



EUROPEAN POLICY BRIEF



SEARCH
SHARING KNOWLEDGE ASSETS:
INTERREGIONALLY COHESIVE
NEIGHBORHOODS

**Sharing Knowledge Assets: InteRregionally Cohesive
Neighborhoods (SEARCH) Project**

Ongoing project (01/08/2011-31/07/2014)

Analysis of trade patterns over time in EU and neighboring countries

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November 2013

INTRODUCTION

Setting the scene

The recent (i.e. years 2004, 2007, and 2013) EU enlargements brought the borders of the EU to a set of countries in the East with historically less intensive economic relations. These countries have been part of the (former) Soviet Union and are characterized by lower development levels and significant institutional and structural differences. At the same time, in the Southern and the Eastern rim of the Mediterranean Sea, the EU is faced with countries that are linked to individual EU countries through their colonial past. Both bordering areas, in the EU East and the EU South, have been gaining significance as they include emerging economies, energy suppliers, or, simply, a large neighboring market, which is crucial for the EU economy.

Thus, the EU launched, in 2004, the European Neighborhood Policy (ENP), a unified policy framework towards its neighboring countries (the ENP countries). The objective of the ENP is to strengthen 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 countries) as well as to Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Occupied Palestinian Territory (hereinafter: Palestine), Syria and Tunisia (the ENP South countries). The ENP is synergic to other EU initiatives in this area such as the Eastern Partnership (launched in Prague, in 2009), the Euro-Mediterranean Partnership or Union for the Mediterranean (re-launched in Paris, in 2008), and the Black Sea Synergy (launched in Kiev, in 2008).

The ENP is a distinct and separate process from the EU enlargement; however, the ENP countries operate under conditions of “neighborhood Europeanization”. This indicates an apparent mismatch – the so-called “capabilities-expectations” gap – between ENP requirements/demands, on the one hand, and ENP potential gains/rewards, on the other. To put it simply, on the one hand, the EU has designed the ENP, for its neighboring countries, aiming to expand relations and strengthen prosperity, stability and security in its external borders. On the other hand, the neighboring countries understand the ENP as a first step in a long road that will end-up with full membership. Such an expectation is, partly, justified on the historical record of the EU formation, which, in a series of enlargements, has managed to expand, first southwards and then eastwards, and integrate countries with different development levels and institutional endowments.

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, since according to the Treaty of Lisbon, forced in 2009, EU policies with a bearing on relations to third countries (such as the ENP countries) should be guided by a common set of principles and objectives such as the consolidation and support of democracy and the preservation of peace. Thereof, the ENP offers conditional preferential economic and political relations in exchange of the recipient countries’ adherence to the ENP principles. In particular, the EU pursues the implementation of Deep and Comprehensive Free Trade Agreements (DCFTAs) with its neighboring countries. DCFTAs are the main policy thrust of the ENP, involving tailor-made agreements and conditions (in contrast to the rigid Copenhagen criteria that characterize the EU eastwards enlargement) aiming at bringing the EU neighbors gradually closer to the Single Market. Hence, in practice, the ENP countries operate, within the ENP framework, under conditions tantamount to economic integration.

Objective of the research

SEARCH (“Sharing Knowledge Assets: InteRregionally Cohesive NeighBorhoods”) Project, being implemented within the 7th European Community Framework Programme (FP7-SSH-2010.2.2-1(266834) European Commission), analyses the impact of the ENP on the integration of neighboring countries and the EU in the areas of trade and capital flows, mobility and human capital, technological activities and innovation diffusion, and the institutional environment. In particular, the 2nd Work Package (WP2) of SEARCH Project, titled “Trade Flows and Localization Choices” has the general objective to study, both theoretically and empirically, the patterns of economic interaction between the EU and its neighboring countries, to project future trends and identify the effects of higher levels of economic integration to the growth, competitiveness and cohesion prospects of the two areas.

The specific objectives of WP2 are: a) the analysis of the trade patterns between the EU and its neighboring countries and their possible effects on growth, structural change and cohesion in both areas; b) the analysis of the locational choices of EU mobile investment, the direction and drivers of capital mobility and its effects on the EU new member states and its neighboring countries; c) the assessment of the efforts made by domestic and foreign firms to invest in technological and organizational capacities with a special focus on the impact of localized institutional environments; d) the analysis of the spatial intra-country effects of higher levels of trade and investment interaction in both the EU and its neighboring countries; and e) the discussion of the policy options at the EU level that take into consideration the effects of integration and attempt to increase and spread its benefits on both sides of the external EU borders.

The findings of WP2 provide clear-cut answers to a series of research questions: Which is the evolution of trade patterns between EU countries and their neighboring countries? Which is the impact of trade activity between EU countries and their neighboring countries on growth, structural change and cohesion? Which is the evolution of capital mobility between EU countries and their neighboring countries? Which is the impact of capital mobility between EU countries and their neighboring countries on growth, structural change and cohesion? Which are the policy implications of the evolution of trade activity and capital mobility between EU countries and their neighboring countries?

WP2 is carried out in parallel to WP3 (“People Mobility and Human Capital”), WP4 (“Technological Activities and Innovation Diffusion in the EU and Interaction with Neighboring Countries”), and WP5 (“Institutional Environment”). Hence, a strong cooperation methodology has been established among the WP leaders, ensuring the progressive coordination and alignment of the research activities. Building on the relevant findings, this allows for cross-fertilization and strengthening of the existing interrelation among the WPs of SEARCH Project. Given that SEARCH Project places strong emphasis on the policy dimension, research results of WP2 – as well as of WP3, WP4, and WP5 – are closely monitored and assessed as they emerge from WP6 (“Policy Issues and Research Implications: Toward an integrated European Research Neighborhood Policy Posture”) in order for their relevance for the formulation of policy recommendations to be ensured.

“Departure” for the present Policy Brief

The present Policy Brief draws on Deliverable 2.2 of SEARCH Project, and, in particular, on

the part that refers to Task 2.1. Deliverable 2.2 is a complete report on patterns of economic interaction between the EU and its neighboring countries, submitted for review to the European Commission in line with the structure of Annex I to the Grant Agreement (i.e. the reference document for the work and the effort to be executed by SEARCH Consortium in carrying out SEARCH Project). Deliverable 2.2 synthesizes the work done on patterns of economic interaction between the EU and its neighboring countries, informing both the empirical direction and the theoretical underpinnings of WP2 of SEARCH Project. The general objective of Task 2.1 (analysis of trade patterns over time in EU and neighboring countries), in particular, is to conduct an in-depth study of the ENP trade flows to and from the EU, and world-wide, in order to provide a thorough insight into the evolution, over time, of their direction, size and composition as well as into the impact of trade activity on the growth performance of the ENP.

According to Task 2.1, there are six (6) Working Papers analysing trade patterns, over time, in EU and its neighboring countries. These Working Papers are: a) WP2/06: Trade activity between the EU and the ENP countries: A “reproduction” of the “core-periphery” pattern? (author: Dimitris Kallioras); b) WP2/07: The geography of trade relations between the EU and the ENP countries: Emerging patterns and policy recommendations (authors: George Petrakos, Dimitris Kallioras and Panagiotis Artelaris); c) WP2/08: The determinants of trade activity among the EU and the ENP countries (authors: Dimitris Kallioras and George Petrakos); d) WP2/09: Mind your step: The heterogeneous effect of relatedness on the diversification process in EU and ENP countries (authors: Ron Boschma and Gianluca Capone); e) WP2/10: The European firms’ export activity to the neighboring countries (authors: Anna Maria Pinna, Fabiano Schivardi and Vania Manuela Licio); and f) WP2/11: Integrating the neighbors: A dynamic panel analysis of EU-ENP trade relations (authors: Ageliki Anagnostou, Dimitris Kallioras and George Petrakos).

Each Working Paper has a Policy Notes addendum i.e. a 2-3 pages text consisting of three (3) parts: (a) objectives of research in reference to policy; (b) scientific/research methods; and (c) policy value-added. Each Policy Notes text has contributed to the preparation of the present Policy Brief text, which incorporates the policy implications of the research findings, easing, thus, the (effective) communication with the policy-makers.

Scientific approach

Task 2.1 provides a theoretical discussion and a detailed empirical analysis of trade patterns over time, by sector, by origin and destination for the EU and the neighboring countries. The analysis includes intra- and inter-industry patterns of trade, patterns of specialization and change as well as export portfolios performance and structure, and assesses their effect to competitiveness and growth performance in both economic areas. Exploiting a number of research methodologies, a number of assignments examine: a) the degree of relatedness between export products; b) the evolution of the export mix of EU and neighboring countries over time and the extent to which new products are related to existing products at the national level; c) the degree of relatedness between imports and exports at the national level and the possible benefits that national export sectors can derive from learning opportunities in related import sectors; d) how both integration and the role of trade in the local economies relies on the type of product which is traded; e) the relation between the patterns of integration and the patterns of production and the impact of integration on specialization and growth performance; and f) EU trade policies towards neighboring countries, including restrictions arising from sectoral policies and environmental or quality requirements and standards.

The analysis covers the period 1995-2011 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 (i.e. the euro currency, the eastwards enlargement, and the on-going financial and economic crisis) and the ENP countries (i.e. the “color” revolutions, and the Arab “spring”), besides the ENP in itself. Data derived from UN COMTRADE, CEPII BACI and EFIGE databases are utilized. COMTRADE and BACI databases contain aggregate and disaggregated (up to 6-digit level) trade data at the national level (in fact, BACI has been developed on the basis of COMTRADE data), whereas EFIGE database contains aggregate and disaggregated (up to 2-digit level) trade data at the firm level.

Structure of the present Policy Brief

The current part of the present Policy Brief is introductory. The next part presents the main evidence of the analysis, offering valuable, conceptual and empirical, insight to both theory

and policy-making. The third part provides policy recommendations on the basis of the analysis conducted. The fourth part summarizes the research parameters. The last part of the present Policy Brief presents the identity of SEARCH Project.

EVIDENCE AND ANALYSIS

The European perspective stimulates and facilitates development

It is widely accepted that the European perspective acts as a very strong stimulus for – and facilitator of – economic, political and institutional development by providing not only the incentives but also the (financial) resources to promote economic restructuring and institutional capacity-building. It is, thus, no surprise that especially for countries that are in dire need for economic restructuring, socio-political transformation and development, the process of European integration, in all of its facets (i.e. economic integration, political approximation and policy harmonization), has largely gone unquestioned. Indeed, deeper association with the EU brings a number of political and economic benefits at the domestic national level, strengthening domestic policies and, thus, facilitating political reforms that consolidate the process of political transition, democratization and, in some cases, conflict resolution and normalization of external relations.

The ambiguous impact of economic integration

The paradigm of the European communities indicates that the process of integration, although it does not stem solely from economic incentives, is realized, first and foremost, in the economic field, as economic integration. Economic integration denotes a state of affairs or process which involves the amalgamation of separate economies into larger free trade regions. Indeed, international trade is usually the first type of linkage between independent economic units, and one of the most expedient (economic) factors in pushing economies into integration. Economic integration reduces the role of national borders as barriers to factor mobility, and is, further, reinforced (self-sustained process) by the reduction of trade costs. “Closed” borders distort market size, whereas the removal of economic barriers generates (releases) a number of spatial dynamics linked to better access to foreign markets and import competition. Therefore, even if there is, almost, unanimous consensus in the economic literature that the (market-based) process of economic integration is a positive-sum game, an on-going debate is currently taking place concerning the distribution of its overall welfare gains.

The pre-accession experience of the new EU countries

In the 1990s, the new EU countries (i.e. acceded in 2004 and 2007) have experienced the processes of transition, from central planning to a free market economy, and integration, into the European economic space. The dynamics of these interacting processes have generated unprecedented pressures and have upset the structural bases of these countries. In particular, the new EU countries experienced a major decline in their GDP levels during the early transition period. Despite the partial reversal of this trend in the late 1990s, the new EU countries were still, at the time of accession, significantly behind not only from the respective figures of the EU-15 countries (i.e. the old EU countries) but also from their own earlier figures. This is so as the new environment has significantly affected the economic structures of the new EU countries. Market forces and transition policies of openness, privatization and deregulation changed the old internal organization of activities in ways that were often painful and forceful. The impact was recorded on the secondary sector of production, and especially on the sector of manufacturing. The recorded de-industrialization in the new EU countries is the combined outcome of market forces and transition policies, which led to an abrupt exposure of poorly organized domestic activities to external competition. Overall, the process and the policies of transition in EU NMS have led to a concentration of industrial activities in labor-intensive and resource-intensive sectors. The shares of capital-intensive sectors were reduced significantly, indicating a structural deviation from the corresponding pattern of the EU-15 countries.

The EU-ENP trade relation: An unequal relation

For the vast majority of the EU-ENP country pairs either there is a neutral relation or the EU countries dominate over the ENP countries. Hence, a spatial pattern of unequal (trade)

relations between the EU and its neighbors is consolidated, “reproducing” the well-established “core-periphery” EU spatial pattern of development. This makes evident that the neoclassical-type position that the market forces released in the process of economic integration (even under conditions of “neighborhood” Europeanization) are, overall, beneficial for the least developed economies, leading, thus, to greater cohesion, is difficult to verify.

The EU-ENP trade relation: An uneven, unbalanced and asymmetric relation

The EU-ENP trade relations have been evolved in a rather uneven, unbalanced and asymmetric way. Uneven relation means that whilst the EU is the most significant trade partner for the vast majority of the ENP countries, the latter are not so important trade partners for the EU. This is so especially for the ENP countries that do not exhibit revealed comparative advantage, against the EU, in the sector of fuel primary commodities. Unbalanced relation means that the ENP countries that do not exhibit revealed comparative advantage, against the EU, in the sector of fuel primary commodities, have a negative trade balance with the EU. Such a negative trade balance may be “converted” into fiscal deficit, given the experience of the peripheral EU countries. Asymmetric relation means that the ENP countries experience an inter-industry type of integration with their more advanced EU counterparts. Even though it provides an alternative (and perhaps the only feasible) route for the exploitation of the locally available skills, it is doubtful whether such type of trade relations can produce long-term income convergence between the EU and the ENP countries. This is so as the, peripheral and less advanced, ENP countries, having weaker productive bases with a high share of sensitive, labor- and resource-intensive, sectors and unfavorable geographic coordinates are struggling in the process of integration to effectively redeploy their resources in order to gain from the opening-up of markets.

The EU-ENP trade relation: Increasing importance, in absolute terms

The EU-ENP trade relations have expanded significantly over the period 1995-2010. This is a clear sign of the increased interaction – if not integration – of the ENP countries with the EU. In particular, the ENP South and the EU15 countries have a dominant position in terms of exports and imports shares in relation to the respective (total) ENP and EU shares. However, the ENP East and the EU12 countries have been exhibiting the highest, corresponding, increases, altering, to some extent, the overall picture of the EU-ENP trade activity.

The EU-ENP trade relation: Diminishing importance, in relative terms

The EU is the most important trade partner for the vast majority of the ENP countries. However, it loses its shares over time. In contrast, the shares of the rest of the world (RoW) countries are getting increased over time, mainly due to the dynamism that the BRIC countries (i.e. Brazil, Russia, India and China) exhibit. On the other side, the ENP countries are not important trade partners for the vast majority of the EU countries. EU trade activity is mostly intra-EU.

The intra-ENP trade shares are small

The intra-ENP trade shares are rather small. This indicates that the ENP economic space is still fragmented, with weak demand-supply chain links. Thus, the EU-ENP economic space reminds of a “hub-and-spoke” system (analogous to the one formed in the European economic space, and characterizes the economic relations among the core and the peripheral EU countries).

The key-role of the sector of fuel primary commodities

The sector of fuel primary commodities is a key-sector for the study of the EU-ENP trade relations, given that the EU is a major energy importer. The trade balance figures of the ENP countries reveal that only the ENP countries that exhibit revealed comparative advantage, against the EU countries, in the sector of fuel primary commodities (i.e. Algeria, Azerbaijan, Belarus, Egypt, Georgia, Libya, and Syria) exhibit a positive trade balance (i.e. surplus) in respect to their EU counterparts. In contrast, the rest of the ENP countries record a corresponding negative trade balance (i.e. deficit) over time.

High capacity and potential on behalf of the ENP countries to export

There is a lot of room for the ENP countries to increase their exports flows towards the EU. This is so as high(er) levels of GDP and population in the ENP and the EU countries are associated with high(er) capacity to export and import, respectively. In particular, high level of GDP in the ENP countries indicates a high level of production, which increases the availability of goods for exports, whereas high level of GDP in the EU countries indicates a high level of disposable income, which suggest high capacity to import. Furthermore, high level of population in the ENP countries indicates high potential to export, which may attribute to low absorption capacity, whereas high level of population in the EU countries indicates high potential to import, which, again, may attribute to low absorption capacity. Under a micro-scope angle, noteworthy is the fact that less than 6% of the EU exporting firms (which represent about 70% of the EU firms) have the ENP countries as main (i.e. first, second or third) export destination. Moreover, just 2% have an ENP country as their first export destination.

The inhibitory role of distance

Ceteris paribus, neighboring countries provide the easiest market access for the majority of tradable goods as trade costs are lower over small distances. Over time, the increasing shares of trade activity conducted among the ENP East and the new EU countries, in relation to the total EU-ENP trade, indicate that adjacency exert a strong influence in the formation of trade areas, favouring a more regionalized pattern. This means that as the EU-ENP trade activity is expanded to countries situated further and further from the EU core, the EU-ENP trade relations are not characterized by (the same) strength as the force of attraction diminishes with distance. This means that the proponents of the “end of geography” and the “death of distance” are far from being verified, despite the remarkable progress made in transportation and communication technologies.

Significant geographical irregularities in the ENP countries' exports to the EU, with a negative impact on economic performance

Both over time and across countries, there are cases where significant irregularities in the geographical direction of exports flows, from the ENP to the EU countries, arise. Some countries (i.e. Armenia, Azerbaijan, Belarus, Egypt, Georgia, Libya, and Moldova) experienced their peak, in terms of geographical irregularity, over the period 2001-2003 (i.e. prior to the launch of the ENP), whereas some others (i.e. Algeria, Morocco, Syria, Tunisia, and Ukraine) experienced their respective peak over the period 2006-2009 (i.e. after the launch of the ENP). The majority of the ENP East countries are the ones that experienced their peak prior to the launch of the ENP. This is so as so as the break-up of the Soviet Union led these countries – former members of the COMECON – to a state of isolation. 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. Concerning the majority of the ENP South countries as well as Ukraine, geographical irregularity seems to be associated with the unrest took place, in these countries, over the recent years. In any case, geographical irregularity exerts a negative, though not strong, impact of the economic performance of the ENP countries.

Path-dependence in the diversification process and inability on behalf of the ENP countries to implement export-led growth strategies

Over time, the sectoral composition of exports flows from the ENP countries to the EU remains, more or less, unchanged (i.e. high levels of positive correlation). The rather low changes in the sectoral composition of the ENP exports to the EU provide strong indication that the ENP countries, in their great majority, have not (successfully) implemented export-led growth strategies towards the diversification (expansion) of their exports bases. The degree of relatedness between exports products shows that both in the EU and the ENP countries the evolution of the export mix is strongly path-dependent (i.e. countries tend to keep a comparative advantage in products that are strongly related to their current productive structure, and they also diversify in nearby products). However, this effect is much stronger for the ENP countries, signalling the existence of different types of capabilities (i.e. the EU countries are able to diversify into less related industries because of general-purpose capabilities, while the ENP countries have to rely much more on the relatedness between products and the specific capabilities necessary to produce them). Moreover, the future exports structure of countries is affected by imports (i.e. both EU and ENP countries keep a

comparative advantage in products that are strongly related to their imports, but only EU countries show, also, evidence of learning to diversify in new products from related import sectors). The productive structure of trade partners, instead, does not have any impact on the diversification process, but it provides economic incentives to both EU and ENP countries to keep producing in old sectors that are related to what their partners do.

Trade is not always beneficial

Exports and imports to/from the EU contribute to the growth performance of the ENP countries, providing some support to mainstream theories of trade and development. However, when indicators of trade openness/integration are taken into consideration and the EU countries are divided in economic sub-groups, this contribution becomes conditional. In particular, in terms of trade openness/integration, trade expansion (as a share of GDP) with the EU contributes to ENP growth mainly when it concerns trade with middle- and low-income EU countries (i.e. the Southern and the Central-Eastern EU countries). In contrast, when the corresponding expansion of trade is related to high-income EU countries, the impact on growth is negative. Taken from the opposite perspective, the GDP growth of the ENP countries stimulates the expansion of trade relations only the middle- and the low-income EU countries. The relative expansion of trade with the less advanced EU countries seems to contribute to the long-term growth of the ENP countries, while the corresponding expansion with the more advanced EU countries it does not. This casts some doubt on the mainstream win-win models of trade and development and provides support to alternative theories relating trade outcomes on structural and development gaps, initial conditions, market size, scale effects and geographical coordinates.

DCFTAs do not provide a solid stimulus in the process of “neighborhood Europeanization”

The political upheaval in the ENP South and the slow reforms in the ENP East provide a strong proof that the goals of the ENP undertaking (i.e. prosperity, stability and security at the EU external borders) have, still, a long way ahead. This mirrors to the progress of the DCFTAs, the main policy thrust of the ENP. Given that the trade component of the ENP provides a backdrop for the assessment of the success of the ENP undertaking – since mandatory *acquis communautaire* compliance is a precondition for the progress of the DCFTAs – the DCFTAs do not provide a solid stimulus in the process of “neighborhood Europeanization”. The slow progress of the DCFTAs verifies the fact the “capabilities-expectations” gap remains, points out that the level of tariff barriers to trade is, still, quite high, making it difficult to achieve conditions of trade creation, and indicates the restrictions that may arise from some EU sectoral policies, and the Common Agricultural Policy (CAP), in particular, related to the ENP.

POLICY RECOMMENDATIONS

Improvement of the quality of institutions in the ENP countries

The EU and the ENP countries differ under many respects: education, culture, physical infrastructure. These elements could be, effectively, summarized under the label of institutions. There is, actually, a strong consensus on the role that institutions play in determining innovation and competitiveness of countries. Institutions refer to how societies are organized at all levels, including laws, customs, habits and traditions, and how this has an impact on the incentives, frameworks, ideas and behaviours of individuals and social entities. Some institutions directly favour or hinder the emergence of innovations; moreover, they interact at different levels, generating complex structures such as national, regional or sectoral systems of innovation. Thus, policy-makers might consider taking actions aim at improving the quality of institutions in the ENP countries. Creating an environment where firms can be created and sustained more easily, or returns from innovation appropriated also by local companies and new innovators, policy-makers might provide more incentives and opportunities for diversification, even in very far products, and, therefore, boost the future growth of the ENP countries.

Development of nearby sectors in the ENP countries

Aim at improving and speeding up the diversification process in the ENP countries, policy-makers might consider that this could be obtained mostly by favouring the development of

nearby sectors. Directly favouring the creation of very distant industries might result in severe failures, since the lack of necessary supporting infrastructure and institutions may doom these initiatives before positive diffusion effects may occur.

Enhancement of ENP exports to the EU

Policy-makers might consider the ENP countries' trade flows as a whole: sectors opening to international imports should also be opened very soon to opportunities in exports, so to have the possibility to grow and support the diversification process of the ENP countries. Currently, the EU imposes relatively high (simple) average tariffs to trade with the ENP countries, especially on agricultural goods, making it difficult to achieve conditions of trade creation. The reluctance on behalf of the EU to remove its (agricultural) tariff (and, also, non-tariff) barriers to trade activity with the ENP countries leads to deadlock as it raises major hurdles for the ENP countries to export, to the EU market, the products on which they, mainly, specialize.

The ENP countries need to find the "correct" trade partners

Trade among "unequal" partners can be beneficial for the growth of developing or emerging economies only when it takes place within some limits that should not be exceeded. The ENP trade with the advanced EU economies should be an important part of their total trade, but it should not dominate their overall trade relations. Such trade is, typically, uneven, unbalanced and asymmetric and does not allow for the diversification of the productive bases of the less developed countries, which is necessary for long-term growth. Furthermore, as the geographical allocation of trade relations affects, in an important way, the growth potential of the developing or emerging economies in the external European periphery, improving the participation of the EU countries that are, in many ways, closer to the ENP countries is beneficial for the long-term growth of the latter. It appears that finding trade partners with a geographical, but also economic and cultural, proximity is a necessary ingredient for a successful integration experience for the ENP countries. Policy-makers might aim at developing, along the EU-ENP frontiers, trade among neighbors (which is dominant among the advanced EU countries) in order to balance the (otherwise necessary, within reasonable limits) "core-periphery" EU-ENP trade activity. The idea that the EU can integrate to its core productive system successive homocentric rounds of geographically more and more dispersed and economically less and less developed areas without altering the basic model of integration and without incurring any costs for anyone, needs to be re-examined. The EU policy towards ENP countries needs to obtain a deeper level of understanding of the interactions between trade relations and development prospects in both sides of the external borders. Helping the EU South and the EU East (that is the internal EU periphery) to establish deeper and broader economic relations with the ENP South and the ENP East (that is the external EU periphery) is a feasible way to support growth in the (hit by the crisis) internal European periphery and promote EU cohesion. This may be an urgent assignment in the face of the evidence that the EU-ENP trade is declining over time, in relative terms, as new competitors (i.e. BRICs), arise.

Initiation of proactive industrial and development policies

The ENP undertaking has a limited room for success if not combined with proactive industrial and development policies. The EU has an expertise in such policies, gaining, also, some experience (and drawn some lessons) from the early stages of restructuring in transition countries. Policy-makers need to find the will to allocate sufficient and, largely unconditional, resources for the implementation of such policies in the ENP countries. These policies will help to develop cross-border multiplier effects that will be mutually beneficial for both sides of the external borders of the EU, promoting at the same time a balanced EU-ENP integration and a balanced intra-EU development.

Reinvigoration of the ENP undertaking

Policy-makers might examine the possibility that mandatory *acquis communautaire* compliance related to political requirements should not be a precondition for trade negotiations and (agreements) but for further financial and technical support. This means that a possible ENP review should consider a further (even unilateral) liberalization of trade and a stronger financial support mechanism as a reward for reforms. If the EU is only interested for partnership (not membership) with its trade partners in the East and the South,

it is not totally understandable why it imposes conditionalities related to regulatory issues such as investment protection, public procurement and competition policy. Considering that the ENP area is sensitive in economic (i.e. low welfare level) and in demographic (i.e. high presence of rural population) terms, the current perspective of the ENP faces the danger for the ENP countries to “export” people instead of (agricultural) products to the EU market. Eventually, this may push the (non-fuel producing) ENP countries to gravitate towards different trade poles (i.e. BRICs) that offer less uneven, less unbalanced and less asymmetric trade relations.

Defragmentation of the ENP area

The EU-ENP trading area, clearly, reminds of a “hub-and-spoke” system. This is a reminder of the fact that the ENP area is still fragmented, with weak demand-supply chain links. Accordingly, this fact strongly suggests that it is important for development efforts to assume active and coordinated plans not only at the national but also at the macro-regional level. Policy-makers might adopt a new perspective, taking into consideration the specificities of the ENP countries, their initial constraints and the ensuing competitive pressures that EU association brings. This is a salient issue as, despite their current fragmentation, (many of) the ENP countries have many historical, political and cultural communalities, and, most importantly, common future trajectories.

RESEARCH PARAMETERS

Introductory statement

The present Policy Brief draws on Deliverable 2.2 of SEARCH Project, and, in particular, on the part that refers to Task 2.1 (analysis of trade patterns over time in EU and neighboring countries), incorporating the policy implications of the corresponding research findings. The present Policy Brief offers policy recommendations, easing the (effective) communication with the policy-makers.

Objectives of the research

The specific objectives of the research are: a) the analysis of the trade patterns between the EU and its neighboring countries and their possible effects on growth, structural change and cohesion in both areas; b) the analysis of the locational choices of EU mobile investment, the direction and drivers of capital mobility and its effects on the EU new member states and its neighboring countries; c) the assessment of the efforts made by domestic and foreign firms to invest in technological and organizational capacities with a special focus on the impact of localized institutional environments; d) the analysis of the spatial intra-country effects of higher levels of trade and investment interaction in both the EU and its neighboring countries; and e) the discussion of the policy options at the EU level that take into consideration the effects of integration and attempt to increase and spread its benefits on both sides of the external EU borders.

In particular, the specific objectives of Task 2.1 (analysis of trade patterns over time in EU and neighboring countries) are to examine: a) the degree of relatedness between export products; b) the evolution of the export mix of EU and neighboring countries over time and the extent to which new products are related to existing products at the national level; c) the degree of relatedness between imports and exports at the national level and the possible benefits that national export sectors can derive from learning opportunities in related import sectors; d) how both integration and the role of trade in the local economies relies on the type of product which is traded; e) the relation between the patterns of integration and the patterns of production and the impact of integration on specialization and growth performance; and f) EU trade policies towards neighboring countries, including restrictions arising from sectoral policies and environmental or quality requirements and standards.

Methodology

Addressing the research objectives of Task 2.1, secondary, national-level, data, derived from UN COMTRADE, CEPII BACI, and EFIGE databases, are utilized. COMTRADE and BACI databases contain aggregate and disaggregated (up to 6-digit level) trade data at the national level (in fact, BACI has been developed on the basis of COMTRADE database), whereas EFIGE database contains aggregate and disaggregated (up to 2-digit level) trade

data at the firm level. The utilization of the available data allows for the thorough study of trade flows, between the EU and the ENP countries, by means of a wide array of (sophisticated) research methodologies: a) screening of the EU policy documents related to the ENP; b) review of the theoretical and empirical literature on patterns of economic interaction; c) conduct of descriptive statistical analysis; d) estimation of trade indicators; e) compilation of gravity models; f) analysis of the degree of relatedness between export products, based on co-occurrence analysis; g) investigation of the process of diversification, using the proximity approach; h) implementation of panel cointegration techniques; and i) compilation of panel VAR models. The analysis covers the period 1995-2011.

PROJECT IDENTITY

Project name

Sharing Knowledge Assets: InteRregionally Cohesive NeighBorhoods (SEARCH)

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Duration

1st August 2011 - 31st July 2014

Funding scheme

European Community's Seventh Framework Programme FP7-SSH-2010-2.2-1 (266834), 2011-2014. Collaborative Projects

Budget

EU contribution: 2,636,942.00 €

Website

www.ub.edu/searchproject

Further Reading

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