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Trade activity between the EU and its neighboring countries: Trends and potential

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OBJECTIVE

Ceteris paribus, neighboring countries provide the easiest market access for the majority of tradable goods as trade costs are lower over small distances. Furthermore, when one country is much richer than the other, proximity trade is mutually beneficial as the richer country usually offers a wide variety of goods, with superior quality, while the poorer country, usually, offers lower prices and attractive productive locations. Free trade agreements (FTAs) are strongly based on this argument. Overcoming national borders is meant to create larger economic spaces for exploiting economies of scale, thereby reducing production costs. This means that trade activity among the counterparts involved in a FTA is expected to intensify over time, as the outcome of the impact of FTA on trade activity. The objective of the paper is to test empirically the aforementioned hypothesis, focusing on (the trade component of) the European Neighborhood Policy (ENP). To this end, the paper conducts an in-depth study of the bilateral trade relationships between the EU and its neighboring countries (the ENC), attempting to offer a detailed analysis in terms of trade patterns and to investigate whether the proximity of the ENC to the EU is combined with higher trade flows.

MAIN RESULTS

The gradual dismantling of economic borders between the EU and the ENC allows for the expansion of the EU – ENC trade activity. The Eastern ENC and the EU12 countries, in particular, have been exhibiting the highest increases, altering, to some extent, the overall picture of the EU - ENC trade activity. Yet, despite the fact that the EU – ENC trade activity is growing over time, there are a couple of findings that generate concerns about its progress. The first finding is that the vast majority of the ENC don't play a key role in EU trade, despite their proximity. The role of ENC in EU trade is weak, and not predominant in the global scene. However, aggregating the ENC as a single economic space, things change. ENC gain a key role in international trade, becoming one of the most important EU partners, both in terms of exports and imports. Such an exercise indicates the neighboring area of the EU suffers the presence of many (economic) borders. The second finding is that the EU loses, over time, its relative position in the ENC's trade activity. In contrast, the shares of the

RoW countries are getting increased over time, mainly due to the dynamism that the BRICs exhibit. Such a trend must be alarming for the EU since the BRICs may, also, increase their political influence in the ENCs' area. The (concerning) trends that characterize trade activity between the EU and the ENCs may attribute to the EU trade policy, to the ENCs' trade structures, and the fragmentation of the ENCs' economic space.

The DCFTAs among the EU and the ENCs do not provide a solid stimulus in the process of "neighborhood Europeanization". Being a "carrot and stick" tactic, with serious one-way conditionalities related to progress required on political and institutional issues on behalf of the ENCs, the DCFTAs create obstacles to the further expansion of the EU – ENCs trade activity. Given the political upheaval in the ENP South and the slow reforms in the ENP East, the progress of the DCFTA is bound to be slow. 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 ENCs to export, to the EU market, the products on which they, mainly, specialize. Thus, the ENCs – especially the ones that do not enjoy comparative advantage in the sector of fuel – are "urged", with this "quasi-protectionist" tactic to find new markets for their products. Possibly, the EU should examine the possibility that mandatory *acquis communautaire* compliance related to political requirements should not be a precondition for the progress of the FTAs with the ENCs.

ENCs present high degree of geographical and sectoral concentration, especially in exports. The Southern ENCs, in particular, mainly export in their destination fuel primary commodities, with shares that matter for about 80%. Besides fuel, the ENCs export to the EU market agricultural products. In contrast, trade in capital goods, which has been recognized an important role in spreading the benefits of technological advances, continues to be rather low. By and large, the ENCs are locked-in an inter-industry type of trade integration with their more advanced EU counterparts. This type of trade relations is, mostly, the outcome of the inability of the ENP countries to diversify and expand their export bases, implementing export-led growth strategies. Thus, the ENCs, given the relatively high level of tariffs imposed on agricultural products are in weak position to penetrate into the EU markets. Even though, for the moment, it provides the only feasible route for the conduct of trade activity with the EU, is doubtful whether such type of trade integration can narrow the welfare gap between the ENCs and the EU. In contrast, it seems that the well-established "core-periphery" pattern of development is expanding in the EU neighborhood.

The EU – ENCs trading area reminds of a hub-and-spoke system as the ENCs economic space suffers the presence of many borders. The aforementioned ascertainment is a reminder of the fact that the ENCs 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. Probably, the DCFTAs should adopt a new perspective, taking into consideration the specificities of the ENCs area, their initial constraints and the competitive pressures that EU association brings. This is a salient issue as, despite their current fragmentation, (many of) the ENCs have many historical, political and cultural communalities, and, most importantly, common future trajectories.

Definitely, there is room for the further expansion of the EU - ENCs trade relations. Emphasis should be given on the EU external trade policy, the ENCs trade structure and the fragmentation of the ENCs economic space. Of course, the (further) expansion of the EU – ENCs trade is not the only issue. The nature of the EU - ENCs

trade is another, equally important, issue. This is because the nature of the EU - ENCs trade relations may not be leading to a sustainable type of integration, and, thus, to a reduction of the existing development gap between the EU and the ENCs.