SITE STOCKHOLM INSTITUTE OF
TRANSITION ECONOMICS

# EU's Eastern Partnerships—The real deal[1]

*By Torbjörn Becker, Director of SITE*

*Much of the current discussion of pros and cons of Eastern partnership countries signing DCFTAs with the EU versus joining the Russian-dominated customs union focuses on the wrong numbers. Instead of the excessive focus on short-run costs and benefits from trade and energy deals, the real issue is if people in Eastern partnership countries want to live in modern, democratic and transparent countries or in less open societies where most of the benefits accrue to ruling elites. These different social models are correlated with significant differences in a long list of indicators that are related to the well-being and happiness of people far beyond the billon dollar wheeling and dealing some politicians seem to think the choice between the EU or a Russia-led customs union is about.*

## What matters to regular people (rather than ruling elites)?

In short, what matters to regular people is welfare and happiness; a sense of having a chance to live a decent life and see their children thrive and have opportunities to realize their dreams. If citizens in Eastern Partnership countries (EaP) share this vision of welfare with people around the world, should they strive to become more like their neighbors in the EU or look to Russia and other CIS countries for inspiration? Basically, what is the "role model" they want to base their countries' development strategy on and guide their reform efforts? In this paper, a wide range of indicators are presented that suggest that the EU is a very appealing role model for nations that strive for higher welfare and happiness for its citizens.

The discussion that follows will be organized around a number of charts that compare indicators for four country aggregates and one individual country. The country aggregates in the order they appear in the charts are as follows: *CIS6* consisting of Russia, Kazakhstan, the Kyrgyz republic, Uzbekistan, Tajikistan and Turkmenistan; *CU4* comprising Russia, Kazakhstan, Belarus and Armenia; *EaP* with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine; and *EU10* consisting of Bulgaria, the Czech republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and the Slovak republic. These groups are created to make the data easier to present, but the individual country data is also available in the Annex. A short motivation of the country groups are as follows; the EaP

group is simply the countries that are part of the EU's Eastern partnership program; the CIS6 are the CIS countries that are not EaP countries; the CU4 are the current members of the Customs union plus Armenia that has declared that it will join; and the EU10 include the "new" EU members states in central and eastern Europe and the Baltics. Note that Russia and Kazakhstan appear in both CIS6 and CU4 while Belarus and Armenia are included in both the CU4 and the EaP groups. In addition, data for Sweden is included as a reference point as one of the high-income countries in the EU that ranks well along the dimensions that will be discussed below. Again, for the reader that does not think these are the relevant groups for this type of comparison, individual countries are presented in the Annex.

Economists often look at measures of income as a proxy for individual welfare and happiness, which when comparing countries often amounts to PPP adjusted GDP per capita.[2] The UN expands this one-dimensional measure by adding life expectancy and educational attainment to construct the Human Development Index (HDI). These measures are of course not perfect gauges of the success of societies but in the absence of a perfect measure, they are still widely used to compare basic living conditions in different countries. Comparing these measures for the different country groups provides a strong argument for EaP countries to look at the EU as a role model. On average, the EU10 group had an income level of over 20,000 US dollars PPP per capita in 2012. This was far ahead of both the CIS6 and CU4 groups that had less than half and around two thirds of this income per capita respectively. Sweden had almost twice the level of income of the EU10 so also within the EU, there is plenty of scope for income convergence. The HDI closes some of the gap between the EU10 and the other country groups but the qualitative results remain. The EU10 (and Sweden even more so) is far ahead of the CIS6 and CU4 in terms of basic measures of income and living conditions for their average citizen.

**Figure 1. Income and Human development index**
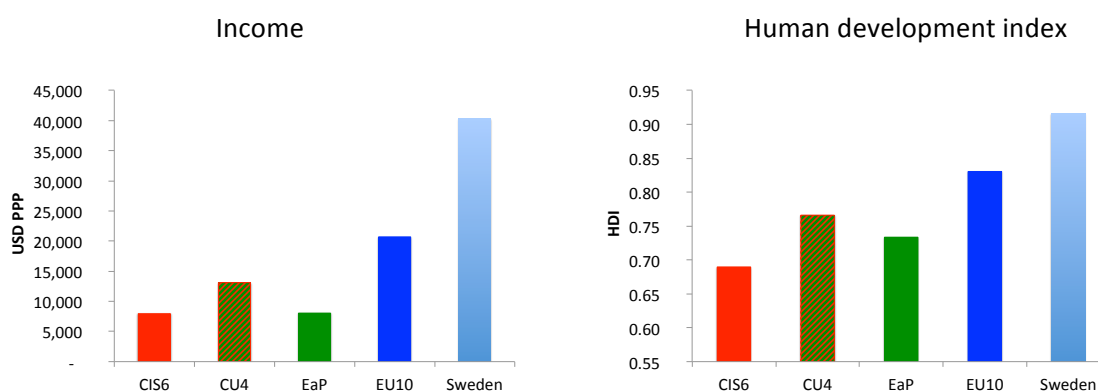


Note: Author's calculations based on IMF (2013) and UNDP (2013). Income is GDP per capita in USD PPP for 2012.

---

[2] In order to make international comparisons, the local currency measures of GDP are converted into purchasing power parity (PPP) adjusted US dollars GDP, which in short increases GDP for countries with relatively low domestic price levels relative to international prices at market exchange rates.

One concern with economic development and increasing income levels is that it may be unevenly distributed among households. If income inequality increase with higher incomes it could mean that poor households do not enjoy rising incomes when GDP per capita increases. This general concern does not appear in a static comparison of GDP levels and income inequality in the sample of countries that we look at here. Instead there is a strong negative correlation between income levels (again measured as GDP per capita) and inequality (measured as the Gini coefficient). The EU10 countries have a more even income distribution at higher income levels compared with both the CIS6 and EaP groups of countries. Sweden has the lowest Gini coefficient of the countries in this sample, but is still relatively close to a linear trend based on the EU10 countries. In other words, the income distribution in Sweden is what could be expected at this income level for a country in the EU10 group. Russia and Azerbaijan, two energy-rich countries, are on the other hand more unequal than what would be predicted from their income levels using the same trend line. Overall, this shows that EU10 countries (or Sweden) that are relatively rich are not more unequal than CIS6 (or CU4) countries. Instead, there may be scope for the less rich EaP countries to also improve their income distributions as they move their incomes closer to EU10 countries.

**Figure 2. Income distribution relative to income levels**
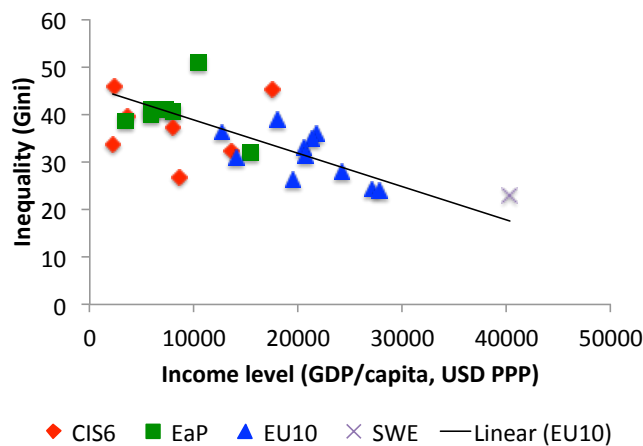


Note: Author's calculation based on IMF (2013) and UNU-WIDER (2013) data on Gini coefficients to measure income inequality, which for most countries are for 2006. A lower Gini coefficient means a more equal income distribution.

The HDI presented above include life expectancy as part of the index. The prospect of living a healthy life is also a strong predictor of happiness according to Helliwell, Layard, and Sachs (2013) *World Happiness Report*. There are more health indicators than life expectancy that matter to people, and one such indicator is child mortality. Reducing child mortality is also one of the UN's Millennium Development Goals. Again the EU10 is far ahead of the other country groups in terms of these health indicators. The average new-born citizen in the EU10 group of countries can expect to live to see his or hers 75th birthday which is five more birthdays than in the CU4 group and 7 more than in the average CIS6 country. Swedes live even longer and on average reach the age of 82 years. Parents in the EU10 also face a significantly smaller risk of losing a child before its fifth birthday than in the

other country groups. With a child mortality of 7.4 per 1,000 live births, the EU10 is far ahead of the other country groups that face a child mortality rate in the range of 19 to almost 35. Sweden's child mortality of 2.7 again shows that there is room for improvement also in the EU10. Nevertheless, the EU10 looks like an attractive benchmark for countries in the region that look to improve the health of its citizens.

**Figure 3. Health indicators**
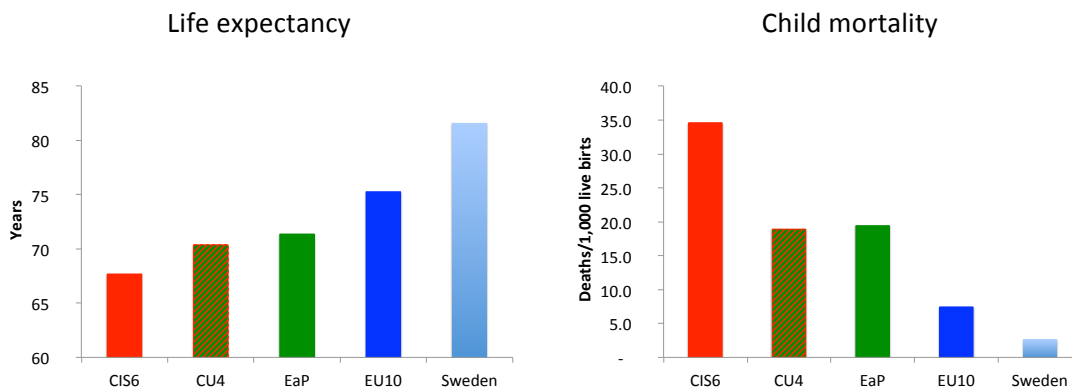


Note: Author's calculation based on life expectancy at birth from UNDP (2013) and child mortality (under 5 deaths per 1,000 live births) from IHME (2010).

The *World Happiness Report* also points out that the freedom to make life choices make people happier. Freedom House, the independent watchdog, has measured freedom along a number of dimensions for more than 40 years. Two of the indicators are political rights and freedom of the press. Political rights are ranked from 1 to 7 and comprise sub-categories that look at the electoral process, political pluralism, and the functioning of government. The scores 1 and 2 indicate that the system is free, 3-5 that it is partly free, while 6 and 7 corresponds to a political system that is not free. For the CIS6 and CU4 groups the rating is around 6, indicating countries that are not free, while for the EU10 (and Sweden), the rating is close to 1, which means that the citizens of these countries enjoy high levels of political rights in free societies.

Freedom of the press is also an important building bloc in open and modern societies that contributes, among other things, to peoples' ability to make sound life choices and to accountability and transparency in the political process. Freedom house's scores go from 0 to 100, where 0-30 is judged to be free, 31-60 partly free and 61-100 not free. The EU10 group average is just below 30, which is some ways behind Sweden's score of 10 (the lowest by any country in the world in the 2013 rating), but far ahead of scores of around 80 for both the CIS6 and the CU4.

In short, the EU10 countries have come a long way in terms of political rights and freedom of press. If the aim of EaP countries is to build modern, open societies where people can influence the direction

of the country and their own lives, it makes a lot of sense to look at their EU neighbors for inspiration.

**Figure 4. Freedom indicators**

Political rights
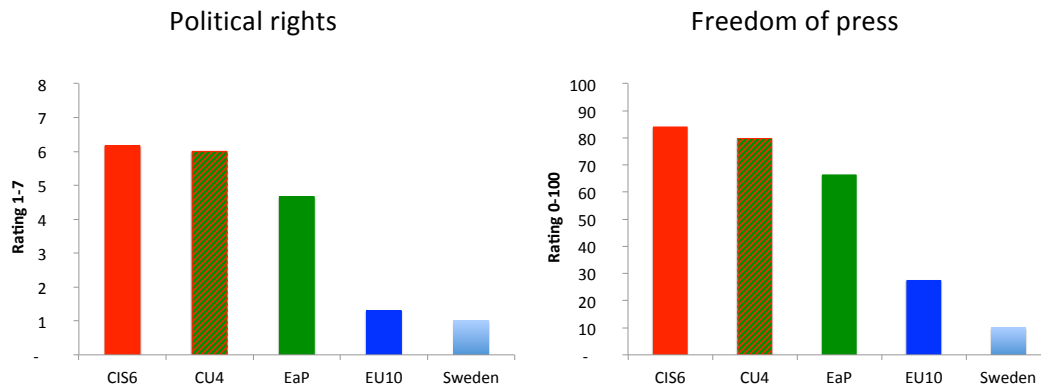
Freedom of press



Note: Author's calculations based on data from Freedom House (2013) and (2014). Lower ratings mean more political liberties and freedom of press.

Life choices and happiness are also linked to the rule of law and corruption. There are again several ways to measure these important concepts. In the following charts, the numbers come from the World Governance Indicators dataset (WGI, 2013)[3], where indicators go from -2.5 to +2.5 and higher numbers are better for all that prefer rule of law, control of corruption[4], efficient governments and high regulatory quality. There are no perfect countries in the world in the sense of scoring 2.5 on these indicators, but Sweden is rather high on all of these dimensions with scores around 2. The EU10 group is above the zero mark but not much more when it comes to control of corruption. This is obviously not entirely satisfactory but still far ahead of the CIS6 or CU4 groups of countries that score in the range of -1 to -0.5 on rule of law, corruption, government efficiency and regulatory quality. When it comes to regulatory quality, the EU10 countries score around 1 and somewhat higher than it does for the other indicators. This is likely a consequence of becoming and being part of the EU, which has a common set of rules and regulations covering a wide range of important regulatory areas for its member states.

---

[3] For a summary of the methodology WGI is based on, see Kaufmann, Kraay and Mastruzzi (2010).
[4] Control of corruption that is shown here and the more widely cited Corruption Perception Index produced by Transparency International are strongly correlated (r=0.99) for this sample of countries.

**Figure 5. Rule of law and corruption**

Rule of law                              Control of corruption
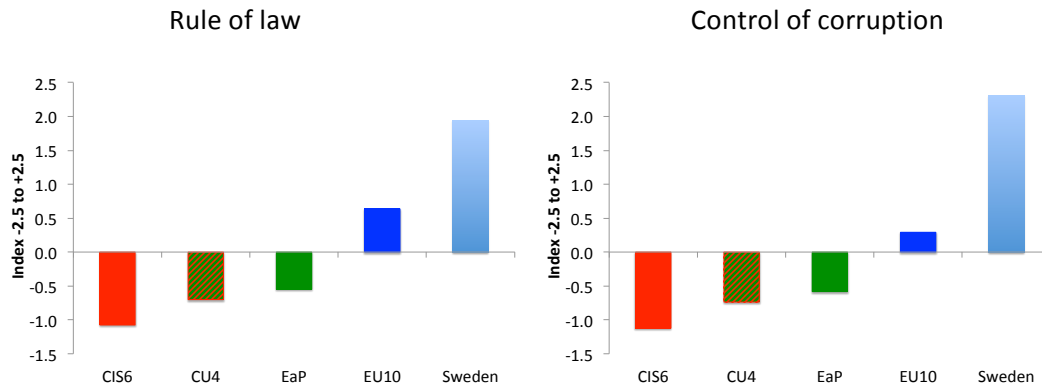


Note: Author's calculation based on WGI (2013). Higher index means more rule of law and control of corruption.

**Figure 6. Quality of government and regulations**

Government efficiency                    Regulatory quality
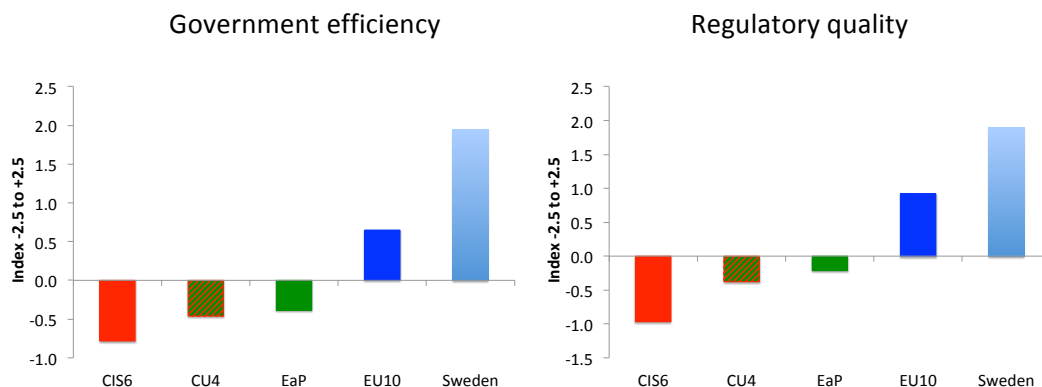


Note: Author's calculation based on WGI (2013). Higher index means higher government efficiency and regulatory quality.

The previous indicators are not only linked to the happiness of citizens and their sense of being protected by the state (rather than being exploited by a ruling elite) they are also connected to the attractiveness of starting and running companies in a country. This is, however, affected by a wider range of issues and the World Bank's "Doing Business" ranking includes a rich set of indicators to describe a country's business environment. The ranking looks at ten broad dimensions of running a business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing

contracts, and resolving insolvency. The subtopics are consolidated to country rankings of the business climate, or "Ease of doing business" as it is called now (it used to be called "*Cost* of doing business" but it may have sounded a bit negative). With 189 countries in the sample, the worst ranking is 189 and the best is 1. In terms of the overall ranking, the average EU10 country is ranked 55 places better that the average CIS6 country; going from 45th in the world to 100th. Countries in the CU4 group fare somewhat better and have an average overall ranking of 61. This is still well behind the EU10, but a bit less striking. What is very striking though is the abysmal performance on the sub-index "trading across borders"; the CIS6 has an average ranking of 180 out of 189 countries! The CU4 is only marginally better at 154. On average. And this is the group that tries to convince other countries to join a customs union to facilitate trade. The EU10 countries have an average ranking that is almost a hundred places better than the CU4. Sweden ranks 6th in this category. If Eastern partnership countries are looking for role models when it comes to developing the business sector and increase international trade, the better way to turn is certainly towards the EU.

**Figure 7. Doing business and trade**
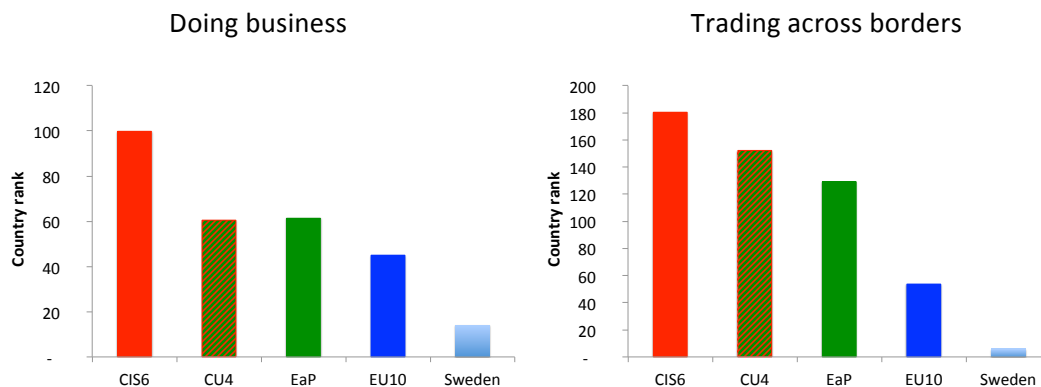


Note: Author's calculation based on World Bank (2014). Numbers refer to country rankings were lower is better in a sample of 189 countries.

# But are there not high costs associated with signing a free trade agreement with the EU?

There have been substantial discussions on the costs and benefits of having a free trade agreement with the EU. In short, free trade with a large economic space like the EU is likely to generate significant increases in trade and income for the countries that sign free trade agreements with the EU. The exact gains depend on many factors and importantly the current economic and trade structure of the countries that enter into a free trade agreement. In terms of putting numbers on the gains from free trade with the EU, estimates for Eastern Partnership countries suggest that incomes

will increase on average by 2-5 percent. More discussion of the estimated impacts of free trade agreements with the EU can be found in Becker (2013).

Since these increases are permanent, cumulating all future income that comes from such an increase amounts to very significant numbers. However, the transition to a stage where the benefits are fully realized may cover several years and some sectors or businesses will potentially lose out in this process. This implies that there may be a need to bridge funding gaps when going from today's economic structures to the ones that have realized the benefits from increased trade. Furthermore, some of the economic transformation could also have distributional consequences. However, this is generally not a problem from an economic point of view when the welfare of all of society is included in the analysis, since the long-run gains are permanent while transition costs diminish over time, and more open markets tend to benefit large segments of the population at the expense of inefficient businesses. There may of course be situations where it is motivated to compensate parties that experience losses in the transition phase to create wider political acceptance for reforms that in the long run are beneficial to society as a whole.

In sum, free trade agreements are good. Free trade agreements with good trade partners are even better. Free trade agreements that also help modernize institutions and societies to the benefit of all citizens are the best. This is what the EU's DCFTAs offer ordinary people in the Eastern Partnership countries.

# Annex. Figures with individual countries that make up aggregates presented in main text

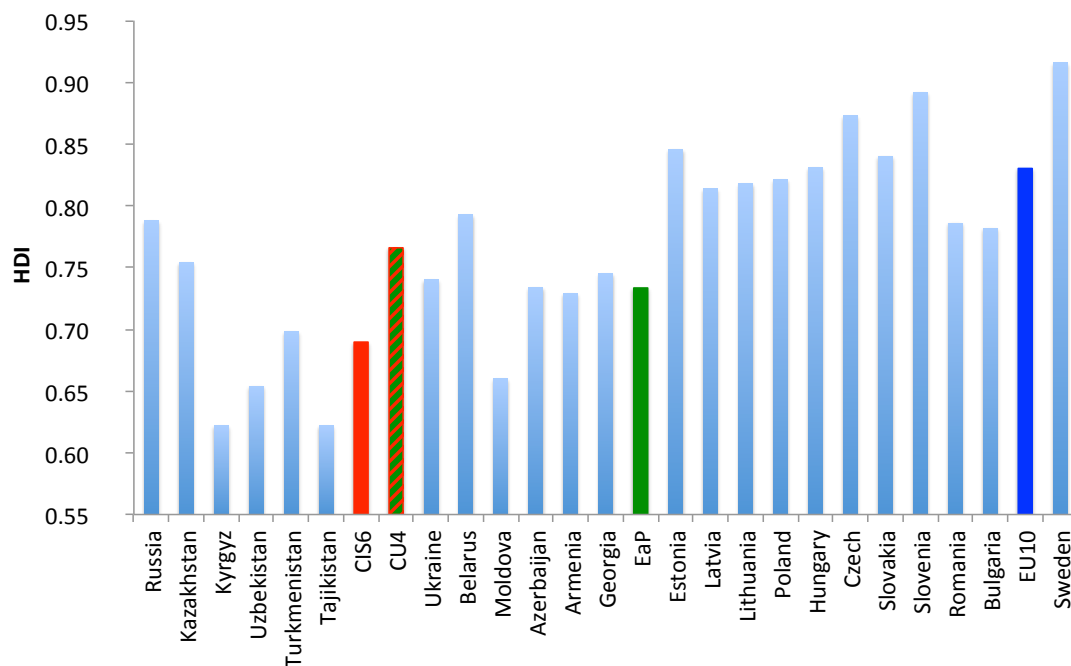**Figure A1. GDP per capita (PPP adjusted USD, 2012)**
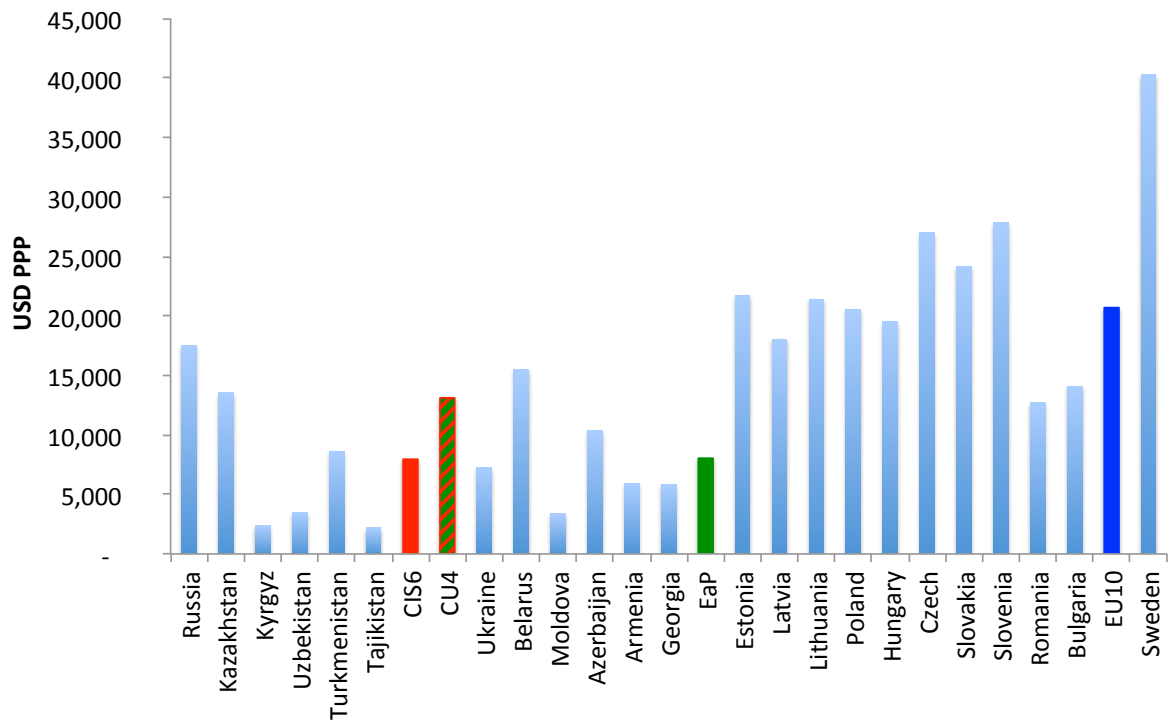


Source: Author's calculation based on IMF (2013).
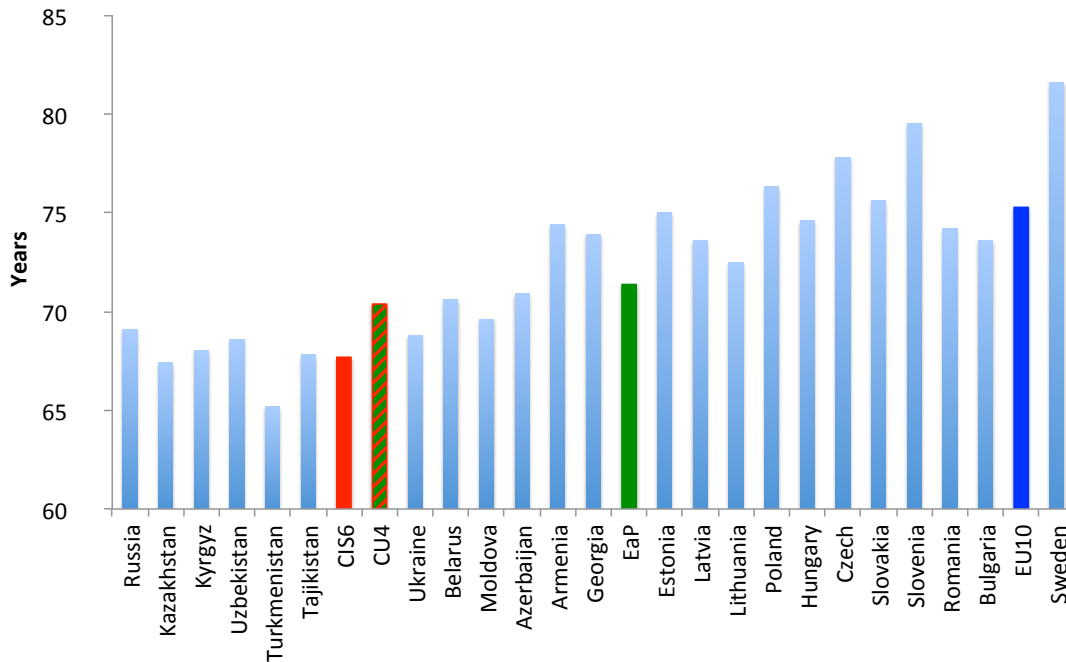
**Figure A2. Income distribution**
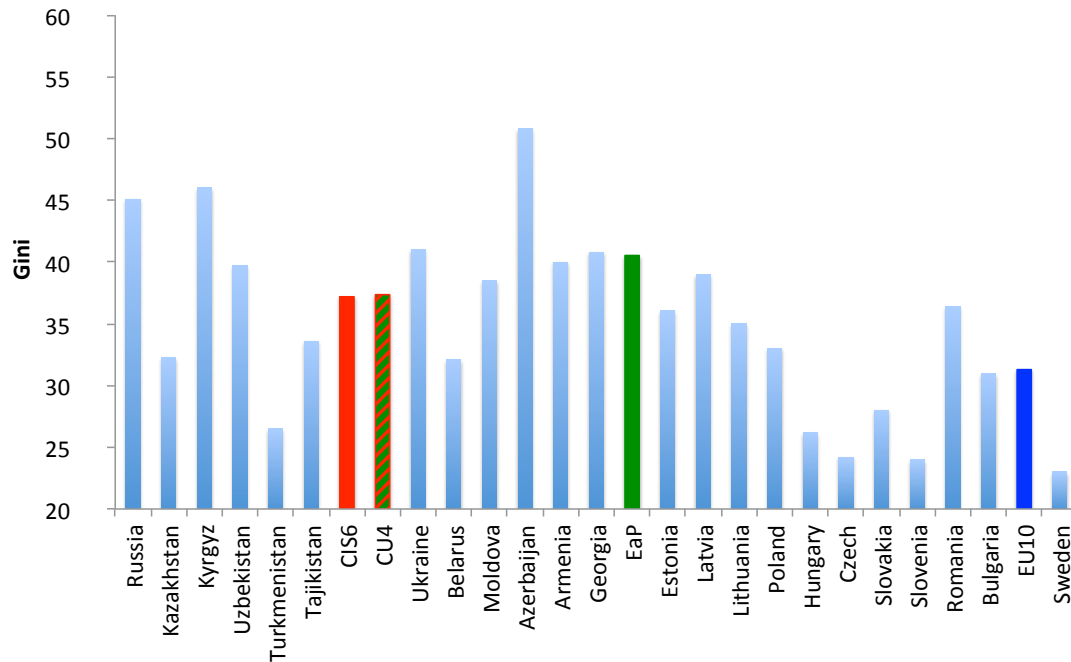


Source: Author's calculation based on UNU-WIDER (2013).
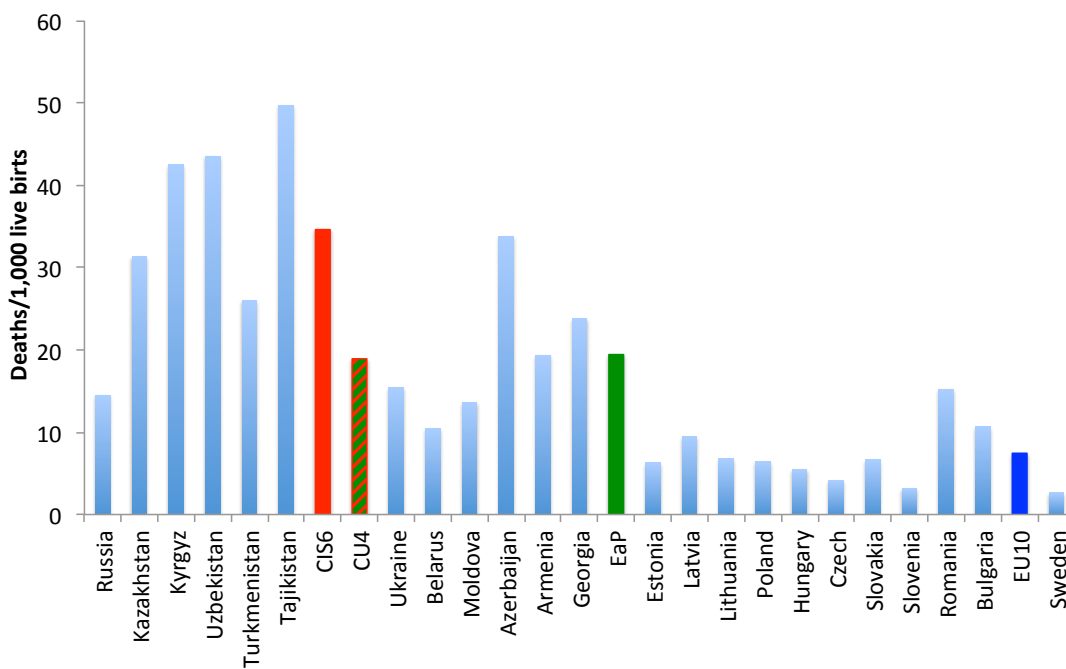
**Figure A3. Human Development Index (2012)**



Source: Author's calculation based on UNDP (2013).
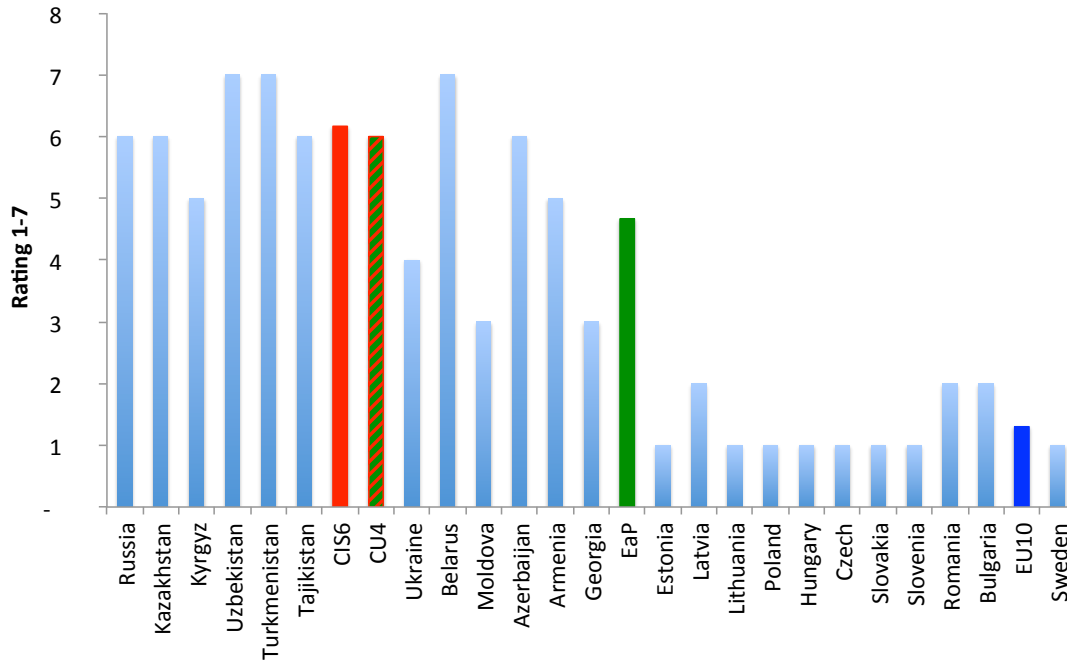
**Figure A4. Life expectancy at birth**



Source: Author's calculation based on UNDP (2013).

**Figure A5. Child mortality (Under 5 year mortality per 1000 live births, 2010)**



Source: Author's calculation based on IHME (2010).

**Figure A6. Political rights**



Source: Author's calculation based on Freedom House (2014).

**Figure A7. Civil liberties**
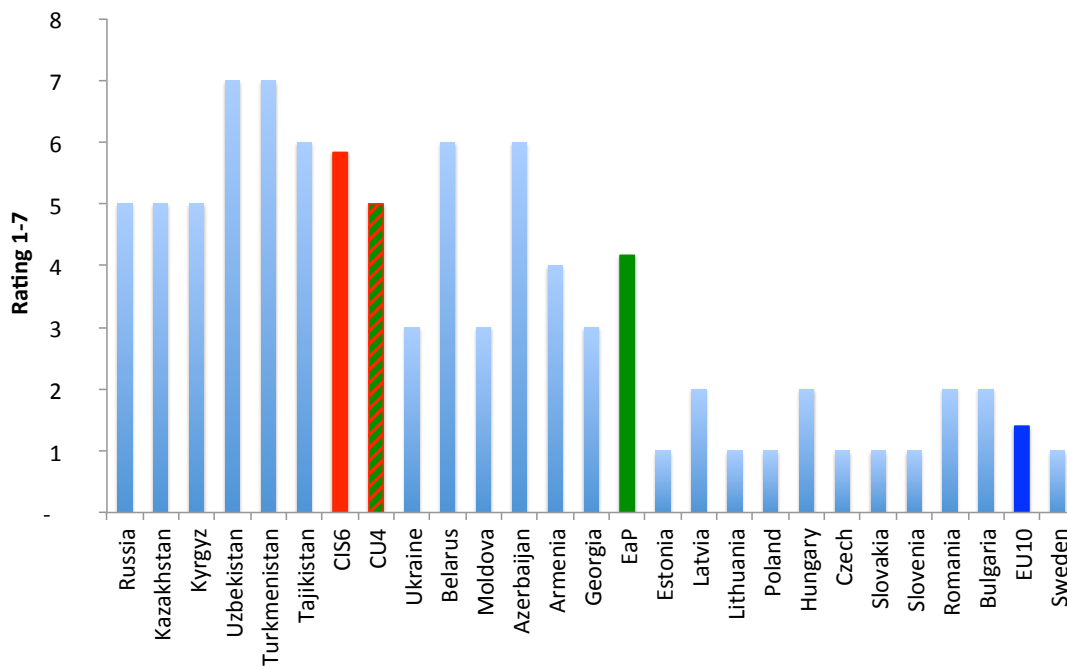


Source: Author's calculation based on Freedom House (2014).

**Figure A8. Freedom of the press**
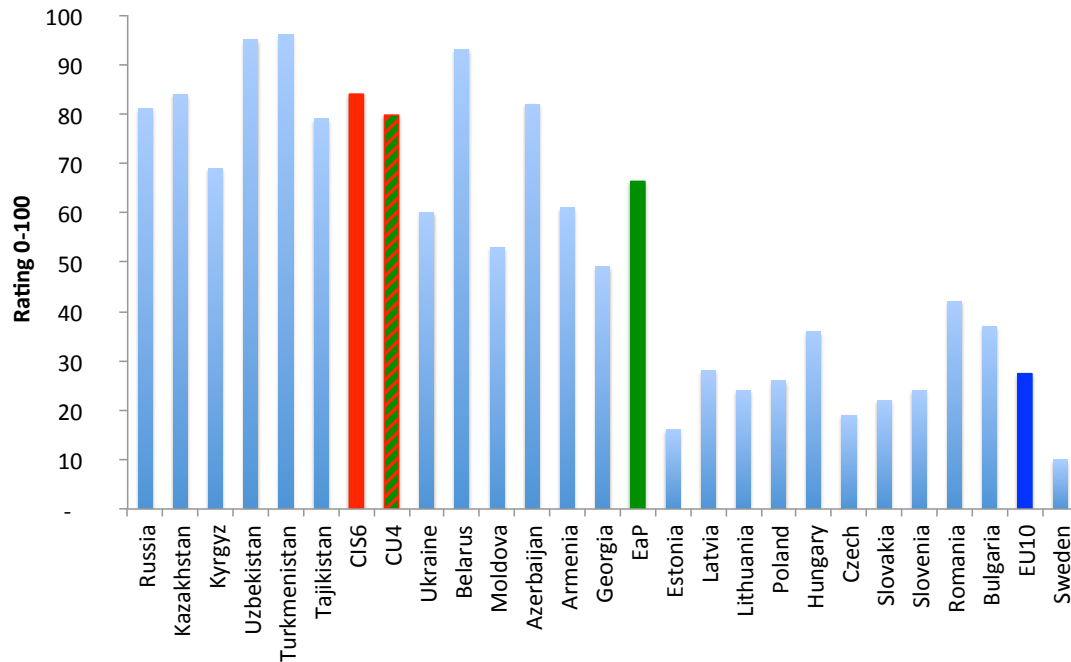


Source: Author's calculation based on Freedom House (2013).

**Figure A9. Corruption perception index**
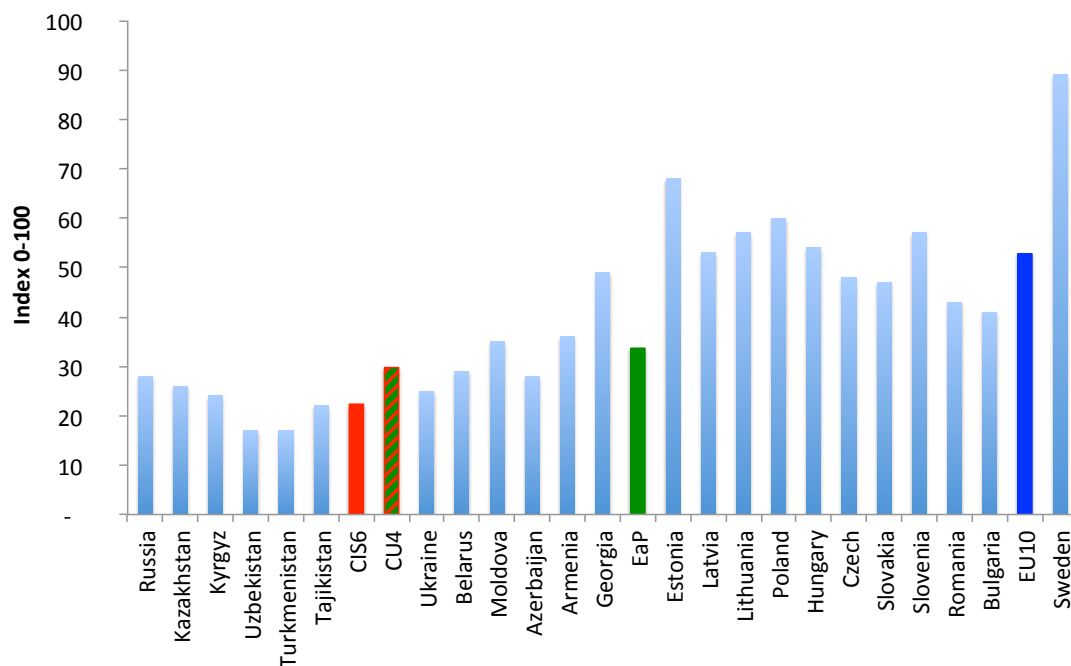


Source: Author's calculation based on Transparency International (2013).
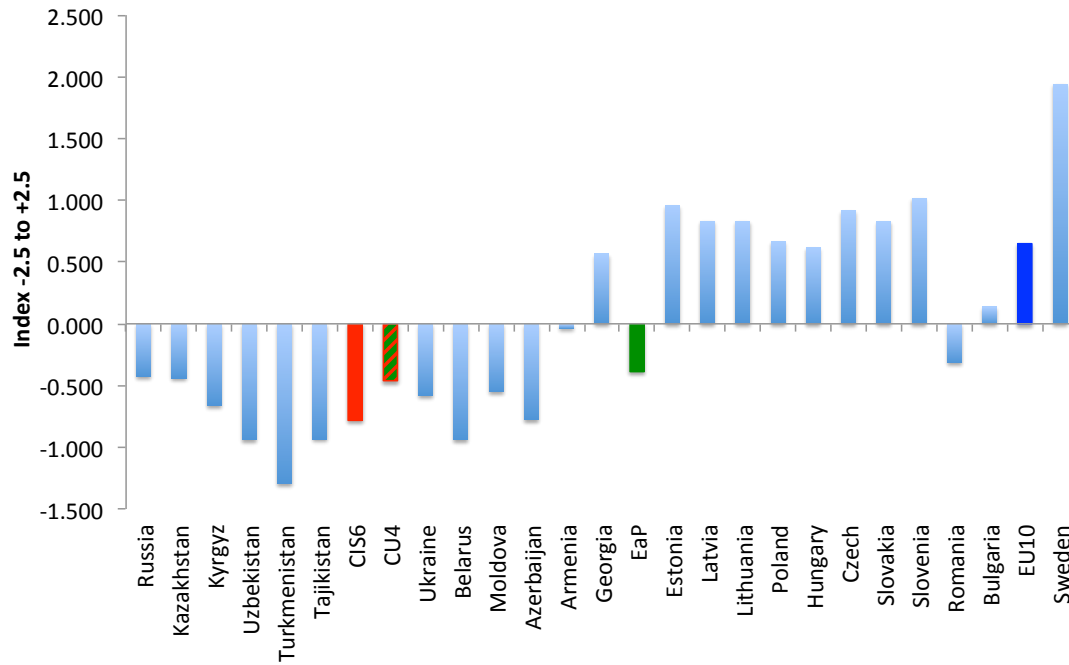
**Figure A10. Voice and accountability**
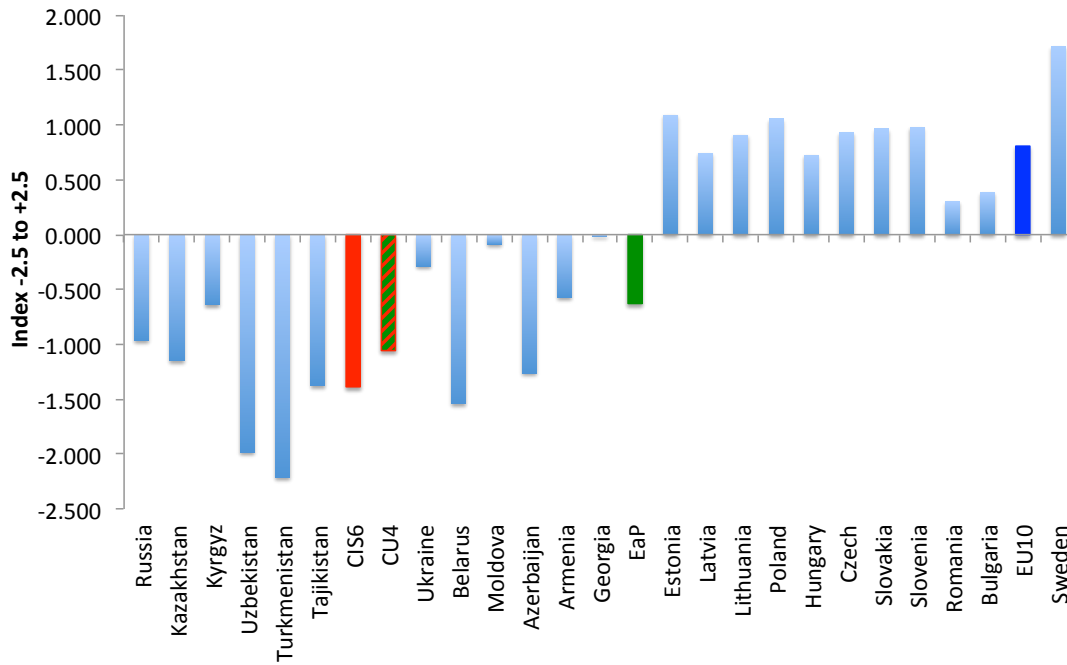


Source: Author's calculation based on WGI (2013).
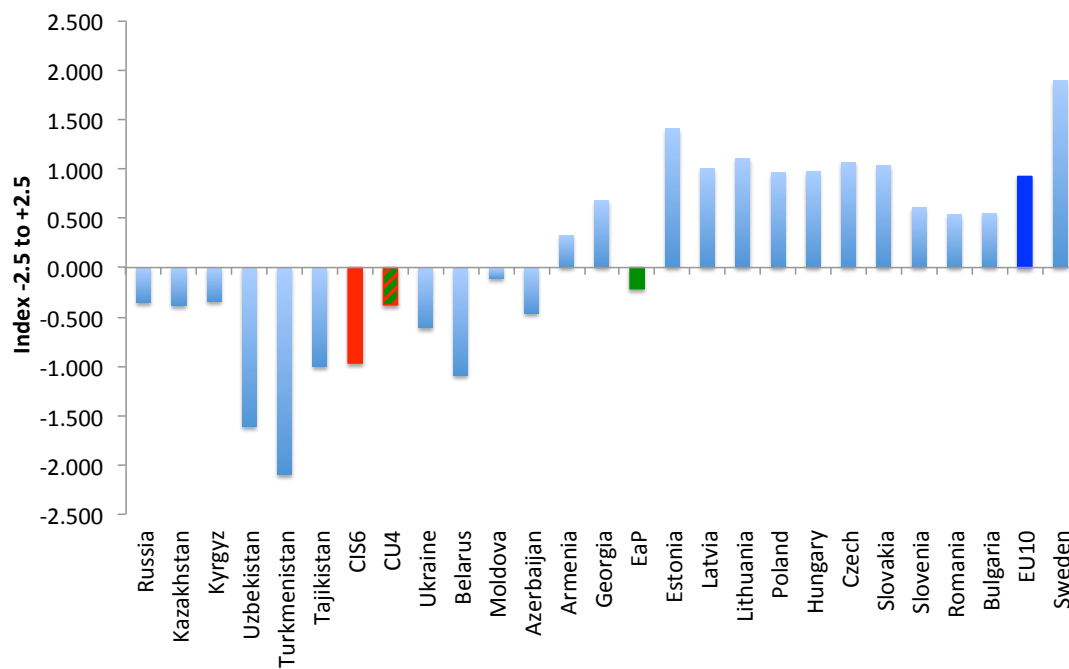
**Figure A11. Political stability**
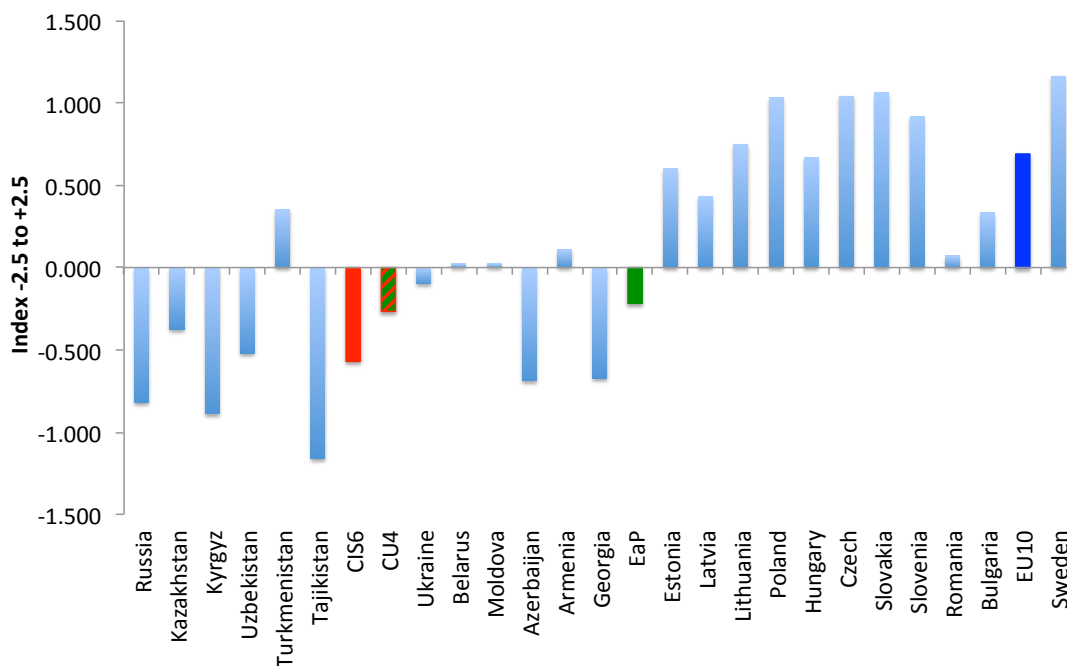


Source: Author's calculation based on WGI (2013).

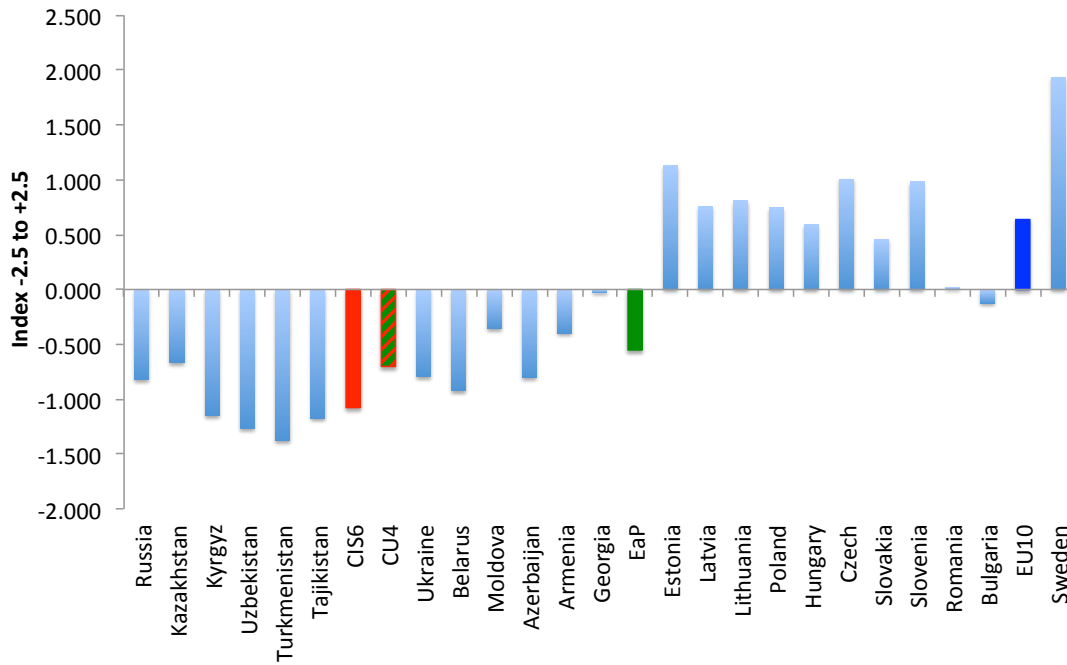**Figure A12. Government efficiency**



Source: Author's calculation based on WGI (2013).

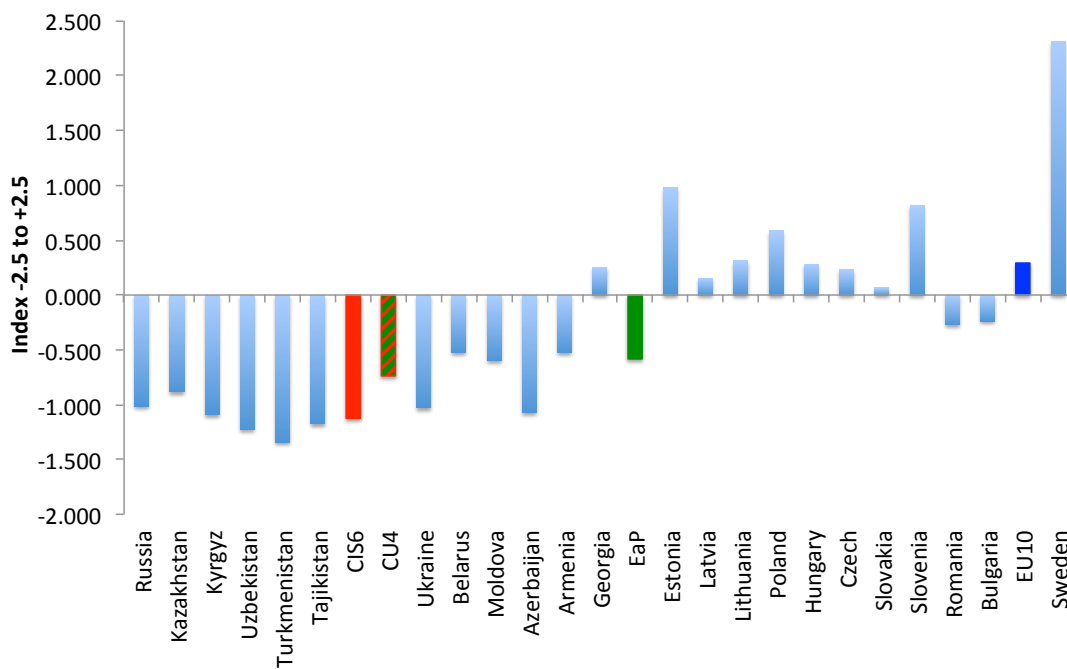**Figure A13. Regulatory quality**



Source: Author's calculation based on WGI (2013).
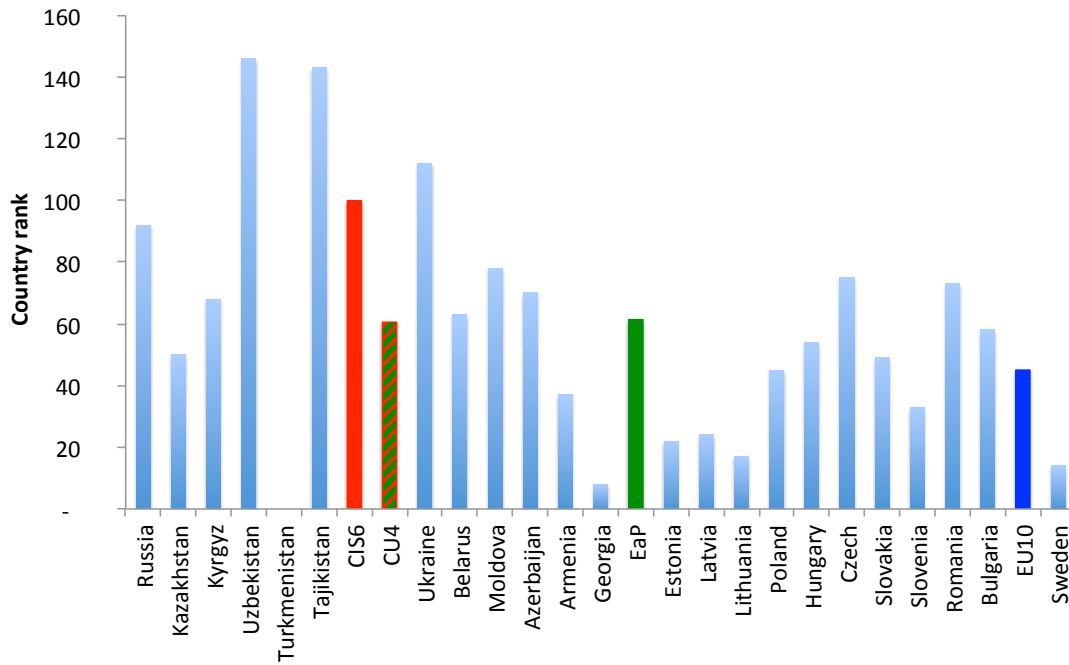
**Figure A14. Rule of law**



Source: Author's calculation based on WGI (2013).
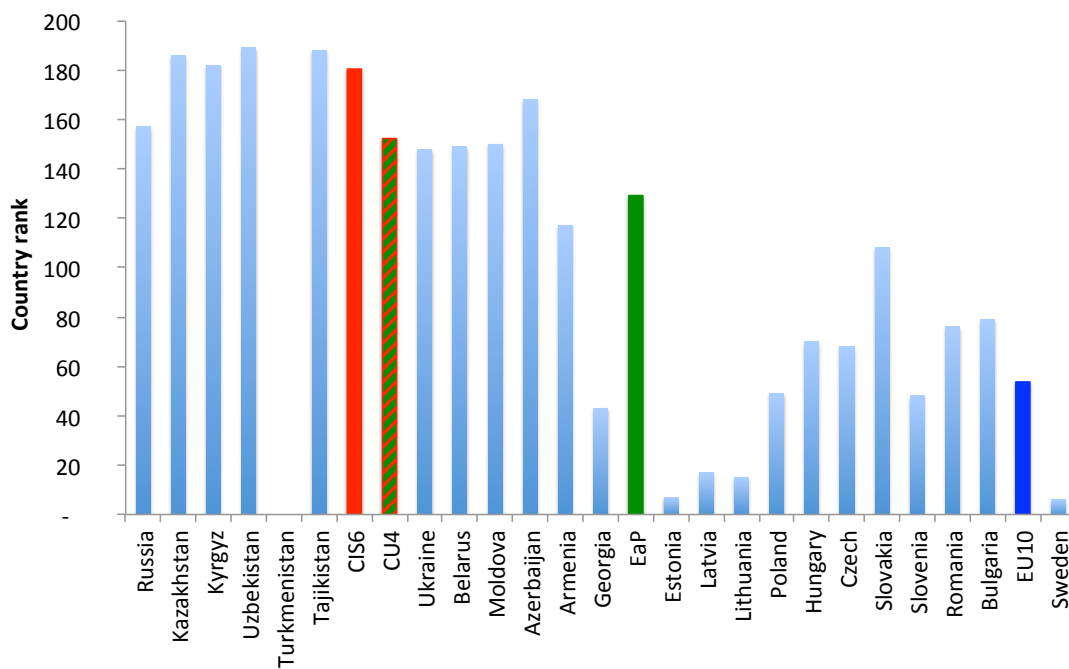
**Figure A15. Control of corruption**



Source: Author's calculation based on WGI (2013).

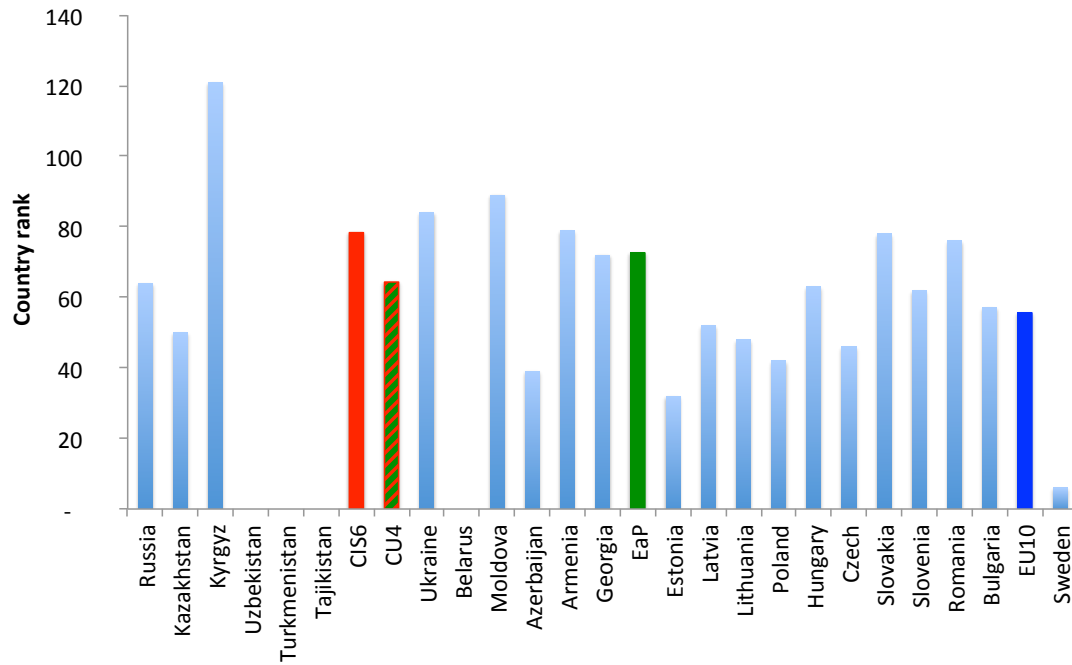**Figure A16. Doing business ranking**



Source: Author's calculation based on World Bank (2014).

**Figure A17. Trading across borders**



Source: Author's calculation based on World Bank (2014).

**Figure A18. Global competitiveness rankings**



Source: Author's calculation based on WEF (2013).

# References

Becker, T., 2013, "The Potential impact of DCFTAs with some Eastern Partnership countries", SITE Policy Brief, October 2013, SITE, Stockholm, Sweden

Freedom House, 2013, Freedom of the Press: Global, 2012 scores, 2013 edition. Data from http://www.freedomhouse.org/report-types/freedom-press#.UxIaEHkop2A

Freedom House, 2014, Freedom in the World 2014 Subscores: Countries & Territories. Data from http://www.freedomhouse.org/report-types/freedom-world#.UxIaSnkop2A

Helliwell, J. F., Layard, R., and Sachs, J. (Eds.) , 2013, *World happiness report, downloaded from* http://unsdsn.org/happiness/

IHME, 2010, *Infant and Child Mortality Estimates by Country 1970-2010,* Institute for Health Metrics and Evaluation, Seattle, United States. Dataset fr

IMF, 2013, *World Economic Outlook: Transitions and Tensions*, October 2013, International Monetary Fund, Washington D.C., USA

Kaufmann, Daniel, Aart Kraay and Massimo Mastruzzi, 2010, "The Worldwide Governance Indicators: A Summary of Methodology, Data and Analytical Issues", World Bank

Transparency International, 2013, Corruption perception index 2013. Data from http://cpi.transparency.org/cpi2013/results/

UNDP, 2013, Human Development Index 2012. Data from http://hdr.undp.org

UNU-WIDER, 2013, WIID2c data from http://www.wider.unu.edu/research/Database/en_GB/wiid/

WEF (World Economic Forum), 2013, *The Global Competitiveness Index 2013-2014*, Geneva. Data from www.weforum.org/gcr

WGI, 2013, World Governance Indicators, 2012 estimate, 2013 update. Data from http://info.worldbank.org/governance/wgi/index.aspx#home

World Bank, 2014, *Doing Business 2013*, World Bank Group, Washington D.C. Data from http://www.doingbusiness.org