THE EUROPEAN UNION'S FOREIGN TRADE COOPERATION WITH EURASIAN ECONOMIC UNION: SELECTED INDICES

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Abstract: *The European Union (EU) has a long-term negative trade balance with the Eurasian Economic Union (EAEU). The ongoing sanctions between the EU and Russia have affected trade relations also with the EAEU, as the EAEU is a customs union. Calculations of revealed comparative advantages and intra-industry trade between the EU and the EAEU illustrate how agrifood sanctions alter their trade cooperation in that commodity group. A significant decrease in the EU's revealed comparative advantages of the EU in the commodity group of food, drinks and tobacco after 2014 was observed. During the last ten years, there was an increase in the index of intra-industry trade by 50% in the same group. The EU has a moderate revealed comparative advantage in the machinery and transport equipment, which is also its most exported item. On the contrary, the EU has comparative disadvantages in mineral fuels, which perform almost 70% of the total imports from the EAEU. The EAEU could be perceived as a vital partner for the EU, considering its strategic raw materials and geographical interconnectedness within the Eurasian continent.*

Keywords: *Eurasian Economic Union, European Union, Foreign trade, Intra-industry trade, Revealed comparative advantages.*

JEL Classification: F10, F15, F60

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1 Introduction

The Eurasian Economic Union (EAEU) is the result of many years of integration efforts of former post-Soviet countries. It is a unique case where previously closely interconnected countries re-establish economic ties in a new form of a globalized market. The development of foreign trade relations between the European Union (EU) and the EAEU countries is determined by many historical, political, economic, and other factors. Their current trade interaction reflects long-term comparative advantages. The intensification of the direct and indirect effects of globalization mechanisms, which are spread to individual economies by the transmission effect in the conditions of instability of the world economy, will affect the direction of their mutual trade cooperation to a large extent.

Several factors motivate this research. First, the EU-EAEU foreign trade relations raise a wide range of research issues. Even though the EAEU is a relatively new integration grouping, there is a slight evaluation in the literature of their relations over the past five years of its existence. Second, the application of sanctions between the EU and Russia affects foreign trade with other EAEU member states. Third, the new economic reality indicates to the EU the importance of shaping trade relations with third countries. In the coming economic recession caused by the COVID-19 pandemic, which has affected almost all sectors, the identification of comparative advantages and the ability to adapt to ever-changing conditions is the key to survival. Although the EU is by far the most successful example of regional integration, it has faced many threats in recent years. These include the declining competitiveness of some member states, power disputes with the United States and China, migration and climate crisis, and last but not least, the definitive withdrawal of the United Kingdom from the EU. The EAEU could be a promising partner for the EU, given its strategic raw materials amenities and geographical proximity. Ongoing trade relations can become one of the incentives for economic development for both parties and at the same time facilitate the process of crisis recovery of their economies.

This paper aims to assess the level of the European Union's foreign trade relations with the Eurasian Economic Union in terms of its revealed comparative advantages and intra-industry trade at the industry level.

2 Literature Review

The European Union's foreign trade policy vis-à-vis the countries of the Eurasian Economic Union is applied primarily on a bilateral basis and can be divided into groups: 1. Eastern Partnership countries, 2. Central Asian countries and 3. Russian Federation (concept of a strategic partner). Partnership and Cooperation Agreements (PCAs) have been concluded with the countries of the Eurasian Economic Union with Armenia, Kazakhstan, Kyrgyzstan, and Russia. In the case of Belarus, the agreement was not ratified because it was suspended for political reasons. As a result of geopolitical changes and ongoing economic development in the region, many provisions of the PCAs have gradually become obsolete, which in some cases has led to their replacement by new, more up-to-date bilateral frameworks (Drieniková, 2020).

According to Vasilieva (2017), cooperation at the level of the EU and the EAEU provides a neutral platform for rapprochement between the EU and the Russian Federation. The regional aspect of the EAEU is an appropriate channel for dialogue, as it allows the depolitisation of cooperation with the Russian Federation. Meister (2015) adds that it should be developed on pragmatic principles. He considers the EU's strength in this area is the ability to negotiate technical standards and other trade barriers. Despite the EU's strong preference for bilateral relations with the individual EAEU Member States, the European Commission has been conducting an informal expert dialogue with the Economic Commission for Europe on the technical norms and standards approximation since 2019. According to Togt (2020), such a dialogue could be further strengthened, and institutionalized and moved to a more ambitious level from approximation to increased harmonization of technical norms and standards.

The advancement of trade and economic relations between the two largest integration blocs in the Eurasian region meets the objectives of long-term economic development. The economic efficiency of the liberalization of foreign economic relations is determined not only by the degree of cooperation between integration blocs, but also by the comparability of key parameters of economic development. This primarily concerns the efficiency of production and the competitiveness of related goods (Jantovskyj and Shirov, 2014).

The concept of comparative advantage adduces the capability of a country to produce some product or service not only with higher productivity, as initially proposed by Ricardo, but also higher product differentiation than other countries in a given trade area (Lafay, 1987). Assessing countries' comparative advantages is a dynamic concept, as a country's ability to produce certain goods changes over time in response to various endogenous and exogenous factors such as changes in property factors, including technology and human capital. There are many studies in which researchers utilizing RCA indexes are interested in the policy implications of countries' patterns of comparative advantage. The most prevalent use of RCA measures is predicting or evaluating the effects of changes in trade barriers, especially tariffs, on a country's producers and exports. That was the impetus for the analysis of Balassa (1965), which gave rise to the widespread use of RCA indexes. Greenaway et al. (2008), Goldberg et al. (2010), Menezes-Filho and Muendler (2011), McCaig and Pavcnik (2014), and Autor, Dorn and Hanson (2013) are recent examples of analyses of the differential effects of changes in trade barriers across products according to countries' patterns of comparative advantage. Mainly descriptive analyses as Fertö and Hubbard (2003) and Tongzon (2005) are often engaged ultimately to expound the effects of past or prospective trade policies, such as tariffs and export subsidies. The theory implies two fundamental principles that should guide future uses of RCA indexes in empirical analyses. First, data on bilateral trade flows should generally be used because it allows for the effects of comparative advantage to be isolated from other bilateral and market-specific effects of trade distortions. Second, since the comparative advantage is by nature a relative value, an RCA index must be a function of trade flows relative to an appropriate point of reference. This reference point must be appropriate for the particular use of the RCA index, and it must not change across products or countries for which values of the index are to be compared (French, 2017).

Intra-industry trade (IIT) appears when countries simultaneously export and import goods produced by the same industries. This effect is not conceptualized by the standard comparative advantage theory of international trade and requires explanations based upon factors such as scale economies, product differentiation, imperfect markets, and consumers' taste for variety (Vona, 1991).

Although works dating back to the phenomenon of intra-industry trade can be traced back to the 1960s literature, Grubel and Lloyd (1975) provided a

comprehensive empirical study of the importance and measurement of intra-industry trade. As defined by Krugman (1981), IIT consists of two-way international trade within an industry because firms in different countries will produce different differentiated products.

IIT enhances welfare by increasing the size of the market, reallocating productive factors toward the most productive firms, raising wages in the most productive firms, and providing greater product variety for consumers. However, it increases competition among producers and can, therefore, drive less competitive firms to exit. Smaller firms that do not export, and their workers, are likely to be the primary losers when trade agreements lead to increased IIT (Madeira, 2016).

3 Methodology

There are several ways to express whether a country has a comparative advantage. One of the initial approaches to determine the country's specialization in the production of goods was Balassa's RCA index from 1965. Since then, it has been refined and revised several times (Balassa, 1977; 1989). There are also some other approaches on how to calculate comparative advantage, as other authors tried to add their contribution to improve and calculate the RCA index, namely Hinloopen and Marrewijk (2001), Vollrath (1991), Yeats (1985), and others. This paper applies the approach to the composition of the formula where revealed comparative advantage is a logarithm of the share of exports and imports of goods categories of the integration group in total exports and imports of the same integration group. It is defined as:

$$RCA_I = ln \frac{\frac{Xij}{Mij}}{\frac{Xj}{Mj}} \quad (1)$$

where X_{ij} stands for the exports of country j in commodity group i; M_{ij} stands for the imports of country j in commodity group i; X_j stands for the value of total exports of country j, and M_j stands for the value of total imports into the country j. If *RCA*is more than 0, it suggests that there exists revealed comparative advantage for exports of the commodity group; and if it is less than 0, it induces revealed comparative disadvantage in the commodity group. For more detailed identification of the revealed comparative advantage (Hinloopen and, Merrewijk, 2001), possible values of the index can be classified into four categories determining its size, or intensity:

- $0 < RCA \leq 1$ no comparative advantage,
- $1 < RCA \leq 2$ weak comparative advantage,
- $2 < RCA \leq 4$ moderate comparative advantage,
- $4 < RCA$ strong comparative advantage.

Many researchers use the RCA to assess the effects of changes in trade barriers, which was Ballassa's original impetus. In the research of Goldberg et al. (2010), Menezes-Filho and Muendler (2011), McCaig and Pavcnik (2014) there are diverse examples of analyses of the different effects of changes in trade barriers between products.

Another one-factor indicator by which we evaluate foreign trade between the EU and the EAEU is the Grubel-Lloyd index (GLI).

$$GLI_i = \frac{(X_i + M_i) - |X_i - M_i|}{X_i + M_i} = 1 - \frac{|X_i - M_i|}{X_i + M_i} \quad ; 0 \leq GLI_i \leq 1 \tag{2}$$

where X_i denotes the export and M_i the import of good I. The index's range is from 0 to1. If $GLI_i = 1$, it indicates that there exists intra-industry trade between considered countries. Conversely, if $GLI_i = 0$, there is no intra-industry trade at all. A higher index value classifies a higher level of specialization in intra-industry exchange, considering that a lower value of GLI indicates that the foreign trade is closer to the inter-industry trade (Egger, Greenaway and Egger, 2005).

In this paper, we evaluate the RCA and GLI indices from the EU's perspective in relation to the EAEU from 2008 to 2019. The reviewed period shows us the development of selected indices five years before and five years after the creation of the EAEU (2014). The indices are expressed at the level of individual industries according to the SITC classification. Data sources used are from Eurostat statistics, more specifically the international trade database (extraEU-27).

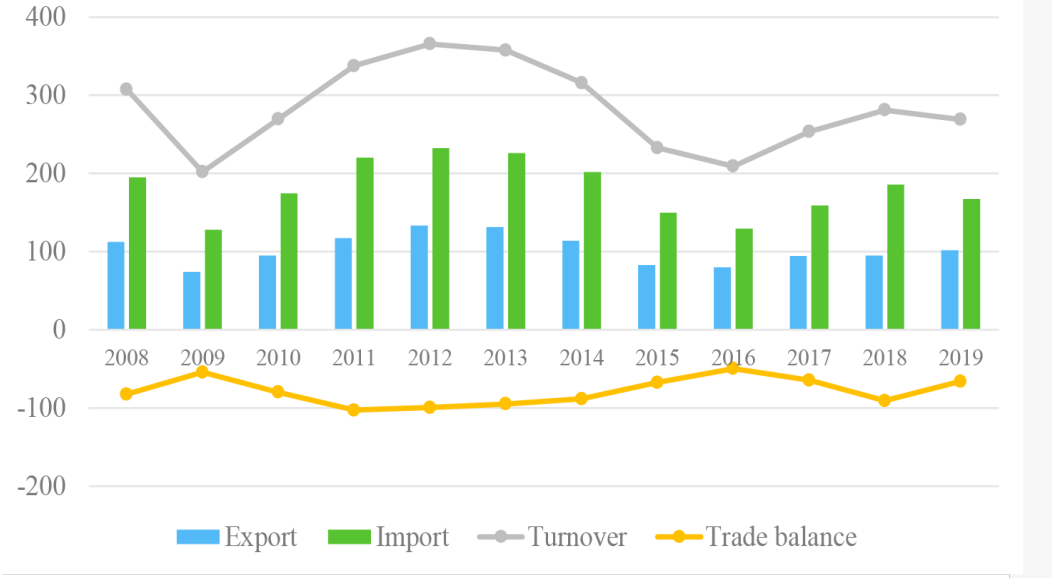
4 Results

Foreign trade between the EU and the EAEU was influenced by several factors that shaped the development of the world economy in the second millennium. These factors included the global financial crisis, fluctuations in world oil prices, sanctions between the EU and the Russian Federation, and other geopolitical factors. As we can see in figure 1, these milestones have

significantly contributed to the development of trade turnover between the EU and the EAEU.

In 2012, their turnover reached its peak during the entire period under review. Subsequently, there was a gradual decline until 2016, when the value of mutual trade was almost at the post-crisis level of 2009. Since 2014, we can observe a decrease in trade turnover, which was mainly caused by a decline in EU imports. During the period under review, the EU has a negative foreign trade balance vis-à-vis the EAEU. Its deepening occurs in the favorable development of commodity prices of the fuel and energy complex on world markets. This development points to the one-sided nature of the focus of the EU's foreign trade relations with the EAEU and the untapped consumer potential of these markets.

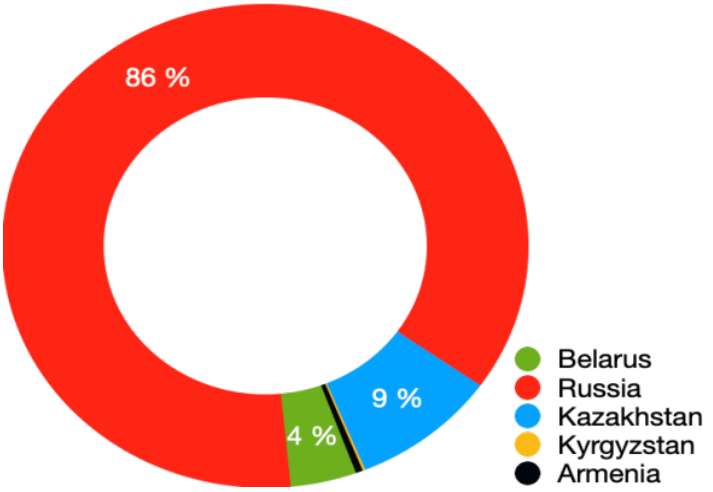
Figure 1: Foreign trade development between the EU and the EAEU, 2008–2019, in bil. of EURO



Source: author's calculations based on EUROSTAT (2020a-g)

Figure 2 shows the shares of individual EAEU countries in trade with the EU. It is Russia that holds the majority, followed by Kazakhstan and Belarus. Armenia and Kyrgyzstan account for only a minority (0.44% and 0.16%) of total trade turnover with the EU.

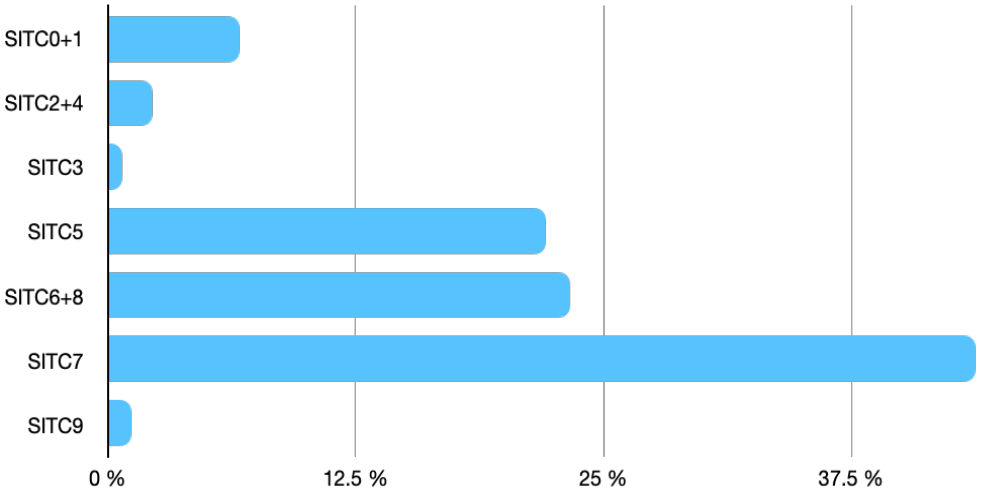
Figure 2: Share of the EAEU countries in trade turnover with the EU in 2019



Source: author's calculations based on EUROSTAT (2020a-g)

In recent years, there have been no significant changes in the export ratios of individual commodity groups. In 2019, machinery and transport equipment had the largest share in the commodity structure of EU exports to the EAEU with a share of 43.75%.

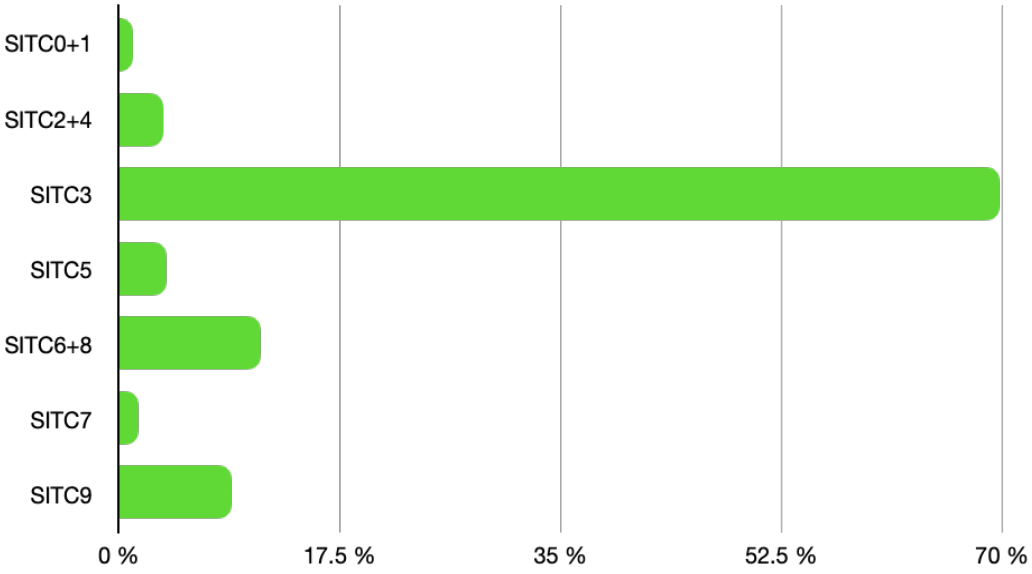
Figure 3: The commodity structure of the EU exports to the EAEU according to SITC in 2019



Source: author's calculations based on EUROSTAT (2020a-g)
Note: 0+1 – Food, drinks and tobacco, 2+4 – Raw materials, 3 – Mineral fuels, lubricants and related materials, 5 – Chemicals and related products, n.e.s., 7 – Machinery and transport equipment, 6+8 – Other manufactured goods, 9 – Commodities and transactions not classified elsewhere in the SITC.

The following are other manufactured goods with the share of 23.32%, and chemicals and related products with a share of 22.09%. Mineral fuels, lubricants, and related materials (0.66%), commodities and transactions not classified elsewhere (1.19%), and raw materials (2.23%) have only a minor share in total exports.

Figure 4: The commodity structure of the EAEU exports to the EU according to SITC in 2019



Source: author's calculations based on EUROSTAT (2020a-g)

The structure of the EAEU exports to the EU differs significantly. In 2019, the largest share 69.75% of EAEU countries' exports to the EU belonged to mineral fuels, lubricants and related materials. The share of exports of other manufactured goods is 11.27% and commodities and transactions not classified elsewhere is 8.93%. Compared to EU exports, the share of export of machinery and transport equipment is much smaller, only 1.59%. The groups of raw materials and chemicals and related products each account for just over 3.5% of EAEU's total exports to the EU.EAEU's export of food, drinks, and tobacco is also lower compared to the export of the EU, with a share of 1.13%.

As the table of results of the interregional revealed comparative advantages shows, there is an asymmetry in foreign trade between the European Union and the Eurasian Economic Union. This is due to the different equipment of natural, human and technological resources and the resulting specialization.

According to Kašťáková and Baumgartner (2017), many geopolitical changes and economic factors such as security issues and global financial crisis also caused changes in revealed comparative advantages. The European Union has a comparative advantage in three groups in its trade with the Eurasian Economic Union. The EU has a comparative disadvantage in four categories, namely raw materials, mineral fuels, lubricants and related materials and commodities and transactions not classified elsewhere. On the contrary, it is in these sectors that the EAEU countries have strong revealed comparative advantages. The EU has a weak comparative advantage in groups of chemical and related materials and food, drinks and tobacco. After 2014, when Russian sanctions were imposed on commodities of the EU agrifood sector, there has been a visible decline. Weak comparative advantages of other manufactured goods were throughout time reclassified to comparative disadvantage. Greatest revealed comparative advantages of the EU are in machinery and transport equipment, which is also the most exported commodity. However, as we can see, at the beginning of the period under review, the revealed comparative advantages of machinery and transport equipment were strong, while by 2019 it had fallen to the level of moderate.

Table 1: RCA between the EU and the EAEU in period 2008 ─ 2019

SITC	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
0+1	2.582	2.707	3.104	2.791	2.510	2.699	2.342	1.896	1.690	1.902	1.795	1.773
2+4	-0.626	-0.218	-0.351	-0.157	-0.121	-0.065	-0.266	-0.337	-0.418	-0.401	-0.358	-0.439
3	-4.698	-4.386	-4.473	-4.236	-4.240	-4.417	-4.572	-4.353	-4.366	-4.469	-4.390	-4.537
5	1.527	1.804	1.781	1.737	1.700	1.722	1.675	1.611	1.695	1.793	1.805	1.756
6+8	1.069	1.273	1.082	1.164	1.286	1.352	1.165	0.867	0.659	0.691	0.712	0.727
7	4.086	3.799	3.944	4.016	3.937	3.934	3.778	3.267	3.186	3.383	3.549	3.314
9	-1.827	-1.491	-1.675	-1.849	-1.891	-1.833	-1.677	-1.649	-1.594	-1.960	-2.166	-2.012

Source: author's calculations based on EUROSTAT (2020a-g)

The Grubel-Lloyd index expresses the size of intra-industry trade between the EU and the EAEU. The development of the index for the years 2008 to 2019 can be observed in table 2. Based on the analysis of the results, we can state that during the observed period there were significant changes in the case of some member groups in the intra-industry trade.

Table 2: GRUBEL-LLOYD INDEX between the EU and the EAEU in period 2008 ─ 2019

SITC	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
0+1	0.231	0.207	0.152	0.206	0.248	0.208	0.291	0.428	0.461	0.401	0.490	0.437
2+4	0.472	0.634	0.554	0.627	0.673	0.705	0.603	0.565	0.577	0.569	0.527	0.562
3	0.010	0.014	0.012	0.015	0.016	0.014	0.012	0.014	0.016	0.014	0.013	0.013
5	0.546	0.444	0.473	0.496	0.483	0.470	0.499	0.532	0.459	0.438	0.486	0.443
6+8	0.745	0.654	0.768	0.738	0.651	0.616	0.713	0.865	0.912	0.915	0.979	0.887
7	0.056	0.075	0.069	0.065	0.066	0.065	0.078	0.129	0.126	0.108	0.106	0.113
9	0.170	0.230	0.185	0.155	0.159	0.170	0.191	0.192	0.223	0.154	0.111	0.150

Source: author's calculations based on EUROSTAT (2020a-g)

Over the last five years, the highest value of the index had the group of other manufactured goods, approximately at the level of 0.9, so we can state the presence of intra-industry trade. In the period 2009-2013, we had the opportunity to observe the growing presence of intra-industry trade within the raw materials group, the decline of which was recorded after the imposition of sanctions. The values of the GLI indicated that trade flows in other product groups are closer to the level of inter-industry trade. The highest increase in value occurred in a group of food, drinks and tobacco, by more than 50%. As Russian retaliatory sanctions against the EU are targeting agri-food production, this may appear controversial.

5 Conclusion

The European Union has a long-term negative trade balance with the Eurasian Economic Union. Russia is the largest trading partner within the EAEU. In terms of commodity structure, the EU imports the most mineral fuels, lubricants and related materials, which accounted for 69.75% of total export in 2019. The European Union exports the most machinery and transport equipment, which accounted for up to 43.75% of total exports in 2019, and in this commodity group, it also has the greatest comparative advantages. Other sectors, where revealed comparative advantages (although weak) were indicated: chemical and related materials and food, drinks and tobacco. The EU has a comparative disadvantage in categories: raw materials; mineral fuels, lubricants and related materials; and commodities and transactions not classified elsewhere. On the

contrary, it is in these sectors that the EAEU countries have strong revealed comparative advantages. In terms of the level of intra-industry trade, there were significant changes during the period under review. While in the case of the development of the revealed comparative advantages, we could observe a declining trend, in the case of intra-industry trade, we can observe an increase in almost all groups. Intra-industry trade between the EU and the EAEU has the highest value in the group of other manufactured goods. The ongoing sanctions between the EU and Russia have also affected trade relations with the EAEU, as it is a customs union. We could see these changes in the group of food, drinks and tobacco, as there was a significant decrease in the revealed comparative advantages of the EU after 2014, and simultaneously there was an increase in the intra-industry trade index.

Based on the results, we can state that after 2014 there has been a deterioration in the EU's position towards the EAEU at the level of individual industries in terms of revealed comparative advantages, or the presence of intra-industry trade. One of the main reasons is the presence of trade barriers between the EU and Russia, which have also affected trade with other EAEU member countries. The EU's foreign relations have become a stalemate with Russia. Given the changing circumstances in the global environment, this situation cannot be considered permanent. The development of the world economy in the new decade will bring several other challenges for the European Union. Current foreign trade cooperation does not exploit the potential for its development in terms of intra-industry trade. The countries of the Eurasian Economic Union can become a vital partner of the EU due to its strategic raw materials and geographical interconnectedness within the Eurasian continent. This article represents one of the possible approaches to the review of the EU – EAEU foreign trade relations and can be a starting point for further research.

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