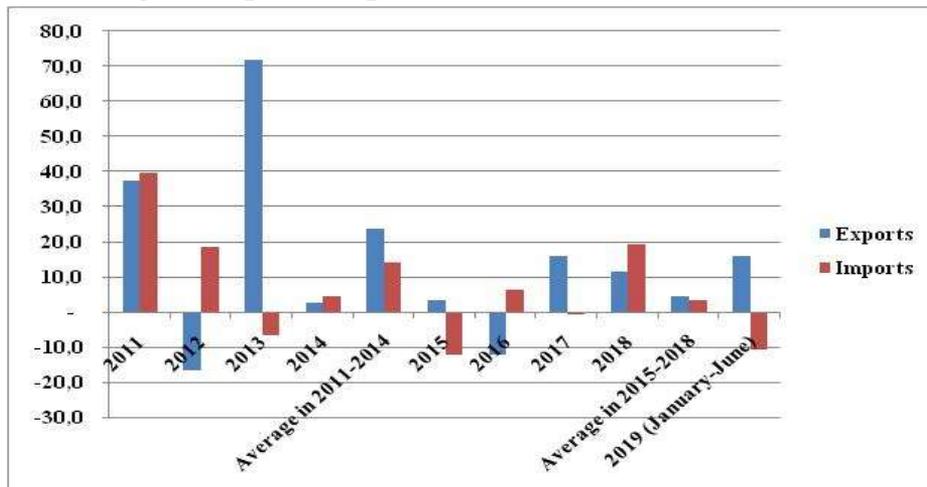
The EU-Georgia Association Agreement based on conditionality via establishing the EU compatible economic system is considered as the best mechanism available to promote exports, attract Foreign Direct Investments and advance economic development of Georgia (Eteria, 2019). Studies conducted in order to evaluate DCFTA's impacts on Georgia's trade in general and particularly on exports were positive. According to the recent study "exports are estimated to increase by 9 and 12 percent in the short and long run respectively, with imports going up by 4.4 and 7.5 percent respectively" (Ecorys/CASE, 2012, p. 37). In addition to that, the main positive aspect of the implementation of the AA (namely, legal approximation and regulatory convergence obligations) is that in long run it will support formation of compatible with the EU economic system in Georgia. An increased compatibility with the EU regulatory and legislative system "is expected to result in a more supportive and stable business environment, facilitating FDI inflows" (Adarov and Havlik, 2016, p. 24). Moreover, legally binding nature of Association Agreement also "...will increase the attractiveness of Georgia as an economic partner for foreign investors" (Kawecka-Wyrzykowska, 2015, p. 88). It is clear, that trade and investment growth rates are the most important criteria to evaluate the AA/DC FTA's effect on Georgia's economic performance, especially in the short-run.

Analysis of Georgia's trade data demonstrates that during 2011-2014, the annual average growth rate of Georgia's exports to the EU was 23,8%, while the annual average growth rate in 2015-2018 was 4,6%. Moreover, imports annual average growth rate sharply declined from 14,1% in 2011-2014 to 3,3% during 2015-2018 (Figure 1).

Despite the fact that after the enactment of AA/DCFTA Georgia has started exports of some new products (kiwi, blueberries, etc.) to the EU market (European Commission, 2018), considerable decrease of annual average growth rates of Georgia's exports to the EU in 2015-2018 as well as imports from the EU is obvious. In 2015, Georgia's exports to the EU increased by 3,3%. However, "this figure is rather favorable compared to the 23% decline in total Georgian exports worldwide. One of the reasons for such a sharp drop was the economic crisis in the

CIS region, especially Ukraine and Russia” (Emerson and Kovziridze (eds), 2018, p. 39).

Figure 1. Georgia's Exports-Imports with the EU (Growth (%)) in 2011-2019



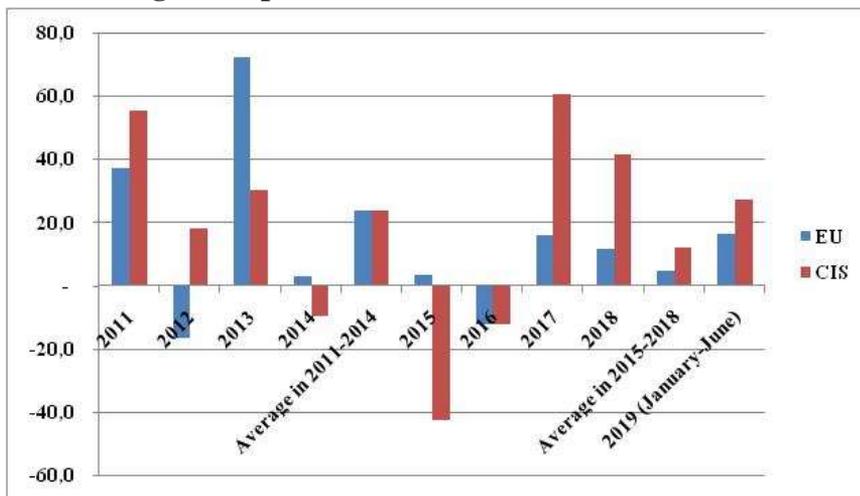
Source: Elaborated by the author based on data from National Statistics Office of Georgia. www.geostat.ge

A significant decline of Georgia’s exports to the EU was observed in 2016 because of “... the price drop for a number of commodities at world level” (European Commission, 2017a, p. 5). A considerable increase of Georgia’s exports to the EU were observed in 2017 and 2018 (15,8% and 11,4% respectively). Increasing trend of Georgia’s exports to the EU remains stable in 2019. According to the last trade data during the first half of 2019, exports growth rate compared to the same period of the previous year was 16,1%, while imports decreased by 10,8%. It should be noted that in absolute terms Georgia’s exports to the EU in 2018 compared 2014 increased by 16,9% (from 624, 2 Mil. USD to 730,3 Mil. USD), while imports from the EU in 2018 compared to 2014 increased by 10,8% (from 2371,9 Mil. USD in 2014 to 2629,1 Mil. USD in 2018).

Noteworthy, that during 2015-2018 the annual average growth rate of Georgia’s exports to the CIS countries compared to 2011-2014 also decreased (from 23,6% on average in 2011-2014 to 11,8% on average in 2015-2018). It is clear that the annual average growth rate of Georgia’s exports to the CIS still remains higher than the annual average growth rate of exports to the EU. Moreover, according to recent trade data, during the first half of 2019 Georgia’s exports growth to the CIS

countries compared to the same period of the previous year is higher (27,1%) than exports growth rate to the EU countries (16,1%). Therefore, despite AA/DCFTA with the EU, CIS countries remain as Georgia's largest trade partners (Figure 2).

Figure 2. Georgia's Exports to the EU and CIS (Growth (%)) in 2011-2019



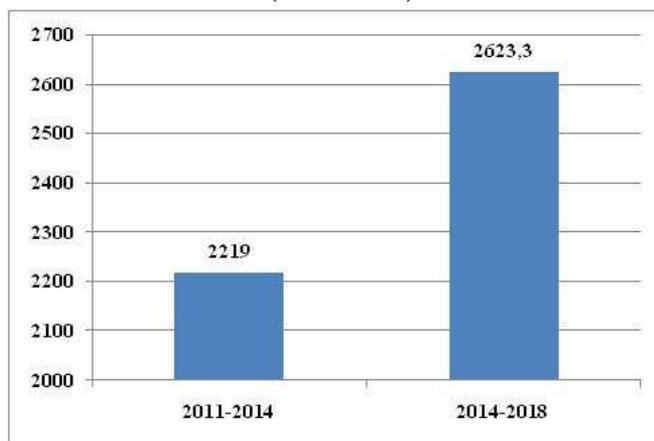
Source: Elaborated by the author based on data from National Statistics Office of Georgia. www.geostat.ge

The second factor to estimate AA/DCFTA impact on Georgia's economy is the investment attractiveness of the country, which should increase as studies predicted. It is clear, that considering the EU-Georgia AA/DCFTA there are two channels to attract more foreign investments to Georgia. First, it should support to attract investments from the EU countries based on same regulatory area. Second, it also should support attractiveness of Georgia for investments from third countries, which do not have free trade agreements with the EU and are willing to increase export to the EU market via producing goods in Georgia.

As data on Foreign Direct Investments reveals during 2011-2014 or pre-AA/DCFTA period, total investments from the EU countries to Georgia was 2 219 Mil. USD, while during 2015-2018 or post-AA/DCFTA period FDI from the EU countries to Georgia reached 2 623,3 Mil. USD. Thus, in 2015-2018 FDI from the EU compared to 2011-2014 increased by 18,2% (Figure 3).

Despite the fact that in absolute terms Foreign Direct Investments from the EU countries increased in 2015-2018 compared to 2011-2014, the annual average growth rate of FDI from the EU countries to Georgia in pre-AA/DCFTA period was much higher than it was during the post-AA/DCFTA period.

Figure 3. Foreign Direct Investments from the EU Countries in 2011-2018 (Mil. USD)



Source: Elaborated by the author based on data from National Statistics Office of Georgia. www.geostat.ge

As conducted analysis demonstrate during 2011-2014 the annual average growth rate of FDI from the EU countries to Georgia was 44,5%, while in 2015-2018 the annual average growth rate of FDI from the EU countries to Georgia significantly decreased and was just 4.1% (Figure 4).

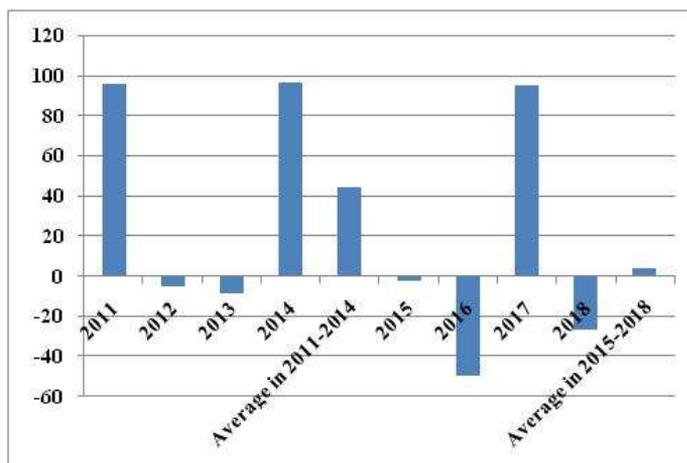
A considerable decrease of the annual average growth rate of FDI from the EU countries demonstrates that DCFTA effect on Georgia's investment attractiveness for European companies is still very low and therefore, already implemented regulatory convergence is not sufficient precondition for increasing of investment attractiveness.

Despite the fact that "Regional agreements can enhance market access by promoting approximation or compatibility of national regulations, standards or conformance assessment provisions (Woolcock, 2003, p. 27), conducted analysis of Georgia's trade and investment data reveal that AA/DCFTA impact on Georgia's trade and investment performance are not yet significant. It is clear that achieving the full compliance with the EU's rules and standards imply heavy costs, especially in the short run, for both the public and private sectors, as it was indicated in CASE/Global Insight feasibility study (2008).

Difficulties related to the exports to the EU market mostly determine redirection of Georgia's export towards markets with relatively low requirements (CIS Countries). It is clear, that Georgia needs more financial aid from the EU as

well as more investments to satisfy EU rules and standards in many economic areas, including agriculture, which is the major exporting sector.

Figure 4. Foreign Direct Investments from the EU Countries (Growth (%)) in 2011-2018



Source: Elaborated by the author based on data from National Statistics Office of Georgia. www.geostat.ge

In addition, it should be noted that the investment attractiveness of Georgia was mostly determined by the liberalized and deregulated business environment. Thus, considering scale and depths of legal approximation and regulatory convergence with the EU envisaged by AA/DCFTA, effective implementation of the Agreement could be seen as encouraging as well as discouraging factor for investment attractiveness because of increased regulations and therefore, establishing more regulated economic system in Georgia. Consequently, this could be considered as kind of “vicious circle”, which might be created by implementation of AA/DCFTA. To break-through a “vicious circle” depends on the increased investments to Georgia from the EU countries, attracted by the same legal environment as well as from other countries attracted by export opportunities to the EU market.

As a result, taking into account major outcomes of initial 5 years since enactment of AA/DCFTA, impacts of already implemented reforms (legal approximation and regulatory convergence with the EU) on Georgia’s exports to the EU and investment attractiveness of the country for foreign investors, including investors from the EU, is vague.

5. Conclusions

The EU's recent trade policy developments have profound impact on the content of economic dimension of the EU-Georgia Association Agreement. Noteworthy that initial positive results of the AA/DCFTA on Georgia's economic performance are not significant. As conducted analysis demonstrate the annual average growth rate of Georgia's exports to the EU as well as the annual average growth rate of Foreign Direct Investments from the EU countries during 2015-2018 significantly decreased compared to the pre-AA/DCFTA period. Despite this, Georgia should effectively continue reforms in all areas, envisaged by the Association Agreement. However, it should be noted, that Georgia needs a new stimulus to advance in transformation process. Therefore, the EU should increase Georgia's incentives to implement all AA/DCFTA related reforms, including proceeding efficiently in dynamic approximation of Georgia's legislation with those of the EU. In this regard to grant Georgia the EU membership perspective and/or at the initial stage advance Georgia towards membership of the European Economic Area (EEA) would be important encouragement, which at the same time will maintain public support towards the European Integration in Georgia on the high level. It is obvious that the high public support is crucial precondition for successful implementation of the European Integration related reforms.

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