

## CHALLENGES AND OPPORTUNITIES OF EUROASIAN ECONOMIC INTEGRATION

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The enlarged European Union, the candidates and potential candidates for EU membership in Southeast Europe, the countries in EU Eastern Neighbourhood (Eastern Partnership countries – EaP – Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) and, last but not least, Russia comprise a highly diverse – both economically, culturally and politically – group of countries on the Euroasian continent. All these countries share, notwithstanding existing differences, a common European history with all associated problems, historical contradictions and development challenges. Their multifaceted economic, political and institutional relations – indeed the challenges of their future integration and development scenarios for positioning in the globalized world – are the subject of the new multidisciplinary research project launched by IIASA in Laxenburg, Austria. This presentation outlines selected economic issues to be analyzed within this project.

Both the EU and Russia often perceive regional integration steps of EaP countries - either with the EU or with Russia - as alternative rather than complementary (as is currently the case with Ukraine, Armenia and Moldova). In this geopolitical rivalry, the EU is effectively discouraging any regional integration in the post-Soviet space involving Russia (and there is hardly any integration in this region without Russia) whereby Russia is attempting the opposite. The EU is a much stronger economic player. However, the dominance of Russia in post-Soviet integration arrangements also opens a plethora of challenges. The analysis of costs and benefits related to alternative integration schemes is plagued by serious problems. There are important structural and regional dichotomies in the commodity trade composition, in particular with respect to Belarus and Ukraine. With the important exception of Russia, the intra-CIS trade structures are more “advanced”, still reflecting the inherited links from the Soviet period and a limited restructuring progress.

Ukraine’s possible membership in the Belarus-Russia-Kazakhstan Customs Union (BRK-CU) has been a subject of heated debates. The country has so far declined a full-fledged BRK-CU membership. Apart from tricky political issues, an important reason for Ukraine’s reluctant position is its WTO-related commitments and the compatibility with the prospective DCFTA (Association Agreement) with the EU. Available estimates of economic effects of the alternative integration arrangements differ by a wide margin, depending on sources, methods and underlying assumptions. There seems to be little (economic) justification for Russia prompting Ukraine to join the BRK-CU. For Ukraine, on the other hand, economic (and other) linkages to Russia are rather important whereby the implementation of the DCFTA with the EU could bring benefits in the medium and long run – especially regarding the pressure on reforms which would lead to a significant restructuring of the economy and higher FDI inflows. In this respect, the earlier experience of former COMECON countries may provide a useful reference: trade integration with the EU was advancing rapidly and inflows of FDI brought new technologies, higher quality standards, know-how in management and marketing. Last but not least, FDI were crucial in raising the energy efficiency of the recipient countries’ economies (which remains an important

challenge for Ukraine). In this way, the former COMECON countries have successfully restructured their industrial sector, which in many cases became competitive on the European scale and has been increasingly gaining market shares.

Although in the case of Ukraine – unlike in the above-mentioned countries – one important factor behind this success story, namely the ‘carrot’ of prospective EU membership, is missing and is unlikely to be in place any time soon, Ukraine could still replicate these developments via closer EU integration. The latter does not rule out that Ukraine maintains close economic links with Russia, e.g. via a preservation of the current free trade regime (albeit with ‘exemptions and limitations’). On the contrary, Ukraine – where wages are standing at around half of the Russian level – could potentially attract European investments into production destined for the Russian market. However, a full-fledged membership of Ukraine in the BRK-CU is only realistic if: (1) the Common External Tariff of the BRK-CU does not exceed Ukraine’s level, and (2) the BRK-CU members – and first of all Russia – advance their own integration with the EU at least to the stage of a free trade area. A closer EU-Russia integration is a potentially preferred option in the future which, when accompanied by a parallel integration of the EaP countries, would lay the foundation for a Pan-European Economic Space and a wider Euroasian integration.