

NON – PAPER

EXPANDING ON THE PROPOSALS CONTAINED IN THE COMMUNICATION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL ON “STRENGTHENING THE ENP” – COM (2006) 726 FINAL OF 4 DECEMBER 2006

ENP – A PATH TOWARDS FURTHER ECONOMIC INTEGRATION

Summary

Deeper economic integration between the EU and its neighbours is a shared interest of all concerned. It is neither benevolence on the part of the EU, nor an imposition. It will be the result of our shared trade and economic interests and complementarities between the two sides. Fostering greater prosperity will be crucial not only for its own sake, but also to increase stability and security as well as to respond to a globalised economy.

The EU's neighbours are highly diverse, as are the EU's relations with each of them. Almost all face major reform and development challenges. This means that any approach to economic integration must take a long-term perspective and be tailored to each country's specific situation. Also, the reforms required for such an ambitious agenda are far from simple. The EU should support these reform processes: by sequencing phases, by setting clear objectives, by technical assistance and by clear incentives not only at the end of the road, but also along the way.

The first phase towards deeper economic integration has started, through implementation of the ENP Action Plans that foresee regulatory convergence in many areas of interest to partner countries and the EC. The next step will be deep and comprehensive free trade agreements, which will liberalise substantially all trade and codify regulatory alignment through binding commitments and a dispute settlement mechanism. This is an ambitious medium- to long-term goal for most partners, and will create the basis for deep economic integration between the EU and ENP partners on the one hand and among ENP partners on the other. Establishing, let alone implementing, a series of such agreements with ENP partners will be an arduous process, requiring commitment, political will and time.

Concurrently, the EU will continue its efforts to promote trade and economic integration within the ENP region. In addition to bilateral free trade agreements with the EU, ENP partners will be encouraged to conclude bilateral or regional agreements to boost South-South or East-East trade and investment and possibly East-South. The challenge posed by this objective should not be underestimated. Intra-regional trade is currently at low levels in the Mediterranean region; boosting it will require inter alia political will, substantial efforts towards harmonisation of regulatory systems and the development of transport networks.

Looking beyond this crucial phase of integration, this non-paper also sketches the concept of a Neighbourhood Economic Community (NEC) as a possible ultimate goal. At present this can only be articulated as a long-term vision. Its precise objectives and shape require very considerable further thought and debate between all concerned. This non-paper aims to pose the challenge and contribute to the discussion.

Introduction

As noted in the Commission's Communication of 4 December 2006 on "strengthening the European Neighbourhood Policy"¹, deeper trade and economic integration with ENP partner countries will be a central element in ensuring the success and credibility of the policy. The purpose of this paper is to expand on the proposal in the Communication to enhance the trade and economic component of the ENP.

The economic integration of ENP partner countries with the European Union is not only an incentive and reward for economic and regulatory reform in our neighbouring countries; in a globalised economy, it is also of **interest to the EU** to build a common EU-ENP area of economic integration where the same or similar regulatory standards apply. Yet the challenge with regard to most ENP partners is how to engage them to pursue their ongoing reform processes and to lock in the results. Any approach will need to be **gradual** and, in the field of trade, include an element of asymmetry to take into account the circumstances of each partner country.

In the Communication of the Commission on "a single market for citizens" of 22 February 2007², the ideas of extending aspects of the Internal Market policy through the ENP, of increasing benchmarking of rules against practices in non-EU countries and of promoting European standards in ENP partner countries have already been evoked.

We will need to offer **all willing and able ENP partners** clear benefits of deep trade and economic liberalisation with the EU. This entails including within the EU's liberalisation offers improved access in the areas of trade and economic potential and interest for each of our partners.

The Commission proposed in its December 2006 Communication a series of deep free trade agreements, having a "beyond-the-border" impact on reform measures in our ENP partner countries themselves, as the most appropriate way forward. Thanks to increased regulatory convergence, such a network of FTAs would considerably facilitate the flow of goods, capital and services in the whole neighbourhood area. However, the negotiation of deep and comprehensive FTAs with ENP partners will entail significant challenges for ENP partners.

The December 2006 Communication also reiterated the need to **enhance regional cooperation** between ENP partners themselves. Whereas there has been some progress

¹ Communication COM (2006) 726 final;

² Communication COM (2007) 60 final;

made in this respect, the difficulties to enhance this regional integration should not be underestimated, particularly in the case of Mediterranean partners where political considerations play a crucial role. Moreover, the East-South dimension still needs to be explored.

The long-term vision is that this network of deep and comprehensive FTAs could eventually be transformed into a **Neighbourhood Economic Community**. An open dialogue with ENP partners on the scope and development of a NEC would be essential to ensure **joint ownership** of this process and goal. The ultimate realisation of a NEC would be the creation of an area of economic integration common to the EC and its neighbouring ENP partners.

This paper provides an initial outline of the steps for achieving such deeper economic and trade integration with all our ENP partners, as well as sketching the challenges that would need to be met along this path.

State of play

The **degree of trade liberalisation varies** considerably with and among our ENP partner countries.

- The EU grants to some ENP partners autonomous trade preferences under the GSP (Generalised System of Preferences) or GSP+ system.
- Negotiations on a deep and comprehensive FTA with Ukraine, as a core element of an EU-Ukraine new Enhanced Agreement, will be launched once the WTO accession process of Ukraine has been finalised.
- We have traditional FTAs with most of our Euro-Mediterranean partners. Negotiations are ongoing with Mediterranean ENP partner countries to liberalise trade in services and establishment, to further liberalise trade in agriculture and processed agricultural products and to establish a dispute settlement mechanism. Even after their conclusion, our FTAs with Mediterranean partners will not be deep and comprehensive, particularly in terms of trade and economic regulatory aspects³. Further deepening of our agreements is needed and will be a major qualitative improvement of our relations with Mediterranean partners but we should not underrate the difficulties and challenges of these additional negotiations for them.
- A recent feasibility study found that Moldova was not yet in a position to establish a free trade area with the EU; consequently the EU is in the process of providing additional autonomous trade preferences to this ENP partner .

³ There are a number of issues which the EU intends to include in its deep and comprehensive FTA with Ukraine and for which the Association Agreements with Mediterranean partners do not include binding commitments, such as sanitary and phytosanitary practice (SPS), intellectual and industrial property rights (IPR), public procurement, trade facilitation, competition etc.;

- A feasibility study on FTAs with Armenia and Georgia has been launched.
- Some Mediterranean ENP partners have started discussions on free trade among themselves (the Agadir Agreement concluded among Egypt, Jordan, Morocco and Tunisia is now legally in force although not yet fully operational). Israel has an agreement with Jordan. But the whole process of South-South economic and trade integration is far from being completed, not least due to political considerations.
- While some Eastern European ENP partner countries are linked between themselves by a series of FTA agreements, these contain major exceptions and are essentially focused on trade in goods.
- East-South economic liberalisation has not yet started and a preliminary analysis of current trade and investment flows does not suggest that this may become a priority for our partners.
- Negotiations on Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAAs) are ongoing on a bilateral basis.

This is evidently still a modest starting point from which to consider an economic community as a long-term vision. It therefore seems appropriate to first anticipate the probable and achievable steps to deeper integration over the medium term.

In short, we currently have an increasingly **complex system of “hub and spokes”** trade agreements with and among ENP partner countries, with different levels of liberalisation and ambition. Deeper integration and the ultimate development of a common EU-ENP economic area is clearly an ambitious goal. Achieving it will require political courage from all involved. Yet such courage is essential if we are to meet the challenges to the region of increasing globalisation⁴, including the forces of global competition, the impact of new technologies and the ramifications of demographic changes.

Scope for deeper integration - a long and winding path

Deeper economic integration is a **lengthy and complex multi-step process**, with each step representing a major progression: (1) full implementation of the ENP Action Plans; (2) agreement and implementation of deep and comprehensive FTAs; (3) increasing intra-regional trade between ENP partners, depending on their willingness to integrate further; and (4) agreement among EU Member States and ENP partners to work towards building a NEC, including discussion on its possible scope and institutional framework. Over the coming years, commitment to putting the first three steps into practice will constitute a major challenge.

⁴ As elaborated in the Commission’s Communication on “Global Europe: Competing in the World”, COM (2006) 567 final, 4 October 2006;

1. Implementation of the ENP Action Plans

In their Chapters on “trade-related issues, market and regulatory reform”, all ENP Action Plans concluded to date with twelve neighbouring partner countries contain commitments to implement or support reform measures in many areas directly relevant to economic integration⁵. Other Chapters refer to equally important measures such as fighting corruption or money laundering and economic crime, judicial and legal reform, the functioning of the market economy, or the reform of flanking sectors – from transport to information society. The Commission has recently reported on progress achieved in these areas⁶, which all have economic relevance.

The amount of effort required for ENP partner countries to fulfil the Action Plan commitments is considerable. Particular attention must be given by the EU to supporting their implementation. Policy dialogue, including clear objectives and sequencing actions, will be important to support reforms and efforts to improve the trade and economic regulatory environment and the investment climate. Technical assistance, including TAIEX and twinning, provided under the European Neighbourhood and Partnership Instrument (ENPI) will also play a key role.

2. Ambitious trade agreements

Traditional FTAs covering essentially industrial goods and, to a lesser extent, agricultural products were concluded between the EC and Mediterranean ENP partners in the past. As mentioned above, even after the conclusion of the ongoing negotiations, our Association Agreements with Mediterranean partners will still lack provisions on crucial areas. Over time, the full implementation of the ENP Action Plans, particularly on regulatory areas, will **prepare the ground** for a new generation of “deep and comprehensive” FTAs.

A deep and comprehensive FTA should cover substantially all trade in goods and services between the EC and ENP partners, including the products of particular importance for our partners, and should include binding provisions on the implementation of trade and economic regulatory commitments. Existing agreements with Mediterranean partners should accordingly be deepened and expanded to include other regulatory areas, such as sanitary and phytosanitary practice (SPS), intellectual and industrial property rights (IPR), public procurement, trade facilitation and competition.

Following Ukraine’s accession to the WTO, a deep and comprehensive FTA will be established covering: trade in industrial, agricultural and processed agricultural products; trade in services; and a wide range of regulatory areas, with binding provisions where

⁵ Trade relations, customs, technical regulations, standards and conformity assessment procedures, restrictions, sanitary and phytosanitary issues, establishment and company law, services, movement of capital and current payments, movement of persons including workers and social security coordination, taxation, competition policy and state aid, intellectual and industrial property rights, statistics, public procurement, enterprise policy as well as public internal financial control;

⁶ See Progress Reports annexed to the Communication of 4 December 2006, COM (2006) 726 final;

practicable. Moreover, a dispute settlement mechanism will apply for all areas of the FTA.

The intention is to negotiate such agreements with all willing and able ENP partners. Work towards this goal is underway, for example through the feasibility study launched for Armenia and Georgia. Results of trade sustainability impact assessments should be integrated into this process in order to identify potential economic, social and environmental implications. This deep FTA process offers the ENP region a **powerful instrument for further integration**. Progress towards a harmonised regulatory framework, along with substantially liberalised trade, will bring intensified trade and investment flows.

This ambitious phase of economic integration should be pursued with a certain level of asymmetry if appropriate. The FTAs will need to be **tailored and sequenced carefully** to take account of each partner country's economic circumstances and state of development. Negotiation of deep and comprehensive FTAs with ENP partners needs to be an incremental and dynamic process, allowing each member to participate at a rate reflecting their individual circumstances. Each FTA will need to include the areas of economic potential and interest for the parties involved, and (under WTO rules) cover nearly all trade. As noted in the December 2006 Communication, such differentiation needs to remain at the heart of the ENP⁷. In light of their complexity and ambitiousness, these FTAs will necessarily be medium-term – and indeed for some ENP countries long-term – objectives.

Further monitoring of the implementation of ENP Action Plans will remain vital to track the **compliance and enforcement** of existing commitments to regulatory alignment. In due course this will need to be extended to the compliance and enforcement of the deep and comprehensive FTAs, as and when they are negotiated.

Only over time will it become clearer to what extent ENP partner countries are willing and able to **align with EU standards**. The very nature of deeper economic integration calls for a high degree of alignment that could become a key element of EU/ENP relations, if genuinely espoused by all stakeholders. In this context, it should be noted that deep and comprehensive FTAs are only intended to cover selective alignment with the EU *acquis* in regulatory areas and that the degree of alignment may well differ amongst partners.

Accession to the WTO is an important step for ENP partners and one which the EU will continue to support since it would contribute to the strengthening of the partners' administrative and legal structures. Our deep and comprehensive FTAs would need to take into account the global trade agenda, including the outcome of the Doha Round of WTO negotiations, and must be compatible with **WTO Rules**.

The outcome of the current discussions within the EU and stakeholders on the simplification of **rules of origin** would also have to be taken into account. Consideration

⁷ Communication COM (2006) 726 final.

will have to be given to the conditions for the subsequent participation of ENP partners in diagonal cumulation of origin. This is a key instrument in our aim to enhance intra-regional integration.

3. Intra-regional trade – willingness to integrate further

FTAs are a way of achieving deeper integration with selected regional partners but there is a need for deeper economic integration **within** the neighbourhood.

Existing economic barriers, differing political relationships and the preparedness of ENP partner countries to integrate further with each other have so far prevented substantial integration between **Mediterranean ENP partners**. That said, and as mentioned above, there have been recent developments such as the Agadir Agreement which should be encouraged. Indeed, the EU should encourage ENP partners to conclude amongst themselves FTAs which are as “deep and comprehensive” as possible so as to stimulate intra-regional trade.

The situation in **Eastern European ENP partner countries** is different, with more integrated markets, a long-established transport network and traditional trading contacts. Their trade and economic integration should be further encouraged to cover areas beyond trade in goods.

It remains to be seen whether ENP partners would subscribe to such a wide-reaching approach to economic integration. The slow pace of South-South integration is not an encouraging indicator in this regard. **Serious discussion and review** of the impact of this slow ongoing progress on integration on the basis of current commitments might first be needed to address concerns.

4. Building a Neighbourhood Economic Community (NEC)

In the long term, the EU and ENP partners may decide to integrate even deeper, into a **Neighbourhood Economic Community (NEC)**. A NEC would boost trade further among ENP partners via the elimination of both tariffs and non-tariff barriers and by establishing a minimum base of common behind-the-border rules, thereby creating a common regulatory space. This would expand the size of the common market, stimulate growth in all ENP partners, and boost productivity through a better exploitation of economies of scale. A NEC would improve business climates in ENP countries and further boost investment opportunities for all partners. It would also help the EU and its partners face the challenges and seize the opportunities of increased globalisation. A NEC’s effects would go beyond trade enhancement as it would also contribute, for example, to better consumer protection by improving sanitary and phytosanitary practice.

The EU and ENP partners would need to develop and pursue **flanking policies** to support the effective functioning of a NEC, including in key sectors such as energy, environment, transport and human capital.

If and when the EU and ENP partners show **sufficient willingness to integrate** into an economic community, the issue of its **institutional framework** will need further exploration. Any change from the bilateral/regional “hub-and-spokes” approach to a broader regional approach would need to be supported with appropriate structures, including the possibility to let partners have a voice in policy-shaping. The EU and ENP partners would need to take a conscious decision to move to this phase of institutionalising a NEC, which would entail addressing several political, legal and budgetary questions. Not only would there need to be new institutions to manage a NEC, but the impact on other Community institutions would need to be seriously examined.

The benefits of moving towards creating a NEC would need to be weighed against the challenges involved. Bringing such benefits within reach will require considerable commitment and efforts from all sides.

Follow-up

In summary, this paper has provided an initial outline of steps for achieving deeper EU-ENP economic integration and the challenges involved. Only through further discussion and consultation with stakeholders can the precise methodology for proceeding along this path be developed.

In light of the issues outlined in this paper, it might be helpful to undertake a **series of exploratory activities** in EU Member States and ENP partner countries over the next few years with the objective of exploring ways to enhance economic cooperation in the neighbourhood. These activities could include, for example, conferences, meetings, debates and public consultation. By 2015, the EU and ENP partners could assess the progress achieved, including the overall level of economic integration within the EU-ENP area obtained through the deep and comprehensive FTAs negotiated by then. A key step at an appropriate time will be debate within the EU and consultations with ENP partner countries to ascertain if there is **sufficient willingness** to go down the path towards establishing an economic community.

Conclusion

From the outset, it is clear that the creation of a common EU-ENP area of economic integration is a highly ambitious and long-term objective. Achieving it will require political courage from all involved. A Neighbourhood Economic Community goal cannot be promoted precipitously but needs to be developed over time in consultation with all stakeholders.

To take account of the differences in partner countries’ political and economic situations, the focus first and foremost needs to be on fully implementing the commitments made under the ENP Action Plans and negotiating deep and comprehensive bilateral and regional FTAs with and among ENP partners. This is necessarily a flexible, step-by-step approach, with deeper integration dependent on the willingness and capacity of the parties involved.

Such an integration process would be distinct from the process of EU enlargement, and the eventual development of a NEC with ENP partners would not in any way prejudge the possible future development of their individual relationships with the EU, in accordance with Treaty provisions.

In the context of increased challenges of globalisation facing the EU and its neighbourhood, and notwithstanding the inherent challenges, it is in the mutual interest of the EU and ENP partner countries to commit to achieving deeper economic integration in the region.