Future of economic integration with EU Neighbours: opportunities & challenges

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Outline

- Current stage of integration – different starting points
- Further integration – what are the benefits?
- Challenges
- What are the options
- Conclusions & open questions

Basis for this presentation

- CASE co-ordinated project for the Dutch Ministry of Economic Affairs on the options for ENP
- Completed in March 2006
- Focus primarily on Ukraine, Russia, Egypt, Morocco and Algeria
- Abridged version of the report will be published at CASE website in the coming weeks – check www.case.com.pl

- Views presented here are those of authors and not of the Ministry of Economic Affairs of the Netherlands

Diversity of currently applied models of integration between EU and Neighbours

- EU Neighbourhood is very diverse in terms of political, social and economic models of development
- … also in terms of economic integration with the RoW and EU in particular
- Some countries are still negotiating WTO entry – e.g. Russia, Ukraine, Algeria (with good chances of entering soon)
- Other have been GATT/WTO members for years
- Some MED countries are quite advanced in implementing FTAs with the EU

Strength of actual trade integration

- EU as the largest or one of the largest trade partners for most of the Neighbour countries
- E.g. for Russia EU accounts for 60% of exports (mostly mineral fuels) and 50% of imports (mainly machinery and various manufacturing goods)
- Importantly, the commodity structure of trade (particularly EU imports from Neighbour countries) is not balanced (e.g. oil& gas dominate for Algeria & Russia)

- From the EU perspective, majority of Neighbour countries are not among major external trade partners (but Russia ranks 4th)
- However, trade in some commodities very important – mainly oil & gas

- This specific nature of trade relations impacts on interests and policies of involved parties

An example: importance of gas imports

- In 2004, the EU produced 215 bcm of gas; and consumed some 467 bcm.
- Net imports - 252 bcm. Essentially, all these imports from three countries: Russia, around 125 bcm (all by pipeline); Norway, around 75 bcm (all by pipeline); and Algeria, 51.6 bcm (33.8 bcm by pipeline and 18.8 bcm as LNG).
- EU dependence on gas imports is forecast to strongly increase over next decades
- Additional ‘complication’ - situation of particular EU member states very different: in 2004, Russian gas accounted for more than 80% of all consumed gas in the Czech Republic, Finland, Greece, Lithuania and Slovakia; Algerian gas accounted for above 50% of consumption in Portugal and Spain. Netherlands produced much more gas than it consumed.

Benefits of strengthening economic integration between EU and Neighbourhood [1]

- Large potential benefits to all parties stemming from deeper integration of markets; the EU itself as an example of how economic integration fosters economic growth and convergence of income levels
- … but EU is much more than an economic agreement, other dimensions matter a lot
- … and EU readiness to engage in deep integration is different than 15 years ago
- … and catch-up processes are often difficult and take decades rather than years – it is important not to have overly high expectations concerning the short-term

Benefits of strengthening economic integration between EU and Neighbourhood [2]

- Vast literature on this – here summary of selected issues
- WTO entry – key for further steps; direct impact limited, indirect possibly much stronger
- FTAs - the coverage and specific features of agreements are crucial – can determine if an FTA is very beneficial, irrelevant or even harmful
- Wide coverage and inclusion of other issues ('FTA+') – e.g. elimination of NTBs, implementation of good market regulatory rules, etc.: can bring truly large benefits

Benefits of strengthening economic integration between EU and Neighbourhood [3]

- Services: potentially very large gains, but experience of services trade liberalisation within the EU suggests caution in forming expectation on what is feasible; large agenda for domestic reforms in EU neighbourhood (e.g. more efficient market regulations);
- Agriculture: potentially very large gains for EU Neighbours, but CAP…
- Migration – consequences hinge on home and host countries’ policies (mostly domestic ones); potentially large benefits from free movement of people

Challenges for integration agenda

- Political will on both sides, internal political developments
- Institutional capacity on both sides
- Sectoral interests and lobbying on both sides (gradual integration will involve some distribution of gains and losses – even if partly only temporary)
- Incentives for both sides

Menu of integration options [1]

- integration in selected sectors only (mainly networks)
- completion of FTAs
- customs union
- FTA+ (more regulatory convergence and mutual recognition than the typical EU's FTAs)
- "EEA light" (significantly abridged version of the European Economic Area),
- deep integration (complete internal market)

Menu of integration options [2]

- Selected sectors - interesting way of proceeding in some cases; can allow faster progress in fields of particular interest
- Completion of FTAs - ‘realistic’ option, not too demanding
- Customs union - not attractive; won’t be pursued
- FTA+ (more regulatory convergence and mutual recognition than the typical EU’s FTAs) - attractive, demanding option offering large gains
- “EEA light” (significantly abridged version of the European Economic Area) - attractive, very demanding option offering large gains
- Deep integration (complete internal market) - very distant future at best

Menu of integration options [3]

- Paths of further integration will differ between neighbour countries.
- Negotiating FTAs or proceeding with their smooth implementation can keep the momentum of integration processes. This avenue should not be abandoned.
- However, a clear perspective for the future might be needed to motivate parties.
- Besides, these are more ambitious scenarios (FTA with wide coverage – in the direction of FTA+) that offer more visible gains.
- Trade-off: choosing more advantageous modes of integration offering stronger incentives to reform – vs. – institutional and political burden of necessary adjustments

Integration perspective: Russia

- WTO membership – the most realistic step to happen in near future (2007?)
- EU-RF free trade area can be negotiated after Russia enters WTO (2008)
- If FTA in manufacturing is signed, it usually takes 10 years to be implemented. Will and when it be signed?
- Along: further convergence of legislation and standards
- Common networks in telecommunications, transport, energy, space, environment
- The dialogue will most likely be dominated by energy issues in the near future
- More „integrated market" in the future, with the exact form of „integrated market" not known yet

Integration perspective: Ukraine

- Realistically, Ukraine can enter WTO in 2007
- Possibly FTA talks will start in the same year
- FTA+ package?
- EU-Ukraine FTA in manufacturing likely implemented by 2017
- Along: Ukraine participation in EU networks (transport, energy, space)
- Further approximation of norms and standards

Effects of EU-Russia and EU-Ukraine economic integration

Effects for Neighbouring countries

- Various studies estimate WTO accession to be welfare improving for both Russia and Ukraine (welfare gains also through elimination of domestic subsidies)
- FTAs in manufacturing with the EU estimated to increase production (at least in Russia), with negligible result for welfare
- Growth of exports to the EU can be in the range of 15%-35%
- Typical EU FTAs have locked-in reforms that go beyond WTO commitments and that stimulate mutual long-term investment (competition provisions, rights of establishment, liberalisation of capital flows, public procurement etc.)

Future integration: Morocco

- Advanced starting point
  - FTA in manufacturing to be completed in 2013
  - Reciprocal liberalisation of agricultural trade
  - Deeper integration commitments
- „EEA light" should be a long-term perspective:
  - Further dialogue on liberalisation of agricultural trade, movement of workers, regulatory harmonisation where necessary otherwise relaying on prudent domestic regulation, integration in transport networks
  - Attractive politically for Moroccan side?

Future integration: Egypt

- FTA in manufacturing to be completed in 2018?
- Start of talks on services and investment liberalisation
- FTA+?
  - Some liberalisation of agricultural trade
  - Commitments supporting private sector development
  - Increasing independence of regulators
- Long-term cooperation in pipeline transport

Effects of deeper EU-Morocco and EU-Egypt economic integration

Effects for Neighbouring countries

- Morocco: important trade gains even from FTA in manufacturing (large proportion of trade with the EU, productivity gains in labour-intensive sectors)
- Egypt: FTA in manufacturing can be welfare reducing due to:
  - high third-party imports protection
  - slow elimination of tariffs on consumer goods: inadequate preparation to competition from imports from the EU, once tariffs are dismantled
  - support for liberalisation of Egyptian trade regime towards third parties needed

Future integration: Algeria

- Dominated by energy issues:
  - opening of Algerian hydrocarbon sector
  - pipeline transport networks
- Algeria's WTO accession: 2007?
- FTA in manufacturing completed in 2017?

Remaining questions

- Are benefits from integration attractive to domestic actors in the CIS and Med regions?
- What are the key issues affecting perceptions of attractiveness / costs of integration?
- Can one realistically expect sufficient reform momentum on both sides to foster integration agenda?
- Is EU ready to offer deeper integration perspective? Does it really have a vision of how to shape relations with Neighbours? Will it give a high priority to political and economic investment in the Neighbourhood Policy concept?

- Are there alternatives to gradually deepening integration for the EU and Neighbours?