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FREE MOVEMENT OF COMMODITIES, INVESTMENT AND PEOPLE IN THE BLACK SEA REGION

CASE STUDIES OF AZERBAIJAN, GEORGIA, AND UKRAINE

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CONTENTS

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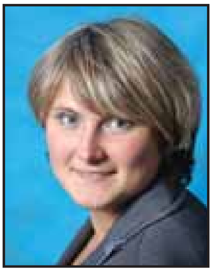

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ACRONYMS

AMS	Aggregate measure of support
ASYCUDA	Automated System for Customs Data
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
RBK CU	Customs Unions of Russia, Belarus and Kazakhstan
DB	Doing Business
DCFTA	Deep and Comprehensive Free Trade Area Agreements
EFTA	European Free Trade Association
EU	Europen Union
FTA	Free Trade Agreement
FDI	Foreign Direct Investment
FYR	Former Yugoslav Republic
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GCI	Global Competitiveness Index
IIPA	International Intellectual Property Alliance
NBU	National Bank of Ukraine
MFN	Most favoured nation
MoED	Ministry of Economic Development
SME	Small and medium enterprises
SPS	Sanitary/Phyto-Sanitary
TBT	Technical barriers to trade
TRIPS	Trade Related Aspects of Intellectual Property Rights
OECD	Organisation for Economic Co-operation and Development
PCA	Partnership and Cooperation Agreement
WB	World Bank
WTO	World Trade Organization
UN	United Nations
UNHCR	United Nations High Commissioner for Refugees
UNSTAD	United Nations Conference on Trade and Development
USA	United States of America
USSR	United Soviet Socialist Republics

SUMMARY

Azerbaijan, Georgia, and Ukraine each show distinguished economic performances. Although these countries were part of a single political entity underSoviet rule, the post-independence period has seen a new era for their national development. Foreign trade plays important role in the economies of these three states. For Azerbaijan, exports of oil and gas provide a crucial source of revenues for economic development. Azerbaijan's imports are much smaller, giving a positive trade balance. The distinctive feature of Azerbaijan's foreign trade is the high share of state trading, not shared with the other two countries. Ukraine is an open economy that depends on both exports and imports. Ukraine imports a greater volume of goods than it exports, giving rise to a negative trade balance. In Georgia, the share of trade in GDP has recently reached 63%, largely due to imports. All three countries see diversification of exports as an important part of their economic strategies. Georgia has the most liberal and foreign trade regime of the three, followed by Ukraine and then Azerbaijan. Georgia also has the lowest tariffs. The simple average for the most favoured nation (MFN) tariff is 1.5% in Georgia, 4.5% in Ukraine and 9.0% in Azerbaijan, while trade weighted average import duties are 2.2%, 2.7% and 5.9%, respectively. A comparison of import tariff schedules shows that Azerbaijan applies the highest MFN duties for all major product categories except for beverages and tobacco products, for which Georgia has the highest duties. Ukraine applies the highest tariffs on imported sugar and confectionary. All three countries tend to apply higher tariffs for agricultural products than for non-agricultural ones. Georgia has performed the most radical liberalisation of trade for non-agricultural products. The easing of cross-border trade in Georgia is partly explained by the adoption of the new Customs Code in 2005. The Code significantly simplified and reduced the number of procedures, introduced clear definitions for customs implementing provisions such as customs valuation, rules of origin and classification of goods. Azerbaijan and Ukraine followed this pattern in 2011 and 2012 respectively with enactment of new Customs Codes.

Our analysis reveals that Azerbaijan, Georgia and Ukraine are interested in attracting foreign direct investment (FDI). The countries have adapted their legislative

frameworks to create a more conducive environment for attracting FDI. Various laws and regulations protect investments including foreign investments. *Azerbaijan* has adopted various laws and regulation associated with foreign investment. While in recent years the share of FDI in foreign investment has started to decline, the oil sector is still a leading draw of FDI. The question that arises is why the non -oil sector is not good as the oil sector at attracting FDI. Following our investigations, we can conclude that the credibility of the country, its business environment and institutional issues, arbitrary tax and customs regulations, the weak court system, monopolistic regulation of the market, corruption, and poor protection of property rights are the main impediments to attracting FDI to the non-oil sector.

In contrast to Azerbaijan, *Georgia* does not have an oil sector, so FDI goes to the non-oil sector. Georgia has a well-developed legal and institutional framework that promotes the attraction of FDI, through legal taxes, free movement of capital, and minimal barriers and restrictions for registering and starting businesses. The free participation of foreign companies and citizens is guaranteed in any government public procurement bids aimed at privatization, providing concessions, etc. As demonstrated in the discussion above, there are few regulatory obstacles to inflow of investments in *Ukraine* (mainly ownership restrictions). The main obstacles to incoming investments are institutional: excessively tight regulation of business activities, weak law enforcement, and other factors that in general make it hard to do business there. Outward investments are restricted to a large extent, although the official statistics on outward investment do not reflect the actual outflow of capital from Ukraine. Domestic companies use wildcat schemes to transfer capital abroad. The list of schemes includes concealment of proceedings from export sales, payments for imported goods and services that were not received, and fictitious operations with securities. Furthermore, the conventional wisdom is that a significant part of foreign direct investment to Ukraine comes from Ukrainian business people who transferred their capitals abroad. That belief is consistent with some indirect evidence. Cypriot companies transfer most of their investments to Ukraine not from Cyprus, but from other countries.

Azerbaijan, Georgia and Ukraine share many similarities related to their Soviet heritage and the transition from the Soviet system. Notably, they face common problems in sphere of migration. All three countries have experienced and continue to suffer as a result of the exodus of the active population together with increased numbers of illegal immigrants. Azerbaijan and Georgia also face problems relating to internally displaced persons and refugees from the conflict zones inside and outside of the country.

Due to the differences in geography, size, and economic structure of three states, they face some substantially different challenges. For example, Ukraine has higher labour migration flows to the EU, and faces problems with the protection of the extra territorial rights of labour migrants. Azerbaijan tries to manage the massive migration from neighbouring Iran, at the same time as being an “exporter” of labour to Russia and other CIS countries. Georgia, with its declining population, has almost opened its borders to foreign migrants, allegedly bringing new business initiatives to the country. Respectively, there are substantial differences in the policies pursued by the countries: the Ukrainian government focuses on securing bilateral institutional guarantees for the protection of the labour rights of Ukrainian workers in EU (especially CEE) countries. It has also acceded to a number of important international conventions. All three countries enjoy visa free regimes to/from CIS countries. Ukrainian citizens have the best access to foreign states (76); Georgia and Azerbaijan respectively have visa-free access to 60 and 57 states in total. Georgia is more open to other nationalities, granting visa-free access to more than 70 states (Ukraine to 43). Azerbaijan operates the most restrictive visa policy among the three, essentially limiting visa-free opportunities to CIS member states. Georgia and Ukraine have lifted visa requirements for EU member states, reflecting their European aspirations. At the institutional and legal levels, all three countries have well-developed frameworks to deal with the migration issues. However, the migration services seemed to be weighed down with bureaucratic demands in all three countries. Labour migration from Ukraine, Georgia and Azerbaijan toward the direction of EU also depends on the development of respective bilateral agreements in the direction of the so-called “mobility partnership” program, designed to foster circular migration, reducing risk of illegal movement from these countries to the EU.

Integration into the global trade system has had a substantial impact on policy making in all three countries. The changes were led mainly by two institutions: the World Trade Organization (WTO) and the European Union (EU), an important trade partner of all three countries. In general, reforms encouraged by the WTO were consistent with ones promoted by the EU. In all three countries, the reforms included steps in the following directions: trade liberalisation (including reduction of import duties, elimination of quotas and licenses); approximation of trade rules (such as rules of origin, trade remedies) to the WTO norms and practices; changes in general economic policies (in the spheres of technical regulation, sanitary and phyto-sanitary control, public procurement, subsidies, intellectual property rights protection etc.). However, the countries implemented those reforms to different extent, depending on the stage of integration of each country into the global trade system, and on domestic factors. Georgia joined the WTO in 2000, the first among the three countries, and made the greatest progress in trade liberalisation, far beyond the requirements of the organization. The liberalisation trend will be reversed to some extent if Georgia signs a Deep and Comprehensive Free Trade Agreement with the EU. The agreement makes provision for stricter regulation in the spheres of technical regulations, sanitary and phyto-sanitary measures. Ukraine has also been a member of the WTO since 2008, but liberalised its trade to a lesser extent than Georgia. As a result of cooperation with the WTO and the EU, Ukraine abolished a lot of subsidies, reformed the system of technical regulation, and improved protection of intellectual property rights. Reforms are expected to go much further if Ukraine signs a DCFTA with the EU. The agreement envisages the approximation of Ukraine's TBT/SPS regulation to EU standards, advanced reforms in the spheres of public procurement, state aid, competition policy, among other changes. Azerbaijan applied for WTO membership in 1997, and the negotiations are still on going. The cooperation between Azerbaijan and the EU has been based on the Partnership and Cooperation Agreement effective since 1999, and Baku is also part of the EU's European Neighbourhood Policy. The WTO accession negotiations and the cooperation with the EU have contributed to reforms in the areas of customs valuation, rules of origin, SPS and TBT policy, public procurement, and subsidies. Azerbaijan expects to start negotiations on a DCFTA with the EU, which will make further push for reforms.

The effects of reforms and comparative analysis of performances of three countries were based on three relevant indices (Doing Business, Economic Freedom Indexes, World Competiveness Index, and Bertelsmann Transformation Index). International rankings and indicesenable comparisons of different countries' performances in economic, social, political, and other sectors. According to the Doing Business report, Georgia performs fairly well, not only in comparison with Azerbaijan and Ukraine but also globally. In this index, starting businesses, cross border trade, access to electricity and other indicators are considered. Georgia also has the highest position in the Economic Freedom Index. While Georgia is ranked 21st in the world, Azerbaijan and Ukraine are placed 88th and 161st respectively. Corruption, fiscal, monetary, labour, business, and investment freedoms, along with government spending, are major indicators considered by the Heritage Foundation. The Global Competitiveness Report looks for institutional, infrastructural, macroeconomic, and efficiency conditions in different markets. Compared with Georgia and Ukraine, Azerbaijan performs best. According to the Bertelsmann Transformation Index (Economic Transformation) Ukraine, Azerbaijan and Georgia do not differ significantly from one another. Levels of socioeconomic development, welfare regime, and stability are the main concerns.

BACKGROUND

Azerbaijan

After declaring its independence from the Soviet Union, the structure of Azerbaijan economy shifted from a centralized managerial type to a free market economy. The current economic situation shows that economic growth mainly is driven by the oil sector. In 1994, Azerbaijan signed a major oil contract, the so-called "Contract of the Century", with leading global oil companies. Thus, Azerbaijan became an oil-producing country, and the oil industry places a key role in the country's economy. Between 1996 and 2006 in particular, oil extraction amounted over half of Azerbaijan's GDP. According to the State Statistical Committee, between 1996-2004, the average annual growth rate for GDP was around 8.25%, and during 2005-2008, 28.63% growth was observed. In 2006, the growth rate of GDP was 34.5%. In the same year, the growth rate of non-oil GDP was 11.7%. However, after 2008, this rapid growth was replaced by declines. Although growth remains positive, it is declining year by year. In 2012, GDP per capita was $ 7228, according to World Bank statistics).

Azerbaijan drafted and adopted its rules and legislation to attract foreign investment. Foreign investment protection and state guarantees are regulated by different laws and articles. Attracting high volumes of foreign direct investment is not only the result of a well-designed legislative system, but also the result of the country's resource wealth. Azerbaijan is one of the largest recipients of FDI in the Eastern European/South Caucasus Region. These investments were an important vehicle for the start of the country's remarkable economic boom. More than 90% of total inward FDI went to the oil sector. Although in recent years the share of FDI in the oil sector has declined, this sector remains the leader in terms of attracting FDI. In the past five years, FDI in the Azerbaijan economy has more than doubled. In 2011, the Azerbaijan economy has received around USD 13 billion FDI. However, diversification of FDI remains very low.

Free trade is a strong engine of economic growth. The EU is negotiating a non-preferential trade and investment agreement as Azerbaijan is not yet a member of the

WTO. Additionally, Azerbaijan has signed regional and bilateral trade agreements with member countries of the Economic Cooperation Organization. According to the official statistics, the volume of foreign trade turnover in 2012 was USD 33.6 billion including imports valued at USD 9.7 billion, exports of USD 23.9 billion. During 2012, Azerbaijan cooperated with 155 countries and the foreign trade balance was positive, at USD 14.3 billion. Crude oil, oil products and natural gas heavily dominate in Azerbaijan's exports, making up 92.87% of the country's total exports in 2012.

Georgia

Georgia gained independence following the dissolution of the Soviet Union in 1992. Georgia has chosen a western-oriented foreign policy, and as a result has faced two separatist conflicts in the areas of South Ossetia and Abkhazia, where separatists enjoy support from the Russian military. The collapse of the USSR provoked a serious economic crisis, as Georgia lost its traditional market for its goods as well as its regular import channels. The most important factor for the recession was the disbanding of the "cooperative connections". Industrial outputs fell to 17% of the 1989 level. The unstable political context (caused by Georgia-Russia tensions as well as the Armenia - Azerbaijan Nagorno Karabakh conflict) further complicated economic development.

In 1990, the country underwent drastic reforms to recover from these problems and to transition to anindependent market economy. Close partnerships with the EU and US, political and economic assistance from the West, sometimes channelled through international organizations, International Financial Institutions guaranteed the survival of the country and smooth development. Georgia made significant political progress during the 1990s: Tbilisi signed a PCA with the EU, which established an intuitional basis for cooperation and rapprochement; it also joined the Council of Europe and WTO. At the same time, the country launched cooperation projects with the aim of joining NATO. However, widespread corruption and weak state institutions prevented Georgia from achieving the necessary level of stability and economic development until the Rose Revolution of 2003. The following five years were very productive for the country. Major success of the post-revolution period included cleansing the institutional environment of corruption, securing an average 10% annual GDP growth, drastically increasing budgetary revenues, and consolidating fiscal discipline. Increased public safety, thanks to police reforms, and reduced regulatory and tax burdens for businesses have attracted important foreign investments to the country. President Mikhail Saakashvili was a dedicated libertarian in regard to economic policy. This led to almost full deregulation of market surveillance fields and the establishment of the "*laissez faire*" principle in all spheres of the economy.

The government adopted a minimal interventionist policy in the economy; foreign trade was liberalised to the extent that 90% of import tariffs have been suppressed. International ratings agencies started ranking Georgia higher. In particular, in 2012, Georgia was rated 21st by Economic Freedom Index and as high as 9th by the WB Doing Business. The visa regime was lifted for more than 70 countries, with very simplified procedures for the rest, even for long-term visas. The government actively invested in infrastructure development and urban reconstruction work.

But despite the impressive statistics, the country still remained poor, with GDP per capita at USD 3520 per year. Beyond institutional and business freedoms, development has been limited, as is reflected in the ratings by the Global Competitiveness Index (58th) and Bertelsmann TI (77th). The situation has given rise to social discontent, aggravated by the protests in response to human rights violations by the government. The war with Russia in 2008 and the world economic crisis have influenced national dynamics. Georgia has lost some of its investment inflows and, for stability, became dependent once again on international assistance. Difficult social conditions caused the government to deviate from its libertarian positions, little by little,and turning its focus to the distributional side and to direct important budgetary channels into social assistance programs. Since 2010, the government has implemented special supportive programs for SMEs, agricultural farms development and tourism. The lack of resources prevented economic stimulation measures and the reduction of the unemployment rate, which together damaged the credibility of the “Rose Government”.

The 2012 parliamentary elections marked the country’s first peaceful constitutional change of power. The new government, appointed by the Georgian Dream, a coalition of political parties, is continuing efforts for the Europeanization of the country. It has resumed the negotiations on Association Agreement, including arrangements for the Deep and Comprehensive FTA with the EU. It has also conducted an intensive visa dialogue with the EU, and in 2012 received Visa Liberalisation Action Plan. The new government has no intention to downgrade the cooperation ambitions and even integrative aspirations towards the West. It is also committed to the intensive development of ties with neighbouring countries, and is trying to conduct a more active interventionist policy by supporting the priority sectors of economy, and developing business-private partnership projects with the help of the specially created “Partnership Fund”. Indeed there are no signs of the consolidation of the Georgian economy, no innovative or creative policy decisions taken to open perspectives for the rapid development. It seems that the leading political force still does not have a clear vision of economic policy direction, and Georgia is still in a state of uncertainty. There are some expectations that the Presidential elections on October 2013 may provoke changes.

Ukraine

Ukraine is located at the crossroads between Europe and Asia. Ukraine is the second largest country in Europe by land area (603,500 sq. km) and the seventh largest by population (45.6 million as of January 1, 2013). In 1990's Ukraine's economy experienced a deeper recession than most other transition economies. Real GDP plummeted by 59.2% in 1991-1999. Economic growth resumed only in 2000. GDP increased by 6.9% per year on average in 2000-2008, driven by strong external demand and an increase in household consumption. The global financial crisis led to a sharp decline in GDP in 2009 (by 14.8%), and the subsequent economic recovery was weak (3.1% on average in 2010-2012) because of a lack of political will to implement structural reforms and to achieve fiscal consolidation. In 2012, nominal GDP in Ukraine was USD 3,877 per capita, GDP by purchasing power parity — USD 7,374 per capita. Ukraine is an open economy with a large volume of foreign trade. In 2001-2012, trade in goods and services ranged from 95% to 120% of GDP. As a result of the crisis the average volume of exports declined from 53.5% of GDP in 2001-2007 to 49.9% of GDP in 2008-2012. The share of imports increased to 55.3% of GDP in 2008-2012 on average, while in 2001-2007 it averaged 52.3% of GDP.

Ukraine's main trade partners are the CIS (chiefly Russia) and the EU. The share of trade in goods with the CIS countries decreased during the 1990's and the early 2000's (it was 57.3% in 1996, and 37.8% in 2003), but has increased in recent years (38.9% in 2012). The increase was due, to a large extent, to growing prices for energy products, which are the main imports from the CIS. By contrast, the share of trade in goods with the EU grew in the 1990's (it was 25.0% in 1996, and 36.0% in 2003), but declined later (28.2% in 2012). Ukraine diversified its trade as the share of the other countries increased (from 17.7% in 1996 to 26.2% in 2003, and to 32.8% in 2012). Ukraine exports primarily semi-finished products (steel, chemicals), food (grain, vegetable oil) and equipment (rail wagons, industrial equipment). The country imports mainly fuels and high value added products (industrial equipment and consumer goods). The country is open to inflow of foreign capital, but investments abroad are restricted. As of the end of 2012, Ukraine's inward FDI stock was USD 72.8 billion, while the outward FDI stock was USD 9.4 billion. 31.7% of FDI came into Ukraine from Cypriot companies. The list of the five largest investors also includes Germany (11.6%), the Netherlands (9.5%), Russia (7.0%), and Austria (6.2%). Ukraine is encircled with significant and non-symmetrical visa barriers. Ukraine citizens can travel visa-free to 43 countries of the world (mostly to developing states). Ukraine grants visa-free access to 62 countries, mostly developed ones and the members of the CIS.Ukraine has been a member of the World Trade Organization since 2008. The cooperation between Ukraine and the EU is based on a Partnership and Cooperation Agreement, signed in 1994 and in force since 1998, the EU-Ukraine European Neighbourhood Policy Action Plan (2005), and the EU-Ukraine Association Agenda (2009). In 2008, Ukraine and the EU launched official negotiations on a Deep and Comprehensive Free Trade Agreement (DCFTA). The completion of the negotiations was announced in October 2011. The DCFTA, which is a part of the EU-Ukraine Association Agreement, is expected to be signed in November 2013 (though the chances of signature of the agreement depend on political circumstances). In 2010, Ukraine and the EU agreed an Action Plan on Visa Liberalisation.

CHAPTER I. FREE TRADE

Free trade is a strong engine of economic growth**.** Free trade as a concept also requires policy reforms toward the reduction of tariffs and for quantitative restrictions for efficacious trade liberalisation. Nations are getting to be convinced to have trade liberalisation as a result of a series of rounds of trade policy reforms addressed primarily toward the reduction of tariffs and of quantitative restrictions. Given the interrelation and interdependence between trade and economic growth, high dependence on crude oil also can lead to the discretions in economic growth of country. According to a 2012 UN trade report, "commodity price volatility is one of the reasons why commodity-dependent economies have lower long-term average growth rates than economies with diversified production structures"[1]. Unfortunately, among the countries oil-gas, minerals and mining products make up the dominant share of their exports, there has been a trend toward the increased use of protective trade measures of a discretionary character. This tendency has accelerated in recent years.

1.1. Trend and data analysis

Azerbaijan

According to official statistics for 2012, the volume of foreign trade turnover was USD 33.6 billion, with imports at USD 9.7 billion and exports at USD 23.9 billion. During 2012, Azerbaijan cooperated with 155 countries and the foreign trade balance was positive, at USD 14.3 billion.[2]

The non-state sector, including the private sector and individuals, accounted for only 6% of total export volume in 2012. In the same year, the private sector generated more than 80% of Azerbaijan's GDP, but was only able to export 3-4% of produced commodities

[1] Trade and development report, 1981–2011: three decades of thinking development, UNCTAD, 2012

[2] http://economy.gov.az/index.php/en/international/foreign-trade/2012-ft/98-international-relations/foreign-trade/2012/496-xt2012

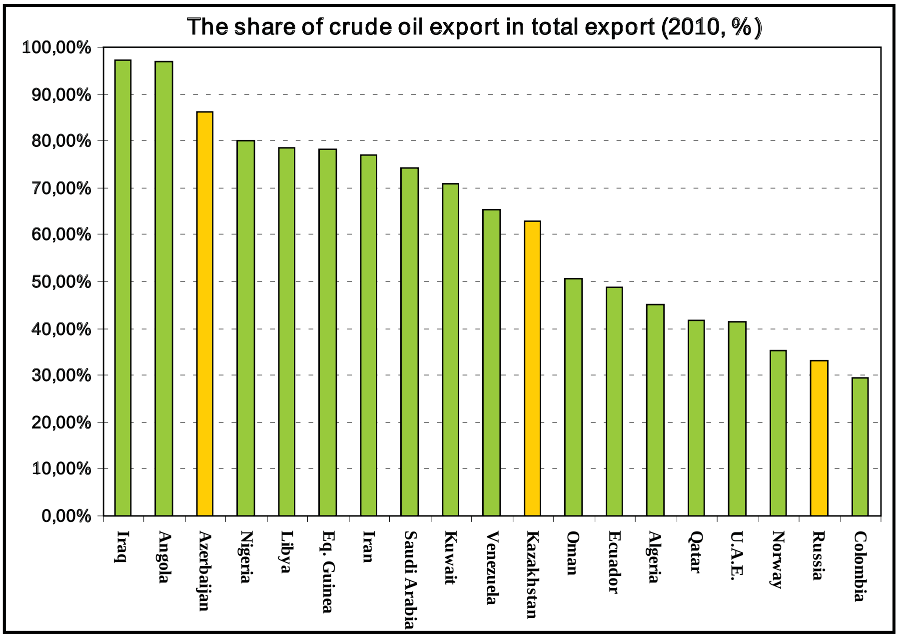
and services. This demonstrates that the *private sector* has not yet established itself as a key player in the economic sphere. Azerbaijan has very high commodity and country concentration in foreign trade, especially in export operations. Crude oil, oil products and natural gas heavily dominate Azerbaijan's exports, making up 92.87% of total exports in 2012. The lack of export diversification is one of the main challenges for Azerbaijan's economy. In a survey conducted for 'Aid for Trade at a Glance 2009 - Maintaining Momentum' (OECD/WTO, 2009), "the country identified three major binding constraints: trade policy analysis, negotiation and implementation; network infrastructure; and export diversification".

Table 1: Export basket of Azerbaijan

Leading products exported based on average 2010-2011 values SITC Revision 3 (3-digit level) / Principaux produits exportés d'après la moyenne des valeurs de 2010-2011 CTCI révision 3 (positions à 3 chiffres)	2010-2011			
	Value (f.o.b., thousands of dollars) / Valeur (f.a.b., milliers de dollars)	As percentage / En pourcentage		
		of country total / du total du pays	of "" (1) / des "" (1)	of world / du monde
Azerbaijan - Azerbaïdjan (""=Transition) (2)				
All commodity groups	30 485 450	100.0	4.37	0.18
333 Crude petroleum & bituminous oil	27 016 394	88.6	12.08	1.90
334 Heavy petroleum & bituminous oil	1 162 347	3.8	1.16	0.14
343 Natural gas, liquefied or not	376 878	1.2	1.14	0.15
061 Sugar, mollasses and honey	180 090	0.6	16.52	0.43
057 Fruit nut (exc oil), fresh or dried	130 796	0.4	8.04	0.16
793 Ships boats floating structures	111 962	0.4	3.67	0.06
571 Primary form ethylene polymers	79 113	0.3	6.97	0.11
344 Petroleum and hydrocarbon gas nes	75 012	0.2	10.49	0.52
672 Ingots, Iron steel primary products	69 197	0.2	0.47	0.17
897 Jewellery nes (667)	67 730	0.2	42.49	0.07
Remainder	1 215 932	4.0		

Source: UNCTAD Handbook of Statistics 2012

Chart 1. Crude oil exports as a share of total exports, 2010



Source: UN Trade Statistics 2011

Export diversification refers to policies designed to change the shares of commodities in the existing export mix, to introduce new products in the export portfolio, or to break into new geographical markets. Entering new markets requires both the capacity to produce new products, and the application of innovative solutions. Also, higher oil prices have boosted the current account surplus, although the non-oil trade balance continues to deteriorate. In addition, Azerbaijan's foreign trade was affected by the exchange rate regime created by the Central Bank. From the start of 2011 the Central Bank has kept the national currency (AZN or manat) pegged to the USD. It is assumed that this presented a shift from a managed float against a basket of the dollar and the Euro, reflecting the rising importance of the oil sector – whose main outputs are prices in dollars - and the authorities' goal of ensuring the stability of the financial sector and attaining single digit inflation rate[3]. There are estimations about Azerbaijan's currency depreciation and trade surplus (the well-known "J-curve phenomenon; the weighted average of the production indexes of country's four major trading partners account for 70% of Azerbaijan's total trade turnover. Empirical results suggest that for 3 of 10 cases there is strong evidence that trade balance in each of those three industries improves in the long run in response to a currency devaluation[4].

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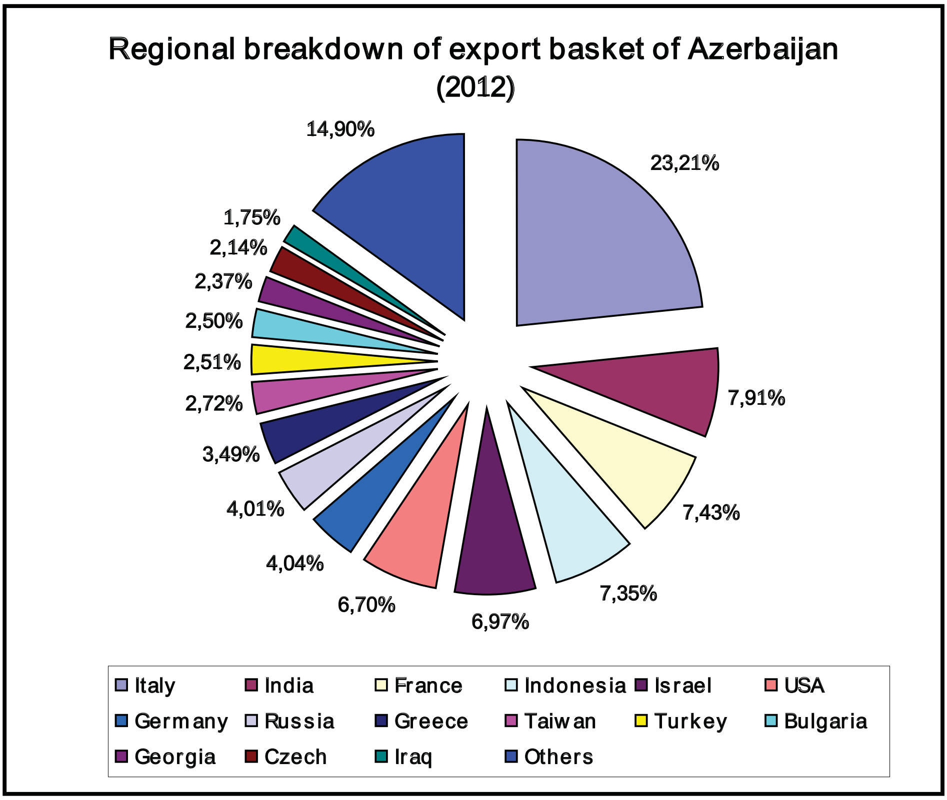
[3] "Azerbaijan: switching the drivers of growth", World Bank, Azerbaijan regular economic report, no. 1, 2012

[4] http://ideas.repec.org/p/pra/mprapa/39370.html

Chart 2. Regional breakdown Azerbaijan's export basket, 2012



Source: State Customs Committee of the Azerbaijani Republic

The EU is one of Azerbaijan's main trade partners. In 2012, the trade turnover with the EU exceeded the share of total trade by 41%, and this figure reached 43.7% in Q1 of 2013. The trio of Azerbaijan's key trading partners however, changed radically in January 2013, and the current trio is Italy, Russia, and India. The top three of trade partners was Italy, Russia and France for 2012, Italy, France and Russia in 2011, Italy, Russia and France in 2010, Italy, USA and Russia in 2009, Italy, USA and Israel in 2008[5].

Georgia

Georgia is a small economy with total annual output of around USD 16 billion (2012). The share of trade in GDP is high –62.5%, due mainly to imports[6]. The dominant role of imports can be explained by a weak industrial and agricultural output. The country's

5 http://abc.az/eng/news/71942.html

6 The proportions have been calculated by the author based on the GeoStat data available at: http://www.geostat.ge/index.php?action=page&p_id=116&lang=eng

huge trade deficit[7] amounted to USD 5.5 billion, and despite significant inflow of remittances, this still causes tensions with the *current account*. Table 2, below, shows the current account deficit dynamics from 2009. The government plans to secure a downward trend in the coming years, reducing the deficit to 4.1% of GDP by 2016.

Table 2. Current account deficit projections in **Basic Data and Directions** *2013-2016*[8]

Year	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*	*2016*
Current account (% of GDP)	-10.7	-10.3	-11.7	-10.6	-9.8	-8.3	-6.4	-4.1

Source: Ministry of Finance of Georgia, 2013

To achieve this change, the Georgian government plans to boost agricultural production, tourism and industrial outputs, including through the improvement of the investment climate and support of SMEs[9]. The diversification of exports in terms of geographical destination is another important target. Approximation of trade related regulatory environment, including technical regulations and standards along with other rules affecting market access should affect the international competiveness of goods produced in Georgia. For last ten years, Georgia has shown impressive economic growth. GDP has grown due to foreign trade, which has increased more than six fold since 2003 (Table 3). In 2012 total trade volume exceeded USD 10 million, around 62% of GDP. Another characteristic of the Georgian economy is that imports exceed exports, and the country permanently faces a trade deficit.

Table 3. Dynamics of export and import of goods for last 10 years (million USD)[10]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Exp.	461	647	865	936	1,232	1,495	1,134	1,677	2,189	2,377
Imp.	1,139	1,844	2,488	3,675	5,212	6,302	4,500	5,257	7,058	7,842

Despite the fact that Georgia has diversified its trade geography, especially since 2006, when Russia introduced a politically motivated embargo on imports of Georgia's main commodities, it was still the case in 2012 that the top ten partners accounted for 66% of total Georgian trade (Table 4). Two regional groupings - CIS (32%) and EU (27%) have been the main destinations for Georgian exports. Azerbaijan is the top destination for Georgian exports above even the EU. We will try to explain the reason for this below, coupled with an analysis of Georgian exports by commodities.

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7 Ibid

8 Basic Data and Directions 2013-2106, page 7, available at: http://www.mof.ge/en/4618

9 Ibid, page 7

10 See at: http://www.geostat.ge/cms/site_images/_files/english/bop/2013/FTrade_1995-2013_eng.xls

Table 4. Top Trading Partners in 2012

	Exports		Imports		Turnover	
	Thsd. US dollars	Share in total (%)	Thsd. US dollars	Share in total (%)	Thsd. US dollars	Share in total (%)
Total	**2 377 455,0**	**100,0**	**7 842 108,9**	**100,0**	**10 219 563,9**	**100,0**
of which:						
Turkey	142 777,0	6,0	1 392 937,5	17,8	1 535 714,4	15,0
Azerbaijan	626 854,9	26,4	633 541,8	8,1	1 260 396,7	12,3
Ukraine	167 016,3	7,0	597 099,6	7,6	764 115,9	7,5
China	25 607,1	1,1	565 950,7	7,2	591 557,8	5,8
Germany	38 571,9	1,6	541 896,7	6,9	580 468,6	5,7
Russia	45 816,0	1,9	473 796,8	6,0	519 612,9	5,1
United States	226 170,9	9,5	213 156,9	2,7	439 327,8	4,3
Bulgaria	69 654,7	2,9	271 475,4	3,5	341 130,1	3,3
Armenia	260 981,6	11,0	70 405,5	0,9	331 387,0	3,2
Italy	53 330,1	2,2	270 969,3	3,5	324 299,4	3,2
Other countries	720 674,5	30,3	2 810 878,8	35,8	3 531 553,4	34,6

Source: GeoStat 2013

Georgia's exports are not very diverse. The top 10 export lines constitute 62% of total exports. The rest of the commodities constitute less than 2% of total exports. This pattern shows similarities with less developed states. For example, the top export– cars – is the result of the hidden practice of the re-export of used cars, as Georgia does not produce cars at all. This actually constitutes major part of Georgian exports to Azerbaijan, which "absorbs" used European cars in big quantities via Georgia. All other positions at the top of the list are raw materials, processed mineral resources, primary agricultural products, and some processed food and beverages. There are no practically manufactured products, or other goods produced by skilled labour.

On the other hand, Georgian imports have been well diversified. The country imports the majority of its consumed goods from more than 200 countries. The top ten commodity positions here account for 38.3% of total imports, and include petroleum and other energy products, cars, wheat, medicines/pharmaceuticals, cellular phones, machines, construction structures and various food products and manufactured goods.

Table 5. Major commodity positions by exports 2011-2012

	2011		2012	
	Thsd. US dollars	Share in total (%)	Thsd. US dollars	Share in total (%)
Total Exports	**2 189 135,8**	**100,0**	**2 377 455,0**	**100,0**
Of which:				
Motor cars	450 296,6	20,6	587 296,3	24,7
Ferro-alloys	254 910,8	11,6	260 477,6	11,0
Mineral or chemical fertilizers, nitrogenous	144 090,7	6,6	137 221,3	5,8
Gold unwrought or in semi-manufactured forms	109 890,0	5,0	87 977,3	3,7
Other nuts, fresh or dried	130 085,7	5,9	83 659,5	3,5
Undenatured ethyl alcohol, spirits, liqueurs and other spirituous beverages	67 852,1	3,1	80 026,9	3,4
Wine of fresh grapes	54 103,4	2,5	64 871,4	2,7
Waters, including natural or artificial mineral waters	47 606,6	2,2	59 340,8	2,5
Copper ores and concentrates	85 135,3	3,9	53 535,0	2,3
Wheat	6 169,2	0,3	52 062,5	2,2
Other products	838 995,3	38,3	910 986,6	38,3

Table 6. Major commodity positions by imports 2011-2012

	2011		2012	
	Thsd. US dollars	Share in total (%)	Thsd. US dollars	Share in total (%)
Total Imports	**7 057 759,7**	**100,0**	**7 842 108,9**	**100,0**
Of which:				
Petroleum and petroleum oils	910 975,5	12,9	951 041,5	12,1
Motor cars	510 545,3	7,2	662 759,3	8,5
Petroleum gases and other gaseous	236 633,1	3,4	252 668,3	3,2
Wheat	184 232,2	2,6	239 953,2	3,1
Medicaments	201 377,2	2,9	232 480,0	3,0
Telephones for cellular networks or for other wireless networks	133 661,1	1,9	118 833,4	1,5
Automatic data processing machines	75 923,0	1,1	104 546,1	1,3
Structures and parts of structures	102 059,7	1,4	92 565,4	1,2
Cigarettes	86 742,7	1,2	90 564,9	1,2
Electrical transformers	57 855,9	0,8	88 482,2	1,1
Other products	4 557 753,9	64,6	5 008 214,7	63,9

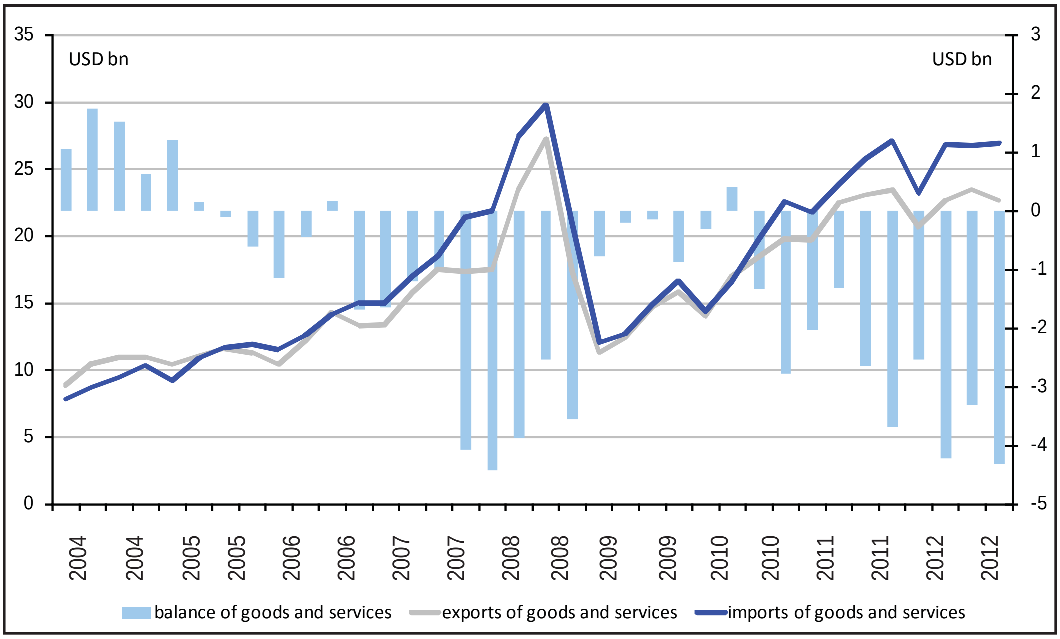
Source: GeoStat, 2013

Ukraine

Ukraine is a small open economy. Exports of goods and services accounted for 50.9% of GDP in 2012, while the share of imports of goods and services was 59.3% of GDP. Since 2006, Ukraine's imports of goods and services have been higher than its exports of goods and services, giving rise to a negative trade balance (Chart 3). In 2012, Ukraine's deficit in trade of goods and services reached USD 14.8 billion, more than 8% of its GDP. The previous peak was reached in the economic crisis in

2008, when the deficit was USD 14.4 billion. The increase in the trade deficit in 2012 has been caused by very slow growth of merchandise exports of goods at 0.6% year-on-year (yoy) and relatively higher –5.4% yoy–growth rates of merchandise imports. Export development was undermined by unfavourable global market conditions, in particular the drop in prices and demand for traditional export commodities such as metals and chemicals, while demand for imported products was stimulated by preparations for the European championship Euro-2012 that was co-hosted by Ukraine and Poland. Thus, the situation in 2012 was markedly different to the crisis in 2008-2009, when reduction in exports against the drop of global demand was accompanied by a dramatic reduction in imports.

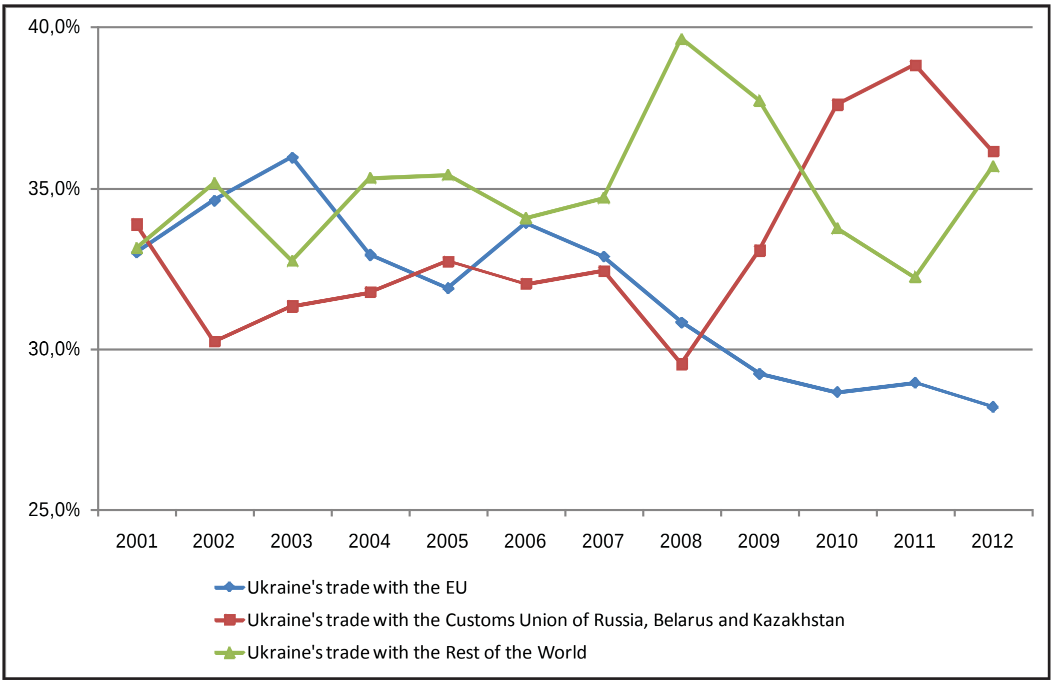
Chart 3: Trade in goods and services, 2004-2012



Source: National Bank of Ukraine

Maintaining a positive balance of service trade is an important factor for the partial balancing deficit in goods trade. However, trade in services also suffered as a result of the global economic situation, which primarily affected the exports of transport and financial services. Although Euro-2012 increased exports of services related to travel, culture and leisure activities, the volume of these services remained insignificant in the context of the overall structure and failed to compensate for the costs associated with the organization of the championship, at least in the short-term. Ukraine's largest trade partners are the EU and the Customs Unions of Russia, Belarus and Kazakhstan (RBK CU). In 2012, these two unions accounted for 64% of Ukraine's merchandise trade. The gradual decline of trade with the EU continued in 2012, mostly due to declines in Ukraine's exports, explained by the financial crisis within the EU and a lack of preferential access to this market. Trade with the Customs Unions of Russia, Belarus and Kazakhstan also declined in 2012 after several years of growth. At the same time, the share of rest of the world increased in the context of Ukraine's increased exports to Asia and Africa (Chart 4).

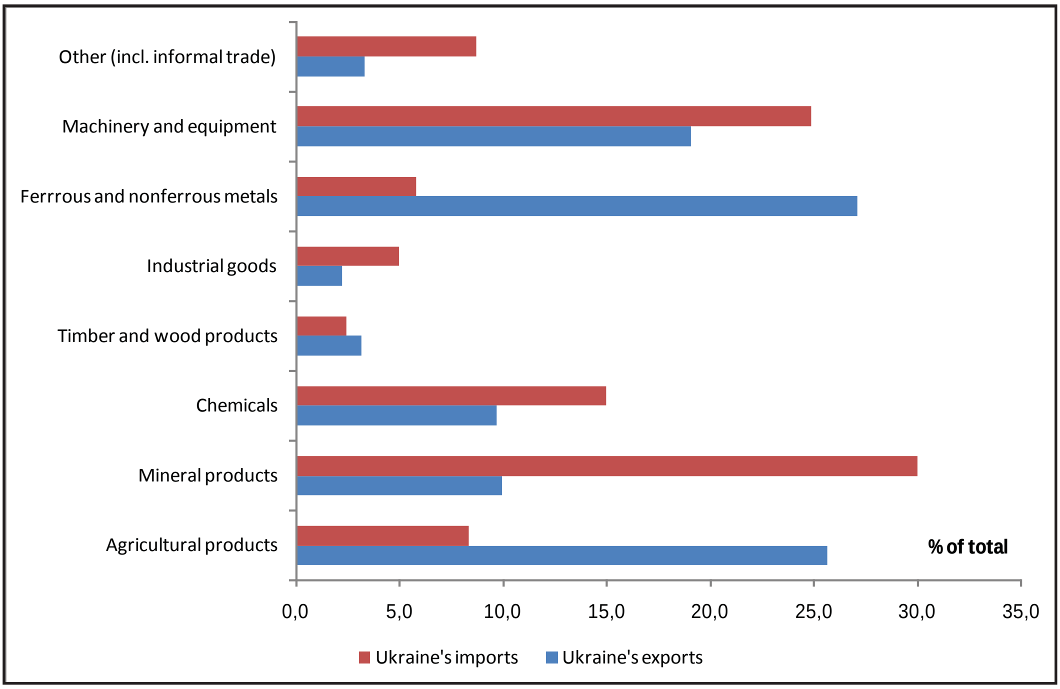
Chart 4. Geographic structure of Ukraine's trade, 2001-2012



Source: Ukrstat

In terms of individual countries, Russia is Ukraine's largest trading partner accounting for 29% of total trade. Germany, Poland and Italy are the largest European partners. In both trade with Russia and the EU, Ukraine faced a merchandise trade deficit. In 2012, the deficit was USD 10 billion in trade with Russia, and USD 9 billion in trade with the EU, while the balance of trade with Asian and African countries was positive. The major export commodities of Ukraine are metals and products thereof, agricultural products, and machinery and equipment. In 2012, these three categories accounted for 72% of Ukraine's total exports (Chart 5).The RBK CU is the largest recipient of Ukrainian exports, accounting for 31% of total exports in 2012.The EU took in 25% of Ukraine's exports, and the rest of the world 44%. To the RBK CU, Ukraine supplies capital goods and transport equipment (38% of exports to this customs territory), and other industrial foods, primarily metals. Exports to the EU consist of industrial supplies like metals and chemicals, agricultural products, and to a lesser extent, machinery and equipment. Instead, Ukraine imports mineral products that constitute about one-third of total merchandise imports. Mineral products are imported primarily from Russia; oil and gas constitute two-thirds of Ukraine's imports from this country. The next largest import category is machinery and equipment, which accounts for a quarter of total imports, and these products are purchased mostly in the EU and in other countries outside the CIS.

Chart 5. Merchandise structure of Ukraine's foreign trade, 2012



Source: National Bank of Ukraine

In 2012 Ukraine applied specific duty rates only to certain products, such as beer made from malt, wine, tobacco and tobacco products. The significant reduction in the number of specific import duty rates was achieved during the course of Ukraine's WTO membership negotiations, making the tariff schedule more transparent and predictable.

1.2. Legislation and institutions

Azerbaijan

Different legislative acts influence the regulation of trade, including laws and regulations on natural monopolies, protection of consumer rights, state support for small business, state registration of legal entities, unfair competition, antimonopoly policy and consumer rights protection, certification of the country of origin, and special economic zones[11]. Strong technical support from the European Union and the United Nations Development Program (UNDP), along with the accession process to the WTO, played a strong role in the adoption of the new Customs Code in 2011. Under the decree on the approval of the Customs Code, the government was tasked with updating 59 acts to meet the requirements of the new Code. The necessary amendments to the regulatory framework have been made. One of the most important bills to be passed is the Bill on Customs Tariff, which under consideration in parliamentary committees. Beside these, Azerbaijan has signed bilateral free trade agreements with the Russian Federation (1992), Moldova (1995), Ukraine (1995), Turkmenistan (1996), Uzbekistan (1996), Georgia (1996) and Kazakhstan (1997). Also, a free trade agreement was signed between Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and the Kyrgyz Republic in Moscow on 15 April 1994. The EU started negotiations with Moldova, Armenia and Georgia for a Deep and Comprehensive Free Trade Area as part of Association Agreements in early 2012[12]. With Azerbaijan, the EU is negotiating a non-preferential trade and investment agreement, as Azerbaijan is not yet a member of the WTO. Azerbaijan's State Commission for European Integration, which consists of representatives of relevant structures, regularly discusses the current and future state of trade and economic relations between the EU and Azerbaijan. Additionally, Azerbaijan has signed regional and bilateral trade agreements with member countries of the Economic Cooperation Organization.

The State Customs Committee is a leading player in institutional regulation of foreign trade in Azerbaijan. After the restoration of the independence of Azerbaijan, the State Customs Committee was established in 1992, January. But domestic trade has suffered from the lack of a special regulative framework, which has led to some uncertainties. The legislative body adopted Customs Code back in 1997, following which the government continued to update the regulatory framework for foreign trade relations. Another relevant state body,the Ministry of Commerce of the Republic of Azerbaijan, was established by special decree on 24 June 1997. The Ministry of Commerce regulates relations with international trade organizations and implements harmonized state policy in the field of domestic and foreign trade[13]. In 2001, the Ministry of State Property, Ministry of Economy, Ministry of Commerce, State Antimonopoly Policy and Support of Entrepreneurship Committee and the Foreign Investments Agency were dissolved and replaced by the Ministry of Economic Development

11 http://economy.gov.az/index.php/en/legislation/laws

12 http://europa.eu/rapid/press-release_MEMO-13-282_en.htm

13 http://www.e-qanun.az/files/framework/data/1/f_1779.htm

(MoED) was established on their basis. The MoED designs and implements state policy on domestic trade, foreign economic and trade contacts, on partnerships with international economic and trading institutions. It also works to ensure the efficient function of the commodity circulation system within the country[14].

Georgia

The trade regime established in Georgia is one of the most liberal in the region. Georgia joined the WTO in 2000 and subsequently granted MFN status to all member states. The country have already had set relatively law tariff rates on imported goods. The country has no restrictionson the transit of goods across its territory. The following goods are exempted from the custom tariffs: re-exports; goods in transit; imports of goods produced in Free Industrial Zones; goods for official use of diplomatic representatives in Georgia; goods intended for oil and gas operations under the Law on Oil and Gas. In addition, imported goods for export production can also obtain tariff exemptions. Georgia excludes some partner states from MFN trade (free from import duties) due to existing preferential agreements, in particular most CIS countries (Azerbaijan, Moldova, Ukraine, Uzbekistan, Kazakhstan, Turkmenistan, Russia, Armenia)[15] and Turkey. The Free Trade Agreement between Georgia and Turkey has been in force since November 2008. All industrial products are exempt from customs tariffs, with exceptions remaining for some agricultural goods. Georgia has certain quotas for wine and some other agricultural goods at the Turkish market entry point.

Georgia also benefits from the Generalised System of Preferences (GSP) scheme granted by the following countries: the EU, the USA, Japan, Canada, Switzerland and Norway. The most comprehensive and sophisticated scheme is provided by EU (GSP+), which grants free access to the EU market for more than 7200 goods. Some sensitive agricultural and processed food products remain subject to tariffs. At present, Georgia is negotiating a Deep & Comprehensive FTA with the EU. The negotiations will finish in fall 2013, and the FTA is expected to become operational from 2016. Apart from the tariff nullification, Georgia expects to gain easier access to EU markets because of the elimination of a substantial part of non-tariff barriers, as an effect of the harmonisation of Georgian regulatory norms and standards with those of the EU. Among the measures to be undertaken by the Georgian government is the introduction of technical regulations in line with EU Global directives, tightening quality control infrastructure including certification, market surveillance, conformity

[14] http://economy.gov.az/index.php/en/ministry/history

[15] Agreements In force since 1994

assessment at the EU required level. Food safety institutions and sanitary and phyto-sanitary control should also be upgraded to the appropriate level. The competition agency needs to be capable of implementing the recently adopted law on free competition, complying with EU requirements. The government procurement agency needs to further improve its performance, and the protection of intellectual rights needs to be strengthened via the enforcement of laws.

Through these various measures, the Georgian market will certainly be better protected from unsafe products, and to a certain extent, will lose its appeal to countries with poor quality and safety control bodies and legislation. At the same time, the agreement will push the country to improve and ease its customs and transportation services, as well as other trade related procedures, which should increase trade. Customs administration plays an important role in the realization of the country's trade potential. Since its accession to the WTO and the EU-Georgia PCA, the Georgian government has been under sustained pressure from international institutions, which have criticised the deficiencies of the customs institution, calling for reforms.

In 2005 and 2007, changes to the tax and customs codes respectively improved the situation. The Customs system has been incorporated into the revenue services and the total number of taxes was reduced from 27 to 6. The new code introduced clear definitions for customs, implementing provisions such as customs tariffs, classification of goods, determination of origin, and customs valuation. It also reduced the procedures (from 15 to 7) and documentation required for registration. The code allowed the suspension of the duty payment if the procedure is pending. It also introduced free customs zones and free warehouses to facilitate the procedures, and clarified definitions of customs violations. Progress reports on the ENP AP implementation, presented by the EC every year since 2007, motivated Georgian authorities to further simplify customs procedures and bring up them to EU standards. The latest changes have marked important progress in this regard: Georgia has introduced "one-stop-shop services"through Customs Clearance Economic Zones. Local Clearance Procedures, which allow the provision of clearance procedures at the company's warehouse, without bringing (leaving) the merchandise at customs, is a very important and efficient innovation. The so-called *Blue Corridor* of the risk assessment-based control and management has recently become operational. The process is based on the ASYCUDA World system for automatic risk management, which directs suspicious items to special control check points. The system is still undergoing improvements, and has not yet been implemented in a number of spheres, including for the physical control of goods at border crossing points, security checks on declared customs value of goods, and others. It should also be mentioned that the post clearance audit and control is not yet at a satisfactory level and needs further improvements, especially with regard to increasing the number of qualified and trained staff[16].

Integrated border management provides new opportunities for bordering states to increase the effectiveness of their customs procedures through effective harmonization of procedures and exchange of information. Georgia has established cooperation with the customs authorities of Turkey. Two customs offices are working on the development of the integrated management system. Agreements have been signed with Azerbaijan, Ukraine and Armenia. These agreements provide for cooperation on exchange of information, but further steps and commitments are needed to develop well-functioning integrated border management between Georgia and its neighbours.

Ukraine

Ukraine applies both import and export duties on merchandise trade. Ukraine's tariff schedule has three different rates of import duty: full rates, MFN rates, and preferential rates.[17] Ukraine also provides exemptions from import duties in accordance with signed free trade agreements (FTAs). As a WTO member, Ukraine applies the MFN rate to all goods originating from WTO Members, if there is no other rate stipulated by other international treaties signed by Ukraine. For agricultural products, the average MFN tariff rate is 9.5%, while for non-agricultural it is 3.7%.[18]Currently, the tariff rates for selected products are below bound tariff rates, providing some policy space for increase in tariff protection in the country. Ukraine has signed fourteen FTAs, including bilateral FTAs with each of the CIS countries, with Georgia and with FYR of Macedonia, and several plurilateral FTAs, with selected CIS countries and with the EFTA. Ukraine signed the FTA agreements with Azerbaijan and with Georgia, both in 1996. In 2011, Ukraine successfully completed negotiations of the establishment of a DCFTA with the EU, which constitutes an integral part of the anticipated Association Agreement between Ukraine and the EU. The DCFTA is expected to significantly improve Ukraine's access to the EU market, as currently trade operates under the MFN rates with some preferences provide by the EU in the framework of the generalized

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16 See "M.Kakulia, B.Bolkvadze& others. Implementation of ENP AP for 2012 in Georgia in Trade and Some Trade Related Areas. Assessment of Civil Society Representatives…" available at http://www.epfound.ge/files/report_final_eng.pdf

17 According to the Customs Code (2012), preferential rate is applied in case if special preferential customs regime is established according to international agreements (Article 280). But the existing Treaties don't envisage preferential rates, instead they provide for exemption from the import duties' payments.

18 See WTO data on Ukraine, 2012. http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=UA

system of preferences (GSP). Full rates are applied by Ukraine to very few countries, including Lebanon, Serbia and the Syrian Arab Republic. Import duties are levied in accordance with the Law of Ukraine "On the Customs Tariff of Ukraine".[19] Their levels are changed annually as provided for in the Article 2 of the Customs Tariff Law. Ukraine applies *ad valorem* and specific rates to imported goods. The maximum *ad valorem* rate of import duty is 50%, which is levied on sugar[20]. Due to the existence of specific rates, actual tariff protection of selected products is higher than 50%. According to the WTO, in 2011 the highest applied import duty in Ukraine was 445% for beverages and tobacco, as measured by ad valorem equivalent of specific rates. Bound zero import tariff rates are set for 12.6% of agricultural products and 33.8% of non-agricultural products. Defacto, Ukraine has applied even more zero import tariffs. According to WTO information, in 2011 Ukraine set zero tariffs for 21.2% of MFN rates for agricultural products and for 43.1% of MFN rates for non-agricultural products. Zero tariffs constitute over two-thirds of import duties for the import of fish and fish products, petroleum products, and wood and paper products.

1.3. Tariffs and non-tariff barriers

Azerbaijan

In some cases, it is more expensive for countries to trade manufactured goods with their next-door neighbours than to trade with distant countries. Research by the World Bank has revealed that the two most important factors determining "thickness of borders" (in terms of trade costs) are maritime transport connectivity and logistics performance. Thus, poorer countries tend to have higher levels of trade costs than richer countries, in both manufactured and agricultural goods[21]. This is a technical approach to cost of trade, but we also have to take into account the potential of free trade to diminish trade cost in the long run. Trade regimes, customs and trade finance are key aspects of free trade. Specializing in goods and services where countries have relatively lower opportunity costs can encourage more benefits in terms of mutual trade turnover. Free trade enables countries to specialize in those goods for which they have a comparative advantage. The existing literature defines free trade as "the importation and exportation of goods without any barriers in the form of tariffs, quotas, or other restrictions"[22]. Trade freedom is also considered as a composite

[19] The Law of Ukraine "On the Customs Tariff of Ukraine" dated April 5,2011, N 2371-III

[20] Cane or beet sugar and pure sucrose, in solid form (UCCFEA code 1701)

[21] http://blogs.worldbank.org/trade/why-is-trade-more-costly-for-poor-countries-a-new-database-gives-us-some-answers

[22] Economic Development, Michael Todaro and Stephen Smith, 11th edition, (page 570), 2012

measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The trade freedom assessment is based on two inputs: (i) Trade-weighted average tariff rate; (ii) Non-tariff barriers (NTBs). Different imports entering a country can face different tariffs. The weighted average tariff uses weights for each tariff based on the share of imports for each good. NTBs are used extensively across many goods and services and/or act to effectively impede a significant amount of international trade. Methodology of Index of Economic Freedom includes these categories of NTBs:

"Quantity restrictions - import quotas, export limitations, voluntary export restraints, import-export embargoes and bans, countertrade etc.

Price restrictions - antidumping duties, countervailing duties, border tax adjustments, variable levies/tariff rate quotas.

Regulatory restrictions – licensing, domestic content and mixing requirements, sanitary and

phyto-sanitary standards (SPSs), safety and industrial standards regulations, packaging, labelling, and trademark regulations, advertising and media regulations;

Investment restrictions - exchange and other financial controls;

Customs restrictions - advance deposit requirements, customs valuation procedures, customs classification procedures, customs clearance procedures.

Direct government intervention—subsidies and other aid, government industrial policy and regional development measures, government-financed research and other technology policies; national taxes and social insurance, competition policies, immigration policies, government procurement policies, state trading, government monopolies, and exclusive franchises". In Azerbaijan, the trade-weighted average tariff rate is 3.9%, and non-tariff barriers such as arbitrary customs administration raise the cost of trade[23].

Table 7 indicates the regional comparison on trade freedom, revealing that Azerbaijan has the highest trade-weighted average tariff rate and lowest trade freedom score in the region. In order to achieve a free and integrated trade system in the Black Sea region, countries should commit to the gradual removal of customs duties, taxes and levies which have equivalent effect and quantitative restrictions in mutual trade; elimination of other barriers to a free transfer of goods and services; creation and development of an effective system of mutual settlements and payments on trade

[23] 2013 Index of Economic Freedom, (page 483-484), The Heritage Foundation

and other transactions; coordination of trade policy with respect to other countries; coordination of economic policy to that extent to which this is necessary to achieve the regional objectives in the area of industry, agriculture, transport, finance, investment, social sphere, development of fair competition; promotion of cooperation of different branches, intra-branch and scientific technical cooperation; harmonization and unification of legislation[24]. All these conditions are applicable to Azerbaijan, which needs to make its national policies consistent.

Table 7. Regional comparison (Black Sea and Caspian Countries) on trade freedom

Country	Trade freedom score (out of 100)	Trade freedom rank (out of 177)	Trade-weighted average tariff rate
Georgia	89.2	6th	0.4%
Armenia	85.4	39th	2.3%
Turkey	85.2	41st	2.4%
Ukraine	84.4	48th	2.8%
Kazakhstan	78.2	78th	3.4%
Russia	77.4	83rd	3.8%
Azerbaijan	77.2	85th	3.9%

Source: 2013 Index of Economic Freedom, (page 483-484), The Heritage Foundation

The World Bank's Doing Business 2013 special report on Azerbaijan tried to answer the simple question: "What does it take to export or import in Azerbaijan"? According to data collected by Doing Business, "exporting a standard container of goods requires 8 documents, takes 38 days and costs $3430. Importing the same container of goods requires 10 documents, takes 38 days and costs $3490. Globally, Azerbaijan is ranked 169th of 185 economies on the ease of trading across borders. The rankings for comparator economies and the regional average ranking provide other useful information for assessing how easy it is for a business in Azerbaijan to export and import goods".

The OECD's paperadds to the literature by identifying and quantifying the severity of binding constraints to trade expansion by assessing the role of complementary policies in the impact of trade reforms on economic growth, using two case studies (Azerbaijan and Uganda) to illustrate the issue. According to that report: "for commodity exporters like Azerbaijan, general governance framework is a priority. In addition to policies related to better governance, lack of export diversification, the tariff regime and access to credit are constraints to foreign trade performance"[25].

[24] http://wits.worldbank.org/GPTAD/PDF/archive/CIS.pdf

[25] http://www.oecd.org/trade/aft/47428944.pdf

Table 8. The ease of trading across borders in Azerbaijan over time (Doing Business report year)

Indicator	DB2006	DB2007	DB2008	DB2009	DB2010	DB2011	DB2012	DB2013
Rank	..	..	..	..	..	..	169	169
Documents to export (number)	8	8	8	8	8	8	8	8
Time to export (days)	43	43	43	43	41	38	38	38
Cost to export (US$ per container)	3,155	3,155	3,155	3,515	3,420	3,420	3,345	3,430
Documents to import (number)	10	10	10	10	10	10	10	10
Time to import (days)	48	48	48	48	42	38	38	38
Cost to import (US$ per container)	2,945	2,945	2,945	3,420	3,480	3,480	3,405	3,490

Note: n.a. = not applicable (the economy was not included in *Doing Business* for that year). DB2012 rankings shown are not last year's published rankings but comparable rankings for DB2012 that capture the effects of such factors as data corrections and the addition of 2 economies (Barbados and Malta) to the sample this year.
Source: Doing Business database.

Georgia

Current legislation and mutual agreements with EU includes provisions for the elimination of tariff barriers on industrial goods, agricultural products, and services. In addition, it provides ground for substantial reduction and gradual elimination of any kind of non-tariff barriers, first of all through harmonization of regulatory norms and practices and legislation in trade related areas.

Georgia does not apply any quantitative restrictions or export duties and VAT on exports is refundable. It does not directly apply such restrictive measures as advance payment of customs duties, quantity controls (seasonal quotas), monopolies (sole importing agency), technical requirements (packaging requirement), though in certain cases the licensing and financial control (minimal import price) are applied. Together with the GATT[26] Georgia joined General Agreement on Trade in Services (GATS) and applies non-discriminative – domestic regime for foreign companies in sectors such as banking, insurance, securities, auditing, legal services, and tourism.

Accession to the TRIPS[27] obliged Georgia to build in protection of the intellectual property rights of foreign companies for industrial property, copyrights, geographical

[26] General Agreement on Trade and Tariffs

[27] Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). See at: http://en.wikipedia.org/wiki/TRIPS_Agreement

indications, and patents. Georgia also undertook these obligations through the Partnership and Cooperation Agreement with EU in 1996 (in force since 1997)[28]. Starting in 2005, Georgia voluntarily liberalised its trade regime and went beyond the WTO requirements in areas such as import licensing and duties. It has eliminated more than 80% of all import licenses and applied zero tariff rates to more than 85% of product lines. Duties for 98% of goods are calculated with *ad valorem* rates, and the average MFN rate for the remaining tariff lines amount to 7.5% (12% maximum with exclusion of tobacco at 30%). Some 130 products (basically alcoholic beverages) are subject to specific duties. There are only two tariff rates: a 5% tariff rate applied on 63 lines (mainly cheese products and vegetables) and 12%, applied to 1300 lines of products including live poultry, meat, dairy products, edible vegetables, fruits and nuts, products of the milling industry, sugar and sugar confectionary, non-alcoholic beverages and beer, salt, plastering materials, and lime and cement. More than 9300 products were made duty free after the 2005 changes.

Ukraine

Ukraine applies 15 anti-dumping measures concerning imports from 10 countries. The largest number ofanti-dumping measures applies to imports from the Russian Federation – 7 measures and to goods from China- 6 measures. The anti-dumping measures concern mostly glass products, products of chemical and wood industries, and textiles.[29] In 2012, Ukraine started to apply three *anti-dumping measures* on imports of the following products: flat float glass (thermally polished glass) originating from five countries (Russian Federation, Bulgaria, Poland, Turkey, Belarus); methanol from the Russian Federation and slate from Belarus. Also, in 2012, Ukraine initiated three anti-dumping investigations on imports of citric acid from China, medical glass from the Russian Federation, and PVC from the USA. In regards to *safeguard measures*, Ukraine has applied one measure as of the end of 2012. In 2011, Ukraine imposed a special import quota for steel pipes regardless of the country of origin for a 6-year period. In 2012 Ukraine also completed a safeguard investigation of the import of cars to Ukraine - regardless of the country of origin and export. Regarding *compensatory measures*, so far Ukraine has not conducted any anti-subsidy investigations.

Ukraine applies wide range of non-tariff measures such as licensing of foreign economic transactions, technical barriers, export restrictions, sanitary and phyto-sanitary measures and other types of state control. Below we provide short overview of main measures. Import and export licenses are required for limited number of

28 See: PCA Article 42(2)

29 See http://www.me.gov.ua/control/uk/publish/category/main?cat_id=90070

goods, including alcoholic and tobacco products, selected printing materials, ozone-destroying substances and products, optical media products etc. The list of goods that require licenses for foreign economic transactions is published annually by the Cabinet of Ministers. In 2013, the list of goods subject to *import and export licensing* includes printers' ink, paper with watermarks, optical media production inputs such as polycarbonate, equipment for the production of CDs, ozone-destroying substances and products that may contain them.[30]Additionally, there are two separate lists of goods subject to import and export licensing. Exports and imports of spirits, alcoholic beverages and tobacco products are also subject to licensing in Ukraine in accordance with the Law "On state regulation of production and circulation of ethyl, cognac and fruit spirits, alcoholic beverages and tobacco goods".[31] Officially, the objective of quantitative export restrictions is to create conditions for efficient use of state resources, and to ensure security, including energy and food security. In 2013, Ukraine applied a ban (zero quotas) on exports of gold and silver, except for bank metals, waste and scrap of precious metal or of metal clad with precious metal, and crude oil. For 2013, quotas for slag, ash and residues containing mainly copper or zinc were preserved at the 2012 level.

The quota for exports of Ukrainian natural gas has not been defined yet. It is expected to be set according to the predicted annual balance of income and distribution of natural gas, approved by the Cabinet of Ministers.[32]In Ukraine there has been a high level of administrative pressure on the grain market, especially in the area of export restrictions. In 2012, there was a high risk that export restrictions would be imposed.[33] The instability and unpredictability in the Ukrainian grain market leads to losses for grain exporters and producers and negatively influences investments in the Ukrainian agricultural sector. To increase predictability and transparency on the market and avoid export bans, a Memorandum of Understanding between the Ministry of Agrarian Policy and Food of Ukraine and grain market participants was signed on July 31, 2012, and later on the amendments regarding grain exports in the 2012/2013 marketing year were agreed. Under the amended Memorandum of Understanding, traders undertake to carry out export policy within the approved amounts of supplies,

[30] Decree of the Cabinet of Ministers of Ukraine "On approval of the lists of commodities, exports and imports of which are subject to licensing and for which quotas are set in 2013" No.1201, dated December19, 2012

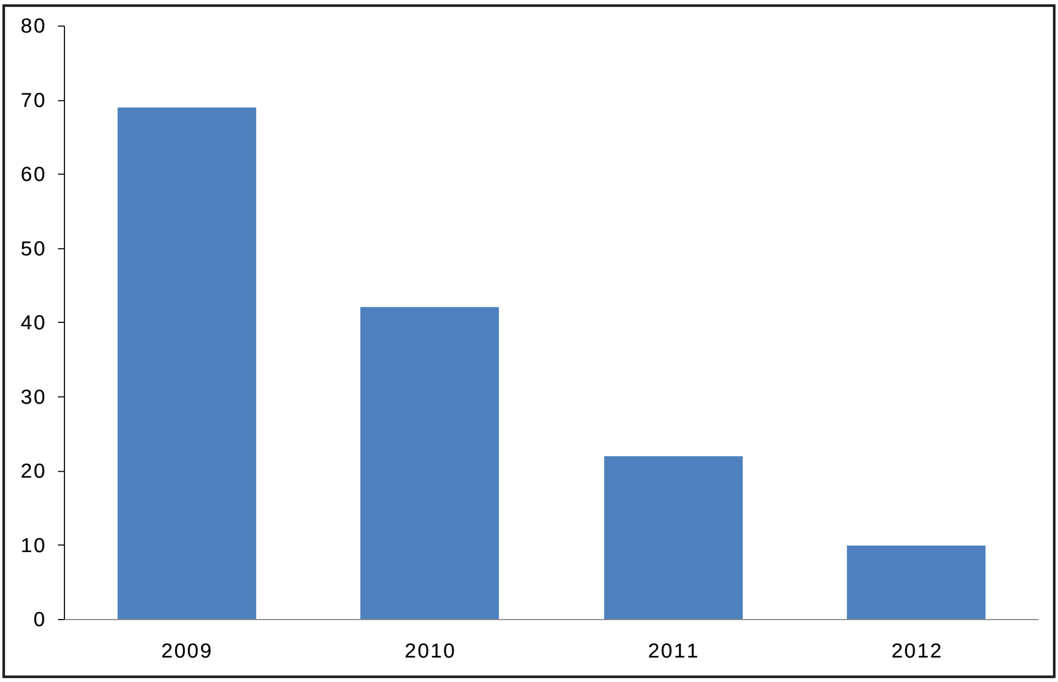
[31] The Law of Ukraine "On state regulation of production and circulation of ethyl, cognac and fruit spirits, alcoholic beverages and tobacco goods" No. 481/95-VR, dated December 19, 1995

[32] Decree of the Cabinet of Ministers of Ukraine "On approval of the lists of commodities, exports and imports of which are subject to licensing and for which quotas are set in 2013" No. 1201, dated December 19, 2012

[33] See http://www.rbc.ua/ukr/top/show/zapret-na-eksport-pshenitsy-budet-vveden-v-ukraine-s-15-noyabrya--24102012140100

while the government undertakes not to impose restrictions.[34]Mandatory certification is still required in Ukraine for certain products, despite significant progress through reforms across the technical regulation system. The list of products subject to mandatory certification in Ukraine is currently regulated by the Order of the State Committee of Ukraine for Technical Regulation and Consumer Policy dated February 1, 2005, with subsequent amendments.[35] During WTO accession negotiations, Ukraine pledged to continually review the list of products subject to mandatory certification and to reduce the number of products on this list, if the legitimate objectives could be met in a less trade-restrictive manner.

Chart 6. Volume of goods physically inspected by the State Customs Service of Ukraine, 2009-2012



Source: The State Customs Service of Ukraine (http://www.customs.gov.ua)

The Ukrainian system of technical regulation has undergone important changes. First, it is moving to mandatory compliance with technical regulations. As of April 2013, there are 43 valid technical regulations in Ukraine largely based on international standards, including EU ones.[36] Second, a practice of recognition of the supplier's declaration

[34] See http://www.epravda.com.ua/news/2012/09/5/334090/; http://minagro.gov.ua/uk/node/4235

[35] The Order of State Committee of Ukraine for technical regulations and consumer policy «On approval of the list of products subject to mandatory certification in Ukraine» dated February 1, 2005.

[36] http://www.csm.kiev.ua/index.php?option=com_content&view=article&id=111&Itemid=66

of conformity has been expanded. Third, the market surveillance system constantly monitors products' compliance with technical regulations, completeness and reliability of product information. Third, themarket surveillance system constantly monitors products' compliance with technical regulations, appropriateness of nationalmark of conformity usage, completeness and reliability of information about such products.[37] Finally, the number of goods subject to mandatory certification has been gradually reduced. The implementation of technical regulations for specific types of products will allow Ukraine to switch from the list of products subject to mandatory certification to the application of conformity assessment procedures recognized at the EU and international level. Products imported into or exported from the customs territory of Ukraine, except customs control, may be subject to radiological, ecological, sanitary-epidemiological, veterinary, phyto-sanitary controls, and/or controls over movement of cultural property. Customs clearance is completed only after the execution of all necessary product control procedures have been concluded.

In order to create favourable conditions for businesses, the new Customs Code was passed in 2012.[38]The new electronic declaration (E-declaration) procedure for goods was introduced. This is the first time that the possibility of electronic declaration using an electronic digital signature has been provided through the Customs Code.[39] According to the new Code, a customs declaration and other documents submitted to customs authorities in hard-copy format or as electronic documents have equal legal power. According to the customs authorities, in December 2012 the share of e-declarations was 60%,[40] but the full implementation of the e-declaration in Ukraine, including the electronic circulation of documents between various state authorities, may be realized within the next four to five years.[41]The new Customs Code also reduced the maximum time for customs clearance of goods was from 24 hours to four working hours. The number of required customs documents was reduced to three: a customs declaration, invoice, and declaration of customs value. According to customs statistics, in December 2012, the average time for customs clearance in the import regime was 1 hour and 39 minutes, while the average for customs clearance within the export regime was much less – 40 minutes.[42] Thus, according to official reports, the time for customs clearance

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37 See http://www.me.gov.ua/control/uk/publish/article?art_id=188046&cat_id=38231

38 The new Customs Code of Ukraine took effect on 1 June 2012

39 TOP-10 Novelties of Customs Code of Ukraine Retrieved from http://ukrainiantax.blogspot.com/2012/08/top-10-novelties-of-customs-code-of.html

40 In general, in 2012, 3.3 million of customs declarations were presented for customs clearance in Ukraine. See http://www.customs.gov.ua/dmsu/control/uk/publish/article?art_id=3794156&cat_id=295923

41 http://www.pwc.com/ua/en/publications/2013/acc_customs_code.jhtml

42 http://www.customs.gov.ua/dmsu/control/uk/publish/article?art_id=3794156&cat_id=295923

of imported and exported goods was less than half of the established maximum of 4 hours. Furthermore, the number of customs inspections was significantly reduced in Ukraine in 2012 due to the implementation of provisions of the new Customs Code on customs examination, after the results of application of the risk management system. The number of customs checks from June to December 2012 was 3.9% for all customs regimes, including 5.1% for imports, 0.8% for exports and 0.6% for transit[43].In 2012, the number of customs inspections was one-seventh of the same figure in 2009, one-fourth of the same number in 2010 and half of the same number in 2011 (Chart 4).The Customs Service of Ukraine physically inspected only 9.9% of goods in 2012 - less than the 15% benchmark level that Ukraine pledged to achieve by January 1, 2013.

Thus, the simplification of customs procedures and the reduced number of customs checks led to faster customs clearance in Ukraine in 2012. As the new Customs Code was only implemented in the second half of 2012, businesses and the international community have not yet completed the full assessment of these changes. The Doing Business 2013 World Bank survey, using the June 2012 data, still ranks Ukraine fairly low down for ease of cross-border trading. Ukraine is ranked as 145 out of 185 economies. Ukraine has export duties on certain cereals, some oil seeds, live animals, raw hides, natural gas and scrap of metals. According to Ukraine's WTO commitments, Ukraine was gradually reducing export duties on certain oil seeds by 1% annually in order to reach 10%. In 2012 this reduction was completed. A similar approach has been developed for export duties on cattle and certain other livestock since January 1, 2009. Export duties on live calves, cows and sheep are currently at 30%, and will drop to 10% in 2016. The export duty on raw hides, currently at 26%, will drop to 20% in 2018. In 2013 Ukraine completed the reductions in export duty for scrap alloy metals, non-ferrous metals, and semi finished items with such metals, and in 2014 Ukraine will fulfil its commitments on export duty for waste and scrap of ferrous metals; the export duty will be equal to 10%the next year.

Ukraine does not apply quantitative restrictions on imports of goods that are not in line with WTO rules and practices. According to its WTO commitments, Ukraine uses only one tariff quota, on raw cane sugar[44]. The quota permits the import of more than 260 thousand tons of raw cane sugar at 2 % duty. [45]The out-of-quota tariff rate is 50%. According to Ukraine's WTO commitments, in 2011 a procedure for quota distribution for imports of raw sugar cane based on the "first come, first served" principle was

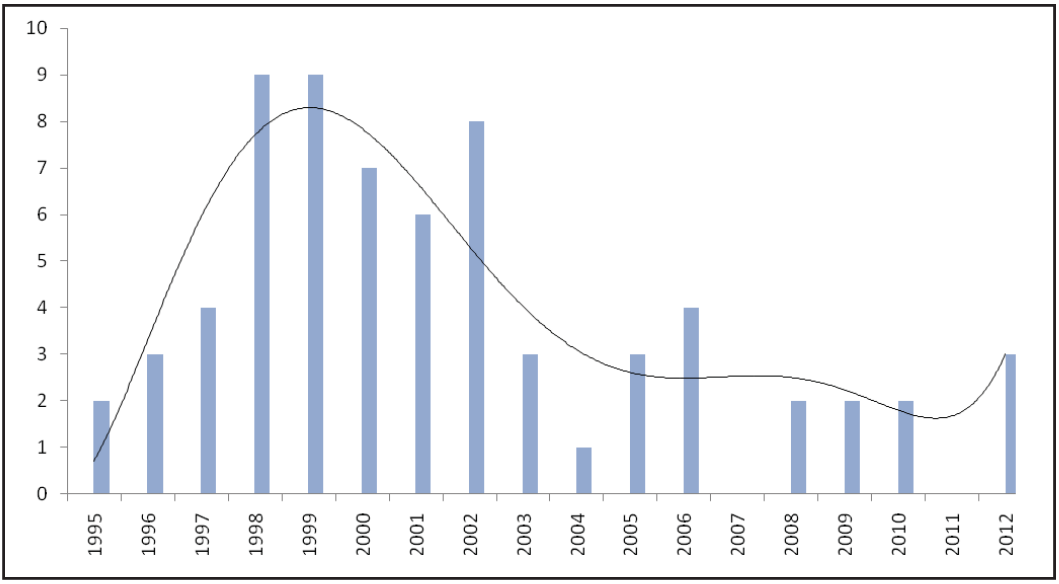
[43] http://www.customs.gov.ua/dmsu/control/uk/publish/article?art_id=3794150&cat_id=295923

[44] Initial volume of tariff quota was 260 thousand tones, while final volume of quota has been 267.8 thousand tones since 2010 (The Law of Ukraine "On the Ratification of the Protocol on the Accession of Ukraine to the World Trade Organization" 250-VI, dated April 10, 2008)

[45] The Law of Ukraine «On introduction of tariff quota for importation to Ukraine of raw cane sugar» № 404-V dated November 30, 2006.

approved.[46]In addition, the procedure for obtaining approvals from the State Reserve Agency of Ukraine and the Ministry of Agriculture and Food, which should be added by economic operators to applications for a license, was introduced. Thereafter, the mechanism of granting licenses became more complicated and subject to additional state controls.[47]Current Ukrainian legislation is in full compliance with the WTO norms on the application of antidumping, countervailing and safeguard measures. As shown in Chart 7, since 1999 there has been a significant reduction in *anti-dumping initiations* against goods from Ukraine on foreign markets, including markets of the WTO members. In general, during the period 1995-2012[48], according to the WTO data, 67 anti-dumping initiations against Ukrainian goods on foreign markets were recorded; in relation to those, 52 anti-dumping measures were implemented. The largest number of measures concerned base metals and their products (79%), and chemicals (17%). Other anti-dumping measures were imposed on mineral products (2%) and plastics (2%).

Chart 7. Number of anti-dumping initiations against Ukrainian products, 1995-2012[49]



Source: WTO, Anti-dumping initiations: by exporting country (Measures Date: 01/01/1995 to 30/06/2012); Ministry of Economic development and Trade of Ukraine, Anti-dumping initiations on Ukrainian products (2012)

46 According to Decree of the Cabinet of Ministers of Ukraine № 204 «On changes to the Order of distribution of the tariff quota for import into Ukraine of raw sugar cane» dated February 28, 2011

47 http://www.ier.com.ua/files/Projects/2011/2011_09/WTO_three_years.pdf

48 Measures Date : 01/01/1995 to 30/06/2012

49 It concerns measures and initiations applied by WTO members

Currently, there are 25 antidumping measures against Ukraine's products by WTO members and other countries[50]. Products from Ukraine's metal and chemical industries are the most affected by *anti-dumping measures*. In 2012, three anti-dumping initiations on Ukrainian products were started, including one by the European Union (welded pipes and hollow profiles) and two by Brazil (flat-rolled, tires). In relation to *safeguard (special) measures* on Ukrainian products, there have been four measures applied as of the end of 2012. Three measures have been imposed by the Customs Union of Russia, Belarus and Kazakhstan,on stainless pipes, building hardware, and caramel products. Also, one safeguard measure on confectionery was introduced by Kazakhstan in 2011[51]. Ukraine has signed fourteen FTAs that provide for its duty-free access to the market of one of its major trading partners, namely the RBK CU. Trade with the EU operates under MFN rates with some preferences provided by the EU within the framework of the GSP. The DCFTA between Ukraine and the EU is expected to significantly improve Ukraine's access to this market.

Concluding remarks on Chapter I

Azerbaijan as an energy rich and energy dependent country faces unavoidable challenge in terms of free trade and fair regulation of foreign trade. Azerbaijan's foreign trade has several key features which deserve special attention: (i) huge dependence on crude oil and other raw materials, in other words, high commodity concentration and lack of diversification of exports; (ii) high regional concentration of exports (mostly EU countries – Italy, France, also Israel) and import (Russia and Turkey) operations; (iii) monopolistic attitudes to export and import operations, promoted by non-tariff barriers of relevant regulatory agencies; (iv) unfavourable exchange rate regime which make local products more expensive in foreign markets. Azerbaijan is not yet a member of the WTO and therefore cannot sign a DCFTA with the EU. Non-tariff barriers and regulatory shortcomings in export-import operations are serious challenges for the country.

Georgia has significantly increased its trade turnover in the last ten years. Indeed, the increase in trade in goods did not serve as a driver of economic growth. FDI and International Assistance, as well as trade in services, have supposedly been major growth factors. Georgia did not manage to diversify its trade in terms of the variety of goods exported, but it did broaden the geography of its trade, especially after the 2006 Russian embargo. Given its huge trade deficit, the country needs to increase investments in the export-oriented sectors. Georgia's import duties are among the lowest in the whole region. This fact has certainly contributed to the import-oriented

50 As of January 17, 2013

51 See http://www.me.gov.ua/control/uk/publish/category/main?cat_id=90081

growth of domestic consumption. Indeed, it has not resulted in reciprocity from other partners and has not facilitated the access of Georgian goods to foreign markets. Georgia has made progress in simplifying customs clearance procedures, introducing modern systems and practices. There is still considerable progress required to increase the efficiency of customs, especially with regard to improving the quality of personnel. The EU-Georgia DCFTA, once it has been concluded and has entered into force, with the condition that Georgia harmonizes its trade related regulatory sectors with EU standards, will a play crucial role in prompting European investors to exploit Georgia's export potential. In addition to other steps taken (support for innovations, structural reforms, labour market development, etc.) this aims to substantially raise the competitiveness of Georgian goods. Improvements to integrated border management and harmonization of customs procedures with neighbouring countries will also play positive role in increasing intra/interregional trade operations involving Georgia.

Ukraine is a small open economy highly dependent on both export and imports. Its major training partners are its neighbours, namely the EU and the Customs Union of Russia, Belarus and Kazakhstan. Ukraine's trade regime is quite open. For agricultural products, the average MFN applied tariff rate is 9.5%, while for non-agricultural it is 3.7%. Moreover, 21.2% of the MFN rates for agricultural products are set at zero level, and 43.1% of MFN rates for non-agricultural products. Export duties are applied for few products, and the majority of export duties are gradually being reduced in line with Ukraine's WTO commitments. Ukraine's non-tariff barriers to trade are also being gradually reduced, as the country continues to conduct reforms in important trade-related spheres, such as technical barriers to trade and customs reform.

Foreign trade plays an important role in the economies of Azerbaijan, Georgia and Ukraine. For Azerbaijan, exports of oil and gas provide crucial sources of revenue for economic development. Azerbaijan's imports are much lower, allowing for a positive trade balance. The distinctive feature of Azerbaijan foreign trade is the high share of state trading, not found in the other two countries. Foreign trade constituted about 110% of Ukraine's GDP in 2012. Since 2006, Ukraine has been importing more goods than it has been exporting, leading to a negative trade balance. In Georgia, the share of trade in GDP has recently reached 63%, largely due to imports.

All three countries consider diversification of exports a key part of their economic strategy. Azerbaijan suffers both from high commodity concentration with oil and gas accounting for over 90% of their exports, and from significant regional concentration. For Ukraine and Georgia, commodity diversification is more important, as their exports are skewed towards semi-finished products and raw materials. Georgia offers the most liberal environment for foreign trade among the three countries, followed by Ukraine and then Azerbaijan. According to the WTO Tariff Profiles, Georgia has the lowest tariffs of the three countries. The basic average for the (MFN) tariff is 1.5% in Georgia, 4.5% in Ukraine and 9.0% in Azerbaijan, while trade weighted average import duties are 2.2%, 2.7% and 5.9%, respectively. A comparison of import tariff schedules shows that Azerbaijan applies the highest MFN applied duties for all major product categories except for beverages and tobacco products, for which Georgia has the highest duties. Ukraine applied the highest tariffs on imported sugar and confectionary. All three countries tend to apply higher tariffs for agricultural products than for non-agricultural ones. Georgia has most radically liberalised trade in non-agricultural products. The vast majority of these products (90.7% of imports) are traded duty-free under the MFN regime. The respective shares for Ukraine and Azerbaijan are 66.4% and 14.5% of national imports. Both Georgia and Ukraine are WTO members, and their tariff rates are bound. However, Georgia has retained a much higher "policy space" for increases in applied tariffs in case of economic shock compared to Ukraine. Currently Georgia applies import duties well below the bound level, while Ukraine's applied tariffs are very close to or even equal to bound rates. Neither Georgia nor Azerbaijan apply antidumping and safeguard measures. Neither country has legislation regulating these issues. Ukraine applies trade remedy measures quite intensively, and also faces measures applied towards its products in other countries, primarily in the Customs Union of Russia, Belarus and Kazakhstan, the EU, and the US.

Georgia is also a leader with regard to ease of cross-border trading, i.e. ease of fulfilling documentation requirements and procedures at customs and other regulatory agencies, as well as ease of trade logistics when exporting or importing one standard container. According to the Doing Business 2013 report, Georgia is ranked 38th among 185 economies for ease of trading across borders. Cross-border trading with Azerbaijan and Ukraine is much more difficult. Doing Business 2013 reports that Ukraine stands in 145th place among 185 economies, while Azerbaijan is 169th. Both countries have longer, more costly procedures with more documentationrequired (Table 9).

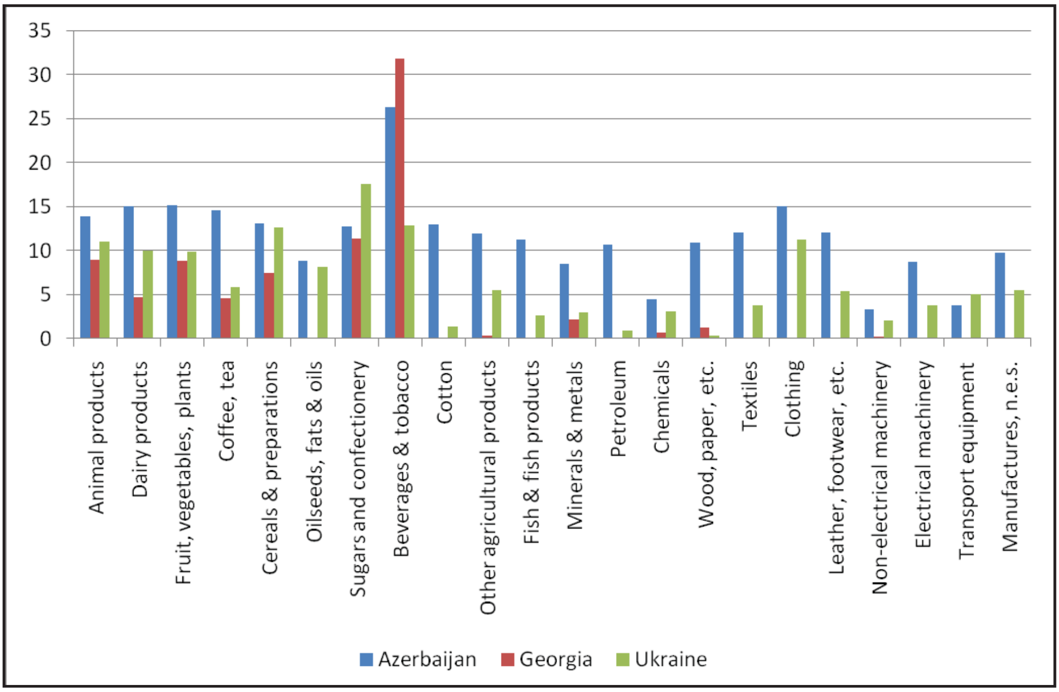
Table 9. Doing Business 2013: ease of trading across borders in Azerbaijan, Georgia and Ukraine

Indicators	Azerbaijan	Georgia	Ukraine
Rank	169	38	145
Documents to export (number)	8	4	6
Time to export (days)	38	9	30
Cost to export (USD per container)	3430	1355	1865
Documents to import (number)	10	4	8
Time to import (days)	38	10	33
Cost to import (USD per container)	3490	1595	2155

Source: *Doing Business 2013*

The relative ease of cross-border trade in Georgia can be partly explained by the adoption of the new Customs Code in 2005. The Code significantly simplified and reduced the number of procedures, introduced clear definitions for customs implementing provisions like customs valuation, rules of origin and classification of goods. Azerbaijan and Ukraine followed this pattern in 2011 and 2012 respectively with new Customs Codes. The long term success of these reforms has yet to be assessed; the survey conducted for the Doing Business 2013 report based on June 2012 data did not report any significant improvements in ease of cross-border trade for these two countries.

Chart 8. MFN applied import duties in Azerbaijan, Georgia and Ukraine



Source: *WTO Tariff Profiles 2012*

CHAPTER II.
CAPITAL FLOWS

2.1. Legal framework for investment and foreign investment

Azerbaijan

In developing countries, private investment and entrepreneurship is a common determinant of long term growth. Considering that a developing country lacks capital, it is crucial for such a country to attract foreign investments. Many economists believe that Foreign Direct Investment (FDI) is more effective than simply investing in the financial sector. It is also clear that developing countries do not have an appropriate financial market for such investments. Thus FDI might be more helpful as a type of foreign investment. There is a vast range of literature on the determinants of FDI attraction. In this study, we will not discuss each of these determinants in depth. However, we can state that the political and economic credibility of the country plays significant role in attracting FDI. In brief, if a country's institutions do not function properly, the country might struggle to attract foreign investments. In this chapter, the individual legal framework for foreign investment and investment protection in Azerbaijan, Georgia, and Ukraine will going to be analysed. There is a special law associated with foreign investments, called the Law of the Azerbaijan Republic on protecting foreign investment. The present Law determines the legal and economic principles of realization of foreign investments on the territory of the Azerbaijan Republic. The Law is aimed at the attraction and efficient use of foreign material and financial resources in the economy, modern foreign equipment and technology and managerial experience, and guarantees the rights of foreign investors[52]. According to this law, foreign investors can make investments at the territory of the Azerbaijan Republic through:

a) participation in enterprises, organizations established together with legal entities and citizens of Azerbaijan Republic on the sharing basis;

b) establishment of enterprises fully owned by foreign investors;

[52] http://www.azpromo.az/domains/azpromo/assets/file/Protection_of_Foreign_Investments.pdf

c) purchase of enterprises, proprietary complexes, buildings, structures, shares in enterprises, other shares, bonds, securities and also other property which according to legislation of the Azerbaijan Republic might belong to foreign investors;

d) acquisition of rights for use of land and other natural resources and also other proprietary rights;

e) conclusion of agreements with legal entities and citizens of the Azerbaijan Republic providing for other forms of realization of foreign investments.

Beyond this law, foreign investment activities are also regulated by other national laws and articles. The Law of the Azerbaijan Republic on Investment Activity also includes elements relating to foreign owned investments[53]. This law indicates that persons without citizenship can be investors in Azerbaijan and the protection of their investments is guaranteed by the state. Additionally, Azerbaijan has signed contracts with various countries to prevent double taxation. All barriers related to the conversion of profit into different currencies, transferring to other countries or reinvesting have been removed, and a single exchange rate was formed based on market economy principles. Currently the government is implementing an "open door" policy to attract foreign investments to the economy. Recently, the integration process of the Azerbaijan economy with the world economy has accelerated. While the volume of FDI was 9 billion USD between 1995 and 2004, in 2003-2011 this figure reached 54 billion USD - six times higher than in the previous period.

Georgia

Since independence, Georgia has sought to establish itself as a country with an attractive investment climate. The first steps in this direction were taken due to the wider international support and obligations derived from "investment protection", "avoidance of double taxation", trade and cooperation and other international agreements signed in 1990. In the same period, Georgia developed an enterprise law close to international standards, and signed a PCA with EU granting national treatment to European companies for their establishment in the country[54]. In 2004, the Georgian government started focusing on attracting investments, and the intensive reforms have quickly reduced burdens on businesses. Any kind of legal development affects the investment climate to a certain degree, and according to the significance of the impact, we can classify them into three categories.

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53 http://aic.az/pdf/investment.pdf

54 EU-Georgia PCA, Art.

- *Laws that directly the determine investment regime in the country*
- *International agreements that create additional guarantees*
- *Special acts regulating or affecting entrepreneurial activities*

Through the reforms of the past decade, Georgia has become a country with low taxes, and highly simplified procedures for opening businesses, importing and exporting goods and services. The Law on Promotion and Guarantee of Investment Activity (1996) establishes that "investment shall be fully and unconditionally protected under the legislation of Georgia"[55], allows for unlimited repatriation of profits, and for any dispute related to investors' rights and contract enforcement to be handled by an international arbitration body set up by the UNCITRAL. Aside from Georgia's WTO membership, which influences the investment climate, the country has signed agreements on Promotion and Mutual Protection of Investments. This type of agreement has been signed with 32 countries over the last two decades. The other important international agreement on Avoidance of Double Taxation and the Prevention of Fiscal Evasion has been intensively negotiated with different partners over recent years. The total number of such agreements signed reached 42, including 24 EU member states where the agreement is in force[56].

The third type of legislation affecting the investment related decision-making concerns ownership and privatization of property, along with other laws regulating economic activities that may affect the interests of foreign investors. The Law on ownership of Agricultural Land prohibits ownership of agricultural land by a private person who is not a citizen of Georgia, but it does allow ownership by a non-Georgian legal person (i.e. a company).

The Law on Licenses and Permits[57] covers 115 types of authorization issued by different governmental institutions. With the entry into force of the Law in 2005, around 1500 types of different licenses and permits were abolished, and the majority of legally permitted activities have been released from the requirement of a preliminary agreement with the state.

The Law on State Property[58]adopted in 2010 provides for transfer of state property to private ownership/management through the following means: Competitive Bidding; Auction; Lease-Redemption; Direct Sale; transfer the Right of Management of State-Owned Stocks. The law provides the right to take part in the privatization of the

[55] see at: http://www.mfa.gov.ge/files/79_9438_624394_60_69_132776_LawonInvestm.Prom.pdf

[56] see at: http://www.mof.ge/en/4794

[57] available at: http://www.economy.ge/uploads/kanonmdebloba/sagareo_vachroba/Licenses_and_Permits_Legislation_ENG.pdf

[58] available at: http://www.economy.ge/uploads/kanonmdebloba/kanoni_qonebis_shesakheb.pdf

state property for any " …physical or legal person of Georgia or any other foreign country, owner of any property, where the state share of the Georgian government or local authorities constitutes less than 25% is authorized to buy the state property sold through the direct sale method". Foreign citizens are not excluded from participating in other forms of privatization (with the exception of the above mentioned restriction on the ownership of agricultural land). A wide legal base regulates *banking activity* in Georgia. The Law on Commercial Banks establishes equal treatment for the operation of representations of foreign banks and Georgian banks, starting from the minimal reserve requirements and criteria for administrators and main shareholders. The "licenses applied for by foreign banks shall be granted only following consultations between the National Bank and the competent bank supervisory authorities of the pertinent foreign country"[59].

Table 10. Tax rates

Income	Profit	VAT	Excise	Import duty	Property
20%	15%	18%	NA*	0-12	Max 1%
Flat	Flat	Unified	Differentiated	Differentiated	Differentiated

**Excise rate is calculated on the basis of physical size of the product.*

Foreign capital/participation is freely allowed in the *insurance* business in Georgia. The Law of Georgia on Insurance Activity states that "foreign nationals, foreign legal persons, legal persons established by foreign capital, branches and subsidiaries of foreign companies can be insured by a Georgian company. Participation in extractive industries is regulated by following laws: Law on Concessions, the Law on Deposits, and the Law on Oil and Gas. According to the assessment by European Bank for Reconstruction and Development done in 2011, the Law of Georgia On the Procedure for Granting Concessions to Foreign Countries and Companies refers to the protection of rights and security guarantees, right of the concessionaire to manage its own products and profits after paying all dues and taxes, and to the obligation of the Contracting Authority to reimburse all damages suffered by the concessionaire due to "illegal acts of state organs".[60]

Intellectual property rights are also very important to investment protections in the country, and are addressed by the Civil Code and the Law on Patents and Trademarks. The legal base is sufficiently approximated to EU standards, but the implementation is still weak due to the lack of *ex-officio* powers, and preparation level of customs or

[59] Law of Georgia on Activities of Commercial Banks, Art.4, available at: http://www.nbg.gov.ge/uploads/legalacts/nbg1.4.2combanksloweng.pdf

[60] see: http://www.ebrd.com/downloads/legal/concessions/georgia.pdf

courts to deal with the cases entailing breaches of legislation. The Tax Code determines just *six types of taxes* for physical and legal persons, at the following rates:

Ukraine

The capital flow regulation in Ukraine, designed mostly during the mid-1990's, is based on two principles: (1) Ukraine is open to inflow of foreign capital and (2) investments abroad are restricted.

Table 11. The ceiling interest rate on foreign loans

Loan type	Ceiling interest rate, per annum
Convertible currencies	
Loans with fixed interest rate	
- for a term less than 1 year	9.8%
- for a term from 1 to 3 years	10%
- for a term exceeding 3 years	11%
Loans with floating interest rate	3 month USD LIBOR + 750 basis points
Other foreign currencies	20%

Note: the listed ceiling interest rates have been effective since October 2009
Source: the NBU Decree #363 dated August 3, 2004 (with amendments)
(http://zakon1.rada.gov.ua/laws/show/v0363500-04)

In general, Ukraine is open to inflow of foreign capital[61]. Companies from abroad may set up subsidiaries in Ukraine, which will be subject to basically the same regulation as domestic businesses, and invest in Ukrainian securities or bonds. Capital inflows are, however, conditional upon a number of restrictions and procedures, which are reviewed below. Different regulations apply to three types of investment: trade credits, money loans, and other investments (including equity capital, reinvested earnings, equity securities, debt securities, currency and deposits).

(a) Trade credits

Trade credits from non-residents to residents are the least regulated type of investment in Ukraine. There is no restriction on the duration of such credits.

(b) Money loans

Residents may receive foreign loans provided that the loans are registered with the NBU in advance[62]. The NBU may refuse to register a loan only if the loan agreement

[61] The regulation reviewed in this paper is as of March 2013.

[62] http://zakon4.rada.gov.ua/laws/show/z0885-04

does not meet certain requirements (discussed below) or an application is not filled in properly. Those requirements are as follows:

First, the interest rate on a foreign loan cannot exceed a ceiling set by the NBU (see Table 11). Moreover, the total payment on a loan excluding the principal, but including fines, forfeits, and penalties cannot exceed the payment based on the ceiling interest rate[63]. Second, cash loans are not allowed. Third, individuals may receive foreign loans for at least six months.

(c) Other investments

A foreign investor may set up or buy companies in Ukraine, either individually or with Ukrainian or foreign partners. An investor may also open offices and branches in Ukraine and operate through them. The list of restrictions, which may be imposed only by law or international agreement, is short:

- *Land ownership. A company with foreign capital is prohibited from owning agricultural land in Ukraine (but agricultural land trade is prohibited in Ukraine for all companies and individuals for the moment).*
- *Ownership of news agencies. A stake of a foreign company in a news agency's capital cannot exceed 35%[64].*
- *Money transfer procedures. Foreign investment may be made only in a foreign convertible currency or in the national currency of Ukraine.*
- *Investors from abroad may easily avoid the above mentioned ownership restrictions by using a string of Ukrainian subsidiaries. If a foreign investor establishes a subsidiary company in Ukraine, and that company sets up its own subsidiary, the latter is officially seen as a domestic company. Thus, it is not subject to any limitations applied to foreign investors[65].*

Privileges are granted to foreign companies only if their investments are registered with local authorities. The registration is rather a formal procedure, which takes up to 7 days. Registered investors are given the following guarantees:

- *foreign investment cannot be nationalized;*
- *it cannot be subject to requisition, except for rescue operations in cases of natural disasters, accidents, epidemics, and epizootics;*
- *investors have the right to restitution for losses from requisition and from any incorrect decisions made by officials (the restitution is to be paid promptly, with the amount to be calculated based on market prices);*

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[63] But there are exceptions: loans for financing projects that are "strategically important for the economy of Ukraine" and loans from international financial institutions.

[64] http://zakon2.rada.gov.ua/laws/show/74/95-%D0%B2%D1%80

[65] http://www.epap.ua/ukr/publications/view/oleg-boichuk-spetsialino-dlya-yuridicheskoi-gazety-podgotovil-obzor

- *investors have the right to unimpeded repatriation of profits, dividends and the investments themselves (after all due taxes are paid),*
- *if Ukraine cancels the above-mentioned guarantees, they will be still effective for 10 years from the moment when the annulment enters into force.*

There are different regulations for the four types of investment abroad: (a) trade credits, (b) investment of money, securities, and gold, including FDI and portfolio investment, but excluding loans, (c) investment in kind, and (d) loans from residents to non-residents.

(a) Trade credits

Residents may provide trade credits to non-residents. Nevertheless, the duration of such credits is limited. In general, proceeds from export sales must be transferred into Ukraine within 180 days after the goods or services are supplied (starting from the day of customs clearance in Ukraine).

(b) Investment of money, securities, and gold

If an investor intends to invest money abroad, the individual or legal person must receive at least two separate licenses from the NBU: (1) a license to invest in foreign assets and (2) a license to transfer money abroad[66]. There is a lot of red tape involved in obtaining the licenses. First, an investor has to collect and submit to the NBU a number of documents along with application forms. Second, it takes time to obtain a license. The NBU has to consider an application for licenses to invest or transfer money abroad within 25 days. Third, law enforcement bodies are involved in the licensing process in order to prevent money laundering, terrorist attacks, and other crimes. Fourth, license fees must be paid — UAH 1610-1650 (USD 203-208) if an investor is a legal entity, or UAH 170 (USD 21) the investor is an individual receives a license[67]. Fifth, an investor has to submit to the NBU a number of reports after getting the license. For example, a company that was allowed to transfer money to a foreign bank account has to supply monthly reports about the transactions on the account to the NBU. Finally, the license's duration is fairly short. The authorization to transfer money abroad is valid for at most one year, and the license to invest covers only a single transaction. The implication is that a company developing its business abroad has to go through the licensing process at least several times a year.

(c) Investment in kind

A resident of Ukraine can invest in kind to make contributions to the capital of a foreign company or to provide equipment to its offices abroad. A license from the Ministry of Economic Development and Trade of Ukraine is mandatory for such an investment[68].

[66] http://zakon1.rada.gov.ua/laws/show/15-93

[67] http://zakon4.rada.gov.ua/laws/show/z0787-03

[68] http://zakon2.rada.gov.ua/laws/show/229-96-%D0%BF

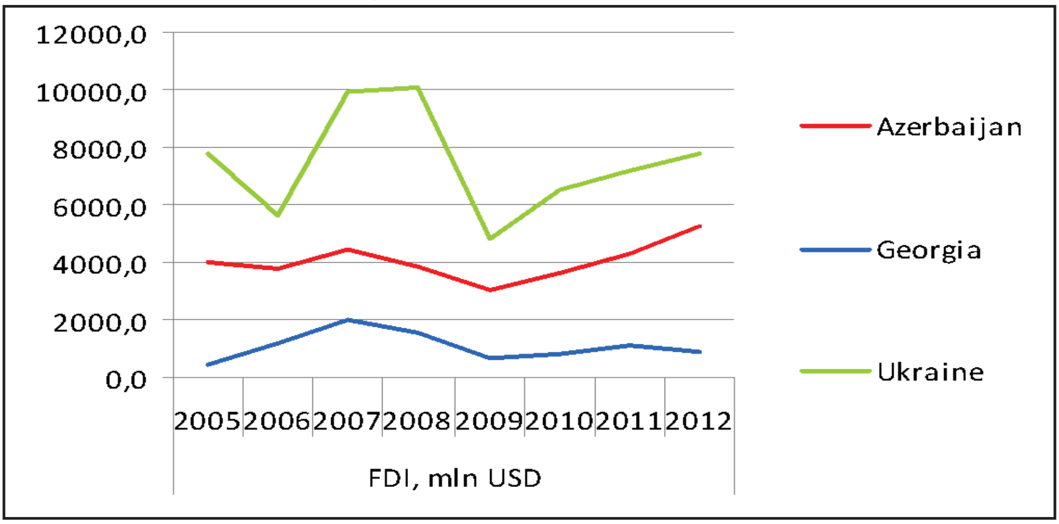
(d) Loans

Loans from residents to non-residents are allowed, but are subject to multiple restrictions[69]. First, only legal entities and individuals registered as entrepreneurs may provide loans to non-residents. Second, cash loans are prohibited. Third, a resident may not lend currency that was bought on the Interbank foreign exchange market, the only legitimate non-cash currency exchange in Ukraine, or any borrowed money. Fourth, a foreign borrower has to provide collateral, namely a guarantee of a foreign bank with a credit rating assigned by international rating agencies. Fifth, there is a lot of red tape involved in obtaining the license. The procedure is even more complicated than the one to get a license to invest abroad (a lender has to submit more documents to the NBU than an investor). The Ministry of Internal Affairs and the Security Service of Ukraine are also involved in the authorization process[70]. Finally, the licenses are issued at the full discretion of the NBU. It may refuse to issue a license if it considers a transaction as one that "does not make economic sense".

2.2 Foreign Direct Investment Dynamics

As previously mentioned, the existing legal and institutional framework is one of the main determinants of foreign capital flow.

Chart 10. Foreign Direct Investment flow in Azerbaijan, Georgia and Ukraine, Million USD



[69] http://zakon4.rada.gov.ua/laws/show/z0885-04

[70] There is an exception: banks that have a general license for operations with currencies may loan to foreign banks without going through that procedure.

Foreign Direct Investment flow will be analysed for all three countries. In this paragraph, the trends across the three countries are compared. From the Chart 10, it is seen that Ukraine is the major recipient of FDI among these countries. First, Ukraine is the biggest economy. Since its economy is bigger, it has more potential to attract FDI across more sectors and activities. In different years, countries show different trends. Ukraine experienced a sharp decrease in 2009, while in Georgia and Azerbaijan the decline was more moderate. Since 2009, FDI received by Azerbaijan and Ukraine has started to increase while in Georgia it has remained either stable or declining.

Azerbaijan

Azerbaijan has adapted its rules and legislation with the aim of attracting foreign investment. Foreign investment protection and state guarantees are regulated by different laws and articles. Attracting foreign direct investment in Azerbaijan is not only the result of a strong legislative system; thanks to its resource wealth, Azerbaijan is one of the largest recipients of FDI in the Eastern European/South Caucasus Region. These investments were an important vehicle for the start of the country's remarkable economic boom. In 1994, Azerbaijan signed the so-called Contract of the Century with leading global oil companies, and became an oil producing country. The oil industry plays a central role in the country's economic activities. Between 1996 and 2006 in particular, the oil extraction industry amounted to over half of Azerbaijan's GDP. According to the State Statistics Committee of the Republic of Azerbaijan, between 1996-2004, the average annual growth rate of GDP was around 8.25%, and during 2005-2008, growth of 28.63 % was observed. In 2006, the growth rate of GDP was 34.5 %. In the same year, the growth rate of non-oil GDP was 11.7%. However, after 2008, growth started to decline. Although growth remains positive, it is declining year by year. In 2012, GDP growth in Azerbaijan was 2.2%[71]. Azerbaijan's GDP is heavily dependent on the oil sector, and not just from oil production, but also on FDI in this sector. As the graph below illustrates, most FDI goes to the oil sector. Although in recent years, FDI in the oil sector has been declining, this sector remains the leader in terms of attracting FDI. In the past ten years (2003-2013), direct investments from EU countries in the main capital and the non-oil sector in Azerbaijan amounted to 51% and 36.5%, respectively[72].

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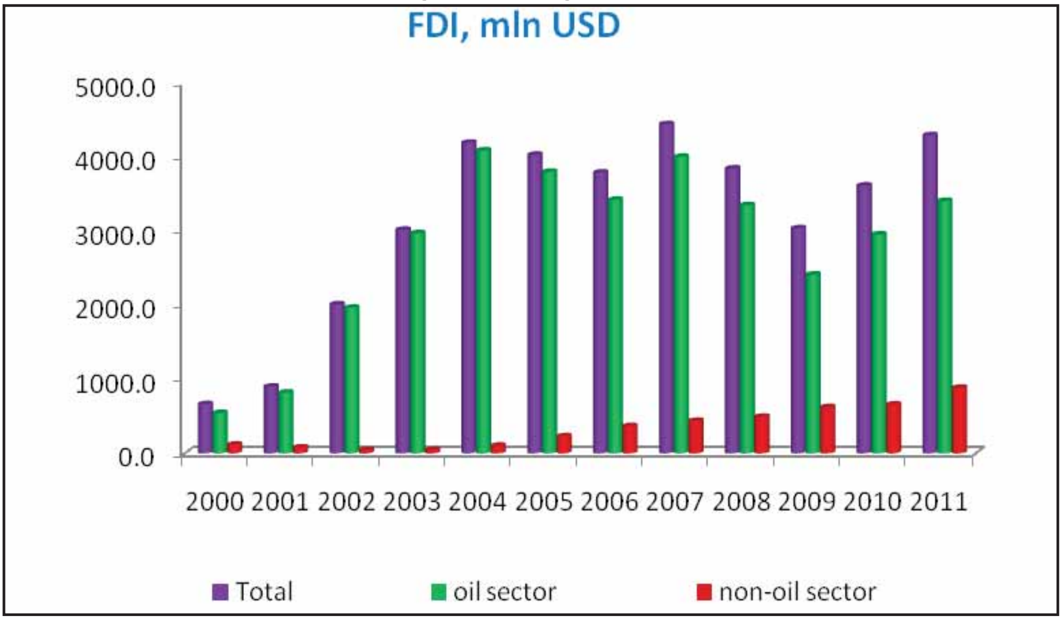
71 http://www.cbar.az/assets/2595/WEB-BULLETEN_12-2012_AZERI.pdf

72 http://en.apa.az/news/198211

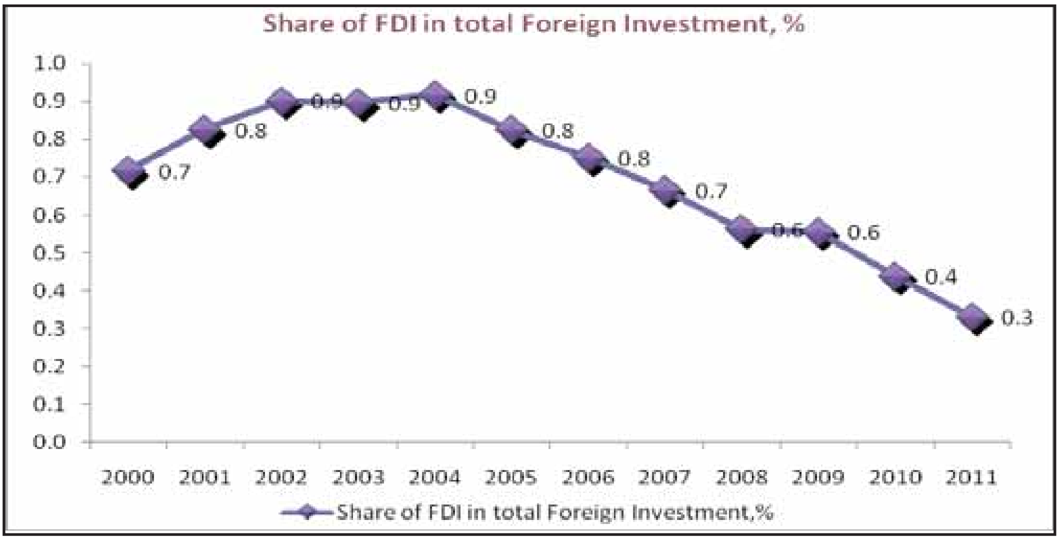
Chart 11. Azerbaijan's FDI by sectors, Million USD



Source: State Statistical Committee of the Republic of Azerbaijan

In the past five years, the volume of FDI in the Azerbaijani economy has more than doubled. In 2011, Azerbaijan economy received around 13 billion USD in FDI. However, diversification of FDI is very low. If we look at statistics, we will see that in the past ten years, on average, 90 % of FDI is in the oil sector. Before trying to establish the possible reasons for this huge disparity, we will comment on another interesting pattern.

Chart 12. Share of Azerbaijan's FDI in total Foreign Investment, %



As demonstrated by the graph above, the share of foreign direct investment in total foreign investment started to decline after 2004. While in 2004, share of FDI in total foreign investment was 90%, in 2011 it was only 30%. Possible answers to the questions "why has the non-oil sector failed to attract significant volumes of FDI", or"why is the share of FDI in total foreign investments declining year by year" will be considered. Various studies have been done by international organizations on the FDI pattern in Azerbaijan. Joint research conducted by the German Association for East European Studies, Institute for European, Russian, and Eurasian Studies the George Washington University along with other organizations claims that based on theoretical and empirical evidence, the low level of non-oil sector depends on Azerbaijan's credibility index[73]. As indicated by this research, and confirmed by various international rankings, Azerbaijan is offers weak protections for property and intellectual rights. Due to restrictions on economic freedoms and corruption, the business environment is not investor friendly. Azerbaijan is perceived as a tough dictatorial system with widespread corruption, high informal market-entry barriers, sector monopolies, and unfavourable monetary conditions[74].The Doing Business Report of the World Bank and the Index of Economic Freedom of the Heritage Foundation and Dow Jones & Company are the most famous international indices on countries' business environments and institutional issues. The Doing Business Report (DB) only focuses on the formal aspects of doing business in a country. In 2009, Azerbaijan was considered a top reformer, and jumped more than 60 positions up to the 33rd rank, but was overtaken by other reformers a year later. However, later Azerbaijan gave a weak performance, and according to DB 2013 the country's rank was 67[75]. In 2011, the Index of Economic Freedom ranked Azerbaijan 92nd worldwide (above the CIS average, but significantly below neighbouring Georgia and Armenia). This index relies on polls among businesspersons. Azerbaijan does well on measures of fiscal freedom, labour freedom and business freedom, but performs poorly in property rights, freedom from corruption (Transparency International places it 143 out of 180 countries) and monetary freedom (distortion of domestic prices).

The international indices show that investors are faced with risks relating to political and economic credibility. According to the U.S. Department of State, Azerbaijan remains a difficult place for investors to do business. Arbitrary tax and customs regulations, a weak judicial system, monopolistic regulation of the market, and corruption are all impediments. World Bank surveys also show that CIS countries

[73] June 2011, Caucasus Analytical Digest.

[74] Compare: Gerald Hübner, "As If Nothing Happened? How Azerbaijan's Economy Manages to Sail Through Stormy Weather," Caucasus Analytical Digest, No. 18 (The South Caucasus after the Global Economic Crisis), 05.07.2010, pp 8.

[75] Doing Business 2013, economic profile of Azerbaijan.

in addition to Azerbaijan have the lowest political and economic credibility when viewed in terms of world rankings. Foreign investors are not willing to invest in such a country for fear of future problems. Nonetheless, Azerbaijan does not have problems attracting foreign direct investments. Azerbaijan is one of the largest recipients of FDI in the Eastern European/South Caucasus Region. According to FDI per capita, among CIS countries Azerbaijan takes first place. The problem is that approximately 90% of FDI is in the oil sector. Almost no internationally recognized non-oil projects have been done in Azerbaijan.

This raises the question of how Azerbaijan manages to attract so much FDI to its oil sector if it also has all these credibility issues. The answer is not straightforward, but sector specification can explain few points. Compared with other sectors, the marginal cost of oil production is low, and mark-up is high. Oil companies that invest in Azerbaijan are internationally well known. These companies do not only extract oil in Azerbaijan. For transnational companies it is less costly to carry out legal or other issues in international courts and mediations. Small companies are more likely to suffer from non-transparent condition, while oil companies can set their own terms.

Market size is also an important determinant of FDI. Especially in an oil rich country like Azerbaijan, diverting FDI to non-oil sector is difficult. Foreign companies care about the size of the local market. They also take into account the opportunities to access bigger markets. The national market of Azerbaijan is small, and the country does not have access to large markets.

Beside market size, trade barriers with other countries also might discourage companies from investing in the non-oil sector of Azerbaijan. If the country is not able to enlarge the market by removing trade barriers, improving the quality of infrastructure and the ease of doing business can help to attract FDI to the non-oil sector.

Georgia

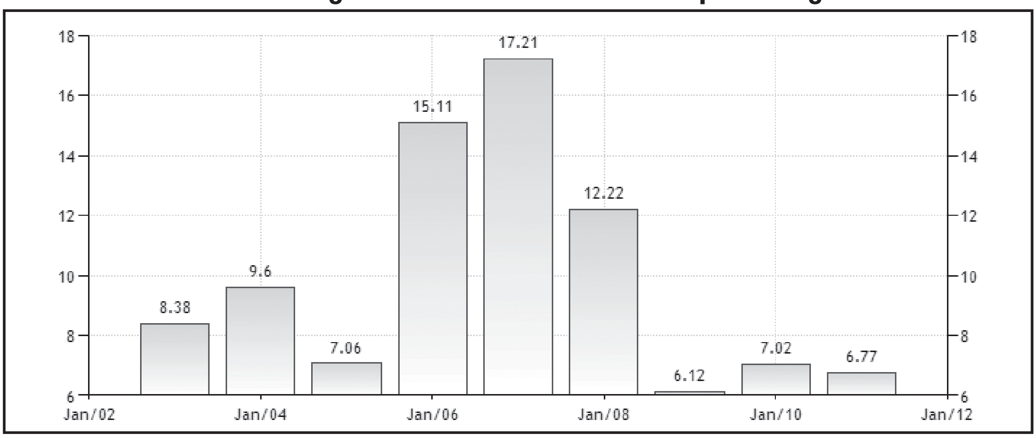
The question of whether or not net FDI is an important driver of growth is matter of debate in wider economic circles. There is no constant simple FDI elasticity of growth. A country's absorptive capacity influences acquisitions through investments of technology, know-how and other important elements needed for sustainable growth. Eduardo Borensztein and others proved in 1998 that "possible channels through which FDI may be made more effective as a minimum threshold level of absorptive capacity: well-developed domestic financial markets, institutional quality and human capital".[76] In 2006, Ivan Samson, a French economist published an article on the

[76] Borensztein, Eduardo; Jose De Gregorio and Jong-Wha Lee (1998), "How Does Foreign Direct

Georgian economic trends, where he argued that Georgia's economy had no chance to overcome strong structural difficulties without filling its huge investment gap. At that time, Georgia's gross savings were at 6% of GDP; the usual figure for developing countries is around 20-25%. Different sources show that the share of FDI in the gross capital formation in the country varies between 30-60%[77]. The most recent decade of FDI growth in the country certainly heavily influences the investment/GDP ratio and correlates with economic growth.

Foreign Direct Investment is an important factor for the Georgian economy. It makes considerable contributions to GDP growth, and moreover is absolutely crucial for maintaining monetary and financial stability. The Georgian Balance of Payment data makes this clear – the net investment inflow is one of several basic means of neutralizing the possible negative impact of a huge (20% of GDP) current account deficit[78]. Georgia has no restrictions on the flow of capital, and no limits or taxes on the repatriation of gains. Therefore, the positive net FDI investment is the result of an attractive investment climate or an important investment gap fuelling excessive demand on capital inflow, from one side, and the lack of strong domestic economic agents able to export the capital, from the other.

Chart 13. Net Foreign Direct Investments as the percentage of GDP.



Source: Trading Economics, 2013[79]

Investment Affect Economic Growth?" Journal of International Economics, 45, pp. 115–35. See at:http://s3.amazonaws.com/zanran_storage/www.wbiconpro.com/ContentPages/2559816589.pdf#page=16

77 See at: http://chartsbin.com/view/2272

78 See Georgia BOP in 2013 at http://www.nbg.gov.ge/index.php?m=306

79 http://www.tradingeconomics.com/georgia/foreign-direct-investment-net-inflows-percent-of-gdp-wb-data.html

Chart 14 shows the dynamics of investment/GDP relation in Georgia since 2002. We can observe two periods of high FDI inflows in Georgia – 2002-2004 and 2006-2008. The first period was not caused by any policy change in Georgia, but by construction of the BTC and BTE international gas pipeline[80], which became operational in 2005 and 2006 respectively. The second wave of FDI inflow was the result ofan economic policy shift: deregulation, successful anti-corruption measures, increased safety and security, and intensive privatization of state-owned assets. All these measures, together with apparent political improvements, have contributed to the country's increased credibility for investors. Graph 5 shows the FDI dynamics since 2005 in four major emerging markets. Basic trends in Georgia closely follow CIS averages (which reflect the global trend)[81]. The drastic fall of investment inflow in Georgia after 2008 may reflect the effects of both the war with Russia and beginning of the international financial crisis.

Chart 14. Net FDIs by region, Billion USD

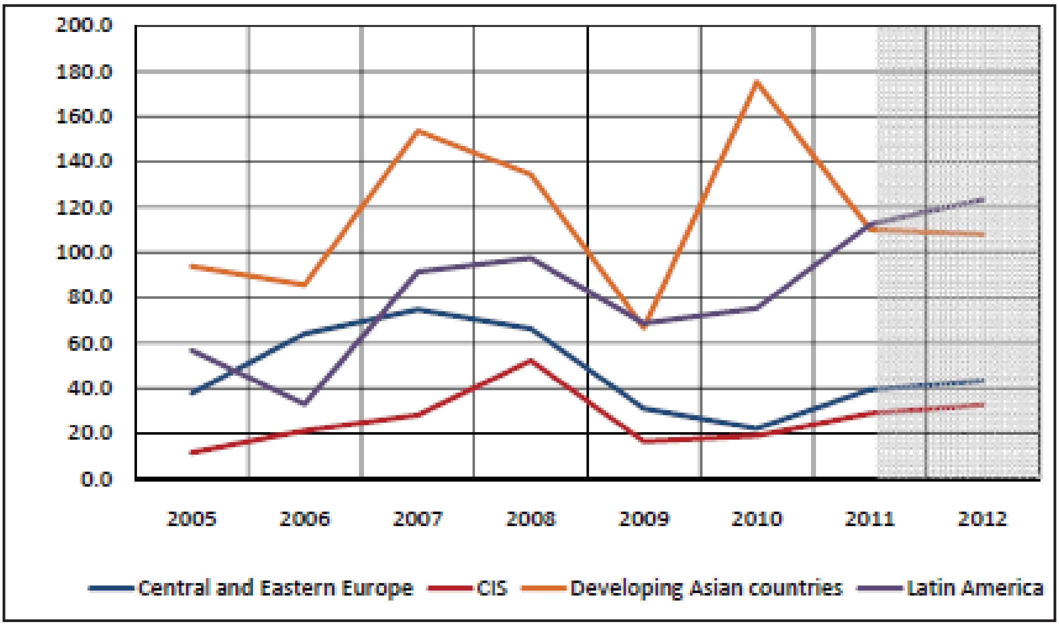


Table 11 demonstrates the sharp increase in the share of reinvestments in the last three years. We interpret this fact as an indication of long term project-based investments remaining in the country, while speculative capital leaves the country.

80 See: http://en.wikipedia.org/wiki/Shah_Deniz_gas_field

81 Georgia left CIS in September 2008, jut after the Russian aggression.

Table 11: Reinvestments in total FDI

	2006	2007	2008	2009	2010	2011	2012*
Share of reinvestments in total FDI (%)	5,4	2,4	4,9	-8,4	28,1	30,0	12,8

*Preliminary data.

Kamal A. El-Wassal (2008), following a ten-year study of developing Arab countries, argued that "very comprehensive study investment incentives programs should focus not only on FDI "quantity" but also on FDI "quality"…primary focus of domestic policy solutions…to direct FDI inflows to dynamic sectors that have a high potential for beneficial spillovers for growth, such as the manufacturing sector…"[82] According to the GEOSTAT, since 2007, transport, energy and manufacturing were, respectively, the most "invested in" sectors in Georgia. In 2012 the manufacturing sector became a major recipient of foreign direct investments.[83]The regression analysis offered by Kbitsekhlashvili (2008)[84] revealed the following relationship: "one-per cent increase in FDI leads to 0.37 percept increase in GDP. ... 85% of GDP variability is explained by changes in FDI, and 15% - by other factors[85]. Another interesting study from Faruk Gürsoy and Hüseyin Kalyoncu (2012) using the Engle-Granger (EG) co-integration test, a highly sophisticated method, confirms the GDP dependence on FDI in Georgia.[86]At the same time the test did not prove the dependence in the opposite direction, which puts into question the opinion expressed by several Georgian scientists that GDP itself attracts investments. The conclusion is that FDI positively influences the growth in Georgia, but high economic growth itself cannot guarantee higher investment inflow. Other factors should be considered, among them, removal of administrative barriers, improving labour market conditions, land reform, reduced political risks, improving infrastructure, strengthening the judiciary, etc.

Institutional measures. During the last decade, the Georgian government has made significant efforts to create a favourable climate for foreign investors. Among the major advantages are the absence of any restriction or burden on the liquidation and repatriation of investments or profits, law taxes, equal treatment of foreign and domestic investors, and easy business registration. The Georgian government has sought to introduce several advanced measures to attract more FDI. Among these is the establishment of the Georgian Investment Agency, which provides a "one-stop-shop" for procedures necessary for foreign investors. The establishment of the Free Industrial

[82] Kamal A. El-Wassal. Foreign Direct Investment and Economic Growth in Arab Countries (1970-2008): An Inquiry into Determinants of Growth Benefits.

[83] See at: http://www.geostat.ge/index.php?action=page&p_id=140&lang=eng

[84] Data used: 1997-2007

[85] Kbiltsetskhlashvili, Tea, Investment climate of Georgia after Rose Revolution: Recent improvements and new challenges, BSU Scientific Journal (IBSUSJ), p.58, 2008

[86] Gürsoy and Hüseyin Kalyoncu , International Journal of Economics and Financial Issues
Vol. 2, No. 3, 2012, pp.267-271http://www.econjournals.com/index.php/ijefi/article/view/238/pdf

(FTZ) and Touristic Zones (TZ) with special incentives for investors is another such measure. However, the existing six FTZ and TZ have not yet shown tangible results. The government is still considering whether to pass a law exempting businesses in these zones from profit taxes. They are already exempt from VAT. The establishment of the Partnership Fund attempts to attract foreign businesses through active public-private partnership (PPP) projects. Several dozen such project ideas have already been developed, and the negotiations are ongoing with different businesses. The so-called "one billion" Agricultural Fund intends to attract investment (including FDI) to rural areas based on the same principle, in addition to providing direct assistance to Georgian farmers. The establishment and high functionality of the competition agency is an important factor for the development of fair market conditions. The Georgian government has just started this process and needs to prove its dedication to success.

Ukraine

The flow of foreign direct investment into Ukraine showed different trends across 2000-2012. According to the NBU, in 2002-2004 the amount of FDI increased steadily — from USD 0.7 billion in 2002 to USD 1.7 billion in 2004, or from 1.6% to 2.6% of GDP. In 2005, FDI rocketed to USD 7.8 billion, reaching its highest value in terms of its proportion of GDP (9.5%). The jump was caused by a very large privatization deal — the world's biggest steel producer Mittal Steel (now Arcelor Mittal) bought the Kryvorizhstal steel plant for USD 4.8 billion.

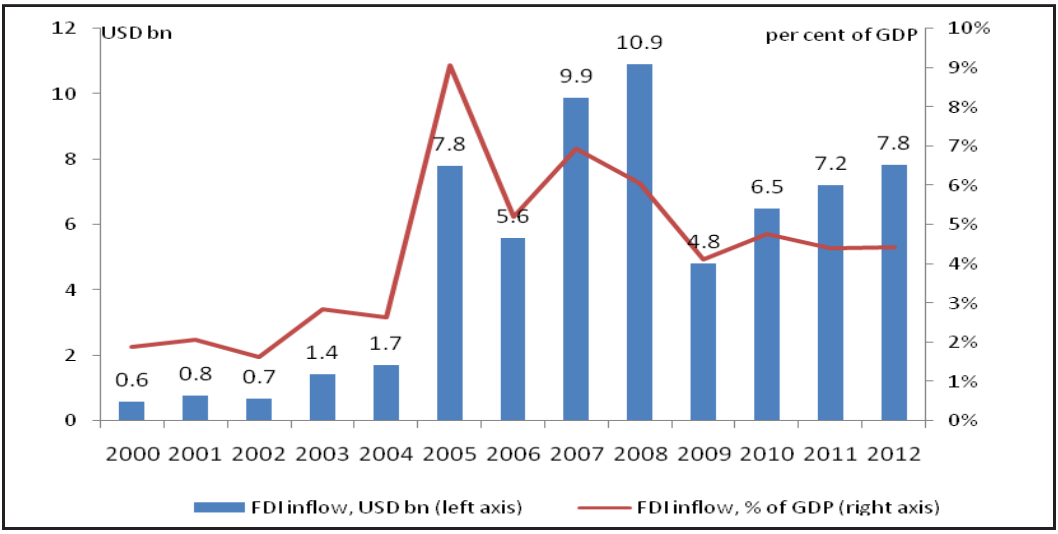
Inward investment. In 2006, the inward FDI fell to USD 5.6 billion. But in the next two years, it spiked at USD 9.9 billion and then USD 10.9 billion. The flow of capital was driven by a large investment into the financial sector. The amount of investment declined substantially in 2009 (to USD 4.8 billion, or 4.1% of GDP) as a result of the world financial crisis. It then partly recovered in 2010-2012. In 2012, the amount of FDI was USD 7.8 billion, or 4.4% of GDP. As of January 1, 2013, the total inward FDI stock was USD 72.8 billion.

The majority of investments flowed into the financial sector (28.5%), steel industry (17.3%), business services sector (14.2%), and wholesale trade (7.0%). According to the State Statistics Service of Ukraine (Ukrstat)[87], 31.7% of foreign direct investment

[87] There is a difference between the FDI statistics from the NBU and Ukrstat. This is mainly because the NBU uses a greater number of sources to calculate the amount of investment. Specifically, it uses bank reports on money transfers along with firms' reports on capital structure and investment while Ukrstat uses only the latter source. The difference however is not huge: as of January 1, 2013, the NBU figure for inward FDI stock is USD 72.8 bn; the corresponding figure from Ukrstat is USD 64.0 bn. The current paper uses the data from Ukrstat because the NBU does not disclose some of the details relating to inward and outward FDI.

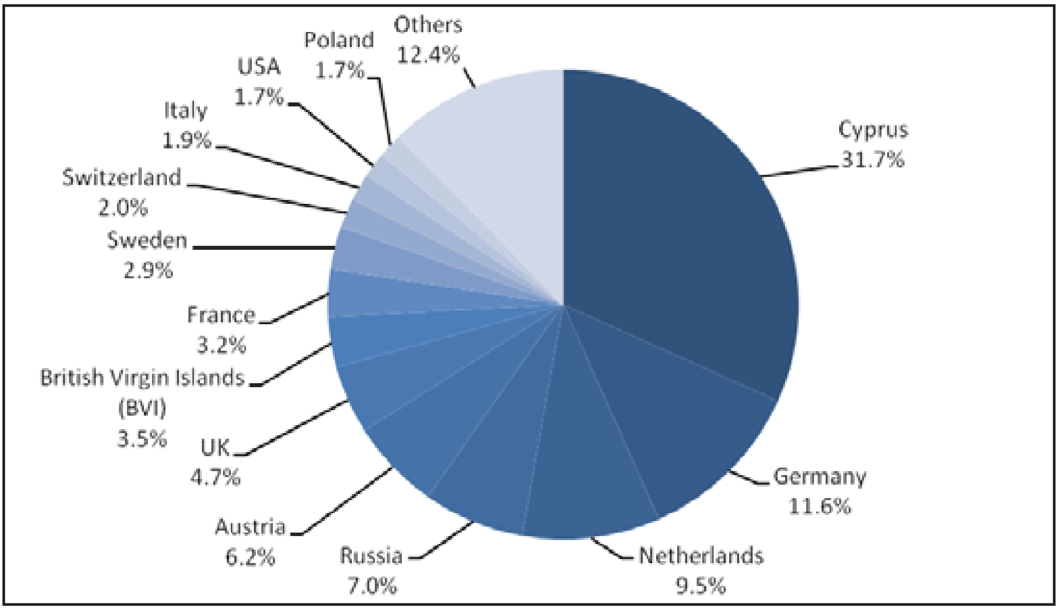
came from Cypriot companies, which invested USD 17.3 billion in Ukraine. The list of the five largest investors also includes Germany (USD 6.3 billion, or 11.6%), Netherlands (USD 5.2 billion, or 9.5%), Russia (USD 3.8 billion, or 7.0%), and Austria (USD 3.4 billion, or 6.2%).

Chart 15. Ukraine's inward FDI flows in 2000-2012



Source: the NBU

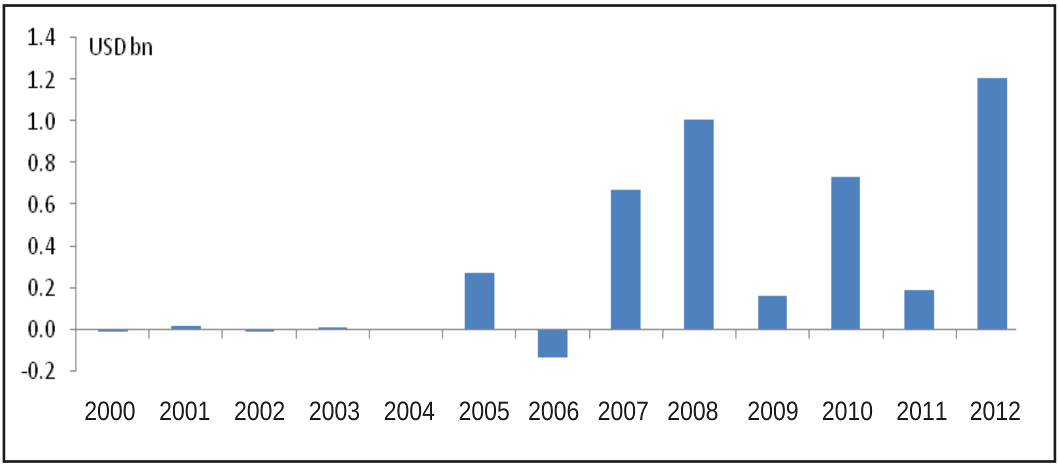
Chart 16. Ukraine's inward FDI stock by country of origin, as of December 31, 2012



Source: Ukrstat

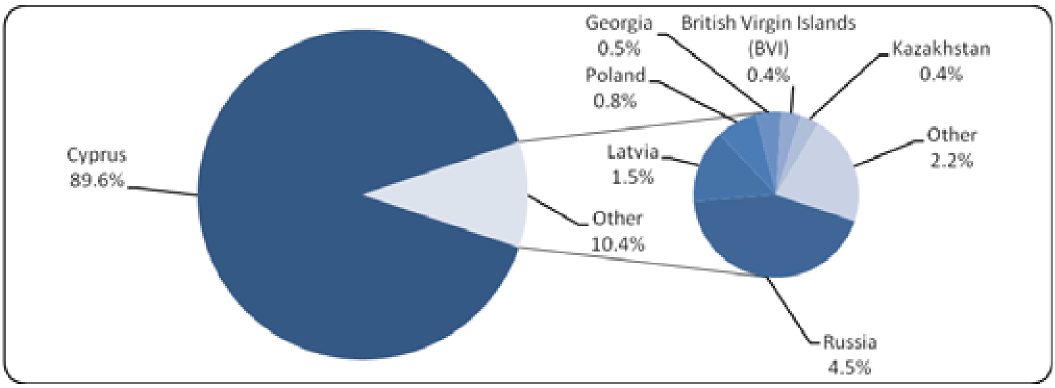
Outward investment. According to the NBU the amount of outward foreign direct investment is small compared to the inward FDI. In 2000-2004, the amount of investment flowing out of Ukraine fluctuated within the range of "minus" USD 5 million and USD 23 million. Later, investments increased substantially, but the increase was not stable (chart 17). The largest outflow of capital was in 2012 — USD 1,206 m, or 0.7% of GDP. As of January 1, 2013, the total outward FDI stock was USD 9.4 billion.

Chart 17. Ukraine's outward FDI flows in 2000-2012



Source: the NBU

Chart 18.Ukraine's outward FDI stock by country of destination, as of December 31, 2012.



Source: Ukrstat

According to Ukrstat, as of the end of 2012, 89.6% of foreign direct investment went to Cyprus (USD 5,811 m). The list of the five largest recipient countries also includes Russia (USD293 m, or 4.5%), Latvia (USD 96 m, or 1.5%), Poland (USD 54 m, or 0.8%), and Georgia (USD 33 m, or 0.5%). Most of investment was directed to the business services sector (83.1%), financial sector (10.2%), trade (3.2%), and manufacturing (2.3%).

Policy changes. The capital flow regulation in Ukraine was designed in the mid-1990's, and has undergone only slight modifications during the last decade. Policy modifications were inconsistent — some of them restricted capital flows, while the others had the opposite effect. A substantial number of changes were situational, and aimed at addressing different balance of payment problems. But in general, the regulation was only marginally liberalised. A few examples of important changes are presented below. In May 2008, after joining the World Trade Organization, Ukraine allowed branches of foreign banks to operate in the country. In June 2008, the NBU increased bank reserve requirement for loans or deposits from non-residents from 4% to 20% to prevent the inflow of "hot money" to Ukraine[88]. In December 2008, in the midst of the world financial crisis, the NBU decreased the reserve requirement for short-time loans or deposits from non-residents (with a term not exceeding 183 days) to 0%.[89] This latter amendment was revoked in September 2010[90]. In September 2008, the NBU also relaxed the requirements for obtaining foreign loans; namely it removed the ceiling interest rate on loans in convertible currency with a term not exceeding one year. But just a year later, the interest rate restrictions were restored[91]. In late 2009, the process of investment was made more burdensome for a period of time. The parliament declared the registration of foreign investment as mandatory, and made the NBU (rather than local authorities) responsible for the registration of monetary investments. In its turn the NBU increased the number of documents required for the registration, and stipulated that investors must register their investments within 30 days (earlier there had been no set time)[92]. Those changes were revoked in 2010[93]. In the 1990's, the NBU could refuse to grant a license to invest abroad based on vague "balance of payments considerations"[94]. This changed in 1999 when the list of possible grounds for denial was shortened to a set of technical reasons. But two years later the NBU decided that law enforcement bodies would be involved in the licensing process, and a negative reference from them would make getting a license impossible. That regulation was relaxed only in 2011 — the NBU decided that the opinion of law enforcement officials would be only taken into

[88] http://zakon2.rada.gov.ua/laws/show/z0617-08

[89] http://zakon2.rada.gov.ua/laws/show/v0413500-08

[90] http://zakon2.rada.gov.ua/laws/show/v0431500-10

[91] http://zakon2.rada.gov.ua/laws/show/v0294500-08
http://zakon2.rada.gov.ua/laws/show/v0614500-09

[92] http://zakon4.rada.gov.ua/laws/show/1533-17
http://zakon4.rada.gov.ua/laws/show/z0195-10

[93] http://zakon4.rada.gov.ua/laws/show/z0096-11

[94] http://zakon2.rada.gov.ua/laws/show/v3027500-93

consideration[95]. In July 2008, the NBU slightly relaxed the requirements for receiving a license to invest abroad. In particular, it reduced the number of documents that an applicant must submit, and shortened the maximum application examination period from 40 working days to 25 calendar days[96].

Concluding remarks on Chapter II

From our analysis, it can be concluded that Azerbaijan, Georgia and Ukraine are all interested in attracting FDI. To this end, they have adapted their legislation system to create better investment conditions. Various laws and regulations are in place to protect investments, including foreign investments. *Azerbaijan* has adopted various laws and regulation associated with foreign investment. Under a different set of laws, the country provides protection for foreign investment in Azerbaijan. Together the "Law of the Azerbaijan Republic on protecting foreign investment" and the "Law of the Azerbaijan Republic about Investment" establish legal and economic principles for the realization of foreign investments in Azerbaijan. Both laws aim to attract and efficiently manage foreign material and financial resources, modern foreign equipment and technology and managerial experience, and to guarantee protection of rights of foreign investors.

Azerbaijan's economy is heavily dependent on the oil sector. Indirectly it can be said that GDP growth is dependent not only oil production; it also depends on FDI in the oil sector. Data analysis shows that until 2004 the share of FDI in total foreign investment was very high. However in recent years, the share of FDI in total foreign investment has declined sharply. Data analysis also shows that the oil sector receives the vast majority of the FDI that enters the country. In 1995 and 2007, more than 90% of total FDI went to the oil sector. While in recent years while this share has started to decline, the oil sector is still leading in terms of attracting FDI.

This raises an important question: why does the non-oil sector attract less FDI than the oil sector? As a result of our investigations, we can conclude that the main impediments to attracting FDI to the non-oil sector are: the credibility of the country; its business environment; institutional issues; arbitrary tax and customs regulations, a weak judicial system, monopolistic regulation of the market and corruption, and inadequate protection of property rights. Our analysis also considers whether given these problems and obstacles, how the oil sector receives such significant injections of FDI.

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95 http://zakon2.rada.gov.ua/laws/show/z0259-99

96 http://zakon2.rada.gov.ua/laws/show/z0777-08

This research concludes that there are different requirements for attracting investors to the oil and non-oil sectors. In contrast to Azerbaijan, *Georgia* does not have an oil sector; FDI goes to its non-oil sector. Georgia has a well-developed legal framework that promotes the attraction of FDI. Georgia has a well-developed legal and institutional framework to regulate businesses and attract foreign investments, through low taxes, free movement of capital, and the annulment of small barriers and the restrictions to registering and starting the businesses. The free participation of foreign companies and citizens in any bids organized by the government with the aims of procurement, privatization, concessions, etc. is guaranteed. In previous years, the FDI flow in Georgia was determined by interest in acquisition of assets and services (transport, communications, hotels, and restaurants). The changes in investments in the manufacturing sector are expected to have a multiplier effect. Georgia's openness to international trade, WTO membership, GSP+ with the EU, and further DCFTA negotiations combine to create additional incentives for foreign investors, especially those interested in investing in export-oriented industries. The attempts to push Private Public Partnership projects can have a multiplying effect if directed in the proper fields, in particular manufacturing and agriculture.

The disincentives for foreign investors are not, for the most part, caused by administrative barriers, but by other factors, such as: security, which since the August 2008 war and its fallout has become a key challenge to economic development and investor confidence; property rights, which over the years have not been fully respected by the government; non- transparent and discriminative legal provisions relating to land ownership; human capital and a labour market ready to satisfy investors' demands. The judicial impartiality has represented a matter of special concern during recent years. The recently adopted Law on Common Courts is expected to improve the situation. The protection of intellectual rights will likely also remain a challenge in the future, because it requires important state action in the provision of tools and mechanisms for the enforcement of adopted legislation, including training of administrative staff, experts and judges.

As the above discussion has shown, there are few regulatory obstacles to the inflow of investments in *Ukraine* (mainly ownership restrictions). The main existing obstacles to inward investments are institutional: heavy regulation of business activities, weak law enforcement, and other factors that make the general business environment unfavourable. The outward investments, on the other hand, are restricted to a large extent. However, the figures of outward investment do not reflect the actual outflow of capital from Ukraine. Domestic companies use wildcat schemes to transfer capital abroad. According to the estimates of the NBU, in 2000-2011, the outflow of capital by non-official channels totalled 27.4 billion. The list of schemes includes concealment of proceedings from export sales, payments for not received import goods and services, and fictitious securities operations. Furthermore, the conventional wisdom is that a significant part of foreign direct investment to Ukraine comes from Ukrainian business people who transferred their capital abroad. That belief is consistent with some indirect evidence. Cypriot companies transferred most of their investments to Ukraine not from Cyprus, but from other countries. According to the Central Bank of Cyprus, the country's outward FDI stock to Ukraine was USD 218 million at the end of 2011[97]. At the same time, according to Ukraine's official data, incoming FDI from Cyprus reached USD 12.7 billion, far exceeding the amount reported by the Central Bank of Cyprus.[98]

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97 http://www.centralbank.gov.cy/nqcontent.cfm?a_id=11128

98 http://www.ukrstat.gov.ua/

CHAPTER III. MIGRATION

3.1. Azerbaijan

3.1.1. Legal Framework/Policy

The first significant action taken regarding the regulation of cross-border movement of people in Azerbaijan after independence was the adoption of *the Law on the legal status of foreign citizens and stateless persons* on 13 March 1996.[99] Consequently, on 22 December 1998, the *Law on Immigration* was adopted by the National Assembly. This law outlines rules for the immigration quotas, required documentation for immigrants, rules on entry via foreign grants and stateless persons who have been granted immigrant status, and procedures for applying for such status.[100] *Immigrant status* in the Republic of Azerbaijan is determined by the Constitution of the Republic of Azerbaijan, in addition to the two laws noted above.

Table 12. Legal acts regulating migration in Azerbaijan

1. Law of the Republic of Azerbaijan on entry, exit and passports 14 June 1994 N 813
2. Law of the Republic of Azerbaijan on the state border of the Republic of Azerbaijan.
3. Law of the Republic of Azerbaijan on the identity card of citizens of the Republic of Azerbaijan 14 June 1994 N 817.
4. Law of the Republic of Azerbaijan on the legal status of foreigners and stateless persons. March 13, 1996 N 41-IQ
5. Law of the Republic of Azerbaijan on registration based on residence and actual address 4 April 1996 N 55-IQ
6. Law of the Republic of Azerbaijan on the citizenship of the Republic of Azerbaijan September 30, 1998 527 -IQ
7. Law of the Republic of Azerbaijan on Immigration 22 December 1998 N 592-IQ
8. Law of the Republic of Azerbaijan on labour migration. No. 724-IQ, 28 October, 1999

[99] Law of the Republic of Azerbaijan on the legal status of foreigners and stateless persons, No. 41-IQ, 13 March, 1996

[100] Law of the Republic of Azerbaijan on Immigration, No. 592-IQ, 22 December 1998,

Foreigners and stateless persons may enter Azerbaijan for the purpose of permanent or temporary residence only after obtaining immigrant status as determined by the relevant law and through the observance of relevant immigration quotas. Immigrants have the right to benefit from the rights and freedoms reserved for foreigners and stateless persons according to national legislation, and they will also be required to uphold certain responsibilities. Immigrants receive a document certifying his/her status [101]. Aside from these laws and the *Presidential Decrees* that followed (such as the *Presidential Decree No. 419* approving the procedures for considering applications for refugee status dated 13 November 2000), no other serious policy actions were taken during this period. According to the International Organization for Migration, it is only since 2001 that the Ministry of Labour and Social Protection of the Population has been issuing individual permits for employment in Azerbaijan.

Table 13. Presidential Orders and Decrees relevant to the migration policy

Presidential Decrees and Orders
National Security Concept of the Republic of Azerbaijan", Presidential Decree No. 2198, 23 May 2007
Presidential Decree No. 419, 13 November 2000
Presidential Decree on Entry-exit and registration interdepartmental automated data-retrieval system, No. 276, 4 June 2010
Presidential Decree on the application of "One Window" principle to the migration management, No. 69, 4 March 2009
Presidential Decree on the creation of a single migration information system, No. 244 22 April 2008
Presidential Decree on the Establishment of Migration Service within the Ministry of Internal Affairs No. 254, 29 June 2005
Presidential Decree on the Establishment of State Agency on Social Innovations and Services to Citizens under the Administration of the President of the Republic of Azerbaijan, No. 706, 5 September 2012
Presidential Decree on the Establishment of the State Migration Service, No. 560, 19 March 2007 set up the State Migration Service

Cross-border migration policy and government oversight during the first decade of independence was characterized by:

- *Lack of experience and knowledge of migration management and absence of directed policy on the possibility of increased flow of people both in and out of the country*

- *Lack of resources and legislature to control the cross-border migration processes*

[101] International Organization for Migration, 2008. 'Migration in the Republic of Azerbaijan: A country Profile 2008'. p. 30, Geneva

Migration Policy Reforms began in 2003 with the *State Program on Poverty Reduction and Economic Development for 2003-2005* (Table 3), approved by Presidential Decree No. 854 on 20 February 2003. The program assessed the preparatory work for the *State Migration Program for 2006-2008 of the Republic of Azerbaijan*. The *State Program on Migration* was approved by *Presidential Order No. 1575* on 25 July 2006. In the state program, the situational analysis is limited to a short paragraph and cannot be considered satisfactory. The program also fails to include indicators for short, medium and long terms, nor tools for measuring achievements of the state policy. The State Program was preceded by the *State Migration Management Policy Concept*, which the Cabinet of Ministers of Azerbaijan had approved by *Decision No. 94 on the 13th of July 2004*, following inter-ministerial consultations and the compilation work of the Unified Migration Management Commission, in cooperation with the International Organization for Migration (IOM).[102]The *State Migration Management Policy Concept* provides the basis of the migration policy of the state, clearly setting objective, principles and aims and remains the main policy document of the state.[103]The *State Migration Program for 2006 – 2008*sets out the following main objectives:

- *improvement of management mechanisms in the field of migration;*
- *improvement of national legislation to meet international norms and standards;*
- *increased efficiency of state regulation in the field of migration;*
- *coordination of the activities of relevant state bodies in the field of migration;*
- *introduction of quotas in the field of labour migration;*
- *ensuring national security and promoting sustainable socio-economic and demographic development;*
- *more effective use of the workforce and promotion of even distribution of the population throughout the country;*
- *benefiting from the intellectual and labour potential of migrants;*
- *eliminating the negative consequences of unregulated migration and preventing illegal migration and human trafficking;*
- *implementation of complex measures to prevent illegal migration;*
- *cooperation with migration services of foreign countries and international organizations*

This was followed by the approval of the *State Program on Biometric Identification System* with the *Presidential Order No. 1913, signed on 13 February 2007*. Consequently, the *Decree of the President of Azerbaijan dated 19 March 2007* set up the State Migration Service. However, earlier and with another *Presidential Decree No. 254, dated 29 June*

[102] International Organization for Migration, 2008. 'Migration in the Republic of Azerbaijan: A country Profile 2008'. p. 29, Geneva

[103] Conception of the State Migration Policy of the Republic of Azerbaijan" Decision of the Cabinet of Minister, No. 94, 13 July 2004

2005, Migration Service was created within the Ministry of Internal Affairs(MIA) and came into service on 16 May 2006; it is now called the *Chief Passport and Registration and Migration Department*. The Passport and Registration Department is a separate structural unit within the MIA[104]. Moreover, the *National Security Concept*, a document approved by the President of Azerbaijan in May 2007 indicates that "the rapid socio-economic development of Azerbaijan, the expansion of international energy and transportation communications and the geopolitical position of the country have accelerated the migration processes. This requires the adaptation of migration policy and improvement of the management of migration processes to take into account the national interests aimed at development of the country and ensuring its security."

Table 14. State Programs to support migration policies

State Programs
Conception of the State Migration Policy of the Republic of Azerbaijan" Decision of the Cabinet of Minister, No. 94, 13 July 2004
The State Program on Migration of the Republic of Azerbaijan", Presidential Order No. 1575, 25 July, 2006
The State Program on Poverty Reduction and Economic Development for 2003-2005", Presidential Decree No. 854, 20 February 2003
The State Program on Biometric Identification System of the Republic of Azerbaijan", Presidential Order No. 1913, 13 February 2007

Migration Reforms continued towards the end of the 2000s. To improve the management of the information system for the cross-border movement of people in Azerbaijan, *a single migration information system* and *Entry-exit and registration interdepartmental automated data-retrieval system* were established with the *Presidential Decrees No. 244 (22 April 2008)* and *No. 276 (4 June 2010).* The most salient step was the application of the *One Window* principle to migration management with *the Presidential Decree No. 69* on 4 March 2009. With this decree, the procedures for applying for permanent or temporary stay in the country and individual work permits were simplified for foreign citizens and stateless persons. This decree determined the main responsibilities of the State Migration Service. Many responsibilities previously carried out by different governmental bodies were given to the Service. Recently, some of the responsibilities of the State Migration Service were shared with ASAN Service (*State Agency on Social Innovations and Services to Citizens under the Administration of the President*), which was established with the *Presidential Decree No. 706 on 5 September 2012*.

[104] International Organization for Migration, 2008. 'Migration in the Republic of Azerbaijan: A country Profile 2008'. p. 30, Geneva

Table 15. Institutional set-up of migration control in Azerbaijan

Institution	Responsibilities
Ministry of National Security	• to fight against human trafficking and illegal migration,to consider applications (sent by the State Migration Service) and give consent/view on the provision of immigrant and refugee statuses, citizenship and work permits.
Ministry of Internal Affairs (MIA)/Chief Passport and Registration and Migration Department	• to register Azerbaijani nationals, foreign citizens and persons without citizenship (based on their residence), • to issue identity registration documents including national passports for Azerbaijan citizens, • to manage immigration issues within the competence of the Ministry (National passports may also be issued to citizens of the Republic of Azerbaijan at the regional divisions situated in the cities of Nakhchivan, Sheki, Lankaran, and Guba) • etc.
Ministry of Foreign Affairs (MFA)	• to process the visa applications through embassies and consulates of the Republic of Azerbaijan, of which there are about 50 worldwide; • to provide consular services to Azerbaijani citizens abroad; • to deal with questions related to the registration of Azerbaijani citizens who live in foreign countries; • to promote and develop cooperation with international organizations and interested countries in the field of migration • etc.
State Migration Service	• to implement Azerbaijan's migration policy, • to manage migration processes as well as to coordinate the activities of relevant governmental bodies with competencies in matters of international cooperation • to consider citizenship applications and issue decisions on the extension of temporary residence permits of foreigners and stateless persons in Azerbaijan, • to issue permits for foreigners and stateless persons to reside temporarily in the country and to grant immigrant status as well as issue decisions on refugee status, • etc.
State Border Service	• to prevent illegal migration • to ensure the deportation of foreign citizens and stateless persons whose cases have been decided, and to inform the State Migration Service about them • to accept applications by foreign citizens and stateless persons for refugee status at the border, and communicate with the State Migration Service • etc

Ministry of Labour and Social Protection of the Population	• to participate in the formulation and implementation of the migration policy of the state • to investigate trends in migration and present the government with policy recommendations • to draft regulations on the employment of Azerbaijanis living abroad and foreign citizens and stateless persons in the country • to investigate employment opportunities for foreign citizens • to regulate the employment of foreign citizens for enabling wider use of local human resources • to consider applications of foreign citizens and stateless persons for work permits • to carry out work related to social protection and accommodation of immigrants in conjunction with relevant governmental institutions • to take measures for the prevention of illegal migration and implement these measures in conjunction with relevant governmental institutions • etc.
State Committee on Refugees and Internally Displaced Persons (IDPs)	• to provide humanitarian assistance to refugees, IDPs and asylum seekers • to ensure respect for the rights of refugees, IDPs and asylum seekers • to investigate the problems of refugees, IDPs and asylum seekers and produce policy recommendations • to provide refugee statues and abolish it • to provide recommendations for drafting regulations for the resolution of the problems of refugees, IDPs and asylum seekers • to register the accommodation of refugees, IDPs and asylum seekers, create and manage an information system • to carry out rehabilitation and reintegration measures during and before the repatriation period • to take measures foremployment of and capacity building for refugees, IDPs and asylum seekers • etc.
ASAN Service, State Agency on Social Innovations and Services to Citizens under the Administration of the President	• to issue and decide on the extension of temporary or permanent residence permits of foreigners and stateless persons in Azerbaijan, • to issue work permits for foreigners and stateless persons to reside temporarily in the country,

ASAN Service provides many other services to citizens, mainly in Baku. Observations show that many people who deal with ASAN Service are happy with the quality of services provided. However, the provision of migration-related services by ASAN

Service is not in accordance with the *One Window* principle for foreign citizens and stateless persons. On the other hand, it seems likely that as the coverage area of ASAN Service enlarges, its workload will also increase. This may well create further problems in migration-related issues. Detailed investigations (which are beyond the scope of this research) show that, in general, the state migration system is very bureaucratic, and there is a need for further policy reforms in migration management system. Nonetheless, the steps already taken by the government in the last ten years are worthy of mention.

3.1.2. Visa regime

According to the 2012 publication of the Henley Visa Restrictions Index, a minimum of 57 countries and territories granted visa-free or visa-on-arrival access to regular Azerbaijani passport holders, and 31 of them are visa free accessible.[105] There are also discussions between Azerbaijan and the European Union on liberalising the visa regime. The Republic of Azerbaijan itself cannot be characterized as a liberal country in terms of its visa regime. The Government of Azerbaijan allows citizens of specific countries to visit Azerbaijan for tourism or business purposes with an ordinary passport, and for official purposes with a diplomatic and service passport, without having to obtain a visa for a given period. Citizens of other countries are required to obtain a visa before travelling to Azerbaijan, from the embassy or consulate of the Republic of Azerbaijan. The countries whose citizens do not require a visa to visit Azerbaijan are post-Soviet countries, namely, Russia, Belarus, Ukraine, Moldova, Georgia, Kazakhstan, Uzbekistan, Turkmenistan and Kyrgyzstan. The citizens of Iran and Turkey can obtain visas upon arrival.[106]The status of visa regimes between Azerbaijan and Turkey on the one hand, and Azerbaijan and Iran on the other hand are politically interrelated. In July 2011, this was made very clear in the statement by a senior Azerbaijani official, Ali Hasanov, the head of the Azerbaijani Presidential Administration's Social and Political Department. He said that a visa-free travel regime proposed by Turkey in 2009 had fallen victim to Iranian pressure on Azerbaijan, prompting the last minute cancellation of the deal between Baku and Ankara. "We do not have any concern with lifting visa requirements for Turks. If we waive the visas, we have to do it for both Turkey and Iran simultaneously. But I do not think the Azerbaijani government is prepared to undertake the visa-free regime

[105] Henley & Partners, 2012. 'Visa Restrictions Index Global Ranking', Available at: < https://www.henleyglobal.com/fileadmin/pdfs/visarestrictions/Global%20Ranking%20-%20Visa%20Restriction%20Index%202012-06.pdf>, Accessed [15 April 2013]

[106] Azerbaijans. Com, n.d., "Visa Regime in Azerbaijan". Available at: <http://www.azerbaijans.com/content_1417_az.html>, Accessed [15 April 2013]

with both countries at this time," Hasanov explained.[107] The Islamic Republic of Iran unilaterally lifted visa requirements for nationals of the Republic of Azerbaijan as of February 2010.[108]On 11 December 2012, the National Assembly of the Republic of Azerbaijan (Milli Majlis) denounced the validity of the *Memorandum on the elimination of the visa regime for citizens of Azerbaijan and Iran, living in the border areas*.[109][110] Similarly, Azerbaijan has not yet lifted the visa regime for Turkey, although Turkey abolished the visa requirements for Azerbaijanisin 1 August 2007.[111]

EU-Azerbaijan. Azerbaijan and the EU are in discussions over *visa facilitation and readmission* issues. The Council of the European Union issued a mandate for negotiations on visa facilitation with Azerbaijan on December 20, 2011,[112] and the official negotiations between Azerbaijan and the EU on visa facilitation started on March 2012 in Baku.[113]While other Eastern Partnership countries, like Ukraine, Georgia, Moldova and Armenia have already made progress in the political dialogue on visa issues and have concluded Visa Facilitation agreements, the discussion between Azerbaijan and the European Union remains ongoing. Notably, a visa facilitation agreement does not provide for the complete abolition of the visa regime. Such an agreement is expected to promote interaction between EU and Azerbaijani citizens. The proposed measures on easing the procedures of visa issuance to the citizens of Azerbaijan suggest a simplified list of necessary documents, possible issuance of multiple visas of longer term validity, reduction of the cost of visa for separate categories of citizens, establishing terms of visa registration, as well as possible visa-free entry to EU states for diplomatic passports owners.

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107 Bozkurt, A., 2011. 'Azerbaijan says visa-free regime with Turkey fell victim to Iranian pressure'. TodaysZaman. Available at: <http://www.todayszaman.com/news-250984-azerbaijan-says-visa-free-regime-with-turkey-fell-victim-to-iranian-pressure.html>, Accessed [15 April 2013]

108 Tehran Times, 14 December 2012. 'Iranian envoy says Azerbaijan's visa decision will affect cross-border trade'. Available at: <http://www.tehrantimes.com/politics/104048-iranian-envoy-says-azerbaijans-visa-decision-will-affect-cross-border-trade>, Accessed [15 April 2013]

109 ABC, AZ, 11 December 2012. 'Azerbaijan abolishes visa regime with Iran for residents of border regions'. Available at: < http://abc.az/eng/news/70152.html>, Accessed [15 April 2013]

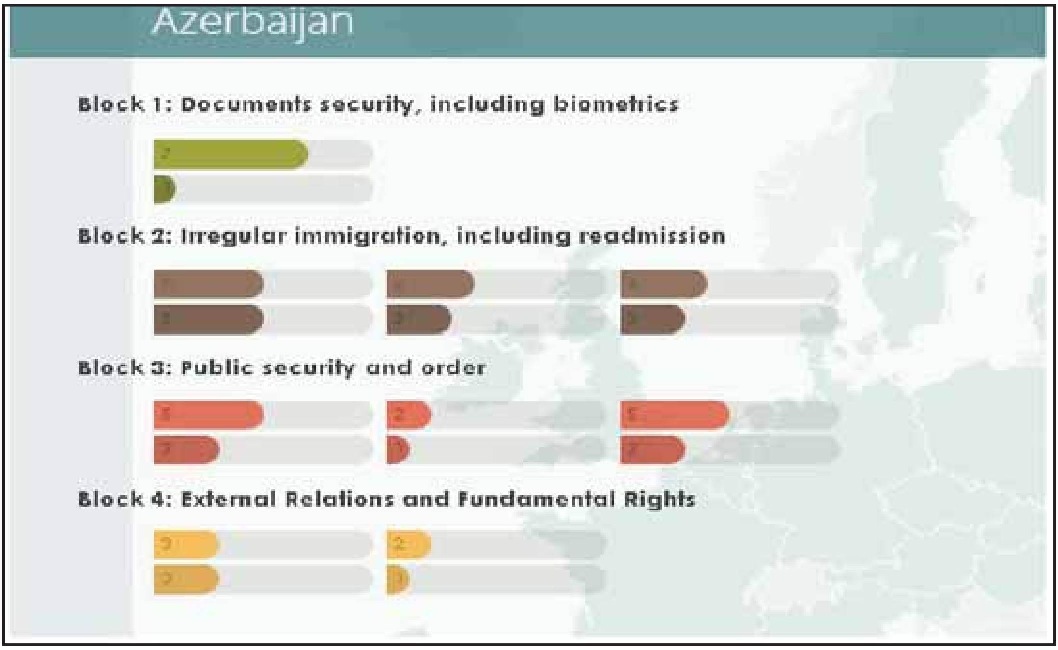
110 For Iran's position of the issue look at: http://english.farsnews.com/newstext.php?nn=9107135137

111 News, AZ, 02 July 2012. 'Turkey not to restore visa regime with Azerbaijan. Available at: < http://www.news.az/articles/politics/63494>, Accessed [15 April 2013]

112 Centre for Economic and Social Development (CESD), 20 December, 2011. 'EU issues mandate for negotiations on readmission and visa facilitation with Azerbaijan'. Available at: < http://cesd.az/new/2011/12/eu-issues-mandate-for-negotiations-on-readmission-and-visa-facilitation-with-azerbaijan/>, Accessed [15 April 2013]

113 AzerNews, 18 January, 2013. 'Azerbaijan, EU to continue negotiations on association agreement' Available at: <http://www.azernews.az/azerbaijan/48678.html>, Accessed [15 April 2013]

Chart 19. Eastern Partnership Visa Liberalization Index, June 2013



The cost of a visa will be reduced from EUR 60 to EUR 30-35. Visas may be free for categories such as groups of students and businessmen.[114] The agreement on readmission will develop a mechanism for repatriation of those residing in the EU and Azerbaijan without permission.[115] A visa facilitation agreement between the European Union and Azerbaijan will open the way for easier travel and people-to-people contact across Europe. Indeed, *visa liberalisation* will constitute a significant step towards the creation of guarantees of the free movement of persons between EU and Azerbaijan. Visa liberalisation will stimulate people-to-people contact, which can play a significant role in the understanding of EU values.

Asignificant side effect will be improved economic integration, by providing Azerbaijani citizens with easier access to the European single market, and the opportunity to explore trade and investment opportunities[116]. According to the *Eastern Partnership Visa Liberalisation Index*, (which presents the progress made by Eastern

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[114] Centre for Economic and Social Development (CESD), 3 April, 2013 'EU WILL FACILITATE VISA REGIME WITH AZERBAIJAN IN 2013', Available at: < http://cesd.az/new/2013/04/eu-will-facilitate-visa-regime-with-azerbaijan-in-2013/>, Accessed [15 April 2013]

[115] AzerNews, 18 January, 2013. 'Azerbaijan, EU to continue negotiations on association agreement' Available at: <http://www.azernews.az/azerbaijan/48678.html>, Accessed [15 April 2013]

[116] Centre for Economic and Social Development (CESD), April 2011. 'Paving the Road towards Visa-free Travel between the Eastern Partnership countries and the EU; a Case of Azerbaijan' Report

Partnership countries in satisfying the EU's basic conditions for granting a "visa free" regime), Azerbaijan shows the poorest performance (Table 16), only slightly better than Belarus. In terms of average performance across the four indicators, Georgia and Armenia show better results than Azerbaijan. The front-runners are Moldova and Ukraine, followed by Georgia and Armenia. The situation is much worse when we look at the details. In terms of freedom of movement and citizens' rights, including minorities, Azerbaijan's performance is only marginally better than that of Belarus, which is in last place.[117]

Table 16. EaP countries progress towards Visa Liberalisation with the EU

Countries	Block 1: Documents security, including biometrics	Block 2: Irregular immigration, Including readmission	Block 3: Public Security and Order	Block 4: External Relations and Fundamental Rights
Armenia	7.5	6.2	4.2	4.5
Azerbaijan	4	3.7	3.2	2.8
Belarus	4	5	3.2	2.5
Georgia	7.5	6.3	4.8	6
Moldova	9.5	8.7	8	8
Ukraine	4.5	7	6.5	6.7

Source: Eastern Partnership Visa Liberalisation Index, February 2013

According to the head of the Delegation of the European Union to Azerbaijan, Roland Kobia, the main obstacle to expediting the process of easing the visa regulations concerns the signing of an agreement on readmission.[118]A similar statement was given by the Azerbaijani side, by the Deputy Foreign Minister Mahmud Mammadguliyev.[119]According to the EU, the only remaining requirement is to coordinate some minor issues, after which an agreement on easing visa regime and readmission can be signed by theend of this year.[120]

117 Eastern Partnership Visa Liberalisation Index, February 2013. http://monitoring.visa-free-europe.eu/

118 AzerNews, 12 December, 2012, 'EU-Azerbaijan talks on visa rules to resume in 2013'. Available at: <http://www.azernews.az/azerbaijan/47403.html>, Accessed [15 April 2013]

119 AzerNews, 28 January, 2013. 'EU: Talks on visa facilitation with Azerbaijan underway'. Available at: < http://www.azernews.az/azerbaijan/49018.html>, Accessed [15 April 2013]

120 Centre for Economic and Social Development (CESD), April 2011. 'Paving the Road towards Visa-free Travel between the Eastern Partnership countries and the EU; a Case of Azerbaijan' Report

3.1.3. Data Analysis/Trends in cross-border movement of people

In the early years of independence, the flow of people from the country was mainly due to the conflict between Armenia and Azerbaijan over the Nagorno-Karabakh.[121]Altogether refugees and IDPs numbered 947,586, more than 10% of the total population of the country, the highest rate in Eastern Europe and Central Asia.[122]Refugees were mainly ethnic Azerbaijanis who fled Armenia during 1988-1991, together with Kurds and Russians, as well as formerly deported Meskhetian Turks who fled Uzbekistan in 1989 and refused to apply for Azerbaijani citizenship in hopes of returning someday to their homeland in Georgia. Due to the conflict, some 185,519 (according to Armenian statistics this figure is slightly less 160,000) Azerbaijanis left Armenia and the majority of them settled in Azerbaijan.[123] At the same time, around 360,000 Armenians left Azerbaijan for the same reason[124]. All of them remained stateless. In the second half of the decade, the number of refugees remained stable, decreasing slightly because of emigration (233,682 in 1998 and 219,124 in 2000. Towards the end of the decade, the Russian population has steadily decreased (from 30.3% in 1998 to 21.6% in 2000), indicating that the repatriation of Russians from Azerbaijan is almost completed[125].

While in the late 1980s and the first half of the 1990s migration flows in Azerbaijan resulted mostly from the Nagorno-Karabakh conflict and political instability in the country, since 1996, and particularly since 1998, economic factors have become predominant. The rising poverty level among the refugee and IDP populations, coupled with the low living standards and mass unemployment of the population as a whole, spurred significant rural-to-urban migration and emigration for labour purposes. According to Azerbaijani statistics, in 1998-2000, net migration to other Eastern European, Central Asian and Baltic States was -13,912 persons. However, according to statistics provided by other accepting countries, this figure was as high as up to -44,178 persons[126]. Emigration flows were overwhelmingly directed towards Russia; in 1998-2000, net migration with this country was -16,198 persons (-42,069 persons

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121 Yunusov, A., 2002. ‘Migration Trends in Azerbaijan’ pp. 59-61 in: International Organization for Migration. 2002 ‘Migration Trends in EECA: 2001-2002 Review’. Geneva

122 Aliyev, A., 2006. ‘Migration to and from Azerbaijan’. In: Rios, R. Ed., October 2006. ‘Migration Perspectives: Eastern Europe and Central Asia’. International Organization for Migration, p. 27, Geneva

123 Yeganyan, G., 2006. ‘The Migration Situation in Armenia: Challenges and Solutions’. In: Rios, R. Ed., October 2006. ‘Migration Perspectives: Eastern Europe and Central Asia’. International Organization for Migration, p. 27, Geneva

124 Ibid. p. 18

125 Ibid. p. 59

126 Ibid.

according to Russian data). As of early 2001, Russia hosted a total of 37,478 refugees and "forced migrants" from Azerbaijan. The majority of emigrants were ethnic Azeris (67.3% in 2000), followed by Russians. In 1999-2000, this trend significantly decreased, due to military operations in Chechnya and the August 1998 economic crisis in Russia. In 2000, Azerbaijan hosted 2,462 refugees from Chechnya, without, however, granting them residence permits which would allow them to work, access social services and send their children to school[127]. Unregistered emigration was significantly higher: according to government sources, around 600,000 Azerbaijanis in 1998 and around 800,000 in 1999 (i.e. a full tenth of the population of Azerbaijan) lived in Russia.[128] During the period from 1998 to 2003, the number of migrants who left the country for Russia reached 1,150,000[129]. In early years of independence and on many Azerbaijani Jews migrated to Israel in search of better living conditions. However, there is no data available on this. In short, in the first decade of independence, Azerbaijan was hit hard by mass migration, both in and out of the country.

The main motivations for emigration from Azerbaijan were economic crisis, poor public service provision, political repression and ethnic tension. If Azerbaijanis left mainly because of poor living conditions and public service provision, as well as political repression, for Armenians, the main reason for leaving the country were the ethnic tensions that erupted after the outbreak of the Armenian-Azerbaijani war over Nagorno-Karabakh. Russians and other people from post-Soviet countries were motivated by their wish to return to their homelands. For people entering the country, the main motivations were: repatriation (in the case of Azerbaijanis); forced deportation (in the case of Azerbaijanis and Meskhetian Turks); and hopes for better living conditions (in the case of Chechens and Azerbaijanis who left Georgia).

The situation began to improve from the end of the 1990s, and in 2000s the flow of people from and to the country stabilized. This was for a number of reasons:

- *Repatriation of people from other post-Soviet countries and Azerbaijanis who had been in other post-Soviet countries finished.*
- *The Azerbaijan-Armenia ceasefire was signed, marking an end to the immediate conflict.*
- *The economic situation - and therefore living conditions - started to improve*
- *Political stability was achieved in the country and region.*

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127 Ibid.

128 Ibid.

129 Aliyev, A., 2006. 'Migration to and from Azerbaijan'. In: Rios, R. Ed., October 2006. 'Migration Perspectives: Eastern Europe and Central Asia'. International Organization for Migration, p. 27, Geneva

In the second decade of independence and in particular following the 2005 oil boom, new trends emerged in migration processes in Azerbaijan. According to information provided by the website of the State Statistics Committee, the net migration figure reached 1.1 in 2008 from -53 in 1990. That is, in 2012, the number of immigrants outnumbered the number of emigrants for the first time since 1970, reaching 1.7.[130] In addition to the reasons noted above, this can be attributed to the growing number of international companies operating in the country and foreign workers in the rapidly developing construction and oil sectors. The majority of immigrants are from Georgia, Turkey, India, Iran, Pakistan, Russia, Turkmenistan, Uzbekistan, Kazakhstan and Ukraine, the United Kingdom. Russia, Ukraine, Israel, Kazakhstan, Germany, Turkey, the United Arab Emirates, the United States, Georgia, Turkmenistan and Western European countries are the preferred countries for those leaving Azerbaijan. In comparison with the 1990s, the range of the country of origins of immigrants and of the countries preferred by Azerbaijani emigrants expanded during the 2000s, encompassing more countries in Europe, America as well as Asia.[131]

3.2. Georgia

Migration is one of the most complicated and important issues currently affecting Georgia. The population drain in 1990 was very high. Net migration from Georgia in 1992-1996 reached around half a million people. According to different estimates, approximately one million Georgians left the country for temporary or permanent residence abroad. A significant proportion of them now reside illegally in Russia, Ukraine, EU, US, and other countries. Official statistics show a positive trend from 2000; for the last four years, the annual net inflow of migrants is on average 25,000[132]. The movement of persons in Georgia is fairly easy, as the national regulations do not prevent Georgians from leaving the country. It is also easy for foreign citizens to enter and stay temporarily in Georgia. The barriers to movement are mainly related to the restrictions that other countries put on the citizens from Georgia.

3.2.1. Legal/Regulatory framework

*Visa issues.*The entry regime for foreigners in Georgia is one of the most liberal in the world. Georgian legislation regulates the proceedings of entry into the country, transit

[130] The State Statistical Committee, 2013. 'International Migration'. Available at: <http://www.stat.gov.az/source/demoqraphy/>, Accessed [15 April 2013]

[131] Ibid.

[132] National Statics Office of Georgia. See at: http://geostat.ge/index.php?action=page&p_id=173&lang=eng

and stay by foreign citizens. There are more than 70 countries whose citizens do not need a visa to enter and stay on the territory of Georgia for 360 days (OECD member states, Latin American countries, "Gulf" states and East Asian developed countries. The other group of countries are those with bilateral agreements with Georgia (CIS countries, save Turkmenistan) that establish visa free entry with unlimited stay. A bilateral agreement with Iran provides a 45 days visa free stay for citizens, while Russian citizens enjoy a 90-day visa free stay in the country, unilaterally granted by Georgian Government.

- In cases determined by Georgian legislation, a visa/entry permit for up 90 days (visa fee 50 GEL) or for 360 days (visa fee 100 GEL) can be issued by the Patrol Police of Georgia (sub-divisional institution of the Ministry of Internal Affairs) at border crossing points situated at the Georgian State Border.

- The basis for the stay of an alien in Georgia is a visa or residence permit (permanent or temporary) if no other is provided by this law and international treaties of Georgia.

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Source: MFA of Georgia

In addition, foreign citizens who have Schengen, EU or USA multiple entry visas can stay in Georgia for up to 90 days. The same treatment is guaranteed to UN travel document holders. The main document regulating the regime and procedures of entry for the territory of Georgia is *Decree No 399 of 28 June 2006 of the President of Georgia*. A number of other legal regulations were adopted later, the most recent in 2012[133]. Georgia's entry regime, as demonstrated above, is very liberal and provides free movement for the citizens of large number of states. For others, the entry visas are easy to get at the airports and border crossing checkpoints, and the costs of visas are quite low. The procedures for remaining in the country and for registration, conducted by the *Civil Service Bureau* of the MoJ, are quite simple and inexpensive.

133 Georgian Law Review, Ministry of Justice of Georgia, available at: https://matsne.gov.ge/index.php?option=com_ldmssearch&view=docView&id=98272&lang=ge#

Table 17. Institutional set-up of migration control in Georgia

Institution	Responsibilities
President	• Exclusive rights of granting, restoring and stripping citizenship • Can declare any member of foreign diplomatic corps *persona non grata*.
Ministry of Justice/State Registry	• Issuing visas and residence permits for foreign citizens • Travel documents to persons without a citizenship and refugees • Registration of migrants • Preparation of documents for citizenship related issues
Ministry of Accommodation and Refugees1	• Development and implementation of the policy on refugees, asylum-seekers, internally displaced persons, repatriates, victims of the natural disasters and other migrants as regards their social and legal protection, accommodation and overall migration control, including granting of status and registration.
MIA, Patrol Police Department	• Management of cross-border migration. Control of cross-border check points (document control, issuing visas, and law enforcement). • Securing organizational and procedural issues for the implementation of the EU-Georgia Readmission agreement.
MIA, Border Police	• Conducting migration related law enforcement actions on the land and maritime borders of the country.
Ministry of Internal Affairs	• General obligation to fight against any type of the cross-border crime
Ministry of Foreign Affairs	• Consular registration of Georgian citizens abroad, • Issuing of return documents, • Issuing entry visas by Georgian consular missions abroad • Information support of Georgian citizens abroad • Registration of civil acts, • Issuing proof of identity documents
State Minister for European and Euro-Atlantic Integration	• Coordination of EU-Georgia EN Action Plan Implementation including JLS issues. • Migration issues in the framework of Eastern Partnership • Projects under the "Mobility Partnership" initiative
State Ministry for Diaspora Issues	• Contacts, information sharing and support of Georgian compatriots living abroad • Providing conditions for the integration into the Georgian society of repatriates.
Governmental Commission on Migration Issues	• Oversees and monitors activities of Georgian institutions involved in the development and implementation of the migration policy.

Georgian citizens, on the other hand, do not enjoy the same privileges to travel freely. *Henley Visa Restrictions Index 2012* puts Georgia in 73rd place. There are 60 states that Georgian citizens can enter without a visa. The bilateral agreements mentioned above provide *visa-free travel* for Georgians in CIS countries (save Russia, which cancelled its visa-free regime with Georgia in 2006). They can also travel to Iran for up 45 days without a visa. Around 30 Central and Eastern European states, as well as China, Egypt, Singapore and Cyprus, provide a similar possibility (up to 30-45 days) for Diplomatic and Service type passport holders. The remainder among these 60 states provide visa-free travel for the whole world.

Institutional set-up. Table 17 shows the institutions involved in migration-related issues and their responsibilities in the regulation of the movement of persons into/out of Georgia

The *Integrated Border Management Strategy*[134] adopted in 2008 and amended in 2011 provides for coordination between all bodies involved in safeguarding border security [135]. The aim of the strategy is narrower than the management of migration, and focuses mainly on strengthening border security and combating illegal cross-border activity. Other relevant agencies (not listed in the Table 17.), such as the Ministry of Defence and Ministry of Finance, are also involved in the integrated border management work, which envisages coordination within agencies, between them and between the respective agencies of bordering states (i.e. south Caucasian Cooperation on Border Management)[136].

Legislation. Georgia has quite extensive legislation regulating migration flow. The legal document regulating entry procedures for foreign citizens is the *Presidential Ordinance N399 of June 28, 2006 on Issuance of Visas, Extension of Validity and its Expiring.* Foreign citizens legally residing in Georgia enjoy same rights and have same obligations as Georgian citizens with the exception of rights granted by the *Constitution of the State* only to Georgian citizens. Otherwise, they are free to choose their place of being and movement, and to leave freely at any time. The state undertakes the obligation to defend the labour rights of Georgian citizens abroad and to prevent them from becoming the victims of trafficking or other types of inhuman or discriminatory treatment. This is regulated by *special bilateral agreements with third countries.* However, studies show that there are no effective "legal mechanisms to protect Georgian labour migrants with their rights are violated"[137].

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134 available at: http://www.carim-east.eu/media/sociopol_module/Strategy%20of%20Border%20Management-2012-engl.pdf

135 see at: http://www.gbg.ge/?lang=eng&page=203

136 http://www.enpi-info.eu/maineast.php?id=299&id_type=10

137 Caucasus Research Resource Centres (CRRC): Migration and Return in Georgia: Trends,Assessments, and Potential. Tbilisi, 2007 http://crrccenters.org/store/files/Projects/DRCCRRC%20Migration%20Trends%20Study%20final%2030JAN2008.pdf

The *Law on Citizenship* regulates the rules for granting/depriving of citizenship. The *Law on Legal Status of Aliens* (last amended in 2011) regulates the rules and institutional provisions on theentrance, departure, transit, and deportation of foreign citizens from the country. Granting refugee status and humanitarian status is regulated by the *Law on Refugees and the Humanitarian Status*. The law also determines which institutions are responsible for the implementation. The *Law on the State Border of Georgia* defines the maritime, air and land borders of the country and the rules and procedures for crossing them. In addition, the *Georgian Criminal Code* introduces criminal responsibility for human trafficking and illegal border crossing. There is also a special *Law of Human Trafficking* establishing the status of such victims and introducing the legal and social protection guarantees.

3.2.2. EU-Georgia Visa Liberalisation process

The EU is one of the major destinations for Georgian migrants. Travelling to the EU is still not easy for Georgian citizens. There are multiple obstacles, not least the visa issue. The internet edition of 'Visa Free Europe' quotes Georgia's former State Minister for European Integration saying that more than 15% of requests by Georgian citizens for EU entry visas were rejected[138], while some EU Member States' embassies shown even higher rates of visa refusals (Netherlands – 26%). The *Visa facilitation agreement* between the EU and Georgia entered the force on March 1, 2011. The agreement simplified visa procedures for certain categories of citizens of Georgia looking for entry visas for temporary stays in EU Member States. The facilitation affects over 15 categories of citizens in terms of the liberalisation of the fee structure, issuance of multiple-entry visas, and documentary evidence for visa issuance[139]. Despite the positive impact of the agreement, there remain significant problems with its implementation; in particular, a number of Schengen state consulates are not represented in Georgia, and so citizens wishing to travel to that country need to travel to a neighbouring state[140]. Monitoring of the implementation of the agreement by several NGOs (i.e. European Initiative - Liberal Academy, 10112) revealed a number of other problems too: the list of documents due to be presented in the consulates is not exhaustive and the consulates of different EU member states ask for additional documents for issuing the visas; the agreement does not address the citizens going to EU for tourist purposes, which according to statistics is the main reason people want to travel; application procedures are not uniform across different EU consulates, and the information on application

[138] See at: http://visa-free-europe.eu/2012/05/georgia-with-highest-eu-visa-refusal-rate/

[139] L 52/34 Official Journal of the European Union 25.2.2011

[140] Tamara Pataraia, Baseline Study on Visa Facilitation between Georgia and EU, p.9, CIPDD, Tbilisi, 2010 availabl

procedures is not always easily accessible[141].Another important legal institutional document regulating aspects of migration between EU and Georgia is the bilateral agreement on the readmission of persons residing without authorization[142],the so-called Readmission Agreement. This agreement requires to Georgia to readmit any of its own nationals who have been residing illegally in EU states, following a request by EU Member State. It also provides for the readmission of nationals of third countries residing in EU illegally and having travelled to EU from Georgia (residing in Georgia legally before departing to EU). While there was no single case of a readmission request to Georgia regarding a citizen from a third country, according to the patrol police of Georgia, "758 applications for readmission were submitted by March 1, 2012; 66 were rejected, and 53 out of 838 applications submitted from March 1, 2012 until the end of December 2012, were rejected".[143]This agreement charges Georgia with important responsibilities for the safety, protection and deportation of readmitted persons to their countries of permanent residence. Georgia must also to secure adequate standards of data protection, document security, asylum, transport, etc. Despite assistance rendered to Georgia by the UNHCR, EU, and US, there remains an important gap in establishing an effective asylum systems: there is currently only one accommodation centre for asylum seekers in Georgia. Two migration advisory centres, in the regional centres of Gori and Zugdidi, provide the local population with information to discourage them from illegal migration. The centres also assist with the social reintegration of repatriates. Georgia is also committed to negotiating and signing readmission agreements with the neighbouring states.

*Visa-Free regime***.** In the scope of the continuing Georgia - EU visa dialogue, it has been agreed to work toward deepening the visa liberalisation process in direction of introducing a visa-free regime for Georgian citizens traveling to EU Member States. On February 25, 2013 Commissioner Malmström endorsed a *Visa Liberalisation Action Plan* for Georgia[144]. The Plan consists of four categories, for which Georgia should meet the necessary technical conditions: document security, border and migration management, public order and security, and relevant external relations issues. The completion of the action plan will prepare the ground for the EU Council decision on allowing Georgian citizens to travel to EU visa-free for short stays (under 90 days).

The Mobility Partnership is another important instrument that EU and its member

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141 ვიზისფასილიტაციადარეადმისია: უვიზომიმოსვლისპერსპექტივები, ევროპულიინიციატივა – ლიბერალურიაკადემიათბილისი, 2012 წელი

142 See: Official Journal of the European Union L 52/47, 25.2.2011. available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:052:0047:0065:EN:PDF

143 Readmission, Returnand Reintegration in Georgia, Natia Chelidze, CARIM-East Explanatory Note, 13/2, page 3. see at: http://www.carim-east.eu/media/exno/Explanatory%20Notes_2013-25.pdf

144 See. At: http://europa.eu/rapid/press-release_IP-13-156_en.htm

states are offering Georgia in order to provide better opportunities for regulated and controlled migration (labour migration first of all). The Joint Declaration on a Mobility Partnership between the European Union and Georgia (2009)[145] set out the basics for such cooperation. The framework indicates different actions in order to help Georgian professionals obtain legal employment in the EU. The projects under this initiative include training of potential migrants in different professions, EU languages, training on the legal procedures for employment and residence in EU, assisting Georgian authorities in improving the institutions and services dealing with data security, and asylum policy, among others. As far as the statement that "labour migration and temporary labour migration still acts as a national wide strategy for a significant portion of households in Georgia[146]", the most important component of the initiative is the facilitation of circular migration of workers from Georgia to EU countries, with the prospects of finding temporary work and then returning to the country (i.e. Georgia) after its completion. Individual Member States (France) are negotiating with Georgia on the terms and conditions of an agreement on circular migration, which will allow a set quota of Georgian professionals (i.e. 500 migrants yearly) to travel to their country with the prospect of gaining a temporary residence permit and job. Development of this initiative will facilitate legal migration from Georgia to the EU.

3.3. Ukraine

Ukraine is encircled by substantial and non-symmetrical visa barriers. Citizens of the country can travel mostly visa-free to developing states, but people that enjoy visa-free travel to Ukraine are chiefly nationals of developed countries. Those barriers restrict migration flows only to a limited extent: for example, the number of migrant workers from Ukraine was estimated at the level of 5.1% of the working age population of Ukraine. The government of Ukraine has been negotiating visa liberalisation and enhancement of protection of migrant workers, but progress has been slow.

3.3.1. Legal framework

Visa policy. Citizens of Ukraine can travel *visa-free* to 43 countries of the world[147], mostly CIS countries and the countries that focus on attracting tourists. The *principle*

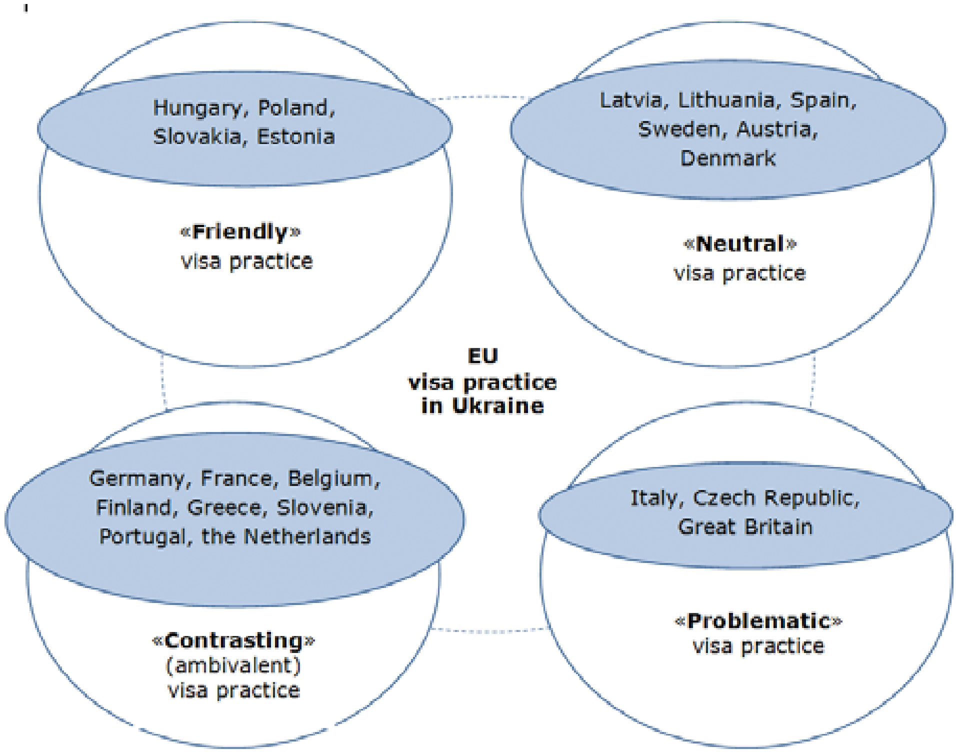
[145] Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/jha/111580.pdf

[146] Irina Badurashvili, The Socio-Political Impact of Labour Migration on Georgia, CARIM-East Research Report, p.18, 2012/21

[147] See http://mfa.gov.ua/ua/consular-affairs/travel-advice/entering-foreigh-countries

of reciprocity is applied only in a small number of cases. Ukraine grants *visa-free* access to 62 countries, mostly developed ones and the members of the CIS. The visa policies of foreign countries towards citizens of Ukraine are not always open and transparent. According to research by Ukrainian think tanks, visa practices of the consulates of the EU member states may be divided into four groups: «friendly», «neutral», «contrasting» and «problematic». Most countries in Central and Eastern Europe (Poland, Hungary, Slovakia and the Baltic states) have relatively friendly visa practice, while visa requirements of Western European countries are more stringent.

Chart 20: Visa practice types of the EU consular establishments in Ukraine (2012)



Source: Europe without barriers, Independent Monitoring Findings 2012

Removing visa barriers. Ukraine's policy is aimed at reducing visa barriers. The policy has two main components: negotiations on visa liberalisation with the EU and negotiations with other countries. Ukraine has been working on the Action Plan on Visa Liberalisation with the EU since November 2010. The plan envisages reforms in such areas as document security, migration control, border management, and public security. The implementation of the plan will allow Ukrainian citizens to enjoy visa-free travel regime in the EU countries. But this is not a short term goal, given that so far the implementation of the plan has been slow. Ukraine is still carrying out the first phase of the Plan, preparing to implement the Law on Introduction of Biometric Documents (including passports). The EU urged Kyiv to fulfil important obligations to complete the first phase of the Plan, especially within the political and legal framework, namely in the fight against corruption and discrimination, protection of minority rights and protection of personal data.

Authority on regulation of migration processes. Two government bodies are responsible for development and implementation of migration policy in Ukraine — the State Migration Service of Ukraine (SMSU), which is subordinate to the Ministry of Internal Affairs, and the Ministry of Social Policy of Ukraine. The former is responsible for registration of residents and non-residents (including refugees), handling citizenship issues, combating illegal migration, and expanding migration policy. The latter is responsible for labour migration regulation. The agreements on readmission are carried out by the SMSU along with the State Border Guard of Ukraine. The system of government bodies responsible for implementation of migration policy was reformed in 2010-2011. Previously, migration issues in Ukraine were handled by several ministries and other central executive bodies.[148] The SMSU was formally established in December 2010 in the framework of administrative reform.[149] In 2011,territorial bodies of the SMSU were set up, other organizational and financial issues were settled, and necessary amendments to the legislation of Ukraine were prepared. In 2012, the SMSU gradually started performing its functions. Specifically, it began working with foreigners and stateless persons who applied for protection in Ukraine, dealing with citizenship and residence registration issues, issuing foreign passports, submitting information to the State Register of Voters, and combating illegal migration[150]. However, the labour migration management was not included in the area of responsibility of the SMSU[151]. The Council on Labour Emigration of

[148] Previously the implementation of the migration policy was the responsibility of the Ministry of Internal Affairs (specifically, the State Department of Citizenship, Immigration and Registration of Individuals) and the State Committee on Nationalities and Religions. Four other government agencies were also involved in migration regulation: the Ministry of Labour and Social Policy (now the Ministry of Social Policy), the State Customs Service, the State Border Service, and the Security Service of Ukraine. Thus, migration authority was fragmented; there was not a national body responsible for coordinating the above mentioned entities in that field. As a result, the effectiveness of the policy implementation was not sufficient.

[149] Decree of the President of Ukraine "On optimization of the central authorities", № 1085/2010, dated 09.12.2010

[150] http://migraciya.com.ua/news/the-state-migration-service-of-ukraine/ua-state-migration-service-of-ukraine-stages-of-development-and-prospects/

[151] Prohorenko N. E. Migration processes in Ukraine: features of migratory situation and policy. «SOCIOПРОСТІР: the interdisciplinary collection of scientific works on sociology and social work»,

Citizens of Ukraine was established in January 2010. It is a temporary[152] advisory body chaired by the Deputy Prime Minister – Minister of Social Policy of Ukraine and comprised of representatives of other executive bodies including Ministry of Foreign Affairs, Ministry of Internal Affairs, Ministry of Finance, etc. as well as representatives of trade unions, NGOs. The Council tasks include development of proposals regarding Ukraine's state policy on labour migration[153]. To sum up, administrative reforms have streamlined state regulation of migration processes in Ukraine, although these functions still have been divided between several state agencies, between which there is no clear coordination[154].

3.3.2. Migration flows

Official data on international migration. In 2012 the number of international migrants in Ukraine grew, mainly due to an increase in the number of immigrants. According to the *State Statistics Service*, 76400 people came to Ukraine in 2012, twice as many as in the preceding year (31700 people). On the other hand, 14500 individuals left Ukraine, which is close to the last year's level, likely due to limited progress in visa liberalisation negotiations and the difficult economic situation in the EU. Thus, the total number of interstate migrants was 90900, which is 96.4% higher than a year ago. The net inflow of international migrants reached 61800 people. Immigration is unlikely to be a significant factor in the increase in Ukraine's population, or – especially - to become a driving force of the economic growth. According to Lidia Tkachenko, a senior research fellow at the *Institute of Demography and Social Studies* (IDSS) of the *National Academy of Sciences of Ukraine*,[155] "unlike the EU countries, where migration growth is formed almost entirely by people aged 18-40 years, in Ukraine about half of migration growth is due to persons aged 45 years and older. The biggest share of immigrants accounted for citizens of the CIS countries, with which Ukraine has agreements on pension benefits (the so-called territorial principle of pensions)".

Labour migration. Reliable information on labour migration of Ukrainians is quite limited. According to the results of a full-scale survey on labour migration, conducted by researchers from the IDSS in 2008[156], from 2005 to the first half of 2008, 1.5 million

No 3,2012. http://www.sociology.kharkov.ua/socioprostir/Files/magazine/3_2012/2_2_1.pdf

152 Initially, it was a permanent advisory body

153 http://zakon1.rada.gov.ua/laws/show/42-2010-%D0%BF

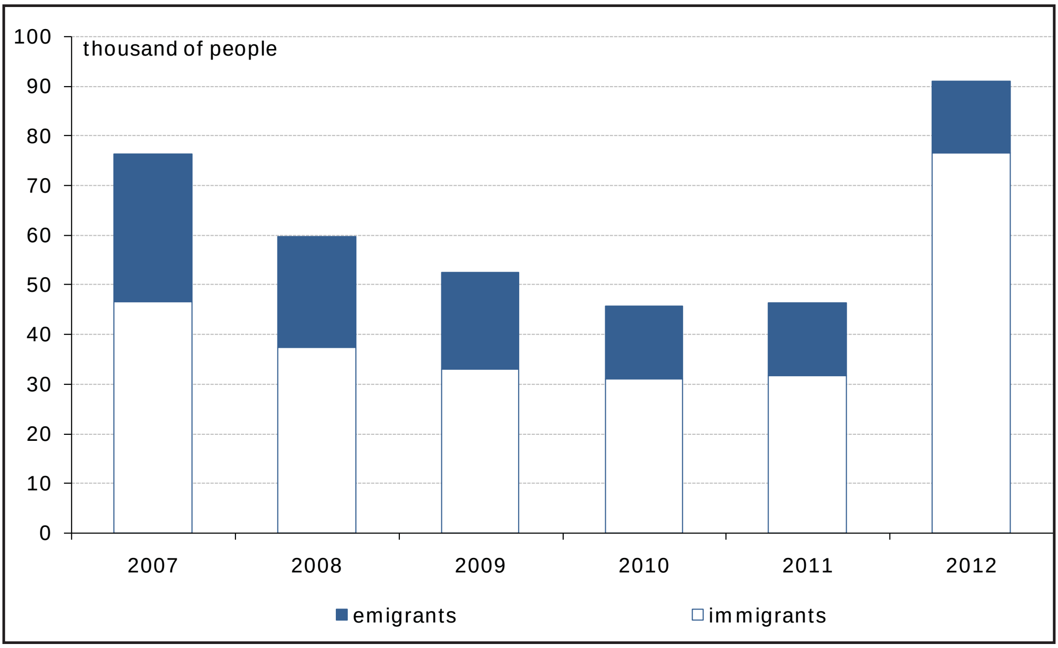
154 Osokorski O.P. Problems of the State Migration Service of Ukraine in terms of European integration. http://radnuk.info/statti/547-evro/14582-2011-01-18-06-08-27.html

155 Tkachenko L. Females will live up to 84 years and men up to 79? http://ukurier.gov.ua/uk/articles/zhinki-zhitimut-do-84-rokiv-choloviki-do-79-ti/

156 http://www.idss.org.ua/monografii/poznyak_2010.pdf

Ukrainians or 5.1% of the working age population of Ukraine left the country as labour migrants. The SMSU claimed that there were 2.5 million Ukrainian labour migrants abroad in 2011. The main destination countries were Russia, USA, Germany, Moldova, Belarus, Israel, Poland, the Czech Republic, Hungary, Canada, Spain, and Italy[157]. According to the IDSS survey results, labour migration was driven mostly by economic factors, including low wages and limited labour demand in Ukraine.

Chart 21. Interstate migration in Ukraine, 2007-2012



Source: State Statistics Service of Ukraine

Social protection of migrant workers. Labour migration is the most important issue for Ukraine in the field of migration. Today the social and legal protection of Ukraine's labour migrants is ensured by bilateral agreements and Ukraine's accession to the multilateral treaty documents. Ukraine is a party to *the European Convention on the Legal Status of Migrant Workers*, the *CIS Agreement on Cooperation in the Field of Labour Migration* and *Social Protection of Migrant Workers* and the Protocol to this Agreement that regulates the process of border migration in the CIS, the *Convention on Legal Status of Migrant Workers and Members of their Families of the CIS*. Also, Ukraine is a party to 13 bilateral agreements on employment and social protection of migrant workers (with Baltic States, Bulgaria, Spain, Libya, the Czech Republic, Mongolia, Portugal,

[157] http://migraciya.com.ua/news/the-state-migration-service-of-ukraine/ua-state-migration-service-of-ukraine-stages-of-development-and-prospects/

Poland[158], Romania, Slovakia, Hungary and Czech Republic)[159]. The level of social protection of Ukraine's labour migrants is very low.[160]

Ukrainian labour migrants can be divided into separate groups: people employed on temporary contracts, skilled workers, workers with uncertain status, and seasonal employees (including fly-in - fly-out employees working in Russia). The implementation of existing agreements on social protection is difficult due to the lack of implementation mechanisms, financial resources and qualified personnel. Moreover, bilateral agreements on social protection with countries that have multiple communities of Ukrainian labour migrants (particularly with Italy and Greece), have not yet been concluded. Moreover, agreements based on the territorial principle (particularly agreements within the CIS) have not fully addressed existing challenges.

The *Ministry of Social Policy* has identified two main tasks in its work concerning labour migration and protection of migrant workers: first, the expansion of contractual bases with countries with the highest number of Ukrainian migrant workers-citizens, and second, more active implementation of already signed bilateral agreements[161]. Thus, Ukraine is expected to focus on strengthening social and legal protections for migrant workers. The adoption of the *Law On Foreign Labour Migration*, which has been drafted by the Ministry of Social Policy with the aim of outlining rights and state guarantees for migrant workers and their families, is expected to significantly strengthen the social and legal protection of migrant workers[162].

Illegal migration. Ukraine is a transit country for illegal migrants. The country lies on the Central European route, which is one of the key cross-border routes for illegal migration to Western Europe. It goes through Russia, Ukraine, Poland, Slovakia and Hungary. However, Ukraine is also becoming a destination country for illegal migrants due to the harsh economic conditions in some other countries, and its geographical position.

3.3.3. Readmission

The implementation of agreements on readmission in Ukraine is the responsibility of the *State Border Guard and the State Migration Service*, which has recorded steady

158 The agreement with Poland is signed, but still has not been ratified

159 http://www.kmu.gov.ua/control/uk/publish/article?art_id=245370267&cat_id=244276429

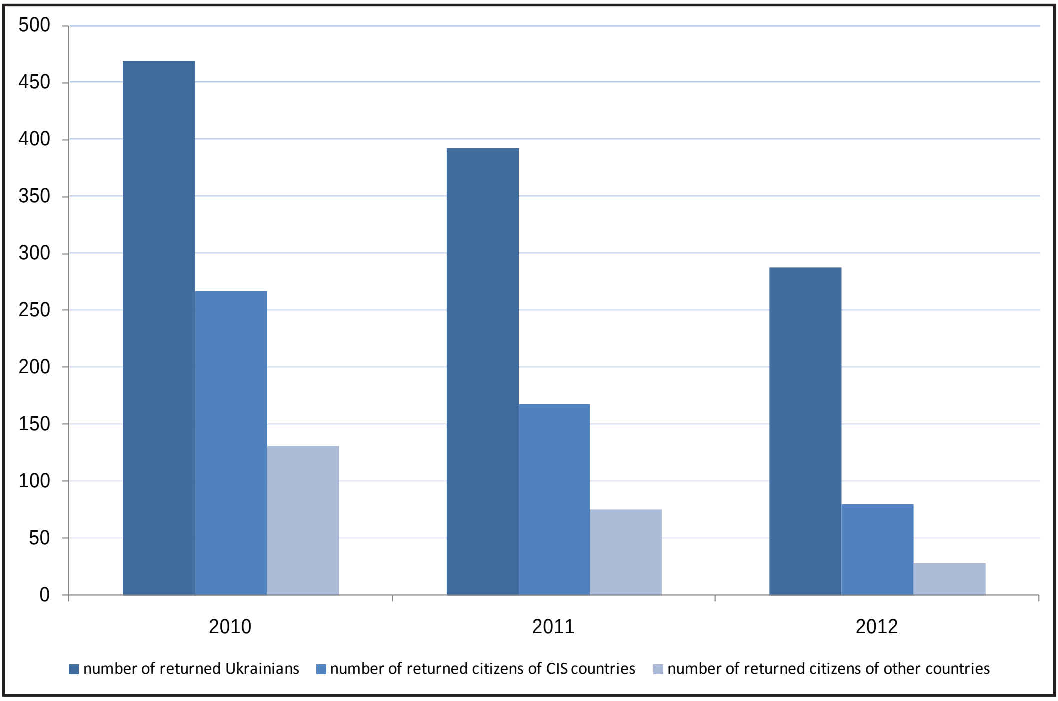
160 http://www.ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---sro-budapest/documents/publication/wcms_195187.pdf

161 http://www.kmu.gov.ua/control/uk/publish/article?art_id=245370267&cat_id=244276429

162 The draft law is aimed at stipulating the rightsof migrant workers and members of their families and providing state guarantees to them.

reductions in the number of people returning from neighbouring states. In 2012, there was close to a four-fold reduction in the number of citizens returned within the framework of readmission at the EU border. Most people who were returned in 2012 were taken at the border with Poland (64%), Slovakia (14%) and Romania (13%).

Chart 22. Number of returned to Ukraine in the readmission framework, 2010-2012



Source: State border guard service of Ukraine, 2013
http://www.kmu.gov.ua/control/publish/article?art_id=246083269

The number of Ukrainian citizens returned decreased by 26% in 2012 compared with 2011, while the number of returned citizens of the CIS countries dropped by half, and the number of returned nationals from the other countries decreased by 63%. In 2012, Ukraine transferred 65 people to other countries. Most of them were citizens of Romania (30 persons), Poland (11), and Hungary (5). Additionally, citizens of France, Russia, the Czech Republic, Germany, Netherlands, and Belgium were transferred[163]. The proper implementation of readmission agreements is a good instrument for the reduction in transit flows of illegal migration. Ukraine has signed a number of such agreements. Specifically, Ukraine has the Agreement with the EU on readmission, signed on June 17, 2007, and bilateral agreements on acceptance/transfer (readmission) of people with following 16 countries:

[163] State border guard service of Ukraine 22.02.2013 http://www.kmu.gov.ua/control/publish/article?art_id=246083269

- *European countries - Bulgaria, Denmark, Lithuania, Latvia, Norway and Switzerland*
- *Neighbouring countries - Russia, Moldova, Hungary, Slovakia, and Poland*
- *Countries that are main suppliers of illegal migrants - Vietnam, Georgia, Turkmenistan, Turkey and Uzbekistan*[164].

In addition, Ukraine continues to work towards the conclusion of readmission agreements with several CIS countries: Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan and Belarus, as well as with a country with high risks of migration - Lebanon.

Concluding remarks on Chapter III

Azerbaijan, Georgia and Ukraine share many similarities related to their Soviet heritage and the transition from the Soviet system. Notably, they face common problems in sphere of migration. All three countries have experienced and continue to suffer as a result of the exodus of the active population together with increased numbers of illegal immigrants. Azerbaijan and Georgia also face problems relating to internally displaced persons and refugees from the conflict zones inside and outside of the country.

Due to the differences in geography, size, and economic structure of three states, they face some substantially different challenges. For example, Ukraine has higher labour migration flows to the EU, and faces problems with the protection of the extraterritorial rights of labour migrants. Azerbaijan tries to manage the massive migration from neighbouring Iran, at the same time as being an "exporter" of labour to Russia and other CIS countries. Georgia, with its declining population, has almost opened its borders to foreign migrants, allegedly bringing new business initiatives to the country. Respectively, there are substantial differences in the policies pursued by the countries: the Ukrainian government focuses on securing bilateral institutional guarantees for the protection of the labour rights of Ukrainian workers in EU (especially CEE) countries. It has also acceded to a number of important international conventions. All three countries enjoy visa free regimes to/from CIS countries. Ukrainian citizens have the best access to foreign states (76), Georgia and Azerbaijan respectively have visa-free access to 60 and 57 states in total. Georgia is more open to other nationalities, granting visa-free access to more than 70 states (Ukraine to 43). Azerbaijan operates the most restrictive visa policy among the three, essentially limiting visa-free opportunities to CIS member states. Georgia and Ukraine have lifted visa requirements for EU member states, reflecting their European aspirations. At the institutional and legal levels, all three countries have well-developed frameworks

164 http://dmsu.gov.ua/normatyvna-baza/mizhnarodni-dokumenty/readmisiia

to deal with the migration issues. However, the migration services seemed to be weighed down with bureaucratic demands in all three countries. Labour migration from Ukraine, Georgia and Azerbaijan toward the direction of EU also depends on the development of respective bilateral agreements in the direction of the so-called "mobility partnership" program, designed to foster circular migration, reducing risk of illegal movement from these countries to the EU.

CHAPTER IV. EFFECTS OF REFORMS

Analysing the effects of reforms and comparative analysis of performances of three countries will be based on three relevant indices (Doing Business, Economic Freedom Indexes, World Competiveness Index, and Bertelsmann Transformation Index). International rankings allow comparisons of countries' performancesin economic, social, political, and other sectors. Reports produced by various international organizations also provide useful information on reforms and the impact of policy changesin different countries.

Azerbaijan

The Doing Business Report of the World Bank and the Index of Economic Freedom of the Heritage Foundation and Dow Jones & Company are most famous international indices on countries' business environments and institutional issues. The Doing Business Report (DB) only focuses on the formal aspects of doing business in a country. In 2009, Azerbaijan was considered a top reformer in 2009, having jumped more than 60 positions up to 33rd place, before being overtaken by other reformers a year later. Since then, however, Azerbaijan has given a weak performance, and according to DB 2013 the country's rank was 67[165].

The Doing Business report ranks a country based on "Starting a business", "Dealing with construction permits", "Getting electricity", "Registering property", "Getting credit", "Protecting investors", Paying taxes", "Trading across borders", "Enforcing contracts" and "Resolving insolvency". According to the 2013 DB report, Azerbaijan has a better performance on "Registering Property" (9th rank), "Starting Business" (18th rank), "Protecting Investors" (25th rank) and "Enforcing Contracts" (25th rank). According to the report, "Getting Electricity" (175th rank) and "Dealing with construction permits" (177th rank) were the most problematic issues in Azerbaijan.

165 Doing Business 2013, economic profile of Azerbaijan.

According to *Index of Economic Freedom* (2013) Azerbaijan is ranked 88th. This index relies on polls among businesspersons. Although Azerbaijan does well on measures of fiscal freedom, labour freedom and business freedom,it performs poorly in property rights, freedom from corruption (Transparency International's Global Corruption Index ranks it140 out of 180 countries) and monetary freedom (distortion of domestic prices). Rule of law remains problematic in Azerbaijan, and according to the report, despite some improvement, corruption remains a major concern in Azerbaijan. The freedom from corruption score is 24. The system for registering property is prone to onerous bureaucratic requirements. Azerbaijan's score on property rights is very low (25). Azerbaijan does better on the "Limited government" index. "Government spending" (67.8) and "Fiscal freedom" (85.5) are subcategories of the index. Other taxes include a value-added tax (VAT) and a property tax. The overall tax burden equals 12.4% of total domestic income. Government spending has fallen to 32.8 per cent of GDP. Large revenues from the energy sector enable budget surpluses, but strong growth in the non-energy sector has also encouraged fiscal health. Public debt remains low[166]. "Business Freedom" (69.2), "Labour Freedom" (79.4) and "Monetary Freedom" (73.5) scores demonstrate regulatory efficiency. Although Azerbaijan has made various reforms to create an investor friendly business environment, completing licensing requirements and enforcing the labour code remain obstacles. Customs restrictions create troubles with imports, and there are also threats to the open market. "Trade Freedom" (77.2), "Investment Freedom" (55) and "Financial Freedom" (40) scores reveal the issues there.

Bertelsmann Transformation Index (BTI) has two dimensions: political and economic transformations. According to the BTI Status index, Azerbaijan is in 85th place. However, BTI ranks Azerbaijan as 63rd in the world based on Economic Transformation. Economic Transformation is based on indicators such as currency and price stability, property rights and others.

Competitiveness Report (GCR) is a yearly report published by the World Economic Forum. The Global Competitiveness Index offers a systematic and comprehensive approach to identifying and measuring the drivers of economic performance of more than 140 economies. The Index consists of different sub indices; a higher score means a better performance. Institutions, infrastructure, macroeconomic environment, health and primary education are basic requirements for global competitiveness. According to the index, corruption and access to finance are the most problematic factors for doing business in Azerbaijan[167].

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166 http://www.heritage.org/index/country/azerbaijan

167 http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf

Georgia

When we analyse the positions of Azerbaijan, Georgia and Ukraine in international rankings, we can observe some contradictory perceptions of economic policy success. For example, discrepancies between Georgia's positions across different world ratings provoke confusion and distrust. Freedom of business indexes such as the World Bank's *Doing Business* and the Heritage Foundation's *Index of Economic Freedom* gave Georgia high rankings in 2013 (9th and 21st respectively). But another well-regarded source, the *Global Competiveness Index* (GCI), which is issued yearly by *World Economic Forum* (2012), put Georgia in 77th place. *Bertelsmann Transformation Index* (BTI), which assesses the status of the country both in terms of democratic achievements and economic performance ranked Georgia 58th. The Market Economy Status for Georgia by the BTI puts Georgia even lower, at 64th place.

Can we reach any definite conclusions from the mentioned rankings? It is clear that the results of a single index cannot providean objective assessment about the performance of a country. The indexes mentioned above serve different aims, but nonetheless let us try to compare the main indexes of the ratings and identify any commonalities. Only two of the well-known indexes – *Doing Business* (World Bank) and the *Index of Economic Freedom* (Heritage Foundation) have directly comparable features in five areas, among them Fiscal Freedom/Paying Taxes, Business Freedom/ Starting Business, investment Freedom/Protecting Investments, Getting Credit/ Financial Freedom, Trade Freedom/Trading Across Borders. Georgia occupies surprisingly high positions in both ratings, thanks to the government's focus during recent years on deregulation (elimination of permits, licenses, import duties, etc.) and easing barriers to starting and operating businesses. Key policy objectives included the reduction of the number and level of taxes, elimination of corruption, improving and easing customs clearance procedures, and reducing any other challenges to smooth operation of businesses. All these efforts have contributed to rapid economic growth, more investors, increasing the trade turnover, boosting the growth of financial sector, etc. Observing the reform process from that angle, one can see that the problems with the inefficient judiciary and property rights have been dragging the general figures down. Notably, Georgia was selected by *Doing Business* as the number one reformer from 2005 until the present[168]. In 2012, Georgia improved in six areas. In particular, there were significant improvements in *Trading Across Borders* (TAB), through the introduction of customs clearance zones (24-hour one stop shops) in the cities of Tbilisi and Poti. However, the country is still ranked 38th in *Trading Across Borders.* The *Index of Economic Freedom* (IEF) in its *Trade Freedom* section gives Georgia a very high score (89%) and rates it 6th in the world. This is due to the drastic reduction of

[168] Doing Business, p.1

tariffs on imports (trade-weighted average tariff is the world's lowest at 0.4%). At the same time Georgia has practically no market access barriers, food safety regulations, technical product regulations, environmental or other regulations used by some other countries as non-tariff barriers.

These two rankings, from two different and equally respectable sources, appear incompatible and contradictory. The difference is due to the methodologies used. While DB calculates the TAB index by measuring the number of necessary documents, duration of procedures, and the cost of procedures for export-import (taken in customs and ports), IEF focuses on the tariff and non-tariff barriers. An analysis of the above indices leads us to conclude that Georgia still needs to reduce costs on cargo handling in terminals and inland transportation and handling, which together with the document processing and clearance makes the cost 50% higher than the OECD average. The two indexes also characterize also Georgia in terms of attractiveness to investors. A direct indicator (protection of investors) for DB puts the country in 19th place, two places lower than in 2012. For protections for minor shareholders' rights, especially against abuse from big shareholders or the board members, Georgia ranks 19th. IEF measures the attractiveness to investors from different angles, looking in particular at thefollowing: national treatment of foreign investment, foreign investment control, restrictions on land ownership, sectoral investment restrictions, expropriation of investments without fair compensation, foreign exchange controls, and capital controls. The overall score for this indicator puts Georgia in 23rd place internationally. The strongest position here is the *national treatment* given to all investors, and the weakest position is the *land ownership*. There are also topics from the DB that are indirectly related to the opportunities for the investments. Among them are ease of registering property (rank #1), enforcing contracts (rank #30), getting electricity (rank #50) and resolving insolvency (rank #81). In the last two areas, Georgia still has a long way to go.

The very different approach taken by the *Global Competitiveness Index* (GCI) focuses on the indicators characterizing sustainable and efficient economic growth. Despite the progress made last year (a ten point improvement), Georgia is still only 77th in the world. It is considered to be an 'efficiency driven' economy, while the top performing 30 economies are considered to be 'innovation driven'. Each GCI pillar is compiled from the scores of 12-20 indicators. A closer analysis of pillar indicators shows more similarities with the components used in other ranking systems. Frequently, the scores coincide or are close to those seen in other indexes. For example, Pillar I – *Institutions*- contains among others an indicator of "Burden of Government Regulation",for which Georgia is ranked as 9th. In terms of content, this indicator is similar to the *Business Freedom* (Rank #16) indicator from the IEF, and is almost same as the overall DB indicator, for which Georgia is ranked 9th. Taking into consideration that the data used for different rankings fluctuates across 2011-2012, we cannot expect scores to match completely, but the trends are certainly compatible. Another example is the "Strength of Investors protection" indicator from CGI (Rank #17), which is very close to a DB topic (Rank #19), and broadly compatible with the IEF (Rank #27). Despite these similarities within Pillar I (Institutions), GCI gives Georgia quite a low overall score, because of weaknesses in other indicators like *Property Rights, Efficacy of Legal Framework, Protection of minority shareholders interests,* etc. Georgia does quite well (#9) on the indicator "Hiring and firing practices" from the Pillar 7 – "Labour Efficiency". The IEF ranks Georgia as third in the world with a similar indicator, "Labour Freedom". But again the overall score for the Pillar 7 is low because of the high level of brain drain, non-reliance management, poor cooperation in labour-employer relations, and so on. Looking at Pillar 6, "Goods Market Efficiency", such indicators as "Number of days to start business" or "Procedures to start business" or "burden of customs procedures" rank Georgia respectively at 2nd, 3rd and 13th place in the world, but for "Extent of market dominance" or "Effectiveness of competition policy", it ranks extremely low.[169]

Bertelsmann Transformation Index (BTI) ranks Georgia 58th in the world. It has two main dimensions – *Political Status* and *Market Economy Status* (Economic Transformation). For the purposes of our research we have analysed *Economic Transformation.* In 2012 (last available data), Georgia is ranked 64th. Again, the methodology is different and this particular index is estimated according to seven criteria: Level of socioeconomic development, Organization of the market and competition, Currency and price stability, Private property, Welfare regime, Economic performance, Sustainability. The scores given in the two areas most important for trade and investment – *Organization of the Market* and *Private Property*- are highest (7.3 and 7.0) and close to similar indicators from the detailed data on the CGI, which is also measured with 1-10 scale. The BTI country report[170] in the section on Private Property in Georgia emphasises on two main things – protection of the private property and privatization. With regard to the protection of property, it makes reference on the World Bank DB Index, where Georgia is ranked number two for legal improvements in this field. But BTI goes further, and provides a narrative analysis with evidence of misconduct and violations by the government and local authorities of the property rights of individuals and companies in number of cases, which downgrades and corrupts the progress made in the legal development field. The same report analyses "Organization of the Market and Competition" indicator in terms of four main aspects:

169 Ibid, page 175

170 Available at: http://www.bti-project.org/laendergutachten/pse/geo/2012/#chap9

Market Based Competition, Antimonopoly Policy, Liberalisation of Foreign Trade and Banking System. The report mentions tangible progress across all spheres made in recent years, but the following problems prevented a higher ranking: Arbitrary application of the tax rules, high share of shadow economy, absence of independent competition authority, small size of the banking sector.

The four best-known indexes for measuring economic success give a diverse picture due to the differences in methodologies. Such rankings as *Doing Business* and *Economic FreedomIndex* provide narrower views of economic reform successes, as they assess a very concrete and limited view of the achievements. The sectoral indexes with these two systems are simple, and on rare occasions, are based on different data. The sectoral (pillar) indexes of CGI and BTI, on the contrary, are highly aggregated and complex. It is very important for the country to be as high as possible in these rankings, as they inspire confidence in investors and foreign business partners. According to these two indexes, Georgia is one of the best reformers, accelerating the rate of reforms every year. The ratings in the foreign trade and investment protection related fields are quite high, and the absence of important legal or administrative barriers to trade and investment are secure. At the same time, the problems in such spheres as *contact enforcement* (linked to judicialindependence) or *insolvency solutions* remain problematic. The *Global Competitiveness Index* is based on very large number of parameters and shows Georgia's performance not just in terms of the possibilities, but its real achievements and strengths. The research revealed that there are no significant discrepancies in the evaluation of identical or closely related indicators with other indexes and Georgia remains high in terms of the freedom and opportunities related to trade and investments, but for a significant number of other important indicators such aslabour efficiency, anti-monopoly policy, technological absorption, state cluster development, R&D, Innovations, etc., the country does poorly. On a list of *Efficiency driven Economies*, CGI places Georgia *in* between Resource Driven and Innovation Driven, which is typical for a country in transition.

The Bertelsmann Index is focused on reforms that not only ease the process of starting and operating a business, but increase the rate of the sustainable changes through strong market organization, infrastructure, and institutions. The components of the index related to doing business are taken into consideration, but the legal and administrative changes influencing the mentioned indicators are closely analysed and weighted by practical application. This ultimately downgrades the overall status of the country and puts it just above the average.

Finally, according to all the mentioned indicators it can be concluded that the reforms in the country were predominantly oriented at satisfying the simpler benchmarks of the DB and IEF Indexes. This makes sense as an initial strategy, but without focusing on in-depth institutional development goals, the country cannot become attractive for investors. There is a need for sustainable institutional changes, societal development and investment in human capital, innovation and good governance, and efficient market regulation in order to really attract for investments, as well as for trade operations. A small and poorly developed market, even with good freedom of access, will never really be attractive to investors.

Ukraine

Different indices provide widely varying estimates of the quality of business environment in **Ukraine**. On the one hand, two indices put Ukraine in the group of the worst performing countries. According to the 2013 Index of Economic Freedom (IEF)[171], Ukraine is a repressed economy, ranked 161st out of 177 countries[172]. The World Bank's Doing Business 2013 (DB) Index[173], which measures "the regulation and red tape relevant to the life cycle of a domestic small to medium-size firm", rates Ukraine 137th out of 185 countries. On the other hand, Ukraine holds much better positions in two other indices. The Global Competitiveness Index 2012-2013 (GCI)[174]rates Ukraine 73rdout of 144 countries. The Bertelsmann Stiftung's Transformation Index 2012 (BTI)[175], which evaluates whether developing countries are "steering social change toward democracy and a market economy", ranks Ukraine 60thout of 128 countries with the Economic Transformation indicator. The discrepancy, however, can be explained by the different scopes of the indices. If similar components of the indices are compared, it will be found that all four indicators provide a consistent view of the effects of reforms in Ukraine. That view is described in detail below.

It should be mentioned that all indices are based on the idea that economic freedom fosters economic development[176]. Therefore, the lighter and more effective regulation

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171 The Index of Economic Freedom by The Wall Street Journal and The Heritage Foundation (http://www.heritage.org)

172 The number of countries in the rankings by the components of the Index of Economic Freedom (IEF) varies in the range 177-184 since a few countries were not ranked by several indicators due to a lack of data.

173 http://www.doingbusiness.org

174 http://www.weforum.org/issues/global-competitiveness

175 http://www.bti-project.org/

176 As stated on the IEF website: "Countries with higher levels of economic freedom substantially outperform others in economic growth, per capita incomes, health care, education, protection of the environment, and reduction of poverty". (http://www.heritage.org/index/book/executive-highlights)

is, the higher a country is ranked by all indices. Some rules in Ukraine are liberalised: income and corporate tax rates are relatively low, as are customs duties. But in general, the regulation of business in the country is heavy and ineffective. The relatively high positions that Ukraine holds are in the rankings for contract enforcement and legal protection of borrowers and lenders. The lowest positions are related to getting construction permits, taxation, and property rights protection. Starting a business is not very difficult in Ukraine — the country is ranked 50th out of 185 by the corresponding indicator of the DB index. But the regulation of business activities is much more burdensome. Ukraine is among the three countries that have the most complicated and costly procedures for getting construction permits in the world (183rd position). The IEF estimates that the level of fiscal freedom in the country is moderate (95th out of 179 countries with a score of 78.2 out of 100) while the DB index puts Ukraine among the 21 countries deemed to have the worst tax regimes in the world (165th position in the list of 185 countries, ranked by the Paying Taxes indicator). The discrepancy is due to different measures of the tax burden. The IEF takes into account income and corporate tax rates, which are relatively low in Ukraine (the highest marginal rates are 17% and 21%, respectively), and the overall tax burden (38.1% of GDP, 168th in the world). The DB indicator, on the other hand, also places an emphasis on administrative burden in paying taxes, including number of payments and time cost of the procedures. The administrative burden is very high in Ukraine: employees of a medium-sized company have to spend 491 hours per year to make all due payments to the government.

Three out of four indices put Ukraine in a group of countries with poor protection of property rights. Registering property is complicated and cumbersome: the country is ranked 149th out of 185, according to the corresponding DB indicator. Furthermore, the ability of the government to secure the rights is weak. Ukraine is among the countries that hold 94-134th positions in a list of 180 countries (with a score of 30 out of 100), according to the IEF Property Rights component. Ukraine is also rated 134th out of 144 countries by the GCI property rights indicator (with a score of 2.73 out of 7). Only the BTI estimates that the situation with property rights in Ukraine is mediocre rather than poor. The index puts Ukraine among the countries ranked 62-76th (out of 128) with a score of 6 out of 10. The higher rank can be explained by the broader scope of the Private Property component of the index: it evaluates not only property rights protection but also private business limitations and privatization procedures. Inferior protection of private property is linked to more general problems — weak judiciary and corruption. Ukraine is ranked 157th by the DB Resolving Insolvency indicator, which measures the ability of creditors to recover their funds from a bankrupt company. Shareholders' rights protection is also weak: Ukraine holds 117th position in the DB ranking of countries by the Protecting Investors component. According to the IEF Freedom from Corruption indicator, Ukraine is in the list of the most corrupt countries in the world, sharing 152nd-153rd positions out of 184 countries with Tajikistan (with a score of 23 out of 100). The only indicator that leaps out is the DB Enforcing Contracts indicator. Given low ranks by the other judiciary-related components of the indices, it ranks Ukraine surprisingly high —42nd out of 185 countries.

Judgments about barriers to trade are contradictory. On a list of countries that are open to foreign trade, the IEF ranks Ukraine 50th out of 180 countries (and with a score of 84.4 out of 100) according to the Trade Freedom component. But according to the DB index, trading across borders is not easy in Ukraine: the country is 145th out of 185 countries. The divergence is due to different methodologies used. The IEF Trade Freedom component is calculated based on weighted average tariff rate, and it also includes a penalty for non-tariff barriers, whereas the DB indicator takes into account the real costs of export and import operations that integrate all due payments (which include not only duties) and non-monetary costs (time, number of procedures). In particular, the DB index recorded that on average a company has to pay USD 2,155, fill in 8 documents, and spend 33 days to import a container into Ukraine. Preparation of documents is the lengthiest part of the import procedures, while cargo handling and transportation is the costliest part. The corresponding figures for OECD countries are USD 1,080, 4 documents, and 10 days[177]. The export procedures in Ukraine are easier but only to a minor extent. The indices also assert that competition in Ukraine is weak. The country is ranked 134th out of 144 countries, according to the GCI Competition component, which measures both domestic and foreign competition. The BTI gives a more positive assessment: Ukraine holds 62nd position out of 128 countries by Organization of the Market and Competition component of the index (with a score of 6.3 out of 10). But that index has a broader scope that also encompasses the level of development of the financial sector.

Conclusion on Chapter IV

Considering that the study analyses three countries, it is worth comparing Azerbaijan, Georgia, and Ukraine based on their respective rankings.

According to the Doing Business report, Georgia performs fairly well - not just in comparison to Azerbaijan and Ukraine but also internationally. In this index, ease of starting a business, trade across countries, getting electricity and other indicators are considered. Georgia performs better in the Economic Freedom Index. While Georgia is ranked 21st, Azerbaijan and Ukraine are 88th and 161st place in the world. Freedom from corruption, fiscal, monetary, labour, business, and investment freedoms,

177 http://www.doingbusiness.org/data/exploreeconomies/ukraine#trading-across-borders

along with government spending are major indicators considered by the Heritage Foundation. The Global Competitiveness Report looks for institutional, infrastructural, macroeconomic and efficiency conditions in different markets. Compared with Georgia and Ukraine Azerbaijan does best. According to the Bertelsmann Transformation Index, on Economic Transformation, Ukraine, Azerbaijan and Georgia do not differ significantly. Levels of socioeconomic development, welfare regime, and stability are the main concerns.

Table 18. Major economic indexes by region, 2013

Index 2013	Azerbaijan	Georgia	Ukraine
Doing Business	67	9	137
Economic Freedom	88	21	161
The Global Competitiveness Report	46	77	73
Bertelsmann TI (Economic Transformation)	63	64	60

CHAPTER V. EXTERNAL INITIATIVES FOR REFORMS

The role of external initiatives in reforming economic policy in Azerbaijan, Georgia and Ukraine has been huge. Integration into the global trade system required adjustment of trade regulation to the norms and practices of the World Trade Organization (WTO). Development of cooperation with the European Union (EU) brought about the approximation of certain economic policies to the EU standards. However, the three countries have implemented those reforms to different extents.

5.1. The role of the EU

The framework for cooperation. The EU is the largest market in the world[178] and an important trade partner for each of the three countries. In 2011, the EU's share in foreign trade of Azerbaijan was 42.5%; the respective figures for Georgia and Ukraine were 26.1% and 29.7%. Looking in the other direction, the proportions were much smaller: Azerbaijan's share in the overall EU trade was 0.5%, the shares of Georgia and Ukraine were 0.1% and 1.1%, respectively (2011)[179]. All three countries benefit from the EU's Generalized Scheme of Preferences (GSP). Moreover, under the current GSP Regulations, applied from January 2009, Azerbaijan and Georgia qualify for the special incentive arrangement for sustainable development and good governance (GSP+), offering advantageous access to the EU market. Generally, trade relations are a part of the EU's overall political and economic relations with Azerbaijan, Georgia and Ukraine.

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178 The GDP of the EU was USD 17578 billion in 2011

179 Source: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113347.pdf
http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113383.pdf
http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf

The current relationships between the EU and the countries are governed by bilateral Partnership and Cooperation Agreements (PCAs), which entered into force in 1998 (with Ukraine) and 1999 (with Azerbaijan and Georgia). The relationships have been developing through the European Neighbourhood Policy (ENP), which is complemented by the Eastern Partnership (EaP) initiative. The EaP provides for wider opportunities for developing regional cooperation in Eastern Europe. Multilateral framework of cooperation through Thematic Platforms and Panels is dedicated to developing opportunities for trade openness, movement of people, people to people contact, energy and transport connections etc. The cooperation in the framework of EaP stimulates work on Europeanization of legislation and institutions in partner countries. This is aimed at increased openness of partner states towards the EU, but also towards each other. Following the conclusion of bilateral free trade agreements (FTAs) between the EU and the partner countries (Georgia, Azerbaijan, Armenia, Ukraine, Moldova), the establishment of a so-called Neighbourhood Economic Community[180] will be just a matter of political will once their trade related legislation has become fully compatible. Almost all EaP countries have reciprocal visa free regimes, and compliance with the demands related to EU visa liberalisation process, especially through so-called Visa Liberalisation Action Plans, will increase appeal and safety of mobility among partner countries as well[181]. The EaP will contribute to the development of transport and energy infrastructure through the Eastern Europe and South Caucasus region, which will increase opportunities for economic cooperation, including trade, investment, and establishment of businesses. The biannual meetings of the heads of states, annual meetings of foreign ministers and frequent contact and constructive interactions between government officials supports bilateral relationships in the region and reconciliation of those states that have political differences or even conflicts. This is the most important aspect of the Eastern Partnership, and should be recognised, used, and supported by all the partner states for their individual and collective benefit. As mentioned earlier, the Eastern Partnership provides for closer economic and trade relations with the EU through bilateral FTA's, namely Deep and Comprehensive Free Trade Agreements (DCFTAs). This is a newly developed type of EU agreement, first signed with Chile in 2002. The agreement may include complete elimination of customs duties, bringing the partners' customs procedures closer to the EU ones, application of EU sanitary and phyto-sanitary rules, and approximation of rules on public procurement and competition to the EU *acquis*[182]. However, the

180 Eastern Partnership, Communication from the Commission to the European Parliament and the Council, {SEC(2008) 2974}Brussels, 3.12.2008, COM(2008) 823 final, page 3

181 That aspect of the countries' relationship with the EU is described in the chapter IV.

182 According to the official EU definition, "a deep and comprehensive free trade area (DCFTA) is about closer economic integration, including:

- *complete elimination of customs duties — so that products can enter duty free and result in lower prices of goods to the benefit of consumers;*

agreements can be concluded only with countries that are WTO members. Georgia and Ukraine have been WTO members since 2000 and 2008, respectively. Azerbaijan applied for membership to the WTO in 1997 and the negotiation process is ongoing. As the country is not yet a member of the WTO, the EU is negotiating a non-preferential trade and investment agreement with Azerbaijan. Azerbaijan also receives technical assistance from the EU to help it to prepare for WTO membership.

The role of the EU: Azerbaijan. It is important to note that the South Caucasus region plays an important role both in supplying energy to the EU, and as a transit route to the EU market Azerbaijan is a major supplier of oil and gas to the EU, as recognized in the EU-Azerbaijan memorandum of understanding on energy concluded in 2006. Azerbaijan's economy has surged mainly due to its oil exports; however, trade and investment in the non-oil and gas sectors of the economy have been lagging, due to policy and regulatory distortions and a hostile business environment. With comparatively poor performances in the areas of business registration and licensing procedures, restrictive trade practices, taxation guidelines, and investor protections, the government of Azerbaijan made particular reforms that were required for the country to compete in the global economy. Those reforms included designing accession-related legislative packages in areas such as customs valuation, rules of origin guidelines, tariff bindings, import and export control requirements, trade remedies, SPS-related legal and policy reforms. The packages also covered service sector market access, public procurement reforms and general subsidy/countervailing duty legislation[183]. Mutual relations with the European Union and the WTO accession process played an important role in those reforms. The EU's relations with Azerbaijan are regulated by the EU-Azerbaijan Partnership and Cooperation Agreement (PCA), signed in 1996 and effective since 1999. The PCA provided the legal framework for the EU-Azerbaijan bilateral relations in different areas including trade, investment and economic cooperation. Various joint institutions set up under the PCA (e.g.

- *improvement of customs procedures — bringing the partners' legislation closer to the EU one to unify procedures for imports;*
- *increased protection of intellectual property — to improve in particular enforcement of legislation and bring the level of IP protection on a par with that in the EU;*
- *application of EU sanitary and phyto-sanitary rules — to increase the level of food safety protection within the countries and so allow exports of products of animal origin to the EU;*
- *upgrade rules on public procurement and competition — thereby creating a transparent and predictable regime for economic operators both in private and public commercial transactions;*
- *removal o*f technical obstacles to trade — to facilitate trade in industrial products but also, by upgrading infrastructure and conformity assessment procedures, to gradually increase competitiveness of their industries".

From http://ec.europa.eu/trade/policy/countries-and-regions/regions/south-caucasus/

183 http://www.chemonics.com/OurWork/OurProjects/Pages/Azerbaijan-Trade-and-Investment-Reform-Support-Program.aspx

the Subcommittee on Trade, Economic and Related Legal Affairs) have functioned efficiently and have ensured a regular dialogue at the political and technical levels.

Following the enlargement of the European Union, the EU launched the European Neighbourhood Policy (ENP), of which Azerbaijan became a part in 2004. In the context of the ENP, the EU developed the five-year Action Plan in consultation with Azerbaijan. That plan both reflects the specific needs of the country and contains concrete goals, actions and socio-economic reforms to be achieved in the short and medium term. The Action Plan is also a long-term reform agenda for various policy areas, including trade and trade-related matters. However, the reform process, in line with the similar Action Plans, is continuing for Armenia and Georgia parallel to ongoing trade negotiations, but not for Azerbaijan[184]. In addition to the European Neighbourhood and Partnership Instrument (ENPI) national program, Azerbaijan also benefits from the ENPI regional and interregional programs, plus a number of thematic programs such as the European Instrument for Democracy and Human Rights (EIDHR). In the case of Azerbaijan, Technical Assistance to the Commonwealth of Independent States (TACIS) has in recent years focused on continued support for institutional, legal and administrative reform as well as addressing the social consequences of transition. Among the priorities of the ENPI National Indicative Program (NIP) were socio-economic reforms and meeting EU standards for national legislation. The package of assistance within EU programs for Azerbaijan was expected to total EUR 88 millon in 2007-10 and approximately EUR 122.5 million in 2011-13. The assistance directed at building capacities of government institutions in the justice sector, trade matters and public administration in general.

Azerbaijan has made some positive steps towards cooperation with the EU by beginning discussions for an Association Agreement to succeed the PCA. That agreement, which will be the new basic legal document for the bilateral cooperation, will significantly deepen Azerbaijan's political association and economic integration with the EU[185]. The agreement negotiations are conducted on four thematic platforms – political dialogue (foreign policy, security); law, human rights, public security; economy, including social and humanitarian cooperation; trade. The EU passed guidelines for Association Agreement negotiations in 2010. Negotiations will also cover issues of maximum possible trade liberalisation. Azerbaijan is not a member of the World Trade Organization, and at the current stage there is no discussion of a sound free trade area. A sound trade agreement can be accorded and signed at later stages when Azerbaijan becomes a WTO member. Azerbaijan is receiving technical assistance from the EU to help it to prepare for WTO membership. Moreover, with a

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184 http://www.eeas.europa.eu/azerbaijan/eu_azerbaijan_summary/index_en.htm

185 http://www.eeas.europa.eu/azerbaijan/

view to supporting Azerbaijan's future WTO membership and subsequent eventual bilateral Deep and Comprehensive FTA, negotiations on upgrading the existing trade related provisions of the Partnership and Cooperation Agreement (non-preferential trade and investment agreement) were launched on 16 July 2010.

Potential global developments also will impact trade partners of the EU including Azerbaijan. The process of combining two of the largest free trade zones — the European Union and NAFTA (the North American Free Trade Agreement), which includes the USA, Canada and Mexico, has been launched. The idea, proposed in 2007 by Germany but rejected by the US, today is considered by the American and European authorities to offer the best way out of the debt crisis, currently devastating the eastern and western coasts of the Atlantic. The choice of Belarus, Russia and Kazakhstan, which have joined to create their own Customs Union, is obvious, like the choice of their neighbours in Central Asia. However, the path for Ukraine, Moldova, Armenia, and even Georgia is less clear. In this regard, Azerbaijan, which directed 80-90% of its exports to the EU and the United States, is de facto a part of the transatlantic trade market. Whether it will become a formal member of alliance NAFTA/EU, depends on many factors, not necessarily related to the policy of the country[186].

The role of the EU: Georgia. The Partnership and Cooperation Agreement between the EU and Georgia has been in force since 1999. The part of the agreement that covered trade entered into force in 1997, in the form of an interim agreement that did not require completion of internal procedures in the EU member states to become effective. Trade provisions of the PCA were designed according to the WTO provisions. The EU's aim was to establish MFN and other WTO rules for trade with Georgia, as well as other former Soviet countries, on a bilateral basis. The PCA also granted MFN status for Georgian and Community companies for trade in services. It provided the EU companies with the national treatment in both establishment and operations on Georgian territory. The EU granted Georgia treatment that was not less favourable than to any third country. The PCA also contains a provision on the Generalized System of Preferences in trade in goods for Georgia. As Georgia acceded WTO in 2000, most of the provisions of the PCA became duplications of WTO articles, but the agreement played an important role in preparing the country for WTO accession. In addition the PCA introduced a special article (43) representing a binding commitment on approximation of Georgian regulatory basis and legislation with the EU *acquis*. Even though that was a soft obligation, it stimulated development of institutions regulating the food safety, competition, government procurement, companies, financial rules and certain other topics in accordance with the EU practices. The country did develop an EU compatible Customs Code defining clearance and other customs procedures.

186 http://abc.az/eng/news/70592.html

Later, cooperation formats like ENP and EaP established more concrete benchmarks and pushed Georgia to further approximate its laws to the EU standards. Georgia embarked on talks for a Deep and Comprehensive Free Trade Area with the EU in early 2012. The draft agreement is structured according to four main titles, as provided in Table 19.

Table 19. Chapters of the draft DCFTA between Georgia and the EU[187].

#	Title	Chapter
1	Free movement of goods	Trade in goods
2		Rules of origin
3		Customs and trade facilitation
4		Technical regulations on industrial products, standards and conformity assessment procedures
5		Sanitary and phyto-sanitary measures
6	Services and investment	Services, freedom of establishment and investment
7		Capital movement and payments
8	Rules and horizontal matters (including trade defense)	Competition
9		Intellectual property rights protection, including geographical indicators
10		Public procurement
11		Trade and sustainable development
12		Transparency
13		Trade defense instruments
14	Institutional provisions	Dispute-settlement/mediation mechanism
15		Institutional structures /provisional application

Source: own compilation from various official and unofficial sources

According to official sources, negotiations on the main chapters of the DCFTA went relatively smoothly (in contrast to talks with Ukraine). This is due to the openness of the Georgian trade regime and near-absence of tariff and other forms of market protectionism. Secondly, Georgia, with its small volumes of trade, does not pose

187 The table provides a tentative description of the DCFTA content, derived from different partial comments and incomplete sources. Before the negotiation results are disclosed to the public, full information on the draft agreement will not be available, and nor are the annexes.

any threat of distortion for the EU market. The major burden for Georgia is the commitment to implement provisions demanding setup of regulatory institutions providing full control over SPS sphere, technical regulations on industrial standards and conformity practices satisfying EU demands. A significant effort will be required to implement the provision on conformity assessment procedures, which will be important for signing the "Agreement on Conformity Assessment and Acceptance of Industrial Products". The Chapter on services indicates the need for EU standards across such spheres as insurance, at which point Georgian companies may encounter serious difficulties. Georgia has poorly developed trade defense instruments, which cannot create obstacles to imports of goods or services. Georgian legislation does not recognize antidumping or countervailing measures, although these measures are referred to in a number of bilateral and multilateral agreements to which Georgia is a signatory. Georgia has no safeguards[188] or other contingency measures agreed within the WTO, so such provisions would not constitute any problem for speedy negotiations. It is unofficially known that both parties plan to conclude negotiations on DCFTA chapters. It is also planned that the full Association Agreement will be concluded at the Vilnius summit in November 2013. In case it is impossible to introduce *an enabling close* for the DCFTA chapters, the ratification procedures in EU member states will take an additional two years.

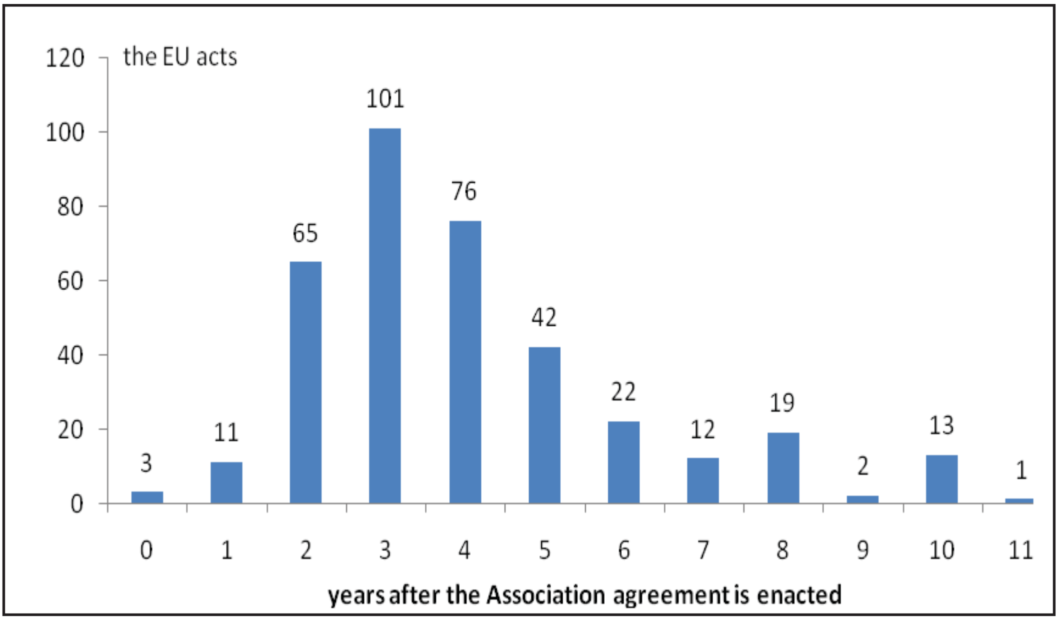
The role of the EU: Ukraine. The cooperation between Ukraine and the EU is based on the Partnership and Cooperation Agreement, which was signed in 1994 and has been effective since 1998. The agreement introduced the MFN principle to bilateral trade. The PCA also made provisions for use of other WTO principles in the spheres of anti-dumping and countervailing measures, valuation for customs purposes, rules of origin, and certain others. EU-Ukraine cooperation has been developing through the country's European Neighbourhood Policy Action Plan (2005), and the EU-Ukraine Association Agenda (2009). The cooperation with the EU induced important policy changes in Ukraine. For example, in 2005, the EU granted market economy status to Ukraine after the country pledged to revoke some price controls. The visa facilitation negotiations within the framework of the EU Eastern Partnership urge Ukraine to implement a migration policy reform, as well as anti-corruption policy and internal affairs reforms. In 2008, Ukraine and the EU launched official negotiations on a Deep and Comprehensive Free Trade Agreement. The DCFTA, which is part of the EU-Ukraine Association Agreement, is expected to be signed in November 2013[189]. Currently Ukraine has free trade agreements with the CIS countries that account for about 40% of the country's trade. The process of bilateral tariff liberalisation

[188] See: Trade Policy Review, Georgia Revision, WT/TPR/S/224/Rev. Page 43, 19 January 2010

[189] But the chances of signature of the agreement depend on political circumstances.

will continue if Ukraine signs the DCFTA with the EU, Ukraine's second largest trade partner. But the DCFTA envisages not only significant liberalisation of tariff protection; the implementation of the DCFTA is expected to advance reforms that were made during the WTO accession process (see "The impact of the WTO: Ukraine"). Specifically, the anticipated regulatory reforms include approximation of Ukraine's TBT/SPS regulation to EU standards, advanced reforms in the spheres of public procurement, state aid, competition policy, financial regulation, etc. More than 350 EU directives and other documents are expected to be implemented into Ukraine's legislation. The anticipated impact of the DCFTA on Ukraine's policies is reviewed below.

Chart 23. The timetable for implementation of the EU directives and other acts into Ukrainian legislation, by years



Source: the EU-Ukraine Association Agreement draft

Merchandise trade liberalisation. The DCFTA makes provision for further reduction in tariffs in the bilateral trade. Over 95% of the EU's and Ukraine's import duties will be set at zero, and the rest will be substantially reduced[190]. While the EU has committed to nullify import tariffs for majority of products immediately after the DCFTA enactment, tariff liberalisation in Ukraine would not be so instantaneous. A transition period would allow Ukraine to decrease imports duties gradually thus

[190] Sushko O. et al (2012) EU-Ukraine Association Agreement: Guidelines for Reform. KAS Policy Paper No.20.http://www.kas.de/wf/doc/kas_32048-1522-2-30.pdf?120911173352

ensuring smooth adjustment to growing domestic competition. Also, Ukraine will be able to put in place temporary protections for several sensitive markets, to soften the impact of reduced customs duties. For instance, Ukraine will be able to introduce a safeguard duty against imports of passenger cars (HS 8703) originating from the EU if these imports cause or threaten to cause serious injury and if the volume of imports exceeds certain thresholds. But the duty cannot exceed the MFN tariff rate for passenger cars, bound at 10%. The length of the transition period will be 15 years. Ukraine has committed not to apply export duties in the bilateral trade with the EU after conclusion of the agreement. The elimination of existing export duties will be gradual and will take 10 years. At the same time, the country will be able to impose surcharges on several export products (sunflower seeds, skins and non-ferrous metals scrap) during the transition period.

Trade in services. Further liberalisation of trade in services is expected within the framework of the DCFTA. In particular, the DCFTA envisages legislative approximation in financial services, telecommunication services, postal and courier services, and international maritime services. When Ukraine implements the EU *acquis* in those sectors, Ukrainian firms will be granted access to the EU internal market for these sectors[191].

Equal opportunities policy implementation. The DCFTA provides for reforms aimed at the implementation of an equal opportunities policy. First, the agreement with the EU will induce policy changes aimed at enhancement of competition. Ukraine will adapt its laws and enforcement practices to the corresponding EU *acquis*. Second, the obligations of Ukraine concerning state aid will be reinforced. According to the EU legislative principles embedded in the DCFTA, any state aid that distorts or threatens to distort competition must be avoided. The EU *acquis*, however, contains a list of exceptions: generally prohibited state aid may be granted if (1) it has a social character, (2) a natural disaster occurs, (3) the aid is aimed at facilitating the development of certain economic activities or areas (provided that the aid does not have a negative impact on the trade between Ukraine and the EU), and some others. Ukraine has committed to approximate its legislation to the EU directives, and to set up an operationally independent executive body to control state aid. The state aid reform has to be implemented within three years after the agreement becomes effective. Third, the DCFTA requires reform of public procurement procedures. Ukraine has committed to further harmonize its corresponding laws to the EU *acquis*, implementing the basic EU principles of public procurement regulation including

[191] EC (2013) EU-Ukraine Deep and Comprehensive Free Trade Area. European Commission http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150981.pdf

procedures for the conclusion of contracts, procedures of informing contenders, determination of winners, and legal defense.

TBT/SPS reform. If the expected reform is achieved, the system of technical regulation in Ukraine will correspond to the EU model. The agreement makes provision for reforms aimed at harmonizing Ukraine's systems of standardization, metrology, conformity assessment, and market surveillance system with EU norms and practices. The country will approximate its laws to the EU *acquis*, and implement institutional reforms in order to achieve this goal. Ukraine also is expected to join the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), which is included in the DCFTA as an addendum. Joining the ACAA implies that trade between Ukraine and the EU in certain sectors (defined by the agreement) will be subject to the same technical regulation as trade among the EU members.

In the SPS sphere, the conclusion of the agreement will lead to the establishment of the committee on SPS management, which will assess the equivalence of SPS measures in Ukraine and the EU. If many of the measures are recognized as equivalent, trade in agricultural products will become much easier.

Capital controls reform. Ukraine is open to inflow of capital, but outward investments are subject to heavy restrictions. There is a lot of red tape involved for a domestic company to get authorization to invest abroad or to provide a loan to a non-resident. Authorizations are granted by the National Bank of Ukraine, and subject to checks by the Ministry of Internal Affairs and the Security Service of Ukraine. The DCFTA may bring radical changes to the regulation of outward investment. The agreement allows for free movement of capital in connection with the following: direct investments, credits related to commercial transactions, portfolio investments, and financial loans and credits between Ukraine and the EU. Furthermore, Ukraine has committed to liberalise the "transactions on the capital and financial accounts of balance of payment equivalent to the liberalisation in the EU Party". If this final commitment is fulfilled, the national regime ("internal market treatment") may be granted trade rights within financial services between Ukraine and the EU.

Intellectual property rights protection. The DCFTA entails commitments by Ukraine to facilitate reforms in the sphere of intellectual property rights protection, including joining certain conventions, implementing TRIPS, and harmonizing legislation with the EU *acquis*. The agreement also regulates the use of 3,000 product names that are also geographical indicators (for example "Cognac", "Roquefort"). Ukrainian companies must stop using those names following a ten-year transition period from the date the DCFTA enters into force.

5.2. The impact of the WTO

5.2.1. The framework for cooperation

The World Trade Organization (WTO) defines the rules of international trade. The role of the organization is huge, given that the activity of its members now accounts for 92.7% of international merchandise trade[192]. The adjustment of economic policies to the WTO principles encompasses steps in trade liberalisation (including reduction of import duties, elimination of quotas and licenses), approximation of trade rules (such as rules of origin, trade remedies) to the WTO norms and practices, and changes in general economic policies (in the spheres of technical regulation, sanitary and phyto-sanitary control, subsidies, intellectual property rights protection etc.).

The legal basis for cooperation in the framework of the WTO includes primarily the Uruguay Round agreements including the General Agreement on Tariffs and Trade (GATT 1994), the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the Agreement on Technical Barriers to Trade (TBT), the Agreement on the Application of the Sanitary and Phyto-sanitary Measures and many others. As mentioned above, Georgia and Ukraine have been WTO members since 2000 and 2008, respectively. Azerbaijan applied for membership in 1997, and the negotiations are still continuing.

5.2.2. The impact of the WTO: Azerbaijan

The Working Party on Azerbaijan's accession to the World Trade Organization was established on 16 July 1997, and the first meeting of the Working Party was held in June 2002. Bilateral negotiations on market access are underway on the basis of revised offers in goods and services. Multilateral work is proceeding on the basis of a Factual Summary of Points Raised since December 2008. The Factual Summary was last revised in November 2012. The tenth meeting of the Working Party took place in December 2012. On 7 December 2012, WTO members reviewed the state of play in the market access negotiations, foreign trade regime and legislative reforms to advance Azerbaijan's accession to the WTO. The 10th meeting of the Working Party on the Accession of Azerbaijan on 7 December 2012 was the second meeting in 2012 (the 9th meeting took place in late February). Members reviewed the status of the bilateral market access negotiations on goods and services, examined the country's foreign trade regime, and reviewed legislative developments.

Azerbaijan signed a bilateral agreement with the Kyrgyz Republic in March 2012, and recently concluded bilateral negotiations with China. It also held bilateral negotiations

[192] In 2011, by value, including intra-EU trade. Source:
http://www.wto.org/english/res_e/statis_e/its2012_e/charts_e/chart07.pdf

with Brazil, Canada, the European Union, Japan, Norway and the United States on the margins of the meeting of the Working Party. Representatives from China, the European Union, India, Japan, the Kyrgyz Republic, Norway, Pakistan, Switzerland, Turkey and the United States welcomed the substantive inputs submitted by Azerbaijan and expressed their support for this accession. During the talks, members requested clarifications on Azerbaijan's economic policies, state-trading enterprises and privatization, pricing policies, investment, competition policy, VAT exemptions, application of excise taxes, and enactment of the Customs Tariff Law. Members also requested clarifications on fees and charges for services rendered, customs valuation, rules of origin, export bans, industrial subsidies, agricultural export subsidies, technical barriers to trade, sanitary and phyto-sanitary measures, government procurement and intellectual property[193]. As mentioned above, Azerbaijan'snegotiations with the WTO have produced accession-related legislative packages in areas such as customs valuation, rules of origin guidelines, tariff bindings, trade remedies etc.

5.2.3. The impact of the WTO: Georgia

Georgia acceded to the WTO in 2000, becoming the second WTO member from the CIS countries following Kyrgyzstan. Georgia granted MFN in trade in goods to all WTO member states in accordance with Article Iof GATT. In acceding to GATS, Georgia also granted MFN in trade of services. The country has signed a number of regional trade arrangements in accordance with Article XXIV of GATT[194]; for instance, Georgia was a part of aregional free trade agreement with CIS countries, though this did not function properly duetoa number of unresolved issues. Tbilisi has also signed and implemented a number of bilateral free trade agreements with other regional partners like Ukraine, Russia, Kazakhstan, Turkmenistan, Armenia, and Azerbaijan (2001). Later, in 2009, Georgia signed a free trade agreement with Turkey. In 2005, Georgia unilaterally reduced its import duties on a significant range of goods, including a large proportion of agricultural goods. In some notable cases, duties were reduced to zero. WTO data from 2011 showed that Georgia's average simple MFN tariff (including agricultural and non-agricultural rates) was 1.5% of the total value of goods in 2010, and the bound tariff was 7.4%. Trade weighted average tariff was 2.2%. This was very low compared with other WTO member states. Georgia does not use either tariff quotas or safeguard measures. Table 20 shows the tariff barriers Georgia faces while exporting.

The country's main trade partners enjoy either a free trade arrangement or a preferential

[193] http://www.wto.org/english/news_e/news12_e/acc_aze_07dec12_e.htm

[194] https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(+%40Symbol%3d+wt%2freg*+and+n)+and+(+%40Title%3d+georgia+not+(notification+from+the+kyrgyz+republic))&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true

treatment arrangement. Georgia's exports to Ukraine, Azerbaijan, Kazakhstan and certain other countries are 100% free of duties. Georgia enjoys GSP+ regime with the EU that allows almost 90% of goods originating in Georgia enter EU markets free of customs duties. The tariff application is differentiated between agricultural and non-agricultural goods respectively, set at 91% and 99.8% (by value). Nonetheless, because of the narrow diversification of exports, only 54% of products destined for the EU are duty free. The US, Canada, Switzerland, Norway and Japan have granted Georgia a GSP regime that substantially reduces barriers for the country's exports. According to 2012 WTO statistics[195], the average Turkish bound tariff (50% coverage) was 26% of the value of goods, and the MFN tariff was 9.6%. Trade with other WTO member states is less liberal in terms ofduty free possibilities. On average Georgia imposes much smaller tariff barriers for its trade partners than vice versa, but thanks to the WTO's general strategy on overall reduction of import duties, there are no prohibitively high barriers imposed on Georgian exports.

Table 20. Tariff burden on Georgian goods exported to certain countries

Part B	Exports to major trading partners and duties faced								
Major markets	Bilateral		Diversificati		MFN AVG		Pref.	Duty-free	
		in million	95% trade		traded TL		margin	TL	Value
		US$	HS 2-digit	HS 6-digit	Simple	Weighted	Weighted	in %	in %
Agricultural products									
1. European Union	2010	77	8	15	10.8	5.1	4.6	54.5	91.2
2. Ukraine	2010	75	4	10	11.1	9.7	9.7	98.5	100.0
3. Azerbaijan	2010	14	5	14	21.8	25.3	25.3	100.0	100.0
4. Belarus	2010	13	2	8	16.4	31.8	31.8	100.0	100.0
5. Kazakhstan	2010	9	3	6	19.7	30.0	30.0	100.0	100.0
Non-agricultural products									
1. European Union	2010	639	8	13	3.5	0.8	0.8	98.8	99.8
2. Turkey	2010	260	12	26	5.0	2.8	2.5	98.2	97.5
3. United States	2010	186	5	8	2.2	2.2	2.1	89.8	90.4
4. Lebanon	2010	135	2	3	5.7	1.9	0.0	19.4	42.6
5. Canada	2010	124	2	3	3.2	0.0	0.0	70.1	99.8

Source WTO, 2012

Georgia is asignatory and party to all WTO arrangements derived from the General Agreement on Tariff and Trade. It has acceded to the General Agreement on Trade in Services (GATS), the Agreement on Government Procurement, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the Agreement on Technical Barriers to Trade (TBT), and the Agreement on the Application of the Sanitary and Phyto-sanitary Measures, as well as plurilateral agreements, namely the Information Technology Agreement, the Agreement on Trade in Civil Aircraft.

195 http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=TR

Participation in the WTO provides good guarantees for Georgia against discriminatory treatment. The 2006 ban on Georgian wine and mineral water imports by Russia (not a WTO member at the time) clearly illustrates the risk the country runs by trading with states that are not WTO members.

5.2.4. The impact of the WTO: Ukraine

In line with WTO principles, Ukraine has reduced import and export tariffs, abolished a number of subsidies, reformed the system of technical regulation, and improved protection of intellectual property rights.

Merchandise trade liberalisation. Trade liberalisation has been the most obvious result of WTO membership. Ukraine has reduced customs tariffs, and put an end tothe majority of its quantitative restrictions. Ukraine joined the WTO in May 2008, but the process of trade liberalisation took place over a relatively long period of time: the country began in the 2000's, and continued after formal membership in the WTO was granted. Import duties in Ukraine were sufficiently low even before the country started the WTO-oriented liberalisation. As of January 2005, the year that Ukraine made key steps toward trade liberalisation, the average MFN import tariff was 10.5%. In 2005, the majority of import tariffs were significantly cut so that the average MFN tariff rate dropped to 6.5%. The simple average bound MFN tariff reached 5.8% at the end of the five-year transition period, according to the WTO estimates[196].

If trade volumes are taken into account, however, the picture is somewhat different. The reduction of tariff protection for goods that are most sensitive for Ukraine's trade took place mostly after the country joined the WTO. In the beginning of 2005 the weighted average MFN tariff was 7.8%, in May 2008 it was 7.0%, and after the transition period the final bound average MFN tariff was estimated at 5.1%[197].

The actual import duties are lower than final bound MFN rates. The trade weighted average MFN tariff in 2010 was 2.7% including 7.9% for agricultural goods and 2.2% for non-agricultural goods[198]. It should be also noted that import duties on agricultural products havebeen persistently higher than duties on non-agricultural products. Thus, agricultural tariffs were reduced to a greater extent in both absolute and in relative terms. For example, atthe beginning of 2005, the weighted average MFN tariff for agricultural products was 21.1%, and the final bound MFN tariff was expected to be 10.1% (see Table 20 for details).

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196 http://stat.wto.org/TariffProfiles/UA_e.htm

197 Ukraine's membership in the WTO: commitments, overview and comments. Report of the Institute for Economic Research and Policy Consulting.Kyiv, 2008. – www.ier.com.ua

198 http://stat.wto.org/TariffProfiles/UA_e.htm

Table 21. Import tariffs in Ukraine before and after joining the WTO, %

Indicators	Agricultural products	Industrial products	All products
Average MFN tariff:			
— before changes in 2005	19.7	8.3	10.5
— at the moment of joining the WTO	13.8	4.4	6.5
— the final bound MFN rate	11.0	5.0	5.8
Weighted average MFN tariff:			
— before changes in 2005	21.1	6.7	7.8
— at the moment of joining the WTO	18.2	6.1	7.0
— the final bound MFN rate	10.1	4.8	5.1

Note: weighted average duties were calculated based on the trade data for 2004-2005

Source: Членство України в СОТ: огляд зобов'язань та коментарі до них. Звіт Інституту економічних досліджень та політичних консультацій. Київ, 2008 (Ukraine'smembershipintheWTO: commitments, overviewandcomments. Report of the Institute for Economic Research and Policy Consulting. Kyiv, 2008), WTO Tariff Profile: Ukraine

Ukraine also imposedonly a few export duties - on oilseeds, cattle, skins, and ferrous and certain non-ferrous scrap metals. After its accession to the WTO, the country set ad valorem rates for all export duties and/or reduced them. The country also cancelled the majority of quantitative restrictions on exports and imports from the date of joining the WTO. In particular, it lifted the ban on exports of some non-ferrous scrap metals and gemstones except for gold, silver, and diamonds. Grain export restrictions were also revoked. The country stated that it would not apply quantitative restrictions on imports or other non-tariff measures such as licensing, bans, permits, and other restrictions of similar effect that do not comply with the WTO principles. It should be added that Ukraine has introduced temporary restrictions on grain exports several times since it joined the organization, justifying them against the WTO rules. According to its commitments to the WTO, Ukraine uses a tariff quota on imports of raw cane sugar. The in-quota tariff rate has been set at 2%; the over-quota rate has been set at 50%. Since 2010, the quota has been equal to 267,800 tons per year.

Trade in services. Ukraine liberalised trade in services once it joined the WTO. The country has accepted a number of commitments regarding access to service sectors by joining the WTO. The commitments have been both pervasive and liberal. The number of service sector commitments made Ukraine the record-holder among other countries that have joined the WTO recently. Ukraine has made commitments in 148 service sub-sectors, compared with Croatia's 121, Estonia's 117, Russia's 116, and Bulgaria's 67. Ukraine's commitments cover all eleven "core" service sectors, including business services, communication services, construction and related engineering services, distribution, education and environmental services, financial services, health and social services, tourism and travel, recreational, cultural and sporting services, and transport services. For the majority of sectors, free access to the market and national treatment regime for services supplied under the first three modes of supply wasbinding for Ukraine.

Moreover, the country undertook several additional commitments in the telecommunication and transport sectors. The list of limitations on market access and/or national treatment is short and includes only a fewsectors: notary activities, postal services, wholesale trade services of books, newspapers, and magazines, educational services, insurance, health care services, and information agency services. For notary activities and education, national requirements are applied. For information agency services and wholesale trade services of books, newspapers, and magazines, a limit on foreign capital share is imposed. Qualification requirements are applied to health care services. Among horizontal provisions, a limitation on movement of natural persons has been especially important, as it generally applies to the fourth mode of service supply in all sectors. Here, Ukraine specified that the entry and temporary stay in Ukraine of a foreign supplier requires a temporary residence or work permit. This obligation did not change existing practice. Other horizontal limitation concerns land ownership laws that prohibit foreign persons and persons without citizenship from buying agricultural land. Finally, Ukraine left unbound a provision of state subsidies and other forms of state support in all service sectors. Moreover, it was stipulated that access to subsidies and other forms of state support must be limited to citizens of Ukraine and/or juridical persons of Ukraine. Several sub-sectors in transport and audio-visual services have remained exempt from Article II (MFN) on the grounds of primacy of intergovernmental agreements and infrastructure integrity for transport, and cultural value promotion of audio-visual services. Importantly, Ukraine's service sectors commitments have not brought any drastic changes compared to previous regulatory practices. Commonly, changes introduced at the request of the WTO members entered into force a number of years before the country actually joined the WTO. That was the case with the abolition of national requirements forauditing and legal activities, and with telecommunication sector reforms. Only afew issues gave rise to heated debates, including the issue of the need for permission to open foreign branches in banking and insurance sectors. Similarly, an introduction of non-discriminatory rail freight rates did not take place until after the accession. However, in the majority of cases, the commitments only fixed or consolidated the status quo. *Equal opportunities in policy implementation.* External initiatives have urged Ukraine to conduct reforms aimed at enhancing competition, reducing competition-distorting state aid, and improving access for both domestic and foreign businesses to the national public procurement market. Before becoming a member of the WTO, Ukraine used subsidies for various in dustries: agriculture, shipbuilding, aircraft manufacturing, the automotive industry, space industry, and coal mining. State aid was granted in various forms: direct subsidies, reduced rail freight rates, tax exemptions and deferrals, including VAT and land tax exemptions, and import duties exemptions. Most of subsidies were revoked in 2005, a policy change that was partly induced by the WTO.

According to WTO principles, Ukraine has committed to avoid the use of subsidies that distort international trade, including a ban on export subsidies. In agriculture, the agreed aggregate measure of support (AMS) has been set at UAH 3 billion plus 5% de minimus. In 2010, Ukraine spent about UAH 16.1 billion on agriculture subsidies, including UAH 2.2 billion as the AMS, UAH 10.4 billion as de minimus, and UAH 3.5 billion as green box support.

TBT/SPS reform. Non-tariff measures affecting trade have become more important in recent decades as import duties have been greatly reduced as a result of multilateral trade liberalisation. WTO membership induced Ukraine to modernize its obsolete system of technical regulation and standardization, inherited from the USSR. Ukraine changed its system of technical regulation in order to implement WTO principles. First, the system of mandatory technical regulations and voluntary standards was established based on international norms to replace the system of mandatory national standards developed largely before 1993. As of April 2013, there were 43 valid technical regulations in Ukraine largely based on international norms, EU standards[199]. These technical regulations, however, have not completely replaced the old standards. Second, the country started to reform the certification system, greatly reducing the number of goods subject to obligatory certification. Declarations of conformity were introduced instead, and later on, the obligatory registration of these declarations was abolished. Third, Ukraine established the national market surveillance system.

199 www.wto.org

Ten government bodies perform market surveillance across different sectors of the economy[200]. They are coordinated by the State Market Surveillance Council, which is chaired by the Minister of the Economic Development and Trade of Ukraine. Ukraine also reformed its sanitary and phyto-sanitary (SPS) control system based onits commitments to the WTO. In 2011, the State Veterinary and Phyto-sanitary Service of Ukraine was established as a single surveillance authority in the area of food safety[201]. Ukraine also reduced red tape: compulsory certification of food products (except for alcohol and tobacco) was revoked, and the regime of general product safety in case of absence of specific mandatory requirements was introduced. As a part of its WTO commitments, Ukraine allowed imports of meat produced with growth hormones.

Intellectual property rights protection. Ukraine has promised to fulfil the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which ensures that member countries provide equal protection for the intellectual property rights of both domestic and foreign copyright holders. In fact, the main disputes between Ukraine and other countries in the sphere of intellectual property rights protection were settled before Ukraine became a member of the WTO. Those disputes also urged Ukraine to implement reforms. In 2001-2002, the USA excluded Ukraine from the Generalized System of Preferences and imposed 100% import duties on 23 goods from Ukraine[202] because the country had not taken measures to combat intellectual property piracy (music, software). The required measures were not taken until 2005, when the Parliament of Ukraine adopted alaw that introduced licenses on export and import of optical disks and raw materials and equipment necessary for their production. The law also increased criminal liability for intellectual property piracy related to optical discs. As a result, the US sanctions were lifted in 2005-2006. However, intellectual property piracy became an issue again in 2012, when the International Intellectual Property Alliance (IIPA) urged the US government to withdraw Ukraine's GSP benefits because of "inadequate and ineffective protection for copyright works and sound recordings" in the country[203]. The US authorities are now considering the request of the IIPA.

[200] http://www.csm.kiev.ua/index.php?option=com_content&view=article&id=111&Itemid=66

[201] http://zakon4.rada.gov.ua/laws/show/573-2011-%D0%BF

[202] http://www.ier.com.ua/files/Projects/2012/trade_policy/11.12.2012_presentations_workshop/0000015461-Dmytro_Lutsenko_Eng2.pdf

[203] http://www.ustr.gov/trade-topics/trade-development/preference-programs/generalized-system-preferences-gsp/gsp-documents-4

Concluding remarks on Chapter V

Integration into the global trade system has had a substantial impact on policymaking in all three countries — Azerbaijan, Georgia, and Ukraine. The changes were led mainly by two institutions: the World Trade Organization (WTO), whose members account for 92.7% of the world merchandise trade[204], and the European Union (EU), which is an important trade partner of the three countries. In 2011, the EU's share in foreign trade of Azerbaijan was 42.5%; the respective figures for Georgia and Ukraine were 26.1% and 29.7%. In general, reforms encouraged by the WTO were mutually consistent with ones supportedby the EU. In all three countries, the reforms included steps in the following directions:

1. trade liberalisation (including reduction of import duties, elimination of quotas and licenses),
2. approximation of trade rules (such as rules of origin, trade remedies) to WTO norms and practices,
3. changes in general economic policies (in the spheres of technical regulation, sanitary and phyto-sanitary control, public procurement , subsidies, intellectual property rights protection etc.).

However, the countries have implemented those reforms to different extents, depending on the stage of integration of each country into the global trade system, and on domestic factors. Georgia joined the WTO in 2000, first among the three countries, and has made the greatest progress in trade liberalisation, far beyond the requirements of the organization. Georgia's weighted average applied MFN import tariff was 2.2% in 2010, whereas the simple average bound tariff was 7.4%. The laws of the country do not recognize antidumping and countervailing measures. The liberalisation trend will, of course, be reversed to some extent if Georgia signs a Deep and Comprehensive Free Trade Agreement with the EU. The agreement makes provision for stricter regulation in the spheres of technical regulations, sanitary and phyto-sanitary measures.

Ukraine has also been a member of the WTO since 2008, but liberalised its trade to a lesserextent than Georgia. The trade weighted average MFN tariff was 2.7% in 2010, and the country's laws allow for antidumping, countervailing and safeguard measures. As a result of cooperation with the WTO and the EU, Ukraine has abolished a number of state subsidies, reformed the system of technical regulation, and improved protection of intellectual property rights. Reforms are expected to go much further if Ukraine signs a DCFTA with the EU in November. The agreement envisages the

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[204] http://www.iipa.com/pdf/2012_Sep18_Ukraine_GSP_Request_to_Testify_PreHearing_Brief.PDF

approximation of Ukraine's TBT/SPS regulation to EU standards, advanced reforms in the spheres of public procurement, state aid, competition policy and others.

Azerbaijan applied for WTO membership in 1997, and the negotiations are ongoing. The cooperation between Azerbaijan and the EU has been based on the Partnership and Cooperation Agreement (effective since 1999); the country is also a partner of the EU within the framework of the European Neighbourhood Policy. The WTO accession negotiations and the cooperation with the EU have contributed to reforms in the areas of customs valuation, rules of origin, SPS and TBT policy, public procurement, and subsidies. Azerbaijan expects to start negotiations on a DCFTA with the EU, which will entail a further push for reforms.

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FREE MOVEMENT OF COMMODITIES,
INVESTMENT AND PEOPLE IN THE BLACK SEA REGION
CASE STUDIES OF AZERBAIJAN, GEORGIA, AND UKRAINE

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