Challenges of European, Eurasian and a wider European Integration in View of Ukraine’s Crisis

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Peter Havlik
The Vienna Institute for International Economic Studies, wiiw
International Institute for Applied Systems Analysis, IIASA

Topics covered

- Two competing integrations: European Union and Eurasian Economic Union
- Regional trade and FDI patterns
- Economic consequences of the Ukraine conflict
- Summary conclusions and the way forward
- Additional reading
Integration and disintegration: the EU vs CIS/EEU (I)

- European Union (EU) remains attractive and is expanding, notwithstanding numerous problems and crises
  - After 60 years, the EU currently has 28 member states (Croatia joined in July 2013), with more than 500 million inhabitants and aggregate GDP of €13,000 billion
  - Eurozone currently has 19 member states (Lithuania joined in January 2015)
- A number of SEE/FSU countries are candidates or aspire for EU membership (e.g. Serbia, Turkey, Georgia, Moldova, Ukraine…)
- Yet some current EU members may leave (e.g. UK, Greece)

Integration and disintegration: the EU vs CIS/EEU (II)

- Commonwealth of Independent States (CIS) was established after the dissolution of the Soviet Union in 1991
- CIS has currently 10 member states (Georgia left in August 2008, Ukraine in 2014), with 240 million inhabitants and aggregate GDP of close to €2,000 billion
- A number of alternative integration endeavours on the post-Soviet space, mostly Russian-led, exist (BY-RU-KZ Customs Union, SES, EurAz, GUAM, etc.)
- Customs Union and, currently, Eurasian Economic Union (EEU) comprising RU, KZ, BY and AR are the most important
- EEU is modelled on the EU example (“four freedoms”, economic policy coordination, etc).
Economic dimension: Real GDP in the enlarged EU, in % of total

Germany and France account together for more than 30% of enlarged EU economy

New Member States and Candidates for 20%

Economic dimension: GDP in the CIS/EEU, in % of total

Russia dominates by far the CIS/EEU economy

Ukraine would bring a bit more balance

Other CIS/EEU have little economic weight
Real GDP in Eurasia (Lisbon-Vladivostok), in % of total (Eurasia = enlarged EU and CIS/EEU)

The EEU represents just a fraction (about 13%) of Eurasian economy.

The EU is bigger market (€14000 bn) and much richer than EEU.
Average real per capita GDP is €27300 in the EU, compared with €7000 in the EEU.

RU: €18700, KZ: €18000, BY: €13800, UA: €6400

Russian foreign trade by regions (EUR mn): overall surplus yet rising deficit with China.
Russian foreign trade by regions (% of total): diversification from the EU not easy

<table>
<thead>
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<th>Year</th>
<th>USA</th>
<th>China</th>
<th>Ukraine</th>
<th>EaEU</th>
<th>EU-28</th>
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<td>2008</td>
<td>57.2</td>
<td>18.4</td>
<td>7.4</td>
<td>7.4</td>
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<td>2010</td>
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<td>18.4</td>
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<td>2013</td>
<td>53.8</td>
<td>18.4</td>
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<td>2014</td>
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Source: wiiw Database incorporating national and Eurostat statistics.

Russia’s main trading partners, 2014, in % of total

RU exports (EUR 373.9 billion)

- RoW: 40.9%
- CN: 7.5%
- DE: 7.5%
- IT: 7.2%
- NL: 13.3%
- JP: 4.0%
- KO: 3.7%
- PL: 3.2%
- BY: 4.0%
- TR: 4.9%

RU imports (EUR 215.2 billion)

- RoW: 38.6%
- CN: 17.6%
- DE: 11.5%
- IT: 3.8%
- UA: 3.8%
- JP: 3.8%
- KZ: 2.5%
- BY: 4.1%
- KO: 3.2%
- FR: 4.4%
- US: 6.5%

Source: wiiw Annual Database, national statistics.
Russia’s main trading partners in the EU, 2014
in % of total EU trade with Russia

Source: wiiw Annual Database, ROSSTAT

EU exports: EUR 103.3 billion
(2.2% of total EU exports)

EU imports: EUR 181.8 billion
(4.0% of total EU imports)

Memo:
US exports: EUR 13.9 bn
(6.5% of total RU imports)

Memo:
US imports: EUR 8 bn
(4.1% of total RU imports)

Sources: wiiw FDI Database incorporating national statistics (CBR); own estimates.

Russian inward FDI stocks: USD 566.5 billion,
end-2013

Sources: wiiw FDI Database incorporating national statistics (CBR); own estimates.
There seems to be little (economic) justification for Russia prompting Ukraine to join the Customs Union; Economic dominances have serious implications for integration success and sustainability (viz Germany-EU and Russia-EEU); Estimates of Customs Union, EU accession, EU Single Market, DCFTA, EU-USA Free Trade Agreements, etc. differ widely; Long-run effects estimates are always bigger than short-run! Effects of non-tariff barriers are always more important than plain customs duties reductions! Estimation methods, data sources and model assumptions matter a lot in evaluations/interpretations of integration effects! See selected references attached for additional reading.

Scenario (II): Overall EU losses could add up to EUR 55 billion if goods and services exports to Russia drop by 50% Germany, followed by Italy, France, Great Britain and Poland would lose most in absolute terms. In terms of value added, Austria would lose EUR 1.5 bn

Source: Own estimates (Havlík, 2014).
Scenario (II) sectoral impacts: estimated loss of GDP (in %) if gross exports to Russia drop by 50%

Baltics, SK, BG, PL, CZ, FI, HU more affected than others; Lithuania would lose up to 2% of GDP

Russia ‘stuck in transition’ already before Ukraine crisis escalated

- Energy exports revenues and growth sustainability
  - Increased pressures on energy supply diversification (both in the EU and RU)
  - Sectoral sanctions bite, no longer largely symbolic
  - Investment climate suffers, imports and FDI down, capital flight up

- Diversification and modernisation of the economy under threat
  - Growing reform pressures owing to lower oil price and sanctions?
  - Yet modernisation definitely more difficult without more FDI!

- Stability of the ruling elite threatened?
  - Putin’s ratings grow, Russia’s ratings fall, rouble and MICEX fluctuate
  - Yet this may change with more hardship …

- Integration on the post-Soviet space derailed/fails?
  - Crimea and Donbas not really helpful for Putin’s Eurasian integration project
  - New design/reset of EU neighbourhood policies?
  - Pivot to China?
**Impact of sanctions on the Russian economy**

- Decrease of funding from EU and US financial markets
- Embargo on trade with dual-use technologies
- Less FDI from the EU
- Higher inflation
- The reduction of production cooperation
- Embargo on trade of oil drilling technology

**Estimates:**
- EUR 115-150 bn
- EUR 4-5 bn
- EUR 20-40 bn
- EUR 15-20 bn
- EUR 10 bn

*Up to 50-70 mn tons of oil lost by 2030 (up to EUR 25 bn at 70$ per bbl)*

In extreme case, the impact of sanctions could add up to 8-10% of Russian GDP according to estimates of Moscow’s Institute of Economic Forecasting (Alexander Shirov, IIASA Workshop, 20 Nov. 2014).

**Preliminary conclusions and the way forward**

- Both Russia and the EU should abstain from geopolitical games over the influence in the Eastern Neighbourhood;
- EU-Russia negotiations should not be about Ukraine or other Eastern Partnership countries but involve the latter in the process;
- FTA negotiations should focus less and only selectively on costly harmonisations (‘acquis takeover’ for non-EU membership candidates);
- Visa liberalisation procedures, human contacts and other confidence-building measures on the European continent should be fostered;
- Closer integration of the enlarged EU, Russia, EEU and other Eastern Partnership countries would boost trade, investment and growth in a wider Europe;
- Wider Eurasian integration – from Lisbon to Vladivostok – would relieve Ukraine and other Eastern Partnership countries from ‘impossible either/or choices.
Selected references (I)


Selected references (II)

- Francis et al. (2013), ‘Reducing Trans-Atlantic Barriers to Trade and Investment’. IIDE and CEPR, London, UK
Selected references (III)

Thank you for your attention!