

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 respectively Georgia and the Republic of Moldova

1. INTRODUCTION

The European Union and the Republic of Moldova and Georgia respectively 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 DCFTAs are intended to provide for substantial liberalisation of trade and investment conditions and are 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 2011 and carried out in 2012 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 October 2012 and is available on-line at:

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

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

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

In line with the methodology guidelines, the study involved a series of public meetings with stakeholders in the EU and in Georgia and the Republic of Moldova 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 – MOLDOVA, GEORGIA 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 respectively Georgia and the Republic of Moldova. 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 and sectorial analysis (incl. partial equilibrium modelling) and stakeholder consultations. Data is used from the GTAP 8.0 database and the 2009 Household Integrated Survey Database.

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 Georgia/ two separate TSIA workshops in Chisinau and Tiraspol in the Republic of Moldova; (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. 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 EU and Georgian and Moldovan side, in order to maximise gains from trade integration.

3. OVERVIEW OF THE FINDINGS OF THE TSIA

3.1. Georgia

The scenario for the EU-Georgia 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 Georgia 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 Georgia and third countries.

3.1.1. Economic impact

The TSIA projects a positive long-term impact of the DCFTA on Georgia, for whom trade with the EU constitutes an important proportion of Georgia's overall trade due to the size of the EU market and its large consumer-base. For the EU, in the long run, the impact of the DCFTA on the EU's GDP, trade balance, wages and prices is expected to be negligible. For Georgia, the expected positive economic impact is significant. The study confirms that many gains in trade are to be achieved already in the short run (i.e. due to immediate tariff liberalisation). The long run gains, however, are conditioned in many respects on the implementation of overall economic and sector-specific reforms. Accordingly, the study projects an increase of exports from Georgia to the EU by 9% already in the short run, and an increase of imports by 4.4%. These gains are projected to grow in the long run to 12% growth of exports and 7.5% growth of imports. In the short run, the increase in national income for Georgia is estimated to reach around EUR 114 million, which is expected to more than double to 292 million, or 4.3% of GDP, in the long run.

The consumer is expected to be better off by having an improved access to better quality products at lower prices (effect of increased competition), while the average wages in Georgia

are projected to increase by 3.6 % in the long run. As the overall consumer prices are expected to decrease by about 0.6 %, the purchasing power of Georgian consumers is expected to increase in the long run.

The DCFTA is expected to have a significant impact on Georgia's economic structure, although the degree of this impact will vary, depending on the individual sectors. Overall, the DCFTA is expected to induce further economic development by initiating or continuing relevant structural and legislative reforms, notably for several industrial sectors and the agricultural sector at large, as well as address cross-cutting issues related to protection of intellectual property or further trade facilitation. Impact of such changes varies in the short and long term.

The study projected the biggest relative effect through a 62 % increase in the output of chemicals, rubber and plastic, which is due to a combination of tariff reductions and reduction of non-tariff barriers. Other important sectors, where output is expected to increase more than 5 %, are other machinery¹ and equipment and primary metals. Livestock and meat products, other processed foods, electronics & computers, and other manufacturing are all expected to contract by 8-24 % in terms of output. This projected contraction of output implies however significant restructuring to the sector and – in some areas – increase of efficiency leading to increased exports. Such projections are made for livestock and meat products sector other processed foods, or electronics and computers.

The study focussed the analysis on two sectors according to their economic relevance (initial importance, economic impact, social/environmental aspects): chemicals, rubber and plastics sector, and vegetables, fruits, nuts and oilseeds sector. In both cases, projected impact of the DCFTA is positive in the short and long term, though conditioned on implementation of relevant reforms.

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

3.1.2. Social impact

In the EU no effects on wages are expected and labour relocation across sectors is not likely to take place. In Georgia, overall employment and wages are likely to increase in line with rising output (the average wage increase is estimated at 3.6 %). An increased demand for labour in some sectors (e.g. chemicals, rubber and plastics) may trigger migration within

¹ For the sectoral aggregation of the study, the reader is referred to the main text.

Georgia's territory towards industrial centres and a higher demand for relevant education and training. Wage increase combined with a predicted fall in consumer price inflation is expected to support improvements in average living standards. The poorest part of the population will benefit less from the DCFTA, mainly because food prices will increase slightly, and less affluent households spend a higher share of their total expenditures on food. The favourable DCFTA impact on equality may come about if and when increasing living standards begin to support gradual changes in societal preferences on equality. Other mechanisms of positive influence may be related to international conventions supporting equality and condemning discrimination. Sectoral employment reallocations (3.6 % for more skilled workers and 5.1 % for less skilled ones) may affect the weakest workforce groups with low education and skill levels. Overall, however worsening of the inequality situation relative to current trends does not appear likely. With regard to labour rights, the DCFTA may also trigger various forces acting towards either improving or worsening the situation, but on balance positive forces are likely to be somewhat stronger implying an overall positive contribution. This may be the case if administrative capacity to implement labour rights is enhanced and public demand for rising standards in this area increases. With regard to social protection, DCFTA impact may rather be limited and related to budget income (changes in revenues from tariffs on the one hand and taxes on the other) and the need to mobilise resources to support groups affected by the agreement. DCFTA may also have a positive, albeit limited impact on further development of social dialogue. Moreover, DCFTA (through the need for Georgia to improve sanitary and phyto-sanitary standards) is likely to positively contribute to consumer protection and to help to limit the number of health problems caused by poor food quality or respectively insufficient or misleading consumer information.

3.1.3. Environmental impact

The estimated environmental effects of the DCFTA in Georgia are expected to be small. CO₂ emissions hardly increase (0.2 %), while land use intensity is estimated to increase by 2 %. Since the DCFTA is expected to have a positive impact on output of the Georgian economy air emissions of other pollutants are expected to rise by up to 3.1 %, translating into associated total external costs of the DCFTA to the tune of EUR 20 million for Georgia. On the other hand, the DCFTA is expected to encourage a more effective implementation of international environmental agreements in Georgia that should also contribute to solving some of the outstanding environmental challenges facing the country. This mechanism may prove important in greening economic growth in Georgia.

3.2. Republic of Moldova

The scenario for the EU-Republic of Moldova DCFTA has been 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 and sanitary and phyto-sanitary measures. The liberalisation of non-tariff barriers to goods is assumed to be asymmetric, as the Republic of Moldova 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 Moldova and third countries.

3.2.1. Economic impact

For the Republic of Moldova the TSIA reports significant positive impacts. In the short run, the DCFTA is expected to lead to an increase in national income of EUR 75 million. This translates to an increase in GDP of 3.2%. In the long run, the change in national income is estimated to double and to amount around EUR 142 million, which is a 5.4 % increase. These increases are mainly attributed to the reduction of SPS and TBT types of non-tariff barriers, in result of the expected approximation to EU standards. The approximation will not only open the EU market for Moldovan exports, but also lead to more market access of Moldovan products to third countries when Moldovan producers adhere to EU standards. For the EU, in the long run, the impact of the DCFTA on the EU's GDP, trade balance, wages and prices is expected to be negligible, due to the size of its economy.

For the Republic of Moldova, the DCFTA will have a significant impact on the economy with more pronounced changes in the long run when dynamic investment effects commence. Moldovan exports are estimated to increase by 15% and 16 % in the short and long run respectively, with imports increasing by 6% and 8 % respectively. This implies that the DCFTA is expected to relatively improve the trade balance for the Republic of Moldova. Average wages are projected to increase by 3.1% and 4.8 % in the short and long term respectively. As the overall consumer price index is expected to decrease by about 1.0% to 1.3 %, over the short and long term respectively the purchasing power of Moldovan citizens will increase.

The impact of the DCFTA on individual sectors differs. Sectors with expected output gains exceeding 10 % are other crops, textiles and clothing, and air transport. Livestock and meat products, motor vehicles, electronics and computers and other manufacturing are expected to see output contract by 8-22%.

The study focussed the analysis on two sectors according to their economic relevance (initial importance, economic impact, social/environmental aspects): grains and crops sector, and textiles and clothing sector. In both cases, projected impact of the DCFTA is positive in the short and long term. Output and value added are expected to see significant gains. The driving force for the positive effects will be the abolishment of tariff barriers and reduction of non-tariff barriers in result of approximation of regulatory regimes.

For the rest of the countries in the region, the EU-Republic of Moldova DCFTA is expected to have a limited effect. The liberalisation of trade between the EU and the Republic of Moldova is not expected to lead to any significant effect for the EU-Turkey Customs Union.

3.2.2. Social impact

In the EU no effects on wages are expected and labour relocation across sectors is not likely to take place. In the Republic of Moldova, overall employment and wages are likely to increase in line with rising output (the average wage increase is estimated at 3.1 and 4.8 % in the short and long run respectively). Combined with a predicted fall in consumer price inflation, this is expected to support improvements in average living standards. The poorest part of the population will benefit less from the DCFTA, mainly because food prices will increase slightly, and less affluent households spend a higher share of their total expenditures on food. Labour reallocation is expected to be slightly higher for the less skilled workers compared to the more skilled workers (5 and 4.5 % respectively). The favourable DCFTA impact on equality may come about if and when increasing living standards begin to support gradual changes in societal preferences on equality. Other mechanisms of positive influence may be related to international conventions supporting equality and condemning discrimination. Some positive impact (albeit limited) may also be related to increase in women's participation in the labour market e.g. through a growing employment in the textile and clothing sector dominated by female workers. Overall, worsening of the inequality situation relative to current trends does not appear likely. As regards the labour rights, the DCFTA may also trigger various forces acting towards either improving or worsening the situation. On balance, positive forces are likely to be somewhat stronger compared to the current situation. This is inter alia due to the implementation of earlier EC recommendations on preparations for the DCFTA negotiations. This effect may be further strengthened if administrative capacity to implement labour rights is enhanced and public demand for rising standards in this area increases. With regard to social protection, DCFTA impact may rather be limited and related to budget income (changes in revenues from tariffs on the one hand and taxes on the other) and the need to mobilise resources to eradicate poverty. The DCFTA may also have a positive, albeit limited impact on further development of social dialogue.

3.2.3. Environmental impact

The environmental effects of the DCFTA in the Republic of Moldova are expected to be small. CO₂ emissions hardly increase (0.1 %), while land use intensity is estimated to increase

by 1.9 %. Since the DCFTA is expected to have a positive impact on output of the Moldovan economy air emissions of other pollutants are expected to rise by 1.9-2.9 %, translating into associated external costs of the DCFTA of up to EUR 15 million for the Republic of Moldova, mainly through the negative impact on human health. While higher economic growth due to the DCFTA will lead to higher environmental burden, economic growth in the Republic of Moldova can become greener by effective implementation of international environmental conventions.

4. DISCUSSION OF THE FINDINGS AND VIEWS OF THE COMMISSION SERVICES

4.1 Economic aspects

The European Commission follows an approach aimed at assisting its decision-making as regards DCFTAs with the prior identification of their positive and negative potential impacts on sustainable development, screened in terms of economic, social and environmental criteria. In this view the study makes several recommendations in order to mitigate potential adverse effects that may appear as a result of the DCFTA for Georgia and the Republic of Moldova. These consequences may appear in particular in relation to economic restructuring of certain sectors, characterised by inefficiency of production methods, absence of technology/related capital or under-used potential.

While the DCFTA offers an important opportunity to tackle these inefficiencies, the study also correctly points out that many of the projected benefits of the DCFTA remain conditional on the implementation of reforms. The Commission services agree with this conclusion and are already undertaking efforts to provide relevant technical assistance and induce long-term approach to policy planning and programming, to ensure the assistance is targeted and leads to sustained growth. Substantial assistance is already being provided in such areas as sanitary and phyto-sanitary measures, where complex assistance aims to target not only the necessary legislative reforms but also to assist in reforming the agricultural sector in Georgia and the Republic of Moldova. Further assistance will also be needed in the reform of some non-agricultural sectors, and in cross-cutting matters (such as IP protection, trade facilitation or competition rules which are vital to attract investment) within the scope of DCFTA-related assistance that the EU provides and intends to continue providing under its 2014-2020 Multiannual Financial Framework. Relevant provisions on support to the reform processes are contained in the Title on Financial Assistance in Association Agreements with respectively Georgia and the Republic of Moldova and in the chapters of DCFTA which include reform commitments.

The Commission services further support the study's claim that a phasing-in is necessary to allow for the required adjustments within the sectors of the Georgian and Moldovan economy,

both in terms of reform process as well as with regard to trade liberalisation. The EU pursued an asymmetric approach to the commitments of the two partners. In this regard, the trade in goods liberalisation contains an important phase-in period, including standstill and tariff-rate-quotas, which the Republic of Moldova requested in order to gradually mitigate the impact of trade liberalisation in sensitive and developing industrial sectors as well as in agriculture. Georgia, in turn, decided not to apply any progressive liberalisation of its import duties and it did not consider the benefits of a gradual liberalisation to be significant, given the country's already substantial openness to trade. Both countries advocated their position during the negotiations on the basis of consultations with relevant stakeholders. The EU, on the other hand, liberalises fully trade with both partners, retaining merely a monitoring mechanism (rather than introducing quantitative restrictions) for certain sensitive products.

A gradual approach to approximation, which is paced to suit the countries' needs and absorption capacity, was also pursued in the negotiations, as an important objective for the EU. The partner countries decided on the content and timing of the relevant reforms, adapted to the specificity of their markets, needs and sensitivities. Accordingly, partners are yet to define the exact sectors subject to reforms in the SPS area, which will allow the products (e.g. dairy) to enter the EU market once completed. Reforms in other DCFTA-related areas are paced by the partner. The provisions of the Association Agreement, as well as those of DCFTA more specifically, contain flexibilities to cater for the needs of the partners during the reform process. These include the monitoring of progress made, regular consultations and dialogue in this regard, and allow for modification of deadlines agreed if need be.

In this context, a further suggestion by the study to continue promoting investment and ensure good business climate, as well as stimulate further entrepreneurship is inherent both in the logic of DCFTA, which should induce further EU investors to locate in Georgia and the Republic of Moldova, as well as spurs the EU administration's efforts to promote greater awareness of DCFTA among Georgian and Moldavian stakeholders. To this effect, the Commission services will continue to reach out to the Georgian and Moldavian businesses and consumers and civil society through public presentations, conferences, roundtables, publications and EU delegation activities, to promote information about DCFTA. The Commission already started these efforts in the course of negotiations, both by negotiating the transparency chapter, which commits the partner to foster an inclusive policy-making in trade area, and by discussing with local businesses in parallel their needs and expectations, as well as promoting their active outreach to the Georgian and Moldovan authorities. The Commission will continue to support stakeholder participation in the domestic legislative process, which will be a crucial vehicle to reforms, by e.g. providing the partner country with information and best practices on the regulatory policies.

The Commission services are further sensitive to the projected structural changes in relevant economic sectors, where some may be subject to substantial output reduction and hence have an impact on employment. Whereas the commitments to sectoral reform are contained both in DCFTA chapters and sectoral cooperation chapters of the Association Agreement, financial assistance takes in practice different forms, including sector budget support, and provides

support for sector reforms. The Commission already assists Georgia and the Republic of Moldova by drawing their attention to adequate planning of their needs and points to the importance of creating mitigating measures in particular in the social and employment sphere. In addition, the DCFTA contains a commitment to joint dialogue with civil society, including social partners, and stakeholders on the implementation of the Agreement, which is expected to channel the feedback and thus to help adjust the necessary measures during the reform process.

4.2. Social aspects

The Commission services share the consultants' views on the need to include into DCFTA clauses preventing the lowering of labour standards. They also recognise importance of establishing an appropriate monitoring mechanism and involving representative social partners (trade unions and employers' organisations), as well as other civil society representatives into a broader dialogue on DCFTA implementation and the overall reform process.

Both DCFTAs contain a comprehensive trade and sustainable development chapter aiming to promote high levels of labour protection in the context of trade relations between the Parties. This chapter reiterates both Parties' commitment to effectively implement ratified ILO (International Labour Organisation) conventions and to consider ratification of further international conventions on the matter, to enforce domestic legislation in the area of labour and not to lower the labour standards in order to attract trade or investment. The chapter further envisages cooperation in a number of related areas aiming to promote the Decent Work Agenda and responsible business conduct. The chapter also establishes a monitoring mechanism based on transparency, dialogue and cooperation in order to oversee implementation of the chapter and follow up on provisions on evaluation of DCFTA impacts. The Commission services also recognise importance of dialogue with civil society, including with social partners, both within the DCFTA monitoring mechanism and in the framework of domestic structures of both Parties. In this regard, a Joint Civil Society Dialogue Forum is provided for in the DCFTA, with view to overseeing the implementation of commitments in an inclusive manner. The partner countries commit to inclusive policy-making process through their transparency obligations across the entire DCFTA. Furthermore, the reform process in trade-related areas has a gradual character, allowing for mitigation of the negative effects of reform through a longer period and phasing-in of reforms. The DCFTA contains commitments to dialogue with the partners on the experience with and impact of the reform on the sectors of the economy and the citizens, and allows for flexibility through adjustable timeframes necessary to complete the reforms.

In this context, the Commission services note that relevant DCFTA provisions should be coupled by measures to be taken by each Party and its competent institutions. This applies in particular to the need to bring domestic legislation and practice in line with the ratified ILO conventions and recommendations of the ILO monitoring bodies, as well as to further develop capacity of relevant institutions to ensure proper implementation and enforcement of labour

standards. In this context, each Party will need to ensure that tasks of the labour inspection are carried out efficiently.

The Commission services will continue a sectorial dialogue with Georgia and the Republic of Moldova, including in the area of employment and social policy, with a view to exchange information and best practice and to provide relevant assistance.

4.3. Environmental impacts

The Commission services consider the TSIA conclusions as relevant for the policy-making (i.e. efforts to assess impacts on environment, to screen major sectors of an economy, to consult civil society), but take note of the limits of this exercise.

The DCFTA includes a number of elements that aim to ensure that environmental policy objectives are not undermined and effective policy is encouraged. In this regard, the chapter on trade and sustainable development in particular contains the commitment to uphold the existing levels of protection, and prohibition of derogation from the existing domestic environmental laws, or other efforts aiming at lowering the level of protection in order to attract trade or investment. Furthermore, they reaffirmed the obligation to effectively implement the multilateral agreements to which they are already a party and encourage taking further measures that do not constitute an unjustified discrimination in trade.

Furthermore, the DCFTA with both partners includes a monitoring mechanism, both via government-to-government dialogue, as well as with civil society, to oversee the implementation of the DCFTA and its impact on the environment. In this regard, the Commission services see an essential role for civil society in ensuring that sustainable development considerations are brought to the attention of the Parties to the DCFTA as well as in providing advice and follow-up on the implementation of the agreement and related matters

It should also be stressed that the DCFTA is just a part of the Association Agreement, which in its other parts contains provisions for approximation to the EU acquis that are expected to significantly help to mitigate potential adverse impacts of the DCFTA on the environment.

Conclusions

The EU commenced the path towards a Deep and Comprehensive Free Trade Area (DCFTA) with the Government of Georgia and of the Republic of Moldova in the firm belief that aspirations and objectives of both sides are based on a common overarching objective of ensuring sustainable economic development.

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 and

investment can make to sustainable economic development. In this context, the launch of the EU-Georgia and EU-Republic of Moldova DCFTA negotiations presented both challenges and opportunities.

Consequently, the DCFTAs with Georgia and the Republic of Moldova address essentially all recommendations put forward in the TSIA to the European Commission. The adjustments made take into account both the economic situation of the partner countries, their trade structure, social and environmental protection levels, as well as desired economic development perspective. The European Commission services stress the principle of ownership that guided the negotiations on reform commitments, so that the pace and content of reforms reflects the needs and expectations of the partners, and represent a viable reform path that will lead to more trade and economic growth. The European Commission remains attentive to the needs of Georgia and the Republic of Moldova and will closely assist both partners in the reform process.