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Article

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Impact of the EU Deep and Comprehensive Free Trade Area Agreements on Trade Performance of Georgia and Moldova

Emir ETERIA*

Abstract

The paper aims to analyse the effects in the trade performance of Georgia and Moldova in light of the Deep and Comprehensive Free Trade Area (DCFTA) agreements with the EU. Hence, data for the period 2010-2019 is analysed to reveal the latest developments in the trade performance of these countries. The conducted analysis points to some positive developments in the trade of Georgia and Moldova with the EU for 2015-2019, however, compared to 2010-2014 or pre-DCFTA period the average annual growth rate of exports of both countries declined. Moreover, Georgia's success to increase exports to the EU remain relatively modest as compared to Moldova. Therefore, Moldova has achieved more deep trade integration with the EU than Georgia. Furthermore, the effect of DCFTAs on trade relations between Georgia and Moldova is not substantial, and therefore, increased economic integration between the EU associated countries is not yet evident.

Keywords: Deep and Comprehensive Free Trade Area, Trade Performance, Georgia, Moldova, EU

Introduction

The EU Association Agreements (AAs) with Georgia and Moldova including parts of Deep and Comprehensive Free Trade Areas (DCFTAs), entered into force on July 1, 2016. However, many Titles as well as annexes of these agreements including those on Trade and Trade-related Matters (Title IV related to Georgia and Title V related to Moldova) have been provisionally applied since September 1, 2014.

In both countries, the DCFTA Agreements were considered as a key instrument to boost trade, especially exports to the EU. Moreover, as it was envisaged, the DCFTAs should support the creation of the EU compatible economic system in these countries via regulatory convergence and legal approximation, which in turn would foster investments from the EU member states and increase the investment attractiveness of the country in general. As a result, an increase in investments, as well as in exports to the EU countries should be seen as significant positive outcomes of the Association

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Agreements and the DCFTAs in particular. Accordingly, after 5 years since the enactment of the Association Agreements the impact on the trade performance of these countries could be observed.

The trade data for the period 2010-2019 is analysed to examine the impact of the DCFTAs on Georgia and Moldova's trade performance. A study period is divided into two five-year periods. The first period includes 2010-2014 or 5 years before the enforcement of DCFTA and the second - 2015-2019 or 5 years after the entry into force of the DCFTA. This allows us to examine new developments in Georgia and Moldova's trade relations with the EU and gives possibilities to compare the initial impact on the trade performance of the countries in question. Moreover, trade relations of Georgia and Moldova with the Commonwealth of Independent States (CIS) for the period 2010-2019 are analysed. It is worth mentioning that CIS countries along with the EU are the largest trading partners of Georgia and Moldova. In order to reduce the impact of year-on-year data instability as well as to explore current trends, in such cases average rates are applied.

The first part of the article examines the EU's trade policy developments towards the Eastern partners in general and namely, towards Georgia and Moldova. Accordingly, this part of the paper explores the essence and major peculiarities of the EU DCFTAs. The next part is devoted to the analysis of the latest tendencies in trade performances of the countries, in particular, Georgia's and Moldova's export-import data in 2010-2019 with the EU and CIS countries is analysed.

1. Core features of the EU DCFTAs with Georgia and Moldova

Since the mid-2000s, the priorities of EU's trade policy shifted towards the expansion of bilateral trade relations based on comprehensive rather than "simple" free trade agreements (Woolcock, 2007, 2014; Koopmann and Wilhelm, 2010; Gstöhl and Hanf, 2014). Disappointment by the "Doha Development Round" of the multilateral trade negotiations within the framework of the World Trade Organization (WTO) and increased competition in the global economy were key reasons for the trade policy transformation. An increased bilateral dimension of the EU's trade policy was considered as "...easier and speedier way to advance European goals and project its values onto the global stage than multilateral forums" (Bongardt and Torres, 2018, p. 248). The importance of bilateral trade relations was underlined in the European Commission's communication "Global Europe: Competing in the world" (Commission of the European Communities, 2006). According to it, the EU should negotiate new comprehensive bilateral trade agreements with the selected countries/country groups based on economic criteria (economic size and growth, tariffs and non-tariff barriers against the EU export). Therefore, this communication focused on economics-driven trade agreements. It is clear that considering countries' economic size and trade volume with the EU,

Georgia and Moldova were not among the priority countries indicated in the communication to negotiate new comprehensive trade agreements.

The EU's trade policy priorities towards the neighbouring countries were highlighted in the communication on "A Strong European Neighbourhood Policy" (Commission of the European Communities, 2007). Along with the many areas of cooperation, the communication also explored trade-related issues and envisaged possibilities to negotiate new comprehensive trade agreements with the countries willing to have closer relations with the EU and at the same time, they were able to undertake the comprehensive reform agenda. The EU's trade policy towards the Eastern neighbours was mostly based on political considerations rather than the economic criteria, underlined in the EU's new trade strategy and therefore, it could be described as politics-driven trade agreements. Association Agreements, including DCFTAs with Georgia and Moldova "...is indicative of the political considerations underlying the EU's trade policy in its neighbourhood" (Manoli, 2013, p.52). Moreover, as Gstöhl and Hanf (2014) pointed out "The EU thus aims to combine economic interests, political values and other norms in its external relations, yet without indicating any prioritisation among these objectives" (p. 736). Political considerations behind the DCFTAs and the Association Agreements in general, also encompassed aspirations of Georgia and Moldova to achieve closer political and economic integration with the EU. Accordingly, these countries expressed readiness to implement comprehensive reforms in many areas envisaged by the new agreements. Along with the political consideration, DCFTAs have a geographical dimension as these agreements "aim to deepen economic relations between the respective neighbouring countries and the EU and focus on approximating their legislation to EU legislation, notably in trade-related areas" (European Commission, 2019b, p. 5). At the same time, the EU DCFTAs were considered as a supporting factor of economic integration among the associated countries via the diagonal cumulation between the partner countries. It is clear that all types of trade agreements have been concluded to increase trade, especially exports. Other goals of trade agreements include an increase of Foreign Direct Investments (FDIs), which along with the export should support an economic growth. Export growth and increased investments are the most important pillars of any preferential trade agreement (PTAs), so-called "pure" or "deep" free trade agreements. As a result, despite the fact that the share of Georgia and Moldova in the EU's total trade was not significant (less than 0.5%), the EU concluded Association Agreements, including DCFTAs with these countries to support their political association and gradual economic integration with the EU as well as the regional economic integration among the partner countries.

Both types of the EU trade agreements (economics-driven or politics-driven) were perceived as the best path to export the EU's standards and regulations in many areas to the countries willing to

strengthen trade relations with the EU. It is clear that trade agreements with developing countries gave more opportunities to the EU to consider in agreements some strict obligation on legal approximation and regulatory convergence in many areas that are directly or indirectly related to the trade. Accordingly, the EU DCFTAs with Georgia and Moldova envisage the regulatory convergence and legal approximation in many areas of the economy such as intellectual property rights, sanitary and phytosanitary measures, trade in services and electronic commerce, public procurement, technical barriers to trade, standardization, competition policy, etc. However, as Woolcock (2003) pointed out “Regional agreements can enhance market access by promoting approximation or compatibility of national regulations, standards or conformance assessment provisions (p. 27). Therefore, the EU DCFTAs with Georgia and Moldova are based on conditionality and opening of the EU market for products from Georgia and Moldova directly depends on the effective implementation of reforms, especially on effective implementation of the legal and regulatory approximation, including a dynamic approximation of legislation with those of the EU (European Commission, 2017). A final goal of DCFTAs with Georgia and Moldova, considering the scope of liberalization, regulatory convergence, and legal approximation under the supervision of joint institutions is “to arrive at a more Europe-like regulatory environment in the DCFTA countries” (Adarov and Havlik, 2016, p. 23). It is noteworthy that the areas covered by the EU DCFTAs with these countries are the same (EU-Georgia Association Agreement, 2014; EU-Moldova Association Agreement, 2014).

Moreover, it should also be noted that in case of Georgia, there was not the transitional period for trade liberalization and by September 1, 2014 “both parties have thus abolished import duties for almost all products” (Emerson and Kovziridze (eds), 2018, p. 36). In case of Moldova, there is a transitional period for trade liberalization, namely, three to five years for industrial goods and up to ten years for agricultural products (Emerson and Cenușa (eds), 2018). Consequently, under DCFTA “the EU also applies significantly more trade restrictions to Ukraine and Moldova than to Georgia” (Adarov and Havlik, 2017, p. 3).

It is worth mentioning that before signing the Association Agreements, Georgia and Moldova benefited from the preferential trade regime with the EU within the framework of the EU Generalized System of Preferences (GSP+), the Special Incentive Arrangement for Sustainable Development and Good Governance, which was granted to Georgia and Moldova in 2005. In 2008, Moldova was granted additional preferences, so-called Autonomous Trade Preferences (ATPs). After signing the Association Agreements, there was a transition period for Georgia from GSP+ to DCFTA until December 31st, 2016, and for Moldova from ATPs to DCFTA until December 31st, 2015.

The EU DCFTAs with Eastern neighbours could be described as complex, multidimensional, and far-reaching trade agreements, resulting in unprecedented transformation and modernization of

economies. Hence, considering the scope and depth of legal approximation and regularity convergence supervised by joint institutions, EU DCFTAs with Georgia and Moldova in terms of “negative” and “positive” integration¹ could be described as a scheme of positive economic integration. Accordingly, considering the areas covered by the EU DCFTAs with Georgia and Moldova, the “depth index” of these agreements is 7, the highest possible index according to data on the Design of Trade Agreements (DESTA). It is noteworthy that the DESTA measures the depth of trade agreements taking into consideration the areas (services, investments, technical barriers to trade (TBT) and/or sanitary and phytosanitary (SPS) measures, public procurement, competition, and intellectual property rights) covered under the Agreements (Dür *et al.*, 2014).

It should be underlined that according to the recent reports of Association Implementation issued by the European Commission, both countries, Moldova and Georgia have demonstrated steady progress in the implementation of AA/DCFTA related reforms. As it was highlighted in the Association Implementation Report, Moldova “...has continued making progress on implementing reforms in line with the AA/DCFTA” (European Commission, 2019a, p.1). Regarding Georgia report of Association Implementation underlined that “the implementation of commitments stemming from the AA including its Deep and Comprehensive Free Trade Area (DCFTA) has continued within agreed timelines” (European Commission, 2019d, p. 1). Nevertheless, it should be noted that the benefits from the DCFTAs are directly related to the effective implementation of obligations envisaged by DCFTAs and Association Agreements in general, which in turn is long-lasting process and requires modification of many areas of economy directly or indirectly related to trade.

2. Latest Developments in Trade Performance of Georgia and Moldova

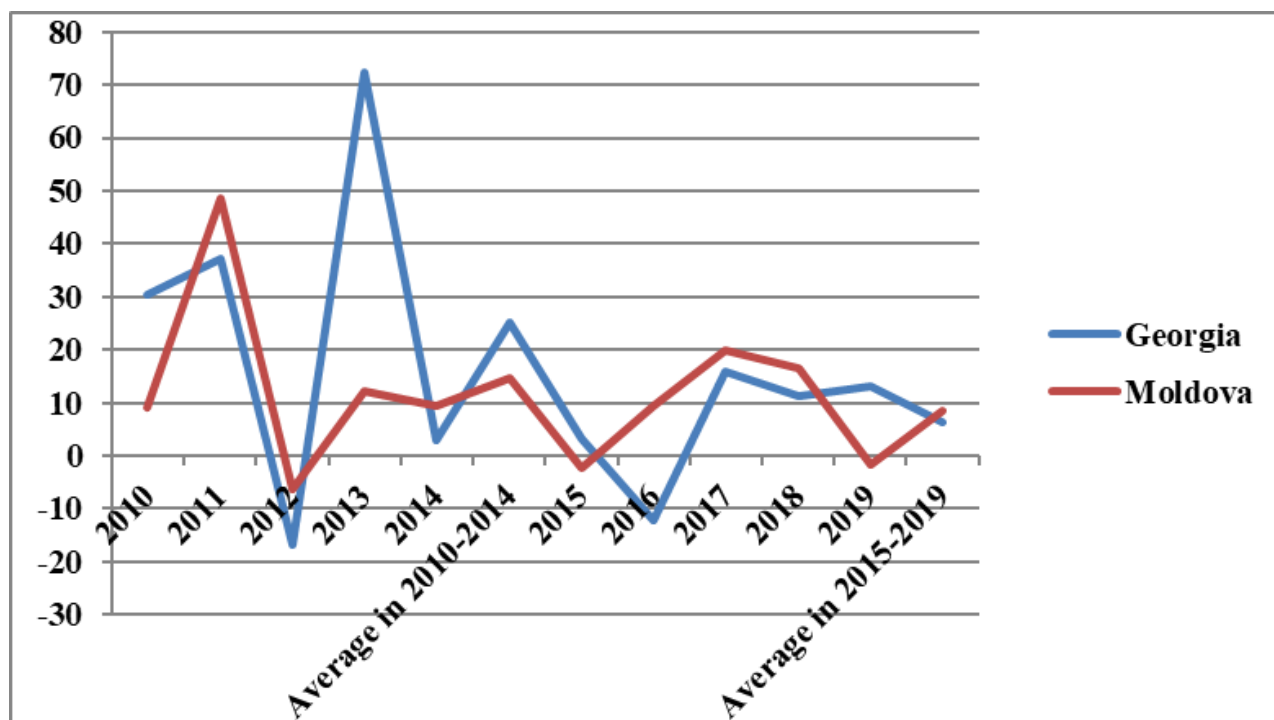
It is noteworthy that various aspects of the EU trade agreements with Georgia and Moldova have been widely analysed before, as well as after the enactment of the Association Agreements (Ecorys/CASE, 2012; Messerlin *et al.*, 2011; Dreyer, 2012; Kawecka-Wyrzykowska, 2015; Bulgari, 2015; Adarov and Havlik, 2016, 2017; Emerson and Kovziridze (eds), 2018; Emerson and Cenuşa (eds), 2018; Lupuşor and Gumene (2018); Eteria, 2019a, 2019b; Perju and Crudu, 2019).

Studies conducted before the enactment of the agreements to evaluate DCFTA’s impact on trade performance of Georgia and Moldova with the EU and particularly on exports to the EU countries were positive. According to the study, in case of Georgia “exports are estimated to increase by 9 and 12 percent in the short and long run respectively, with imports going up by 4.4 and 7.5

¹ Terms “negative” and “positive integration” coined by Jan Tinbergen (1954)

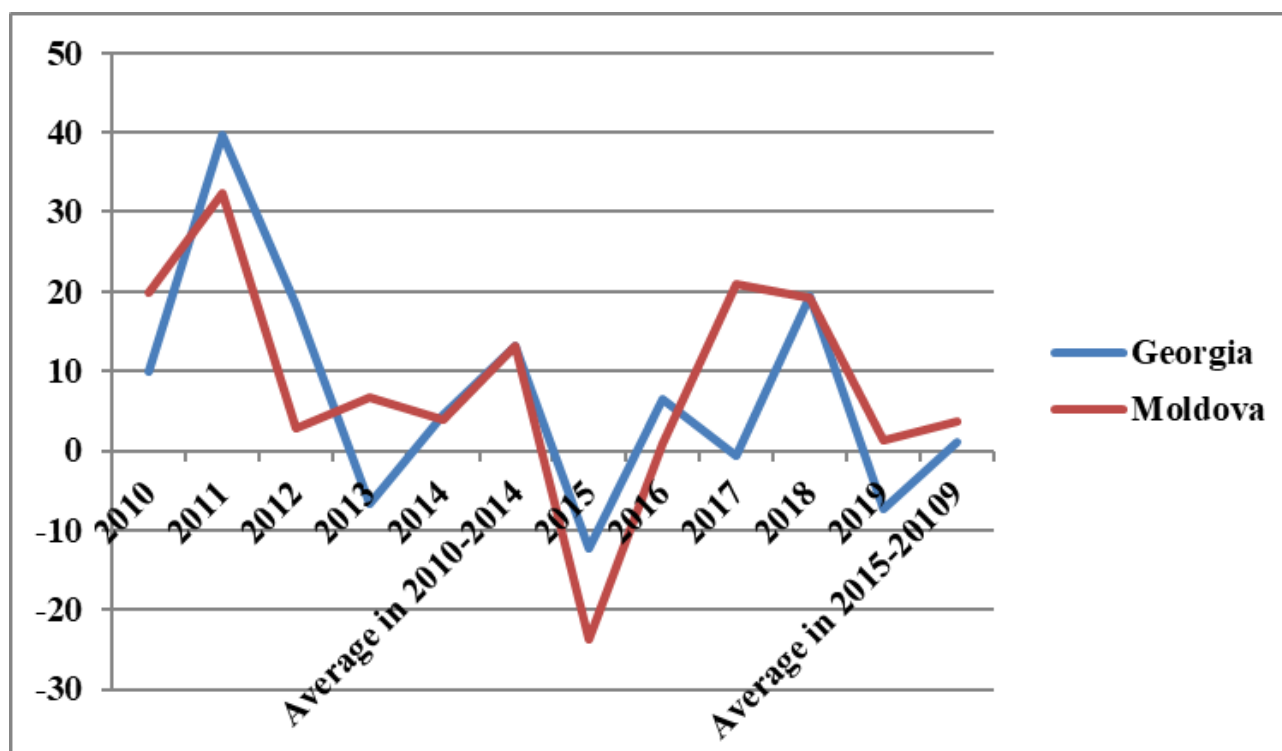
percent respectively” (Ecorys/CASE, 2012, p. A37). In case of Moldova "Exports are estimated to increase by 15 and 16 percent in the short and long run respectively, with imports increasing by 6 and 8 percent respectively (ibid, p. B33). However, according to this study, there was no clear distinction between the long-run and short-run periods. It is noteworthy that expectations in both countries were not merely optimistic. In case of Moldova, as Lupușor and Gumene (2018) pointed out “Even before the signing of the Association Agreement and the direct creation of the DCFTA, there existed many expectations, some being optimistic and other pessimistic” (p.1). In Moldova, pessimistic expectations mostly were related to the agricultural sector. In case of Georgia, according to some studies (Messerlin *et al.*, 2011; Dreyer, 2012) effects of the AA/DCFTA obligations (legal approximation and regulatory convergence) on Georgia’s export promotion and investment attractiveness of the country is vague, especially in the short run period. Nonetheless, it should be noted that the static effects of trade agreements occur in a short period after the enactment of an agreement and therefore, static effects of the EU trade agreements with Georgia and Moldova are already in place, considering 5 years since the provisional application.

For 2010-2014 the average annual growth rate of Georgia’s export to the EU was 25,2%, while the average annual growth rate of Moldova’s export was 14,6%. In contrast, for 2015-2019 the average annual growth rate of Georgia’s export drastically declined and only amounted to 6,3%, even though “throughout the first four years of DCFTA implementation Georgia started to export some new products to the EU e.g. kiwi fruit, blueberries, and honey (European Commission, 2019c, p. 99). In the same period, Moldova's export growth rate also declined, and the average annual growth rate of export was 8,4%. It should be noted that in absolute terms Georgia’s export to the EU in 2019 increased by 32,2% (from 624, 2 Mil. USD to 825,6 Mil. USD) compared to 2014, while Moldova’s export to the EU in 2019 increased by 46,9% (from 1 245,9 Mil. USD to 1 830,5 Mil. USD) compared to 2014. In 2019, export share to the EU countries in Georgia’s total exports was 21,8%, while the EU’s share in Moldova’s total export in 2019 was 65,9%. As Lupușor and Gumene (2018) pointed out “Against a difficult economic and political background, DCFTA succeeded in generating the first tangible results while the EU succeeded in strengthening its position as the main selling market for Moldova” (p. 6). It is clear that in 2015-2019 decline in the average annual growth rate of Georgia’s exports was more dramatic than in Moldova and in 2015-2019 Moldova’s exports to the EU grew significantly faster than Georgia's exports (Figure 1). Moreover, in Moldova “Contrary to concerns over the negative impact of the DCFTA on the agri-food sector, the biggest benefits of the liberalization of trade with the EU have been noted in the case of agri-food exports (Lupușor and Gumene, 2018, p.6).

Figure 1. Exports to the EU (Growth (%)) in 2010-2019

Source: Elaborated by the author based on data from the National Statistics Office of Georgia and National Bureau of Statistics of the Republic of Moldova

As the trade data indicates, in 2015-2019 the average annual growth rate of the EU imports to Georgia and Moldova significantly decreased in both countries compared to 2010-2014. For 2010-2014 the average annual growth rate of the EU imports was almost the same in Georgia and Moldova (13,2% and 13,0% respectively). In 2015-2019 Moldova's import growth rate fall to 3,7%, while Georgia's average annual growth rate of the EU imports considerably decreased and reached about 1,1%. In absolute terms, Georgia's imports from the EU countries in 2019 slightly decreased (by 0,02%, from 2 371,9 Mil. USD to 2 321,4 Mil. USD) compared to 2014, while in Moldova imports from the EU increased by 12,5% (from 2 567,6 Mil. USD to 2 889,9 Mil. USD). In 2019, the EU's share in Georgia's total imports was 25,6%, while in Moldova the EU's share was 49,5%. During the five years since the provisional application of DCFTA, in Georgia the decline in imports from the EU was observed in 3 years, namely, in 2015 (-12,2%), 2017 (-0,6%), and 2019 (-7,3%). In case of Moldova, a negative growth rate of imports was observed only in 2015 (-23,8%) (Figure 2).

Figure 2. Imports from the EU (Growth (%)) in 2010-2019

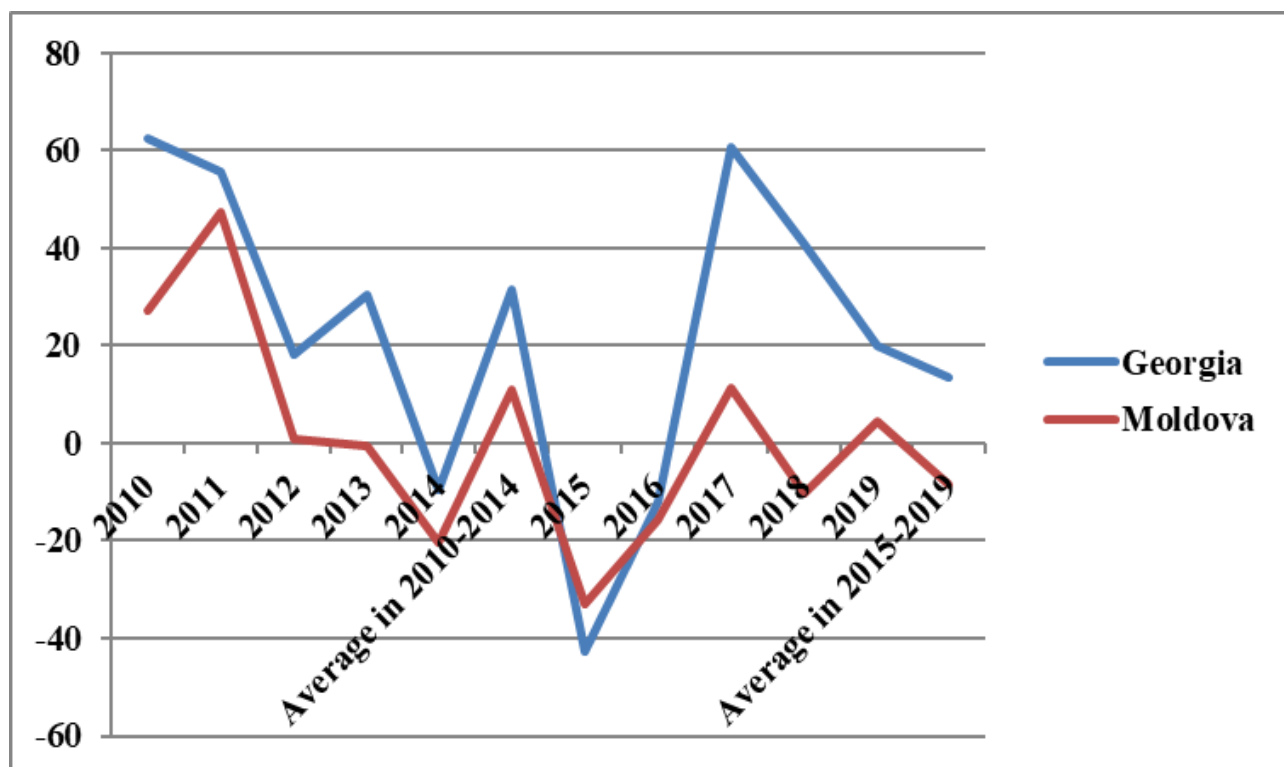
Source: Elaborated by the author based on data from the National Statistics Office of Georgia and National Bureau of Statistics of the Republic of Moldova

It is noteworthy that the CIS countries are major trade partners of Georgia and Moldova. In case of Georgia, for 2010-2014 the average annual growth rate of exports to CIS was higher (31,4%) than to the EU (25,2%). For 2015-2019 the average annual growth rate of Georgia's exports to CIS decreased but remained higher (13,3%) than the average annual growth rate of exports to the EU (6,3%). In absolute terms, in 2019 Georgia's exports to the CIS countries increased by 36,7% (from 1 465, 2 Mil. USD to 2 003,0 Mil. USD) compared to 2014. In 2019 the CIS countries' share in Georgia's total exports was 53,1%. It means that the DCFTA with the EU does not change key features of Georgia's trade relations and CIS countries remain as the key trade partners. At the same time, higher growth rates of export to the CIS countries than to the EU indicate that the CIS market is more attractive for Georgian exporting companies because of relatively low regulations. Consequently, the trade data shows that the EU-Georgia DCFTA does not support a shift of Georgia's exports from CIS countries to the EU.

Analysis of Moldova's trade relations highlights different trends. In 2010-2014, the average annual growth rate of Moldova's exports to the CIS countries was 10,9%, lower than the export growth rate to the EU (14,6%). Even though in 2015-2019 compared to the previous period, Moldova's average annual growth rate of exports to the EU decreased (from 14,6% to 8,4%), the

export growth rate remained positive. In contrast, the average annual growth rate of Moldova's exports to CIS countries in 2015-2019 drastically declined from 10,9% to -8,5% as compared to 2010-2014. In absolute terms, Moldova's exports to CIS countries in 2019 decreased by 40,8% (from 735,6 Mil. USD to 434,9 Mil. USD) compared to 2014. In 2019, the share of CIS countries in Moldova's total exports was 15,6%. Accordingly, as Lupușor and Gumene (2018) pointed out, in case of Moldova "The comparative analysis by destination of exports shows a much more stable evolution of them towards the EU compared to other destinations" (p. 8). It is clear that since the enactment of the DCFTA, Moldova, compared to Georgia, successfully managed to redirect exports, especially export of some agri-food products from the CIS countries to the EU and "Thus, a reorientation can be noticed regarding the exports from the CIS countries to the EU due to the restrictions imposed by the Russian Federation on the one hand and the new opportunities offered by the DCFTA, on the other hand (Lupușor and Gumene, 2018, p. 13) (see Figure 3).

Figure 3. Exports to CIS (Growth (%)) in 2010-2019

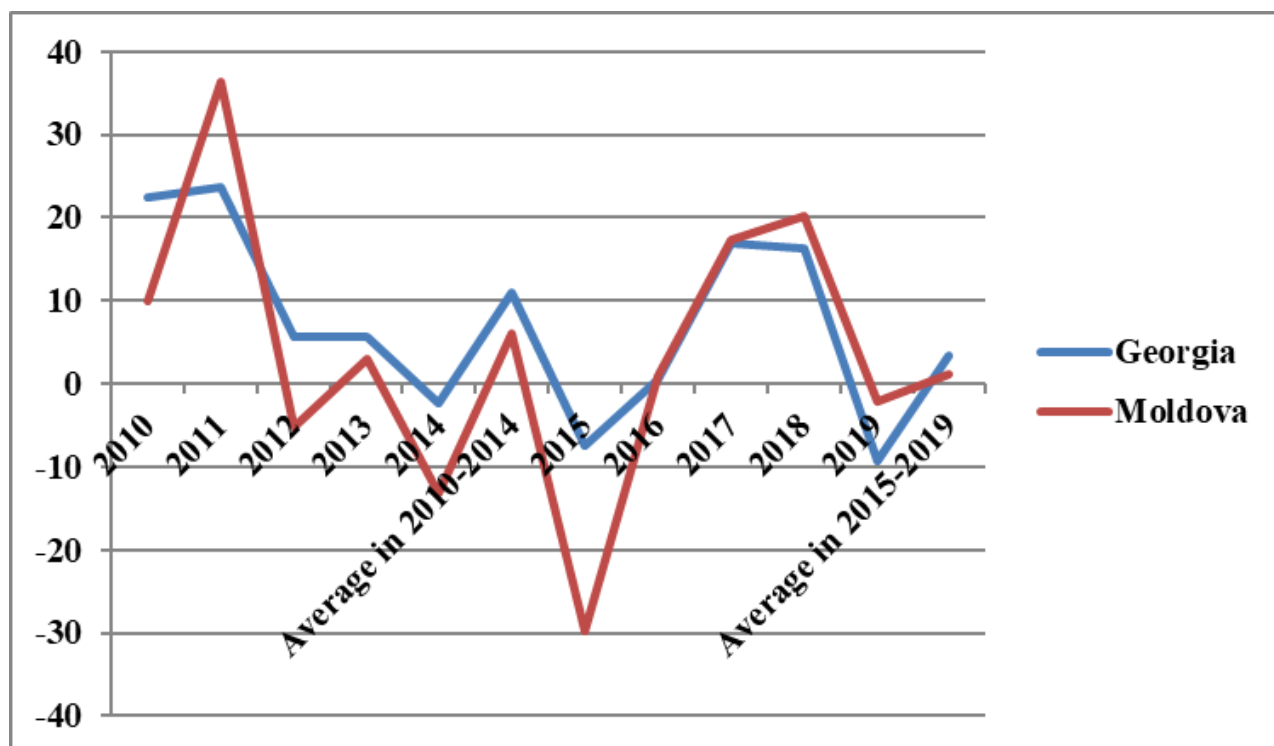


Source: Elaborated by the author based on data from the National Statistics Office of Georgia and National Bureau of Statistics of the Republic of Moldova

It is worth mentioning that the average annual growth rates of imports of both countries from the CIS countries significantly decreased for 2015-2019. In case of Georgia, the average annual growth rates of imports decreased from 11% in 2010-2014 to 3,4% in 2015-2019. However, in absolute terms, in 2019 Georgia's imports from CIS countries increased by 14,6% (from 2 127,4 Mil.

USD to 2 438,5 Mil. USD) compared to 2014. In 2019, the CIS countries' share in Georgia's total imports was 26,9%. The average annual growth rates of Moldova's imports decreased from 6,1% in 2010-2014 to 1,2% in 2015-2019 (Figure 4). In absolute terms, Moldova's imports from CIS countries in 2019 slightly decreased (by 0,02%, from 1 449,2 Mil. USD to 1 416,5 Mil. USD) compared to 2014. In 2019 the CIS countries' share in Moldova's total imports was 24,2%.

Figure 4. Imports from CIS (Growth (%)) in 2010-2019

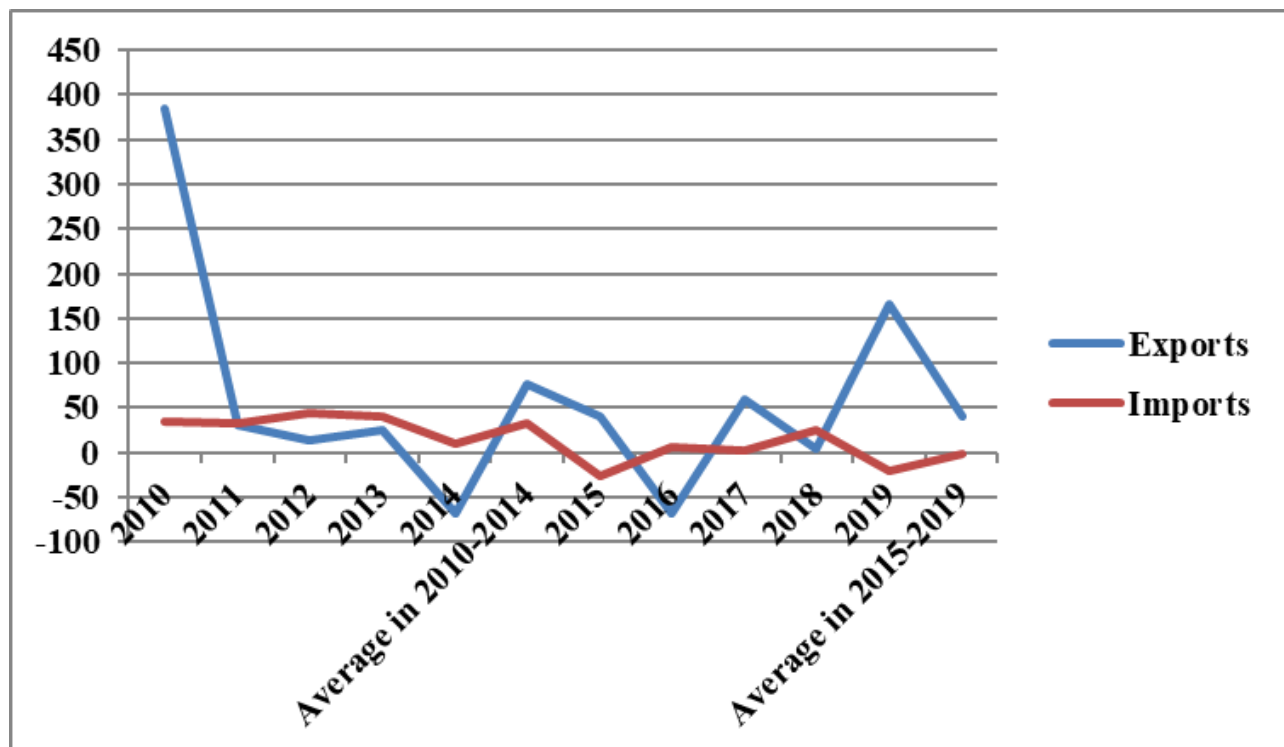


Source: Elaborated by the author based on data from the National Statistics Office of Georgia and National Bureau of Statistics of the Republic of Moldova

The EU DCFTAs along with increased trade opportunities with the EU was also considered as a key instrument to strengthen trade relations among the EU associated countries. However, in case of Georgia and Moldova, data on trade relations between these countries throughout the post-DCFTA period do not demonstrate such upward trends. In 2010-2014, the average annual growth rate of Georgia's exports to Moldova was 77,3%, while average annual growth rate of imports from Moldova to Georgia was 32,2% in the same period. For 2015-2019 average annual growth rate of Georgia's exports significantly decreased to 39,9%, while average annual growth rate of imports from Moldova decreased drastically to -2,0%. In absolute terms, in 2019 compared to 2014, Georgia's exports to Moldova increased by 93,4% (from 4, 6 Mil. USD to 8,9 Mil. USD), while Georgia's imports from Moldova decreased by 17,6% (from 13,6 Mil. USD to 11,2 Mil. USD). Consequently, there is no

solid evidence for the positive impact of the DCFTAs on trade relations between Georgia and Moldova (Figure 5).

Figure 5. Georgia's Exports-Imports with Moldova (Growth (%)) in 2010-2019



Source: Elaborated by the author based on data from the National Statistics Office of Georgia

It is noteworthy that after five years since the provisional application of the EU DCFTAs with Georgia and Moldova, the impact of these agreements on the trade performance of Georgia and Moldova still remains uncertain. In case of Georgia, the growth rate of exports to the EU remains positive but is lower compared to the pre-DCFTA period. At the same time, for 2015-2019, Georgia's exports to the CIS countries increased at a faster rate than to the EU countries. Moreover, after five years since the signing of AA/DCFTA with the EU, the CIS countries' share in Georgia's total exports remain high (53,1%), which indicates that the EU's standards and regulations make the EU market less attractive for Georgian exporting companies than less regulated market of CIS countries. In contrast, Moldova succeeded to redirect exports from CIS countries towards the EU and as Lupușor and Gumene (2018) concluded "Despite the difficult economic and political circumstances during the first years of DCFTA implementation, we notice the first obvious positive effects" (p. 30). Moreover, the EU DCFTAs with Georgia and Moldova do not significantly change trade relations between Georgia and Moldova and accordingly, DCFTA's impact on deepening regional economic integration is not yet obvious.

Conclusions

The EU DCFTAs with the Eastern partners, namely with Georgia and Moldova, and taking into consideration Georgia's and Moldova's minor share in the EU's trade, could be described as politics-driven rather than an economic-driven trade agreement. For 2015-2019, despite some optimistic developments, especially for Moldova, the DCFTA's positive impact on the trade performance of these countries is still limited, especially in case of Georgia. In contrast to Georgia, Moldova succeeded in the reorientation of exports from the CIS countries to the EU and accordingly, Moldova's trade integration with the EU is higher. In the long run, considering effective implementation of all reforms envisaged by the agreements, the DCFTAs could become the best instrument available to Georgia and Moldova towards gradual economic integration with the EU as well as to strengthen economic integration among the EU associated countries. However, it is clear that dynamic effects related to the DCFTAs will occur only in the long run, and only after effective implementation of all obligations imposed under these agreements. Moreover, positive dynamic effects are directly related to the interaction of the legal approximation and regulatory convergence with those of the EU, on the one hand, and investment attractiveness and increase of exports to the EU of these countries on the other hand. An increase of investments from the EU countries to Georgia and Moldova attracted by the same regulatory system due to legal approximation would support to enhance the positive impact of the Association Agreements and the DCFTAs in particular. The trade data of 2015-2019 shows that the positive impact of the DCFTAs on trade relations with the EU is still ahead for Georgia and Moldova. Accordingly, Georgia and Moldova should effectively continue reforms in all areas as envisaged by the Association Agreements/DCFTAs.

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