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The Economic Dynamics of the Eastern Partnership Countries: Between Development Gaps and Internal Fragilities

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1 Introduction

There is a vast body of literature dedicated to the topic of economic resilience and its main drivers. Generally, economic resilience implies the adaptive capacity of an economic system in front of both long- and short-term shocks, a fact which determines a change of their social, economic, even ecological conditions in order to return to the pre-shock state whilst using "its fair share of ecological resources" (Greenham et al. 2013, p. 6). In a deeper perspective, resilience means the ability of governments, or even local communities, to recover after natural disasters, economic crises, social or political imbalances but also their capacity to anticipate global trends that may affect employment and labour market, industries, economic sectors, the environment and so on (Giacometti et al. 2018, p. 6).

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Economic resilience is based on three phases: (1) *vulnerability to shocks*, (2) *absorption capacity* and (3) *recovery* (G20 Hamburg Action Plan 2017; Brinkmann et al. 2017). Concerning the first phase, the predisposition towards imbalances is highly dependent on the structure of the economy—sectorial structure or specialization, foreign imports, energy security (dependence on energy imports), prudential measures or the share of public debt in GDP. The second phase reflects the capacity of the economy to suppress the immediate effects of the shock as to limit job losses and contraction of the output. Consequently, this phase is strongly connected with the labour market conditions, inflationary pressures or the attitude towards international trade and foreign investments (European Commission 2017). The recovery was linked strictly with the smooth reallocation of existing resources to productive activities; thus, it depends also on the flexibility of the labour market (European Commission 2017, p. 8). Economic resilience illustrates an important pillar for the concept of resilience, in general, due to its numerous contributions in terms of competitiveness, productivity, specialization and labour market conditions, each of these components being able to support the restoring process after an external shock. In this chapter, we are interested in providing an economic overview of the Eastern Partnership (EaP) countries, by highlighting their capacity to contribute to their own as well as to the regional resilience, given their significant importance as Eastern EU partners.

Between the six EaP countries and the EU, there is an interdependence relationship. On the one hand, the EU definitely needs more stable neighbours, in terms of economic, social, political or security dimensions, at Eastern borders to protect itself from outside imbalances. It is a sort of prudential set of measures able to diminish the cushion of any direct impact of an external challenge. On the other hand, the Eastern Partnership (EaP) represents a unique chance for Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, as former Soviet countries, to boost their economies, following the path of capitalism and freedom. Moreover, these countries could strengthen their good governance, rule of law and democracy, to the benefit of European investments and trade opportunities, to increase the quality and skills of human capital, to address energy security and climate change issues and so on (European

Union External Action 2016a). These countries have not benefitted in the past from a democratic tradition; consequently, their predisposition towards instability definitely raised the awareness in this concern—the need for predictability and equilibrium. For all of them, the EU is a source of aid in this respect. Practically, the ability of these societies to reform themselves in accordance with the principles of democracy, rule of law, human rights and free market mechanism was completely cancelled by the hard legacy of the Soviet era. In such context, where countries remained guided by opportunism, corruption, ineffective governments, severe macroeconomic imbalances, social and political instability, the membership to the Eastern Partnership is a unique chance to benefit from the EU support. This could be translated into multilateral co-operation for stronger economies and governance, and powerful connectivity among the EaP countries, but also between them and the EU (European Union External Action 2016b).

This chapter is focused on providing an in-depth analysis with respect to the economic dynamics of the EaP countries during the transition period and their present disparities in terms of development in the ex post phases of most relevant crises that affected the region. The conclusion section highlights the main sources of internal fragilities that need to be addressed in order to strengthen the capacity of resilience of both: the EaP region and, consequently, the EU's social and state resilience.

2 The Eastern Partnership Countries During the Transition Process: At the Crossroads of New Expectations and Old Roots

The Soviet regime was built on fear and coercion, a fact which took a toll even on the aftermath of the 1991 USSR implosion. Although this moment was perceived with enthusiasm, the lack of prominent leaders able to enhance a real institutional, political, social and economic transformation was evident. After so many decades of forced silence and actions dictated by the central government, forced collectivization, famine and an ideology deeply rooted into the mind and behaviour of the population, perpetuated from one generation to another, it was hard to believe that a miracle could occur. And it hasn't!

When trying to explain why the transition process was so reluctant and failed in Eastern Europe and Caucasus, it is extremely important to take into consideration the content and virulence of the Soviet rules and practices in the area. According to the 2011–2012 report of World Economic Forum, in order to quantify the results of the two decades of transition, post-Soviet economies were grouped into two separate categories: *factor-driven economies* (first stage of development, based on primarily unskilled labour force and natural resources), where Moldova was nominated, and *transitioning economies from factor to efficiency driven* (between Stage 1 and Stage 2, based on efficient production processes), namely Armenia, Azerbaijan, Georgia and Ukraine (World Economic Forum 2012, p. 11). Belarus was not even included in the analysis, probably because of its slow process of economy opening towards the private sector, as a transition in the real sense of the term did not occur there. The new leader of the country prolonged the Soviet model of governance, controlling in depth the economy through fiscal and monetary policy, banking sector and so on. As the World Bank pointed out, in 2016, after more than 25 years of transition, the share of state-owned enterprises in the GDP was very large, 46.7%, having an equivalent of almost 70% of the industrial output (World Bank 2018, p. 7).

Basically, in comparison with the communist countries belonging to the same communist bloc, these nations seemed to have benefitted from a less favourable basis at the debut of the transition process, as they also had from the position of Soviet republics. The same report of competitiveness placed countries like Romania, Bulgaria, Poland, the Czech Republic, Hungary and even Russia in a much better position after the first two decades following the regime change, from Stage 2 of transition—*efficiency-driven economies* on their way to Stage 3—*innovation-driven economies*, considering the level of GDP per capita and the share of exports of mineral goods in total exports (World Economic Forum 2012, pp. 9–10).

Despite the initial enthusiasm of the countries of Eastern Europe and Caucasus in 1991, in terms of starting the liberalization of prices, the preparation of the background in order to implement the privatization process, or the so-called policy of "cheap dollar", these republics were missing some fundamental prerequisites in order to materialize the transition. There were no foundations in order to support the market economy, the rule of law, the institution of private property, the minimum knowledge with respect to labour market, structural reforms, the restructuring of the state-owned enterprises, how to attract foreign direct investment (FDI) and so on. The economies of the six countries were strongly dependent, especially in the case of Armenia, Moldova, Georgia, Belarus or Ukraine, on resources from Russia, such as gas and oil. Furthermore, the absence of skilled labour force, capital or the necessary primary resources in order to sustain internal industrial production, the higher dependence of the economy on only one sector, *agriculture*, for some countries like Moldova, Armenia, Georgia, Ukraine or *industry* for others, like Azerbaijan, Ukraine and Belarus, complemented by a higher level of corruption definitely placed the countries into a vulnerable position during the entire transition process.

Those who got the power after 1991 continued, in most cases, the old ideas and reforms, prolonging, thus, the regime. Belarus, as we have previously pointed out, illustrates the most representative example. The transition process became slow and difficult, lacking effectiveness and concrete measures undertaken in order to boost the economic development, attract FDI, increase the level and effectiveness of the educational system, support the private sector or create good governance. In 1995, for example, the share of the private sector in the GDP of the countries was different from one case to another. Belarus was the most conservative one, in the sense that only 15% of the GDP emphasized the activity of the private ownership. The second reluctant country in promoting private sector was Azerbaijan, with a proportion of 25%, followed by countries like Georgia and Moldova with a share of 30%, Ukraine with 35% of GDP and Armenia as a promoter of the private sector with a share of 45% of its GDP (European Bank for Reconstruction and Development 1995, p. 11).

Having an improper institutional background, severely vitiated by the Soviet "experiments", the state-owned property remained dominant in the first years of transition in most of the countries. With the exception of Moldova, which, although problematic, managed to privatize the state-owned enterprises in a proportion of approximately 25%, the remaining countries made few steps in this direction. Thus, in Armenia, Belarus, Georgia and Ukraine, only modest progress was made, while Azerbaijan prolonged the state control in the first years of independence. Concerning the enterprise restructuring, all the nations were defined through a weak enforcement with respect to bankruptcy laws while preserving the dominant position on the internal market of the state-owned companies, all these affecting the liberalization process. For instance, Azerbaijan, Belarus and Georgia made some small steps in terms of liberalizing imports and exports, but the exchange regime was not fully transparent. The situation for Armenia and Ukraine was slightly advanced, meaning that these countries managed to remove most of the existing barriers against the international trade, but more should have been done to promote a free trade in accordance with international practice. From all the nations, Moldova seemed to have accomplished the objectives of removing most significant quantitative and administrative restrictions, with the exception of the agricultural sector, where it remained in force. Moreover, the country succeeded to eradicate all significant tariffs that affected the exports.

Considering this background of "great" changes in order to transpose the market-oriented system into their economies, the failure of the new governments can be quantified into the enormous contraction of purchasing power and GDP. Consequently, comparing the situation from 1994 with the one from 1989, the purchasing power suffered a decline of 56.6% in Armenia, 24.5% in Azerbaijan, 27.6% in Belarus, 55.6% in Georgia, 33% in Moldova and a reduction of 24.6% in Ukraine. In terms of GDP cuts, the situation was worse. After four years of the so-called transition, the gross domestic product of Armenia declined to 64.7%. For Azerbaijan, despite its significant endowment with natural resources, the economy decreased to 59.2%. Georgia suffered the highest decline of all countries, at 82.1%, while Belarus remained the most stable with a GDP reduction of 39.9%. Moldova and Ukraine were placed in relative similar positions, with a decline of 56.3% and 54.9% (European Bank for Reconstruction and Development 1995, p. 182). The fragile macroeconomic environment of the Eastern Europe and Caucasus countries can be explained, in general terms, in the light of their increased dependence on exported goods, political instability, as well as their exchange rate supervision, in order to take inflation under control

(European Bank for Reconstruction and Development 2000, p. 54). Even though the drastic depreciation of their national currencies had a positive impact in terms of import-substitution activities, large external debts were consolidated. In the next section, we focus on highlighting the existing disparities, in terms of development, between the six economies on their way to accomplish transition towards a market economy.

3 Development Gaps Between the Eastern Partnership Countries: A Comparative Approach

In order to frame a more representative picture on the economic dynamics and macroeconomic environment of the six EaP countries, we divided this subchapter into three parts. The first part highlights the general conditions which supported the economic development of the EaP countries—focusing on the endowment with natural resources and the status of human capital. The second part consists of a presentation of the economic path for each country with the impact of the most important shocks (economic, social, political, environmental) that have affected national economies. The third part is dedicated to a short analysis of the labour market, in order to emphasize the existing problems that may increase concerns for the resilience of the EaP countries.

3.1 The Economic Dynamics of the Eastern Partnership Countries

The mix of economic policies and political regimes of the EaP countries illustrates a topic of increased interest for European security in the larger framework of expanding geopolitical rivalry between West and East. Their capacity to consolidate competitive economies and a stable macroeconomic environment will contribute, undoubtedly, to strengthening their capacity for resilience in front of new disequilibria, but, consequently, as Eastern neighbours, will also have a positive impact on the capacity of the EU to manage forthcoming outside shocks.

On the one hand, in order to better visualize the dynamics of each country, it is important to focus on the main internal events with social, political or economic connotations, which directly impacted the economic area. On the other hand, there are some special moments that need to be addressed, given their extended impact for the economies of all the countries from the EaP group, such as the crisis that Russia experienced in 1998, as a consequence of the collapse of the oil price and also the impact of the recent important crisis from 2008.

The process of transition from a centrally planned to a market-oriented economic system was difficult and reluctant in terms of policies for most of the countries belonging today to the EaP group. Despite poor institutional transformations as to create the pillars of a capitalist economy based on privatization and private property, liberalization of prices, the exchange rates and so on., the countries from Eastern Europe and Caucasus experienced harsh periods dominated by war, such as the one from the region Nagorno-Karabakh (1988–1994), which marked the conflict between Armenia and Azerbaijan, with consequences on a long term. The forced occupation of the region by Armenia generated isolation for the country (Karapetyan 2018). The reminiscences of this past conflict definitely affected the integration of Armenia with its neighbours and thus its economic development. On the same wavelength, countries like Georgia or Moldova have also experienced difficult times of internal tensions sustained by Russia, in the first years of transition, in order to detract their attention from building a solid market economy. Georgia, for instance, faced severe problems with secessionist regions Abkhazia and South Ossetia that were supported by Russia, so between 1991 and 1994, the country was implied in numerous conflicts with these regions. The situation reiterated in 2004 (the war with South Ossetia) and in 2008 in a direct confrontation with Russia. As for Moldova, the same scenario occurred with Transnistria, as a secessionist region. Consequently, during 1991–1992, the Transnistrian War took place, and the region was under Russia's influence. Ukraine suffered something similar but, more recently, in 2014, in the area of Donbass and the annexation of Crimea. The war lasted until 2017, with Russia also as main actor. Obviously, all these open conflicts implied enormous economic and social costs, having no contribution to these countries' development. As if experiences of war were not enough, other major political imbalances occurred, harnessing even more the social and economic areas. Events such as the Rose Revolution from Georgia (November 2003), the Orange revolution from Ukraine (November 2004–January 2005), Jeans Revolutions in Belarus (March 2006), Grape Revolution from Moldova (April 2009) or Velvet Revolution from Armenia (May 2018), all dealing with protests caused by political elections have also highlighted the fragility of these countries on their road to regime changes. While political regimes promote economic policies that allow higher levels of State intervention in the economy, perpetuating, moreover, the higher dependency on Russia's resources and tight economic dependence with it, their ability to strengthen their country's power to resist and overcome external imbalances remains problematic. If we take a look at the nominal gross domestic product (GDP) of the EaP countries for the entire transition time span until present times, we will notice that all the earlier mentioned political and war instability moments directly affected the economy.

As shown in Fig. 4.1, countries like Azerbaijan, Armenia, Moldova, Georgia and Belarus experienced the poorest economic results in the first decade of transition, with GDP levels lower than US$25 billion, confirming, thus, the negative impact on the economy of wars and political tensions. The most performing countries were Ukraine, with the highest GDP levels of around US$180 billion in the pre-crisis moments in 2008 and 2013, respectively, followed by Azerbaijan and Belarus, where the

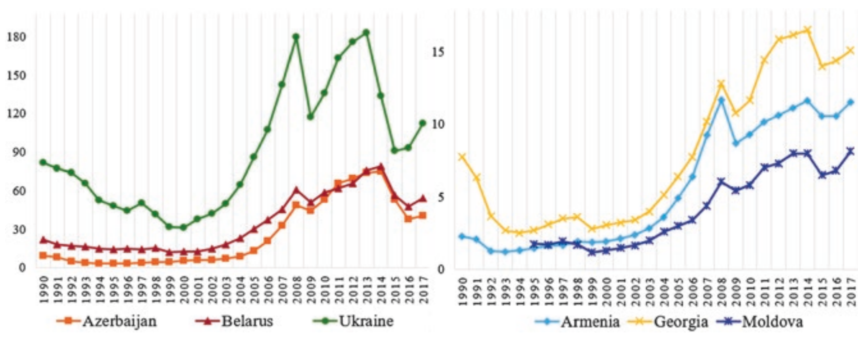

Fig. 4.1 GDP—current US billions of Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

economic dynamics was rather symmetric, having 2008 and 2014 as points of inflection in their economic evolution. We can observe that most of the economies were confronted with important cuts in terms of the GDP after 1998, 2008 and 2013–2014, but the decline was even more pronounced for the case of Azerbaijan, Belarus and Ukraine. The remaining countries—Armenia, Georgia and Moldova—were less developed; so in their case, the downturn existed but at a lower amplitude.

When looking at what happened in 1998 that generated a sharp GDP decline, we must pay attention to Russia's crisis and the enormous importance of Russia for the geometry of economic development of the EaP countries. Their higher economic dependency on Russia determined severe economic imbalances that were able to justify the drops of their GDP. A deeper look provided the evidence of some dangerous practices, such as the depreciation of national currencies and large external debts which fuelled the economic decline. Georgia, Armenia and Azerbaijan were negatively affected because of the sharp decline of exports to Russia and also because of significant losses in terms of their citizens' remittances from Russia. Armenia's GDP fell from US$1.89 to US$1.84 billion, while Georgia's GDP diminished from US$3.61 billion to US$2.8 billion (World Bank Database 2019). For countries like Moldova, Ukraine and Georgia, where exports to Russia reached more than 50% of their total exports, the crisis affected their agricultural sector, increasing, thus, their trade balance deficits. The GDP of Moldova contracted, thus, from US$1.7 billion in 1998 to US$1.17 billion in 1999, while the GDP reduction in Ukraine was severe, standing at US$10 billion, from US$41.88 billion to US$31.58 billion (World Bank Dabatase 2019). The initial economic slowdown had further social consequences, meaning important cuts of wages, pensions, difficulties to access social services and many job losses, nurturing the already widespread poverty (Archives of European Integration 1999, p. 2). In Armenia, for example, the government could not support expenditures with education, social safety and healthcare. The economy of Belarus was so severely damaged that rationing was implemented for basic goods. Georgia was also confronted with a decline of investors' confidence, affecting, thus, the privatization process and FDI inflows, encountering the same problems of budgetary deficits that could not cover salaries and pensions. Ukraine also experienced something similar, having an inflation rate of almost 40%. The case of Ukraine is special, given the economic impact of annexation of Crimea in 2014, by the Russian Federation. This moment of dangerous political instability generated severe economic consequences, the economic decline being a harsh one (International Monetary Fund 2019a). As a result, these countries benefitted from a US$120 million financial support provided by the International Monetary Fund (IMF) and additional support provided by the EU, Japan and Switzerland (Archives of European Integration 1999, pp. 4–8).

After the 1998 decline, the economic recovery of Eastern Europe and Caucasus was difficult and implied higher rates of unemployment with double digits in cases like Ukraine (11.7% of total labour force), Armenia (16.36%) or Georgia (17.87%) (World Bank Database 2019). The quality of life in these nations pushed more people to leave the country, especially the young labour force. Consequently, problems, such as poverty, severe inequalities in terms of revenues, poor educational and healthcare reforms or the unequal development of the private sector in the economy to sustain employment and GDP, remained serious obstacles that needed solutions. Moreover, the situation remained poor until 2003–2004, where new moderate positive evolution could be observed. For Azerbaijan, the implementation of new policies designed to promote and economically exploit its oil resources helped the country to attract investors from abroad and to acquire a stable economic environment. In Belarus, the model of prominent governance in the economy through state-owned enterprises, which controlled the productive activities, protected employment and salaries (World Bank 2003). Even so, the 2008 crisis determined most economies to wander off from their positive trend.

The crisis can be perceived as a test for the soundness of their own economies; consequently, we can observe that most countries were severely affected, while Azerbaijan's economy and that of Belarus have followed a limited downturn. Even though the economy of Azerbaijan is strongly dependent on the price of the oil on international markets, it is not that widely inserted into the world economy, so this position protected the country against aggressive negative outcomes of the crisis. On the same wavelength, we find Belarus. In the opposite position, there is Ukraine, with a GDP decline of almost 34%, from US$179.82 billion to US$117.11 billion in 2009 (World Bank Database 2019). For Ukraine, the determinants of the larger GDP contraction can be identified in erroneous policies which supported the economy in the years that preceded the crisis (Mayhew 2009). The government promoted an expansionary fiscal and income policies coupled with the policy of cheap money. The positive evolution of steel prices, together with the possibility to easily obtain a cheap credit, unnaturally boosted the internal demand. When the crisis hit the economy in the second half of 2008, internal demand suffered the most and investments decreased sharply, while the industrial production was drastically reduced (OECD 2011a, p. 234). If we also take into consideration the higher debts of the population, the background becomes even more explicit for the negative dynamic of GDP in 2009.

For Georgia, Armenia and Moldova, the GDP reduction was important, given their limited economic performances, reaching almost 5%. Georgia and Moldova suffered because their economies were dependent on imports and exports from the Russian Federation (United Nations Development Programme 2009). The government of Armenia neglected the increased poverty, the problem of higher unemployment as well as the brain drain phenomenon, without paying attention to education and health sectors. The economy depended drastically on remittances of the citizens who worked abroad but also on imports, which became more expensive after the crisis (Armenian International Policy Research Group 2005). Another significant problem which completes the background is the informal economy. If in 2000 the taxation level was at 13.9% of GDP, while government revenues were placed at 83.2% of GDP, in 2008, despite a higher level of tax burden, 16.4%, the revenues were lower, of only 76% of GDP (OECD 2011a, p. 40). So, the crisis accentuated some important internal fragilities that required further attention. In general, while the crisis brought major disequilibrium, such as higher debts, most of these countries applied also for financial aid, which was provided by the International Monetary Fund and World Bank. Consequently, it determined an increase of external debt but also problems with employment, investments and inflationary pressure. Georgia, Ukraine, Moldova, Armenia and Belarus needed financial assistance in order to restore their economies, especially after the hard times of war experienced by Georgia in August 2008 with Russia. The total external debt for Armenia in 2010 reached US$3 billion after the intervention of the IMF, while Ukraine's external debt was US$17.8 billion (OECD 2011a). Taking into consideration that most of these countries are highly dependent on remittances and have a weak economy with fragile economic sectors, unquantified shares of informal economy in GDP, external financial support was needed in order to compensate with increased government expenditure from the phase that preceded the crisis. Unfortunately, most of the borrowed money was not used to strengthen the private sector, education and health, but to pay pensions and salaries or to cut inflation. Furthermore, the crisis increased the taxation level, a fact which further worsened the situation of the already weakened private sector.

If we take a look at the situation from 2014, when Ukraine was faced with an internal turmoil based on political and institutional reasons and the annexation of Crimea by the Russian Federation, we can observe that such an unexpected conflict damaged the already fragile economy and destroyed an important part of its industrial area. Higher uncertainty concerning the future progression of the military intervention drastically reduced the economic activity, unemployment rose, people began to leave the country and FDI slowed down. Furthermore, to avoid Ukraine, the national currency depreciated, and the economic decline was harsh, at more than 27% decrease of GDP in 2014 (International Monetary Fund 2019b), from US$183.31 billion to US$133.5 billion (World Bank Database 2019). The general disturbance in terms of trade, the loss of confidence and the loss of production affected the entire Eastern area, by weakening the business environment and discouraging investments in the zone because of higher volatility.

Perceiving things from the perspective of GDP components, as shown in Fig. 4.2, we can see that countries with positive net exports as a percentage of GDP, namely Azerbaijan, Belarus and Ukraine, were those with better economic dynamics, while Georgia, Moldova and Armenia, which had constant negative net exports as a share in GDP, got the poorest economic results. This can also be explained in the light of natural resources endowment and specialization (Heyne et al. 2003). The latter group of countries are not that rich in resources and specialized mainly in agriculture (OECD 2011b). Their industrial activity is poor and is based mainly on imports of raw materials—an aspect that makes their economic activity so exposed to crisis and external shocks. For the former group of countries, the situation is the reverse, a trait that can also be

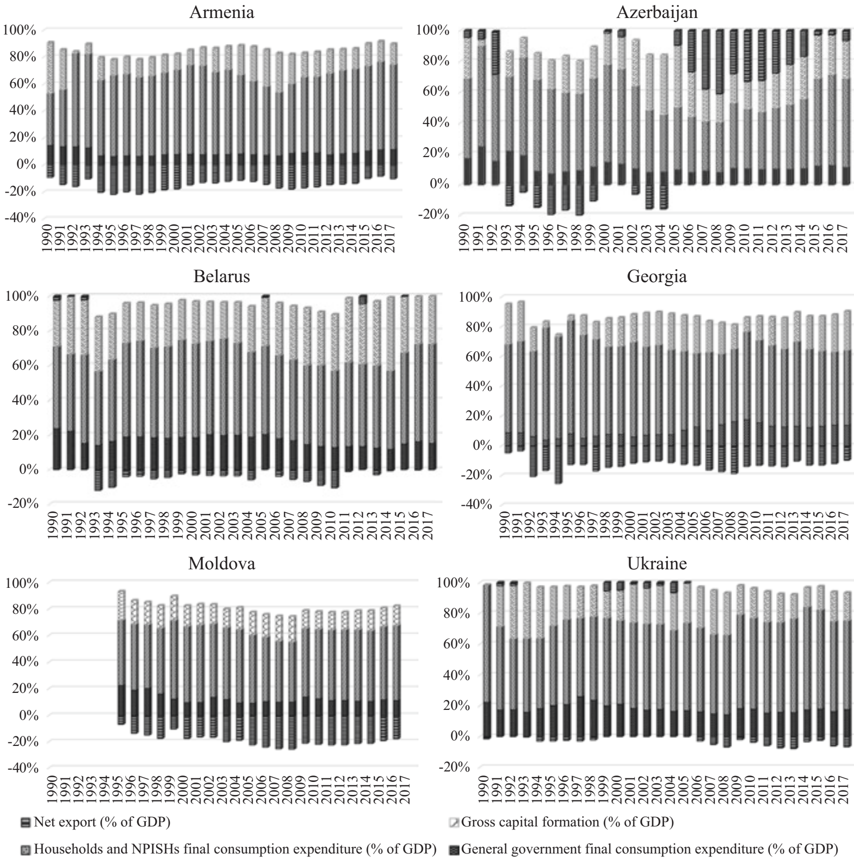

Fig. 4.2 GDP components for the EaP countries (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

determined from the structure of their GDP. These countries have higher shares of gross fixed capital formation in GDP than the others, meaning that the net investment in fixed capital was a priority of the governments of Belarus, Azerbaijan and Ukraine. Here the industrial activities are significant, so there was higher spending with industrial plants, machinery, equipment and so on. In the case of Armenia, Georgia and Moldova, industrial activity is rather modest, and investments in fixed capital follow, thus, the same limited trend. Specialization among the EaP coun-

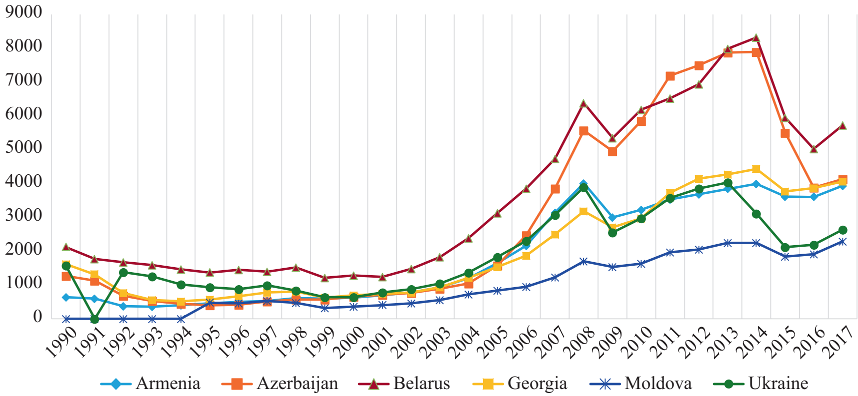

Fig. 4.3 GDP per capita—current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

tries follows two separate ways—(1) countries rich in terms of resources that have prolonged the old specialization based on industry, machinery and exports of raw resources and (2) those that are dependent on imported resources (World Atlas 2019); thus, their exports are based on raw materials, food, in general, products with low value added.

When addressing the GDP per capita, as highlighted in Fig. 4.3, the situation changes a little bit. If Azerbaijan appears to be the most performant economy from the entire group, and there are enough reasons previously mentioned to support this reality, Belarus illustrates an example of how a state's massive intervention in the economy through state-owned enterprises, preferential prices for Russia's gas and many other resources and so on succeed to maintain a relatively linear evolution of GDP per capita for the entire period of transition, until 2008. Practically, Belarus was the most performant country in this respect with more than US$1500 in the first decade after independence, while most of its neighbours suffered severe cuts. On the opposite perspective, Moldova had the poorest levels of GDP per capita, at under US$500 on the same time span. If the event from 1998 generated some short reductions of this indicator for all the countries, the crisis from 2008 had a greater magnitude. We can also observe the relatively similar evolution for Belarus and Azerbaijan for the entire analysed period. In 2014, the GDP per capita reached a maximum of around US$8300 in these countries, while the rest of the economies from the group experienced lower levels of about US$3500–4000. As a consequence of the War in the Donbass region and the annexation of Crimea by Russia, in 2014, Ukraine suffered not only a significant drop of the nominal GDP but also an important reduction of per capita GDP of 32%, from US$3104.66 to US$2124.66 in 2015 (World Bank Database 2019). The drop in the economy from 2015 was also related to the situation in Ukraine; it stabilized in 2016 and 2017, for all countries, Belarus remaining the leading country with the highest GDP per capita in the entire region.

A deeper perspective with respect to the sectorial distribution of the GDP will highlight significant aspects related to specialization and also the appropriate mix of sectors able to provide a higher economic resilience for a country. The group can also be divided into two clusters. On the one hand, we have the most developed and performant economies from the EaP region, namely Azerbaijan, Belarus and Ukraine—those which have experienced highest levels of GDP and GDP per capita from all the six nations. From Fig. 4.4, we can observe that for the former group, the economy is relatively well proportioned, meaning that industry and services have a prominent share in GDP, while agriculture, even though it is not that vastly expanded, still captures a proportion of 10–15% from the economic output of the country. Practically, the old industrial base built under the Soviet experience was kept alive in order to further produce, but on a smaller scale and productivity, considering the significant lack of investments and technological progress in this area. Belarus seemed to be very much similar to Ukraine in terms of sectorial distribution, the only exception being that industry in Belarus had a larger share of GDP (almost 35–40%) than for Ukraine (25–30%). Services gain the second place in their economies, with shares of 35%, followed by agriculture, with an overall constant share of 10–15%.

As highlighted in the graphic, the case of Azerbaijan was different in terms of proportions, the economy being supported mainly by higher shares of industry (40–60% of GDP), while the importance of agricultural sector had constantly decreased since 1990 in favour of services. Azerbaijan is a country abundant in natural resources, like gas and oil, with a solid industrial basis. The country managed to reduce the contribution of agriculture to GDP from 32% in 1991 to almost 5% in the

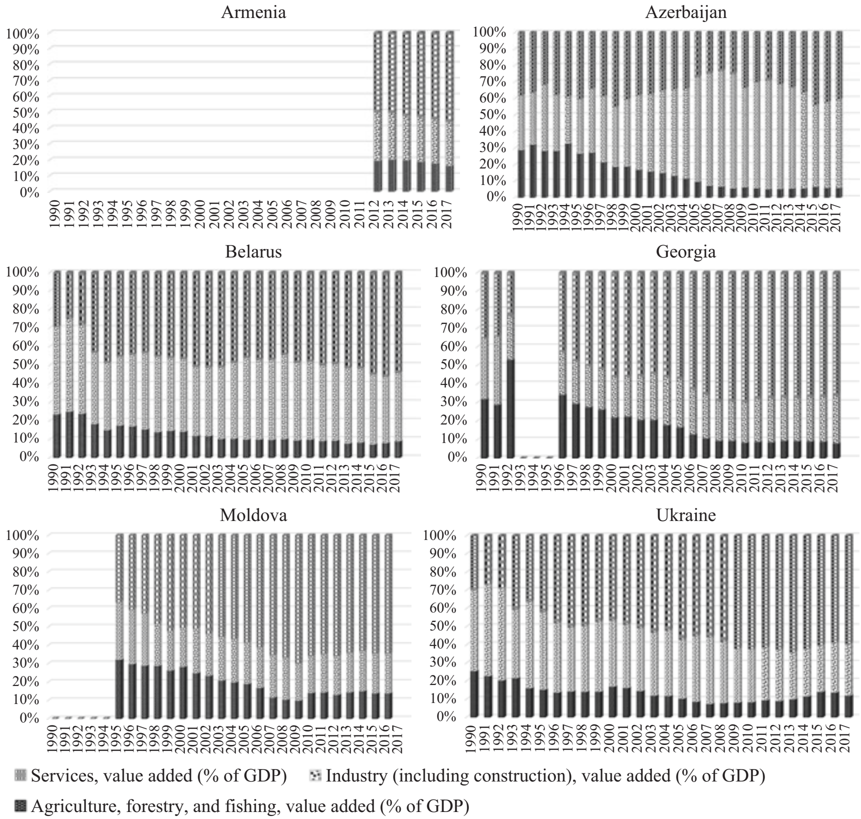

Fig. 4.4 Sectorial distribution of GDP in the EaP countries (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

period that followed the recent global crisis, until 2017. In 1996, the government managed to induce a stable macroeconomic environment to further exploit the existing advantage of oil resources endowments and to attract foreign direct investors. Therefore, industry became a core activity of wealth production, especially after 2000 when people started to return to the country as a result of positive economic dynamics.

Belarus and Ukraine are also countries with a past tradition in terms of industry, but with outdated equipment even to this day. Ukraine has a long tradition in industrial production, but it can be observed that starting with 2000, the share of industry in GDP decreased from 31% to less than 25%. Being a highly integrated country in the world economy, the global turmoil can be considered one factor of such detraction, but the most prominent determinant of this decline is the lack of effective government policies oriented towards modernizing the industrial park. In Belarus, the effect of massive state intervention and the low openness towards enabling private property had a positive effect, the one that the state maintained through providing subsidies to those economic activities, including industrial activities, while also investing in education and the healthcare system. In other words, the government managed to keep alive the old commercial networks, without creating other social costs, like job losses and so on. Until the financial crisis from 2008, the general macroeconomic context of the country improved, while poverty declined, but such positive outcome was also supported by a fertile external climate, such as the membership to Eurasian Economic Union and the facilities provided by the Russian Federation in terms of trade and energy supply. Higher demand from Russia and its neighbours fuelled the expansion of industrial production or exports of agricultural goods. Practically, we can conclude that the economy of these countries was not depending so much on services, but on industry, especially oil production and pipeline infrastructures and the activity of plants.

For the rest of the EaP members, namely Armenia, Moldova and Georgia, these economies do not have intense industrial activity, but mainly services, with increased share in time, so the level of GDP stands at 50%, while the share of agriculture has diminished (10–15% in GDP). In such circumstances, the latter economies are more vulnerable in front of external shocks because the services sector is the first affected in times of a crisis and their small industrial base cannot be supported with internal resources, but with imported resources that will be procured in times of disequilibrium at higher prices with inflation risks. Considering a more recent data, after the 2008 global crisis, from the entire group, only Azerbaijan and Ukraine maintained inflation rates of over 20%, the rest of the countries managing to keep it at around 10–12%. The financial assistance provided by the IMF and the EU had a positive impact in terms of purchasing power stabilization, given the fact that in 2009, only Belarus and Ukraine were facing two-digit inflation of 12.95% and

15.88%, respectively, while the rest of the countries kept it under control with 3.41% in Armenia, 1.46% in Azerbaijan and 1.73% in Georgia. After Ukrainian crisis, only Belarus and Ukraine remained with greater problems of purchasing power reduction, but the situation got under control in 2017, when only Ukraine remained affected by higher uncertainty and political instability.

When addressing the issue of economic resilience and the capacity of a government to cushion throughout its policies any potential imbalances, public debt was an indicator that provided too significant feedback in this respect. Basically, it reveals the responsibility of a government faced with its future obligations, as the payment of external financial borrowings. This aspect was brought to discussion especially because we had previously addressed macroeconomic problems, such as inflation, problems which appeared during hard transition times or as an outcome of crisis. From a general perspective, even though debt is a way of boosting aggregate demand, severely contracted after crises, higher debt creates the crowding-out effect on capital. This reduces the economic output. Countries with higher public debt shares in GDP have a more fragile economy, more exposed to shocks. In other words, their economies are less resilient, and this concerns our analysis.

As pointed out in Fig. 4.5, we can notice that the EaP countries were confronted with higher public debts at the debut of transition process. Moldova experienced the highest rate of public debts in 1998 of more than 150% of its GDP, when the economy was shaken by Russia's crisis. Considering the time span that followed the global turmoil from 2008, all the countries have increased the share of their public debt in GDP, in 2009, as to redress their economies, from smaller shares of 5.29% in the case of Azerbaijan, to larger shares of 9% for Moldova, 10% for Georgia, 13% for Belarus, 15% in the case of Ukraine or almost 20% in the case of Armenia. The crisis of Ukraine from 2014 had similar effects for its neighbours, boosting their public debt.

Perceiving the situation from the perspective of associated level of risk to countries, we can shape the evolution in time of the EaP countries, from the viewpoint provided by the Moody's Investors rating agency. The available data covers1997–2019, with some missing values in the cases of Moldova, Azerbaijan, Belarus and Georgia for some years, as pointed out

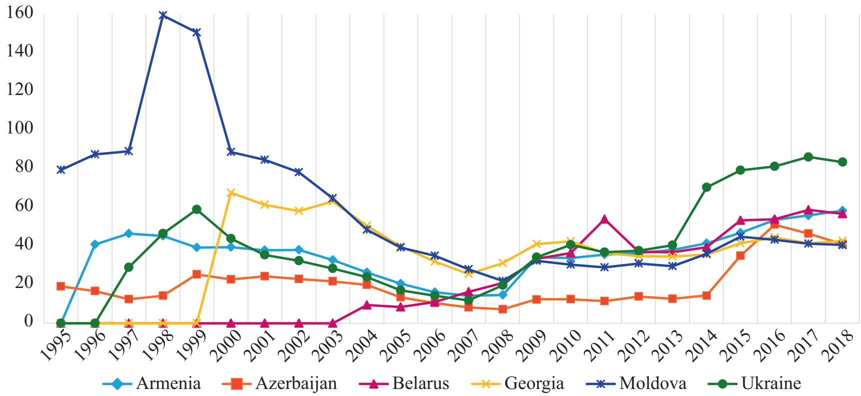

Fig. 4.5 Public debt at the level of the EaP countries (% of GDP) (1995–2018) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

in Fig. 4.6. Overall, there are eight levels of risks starting with Aaa meaning prime or zero risk, Aa1(2,3) meaning high grade, A1(2,3) = upper medium grade, Baa1 (2,3) = lower medium grade, Ba1(2,3) = non-investment grade speculative, B1(2,3)= highly speculative, Caa1(2,3) = substantial risk and Ca = extremely speculative (Moody's Rating 2019). The attention focused on the EaP region points out additional evidence concerning the capacity of these countries to anticipate and overcome the impact of shocks, most of it being placed under the mark of risk and significant uncertainty.

As we can see from Fig. 4.6, the evolution of ratings per each country was different from one year to another. Moldova, for instance, had the highest associated risk as extremely speculative, in 2002, because of its large external debt and political risk. The country has experienced another level of higher risk being rated Caa3 in 2016, after the higher political instability, Moldova having more than five prime ministers in one year. Other countries that were severely affected were Ukraine after the crisis and war from 2014, when it was rated as lacking confidence for investors, and Belarus. Between 2015 and 2017, sovereigns of Belarus were affected by oil price movements and Russia spillovers. Other determinants were limited economic growth and fiscal and political concerns. The rating

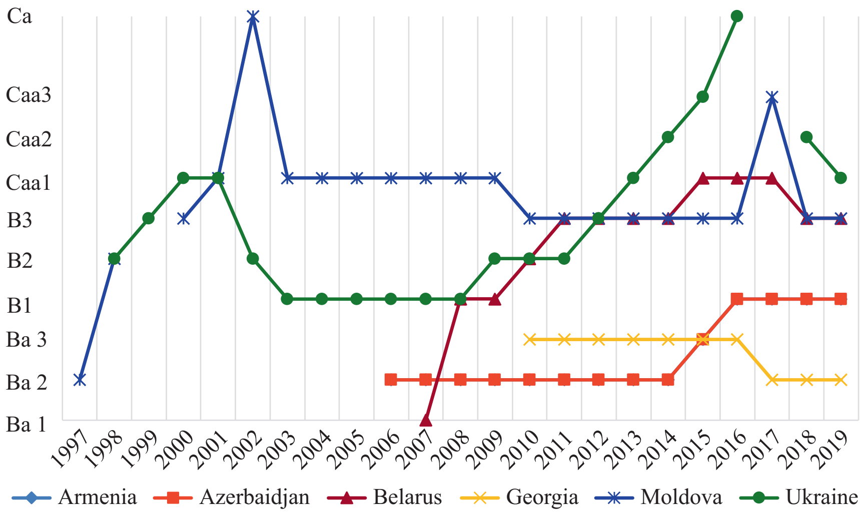

Fig. 4.6 Country ratings for the EaP countries (1997–2019) (Source: Own computation after Moody's Rating (2019))

attributed to Azerbaijan became more problematic in 2016 because of oil production which became lower, with a decrease on almost one-quarter in the past years. The weak banking system, the risk of reopening the conflict with Armenia and significant problems in terms of corruption or offshore money laundering illustrated additional reasons (Coface 2019). The situation of Georgia with a rating of non-investment trade speculative can be explained as being due to the conflicts between Abkhazia and South Ossetia that worsened the relations with Russia.

3.2 Human Capital and the Labour Market in the Eastern Partnership Region

Human capital is one of the endogenous factors that drives economic development together with investments, macroeconomic conditions or the openness to trade. Its role becomes even more important, in particular, in the case of developing countries, where such resources remained inadequately explored. The recent years highlight that all the six EaP countries

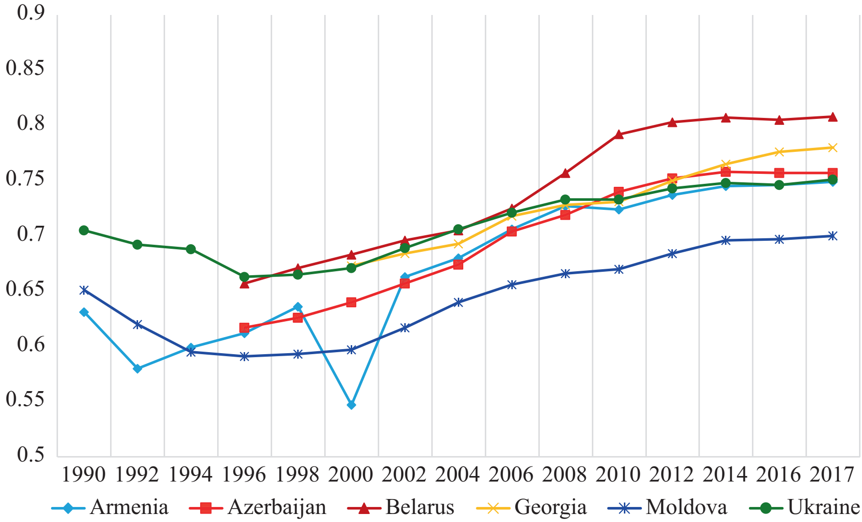

Fig. 4.7 HDI in the EaP countries (1990–2017) (Source: Own computation after United Nations Development Programme (2018). *Human Development Index*)

are placed in good positions from the perspective of Human Development Index (HDI), with a *high level of human development* for Armenia, Azerbaijan, Georgia, Moldova and Ukraine and a *very high level of human development* for Belarus (United Nations Development Programme 2018). Figure 4.7 presents the evolution of HDI concerning EaP countries starting with the unveiling of the transition process up to the present.

As we can see, the graphic points out a general positive trend of the EaP countries towards boosting their achievements in terms of health, education and living standards. Nonetheless, Armenia is not within the line, being confronted with a significant decrease of HDI in 2000 from the level of 0.65 in 1998 to 0.550 in 2000. This situation can be partially attributed to the Russian crisis from 1998. Due to the fact that most of its labour force emigrated from Russia, the Armenian economy was affected because of lower remittances, forcing the government to limit public expenditures. Another cause of the HDI's sharp decline had political roots. The assassination of the prime minister of the country and of many other members of the Parliament in 1999 determined a political and social crisis (United Nations Development Programme 2000, p. 45).

The prospect of education is not that optimistic—most countries are spending around 2–3% of their GDP in this respect. As expected, countries with the highest levels of HDI are the ones that spend the most on education—Belarus and Ukraine, respectively, with a share of more than 5% in the past few years. In 2017, Moldova allocated a share of 6.7% of its GDP to education, but its overall results in terms of human development remain modest. The quality of education and acquired knowledge is reflected in the harmonized test scores with a scale from 300 (minimum attainment) to 625 (maximum attainment). Armenia, Georgia and Moldova received lower values of around 445 point, while Azerbaijan and Ukraine have a better position, with scores of 472 and 490 points, respectively (World Bank 2019b). Obviously, human capital is extremely important, as a separate piece of the entire picture of economic dynamics in relation to the labour market.

The labour market from the EaP region highlights the prominent affinity towards leaving home countries and going to work abroad with the intention to have a better life. Figure 4.8 shows the unemployment dynamics for the EaP countries from 1990 to 2018.

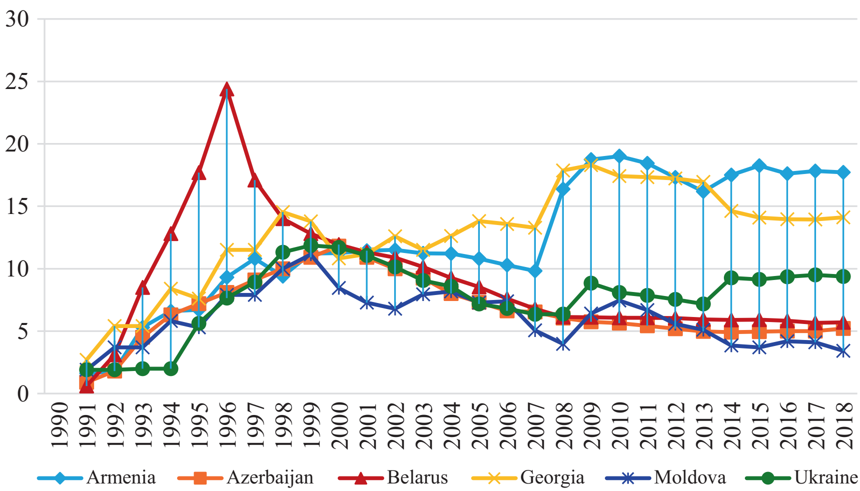

Fig. 4.8 Unemployment rate (% of total labour force) in the EaP countries (1990–2018) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

As we can see, on the one hand, unemployment was high at almost 10% in 2014 in Ukraine, 12% in Georgia and 18% in Armenia, where the phenomenon of brain drain was not stopped yet. On the other hand, Azerbaijan, Belarus and Moldova experienced moderate unemployment of around 2–5%. As presented in the graphic, Moldova remained the most exposed economy from the perspective of unemployment, considering the entire time span of the analysis, and this can be explained by the massive emigration of the young generation after 1992. Belarus, conversely, managed to maintain lower levels of unemployment due to the prolongation of the state-owned enterprises, which continued to support local workplaces, despite their lower productivity. Even so, in 1996, unemployment reached a worrying level of 25% because of transition difficulties to adapt the economy to the new requirements and the ageing population. For Georgia and Armenia, mainly, the situation is problematic because of internal conflicts and massive emigration.

When looking at the prospect of employment, overall, we can observe that the employment rate had limited variations at the beginning of the transition process, as highlighted in Fig. 4.9. The country with the highest employment at the dawn of independence was Georgia, with a share

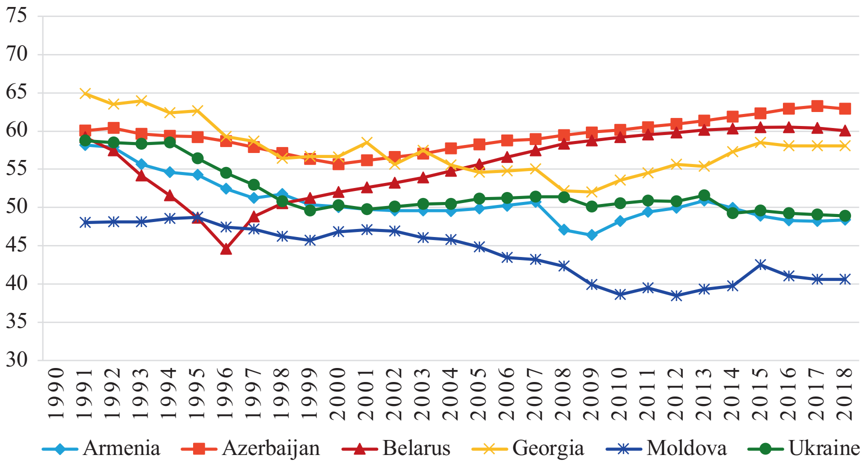

Fig. 4.9 Employment to population ratio 15+, total (%) (1990–2018) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

of almost 65% in 1990. On the other side, we find Moldova, with the lowest share of employment at 48% for the same year. Unfortunately, for Moldova the situation grew worse as the years progressed because of migration and the ageing population; consequently, the employment rate in 2018 was lower than the one from 1998. Russia's crisis affected most countries in terms of employment, but they recovered in a short time. After the war in Ukraine, in 2014, there was a decline in employment, as well as in Armenia. This depended on the labour market conditions, policies implemented by the government as well as on the sectorial distribution of economic activities.

In Georgia, more than 55% of the total population employed are from the agricultural sector, followed by the services sector, with an overall share of almost 40% for the entire time span, and industry, with the remaining 10%. On the other side, we have Belarus, with the lowest share of employment in agriculture, at around 10%, but higher share of employment in industry, almost 33% and an increasing share of people employed in services. We encounter a similar trend in the case of Ukraine, having around 20% of people employed in agriculture, but with a 5% decrease following the 2014 crisis, which also affected the industrial sector, where the rate of employment as a share of total employment decreased by 6%. Even so, the crisis raised the level of employment in the services sector from Ukraine, from around 55% to more than 61% in the following years. The employment profile of Azerbaijan represents a mix of around 40% in the agricultural sector, an overall rate of 47% employed in services and a smaller share in the industrial sector, but with a positive trend, rising from 10% in 1990 to 15% in 2018. Boosting the industry on the basis of the relocation of employees from the agricultural sector is a good sign that highlights a more equilibrate economic structure able to generate further stability in front of internal or external imbalances.

Considering the efficient labour force used, the comparison between the six EaP countries offers a background of how active population is distributed among sectorial activity and how much it contributes to the gross domestic product. If we create a nexus between the sectorial profile of each economy and the value added created by the occupied labour force in each sector, we can draw conclusions of great significance with respect to a country's economic health and the manner in which labour force can be used to absorb potential external shocks. The labour migration from sectors with higher shares in GDP, but low economic productivity, to sectors with high productivity will strengthen the efficient allocation of human resource and will provide a healthier approach of supporting specialization, perceived as a tool for development. When addressing economic productivity, or how much the agricultural, industrial and services sectors are contributing to the output of every country, we have chosen the output per employed person. Therefore, we have determined labour productivity, by dividing the GDP created in every sector by the number of employed persons in that particular sector. The results are presented in Fig. 4.10.

If we take a look at Armenia, there are some missing data, but starting with 2011, we can see that the highest employment productivity came from the services sector, where the trend was positive, from US$24,000 per year, in 2011, to almost UD$39,000 in 2017. Labour productivity in the industrial and agricultural sectors remained limited for the entire period, with a modest level of around US$5000–6000 per year between 2011 and 2017. Even though Azerbaijan has relatively higher rates of employment in agriculture, of almost 40%, the labour productivity in this sector remains very low for the entire time span, with less than US$700in 2003–2004 or US$1400 in 2017. Thus, the contribution of agriculture to GDP is very limited, not being based on products with higher value added. In the second place, in terms of labour productivity, is the work from the services sector, which followed an upward trend until 2014, when it reached US$12,250, decreasing afterwards to US$7000 in 2017, as a consequence of the contagion effect of the Ukrainian crisis. The highest labour productivity is found in the industrial sector, where a sharp decline appeared after the 2008and 2014 crises. The decrease of oil prices on financial markets and also the limited number of investors that remained in the projects of resource extraction after both crises explain such decline.

For the case of Belarus, we see the relatively similar trend of labour productivity, but with a different amplitude. The highest productivity is encountered also in the industrial sector, but because of preserving dictatorship, the productivity value is inferior. For instance, Belarus reached higher labour productivity in the industrial sector in 2014, but

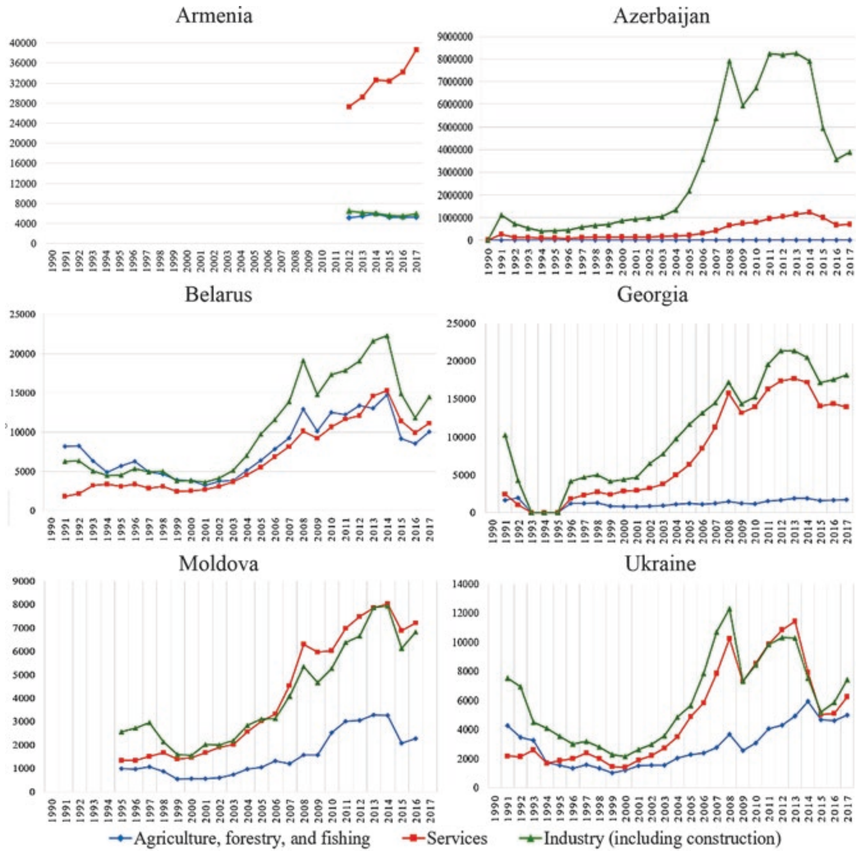

Fig. 4.10 Labour productivity by sector in the EaP countries—current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

its value was only US$23,000. Concerning the other two sectors, the productivity of employed population was lower, reaching a maximum of US$15,200 in 2014, for services and US$15,000 for agriculture. Almost in the same position, we find Ukraine. Most people were employed in the services and industrial sectors; consequently, these were also the sectors with the highest productivity levels, despite the drops after 2008 and 2014.

Georgia and Moldova highlight the type of productivity profile that is not sustainable. Most part of the employed people work in the agricultural and services sectors, while labour productivity appears to be higher in the industrial and services sectors and very low in the agricultural sector. Basically, there is a waste of productive resources here. Furthermore, both economies depend much on services that were affected after the shocks from 2008 and 2014. Countries dependent mainly on the services sector were less resilient in times of crisis in the absence of other developed sectors, able to absorb the unemployed and to use human resources in different productive activities.

From this analysis, we have extracted an important aspect: it is dangerous to employ most of the active population in non-productive activities, while depending more on sectors that are fragile and highly exposed to external imbalances, precisely because they are not based on comparative or competitive advantages. This, to a great extent, ruins the country's capacity for resilience, promoting a contagion effect among the other nations from the group. In order to complete the framework of discrepancies among the EaP countries, the Gini index provides us a different perspective in terms of economic inequalities.

As pointed out in Fig. 4.11, the same limited availability of data makes it impossible to provide a general perspective of income inequalities evo-

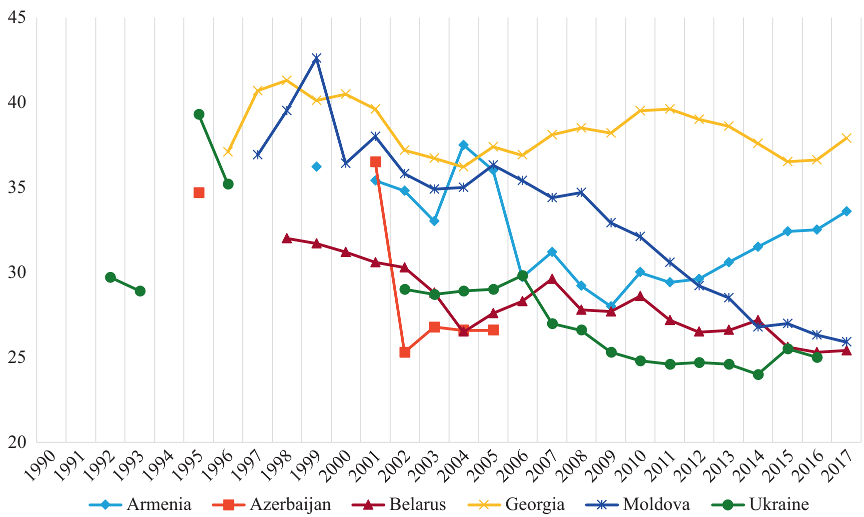

Fig. 4.11 Gini Index for the EaP countries (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

lution among the six economies between 1990 and 2017. The higher the value of Gini index is, the greater the income inequalities are for that country. By correlating the development profile previously developed with this indicator, we can observe that the highest levels of income inequalities are in Georgia, and that they have increased after the crisis from 1998 and the one from 2008. In general, we observe that crises and moments of severe economic contractions have the power to widen inequalities. In this case, shadow economy or corruption gets worse. In the next position, we may place Moldova with higher inequalities in 1998, but the index decreased permanently after 2009. The policies of the government oriented towards promoting equity and an inclusive society are not responsible for such a dynamic; it is the intensive migration from the past years that is responsible. For Armenia, we find a higher value of Gini index after 2004 and 2009, meaning that the conflict involving Nagorno-Karabakh, that remained dormant, and the crisis led to increased inequalities. From the entire group, Belarus and Ukraine seem to be the most egalitarian states, with modest dynamics on the whole analysed period.

4 Economic Openness of the Eastern Partnership Countries

The openness to international trade can be a source of both economic development and economic fragility. It depends on the specific context in which the country is becoming part of the global market. If the contribution of trade to the economic progress is already known, trade being a factor of endogenous growth models, we focus more on the opposite perspective, highlighting the manner in which the EaP countries are becoming more exposed to international shocks and external vulnerabilities, precisely because of their international trade flows. For instance, countries have mainly focused on exports because of their higher specialization in one sector and are becoming increasingly dependent on their trading partners. Moreover, export prices may also harm the economy, if we are referring to intense specialization. Azerbaijan is an illustrative example in this case, when the fall of oil prices from 2014–2015 determined significant output cuts. Another important factor of fragility is, in our perspective, the higher dependence on certain trading partners or the so-called geographic export concentration. For the EaP economies, the dependence on Russia is a source of great instability and risk. Also, the dependence of a country on strategic imports, in order to sustain industrial sector, energy sector and other main activities, is making it more vulnerable and, therefore, less resilient.

4.1 International Trade

The participation in international trade illustrates, on the one hand, a driver of economic development, especially when a country can sell outside its borders those categories of products that it possesses in exceeding quantities, in order to obtain other goods where it has no advantage as to produce it inside the country. On the other hand, too much openness to trade means vulnerability. When the economy has economic sectors highly dependent on imported raw materials, or sectors that depend mainly on exports, in these cases, any external imbalance or crisis will affect the economic output.

When the topic of the EaP countries is addressed, their trading partners emphasize important information about how vulnerable and dependent these economies are on their neighbours, who those neighbours are and which are the long-term prospects with respect to their capacity of improving internal vulnerabilities linked to trade. The economic dependency on exports and, mainly, imports, of goods and services from Russia and the Commonwealth of Independent States (CIS) area remained very high even after more than two decades of transition, as highlighted in Fig. 4.12.

As we can see, the most prominent countries at the world level in term of exports is Ukraine, a country that has a strong foothold in the global market. Even from the very beginning of the transition period, the country has followed an upward trend with exports of more than US$24,000. The only moments which decoupled Ukraine from its positive evolution were the crisis from 1998, with a lower impact of almost US$3,000 and those from 2008 and 2014, with wider declines of almost US$30,000 mil-

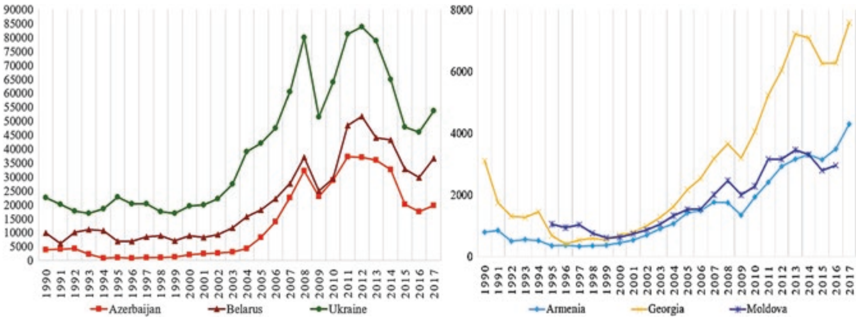

Fig. 4.12 The total exports of the EaP countries—millions of current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

lion for 2008 and around US$35,000 million in 2014. The graphic highlights a situation that is similar to the path of Ukraine for Belarus and Azerbaijan, but at a smaller scale. If, in Belarus, the higher shares of state-owned enterprises sustained the economic activity after 1991 and, thus exports, Azerbaijan was statistically helped by the international enterprises, which gained important contracts with the state in order to extract with their own technologies the existing natural resources. These companies extracted and also exported most of the resources. The same moments of crisis limited export levels of Azerbaijan, in the context of a decreased external demand.

Concerning the remaining three countries from the EaP block, Georgia tends to be more present on the international markets through exports of raw materials and agricultural products, while Armenia and Moldova have a rather modest position, exporting only few agricultural products. Their exports depended too much on Russia's demand. Thus, when Russia started to apply trade restrictions on imports from Georgia and on agricultural products in 2005, or when it totally banned imports of wine and vegetables from Moldova, in 2014, the generated results harnessed the economies of both countries.

Regarding the situation of imports (Fig. 4.13), the path followed by the six countries from the Eastern partnership is rather similar to the one of exports, meaning that Ukraine remains the main trading partner from the entire area, with the highest values of goods and services imported,

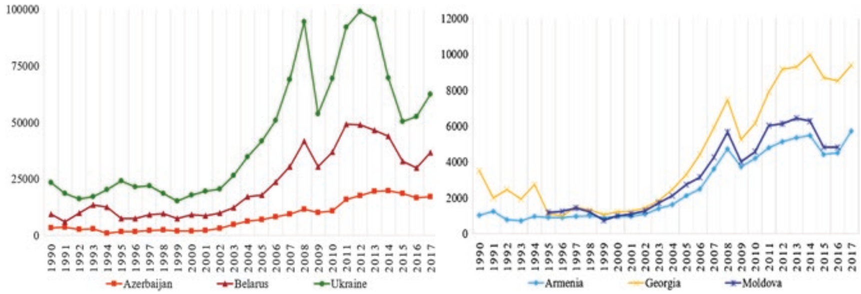

Fig. 4.13 The total imports of the EaP countries—millions of current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

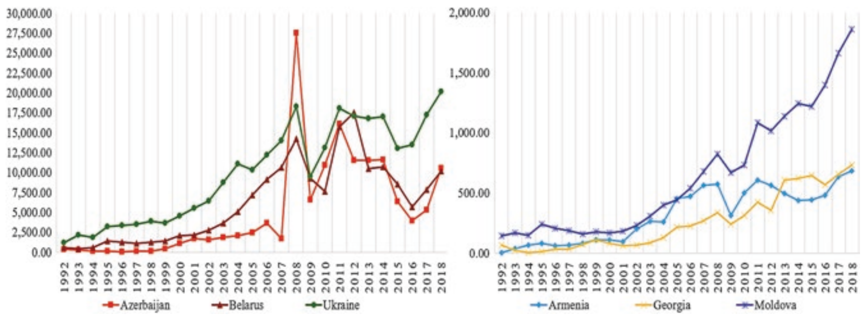

Fig. 4.14 The exports of the EaP countries to the European Union—millions of current US Dollars (1992–2018) (Source: Own computation after International Monetary Fund (2019a). *Direction of Trade Statistics*)

followed by Belarus and Azerbaijan, but with lower level of imports for Azerbaijan. Being a country rich in natural resources, its dependency on external markets is reduced, an aspect that makes the country less vulnerable in moments of crisis. Georgia, Armenia and Moldova keep the same trend in developing countries, less visible in international trade arena, but with higher imports than their export levels, pointing out severe fragility of their economies from the trade openness viewpoint (Fig. 4.14).

The destination of traded goods and services matters mainly as all the six economies have joined the Eastern Partnership. As we can see, Ukraine is the main trading partner for the EU, with a harsh decline in terms of value of exported goods and services after the 2008 and 2014 crises. Belarus and Azerbaijan remain the other two important partners for the EU in terms of exports. In 2007, Azerbaijan exported significant quantity of mineral fuels to the EU, contributing thus to an increase of exported value of almost $US27,500 million (International Monetary Fund 2019a). The moments of crisis also affected both economies' exports, while the decrease from 2015–2016 can be explained in the light of effects generated by the crisis from Ukraine on their economies. As usual, Moldova, Armenia and Georgia have modest contributions in terms of exported goods, Moldova being appreciated on the EU market for its exports of vegetables, fruits and, mainly, wines.

Despite the differentiated amplitude of the exports oriented towards the single European market, undoubtedly, the membership to the EaP had a significant contribution in terms of reorienting the trade flows to the benefit of positive economic results and, furthermore, of a higher capacity to cushion fragilities and risks from external area by being present on multiple markets.

Concerning the trade flows oriented towards the old economic partners inherited from the times of the USSR block, we can observe that in a very short period of time, the EU captured significant flows attained in the past by the CIS countries and Russia, especially, as pointed out in Fig. 4.15.

As we can see from the graphic, the situation is very similar, Russia being the most significant partner from the entire CIS partner countries. Belarus and Ukraine are the most active countries in terms of exports with almost the same evolution of the trade flows. As can be observed, Russia's crisis affected all the EaP economies, but the case of Ukraine and Belarus was more visible, suffering a reduction of exports oriented towards CIS and Russia of approximately 50%. The 2008 crisis and the one from Ukraine affected the trade flows for both exporting countries. Ukraine was more severely harmed than Belarus, given its stronger connection with the world economy. Azerbaijan has modest exports oriented towards CIS economies, and also to Russia. In 2011, it reached the highest value of exports of almost US$3500 million (International Monetary Fund 2019a). Russia is not such an important trading partner for Azerbaijan because the country has its own resources and does not depend on gas or

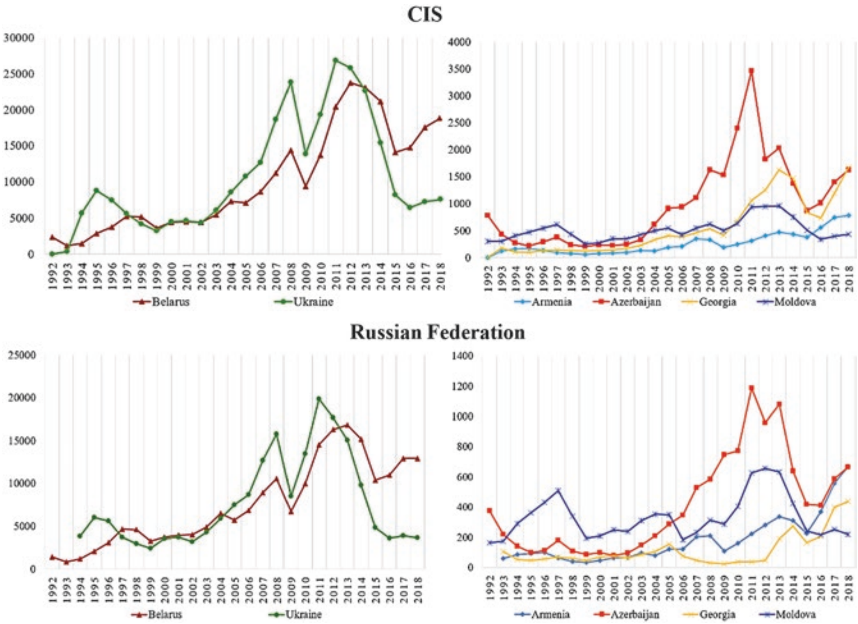

Fig. 4.15 The exports of the EaP countries to the CIS countries and Russian Federation—millions of current US Dollars (1992–2018) (Source: Own computation after World Bank (2019a). *World Integrated Trade Solutions*)

oil imports from Russia. As usual, the situation for Armenia, Georgia and Moldova remains the same—poor and highlighting a higher dependency on Russia's imports of raw material and agricultural products.

Perceiving things in terms of imports, Fig. 4.16 provides us a general picture with respect to their evolution after the independence of each country, until present.

As expected, Ukraine and Belarus remained the most active countries from the entire group also in terms of the value of imported goods and services from the EU market. Ukraine shows once more that it is strongly connected to the world economy, having a positive trend on imported goods until 2007, when their level reached almost US$30,000 million. After the crisis, the imports contracted with almost 50% to US$15,000 million. The crisis from 2014 determined a decrease of imports with UD$10,000 million (International Monetary Fund 2019a). For Belarus,

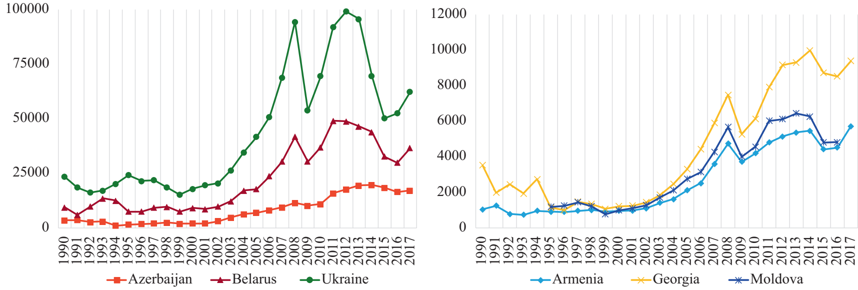

Fig. 4.16 The imports of the EaP countries from the European Union—millions of current US Dollars (1992–2018) (Source: own computation after International Monetary Fund (2019a). *Direction of Trade Statistics*)

the trend was rather similar but with a lower amplitude because the political regime of the country was not encouraging trade openness. Even so, the effects of both crises were felt, imports being cut with US$2500 million in 2009 and more than US$5000 million in 2015. In the next positions, we have Azerbaijan, Georgia and Moldova, Armenia having a weaker foothold in the international trade area. Here, the moments of shock did not badly affect the value of imports because their level was already low—less than US$3000 million. When changing trade partners, we can observe a more active Belarus, as pointed out in Fig. 4.17.

As in the case of exports, we can notice two similarities. Firstly, Ukraine and Belarus remained the most important partners for both CIS and Russia in terms of imported goods and services. Secondly, the trend of imports for all countries, but mainly for the most dependent ones, is rather similar, when imports from CIS countries are compared with those from Russia, an aspect that highlights once more the massive influence of Russia on the economies from the Eastern Partnership block. The influence is even higher than that of the EU, given the higher imports from the Russian Federation during the entire time span. The same moments of crisis from 1998, 2008 and 2014 had detached imports from their growth path for Ukraine and Belarus, while the evolution of imports in the rest of economies shows that Azerbaijan is more dependent on imports of the CIS community than on those of Russia, but Georgia and Moldova remain linked with Russian imports.

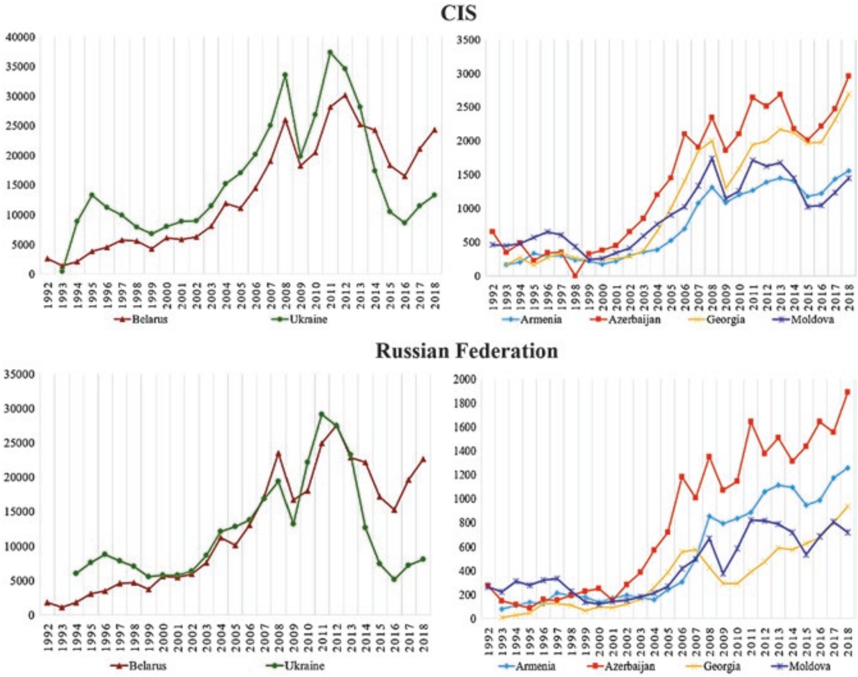

Fig. 4.17 The imports of the EaP countries from the CIS countries and the Russian Federation—millions of current US Dollars (1992–2018) (Source: Own computation after International Monetary Fund (2019a). *Direction of Trade Statistics*)

4.2 Foreign Direct Investments

FDIs illustrate another determinant of growth and development for the host country, given their main contribution in terms of increasing capital resources, know-how, the creation of new working places or the expansion of internal production with direct impact on the trade balance improvement. Furthermore, they also provide additional money for the public administration by tax payments and help the development of the local human capital through training and education and so on. Considering the situation of the EaP countries, we are expecting to discover that countries abundant in resources were perceived as the most attractive for foreign investors, but without neglecting their internal fragilities, political risks or conflict that may determine investors to stay apart. In Fig. 4.18, we can find the evolution of FDI inflows.

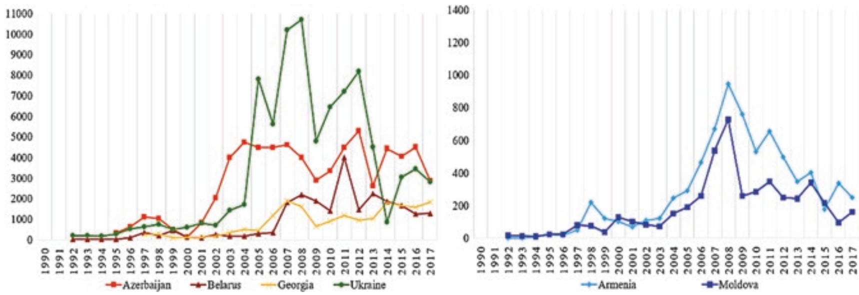

Fig. 4.18 FDI net inflows (BoP)—millions of current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

As data from the graphic points out, at the initiation of the transition process, the inflows were rather modest, but after 1995 and until 2000, Azerbaijan was the most attractive country for foreign investors, especially because of its large reserves of oil and gas, and it was followed by countries like Armenia, Georgia and Moldova, where investments remained modest (United Nations Conference on Trade and Development 2010). Belarus, because of its limited openness towards market economy, and Ukraine, a country dominated by higher uncertainty, made investors to be reluctant when deciding their further capital placements. Obviously, the crisis from 1998 affected the inflows of FDI attracted by Azerbaijan because that was the moment when oil prices fell significantly, and main investments were directed to that particular sector. But after Russia's crisis and until the next global crisis from 2008, the attracted FDI began to rise again, Azerbaijan and Ukraine being targeted by investors from abroad. The Ukrainian political crisis from 2006 affected investment flows severely, with a significant decline of almost US$2000 million. After this moment, the global crisis and the Ukrainian crisis from 2014 have also generated major losses, but even so, Ukraine remained attractive in the eyes of foreign investors, given the short recoveries for attracting new money.

Azerbaijan, Belarus and Georgia have also benefitted from flows of FDI, Russia being the main investor, especially for Belarus and Georgia, while countries like Armenia and Moldova had benefitted from limited inflows of FDI, lower than US$600, the 2008 and 2014 crises affecting them also from this perspective. Considering the opposite perspective of

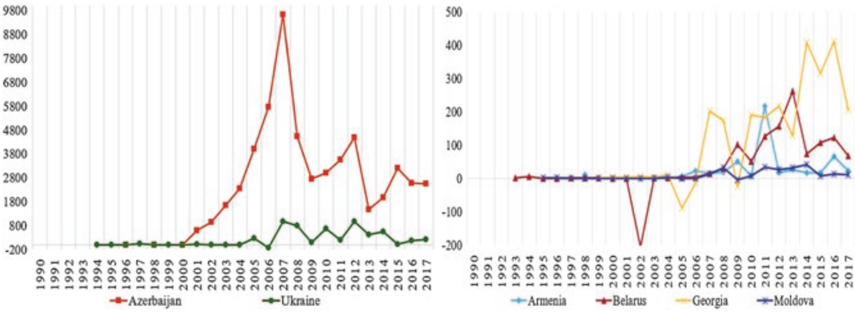

Fig. 4.19 FDI net outflows (BoP)—millions of current US Dollars (1990–2017) (Source: Own computation after World Bank Database (2019). *World Development Indicators database*)

investing abroad, Fig. 4.19 highlights a totally different situation, as pointed out later. Direct investments represent cross-border investments associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Ownership of 10% or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship. This series shows net outflows of investment from the reporting economy to the rest of the world (World Bank Database 2019).

Azerbaijan remains the privileged economy, with significant investment outflows of US$9800 in 2007 and US$2800 million after the crisis, in 2009. Even the Ukrainian crisis was not able to limit its investing capacity abroad. Ukraine, on the contrary, is a modest investor in the EaP area, but the political crisis from 2006, the global crisis from 2008 as well as internal crisis from 2014 retracted the country from this position. Considering the rest of the EaP countries, their condition as donors of foreign investments remains very limited, mainly because of their low economic development. Belarus and Georgia have experienced negative FDI outflows in 2002 and 2005, respectively, on the basis of their internal economic fragilities and limited results in terms of transition performances.

Taking into consideration all the existing fragilities and macroeconomic disorders that hardly could be set under control by their governments, the repetitive internal crises affecting local currencies, boosting trade deficits and empowering unemployment, together with higher levels of institutional fragility that lack predictability and security in the area, the capacity of these countries to attract foreign investors that can benefit their capital and expertise in order to further expand their economic potential remains unsatisfactory.

5 Conclusion and Recommendations

When addressing the economic dynamics of the countries belonging to the Eastern Partnership of the European Union, and mainly their capacity to contribute to the process of strengthening resilience in the area, we can observe that several aspects deserve our attention. All these countries which belonged to the USSR in the past inherited and prolonged the old Soviet values and mentality, in their own version, after the implosion of the Soviet Block. Consequently, their willingness to transform the social, political and economic areas varies from one country to another. Azerbaijan and Belarus illustrate two examples of countries which managed to create a certain prosperity, following two different transition paths and methods in order to stabilize their macroeconomic area, the former being more interested to promote a more market-oriented approach, while the latter preserved the massive intervention of the government in the economy and the activity of the state-owned enterprises.

The evolution within more than two decades of social, economic and political transformations embraced the national path and was different for some countries. Their capacity to transform the endowment with natural resources into a strength as to employ productive activities and to better cushion the external shocks remained limited.

From an overall perspective, some important fragilities must be pointed out. The most important vulnerability that must be addressed is the *weak market institutions and the poor governance* in order to improve the effectiveness of implemented policies, as well as the trust of both: its own citizens in the economy and the trust of foreign investors or partners (North 2010); Georgia, for example, made significant progress in this respect and managed to support the investment climate. Belarus illustrates a challenge from this point of view, while Ukraine, Moldova and Armenia need more effective results and less political fragility in order to become more resilient.

Another vulnerability that needs to be addressed is the *poor privatization initiatives in some countries* like Belarus, Moldova and Armenia, which sets boundaries for economic development, limiting thus the access of foreign investors to these countries. *Limited transparency in terms of business regulation* decreases predictability of the economic environment for the case of all six economies. On the same wavelength with the previous idea, there is the problem of *insufficient development of the private sector*, as well as *limited reinforcement of the existing private owners* in the local economies. This could be done by taking advantage of the assistance and financial aid provided by the EU through the channels of European Neighbourhood Instrument (ENI) because countries have limited possibilities to solve these issues on their own, by not having a tradition in this respect.

Despite the endowment with natural resources like oil, gas, coal and forests in the case of some economies like Ukraine, Belarus and Azerbaijan, there is a *higher dependency on energy provided by Russia* (oil and gas). Azerbaijan is the only economy, which has gained a sort of independence in front of Russia because of its natural endowment with resources, but the rest of the EaP nations, despite their own reserves are still depending too much on Russia. Consequently, such dependence was already pointed out during our analysis on many internal conflicts with secessionist regions supported by Russia; the threat of stopping gas delivery for Ukraine, Georgia or Moldova; and significant political disequilibrium supported also by Russia, in order to destabilize the European trajectory of these countries, in the case of Ukraine it was the use of force and armed conflicts. Furthermore, such dependence means higher uncertainty, especially if we take into consideration the bans of Russian imports from Moldova, Armenia and Georgia based on artificially created reasons. All these aspects raise the awareness with respect to an enormous vulnerability of those economies in front of any manoeuvre made by Russia. Basically, their capacity to resist such shocks is almost zero. From this point of view, the European Neighbourhood Policy (ENP) specifies precise directions in terms of increasing energy efficiency on the basis of using own renewable energy sources to limit higher expenditures from this area and also in terms of expanding local economies to support the consumption on the basis of internal production.

Another vulnerability that diminishes resilience of the EaP economies is reflected by the *higher dependence on imports and limited attention paid to the expansion of local production*, especially of those industries or activities with a high potential of sustainable economic growth. Most of these countries remained attached to the agricultural and industrial sectors, but no serious investments were made in order to endow them with new technologies, as to raise their productivity. As we have already pointed out in the cases of Ukraine and Azerbaijan, countries rich in resources depend on the extraction activity of foreign companies, becoming more fragile in front of their opportunism and hidden intentions of depleting resources, while gaining profits. Here, the so-called resource curse may happen and corruption, bureaucracy and the monopolistic positions of those foreign large companies may severely harm not only the industrial sector but also the economy on the long run, by cancelling the attention paid by the governments to education and the quality of human capital, to the development of the other sectors, like agriculture or manufacturing. The effects can be perverse and damaging.

The lack of investments (public or private ones) oriented towards modernizing the existing industries and agriculture. The exports of the EaP countries are mainly based on raw materials or low added-value products, consequently, *their permanent trade deficits* can be justified in terms of *poor competitiveness and limited economic diversification*. If we aren't referring to the case of countries endowed with resources, but on the contrary, to those like Armenia, Moldova or Georgia, here, the "resource curse" cannot be invoked in order to explain the situation. The measures undertaken by the governments of these countries should be focused less on expanding the services sector, and more on expanding the economic activity in agriculture and industry, while also paying attention to labour productivity from these areas. Therefore, investing in technologies and better preparation of human capital are ways to improve the situation.

Because we have reached the labour market issue of limited productivity in some sectors, another important idea must be brought into light: the problem of migration and the *increased importance of remittances*, for most of those economies (Armenia, Georgia, Moldova), while neglecting economic diversification as to be able to retain the young labour force inside the country. Being so strongly dependent on the money gained outside the borders of the country, the economies of these countries are faced with higher risks associated to any external imbalance that may occur in the countries which adopted their citizens. On the one hand, the native country loses in the long term; the phenomenon of ageing population is already a problem for most of the EaP countries. Those who decided to leave the country for a better life are, in general, trained and educated people; consequently, the remaining human capital is not able to support further development. Additionally, a new fragility arises, one that depends on money sent from abroad. The capacity of those economies to resist shock is extremely limited; they are too fragile, so this vulnerability definitely needed to be addressed by the government policies in order to strengthen the labour market, to make it more solid and more attractive for its own citizens.

The *higher dependence of some economies of only one economic sector*, such as oil, for the case of Azerbaijan, or agriculture, for Moldova is a sign of fragility. If exports are strictly dependent on only one category of goods, in case of a crisis, for example the one from 1998 when the price of oil declined sharply, the entire economy will suffer. Therefore, diversification is needed and required in order to reach economic stability. Another source of fragility is, in our viewpoint, *the lack of public investments in education, health and infrastructure*. The lower levels of attracted FDI can also be explained in light of these prominent problems that define EaP countries. Limited attention paid to health and education illustrate a main determinant of the brain drain phenomenon, specific for most of the cases, with the exception of Belarus. According to the human development indices, all the six economies must pay more attention to education and health of its citizens in order to address the existing limitations in this respect.

Changing the register and focusing more on the economic perspective, some serious concerns and economic fragilities can also be pointed out. From this perspective, the EaP countries should consolidate their internal reserves when promoting tight macroeconomic policies. As pointed out in the subchapter where the country ratings were approached, according to Moody's Investors, all the EaP economies were placed in the red zone with higher vulnerability and uncertainty associated. *Severe macroeconomic disorder meaning easiness in taking credits, large government expenditures oriented towards boosting consumption and not for investments that* have the role to boost internal demand and to generate inflationary pressure, contributing thus to the decrease of the associated ratings. In order to promote more stable and sustainable sound macroeconomic policies, the governments should renounce at the practice of devaluating their own currencies in order to gain competitiveness for exports.

In general terms, we conclude that the countries from the Eastern European Partnership present a lot of internal, as well as regional fragilities, but their ability to redress all the existing issues remains limited. On such a basis, the membership to the EaP is the only way to further evolve on the path of stability, growth and prosperity by detaching themselves as much as possible on the harming influence and dependence on Russia, in all its multiple hypostases: energy supplier, consumer country that buys goods and services, investor in their economies and so on. As we have already pointed out, since the partnership was launched, the EU started to gain a more pronounced role in the area becoming a significant partner in terms of trade and investments.

From our perspective, the process of strengthening resilience at the country and regional level is not impossible to achieve but must be focused mainly on promoting and expanding even more those sectors where there is an advantage in terms of resources endowment. Additionally, there must be a higher attention paid to democracy, rule of law and anti-corruption) reforms (North 2010). Perceiving things from the perspective provided by the Eastern Partnership Index from 2017, Ukraine took important steps in terms of democracy and EU integration and convergence, but there is much to be done in terms of sustainable development (EaP 2017). Concerning Moldova, here the vulnerabilities are higher on multiple levels, meaning a decrease in terms of deep and sustainable democracy because of presidential elections and problems with sustainable development as well as with international security, political dialogue and co-operation. For this country, EU must strengthen the conditions to provide financial assistance in accordance with its effective results. The case of Georgia is much worse, having fragilities and issues with democracy, sustainable development, EU integration and also co-operation and political dialogue. Georgia must focus first on improving its judicial system and eradicating corruption. For Armenia, there are problems with sustainable development and EU integration, lacking also the sectoral co-operation and trade flows—this latter problem and higher corruption being also specific to Azerbaijan. As expected, Belarus, should pay more attention, first, to building a sustainable democracy and afterwards to enhancing a more stable political dialogue and co-operation with the EU if it wants to fully benefit from the membership to the EaP. Countries need time and assistance to correct their most important vulnerabilities, but their will and efforts will dictate the rhythm and pace of the changing process and their capacity to better respond, individually, as well as from a concerted perspective, to any external imbalances.

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