

Eastern Partnership countries between East and West

Perspectives and challenges

2nd east forum Berlin

Opportunities for an economic area from Lisbon to Vladivostok

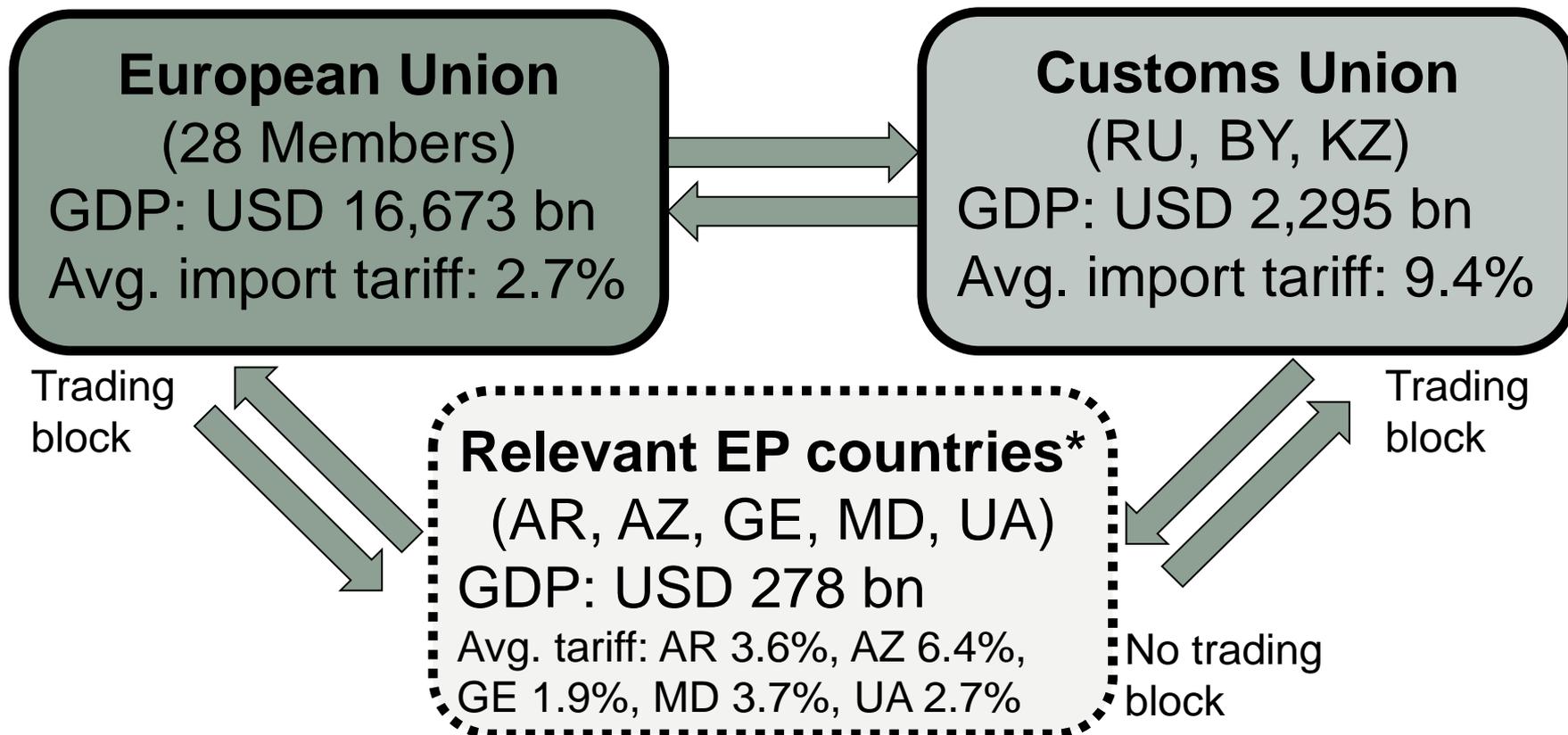
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1. Three groups of countries

Topic: Perspectives for free trade from Lisbon to Vladivostok

Key fact: Not 2, but **3 groups** of countries between Lisbon and Vladivostok



Source: IMF, WTO. Data GDP for 2012. * For our purposes only those Eastern Partnership (EP) countries are relevant, which do not belong to a trading block. Since Belarus is a member of the Customs Union, it is not a relevant EP country for our research.

Two separate issues

Implications of having three groups of countries:

- Not just one issue to be analysed; question is not just how to achieve “free trade between East and West”
- Instead: **Two distinct issues** need to be looked at
 - How can relevant EP countries establish free trade with the two trading blocks (EU & CU)?
→ **Part 2 of presentation**
 - What are the perspectives for free trade between the two trading blocks (EU & CU)?
→ **Part 3 of presentation**

2. EP countries: Free trade with both blocks?

	AR	AZ	GE	MD	UA
GDP, USD bn	9.9	68.8	15.8	7.3	176.2
Openness (exports + imports)/GDP, %	57.4	48.6	64.5	101.7	87.0

Source: IMF, International Trade Centre, data for 2012.

Relevant EP countries:

- Very open economies, especially MD and UA
- On top: Very diversified regional trade structure, with significant share of exports to EU, CU and third countries
- Openness and diversification are positive features

Objective of EP countries and how to achieve it

Objective of EP countries:

- Free trade with both trading blocks, EU and CU

How to achieve objective?

- Free trade agreement (FTA) is the ideal instrument

Conclusion: Only way to achieve free trade with EU **AND** CU is by having parallel FTAs

- FTA with CU

AND

- FTA with EU

Perspectives for EP countries

Trade with **CU**:

- EP countries already have FTAs with CU countries

Trade with **EU**:

- UA/MD/GE: DCFTA initialled; signature expected in 2014
- AR/AZ: No DCFTA to be expected in the near future

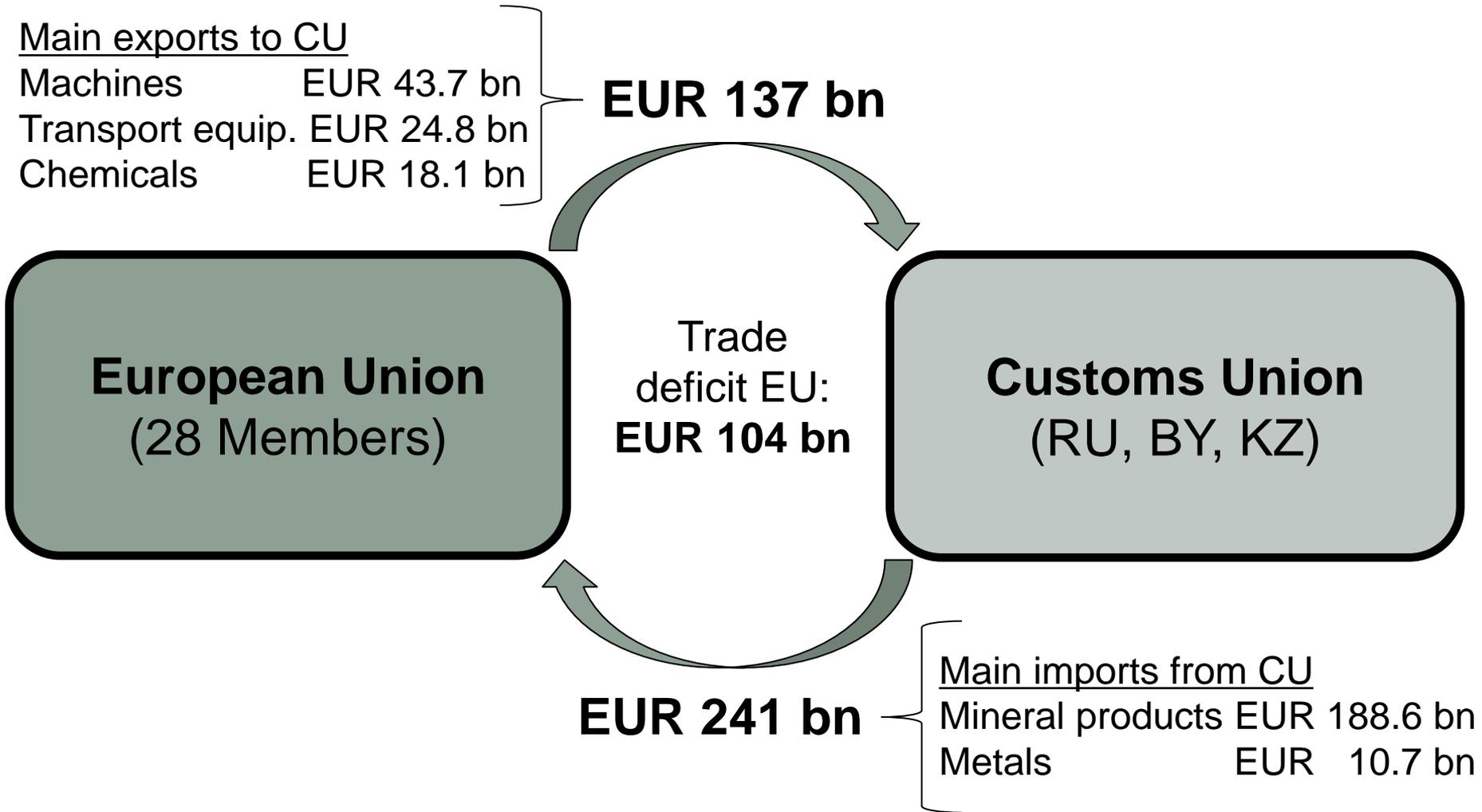
→ **UA/MD/GE: Parallel FTAs are feasible in short term**

→ AR/AZ: This is not the case, for different reasons

Main **challenges** for UA/MD/GE:

- Trade with **CU**: Making sure free trade with RU is maintained
- Medium term: Inclusion of energy, services, intellectual property right and procurement into FTAs with CU countries
- Trade with **EU**: Proper implementation of DCFTA

3. Free trade between the EU and CU?



Source: European Commission, data for 2012.

Perspectives for a EU-CU FTA

EU: Strong economic interest in FTA

- Sizeable bilateral trade deficit with CU
- EU exports goods to CU, for which FTAs are crucial

CU: Situation rather **ambiguous**

On the one hand:

- FTA with EU is the only effective way to modernise the economy and to reduce dependency on energy sector
- Political announcements in favour of a FTA with EU

On the other hand:

- For current exports FTA with EU not crucial, since energy exports do not require FTAs

→ **Substantial economic interest in the EU,
but ambiguous situation in CU**

Challenges for FTA EU-CU

Formal hurdle:

- Two members of CU (BY and KZ) not in WTO

Key hurdle: High import tariffs in CU

- Average tariff: 9.4%; for comparison EU: 2.7%
- Moderate schedule (WTO) for reduction: 7.2% until 2019
- On top: WTO implementation in RU far from ideal

→ **Unrealistic to expect the necessary tariff reduction in the medium term; FTA is a long term vision**

Measures to support FTA vision

Necessary condition for serious FTA dialogue:

- High level decision in CU to liberalise trade
- Strict implementation of decision

Arguments **for trade liberalisation** in CU:

- Objective of economic policy in CU should be:
 - Modernisation of economy in the near future
 - Not conservation of existing economic structures

→ **Economic and trade policy should be future-oriented!**

How to **achieve** this objective?

- Only through a more liberal trade policy; FTA with EU

→ **Modernisation requires a modern trade policy**

Supporting **measures**:

- Economic research on impact and scope of FTA
- Dialogue between experts in EU and CU

4. Contact

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5. Appendix

A1. What would happen if UA/MD/GE join the CU?

A2. Compatibility DCFTA & CU?

A3. Why no compatibility between CU membership & DCFTA?

A4. The case of Turkey as a member of the EU customs union

A5. EP countries: Free trade with EU through CU membership?

A1. Impact of UA/MD/GE joining the CU?

Main implication:

- Huge **increase** in average import tariffs, from currently 2.7% (UA), 3.7% (MD) or 1.9% (GE) to 9.4% (CU)
- **Impact on foreign trade***:
 - Lower exports UA: - 4.6% MD: - 22.2%
 - Lower imports UA: - 4.3% MD: - 11.1%
- Furthermore: WTO re-negotiations would be necessary
- Discontinuation of existing (non-CIS) FTAs necessary
- No new FTAs possible, including DCFTA with EU
- **Result**: Less diversified regional trade structure

Joining CU not in the economic interest of UA/MD/GE

** Source: German Advisory Group Ukraine/IER Kiev and German Economic Team Moldova/Expert Grup*

A2. Compatibility DCFTA & CU?

Crucial: Separation of two issues

- i. **Full compatibility** of DCFTA with existing trade regime
 - DCFTA is fully compatible with existing FTAs between relevant EP countries (AR/AZ/GE/MD/UA) and CU countries
 - Thus: EU did not force EP countries to decide for one side or the other
- ii. **No compatibility** of hypothetical CU membership & DCFTA
 - If AR/AZ/GE/MD/UA were to join the CU in the future, then they could not conclude any FTA (incl. DCFTA); only exception: FTAs with CIS countries
 - Thus: Membership in CU and FTAs (incl. DCFTA) are not compatible with each other

A3. Why no compatibility between CU membership & DCFTA?

In general: A customs union features common external import tariffs; thus, a member country cannot conclude a FTA with a third country; only the customs union can do this

Illustration with an example:

- DCFTA: Import tariff in UA for a certain EU good: 0%
- CU: Tariff in CU (incl. UA) for same EU good: 10%
- Possible: Company in UA imports EU good at 0% and resells it to RU at 0% (no certificates of origin needed in a customs union; key feature of a customs union)
- Result: 10% import tariff of CU circumvented
- RU companies could take legal actions

For legal reasons: Import tariffs have to be unambiguous; not the case if CU membership and DCFTA would coexist

A4. The case of Turkey

But what about Turkey?

- Member of EU customs union since 1996
- At the same time: FTAs with third countries
- Are memberships in customs union and FTAs compatible after all?

Turkey: Very special case

- Turkey is obliged to adopt EU import tariffs, including new import tariffs resulting from bilateral EU FTAs
- Turkey can conclude FTAs with third countries which also have FTAs with the EU, but the import tariffs are given (not subject of negotiations)
- Thus: Turkey has practically no independent foreign trade policy; special case with no relevance to EP countries

A5. EP countries: Free trade with EU through CU membership?

Idea:

- EP countries join the CU
- Later: CU concludes a FTA with EU
- Thus: EP countries achieve free trade with both blocks by joining the CU

However: Timing is crucial

- DCFTAs between UA/MD/GE and EU are imminent (2014)
- FTA between CU and EU only possible in the long term
- Thus: Not a realistic perspective for UA/MD/GE