

**Commission services position paper
on the Trade Sustainability Impact Assessment
in support of negotiations of a Deep and Comprehensive Free
Trade Area between the European Union
and the Republic of Armenia**

1. INTRODUCTION

The European Union and the Republic of Armenia have been negotiating since July 2010 a new Association Agreement (AA) replacing the current Partnership and Cooperation Agreement, in order to reinforce and further develop political and economic cooperation as well as their economic integration with the EU. In February 2012, the EU announced the launch of negotiations on a Deep and Comprehensive Free Trade Area (DCFTA), as an integral part of the AA. The DCFTA is intended to provide for substantial liberalisation of trade and investment conditions and is underpinned by gradual approximation with selected EU acquis leading to further improvement of trade conditions and investment climate through greater convergence with EU trade-related laws and practice.

In line with the policy of the European Commission, a Trade Sustainability Impact Assessment study (TSIA) was commissioned in 2012 and carried out in 2013 by a consortium of Ecorys, the Netherlands, and Case-Center for Social and Economic Research, Poland.

The final report of the study was released in September 2013 and is available on-line at:

- <http://ec.europa.eu/trade/analysis/sustainability-impact-assessments/assessments/>

- <http://tsia.ecorys.com/armenia/>

In line with the methodology guidelines, the study involved a series of public meetings with stakeholders in the EU and in the Republic of Armenia respectively, bilateral contacts with experts and on-line consultations. This allowed to take into account views from a broad base of actors from different sectors and to raise awareness about the on-going negotiations.

The present document constitutes the response from the Commission Services to the study's findings and recommendations on policy measures.

2. THE FRAMEWORK FOR EU – REPUBLIC OF ARMENIA TSIA

2.1. Objectives of the TSIA

The main objective of the TSIA was to assess the potential economic, social, environmental, and human rights impacts of a Deep and Comprehensive Free Trade Area (DCFTA) between the EU and the Republic of Armenia. Thereby, the TSIA supported the negotiation process for the Association Agreement and its trade part in particular, based on the projected result before the completion of negotiations.

The TSIA presented recommendations and policy measures that, according to the analysts, should provide guidance for the negotiation process, with view to ensuring the future performance of the DCFTA against the sustainability criteria mentioned above.

It should be noted that the objective of achieving a positive impact of trade liberalisation on sustainable development is a shared concern of the EU and its partner country. The results of the analysis are thus relevant for all Parties concerned.

2.2. Scope and Methodology of the TSIA

The methodological framework for the TSIA is based on the Commission's Handbook for Trade Sustainability Impact Assessment from 2006:

http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127974.pdf

This methodology covers screening and scoping analysis, scenario analysis and quantitative modelling (Computable General Equilibrium model - CGE), additional quantitative and qualitative social, human rights and environmental impact analysis, causal chain analysis, sectorial analysis and stakeholder consultations. Data is used from the GTAP 8.0 database and the 2010 Household Integrated Living Conditions Survey.

A range of consultation methods were deployed at all stages of the report to gather inputs from key stakeholders: (1) electronic consultation and documentation (discussion forum, websites, feedback forms); (2) public meetings in the EU; (3) a TSIA workshop in Yerevan in the Republic of Armenia; (4) visiting other relevant conferences / workshops; and (5) personal interviews with individual stakeholder representatives, and targeted surveys.

It is important to note that this study takes an incremental approach, i.e. the impact of the DCFTA is analysed by comparing a specified liberalisation/integration scenario encompassing the DCFTA, with a baseline scenario that assumes no DCFTA in place. The only difference between the two scenarios is thus the DCFTA (*ceteris paribus* assumption). Specifically, and important for interpretation of all results presented in this report, no

additional policy measures have been included in the scenarios. Nonetheless, such accompanying measures are likely to be taken, both on the EU and the Armenian side, in order to maximise gains from trade integration.

3. OVERVIEW OF THE FINDINGS OF THE TSIA

The scenario for the EU-Republic of Armenia DCFTA was developed in consultation with the Steering Committee for this study, based on the assumptions regarding a likely outcome of the negotiations. The scenario included a tariff, services and non-tariff measures liberalisation. As regards tariffs on goods, a full liberalisation for all sectors was modelled, except for sensitive sectors, for which tariff rate quotas were included. Non-tariff barriers liberalisation for goods was modelled to account for impacts of regulatory approximation, focusing on technical barriers to trade (TBT) and sanitary and phyto-sanitary (SPS) measures. The liberalisation of non-tariff barriers to goods is assumed to be asymmetric, as the Republic of Armenia approximates to selected EU rules and regulations and not the other way around. Non-tariff barriers liberalisation for services was mainly modelled to account for the effect of binding to current levels of commitments. For both goods and services, spill-over effects are assumed to reduce non-tariff barriers to trade between the Republic of Armenia and third countries.

3.1. Economic impact

The TSIA reports positive impacts of the EU-Republic of Armenia DCFTA. Liberalising trade between the EU and the Republic of Armenia would result in national income gains for both partners. The long-term estimated benefits are about twice as large as the ones in the short-term. The DCFTA is also shown to have a much more pronounced positive effect on the Armenian economy than on the EU's. For the EU, given the size of its economy, the impact of the DCFTA on the EU's GDP, trade balance, wages and prices is projected to be negligible in relative terms.

For the Republic of Armenia trade with the EU constitutes an important proportion of Armenia's overall trade (27% in 2012). The EU is the first trading partner of the Republic of Armenia (both in terms of its exports and imports), which implies that lowering the costs of trade will result in larger economic gains for the Republic of Armenia in relative terms.

The TSIA projects that the DCFTA would have a significantly positive impact on Armenia's economy, which is shown to increase over time. In the short term the DCFTA is estimated to yield a national income increase of EUR 62 million and in the long-term EUR 146 million. These gains correspond to an increase of 1.1% and 2.3% of GDP in the short and long term respectively.

Different trade policy measures envisaged under the DCFTA to liberalise trade, e.g. lowering of tariffs, reduction of non-tariff measures and the liberalisation of services trade, contribute to the total gains in national income. The largest share of these gains is attributed to the lowering of SPS and TBT types of non-tariff barriers in result of the expected approximation to EU standards. The study projects that a successful approximation of Armenian legislation with the EU acquis will result in national income gains for the Republic of Armenia of EUR 49 million in the short term and will even increase to EUR 108 million in the long-term. The most significant gains of the DCFTA for the Republic of Armenia are therefore expected to arise from the reduction of costs to trade with the EU, which is Armenia's biggest export and import market.

The approximation, resulting in lower barriers to trade with the EU, would not only open the EU market for Armenian exports, but also lead to more market access of Armenian products to third countries when Armenian producers adhere to EU standards. The TSIA projects that Armenian total exports would increase by 11% in the short term, and over 15% in the long run. Imports are also shown to increase, albeit not as much as exports. Armenian total imports would expand by 5% and 8% in the short and long term respectively. This would lead to an improvement in Armenia's trade balance.

The DCFTA is expected to have an impact on Armenia's economic structure, although the degree of this impact would vary, depending on the individual sectors. In terms of value added, the sectors expected to expand the most in the Republic of Armenia are Textiles and Clothing (207.1% in the long-term), Other Machinery and Equipment (49.8% increase) and Personal and recreational services (15.7% increase). These sectors would also experience an increase in employment and exports. Whereas the Motor Vehicles sector, Vegetable Oils and Fats sector as well as Livestock and meat sector may contract most, by 22.7%, 10.7% and 6.5% respectively. However as their shares of total value added are very small, these decreases would have a negligible effect on national production.

The TSIA reports also that in result of the DCFTA the consumers in the Republic of Armenia are expected to be better off by having an improved access to better quality products at lower prices (effect of increased competition), while the wages in the Republic of Armenia are projected to increase by 2.6 % in the long run. As the overall consumer prices are expected to decrease slightly by 0.05 %, the purchasing power of Armenian consumers is expected to increase in the long run as well as their disposable income.

Overall, the DCFTA is expected to induce further economic development by initiating or continuing relevant structural and legislative reforms as well as address cross-cutting issues like further trade facilitation.

The EU-Republic of Armenia DCFTA is expected to have a limited effect on regional trade relations. The liberalisation of trade between the EU and the Republic of Armenia is expected to have a negligible effect for the EU-Turkey Customs Union.

3.2.Social impact

The decline in average price level in combination with wage growth projected by the TSIA suggests an overall positive social impact of the DCFTA on the Republic of Armenia. Average welfare (in terms of household expenditures) in the Republic of Armenia is expected to grow by around 2.5% in the long run. Less affluent households are found to benefit slightly less from the DCFTA, compared to other strata of population, although the difference is modest. The DCFTA is also expected to lead to a reduction of absolute poverty, as well as extreme poverty. The DCFTA is likely to contribute to job creation in the Republic of Armenia in line with increasing output provided that the labour market institutional environment, the situation in the informal economy, and skills developments are also supportive. The materialisation of the DCFTA gains requires employment reallocation between sectors, which are rarely easy and may be particularly difficult for groups with weaker socio-economic status. There are various forces at play that may improve or worsen the situation with respect to labour rights, although positive forces are expected to prevail.

With respect to human rights, the DCFTA is expected to mainly affect economic and social rights and not cultural, civil or political rights. With respect to the economic and social rights, there are various forces at play as indicated above for labour rights. The projected increase in welfare is likely to result in positive human rights effects, while at the same time the effects on some human rights are mixed, depending on the sector and if those rights are properly enshrined in domestic Armenian law and effectively enforced. The monitoring system as part of the sustainable development chapter could be an additional channel for communication between the social partners and with the EU social partners.

For the EU the effects of the DCFTA on wages and prices are projected to be negligible.

3.3. Environmental impact

The DCFTA is one of several forces that shape environmental developments in the Republic of Armenia and may constitute an incentive for developing environmental protection policies in Armenia. Its overall impact would be a combination of effects of economic sectors' growth and technological and other transformations. In some sectors that have a significant bearing on Armenia's environmental situation, the impact is expected to be positive albeit small (e.g. agriculture, construction, energy efficiency), while the expansion of the mining sector may increase environmental pressure. The quantitative environmental analysis carried for one specific aspect of environmental effects, i.e. air emissions suggests that in the long run the

largest changes in Armenia's emission are expected for SO_x (3.5% rise) and CO₂ (3.9% increase). The bulk of SO_x emissions change is linked to the situation in 'Primary metals' sector. In monetary terms, this translates to a total external costs of DCFTA estimated at EUR 11.2 million for the Republic of Armenia in the long run.

The DCFTA is expected to maintain the incentives for the Republic of Armenia to more effectively implement international environmental agreements relative to incentives inherent in currently existing unilateral trade preferences under the GSP+ regime.

4. VIEWS OF THE COMMISSION SERVICES

A key objective, that the EU increasingly pursues both multilaterally and in all its bilateral and regional trade negotiations, is to fully exploit the important contribution that trade can make to sustainable development. In this context, the DCFTA negotiations between the EU and the Republic of Armenia, aiming at promoting co-operation, economic growth and good neighbourly relations, presented not only opportunities but also challenges in respect of sustainable development. In support of the DCFTA the TSIA provided recommendations, which could assist parties to maximise and enhance gains from trade integration and to mitigate potential negative effects. The Commission services share the consultants' views regarding the main recommendations for the DCFTA objectives including:

- allowing for phasing in of tariff reductions or regulatory approximation at sector level, especially for those sectors where the economic, social and environmental impact is expected;
- including provisions of technical assistance in regulatory approximation process, based on a needs assessment;
- upgrading education and training provision, and supporting training programmes to allow labour mobility and ease re-allocation between sectors, while ensuring that workers' rights are respected in law and practice;
- creating mechanisms for monitoring of social and environmental impact of the DCFTA;
- maintaining incentives and encouragement to implement international environmental agreements.

Several of the TSIA recommendations have been taken on board in the final text of the agreement.

Although the EU–Republic of Armenia negotiations on the DCFTA were completed in July 2013, parties could not proceed with initialling of the DCFTA, following Armenia's decision to apply for the membership in the Eurasian Customs Union of Russia, Belarus and Kazakhstan.

The implementation of the negotiated DCFTA, which addressed the recommendations identified in the TSIA, would be a great achievement as the DCFTA went significantly further than classical forms of economic integration, by offering to the Republic of Armenia not only improved trade and investment environment but also assistance in relevant economic and social reforms with the aim to contribute to Armenia's economic recovery and growth and to better integration with the world.

The Commission services believe that the DCFTA offered a platform for seizing new opportunities to boost growth, increase employment, develop strategies to diversify production, diversify trade, strengthen the domestic private sector and avoid overreliance on a few volatile export markets. The DCFTA implementation would provide an excellent chance to develop export industries with resulting revenue and economic growth.

Liberalisation of trade would be a challenge but producers in the Republic of Armenia would be given time to prepare for the adaptations, because liberalisation would be asymmetrical (EU provides for more market access earlier than the partner country), likewise for particularly sensitive sectors, the DCFTA would provide for partner country producers more time to adapt over longer time periods.

Moreover the DCFTA is foremost a blueprint for reforms, helping to advance necessary economic policy changes. Reforms of economic regulations with an upgrading of quality standards would not only have benefits in terms of increased trade, but could also bring other positive changes for society. Higher sanitary standards in food production would contribute to better food safety, better protection of intellectual property rights could induce innovation, and improved competition policy would prevent abuse of market power. The competitive pressure stemming from liberalisation of market access would encourage specialisation, thereby lowering costs and generating innovation. Better products and services would enhance the overall standard of living. The reforms required by the DCFTA would make the Republic of Armenia more attractive for investment and trade. Better governance would benefit all economic operators. Adoption of EU standards would not only improve the quality of domestic goods available for consumers in the Republic of Armenia, and give access to the EU market, but could also boost the competitiveness of such goods in other international markets.

In this view the EU and the Republic of Armenia have taken a commitment at the Eastern Partnership Summit in Vilnius (November 2013) to continue bilateral engagement. A bilateral EU-Republic of Armenia Joint Statement issued in this respect gives clear guidance on a forward-looking and positive agenda for future cooperation.