Trade aspects of the Eastern Partnership

European Neighbourhood Policy review

SUMMARY *For the European Neighbourhood Policy and its eastern regional dimension, the Eastern Partnership (EaP), trade is considered an end in itself, but also a means to improve relations and create incentives for reform.*

The main trade instrument for the reformed European Neighbourhood Policy will be deep and comprehensive free trade areas (DCFTAs). These go beyond basic free trade agreements, aiming also to reduce non-tariff barriers. The countries of the Eastern Partnership will be assisted in adopting parts of EU internal market legislation so that their products reach the standards demanded on the EU market.

DCFTA negotiations with Ukraine have been concluded. Its implementation will be expensive for Ukraine and its businesses, but will bring long-term benefits, such as a better business and investment climate. With Moldova and Georgia, negotiations are to start early in 2012. The Commission is assisting Armenia with technical support to prepare for DCFTA negotiations. Azerbaijan and Belarus are not yet WTO members and thus not eligible for such negotiations.

Container terminal in Odessa.

In this briefing:

Glossary

AA: Association Agreements go further than PCAs, which they will replace in ENP. Provide for a privileged relationship with the EU and normally for progressive trade liberalisation. The EP must give its consent to an AA.

DCFTA: Deep and Comprehensive Free Trade Area. The form of trade agreement planned with Eastern Partnership countries. The core economic part of an AA, aimed at achieving three of the "Four Freedoms": free movement of goods, (many) services and capital.

EaP: Eastern Partnership, concerns Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine.

ENP: European Neighbourhood Policy.

PCA: Partnership and Cooperation Agreement, concluded with all Eastern Partnership countries except Belarus since the mid-1990s in order to strengthen democracy and economic development; do not offer perspective of EU membership.

International and regional context

The **European Neighbourhood Policy (ENP)** was established in 2004 to foster special relationships with countries near the EU. It aims to increase stability, security, and prosperity in the Union for the Mediterranean countries, and in the EU's eastern neighbours, which make up the **Eastern Partnership (EaP).** Relations with these countries are supposed to be based on common values (democracy, the rule of

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law, good governance, human rights) and certain principles (market economy, free trade, sustainable development, poverty reduction).[1] The EaP was launched in May 2009.[2] Its aims are political and economic. Financial means were increased. At the EaP Warsaw Summit, EU leaders announced funds of up to €1.9 billion for 2010-2013.

For the ENP and EaP, **trade** is an end in itself (and for companies and investors from both sides) as well as an important means to improve relations with these countries. Contacts with companies and people abroad can contribute to poverty reduction and democratic development in a society.

International background

DCFTAs can only be concluded with WTO members and must be neutral towards third countries. This means that an increase in trade barriers is ruled out.

All EaP countries were part of the Soviet Union before 1991, and are now influenced to some degree by their relations with **Russia**. These range from customs union (with Belarus, also including Kazakhstan) to war (in 2008, with Georgia). Russia is set to join the WTO in 2012.

On 1st January 2012, the Free Trade Area (FTA) of the Commonwealth of Independent States (CIS) entered formally into force. It includes Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Ukraine. Oxford Analytica however maintains that a few problems still have to be overcome for it to work. Unlike the Russia-Belarus-Kazakhstan customs union, it would not impede closer trade integration with the EU.

Trade aspects of the ENP review

ENP review COM (2011) 303

As a consequence of the Arab Spring and the repression of several citizens' uprisings, the Commission and High Representative Catherine Ashton proposed to review the ENP to make it more effective in promoting the EU's values and achieving its other objectives. Greater flexibility and stronger conditionality on adherence to values and principles would be needed. For a country which shows rapid progress in its reforms, Europe should offer a maximum of cooperation and financial assistance ("**more for more**"). In countries whose authorities refuse change, civil society should receive support rather than official bodies. The Commission proposes that ENP countries should be helped to strive towards "deep democracy" and inclusive and sustainable economic development. The two regional dimensions of ENP, of which EaP is one, are to be strengthened.

Investment and trade in the review

According to the Commission, the aim of the revised policy should be to create jobs, boost growth, improve social protection and revitalise crises-affected sectors. It mentions technology transfer and innovation. The business environment should be improved by strengthening the rule of law and reducing corruption, thus attracting more foreign direct **investment** (FDI). The Commission will explore options for an "enhanced investment protection scheme" in 2012, and organise investors' conferences. Possibilities for additional guarantees for EU SMEs through the European Investment Fund will be examined from 2012. The Commission also plans to encourage local business development around FDI. An EaP SME Facility has been set up as a flagship initiative for advisory services, grants and loans for SMEs. An Eastern Partnership Business Forum to channel ideas on the EaP to policy makers has been founded.

Deep and Comprehensive Free Trade Areas (DCFTAs) will be the main instrument of EU trade policy for EaP countries. Trade barriers will be gradually removed, making integration of the partner country into the internal market possible in the long run. According to DG EXPO Policy Department (PD), covering all trade in goods means including at least 95% of trade. Movement of capital and services will be liberalised in the longer term.

Regulatory convergence in a wider range of **areas** (thus the term "comprehensive") with an impact on trade is one goal: partner countries will move closer towards the *acquis* ("deep"), without having to adopt it fully. The Commission lists as relevant areas sanitary and phytosanitary rules (SPS), animal welfare, customs and border procedures, competition and public procurement. According to the analyst Per Magnus Wijkman, other non-tariff barriers such as technical regulations for industrial products, intellectual property rights and rules of origin must also be considered. The Commission plans to offer technical assistance to help partner countries meet standards. In comparison to all these areas, reducing tariffs and quotas will be a relatively easy first step, according to Wijkman.

EaP country	WTO member since	DCFTA negotiations since/to	Other trade links	% of trade with EU
Ukraine	2008	2/2008-12/2011	GSP	28.6%
Moldova	2001	2012	ATP	45.3%
Georgia	2000	2012	GSP+	26.1%
Armenia	2003	on horizon	GSP+	32%
Azerbaijan	-	far off	GSP+	46.9%
Belarus	-	far off	-	25.2%

Countries not in line for a DCFTA can be offered other trade concessions in specific sectors that would offer most benefits for the country's economy. The free movement of industrial goods in specific sectors would be set out in **Agreements on Conformity Assessment and Acceptance of industrial products (ACAAs)**, which lead to mutual acceptance of conformity certificates. Countries with ACAAs could eventually be included in a free trade area for industrial products including the European Economic Area (EEA) and Turkey.

ENP Countries with DCFTAs could be further integrated, into a **Neighbourhood Economic Community (NEC)**, a potential future free trade area modelled on the EEA.

EP position

In its resolution on ENP, the EP demands that DCFTAs should be used as a means to enhance ENP countries' commitment to democratic values. Respect for international conventions on child labour and labour laws should be monitored. In an April 2011 resolution on the ENP's eastern dimension, the EP considers that DCFTAs offer a strong incentive for reform if their social and environmental impact is fully assessed.

Opinions of analysts and think tanks

Wijkman considers that the NEC will have to be much more clearly defined to let EaP countries know what the EU can offer short of actual EU membership.

Michael Emerson of CEPS criticises the fact that EaP countries are pushed towards a DCFTA immediately, while the EU's southern neighbours are given the chance to negotiate simple free trade agreements first and deepen them later, possibly in the form of a DCFTA. For him, approximating the *acquis* is too costly for poorer economies, and if these countries are denied the perspective of EU membership, they may well not consider a DCFTA worth the effort.

EU trade with the Eastern Partnership

Trade relations with Ukraine, Moldova and Georgia are the most advanced. All three South Caucasus countries (Georgia, Armenia and Azerbaijan) are included in the GSP+ scheme of the EU under WTO rules, offering incentives for sustainable development and good governance not included in the "regular" Generalised System of Preferences. This will change after adoption of the new GSP focused on fewer, more vulnerable countries.

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Ukraine

Imports into the EU were already largely liberalised in 1993, under GSP. The main EU exports to Ukraine are machinery (mechanical and electrical) and transport, as well as chemicals, while Ukraine exports mainly manufactured goods and inedible raw materials (e.g. iron, steels, other raw materials, except fuel) to the EU.[3]

The **DCFTA, part of the EU-Ukraine AA**, was initialled on 19 December 2011 at the 15th EU-Ukraine Summit. The President of the European Council Herman Van Rompuy said that the EU would strive towards ratifying the agreement as soon as possible, but that recent anti-democratic activities in Ukraine (such as the Tymoshenko trial) could very well become a factor that would turn public opinion in the Member States (MS) against an early ratification.

According to the policy adviser Ina Kirsch, the AA and DCFTA create deeper links than the EU has ever had with any other country without candidate status. The DCFTA foresees that Ukraine adopts 80% of the *acquis* (with a transition period of up to ten years). Kirsch reports that the EU is Ukraine's most important investor (54%). **Investments** (as well as the local economy) are still being impeded by limited competition, excessive bureaucracy, an intransparent system of subsidies, and omnipresent corruption. SMEs therefore have particular trouble developing.

Ukraine predicts annual losses of €320 million through lowering tariffs under the DCFTA. Many reforms that the EU deems necessary will, according to Kirsch, lead to the closure of companies and thus the loss of jobs. In particular in agriculture, she expects Ukrainian consumers to initially show a preference for EU products because they adhere to better quality standards. It will cost local producers time and money to approximate EU standards, but when they do, it will also enhance their exports. Professor Marek Dąbrowski[4] expects both **costs and benefits** of the DCFTA to be higher for Ukraine: this painful adaptation will modernise the economy and improve the business and investment climate.

EP position

The EP, in its December 2011 resolution on the EU-Ukraine AA, considers that the DCFTA should be applied provisionally, even before AA ratification.

Moldova

Moldova is one of the poorest countries of Eastern Europe and home to one of the "frozen conflicts" in the former USSR, the unilaterally seceded region of Transnistria. Moldova benefits from **Autonomous Trade Preferences (ATP)**, granted by the EU in 2008 (extended to 2015) to help the country through a particularly difficult political and economic period following a Russian import ban on many of its products. It also alleviates the effects of the ending of the Romania-Moldova Free Trade Agreement, due to Romania's EU accession. Agriculture represents a high percentage of the **Moldovan economy and exports**. It exports wine, other beverages and tobacco to the EU, as well as textiles and vegetable products. Moldova is dependent on energy imports, and it lacks mineral resources. The EU also exports machinery and chemicals to Moldova. It is one of the EaP countries with the highest degree of EU trade integration (together with Azerbaijan).

The **launch of DCFTA negotiations** was agreed with the EU on 12 December 2011. Technical talks were scheduled to begin in January 2012, and formal negotiations in spring 2012. An AA has been under negotiation since January 2010. The analyst Evghenia Sleptsova considers that, since Moldova is already able to export easily to the EU thanks to the ATP, the main interest of a DCFTA for Moldova would be greater attractiveness to foreign investment through institutional and legislative harmonisation. Moldovan enterprises will also become more competitive in the long term by adopting higher production standards. Sleptsova estimates that the

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reforms a DCFTA demands could require 20% of Moldovan GDP and thus only be borne with considerable financial assistance from the EU. However, its GDP is predicted to rise by 12.5% once a DCFTA is in force.[5]

EP position
The EP, in its resolution on negotiations on the EU-Moldova AA, calls for efforts to include Transnistria in the future DCFTA.

Georgia
The Georgian economy had strong links with Russia until Georgia's Rose Revolution. After Russia banned imports from Georgia in 2006, Georgia reoriented its trade towards the EU, Eastern Europe and other regions. The 2008 war cemented the economic integration of the breakaway regions of South Ossetia and Abkhazia into Russia and their isolation from the rest of Georgia. Georgia is also an important transit country for gas, oil and other goods.

The EU grants favourable import conditions to Georgia under the GSP+ scheme. Georgia mainly **exports** mineral products, chemical products, base metals, and vegetable products. Georgia **imports** from the EU machinery and transport equipment, mineral fuels and chemicals. DG EXPO PD reports that *(*according to the World Bank), Georgia has greatly improved its business environment, simplifying the tax system, fighting corruption, and offering a one-stop shop for starting a business.

An AA with the EU has been under negotiation since July 2010, and the launch of **DCFTA negotiations** was agreed on 12 December 2011. Konstantin Zaldastanishvili (EU-Georgia Business Council) writes that the DCFTA would achieve what GSP+ could not, namely facilitate Georgia's exports to the EU, since they currently often do not reach the EU's high standards (especially sanitary, phytosanitary and food safety standards in agriculture). With a DCFTA and the resulting more favourable investment conditions, Georgia also hopes to further develop its already quite strong services sector, including tourism, ICT, financial services, and energy-related services. CASE Research predicted in 2008 that a DCFTA could boost Georgia's GDP by 7.5%.

EP position
In its resolution on Georgia, the EP calls for DCFTA negotiations to be started as soon as possible. It appreciates that Georgia has agreed Russia's WTO entry, and calls on Georgia to properly dispose of toxic waste.

Armenia
Armenia has no direct commercial exchanges with Azerbaijan and Turkey because of the conflict over the autonomous Nagorno-Karabakh region. Turkey and Armenia are now undertaking moderate efforts to normalise relations. Armenia depends largely on Russia for energy (gas, fuel, and uranium) and infrastructure, especially in the energy sector. Diamond processing is a traditional Armenian industry, however it is experiencing difficulties in competing internationally. The country possesses large copper, lead, zinc, iron, and gold reserves. Bilateral **EU-Armenia trade** is still quite low in volume. Armenia exports mainly base metals and products made of them, as well as pearls and precious stones. From the EU, it imports machinery and transport equipment, pearls and precious stones for further processing, food products, and textiles.

CASE Research considers that the **sectors** that stand to gain most from a DCFTA are the agro-food sector, mining, and processing of precious stones. To improve the business environment, Armenia has already started reforming its tax system.[6] Armenia also hopes that the reforms a DCFTA demands will stimulate its economy, render it more competitive, and improve competition in the country. The Commission is assisting Armenia with technical support to prepare for DCFTA negotiations.

Azerbaijan

Azerbaijan did not sign up to the CIS FTA because Armenia is involved. The GSP+ conditions it is eligible for do not offer much for Azerbaijan, since they do not concern more than 5% of its exports to the EU: oil and gas represent more than 99% of them. Azerbaijan imports machinery and transport equipment from the EU, as well as manufactured products and chemicals. Oxford Analytica comments that Azerbaijan's efforts to diversify production away from oil and gas are only progressing slowly. DG EXPO PD reports that in its dealings with Azerbaijan, the EU pays particular attention to ensuring its energy security, as confirmed in the EU-Azerbaijan memorandum of understanding on energy. Oil revenues are only bringing wealth to a small circle in society. This inequality, high unemployment and corruption (described as worse since independence) foster social unrest. WTO membership is not expected soon, so a DCFTA is still a distant possibility.

EP position on South Caucasus

The EP asks the Commission to identify common economic interests that could unite Armenia, Azerbaijan and Georgia.

Belarus

Belarus's customs union with Russia and Kazakhstan would be a hindrance to closer trade relations, even if they were desired at the moment. In reaction to human rights violations, not only since the brutal clampdown on citizens and the opposition after the December 2010elections, the EU suspended efforts towards trade integration. The EU does not apply trade sanctions, but GSP+ was withdrawn in 2007, so Belarusian exporters have to pay the standard non-preferential import tariff. For textile imports from Belarus, the EU applies quotas. Belarusian relations with the EU are governed by the 1989 Soviet Union Trade and Cooperation Agreement.

The EU is Belarus' second biggest trade partner (after Russia). Belarus imports machinery and transport equipment and chemicals. Belarus exports mainly mineral fuels to the EU, and also chemicals, agricultural products and textiles. Belarus is another important transit country for Russian oil. The country is deeply affected by the financial and fiscal/liquidity crises and is selling off its assets, mainly to Russia[7].

According to the academic Anaïs Marin, the EaP still has potential to help trigger reforms in Belarus by supporting civil society. She argues that the EU should help empower pro-European NGOs.

EP position

In its resolution on the ENP the EP agrees, urging the EU to reorient funds towards Belarusian civil society.

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