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A EUROPEAN PLACE FOR GEORGIA'S FARMERS

Georgia's free-trade agreement with the European Union and its impact on smallholders

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The new agreement with the EU needs to be handled with great care if it is to achieve its potential for Georgia's people. While Georgian exports may expand, there is a danger that there will be little or no benefit for the majority farming population, as the gains accrue to Tbilisi and other cities. This paper explores the situation and recommends policies to ensure a fair outcome for all.

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SUMMARY

Georgia is a small country with many advantages and a huge potential. It is geographically diverse, it has a long history and ancient culture, magnificent landscapes, a highly developed food culture and fine cuisine, a unique wine tradition and many ways of attracting tourists. Agriculture is of central importance to the country, providing over half of employment, mostly on subsistence and semi-subsistence farms. Imports nevertheless continue to provide about three-quarters of the food supplies, as domestic production remains below the levels achieved before independence in 1991.

As in other countries that came out of the Soviet Union and the Comecon bloc, there is an aspiration to be close to 'Europe' and eventually join the European Union (EU). An important step was taken on July 1st, 2016, when an Association Agreement with the EU came into full force. The main part of it is a trade agreement which will remove all tariffs on trade between the EU and Georgia and adapt Georgia's legislation to match the laws that support the EU's Internal Market. With the free movement of goods, services and capital, and a common set of economic regulations, Georgia will almost become part of the EU's market, except that movements of people (workers) will still be restricted.

The Agreement undoubtedly offers advantages to Georgia. However, it also presents serious risks, especially in those parts of the legislation which will affect that half of the population who live off small family farming plots. In food and agriculture its most important requirement lies in strict regulations on hygiene, food safety and animal health. The impact on actual trade in food and agriculture is expected to be rather limited, but with free movement of capital, a little-noticed risk could arise if foreign companies enter food retailing in Georgia.

For these new measures to achieve their potential and serve as catalysts for future development, they will need to be handled with great care. The Government needs to engage with and listen to smallholders, discover what their responses to the DCFTA are, and build on them. Without compensating changes in policy for smallholders, there is a danger that while Georgia's exports may expand, perhaps mostly in services and possibly wine, there will be little or no benefit for most of the farming population as the gains accrue to Tbilisi and a few other cities. To avoid this, it is vital to work for rapid agricultural and rural development alongside integration with EU markets.

We therefore put forward some proposals to assist in the redevelopment of smallholding farming. Widespread experience shows that it takes public action to seriously improve the position of smallholders, and a full range of supports and reforms is required. The following policies are among those proposed:

- Increase the Ministry of Agriculture's budget in time to 10 per cent of government expenditure.

- Support the expansion of the sown agricultural area, especially for staple food crops.

- Develop rural infrastructure, including transport, storage and rural waste services.

- Set up a national agricultural extension and training service, generally to be provided free and always to assist women as much as men.

- Ensure smallholders have enforceable legal title to their land, build up agricultural cooperatives, and create institutions for financial support.

- Provide special support for agriculture in mountainous regions.

- Assist all farmers to meet the new food safety standards introduced under the DCFTA.

- Develop the grape and wine sector, especially among smallholders.

- Develop rural and gastronomic tourism, as an important opportunity for rural development.

This briefing does not try either to create exaggerated expectations of benefits from the DCFTA or to see the main task as sheltering smallholders from it. Rather than protection from any negative effects, it looks to parallel programmes, working with the grain of the government's own plans, to enable smallholders and rural communities to prosper in new ways under the opportunities that will be available under the DCFTA, even if the Agreement's direct beneficiaries will mostly be found in other parts of Georgian society.

1 INTRODUCTORY REMARKS

Georgia is a small country with many advantages and a huge potential. It is geographically diverse, it has a long history and ancient culture, magnificent landscapes, a highly developed food culture and fine cuisine, a unique wine tradition and many ways of attracting tourists. Agriculture is of central importance to the country, providing over half of employment, mostly on subsistence and semi-subsistence farms. Imports nevertheless continue to provide about three-quarters of the food supplies.

As in other countries that came out of the Soviet Union and the Comecon bloc, there is an aspiration to be close to 'Europe' and eventually join the European Union (EU). An important step was taken on July 1st, 2016, when an Association Agreement with the EU came into full force. Like similar agreements reached by Moldova and the Ukraine, the main part of it is an agreement to create a 'Deep and Comprehensive Free Trade Area' (DCFTA), removing all tariffs on trade between the EU and Georgia and in other ways aligning Georgia's economy with the EU's. Most ambitiously, it will adapt Georgia's domestic legislation to match the laws that support the EU's Internal Market.

This agreement undoubtedly offers advantages to Georgia. However, it also presents serious risks, especially in those parts of the legislation which will affect that half of the Georgian population who live off small family farming plots. **For the new measures to achieve their potential and serve as catalysts for future development, they will need to be handled with great care.** The Government needs to engage with and listen to smallholders, discover what their responses to the DCFTA are, and build on them. How serious are the risks, what need is there for complementary policies to counter them, and what should those policies be?

This briefing attempts to answer those questions. The next section briefly describes the DCFTA and the experiences of other countries from economic integration with richer ones. Then the status of Georgian agriculture and food security are described, while sections 4 and 5 discuss the implications for agricultural trade and inward investment from the EU. Finally, a set of policies is recommended to enable Georgian smallholders to make the most of the situation, and section 7 concludes.

2. THE DCFTA AND INTERNATIONAL ECONOMIC INTEGRATION

Agriculture and agricultural policy were largely neglected before the Georgian Dream party was elected to government in 2012. The new government has placed them near the centre of its concerns, alongside realisation of the Association Agreement. The Agreement aims 'to achieve Georgia's gradual economic integration into the EU Internal Market, … in particular through establishing a Deep and Comprehensive Free Trade Area which will provide for far-reaching market access on the basis of sustained and comprehensive regulatory approximation.'[1]

The DCFTA has far-reaching implications: the removal of all tariffs on imports and exports between the EU and Georgia, and the unrestricted circulation of capital between the two, including that of companies from one side investing in the other. Georgia's laws also have to be revised to approximate those that support the EU's Internal Market. This means adopting the EU regulations that govern business, as far as may be done. In food and agriculture the most important requirement lies in strict regulations on hygiene, food safety and animal health (often jointly referred to just as 'food safety' or, in the terminology of trade negotiations, as Sanitary and Phytosanitary – or SPS – Standards). If done comprehensively this alone is a colossal task, involving the assimilation of 375 EU directives and regulations by 2030. A project to do so started in 2010, before the DCFTA was negotiated, with a plan to match 43 directives and regulations by 2014 (later extended to 2020 since 'a significant lag in the planned activities had developed').[2]

This is a very demanding task in a situation where standards already required under Georgian law often meet resistance. For example, some farmers resist registration and vaccination of farm animals and hide livestock from officials undertaking these tasks, for fear that they will be a source of taxation.[3] This is how a Georgian consumer rights advocate described the EU's requirements in the meat sector:

> In Europe, food safety begins with livestock health, which means regular vaccination and constant observation for contact with ill or unvaccinated animals. Besides, all livestock should be registered and undergo veterinary supervision. In addition, there are norms for slaughtering, processing of meat, hygiene and so on. It will take several years for our industry to match all these requirements.[4]

Rules also have to be aligned in many other areas, such as technical standards, trade procedures and intellectual property rights (IPR, which means patents, copyrights and trademarks). EU laws on competition policy, taxation and other matters must be assimilated. With the free movement of goods, services and capital, and a common set of economic regulations, Georgia will almost become part of the EU's market, with one important exception: movements of people (workers) will still be restricted.

It has to be admitted that a large part of this cooperation will work to the benefit of the EU's own businesses, due to their greater size and technical and managerial capacity. **The EU's combined gross domestic product (GDP) in 2014 was €13,921 billion, more than 1,000 times Georgia's GDP of €12.1 billion.**[5] So it can be confidently foreseen that most investment will be from the EU into Georgia. In this situation, for example, competition law within Georgia might seem redundant, since even a national monopoly is likely to be far smaller than any leading EU company in the same sector, and therefore have difficulty competing with it.

The EU's laws were developed by a group of wealthy countries with highly developed and diverse economies, supporting strong administrative and judicial systems. It cannot be assumed that their adoption is appropriate or even necessarily feasible in a small, lower-middle income country with a largely agrarian economy in which half of the people depend on subsistence agriculture. With this in mind, the DCFTA provides important opportunities for Georgian exporters but also poses serious risks to domestic markets if European products or companies were to swamp the capacity of local producers to compete.

The DCFTA also contains short chapters with aspirations on environmental and labour regulation. However, in these areas there is no requirement to approximate the EU's very advanced legislation, except as regards food safety and the health of livestock. Rules against the use of genetically modified organisms (GMOs) must be taken on, but nothing concerning other effects on the rural environment, such as pesticide run-offs, the misuse of chemicals and soil depletion. Art. 242.1 expressly rules out any recourse to the World Trade Organisation (WTO) and other external disputes procedures in environmental matters. Equivalent sections in EU trade agreements with other countries have usually turned out to be weak and sometimes little more than declaratory, and there is a risk of that happening here too.

Many countries in Georgia's position have benefited from similar processes of integration with more powerful economies. But not all have. Experiences vary and it is important to understand why.

Several countries joined the EC/EU when they were substantially poorer than existing member states, mainly from Southern Europe between 1973 and 1986, and then East and Central Europe since 2004. The integration of the former (Greece, Portugal, Spain and the Republic of Ireland) was quite fast and successful, with rapid expansion in both the urban and rural economies, partly because of generous benefits from the Common Agricultural Policy and regional development programmes.

Most of the 13 countries which joined the EU more recently have also experienced strong economic growth. Real euro GDP *per capita* expanded by between 9 and 38 per cent over 10 years (2005-15) in eight of the 10 countries which joined in 2004, although Cyprus and Slovenia experienced declines of 17 per cent and 4 per cent respectively. Over the same period GDP *per capita* increased in all three of the most recent members, and by 65 per cent in the case of Romania.[6] However, this says nothing about the distribution of income or the situation of farmers and rural areas; nor is it clear how much it is due to EU membership and how much to the bedding in of deeper processes of change that have occurred since the 1990s. **One frequent factor is the remittance of**

income by citizens who went to work in more prosperous EU countries, an option which will not be freely available to Georgians.

By contrast, small agrarian countries in other parts of the world, when faced with globalisation in recent times, have generally experienced increases in food imports and declining self-sufficiency in food, not matched by any substantial benefits for subsistence and semi-subsistence smallholders. This tends to harm both food security and a country's foreign trade balance. Part of the reason is a disconnection between internationally traded goods and the informal markets used by smallholders, and the very different ways in which food safety and other standards are achieved on them.[7]

In one well-known case in a much larger country, Mexico liberalised its trade with the United States and Canada under the North America Free Trade Agreement (NAFTA) in 1994. This led to a rapid increase in agricultural imports, especially of maize, the main staple food, lower prices and greater income inequality, with the worst consequences felt by poorer regions and the poorest farmers. An analysis of rural incomes found:

> [I]n 1991, self-employed farmers earned 1959 pesos per month, while in 2003, they earned only 228 pesos for the same amount of work. Conversely, [agricultural] employers' wages rose from 626 pesos in 1991 to 1165 pesos in 2003… [W]hile agricultural employers gained under NAFTA, subsistence farmers suffered a massive loss of income.[8]

Another report concluded, 'In NAFTA, the Mexican government sacrificed the bulk of the agricultural sector, in exchange for advantages – more theoretical than real – for exports of fruits and vegetables.' Although Mexico was 'without any competitive level whatsoever' in agricultural trade, it 'totally opened its agricultural sector and threw itself, unprotected – without arms and against the stream – into a commercial battle in a world structured around protectionism and subsidies.'[9]

Without compensatory changes in policy for smallholders, **there is a danger that while Georgian exports may expand, perhaps mostly in services and wine, there will be little or no benefit for most of the farming population as the gains accrue to Tbilisi and a few other cities.** To avoid this, it is vital to work for rapid agricultural and rural development alongside the path of integration with EU markets. This is necessary in any case, for the sake of the most hard-hit members of Georgian society.

3. GEORGIAN AGRICULTURE AND FOOD SECURITY

By some measures, Georgia is in a good position for basic food supplies and elementary nutrition. It was rated 16th best among 118 countries in the *Global Hunger Index* for 2016. Its overall score for hunger of 8.2 was rated 'low,' while the seven countries rated as 'alarming' had scores between 35.0 and 46.1. However, in Georgia there was no overall improvement since 2008. Of the four components of the index, the country's worst score of 10.9 (rated 'moderate') was for 'stunting' (low height for their age) among children under five; this reflects *chronic* malnutrition. On the other hand, the figures for 'wasting' in children under five (low weight for their height, a sign of *acute* malnutrition) and under-five mortality were very low, at 2.4 and 1.2 respectively.[10]

However, this gives us no details about financial and physical access to nutritious food, especially in rural areas and among people with low incomes.[11] When, in addition, economic and political factors are taken into account, serious food insecurity is found to exist, and it has been experienced twice in the last generation. The first time was during the civil war which followed independence in 1991, and it continues up to the present in the shape of a reliance on a powerful neighbouring country which occupies parts of Georgia's sovereign territory for some vital food supplies and markets.

Georgia's international trade in agriculture, food and beverages remains in severe deficit, but there has been some improvement recently. Nevertheless, even the degree of import dependence is in doubt. In 2012, the U.N. Food and Agriculture Organisation (FAO) estimated as much as 80 per cent of all food requirements were met by imports; but another estimate in 2014 put this at 66 per cent (which is also unusually high).[12] This lack of precise knowledge itself illustrates the extent to which agricultural production, as well as the informal trading of food, escapes the attention of the authorities, including their statisticians. That applies most of all in remote mountain areas.

The Government is therefore right to place a strong emphasis on agriculture and rural development, and pursue a comprehensive plan of support and development. The extent of the previous official neglect was illustrated in the new Agricultural Strategy which the Ministry of Agriculture published in 2015:

> At its low-point in 2010 spending on agriculture was 0.44% of total government spending… From 2007-2010 the majority of the large expenditure items in the Ministry of Agriculture budget were social support of one kind or another, providing hand-outs of flour, food and fuel.[13]

By 2014 the Ministry's share of the budget had increased to 2.9 per cent, and the sector was declared a 'top priority.'[14] A U.N. commentary summarised the main goals of the Strategy thus:

> Modernizing agriculture and increasing agricultural competitiveness; developing agricultural infrastructure (i.e. irrigation and drainage, modern production technologies, processing and storage facilities, rural roads); improving the land market and land registry system; promoting new credit schemes in cooperation with financial institutions; and facilitating the establishment of farmers' groups and cooperatives.[15]

Over the last ten years both land use and agricultural production have fluctuated, after declining sharply immediately after independence. At that time the land was divided into small family plots, and most of the new farmers did not have general agricultural skills because of the specialisation of labour within the former collective farms. Recently the area sown to annual crops declined from 299,000 HA in 2006 to 246,000 HA in 2010, but it recovered to 294,000 HA in 2013, mainly because of cultivation subsidies from the government.[16] Meanwhile, the number of cattle declined from 1.08 million in 2006 to 1.01 million in 2009 but recovered to 1.23 million in 2013, and the number of sheep and goats from 789,000 in 2006 to 630,000 in 2011 before recovering to 857,000 in 2013.[17] Gross annual agricultural production declined by 11.2 per cent from 2006 to 2010 but by 2013 it had risen to 14.6 per cent above the 2006 level.[18]

Productivity of all sorts is low. Yields of the main annual crops are reported to be among the lowest in all the post-Soviet countries, although some have shown ‘steady incremental growth.’ In 2013 the average yield of wheat was 1.8 tonnes per hectare and barley 1.3 t/HA, which are still below the average levels of the 1970s. Potato yields were 11.3 t/HA, vegetables 8.3 t/HA and annual grasses 3.9 t/HA.[19] An assessment for the European Commission commented, ‘Apple yields are often below 3 tonnes per hectare, while improved production practices and investments in certain production inputs could bring up yields to around 20 tonnes per hectare.’[20]

The present government admits to the previous neglect of agriculture, as well as the economic importance of self-employed rural smallholders. The Agricultural Census for 2014 found that there were 572,000 family farms and 2,200 other agricultural holdings owned by companies, averaging 1.2 and 49.2 hectares respectively in size. Agriculture accounts for 52 per cent of Georgia’s labour force.[21] But the agricultural population is ageing, with only 22 per cent of family holdings run by a person under 45.[22]

However, **agriculture’s importance is not reflected in standard measures of the economy since so much of the production is for subsistence and, where traded, it goes on informal markets, the transactions on which do not go into GDP data.** By 2015 agriculture’s share of Georgia’s GDP had therefore fallen to 8.1 per cent.[23] Even access for smallholders to informal markets is difficult and their position on them is precarious. Due to the small size of each farming unit, smallholders are in a weak position on any market, whether formal or informal, and are therefore ‘price-takers.’ Policies are needed to counteract this.

The degrees of import dependence vary greatly between foodstuffs. Thus, in 2014 Georgian production only covered 8 per cent of consumption of wheat, the main staple food which provides 41 per cent of the dietary energy supply. Most wheat imports have been from Russia or, more recently, the Ukraine. However, in other major staples the self-sufficiency rates were quite high at 92 per cent for maize, 89 per cent for potatoes, 70 per cent for vegetables, 96 per cent for eggs and (in 2012) 92 per cent for milk and milk products. Most vegetable imports are from Turkey. On the other hand, meat self-sufficiency was very low overall at 41 per cent overall; in 2012 the rates for different meats ranged between 83 per cent for sheep meat and 21 per cent for poultry.[24]

4. AGRICULTURAL TRADE AND THE DCFTA

The DCFTA offers certain useful opportunities – for example, in making wine exports to the EU easier and more lucrative by removing tariffs, and forcing improvements in food safety and hygiene – but the increase in competitive pressure on Georgian agriculture, including smallholdings, also poses risks. The European Commission's Trade Sustainability Impact Assessment (TSIA) report predicted agricultural export opportunities for Georgia since most of the fruit and vegetables produced there are 'ecologically clean' and almost none are genetically modified. It argued that the 'consumer would probably be willing to pay more if this information was provided to them (or if farmers would obtain organic certification and market their products as such).'[25] In recent years, Georgia has reduced its agricultural trade deficit from US$762 million in 2012 to $497 million in 2015, although it increased slightly in 2015 as both exports and imports fell back. The EU accounted for only $36.8 million of the deficit in 2015, with $208 million worth of exports and $245 million of imports. Hazelnuts were the biggest exports overall, worth $176 million, followed by wine ($96 million), mineral and fresh water ($82 million) and spirits ($65 million).[26]

Even with zero tariffs, poorer countries generally have great difficulty exporting agriculture produce to the rich world because most farmers cannot meet the public or private standards required on developed countries' markets.[27] Besides the public SPS rules, exporters of non-animal farm products to EU markets usually require a certificate from a private standard-setting organisation, GlobalGap, and the requirements for it are expensive. Nearly ten years ago a U.N. report expressed concern about 'the increasingly complex and stringent food safety and environmental requirements in key [fresh fruit and vegetables] export markets as a result of a combination of government regulations and private sector requirements.' They included an 'implicit incentive to create an institutional structure on food controls that is equivalent to the one in importing countries.'[28] Under the DCFTA, the public part of that 'incentive' has turned into a treaty obligation.

In any case, the EU protects its fruit and vegetable markets through a minimum entry price system, which is still permitted under WTO rules. This system imposes special tariffs when imports are priced below predetermined levels, which vary according to the season. This provides a serious barrier to entry from countries with lower costs than the EU that happen to share its growing seasons (such as Georgia).

Georgia cannot export meat to the EU until it meets the SPS requirements, which will take time. Among other obstacles, there is a shortage of the accredited laboratories required for these purposes. It is for cattle that slaughtering standards come closest to the EU's norms. However, in the other direction some food products from Poland and France, as well as non-EU countries, have been prevented from entering Georgia on food safety grounds.[29]

Many agrarian countries have become reliant on imports of basic foods for the first time as their markets opened up over the last 20-25 years.

Import expansion under trade liberalisation is very sensitive to prices, and at recent values of the lari, Georgian prices are relatively low internationally. This suggests that substantial penetration by more expensive EU products is unlikely in the short term on most food markets; however, it is by no means impossible, especially in view of continuing EU subsidies. Even the current tariffs for agricultural imports from the EU are quite low at 5.57 per cent on average, although the tariff for most vegetables, fruits and nuts is a more prohibitive 12 per cent.[30]

Third-party effects are also likely from the DCFTA, according to the EU's impact assessment:

> For fresh vegetables and fruits [but not nuts] we expect positive, yet difficult to quantify output gains as domestic production is more protected from low quality imports following much stricter SPS measures to be introduced in Georgia. No significant effects are expected for EU-Georgia trade but exports to other countries may increase significantly.[31]

We consider that the focus should remain on hazelnuts (and possibly other nuts in the future) as a priority export crop. For a small country, a significant presence in even one global export market is important in itself. Other products with export potential should also be developed, such as honey, organic fruits, berries and non-timber forest products.

But even the EU's Delegation in Tbilisi has encouraged Georgia to concentrate more on substituting for imports: 'Priority for Georgia should be to replace import. It is a shame that *khachapuri* is produced with imported wheat, it is a shame that your cheese is made from imported milk powder, and this is precisely what you need to think about,' its Food Safety and Rural Development Attaché is reported to have said.[32]

5. OPENING THE INVESTMENT FRONTIER

The free movement of capital poses several little-noticed risks to Georgian agriculture, especially smallholders, and to the government's ability to retain control over economic levers. The main risks lie in the areas of food retailing, land investment and tax revenues.

Food retailing is already dominated by West European and North American companies in many parts of the world. In Georgia the investing firms might be from Europe, Turkey or other countries. **As the country is already heavily dependent on food imports, foreign-owned supermarkets are likely to look to foreign sources of supply** since they might think Georgian smallholders cannot achieve the scale and reliability they require. In other countries with similar economic and agrarian structures, supermarket chains have replaced existing wholesalers with their own centralised systems, and purchased only from large farms or, at most, a small number of smallholders. They require volumes, product standards, packaging and deadlines which are beyond the capacity of most smallholders. Large supermarket firms have the commercial power to enforce all of this. According to a review of the situation,

> The changes in standards, and the implied investments, have driven many small firms and farms out of business in developing countries... The supermarket chains, locked in struggle with other chains in a highly competitive industry with low margins, seek constantly to lower product and transaction costs and risk – and all that points toward selecting only the most capable farmers, and in many developing countries that means mainly the medium and large farmers.[33]

In places where supermarkets from a larger and more advanced country invest in a poorer neighbour, they frequently maintain many of their existing, external supply chains rather than buying locally at all. In Zambia, where agriculture dominates employment to an even greater extent than in Georgia but is almost as invisible in GDP, this led farmers in one area to threaten to 'burn down the company that had robbed them of their livelihoods.' They complained:

> Vegetables that they had regularly sold at the local town market were now being supplied from South Africa at the local Shoprite supermarket... Because the Shoprite supermarket had a better distribution system and a nicer store, the farmers could not compete with this multinational. Previous sources of cash income through the sale of vegetables at the market were now disrupted and, as a result, villagers couldn't pay for the things they needed.[34]

Most countries have found it difficult to support smallholders in these circumstances. The best that can be proposed here is an indirect approach, encouraging cooperative production and marketing, and raising smallholders' standards to the levels required. In the past the government might have required foreign supermarket chains to buy from local farms as a condition of investment, but under WTO rules and the DCFTA this is no longer possible.

Oxfam has also warned of the dangers posed by the recent wave of international investments in land. It has been reported:

> Between 2000 and 2011, large-scale plots of land acquired or negotiated through deals brokered on behalf of foreign governments or transnational corporations covered, in total, 203 million hectares of land worldwide… equivalent to over eight times the size of the United Kingdom, or nearly the whole of north-western Europe.

In 2011 Oxfam warned:

> The poorest people are being hardest hit as competition for land intensifies. Oxfam's research has revealed that residents regularly lose out to local elites and domestic or foreign investors because they lack the power to claim their rights effectively and to defend and advance their interests.

Land investments tend to provide very different results from the improvements in livelihoods, jobs, services and infrastructure that other forms of investment can bring. According to one analysis, they are all too often done 'with limited (if any) consultation of the local communities, limited (if any) compensation, and a lack of regard for environmental sustainability and equitable access to, or control over, natural resources.'[35] A fairly typical agreement by international standards was agreed with China in September 2014, to invest $25 million in 'production of many types of agricultural crops, fisheries, livestock, tea, cold storage, infrastructure development and agro-tourism' in the Svaneti region.'[36] This may well prove entirely positive, but experience elsewhere suggests that in all such cases the government should monitor not only the terms of the agreement but its implementation, and ensure that local residents' concerns are listened to throughout the process.

More widely, the two largest national sources of foreign investment in Georgia in 2013 were the Netherlands and Luxembourg, according to the EU's publicity material.[37] Both of these countries are well-known channels for corporate tax planning. The Luxembourg investment is from the Ferrero corporation, which is the world's biggest purchaser of hazelnuts and the biggest foreign investor in Georgian agriculture. Like many large Italian companies, Ferrero now has its corporate registration and headquarters in Luxembourg, which has been described as 'a traditional destination due to its friendly tax rules.'[38] In recent years there has been serious political concern in major countries of the EU about the practice by transnational companies of channelling their profits into small countries with favourable tax rules by manipulating payments on royalties, intra-group debts and other techicalities. This concerns small island states in the Caribbean Sea, the English Channel and elsewhere, and European countries such as Luxembourg and Ireland.

The Kiev-based law firm Aequo has advised Ferrero on customs and tax issues related to royalty payments in the Ukraine.[39] No doubt Ferrero finds equally good advice on similar matters in Georgia, as it will throughout the world. There is no suggestion that Ferrero has broken any laws or abused its position. However, similar situations pose problems for the tax authorities of Britain and Germany, which suggests that Georgia too risks suffering from abusive international transfer payments by less scrupulous foreign investors. It is a perilous situation both for government revenues and the balance of payments.

In these areas, low- and middle-income countries are in a weak position, whether to ensure that the right amounts of tax are paid, land investments do not exploit existing residents and large-scale food retailing adequately supports agricultural development, or to discover and pursue any abuses. **The government of Georgia needs to keep a careful watch over these questions and take as much professional advice as it can.**

Outside the DCFTA, 16 bilateral investment treaties (BITs) between member states of the EU and Georgia provide further protection for investing companies by enabling them to seek compensation in special tribunals when they consider themselves to have been treated unfairly by government actions. They cover 17 EU countries, including all the biggest ones except Poland.[40] The EU collectively is calling for similar procedures in its latest round of trade agreements with larger countries, including Canada and the US, but this is proving controversial within the EU itself. The possibility of later measures of this sort between the EU and Georgia is provided for in Art. 80 of the DCFTA.

6. POLICIES FOR RURAL REGENERATION

The present government has shown its serious intent by publishing numerous plans and strategies. They include the *Social-Economic Development Strategy of Georgia 'Georgia 2020,'* the *Strategy For Agricultural Development In Georgia 2015-2020* and a 46-point *Action Plan for the Implementation of DCFTA 2014-2017*. In this context, we put forward here some proposals to assist in the redevelopment of smallholding farming, with a view to reducing as far as possible any adverse effects from the DCFTA. Some of them were proposed by the Georgian Farmers' Congress of June 2016, others were inspired by developments elsewhere. Where they already exist in the government's Agricultural Strategy we are greatly encouraged, but for the sake of Georgia's future development we urge that they should be taken up in full.

As a first principle, agriculture's share of the government budget should be further increased, and quite substantially. Widespread international experience shows that public action is essential to seriously improve the position of smallholders.[41] Ten per cent of the budget is suggested as a medium-term target, in view of the importance of rural life and food security, and the volume of work which is required to support them. A wide range of supports and reforms is also required. Many of the methods are well-known and they have been used successfully in many places over long periods. But they need to be fully identified and then pursued in government, as listed here:

1. Increase the Ministry of Agriculture's budget to 10 per cent of government expenditure by 2020.

2. Expand the sown agricultural area, especially for staple food crops, giving substantial further assistance to wheat-growing. This should be seen as an urgent requirement and it demands adequate financial support, within the rules laid down by the WTO.

3. Develop rural infrastructure, including:

   - Road and rail transport, to facilitate access to markets for farmers, especially but not only those in mountain areas.

   - The Government's Agriculture Strategy promised a feasibility study on investments in post-harvest facilities, so as to 'extend storage period, retain quality and marketability, as well as widen distribution channels.' It recognised the importance of involving 'farmer organizations, including cooperatives' in this, and it is important to make sure this is done in this way.[42]

   - Develop in particular a national system of cold storage, extending from village stores to local delivery points and then the regional and national levels. This would change the situation in domestic markets radically, by limiting seasonal price swings and enabling farmers to earn the higher prices which are available in more distant markets and long after the harvest.

- Set up effective rural refuse services by decontaminating village-based landfill sites, providing waste bins and regular waste collection, and recycling waste.

4. A national agricultural extension and training service, with services generally provided free. It should include, among other tasks:

   - Regular agrarian and commercial advice provided locally to farms throughout Georgia, with related online services. Men and women need to receive similar amounts of advice.[43]

   - A free national programme of agricultural training courses for men and women smallholders of all ages.

   - A Market Information Service geared to smallholders' needs, providing regular information on rural, urban and foreign markets and other commercial opportunities in food and agriculture.

   - Ensure smallholders get adequate information and advice on agricultural chemicals and fertilisers.

   - Support for the revival and development of traditional Georgian agricultural methods, crop varieties and livestock breeds. This will increase ecological and nutritional diversity while reducing risks of farmers' indebtedness and environmental damage.

5. Economic regulation:

   - Monitor the lari's exchange rate with a view to keeping Georgian farm products fully competitive with imports. This is a sensitive but important area of policy, as the experience of many countries has shown, and the government's exchange rate policy should keep this in mind.

   - Measures to reduce farmers' reliance on middlemen for access to markets. A new programme in Malaysia, where the average farm size is similar to Georgia's, has achieved early successes by expanding farmers' associations' responsibility for marketing, offering loans to farmers and fishermen, and helping them to sell directly through farmers' markets.[44]

   - Programmes to encourage supermarkets and other significant urban retailers to take more supplies from Georgian smallholders, including via cooperatives and contract farming.[45]

   - Effective competition policy, especially as regards agricultural traders ('middlemen' or 'resellers'), wholesalers and retailers.

6. Institutional and financial support:

   - Ensure smallholders have enforceable legal title to their agricultural land, and that banks then accept land as collateral for loans.

   - Continue to build up the Agricultural Cooperatives Development Agency in support of smallholder farming. It is important to ensure that information on cooperatives for rural income generation and business should be available to women as easily as men.

Rural and gastronomic tourism

Tourism has developed rapidly in Georgia over the last few years and it earns more foreign currency than agriculture and food put together. It is diverse and decentralised, and much of it is linked with the countryside, including good food and wines.

As economic integration proceeds under the DCFTA, visits to Georgia can be expected to become particularly attractive for Europeans due to the country's relative proximity and unique features. To European eyes, Georgia offers a beguiling mixture of the familiar and the exotic, but many potential visitors are put off by an image of political unrest. News of exceptionally low rates of crime is however not reported widely.[46]

Tourism can provide non-farm incomes for many rural residents as well as immediate outlets for Georgian farm produce, indirectly earning foreign exchange without the need to meet onerous export standards. Besides providing food for ski resorts and adventure holidays, Georgia's cuisine could be promoted through gastronomic tours in rural areas, which could add to non-farm as well as agricultural incomes for smallholders.

The options on offer are displayed on the Georgia Travel website (http://georgia.travel/): the categories include adventure, culture, food and wine, skiing and national parks. Under an international campaign supported by the government, this could be developed further to maximise the benefits to smallholders and their families. It is not hard to imagine appealing slogans, such as 'The Land of the Golden Fleece' and 'The Place that Invented Wine.'

- Develop the government-sponsored Preferential Agro-credit Project into a state- or mutually owned agricultural bank, to lend to farms of all sizes as well as cooperatives. France's Crédit Agricole and the Netherlands' Rabobank have had many decades of successful experience in this area, under mutual ownership. Methods of guaranteeing credits for smallholders should also be developed, as already done by the Rural Credit Guarantee Foundation in Hungary and similar agencies. The Law on Agricultural Cooperatives and the Law on Credit Unions need to be used to assist this aim.

- Continue development of the Agro-Insurance Programme with a view to it too becoming eventually a state- or mutually owned national agency.

- Ensure there is equitable access to loans for women smallholders, farmers and business start-ups, through governmental support.

- Direct representation of smallholder and subsistence farmers on relevant government programmes.

- Priority to smallholders in agricultural and food procurement at all levels of government.

- Create an official programme of 'Georgian Farmer' labelling, geared to supplies from smallholders. Show pride in the link between Georgia's name (in English and many other languages) with the Greek word γεωργος ('georgos'), which means 'farmer.'

- Establish weekly farmers' markets in urban areas, to be locally organised with government finance and support.

Smallholders and wine

Georgia has as distinctive and ancient a wine culture as any in the world; some would say more so, because of its antiquity, the local varieties of grape, and some excellent historical practices – for example, in underfloor wine storage – that still prevail. Every visitor to Georgia knows about its wine, but few other foreigners do.

Some Georgian wines are exported to Western Europe and North America, but they are generally grouped with those of other little-known origins and fetch mediocre prices. As the country opens up, with tourism and by other means, Georgian wines' quality will no doubt improve further and they will find their rightful place on export markets.

The government should assist all this by working on *Appellation Contrôlée*, Geographical Indications and indigenous grape varieties to enable Georgia to establish a worldwide reputation as a supplier of distinctive high-quality wines.

One of the distinguishing features is that many vines are grown by smallholders, not on estates. This is also true in some other countries, such as France, but it runs counter to the usual pattern.

Among other tree-based beverage crops, most coffee is grown by smallholders, while the biggest tea-exporting country, producing the highest-quality tea, is Kenya. Tea was first grown in Kenya in 1960 as a crop for smallholders, pioneering the use of contract farming. Since then it has outcompeted all the tea estates in other countries, under the guidance of the Kenya Tea Development Agency, an extension and marketing body which is indirectly owned by the smallholder farmers themselves. The record of smallholder coffee marketing in Colombia is similar.

A similar arrangement in Georgia could promote rural social development along with the crucially important development of the wine sector.

- Special support for agriculture in high mountain regions, to include support for traditional farming methods and food safety development. Among other countries, Switzerland, Norway and Japan have highly developed agricultural policies for mountain areas but they are heavily subsidized. The EU has itself introduced a specific policy with two forms of support: direct payments per hectare of farmland for areas with natural constraints, plus further compensation to farmers for resulting additional costs and loss of income.[47]

7. Food safety and environmental control:

- Assist *all* farmers via the national extension service to meet new food safety standards introduced under the DCFTA. Support for smallholders' upgrading should be required in all new food safety laws.

- Legal pursuit and prosecution of all trade in unregistered chemicals.

- Investigate the best ways to set up local laboratory services and ensure access to them for smallholders.

- Grants, subsidies and preferential purchase terms for the farm equipment required for food safety purposes.

- Promote the prevention of brucellosis and other animal diseases, with mandatory reporting and full compensation to farmers when diseased animals have to be slaughtered.

8. Sub-sectors:

    - Develop the grape and wine sector, especially among smallholders. See the ‘box’ on p. 19.

    - Support sea fishing, including the establishment of a cannery.

9. A programme of organic certification for smallholders, including free registration if possible, or subsidised fees.

10. Rural and gastronomic tourism. See the ‘box’ on p. 18.

7. CONCLUSIONS

This briefing has not tried either to create exaggerated expectations of benefits from the DCFTA or to see the main task as sheltering smallholders. Rather than protection from any negative effects, it looks to parallel programmes, working with the grain of the government's own plans, to enable smallholders and rural communities to prosper in new ways under the opportunities that will be available under the DCFTA, even if its direct beneficiaries will mostly be found in other parts of Georgian society.

Georgia's agrifood sector has a strong character and traditions to build on, and there are numerous opportunities ahead of it. It is important to look to the long term, based on identifiable strengths while drawing lessons from other countries' experiences. All needs to be part of the government's wider development strategy.

It is necessary to maintain recent positive trends, such as the growth in agricultural exports and the government's support and encouragement for rural entrepreneurship. Development of the international tourism and wine sectors is still in its early stages, when one considers the potential, but the progress over the last ten years has already been substantial.

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