

## THE ROLE OF THE ASSOCIATION AGREEMENT WITH THE EUROPEAN UNION IN THE PROCESS OF RECOVERY AND DEVELOPMENT OF AGRICULTURE IN GEORGIA

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**Abstract.** Given the challenges facing the Georgian economy, it is especially important to restore agriculture and develop rural areas to overcome poverty and improve living standards, which is achievable in condition of efficient use of the country's natural resources potential.

In the process of agricultural recovery and development in Georgia, the Association Agreement with the European Union also plays a strategically important role, helping to stimulate agricultural production and diversify exports.

The paper aims to assess the reasons for the setback in agricultural development and the prospects for its recovery within the framework of the Association Agreement with the European Union.

The study focused on Georgia's failure to take full advantage of the Deep and Comprehensive Free Trade Area (DCFTA), which is hampering economic modernization, investment and economic integration into the European Union. Initial expectations for the Association Agreement were much more positive. Since 2016, after the entry into force of the Agreement, no changes have been made to the structure of exports by commodity items. The country's agricultural sector cannot compete either on the domestic or foreign markets.

The main problems in the export of Georgian products to the EU market are non-compliance with EU standards and disruptions in the production chain, the primary reason for which is improperly planned and implemented reforms.

In the current situation, Georgia needs an accelerated pace of targeted reforms to modernize and develop the agricultural sector, and this requires developing the agricultural sector in two stages: a return to the domestic market and an expansion of the export structure.

**Keywords:** agriculture, Association Agreement, modernization.

**JEL code:** Q15, Q17

### Introduction

For the last three decades, due to the existing model of management of the potential of Georgian natural resources, we can see that the process of poverty elimination, development of the economical real sector, and reduction of dependence on imports is progressing very slowly. Under the conditions rehabilitation and development of the agricultural sector in Georgia, there is the potential to partially overcome the challenges, which Georgia is facing. However, land reform is still unfinished, rural infrastructure is outdated and crumbling, land plots fragmentation is high, motivation for agricultural production is low because of difficulties with access to internal and external markets, the issue of food independence and security is unresolved.

For the economy of Georgia, it is critically important to maximally utilize the agricultural potential of the country and use it purposefully. In Georgia, the total area of agricultural land is 30,3 thousand km<sup>2</sup>, which constitutes 43.4% of the country's territory (Georgia Agriculture and..., 2019). 40.6% of the population is employed in rural areas (Demographic Situation in..., 2020), from them 75% are self-employed in the agricultural sector. That is why, in recent years, some reforms were implemented, and this process is still ongoing.

Bilateral and multilateral agreements on free trade were concluded with various countries for stable growth of the economy and exports facilitation. In terms of promotion of agricultural production and exports diversification, there were high expectations from the Association Agreement with European Union, but these expectations did not materialize. It turned out that neither the agricultural sector is able to adapt to the new opportunities, nor exports diversification is progressing successfully. Considering the above-

mentioned, a hypothesis is introduced in the process of research: Bilateral and multilateral agreements on free trade do not necessarily help the growth of the economy and exports.

The paper aims to assess the reasons for the setback in agricultural development and the prospects for its recovery within the framework of the Association Agreement with the European Union.

The tasks are formulated as follows:

- 1) assessment of agricultural development after the entry into force of the Association Agreement with the European Union;
- 2) analysis of exports, including exports of agricultural products to the EU market, after the entry into force of the Association Agreement with the European Union;
- 3) review of the regulatory documents related to the agricultural sector;
- 4) analysis and assessment of the reforms implemented in the sector;
- 5) determination of main development policies in the sector and elaboration of proposals for overcoming the existing challenges.

The following research methods were used in this article: review of scientific literature; analysis of statistical data; comparative analysis and synthesis techniques.

Novelty and topicality of the research: programs and projects implemented in the agricultural sector in the form of co-financing, turned out to be not goal-oriented, and could not ensure effective use of natural resources of the country.

Problematic questions of the conducted research:

- 1) What would be a starting point in facilitating the development of the agricultural sector?
- 2) What are the ways by which Georgia can increase exports to the EU market and change its structure?

During the research, following information sources were used: scientific articles, official information of the National Statistics Office of Georgia, Eurostat Statistics Explained and normative acts of the Government of Georgia.

## **Research results and discussion**

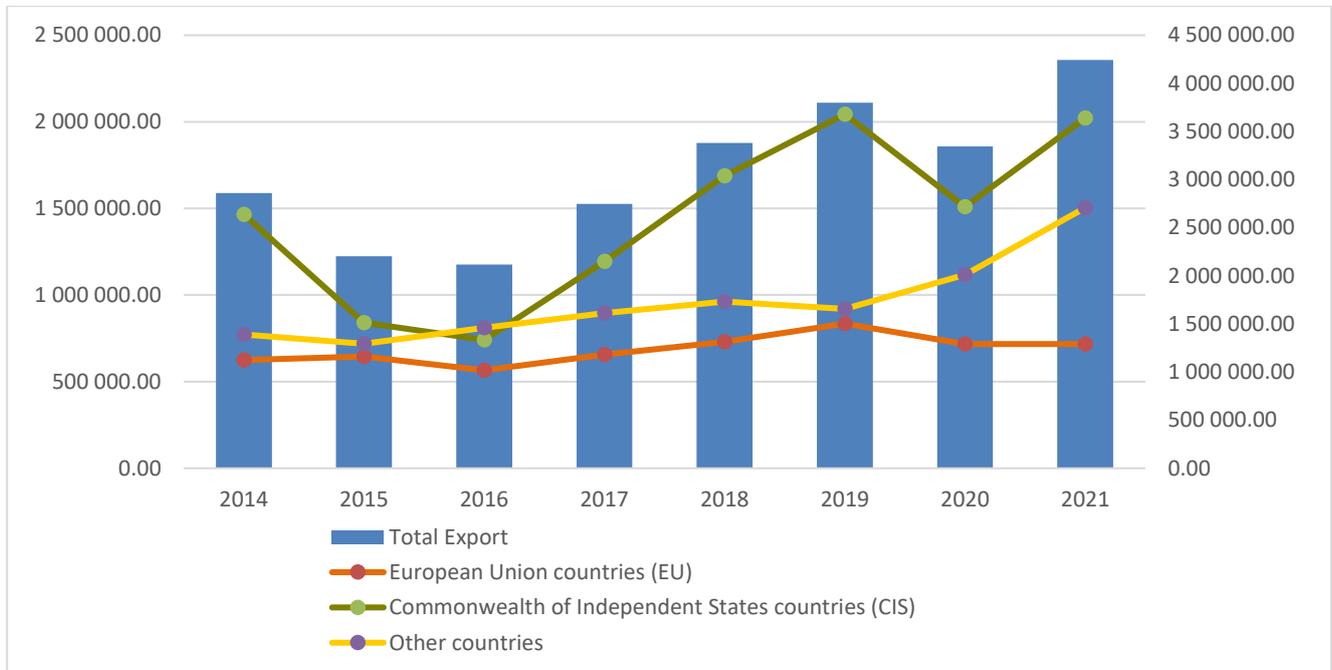
Georgia's economy, with its underdeveloped real sector and in conditions economic globalization, often faces difficult challenges. The current model of resource management of the country cannot ensure the development of the agrarian sector of the economy. Due to the natural-climatic conditions, the segment of unsustainable tourism occupies an important place.

The chronically deficit balance of payments with its consequences, the investment deficit and the permanently growing negative trade balance has remained an insurmountable problem for years.

In order to improve the country's negative trade balance, to promote sustainable economic growth and exports, Georgia has signed bilateral free trade agreements with the following countries: Russia, Azerbaijan, Armenia, Ukraine, Moldova, Belarus, Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan, Turkey, China and has The Multilateral International Trade Agreement with: With the CIS, GUAM, the European Union and the European Free Trade Association.

The analysis of the results of Georgia's foreign trade shows that free trade agreements do not work properly in the conditions of a weakly developed real sector of the economy and do not provide significant growth in exports and the economy. Export dynamics (Figure 1), by groups of countries, (Georgian Exports by..., 2021) in the analysis period are characterized by insufficient growth rate and volatility. According to 2021 data, registered imports of goods amounted to USD 10 073.3 million, which was 2.4 times more than

registered exports of goods. Local production has always been unprepared for the competition, which has been growing every year in terms of imported goods. The involvement into the international trade integration forces developing countries to open their domestic markets for foreign agricultural and food commodities. The effective protection of domestic farmers in developing countries is impeded by the low import tariffs, which facilitate an easier market access for the foreign agricultural and food commodities and lead to the reduction of the domestic production (Erokhin V. et al., 2014).



Source: constructed by the author based on data from <https://www.geostat.ge/en>

Fig. 1. Georgian Exports by Country Groups (Thsd. USD)

Given the resource potential of the country, in the case of modernization, restoration and development of the agricultural sector, it is possible to partially overcome the existing challenges and maintain a balance between the principles of open economy on the one hand and economic and food security on the other.

The Association Agreement with the European Union should have played an important role in the process of restoration and development of Georgia's agriculture, within scope of which the production of agricultural products should be stimulated and exports should be diversified. New market opportunities in the EU and higher production standards in Georgia will spur investment, stimulate the modernisation of agriculture and improve labour conditions (The EU's Association..., 2014). That is why the initial expectations for the Association Agreement were much more positive, although the final results showed that after the entry into force of the Agreement, neither exports of agricultural products increased nor its structure changed according to commodity positions (External Trade Of..., 2016). The main export goods are again vegetable fats and oils, wine, fresh or frozen vegetables, dried vegetable flour, alcoholic beverages, nuts, fruit jams, canned fruits and vegetables and mineral water (External Trade Of..., 2020).

The Deep and Comprehensive Free Trade Agreement between Georgia and the European Union, which Georgia has been looking forward to, entered into force on July 1, 2016. Prior to the entry into force of the agreement, by 2015, the EU's share of Georgia's total exports was 29.25%, although this figure has been steadily declining with each subsequent year, reaching 16.95% as of 2021. For comparison, the share of CIS in Georgia's total exports in 2015 was 38.15%, and by 2021 it was up to 47.64%, the share of other countries in Georgia's total exports in 2015 was 32.6%, and by 2021 it was up to 35.45%. In 2016-2021,

the average annual growth rate of exports to EU countries was 2.54%, while the same figure was 19.9% in the Commonwealth of Independent States and 13.7% in the rest of the world.

The available data indicate that under the current agrarian policy, the situation in terms of exports to the EU market since 2016 has not improved significantly, and Georgia is not fully utilizing the benefits of the Deep and Comprehensive Free Trade Agreement (DCFTA), which should accelerate Georgia's economic integration into the European Union.

The analysis showed that in the EU single market, the low rate of average annual growth of exports is due to non-compliance of Georgian products with the highest EU standards and a faulty production chain, which, considering non-tariff barriers, makes the product of Georgian origin more expensive and does not provide the prospect of significant export growth.

The research revealed that the non-compliance of Georgian products with the standards of the EU market and the faulty production chain are primarily related to the problems accumulated in the agricultural sector over the decades and which are still unsolved, including the following issues.

- Unfinished land reform, without which it is impossible to develop the agricultural sector. Delays in land reform and the existence of unregistered lands in private ownership hinder the development of the land market, lead to small-scale production, non-uniform product production, and fail to reduce products prime costs. Land regulations have a major impact on economic development, especially in agrarian societies, and they continue to affect the efficiency of the rural economy when economies develop further. Land markets are generally regulated through land administration systems and land tenure (Lazikova J. et al., 2021). The reform of agricultural land in Georgia started in 1992, but it is still unfinished. On August 1, 2016 the State Program of Land Registration was divided into two stages. Stage 1, comprising sporadic registration of land titles based on the citizens' applications. Systemic registration included in Stage 2 envisages the registration of land plots based on the systemically collected and processed data (Law of Georgia..., 2016). International experience confirms that land reform is one of the most important and necessary preconditions for agricultural development. For decades, China has achieved significant productivity growth in agriculture through either land reform, technological innovation, market reforms or public investment in rural infrastructure (Huang J. et al., 2020). Secure land rights enable farmers to work and invest in their farms with the expectation that they will reap the benefits without fear that their land may be confiscated arbitrarily. Formal and informal land rights are therefore seen as key to improving the conditions of the poor in developing countries in terms of economic growth, agricultural production, food security (Lawry S. et al., 2017).
- Infrastructure works are incomplete, there is a lack of irrigation systems, roads are out of order, refrigeration and storage facilities are insufficient, and this is compounded by the low availability of internet in rural areas. Digital technologies overcome information problems that hinder market access for many small-scale farmers, increase knowledge through new ways of providing extension services, and they provide novel ways for improving agricultural supply chain management (Deichmann U. et al., 2016).
- Large fragmentation of the agrarian structure adversely affects the economic results and land productivity. Fragmentation contributes to a significant reduction in the small farms' competitiveness (Timofti E. et al., 2015). It should be noted that, according to the most recent agricultural census conducted in 2014, the share of commercial farms in agricultural production remained low. The overwhelming majority of households (93.6 %) own less than two hectares of agriculture land. Only 4.8 % of households own two to five hectares of land, and 1.5 % own more than five hectares. With such

ownership structure, commercial farming remains underdeveloped (Georgia - Country Commercial..., 2021). The process of forming cooperatives is proceeding at a slow pace. Without unification in cooperatives, it is difficult for small entrepreneurs to enter the EU market.

- Access to education, modern technologies and agricultural credit for small and medium-sized enterprises operating in the agricultural sector is limited. There is low level of awareness about the possible benefits of DCFTA. Agricultural insurance products offered to farmers are scarce and monotonous.
- The pace of implementation of the international quality certification system is low, there is a lack of laboratories and they are less available in the regions.

Accumulated and unsolved problems in Georgian agriculture, respectively, reflected on the development of the sector. Although, export of Black Sea anchovy to the EU market has been allowed since 2017, export of pet food and certain categories of non-food animal products (leather, wool) from 2020, export of natural honey since 2016, and according to EU Commission Regulation 2022/34 of 22 December 2021, Georgia has been added to the list of third countries from which exports of certain animal products are also allowed to the EU market (In particular, fishery products, and of frogs' legs and snails) (Commission Implementing Regulation..., 2022), Georgia still fails to make good use of these opportunities. For example, the volume of local exports of live animals and animal products is very low in the EU market during the analysis period (Table 1). This figure in 2021, compared to previous years, increased significantly to 519.09 thousand US dollars, of which 97.7% came from natural honey. As for local exports of vegetable products, the highest rate was recorded in 2016, and a significant decline began in the period following the Association Agreement. The average annual growth rate of imports of vegetable products is 7.84%, while the same rate of local exports is only - 0.02%. It is noteworthy that local exports of products of vegetable origin for the whole analytical period exceeded imports, while exports of live animals and products of animal origin, on the contrary, lagged significantly behind imports.

Table 1

**Domestic export and import with the EU**

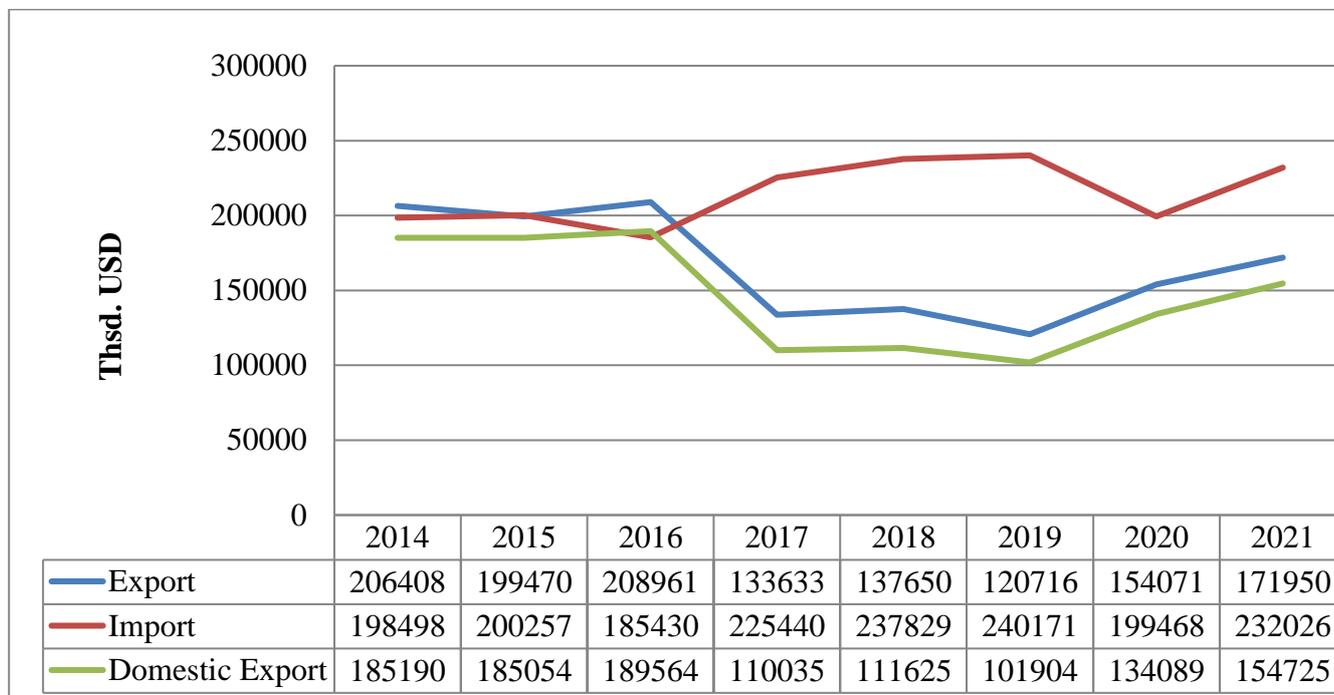
Year	Live animals; animal products		Vegetable products	
	Domestic Export Thsd. USD	Import Thsd. USD	Domestic Export Thsd. USD	Import Thsd. USD
<b>2014</b>	105.29	63711.12	146312.80	32546.34
<b>2015</b>	183.59	72154.24	152308.47	28166.77
<b>2016</b>	0.42	62348.82	153653.44	27524.14
<b>2017</b>	63.54	75060.52	59932.03	30950.49
<b>2018</b>	0.54	75392.77	43224.97	32722.48
<b>2019</b>	18.03	79663.69	52163.30	31634.60
<b>2020</b>	57.85	69634.31	79492.87	34631.58
<b>2021</b>	519.09	72857.51	91251.82	43281.19

*Source: author's calculations based on data from <http://ex-trade.geostat.ge/en>*

In the EU market, the local export of fruit and vegetable juices is also characterized by a downward trend, in particular, in 2014, local exports amounted to 5,677.3 thousand USD, and in 2021 to only 3,631.59 thousand USD. The same situation is in the local exports of hazelnuts and other nuts, the highest rate of which was recorded in 2015 at 144,050.78 thousand US dollars, and in 2021 amounted to 79,961.11 thousand US dollars. The highest rate of local exports of jams, fruit-berry jellies and other products was

recorded in 2017 at 6,312.67 thousand US dollars, and by 2021 decreased to 66.10 thousand US dollars (External Trade Portal, 2022).

Following the Association Agreement with the EU, since 2016, local exports of food and beverages have been declining instead of increasing, while imports have begun to increase. The situation is changing positively from 2019, although imports are still significantly higher than exports (Figure 2).



Source: constructed by the author based on data from <https://www.geostat.ge/en>

Fig. 2. **External trade food and beverages of Georgia with the European Union (Thsd. USD)**

The study confirmed that the difficult situation in the agricultural sector is due not only to the problems accumulated and unresolved over the years, but is also caused by, improperly planned programs and projects implemented within the co-financing, which started from 2013 to address these issues. These programs included the promotion of primary agricultural production, processing production, storage of agricultural products and modernization of agriculture (Verulidze V., Leibus I., 2020). However, it was found that the implemented measures were of a formal nature and were not problem-oriented, as they did not substantially affect the development of the agricultural sector. The agricultural sector, up to this day, cannot cope with the problems accumulated in the sector, cannot compete in either the domestic or foreign markets. The existing challenges create the need to modernize the agricultural sector, which is very difficult to achieve in the short term as it requires both a high level of professionalism and a large amount of financial resources.

The analysis shows that Georgia has not properly assessed the Free Trade Agreement with the European Union as an opportunity to increase exports of domestically produced goods to the European market. The country did not appear to be properly prepared to enter the EU stable market. Regarding the EU export potential, it is better utilized by Moldova; while Georgia and Ukraine should make more efforts to reach the same level of export potential utilization (Gaganidze G., 2018).

In order for Georgian products to enter the European market, it must meet European standards of product safety, which primarily has a positive impact on the quality of the local market. The introduction of HACCP standards requires not only a range of technical and human resources, but also financial costs, and involves the process of upgrading and re-equipping the enterprise infrastructure, equipment, facilities.

The Deep and Comprehensive Free Trade Agreement provides for Georgia's approximation to EU legislation in the field of food safety, which began in 2015 and will be phased in until 2030. Some progress has been made in this direction as well, although it is insufficient. On food safety and sanitary and phytosanitary (SPS) standards, Georgia has approximated 169 veterinary, phytosanitary and food safety regulations out of 272 EU agrifood legal instruments envisaged to be approximated by 2027 (Joint Staff Working..., 2021).

As of today, unfortunately, Georgian business is not ready to take into account all the European regulations, because it requires a significant investment. Consumers are not ready for this either, as products will become more expensive in the local market.

In the current situation, Georgia needs an accelerated pace of goal-oriented reforms, and for this it is necessary to develop the agricultural sector in two stages. The first stage should begin with the following steps.

- 1) With the land reform, which is still unfinished, and the return of Georgian products to the Georgian market, from which it has long been expelled.
- 2) Review of public procurement policy to encourage the production of local agricultural products, as public food procurement can also be an instrument to foster agricultural development by directing government food demand to domestic suppliers, particularly smallholder farmers. Most rural households in the developing world are smallholders who rely on agriculture for their livelihoods. Strengthening smallholder livelihoods is thus key to poverty reduction and agricultural development (Food and Agriculture..., 2018). Also important, contract farming—a preharvest agreement between farmers and buyers—can facilitate smallholder market participation, improve household welfare, and promote rural development (Meemken E. M., Bellemare M. F., 2020).
- 3) Refinement of co-financing programs so as to reduce barriers for involvement of small businesses (significant start-up capital requirements, bank guarantees) to motivate them.
- 4) With the support of the state, for the arrangement and development of crop storage, sorting, packaging, processing, distribution sectors and refrigeration equipment.

The second stage of the development of Georgia's agricultural sector should include the promotion of local exports to the EU market, for which it is necessary to make the following steps.

- 1) Encourage the development of agricultural cooperatives to optimize and organize the logistics of producers and exporters, as well as reduce the production of heterogeneous products.
- 2) Accelerating the process of approximation of the food safety, veterinary and phytosanitary fields with the relevant EU legislation under the DCFTA plan.
- 3) Production and export of products for which demand is high or in short supply based on EU market demand analysis. For example, on EU market in 2020 in imports, the largest group was vegetable products (47 %) followed by foodstuffs (33 %) and animal products (20 %). In imports of vegetable products, the largest chapter was 'edible fruit and nuts; peel of citrus fruits or melons' (30 %) (Eurostat Statistics Explained, 2022). It should also be noted that, in the European Union, the production volume of protein raw materials has failed to meet the demand for many years now. The deficiency reaches 60–80% of protein raw material and is covered by imported goods, primarily including soya bean meal sourced from the Americas (Jerzak M. A., Smiglak-Krajewska M., 2020).
- 4) To develop the organic agriculture segment and encourage the export of organic products to the EU market, which the country has resources for.

Only after this, in the long run, will there be a basis for small and medium-sized enterprises can also within the DCFTA to meet the quality requirements of European standards and overcome non-tariff barriers,

resulting in increased production capacity and entrepreneurs will be able to ensure a continuous supply product to the EU market.

### **Conclusions, proposals, recommendations**

- 1) The incompleteness of land reform and the existence of unregistered lands in private ownership hinders the development of land market and agricultural sector.
- 2) State purchases of agricultural goods produced by small farmers would increase the motivation for the production of agricultural goods.
- 3) Access to co-financing programs for small farmers and introduction of post-harvest technology would eliminate interruptions in production deliveries.
- 4) Facilitating the development of agricultural cooperatives would decrease costs, prevent the production of non-standard goods and ensure optimization of logistics for producers and exporters.
- 5) Acceleration of convergence processes of the fields in food security, veterinary science and phytosanitary to the relevant legislation of the EU, stipulated by DCFTA plan, would increase the volume of local exports.
- 6) Based on the analysis of the European Union market, production and shipping of highly demanded or scarce products would improve exports' structure and help to increase the motivation of production in such segments.
- 7) Development of organic agriculture and facilitation of organic products exports on the market of the European Union would have a positive impact on the stable development of the agricultural sector.

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