

# CASE Network Reports

## EU cooperation with non-member neighboring countries: the principle of variable geometry

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## Abstract

The European Union (EU) represents a large and highly integrated bloc which contributed 19.4% of global GDP and over 30% of global exports in 2012. As of July 1, 2013 it consists of 28 member states. All of them belong to the customs union and the Single European Market (SEM) in which most formal and informal barriers to the free movement of goods, services, people and capital have been removed. In addition, most members share a common currency (Euro) and form a free-travel Schengen zone. The important policy areas such as external trade, customs, competition, other regulations related to SEM, monetary policy (in the case of the Eurozone), certain fiscal and other macroeconomic policies, part of indirect taxation, research, energy policy, etc. have been transferred to the competence of supranational EU bodies. Several other questions such as immigration and asylum, visas, common border management, justice and home affairs, and foreign and security policy remain subject to coordination and common decisions.

Since the beginning of its existence, the EU has been involved in building close economic and political relations with non-member countries, involving a variety of legal forms. The EU has always been flexible in offering or accepting the exact cooperation model, trying to adjust itself to the specific needs, constraints and sovereignty concerns of individual partners. The EU has never pushed any country to join the EU or sign association/free trade agreements. EU membership is considered a scarce good, membership in the elite club of developed and rich nations, a prize for good policies and institutions of the potential candidate. The same principle works in the case of association and free trade agreements with countries which are not going to join the EU: it is an offer and a prize for good performance rather than an instrument of economic or political pressure. It is the choice of a potential partner to accept, postpone or reject such a cooperation offer.

The EU's experience in building a complex and flexible net of economic and political relations with non-member countries can serve as a good lesson and example to follow by other regional integration blocs which also face the problem of shaping their external relations with countries which are interested in close cooperation but not membership in a given bloc. On the other hand, the EU's institutional flexibility creates room for negotiating cross-regional trade and economic integration deals not only with individual countries but also with other blocs such as NAFTA, MERCOSUR, ASEAN or the Eurasian Economic Community.



# 1. Introduction

The purpose of this study is to analyze the experience of the European Union (EU) in cooperation with non-member neighboring countries<sup>1</sup>. The EU represents a large and highly integrated bloc which contributed 19.4% of the world's GDP (estimation based on purchasing power parity) and over 30% of global export in 2012 (IMF, 2013, Table A, p. 139). As of July 1, 2013 it has consisted of 28 member states of either high-income or upper-middle-income status<sup>2</sup>.

In institutional terms, all of the EU members belong to the customs union and Single European Market (SEM) in which most formal and informal barriers to free movement of goods, services, people and capital have been removed<sup>3</sup>. In addition, 18 member states (19 from January 1, 2015) share the common currency (Euro) and 22 member states plus 4 non-member states form a free-travel zone without internal border controls (the so-called Schengen zone). The EU can be considered a mature and highly advanced unit of economic integration in which several important areas of economic policy such as external trade, competition, other regulations related to the functioning of the EU internal market, monetary policy (in the case of Eurozone members), some fiscal and other macroeconomic policies, customs, part of indirect taxation, research, energy policy, etc. have been transferred to supranational EU bodies – the European Parliament, European Council and European Commission. Beyond trade and economic issues, several important institutional and political questions such as immigration and asylum, visas, common border management, justice and home affairs, and foreign and security policy remain subject to coordination and common decisions within the EU, even if integration in those policy areas is not as deep as in the 'traditional' fields of economic policy.

The EU integration process and institutions are not limited to EU members only. On the one hand, several non-member countries are interested in close cooperation/integration with the EU because of their future EU membership aspirations

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<sup>1</sup> This is the substantially revised and updated version of the report commissioned by the Russian Academy of the National Economy and Public Administration (RANEPA) in Moscow in 2013. It reflects solely the views and opinions of the author and not necessarily those of RANEPA, CASE or any other institution which author has been affiliated with or has cooperated with in the course of its preparation.

<sup>2</sup> See <http://data.worldbank.org/about/country-classifications> for the World Bank classification of country income-per-capita grouping.

<sup>3</sup> The process of building SEM remains unfinished in respect to some segments of financial, transportation and communication services, energy supply, government procurement, etc. In addition, the newly admitted member states are usually subject to some temporary restrictions in the free movement of labor and partly of capital transactions (the latter relates to free access of non-residents to a country's land market – see Section 5.2.5).

or simply because they consider the EU an important economic and political partner. On the other hand, the EU itself is also interested in building such close relations, for economic but often also for geopolitical and security reasons.

This has been enshrined in Article 8 of the Treaty of the European Union (TEU) which states that the EU ‘...shall develop a special relationship with neighbouring countries, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterised by close and peaceful relations based on cooperation’. Similar language (‘...to strengthen prosperity, stability and security in EU’s neighborhood’) was used in the European Neighborhood Policy program document (European Commission, 2004).

The EU is also strongly interested in propagating its institutional model in economic, social and political spheres beyond its borders which decreases transaction costs in trade and investment activity and increases its competitiveness. Some EU partners are seen as future EU member countries and here association agreements (AAs) and free trade agreements (FTAs) serve as the intermediate stage to full membership. In other cases their purpose is building close economic and political relations but not necessarily with the perspective of EU membership.

Taking into consideration the various interests of both the EU and its neighbors one can distinguish three groups of non-member countries and external integration arrangements:

1. The group of high-income countries which refused to join the EU for political and economic reasons but would like to maintain very close economic and institutional links to the EU because of its dominant role in their external economic relations. This group consists of Norway, Iceland, Liechtenstein, Switzerland and a few micro-states (Andorra, Monaco, San Marino and the Vatican). The first three belong to the multilateral comprehensive arrangement called the European Economic Area (EEA) while Switzerland and the micro-states’ cooperation with the EU is based on bilateral agreements which have, in most cases, a sectoral character. Similar status and cooperation arrangements (i.e. bilateral agreements) apply to 25 overseas countries and territories (OCT<sup>4</sup>), i.e. political dependencies of individual EU member states (UK, France, Netherlands and Denmark) which remain outside of the EU’s territory and jurisdiction<sup>5</sup>.

2. The group of actual and potential EU candidates, i.e. the Western Balkan countries and Turkey.

3. The group of EU neighbors in Eastern Europe (countries of the former USSR) and Southern and Eastern Mediterranean which are not considered potential members by the EU (and many of them are not interested to joining the EU either). They are subject to the European Neighborhood Policy (ENP) and accompanying arrangements such as the Eastern Partnership and the Union for Mediterranean.

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<sup>4</sup> See [http://ec.europa.eu/europeaid/where/octs\\_and\\_greenland/index\\_en.htm](http://ec.europa.eu/europeaid/where/octs_and_greenland/index_en.htm)

<sup>5</sup> Greenland is the biggest of them in terms of its territory. As a Danish dependent territory, it joined the EU together with Denmark in 1972 but left it thereafter (in 1985 as a result of the 1982 referendum) after a dispute on fishing rights.

In the subsequent chapters of this study we will analyze these arrangements in more detail, going from the strongest form of integration and partnership (EEA) to the weakest one (ENP). Chapter 1 will deal with the EEA, Chapter 2 – with the set of EU-Switzerland bilateral agreements, Chapter 3 – with the EU’s cooperation with micro-states and OCT, Chapter 4 – with the EU policies and institutional arrangements towards candidate and potential candidate countries, Chapter 5 – with EU relations with their Eastern neighbors and Chapter 6 – with EU relations with their Southern neighbors. Chapter 7 will summarize our analysis and offer potential lessons for integration blocs in other parts of the world.

## 2. EU cooperation with Norway, Iceland and Liechtenstein within the European Economic Area

### 2.1. Origins of the EEA and the process of its formation

In some ways, the institutional legacy of the EEA goes back to the times of the cold war and the creation of the European Economic Community (EEC), the EU's predecessor. The EEC was founded in 1957 by the Treaty of Rome signed by six continental Western European countries, i.e. Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Other Western European countries did not join because they were skeptical, they were not welcomed by the EEC founders (President Charles De Gaulle vetoed the UK's membership applications in 1963 and 1967 – see BBC, 2007), or they could not do so for geopolitical reasons. The latter group included neutral countries which were constrained either by self-imposed policies (Switzerland and Sweden) or by post-WW II peace treaties (Austria and Finland).

The external ring of EEC neighbors founded the European Free Trade Association (EFTA). Its scope was limited to an FTA and it did not have ambitions of proceeding with deeper institutional and political integration (like a customs union or supranational institutions). The Stockholm Convention of 1960 was signed by the seven founding members of the EFTA: Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK. Finland joined the EFTA in 1961, Iceland in 1970 and Liechtenstein in 1991<sup>6</sup>.

However, several EFTA members gradually applied for EEC and then EU membership. The first EEC enlargement in 1973 brought the UK, Ireland and Denmark to this bloc. Norway was also part of those negotiations but eventually rejected EEC accession in a popular referendum. The Southern enlargement of 1986 involved another EFTA member – Portugal. Finally, three EFTA members – Austria, Finland and Sweden – joined the EU in 1995. Once again, Norway was an EU candidate during that enlargement and successfully completed membership negotiations but the results were, however, rejected in a national referendum. As a result, after the 1995 EU Enlargement, the EFTA was left with four members, i.e. Iceland, Liechtenstein, Norway and Switzerland.

In the meantime, an intensive process of economic, and partially, institutional integration

<sup>6</sup> For a history of EFTA – see <http://www.efta.int/about-efta/european-free-trade-association>

between EFTA and EEC/EU members took place. As the first step, in the early 1970s, EFTA members concluded FTAs with then EEC members. In 1984, the EEC and EFTA launched negotiations on deepening FTAs with the aim of also covering non-tariff barriers (NTB) to trade in goods and services (the so-called Luxembourg process see Emerson et al., 2002; Vahl & Grolimund, 2006). This was, among others, the effect of the successful GATT Tokyo Round completed in 1979 which covered both kinds of issues<sup>7</sup>.

When the process of building the SEM within the EEC started in 1985 it gave a new impulse to deepening economic integration between the EEC and EFTA. In his January 1989 address to the European Parliament, the President of the European Commission Jacques Delors called for the creation of ‘a common European economic space’ between both blocs. On the other hand, the end of Cold War softened neutrality concerns in some of the then EFTA members.

As a result, in the beginning of the 1990s, the EU and EFTA members negotiated the EEA agreement which was signed in Porto on May 2, 1992 by all 12 members of the EU at that time (Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, UK) and six EFTA members (Austria, Finland, Iceland, Norway, Sweden and Switzerland). However, the Swiss voters rejected the EEA Agreement in a referendum on December 6, 1992, which forced both the EU and the government of Switzerland to look for alternative legal solutions (see Chapter 2).

The EEA Agreement entered into force on January 1, 1994. A year later, three EFTA members (Austria, Finland and Sweden) joined the EU but as EU members, they remained within EEA. The Principality of Liechtenstein joined the EEA on May 1, 1995. All subsequent EU enlargements (2004, 2007 and 2013) resulted in a respective enlargement of the EEA. As of July 2014, the EEA consists of 30 member countries with the 31st (Croatia) awaiting the completion of the ratification process of its EEA accession and already provisionally applying EEA rules.

More recently, in 2009, Iceland submitted an EU membership application, as a consequence of a severe financial crisis which hit this country in 2008. The EU Council granted Iceland candidate status and opened accession negotiations in July 2010. However, after general elections in April 2013, the new coalition government and parliamentary majority suspended the EU accession process (see Bragi Sveinsson, 2013).

## **2.2. The scope of integration under the EEA**

The EEA Agreement includes 129 articles, 22 annexes and 49 protocols. The annexes include the list of EU acts which are applicable to the EEA (6,555 as of April 30, 2012 – see EEA, 2013). The Agreement has a dynamic character, i.e. it includes not only the initial stock of EU regulations related to the SEM at the moment of its signing (1992) but also a mechanism of incorporating the new ones (see Section 2.3).

<sup>7</sup> See [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact4\\_e.htm#rounds](http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm#rounds) for a history of the GATT/ WTO trade negotiation.

Generally, EEA members accepted EU legislation in respect to its four freedoms, i.e. the free movement of goods, services, persons and capital, as well as competition and state aid rules (see EEA, 2013). The EEA Agreement also covers several so-called horizontal policies such as consumer protection, company law, environment, social policy, and statistics as well as flanking policies such as research and technological development, education, training and youth, employment, tourism, culture, civil protection, enterprise, entrepreneurship and small and medium-sized enterprises. The EEA Agreement guarantees equal rights and obligations within the SEM for citizens and economic operators from the EEA.

There is also close cooperation between EEA EU and EEA EFTA members in several important policy areas such as development aid outside the EEA and support to those EEA EU members which represent below average levels of GDP per capita. In parallel to EU cohesion and structural funds, the EEA EFTA countries offer social and economic development funding (joint EEA Grants and, in addition, Norway Grants<sup>8</sup>). The EEA EFTA countries also joined several EU programs (such as the Seventh Framework Program and Horizon-2020 in research or Marco Polo – Transport) and EU agencies (like the European Aviation Safety Agency or European Environmental Agency).

On the other hand, the EEA Agreement does not cover the common agriculture and fisheries policies (although it contains provisions on trade in agricultural and fish products), customs unions, common external trade policy, common foreign and security policy, justice and home affairs (although the EEA EFTA countries belong to the Schengen area), direct and indirect taxation, or the economic and monetary union. It is worth noting that Liechtenstein has been in a monetary and customs union with Switzerland since 1924.

Summing up, the EEA Agreement provides for a far-going though incomplete integration of the EEA EFTA countries into the SEM and several accompanying policies.

### **2.3. EEA's institutions and decision making process**

The EEA's institutions and decision making process have to reflect constitutional differences between its EU and non-EU members (see Emerson et al, 2002). While EU membership involves the delegation of several competences (primarily but not exclusively related to economic policy) to the supranational bodies (the European Parliament, Council of Ministers, European Commission, European Court of Justice), the EFTA members have been reluctant to relinquish this decision-making authority and this is the main reason they have chosen to stay outside the EU. Consequently, the decisions within the EEA must be taken by consensus and the EEA governing bodies have only consultative competences<sup>9</sup>.

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<sup>8</sup> See <http://eeagrants.org/>

<sup>9</sup> Within the EU, almost all regulations related to the SEM are subject to joint competence of the directly elected European Parliament (which adopts legislation by a simple majority voting) and the Council (representatives of national governments) which takes decisions by qualified majority voting (QMV). i.e. as of November 1, 2014, at least 55% of member states, representing at least 55%

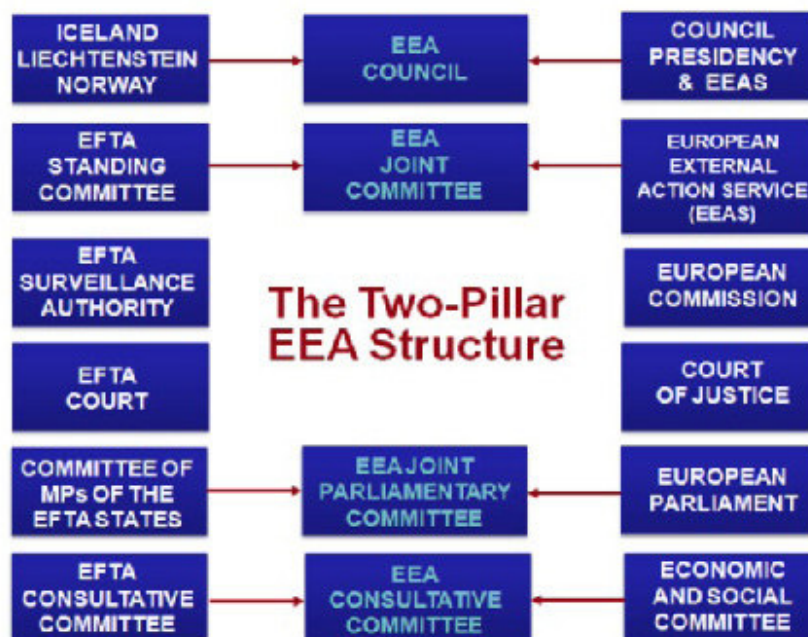


This is well illustrated by Figure 1, where the left pillar shows the decision making process within the EFTA (primarily on the national level) and the right pillar – within the EU (primarily on a supranational level). The middle pillar represents joint EEA bodies. They include representatives of the respective EU governing bodies, on the one hand, and three EEA EFTA countries on the other. However, the EEA EFTA countries must first agree to a common position on any issue before it will be discussed with the EU side in joint EEA bodies.

New EU regulations relevant for the EEA are discussed by the EEA governing bodies and are then adopted by the EEA EFTA governments, in some cases after the ratification process in their parliaments (if this is required by their constitutions).

According to the letter of EEA Agreement, EFTA countries have the opportunity to ask for certain modifications of new regulations, which are subject to approval by the EU Commission (in the case of technical modifications) or the European Parliament and EU Council (in the case of substantial ones). Furthermore, they are able to comment on draft legislation and their experts can participate in its preparing/discussion. Nevertheless, the actual influence of EEA EFTA countries on new EEA legislation and regulations is very limited (Emerson et al. 2002). Eventually, they must adopt every new piece of legislation coming from the EU. This is sometimes called a ‘faxed’ democracy.

**Figure 1. Institutions and decision making process within the EEA**



*This diagram illustrates the management of the EEA Agreement. The left pillar shows the EFTA States and their institutions, while the right pillar shows the EU side. The joint EEA bodies are in the middle.*

Source: EEA (2013).

of the population (if the draft law is proposed by the European Commission, otherwise the required majority is 72% of member states). In the case of disagreement between the European Parliament and the Council, a reconciliation procedure is launched. Overall, the above rules mean that no EU member state has veto power in respect to Single Market regulations.

Ironically, the EEA EFTA countries which do not want to join the EU because of their sovereignty concerns enjoy less actual sovereignty in several important economic policy areas related to the SEM as compared to EU member countries which participate in the EU legislation process with full voting rights.

## **2.4. Trade and investment flows between the EU and EEA EFTA countries**

All three EEA EFTA countries are highly integrated with the EU in terms of their trade, investment and financial flows. Therefore they are highly dependent on other EU economies and free access to the SEM is an issue of fundamental importance for their economic development.

In the case of Norway, the share of EU27 amounted to 80.1% of its exports and 63.6% of its imports in 2012<sup>10</sup>. In the case of Iceland, the figures were 71.1% and 43.8%<sup>11</sup>. However, in both cases, the EU share declined by a few percentage points between 2008 and 2012. Data on the geographic structure of Liechtenstein exports and imports is not available due to its customs union arrangement with Switzerland.

Norway is the EU's 5th largest import partner (5.6% of total EU27 external imports in 2012) and the 7th largest export destination (3% of EU27 total external exports in 2012). The role of two other EEA EFTA countries in EU trade is much smaller because of their limited size. In 2012, Iceland amounted to 0.2% of EU27 external imports (56th rank) and 0.1% of its external exports (67th rank). In the case of Liechtenstein it was 0.1% of both imports and exports (73rd and 78th ranks, respectively)<sup>12</sup>.

The investment flows are also intensive in both directions. In 2011, the accumulated stock of the EU's foreign direct investment (FDI) in Norway amounted to EUR 74.6 billion and Norwegian FDI in the EU amounted to EUR 76.6 billion<sup>13</sup>. In the case of Iceland the figures were EUR 6 billion and EUR 1.4 billion<sup>14</sup>, respectively.

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<sup>10</sup> See [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113429.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113429.pdf)

<sup>11</sup> See [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113389.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113389.pdf)

<sup>12</sup> See [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147313.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147313.pdf)

<sup>13</sup> See <http://ec.europa.eu/trade/policy/countries-and-regions/countries/norway/>

<sup>14</sup> See <http://ec.europa.eu/trade/policy/countries-and-regions/countries/iceland/>



## 3. EU's cooperation with Switzerland

### 3.1. History of cooperation between the EU and Switzerland

Switzerland is located at the heart of Western Europe and is totally surrounded by EU member states<sup>15</sup>. In fact, it is like an enclave within the EU territory. As a result, its economy and society have been very closely integrated with its EU neighbors for a long time (see Section 3.4). In 1972, Switzerland and the EEC signed an FTA supported by a large majority of Swiss voters in a referendum. The next integration step involved negotiating and signing the EEA Agreement which, however, as mentioned in Section 2.1, was rejected in the national referendum on December 6, 1992. The vote was close, with 49.7% of Swiss voters supporting EEA membership but most cantons voting against it (Vahl & Grolimund, 2006). As a result, Switzerland remained beyond the EEA Agreement and EEA institutions. Its government also had to suspend its EEC membership application submitted on May 20, 1992, just two weeks after signing the EEA Agreement.

In the next couple of years the motion of resuming Switzerland's EU accession process was put under either parliamentary voting (June 1996) or referenda (June 1997 and March 2001) but was rejected each time by quite a large margin of voters (Vahl & Grolimund, 2006).

Having political doors to both EEA and EU membership formally closed, the Government of Switzerland had to look for other legal avenues to deepen its country's bilateral cooperation with the EU, against the obvious economic benefits of such cooperation for both sides. The legal challenges originated not only from the political resistance to EEA and EU membership as expressed by the results of subsequent referenda but, even more importantly, from the peculiarities of Switzerland's constitutional system, i.e. the role of referenda in accepting many major decisions and international treaties and the role of cantons in the co-decision process at the federal level (see Vahl & Grolimund, 2006 for details).

Against the above mentioned legal and political constraints, the Government of Switzerland suggested the EEC/EU sign several bilateral sectoral agreements, which would have a technical rather than political character. The negotiation

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<sup>15</sup> Apart from the Principality of Liechtenstein which is located on the border between Switzerland and EU member state Austria.

process started in 1993 and was completed in two rounds (1999 and 2004) by the two sets of bilateral agreements (see Section 3.2). Another important agreement regarding Switzerland's participation in the EU's education, professional training and youth programs was signed in 2010<sup>16</sup>. In May 2013, both sides signed a Cooperation Agreement in Competition Matters, which requires ratification by both the European Parliament and the Swiss Parliament<sup>17</sup>.

On February 9, 2014 most Swiss voters approved a proposal in a federal referendum to introduce immigration quotas with respect to EU citizens which conflicts with the EU-Switzerland agreement on the free movement of persons signed within Bilateral I (see Section 3.2). The Government of Switzerland has three years to adjust the existing legislation and international agreements to the results of this referendum. The reaction of the European Commission pointed to the package character of existing bilateral agreements (see European Commission, 2014).

### **3.2. The content of bilateral agreements**

As mentioned in Section 3.1, most bilateral sectoral agreements between the EU and Switzerland were part of two broad packages signed in 1999 and 2004 referred to in Switzerland as Bilateral I and Bilateral II.

The Bilateral I package negotiated between 1994 and 1998 included 7 sectoral agreements related to: research, technical barriers to trade, free movement of persons, air transport, land transport, agriculture, and public procurement. The Bilateral II package negotiated between 2001 and 2004 included 9 additional sectoral agreements on processed agriculture goods, statistics, media, environment, pensions, taxation on savings, the Schengen association agreement, the Dublin convention association agreement (common asylum procedures), and the fight against fraud (see Vahl & Grolimund, 2006 for details). The two additional sectoral agreements (on education, professional training and youth programs of 2010 and on competition matters of 2013) were mentioned in Section 3.1. Several other bilateral agreements cover either narrow technical issues, update the previous ones, or extend their territorial coverage as a consequence of subsequent EU enlargements<sup>18</sup>.

Switzerland participates in some external EU programs and missions such as EULEX in Kosovo (since 2008) and EUPOL Proxima in Macedonia. It also provides financial contributions to economic and social cohesion in the new EU member states.

What is perhaps even more important, as of 1988 Switzerland has tried to unilaterally approximate its national legislation to the EEC/EU *acquis communautaire* (Maiani, 2008).

<sup>16</sup> See <http://ec.europa.eu/trade/policy/countries-and-regions/countries/switzerland/>

<sup>17</sup> [http://europa.eu/rapid/press-release\\_IP-13-444\\_en.htm](http://europa.eu/rapid/press-release_IP-13-444_en.htm)

<sup>18</sup> For the full list of bilateral agreements see <http://ec.europa.eu/world/agreements/searchByCountryAndContinent.do?countryId=3820&countryName=Switzerland>.

This was enshrined in the so-called Eurolex law adopted in 1992 by the Swiss federal parliament (Vahl & Grolimund, 2006). As a result, ca. 40% of Switzerland's legislation originates from EU rules (University of Kent, 2013).

Nevertheless, the scope of Switzerland's integration with the EU remains narrower than that of the EEA EFTA countries. The main difference concerns the free movement of services, an area in which Switzerland has failed to reach a comprehensive agreement with the EU so far. The same concerns state aid rules. Worse, some tax regulations in Switzerland, especially corporate income taxes (CIT) on the cantonal level, are considered by the EU as a hidden form of state aid and an '...unacceptable distortion of competition between the EU and Switzerland' (Council of the European Union, 2012b, p. 33, para. 36). Also, Switzerland's participation in various EU programs and agencies is more limited than that of the EEA EFTA countries.

It is also important to notice that the system of bilateral sectoral agreements is more static and less flexible in adapting to new SEM regulations as compared to the EEA Agreement which provides a greater degree of automatism in transferring SEM related acquis to non-EU EEA members. In the case of Switzerland, the adaptation to the new acquis usually requires renegotiation and amendments to respective bilateral agreements, some of them subject to ratification procedures on both sides. It takes time and makes Switzerland lag behind its EEA EFTA partners in terms of formal access to the SEM.

The above shortcomings of the system of bilateral sectoral agreements made the EU side reluctant to continue this integration avenue. This was clearly stated by the Council of the European Union (2012b, p. 32, para. 31):

'...the Council reaffirms that the approach taken by Switzerland to participate in EU policies and programmes through sectoral agreements in more and more areas in the absence of any horizontal institutional framework, has reached its limits and needs to be reconsidered. Any further development of the complex system of agreements would put at stake the homogeneity of the Internal Market and increase legal insecurity as well as make it more difficult to manage such an extensive and heterogeneous system of agreements. In the light of the high level of integration of Switzerland with the EU, any further extension of this system would in addition bear the risk of undermining the EU's relations with the EEA EFTA partners.'

The EU would welcome either a reconsideration of Switzerland's decision on membership in the EEA or the conclusion of another comprehensive agreement (a kind of AA). Such an agreement '...should, inter alia, provide for a legally binding mechanism as regards the adaptation of the agreements to the evolving EU acquis' (Council of the European Union (2012b, p. 32, para. 33). However, in light of the results of the anti-immigration referendum of February 9, 2014 (see Section 3.1), such a scenario does not look politically probable at the moment.

### **3.3. Institutional arrangements and the decision making process**

The system of bilateral sectoral agreements is monitored and managed by several joint or mixed committees consisting of representatives of the European Commission and the Government of Switzerland. Those committees are also in charge of dispute settlements. The decisions are taken by consensus.

Again, the EU side is not particularly happy with this mechanism. In its recent conclusions, the Council of the European Union (2012b, p. 32, para. 33) called for establishing ‘...international mechanisms for surveillance and judicial control’ in the future comprehensive cooperation agreement between the EU and Switzerland following the experience of the EEA.

The Government of Switzerland can participate, through its experts, in the early stages of the discussion on new SEM regulations in the areas covered by bilateral sectoral agreements. Nevertheless, its role is even more limited than that of governments of the EEA EFTA countries.

Once again, as in the case of EEA EFTA countries, strong sovereignty concerns which did not allow Switzerland to join the EU or even the EEA led to a paradoxical situation in which the country faced a dilemma: either unilaterally adopt a substantial part of the *acquis* (without being able to influence its content) or be denied access to the SEM. Despite formal equality in bilateral relations (which in some cases has been confirmed by the principle of mutual recognition of some regulatory standards and mechanisms), Switzerland’s bargaining power is very limited.

### **3.4. Trade and investment flows between the EU and Switzerland**

In 2012, 73.2% of Switzerland’s imports came from the EU while the share of EU exports in its total exports amounted to 53.3%. Switzerland was the EU’s 3rd most important export destination (7.9% of EU total external exports in 2012) after the US and China and the 4th most important import destination (5.8% of total imports) after China, Russia and the US<sup>19</sup>. Similarly to other EFTA countries (see Section 2.4), the share of bilateral trade decreased on both sides between 2008 and 2012, reflecting the growing role of emerging market economies in global and European trade.

In 2010, the inward stock of Swiss investment in the EU amounted to EUR 365.4 billion and the outward stock of the EU’s investment in Switzerland – to EUR 562.8 billion. Both trade and investment figures confirm very close economic relations between the EU and Switzerland and deep integration of the Swiss economy into the EU’s (similar or perhaps even stronger compared to other EFTA countries).

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<sup>19</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113450.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113450.pdf)

## **4. EU's cooperation with European micro-states and the OCT**

The EU's economic, institutional and political relations with European micro-states and OCT are also based on bilateral agreements with more or less comprehensive characters, somewhat similar to the EU's cooperation with Switzerland.

### **4.1. Micro-states**

The first group, i.e. micro-states, is represented by the Principality of Andorra, the Republic of San Marino, the Principality of Monaco, and the City of the Vatican State (the Holy See). All of them cover very small territories which are enclaves within the EU. Andorra is located in the Pyrenees between France and Spain, Monaco is on the French Mediterranean coast (surrounded by France and the Mediterranean Sea), and San Marino and the Vatican are full enclaves within the Italian territory. Their very small size and geographical location make micro-states almost totally dependent on trade and infrastructural links with the EU.

This makes a very strong case for their far-going cooperation if not full integration with the EU. However, in practice, their relations with the EU have been shaped on a case-by-case basis, often as a legacy of their previous economic, institutional and political relations with surrounding EU member states (Italy, France and Spain). As a result, their cooperation with the EU is only partial and based on bilateral sectoral agreements of varying thematic scopes and integrational depths (see European Commission, 2012a for detail overview).

All of the microstates use the Euro as their own currency with the limited right to mint their own coins. This means they remain in a kind of unilateral monetary union with the Eurozone, i.e. without participating in the monetary decisions of the European Central Bank (ECB), unlike the member states of the Economic and Monetary Union (EMU).

San Marino concluded a full customs union agreement with the EU in 2002. Andorra has a similar agreement with the EU as of 1990 but it is limited to industrial goods only. Monaco belongs to the EU customs territory by virtue of its old customs agreement with France. Formally, the Vatican does not belong to the EU customs territory but it enjoys preferential customs treatment on the basis of its old agreement with Italy.

None of the microstates is an official party of the Schengen Convention. However,

Monaco, San Marino and the Vatican belong de facto to the Schengen area because they have open borders with France and Italy, respectively. They therefore accept Schengen visas and holders of their travel documents can move freely within the Schengen area. Andorra retains external border control but accepts Schengen visas. France and Spain continue customs controls on their borders with Andorra because of its low VAT and excise tax rates.

Bilateral agreements between the EU and the microstates also cover other issues, for example, taxation on saving which is a sensitive problem for several EU member states (fighting tax havens). In many cases, microstates have unilaterally adopted various parts of the EU acquis either directly, or as a result of their old bilateral agreements with the surrounding EU member states (for example, Monaco with France). Nevertheless, microstates' citizens and the economic subjects registered in their jurisdictions have only partial access to the SEM and vice versa, i.e. the EU's economic subjects and citizens face various restrictions in terms of residence and access to the microstates' markets. The restrictions concern, firstly, the free movement of people (resident permits for visits longer than 3 months), access to services markets, and NTB in the trade of goods (technical, veterinary and phyto-sanitary standards).

The overall picture of EU relations with the microstates is far from transparent and the EU side calls them 'fragmented' relations (European Commission, 2012a). The European Commission (2012a) and the Council of the European Union (2012b) recommend upgrading these relations by either concluding comprehensive AA or offering the microstates accession to the EEA. However, the latter would require the prior accession of the microstates to the EFTA. A more ambitious option, i.e. EU accession, is not realistic in the near future as the EU is not prepared institutionally for the membership of such small states.

## 4.2. Overseas countries and territories

In 2014, the list of OCTs included 25 territorial units remaining in political dependency to four EU member states, i.e. Denmark, France, Netherland and the UK<sup>20</sup>. In most cases, OCTs enjoy far reaching autonomy on internal matters while foreign policy and defense competences are delegated to the governments of the EU member states to which they are linked to.

OCTs enjoy the status of EU associated territories based on Articles 198-204 of the Treaty on the Functioning of the European Union (TFEU), EU secondary legislation, i.e. the Overseas Association Decision (OAD) of November 25, 2013<sup>21</sup>, and specific sectoral agreements such as the Fisheries Partnership Agreement of July 30, 2006 between the EU, the Government of Denmark and the Home Rule Government of Greenland<sup>22</sup>.

<sup>20</sup> See [http://ec.europa.eu/europeaid/where/octs\\_and\\_greenland/index\\_en.htm](http://ec.europa.eu/europeaid/where/octs_and_greenland/index_en.htm)

<sup>21</sup> Council Decision 2013/755/EU of 25 November 2013 on the association of the overseas countries and territories with the European Union (OJ L344, 19.12.2013) - see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:344:0001:0118:EN:PDF>

<sup>22</sup> See [http://ec.europa.eu/europeaid/where/octs\\_and\\_greenland/documents/20130327-note3.pdf](http://ec.europa.eu/europeaid/where/octs_and_greenland/documents/20130327-note3.pdf)

There is also a separate Council Decision 2014/137 from March 14, 2014 on relations between the European Community on the one hand, and Greenland and the Kingdom of Denmark on the other<sup>23</sup>, in addition to the OAD.

The list of OCTs includes (as of July 1, 2014):

- Anguilla (UK),
- Aruba (Netherlands),
- Bermuda (UK),
- Bonaire (Netherlands),
- British Antarctic Territory (UK),
- British Indian Ocean Territory (UK),
- British Virgin Islands (UK),
- Cayman Islands (UK),
- Curaçao (Netherlands),
- Falkland Islands (UK),
- French Polynesia (France),
- French Southern and Antarctic Territories (France),
- Greenland (Denmark),
- Montserrat (UK),
- New Caledonia and Dependencies (France),
- Pitcairn (UK),
- Saba (Netherlands),
- Saint Barthelemy (France),
- Sint Eustatius (Netherlands),
- Sint Maarten (Netherlands),
- South Georgia and South Sandwich Islands (UK),
- Saint Helena, Ascension Island, Tristan da Cunha (UK),
- St. Pierre and Miquelon (France),
- Turks and Caicos Islands (UK),
- Wallis and Futuna Islands (France).

Except for Greenland, most OCTs are rather small islands with small populations, and some of them (the British Antarctic Territory, British Indian Ocean Territory, South Georgia and South Sandwich Islands, French Southern and Antarctic Territories) do not have a permanent local population at all. Bermuda has never adopted the association regime offered it by the EU.

The importance of the OCTs' trade relations with the EU differs territory by territory. For example, in 2012, 91.3% of Greenland's imports came from the EU and 63.5%

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<sup>23</sup> Council Decision 2014/137/EU of 14 March 2014 on relations between the European Union on the one hand, and Greenland and the Kingdom of Denmark on the other (OJ L76, 15.03.2014) – see <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0137&from=EN>



of its exports went to the EU (for the EU, Greenland was the 100th largest import and 108th largest export destination)<sup>24</sup>. For New Caledonia, the EU also remains the largest trade partner but with smaller shares in its total imports (42.3%) and exports (29.6%) as compared to Greenland. For the EU, New Caledonia was the 104th largest import and 88th largest export destination (all data for 2012)<sup>25</sup>. However, in the case of the Netherlands' Antilles (Aruba, Bonaire, Curacao, Sint Maarten, Saba and Sint Eustatius), only 7.5% of their imports came from the EU and 4.9% of their exports went to the EU in 2012. Venezuela, Brazil and the US are more important trade partners for the islands than the EU<sup>26</sup>.

Regarding trade regimes, the OCTs enjoy privileged trade relations with the EU but they do not belong to the EU customs territory and have only partial access to the SEM (because the application of the EU *acquis* is also partial). The new OAD of 2013 which replaced the previous one of 2001 opens the perspective of deeper trade integration between OCTs and the EU, including trade in services. All OCTs are beneficiaries of EU financial assistance under the European Development Fund (EDF).

Few French OCTs use the Euro, other OCTs use the Danish krone, the British pound, the US dollar or local currencies. None of the OCT belong to the Schengen zone. However, most OCTs residents have EU citizenship as they are holders of passports of their respective EU member states (Denmark, France, Netherlands and UK).

Summing up, despite the TFEU's common provision and OAD, the EU cooperation with the OCTs follows a rather country-by-country individualized pattern with various degrees of actual economic and institutional integration.

The EU relations with the OCTs are managed through various forms of multilateral for a and bilateral dialogue<sup>27</sup>:

- the annual OCT-EU forum (Commission, all OCTs and all the Member States to which they are linked),
- regular tripartite meetings (Commission, all OCTs and the Member States to which they are linked),
- partnership meetings (Commission, individual OCT and related Member State).

On an operational level, there is a special OCT Task Force within the European Commission and its Directorate-General for Development and Cooperation – EuropeAid, which is in charge of the day-to-day management of those relations.

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<sup>24</sup> [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147287.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147287.pdf)

<sup>25</sup> [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147347.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147347.pdf)

<sup>26</sup> [http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc\\_147345.pdf](http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147345.pdf)

<sup>27</sup> See [http://ec.europa.eu/europeaid/where/octs\\_and\\_greenland/index\\_en.htm](http://ec.europa.eu/europeaid/where/octs_and_greenland/index_en.htm)



## 5. EU cooperation with its future members

The EU does not have fixed external borders and it systematically expands by accepting new member states. However, as a deeply integrated bloc in economic, institutional and political terms, and with complex mandatory legal regulations (*acquis communautaire*), the EU cannot be joined overnight even by a country which has similar institutions and economic policies (as in the case of the EFTA countries). As a result, the accession process of new members, at least since the 1980s, takes years if not decades to be completed and involves several intermediate phases which bring applicants step-by-step to the EU. The accession process involves not only policy and institutional changes in candidate countries aimed at adopting the *acquis* but also privileged trade and investment relations with the EU, which bring them closer to the SEM.

### 5.1. The subsequent waves of EEC/EU enlargements

Historically, the subsequent waves of EEC/EU enlargements involved:

1. accession of Denmark, Ireland and the UK in 1973 (see Section 2.1),
2. accession of Greece in 1981,
3. accession of Portugal and Spain in 1986,
4. accession of Austria, Finland and Sweden in 1995 (see Section 2.1),
5. accession of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia in 2004,
6. accession of Bulgaria and Romania in 2007,
7. accession of Croatia in 2013.

The current list of official EU candidates includes (year of obtaining candidate status is indicated in brackets): Turkey (1999), Macedonia (2005), Iceland (2010), Montenegro (2010) and Serbia (2012). Three other countries (Albania, Bosnia and Herzegovina, Kosovo) are considered ‘potential candidates’<sup>28</sup>.

How many other countries may be considered in the future as potentially eligible for EU membership? To answer this question one must refer to Article 49 of the TEU, which determines that ‘any European state which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union’.

<sup>28</sup> See [http://europa.eu/about-eu/countries/on-the-road-to-eu-membership/index\\_en.htm](http://europa.eu/about-eu/countries/on-the-road-to-eu-membership/index_en.htm)

A literal interpretation of this article leads us to the conclusion that the future list of potential candidates might include EFTA countries (see Chapter 1 and 2), European microstates (Section 4.1) and those post-Soviet countries which are located in Europe, i.e. Belarus, Moldova, Russia and Ukraine (see Chapter 5). The hypothetical eligibility of Armenia, Azerbaijan and Georgia may be more problematic because of their geographical location in Asia (south of the main Caucasus range) despite their participation in the European Neighborhood Policy and Eastern Partnership (see Chapter 5). The Southern and Eastern Mediterranean neighbors of the EU (see Chapter 6) do not meet this geographic criterion, a fact that was practically confirmed by the rejection of Morocco's 1987 EEC application.

## **5.2. Conditions of EU membership and the logic and sequence of the EU accession process**

### **5.2.1. EU membership criteria**

In Section 5.1, we quoted Article 49 of the TEU which defines eligibility criteria to become an EU member in terms of both geography (location in Europe) and adherence to basic human rights and democratic values, with reference to Article 2 of the TEU. In turn, Article 2 of the TEU describes the values mentioned in Article 49 as ‘...respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities.’ Furthermore, they ‘...are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail’. This means that no economic preconditions are explicitly mentioned in Articles 2 and 49.

Nevertheless the economic conditions were set by the European Council in December 1993 in Copenhagen, along with the political and institutional ones. They are called now the Copenhagen criteria and they include<sup>29</sup>:

- political criteria: stability of institutions guaranteeing democracy, rule of law, human rights and respect for and protection of minorities,
- economic criteria: a functioning market economy and the capacity to cope with competition and market forces,
- administrative and institutional capacity to effectively implement the *acquis* and ability to take on the obligations of membership.

### **5.2.2. The main stages of the EU accession process**

Since the 1980s, the process is that each EEC/EU candidate country starts its accession process by signing an AA and FTA with the EEC/EU. This is followed by obtaining

<sup>29</sup> See [http://ec.europa.eu/enlargement/policy/glossary/terms/accession-criteria\\_en.htm](http://ec.europa.eu/enlargement/policy/glossary/terms/accession-criteria_en.htm)

EEC/EU candidate status and membership negotiations aimed at setting the pace and terms of the *acquis* adoption by the prospective member. After completing negotiations, both the incumbent members and the applicant countries have to formally approve the terms of enlargement through the ratification of accession treaties. In the case of most candidate countries, this has taken the form of a referendum<sup>30</sup>. As the EEC/EU integration has progressed and covered new policy areas, accession negotiations have become increasingly complex and take more and more time. The same concerns the content of AAs and FTAs which constitute the first step of the integration process.

As of now, one can distinguish the following major milestones in the EU accession process:

- negotiation and signing the AA and FTA, which includes political and legal provisions for starting the EU accession process,
- formal EU membership application,
- obtaining EU candidate status,
- opening membership negotiation,
- concluding membership negotiation,
- signing accession treaty,
- ratification of accession treaty and entering the EU,
- post-accession monitoring (Cooperation and Verification Mechanism),
- post-accession transitory periods, Schengen accession, EMU accession.

Each accession step, from signing and ratifying an AA and FTA to accession to the Schengen zone and the EMU requires the unanimous decision of all incumbent member states. The latter use this multi-step process not only to ensure that future members will be ready and able to meet all EU membership requirements but also as a tool to extract bilateral concessions from candidates (for example Greece put pressure on Macedonia to change its official name – see below).

Generally speaking, EU candidates are subject to extensive policy conditionalities set by the incumbent EU member states and EU governing bodies, which are considered the strongest and most effective incentives for EU applicants to conduct economic, institutional, political and social reforms (see Dabrowski & Radziwill, 2007). However, meeting such conditionality by the prospective candidate requires a lot of political effort and usually takes time. Furthermore, in some exceptional situations when the upfront costs are considered too high as compared to the quite distant membership perspective and the related benefits, the accession process can become stalled for quite a long period of time (see the examples of Turkey and Macedonia).

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<sup>30</sup> Norway's citizens rejected EEC/EU membership twice (referenda of 1972 and 1994) – see Section 2.1.

### **5.2.3. Free trade and association agreements**

Signing an AA and FTA constitutes the first step on a country's road to the EU. The most recent version applied to the Western Balkan countries was called the Stabilization and Association Agreement (SAA)<sup>31</sup>, which underscores the economic as well as political goals and content of the agreements.

The trade components of AAs with prospective EU members (at least in the case of the CEE and the Western Balkan applicants) belong to the category of so-called deep and comprehensive free trade arrangements (DCFTA), i.e. they involve not only the elimination of import tariffs but also non-tariff barriers, a liberalization of trade in services and investment regimes, and the far-reaching harmonization of various trade and investment-related regulations and institutions, especially in the area of competition policy, state aid, and public procurement (see Evans et al, 2004 for details of DCFTA concept). The association components of those agreements usually include mechanisms of political consultation and dispute settlement (e.g. the Association Council which holds meetings at least once a year), further institutional and legal harmonization commitments, and an outline of the political perspective of EU membership. In parallel, prospective EU members participate in various horizontal EU policies (for example, in multi-year framework research programs or student exchanges). They also benefit from EU financial and technical assistance<sup>32</sup> and most of them enjoy a visa free regime for short-term travel (up to 90 days) to the EU/EEA countries.

The political part of the AA requires ratification by the European Parliament and the national parliaments of all EU member states while the trade part is subject to the ratification procedure in the European Parliament only. As a result, the trade related chapters of those agreements often enter into force before the ratification procedure of the political chapters is complete. The implementation period of each agreement is scheduled for several years (usually up to 10). Quite often, the EU offers its prospective members the asymmetric import liberalization scheme in respect to manufacturing goods, i.e. the immediate removal of EU import barriers and the gradual liberalization of the import regimes of their partners.

At the end of the implementation period, the EU candidate obtains full or close to full access to the SEM in respect to manufacturing goods, capital movement and certain services while it continues to face restrictions in access to the EU market for agriculture products (because the country does not participate in the Common Agriculture Policy yet) and the free movement of labor. Summing up, the actual degree of the candidate's integration with the SEM falls short of that enjoyed by the EEA EFTA countries. However, it may be comparable to that of Switzerland.

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<sup>31</sup> Trade and Association Agreements (TAAs) in the case of countries which joined the EU in 2004 and 2007.

<sup>32</sup> Called the Instrument for Pre-Accession Assistance (IPA) in the EU Multiannual Financial Framework (MFF) for years 2007-2013.

FTAs and AAs have a bilateral character, i.e. they are concluded between the respective country and the EU. However, the EU tries to follow a similar template in each agreement to ensure they are maximally compatible with the *acquis* and will eventually facilitate EU membership negotiation with the respective country. In addition, the EU promotes the network of horizontal FTAs between candidate countries using the umbrella of the Central European Free Trade Agreement (CEFTA – see <http://www.cefta.int/> for details) which currently involves six Western Balkan actual or potential EU candidates (Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia) plus Moldova. Originally funded by the four so-called Visegrad countries (the Czech Republic, Hungary, Poland and Slovakia) in December 1992, it was subsequently joined by the new prospective EU candidates and eventually taken over by the Western Balkan countries in 2006-2007 after CEFTA funding members left this trade bloc as a result of their EU accession.

#### 5.2.4. EU candidate status and EU accession negotiations

After ratifying an AA and FTA and starting their implementation, a country interested in EU membership can submit a membership application. After a comprehensive screening of the applicant and based on the recommendation of the European Commission and European Parliament, the Council of the European Union can grant EU candidate status, which means the country is eligible to become an EU member.

Until the 1990s, obtaining EU candidate status meant starting EU membership negotiations but since the decision on Turkey's prospective EU membership, those two decisions have been split.

In the case of Turkey it took 6 years from obtaining EU candidate status (1999) to starting EU membership negotiations (2005)<sup>33</sup>. In the case of Macedonia, which obtained EU candidate status in 2005 but has not started EU membership negotiation yet (due to Greece's historic objections to Macedonia's country name), this time lag has been even longer (more than 8 years)<sup>34</sup>. However, in the case of other countries, it was shorter: Croatia obtained EU candidate status in June 2004 and started accession negotiations in October 2005<sup>35</sup>, Montenegro became an EU candidate in December 2010 and started accession negotiations in June 2012<sup>36</sup>, Serbia became an EU candidate in March 2013 and started negotiations in January 2014<sup>37</sup>. In the case of Iceland, the Council's decision to confirm EU candidate status (on June 17, 2010) meant the immediate opening of EU membership negotiations<sup>38</sup>.

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<sup>33</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index_en.htm)

<sup>34</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/former-yugoslav-republic-of-macedonia/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/former-yugoslav-republic-of-macedonia/index_en.htm)

<sup>35</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/croatia/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/croatia/index_en.htm)

<sup>36</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/montenegro/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/montenegro/index_en.htm)

<sup>37</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/serbia/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/serbia/index_en.htm)

<sup>38</sup> [http://ec.europa.eu/enlargement/countries/detailed-country-information/iceland/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/iceland/index_en.htm)

Membership negotiations cover 35 chapters, which correspond to the respective chapters of the *acquis*:

- Chapter 1: Free movement of goods,
- Chapter 2: Freedom of movement for workers,
- Chapter 3: Right of establishment and freedom to provide services,
- Chapter 4: Free movement of capital,
- Chapter 5: Public procurement,
- Chapter 6: Company law,
- Chapter 7: Intellectual property law,
- Chapter 8: Competition policy,
- Chapter 9: Financial services,
- Chapter 10: Information society and media,
- Chapter 11: Agriculture and rural development,
- Chapter 12: Food safety, veterinary and phytosanitary policy,
- Chapter 13: Fisheries,
- Chapter 14: Transport policy,
- Chapter 15: Energy,
- Chapter 16: Taxation,
- Chapter 17: Economic and monetary policy,
- Chapter 18: Statistics,
- Chapter 19: Social policy and employment,
- Chapter 20: Enterprise and industrial policy,
- Chapter 21: Trans-European networks,
- Chapter 22: Regional policy and coordination of structural instruments,
- Chapter 23: Judiciary and fundamental rights,
- Chapter 24: Justice, freedom and security,
- Chapter 25: Science and research,
- Chapter 26: Education and culture,
- Chapter 27: Environment,
- Chapter 28: Consumer and health protection,
- Chapter 29: Customs union,
- Chapter 30: External relations,
- Chapter 31: Foreign, security and defense policy,
- Chapter 32: Financial control,
- Chapter 33: Financial and budgetary provisions,
- Chapter 34: Institutions,
- Chapter 35: Other issues.

Negotiations on each chapter consist of two stages: screening (i.e. the detailed examination by the European Commission of the degree of the candidate's preparedness to adopt the respective part of *acquis*) and the negotiations related to the timetable and the detailed conditions of adopting the *acquis*. When the positions of both negotiating sides (the EU and the candidate country) are agreed upon, the negotiation on individual chapter becomes provisionally closed. The definite closing of negotiations can be declared only when there is agreement on all chapters.

Once negotiations on all chapters are completed the accession treaty is drafted. In the period between signing the accession treaty and formally joining the EU (usually one year or more), the future EU member enjoys the status of acceding country with the right to comment and issue opinions in respect to forthcoming EU legislation and participate in the meetings of EU governing bodies in an observer capacity.

### **5.2.5. Completing the accession agenda and post-accession monitoring**

The date a country joins the EU does not end its accession process. Usually the accession treaty and accompanying protocols determine transitory periods in respect to the adoption of various parts of the *acquis* based on the demand of either the new member or the incumbents. The first case relates, most frequently, to institution building (which takes time), adopting infrastructure and an environmental *acquis* (which are costly and take time) or non-residents' rights to purchase land (sovereignty concerns). Incumbents retain the right to postpone opening their labor markets for citizens of new member states (up to 7 years).

Although it is obligatory for new members to accede to the Schengen area and the EMU (they do not have the opt-out option as the UK and Denmark did in the case of the common currency and UK and Ireland in the case of Schengen), this is subject to separate conditionality and requires the unanimous approval of the incumbents. As demonstrated by difficulties in Bulgaria's and Romania's accession to the Schengen area or Bulgaria's desire to join the exchange rate mechanism ERM2 (which is the first step to join the EMU), meeting technical criteria is not always enough because of the various political concerns of the incumbents.

However, in the case of the EMU, one can also observe the opposite tendency: some EU member states which are formally obliged to adopt the common currency (i.e. they do not have the opt-out option) are in no hurry to do so for various economic and political reasons<sup>39</sup>. This concerns not only Sweden but also the Czech Republic, Hungary and Poland. This kind of wait-and-see approach does not necessarily mean violating the EU membership obligations assumed under the EU accession treaty (which includes the adoption of the common currency in due time); a country can simply postpone meeting the so-called Maastricht criteria,

<sup>39</sup> Analysis of these reasons and the political economy of EMU accession falls beyond the agenda of this study.



which is precondition to join the EMU.

In addition, Bulgaria and Romania became subject to a special post-accession monitoring procedure called the Cooperation and Verification Mechanism (CVM) in policy areas considered sensitive and critical by incumbent members, i.e. fighting corruption and organized crime and judicial reform (see [http://ec.europa.eu/cvm/index\\_en.htm](http://ec.europa.eu/cvm/index_en.htm), Gateva, 2010). If the semi-annual progress assessment carried out by the European Commission is considered unsatisfactory, a member state can be subject to sanctions, for example, the suspension of transfers from the EU cohesion and structural funds or the suspension of mutual recognition of court decisions in the area of criminal law and civil matters.

### 5.3. Western Balkan candidates

#### 5.3.1. Geography and economic relations with the EU

Countries which are called considered part of the Western Balkan region according to EU terminology include the post-Yugoslav states (all but Slovenia which joined the EU in 2004) and Albania. They are located in close geographical proximity to the EU, especially after its 2004, 2007 and 2013 enlargements. All of them except Kosovo have direct land borders with at least one EU member state.

The EU also remains their main trading partner and most FDI originates from the EU. In 2012, 72.5% of Macedonia's imports came from the EU27 and another 17.9% from EU actual and potential candidates (including Croatia). On the export side, the respective shares amounted to 52.6% (EU27) and 30.9% (EU actual and potential candidates)<sup>40</sup>. In Montenegro, 72.5% of total imports in 2012 came from the EU27 and another 3.8% from EU candidates<sup>41</sup>. 74.0% of its exports went to the EU27 and 7.9% to EU candidates. In Serbia in 2012, 62.9% of its imports came from the EU27 and 11.6% came from EU candidates. On the export side, the respective shares were 47.5% (EU27) and 31.7% (EU candidates)<sup>42</sup>. In Bosnia and Herzegovina, the respective figures for 2012 were 63.2% and 26.0% (imports), and 69.0% and 2.6% (exports)<sup>43</sup>. In Albania – 64.4% and 15.7% (imports) and 66.8% and 19.2% (exports)<sup>44</sup>.

For the EU, all of the Western Balkan countries (including Croatia) accounted for 0.9% of its external imports and 1.8% of its external exports in 2012<sup>45</sup> which resulted from the relatively small size of their economies.

<sup>40</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113381.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113381.pdf)

<sup>41</sup> [http://trade.ec.europa.eu/doclib/docs/2008/august/tradoc\\_140030.pdf](http://trade.ec.europa.eu/doclib/docs/2008/august/tradoc_140030.pdf)

<sup>42</sup> [http://trade.ec.europa.eu/doclib/docs/2008/august/tradoc\\_140028.pdf](http://trade.ec.europa.eu/doclib/docs/2008/august/tradoc_140028.pdf)

<sup>43</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113358.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113358.pdf)

<sup>44</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113342.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113342.pdf)

<sup>45</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_111477.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111477.pdf)



### 5.3.2. Dynamics of the EU accession process

Prior to 1990, the former Yugoslavia represented the so-called market socialism model, i.e. its economy was more market based and open to the outside world as compared to the Soviet bloc countries and Albania (the latter represented the extreme variant of a command economy and economic autarky). However, the disorderly collapse of the Yugoslav federation, accompanied by bloody ethnic and territorial conflicts in the 1990s, stopped the process of political and economic transition in its successor states for almost a decade. Only Slovenia managed to leave the Yugoslav federation at relatively low political and economic costs and join the EU in the first group of former communist countries in 2004. All of the other post-Yugoslav states and Albania were left behind.

The opportunity for Euro-Atlantic integration was offered to this region in 1999 in the aftermath of the Kosovo conflict. The first step involved proclaiming the Stability Pact for Southern and Eastern Europe (SEE) in June 1999. This was an EU initiative but other countries (the US, Canada, Japan, Russia, Turkey, Norway and Switzerland) and a number of international organizations were also involved. It consisted of three major pillars: Democracy, Economy and Security<sup>46</sup> and it opened the Stabilization and Association Process for the Western Balkans region.

The potential eligibility of the Western Balkan countries to become EU members was confirmed by the EU Summit in Thessaloniki in June 2003. The European Council reiterated ‘...its determination to fully and effectively support the European perspective of the Western Balkan countries, which will become an integral part of the EU, once they meet the established criteria’ (Council of the European Union, 2003, para. 40, p. 12). Subsequently, the SAAs were negotiated, signed and ratified with all Western Balkan countries except Kosovo. The SSA with Macedonia entered into force in 2004, with Croatia in 2005, with Albania in 2009, with Montenegro in 2010, and with Serbia in 2013 (as mentioned in Section 5.2.3, the trade parts of SAAs became effective earlier). The ratification process of SSA with Bosnia and Herzegovina is complete but its entering into force has been suspended because of the country’s inability to conduct the constitutional and legal reforms required by the EU and envisaged in the SAA. However, the trade part of SAA has been active since 2008.

Macedonia and Croatia obtained EU candidate status in 2004, Montenegro in 2010, and Serbia in 2012 (see Section 5.1). Croatia started membership negotiations in 2005 and finished them in 2011, becoming the 28th EU member on July 1, 2013. Montenegro started membership negotiations in 2012 (see Section 5.2.4) and Serbia started in January 2014. The EU candidate status of Macedonia is in fact frozen, in spite of the European Commission’s recommendation to open accession negotiations in October 2009 due to Greece’s reservations as to the country’s name (see above). The membership prospects of at least two potential candidates – Bosnia and Herzegovina

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<sup>46</sup> See <http://www.stabilitypact.org/about/default.asp>  
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and Kosovo – are currently under question. Bosnia and Herzegovina is paralyzed by the constitutional crisis originating from the dysfunctional Dayton Treaty of 1995 (ICG, 2012). Kosovo has not been recognized yet as a sovereign state by 5 EU members (Cyprus, Greece, Romania, Slovakia and Spain) which has delayed the launch of negotiations on SAA until 2013.

#### **5.4. EU relations with Turkey**

Turkey was the 16th largest economy in the world in 2012 as measured by GDP in millions of international USD based on purchasing power parity (PPP). It was the 5th largest destination of EU external exports in 2012 (4.5% of total) and it was the 7th most important source of EU imports (2.7% of total). The EU27 is Turkey's largest trade partner, with 29.3% of its exports going to the EU27 and 33.7% of its imports coming from the EU27 in 2012. However, the share of exports to the EU declined by almost 10 percentage points of the total since 2008<sup>47</sup>. Since the 1960s, a large number of Turkish migrants has been employed in EU member states, especially in Germany or Austria.

Turkey's close relations with the EEC/EU date back to the very beginning of the existence of this bloc. Turkey applied for EEC associated status as early as 1959, i.e. two years after signing the Treaty of Rome. After negotiations, it signed an AA in 1963 (called the Ankara Agreement). The country applied for full EEC membership in 1987 but obtained only EU candidate status 12 years later (in 1999). Its membership negotiations started in 2005. However, this negotiation has moved ahead at a very slow pace and was almost completely frozen in 2010 as a result of Turkey's refusal to normalize its relations with Cyprus on the one hand, and France's veto to opening negotiations on chapters which would assume Turkey's full EU membership (like Chapter 17 on Economic and Monetary Policy).

Several EU member states, especially Austria, France and Germany, are reluctant to grant EU membership to Turkey, referring to its continuous failure to meet the first set of the Copenhagen criteria (stable institutions able to guarantee democracy, rule of law, human rights and respect for and protection of minorities). However, the real cause behind these reservations is related to cultural differences and fears of large-scale migration. The same kind of fears slow down the process of visa liberalization between Turkey and EU/EEA. Turkey is the only EU candidate country whose citizens must obtain visas to travel to the EU.

On the trade policy front, however, Turkey moved closer to the EU than other EU candidates or even EEA EFTA countries by launching the EU-Turkey Customs Union for industrial and processed agricultural products on January 1, 1996. The Union does not cover agricultural products and coal and steel products for which Turkey has preferential trade agreements with the EU. The Customs Union requires the full harmonization of Turkey's customs tariffs and procedures with those of the EU. It also calls for following the EU's

<sup>47</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113456.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113456.pdf)

external trade policy. In practice, all FTAs signed by the EU with external partners must be automatically applied in Turkey. Meanwhile, Turkey's access to EU partners' markets requires negotiating and signing separate agreements with each of them, although they must remain in line with those signed by the EU. However, the existence of a customs union has helped Turkish industry increase its competitiveness on international markets (see Togan, 2012).

## **5.5. Political economy of EU accession process**

As mentioned in Section 5.2.2, the EU accession process has a powerful impact on candidate country's policies and their political, economic and social reforms. This has been demonstrated in the case of the Mediterranean (Southern) enlargement of the 1980s, the Eastern enlargement of 2004 and 2007 and the EU accession process of the Western Balkan countries in the 2000s and 2010s (among various studies, see Dabrowski and Radziwill, 2007; Dabrowski, 2013). Perhaps the case of the Western Balkans is the most telling: a region which suffered in the 1990s from bloody ethnic conflicts began to recover economically, resolve its ethnic and border conflicts, overcome totalitarian temptations and consolidate its young and fragile democracies once it received the opportunity of EU accession. For example, the gradual normalization of relations between Serbia and Kosovo, seemingly impossible in other circumstances, is happening only because of the strong interest of both societies to join the EU.

It is enough to compare the developments in SEE vs. Commonwealth of Independent States (CIS)<sup>48</sup>. In the mid-1990s, both regions represented, on average, similar levels of economic development and comparable progress in economic and political reforms (Dabrowski, 2013). However, after the Western Balkan countries were offered the EU membership perspective in the early 2000s, they moved quickly ahead in both areas while the CIS countries stagnated and even regressed in the political sphere.

The analysis of the deep roots of such strong EU magnetism for prospective members goes beyond the agenda of this study. In summary, one can say that this is a combination of expectations of economic wellbeing related to EU membership (including financial transfers from EU cohesion and structural funds), free access to SEM (in all its segments, including the free movement of people), a lack of trust in domestic political institutions and elites and the search for firm external anchors, historical sentiments (rejoining political Europe after centuries or decades of political isolation), geopolitical security and, last but not least, prestige coming from membership in the club of developed and rich nations.

Not surprisingly, these kinds of incentives do not always work in the case of rich nations with deeply rooted democratic traditions. In such cases, either sovereignty concerns (in the case of Switzerland) or strong sectoral interests (fears of potential losses due to the common EU fishery policies in Norway, Iceland and Greenland) can effectively block a country's accession to the EU.

<sup>48</sup> Georgia left the CIS in 2009. However, for analytical convenience, this study continues to refer to the 12 successor countries of the former USSR (all but Baltic states) as CIS countries/ economies.

Also, when moving towards Europe's geographical periphery, the interest to join/closely integrate with the EU can be weaker for various historical, geographical and political/geopolitical reasons. This is the case of some countries of the former Soviet Union.

Finally, when the incumbents' commitment with respect to an EU candidate's membership prospects is not strong enough it may discourage both the politicians and the population of the latter from investing in accession-related reform efforts. This is evident in the case of Turkey, where popular support for EU membership declined dramatically in the second half of the 2000s and the early 2010s after the EU membership negotiations had become effectively frozen. Support dropped from 73% in 2004 to 44% in 2013 (GMF, 2013, p. 46). Unfortunately, this decline led to the delay or even reversal of some political and legal reforms that were put in place to meet the Copenhagen criteria.

## 6. EU cooperation with East European countries

### 6.1. Importance of Eastern neighbors for the EU and vice versa

#### 6.1.1. Geography, historic and cultural factors

The 2004 and 2007 EU enlargements moved the EU external borders to the East and Southeast, radically altering the EU's geopolitical and economic perception of CIS countries and their potential importance as economic and political partners.

Until these enlargements, CIS countries formed the second, outer 'ring' of EU neighbors, being geographically separated from the EU by the EU accession countries of Central and Eastern Europe (CEE). Their economic and political importance for the EU15 (i.e. 'old' member states) was quite limited with the exception of Russia, the largest (territorially) country in the world with huge natural resources and nuclear weapons, directly bordering one of the EU members (Finland).

To simplify, the real economic and foreign policy interests of the EU15 in cooperation with the CIS countries concentrated primarily on the supply of oil and natural gas from Russia, and on the relative geopolitical stability of the post-Soviet area (avoiding proliferation of regional and ethnic conflicts).

The picture changed with the Eastern Enlargement of the EU. First, in purely geographical terms, four post-Soviet countries – Russia, Ukraine, Belarus and Moldova – became direct EU neighbors, sharing long land borders. In a longer time horizon, with Turkey's potential accession, three Caucasian countries (Armenia, Azerbaijan and Georgia) will also share land borders with the EU. They already share the Black Sea basin with the enlarged EU. This means that all but the Central Asian post-Soviet countries have already moved, or will move, geographically from the second to the first ring of EU neighbors.

Most of the new members states (NMS) of the EU have a political and economic history that is similar to the countries of the former USSR. This is not only due to their experience with communism during the second half of the 20th century, as some of them were part of the Russian empire (part of Poland, Baltic countries, Finland) before World War I. There are close ethnic and cultural links between the NMS and EU candidate countries on the one hand and the CIS countries on the other

(Romania with Moldova, Poland with Belarus and Ukraine, the Russian speaking minority in the Baltic countries with Russia, Turkey with Azerbaijan and most of post-Soviet Central Asia).

### 6.1.2. Trade

Among this group of countries, Russia is the most important trade partner of the EU27 due to the size of its economy<sup>49</sup> and its role as major oil and natural gas supplier. It was the 2nd biggest source of EU external imports in 2012 (11.9% of total) after China and the 4th largest EU export destination (7.3% of total EU external exports) after the US, China and Switzerland<sup>50</sup>. For Russia, the EU27 is the biggest trade partner: 35.5% of its imports came from the EU in 2012 and 45.7% of its exports went to the EU (see Table 1).

Ukraine is the second largest EU trade partner in this region. In 2012, it was the 19th largest export destination (1.4% of total external EU exports) and the 25th largest source of EU imports (0.8% of total external imports). As in the case of Russia, the EU27 is Ukraine's biggest trade partner: 39.9% of Ukraine's total imports in 2012 came from the EU and 21.8% of its exports went to the EU<sup>51</sup>.

Kazakhstan comes in third. Its share in the EU's external imports is even higher than that of Ukraine (1.4% and 16th rank in 2012 due to the role of oil). As an EU export destination, it occupies the more distant 37th position with a share of only 0.4% of its total exports. For Kazakhstan, the EU27 is its most important export destination (39.9% of total exports in 2012) but only the 3rd most important import destination (19.9% of total) after Russia and China<sup>52</sup>.

**Table 1. Share of EU27 in % total imports and exports of CIS countries, 2012**

Country	imports	exports
Armenia	24.5	35.4
Azerbaijan	28.5	53.8
Belarus	20.0	37.8
Georgia	27.4	23.5
Kazakhstan	19.9	39.9
Kyrgyzstan	5.7	2.9
Moldova	53.4	51.9
Russia	35.5	45.7
Tajikistan	4.6	8.1
Turkmenistan	17.3	6.8
Ukraine	39.9	21.8
Uzbekistan	14.0	2.8

*Source:* Data from European Commission, Directorate-General for Trade.

<sup>49</sup> In 2012, Russia was the 6th largest economy in the world as measured by GDP in international dollars PPP based and it contributed to 3% of global output (WEO, 2013, Table A, p. 139).

<sup>50</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113440.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf)

<sup>51</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113459.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf)

<sup>52</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113406.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113406.pdf)



Table 2a. EU-CIS trade: five main imported and exported products, 2010, by country

EU-27 imports				EU-27 exports			
SITC code	Product	Value (EUR million)	Share in total imports from the country	SITC code	Product	Value (EUR million)	Share in total exports to the country
<b>ARMENIA</b>				<b>ARMENIA</b>			
67	Iron & steel	91	35	66	Non-met. mineral manufactures	52	9
68	Non-ferrous metals	66	26	74	General industrial machinery	44	8
66	Non-met. mineral manufactures	44	17	72	Specialized machinery	34	6
28	Metalliferous ores	20	8	76	Telecomm. & sound-rec. equipm.	33	6
84	Art. of apparel, clothing access.	16	6	77	Electrical machinery	27	5
<b>AZERBAIJAN</b>				<b>AZERBAIJAN</b>			
33	Petroleum, petroleum products	9 537	98	89	Miscellaneous manufactured art.	327	14
71	Power-generating machinery	17	0.2	74	General industrial machinery	213	9
05	Vegetables and fruit	16	0.2	79	Other transport equipment	200	9
34	Gas, natural & manufact.	14	0.1	72	Specialized machinery	170	7
72	Specialized machinery	7	0.1	78	Road vehicles	141	6
<b>BELARUS</b>				<b>BELARUS</b>			
33	Petroleum, petroleum products	700	27	78	Road vehicles	978	15
67	Iron & steel	361	14	72	Specialized machinery	791	12
56	Fertilizers	284	11	74	General industrial machinery	633	9
24	Cork and wood	160	6	77	Electrical machinery	336	5
69	Manufactures of metals	122	5	57	Plastics in primary forms	334	5
<b>KAZAKHSTAN</b>				<b>KAZAKHSTAN</b>			
33	Petroleum, petroleum products	13 769	87	74	General industrial machinery	609	12
68	Non-ferrous metals	433	3	72	Specialized machinery	499	10
34	Gas, natural & manufact.	415	3	77	Electrical machinery	488	9
52	Inorganic chemicals	308	2	54	Medicinal & pharmaceutical prod.	460	9
67	Iron & steel	131	1	78	Road vehicles	294	6
<b>KYRGYZ REPUBLIC</b>				<b>KYRGYZ REPUBLIC</b>			
52	Inorganic chemicals	182	91	72	Specialized machinery	23	11
68	Non-ferrous metals	4	2	33	Petroleum, petroleum products	23	11
05	Vegetables and fruit	4	2	78	Road vehicles	23	11
28	Metalliferous ores	3	1	54	Medicinal & pharmaceutical prod.	19	9
12	Tobacco and tobacco manufact	2	1	74	General industrial machinery	13	6
<b>MOLDOVA</b>				<b>MOLDOVA</b>			
84	Art. of apparel, clothing access.	148	25	33	Petroleum, petroleum products	178	12
05	Vegetables and fruit	51	9	78	Road vehicles	148	10
65	Textile yarn, fabrics	49	8	65	Textile yarn, fabrics	118	8
85	Footwear	47	8	77	Electrical machinery	101	7
77	Electrical machinery	38	7	74	General industrial machinery	60	4
<b>RUSSIA</b>				<b>RUSSIA</b>			
33	Petroleum, petroleum products	100 075	63	78	Road vehicles	9 425	11
34	Gas, natural & manufact.	13 563	9	74	General industrial machinery	6 935	8
68	Non-ferrous metals	5 996	4	54	Medicinal & pharmaceutical prod.	6 703	8
67	Iron & steel	4 331	3	77	Electrical machinery	5 239	6
32	Coal, coke and briquettes	3 676	2	72	Specialized machinery	4 851	6

Source: [http://epp.eurostat.ec.europa.eu/statistics\\_explained/images/c/c1/Five\\_main\\_imported\\_and\\_exported\\_products%2C\\_2010%2C\\_by\\_country.PNG](http://epp.eurostat.ec.europa.eu/statistics_explained/images/c/c1/Five_main_imported_and_exported_products%2C_2010%2C_by_country.PNG).

For the same reason (the role of oil), Azerbaijan contributed 0.8% of total EU27 external imports in 2012 (ranked 27th) while its share in EU27 external exports amounted

to 0.2% (58th). For Azerbaijan, the EU27 was its number one trade partner in 2012, accounting for 53.8% of the country's exports and 28.5% of its imports<sup>53</sup>.

Belarus was ranked as the EU's 35th most important export partner in 2012 (0.5% of total EU external exports) and 49th in terms of imports (0.3% of total EU's external imports). Interestingly, for Belarus, the EU was the largest export destination in 2012 (37.8% of its total exports) and the 2nd largest import partner (20% of total imports) as compared to Russia, which provided 59.0% of imports<sup>54</sup>.

**Table 2b. EU-CIS trade: five main imported and exported products, 2010, by country – cont.**

EU-27 imports				EU-27 exports			
SITC code	Product	Value (EUR million)	Share in total imports from the country	SITC code	Product	Value (EUR million)	Share in total exports to the country
<b>TAJKIKISTAN</b>				<b>TAJKIKISTAN</b>			
68	Non-ferrous metals	31	54	06	Sugars, sugar prep. and honey	24	16
26	Textile fibres	12	20	78	Road vehicles	23	16
84	Art. of apparel, clothing access.	10	18	72	Specialized machinery	21	15
65	Textile yarn, fabrics	3	5	54	Medicinal & pharmaceutical prod.	16	11
67	Iron & steel	1	1	84	Art. of apparel, clothing access.	8	5
<b>TURKMENISTAN</b>				<b>TURKMENISTAN</b>			
33	Petroleum, petroleum products	317	86	74	General industrial machinery	145	20
65	Textile yarn, fabrics	14	4	69	Manufactures of metals	74	10
84	Art. of apparel, clothing access.	10	3	72	Specialized machinery	72	10
26	Textile fibres	3	1	78	Road vehicles	62	9
28	Metalliferous ores	2	1	77	Electrical machinery	39	5
<b>UKRAINE</b>				<b>UKRAINE</b>			
67	Iron & steel	3 213	28	77	Electrical machinery	1 317	8
28	Metalliferous ores	1 400	12	78	Road vehicles	1 220	7
33	Petroleum, petroleum products	892	8	54	Medicinal & pharmaceutical prod.	1 143	7
77	Electrical machinery	654	6	74	General industrial machinery	984	6
22	Oil-seeds and oleaginous fruits	558	5	33	Petroleum, petroleum products	910	5
<b>UZBEKISTAN</b>				<b>UZBEKISTAN</b>			
52	Inorganic chemicals	88	21	79	Other transport equipment	251	20
34	Gas, natural & manufact.	74	18	72	Specialized machinery	143	11
65	Textile yarn, fabrics	56	13	54	Medicinal & pharmaceutical prod.	131	11
28	Metalliferous ores	37	9	74	General industrial machinery	118	9
56	Fertilizers	31	7	78	Road vehicles	59	5

Source: [http://epp.eurostat.ec.europa.eu/statistics\\_explained/images/1/16/Five\\_main\\_imported\\_and\\_exported\\_products%2C\\_2010%2C\\_by\\_country\\_%28continued%29.PNG](http://epp.eurostat.ec.europa.eu/statistics_explained/images/1/16/Five_main_imported_and_exported_products%2C_2010%2C_by_country_%28continued%29.PNG)

The share of other CIS countries in EU27 total external trade remains insignificant (in the range of 0.0% to 0.1%) due to the small size of their economies. However, for some countries, the EU27 is the most important trade partner (see Table 1). This concerns, in first instance, Moldova (53.4% of its imports and 51.9% of its exports in 2012) and, to a lesser degree, Armenia (24.5% and 35.4% respectively) and Georgia (27.4% and 23.5%). For Central Asian countries other than Kazakhstan, trade with the EU27 plays a less important role. Russia, China, Turkey and their Central Asian neighbors

<sup>53</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113347.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113347.pdf)

<sup>54</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113351.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113351.pdf)



are often the key trade partners for these countries.

In most cases, the CIS exports to the EU consist of just one commodity or group of commodities: energy resources in the case of Azerbaijan, Kazakhstan, Russia, Turkmenistan and Belarus, ferrous and non-ferrous metals in Armenia, Tajikistan and Ukraine, and inorganic chemicals in Kyrgyzstan (Table 2a and b). The monoculture structure of CIS countries' exports can be considered a serious source of vulnerability in case of external shocks.

For the EU, energy resources imported from the CIS, especially from Russia and the Caspian Sea region play a very important role. For example, many CEE countries remain almost totally dependent on natural gas imports from Russia (see Paczynski & Papava, 2011).

### 6.1.3. Migration

Migration represents an important economic and social phenomenon in CIS countries, especially those representing a low or lower-middle-income level, as illustrated by the size of remittances and number of migrants. Emigrant remittances constitute a substantial portion of GDP (Table 3) and an important balance-of-payment item, especially in Tajikistan, Moldova, Kyrgyzstan and Armenia. According to the estimation of Barbone et al. (2013, Table 1, p. 32), between 4 and 26% of the labor force in the Eastern Partnership (EaP) countries emigrated abroad. However, only a smaller number of them went to the EU (mostly from Moldova, Ukraine and Georgia). Russia remains the most popular destination for CIS labor migrants. They also go to Turkey, Kazakhstan and other countries.

**Table 3. CIS: Labor remittances as a % of GDP**

Country	2005	2008	2012
Armenia	10.2	9.1	14.6
Azerbaijan	5.2	3.2	2.7
Belarus	0.8	1.1	1.1
Georgia	5.4	5.7	6.7
Kazakhstan	0.3	0.1	0.1
Kyrgyzstan	13.1	24.0	32.7
Moldova	30.8	31.3	24.1
Russia	0.4	0.4	0.3
Tajikistan	20.2	49.3	49.3
Ukraine	0.7	3.2	3.6

Note: Workers' remittances are goods and financial instruments transferred by migrants living and working (as residents) in a new economy to residents of the home economy.

Source: <http://unctadstat.unctad.org/TableViewer/tableView.aspx>

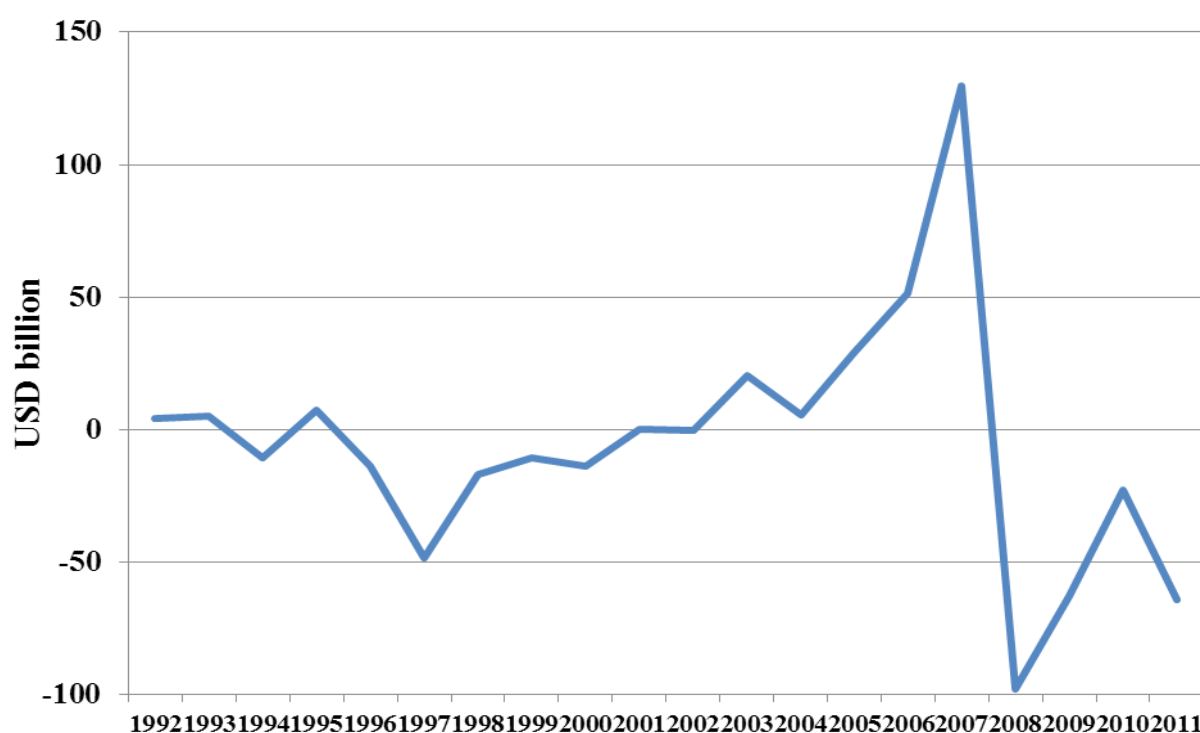
For the EU as a whole, immigrants from the CIS still constitute a small share of total migrant inflows. Intra-EU flows and migration from the Middle East, Africa and Asia represents a much larger share. However, migration flows from the CIS are unevenly distributed

between EU member countries, with the majority of immigrants settling in EU NMS and Northern Mediterranean countries (factors of geographical, cultural and language proximity play an important role here).

#### 6.1.4. Foreign investment

For many years, CIS countries lagged behind the CEE in attracting FDI. This was mainly due to the poor business and investment climate in this region which was caused by high inflation, high fiscal deficits, currency instability, poor protection of property rights, insider-oriented privatization, numerous bureaucratic obstacles (including those directly affecting foreign investors), delays in adopting market-oriented legislation and its effective enforcement, pervasive corruption, a fragile financial sector, and underdeveloped infrastructure (see Kudina & Jakubiak, 2011).

**Figure 2. Net private capital flows to the CIS region, in USD billion, 1992-2011**



Source: IMF (World Economic Outlook database, October 2012).

A substantial part of recorded FDI had, in fact, post-Soviet origins, even if it was formally recorded as originating in other countries (repatriation of capital, which earlier fled CIS countries). Most investments were concentrated in only a few sectors such as energy or mobile telephony. The situation began to change in the mid-2000s, with rapid capital inflows to the largest CIS economies such as Russia, Ukraine and Kazakhstan (see Figure 2). Their sectoral destination was much broader than before, including various manufacturing

industries, retail trade, financial services, etc. Also, portfolio capital flows did seriously increase (see Lozovyi & Kudina, 2007). Some smaller CIS economies managed to increase FDI flows either due to investment in the energy sector (Azerbaijan), or as a result of privatization and some improvement in the investment climate (Armenia, Georgia and Moldova). A substantial part of these capital inflows came from the EU.

**Table 4. Foreign direct investment, CIS countries, inward stock, 2007 and 2009**

Country	USD per capita <sup>a</sup>		Percentage of GDP	
	2007	2009	2007	2009
CIS countries				
Armenia	797	1,177	26.6	41.6
Azerbaijan	990	1,024	25.8	21.0
Belarus	461	878	9.9	17.2
Georgia	1,229	1,771	52.7	70.3
Kazakhstan	2,900	4,626	42.6	67.7
Kyrgyzstan	153	196	21.5	23.9
Moldova	504	723	42.0	48.2
Russia	3,461	1,792	38.0	20.3
Tajikistan	151	125	44.7	36.2
Turkmenistan	789	1,194	49.5	..
Ukraine	822	1,138	26.7	45.0
Uzbekistan	81	132	9.7	12.4
EU NMS				
Bulgaria	4,955	6,724	95.7	107.7
Croatia	10,175	8,288	76.9	58.1
Cyprus	23,484	33,771	84.9	116.1
Czech Republic	10,947	11,177	64.6	59.2
Estonia	12,493	12,123	80.3	86.3
Hungary	19,809	24,886	143.2	192.8
Latvia	4,779	5,213	37.7	44.8
Lithuania	4,488	4,210	38.7	37.0
Malta	20,642	23,037	112.4	120.0
Poland	4,679	4,801	42.0	42.5
Romania	2,935	3,478	37.2	46.1
Slovakia	8,389	9,297	60.3	56.8
Slovenia	7,151	7,542	30.5	31.2
EU candidates and potential candidates				
Albania	792	1,121	22.8	28.5
Bosnia & Herzegovina	1,822	2,075	45.5	45.9
Macedonia	1,833	2,208	47.2	51.7
Montenegro	—	7,336	—	105.1
Serbia	—	2,090	—	42.3
Turkey	2,097	1,039	23.3	12.4

Note: a - at current prices and current exchange rates

Source: <http://unctadstat.unctad.org/TableViewer/tableView.aspx>

However, capital inflows to the CIS (including FDI) have been either slowed down or even partly reversed (in the case of Russia) as a result of the global financial crisis of 2008-2010, and the after-crisis recovery of these inflows has been slow and uneven.

Overall, as demonstrated by Table 4, CIS countries continue to experience a substantial gap in the size of FDI flows, not only with respect to EU NMS, but also with respect to EU candidate countries. Furthermore, FDI in the CIS differs from that in the two other regions

(Kudina & Jakubiak, 2011): foreign investors in the CIS predominantly seek domestic market opportunities in the host country (with most production supplies coming from abroad) rather than efficiency considerations (low-cost opportunities for developing a global production chain). Therefore, the potential innovation and efficiency spillovers to domestic producers are limited. Such a strategy is caused by a continuous poor business climate in the CIS region.

## 6.2 EU – CIS cooperation before 2004

Cooperation between the EU15 and CIS countries was built on the basis of bilateral Partnership and Cooperation Agreements (PCA) negotiated during the 1990s. Nine of them entered into force between 1997 and 1999, and one in 2010 (see Table 5). The PCA with Belarus was signed in March 1995 and the PCA with Turkmenistan in May 1998; yet, to date, neither has entered into force due to political reasons. The economic relations between EU and Turkmenistan are governed by the 1998 Interim Trade Agreement and Memorandum of Understanding and Cooperation in the Field of Energy signed in 2008<sup>55</sup>.

**Table 5. Partnership and Cooperation Agreements between EU and CIS countries**

Country	Entered in force
Armenia	1.07.1999
Azerbaijan	1.07.1999
Georgia	1.07.1999
Kazakhstan	1.07.1999
Kyrgyzstan	1.07.1999
Moldova	1.07.1998
Russia	1.12.1997
Tajikistan	1.01.2010
Ukraine	1.03.1998
Uzbekistan	1.07.1999

*Source:* [http://europa.eu/legislation\\_summaries/external\\_relations/relations\\_with\\_third\\_countries/eastern\\_europe\\_and\\_central\\_asia/r17002\\_en.htm](http://europa.eu/legislation_summaries/external_relations/relations_with_third_countries/eastern_europe_and_central_asia/r17002_en.htm)

The PCAs offer little in the area of economic integration: the MFN clause, some technical, legal and institutional cooperation in such sectors as transportation, energy, competition policy, some legal approximation in the areas of customs law, corporate law, banking law, intellectual property rights, technical standards and certification, etc. This was even recognized in the official communication of the European Commission (2003, p. 5): ‘In contrast to contractual relations with all of the EU’s other neighbouring countries, the Partnership and Cooperation Agreements (PCAs) in force with Russia, Ukraine and Moldova grant neither preferential treatment for trade, nor a timetable for regulatory approximation’.

The EU cooperation offer towards the CIS differed from the agenda and implementation mechanism of the TAAs and SAAs (see Section 5.2.3). Both the TAAs and SAAs were

<sup>55</sup> [http://ec.europa.eu/energy/international/doc/mou\\_turkmenistan.pdf](http://ec.europa.eu/energy/international/doc/mou_turkmenistan.pdf)

aimed at building DCFTA, and included a broad agenda of institutional harmonization (adopting the *acquis* by EU partners). Most importantly, they offered the perspective of EU membership. Some of the TAAs and SAAs were negotiated and signed simultaneously with respective countries' accession to the WTO, in a few cases even before the formal conclusion of the latter. This stood in sharp contrast to the EU's attitude towards CIS countries: their WTO membership was considered by the EU as a basic precondition to starting negotiations on any kind of bilateral FTA.

The WTO accession process of the largest CIS countries went slowly (Ukraine completed it successfully in 2008, Russia in 2012) so the perspective of trade liberalization between the EU and these large economies remained distant until very recently. However, the same concerned the smaller countries – Kyrgyzstan, Moldova, Armenia and Georgia – which joined the WTO in the late 1990s or early 2000s (Tajikistan joined the WTO in 2013).

To have a complete picture, one must admit, however, that all CIS countries could benefit, to various degrees, from the Generalized System of Preferences (GSP) offered unilaterally by the EU to less developed countries. These are primarily preferential import tariffs.

From the very beginning of their independence, CIS countries also benefited from generous European aid programs delivered both by the EEC/EU as a whole and its individual member states (Light, 2007). Among these programs, the TACIS (1991-2012) was aimed at supporting the democratic and market transition, economic and social modernization, cross-border cooperation and solving numerous regional/sub-regional issues.

### **6.3. European Neighborhood Policy**

The EU attitude towards the CIS region began to change at the beginning of the 2000s. The imminent EU Eastern Enlargement stimulated an intra-EU debate and conceptual effort to upgrade relations with both its Eastern and Southern neighbors. The debate highlighted the notion that the CIS region is far from homogeneous in political, economic and social terms, and CIS countries require a more individualized approach (Light, 2007).

The Communication on Wider Europe of March 11, 2003 (European Commission, 2003) was the first attempt to propose a new policy framework towards the countries which were to become direct geographical neighbors after the Eastern Enlargement. This document was followed by the official launch of the ENP on May 12, 2004 (European Commission, 2004).

Interestingly, the 2003 Communication on Wider Europe, which reflected the initial position of the Commission, offered a wider and more far-reaching vision of cooperation with neighbors and clearer incentives for them than the subsequent 2004 ENP Strategy Paper, which also took into account the views of the individual EU member states. The first paper used clearer language regarding access to the EU internal market, perspectives of free movement

of people, visa facilitation, and other potential incentives, while the Strategy Paper put more emphasis on EU security interests, fighting illegal migration, etc. (Schweickert et al., 2007).

According to the ENP Strategy Paper, the declared ENP objective was to avoid the emergence of new dividing lines between the enlarged EU and its old and new direct neighbors, as well as strengthening stability, security and well-being in the entire mega-region. The European Commission (2004, p. 3) offered its neighbors a privileged relationship built upon ‘...mutual commitment to common values principally within the fields of the rule of law, good governance, the respect for human rights, including minority rights, the promotion of good neighbourly relations, and the principles of market economy and sustainable development. (...) The level of ambition of the EU’s relationships with its neighbours will take into account the extent to which these values are effectively shared’.

Originally this general declaration was followed by a clear statement that the ENP is not concerned with the next EU enlargements nor does it offer neighbors an EU accession perspective. At the end of 2006, it was replaced by a more flexible approach: ‘the ENP remains distinct from the process of enlargement although it does not prejudice, for European neighbors, how their relationship with the EU may develop in the future, in accordance with Treaty provisions’. ([http://eeas.europa.eu/enp/about-us/index\\_en.htm](http://eeas.europa.eu/enp/about-us/index_en.htm))

In fact, this can be considered a return to both the language and spirit of the 2003 Communication on Wider Europe. As a result, the door became hypothetically opened for those CIS countries which are participants in the ENP (see below) and which will be ready to harmonize their political, economic and legal systems with the *acquis*. This seems to be, however, a very distant and unclear perspective, particularly if one takes into consideration the phenomenon of ‘enlargement fatigue’ that has recently been observed in some EU member states. Although the anti-enlargement sentiment works particularly strongly against the EU membership aspirations of Turkey (see Section 5.4), one can expect a similar reaction to the EU membership aspirations of Ukraine, Moldova or the Caucasus countries when they begin to materialize.

So, if the perspective of EU membership is either very weak and distant (as in the case of European CIS countries) or non-existent (as in the case of the Southern Mediterranean neighbors), what are the alternative incentives provided by the ENP to encourage neighboring countries to undertake a costly modernization effort (see Kolesnichenko, 2011), accept European values in terms of democracy, human rights and market economy, and cooperate closely with the EU on security issues? The general answer is: access to the EU internal market: ‘The approach proposed by the ENP [...] offers neighbouring countries the prospect of a stake in the EU Internal Market based on legislative and regulatory approximation, the participation in a number of EU programmes and improved interconnection and physical links with the EU’ (European Commission 2004, p. 14).

However, so far there has been no clear interpretation of what a stake in the EU Internal Market means in practice. Furthermore, taking into consideration the poorly developed



institutional basis of trade and economic relations between the EU and Eastern neighbors (so far based only on PCAs – see Section 6.2), it is very unlikely that the ENP can offer the latter full participation in the SEM, similar to that of EEA EFTA countries. This has been confirmed by the content of the DCFTAs negotiated with Ukraine (2008-2011) and with Moldova, Georgia and Armenia (2011-2013) which envisage only selective participation in some segments of the SEM (see Section 6.4).

The Council of the European Union (2007a) strengthened the concept of the ENP by suggesting the institutional framework of the DCFTA as a tool of modernization and support to economic and institutional reforms in neighborhood countries. At the last review of the ENP conducted in 2010-11, the EU introduced the more-for-more principle, which offers stronger partnerships and greater incentives ‘...to countries that make more progress towards democratic reform – free and fair elections, freedom of expression, of assembly and of association, judicial independence, fight against corruption and democratic control over the armed forces<sup>56</sup>’.

The ENP is conducted through bilateral Action Plans and the principle of bilateralism is deeply rooted in this policy framework, contrary to the regional approach, which governed the EU Eastern enlargements of 2004 and 2007. This does not mean, however, that third-country externalities of bilateral agreements will be completely ignored. For instance, simultaneous negotiations and signing action plans between the EU and all three Caucasus countries (in mid-November 2006) serve as an example of a coordinated sub-regional approach.

The ENP has actively covered five Eastern neighbors to date: Armenia, Azerbaijan, Georgia, Moldova and Ukraine. All of them agreed and signed bilateral Action Plans (AP) with the EU in 2005-2006, which included broad sets of bilateral cooperation and domestic reform measures in various areas with an implementation horizon of 3-5 years. In the case of Ukraine, the AP was updated and upgraded into the EU-Ukraine Association Agenda<sup>57</sup> in 2009 and then updated once again in June 2013 with a focus on the implementation of the AA<sup>58</sup> (see Section 6.4). A similar upgrade of the AP took place in Georgia on June 26th, 2014<sup>59</sup>. Belarus is a potential ENP participant but its status is ‘frozen’ for political reasons (an autocratic regime and violation of human rights).

Once a year, the implementation of APs is assessed by the European External Action Service (EEAS) and the European Commission in the form of progress reports (see [http://eeas.europa.eu/enp/documents/progress-reports/index\\_en.htm](http://eeas.europa.eu/enp/documents/progress-reports/index_en.htm)).

## 6.4. Eastern Partnership

To address part of the critical comments in respect to the limited offer of the ENP and take into account the regional specifics of Eastern neighbors, the EU launched the EaP

<sup>56</sup> See [http://eeas.europa.eu/enp/index\\_en.htm](http://eeas.europa.eu/enp/index_en.htm)

<sup>57</sup> See [http://eeas.europa.eu/enp/pdf/pdf/action\\_plans/2010\\_eu\\_ukraine\\_association\\_agenda\\_en.pdf](http://eeas.europa.eu/enp/pdf/pdf/action_plans/2010_eu_ukraine_association_agenda_en.pdf)

<sup>58</sup> See [http://eeas.europa.eu/ukraine/docs/eu\\_ukr\\_ass\\_agenda\\_24jun2013.pdf](http://eeas.europa.eu/ukraine/docs/eu_ukr_ass_agenda_24jun2013.pdf)

<sup>59</sup> [http://www.eeas.europa.eu/statements/docs/2014/140626\\_05\\_en.pdf](http://www.eeas.europa.eu/statements/docs/2014/140626_05_en.pdf)



initiative in May 2009. The EaP is the supplementary cooperation framework (in addition to the ENP) aimed at deepening both the bilateral and multilateral integration of six Eastern neighbors (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) beyond the original ENP design. It involves, among others, the perspective of bilateral AAs and the DCFTAs, close cooperation in various sectors, visa facilitation and (in the long-term perspective) visa liberalization, and the launching of Comprehensive Institution-Building Programs aimed at improving the administrative capacity of the Eastern partners (Council of the European Union, 2009). Signing AAs and DGFTAs between EU and Georgia, Moldova and Ukraine (see Section 6.5) may be considered tentative evidence that the EaP has brought some progress.

## **6.5. Association Agreements**

In March 2007, the EU and Ukraine started negotiations on a new enhanced agreement in order to replace the PCA. Since the Paris EU-Ukraine Summit in September 2008, the negotiated agreement was upgraded to an AA and included the DCFTA as an integral part. The negotiation was concluded in December 2011 and the text of the AA was initialed on March 30, 2012 and signed on June 27, 2014 after a series of dramatic political events in 2013 and the first half of 2014. They included Ukraine's failure to meet the political precondition of signing the AA raised by the EU (related to the issues of fair elections, judicial reform and the so-called selective justice against opposition leaders see Council of the European Union, 2012a) and the resulting last-minute refusal to sign the AA during the Third EaP Summit in Vilnius on November 28-29, 2013 (also under Russia's pressure – see below), the subsequent 'Euro-Maidan' mass protests in Kyiv and the regime change (November 2013 – February 2014), the Russian annexation of Crimea and the war in Eastern Ukraine (since March 2014).

The AA between the EU and Ukraine covers a broad set of issues (AA, 2013):

- general principles such as respect for democratic principles, human rights, fundamental freedoms, free market economy, rule of law, fight against corruption, organized crime and terrorism, promotion of sustainable development (Title I),
- political dialogue and reform, political association, cooperation and convergence in the field of foreign and security policy (Title II),
- justice, freedom and security (Title III),
- trade and trade related matters (Title IV),
- economic and sector cooperation (Title V),
- financial cooperation with anti-fraud provisions (Title VI),
- institutional, general and final provisions (Title VII).

Title IV on trade and trade related matters regulates the following questions:

- national treatment and market access for goods, including the elimination of customs duties, fees and other charges and non-tariff measures (Chapter 1),
- trade remedies (Chapter 2),
- technical barriers to trade (Chapter 3),
- sanitary and phytosanitary measures (Chapter 4),
- customs and trade facilitation (Chapter 5),
- establishment, trade in services and electronic commerce, including conditions of temporary presence of natural persons for business purposes, electronic communications and financial services (Chapter 6),
- current payments and movement of capital (Chapter 7),
- public procurement (Chapter 8),
- intellectual property, including geographical indications (Chapter 9),
- competition rules, including state aid (Chapter 10),
- trade-related energy issues (Chapter 11),
- transparency issues (Chapter 12),
- trade and sustainable development, including labor and environmental standards, and trade in forest and fish products (Chapter 13),
- dispute settlement (Chapter 14),
- mediation mechanism (Chapter 15),

Title V on economic and sector cooperation includes the following topics:

- energy cooperation, including nuclear issues (Chapter 1),
- macroeconomic cooperation (Chapter 2),
- management of public finances: budget, internal control and external audit (Chapter 3),
- taxation (Chapter 4),
- statistics (Chapter 5),
- environment (Chapter 6),
- transport (Chapter 7),
- space (Chapter 8),
- cooperation in science and technology (Chapter 9),
- industrial and enterprise policy (Chapter 10),
- mining and metals (Chapter 11),
- financial services (Chapter 12),
- company law, corporate governance, accounting and auditing (Chapter 13),
- information society (Chapter 14),
- audio-visual policy (Chapter 15),
- tourism (Chapter 16),
- agriculture and rural development (Chapter 17),

- fisheries and maritime policies (Chapter 18),
- danube river (Chapter 19),
- consumer protection (Chapter 20),
- cooperation on employment, social policy and equal opportunities (Chapter 21),
- public health (Chapter 22),
- education, training and youth (Chapter 23),
- culture (Chapter 24),
- cooperation in the field of sport and physical activity (Chapter 25),
- civil society cooperation (Chapter 26),
- cross-border and regional cooperation (Chapter 27),
- participation in EU agencies and programs (Chapter 28).

Overall, the AA, especially its DGFTA part (Title IV and numerous annexes) offers Ukraine partial integration with the SEM in the medium-to-long term perspective, mostly in the areas of manufacturing trade, some service sectors and capital movement. Is it less generous in respect to trade in agricultural goods where Ukrainian exporters can count only on the partial and gradual opening of the EU market through the mechanism of Tariff Rate Quotas (TRQ). There has been minimal progress in labor movement and it is mostly limited to highly qualified specialists in the services sector. The scope and degree of integration offered by the EU-Ukraine AA is definitely narrower and less ambitious than the SAA signed by the EU with the Western Balkan countries (see Section 5.2.3)

On the other hand, the various institutional provisions of the AA, if implemented correctly by the Ukrainian side, could radically improve the country's business and investment climate (Dabrowski & Taran, 2012).

Following negotiations with Ukraine, the EU started to negotiate AAs with Armenia, Georgia and Moldova. They were concluded in the summer of 2013 and two of them (with Georgia and Moldova) were initialed during the EaP Vilnius summit in November 2013 and signed on June 27th, 2014 in Brussels. The AA between the EU and Armenia has been put on hold as a result of Armenia's declaration (in September 2013 under Russian pressure) of its willingness to join the Customs Union with Belarus, Kazakhstan and Russia which is incompatible with the DCFTA part of the AA.

The structure and content of the EU-Moldova and EU-Georgia AAs does not fundamentally differ from the EU-Ukraine AA, although in both cases there are fewer transitory periods in opening both countries' internal markets to imports from the EU as compared to Ukraine<sup>60</sup>.

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<sup>60</sup> See [http://eeas.europa.eu/moldova/assoagreement/assoagreement-2013\\_en.htm](http://eeas.europa.eu/moldova/assoagreement/assoagreement-2013_en.htm), [http://eeas.europa.eu/georgia/assoagreement/assoagreement-2013\\_en.htm](http://eeas.europa.eu/georgia/assoagreement/assoagreement-2013_en.htm)

## 6.6. Russia and Central Asia

In spite of an initial offer from the EU, the Government of the Russian Federation opted out of participating in the formal ENP and EaP frameworks, preferring to have separate strategic partnership relations with the EU. This framework was to be built on the concept of the Common European Economic Space between the EU and Russia, as defined by joint declarations of subsequent EU-Russia summits in 2001 and 2003. The next step was the joint EU-Russia declaration on May 10, 2005, which defined the so-called road maps for the four common spaces (Road Map 2005):

- Common Economic Space (including environmental and energy issues),
- Common Space of Freedom, Security and Justice (including migration and visa issues),
- Common Space of External Security,
- Common Space on Research, Education and Culture.

Beginning in 2007, Russia was also a beneficiary country of the European Neighborhood Policy Instrument (ENPI), which replaced TACIS, the previous aid program.

In June 2008, negotiations were launched on the new EU-Russia Agreement which would replace the old PCA. They moved ahead at a very slow pace. The details of the new treaty were never determined. In particular, the trade and investment component of this agreement remained unclear. On the one hand, Russia's WTO accession in 2012 made negotiating an FTA between the EU and Russia possible. On the other hand, the formation of a Customs Union between Belarus, Kazakhstan and Russia made such negotiations technically difficult.

In 2010, the Government of Russia proposed a new idea, the Partnership for Modernization, which obtained general political backing at the EU-Russia summit which took place in Rostov on May 31 – June 1, 2010. This new framework took over the dialogue and cooperation on four common spaces (see Progress Report, 2012).

Generally, Russia has had the chance to develop a broad agenda of economic, political and institutional cooperation with the EU, comparable to that of the most advanced EaP countries (Ukraine, Moldova and Georgia) or even beyond. Given the large size of the Russian economy, the key role of its energy exports in meeting EU energy demand, and the geopolitical importance of this country (without EU membership aspirations at the moment), the EU might be potentially interested in closer economic integration with Russia. This, in turn, could help the Russian economy to complete its market transition and advance its modernization and diversification.

However, the strong and active opposition of Russia against the AAs and FTAs between the EU and EaP countries (see Section 6.5) is an attempt to force the latter to join the Russia-led Customs Union and Eurasian Economic Community instead. Russia is willing to use trade sanctions, political pressure and even military intervention against the EaP

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countries interested in cooperating with the EU (as in the case of Ukraine). Its actions in March 2014 halted the entire EU-Russia cooperation process.

Five Central Asian countries have been left out of the ENP. During its meeting on June 21-22, 2007, the European Council approved the program document, which outlines the EU strategy towards this sub-region (Council of the European Union, 2007b). Its agenda is, however, narrower and less ambitious than the ENP.

## 6.7. Visa facilitation and liberalization

Progress in the area of travel facilitation has so far been focused on visa facilitation agreements used by the European Commission as an instrument to encourage its partners to sign the readmission agreements, which mostly serve the EU's policy of fighting illegal migration (Trauner and Kruse 2008). Until mid-2014, six such agreements were signed: EU-Russia (May 2006, upgrade being negotiated), EU-Ukraine (June 2007, upgraded in July 2012), EU-Moldova (October 2007), EU-Georgia (June 2010) and EU-Armenia (December 2012), EU-Azerbaijan (November 2013).

Three EaP countries (Georgia, Moldova and Ukraine) and Russia have been involved in an official visa liberalization dialogue with the EU. It is based on the Visa Liberalization Action Plans set by the European Commission in the case of the EaP countries and the bilateral agreement called 'Common steps towards visa free short-term travel of Russian and EU citizens'<sup>61</sup>. The conditionality imposed by the EU side includes four policy blocs: security of travel documents, border management and irregular migration, public security, external relations and fundamental rights.

Moldova is the first EaP country which successfully completed this process and its citizens have enjoyed visa-free travel to the EU since April 28, 2014. The visa liberalization dialogue between the EU and Russia was suspended in March 2014 as one of the EU sanctions against Russia, following its annexation of Crimea.

Meanwhile four EU Eastern partners (Ukraine, Moldova, Georgia, and Armenia) plus Kyrgyzstan in Central Asia unilaterally granted a visa waiver to EU/EEA citizens (as well as citizens of other developed countries such as the US, Canada or Japan) in order to stimulate business contacts and incoming tourism.

## 6.8. Shortcomings of the ENP and EaP

A general weakness of the ENP and EaP (despite their subsequent upgrades) is the lack of balance between far-reaching expectations with respect to neighbors' policies and reforms, and the limited and distant rewards which it can potentially offer. This imbalance is especially acute in areas such as migration policy, where the EU is looking for the extensive

<sup>61</sup> [http://visa-free-europe.eu/wp-content/uploads/2013/03/common\\_steps\\_towards\\_visa\\_free\\_short\\_term\\_travel\\_en.pdf](http://visa-free-europe.eu/wp-content/uploads/2013/03/common_steps_towards_visa_free_short_term_travel_en.pdf)

cooperation of neighboring countries in fighting illegal migration to the EU (very often, against the interests of their own citizens), while offering very little in the realm of facilitating legal migration and freer movement of people (see Guild et al. 2007).

More generally, there is doubt as to whether the lack of a clear offer of EU membership can mobilize the governments of neighboring countries to conduct the difficult and sometimes unpopular economic and institutional reforms required to align with the *acquis* (Milcher et al 2007). On the other hand, one could question whether the perspective of EU membership, even if hypothetically provided, would be interesting and attractive enough for all the neighboring countries, many of which have different historical and cultural backgrounds, and different geopolitical and economic priorities than those shared by EU members.

## **7. EU cooperation with Southern and Eastern Mediterranean countries**

### **7.1. Importance of Southern neighbors for the EU and vice versa**

#### **7.1.1. Geography, geopolitics, historic and cultural factors**

Countries located on the Southern and Eastern shore of the Mediterranean Sea belong to the EU's immediate geographical, historical and cultural neighborhood, similarly to its Eastern neighbors (despite the fact that they are not technically located in Europe). Going back to the ancient times of the Greek and Phoenician colonization and then the Roman and Byzantine empires, Arab and Ottoman expansions and, more recently, the colonial era, cross-Mediterranean political and economic relations have been always of crucial importance for all sides of the Mediterranean basin. For example, four EU member states – France, Italy, Spain and the UK – have colonial experience in this region, which started in the second half of the 19th century and lasted until the early 1960s, i.e. the end of Algeria's liberation war against France and the Treaty of Evian.

The colonial era and then the decolonization process (sometimes involving violent conflicts) have had serious and lasting consequences both for the Southern and Eastern Mediterranean countries (SEMC) and their former colonial powers. This concerns, for example, large migration flows from the former colonies to the EU as well as terrorism.

Due to their strategic geographical location, historic links to Europe, and natural resources, the SEMC play a very important role for EU countries in terms of geopolitical stability and regional security, direct trade and investment relations, safe transit routes to Asia and Africa, energy supply, tourism, and as a source of labor migration (legal and irregular). Unfortunately, the relative economic and social backwardness of this region and its numerous unresolved conflicts (between Israel and its Arab neighbors, between Algeria and Morocco, internal conflicts in Lebanon, Syria and Libya, and others) make it a source of increasing political and security troubles for the external world. This continues to impede it from taking advantage of all potential opportunities of economic cooperation with the EU.

Average GDP per capita in the SEMC is less than the global average. In 2010, it ranged from a high of nearly USD30,000 in Israel to less than USD5,000 in Morocco. The pace of the region's economic growth was not impressive for quite a long time, especially



in the 1980s and early 1990s (see Dabrowski & De Wulf, 2013, for details).

The economic model which dominated in several Arab countries in the 1960s and 1970s (especially in Algeria, Egypt, Libya, Syria, Iraq, and Southern Yemen), and was sometimes referred to as Arab socialism, relied heavily on public ownership, administrative interference in market forces, central planning, the militarization of the economy, and trade protectionism. Israel also followed a somewhat ‘socialist’ economic model at that time, with a large share of public and collective ownership and heavy government regulation.

In the first decade of the 2000s, there was finally a visible improvement in terms of higher growth and lower inflation, fiscal deficits, and public debt levels in those countries which undertook market-oriented reforms. However, this did not fully compensate for the previous poor performance.

Per capita income growth has also been tempered by high population growth; the region’s population has grown more than 2% annually as compared with 1.2-1.3% worldwide. As a result, economic growth has not been sufficient to reduce unemployment, which remains at more than 10% in most countries, with even higher rates for female workers. At 25% or more, the region’s youth unemployment is the highest in the world. Better education and labor market reforms could help address this dramatic social challenge.

Persistent high unemployment, growing income disparities, an unequal playing field in business, corruption and nepotism, poor governance, the conspicuous consumption of a small elite, and the lack of a political voice have led to widespread discontent, and, ultimately, to the Arab Spring. It is too early to assess the impact of the Arab Spring on long-term economic policies and growth performance. In the short run, political turbulence and populist policies have damaged growth performance and macroeconomic stability and caused a lot of security problems in the region and its neighborhood (Dabrowski & De Wulf, 2013). This relates, in first instance, to the protracted bloody conflict in Syria.

### 7.1.2. Trade

**Table 6. Shares of EU-SEMC trade in total trade flows, 2012, in %**

Country	% of total EU trade		EU in % of country's total trade	
	Imports	exports	imports	Exports
Algeria	1.8	1.2	51.3	49.1
Egypt	0.5	0.9	24.5	21.1
Israel	0.7	1.0	34.5	26.7
Jordan	0.0	0.2	13.1	3.0
Lebanon	0.0	0.4	32.4	6.3
Libya	1.8	0.4	31.3	66.5
Morocco	0.5	1.0	41.4	50.1
Palestine	0.0	0.0	n/a	n/a
Syria (2010)	0.2	0.3	13.8	19.2
Tunisia	0.5	0.7	54.4	58.1

*Source:* Data from European Commission, Directorate-General for Trade.

The share of 10 SEMC amounts to 6.0% of total EU imports and 6.1% of total EU exports (Table 6) and has followed a declining trend since the late 2000s as a result of the global and European economic crisis and the Arab Spring. The latter has negatively affected both economic activity and trade in Syria, Egypt, Libya, Tunisia and, indirectly, Lebanon.

### 7.1.3. Migration

**Table 7. SEMC: Migrants remittances in % of GDP, 1980-2011**

Country	1980	1985	1990	1995	2000	2005	2008	2011
Algeria	1.0	0.5	0.6	2.7	1.4	2.0	1.3	1.0
Egypt	13.4	13.6	11.9	4.9	3.0	5.3	5.3	3.5
Israel	1.8	0.8	1.4	0.7	0.3	0.6	0.7	0.7
Jordan	19.8	20.0	12.4	21.4	21.8	19.9	16.7	11.7
Lebanon	..	..	64.7	11.2	9.5	22.5	24.0	18.3
Libya	..	..	..	..	0.0	0.0	0.0	0.1
Morocco	5.0	6.8	7.0	5.3	5.8	7.7	7.8	7.1
Palestine	..	..	..	18.1	24.1	15.2	19.7	16.3
Syria	5.9	3.5	3.5	2.5	0.9	2.9	2.7	2.7
Tunisia	3.3	2.9	4.1	3.4	3.7	4.3	4.4	4.0
Turkey	2.2	1.9	1.6	1.5	1.7	0.2	0.2	0.1

Source: <http://unctadstat.unctad.org/TableViewer/tableView.aspx>.

For most SEMC (all except Jordan, Palestine and Syria), the EU remains the largest trade partner. This is particularly true in the case of the North African countries: Algeria, Libya (both major suppliers of hydrocarbons to the EU), Morocco, and Tunisia (Table 7). Unlike in the case of the Western Balkans and the CIS, intra-regional trade plays a marginal role in most SEMC except Palestine (which trades mostly with Israel and through Israel), Lebanon, Syria, and Jordan (see De Wulf, Maliszewska et al., 2009, Table 3, p. 46). This is the result of intra-regional political conflicts (see Section 7.1.1) and continuous trade protectionism (Section 7.3).

Like in the case of the Western Balkan and CIS countries, labor migration and remittances are the important economic and social phenomena in SEMC. As illustrated by Table 7, labor migrant remittances contributed to strengthening the external positions of several SEMC, particularly Lebanon, Jordan and Palestine and, to a lesser extent, Morocco, Tunisia, and Egypt (Dabrowski & De Wulf, 2013). However, only some of migrant flows are absorbed by the EU, primarily from Maghreb countries (Algeria, Morocco and Tunisia). Other migration destinations include the Gulf countries, Libya and some other developed economies.

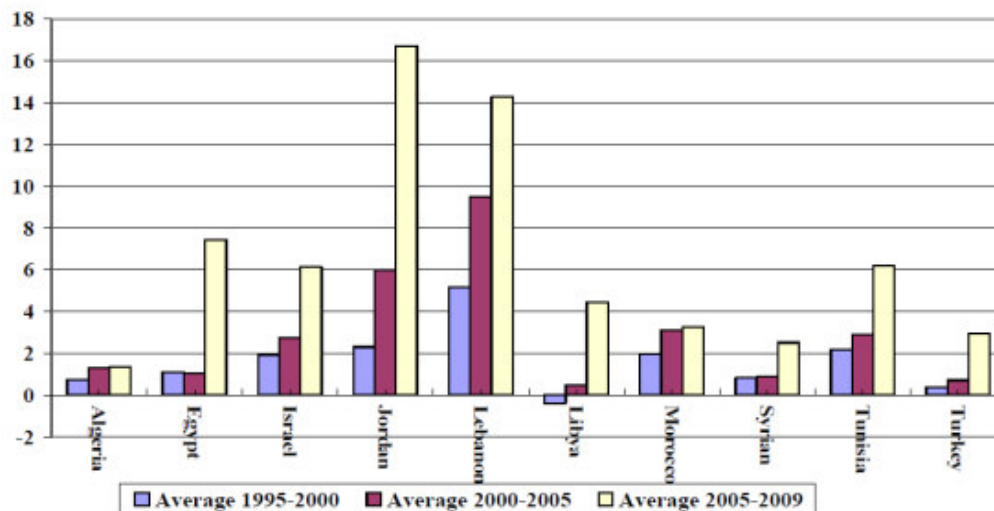
The potential outward migration flows from SEMC, especially to the EU, are much larger than actual flows. However, the very restrictive visa and immigration policies of the EU

towards the SEMC determined by security and migration fears make this impossible<sup>62</sup>. Only Israel enjoys a visa-free travel regime with the EU<sup>63</sup>.

In the foreseeable future, the SEMC do not have the chance to benefit from even such limited visa facilitation and liberalization steps as those which have been offered to the EU Eastern neighbors (see Section 6.7).

#### 7.1.4. Foreign investment

**Figure 3. FDI Flows to SEMC as % of GDP, 1995-2009**



Source: UNCTAD (2009), World Investment Report 2009 (online database).

In 1995-2000, the SEMC had one of the lowest FDI flows to GDP ratio (1.11%) as compared with other regions in the world. In 2005-2009, this changed and the region exhibited one of the highest ratios (4.2% of GDP), just behind Europe & Central Asia (4.5%) and the EU (4.7%) and far ahead of the other regions. However, there were notable differences across countries (Figure 3). In 2005-2009, Jordan and Lebanon, for instance, scored much better than others, particularly Algeria, which remained the most closed to foreign investors (Dabrowski & De Wulf, 2013; Sekkat, 2012).

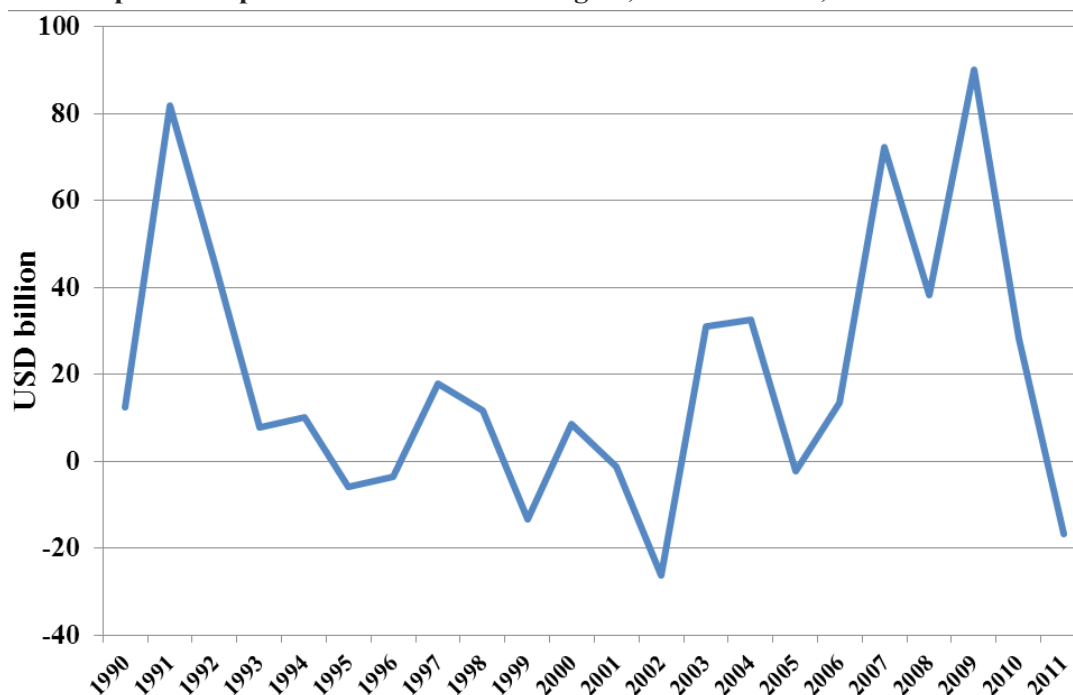
The global financial crisis of 2008-2009 and its second 'European' round of 2010-2013 diminished the size of capital flows from developed countries to emerging markets. In addition, the Arab Spring (since the end of 2010) also caused the investment climate to deteriorate and the prospects in a number of countries were affected by revolutionary events (Tunisia, Egypt, Libya and Syria) which resulted in rapidly diminishing FDI inflows (see MENA, 2012, Figure 1.10, p.12). This declining trend is also clearly demonstrated in Figure 4,

<sup>62</sup> Similar visa restrictions are also applied to SEMC citizens by the Gulf countries but they remain selectively open for certain categories of labor migrants from the SEMC.

<sup>63</sup> Few SEMC unilaterally either waived visas for EU citizens (Morocco, Tunisia) or applied simplified procedures for selling visas at their cross-border posts (Egypt, Jordan, Lebanon) with the aim of encouraging incoming tourism.

which presents statistics on net private financial flows to the Middle East and North Africa (MENA) region<sup>64</sup>.

**Figure 4. Net private capital flows to the MENA region, in USD billion, 1992-2011**



Source: IMF (World Economic Outlook database, October 2012).

Only part of FDI coming to the SEMC originates from the EU27. Other sources of investment include, among others, the Gulf countries, China, and the US (especially in the Eastern part of the Mediterranean basin).

## 7.2. From the Barcelona Process to the Partnership for democracy and prosperity with the Southern Mediterranean

Since the 1990s, the political and economic framework of the EU-SEMC cooperation has undergone several changes. On a multilateral level, it started with the launch of the Barcelona Process in November 1995, which included three major dimensions<sup>65</sup>:

- Political and Security Dialogue, aimed at creating a common area of peace and stability underpinned by sustainable development, rule of law, democracy and human rights,
- Economic and Financial Partnership, including the gradual establishment of a free-trade area,
- Social, Cultural and Human Partnership, aimed at promoting understanding and intercultural dialogue between cultures, religions and people, and facilitating exchanges between civil society and ordinary citizens.

<sup>64</sup> The MENA region includes not only the 10 SEMC but also 6 Gulf countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), Iran, Iraq, Yemen, Djibouti, Sudan and Mauritania.

<sup>65</sup> See [http://www.eas.europa.eu/euromed/barcelona\\_en.htm](http://www.eas.europa.eu/euromed/barcelona_en.htm)

In 2004, all SEMC were included in the ENP, together with their Eastern European neighbors (see Section 6.3), using similar rules and instruments. Consequently, individual SEMC started to negotiate and sign bilateral APs with the EU. As of mid-2013, 7 SEMC had active APs with the EU (all except Algeria, Libya and Syria<sup>66</sup>) which are monitored by the European Commission in a similar way as those signed with their Eastern neighbors<sup>67</sup>. The SEMC also benefit from the ENPI.

In 2008, at the initiative of the President of France, Nicholas Sarkozy, the Barcelona Process was institutionally upgraded through the creation of the Union for the Mediterranean (UfM), which included all EU member states, EU actual and potential candidates, 9 SEMC (all but Libya), Mauritania and Monaco. The UfM initiated a number of joint projects in the area of environment, energy, prevention and response to natural and man-made disasters, education and small business (see [http://www.eeas.europa.eu/euromed/index\\_en.htm](http://www.eeas.europa.eu/euromed/index_en.htm)).

Finally, as a result of the Arab Spring, the European Commission (2013b) solicited a new initiative, the Partnership for Democracy and Prosperity with the Southern Mediterranean, which is to be built on the results of the Barcelona Process and the UfM with the aim to support ‘...countries engaged in political and economic reforms contributing towards increasing human rights and freedoms’<sup>68</sup>.

### **7.3. Euro-Mediterranean Association Agreements**

In implementing the Barcelona Process and the ENP, the EU signed AAs with 8 SEMC (all but Libya and Syria) in the 1990s and 2000s (Table 8). The AA with Syria was initiated in December 2008 but it has not been signed yet due to the political situation in this country.

Like other AAs, the Euro-Med ones include political, institutional, economic and trade provisions. However, the free trade parts of these agreements remain much less ambitious and comprehensive as compared to the SAAs signed with the Western Balkan countries and the AAs signed with Georgia, Moldova and Ukraine in June 2014 (see Section 6.5). The Euro-Med FTAs represent the so-called simple or shallow ones limited to tariff reduction (not always their complete elimination), the elimination of import quotas for industrial goods and the protection of intellectual, industrial and commercial property rights.

The provisions of the original AAs in respect to trade in agricultural goods (a very important export item for the SEMC – see Belghazi, 2012), trade in services, investment, NTBs and competition rules were also very limited. Some of the AAs were upgraded in the 2000s with respect to agriculture trade and trade in services by signing additional protocols (see De Wulf & Maliszewska, 2009). However, there is still a long way to go before genuine DCFTAs between the EU and SEMC are reached.

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<sup>66</sup> See [http://eeas.europa.eu/enp/documents/action-plans/index\\_en.htm](http://eeas.europa.eu/enp/documents/action-plans/index_en.htm)

<sup>67</sup> See [http://eeas.europa.eu/enp/documents/progress-reports/index\\_en.htm](http://eeas.europa.eu/enp/documents/progress-reports/index_en.htm)

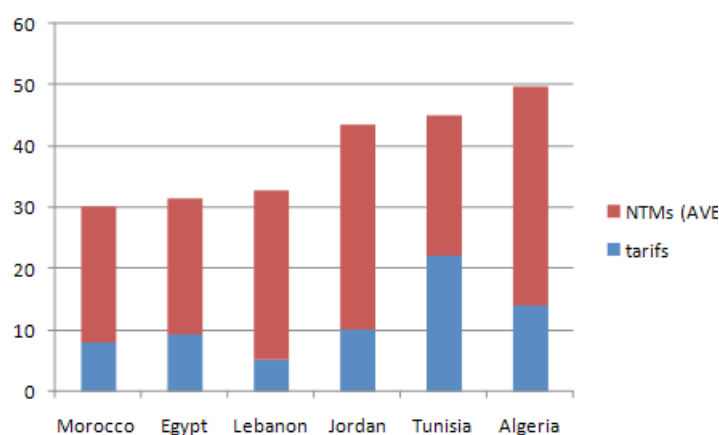
<sup>68</sup> See [http://europa.eu/legislation\\_summaries/external\\_relations/relations\\_with\\_third\\_countries/mediterranean\\_partner\\_countries/rx0024\\_en.htm](http://europa.eu/legislation_summaries/external_relations/relations_with_third_countries/mediterranean_partner_countries/rx0024_en.htm)

**Table 8. Euro-Mediterranean Association Agreements**

Country	Status	Date signed	Entry into Force
Algeria	Signed	April 2002	September 2005
Egypt	Signed	June 2001	June 2004
Israel	Signed	Nov 1995	June 2000
Jordan	Signed	Nov 1997	May 2002
Lebanon	Signed	June 2002	April 2006
Morocco	Signed	Feb 1996	March 2000
Occupied Palestinian Territory	Signed	Feb 1997	Interim Agreement July 1997
Syria	Initialed (Dec. 2008)		
Tunisia	Signed	July 1995	March 1998

Source: <http://ec.europa.eu/trade/policy/countries-and-regions/regions/euro-mediterranean-partnership/>

The net of AAs also failed to liberalize intra-regional trade among the SEMC, in spite of their respective declarations in the AAs themselves and in the regional trade deals such the Agadir Agreement of Egypt, Jordan, Morocco and Tunisia (signed in 2004 and put into practice as of 2007) and the Pan-Arab Free Trade Area, which involves 17 Arab countries (in force since 2005). This remains in sharp contrast to the Western Balkans, where the net of bilateral SAAs is interlinked with horizontal CEFTA and Eastern Europe where forthcoming DCFTAs will coexist with the system of FTAs within the CIS.

**Figure 5. Overall trade protection in selected MED countries: tariffs and NTBs (%)**

Source: Ghoneim, Peridy et al (2012), Annex 3.

Overall, import barriers in most SEMC, both tariff and non-tariff, remain high, one of the highest in the world (Figure 6.3). The protracted political conflicts, closed borders, poor cross-border transport infrastructure and poor export logistics constitute additional barriers to trade and investment (Ghoneim et al, 2012).

#### 7.4. Political economy of the Euro-Mediterranean Partnership

All of the shortcomings of the ENP discussed in Section 6.8 apply to its Southern

dimension. Furthermore, the Southern dimension of the ENP lacks even those very vague and limited incentives which are present in its Eastern dimension. We mean a very hypothetical and blanket possibility to apply for EU membership in the future (Article 49 of the TEU), which is closed to the SEMC.

On the other hand, most of the SEMC seem to be less interested in close integration with the EU than the CIS countries for historical, cultural and geopolitical reasons. The Maghreb countries may be the exception because of their close geographic proximity to Western Europe, their strong trade links with the EU (see Section 7.1), the large stock of their migrants within the EU and their close cultural ties with France (the widespread use of the French language by their intellectual and business elite).

Migration and visa policy is another area where the differences leave the SEMC at a disadvantage. The Eastern partners have been beneficiaries of a partial liberalization (visa facilitation agreements) and are engaged in the Visa Liberalization Action Plans (see Section 6.7) which may lead to a visa free regime for short-term travels in the future. Such a perspective is unbelievable in the case of the SEMC which are considered by the EU as a source of very high migration and security risk. As a result, EU visa practices with respect to SEMC (except Israel) citizens remain particularly restrictive.

In the area of migration policy, the EU expects the SEMC to actively contribute to fighting illegal migrant flows and protecting the EU's Mediterranean borders while it offers very limited incentives in terms of legal migration flows.

Summing up, the cooperation model offered to the SEMC by the EU leaves the latter with few incentives to positively influence the economic and political development of this region and propagate its political and economic institutions. As a result, nobody can be surprised that the EU's role in the Southern and Eastern Mediterranean remains limited as demonstrated by the dramatic developments since the beginning of the Arab Spring.



## 8. Summary: policy lessons for other integration blocs

Since the beginning of its existence, the EEC and then the EU have been involved in building close economic and political relations with neighboring non-member countries. They have had various legal forms: AAs, FTAs, bilateral or multilateral sectoral agreements, bilateral action plans, etc. and various substantial contents. In principle, the EU has always been flexible in offering or accepting the exact cooperation model, trying to adjust itself to specific needs, constraints and concerns of individual partner countries (even in the case of the OCTs which are not sovereign states). As a result, quite a complicated net of cooperation agreements have been built which represent various degrees of potential integration (simple FTA, DCFTA with partial access to SEM, customs union, membership in SEM without EU membership, EU membership), various speeds and intermediate stages of integration, various political commitments, etc. Such a net is neither easy to manage (even by an integration bloc as large as the EU, with a highly qualified bureaucracy in the European Commission), nor necessarily transparent enough for economic agents.

These management and transparency considerations have led the European Commission and Council of the European Union to attempt to standardize, at least partially, their cooperation models and reduce their number to a few templates such as association agreements, membership in the EEA and EU membership. It remains unclear whether these attempts will prove successful, especially with respect to EU cooperation with Switzerland (which faces numerous constitutional and domestic political constraints to engage itself in comprehensive integration with at least a partial transfer of its sovereignty to a supranational organization), European microstates (due to their very small size and limited administrative capacity) and OCTs (lack of full sovereignty, small size, distant geographical location).

In building various cooperation and integration arrangements, the EU respects the sovereignty concerns of its partners. In particular, it never pushes any country to join the EU or sign an AA or FTA. EU membership is considered a scarce good; membership in the elite club of developed and rich nations is seen as a prize which can be offered to the potential candidate for good policies and good domestic institutions. In a somewhat similar way, the same principle works in the case of AAs and FTAs with countries which are not going to join the EU (at least in the near future), especially those located in the Eastern and Southern EU neighborhood: it is an offer and a prize for good performance rather than an instrument of economic or political pressure. It is the choice of a potential partner to accept, postpone or completely reject such a cooperation offer.

In some cases (for example the ENP – see Chapters 5 and 6), the EU cooperation offer may not be attractive enough to push partner countries towards deeper economic and political reforms and comprehensive modernization efforts.

However, once the EU partner accepts the invitation to either join the bloc as a full member or negotiate and sign a comprehensive AA and FTA, it must follow the rules of the game set by the EU. This is obvious in the case of EU accession when the prospective member must accept all *acquis* and the negotiation concerns only the speed and terms of their adoption, EU assistance in this process, some transitional provisions on both sides (see Sections 4.2.4 and 4.2.5), and minor exemptions related to candidate country specifics. Only after becoming an EU member can a given country influence, through its representatives in the EU governing bodies, the content of the *acquis* and try to modify them.

In the case of other agreements such a ‘take or leave,’ the logic of negotiation is less obvious as demonstrated by the various legal forms and contents of agreements between the EU and non-member neighboring states (see above). Nevertheless, no EU partner, not even a very important one (like the EFTA countries) can expect a modification of the *acquis* in response to its concerns, interests and limitations. This means, in practice, that the ‘take or leave’ logic of negotiation also applies but on the sector rather than the general level: a partner country can choose to remain outside the integration framework with the EU in some sectors or policy areas to avoid applying those EU *acquis* which it considers harmful to its national interests.

Unlike the future EU members those EU partners who are going to stay outside this bloc will not have the chance to have a real impact on the *acquis* content in any point in future. This is confirmed by the experience of EFTA countries (see Chapters 1 and 2).

Such a discrepancy between the legal and institutional provisions of cooperation agreements with the EU (which always pay due respect for the sovereignty of both sides) and the actual asymmetry in negotiating and implementing their content (approximation to EU *acquis*) should not be surprising. This is a natural consequence of asymmetry in the economic potential of the EU and any of its individual neighbors (even as large as Russia, Norway and Switzerland), the institutional maturity of the EU, and the complicated decision making process within the EU.

Despite negotiating asymmetry, the EU remains an attractive economic partner for most of its neighbors due to its large internal market and close geographic proximity. And this is the main factor which encourages EU neighbors (even those who do not consider future EU membership) to seek close cooperation arrangements with this bloc. They are also interested in engaging themselves in cooperation with the EU in non-economic areas such as scientific research, education, people-to-people contacts, non-visa travels, etc. For those who are interested in EU membership, the adoption of the *acquis* is considered a necessary investment in order to gain membership in the exclusive club and to promote their country’s long-term modernization.

For the EU, most neighboring countries represent relatively small economic and trade potential and the aggregate impact of trade liberalization (even of a deep one) on its economic welfare, GDP, employment, etc. is usually close to negligible (however, it may have a bigger impact on individual member states or sectors). This shows the importance of the non-economic justification of such cooperation: helping neighbors in their political and economic stabilization and modernization, mitigating regional security risks, and exporting the EU institutional model which may further facilitate economic and political links. The content of the AAs clearly confirms that developing business activity, trade and investment are not their only purposes.

The EU's experience in building a complex and flexible net of economic and political relations with non-member countries can serve as a good lesson and example to follow by other regional integration blocs which also face the problem of shaping their external relations with countries which are interested in close cooperation but not membership in a given bloc. On the other hand, the EU's institutional flexibility creates room for negotiating cross-regional trade and economic integration deals not only with individual countries but also with other blocs such as NAFTA, MERCOSUR, ASEAN or the Eurasian Economic Community.

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