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The Eastern Partnership as a Vector of Economic Growth
for EU Neighbours: Evidence from Panel Data

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Abstract
The global economy is significantly shaped by a complex process of globalization and regional economic integration that has induced various global transformations. In Europe, the regional integration deepening has generated significant socio-economic developments for the EU Member States, as well as for candidate countries or other EU neighbouring partners. Therefore, the research performed within this paper aims to analyse the role played by the Eastern Partnership (EaP), as a vector of economic growth for EU’s Eastern neighbours. The main focus is on the impact of international trade and capital flows emerged after 2009 (when the EaP was signed) upon the economic activity of six EU partners, as well as during longer time series, respectively 1992-2015. Thus, we have developed various macroeconometric double-log and semi-log (lin-log) models, processed through the correlated panels corrected standard errors (PCSE) method of estimation. The results highlight a significant positive impact of international trade flows upon the economic activity, an increase in exports and imports, as well as a higher openness degree
towards the global market leading to improvements in GDP per capita levels. At the same time, international investment, mainly the foreign direct investment inflows, have important positive effects upon the living standards and welfare of citizens within the six panel considered economies.

**Keywords:** EaP, regional integration, international trade, FDI, economic growth

**Introduction**

The European Union has a strategic key objective to ensure stability, improve the coordination and collaboration degrees across Europe, along with the economic growth of EU’s Southern and Eastern neighbours. Moreover, its partners in Eastern Europe and South Caucasus are also focusing on intensifying their relations with the EU. In this context, the European Union has developed a proactive policy in order to grant them constant support in the efforts performed for joining the EU, as well as for implementing various reforms that are extremely necessary for their long term economic development. This particular assistance is provided through a specific East oriented dimension of the European Neighbourhood Policy (ENP) under the framework of the Eastern Partnership (EaP). Thus, through the ENP as a key component of EU’s Foreign Policy, the European Union co-works with Southern and Eastern neighbours to develop a tight political association and a higher degree of economic integration. This objective is build based on a series of common interests and values, like democracy, rule of law, human rights and social cohesion.

The last two decades have brought significant changes in the Eastern part of the European Union, therefore along with the Partnership Agreements signed for a better cooperation between the EU and its Eastern neighbours, the following enlargements have ensured a wider geographical proximity, while the reforms supported through the European Neighbourhood Policy have brought these countries closer to the EU in political and economic terms.

The European Union has an important responsibility towards its partners in terms of guiding them to overcome numerous economic and political challenges that they are facing, and to support their efforts in joining the EU within the context of a deeper regional economic integration process.
To this respect, the linkages developed by the EU with some Eastern countries have been strengthened through the Eastern Partnership signed by the EU in 2009 together with six East-European partners: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. This partnership is based on the commitment to international law principles and fundamental values of democracy, rule of law, human rights and social inclusion. In economic terms, the EaP provides constant support for the market economy, sustainable economic development and good governance.

**Literature review on regional economic integration**

In the relevant literature there are several authors trying to explain that regional economic integration is a process through which the boundaries between state-nations become less discontinue, thus leading to the formation of more comprehensive systems (Viner, 1950; Marchal, 1965; Bourenane, 1997; Haile, 2000). To this respect, Viner (1950) highlighted that the economic integration could lead either to trade creation or to a reorientation of trade flows, due to significant reduction in trade barriers between neighbouring countries, towards a gradual strengthening of international trade.

Haile (2000) pointed out that regional integration as a process involves a unification of various structures, mainly industrial, economic and administrative, for the member states. This type of process is directed by a recognition of the fact that national economic welfare can be improved more efficiently through a such partnership, compared to unilateral policy design performed by each country.

Regional economic integration can thus be defined as an association of two or more countries in order to strengthen their reciprocal economic relations that will lead to economic growth and several benefits for the population through the coordination of fiscal and trade policies, along with efficient resource allocation.

Ousmane (1997) pointed out that trade policy represents a key element of growth and industrialization for developing economies that also coordinates other macroeconomic and sector policies adopted and implemented by these countries. The general strategic framework for long term economic development has shaped trade relations between these nations and the rest of the world, having at the same time a significant impact upon their tendency to operate on regional markets. To this respect, in the relevant literature there is a significant amount of
empirical work that has attested strong interdependencies between the macroeconomic and trade policies developed at country level and the impact of such policies upon global trade and economic growth (Oyejide, 1986; Avillez et al., 1988; Krueger et al., 1988; Mundlak et al., 1989; Stryker, 1990; Dollar, 1992; Ousmane, 1997).

The study of regional economic integration implies recognition of the key role played by international trade within the economic development process (Ousmane, 1997). However, a large part of the literature suggests that the failure of traditional regional integration systems is mainly due to governments (Berg, 1988; Mytelka, 1997). Steven (2004) refers to different integration degrees that are influenced by mutual trust, respect, common interests and responsibility.

The empirical evidence on regional economic integration impacts upon economic growth is still controversial. Vamvakidis (1998) considers that open economies have higher economic growth rates and that countries having large neighbours with increased openness degrees are developing much faster, but their own growth rates do not generate a significant positive impact upon the other neighbouring areas. Moreover, Vamvakidis (1998) examines the effects of regional integration within ASEAN, Andean Community and the European Union upon the economic growth rates of their member states. The results obtained show that there aren’t significant effects induced by regional economic integration in the case of the above mentioned trade blocks, except for the European Union, and suggests that trade agreements between small, closed and developing countries are less likely to induce a faster economic growth path.

Schiff and Wang (2003) reveal that they found no empirical evidence on the dynamic effects generated by regional integration based on technology diffusion between partner and non-partner states. They continue their research by showing that NAFTA imports have increased productivity rates (between 5.5-7%) in Mexico, while the extra-regional imports don’t have a significant economic impact.

European economic integration and the importance of European Neighbourhood Policy

Open markets and regional economic integration are essential for the economic development of EU partner countries. Therefore, the Association Agreements (AA) provides access to common markets and creates new opportunities on both sides that also warrant the political
stability of the area. Moreover, the association agreements include as a main purpose the creation of a deep and comprehensive free trade area (AA/DCFTA) with every partner of the EU. These free trade areas will be established once those countries become WTO members, thus substantially covering the overall trade flows, including the energy sector, and aim at the highest possible liberalization degree (with a correspondent asymmetry of the liberalization degree that is appropriate for EU partners).

Within this context, the European Neighbourhood Policy – ENP coordinates the relations developed by the EU with 16 of the closest neighbouring countries in the Southern and Eastern parts. Thus, at South we find partnerships formed by the EU with Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria and Tunisia, while at the East there are partnerships with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Even though the Russian Federation is an EU neighbour, the bilateral relations are approached differently compared to the ENP, Russia taking part in the EU’s cross-border projects (European Commission, 2015b).

The European Neighbourhood Policy was launched in 2003 and developed gradually during 2004 with the main objective to avoid the emergence of separating lines between the enlarged European Union and its neighbours and, at the same time, to strengthen the stability, security and prosperity for all the countries involved, by complying to the values of democracy, rule of law and human rights. The ENP also approaches some of the strategic aims debated at the European Security Strategy in December 2003 and was renewed in 2011 due to the significant changes induced by the Arab Spring. Still, taking into account the recent development in the EU neighbouring area, starting with 2011 the constant re-examination of the ENP became more obvious. Therefore, the most recent guidelines have been defined on November 18, 2015, after a public consultation attended by all partner countries, international organizations, civil society and various experts on external policy. Through the ENP, the European Union focuses on designing a coherent approach of its relations with the Eastern and Southern neighbourhood that will allow an intensified cooperation between these countries in order to create a stable and prosperous area. The central element of the ENP is represented by bilateral action plans established by the EU with each of its partner countries. These plans
define a program of political and economic reforms with targets set on short and medium terms.

The Eastern Partnership (EaP): fundamental mechanism of a deeper European economic integration

The Eastern Partnership (EaP) represents a political initiative developed by the European Union with the main purpose to deepen and strengthen its relations with six Eastern neighbouring countries, namely Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. The EaP was launched at the Prague Summit in May 2009, being focused on encouraging and supporting the reform initiatives performed by the associated countries for the socio-economic welfare of their citizens. Therefore, the Eastern Partnership is based on the commitment of these countries to the principles of international law and fundamental values that include democracy, rule of law, human rights and freedoms, along with empowering the market economy, sustainable economic development and good governance (European Commission, 2015b).

The EaP is comprised within the Eastern dimension of the European Neighbourhood Policy, being constantly updated, so that its initiatives and objectives were firstly reconfirmed at the Warsaw Summit in 2011, and afterwards at the Vilnius Summit in 2013. Moreover, the latest EaP common declaration was performed on May 2015 at the Riga Summit, when the cooperation strategies were revised and thus established future common action guidelines (European Commission, 2015c). There are two basic coordinates of the EaP: (i) bilateral and (ii) multilateral. The bilateral dimension covers political and economic reforms implemented by partner countries in order to ensure the EU adhesion and deeper economic integration, respectively to support people’s mobility and no-visa travels as the main long term objective. Therefore, the bilateral cooperation programs contribute to achieving these objectives by granting support on priority areas identified by each partner country. The multilateral dimension complements bilateral relations with a series of thematic platforms used for the exchange of good practices on various issues of common interest, like good governance, economic integration and development, energetic security and transport. At the same time, there are new initiatives designed within the context of regional cooperation programmes in other areas that cover environment, energy, natural disasters, border management, SMEs.
Through the Eastern Partnership, the European Union took its commitment to develop a tight cooperation with its six partner countries, regardless of the individual level of implication in their relations with the EU. To this respect, the AA/DCFTAs established in 2014 have brought the EU relations with Georgia, Moldova and Ukraine to a different (higher) level. These arrangements have the main purpose to enforce the political and economic integration degree, thus representing a set of reforms that will bring the six partner countries closer to the EU, through aligning the legislation and own standards to the community ones and improving the living standards of citizens in a tangible manner. Moreover, a differentiated and better shaped approach of the relations developed with Armenia, Azerbaijan and Belarus will contribute to the inclusive nature of the EaP (European Commission, 2015a). Thus, Armenia’s tight political association and economic cooperation with the European Union will be accomplished in line with other international commitments previously assumed by it. At the same time, the European Union performs constructive negotiation with Azerbaijan in order to develop a closer political and economic relationship that reflects common values and interests, while deepening the critical commitment acknowledged with Belarus.

**Data and methodology: developed models, equations**

Based on the main coordinates of the Eastern Partnership developed by the European Union with six neighbouring countries within the context of a deepen regional economic integration process, we have assessed the importance of this partnership through the effects induced by international trade and capital flows of EU’s EaP partners upon their economic growth, living standards and long-term development. The panel thus comprises six countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine) and a complex set of macroeconomic indicators compiled during 1992-2015. The main data sources accessed are Eurostat (European Commission) and UnctadStat (United Nations Conference on Trade and Development – Statistics – Data Centre). The macroeconomic indicators used as proxies and variables of developed models include: (i) the GDP growth rates and GDP per capita; (ii) export and import of goods and services (thus comprising international trade operations performed by these countries in terms of product sales and purchases on a global market), along with the trade openness degree; (iii) international investment as FDI (foreign
direct investment) inflows and outflows that reflect the globalization degree of an economy based on the economic environment during a certain period of time, as well as its relative attractiveness in performing new FDI; (iv) total labour force.

**Fig. no. 1a.** GDP growth (left), GDP per capita (middle) and Exports (right), 2015

![GDP growth](image)

![GDP per capita](image)

![Exports](image)

**Fig. no. 1b.** Imports (left), FDI inflows (middle) and FDI outflows (right), 2015

![Imports](image)

![FDI inflows](image)

![FDI outflows](image)

**Source:** own process of panel data with Stata 13

In the first stage of the performed research we’ve focused on dynamic evolutions, trends and patterns of selected indicators for the six panel considered economies. Thus, the total GDP, its growth rates and per capita levels have registered an increasing trend during the last two decades, especially for Ukraine, but these positive tendencies were counterbalanced by the negative effects of the global economic and
financial crisis during 2008-2010, being followed by a new upward trend of economic growth after the EaP development in 2009. However, the present geopolitical context and the areas’ instability have negatively reflected upon Ukraine’s economy, both total and per capita GDP significantly decreasing. On the other hand, the living standard has improved for two of the EaP partner countries (Azerbaijan and Belarus), as reflected by significant increases in GDP per capita levels. International trade flows developed by the EaP countries globally have intensified starting with the second half of 2000 and especially during 2009-2013, with positive upward trends even though the imports are larger than exports, so that the overall trade balance is on deficit. At the same time, the openness degree reveals the important position held by Ukraine, Belarus and Azerbaijan on the global market compared to the other EU partners under the EaP.

**Fig. no. 2.** Panel correlation of GDP per capita and exports (left), respectively GDP per capita and FDI inwards (right)

![Graph showing correlation](image)

**Source:** own process of panel data with Stata 13

By analysing the FDI patterns for panel considered economies, it can be noticed that Ukraine leads the way for foreign investors with an important upward trend during 2004-2015, both in terms of inflows and outflows. Moreover, the FDI outwards shape a different view upon the six considered economies, and bring up front the dominant position of Azerbaijan compared to the other EaP countries, along with the important positive evolutions of Ukraine’s investment.

A second step of the research performed was made in order to ensure the validity of developed models and the accuracy of the results
(coefficients) obtained by applying the panel corrected standard error (PCSE) method of estimation.

**Fig. no. 3.** Kernel density estimates for the main panel indicators used within the empirical analysis

**Source:** own process of panel data with Stata 13

Figure no. 3 highlights a good panel distribution of data used for the empirical analysis revealed by the associated Kernel density estimates.
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On the final stage of the research, we’ve assessed the impact induced by international trade and capital flows emerged in the context of regional economic integration and EaP developments upon the economic growth and long term development. To this respect, we’ve developed two sets of five macroeconometric double-log and semi-log (lin-log) multiple regression models by using as endogenous and exogenous variables the indicators described in the previous section and compiled within a panel of six EaP countries during 1992-2015. Therefore, the panel comprises 144 observations, respectively six countries (panel spatial units) and 24 years (panel temporal units). However, some of the time series are incomplete due to unavailable or lack of data. As a result of the detailed analysis of macroeconomic indicators and relevant literature review, we were able to design the econometric models used for the empirical assessment of the impact generated by international trade and capital flows upon the economic activity (in terms of GDP per capita and growth rates).

The first set of macroeconometric models uses as dependent variable the GDP growth rate and the second set comprises the GDP per capita along with a combination of explanatory variables that are proxies for international trade and capital flows.

The general form of the models synthesised in table no.1 is:

**Model 1**

\[ \text{GDP\_growth}_{it} = \beta_0 + \beta_1 \text{Open\_degree}_{it} + \beta_2 \text{FDI\_inward}_{it} + \epsilon_{it} \]

**Model 2**

\[ \text{GDP\_growth}_{it} = \beta_0 + \beta_1 \text{Export}_{it} + \beta_2 \text{FDI\_inward}_{it} + \epsilon_{it} \]

**Model 3**

\[ \text{GDP\_growth}_{it} = \beta_0 + \beta_1 \text{Import}_{it} + \beta_2 \text{FDI\_inward}_{it} + \epsilon_{it} \]

**Model 4**

\[ \text{GDP\_growth}_{it} = \beta_0 + \beta_1 \text{Export}_{it} + \beta_2 \text{FDI\_inward}_{it} + \beta_3 \text{Labour}_{it} + \epsilon_{it} \]

**Model 5**

\[ \text{GDP\_growth}_{it} = \beta_0 + \beta_1 \text{Import}_{it} + \beta_2 \text{FDI\_inward}_{it} + \beta_3 \text{Labour}_{it} + \epsilon_{it} \]

The general configuration of the models comprised in table 2 is:

**Model 1**

\[ \text{GDP\_capita}_{it} = \beta_0 + \beta_1 \text{Open\_degree}_{it} + \beta_2 \text{FDI\_inward}_{it} + \epsilon_{it} \]

**Model 2**
GDP\_capita_{it} = \beta_0 + \beta_1\text{Export}_{it} + \beta_2 FDI\_inward_{it} + \epsilon_{it}

**Model 3**

GDP\_capita_{it} = \beta_0 + \beta_1\text{Import}_{it} + \beta_2 FDI\_inward_{it} + \epsilon_{it}

**Model 4**

GDP\_capita_{it} = \beta_0 + \beta_1\text{Export}_{it} + \beta_2 FDI\_inward_{it} + \beta_3\text{Labour}_{it} + \epsilon_{it}

**Model 5**

GDP\_capita_{it} = \beta_0 + \beta_1\text{Import}_{it} + \beta_2 FDI\_inward_{it} + \beta_3\text{Labour}_{it} + \epsilon_{it}

We’ve specifically selected the explanatory variables associated with each model in order to comprise the cumulative impact of international trade and foreign direct investment upon the economic activity.

**Results and discussions**

The results obtained after processing the first set of five macroeconomic models based on PCSE method are synthesised in table no. 1.

**Table no. 1.** Results of the macroeconomic models, PCSE method, dependent variable: GDP growth rate

<table>
<thead>
<tr>
<th></th>
<th>(1) GDP_growth</th>
<th>(2) GDP_growth</th>
<th>(3) GDP_growth</th>
<th>(4) GDP_growth</th>
<th>(5) GDP_growth</th>
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<td>log_Open_degree</td>
<td>-2.904***</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(0.665)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>log_FDI_inward</td>
<td>3.605***</td>
<td>3.298***</td>
<td>3.708***</td>
<td>2.616***</td>
<td>3.408***</td>
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<tr>
<td></td>
<td>(0.729)</td>
<td>(0.692)</td>
<td>(0.683)</td>
<td>(0.680)</td>
<td>(0.693)</td>
</tr>
<tr>
<td>log_Export</td>
<td>-2.370***</td>
<td></td>
<td>-0.222</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>(0.559)</td>
<td></td>
<td>(1.043)</td>
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<tr>
<td>log_Import</td>
<td></td>
<td>-3.745***</td>
<td></td>
<td>-2.497*</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>(0.661)</td>
<td></td>
<td>(1.255)</td>
<td></td>
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<tr>
<td>log_Labour</td>
<td></td>
<td></td>
<td>-3.533**</td>
<td>-1.821</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(1.310)</td>
<td>(1.271)</td>
<td></td>
</tr>
<tr>
<td>_cons</td>
<td>1.309</td>
<td>-1.686</td>
<td>7.917</td>
<td>14.58***</td>
<td>14.33***</td>
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<tr>
<td></td>
<td>(4.189)</td>
<td>(3.836)</td>
<td>(4.181)</td>
<td>(4.262)</td>
<td>(3.337)</td>
</tr>
<tr>
<td>N</td>
<td>126</td>
<td>131</td>
<td>132</td>
<td>131</td>
<td>132</td>
</tr>
<tr>
<td>R^2</td>
<td>0.234</td>
<td>0.200</td>
<td>0.257</td>
<td>0.243</td>
<td>0.270</td>
</tr>
</tbody>
</table>

Standard errors in parentheses

* p < 0.05, ** p < 0.01, *** p < 0.001
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For the first set of macroeconometric models, the PCSE estimated coefficients have a high degree of statistical significance, mostly at 0.1% level, thus confirming the influence induced by the selected independent variables upon GDP growth rates.

The results reveal a very strong positive impact of international capital flows (reflected through FDI inwards) upon the economic activity of EaP countries, while the international trade tends to negatively impact the GDP growth rates. At the same time, the r-square values point out that around 20% of the variations in GDP growth rates could be explained through the variations in international trade flows (goods and services) along with international investment.

Moreover, if we consider the impact of regional economic integration measured here through trade and FDI upon living standards and welfare of EaP citizens, the results highlight important positive effects induced by these two types of international flows, as shown in table no. 2.

| Table no. 2. Results of the macroeconometric models, PCSE method, dependent variable: GDP per capita |
|---------------------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|
|                                                            | (1) log_GDP_cap                                   | (2) log_GDP_cap                                   | (3) log_GDP_cap                                   | (4) log_GDP_cap                                   | (5) log_GDP_cap                                   |
| log_Open_degree                                             | 0.308***                                          | 0.174***                                          | 0.171***                                          | 0.0183                                           | 0.0593*                                          |
|                                                             | (0.0480)                                          | (0.0426)                                          | (0.0415)                                          | (0.0231)                                          | (0.0254)                                          |
| log_FDI_inward                                              | 0.142**                                          | 0.252***                                          | 0.741***                                          |                                                  |                                                  |
|                                                             | (0.0438)                                          | (0.0391)                                          | (0.0379)                                          |                                                  |                                                  |
| log_Export                                                  |                                                  | 0.768***                                          |                                                  |                                                  |                                                  |
|                                                             |                                                  | (0.0506)                                          |                                                  |                                                  | (0.0558)                                          |
| log_Import                                                  | 0.301***                                          |                                                  |                                                  |                                                  |                                                  |
|                                                             | (0.0506)                                          |                                                  |                                                  |                                                  | (0.058)                                          |
| log_Labour                                                  | -0.805***                                         | -0.681***                                         |                                                  |                                                  |                                                  |
|                                                             | (0.0415)                                          | (0.0429)                                          |                                                  |                                                  |                                                  |
| _cons                                                       | 3.551***                                          | 3.854***                                          | 3.369***                                          | 7.558***                                         | 5.768***                                         |
|                                                             | (0.351)                                          | (0.328)                                          | (0.368)                                          | (0.125)                                          | (0.0890)                                         |
| N                                                           | 126                                               | 131                                               | 132                                               | 131                                               | 132                                               |
| R²                                                          | 0.615                                             | 0.611                                             | 0.611                                             | 0.859                                             | 0.812                                             |

Standard errors in parentheses
* p < 0.05, ** p < 0.01, *** p < 0.001
After processing the second set of five macroeconometric models (double log multiple regression models) that focus on assessing the impact induced by international trade and investment flows upon GDP per capita levels (used here as a proxy for the living standards and welfare of the population), we’ve obtained highly statistically significant coefficients, along with improved levels of the r-squared that point out a tighter interdependence between selected endogen and exogenous variables (more precisely, around 80% of the variations in GDP per capita could be explained by the variations in international trade and capital flows along with the total labour force and about 60%, if we consider only the international flows).

Thus, there are positive significant effects upon the six panel considered countries, generated by a higher openness degree towards the global market, as a result of closer relations developed with the EU through the EaP, corroborated with additional exports and imports that also induce increases in the GDP per capita levels (with about 0.252%, respectively 0.301%). Moreover, additional foreign direct investment inflows into the six EaP panel considered economies have positive effects on the living standards of their population, with significant improvements in the GDP per capita.

**Conclusions**

The analysis of EU’s Eastern Partnership and its role as a key mechanism in deepening regional economic integration is relatively new in relevant literature and extremely important in the present context of the globalized world economy. The EaP represents a key component of the European Neighbourhood Policy, part of the EU’s Foreign Policy, that was developed in 2009 at the Prague Summit with some of its Eastern neighbours, namely Armenia, Azerbaijan, Belarus, Georgian, Moldova and Ukraine and constantly revised until present. Through the EaP, EU takes the commitment to support its partners in various strategic areas that require a coherent set of reforms necessary for long term economic development and welfare in the benefit of their citizens, thus ensuring to EaP countries a gradual integration within the EU.

Based on all these aspects, the empirical analysis performed within this paper highlighted the importance of international trade and capital flows emerged due to recent developments of the European economic integration, especially for the six panel considered countries as EU Eastern Partners.
The results reveal positive effects of the external trade in goods and services performed by the EaP countries, along with additional FDI inflows, upon their economic activity, especially in terms of GDP per capita levels and, to a smaller extent, upon GDP growth rates. Therefore, the results are in line with some of the theories found in the literature that recognise the importance of regional economic integration, respectively international trade and investment, in the process of long term economic development.

Bibliography


