wiiw

Wiener Institut für Internationale Wirtschaftsvergleiche

The Vienna Institute for International Economic Studies

www.wiiw.ac.at

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

Conference „Europe current evolution“

The Prague Castle, 24 June 2015

Peter Havlik

The Vienna Institute for International Economic Studies, wiiw

International Institute for Applied Systems Analysis, IIASA

wiiw

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

wiiw

3

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)

wiiw

4

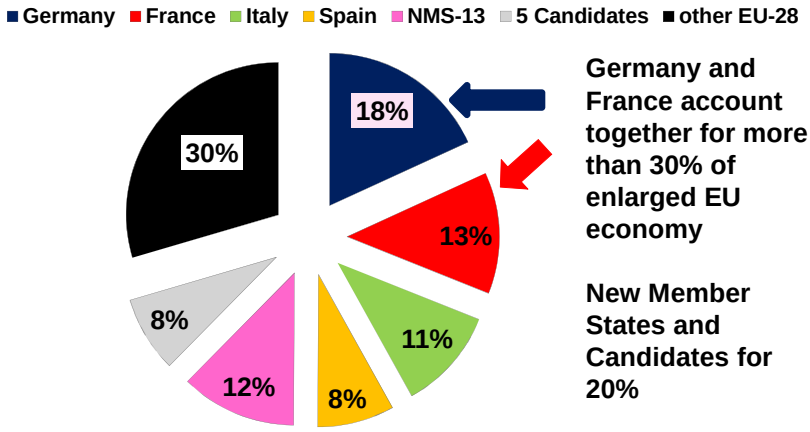
Integration and disintegration: the EU vs CIS/EEU (II)

- 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 endeavers 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).

wiiw

5

Economic dimension: Real GDP in the enlarged EU, in % of total



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

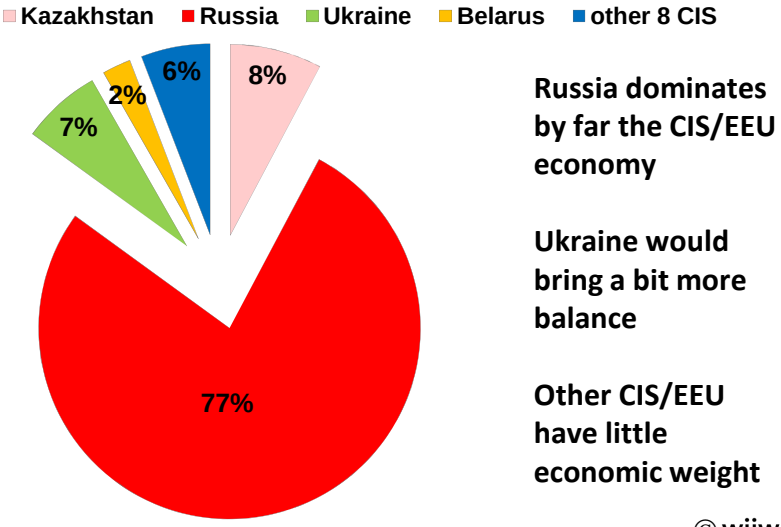
New Member States and Candidates for 20%

Sources: wiiw Database incorporating national and Eurostat statistics; own estimates.

wiiw

6

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



Russia dominates by far the CIS/EEU economy

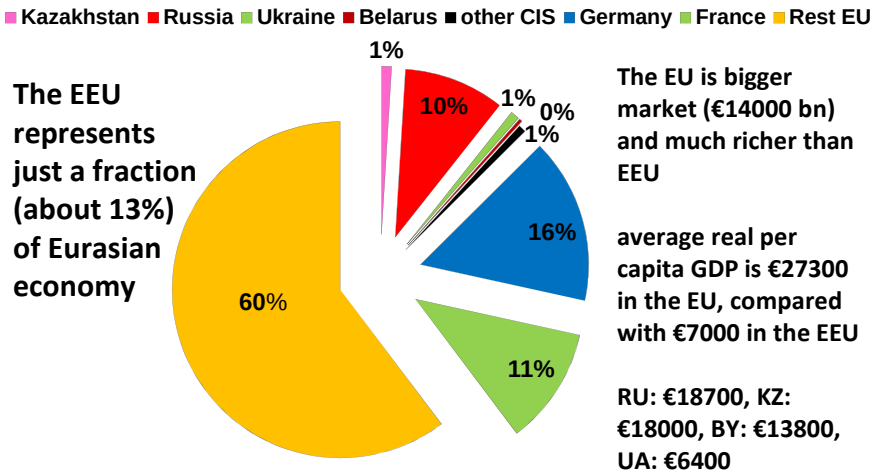
Ukraine would bring a bit more balance

Other CIS/EEU have little economic weight

Sources: wiiw Database incorporating national and CISSTAT statistics; own estimates.

wiiw

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

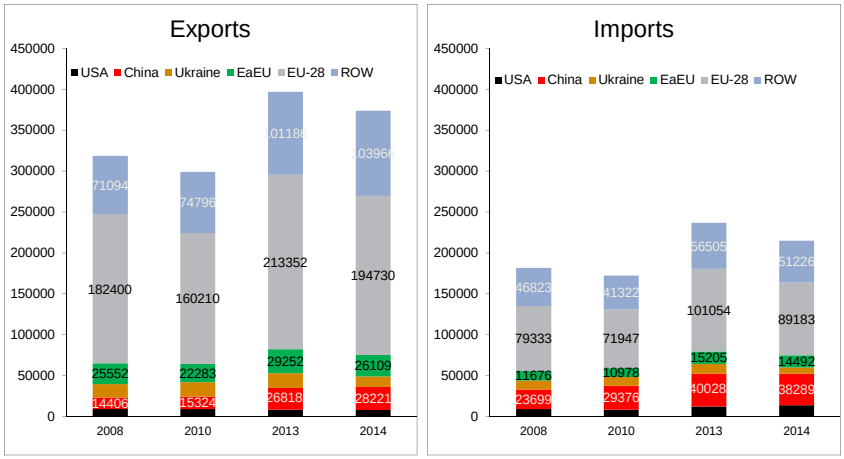
average real per capita GDP is €27300 in the EU, compared with €7000 in the EEU

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

Sources: wiiw Database incorporating national, CISSTAT and Eurostat statistics; own estimates.

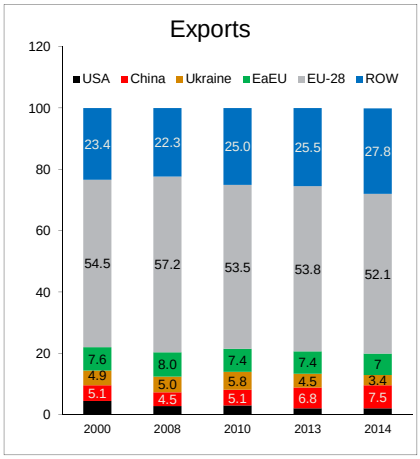
wiiw

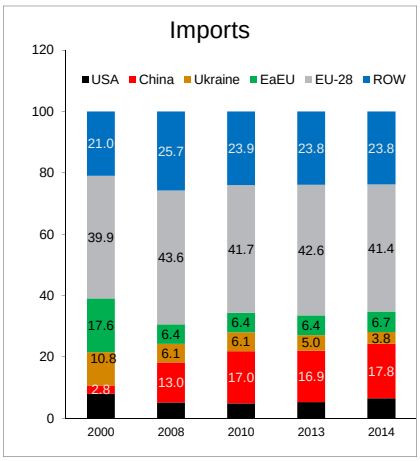
Russian foreign trade by regions (EUR mn): overall surplus yet rising deficit with China



Source: wiiw Database incorporating national and Eurostat statistics.

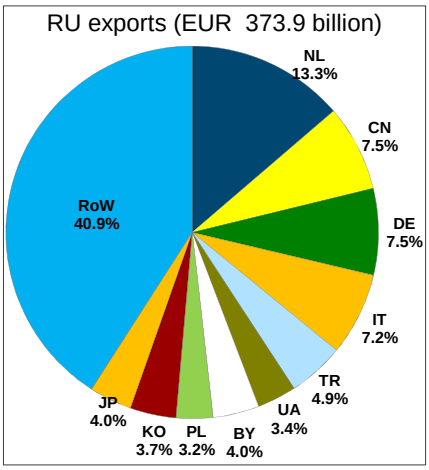
Russian foreign trade by regions (% of total): diversification from the EU not easy

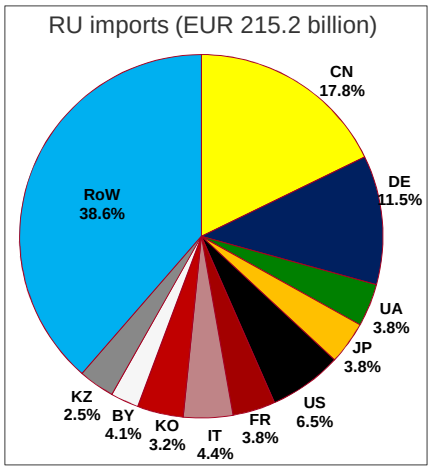




Source: wiiw Database incorporating national and Eurostat statistics.

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



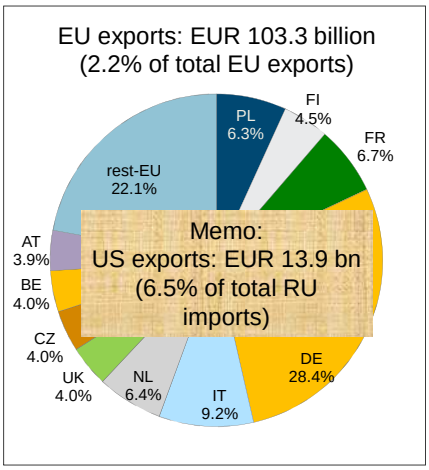


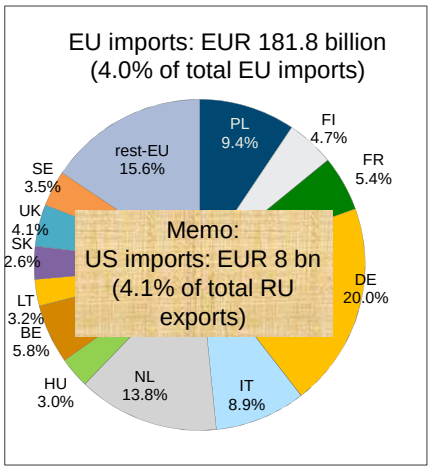
Source: wiiw Annual Database, national statistics.

wiiw

11

Russia's main trading partners in the EU, 2014
in % of total EU trade with Russia





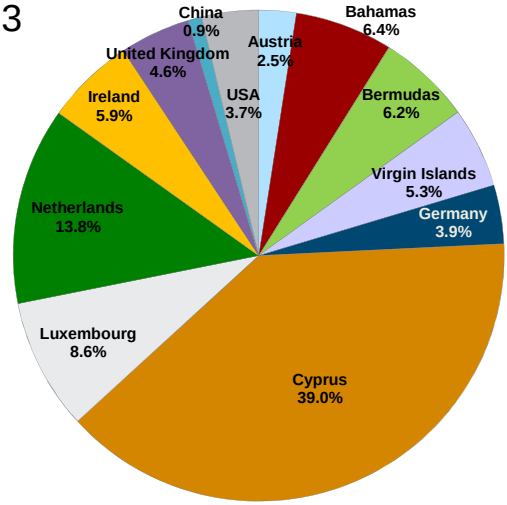
Source: wiiw Annual Database, ROSSTAT

© wiiw

wiiw

12

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



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

© wiiw

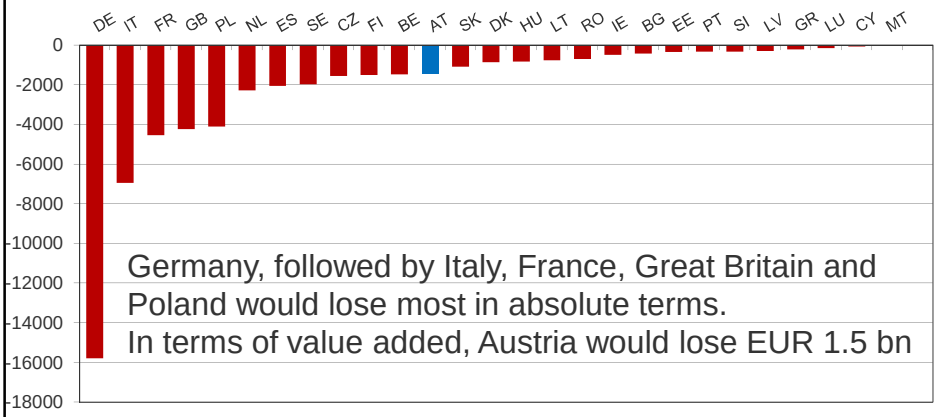
wiiw

Effects of Eurasian integration

- 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.

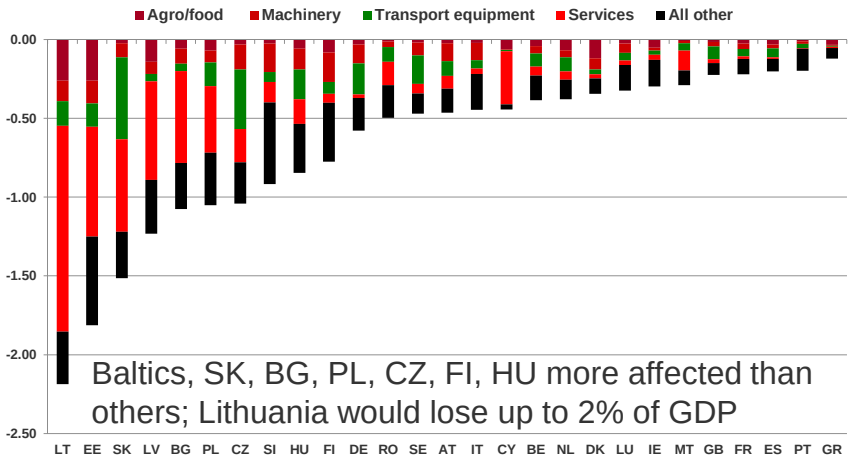
wiiw

Scenario (II): Overall EU losses could add up to EUR 55 billion if goods and services exports to Russia drop by 50%



Source. Own estimates (Havlik, 2014).

Scenario (II) sectoral impacts: estimated loss of GDP (in %) if gross exports to Russia drop by 50%



Source. Own estimates (Havlik, 2014).

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 ?

wiiw

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
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).

wiiw

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.

wiiw

19

Selected references (I)

- Astrov, V., Havlik, P. and Pindyuk, O. (2012), 'Trade Integration in the CIS: Alternate Options, Economic Effects and Policy Implications for Belarus, Kazakhstan, Russia and Ukraine'. wiiw Research Report No. 381, September. Vienna: Vienna Institute for International Economic Studies, wiiw.
- Adarov, A., Astrov, V., Havlik, P., Hunya, G., Landesmann, M., and Podkaminer, L. (2015), 'How to Stabilise the Economy of Ukraine'. wiiw and United Europe, April.
- Bradley, B. (2015), '5 Steps for Peace in Ukraine'. Time, 11 June.
- Boss, H. and P. Havlik (1994), 'Slavic (dis)union: consequences for Russia, Belarus and Ukraine', Economics of Transition, Vol. 2, No. 2, Oxford University Press, pp. 233-254.
- Brzezinski, Z. (2014), 'Russia needs a 'Finland option' for Ukraine'. Financial Times, 24 February.
- Cameiro, F.G. (2013), 'What Promises Does the Eurasian Customs Union Hold for the Future?' Economic Premise, The World Bank, No. 108, February.
- Freeland, Ch. (2014), 'Russia has already lost the war'. International New York Times, 8-9 March.
- Dabrowski, M. (2013), 'EU's cooperation with non-member neighbouring countries: the principle of variable geometry'. RANEPA, Moscow and Warsaw, October.
- De Micco, P. (2015), 'When choosing means losing. The Eastern partners, the EU and the Eurasian Economic Union'. European Parliament, DG EXPO/B/PolDep/Note/2015_108, March.
- Dreyer, I. (2012), 'What economic benefits to expect from DCFTAs?'. Visegrad Group and Germany Policy Makers Seminar, Prague, November.

wiiw

20

Selected references (II)

- ECORYS/CASE (2013): Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and the Republic of Armenia. European Commission, Rotterdam, DG Trade, September.
- Efremenko , D.V., (2013): Life after Vilnius. A New Geopolitical Configuration for Ukraine, Russia in Global Affairs, No. 3, pp. 133-146.
- Eurasian Development Bank (2012), 'Ukraine and the Customs Union'. Centre for Integration Studies, Report No. 1, St Petersburg.
- Euroasian Development Bank (2014), 'Quantifying Economic Integration of the European Union and the Eurasian Economic Union: Methodological Approaches'. Centre for Integration Studies, Report No. 23, St Petersburg.
- Euroasian Development Bank (2015), 'Estimating the Economic Effects of Reducing Non-Tariff Barriers in the EEU', Report No. 29, St Petersburg,
- Francois, J. and Manchin, M. (2009) , '*Economic Impact of a Potential Free Trade Agreement (FTA) between the European Union and the Commonwealth of Independent States'*, Institute for International and Development Economics Discussion Paper Nr. 200908-05, August.
- Francois et al. (2013), 'Reducing Trans-Atlantic Barriers to Trade and Investment'. IIDE and CEPR, London, UK
- Füle , Š. (2013): EU-Ukraine: Dispelling the Myths About the Association Agreement. International Conference "The Way Ahead for the Eastern Partnership", Kyiv, Ukraine, 11. October, Speech/13/808.
- Grinberg, R., Havlik, P. and Havrylyshyn, O. (eds) (2008) 'Economic Restructuring and Integration in Eastern Europe. Experiences and Policy Implications.' Baden Baden: Nomos.

Selected references (III)

- Havlik, P., Stöllinger, R., Pindyuk, O., Hunya, G., Dachs, B., Lennon, C., Ribeiro, M.P., Ghosh, J., Urban, W., Astrov, V. and Christie, E. (2009), '*EU and BRICs: Challenges and opportunities for European competitiveness and cooperation*', Industrial Policy and Economic Reform Papers No. 13.
- Havlik, P. (2010), '*European Energy Security in View of Russian Economic and Integration Prospects*', wiiw Research Report No. 362. Vienna: Vienna Institute for International Economic Studies, wiiw.
- Havlik, P. et al. (2012), European Neighbourhood – Challenges and Opportunities for EU Competitiveness'. wiiw Research Report No. 382, September. Vienna: Vienna Institute for International Economic Studies, wiiw.
- Havlik, P. (2013), 'Vilnius Eastern Partnership Summit: A Milestone in EU-Russia Relations – not just for Ukraine'. *wiiw Policy Note*, No. 11, Vienna, November.
- Havlik, P. (2014), 'Economic consequences of the Ukraine conflict'. wiiw Policy Notes and Reports, No. 14, Vienna, November.
- Hunya, G. (2015), 'wiiw FDI Database' (June).
- Institute for Economic Research and Policy Consulting (2011) '*Ukraine's Trade Policy Choice: Pros and cons of different regional integration options.*' Kiev: IERPC.
- Kotkin, S. (2015), 'The Resistible Rise of Vladimir Putin'. Foreign Affairs, March/April.
- Krastev, I., Leonard, M. (2015), 'Europe's Shattered Dream of Order'. Foreign Affairs, May/June.
- Kudrin, A., Gurvich, E. (2015), 'A new growth model for the Russian economy'. BOFIT Policy Brief, No.1
- Lukyanov, F. (2013): What Customs Union Can Be Without Ukraine (www.gazeta.ru, 1 November 2013).

Selected references (IV)

- McFaul, M.A. (2014), 'Confronting Putin's Russia'. International New York Times, 24 March, p. 9.
- Myers, S.L. (2014), 'Sense of betrayal drove Putin's actions in Ukraine'. International New York Times, 7 March.
- Paik, Keun-Wook (2015), 'Sino-Russian Gas and Oil Cooperation'. Oxford Institute for Energy Studies, WPM 59, April.
- Techau, J. (2014), 'Europe's Five Deadly Sins on Ukraine'. Carnegie Europe. 4 March.
- Tochitskaya, I. (2010), 'The *Customs Union between Belarus, Kazakhstan and Russia: an overview of economic implications for Belarus*', CASE Network Studies & Analyses No. 405. Warsaw: CASE.
- Trenin, D. (2014), 'A War of Escalation'. Carnegie Moscow Center, OP-ED Foreign Policy, 19 March.
- Samson, I. (2002), '*The Common European Economic Space Between Russia and the EU: An Institutional Anchor for Accelerating Russian Reform*'. Russian Economic Trends, Vol. 11, No. 3.
- Snyder, T. (2014), 'Fascism, Russia and Ukraine'. The New York Review of Books, March 20.
- Summers, L. (2014), 'Potemkin money' is the wrong way to help Ukraine. Financial Times, 10 March, p. 7.
- Vavilov, A. and O. Vyugin (1993), 'Trade Patterns After Integration into the World Economy'. In: J. Williamson (ed.), Economic Consequences of Soviet Disintegration, Institute for International Economics, Washington DC.
- Williamson, J. (ed.) (1993), 'Economic Consequences of Soviet Disintegration', Institute for International Economics, Washington DC.
- World Bank (2012), 'Assessment of Costs and Benefits of the Customs Union for Kazakhstan', Report No. 65977-KZ, November.

wiiw

Thank you for your attention!