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The geography of trade relations between the EU and the ENP countries:

Empirical analysis and implications for theory and policy-making

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OBJECTIVE OF RESEARCH

Even though the ENP is distinct from the process of EU enlargement, the ENP countries operate under conditions of "neighborhood Europeanization". This indicates a misfit (i.e. the so-called "capabilities-expectations" gap) between ENP demands (i.e. demands that do not differ much from those of "accession Europeanization"), on the one hand, and ENP rewards (i.e. the possibility of EU membership has been ruled out for the majority of ENP countries), on the other. Given this misfit – and the concomitant scepticism about the ENP capacity to transfer EU values and rules to the neighboring countries – deep(er) economic (in particular, trade) integration between the EU countries and the ENP countries is considered to be a catalyst for the success of the ENP undertaking.

Considering (trade) integration as a proper proxy for the evaluation of the success of the ENP undertaking, the objective of the paper is to study the geography (i.e. the size, the composition and the direction) of trade relations (i.e. imports and exports flows) between the EU and the ENP countries

(hereinafter: the EU-ENP trade). To this end, the paper conducts an in-depth empirical analysis, providing empirically-based responses to a series of research questions: What is the size, the composition and the direction of trade activity between the EU and the ENP countries? What changes, if any, can be recorded, diachronically? What is the impact on the trade balances of the EU and the ENP countries? What is the pattern of integration between the EU and the ENP countries? Which theoretical school tends to be confirmed? Is there evidence of "developmental gap"? What are the implications for the prospects of income convergence, in the long-term? Is it possible to detect (trade) relations of dominance among the EU and the ENP countries? Is there a corresponding distinct spatial footprint? Lastly, is it possible to acquire new knowledge and critical insight on the issues of EU integration? The paper provides a clear picture regarding the geography of trade between the EU and the ENP countries, aspiring to offer valuable insight not only to the (economic integration) theory but also to policy-making.

SCIENTIFIC METHODS

The paper provides comparative empirical evidence concerning paths of trade integration between the EU and the ENP countries. It does so by undertaking a descriptive statistical and graphical analysis of the findings derived from the estimation of a series of trade indicators. The analysis utilizes trade data derived from the United Nations COMTRADE database. The analysis covers the period 2000-2010. This period has been selected so as to gauge the latest shifts operated in trade structures as a result of the recent economic and political reforms (evolutions) implemented (took place) in the EU economy and the ENP countries, besides the ENP in itself. Trade data refer to the national-sectoral (2-digit SITC classification) level. The sectors included in the

analysis grossly belong to the primary and the secondary sector of production and may form groups of activities according to the intensity of the production factors used. For the sake of comparison, the figures for Russia (has a "common spaces" relation with the EU), Turkey (is a candidate country for EU membership) and Croatia (is set to become the 28th EU member-state on 1st July 2013) are, also, quoted.

The paper analyses empirically the geography of the EU-ENP trade, aspiring to fill in (part of) the gap in the corresponding literature. Among the plethora of trade indicators, the empirical analysis is based, mainly, on the following trade indicators: (a) the Index of Trade Balance, (b) the Index of Trade Intensity, (c) the Index of Trade Openness, (d) the Index of Revealed Comparative Advantage, (e) the Index of Imports Penetration, (f) the Index of Trade Composition Change, (g) the Index of Trade Asymmetry, (h) the Index of Intra-Industry Trade, and (i) the Index of Domination. Even though each of the aforementioned indicators is subject to many considerations, the wide variety of indicators taken into consideration covers many aspects of the EU-ENP trade activity, offering a rather comprehensive picture. Depending on their properties, some indicators are estimated separately for exports and imports and some indicators are estimated only for exports or imports. Since the ENP is a bilateral policy (i.e. the ENP countries do not constitute a unified trade bloc), the analysis concerns each ENP country separately and not the ENP area as a unified group. The same practice is followed for the EU (even though the EU constitutes a unified trade bloc), also, in order for the internal differentiations (i.e. between the EU countries) to be detected.

The paper may be added to the plethora of empirical papers within the scientific field of international trade. Indeed, empirical research in international trade literature has undergone a significant resurgence, especially after the enouncement of the new trade theory. This is because, in contrast to the traditional trade theory of comparative advantage, the new trade theory

provided a new framework of thinking emphasizing that much of international trade involves the two-way exchange of goods within industries that belong to developed countries. Of course, the proliferation of empirical papers in international trade literature has been based, mainly, on the wide use of sophisticated econometric models / techniques, such as the gravity models and the Computable General Equilibrium (CGE) models. Gravity models relate the volume of bilateral trade flows between any pair of countries to their economic sizes, the distance *inter se*, and a number of other variables, whereas CGE models are numerical models based on general equilibrium theory. The aforementioned models / techniques allow for the detection of the determinants of (the size, the composition, and the direction of) international trade flows. To this end, trade indicators are the stepping stones, providing information in a rather straightforward and reliable manner, at the global, national or regional level. This is because trade data themselves are widely available, relative reliable and highly disaggregated. It is, thus, not surprising the fact that trade indicators are extremely popular in trade literature and, as the result of using trade data, often, the most available input for evidence-based policy-making.

POLICY VALUE-ADDED

The gradual "abolition" of economic borders between the EU and the ENP countries allows for the emergence (detection) of some, rather, contrasting pictures. Firstly, and perhaps most importantly, for the vast majority of the ENP countries, the EU, even though it is the most important trade partner, loses its shares diachronically, in both exports and imports terms. This means that the EU is becoming a less significant partner for the ENP countries. Noteworthy is the fact that, especially for the ENP imports flows, the shares of

the BRIC countries are getting increased in the vast majority of the ENP countries. Concerning the EU countries, it is evident that, for their majority, the ENP countries are not considered to be significant trade partners. Secondly, for the ENP countries imports flows from the EU countries are, by and large, more significant comparing to the corresponding exports flows. In particular, for the vast majority of the ENP countries, imports account for higher, and diachronically increasing, GDP shares. Concerning the EU countries, both the exports and the imports GDP shares to and from, respectively, the ENP countries are, on average, extremely low, diachronically. Thirdly, it can observed that, on average, the ENP South and the EU15 countries are the ones that exhibit, diachronically, the highest exports and imports shares in relation to the corresponding total ENP and EU figures. However, the ENP East and the new EU countries are the ones that, by and large, exhibit the highest increase in their shares, changing, thus, the overall picture of the EU-ENP trade activity. Fourthly, the vast majority of the ENP countries has a negative trade balance with the EU, exhibiting deterioration, diachronically. In contrast, the situation is more balanced for the EU countries since their trade balance figures with the ENP countries are, in absolute terms, significantly smaller than the corresponding figures for the ENP countries. The majority of the EU countries exhibits positive, and diachronically increasing, trade balance figures.

The more detailed examination of the EU-ENP trade allows for the detection of a clear and strong geographical orientation. Concerning the exports flows from the ENP countries to the EU countries, it can be observed that the main EU trade partner for each ENP country is a EU15 country. Moreover, in many cases, the shares of the main EU partner are quite high. The shares of the new EU countries are extremely low. Exceptions are provided from the ENP East countries that retain strong trade relations with the new EU countries. Analogous, even though some exceptions do exist, is the picture for the imports flows from the EU countries to the ENP countries. The aforementioned

patterns indicate that factors such as proximity, history and language seem to have an impact. Of course, such an impact needs to be detected and evaluated. Analogous is the situation for the exports and the imports flows of the EU countries to and from the ENP countries, respectively.

The more detailed examination of the EU-ENP trade allows, also, for the detection of a clear and strong sectoral orientation. In particular, many ENP countries export, to the EU countries, mainly (or even, in many cases, almost exclusively) fuel primary commodities and labor-intensive and resource-based commodities. In contrast, the vast majority of the ENP countries imports, from the EU countries, mainly medium-skill capital-intensive commodities. The reversed picture, of course, holds for the EU countries, concerning their exports and imports flows to and from the ENP countries, respectively. This contrast accentuates the fact that the EU-ENP trade relation is rather asymmetric. Indeed, the majority of the ENP countries exhibits revealed comparative advantage in fuel primary commodities and in labor-intensive and resource-based commodities, whereas the majority of the EU countries exhibits revealed comparative advantage in medium-skill capital-intensive commodities. Furthermore, the picture of asymmetry that characterizes the EU-ENP trade relation is verified from the fact that the EU countries are the ones that penetrate more to the ENP countries (and not the ENP countries that penetrate more to the EU countries). However, the ENP countries tend, also, to penetrate more to the EU countries.

Diachronically, the sectoral composition of EU-ENP trade remains rather unchanged (exceptions concern mainly the exports flows from the EU countries to the ENP countries). Indeed, the majority of the ENP and the EU countries retain a rather asymmetric trade pattern. This means that the composition of their exports (i.e. the sectoral shares of their exports) is rather irrelevant to the composition of their imports (i.e. the sectoral shares of their imports). Moreover, the ENP and the EU countries experience an inter-industry

type of integration. This type of integration advocates for a "developmental gap" between the EU and the ENP countries. Indeed, it is revealed that for the vast majority of EU-ENP country pairs either there is a neutral relation or the EU countries dominate over the ENP countries.

The clear-cut empirical responses to the research questions that have been set in the paper have significant implications for policy-making. Overall, the success of the ENP undertaking seems to be problematic; the EU objective to create a "ring of friends" does not go hand-in-hand with the relations of domination that tend to characterize the EU-ENP trade activity. Questioning (contrasting) the theoretical positions of the neoclassical school of thought for the operation of the spatial economy, the "reproduction" of the well-established "core-periphery" EU spatial pattern in the wider EU area accentuates the need for the reinvigoration of the ENP. The reinvigoration of the ENP is, also, dictated from the fact that the EU is becoming, diachronically, a less significant trade partner for the ENP countries (and, also, from the fact that the ENP countries are not significant trade partners for the EU countries at all) and from the fact that the majority of the ENP countries continue to trade chiefly with specific EU countries. Within the aforementioned problematic framework of the EU-ENP trade activity, an additional concern is raised. The inter-industry type of (trade) integration between the EU and the ENP countries, an outcome of the inability of the ENP countries to compete, successfully, in markets for capital-intensive and / or knowledge-intensive activities (or, to put it differently, an outcome of the inability of the ENP countries to implement, successfully, export-led strategies towards the diversification / expansion of their export bases), even though it provides an alternative (and perhaps the only feasible) route for the exploitation of the locally available skills, is not in a position to guarantee (generate) prospects for long-term income convergence.