Can and should the Eastern Partnership be saved?

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Failure at Vilnius Summit Nov 2013

Georgia and Moldova initial DCFTA against Russian opposition BUT

• Armenia chooses not to initial DCFTA
• Ukrainian President refuses to sign and to fulfill political conditions for DCFTA
• Popular demonstrations in Kiev; President flees; Russia annexes Crimea; conflict in Eastern Ukraine
  — Threat of civil war

ENP’s credibility is at stake
Should the EaP be saved? Yes

• An FTA with their two major trading blocs (EU, Russia) is EaP’s best trade policy
• Deep trade agreements are significantly more effective than shallow agreements, and are possible with EU but not with Russia
• DCFTAs between EaPs give significant benefits

Thus, EaP countries reap economic gains and EU earns political credibility vis-à-vis its EAP partners
Purpose of paper

• Compare and contrast EaP countries in terms of economic and other indicators in view of prerequisites for trade agreements
  – Compare and contrast their direction of trade, eastward and westward
• Present econometric evidence of the effects of trade agreements on trade relations based on estimates of a modern gravity model of trade
From agreements to trade

From astronomy to economics

— Gravity model explains trade between two countries by their mass (e.g., national output) and distance between the two countries plus other factors, including trade costs, trade agreements, and various other considerations (common border, common language, colonial history, etc.)

— Can be extended from bilateral trade to trade among many countries
But first: Why did Vilnius Summit fail?

Most EaPs seem not well prepared for DCFTA

– Lack of democracy and free press
– Poor functioning of market economy
– Difficult to do business
– Poor governance, lack of social trust, and pervasive corruption

Their credibility as negotiating partners appears uncertain

Look at the evidence
Former Soviet Republics: Democracy 1991-2012

Baltic States and Russia

Six EaP States

Democracy on a scale from -10 to +10

Source: Polity IV Project.

Baltic States and Russia
- Estonia
- Latvia
- Lithuania
- Russia

Six EaP States
- Armenia
- Azerbaijan
- Belarus
- Georgia
- Moldova
- Ukraine

Lower index means more freedom

Source: Freedom House.
Neither democracy nor free press

- Azerbaijan and Belarus are not democracies by conventional standards, and lack even partly free press
  - Not much different from Russia
- Ukraine and Armenia are borderline cases, moving in the right direction, yes, but they still have far to go
- Georgia and Moldova have democracy with partly free press and good prospects
EaPs Ill-functioning market economies

Source: EBRD.
Former Soviet Republics: Ease of doing business 2005-2013

Baltic States and Russia

Six EaP States

Lower index means more ease

Former Soviet Republics: Corruption in 1996-2013

Baltic States and Russia

Six EaP States

Lower index means more corruption

Source: Transparency International.
Former Soviet Republics: Corruption in 2012
(Business corruption as measured by Transparency, political corruption as measured by Gallup)

Transparency
Lower index means more corruption

Gallup
Higher index means more corruption

Source: Transparency and Gallup.
Former Soviet Republics: Corruption and trust in 2012 or earlier

**Corruption**

- Higher index means more corruption

**Trust**

- Lower index means less trust

Source: Legatum Institute.
Verdict: EaP countries are a mixed bag

- Georgia and Moldova score highest both on democracy and market economy
- Belarus and Azerbaijan fall short; they are not WTO members
- Ukraine and Armenia are intermediate cases, with serious internal and external conflicts, respectively
  - Both resemble Russia in some respects, and seek relations also with the EU

Failure at Vilnius was not surprising
Former Soviet Republics: Exports of goods and services 1989-2012 (% of GDP)

Baltic States and Russia

Six EaP States

Former Soviet Republics: Exports of manufactures 1994-2012 (% of total exports)

Baltic States and Russia

- Estonia
- Latvia
- Lithuania
- Russia

Six EaP States

- Armenia
- Azerbaijan
- Belarus
- Georgia
- Moldova
- Ukraine

Former Soviet Republics: Direction of trade in 2012 (% of total)

Belarus
- EU: 29%
- Rest of world: 15%
- Russia: 47%
- Ukraine: 9%

Ukraine
- EU: 34%
- Rest of world: 27%
- Russia: 22%
- China: 7%
- Turkey: 4%
- Belarus: 6%

Source: European Commission.
Former Soviet Republics: Direction of trade in 2012 (% of total)

**Georgia**
- EU: 28%
- Rest of world: 30%
- China: 7%
- Ukraine: 7%
- Russia: 7%
- Azerbaijan: 8%
- Turkey: 13%

**Moldova**
- EU: 54%
- Ukraine: 16%
- Russia: 12%
- Rest of world: 8%
- Belarus: 5%
- Turkey: 5%

Source: European Commission.
Estimated once-off trade gain for EaP countries from FTAs with

<table>
<thead>
<tr>
<th></th>
<th>EU</th>
<th>EaP</th>
<th>Russia</th>
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<tbody>
<tr>
<td>Shallow</td>
<td>938%</td>
<td>293%</td>
<td>0% or less</td>
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<tr>
<td>Deep</td>
<td>86%</td>
<td>...</td>
<td>0%</td>
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- Bilateral exports for 34 exporters and 150 importers
- Exporters are EU countries plus all European, North African, and Middle East countries that are EU neighbors
- Estimates show effects of shallow vs. deep FTAs on trade on top of gravity considerations (economic mass plus distance, etc.)

Source: Gylfason, Martínez-Zarzoso, and Wijkman (2014).
Can the EaP be saved? Only if ... 

- EU members can agree on a common policy vis-à-vis EaP
- EU and others coordinate policies to exercise both soft power and hard power in region
- The UN, the Council of Europe, and the OSCE increase international surveillance in the region, especially in Ukraine

But there is risk of too little, too late

OSCE = Organization for Security and Co-operation in Europe
What the EU can do

- Encourage speedy implementation of DCFTAs with Georgia and Moldova signed in June
- Hold internationally supervised referendum in Ukraine to determine scope of DCFTA signed in June by new government in Ukraine
- Offer to negotiate a DCFTA with Russia
- Involve Russia in intensified negotiations to resolve regional conflicts prior to DCFTA
  - Transnistria, Nagorno Karabahk, South Ossetia and Abkhasia

“When goods do not cross borders, soldiers will.”
Frédéric Bastiat