

# Connectivity and DCFTA: What Happened to Trade and Foreign Direct Investment ?

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## DCFTA in a nutshell

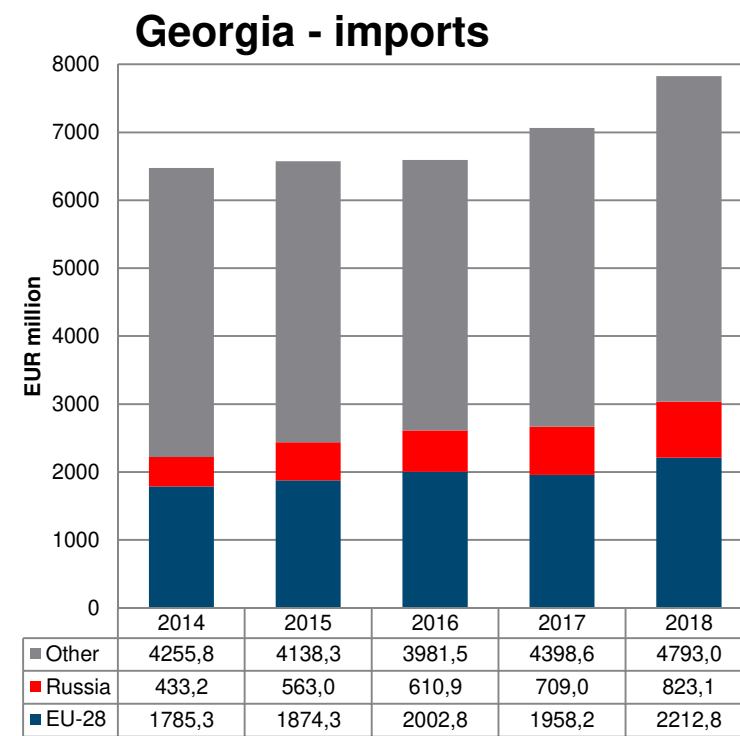
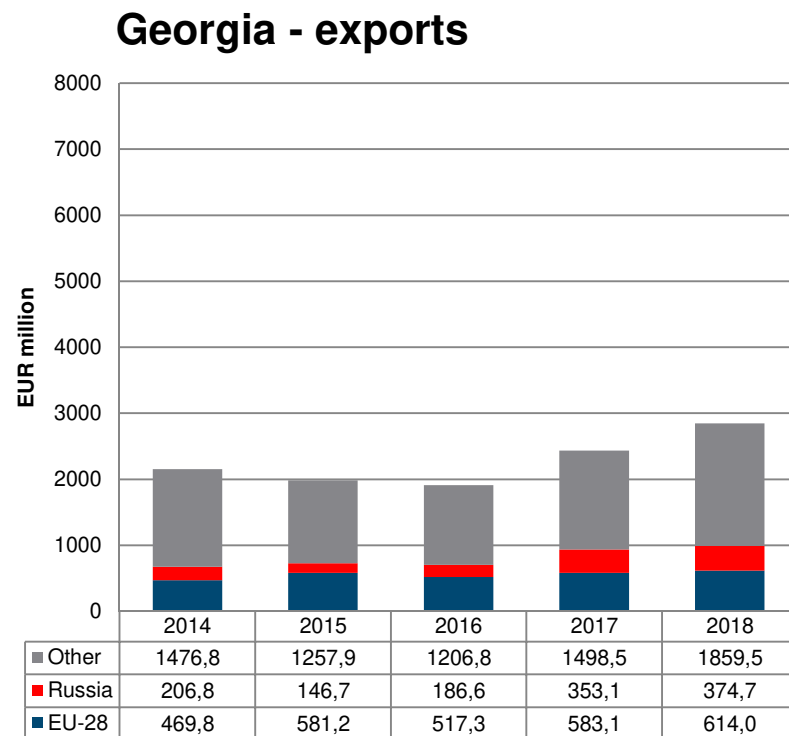
- **Deep and Comprehensive Free Trade Area (DCFTA)** is a part of the **Association Agreement with the EU**
- **AA/DCFTAs** with GE, MD and UA were negotiated since 2008/2010/2012 and signed during 2014, provisionally in force since 2016.
- **DCFTA** covers:
  - ✓ **Trade-related aspects:** conventional FTA aspects focusing on reduction of tariff duties and rules of origin;
  - ✓ **‘Deep’ aspects:** relate to non-tariff barriers (NTBs), including food safety and SPS measures, technical standards, national treatment, public procurement, services liberalization and customs administration;
  - ✓ **‘Comprehensive’ aspects:** wide scope of approximation to EU ‘acquis’ regarding national treatment, customs and trade facilitation, trade in services, intellectual property, e-commerce, energy market, public procurement, anti-trust and competition, etc.

## Additionally, DCFTAs contain

- Approximation to the EU *acquis communautaire* (both current and future)
- Transitory arrangements (e.g. special regime for worn clothing and passenger cars for UKR; gradual elimination of duties in MDA and UKR), etc.
- Temporary (during 2014-2015) autonomous concession of the preferential access to the EU market
- Barriers to trade: tariff rate quotas (TRQs), TBTs and SPS regulations.

## Recent foreign trade developments: Georgia

- Exports to the EU down by 10% in 2014-2016, yet up by 16% in 2017 and 17% in 2018
- Imports from the EU down by 7% in 2014-2016, and flat in 2017; up by 13% in 2018
- Persisting trade deficits: EUR 5 billion in 2018 (of which EUR 1.6 with the EU)

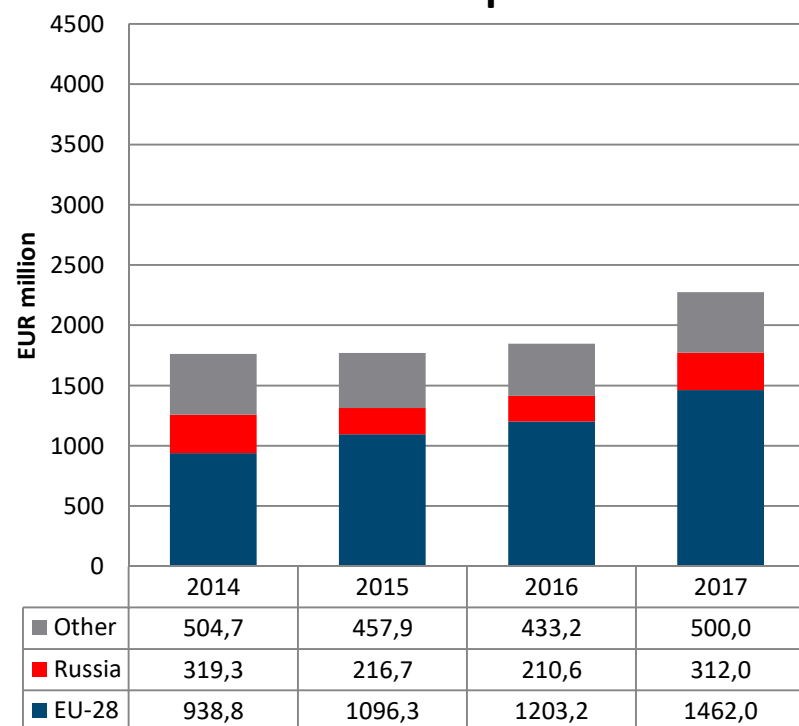


Source: National statistics.

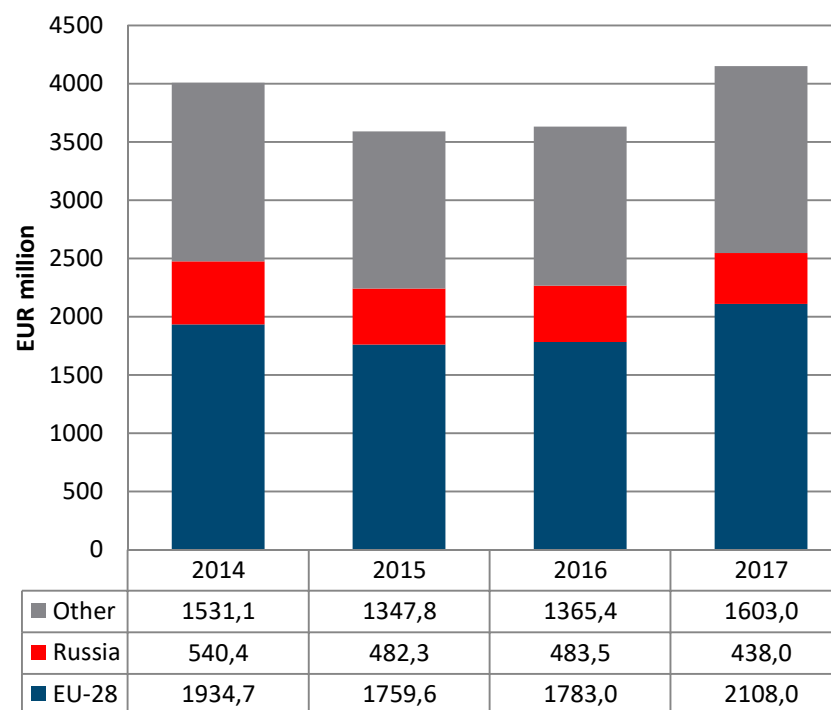
## Recent foreign trade developments: Moldova

- Exports to the EU up by 28% in 2014-2016, up by another 22% in 2017
- Imports from the EU down by 8% in 2014-2016, up by 18% in 2017
- Widening trade deficits: EUR 1.9 billion in 2017 (of which EUR 0.6 with the EU)

### Moldova - exports

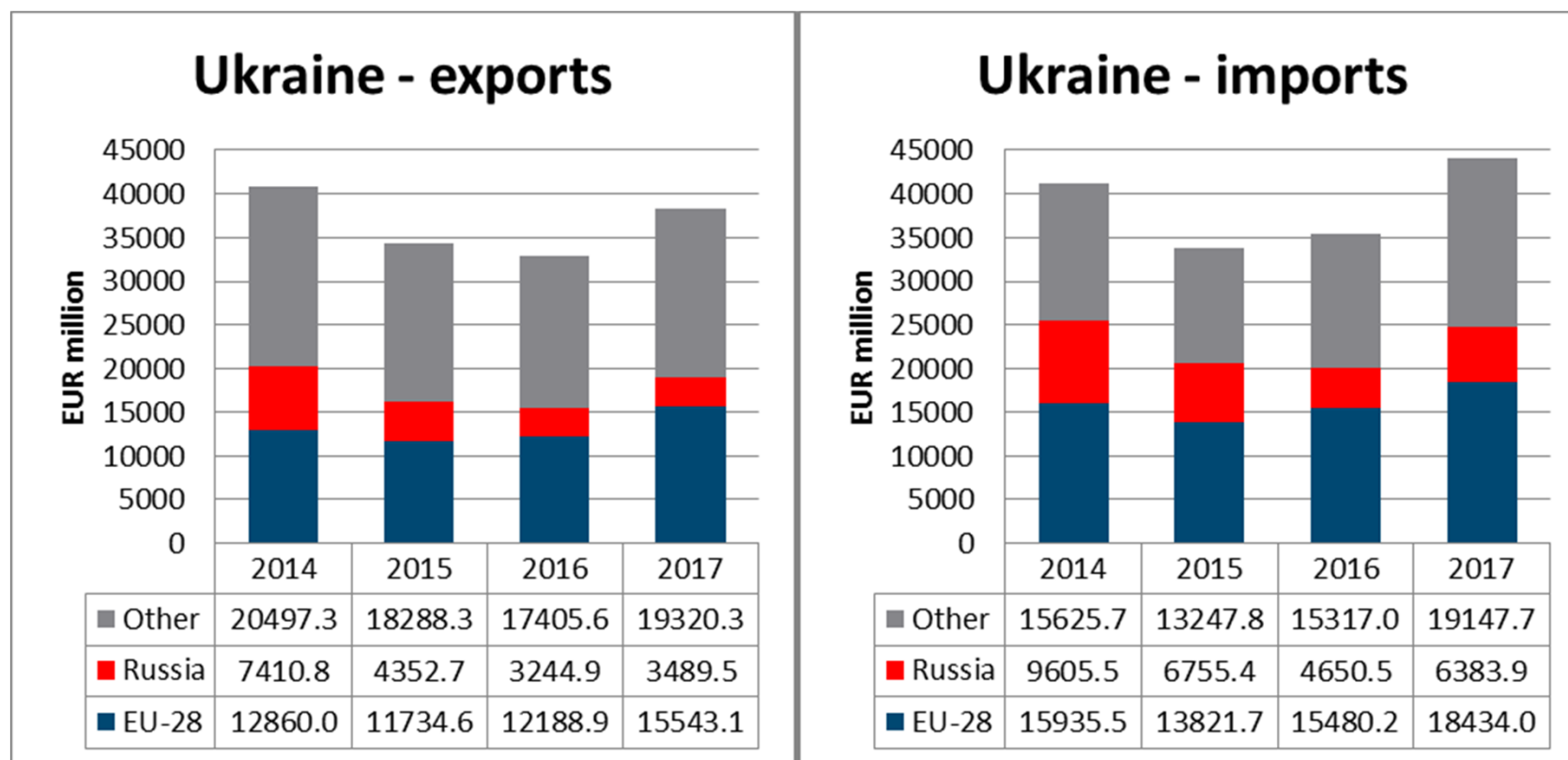


### Moldova - imports

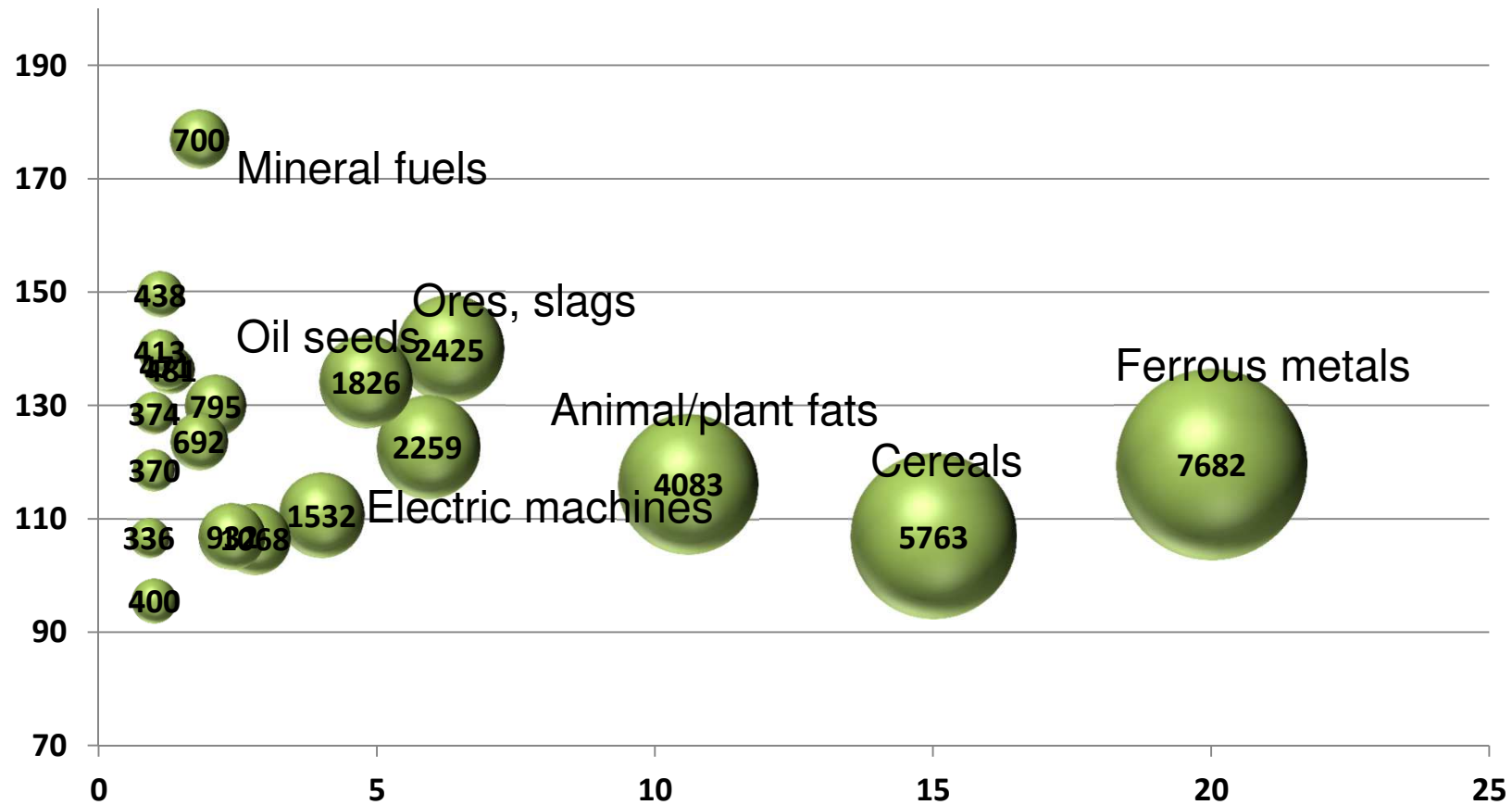


## Recent foreign trade developments: Ukraine

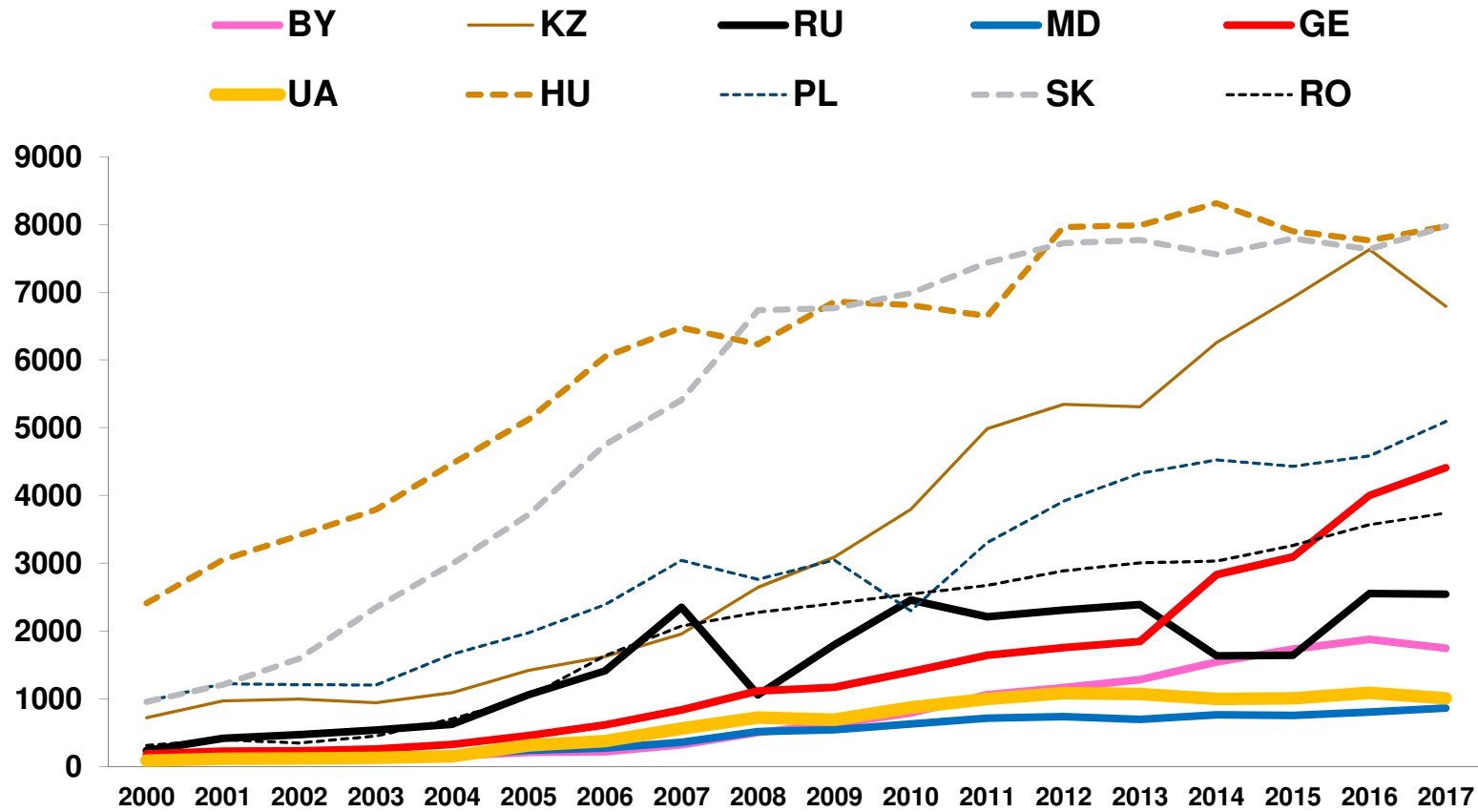
- Exports to the EU down by 5% in 2014-2016, yet up by 27% in 2017
- Imports from the EU down by 3% in 2014-2016, yet up by 19% in 2017
- Widening trade deficits: EUR 5.6 billion in 2017 (of which EUR 2.9 bn with the EU)



Ukraine top exports, 2017 (40% of the total go to EU)  
 annual growth 2016-2017 (Y: +19%) and shares in total (X)

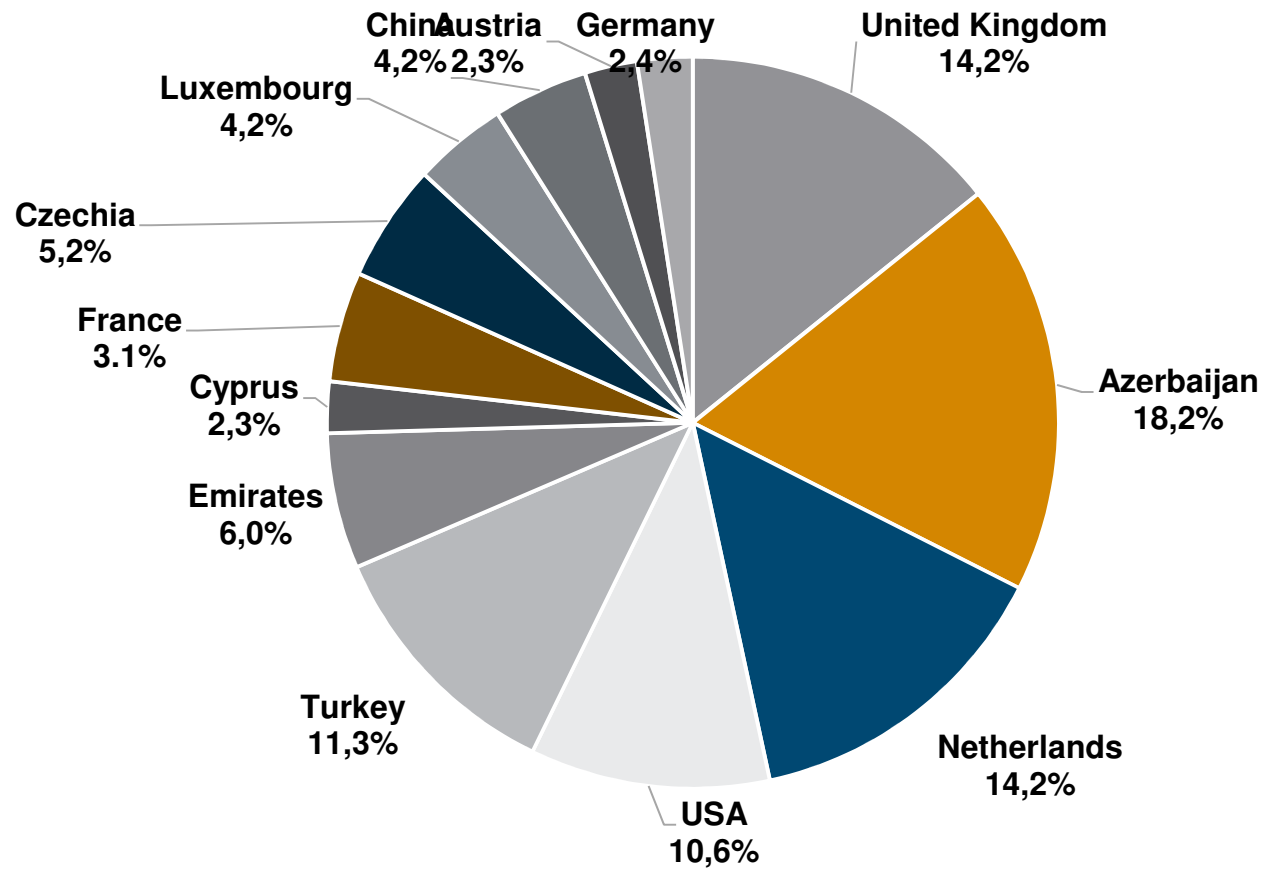


# FDI inward stocks per capita, in EUR

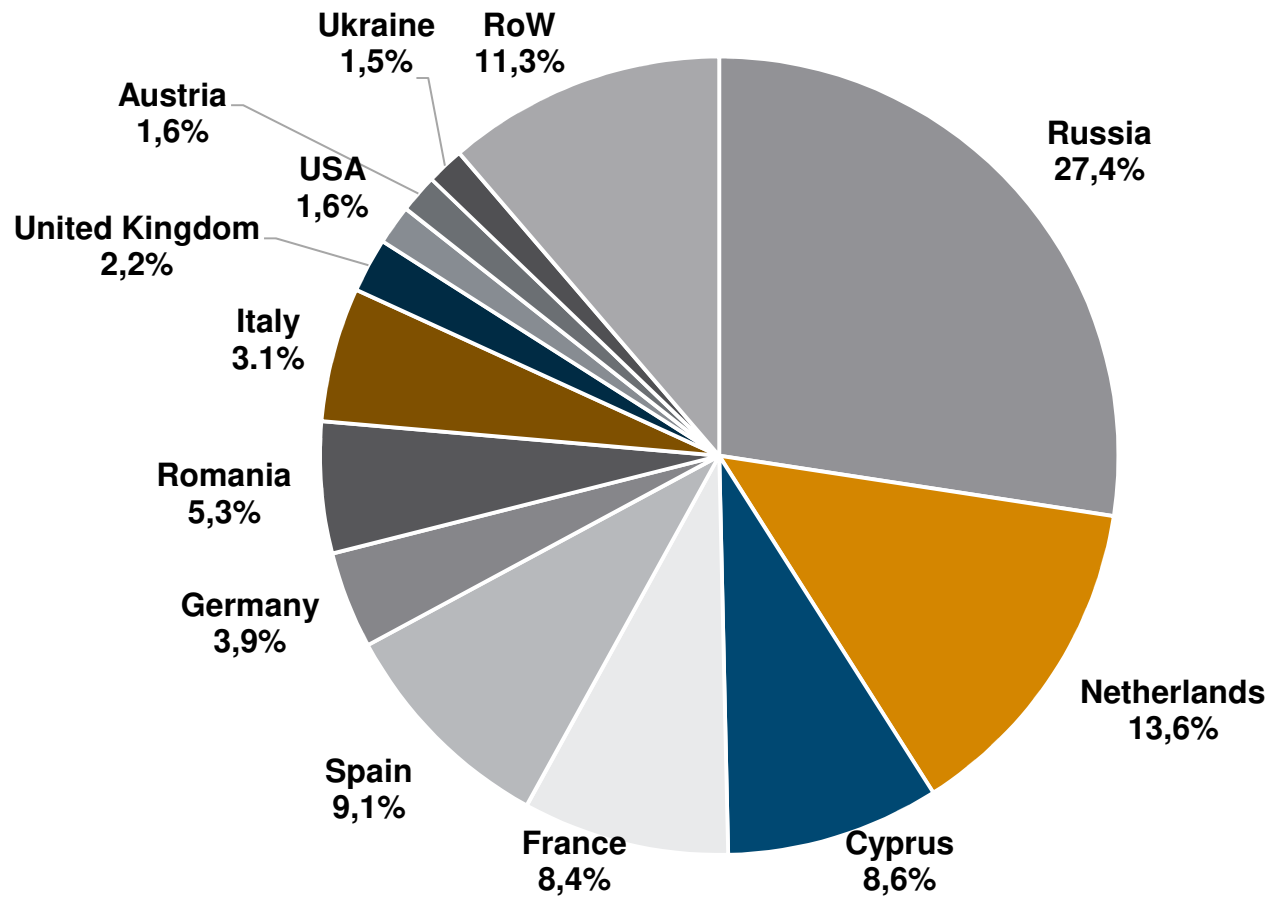




Georgia's inward FDI stock by main investors, EUR 16.3 billion, end-2017

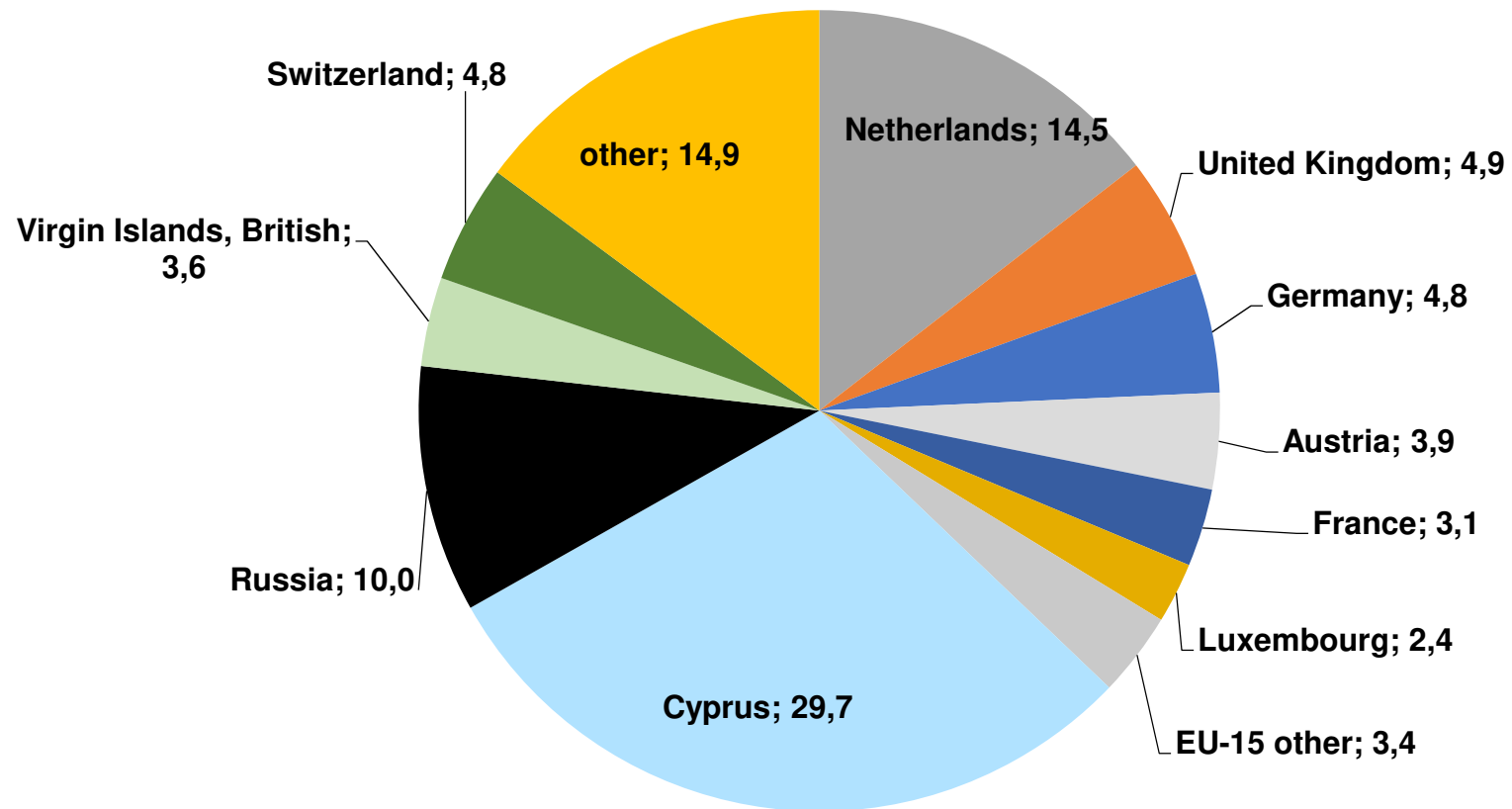


## Moldova's inward FDI stock by main investors, EUR 2.5 billion, end-2016



Ukraine's inward FDI stock: EUR 39.9 billion (end-2017)

Top 10 investors in % of total



**Facit:**

- Uneven trade performance: Moldova is doing better than others
- Exports highly concentrated, early signs of restructuring (MD, UA)
- Widening trade deficits, also with the EU
- FDI stocks still low, especially compared to CEE peers
- Sources of FDI questionable (round-tripping, capital flight, etc.)
- DCFTA should facilitate FDI inflows (from the EU, beyond Cyprus)
- More pro-active FDI policies needed: lessons from CEEs

## Challenges of the 'frozen conflicts'

- All three DCFTA countries suffer:
  - Georgia: South Ossetiya and Abkhasia (600 th people directly affected)
  - Moldova: Transnistriya (500 th people directly affected)
  - Ukraine: Crimea (2 mn) and parts of Donbass (nearly 3 mn people directly affected)
  - This is about 15% of the population in each country.
- Formally, DCFTA applies to the whole country
- Yet, de facto, „frozen“ conflict territory is not covered and DCFTA implementation is hindered even beyond the „freeze“.
- Will DCFTA foster a „de-frosting“ or a „climate change“?

## Policy recommendations

### **Pillar 1: Background conditions and public awareness**

- Establish supportive macroeconomic and political background conditions.
- Institutional reforms directly relevant for the business environment should be prioritised and accelerated.
- More effort should be put to increase specific rather than generic awareness of AA/DCFTA by stakeholders.
- Cross-border dialogues between the business communities of the EU and the DCFTA countries should be enhanced to facilitate incorporation of the DCFTA industries in the European and global value chains

### **Pillar 2: Strategic sequencing of reforms and gradualism**

- Careful sequencing of reforms to target competitiveness and market access challenges.
- Better accounting of adjustment costs and pragmatic gradualism of implementation is needed to balance costs and benefits over time.
- Long-run economic strategy should be developed or adjusted with the medium-run and long-run impacts of AA/DCFTA in mind.
- Diversify export markets and attempt to normalise relations with Russia.

### **Pillar 3: Increased financial and technical support from the EU with strict conditionality**

- More financial and technical assistance should be provided to the private and the public sector in the DCFTA countries.
- Strict conditionality of financial assistance should be enforced.
- Effective monitoring should be enforced and a functional scoreboard system developed to systematically track progress of reforms along multiple dimensions.
- A competition element for the EU funding needs to be introduced and a mix of merit-based and need-based financial aid opportunities should be further developed.

## Key policy recommendations for DCFTA countries

### Pillar 1: Background conditions

- Supportive macroeconomic, institutional and political background is crucial.
- More efforts to raise specific awareness of AA/DCFTA by all stakeholders.
- External pressure necessary, yet domestic ownership of reforms still crucial !
- Support cross-border linkages between the businesses and other stakeholders, including SMEs, to facilitate incorporation in global value chains.
- „Frozen conflicts“ resolution; normalization of relations with neighbours.

## Pillar 2: Strategic sequencing of reforms

- Priority of reforms targeting exports, competitiveness and market access via FDI.
- Pragmatic gradualism in implementation, balancing costs and benefits over time.
- Long-term economic development strategy coordinated with the medium- and long-term impacts of AA/DCFTA.
- Diversify export markets and attempt to normalise trade relations with neighbours.



## **Pillar 3: Increased financial and technical support with strict conditionality**

- More financial and technical assistance to both the private and the public sector.
- Address issues related to the lack of domestic technical and other expertise.
- Strict conditionality of financial assistance should be enforced.
- Effective monitoring and a functional scoreboard system developed to systematically track progress of reforms.
- A competition for the EU funding with a mix of merit-based and need-based financial aid opportunities.

## Thank you for your attention!

See the full report Adarov A. and P. Havlik (2016): “Benefits and Costs of DCFTA: Evaluation of the Impact on Georgia, Moldova and Ukraine” and the Policy Brief (2017): “Challenges of DCFTAs: How can Georgia, Moldova and Ukraine succeed?”

Both available at:

**Bertelsmann Stiftung** <http://www.bertelsmann-stiftung.de/>

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