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South Caucasus Trade Study

Tbilisi, Georgia
2019

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List of abbreviations

AZPROMO	Azerbaijan Export and Investment Promotion Foundation
bn	Billion
BTK	Baku-Tbilisi-Kars
CIS	Commonwealth of Independent States
CPI	Consumer price index
DCFTA	Deep and comprehensive free trade area
DCS	Developing country status
DFA	Development Foundation of Armenia
EAEU	Eurasian Economic Union
ECA	Export credit agency
EDA	Entrepreneurship Development Agency (Georgia)
EFTA	European Free Trade Association
ETI	Enabling Trade Index
EU	European Union
EWH	East-West Highway
FDI	Foreign direct investments
FEZ	Free economic zone
FIZ	Free industrial zone
FTA	Free trade area
GDP	Gross domestic product
GNI	Gross national income
GSP	Generalized System of Preferences
GUAM	Georgia, Ukraine, Azerbaijan and Moldova
HDI	Human Development Index
HS	Harmonized Commodity Description and Coding System
ILO	International Labour Organization
ISET	International School of Economics at Tbilisi State University
LDCs	Least developed countries
LPI	Logistics Performance Index
m	Million
MAPS	Mainstreaming, Acceleration and Policies Support
NCCSD	National Coordination Council for Sustainable Development (Azerbaijan)
NTM	Non-tariff measure
OBOR	One Belt-One Road
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing power parity
PTA	Preferential trade agreement
RCA	Revealed comparative advantage
ROW	Rest-of-the-World
RTA	Regional trade agreement
SDG	Sustainable development goal
SME	Small and medium enterprises
SPS	Sanitary and phytosanitary measures
TBT	Technical barriers to trade
TFA	Trade Facilitation Agreement
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TSI	Trade support institution
TVA	Total value added
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USD	US dollar
VAT	Value added tax
WB	World Bank
WEF	World Economic Forum
WTO	World Trade Organization



Executive Summary and Key Recommendations

Introduction

In September 2015, United Nations member states adopted the 2030 Agenda for Sustainable Development (the “Agenda”) and seventeen Sustainable Development Goals (SDGs). The Agenda and the SDGs propose that countries achieve sustainable development in economic, social and environmental dimensions simultaneously. **The Agenda stipulates that international trade is expected to play a role in the implementation of achieving the SDGs.** The United Nations Conference on Trade and Development (UNCTAD) has a long-standing tradition, going back at least to 1964, of recognizing international trade as a means of promoting socio-economic development:

“Economic and social progress throughout the world depends in large measure on a steady expansion of international trade. The extensive development of equitable and mutually advantageous international trade creates a good basis for the establishment of neighborly relations between States, helps to strengthen peace and an atmosphere of mutual confidence and understanding among nations, and promotes higher living standards and more rapid economic progress in all countries of the world.”¹

In order to accomplish the SDGs, in practice, trade policy formulation and implementation poses an important challenge for policy-makers. In an increasingly globalized world, it requires policy coherence at national, regional and global levels.² The objective of this report is to assist in the design of each trade and trade facilitation policies, and of institutions and projects that contribute to the achievement of the SDGs in the South Caucasus.

As part of a broad development strategy to increase growth, reduce poverty and achieve the SDGs within small, open economies, Armenia, Azerbaijan, and Georgia need to develop and expand exports and further integrate into the world economy. This report (produced during February 2017 – May 2018) discusses how trade policy and trade facilitation can be used to expand exports in Armenia, Azerbaijan and Georgia, thereby contributing to faster growth and poverty reduction. This work evaluates the situation and offers recommendations on the trade policies of the three countries. It also assesses trade policy broadly to include not only tariffs, but also non-tariff barriers, standards and regulations, as they impact trade and trade support institutions; and it further assesses multilateral, unilateral and regional trade policies. Under trade facilitation, we assess policies that facilitate or hinder the flow of goods across borders, as well as addressing the region’s substantial infrastructural requirements for international trade. Considering the dynamic nature of barriers to trade, as well as the often-difficult task of distinguishing between legitimate regulatory functions and non-tariff barriers, this study proposes an institutional mechanism that is able to address the most pressing blocks facing exporters and importers. Furthermore, this report also evaluates the issues and provides recommen-

¹ UNCTAD. (1964). *Final Act and Report, Proceedings of the United Nations Conference on Trade and Development*. 23 March - 16 June 1964.

² The preceding text draws on UNCTAD. (2016). *Trading Into Sustainable Development: Trade, Market Access and the Sustainable Development Goals*. Available from: http://unctad.org/en/PublicationsLibrary/ditctab2015d3_en.pdf

dations pertaining to the two sectors that are vital to earnings from exports throughout the region, and which have been prioritized by the authorities in each of the three countries: agriculture and tourism.

Trade policies that are global in perspective alongside the lowering of trade costs are critical for the South Caucasus. Certain economies, since 1980, with significantly increased growth and a reduction in poverty have used exports and trade to attain their successes. These include the “development miracle” countries of Singapore, South Korea, Hong Kong and Taiwan (China), as well as Mauritius and Chile.³ Their experiences indicate that the countries of the South Caucasus should consider trade strategies that are global in scope and which work to reduce trade costs. Trade and transport links are also seen as appropriate growth engines for the region, however crucial gains are to be generated externally. Therefore, it is important to keep trade barriers low to capture these gains and to lower trade costs by improving facilitation.

Trade Policies

World Trade Organization (WTO) membership

A key recommendation of this report towards the trade policy of Azerbaijan is to actively pursue a WTO accession. Armenia and Georgia are members of the WTO, while Azerbaijan has yet to achieve membership. WTO membership is a crucial step for any country committed to integration within the global trading environment. Membership crucially allows a country to utilize international trade to help develop according to the principles of comparative advantage – both for goods and, with the formation of the General Agreement on Trade and Services, for services as well. WTO accession typically affects a broad range of national policies, *inter alia* concerning customs, intellectual property, trade-related investment measures, foreign direct investment rights in services, rights in antidumping and countervailing cases, subsidies, and agricultural support. The WTO accession process also provides access to the representatives of trading partner countries, who negotiate for healthier contact within the markets of the acceding country, which consequently helps to offset domestic protectionist lobbies. As a result of such negotiations, acceding countries typically benefit from a more open trade regime than they might have attained were only domestic lobbies present. Of the fifteen countries of the former Soviet Union, only Azerbaijan, Belarus, Turkmenistan and Uzbekistan remain outside of the WTO. **Experience has shown, however, that substantial technical assistance is useful, if not required, in the implementation of all the necessary legal, policy and technical measures required for a WTO accession.**

Tariff protection

Tariff protection is relatively low in the region, with the highest average tariff, at 9%, in Azerbaijan and the lowest, 1.5%, in Georgia. Armenia’s tariff protection has been growing since 2015 as a result of its accession to the Eurasian Economic Union (EAEU). Although Armenia’s tariffs remain moderate, EAEU membership has resulted in its applied tariffs exceeding its WTO commitments in selected tariff lines; Armenia has therefore had to negotiate with its WTO trade partners on acceptable compensation.

Non-tariff barriers

As is typical with most countries, none of the region’s three countries applies “core” non-tariff barriers, such as quotas or restrictive licensing requirements, except where permitted by the WTO on products that affect

³ Research on the impact of regional trade agreements on the growth of developing countries is vast and ambiguous. An overview of the subject is provided by Schiff & Winters (2003). While, for example, Venables (1999) finds that developing countries benefit more from regional trade agreements with industrialized countries. He reveals that agreements among developing countries tend to lead to a divergence of per capita incomes, while agreements between developed and developing countries lead to a convergence of per capita incomes. Furthermore, Liu (2016) shows that regional trade agreements increase growth for countries that are not WTO members, but have little or no impact on the growth of WTO member countries. See: Schiff, M. & Winters, L.A. (2003). *Regional Integration and Development*. Oxford: Oxford University Press. Available from: <http://siteresources.worldbank.org/BRAZILINPOREXTN/Resources/3817166-1185895645304/4044168-1186324101142/12RegionallIntegrationFull.pdf>; Venables, A. (1999). *A Force for Convergence or Divergence*. World Bank Policy and Research Working Paper. Available from: <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-2260>; Liu, X. (2016). *Trade Agreements and Economic Growth*. Southern Economic Journal, Vol. 82 (4), 1374-1401.

health or safety. In the case of Azerbaijan, the experts surveyed for this research highlighted the continually significant role of the state on the economy, including on foreign trade.

Standards and technical regulations

The principle concerns regarding non-tariff barriers to trade in the region lie in the three different national systems of standards and technical regulations employed within Armenia, Azerbaijan and Georgia. Production, to a given standard, requires costly investments, thus if the three countries maintain different standards, it ensures intra-regional trade will be more problematic.

Georgia- Under its Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union, Georgia has agreed to adapt to the EU system of product standards and regulations concerning food safety, as well as (other) industrial goods. This could be worrisome for Georgia's trade with its neighbors, and for some domestic producers. Crucially, once it adapts to the EU system for a given product, Georgia will be obliged to deny entry to those imports that fail to meet the EU standards and regulations. Thereby, the system will reduce market access to Armenian and Azerbaijani exporters, alongside other countries. EU standards are designed for countries wealthier than those of the South Caucasus, and prior experience from the Baltic states (which joined the EU in 2004) shows that rapid conversion to the regulations can be extremely costly for the agricultural and food processing sectors. **This report recommends, based on these experiences, that Georgia adopt a gradual approach in converging with EU standards and technical regulations, with the speed of adjustment evaluated on a case-by-case basis.**

Armenia- Like the European Union, the EAEU intends to determine policies for product standards and technical regulations. With its membership, Armenia has embarked on the process of convergence with EAEU product standards and technical regulations. EAEU member countries primarily use the Soviet-style GOST system for food and agricultural products, although the EAEU has the long run objective of meeting EU product standards and technical regulations. Considering that the EAEU has principally employed harmonization (adoption of a common technical regulation among member states) as opposed to mutual recognition (acceptance of differing standards among the member states, provided that all health and safety concerns are met), standards and technical regulation convergence within the EAEU has been slow. Since harmonized regulations within the EAEU are negotiated among the member countries, the resulting regulations can be different from accepted science-based international regulations. Therefore, for many years to come, Armenia could have standards that are compatible neither with the old Soviet-style nor the European Union standards.

Azerbaijan- The Soviet-style GOST system is primarily utilized in Azerbaijan, which, regarding health and safety, has performed adequately. As a member of the Central Asia Regional Economic Cooperation program (CAREC), and a signatory of the CAREC Trade Policy Strategic Action Plan for 2013-2017, Azerbaijan has recognized that the excessive mandatory nature of the GOST system is costly and hinders economic development and trade.⁴ Azerbaijan has been gradually reforming the system into the framework of its WTO accession negotiations, though the process is far from complete. If Azerbaijan retains the GOST system, while Georgia, the Russian Federation and the EAEU evolve away, Azerbaijani exporters could experience greater difficulties in accessing markets in the South Caucasus, as well as from outside of the region. **Therefore, this report proposes that Azerbaijan should consider moving toward an EU-compatible (or other internationally accepted) system of standards and technical regulations. Although the advisable change of direction is clear, as in the case of Georgia, the speed of adjustment should be evaluated on a case-by-case basis.**

⁴ CAREC Trade Policy Strategic Action Plan for 2013-2017, which was unanimously adopted by the CAREC Ministers on 23 October 2013. Available from: <https://www.carecprogram.org/uploads/Trade-Policy-Strategic-Action-Plan-2013%E2%80%932017.pdf>. Furthermore, international experts view the GOST system as a violation of the WTO SPS and TBT agreements. See: Asian Development Bank. (2013, p.11). *Modernizing Sanitary and Phytosanitary Measures to Facilitate Trade in Agricultural and Food Products: Report on the Development of an SPS Plan for the CAREC Countries*. Manila: Asian Development Bank. Available from: <http://www.adb.org/publications/modernizing-sps-measures-facilitate-trade-agricultural-and-food-products>.

Regional Trade Agreements (RTAs)

Bilateral and plurilateral Free Trade Agreements (FTAs) are in place among the present and former members of the Commonwealth of Independent States (CIS), which generally ensures that trade among the applicable countries is duty-free. These include, in particular, the CIS free trade agreements of 1994 (affecting Georgia, Azerbaijan, Turkmenistan and Uzbekistan) and 2012 (for the eight other original CIS members), with non-overlapping membership. The positive impact of these FTAs is supported by the CIS Rules of Origin Treaty, which allows full cumulation for the purposes of determining whether products achieve their rules of origin requirements (in order to qualify for preferential tariff treatment).

RTAs could have a mixed impact on the region. While intra-regional trade at present only constitutes about four percent of the total trade in the South Caucasus, these flows could be negatively affected by further divergence in trade standards. However, if this problem can be overcome, Armenia's membership in the EAEU creates opportunities for countries in the region to use Armenia's customs clearance and product certification services to access the EAEU market. The EU-Georgia DCFTA could also stimulate export-platform foreign direct investment (FDI) into Georgia as has already occurred with hazelnuts (see below). Nevertheless, the development of regional value chains using local products as inputs for exports to the EU, especially in agriculture, will be constrained by the EU rules of origin, which do not allow for cumulation among these countries.

The proposed Free Economic Zone (FEZ) in the Syunik region of Armenia

The prospects for the proposed free economic zone (FEZ) in Armenia's Syunik region are questionable. The FEZ appears to be primarily governmentally driven with little commitment from the private sector. International experience with export processing zones shows that active private sector engagement is critical for success. Moreover, the proposed FTA, being negotiated between the EAEU and Iran, appears to be limited in scope; and the completion date of Armenia's North-South Road Corridor remains uncertain. While the expansion of trade with Iran would be beneficial for Armenia, the logic of doing so through the construction of a FEZ in the Syunik area has yet to be fully elaborated.

Trade support institutions

While support institutions' role in promoting exports and attracting investors can be positive, their performance in the South Caucasus could certainly be improved. All three countries have established export promotion agencies, nonetheless it would prove helpful if **they would focus on a greater connection with domestic businesses, especially by providing further information online regarding market opportunities** and the costs of exportation, as well as expanding their training activities. The establishment of a regular joint forum to discuss cross-border trade opportunities could also contribute to trade expansion.

Trade Facilitation

Moving goods across borders remains quite costly throughout the region. In our survey of Georgian businesses, respondents identified the expansion of logistics services and reductions in transport costs as vital tasks for trade facilitation. Our interviews with Armenian and Azerbaijan businesses also confirmed that the costs of border crossings remain high, and there remains potential for improvement. Out of 190 countries, the South Caucasus had moderate rankings in the "Trading Across Borders" category of the World Bank's Doing Business Survey in 2018: where Armenia is 52nd, Georgia is 62nd, and Azerbaijan 83rd. Whereas, in the Logistics Performance Index (LPI), the countries did not fare as well: out of 160 countries, Azerbaijan is 125th, Georgia 130th, and Armenia 141st.

Trade facilitation policies

A variety of policies could be implemented, although most require expenditure, to reduce the costs of trading across borders in general and delays at border crossings in particular. Further development of automated customs procedures, information exchange and other policy measures, in line with the WTO Trade Facilitation

Agreement (WTO TFA), are additionally important. Armenia and Georgia have taken excellent steps by signing the WTO TFA and by submitting their schedules of commitments for WTO TFA implementation. They have also indicated the spheres in which technical support is required. **This report recommends that Armenia and Georgia continue to pursue the implementation of commitments under the WTO Trade Facilitation Agreement, including seeking technical assistance for feasibility studies.**

In Azerbaijan, international assessments and local respondents note the high costs and cumbersome procedures for moving goods across the border, despite having the best internal transit infrastructure in the region. Donor assistance in this area (should it be requested) could be particularly helpful.

At the regional level, the countries of the South Caucasus do not have either joint (bilateral) cargo tracing systems or harmonized cargo procedures in place. This, at times, slows transit and increases the related costs. To reduce bottlenecks at regional border crossings, it is possible to explore the establishment of joint customs clearance- a single customs clearance at a border crossing, operated by both countries- to facilitate the movement of goods. Once again, donor assistance could be warranted for policies and projects where border crossings are slow.

Trade facilitation infrastructure projects

The ongoing expansion of transportation corridors will help facilitate trade. The region is experiencing an active expansion of transport infrastructure projects, including the North-South Road Corridor in Armenia; the Baku-Tbilisi-Kars Railway in Azerbaijan and Georgia; the North-South Railway Corridor in Azerbaijan; the East-West Highway in Georgia; as well as the expansion of port facilities on the Caspian (Alat, Azerbaijan) and Black (Anaklia, Georgia) Seas. The new infrastructure should help facilitate trade both within the region and beyond. Most notably, improved intra-regional connectivity, through these infrastructural developments, increases the region's attractiveness for both tourists and commercial cargo. It should furthermore allow the region to connect efficiently with one of the planned routes of the Chinese government's "One Belt-One Road" (OBOR) initiative.

Armenia faces the most severe transport bottlenecks in the region. As it is a landlocked country with open borders with only Georgia and Iran, Armenia's access to the rest of the world is severely constrained. While road access to Russia, its major market, is currently only available through one border crossing (Larsi), which can be jeopardized by poor weather conditions.

Support for infrastructural development, in particular, logistics infrastructure, could address another important bottleneck in the region. Survey respondents in Georgia highlighted the lack of transportation and logistics capacity, and the low quality of logistics services as significant problems. Alongside the major projects to develop land transport corridors and port infrastructure, smaller-scale regional projects to develop inter-modal terminals for handling cargo, expand warehouses, and improve cargo tracing systems are also required. Attention should likewise be paid to the development of passenger transport services, to stimulate tourism. In all infrastructural projects, there is a primary role to be played by international financial institutions, namely the World Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the European Investment Bank. **This report therefore recommends the continued expansion of transportation corridors and the development of logistics capacity, often via smaller-scale regional projects. Many of these projects, however, would still require feasibility and cost-benefit studies.**

Sectoral Issues, including Agriculture and Tourism

Agriculture

Agriculture has been designated as a priority sector in all three countries. It is typically characterized by small holdings, low productivity, and foregone export opportunities. In Georgia, 51% of the labor force is engaged in agriculture, but only 9% of value-added originates from agriculture. In Armenia and Azerbaijan, the shares of the labor force engaged in agriculture are 35% and 36%, respectively, with only 6% of value-added derived from agriculture in Azerbaijan.

The lack of “aggregators” for most agricultural products appears to be an important constraint on its exports and on broader agricultural development. Most foreign buyers do not want to purchase from hundreds of small farms or manage such challenges as quality control, certification, storage, and packaging. Furthermore, small farmers are typically unable to perform many of these functions, even if foreign buyers were willing to buy their appropriate quality products. Many agricultural markets in the South Caucasus lack intermediary firms that perform these essential services (alongside marketing) offered between the multiple small-scale producers and foreign buyers.⁵

Hazelnut production in Georgia has been an important success story, where aggregators were present. Hazelnuts are now Georgia’s most significant agricultural export. The sector’s strong growth has been fueled by export-oriented foreign direct investment, firstly by Ferrero SpA (the maker of Nutella, which buys 25% of hazelnuts globally), and more recently by the Olam Group (which purchased Georgia’s largest processing plant in Zugdidi). Importantly, the sector has active intermediate divisions that complete the drying, storing, deshelling, calibration, processing, and sometimes even the marketing. In an interesting development, the Darcheli Hazelnut Cooperative (of around 600 farms) has received EU donor and Georgian governmental support, to help determine whether a large farming cooperative can efficiently substitute for independent private firms that might otherwise perform these functions. Significantly, support of the sector has not taken the form of financial subsidies, rather it has come as a wide range of services designed to increase productivity (for instance, concerning disease and pest control, plant and seedling instruction, soil preparation, harvesting methods, and post-harvesting techniques). These are known as “green box” services by the WTO, where governmental support is unconstrained by WTO regulations. This reflects the broad research findings that agricultural extension services need to increase productivity to become substantially more beneficial to the income of farming, as opposed to direct financial support for output or export.

In Armenia, the Spayka freight forwarding company appears to perform many aggregator functions. Spayka offers agricultural producers such services as storage, calibration, and packaging, as well as exporting goods to Russia. In general, intermediary firms or cooperatives appear to be able to help small farmers go beyond small-scale local production, possibly increasing the quality of their products and subsequently their incomes. This appears to have motivated, in November 2017, the Ministry of Agriculture of Armenia to start the “Armenia Prod.” This state-run company is designed to assume many aggregator functions, including marketing and quality control. Although only newly formed, it hopes to export under the Armenia Prod brand name, trading in “dairy products, meat products, dried fruits and other spheres which have sufficient capacity to enter the foreign market.”⁶

In Azerbaijan, “ABAD” and the Food Products Procurement and Supply Company focus on integrating agricultural smallholders into their relevant value chains. In particular, “ABAD” provides selected rural house-

⁵ World Bank. (2006). *Azerbaijan: Agricultural Markets Study: Realizing Azerbaijan’s Comparative Advantages in Agriculture*. Available from: <http://documents.worldbank.org/curated/en/198631468207847565/pdf/362830AZ.pdf>

⁶ Available from: <https://www.panorama.am/am/news/2017/11/03/%D4%B1%D6%80%D5%B4%D5%A5%D5%B6%D5%AB%D5%A1-%D5%BA%D6%80%D5%B8%D5%A4/1860538>

holds with modern equipment, training on such topics as financial literacy, food security, the use of equipment, and food processing technologies, as well as with services related to quality assurance and food safety, packaging, logistics, and branding.

With these features in mind, this report recommends encouraging the expansion of aggregators in agricultural markets (where warranted) as potential “game changers” to export and rural development.

Tourism services

Trade in services has been growing steadily, dominated by tourism and transportation. Approximately 60% of the value of service exports in Armenia, Azerbaijan and Georgia come from the travel and tourism sector.

Tourism is designated as a priority sector in all three countries. Throughout the region, tourism has actively and successfully been promoted. When questioned about expanding intra-regional tourism (i.e., involving visits to more than one country in the South Caucasus), the survey respondents expressed various ideas for bilateral and regional tourist routes, such as agro-tourism, gastro-tourism, wine tourism, and cultural heritage tourism, as with the German settlements. The promotion of regional tourism would be assisted by: (a) better transport connectivity; (b) appropriate visa and border crossing conditions in all three countries; (c) touristic products revealing the region’s diversity; and (d) mediation by international brokers to assist with regional coordination.

This study endorses the development of regional “special road stations” network, offering unique local products, which would support regional traditional specializations, preserve cultural heritage, offer local employment and provide tourist attractions. The idea is based on the experience of Eco-Bazaars in Azerbaijan and the Japanese Michi-no-Eki road station models, which provide local tourist, cultural and entertainment information, in addition to locally produced and branded foods, arts and crafts.

Supply Chain Councils

New approaches need to be considered to reduce trade costs. **This report recommends the creation of “supply chain councils” organized around the major export sectors of the South Caucasus**, either nationally or bilaterally. Supply chain councils are public-private partnerships that include the active engagement of the business community, as well as policy officials and regulators. They are required to reduce uncertainty for producers by facilitating trade and cross-border investment flows. National supply chain councils can focus on important “backbone” services, such as communications, finance and transport, as well as non-tariff barriers. They can also play important roles in addressing policy barriers that inhibit greater integration with regional trading partners: most notably, to include business representatives and regulators from trading partners to focus policy attention on lowering trade costs, due to the differences in regulations and standards, and customs and border issues; resolve uncertainties regarding the treatment of products, services and businesses; and to reduce impediments to supply chain investments.

The councils would have a mandate to identify vital causes behind supply chain inefficiencies, and act to resolve them. They could also help determine priority areas for intergovernmental negotiations on these matters. Businesspeople between countries have on-the-ground knowledge relating to the most significant problems and are likely to have many common interests in lowering trade costs. Thus recommendations for regulatory reform of these councils can be implemented by governments, with the knowledge that they have support from business on all sides.

1. Introduction

In September 2015, United Nations member states adopted the 2030 Agenda for Sustainable Development (the “Agenda”) and seventeen Sustainable Development Goals (SDGs). The Agenda and the SDGs advocate that countries achieve sustainable development in economic, social and environmental dimensions simultaneously. The Agenda stipulates that international trade is expected to play a role in achieving the SDGs implementation. Trade indicators are explicitly included in Target 17: “Strengthen the means of implementation and revitalize the global partnership for sustainable development.” In particular:

- ▶ Target 17.10: Promote a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the World Trade Organization (WTO) including through the conclusion of negotiations within its Doha Development Agenda;
- ▶ Target 17.11: Significantly increase the exports of developing countries, in particular with a view to doubling the least developed countries’ (LDCs) share of global exports by 2020.⁷

Moreover, trade policies contribute to the achievement of other SDGs, related to food security, health, employment and sustainable work, including:

- ▶ Target 2.b: Correct and prevent trade restrictions and distortions in world agricultural markets, including through the parallel elimination of all forms of agricultural export subsidies and all export measures with equivalent effect, in accordance with the mandate of the Doha Development Round;
- ▶ Target 3.b: [...] provide access to affordable essential medicines and vaccines, in accordance with the Doha Declaration on the TRIPS Agreement and Public Health, which affirms the rights of developing countries to use to the full provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights regarding flexibilities to protect public health and, in particular, provides access to medicines for all;
- ▶ Target 8.a: Increase Aid For Trade support for developing countries, particularly LDCs, including through the Enhanced Integrated Framework for LDCs;
- ▶ Target 10.a: Implement the principle of special and differential treatment (SDT) for developing countries, in particular LDCs, in accordance with WTO agreements;
- ▶ Target 15.c: Enhance global support for efforts to combat the poaching and trafficking of protected species, including by increasing the capacity of local communities to pursue sustainable livelihood opportunities.

The United Nations Conference on Trade and Development (UNCTAD) has a long-standing tradition, going back at least to 1964, of recognizing international trade as a means of promoting socioeconomic development:

“Economic and social progress throughout the world depends in large measure on a steady expansion of international trade. The extensive development of equitable and mutually advantageous international trade creates a good basis for the establishment of neighborly relations between States, helps to strengthen peace and an atmosphere of mutual confidence and understanding among nations, and promotes higher living standards and more rapid economic progress in all countries of the world.”⁸

⁷ UNCTAD. (2016). *Trading Into Sustainable Development: Trade, Market Access, and the Sustainable Development Goals. Developing countries in international trade studies*. United Nations Publication. Available from: https://unctad.org/en/PublicationsLibrary/ditctab2015d3_en.pdf.

⁸ UNCTAD. (1964). *Final Act and Report, Proceeding of the United Nations Conference on Trade and Development*, 23 March - 16 June, 1964.

It remains a practical challenge for policy-makers to formulate trade policies in a manner that leads to the attainment of the SDGs. In an increasingly globalized world, coherence of policies at the national, regional and global level is required.⁹ The objective of this report is to assist in the design of each of those trade and trade facilitation policies, and of institutions and projects that contribute to the achievement of the SDGs throughout the South Caucasus.

The South Caucasus, comprised of Armenia, Azerbaijan and Georgia, is a small but strategically important region at the crossroads of Europe and Asia. The region's economies are deeply integrated in global markets through trade, capital and personal mobility, however they have weaker intra-regional economic ties and are split into two pairs: Armenia-Georgia and Azerbaijan-Georgia. Regrettably, the relations between Armenia and Azerbaijan have remained frozen, amid the unresolved conflict around Nagorno-Karabakh. However, the budding integration of transport and energy infrastructure, and very intensive personal mobility, are all factors pushing the countries of the region closer together, despite weak intra-regional trade flows. Furthermore, the region shares the same sustainable development challenges, including poverty, a lack of decent jobs, and environmental problems.

There is a question of how the integration of the countries of the South Caucasus into international markets, and the strengthening of bilateral relations of Armenia and Azerbaijan with Georgia, can contribute to their sustainable development, and ultimately help to stimulate inclusive growth, overcome poverty and protect the environment. In other words, how can the trade policies of Armenia, Azerbaijan and Georgia help achieve the SDGs, and thereby contribute to the global success of the Agenda?

When considering how trade policies can be designed to help achieve rapid income growth, it is useful to consider concrete experiences.¹⁰ In particular, we refer to the experience of six countries and territories which have proliferated over time- the four so-called East Asian tigers: Singapore, Hong Kong (China), South Korea, Taiwan (China), alongside Chile and Mauritius, which have each grown rapidly over the past 30 years. Despite the considerable diversity in policies and institutions among the six, certain important common features have spurred their development. Firstly, global trade strategies were pursued so that growth was fueled by export. They each achieved a significant expansion of exports equally through policies and institutions. Regarding policies, their trade and regulatory regimes all provided exporters with incentives that were no less than those for domestic market sales. Secondly, they each developed supportive business and investment climates. From the former Soviet Union, the Baltic countries are a good example of export-driven growth, facilitated by the establishment of a favorable business and investment climate.

This report will analyze trade policies in the South Caucasus and identify opportunities for practical trade-related projects, which could become vehicles to stimulate inclusive growth and reduce poverty in the region.¹¹ This research suggests that it would be best to focus on how the South Caucasus can use integration into the global economy and strengthen its intra-regional bilateral cooperation to achieve its sustainable development and growth objectives.

⁹ The preceding text of this chapter draws on: UNCTAD. (2016). *Trading into Sustainable Development: Trade, Market Access and the Sustainable Development Goals*. United Nations Publication. Available from: http://unctad.org/en/PublicationsLibrary/ditctab2015d3_en.pdf

¹⁰ Hoekman, B., Jensen, J. & Tarr, D. (2013). *A Vision for Ukraine in the World Economy. Defining a Trade Policy Strategy that Leverages Global Opportunities*. Available from: <https://yes-ukraine.org/files/Documents/UkraineTradeVision.pdf>

¹¹ There is growing literature regarding the links between trade policies and poverty reduction. See, for example: Dollar, D. & Kraay, A. (2001). *Trade Growth and Poverty*. Finance and Development, September, Vol. 38, Number 3; Winters, L.A., McCulloch, N. & McKay, A. (2004). *Trade Liberalization and Poverty: The Evidence So Far*. Journal of Economic Literature, 42 (1): 72-115; Hoekman, B., Michalopoulos, C., Schiff, M. & Tarr, D. (2001). *Trade Policy Reform and Poverty Alleviation*. Policy Research Working Paper; No. 2733. World Bank, Washington, DC.

The methodological tools of the study include a desk research and literature review, data analysis, in-depth interviews (the list of organizations and surveyed representatives can be found in Annex 7), a business survey,¹² and case studies. We have used multiple international statistical data sources, including the World Bank, the Asian Development Bank, the World Trade Organization, various organizations of the UN, and data provided by national statistics offices. Whenever possible, we have used data from one source to ensure its cross-country compatibility. The official statistics have been complemented with various indexes, in particular, the Human Development Index, the Logistics Performance Index, and the Enabling Trade Index, as well as with personal interviews. While, all findings were developed using applied international economic theory. The remainder of the report is structured as follows. Section 2 provides an overview of the region's social and macroeconomic climate, with a focus on the countries' commitments to the implementation of the Agenda and the achievement of the SDGs. Section 3 is devoted to the economic links of the South Caucasus to the rest of the world, including the trade in goods and services, foreign direct investments and personal mobility. While special attention is paid to the comparative advantages revealed by the South Caucasus trade in goods, including recent changes to their competitiveness. Section 4 considers the trade policies of the three countries, including relations with the WTO and preferential trade agreements. Section 5 is focused on the general trade facilitation framework, as well as the status and efficiency of trade support institutions in the region, while Section 6 reviews transport and energy infrastructure, specifically, internal and external linkages within the region and the development of transport corridors. In Section 7 the "emerging game changers" are analyzed, including the potential impact of newly signed regional agreements with the EU and the EAEU, China's "One Belt-One Road" initiative, and the development of free economic zones. Section 8 is devoted to two case studies, in the sectors of agriculture and tourism that play an essential role in the region's sustainable development. The study's recommendations developed after each section contribute to Section 9: including the overarching conclusions and suggestions regarding potential feasibility studies.

¹² The business opinion survey was successfully completed in Georgia. However, in Armenia, the number of responses was regrettably insufficient to make sufficient conclusions, while the survey was not conducted in Azerbaijan.

2. The Economic and Social Profile of the Region

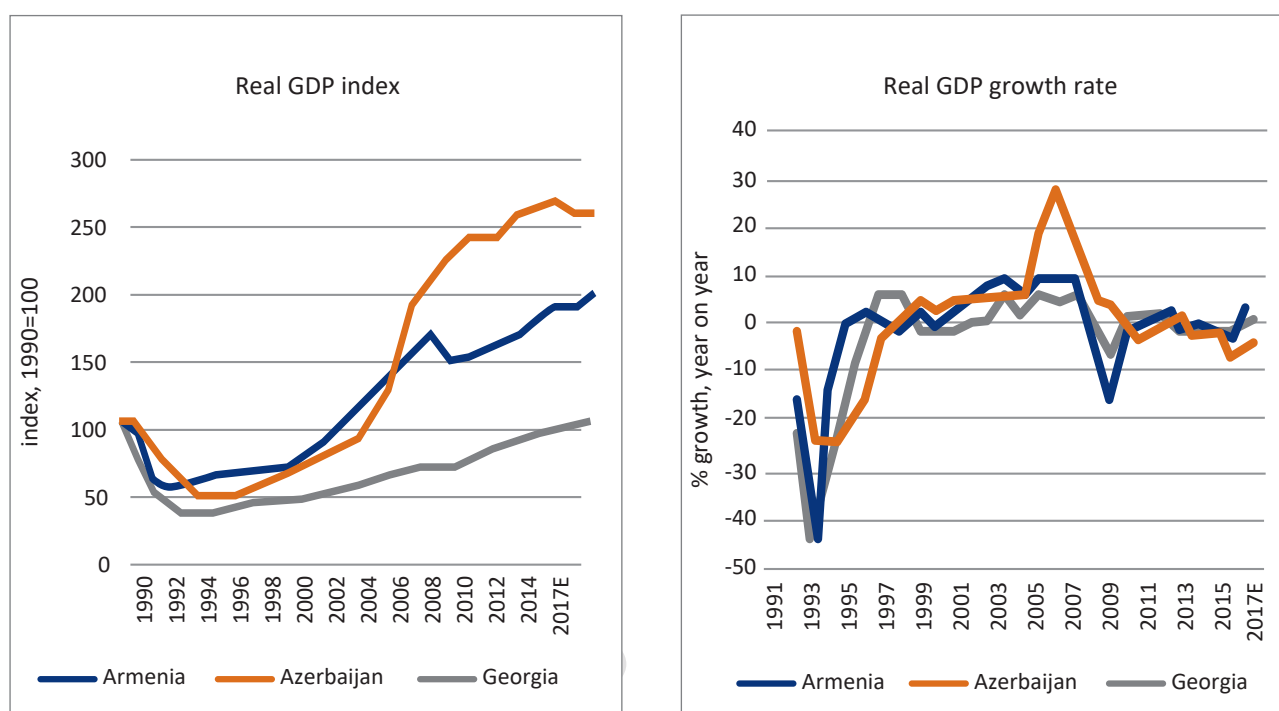
The economic profile of the region

The South Caucasus is a mountainous region comprised of three small countries: Armenia, Azerbaijan, and Georgia. Located at the crossroads of Europe and Asia, the region plays a strategic role in energy and transportation routes. However, the economic potential of the area remains modest.

Out of the three, Azerbaijan is the largest, accounting for 59% of the region's population, 47% of its territory, and around 70% of the aggregated GDP in current USD value (the 2012-2016 average). Azerbaijan's average GNI per capita (PPP), between 2012-2016, was 16,394 USD, almost twice that of the other two countries (Table 21). In 2017, Azerbaijan and Armenia belonged to the upper-middle-income economies category, according to the World Bank country classification,¹³ while Georgia belonged the lower-middle-income category.

After the initial economic shock of the dissolution of the Soviet Union, and the violent conflicts experienced by all three countries, the economies of Armenia, Azerbaijan and Georgia started to grow by the mid-1990s, although at different paces. Fueled by extensive oil and gas reserves and the successful attraction of foreign investments in the sector, Azerbaijan's economic development has been the strongest in the region (Figure 21).

Figure 2-1: Real GDP, 1990-2017



Sources: WB World Development Indicators (with an estimate for 2017), the National Statistical Service of Armenia, the State Statistical Committee of Azerbaijan, and the National Statistics Office of Georgia.

¹³ See: <https://data.worldbank.org/indicator/NY.GNP.PCAP.CD?locations=XM-XD-XT-XN>

Table 2-1: Economic snapshot of the region, 1990-2016

	Armenia					Azerbaijan					Georgia				
	1990	2000	2010	2016	average 2012 -2016	1990	2000	2010	2016	average 2012 -2016	1990	2000	2010	2016	average 2012 -2016
Population (total m)	3.5	3.1	2.9	2.9	2.9	7.2	8.1	9.1	9.8	9.5	4.8	4.4	3.9	3.7	3.8
Population growth (% per annum)	0.0	-0.6	-0.4	0.3	0.3	0.4	0.8	1.2	1.2	1.0	0.0	-0.8	-1.3	0.1	-0.6
Rural population (% of total)	32.6	35.3	36.4	37.4	37.2	46.3	48.6	46.6	45.1	45.6	45.0	47.4	47.1	46.2	46.5
Life expectancy at birth, total (years)	68.0	71.0	73.0	74.0	74.0	65.0	67.0	71.0	72.0	71.7	70.0	72.0	72.0	73.0	72.8
Surface area (thous. sq. km)	29.7	29.7	29.7	29.7	29.7	86.6	86.6	86.6	86.6	86.6	69.7	69.7	69.7	69.7	69.7
GDP (current bn USD)	2.3	1.9	9.3	10.6	10.9	8.9	5.3	52.9	37.9	62.0	7.8	3.1	11.6	14.4	15.4
GNI per capita, PPP (current international \$)	2,330	2,380	6,890	9,020	8,676	3,360	3,340	14,690	16,130	16,394	5,170	2,690	6,390	9,510	8,872
Agriculture, value-added (% of GDP)	17	26	19	18	20	29	17	6	6	6	32	22	8	9	9
Industry, value-added (% of GDP)	52	39	37	27	29	33	45	64	52	57	33	22	22	25	24
Services, etc., value-added (% of GDP)	31	35	44	55	51	38	38	30	42	37	35	56	69	66	67
Gross capital formation (% of GDP)	47	19	33	18	22	27	21	18	25	25	31	27	22	33	30

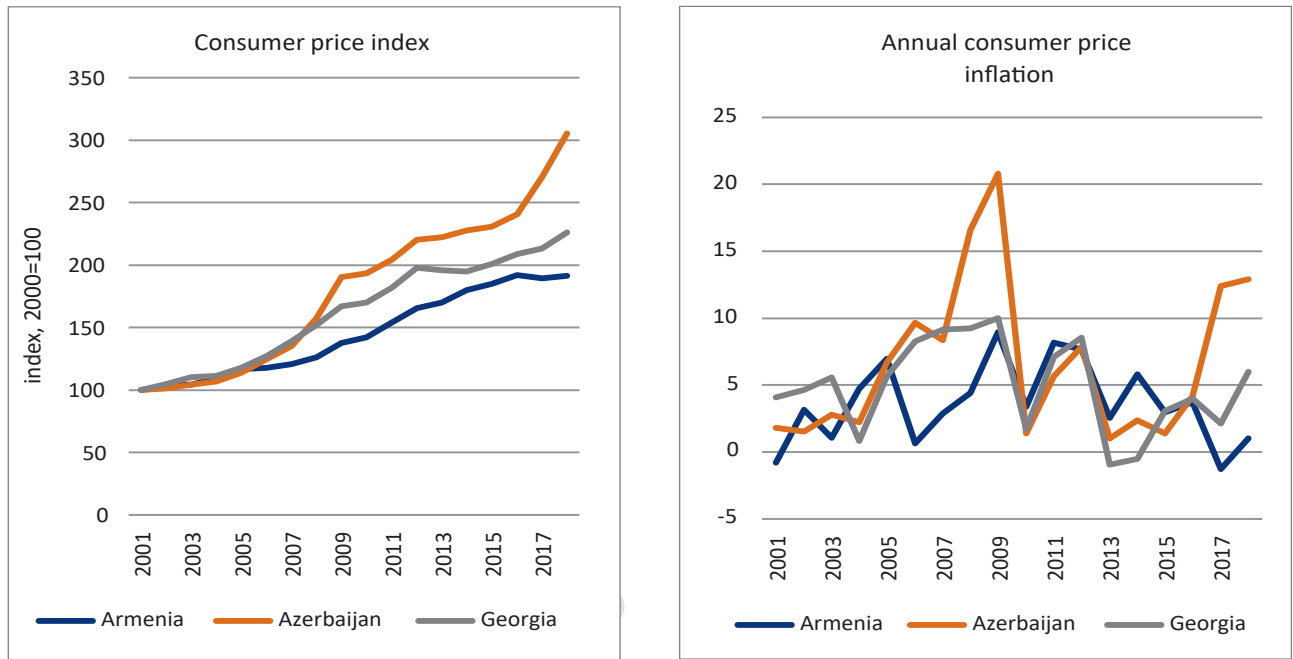
Source: WB Development Indicators as of March 2018.

In 2017, economic development accelerated in the South Caucasus. Armenia demonstrated the fastest growth, with a real GDP increase of 7.5% annually, amid a strong expansion of industrial production and improved external conditions, particularly, better economic conditions in Russia. Georgia's real GDP also accelerated by 5%, due to a boost in net exports and domestic demand. While, Azerbaijan's economy stabilized after the decline of 2016, where its real GDP was 0.1% above the previous year. In 2018, the global economic situation remained favorable for continued economic growth within the South Caucasus.

Consumer price inflation accelerated in all three countries in 2017, although it still remained relatively moderate (Figure 22). Azerbaijan faced the fastest growth of consumer prices, with an increase of 12.9% per annum, driven by multiple factors, including the depreciation of the manat against the euro, increased fuel prices, and new wage regulations.¹⁴ Georgia's consumer price index (CPI) rose by 6%, reflecting an increase in excise taxes designed to compensate for changes in corporate profit taxation, while in Armenia, CPI grew by a healthy 1% due to deflation the previous year.

¹⁴ See: http://cesd.az/new/wp-content/uploads/2018/01/CESD_Research_Paper_Azerbaijan_Economy_2017.pdf

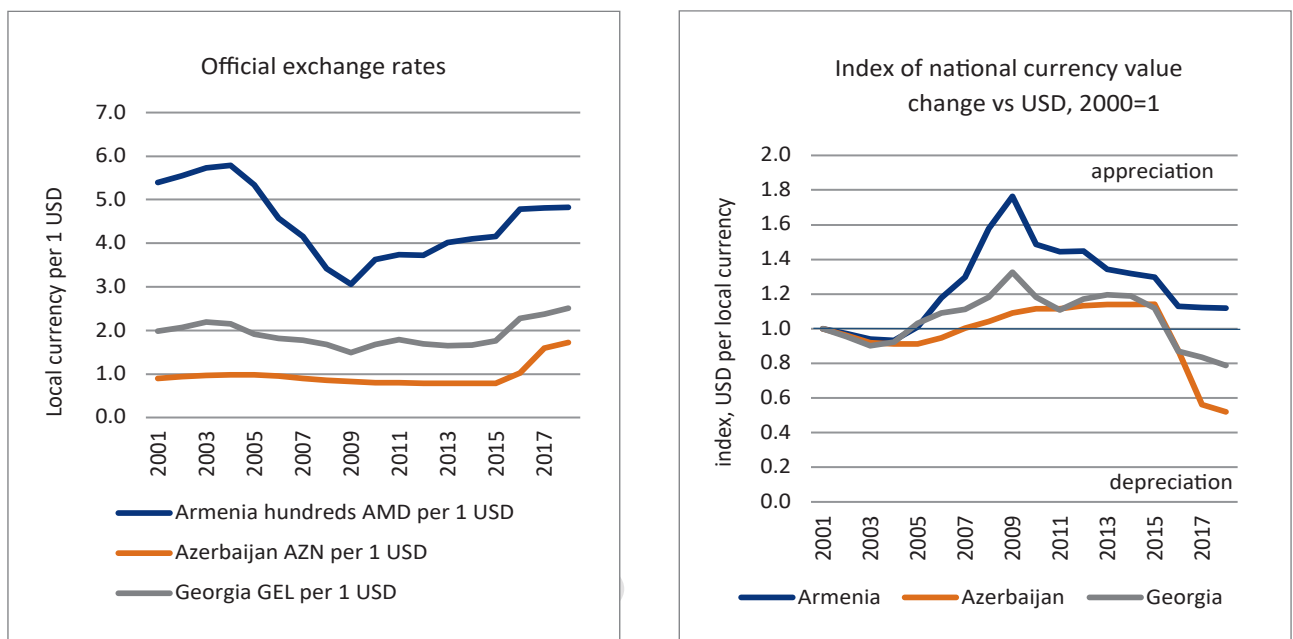
Figure 2-2: Consumer price inflation, 2000-2017



Sources: for 2000-2016 - WB World Development Indicators; for 2017 - the National Statistical Service of Armenia, the State Statistical Committee of Azerbaijan, and the National Statistics Office of Georgia.

The national currencies of Armenia, Azerbaijan and Georgia have recently each significantly depreciated nominally (Figure 23). Azerbaijan’s manat took the strongest hit due to the oil price shock. The overall loss of the manat against the US dollar was almost 50% between 2014-2017. Georgia also faced a rather fast depreciation in 2015, where the lari has lost approximately 30% of its value since 2014. The depreciation of Armenia’s dram has been more gradual, occurring since 2008. Over the decade, the currency lost approximately 36% of its value against the US dollar. In 2017, depreciation pressure decelerated within the region. There were almost no changes in the nominal exchange rate of the dram against the USD in Armenia, and very moderate depreciation of Azerbaijan’s manat and Georgia’s lari.

Figure 2-3: Nominal exchange rates against the US dollar, 2000-2017

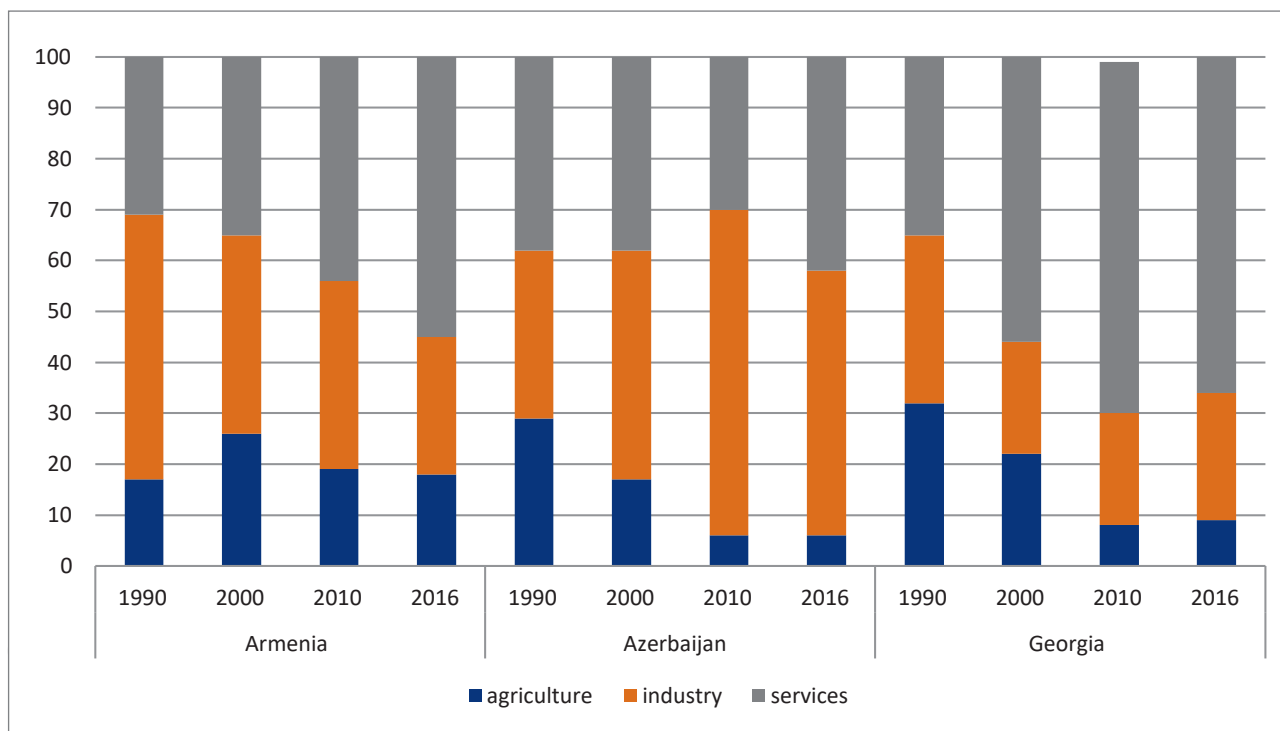


Sources: for 2000-2016 - WB World Development Indicators, for 2017- the National Statistical Service of Armenia, the Central Bank of the Republic of Azerbaijan, the National Bank of Georgia, and the authors’ calculations.

The structure of economies in the South Caucasus has changed significantly over the last few decades. In Armenia and Georgia, the service sectors expanded, producing more than half of value-added, although in Armenia, this occurred mostly at the expense of a lower share of industrial production. In Georgia, the proportion of agricultural production was reduced the most notably (Figure 24). Whereas, Azerbaijan developed a very strong expansion of industrial production (extractive industry), at the expense of a smaller share in agriculture. As a result, by 2016, Armenia’s and Georgia’s economies had become dominated by services, accounting for 55% and 66% of the aggregated value-added, respectively, while Azerbaijan’s economy remained dominated by industrial production (52%).

The industrial structure of Armenia, Azerbaijan and Georgia differ considerably. The production of food and beverages is the only industrial sector which plays an important role in all three countries. Aside from the food industry, Armenia has extensive non-energy mining and metal production industries. While, Azerbaijan’s industrial output is concentrated on the extraction of energy products. In Georgia, other than food, output is divided in several sectors: construction materials, metals, chemicals, plastics, and rubber have noticeable shares within industry. In all three countries, the manufacture of machines and equipment has a proportion of 1-2% of the total production, remaining outside the focus of their current specializations.

Figure 2-4: The sectoral structure of the economy in Armenia, Azerbaijan and Georgia, 1990-2016



Source: WB Development Indicators.

In conclusion, the economic potential of the South Caucasus has been uneven, although in 2017, all three countries increased their real GDP, and maintained moderate consumer price inflation and relatively stable exchange rates against the US dollar. Though, the structures of the three economies differ considerably. In value-added terms, Azerbaijan’s economy is dominated by industrial (mostly, extractive) production, Georgia has the largest service sector, while Armenia features quite a high share of agriculture, although services still produce the most value-added.

Labor and social profiles of the region

The labor markets within the region feature several imbalances, which negatively affect the economic performance of the countries and their export potential, as well hampering their achievement of the SDGs. In particular, Target 8 aims to “promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.” The key indicators of the labor markets in the South Caucasus will be analyzed below.

Of the region, Armenia has the lowest labor force participation: where only 62% of the working-age population is involved, compared to 66% in Azerbaijan, and almost 68% in Georgia. The participation of women in the labor force is even lower in Armenia, with only 52% of working age women participating in the labor force, while 58% of women in Georgia and 63% in Azerbaijan contribute. Extensive seasonal labor migration to Russia could partly explain these figures from Armenia, as the migrants are not counted, however there is no data on seasonal migration to confirm such a hypothesis.

A productivity gap is revealed through the distribution of the labor force among the sectors, compared to their contribution into GDP. Specifically, agriculture features the highest employment in the region, and the lowest contribution to GDP, this serves to highlight the extremely low productivity of the sector. The gap is the highest for Georgia and Azerbaijan. In Georgia, agriculture accounts for approximately 49% of employment (including the self-employed), but only 9% of the produced value-added. In Azerbaijan, agriculture accounts for 36% of total employment and 6% of their GDP (Table 22).

Table 2-2: Labor snapshot of the region, 2016

	Armenia	Azerbaijan	Georgia
Labor force participation rate (% of working-age population)	60.7	66.0	67.5
Labor force participation rate, men (% of working-age men)	70.9	69.5	78.2
Labor force participation rate, women (% of working-age women)	52.4	62.8	58.0
Employment-to-population ratio (% of working-age population)	50.0	62.7	59.5
Employment-to-population ratio, men (% of working-age men)	58.4	66.6	67.1
Employment-to-population ratio, women (% of working-age women)	43.2	59.0	52.9
Share of agriculture in total employment (%)	33.6	36.3	49.1
Share of industry in total employment (%)	15.8	14.3	10.8
Share of services in total employment (%)	50.6	49.3	40.1
Waged and salaried workers, total (% of total employment)	57.8	35.5	42.4
Waged and salaried workers, men (% of men employment)	57.7	38.3	43.0
Waged and salaried workers, women (% of women employment)	57.9	32.6	41.8
Unemployment rate (% , ILO methodology)	17.6	5.0	11.8
Unemployment rate, men (% , ILO methodology)	17.7	4.2	14.2
Unemployment rate, women (% , ILO methodology)	17.5	6.0	8.9
Share of long-term unemployment in total unemployment (%)	60.0	66.6	43.3
Youth unemployment rate (%)	36.3	13.1	30.5
Quality of primary education (score 1-7 (best))	4.3	4.2	3.1
Quality of the education system (score 1-7 (best))	3.8	4.4	3.0
Local availability of specialized training (score 1-7 (best))	4.2	4.7	3.2
Country capacity to retain talent (score 1-7 (best))	3.0	4.5	3.0
Country capacity to attract talent (score 1-7 (best))	2.9	4.7	2.7

Source: ILO, WEF Global Competitiveness Report 2017-2018 & WB Development Indicators.

Irregularly-paid employment, that which increases people’s vulnerability and deprives them of decent jobs, is high in the South Caucasus. Azerbaijan’s employees are particularly vulnerable: only 36% of total employment is composed of waged and salaried jobs,¹⁵ while for women, this share is even lower- only 32% of total female employment. In Georgia though, the situation is moderately better, 42% of total employment are waged and salaried jobs, while Armenia features 58% waged and salaried jobs.

The region also has high unemployment rates. Armenia has the highest level of unemployment at 17% of population, with only small differences between male and female unemployment. In Azerbaijan, more women are unemployed (6%) compared to men (4%). In Georgia, the situation is the opposite, where male unemployment is much higher: 15% compared to 9% of women.

The youth are among the most vulnerable subset of the population from the perspective of the labor market. While the aggregate unemployment rate in the region varies between 4% and 18%, depending on the county and the gender, youth unemployment is between 13% and 32%, two to three times higher than their country average. In addition, women are further likely to be unemployed than men in the region, except for Georgia. High labor market rigidity in all three countries is emphasized by the very high proportion of long-term unemployment within total unemployment. According to the International Labor Organization (ILO), long-term unemployment has reached 66% in Azerbaijan, 60% in Armenia, and around 43% in Georgia.

The World Economic Forum suggests there is a low capacity to retain and attract talent, and with moderate scores for the quality of education, both of which constitute another problem within the region’s labor market. Better education, especially lifelong education necessary to sustain a competitive labor force in a dynamically changing modern world, is one of the prerequisites for higher competitiveness of economies, both regionally and globally.

The population of the South Caucasus is generally poorer than in the surrounding countries. If living on 5.50 USD a day (2011 PPP) is used as a benchmark, around 55% of Georgians, 48% of Armenians and 19% of Azerbaijanis (in 2008, the latest available year) are below the poverty line. In contrast, the average level for Europe and Central Asia is 15%.

Table 2-3: Social snapshot of the region, 2015

	Armenia	Azerbaijan*	Georgia
Poverty headcount ratio at national poverty lines (% of population)	30	5	15
Poverty headcount ratio at 1.90 USD a day- 2011 PPP (% of population)	1.9	0.5	8.3
Poverty headcount ratio at 3.20 USD a day- 2011 PPP (% of population)	13.5	2.7	25.3
Poverty headcount ratio at 5.50 USD a day- 2011 PPP (% of population)	48.3	18.8	54.8
Poverty gap at 1.90 USD a day- 2011 PPP (% of population)	0.3	0.2	2.2
Poverty gap at 3.20 USD a day- 2011 PPP (% of population)	3.0	0.7	7.8
Poverty gap at 5.50 USD a day- 2011 PPP (% of population)	14.8	4.3	21.8
Gini coefficient	32.4	31.8	38.5
Existence of personal savings (% of population)	9	18	10
Human Development Index (HDI)	0.743	0.759	0.769
Human Development Index (HDI) rank	84	78	70

Source: WB Development Indicators, WB Poverty and Equity Database, UNDP Human Development Report, Caucasus Barometer, & MDG Indicators for Azerbaijan.

Note: * all internationally-comparable poverty lines for Azerbaijan are for 2008 (the latest available); therefore, the comparisons should be made with caution.

¹⁵ According to the ILO definition, waged and salaried workers (employees) are those who hold the type of jobs defined as “paid employment”, where the incumbents hold explicit (written or oral) or implicit employment contracts that give them basic remuneration that is not directly dependent upon the revenue of the unit for which they work.

By typical poverty measures, Georgia maintains the highest level of poverty in the region. Where, 8.3% of the population lives in acute poverty, defined as less than 1.90 USD per day (2011 PPP), compared to 1.9% in Armenia and less than 1% in Azerbaijan (Table 23). One crucial reason for the high level of poverty in Georgia is the significant share of the population that lives in rural areas, where they are largely involved in small-scale production, self-employed agriculture.¹⁶ On the other hand, Azerbaijan's high oil and gas earnings help to reduce poverty, even though Azerbaijan also has important structural/spatial disparities, with older people, women, and refugees suffering the most.¹⁷

The acceleration of export-driven economic development, based on comparative advantage, could become an important contributor to growth and poverty reduction in the region. Trade policies must rely on comparative advantage; but for a sustainable development strategy, trade policies must be complemented with a wide range of other policies. Sustainable development also implies an ecological balance, the protection of vulnerable groups who do not benefit from broader economic growth, and good health outcomes, among many other objectives.

A key complementary policy is in education, which is important to improve the quality of the labor force, including the female workforce, and to increase its productivity. Such policies may lead to a change in the comparative advantage of the country, and raise the newly educated out of poverty. Appropriate environmental policies should also be adopted by governments to address issues of environmental damage by production or consumption. Effective social safety nets should be in place to address income redistribution for the most vulnerable.

An effective sustainable development strategy would encompass these complementary policies, as well as many others, such as health, macroeconomic and financial policies. As explained by Bhagwati and Ramaswami,¹⁸ a key principle of economics shows the most efficient way to achieve an objective is to use the policy instrument that most directly impacts the desired outcome. For example, in the case of income redistribution, direct measures to distribute income to the poor are the most effective way to provide income to the poor, rather than via trade policy. Regarding ecological considerations, measures to deliver proper incentives to industries that are directly related to their ecological impacts (possibly through taxes or tradable permits) are also more efficient than trade policies.

In general, trade policy is inefficient at achieving objectives beyond its part in contributing to growth and poverty reduction; vitally, attempting to use it for additional inefficient objectives simply reduces its effectiveness as a tool for growth and poverty reduction. Trade policy is not a substitute for a broad sustainable development strategy, nevertheless it can be an important component in a sustainable development strategy, if efficiently operated.

Development strategies within the South Caucasus

On 1 January 2016, the Agenda and SDGs, built upon the success of the Millennium Development Goals (MDGs), officially came into force. Between 2016-2030, the SDGs are expected to mobilize countries to alleviate poverty, fight inequalities and discrimination, and tackle climate change. While the SDGs are not legally binding, governments are expected to take ownership and establish national frameworks for the achievement of the SDGs. Below, we summarize the actions taken by Armenia, Azerbaijan and Georgia for the establishment of their national frameworks, including incorporation of the SDGs into the development strategies of each country.

¹⁶ Gugushvili, A. (2011). *Understanding Poverty in Georgia*. Caucasus Analytical Digest No.34, December 2011. Available from: <http://www.css.ethz.ch/content/dam/ethz/special-interest/gess/cis/center-for-securities-studies/pdfs/CAD-34.pdf>

¹⁷ Habibov, N. (2011). *Poverty in Azerbaijan*. Caucasus Analytical Digest No.34, December 2011. Available from: <http://www.css.ethz.ch/content/dam/ethz/special-interest/gess/cis/center-for-securities-studies/pdfs/CAD-34.pdf>

¹⁸ Bhagwati, J. & Ramaswami, V. K. (1963). *Domestic Distortions, Tariffs, and the Theory of Optimum Subsidy*. *Journal of Political Economy* 71(1), February, 44-50.

Armenia

Armenia formally launched the SDG nationalization process by developing its architecture, including a coordination structure, an institutional framework, and inter-agency thematic working groups in the first half of 2016. Most notably, the National Council on Sustainable Development of Armenia has been established.¹⁹ Four thematic working groups have also been created: social, economic, environmental, and legal and democratic equality.

In July 2017, Armenia and the UN hosted the SDG's Mainstreaming, Acceleration and Policies Support mission (MAPS) a part of the UN/UNDP. The mission's objective is "to support the Government in mainstreaming and acceleration of the SDGs implementation taking into consideration the specificities of the national context and progress already made in aligning the SDGs with Armenia's Development Strategy 2014-2025".²⁰ The Strategy sets four priorities for the country's development:

- ▶ Growth of employment, aimed at creation of quality, well-paid jobs;
- ▶ Development of human capital aimed at enhancing the scope, quality and accessibility of primary services including healthcare, education, science, culture and primary infrastructures;
- ▶ Improvement of the social protection system to achieve higher effectiveness and long-term financial stability of the systems (including improvement of its targeting);
- ▶ Institutional modernization of the public administration and governance aimed at higher efficiency, better services and transparency.

In particular, the Strategy defines several priority sectors and areas including: industry and export promotion; development of tourism; ICT sector development; agriculture and rural development; and small and medium enterprise (SME) development. In addition, in 2017, the Armenia National Development Strategy 2030 (Armenia Vision 2030), was launched.²¹ It is expected to be comprehensively tied with the seventeen SDGs, embracing them as both a conceptual and methodological tool. Moreover, the government of Armenia, with the help of the MAPS mission, has been developing its Roadmap of the SDGs. Their draft SDG indicators have already been published by the National Statistical Service of Armenia.²²

In November 2017, Armenia's government together with the UN created the world's first National SDG Innovation Lab to accelerate the achievement of the SDGs in Armenia.²³ The Lab is designed to serve as space for experimentation, collaboration, analytics, and world-class human resource development to hasten Armenia's implementation of the Agenda. The activities of the Lab will be supported by the UN Development Programme (UNDP) and hosted in the reform center of the government, the Center for Strategic Initiatives.²⁴

Azerbaijan

In October 2016, almost immediately after adopting the SDGs, the president of Azerbaijan issued a decree to establish the National Coordination Council for Sustainable Development of the Republic of Azerbaijan (NCCSD) and its Secretariat in the Ministry of Economy. Four Thematic Working Groups (TWGs)- Economic Growth and Decent Jobs, Social Development, Environmental Issues, Monitoring and Evaluation- were established to support the NCCSD in both nationalizing the SDGs and further implementing respective programs

¹⁹ See: https://www.unece.org/fileadmin/DAM/stats/documents/ece/ces/ge.32/2017/mtg2/6a-1_Presentation_National_Road_Map_on_SDGs.pdf

²⁰ See: <http://un.am/en/news/611>

²¹ See: <https://armenpress.am/eng/news/904413/government-develops-armenia%E2%80%99s-development-strategy-2030-document.html>

²² See: http://armstat.am/file/SDG/SDG_eng.xlsx

²³ See: <http://un.am/en/news/657>

²⁴ See: <http://new.reforms.am/about/>

and plans.²⁵ Moreover, the State Statistical Committee (SSC) is the key national agency responsible for processing and maintaining an effective and responsive database to measure progress in achieving nationalized SDGs.

In July 2017, Azerbaijan's NCCSD submitted to a Voluntary National Review on its first steps of the implementation of the Agenda.²⁶ According to the review, several strategic documents play an important role in achieving the SDGs. Within which there is the initial "Azerbaijan 2020: Look into the Future" Development Concept (the Concept). The main priorities included in the Concept are: the formation of a highly competitive economy; the development of ICT and ensuring the country's transition to an information-age society; human capital development and building of an effective social security system; the improvement of legislation and institutional capacity building; the development of civil society; the preservation and effective management of cultural heritage; and ensuring environmental protection and an effective ecological balance.

In December 2016, the president of Azerbaijan approved twelve "Strategic Roadmaps", defining priority areas for the country's economic and social development. These include a roadmap on the National Economy, and eleven roadmaps for the priority sectors of economy: the oil and gas industry (including chemical products); agricultural production and processing; the production of consumer goods by small and medium-sized enterprises; heavy industry and mechanical engineering; the specialized tourism industry; logistics and trade; affordable housing; vocational education and training; financial services; telecommunications and information technologies; and utilities (power and thermal energy, water and gas).

Georgia

Georgia started to move forward immediately after the adoption of the post-2015 development agenda, held in New York in September of 2015.²⁷ In 2016, the country had its first Voluntary National Review, submitted to the High-Level Political Forum. Georgia's next review is scheduled for 2019.

For its institutional arrangement, the administration of the government of Georgia established a joint technical working group, consisting of experts from different line ministries and the National Statistics Office, to facilitate nationalization of the SDGs. The SDGs have been well placed within national policies, and have also been integrated into the strategic umbrella document, the "Annual Governmental Work Plan" (AGWP), alongside other national, multi-sectorial strategy and action plans.²⁸

In 2016, the Georgian government presented the "Basic Data and Directions Document for 2017-2020" (the Document), designing the key principles and the direction for reforms in the country. The Document sets forth a Four-Point Plan aimed at ensuring strong and inclusive economic development. These four points include:

- ▶ Economic reform focused on promotion and the strengthening of the private sector;
- ▶ Education reform aimed at the development of human capital and its effective engagement in the economy;
- ▶ The Spatial Arrangement Plan, to be used as a spatial-territorial planning tool, intended to improve the attractiveness of tourism and strengthen the transportation network;
- ▶ Public governance reform designed to elaborate on public services policy, and to improve service quality and the effectiveness of agency performance.

Sectoral economic policy is included within Georgia's economic reforms and focuses on the following sectors: energy, agriculture, transport, and tourism.

²⁵ See: <https://sustainabledevelopment.un.org/memberstates/azerbaijan>

²⁶ See: <https://sustainabledevelopment.un.org/content/documents/16005Azerbaijan.pdf>

²⁷ See: https://idfi.ge/en/global_agenda_for_sustainable_development_and_georgian_path_from_2015

²⁸ See: <https://sustainabledevelopment.un.org/memberstates/georgia>

In summation, all three countries have demonstrated their readiness and commitment to take ownership of the SDGs and to integrate them into their national development documents. Significantly, the countries prioritize the development of sectors that exemplify the importance of “integrated” approaches, which simultaneously address economic, social, and environmental challenges. The prominent examples of which are the knowledge economy (Armenia’s ICT services) and the green economy (renewable energy in Azerbaijan and Georgia).

Summary

Armenia, Azerbaijan and Georgia are each middle-income countries, and further efforts are still required to improve the economic well-being of their population.

Azerbaijan is the largest country of the region, both in terms of this economic potential and physical characteristics. However, its economy has remained dominated by the extraction of energy resources, which poses a significant threat to its long-term economic development. The agriculture, although providing around one third of total employment, is largely unproductive. Moreover, Azerbaijan’s labor market has the lowest share of waged and salaried jobs in the region (36% of total employment), and this highlights the need for further efforts to ensure the availability of decent jobs in accordance with the SDGs.

Armenia, in comparison to the other two countries, has a relatively large share of agriculture in its total value-added, yet its largest share of value-added is derived from services, including tourism. In industry, the country’s quite narrow specialization in the production of food products and the extraction of metal ores also makes it vulnerable to external shocks. Their weak labor market participation rate may be explained by significant seasonal labor migration, the remittances which constitute an important source of the country’s income (see Chapter 3). However, Armenia has the best supply of decent jobs in the region, for those fortunate enough to be employed: 58% of employees are waged and salaried workers.

The Georgian economic specialization lies in its services, in particular, tourism. Although about half the population is employed in agriculture, their productivity is disastrously low- providing only 9% of the economy’s total value-added. Low labor productivity is attributable, at least partly, to a quite deprived education system. The situation in the labor market is simply mediocre, with around 43% of workers holding wage guarantees, while unemployment is about 12%, although youth unemployment is three times higher.

The countries of the South Caucasus remain quite poor, however there are great discrepancies between them. Azerbaijan has the lowest poverty rate, although there are groups of the population that are left behind, including elderly people, women and refugees. In Armenia and Georgia, poverty is still widespread, with approximately half of the population living on 5.50 USD a day (2011 PPP).

Armenia, Azerbaijan and Georgia have each committed to the implementation of the Agenda. The institutional arrangements for the nationalization of the SDGs were developed in all three countries in 2016-2017. Azerbaijan and Georgia have already presented their first Voluntary National Reviews, while Armenia is expected to do so in 2018. Importantly, the countries now prioritize the development of the sectors that exemplify the importance of “integrated” approaches, those which simultaneously address economic, social, and environmental challenges: for instance, the knowledge economy (Armenia’s ICT services) and the green economy (renewable energy in Azerbaijan and Georgia).

The acceleration of export-driven economic development, together with improvement in the quality of the labor force and an increase in its productivity, may become important contributors to poverty reduction in the region, contributing to the achievement of the SDGs nationally, regionally and globally.

3. Movement of Goods, Services, Capital and Labor

The countries of the South Caucasus have extensive economic links throughout the world via trade, capital flows and personal mobility (Table 31). Georgia is the most open among the three countries, with a trade over GDP ratio at an average 98% in 2012-2016, compared to Armenia's 79% and Azerbaijan's 76%. However, Georgia also features the most extensive trade deficit, compensated by a stable inflow of remittances and foreign direct investments. Azerbaijan is the only country in the region with a positive trade balance, although this was almost destroyed during the current account shock of 2014-2016.

Table 3-1: External economic links, by country, ratio to GDP, percentage, 2010-2016

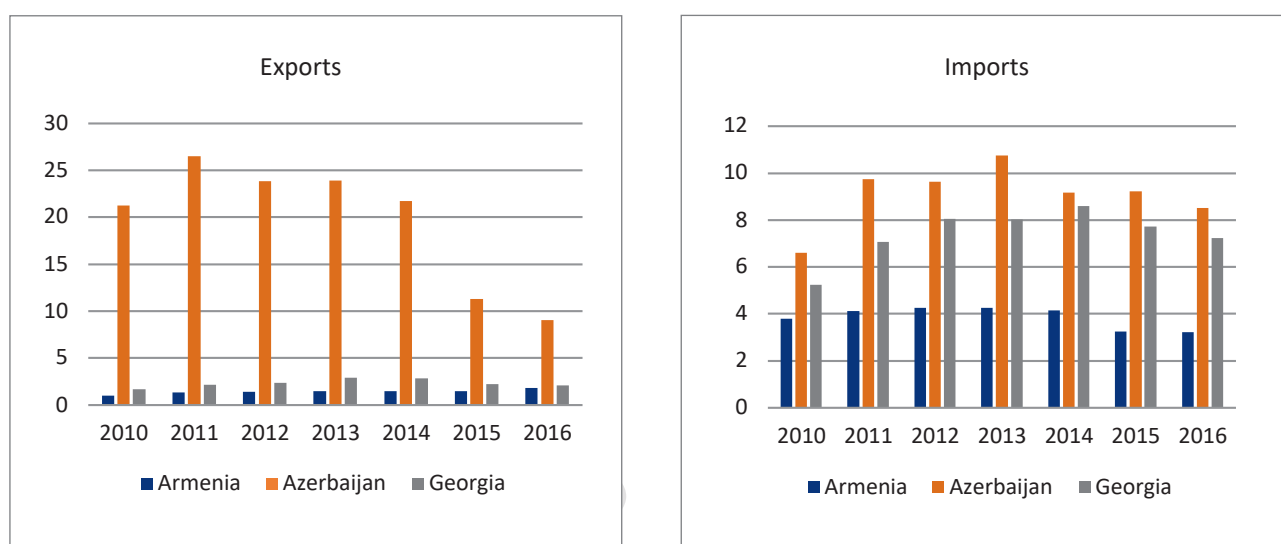
	Armenia			Azerbaijan			Georgia		
	2010	2016	5-year average (2012-2016)	2010	2016	5-year average (2012-2016)	2010	2016	5-year average (2012-2016)
Current account balance	-14	-2	-6	28	-4	12	-10	-13	-11
Trade	76	79	79	75	90	76	83	101	98
Trade balance	-33	-15	-23	35	3	16	-26	-25	-26
Trade in goods	52	48	50	63	59	55	60	65	67
Export of goods	11	17	14	50	35	39	14	15	16
Import of goods	41	31	36	13	24	16	45	51	51
Trade in services	25	31	29	12	31	21	23	36	30
Export of services	11	15	14	5	12	7	14	23	20
Import of services	14	16	15	7	20	14	9	12	11
Personal remittances, received	18	13	17	3	2	2	10	11	11
Personal remittances, paid	2	3	3	2	2	3	0	1	1
FDI, net inflows	6	3	3	6	12	7	7	11	9
FDI, net outflows	0	1	0	6	7	4	2	2	2

Source: WB Development Indicators.

Trade in goods

Global price shocks, changes in trade regimes and domestic volatilities have resulted in a decline in foreign trade for the countries of the South Caucasus, although their depth and duration have fluctuated (Figure 31). Azerbaijan suffered the most, affected by the sharp decline in global oil and gas prices- its exports dropped to 9.0 bn USD in 2016, compared to the peak 26.5 bn USD, in 2011. Though, the weakening of imports was less dramatic than exports. In Georgia, both exports and imports have declined over the last three years. The deterioration of exports was driven by unfavorable price shocks, and a reduction in demand from partner countries, while import decline was mainly in response to the depreciation of the national currency. Unlike other countries in the region, Armenia's exports have continued to grow and reached 1.8 bn USD in 2016. However, Armenia has witnessed a significant reduction in imports against a lower domestic demand and changes in its trade regime, due to its membership in the EAEU.

Figure 3-1: Trade in goods, 2010-2016, bn USD



Source: UN Comtrade and the authors' calculations.

The countries of the South Caucasus primarily trade outside the region. Intra-regional trade only accounts for 6% of exports and 3% of imports. While, the region's largest trade partners are EU countries and the Russian Federation, followed by Turkey and China.

For exports EU countries are the most significant trade partner for all three countries (Table 32), although the EU is the most significant to Azerbaijan. Georgia's exports to the EU are growing, and its share reached 27% in 2016, after several years of implementation of the Deep and Comprehensive Free Trade Area (DCFTA) with the EU. Russia is the second largest destination for exports, however only for Armenia is its role is comparable with the EU. Iran, thus far, plays a limited role as an export destination for the region, taking an average 5% of Armenia's exports, with electricity being the chief export commodity, and approximately 1% of Azerbaijan's and Georgia's exports.

Table 3-2: Geography of exports in goods, 2012-2016, total percentage

5-year average (2012-2016)									
	Armenia	Azerbaijan	Georgia	EU	China	Iran	Russia	Turkey	ROW
Armenia	--	0.1	6.2	31.7	7.0	5.4	19.7	0.0	30.0
Azerbaijan	0.0	--	2.7	49.7	0.7	0.4	3.9	3.6	39.0
Georgia	9.3	18.2	--	22.5	3.6	1.4	6.8	7.1	31.1
The year 2016									
	Armenia	Azerbaijan	Georgia	EU	China	Iran	Russia	Turkey	ROW
Armenia	--	0.1	7.8	26.8	5.5	3.9	20.6	0.0	35.2
Azerbaijan	0.0	--	3.8	43.5	3.0	0.5	4.5	12.5	32.1
Georgia	7.1	7.3	--	27.0	8.0	2.2	9.8	8.2	30.4

Source: UN Comtrade and the authors' calculations.

Note: Georgian-Russian exports do not consider flows related to Abkhazia or South Ossetia.

As with exports, the key import partners in the South Caucasus are EU countries, Russia, and Turkey, while the intra-regional imports are small. Iran also plays a minor role as a source of imports to the region, again with the noticeable exception of Armenia, which buys gas from Iran.

Table 3-3: Geography of imports in goods, 2012-2016, total percentage

5-year average (2012-2016)									
	Armenia	Azerbaijan	Georgia	EU	China	Iran	Russia	Turkey	ROW
Armenia	--	0.0	1.8	23.7	9.8	5.1	27.2	5.0	27.5
Azerbaijan	0.0	--	1.0	30.9	6.7	1.6	15.4	14.2	30.2
Georgia	2.1	4.9	--	29.7	7.8	1.3	6.4	18.4	29.4
The year 2016									
	Armenia	Azerbaijan	Georgia	EU	China	Iran	Russia	Turkey	ROW
Armenia	--	0.1	3.0	22.1	11.3	5.1	30.8	5.2	22.4
Azerbaijan	0.0	--	0.6	25.0	8.7	1.8	19.0	14.8	30.0
Georgia	3.0	6.8	--	30.3	7.6	1.2	9.3	18.7	23.1

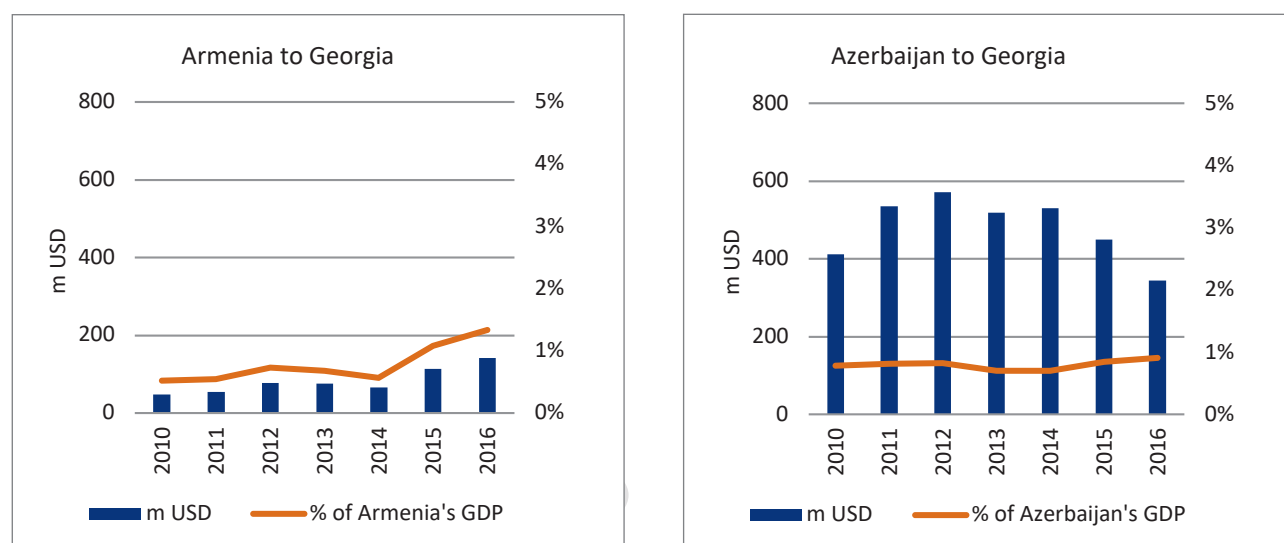
Source: UN Comtrade and the authors' calculations

Note: Georgian-Russian imports do not consider flows related to Abkhazia or South Ossetia.

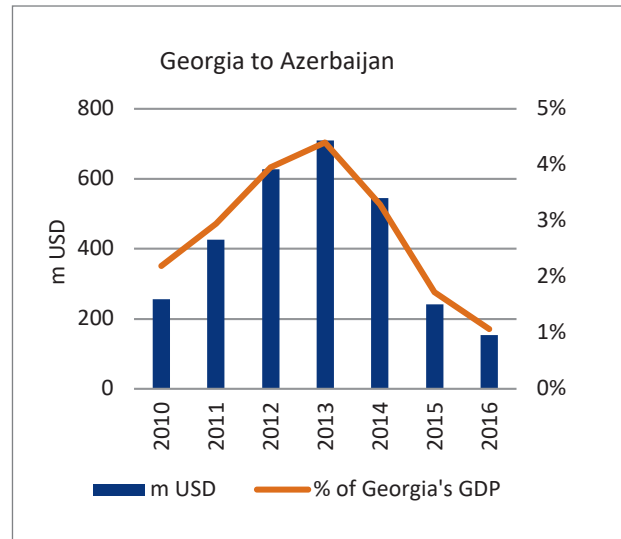
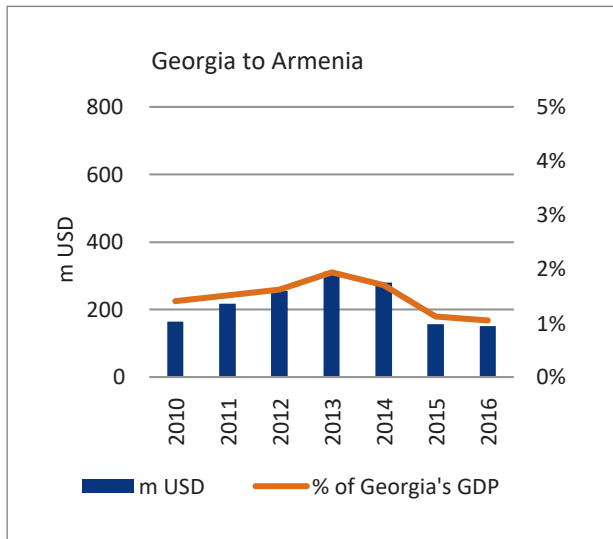
The nominal value of intra-regional trade, already minor, further declined in 2013-2016 for most trade partners, with the exception of Armenia's exports to Georgia (Figure 32). In particular, Georgian exports to Azerbaijan dropped dramatically. In part, this is a consequence of the slowdown of both countries' economies. Changes in Azerbaijani environmental regulations, related to passenger cars, was another reason for the reduction in Georgia's exports: in 2012, Georgia exported 345 m USD worth of cars to Azerbaijan, while in 2016, this figure fell to 49 m USD. Measured as a share of GDP, Georgia's exports to Armenia and Azerbaijan dropped, nevertheless its importance as an export destination increased for Armenia and remained stable for Azerbaijan.

The decline in Georgia's exports to Armenia can also be largely explained by the reduction in used car exports. Certain tax exemptions, for instance the simplified re-selling of cars originating from the EAEU and fewer administrative burdens on the cars imported from the EAEU, tilted competitiveness away from Georgian re-exports.²⁹ After Armenia completes its convergence with the EAEU tariffs, the imports of automobiles from non-EAEU countries, through Georgia, will become even less attractive due to the rather high import duties applied to vehicles by the EAEU.

Figure 3-2: Intra-regional trade, exports, m USD and as % of GDP, 2010-2016



²⁹ Movchan, V. & Giucci, R. (2016). *Georgia's exports to Armenia: Does Armenia's membership in the Eurasian Economic Union matter?* GET-Georgia Policy Briefing Series, [PB/01/2016]. Available from: http://www.get-georgia.de/wp-content/uploads/2016/08/PB_01_2016_en.pdf



Source: UN Comtrade.

In general, re-exports are an essential part of trade flows within the region. For example, Armenia exports copper ores to the world and to Georgia, which, in turn, further re-exports the ores to the EU and China. While, passenger cars constitute a large, although declining, part of Georgia's exports to both Armenia and Azerbaijan, however they report the cars not as imports from Georgia, rather as imports from the original manufacturers.

The structure of trade within and outside the region is not alike for the three countries (Table 34). Exports to the world are concentrated on several key commodities, like ores (Armenia), mineral fuels (Azerbaijan), or agro-food products (Georgia), while imports are more diversified.

Despite the limited intra-regional trade, there are several interlinks and value chains in the region. For instance, Georgia provides fertilizers for Armenia's agriculture, while it imports Azerbaijani gas for the manufacturing of these fertilizers. Georgia re-exports copper ores from Armenia to the EU and used cars from both the EU and other countries of the region (these cars are often repaired or refurbished in Georgia before re-export).

Product diversification within the South Caucasus outputs and exports is quite low in general, and even more so for intra-regional trade. In 2016, Armenia exported 1,806 products worldwide (HS-2007, 6 digits), from over 5,000 products in the trade nomenclature. However, its exports to Georgia were even narrower, with 587 products, or 32% of the variety sent globally. Azerbaijan has an even smaller product supply, where 1,629 products were supplied worldwide, and 548 of those were to Georgia. Due to re-exports, Georgia is the leader in the region, exporting 2,269 products worldwide, including 1,283 to Armenia and 1,171 to Azerbaijan.

The countries' exports are also poorly diversified within their markets. In 2016, Armenia exported to 103 countries, while, for instance, Estonia exported to 183 and Lithuania to 200 in the same year. Azerbaijan and Georgia exported to 116 markets each. Thus, all three countries have realized relatively poor market diversification.

Overall, foreign trade in goods is an integral part of the regional economy, but the majority of trade occurs outside of the region. The central trade partners are EU countries, Russia, Turkey and China. The value of intra-regional trade has been declining over several years (excluding Armenia's exports to Georgia), due to a slowdown in the region's economic development and changes in trade policies, including Armenia's membership in the EAEU and stricter environmental regulations in Azerbaijan. The product structure of exports is concentrated on several key commodities, and the concentration increases for intra-regional trade. Though Georgian exports are slightly more diversified, this is largely due to re-exports.

Table 3-4: Trade in goods in the world and region, by country & percentage, 5-year average (2012-2016)

	Armenia				Azerbaijan				Georgia					
	Exports		Imports		Exports		Imports		Exports			Imports		
	World	GE	World	GE	World	GE	World	GE	World	ARM	AZ	World	ARM	AZ
Animal origin products	2.6	1.6	3.3	0.7	0.0	0.0	1.5	4.5	2.6	1.0	8.4	2.8	1.6	0.1
Vegetables, fruits, grains	2.7	4.2	7.1	9.4	2.8	6.6	6.4	1.7	9.9	13.0	1.8	5.3	4.0	3.1
Food products	21.2	16.5	9.3	16.0	1.5	2.8	8.0	10.9	14.9	9.6	5.4	7.1	9.1	3.5
Minerals	22.1	34.6	0.4	3.5	0.1	2.1	1.5	23.6	9.5	0.7	3.6	3.2	64.8	7.1
Fuels	5.7	9.3	20.3	6.9	91.8	81.5	2.0	0.4	3.2	1.3	0.5	16.4	0.6	73.4
Chemicals	1.0	5.9	8.7	31.8	0.5	1.8	7.5	11.7	10.8	12.9	7.8	9.5	3.5	1.0
Plastic & rubber	0.7	8.8	4.1	2.4	0.7	0.3	3.6	2.1	1.1	2.4	1.7	4.4	4.9	0.5
Hides & skins	0.3	0.2	0.3	0.0	0.1	0.0	0.1	0.3	0.2	0.2	0.1	0.3	0.3	0.0
Wood products	0.2	0.8	3.7	13.4	0.1	0.3	3.9	0.4	1.3	4.9	0.4	3.4	0.2	0.3
Textile & clothing	3.7	1.2	4.5	0.1	0.2	0.4	1.4	0.6	3.0	2.3	0.5	3.9	0.6	1.0
Footwear	0.1	0.2	0.8	0.0	0.0	0.0	0.2	0.3	0.1	0.4	0.1	1.0	0.2	0.1
Stone & glass	16.0	11.3	7.6	6.8	0.0	0.3	5.0	1.1	3.7	2.3	0.8	2.5	6.6	0.4
Metals	18.3	0.8	7.4	6.3	1.0	0.6	15.3	31.2	15.6	2.7	9.0	7.4	0.7	1.1
Machines & equipment	1.6	2.1	13.8	1.6	0.3	2.3	26.3	4.3	2.7	4.8	3.7	17.2	1.5	4.8
Transport equipment	1.3	1.3	3.7	0.9	0.3	0.7	11.0	5.6	19.9	40.7	55.2	10.8	0.7	2.9
Miscellaneous products	2.3	1.2	5.1	0.2	0.7	0.2	6.4	1.3	1.6	0.6	1.0	4.7	0.7	0.7

Source: UN Comtrade.

The revealed comparative advantages of the region

We have calculated the “revealed comparative advantage” (RCA) measure for the major groups of goods for Armenia, Azerbaijan and Georgia. Although not definitive, the RCA is a useful indicator of the products in which a country is currently internationally competitive. It identifies how intensively a country exports a product, in comparison to an average country’s intensity exporting the same product.³⁰

However, one must be cautious using RCAs for development policy, since they do not adjust for distortions such as subsidies or taxes (both domestically and in export markets), differences in business environments (such as regulations or infrastructure), or for market failures (such as the absence of intermediaries in agriculture, emphasized below). Therefore, one should not take the RCA measure as definitive of a long-run comparative advantage.

To highlight a prominent example in Georgia, the RCA for hazelnuts, prior to the entry of Ferrero SpA (Nutella manufacturer), would have indicated that Georgia simply does not have an RCA in hazelnuts. There has since been a comparative advantage in hazelnuts with the entrance of Ferrero SpA, and the Darcheli cooperative, and the market failure has been overcome. For policy purposes, it is better to look beyond the RCAs to assess potential underlying issues impeding development in each sector or subsectors. Detailed industry studies are

³⁰ For a brief explanation of RCA, see: https://en.wikipedia.org/wiki/Revealed_comparative_advantage

beyond the scope of this report, however one such study of agriculture in Azerbaijan has emphasized the need for the impact assessment of the state resources entering Azerbaijan, in order to improve allocation and performance. The study notes that the president of Azerbaijan has criticized the lack of knowledge surrounding the effectiveness of support and whether it reaches its intended targets.³¹ This report will focus on the vital issue of agriculture aggregators and intermediaries below.

The competitiveness of South Caucasus countries differs, but generally, all three tend to be globally competitive in the export of raw materials, though less so with intermediate products and consumer goods. Either fuel or minerals are at the top of the region's revealed competitive advantage, followed by metals, agro-food products, and textiles. The region currently has a limited comparative advantage in the export of capital goods, including transport equipment (see Annex 3 for detailed figures). At an aggregate level, Azerbaijan is competitive in mineral fuels and vegetables, with the latter reaching its RCA threshold in 2016. An analysis of the disaggregated data demonstrates that Azerbaijan has a definite competitive advantage with many agricultural products, such as hazelnuts, tomatoes, cherries, cucumbers and potatoes. There are two studies that discern considerably varied results in the subsectors for RCAs, although their results are not the same across the subsectors.³² Since 2012, the country has also become competitive in the export of other goods, including metal products (aluminum plates, steel), and selected chemicals and equipment, for example floating drilling platforms. Yet, the country's ongoing comparative advantage is predominantly in raw materials. Altogether in 2016, Azerbaijan had an RCA of 11% of its trade nomenclature (where, for example, Estonia had 26%).³³ While on the Georgian market, Azerbaijan has a comparative advantage in minerals and fuels.

Armenia has more export diversity, with 19% of its export nomenclature including RCA. At an aggregate level, Armenia has RCA in exports of minerals, metals, stone and glass products, textile and clothing, agriculture, and food products. The disaggregated data highlights Armenia's competitive advantage, especially in metals, including non-ferrous, ferrous and precious metals and products thereof. Since 2012, Armenia has become globally competitive in the export of tomatoes, which enhanced the entire category of vegetables. Moreover, the competitiveness of various types of clothing exportation has been growing. Armenia is less competitive on the Georgian market, losing its edge with metals and textiles, though gaining with skins and hides. Georgia features RCA in all three agro-food aggregated categories, and in minerals (manganese), metals (ferroalloys, lead) and chemical products (fertilizers). The disaggregated data reveals that Georgia is also competitive in the production of locomotives, supplying them to CIS countries. Overall, Georgia had an RCA of 16% of its trade nomenclature in 2016. Bilaterally, it has a competitive advantage in chemicals, agro-food products, minerals and wood over Armenia's market, and in chemicals, agro-food products and metals over Azerbaijan. Furthermore, Georgia is still regionally competitive supplying transport equipment, thanks to its continued re-exports of cars.

Between 2012-2016, Azerbaijan and Georgia increased their competitiveness in the majority of aggregated categories of goods, with the most noticeable improvements in minerals, shoes, plastics and textile in Georgia, and minerals and metals for Azerbaijan. While Armenia had more moderate achievements with the RCA, and the measures decreased for almost half of the aggregated categories. Nonetheless, Armenia's competitiveness improved significantly in textiles.

In conclusion, the analysis of regional RCAs confirms the relative strengths of the region on resource-intensive

³¹ Khalilav, H., Shalbuzov, N. & Huseyn, R. (2015). *Country Report for Azerbaijan*. Research Institute of Agricultural Economics of Azerbaijan for AgriCISTrade. Available from: http://www.agricistrade.eu/wp-content/uploads/2015/06/Agricistrade_Azerbaijan.pdf

³² The Center for Economic and Social Development in Baku calculated their version of RCAs for several agricultural products. Their study, entitled *Evaluation and Modeling of Comparative Advantage in Agriculture in Azerbaijan*, is available from: http://cesd.az/new/wp-content/uploads/2015/12/CESD_Research_Paper_Agriculture.pdf. Also see: FAO. (2017). *Organic Agriculture in Azerbaijan: Current Status and Potential for Future Development*. Available from: <http://www.fao.org/3/a-i8318e.pdf>.

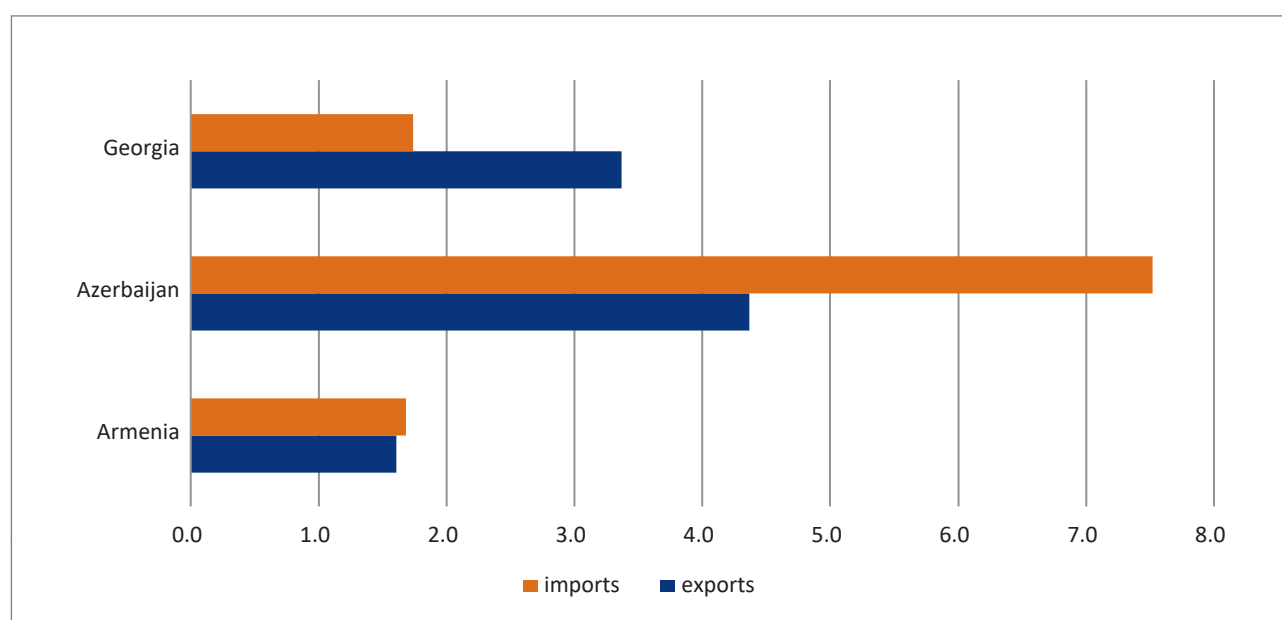
³³ For all three countries, the estimates are based on HS 2007 at a 4-digit level. The number of exported goods is calculated for all goods where export is equal to or exceeding one thousand USD.

exports, those which largely have limited direct impact on the labor market and entail environmental costs. However, throughout the region there is growing competitiveness in agriculture and food, metal and chemical production, textile and even selected transport equipment. Improvements in the business environment, in particular, trade facilitation measures, could help sustain these trends and strengthen the overall competitiveness of the region.

Trade in services

The trade in services account for an important part of the overall foreign trade within the region, constituting, on average in 2012-2016, 30% of GDP in Georgia, 29% in Armenia, and 21% in Azerbaijan. Georgia is the only country in the region enjoying a large positive balance of trade in services (Figure 33).

Figure 3-3: Trade in services by country, bn USD, 2016



Source: WB Development Indicators.

Travel and transport are the most actively traded services in the region, and both are crucial for the achievement of the SDGs in the South Caucasus. Transport is an essential tool for the delivery of many SDGs, but especially those related to food security, health, energy, infrastructure, and cities and human settlements.³⁴ While the role of tourism in job creation and local culture promotion is further recognized in Goal 8.9.³⁵

In 2012-2016, travel services were the largest export category for all three countries, accounting for, on average, 60% in Georgia and Armenia, and 56% in Azerbaijan. For imports, travel services are vital for Armenia (60% of the total), and noticeable in Azerbaijan and Georgia (Table 35). There is moreover active intra-regional travel, maintaining Georgia as a hub. According to the Georgian National Tourism Administration, approximately 6.4 m tourists came to Georgia in 2016, out of which 3 m, i.e. almost a half, came from Azerbaijan and Armenia, each supplying an essentially equal number of visitors.³⁶ Turkey and Russia were the third and the fourth, with 1.2 and 1.0 m visitors, respectively. The primary purpose of travel was visiting friends and relatives, that typically associated with intra-regional mobility.

³⁴ See: <https://sustainabledevelopment.un.org/topics/sustainabletransport>

³⁵ See: <http://icr.unwto.org/content/tourism-and-sdgs>

³⁶ See: <https://gnta.ge/wp-content/uploads/2016/08/ENG-2016.pdf>

Interviews with business respondents suggest that there is great potential for development of regional tours, with Georgia serving as a hub connecting the region; as Georgia has already acquired better connections to the world and Georgian tour agencies have often already brought tourist groups to areas throughout the region. These opportunities will be discussed in more detail in Chapter 8.

For two of the three countries, Armenia and Georgia, transport services are especially crucial for import. Equally Georgia, as the regional transport hub, has the largest share of transport exports, with 31% of the total on average, followed by Azerbaijan with 24%. The countries of the South Caucasus have actively been developing transport infrastructure links to the rest of the world, while also strengthening bilateral cooperation within the region. There will be further information on transport corridors in Chapter 6.

Table 3-5: Structure of trade in services, by country & percentage, 5-year average- 2012-2016

	Armenia		Azerbaijan		Georgia	
	Exports	Imports	Exports	Imports	Exports	Imports
Manufacturing services on physical inputs owned by others	0	0	1	0	1	0
Maintenance and repair services	0	0	2	1	0	0
Transport	11	26	24	11	31	55
Travel	60	59	56	32	60	19
Construction	12	1	2	30	0	0
Insurance and pension services	1	3	0	2	1	8
Financial services	0	1	0	0	0	1
Charges for the use of intellectual property	0	0	0	0	0	1
Telecommunications, computer, and information services	8	2	2	2	2	3
Other business services	3	5	11	21	2	6
Personal, cultural, and recreational services	1	1	0	0	1	1
Government goods and services	2	2	1	2	3	5

Source: Trade Map, ITC, and UN ComTrade.

Telecommunication and computer services have a small share of exports, except for Armenia, where around 8% of its five-year average exports are from ICT, and its role is still growing, thanks to the development of an ICT cluster in Yerevan. This sector's development and exports have been stimulated by an influx of foreign investments, partly associated with the diaspora in early 2000 (for example, Synopsis and Synergy companies, owned by Armenian Americans).³⁷

Education provides another interesting intra-regional opportunity for trade in services, though currently it occupies only a tiny share of the total service trade. For example, the International School of Economics at Tbilisi State University (ISET), established in 2005, provides first class educational opportunities in economics and business administration for students from the entire South Caucasus region.³⁸ The development of this and similar programs in the region positively contributes towards achieving the SDGs.

Therefore, trade in services play an essential role in the region, mostly concentrating on tourism and transport. These two sectors also provide major bilateral links within the region, with Georgia serving as a hub.

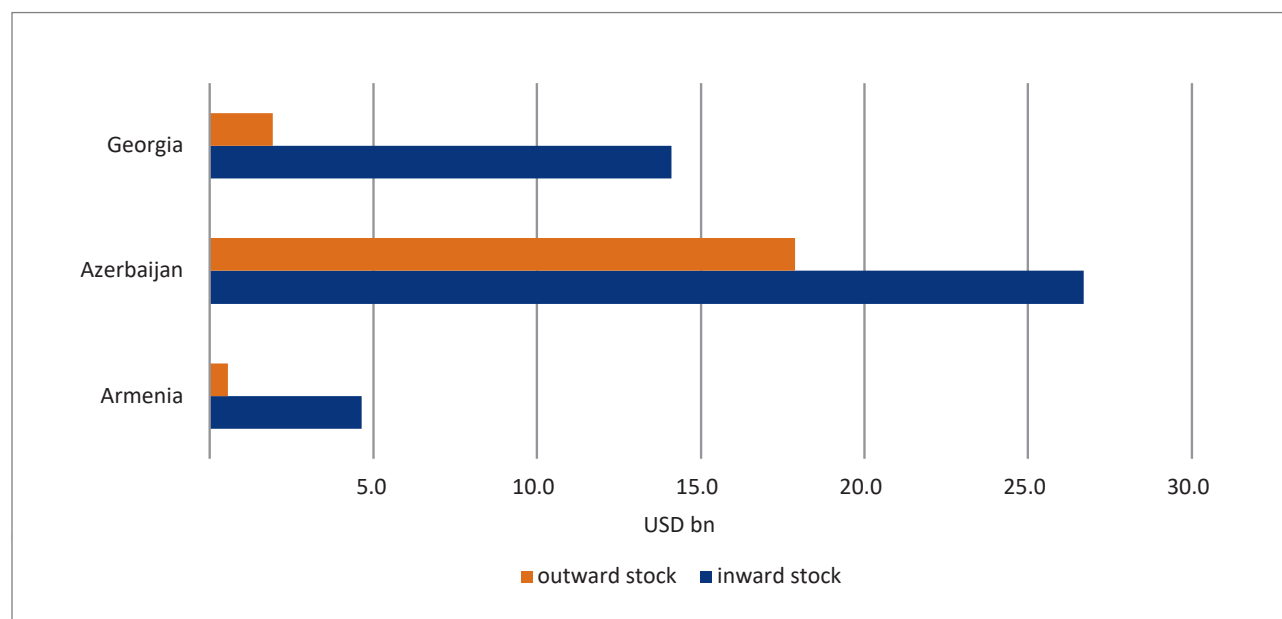
³⁷ OECD (2011), Development in Eastern Europe and the South Caucasus: Armenia, Azerbaijan, Georgia, Republic of Moldova and Ukraine, OECD Publishing, Paris. Available from: <https://doi.org/10.1787/9789264113039-en>.

³⁸ See: <https://iset.tsu.ge/index.php/who-we-are/iset/about-us>

Foreign direct investments

All three economies are the net recipients of FDI. Investments in other countries are only pivotal for Azerbaijan, which has comparable stocks of inward and outward FDI (Figure 34).

Figure 3-4: FDI inward and outward stock by countries, bn USD, 2016

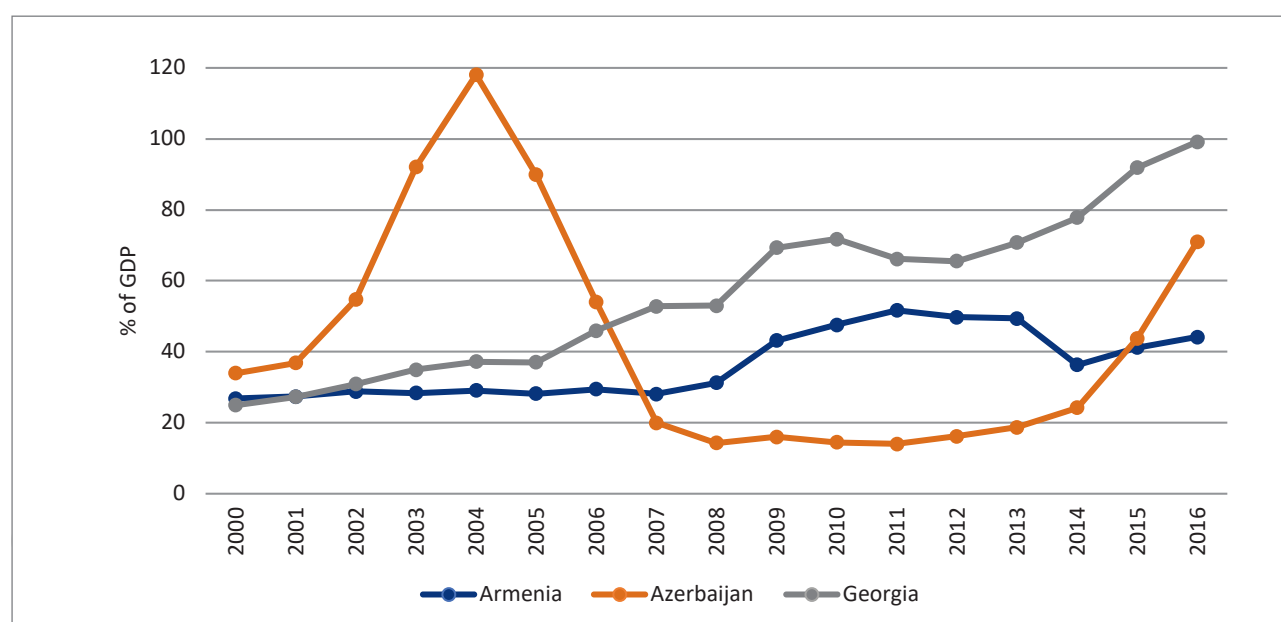


Source: UNCTAD.

After a drop amid the global financial crisis of the late 2000s, FDI inflow in the region has been growing steadily since 2010. The distribution of FDI inflows is uneven, with Azerbaijan attracting the highest amount of FDI and Armenia the lowest. The majority of FDI inflows enters existing projects. Though according to UNCTAD, since 2014, the region faces a downward trend in green-field projects.

In nominal terms, Azerbaijan receives less than Georgia, which has nonetheless accumulated the largest stock of inward FDI in the region, measured by percentage of GDP (Figure 35). A favorable business climate, openness to trade, an important geographical location, and the acute need for modernization of infrastructure, are among the reasons for Georgia's larger FDI inflows. In contrast, Azerbaijan experienced an outflow of FDI from 2006-2007, the recovery from which has only recently begun.

Figure 3-5: FDI inward stock as a percentage of GDP, 2000-2016



Source: UNCTAD.

Countries of the EU, the Russian Federation and Turkey are the main investors in the region. Intra-regional investments are minute. The only noticeable direction of FDI is from Azerbaijan to Georgia, which accounts for 6% of Georgia’s FDI inward stock, and around 7% of Azerbaijan’s FDI outward stock. In Chapter 7, we will discuss the potential impact of emerging opportunities within the region, including the newly concluded trade agreements and transport network initiatives on FDI.

Table 3-6: FDI geography, the percentage of FDI inward stock in each country

Origin \ Destination	Armenia	Azerbaijan	Georgia	South Caucasus
Armenia	n/a	0%	0%	0%
Azerbaijan	0%	n/a	6%	2%
Georgia	0%	0%	n/a	0%
EU-28	20%	34%	40%	34%
USA	4%	4%	12%	7%
China	0%	2%	0%	1%
Iran	0%	8%	0%	4%
Turkey	0%	17%	8%	11%
Russia	53%	4%	5%	13%
ROW	23%	31%	29%	29%

Source: UNCTAD.

The sectoral structure of FDI is very different among the region’s countries. In Azerbaijan, about 79% of foreign investments, in 2007-2016, were in the mining industry, more specifically in the extraction of oil and gas, and the remainder was split between construction, warehouses and other transportation support activities. There are very small foreign investments in other sectors. The importance of FDI in fuel extraction has been enormous for Azerbaijan’s strong economic performance for more than two decades, and is reasonable for them to rely on this experience to foster economic development and to diversify their exports by attracting modern technologies through foreign investments in other sectors as well.

The framework of FDI in Armenia is diversified, with a focus on services. In 2007-2016, 41% of foreign investments were directed to transport and communication, mostly in telecommunication, and 26% in the production of electricity, gas and steam. Investments in agriculture remained small at about 2% of the total, while industry received 18%, split almost equally between extractive industry and manufacturing, chiefly in the production of metals and beverages. FDI in industry largely correspond with Armenia's RCAs, while investments in agriculture remains lower than its economic role and considering its importance towards the achievement of the SDGs.

The structure of FDI in the Georgian economy partly resembles the situation in Armenian. Agriculture received only 1% of FDI in 2007-2016, although it accounts for approximately half of the nation's labor force. Industry received 29% of foreign investments, including 4% in mining, 13% in manufacturing and 13% in energy. The majority of investments were centered on services, most notably transport and communication (24% of the total in 2007-2016), financial services (10%), and construction (9%). While the hospitality sector attracted a moderate 6% of FDI.

To summarize, in 2014-2016, the region saw growth in FDI inflow, though it is distributed unequally across the region. Azerbaijan received the largest inflow in USD terms, while Georgia received the largest relative to GDP. The deceleration of FDI inflow to Armenia ended in 2016, although it is still lower than it has previously been. For Azerbaijan and Georgia, the EU is the most significant investor, while for Armenia, it is Russia. The sectoral structure of FDI is also skewed. Azerbaijan channeled most FDI into its extractive industry, while Armenia and Georgia focused on their nominated service sectors. Agriculture amounted from 0% to 2% of FDI, depending on the country, which is disproportional to the role of agriculture in each regional economy and its growing competitiveness.

Labor migration, diaspora and remittances

In the 2030 Agenda, for the first time, migration was included in the sustainable development framework. Specifically, Target 10.7 highlights the importance of the role of well-managed migration policies to ensure safe, responsible and orderly migration and mobility, while Target 10.C sets the benchmark for a reduction of less than 3% of the transaction costs for migrant remittances.³⁹

Migration constitutes an essential part of the region's economic ties locally and to the rest of the world. Russia was a key destination of migration outflow for the entire region, and thus the main source of remittances. Consequently, the region is dependent on the Russian Federation's economic situation, as well as their own migration policies.

The inflow of remittances to the South Caucasus has increased more than tenfold, from 354 m USD in 2000 to 5,912 m USD in 2014, though, in 2016, this then reduced to 3,546 m USD. In 2016, Georgia received 1,521 m USD in remittances, while Armenia received 1,382 m USD, and Azerbaijan 643 m USD.⁴⁰ The deceleration of inflow was caused by the worsening of the economic situation in Russia.

Aside from inflows, the South Caucasus also transfers remittances to other countries, including within the region. Azerbaijan is the largest financier behind such remittances, to the extent that it faces a net outflow of payments (for instance in 2016, the net outflow was 97 m USD).

The economic significance of remittances for each country differs. For Georgia and Armenia, remittances accounted for 11% and 13% of their 2016 GDP, respectively, while for Azerbaijan, remittances are only about 2%. Moreover, in Armenia remittances are one key sources of foreign currency. In 2016, remittances in the region were more than four times higher than net FDI inflow. For Georgia, the inflow of remittances and FDI in

³⁹ See: <https://unofficeny.iom.int/2030-agenda-sustainable-development>

⁴⁰ See: <http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data>

2014 was approximately 1:1, while for Azerbaijan, around 0.4:1. Remittances have also been more important than the Official Development Assistance (ODA) received by the three countries. In 2015, Armenia acquired four times more in remittances than ODA, Georgia received three times more, and Azerbaijan a full eighteen times more.

Thus, on the whole, remittances contribute a very significant role within the region, as their inflow is comparable with the inflow of FDI and much higher than ODA. However, unlike FDI, remittances do not lead to significant business activities, rather they help to increase welfare and alleviate poverty. As the main destination for migrants from all three countries is Russia, Armenia's and Georgia's economies, for which the remittances play significant roles, are dependent on the economic situation in Russia, as well as on their own migration policies.

Summary

The countries of the South Caucasus have extensive economic links to the world through trade, capital and personal mobility. Trade particularly plays an important role in all three economies of the region, with, on average, a trade over GDP ratio at 98% in Georgia, 79% in Armenia, and 76% in Azerbaijan. Most trade occurs outside the region, though also with regional neighbors. EU countries, Russia, Turkey and China are vital trade partners for all three countries, although their importance varies depending on the commodity composition of trade and the trade policy of each country (see Chapter 4 for an analysis of the trade policies in the region). Iran, so far, holds a minor role in trade within South Caucasus, though there is potential for its expansion.

The commodity structure of exports of the three South Caucasus countries features limited diversification. Azerbaijan's trade is the most concentrated, with fuel contributing to over 90% of its exports. While their second most significant facet is agro-food production. Analysis of the country's RCA shows Azerbaijan is competitive in exports of selected vegetables, fruits and nuts, as well as some metals, chemical products and even transport equipment (like floating platforms). However, the lion's share of FDI has been channeled into the extractive industry, thereby depriving other sectors of the economy of the potentially constructive influences of technological transfers and the efficiency gains associated with FDI.

Armenia's exports are more diversified, yet are still dominated by only a few trade categories, namely agro-food and minerals. The country has a strong RCA in the export of various metals (non-ferrous, ferrous, and precious) and food products, in particular, beverages and tobacco products. Recently, Armenia became globally competitive in the export of vegetables. The structure of FDI in the economy partly reflects the export strengths of the country. Much of the foreign investment has been directed towards transport and telecommunications, and Armenia is much stronger than the rest of the South Caucasus in the ICT exports. Furthermore, the inflow of FDI in the production of beverages directly corresponds with Armenia's high level of beverage exports. While at the same time, agriculture received only 2% of FDI.

Georgia exports mostly agro-food products, chemicals (fertilizers), metals and minerals, those that resemble the country's RCAs. The re-exports of cars, which Georgia practiced extensively several years ago, has diminished significantly after changes to the regulations in both Azerbaijan and Armenia. The structure of FDIs into Georgia only partly reflects the country's competitiveness. For instance, despite their strong agricultural exports, foreign investments in the sector account for only around 1% of the total. Georgia is also concurrently focused on investments in transport infrastructure, which are significant for the overall economic development of the country and for strengthening intra-regional cooperation.

Labor migration and remittances have a similar, or even greater, importance to the region's economy as new FDI. In Armenia and Georgia, remittances exceed 10% of GDP and are three to four times higher than the ODA they receive. Nearly half of migrants from the region are in Russia, thus the Russian economic situation and their migration policy plays an essential role in the South Caucasus.

4. Trade Policies in the Region

Trade liberalization belongs within the toolkit of those policy actions aimed at achieving the SDGs.⁴¹ It can lead to growth and poverty reduction;⁴² promote decent and productive employment by encouraging specialization and exportation; restrain inflation by stimulating imports at competitive prices; and contribute to health protection by ensuring product safety and environmental standards in the least-trade-restrictive manner. The Addis Ababa Action Agenda (AAAA)⁴³ specifically highlights meaningful trade liberalization as an important step towards achieving the SDGs.

Below is an analysis of the trade policies of the South Caucasus; in particular, an examination of how these policies could contribute to the achievement of the SDGs for each country. Our analysis demonstrates that the level of tariff protection applied by Armenia, Azerbaijan and Georgia is reasonably low, while trade costs associated with non-tariff measures, especially in the areas of technical regulation and food safety, have become a source of concern, exacerbated by the divergent and accelerated regional integration processes. Azerbaijan is the only country in the region that has not yet joined the WTO, and we recommend that the accession process be accelerated.

Trade regime: an overview

South Caucasus countries have relatively low import duties, which could be meaningful to trade liberalization. The highest tariff level is in Azerbaijan, with the average applied most-favored-nation (MFN) duty at 9%,⁴⁴ and only 3% of duty-free lines in its tariff schedule. Georgia is the most liberal, with a 1.5% average import duty, and 87% of tariff lines being equal to zero. Armenia is in-between, with a 6% import duty,⁴⁵ and 21% duty-free lines,⁴⁶ although this incorporates moving from a lower to higher level of protection after becoming a member of the EAEU.

In all three countries, tariff protection of agricultural imports is higher than the protection of non-agriculture goods. In Azerbaijan and Georgia, the difference is around five percent (13% vs. 8% for agriculture and non-agriculture goods in Azerbaijan, and 6% vs. 1% in Georgia). Armenia's import duties are less dispersed, with only a 2% gap between the average agricultural and non-agricultural duties (8% vs. 6%). The higher tariff protection of agricultural products shields the sector against external competition, supporting short-term employment, however it also conserves the sector's inefficiencies and thus undermines the long-term achievements of sustainable poverty reduction and maintaining decent jobs.

⁴¹ UNCTAD. (2016). *Trading Into Sustainable Development: Trade, Market Access, and the Sustainable Development Goals*. Available from: http://unctad.org/en/PublicationsLibrary/ditctab2015d3_en.pdf

⁴² Dollar, D. & Kraay, A. (2001). *Trade Growth and Poverty*. Finance and Development, September, Vol. 38, Number 3.

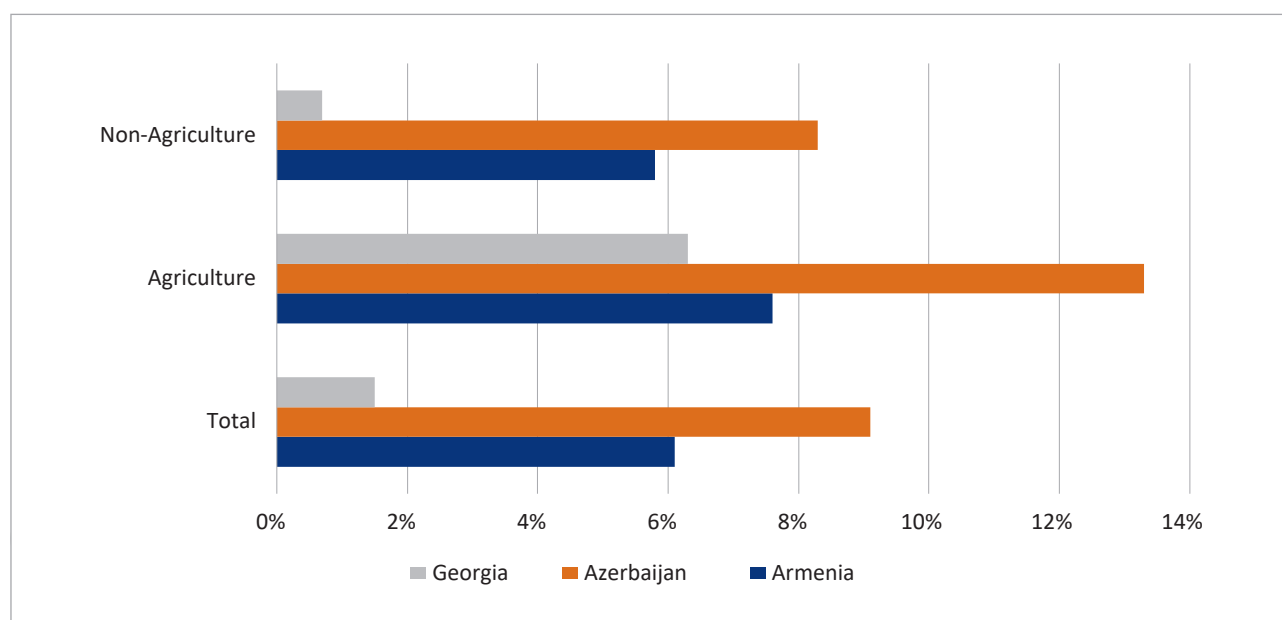
⁴³ See: https://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

⁴⁴ According to the WTO Glossary, MFN is a "normal non-discriminatory tariff charged on imports that excludes preferential tariffs under free trade agreements and other schemes or tariffs charged inside quotas". (Available from: https://www.wto.org/english/thewto_e/glossary_e/mfn_tariff_e.htm). The members of the WTO agree to accord MFN status to each other. Exceptions are preferential treatment of developing countries, regional free trade areas, and customs unions.

⁴⁵ The tariff schedule of Armenia already considers the changes that occurred due to the country's membership in the EAEU. In 2014, before joining the EAEU, Armenia had a simple average tariff at 3.7%.

⁴⁶ Before joining the EAEU, over 70% of Armenia's tariff lines were duty-free (applied MFN tariffs).

Figure 4-1: Average MFN imports duties, 2015



Source: WTO.

Beyond tariffs, each country has established a system of non-tariff regulations. In general, the countries in the region avoid applying “core” non-tariff barriers in the form of quotas or widespread licensing requirements.⁴⁷ However, non-tariff measures (NTMs) that are applied by these countries, notably, in the area of food safety and industrial product safety, could constitute an increasingly important barrier to intra-regional trade.

Box 4-1: Non-tariff barriers and sustainable development goals

With the global reduction of tariffs, the non-tariff measures (NTMs) have become a major source of trade costs and thus a factor that is affecting trade flows. Equally, NTMs play an important role in achieving developmental, in particular social and environmental, objectives that are not directly related to trade. According to UNCTAD (2016), “the vast majority of NTMs are SPS measures and TBT which are commonly used to protect consumer health, animal or plant life and the environment. They directly target issues related to sustainable development, such as the quality of food, health and safety standards or requirements for sustainable production methods.” The TBT/SPS measures support the achievement of the following SDGs:

- Target 2: End hunger, achieve food security and improved nutrition; promote sustainable agriculture
- Target 3: Ensure healthy lives; promote well-being for all
- Target 12: Ensure sustainable consumption and production patterns
- Target 13: Take urgent action to combat climate change and its impacts
- Target 14: Conserve and sustainably use oceans, seas and marine resources
- Target 15: Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification; halt and reverse land degradation; halt biodiversity loss

⁴⁷ Most import licenses and permits cover the movement of internationally regulated products, like radioactive substances, narcotics, etc.

Therefore, SPS and TBT measures have a role in the implementation of the SDGs, while at the same time can be applied in a more trade restrictive manner than is required to achieve their legitimate regulatory function of achieving the health, safety and environmental goals. For this reason, the World Trade Organization rules of SPS and TBT measures appropriately require that such measures be applied in the least trade restrictive manner, consistent with the achievement of their legitimate regulatory role. Later in this report, we propose the establishment of “supply chain councils” within countries, to monitor and recommend regulatory procedures so that the SPS and TBT measures (as well as other regulations and institutions) are applied in a manner that imposes the least costs on the trade regime, consistent with the achievement of their legitimate regulatory functions.

Source: UNCTAD (2016), Trading Into Sustainable Development: Trade, Market Access, and the Sustainable Development Goals. Developing countries in international trade studies.

Armenia’s membership in the EAEU ensures that the country has embarked on a process of convergence with EAEU product standards and technical regulations, a system that the ITA-run website, www.export.gov, described as “extremely complex, lacking clarity and highly redundant.”⁴⁸ Armenia has committed to implementing the technical regulations of the EAEU within the following years. For most of their goods, the two-year transitional period began on 1 January 2016 and lasted until 2018. For certain products, like furniture or wheeled vehicles, the new requirements will go into effect in 2019 and 2022, respectively.⁴⁹

As of March 2018, the EAEU enforces 38 technical regulations.⁵⁰ National mandatory requirements can be applied only to products that are not subject to EAEU technical regulations. The EAEU Commission has approved a Common List of Products to which the Technical Regulations of the EAEU or National Mandatory Requirements of its Member States can be applied. EAEU members cannot impose mandatory requirements on products outside this list. To import products subject to technical regulation, it is necessary to attain a conformity assessment certificate or provide a declaration of conformity as defined by the EAEU.

EAEU member countries primarily use the Soviet-style GOST system for food and agricultural products,⁵¹ although the EAEU has a long-term objective of convergence with European Union product standards and technical regulations.⁵² Given that the EAEU has principally employed harmonization (the adoption of a common technical regulation that all member countries must adopt), as opposed to mutual recognition (the acceptance of differing standards among member countries, provided they maintain all health and safety concerns), the reduction of standards and technical regulations as non-tariff barriers within the EAEU has been painfully slow. Since any harmonized regulation within the EAEU is negotiated among member countries, the resulting regulation can be distinct from others regulations around the world. For many years to come, Armenia could have standards that are compatible neither with the old Soviet-style nor the European Union standards. Therefore, harmonization or mutual recognition within EAEU standards will facilitate trade within the union, but it may harm imports and impose additional costs on exports to the rest of the world if the harmonized EAEU standards diverge from international requirements.

⁴⁸ See: <https://www.export.gov/article?id=Armenia-trade-barriers>

⁴⁹ See: <https://www.export.gov/article?id=Armenia-trade-barriers>

⁵⁰ See: <http://www.eurasiancommission.org/ru/act/txnreg/deptexreg/tr/Pages/TRVsily.aspx>

⁵¹ Tarr, D. (2016). *The Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia, and Kyrgyz Republic: Can It Succeed Where Its Predecessors Failed?* Eastern European Economics, 54:1.

⁵² The EAEU technical regulations are based on international regulations, unless the latter does not comply with EAEU regulatory objectives, including climatic and geographical factors, or technological and other particularities. Available from: *Trade policy review. Russian Federation Report by the Secretariat (2016), WT/TPR/S/345/Rev.1.*

Like other countries, **Azerbaijan** applies a standard set of trade restrictions on dangerous products.⁵³ These regulations are largely compliant with WTO norms and practices. Tariff rate quotas are applied to the import of wine and tobacco products.⁵⁴ Azerbaijan applies export duties on selected metals and products thereof,⁵⁵ while exports of certain types of scrap metal are prohibited. It is noteworthy that the export ban is not compliant with GATT XI,⁵⁶ and it should be removed when Azerbaijan becomes a member of the WTO.

Azerbaijan is still in the process of adapting to the WTO TBT/SPS system. Products are currently subject to mandatory certification, which is regulated by a 1993 government decree (with several subsequent amendments).⁵⁷ Although the system has performed adequately in terms of safety, its excessive mandatory nature is costly, hindering economic development and trade.⁵⁸ Furthermore, international experts indicate that it is not fully compliant with the WTO agreements on Technical Barriers to Trade (TBTs) and Sanitary and Phyto-Sanitary (SPS) measures. As the Russian Federation and the EAEU evolve away from the GOST system, if Azerbaijan delays its TBT/SPS reform process, it will make it difficult for its exporters to market in the South Caucasus and the Commonwealth of Independent States (CIS), as well as outside the region. Azerbaijan would benefit by moving toward an internationally accepted system of standards and technical regulations.

In addition to the legal barriers, international assessments and local respondents note the high costs and cumbersome procedures involved in moving goods across the border, as well as the importance of informal networks,⁵⁹ a high level of monopolization, uncertainty in the application of legal norms, and the significant role of the State in the economy. While improvements in customs procedures was noted by some respondents, they also identified the need for further improvement. The accession of Azerbaijan to the WTO (discussed below) could help tackle these trade obstacles. In the 13th meeting of the WTO Working Party on the accession of Azerbaijan, held in July 2017, the representative of Azerbaijan indicated that the country had recently implemented twelve Strategic Roadmaps for the reform of the economy, in addition to regulations on trade facilitation that would serve as a foundation for the successful accession of Azerbaijan to the WTO.⁶⁰ **Georgia** does not apply any quantitative restrictions on trade, except for the internationally recognized restrictions on dangerous products. The Law on Licenses and Permits does not allow non-tariff restrictions on foreign trade, except when it is necessary for health, security and environmental protection purposes.

As a part of its Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU, Georgia has agreed to adapt to the EU system of product standards and regulations. This includes its food and product safety system, as well as industrial goods. This is a worrisome obligation for Georgia's regional trade partners, as well as for its domestic producers, as the differing standards will have a significant impact on trade.

Crucially, once Georgia adopts the EU system for a product, Georgia will be obligated to deny entry to imports that fail to meet the equivalent EU standards and regulations. This will thus deny access to many Armenian

⁵³ See:

<https://en.portal.santandertrade.com/international-shipments/azerbaijan/customs-and-transportation>; <https://www.export.gov/article?id=Azerbaijan-Prohibited-and-Restricted-Imports>

⁵⁴ See: http://www.carecprogram.org/uploads/events/2013/TPCC-meeting-KAZ/006_105_209_trade-policy-AZB-ru.pdf

⁵⁵ <http://www.az-customs.net/rus/4658.htm>

⁵⁶ See: https://www.wto.org/english/res_e/publications_e/wtr10_21may10_e.htm

⁵⁷ See: http://www.ved.gov.ru/exportcountries/az/about_az/laws_ved_az/laws_trade_az/

⁵⁸ Tarr, D. (2016). *The Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia, and Kyrgyz Republic: Can It Succeed Where Its Predecessors Failed?* Eastern European Economics, 54:1.

⁵⁹ These issues were mentioned in our interviews in both Azerbaijan and Georgia. For a discussion of the widespread use of informal networks in Azerbaijan, see: Aliyev, H. (2017). *Informal Institutions in Azerbaijan: Exploring the Intricacies of Tapsh*. Europe-Asia Studies, DOI: 10.1080/09668136.2017.1329404.

⁶⁰ See: *Azerbaijan urged to step up bilateral talks with WTO members on membership terms*. Available from: https://www.wto.org/english/news_e/news17_e/acc_aze_28jul17_e.htm

and Azerbaijani imports, as well as imports from other countries, unless they have complied with the same EU standards. Even Georgian firms will legally be prohibited from selling in Georgia unless they meet the relevant EU standards. The experience in the Baltics, after their accession, has shown that rapid conversion to EU standards was extremely costly to their agricultural and food processing sectors. This experience suggests that Georgia needs to adopt a more gradual approach to the convergence of EU standards and technical regulations. Therefore, it is recommended that Georgia use a case-by-case basis, which considers the costs versus the benefits, in line with its commitments.

For the often-problematic goods of animal-origin, an intermediary solution could be applied. It requires the establishment of a proper national control system recognized by the EU, and the subsequent verification of individual enterprises aimed at exporting to the EU, while other enterprises (temporarily) remain non-complaint. However, even the establishment of a national control system is a cumbersome procedure. In 2017, Georgia succeeded in gaining access for two types of animal products- honey and fishery goods, as well as for several animal by-products, not designated for human consumption.

WTO membership

The importance of the WTO in the achievement of the SDGs has been explicitly recognized. Target 17.10 promotes “a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the World Trade Organization (WTO) including through the conclusion of negotiations within its Doha Development Agenda.”⁶¹ Currently, two of the region’s countries, Armenia and Georgia, are members of the WTO, while Azerbaijan is still negotiating the terms of its accession.

Armenia

Armenia became a WTO member in 2003. Despite the recent increase in import duties, resulting from its membership in the EAEU, the total average of Armenia’s applied MFN duties are still below its bound levels. Where the simple average final bound rate for Armenia is 8.5% compared to a 6.1% applied MFN rate.⁶² In agriculture, Armenia has the significant potential to increase tariff rates within the EAEU, without violating its WTO commitments, as the difference between the bound and applied rates is almost twofold (14.7% bound vs. 7.6% applied). For non-agricultural products, the gap between bound and applied is already much smaller: 7.6% vs. 5.8%.

In October 2014, the country notified the WTO of its intention to join the EAEU and thus to modify its goods schedule. The changes are expected to affect 6,536 tariff lines,⁶³ i.e. more than a half the entire schedule. The average Armenian bound tariffs are higher than Russian bound tariffs for the majority of product categories. However, there are categories for which Armenia is likely to set a higher rate than the current bound rate. These categories may include chemicals and wood, also minerals and metals, beverages and tobacco products, and animal products.

The enactment of the WTO Trade Facilitation Agreement (TFA) imposed new commitments on Armenia in the relation to transparent and efficient customs managements. Specifically, Armenia explicitly requires technical assistance for:

The use of international standards in implementation of formalities related to importation, exportation and transit;

- ▶ The operation of a “single window”;
- ▶ The establishment of a separate infrastructure for transit;

⁶¹ See: <https://sustainabledevelopment.un.org/sdg17>

⁶² See: http://stat.wto.org/TariffProfiles/AM_e.htm

⁶³ See: <http://data.consilium.europa.eu/doc/document/ST-5799-2015-INIT/en/pdf>

- ▶ The implementation of other commitments related to transit, such as transit formalities, conformity assessment, prior processing of documentation, and transit termination.

The full list of Armenia's obligations can be found in Annex 4.

Azerbaijan

Azerbaijan applied for WTO membership in 1997, and the negotiations are still ongoing.⁶⁴ The latest, the 14th round of talks, was held in July 2017, and progress is yet slow.⁶⁵ According to the Ministry of Economy of Azerbaijan, the country is conducting bilateral accession talks with 21 countries.⁶⁶ The first bilateral protocol of accession was signed with Turkey in 2007, followed by Oman and the United Arab Emirates in 2008, Georgia in 2010, and Kyrgyzstan in 2012.

Azerbaijan has offered to set the bound rate at a level above its current applied level of tariff protection. Notably, for agricultural products, Azerbaijan's initial offer was around 23%,⁶⁷ while the currently applied rate is approximately 13%. For non-agricultural products, the initial offer was 10%, while the applied rate is about 8%. Azerbaijan also aims to get a tariff rate quota on wheat with a 30% customs duty outside the quota.

According to the Action Plan 39 legal acts, adopted by presidential decree No.1583, from 2 August 2006,⁶⁸ covering such areas as the customs code, import licensing, technical barriers to trade and food safety issues, enforcement of intellectual property rights, etc., are to be passed to harmonize Azerbaijani legislation with WTO norms. Currently, eighteen of such acts have been adopted and enacted, while ten draft acts are being prepared and approved by the relevant public authorities, and the remainder are in the preparatory process. Thus, Azerbaijan will need to implement substantial reforms before its trade regime will become WTO compliant.

There are several critical points relating to Azerbaijan's negotiations. Azerbaijan is currently seeking "developing country status" (DCS), which is one of the most debated issues within the nation.⁶⁹ DCS status provides certain privileges to a WTO member, including prolonged implementation periods, an increased *de minimis* level of agricultural support, and provision of special assistance. Azerbaijan aims to attain the status for the entire country, or at least in certain areas, particularly in agriculture. Previous experience of transition countries that have acceded to the WTO suggests that the negotiation will be very difficult. Transition countries have agreed to aggregate levels of support in agriculture of less than or equal to ten percent. Since a developing country without any such accession commitment to an aggregate level of support can have *de minimis* levels of support at twenty percent (ten percent for specific products and ten percent in general), a commitment to the maximum level of support between five and ten percent makes DCS and *de minimis* negotiations irrelevant. For example, Georgia had to accept 5% *de minimis* for agriculture, and Armenia had a transitional period, during which 10% *de minimis* was applied before it was lowered to 5%. Moreover, Saudi Arabia joined the WTO in 2005 with 10% *de minimis*.⁷⁰

We believe that in trade policy the highest priority for Azerbaijan is to accede to the WTO, a crucial step for any country committed to integration within the world trading arena. Therefore, the country hopes to use international trade to help develop according to the principle of comparative advantage- both for goods and, with the formation of the General Agreement on Trade in Services (GATS), for services too. As a result of the

⁶⁴ See: http://www.economy.gov.az/index.php?option=com_content&view=article&id=292&Itemid=182&lang=en

⁶⁵ See: https://www.wto.org/english/news_e/news17_e/acc_aze_28jul17_e.htm

⁶⁶ USA, EU, Canada, Japan, Norway, Russian Federation, Brazil, South Korea, Ecuador, Chinese Taipei, Sri-Lanka, India, Switzerland, Honduras, Indonesia, Malaysia, Republic of Dominican, Saudi Arabia, China, Viet Nam, and Paraguay.

⁶⁷ See: <http://www.wto.az/indexENG.htm>

⁶⁸ See: http://www.wto.az/pdf/Tedbirler_PlaniENG.pdf

⁶⁹ See: <http://www.wto.az/indexENG.htm>

⁷⁰ See: https://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c5s3p2_e.htm#table9

negotiation process, acceding countries typically benefit from a more open trade regime than they would have attained with only domestic lobbying present. Of the fifteen countries of the former Soviet Union, only Azerbaijan, Belarus, Turkmenistan and Uzbekistan remain outside the WTO. Experience has shown, however, that substantial technical assistance is useful, if not required, in the effort to implement all the necessary legal, policy and technical measures required for WTO accession.

Georgia

Georgia joined the WTO in June 2000.⁷¹ The country agreed to fairly liberal commitments, though its actual trade policy has been even more liberal. According to the WTO, Georgia's total final bound rate is 7.3%, while the applied MFN rate is only 1.5%. The discrepancy is notable both for agricultural (12.5% vs. 6.3% for bound and applied rates, respectively) and non-agricultural (6.5% vs. 0.7%) products.

Georgia's average applied MFN duties are lower than the final bound rates for all aggregate product categories. Moreover, for about half of the product categories, in particular, non-agricultural products, Georgia applies zero duties, although its bound rates are positive. According to its commitments, Georgia only has 23% duty-free bound tariff rates, while its applied schedule features 87% duty-free rates.

The enactment of the WTO TFA imposed commitments on Georgia for transparent and efficient customs managements. The country requested technical assistance for the implementation of:

- ▶ Trade facilitation measures for authorized operators;
- ▶ Prior processing of documentation (in the case of transit).

The precise list of the country's obligations can be seen in Annex 4.

Regional trading arrangements

Regional trade agreements (RTAs) provide additional trade liberalization among participating countries, however they may provide a less favorable trading environment for countries excluded from an agreement. Whether an RTA contributes to or detracts from the achievement of the SDGs must be evaluated on a case-by-case basis. An RTA may be beneficial on balance but have negative components regarding the achievement of the SDGs.

The countries of the South Caucasus actively participate in the development of an RTA network. Most notably, Armenia is a member of the EAEU and has recently signed the Comprehensive and Enhanced Partnership Agreement (CEPA) with the EU. Georgia has concluded an Association Agreement (AA) with the EU and Free Trade Agreements (FTAs) with China, Turkey, and the European Free Trade Association (EFTA). While Azerbaijan, alongside Georgia and Armenia, are a part of the overlapping FTA network with the CIS.

Armenia

Armenia features an extensive network of RTAs. The country has seven bilateral and plurilateral FTAs within the CIS space. Since becoming an EAEU member, Armenia is facing another wave of expansion of RTAs. An FTA with Viet Nam is already in force, and several more are currently at different stages of negotiations (see Annex 5). The enacted agreements provide access to around 5% of the population and 3% of GDP, due largely to the inclusion of Russia. If the EAEU successfully completes all ongoing talks, Armenia will gain free trade access to a market of 25% of the world's population, producing 7% of the world GDP, measured in current USD.

For Armenia, the most important RTA is the EAEU; of which Armenia became a member in 2016. As the member of the customs union, Armenia is committed to implementing a common trade policy. As a result, the country has shifted towards higher levels of protection for most products, especially industrial goods. The

⁷¹ See: https://www.wto.org/english/thewto_e/acc_e/a1_georgia_e.htm

transitional periods for convergence with EAEU tariffs will last until 2022, although the majority of tariffs will be equivalent by 2020.

EAEU membership envisages not only convergence of tariff schedules, but also common policies regarding trade remedies, product safety regulations, customs services, and consumer protection: thereby forming an important transformative power within the Armenian economy. The goal of the EAEU is to achieve the free movement of goods, services, capital and labor. As previously discussed, Armenia is committed to implementing the EAEU TBT and SPS regulations within the following several years. However, the short-term efficiency of the system, into which Armenia is converging, is questionable, as non-tariff barriers within the EAEU remain high.⁷²

The EAEU has already had manifold impacts on Armenia. Although Armenian exporters have faced no improvement in tariff access to the EAEU market, they have gained through the reduction of customs costs (their elimination is impossible due to Armenia's geographic location) and an abolishment of the rules of origin checks (as a complementary measure to the common trade policy vis-à-vis the rest of the world). The ongoing harmonization of standards will reduce the costs of access to the EAEU market, in particular products of an animal origin. However, the improvement of exports to the EAEU could come at the expense of more costly imports from other countries due to diverging standards.

The expansion of the RTAs signed by the EAEU could help compensate the increased protectionism of Armenian trade policy. In 2016, the FTA with Viet Nam came into force, assisting the liberalization of trade in agriculture and industrial products and cooperation on many trade-related issues,⁷³ including the technical barriers to trade, food safety regulations, IPRs protection, trade in services, etc. Although, this FTA will only have a minor impact on Armenia, whose trade with Viet Nam is around 0.3% of its total trade in goods. Other forthcoming RTAs could be more promising, as the EAEU is currently negotiating a preferential trade agreement (PTA) with Iran, which could be the first step in finalizing an FTA later on. The preferential trade agreement envisages a reduction of import duties on 200 tariff lines.⁷⁴ The EAEU also announced FTA talks with Israel, Egypt, Singapore and India, out of which the FTA with India could be the most stimulating for Armenia. Of the four areas of liberalization in the EAEU (goods, services, capital and labor), the most valuable for Armenia is likely to be free movement of labor within the EAEU. Armenian workers are currently legally permitted to work in Russia and the other countries of the EAEU. A preliminary estimate has placed the value of the free movement of Armenian labor in Russia at about five percent of Armenian GDP; this exceeds the estimated Armenian losses from its increased tariff requirements in implementing the common EAEU external tariff.⁷⁵

Post-Soviet FTAs were mostly concluded by the second half of the 1990s and early 2000s. An exception is the CIS FTA (2012), which replaced an earlier CIS FTA (1994). A key feature of the various CIS free trade agreements is that they use the CIS Treaty on Rules of Origin, which allows full cumulation.⁷⁶ Full cumulation is the least restrictive cumulation rule, signifying that all value-added activities carried out in participating FTA countries are taken into account for origin determination purposes.⁷⁷ This feature significantly improves the importance of the CIS network of FTAs for its participants.

⁷² Tarr, D. (2016). *The Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia, and Kyrgyz Republic: Can It Succeed Where Its Predecessors Failed?* Eastern European Economics, 54:1.

⁷³ See: <http://www.vietnam-briefing.com/news/eurasian-economic-unionvietnam-fta.html/>

⁷⁴ See: <https://ria.ru/world/20170616/1496691104.html>

⁷⁵ The preliminary estimate by A. Knobel, A. Lipin, A. Malokostov, D. Tarr & N. Turdyeva as part of an evaluation of the impact of the EAEU on its members.

⁷⁶ See: http://www.armcci.am/files/Pravila_opredeleniya_strany_proisxozhdeniya_tovarov.pdf

⁷⁷ See: <http://www.wcoomd.org/en/Topics/Origin/Instrument%20and%20Tools/Comparative%20Study%20on%20Preferential%20Rules%20of%20Origin/Specific%20Topics/Study%20Annex/CUM%20FUL>

“Armenia and the EU have negotiated and initialed AA which encompassed the DCFTA similar to those signed by Georgia, Moldova and Ukraine. The AA was not signed due to Armenia’s decision to join the EAEU in 2013. Negotiations on a new framework agreement were launched in December 2015, resulting in the signing of the EU-Armenia Comprehensive and Enhanced Partnership Agreement (CEPA) in November 2017. The new agreement can be viewed as an Association Agreement without the DCFTA, as it retains the important parts of an Association Agreement, such as political dialogue, justice and freedom, and security. Moreover, it maintains the legal approximations in some cases, including those important for the achievement of SDG areas, for instance safety at work, equal treatment, gender and racial equality, anti-discrimination, essential labor market regulations, and environmental standards.⁷⁸ However, its economic impact is expected to be less significant than with the DCFTA. Armenia’s admission to the EU market is currently subject to the enhanced Generalized System of Preferences (GSP+), providing duty-free access for about two-thirds of tariff lines.

Azerbaijan

In comparison to its South Caucasus neighbors, Azerbaijan is the least active in establishing regional trade agreements. As of mid-2017, Azerbaijan has signed six RTAs, including five FTAs and one PTA (see Annex 5). These RTAs cover thirteen countries, representing around 9% of the world’s population and 4% of world GDP (in current USD, 2015), and include FTAs covering 3% of the population, and 2% of the GDP and the PTA- 6% and 2%, correspondingly.

The geographic coverage of Azerbaijan RTAs has recently shrunk. Initially, the CIS FTA (1994) was signed by the majority of former Soviet Union members.⁷⁹ However, it was never ratified by all signatory parties, in particular, Russia. In 2012, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Ukraine left the CIS FTA (1994) when the new CIS FTA (2012) was signed.⁸⁰ As a result, the remaining CIS FTA (1994) has only four signatory parties- Azerbaijan; Georgia, Turkmenistan, and Uzbekistan- which narrows its coverage tremendously.

Azerbaijan has bilateral FTAs with Georgia, Ukraine, Russia, and the plurilateral CIS FTA (1994). All of which cover trade in goods and feature a limited number of details. Bilateral agreements cover only trade in goods and are quite simplistic, envisaging duty-free trade, no quantitative restrictions, and free transit. While, the CIS FTA (1994) is slightly more elaborate. It stipulates duty-free trade and calls for harmonization of technical regulation and other special requirements that constitute trade restrictions, and the unification of customs procedures. Moreover, it allows for the possibility to cancel restrictions of trade in services, although with no clear guidelines.

In 2003, Azerbaijan joined the GUAM FTA with Georgia, Ukraine, and Moldova. This agreement largely replicates the preexisting Azerbaijan FTAs within the CIS, making it largely redundant. Nevertheless, as the first agreement signed without Russia, it has become the next step in the regional integration of the post-Soviet space. In 2017, the GUAM FTA was revived; during the GUAM Summit in Ukraine, March 2017, the parties signed a protocol aimed at enhancing coordination within the GUAM FTA and the protocol on Mutual Recognition of Selected Customs Checks.⁸¹ The latter is expected to stimulate trade under the GUAM FTA.

Thus far, only one “new” RTA was signed by Azerbaijan- the Economic Cooperation Organization Trade Agreement (ECOTA) with Afghanistan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkmenistan and Uzbekistan, which foresees trade preferences, but not free trade. The ECOTA focuses on tariff concessions, certain competition issues, and protection of intellectual property rights. The parties agreed to liberalize import du-

⁷⁸ Kostanyan, H. & Giragosian R. (2017). *EU-Armenian Relations: Charting a fresh course*. Available from: https://www.ceps.eu/system/files/HKandRG_EU_Armenia.pdf

⁷⁹ Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan (only three Baltic countries and Turkmenistan did not sign).

⁸⁰ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=762>

⁸¹ See: http://www.kmu.gov.ua/control/uk/publish/article?art_id=249853228&cat_id=244276429 (in Ukrainian)

ties for about 80% of products, to set a maximum rate at 15%, and to limit the use of quantitative restrictions and state aid policies, which distort competition.⁸² ECOTA is the most elaborate RTA signed by Azerbaijan, although it still requires “operationalization.”⁸³ At the 13th Economic Cooperation Organization (ECO) Summit, held in Islamabad in March 2017, the parties adopted the ECO Vision 2025,⁸⁴ which specifically aims at boosting trade by establishing an FTA. If these plans are implemented, Azerbaijani trade will benefit from an important impetus in development.

Considering the current structure of Azerbaijani trade, dominated by mineral fuels, the benefits of RTAs for Azerbaijan’s exports remain quite limited, although they will grow with the expansion of non-energy exports, especially agricultural exports. Thus, Azerbaijan should consider the possibility of new RTAs to stimulate non-energy exports. For which, membership in the WTO would become a prerequisite.

Georgia

Georgia has established, economically, the most powerful network of FTAs in the South Caucasus. Currently, Georgia has twelve enacted FTAs;⁸⁵ one has completed negotiations, another is at the feasibility stage. If all these FTAs are considered together, Georgian exporters will have duty-free access to 48% of the world’s population, representing 45% of global GDP in current USD. Currently, the ratified FTAs provide access to 31% of the world’s population and 41% of global GDP.

There have been several ‘waves’ of FTAs in Georgia. The first wave incorporates the post-Soviet FTAs, typically signed in the 1990s or early 2000s. These are the most simplistic FTAs, covering trade in goods (duty-free trade, with no quantitative restrictions), and without detail regarding the trade-related regulatory environment. Crucially, FTAs within the CIS stipulate the principle of free transit to ensure the inter-connectivity of the region. The stand-alone CIS Rules of Origin Agreement regulates the application of such rules within the various CIS free trade agreements.⁸⁶

The second wave includes FTAs with Turkey, the EU, and the EFTA, signed between 2007-2016. These FTAs differ in their scope but are interlinked through the EU and Pan-Euro-Med Convention of the Rules of Origin. The Georgia-Turkey FTA entered into force in 2008. It works towards duty-free trade in industrial goods, some liberalization for agricultural products, and no quantitative restrictions.⁸⁷ According to Tvalodze (2016), despite its rather limited scope in agriculture, the Georgia-Turkey FTA has had a positive impact on trade and GDP. In particular, bilateral trade has increased by 2.2% and extra-regional trade by 0.2%.

In 2017, Georgia re-opened FTA talks with Turkey, and there are two issues to be agreed upon. Firstly, the rules of origin of the Pan-Euro-Med guidelines are to be adapted so that both partners are able to use diagonal cumulation.⁸⁸ Secondly, the parties are negotiating liberalization in the service trade. The implementation of the Pan-Euro-Med rules for trade with Turkey could help Georgia to develop their production of apparel. Turkey has already invested in this Georgian sector, attracted by low labor costs, while the Pan-Euro-Med removes the trade costs associated with the rules of origin requirements.

⁸² See: <http://wits.worldbank.org/GPTAD/PDF/archive/ECO.pdf>

⁸³ See: <http://www.pid.gov.pk/?p=35664>

⁸⁴ See: <http://www.pid.gov.pk/?p=35664>

⁸⁵ The FTA with the EFTA entered into force in September 2017 for Norway and Iceland, and in May 2018 for Switzerland and Liechtenstein.

⁸⁶ See: http://www.armcci.am/files/Pravila_opredeleniya_strany_proisxozhdeniya_tovarov.pdf

⁸⁷ Tvalodze, S. (2016). *Georgia-Turkey Trade Relations - Challenges and Opportunities*, within *Policy Research for Sustainable Economic Development*. PMC Research Center with the support of the Konrad-Adenauer-Foundation.

⁸⁸ Diagonal cumulation can be used if three or more countries have free trade agreements with each other. The domestic content of goods is composed of not only the exporting country but also third parties, which provides further opportunities for cumulating origin. See: Kovziridze, T. et al. (2017). *PEM Convention and its Benefits. A Comparative Analysis of Georgia, Moldova and Ukraine*. Available from: www.3dcftas.eu

The signing of the Association Agreement, including the DCFTA, with the EU at the end of 2013, became a break-through event, not only for Georgia's trade policy, but also for the landscape of its entire economic policy. The AA/DCFTA came into force, provisionally, in September 2014, and was fully enacted by July 2016. The Agreement is expected to have a significant transformative impact on the country. Unlike any other FTA signed by Georgia, this agreement covers a very large range of trade-related issues, and aims to ensure free trade in goods, liberalization of trade-in-services, as well as widespread regulatory harmonization. The DCFTA envisages duty-free trade without transitional periods or quantitative restrictions, the harmonization of TBT and SPS regulations, mutual access to public procurement, and the liberalization of services.⁸⁹ In addition, the AA envisages cooperation and gradual legislative harmonization in many other areas, including customs, intellectual property rights protection, energy market regulation, for the environment, consumer protection, and social and labor policy. Georgia has specifically committed to strengthening health and safety at work, combating discrimination in the workplace, and harmonizing its labor regulations with EU norms. These commitments will contribute to the achievement of the SDGs, though they are costly, and thus a gradual approach to their attainment is required to avoid putting excessive pressure on the economy.

The AA/DCFTA, as a very complex agreement, has multiple impacts on Georgia. Firstly, it significantly improves access to the EU market for Georgian products. Secondly, through preferential access to the EU market and the improvement of the economic governance needed to attract FDIs, it creates stimulus for investment in Georgia, which serves the EU market (see the discussion in Chapter 7). Likewise, it creates opportunities for the negotiation of FTAs with countries who were previously unconcerned about establishing deeper trade relations with Georgia, in particular, China.

However, the economic benefits are accompanied by the costs related to standards harmonization. As discussed above, a gradual process with a step-by-step analysis is required to manage the process carefully.

The third wave of FTAs might tentatively be named "Asian" FTAs. These FTAs will not be able to benefit from the Pan-Euro-Med Rules of Origin. However, they will benefit from fully liberalized trade in goods with the EU and a very favorable business environment, conducive for export-platform FDIs. Of these, the Georgia-China FTA is the best example: the agreement of which was signed in May 2017, after only around one year of talks, and it entered into force in January 2018.⁹⁰

The main features of the Georgia-China FTA are liberalization of tariffs, although with exemptions on both the Chinese and Georgian sides, liberalization of trade in selected service sectors, in addition to existing WTO obligations, and a commitment to WTO obligations with respect to trade-related regulatory issues, like technical barriers to trade or food safety.⁹¹ The implementation of the Georgia-China FTA is expected to stimulate trade and GDP for both partners. Georgia's exports to China are estimated to grow by an additional 29.1% (24.5 m USD) and China's exports to Georgia are expected to grow by 6.7% (53.0 m USD).⁹² However, the key impact of the FTA is not expected to be trade with China, rather attracting investment, in particular, export-platform investments targeting markets: crucially, those with which Georgia has FTAs, namely the EU, Turkey, the CIS and the EFTA.

Summary

The South Caucasus has relatively low import duties, ranging from 9% in Azerbaijan to 1.5% in Georgia. As a result of its accession to the EAEU, Armenia has started to gradually increase its tariffs to align them with the tariff schedule of the EAEU. This has forced Armenia to negotiate compensation with its WTO partners, and on many product lines it violates its WTO bound tariff commitments.

⁸⁹ Emerson, M. & Kovziridze, T. (ed.) (2016). *Deepening EU-Georgian Relations. What, why and how?* Available from: <http://3dcftas.eu/publications/key/deepening-eu%E2%80%93georgian-relations-what-why-and-how>

⁹⁰ See: http://fta.mofcom.gov.cn/enarticle/chinageorgiaen/chinageorgiaennews/201801/36885_1.html

⁹¹ Kovziridze, T. (2017). *Georgia-China FTA: A Side Effect of the EU-Georgia DCFTA?* Available from: <http://3dcftas.eu/publications/other/georgia-china-fta-side-effect-eu-georgia-dcfta>.

⁹² See: *Joint Feasibility Study on China – Georgia's Possible Free Trade Agreement* (2015), the research was conducted by PMC Research Center and University of International Business and Economics (UIBE), with close cooperation of the Ministry of Economy and Sustainable Development of Georgia and the Ministry of Commerce of China.

Armenia, Azerbaijan and Georgia do not typically apply core quantitative restrictions. However, non-tariff barriers remain an important impediment to trade. Additionally, Azerbaijan is not yet a member of the WTO, the organization which plays a critical role in achieving global partnerships (SDG 17). Azerbaijan has been negotiating WTO accession for more than a decade, but progress remains slow.

Recently, regional trade arrangements in the South Caucasus have evolved dramatically, changing the established balance of trade relations in the region.

In 2014, Georgia signed the AA/DCFTA with the EU, which provides duty-free access for all Georgian-origin products to EU markets and requires a gradual harmonization of the standards that will eventually make access to the Georgian market more expensive. Duty-free access to the EU was used as a “selling point” to complete the next generation of the FTAs. As of March 2018, Georgian agreements with the EFTA and China are in place and talks with Hong Kong (China) have been completed. These FTAs are expected not only stimulate trade, through better market access, but also to attract FDI into the Georgian economy.

The further relaxation of rules of origin requirements within the Pan-Euro-Med area has become another avenue tapped by Georgia to reap DCFTA benefits. With the change in AA/DCFTA protocols regarding rules of origin, Georgia can now utilize the Pan-Euro-Med rules to trade between the EU, Turkey, and the EFTA.

In 2016, Armenia became a member of the EAEU, further ensuring improved access for Armenian-origin products into this market and simultaneously increasing tariffs for all partners with which there were no existing FTAs. On the positive side, the commitment of EAEU members to accept the free movement of labor allows Armenian workers to legally work in Russia and other countries in the EAEU. Preliminary estimates reveal that the economic value of the right of its workers to work in Russia likely exceeds Armenia’s cost of increasing its tariffs to implement the common external tariff. While regarding product standards, harmonization with EAEU standards will further increase the cost of access to the Armenian market for the rest of the world, including its FTA partners.

Thus, the region has diverging vectors of regional integration. Although the old FTAs between Azerbaijan and Georgia and between Armenia and Georgia have remained intact, they do not provide fresh impetus for trade development. One of very few new developments comes from the revival of the GUAM, where the members agreed on the mutual recognition of customs checks.

The membership of Azerbaijan in the WTO could provide a new stimulus for Georgia-Azerbaijan trade, by a partially reversing the ongoing process of TBT/SPS divergence. Another major stimulus could be derived from the reduction of trade costs associated with the movement of goods across the border. The next chapter will focus on these factors.

Recommendations:

For Azerbaijan to actively pursue its accession to the WTO, in particular, to gradually move toward the EU’s, or an internationally accepted, system of standards and technical regulations. The country should seek technical assistance to implement all the necessary changes.

For Georgia to adopt a gradual approach to its convergence with EU standards and technical regulations, and to consider and evaluate the costs versus the benefits on a case-by-case basis.

For Armenia and Georgia to continue pursuing the implementation of their commitments under the WTO Trade Facilitation Agreement, including seeking technical assistance for feasibility studies.

5. Transport Corridors in the Region

Although transport is not directly mentioned within the SDGs, the development of transport networks plays a special role in the achievement of the SDGs, including road safety (Target 3.6), energy efficiency (Target 7.3), sustainable infrastructure (Target 9.1), urban access (Target 11.2), and fossil fuel subsidies (Target 12.c). This development also contributes indirectly to other goals, including agricultural productivity (Target 2.3), sustainable cities (Target 11.6), and the reduction of food loss (Target 12.3).⁹³

Located at a crossroads between Europe, Central Asia, Russia, the Middle East and Asia, the South Caucasus connects several important global economic regions and thus acts as center point for many international transport corridors. In particular, there is an East-West Transport Corridor crossing Georgia and Azerbaijan; linking them with the Black Sea countries and the EU to the west and the Caspian Sea and Asia to the east. There are also two North-South corridors crossing the South Caucasus. One passes through Armenia and Georgia, connecting the Black Sea countries and Russia to the north and Iran to the south. Another North-South corridor passes through Azerbaijan, connecting Russia and Iran, and through them, Europe and Asia.

Notwithstanding the existing corridors, development of the transport network has been restrained as a result of the protracted conflicts that broke out in the early 1990s, which remain a source of uncertainty and instability. Notably, transport connections between Azerbaijan and Armenia have long ceased to exist due to conflict. While after the war in Abkhazia, a railway connection between Georgia and Russia was closed in the early 1990s. Armenia is a land-locked country, which continuously faces serious transport challenges associated with its location, topography, and the geopolitical situation.⁹⁴ The country only has two of its four borders open, those with Georgia and Iran. Although international agreements formally permit Armenian companies to transit goods through Turkey, businesses report major difficulties.

To tap into existing and new opportunities, and mitigate the consequences of existing limitations, it is necessary to strengthen both the physical and institutional capacities of transport and logistics services in the region, as well as to improve border management. In this chapter, we will focus on the transport infrastructure of the region, while issues associated with logistics and border management will be discussed in the next chapter.

Railways

Recently, the region's railways have actively been developed along all three key transport corridors. Azerbaijan is the most active in this field. The Azerbaijan North-South Railway Corridor is designed to connect the railways of Azerbaijan and Iran. It is considered a component of the International North-South Transport Corridor initiated by Russia, Iran and India to connect Northern Europe to Southeast Asia.⁹⁵

It is expected that the new corridor will be more competitive both in time and cost than the alternate options, such as the Suez Canal-Mediterranean-Northern Europe and Turkmenistan-Kazakhstan-Russia-Northern Europe routes. The current sea route, via the frontiers of Western Europe, through the Mediterranean and the Suez Canal, takes 40 days; the new North-South Corridor envisages reducing this by half and even delivering

⁹³ Based on the assessment of the role of transport in the SDGs completed by the Partnership on Sustainable, Low Carbon Transport. Available from: <http://www.slocat.net/sdgs-transport>

⁹⁴ See: <https://www.adb.org/sites/default/files/project-document/67653/40610-arm-tacr.pdf>

⁹⁵ See: <http://www.visions.az/en/news/795/0fba616/>

goods in as quickly as twelve days. The construction of a railway bridge over the Astara River, on the border between Azerbaijan and Iran, and the construction of the Qazvin-Rasht-Astara railway in Iran, are each important preconditions for the efficiency of the North-South Corridor project.

Figure 5-1: Rail map of the South Caucasus



Source: http://www.railway.ge/?web=0&action=page&p_id=290&lang=eng.

The construction of the Baku-Tbilisi-Kars Railway (BTK) has become a central component of the East-West Transport Corridor through the South Caucasus, and also a crucial link in the development of the Trans-Caspian International Transport Route (TITR).⁹⁶ This extensive route starts from Southeast Asia and China, runs through Kazakhstan, the Caspian Sea, Azerbaijan, Georgia and on to further European countries, and it was envisaged as a part of the Chinese “One Belt-One Road Initiative” (to be discussed in Chapter 7).

The BTK Railway was launched in October 2017, connecting Baku to Tbilisi through to Turkey’s Kars and finally to Mersin port. The BTK route was initially planned to transport around five million tons of freight and a million passengers per year, though in future expanding to seventeen million tons of goods and a few million passengers annually.⁹⁷

The railway connection between Georgia and Armenia has also been strengthened. The South Caucasus Railway CJSC, a subsidiary of the Russian Railway Company operating the Armenian Railway, has reached an agreement on regular activities with the Kavkaz Port to Poti ferry service (three times a month), which allows direct cargo transportation between Armenia, Russia and other CIS countries. Due to this connection, the ferry service tariffs are expected to drop by about 30%.⁹⁸

Although the development of the railway network is progressing swiftly, businesses yet complain about the quality of the services. For example, in Azerbaijan, a significant number of the rolling stock fleet that is used

⁹⁶ See: <http://titr.kz/en/route>

⁹⁷ See: <http://www.visions.az/en/news/795/0fba616/>

⁹⁸ See: http://www.finport.am/full_news.php?id=28333&lang=3; <https://www.azatutyun.am/a/28343888.html>

in railway transportation does not meet proper standards or is in very poor condition. While, half of the electric locomotives require replacement. The old rolling stock fleet and wagons require greater maintenance costs, which subsequently increases transportation charges. For older locomotives, running a longer distance without cooling their engines is not possible, often resulting in significant losses of time and an increase in transportation costs. Similarly, Georgian Railways needs to modernize its rolling stock, which contributes to lower speed and suboptimal operational practices.⁹⁹

Economically, railways are crucial for cargo transportation of bulk shipments, for instance, of ores, metals, and fertilizers. Moreover, the development of railways facilitates passenger traffic and helps to promote tourism. Scenic railway routes, for example, through the Caucasus mountains could become very attractive as tours.

Roads

The developed network of roads offers the most important domestic mode of transportation for all three South Caucasus countries, linking distant and frequently difficult-to-access villages high in the mountains with main roads and other modes of transportation. Roads also play a substantial role in the development of the South Caucasus transport corridors.

In Armenia, the North-South Road Corridor is a key transport artery. It runs from the border with Georgia at Bavra to the border with Iran at Meghri. The quality of roads connecting Armenia and Georgia are of particular importance, as trucks are the main means of cargo transportation in Armenia, while Georgia provides the only land access to the Russian Federation and Europe. Armenian businesses report that it takes approximately five hours to drive the 300 km from Yerevan to Tbilisi. These issues are due to the poor quality of the pavement and road congestion, both of which decrease speed and increase travel time and cost.

The EU's Neighborhood Investment Facility, the European Investment Bank, and the Asian Development Bank together provide loans to support the upgrade of sections of the North-South Road Corridor.¹⁰⁰ For example, in November of 2016, the Vanadzor-Alaverdi section of the North-South Road Corridor was closed for 36 months due to capital reconstruction. Although ultimately the quality of road services will improve, businesses presently lament that the alternative routes are less convenient for heavy trucks in terms of length and altitude, resulting in higher costs.

Moreover, major delays in the North-South corridor implementation, and an increase in construction costs, have been reported. The initial loan agreement between the Armenian government and the Asian Development bank envisaged the completion of the works by 2017, however, out of five sections, only one is currently close to completion. Moreover, that particular segment had some of the best conditions prior to renovation, and its repairs were not technically difficult. There are some further concerns that the costs are too great, for instance, a tunnel connecting to Iran is estimated at 300 m USD.

⁹⁹ Benmaamar, Keou, & Saslavsky (2015). *Georgia's Transport and Logistics Strategy Achievements to Date and Areas for Improvements*.

¹⁰⁰ See: http://ec.europa.eu/europeaid/blending/north-south-road-corridor-section-yerevan-bavra_en

Figure 5-2: Road map of the South Caucasus



Source: <http://maps.gol.ge/transport.htm>.

An equally important issue for Armenia is the development of roads network in Georgia, as they provide the only land connection to Russia. The current connection passes through one border crossing, Upper Larsi, which suffers from harsh weather conditions and a poor capacity. The re-opening of previous transport corridors through Georgian occupied territories was considered in the framework of Russia’s accession to the WTO, however it remains politically challenging.¹⁰¹

For Georgia, the most important task is the development of the East-West Highway (EWH); the road component of the East-West Transport Corridor. The EWH is the main transport artery for long-distance tariffs in Georgia and for transit from Azerbaijan and Armenia. It is a section of the Pan-European corridor linking the EU with Central Asia through the Caucasus, and a part of the Transport Corridor Europe-Caucasus-Asia (TRACECA) programme.¹⁰² In 2006, a rehabilitation program was launched, financed largely by international donors, including the EU’s Neighborhood Investment Facility, the European Investment Bank, and the World Bank.

Azerbaijan also intensively invests in road construction and modernization. The main transport corridors are the Baku-Alat-Ganja-Qazakh-Georgian border corridor (the Azerbaijani section of the TRACECA corridor) and the North-South Transport Corridor linking Russia and Iran through Azerbaijan. Aside from the roads themselves, efforts also need to be devoted to the quality of road services. For instance, businesses often complain about the lack of directional and speed limit signs, and insufficient traffic lights on the highway between Ganja and Georgian border.

¹⁰¹ De Waal, T. (2017). *Georgia and Russia Inch Towards a Business Deal*. Carnegie Europe. Available from: http://carnegieeurope.eu/strategieurope/?fa=74826&utm_source=rssemail&utm_medium=email&mkt_tok=eyJpIjoiWWpBeFluQUXhNakJpTW1abSIsInQiOiI1SVUxZWk2ZHU5VQ1draHlxVjdwS2YzSUR3aXhBa1dmQUtTld4Yng1ZGgrWlFZTXlpZHJyUURKdndRUUVEZmN2WTQxMF-pzZmZMQllzdEpKQVFBMWE0akZRdUxNZjRPYzhaY1R2RjlzUGVhWWpJVkl1dnVzWjRhYmhhLYXICVBTVCj9

¹⁰² See: https://ec.europa.eu/europeaid/blending/georgia-east-west-highway_en

Box 5-1: TRACECAA The Transport Corridor Europe-Caucasus-Asia (TRACECA) is an internationally recognized programme aimed at strengthening economic relations, trade and transport communication in the regions of the Black Sea basin, the South Caucasus and Central Asia.

TRACECA was established in May 1993 with the active support and involvement of the EU. In September 1998, twelve TRACECA countries signed the “Basic Multilateral Agreement on International Transport for Development of the Europe-the Caucasus-Asia Corridor” (MLA) with the aim of realizing their full geopolitical and economic potential. These countries are Azerbaijan, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkey, Ukraine and Uzbekistan. In 2009, the Islamic Republic of Iran joined TRACECA.

Since 2009, the organization has been entirely financed by its member countries.

Source: <http://www.traceca-org.org/en/countries/>.

The development of the road network and its continuous rehabilitation will help countries to achieve their SDGs targets, as many agricultural and food products, especially perishable goods, are transported by road. Additionally, roads have a much higher concentration and thus ensure interconnectivity between the region and its neighbors.

Ports and maritime transportation

Two South Caucasus countries, Azerbaijan and Georgia, have access to seaports. Azerbaijan has direct maritime connections with the Caspian Sea, and access to the high seas through the Volga-Don canal. The Baku International Marine Trade Port is Azerbaijan’s largest port in the Caspian Sea; with a present cargo capacity of around 5 m tons, however its capacity is not fully utilized.¹⁰³ Recently, Baku Port has undergone major operations streamlining, where an electronic “port community system” has been introduced. Trucks are assigned a sticker at its entrance, which has stopped the practice of queue jumping. A new port has also been built in Alat. Its initial capacity is 15 m tons per year, with the potential for a further expansion to 25 m tons, linked to growth in trade volumes (see Chapter 7 for more detail).

Georgia has two large Black Sea ports, Poti and Batumi, both acting as key links within the TRACECA trade route (Figure 53). Batumi port operates the oil, container and railway ferry, and dry cargo and marine passenger terminals.¹⁰⁴ The port is managed by the Green Oak Group of Denmark, which gained a 49-year contract for the role. Poti port operates each dry cargo, container and ferry terminals. A new deep-sea port Anaklia is also currently under construction. In addition, Georgia has the Kulevi Oil Terminal, pumping station and tank storage at the end of the Baku-Supsa Pipeline.

¹⁰³ From the interview with Tural Aliev, Baku Port.

¹⁰⁴ <http://batumiport.com/text/122/eng>

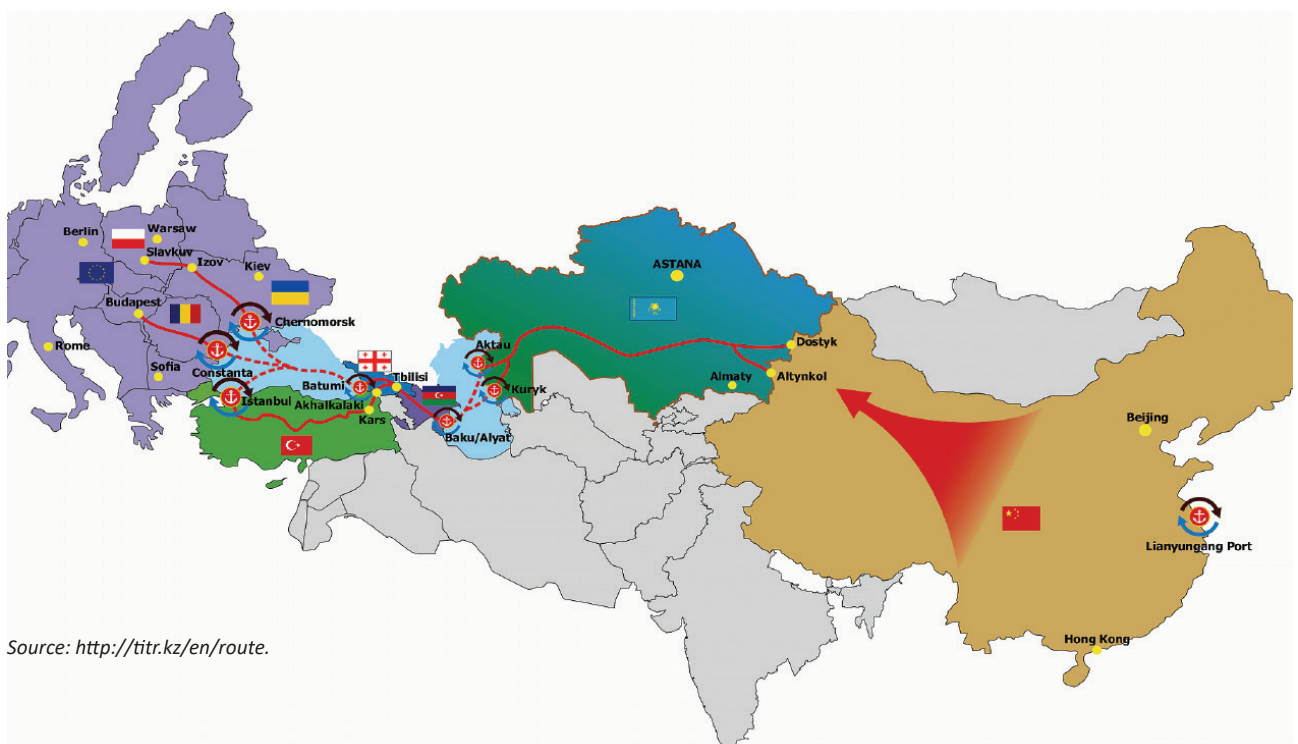
Figure 5-3: Georgia's ports



Source: <https://www.maritime-executive.com/article/american-consortium-wins-25b-black-sea-port-project#gs.w98jOPI>.

Georgia and Azerbaijan's ports play an eminent role in the running of all transport corridors throughout the region, providing access to the rest of the world through international waters. These ports are also a link in the Trans-Caspian International Transport Route initiative (Figure 54). Where Azerbaijan's ports are connected to Kazakhstan's ports of Aktau and Kuryk, and then further on to China, while Georgia's ports are linked with the Turkish, Ukrainian, Romanian, and Bulgarian ports on the Black Sea, and with many others via the Bosphorus.

Figure 5-4: Trans-Caspian International Transport Route



Source: <http://titr.kz/en/route>.

Airports

The importance of airports is determined by their role in the traffic of tourism within the region. Furthermore, airports are the only transport that provides international connections independent from a country's neighbors. All three South Caucasus countries are actively developing their air connectivity. Armenia has a very modern airport in Yerevan, and its Open Sky policy, launched several years ago, has proved very effective. There are many new direct lines: for instance to Brussels and many neighboring countries. While Azerbaijan has five international airports, located in Baku, Ganja, Nakhchivan, Lenkaran, and Zaqatala. The largest of which is Heydar Aliyev International Airport in Baku, renovated in 1999. Whereas, there are three main airports in Georgia, in Tbilisi, Kutaisi and Batumi. Tbilisi International Airport has been recently renovated to increase its capacity.

Pipelines

Apart from its transportation networks, the South Caucasus is interlinked via a network of oil and gas pipelines. Armenia receives most of its gas from Russia through Georgia. Gazprom Armenia, a subsidiary of Gazprom Russia, owns its gas distribution network and operates the supply to the Armenian market. Gazprom Armenia also controls the Iran-Armenia gas pipeline, built in 2002-2006 and officially launched in 2007. The Armenian section of the Iran-Armenia pipeline currently runs from the Meghri region to Sardarian. There are plans to build another branch of the pipeline reaching the center of the country, in order to link it with the existing gas distribution network.

For Azerbaijan, the pipelines are of crucial strategic importance as they are the only means to supply oil and gas, its key exports, to its customers. The Baku-Tbilisi-Ceyhan and the Baku-Tbilisi-Erzurum natural gas pipelines intersect Georgia, linking Azerbaijan with the European market. The Baku-Supsa Pipeline provides oil from the Sangachal Terminal near Baku to the Supsa terminal in Georgia. There are also oil pipelines running from Baku-Batumi and Baku-Novorossiysk. There are further plans for development of a pipeline network by the new projects and initiatives, the Trans-Anatolian Pipeline (TANAP) and the Trans-Adriatic Pipeline (TAP).

Summary

The ongoing expansion of transportation corridors will inevitably help facilitate trade. The region is engaged in an active expansion of transport infrastructure projects along the key North-South and East-West Transport Corridors. In particular, there are rehabilitation and upgrade projects for the North-South Road Corridor in Armenia; the modernization of the East-West Highway in Georgia; the construction of the new Baku-Tbilisi-Kars Railway connecting Azerbaijan, Georgia and Turkey; the North-South Railway Corridor in Azerbaijan, linking Iran and Russia; and the expansion of port facilities in the Caspian Sea (Alat, Azerbaijan) and the Black Sea (Anaklia, Georgia).

The new infrastructure should facilitate trade both internationally and regionally. In particular, the improved intra-regional connectivity, due to these infrastructural developments, increases the attractiveness of the area for tourists and for commercial cargo, and it should connect the region with one of the planned routes of the Chinese "One Belt-One Road" initiative.

Armenia's access to the rest of the world is severely constrained. As it is a landlocked country it faces the most severe transport bottlenecks, with only two open borders with Georgia and Iran. Road access to Russia, its chief market, can be made currently through only one border crossing (Larsi), which is sensitive to poor weather conditions.

Support for infrastructural development will contribute to Armenia, Azerbaijan, and Georgia achieving their SDGs. Alongside the major projects aimed at developing land transport corridors and port infrastructure,

there is a need for smaller-scale regional projects, such as development of intermodal handling cargo terminals and warehouses. Attention should be also paid to the development of passenger transportation services, which can increase regional interconnectivity, and thus stimulate tourism. In all infrastructural projects, a primary role is required of international financial institutions, namely the World Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the European Investment Bank.

Recommendation:

To continue the planned expansion of the transportation corridors in cooperation with international financial institutions.

6. Trade Support Institutions and Trade Facilitation

As previously highlighted, trade is an important means for the implementation of the SDGs, while trade expansion is sensitive to trade barriers. In the previous chapter, we analyzed the trade policies within the South Caucasus and its transportation networks. Here, we focus on another essential component of trade costs, namely, the costs associated with moving goods across borders, which has recently become the subject of many trade policy discussions. Before analyzing the data, we provide an overview of the format of trade support institutions in Armenia, Azerbaijan and Georgia.

Our analysis has revealed that trade costs have remained quite high in all three countries of the region, and new approaches are therefore required to reduce them. We propose the creation of various “supply chain councils”, organized around the major export sectors within the South Caucasus. The councils would have a mandate to identify the most important sources of supply chain inefficiencies and act to resolve them. These supply chain councils would also determine the priority areas for intergovernmental negotiations.

Trade and investment promotion institutions

Trade support institutions (TSIs) are comprised of a variety of public and private organizations, including trade promotion offices, chambers of commerce, business associations, and enterprise development agencies.¹⁰⁵ Such organizations can provide multiple services for exporting companies, including: assistance in marketing and packaging; information support, for instance, the provision of data relating to a trade regime or standards in a recipient country; and legal and financial support. By doing so, they play an important role in trade and investment promotion.¹⁰⁶ Below is a review of the role of vital TSIs working in the region (Table 61), focusing on the role of the state.

Table 6-1: Key trade support institutions by country

Country	Key Institutions
Armenia	Development Foundation of Armenia Export Promotion Council Export Insurance Agency of Armenia Trade and Transport Facilitation Committee Non-State TSIs, e.g. the Chamber of Commerce and Industry
Azerbaijan	Azerbaijan Export and Investment Promotion Foundation (AZPROMO) National Trade and Transport Facilitation Committee Center for Analysis of Economic Reforms and Communication (CAERC) Non-State TSIs, e.g. the Chamber of Commerce and Industry
Georgia	Enterprise Georgia Non-State TSIs, e.g. the Chamber of Commerce

Source: Official information and interviews.

¹⁰⁵ Prunello J. (2012). *Trade Support Institutions (TSIs): ITC’s beneficiaries and key partners. Overview of ITC’s work with TSIs*. Available from: http://cdn02.abakushost.com/pam/filerepo/files/Jose_Prunello_ITC.pdf

¹⁰⁶ Harding and Javorcik (2011) showed that investment promotion efforts lead to an increase in FDI inflows in developing countries, but not in industrialized countries. The authors explain this finding by higher bureaucracy and lower efficiency of public governance in those countries that investment promotion offices help to overcome. (See: Harding, T. & Javorcik, B. S. (2011). *Roll Out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows**. The Economic Journal, 121: 1445–1476. doi:10.1111/j.1468-0297.2011.02454.x). Martincus et al. (2010) showed that trade promotion organizations tend to be associated with larger exports. (See: Martincus, C.V., Carballo, J. & Gallo, A. (2010). *The Impact of Export Promotion Institutions on Trade: Is It the Intensive or the Extensive Margin?* IDB Working Paper Series No. IDB-WP-199. Available from: <http://www19.iadb.org/intal/intalcdi/PE/2012/09589.pdf>)

Armenia

In Armenia, the Ministry of Economic Development and Investments is responsible for the development of trade policy, while multiple TSIs conduct trade and investment promotion activities. Thanks to recent reforms, Armenia currently has the most developed system of state TSIs in the South Caucasus, featuring both trade promotion agencies and an export insurance agency.

The Development Foundation of Armenia (DFA) is Armenia's national authority behind investment, export and tourism promotion, with the Armenian prime minister the ex officio head of DFA's board. The mission of the DFA, created in 2015, is to promote the country's economic growth by attracting foreign investment, increasing the export of Armenian products, promoting Armenia's tourist attractions, and as a result, enhancing Armenia's rating and competitiveness.¹⁰⁷ The DFA's Export Department (Export Armenia) offers a number of services, including a search for market opportunities; financial support through export development grants and interest rate subsidies; and capacity development.¹⁰⁸ To obtain these services, companies must directly contact the agency, as publicly-provided information is quite limited. Thus, an improvement to open information is certainly advisable.

In 2016, the Export Promotion Council was created for the purpose of selecting export-oriented projects that would gain support from the DFA to promote their goods abroad. The Council therefore complements the activities of the DFA.

The Export Insurance Agency of Armenia (EIAA)¹⁰⁹ is a state-owned company, established in 2013. EIAA's mission is the promotion of Armenian exports within the framework of the Export-Oriented Industrial Policy of Armenia. The EIAA is designed to insure against financial losses incurred due to non-payment of supplied goods by a foreign buyer or its bank. EIAA's operations are steadily growing. In 2016, it insured 116 contracts, with a total insured sum amounting to 2,185 m AMD (approximately 4.5 m USD), an increase of 463% over the previous year.¹¹⁰ However, the EIAA impact on exportation remains small, as the insured figures account for less than 1% of Armenia's total exports.

The Armenian Trade and Transport Facilitation Committee (ArmPro) was created in 2002 as part of a World Bank program, endorsing private and public partnerships for trade facilitation. ArmPro's mission was to "facilitate trade and transport in Armenia and South Caucasus through fostering stability and cooperation in the region, eliminating administrative barriers and harmonizing trade and transport procedures to regional and international standards."¹¹¹ It is currently de facto inactive, however, in accord with the WTO Trade Facilitation Agreement (Article 23.2), Armenia has to establish a national trade facilitation committee or designate an existing mechanism to "facilitate both domestic coordination and implementation of the provisions of this Agreement." Therefore, ArmPro could be reactivated to serve that very purpose.

Azerbaijan

In Azerbaijan, the Ministry of Economy is responsible for the development of trade policy,¹¹² while the key institution responsible for trade promotion is the Azerbaijan Export and Investment Promotion Foundation (AZPROMO).¹¹³ AZPROMO is a joint public-private initiative, established by the Ministry of Economy in 2003 with "the aim to contribute to the economic development through attracting foreign investments in the

¹⁰⁷ See: <http://www.dfa.am/funds/about-dfa/mission-and-vision/>

¹⁰⁸ See: <http://www.dfa.am/export-armenia-category/services/>

¹⁰⁹ See: <http://www.eia.am/en/home.html>

¹¹⁰ The Export Insurance Agency of Armenia intends to ensure about 50 percent of portfolio growth in 2017 (April 11, 2017). See: <http://www.eia.am/en/news.html>

¹¹¹ See: <http://unctad.org/en/DTL/TLB/pages/TF/Committees/default.aspx>

¹¹² See: <http://www.economy.gov.az/index.php?lang=en>

¹¹³ See: <http://www.azpromo.az/>

non-oil sectors of the economy and stimulating the expansion of country's exports of non-oil goods to the overseas markets."

As AZPROMO is aimed at export and investment promotion, they provide two key types of services- firstly, for foreign investors interested in Azerbaijan, and secondly, for domestic companies interested in exports. AZPROMOs export promotion services cover informational services, regarding the trade regime and regulatory requirements, market search, legal and managerial support, and training. However, wider dissemination of information services is still required, as many services are provided only upon request, and information is not publicly available on the agency's website (<http://www.azpromo.az/>). Moreover, many of the services are expressly designed for foreign buyers, where reorientation toward domestic users would prove beneficial.

The Center for Analysis of Economic Reforms and Communication (CAERC) was established in 2016 by a decree of the president, and remains under his oversight.¹¹⁴ In May 2017, CAERC opened the Export Support Center, working on the "single window" principle. The main goals of this Center are facilitation of export procedures, simplification of export transactions, and the provision of necessary information to entrepreneurs. Businesspeople can attain any necessary certification, such as international veterinary, phytosanitary, quality, country of origin, etc., all from one location. The Center resembles the working principle of Azerbaijan Service and Assessment Network (ASAN) Khidmah, in which the functions of many state bodies are concentrated in one locale, which facilitates procedures and documentation, and saves time.

There are several agencies enabling business in Azerbaijan. ASAN, initially designed as a "one stop shop" public service agency, is steadily expanding its role to become an SME enabler, and a rural/agricultural development agency. ABAD, a daughter company of ASAN, is specifically tasked with integrating agricultural smallholders into food processing value chains.

Recently, Azerbaijan has developed several important digital tools to facilitate external trade. In 2016, the Azexport.az portal was established as the first Azerbaijani business to business marketplace, promoting both domestic and foreign trade. A year later, the Digital Trade Hub Platform was launched, offering numerous online administrative services, including attaining export-related documents, requesting export subsidies or validating identities via e-signatures.

There are other institutions whose objective is to facilitate trade. However, their activities are not so pronounced. These institutions are, namely, the National Trade and Transport Facilitation Committee of Azerbaijan¹¹⁵ and the State Customs Committee of the Republic of Azerbaijan.¹¹⁶

Georgia

In Georgia, the Ministry of Economy and Sustainable Development is responsible for the development of trade policy, while various TSIs are involved in trade and investment promotion, and entrepreneurship development. The architecture of the state TSIs in Georgia has recently changed. Two key TSIs (Enterprise Georgia and Invest in Georgia) have merged under the umbrella of Enterprise Georgia.¹¹⁷

Enterprise Georgia was established in March 2014, with the mandate to facilitate private sector development through a variety of financial and technical support mechanisms, and to support exports.¹¹⁸ The majority of the supporting trade activities are implemented by Enterprise Georgia through several programs, including

¹¹⁴ See: <http://ereforms.org/pages/nizamname-4>

¹¹⁵ See: <http://unctad.org/en/DTL/TLB/pages/TF/Committees/detail.aspx?country=AZ>

¹¹⁶ See: <http://customs.gov.az/addons/qanun/index.php>

¹¹⁷ See: <http://www.enterprisegeorgia.gov.ge/en/about>.

¹¹⁸ See: <http://enterprisegeorgia.gov.ge/en/aboutus/Mission--Vission?v=78>

international trade fairs, local and international trade missions, and a trade portal, their online export catalogue (www.tradewithgeorgia.com). The supporting programs are primarily oriented towards foreigners, providing them with information about local products and export opportunities from Georgia. However, the agency does not provide sufficient information to Georgian companies regarding foreign markets and export opportunities, even though, according to the Georgian Social and Economic Development Strategy 2020, knowledge of the export market is a priority for Georgia. Therefore, reorientation toward domestic users is advisable.

In 2015, the Georgian government awarded the Italian financial company SACE with a contract to establish an Export Credit Agency (ECA). The ECA is to be managed by the Partnership Fund, a state-owned investment fund created in 2011, with the aim of providing financial support for high-priority projects.¹¹⁹

International assessments of trade barriers in the region

International indexes identify that moving goods across the border remains quite costly throughout the region, while the related institutional support and infrastructure could also be improved.

The “Trading Across Borders” component of the World Bank’s Doing Business index measures actual trade costs, using a representative product, its largest trade partners and a specific border crossing as a proxy. For example, Armenia’s trade costs are analyzed based on trade with Russia, its chief partner in the Eurasian Economic Union. This index places the countries of the South Caucasus in the upper middle section of its countries list. The 2018 Trading Across Borders release reveals that Armenia has the highest rank; at 52 out of 190, followed by Georgia (62nd) and Azerbaijan (83rd). The most problematic issues, for all three countries, are the costs associated both with border and documentary compliance (Table 62).

Table 6-2: Trading across borders in Doing Business, 2018

	Armenia	Azerbaijan	Georgia	Europe & Central Asia
Trading Across Borders – distance to frontier (DTF)	86.45	73.56	82.43	
Trading Across Borders – rank (out of 190)	52	83	62	
Time to export: Border compliance (hours)	39	29	48	28
Cost to export: Border compliance (USD)	100	214	383	191
Time to export: Documentary compliance (hours)	2	33	2	28
Cost to export: Documentary compliance (USD)	150	300	35	113
Time to import: Border compliance (hours)	41	30	15	26
Cost to import: Border compliance (USD)	100	300	396	185
Time to import: Documentary compliance (hours)	2	38	2	27
Cost to import: Documentary compliance (USD)	100	200	189	95

Source: <http://www.doingbusiness.org/rankings>.

An analysis of the pillars of the World Economic Forum’s (WEF) Enabling Trade Index (ETI) provides additional insights into the quality of trade facilitation institutions and the infrastructure in the South Caucasus (Table 63). Gauged by efficiency and transparency of border administrations, Armenia and Azerbaijan are positioned in the middle of the 136 countries, ranked 63rd and 65th. Whereas, Georgia’s performance is healthier (39th), thanks to its decisive customs reforms completed in 2000. The availability and quality of transport infrastructure remains a bottleneck for Armenia and Georgia, while Azerbaijan’s significant investment into the development of transport corridors (see Chapter 5) proved beneficial within the rankings.

¹¹⁹ See: <http://www.sace.it/en/media/press-releases/press-release/sace-advisor-to-georgia%27s-new-export-credit-agency>; http://www.fund.ge/eng/view_news/286

Table 6-3: Efficiency of border administration, and quality of transport infrastructure and services in the WEF Enabling Trade Index, by rank, 2016

	Armenia	Azerbaijan	Georgia
Pillar 3: Efficiency and transparency of border administration (rank out of 136 countries)	63	65	39
<i>including</i>			
Customs services index	65	35	20
Irregular payments in exports and imports	75	83	19
Customs transparency index	40	40	86
Pillar 4: Availability and quality of transport infrastructure	98	42	76
<i>including</i>			
Availability and quality of air transport infrastructure	77	50	94
Availability and quality of railway infrastructure	66	29	38
Availability and quality of port infrastructure	112	34	97
Availability and quality of road infrastructure	99	71	67
Pillar 5: Availability and quality of transport services	112	97	98

Source: WEF Enabling Trade Index Report 2016.

The availability and quality of transport services in Armenia, Azerbaijan and Georgia hold a very low rank in the ETI. This pillar of the ETI is directly linked with the World Bank's assessment of countries' Logistics Performance Index (Table 64),¹²⁰ in which the countries of the South Caucasus are near the very end of the list for many logistical characteristics, such as timeliness, tracking and tracing, and logistics quality and competence.

Table 6-4: Logistics Performance Index, by rank

	Armenia (2016)	Azerbaijan (2014)	Georgia (2016)
Overall LPI (rank out of 160 countries)	141	125	130
Customs	148	82	118
Infrastructure	122	68	128
International shipments	146	113	131
Logistics quality and competence	137	149	146
Tracking and tracing	147	148	112
Timeliness	139	143	117

Source: WB LPI.

Finally, and crucially, the OECD trade facilitation indicators (Table 65) identifies that Georgia is a vital performer in the sphere of trade facilitation, followed by Azerbaijan and then Armenia. Georgia achieves its best in the categories "involvement of the trade community" and "government and impartiality," while it is weakest in external border agency cooperation, appeal procedures and advanced rulings (although they are still the highest within the South Caucasus). Azerbaijan is rated highest in information availability and automation of formalities, and Armenia in fees and charges, and information availability.

¹²⁰ It should be highlighted that Azerbaijan was not evaluated in the framework of the LPI in 2016. We have presented its score and rank from 2014. Therefore, the data is to be interpreted with caution, as Azerbaijan's most recent reforms in the areas related to the index are not taken into account.

Table 6-5: OECD Trade Facilitation Indicators 2017, scores

Category	Armenia	Azerbaijan	Georgia
Information availability	1.4	1.5	1.4
Involvement of the trade community	1.1	1.0	1.9
Advance rulings	1.1	1.1	1.3
Appeal procedures	1.1	1.2	1.2
Fees and charges	1.6	1.2	1.6
Formalities - documents	0.6	0.9	1.8
Formalities - automation	1.1	1.3	1.8
Formalities - procedures	0.9	0.9	1.6
Internal border agency co-operation	0.5	0.8	1.6
External border agency co-operation	0.7	0.8	0.9
Governance and impartiality	1.0	1.6	1.9
Total score (max 22)	11.0	12.3	17.1
Average score (0-2)	1.0	1.1	1.6

Source: OECD Trade Facilitation Indicators simulator.

In conclusion, the international assessments of trade barriers in the region reveals that the countries of the South Caucasus generally have considerable room for improvement in their performance in the institutions and infrastructure related to the movement of goods across borders. Nevertheless, each country has its own strengths and weaknesses. Azerbaijan, relatively, has a more developed transport infrastructure, though ought to pay more attention to its customs-related procedures. Georgia has the most efficient customs and customs-related procedures in the region, yet lacks transport infrastructure. While Armenia features comparatively lower trade costs, the country, however, needs to improve both its customs and transport infrastructure. Moreover, all three countries perform poorly in the indicators related to logistics services.

Assessment of trade barriers in the region by business and other stakeholders

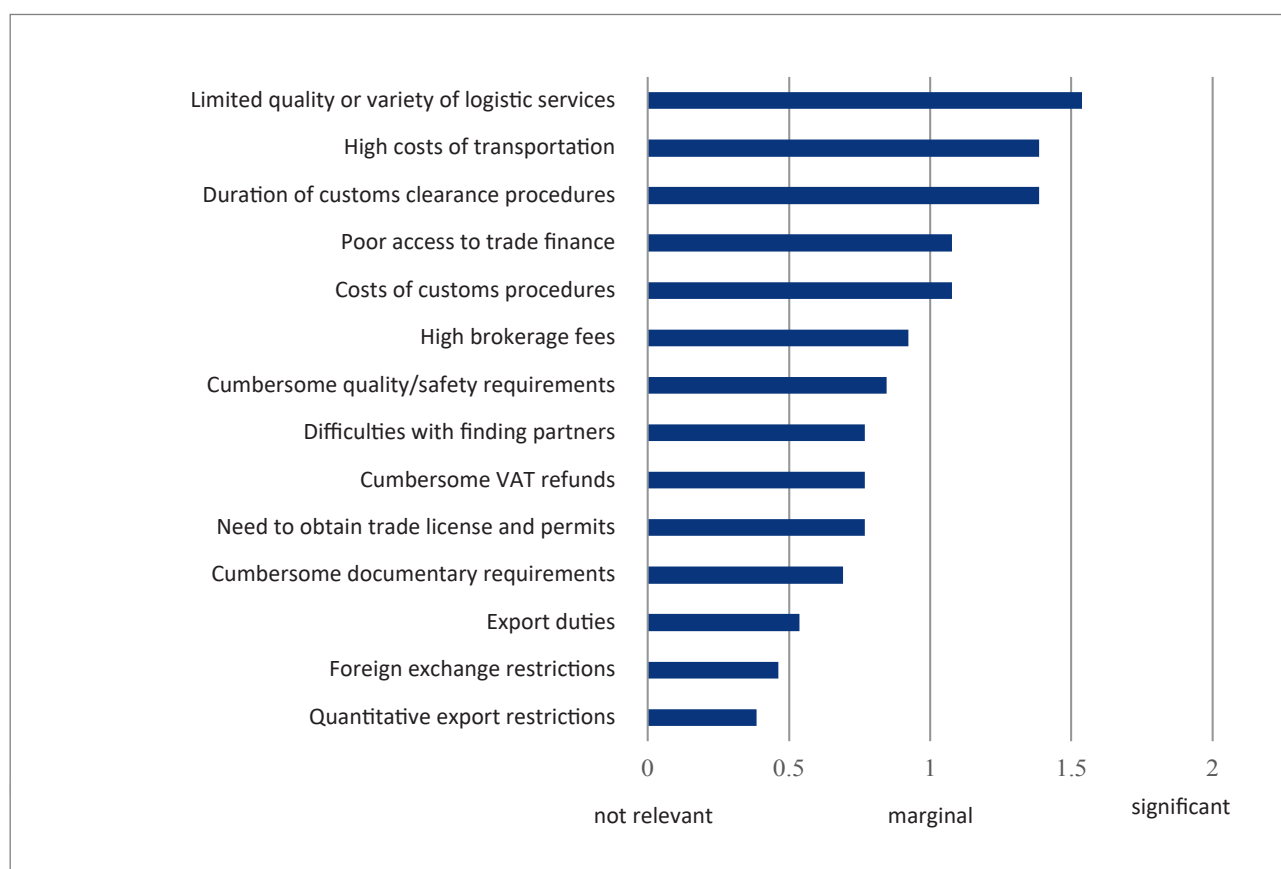
This report's assessments of trade costs by international organizations has been complemented with information acquired through in-depth interviews and an online survey of business representatives. While interviews were conducted in all three countries, the survey was only successfully run in Georgia.¹²¹ Out of 74 of these responses, 33 firms confirmed their export and/or import operations and were analyzed. Significantly, the respondents were asked to assess not only the barriers that they faced in Georgia, but also barriers they encounter in their partner countries, including Armenia and Azerbaijan. Hereafter we present results of the survey and interviews, which largely confirm the findings of international studies.

Business opinion survey

The Georgian respondents evaluate their country's trade-related environment positively, finding no measures as truly significant barriers to trade. For exporters, the most important trade barrier in Georgia was the low quality or lack of a variety within logistics services (Figure 61), which ranged between marginal and significant. These findings correspond with Georgia's low LPI score for logistics services. Other noteworthy export barriers mentioned were the high costs of transportation and lengthy customs procedures.

¹²¹ The business opinion survey in Georgia was the only successful survey within the project. The number of responses in Armenia remained too small for any meaningful conclusions, while the survey in Azerbaijan was abolished.

Figure 6-1: The importance of the following barriers for Georgian exporters

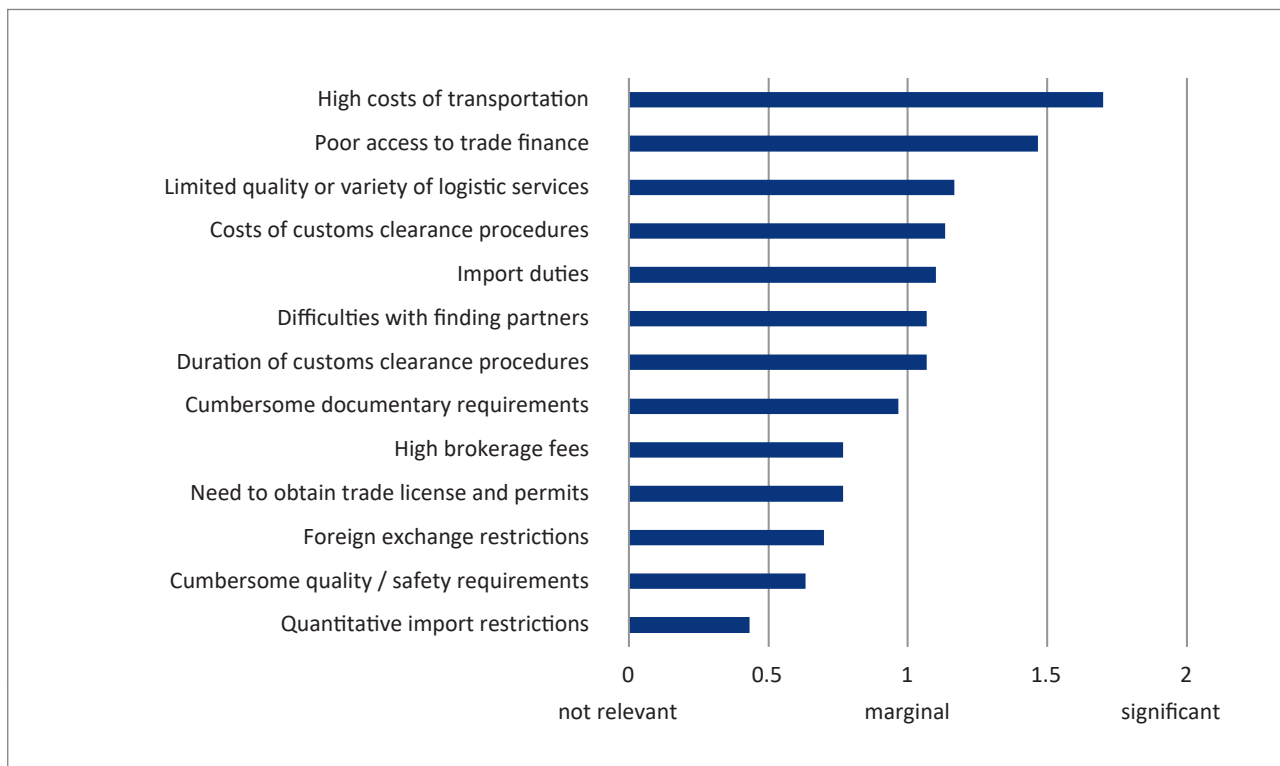


Source: Project business survey.

When asked to rate the trade barriers in various destination countries, Georgian exporters generally identified logistic service quality and the cost of transportation as marginal to significant barriers; though their assessment varied dependent on the destination. In the case of exports to Azerbaijan, the low competitiveness in the partner market, and the duration and costs of customs held first and second place, thus shifting problems related to logistics and transportation into third place (marginal to significant). Whereas, exports to Armenia were evaluated as having fewer problems, with marginal issues related to the duration of customs clearance and low competitiveness in the partner market.

Contrastingly, importers were more critical than exporters regarding the domestic environment. The high cost of transportation received a score of almost two, indicating that it is a significant problem for businesses (Figure 62). Poor access to finance is the second most important barrier for imports into Georgia, followed by the logistic service quality and variety, and the costs of customs clearance procedures. The trade barriers that Georgia’s importers face in countries of origin is generally considered low (between not relevant and marginal), however with Azerbaijan, the importers report significant problems relating to the cost and duration of customs clearance.

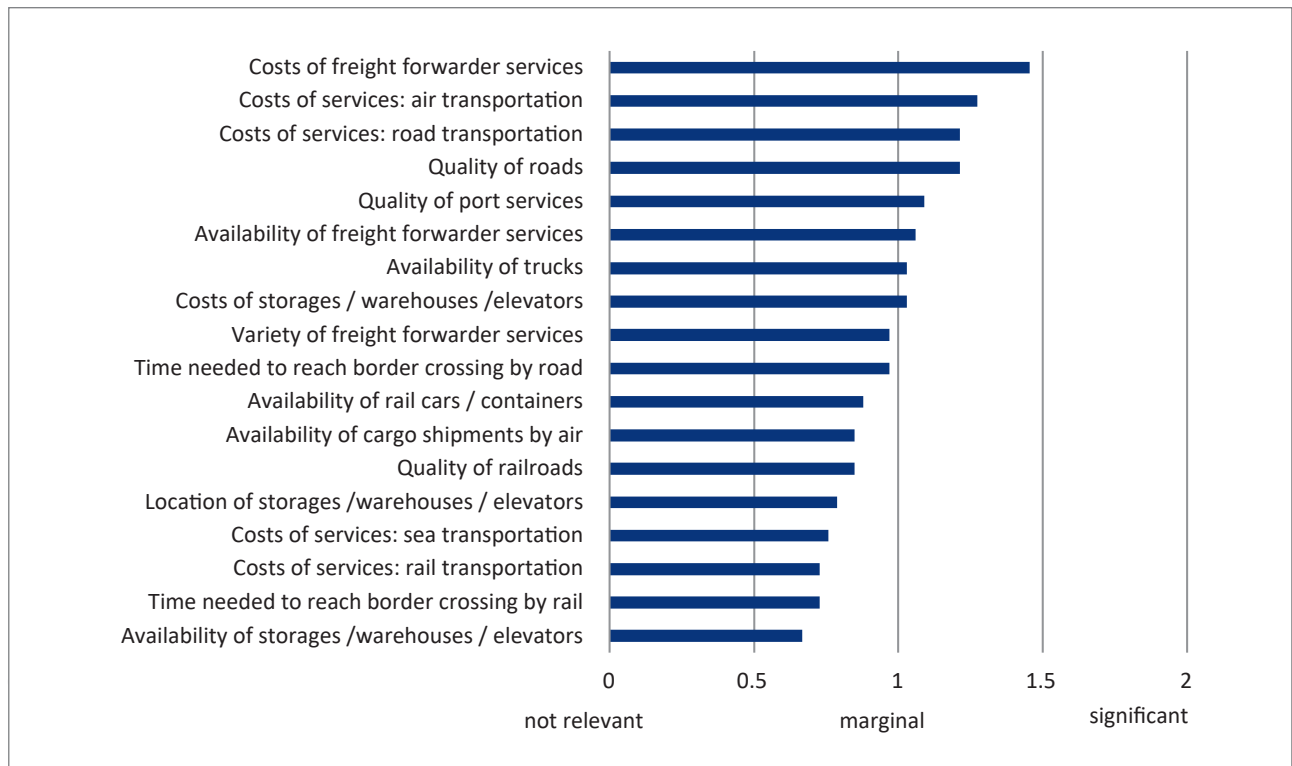
Figure 6-2: The importance of the following barriers for Georgian importers



Source: Project business survey.

The more detailed questions surrounding transport and logistic infrastructure in Georgia allow for a better understanding of exactly what troubles businesses. The costs of freight forwarding services are assessed as one of the most relevant barriers to transportation and logistics; classified between marginal and significant by the respondents (Figure 63). The second most problematic issue is the cost of air transportation services; the third, the costs of road transportation; and the fourth, the quality of roads. While, the availability of storage and warehouses is the least problematic issue for Georgian businesses.

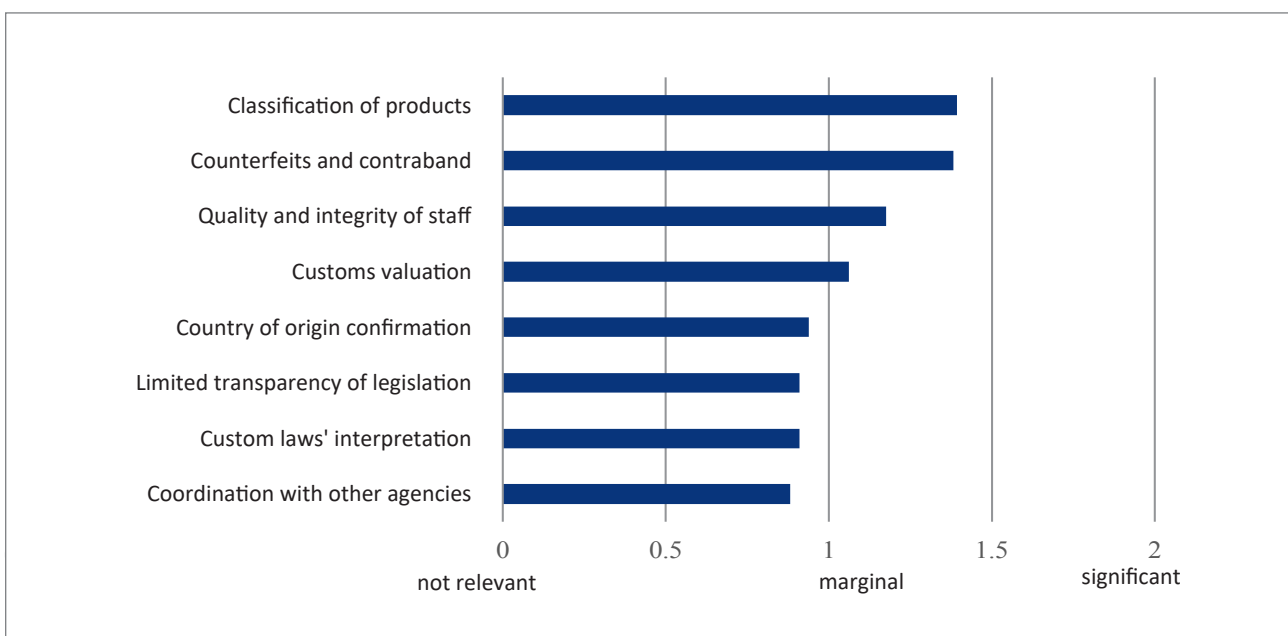
Figure 6-3: Whether transport and logistics infrastructure constitute a trade barrier for companies in Georgia



Source: Project business survey.

The classification of products, and counterfeits and contraband are the most topical customs-related issues for Georgian businesses (Figure 64). While, the circulation of Georgian customs-related documents is still not fully electronic: approximately only one third of respondents always submit customs declarations electronically, and 25% never provide electronic declarations.

Figure 6-4: Which of the following customs-related issues constitute a problem for business in Georgia



Source: Project business survey.

Access to trade finance remains a challenge, with around 40% of exporters and importers claiming to use at least one trade finance instrument, usually insurance, while one-fifth of respondents do not use trade finance instruments at all. Insurance and bank guarantees are the key instruments used; where more sophisticated tools, like forfeiting, are exploited by just a few respondents.

The crucial elements of trade that Georgian businesses would like to receive from the state are: better access to new markets through new preferential trade agreements; upgraded access to trade finance; systematic updates for changes in trade-related legislation; and improved transport infrastructure (Figure 65). Whereas, Georgian businesses do not consider state export and import guarantees as an important governmentally supported instrument.

Figure 6-5: The services and support required from the state related to foreign trade



Source: Project business survey.

Note: The questions allowed the choice of up to three options.

In summation, Georgian businesses confirmed the international findings that the functioning of customs and related services are, in Georgia, business-friendly. While customs services in Azerbaijan are costlier and slower, requiring further improvements to facilitate trade. In Georgia, transport infrastructure and logistics, as well as access to trade finance, remain the key barriers, although they are more significant to importers than exporters. The businesses priorities for state support are new FTAs, better access to trade finance, regular updates regarding regulatory changes, and improved transport infrastructure.

The key challenges identified through interviews

The interviews with key respondents, including representatives of businesses and business associations, experts, representatives of state bodies, and international organizations, all provided important insights into the situation in each of three countries. This information further helps complement the data provided by international indexes and the business survey. Below we provide brief summaries of the key challenges identified within each country.

Armenia

Problems with customs clearance. Customs declarations cannot be processed at the border. Cargo can be collected near the border, but must be brought to one of five customs clearance centers to process a customs declaration. Besides which, Russian customs officers do not always trust Armenian customs declarations concerning transit cargo, for instance, from Iran. Thus, the Armenian documentation is often scrutinized, and sealed cargo may be opened and inspected.

Incomplete implementation of “single window” principle at customs. Armenia is working on the implementation of the “one stop shop” principle for border checkpoints. The initial proposal was to begin in 2015 and be completed by 2017; however, it appears that full implementation will yet take longer. Currently, several agencies are involved in custom clearance of certain types of products, which requires time and expense. The single window approach is expected to eliminate this dependency on other agencies. Customs officers will either be trained to perform all TBT and phytosanitary control functions, or all relevant agencies will be represented at customs check points.

Poor transport connectivity with Georgia. Although Georgia is the main transport artery for Armenia, the countries have poor connectivity. It takes around five hours by car from Yerevan to Tbilisi. Flights are convenient but expensive (130-150 USD), and trains offer little comfort and take far longer, 8-10 hours.

Problems with the Upper Larsi border (Georgia). There are several issues related to this crossing point. Firstly, it can be closed unpredictably due to weather conditions, like ice, snow, landslides, etc. Secondly, its transit capacity is limited, even if there are no weather events. Thirdly, there is remaining political uncertainty related to Russian and Georgian relations. Finally, businesspeople criticize the corruption risks associated with the border.

Bottlenecks in transportation to Europe. Armenian freight forwarders are at a disadvantage when transporting goods to Europe. Armenia is not a member of the international motor insurance card system (Green Card),¹²² and drivers are required to buy Green Cards in other countries, for example, Bulgaria. Further bureaucratic bottlenecks for transport to the EU are the Schengen visa and the environmental requirements for trucks.

Higher costs of transit due to the de facto closed crossing with Turkey. While Turkey serves as a transit hub for about 20-30% of ground EU cargo for Armenia, it enters via Georgia, with a change in documentation. There are 400-500 20-ton trucks that travel every month from Turkey to Armenia, and Georgia earns 1,000-1,500 USD from each.

Azerbaijan

Complex customs laws and regulations. The customs laws and regulations are not easy to interpret or understand from a business standpoint. A lack of certainty about the level of duties is a problem for business.

Significant delays in border crossings and long custom procedures. A long waiting time at the border crossing between Azerbaijan and Georgia is one of the major problems reported by businesses. The custom proce-

¹²² See: <http://www.cobx.org/content/default.asp?PageID=1>.

dures are too long on both sides of the border, and often result in three or more hours of delay, particularly affecting importers. One of the key causes of these delays is non-harmonized border procedures.

High costs and low quality of brokerage services. The brokerage service fee is great in Azerbaijan compared to other countries. The fee ranges from 100 to 150 USD per declaration, plus significant extra payments for each additional page. Moreover, efforts to increase the numbers of well-trained brokers with expertise in clearance processes could result in important trade facilitation gains.

The absence of warehouses at the customs border. The lack of warehouses for imported and exported goods at the border hampers Azerbaijan's trade opportunities. Furthermore, higher storage fees and time limitations for storing goods, and waiting for customs clearance are some of the main challenges to trade.

The lack of block container and tracing systems. There are no block containers running between Azerbaijan and Georgia, except those NATO non-commercial containers. Furthermore, there is no uniform information system to allow traders to trace the location of their cargo.

Transit fees. Azerbaijan Railway faces additional payments for freight transit. There are also complains about the volatility of shipping service rates in Baku, as well as the capacity constraints, resulting in delays due to the prioritization of liquid transportation.

Georgia

Insufficient development of logistics services. Currently, except for Gebruder Weiss, there are no logistics companies in Georgia.

Road transport sector bottlenecks. The main challenges are road safety and poor connectivity between cities; Georgia has a severe lack of road engineers, and specialists in the related fields of infrastructural management and services. Georgia is not a member of the international motor insurance card system (Green Card)¹²³ and drivers must buy Green Cards in other countries, like Turkey or Bulgaria.

Insufficient port capacities. The capacities of the existing ports are limited. For instance, Poti is often congested and needs to expand its capacity, in particular, it needs to clean the bottom of the port and develop deeper into the sea.

Insufficient supply of ferries. Additional ferries are needed to match the capacity of the railways. Frequent ferry service to Constantza and Burgas should also be developed. A once-daily ferry would greatly increase Georgia's competitive advantage in transportation.

Bottlenecks in railway transport. A key infrastructural bottleneck is the Khashuri-Zestaponi Gorge, which currently has a maximum capacity of 27.6 million tons per year; a new section is under construction and is expected to be completed in November 2019. There is no infrastructure in Tbilisi to unload trucks onto the rail, nor a container terminal. The container business is still not competitive for the trucking business. While, bulk is currently the railways' only competitive advantage.

To sum up, the in-depth interviews generally confirm the findings of other sources. Among the key challenges identified in Armenia, there are problems with customs clearance, including the still incomplete implementation of the single window principle at customs points. Armenia also faces severe transportation bottlenecks and high costs of transit. In Azerbaijan, many challenges are associated with customs procedures, which are gauged as time-consuming and thus costly. High brokerage fees and transit fees further increase the costs of moving goods across borders. For Georgia, the development of transport and logistic infrastructure are the main challenges.

¹²³ See: <http://www.cobx.org/content/default.asp?PageID=1>

Summary

The three partnering countries of the South Caucasus have developed trade support institutions, and while their role in promoting exports and attracting investors has certain positives, their performances could be improved.

All three countries have established export promotion agencies, but it would help if they would focus more on their connection with domestic businesses; namely, by providing more information on market opportunities and the costs of exporting, alongside expanding their training activities. It is also necessary to provide more detailed information online to ensure wider availability to domestic businesses. The establishment of a regular joint forum to discuss cross-border trade opportunities could further contribute to trade expansion.

We propose the creation of a number of “supply chain councils”, organized around the major export sectors within the South Caucasus. Supply chain councils are public-private partnerships that involve the active engagement of the business community, as well as policy officials and regulators. They are needed to reduce levels of uncertainty for producers by facilitating trade and cross-border investment flows. National supply chain councils would focus on important “backbone” services such as communications, finance and transport, as well as non-tariff barriers. They can also play an important role in addressing policy barriers, which currently inhibit greater economic integration with regional trading partners. The councils can establish such integration if; they include business representatives and regulators from trading partners to focus policy attention on lowering trade costs, due to the differences in regulations and standards, customs and border issues; resolve uncertainty regarding the treatment of products, services and businesses; and reduce impediments to supply chain investments.

The councils would have a mandate to identify the most important sources of supply chain inefficiencies, and consequently seek their resolution. These supply chain councils would determine the priority areas for inter-governmental negotiations. Businesspeople on all sides of the negotiations have on-the-ground knowledge of the most pressing issues and are likely to have common interests in lowering trade costs. Thus, recommendations for regulatory reform of these councils can be implemented by governments, with the knowledge that they have unilateral support from business.

There are a variety of policies that could be implemented (most requiring initial expenditure) to reduce the general costs of trading across borders and the delays at border crossings. Currently, all three countries face challenges associated with long and costly customs and customs-related control procedures, as well as an insufficiently developed transport and logistics infrastructure. Further development of automated customs procedures, information exchanges and other policy measures, in line with the WTO Trade Facilitation Agreement (WTO TFA), are therefore critical. Armenia and Georgia have taken the excellent steps of signing the WTO TFA and submitting their schedules of commitments for WTO TFA implementation, and they have indicated the spheres in which technical support is currently required.

In particular, Armenia explicitly requested technical assistance for the use of international standards in the implementation of formalities related to importation, exportation and transit; notably, the operation of the single window principle; the establishment of a separate infrastructure for transit; and the implementation of other commitments related to transit, like transit formalities, conformity assessment, prior processing of documentation, and for transit termination.

Armenia would additionally benefit from the improved availability of customs clearance at borders, as opposed to customs houses within the country. Armenian freight forwarders would profit from membership in the international motor insurance card system (Green Card), as presently, their drivers must buy Green Cards in other countries, like Bulgaria.

Whereas, Georgia requested for technical assistance from the WTO for authorized economic operators, such as freight forwarders (for legal assistance and training), and the prior processing of transit documentation. Georgia freight forwarders would also benefit from membership in the Green Card system.

In Azerbaijan, international assessments and local respondents note the high costs and cumbersome procedures for moving goods across the border. Furthermore, despite having the best internal transit infrastructure in the region, internal transit in Azerbaijan is very costly due to its high fees. Donor assistance in these areas would be warranted if the Azerbaijani authorities requested help with the implementation of policies or projects to reduce trade facilitation problems.

At the regional level, the South Caucasus has neither joint (bilateral) cargo tracing systems in place, nor do they have harmonized cargo procedures. This sometimes slows transit and increases the cost. One possibility to be explored, designed to reduce bottlenecks at the region's border crossings, would be the establishment of joint bilateral customs clearances to facilitate the movement of goods; such as, one customs clearance at a border crossing operated by both countries. Donor assistance or international financial institution action would again be warranted for policies and projects to assist these slow border crossings.

Support of logistics infrastructural development could address another important bottleneck in the region. The lack of logistics capacity and the low quality of logistics services has been highlighted as a problem in Georgia, but it is typical for the region as a whole. There is a need for smaller-scale regional projects, like the development of intermodal terminals for handling cargo, the construction of warehouses, the improvement of cargo tracing systems, and the promotion and development of logistics services.

Recommendations:

To create a number of "supply chain councils" organized around the major export sectors for the countries of the South Caucasus, either on a national or bilateral level.

To ensure the wider availability of online information on export promotion agencies' websites, especially information regarding export opportunities and the constraints affecting domestic business-people.

To establish a joint bilateral customs clearance to facilitate the movement of goods in order to reduce bottlenecks at border crossings.

To support the development of logistics capacity and smaller scale regional projects, like the development of intermodal terminals for handling cargo, the construction of warehouses, and the improvement of the cargo tracing systems.

7. “Emerging Game Changers” – New Opportunities for the Region

International agreements and the reconfiguration of regional trading blocs, the rapid development of transport and logistic networks, new communication technologies, alongside many other factors, impact the trade potential of the three South Caucasus states, while also creating new opportunities for cooperation.

Our analysis of certain freshly emerging opportunities in the region highlight that such gains could be significant. For example, Armenia could provide customs clearance and product certification services for Georgia and other countries to access the EAEU market. The Georgian development of an FTA network makes the country an attractive hub for export-platform investments, although it is restrained by the rules of origin. The Chinese One Belt-One Road initiative, coupled with the improvement of transport infrastructure in the region, in particular, the completion of the Baku-Tbilisi-Kars Railway and the construction of the Alat and Anaklia ports, each create compelling potential for transit in the region. Such potential could also stimulate the development of additional productions and services along the transit corridor. These opportunities combined should have a positive impact on the economic development of the region and contribute to the alleviation of poverty.

Opportunities generated by RTAs for non-participating South Caucasus countries

The signing of a regional trade agreement (RTA) affects not only the signatory parties (see Chapter 4 for details), but also their trading partners. Aside from a traditional trade diversion effect, a new agreement could generate other important spillover results. These new opportunities could include:

- ▶ **An export-platform for FDI:** there is the opportunity to use the countries as a destination for export-platform investments, i.e. investments for the export-oriented production targeting the external market, generally protected by relatively high tariffs, but opened within the RTA (so called “tariff jumping”). This is conditional on the fulfillment of the rules of origin requirements;
- ▶ **Value chains:** it is possible to build regional value chains aimed at the wider market. This is again conditional on the fulfillment of the rules of origin requirements;
- ▶ **Access to conformity assessment services:** it could be easier for the authorities to conduct conformity assessment in a neighboring country than in the destination country (assuming a mutual recognition of certificates);
- ▶ **Economic development spillover:** faster economic development in one country will positively affect economic development in its neighboring countries;
- ▶ **Setting a positive example:** a country that gains from the reforms associated with an RTA might serve as a positive example as a transformational power, facilitating a similar process in other the countries of the region.

Currently, there have been two, potentially, “game changing” RTAs signed within the region, namely the Georgia-EU Association Agreement/DCFTA and the accession of the EAEU by Armenia. Below we analyze whether these agreements could provide positive spillover for the region.

The Georgia-EU Association Agreement / DCFTA

The establishment of duty-free trade with the EU, without exemptions, coupled with strengthened economic governance creates a strong opportunity for Georgia to become a destination for foreign investors interested in better access to the EU market.

In particular, many agricultural and food industry goods include very high tariff protection and non-tariff barriers on the EU market, and thus have potential for export-platform investment. However, these opportunities are to be evaluated considering the rules of origin, as only products deemed acceptable are entitled to DCFTA preferences. Most agricultural and food products must be exclusively produced in Georgia or use wholly Georgian inputs, to be eligible for tariff-free trade, therefore investment projects must be economically feasible under these conditions. For instance, the foreign investments in the production of hazelnuts, discussed in Chapter 8, meet the origin requirements: where the investors contributed the technology, but the hazelnuts are grown in Georgia. Moreover, export-platform investments should consider the harmonization progress of Georgian safety regulations with EU norms. As discussed in Chapter 5, a gradual approach to harmonization is required to ensure a smooth transitional period for businesses, although, without progress in legal harmonization, many potential benefits of the DCFTA cannot be achieved.

The number of industrial goods featuring high tariff differentials is smaller, yet interesting options still exist, primarily in textiles and footwear, chemical goods, and the production of ceramic and glass articles.

The study of potential export-platform FDI opportunities associated with the Georgia-EU DCFTA shows that Azerbaijan is among the strongest candidates to benefit from the changes in trade regime.¹²⁴ Azerbaijan has recently lost preferential access to the EU in the framework of the Generalized System of Preferences (GSP), thus it currently faces higher tariff duties on non-fuel exports, and has incentives to overcome these barriers. In addition, among the countries of the South Caucasus, Azerbaijan has the most extensive experience in investing abroad. However, the drawback is that Azerbaijan has very limited experience in producing non-fuel products or selling them on the EU market, and consequently it might have limited capacity to implement export-oriented projects to the EU.

Armenia is less likely to use Georgia as an export-platform, primarily because the country enjoys preferential access to the EU market through the GSP+ regime. Though Armenia is a net recipient of FDI, it has extremely limited outward FDI experience.

The development of regional value chains in the last stage of Georgian production is partly constrained by the EU's elaborate rules of origin requirements. More specifically, the establishment of value chains related to the food industry is largely infeasible for most products; the requirement of goods wholly obtained from the country of origin is applied, so inputs cannot be sourced from neighboring countries. The prospects are better for industrial goods, but in this case short-term development could be constrained by the limited industrial potential of the region.

The conformity assessment services in Georgia could be very beneficial for its neighboring countries, though it is a long-term benefit. Beforehand, Georgia must complete legal and institutional harmonization with EU norms and practices, and then reach the point of issuing certificates of conformity, as recognized by the EU authorities. At that point, it might be both cheaper and more (culturally) expedient to conduct conformity assessments in Georgia, rather than in the EU or, for instance, in Turkey.

Armenia's membership in the EAEU

The EAEU allows its members to preserve existing FTAs within the CIS and with Georgia. Therefore, as Georgia has duty-free trade with all members of the EAEU, Armenia's membership in the EAEU does not generate tariff-related opportunities for Georgia, e.g. in the form of export-platform FDI.

¹²⁴ See: http://www.get-georgia.de/wp-content/uploads/2016/06/PS_01_2016_en.pdf

Moreover, although trade between Georgia and Armenia is based on the FTA, Armenia's membership in the EAEU has a negative impact on Georgia, as it affects Georgian re-export capabilities. In particular, the re-exportation of used cars via Georgia was significantly affected due to tax regime peculiarities within the EAEU.¹²⁵ There is moreover a risk of accelerated trade divergence between Armenia and Georgia due to the potential divergence in standards (see discussion in Chapter 4). However, this situation also creates an opportunity for Georgia, after the systems complete transformation, to use Armenia for conformity assessment procedures in the long-run.

Considering the preservation of the CIS rules of origin in trade within the EAEU and with Georgia, Armenia's membership in the EAEU could facilitate exports of Georgian products through its territory to EAEU markets, and benefit from simpler customs clearance.

Box 7-1: Armenia as a convenient entry point into the EAEU

Armenian freight forwarders have established logistical and administrative links with Russia and the EAEU. For example, Georgian mandarin exports to Russia pass through Armenia. It would take 4-7 days to clear Georgian cargo through customs, if sent directly into Russia. Exporting to Armenia and then shipping to Russia takes a single day: customs clearance and phytosanitary inspection can be arranged at Bagratasheni border. The trucks come to Adjara, load mandarins, drive to Armenia, complete the paperwork and continue to Larsi in the transit regime. By doing so, they save time and money, without violating EAEU rules.

Source: Interview with stakeholders.

Free economic zones in the region

Currently, the region is witnessing active development of free economic zones (FEZ) and industrial parks aimed at overcoming the deficiencies of "mainland" regulations and creating a very favorable business environment in specially designated territories, and thereby stimulating economic activity. The efficiency of the existing FEZs remains unconfirmed, while their ultimate success depends on whether the active engagement of the private sector in their activities can be ensured.

China's "One Belt-One Road" Initiative

China's One Belt-One Road (OBOR) was launched in 2013. The initiative focuses on improving and creating new trading routes, links and business opportunities with China. The route passes through more than 60 countries along the way, across Asia, the Middle East, Europe and Africa. It has two main elements: the Silk Road Economic Belt, comprising of six transport corridors, and the 21st Century Maritime Silk Road.

Initially the six corridors proposed by China did not include the South Caucasus. However, the active development of the transport and logistics infrastructure in Azerbaijan and Georgia, including the Alat and Anaklia seaports, and the launch of the new Baku-Tbilisi-Kars Railway (BTK) linking Azerbaijan, Georgia and Turkey, created an opportunity for the establishment of a new Silk Road corridor through the region.

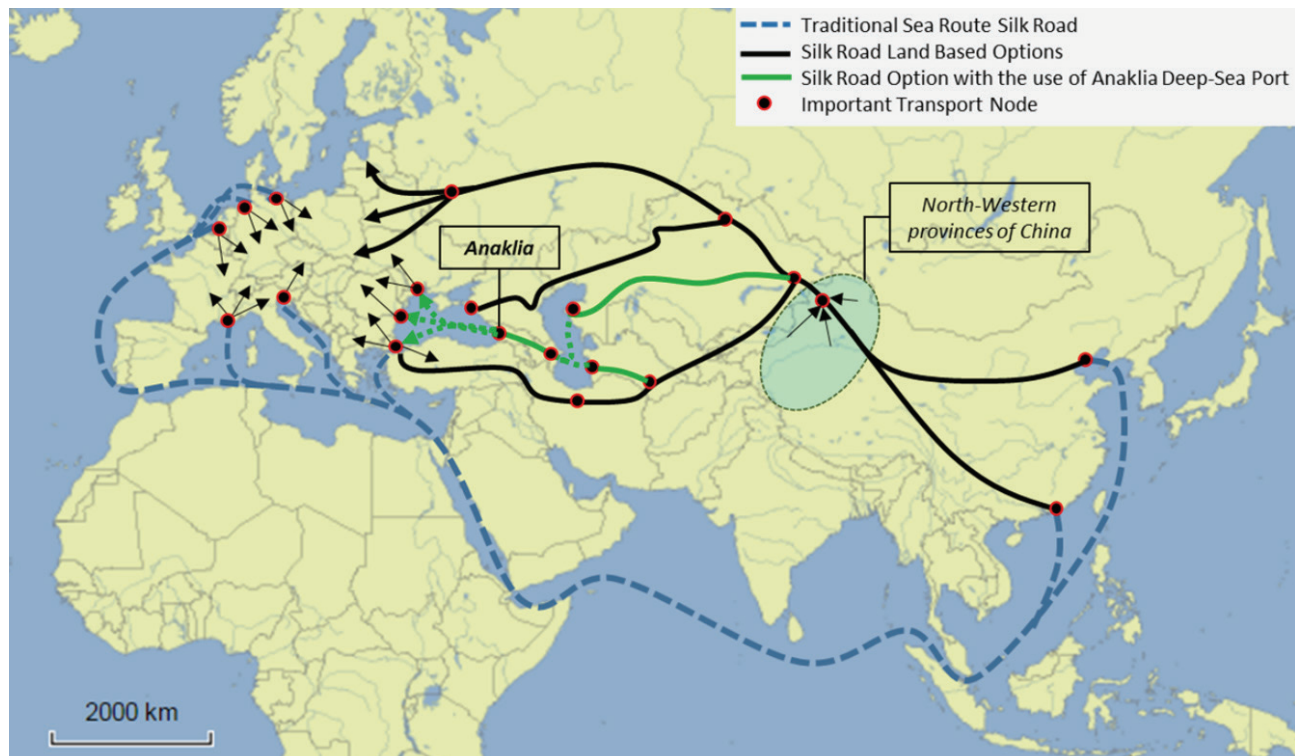
In October 2016, Azerbaijan, Kazakhstan and Georgia signed an agreement for the establishment of the Trans-Caspian International Transport Route Association. It is aimed at attracting transit and foreign trade cargo, as well as developing integrated logistics for products via the Trans-Caspian International Transport

¹²⁵ See: https://www.get-georgia.de/wp-content/uploads/2016/08/PB_01_2016_en.pdf

Route.¹²⁶ The Route is intended to run through China, Kazakhstan, Azerbaijan, Georgia, and then through Turkey and Ukraine to Europe.¹²⁷

However, the assessments of the Trans-Caspian International Transport Route are quite cautious.¹²⁸ As the transportation of goods using this route will require complex intermodal solutions including railways, ferries over Caspian and Black Seas, and probably road networks, and these factors make the route relatively costly. For example, assessments completed in early 2016 revealed that for the shipment of a container from Ukraine to Kazakhstan the Silk Road route would increase the price of a shipment two or three-fold compared to the land route through Russia, largely due to the high costs of intermodal transactions, including ferries and railway connection in Georgia and Azerbaijan.¹²⁹ However, later in 2016, rail tariffs along the route were reduced to stimulate transit.

Figure 7-1: One Belt-One Road Initiative, the Silk Road Option in the South Caucasus



Source: Anaklia project.

Beyond the infrastructural bottlenecks, which may be partly resolved with the launch of the BTK railway and will be further reduced with the completion of ports, the route faces other problems related to border formalities, aggravated by the fact that six customs zones function along the corridor. Thus, trade facilitation measures in the region aimed at reducing the costs of moving goods across borders would also significantly increase the Silk Road's chances of success crossing the South Caucasus.

The project interviews highlighted another aspect of participation in the Chinese OBOR initiative. Most of the participants emphasized the importance of the establishment of new production alongside the route, so

¹²⁶ See: <http://en.trend.az/azerbaijan/business/2737246.html>

¹²⁷ See: <http://en.trend.az/business/economy/2766699.html>; http://europe.chinadaily.com.cn/epaper/2017-01/20/content_28006234.htm

¹²⁸ Jakóbowski J., Popławski K. & Kaczmarek M. (2018). *The Silk Railway. The EU-China rail connections: background, actors, interests*. OSW Studies Number 72.

¹²⁹ See: https://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2016/04/PB_04_2016_en.pdf

that countries could benefit not only from the development of infrastructure, infrastructure-related jobs and reduced transit fees, but also gain from the new job opportunities throughout the region. Though highly important, this effect is far from guaranteed, as current transportation technologies generally do not envisage a need to stop for processing. Nonetheless, the points of reloading provide very convenient locations, namely the Alat FEZ and Anaklia FIZs, for the development of processing facilities, such that the countries should try to elaborate further on this idea. Additionally, improved intra-regional connectivity through such infrastructural developments could further increase the attractiveness of the region for tourists.

Armenia

As of late 2017, there are two FEZs operating in Armenia, both in designated territories in Yerevan. The first, the “Alliance” FEZ, was established in 2014 with a specific sectoral framework for companies operating within the zone: the export-oriented hi-tech sector, particularly in electronics, precise engineering, pharma and bio technologies, ICT, alternative energy, and items of production not manufactured in Armenian territory. As of June 2017, there were seven companies operating in the FEZ (where in November 2016 there were nine).¹³⁰ The second FEZ, “Meridian,” was opened in 2015, with an even narrower sectoral activity: jewelry, diamond cutting and watchmaking. There are currently seven companies operating in the Meridian FEZ.

Both FEZs operate under the 2011 Law on Free Economic Zones. Alongside office and production facilities, each FEZ organizer provides warehouses and logistical services, broadband internet access, security and parking, modern facilities to establish expos, and finally “single window” access to its services. All FEZs are exempt from profit tax, custom tariffs, property tax, and zero rate VAT is applicable to sales.¹³¹

Box 7-2: FEZ in Armenia, when it works and when it fails

Instigate Robotics was the first company to be registered with Alliance FEZ in 2014. It specializes in the production of robots and drones for educational and industrial purposes. R&D and prototyping is an essential part of the company’s business.

The company withdrew from the FEZ in March of 2017. While it provides certain advantages, the business model chosen for the FEZ does not seem to be convenient for companies involved in R&D and prototyping. There were regular issues, during daily operations, that were hindering efficient operations and outweighing the benefits of the FEZ. On top of that, the company, operating in two locations, had to receive customs approval to deliver items to expos. Considering that this required custom clearance every time, and each time the request was specific (due to the nature of the business), this caused delays, where customs officers were not aware of how to clear such items. There were also issues with the proper functioning of the “one window” approach, as coordination between various state agencies was not always efficient. Finally, considerable issues were dependent on the capacity of the organizing company of the FEZ, which was not always optimal.

Equally however, a FEZ is quite a convenient way to run businesses, particularly for companies already at the stage of mass production when routine processes are in place and specific circumstances are an exception. In fact, there are some, indirect, indications that companies operating in jewelry and pharma production are satisfied with the FEZ services.

Source: Interview with stakeholders.

¹³⁰ According to the Ministry of Economic Development and Investments. Available from: <http://www.mineconomy.am/hy/361> (in Armenian) and <http://hetq.am/arm/news/72600/hh-i-azat-ntesakan-gotinerum-gortsuneutyun-e-tsavalum-15-ynerutyun.html>

¹³¹ See: <http://mineconomy.am/media/2017/02/858.pdf>

In addition to the two existing FEZs, the Armenian government has already started a project establishing a FEZ in the south, in the Syunik Region, in immediate proximity of the Iranian border. The government estimates that investments for development of the area will cost around 28 m USD, with a projected internal rate of return of 12%. This is planned to be the largest FEZ in Armenia, situated over 37 hectares (ha), with an estimated organizational staff of 70 people, and to be implemented through a public-private partnership.

The notion behind the FEZ is to create a logistical center, near the border of Iran, that will facilitate mutual trade, as well as attract investments from potentially interested countries (such as, Iran, Georgia, other member countries of the Eurasian Economic Union, the Middle East, etc.). According to the business plan developed by the government, this particular FEZ will not be limited to specific sectors.¹³²

The Armenian government considers the strengths of the project to include a possible cooperation with the Aras FEZ in Iran (only 2km away) and the probable signing of a preferential trade agreement between Iran and the EAEU. Other factors contributing towards the potential success of the FEZ are the North-South Road Corridor, which intends to connect Armenia's southern border with its northern point along the 556 km long Meghri-Yerevan-Bavra highway, and access to the country's diverse trade regimes (an FTA with the EAEU and CIS and the GSP+ regime with the EU).

While the plan is quite ambitious, the success of the proposed free FEZ in the Syunik region is questionable. The FEZ appears to be government-driven, with little commitment from the private sector. Experience with Export Processing Zones throughout the world has shown that active engagement with the private sector is critical for success. Additional limiting factors are that the proposed FTA, being negotiated between the EAEU and Iran, appears to be very limited, nor will the North-South Road Corridor will be completed in the near future. Expansion of trade with Iran would be beneficial for Armenia, but the logic of expanding that trade through the construction of a FEZ in Syunik has not yet been elaborated.

Azerbaijan

Although there is no operational FEZ in the country, there are several industrial parks (IP): the Sumgait Chemical IP, Balakhani IP, Garadagh IP, Mingachevir IP, Pirallahi IP, High Tech Park, and the Mingachevir High Tech Park.

The state program for development of industrial parks aims to increase the capacity of the current industrial production sectors, create new production sectors, boost the extent of non-oil export capacity, and develop innovative production. The Azerbaijani government exempt residents of industrial parks from paying customs duties on imports for five years, starting 1 May 2016, and from income tax, land tax and property tax for seven years. The equipment and technology used in the industrial parks are also exempt from VAT.

In 2016, the president of Azerbaijan signed a decree concerning the "Facilitation of the Creation of Free Economic Zones." Resultantly, Baku Port was tasked with creating a new port in Alat to accelerate the trade of goods between Europe and Asia, and with becoming an integral part of the Silk Road. The entire territory of proposed the Seaport is 450 hectares, out of which 110-115 hectares belong to the FTZ, where goods can be deposited, stored, manufactured, and re-exported with minimum governmental intervention and few bureaucratic barriers. Logistics services will be also offered to support the exploration and production operations of hydrocarbon resources in Azerbaijan and the Caspian region, alongside petrochemical facilities.¹³³

¹³² See: <http://www.investmentprojects.am/en/111>

¹³³ AMCHAM in Azerbaijan. (2016). *Logistics in Azerbaijan: connecting East-West and North-South*. IMPACT Azerbaijan magazine 23rd edition. Available from: <http://amcham.az/wp-content/uploads/2016/11/Impact-23.pdf>.

The efficiency of the Alat FEZ will to a large extent depend on whether Azerbaijan and Georgia will be able to ensure that transit flows through their East-West Transport Corridor by successfully linking it to the Chinese transport initiative and the EU TEN-T programs, which were established to support the construction and upgrade of transport infrastructure across the EU.

In addition, the establishment of the FEZ in the Nakhchivan region has already begun. Trade in the Nakhchivan region will be similar to trade in the Turkish territory, and the Turkish lira will also be used as the main currency in transactions.

Georgia

According to the Tax Code of Georgia, a Free Industrial Zone (FIZ) is a type of a free economic zone with business-friendly regulations and a favorable tax and customs system. Specifically, businesses registered in a FIZ benefit from tax privileges, including no corporate tax on income, no tax on interest and dividends paid by the FIZ, with no VAT on trade between FIZ enterprises, and no administration of employees' personal income tax. Property, including land, located in a FIZ is exempt from property tax, while trade between a FIZ enterprise and a Georgian company is taxed at 4% of the invoice value. However, there are also limitations related to FIZ operations, for instance, a ban on operations with tobacco products, and on hotels and residential buildings in its territory.

Currently several FIZs operate in Georgia, for instance, in Poti (a seaport), Kutaisi (the third largest city), and in Tbilisi (the capital city). Poti FIZ provides logistics and trading services and hosts more than 100 companies, producing chemical products, spirits, perfume ingredients, construction materials, etc. The first and largest tenant within Kutaisi FIZ, LLC Fresh Georgia, includes several factories that produce home appliances. Tbilisi FIZ builds its business model on its proximity to the international airport. All FIZs are operated by private companies and investors rent a space from the FIZ operator.

Currently, there are plans for the establishment of another FIZ in Georgia, adjacent to the Anaklia port site. The government offered a plot of land, around 600 ha, adjacent to the port with a standard set of tax incentives. However, the consortium developing Anaklia will be approaching the Georgian government for the establishment of a new concept and regulatory framework to help develop Anaklia City.¹³⁴ They suggest expanding the territory, establishing internal clusters with different focuses (light manufacturing, logistics, education, tourism, services, financial, retail, entertainment, etc.), and using the Green and Smart City concepts in its construction. This is envisaged with a full pledge for urban and spatial planning, from scratch.

In conclusion, FEZs are developing rapidly in the region, though their aggregate efficiency remains unproven. Georgia and Azerbaijan are now focusing on FEZ development with the goal of connecting to China's One Belt-One Road. While Armenia plans to develop anFEZ at the border with Iran, this initiative faces important logistic constraints and lacks business commitments, which could hinder its success.

Summary

Changes in trade regimes, new transport and logistic initiatives, as well as new domestic regulations, could affect not only the incumbent countries, but also their neighbors. This report has evaluated several of the opportunities currently emerging, including the impact of the Georgia-EU DCFTA, Armenia's membership in the EAEU, the development of free economic zones in the region, and the potential of the Chinese One Belt-One Road initiative.

¹³⁴ Anaklia Development Consortium. *Project ANAKLIA Port and Special Economic Zone "Anaklia City"*.

The RTAs could have a mixed impact on the region. Where new RTAs could negatively impact intra-regional trade due to the divergence of various standards. However, if these problem can be overcome, Armenia's EAEU membership will offer opportunities for countries in the region to use its customs clearance and product certification services to access the EAEU market. The EU-Georgia DCFTA could stimulate export-platform FDI in Georgia (such as with hazelnuts, discussed in Chapter 8). Although, the development of regional value chains using local products as inputs for exports to the EU, especially agricultural, will be constrained by the rules of origin of the EU, which do not allow for cumulation among these countries.

Though FEZs have proliferated throughout the region, the success of the proposed economic FEZ in the Syunik region of Armenia is questionable. This FEZ appears to be primarily governmentally-driven, with little commitment from the private sector. Prior global experience with Export Processing Zones has shown that the active engagement of the private sector is critical for such success. There are additional limiting factors, for instance, the proposed FTA being negotiated between the EAEU and Iran appears to be very limited and the North-South Road Corridor will not be completed in the foreseeable future. While expansion of trade with Iran would be beneficial for Armenia, the logic of expanding through the construction of a FEZ in Syunik has not been wholly expounded.

The development of the Alat FEZ and Anaklia FIZ could be beneficial for Azerbaijan and Georgia if the Chinese One Belt-One Road initiative and in particular the Trans-Caspian Transport Route are fully realized. For their success, the development of hard infrastructure should be accompanied with the development of "soft infrastructure", namely a further reduction of costs of the border formalities and the improvement of logistics services.

Recommendations:

To move toward the European Union's, or an internationally accepted, system of standards and technical regulations to benefit from the proliferation of RTAs.

To support the development of logistics capacity, especially intermodal terminals for handling cargo, to benefit from association with the development of the Chinese One Belt-One Road initiative and the Trans-Caspian Transport Route.

8. Sector Case Studies

Agriculture and tourism are the two sectors at the heart of both national and international development policies. These sectors have been defined as development priorities by all three countries in the region and are significant for the achievement of the SDGs. This study's analysis, presented below, reveals that these sectors have serious potential to become game changers in the region, through the implementation of development projects aimed at fostering inclusive economic development and poverty alleviation.

Agriculture

The South Caucasus remains a largely agrarian region. More than a third of Georgia's landscape and almost two-thirds of Armenia and Azerbaijan's territories consist of agricultural lands; although mountainous terrain significantly limits productivity. Approximately 37% of Armenia's population, and 45-46% of Azerbaijan and Georgia's populations live in rural areas. Moreover, from 2010-2015, the proportion of the rural population increased by around 4% in Armenia and Azerbaijan (Table 81).

Table 8-1: The role of agriculture in the region

	Armenia		Azerbaijan		Georgia	
	2010	2016	2010	2016	2010	2016
Agricultural land (% of total land)	60.9	58.9	57.7	57.7	35.7	36.7
Rural population (m people)	1.0	1.1	4.2	4.4	1.9	1.7
Rural population (% of total population)	36.4	37.4	46.6	45.1	47.1	46.2
Rural population growth index (2010=100)	100	108.4	100.0	108.1	100.0	85.9
Agriculture, value-added (% of GDP)	19.2	17.7	5.9	6.0	8.4	9.0
GDP growth index (2010=100)	100	124	100	108	100	131
Agriculture, value-added index (2010=100)	100	152	100	126	100	119
Employment in agriculture (% of total)	38.6	35.2	38.2	36.6	49.1	45.0
Agriculture and food exports (% of merchandise exports)	17.8	34.8	2.8	6.8	22.2	38.8
Agriculture and food imports (% of merchandise imports)	18.9	21.1	20.2	16.0	13.7	14.9

Sources: World Bank and ILO.

Note: Data taken from 2015 is marked in italic.

Agriculture and food processing continue to account for a very significant share (30-36%) of Armenia and Georgia's total exports, and remain the largest non-oil export category for Azerbaijan. Nevertheless on average, agriculture clearly underperforms relative to the rest of the economy. In 2015, around half of all Georgians employed or self-employed were working in the sector. Yet, their share of total GDP was a mere 9%, and there is a similar situation in the other two countries of the region.

The role of agro-food imports is also considerable. In 2016, the ratio of agro-food imports to the domestic output of the agriculture and food industry was 15% in Georgia, 22% in Armenia and 26% in Azerbaijan.

The critical inefficiency in the region's agriculture is rather straightforward: too many villagers are "stuck" using subsistence agricultural practices. In Georgia, of all those employed in agriculture in 2016, only approximately 11,000 (less than 1.3% of total agricultural employment) were hired as workers, presumably employed in commercial farming.¹³⁵ Similarly, according to Azerbaijan's State Statistical Committee, only 46.3 thousand (2.7%) are officially employed in Azerbaijani agriculture, out of 1,692.4 thousand employed in the sector.

The overwhelming majority of the remaining workers were self-employed (or, rather, under-employed) in semi-subsistence and subsistence agriculture on relatively small plots of land. According to the latest Georgian Agricultural Census, in 2014, 77% of all Georgian holdings owned less than 1 ha of agricultural land. In Armenia, the average farm size is currently about 3 ha, a considerable improvement compared to the 1.5 ha of a decade ago.¹³⁶ The issues encompass, a lack of leadership, skills, infrastructure and essential support services (e.g. machinery, veterinary centres), alongside poor organization. While many producers simply remain in agriculture due their age (the average Georgian farmer is around 55 years old), an emotional attachment to their lands, or a lack of other opportunities.

External interventions in the sector, such as government subsidies, donor-financed loans and grants, certainly help alleviate rural poverty, though they fundamentally fail to change farming and business practices in the region's countryside, thus leaving hundreds of thousands of people behind in all aspects of human development.

One key concern is that a significant part of agriculture is locked-in to traditional products, traditional cultivation methods and traditional export markets. Russia and Iraq are vital destinations for Armenia and Azerbaijan's agricultural and food products. While Georgia's agricultural exports to the EU did grow on the strength of its increased hazelnut production, Russia and the CIS remain the main export destinations for most Georgian products. Export potential to other markets like China, the largest importer of agricultural products, is almost unexploited. Even the South Caucasus domestic markets for mid and high-end comestibles are underdeveloped and are instead serviced by imports from the EU.

However, it is also a noteworthy symptom of an underlying problem. There is a dependence on a minimal number of traditional agricultural products, which are frequently not competitive in price or quality beyond their traditional markets where the products enjoy unique, nostalgia-based recognition. Escaping the traditional equilibrium is easier said than done, since the prices these products fetch in Russia and CIS may be unattainable in other markets. Moreover, meeting the food safety and quality standards imposed elsewhere (consistency over time, homogeneity, traceability) is a daunting task in the value chains dominated by a multitude of small, independent producers, who are not directly linked to downstream buyers.

The lack of consolidated downstream buyers (hereafter aggregators), for most agricultural products, appears to be an important structural deficiency undermining export potential and hampering overall development of the sector. Crucially, most foreign buyers do not want to make purchases from hundreds of small farms, requiring them to exercise a myriad of functions like quality control, certification, storage, packaging and other processing. Furthermore, small farmers are typically not capable of performing many of these functions, even if foreign buyers were to buy their suitable quality products. Many agricultural markets in the South Caucasus are missing intermediary firms, which connect multiple small producers and foreign buyers, and crucially perform the aforementioned essential services (alongside marketing).

There are also several positive examples of sectors within agriculture where development has been stimulated by the establishment of aggregators. One of which is hazelnut production in Georgia (the full story is

¹³⁵ Livny E., Maximov A. (2017). *Identifying Sectoral Priorities in Georgian Agriculture*. ISET Policy Institute. Available from: <http://tbilinomics.com/images/Consulting/Sectoral-priorities-in-Georgian-agriculture.pdf>.

¹³⁶ See: http://www.agricistrade.eu/wp-content/uploads/2015/05/Agricistrade_Armenia.pdf

detailed in Annex 6). Hazelnut production is now the most significant agricultural export in Georgia. The robust growth of the sector was initially fueled by foreign direct investment, firstly by Ferrero SpA, the makers of Nutella, and more recently by the Olam Group.

Importantly, the sector has an active intermediary actor, the Darcheli Hazelnut Cooperative, a cooperative of approximately 600 farms, that completes the drying, storing, deshelling, calibration and processing, and sometimes marketing, of the product. It has received an EU grant and Georgian governmental support to determine whether a large farm cooperative can efficiently substitute private independent firms that would otherwise perform these functions. The support of the sector has not been in financial subsidies, rather in a wide range of services designed to increase productivity, such as disease and pest control, plant and seedling education, soil preparation, harvesting methods and post-harvesting techniques. These facilities are entitled “green box” services by the WTO, as governmental support behind them is unconstrained by the WTO. These benefits are in part due to research showing that agricultural extension services that increase productivity are substantially more beneficial to farm income than direct financial support for output or exports.

In Armenia, the Spayka freight forwarding company appears to perform many aggregator functions. Spayka offers agricultural producers such services as storage, calibration, and packaging, as well as exporting goods to Russia. In general, intermediary firms or cooperatives appear to be able to help small farmers go beyond small-scale local production, possibly increasing the quality of their products and subsequently their incomes. This appears to have motivated the Ministry of Agriculture of Armenia, in November 2017, to start the “Armenia Prod”. This state-run company is designed to assume many aggregator functions, including marketing and quality control. Although only newly formed, it hopes to export under the Armenia Prod brand name, trading in “dairy products, meat products, dried fruits and other spheres which have sufficient capacity to enter the foreign market.”¹³⁷

In Azerbaijan, one of the tasks of the ABAD,¹³⁸ established in 2016 as a daughter company of ASAN, is to integrate agricultural smallholders and craftsmen into relevant value chains. For example, ABAD provides selected rural households with mobile containers equipped with modern machinery to process branded cheese or sausages. In addition to the equipment, ABAD also provides its partners in family businesses with a full-cycle of training on topics such as financial literacy, food security, the use of equipment, and food processing technologies. Moreover, ABAD offers services related to quality assurance and food safety, packaging, logistics, product branding (including the design of labels, the creation of family brands, and the production of advertising videos), and sales through own-branded boutiques and supermarkets. The state-owner, OJSC “Food Products Procurement and Supply”, was founded in 2016 with the mandate to purchase food products from producers and sellers, and deliver them to state enterprises (army, hospitals, kindergartens, etc.) and organizations.¹³⁹ Thus, the company serves as an “internal aggregator” for public procurement purposes.

This study suggests that if the aggregation problem could be, generally, resolved, it could result in the increase of farm incomes and the substantial development of the agricultural sectors in all three countries.

Tourism

The three South Caucasus nations each carry significant touristic potential, due largely to their pristine and versatile landscapes, and unique, ancient cultures. Unsurprisingly, Armenia, Azerbaijan and Georgia have all

¹³⁷ See:

<https://www.panorama.am/am/news/2017/11/03/%D4%B1%D6%80%D5%B4%D5%A5%D5%B6%D5%AB%D5%A1-%D5%BA%D6%80%D5%B8%D5%A4/1860538>

¹³⁸ See: <http://abad.gov.az/en>

¹³⁹ See: <http://tedaruk.gov.az/en/>

designated tourism as key national priorities; investing in infrastructure and international marketing, easing visa regulations, and improving border-crossing procedures.

The travel and tourism sector has already played a significant role in the economy of the region (Table 82), directly contributing to around 4% of GDP in Armenia and Azerbaijan and twice that in Georgia.¹⁴⁰ The total contribution to GDP in 2016, when the entire value chain is taken into account, is much higher, with about 14% in Armenia and Azerbaijan, and 27% in Georgia.¹⁴¹ Moreover, tourism is among the most dynamically expanding economic activities in the region, with stable growth rates.

Table 8-2: Travel and Tourism overview, 2016

	Armenia	Azerbaijan	Georgia
Direct contribution (% of GDP)	3.8	4.1	8.1
Total contribution (% of GDP)	14.0	14.6	27.1
Direct contribution (bn USD)	0.4	1.4	1.2
Total contribution (bn USD)	1.5	5.1	3.9
Direct jobs (thousand people)	38.4	171.2	121.9
Total jobs (thousand people)	143.4	609.1	420.4
Direct jobs (% of total employment)	3.3	3.7	6.8
Total jobs (% of total employment)	12.5	13.2	23.4
Leisure spending (% of total spending)	82.1	80.6	61.7
Business spending (% of total spending)	17.9	19.4	38.3
Foreign spending (% of total spending)	81.6	73.4	75.9
Domestic spending (% of total spending)	18.4	26.6	24.1

Source: World Travel and Tourism Council.

While countries working alone may be a fine strategy in the short-run, one should also consider the synergistic effect of promoting the inflow of tourists from the outside the region through bilateral intra-regional cooperation. Fully harmonizing border management procedures, improving communication and transport linkages, and making a joint effort, would promote the entire region as a world-class touristic destination. Thus, the South Caucasus as a whole could unlock new, lucrative markets for high-end tourism from the Gulf, Eurasia, Western Europe and North America. The geographical proximity of Georgia, Armenia, and Azerbaijan, and the low cost of intra-regional transportation, could attract tourists who would otherwise never consider visiting only for the sake of one (small) country.

To estimate the potential of regional tourism,¹⁴² we will use the concept of “transit tourism,” which is defined as a genuine, international tourist passing through a country which is neither the country of origin nor destination (for example, an American tourist traveling to Armenia, though spending a few days in Georgia).¹⁴³

Georgia’s total share of transit tourists is not very high. However, it is increasing over time, both in absolute terms (more than tripling since 2010), and as a share of total tourism. In the first nine months of 2017, the country hosted about 2.7 million tourists: of which, at least 450,000 (16.5%)¹⁴⁴ visited more than one country, Georgia and an immediate neighbor, and, thus, can be considered transit tourists.

¹⁴⁰ Georgian Tourism in Figures, Structure & Industry Data (2016), GNTA. Available from: <https://gnta.ge/wp-content/uploads/2016/08/ENG-2016.pdf>

¹⁴¹ World Travel and Tourism Council, Travel and Tourism Economic Impact 2017 reports for Armenia, Azerbaijan and Georgia. Available from: <https://www.wttc.org/>

¹⁴² This part of the report was also released the ISET Economist Blog. See: <http://www.iset-pi.ge/index.php/en/iset-economist-blog-2/entry/your-guest-is-my-guest-or-why-tourism-is-not-a-zero-sum-game>.

¹⁴³ Just like the traditional definition, transit tourism does not include visitors who stayed in a country for less than 24 hours.

¹⁴⁴ According to Georgia’s Ministry of Internal Affairs. Given the data limitations, we can identify “transit tourists” as only those visitors who used a land border crossing on their way in or out of Georgia, and these figures are thus underestimating the actual volume of transit tourism through the country. For example, we cannot observe visitors traveling Tbilisi-Baku by air, nor can we identify truck drivers who take longer than 24 hours traveling through Georgia.

Table 8-3: Transit tourism concerning Georgia, 2010 vs 2017

Package	Entry	Exit	Transit tourists		% of total transit tourists		% of total tourists		"Real" transit tourists	
			2010	2017	2010	2017	2010	2017	2010	2017
Georgia, Turkey	Georgia	Turkey	8,994	60,512	6.3%	13.4%	0.9%	2.2%	6,769	55,922
	Turkey	Georgia	9,971	53,410	7.0%	11.9%	1.0%	2.0%	7,886	49,294
Georgia, Azerbaijan	Georgia	Azerbaijan	6,160	23,581	4.3%	5.2%	0.6%	0.9%	5,031	18,232
	Azerbaijan	Georgia	10,508	24,557	7.4%	5.5%	1.0%	0.9%	9,159	18,479
Georgia, Armenia	Georgia	Armenia	10,013	57,942	7.0%	12.9%	1.0%	2.1%	8,346	50,472
	Armenia	Georgia	14,242	64,917	10.0%	14.4%	1.4%	2.4%	10,999	55,146
Armenia, Georgia, Turkey	Armenia	Turkey	10,903	14,102	7.6%	3.1%	1.1%	0.5%	6,443	11,541
	Turkey	Armenia	9,437	11,287	6.6%	2.5%	0.9%	0.4%	4,819	7,588
Armenia, Georgia, Azerbaijan	Armenia	Azerbaijan	1,164	3,346	0.8%	0.7%	0.1%	0.1%	1,164	3,346
	Azerbaijan	Armenia	1,977	7,545	1.4%	1.7%	0.2%	0.3%	1,977	7,545
Turkey, Georgia, Azerbaijan	Turkey	Azerbaijan	31,993	52,025	22.4%	11.5%	3.2%	1.9%	2,038	5,667
	Azerbaijan	Turkey	25,236	50,548	17.7%	11.2%	2.5%	1.8%	3,209	6,464

Source: Ministry of Internal Affairs of Georgia.

Several conclusions can be taken from the data presented in Table 83:

The **"Georgia & Armenia"** package is most popular within regional tourism. From January-September 2017, at least 123,000 tourists (accounting for 27.3% of the overall transit tourism) arrived in Georgia from Armenia or vice versa. An additional 25,000 came to Georgia from Armenia and continued to Turkey or the other way. Finally, almost 11,000 used Georgia as a springboard for visiting all three South Caucasus nations. In total, nearly 160,000 visited both Georgia and Armenia.

The **"Georgia & Turkey"** package is the second in popularity, attracting almost 114,000 tourists in the first nine months of 2017 (25.3% of all transit tourism). In combination with Azerbaijan or Armenia, the Georgia & Turkey package accounts for almost 242,000 visitors, leaving the other packages considerably behind.

The **"Georgia & Azerbaijan"** package is the third most popular, attracting 48,000 tourists from January-September 2017 (10.7% of all the transit tourism during this period). When combined with Turkey or Armenia, Georgia and Azerbaijan served an additional 113,000 visitors, bringing its total to over 161,000 people.

One must question, how many transit tourists are real tourists, as opposed to truck drivers, who simply face delays at the border or have other reasons to extend their stay beyond 24 hours? While precise information is not available, one can speculate by excluding Azerbaijani, Armenian and Turkish nationals from the transit tourism packages that include their native countries (for example, Turkish or Azerbaijani drivers on the Turkey-Georgia-Azerbaijan route, or Armenian or Turkish drivers on the Turkey-Georgia-Armenia route). Excluding professional drivers, the two most significant packages (by a large margin) are Georgia & Armenia, and Georgia & Turkey.

Not surprisingly, these two packages also represent the fastest growing segments in transit tourism involving Georgia. For example, the number of tourists on the Georgia-Turkey and Georgia-Armenia routes, in just the first nine months of 2017, was six to eight times higher than the corresponding figures for the entirety of 2010.

When studying the dominant packages, two things stand out. Firstly, a very large number of transit tourists are Russian nationals: approximately 42,000 from 106,000 (39.8%), and 43,000 out of 105,000 (40.7%) on the Georgia & Armenia and Georgia & Turkey routes, respectively. Secondly, regional packages also attract tourists from more distant destinations:

- ▶ Iran, Ukraine, Saudi Arabia, Belarus, and Kazakhstan account for 44.8% of all transit tourists on the Georgia & Turkey route.
- ▶ Poland, Iran, Germany, Ukraine, Japan and Italy account for 27.4% of transit tourists on the Georgia & Armenia route.

Very significantly, the Georgia & Armenia route appears to be particularly suited to attracting high-end tourist from Asia and Western Europe, who tend to spend sums on higher quality hospitality services and shopping. Finally, something must be said about those tourists who visit the South Caucasus to explore all the region's three countries. Their numbers are relatively low, a little less than 11,000 in the first nine months of 2017. Nevertheless, they represent a fast-growing segment, increasing by almost five times in comparison to 2010. It is particularly noteworthy that a relatively large share of such tourists are long-distance travelers, from places like Germany, the US, the UK, Hungary, Russia, China and South Korea. Truly regional tourism in the South Caucasus is still hampered by many bureaucratic barriers and borders, as well as unresolved conflicts in the region. Yet, its development demonstrates that tourism is not a zero-sum game. This information therefore helps to build the case for closer cooperation and coordination between the countries of the region.

Interviews with stakeholders forwarded various ideas regarding the development of regional tourism, in order to attract visitors who are interested in visiting two or three countries in one trip, like agro-tourism, gastro-tourism, wine tourism, and cultural heritage tours, as with the German settlements. The promotion of regional tourism would require:

- ▶ Safe and affordable transport connectivity, in particular, rail connectivity;
- ▶ Appropriate conditions in all three countries for instance, relaxed visa regulations, and simple and transparent border crossing procedures;
- ▶ Touristic products representing the region's diversity;
- ▶ Mediation by international brokers to assist with regional coordination.

Attention should also be paid to the development of the infrastructure of agro-tourism (including ICT needs for international and regional marketing), aggregation, processing of locally branded agricultural products, arts and crafts, etc.

While attention may also be required for the development of a regional network of special road stations; providing unique local products supporting the traditional local specializations, preserving cultural heritage and offering tourist attractions. This idea is based on the Eco-Bazaars in Azerbaijan and the Japanese "Michi-no-Eki" road station models. Japan created about 1,000 special roadside stations, entitled Michi-no-Eki, which cater to more than 500 million people a year. Rather than selling identical products, Michi-no-Eki emphasize innovation and uniqueness: offering local tourist, cultural and entertainment information, as well as regionally produced and branded food, arts and crafts. For instance, a Michi-no-Eki may specialize in apples, and rather than just selling whole apples, it would venture into a whole range of derivatives such as jams, apple chips, apple pies, apple-shaped memorabilia, etc.¹⁴⁵ Aside from agro-food products, the stations could also offer locally made craft goods.

¹⁴⁵ See:

<http://www.iset-pi.ge/index.php/en/iset-economist-blog-2/entry/georgian-churchkheldas-thinking-out-of-the-traditional-box>

Summary

Agriculture and tourism have been selected as case studies for several reasons. First of all, they have been designated as priority sectors by the governments of Armenia, Azerbaijan and Georgia. Secondly, these sectors play a significant role in the exports of the South Caucasus. Thirdly, and perhaps most importantly, these sectors are vital for the region's implementation of the SDGs and the Agenda. The increase in agricultural productivity and the boost to agro-food exports would not only improve the incomes of the rural population and contribute to poverty alleviation, but it would also strengthen food security both globally and in the region. In turn, tourism is considered an important component for the promotion of inclusive economic growth. Notably, it attracts a large segment of the low-skilled labor force, including women, frequently in rather distant parts of the region and in areas with limited employment opportunities.

Agriculture- Agriculture has been an important sector for all three countries. It is typically characterised, especially in Georgia, by small holdings and low productivity. In Georgia, 51 percent of the labor force is engaged in agricultural employment, but only 9 percent of the value-added comes from agriculture. In Armenia and Azerbaijan, the share of the labor force in agriculture is 35 and 36 percent, respectively. A great deal has been written by experts about agriculture in the region, and unfortunately detailed sub-sector studies are beyond the scope of this study. We do, however, focus on one problem, namely, the region's lack of "aggregators", i.e. intermediaries that provide services like quality control, certification, storage, packaging and other processing to multiple small farmers, and thereby increase potential consignments and help make the products more attractive on the market.

The three countries have already started addressing this structural deficiency. For instance, in Georgia, the farmers' Darcheli Hazelnut Cooperative, supported by the government and additional donors, has been very successful in performing the functions of an aggregator in hazelnuts production. In Armenia, a large private company, Spayka, provides aggregation services both within and outside of its territories; the Armenian government has also recently established a state company to deliver a similar function. In Azerbaijan, the state entity ABAD is permitted to provide aggregator services to small farmers. We believe that if the institution of aggregators could be significantly strengthened, it could result in the substantial development of the agricultural sector and create an increase in farm incomes in all three countries.

Tourism- The countries of the region have actively and successfully promoted tourism. The interview participants were asked how to best increase regional tourism, that is, to encourage visits to more than one of the region's countries in a single trip. They expressed various ideas for bilateral and regional tourist routes, like agro-tourism, gastro-tourism, wine tourism, and cultural heritage tourism. The promotion of regional tourism would be helped by; (a) safe and affordable transport connectivity; (b) appropriate visa and border crossing conditions in all three countries; (c) touristic products representing the region's diversity; and (d) mediation by international brokers to facilitate regional coordination.

The development of a regional network of special road stations offering unique local products would further support traditional local specialization, preserve cultural heritage and local employment, and offer tourist attractions. The concept is based on the experience of Eco-Bazaars in Azerbaijan and the Japanese Michi-no-Eki road station models. These experiences offer local tourist, cultural and entertainment information, and equally locally produced and branded foods, arts and crafts.

Recommendations:

To encourage aggregators throughout agricultural markets to potentially innovate trade.

To promote regional tourism, namely, to encourage visits to more than one of the region's countries in a single trip. This can be motivated by improving transport connectivity, and offering tourist routes and products representing the region's diversity.

9. Towards a Feasibility Study

Key findings

The implementation of the Agenda and the SDGs started in January 2016 and will be completed by December of 2030. The Agenda and the SDGs propose that countries achieve sustainable development in economic, social and environmental dimensions simultaneously. The Agenda advocates that international trade is expected to assist in the achievement the SDGs.

There is a long-standing UNCTAD tradition of recognizing international trade as a means of promoting socioeconomic development. However, it remains a challenge for policy-makers to formulate trade policy in a manner that leads to the achievement of the SDGs. In an increasingly globalized world, this requires coherence of policies at the national, regional and global level. The objective of this report is to assist in the design of each of those trade and trade facilitation policies, and of institutions and projects that contribute to the achievement of the SDGs.

Armenia, Azerbaijan and Georgia belong to a group of middle-income countries, and further efforts are required to improve the economic wellbeing of their populations. **The three countries still face challenges due to high levels of poverty, and their distorted labor markets, which cannot provide people with decent jobs or ensure non-discrimination.** Only 36% of total employment in Azerbaijan are waged and salaried jobs, though for women, this share is even lower, with only 32% total female employment. In Georgia, the situation is moderately better, where 42% are waged and salaried jobs, while Armenia includes 58% waged and salaried jobs. The development of better jobs, and those with regular pay, would contribute to the inclusivity of the economic growth in these countries.

Trade plays an important role in all three economies of the region, with an average trade over GDP ratio at 98% in Georgia, 79% in Armenia, and 76% in Azerbaijan. **The majority of trade occurs outside the South Caucasus, although still largely with its neighbors.** The EU, Russia, Turkey and China are each key trade partners for all three countries. The commodity structure of the region's **exports features limited diversification**, focusing on mineral products, agro-food, metals, and chemicals. In services, tourism is the main export category in the region.

The countries of the region have RCAs in their resource-intensive exports, which have a limited direct impact on the labor market and entail environmental costs. However, there is growing competitiveness in agriculture and food, metal and chemical production, textiles, and even selected transport equipment. The improvement of the business environment, in particular, trade facilitation measures, could help to sustain these trends and strengthen the overall competitiveness of the region.

The countries of the South Caucasus have relatively low import duties, ranging from 9% in Azerbaijan to 1.5% in Georgia. Although Armenia's tariffs remain moderate, implementation of the EAEU charges has resulted in its applied tariffs exceeding its WTO bound commitments on selected tariff lines; this has caused Armenia to have to negotiate with its WTO trade partners for acceptable compensation.

As with most countries in the post-WTO world, **the countries generally avoid "core" non-tariff barriers, such as quotas or restrictive licensing requirements, except where permitted by the WTO, as with the case of products that impact health or safety.** In Azerbaijan, however, stakeholders report the existence of informal

importer networks in importing, alongside a lack of transparency in the application of legal norms on imports. The principle concerns regarding non-tariff barriers to trade, however, are with standards and technical regulations. **Intra-regional trade is likely to be progressively impeded by the three countries' diverging systems of standards and technical regulations.** Production to a given standard requires costly investments, thus if the three countries each have different standards, trade will become more difficult.

Azerbaijan is the only country in the region that is not a WTO member. Its WTO accession will impact an enormous range of policies, including customs, intellectual property, trade related investment measures, services, trade remedies, subsidies, and agricultural support among others. Experience has shown that substantial technical assistance is valuable, if not required, in the effort to implement all the necessary legal, policy and technical measures required within WTO accession.

The involvement of the South Caucasus in regional trade agreements has recently intensified. **The most important regional trade agreements are with the EAEU, since Armenia's membership, and the EU-Georgia DCFTA.** There is also a **network of bilateral and plurilateral Free Trade Agreements (FTAs) within CIS,** which ensure that intra-regional trade is duty-free. The positive impact of the network of CIS FTAs is supported and facilitated by the CIS Rules of Origin Treaty, which allows full cumulation for the purposes of determining whether a product meets such rules to qualify for preferential tariff treatment.

The RTAs are expected to positively impact its signatory parties, however, they could have a mixed impact on non-participating countries. Presently intra-regional trade accounts for only around four percent of the total trade within the South Caucasus. **The new RTAs could negatively impact intra-regional trade because of diverging standards.** However, if these standards problem can be overcome, **Armenia's membership in the EAEU will generate opportunities for its neighbors to use its customs clearance and product certification services to access the EAEU market. The EU-Georgia DCFTA could also stimulate export-platform FDI to Georgia** (as has occurred with hazelnuts). Although, the development of regional value chains using local products as inputs for exports to the EU, especially in agriculture, will be constrained by the EU's rules of origin, which do not allow for cumulation among these countries.

The region has also witnessed an ongoing expansion of transport infrastructural projects along the key North-South and East-West Transport Corridors. In particular; the rehabilitation and upgrade of the North-South Road Corridor in Armenia; the modernization of the East-West Highway in Georgia; the construction of the new Baku-Tbilisi-Kars Railway connecting Azerbaijan, Georgia and Turkey; the North-South Railway Corridor in Azerbaijan, linking Iran and Russia; and the expansion of port facilities in the Caspian Sea (Alat, Azerbaijan) and the Black Sea (Anaklia, Georgia). This new infrastructure should facilitate trade both internationally and regionally. Notably, **the improved intra-regional connectivity from these infrastructural developments will increase the attractiveness of the region for tourists** and for commercial cargo, it should furthermore allow the region to connect seamlessly with one of the planned routes of the Chinese "One Belt-One Road" initiative.

Armenia faces the most severe transport bottlenecks, where, as a landlocked country with only two open borders with Georgia and Iran, access to the rest of the world is severely constrained. While road access to Russia, its major market, is currently only available via a single border crossing (Larsi), and which is sensitive to weather conditions. While the reopening of existing transport corridors through Abkhazia and South Ossetia was considered in the framework of Russia's accession to the WTO, it has yet to transpire.¹⁴⁶

The countries of the South Caucasus have a developed system of trade support institutions. While their

¹⁴⁶ More information about Georgian trade relations with Abkhazia can be found, for example, in, *The Caucasus Conflicts: Frozen and Shelved?* Politorbis, 2 / 2015. Available from: https://www.eda.admin.ch/dam/eda/mehrsprachig/documents/publications/Politorbis/Politorbis%2060_dfe.pdf

role in promoting exports and attracting investors could be positive, **their performance in the South Caucasus could also be improved.** Further efforts are necessary in the area of trade facilitation. Nonetheless, each country has its own strengths and weaknesses. Azerbaijan has, comparatively, a better developed transport infrastructure, but more attention is yet required on its customs procedures. Georgia has the most efficient customs and related procedures in the region, though it lacks transport infrastructure. Armenia features relatively low trade costs, while it still needs to improve both its customs and transport infrastructure. Moreover, all three countries perform poorly with logistics services.

FEZs have proliferated throughout the region, though **the success of the proposed FEZ in the Syunik region of Armenia is questionable.** This FEZ appears to be primarily government driven, with little commitment from the private sector. Prior global experience with Export Processing Zones has shown that the active engagement of the private sector will prove vital for its success. Additional limiting factors are that the proposed FTA, being negotiated between the EAEU and Iran, appears to be limited in scope; and the completion date of Armenia's North-South Road Corridor remains uncertain. Equally, while the expansion of trade with Iran would be beneficial for Armenia, the logic behind expanding through the construction of a FEZ in Syunik has not been fully explained.

Case studies were conducted for two sectors- **agriculture and tourism.** These sectors have been designated as essential priorities by the governments of Armenia, Azerbaijan and Georgia, and each plays a significant role in exportation in the South Caucasus. Moreover, these sectors **are vital for the implementation of the SDGs and the Agenda, thus potentially becoming “game changers” within the region.** An increase in productivity in agriculture and a boost to agro-food exports would not only increase the incomes of the rural population and contribute to poverty alleviation, but they would also strengthen food security in both the region and globally. In turn, tourism is considered an important component for the promotion of inclusive economic growth. Significantly, it attracts a large segment of the low-skilled labor force, including women, frequently in rather distant parts of the region and in areas where there are limited employment opportunities.

Options for further feasibility studies

Based on the trade policies analyzed and on the practices of all three countries, as well as on the experience of other countries that have achieved rapid income growth through export-oriented policies, our recommendations are:

1. For the three countries to create a number of “supply chain councils” organized around the major export sectors of the countries of the South Caucasus, either on a national or bilateral level.
2. For the three countries to ensure wider availability of online information on export promotion agencies’ websites, specifically for information regarding export opportunities and the constraints affecting domestic businesspeople.
3. For the three countries to establish joint bilateral customs clearances to facilitate the movement of goods, in order to reduce bottlenecks at border crossings.
4. For Armenia and Georgia to continue pursuing the implementation of their commitments under the WTO Trade Facilitation Agreement, including seeking technical assistance for feasibility studies.
5. For Azerbaijan to actively pursue its accession to the WTO, particularly to gradually move toward the EU or an internationally accepted system of standards and technical regulations. The country should also seek technical assistance to implement all the necessary changes.
6. For the three countries to continue the planned expansion of the transportation corridors in cooperation with international financial institutions.
7. For the three countries to support the development of logistics capacities and smaller scale regional projects, like the development of intermodal terminals for handling cargo, the construction of warehouses, and the improvement of cargo tracing systems.

8. For Georgia to adopt a gradual approach to its convergence with EU standards and technical regulations, and consider and evaluate the costs versus the benefits on a case-by-case basis.
9. For the three countries, where warranted, to encourage aggregators in agricultural markets as potential game changers within those markets.
10. For the three countries to promote regional tourism, specifically, to encourage visits to more than one country in the region within a single trip. This can be assisted by improving transport connectivity, and by offering tourist routes and products representing the region's diversity.

Based on these suggestions, there are several worthwhile options for further feasibility studies.

New approaches should be considered to help reduce trade costs. This study proposes **the creation of a number of supply chain councils** organized around the region's major export sectors at national or bilateral levels. Supply chain councils are public-private partnerships that involve the active engagement of the business community, as well as policy officials and regulators. They are needed to reduce uncertainty for producers by facilitating trade and cross-border investment flows. These supply chain councils would focus on important "backbone" services such as communications, finance and transport, as well as non-tariff barriers. They can also play an important role in addressing the policy barriers that inhibit greater economic integration with regional trading partners. This can be facilitated if they include business representatives and regulators from trading partners to focus policy attention on lowering trade costs due to differences in regulations and standards, and customs and border issues; resolve uncertainties regarding the treatment of products, services and businesses; and reduce any impediments to supply chain investments.

The councils would have a mandate to identify the most important sources of supply chain inefficiencies, and consequently seek their resolution. These supply chain councils would determine the priority areas for inter-governmental negotiations. Businesspeople on all sides of the negotiations have on-the-ground knowledge of the most pressing issues and are likely to have common interests in lowering trade costs. Thus, recommendations for regulatory reform of these councils can be implemented by governments alongside the knowledge that they have unilateral support from business.

Trade support institutions could also be developed further. While their role in promoting exports and attracting investors has the potential to be very positive, their performance still requires improvement. All three countries have established export promotion agencies, and it would help if they would expand their connection to domestic businesses by providing more information on market opportunities and the costs of exporting. Our review of the export promotion agencies' websites suggests more assistance is still required to ensure wider availability of information. **Domestic businesses would specifically benefit from more information online regarding both export opportunities and constraints.** The establishment of a regular joint forum to discuss cross-border trade opportunities could also contribute to trade expansion.

Trade facilitation measures should be aimed at removing bottlenecks, and in reducing the costs of border crossing. **One possibility to be explored is the establishment of bilateral joint customs clearances to facilitate the movements of goods.** The further development of automated customs procedures, information exchanges and other policy measures, in line with the WTO TFA and OECD recommendations, are also important.

Armenia and Georgia have already submitted their schedules for WTO TFA implementation, providing a clear indication of where technical support is still necessary. In particular, Armenia explicitly requires technical assistance for the use of international standards in customs formalities, the operation of a single window, the establishment of separate infrastructure for transit, and the improvement of transit formalities. While Georgia appealed for authorized economic operators (with legal assistance and training) and prior processing of transit documentation. **Support in technical assistance from the WTO TFA will help reduce trade costs and stimulate exports.**

For Azerbaijan, accession to the WTO is highly recommended and the uppermost priority for their trade policy. Armenia and Georgia are members of the WTO, while Azerbaijan remains an applicant. WTO membership is a crucial step for any country committed to integration within the world trading environment. Moreover, membership helps support the implementation of the SDGs, which directly references the WTO as a tool to promote universal, rules-based, open, non-discriminatory and equitable trade. Experience has shown, however, that substantial technical assistance is useful, if not required, in the effort to implement all the necessary legal, policy and technical measures required of WTO accession.

The principle concern regarding non-tariff barriers in the region's trade remains the various differing standards and technical regulations. Intra-regional trade is likely to be progressively impeded by the three diverging systems of standards and technical regulations utilized within Armenia, Azerbaijan and Georgia. Production to a given standard requires costly investments, thus if the three countries have different standards, trade becomes more difficult. In the case of **Georgia, we recommend the adoption of a gradual approach to convergence with EU standards and technical regulations**, and selection on a case-by-case basis, by evaluating the costs versus the benefits and considering where technical assistance may be necessary. Moreover, as the Russian Federation and the EAEU evolve away from the GOST system and toward the EU system, we support **Azerbaijan's movement toward the EU's, or internationally accepted, system of standards and technical regulations**.

The support of infrastructural development, in particular, in transport and logistics, could address another important bottleneck in the region. Alongside the major projects aimed to develop land transport corridors and port infrastructure, there is a need for **smaller-scale regional projects, like the development of intermodal terminals for handling cargo, the construction of warehouses, and the improvement of cargo tracing systems**. Any activities related to infrastructural development likely must be coordinated with the World Bank, the Asian Development Bank, the European Bank for Reconstruction and Development or the European Investment Bank.

Case studies of agriculture and tourism, designated as priority sectors in the development strategies in all three countries, allowed for the identification of the following promising opportunities:

The facilitation of regional cooperation in agricultural product aggregation, calibration, packaging and/or processing for exports. The lack of aggregators for most agricultural products appears to be an important explanation behind deficiencies in agricultural exports and broader agricultural development. Most foreign buyers simply do not want to purchase from hundreds of small farms, which would require a myriad of functions like quality control, certification, storage, packaging and other processing. Moreover, small farmers are typically not capable of performing many of these functions, even if foreign buyers would buy their products. Many agricultural markets in the South Caucasus are missing an intermediary firm, between the multiple small producers and foreign buyers, that would perform the essential services mentioned (as well as marketing).

The development of regional tourism to attract visitors that are interested in seeing two or three countries within a single trip. The interviewees expressed various ideas for bilateral and regional tourist routes, like agro-tourism, gastro-tourism, wine tourism, and cultural heritage tours, as at the German settlements. The promotion of regional tourism would require:

- ▶ Safe and affordable transport connectivity, in particular, rail connectivity;
- ▶ Appropriate conditions in all three countries, for instance, relaxed visa regulations, and simple and transparent border crossing procedures;
- ▶ Touristic products representing the region's diversity;
- ▶ Mediation by international brokers to facilitate regional coordination.

Attention could also be paid to the development of agro-tourism infrastructure (including ICT for international and regional marketing), alongside aggregation, the processing of locally branded agricultural products, arts and crafts, etc. The development of a regional network of special road stations offering unique local products, supporting regional traditional specializations, preserving cultural heritage, and offering tourist attractions and thus employment, could be accomplished throughout the area. Aside from agro-food products, the stations could moreover offer locally made craft goods.

Box 9-1: Intra-regional trade

Intra-regional trade in South Caucasus (indicating the bilateral trade between Armenia and Georgia and between Azerbaijan and Georgia) is not constrained by tariffs barriers, thanks to the existing FTAs. Non-tariff trade barriers are more important. Currently,¹⁴⁷ the high costs of moving goods across the borders is one of the key obstacles for the region's trade development, affecting both external and intra-regional trade. The reduction of the costs (including time) associated with customs clearance and logistics could bring tangible benefits to the economies of the South Caucasus, both in terms of intra-regional and external trade. In agriculture, the important barrier for the development of exports, including intra-regional exports, is the lack of aggregators (market failure or missing the market). Finding a resolution to this aggregator problem could unlock the export potential of the sector.

A significant problem for the export potential, specifically, of the agriculture sector is its domination by small firms. The OECD Trade by Enterprises Characteristics (TEC) identifies that among OECD countries, typically fewer than ten percent of firms export, with only limited exceptions. Furthermore, the bulk of exports are completed by large firms (those with at least 250 employees). In the United States, for example, large firms are responsible for 72% of exports, and in an additional ten OECD countries, large firms account for more than two-thirds of exports.¹⁴⁸

The reason for the lack of exporting by small firms is that there are significant fixed costs behind export to any bilateral link. These costs include the search for partners and the maintenance of partnerships; the fulfillment of standards; labelling and packaging requirements; adjustment of products to taste and cultural preferences; and providing after sales services to foreign markets. For small firms, with slight volumes of sales, the fixed costs are often too high to make exports profitable. Additionally, those who do export naturally gravitate to large markets, where greater volumes of sales will allow them to recover the fixed costs associated with serving that market. In the case of the South Caucasus, these markets are Russia, the EU, Turkey and China. Understanding the dynamics of export by analyzing the size of a firm further emphasizes the importance of resolving the problems behind export aggregators. However, economies of scale in the export market suggest that the aggregators will still focus on larger markets.

Nonetheless, there are multiple opportunities for local cooperation that could encourage regional trade, including:

Creating a number of "supply chain councils" organized around the major export sectors on a **bilateral** level;

¹⁴⁷ In the future, after Georgia incorporates the EU standards harmonization and as Armenia progresses with the adoption of the EAEU standards, the costs of product safety compliance will increase and therefore become more significant.

¹⁴⁸ OECD Statistics Directorate. (2016). *Statistical Insights Who's Who in International Trade: A Spotlight on OECD Trade by Enterprises Characteristics data*. Available from: <http://oecdinsights.org/2016/04/>

Establishing **joint bilateral customs clearances** to facilitate the movement of goods in order to reduce bottlenecks at border crossings;

Supporting the development of smaller scale **regional projects like regional/bilateral cargo tracing systems**, and other transit and logistics infrastructure;

Continuing the **expansion of transportation corridors in cooperation** with international financial institutions. The successful development of the **Trans-Caspian International Transport Route** is conditional upon the reduction of moving goods across borders and thus trade facilitation measures;

Developing *inter alia* **regional aggregators in agriculture** to serve external markets. For instance, the Armenian company, Spayka, operating in the Georgian market;

Promoting **regional tourism**, to encourage visits to more than one country in the region within a single trip. Facilitated by improving transport connectivity, and offering tourist routes and products representing the region's diversity;

Utilizing **Armenia's services** for customs clearance and conformity assessments procedures for exports to the EAEU market;

Making use of **Georgian export-platform FDIs** to assess the EU and Chinese markets (conditional upon rule of origin requirements).

Each of these opportunities are discussed in detail within the report.

Annexes

Annex 1: Selected trade-related means of implementation in the SDGs and the Addis Ababa Action Agenda (AAAA)

Goal 17. Strengthen the means of implementation and revitalize the global partnership for sustainable development

- 17.10**
AAAA, para. 79 **Promote a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the World Trade Organization (WTO) including through the conclusion of negotiations within its Doha Development Agenda**
We will continue to promote a universal, rules-based, open, transparent, predictable, inclusive, non-discriminatory and equitable multilateral trading system under the WTO, as well as meaningful trade liberalization.
- 17.11**
AAAA, para. 82 **Significantly increase the exports of developing countries, in particular with a view to doubling the least developed countries (LDCs)' share of global exports by 2020**
We will endeavour to significantly increase world trade in a manner consistent with the sustainable development goals, including exports from developing countries, in particular from LDCs with a view towards doubling their share of global exports by 2020 as stated in the Istanbul Programme of Action.
- 17.12**
AAAA, para. 85 **Realize timely implementation of duty-free and quota-free (DFQF) market access on a lasting basis for all LDCs consistent with WTO decisions, including by ensuring that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access**
We call on developed country WTO members and developing country WTO members declaring themselves in a position to do so to realize timely implementation of DFQF market access on a lasting basis for all products originating from all LDCs consistent with WTO decisions. We call on them to also take steps to facilitate market access for products of LDCs, including by developing simple and transparent rules of origin applicable to imports from LDCs, in accordance with the guidelines adopted by WTO members at the Bali ministerial conference in 2013.

Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture

- 2.b***
AAAA, para. 83 **Correct and prevent trade restrictions and distortions in world agricultural markets, including through the parallel elimination of all forms of agricultural export subsidies and all export measures with equivalent effect, in accordance with the mandate of the Doha Development Round**
In accordance with one element of the mandate of the Doha Development Agenda, we call on WTO members to correct and prevent trade restrictions and distortions in world agricultural markets, including through the parallel elimination of all forms of agricultural export subsidies and disciplines on all export measures with equivalent effect.

Goal 3. Ensure healthy lives and promote well-being for all at all ages

- 3.b***
AAAA, para. 86 **[...] provide access to affordable essential medicines and vaccines, in accordance with the Doha Declaration on the TRIPS Agreement and Public Health, which affirms the right of developing countries to use to the full the provisions in the Agreement on Trade-Related Aspects of Intellectual Property Rights regarding flexibilities to protect public health and, in particular, provides access to medicines for all**
We reaffirm the right of WTO members to take advantage of the flexibilities in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and reaffirm that the TRIPS Agreement does not and should not prevent members from taking measures to protect public health.

Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all

- 8.a***
AAAA, para. 90 **Increase Aid for Trade support for developing countries, particularly LDCs, including through the Enhanced Integrated Framework for LDCs**
We will strive to allocate an increasing proportion of Aid for Trade going to LDCs, provided according to development cooperation effectiveness principles.

Goal 10. Reduce inequality within and among countries

- 10.a***
AAAA, para.84 **Implement the principle of special and differential treatment (SDT) for developing countries, in particular LDCs, in accordance with WTO agreements**
Members of the WTO will continue to implement the provision of special and differential treatment for developing countries, in particular LDCs, in accordance with WTO agreements.

Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development

14.6
AAAA, para.83 **By 2020, prohibit certain forms of fisheries subsidies which contribute to overcapacity and overfishing, eliminate subsidies that contribute to illegal, unreported and unregulated fishing and refrain from introducing new such subsidies, recognizing that appropriate and effective special and differential treatment for developing and least developed countries should be an integral part of the World Trade Organization fisheries subsidies negotiation**

We call on WTO members to commit to strengthen disciplines on subsidies in the fisheries sector, including through the prohibition of certain forms of subsidies that contribute to overcapacity and overfishing in accordance with the mandate of the Doha Development Agenda and the Hong Kong Ministerial Declaration.

Goal 15. Protect, restore and promote the sustainable use of terrestrial ecosystems [...] and halt biodiversity loss

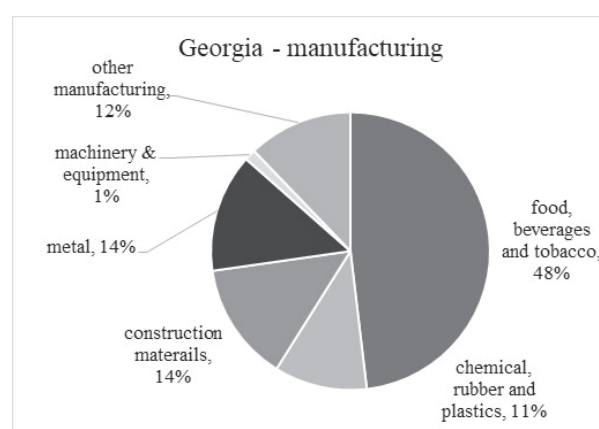
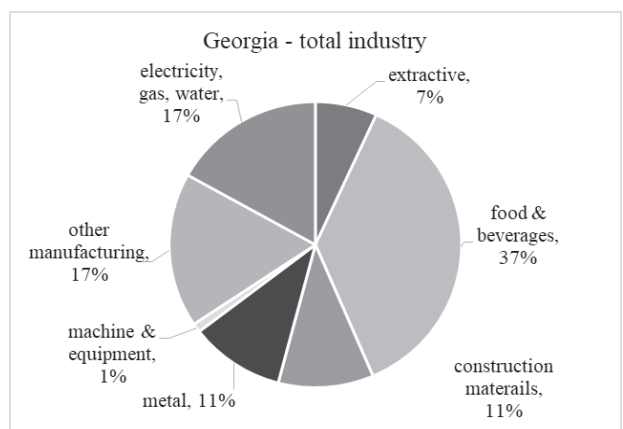
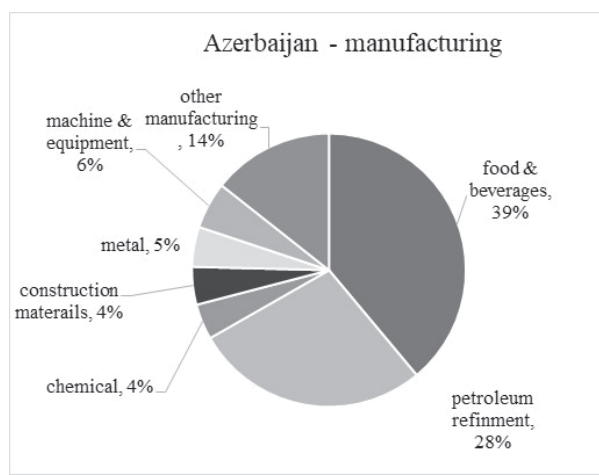
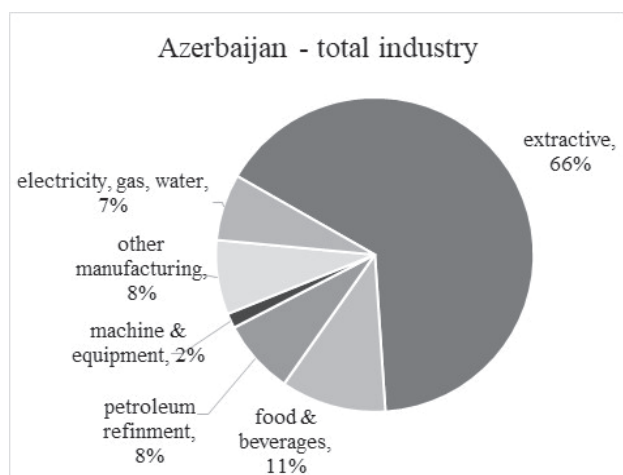
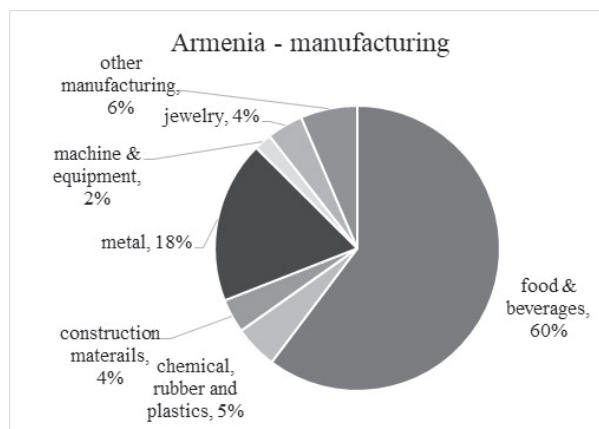
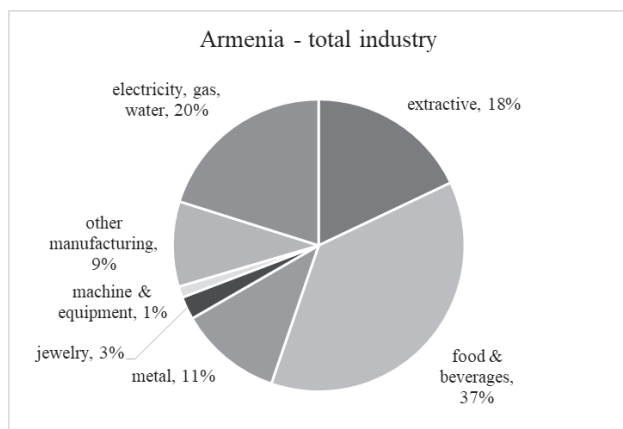
15.c*
AAAA, para.92 **Enhance global support for efforts to combat the poaching and trafficking of protected species, including by increasing the capacity of local communities to pursue sustainable livelihood opportunities**

We resolve to enhance global support for efforts to combat poaching of and trafficking in protected species, trafficking in hazardous waste, and trafficking in minerals, including by strengthening both national regulation and international cooperation and increasing the capacity of local communities to pursue sustainable livelihood opportunities.

** In the SDGs, other than Goal 17, goal-specific means of implementation are listed along with the targets, but they are distinguished from the targets by being ordered alphabetically.*

Source: UNCTAD (2016).

Annex 2: The structure of industry in Armenia, Azerbaijan and Georgia, 2016



Source: The National Statistical Service of Armenia, the State Statistical Committee of Azerbaijan, and the National Statistics Office of Georgia.

Annex 3: Revealed Comparative Advantages of Armenia, Azerbaijan and Georgia, 2012 and 2016, Harmonized System 2007 at an aggregated level and 4 digits

Revealed comparative advantage by country, destination and product category, 2016

	Armenia		Azerbaijan		Georgia		
	World	Georgia	World	Georgia	World	Armenia	Azerbaijan
Animal origin products	0.98	0.04	0.02	0.02	1.74	0.35	2.26
Vegetables, fruits, grains	1.05	0.37	1.33	0.49	3.55	1.05	0.45
Food products	6.82	1.37	0.38	0.32	5.13	2.29	2.15
Minerals	19.53	22.59	0.29	2.60	13.68	11.15	0.29
Fuels	0.40	0.34	10.40	6.09	0.35	1.03	0.36
Chemicals	0.11	0.35	0.07	0.10	1.18	1.99	2.45
Plastic & rubber	0.11	0.96	0.25	0.08	0.36	0.76	1.33
Hides & skins	0.66	1.30	0.25	0.16	0.30	0.76	0.24
Wood products	0.07	0.07	0.03	0.11	0.68	1.63	0.09
Textile & clothing	1.15	0.07	0.09	0.15	0.90	0.95	0.20
Footwear	0.14	0.12	0.00	0.00	0.11	1.06	0.09
Stone & glass	3.88	1.85	0.00	0.05	0.91	0.34	0.31
Metals	1.96	0.04	0.39	0.32	1.87	0.51	0.69
Machines & equipment	0.06	0.06	0.02	0.08	0.10	0.26	0.26
Transport equipment	0.07	0.04	0.06	0.30	0.79	3.81	4.65
Miscellaneous products	0.27	0.09	0.01	0.03	0.19	0.06	0.12

Source: WITS.

Note: Here, the RCA is estimated separately for the global market and for the market of partner countries in the South Caucasus. For instance, this table shows that Armenia is globally competitive in the exports of textile and clothing (the RCA in the column "World" for Armenia is over unity), but it has no competitive edge with textile and clothing on the Georgian market (the RCA in the column "Georgia" for Armenia is close to zero).

Armenia

Armenia's top-20 products with the highest RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
7402	Unrefined copper; copper anodes	62,756	210.1	151.0
2512	Siliceous fossil meals	2,061	168.9	115.9
8102	Molybdenum and articles thereof	5,024	301.2	108.4
9111	Watch cases and parts thereof	18,128	71.6	97.3
2402	Cigars, cheroots, cigarillos and cigarettes, of to	211,458	20.6	79.5
2603	Copper ores and concentrates	370,050	57.8	69.7
7607	Aluminum foil (whether/not printed or backed)	77,066	84.7	60.3
2616	Precious metal ores and concentrates	31,429	45.1	46.4
2208	Undenatured ethyl alcohol of an alcoholic strength	150,923	68.3	46.2
7202	Ferro-alloys	66,015	45.4	32.0
2206	Other fermented beverages (for example, cider)	4,510	26.7	27.3
2716	Electrical energy	57,073	30.2	19.9
0702	Tomatoes, fresh or chilled	19,076	0.1	19.2

0806	Grapes, fresh or dried	16,979	14.1	16.1
2201	Waters, including natural or artificial mineral water	6,291	29.0	15.0
6201	Men's or boys' overcoats, car-coats, capes, cloaks	20,941	5.7	14.4
2608	Zinc ores and concentrates	10,507	29.8	12.5
6202	Women's or girls' overcoats, car-coats, capes, clothing	17,648	1.5	9.9
8468	Machinery and apparatus for soldering, brazing	980	20.3	8.5
0809	Apricots, cherries, peaches (including nectarines)	4,805	31.8	7.2

Source: WITS.

Armenia's top-20 products, where RCA exceeded 1 since 2012, sorted by RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
0702	Tomatoes, fresh or chilled	19,076	0.1	19.2
6116	Gloves, mittens and mitts, knitted or crocheted	2,261	0.0	4.7
2530	Mineral substances not elsewhere specified	748	0.7	4.2
6207	Men's or boys' singlets and other vests, underpants	573	0.0	4.0
7317	Nails, tacks, drawing pins, corrugated nails, staples	677	0.1	2.4
4907	Unused postage, revenue or similar stamps of currency	426	0.1	2.3
8548	Waste and scrap of primary cells, primary batteries	1,360	0.1	2.1
2703	Peat (including peat litter), whether/not agglomerated	273	0.9	1.9
4301	Raw fur skins (including heads, tails, paws, etc.)	567	0.5	1.8
4203	Articles of apparel and clothing accessories	1,495	0.0	1.8
6111	Babies' garments and clothing accessories, knitted	1,150	0.7	1.6
0808	Apples, pears and quinces, fresh	1,654	0.0	1.5
7610	Aluminum structures (excluding prefabricated buildings)	1,938	0.1	1.5
0209	Pig fat, free of lean meat, and poultry fat	94	0.0	1.4
6206	Women's or girls' blouses, shirts and shirt-blouse	1,893	0.1	1.4
7112	Waste and scrap of precious metal or of metal clad	2,514	0.2	1.3
0602	Other live plants (including their roots), cuttings	1,280	0.0	1.3
6205	Men's or boys' shirts	1,890	0.1	1.3
6115	Panty hose, tights, stockings, socks and other hosiery	1,774	0.1	1.2
6110	Jerseys, pullovers, cardigans, waistcoats and similar	6,203	0.1	1.2

Source: WITS.

Azerbaijan

Azerbaijan's top-20 products with the highest RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
080222	Hazelnuts/filberts (<i>Corylus</i> spp.), shelled	104,852	23.8	93.1
410221	Raw skins of sheep/lambs, pickled but not tanned	2,330	14.7	54.9
081090	Fresh fruit, Fresh fruits, not specified elsewhere	80,509	29.0	38.7
271121	Natural gas, in a gaseous state	970,676	2.7	29.8
720720	Semi-finished products of iron/non-alloy steel	34,446	5.6	28.4
270900	Petroleum oils & oils obtained from bituminous mins.	6,504,517	12.0	21.6
070200	Tomatoes, fresh/chilled	94,179	1.8	18.9

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
080920	Cherries, fresh	22,981	4.3	16.2
760611	Plates, sheets & strip, rectangular (incl. square)	21,439	0.0	11.9
740321	Copper-zinc base alloys (brass), unwrought	3,396	1.3	11.5
230610	Oil-cake & other solid residues, whether/not ground	1,479	19.4	11.0
230230	Bran, sharps & other residues	4,394	1.8	10.7
250810	Bentonite	4,110	13.5	10.6
070700	Cucumbers & gherkins, fresh/chilled	13,649	4.3	10.0
280120	Iodine	4,126	4.1	9.7
890520	Floating/submersible drilling/production platforms	44,022	0.0	9.1
070190	Potatoes, other than seed potatoes, fresh/chilled	15,789	5.8	8.9
290512	Propan-1-ol (propyl alcohol) & propan-2-ol	4,947	2.8	8.8
721810	Stainless steel in ingots & other primary forms	1,128	0.5	8.6
740329	Other copper alloys	1,596	2.7	8.6

Source: WITS.

Azerbaijan's top-20 products, where RCA exceeded 1 since 2012, sorted by RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
760611	Plates, sheets & strip, rectangular (incl. square), of non-alloy aluminum	21,439	0.0	11.9
890520	Floating/submersible drilling/production platforms	44,022	0.0	9.1
721810	Stainless steel in ingots & other primary forms	1,128	0.5	8.6
410120	Whole equine/bovine (incl. buffalo) hides & skins	2,469	0.7	7.5
410419	Tanned/crust hides & skins of bovine (incl. buffalo)	3,327	0.3	7.0
120720	Cotton seeds, whether/not broken	847	0.7	5.1
391190	Polysulphides, polysulphones & other products specified	12,751	0.4	4.8
760110	Aluminium, not alloyed, unwrought	38,421	1.0	3.3
380190	Preparations based on graphite/other carbon	549	0.3	3.3
730411	Line pipe used for oil/gas pipelines	569	0.0	3.2
070930	Aubergines (eggplants), fresh/chilled	624	0.2	2.5
080221	Hazelnuts/filberts (Corylus spp.), in shell	161	0.5	2.2
850434	Electrical transformers (excl. dielectric)	1,892	0.8	2.2
870540	Concrete-mixer trucks	1,099	0.1	2.1
760612	Plates, sheets & strip, rectangular (incl. square), of aluminum alloys	26,063	0.0	2.0
271600	Electrical energy (optional heading)	28,344	0.5	2.0
200540	Peas (Pisum sativum), preserved/preserved	265	0.7	1.7
410510	Tanned/crust skins of sheep/lambs, without wool	148	0.2	1.7
740200	Unrefined copper, copper anodes	3,386	0.1	1.6
740721	Bars, rods & profiles, of copper-zinc base alloys	1,609	0.0	1.4

Source: WITS.

Georgia

Georgia's top-20 products with the highest RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
2201	Waters, including natural or artificial mineral water	79,817	147.4	162.8
2820	Manganese oxides	5,776	129.9	148.3
2837	Cyanides, cyanide oxides and complex cyanides	10,002	240.8	106.1
1106	Flour, meal and powder of the dried leguminous vegetables	7,148	49.9	99.2
0802	Other nuts, fresh or dried, whether/not shelled	178,904	48.4	80.6
7202	Ferro-alloys	169,265	66.6	70.2
0104	Live sheep and goats	10,195	91.5	66.6
2602	Manganese ores and concentrates	19,853	8.9	60.0
2603	Copper ores and concentrates	311,703	8.2	50.2
0102	Live bovine animals	36,842	32.6	34.8
8601	Rail locomotives, powered from an external source	3,790	118.7	31.9
3102	Mineral or chemical fertilizers, nitrogenous	65,650	38.4	30.6
2205	Vermouth and other wine of fresh grapes, flavored	1,687	22.0	28.7
0910	Ginger, saffron, turmeric (curcuma), thyme, bay leaves	7,650	20.8	27.3
2204	Wine of fresh grapes, including fortified wines	113,497	14.4	25.6
1504	Fats and oils and their fractions, of fish	5,959	0.9	24.7
2208	Undenatured ethyl alcohol of an alcoholic strength	91,847	19.9	24.1
2301	Flours, meals and pellets, of meat or meat offal	15,180	1.1	20.3
2522	Quicklime, slaked lime and hydraulic lime	2,440	0.1	19.9
7806	Other articles of lead	907	35.4	17.2

Source: WITS.

Georgia's top-20 products, where RCA exceeded 1 since 2012, sorted by RCA, 2016

Product Code	Description	Exports, thous. USD, 2016	RCA, 2012	RCA, 2016
1504	Fats and oils and their fractions, of fish	5,959	0.9	24.7
2522	Quicklime, slaked lime and hydraulic lime	2,440	0.1	19.9
4421	Other articles of wood	8,157	0.1	10.6
7801	Unwrought lead	5,086	0.9	6.8
6209	Babies' garments and clothing accessories	1,436	0.6	5.4
1211	Plants and parts of plants	2,229	0.8	5.4
1515	Other fixed vegetable fats and oils	2,490	0.5	4.9
6202	Women's or girls' overcoats, car-coats, capes, clothes	8,824	0.6	4.2
7010	Carboys, bottles, flasks, jars, pots, phials	5,335	1.0	4.1
1101	Wheat or meslin flour	2,459	0.4	4.0
0701	Potatoes, fresh or chilled	1,986	0.2	3.8
2402	Cigars, cheroots, cigarillos and cigarettes, of tobacco	10,392	0.0	3.3
1206	Sunflower seeds, whether/not broken	1,468	0.2	3.2
0207	Meat and edible offal, of poultry	9,674	0.2	3.0
0303	Fish, frozen, excluding fish fillets and other fish	7,784	0.5	2.8
4011	New pneumatic tyres, of rubber	19,833	0.1	2.1
0702	Tomatoes, fresh or chilled	2,255	0.3	2.0
7304	Tubes, pipes and hollow profiles, seamless, of iron	4,582	0.7	1.8
2508	Other clays	372	1.0	1.7
0707	Cucumbers and gherkins, fresh or chilled	495	0.0	1.6

Source: WITS.

Annex 4: TFA implementation commitments of Armenia and Georgia

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 1.1	Publication Information Available through Internet	A	-	-	-	A	-	-	-
Article 1.2	Enquiry Points	A	-	-	-	A	-	-	-
Article 1.3	Notification	B	31-Dec-18	To be determined	-	A	-	-	-
Article 1.4	Opportunity to Comment and Information Before Entry into Force	B	31-Dec-18	To be determined	-	A	-	-	-
Article 2.1	Consultations	B	31-Dec-18	To be determined	-	A	-	-	-
Article 2.2	Advance Rulings	B	31-Dec-18	To be determined	-	A	-	-	-
Article 3	Procedures for Appeal or Review	B	31-Dec-18	To be determined	-	A	-	-	-
Article 4	Notification for Enhanced Controls or Inspections	A	-	-	-	A	-	-	-
Article 5.1	Detention	B	31-Dec-18	To be determined	-	A	-	-	-
Article 5.2	Test Procedures	B	31-Dec-18	To be determined	-	A	-	-	-
Article 5.3	General Disciplines on Fees and Charges Imposed on or in Connection with Importation and Exportation and Penalties	B	31-Dec-18	To be determined	-	A	-	-	-
Article 6.1	Specific Disciplines on Fees and Charges for Customs Processing Imposed on or in Connection with Importation and Exportation	A	-	-	-	A	-	-	-
Article 6.2	Penalty Disciplines	A	-	-	-	B	1-Jan-17	To be determined	-
Article 6.3	Pre-arrival Processing	A	-	-	-	A	-	-	-
Article 7.1	Electronic Payment	B	31-Dec-18	To be determined	-	A	-	-	-
Article 7.2		B	31-Dec-18	To be determined	-	A	-	-	-

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 7.3	Separation of Release from Final Determination of Customs Duties, Taxes, Fees and Charges	B	31-Dec-18	To be determined	-	A	-	-	-
Article 7.4	Risk Management	B	31-Dec-18	To be determined	-	A	-	-	-
Article 7.5	Post-clearance Audit	A	-	-	-	A	-	-	-
Article 7.6	Establishment and Publication of Average Release Times	B	31-Dec-18	To be determined	-	A	-	-	-
Article 7.7	Trade Facilitation Measures for Authorized Operators	B	31-Dec-18	To be determined	-	C	31-Dec-18	To be determined	1. Structuring and adopting the relevant primary and secondary legislation for establishing the institute of Authorized Economic Operators; - Granting AEO by issuing of an appropriate (AEOC, AEOs, AEOF) certificate; - Criteria for granting AEO status;- Benefits for AEOs; - Application for AEO status; - Monitoring of AEOs. 2. Training of Georgian Customs staff while sharing the practical experience of EU countries.
Article 7.8	Expedited Shipments	B	31-Dec-18	To be determined	-	A	-	-	-
Article 7.9	Perishable Goods	A	-	-	-	A	-	-	-
Article 8	Border Agency Cooperation	A	-	-	-	A	-	-	-
Article 9	Movement of Goods Intended for import under Customs Control	A	-	-	-	A	-	-	-
Article 10.1	Formalities and Documentation Requirements	A	-	-	-	A	-	-	-
Article 10.2	Acceptance of Copies	B	31-Dec-18	To be determined	-	A	-	-	-

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 10.3	Use of International Standards	C	31-Dec-20	To be determined	<p>Assistance Required:</p> <ul style="list-style-type: none"> Capacity building Training of Armenian Customs staff Changes in legislation <p>Technical experts mission in order to make gap analysis in the field of International Standards implementation, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.</p>	A	-	-	-
Article 10.4	Single Window	C	31-Dec-20	To be determined	<p>Assistance Required:</p> <ul style="list-style-type: none"> Capacity building Training of Armenian Customs staff Changes in legislation <p>Technical experts mission in order to make gap analysis in the field of International Standards implementation, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.</p>	A	-	-	-
Article 10.5	Pre-shipment Inspection	A	-	-	-	A	-	-	-
Article 10.6	Use of Customs Brokers	B	31-Dec-18	To be determined	-	A	-	-	-
Article 10.7	Common Border Procedures and Uniform Documentation Requirements	A	-	-	-	A	-	-	-
Article 10.8	Rejected Goods	A	-	-	-	A	-	-	-
Article 10.9	Temporary Admission of Goods and Inward and Outward Processing	A	-	-	-	A	-	-	-

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 11.7	Customs changes	C	31-Dec-20	To be determined	<p>Assistance Required:</p> <ul style="list-style-type: none"> Capacity building; Training of Armenian Customs staff; Changes in legislation; <p>Technical experts mission in order to make gap analysis in the implementation of the respective field, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.</p>	A			
Article 11.8	Conformity assessment	C	31-Dec-20	To be determined	<p>Assistance Required:</p> <ul style="list-style-type: none"> Capacity building; Training of Armenian Customs staff; Changes in legislation; <p>Technical experts mission in order to make gap analysis in the implementation of the respective field, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.</p>	A			

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 11.9	Prior processing of documentation	C	31-Dec-20	To be determined	<p>Assistance Required:</p> <ul style="list-style-type: none"> Capacity building; Training of Armenian Customs staff; Changes in legislation; <p>Technical experts mission in order to make gap analysis in the implementation of the respective field, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.</p>	C	31-Dec-18	To be determined	<p>Acceding the conventions on Simplification of Formalities in Trade and Goods (SAD), Common Transit Convention (CTC) and implementation New Computerized Transit System (NCTS);</p> <ul style="list-style-type: none"> Providing advice and recommendations in order to draft the relevant guidelines for the implementation of new regulations of Customs law with regards to transit; review and follow-up of all necessary legal, administrative and procedural arrangements; Providing assistance in setting up a team responsible for the implementation of the business processes and a team responsible for the IT aspects aiming at the implementation of NCTS; Providing assistance in elaborating Business Process Models (NCTS-Core Business: normal and simplified procedures; enquiry; and recovery procedure; guarantee management; fall-back procedure; trade related data management (authorization)); Providing assistance in elaborating functional specifications for Transit Module: requirements of all the business requirements concerning the core-business of NCTS; specifications of all the business requirements concerning the guarantee management of NCTS; specifications of all the business requirements concerning enquiry and recovery procedure of NCTS; specifications of all the business requirements concerning management of authorizations; specifications of all the business requirements concerning risk-management for NCTS; specifications for all the business requirements concerning fall-back procedures in NCTS; Establishment of Trade Awareness Policy; Training for Customs Staff; To.T.

Provision	Heading/Description	Armenia				Georgia			
		Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support Required for Implementation (for category C)	Category	Indicative date for implementation (for categories B and C)	Definitive date for implementation (for categories B and C)	Assistance and Support for Capacity Building Required for Implementation (for category C)
Article 11.10	Termination of transit	C	31-Dec-20	To be determined	Assistance Required: • Capacity building; • Training of Armenian Customs staff; • Changes in legislation; Technical experts mission in order to make gap analysis in the implementation of the respective field, as well as provide us with further action plan and advise on financial costs expected, as well as assistance in seeking donors if needed.	A	-	-	-
Article 11.11-11.17	Guarantees, cooperation and coordination	B	31-Dec-18	To be determined		A	-	-	-
Article 12	Customs Cooperation	A	-	-	Article 12 Customs Cooperation	A	-	-	-

Annex 5: Regional Trade Agreements of Armenia, Azerbaijan and Georgia

The network of Armenia's RTAs

Country/region	Type of RTA	Status	Partners' population, m (current signatories)	Partners' GDP, bn USD (2015)	Coverage
Kyrgyzstan ¹⁴⁹	FTA	Entry into force: 1995	6	7	Goods
Moldova ¹⁵⁰	FTA	Entry into force: 1995	4	7	Goods
Turkmenistan ¹⁵¹	FTA	Entry into force: 1996	5	36	Goods
Ukraine ¹⁵²	FTA	Entry into force: 1996	45	91	Goods
Georgia ¹⁵³	FTA	Entry into force: 1998	4	14	Goods
Kazakhstan ¹⁵⁴	FTA	Entry into force: 2001	18	184	Goods
CIS FTA 2012 (current signatories: Armenia, Belarus, Kazakhstan, Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Ukraine) ¹⁵⁵	FTA	Entry into force: 2012	234	1,716	Goods
Eurasian Economic Union (EAEU) ¹⁵⁶	The Customs Union & Economic Integration Agreement	Entry into force: 2015	177	1,611	Goods & services
EAEU – Viet Nam ¹⁵⁷	FTA	Entry into force: 2016	92	194	Goods
EAEU – Egypt ¹⁵⁸	FTA	Negotiations	92	331	n/a
EAEU – India ¹⁵⁹	FTA	Negotiations	1,311	2,089	n/a
EAEU – Iran ¹⁶⁰	Temporary preferential agreement	Negotiations	79	425	Goods
EAEU – Israel ¹⁶¹	FTA	Negotiations	8	299	n/a
EAEU – Singapore ¹⁶²	FTA	Negotiations	6	293	n/a
Total (by countries)			1,831	5,397	

Source: WTO and EAEU.

The network of Azerbaijan's RTAs

Country/region	Type of RTA	Status	Partners' population, m (current signatories)	Partners' GDP, bn USD (2015)	Coverage
Russia ¹⁶³	FTA	Entry into force: 1993	144	1,366	Goods
CIS FTA 1994 (Current signatories: Azerbaijan, Georgia, Turkmenistan, Uzbekistan) ¹⁶⁴	FTA	Entry into force: 1994	40	117	Goods

¹⁴⁹ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=90>

¹⁵⁰ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=49>

¹⁵¹ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=47>

¹⁵² See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=51>

¹⁵³ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=82>

¹⁵⁴ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=50>

¹⁵⁵ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=762>

¹⁵⁶ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=909>

¹⁵⁷ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=973>

¹⁵⁸ See: <http://www.eurasiancommission.org/ru/nae/news/Pages/28-12-2016-9.aspx>

¹⁵⁹ See: <http://www.eurasiancommission.org/ru/nae/news/Pages/28-12-2016-9.aspx>

¹⁶⁰ Ibid.

¹⁶¹ See: <http://ereforum.org/israel-to-begin-negotiations-on-a-free-trade-zone-with-the-eeu-to-the-end-of-the-year/?lang=ru>

¹⁶² See: <http://www.eurasiancommission.org/ru/nae/news/Pages/28-12-2016-9.aspx>

¹⁶³ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=830>

¹⁶⁴ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=99>

Country/region	Type of RTA	Status	Partners' population, m (current signatories)	Partners' GDP, bn USD (2015)	Coverage
Georgia ¹⁶⁵	FTA	Entry into force: 1996	4	14	Goods
Ukraine ¹⁶⁶	FTA	Entry into force: 1996	45	91	Goods
GUAM ¹⁶⁷ (Georgia, Ukraine, Azerbaijan, Moldova)	FTA	Entry into force: 2003	52	111	Goods & services
Economic Cooperation Organization (current signatories: Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan) ¹⁶⁸	Preferential trade agreement	Entry into force: 2008	448	1,310	Goods
Total (by countries)			644	2,787	

Source: WTO, WIPO, and WB Development Indicators.

The network of Georgia's RTAs

Country/region	Type of RTA	Status	Partners' population, m (current signatories)	Partners' GDP, bn USD (2015)	Coverage
CIS FTA 1994 ¹⁶⁹ (current signatories: Azerbaijan, Georgia, Turkmenistan, Uzbekistan)	FTA	Entry into force: 1994	46	156	Goods
Russia ¹⁷⁰	FTA	Entry into force: 1994	144	1,366	Goods
Azerbaijan ¹⁷¹	FTA	Entry into force: 1996	10	53	Goods
Ukraine ¹⁷²	FTA	Entry into force: 1996	45	91	Goods
Armenia ¹⁷³	FTA	Entry into force: 1998	3	11	Goods
Kazakhstan ¹⁷⁴	FTA	Entry into force: 1999	18	184	Goods
Turkmenistan ¹⁷⁵	FTA	Entry into force: 2000	5	36	Goods
GUAM ¹⁷⁶	FTA	Entry into force: 2003	58	150	Goods & services
Turkey ¹⁷⁷	FTA	Entry into force: 2008	79	718	Goods
EU ¹⁷⁸	FTA	Entry into force: 2014	510	16,315	Goods & services
EFTA ¹⁷⁹	FTA	Entry into force: 2017 for Iceland and Norway; 2018 for Liechtenstein and Switzerland ¹⁸⁰	14	1,074	Goods & services
China	FTA	Entry into force: 2017 ¹⁸¹	1,371	11,065	Goods & services
Hong-Kong (China)	FTA	Negotiations completed: 2017	7	309	n/a
India	FTA	Feasibility study	1,311	2,089	n/a
Total (by countries)			3,551	33,383	

Source: WTO, WIPO, and WB Development Indicators.

¹⁶⁵ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=83>

¹⁶⁶ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=570>

¹⁶⁷ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=620>

¹⁶⁸ See: http://www.wipo.int/wipolex/en/other_treaties/details.jsp?treaty_id=415

¹⁶⁹ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=99>

¹⁷⁰ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=85>

¹⁷¹ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=83>

¹⁷² See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=87>

¹⁷³ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=82>

¹⁷⁴ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=84>

¹⁷⁵ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=86>

¹⁷⁶ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=620>

¹⁷⁷ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=636>

¹⁷⁸ See: <http://rtais.wto.org/UI/PublicShowMemberRTAIDCard.aspx?rtaid=848>

¹⁷⁹ See: <http://www.efta.int/free-trade/free-trade-agreements/georgia>

¹⁸⁰ Ibid.

¹⁸¹ See: http://fta.mofcom.gov.cn/enarticle/chinageorgiaen/chinageorgiaennews/201801/36885_1.html

Annex 6: Hazelnuts in Georgia

Western Georgia's soil and climate conditions are very well suited for growing hazelnuts. Moreover, being relatively expensive (per ton), storable and easy to transport, hazelnuts are an ideal international trade commodity. These features, and the possibility of customs-free exports to Europe under the GSP+ and, thereafter, the DCFTA regime, have turned the sector into a relative Georgian goldmine. The trade has swelled with the arrival of major international investors: most notably, Ferrero SpA (the maker of Nutella, which utilizes 25% of the global supply of hazelnuts), and very recently, the Olam Group (which purchased Georgia's largest processing plant in Zugdidi). The total area of hazelnut orchards has expanded extremely rapidly, displacing many other crops, and by 2016, reaching approximately 60,000 ha. The majority of new orchards are not yet producing at their full capacity (including Ferrero's own 3,500 ha plantation). Basic processing capacity (deshelling, drying, calibration) has also grown, with more than 30 plants currently involved in the collection and export of hazelnuts.

To date, the main prospects for the sector are to:

- ▶ Expand the planting area (the Georgian government's Plant the Future program offers a 70% subsidy on the cost of seedlings);
- ▶ Raise productivity (quantity per ha) through better selection of tree varieties (to optimally match seedlings to soil, elevation and humidity conditions in different micro-zones¹⁸²), improved cultivation, and plant protection;¹⁸³
- ▶ Improve the quality of drying and processing (to establish a reputation and achieve a better price);
- ▶ Add value through deeper processing;
- ▶ At 183 million and 176 million USD in 2014 and 2015, respectively, hazelnuts are Georgia's number one agricultural export (and one of the largest exports to the EU). As a result, the sector is the target of a multitude of donor interventions.

The first such intervention involved an alliance between USAID's Economic Prosperity Initiative and **AgriGeorgia**,¹⁸⁴ with a more than 40 m EUR investment in hazelnut production by Italy's Ferrero. In a departure from the classical PA blueprint, AgriGeorgia is not a buyer of hazelnuts, and its willingness to engage smallholders is motivated by strategic CSR rather than supply chain considerations.¹⁸⁵ By allying with USAID, AgriGeorgia was able to leverage its agronomical expertise to deliver training and extension services in cultivation and post-harvest handling methods for thousands of hazelnut growers in Samegrelo. **Nevertheless, in the absence of intrinsic business motivation, Ferrero's participation in the project was and remains conditional on external donor funding.**

USAID's 5-year **Georgian Hazelnut Improvement Project (G-HIP)** is the second iteration of USAID's cooperation with Ferrero, a Global Development Alliance in USAID's parlance. G-HIP supports two associations: the Georgian Association of Hazelnut Growers (GHGA) and the Hazelnut Exporters and Processors Association (HEPA), and it provides technical training for husking/drying/storage (HDS) operators. GHGA is focused on building the capacity of farmers by organizing association members in groups of 8-12 people, which help each other and acquire communal knowledge. A total of 30 such groups have been created thus far, and an additional fifteen groups were expected to be formed in 2017. While farmers meet four times a year in each other's orchards to perform seasonal work (soil preparation, pruning, plant protection, harvesting and post-harvest treatment) under the guidance of a GHGA-hired agronomist.

¹⁸² According to our interview with David Arveladze and Irakli Moistsravishili, from the Georgian Hazelnut Growers Association, the Italian variety (Giffoni), promoted by AgriGeorgia's 60 ha nursery (the largest in the country), may not be optimal for higher humidity regions.

¹⁸³ According to Vincent Morabito, Chief of Party for USAID's Georgia Hazelnut Improvement Project, the yields and product quality dropped significantly for the 2016 crop due to the dramatically increased infestation levels of the brown marmorated stink bug (BMSB).

¹⁸⁴ Appleby S. & Livny E. (2014). Competitiveness of Georgian Agriculture: Investment Case Studies. AgriGeorgia (Ferrero). Available from: http://iset-pi.ge/images/Projects_of_APRC/Case_Study_AgriGeorgia_Ferrero.pdf

¹⁸⁵ The company faced significant issues with access to about a third of its landed properties (4000 ha), as a result of ownership disputes with local communities. These disputes have ultimately been resolved through governmentally-arranged land swaps and compensation for the affected smallholders.

While extremely useful, training and extension services alone may not be sufficient to sustain the GHGA.¹⁸⁶ Thus, there may be room for a complimentary, more traditional PA project, including an element of ‘productive investment’ for GHGA to expand the range of its services to the provision of seedlings, drying and storage, and potentially also processing and exportation.

Another fascinating attempt at creating a PA, by the Georgian government, is embodied by the **Darcheli Hazelnut Cooperative** initiative. Launched in 2015, Darcheli gave almost 600 individual hazelnut growers exclusive access (to convert to ownership after 2020) to a hazelnut processing facility with the capacity to dry and store up to 500 tons of nuts (estimated at 1 m GEL in commercial value). The main results of this intervention are the improved quality of the product (due to industrial drying) and a larger share of the total earnings remaining with the farmers (thanks to subsidised storage), at the expense of local processors and exporters,¹⁸⁷ who act as middlemen between farmers and international buyers. By reducing their costs and increasing the price farmers receive for their product, this scheme, indirectly, also encourages farmers’ investment in new and existing orchards, the adoption of more sophisticated cultivation methods, and it improves their access to labor, machinery and other services. However, given the cost of subsidisation by the government, this PA model must be carefully assessed to make sure it creates net benefits for Georgia.

Darcheli is a truly unique PA model in Georgia’s agricultural landscape. The project created, by far, the largest Georgian farmer cooperative, and one that focuses on the best aspects; cooperation in services and processing, rather than primary production. As such, Darcheli quickly became a magnet for complementary donor interventions, such as the EU’s **ENPARD** program, which injected additional capital (50,000 EUR for deshelling and calibration equipment) to vertically extend the processing chain, provide co-op members with direct access to export markets, and (potentially) eliminate their dependence on intermediary processors and exporters.

In 2015-16, Darcheli also piloted an exciting scheme of value chain financing (VCF) as part of the Swiss-supported **PAFAI** project, who act as a useful addition to the original PA concept. Contrary to VCF models that rely on input providers (like sellers of chemicals) or buyers for financing producers’ working capital needs, PAFAI uses hazelnuts stocks (owned and managed by individual members of the cooperative) as collateral for Crystal MFO’s loans, which cover the costs of inputs (for example, chemicals) and labor. The PAFAI scheme carries a lot of promise, though its sustainability is yet to be tested in the absence of the Swiss-financed facilitation (the PAFAI project officially ended in early 2017).

When it comes to designing future PA-style interventions, the hazelnut sector is distinguishable from most other agricultural value chains in Georgia because of its efficient horizontal organization (for instance, GHGA-style associations or Darcheli-type cooperatives) and productive investment in drying, storage and processing capacity. Smallholders can cut out some of the middlemen and gain more direct access to export markets, resulting in the development of better outcomes for thousands of households (up to 60,000, according to some counts) working in the sector. This implies that PA projects in the hazelnut sector should not be conditional on the identification of a specific buyer or on an explicit, upfront vertical alliance with processors and exporters. Rather, they should additionally permit smallholder producers to form large enough cooperative groups, preferably, in a single geographic area, and to help develop business plans with clear investment and marketing strategies.

The hazelnut sector has been assigned a very high priority by the Georgian government, as is reflected, for example, in the government’s willingness to work with foreign investors and donors, to fine-tune tax administration procedures, and to invest in proper infrastructure. Going forward, there will be an additional role for the government, ensuring the PA concept successfully functions for the hazelnut sector. One element will likely be coordination and assistance with the creation and incubation of larger farmer associations and groups, including initial funding and management. Other significant factors are plant disease and pest control, R&D and research-based extension services to help with optimal location of orchards, cultivation, and the choice of seedlings and chemicals.

¹⁸⁶ The current GHGA membership fees (2 GEL/month/ha) are much lower than would be required to sustain it in the absence of USAID funding.

¹⁸⁷ It is not easy to assess the full extent of earnings due to price fluctuations in the global hazelnut market.

Annex 7: List of interviews

Armenia

- ▶ Ernesto Marzano, Consultant; Heghine Manasyan, Armenia Coordinator, EU Delegation's study- *Iran and possible implication on Southern Caucasus and Turkey trade and passenger flow*
- ▶ Mikayel Pashayan, Head of IT Department, State Revenue Committee
- ▶ Zarmine Zeituntsyan and Artak Apresyan, Head and Deputy Head respectively, Tourism promotion agency of the Ministry of Economic Development and Investment
- ▶ Suren Bekirski, Owner and CEO, Tosp
- ▶ Artur Petrosyan and Artak Petrosyan, Trade Finance Unit of HSBC Bank Armenia
- ▶ Hayk Mirzoyan, Head of Export Promotion Section, Development Foundation of Armenia (DFA)
- ▶ Ashot Iskandaryan and Davit Harutyunyan, Tax and Customs Administrative Reforms Unit, Centre for Strategic Initiatives (government of Armenia)
- ▶ Suren Karayan, Minister, Ministry of Economic Development and Investments
- ▶ Gagik Makaryan, President, Republican Union of Employers of Armenia
- ▶ Dmitry Maryasin and Alla Bakunts, Deputy Resident and IBM Portfolio Analyst respectively, UNDP
- ▶ Makar Arakelyan, Head, Freight Forwarders Association of Armenia
- ▶ Areg Barseghyan, Senior Portfolio Management Officer, Asian Development Bank
- ▶ Armen Avakyan, Director, Development Foundation of Armenia (DFA)
- ▶ Vazgen Abgaryan, Director, Export Insurance Agency of Armenia
- ▶ Vladimir Amiryman, Head of International Relations Department, Chamber of Commerce and Industry of the Republic of Armenia
- ▶ Hovhannes Azizyan and Naira Karapetyan, Deputy Minister and Head of EAEU and external trade department respectively, Ministry of Economic Development and Investments
- ▶ Vahram Avanesyan, Former Minister of Economy (2013-2014, 1995-1996) and Founder of AVAG Solutions Consulting Company

Azerbaijan

- ▶ Qubad Ibadoglu, Senior Researcher at the Economic Research Center
- ▶ Vugar Bayramov, Head of Center for Economic and Social Development (CESD)
- ▶ Mr. Baumann, Director of German-Azerbaijani Chamber of Commerce
- ▶ Natavan Mammadova, Executive Director of American Chamber of Azerbaijan
- ▶ Samir Aliyev, Head of Support for Economic Initiatives (NGO)
- ▶ Fikrat Yusifov, Head of International Economic Research Association, Economist, and Ex Minister of Finance
- ▶ Azer Mehdiyev, Economist, Azerbaijan State Economic University, and Support for Economic Initiatives
- ▶ Rashad Huseynov, Analytics and Project Manager, Center for Analysis of Economic Reforms and Communication (government-based organization)
- ▶ Vusal Aliyev, Chief director of "Ata travel" company
- ▶ Ameliya Seyidova, Institute for Agricultural Economics
- ▶ Namig Mammadov, Department Director, Ministry of Agriculture
- ▶ Ministry of Economy, Trade Policy and World Trade Organization Department
- ▶ Shahin Ismayilov, Ministry of Transport of Azerbaijan Republic, Deputy Head of Transport Policy and Economic Department
- ▶ Khayala Pashazadeh, Associate of the International Cooperation Department
- ▶ Tural Aliyev, Logistics Adviser of the Deputy Head of "Baku International Sea Port" Representative from "Azerpost" and Representative of the State Automobile Transport Service
- ▶ Rauf Pashayev, Deputy Head of Tourism Department, Ministry of Culture and Tourism
- ▶ ASAN/ABAD state agency
- ▶ Farzali Gadirov, Deputy Head of Apparatus, Ministry of Education of Azerbaijan

- ▶ Shahmar Movsumov, Executive Director of State Oil Fund of Azerbaijan Republic (SOFAZ)
- ▶ Meeting with the representatives of the Ministry of Economy of the Republic of Azerbaijan
- ▶ Jeroen Willems, EU Head of Operations sector
- ▶ Firdovsi Fikretzadeh, Head of Consolidation and Statistical Analysis, Department Ministry of Agriculture of Azerbaijan Republic
- ▶ Iqbal Huseynov, Deputy Chairman of Azerbaijan Railways
- ▶ Alessandro Fracassetti, UNDP Deputy Resident Representative

Georgia

- ▶ Nugzar Gasviani, First Deputy Chair, MRDI, Roads Department
- ▶ Samanishvili Giorgi, Chairman, National Wine Agency
- ▶ Irakli Abazadze, Head of Commerce Department, Rustavi Steel
- ▶ Rusudan Mamacashvili, Georgian National Tourism Agency
- ▶ Meeting with the representatives of food processing industry (Nikora, Biu Biu, Marneuli) at the MoESD
- ▶ Meeting with stakeholders of capital markets reform in Georgia, ISET
- ▶ Akaki Saghirashvili, Head of Operations Management Department, Railways
- ▶ Aleksandre Kharlamov, Gebruder Weiss
- ▶ Avtandil Kasradze, GITA
- ▶ Irakli Kashibadze, GITA
- ▶ Ketevan Salukvadze, Head of Transport and Logistics Development Policy Department
- ▶ Mariam Gabunia, Head of Trade Policy Department, MoESD
- ▶ Mariam Turnava, Enterprise Georgia, Export Promotion Department, Export Development Manager
- ▶ Nikoloz Gamkrelidze, Georgia Healthcare Group
- ▶ Bruno Balvanera, EBRD Georgia
- ▶ Robert Mutyaba, Transport Specialist at the World Bank
- ▶ Nodar Kereselidze, Ministry of Agriculture
- ▶ George Welton, Executive Director, AmCham
- ▶ Zurab Katchkatchishili, Deputy Chairman, International Chamber of Commerce
- ▶ Samson Uridia, Head of the Department for International Relations, Revenue Service
- ▶ Ketii Bochorishvili, CEO, Anaklia City project

