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CHARACTERISTICS OF THE LARGE CORPORATION-BASED, BUREAUCRATIC MODEL AMONG OECD COUNTRIES – AN FOI MODEL ANALYSIS

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Abstract

Deciding on the development path of the economy has been a delicate question in economic policy, not least because of the trade-off effects which immediately worsen certain economic indicators as steps are taken to improve others. The aim of the paper is to present a framework that helps decide on such policy dilemmas. This framework is based on an analysis conducted among OECD countries with the FOI model (focusing on future, outside and inside potentials). Several development models can be deduced by this method, out of which only the large corporation-based, bureaucratic model is discussed in detail. The large corporation-based, bureaucratic model implies a development strategy focused on the creation of domestic safe havens. Based on country studies, it is concluded that well-performing safe havens require the active participation of the state. We find that, in countries adhering to this model, business competitiveness is sustained through intensive public support, and an active role taken by the government in education, research and development, in detecting and exploiting special market niches, and in encouraging sectorial cooperation.

Keywords

Development Factors, Development Paths, FOI Model, OECD Countries

I. Introduction

As growth rates have slowed across the developed world since 2008, the topic of economic development has become more relevant than ever. Governments across the globe seem to be struggling to find the right economic policy instruments that will make their economies

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more dynamic. The aim of this paper is to contribute to the literature of economic development by identifying crucial development factors, and describing a special development path that we call the large corporation-based, bureaucratic model.

The method used to deduct the large corporation-based, bureaucratic model is called the FOI model. It was developed by the authors within the framework of a research project funded by the Hungarian Scientific Research Fund between 2009 and 2013. The FOI model is based on the assumption that there are several ways to achieve economic development. Its structure was formulated in such a way as to make it possible to capture the significant differences in the development paths taken by different nations. Using the sample of the OECD countries, we detected three viable development paths, one of them being the large corporation-based, bureaucratic model.

The large corporation-based, bureaucratic model is characterised by a strong and competitive business environment, but the countries choosing this path are also characterised by a strong state presence. We used country studies to be able to show how these two elements can be combined successfully, and our findings may therefore be used to shape economic policy decisions.

II. Growth and development in economics

Growth and development are mentioned almost as synonyms in this paper, although the literature usually addresses them separately. The simplest approach is to say that growth is the narrower, and development is the more complex class, as growth is usually defined as an increase in certain quantitative variables, while development describes a process of moving from a lower level of quality to a higher one (Szentes, 2011). As the measurement of the phenomena economics usually deals with is in any case problematic, the most popular, formalised growth models (e.g. Domar, 1947; Harrod, 1948; Solow, 1956; Romer, 1986 and Lucas, 1988) concentrate on national income or on its per capita version. These models therefore map the problem of growth/development through the quantitative change of a single indicator, so they offer tools to analyse the problem of growth, the narrower category.

However, GDP – being an aggregate indicator – veils more profound processes that are crucial for development, such as the structure of the economic system, changes in employment, income distribution or the institutional framework, etc. For this reason, we will from now on use the more complex approach to development whenever we touch upon issues of growth and/or development paths, factors of growth and/or development, meaning that we interpret development as a combination of two things: growth in the indicators of national income, and the modernising of the socioeconomic structures.

Theories of development

Different schools of economics have different views on the rules of the economy, and neither do they agree on the basic assumptions; hence, a wide variety of theories have been developed over the centuries. While most schools implicitly assume that the models used are universal, List (1841) was convinced that the classical theories may only apply to the most developed economies; the followers of new institutionalism (see Williamson, 2000, for example) point out that the institutional structure of different countries can be very different. A similar confrontation can be observed regarding development paths. It is widely accepted that development is unilinear, meaning that all countries have to go through the same development stages (with timing being the only difference among them). Veblen (1919), on the other hand, argued against the teleological approach of economics, and suggested an evolutionary one instead.

It worth mentioning that mainstream theories do not consider the effects of national interests and bargaining power in their models; heterodox schools, on the other hand, cannot accept the independent development of countries (although there is no agreement among them considering the exact nature of the interdependencies). It may seem natural to choose the countries and national economies as the unit of analysis; Wallerstein (1974), however, when describing the economic history of medieval Europe, concludes that modernisation cannot be understood within the framework of the national economy. He instead chooses the world system as the unit of analysis.

Some scholars have developed models with few explanatory factors; others have gone for more variables. The well-known growth theories pick one or two variables; Porter's diamond model (1990) combines four quite complex factors; the empirical study of Barro (1998) of 100 countries over 30 years finds seven factors that are strongly connected to the growth rate of real GDP.

The factors of development identified in economics literature can be categorised along many principles, but the location of factors is probably the most important dividing line. One camp of economists traces back differences in economic development to reasons that can be found inside the country. They point to factors whose presence (e.g. physical or human capital) or lack (e.g. government failures) enables high growth rates. Another group of economists finds the causes of underdevelopment in outside factors. Usually these theories take the differences in the development level as given in the world economy, and they assume that these differences lead to asymmetric dependencies. The asymmetric dependencies, on the other hand, make it very difficult for underdeveloped countries to catch up with the rich world. The inside-outside distinction among the factors of development plays a crucial role in the model developed during our research.

The inside factors of development

Adam Smith (1776) saw the division of labour as the main source of wealth. Those countries that are able to extend the division of labour among their firms and citizens can become wealthier, as they are able to produce greater quantities from the same labour input. The main finding of the Harrod-Domar model (1947, 1948) is that investments are the key to economic growth. Investments, however, are mainly dependent on the savings rate. Around a decade later, Solow (1956) pointed out that investments and savings cannot contribute to growth in the long run. In his view, long-term economic growth is driven by technical change.

Keynes (1936) suggested that crises are generated by limits in demand, and the latter may be strengthened by large income differences. The speculative demand for money of those who are well off can be especially high, which prevents a substantial part of the income from turning into effective market demand. Inequalities in income distribution can thus be a setback for balanced growth.

Schumpeter (1934) stressed that cyclical fluctuations should be regarded as a natural part of the economy, as entrepreneurs may only draw profits if they break the status quo of equilibrium. The way to break the status quo is through innovation, which therefore becomes the primary driver of cyclical development. McClelland (1957) also emphasised the importance of the entrepreneurial class. In his view, entrepreneurs are the pioneers of development, and their biggest motivator is not profit, but the achievement of some special goals (N-achievement).

When the big colonial empires collapsed, several academics explained the situation of the underdeveloped former colonies with a value system and social structure that was different from the Western one. In underdeveloped countries the rural characteristics of society are dominant, meaning that labour is inefficient, immobile, the social structure is rigid, and the general attitude rejects individualism and risk taking (Meier, 1964). When local values confront Western values, society is split into two groups, and a dual social structure is formed (Boeke, 1953), a state which is completed with a dual economic structure (where the traditional and modern sectors are insulated from each other).

The role of human capital in growth and development is highlighted in various forms in the literature. Szentes (2011) quotes from A. Marshall: from a national perspective, the capital invested in workers' children is just as productive as capital invested in horses or machinery. Newer theories unquestionably suggest that capital invested in children is far more productive than that invested in horses and machinery. Endogenous growth theories see increasing returns as a prime source of long-term growth, and they directly or indirectly explain increasing returns with human capital. Lucas (1988) treats human capital as reproducible, an element of capital that the society is able to broaden at a constant rate. The expansion of human capital, on the other hand, leads to a constant increase in the productivity of physical capital. Romer (1986) can also be connected to human capital. In his model, investments made in research and development produce positive externalities that enable a constant increase in the productivity of physical capital.

Veblen (1919) points out that human behaviour is deeply affected by institutionalised rules of society. His views were taken over by new institutional economists (e.g. North, 1993; Williamson, 1998). According to them, institutions affect the incentive system of an economy, while the incentive system, on the other hand, influences the behaviour, size and competition of firms, the level of investments and technological development, and so, ultimately the level of development of an economy. Underdevelopment is thus explained by institutional frameworks consisting of bad incentives, according to the new institutional school.

Partially connected to the institutional approach is the theory of government failures, which was mainly brought to the attention of development experts by Tullock (1993). It was back in the 1960s that Tullock (1967) suggested that the super profits that monopolistic structures offer can be an incentive for firms to lobby for government regulations granting monopolistic positions and monopoly profits. According to calculations made by Krueger (1974), the rent-seeking behaviour of firms in the field of import licences caused a 7.3%

GDP loss in India, and a 15% GDP loss In Turkey in 1964. The more corrupt a country is, the weaker the state is, the heavier the costs of rent seeking are, and so rent seeking can be one of the major obstacles of economic development.

Porter's (1990) national competitiveness theory adds some highly complex factors to the literature of economic development. A somewhat similar idea is suggested by Freeman (1987), who developed the theory of national innovation systems. These systems are centred on cooperation among businesses, the education system and the research infrastructure.

The outside factors of development

The theory of comparative advantage developed by Ricardo (1817) was one of the cornerstones of the laissez-faire approach of international relations. According to Ricardo, the highest welfare level can only be ensured if trade is conducted along the lines of comparative advantages and there is a free flow of goods. This free trade principle was questioned by many. List (1841) argued against *laissez-faire*. He defended protectionism, and suggested protective tariffs for newly-established industries (the infant industry argument). His suggestions echoed those of Alexander Hamilton (1791) made in the newly-formed USA. After the Second World War, the focus of development economics shifted towards the power relations of different countries. Prebisch (1964) and Myrdal (1957) point out that underdeveloped states are dependent on richer countries, and so the current system of international division of labour is not based on comparative advantages. The internal economic structures of most developing countries are directly influenced by the developed ones through the colonial system (Myrdal: forced bilateralism). Balogh (1963) argues that, as a result of power inequalities among parties, the economic structure of the developing countries has to be adjusted time after time to take into account the changes generated by technical progress made in the developed economies, and the adjustment process prevents them from achieving long-term growth. Dependency relations lead to one-track specialisation (Singer 1964). The majority of exports of the developing countries are primary products and commodities, which leads to a decrease in the terms of trade over the long run. Bhagwati, in his 1958 paper titled "Immiserizing growth", showed that the decrease in terms of trade can result in a decrease in the national income even if there is dynamic growth in the production of the export sector. One lesson learned from the literature of interdependencies is that a diversified export structure can be an important development factor.

Emmanuel (1972) has gone so far as to claim that trade between developing and developed countries is an unequal exchange, which is a manifestation of the imperialism of trade. Unequal exchange was triggered by wage differences, and is sustained by the immobility of labour. Wallerstein (1974) also accepted the concept of unequal exchange, although he argued that it is a result of the different bargaining power of nations. The core-periphery relations and the geographical position basically predestine the fate of nations, according to Wallerstein.

As the role played by transnational companies in the international flow of goods and capital became more and more dominant, a great deal of attention was directed towards them. Furtado (1970) suggested that the most important development factor is no longer interdependencies among countries, but the investment strategies of transnational companies. Transnational companies can bring capital to a country, creating jobs, but the newly-formed subsidiaries may be isolated from the local economy (Singer 1964). The ability of a country to attract foreign capital, especially if the capital is invested in fields that can fit in well with the current economic structure of the economy, is another important development factor.

The demonstration effects of modern consumer societies are also worth mentioning. Generally, the consumers of the developing countries try to follow the consumption patterns of the developed nations. This usually has a cut-down effect on local growth, as the goods most fitting to current consumption trends are generally produced overseas, so following the trends increases imports, and can contribute to the trade balance deficit.

Table 1: Inside and outside development factors

Inside factors	Outside factors
Division of labour (Smith)	Free trade – international division of labour (Ricardo)
Savings rate (Harrod-Domar) Abundance-scarcity of capital	Protectionism Defence of infant industries (List)
Equal-unequal income distribution (Keynes)	Equal or unequal trade partners (Balogh) Pressure to fit to modern patterns (Balogh)
Drive to innovate (Schumpeter)	Unilateral dependency – diversification (Myrdal)
Entrepreneurial behaviour (McClelland)	One-sided specialisation (Singer)
Rigid-flexible social structure (Meier) Imported or organically developed social structures (Boeke)	Immiserising growth – terms of trade (Bhagwati) Forced bilateralism (Myrdal)
Dual-homogeneous economic structures (Meier)	International wage division- mobility of labour (Emmanuel)
Investment into human capital (Marshall) Human capital as a renewable resource (Lucas) Positive externalities of R&D (Romer)	Geographical position – core and periphery (Wallerstein)
Institutional incentives (North) Path-dependent development	Investment strategies of multinational companies (Furtado)
Government failure (Tullock) Rent-seeking (Krueger)	Demonstration effect
National diamond (Porter) Innovation systems (Freeman)	
Rule of law, democracy (Barro)	

The role of institutions in development

According to the followers of the institutional school, institutions affect human behaviour; in other words they influence the decisions of economic agents. Veblen was the first to point that out (1919), and also added that it is an oversimplification to assume that market decisions can be analysed independently from any other outside factors, like family, culture, community, politics, etc. His views were neglected by mainstream economics, but the topic was brought to the forefront again by two new research agendas.

On the one hand, it was proved by a series of psychological experiments that we are not capable of making such rational decisions as is assumed by economics. The notion of *homo economicus* was debunked by the theory of bounded rationality (Simon, 1957). Agents with bounded rationality behave opportunistically. On the other hand, Coase's pioneering article (Coase, 1937) shed light on the fact that the transactions conducted among agents are not frictionless, and, depending on the rate of frictions, very different market solutions may prove to be the most efficient ones. If we take a closer look at market transactions, it becomes clear that there are numerous social phenomena that are disregarded by mainstream economics, yet they influence the opportunistic behaviour of market agents and the rate of frictions during transactions. These social phenomena are collectively called institutions.

Hodgson defines institutions (2006) as systems of established and prevalent social rules that structure social interactions. According to the definition above, language, money, etiquette, the measurement system, and firms can all be regarded as institutions. Institutions make it easier to calculate and forecast the behaviour of agents, and thus they contribute to the decrease of uncertainty and frictions during transactions. North (1993) offers a similar definition of institutions: institutions are the rules of the game in a society or, more formally, are the human-devised constraints that shape human interaction.

Williamson (1998) suggested a hierarchy that proved very useful during our analysis. He separated social analysis into four levels (Figure 1). The different levels are ranked according to the time needed to change them, but they also show what influences what in the society. Higher levels directly influence the level just below them, meaning that no practices may be adopted on the lower levels that are not compatible with the superior levels. Social embeddedness is at the top of the hierarchy (L1). Williamson puts norms, customs, ethical principles, traditions, conventions and religion into this category. Some development factors found in the literature at least partly belong to this level (e.g. the dual structure of the society, entrepreneurial behaviour).

The institutional environment forms the second level (L2). While informal rules were placed in Level 1, the rules of L2 are formal, codified ones (e.g. constitution, laws, property rights). Although the change of Level 2 rules is also partly evolutionary in nature, calculated interference is also possible on this level (unlike on L1). Such interferences are called first-order economising, which is about finding the ideal combination of formal rules. Many of the development factors belong to the institutional environment: the rule of law, democratic rights, market regulation and protectionism.

First-order economising, however, does not ensure the optimal economic structure. As agents behave opportunistically, they do not keep to the formal rules of the economy all the time. Jurisdiction also has its frictions, meaning that those who follow the rules are not always able to enforce their rights against opportunists instantly and without any costs. This is where the third level (L3) kicks in, called governance by Williamson. The unit of analysis in governance is the transactions made among economic agents, and the contracts mediating those transactions. Such development factors as the coordination of education and research, Porter's national diamond, government failures or rent seeking, can all be reckoned among L3 items.

The final level (L4) is concerned with the allocation of resources, an area which is traditionally addressed by neoclassical economics. The factors of the better-known growth theories (quantities of labour and capital, savings, investments, etc.) all belong to this level. Williams thinks that new institutional economics addresses problems belonging mainly to Levels 2 and 3. North's and Hodgson's definitions cited above, however, suggest that all phenomena belonging to L1, L2 and L3 can be regarded as institutions. This paper therefore treats all factors as institutional factors that can be categorised in one of the top three levels of Williamson's hierarchy.

Figure 1: Economics of institutions

Source: Williamson, 1998, p. 26

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III. Methodology

Structure of the model

To identify the crucial development factors of Hungary, and in order to sketch potential development paths for the country, we developed the FOI model. The model is primarily based on the factors collected from the literature, but these factors are structured in a unique way which allows us to draw up characteristic development paths that can be clearly separated from each other. We used the following assumptions when the FOI model was set up:

- National economies are the unit of our analysis; international interdependencies are mostly disregarded in the paper.
- The key to development is not a single factor, but rather a combination of many factors. According to our assumption there are several important motors of development; sometimes these factors influence each other, and it is very difficult to determine what causes what; still, they can be equally important, and they all have to be used to draw up a potential development path for Hungary.
- Among the many factors considered in the model, the so-called institutional factors play a primary role. Institutional factors are detected using the hierarchy put forward by Williamson (1998). In fact, the model was developed with the aim of stressing the importance of institutional factors in development.
- Development can take more than one shape and form. There are several feasible development paths, and Hungary is not constrained to follow only one of them, but may choose from a (limited) number of such paths. To determine these development paths, the FOI model was used to test OECD countries.

The FOI model offers a new typology of development factors, but is also capable of structuring these factors along three clear directions of development. As shown previously, the inside-outside typology of development factors is a standard part of the literature. The FOI model, however, is based on a three-dimensional structure. These three dimensions are:

- F, i.e. the future potential of a country;
- O, i.e. the outside potential of a country;
- I, i.e. the inside potential of a country.

All three dimensions are complex and composed of a large number of factors. However, they can still be clearly distinguished from each other, which is useful because this clear distinction can help in the formulation of distinctive development strategies.

Future potential includes factors that are regarded as crucial for the sustainability and future competitiveness of the Hungarian economy. As sustainability has become one of the main paradigms of all social sciences, we felt that the inclusion of it as a separate development dimension was essential. In our case, sustainability translates to ensuring that the typical signs and indicators of a developed country characterise not only the current state of the economy but also the relatively distant future.

Outside potential includes factors crucial to the current world market position of Hungary. This second dimension can be treated as equivalent to the outside factors listed based on the literature. Some elements of the outside potential may not be influenced from the inside; others, such as the conditions affecting the international flow of goods, services and factors of production, are a standard part of economic policy.

Inside potential is made up of factors that are regarded as crucial to the current well-being and development of Hungary. Most of the inside factors listed in Table 1 fall into the category of this potential. Countries which offer favourable conditions to local entrepreneurs, and provide a high level of quality of life to their inhabitants, can have remarkable inside potential.

It is not difficult to spot that certain trade-offs exist among the three potentials. Higher wage levels, for example, are absolutely favourable from the perspective of inside potential, but they can be dangerous for the outside potential of the country. They can also be threatening to future potential, if the result of a high wage level is overconsumption. If a country is well endowed with natural resources, this can boost its inside and outside potentials, but the abundance of resources usually leads to high proportions of waste, which again harms future potential. The three potentials were drafted with these trade-offs in mind.

Formulating a measurement method

During a brainstorming session a list of 50 indicators was compiled with the help of experts. These 50 indicators were chosen to measure the relevant development factors and were all included in a questionnaire. Experts were asked to rank all 50 indicators on a 1–7 scale (1 = not at all relevant; 7 = of highest significance). Each indicator received three separate scores: one for future potential, one for outside potential and one for inside potential. The respondents had to give a high score to an indicator if they believed it greatly contributed to the sustainability and future competitiveness (F potential), current world market position (O potential) or current well-being (I potential) of Hungary. The questionnaire was completed by 28 experts. Most were active members of the Committee on Future Research of the Hungarian Academy of Sciences. Representing several academic fields (arts, engineering, medicine, natural and social sciences), they offered a wide perspective and a strong future-oriented attitude, values that are highly useful in this kind of research.

During the processing of the questionnaires, every indicator was placed in the group (F, O or I potential) where it scored highest, meaning that an indicator could only be part of one of the potentials. In order to eliminate some of the less important factors (which received low scores in all three dimensions), we disregarded everything that had a score below average. The final transformation left us with 27 factors: 12 of them influence the future potential, 10 the inside and 5 the outside potential (Table 2).

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Table 2: The components of the future, outside and inside potentials

Future potential	Outside potential	Inside potential
Social responsibility (L1–3)	Trade to GDP ratio (L3–4)	Burden of government regulation (L2–3)
Industrial disputes (L1)	Country credit rating (L4)	Quality of life (L4)
Energy infrastructure (L3)	Exchange rate stability (L3)	Collected total tax revenues (L3)
Total public expenditure on education per capita (L3)	Financial institutions' transparency (L3)	Pension funding (L2–3)
Ageing of society (L1–2)	English proficiency (L4)	GDP (PPP) per capita (L4)
Renewable energies (L3)	Real GDP Growth (L4)	Healthy life expectancy (L3)
Ease of access to loans (L3)	Ecological footprint (L1–2)	Rigidity of employment (L3)
Total expenditure on R&D per capita (L3)		Labour force (L4)
Total R&D personnel nationwide per capita (L3)		Skilled labour (L3)
Educational assessment / Mathematics (L3)		

The final version of the model was fine-tuned using statistical data from OECD countries.

IV. FOI analysis of OECD countries

To quantify the future, outside and inside potentials, the FOI-indices were calculated. The value of the 27 components (listed in Table 2) were gathered for all 34 OECD members for the year 2010, and then all values were transformed to a 1–7 scale using the min-max method. By averaging the standardised values, we were able to calculate the F-, O- and I-indices of all 34 countries (Table 3).

Table 3: The F-, O- and I-indices of OECD countries

	F	O	I		F	O	I
Australia	4.20	5.32	4.35	Japan	4.80	3.68	4.01
Austria	4.70	5.41	4.05	South Korea	4.00	4.26	3.33
Belgium	3.90	5.56	3.47	Luxembourg	5.30	6.56	4.45
Canada	3.90	5.41	4.50	Mexico	2.70	3.98	2.85
Chile	3.80	5.03	4.13	Netherlands	4.40	5.54	3.83
Czech Republic	3.10	4.97	3.57	New Zealand	4.20	4.52	4.00
Denmark	4.80	5.77	4.30	Norway	5.20	5.70	4.13
Estonia	3.00	4.94	3.08	Poland	2.90	4.42	3.07
Finland	5.00	5.72	4.02	Portugal	3.50	4.33	2.91
France	4.40	4.46	3.04	Slovakia	3.00	4.82	3.25
Germany	4.30	5.26	3.73	Slovenia	3.40	5.08	2.70
Greece	2.90	3.66	2.50	Spain	3.40	4.23	2.99
Hungary	2.90	4.56	2.55	Sweden	5.10	5.22	4.13
Iceland	5.90	2.33	4.42	Switzerland	5.40	5.37	4.89
Ireland	3.90	4.17	3.91	Turkey	3.30	3.63	3.14
Israel	3.60	4.89	4.13	United Kingdom	3.90	4.35	3.60
Italy	3.50	3.82	2.66	USA	3.80	4.27	4.47

Factor analysis

In order to better understand what background factors drive the value of the different F-, O- and I-indices, a factor analysis was conducted with SPSS 19. Almost 150 variables were tested during the analysis. In the first step, we checked how closely related those variables are to the three index values in OECD countries, and what the direction of the relationship is. As a second step, all variables were only considered in the factor analysis of the index they had the highest correlational relationship with.

We were able to establish three main groups of indicators that showed a significant correlation with the index of the future potential of OECD countries. They were labelled Human capital, Accountable corporations and Quality of the education system. The Human capital factor is a combination of indicators measuring the education and health sectors, and productivity. The Accountable corporations factor combines such factors as the ethical and social responsibility of organisations and the credibility of managers, and so represents the social, ethical and environmental considerations of businesses. The third factor, Quality of the education system, shows the returns on efforts made in the education system.

Two factors were found with the factor analysis of the O-index, namely National goodwill and Investment conditions. The main distinction between the two factors is the timeframe within which their indicators may be influenced by the decision maker. The Investment conditions factor includes variables that can be influenced relatively easily, even over the short term; the National goodwill, on the other hand, may only be changed over the very long term.

Variables having a significant correlation with the I-index can be separated into three factors. These factors were labelled Business competitiveness, Government intervention and Availability of resources. The Business competitiveness factor measures the microeconomic position of all businesses (small and medium-sized enterprises and large corporations) along such dimensions as productivity, efficiency and R&D&I. The other two factors describe the macroeconomic environment of the businesses, where the Government interventions consists of the regulation part and the Availability of resources the allocation part.

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Table 4: The factors of the F-, O- and I-index

F-index	O-index	I-index
F1 Human capital	O1 National goodwill	I1 Business competitiveness
Labour productivity (PPP) Overall productivity (PPP) Total health expenditure per capita Total public expenditure on education per capita Healthy life expectancy Total expenditure on R&D per capita	Parallel economy Investment risk Image abroad Country credit rating Brain drain Risk of political instability	Innovative capacity Productivity of companies Small and medium-size enterprises Information technology Large corporations
F2 Accountable corporations	O2 Investment conditions	I2 Government intervention
Ethical practices Social responsibility Credibility of managers	Foreign investors Exchange rate stability Capital markets Investment incentives State ownership of enterprises	Subsidies Finance and banking regulation Protectionism Legal and regulatory framework Ease of doing business Bureaucracy
F3 Quality of the education system		I3 Availability of resources
Educational assessment / Mathematics Educational assessment / Sciences Science in schools Educational system		Labour force Total primary energy supply per capita Burden of government regulation Employment rate Gross domestic savings

F-index: KMO = 0.823, explained proportion 76.4%; O-index: KMO = 0.803, explained proportion 73.7%; I-index: KMO = 0.791, explained proportion 73.408%[3]

Forming clusters

The FOI-indices and the factors determined during the factor analysis were used to identify typical clusters within OECD countries. These artificial clusters were created based on the values of the F-, O- , and I-index, with the so-called half-scale method. As the indices can have a value between 1 and 7, 4 is the mid-value. So all three indices were split into two groups: the values from 1 to 4 went into the group labelled as "low" (1), while the values above 4 were labelled as "high" (2).

Theoretically, all 8 clusters could represent feasible combinations, but most of the 34 OECD members fall into 4 groups (the distribution is shown in Table 5). In our interpretation these

[3] The Kaiser-Meyer-Olkin (KMO) value helps in determining how suited our variables are to factor analysis. A KMO value above 0.8 means that the variables are highly suitable. Principal component analysis and Varimax rotation were used during the analysis.

four groups of countries represent the development models within the OECD. The current paper focuses on group nr. 7, which is called the large corporation-based, bureaucratic model. As half-scaling was used as a method of clustering, it is obvious that Belgium, France, Netherlands, Ireland, South Korea and New Zealand perform above average in their future and outside potential.

A closer inspection of the factors shows however, that these countries are especially strong on the field of Accountable corporations, while their Human capital endowments and the Quality of the education system (the other factors of the F-index) are barely above average. The factors of the O-index show a balanced performance. Group nr. 7 is below average in the I-index, but a more sophisticated picture can again be drawn based on the factors: Business competitiveness is above average, but the factors describing the macroeconomic environment (Government intervention and Availability of resources) indicate below average performance.

Table 5: The clusters of OECD countries according to the half-scale method

Code	Country
1 (111)	Greece, Italy, Mexico, Portugal, Turkey
3 (112)	Chile, Czech Republic, Estonia, Hungary, Israel, Poland, Slovakia, Slovenia, Spain
5 (211)	United Kingdom
6 (212)	Iceland
7 (221)	Belgium, France, Netherlands, Ireland, South Korea, New Zealand
8 (222)	Australia, Austria, Canada, Denmark, Finland, Germany, Japan, Luxemburg, Norway, Sweden, Switzerland, United States

The F-, O- and I-index values indicated in brackets, where 1 = countries with index values between 1 and 4; 2 = above 4. No countries fell into group 2 and 4.

Group 7 is called the large corporation-based, bureaucratic model for two reasons. On the one hand, these countries perform really well in two factors measuring the performance of the business sector (they excel in Accountable corporations and are above the average in Business competitiveness). On the other hand, they fall below average in the regulatory environment and in the availability of local resources (both indicate the presence of extensive state regulation that often overwrites market decisions).

V. The large corporation-based, bureaucratic model as a development strategy

The cluster and factor analysis based on the FOI-indices led us to three promising development models (cluster 3, 7 and 8). The paper discusses the large corporation-based, bureaucratic model in detail, which implies a defensive strategy that is focused on the creation of local safe havens. In other words we argue that, if the goal is to move towards the large corporation-based, bureaucratic model, then economic policy should primarily be defensive and protectionist, concentrating on creating an environment for large domestic corporations that at least partially protects them from global competition.

By drawing a parallel between the development model (deducted from the clusters of countries) and economic policy strategy, we can also tell which factors are most important for the local safe haven-oriented defensive strategy. Based on our analysis, we can tell those factors in which the countries belonging to different clusters (which represent possible development models within the OECD) perform exceptionally well. These outstanding factors then can be rendered to the development strategies. For the countries belonging to Cluster 7, the outstanding factors are the following: F2 Accountable corporations; I1 Business competitiveness; I3 Availability of resources (the latter factor also has a significantly high value for cluster 8).

As a next step, we checked which of the OECD members scored well in these three factors, and which of them has a comparable size to Hungary. Finland is number one in F2 Accountable corporations among OECD countries. Denmark is second, Austria is third in I1 Business competitiveness, while Norway is fifth in I3 Availability of resources. Country studies were prepared of the four countries (Austria, Denmark, Finland and Norway) to detect those best practices that allowed them to excel in the areas measured by the key factors listed above. The country studies are fairly extensive and therefore cannot be included in the paper, but the lessons learned from them are featured in the final sections (the country studies are accessible in the Appendix of Bartha, Gubik and Tóthné Szita, 2013). The final goal is to use the FOI analysis and the country studies to offer relevant policy recommendations for Hungary.

A defensive strategy focused on the creation of local safe havens

As part of a strategy focused on the creation of local safe havens, the state is committed to creating and sustaining a regulatory safety net that enables a well-functioning corporate-enterprise sector (with the emphasis being on large national corporations). According to our model, the strategy is best described by the accountable (F2) and competitive (I1) business sector. The availability of resources (I3) is also key, however this factor is also featured in another strategy represented by Cluster 8.

Table 6: Development areas for a strategy focused on the creation of local safe havens

Level	Component
L1	Value system characterised by low level of power distance Feminine culture Long-term orientation in resource management*
L2	Social acceptance of entrepreneurs*
L2–L3 transition	Supportive role of the state Favourable business environment*
L3	Education system supporting the needs of the business sector Ease of starting new businesses, assistance provided for new entrepreneurs
L4	R&D&I incentives Supporting cluster development Avoiding price competition by making use of special market niches Extensive ITC use Geographical position, exploiting domestic endowments Qualified and productive labour force*

**Key components of cluster 8 as well.*

Hungary performs rather poorly in the key factors of the strategy focused on the creation of local safe havens. It is ranked 20th in Accountable corporations (F2), 26th in Business competitiveness (I1), and 33rd (last but one within the OECD) in Availability of resources (I3). There is plenty to be done if the local safe haven strategy is chosen. Table 6 contains those key components that were collected from the country studies (analysing the best practices of countries doing exceptionally well in factors F2, I1 and I3). They can set the development priorities for a local safe haven-oriented economic policy strategy. The components are presented in the hierarchical order suggested by Williamson (see Figure 1). According to our country studies, the low level of power distance and the feminine nature of the culture are the most deep-rooted elements of this strategy. Both contribute to the accountability of firms. The low power distance, because the horizontal employee-employer, company-stakeholder, company-supplier relations make it possible for less powerful parties to have a say in the principles according to which the companies are managed. The feminine culture, because it represents a high level of social solidarity, an element that is crucial to the social responsibility of companies.

These two components, however, are ranked at the highest level of Williamson's hierarchy (L1), which means that the chance of influencing them is minimal. However, they still have to be mentioned, as the nature of the hierarchy is that the components high up have an effect on the lower levels (which are easier to manipulate). A decision has to be made whether or not it is possible to balance the lack of L1 components with lower level changes, and whether or not the strategy can be successful without having the proper L1 cultural elements in place, before any steps are taken to move the economy toward the large corporation-based, bureaucratic model. For example, the lack of trust which can be a consequence of a masculine culture (L1), might be replaced by such formal governance structures (L3) as can minimize transaction costs.

The long-term orientation towards resource management is also on the top level of the hierarchy. The responsible and sustainable use of natural resources is partially dependent on the institutional structures (L2, the vision driving long-term government decisions), but long-term orientation is a characteristic of the society as a whole (see Cernic, 2012, for an example on the importance of long-term orientation). Norway offers prime examples of this, be it the management of oil extraction, or the preservation policy followed regarding the renewable resources possessed by the country. But Norway's efforts in sustainability go way beyond the national borders. Prime Minister Gro Harlem Brundtland offered a great example of the international role played by Norway in matters of sustainability when she participated in the drafting of the report titled Our Common Future. The main message of the report, a "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (WCED 1987, p. 27), has become the most often quoted definition of sustainable development.

A critical element of the institutional structure (L2) for the strategy focused on the creation of local safe havens, is the social acceptance of entrepreneurs and entrepreneurial behaviour in general. This component can be influenced, and, through education and proper communication, the attitude towards entrepreneurship can be changed within a reasonable amount of time (although this still means several years, possibly decades).

The supportive role of the state is also key to this strategy. This factor is only part of the institutional structure, so it was put as a transition element between Levels 2 and 3. In Finland, for example, the country that is first in Accountable corporations, government support was crucial in establishing world-leading social responsibility practices. It is also worth mentioning that the state's role is more that of night-watchman, focused on coordination and harmonization, rather than direct control (according to the WTI, the tax burden of Cluster 7 countries is not significantly high within the OECD, Machova-Kotlan, 2013). The favourable business environment is also part of the L2–L3 transition level, which is driven by the good availability of resources, on the one hand, and by the regulation of the state, on the other.

On the level of governance (L3), the following are the key ideas: what are the administrative costs of starting and operating a private business; and what is the state's contribution to the competitiveness of domestic companies. The technical and administrative costs of starting a new business in Denmark are minimal. Furthermore, new entrepreneurs receive consultancy services partially funded by the central budget. Norway, where starting a new business is also cheap and quick in international comparison, excels in the availability of financial resources (availability of credit and risk capital).

The structure and the efficiency of the education system is also crucial to the competitiveness of the business sector. The country studies of both Austria and Denmark shed light on the importance of ITC use and foreign language skills alongside a high level of professional skills. The traditional educational system and lifelong learning structures both contribute to good performance in these fields. Denmark's example also shows how the involvement of stakeholders contributes to higher quality in education. Parents and students, through school councils, and companies, through apprenticeship programs, have a say in key education matters (such as curricula, student schedules, apprenticeship).

Level 4 (L4) covers those components related to the allocation of resources in general, and especially to labour market issues. A change on this level can have immediate effects. One of the key elements on L4 is cluster development. Clusters play an important role in the economy both in Austria and in Denmark. Industry-level cooperation has great traditions in both countries, so the development of clusters is a result of a natural process. Formal automotive industry cooperation has a 100-year history in Austria, and the Danish agribusiness, wind power and pharmaceutical industry clusters are also good examples of such development.

Competitiveness is sustained through the setting of proper development priorities, and government incentives for R&D&I. R&D spending in Austria has grown the fastest within the European Union. Private funding of R&D is on the rise as well, a process that is driven by tax benefits and direct transfers. As a result of public support, cooperation between private firms and universities and research institutes is getting stronger. Although it has to be mentioned again, that cooperation is also strengthened by cultural elements. The low power distance (Hofstede, 2001) and the horizontal nature of relationships (in which Austria ranks first, Denmark third) both help a lot.

Austria and Denmark can rely on their developed physical infrastructure, and can exploit their geographical position and unique endowments. Stressing the importance of uniqueness is also part of their market strategy. Many Austrian firms, for example, try to make use of special market niches, and so can avoid global price competition. They operate in traditional industries, where special knowledge is needed, and high market share can be achieved because of the high quality of the products.

Last but not least, the highly qualified and efficient labour force is also a key L4 component (although this is also a significant factor of Cluster 8). Some lessons to be learned from the Norwegian country study include: the identifying and prioritising of fields of education (mathematics, natural sciences and entrepreneurial studies in the case of Norway); high involvement in lifelong learning; high proportion of GDP spent on education.

VI. Conclusion

The large corporation-based, bureaucratic model requires a defensive strategy focused on the creation of local safe havens. This model can also be interpreted as a modern version of protectionism. It can be characterised by a well-functioning large corporation sector, but this is partially due to the high level involvement of the state. This is important in the global environment, because the state can create a sort of safe haven for domestic companies. It is unclear, however, just how long this safe haven can be sustained in a global environment where state regulation is becoming more and more uniformalised.

According to our country studies, by supporting cooperation between firms, among firms, universities and research institutes, cooperation within clusters, the economic policy of a country can move toward a strategy focused on the creation of local safe havens. Intensive public support is required to sustain the competitiveness of the corporate sector, which is partially achieved by creating and sustaining a reliable incentives environment (e.g. intellectual property rights, start-up regulation, flexible labour market, financial resources), and partially by taking an active role (e.g. education, R&D funding, infrastructure).

The role of the state can also be extended on the identification and exploiting of unique endowments (e.g. special national goods, market niches). This can be done through consultancy services, or through providing publicly funded added value (e.g. marketing), or even through providing public support to encourage entrepreneurial involvement.

The other cornerstone of the strategy is an education system that provides such competitive skills and knowledge that suit the needs of large corporations, but also help people if they want to become self-employed. An education system like that can set the supply to the needs of the labour market, can involve the stakeholders of the system (parents, students and companies), and can offer a reliable alternative for teachers.

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VILNIUS EASTERN PARTNERSHIP SUMMIT: MILESTONE IN EU-RUSSIA RELATIONS – NOT JUST FOR UKRAINE

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Abstract

The Vilnius Eastern Partnership Summit on 28–29th November 2013 represents a milestone in EU relations not just with respect to the six Eastern Partnership countries (EaP Armenia, Azerbaijan, Belarus, Georgia, Moldova and particularly Ukraine), but also with the EU's 'strategic partner' Russia. The turbulence and numerous speculations regarding expectations about the signature of the EU-Ukraine Association Agreement (comprising a Deep and Comprehensive Free Trade Agreement – AA/DCFTA), as well as progress in initialling similar future agreements with Georgia and Moldova, have been escalating before the summit. The association agreements would bring EaP signatory countries closer to the EU not really closer to EU membership, but closer to the application of various EU norms and standards (takeover of the 'acquis communautaire') and – significantly – out of the Russian orbit, for the beginning at least symbolically. The last minute postponement of the EU-Ukraine AA/DCFTA signature announced by Ukraine's government just one week before the summit represents a serious setback for the EU. Though the EU has no 'Plan B' and was stunned after Ukraine's announcement, life will continue after the summit and new initiatives will have to be started. What are the relevant issues and challenges and what is at stake? This note attempts to evaluate the consequences (economic and otherwise) of alternate decisions following the Vilnius Eastern Partnership Summit, reviews some of the disputed arguments and discusses selected relevant economic issues.

Keywords

Vilnius Eastern Partnership Summit, European Union, Ukraine, EU-Ukraine Association Agreement, Russia

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I. Introduction

The Vilnius Eastern Partnership Summit on 28–29 November 2013 represents a milestone in EU relations not just with respect to the six Eastern Partnership countries (EaP: Armenia, Azerbaijan, Belarus, Georgia, Moldova and particularly Ukraine), but also with the EU's 'strategic partner', Russia. The turbulence and numerous speculations regarding expectations about the signature of the EU-Ukraine Association Agreement (comprising a Deep and Comprehensive Free Trade Agreement – AA/DCFTA), as well as progress in initialling similar future agreements with Georgia and Moldova, escalated before the summit. The association agreements would bring EaP signatory countries closer to the EU: not really closer to EU membership, but closer to the application of various EU norms and standards (takeover of the 'acquis communautaire') and – significantly – out of the Russian orbit, at least symbolically at first. The postponement of the EU-Ukraine AA/DCFTA signature – Ukraine's government halted the related preparations just one week before the summit – represents a serious setback for the EU, while Russia has gained another strategic point, at least for a while.[2] Though the EU has no 'Plan B' and EU High Representative Catherine Ashton expressed her disappointment immediately after Ukraine's announcement, life will continue after the summit and new initiatives will have to be started.

What are the relevant issues and challenges and what is at stake? This note briefly discusses the positions of the key individual parties (the European Union, Ukraine and Russia), presents details on foreign trade and tariff data and attempts to evaluate the consequences (economic and otherwise) of alternate decisions following the Vilnius Eastern Partnership Summit. It also reviews some of the disputed arguments and discusses selected relevant economic issues.

II. Tug-of-war over Ukraine

In its present form, the conclusion and implementation of an AA/DCFTA between Ukraine and the EU has been presented by both the EU and Russia as incompatible with the participation of EaP countries in the Russian-led Customs Union (BRK-CU: the other members being Belarus and Kazakhstan) and especially with Ukraine joining the envisaged 'deeper and wider' post-Soviet integration project in the framework of the Eurasian Union and the Single Economic Space (SES).[3] Until compromise solutions regarding tariff regimes have been negotiated, the two directions for integration – either with the EU or participation in the BRK-CU/SES – are indeed incompatible. Russia's 'success' in luring Armenia into the BRK-CU instead of opting for an AA/DCFTA with the EU, as announced on 3 September, 2013, was initially interpreted by some in the EU as incompatible with Armenia's

[2] Ukraine's government proposed the establishment of a tripartite commission with the EU and Russia in order to jointly discuss trade and economic issues – see www.gazeta.ru, 21 November, 2013. The interruption of the AA/DCFTA process was presented by Ukraine's Prime Minister Mykola Azarov as a 'tactical decision' driven solely by economic reasoning.

[3] The Eurasian Union (EurAz) currently includes, apart from Russia, Belarus and Kazakhstan, Kyrgyzstan and Tajikistan. The future Eurasian Union and SES envisages a common market entailing 'four freedoms' modelled on the EU experience.

prospective conclusion of an AA/DCFTA. Later on, European Commissioner for Enlargement and Neighbourhood Policy Štefan Füle attempted to de-escalate tensions and tried to dismiss such fears by stating in October at a conference in Kyiv that the AA/DCFTA should 'not be seen as a threat but as an opportunity, a contribution to creating an area of free trade between Lisbon and Vladivostok'. Furthermore, he explained that the European Commission is 'working on the issue of legal incompatibility between the Association Agreement and Customs Union', while requiring once again that Ukraine shows 'determined action' and delivers 'tangible progress on all European Union benchmarks'.[4] Ukraine, for its part, would opt for signing the AA/DCFTA agreement (a corresponding decision was already adopted by Ukraine's government in September 2013) while, ideally, desiring to 'cherry pick' and maintain and develop good relations with both the Russian-led Customs Union and the EU. One of the EU's key demands – to cease the application of 'selective justice' and in particular the release of former Prime Minister Yulia Tymoshenko from prison – will obviously not be fulfilled, at least not before the Vilnius Summit.[5]

III. Russia's bullying pays off

To deal first with Russia, there has been some history of this country's use of economic sanctions in order to retaliate for perceived unwelcome political developments in the 'near abroad'. Russian sanctions ranged from import bans on Georgian wine and mineral water in 2004–06 after the 'Rose Revolution' in Georgia, the interruption of gas deliveries to Ukraine and Belarus related to disputes over pricing and access to pipelines, restricting the import of wine and spirits from Moldova, imposing import restrictions on dairy products and chocolate from Ukraine, on dairy product imports from Lithuania, etc.[6] The latest sore point in Russian external relations with potentially severe economic consequences has been Russia's concentrated efforts in bullying Ukraine (as well as Georgia and Moldova) related to the envisaged AA/DCFTA signature at the forthcoming Eastern Partnership Summit in Vilnius.[7] The frequency and intensity of Russia's rather crude attempts to prevent Ukraine from signing the AA/DCFTA prior to the Vilnius Summit and to 'explain the adverse consequences of the signature', together with simultaneous efforts to 'lure' Ukraine into joining the Russian-led Customs Union with Belarus and Kazakhstan, escalated before the Vilnius Summit.[8] Repeatedly, Sergey Glazyev, one of President Putin's

[4] See Füle (2013a, 2013b). The latter requirement was spelled out by Mr Füle in a speech before the Ukrainian parliament in Kyiv on the same day (Füle, 2013c).

[5] EU foreign affairs ministers reiterated conditions for signing the AA/DCFTA agreement at their meeting on 18 November, 2013, in Brussels as follows: 'Determined action and tangible progress is needed in three areas: the compliance of the parliamentary elections with international standards, addressing the issue of selective justice and preventing its recurrence, and the implementation of the reforms jointly agreed in the Association Agenda' (http://www.euractiv.com/specialreport-ukraine-way-reform/analysts-slam-germany-ukraine-po-news-531768).

[6] It must be added, for the sake of completeness, that Russia also employed trade sanctions – with varying justification – with respect to imports of US poultry, Polish pork, Dutch flowers, etc.

[7] See Moldova's Foreign and European Integration Minister (who is also chief AA negotiator) Natalia Gherman at Euractiv.com, published on 30 October, 2013, and the interview with newly elected Georgian President Giorgi Margvelashvili in *Kommersant Vlast'*, No. 41, October 2013, respectively.

[8] There was even a 'secret' (although leaked) strategy for preventing Ukraine from signing the AA/DCFTA agreement published in August by the Ukrainian paper Zerkalo Nedely – see http://gazeta.zn.ua/internal/o-

economic advisors, lectured Ukraine on the alleged adverse consequences of signing the 'discriminative' AA/DCFTA agreement while simultaneously threatening Russian sanctions. Indeed, Russian border controls on Ukrainian exports were briefly introduced (on a 'trial' basis, but still violating the CIS FTA agreements where Ukraine participates) while simultaneously praising the economic benefits of Ukraine joining the Customs Union. Similar warnings were spelled out by Russian Ambassador to the EU Vladimir Chizhov and reiterated, albeit in a more polite form, by Russian First Deputy Prime Minister Igor Shuvalov, who is in charge of EurAz economic relations in Russia.[9] Last but not least, Russian Prime Minister Dmitry Medvedev warned his Ukrainian colleague Mykola Azarov that after signing the AA/DCFTA Ukraine will have 'zero chance' of full-scale CU membership, while Russian Foreign Affairs Minister Sergey Lavrov mentioned the possibility of tightened border controls between the two countries.[10] The latest serious and immediate threat was expressed by Mr Medvedev at the beginning of November in connection with Ukraine's payment arrears for Russian gas deliveries (amounting to nearly USD 900 million as of August 2013). Prime Minister Medvedev required prompt debt repayment, rejected new Russian credit and required a pre-payment for additional gas deliveries (envisaged by the existing contract with Gazprom) while suggesting that, if necessary, Ukraine should ask the EU for financial assistance instead.[11] Meanwhile, Ukraine is also being squeezed by the IMF, which is urging the government to reduce budgetary expenditures and raise domestic gas tariffs, as well as to implement a number of other unpopular reforms before resuming new financing.[12]

Russia's bullying attempts to pressure its neighbours to 'integrate' with Russia instead of with the EU was seen as counterproductive not only by many Ukrainians and most outside observers, but even by a number of commentators in Russia.[13] On the other hand, a negative view regarding the consequences of an AA/DCFTA signature is shared by Ukraine's communists, who claim – probably correctly – that the country has no prospects of joining the EU in the next 20–30 years and that the implementation of EU regulations would be too costly, while EU integration is allegedly supported by just 40% of Ukrainians.[14] Last but not least, there have been tensions among current BRK-CU members as neither Belarus nor Kazakhstan – the two other members of BRK-CU – are particularly happy with current Russian dealings related to the CU stance. For example, at the recent BRK-CU summit in Minsk (end-October 2013), Kazakh President Nursultan Nazarbayev

komplekse-mer-po-vovlecheniyu-ukrainy-v-evraziyskiy-integracionnyy-process-_.html.

[9] See http://www.euractiv.com/europes-east/top-envoy-russia-offer-ukraine-e-news-530890 and http://www.euractiv.com/europes-east/russia-reiterates-warnings-ukrai-news-530671.

[10] See report from the meeting of the two prime ministers in Kaluga on 15 October, 2013 (www.gazeta.ru/business/2013/10/15). For Lavrov's speech, seehttp://www.gazeta.ru/politics/2013/10/28_a_5727929.shtml.

[11] See www.gazeta.ru, 4 November, 2013.

[12] See IMF Mission Statement to Ukraine, Press Release No. 13/419, 31 October, 2013.

[13] See, for instance, http://www.vedomosti.ru/opinion/print/2013/10/29/18070451, K. Sonin and Financial Times, 4 November, 2013, p. 9.

[14] See http://www.euractiv.com/europes-east/ukrainian-communists-expose-myth-news-531359. It must be added that the high costs and the rationality of the request to take over the 'acquis' and other provisions of the DCFTA without prospects for EU accession is criticised by other observers as well (Dreyer, 2012). The earlier experience of CEE NMS suggests that 'acquis takeover' is indeed costly and problematic (Havlik, 2003).

complained about the 'excessive politicisation' of the CU Commission's decisions pursued by Russian representatives who are 'not independent enough' from the government (a situation which contradicts CU Commission statutes). Furthermore, Belarus President Alexander Lukashenko complained at the same summit about increased bureaucratic obstacles in BRK-CU customs procedures and delays in other integration steps.[15] On the sidelines, Mr Nazarbayev also suggested inviting Turkey to join the BRK-CU.[16]

IV. EU's failed Eastern Partnership

Following a number of resolute previous 'either/or' statements regarding the direction of integration by various EU representatives, European Commissioner for Enlargement and Neighbourhood Policy Štefan Füle attempted to de-escalate the situation, declaring that this issue 'is not a choice between Moscow and Brussels' and promised Ukraine a speedier AA/DCFTA implementation after the Vilnius summit. Mr Füle also declared that the European Commission is 'working on overcoming the issues of legal compatibility between the AA and CU' in order to 'prevent new walls in Europe',[17] and sharply rebuked claims regarding the adverse effects of an AA/DCFTA.[18] On the same day, Mr Füle announced a 'post-Vilnius agenda' for Ukraine which would include financial assistance to support the implementation of the Association Agreement amounting to EUR 186 million and move ahead with macro-financial assistance of EUR 610 million, 'once the conditions are in place' (ibid). The current EU stance with respect to both Eastern Partnership countries and the 'partnership for modernisation' with Russia, as well as the lack of a corresponding longer-term strategy, have long been criticised by numerous observers and experts.[19]

V. Economic integration effects

Available studies dealing with the (economic) effects of alternative integration agreements provide widely conflicting results, depending on methods, assumptions and data sources. One of the common findings of these studies is that (economic) effects on Russia (or the EU for that matter) are asymmetric: they are rather small compared to the effects on smaller prospective integration partners such as Ukraine, Armenia, Georgia or Moldova – owing to the sheer size of the Russian/EU economy (see, among others, Astrov et al., 2012; EDB, 2012, 2013; Vinokurov and Libman, 2012; Dabrowski and Taran, 2012;

[15] See http://www.vedomosti.ru/politics/print/2013/10/25/17942981.

[16] Ibid. Note that Turkey has been in a customs union with the EU since the mid-1990s.

[17] See Mr Füle's speech at the conference in Yalta, Ukraine, on 20 September, 2013.

[18] See the above quoted speeches by Mr Füle at the international conference in Kyiv and before the Ukrainian Parliament on 11 October, 2013, at http://europa.eu/rapid/press-release_SPEECH-13-808_en.htm and 13-810 (ibid).

[19] See, for example, Wallace (2009), Grant (2011), Emerson (2011a) and recent statements by German Bundestag MP Karl-Gerog Wellmann and former EU Enlargement Commissioner Gunter Verheugen during a panel discussion in Berlin on 18 November, 2013, (http://www.euractiv.com/specialreport-ukraine-way-reform/analysts-slam-germany-ukraine-po-news-531768). Similar views have recently been expressed also by French diplomats (http://www.euractiv.com/europes-east/france-supports-association-agre-news-531726as), as well as by Youngs and Pishchikova (2013) and Wisniewski (2013).

Dreyer, 2012; Movchan and Shportyuk, 2012; EBRD, 2012). Another common finding of most integration studies is that (mostly short-term) tariff reduction effects are relatively small compared to the effects from the abolishment of non-tariff barriers and the expected medium- and long-term efficiency gains from capital inflows and related restructuring. This applies not only to post-Soviet integration or the AA/DCFTA but, for example, to the Transatlantic Trade and Investment Partnership (TTIP) under negotiation between the EU and US as well (see Francois et al., 2013).

Regarding the effects of alternative integration scenarios, there is a plethora of different evaluation approaches, applying various methodologies, assumptions and data sets (see references for a selection of the relevant literature). Not surprisingly, the evaluation results differ by wide margins and the issue – economic effects of alternate integration directions – is excessively politicised. Ukraine has so far rejected a full-fledged BRK-CU membership and has instead acquired ‘observer status’. Apart from tricky geo-political aspects, important reasons for Ukraine’s reluctant position are its WTO-related commitments and questions of BRK-CU compatibility with the prospective AA/DCFTA with the EU. While there seems to be little (economic) justification for Russia prompting Ukraine to join the BRK-CU (the economic impacts on Russia are rather small, partly owing to its size), for Ukraine, on the other hand, the economic (and other) linkages to Russia are rather important.

Box 1

What is the content of the EU-Ukraine DCFTA?

The EU-UA DCFTA represents part of the Association Agreement and consists of 15 Chapters, 14 Annexes and 3 protocols – altogether more than 900 pages of text published in November 2012, with few experts ever having probably actually read it. According to Chapter 1 (Market Access for Goods), the vast majority of customs duties (99.1% by Ukraine and 98.1% by the EU) will be removed as soon as the Agreement enters into force after the ratification process is completed. A few sectors will obtain transition periods for the removal of customs duties (e.g. the automotive sector in Ukraine for 15 years and some agriculture products in the EU for up to 10 years); WTO rules will be generally applied to non-tariffs barriers. According to EC estimates, Ukrainian exporters will save EUR 487 million annually due to reduced EU import duties, while Ukraine will remove around EUR 390 million in duties on imports from the EU.[20] Ukraine will progressively adapt its technical regulations and standards to those of the EU.[21] Chapter 6 (which deals with services) aims at the expansion of the EU internal market 'once Ukraine effectively implements the EU-acquis'. Similar wording is used in relation to financial services, telecom, postal and maritime services. Chapter 8 (Public procurement) provides exceptions for the defence sectors in both Ukraine and the EU. For the first time, Ukraine's DCFTA includes specific provisions on trade-related energy issues (Chapter 11; Ukraine is already a member of the Energy Community Treaty, which imposes an obligation to implement the EU energy acquis on electricity and gas). These include rules on pricing, the prohibition of dual pricing and transport interruption to third countries, as well as rules on non-discriminatory access to the exploration and production of hydrocarbons.[22] Importantly, Protocol I of the DCFTA deals with rules of origin and defines the 'economic nationality' of products needed to determine the duties applicable to traded goods.[23] Future EU-Ukraine relations will include EU-Ukraine summits and the Association Council with the power to take binding decisions. Last but not least, Article 39 of the agreement explicitly stipulates that the DCFTA 'shall not preclude the maintenance or establishment of customs unions, free trade areas or arrangements for frontier traffic except insofar as they conflict with trade arrangements provided for in this agreement' and consultations regarding these matters will take place within the Trade Committee.

[20] The net effect on Ukraine would thus be a gain of some EUR 100 million. In contrast, at a recent conference in Kharkiv, Sergey Glazyev predicted a deterioration of Ukraine's trade balance in the event of DCFTA signature by USD 5 billion owing to the abolishment of customs duties on 75% of imports (see www.gazeta.ru from 1 November, 2013).

[21] Ibid., Chapter 3, Technical barriers to trade. There is no available EC estimate for Ukraine's acquis takeover costs but, according to Ukrainian sources, these costs are doubtless considerable (see also Dreyer, 2012). Commissioner Füle, in his speech on 11 October, 2013, mentioned the intention to help with an 'indicative amount of EUR 186 million'. For an earlier experience of NMS see Havlik (2003).

[22] Note the similar above-quoted conditionality required by the IMF.

[23] The latter is one of Russia's major complaints regarding the incompatibility of the DCFTA and the BRK-CU (and the existing CIS-wide FTA where Ukraine is a member) and is used as an argument for the erection of trade barriers.

Source: European Commission, DG Trade and Industry. For the English version of the text, see EU Ukraine Association Agreement English – 2012_11_19_EU_Ukraine_Association_Agreement_English.pdf published on 19 November, 2012 (a concise summary was published on the European Commission DG Trade website on 26 February, 2013).

Notwithstanding the above incompatibilities, which would have to be re-negotiated and would doubtless leave room for compromises, the polarisation of Russian and EU standpoints regarding these issues is not only endangering future Russian-EU relations, but is also counterproductive with respect to Ukraine, which remains sandwiched between the two and would be ultimately adversely affected by EU-Russia frictions the most. As far as foreign trade volumes are concerned, Russia and the EU are of about the same importance for Ukraine: Ukraine's exports to each of the destinations amounted to some USD 17 billion in 2012. Russia accounted for 26% of Ukraine's exports and the BRK-CU (together with Belarus and Kazakhstan) for 33% of Ukraine's exports in 2012. The enlarged EU(28) accounted for 25% of Ukraine's exports in 2012 (see Annex for additional trade statistics). As regards imports, the situation is similar: 32% of Ukraine's imports originated from Russia in 2012 (and more than 40% from the BRK-CU), whereas imports from the EU(28) accounted for 31% of the total. However, there are important structural aspects of Ukraine's trade to either destination: the structure of exports to Russia is more 'advanced', since Ukraine's exports of transport equipment and machinery play a much bigger role. Some Ukrainian estimates reckon with an additional export and GDP growth potential from exports to Russia, especially in aircraft, shipbuilding and railway machinery industries.[24]

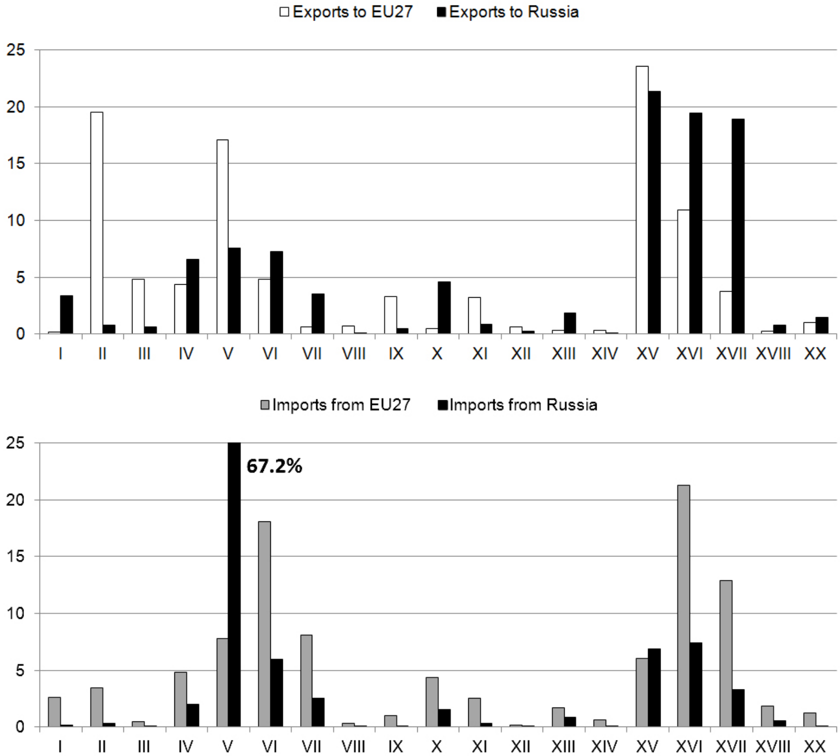
With respect to the EU, Ukraine's exports are specialised on vegetable products, mineral products (partly refined from Russian oil imports) and base metals. Ukraine's imports from Russia are traditionally dominated by mineral products, whereas imports from the EU consist mostly of chemicals, machinery and transport equipment (Figure 1).

Russia and the EU are thus nearly equally important trading partners for Ukraine. From a purely trade importance point of view the either-or decision regarding the direction of Ukraine's trade integration is rather meaningless: both directions are important. Restricted access to the Russian market – if trade barriers are introduced by Russia as a punishment in case of Ukraine's 'European integration' choice – would hit a more advanced part of Ukraine's economy (located largely in the eastern part of the country) immediately and disproportionally, irrespective of the fact that a large part of these exports may represent remnants of cooperation links from the Soviet past (and are largely not competitive on EU markets). A BRK-CU-oriented integration of Ukraine would help to maintain and develop existing technological cooperation linkages, though probably without much modernisation and restructuring pressures (unless Russia itself embarks on a more radical reform path). On the other hand, the implementation of the AA/DCFTA with the EU would bring benefits to Ukraine only in the medium and long run – especially regarding the expected pressure

[24] Calculations by L. Shinkaruk, Institute for Economics and Forecasting, National Academy of Sciences of Ukraine (mimeo).

on modernisation and reforms which would eventually lead to a significant restructuring of the Ukrainian economy and higher FDI inflows. There is little doubt that the EU, as a more developed economy, would introduce more competition, modernisation and reform pressures on Ukraine; the EU market is also much bigger than the Russian one.

Figure 1: Structure of Ukraine's foreign trade (in % of total, 2012)



Note:
I Live animals, animal products;
II Vegetable products
III Animal or vegetable fats, oils, waxes, prepared edible fats
IV Prepared foodstuffs, beverages, tobacco and substitutes
V Mineral products
VI Products of the chemical or allied industries
VII Plastics and articles thereof, rubber and articles thereof
VIII Raw hides and skins, leather, furs, etc.
IX Wood and articles of wood, wood charcoal, cork, etc.
X Pulp wood, paper or paperboard (incl. recovered) and articles
XI Textiles and textile articles
XII Footwear, headgear, umbrellas, walking sticks, etc.
XIII Articles of stone, plaster, cement, ceramic products, glassware

XIV Natural or cultured pearls, precious stones and metals, etc.
XV Base metals and articles of base metal
XVI Machinery, mech. appliances, electr. equipment
XVII Vehicles, aircraft, vessels and associated transport equipment
XVIII Optical, measuring, medical instr., clocks, musical instr., etc.
XX Miscellaneous manufactured articles
Source: State Statistics Committee of Ukraine; own calculations.

As far as customs tariffs are concerned, Ukraine and Russia have a formal free trade agreement (with some important exceptions for agricultural products such as sugar) while in trade with the EU, 70.6% of the value of Ukrainian agricultural products and 90.8% of the value of non-agricultural products were already exported duty-free in 2011. Russia faced similar tariff protection in the EU for agriculture products like Ukraine while nearly all Russian non-agricultural exports to the EU were duty free (in value; in terms of the number of duty-free tariff lines, Ukraine's agricultural products face greater trade barriers in the EU – see Table 1 and Annex). Ukraine's (as well as Russia's) exports face the highest tariff protection in dairy products, cereals, sugar, beverages and tobacco, whereas industrial products generally enjoy more tariff protection in both Ukraine and Russia. In fact, average final bound duties in both Ukraine and Russia are very similar (except for animal products, beverages and tobacco, and wood and paper where Russian tariffs are higher and the harmonisation of tariff lines should not, given the will to negotiate, pose too big a problem – with the above-quoted few exceptions, see Table 1).

Table 1 Tariffs and imports by product groups, Ukraine

Product groups	Final bound duties				MFN applied duties			Imports		Differences in final bound duties AVG		
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %	**EU-RU**	**EU-UA**	**RU-UA**
Animal products	13.0	0	20	100	11.0	9.0	20	0.5	15.0	0.3	10.4	10.1
Dairy products	10.0	0	10	100	10.0	0	10	0.2	0	39.8	44.7	4.9
Fruit, vegetables, plants	13.1	10.2	20	100	9.9	18.9	20	1.4	54.6	1.5	−2.9	−4.4
Coffee, tea	5.8	35.4	20	100	5.8	35.4	20	1.3	42.0	−0.2	0.4	0.6
Cereals & preparations	12.7	3.3	20	100	12.6	3.8	20	0.9	27.1	12.1	9.5	−2.6
Oilseeds, fats & oils	10.7	11.0	30	100	8.3	20.1	30	0.9	89.9	−1.5	−5.1	−3.6
Sugars and confectionery	17.5	0.6	50	100	17.5	0	50	0.3	0	18.3	13.5	−4.8
Beverages & tobacco	7.9	25.7	64	100	12.2	26.2	424	1.2	23.9	−2.3	13.4	15.7
Cotton	1.4	40.0	5	100	1.4	40.0	5	0.0	61.3	0	−1.4	−1.4
Other agricultural products	7.6	23.9	20	100	5.5	45.2	20	0.5	19.3	−1.2	−3.5	−2.3
Fish & fish products	3.7	61.7	20	100	2.6	68.2	20	0.7	68.0	3.4	7.2	3.8
Minerals & metals	4.5	42.4	20	100	3.0	47.6	20	32.8	79.0	−6	−2.5	3.5
Petroleum	1.5	72.0	10	100	0.9	84.3	10	13.7	97.3	−3	0.5	3.5
Chemicals	5.1	16.1	10	100	3.2	39.3	65	12.7	55.4	−0.6	−0.5	0.1
Wood, paper, etc.	0.4	95.8	10	100	0.3	95.8	10	3.1	99.1	−7	0.5	7.5
Textiles	4.1	33.7	13	100	3.8	35.6	13	2.1	25.6	−1.3	2.4	3.7
Clothing	11.4	1.0	12	100	11.3	1.1	12	0.6	0.1	−0.3	0.1	0.4
Leather, footwear, etc.	7.2	14.9	25	100	5.4	27.0	25	1.9	20.3	−2.2	−3	−0.8
Non-electrical machinery	4.2	38.7	12	100	2.1	51.3	10	8.8	62.4	−4.1	−2.5	1.6
Electrical machinery	5.3	33.0	25	100	3.8	39.1	25	6.8	34.2	−3.8	−2.9	0.9
Transport equipment	7.5	15.8	20	100	5.1	39.6	20	7.5	21.4	−4.8	−3.4	1.4
Manufactures, n.e.s.	6.4	31.9	25	100	5.5	32.0	25	2.1	68.6	−5.9	−3.9	2

Source: WTO; own calculations.

VI. Conclusion

Cooperation and integration, not confrontation

The earlier (both positive and negative) integration experiences of the new EU Member States (NMS) may provide a useful reference point for Ukraine. NMS trade integration with the EU advanced rapidly after they had signed association agreements and inflows of FDI to the region had already accelerated before EU accession. FDI inflows have brought new technologies, higher quality standards, and better know-how in management and marketing (Hunya, 2008). Last but not least, FDI inflows have facilitated access to EU markets and fostered modernisation; they even contributed to a revival of intra-NMS trade (Richter, 2011). FDI-induced modernisation was also crucial in raising the energy efficiency of the recipient countries' economies (which remains an important challenge for Ukraine – see Astrov et al., 2012). 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 gaining global market shares (Havlik, 2008). But the experience of the NMS in the recent crisis has also taught important lessons regarding the negative effects of capital flows and integration – neither being a panacea with respect to growth and convergence (see, for example, Gligorov et al., 2012).

In the case of Ukraine – unlike in the above-mentioned NMS countries – one important factor behind the success restructuring story, namely the 'carrot' of prospective EU membership, is missing and is unlikely to be in place any time soon. Theoretically, Ukraine (just as Russia) could still try to emulate these developments via closer EU integration – even without a formal accession anchor, as the Baltic States did in the early 1990s.[25] 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). The BRK-CU members – and first of all Russia – should also advance their integration with the enlarged EU, at least to the stage of a free trade area. Closer EU-BRK-CU integration which would include Ukraine is a potentially preferred option in future, and would, if accompanied by a parallel integration of other EaP countries, lay the foundation for a broader Pan-European Economic Space and wider Eurasian integration 'from Lisbon to Vladivostok'. This could be part of the new inclusive strategy for the EU Eastern Partnership which would refrain from strategic rivalry with Russia and revitalise the Partnership for Modernisation, especially in order to avoid trade wars and the raising of new walls in Europe (Samson, 2002; Havlik, 2010; Emerson, 2011a; Havlik, 2013; Wisniewski, 2013; etc.).

In summary, both Russia and the EU should abstain from counterproductive geopolitical games over influence in the EaP region which would have adverse consequences, especially for the EaP countries concerned. EU-Russia negotiations should not be about Ukraine or other EaP countries but should involve the latter in the process. All parties should also continue/resume FTA negotiations – perhaps with a lesser and selective focus on costly harmonisations of norms and regulations. Last but not least, progress on visa liberalisation

[25] It is questionable as to whether this incentive is sufficient for truly sustained reform efforts. WTO membership is definitely not a sufficient 'reform anchor' – see O. Havrylyshyn in Grinberg et al. (2008).

procedures and other confidence-building measures should be decisively speeded up and here it is the EU which should deliver. Apart from confidence building measures, closer integration of the enlarged EU, Russia and the Eastern Partnership countries – from 'Lisbon to Vladivostok' – would boost trade and investment, thus fostering badly needed economic growth and stability in Europe.

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Statistical Annex

Tables from the *wiiw Handbook of Statistics: Countries in Transition 2013*.

Table A1: Kazakhstan – Foreign trade by country groupings

	2000	2005	2009	2010	2011	2012*
EUR mn[1] [2]						
Exports, fob						
Total	9319	22371	30977	45387	62929	67249
EU-28	2400	9034	15164	23203	30738	35364
EU-15	2181	7752	12705	20391	27253	30665
Other countries[3]	6919	13337	15813	22185	32191	31884
Imports, cif						
Total	5330	13939	20373	23440	26619	36021
EU-28	1253	3453	5588	5482	5271	7270
EU-15	1074	2995	4805	4567	4355	6069
Other countries[3]	4077	10486	14785	17958	21348	28752
Trade balance						
Total	3989	8432	10604	21947	36310	31227
EU-28	1147	5581	9576	17721	25467	28095
EU-15	1108	4757	7900	15824	22898	24597
Other countries[3]	2842	2851	1028	4226	10843	3133
Annual growth in %						
Exports, fob						
Total	72.6	38.3	−36.0	46.5	38.6	6.9
EU-28	62.1	59.5	−27.0	53.0	32.5	15.1
EU-15	87.0	52.7	−32.1	60.5	33.7	12.5
Other countries[3]	76.6	26.9	−42.7	40.3	45.1	−1.0
Imports, cif						
Total	58.6	35.5	−20.9	15.1	13.6	35.3
EU-28	26.9	22.6	−4.3	−1.9	−3.8	37.9
EU-15	29.1	25.9	−3.2	−5.0	−4.6	39.3
Other countries[3]	71.8	40.4	−25.7	21.5	18.9	34.7
Shares in %						
Exports, fob						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	25.8	40.4	49.0	51.1	48.8	52.6
EU-15	23.4	34.7	41.0	44.9	43.3	45.6
Other countries[3]	74.2	59.6	51.0	48.9	51.2	47.4
Imports, cif						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	23.5	24.8	27.4	23.4	19.8	20.2
EU-15	20.1	21.5	23.6	19.5	16.4	16.8
Other countries[3]	76.5	75.2	72.6	76.6	80.2	79.8

1) Officially registered trade.
2) Values in EUR converted from USD to NCU to EUR at the average official exchange rate.
3) Refers to total minus EU-28 from 2000.

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Table A2: Russia – Foreign trade by country groupings

	2000	2005	2009	2010	2011	2012*
EUR mn1)						
Exports, fob						
Total	111449	193709	216560	299354	371071	408182
EU-28	60780	111619	116080	160210	192189	216319
EU-15	39870	80255	88564	121657	142915	164148
Other countries2)	50668	82090	100480	139143	178882	191863
Imports, cif						
Total	36613	79190	120136	172579	219576	246447
EU-28	14617	35375	53962	71947	91606	96044
EU-15	12044	29283	43287	56998	74154	79421
Other countries2)	21996	43815	66174	100632	127970	150403
Trade balance						
Total	74836	114519	96424	126775	151495	161735
EU-28	46164	76245	62119	88263	100583	120275
EU-15	27827	50972	45278	64659	68761	84727
Other countries2)	28672	38275	34306	38511	50912	41460
Annual growth in %						
Exports, fob						
Total	63.0	32.6	−32.0	38.2	24.0	10.0
EU-28	80.1	46.2	−36.4	38.0	20.0	12.6
EU-15	71.0	51.2	−34.2	37.4	17.5	14.9
Other countries2)	46.3	17.7	−26.2	38.5	28.6	7.3
Imports, cif						
Total	28.9	30.3	−34.0	43.7	27.2	12.2
EU-28	17.9	27.8	−32.0	33.3	27.3	4.8
EU-15	14.9	28.0	−32.3	31.7	30.1	7.1
Other countries2)	37.4	32.3	−35.5	52.1	27.2	17.5
Shares in %						
Exports, fob						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	54.5	57.6	53.6	53.5	51.8	53.0
EU-15	35.8	41.4	40.9	40.6	38.5	40.2
Other countries2)	45.5	42.4	46.4	46.5	48.2	47.0
Imports, cif						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	39.9	44.7	44.9	41.7	41.7	39.0
EU-15	32.9	37.0	36.0	33.0	33.8	32.2
Other countries2)	60.1	55.3	55.1	58.3	58.3	61.0

1) Values in EUR converted from USD to NCU to EUR at the average official exchange rate.
2) Refers to total minus EU-28 from 2000.

Table A3: Ukraine – Foreign trade by country groupings

	2000	2005	2009	2010	2011	2012*
EUR mn1)						
Exports, fob						
Total	15764.6	27455.0	28457.9	38729.2	49129.8	53536.7
EU-28	5215.2	8256.5	6820.9	9858.6	12945.4	13321.2
EU-15	2811.6	4578.1	3906.7	5474.5	6787.7	7371.1
Other countries2)	10549.4	19198.5	21637.0	28870.6	36184.3	40215.5
Imports, cif						
Total	15097.7	28985.3	32571.0	45763.8	59340.2	65867.2
EU-28	4378.8	9794.8	11067.9	14428.9	18536.3	20404.6
EU-15	3116.9	6755.8	7225.0	8921.6	11938.4	13168.3
Other countries2)	10718.9	19190.5	21503.1	31334.9	40803.9	45462.6
Trade balance						
Total	667.0	−1530.3	−4113.1	−7034.6	−10210.4	−12330.5
EU-28	836.4	−1538.3	−4247.1	−4570.3	−5590.9	−7083.5
EU-15	−305.3	−2177.7	−3318.3	−3447.1	−5150.6	−5797.2
Other countries2)	−169.5	8.0	133.9	−2464.3	−4619.5	−5247.1
Annual growth in %						
Exports, fob						
Total	44.8	4.4	−37.8	36.1	26.9	9.0
EU-28	51.4	−7.3	−45.4	44.5	31.3	2.9
EU-15	41.2	−4.7	−40.7	40.1	24.0	8.6
Other countries2)	41.7	10.4	−35.0	33.4	25.3	11.1
Imports, cif						
Total	35.6	24.2	−44.3	40.5	29.7	11.0
EU-28	34.6	27.3	−44.0	30.4	28.5	10.1
EU-15	38.2	23.7	−42.7	23.5	33.8	10.3
Other countries2)	36.0	22.7	−44.4	45.7	30.2	11.4
Shares in %						
Exports, fob						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	33.1	30.1	24.0	25.5	26.3	24.9
EU-15	17.8	16.7	13.7	14.1	13.8	13.8
Other countries2)	66.9	69.9	76.0	74.5	73.7	75.1
Imports, cif						
Total	100.0	100.0	100.0	100.0	100.0	100.0
EU-28	29.0	33.8	34.0	31.5	31.2	31.0
EU-15	20.6	23.3	22.2	19.5	20.1	20.0
Other countries2)	71.0	66.2	66.0	68.5	68.8	69.0

1) Values in EUR converted from USD to NCU to EUR at the average official exchange rate.
2) Refers to total minus EU-28 from 2000.

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Table A4: Kazakhstan – Exports to top thirty partners

		2000	2005	2009	2010	2011	2012*
Total exports, fob, EUR mn[1)]		9319.0	22370.9	30977.2	45387.1	62928.6	67248.6
Shares in % (ranking in 2012)							
Italy	1	10.41	15.05	15.48	15.89	17.17	17.77
China	2	7.65	8.70	13.63	16.79	18.60	16.46
Netherlands	3	2.57	3.15	5.15	6.90	7.58	8.43
Russia	4	19.87	10.51	8.21	9.48	7.99	7.09
France	5	0.18	9.57	7.83	7.36	6.18	6.52
Austria	6	0.01	0.00	2.77	4.20	4.43	5.73
Switzerland	7	5.15	19.78	6.18	2.05	5.66	5.69
Canada	8	0.08	1.90	3.21	4.06	3.00	3.56
Romania	9	0.01	1.65	1.95	2.13	2.59	3.51
Turkey	10	0.71	0.56	1.83	2.05	2.94	3.13
Ukraine	11	2.88	0.72	2.98	1.11	3.05	2.76
United Kingdom	12	2.58	1.15	2.86	2.30	1.85	1.94
Poland	13	0.64	1.32	1.93	2.02	1.49	1.87
Israel	14	.	.	2.60	2.12	1.62	1.78
Germany	15	6.25	1.47	2.08	2.90	1.84	1.61
Uzbekistan	16	1.51	0.87	2.06	1.82	1.35	1.36
Portugal	17	.	1.14	0.64	1.22	1.30	1.18
Spain	18	0.07	1.67	1.34	1.53	1.30	0.77
Greece	19	0.01	0.50	1.26	1.65	0.66	0.76
Kyrgyzstan	20	0.66	0.81	0.90	0.70	0.58	0.74
Iran	21	2.31	3.18	2.96	1.81	1.23	0.70
Japan	22	0.11	0.49	0.57	0.89	1.19	0.64
Finland	23	0.79	0.64	1.04	0.45	0.67	0.60
Tajikistan	24	0.60	0.54	0.56	0.43	0.41	0.54
United States	25	2.38	2.39	1.42	1.46	1.17	0.46
Bulgaria	26	0.02	0.00	0.42	0.28	0.55	0.41
Azerbaijan	27	0.53	0.46	0.21	0.57	0.27	0.40
Afghanistan	28	0.66	0.59	0.95	0.60	0.38	0.34
Cyprus	29	0.02	1.03	.	0.01	0.10	0.26
Korea Republic	30	0.41	0.67	0.30	0.39	0.32	0.25

1) Officially registered trade.

Table A5: Russia – Exports to top thirty partners

		2000	2005	2009	2010	2011	2012*
Total exports, fob, EUR mn		111449	193709	216560	299354	371071	408182
Shares in % (ranking in 2012)							
Netherlands	1	4.22	10.19	12.07	13.59	12.13	14.64
China	2	5.09	5.40	5.53	5.12	6.78	6.81
Germany	3	8.95	8.17	6.20	6.46	6.61	6.78
Italy	4	7.03	7.89	8.32	6.92	6.32	6.18
Turkey	5	3.00	4.49	5.43	5.12	4.91	5.23
Ukraine	6	4.87	5.14	4.59	5.83	5.90	5.18
Belarus	7	5.40	4.19	5.54	4.55	4.82	4.68
Poland	8	4.32	3.57	4.14	3.76	4.14	3.79
Japan	9	2.68	1.55	2.40	3.23	2.83	2.97
Kazakhstan	10	2.18	2.71	3.03	2.69	2.73	2.87
United Kingdom	11	4.53	3.43	3.01	2.85	2.71	2.86
Korea Republic	12	0.94	0.98	1.88	2.63	2.59	2.63
United States	13	4.50	2.62	3.03	3.10	3.18	2.47
Finland	14	3.01	3.17	3.04	3.06	2.55	2.29
Switzerland	15	3.74	4.46	2.06	2.20	2.22	2.05
France	16	1.85	2.53	2.89	3.13	2.88	2.01
Latvia	17	1.58	0.49	1.37	1.48	1.43	1.70
India	18	1.05	0.96	1.97	1.61	1.18	1.51
Belgium	19	0.73	1.02	1.34	1.24	1.45	1.30
Hungary	20	2.33	2.07	1.29	1.35	1.50	1.27
Sweden	21	1.68	0.96	1.06	0.90	0.99	1.18
Slovakia	22	2.06	1.32	0.98	1.15	1.37	1.17
Greece	23	1.23	0.80	0.77	0.72	0.91	1.13
Spain	24	1.04	1.17	0.96	1.02	1.19	1.09
Lithuania	25	2.01	1.66	1.13	0.89	1.40	1.03
Czech Republic	26	1.69	1.58	1.47	1.39	1.05	1.00
Bulgaria	27	0.57	0.79	0.73	0.86	0.68	0.83
Estonia	28	1.20	0.88	0.38	0.43	0.55	0.70
Taiwan	29	0.39	0.60	0.26	0.45	0.41	0.63
Egypt	30	0.44	0.43	0.60	0.48	0.45	0.61

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Table A6: Ukraine – Exports to top thirty partners

		2000	2005	2009	2010	2011	2012*
Total exports, fob, EUR mn		15764.6	27455.0	28457.9	38729.2	49129.8	53536.7
Shares in % (ranking in 2012)							
Russia	1	24.12	21.88	21.40	26.12	28.98	25.62
Turkey	2	5.96	5.92	5.36	5.89	5.48	5.36
Egypt	3	1.52	2.33	2.55	0.43	1.95	4.21
Poland	4	2.87	2.95	3.04	3.48	4.09	3.74
Italy	5	4.38	5.53	3.09	4.69	4.44	3.60
Kazakhstan	6	0.53	1.95	3.57	2.53	2.72	3.57
India	7	1.15	2.15	2.90	0.97	3.31	3.33
Belarus	8	1.87	2.60	3.17	3.69	2.81	3.27
China	9	4.32	2.08	3.61	0.91	3.19	2.58
Germany	10	5.09	3.75	3.14	2.92	2.58	2.39
Spain	11	1.12	1.68	1.44	0.80	1.42	2.24
Hungary	12	2.25	2.01	1.84	1.67	1.96	2.19
Lebanon	13	0.42	0.30	1.75	0.58	1.99	2.07
Iran	14	0.62	1.69	1.90	0.55	1.65	1.69
United States	15	4.98	2.79	0.63	1.58	1.63	1.47
Saudi Arabia	16	0.25	1.13	1.26	0.16	1.19	1.35
Netherlands	17	0.95	1.51	1.50	1.10	1.22	1.21
Moldova	18	1.21	1.98	1.75	1.39	1.28	1.20
Israel	19	0.73	0.85	0.99	0.31	0.75	1.16
Azerbaijan	20	0.28	0.85	1.38	1.19	1.04	1.11
Czech Republic	21	1.30	1.10	0.86	1.22	1.23	1.03
Slovakia	22	1.58	1.48	1.09	1.11	1.23	0.98
Syria	23	1.10	1.96	1.90	0.36	1.35	0.84
Bulgaria	24	2.62	1.59	1.00	0.88	1.10	0.83
Romania	25	1.13	1.43	0.80	1.37	1.39	0.80
United Kingdom	26	0.94	1.05	0.87	0.99	0.71	0.80
France	27	0.77	0.58	1.11	0.93	0.83	0.80
Georgia	28	0.26	0.58	1.00	1.03	0.96	0.79
Jordan	29	0.31	0.53	1.20	0.20	0.66	0.78
Turkmenistan	30	1.02	0.55	0.82	0.41	0.35	0.77

Table A7: Kazakhstan – Imports from top thirty partners

		2000	2005	2009	2010	2011	2012*
Total imports, cif, EUR mn 1)		5329.9	13939.0	20372.8	23440.1	26618.5	36021.2
Shares in % (ranking in 2012)							
Russia	1	48.40	37.98	31.32	39.38	41.38	36.59
China	2	3.00	7.21	12.56	12.73	13.55	16.08
Germany	3	6.66	7.50	7.19	5.93	5.62	8.26
Ukraine	4	1.61	4.87	7.50	4.37	4.68	6.33
United States	5	5.50	6.94	4.90	4.24	4.63	4.60
Italy	6	3.09	3.91	6.74	5.10	3.09	2.11
Korea Republic	7	1.66	1.48	1.32	1.69	1.68	2.09
Japan	8	2.09	3.45	2.24	1.80	1.74	1.97
Turkey	9	2.86	2.30	2.01	1.99	1.97	1.74
Uzbekistan	10	1.40	1.47	1.07	1.52	2.08	1.74
Belarus	11	0.78	1.20	1.29	1.70	1.60	1.43
France	12	1.50	1.68	1.62	1.60	1.86	1.41
United Kingdom	13	4.43	2.44	2.47	2.34	1.42	1.30
Poland	14	1.16	1.14	1.48	1.22	1.06	1.04
Kyrgyzstan	15	0.60	0.68	0.41	0.53	0.65	0.79
India	16	0.91	0.58	0.55	0.64	0.66	0.72
Czech Republic	17	0.67	0.55	0.63	0.54	0.44	0.70
Brazil	18	0.55	0.96	0.71	0.75	0.92	0.65
Netherlands	19	1.30	0.81	1.12	0.97	0.79	0.62
Austria	20	0.36	0.90	0.89	0.71	0.60	0.58
Sweden	21	0.51	1.51	0.92	0.67	0.84	0.54
Finland	22	1.14	1.14	1.09	0.67	0.67	0.54
Spain	23	0.18	0.44	0.42	0.32	0.40	0.50
Switzerland	24	1.08	1.16	0.55	0.58	0.42	0.48
Canada	25	0.46	0.73	0.87	0.70	0.47	0.45
Belgium	26	0.66	0.83	0.55	0.57	0.48	0.44
Lithuania	27	0.19	0.16	0.38	0.35	0.27	0.41
Turkmenistan	28	0.86	0.29	0.22	0.03	0.18	0.39
Hungary	29	0.51	0.40	0.35	0.41	0.44	0.31
Ireland	30	.	.	0.23	0.27	0.28	0.27

1) Officially registered trade.

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Table A8: Russia – Imports from top thirty partners

		2000	2005	2009	2010	2011	2012*
Total imports, cif, EUR mn		36613	79190	120136	172579	219576	246447
Shares in % (ranking in 2012)							
China	1	2.80	7.36	13.62	17.02	15.78	15.40
Germany	2	11.51	13.45	12.69	11.66	12.32	12.09
Ukraine	3	10.78	7.92	5.46	6.14	6.58	5.68
Japan	4	1.69	5.91	4.33	4.48	4.91	4.95
United States	5	7.95	4.62	5.48	4.85	4.77	4.83
France	6	3.50	3.72	5.04	4.39	4.34	4.35
Italy	7	3.58	4.47	4.72	4.39	4.38	4.24
Belarus	8	10.95	5.79	4.01	4.35	4.48	3.56
Kazakhstan	9	6.49	3.27	2.21	1.94	2.34	2.72
United Kingdom	10	2.54	2.81	2.12	2.00	2.35	2.59
Korea Republic	11	1.06	4.06	2.91	3.18	3.79	2.17
Turkey	12	1.03	1.75	1.92	2.13	2.08	2.16
Poland	13	2.11	2.78	2.52	2.55	2.18	2.13
Netherlands	14	2.18	1.97	2.14	1.94	1.94	1.61
Finland	15	2.83	3.14	2.36	2.00	1.85	1.51
Spain	16	0.92	1.24	1.36	1.33	1.41	1.24
Belgium	17	1.42	1.50	1.52	1.43	1.35	1.18
Czech Republic	18	1.08	1.00	1.39	1.27	1.47	1.12
Brazil	19	1.14	2.38	2.08	1.78	1.44	1.03
Austria	20	1.24	1.23	1.23	1.08	1.02	0.99
Sweden	21	1.37	1.88	1.22	1.25	1.32	0.94
India	22	1.64	0.79	0.91	0.94	0.91	0.93
Hungary	23	1.19	1.11	1.57	1.37	1.09	0.88
Switzerland	24	0.80	0.89	1.17	1.05	0.97	0.86
Vietnam	25	0.11	0.18	0.41	0.49	0.56	0.71
Slovakia	26	0.31	0.51	1.08	1.09	0.97	0.66
Denmark	27	1.02	0.93	0.82	0.74	0.67	0.63
Canada	28	0.57	0.52	0.72	0.65	0.60	0.61
Taiwan	29	0.26	0.50	0.55	0.67	0.67	0.60
Norway	30	0.46	0.76	0.67	0.62	0.62	0.56

Table A9: Ukraine – Imports from top thirty partners

		2000	2005	2009	2010	2011	2012*
Total imports, cif, EUR mn		15097.7	28985.3	32571.0	45763.8	59340.2	65867.2
Shares in % (ranking in 2012)							
Russia	1	41.74	35.54	29.13	36.54	35.27	32.39
China	2	0.94	5.01	6.02	2.03	7.59	9.33
Germany	3	8.13	9.36	8.48	7.58	8.31	8.04
Belarus	4	4.31	2.60	3.73	4.23	5.10	5.99
Poland	5	2.24	3.89	4.78	4.59	3.85	4.21
United States	6	2.58	1.96	2.83	2.91	3.14	3.43
Italy	7	2.48	2.85	2.51	2.29	2.43	2.64
Turkey	8	1.15	1.68	2.10	2.14	1.79	2.31
France	9	1.69	2.21	2.14	1.82	1.82	1.97
Korea Republic	10	0.79	1.79	1.25	0.46	1.50	1.83
Kazakhstan	11	2.96	0.52	4.48	1.26	2.03	1.77
Czech Republic	12	1.17	1.64	1.37	1.23	1.43	1.47
Japan	13	0.71	1.52	1.14	1.32	1.23	1.41
Hungary	14	1.19	1.79	1.49	2.00	1.61	1.37
United Kingdom	15	1.45	1.39	1.43	1.35	1.37	1.36
Netherlands	16	1.05	1.28	1.49	1.38	1.44	1.33
India	17	0.54	0.89	1.05	0.28	0.98	1.21
Romania	18	0.35	0.59	1.07	1.12	1.36	1.10
Lithuania	19	0.97	0.55	0.90	1.05	1.00	1.08
Singapore	20	0.03	0.05	0.06	0.01	0.05	0.97
Switzerland	21	1.55	0.70	0.96	0.84	0.96	0.90
Spain	22	0.72	0.65	0.82	0.77	0.83	0.88
Austria	23	1.33	1.27	1.35	1.15	0.86	0.87
Belgium	24	0.97	0.87	1.02	0.97	0.80	0.84
Slovakia	25	0.89	0.84	0.67	0.73	0.73	0.69
Brazil	26	0.67	0.86	0.83	0.17	0.66	0.68
Sweden	27	1.08	1.51	0.99	0.59	0.77	0.64
Finland	28	0.69	0.97	0.93	0.71	0.63	0.57
Indonesia	29	0.20	0.34	0.57	0.20	0.64	0.49
Norway	30	0.32	0.35	0.57	0.43	0.33	0.45

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Table A10: Kazakhstan – Exports and imports by SITC commodity groups

	2000	2005	2009	2010	2011	2012*
Exports1)						
Total exports, fob, EUR mn	9319.0	22370.9	30977.2	45387.1	62928.6	67248.6
Shares in %						
0 Food and live animals	6.7	2.2	3.5	3.1	1.8	2.9
1 Beverages and tobacco	0.2	0.2	0.1	0.1	0.1	0.1
2 Crude materials, inedible, except fuels	7.5	6.7	6.0	5.4	6.9	6.2
3 Mineral fuels, lubricants and related materials	52.8	70.1	69.5	71.7	72.0	69.9
4 Animal and vegetable oils, fats and waxes	0.0	0.0	0.1	0.1	0.0	0.1
5 Chemicals and related products, n.e.s.	1.1	1.9	4.5	4.4	3.3	3.8
6 Manufactured goods classified chiefly by material	26.9	16.7	13.7	13.0	13.7	14.0
7 Machinery and transport equipment	2.2	1.2	0.9	0.6	0.8	1.4
8 Miscellaneous manufactured articles	0.5	0.2	0.1	0.1	0.3	0.7
9 Commodities not classified elsewhere in the SITC	2.0	0.7	1.5	1.5	1.1	1.0
Imports1)						
Total imports, cif, EUR mn	5329.9	13939.0	20372.8	23440.1	26618.5	36021.2
Shares in %						
0 Food and live animals	7.1	5.7	6.8	8.0	8.7	7.8
1 Beverages and tobacco	1.3	1.1	1.2	1.0	1.1	1.1
2 Crude materials, inedible, except fuels	2.8	2.0	1.2	1.3	1.4	2.3
3 Mineral fuels, lubricants and related materials	11.4	11.9	10.0	9.9	12.8	10.8
4 Animal and vegetable oils, fats and waxes	0.8	0.4	0.5	0.5	0.5	0.4
5 Chemicals and related products, n.e.s.	10.2	9.3	10.0	11.9	10.4	10.3
6 Manufactured goods classified chiefly by material	18.8	21.6	26.5	18.1	17.3	19.7
7 Machinery and transport equipment	39.7	41.5	37.0	40.3	35.8	38.0
8 Miscellaneous manufactured articles	6.4	6.5	6.8	9.0	11.8	9.4
9 Commodities not classified elsewhere in the SITC	1.4	0.1	0.2	0.1	0.2	0.4

1) Officially registered trade.

Table A11: Russia – Exports and imports by SITC commodity groups

	2000	2005	2009	2010	2011	2012*
Exports						
Total exports, fob, EUR mn	111449	193709	216560	299354	371071	408182
Shares in %						
0 Food and live animals	0.9	1.3	2.5	1.6	1.8	2.5
1 Beverages and tobacco	0.1	0.2	0.3	0.2	0.1	0.2
2 Crude materials, inedible, except fuels	4.5	4.4	3.1	3.1	3.3	2.4
3 Mineral fuels, lubricants and related materials	50.6	61.8	63.0	65.6	67.0	70.3
4 Animal and vegetable oils, fats and waxes	0.1	0.1	0.3	0.1	0.2	0.4
5 Chemicals and related products, n.e.s.	6.0	4.2	4.1	4.0	4.2	4.7
6 Manufactured goods classified chiefly by material	17.8	14.8	12.3	11.2	9.8	9.5
7 Machinery and transport equipment	6.2	4.1	3.6	2.8	2.3	2.7
8 Miscellaneous manufactured articles	2.0	0.8	0.8	0.6	0.4	0.6
9 Commodities not classified elsewhere in the SITC	11.8	8.4	10.1	10.8	10.8	6.6
Imports						
Total imports, cif, EUR mn	36613	79190	120136	172579	219576	246447
Shares in %						
0 Food and live animals	15.6	12.8	13.1	11.6	10.1	10.2
1 Beverages and tobacco	3.3	2.4	1.7	1.5	1.3	1.4
2 Crude materials, inedible, except fuels	7.2	3.7	3.0	2.2	2.1	2.2
3 Mineral fuels, lubricants and related materials	4.1	1.6	1.4	1.2	1.6	1.3
4 Animal and vegetable oils, fats and waxes	1.1	0.8	0.7	0.7	0.6	0.5
5 Chemicals and related products, n.e.s.	11.8	12.7	13.1	12.8	11.7	12.1
6 Manufactured goods classified chiefly by material	13.9	13.0	11.5	11.9	11.6	12.8
7 Machinery and transport equipment	24.5	39.9	37.1	39.0	41.9	31.5
8 Miscellaneous manufactured articles	7.2	7.0	10.2	11.0	10.0	11.3
9 Commodities not classified elsewhere in the SITC	11.2	6.2	8.0	8.2	9.1	16.7

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Table A12: Ukraine – Exports and imports by SITC commodity groups

	2000	2005	2009	2010	2011	2012*
Exports						
Total exports, fob, EUR mn	15764.6	27455.0	28457.9	38729.2	49129.8	53536.7
Shares in %						
0 Food and live animals1)	6.3	10.3	16.8	12.2	11.7	17.4
1 Beverages and tobacco	.	.	.	.	.	.
2 Crude materials, inedible, except fuels	12.7	7.2	9.6	10.4	11.0	10.3
3 Mineral fuels, lubricants and related materials	5.5	9.8	5.4	7.1	8.3	5.3
4 Animal and vegetable oils, fats and waxes	1.6	1.7	4.4	5.0	4.8	6.0
5 Chemicals and related products, n.e.s.	9.0	9.0	6.2	6.7	7.9	7.3
6 Manufactured goods classified chiefly by material	45.6	44.1	36.1	37.1	33.3	28.8
7 Machinery and transport equipment	12.3	12.6	16.6	17.3	12.9	14.4
8 Miscellaneous manufactured articles	4.5	3.8	4.0	3.5	3.0	2.8
9 Commodities not classified elsewhere in the SITC	2.4	1.6	0.8	0.7	7.1	7.6
Imports						
Total imports, cif, EUR mn	15097.7	28985.3	32571.0	45763.8	59340.2	65867.2
Shares in %						
0 Food and live animals1)	5.9	6.5	9.5	8.2	6.3	7.2
1 Beverages and tobacco	.	.	.	.	.	.
2 Crude materials, inedible, except fuels	5.6	3.9	3.4	3.7	2.8	2.6
3 Mineral fuels, lubricants and related materials	43.0	29.5	32.2	32.3	34.6	30.9
4 Animal and vegetable oils, fats and waxes	0.3	0.5	0.7	0.7	0.5	0.4
5 Chemicals and related products, n.e.s.	8.8	11.7	15.3	14.3	11.9	12.1
6 Manufactured goods classified chiefly by material	12.8	14.6	13.7	14.4	12.5	11.6
7 Machinery and transport equipment	17.5	25.0	18.5	19.6	16.6	19.5
8 Miscellaneous manufactured articles	3.6	5.4	5.8	6.0	3.9	5.1
9 Commodities not classified elsewhere in the SITC	2.6	2.9	0.9	1.0	11.0	10.4

1) Including beverages and tobacco.

Table B1: Tariffs and imports, Russian Federation

Part A.1 **Tariffs and imports: Summary and duty ranges**

Summary		Total	Ag	Non-Ag	WTO member since		2012
Simple average final bound		7.8	11.2	7.2	Binding coverage:	Total	100
Simple average MFN applied	2012	10.0	13.3	9.4		Non-Ag	100
Trade weighted average	2011	9.9	16.7	8.8	Ag: Tariff quotas (in %)		3.2
Imports in billion US$	2011	277.6	37.4	240.2	Ag: Special safeguards (in %)		0

Frequency distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV in %
		Tariff lines and import values (in %)								
Agricultural products										
Final bound		3.0	43.3	21.5	24.5	4.2	0.8	2.3	0.3	22.9
MFN applied	2012	8.2	36.9	7.8	30.2	10.7	3.8	2.1	0.3	28.2
Imports	2011	9.0	24.8	7.2	27.9	18.6	8.0	4.4	0.0	54.7
Non-agricultural products										
Final bound		3.4	50.0	30.4	14.9	1.2	0.1	0.0	0	7.0
MFN applied	2012	14.2	34.4	19.9	20.6	8.9	1.5	0.3	0.1	10.1
Imports	2011	32.6	21.9	17.8	12.9	8.5	6.0	0.1	0.0	9.6

Part A.2 **Tariffs and imports by product groups**

Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Animal products	23.1	7.4	80	100	23.7	14.8	90	2.5	3.6
Dairy products	14.9	0	21	100	18.4	0	50	0.8	0
Fruit, vegetables, plants	8.7	0.2	45	100	11.7	4.6	134	4.1	8.6
Coffee, tea	6.4	4.2	13	100	9.1	20.8	23	1.1	34.1
Cereals & preparations	10.1	1.3	77	100	12.9	3.5	77	0.9	1.6
Oilseeds, fats & oils	7.1	8.2	25	100	8.5	10.9	48	0.8	22.1
Sugars and confectionery	12.7	0	48	100	12.9	0	39	0.7	0
Beverages & tobacco	23.6	0	292	100	29.2	5.2	292	1.6	2.7
Cotton	0.0	100.0	0	100	0.0	100.0	0	0.1	100.0
Other agricultural products	5.3	0	10	100	5.6	7.4	20	0.8	7.0
Fish & fish products	7.5	0	77	100	12.4	0.4	77	0.9	2.6
Minerals & metals	8.0	0.1	20	100	9.9	6.4	90	9.5	12.8

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Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Petroleum	5.0	0	5	100	4.5	10.0	5	1.1	1.3
Chemicals	5.2	0.4	10	100	6.4	5.8	21	13.8	13.2
Wood, paper, etc.	7.9	5.0	15	100	12.8	6.1	30	3.3	9.8
Textiles	7.8	0	18	100	10.9	0.6	37	2.1	2.7
Clothing	11.8	0	42	100	19.6	0	100	2.4	0
Leather, footwear, etc.	6.4	0	15	100	10.3	8.7	176	3.2	7.7
Non-electrical machinery	5.8	7.9	15	100	3.4	66.2	21	18.7	73.6
Electrical machinery	6.2	23.3	16	100	7.3	25.2	27	11.1	37.8
Transport equipment	8.9	2.5	20	100	10.6	17.7	35	16.1	29.9
Manufactures, n.e.s.	8.4	7.9	20	100	11.4	17.2	190	4.4	39.7

Part B **Exports to major trading partners and duties faced**

Major markets	Bilateral imports in million US$		Diversification 95% trade in no. of		MFN AVG of traded TL		Pref. margin	Duty-free imports	
			HS 2-digit	HS 6-digit	Simple	Weighted	Weighted	TL in %	Value in %
Agricultural products									
1. Kazakhstan	2011	1,569	22	120	20.8	24.5	24.5	100.0	100.0
2. European Union	2011	1,510	22	55	14.6	7.9	1.3	21.8	67.7
3. Egypt	2011	1,386	2	2	112.0	0.5	0.0	25.0	97.4
4. Turkey	2011	863	6	13	29.5	85.4	0.0	14.2	3.7
5. Ukraine	2011	679	12	49	9.8	10.4	8.8	96.1	80.8
Non-agricultural products									
1. European Union	2011	241,503	16	62	4.1	0.3	0.2	69.5	97.1
2. China	2011	40,298	18	46	7.7	1.4	0.0	17.1	73.3
3. United States	2011	33,383	19	49	2.3	0.2	0.1	87.7	33.4
4. Ukraine	2011	28,386	45	347	3.7	0.9	0.9	100.0	100.0
5. Belarus	2011	23,958	50	540	9.5	3.3	3.3	100.0	100.0

Source: WTO (http://stat.wto.org/TariffProfiles/).

Table B2: Tariffs and imports, Ukraine

Part A.1 **Tariffs and imports: Summary and duty ranges**

Summary		Total	Ag	Non-Ag	WTO member since		2008
Simple average final bound		5.8	11.0	5.0	Binding coverage:	Total	100
Simple average MFN applied	2012	4.5	9.5	3.7		Non-Ag	100
Trade weighted average	2011	2.7	9.1	2.2	Ag: Tariff quotas (in %)		0.1
Imports in billion US$	2011	82.2	5.8	76.3	Ag: Special safeguards (in %)		0

Frequency distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV in %
		Tariff lines and import values (in %)								
Agricultural products										
Final bound		12.6	19.6	27.5	13.9	25.5	0.8	0.1	0	1.0
MFN applied	2012	21.1	22.0	26.3	12.1	17.5	0.8	0.2	0.1	0
Imports	2011	39.3	20.4	28.4	5.8	1.6	3.8	0.7	0.0	0
Non-agricultural products										
Final bound		33.8	16.8	43.0	5.8	0.5	0	0	0	0.0
MFN applied	2012	43.1	29.9	21.3	5.4	0.3	0	0.0	0	0
Imports	2011	66.4	18.1	14.7	0.9	0.1	0	0	0	0

Part A.2 **Tariffs and imports by product groups**

Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Animal products	13.0	0	20	100	11.0	9.0	20	0.5	15.0
Dairy products	10.0	0	10	100	10.0	0	10	0.2	0
Fruit, vegetables, plants	13.1	10.2	20	100	9.9	18.9	20	1.4	54.6
Coffee, tea	5.8	35.4	20	100	5.8	35.4	20	1.3	42.0
Cereals & preparations	12.7	3.3	20	100	12.6	3.8	20	0.9	27.1
Oilseeds, fats & oils	10.7	11.0	30	100	8.3	20.1	30	0.9	89.9
Sugars and confectionery	17.5	0.6	50	100	17.5	0	50	0.3	0
Beverages & tobacco	7.9	25.7	64	100	12.2	26.2	424	1.2	23.9
Cotton	1.4	40.0	5	100	1.4	40.0	5	0.0	61.3
Other agricultural products	7.6	23.9	20	100	5.5	45.2	20	0.5	19.3
Fish & fish products	3.7	61.7	20	100	2.6	68.2	20	0.7	68.0
Minerals & metals	4.5	42.4	20	100	3.0	47.6	20	32.8	79.0

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Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Petroleum	1.5	72.0	10	100	0.9	84.3	10	13.7	97.3
Chemicals	5.1	16.1	10	100	3.2	39.3	65	12.7	55.4
Wood, paper, etc.	0.4	95.8	10	100	0.3	95.8	10	3.1	99.1
Textiles	4.1	33.7	13	100	3.8	35.6	13	2.1	25.6
Clothing	11.4	1.0	12	100	11.3	1.1	12	0.6	0.1
Leather, footwear, etc.	7.2	14.9	25	100	5.4	27.0	25	1.9	20.3
Non-electrical machinery	4.2	38.7	12	100	2.1	51.3	10	8.8	62.4
Electrical machinery	5.3	33.0	25	100	3.8	39.1	25	6.8	34.2
Transport equipment	7.5	15.8	20	100	5.1	39.6	20	7.5	21.4
Manufactures, n.e.s.	6.4	31.9	25	100	5.5	32.0	25	2.1	68.6

Part B **Exports to major trading partners and duties faced**

Major markets	Bilateral imports in million US$		Diversification 95% trade in no. of		MFN AVG of traded TL		Pref. margin	Duty-free imports	
			HS 2-digit	HS 6-digit	Simple	Weighted	Weighted	TL in %	Value in %
Agricultural products									
1. European Union	2011	3,627	15	25	13.7	4.5	0.9	27.3	70.6
2. Russian Federation	2011	2,093	17	77	15.6	20.9	20.9	99.7	100.0
3. Turkey	2011	1,183	4	11	30.6	46.7	0.0	12.7	2.2
4. Egypt	2011	997	3	5	4.6	0.2	0.0	24.3	95.3
5. India	2011	903	1	1	40.2	2.2	0.0	15.6	95.9
Non-agricultural products									
1. Russian Federation	2011	17,846	45	514	9.6	7.9	7.9	100.0	100.0
2. European Union	2011	14,866	37	249	4.0	0.9	0.6	71.5	90.8
3. Turkey	2011	3,564	14	50	5.0	7.3	0.7	66.1	39.6
4. China	2011	3,174	11	17	8.0	0.9	0.0	16.1	77.7
5. Belarus	2011	1,615	43	477	9.4	7.3	7.3	100.0	100.0

Source: WTO (http://stat.wto.org/TariffProfiles/).

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Introducing Good Money: Legal Tender Problem or Question of Structured Approach?

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Abstract

The aim of this paper is to theoretically analyse the issues concerning the introduction of alternative moneys. A brief performance evaluation of the current monetary system, as well as two alternatives, namely gold and a private currency, i.e. the Swiss WIR, is followed by a historical look at the relationship between legal tender laws and Gresham's Law. The significance of legal tender laws in introducing alternative moneys is questioned and the focus is shifted to the political and ideological problems. It is pointed out that a professional and structured approach needs to be adopted to successfully introduce monetary substitutes. The derived conclusion is that legal tender laws are not the major factor hindering the introduction of alternative moneys, but that a range of legal, economic and political factors require a dedicated and professional approach to enable the private sector to work on better exchange mechanisms.

Keywords

Money, Legal Tender Law, Private Currency

I. Introduction

Many voices have been raised against the legal tender law enjoyed by national currencies, accusing it of giving the beneficiaries a market advantage over alternatives, which, so it is argued, would outperform national moneys. The critics are sometimes very strident. Gnazzo (2009), for example, claims that the legal tender law has only one purpose: to "*force the acceptance of the unacceptable*"; while Hornberger (2000) describes it as a method tyrannical governments use to get their hands on the wealth and property of the people. Without evaluating the substance of the abovementioned claims, this paper will examine the effects of legal tender law on the introduction of alternative or complementary moneys.

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Before looking into the matter of legal tender, a simple evaluation of the current system will be provided along with two potential alternatives, namely a return to commodity moneys or the introduction of complementary/alternative currencies and/or credit systems. The paper continues by providing the contemporary definition of legal tender, a brief historical comparison of its application and its relevance to Gresham's Law. What follows is an examination of the role legal tender law plays and what can be done to introduce good moneys, as perceived by the introducers.

II. A brief performance assessment of the current monetary system

As is widely agreed, money has three main functions upon which one can assess the performance of a chosen currency, namely that of unit of account, medium of exchange and store of value. Money as a unit of account is needed to set the prices of goods and services offered for exchange, expressing their relative economic values. A better unit of account would be one which is more reliable in quoting prices. This function is closely related to its function as a store of value, a feature which enables money to be used to transfer purchasing power from the present to the future. A stable unit of account is a requirement for a stable store of value. A convenient way for a layman to assess the performance of the current globally implemented interest based fiat monetary system (or in short "**debt money**") in providing a stable unit of account and store of value, is to visit the website http://www.usinflationcalculator.com and check how much prices have changed in the United States. If one, for example, compares changes in price levels from 1980 to 2009, the inflation rate, meaning the increase in the price level (related to the function as a unit of account) or loss in purchasing power (related to the function as a store of value) would be 162.5%. Thus, an item that cost USD 1 in 1980 would cost USD 2.63 in 2009. A more shocking figure would be if one compares changes from 1913 to 2009. The result is an incredible 2085.2% increase in the price level. Hence, an item that cost USD 1 in 1913 would be priced today at USD 21.85. The situation in the US is still tolerable compared to many countries in which inflation rates reach similar levels within just a fraction of this time.

The performance of debt money as a medium of exchange might be evaluated based on its supporting role in the exchange process, as well as the cost of facilitating that process. Looking at the number of financial crises and periodic business cycles, one might at least doubt this performance. The cost of maintaining this doubtful system is, on the other hand, simply shocking. Without performing a deep analysis, one might just look at the fact that Germany has budgeted an incredible EUR 40,400,000,000 for interest payments (Reißmann, 2009) for the year 2010 – more than forty billion euro just to be paid in interest. It is estimated that this figure would allow Germany to, for example, build 3,333 km of new highways, or provide high-speed Internet to every household and catapult Germany into a high-tech future (Reißmann, 2009). It is also worth noting that this figure does not include the cost incurred by the private sector.

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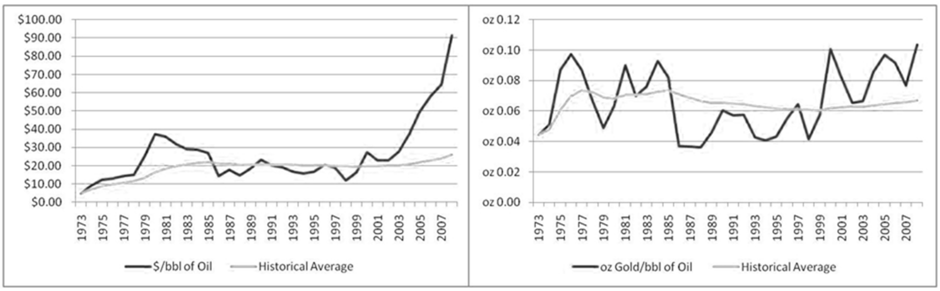
III. The acclaimed performers

Some claim that commodity moneys, for example, gold, perform money functions better than debt money (Hülsmann, 2008; Buffett, 1948; Paterson, 1943). Others deny these claims of superiority (Gesell, 1918) or even go so far as to ridicule calls for a return to gold (Hasan, 2007). As much as the performance of gold as a medium of exchange might be debated, it seems that gold performed much better as a unit of account, and hence as a saving medium. For example, as shown in figure 1, the oil price between 1973 and 2008 fluctuated when compared to the gold price as well as the dollar price, but the gold price fluctuated around a stable mean, while the dollar fluctuated around an increasing mean. The relatively higher price anchoring displayed by gold versus other goods of course also contributes to its role as a store of value. The performance of gold for storing wealth was so successful that Ibn Kahldun, for example, considered gold (and silver) to be God-given measures of value and to constitute the basis of profit, property, and treasure (Dawood, 2005).

Others claim that a return to commodity moneys is unnecessary. An alternative might simply be the implementation of complementary money and credit systems based on fiat mediums of exchange (Greco, 2001). The case of the Swiss WIR Bank could be used as an example, whereby the bank issues its own private currency, called the WIR, parallel to the official Swiss franc. WIR money circulates only among members (loans are much cheaper than those paid out in Swiss francs) and is used to strengthen trading ties between participants mostly limited to small- and medium-sized enterprises. Stodder (2007) even found evidence that the WIR money supply is countercyclical (while the national currency is cyclical) and contributes to maintaining price stability. However, given that the WIR supply constitutes only about 1% of the national M1 money supply, the positive effects might not be shown to their full extent.

Figure 1: Dollar vs. gold price of crude oil

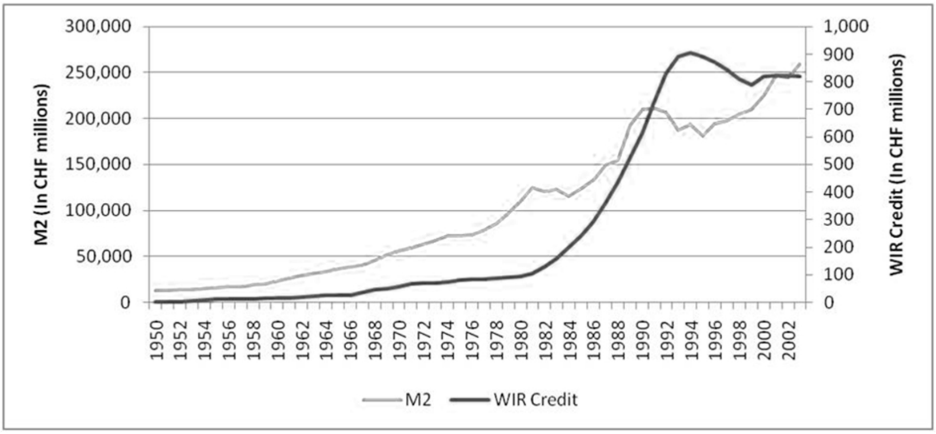


	$/bbl of Oil	oz Gold/bbl of Oil
Std. Dev.	17.12%	0.02%
Mean	$25.86	oz 0.07
Median	$20.33	oz 0.07

Source: Bloomberg & www.inflationdata.com

Looking at the growth pattern between the general M2 and the WIR credit as shown in figure 2, it can be seen that the M2 imitates a rather linear growth pattern, which would require linear GDP growth if inflation is to be avoided, while the WIR credit is somewhat normal, having started on an exponential growth pattern, simulating a natural growth limitation. Hence, the WIR growth path seems to be more adapted to human nature than the official national currency. And yet, in Switzerland and elsewhere, national currencies prevail versus commodity and alternative fiat currencies. The response to those seeking alternative moneys could therefore be that, if the alternatives offered really perform and meet the requirements of exchanges economies (or societies) better, market participants would make the shift away from inferior national debt moneys. So why do they not?

Figure 2: Swiss M2 vs. WIR outstanding credit and growth patterns



Source: Swiss National Bank, Stodder (2007)

IV. Legal tender law and Gresham's Law

The widely agreed upon contemporary definition of legal tender is that it is "*. . . money which a creditor is legally obliged to accept in settlement of a debt (Black, 1997, p. 266).*" Hence, the contemporary legal tender law is actually intended to regulate the settlement of debts. This was not always the case. In the era of metallic moneys, legal tender law has been used to regulate the acceptance of coins which had variations in their metal content, resulting in different intrinsic values, while enjoying the same purchasing power in the market, power which was based on the face value as guarantied and enforced by the privilege of the legal tender status. As such, the clipping of coins was a common way for governments and sovereigns to increase their finances at the cost of the general population, as was the modification of coin alloys or even the issuance of coins with the same face value but produced fully from a much cheaper metal (e.g. the introduction of copper coins as a third metal in gold and silver denominated monetary systems). For example, medieval English sovereigns would give themselves the privilege of being the sole authorized party for coining money and sometimes go as far as to stipulate penalties for refusing to accept face value irrespective of intrinsic content. As mentioned by Allen (1999), referring to medieval English sovereigns, the:

> "*. . . orders from the crown went so far as to require the acceptance of pennies that had been halved and demanded that anyone refusing to accept half pennies should be seized for contempt of the king's majesty, imprisoned, and exposed to public ridicule in a pillory (p. 183).*"

The effect of such actions would, of course, result in a preference for coins of lower quality to be used for exchange purposes. Should lower quality coins reach a level of supply high enough to cover all the transactions taking place in the market, coins with a higher intrinsic value would cease to circulate and it might be observed that lower quality coins drove out those of better quality. Such a development is described as Gresham's Law, which states that "bad money drives out good".

In bimetallistic monetary systems, the legal tender law was also used to regulate exchange rates between the different types of coins, which was usually different from the market exchange rate and hence resulted in arbitrage opportunities; sometimes the effects would be so strong that the overvalued currency would drive the undervalued one out of circulation, causing an evolution into a monometallic monetary system. Legal tender law has also been applied to fiat moneys and credit moneys. In fact, it has been pointed out that fiat moneys in particular enjoy purchasing power only by means of legal tender privileges (Hülsmann, 2004). Hence, legal tender law has been employed for all types of moneys and in various forms.

Based on its historical track record, it might be argued that market participants are not shifting to the 'better' moneys because of the existing legal tender privileges national currencies enjoy, given that legal tender law historically led to the Gresham effect. However, as has been pointed out by many, Gresham's Law comes into existence only in those cases where the attached legal value does not correspond to the market determined purchasing power (Strand, 2001; Selgin, 2003; Mundell, 1998). The classic example would be two gold coins circulating in the market, both with the same face value but with different intrinsic values, or gold content. Imagine two gold coins with a face value of 1 dinar, one having a gold content of 4.25 grams and another which only contains 3 grams. Assuming both coins can be utilized at a face value of 1 dinar, and that you are a very economical person, you will tend to keep the coin with the higher gold content and use the other for the payment of a 1 dinar bill. You might thus accumulate many 4.25 gram coins, melt them down and make more coins with a content of 3 grams, a process of an easy enrichment, provided the coin can still be used at its face value of 1 dinar. As a result, in aggregate, if enough lower quality coins are available, the higher quality coins would cease to circulate in the economy. Such misuse has indeed taken place, as mentioned at the beginning of the paper. However, if the value of the coins is left to be determined by the market based on the gold content, the lower quality coins would simply be priced below their face value, according to the extent of their inferiority. Gresham's Law would not materialize, as the situation would be similar to that of coins with different face values, like 1 cent and 10 cent coins, in which the 1 cent coin does not drive the 10 cent coin out of circulation. Hence, by having two circulating moneys in an economy, the bad one would be driving the good one out of circulation only in those cases where the face value differs from the intrinsic value, or if the exchange rate is set at a different rate than the market determined rate.

But how is the logic for previous monetary arrangements to be applied to the contemporary scenario? As mentioned above, today's widely applied legal tender takes the form of the granting of a debt settlement function to national currencies and not regulating their purchasing power. Hence, is the legal tender law really stopping market participants from shifting to better moneys (or what they perceive as better)?

V. Legal tender law and Gresham's Law

As mentioned earlier, today's legal tender law gives absolute power to national currencies to act as mediums for all debt settlements. However, the situation has changed in one major aspect. Previously, a connection existed between money and commodities (either they would be converted into, or they would have a fixed convertibility into, commodities). Thus, for example, a dollar would have a convertibility rate into gold (or silver). Hence a legal tender ensuring purchasing power equivalent to the face value of money would mean that the issuer of the notes was able to purchase with the notes according to the purchasing power of the reference commodity rather than the money's intrinsic value. In such a scenario, Gresham's law would come into play and, if the supply was sufficient, the 'worthless paper' would drive out of circulation any gold or silver coins. In a similar manner, if two commodities circulated as money under a fixed exchange rate, at which the nominal does not correspond to the real exchange ratio, the overvalued currency would drive out the undervalued one.
However, today's paper money has no commodity reference: one United States dollar is worth one dollar, whatever that might mean. Thus, is there a difference between the face and intrinsic value of the monetary unit? Such a difference would exist in the event that the purchasing power is expressed in terms of the cotton fibre paper from which the dollar bills are made, and if the expressed face value was different from the intrinsic value of the money. But the face value of the dollar is not expressed in terms of cotton paper, but in terms of dollars. The cotton seller, and any other seller, is free to determine how many dollars to demand or even to reject the dollars altogether.[2] As a result, it should actually be possible to introduce alternative moneys. And the current real world scenario confirms that possibility. The previously mentioned WIR Bank has been successful in issuing its officially recognized alternative currency, the WIR; the internationally successful barter company Bartercard issues its T$ (trade dollars) and both Europe and the North American continent have witnessed the existence of hundreds of private moneys as well as many Local Exchange Trading Systems (LETS)[3]. In the United States of America, people were able to use Liberty Dollars, alternative silver and gold based monetary units. Most alternative fiat or credit moneys do not have their own value, but refer to the national debt money as

[2] What must be mentioned here is that country and time differences exist. While today, for example, parties in most countries are allowed to mutually decide on what payment modes and forms to use, while payment with legal tender only ensures that a debtor cannot successfully be sued for non-payment if he pays into court in legal tender (TRM, 2010), acceptance might be obligatory at some places at any stage of a transaction, even before the occurrence of debt.

[3] Germany alone has about 16 alternative currencies in circulation, and another 60 known initiatives as of 2006 (Rösl, 2006). LETS are even too many to be counted and exist in almost any mid- and big-size city.

a reference unit, and yet some, like the Liberty Dollar, have their own value and hence an exchange rate with the national debt money. Having a private credit or fiat currency can save users a lot in interest and, with a decoupled and independent valuation, private currencies can to a great extent protect their bearers from the inflationary pressures exercised via national debt moneys. In short, legal tender law, as applied today in most countries, does not represent an unbreakable barrier to alternative money systems.

VI. It is a political and ideological problem

As mentioned above, the legal tender law is not a barrier to new and alternative currencies, money, and exchange systems to be introduced into the market. However, it might be said that the success of all alternatives has been rather negligible. Is this simply because of the intrinsic weakness or fundamental inferiority of the offered alternatives? Is it simply a fact that national debt moneys, despite their bad performance and expensive maintenance, still outperform any alternatives?

The answer is not simple. To accuse the alternative models of inferiority would be justified if they failed all by themselves. However, the facts actually indicate the opposite. In many success stories of alternative systems, it is the interference of the debt money managers (central banks, governments or their mints) which influence or terminate the existence of successful alternative models. Hence, on the international level, it is very obvious that it is difficult for gold to celebrate a return if the yellow metal has been declared the only item countries cannot use for defining the value of their currencies (Weiss, Martin A. & Sanford, Jonathan E., 2007). Even on the national level the movement is facing difficulties. Thus, the US Mint claimed that the usage of Liberty Dollar's gold and silver coins constitutes a Federal crime (Liberty Dollar v. US Mint, 2007). But it is not only metallic moneys which face difficulties – so do fiat and credit moneys. An experiment took place in 1932–33 in the Austrian city of Wörgl to introduce a local currency with the aim of ending local unemployment and strengthening the local economy but was ended by force by the Austrian government, despite its recorded success and strong local interest and support (Unger, 2010). The WIR money issued by the WIR Bank is under the regulation of the Swiss National Bank and subject to their requirements, and Germany's central bank only just tolerates the various existing currencies, but monitors the "social cost" caused by them (Rösl, 2006). It might be assumed that, should the mentioned 'social cost' (which in reality could be understood to be a figurative synonym for market penetration) become too significant, the State might intervene, as was the case in Wörgl in Austria.

In reality, the whole matter might be a struggle between ideologies, between one which centres economic control in the hands of governments and the banking sectors and the other which stands for decentralized control over economic growth patterns and structure as well as decentralized and localized credit creation power. The implications of this struggle are immense and will determine the future of our lives; the way our economic structure will be determined, either by aggregate decision-making process by each market participant, or by a group of people setting the economic targets for the rest of the society; the way our savings are mobilized, forcefully via inflation or democratically via incentives; the way credit is issued, at a price set by central banks, or at a price determined by the actual creditors; and more important implications. The significance of this struggle has been put into words by an economist from the German School of Money and Banking, Ulrich von Beckerath (1882–1969):

> "*Extension of exchange transactions without State money is in reality the beginning of a new system of settling accounts, **indeed the beginning of a new economic order** (Greco, 2004, p. 3, bold added).*"

VII. How to introduce alternatives?

As discussed above, the legal tender law 'only' gives national currencies the power to act as settlement items for outstanding debts. However, such a function is very powerful for influencing the decision-making process of market participants on the exchange medium they are going to use and how they will express their contractual obligations. The fact is that national currencies can be legally used to settle past, present, and future liabilities, which makes them an excellent tool to quote and of course settle obligations. Besides settling outstanding debts, governments create a market for their currencies by making taxes payable only in national moneys and it might be assumed that no companies with links to government (mostly huge market participants on which a lot of businesses depend) would accept dealing in a currency which is competing with the national ones. Hence, the legal tender law is just one out of a set of means to ensure the monopoly of national currencies. And as mentioned above, even when an alternative currency succeeds in attracting large enough participation, governments might simply take legal action against it. That, however, would be a last resort, and one which does not have to happen often, given all the privileges national currencies enjoy in the market, all of which make the emergence of alternatives a very challenging task.

Given the strong competition faced in the form of national currencies, Greco (2009) points out four factors which influence the success (or failure) of an issuing entity (the "**alternative provider**"):

- The architecture of the alternative provider or the alternative itself
- The management of the alternative provider
- The implementation strategies
- The context into which the alternative is introduced

It is very important not to burden the alternative provider with objectives which might endanger the main objective – supporting the exchange process. Trying to solve all problems perceived by alternative providers might jeopardize the success of their undertaking. The issue as to who is authorized to supply alternative money must be clearly and transparently defined, as well as the basis and the limits of issuance.

It is also very important to plan how the alternative is to be promoted among potential users. A critical mass of participants is decisive for the sustainability of the alternative. Should a critical mass not be achieved within a reasonable time period, the alternative might lose its attractiveness and even fail to secure its continued existence.

The timing of the introduction of the alternative is also very important and must coincide with the appropriate situational context. Introducing an alternative during a period of easy money and an economic boom might be more difficult than during a period of financial scarcity and economic depression. Hence, timing is definitely a factor which might influence the success of an alternative.

In addition to Greco's four factors, one more should be added, namely the legal aspect. It is very important to make sure the law is satisfied when launching alternative moneys. Laws differ from country to country, so what is left for those looking into the possibility of establishing a private monetary alternative is to structure the alternative provider in compliance with the legal standards of the host country and try to look for spaces in the law which enable such private initiatives.

Freire (2009) provides an excellent overview of the legal challenges to establishing alternative monetary mediums (termed as "**social currencies**"), but only in the case of Brazil. A taste is given of what considerations need to be observed when deciding on the organizational structure of the alternative provider:

> "*Under Brazilian legislation, in principle, not-for-profit non-government organizations (NGOs), Organizations of Civil Society in the Public Interest (OSCIPs), and Municipal Funds do not require authorization from the Government or from the Central Bank to carry out projects entailing social currencies. Municipal Funds, however, are subject to limitations under the Fiscal Responsibility Law (Enabling Law (LC) 101, of 2001), particularly with respect to the assuming of obligations within the scope of social currency systems.*
>
> *If social currencies are linked with microfinance programs, both NGOs and Municipal Funds are subject to limitations under the Usury Law (Dec. 22.626/33), whereas OSCIPs are not (Executive Order (MP) 2.172-32/01). The situation is different when social currencies are established for profit-making ventures. In this case, it would be generally necessary to obtain authorization from the Government or from the Central Bank. For example, a benefits program involving the issuing of bonds or vouchers that serve as a social currency might require an authorization by the Ministry of Finance (Law 5.678/71), whereas a Credit Society for Micro-businesses or a Credit Cooperative that wishes to issue a social currency must seek authorization from the Central Bank (p. 87, 88).*"

Hence, it is highly advisable to get legal advice before deciding on the legal structure of the alternative provider in order to avoid future legal disputes. Once it has been legally approved, it will surely be more difficult to challenge the legality of the alternative at a later date.[4]

[4] Unfortunately, in some countries the laws against alternative currencies are very rigid. Thus, for example, in Canada's 1980 statute it is stated that "Every bank or other person who issues or reissues, makes, draws or endorses any bill, bond, note, check or other instrument, intended to circulate as money, or to be used as a substitute for money, is guilty of an offense against this Act (Rozeff, 2009)."

VIII. Conclusion

To conclude this brief paper on introducing alternatives which are perceived by users as good or better moneys, in the current monetary framework legal tender laws in most of the world might not be a legal barrier that cannot be breached to introduce alternative moneys under private initiative. Even though legal tender laws have been historically abused to impose mediums of exchange on market participants, in the contemporary scenario it does not represent the main hindrance to introducing alternatives. Unfortunately, a much broader and wider political and economic scenario has been created, with the impact that the introduction of alternatives might be legal, but economically difficult to realize. Hence, even in a situation in which the legal framework allows for the introduction of private exchange mechanisms, what is equally necessary is a serious and professional approach which requires human and capital commitment. However, besides the efforts made by alternative providers, it must be clear that, in the end, the limits of growth, development and finally the success of alternatives are subject to the willingness of the respective governments to allow such developments to take place and to accept the decentralization of money and credit control.

But no change happens overnight, and especially not a change in power. As much as the struggle will be difficult, a transformation to a new economic order, one in which economic and credit power is decentralized and based on diversified views on credit and exchange processes can take place as long as persistence towards change continues.

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LEGAL ASPECTS OF THE ASSOCIATION OF OVERSEAS COUNTRIES AND TERRITORIES WITH THE EUROPEAN UNION

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Abstract

This article is concerned with an issue in European law that is historically derived from the Treaty establishing the European Economic Community. The aim is to illuminate the functions and objectives of the European Union that correspond to the provisions of Part Four of the Treaty on the Functioning of the European Union – Association of the Overseas Countries and Territories. The basic provisions are laid down in the primary law of the European Union but there are also other documents and legislative acts that lay down more detailed provisions on the given issue and reveal a more complex perspective. The article focuses on the existing legislation regulating the association of overseas countries and territories with the Union. The author first draws attention to the key provisions of the Treaty establishing the EEC that define the purpose, objectives and fundamental principles applied between the Union and the overseas countries and territories. The main purpose of the article, however, is to analyse the current legal basis of association and to highlight the need for a new legislative framework of cooperation. New legislation should take into account not only the interests of the Union, but also the desire of the overseas countries and territories for a new quality of mutual cooperation. The author argues that the best way to improve the association mechanism based on the Lisbon Treaty is to modernise the Union's existing secondary legislation in this area. In this regard the author analyses issues related to Council decision 2001/822/EC on the association of the overseas countries and territories with the European Community and the proposal for a Council decision (COM/2012/362) of 16 July, 2012.

Keywords

European Union, European Law, Primary Law, Council Decisions, Association of Overseas Countries and Territories

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I. Introduction

The current legal framework for the association of overseas countries and territories (hereinafter "OCTs") with the Union builds on the provisions on support for economic and social development in the original Treaty establishing the European Economic Community (hereinafter the "EEC") of 1957 (articles 131–136). The development of economic and later social and cultural relations of the Member States of the Community and the Community as a whole with "non-European" countries and territories is characterised as "special relations" that were historically determined and linked initially with the countries Belgium, France, Italy and the Netherlands. Article 131 of the Treaty establishing the EEC lists these Member States and refers to a list of the relevant countries and territories in Annex IV of the Treaty.[2]

The basis for equal relations between overseas countries and territories (non-European countries and territories) on the one side and the Community and its Member States on the other is therefore the Treaty establishing the EEC. The fundamental provision for legislation on association and the provision that defines its main purpose is the second paragraph of Article 131 of the Treaty establishing the EEC: "... to establish close economic relations between them and the Community as a whole."[3] Article 132 of the Treaty establishing the EEC then gives a more detailed presentation of the objectives of association. Article 132 also presents a suitable basis for the advantages that Member States of the Community and the Community as a whole provide in certain areas for non-European countries and territories. It lays down the principle of equal treatment for non-European countries and territories in commercial exchanges, not only between them and the European states with which they have a special relationship, but also with the other Member States of the Community. It permits natural persons and legal entities (nationals of Member States of the Community and non-European countries and territories) to participate on equal terms in tenders and supplies for investments financed by the Community. It includes provisions that create preconditions for the right of settlement on a non-discriminatory basis. This legislation provides a good basis for equal relations between these countries and territories and the Community and they are still reflected in current law based on the Treaty on the functioning of the European Union (hereinafter the "TFEU"). It is understandable that the provisions of the Treaty establishing the EEC should open the path to the principle of equal treatment between EEC Member States and non-European countries and territories, particularly in economic and commercial cooperation. The above articles of the Treaty establishing the EEC are elaborated on by articles 133–136 (including the principle of equal treatment), which lay down:

[2] Annex IV. Overseas countries and territories to which the provisions of Part Four of the Treaty apply: French West Africa (Senegal, French Sudan, French Guinea, Ivory Coast, Dahomey, Mauritania, Niger, and Upper Volta), French Equatorial Africa (Middle Congo, Ubangi-Shari, Chad and Gabon), Saint Pierre and Miquelon, the Comoro Archipelago, Madagascar and dependencies, French Somaliland, New Caledonia and dependencies, French Settlements in Oceania, Southern and Antarctic Territories, the Autonomous Republic of Togoland, the Trust Territory of the Cameroons under French Administration, the Belgian Congo and Ruanda-Urundi, the Trust Territory of Somaliland under Italian Administration, Netherlands New Guinea.
See Annex IV. Overseas countries and territories, Treaty establishing the EEC (Euroskop, 2013).

[3] Quoted from Article 131 of the Treaty establishing the EEC (Euroskop, 2013, p. 51).

- a path to the abolition of customs duties on goods imported from non-European countries and territories (the gradual abolition of customs duties on goods imported from Member States and non-European countries and territories in accordance with the corresponding articles of the Treaty establishing the EEC),
- an important basis for subsequent law on the free movement of workers from non-European countries and workers from Member States.
- the setting of future legal procedure and particulars of the association of non-European countries and territories with the Community by means of implementing conventions,
- the Council's competence to decide on the provision to be made for a further period based on the results achieved and on the principles set out in the Treaty.

The legislative provisions in the Treaty establishing the EEC laid a foundation for cooperation in economic and commercial matters. Association gradually developed to include issues connected with social development and the potential development of the work force. The Treaty foresaw that in the future there would of necessity be a positive influence and benefits from cooperation in the area of further social development and cultural and regional cooperation. The aim of the following parts of the article is to highlight certain aspects of current legislation on the association of overseas countries and territories with the Union and to analyse the rules, objectives and principles that apply to relations between them. This information is used to analyse the need for a new legal framework based on a new quality in the implementation of common interests, reciprocity, rights and obligations.

II. Legal basis of the Association of Overseas Countries and Territories with the Union

In every revision of the foundational treaties or primary law, the treatment of this issue was based on the provisions of the original Treaty establishing the EEC. The current form of the legislation, laid down by the Lisbon Treaty in articles 198–204 of the TFEU, corresponds in many ways to the formulation in the original primary law. It also builds on the basic purpose of association defined in paragraph 2 of article 198 of the TFEU, which is "to promote the economic and social development of the countries and territories and to establish close economic relations between them and the Union as a whole". It defines the basic mechanism of cooperation and partnership in association as a trilateral partnership involving the Commission, the Member State with which an OCT has special relations and the country or territory itself.[4] Association is intended primarily to further the interests and prosperity of the inhabitants of the OCTs in order to lead them to successful economic, social and cultural development. At the same time, a basic prerequisite and starting point for association arrangements is that they must be in accordance with the principles representing the fundamental values of the Union. According to Article 198 of the TFEU "the Member States agree to associate with the Union the non-European countries and territories which have special relations with Denmark, France, the Netherlands and the United Kingdom".

[4] For further information on trilateral partnership and cooperation under association see Syllová, Pítrová, Paldusová (2010, p. 714).

A list of the relevant OCTs is given in Annex II of the TFEU "Overseas countries and territories to which the provisions of Part Four of the Treaty on the functioning of the European Union apply".[5] Like the original Treaty establishing the EEC[6] and the later revisions of the foundational treaties, the TFEU gives the main voice in further legislation on issues relating to association with OCTs to the bodies of the Union. In addition to the traditional references to the Council and the Commission, the primary law also brings in the European Parliament. The powers of the above bodies are set out in article 203 of the TFEU, which recognises the right of the Council and the Commission to lay down detailed rules and the procedure for association. The relationship between the two bodies is that the Council lays down the rules and the procedure unanimously based on a proposal from the Commission. At the same time, the bodies of the Union must act on the basis of the experience acquired under association and of the principles set out in the Treaties.[7]

The basic legal framework for association of OCTs is developed in more detail by Council Decision 2001/822/EC of 27 November, 2001, on the association of the overseas countries and territories with the European Community,[8] Article 2 of which states that association shall be based on the principles of liberty, democracy, respect for human rights and

[5] Greenland, New Caledonia and Dependencies, French Polynesia, French Southern and Antarctic Territories, Wallis and Futuna Islands, Mayotte, Saint Pierre and Miquelon, Aruba, Netherlands Antilles: Bonaire, Curaçao, Saba, Sint Eustatius, Sint Maarten, Anguilla, Cayman Islands, Falkland Islands, South Georgia and the South Sandwich Islands, Montserrat, Pitcairn, Saint Helena and Dependencies, British Antarctic Territory, British Indian Ocean Territory, Turks and Caicos Islands, British Virgin Islands, Bermuda (Siman and Slašťan, 2010, p. 898).

Article 204 of the TFEU regulates the application of Articles 198–203 of the TFEU in relation to Greenland. It recognises an exception for Greenland from the association regime although in general Part Four applies to Greenland. The basic legislation for this is Protocol 34 on Special Arrangements for Greenland annexed to the Treaty. The regime is further regulated by Commission notices and regulations, Council regulations and decisions and agreements between the European Communities (the Union), Greenland and the Member States (for example, EC – the government of Denmark and Greenland). In 2011, a proposal was made for new legislation in the form of a proposal for a Council decision on relations between the European Union on the one hand and Greenland and the Kingdom of Denmark on the other (COM/2011/846).

[6] Article 136(2) of the Treaty establishing the EEC: "Before the expiry of the Convention . . . the Council, acting by means of a unanimous vote, shall, proceeding from the results achieved and on the basis of the principles set out in this Treaty, determine the provisions to be made for a further period".

Quoted from the second paragraph of Article 136 of the Treaty establishing the EEC (Euroskop, 2013, p. 52).

[7] Refers to the general principles (Article 2 of the Treaty on European Union refers to values) on which the EU is founded. These are defined in the Treaty on European Union (hereinafter the "TEU") and the TFEU, and according to the judgement of the Court of Justice in case C-17/98 Emesa Sugar (Free Zone) NV v. Aruba of 8 February, 2000, account must be taken both of the principles set out in Part Four of the Treaty and of the other principles of Community law, including those relating to the common agricultural policy (previously Article 38 of the Treaty establishing the European Community, not Article 38 of the TFEU).

For further information on the principles enshrined in Article 2 of the TEU, Article 1 and following of the TFEU and Article 38 of the TFEU, see the work cited in note no. 5, p. 758, 782 and 791.

For further information on case C-17/98 Emesa Sugar (Free Zone) NV v. Aruba, see Judgement of the Court of 8 February, 2000 (Court of Justice, 2000).

[8] The content structure of Council Decision 2001/822/EC has a comprehensive character and the provisions concerning the issue of overseas association are specified in detail. The decision specifies the reason for its adoption with reference to the Treaty establishing the European Community (in particular Article 187) and the proposal of the Commission. The decision has four main parts, four annexes and seven appendices to the annexes.

Content structure of the decision:

Part One: General provisions of the association of the OCTs with the community (Articles 1–9) fundamental freedoms and the rule of law These principles shall be common to the Member States and the OCTs linked to them. There shall be no discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation in the areas of cooperation referred to in this Decision.

The amendment of the foundational treaties by the Lisbon Treaty also affected the question of the adoption of rules and the procedure for association, to which it added the possibility of adoption in accordance with a special legislative procedure. This extended the previous provisions set out in Article 187 of the Treaty establishing the EC to the effect that where the provisions in question are adopted by the Council in accordance with a special legislative procedure, it shall act unanimously on a proposal from the Commission and after consulting the European Parliament. Special legislative procedure is defined in Article 289(1) of the TFEU. The use of a special legislative procedure to define detailed rules and procedures for association (adoption by the Council on a proposal from the Commission and after consulting the European Parliament) is possible when the Treaties require it, or "in the specific cases provided for by the Treaties".

The status of associated OCTs can change based on measures that the Council is competent to adopt having regard for the objectives laid down in the foundational treaties (the curtailment or cancellation of certain advantages). On the other hand, the list of OCTs in Annex II of the TFEU can also be enlarged, as in the case of the Council Decision of 29 October, 2010, amending the TFEU, by which the French Collectivity of Saint Barthélemy became an overseas country and territory associated with the Union. This involved an amendment of the TFEU, and in particular Annex II thereto, by including the island of Saint-Barthélemy in the list of OCTs to which the fourth part of the Treaty applies.[9]

- Chapter 1: General provisions
- Chapter 2: Actors of cooperation in the OCTs
- Chapter 3: Principles and Procedures of the OCT-EC Partnership

Part Two: The Areas of OCT – EC Cooperation (Articles 10–17)
Part Three: Instruments of OCT – EC Cooperation (Articles 18–60)
Title I. Development Finance Cooperation

- Chapter 1: General provisions
- Chapter 2: Resources made available to the OCTs
- Chapter 3: Private sector investment support
- Chapter 4: Additional support in the event of fluctuations in export earnings
- Chapter 5: Support for other actors of cooperation
- Chapter 6: Support for humanitarian and emergency aid
- Chapter 7: Implementation procedures
- Chapter 8: Transition from previous European Development Funds (EDFs) to the 9th EDF

Title II. Economic and trade cooperation

- Chapter 1: Arrangements for trade in goods
- Chapter 2: Trade in services and rules of establishment
- Chapter 3: Trade-related areas
- Chapter 4: Monetary and tax matters
- Chapter 5: Vocational training, eligibility for Community programmes and other provisions

Part Four, Final provisions (Articles 61–64).

[9] On the inclusion of Saint-Barthélemy in the list in Annex II of the TFEU, see COM/2012/061 final-2012/0024 (CNS) (Council, 2012).

Articles 199–203 of the TFEU define the conditions of association in the form of objectives and principles,[10] which shall be applied in mutual relations between Member States and OCTs.

- Member States shall apply to their trade with OCTs the same treatment as they accord each other. Likewise, each OCT shall apply to its trade with Member States the same treatment as that which it applies to the European State with which it has special relations.
- The Member States shall contribute to the investments required for the progressive development of OCTs. For investments financed by the Union, participation in tenders and supplies shall be open on equal terms to all natural and legal persons who are nationals of a Member State or of one of the countries and territories.
- In relations between Member States and OCTs, the right of establishment of nationals and companies or firms shall be regulated in accordance with the provisions and procedures laid down in the Chapter of the TFEU relating to the right of establishment (Articles 49–55 of the TFEU). The provisions guarantee equal conditions for establishment not only from the side of the Member States but also oblige the OCT authorities to afford equal treatment for nationals and companies or enterprises from Member States of the Union in relation to the right of establishment, with treatment no less favourable than that which they extend to subjects from third countries. The OCT authorities shall not discriminate between nationals, companies or enterprises of Member States. These issues are thus subject to a prohibition of discrimination, which can be derogated from (an exception can be made) by a procedure pursuant to Article 203 of the TFEU.[11]
- Customs duties on imports into the Member States of goods originating in OCTs shall be prohibited in conformity with the prohibition of customs duties between Member States in accordance with the provisions of primary law (prohibition of customs duties and charges having equivalent effect and also the prohibition of customs duties of a fiscal nature). Customs duties on imports into each OCT from Member States or from the other OCTs are also prohibited in accordance with the provisions of primary law. On the other hand, there is an exception whereby in certain cases an OCT can levy customs duties (provided that they meet the OCT's development and industrialisation needs) or customs duties of a fiscal nature which are part of the budget of the OCT. These customs duties must, however, not exceed the level of those imposed on imports of products from the Member State with which the OCT has special relations,[12]

[10] P. Svoboda notes that the formulation or presentation of Article 199 of the TFEU is not precise or the principles of association are erroneously referred to as "objectives" of association (Svoboda, 2010, p. 2005).

[11] Article 203 of the TFEU and Article 44 of Council Decision 2001/822/EC permits an OCT to adopt regulations concerning, for example, restrictions on the movement of workers if this promotes or supports local employment. In this case, the OCT authorities shall notify the Commission of the regulations they adopt so that it may inform the Member States. For further information, see Council decision 2001/822/EC (Council, 2001, p. 31–32).

[12] Article 40 of Council decision 2001/822/EC permits the OCT authorities to retain or introduce, in respect of imports of products originating in Member States, such customs duties or quantitative restrictions as they consider necessary in view of present development needs.

- If the level of the duties applicable to goods from a third country on entry into an OCT is liable (when the above principles concerning customs duties have been applied) to cause deflections of trade to the detriment of any Member State, the latter may request the Commission to propose to the other Member States the measures needed to remedy the situation. This permits the situation described above to be rectified through the Commission,
- Subject to provisions relating to public health, public security or public policy, freedom of movement within Member States for workers from OCTs, and within the OCTs for workers from Member States, shall be regulated by acts adopted in accordance with Article 203 of the TFEU (for Article 203 of the TFEU, see above). There is, however, a requirement that the adopted acts must not interfere with general principles for the protection of public health, public security and public policy.

III. The need for a new legislative framework and its basis

Council decision 2001/822/EC on the association of the OCTs with the EC is (after the primary law) the basis for the regulation of relations in the association of the OCTs. It is, however, applicable only until 31 December, 2013. In addition, new political priorities have emerged at a European and international level, including the need to deal with environmental problems, climate change, and changes in global trade patterns. Since the adoption of the Council decision, the regional and international environments in which OCTs operate have also changed considerably. For these reasons the stakeholders (the Commission, the OCTs, the Member States to which the OCTs are linked and other stakeholders) began work on specific legislative proposals intended to lead to a new document putting relations with OCTs on a new basis and replacing Council decision 2001/822/EC (which has been in effect since 2001).

Preparation of the new legislation began with public consultation on the green paper on future relations between the EU and OCTs (green paper adopted on 25 June, 2008, COM/2008/383). The result of consultation on the green paper was the adoption of a consensus of the stakeholders on a number of general issues leading to a declaration that current measures in the relations between the OCTs and the EU no longer reflect reality and should be replaced by a new approach.

The resulting Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Elements for a new partnership between the EU and the overseas countries and territories of 6 November, 2009 (COM/2009/623) states that the special relationship between the EU and the OCTs should move away from a classic development cooperation approach to a reciprocal partnership to support the OCTs' sustainable development and promote the EU's values and standards in the wider world. The principles of association set out in the primary law and the Council decision of 2001 should be replaced by a more contemporary approach. Solidarity implies that the EU should promote the OCTs' sustainable development, in its economic, social and environmental dimensions. Future relations and partnership should be more reciprocal, based on give and take (a relationship between the

OCTs and the EU based on mutual interests, reciprocity, rights and obligations). They must also take due account of the OCTs' specificities, in particular their economic and social development, diversity and vulnerability, as well as their environmental importance. The Commission communication (COM/2009/623) proposed that the new partnership between the EU and the OCTs should have three central objectives tailored to the OCTs' specificity: 1. enhancing competitiveness; 2. strengthening resilience and 3. promoting cooperation.[13] In 2012, the Commission presented the results of its work to develop new legislation regulating the association of OCTs with the EU. This is the Proposal for a Council decision on the association of the overseas countries and territories with the European Union ("Overseas Association Decision") of 16 July, 2012 (COM/2012/362). The Proposal for a decision was preceded by a Commission staff working document accompanying the Council decision on the association of the overseas countries and territories with the European Union (SWD/2012/193).[14] The Commission document takes over the objectives of association developed in the Commission communication (COM/2009/623) when it states that the purpose and objectives and/or principles of association known from primary law (Articles 198–199 of the TFEU) would need to be translated into the objectives identified by the Commission in the communication (COM/2009/623) and which were endorsed by the Council. According to the Commission, the specific objectives of the next association framework would be as follows:

- to help promote the EU's values and standards in the wider world,
- to establish a more reciprocal relationship between the EU and OCTs based on mutual interests,
- to enhance OCTs' competitiveness,
- to strengthen OCTs' resilience, reduce their economic and environmental vulnerabilities,
- to promote cooperation of OCTs with third partners,
- to integrate the latest EU policy agenda priorities,
- to take into account changes in global trade patterns and EU trade agreements with third partners.[15]

The Commission also commented on the possibility of implementing policy to amend the legislation governing OCT association with the EU based on previous consultation, analyses and proposals. The Commission's opinion was based on public consultations, regular ad hoc meetings of the OCTs, the Member States to which the OCTs are linked and the Commission, and forms of dialogue such as annual forums, regular trilateral meetings and partnership working parties dedicated to environmental issues, trade issues, regional integration of the OCTs, financial services in the OCTs and the future EU-OCT relations.

[13] For further information on the Commission communication (COM/2009/623), see Eur-Lex-52009DC0623-SK (European Commission, 2009).

[14] Full title of document: Commission staff working document. Executive summary of the impact assessment. Document accompanying the Council decision on the association of the overseas countries and territories with the European Union (SWD/2012/193).

[15] For further information, see SWD/2012/193 (European Commission, 2012a, p. 5).

In the Commission staff working document (SWD/2012/193), it was proposed that the preferred option should be the modernisation of the Overseas Association Decision and alignment with EU policy framework, since this would best reflect:

- the shared ambition of the European Commission, the OCTs, the Member States to which the OCTs are linked, and the EU to review and revise the EU-OCT association, and to establish a more reciprocal partnership, based on mutual interests and taking into account the various challenges OCTs face,
- the purpose and general objectives of the EU-OCT association as set out in Part Four of the TFEU,
- the specific objectives of the next association framework.

The resulting legislation in the form of the abovementioned Council decision on the association of the overseas countries and territories with the European Union ("Overseas Association Decision") will replace Council decision 2001/822/EC. The proposal for a Council decision will be in accordance with the provisions of the TFEU and will have the general objective of renewing the association, and focusing its areas of cooperation around priorities recognised by all parties as being of mutual interest. The proposal for a new Council decision should:

- set the legal framework,
- define the General Framework of the EU-OCT Association,
- identify the possible areas of cooperation between the EU and the OCTs,
- set out the trade regime that will govern the exchanges and the cooperation in that field between OCTs and the EU,
- define the different financial instruments to which OCTs will be eligible (11th EDF and the horizontal programmes)

The proposal for a Council decision is a legislative proposal that takes into account the political orientations of the Council of the EU and the requests the OCTs and the Member States that have special relations with them have expressed in previous discussions, consultations and proposals in this area. The structure of the proposed new Council decision is qualitatively different from the Decision of 2001 and covers a very broad range of areas.[16] The introductory provisions of the decision are also important for the applications of the principles laid down in the primary law of the EU. Article 1 sets out the purpose of association, which is a partnership based on Article 198 of the TFEU to support the OCTs' sustainable development as well as to promote the values and standards of the Union in the wider world. The partners to the association are the Union, the OCTs and the Member States to which they are linked. In a change from previous legislation, Article 2 specifies the objectives, principles and values of association. Association is based on objectives,

[16] The Proposal for a Council Decision (COM/2012/362) has five basic parts: 1. General provisions of the Association of the Overseas Countries and Territories with the Union (Articles 1–13); 2. Areas of cooperation for sustainable development in the framework of the Association (Articles 14–39); 3. Trade and trade-related cooperation (Articles 40–72); 4. Instruments for sustainable development (Article 73–88); 5. Final provisions (Articles 89–94). It has eight annexes and thirteen appendices.

principles and values shared by the OCTs, the Member States to which they are linked and the Union. Its function is to pursue the objectives laid down in Article 199 of the TFEU. This will be achieved through the enhancement of the OCT's competitiveness, the strengthening of the OCTs' resilience, the reduction of their vulnerability and the promotion of cooperation between them and other partners. In pursuing those objectives, the association shall respect the fundamental principles of liberty, democracy, human rights and fundamental freedoms, the rule of law, good governance and sustainable development, all of which are common to the OCTs and the Member States to which they are linked. Article 2 prohibits discrimination in the same way as Article 2 of the previous Council decision 2001/822/EC. On the other hand, Article 2(5) recognises partners' rights to determine their own sustainable development policies and priorities, to establish their own levels of domestic environmental and labour protection, and to adopt or modify accordingly the relevant laws and policies, consistently and with commitment to internationally recognised standards and agreements. In exercising their rights, partners shall strive to ensure high levels of environmental and labour protection. Article 2(6) stipulates that implementation of the decision must be guided by the principles of transparency, subsidiarity and the need for efficiency, and equally address the three pillars of OCTs' sustainable development – economic development, social development and environmental protection. The content of Article 5 on mutual interests, complementarity and priorities is also new, in particular the identification of seven priority areas for cooperation.[17]

IV. Conclusion

The process of modernising the legislation governing the association of OCTs with the European Union described above has involved a movement away from the traditional understanding of the EU-OCT relationship as that of "donor and beneficiary". It responds to the ambition of the OCTS to change the focus of association from poverty reduction and development cooperation to a reciprocal relationship focussed on sustainable development of the OCTs and also taking into account the political orientations of the Union. The aim is to promote a development model that conciliates economic activities and social well-being in the long run while preserving natural resources and ecosystems for future generations Association with the Union is based on constitutional ties that link OCTs to the Member States listed in Article 198 of the TFEU (Denmark, France, the Netherlands and the United Kingdom). It is accepted that OCTs have wide ranging autonomy, covering areas such as economic affairs, employment market, public health, home affairs and customs. The OCTs are not part of the Union's customs territory and are outside the Internal Market. OCT inhabitants hold EU citizenship because they are nationals of the EU Member States to which their countries and territories are constitutionally linked.

[17] 1. The economic diversification of OCT economies, including their further integration in world and regional economies; 2. The promotion of green growth; 3. The sustainable management of natural resources; 4. The adaptation to and mitigation of impacts of climate change; 5. The promotion of disaster risk reduction; 6. The promotion of research, innovation and scientific cooperation activities and 7. The promotion of social, cultural and economic exchanges between the OCTs, their neighbours and other partners.

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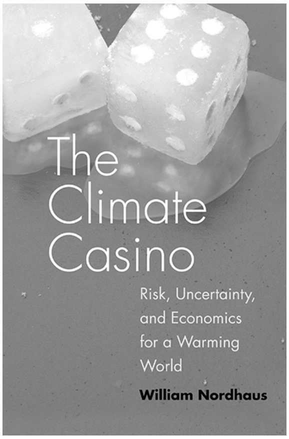

WILLIAM NORDHAUS

The Climate Casino: Risk, Uncertainty, and Economics for a Warming World

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Pitched at a general audience, The Climate Casino explains pretty much all the economics necessary for an understanding of climate change policy, along with the related science and politics. As such, it's a vitally important resource, filling a much-needed gap in the vast number of popular books on climate science and climate politics.

The emphasis throughout is on making the key ideas and results as clear as possible, which involves some simplification. So concepts such as integrated assessment models, externalities, discount rates, carbon prices, tipping points and cost-benefit analyses are introduced only when necessary, and are explained in context. Nordhaus also presents broad conclusions without working through the details. (None of the economics involved is controversial, however, and where there is uncertainty or debate he makes that clear.) The result is that The Climate Casino should be quite broadly accessible. It would be a challenge for a reader with no experience of thinking about economics, but not an impossible one.

In a way, climate change starts with economics and Nordhaus, whose own research is focused on this area, begins by looking at likely future greenhouse emissions under various models for economic growth, carbon intensity and so forth. Significant uncertainty here comes from not being able to predict changes in technology. He goes on to give a brief summary of climate science, looking at predictions for the next century or so, and introducing the possibility of climate tipping points, fairly abrupt transitions which are irreversible in the short term.

Next comes a survey of the likely impact of climate change on agriculture, health, oceans, hurricane intensity, and biodiversity. Adding up the damage from these suggests that the total cost will be small relative to expected changes in economic activity over the next century, but there is considerable uncertainty and the impacts are concentrated in unmanaged, non-market areas, where the uncertainties are highest.

Responding to these impacts will involve adaptation (making changes to economies and societies) and possibly geoengineering, but there are limits to these and mitigation (reducing carbon emissions) will remain a central part of any response. Nordhaus presents estimates of the costs associated with this, from both economic and engineering perspectives, and explains the importance of discounting future costs.

An overview of international policy history is followed by an explanation of the necessity for some kind of cost-benefit analysis and an illustration of the global balance between the costs of mitigation and the costs of climate change. Nordhaus explains how carbon prices work and why they are essential for a response flexible enough to cope with the complexities and uncertainties of economies and technologies. At a national level, he explains the advantages and disadvantages of carbon taxes and cap-and-trade systems. Internationally, he argues that a harmonised minimum carbon price will be easier to negotiate, and to maintain, than a cap-and-trade system such as Kyoto.

The "second best" alternatives to trading systems mostly involve regulation – of, say, car fuel efficiency – and are very much less efficient, sometimes even counter-productive. (The presence of "energy-cost myopia", where consumers don't fully value savings from energy efficiency improvements, may provide some justification for regulation on other grounds.) Governments have an important role to play in supporting research and development of new technology in areas such as energy efficiency, but appropriate carbon pricing will also help here.

A final section looks at "climate politics", with chapters on criticism of climate science, public opinion, and obstacles to policies addressing climate change. This is perhaps the most US-centric part of The Climate Casino.

Despite the subtitle, Nordhaus doesn't really attempt to convey the uncertainty of climate science. To give just one example, he includes a pair of figures showing the projected rise in sea levels through 2100 and 2500, for unconstrained and temperature-limited emission scenarios, which don't indicate any of the uncertainty from climate models or ice-sheet dynamics. Given the economic focus of The Climate Casino, this is a reasonable simplification – and Nordhaus does consider, more abstractly, tipping points and "unknown unknowns". The casino metaphor is also stretched a bit far – at one point Nordhaus has to resort to having us imagine a roulette wheel with an unknown number of slots and unknown bad consequences on getting a zero! – but it's not clear that there is a better alternative.

Minor quibbles aside, The Climate Casino is a clearly presented introduction to an important topic. It will appeal to a broad audience, but should really be read by any politicians responsible for climate change policy.

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- abstract (120–150 words),
- keywords (4–6),
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