

THE DEVELOPMENT OF EU TRADE POLICY TOWARDS NEIGHBORING COUNTRIES

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Introduction

The European Union had been the largest trading power of the world for several years. Successive enlargements as well as special bilateral and multilateral trade agreements helped to foster this position. The leading trade position has contributed to an increasing EU role in global economy, and probably going to contribute to it in the next decades.

The European Union, however, has a vital interest in seeing stability, better governance and economic development at its Southern and Eastern borders. Trade policy was and still is one of the most effective instruments to reach this purpose. A great variety of trade related agreements characterise the current structure of relations with the neighbors: agreements allowing the free movement of goods, services and production factors, customs union agreements, free trade agreements with higher or lower harmonisation commitments to EU regulations. The EU has to find optimal solutions that increase the competitiveness both of the EU and the neighboring regions, but also solutions that are politically mutually acceptable and sustainable. In our study we give a short summary of the development of EU trade policy with the neighborhood and an evaluation on current trends and some future prospects.

The Structure of Trade Relations with Neighbors

EFTA/EEA

The European Economic Community as an economic integration shaped its foreign economic ties with its neighbors from the beginnings. As a concurring institution to the EEC, the EFTA (the European Free Trade Association) was established by the Stockholm Convention in 1960, for countries not willing (or not able) to join to a more centralised integration. The EFTA have dismantled tariff for industrial goods among members, but did not harmonize the external tariffs. Although the EFTA turned out to be effective in fostering foreign trade inside the area, the attractiveness of the EC/EU was stronger: in 1973 Britain and Denmark, in 1986 Portugal joined the EC, while Austria, Sweden and Finland became EU members in 1995.

Before the first wave of accession, in 1972, the EEC signed free trade agreements with the EFTA countries. The agreements abolished customs duties and restrictions for all industrial goods.

In 1992, just as the Single Market was supposed to become a reality, the EU and the remaining EFTA countries – except Switzerland – signed the Treaty about the European Economic Area. The EEA was definitely created for those EFTA countries, which were not willing to join the European Union as full members, but willing to become members of the Single Market. Currently Norway, Iceland and Liechtenstein are the non-EU-member countries in the EEA. Switzerland, also in the group of these EFTA countries, signed bilateral agreement with the EU, with more or less similar content. The EEA offers the four freedoms (free movement of goods, services, labor and capital), and thus the access to the internal market. These countries are not part of CAP, however, and their agricultural products have to face quite high tariff barriers (and quotas) when entering the EU internal market.

Their status contains a limitation of sovereignty for the non-member EEA countries: they are adopting the changes of the acquis automatically, without taking part in the institutions and thus in the decision making on the given issues. The Swiss bilateral

agreements with the EU lack this automatism. Overall, the EEA remains a club for those rich European countries who could but do not want to join the EU.

Trade policy with the Southern neighbors

The Mediterranean has always received much attention from Europe (and the EC) due to its geographic proximity and the former colonial ties. However, there was no such conception towards the Mediterranean like the one governing the relations between Europe and the former African, Caribbean and Pacific colonies under the Lomé Convention. The Community showed a reactive Mediterranean policy, rather than a proactive one, mostly followed the events and not shaped them.

The Community signed several bilateral preferential trade agreements with the countries of the region. The first generation of partnership contracts was signed with the South-European countries. The Community's Association Agreements with Greece in 1962 and with Turkey in 1963 aimed primarily at the reinforcement of the Southern wing of NATO, due partly to some pressure from the USA. Under the AA's the parties wanted to create a customs union for industrial goods in a period of 20-22 years. In the early 1970's two other Mediterranean countries, Malta (1970) and Cyprus (1972) concluded similar agreements with the Community. In all of these cases, the contracting parties were European states, (although it might be a question, as geographically partly (Turkey) or totally (Cyprus) are located in Asia), with the expectation of achieving full membership in the future.

Morocco and Tunisia, as former protectorates of France, had already been treated in a special way based on the protocol of the Rome Treaty. In 1963, they restarted the talks in order to renew the negotiations and they agreed in a 5-year program on partial partnership in 1969. The agreements mainly included trade preferences. As the preferences given for the Maghreb countries would have meant the discrimination of other Mediterranean countries, the EC gradually made agreements for preferential treatments with the other countries of the region. As a result, by the early 1970s the regional agreements involved 15 countries.

The agreements resulted in disputes, as the Mediterranean countries – depending on the interests of the single EC states – were treated differently and their exports from agriculture could not develop due to the CAP. The problematic areas included the food and textile industries as well. The economically underdeveloped countries were offered special preferences by the GSP. With the joining of Great Britain, however, the preferential treatment of Commonwealth countries decreased the value of these agreements.

The Global Mediterranean Policy (GMP) introduced in 1972 aimed at making up the deficiencies of the bilateral agreements and was meant to compensate for the Northern enlargement of the Community in 1973. It wanted to provide free-trade (one-sided) for the industrial goods (except for some critical products, e.g. textile, etc.) within 5 years and the EC treated some 80 % of the exports of agricultural goods of the Mediterranean countries preferentially and offered financial aids and the unified treatment of the labor force issue. Within the GMP, several new agreements had been made from 1974 onwards: Association Agreements with Morocco, Algeria, Tunisia in 1976, and with Egypt, Jordan, Syria and Lebanon in 1977. Due to political reasons not an association agreement, but a free trade agreement was signed with Israel in 1975, while Libya did not want to sign any agreement with the Community.

After the 1973 crisis, the chances to achieve a general agreement decreased. The EC protected its agriculture with one-sided actions, if needed, and the development of the light industry was hampered by the restrictions concerning textile exports. The partnership agreements provided more advantages than a free-trade agreement in theory, although they offered few consultation rights and did not mention the prospect of full membership at all. As a result of protests from the USA, the Mediterranean countries were unable to provide the EC with a preferential treatment themselves. The Southern enlargement of the EC in the 1980s had a further negative effect on the Southern Mediterranean countries, since the agriculture products of Spain, Portugal and Greece entered the EC markets freely, leaving no room for the products of the other states of the region.

By the 1990s, the policy of the EC concerning the Mediterranean changed. With the disappearance of the confrontation between the two systems, the threats moved from the Eastern part of Europe to the South, therefore the states of the Community introduced a new Mediterranean policy. Maastricht and the peace settlement in the Middle-East made it possible to give new dimensions to the relations.

The approach sped up within the frames of the Euro-Mediterranean Partnership (EMP) from 1995. The Euro-Mediterranean partnership agreements, upon which the free-trade zone could be formed, replaced the former agreements made with the Arab countries.

The new, global Euro-Mediterranean partnership consists of three separate, but complementary 'pillars':

- the pillar of politics and security, aiming to define the region of peace and political stability,
- the economic and financial pillar, providing the setup of a mutually booming area,
- the social, cultural and humanitarian pillar, which aims at developing the human resources and the understanding between the different cultures and relations between the civic societies.

The realisation of the process started with bilateral agreements between the EU and certain countries of the region. Most of the Mediterranean countries has signed Euro-Med contracts (Tunisia, Morocco, Israel, the Palestine Authorities, Egypt, Jordan, Algeria, Lebanon), while with Syria the negotiations are finished, but the agreement has not been signed.

Although the contracts signed are not identical in every detail, their structure and the main points are the same. Besides the free flow of goods, they include some minor specifications on the flow of capital, the law of competition and the protection of investments. In addition to the financial and economic co-operation, the political dialogue and the social- and cultural co-operation were also included in the agreements. Overall, the Euro-Med agreements are rather establishing a free-trade "light", without too many strict harmonisation requirements in crucial areas related to trade.

Table 1 EU Trade Relations with Neighbors

Type of relations	Countries	Entry into force	Key characteristics
Accession countries	FYROM Turkey, Iceland, Montenegro, Serbia	Turkey (2005), FYROM (2005 – no negotiations opened), Iceland (2010 – pending), Montenegro (2012), Serbia (2013)	Towards full participation in EU Single Market, CAP, Fisheries Policy
European Economic Area	Norway, Iceland, Lichtenstein, Switzerland	EEA in force since 1994, Swiss Bilateral I 1999	Full participation in Single Market (four freedoms), automatism in adaptation (except Switzerland), No agriculture included (by Swiss partly), External trade autonomy remains.
Customs union	Turkey, Andorra and San Marino	1995, 1991, 2002	Applying Common External Tariffs of EU. Agriculture not included. Harmonisation in several trade related areas, but not all.
Stabilisation and Association Agreements (SAA)	Ukraine, Moldova, Georgia, Morocco offered for other ENP countries	2013-	Duty and quota free trade for manufactured goods, partly for agricultural goods as well. Advanced liberalisation in service sector and public procurement Domestic market rules have to comply with EU regulations.
Euro-Med Agreements	Jordan, Lebanon, Israel, Egypt, Tunisia, Algeria, Morocco	1998-2006	Focus on tariffs in goods. No harmonisation requirements in standards and domestic regulations, no liberalisation requirements in several trade related fields.
Common Economic Space	Russia	Projected, stalled	Unclear, but projected liberalisation in trade and other fields as well.
Others	Azerbaijan, Syria, Libya		n/a

Source: own, based partly on Dreyer (2012)

Turkey

The Association Agreement with Turkey ('Ankara Agreement') was signed in September 1963, more than 50 years ago. Similar to the agreement signed with Greece in 1961, the Ankara Agreement provided for a customs union between the country and the Community at the end of a transitional period of two decades, together with other gradual liberalisation and harmonisation processes. The establishment of the free movement of labor and capital were also among the goals, and the agreement let the possibility of a full-fledged membership of Turkey in the Community open. The Additional Protocol from 1970 set the timetable of the transition process in 22 years, and described the exact trade liberalisation measures to be taken. For the Turkish side, the basic incentive behind the association agreement was rather political than economic, aiming at establishing strong relations with Europe, and following the main political rival Greece. The problems with the implementation of trade liberalisation steps started soon on the Turkish side, as a natural consequence of the trade development strategy followed by Turkey that was based on import substitution with strong protectionist measures. In 1978, Turkey asked for a revision of the agreement, and cancelled the next stage of tariff reductions, but the 1980 military coup in Turkey led to a freeze in bilateral relations anyway. In the 1980's, however, under the lead of the new PM Turgut Özal, Turkey started with economic reforms, changing the state-led import substituting industrialisation process to an export-oriented strategy based on competitive sectors. The new economic strategy was much more compatible with the trade liberalisation requirements of the Association Agreement, and also made Turkey more interested in a better access to the European internal markets. With the ease of political tensions between the two sides, Turkey applied for an EU membership in 1987, as the accession of three Mediterranean countries deteriorated the Turkish positions on the EU markets. Instead of starting accession negotiations, the EU proposed the intensification of economic relations, with a completion of the customs union.

The Customs Union (CU) agreement between Turkey and the EU came into effect on 1st January, 1996. The CU eliminated

most trade barriers between the EU and Turkey, but is also meant a harmonisation process, where Turkish technical standards, competition policy, intellectual property rights were brought closer to EU requirements. Some crucial sectors like agriculture were not included, here bilateral concessions were applied.

Since the EU had already abolished the tariffs on most of the industrial goods imported from Turkey in 1971, the tariff adaptation measures (erasing tariff towards EU members, and reducing tariffs to Common External Tariff (CET) levels with other countries) and also the costs were affecting Turkey.

Central and Eastern Europe

The official relations between the EEC and the Central and Eastern European countries were set up only after 1988, when the systemic transformation in the Eastern bloc countries had started. The first programs (PHARE) included aid and trade facilitation (use of GSP preferences).

The negotiations over a more ambitious plan started in 1990, and ended up in December 1991 with Association Agreements (Europe Agreements) signed by the parties (Poland, Hungary and Czechoslovakia at that time, later followed by other CEE countries). The most important element of the Association Agreement was the free trade for industrial goods regulated in a reciprocal but asymmetric way. It was rather unconventional and due mainly to political motivations that the EU has been opening up sectors where CEE countries were creating competition for EU producers (textile, metal industries, agriculture). Bilateral free trade without obstacles was created by 2002, while in agriculture, the agreement resulted in reduced tariffs and higher quotas. Liberalisation steps allowed larger participation in service supply and in public procurement processes. A gradual approximation of associated countries to the *acquis communautaire* was also included in the agreement.

An important step towards trade liberalisation in the region was the Central European Free Trade Agreement. The CEFTA agreement – came into force in 1994 – created free trade among the Czech Republic, Hungary, Poland and Slovakia, while Slovenia,

Bulgaria, Romania and Croatia joined later. The agreement – a kind of antechamber of EU integration – helped the economic integration process of the CEE countries to the EU and made the region more attractive for foreign investors.

EU Trade Policy with Neighbors – Current Trends and Future Prospects

In 2003, at the Thessaloniki European Council, when the accession treaties with the 10 future member countries had already been signed, the EU created two new groups of non-EU European countries. The Western Balkan countries got the promise of future membership, while other European countries were covered by the "wider Europe" project. The obvious loser of this categorization was Moldova, as full member of the Stability Pact for South Eastern Europe, which was placed to the "wider Europe" group, while all other Stability Pact member countries got the opportunity to become members of the EU.

The Western Balkan countries

For the Balkans – the former Yugoslavian republics of Croatia, Serbia, Bosnia and Hercegovina, Montenegro, Macedonia, plus Kosovo, and Albania (i.e. the Western Balkan countries) – the EU accession is an obvious strategic goal. The Western Balkan countries are surrounded totally by EU member countries. This means that their European future is more or less evident, even if only in the longer term.

The framework invented for the region was the Stability and Association Process. The SAP started in 1999, and was strengthened by the 2003 Thessaloniki summit. In the framework of the Process, the Western Balkan countries signed Stabilisation and Association Agreements with the EU, explicitly including provisions for a future EU membership.

The SAAs are based on the *acquis communautaire*, creating free trade and expecting a gradual harmonisation of policies. The EU offered autonomous trade preferences for Balkan countries in 2000, valid for nearly all exports. An extension of the CEFTA

agreement to Western Balkan countries and Moldova made free trade among countries of the region possible.

From the Western Balkan countries Croatia has already finished the accession process, and joined the Union in July 2013. Montenegro and Serbia are official candidates and have already started accession negotiations with the EU. FYROM, the Former Yugoslavian Republic of Macedonia, a candidate since 2005, was not able to start negotiations due mainly to bilateral disputes with an EU member neighbor, Greece. Albania is waiting for the green light to be accepted as a candidate due mainly to domestic political reasons, while Bosnia-Herzegovina and Kosovo are struggling for their “statehood”. In case of Bosnia Herzegovina, it is the lack of understanding among the three nationalities that is an issue, while in Kosovo the situation is worse, since its independence is not fully accepted by some EU members.

Wider Europe

After the finalisation of the decision on a ‘Big Bang’ enlargement, the EU wanted to initiate a new policy for the Eastern Periphery. The newly formulated policy, however – on the insistence of the Southern member states – included the EMP-participant Mediterranean countries as well.

Originally, the concept of the new European Neighbourhood Policy was intended to be offered (beside the EMP countries) to four Eastern European countries (Russia, Ukraine, Belarus and Moldova). In June 2004, a few months after the ‘Rose Revolution’ in Tbilisi, the decision was made to expand the ENP to the southern Caucasus republics of Georgia, Armenia and Azerbaijan. The largest ‘neighbor’ of the EU, on the other hand, was not included finally: Russia declined to be incorporated into the scheme and opted for developing bilateral cooperation with the Union on an allegedly more ‘equal’ basis, although it was open to accepting similar policies and actions as those implemented with other countries involved in the scheme¹. The EU intended to encourage those states participating in the ENP to implement serious political and economic reforms along with European standards in order to create conditions for a future common space and market.

Eastern Europe

The EU enlargements in 2004 and 2007 moved the external borders of the EU to the East, changing radically the EU's geopolitical and economic perception of the CIS region (former Soviet republics) and its potential importance as economic and political partner (particularly for the new EU member states). Before the enlargements, CIS countries formed the second, outer 'ring' of the EU neighbors, being geographically separated from the EU by the countries of Central and Eastern Europe. Except for Russia, the CIS countries economic and political importance for the EU-15 was quite limited. The EU-15's real economic and foreign policy interests in cooperation with CIS countries concentrated mostly on oil and natural gas supply from Russia, and on a relative geopolitical stability of the post-Soviet area (avoiding the proliferation of regional and ethnic conflicts).

Partnership and Cooperation Agreements (PCA)

The PCAs with the CIS countries were concluded between 1994 and 1996, and they came into effect' in the period of 1997-1999. The PCAs have established a political dialogue between the parties and provided for a very wide range of issues for cooperation.

Though the PCAs were drafted in similar fashion to the Europe Agreements with CEE countries, there were important features which gave the emerging relationship an entirely different character. Despite the fact that in both types of agreement political dialogue was established, their aims differed substantially: dialogue established by the EAs was used for the pre-accession process, the one provided by the PCAs aims at consolidating the rapprochement between the parties, as well as supporting the political and economic changes taking place in these countries. Although similar to the EAs, the PCA consisted of a 'political conditionality'

¹ The European Neighbourhood Policy does not cover countries which are in the process of joining the European Union (Turkey, Croatia, Rep. of Macedonia, Serbia, Montenegro) and those covered by the Stabilisation and Association process (Bosnia-Herzegovina, Albania and Kosovo) that have the same aim. The ENP also does not cover the EFTA states (Iceland, Norway, Switzerland and Liechtenstein) as well.

clause, this did not have the same effect, and since the membership incentive was much more powerful than just establishing a wider area of cooperation between the Union and the relevant country. In addition, the institutions provided by the PCAs generally responded to those established by the EAs, which provides for similar institutions referred to as ‘association’ instead of ‘cooperation’. The major difference affecting the nature of the whole agreement, is, that the Cooperation Council established within a PCA is not entitled to take decisions imposing obligations on the signatories, diminishing the importance of this institution.

The lack of incentive and eagerness by both sides to implement the PCAs was central in the failure to achieve the aims of the agreements. The partnership established was ‘a label on a mere trade agreement’, where the parties failed to develop the PCA.

With the EU’s eastern enlargement, the situation changed substantially. Four CIS countries – Russia, Ukraine, Belarus and Moldova – became direct land-neighbors of the enlarged Union. The Caucasian countries still lie some 1000 km apart from the nearest EU member (Romania), and only Georgia share a maritime border with the enlarged EU by the Black Sea. With a Turkish EU accession in the future, the other two states of the region, Armenia and Azerbaijan would also become direct neighbors of the Union.

The ENP has included the PCAs, as a sound basis for developing future partnership. The ‘political dialogue’ feature introduced by the PCA acquired a different nature within the ENP. The ENP intended to be based on political dialogue, instead of a demand-driven approach usual by the PCAs, where there was only one party, which was obviously deciding on the scope, measures and mechanisms of the cooperation.²

Regional versus bilateral approaches

The European Union’s trade policy instruments are based not only on bilateral cooperation, they may have multilateral forms like the

² The necessity of a political dialogue was realised even before the launch of the ENP, when the Council adopted a new Regulation for relaunching TACIS programme basing it ‘on an understanding that co-operation is a reciprocal process, encouraging a move from a “demand-driven” to a dialogue driven approach’ (Ghazaryan, 2008).

former Lomé Convention, and the different initiatives offered for the neighbors: the Euro-Mediterranean Partnership, and later the Union for the Mediterranean, the Eastern Partnership or the Black Sea Synergy.

The ENP itself is primarily bilateral, but interlinks with regional and sub-regional processes. Actually, the countries participating in the ENP are quite different, the ‘common-nominator’ among them being the rather Eurocentric approach based on their neighborhood to EU. But the Eastern partners are all European countries, members of the Council of Europe, and as such, based on paragraph 237 of the Rome Treaty, these countries have the right to appeal for a full membership.

So the question still remains: why not to make the distinction between countries and regions more explicit, and treat the “sub-regional cluster” of the Union’s neighbors separately. The new initiatives of the European Union seem to follow this logic.

Black Sea Synergy (BSS)

With the joining of two Black Sea littoral states, Bulgaria and Romania, the prosperity, stability and security of the neighbors around the BlackSea have become an immediate concern to the EU more than ever before. An EU initiative, called the Black Sea Synergy was established in 2008, to develop the cooperation within the Black Sea region and also between the region as a whole and the European Union, thus adding a regional dimension to the ENP. In this sense, the "Black Sea Synergy" completed the "chain" of regional cooperation frameworks in the EU's neighborhood, adding to the Euro-Mediterranean Partnership and the Northern Dimension.

The Black Sea Synergy has not established a secretariat but tried to help political agreements and actions to be implemented by existing institutions, such as the Black Sea Economic Cooperation group (BSEC) or the Black Sea Forum (BSF). It was co-funded from the EU's "neighborhood policy" and other existing funds. Regular meetings were envisaged between foreign ministers of Black Sea zone states: EU-member Romania, Bulgaria, Greece, EU membership-candidate Turkey, ENP-participant Ukraine,

Georgia, Armenia, Azerbaijan and Moldova, and Russia. Although the Black Sea Synergy is still existing, without strong 'god-fathers' in the EU, the BSS did not become a really influential institution, and the Eastern Partnership Initiative, launched one year later, took away both the political attention and the financial sources.

Union for the Mediterranean

The idea of the Union for the Mediterranean, previously known as the "Mediterranean Union" was proposed by the French President Nicolas Sarkozy, originally implied a selective approach, suggesting that only France, Spain, Italy, Portugal and Malta should confederate with the five North African countries Morocco, Algeria, Tunisia, Mauritania and Libya. The Union was supposed to place emphasis on cooperation in the fields of counterterrorism, illegal immigration, sustainable development and energy security. It was planned as a looser grouping than the EU. Having been backed especially by Italy and Spain, the proposed Union would reduce imbalances between the North and the South of the EU. Later it emerged as a possible alternative to Turkish membership in the European Union, whereby Turkey would instead form the backbone of the new Mediterranean Union.

However, with modifications to the plan in March 2008, it was agreed to be only "completing and enriching" the existing EU structures and policy in the region, and build upon the existing Barcelona process. It was also agreed that the project would include all the EU member states, not just those bordering the Mediterranean, as originally planned by the French President. Once Turkey was given a guarantee that the project would not be an alternative to Turkish EU membership, it accepted the invitation to participate. The Union for the Mediterranean became an international organization initiated in July in 2008, as a development of the Euro-Mediterranean Partnership. The act unites 43 states, every EU member with several non-EU countries that border the Mediterranean Sea³.

³ Albania, Algeria, Bosnia and Herzegovina, Croatia, Egypt, Israel, Jordan, Lebanon, Mauritania, Monaco, Montenegro, Morocco, Palestinian Authority, Syria, Tunisia and Turkey. Libya remains an observer.

It is still not clear, however, what kind of real novelty the Union for the Mediterranean brings to the EU-Med relations, how the new Union will help to resolve the problems of the region, and whether it will operate better the former Mediterranean initiatives of the EU.

Eastern Partnership

The Eastern Partnership (EaP) is a project which was formally initiated by the European Union. It was presented by the foreign minister of Poland with assistance from Sweden at a meeting of the Council in May 2008.

In their Eastern Partnership proposal, Poland and Sweden suggested that the existing instruments for cooperation between the European Union and its Eastern neighbors would be complemented by an intensified support of the EU. This support would be directed toward those EU neighbors who have advanced furthest in implementing European Neighbourhood Policy (ENP) instruments. It allows for such countries' gradual inclusion in EU policies and programs along with their gradual integration into the EU common market. The plan was open in nature – other countries might join it when willing and ready.

Unlike the Union for the Mediterranean, the Eastern Partnership does not have its own secretariat, but it is controlled directly by the European Commission.

As the Commission projected (EC, 2008), in the medium term the free trade areas with each country and a greater support to meet the related requirements could lead to the establishment of a network of FTAs that can grow later into a Neighbourhood Economic Community. The Partnership also consist a progressive visa liberalisation, a deeper co-operation to enhance the energy security of the partners and the EU, and a support for economic and social policies designed to reduce disparities within each partner country and across borders. A new Comprehensive Institution-Building (CIB) programme was planned to improve the capacity of each partner to undertake the necessary reforms.

Building on previous Commission proposals to strengthen the ENP, the EaP wanted to reinforce the interaction with all six part-

ners, always tailored to each partner's specific situation and ambition. But, as Garcia states, compared to the Barcelona Process, the ENP downgrades the regional dimension to 'a complementary, and in fact optional, element. (Garcia, 2013, p. 530)

Bilateral relations

Currently, from the Eastern partners Ukraine, Moldova and Georgia are in closest relation with the European Union. These countries were the first to have an Action Plan adopted. All of them negotiated an Association Agreement with DCFTA in 2011-2012. At the Eastern Partnership summit in Vilnius, on the 28-29th November, the agreements with Georgia and Moldova were initiated. Ukraine, on the other hand, postponed the signing of her already ratified AA agreement, which led to massive protests in Ukraine.

Azerbaijan also has ongoing negotiation on an Association Agreement with the EU. The WTO membership of the country is a prerequisite, however, to be able to start negotiations on a DCFTA. The third Caucasian country, Armenia, also had negotiations on an Association Agreement and on DCFTA with the EU. The relation, however, cooled down, when Armenia voiced her readiness to join the Eurasian Economic Community, a customs union initiated by Russia, incompatible in its nature with a DCFTA with the EU.

The third Eastern European country, Belarus supports the ENP in general, but Brussels sets political conditions for a full-scale participation of the country. Since 2003, however, Belarus has been taking part in several 'border programs' (with Poland and Ukraine, and with Baltic countries). Closer cooperation with the EU seems to be possible only after a political change in the country.

As far as the Southern partners are concerned, these countries are non-European neighbors. From them, the three Maghreb countries have the closest relations with Europe, mainly due to the former French colonial rule. Morocco asked even for admission to EC in 1987, but the Council refused the request, as Morocco is not a European country. Morocco and Tunisia were the first to sign the Euro-Med agreements and are doing everything to exploit

the possibilities of the agreements. With Algeria there were several problem areas, like the tense, almost war-like political status and the unreadiness of the economy, i.e. the one-sided structure of the exports, the closed market from the outer world. But Algeria's natural resources are indispensable for the EU. Similar is the case with Libya, but in the mid nineties the country opted out of the partnership. Later it became an observant, and, nowadays, both sides try to warm up relations.

The five countries that are in the Eastern part of the Mediterranean and the Palestine Authority are also part of the EU's ENP policy. Although the relation of these countries with the EU is not as close as that of the Maghreb countries, their partnership status existing since the 1970s and the ongoing peace talks in the Near East and the EU's more active role justified their involvement. The co-operation between the Mashrek and the EU countries is rather dependant on the peace talks. Israel has an edge over the others in the region as concerns its economy and is an equal partner of the EU. At the beginning of the partnership process, there was a hope for economic cooperation between Israel and neighboring Arab countries. It did not come up to the expectations, however, and the tension between the Israelis and the Arabs remained.

Advanced forms of cooperation

The contractual frame for a stronger engagement, the **Association Agreements (AAs)** would supersede the current agreements (Partnership and Cooperation Agreements, Euro-med Agreements). The agreements have already been negotiated with Ukraine, Moldova and Georgia, partners that were willing and able to take on the resulting far-reaching commitments with the EU. These new agreements would create a strong political bond and promote further convergence by establishing a closer link to EU legislation and standards. They may also advance cooperation on Common Foreign and Security Policy and European Security and Defence Policy.

The AAs include the goal of establishing a **deep and comprehensive free trade area (DCFTA)** with each of the partner coun-

tries. These DCFTAs can only be established with countries which have joined the WTO⁴. They cover substantially all trade, including energy, and aim at the highest possible degree of liberalisation (with the asymmetry in the pace of liberalisation). The agreements contain legally binding commitments on regulatory approximation in trade-related areas, and they create real perspectives for enhanced movement of goods, capital and the supply of services to be achieved over the long term. In parallel, sectorial measures should be pursued to facilitate market access for partners.

To be able to exploit the fruits of the agreements, the EU will encourage these countries to establish a network of regional free-trade agreements among themselves based on the bilateral commitments undertaken in the DCFTAs with the EU. This would strongly enhance intra-regional trade and economic integration and complement the countries' efforts to better integrate with the EU economy. An important element contributing to further economic integration is the diagonal cumulation of origin.

To promote the legal movement of people, the EU initiated Mobility Pacts with the Eastern Partnership countries. In this framework the EU offered visa facilitation for its partners and, in the longer-term, open dialogues on visa-free travel with all partners. Of course, the speed of establishment always depends on the situation of each partner country. Currently Ukraine, Georgia and Moldova have signed a readmission agreement parallel with visa facilitation agreements with the EU.

In case of ENP countries it remains an important question, however, how far the harmonisation should go in different fields, which regulations of the EU *acquis communautaire* should be adapted by the neighboring countries. They get no full accession perspective, and the more such alignments have to be done, the more costly they are, and their rationality may be questioned by the partner countries.

As a further step, the idea of creating a Neighbourhood Economic Community emerged, similarly to the already existing European Economic Area. In the longer term such a Community

⁴ Currently Azerbaijan, Belarus, plus Algeria, Lebanon, Libya, and Syria have not concluded their WTO accession negotiations.

could be offered full access to the single market.⁵ The lack of full accession perspectives, however, makes the reality of such Community dubious.

A further problem could be the financing of the costs of harmonisation. As the case of the Mediterranean countries shows, without substantial foreign investments following the liberalisation, the partners will not be able to enjoy the economic advantages of the decision. Investments are needed both in the productive sectors and in infrastructure, since the official support coming through EU funds (ENPI) are limited. The attraction of private capital to these activities should be a priority agenda.

The European Neighbourhood and Partnership Instrument (ENPI)

Still, one of the major innovations in the Union's relations with neighboring countries consists in the establishment of a unique financial instrument for the ENP as a whole. The European Neighbourhood and Partnership Instrument (ENPI) replaced the TACIS and MEDA programmes in 2007.

For the budgetary period (2000-2006), the funds available were approximately €5.3 billion for MEDA and €3.1 billion for TACIS, as well as approximately €2 billion in European Investment Bank lending for MEDA beneficiary countries and €500 million for TACIS beneficiary countries. For the next budgetary period (2007-2013), €12 billion in EU funding were available to support these partners' reforms, an increase of 32% in real terms. Still, the new endowment lied below the initial requests of the Commission in the 2005 budget negotiations; it incorporated headings that were previously included elsewhere in the EU budget.⁶

The ENPI was designed to target sustainable development and approximation to EU policies and standards – supporting the

⁵ It would require the partners to develop the capacity of their economies to be able to fully withstand the competitive pressures of the single market and to demonstrate not only a willingness to adopt all relevant elements of the EU acquis but also a capacity to implement them, with comparable standards and practices. Substantially increased technical assistance and funding will be needed to achieve this objective.

⁶ ENPI money has been used for the reconstruction of Lebanon, thus reducing the actual availability of cash. (Missiroli, 2008)

agreed priorities in the ENP Action Plans (as well as the Strategic Partnership with Russia, which was previously also covered by the TACIS programme). The new funding was planned to be much more flexible, policy-driven instrument, where the allocation of funds depended on the countries needs and absorption capacity as well as their implementation of agreed reforms. Based on the 'more-for-more' principle the EU now offers greater incentives to countries that make more progress towards reforms. An important aspect of the ENPI is the improvement in cross-border cooperation with countries along the EU's external land and maritime borders thus avoiding new dividing lines.

For the next budget period (2014-2020) the proposed financial framework of the European Neighbourhood Initiative (ENI, replacing ENPI) will reach 18.2 billion euro, 40 per cent up on the amount available under the ENPI from 2007-2013.⁷ How it will be shared among Eastern and Southern countries is still unclear. In the 2007-13 period, the shares have slightly changed: 62 per cent of the Funds went to the South (it was 70 pre-2007), and 38 to the East (30 per cent previously).

Evaluation of trade relations with neighbors and conclusions

How can we evaluate the effects of EU trade policy concerning neighbors? As far as economic achievements of the EMP are considered, the results are mixed. The Southern partners have reduced their tariff levels according to the Euro-med agreements, but they got no access for their agricultural export to the European market as a compensation, although this is the sector where the South has a comparative advantage. And in reality, a further liberalisation by Euro-med agreements was a goal neither for EU nor for Southern regimes.

The Euro-med Free Trade Area was scheduled to be achieved by 2010 but without functioning free trade agreements between the Southern countries, it still relies on bilateral structures⁸ and

⁷ Sources of datas: <http://www.enpi-info.eu>

⁸ The Agadir Agreement signed in 2004 by Egypt, Tunisia, Morocco and Jordan intends to gradually establish free trade between the signatories.

threatens the region with the negative impacts of ‘hub and spoke’ effect⁹. An indirect proof to that is the fact that – despite previous expectations – the level of FDI coming from European countries to the region remained low. The use of the current system of rules of origins is not attractive for FDI, especially for cross-border production chains in the region. (Dreyer, 2012) A harmonisation of investment and competition policies also stayed outside the scope of the agreements.

To make the system of rules of origin more effective, the EU extended the Pan-European cumulation system to the Mediterranean countries and created the Pan-Euro-Med cumulation of origins. The system operates between 42 countries currently: the EU, the EFTA members, Turkey and Euro-Med countries (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the Palestinian Authority).¹⁰

But even with a broad system of cumulations created, the functioning of a free trade area remains complicated and thus less attractive for investors. As Krugman&Obstfeld states, free trade agreements are politically straightforward but administratively a headache, while customs unions are just the opposite (Krugman&Obstfeld, 2002). In case of a customs union, participant countries have to agree on the common external tariffs used by both sides, which generates political debates and needs compromises from both sides.¹¹ By free trade agreements, the countries preserve their independent trade policy but the necessity of rules of origins makes the operation of the free trade system administratively more complicated.

For the ENP countries, a customs union may be administratively more straightforward than a free trade agreement but politically it

⁹ The ‘hub and spoke effect’ appears, when a large country (hub) has bilateral free trade agreement with other (smaller, developing) countries (spokes), but there is no such agreement among the other countries. The production will rather be in the ‘hub’ and exported to the free trade partners, because a larger area can be achieved freely from there.

¹⁰ The diagonal cumulation means that products which have obtained originating status in one of the 42 countries may be added to products originating in any other one of the 42 without losing their originating status within the Pan-Euro-Med zone. http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_783_en.htm

¹¹ By the EU-Turkey Customs Union Agreement Turkey agreed to adopt the Common External Tariffs of the EU and to harmonize its foreign trade regulation accordingly without compromises.

is much more complicated to construct. Here, the ‘neighboring’ countries willing to join the Customs Union, had to accept the already existing Common External Tariffs and so it is not the construction but the sustainability of the agreement which is questionable. Due to fortunate circumstances, the Turkish CU agreement was able to contribute to Turkey’s economic transition and fast economic growth in the last decade. In case of the ENP countries, however, the applicability of the model seems unlikely without a perspective of a full-fledged EU membership.

And even for the EU, the goal is rather a harmonisation of legislation, not the harmonisation of external tariffs. The free trade agreements negotiated by the EU are seen as bilateral means substituting multilateral liberalization and rule making in the WTO framework. Especially, the Deep and Comprehensive Free Trade Areas (DCFTA) are ‘opportunity to negotiate regulatory and beyond-the-border issues that are not included in the Doha Round and also to deal with ‘tough’ issues like agriculture, which seems almost impossible to be solved in the multilateral talks.’ (Liargovas, 2013)

As regards to the ENP, in particular, the main reason for the EU to follow the road of bilateralism is its objective to deepen the substance of trade agreements, enhancing more comprehensive trade relations with its neighbors and thus, bringing its neighbors gradually closer to the Single Market (Petraikos et al, 2013). The EU offers DCFTA not only for Eastern partners but also for Mediterranean partners.¹² The negotiations on a possible DCFTA between the EU and Morocco were started on 22 April, 2013 in Rabat. The DCFTA will extend significantly beyond the scope of the existing Euro-med Association Agreement. The new agreement will include trade in services, government procurement, competition, intellectual property rights and investment protection, as well as a harmonisation of industrial standards and technical regulations or sanitary and phytosanitary measures.

The ENP was aimed to bring the neighbors closer to the Union both politically and economically. The Union can still rely on its

¹² Currently, potential candidates for negotiating a DCFTA with the EU are Egypt, Jordan, Morocco and Tunisia.

‘high status’ among these countries and motivate them to undertake necessary processes for the possible integration whether within the region itself or with the Union. What is required from the EU is the adaptation of elements in a way which will make it possible to meet the expectations of the neighboring countries concerning integration. At the same time, this would allow the Union to pursue its own interests and guarantee its own security. In order to reach this, the Union would make the ENP a comprehensive policy, where principles of conditionality, joint ownership and differentiation do not contradict each other.

On the other hand, by adding the principles of joint ownership and differentiation, the EU has tried to adapt the pre-accession policy to the ENP as much as possible. However, these principles do not sit well with the main principle of conditionality borrowed from the enlargement experience. Nevertheless, the greatest tension comes generally from the question of using the enlargement policy when membership is not offered, since in case of its success the ENP will result in creating new candidates. Thus the EU cannot demand similar commitments from both the countries who are eventually offered membership and those who are offered just a ‘stake in the internal market’. On the whole, the ENP seems to suffer from being neither enlargement nor foreign policy. (Misroli, 2008): it has elements from both policies but neither from them works properly.

It can be concluded that trade relations and trade policy is continued to be important for the European Union to maintain its competitiveness but it also remains a foreign policy tool of the EU, especially in case of neighboring regions. But since the EU has much poorer countries in the neighborhood, integrating them to the internal market is costly and may be dangerous: instead of creating stability, it may increase instability in the surrounding regions.

In the neighborhood, rather political than commercial goals and considerations shape the EU trade policy.

So the need for strategic policy is a must for at least three other reasons. First, the still existing framework policy, the ENP has to do with at least 15 countries in four regions (Eastern Europe, the Caucasus, the Levant, and North Africa), and the challenge is not

to tailor ENP policies to individual countries but to address the regional level. Second, the ENP has moved into the Russian sphere of influence and challenges Russian interests and the EU can only hope to cope with Russia if it is clear on its priorities on key issues (trade, energy, democracy). And finally, the ENP overlaps with American interest as well. Geopolitically, the United States has an interest in influencing events in the Eurasian periphery and organizing relationships with local partners that enable this influence (Rynning – Jensen, 2008).

The ENP signals that the EU is more ready and able to engage in this type of partnership but it will depend on future developments how the ENP strategy will be able to handle the challenges coming from the neighborhood.

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