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Trade between Georgia and Armenia: Business as usual?

Despite being direct neighbours and having similar economic structures, Georgia and Armenia have been following different paths in their regional trade policy. Whereas Georgia has signed a Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union, Armenia has joined the Eurasian Economic Union (EaEU), the Russian-led customs union. The different regional orientations raise the question, whether trade between the neighbours can continue to flow freely or whether new barriers have emerged.

Despite being a member of the EaEU, Armenia has the right to maintain its free trade agreement with Georgia. Thus, free trade between the countries will continue. However, Georgia will only be able to export domestic products tariff-free to Armenia. Re-exports (i.e. exports of foreign goods) either already have or will eventually become subject to tariffs. Furthermore, in the long run, diverging product standards – mainly in the agri-food sector – may lead to increased compliance costs for Georgian exports to Armenia and vice versa.

To sum up, the different regional alliances will most likely have a negative impact on bilateral trade; however this effect will probably not be large.

Different paths in regional trade policy

Although being direct neighbours and economies of relatively similar structure – without large-scale natural resources, limited industrial and large agrarian sectors – Georgia and Armenia have recently pursued different paths in their regional integration policy. Georgia has clearly oriented itself towards the EU and eventually signed a Deep and Comprehensive Free Trade Agreement (DCFTA) in 2014, granting Georgia basically full tariff-free access to the EU market.

Armenia on the other hand also negotiated a DCFTA with the EU, but ultimately took a very different decision by joining the Eurasian Economic Union. This customs union also includes Russia, Belarus, Kazakhstan and Kyrgyzstan.

Membership in a customs union is in principle incompatible with maintaining bilateral free trade agreements (FTAs) with other nations. As no customs are levied on goods travelling inside the union and common external tariffs are applied on goods entering the union, the union must negotiate free trade agreements as a single entity and bilateral agreements are not possible. The decision to join the EaEU hence precluded the signing of an Armenia-EU DCFTA.

Can Georgia and Armenia keep their FTA?

How does this divergence in trade policy affect trade between Georgia and Armenia? Both countries have traded freely under a bilateral FTA signed in 1995 that included quantitatively unlimited tariff-free trade and free transit of goods. Free transit is particularly important for Armenia as it has no direct border with Russia, its key trading partner, and all Russian-Armenian trade must transit Georgia.

Although one would expect that the Armenian EaEU membership is incompatible with the Georgia-Armenia FTA, there is an explicit clause in the EaEU agreement stating the permissibility of bilateral trade agreements signed before 2015. As such, this clause also applies to the Georgia-Armenia FTA. This unusual feature is feasible as all EaEU members have prior FTAs with Georgia. Hence, no different tariffs apply to Georgian goods in different member states of the EaEU. Additionally, the EaEU is not a perfect customs union, with customs checks and some limits to the free movement of goods remaining.

Georgia: Free trade with EU and EaEU feasible?

Does this not pose problems to the EaEU or the EU, as foreign goods might enter their markets tariff-free through Georgia? In fact, this is precluded by rules of origin regulations, which govern under what conditions goods are considered Georgian goods eligible for tariff-free trade. Only goods that have been entirely produced or sufficiently transformed in Georgia can be traded without tariffs. Goods not fulfilling these conditions (re-exports) will be subject to the respective external tariffs of the EaEU or the EU. Thus, for Georgia, free trade with both the EU and Armenia is therefore possible without the existence of an EU-EaEU free trade agreement.

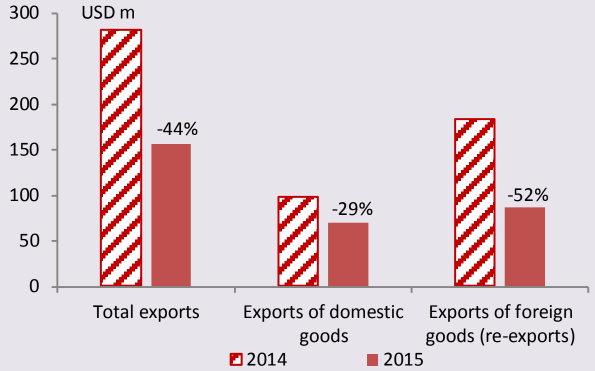
Recent development of Georgia-Armenia trade

Although the Georgia-Armenia FTA remains in place, has the different regional trade orientation nevertheless led to effects on trade between the two countries? This question is justified, since Armenia's EaEU membership involves a gradual process of transposing rules and tariffs, which will continue until the early 2020s.

In general, this process will involve a steep rise in tariffs applied by Armenia. EaEU tariffs are, on average, much higher than the present Armenian tariffs. Between 2014 and 2015, the average tariff on imports by Armenia under Most Favoured Nation rules –

despite its name this is the least preferential regime under WTO rules – already increased from 4.4% to 8.3%. Georgian exports of domestic goods, however, are and will remain exempt from these tariffs, whereas Georgian re-exports either have been or will eventually become subject to tariffs.

Georgia's exports to Armenia



Source: UN Comtrade

Between 2014 and 2015, Georgian exports to Armenia indeed dropped significantly. Most of this drop is due to a halving of re-exports, largely of used cars. Was this due to Armenia's EaEU membership? Indeed, although no tariffs are yet being applied on re-exports of cars, it appears that certain tax exemptions and several administrative factors such as lesser administrative burdens of cars imported from the EaEU and an easier re-selling of EaEU originating cars tilted competitiveness away from Georgian re-exports. Imports of cars from non-EaEU countries through Georgia became relatively less attractive due to these regulations.

Medium- and long term perspectives

Further impacts of the different trade orientations can be expected in future due to Armenia gradually adopting EaEU rules – a process taking until the early 2020s.

In the medium term (i.e. in the next 3 years), most exemptions by Armenia of Georgian re-exports will remain in place. Only for few products will higher tariffs be applied. Furthermore, some non-tariff barriers (NTBs) will increase as a consequence of Armenia's EaEU membership. In the 3-years space, this mainly involves more difficult customs procedures for non-EaEU countries. In sum, a small negative impact on Georgian exports to Armenia as compared to 2015 should be expected.

In the long term from 2020 onwards, the elimination of tariff exemptions for re-exports will lead to an additional, negative impact on Georgian re-exports. Furthermore, one key aspect of the trade orientation difference is that Georgia and Armenia will embark on different paths with regard to product standards and product safety systems. Whereas Georgia will converge to the EU system, Armenia will apply EaEU regulations. This may lead to an increase in compliance costs for Georgian exports to Armenia and vice versa, as additional and possibly expensive tests, particularly in the case of agri-food products, will be required.

Conclusions

Armenia's EaEU membership will – as of today - not lead to the cancellation of the bilateral Georgia-Armenia FTA. Hence, domestically produced goods can continue to be traded duty-free in the future. However, re-exports already shrunk due to different regulations and will continue to fall once higher tariffs are imposed. Finally, the divergence in product standards – especially in the agri-food sector – will lead to an increase in compliance costs and may imply a reduction of trade in the long term.

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Note: A more comprehensive analysis of the topic is provided in the Policy Briefing PB/01/2016 – "Georgia's exports to Armenia: Does Armenia's membership in the Eurasian Economic Union matter?", available at www.get-georgia.de

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