Joint High-level Workshop

THE ECONOMIC DIMENSION OF SECURITY IN EUROPE: FACING NEW CHALLENGES IN A CHANGING ENVIRONMENT

ECONOMIC INTEGRATION AS AN ELEMENT OF CONFLICT PREVENTION IN EUROPE

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Overview:

Economic integration:

International trade

International capital flows

Labour mobility across borders

Integration and conflict:

Integration and economic performance

Economic causes of conflict

Integration and conflict

Other views on integration and security:

Integration: international trade

Centrally planned economies were an isolated trade bloc with limited interactions with the world economy

Today, post-communist economies ship and receive majority of their goods and services from the rest of the world

On average, transition “from plan to market” has gone together with increased integration into the world economy

Integration: international trade

Use openness ratio (exports and imports relative to GDP) to measure an extent of integration

In 2002, in the EU acceding countries, this ratio was more than 50 per cent, about 25 per cent in the South-East European countries and less than 15 per cent in the CIS. In the EU, the openness ratio was about 70 per cent

Since the mid-1990's, this ratio has increased in the acceding countries and SE European countries, but it has decreased in the CIS

The differences in openness among countries may have various causes

Integration: international trade

Gravity models estimate potential trade by taking into account factors such as the level of income, the distance from major markets and exchange rates

In the acceding countries, SEE and CIS, the actual trade flows are less than what the model predicts. The smallest gap in the acceding countries

Factors such as transportation infrastructure, policies and the quality of a country's institutions do not reduce significantly the gap between actual and potential trade in the acceding countries

In the SE European and CIS countries, however, these additional factors, to some extent, reduce the gap between actual and potential trade flows

Integration: international trade

Some policy issues:

While not much can be done about geography, institutions matter for trade

Unfavourable legacies of self-sufficiency

Violent conflicts may have long-lasting effects

Integration: international trade

Countries may choose to impose trade restrictions

According to the 2002 IMF trade restrictiveness index (with 10 being the most restrictive), Belarus was rated 8, Hungary, Russia, Serbia and Montenegro, Ukraine – 5, Kazakhstan – 4, while the rest of transition economies was rated between 1-3. Turkmenistan and Uzbekistan do not allow disclosure of their ratings

Countries may not be able to trade because their exports face market access restrictions

On average, the EU is a relatively open market. Significant restrictions in sectors in which transition economies appear to have comparative advantage. The CIS countries seem to be affected the most

Integration: international trade

Many transition economies do not trade freely with each other. There are clear benefits arising from closer regional co-operation (eg., customs, transit)

Regional trade blocs may lead to trade diversion and in the CIS, a joint negotiating position in WTO accession talks would be required

Participation in international organizations decreases risks by codifying broad rules and processes

Integration: capital flows

Since 1989, total cumulative private capital flows reached over $200 billion.

About three-quarters received by the acceding countries, the rest evenly divided between SEE and CIS. The CIS countries are still recovering from the Russian financial crisis

Improved access to international capital brings many benefits, but its high mobility carries risks if suddenly withdrawn

Integration: capital flows

FDI: a dominant type of capital flow into transition economies (the least volatile and most closely linked to improved economic performance)

FDI flows highly concentrated across the region and within sub-regions

The acceding countries received about two-thirds of cumulative total since 1996. Of which 80 per cent went to the Czech Republic, Hungary and Poland

About one-quarter went to CIS, of which Russia and Kazakhstan account for about 70 per cent

The countries of SEE received less than 10 per cent, of which about three-quarters to Bulgaria and Romania

Integration: capital flows

In general, FDI in the acceding countries is oriented towards exports; in the CIS it tends to be import substituting (aims at domestic market). CIS countries with natural resource have also attracted inward investment

Various motivations for investment, but macroeconomic and political stability (favourable investment climate) are necessary

Many transition economies have not attracted significant amounts of capital - due not to misguided economic policy - but due to unfavourable location and lack of natural resources

Closer regional cooperation or integration may have a positive impact on FDI by increasing the market size and reducing transaction costs

Labour mobility:

Domestic labour markets are not well integrated. Workers do not appear to move in response to economic signals. Differences in regional unemployment rates persist

Labour movement across borders has varied implications

Positive: contributes to closer integration through access to networks, information and finance. May also reduce social and fiscal pressures in poor countries (migrant remittances). May be used as a source of capital

Negative: brain drain

Labour mobility:

EU members may impose restrictions on free movement of labour from the acceding countries, for up to seven years

It appears that Ireland is the only country committed to full liberalization of its labour market. All others have, or likely will, impose some restrictions on new members

A more restricted access to the acceding countries by the nationals of the non-acceding countries have already reduced movement of quasi-legal labour (shuttle trade)

Integration and economic performance:

There is evidence that integration – or opening up economies to investment and trade – leads to higher incomes

The economies that do not integrate into the global economy usually experience lower growth

In some countries, however, opening up does not achieve predicted results

Effective integration cannot happen in the absence of solid fundamentals - sound fiscal and monetary policies, predictable rule of law and secure private property rights

Economic causes of conflict:

Poverty makes conflict more likely. Wealthy countries are less likely to experience conflict

Countries that trade with each other are less likely to fight each other

Countries that rely heavily on primary commodities are more vulnerable to conflict

Countries with severe inequality between ethnic or regional groups are more vulnerable

Economic integration and conflict:

Economic integration may be an effective conflict prevention tool, to the extent it makes countries wealthier and helps it build institutions

Institutions: rules (laws and informal customs) and mechanisms that enforce rules (organizations, reputation)

Other views on integration:

Economists endorse integration because it encourages market mechanism and greater competition improves welfare

The opponents of integration focus on social justice or distributional outcomes of closer ties

They believe that closer links are destabilizing and disruptive due to high adjustment costs

Need for better social protection to support those who find it difficult to adapt

Other views on integration:

Integration only benefits a few democracies that have put in place a suitable institutional framework

It penalizes those nations that are yet to reach the level of development required to benefit from integration

From the security perspective their – both legitimate and illegitimate - fears point to potential danger