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Which conflicts can the European neighbourhood policy help resolve?

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Which Conflicts can the European Neighbourhood Policy Help Resolve?

Thorvaldur Gylfason
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Which Conflicts can the European Neighbourhood Policy Help Resolve?

Abstract

Under what conditions can the European Neighbourhood Policy achieve one of its main objectives: to resolve conflicts in the European Union's neighbourhood? In the spirit of Montesquieu and Monnet, the basic hypothesis of the EU is that closer economic integration encourages governments to take steps to resolve conflicts and vice versa, creating a virtuous circle of prosperity and detente. The EU has a strong motive in this, since conflicts in its neighbourhood spill-over into the EU itself. The paper identifies some factors important for success, including the existence of active facilitators of compromise, strong intraregional trade, and the prospect of accession to the EU. It concludes that the EU's Member States must give conflict resolution greater priority in the European Neighbourhood Policy and provide stronger means, larger resources and better incentives if this goal is to be realised.

JEL-Code: F130, F150.

Keywords: trade, Balkans, European Neighbourhood Policy.

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The natural effect of trade is to bring about peace.

Montesquieu (1748)

Introduction

The founding of what is now the European Union was based on the premise that close economic integration, with the common institutions necessary to administer it, could contribute decisively to stable and peaceful relations between democratically governed countries (Monnet, 1976). The successive enlargements of the EU extended this principle to an ever-larger number of countries that formerly were mutual enemies or dictatorships. In parallel, the EU has applied the principle of free trade and successively closer economic integration in various forms to a number of countries in the European Neighbourhood (Diagram 1): seven Balkan countries,¹ ten Barcelona Process countries on the southern Mediterranean coast,² and six Eastern Partnership (EaP) countries in Eastern Europe and the Southern Caucasus³. It was also applied, less successfully, to the more distant African-Pacific-Caribbean (APC) countries. The aim is to raise income levels and increase political stability, thereby helping to reduce the number of conflicts in the EU's vicinity, conflicts which could spill over into the Union itself. Disrupted energy supplies, inflows of refugees and migrants and spill-over of trans-border criminal activities give the EU a strong self-interest to help resolve conflicts in its neighbourhood. Based on its own historical experience, it sees free trade and close economic integration as a means to resolve these conflicts and foster good-neighbourly relations. Several additional factors are critical for successful conflict resolution.

1. Keys to conflict resolution in the Neighbourhood Policy

The Neighbourhood consists of very disparate countries, each wanting to be judged on its own, widely differing objectives and merits. Among these countries some may be eligible for EU membership while others clearly are not; a few are relatively rich countries while many are very poor; all are in different stages of transition from plan to market; some are budding democracies and others harsh dictatorships;⁴ and, finally, some have excellent relations with neighbours while others are effectively at war with them. Each of these factors has a bearing on whether closer economic integration can help resolve conflicts.

¹ Albania, Bosnia-Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Kosovo. Moldova was included in the Central European Free Trade Area although formally part of the Eastern Partnership .

² Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestinian Authority, Syria and Tunisia plus four coastal states in the Western Balkans that are potential EU candidates along with Turkey.

³ Belarus, Moldova, Ukraine and Armenia, Azerbaijan and Georgia, respectively.

⁴ While the Arab Spring has felled some of these dictators, it is not possible yet to say that the outcome will be more democratic governance.

Diagram 1. The European Union Member States and the participants in the European Neighbourhood Policy



Source: <http://europa.eu/eucalender/event/id/185095-eastern-partnership-summit/mode/standalone>

Supposedly a coherent and consistent policy, the European Neighbourhood Policy (ENP) is, in fact, an improvised amalgamation of policy initiatives undertaken at different times to satisfy the interests of different EU Member States. It includes the Barcelona Process initiated during the Spanish Presidency (Spring 1995) and transformed into the Union for the Mediterranean⁵ by the French Presidency (Autumn 2008) and the Eastern Partnership proposed by Poland and Sweden and adopted by the European Council during the Czech Presidency (Spring 2009). These improvisations co-habit in the framework of the ENP with its bilateral Action Plans and its flora of Cooperation Council and Committee meetings. When the Commission presented the EaP, it “emphasized the need for a differentiated approach respecting the character of the ENP as a single and coherent policy framework.” (Com (2008) 823 final, p. 2). This formulation captures the contradictory nature of the ENP: While one size does not fit all, the suits should be uniform in some respects. But how uniform can procedures be when countries have widely different

⁵ We shall refer to the Barcelona Process when describing events prior to 2008 and occasionally also after the name change.

objectives and preconditions? Effectiveness when dealing with so many countries requires sorting them into a limited number of groups sharing similar objectives, initial conditions and geopolitical situations and designing common procedures and appropriate incentives for each group. If the situation of each country is *sui generis* then the ENP degenerates into a baker's dozen of bilateral relationships. The ENP needs to reduce the number of differentiated approaches sufficiently to maintain a single and coherent policy framework that is cost effective.

We identify five key factors as important in order for closer economic integration to contribute to conflict resolution in the Neighbourhood: the existence of a trustworthy facilitator of compromise (Section 1.1), the size of incentives provided by the EU, e.g. the prospect of accession to the EU or common institutional frameworks (Section 1.2), whether participants in a regional conflict are all in the ENP and not a third party to it (Section 1.3), the potential leverage of foreign trade in the region (Section 1.4), and last but not least, how far the parties to the conflict have progressed in transition to a well-functioning market economy (Section 1.5). This paper groups the ENP countries in these respects in order to identify which conflicts have high or low likelihood of successful resolution through closer economic integration with each other and to suggest how the likelihood of success can be increased.

1.1 Active facilitators of compromise

A conflict which has not ended through unconditional surrender by one party may require a facilitator to assist the parties to settle their differences. In cases where conflicts have involved much death and destruction, outside mediators are usually essential. Bitterness can be so widespread and so deep that neither party is willing either to take an initiative or to respond to one. The EU is in a unique position to act as a facilitator of compromise in its neighbourhood. In major cases it may require support from other facilitators as well, but the facilitators must be well coordinated. In the case of the Western Balkans both the US and the EC played key roles while Member States of the EU (e.g., UK, Germany, Ireland, Sweden) and EFTA (Norway, Switzerland) contributed importantly. Neighbouring Hungary, Slovenia and Turkey also participated and their presence helped prevent bilateral tensions between the parties to a conflict from disrupting attempts at reconciliation. Facilitators of compromise help the parties to take the long view necessary to resolve their problems.

1.2 Sufficiently strong incentives

The prospect of accession to the EU has been a key factor encouraging some countries to take steps to resolve conflicts with previous enemies. This prospect increases an ENP country's interest in normalizing

economic relations with its neighbours. If both parties to a conflict have the possibility to accede to the EU, they have the strongest possible incentive to resolve their differences. An unresolved conflict will effectively prevent accession (e.g. settlement of earlier disputes between Slovenia and Croatia as well as between Hungary and Romania). When the prospect of EU accession is lacking, some other incentive must be found that encourages the parties to solve a regional conflict. A key question is whether the proposed, but as yet undefined, Neighbourhood Economic Community provides sufficient incentives.

The neighbourhood countries fall into the following groups as concerns their interest in and eligibility for accession to the EU.

1. *Acknowledged candidates for full membership.* The EU is conducting accession negotiations with Croatia and Turkey and will start negotiations with Macedonia. Croatia is expected to accede in 2013 while the time-table for Turkey and Macedonia is uncertain. In October 2011 the Commission proposed to open negotiations with Montenegro, which had applied for membership in 2008, and foresaw they would start in June 2012. In October 2011 the Commission indicated preparedness to open accession negotiations with Serbia, once it had normalised its relations with Kosovo as a sovereign state, and conferred candidate status in March 2012.
2. *Acknowledged potential candidates.* The Thessaloniki Declaration of 2003 states that the “future of the countries of the Western Balkans lies in the European Union.” Albania submitted its application for membership in 2009 and awaits candidate status. Bosnia-Herzegovina must first fulfil a number of conditions as must Kosovo.
3. *Unacknowledged potential candidates.* The six countries of the Eastern Partnership could be potential candidates if the EU deems them to be European States in accordance with Article 49 of the Treaty of the EU.⁶ This is no doubt the case for the three countries of Eastern Europe (Belarus, Moldova, Ukraine) which are west of the Urals, considered by geographers to be the Eastern limit of Europe. The three countries in the Southern Caucasus (Armenia, Azerbaijan, Georgia) lie east of the Bosphorus, another traditional geographic limit of Europe, may require further consideration.⁷ Turkey, currently negotiating EU accession, also lies largely east of the Bosphorus and yet is an acknowledged candidate. The three States in the Southern Caucasus each border Turkey, a potential Member State. Thus, their eligibility in accordance with Article 49 can be argued both ways. Georgia, Moldova and Ukraine have expressed interest in membership. Several Member

⁶ Article 49 TEU states *inter alia* “Any *European State* which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union.”(italics here). The official website of the European Union lists all EaP countries as “European countries”.

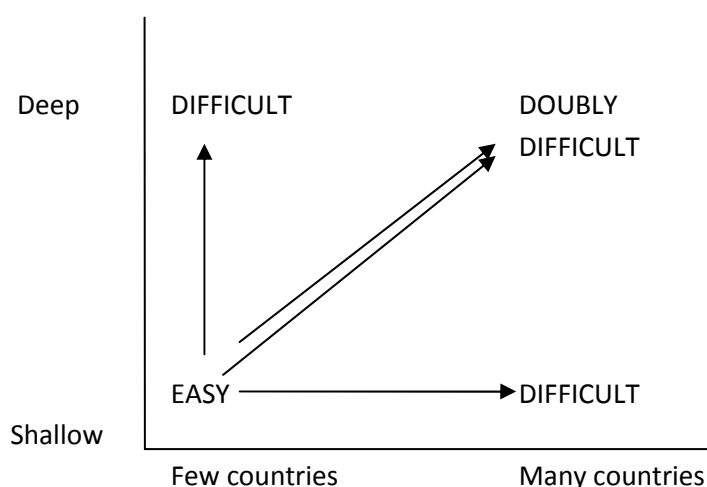
⁷ Regardless of geography, several of these States are currently disqualified on other grounds than geography in that they do not respect the values referred to in Article 2.

States (Sweden, Finland, the three Baltic States, Poland, the Czech Republic and Hungary) support the Eastern Partnership.

4. *Non-candidates.* None of the southern Mediterranean coastal States qualify for accession in accordance with Article 49 of the TEU. Morocco applied for membership but was rejected, as not being a European State. This set an important precedent. Several EU Member States (France, Spain, Italy) have strong ties to and interests in several of the Southern Mediterranean coastal States and have supported the Barcelona Process.

Those countries with no prospect of accession can hardly be expected to opt for deep integration unless they have other incentives that are sufficiently strong. A shallow and limited free trade agreement is easier to negotiate and implement than a deep and comprehensive one (DCFTA).⁸ A bilateral agreement with a single country is easier to negotiate than a plurilateral agreement with many countries. Diagram 2 illustrates schematically how the level of ambition concerning depth and number of countries increases the complexity of the trade agreement.

Diagram 2. Schematic presentation of two dimensions of free trade agreements



The more ambitious the free trade agreement, the greater the reward a neighbourhood country will expect to receive from it. A trade agreement with the EU eliminating tariffs on industrial goods may be its own reward, so to speak, while one involving also several neighbourhood countries and eliminating also non-tariff barriers (NTBs) on all goods and many services requires greater incentives to justify the

⁸ Shallow agreements remove primarily tariff barriers and quotas. Deep agreements remove other non-tariff barriers (NTBs) and provide for some trade-related regulatory convergence. The scope can be limited to industrial goods or be extended to include agricultural products and also services. The free trade agreement, shallow or deep, can be bilateral or plurilateral.

greater costs. Each of these alternatives entails different costs and benefits for different countries. Clearly, the benefits that a neighbourhood country receives from an agreement must be commensurate with its costs.

1.3 No third party to conflict

A second key factor in resolving conflicts is whether the conflict is limited to parties that are members of the Neighbourhood or includes a third party (outside the Neighbourhood). When two ENP countries are in conflict with each other, trade-offs within the framework of the ENP can offer incentives to resolve the conflict. If a third country (outside the ENP) is involved, a separate deal will need to be struck with that country, presumably involving additional side-payments by some actor. Russia is not a member of the ENP.⁹ It is, however, involved directly or indirectly in several of the conflicts in the European Neighbourhood.¹⁰ In an institutional sense it is a third party. This reduces the ability of the European Neighbourhood partners to resolve these conflicts on their own.

Combining the factors laid out in sections 1.2 and 1.3 indicates the likelihood of successful conflict resolution (other factors influence this likelihood as well). The various combinations of these two factors are illustrated in Table 1. The likelihood of successful conflict resolution is greatest if all parties to the conflict are members of the region *and* if they all share an ambition to accede to the EU. The EU can then make resolution of regional conflicts a precondition for trade agreements with the EU itself and insist on regional economic integration as a means to resolve these conflicts. Accession is the reward for conflict resolution. This provides the EU with strong 'soft power' that it can use in the appropriate circumstances. Thus, conflicts that fall in the North West quadrant in Table 1 are likely to be the easiest to resolve, other things being equal. The ex-Yugoslavia countries, after bitter conflicts, all wanted to accede to the EU. It took the prospect of EU accession to convince them finally to settle their differences, although with difficulty.

Conflicts that fall in the South East quadrant are likely to be the most difficult and costly to resolve, since the parties are not potential candidates for accession and a third party is involved in the conflict. The countries in conflict thus have weak incentives to resolve their differences. For instance, the conflict over Nagorno-Karabakh will be difficult to resolve as long as neither Armenia nor Azerbaijan are eligible for accession and Russia is a third party to the conflict. The prospects to solve the Transnistrian conflict in the North East quadrant are somewhat better assuming Moldova and Ukraine are eligible for accession but

⁹ Russia requested not to be included in the ENP preferring instead to have its own Strategic Partnership with the EU.

¹⁰ For instance Russia is involved in the conflict concerning Transnistria with Moldova, South Ossetia and Abkhazia with Georgia, Nagorno Karabakh with Armenia and Azerbaijan.

also here Russia is a key third party to the conflict. Likewise, the conflict between Georgia and Russia concerning Abkhasia and South Ossetia is likely to remain frozen for long. A prospect to accede could help Georgia resolve this conflict.

When it cannot exercise its “soft power”, the EU must resort to more expensive ‘hard power’ (both carrots and sticks) to resolve regional conflicts. Those in the North East quadrant will require side payments/fines to the third party outside the ENP. Those in the South West quadrant will require side payments/fines to the parties with no prospect of accession. Depending on the conflict, the hard power required can be extremely costly.

Table 1. Key factors indicating likelihood of success in resolving regional conflicts in ENP

	Conflicts confined to parties in the region	Conflicts involving third countries
Potential candidate Countries	The Western Balkans (e.g., Kosovo-Serbia, Bosnia-Herzegovina)	Ukraine-Moldova-Transnistria (Russia) Georgia- South Ossetia-Abkhasia (Russia)
Not potential candidate Countries	Western Sahara (Morocco-Algeria) Middle East (Israel-Occupied territories/Lebanon/Syria)	Armenia-Azerbaijan-Nagorno Karabakh (Russia, Turkey)

Note. The horizontal line in the right hand column is dotted since the operational definition of Europe is unclear.

1.4 Strong leverage of foreign trade

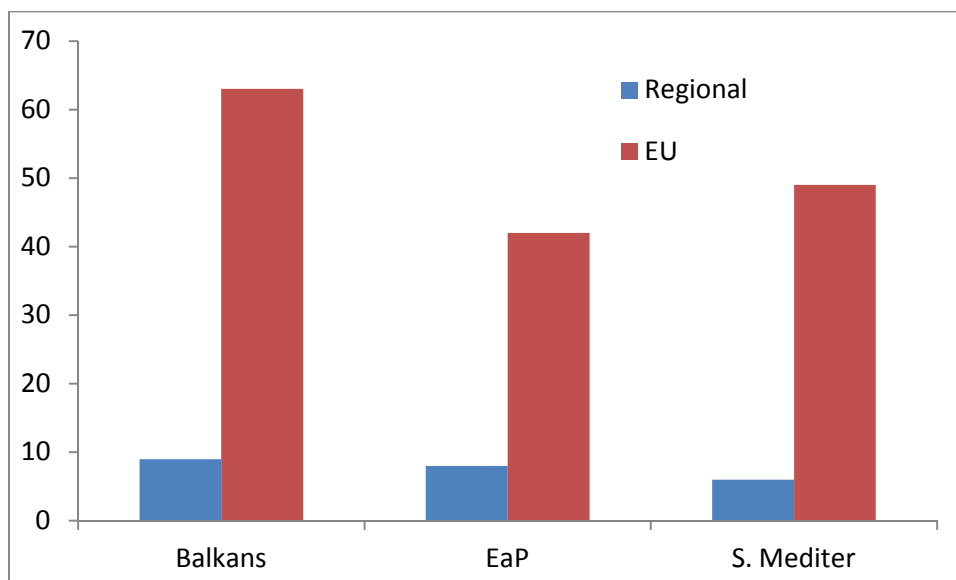
Whether the potential for regional trade is large or small determines how the leverage that trade agreements can have on conflict resolution. The larger the potential for increased mutual trade, the more normalization of political relations and trade liberalization can increase trade flows and standards of living.

Realizing large potential gains from trade can by itself help overcome a reluctance to resolve conflicts. The actual share of a country’s exports or GDP that is conducted with countries in a conflict situation is a very poor indicator of trade leverage. It is the potential for increased barrier-free trade that it is important to know. The World Bank used a gravity model of trade to estimate potential intra-regional trade for the Balkans in 2000 and found trade liberalisation would triple regional trade.¹¹ Lacking estimates of potential trade for ENP countries, Diagram 3 shows actual intra-regional trade flows in both the Barcelona countries and in the EaP countries. In 2005 intra-regional trade was extremely low. Intra-regional trade in the Balkans was not much larger in 2000 but that region was still suffering from the disruptions of the war. The EaP countries and the Barcelona countries appear to believe that regional free

¹¹ Kaminski and de la Roche (2002).

trade would have little leverage. These countries focus on exports to the EU which account for around half of their total exports.

Diagram 3. Shares of intra-regional trade and trade with the EU in total trade 2005 (%)



Source:

1.5 Well-functioning market economies

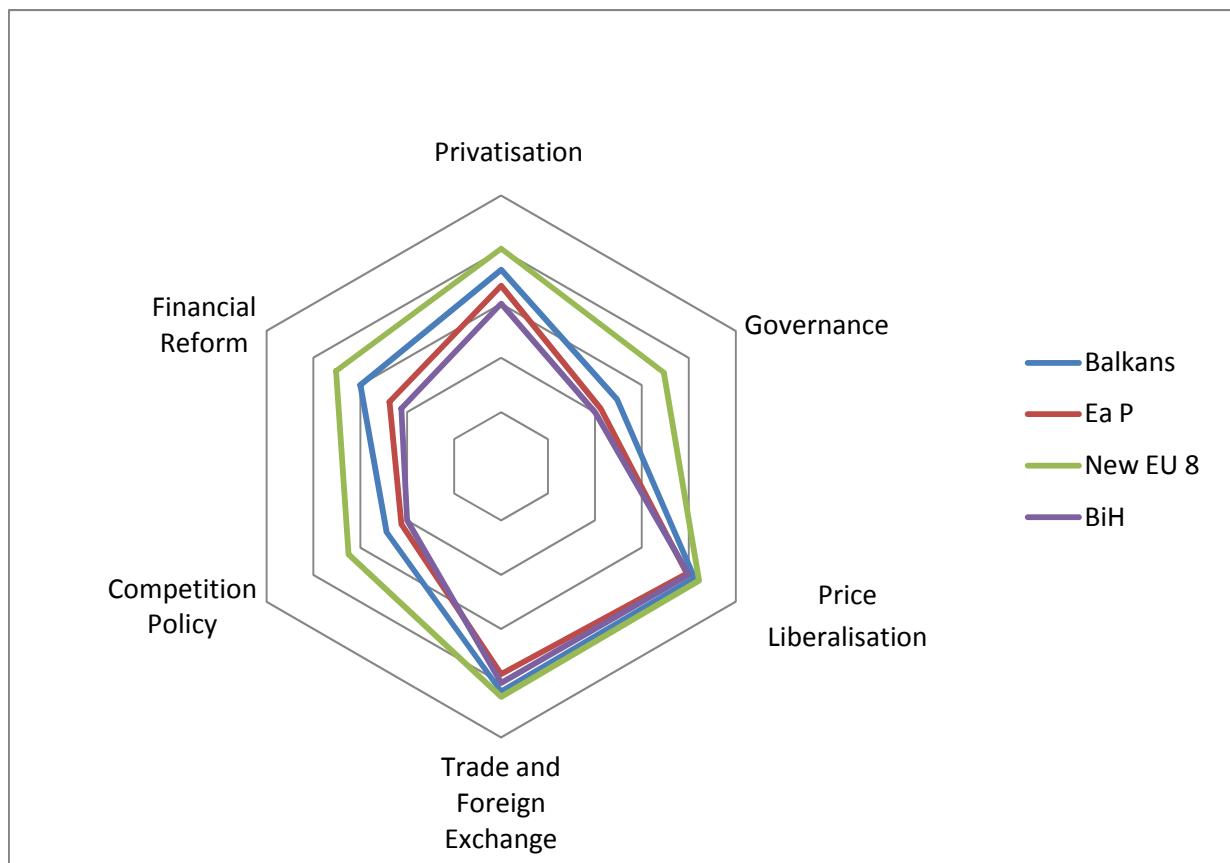
In order for free trade agreements to realise the potential for increased mutual trade, the signatory countries must have well-functioning market economies. This is rarely the case in countries in the European Neighbourhood.

Each EaP country is a former republic of the USSR and thus as yet lacks strong national institutions and well-functioning market economies. Implementing a deep and comprehensive free trade agreement with the EU or with each other requires an EaP country to speed up progress to a well-run market economy. Many of the countries on the Southern coast of the Mediterranean also have weak market economies, though for other reasons. In both cases, participation in a DCFTA will require a Neighbourhood country to invest significant resources to build institutions and train personnel in select parts of the *acquis communautaire*. Presumably, the country wants to modernize its economy. However, if doing so imposes a severe economic burden on a very poor country, it may feel constrained to opt instead for shallow agreements.

An indication of how groups of countries differ as concerns progress made to a functioning market economy is given by transition indicators published annually by the European Bank for Reconstruction and Development (EBRD) (Diagram 4). Six indicators are summarized in the diagram for three groups of

countries for the year 2008. The EBRD score 1 represents “little or no change from a rigid centrally planned economy” and 4+ (portrayed as 4.25 in the diagram) represents “the standards of an industrialized market economy”.¹² These ordinal indicators are rough qualitative assessments made by experts and are consistent over time and across countries, a benefit that offsets their slightly impressionistic character.

Diagram 4. EBRD indicators of transition to a market economy for three country groups and BiH, 2008



Source: EBRD Transition Report 2009.

Diagram 4 indicates that the average score for eight Central and Eastern European countries (new EU 8) that acceded to the EU in 2004 was a four for three of the indicators and close to a four in the other three (Competition policy, Financial reform, Governance and enterprise restructuring).¹³ The group of Balkan countries (including Bulgaria and Rumania but excluding Bosnia-Herzegovina) scored four on the two ‘easy’ indicators (Trade and foreign exchange, Price liberalization) but were weak in the others,

¹² EBRD Transition Report 2010, Table 1.1. EBRD has published these indicators annually for about twenty years.

¹³ Bulgaria and Rumania acceded to the EU in 2007. Until then they participated in the regional cooperation of the Balkans group.

especially in Competition policy and Governance and enterprise restructuring. Bosnia- Herzegovina (BiH), as the lowest scorer in the Balkans, is shown separately in Diagram 4. The EaP countries on average were close to a rigidly, centrally planned economy in three key indicators (Reform of financial institutions, Competition policy and Governance and enterprise restructuring) while being close to a market economy on two indicators. On average, the EaP countries were somewhat better than Bosnia-Herzegovina.

In sum, the Balkan countries on average lag significantly behind the eight Central and Eastern European countries that became EU members 2004 in three issues that are key for a deep and comprehensive free trade agreement. The EaP countries on average lag even farther behind. These significant differences between the county groups suggest that the EaP countries are the least ready to negotiate a DCFTA, either with the EU or with each other. These differences are, of course, even greater when we consider individual countries rather than group averages. The next section considers how these indicators – prospects for accession, existence of a third party to a regional conflict, the leverage of foreign trade and the functioning of market economy – affect the likelihoods that a neighbourhood country will succeed to negotiate a DCFTA.

2. Cases with favourable prospects for conflict resolution

Success in regional conflict solving has been greatest in the Balkans. Progress has been slow and incomplete and some countries still have far to go, nevertheless, step by slow step most countries there have made significant progress (Section 2.1). This progress has been due to the following factors:

- i. Active mediators and facilitators of compromise ('godfathering' by the EU).
- ii. Credible prospect of accession to the EU and absence of third parties to conflict.
- iii. Sufficient progress in transition to a well-functioning market economy.
- iv. Large potential for and strong leverage of intra-regional trade.

Bosnia-Herzegovina is the exception that proves the rule and some reasons for its failure to make progress are treated in Section 2.2.

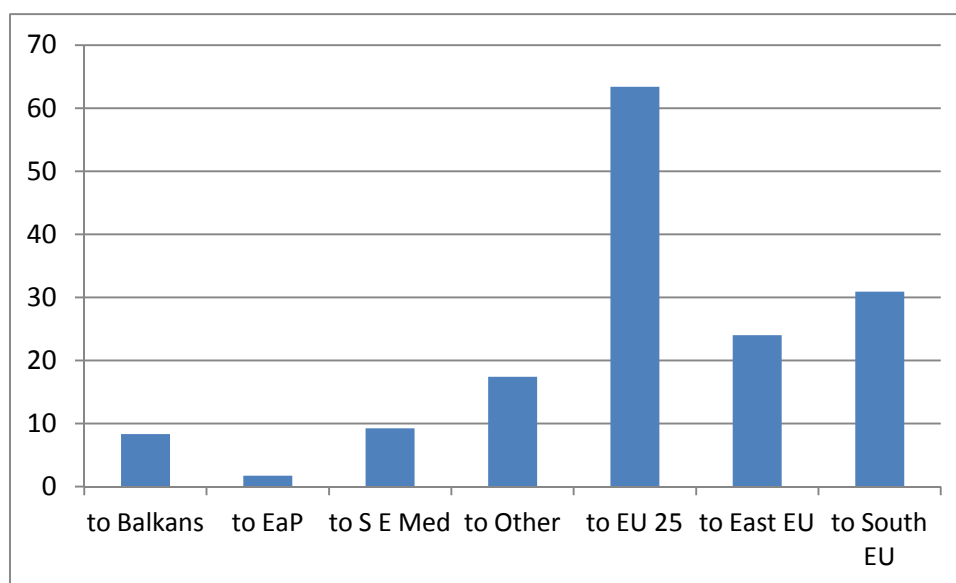
2.1 Lessons of success: The Balkans

The facilitator of compromise in this case was the Stability Pact for South Eastern Europe.¹⁴ Its purpose was to normalize relations between the newly independent States of Yugoslavia after the bloody civil wars

¹⁴ This organization was initiated in 1999 after the end of the Balkan wars by the EU and the US. As previously noted a number of other states were active in this group (UK, Germany, Sweden, Switzerland, Norway) as well as neighbouring Hungary, Slovenia and Turkey. Their presence provided support and encouragement and dampened animosities.

of the 1990s. In 2001 the Stability Pact proposed that these once closely integrated States plus others in the Balkans (including Bulgaria and Romania) negotiate a regional free trade agreement.¹⁵ This was initially rejected by the ex-Yugoslav States because of strong mutual resentments following Yugoslavia's break up. Instead, they opted for a network, not necessarily complete, of bilateral free trade agreements with selected partners. Each country's prime objective was a trade agreement with the EU followed by EU accession, and not free trade with other Balkan countries. As shown in Diagrams 5 and 6, the EU took about 60 per cent of the Balkan countries exports and imports in 2005, whereas less than ten per cent was with other Balkan countries. Important trading partners among the eight new EU members in 2004 were Slovenia, Hungary and Poland while neighbouring Greece and Italy were important traders in southern EU. Intra-regional trade was limited because of the disruptions of the war. However, regional trade had significant unrealized potential, estimated by the World Bank to be about three times larger than actual trade in 2000.¹⁶

Diagram 5. Balkan countries: Distribution of exports to neighbours 2005 (%)

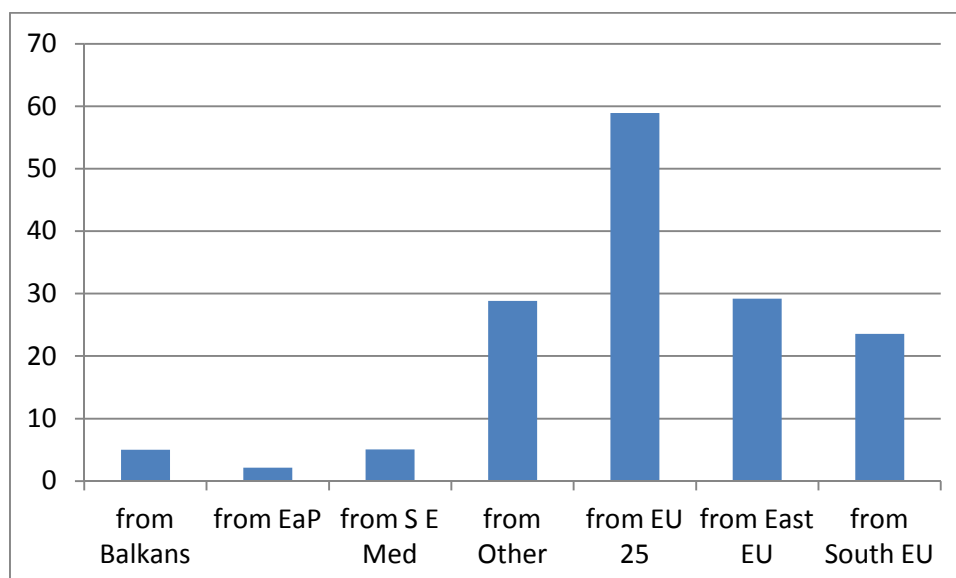


Source: Authors' calculations using The World Bank's WITS program.

¹⁵ Gylfason and Wijkman (2011a).

¹⁶ Kaminski and de la Rocha (2002). Trade between the core countries Bosnia-Herzegovina, Croatia and Serbia had been badly disrupted by wars in the 1990s.

Diagram 6. Balkan countries: Distribution of imports from neighbours 2005 (%)



Source: Authors' calculations using The World Bank's WITS program.

As the network of bilateral agreements grew, the Balkan States finally agreed to convert it into a regional free trade agreement, one which furthermore was to be more ambitious. They signed it in December 2006 and, significantly, called it CEFTA 2006).¹⁷ Why had it taken so long to do achieve this? In addition to the low level of actual intra-regional trade following the wars, the Balkan countries initially suspected that regional free trade was a substitute for EU membership. It took long for the EC negotiator to convince them that regional free trade was, in fact, a prerequisite for accession.¹⁸ A key event was the Thessaloniki Declaration by the European Council in June 2003 stating that the future of the western Balkans lay in the EU. By repeating these words often enough during the Stability Pact meetings the European Commission finally convinced also the sceptics that accession was a credible prospect. This made all the difference. As if to drive home the point, the Commission invited the Parties to conduct the final rounds of negotiations on a single regional free trade agreement in the Charlemagne building in Brussels in the summer of 2006. Once each Balkan State was convinced that it had a credible prospect of accession, it accepted to negotiate a regional free trade agreement, as a precondition for a Stabilization and Association Agreement (SAA) with the EU, which in turn was a precondition for EU membership.

¹⁷ On 1 January 2007 Bulgaria and Romania entered the EU and left CEFTA. Its sole member would have been Croatia if CEFTA had not transformed itself into CEFTA 2006 admitting the Western Balkan countries and revising the treaty. Croatia, which was already negotiating accession with the EC, found this especially appropriate: CEFTA had been a transit station for Central and Eastern European countries on their way to EU.

¹⁸ The EU was not prepared to admit as member a country with unresolved conflicts with its neighbour. Such conflicts could become an external conflict of the EU or an internal conflict if both countries became members.

The regional free trade agreement negotiated in the framework of the Stability Pact and godfathered by the European Union thus put the Balkan countries on track for accession. The track contained the following stations: Regional free trade, deep and comprehensive free trade agreements (so called Stabilisation and Associations Agreements, SAAs) of each country with the European Union and requests for and negotiations on accession to the EU. Each country progressed from one station to the next on its own merits. Thus, in some cases progress was rapid, in others it was slow, but in almost all cases it was steady (Table 2). The fact that there was a common objective (EU accession) and a structured road map on how to get there proved essential for progress. The accession track allowed the Balkan countries to start with the easy things and finish with the more difficult (in terms of Diagram 2): relatively shallow agreements with select partners, a plurilateral deep agreement with each other, and finally a bilateral SAA with the EU with the prospect of future accession.

Table 2. Key dates for Balkan States en route to EU membership

	Signing of SAA	SAA enters Into force	EC moves SAA to second stage	Application for EU membership	Commission issues positive opinion	Council confers candidate status	Accession negotiations start	Screening starts	Screening stops
Albania	2006-06-12	2009-04-01		2009-04-28	2010-11-09				
BiH	2008-06-16								
Bulgaria									
Croatia	2001-10-29	2005-02-01	2009-10-	2003-02-21	2004-04-	2004-06-	2005-10-03	2005-10-20	2006-20-15
Macedonia	2001-04-09	2004-04-01	2009-10-	2004-03-22	2005-11-09	2005-12-16	2009-10-		
Montenegro	2007-10-15	2010-05-01		2008-12-15	2010-11-09	2010-12-17	(2012-06)		
Romania									
Serbia	2008-04-29	2009-12-07		2009-12-22	2011-10-12	2012-03-01			

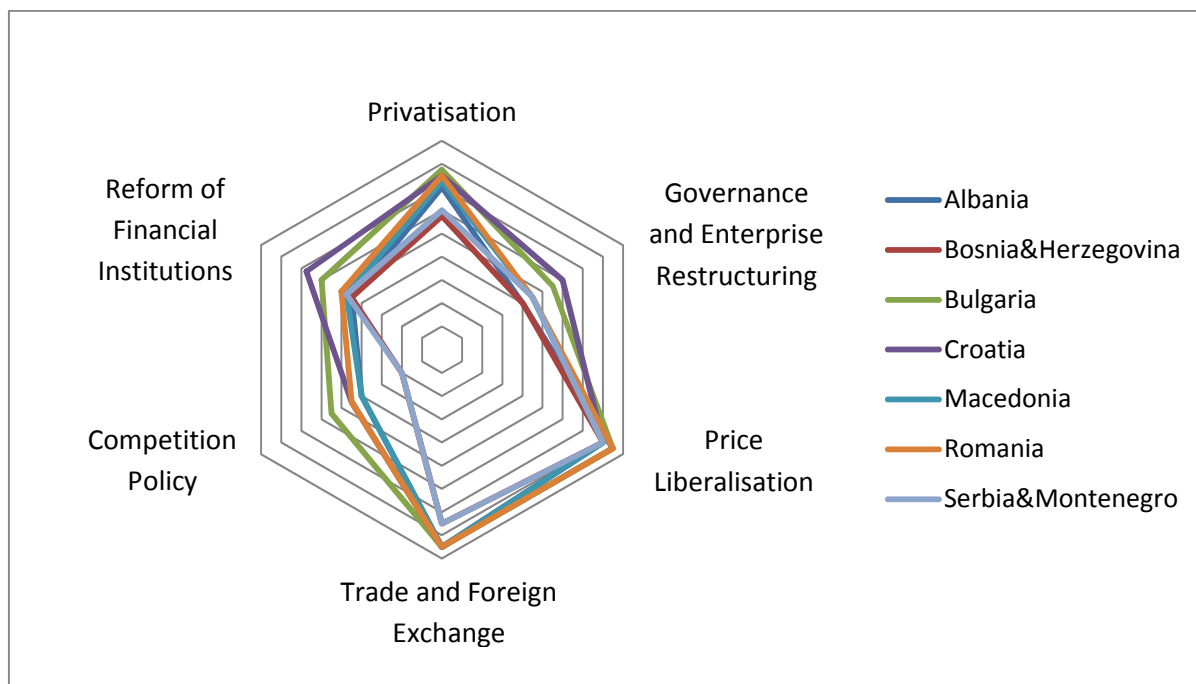
Source: Data assembled from www.EuropeanUnion. Parentheses indicate the date is foreseen.

The order and speed in which the Western Balkan countries passed the various stations on the track to accession is closely related to the progress each had made toward a functioning market economy. A rough measure of this is provided by EBRD's transition indicators in Diagram 7.¹⁹ Croatia scores highest in 2005 and was the first of the Western Balkan countries to be conferred candidate status (June 2004), having been the first to sign a deep and comprehensive free trade agreement (SAA) with the EU in October 2001. Macedonia has the next highest scores on transition indicators after Croatia and was conferred candidate

¹⁹ We disregard Bulgaria and Romania, which became members of the EU already in 2007.

status in December 2005.²⁰ Next comes Albania which scores higher on four indicators than Serbia, with Montenegro and lower on two. No individual scores exist for Montenegro but the country has made significant progress since it voted to separate from Serbia in 2006. It applied for membership in December 2008. In its annual review in December 2010 the European Commission gave qualified support to conferring candidate status and foresees that negotiations will start in June 2012.

Diagram 7. Balkan countries: EBRD transition indicators, 2005



Source: EBRD Transition Report 2006.

Serbia with Montenegro scores higher than Bosnia-Herzegovina on three indicators and is equal on three. Serbia applied for membership in December 2009 a year after Montenegro. In October 2011 the Commission indicated that a positive opinion on Serbia’s candidate status would depend on progress towards recognition of Kosovo as an independent State. Following positive steps on this issue, the EU conferred candidate status in March 2012.

Thus, the Balkan countries have made slow but steady progress. Four of them now have candidate status. They show that a government’s ability to negotiate a deep and comprehensive free trade agreement with the EU depends on how far the country has progressed in transition to a market economy, its ability to resolve regional conflicts and the government’s political determination and endurance. After

²⁰ Macedonia would no doubt have made greater progress to accession if Greece had not blocked the start of negotiations due to a political dispute with Greece over the country’s name.

all, these are 'projects' that take up to ten years to accomplish. Bosnia-Herzegovina, the country with the lowest transition indicators in the Balkans and the most dysfunctional political will, made slower progress than any other Balkan country toward EU membership. The next section shows why.

2.2 Lessons of failure: Bosnia and Herzegovina

The conflicts that once caused the violent disintegration of Yugoslavia remained unresolved *within* the Federation of Bosnia-Herzegovina. These internal dissensions are the main reason for its lack of progress during the more than fifteen years that have passed since the Dayton Accords.²¹

Bosnia-Herzegovina is a dysfunctional state where the politicians of various ethnic groups are unable to agree on the key measures necessary for a trade agreement with the EU: to accede to the WTO, to revise the Constitution imposed by Dayton and to replace the Office of the High Representative (OHR) by an acceptably democratic office.²² In addition, Bosnia-Herzegovina has failed to improve the functioning of its market economy. Each of these tasks could well take five years or more to accomplish. Accession to the WTO is a time-consuming process. The Constitution enacted by the Dayton Accords cannot be revised overnight. It was designed to prevent any of three ethnic groups from dominating, or being dominated by, the others. It created several, often competing levels of government (State, Entity, District and Cantonal), a tripartite Presidency (requiring a consensus between the three ethnic groups), and finally a Parliament with two Chambers (with built-in ethnic vetoes). The absence of common ground between the ethnic groups effectively immobilised the government. It also makes it impossible to replace the Office of the High Representative with a democratically elected local leader.

2.2.1 A frozen conflict

The Dayton Accords were imposed by outsiders on the Serbian aggressors (in both Serbia and Republika Srpska), making Dayton a cease-fire rather than a peace treaty. War-time political leaders remained in power both within Bosnia-Herzegovina and in its immediate neighbours. Ethnic enmities were elevated to national animosities.

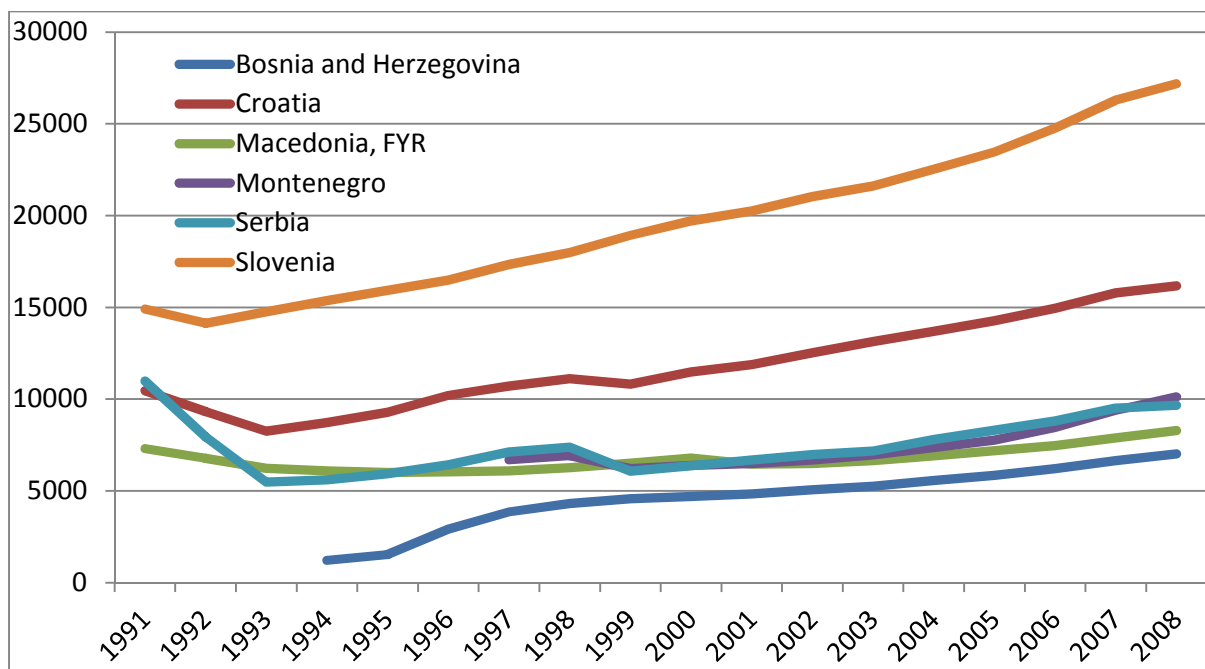
The resulting deadlock of Bosnia-Herzegovina's political system crippled its economic recovery and growth after the war. Although pre-war statistics are uncertain, per capita GDP fell sharply during the war 1992-95, and remains below its neighbours' (Diagram 8). Bosnia-Herzegovina is heavily dependent on

²¹ Gylfason and Wijkman (2011b).

²² The international community created the OHR and empowered it to veto laws. This reflected its distrust of BiH's ability to govern itself in an initial phase. After 15 years this foreign tutelage has led to dependency and irresponsibility on the part of the country's politicians.

remittances from abroad. Few refugees have returned and foreign direct investment is low. Other Balkan countries continue to show modest growth, especially Serbia (with Montenegro) where the Kosovo war had long-lasting economic consequences. Only Croatia, which opened EU membership negotiations in 2005, recovered quickly and continues to grow rapidly.²³

Diagram 8. Balkan countries: GDP per capita 1991-2008 (PPP, constant 2005 international \$)



Source: World Bank, *World Development Indicators 2010*.

2.2.2 An imperfect market economy

Given its low scores on the EBRD transition indicators (Diagram 7), it is not surprising that Bosnia-Herzegovina lags behind other Balkan countries in fulfilling its obligations under the *Central European Free Trade Agreement* (CEFTA) and in negotiating a Stabilization and Association Agreement (SAA) with the EU. In its 2010 assessment of Bosnia-Herzegovina, the [Commission document](#) appears to be at a loss for synonyms to describe the lack of progress made by BiH on key SAA issues. Its verdict in October 2011 confirms its previous negative assessments. BiH may require five more years to implement the SAA fully.

Since politicians in Bosnia-Herzegovina lack a shared vision for the country, the different levels of government have resulted in political deadlocks that prevent enactment of necessary legislation. For instance, the SAA calls for setting up a national state aid agency, but politicians cannot agree on at which

²³ Slovenia, an EU member already 2004, is included for comparison. It recovered very quickly and grew more rapidly than all the others after the civil wars in former Yugoslavia.

level to set it up. A study by the World Bank in 1997 predicted that the fiscal federalism of Dayton would render government decision-making inefficient if the ethnic groups lacked sufficiently common interests.²⁴ This has now proved to be the case. The fiscal problems remained unresolved. The duplication of public functions at various levels of government means that its public sector accounts for the third largest share of employment in Europe (after France and Belgium). As a result, the public sector unions are “wage-leaders” and set wages at levels that have eroded the competitiveness of the private sector.²⁵

2.2.3 Break-up or compromise

Bosnia-Herzegovina faces two alternatives: a break-up of the Confederation or a compromise between the ethnic groups on a *modus vivendi*. A continued vicious circle of political deadlock and economic stagnation is likely to lead to a break-up of Bosnia-Herzegovina relatively soon. Representatives of Republika Srpska continue to express a wish to break out of Bosnia-Herzegovina. The prospect that the centre will not hold and that the confederation will fall apart prolongs economic stagnation by discouraging foreign trade and foreign direct investments.

If Bosnia-Herzegovina breaks up, possible successor states are unlikely to qualify for membership in the EU, especially if the breakup of Bosnia-Herzegovina is bloody. Several EU Member States are likely to oppose the entry of Republika Srpska, whether as a single entity or as a part of Serbia after the genocide committed at Srebrenica and the brutal siege of Sarajevo. Because of some Member States’ own bitter history and the traumatic experience of Srebrenica, the EU cannot compromise the principles of human and minority rights.²⁶

Can Bosnia-Herzegovina transform itself into a viable state with a vision of a common future? Perhaps, if the entities cease to believe they have another option and accept the necessity to live together. Croatia and Serbia in their respective accession process must commit themselves to respect the territorial integrity of Bosnia-Herzegovina and to abstain from interfering in its internal affairs. Deprived of the prospect of outside support, the entities in Bosnia-Herzegovina may finally revise the Constitution to provide for more effective decision-making and remove the ethnic discrimination that is incompatible with European principles. This is necessary but hardly enough to become a candidate country. To remain a viable state, a process of reconciliation between Croats, Serbs and Bosniaks is essential. Only in the last

²⁴ Fox and Wallich (1997).

²⁵ IMF (2010).

²⁶ Bosnia-Herzegovina may do well to recall the problems Turkey faces in its negotiations to accede to the EU. The expulsion of 1.5 million Greeks (albeit formally a ‘population exchange’) and the fate of 1.5 million Armenians during the Ottoman Empire cast long shadows some 90 years later.

year or so have political leaders made statements signalling the possible initiation of such a process. Much more remains to be done.

This reconciliation will require facilitators of compromise to be much more active. The EU and the US must use their considerable soft and hard power to encourage the parties within Bosnia-Herzegovina to resolve their differences. The EU has to convince all parties in the country that membership is only possible subject to specific political conditions given past history and establish an agreed road map and timetable for fulfilment of these conditions. The soft power of the prospect of membership has worked for some countries with internal conflicts between ethnic/linguistic groups, such as the Baltic countries. Resolving Bosnia-Herzegovina's more serious internal conflicts will require the use of hard power as well. A major programme of financial assistance for economic reconstruction and restitution of property to returning refugees may facilitate for Bosniaks to come to terms with some of the injustices done them.

3. Cases with unfavourable prospects for conflict resolution

The Barcelona Process has made little progress to resolve conflicts between parties in the region. This is because (i) the soft power of accession cannot work here and no close substitute for it has been developed, (ii) the large amount of hard power needed to resolve the 'local conflicts' has not been forthcoming, (iii) the amount of intra-regional trade is small and its potential is uncertain, and (iv) most of the countries have poorly functioning market economies incapable of implementing deep and comprehensive free trade agreements. In addition, many of the States have been governed by nepotistic, corrupt and dictatorial regimes for decades. The fundamental problems are political.

The Arab Spring provides a rare window of opportunity for the Barcelona Process to support implementation of far-reaching reforms in some of these countries. This will require a much more assertive and innovative EU policy in the future than in the past, The EU will have to utilize much more hard power —both carrots and sticks -- to encourage the parties to the conflict to make the necessary hard decisions. Assistance must be made conditional on positive responses by the parties. See Section 3.1.

The Eastern Partnership has only just started and an assessment of its successes is premature. However, it is safe to say that it did not get off to a flying start. The prospects for successful conflict resolution between the EaP countries appear dim. The primary reasons for this are (i) poorly functioning market economies, (ii) the existence of an aggressive third party to the conflicts, (iii) ambiguity about the eligibility for accession and hence lack of soft power. It is time for the EU to take stock of these difficulties and for the EaP states to review the strength of their commitment to a DCFTA with the EU and with each other. In this case, the fundamental problems impeding progress appear to be economic. See Section 3.2.

3.1 The Barcelona Process – unaddressed political obstacles to success

The Barcelona Process²⁷ set up as a target that each Southern Mediterranean coastal country should conclude a bilateral free trade agreement with the EU as well as with each other before the end of 2010. This would create a vast free trade area around the Mediterranean with about 800 million people.

This goal has been largely achieved, but with a low level of ambition. The EU concluded bilateral agreements with all countries but Ghadafi's Libya. However, most of these agreements are 'shallow' ones. Those with Egypt, Israel, Jordan, Morocco and Tunisia are deeper although none are as deep as the trade agreements that the EU has with the countries of the Western Balkans or the DCFTAs the EU has proposed to the EaP countries. Free trade has also been achieved between all Arab countries on the Mediterranean coast through the agreement on the Pan-Arab Free Trade Area (PAFTA), established at the initiative of the Economic and Social Committee of the Arab League in 1997.²⁸ PAFTA claims to have realized free trade in industrial and agricultural goods already in 2005. This, too, is a shallow agreement.

Four countries have gone further. Egypt, Jordan, Morocco and Tunisia signed the Agadir Declaration in 2002 and thereafter negotiated the Agadir Agreement which entered into force in 2004. This established free trade between them in 2005, five years ahead of the Barcelona schedule. This Agreement is deeper than PAFTA. It provides *inter alia* for adoption of the Euro-Med protocol on preferential rules of origin, thereby allowing for diagonal cumulation of origin for participating countries.

Considered as an exercise in conflict resolution, however, the Barcelona Process has not produced results. No progress has been made to resolve the conflict over Western Sahara (between Morocco and Algeria/Polisario) or over the former League of Nation's mandate Palestine (between Israel and its neighbours). Indeed, the Barcelona Process does not appear even to have attempted to resolve these conflicts.²⁹

3.1.1 Limited regional trade leverage?

What explains this shallow and incomplete pattern of regional trade liberalisation? Is potential intra-regional trade really small? We lack available studies. Actual intra-regional trade of the Southern and Eastern Mediterranean countries is strikingly low – less than five per cent of their total trade.³⁰ Of this

²⁷ The Barcelona Process was absorbed into the Union for the Mediterranean. We call it the Barcelona Process when dealing with a historical context but also occasionally after 2008.

²⁸ It thus includes eight Arab League countries which are *not* members of the Barcelona Process.

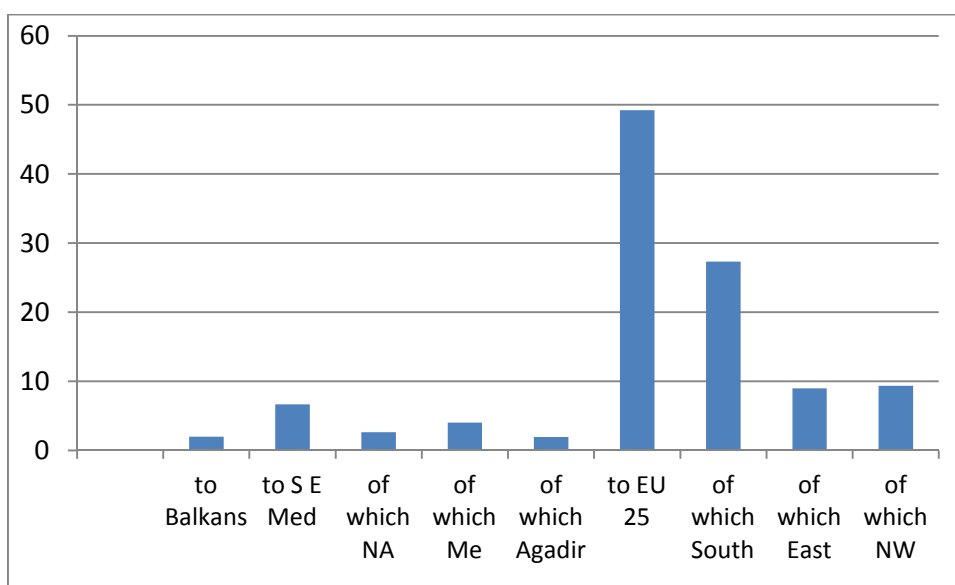
²⁹ This is a task for the "Quartet", of which the EU is one. The point is that the EU could make an important contribution by furthering trade liberalization between countries in conflict.

³⁰ Trade Commissioner Peter Mandelson described the situation bluntly in his address to the First Agadir Investment Forum, in Brussels 8 April 2008. "... creating a regional market place along the southern shore of the Mediterranean ... has turned out to be a political challenge of the first order. You don't need me to tell you how far away you

small amount the States in the Middle East take about 50 per cent more than the States in North Africa, which in turn take marginally more than the four Agadir States (Egypt, Jordan, Morocco, Tunisia). It is possible that policy makers believe that little leverage is to be gained from attempts to expand intra-regional trade. But before such conclusions can be drawn studies of potential trade are needed to determine whether the shallow free trade agreements are a cause of this small volume of intra-regional trade or an effect of it.

If intra-trade between the Agadir countries expands as a result of this Agreement the other PAFTA countries may be encouraged to deepen their trade agreement with each other (and with the EU), including adopting Euro-Med preferential rules of origin. For the present it seems that few countries are prepared to raise their level of ambition for intra-regional trade by moving from shallow to deep free trade agreements.

**Diagram 9. South and East Mediterranean countries:
Distribution of gross exports to neighbours 2005 (%)**



Source: Authors' calculations using The World Bank's WITS program.

However, there is one case where unrealised potential trade is likely to be large: between Israel and its neighbours. The failure to realize this huge economic potential is solely political. No Arab country has signed a free trade agreement with Israel, the country with the largest and fastest growing GDP in the region. Egypt and Jordan, the only two Arab countries with peace agreements and trade agreements with

are from ... [your] ... goals. regional integration in the Southern Mediterranean is lower than anywhere else in the world. You do not trade with your neighbours. It makes you almost unique in the world."

Israel, do not have free trade agreements with it. Free trade agreements between Israel and its bordering countries could generate significant regional growth. The failure of the Barcelona Process to contribute to resolution of this important conflict is striking.

When it started in 1995, the Barcelona Process was fuelled by optimism generated by the Madrid Conference of 1991, the Oslo Accords of 1993 between Israel and the PLO and the Israel-Jordan Peace Treaty of 1994. However, when Israel and the Palestinian Authority failed to reach a final settlement at the Camp David Summit in 2000, hostilities between Israel and Palestinians increased. It would be too easy to blame the failure of the Barcelona Process on the renewed hostilities. The reverse could be equally true. One objective of close economic integration is, precisely, to prevent such hostilities. However, significant amounts of 'hard power' are needed in order to enable the parties to the conflict take the necessary steps to convert a vicious circle into a virtuous one.. The EU did not provide this hard power when it was needed.

A different scenario could have developed. Egypt and Jordan signed peace treaties with Israel in 1979 and in 1994 respectively and have trade agreements with Israel, albeit not free trade agreements. A logical first step would be for them to negotiate and sign deep and comprehensive free trade agreements with Israel. A natural next step would be for the four signatories of the Agadir Declaration to include Israel and the occupied territories, thereby creating an Agadir Plus. Both Morocco and Tunis have good relations with Israel, making an Agadir Plus politically feasible. A third step would be to include Lebanon (and Syria, conditional upon a democratisation process there).

The potential for trade between these mostly contiguous countries is likely to be significant. Deep and comprehensive free trade in due course would benefit in particular the occupied Palestinian territories by providing unfettered access to markets in Egypt, Jordan and Lebanon. This prospect for this is gloomy but no less realistic than the Common Market was after World War II. Through the Barcelona Process, the EU can provide strong political and financial support to post-war reconstruction and reconciliation much as the US did through the Marshall Plan in 1948 and the subsequent creation of the OEEC.

Until now, the Barcelona Process has made progress by avoiding the most difficult issues – and thereby also the most important ones. The goal of free trade between all countries by the end of 2010 remains unfulfilled. Furthermore, most of the free trade agreements that have been concluded are shallow. The fact that no Arab country has entered a free trade agreement with Israel, the country with the largest GDP in the region, makes an economic mockery of the regional free trade area and damages the credibility of the Barcelona Process.

3.1.2 Does the EU encourage conflict resolution sufficiently?

In the absence of accession, what can the EU offer that would make Agadir Plus an offer the participating countries cannot refuse? The EU is the major market for the countries on the Southern coast of the Mediterranean, taking about 50 per cent of their exports. The Southern EU States account for slightly more than half of EU imports from the Southern and Eastern Mediterranean. The Agadir four have close ties to key countries in the EU as do Israel and Lebanon. Most of them have relatively advanced market economies. Some of them have DCFTAs with each other *and* with the EU. Those that do not could negotiate them. If the Agadir Plus countries are integrated closely both to each other and to the EU through DCFTAs they have a strong need for common institutions.

The ENP foresees this need and offers a common institutional framework called the Neighbourhood Economic Community (NEC) encompassing the EU and those countries that have DCFTAs both with the EU and with each other. The EU does not define either the scope or the content of these common institutions except by way of a vague reference to the institutional structure of the European Economic Area. It could however be a powerful institutional framework for reform and modernisation, much as the OEEC was in Europe. It is time for the EU to give precision to this concept of a NEC. It could serve to anchor the countries of an Agadir Plus (in particular Egypt, Jordan, Israel, Lebanon, the Occupied Palestinian Territories) in close economic integration and political cooperation and provide significant economic benefits to the participants. Key issues to deal with are trade in agricultural products and energy, in particular solar energy, and provision of temporary labour permits.

The economic sense of encapsulating all economic relations of the Agadir Plus countries in a tailor-made Neighbourhood Economic Community is strong. However, by itself an institutional superstructure is insufficient to resolve the deep-rooted crises in the Middle East. Significant financial assistance will also be necessary to provide the Palestinian refugees, now numbering about 4.5 million (including their descendants), with decent living conditions and job opportunities. The immediate parties to the conflict are unable and/or unwilling to bear those costs themselves. Outside donors will need to contribute financially to create the political preconditions for a settlement. Economic integration is necessary but not sufficient by itself to resolve this conflict.

3.2 The Eastern Partnership countries: addressing economic obstacles to success

It is too early to evaluate how successful the start of the Eastern Partnership has been. Compared with the first partners' high expectations, progress has been disappointingly slow. The countries that first

responded positively to the offer to negotiate a DCFTA soon discovered that these negotiations were more complex and took longer than they had expected. Just getting started took time.

In the wave of enthusiasm that followed the orange revolution in Ukraine, the EU started negotiations with it on a DCFTA in February 2008. Progress was slow, not only because the Ukraine administration lacked sufficient technical and institutional competence about market economies, but also due to increasing uncertainty concerning the commitment of the country's political leadership to basic democratic values and its geopolitical role. The Joint Declaration of the EaP Summit, 28-19 September 2011 in Warsaw, noted that the negotiations on a DCFTA could be concluded by the end of the year. However, the verdict of the Tymoshenko trial postponed the initialling of the Association Agreement including the Deep and Comprehensive Free Trade Area until 30 March 2012. By then these negotiations had taken about four years.

The difficulties encountered in the negotiations with Ukraine gave the Commission cause for concern. It decided in the future to assess explicitly how prepared a partner country was for negotiating a DCFTA before actually opening negotiations with it. Following the Georgian-Russian war in August 2008, Georgia expressed interest in a DCFTA with the EU, which it previously had found too ambitious for its needs. The Commission sent a fact-finding mission to Georgia to conduct a feasibility study for a DCFTA and presented its assessment of Georgia's preparedness to negotiate such an agreement in March 2009. This assessment identified a number of issues where the Commission suggested that Georgia needed to make progress before negotiations could start. Georgia held discussions with Commission Services in the autumn of 2009 on how to fulfil its "key recommendations" in the fields of *inter alia* sanitary and phytosanitary standards, technical regulations and standards, competition policy and intellectual property rights. Progress was slow during 2010 and into 2011. However, the Joint Declaration of 28-29 September 2011, states that "it is envisaged that such [DCFTA] negotiations could start by the end of this year, provided sufficient progress has been made in fulfilling a number of remaining key recommendations."³¹ A technical preparatory meeting was held on 31 January 2012 and the first formal negotiation round was held 26-30 March 2012. The pre-negotiation stage itself thus took about three years.

The Commission conducted a similar feasibility study in Armenia in Spring 2008, sent a fact-finding mission in Spring 2009 and presented its key recommendations in June 2009. On 17 February 2012 the Council determined that Armenia had made sufficient progress to open negotiations in the coming months. The Commission conducted a feasibility study of Moldova in the fall of 2009 and sent a fact-finding mission there in spring 2010. It presented its assessment in late autumn 2010. Discussions with

³¹ Council of the European Union, 14983/11.

Moldova on how to fulfil the key recommendations started thereafter. Relatively rapid progress has been made since the Joint Declaration of the EaP Summit in September 2011 suggested that negotiations on a DCFTA with Moldova could “start by the end of this year [2011]” and the first technical preparatory meeting was held 18 January 2012 and the first formal negotiating round 19-23 March 2012. Armenia and Moldova thus progressed in less than two years from receiving key recommendations to launching formal negotiations for a DCFTA. Azerbaijan and Belarus are not yet WTO members, a precondition for a DCFTA, so for this and also for political reasons an assessment of these countries preparedness for a DCFTA is far off. Judging from experience to date “negotiations to start negotiations” on a DCFTA with the EU can take up to two to three years. The actual negotiations on a DCFTA are unlikely to take less than four years.

The EaP has focussed on initiating bilateral negotiations on DCFTAs with partner countries. The beginning was difficult but negotiations have been concluded with one country and have in 2012 started with three others. However, no EaP State has as yet opened negotiations with another EaP State on a DCFTA and there is no deadline and not even requirement for this in the EaP. This suggests that realisation of a free trade area encompassing the EU and key EaP States will take time. Consequently, conflict resolution in this region is likely to be slow. The reasons for this are the following:

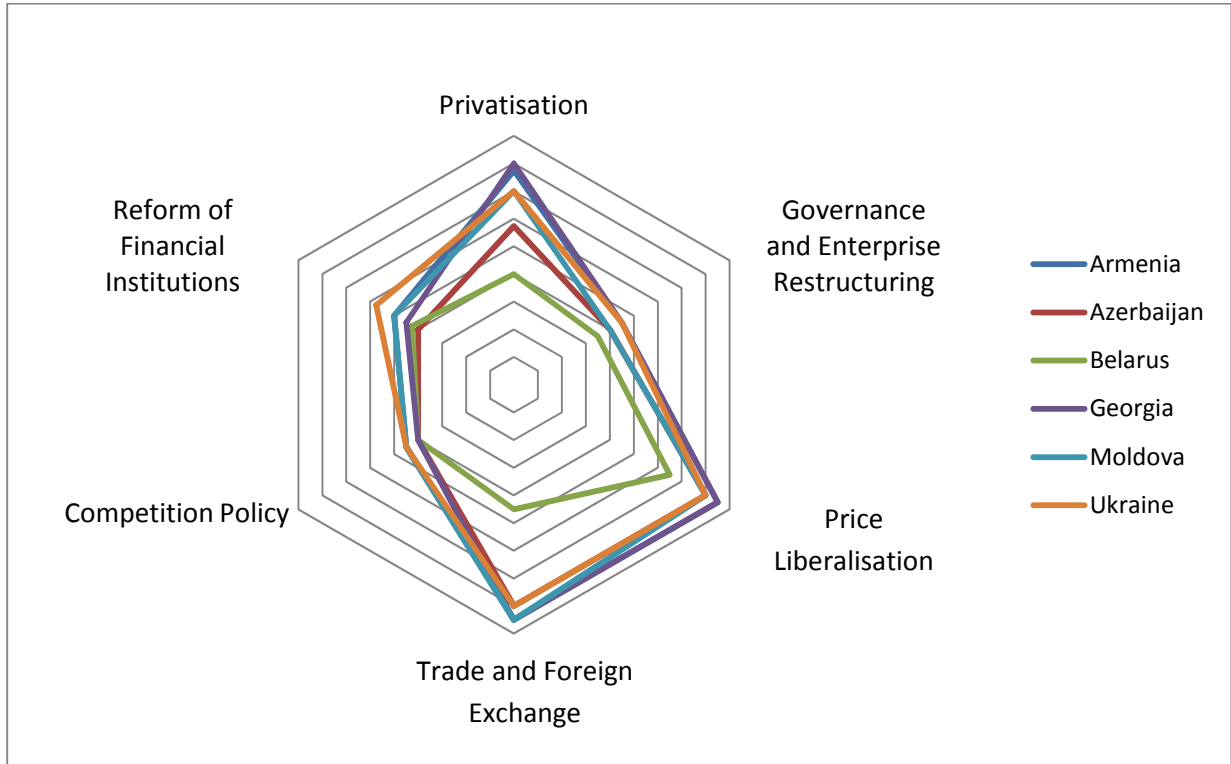
- (i) Insufficient transition from plan to market in the EaP countries.
- (ii) Low levels of intra-regional trade in the EaP.
- (iii) Mixed economic and political objectives of some participants.
- (iv) Starting with the most difficult tasks rather than with the easiest.

3.2.1 Poorly functioning market economies

To negotiate and implement a DCFTA is difficult for EaP countries since most have made only modest transition to a market economy since independence. Administrations in some former republics of the USSR still lack functioning national institutions and retain residual reflexes of central planning. Diagram 4 indicates that the EaP countries as a group have lower scores on the six EBRD transition indicators than the Balkans. Diagram 10 shows that the leading countries in the group (Ukraine, Georgia, Moldova) in 2009 had advanced little past the status of a rigidly planned economy in the key indicators (Competition policy, Governance and enterprise restructuring). All EaP countries achieve high scores in the ‘easy’ indicators (Foreign exchange, Price liberalization) but very low scores in the ‘difficult’ indicators (Financial reform, Competition policy, Governance).

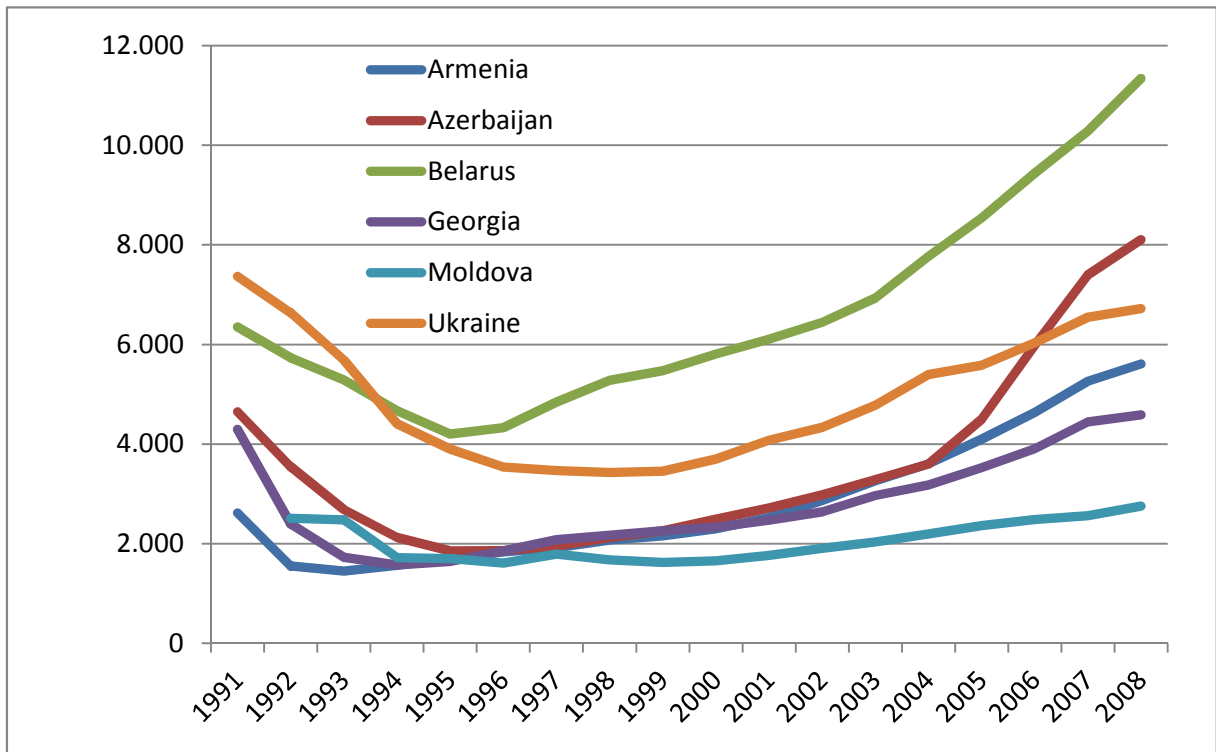
Partly as a result of slow progress toward a market economy, most of the EaP countries had not recovered their per capita income in real terms 15 years after independence (Diagram 11).

Diagram 10. EaP States: EBRD transition indicators 2009



Source: EBRD Transition Report 2010.

Diagram 11. EaP countries: GDP per capita 1991-2008 (PPP, constant 2005 international \$)



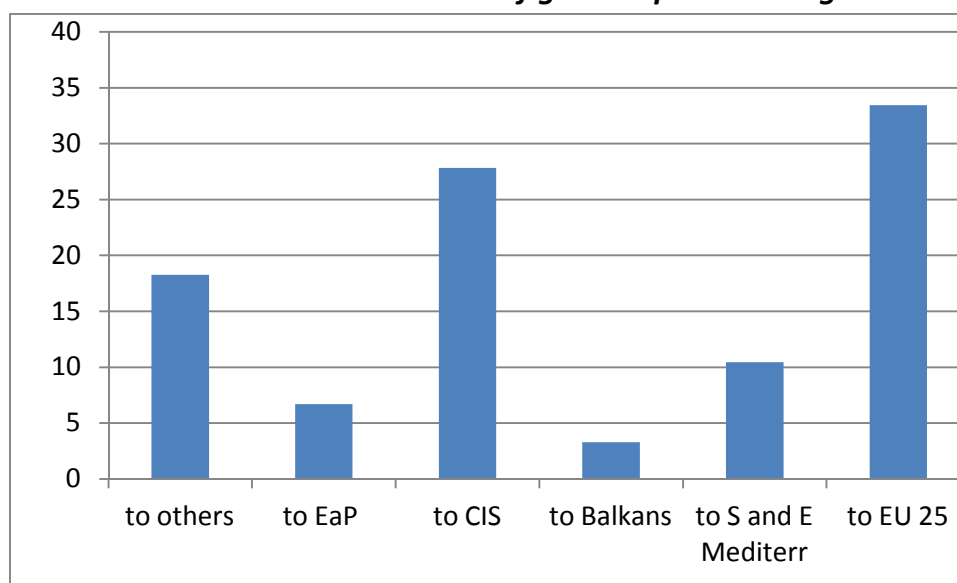
Source: World Bank, Development Indicators 2010.

To manage a DCFTA they must build the institutions necessary to administer a market economy and train staff in relevant parts of the *acquis communautaire*. This takes time and ensures that the process will be a long one.

3.2.2 Limited regional trade leverage?

Intra-regional trade in 2009 (Diagram 12) is small for the EaP six (around five per cent of exports) and even less important than intra-regional trade was in the Balkans (about ten per cent five years after the disruptions of the Yugoslav civil wars). Can regional trade be expected to supply leverage? The EaP six already have regional free trade agreements with each other, albeit very shallow ones, through participation in Community of Independent States (CIS). It is, therefore, unlikely that the priority of any pair of the EaP six will be to conclude a bilateral DCFTA.³² The other CIS countries, mainly Russia, account for almost 30 per cent of EaP countries exports. The European Union now accounts for over 30 per cent of EaP exports. While the EaP countries have dramatically reoriented their trade from East to West in the past ten years, the EU still takes a significantly smaller share of trade than in the Balkans or the Southern and Eastern coastal States of the Mediterranean. Current trade patterns suggest that deep and comprehensive free trade agreements both among the countries of the region and with the EU may have other objectives than strictly economic leading to initial hesitations.

Diagram 12. EaP countries: Distribution of gross exports to neighbours 2009 (%)



Source: World Bank, WITS.

³² However, when two EaP countries with significant (potential) trade flows between them each has a DCFTAs with the EU, they are likely to negotiate a DCFTA with each other in order to avoid the disadvantages of a hub-and-spoke system.

3.2.3 Mixed objectives – mixed minds

In both Georgia and Ukraine political considerations appear to have dominated economic considerations. Georgia, originally satisfied with a shallow agreement, opted for a DCFTA only after the August 2008 war with Russia. Ukraine aimed at a political reorientation to the West following the Orange revolution in 2003. In both countries, the DCFTA was seen as a means of improving national security in the face of an external threat with internal dimensions. A DCFTA was a second-best option in the absence of NATO membership. There was thus a mismatch between what these EaP governments really wanted at the time, namely national security faced with an external conflict, and what the EU really could deliver, namely closer economic integration. The DCFTA was an economic slow-fix applied in a situation where geopolitical threats to vital national interests required a quick-fix. Faced with the tedious nitty-gritty of trade policy and looking in vain for the side-payments that could divert the threat from a third part outside the EaP, the slow and hesitant start resulted in disappointment and frustration in the partner countries.

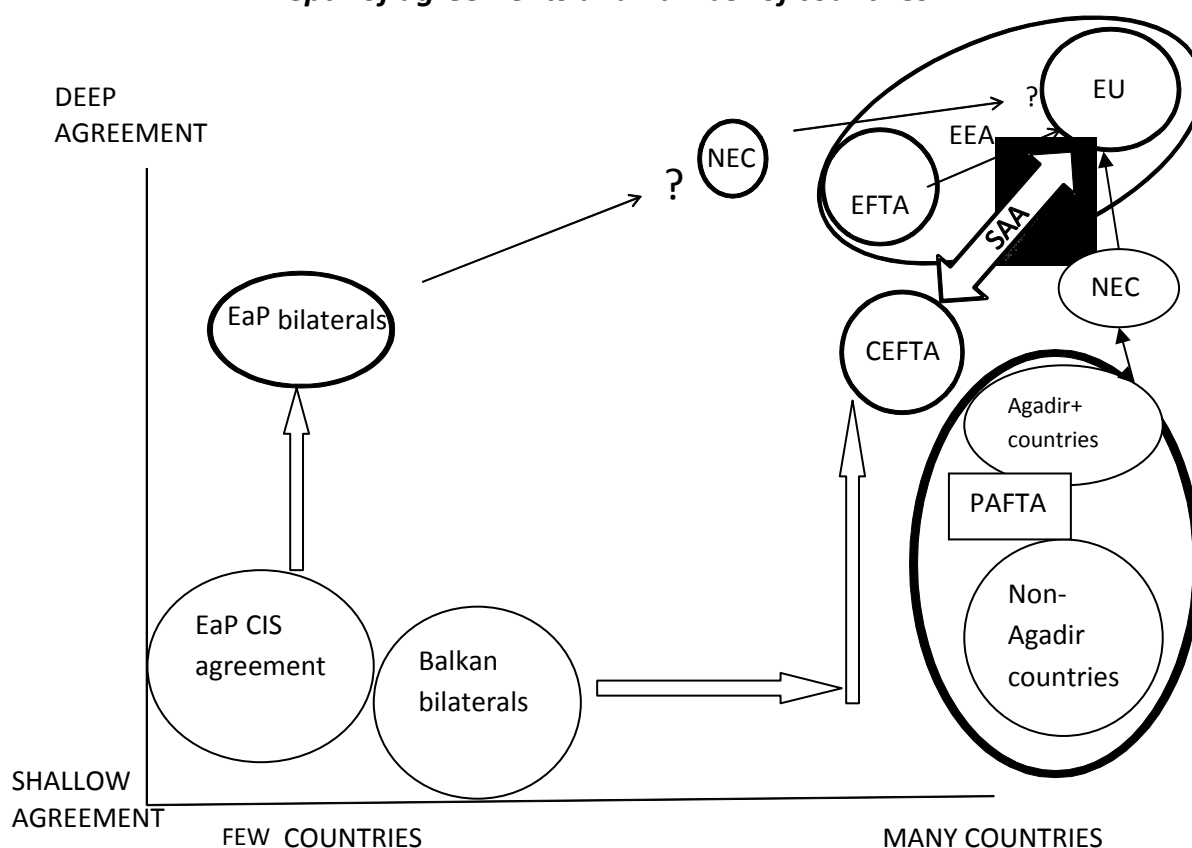
3.2.4 Starting with the most difficult

Both the Balkan countries and the Barcelona Process started with the easier negotiations and proceeded to the more difficult ones while the EaP were required to start with the most difficult – DCFTAs with the EU. This explains the apparent success of the BP countries and the initial difficulties of the EaP countries. The trajectories of the EaP countries, the Balkan countries and the Barcelona countries are illustrated schematically in Diagram 13.

The BP partners could choose to enter free trade agreements with each other and with the EU that were shallow – and most were. A target date (2010) was set for these but it was largely ‘voluntary’ the refusal of all Arab countries to negotiate even shallow free trade agreements with Israel was an important failure. The Balkan countries started with shallow agreements with each other before proceeding to negotiating a deep regional free trade agreement with each other and entering a Stabilisation and Association Agreements(SAA) with the EU. Each Balkan country could thus proceed on an accession track of increasing difficulty.

By contrast, the Eastern Partnership starts with the most difficult. It offers each of the six partner countries the possibility to conclude a deep and comprehensive bilateral free trade agreement with the EU. Wisely, the EaP does not specify a target date for this as the Barcelona Process did. Nor does it not make regional free trade among the EaP countries a condition for a bilateral agreement with the EU, as was the case for the Balkan countries.

**Diagram 13. Schematic presentation of the two dimensions of DCFTAs:
Depth of agreements and number of countries**



But much is demanded of the EaP countries in terms of approximating to the *acquis* and the difficulties they will encounter in doing this are significant. The benefits they receive are in the long-term. No prospect of accession is held forth nor is an accession track provided. The national security concerns of some of the EaP countries are addressed indirectly, at best. An institutional framework called the Neighbourhood Economic Community is proposed but not specified. It is understandable that the EaP partners might have second thoughts about accepting a regime in which they have no decision-making role after their long experience of 'democratic centralisation' in Moscow. Hence, it is not surprising that the EaP got off to a slow and difficult start.

4. Implications for the Partner countries

The disappointments that have characterized the EaP to date are well described, at least as concerns Georgia, in Messerlin et al. (2011). EaP countries appear to have underestimated what was negotiable (transition periods, technical assistance) as well as misjudged what was not (the scope of the *acquis* to be approximated). Hence, they entered the negotiations with an overly optimistic idea of both the cost and the time required to negotiate and to implement a DCFTA and failed to utilize their bargaining chips fully.

This was not the case for the BP partners since they did not face the requirement to negotiate DCFTAs. However, the new approach outlined by the High Representative and the Commission in May 2011 in response to the Arab Spring will change this by encouraging also the partners in the Barcelona Process to have similarly high ambitions (COM(2011)201). It is therefore important they avoid the initial mistakes made in the EaP.

4.1 Understanding what is negotiable and what is not

The Commission has essentially defined the elements that a DCFTA is to contain. It includes *inter alia* technical regulations, sanitary and phytosanitary standards, intellectual property rights, competition policy, state aid and liberalisation of certain services and capital movements. Since the EU is proposing to negotiate DCFTAs with a large number of countries, avoidance of trade diversion and extra administrative costs for both government and business means that there is very little scope to tailor the DCFTA to the wishes of each particular partner. Thus, the scope of the DCFTA is essentially a given. If it does not suit a partner country, it can always opt for a shallow free trade agreement. This means that more BP partners are likely to aim for a DCFTA.

However, while the goal is not negotiable, the way to reach it is. Both the *sequence* in which the various elements are adopted, the *time period* over which they are introduced (transition periods), the degree of *symmetry* in the 'concessions' exchanged and the *technical and financial assistance* provided to the partner country can vary and will be the subject of negotiations (Wijkman, 2011). Thus, attempting to negotiate permanent exceptions from the elements of the *acquis* defining the DCFTA is likely to erode negotiating credibility which can be better used to negotiating sequencing, transition periods, asymmetric concessions and financial and technical assistance.

4.2 Role of credibility and mutual trust in the negotiating process

The pre-negotiations and the negotiations for a DCFTA require a partner country to make a credible commitment to approximate the relevant *acquis*, present a credible time-table for such approximation and a credible plan to implement the *acquis* by an agreed-upon date. If a partner country is in a position to deliver a credible commitment it need not always 'deliver' substance before the negotiations start. The partner must establish a track record as a negotiating partner who delivers as promised. If it does this, negotiations on a DCFTA can start on a credible promise of delivery. Otherwise, the start will have to await delivery itself. Since the pre-negotiations and negotiations on a DCFTA can well take five to seven years, the partner country has time to approximate necessary legislation, train personnel and build institutions.

In addition, in areas where transition periods after the entry into force of the DCFTA have been negotiated, additional time to adapt is available.

If a partner fails to establish sufficient negotiating credibility, it will often have to pay up-front which may considerably prolong the negotiations. The Partner country may see this as the European Commission adding preconditions, when it is simply the result of low negotiating credibility.

4.3 Creating realistic expectations

A DCFTA requires the partner country to legislate and implement significant parts of the *acquis*. It is necessary to have a realistic view of the magnitude of this task and how long it will take.

It takes time to build institutions and train staff to manage market economies. Some countries have unrealistic expectations of the time required to be in a position to implement a DCFTA. This will lead to misunderstandings and disappointments. A realistic view of what is involved and how long it will take allows the partner to sequence events effectively, to negotiate appropriate transition periods if necessary, and to schedule technical and financial assistance accordingly. It is necessary to understand the magnitude of the task involved in negotiating a DCFTA. It can take up to ten years from initiating the first talks to the entry into force of the Agreement. Given that a DCFTA is a powerful instrument for modernising these economies, a partner must have a long-term time plan for taking each of the many required steps.

5. Implications for the European Union

Experiences to date suggest that the Commission lacked sufficient resources to negotiate in a timely manner with its EaP partners. The Commission will as of June 2012 negotiate DCFTAs with three EaP countries. In addition, the Commission will conduct a more ambitious policy vis-à-vis the BP partners following the review by the High Representative of the Union for Foreign Affairs and Security Policy and the European Commission of the European Neighbourhood Policy.³³ The stated policy to negotiate Deep and Comprehensive Free Trade Agreements with “willing and able partners” in the Mediterranean basin. This will require the Commission to devote significantly greater resources to the ENP. In general, the EU has raised its expectations on the BP partners, increased the incentives it provides them (“more for more”) and demanded greater efforts by the institutions of the ENP. In this intensified work the following elements deserve special attention.

³³ *A New Response to a Changing Neighbourhood*, Brussels 25/05/2011, COM(2011) 303. The proposed changes involve *inter alia* setting up a Partnership for Democracy and Shared Prosperity in the Southern Mediterranean, diversifying programmes to address countries’ specific needs, expanding support from government to civil society organizations through a new Civil Society Facility, providing also the Mediterranean countries with a Comprehensive Institution Building Programme, and to increase assistance in the ENP programme by €1242 million up to 2013.

5.1 Inform the Partner countries what a DCFTA entails

All countries require better information at various levels about what negotiating a DCFTA involves in order to avoid the deceptions initially experienced by the Ukraine and Georgia . This could be done in the multilateral components of the BP and the EaP respectively. However, the widely different levels of knowledge that these countries have, make it necessary to follow this up in a bilateral context.

Moldova is perhaps the best informed and prepared partner currently as a result of its negotiation of and participation in CEFTA 2006. Through CEFTA, government staff in Moldova has a better understanding of the nitty-gritty of trade policy involved in a DCFTA than in many other partners. This is borne out by the fact that Moldova is the ENP partner that has made the most rapid progress to date.

5.2 Give trade policy a lead role in the European Neighbourhood Policy

As the European Neighbourhood now offers to negotiate a DCFTA with more countries in the ENP following the Arab Spring, DG Trade will need more staff and larger resources. Already in the pre-negotiations, Georgia was at times more prompt than the Commission Services in submitting requested documents. The pressure on the Commission's personnel will increase as formal negotiations with Armenia, Georgia and Moldova on DCFTAs get underway by mid 2012.

It may also be necessary to strengthen DG Trade's lead role in the negotiations. As the lead directorate, it must have sufficient 'command and control' over the experts in other Directorates General involved in the negotiations. Often experts in specific areas give insufficient priority to DCFTA issues and tend to 'stiffen' conditions previously presented in a more general form. It is also necessary for DG Trade to have precise negotiating mandates on key issues from Member States. When these do not agree among themselves, Council may fail to give DG Trade sufficiently clear backing making it difficult for DG Trade to give quick and clear responses on key issues. In short, DG Trade needs a sufficiently 'complete' negotiating mandate. This problem is likely to increase since the Commission now has to report continually on negotiations to the European Parliament as well as to Member States in the Trade Policy Committee (TPC). Thus, it increasingly risks having its position on various topics 'revised' in practice as it reports to the TPC and to the European Parliament.

The partner countries need to understand that this is an inevitable part of the negotiating process given the institutional set-up of the EU. Complaining about it will not help. When all of these factors are at work, it is not surprising that a partner may feel frustrated. The EC and interested Member States need to address this problem by increasing the partners' awareness of the nature of the negotiating process.

It is possible that some of the strain on the Commission's resources could be eased by making greater use of secretariats for the EaP and the BP respectively. The idea of a secretariat for the EaP was considered but rejected. This rejection may have been due to experience of the secretariat set up by the Union for the Mediterranean. Two factors made this set-up less appropriate for the task at hand. It had two co-chairmen (one from the EU and one from the southern coastal states) to symbolise joint ownership. It was manned by experts seconded by member governments. Neither of these factors is conducive to achieving rapid results. A rotating presidency also provides joint ownership and tends to provide more dynamic leadership over time. A secretariat manned by professional experts owing allegiance to the organisation rather than to an individual government is a stronger force for changes agreed upon in common. This is not a structure conducive to effective action and should be reconsidered.

5.3 Increase financial and technical assistance

Many ENP States, like the EaP States, have a legitimate point in that they cannot now afford the expense of approximating and implementing parts of the *acquis*. Adopting a DCFTA certainly provides a welcome crash course in managing a market economy but one that most of these countries can ill afford. To postpone this 'course' until it is affordable would be penny-wise but dollar-foolish. An early start is necessary given that institution-building and personnel training are investments that take a long time to generate results. Thus, additional financial resources are sorely needed. The Commission needs to prepare such activities and mobilise funding within the framework of the ENP, and in particular to activate the Comprehensive Institution Building Programme. It has proposed additional funds for the ENP. But more will be necessary. The EU must mobilise and coordinate activities with interested Member States' own bilateral assistance programmes to this end and with financial institutions. Friends of the particular partner countries are prepared to provide such, long-term bilateral assistance. The EC and interested Member States need to coordinate their respective efforts during a rather long period until the ENP countries can assume a larger share of these costs.

5.4 Provide greater rewards for closer integration

The ultimate soft power exercised by the EU in the Neighbourhood, is the prospect of accession to the EU. The Western Balkans is a case in point. These countries did not respond actively to the offers to negotiate free trade agreements with each other and with the EU until the EU made the prospect of accession to the European Union credible. However, this soft power is currently not used in the ENP.

The original ambiguity of the ENP (“anything but membership”) does not give the ENP partners a membership prospect, rather the contrary. The EC’s offer of DCFTAs requires extremely poor countries to adopt large parts of the European Union’s *acquis* without the prospect of eventual accession to the EU. The EaP partners may, like once some EFTA States negotiating the European Economic Area, ask themselves: Why should we assume some obligations of membership but without a role in decision-making? Ambiguity concerning the limits of Europe is no longer constructive. It is time for the EU to state explicitly whether or not EaP countries are eligible for accession under Article 49, provided they meet the established conditionality.³⁴ Three countries – Georgia, Moldova and Ukraine – have expressed an interest in accession.

On the geographic definition that Europe extends to the Urals and to the Dardanelles this would include Belarus, Moldova and Ukraine, but possibly not the three South Caucasian states although Turkey is included (most of which lies east of the Bosphorus). These three States border Turkey and the outcome of that country’s accession negotiations will affect their own prospects for accession. Considering some or all of the EaP states to be European States, would provide dramatically increased incentives for them to negotiate a DCFTA with the EU (and with each other) converting bilateral tugs-of-war into the kind of competitive race to the front that eventually took place in the multilateral setting of the Stability Pact.³⁵ Providing them with an accession track, similar to the one the EU provided for the Western Balkans, does not mean that accession will take place any time soon, if at all. Potential candidates must still fulfil the Copenhagen criteria, settle conflicts with each other, allow the EU to absorb its new members and give the old members time to overcome their enlargement fatigue. One should have no illusions about how long this will take nor about the final outcome. But at least it would turn on a light at the end of what is a long tunnel.

Incentives of a different kind are necessary for those partners for whom accession is not possible. What can the EU offer these countries to ensure that the payoff in the form of a DCFTA with the EU (without the prospect of possible accession) and other countries in the region justifies the significant costs? The EU has proposed a Neighbourhood Economic Community (NEC) similar to the European Economic Area (EEA) that joins the EU and the EFTA countries in the internal market. Before the ENP countries negotiate DCFTAs with the EU and especially with each other they will wish to know what exactly the NEC is. The EU will have to provide an answer. One answer is that it is the institutional framework to administer the

³⁴ Article 49 states *inter alia* “Any *European State* which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union.” (italics here).

³⁵ See Gylfason and Hochreiter (2009, 2011).

increasingly closer integration of the EU with the coastal Mediterranean states and of the latter with each other. If so, the NEC will be an important contribution to conflict resolution in the EU's neighbourhood.

6. Conclusion

In this paper we have asked under what conditions the ENP is effective in resolving conflicts in the EU's neighbourhood, one of the main objectives of the EU. In the spirit of Montesquieu and Monnet, the basic hypothesis is that closer economic integration encourages governments to take steps to resolve conflicts and vice versa, creating a virtuous circle. The EU has a strong motive in this because conflicts in its neighbourhood spill over into the EU. We have identified some factors important for success.

1. The existence of active facilitators of compromise, able and willing to exercise both soft and hard power and with a stake in the outcome is essential. We note that these factors were all present in the Western Balkans, a potential black hole inside the EU. While this success cannot be copied, it can be studied. It is clear that in addition major external support must be forthcoming to resolve the conflict in the Middle East. It is also clear that conflicts in the South Caucasus are more difficult to resolve since they involve a third party.
2. The importance of potential intra-regional trade for the countries in the region determines how much leverage deep and comprehensive free trade within the region and with the EU can have on improving economic prosperity and political stability in the countries of the Neighbourhood. We note that this leverage appears greatest in the Western Balkans, is modest in EaP countries and extremely limited in most – but not all – States of the Union for the Mediterranean. Estimates of potential regional trade are necessary before any conclusions can be drawn. However, we believe it likely that an Agadir Plus (the Agadir four plus Israel and occupied territories and Lebanon) has a promising economic potential. This can be an important factor supporting other steps to settle this conflict.
3. Soft power is more effective and cheaper than hard power in persuading parties to resolve a conflict. The ultimate soft power exercised by the EU is the prospect of accession to the EU. The Western Balkans is a positive case in point. This suggests that the EU should state explicitly which EaP countries are eligible for accession under Article 49, provided they meet the established conditionality. The EU should then make an accession track available for these partners, similar to what it provided for the Western Balkans. This option would make a decisive difference for most, if not all, EaP States.

4. When all parties to a conflict are members of the region, it is easier for the concerned parties and the EU to strike a package deal. This was the case in the Western Balkans and is the case in the Union for the Mediterranean (in particular the conflict concerning Western Sahara). However, if a third party (outside the region) is involved in the conflict, as is the case in the EaP where Russia is involved in one way or another in several regional conflicts, different actors will need to be involved and different procedures tried.
5. The EU will have to resort to the exercise of hard power, thankless and costly, in at least some of the cases under consideration. For instance, the significant amounts likely to be involved to make progress in finally resolving the Israel-Palestine conflict exceed the capacity of the EU alone and will require the participation of the US and others. This will require the EU and the US to have a common policy on this issue and the EU's Member States as well.
6. Regardless of the ultimate final relationship of the countries of the Neighbourhood with the EU, a deep and comprehensive free trade agreement (regional and with the EU) must provide each country in the neighbourhood with benefits, which it considers commensurate with the costs. This is especially important given the low *per capita* income of these countries and the high costs of and their limited experience of approximating legislation and institutions on the *acquis communautaire*. This will require the EU and its Member States to provide technical and financial assistance to the neighbourhood countries on a scale exceeding current budget allowances and also to allow transition periods in applying the *acquis* of considerable longer duration than currently foreseen.
7. The EU and the countries in its Neighbourhood today face a truly historic opportunity. After about a century as part of the USSR, the EaP countries are now independent states aiming to establish market economies. The wave of popular demonstrations in North Africa and the Middle East will hopefully soon result in democratic governments there. The population of the Arab countries is now greater than the population of the communist countries of East and Central Europe was in 1989. A new world of opportunities is opening. A key part of this new world will be effectuating the difficult transition to market economies. A DCFTA is an effective instrument to modernize these countries' economies and to accelerate a country's transition to a functioning market economy. Sooner or later they must undertake this transition. It is better that it take place sooner rather than later. The role of the ENP must be to encourage and assist those willing to do this.

Annex 1. Selected indicators for the ENP and Western Balkan countries

	Country	GDP/cap	Size	Governance	Religion	Independ.	Ethnic groups
Balkans	Albania						
	Bosnia and Herzegovina	8000	4.6	Federal democratic Rep.	Islam 48%, Serb orthodoxy 35%	1992	Bosniaks 48%, Serbs 37%, Croats 14%
	Croatia	18000	4.5	Parlamenary Rep.	Roman Catholicism 88%, Atheism 5%	1991	Croats 90%, Serb 4.5%
	Kosovo	6600	1.8	Parlamenary Rep.	Majority muslim	2008	Albanians 88%, Serbs 7%
	Macedonia	9700	2.1	Parlamenary Rep.	Christian Orthodoxy 65%, Muslims 33%	1992	Macedonian 65%, Albanians 24%
	Montenegro						
Eastern Partnership Countries	Belarus	13900	9.6	Presidential Rep.	close to 100 Christianity	1991	Belarusian 81%, Russian 11%
	Ukraine	6700	45.9	Unitary semi-presid. Rep.	close to 100 Christianity	1991	Ukrainian 78%, Russian 17%
	Moldova	3100	3.6	Parlamentary Rep.	close to 100 Christianity	1991	Moldovan 70%, Ukrainian 11%, Russian 9%
	Armenia	5100	3.3	Presidential Rep.	predominantly Christians	1991	Armenian 98%
	Azerbaijan	10300	9.0	Presidential Rep.	Muslim 99%	1991	Azerbaijani 91%
	Georgia	5100	4.6	Unitary semi-presid. Rep.	Orthodox Christianity 94%	1991	Georgian 84%, Azeri 6.5%, Armenians 5.7%
North-African Countries	Algeria	6900	35.4	Semi-presid. Rep.	Muslim 99%	1962	Algerian Arabs
	Marocco	4800	32.2	Constitutional Monarchy	Muslim 99%	1956	Berber 78%, Arabs 20%
	Tunisia	9000	10.4	Presidential Rep.	Muslim 98%	1956	Arab-(berber) 98%
	Libya	13800	6.4	Dictatorship	Muslim 97%	1951	Arab and Arab-Berber (predom.)
	Egypt	6400	80.0	Military junta	Muslim 90%	1922	Egyptians 99%
	Israel	29500	7.7	Parlamentary Democracy	Jewish 80%, Muslim 16%	1948	Jewish 75%, Arab 21%
	Jordan	6000	6.4	Constitutional Monarchy	Muslims 92%	1946	Jordanians, Palestinians, Iraqis
	Syria	5000	22.5	Secular single party state	Muslim 87%	1946	blend of aramaic speaking Syriac groups

Source: Wikipedia data kindly assembled by T. Y. Mattä, Banque Centrale Luxembourg.

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