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Adenauer  
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Research

## **Trade Relations Between Georgia and Armenia: Getting Close or Distant?**

The research is conducted in the framework of the project “Policy Research for Sustainable Economic Development”, implemented by PMC Research Center by the support of Konrad Adenauer Foundation.

The content does not necessarily reflect the view of PMC Research Center or Konrad Adenauer Foundation

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Tbilisi, 2016

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## Introduction

Armenia and Georgia are neighbouring countries and their economic ties have built a history throughout centuries. These neighbouring lands were both Caucasian kingdoms, parts of Soviet Union, then in 90s they both walked through transition and stepped into global economy. Firstly, geographic proximity, cultural connections and similarity in marketplaces makes Armenia and Georgia natural trading partners. Secondly, they are both members of WTO which assumes harmonization of customs codes and favoured treatment to each other. Thirdly, and most importantly, since 1998, Armenia and Georgia have enforced a free trade agreement (FTA) which eliminate tariffs, customs duties and quantitative restrictions on export and import of goods originating in the territory of Georgia.

As integration and globalization trend develops, the economic and business activities become more dynamic and complex. In order to enhance the transfer of skills and technology and withstand competition in the economic and political spheres, as well as to ensure cooperative safety, countries are joining a block or union<sup>1</sup>. In 2013, Armenian Government announced the decision to join Eurasian Customs Union with Russian, Belarus and Kazakhstan (EEU). Whereas in 2014, Georgia signed Association Agreement to initiate membership in European Union with another 28 European countries. As a result, now relationship between Georgia and Armenia needs special attention.

The questions which we will be addressed in this paper are

1. How existing and potential non-tariff barriers (NTBs) can affect trade relations between Georgia – Armenia?
  - 1.1. What are the NTBs to trade between Armenia and Georgia?
  - 1.2. What are the EEU requirements that have been already adopted in Armenia, and what is the future action plan?
2. What are the consequences and recommendations for neighbor countries cooperation having joined two different economic unions?
  - 2.1. What are the traded commodity groups/volumes/dynamics between Georgia and Armenia??

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<sup>1</sup> Here and below speaking of unions I mean trade and economic unions

The paper begins with describing the main problem addressed, as well as methods and data used to shape arguments. Afterwards, the core analysis is divided into sections of non-tariff barriers for trade between Georgian and Armenia, and tariff barriers.

In the NTBs section, we describe legal and institutional framework regulating trade relationship between two countries highlighting existing benefits and challenges in multi- and bilateral agreements, as well as tax and customs laws and regulations.

In the TBs section, we provide descriptive statistics to show the pattern of trade between Georgia and Armenia before and after joining EEU. We discuss turnover and structure of trade. Then look at export divided in categories of net and re-export.

Finally, we present conclusion and policy recommendations for addressing challenges created by the problem discussed in this paper.

## Problem

Armenia's decision to join EEU brings up changes in trade and customs regulations of Armenia and might create challenges in trade relations between Georgia and Armenia.

Apart from political implications, this decision creates a big room for economic concerns. On one hand, for many years, Armenian market was one of the primary destinations for Georgian goods, and if integration with EEU creates impediments for effectiveness of existing FTA, it might negatively influence Georgian exports. On the other hand, for Armenia, Georgia is the only transit corridor for almost all economic relations that need transportation, due to the conflict between Armenia and Azerbaijan, a closed border between Armenia and Turkey, and also taking into account that Georgia has a sea port, hence, any increase of Armenian trade is inevitably beneficial for it.

The main objective of this study is to inform policy makers on potential challenges and benefits for Georgia emerging from Armenia's integration in EEU, based on the quantitative and qualitative analysis of trade relations between Georgia and Armenia. This research has high importance for trade relations between Georgia and Armenia. Informed decision making will allow to minimize potential losses to economies of both countries.

## Methods

- Desk research on *non-tariff barriers* and challenges in current institutional and legal framework of Armenia that Georgia might face in their trade relations
  - Data source: legal documents regulating trade relations between Georgia and Armenia: multi- and bilateral treaties, national legislations, customs codes.
- Analysis of *tariff barriers* for export and import of goods from Georgia to/from Armenia
  - Data source: tariff data and trade statistics before 2013 and according to recent data from 2015

## **Non-Tariff Barriers in trade between Georgia and Armenia**

In this section, we will discuss

- main legal acts regulating trade relations between Georgia and Armenia
- customs administration procedures of Armenia towards non-members of EEU, and Georgia, in particular
- recent progress and remaining challenges for Georgian agents in trading across borders in Armenia

## **Legal framework of trade relationship between Georgia and Armenia<sup>1</sup>**

International economic relations and trade between Georgia and Armenia are regulated by Intergovernmental Commission On Economic Cooperation, headed by the Prime Ministers of Armenia and Georgia. And are binding upon a set of multi- and bilateral agreements and customs regulations such as:

- WTO GATT and GATS rules
- Agreement on Free Trade between Georgia and Armenia (and other narrow specific agreements)
- Customs Codes of both countries, and EEU

## **WTO GATT and GATS Rules.**

Both Armenia and Georgia are members of WTO so their trade relationship is binding upon “Most Favored Nation” (MFN) and “National Treatment” rules. It means that Armenian trading system should not discriminate between its trading partners, giving them equally MFN status; and between its own and foreign products, services or nationals, giving them “national treatment”. As an exception Armenia is allowed to set up a customs union (CU) agreement that applies privileged rules only to goods traded within the EEU — discriminating against goods from outside. However, even though WTO gives exception for CU, the MFN principle implies that, *outside of these unions, the tariff that applies to the MFN country must similarly apply to all.*

This should prevent Armenia as a member of EEU from introducing tariffs on Georgia and other third countries which would be higher than MFN tariffs. The maximum tariff that can be applied will be the same as the tariff applied to any MFN country.

Prior to decision to join EEU, 73% of the lines were duty free in Armenia and majority of the other lines had 10% tariff applied to them. The MFN rate of Armenia was 2.7% while in the EEU its equivalent was 7.6% in 2013, 6.9% in 2014, and 6% in 2015.

Currently, a special delegation to WTO from EEU Commission is negotiating changes to tariff commitments of Armenia towards WTO member states.

### **Agreement on Free Trade between Georgia and Armenia.**

The Free Trade Agreement between Armenia and Georgia entered into force in 1998. It aims to promote the establishment of stronger trade and commercial ties between the countries and to promote free trade in goods by eliminating tariffs, customs duties and quantitative restrictions on export and import of goods originating in the territory of the countries.

Countries agreed that goods envisaged by the present agreement shall not be levied by direct or indirect internal taxes exceeding the corresponding taxes or duties imposed on the similar products manufactured in their own country or the products manufactured in the countries non-members of the agreement. Through regular consultations, the parties agreed to try to set common customs tariffs which will be used in trade with other countries. Countries have an obligation to inform each other of the existing tariffs and all exclusions from them. The parties agreed to conduct a coordinated export control policy towards other countries and take coordinated measures to create a more effective export control system, by means of regular consultations.

This agreement adheres to the principle of free transit. Each country guarantees within its territories the transit of goods originated from the other party's and/or any other country's customs territory and designated for the other party's or any other country's customs territory, and shall provide the exporters, importers or transporters with all means and services necessary for guaranteeing the transit under the conditions which shall not be less favourable than those provided for the same type of services and means to the exporters, importers of their own country.

The quantitative restrictions stated in this article can be set unilaterally and for a strictly defined term only with a prior notice to the party about the reasons, forms and supposed term of application of these restrictions. The given restrictions shall have a specific character and shall be used only under the conditions stipulated by agreements concluded within the framework of the GATT.

This treaty does not allow any activities restricting the competition on the territories of two counties, including any dishonest activities such as agreements between the enterprises, decisions taken by the corporations. Also it gives special attention to activities with the help of which one or more enterprise using its dominating position restricts the competition on the whole or a considerable part of the parties' territories.

The parties shall immediately inform each other of the changes in their national legislation, which can affect the realisation of the present agreement. They shall exchange information regularly on laws and other normative acts, connected with the economic activities, including trade and transport, investments, taxation, bank and insurance activities and other financial services as well as customs service and customs statistics.

Parties agreed to timely inform each other of the reasons, nature, and estimated term of introduction and validity of the state regulation measures. They agreed to conduct preliminary consultations. In case of failure to reach an agreement within six months, the party, which intends to introduce state regulatory measure has a right to introduce it at its own discretion.

However, the present agreement is not in conflict with the right of each party to take measures accepted in the international practice, which it deems necessary to undertake in order to protect its vital interests, or, which are necessary to fulfil those international agreements the member of which it is or intends to become, if these measures concern national security and other issues of state importance.

Nothing in this agreement shall prevent the countries from establishing relationship with the states, which are not the parties of this agreement, also with their unions and international organisations, given that it doesn't violate provisions and goals of this FTA.

### **Customs Code of Armenia: Import and Export Procedures**

As a member of the World Trade Organization since 2003, Armenia has worked to reduce customs burdens and reform the existing customs system. Examples include an on-line customs declaration system (e-declaration); a traffic light system for inspection of goods entering Armenia; and a reduction in the number of import documents from nine to three.

As of 2013, before changing the foreign trade policy direction, Armenia offered a liberal trade and investment regime. The average applied tariff, at 2.7%, was among the lowest of WTO members. Only two tariff<sup>2</sup> rates were applied on imports of goods to Armenia: 0% or 10%. The 0% tariff applied to imports of capital goods, and the 10% tariff to imports of consumer products. All imports were subject to the payment of a VAT of 20% and alcoholic beverages, tobacco products, and fuels were also subject to an excise tax. There were no tariff quotas, licensing requirements or quantitative restrictions on imports. Nor Armenia maintained a system of

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<sup>2</sup> Article 102, RA Customs Code

minimum import prices. Armenia had not tax on exports and any licensing requirements for exporting. There were neither export duties nor VAT payment obligations or limitations.

Out of nine customs houses (five regional and four specialized) and six customs points, seven were working around-the-clock.

At present, except for liberal tariff profile, most of these accomplishments are sustained. According to WB 2016 Doing Business report, in 2015 border compliance took 39 hours in average and cost 100USD, while documentary compliance in Armenia was being processed in 2 hours, and cost 100USD for imports and 150USD for exports.

*At the customs border*, the importer/exporter goes through a preliminary document and physical check, presents *a proof of payment made for the goods being imported or a contract, transportation document/Consignment Note, Certificate of Origin of Imported Goods*, and in applicable cases: *Veterinary, Phytosanitary and/or Food Safety Certificates*. Typically this takes around one hour.

*At the customs warehouse*, optionally, the customs broker (or the owner of the goods) might initiate another preliminary physical check to avoid any mistakes. The conduct of preliminary physical checks for almost all cargos is an unusual practice in the international context. However, there is a low level of trust between customs brokers and traders, between customs brokers and customs authorities, and between traders and customs authorities.

*At the customs house*, importers/exporters must present Customs Declaration, which is the basic legal document for customs clearance procedures. Prior to finalization of the Customs Declaration the Customs Officer has to determine the Customs Code and Customs Value of imported goods as a baseline for calculating the customs duties.

*Customs clearance* is processed after all the documents and payment receipts are submitted. Overall, importers/exporters are given 10 days to clear goods, after which fines are applied.

The most vulnerable step in import procedures is determining *the Customs Code and Customs Value* of imported goods because it is a baseline for calculating the amount of customs duties to be paid, and determining the regime to be applied to the goods being imported.

In some cases importers may be required to present documents with information on the origin of goods, even where the goods in question are not subject to potentially privileged treatment. The reason for this is that the “guiding price list” includes different prices for goods originating from different geographical regions (e.g., products from European countries are accorded higher

prices than products from Asia). This creates an additional need for preliminary physical inspections by the importer/customs broker, adding several days to the clearance process: previously, moreover, no such requirement existed.

International best practice recommends using *transaction value method*. It is also on the top of customs valuation methods in Customs Code of Armenia. But any application for the use of the transaction-value method must be approved at the Central Headquarter of the Armenia Customs Service, on the basis of an application to the Chairman of the State Revenue Committee. This frequently causes delays. More frequently, instead of using the transaction method, the so-called “method four” of customs valuation is applied, on the basis of “the unit price at which the imported goods or identical or similar imported goods are sold in Armenia,” or on the basis of what are known as “*Guiding price lists*,” against which the value of imported goods is estimated, are therefore applied to a majority of products. “*Guiding price lists*” are developed on the basis of market information collected and analyzed by the Armenian Customs Service. These lists are updated periodically, but the frequency of updates is not coherent with price fluctuations in the market. The lists are not publicly available.

Another important procedure relates to getting a Certificate of Origin (COO), which is the primary document proving eligibility for exemption of customs duties. So far many traders have lack of information and resources to obtain this document. In Armenia, COOs are issued by the Chamber of Commerce and Industry of the Republic of Armenia (CCI). ArmExpertiza, established by the CCI, performs the necessary determination—i.e., whether a good qualifies as being produced in Armenia. ArmExpertiza also provides services in determining the appropriate Customs Codes for products.

In general, the COO shall be presented at Customs House when importers wish to claim specific or privileged treatment (exemption from tariffs, lower tariff rates, etc.) applicable under bi-lateral and/or multilateral agreements between the countries involved. This relates, in particular, to those FTAs to which Armenia is a signatory. Armenia has FTAs with all countries of the CIS except Azerbaijan and Uzbekistan, but including Georgia.

The goods pass full examination/testing for certification of origin only on the first occasion of export (the first of applying for COO).

The procedure of COO has been reformed in December 2010. The new procedure envisages the elimination of the practice of testing all consignments and the introduction of testing

on the basis of risk assessment: a given product type will no longer be subject to testing with every consignment, but will be tested on the first occasion of export and subsequently registered. After this, the product is certified with a simplified procedure (without examination/testing).

The new procedure also envisages the possibility of the “producer (exporter) declaration” method for COO, i.e. the producer of exporter can now declare that their product originate in Armenia, and the CCI ratifies and registers the declaration.

COO must be issued within three days if products are tested, and within one day if no testing is required. It is valid for one year

In Armenia, the following prices apply to certification of origin process: For the goods being certified (exported) for the first occasion with full initial testing - AMD 30,000 (eq. USD 63), including VAT. For the goods which have already been certified previously and for the goods wholly obtained (extracted), originated or grown in Armenia, without examination/testing – AMD 10000 (eq. USD 21), including VAT. For locally produced agricultural goods with weight up to 2.5 tons, without examination/testing - AMD 2000 (eq. USD 4), including VAT.

In the next section we will look at changes in these regulations, due to integration with EEU.

### **Main Provision of the Agreement on Armenia’s integration into EEU.**

Ever since the enforcement of integration agreement between Armenia and EEU, import and export of goods to the territory of Armenia are regulated according to the customs procedures stipulated by the Customs Code of Armenia and Customs Code of EEU. There will be zero tariff on imports from union member countries, whereas there will be common tariff on imports from third countries. Armenia will revise all the customs legislation, and partially revise indirect tax regulations related to import of products from member countries and legislation on applying zero VAT and excise tax exemption when exporting products.

Free trade agreement between Georgia and Armenia will remain in force, according to the Annex 3, Article 41, sub. 1, as well as other privileges given by Armenia to third countries before January 2015.

Trade in cars has a special attention of the Agreement. For a certain period, the current rates on customs duty and VAT on car import from non-member countries will not be changed. Transition period for cars is 5 years.

Import of goods from member countries and export of goods from Armenia to member countries through territories of third countries will be registered as transit. This is particularly relevant for the territory of Georgia as it is the only geographic link between Armenia and EEU.

The most sensitive point of the Agreement is VAT exemption for the EEU member states and simplification of excise tax exemption procedures, giving them up to 180 days after export to submit these documents. The approach to VAT collection from member countries will remain the same. Only difference is that VAT will be paid to tax authorities, not customs authorities. Apparently, traders from EEU non-member states will not have this privilege and will be in disadvantaged position. This applies also to Georgia.

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### **Amendments to the Law on VAT stipulated by entrance in the EEU**

Cars are the main commodity group re-exported from Georgia to Armenia. One of the main changes brought by EEU integration of Armenia is that VAT will not be levied for the cars imported from the EEU member states for non-business purposes (i.e. not more than one item in a year), since the citizens almost always buy these cars from resale. Therefore, their VAT is already paid, and there can't be double taxation within the EEU.

When importing cars from outside EEU, VAT and customs duty (in the amount of 32%) will be levied on the border. **This puts third countries suppliers of cars to Armenia in disadvantaged position and violates main provisions of FTA with Georgia.**

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### **Tariff Barriers in trade between Georgia and Armenia.**

In this section, we will discuss

- Common tariff net of EEU member countries on top traded goods between Armenia and Georgia
- Dynamics and composition of trade between Georgia and Armenia
- Trade complementarity between Georgia and Armenia on most traded commodities

### Common tariff of EEU member countries on top traded goods between Armenia and Georgia.

As of 2013, before changing the foreign trade policy direction, Armenia offered a liberal trade and investment regime. The average applied tariff, at 2.7%, was among the lowest of WTO members. Tariff profiles of all EEU member states has to comply with common tariff. In the integration agreement with EEU, Armenia has commitment to gradually adjust its import tariffs to this scheme. Nevertheless, all the countries who had privileged treatment with Armenia as of January 2015 will keep this status and follow the agreed tariffs. Hence, all else equal, FTA with Georgia will protect traders from discriminatory approach of EEU. However, in fact Armenia will change the status of liberal country to highly protectionist country in terms of foreign trade.

Categories	Customs Union	Armenia	Categories	Customs Union	Armenia
Animals	12.2	6.7	Chemicals	7.7	0
Fish and fish products	9.99	10	Plastics products	9.8	0
Dairy products	15.64	10	Leather, footwear	9	6.7
Fruit, vegetables, plants	10.8	10	Timber, paper	13.9	0
Tea, coffee	5.63	10	Cotton	10.7	0
Cereals	7.15	0	Textile	11	2
Other plant products	7	3.3	Clothing	13.1	10
Fats, olive oil	10.3	10	Stone, ceramic and glass items	14.9	6.7
Finished products	13.1	6	Pearls	17.8	0
Sugar, confectionery	6.3	10	Metals	9.8	2.5
Beverages, tobacco	22.4	5	Electric machinery	5.4	5
Mineral products (including fuel)	4.7	0	Transport	9.7	10
Pharmaceuticals	7	0	Devices	5	0

Source: Eurasian Development Bank

Figure 1: Comparison of import tariffs of EEU and Armenia, in %

*Table 1: Main net-imported commodities, in USD*

<b>Commodity name</b>	<b>%, change</b>	<b>2015</b>	<b>2013</b>
Copper ores & concentrates	-5.3	94,660,329	100,001,879
Carboys, bottles, flasks, jars, pots, phials & other containters, of glass	-64.3	5,840,247	16,369,982
Carboys, bottles, flasks & similar articles, of plastics	-36.3	3,251,287	5,104,688
Medicaments (including those in the form of transdermal administration systems)/in forms/packings for retail sale	15.7	2,928,809	2,532,332
Cigarettes containing tobacco	-38.1	2,281,575	3,688,554

This table lists products imported from Armenia by Georgian traders. There is significant decrease in volume of trade for these commodity groups. Even though there are no quantitative restrictions to trade whatsoever, there is a lot ambiguity in documentary requirements ever since the integration process was launched. This can be one reason why Georgian traders refrain from importing products from Armenia as much as they used to do before 2013.

### Total trade turnover between Georgia and Armenia

Trade between Georgia and Armenia started to grow rapidly after Georgia introduced reforms in its tax and customs policy and administration. During war with Russia turnover sharply decreased, but soon it outgrew its pre-war level and continued to grow steadily until 2014. Last two years overall trade turnover is decreasing, first, due to sharp decrease of exports from Georgia to Armenia, then sharp decrease of import to Georgia from Armenia. Currently, export level is down to its 2010 mark, import is also shrinking.

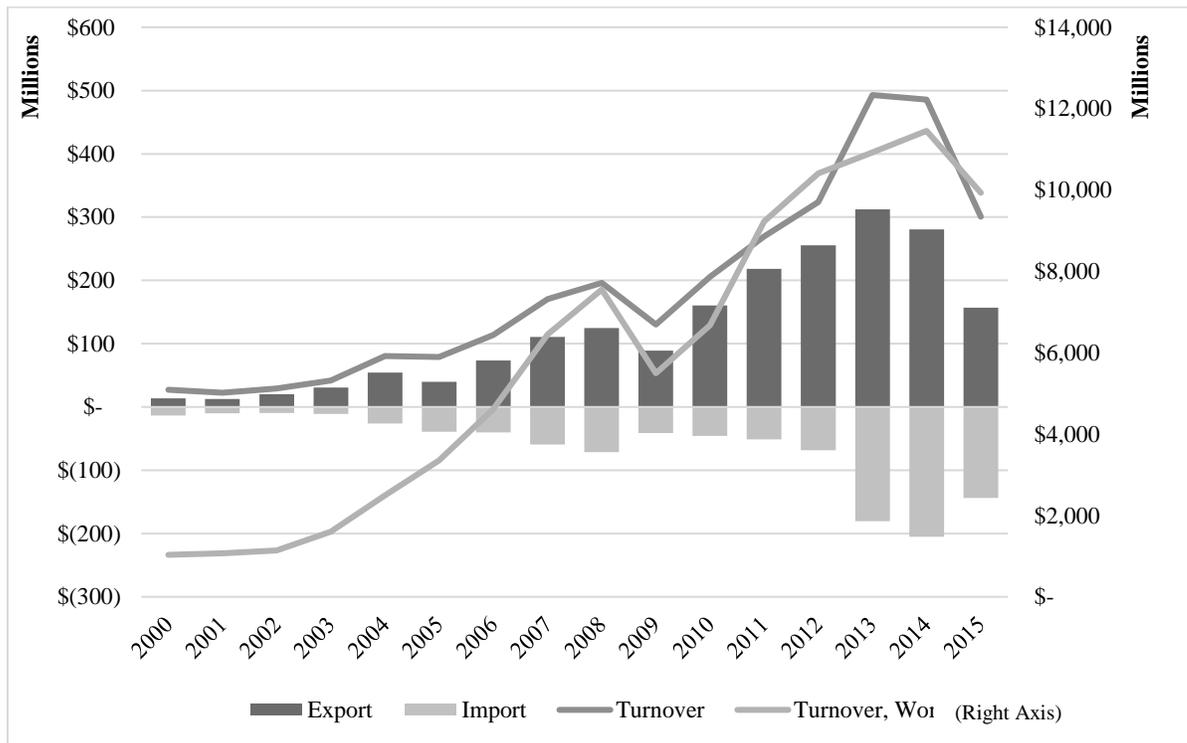


Figure 2: Trade turnover between Georgia and Armenia

### Share of Armenia in Georgia's foreign trade

Share of export to Armenia in Georgian total exports (including re-export) was 7.2% in 2015, where as in 2013 it was 10.74%. We can see in the chart that there was a dramatic decrease in Georgian export to Armenia after the decision to join EEU.

Re-export from Georgia to Armenia also sharply dropped from 18.13% to 15.40%.

Share of import from Armenia in Georgian total import was 1.86% in 2015 versus 2.25% in 2013.

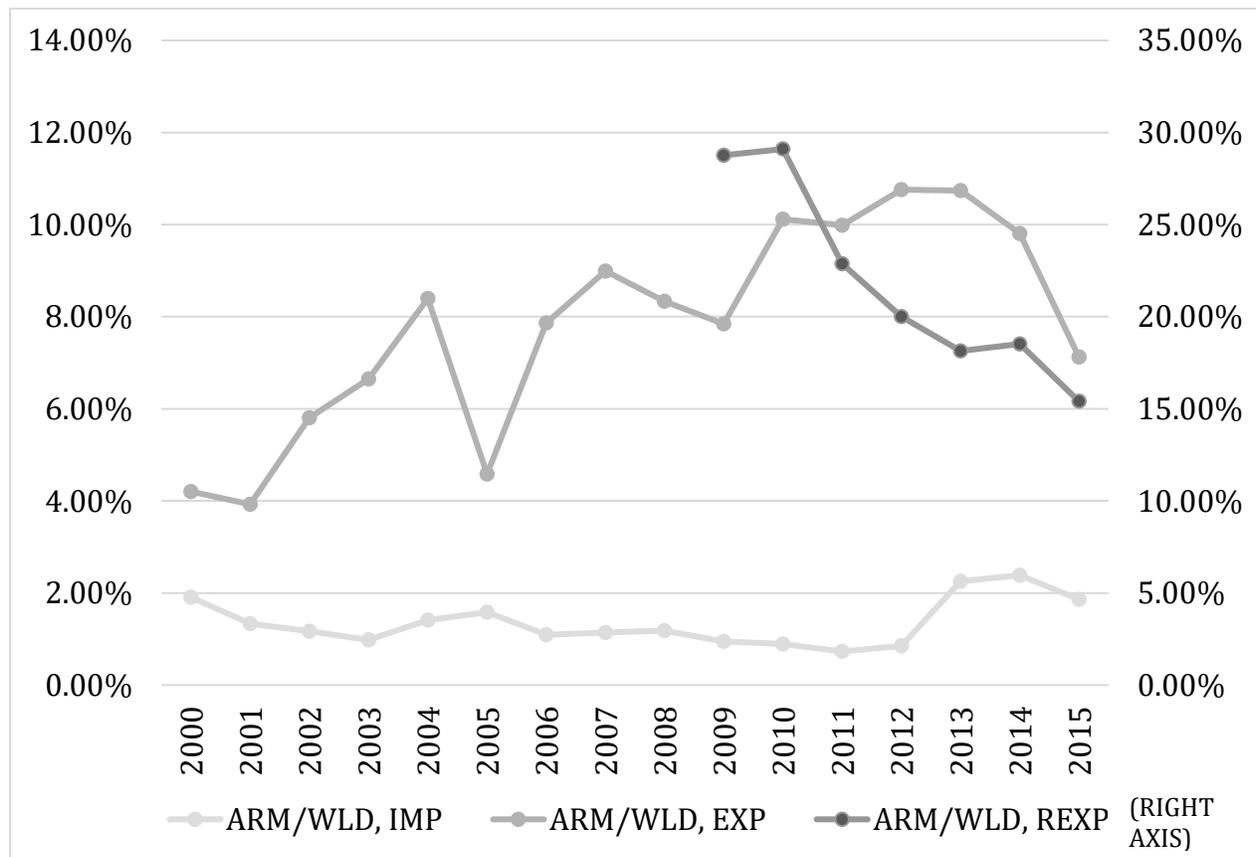


Figure 3: Share of Armenia in Georgia's foreign trade

### Share of re-export in total export from Georgia to Armenia

Re-export has always been the core of export from Georgia to Armenia. Its share was steadily growing after Georgian reforms. Ever since Armenia announced decision to integrate in EEU volume of re-export started to shrink: from 199mln USD in 2013 to 87mln USD in 2015.

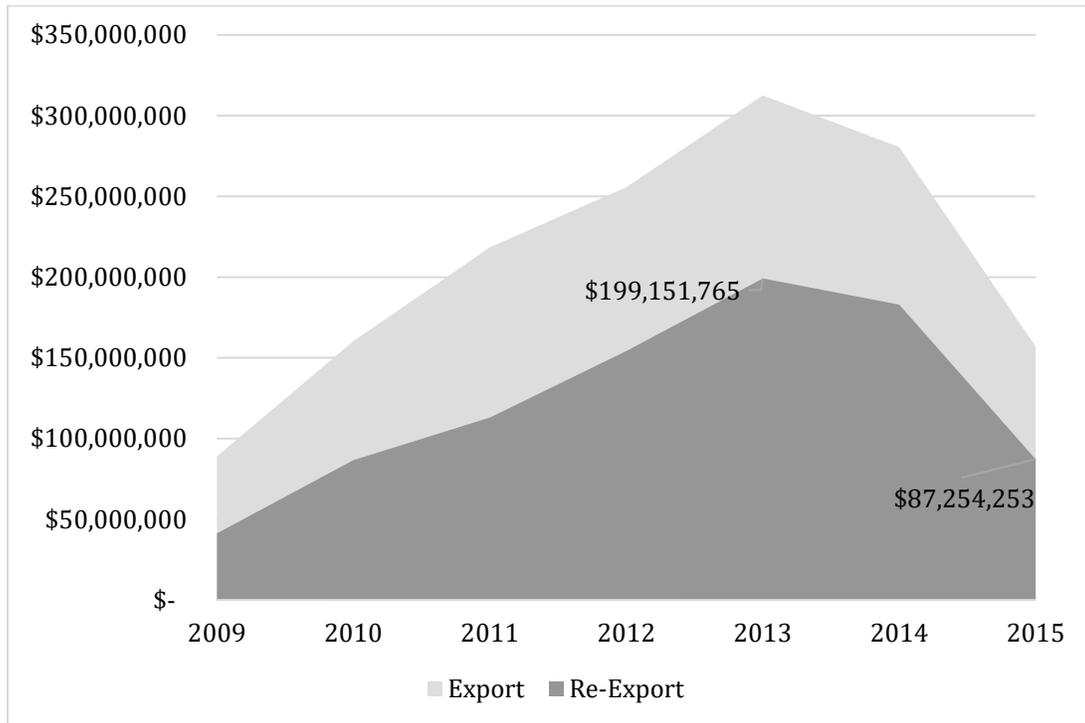


Figure 4: Share of re-export in total export from Georgia to Armenia, in USD, 2009 – 2015

Main re-exported commodity are vehicles/cars and soon after the integration into EEU they shrined dramatically. At the same time, volume of trade of commodities originated in Georgian and exported to Armenia decreased too. Later is specifically important, because provision of FTA exempt these particular commodities from any trade restrictions. Depending on what are the reasons of this decrease and what is its magnitude, one can calculate the benefit of keep FTA in force or the cost of its termination.

Table 2: Vehicles re-exported from Georgia to Armenia, in USD

<b>Commodity name</b>	<b>%, change</b>	<b>2015</b>	<b>2013</b>
Vehicles, engine of 1500-3000 cc	-60.3	28,465,931	71,767,619
Vehicles, engine of >3000 cc	-75.1	8,405,124	33,733,573
Diesel powered trucks weighing < 5 tonnes	-33.3	5,072,306	7,600,987
Automobiles, spark ignition engine o f 1000-1500 cc	-61.2	1,756,900	4,525,589

Table 3: Main commodities originated in Georgia and exported to Armenia, in USD

<b>Commodity name</b>	<b>%, change</b>	<b>2015</b>	<b>2013</b>
Boards, sheets, panels, tiles & similar articles	-39.7	\$3,255,452	\$5,393,926.00
Board of wood	-65.9	\$ 2,214,719	\$6,491,912.00
Medicaments	-51.2	\$2,198,626	\$4,505,203.00
Maize (corn), other than seed	-84.6	\$1,787,734	\$11,600,000.00
Vehicles	-46.9	\$1,578,978	\$2,974,499.00

## Conclusion

Armenia's decision to join Eurasian Economic Union with Russian, Belarus, Kazakhstan and Kyrgyzstan created economic challenges in trade with Georgia

For example, it brought a change in Law on VAT and, negatively affected re-export of cars from Georgia to Armenia.

## Recommendations

Clearly, if Armenia fully integrates and admits all the rules of EEU, it will become discriminative against its trade partners non-member of EEU, and, eventually, restrict trade outside EEU, including Georgia. This paper brings evidence to claim that

1. According to the FTA discussed above, Armenia and Georgia do not apply any restrictive measures in trade with each other. Though Government of Armenia declared that this agreement will remain in force, one clear violation regarding discrimination on VAT and excise taxes has already happened. Therefore it is not clear what are other expected changes and how long will it hold after full integration into EEU.
2. Current WTO rules have power to protect Georgia and other third countries against discrimination. Even though WTO gives exceptions for FTAs and CU, but the MFN principle implies that, outside of these unions, the tariff that applies to the MFN country must similarly apply to all. In practice, this should prevent the Armenia as a member of EEU introducing tariffs on Georgia which would be higher than MFN tariffs, even in the case of breaking FTA. The maximum tariff that can be applied will be the same as the tariff applied to any MFN country. Therefore, Georgia should immediately invite WTO's attention to
  - closely monitor process of Armenia's integration in EEU, in terms of its implication on all the related laws and bylaws which can be potentially harmful to trade of third countries members of WTO
  - ensure further enforcement of at least core points of FTA between Georgia and Armenia
3. Request Armenia to present detailed agenda of the steps towards introducing any changes to its existing laws related to foreign trade.
4. Conduct information campaigns across Georgian traders to ensure (1) they are aware of existing rules for trade across borders and (2) aware of potential changes as a result of

change in Armenia's trade regulations. This will give them information to get prepared and minimize potential losses.

5. Conduct deep analysis of economic implication of the cases (1) when MFN tariffs are imposed instead of free trade and (2) when Armenian tariffs are changed for EEU tariffs. This will allow to predict the costs of any discriminative measures resulting from the Armenia's full integration to EEU, and introduce response measures towards EEU member countries.

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