

Focus Paper

Free Trade from Lisbon to Vladivostok

A Tool for Peace and Prosperity: The Effects of
a Free Trade Area between the EU and the Eurasian Region

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Executive Summary

1. The mutual exclusivity of the EEU and the ENP have contributed to mounting tensions between the EU and Russia. Overcoming this mutual exclusivity and creating a common free trade area would help to overcome these divisions and restore trust and cooperation.
2. The economic benefits of a free trade area between the EU and the EEU (and potentially additional CIS countries) would be substantial. Exports from the EEU to the EU are likely to increase substantially. E.g., Russia's exports to the EU are expected to rise by about 30 percent, while the EU's exports to the EEU would rise by close to 60 percent in the case of an ambitious free trade agreement. These increases in export levels would entail significant increases in real income, which would rise in Russia by about 3.1 percent and in Belarus by 4.9 percent. The eastern member states of the EU would also experience gains in real income between 1.2 and 1.8 percent. These benefits would be even greater if other CIS countries were included.
3. A free trade area between the EU and the Eurasian region would imply some sectoral reorientation. The energy and natural resources sector is especially likely to gain in the EEU countries, whereas on the European side agriculture and the automotive sector are likely to gain the most. The net employment effect is positive, but transitional unemployment should be dealt with through adequate mitigating strategies.

Introduction

Trade is an essential source of prosperity. But with prosperity come other benefits: Trade brings people together. These increased personal contacts lead to a better mutual understanding, to more trust and to cultural exchange. As a matter of fact, trade alliances have a much better track record than military alliances of preventing conflict and maintaining stability.¹ This ability of trade to bring people together makes it a welcome tool of diplomacy. Trade can be used to overcome the political and economic divisions in Europe and to create a more stable and prosperous environment.

Nobody gains from the present tension at the EU's eastern border. The disruption of trade relationships between the EU and Russia following the Ukraine conflict has aggravated Russia's recession and made many European businesses who had previously seen Russia as a growth market suffer. In addition, the climate of confrontation and distrust has led to a flexing of military muscles on both sides. Many security experts and politicians argue, however, that it is important to deescalate the situation and rebuild confidence.² In this context, the idea of a free trade area from Lisbon to Vladivostok has regained importance. Such a free trade area would tie the EU's internal market and at least the Eurasian Economic Union Customs Union (EEU) and perhaps other countries from the Community of Independent States (CIS) together as well.

The idea of a free trade area from "Lisbon to Vladivostok" was first coined by Vladimir Putin on a state visit to Berlin in September 2001 and renewed in November 2010. His aim was to abolish barriers to trade between the Eurasian Economic Union (EEU) and the EU. Chancellor Schröder said that a joint EU-EEU free trade area would be the only way to compete with the US and China in a globalised economy. However, no tangible steps were taken in this direction, not even after Russia's accession to the WTO in 2012. One year

later, tensions over whether the Ukraine should belong to the EEU or sign a free trade agreement with the EU led to a deterioration of mutual relationships. Rather than engaging in free trade, business ties with Russia were significantly curtailed and sanctions imposed.

While the existing sanctions were confirmed to remain in place by the EU Council in June 2016, the rhetoric on both sides suggests that a rapprochement is in the cards for the near future. Both Chancellor Merkel and the Vice-Chancellor and German Minister for Business Affairs, Sigmar Gabriel, had earlier voiced their support for lifting all economic sanctions as soon as Russia has effectively ensured compliance with the terms of the Minsk Protocol by all parties.³ They also saw an option to take steps towards a free trade area between the EU and the EEU in this case. Given that these political conditions are fulfilled, such a free trade area would not only have substantial economic benefits, especially for the countries belonging to the EEU, but also important political benefits. First, it may serve as an incentive for Russia to play a more active role in enforcing the Minsk Protocol and help with building peace in Ukraine. Second, such a free trade area would eliminate the tensions arising from the rivalry between the EU's neighbourhood policy and Russia's endeavour to maintain its sphere of influence. Thus, it would contribute not only to more economic prosperity but also to less political tensions and a more stable environment.

This essay aims to describe the political and economic rationale of such a free trade area. It first discusses the role of free trade areas in Russian and EU diplomacy before turning to the macroeconomic effects of a free trade area involving either the EU and the EEU only alone or including the remaining CIS states.

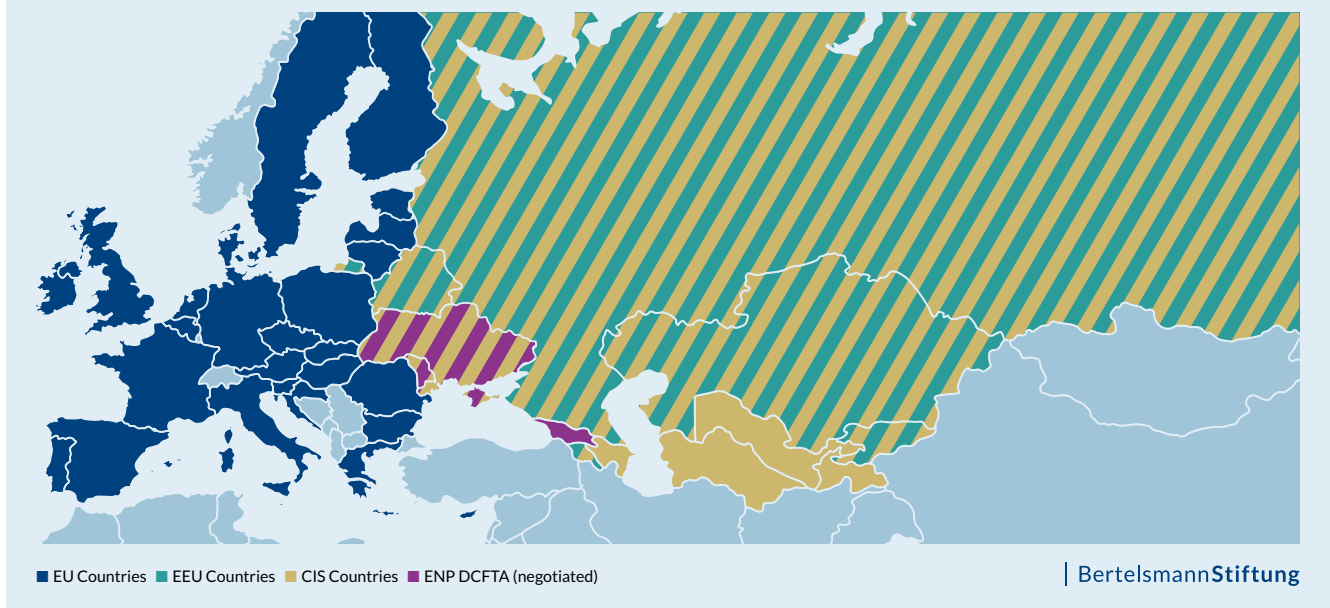
¹ (Jackson, 2014)

² (Spiegel, 2016)

³ e.g. (Der Standard, 03.06.2016)

The Political Rationale of an EEU-EU FTA

Figure 1: Membership in different trading blocs



Free trade areas (FTAs) have played an important part in the diplomacy of both the EU and Russia. The European Neighbourhood Policy (ENP), a programme designed to foster friendly and stable relations with Europe's neighbours, makes use of FTAs to establish closer economic relationships and political ties with its Eastern and Southern neighbours. Russia, however, felt increasingly isolated given the EU's growing role in what it traditionally considered its sphere of influence. In response, Russia set up a series of free trade areas with former Soviet Union countries, now organised in the Community of Independent States (CIS), as part of its "normative rivalry" strategy, out of which the EEU initiative was the most successful.⁴ Russia has since used its influence to dissuade other countries from forming a free-trade area with the EU, a process which culminated in the Ukraine-Crisis. An overview of the different trade agreements is provided in the map in Figure 1.

The political rationale of an EEU-EU FTA would be to overcome this rivalry between two trading blocs presently perceived as mutually exclusive. If Russia were part of the EU's Eastern FTA regime, it would experience substantial economic gains and – perhaps even more importantly – it would no longer feel the threat of marginalisation and isolation. Thus a free trade arrangement involving Russia would create more political stability, less potential for conflict and more prosperous development in general in the region. Once the EU–Russia antagonism is overcome, there would be no reason not to include other countries in the region. These could be the present member states of the EEU – or it could extend beyond this framework and open it up to all remaining CIS countries that are not yet a member of a trading bloc. This would allow further economic integration and put cooperation at the place of confrontation.

⁴ (Dragevna, 2012)

The EU Neighbourhood Policy

The ENP was conceived in the wake of the 2004 EU enlargement. Its aim was to prevent the emergence of new dividing lines between the EU and its neighbours by “developing a special relationship between the EU and each of its partner countries, contributing to an area of security, prosperity and good neighbourliness.”⁵ Trade is only one way through which the ENP tries to achieve its objectives. It is accompanied by financial support, cooperation in various sectors of EU policies as well as arrangements to improve migration and mobility.

The ENP defines several strategic geographical areas: the ENP South, covering the Mediterranean, the Enlargement Agenda, comprised of countries poised to eventually become full EU members, the ENP East, oriented towards Belarus, Ukraine, Moldova, Georgia, Armenia and Azerbaijan. Russia is not part of the ENP East as it was given a special status. Collaboration with Russia takes place through the Shared Spaces programme.

Deep and Comprehensive Free Trade Areas (DCFTAs) are an important part of the ENP East. Through these agreements, the participating countries gain preferential access to the EU’s internal market and become more attractive to investors, as they guarantee that they can operate under the same regulatory environment as in the EU. The first DCFTA negotiations started between the EU and Ukraine, subsequently followed by negotiations with Georgia, Armenia and Moldova. The EU-Ukraine DCFTA was initialled on July 19, 2012. As the Eurasian Economic Commission threatened that Ukraine would lose its membership in the EEU if it engaged in a DCFTA with the EU, the Ukrainian government decided on November 21, 2013 not to sign the agreement. This provoked pro-EU demonstrations, eventually leading to the overthrow of the government and the installation of a pro-European successor. The Ukraine-EU DCFTA has been provisionally applied since January 1, 2016, although it is not yet formally ratified by the EU. The introduction of a DCFTA with Armenia was also cumbersome. The negotiations were completed in July 2013. However, wary of losing good relations with Russia, the Armenian government decided not to ratify the agreement and to join the EEU instead. The DCFTAs with Georgia and Moldova have been implemented since September 1, 2014.

5 (European Commission, 2014)

The Eurasian Economic Union and the Community of Independent States

The World Bank economist Lúcio Vinhas de Souza qualified a Eurasian FTA as “a GDP-reducing framework in which the negative trade-diversion effects surpass positive trade-creation ones”.⁶ Indeed the economic rationale of this free-trade area is not very strong, and the motivation for forging this entity is much more a political than economic one. It can be viewed as an instrument of Russian foreign policy to assert its normative influence among the CIS countries.

Before the present day Eurasian Economic Union, other attempts for regional economic cooperation had seen the light of day. It started already in 1993 when Russia proposed to let the CIS evolve following the EU model, building on economic integration. The first step was a free trade agreement which was signed in 1994 but only partially implemented and the compliance of member states could not be assured. Creating a functional area of economic cooperation was a priority for President Putin. Thus the Eurasian Economic Community was established in 2000, with Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan as member states. A customs union between these countries was implemented in 2010. This organisation emulated the structure of the European Union, featuring an integration council as an executive and a conflict resolution body. In 2014, the EEC was replaced with the EEU, which had a similar institutional set-up and identical member countries but pursues more ambitious policies. It aims at moving beyond a customs union towards a common market for goods, capital and labour, with common regulations on competition, financial regulation and a harmonisation of energy policy.

The EEU has become a tool to challenge the normative predominance of the EU and its ENP, which was viewed by Russia as a threat. Dragevna and Wolczuk write: “Normative convergence as a key tenet of the EU’s approach to the post-soviet countries became a major stumbling block in relations with Russia as the latter questioned the necessity and legitimacy of this approach. Thus Russia is unwilling to yield to what it perceived as the EU’s diktat, demanding greater reciprocity and partnership-like relations.”⁷ Russia’s policy of using the EEU as a tool for “normative rivalry” was effective in the sense that the EU is now

6 (Souza, 2011), p. 1

7 (Dragevna, 2012), p. 14

required to rethink its DCFTA approach and adapt it in response to Russia's policy.

Overcoming Divisions to Build Trust

Countries cannot be a member of both trading blocs. Thus the competition for influence leads to a situation in which governments need to decide whether to engage in free trade with the EU or the EEU, whether to position themselves as pro-European or pro-Russia, accepting the negative effects that such a decision and the alienation of the other partner will inevitably bring. The economic benefits of becoming an EEU member are much weaker – for most countries – than engaging in a free trade area with the EU. However, for many eastern European and central Asian economies, the Russian market remains important and the political goodwill of Russia is essential.

This conflict is highlighted by the developments in Ukraine and Armenia. Armenia's largest trading partner is the EU and Armenia is keen to develop a positive political relationship with the EU. However, traditionally Russia is an important ally of Armenia and the Armenian government did not want to risk losing this support. Hence it saw itself unable to join the already-negotiated DCFTA with the EU. The case of Ukraine is much better known. Being divided in its political and economic structure, the decision of which trade area to belong to is not an easy one. The pro-Russian industrial east did benefit from being part of the EEU. The pro-Western service-orientated west wished for closer economic ties with the EU. The decision of the pro-Russian Yanukovich government to not ratify the DCFTA with the EU led to outrage amongst a large share of the population, eventually leading to the overthrow of the government. The new pro-Western government did ratify the DCFTA at the expense of a severe disruption of economic ties with Russia and the outbreak of separatist belligerent activities in Ukraine's east and the annexation of Crimea by Russia.

This was followed by a sharp response from the West. Economic sanctions were imposed on Russia and the presence of armed forces in the eastern members of the NATO was strengthened. Some observers have already forecast the beginning of a new Cold War.⁸ In order to avoid the dangers inherent in the confrontation of two strong military blocs, new strategies have to be found.

Together with the enlargement of NATO, the strong normative appeal of the EU has provoked Russia's sentiment of isolation and marginalisation. The requirement for many CIS countries to declare themselves either for the EU or for Russia has fuelled a confrontational climate. One strategy for de-escalation would be to take President Putin seriously and pursue the idea of a free trade area between the Eurasian region and the EU. Such cooperation would dispel the fear that European trade policy is directed against Russia. Given the economic gains for both sides that can be expected, it is not difficult to imagine that trade cooperation will lead to a realisation that Russia, the other CIS countries and the EU will benefit more from a partnership.

As mentioned in the introduction, some politicians have called for a stronger role of Russia in ensuring compliance with the Minsk protocol as a prerequisite for lifting the economic sanctions. The prospect of an FTA which would help Russia's economy return to a strong growth path would create another incentive for increased cooperation. The mere proposal could thus lead to a more effective peace process in Ukraine and a de-escalation of EU-Russian relations.

8 E.g. (Bildt, 2016)

Table 1 Evolution of Exports under an EU-EEU FTA

	Total exports	Exports to EU28 / former SU		Evolution of Exports under an EU-EEU FTA	
	Total exports in Euro m	in Euro m	in percent	total exports, in percent	exports to EU / former SU, in percent
Former Soviet Union Countries					
Russia	410,730	223,332	54.00	19.00	32.00
Moldova	1,941	1,020	53.00	-2.00	2.00
Azerbaijan	26,563	12,622	48.00	0.00	-6.00
Armenia	1,475	657	45.00	34.00	81.00
Kazakhstan	59,821	25,861	43.00	10.00	18.00
Belarus	19,152	7,321	38.00	46.00	109.00
Georgia	2,527	946	37.00	-1.00	1.00
Ukraine	60,028	17,225	29.00	-3.00	2.00
Kyrgyzstan	2,068	352	17.00	20.00	100.00
Tajikistan, Turkmenistan, Uzbekistan	23,357	3,967	17.00	-1.00	1.00
EU 28					
Lithuania	18,586	3,313	18.00	10.00	82.00
Cyprus	9,320	1,401	15.00	6.00	43.00
Latvia	9,688	1,163	12.00	10.00	79.00
Estonia	12,696	1,362	11.00	10.00	81.00
Finland	70,053	6,903	10.00	6.00	78.00
Poland	140,875	12,136	9.00	5.00	69.00
Bulgaria	24,474	1,528	6.00	2.00	42.00
Romania	50,152	2,940	6.00	2.00	30.00
Hungary	84,409	4,781	6.00	3.00	55.00
Czech Republic	115,829	6,135	5.00	3.00	60.00
Slovenia	24,228	1,268	5.00	2.00	45.00
Slovakia	57,168	2,686	5.00	5.00	131.00
Germany	1,120,817	51,937	5.00	2.00	59.00
Italy	441,237	17,086	4.00	2.00	67.00
Greece	56,022	2,063	4.00	5.00	61.00
Austria	149,937	5,064	3.00	1.00	49.00
Croatia	21,830	663	3.00	1.00	54.00
Sweden	165,894	4,999	3.00	1.00	58.00
UK	486,034	14,189	3.00	1.00	59.00
France	524,116	15,113	3.00	2.00	64.00
Denmark	113,240	3,160	3.00	2.00	57.00
Netherlands	289,084	7,412	3.00	2.00	72.00
Spain	297,450	7,003	2.00	1.00	65.00
Malta	5,979	135	2.00	1.00	31.00
Belgium	292,423	5,893	2.00	1.00	70.00
Luxembourg	54,919	935	2.00	1.00	34.00
Ireland	174,019	2,258	1.00	0.00	61.00
Portugal	58,682	640	1.00	0.00	56.00
EU 28	4,869,160	184,167	4.00	2.00	63.00

Table 2 Economic Effects of an EU– former SU FTA

	BIP		change in real income (annual)			change in wages	change in prices
	total, in bn Euro	per capita, in Euro	in percent	in bn in Euro	per capita, in Euro	in percent	in percent
Former SU sphere of influence countries							
Moldova	6	1,564	6.20	0.35	97.45	6.90	– 2.80
Belarus	56	5,917	5.30	2.93	310.83	3.20	– 3.30
Ukraine	81	1,896	4.70	3.84	89.93	4.60	– 1.20
Russia	1,111	7,593	3.30	37.10	253.61	0.70	– 3.10
Azerbaijan	58	6,107	3.30	1.92	203.48	0.50	– 3.30
Turkmenistan	40	6,772	3.00	1.18	200.38	1.00	– 2.40
Uzbekistan	59	1,914	3.00	1.75	56.64	1.00	– 2.40
Tajikistan	7	853	3.00	0.21	25.24	1.00	– 2.40
Georgia	12	3,344	2.90	0.36	96.58	3.00	– 0.80
Armenia	10	3,188	2.60	0.25	83.57	2.70	– 0.70
Kyrgyzstan	6	1,077	2.50	0.16	26.48	3.30	– 1.00
Kazakhstan	175	9,912	2.30	3.99	225.44	0.40	– 2.40
Albania	10	3,775	0.00	0.00	0.02	– 0.10	– 0.10
Bosnia–Herzegovina	14	3,622	0.00	0.00	– 1.07	0.00	0.00
Montenegro	4	5,728	0.00	0.00	– 1.70	0.00	0.00
Serbia	33	4,586	0.00	– 0.01	– 1.36	0.00	0.00
Macedonia	9	4,375	0.00	0.00	– 1.30	0.00	0.00
EU28							
Latvia	25	12,340	1.90	0.48	237.39	3.20	0.50
Lithuania	38	12,869	1.80	0.66	226.79	3.80	1.00
Croatia	44	10,383	1.50	0.66	155.17	3.30	1.40
Estonia	21	15,662	1.30	0.27	202.44	2.00	0.10
Cyprus	17	19,352	1.30	0.22	243.28	1.80	0.10
Hungary	107	10,804	1.00	1.03	104.36	1.30	0.40
Slovakia	77	14,284	1.00	0.74	135.84	1.70	0.70
Bulgaria	42	5,916	0.90	0.40	55.30	1.20	0.10
Poland	433	11,381	0.60	2.78	73.02	1.50	0.60
Czech Republic	164	15,576	0.60	1.05	99.34	1.10	0.50
Finland	207	37,893	0.50	1.13	207.04	1.20	0.50
Slovenia	38	18,616	0.50	0.21	100.97	1.10	0.50
Greece	173	15,870	0.50	0.91	82.96	0.60	– 0.10
Romania	157	7,916	0.40	0.69	34.55	0.70	0.20
Malta	8	19,360	0.40	0.03	78.91	0.50	– 0.10
Ireland	204	43,988	0.30	0.67	143.06	0.30	0.10
Belgium	412	36,363	0.30	1.33	117.52	0.60	0.20
Netherlands	675	39,847	0.30	2.18	128.47	0.50	0.20
Italy	1,635	26,827	0.30	4.87	79.87	0.50	0.20
Germany	3,030	37,092	0.30	9.01	110.27	0.60	0.30
Denmark	262	46,220	0.30	0.76	134.54	0.40	0.10
Austria	335	39,140	0.30	0.86	100.05	0.50	0.30
Sweden	435	44,011	0.20	0.82	83.08	0.30	0.20
Spain	1,098	23,663	0.20	1.86	40.02	0.30	0.10
Luxembourg	52	92,746	0.10	0.08	135.06	0.40	0.20
Portugal	178	17,063	0.10	0.25	24.13	0.20	0.00
France	2,178	33,911	0.10	2.91	45.39	0.30	0.10
UK	2,575	39,654	0.10	3.25	50.03	0.20	0.00
EU28	14,620	28,745	0.30	40.07	78.84		

The Macroeconomic Effects

In order to understand why a free trade area between the two trading blocs would be an attractive option, it is important to describe the macroeconomic effects that can be expected. According to a study commissioned by the Bertelsmann Stiftung (Felbermayr, 2016), which studies the long-term effects of trade integration, the trade creation effects are substantial.⁹ The EEU countries in particular are likely to gain substantially. The volume of trade is likely to increase and per capita welfare gains to reach important levels. In Russia, for example, the annual real income might increase by up to 235 Euros, or 3.1 percent. The EU is also likely to experience positive trade effects, especially the Baltic countries. However, since the main benefit of trade comes from the participating parties producing and exporting what they can do best – called a comparative advantage – any trade deal implies a restructuring of the economy. Some sectors will be challenged, others will thrive. The stronger these distributional effects are, the more difficult an economic transition will be. Managing the transition well is key to harnessing the beneficial potential of such a trade deal. While transitional effects are expected to be moderate, the issue cannot be neglected. It is important to devote some attention to this area because if such a trade deal is not a success, the social and political repercussions might be substantial, which would imperil the political rationale of such a trade deal. This section will be devoted to describing the expected effects for the participating economies – overall and on a sectoral level – and to develop ideas on how the implied economic transition can be effectively managed.

Substantial Trade Creation

The economic effects of increased trade between the EU and the Eurasian region have been studied in depth by

⁹ The model used by (Felbermayr, 2016) computes a long-term equilibrium of trade effects. Such a long-term equilibrium is typically achieved 12–15 years after integration. It does not take transitional effects into account.

(Felbermayr, 2016). This section summarises their results. The author's calculations are based on the year 2011 and are thus predating the economic sanctions against Russia. Thus, the estimated effects presented here are likely to be lower than they would be if a free trade area were actually implemented. Several scenarios have been calculated. Geographically, the first case to study was a free trade area between the EEU and the EU but this is subsequently extended to include more CIS countries and other countries in the former Soviet sphere of influence. Generally, a deep and a shallow version of a trade agreement have been computed in order to provide the reader with an idea of the potential upper and lower bounds of the expected effects.

The expected growth potential of a free trade area between the EEU and the EU is substantial. In the case of a deep agreement, Russia's exports to the EU would grow by about 32 percent in comparison to 2011, Armenia's by more than 80 percent and those of Belarus and Kyrgyzstan would double. The EU would also benefit: Its total exports to EEU countries would rise by about 60 percent, with the growth potential being highest in Slovakia, Finland and Poland. German exports would rise by about 59 percent. Should a potential free trade area comprise more than just the EEU countries and also include some other countries from the former Soviet sphere of influence, the positive effects would be even greater. The detailed effects for all countries are presented in Tables 1 and 2.

In terms of income per capita, a deep EEU-EU trade agreement would raise Russia's real annual income by 3.1 percent or €34 billion. Belarus would profit even more, with an income rise of 4.9 percent and also the growth effects in the other EEU countries would be positive and significant. Should other CIS countries not be included in such a trade deal, an EEU-EU trade deal would have slight negative consequences for them because of trade diversion effects. In Europe, the Baltic countries stand to gain most, with per-capital income rises of 1.2 to 1.8 percent, which corresponds to 200 Euros per capita. The EU as a whole would

increase its real income by ca. €30 billion. Germany could expect a rise between seven and nine percent, which corresponds to €90–110 per capita. Even a shallow trade agreement would still generate substantial positive effects.

In Russia, the sectors that would gain most are those linked to natural resources, above all the oil industry. But metals would also experience a positive effect. A more negative effect should be expected in agriculture and in the automotive sector. The opposite sectoral effect is anticipated for the EU: Here the agricultural and automotive sectors would gain most. The Russian sectorial effects are displayed in table 3. The sectoral effects are very similar in all other EEU countries. The total percentage of a displaced workforce – meaning workers that need to change sectors – is presented in Table 4.

So far, I have only described the effects of a deep FTA. Table 5 provides a comparison of different scenarios. As can be observed, the effects of a mere elimination of tariffs are only modest. However, welfare gains are more substantial as soon as NTBs are reduced along with tariffs being eliminated. Please note that Table 5 presents the calculations for an EU–EEU FTA, hence some countries that are not part of either trading bloc would experience some minor trade diversion effects.

Transitional Economic Effects

The divergent effects for different sectors as presented in Table 4 imply certain transitional costs. While the net effect in employment is positive, some sectors will increase employment and others will have to let people go. Table 3 also shows the employment effects per sector for Russia in the case of an EEU–EU agreement. In this scenario, 1.2 percent of the total workforce would have change from one sector to another. In other EEU countries a substantial part of the workforce would also have to change employment, as shown in Table 4.

The economic model used by (Felbermayr, 2016) jumps from one long-term economic equilibrium to another. The advantage of this methodology is that the long-term positive effects of free trade become immediately apparent. The drawback is, however, that short-term transitional costs cannot be studied in detail. The reorientation of the EEU economies would certainly have transitional effects that will need to be managed in order to avoid public dissatisfaction with such a trade arrangement. This mostly concerns EEU countries, the transitional effects in the EU are

negligible and the effects on other CIS countries are also of a much lower magnitude than in EEU countries. The results suggest that the long-term economic benefits outweigh potential negative transitional costs.

Which strategies could be used to smooth the transition?

Two potentially complementary approaches are perceivable:

- **Sequencing the tariff and NTB reductions in the FTA agreement:** In the FTA agreement, not all reductions of trade barriers have to occur at the same time. It would be a smart approach to reduce barriers to trade first in those sectors that stand to gain the most. These sectors would already start expanding, albeit not quite to their full potential yet. Subsequently and gradually, trade barriers could be lowered for those sectors likely to be negatively impacted. Due to the gradual nature of the process, the expanding winning sectors would be able to absorb the newly available workforce and thus minimise transitional unemployment. Theoretically, it would also be possible not to liberalise those sectors that would be negatively impacted. However, the overall economic gain would not be quite as large as it would be in the case of a deep and encompassing trade liberalisation coupled with a smooth transition.
- **Support programmes:** Since the sectors that are expanding and those likely to be contracting require different skill sets, retraining the workforce might be necessary. Also, in some cases the developing new industries might need technical and financial support to get off the ground in the beginning. For these purposes, support programmes could be helpful. These could be implemented by the member states themselves, but depending on the economic situation of the country and the extent of the measures required, this might be a sensible area for the EU to provide help.

Ensuring that a free trade area between the EU and the Eurasian region is a success and achieves popular support is crucial for the political rationale of such an enterprise to work. If the aim is to create peace through prosperity and stability, it is important that the majority of the population perceives itself as winning from such a free trade agreement.

Table 3 Evolution of sectoral value-added in Russia under an EU-EEU-FTA, top and bottom 5

Rank	Sector	Currently		Change through EU-EEU-FTA		
		in m €	Share of national value-added, in percent	in m €	in percent	employment in tsds
1	Oil	162,333	13.55	11,193	7.00	185
2	Metals	13,177	1.10	2,972	23.00	161
3	Petroleum products	13,207	1.10	2,021	15.00	137
4	Minerals	9,143	0.76	1,545	17.00	80
5	Coal	9,037	0.75	1,126	12.00	79
...						
53	Paper	5,080	0.42	-876	-17.00	-67
54	Milk products	5,830	0.49	-1,096	-19.00	-78
55	Manufacturing	28,860	2.41	-1,258	-4.00	-131
56	Automotive	4,831	0.40	-1,801	-37.00	-169
57	Vegetables, Fruits, Nuts	15,455	1.29	-2,647	-17.00	-249

Table 4 Percentage of employees changing sectors following an EU-former Soviet influence-FTA

Kyrgyzstan	2.17
Belarus	1.89
Armenia	1.21
Russia	1.20
Tajikistan, Turkmenistan, Uzbekistan	0.74
Ukraine	0.65
Moldova	0.65
Kazakstan	0.61
Georgia	0.39
Azerbaijan	0.39
Albania	0.30
Bosnia-Herzegovina, Macedonia, Montenegro, Serbia	0.18

Table 5 Welfare Effects of an EU- EEU- FTA Under Different Scenarios – Change in GDP (annually)

	elimination of tariffs				elimination of tariffs and shallow reduction of NTBs				elimination of tariffs and deep reduction of NTBs			
	industry sectors only		all sectors		industry sectors only		all sectors		industry sectors only		all sectors	
	in percent	€ per capita	in percent	€ per capita	in percent	€ per capita	in percent	€ per capita	in percent	€ per capita	in percent	€ per capita
Former SU sphere of influence countries												
Belarus	0.00	1.6	0.10	6.0	2.00	117.2	2.60	151.3	4.00	234.9	4.90	289.4
Russia	0.20	18.9	0.40	28.7	1.10	86.8	1.60	122.4	2.30	173.0	3.10	234.5
Armenia	0.00	0.2	0.00	-0.4	0.70	22.2	1.10	33.8	1.60	50.6	2.30	74.7
Kyrgyzstan	0.10	0.7	0.20	2.2	0.60	6.1	0.80	8.8	1.70	17.8	2.30	25.0
Kazakhstan	-0.10	-9.9	-0.10	-9.9	0.50	49.6	0.70	69.4	1.20	120.8	1.70	165.1
Moldova	0.00	0.7	0.00	0.8	0.00	0.6	0.00	0.3	0.10	1.3	0.10	1.2
Georgia	0.00	0.8	0.00	1.1	0.00	0.7	0.00	1.1	0.00	1.2	0.10	2.0
Azerbaijan	-0.10	-4.3	-0.10	-6.2	0.10	3.4	0.00	2.0	0.10	6.4	0.00	2.9
Tajikistan	-0.10	-0.8	-0.10	-0.9	-0.10	-0.7	-0.10	-0.8	-0.10	-0.7	-0.10	-1.0
Turkmenistan	-0.10	-6.2	-0.10	-7.4	-0.10	-5.5	-0.10	-6.7	-0.10	-5.9	-0.10	-8.1
Uzbekistan	-0.10	-1.8	-0.10	-2.1	-0.10	-1.6	-0.10	-1.9	-0.10	-1.7	-0.10	-2.3
Ukraine	0.00	-0.8	0.00	-0.9	-0.10	-2.2	-0.10	-2.3	-0.20	-3.1	-0.20	-3.3
Bosnia- Herzegovina	0.00	-0.1	0.00	0.0	0.00	0.0	0.00	-0.2	0.00	-0.1	0.00	-0.1
Macedonia	0.00	-0.1	0.00	0.0	0.00	0.0	0.00	-0.2	0.00	-0.2	0.00	-0.1
Montenegro	0.00	-0.2	0.00	0.0	0.00	0.0	0.00	-0.2	0.00	-0.2	0.00	-0.1
Serbia	0.00	-0.1	0.00	0.0	0.00	0.0	0.00	-0.2	0.00	-0.2	0.00	-0.1
Albania	0.00	-0.4	0.00	-0.6	0.00	-0.3	0.00	-0.6	0.00	-0.1	0.00	-0.4
EU 28												
Latvia	0.10	11.1	0.20	24.6	0.80	95.7	1.00	121.3	1.50	179.4	1.80	220.3
Lithuania	0.20	29.1	0.30	38.5	0.60	83.2	0.90	118.1	1.20	155.0	1.60	206.3
Estonia	0.10	12.1	0.20	23.6	0.60	94.2	0.70	112.6	1.10	169.0	1.20	187.2
Cyprus	0.00	-1.2	0.00	-1.3	0.40	69.2	0.60	108.6	0.50	97.0	1.00	199.9
Slovakia	0.30	48.9	0.40	51.0	0.50	69.1	0.50	71.2	0.70	101.3	0.70	105.8
Hungary	0.20	18.8	0.20	23.1	0.40	38.6	0.40	42.7	0.50	52.6	0.50	59.1
Finland	0.10	37.2	0.10	35.2	0.30	108.4	0.30	124.0	0.50	182.2	0.50	197.6
Czech Republic	0.20	24.6	0.20	27.0	0.30	45.7	0.30	50.1	0.50	71.4	0.50	79.9
Greece	0.00	3.2	0.00	4.6	0.30	54.8	0.40	61.3	0.30	52.6	0.40	66.8
Poland	0.10	10.8	0.10	13.3	0.20	25.6	0.30	30.1	0.30	39.5	0.40	47.4
Bulgaria	0.10	3.5	0.10	4.5	0.20	10.5	0.20	13.8	0.30	16.2	0.40	22.3
Slovenia	0.10	17.2	0.10	20.1	0.20	43.8	0.30	47.0	0.30	59.4	0.40	65.6
Ireland	0.10	25.3	0.10	37.0	0.10	47.2	0.20	78.8	0.10	61.6	0.30	122.5
Belgium	0.00	11.6	0.00	15.3	0.10	50.6	0.20	63.2	0.20	79.4	0.30	101.3
Netherlands	0.00	12.5	0.10	22.2	0.10	52.2	0.20	66.6	0.20	90.2	0.30	111
Malta	0.00	4.7	0.00	4.6	0.20	33.7	0.20	38.7	0.20	39.6	0.30	50.8
Denmark	0.00	-2.4	0.00	2.8	0.10	42.8	0.10	50.1	0.20	100.8	0.30	116.7
Germany	0.10	24.4	0.10	27.7	0.10	52.8	0.20	58.9	0.20	80.3	0.20	90.8
Italy	0.00	8.8	0.00	12.5	0.10	27.1	0.10	31.9	0.20	43.6	0.20	51.3
Romania	0.00	1.1	0.00	1.2	0.10	6.5	0.10	6.4	0.20	12.7	0.20	13.4
Sweden	0.00	16.5	0.00	17.7	0.10	35.3	0.10	41.6	0.10	59.4	0.20	73.6
Austria	0.00	11.0	0.00	14.1	0.10	28.4	0.10	39.0	0.10	46.0	0.20	65.3
Croatia	0.00	2.4	0.00	3.8	0.10	6.3	0.10	8.8	0.10	10.0	0.10	15.3
Spain	0.00	3.1	0.00	5.2	0.10	13.5	0.10	19.2	0.10	21.5	0.10	29.7
France	0.00	6.6	0.00	9.5	0.10	24.8	0.10	27.3	0.10	32.2	0.10	38.4
UK	0.00	2.6	0.00	2.1	0.00	16.8	0.10	21.8	0.10	29.6	0.10	38.9
Luxembourg	0.00	5.7	0.00	7.5	0.00	30.6	0.10	51.0	0.00	41.8	0.10	87.2
Portugal	0.00	2.0	0.00	2.3	0.00	4.8	0.00	7.4	0.10	9.3	0.10	11.9

Conclusion

The present confrontation between Russia and the EU is harmful in many ways. The geopolitical use of trade strategies by both actors in the past have contributed to mounting tensions and to the present threat to peace and stability. Hence, new strategies have to be found, capable of overcoming rivalry rather than fostering it. Trade has the capacity to forge stronger ties and thus facilitate greater cooperation. Overcoming the rivalry of trade arrangements could have the potential to improve the security situation and additionally lead to greater prosperity for the countries involved.

The gains to be expected from an EEU-EU free trade area are substantial, especially for the EEU countries and eastern member states of the EU. Even greater effects could be achieved if other CIS countries were part of this cooperation, not just EEU states. The net effects are not only positive, they are of a magnitude that represents a substantial impact on the people's purchasing power, especially in the EEU states. While there are some redistributive effects associated with a potential free trade agreement, these could be effectively mitigated by well-thought out transitional strategies.

A free trade area between the EU and the Eurasian region has considerable potential to deescalate tensions and create a basis for cooperation. Such a plan should not be dismissed lightly.

Abbreviations

CIS	Commonwealth of Independent States
EU	European Union
EEU	Eurasian Economic Union
ENP	European Neighbourhood Policy
FTA	Free trade area
NATO	North Atlantic Treaty Organisation
NTB	Non-tariff barriers (to trade)

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