

# Potential for FDI-attraction from non-EU countries: The role of the EU-Georgia DCFTA A) Potential driven by tariff differentials

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## Structure

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2. FDI in Georgia
3. Export-platform investments
4. Goods with high tariff differentials and lenient rules of origin
5. Identifying possible source countries for FDI
6. Conclusions and policy recommendations

Contact

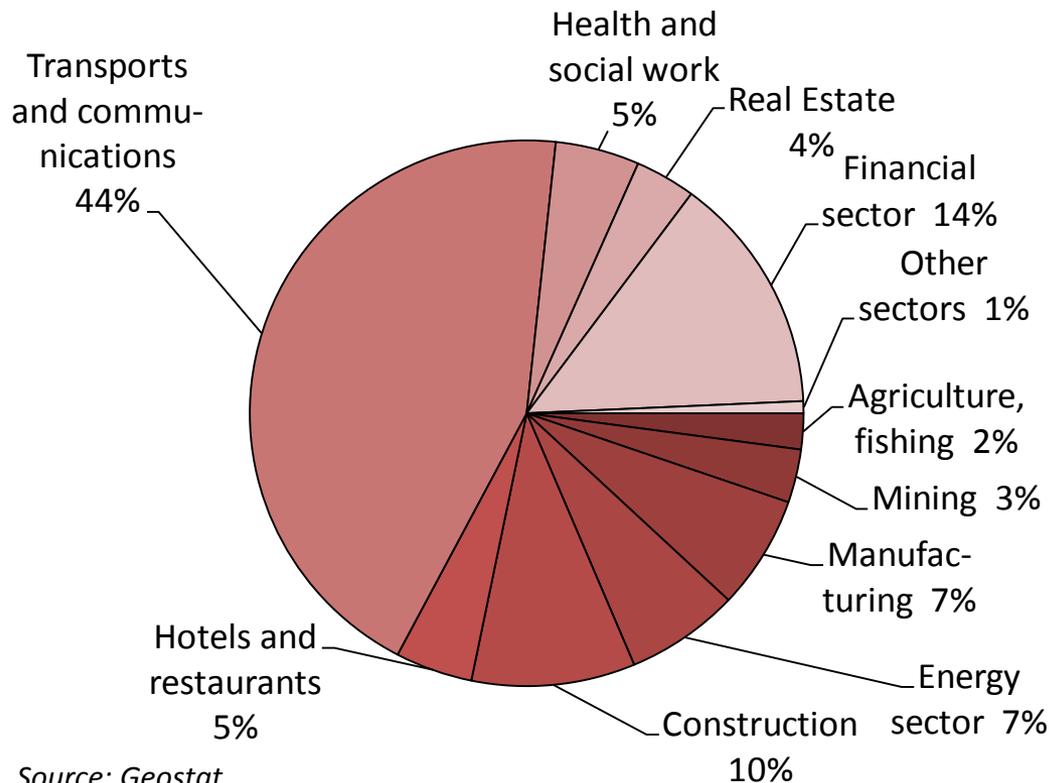
Annex 1: Country-goods mapping – examples of goods

# 1. DCFTA and FDI

- EU-Georgia DCFTA gives Georgia duty-free market access to the EU
- Can attract FDI in **producing goods for export to the EU market**
- 2 types of investors
  - **Investors from EU countries**
  - **Investors from non-EU countries** can use Georgia as an “**export platform**”, produce goods for EU markets, export duty free
- **We focus on the potential for export-platform investments**
- FDI decision for export-platform investments depends on
  - **Attractiveness** of Georgia as production location
  - **Tariff differential** for EU exports vis-à-vis investor home country
- Both matter, but we only **concentrate on tariff differentials** here
- For **which goods** would Georgia be an attractive export platform?
- **Which countries** would potential investors come from?

## 2. FDI in Georgia: Current state

**FDI flow to Georgia by sectors, 2015**



- 2015: High inflows of FDI, USD 1.35 bn or 9.7% of GDP
- Main source countries:
  - Azerbaijan (40%)
  - the United Kingdom (15%)
  - the Netherlands (8%)
  - Luxemburg (6%)
- But: 6 projects accounted for around 70% of all FDI in 2015
- 2015: 75% of FDI in infrastructure
- **Also need for FDI in export-oriented production**

### 3. Export-platform investments

- **Export-platform investments** may work in two ways:
  - **Final stage** or stages of production process in Georgia
  - **Entire production** process in Georgia
- **What kind of investment** is made depends on:
  - **Rules of origin** (regulations) : Need to have sufficient input from Georgia, the EU or another eligible country (depends on goods)
  - **Comparative advantage** of the investors – production know-how or cheap inputs
  - **Production conditions** for the good and its inputs in Georgia
- We analyse
  - Which goods have high **tariff differentials**
  - Which **rules of origin** apply
- **No exhaustive analysis. Production conditions matter**
- **Many other countries have same quality of EU market access**

## 4. Identifying goods with high tariff differentials

- Aim: Identify goods with high tariff rates
- Tariffs for exports to EU under MFN (Most Favored Nation) trade regime
- Tariffs defined at HS 10d level, ~15,000 tariffs
- We use broader **categories** of goods (HS 1d and HS 6d)
- State **maximum** and **average tariff levels** within category
- Disregard goods subject to tariff rate quota
- Tariff rate threshold: Tariffs of at least 5% for some goods in category
  - Significant tariff differential required if it could to be a trigger for investment
- Include animal goods, although export not possible in the short run (food safety issues)
- **RESULT:** 2261 *specific* categories (out of 5205 at HS-6d level) in 17 *broad* categories (out of 22 at HS-1d level) have tariffs above 5%

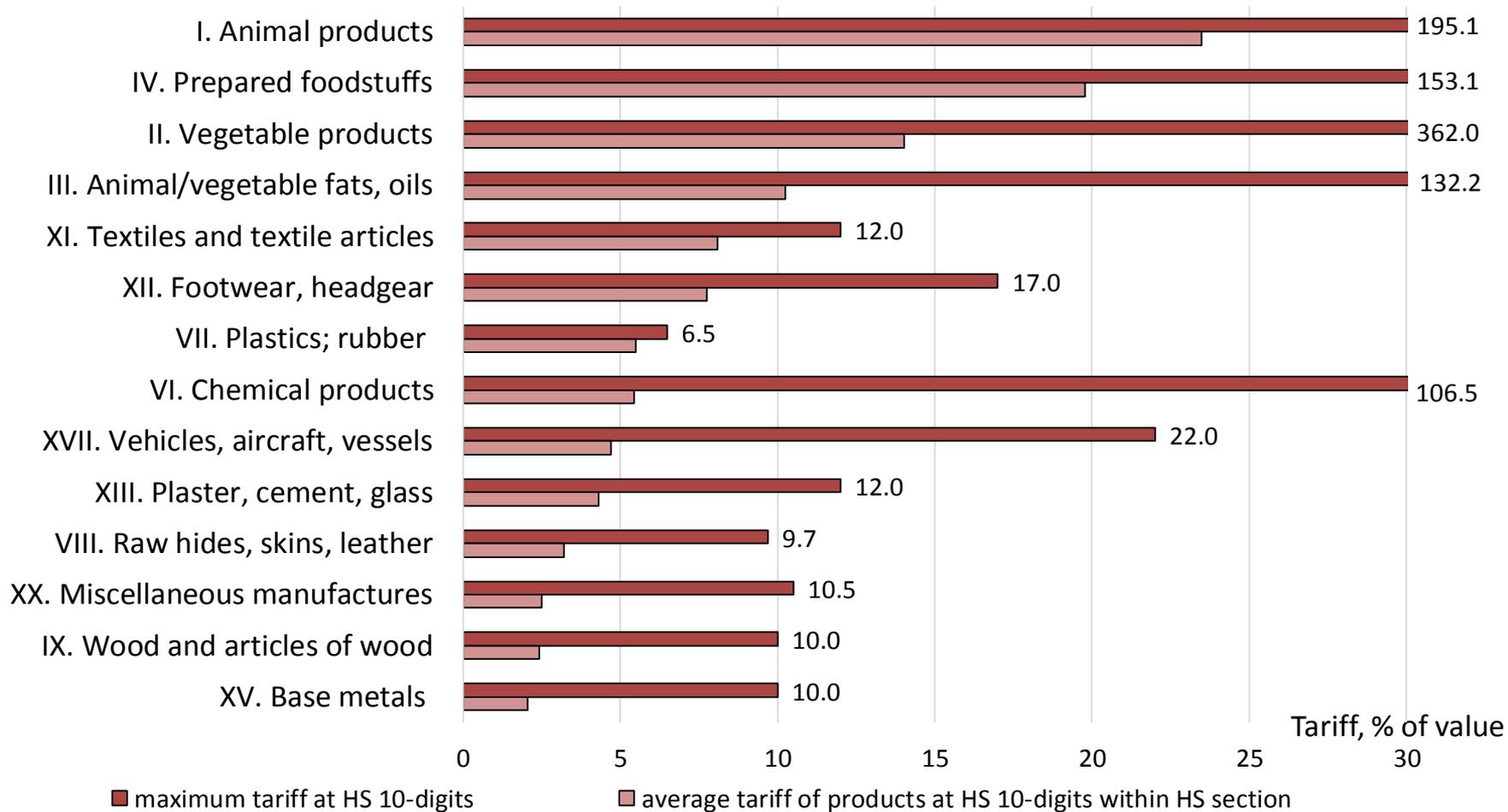
## 4. Identifying goods with lenient rules of origin

- Two broad categories of the rules of origin (ROO):
  - **‘wholly obtained’ goods:** No non-eligible country has been involved in their production. Usually applies for agriculture, food and extractive industries
  - **‘sufficiently transformed’ goods:** Inputs from non-eligible countries are used, but they undergo enough transformation in the process of production. Applies to most industrial goods. To prove a sufficient transformation, various criteria are applied: a different HS heading for inputs and a final good, a maximum value of inputs from non-eligible countries in a goods price, specific types of non-originating inputs permitted in productions etc.
- **Selection criteria:** All goods except those, for which ROO sets a maximum value share of inputs from non-eligible countries.
  - Exemption: maximum value of sugar in food goods
- **RESULT:** 3010 specific categories (out of 5205 at HS-6d level) in 20 *broad* categories (out of 22 at HS-1d level) have been preselected

## 4. Goods with high tariff differentials and lenient rules of origin

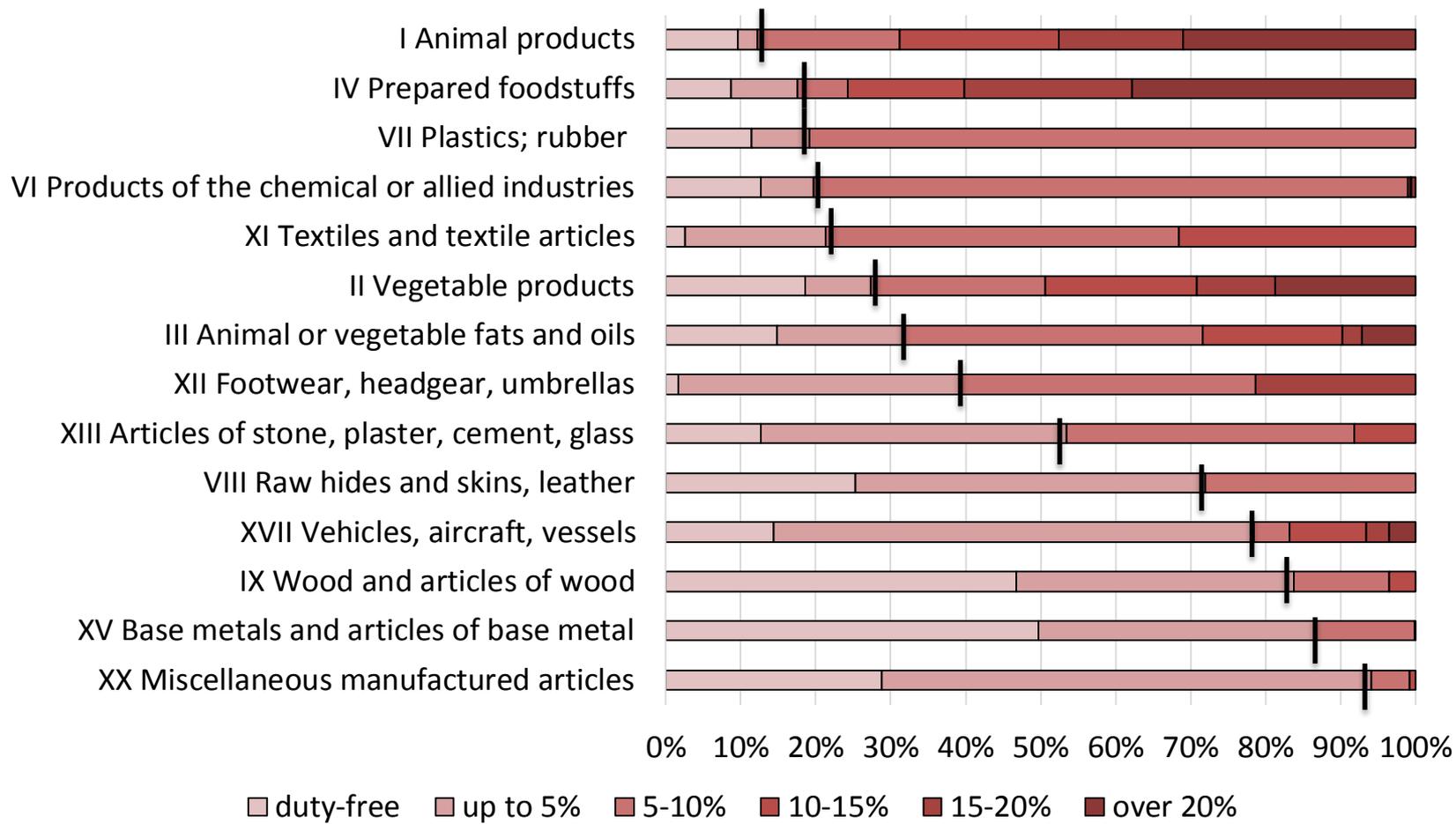
- **1394** specific categories (out of 5205 at HS-6d level) in **14** *broad* categories (out of 22 at HS-1d level) have tariffs above 5% and lenient rules of origin
- Two basic groups apparent:
  - **Agricultural products and food**, particularly animal goods; prepared foodstuffs: Highest tariffs
  - **Industrial goods**, particularly textiles, footwear, chemical goods, also selected engineering goods: Lower tariffs, but with some tariff peaks
- Frequency of tariffs below 5% threshold varies:
  - Agriculture and food: 19%
  - Industrial goods: 58%, moreover for base metals and miscellaneous manufacturing articles about 90%
- **EU market for agriculture particularly protected, but also some significant tariffs on industrial goods**

## 4. Broad categories of goods: EU MFN tariffs



Source: WITS, authors' calculations \* Only for preselected fourteen HS1d categories

## 4. Broad categories of goods: Tariff rate frequencies



Source: WITS, authors' calculations \* Only for preselected fourteen S1d categories

## 5. Trade regimes with EU

- **Most favoured nation (MFN) tariff**

The MFN is the highest tariff level applied by the EU both to WTO and non-WTO members.

- **Unilateral tariff preferences**

These preferences include a generalized system of preferences (GSP) and autonomous trade preferences.

In 2014, the EU has introduced a revised GSP → 20+ high- and upper middle-income countries were considered as graduated from the GSP program and preferences for them were ceased.

- **Reciprocal tariff preferences.**

The reciprocal arrangements take a form of FTA, economic partnership agreements, association agreements etc. Currently, the EU has free trade arrangements with over 50 countries, and more are being negotiated.

## 5. Possible source countries for export-platform FDI

- 33 countries currently trade with the EU under MFN tariffs
- Interest in FDI in Georgia depends on:
  - Relative geographical proximity to Georgia
  - A sufficient level of economic development
  - No (ongoing) FTA talks with the EU
  - Preferably developed economic ties with Georgia
- Possible source countries for export-platform FDI : **Azerbaijan, China, Iran, Kazakhstan, Kuwait, Russia, Saudi Arabia, United Arab Emirates.**
- China lost EU GSP preferences in 2015; now, it has to export under MFN tariffs → could have a strong incentive to use Georgia's DCFTA
- **Which country could be interested in Georgia as an export platform for which goods?**

## 5. Identifying country – goods combinations

- To identify potentially attractive country-goods combinations:
  - Identify goods, in which potential source countries already export more than USD 100 ths per year, but exclusively not to EU countries
  - Match with a list of categories, which have tariffs above 5% and lenient rules of origin → Indicates that barriers to enter the EU market may be too high and therefore Georgia as export platform might solve the issue.
- **RESULTS:**
  - Russia and Saudi Arabia have the longest list of goods that could be potentially attractive for tariff-jumping FDI
  - Due to still preferential access to the EU market in 2014, China has a very short list of goods supplied exclusively to non-EU countries
  - Among goods with high tariff differential and lenient ROO that 8 countries export exclusively to non-EU, agricultural goods and textile dominate

## 5. Which type of goods would potential source countries be interested in?

### Non-EU exports of high tariff differential goods with lenient rules of origin,

*# of preselected HS-6d categories exported exclusively to non-EU (red means that over 25% of HS exported)\**

	# of HS-6d	CH	AZ	IRN	KAZ	KUW	SA	UAE	RU
		2014	2014	2011	2014	2014	2014	2014	2014
I Animal products	279	11	6	38	42	36	64	51	100
II Vegetable products	160	30	10	39	32	23	66	26	54
III Animal or vegetable fats, oils	38	3	6	8	10	8	16	16	10
IV Prepared foodstuffs	169	19	22	43	50	38	67	64	98
VI Products of chemical industries	23	4	0	1	0	0	2	2	11
VII Plastics; rubber	11	0	0	1	2	0	1	2	7
VIII Raw hides and skins, leather	19	6	2	6	6	3	0	3	7
IX Wood and articles of wood	18	1	0	2	3	2	10	5	2
XI Textiles and textile articles	577	19	6	83	54	72	119	113	242
XII Footwear, headgear, umbrellas	24	0	0	12	8	10	15	8	7
XIII Articles of stone, plaster, glass	34	0	1	15	4	12	18	8	8
XV Base metals and articles thereof	30	1	0	1	5	5	2	2	10
XVII Vehicles, aircraft, vessels	3	0	0	0	2	1	2	0	2
XX Miscellaneous manuf. articles	9	0	0	1	1	2	1	3	4
<b>Total</b>	<b>1394</b>	94	53	250	219	212	383	303	562

Source: WITS, authors' calculations \* USD 100 thousand exports threshold applies

## 6. Conclusions and policy recommendations

- The DCFTA could attract export-platform FDI to Georgia
- Use tariff differentials in attracting investors from countries without preferential access to the EU market
- Agricultural goods and textiles are the most promising broad categories of goods attractive for tariff-jumping FDI.
  - Verify case-by-case that production conditions for identified goods in Georgia are suitable
- However, tariff differentials are only one pull-factor for FDI attraction
- Georgia competes with >50 countries with good EU market access for export-platform FDI
- For Georgia to realise the potential from the EU market access, production conditions in the relevant goods sectors need to be attractive and competitive
- Improve investment climate for non-EU investors, tie in tariff differentials with sectoral policy.

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## Annex 1: Country-goods mapping

- For each potential source country we selected goods that are most promising for tariff-jumping FDI using a combination of two factors:
  - Average tariff at HS-6d
  - Share of non-EU exports of goods in total non-EU exports of the country
  
- Tables on next pages contain examples of 5 agricultural and 5 industrial categories that satisfy the following criteria:
  - High tariff differential (more than 5%)
  - Lenient rules of origin (no maximum value of non-originating requirements)
  - High share of non-EU exports of this good in total exports of potential source country

# Azerbaijan: goods with tariff-jumping FDI potential

- **53** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 44 agri-food goods & 9 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Cane or beet sugar and chemically pure sucrose, in solid form (excl. cane and beet sugar containing added flavouring or colouring and raw sugar)	68.5	68.5
Edible mixtures or preparations of animal or vegetable fats or oils and edible fractions of different fats or oils (excl. fats, oils and their fractions, partly or wholly hydrogenated, inter-esterified, re-esterified or elaidinised)	17.7	29.2
Vegetable fats and oils and their fractions, partly or wholly hydrogenated, inter-esterified, re-esterified or elaidinised, whether or not refined, but not further prepared	10.1	12.8
Fresh persimmons	8.8	8.8
Cucumbers and gherkins, fresh or chilled	28.8	61.2
Sacks and bags, for the packing of goods, of polyethylene or polypropylene strip or the like (excl. flexible intermediate bulk containers)	9.6	12.0
Full grains, unsplit and grain splits, in the wet state "incl. wet-blue", of hides and skins of bovine "incl. buffalo" or equine animals, tanned, without hair on (excl. further prepared)	5.5	5.5
Hides and skins of bovine "incl. buffalo" or equine animals, in the dry state "crust", without hair on, whether or not split (excl. further prepared and full grains, unsplit and grain splits)	6.3	6.5
Woven fabrics containing predominantly, but < 85% silk or silk waste by weight	6.9	6.9
Worn clothing and clothing accessories, blankets and travelling rugs, household linen and articles for interior furnishing, of all types of textile materials, incl. all types of footwear and headgear, showing signs of appreciable wear and presented in bul	5.3	5.3

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## China: goods with tariff-jumping FDI potential

- **94** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 63 agri-food goods & 31 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Frozen meat of swine (excl. carcasses and half-carcasses, and hams, shoulders and cuts thereof, with bone in)	29.9	32.7
Prepared or preserved meat or offal of bovine animals (excl. sausages and similar products, finely homogenised preparations put up for retail sale as infant food or for dietetic purposes, in containers of a net weight of <= 250 g, preparations of liver an	32.5	64.4
Fresh or chilled potatoes (excl. seed)	9.6	11.5
Milk and cream of a fat content by weight of > 1% but <= 6%, not concentrated nor containing added sugar or other sweetening matter	46.9	52.4
Undenatured ethyl alcohol, of actual alcoholic strength of >= 80%	18.8	18.8
Woven fabrics containing >= 85% acrylic or modacrylic staple fibres by weight, unbleached or bleached	8	8
Multiple "folded" or cabled flax yarn	5	5
Hides and skins of bovine "incl. buffalo" or equine animals, in the wet state "incl. wet-blue", tanned, without hair on, whether or not split (excl. further prepared and full grains, unsplit and grain splits)	5.5	5.5
Stearic acid, industrial	5.1	5.1
Carpets and other textile floor coverings, woven, not tufted or flopped, not of pile construction, not made up (excl. Kelem, Schumacks, Karamanie and similar hand-woven rugs, and floor coverings of coconut fibres "coir")	8.0	8.0

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## Iran: goods with tariff-jumping FDI potential

- **250** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 128 agri-food goods & 122 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Cucumbers and gherkins, fresh or chilled	28.8	61.2
Cane or beet sugar and chemically pure sucrose, in solid form (excl. cane and beet sugar containing added flavouring or colouring and raw sugar)	68.5	68.5
Yogurt, whether or not flavoured or containing added sugar or other sweetening matter, fruits, nuts or cocoa	54.0	141.1
Buttermilk, curdled milk and cream, kephir and other fermented or acidified milk and cream, whether or not concentrated or flavoured or containing added sugar or other sweetening matter, fruits, nuts or cocoa (excl. yogurt)	71.7	151.3
Cheese (excl. fresh cheese, incl. whey cheese, curd, processed cheese, blue-veined cheese and other cheese containing veins produced by "Penicillium roqueforti", and grated or powdered cheese)	34.9	49.1
Footwear with outer soles and uppers of rubber or plastics	16.8	17.0
Tableware and kitchenware, of porcelain or china (excl. ornamental articles, pots, jars, carboys and similar receptacles for the conveyance or packing of goods, and coffee grinders and spice mills with receptacles made of ceramics and working parts of met	12.0	12.0
Carpets and other floor coverings, of man-made textile materials, tufted "needle punched", whether or not made up (excl. those of nylon or other polyamides)	8.0	8.0
Sacks and bags, for the packing of goods, of polyethylene or polypropylene strip or the like (excl. flexible intermediate bulk containers)	9.6	12.0
Ceramic sinks, washbasins, washbasin pedestals, baths, bidets, water closet pans, flushing cisterns, urinals and similar sanitary fixtures of porcelain or china (excl. soap dishes, sponge holders, tooth-brush holders, towel hooks and toilet paper holders)	7.0	7.0

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## Kazakhstan: goods with tariff-jumping FDI potential

- **219** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 134 agri-food goods & 85 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Wheat or meslin flour	44.2	44.2
Barley (excl. seed for sowing)	41.8	41.8
Seed of wheat and meslin, for sowing (excl. durum)	31.4	40.8
Milk and cream of a fat content by weight of > 1% but <= 6%, not concentrated nor containing added sugar or other sweetening matter	46.9	52.4
Bran, sharps and other residues of wheat, whether or not in the form of pellets, derived from sifting, milling or other working	37.7	50.5
Footwear with outer soles and uppers of rubber or plastics (excl. covering the ankle or with upper straps or thongs assembled to the sole by means of plugs, waterproof footwear of heading 6401, sports footwear, orthopaedic footwear and toy footwear)	16.8	17.0
Sanitary towels (pads) and tampons, napkins and napkin liners for babies, and similar articles, of any material	8.4	10.5
Tableware and kitchenware, of porcelain or china (excl. ornamental articles, pots, jars, carboys and similar receptacles for the conveyance or packing of goods, and coffee grinders and spice mills with receptacles made of ceramics and working parts of met	12.0	12.0
Full grains leather "incl. parchment-dressed leather", unsplit, of the whole hides and skins of bovine "incl. buffalo" or equine animals, further prepared after tanning or crusting, without hair on (excl. chamois leather, patent leather and patent laminat	6.5	6.5
Women's or girls' ensembles of textile materials (excl. of cotton or synthetic fibres, ski ensembles and swimwear)	12.0	12.0

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## Kuwait: goods with tariff-jumping FDI potential

- **212** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 105 agri-food goods & 107 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Milk and cream, concentrated but unsweetened (excl. in solid forms)	114.2	189.7
Wheat or meslin flour	44.2	44.2
Milk and cream of a fat content by weight of > 6% but <= 10%, not concentrated nor containing added sugar or other sweetening matter	79.7	80.3
Food preparations, n.e.s.	11.1	12.8
Whey and modified whey, whether or not concentrated or containing added sugar or other sweetening matter	146.8	190.2
Tents of textile materials (excl. of synthetic fibres, and umbrella and play tents)	12.0	12.0
Webs, mattresses, boards and similar nonwoven products, of glass fibres (excl. mats and thin sheets "voiles")	5.0	5.0
Glass fibres, incl. glass wool, and articles thereof (excl. staple fibres, rovings, yarn, chopped strands, woven fabrics, incl. narrow fabrics, thin sheets "voiles", webs, mats, mattresses and boards and similar nonwoven products, mineral wool and article	7.0	7.0
Special garments for professional, sporting or other purposes, n.e.s., of cotton, knitted or crocheted	12.0	12.0
Footwear with outer soles and uppers of rubber or plastics (excl. covering the ankle or with upper straps or thongs assembled to the sole by means of plugs, waterproof footwear of heading 6401, sports footwear, orthopaedic footwear and toy footwear)	16.8	17.0

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## Russia: goods with tariff-jumping FDI potential

- **562** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 262 agri-food goods & 300 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Buttermilk, curdled milk and cream, kephir and other fermented or acidified milk and cream, whether or not concentrated or flavoured or containing added sugar or other sweetening matter, fruits, nuts or cocoa (excl. yogurt)	71.7	151.3
Milk and cream, concentrated but unsweetened (excl. in solid forms)	114.2	189.7
Bran, sharps and other residues of wheat, whether or not in the form of pellets, derived from sifting, milling or other working	37.7	50.5
Sausages and similar products, of meat, offal or blood; food preparations based on these products	25.4	36.3
Wheat or meslin flour	44.2	44.2
Bicycles and other cycles, incl. delivery tricycles, not motorised	14.6	15.0
Parts of garments or clothing accessories, knitted or crocheted, n.e.s.	12.0	12.0
Binder or baler twine, of polyethylene or polypropylene	8.0	8.0
Tyre cord fabric of high-tenacity yarn of nylon or other polyamides, whether or not dipped or impregnated with rubber or plastic	6.8	8.0
Floor coverings consisting of a coating or covering applied on a textile backing, whether or not cut to shape (excl. linoleum)	5.3	5.3

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

## Saudi Arabia: goods with tariff-jumping FDI potential

- **383** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 213 agri-food goods & 170 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Mixtures of fruit juices, incl. grape must, and vegetable juices, unfermented, whether or not containing added sugar or other sweetening matter (excl. containing spirit)	28.0	52.2
Cane or beet sugar and chemically pure sucrose, in solid form (excl. cane and beet sugar containing added flavouring or colouring and raw sugar)	68.5	68.5
Yogurt, whether or not flavoured or containing added sugar or other sweetening matter, fruits, nuts or cocoa	54.0	141.1
Buttermilk, curdled milk and cream, kephir and other fermented or acidified milk and cream, whether or not concentrated or flavoured or containing added sugar or other sweetening matter, fruits, nuts or cocoa (excl. yogurt)	71.7	151.3
Juice of fruit or vegetables, unfermented, whether or not containing added sugar or other sweetening matter (excl. containing spirit, mixtures, and juice of citrus fruit, pineapples, tomatoes, grapes, incl. grape must, apples and cranberries)	24.4	44.2
Glass fibres, incl. glass wool, and articles thereof (excl. staple fibres, rovings, yarn, chopped strands, woven fabrics, incl. narrow fabrics, thin sheets "voiles", webs, mats, mattresses and boards and similar nonwoven products, mineral wool and article	7	7
Carpets and other floor coverings, of man-made textile materials, woven, not tufted or flocked, of pile construction, not made up (excl. Kelem, Schumacks, Karamanie and similar hand-woven rugs)	8	8
Men's or boys' jackets and blazers of textile materials (excl. of wool, fine animal hair, cotton or synthetic fibres, knitted or crocheted, and wind-jackets and similar articles)	12	12
Felt, impregnated, coated, covered or laminated (excl. needleloom felt and stitch-bonded fibre fabrics)	6.7	6.7
Blankets and travelling rugs of textile materials (excl. of wool or fine animal hair, cotton or synthetic fibres, electric, table covers, bedspreads and articles of bedding and similar furnishing of heading 9404)	12	12

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*

# United Arab Emirates: goods with tariff-jumping FDI potential

- **303** out of 1394 HS-6d categories with high tariff differential and lenient rules of origin and exclusive non-EU exports: 157 agri-food goods & 146 industrial goods
- Examples of 5 agri-food and 5 industrial goods with tariff-jumping FDI potential

Description	Average tariff, %	Max tariff, %
Milk and cream, concentrated but unsweetened (excl. in solid forms)	114.2	189.7
Preparations of a kind used in animal feeding (excl. dog or cat food put up for retail sale)	64.3	153.1
Whey and modified whey, whether or not concentrated or containing added sugar or other sweetening matter	146.8	190.2
Milk and cream of a fat content by weight of > 1% but <= 6%, not concentrated nor containing added sugar or other sweetening matter	46.9	52.4
Meat or offal of fowls of the species "Gallus domesticus", prepared or preserved (excl. sausages and similar products, finely homogenised preparations put up for retail sale as infant food or for dietetic purposes, in containers of a net weight of <= 250	71.4	79.7
Men's or boys' suits of textile materials (excl. of wool, fine animal hair or synthetic fibres, knitted or crocheted, tracksuits, ski suits and swimwear)	12.0	12.0
Carpets and other floor coverings, of nylon or other polyamides, tufted "needle punched", whether or not made up	8.0	8.0
Sports footwear, incl. tennis shoes, basketball shoes, gym shoes, training shoes and the like, with outer soles of rubber or plastics and uppers of textile materials	16.9	16.9
Men's or boys' shirts of man-made fibres (excl. knitted or crocheted, nightshirts, singlets and other vests)	12.0	12.0
Floor tiles, of felt, not tufted or flocked, with an area of <= 0,3 m <sup>2</sup>	6.7	6.7

*Note: For **animal origin goods**, access to the EU market is conditional on development of food safety system in Georgia*