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The determinants of trade activity among the EU and the ENP countries

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OBJECTIVE OF RESEARCH IN RESPECT TO POLICY

The European Neighborhood Policy (ENP), launched in 2004, is a unified European Union (EU) policy framework towards the EU neighboring countries (hereinafter: the ENP countries), aiming at strengthening the prosperity, stability and security of the EU, creating a "ring of friends" around the EU political borders. The ENP framework applies to Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine (the ENP East) as well as to Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Occupied Palestinian Territory, Syria and Tunisia (the ENP South). Even though the ENP is a distinct and separate process from the EU enlargement, the ENP countries operate under conditions of "neighborhood Europeanization". This means that despite the fact that the proper "membership anchor" is missing, the progressive compliance with the *acquis communautaire* (i.e. the corpus of EU laws and policies) is a necessary condition for the ENP countries in order to increase their "weight" on the EU market. This is so as the EU started to conduct Deep and Comprehensive Free Trade Agreements (DCFTAs), bilaterally with the ENP countries, in order to deepen the substance of trade agreements, bringing, thus, the ENP countries closer to the Single Market. Hence, in practice, the ENP countries operate, within the framework of the ENP, under conditions tantamount to economic integration.

Within this framework, the objective of the paper is to detect the determinants of exports flows from the ENP countries to the EU countries, and, moreover, to indicate whether significant irregularities in the geographical direction of exports flows from the ENP to the EU countries, if they exist, have any implications for the economic performance of the ENP countries. What would be the factors determining the geographical distribution of trade flows of a given country? Who are the more likely destinations of these flows? The gravity model for the EU – ENP trade activity, indicates that in an international framework with no major obstacles to commodity flows, the value of exports from the ENP countries to the EU countries is a direct function of a series of explanatory variables. Given that the ENP countries operate under conditions of "neighborhood Europeanization", it is important to know whether (and to what extend) the ENP exports flows to the EU are largely driven by market forces or by a set of less detectable, but existing, political type of considerations. Furthermore, to the extent that there is a bias in the geographical pattern of trade relations, it is interesting to know whether such a bias has affected (and in which direction) the economic performance of the ENP countries. The results of paper provide valuable insight with respect to the EU – ENP trade relations.

SCIENTIFIC / RESEARCH METHODS

The paper constructs a gravity model relating the value of exports flows, from the ENP to the EU countries, to a number of explanatory variables. Then, on the basis of the results derived from the gravity model, the paper estimates a Coefficient of Irregularity in the Geographical Direction of Exports Flows (CIGDEF) in order to measure the degree to which the direction of exports flows from the ENP to the EU countries is diverging or is different from that predicted by the gravity model equation. Plotting the figures of the CIGDEF against the

figures of the ENP countries' per capita Gross Domestic Product (GDP), the paper detects the possible implications of geographical irregularity for the economic performance of the ENP countries. The paper utilizes trade data derived from the United Nations (UN) COMTRADE database, and covers the period 2001-2010 so as to gauge the latest shifts operated in the trade structures of the EU and the ENP countries.

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Based on the results of the gravity model, a number of important observations can be made. The estimator of the GDP variable of the ENP countries, though positive, is significantly low(er) comparing to the one for the EU countries. This finding indicates the inability of the ENP countries to diversify and expand their export bases, implementing export-led growth strategies. Definitely, the inability of the ENP countries to compete (successfully) with their more advanced EU counterparts in the markets for capital-intensive and knowledge-intensive economic activities cannot produce long-term income convergence. The positive sign of the estimator of the ENP population indicates high potential to export. This finding is a signal for the EU to create, through its external trade policy, conditions favoring the ENP exports to the EU market. The reluctance on behalf of the EU to remove its tariff barriers, especially the ones imposed on agricultural products, does favor trade creation conditions, raising major hurdles for the ENP countries to export, to the EU market, the products on which they, mainly, specialize. Given the slow progress of the DCFTAs, the EU may, instead, examine the possibility that mandatory *acquis communautaire* compliance related to political requirements should not be a precondition for trade negotiations (and agreements). The negative sign of the estimator of distance indicates that the ENP exports to the EU countries are not spatially dispersed all over the EU market. In contrast, they present strong trends of spatial concentration since adjacency exerts a strong influence in the formation of trade areas, whereas distance has a negative effect on trade activity. The sings of the coefficients of the income differences variable and the dummy variables of the existence of common land border and colonial relations in the past support the aforementioned findings.

Such a "crypto-protectionist" approach on behalf of the EU has an impact on the geographical pattern of the ENP exports. Indeed, the results of the CIGDEF, showing great variation both over time and across countries, indicate that there are cases where significant irregularities in the geographical direction of exports flows arise. This means that in many cases the geographical pattern of exports is not "normal" or, to say it differently, there is a bias in the geographical pattern of ENP exports to the EU. Such a bias is, to some extent, expectable since the economic space that contains the EU and the ENP countries is not without barriers to interaction. Of course, for many ENP countries (mostly for many ENP East countries) the launch of the ENP led to the normalization of the patterns of trade activity with the EU (and especially with the new EU countries). These countries experienced their peak, in terms of geographical irregularity, prior to the ENP as a side-effect of the break-up of the Soviet Union. In any case, geographical irregularity exerts a negative, though not strong, impact on the ENP countries' economic performance.