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Regional Initiatives

Unveiling the Trans-Pacific Partnership: An Analysis of the Full Text

Y. Dong, Q. Su

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This article systematically analyzes the full text of the Trans-Pacific Partnership (TPP) from the perspectives of breadth, depth and new concepts. First, by comparing it to free trade agreements (FTAs) that the United States has signed with economies in the Asia-Pacific region and FTAs other economies have signed in the region, it assesses the extension of the TPP text's chapters. Second, it classifies those chapters into four categories: deepening traditional topics, deeper integration, new topics and other institutional topics. Third, the article summarizes four new concepts based on an analysis of the text: to generalize the U.S. idea of international trade and investment rules, to respond to the demand for change in global value chains on global trade governance, to consider the interests of multinational corporations and small and medium-sized enterprises, and to prioritize U.S. interests while taking into account other members' interests. Finally, the article analyzes the comprehensive impact of TPP rules on China.¹

Key words: Trans-Pacific Partnership; free trade agreement; trade rules; Asia-Pacific; United States; China; global value chains

Taking the newly published Trans-Pacific Partnership (TPP) text as the object of study, this paper conducts systematic research on the TPP text in terms of scope, depth and new concept. On this basis, this paper analyzes the comprehensive influences of TPP rules on China. It provides a guide for in-depth study of the text, precise analysis of the TPP's economic influences, a layout of the Asia-Pacific integration strategy, and a grasp of the evolutionary trend of new international trade rules.

¹ Yan Dong thanks the financial support from the National Social Sciences Youth Foundation (No. 13CGJ043: The Competitiveness and Complementariness of Two Roadmaps in Asia Pacific Regional Integration). The authors thank the TPP research team at the Department of International Trade of IWEP, CASS. However, responsibility for any results, opinions, and errors is the authors' alone.

The article was submitted to the editors in April 2016.

Extension of TPP Text in Terms of Scope of Issues

(I) The TPP is the second generation of the high-standard FTA template established by the United States (US) after the North American Free Trade Agreement (NAFTA)

The US has always played a leading role in formulating the rules of Free Trade Agreements. In 1994, NAFTA established the first generation of the high-standard Free Trade Agreement (FTA) template in the US, incorporating provisions on competition, industrial standards, intellectual property and environment into FTAs. In over a decade from 2000, FTAs between the US and Singapore, Chile, Australia, Bahrain and Morocco, as well as regional trade agreements (RTAs) between the US and five countries of Central America and the Dominican Republic are generally extended based on the NAFTA template. Meanwhile, its partner countries are gradually extending the US FTA template to the outside. For example, some FTAs between Canada (or Mexico) and other countries were signed with reference to the US template.

By comparing the TPP text with five FTA texts signed by the US with Asia-Pacific countries,² it can be seen that the TPP is based on the US version of the FTA with significant extensions, and establishes the second generation of the high-standard FTA template of the US. For example, agreements such as the US-Korea FTA usually contain 23 or 24 chapters, while the TPP consists of 30 chapters, of which six are newly added, namely Cooperation and Capacity Building, Competitiveness and Business Facilitation, Development, Small and Medium-Sized Enterprises, Regulatory Coherence, and Transparency and Anti-Corruption. Meanwhile, although Chapter 17 (State-Owned Enterprises and Designated Monopolies) and Chapter 12 (Temporary Entry for Business Persons) are also new chapters, their specific contents are not new in the FTA texts of the US.

(II) The TPP establishes a high-standard agreement template exceeding the existing FTAs in the Asia-Pacific region

By using the FTA database of Asia-Pacific Economic Cooperation (APEC),³ we compare the provisions of the TPP with the existing Asia-Pacific FTAs. The database includes 42 bilateral and regional FTAs signed from 1982 to 2009 in the Asia-Pacific region. The FTAs in the database are relatively balanced in quantity, and represent the fundamental state of the rules in Asia-Pacific integration. This database summarizes FTA texts into 16 issues which are common to Asia-Pacific integration agreements.

Table 1 shows comparisons of issues in the TPP and APEC Asia-Pacific FTA database. The first column indicates 20 issues present in the TPP and Asia-Pacific FTAs. In the second column, we calculate the coverage rate of each issue in the existing Asia-Pacific FTAs, namely the percentage of FTAs including the issue in all existing FTAs. We study the full text of each FTA in the database, and check whether the specific issue is included in the texts, and then calculate the coverage rate of each issue, using the number of FTAs with the specific issues, divided by the total number of FTAs in the databases. The third column contains 10 issues existing in the TPP only and not included as major issues in the database. In the TPP, 1/3 of issues are new issues in Asia-Pacific integration agreements.

Similar to the analysis results of US agreements themselves, Chapters 12, 17 and 22–26 (Temporary Entry for Business Persons, State-Owned Enterprises and Designated Monopolies, Competitiveness and Business Facilitation, Development, Small- and Medium-Sized Enterprises, Regulatory Coherence, Transparency and Anti-Corruption) are issues of the new century. Besides, issues on special industries such as financial services, telecommunications,

² <https://ustr.gov/trade-agreements/free-trade-agreements>

³ <http://fta.apec.org/search.aspx>

Table 1: Comparisons of Rules in the TPP and Asia-Pacific FTAs

16 Common Issues in the TPP and Asia-Pacific FTA Database	Coverage Rate in Existing Asia-Pacific FTAs		10 Issues Existing in the TPP only
Deepening of Traditional Issues			
Trade in Goods and Related Issues	100%		
2. Trade in Goods	100%		3. Textiles and Apparel
4. Rules of Origin	100%		
5. Customs Administration and Trade Facilitation	83%		
6. Sanitary and Phytosanitary Measures	79%		
7. Technical Barriers to Trade	88%		
8. Trade Remedies	52%		
Investment			
9. Investment	76%		
Trade in Services			
10. Cross-Border Trade in Services	81%		11. Financial Services
14. Electronic Commerce	29%		12. Temporary Entry for Business Persons
			13. Telecommunications
Issues on Deep Integration			
15. Government Procurement	62%		
16. Competition Policy	69%		
18. Intellectual Property	67%		
19. Labor	40%		
20. Environment	52%		
Cross-cutting New Issues			
21. Cooperation and Capacity Building	36%		25. Regulatory Coherence
			17. State-Owned Enterprises and Designated Monopolies
			24. Small- and Medium-Sized Enterprises
			22. Competitiveness and Business Facilitation
			23. Development
			26. Transparency and Anti-Corruption
Other Institutional Issues			
28. Dispute Settlement	93%		
1. Initial Provisions and General Definitions	*		
27. Administrative and Institutional Provisions	*		
29. Exceptions	*		
30. Final Provisions	*		

and textiles and apparel are generally not included in Asia-Pacific FTAs. Chapter 21 (Cooperation and Capacity Building) is a new issue for the US. However, the chapter on cooperation is included in 36% of Asia-Pacific integration agreements, especially in FTAs signed by Japan.

As indicated by analysis from the two perspectives above, in terms of scope, the TPP has made many breakthroughs compared with FTAs in the US and the Asia-Pacific region.

Deepening of the TPP Text and New Rules

The classification of 30 chapters of the TPP is an important step towards understanding its context. However, it is not easy to classify these chapters, and there are no available unified standards for such a classification in present studies. The World Trade Organization (WTO) and APEC only list general issues in an agreement without classification. Our classification is based on the following two points: (1) the evolutionary stages of global trade rules proposed by Dong [2014]; (2) the degree of application of the agreement, reflected by the coverage rate of the rules in Table 1.

According to Dong [2014], global trade rules have developed in four stages. During the first stage, tariff and non-tariff barriers to trade in goods were reduced. From 1947 to 1962, the first five rounds of the General Agreement on Tariffs and Trade (GATT) mainly focused on tariff concessions for trade in goods. Issues such as non-tariff barriers started from the sixth round of multilateral trade negotiations (the Kennedy Round) from May 1964 to June 1967. The seventh round (Tokyo Round) from September 1973 to April 1979 yielded a breakthrough. During the second stage, trade in services, intellectual property and other issues were included in the trade rules. In the third stage, more issues covering domestic policies were introduced into the negotiation of regional trade rules. From the 1990s, driven by developed countries, more areas involving domestic policies of a country (for instance investment, labor, environmental protection, and competition policies) were brought into the negotiation scope of international trade rules. In 1996, developed countries proposed discussing the “Singapore issues” under the framework of the WTO, but these were not included in multilateral trade negotiations. Then, these issues related to domestic policies were brought into the regional integration negotiation, step by step. Through development over the following 20 years, these rules of “in-depth regional integration” were generally included in regional trade negotiations. The fourth stage is that of high-standard international trade rules oriented towards the 21st century, represented by such agreements as the TPP and featured mainly by rules within borders. According to the coverage rate of Asia-Pacific FTAs in the second column of Table 1, the degree of application of different issues is consistent with the development tendency of the rules.

Based on the above analysis, we classify the 30 chapters of the TPP text into four classes. In the first there is a deepening of traditional issues; in the second are issues on deep integration; in the third is cross-cutting of new issues; and in the fourth are other institutional issues. In general, the TPP is characterised by promoting regional trade liberalization, and aims to build a value chain with a certain exclusivity. It meets the development demands of the 21st century, an era of the digital economy. Based on the facilitation of small and medium-sized enterprises, it gives much space to rules within borders, and takes development diversity into consideration.

New Concepts Reflected in the TPP Text

After interpreting the TPP text in terms of its scope and depth, we will analyze it more deeply by integrating all agreement contents and summarizing the new concepts in the text.

(I) The TPP promotes basic US concepts in international economic and trade rules: fairness, openness and impartiality

The concept of fair trade in the US essentially means that American enterprises can have an equal and fair competition opportunity when competing with foreign enterprises. This concept is highlighted in the TPP. On October 15, 2009, Mr. Obama said in the third debate of the presidential campaign that free trade should be supported, and he emphasized that “fair trade” should be maintained [Ni, 2009]. Thus, Obama inherited the concept of fair trade. Many chapters of the TPP deal with fair trade, so as to enable local enterprises to compete fairly on foreign markets. Chapters involving pre-establishment national treatment include the Trade in Goods, Investment, Cross Border Trade in Services, Financial Services, Telecommunications, and Government Procurement. The purpose is to avoid setting additional competition barriers for foreign enterprises, so that they can enter the market environment fairly. Chapters involving non-tariff barriers include Customs Administration and Trade Facilitation, Sanitary and Phytosanitary Measures, and Technical Barriers to Trade. These aim to reduce transaction costs in international trade resulting from inconsistent systems, regulations and other factors in different countries. The Chapters on Labor and Environment deal with the production costs of enterprises in each country. A country with strict standards for labor and the environment will increase an enterprise’s production costs. Thus, enterprises in a country with loose standards will be more competitive. By setting unified standards for labor and the environment, enterprise cost will not be influenced by these two factors. The Chapters on Competition Policy, State-owned Enterprises and Designated Monopolies, and Small and Medium-Sized Enterprises aim to eliminate government influence so that enterprises will not be at a disadvantage in competition due to government support.

In order to create a fairer environment for international economic and trade competition, the TPP also stresses the concept of openness, which means openness of information. It also refers to transparency, which means that the information provided by the government is not only open to domestic enterprises, but also to foreign enterprises; and that it is not only open to enterprises, but also to consumers. When the government is able to guarantee the transparency of information, foreign enterprises will not lose the opportunity for fair competition due to lack of information availability. Thus, the concept of openness is essentially for the purpose of creating an opportunity for fair competition, and is an extension of fair trade. The TPP attaches much importance to openness and transparency. In terms of statistics, the word “transparency” or “transparent” occurs 102 times in total in the text body of the TPP. Among 31 chapters including the preamble, the quantity of chapters containing the word “transparency” or “transparent” amounts to 21. All of these reflect the principle of openness in the TPP. Among those chapters, the chapter where the aforesaid word occurs most (up to 24 times) is the chapter on State-Owned Enterprises and Designated Monopolies, which indicates that the TPP expects more transparent operations among state-owned enterprises (SOEs). The chapter on Transparency and Anti-Corruption directly deals with the issue of transparency.

In addition to fairness and openness, the TPP also emphasizes the impartiality of dispute settlement by the government. The concepts of fairness and openness attempt to create equal competition opportunities for enterprises prior to and during the process of competition. However, once a dispute occurs involving an enterprise in its competition on the foreign market, the impartiality of the local government becomes very significant. In terms of the subject of the dispute, there are two types involving a foreign enterprise in its competition on the local market. One type involves disputes with local enterprises, and the other involves the disputes with the local government. When a dispute involves domestic and foreign enterprises, in cases where the foreign enterprise is unsatisfied with the resolution, it can raise an objection to the

local government. In this way, these two types of dispute are the same in nature, and both deal with the relationship between the foreign enterprise and the local government. Besides the common dispute settlement mechanism set by various trade agreements, chapters such as Regulatory Coherence, and Administrative and Institutional Provisions aim to encourage the government to maintain impartiality towards local and foreign enterprises in market competition. In the chapter on Investment, Investor-State Dispute Settlement (ISDS) grants foreign investors more power to force the local government to maintain impartiality. In other words, investors can submit disputes directly to third-party procedures and international arbitration, without going through the legal procedures of the host nation.

(II) The TPP reflects the demand of GVCs for changing international economic and trade rules

Since the 1990s, global value chains (GVCs) have become predominant in the international division of labor [Baldwin and Lopez-Gonzalez, 2013; Johnson, Robert and Noguera, 2012]. However, existing WTO rules are mainly based on the results of the Uruguay Round of negotiations in 1994 and fail to reflect this point. Currently, many multilateral regional trade agreements reflect the specialization of global value chains, and the TPP reflects it most thoroughly. In the chapter on Competitiveness and Business Facilitation, it proposes the establishment of a Committee on Competitiveness and Business Facilitation to facilitate the development and enhancement of regional supply chains (value chains).

(1) GVCs mean that goods are manufactured in different countries which undertake different production processes. This implies that goods have to cross borders several times during the manufacturing process. Clearly, compared with the traditional labor-division mode of manufacturing a product in a single country, a product manufactured in GVC will include extra costs for crossing borders, which will increase with the cross-border times. Thus, even if the tariff is lower, the cost may be higher. Hence, GVCs require reducing the goods trade tariff to zero. As shown in the 2014 study by Diakantoni et al., after taking cross-border costs into consideration, the actual tariff faced by each industry is much higher than the nominal tariff. If the tariff is reduced to zero, the actual tariff faced by each industry will be significantly reduced. For TPP parties, the simple average MFN tariff is not high at present. Even the highest tariff, in Vietnam, is only 10.58%, while that of other parties is lower than 7%. While all products in Singapore are zero-tariff, the proportion of zero-tariff products in total product quality in Brunei is the highest, at 75.40%, and in Chile is less than 1%. However, in the first year after the TPP enters into force, the tariffs on most products will be reduced to zero. At that time, the proportion of zero-tariff products in Australia, Brunei, Canada, Chile, Singapore and the US will be up to 90%; that in Japan, Malaysia and Peru will exceed 80%. In Mexico and Vietnam it will be relatively low, but will still reach 76.99% and 64.22% respectively.

(2) GVC specialization requires extending rules across borders to rules within borders. In the traditional labor-division mode, where product manufacturing is completed in a single country and the manufacturing process does not involve other countries, we only need to pay attention to border rules between countries. In a GVC, the product is manufactured in different countries. Thus, to facilitate the smooth completion of the manufacturing process, internal rules of countries should be subjected to appropriate constraints. Evidently, the TPP is more binding on internal rules than in available trade agreements, especially in the manufacturing process. For example, relevant rules in the Investment chapter aim to provide services for transnational corporations to arrange production all over the world; the requirement of yarn forward in the Textiles and Apparel chapter aims to provide services for promoting regional value chain development inside TPP parties.

Table 2: Average Tariffs of TPP Parties and Zero-Tariff Proportions before and after TPP Implementation (%)

TPP Party	Simple Average Tariff	Proportion of MFN Zero-Tariff Products	Zero-Tariff Proportion in 1 st Year after Implementation of TPP
Australia	2.87	46.19	93.04
Brunei	3.46	75.40	92.04
Canada	3.73	52.23	94.93
Chile	5.98	0.45	94.74
Japan	4.21	40.13	86.11
Malaysia	6.54	60.63	84.71
Mexico	6.84	56.12	76.99
Peru	5.12	52.92	80.04
Singapore	0	99.92	100
US	4.32	36.42	92.96
Vietnam	10.58	32.33	64.22

Note: New Zealand is not temporarily included in the table as its schedule of tariff concessions is too complicated to be processed. However, as the levels of trade liberalization of New Zealand and Australia are similar, it is not difficult to infer that the proportion of zero-tariff products in New Zealand will be up to 90% after the TPP enters into force.

Source: Obtained by the authors by systemizing the Tariff Elimination Schedules of the TPP.

(3) GVC specialization requires formulating unified standards. When a product is manufactured in different countries, the product standard should be unified in those countries so as to effectively connect each manufacturing process for the product. The tendency towards unifying standards is inevitable. In order to unify standards, the TPP develops special annexes for particular products such as cosmetics, medical devices, pharmaceuticals, information and communication technology products, red wine and distilled spirit, prepackaged goods and food additive formulations, and organic agricultural products. None of these are available in previous agreements.

(4) GVCs require taking development into consideration. GVCs connect different countries deeply, and their development depends on the balanced and coordinated development of each country. If some countries have limited ability to participate in GVCs, they will affect the development of the entire regional value chain. The GVC specialization mode compels developed countries to consider benefits to developing economies. Thus, it is important to cultivate the capabilities of less developed countries to participate in GVCs, which is the content of the Investment chapter in the TPP. The TPP is the first agreement to include the Investment chapter in the US. For this purpose, a Development Committee has been established to help developing members make the most of economic opportunities created by the TPP, so as to realize the development goals of broader economic growth, sustainable development, and poverty reduction.

(III) The TPP considers benefits of transnational corporations and SMEs and limits special government support for SOEs

In the competition market of international economy and trade, enterprises can be divided into two classes in terms of enterprise size: transnational corporations (usually large) and small-

and medium-sized enterprises (SMEs). Transnational corporations are capable of arranging global or regional production and sales as arrangers of GVCs, while SMEs can make arrangements within their respective countries only, and obtain benefits as participants in GVCs. From the point of view of enterprises, their common opponent is state-owned enterprises (SOEs), and they may lose the chance of obtaining benefits from GVCs due to improper government support for state-owned enterprises. The TPP pays attention to the interests of transnational corporations and SMEs, and sets relevant chapters to restrain the behavior of governments and SOEs.

The chapter directly related to transnational corporations is the Temporary Entry for Business Persons. The arrangement of global production by transnational corporations involves markedly increased cross-border business activity of their staff. In order to reduce the resulting cross-border cost, it is necessary to set a relevant chapter to facilitate temporary entry for business persons. In this chapter, each TPP party makes a commitment in the annex to increase transparency of temporary entry for business persons.

The chapter on Electronic Commerce mainly aims to create a low-cost, safe, and reliable environment for enterprises and persons of each TPP party to access and use the internet to conduct electronic business activities and promote the expansion of electronic commerce, and to encourage relevant innovations by building a free, open, safe, and stable Internet. It can thereby create new trade and investment opportunities for contracting countries, increase employment, and promote economic growth. Ultimately, it will create opportunities for transnational corporations to lead GVCs in the background of "Internet+" and for SMEs to utilize the Internet to integrate into GVCs. The TPP sets a standard for electronic commerce that is higher than that in existing trade agreements and its binding force is clearly enhanced.

Compared with previous agreements, the TPP has a noticeable feature in its emphasis on benefits for SMEs. Innovative development of SMEs is always a focal issue for all APEC economies. Since 1994, as one of the ministerial conferences under the framework of APEC, the APEC SME ministerial conference held every year have discussed issues related to the promotion of SME development. However, existing trade agreements do not pay much attention to SMEs. In the TPP executive summary published earlier by USTR, references to "small- and medium-sized enterprises (SMEs)" occur more than 15 times, which indicates the TPP's focus on SMEs' engagement in international economy and trade. For example, in the framework of multilateral agreements, government procurement agreements (GPAs) do not involve SMEs, since government procurement mainly provides services for large enterprises to enter the market of foreign government procurement, and SMEs are not capable of competing for foreign government procurement. However, the Government Procurement chapter in the TPP is the first to incorporate SMEs into the text, and promote SME development by addressing information sharing and establishing a Committee on SMEs.

While paying attention to transnational corporations and SMEs, the TPP also focuses on SOEs. The State-Owned Enterprises chapter of the TPP limits improper behavior of SOEs on direct subsidies, financing concessions, guarantee facilitation, monopolies, and equity lock-up, and ensures that SOEs operate in a purely commercial manner and competely fairly with private enterprises. Its main contents include: (1) non-discriminatory treatment and commercial concerns, which stipulate that SOEs should operate in a purely commercial manner and compete fairly with foreign and private enterprises; (2) non-commercial assistance, which ensures that commercial procurement and sales of SOEs in each TPP party are driven by commercial concerns, unless such behavior is inconsistent with the purpose of public services; (3) transparency, which requires the elimination of SOE financial concessions and the cancellation of preference for SOEs in government procurement, and guarantees the transparency of SOE information,

such as business contents and financial accounting; (4) immunity and exceptions, which stipulate partial immunity for some state-owned organizations. For example, the Sovereign Wealth Fund of Malaysia has a two-year dispute immunity, and Singapore Temasek Holdings and the Government of Singapore Investment Corporation also have partial immunity.

(IV) The TPP focuses on the US interests and gives consideration to interests of other TPP parties

As mentioned previously, the TPP rules reflect the international economic and trade concepts of the US and help to utilize the advantages of the US objectively. From the viewpoint of the text, many provisions are extensions of American domestic laws and regulations to the international level. They can be accepted by the US easily, and mainly create challenges for other members. However, in order to reach a consensus on the negotiation, the TPP also gives consideration to the interests of other TPP parties, and reflects this in the Exceptions chapter and annexes. Different chapters also make special arrangements for different TPP parties. Relevant chapters include Trade in Goods, Investment, Cross Border Trade in Services, Financial Services, Temporary Entry for Business Persons, Government Procurement, State-Owned Enterprises, Intellectual Property, and Exceptions. For example, in the annexes to Trade in Goods, different countries contain different contents. TPP parties such as Austria, Brunei, Chile, New Zealand, Peru and Singapore only include general notes and tariff elimination schedules, while countries such as Canada, Japan, Malaysia, Mexico, the US and Vietnam also include other annexes, such as tariff rate quotas, agricultural safeguard measures, tariff differentials, motor vehicle trade, and earned import allowance. Moreover, different countries have different transition periods. For instance, the US has the longest transition period (30 years) and the transition period of Australia is only four years.

Comprehensive Influences of TPP on China

(I) The TPP will have a trade diversion effect on China

In the short term, the implementation of the TPP will cause trade diversion in China's economy, but this effect is controllable. According to Table 2, upon the implementation of the TPP, the zero-tariff proportion of most TPP parties will exceed 80%. Meanwhile, much of the contents will cause adverse influences on countries beyond the region, for example, measures for customs administration and trade facilitation, strict sanitary and phytosanitary standards, intellectual property standards, and rules of origin for textiles and apparel. Compared with the results calculated through simulation by the main relevant models in both China and abroad, most tariff reductions set by these models are higher than those actually reflected by the text. Based on these models, in the short run, the influence range of the TPP on China's GDP is about 0.1%-0.3%, which is still adoptable. However, further analysis should be made on the consistency between the model-based quantified results of non-tariff barriers and the actual situations.

China has signed free-trade agreements with eight TPP parties other than the US, Japan, Canada and Mexico. These agreements will offset the trade diversion effect caused by the TPP. According to the published TPP text, tariffs between TPP parties will be eliminated step by step. For some industries, such as vehicles imported by the US from Japan, a protection period as long as 30 years is specified. As a result, the trade diversion effect will not be significant in the short term.

However, trade diversion caused by the TPP to China brings about new pressure for the transformation and upgrading of trade in China. The TPP provides new competitive edges for

developing TPP parties in the low-end manufacturing industry. China's high-end manufacturing and other industries have to compete with those of developed countries. Thus, China's manufacturing industry is facing new challenges. In the market of developed countries such as the US, China's labor-intensive products face competition from developing countries such as Vietnam; in the market of other Asia-Pacific TPP parties, the US manufacturing industry will occupy the Asia-Pacific market with a larger market share. Since the financial crisis, the US has paid more attention to the manufacturing industry. From 2009 to 2014, US exports accounted for nearly one third of the US economy. Due to TPP parties' measures such as tariff reduction and reduction of agricultural export subsidies, a large number of US manufacturing commodities, agricultural products, and natural resource products will be exported to other Asia-Pacific TPP parties, putting China under increased pressure on the Asia-Pacific market.

(II) The TPP will cause an investment diversion effect on China and affect the remodeling of Asia-Pacific value chains

The TPP provisions on investment aim to establish a stable, transparent, predictable and non-discriminatory protection framework for investors of TPP parties when making overseas investments. The improvement of the investment environment for TPP parties will, to some extent, cause an investment diversion effect on China. In particular, the labor-intensive industry in China will be more inclined to shift to TPP parties in Southeast Asia. However, this diversion conforms, to some degree, to the industrial upgrading and development of China. Furthermore, international investment is affected by comprehensive factors such as market potential, labor cost, and government policy. In general, the TPP investment diversion effect on China is controllable.

More attention should be paid to the influence of the TPP on existing Asia-Pacific value chains. The global production and trade pattern has changed from the traditional trade pattern focusing on final products, to the trade pattern focusing on value chains. The TPP Rules of Origin chapter points out clearly that its purpose is to "promote regional supply chains, and help ensure the TPP countries rather than non-participants are the primary beneficiaries of the Agreement." This chapter stipulates the regional accumulation rules regarding the rules of origin. In other words, raw materials from one TPP party are treated the same as materials from any other TPP party, if used to produce a product in any TPP party. These provisions promote production and supply chain integration among TPP parties, and are favorable for forming a single and integrated Asia-Pacific market. Currently, the two centers of Asia-Pacific value chains are China and the US, and Japan is the sub-center. In the Asia-Pacific region, the Sino-US economic and trade relationship is the core which connects other Asia-Pacific countries into a complicated value chain network. The exclusion of China from the TPP breaks the existing Asia-Pacific production network. The high-standard rules of the 21st century represented by the behind-the-border rules proposed by the TPP provide the institutional foundation for a new regional production network based on TPP parties. China should accelerate the construction of the Free Trade Area of the Asia-Pacific (FTAAP) and avoid being marginalized in the reconstruction of the Asia-Pacific production network. From the perspective of specific industries influenced in the Textiles and Apparel chapter of the TPP text, the "yarn forward" requirement is proposed, which means that a TPP party should use yarns and fabrics within the region as originating materials so as to promote supply and investment portfolios within the region, and only products in the list of "supply shortages" can use specific yarns and fabrics supplied by a non-contracting party as raw materials. Thus, the export of yarns and fabrics produced by China will be affected. Besides, in the Cross-Border Trade in Services chapter, the discriminatory provision on SOEs will limit Chinese enterprises' expansion to international

markets; and the provision on intellectual property increases the production costs of China's enterprises and influences their upgrading in the global value chain. It also greatly enhances protection for pharmaceutical patents. All these will have influences on the overseas layout of China's enterprises.

(III) The TPP will influence industrial development, market operation and management systems in China

In the long run, by influencing the market competition environment, setting new technical standards for traditional industries, and establishing new rules framework for emerging industries, the TPP will influence industrial development, market operation and management systems in China.

With the aim of promoting the economic and trade development of TPP parties, the TPP proposes high-standard rules for constructing a new market competition environment. For example, it provides simpler and clearer trade facilitation measures to enhance the customs efficiency of TPP parties, and to help SMEs in their commercial development. By recognizing the best practices in trade remedies, it increases transparency in trade remedies and the legitimacy of procedures, and facilitates temporary entry for business persons. Regarding sanitary and phytosanitary measures, it provides science-based new standards and high requirements for food safety, etc. On the aspect of technical barriers to trade, it proposes new standards and sets specific standards for cosmetics, medical devices, pharmaceuticals, products of information and communication technology, etc. Besides, it stipulates higher requirements for the competition environment faced by China regarding cross-cutting issues such as intellectual property, labor and the environment.

The TPP establishes a new framework of rules for the service industry and emerging industries such as cross-border trade in services, financial services, telecommunications, and electronic commerce. All of these set high standards for China to participate in competition within the global service industry. In respect of new and emerging industries such as telecommunications and electronic commerce, the standards of the TPP are set in accordance with the development situations of countries such as the US. As a decisive country in the development of world electronic commerce, especially as a large country in cross-border consumption, China should strengthen its voice in setting rules for these new industries.

The TPP expands some domestic policies previously under the governance of a country to the whole region, for instance, the chapters on State-Owned Enterprises and Designated Monopolies, and on Regulatory Coherence. The purpose of these rules is to use the framework of domestic policies in developed countries like the US to restrain the operation and supervision behaviors of other countries, so as to form unified business environment and market standards, and to convey the business values of the US. After these rules are extended to become international rules, they will have great influence and impact on the operation of China's enterprises, and on government supervision behavior.

From the above discussions, the traditional trade division effects of TPP on China's economy are controllable, while the exclusion of China from the TPP breaks the existing Asia-Pacific production network. In the long run, the new 21st standard rules in TPP will influence industrial development, market operation, and management systems in China. TPP represents the interests of developed countries, and developing and emerging economies should push for the formation of new trade and investment rules to increase the inclusiveness of global value chains.

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Korea's Trade Strategies for Mega Free Trade Agreements in Regional and Global Economic Integration

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Korea has developed rapidly since the 1960s. It is one of the four Asian tiger economies and a good model for developing countries. Korea shows the world how a developing country can develop its economy rapidly and become industrialized. Its development strategy has mainly been an export-oriented trade policy. As a result, its trade volume grew from \$1 billion in 1966 to \$1 trillion in 2011, which is a 1,000-fold increase within five decades. Since 2011, Korea has become one of seven countries with a trade volume over \$1 trillion. However, the Korean economy has experienced turbulence as well as positive growth. It underwent severe economic crises such as the Asian financial crisis in 1997 and the global financial crisis in 2008. Its economy has been extremely vulnerable to the external economic environment, although it has improved and strengthened, particularly since the global financial crisis. During those two crises, the government carried out an appropriate trade policy with a strategic approach to upgrade its industrial structure and competitiveness in global markets.

This article comprehensively discusses Korean trade policy and strategy over the last five decades, and how its national economy has developed rapidly. It also explores how the government sets its strategic targets in Asia and the Asia Pacific region. It considers two mega free trade agreements (FTAs) — the Regional Comprehensive Economic Partnership and the Trans-Pacific Partnership — as new opportunities for further development. Therefore, it is wise to analyze these regional mega FTAs in order to maximize the national interest.¹

Key words: trade policy; development strategy; free trade agreement; Regional Comprehensive Economic Partnership (RCEP); Trans-Pacific Partnership (TPP)

Introduction

Korea was the fifth largest exporter and sixth largest importer in the world in 2014, registering growth in exports of 29 percent of GDP in 1995 and 54 percent in 2014. Such a rapid increase in exports has helped the nation to grow from a low-income to an industrialized economy in less than 50 years. The trade volume of Korea already exceeded USD1 trillion in 2011. Since then, Korea joined the 1-trillion trade club along with China, the USA, Germany, Japan, the UK, France, Italy, and the Netherlands. It became the ninth nation in world trade history [WTO, 2015].

Four factors account for this success. Firstly, Korea has continuously maintained a proper environment for doing business, particularly by keeping down the tax burden, which is one of

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the lowest in the OECD. Secondly, the government has promoted exports strategically since the 1960s and recognized their importance, while many developing countries have been engaged in import substitution as their development strategies. Based on the export-driven policy, Korea has been aggressive in negotiating free-trade agreements (FTA) with large and growing countries. Thirdly, it has taken advantage of neighboring countries such as Japan and China by attracting Japanese investment and investing in the Chinese market. Last but not least, it has diversified its global markets [World Bank, 2010, 2012]. In 2014, 25.4 percent of Korean exports went to China, 9.1 percent to the EU, 12.3 percent to the USA, and 5.6 percent to Japan. In 2009, just after the global financial crisis, China accounted for over 85 percent of Korea's export growth. Korea's diversification of markets and its growing diversity of exported goods contributed to the highest export growth in the OECD in 2009² [European Commission, 2016].

The government carried out industrial policies during the 1960s and 1970s in order to boost exports, mainly based on government-led trade and industry [Frank Jr. et al., 1975]. During the 1980s, the government transformed its policies from a government-led to a liberalization and competition-led policy. Furthermore, the government strengthened its policy direction toward market openness, deregulation, and free trade during the early 1990s. It built on its policy stance of market openness and competition promotion continuously in the 2000s in order to expedite trade liberalization, in pursuing free trade agreements with developing and developed economies around the world [Noland, 2007; Todaro & Smith, 2012]. As a result, Korea's trade policy has been centered on pursuing active FTA policies more than any other nations, since the 2000s [Lee, 2012; Solis, 2013].

In fact, Korea's FTA policy was initially a reactive response to the rapid proliferation of preferential trade agreements around the world. Its position in trade negotiations was based on a defensive strategy, focusing on limiting market openness in sensitive industrial sectors. Later on, the transformation of Korea's FTA policy towards an ambitious trade strategy dealing with major economic partners, minimizing exclusions, and tackling non-tariff barriers, was based on institutional changes to the trade policy-making setup at the beginning of the 21st century. The entrusting of trade policy to the Ministry of Foreign Affairs and Trade (MOFAT),³ and the efficient coordination of bureaucratic interests between various ministries, has enabled Korea to become an international trade hub. At the same time, however, trade policy has been a very sensitive issue, and the government has struggled to ensure greater inclusivity, transparency, and the development of an effective safety net for disadvantaged sectors.

Since concluding FTAs with three major economic powers – the USA, China, and the EU – Korea has faced a new struggle to choose two mega FTAs, namely RCEP and TPP. This could be either a dilemma or a new opportunity to enter the mega-FTA era, because the Korean trade system can become more regionally and globally integrated than ever before. On the other hand, a negative perspective also arises due to competition backed by economic superpowers such as the USA and China in Asia, as well as the Asia Pacific area. As a result, mega FTA shave become a hot economic and trade policy issue for the Korean trade strategy.

This study is based on a practical approach to strategy and policy analysis instead of arguing the theoretical or conceptual backgrounds to global trade. It focuses on how Korea practices trade strategies as policy tools to generate economic growth. The research questions of this paper are what roles trade policies played in dealing with the global financial crisis in 2008,

² The Korea International Trade Association [KITA]. Available at: <http://stat.kita.net/stat/world/major/KoreaStats06.screen> [accessed 16 November 2016].

³ MOFAT had been in charge of trade policy from the Roh Moo-Hyun government (2003 – 2008) to the Lee Myung-Bak government (2008–2013). The new Park Geun-Hye government switched the assignment of trade policy to the Ministry of Trade, Industry, and Energy (MOTIE) in 2013.

and the EU's sovereign debt crisis in 2011. Moreover, it explores which strategies the government has been carrying out in order to achieve economic growth in the period since the global financial crisis. Last but not least, the paper discusses how to maximize the national interest by choosing mega FTAs – between RCEP and TPP.

Global Trend of Trade Since Global Financial Crisis

Background

The global financial crisis in 2008 hit the world economy severely. The International Monetary Fund (IMF) projected that global economic activity would contract to 0.5 to 1 percent growth in 2009, the lowest in 60 years. Most countries experienced a simultaneous downturn, with the developed economies of North America, the EU, and Japan falling into recession, and a significant downturn in growth rates in developing economies. These declines in economic activity were estimated at trillions of US dollars lost in equity markets, and a credit squeeze that affected not only households and global business, but also world trade and oil exploration [IMF, 2010; Nanto, 2009].

The global financial crisis hit the world labor market negatively as well. The International Labor Organization (ILO) estimated that the number of unemployed increased by 14 million in 2008 after four years of consecutive declines in world unemployment. However, it expected that the number of unemployed worldwide could increase at least by 38 million at the end of 2009 as the financial crisis continued [ILO, 2009]. Moreover, the global financial crisis severely influenced exports of goods and services. Exports of goods and services generate foreign exchange for export countries that enable them to pay for imports and repay international debt. The trade deficit depresses the value of currency in the deficit country, which increases the cost of debt servicing for governments, businesses, and households that have borrowed in international currencies. In February 2009 compared with the previous year, exports in advanced economies and emerging economies were estimated to decline by about 25 percent. However, exports in developing economies declined by more than a third. These represent a historic contraction in trade, which caused a shrinking of international trade, low global economic growth, and the creation of more poverty in the world. This negative trend turned around sharply in 2010 due to a massive unconventional monetary policy in major economies. However, the trend did not last long. Since 2011, growth of trade and GDP became lower than the average export and GDP growth between 2007 and 2014 [Nanto, 2009; WTO, 2015] (See Fig. 1).

Global Trend of Trade

The global financial crisis escalated existing anti-globalization sentiments, and created views of opposition in liberalized trade resulting from neo-liberalism. Under these conditions, many countries have attempted to curtail imports and impose other restrictions on trade. As a result, the G20 summit, and the meetings of finance ministers and central bank governors resulted in an agreement to fight against all forms of protectionism in trade, and to maintain open trade. Despite such a clear political economic statement from the major countries, the World Trade Organization (WTO) gave its official views on the new trend of increased trade protectionism as a result of the deepening global economic crisis. During the crisis period between September 2008 and March 2009, 23 countries imposed 85 verified trade measures in the WTO [WTO, 2009]. The vast majority of imposed cases were trade restrictive, and some were in line with trade liberalization. The largest number of measures were imposed by India, and the

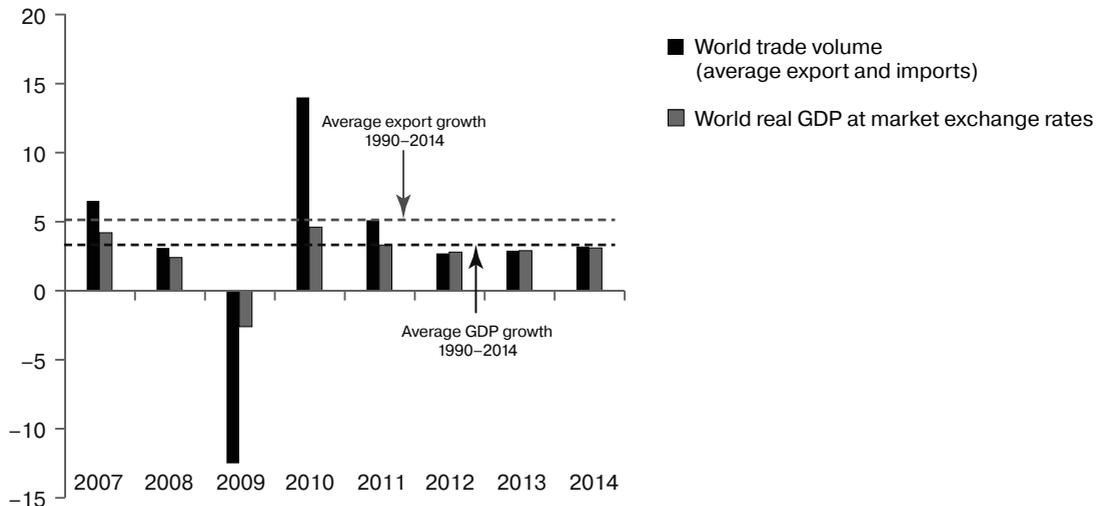


Figure 1: Growth Trend of World Trade and GDP (2007–2014, %)

Source: [WTO, 2015].

EU, China, Indonesia, and Russia. In these imposed trade measures, there is a clear pattern of increased import licensing, import tariffs, surcharges etc. Additionally, investigations of anti-dumping have increased [Ahearn, 2009; Nanto, 2009].

In fact, protectionism or beggar-thy-neighbor policies based on monetary policies, are limited by the rules of the WTO. Despite such a regulatory system based on rules and obligations in the WTO, there is a clear tendency to increase tariffs among member nations, to higher-bound levels that could cause world trade to shrink by up to 8 percent and reduce global welfare by up to USD350 billion [WTO, 2009]. Therefore, major countries have tried to adhere to the WTO rules in order to prevent the world economy from the same path of the Great Depression in the 1930s, when a proliferation of destructive protectionist trade measures prolonged the global economic depression [UNCTAD, 2010].

At the outbreak of the global financial crisis, all leaders of the Group of 20 stressed that the conclusion of the Doha Round could play a pivotal role in the world economy. Under such a circumstance, G20 leaders agreed to reach an agreement on modalities at the G20 summit in Washington DC in 2008, which could lead to a successful conclusion of the WTO's Doha Development Agenda (DDA) with an ambitious and balanced outcome.⁴ This message has been stressed continuously at subsequent G20 summits as well as at other international meetings. However, the conclusion of DDA has unfortunately been delayed until December 2013. Finally, WTO ministers were able to agree the Bali Package in December 2013, which marked the first occasion on which a multilateral trade deal was agreed by WTO members since its foundation in 1995. The final agreement includes three pillars: trade facilitation, selected agricultural issues, and selected development-focused provisions [Bendini, 2013].

Owing to the long delay of agreements in DDA, the number of bilateral and regional free trade agreements significantly increased from 2005 and 2010. There were 546 bilateral and regional FTAs notified by the WTO in 2013. Among these, 241 FTAs were in force, while 305

⁴ It is the declaration of the G20 Summit on Financial Markets and the World Economy. Washington D. C., November, 2008.

FTAs were in the negotiation stage according to the world trade report 2013.⁵ This indicates that the global business community regards bilateral and regional FTAs as a more effective means of market opening than multilateral trade negotiations. The EU and the USA are major players in bilateral and regional FTAs, and East and South Asia follow after these two major economies. The EU is involved in 27 FTAs, 17 of which entered into force after 2000, while the USA is involved in 9 bilateral FTAs, eight of which entered into force after 2000. In East and South Asia, numerous FTAs are under negotiation. Major and emerging economies in the region such as China, India, Japan and Korea are involved in FTA negotiations with one another, which will have massive implications not only for the region, but also for the world, if the negotiations are concluded. Additionally, there are two mega FTAs competing with each other in the Asia and Pacific region, which are RCEP and TPP. The former is initiated by China, while the latter is led by the USA. These mega FTAs are on the way to being realized in the near future. This means that bilateral and regional FTAs will continue due to their effectiveness, despite the completion of DDA in 2013 [UNCTAD, 2010; Das, 2013].

There are four core reasons why bilateral and regional FTAs have recently increased. Firstly, it is based on practical considerations. FTAs may be preferred to multilateral trade agreements because sensitive industrial sectors can be excluded between participating countries. Moreover, partners can be selected, and customization of the contents is also possible.

Secondly, the concept of competitive liberalization has been proliferated particularly in Asia, which has influenced an increase in FTAs. In practice, one major FTA and its market opening could change trade policy in a country from import-competing industries to exporters, which could enable governments to reduce domestic tariffs in exchange for opening markets in partner countries. In the concept of competitive liberalization, the principle of reciprocity is key. Therefore, competitive liberalization works better in a FTA framework than in a multilateral framework. Additionally, market opening by partners in FTAs is clearer and more immediate than in multilateral trade agreements, particularly if big trade partners such as China and India are involved [Bergsten, 1997; Baldwin, 2006].

Thirdly, developing countries could regard FTAs as a proper means of attracting foreign direct investment (FDI), not only from FTA partners but also from major economies outside FTA partners [UNCTAD, 2010]. Last but not least, FTAs may have played a role in regularizing trade and investment between partners, which has enabled the regional integration process in the East Asian region. East Asian free trade pacts codify the integrated production networks already operating in the region, which are linked by expanding flows of intra-regional trade and investment. This means that regional integration is evident in the market, and the governments of partners acknowledge such a fact, and even facilitate its future evolution [Hufbauer and Schott, 2007].

The proliferation of bilateral and regional FTAs has shaped a new trend in the international trade environment. There are still discussions as to whether or not such a new trade environment could undermine the fair and equitable international trading system. Compared to the previous regionalism, based on strengthening trade blocs such as the EU and the North American Free Trade Agreements (NAFTA) in the 1990s, the new regionalism since the 2000s has a different structure. The former was characterized as regional FTAs, while the latter is regarded as a large number of bilateral FTAs. As a result, almost all WTO members become parties of one or more FTAs. Therefore, the most-favored nation (MFN) principle in the WTO is gradually becoming an exception rather than the rule [UNCTAD, 2010].

⁵ World Trade Report 2013. World Trade Organization. Available at: https://www.wto.org/english/res_e/booksp_e/world_trade_report13_e.pdf (accessed 16 November 2016).

In the Asia Pacific region, we are experiencing a new trend, after most nations completed their bilateral FTAs since 2013. Two major economies (G2) initiated mega FTAs in order to strengthen their economic interests because the region has the highest potential to grow rapidly in the next two decades. In the two mega FTAs, many nations are overlapped and all possible member nations have calculated their own economic interests. Korea is not an exception.

Korean Trade Policy and Strategy

Development of Trade Policy

During the 1950s, the economic development policy in Korea was import-substitution industrialization. This policy helped protect domestic import substitution industries. However, at the same time, it impeded export growth. The export-oriented policy started in the early 1960s as the military regime came into power. It was a big policy shift from import-substitution industrialization to export-driven economic development. Although the government shifted its trade policy, the total volume of exports in 1966 accounted only for USD1 billion, because major export goods were mainly in the primary sector as well as light industrial products. During the 1970s, the government initiated a heavy and chemical industry policy in order to maximize export volumes. The government supported these industrial sectors strategically, and large companies such as Samsung and Hyundai participated in the policy direction, and became conglomerates. It is the Korean version of corporatism between government and private companies, and it succeeded in producing high economic growth, which was followed by the Japanese model [Park, 1997, 2000; Park & Lee, 2004; Sakong & Koh, 2010].

In the 1980s, the government carried out a Comprehensive Liberalization Policy, including the Import Liberalization Five Year Plan. This plan was implemented from 1983 to 1988. By implementing the plan, average import tariff rates declined from 23.7 percent in 1983 to 18.1 percent in 1988. As a result, the ratio of import liberalization increased from 80.3 percent to 95.2 percent in the same period. The ratio continuously rose, reaching 99 percent in 1995. A further step was made by the government in terms of trade policy in the 1980s, which was transformed from government-led to liberalization and competition-led policy in order to step up the national industrial structure. By the time the WTO was founded in 1995, Korea had strengthened its trade policy, focused on market openness, deregulation, and free trade [Sakong & Koh, 2010; Lee, 2012].

The proliferation of regional FTAs has played a significant role in encouraging free trade and liberalization in the world trade system since the 1980s. However, Korea had put policy weight on multilateral trade more than bilateral and regional FTAs until the Asian financial crisis in 1997. Owing to the crisis in 1997, Korea had to complete structural reforms across the whole economy and promote trade liberalization [Todaro & Smith, 2012]. As a result, Korea was able to benefit from bilateral and regional FTAs, which could impact the whole economy based on a restructuring process. Moreover, the failure to launch a new multilateral round in Seattle in 1999 also gave rise to doubts over the ability of the WTO to move the liberalization agenda forward. Therefore, many governments including Korea started to negotiate bilateral and regional FTAs as an insurance mechanism for their national economies [Sakong & Koh, 2010].

As a result, a rapid proliferation of bilateral and regional FTAs prompted Korea and other East Asian countries to participate in this new trend of trade, in order to avoid the possible negative effects of trade discrimination, particularly since the 2000s [Mansfield and Reinhardt, 2003]. If Korea had not shifted its trade policy from multilateral trade agreements to bilateral

and regional FTAs, it would have had a relative disadvantage in the world market in the short term. However, it would have reduced economic growth potential severely in the long term. Accordingly, Korea chose bilateral and regional FTAs as critical policy tools and measures for enhancing its industrial and national competitiveness, in order to strengthen its position in the global market [Lee, 2012; Solis, 2013] (See Fig. 2).

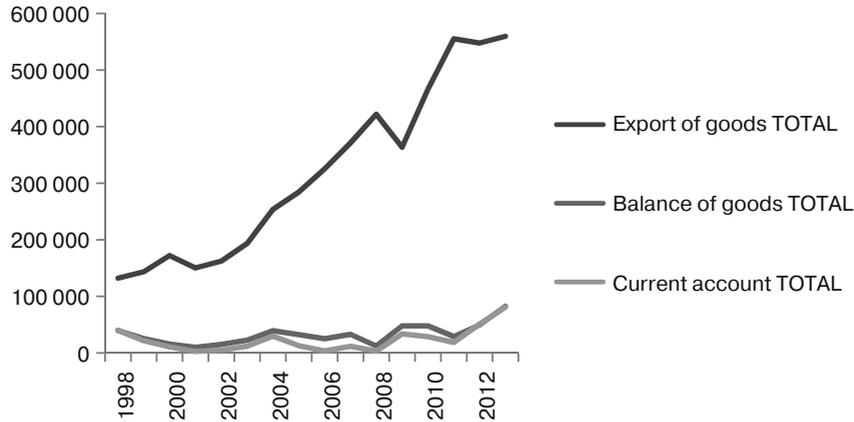


Figure 2: Export Trend after FTAs (1998–2013, USD million)

Source: [Bank of Korea, 2014].

Bilateral and Regional FTAs as a Trade Policy Strategy

Korea started to negotiate a bilateral FTA with Chile in 1999 for the first time in its history, and completed the agreement in October 2002. It was aimed at building an extensive network of FTAs and learning FTA negotiations. The reason why Korea launched the FTA negotiation with Chile was that the two countries are geographically distant, and the opposite seasonal climate could mitigate a sudden increase in agricultural imports. Despite this political and economic consideration, the FTA with Chile generated anti-FTA sentiments, particularly from farmers and interest-related groups, which hindered further FTA negotiations. Despite such a political barrier, the government announced an FTA roadmap as its national economic development agenda. It indicated a trade policy shift from a passive FTA stance to an active one. As a result, Korea was able to negotiate FTA talks with Singapore in 2003 and with the European Free Trade Area (EFTA) in 2004 [Park and Koo, 2008; Ahn, 2010].

The FTA Roadmap is based on two significant principles. Firstly, Korea can recover its competitiveness in the global market and reduce opportunity costs for Korean companies if it can conclude as many FTAs as possible in a short period.⁶ Secondly, the FTA Roadmap pursues multi-track and simultaneous FTA negotiations with large economies such as the USA and the EU. The main reason it is to maximize economic benefits and minimize negative costs from FTA negotiations. Based on those two principles, it aims at comprehensive and high-quality FTAs in terms of sectors and commitments [Lee, 2012].

Based on the FTA Roadmap, 14 FTAs have been ratified, and these are in effect at the end of 2015. The share of exports with these trade partners accounted for 67 percent of total exports

⁶ Opportunity costs for Korean companies have been observed as rising disadvantages in the markets, where Korea did not conclude FTAs.

in 2015. Additionally, seven FTAs are under negotiation. In total, 21 trade partners have either concluded FTAs or been in negotiations with Korea at the end of 2015. The share of exports with 12 countries under FTA negotiations reached 56.1 percent of total exports in the same year. In total, the share of exports with 21 trade partners which are major trade partners for Korea accounted for 77.6 percent [IIT, 2015].

In fact, after completing massive FTAs with major economies such as the EU, the USA, and India, as well as developing economies such as Chile, ASEAN, and Turkey, and negotiating mega FTAs with RCEP and TPP, the trade volume has increased continuously. In 2010, the share of Korea's trade with FTA partners versus Korea's total trade accounted for only 14.6 percent. This share was much lower than that of the world's average, at 49.2 percent. A year later, however, Korea's trade share with FTA partners increased to 27.4 percent after completing FTAs with the EU and Peru. During this period, Korea's exports to its FTA partners accounted for USD 166.8 billion, and imports from them reached USD 129.4 billion. This indicates that Korea generated a trade surplus of over USD37 billion with its FTA partners [Korea International Trade Association, 2012].

The most exciting trade negotiation of the Korean government was that with the USA in 2007, which was seen by the Korean people as rather controversial, as the Roh Moo-Hyun government was regarded as a progressive government.⁷ Despite such a political philosophy, the government policy aimed at generating economic growth based on trade strategies. Therefore, the government initiated the FTA Roadmap in 2003 [Lee, 2012]. The KORUS FTA was ratified, and came into effect in March 2012. After completing the FTA with the USA, Korea was able to increase its exports to the US market, while imports from the USA slightly declined, although Chinese economic growth was weakened and the Eurozone crisis was deepened in 2012. Despite such a global economic environment, Korea's trade with the USA has moderately increased. As a result, the trade surplus of Korea to the USA increased in the same year. This means that Korea benefited more than the USA from its FTA [Cooper et al., 2013].

Right after the negotiation with the USA, Korea aggressively launched an FTA negotiation with the EU, which was the second largest economy, in May 2007. After eight formal rounds of talks, the FTA was initialed by both sides in October 2009, and the two parties approved the FTA in September 2010. The agreement was officially signed on October 2010 during the EU-Korea Summit in Brussels. The parliaments of the EU and Korea ratified the FTA bills in 2011, and the EU-Korea FTA has become in effect since July 2011 [Song, 2011]. Compared to the KORUS FTA, the EU-Korea FTA caused less resistance, except in the agricultural sector. The EU-Korea FTA is the world's largest FTA since NAFTA in 1994. The EU was the third-largest importing and exporting partner of Korea and the second largest trade partner of Korea in 2013 [European Commission, 2014].

In Korea, the EU-Korea FTA was regarded as a win-win negotiation, and vice versa. From the EU's point of view, it needs a close trade partner based on solid economic criteria in order to enhance market access for European companies in the highly dynamic and competitive markets of East Asia. It was estimated that the EU-Korea FTA could create an increase in goods and services worth EUR19.1 billion (c.a. USD24.9 billion) for the EU and EUR12.8 billion (c.a. USD16.8 billion) for Korea in 2011. The EU's exports of goods and services to Korea amounted to EUR 47.4 billion, while Korea's export to the EU reached EUR 42.6 billion in 2012 [European Commission, 2011, 2014].

After completing the EU-Korea FTA, the trade volume in goods increased up to USD103 billion, which is a historical record to reach over USD100 billion for bilateral trade between the

⁷ Progressive governments use to carry out passive FTA policy in their policy framework. However, the Roh Moo-Hyun government carried out proactive FTA policies in its mandate period.

two partners. It increased continuously until 2013. By increasing the trade volume in goods, the EU marked a trade surplus to Korea in 2012 for the first time since 2004. In 2013, the EU's exports to Korea increased continuously, while Korea's exports to the EU declined. This caused an enlarged trade deficit in goods and services for Korea [European Commission, 2014] (See Fig. 3).

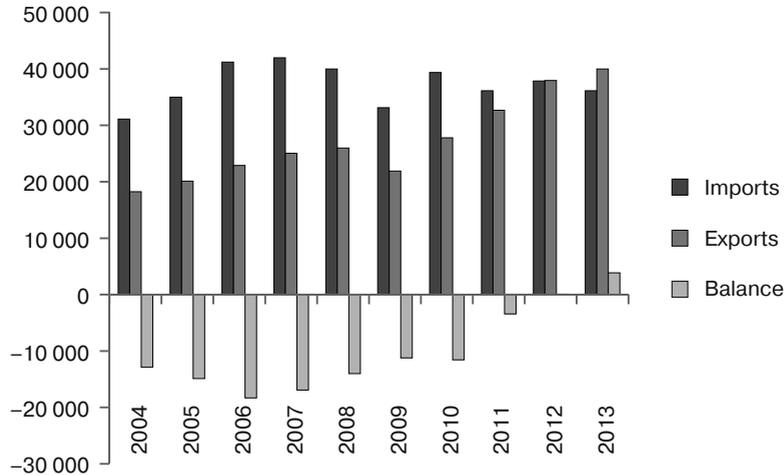


Figure 3: EU trade flows and balances in goods with Korea (2004–2013, million euro)

Source: [European Commission, 2014].

Strategy for Comprehensive and High Quality Oriented FTAs

Korea is the only Asian country to conclude bilateral FTAs with the two major economies, the USA and the EU. After the establishment of FTAs with these economies, Korea marked a trade surplus with the USA and a trade deficit with the EU, in 2012 and 2013. Korea, as a medium-sized economy, actively pursued FTAs with the two major economies. The reason for this is that Korea needs these two major economies more than they need Korea as a market. In this asymmetrical economic interdependence, the USA was the third-largest trade partner, the second-largest export market, and the fourth-largest source of imports for Korea, while Korea was the seventh-largest trade partner, the eighth-largest export market, and the sixth-largest source of imports for the USA in 2013 [US Department of Commerce, 2013; Bank of Korea, 2013; European Commission, 2014]. In the same year, the EU was the second trade partner, the third-largest export market, and the third-largest source of imports for Korea, while Korea was the eighth trade partner, the tenth-largest export market, and the ninth-largest source of imports for the EU in the same year [European Commission, 2014; Bank of Korea, 2013]. In these two major markets, gaining only a large increase in market access was not a critical priority for Korea, because Korean exporters already have a significant competitive position in consumer electronics, automobiles etc., in which they already face low or zero tariffs. The strategy of Korea's FTA with the two major economies is rather to preserve its market share in the face of growing competition from other East Asian producers, particularly China. Moreover, Korea aimed to strengthen its competitive position in the two major markets vis-à-vis Japan, where the elimination of low tariffs with FTAs could generate price advantages for Korean exporters [Cooper et al., 2013; European Commission, 2011].

Additionally, these two economies have been fostered by their own economic blocs such as NAFTA and the European Union, which generate disadvantages for non-member countries. Therefore, it was necessary for Korea to conclude FTAs with these economies, although a trade deficit could occur. Despite possible trade deficits, FTAs with these economies can be regarded as strategic, aiming to extend economic territory in dealing with around 50 percent of the world's economy. Additionally, total trade volume has increased continuously since the conclusion of FTAs with nine partners. Therefore, it is reasonable to say that Korea has established a global FTA network and has become an FTA hub country in the East Asian region. As a result, has benefited from its FTAs by liberalizing the market and enhancing the investment environment.

In line with its trade policy strategy, Korea has pursued comprehensive and high-quality commitments with its partners. From the eight FTAs in force, the average degree of liberalization in Korea's FTAs is 97.5 percent. The concession rate could vary with due consideration of sensitive sectors such as agricultural products. If some or all agricultural goods are excluded, this rate declines slightly with EFTA, the USA, the EU and India. Despite such a slight decline, the average concession rate of Korea's FTA is much higher than the average rate of the WTO, which accounts for 90 percent [Lee, 2012; WTO, 2008, 2012] (See Table 1).

Additionally, the KORUS and the EU-Korea FTAs include all sectors, from goods to services, investment, MRA, competition, IPR, Investor-State Dispute Settlement, e-commerce, and labor and the environment, which can contribute to upgrading Korea's industrial structure and competitiveness, particularly in the service sector. It is worth noting that the EU-Korea FTA includes regulatory transparency and a new approach on trade and sustainable development. It also includes a protocol on cultural cooperation in accordance with the UNESCO Convention. In fact, the EU-Korea FTA is a much more comprehensive agreement than the KORUS FTA [European Commission, 2011].

Overall, the KORUS and EU-Korea FTAs are regarded as strategically successful FTA models for Korean FTA policy in terms of comprehensive and high quality-oriented FTAs. The former has a 99.8 percent degree of liberalization, while the latter accounts for 99.6 percent. Certainly, the Korea-Chile FTA reaches the highest degree of liberalization along with KORUS FTA. However, it is an FTA policy test and a valuable learning process.

Table 1: Degree of liberalization in Korea's FTAs with partners

FTA	Degree of liberalization (%)
Korea – Chile	99.8
Korea – Singapore	91.6
Korea – EFTA	99.1
Korea – ASEAN	99.2
Korea – India	93.2
Korea – USA	99.8
Korea – EU	99.6

Source: [MOFAT, 2012; KIET, 2012].

Korea has been able to diversify its trade destinations on a global scale. In total, the trade share with the three major advanced economies declined from 35.4 percent in 2007 to 28.5 percent in 2012, while its share of developing economies increased from 63.6 percent to 71.5

percent during the same period [KITA, 2013]. This indicates two trade policies of the Korean government. Firstly, the structure of Korea's trade has been more diversified since the global financial crisis, expanding its share in developing countries such as ASEAN and the rest of the world as all major advanced economies faced a severe economic downturn. Secondly, the trade share with China declined in the same period because Korea was keen to reduce its high trade dependency on a single country [Lee, 2012] (See Fig. 4).

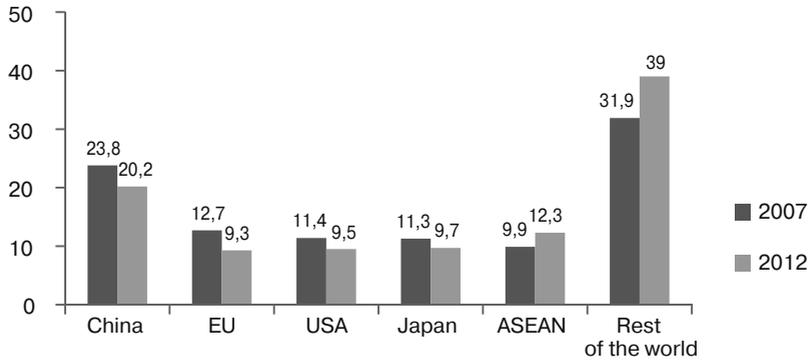


Figure 4: Change of Korea's trade share (as of 2007–2012, %)

Source: [KITA, 2013].

New Challenge for Mega FTAs in RCEP and TPP

Mega FTAs in Asia Pacific Region

Asia's economies have become increasingly vital to each other and to the rest of the world. In 2013, Asia's economic output was roughly equal to that of Europe and North America. By 2020, it will be 50 percent larger than theirs in terms of purchasing power parity (PPP). Additionally, two major economies – the USA and the EU – are recovering slowly with 1 to 2.5 percent economic growth per annum, while Asian emerging economies such as China and India are growing by over 7 percent per year. As a result, the center of the recovery of the global economy has decisively shifted from Europe and North America to Asia. Based on these factors, two different approaches to trade liberalization have become clear in the Asia Pacific Region. One is ASEAN-led or de facto China-led Regional Comprehensive Economic Partnership (RCEP), and the other is the US-led Trans Pacific Partnership (TPP). These approaches were discussed during the ASEAN summit in November 2012.

In fact, the reason for discussing these two mega FTAs at the ASEAN summit was that the Doha Development Agreement (DDA) was delayed at the multilateral level, and bilateral FTAs were able to generate marginal gains for private sectors in ASEAN member nations. Therefore, Asian countries started to raise concerns that a small number of FTAs such as RCEP and TPP could represent the next generation of the trade liberalization process. They regarded these FTAs as easily negotiated and flexible FTAs for their domestic interests. The two mega FTAs have the relatively similar objectives of trade liberalization and economic integration. However, the differences are substantial [Basu Das, 2013].

Furthermore, there is another mega FTA along with RCEP and TPP, namely the Free Trade Area of the Asia Pacific (FTAAP), which could enhance the economic benefits for all countries in the region. FTAAP includes all member nations in RCEP except India and TPP.

It also includes Russia and Taiwan. FTAAP was proposed by the APEC Business Advisory Council (ABAC) in 2004 in order to accelerate progress toward the achievement of trade and investment liberalization. A study carried out by APEC concluded that APEC should target a high-quality and comprehensive FTAAP agreement. Indeed, FTAAP is a super-mega FTA, and the possibility of it being competed may be still under question [APEC, 2009; Petri and Plummer, 2014a] (Fig. 5).

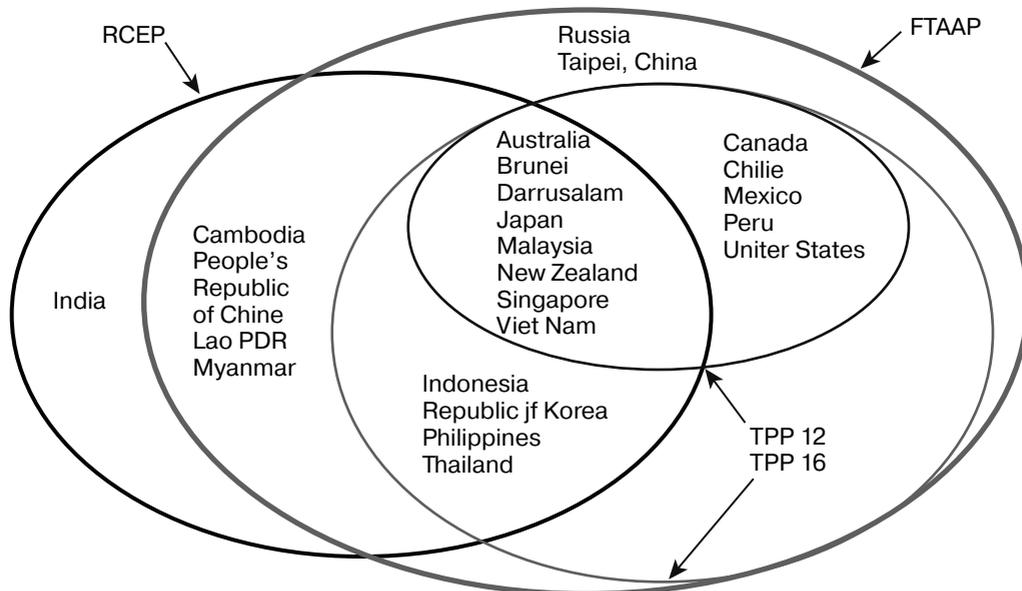


Figure 5: Mega FTAs in Asia Pacific Region

Source: [Petri and Plummer, 2014].

Comparison of Mega FTAs between RCEP and TPP

RCEP, driven by ASEAN and supported by China, is a free trade agreement (FTA) between ASEAN and its trade partners such as Australia, China, India, Japan, New Zealand, and South Korea. It aims to be a high-quality and mutually beneficial economic partnership that can strengthen current FTA engagements in the region. Moreover, it is based on an open accession clause, and allows any ASEAN FTA partners to participate in it later, if they wish to do so. RCEP is expected to be completed by the end of 2016. After concluding RCEP, its share of GDP and of trade in goods in the global economy will be about 32 percent and 28 percent respectively.

Unlike RCEP, TPP is a US-led FTA. The precedent of TPP is the P4 Agreement, which was initiated by Brunei, Chile, New Zealand, and Singapore. The P4 agreed that it will forge a high-standard comprehensive FTA, allowing for full goods market access without exclusion. After the USA joined the P4 Agreement in 2005, it played a leading role and attracted several nations in the region such as Australia, Canada, Malaysia, Mexico, Vietnam, and Japan. It aimed to conclude TPP in October 2013, but delayed until October 2015 due to disputes in the agricultural sector of Japan [Lewis, 2009; Financial Times, 2015].

The two mega FTAs have extraordinary significance in the global economy. Their size and volume are overwhelming even compared with existing large trade blocs such as NAFTA and the EU. Only APEC is larger than the two mega FTAs in economic size and trade volume.

However, APEC is not an FTA. It is a framework for economic cooperation in the Asia Pacific Region (Fig. 6).

On the functional level, RCEP and TPP aim to seek different directions. The former will be built on ASEAN's experience and seek to integrate all ASEAN Plus One FTAs into a regional framework. RCEP is guided by ASEAN's centrality in that objectives and commitments are driven by a process of consensus. Additionally, it will provide flexibility and adjust its mechanisms in line with development differences among member nations, in order to meet the end goals. Furthermore, RCEP is keen to create more physical, institutional, and human resource connectivity in order to narrow development gaps between member nations [Basu Das, 2013; Petri and Plummer, 2014a].

In comparison with RCEP, TPP is regarded as a more demanding set of commitments, which consist of intellectual property rights (IPR), labor standards, competition policy, investment rules, the environment, and the role of state-owned companies. These issues are not directly related to trade, but to challenges in free trade in the 21st century. Therefore, it may be difficult for TPP to reach consensus on optimal standards, because all member nations have a different level of economic development. Additionally, it pursues a gold standard of FTA in 21st century, dealing with next-generation issues such as cross-cutting and new trade challenges. As a result, it may divide ASEAN, undermining ASEAN centrality [Basu Das, 2013].

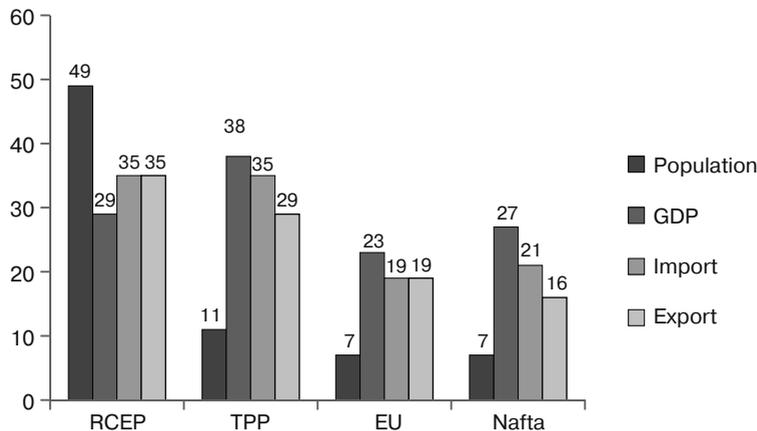


Figure 6: RCEP's Share of World in Population, GDP, and Trade (As of 2014, %)

Source: IMF, World Economic Outlook Database, 2014;⁸ WTO, World Trade Statistics, 2014.⁹

Economic Benefits of Two Mega FTAs in the Region

The two mega FTAs are able to expand trade volumes and market access, and benefit from economies of scale. In addition, they also facilitate trade and investment, promote factors of production of allocation, and create more jobs in member nations. However, in reality visible and invisible trade barriers still exist in developing and developed economies. While some products maintain high tariffs in spite of a significant decline in most products in recent years,

⁸ World Economic Outlook Database, 2014. Available at: <https://www.imf.org/external/pubs/ft/weo/2014/02/weodata/index.aspx> (accessed 21 October 2016).

⁹ International Trade Statistics, 2014. Available at: https://www.wto.org/english/res_e/statis_e/its2014_e/its14_toc_e.htm (accessed 21 October 2016).

non-tariff barriers such as quantitative control measures and technical barriers to trade have become predominant [Urata, 2011].

Economic benefits for RCEP and TPP have been calculated by a computable general equilibrium (CGE) model based on templates using accords previously negotiated by ASEAN for RCEP and the USA for TPP. The CGE model indicates that the two mega FTAs generate substantial economic benefits for each of the member nations. RCEP generates a total increase in income estimated at USD 644 billion, which accounts for 2 percent of Asian GDP by 2025 based on its GDP in 2007. TPP could create a total increase in income of USD223 billion in the same year. For TPP, China must bear the largest share of costs resulting from the trade diversion effect [Petri and Plummer, 2014b].

RCEP and TPP could reduce the noodle-bowl effect of overlapping many bilateral FTAs in the region. The noodle-bowl effect has reduced the potential benefits from economic integration, because the private sector must pay attention to different rules and regulations. As a result, the cost of utilizing preferential concessions for the private sector has increased. Additionally, the two mega FTAs are able to achieve a complete set of free-trade principles.

Last but not least, RCEP and TPP could contribute to paying more attention to the publication of customs laws and regulations, trade procedures and documentation, product standard and conformation, and trade-related infrastructure and services. These frameworks could facilitate better trade performances, particularly in developing nations of the region. Additionally, SMEs in the region could benefit if specific assistance to SMEs is provided by the RCEP and TPP processes. By doing so, the majority of ASEAN countries, China, and India can reduce time and costs in their trade.

Analysis on Trade Policy Strategy and National Interests for RCEP and TPP

Trade Policy Strategy

Korea's trade policy can be regarded as one of the most successful measures of how to generate high economic growth in several decades. In 1966, Korea's total trade volume was only USD1 billion, and it increased to USD1.1 trillion in 2014. It is a tremendous performance for Korea to become a member of USD1 trillion club in 2011. The Korean experience demonstrates that an export-led development strategy based on competitive advantages and structural change is very reliant on other developing economies [Porter, 1990; Todaro & Smith, 2012]. However, despite such a successful result, the Korean trade policy strategy faces various challenges that need to be continuously overcome if it is analyzed by evaluating trade performance not only in terms of quantity, but quality.

First of all, Korea needs to diversify its trade partners and export goods in order to reduce the risk of external economic change, because its economic growth is mainly dependent on trade in global markets. In 2013, Korea's five major trade partners were China, ASEAN, the USA, the EU, and, Japan, which accounted for 64.4 percent of total trade in goods. Korea has made an effort to minimize the risk of high dependence on a small number of trade partners since the 1970s, because the global economic crisis could have a negative impact on its economy through trade and financial channels. This effort has proved successful. As a result, Korea was able to reduce its trade dependency on these five major trade partners from 85 percent in 1971 to 64.4 percent in 2013.¹⁰ Trade dependence on five major trade partners declined by over 20 percent

¹⁰ Trade with China officially started in 1992. Between 1971 and 1991 trade with China was mainly intermediate trade through Hong Kong.

in the last four decades. However, the dependency ratio has remained since 2000 at between 60 percent and 70 percent, which must be corrected [KITA, 2012, 2014] (See Fig. 7).

The second challenge is that Korea's top ten export products are heavily concentrated. In 2011, its share of total exports accounted for 60.3 percent, which was a higher concentration than in other major economies. This heavy concentration has hardly changed, even in 2013. In this regard, the share of top ten export products was 27.1 percent for the USA, 28.8 percent for China, 24.2 percent for Japan, and 34.7 percent for Germany, which were calculated on average between 2008 and 2010, while it was 51.1 percent for Korea in the same period [KITA, 2011]. The reason why Korea's share of top ten export products was so concentrated is mainly based on the industrial structure oriented towards large companies. As a result, small and medium-sized companies cannot achieve competitiveness on the global market to export their various products, compared to the major economies [Lee, 2012].



Figure 7: Korea's export share of China, USA, Japan, the EU, and ASEAN (As of 1971–2013, %)

Source: [KITA, 2014].

The third challenge of the trade policy strategy is that the Korean economy needs to develop its service industry and increase the share of service exports on the global market. The share of Korea's service exports on global markets only accounted for 2.1 percent in 2009, and increased slightly up to 2.4 percent in 2013. This share is very low compared with other major economies. Although the Korean share of service exports has increased along with the USA and China, its capability of increasing is lower than the Chinese capability. The Chinese share of service exports increased from 3.8 percent to 4.4 percent during the same period. During the period from 2001 to 2013, the share of Korea's goods exports to the world increased from 2.4 percent to 3.7 percent, while its share of service exports rose from 2.0 percent to 2.4 percent. The former marked an annual growth rate of 13.9 percent, while the latter generated 12.3 percent of the annual growth rate. Accordingly, Korea's service exports need to be emphasized in order to strengthen export capability, although these annual average growth rates were higher than those of the world average¹¹ [WTO, 2012, 2015] (See Table 2).

¹¹ The annual average growth rate of goods exports was 11.4 percent, and that of world service exports was 10.8 percent from 2001 to 2011.

The lower growth of Korea's service exports compared to that of goods caused a deficit in the balance of trade for services. It peaked in 2006 at USD 13.3 billion, declined to USD 4.4 billion in 2011, and increased to USD 6.5 billion in 2013. From 2002 to 2013, Korea maintained a substantial amount of the service trade deficit. As a result, its ranking in service exports remained at 13th in the world, while the ranking in goods exports rose from 13th to 7th during the same period. This indicates that Korea's trade policy has been strengthened in the manufacturing sector instead of the service sector, causing a rising gap between goods and services in terms of trade balance. Therefore, this must be tackled wisely in order to promote balanced growth in the mid to long term. Otherwise, the Korean economy cannot be sustained without increasing the competitiveness of the service sector [Bank of Korea, 2014] (See Table 3).

Table 2: Shares of service exports by major economies (As of 2009–2013)

Share (%)	2009	2010	2011	2012	2013
USA	14.1	13.9	13.9	14.1	14.3
UK	7.1	6.6	6.6	6.4	6.3
Germany	6.7	6.2	6.1	5.9	6.2
China	3.8	4.5	4.4	4.4	4.4
Japan	3.7	3.7	3.4	3.2	3.1
Korea	2.1	2.3	2.3	2.5	2.4

Source: [WTO, 2012, 2015].

Table 3: Korea's service trade balance (As of 2001–2013, USD 100 million)

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Deficit	64.4	57.9	59.6	99.5	133.3	119.7	57.3	66.4	86.3	43.8	52.1	65.0

Source: [Bank of Korea, 2014].

As the fourth challenge, the effectiveness of FTAs must be improved. For this to happen, domestic reforms in distribution services should be implemented, in order to meet the expectations of consumers. By reducing tariffs, domestic consumers must benefit from the price advantages of imported goods and services. Otherwise, they will not support further trade liberalization as a trade policy strategy. Moreover, it is imperative to make the domestic market more competitive, to benefit from FTAs and to maximize the utilization rates of FTAs which are in force. In fact, the utilization rates of FTAs vary to a high degree. The Korea-Chile FTA has a utilization rate of up to 95 percent, while the Korea-India FTA accounts only for 25 percent [Kim, 2012].

Last but not least, the government needs continuously to create internal constituent support for the trade policy. It is wise for the government to enhance dialogue with a variety of groups and sectors, even including opponents to its FTA policies. It is natural that winners and losers in different sectors may arise while trade liberalization moves forward, even though the national economy could gain overall from growth [Lee, 2012]. As a result, the widening income gap between winners and losers could cause economic and political conflicts that could impede economic growth and consumer benefits. Therefore, the government must deal with this issue

wisely by providing compensation measures and promoting competitiveness in specific sectors which are affected negatively by FTA policies [Solis, 2013].

National Interests for RCEP and TPP

Korea has to deal with two mega FTAs in the region. It declared its interest in participating in the Regional Comprehensive Economic Partnership (RCEP) in 2012 and the Trans-Pacific Partnership (TPP) at the end of 2013, after long deliberation. Both mega FTAs are regarded as very significant for Korean national interests due to their economic scale and the size of their markets. The economic benefits of Korea's negotiations on RCEP with 16 member nations is calculated as larger than in the negotiation of a TPP with 12 countries, although this estimation does not include the impact of non-tariff barriers, which are a major issue in TPP negotiations [Jeong, 2012]. Despite taking a comprehensive estimate including non-tariff barriers, obstacles to foreign direct investment, and utilization rates of tariff preferences into account, RCEP may generate more economic benefits for Korea than TPP, because of the opening of the Chinese market via RCEP.

Korea is in a unique position as it has FTAs with many RCEP and TPP members including the USA and China, but not with Japan. Therefore, it can play a catalytic role in shaping the outcome of the two mega FTAs. Regarding RCEP, Korea has its membership preference, which is similar to the Chinese preference. Korea prefers to have an agreement among ASEAN+3 first, with others joining only after setting up institutions. Regarding TPP, it is not yet clear whether Korea will benefit from what could be a de facto FTA with Japan. Despite the uncertainty, the Korean government decided to participate in TPP negotiations because its industries need to maintain a level playing field with those of Japan. TPP is rules-based and offers little flexibility to member nations compared with RCEP, being goods-centric [Petri et al., 2012; Cheong, 2013; Steven and Wang, 2014].

From the macroeconomic perspective, it is clear that the two mega FTAs could generate a positive impact on Korean economic growth. There is no doubt that RCEP and TPP could be beneficial. At the same time, it is also necessary to analyze which of them could generate greater economic benefits, in order to approach the two mega FTAs strategically. For this, it may be useful to explore trade interdependency with the member nations of the two mega FTAs. In 2002, the Korean interdependency ratio with RCEP member nations accounted for 21.72 percent, and increased to 41.16 percent in 2012. The interdependency ratio almost doubled. The Korean trade interdependency ratio with TPP member nations was 22.30 percent in 2002, which was more or less the same level as RCEP dependency. It increased moderately to 28.33 percent in 2012. The Korean interdependency ratio in the two mega FTAs is particularly high compared to Chinese and Japanese interdependency ratios, because of the high trade dependency in the national economy. Based on the trade interdependency ratio, RCEP can generate more economic benefits for the Korean economy than TPP (See Table 4).

Based on the CGE model, the macroeconomic effects for Korea with RCEP and TPP have been calculated. In terms of real GDP, Korea could gain an additional 2.5% with RCEP, while increasing 1.54% with TPP. In welfare, Korea increases USD 21.4 billion with RCEP, while adding USD 13.4 billion with TPP. In exports, Korea could add 5.41% with RCEP, while increasing 5.05% with TPP. In imports, Korea gains 5.39%, while increasing 5.07% with TPP. In trade balance, Korea increases USD756 million with RCEP, while declining USD66 million with TPP. As a result, RCEP can affect the Korean macro economy more positively than TPP [Ko, 2014].

Table 4: Trade Interdependency Ratio in Different Member Nations (2002 – 2012, %)

	ASEAN+3		RCEP		TPP	
	2002	2012	2002	2012	2002	2012
Brunei	61,57	74,99	68,75	91,99	54,97	62,32
Cambodia	25,19	48,11	25,68	49,37	33,63	38,64
Indonesia	22,61	25,83	25,55	29,04	22,98	19,08
Laos*		84,5		85,7		
Malaysia	85,25	77,84	91,79	87,49	89,13	55,63
Myanmar*		80,8		90,5		
Philippines	39,89	24,98	42,09	26,34	52,4	20,1
Singapore	123,14	131,28	133,95	148,22	124,18	83,09
Thailand	48,62	67,69	52,35	74,67	52,61	51,05
Viet Nam	48,94	80,8	54,4	86,89	37,87	48,44
Chine	14	11,98	14,96	14,39	17,77	15,78
Japan	6	11,68	7,1	13,31	6,94	7,88
Korea	20	36,75	21,72	41,16	22,3	28,33
Australia	15	19,28	17,1	21,27	15,07	11,5
India	4	9,71	4,05	10,6	5,17	8,22
New Zealand	13	17,11	22,52	25,39	23,78	19,18
USA	5	6,52	4,96	7,17	7,76	8,87

Source: Adopted by NEAT working Group based on UN Comtrade and WDI Database, 2014.

Given the analysis of the CGE model, Korea can benefit both from RCEP and TPP. Therefore, Korea needs to create synergy effects from its role in bridging the two mega trade negotiations. If Korea is able to deal with these mega FTAs properly, it can expect better outcomes in opening up foreign markets with higher-quality trade agreements, not only for RCEP, but also for TPP [Petri et al., 2012].

Conclusions

In the last five decades the Korean economy has grown tremendously. Its rapid economic growth is mainly based on an export-oriented development strategy that resulted in a rapidly increasing trade volume from USD1 billion in 1966 to USD 1.1 trillion in 2014. As a result, Korea succeeded in becoming a member of the USD1 trillion trade club, along with other major world economies in 2011. The Korean experience can be a model of how a nation creates high economic growth through exports, which is in line with trade policy.

Korean trade policy has suffered turbulence twice in its economic growth periods. During the Asian Financial Crisis in 1997, the Korean economy was hit severely and saw negative economic growth. The currency was heavily devalued against the US dollar, and the domestic market was forced to become more open, through deregulation and liberalization. The IMF bailout package of USD 21 billion was provided to Korea, and the government carried out an export-driven trade policy in order to maximize the advantages of the weak currency on the global

market. As a result, the trade balance turned from a trade deficit of USD8.5 billion in 1997 to a trade surplus of USD40 billion and USD19 billion in 1998 and 1999 respectively. Such record high trade surpluses enabled Korea to pay back its bailout completely in December 2000.

The second period of turbulence was the Global Financial Crisis in 2008. Since the Asian Financial Crisis in 1997, Korea has become one of the most open market economies in the world, as a result of deregulation and liberalization processes. This means that the market is fully dependent on the external economic environment. Therefore, the national economy experienced a low economic growth rate of 2.4 percent in 2008. Although the Global Financial Crisis is regarded as the most severe economic crisis in the world since the Great Depression in 1929, the Korean economy was in better shape compared with other major economies, because it had increased its foreign reserves, and industries had strengthened their competitiveness. Along with major economies, the Korean government expanded fiscal expenditure in order to boost the domestic economy, and at the same time carried out an export-oriented policy focused particularly on developing countries, as the most advanced economies had suffered severely from the Global Financial Crisis. The trade policy strategy was very effective even during the Global Financial Crisis, and resulted in strong economic growth of 6.2 percent in 2009, which was the highest economic growth rate in OECD countries. It showed the world that a small, open economic system focused on an active trade policy was able to overcome the Global Financial Crisis effectively and efficiently.

In order for the small, open economy to be competitive on global markets, Korea has concluded 21 FTAs with major economies and other small economies since the 2000s. Bilateral and regional FTAs have boosted Korean trade and contributed strongly to economic growth. Thanks to the conclusion of FTAs with the EU and USA, Korea was able to minimize its decline in market share and trade volume in the major markets during the Global Financial Crisis and sovereign debt crisis, while it was able to expand its trade volume in emerging markets, particularly in China and ASEAN. Since 2012, Korea has had to deal with the two mega FTAs, which are RCEP and TPP. These mega FTAs could strongly influence not only the Korean economy, but also the regional economy, due to the massive scale of their economies and markets. Based on analysis of the trade interdependency ratio, Korea has a higher ratio in RCEP than in TPP. This indicates that RCEP can generate more economic benefits for the Korean economy than TPP. Given the analysis of the CGE model, RCEP could also generate more economic benefits for Korea than TPP. However, Korea should not neglect TPP either. It is absolutely necessary for Korea to participate in the two mega FTAs actively, in order to create synergy effects as well as handle security issues.

In sum, Korean trade policy has been successful in strengthening the nation's rapid economic growth and successfully overcoming two major financial crises. It also creates national competitiveness on global markets. Korean trade policy has focused on strategies of how to develop specific industrial sectors and choose special markets in order to maximize trade volume and to minimize market dependency on a few trade partners. Despite such tremendous success, Korean trade faces several challenges, which must be overcome in order to upgrade the structure of trade, with a greater focus on value-added products and services. Otherwise, the successful Korean model cannot be sustainable, as other competitors, particularly China, develop rapidly in order to catch up with advanced economies on global markets. It may be wise to say that in any event, trade policy and strategy are the most important tools for the Korean economy, as it seeks to grow further.

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Explaining Russia's Relationship with the Arctic Council

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Relations between the West and Russia have worsened since Russia annexed Crimea in February 2014. This article explains how this deterioration has affected the Arctic Council. The council is an international institution with eight member states with territory in the Arctic (Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden and the United States) as well as six indigenous peoples' organizations. The mandate of the institution is to promote environmental protection and sustainable development in the Arctic. There is currently a debate in the media about the impact of Russia's actions on Arctic governance. Some accounts argue that the Arctic Council's work continues unabated in the aftermath of Crimea, while others point to worrying signs that the institution is experiencing difficulty. This research helps settle this debate by empirically demonstrating Russia's behaviour. It concludes that the breakdown in Russian-United States relations has not had an immediate impact on the council. The article employs descriptive statistics to understand Russia's patterns of activity in the council in three periods (1998–2000, 2007–2009 and 2013–2015). It examines Russia's participation in meetings and its sponsorship of initiatives. It draws from a variety of council documents. It shows that earlier in the history of the council, Russia's participation was similar to the Nordic countries. The article empirically demonstrates that Russia's participation in the Arctic Council has increased over time.¹

Key words: global governance; Arctic governance; circumpolar relations; Arctic Council; Russia

Can Arctic governance survive Crimea? The Cold War, with its antagonism between two super-powers on opposite sides of an ideological war, made international collaboration in the Arctic next to impossible. Yet, international relations improved greatly following the fall of the Soviet Union and the end of communism. In 1996, the Arctic states, including Russia, created the Arctic Council, the premier governance institution for the region. Russia invaded and annexed Crimea from Ukraine in February 2014, which presented the worst crisis in Russian-American relations since the end of the Cold War. The United States and its allies subsequently hit Russia with waves of harsh sanctions. Slightly under the radar, Russia and the United States both remain members of the Arctic Council. This paper examines how the deterioration in relations between Russia and Western countries has affected the Arctic Council. This paper argues that Russia scaled back on outward shows of Council support, but overall supports the institution more than ever before. The breakdown in Russian-United States relations has not had an immediate impact on the Council, raising hope that a new Cold War is avoidable. This paper employs descriptive statistics to understand patterns of Russian activity in the Council.

First, what is the Arctic Council? It is an international institution consisting of the eight countries that have Arctic territory, namely Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden and the United States. A unique feature is that it includes six indigenous peoples' organizations as members, together representing 659,000 indigenous people from every Council country (with the exception of Iceland). These groups (also known as permanent participants)

¹ The article was submitted to the editors in March 2016.

are the Aleut International Association, Arctic Athabaskan Council, Gwich'in Council International, Inuit Circumpolar Council, Saami Council, and Russian Association of Indigenous Peoples of the North (RAIPON). The Council also consists of 32 observers, which includes 12 countries, such as Britain, China and France. The Arctic Economic Council, three task forces and two expert groups are Council initiatives that work with the institution. The Council's mandate, as articulated in the 1998 *Iqaluit Declaration*, is to "provide a means for promoting co-operation, coordination and interaction among the Arctic States... with the involvement of the Arctic indigenous communities and other Arctic inhabitants on common Arctic issues, in particular issues of sustainable development and environmental protection in the Arctic."² The Council can address any issue except military security.³ Yet in practice, it provides governance on environmental protection and a loosely defined version of sustainable development in the Arctic. The Council mostly completes research on environmental and human security issues, with policy recommendations for state action. The institution has recently completed some work to encourage economic development in the Arctic, but this work represents a minority of the Council's output. In the past, international agreements and formal policy were not part of the purview of the Council. However, that fact has changed, as the Council has created two international agreements, on search and rescue in the Arctic and response to oil spills.

This article contributes to academic literature on the Council. Most literature focuses on the Council's role in regional governance (as either an institution that facilitates research or a soft-law body), namely work by political consultant Terry Fenge [2012], political scientist Rob Huebert [1998], international lawyer Timo Koivurova [Koivurova and Heinamaki, 2006], as well as political scientists Olav Schram Stokke [2007] and Oran Young [2005]. This work adds to this literature by considering the role of greater international relations in the Council's attempt to provide regional governance. It considers the relative contributions of each Council member to regional governance.

This research also helps settle a controversy in media accounts of the Council. Recent media have hypothesized that Russia and the United States are moving toward a new Cold War (for example, see [Barnard and Shoumali, 2015]), as recent events "have effectively put an end to the interregnum of partnership and co-operation between the West and Russia" [Trenin, 2014]. Some media have indicated that Russia still participates in the Council and circumpolar relations are generally strong, as the Council "has hung together" [Bell, 2015]. Other reports have indicated that the breakdown in relations has already negatively affected the Council, as officials balance which meetings to attend amid concerns over optics [Exner-Pirot, 2015]. This work presents a case to understand the nature of Russian-Western relations and assess conflicting reports about its impact on the Council. It demonstrates that Russia's participation in the Council remains strong, despite new tensions in regional relations and anxieties in media accounts of the institution.

This paper proceeds in three sections. The first section describes the function of the Council, in order to discuss the paper's method in the second section. The third section discusses Russia's participation in the Council in three eras.

This paper systematically examines patterns of Russian behaviour in the Arctic Council and its impact on the institution. Questions of causality, or why Russia participates in the Council the way it does, are beyond the scope of this paper. These questions form a basis for future research. The conclusion discusses several competing explanations for Russia's behaviour in the Council over time, though future research is necessary to establish which explanation is most accurate.

² The Iqaluit Declaration. Tromsø, Norway: Arctic Council Secretariat, 1998.

³ Ibid.

Function of the Council

It is necessary to understand how the Council functions in order to understand patterns of Russian activity in the institution. The chair of the Council rotates between member states every two years. Canada was the first Council chair, from 1996 until 1998, followed by the United States (1998–2000), Finland (2000–2002), Iceland (2002–2004), Russia (2004–2006), Norway (2007–2009), Denmark (2009–2011) and Sweden (2011–2013). The United States is the chair from 2015 until 2017, following Canada's second turn from 2013 until 2015. The chair is responsible for organizing meetings and setting some overall themes for Council work. Each turn as chair constitutes a relatively distinct period in the history of the Council, as priorities and projects shift with each new chair country. The Council organizes its work into projects. Member states and permanent participant sponsor projects they wish to support and lead. Project sponsors envision a project, define its goals, design an outcome and organize the work plan, as well as funding, for the project. Projects might include an environmental assessment, database of baseline information, negotiation of an international agreement, or adoption of an action plan. Working groups execute the actual projects. There are currently six: the Arctic Contaminants Action Program; Arctic Monitoring and Assessment Programme; Conservation of Arctic Flora and Fauna; Protection of the Arctic Marine Environment; Emergency Prevention, Preparedness and Response; and the Sustainable Development Working Group. Work on projects can take several years. However, policy makers usually complete a major deliverable during the tenure of each chair country. The Council operates by consensus; all states must agree for a project to move forward. It has three meetings per year, at which it discusses progress on current projects and approves new projects. Each meeting discusses roughly 12 agenda items. A permanent secretariat, created in 2013, assists the Council in its operation.

Method

This paper measures the level of Russia's engagement with the Council, contrasted with the nature of relations between Russia and the West. It thus contrasts Russia's earlier behaviour in the Council with more recent behaviour, in order to demonstrate the impact of Russia's recent provocative actions on its Council activity. The independent variable is the state of Russia's relations with the West, drawn from media accounts of the era. The dependent variable is Russia's engagement with the Council. Specifically, this paper contrasts three periods in the Council, namely 1998–2000, 2007–2009 and 2013–2015. Each of these short periods encompasses one country's complete turn as chair, which is appropriate because each chair country completes a distinct set of projects and activities. It is appropriate to study 1998–2000 because that was the first era in which the Council completed substantive works separate from those undertaken in the Arctic Environmental Protection Strategy. The Council was founded in 1996. The Arctic Environmental Protection Strategy was the precursor institution to the Arctic Council. The era 2013–2015 is appropriate because it encompasses the recent breakdown in Russian-Western relations. Although this era is quite recent, it provides insight as it contains a complete set of projects, activities and priorities. The era 2007–2009 is appropriate because it represents a mid-point in the history of the Council. It was a period when there was great international interest in the Council as new information about the threat posed by Arctic climate change,⁴ as well as the opportunities arising from the Arctic's resource potential (for example, see [Bird, 2008]). These eras are also appropriate for study because there is a reasonably complete set of documents for

⁴ For example, see Arctic Climate Impact Assessment: Impacts of a Warming Climate. Cambridge, UK: Cambridge University Press, 2004, p. 10.

them; in addition, the Council recorded information consistently in these eras, which allows for systematic comparison. For example, Russia was chair of the Council from 2004 until 2006; however, adequate documents to include that period in this research were not available.

Three specific measures form the dependent variable, which is Russia's engagement with the Council. First, the number of projects sponsored by Russia, versus the other Council members, highlights Russia's support for the institution. This measure is appropriate because project sponsorship is the major way that states can participate and show leadership in the Council. Project sponsorship is an important means for states to engage with the Council, since the Council organizes its governance work into projects. However, this measure is imperfect because it does not account for the quality of the projects sponsored by Russia. Some projects cost a few thousand dollars, while others can cost upwards of \$10 million. Sponsoring a few high-quality projects could indicate a greater commitment than sponsoring many low-quality or haphazard projects. Systematic evaluation of the quality of projects is beyond the scope of this research. This paper also briefly examines the character of the projects sponsored by states, namely whether they supported domestic goals or international goals. Examining the character of projects illuminates whether Russia used the Council to engage with other Council countries. The main sources for this data are Senior Arctic Official reports, which the Council publishes every two years. These documents provide an account of the activities of the Council over the preceding two years. They include a reasonably complete list of projects and the sponsors of such projects. A shortcoming of this data source is that the SAO report may not be fully complete. However, it gives us a reasonable picture of the activities of the Council.

Second, the number of delegates sent by Russia to Council meetings demonstrates Russia's engagement with the institution. This measure is appropriate because a fluctuating number of delegates could demonstrate wavering Russian commitment to the institution. The size of delegations illustrates the ability of a country to participate in all facets of a meeting. This measure is imperfect, because sending large delegations does not necessarily correlate perfectly with institutional engagement. Sweden, for example, typically sends relatively small delegations (as a country with a small population), yet few Council observers would doubt Sweden's commitment to the work of the institution. The main sources of data for this measure are complete lists of delegation members, compiled by the Council secretariat.

Third, the number of comments made by Russia in Council meetings is used to measure Russia's work within the institution. This measure is appropriate because providing comments demonstrates Russia's influence and impact in the Council. It demonstrates whether a country engages with all work of the Council, or a smaller number of priority projects. This measure is imperfect because the source for the information is meeting notes, which are inevitably incomplete. In addition, making many comments does not indicate constructive engagement with the Council. Comments may impede progress. But the number of comments gives us a picture of engagement with the Council. The data source is meeting notes, compiled by the Arctic Council secretariat. To reiterate, a shortcoming is that these notes may be incomplete. A second shortcoming is that they are subject to editing by Council states, and thus may be inaccurate. However, they are the only source of data for this information, as video or transcripts of earlier Council meetings are not available.

Russia's Participation in the Arctic Council

1998–2000

Relations between Russia and the West improved between 1998 and 2000, especially compared to the animosity of the Cold War. A desire to improve relations with Russia and address important environmental issues was part of the catalyst that led states to propose and support

the creation of an Arctic council [English, 2013]. There was a belief among policy makers that collaborating on environmental issues could build trust between Russia and the West. But tensions remained in the Russian-Western relationship, such as issues over the expansion of NATO and ongoing hostilities in the former Yugoslavia. Russia's gross domestic product fell by half in the 1990s in the midst of terrible recession [Curtis, 1996]. However, Russia and the West were able to collaborate on international governance for the first time since the Second World War.

The Arctic Council, meanwhile, was a new organization that had yet to distinguish itself on the international stage. The United States was chair between 1998 and 2000. During most of the previous two years, chaired by Canada, the focus was on developing rules of procedure and mandates for the Council's various organs, as well as incorporating the work of an earlier organization, the Arctic Environmental Protection Strategy, into the Council. The Council held four meetings during the United States' turn as chair (May 1999 in Anchorage, Alaska, November 1999 in Washington, DC, April 2000 in Fairbanks, Alaska and October, 2000 in Barrow, Alaska).

Table 1: Russia and the Council, 1998–2000

Country	Comments	Agenda Items	Average Delegation Size	Project Sponsorship
Canada	62	29	16	7
Denmark	25	20	6.5	2
Finland	21	18	5.5	3
Iceland	30	19	2.5	2
Norway	56	32	7.75	10
Sweden	22	15	2	1
United States	24	18	37.5	7
Russia	21	18	4.75	4

Note: "Comments" calculates the total number of comments by each state delegation at all of the Council meetings between 1998 and 2000.

"Agenda Items" calculates the total number of agenda items that each state delegation provided comments on at all Council meetings between 1998 and 2000.

"Average Delegation Size" calculates the average size of state delegations at all Council meetings between 1998 and 2000.

"Project Sponsorship" calculates the total number of projects sponsored by each Council country between 1998 and 2000.

Source: Compiled by the author.

It is clear in Table One that Russia's participation in the Council is comparable to other Council countries between 1998 and 2000. Russia commented in meetings roughly the same amount as the other Council countries, save enthusiastic members Norway and Canada. Similarly, Russia's delegation sizes are comparable to the Nordic countries. However, Russia sponsored fewer projects than Canada, Norway and the United States, but more projects than Denmark, Finland, Iceland and Sweden. Overall, if we grant that all members of the Council are equal, Russia's participation is similar to the Nordic countries, amid improving post-Cold War relations.

In terms of the quality of Russia's participation, the country focused more on projects that benefit Russia directly, as opposed to projects with more international consequences. The Council sponsored a variety of projects that benefited all of the Arctic countries, such as reindeer

husbandry, Arctic shipping, telemedicine, climate change and forest health. Russia's projects focused on the Russian environment, such as projects on biodiversity and contaminants in Russia, as well as Russian environmental protection. An exception is that Russia offered to chair the Conservation of Arctic Flora and Fauna working group. Russia received money from other countries to complete environmental projects. For example, Norway gave Russia money as part of its "regional program of action" on biodiversity. Behind the scenes, many policy makers doubted that Russia used Council funds for the intended purpose, as government corruption in the country was high.⁵ Russia focused on a small number of domestically oriented projects with dubious results.

2007–2009

Russian-Western relations declined slightly in the early 2000s, but did not return to Cold-War level animosity. Vladimir Putin, who became the President of Russia in 2000, is a former Soviet loyalist generally suspicious of the United States. His administration is generally more antagonistic towards the United States, compared to the 1990s Boris Yeltsin administration. Most alarmingly, Russia suspended its participation in the Treaty on Conventional Armed Forces in Europe in 2007 [Kureev, 2015]. The 1990 treaty saw the withdrawal of the most significant Russian forces along its European border and was a major step forward in the quest to end the Cold War, as well as the military threat in Europe.

The Arctic Council, meanwhile, was a much stronger organization in 2007 than in 2000. It had released the 2004 *Arctic Climate Impact Assessment*, a climate change assessment that demonstrated its ability to conduct good quality research that rivaled the United Nations. New optimism emerged that the Arctic could be a source of energy resources, as well as shipping routes. Russia had been chair of the Council from 2004 until 2006 and had some success. The 2007 chair, Norway, seemed dedicated to environmental protection and addressing climate change. There were six meetings during Norway's turn as chair (April 2007 in Tromsø, November 2007 in Narvik, April 2008 in Svolvær, November 2008 in Kautokeino, February 2009 in Copenhagen, Denmark, and April 2009 in Tromsø).

Table 2: Russia and the Council, 2007–2009

Country	Comments	Agenda Items	Average Delegation Size	Project Sponsorship
Canada	21	10	10.8	18
Denmark	15	13	8	3
Finland	10	7	5.5	4
Iceland	10	10	3	6
Norway	34	24	17.5	16
Sweden	19	12	5.3	2
United States	31	20	10.5	18
Russia	47	30	11.8	13

Note: "Comments" calculates the total number of comments by each state delegation at all of the Council meetings between 2007 and 2009.

"Agenda Items" calculates the total number of agenda items that each state delegation provided comments on at all Council meetings between 2007 and 2009.

⁵ A former Council policy maker who works for the United States Environmental Protection Agency made this point during an interview in March 2013. See [Chater, 2015].

“Average Delegation Size” calculates the average size of state delegations at all Council meetings between 2007 and 2009.

“Project Sponsorship” calculates the total number of projects sponsored by each Council country between 2007 and 2009.

Source: Compiled by the author.

It is clear in Table Two that Russia’s participation in the Council increased compared to the previous era. Russia participated in Council meetings more than any other country, making more comments and speaking on a wide variety of Council agenda items. Russia’s delegation size is similar to those of Canada and the United States, yet less than chair Norway. It sponsored more projects than four of the Nordic countries, but slightly less than Canada, the United States and Norway. Overall, Russia increased its participation in the Council.

In terms of the quality of its participation, Russia’s activity became more international in scope, yet less so than the other Council members. Russia co-sponsored the search and rescue agreement, the most ambitious and consequential project in this era.⁶ The negotiation of that agreement changed the Council, evolving it into a venue for formal policy making, as well as a policy-recommendation body. The Council completed a wide variety of projects, on such areas as biodiversity, Arctic flora, Arctic seabirds, shipping and climate change adaptation. Russia’s projects were more domestically oriented than the other countries, as seven of its 13 projects focused on the Russian environment specifically. However, Russia’s projects were more international in nature than in the previous era. A notable feature is that Russia’s projects focused more on economics than the projects of other countries. For example, Russia completed projects on Arctic safety systems, search and rescue, and energy resource potential. In contrast, all of Iceland, Denmark and Sweden’s projects had a clear focus on environmental protection or sustainable development. It is clear that Russia viewed the Council as an institution that could help states make the Arctic region safe for business. The *Arctic Climate Impact Assessment* highlighted economic potential in the Arctic, along with the dire challenges of climate change. It found, for example, that, “The average extent of sea-ice cover in summer has declined by 15–20 per cent over the past 30 years.”⁷ Russia’s activity was more international in scope than it had been from 1998 until 2000, yet more domestic in focus than the other Council countries.

2013–2015

More recently, Russia has been a source of frustration for the West. In February 2014, the Russian military began an invasion of Crimea, eventually completing its annexation from Ukraine. These actions began after a revolution in Ukraine deposed pro-Russian President Viktor Yanukovich. The United States has expressly supported Ukraine in Russia’s war over Crimea. It is still unclear exactly why Russia annexed Crimea, but one strong theory is that Russia sought to ensure its continued access to the Black Sea, which is of military strategic interest [Schwartz, 2014]. The United States has responded with sanctions that harmed the Russian economy. These sanctions limited the ability of United States banks, energy companies and other businesses to operate in Russia [Smith, 2014]. Russia’s economy is officially in recession as a result [Financial Times, 2015]. Yet, according to polls compiled by the Polish Institute of International Affairs, Putin’s popularity has increased since Russia’s hostile action

⁶ Meeting of Senior Arctic Officials Final Report, 19–20 November 2008, Arctic Council, Kautokeino, Norway. Russia also later sponsored an agreement on prevention of oil spills. See: Meeting of Senior Arctic Officials, Stockholm, 28–29 March 2012: Final Report. Tromsø, Norway: Arctic Council Secretariat, 2012.

⁷ Arctic Climate Impact Assessment: Impacts of a Warming Climate. Cambridge, U.K.: Cambridge University Press, 2004.

[Financial Times, 2015]. The European Union banned its companies from providing technology to Russian oil companies [Smith, 2014], and sanctions have led to a decrease in Russian oil and gas production [Cwiek-Karpowicz et al., 2015]. Russia has supported the regime of Bashar al Assad in the ongoing Syrian Civil War, much to the chagrin of the United States. Council members Finland, Denmark and Sweden are also part of the European Union, an institution that also has poor relations with Russia.

Yet, the Arctic Council has become a higher profile institution in recent years. The Council has addressed issues in a wider range of areas, established a permanent secretariat and facilitated the creation of two international agreements. New non-Arctic countries, such as China, have become part of the institution. Nevertheless, Russia's behaviour clearly has had some impact on the institution. Canada and the United States skipped some working group and task force meetings in Russia, such as meetings in April 2014 [Exner-Pirot, 2015]. The Russian Minister of Foreign Affairs skipped a Council meeting in May 2015 in Iqaluit, Canada; Canada then cancelled a planned Arctic Council event in Ottawa amid concerns that Russian officials would attend [Ibid.].

Even before the annexation of Crimea, there were tensions with Russia in the Council. In 2012, Russia attempted to stop its indigenous peoples' organization, the Russian Association of Indigenous Peoples of the North (RAIPON), from attending Council meetings. In Russia, groups such as RAIPON must register with the government. In November 2012, the Russian Department of Justice announced it would not register RAIPON. There were many theories as to why Russia did this, such as fear of foreign influence within the group [Digges, 2012], or the group's opposition to Russian oil production in certain sensitive Arctic areas [Wallace, 2013]. The Council issued a statement supporting RAIPON in November 2012 (ironically, signed by the Russian official present, as well) [George, 2012]. In 2013, Russia registered RAIPON and attended Council meetings, but not after some damage to its relationship with the Council countries. Canada chaired the Council between 2013 and 2015. There were five meetings (Whitehorse in October 2013, Yellowknife in March 2014, Yellowknife in October 2014, Whitehorse in March 2015 and Iqaluit in May 2015).

Table 3: Russia and the Council, 2013–2015

Country	Comments	Agenda Items	Average Delegation Size	Project Sponsorship
Canada	30	21	9	29
Denmark	10	7	5.7	11
Finland	6	6	3.7	8
Iceland	1	1	2.3	3
Norway	16	11	3.3	29
Sweden	5	4	4	5
United States	8	7	5.7	32
Russia	11	6	1.7	21

Note: "Comments" calculates the total number of comments by each state delegation at all of the Council meetings between 2013 and 2015.

"Agenda Items" calculates the total number of agenda items that each state delegation provided comments on at all Council meetings between 2013 and 2015.

"Average Delegation Size" calculates the average size of state delegations at all Council meetings between 2013 and 2015.

“Project Sponsorship” calculates the total number of projects sponsored by each Council country between 2013 and 2015. The Canadian chair has not made available notes from the April 2015 meeting and delegate lists for the March and April 2015 meetings

Source: Compiled by the author.

As shown in Table Three, between 2013 and 2015, Russia reduced its more outward participation in the Council. Russia made about half as many comments in Council meetings as in the other eras. However, it still made more comments than Finland, Iceland, Sweden and the United States. Russia sent the smallest delegation of any Arctic country, as well as the smallest delegations it had ever sent. This fact is significant because it is a pattern over time. Russia may have reduced its delegation size and comments to increase the perception that Putin is taking strong action against the West.

However, Russia increased its participation in the Council, sponsoring more projects than ever. Most of Russia’s recent projects are circumpolar in scope (although four were domestic in scope, focused on contaminants and shipping). Russia also sponsored projects in a wider range of areas, compared to its earlier interest in economic development. Russia is collaborating with the United States in the Council, as well. The United States is sponsoring two projects on environmental protection in the Russian Arctic. The United States and Russia are co-sponsoring eight projects. Russia is co-sponsoring four projects with Canada. Russia remains a Council contributor, despite weakening relationships with the West.

Conclusion

Recent actions by Russia, and the response by the United States, are leading to fears that a new Cold War is on the horizon. How has the deterioration in relations between Russia and Western countries affected the Arctic Council, the Arctic’s preeminent governance institution? It is important to understand patterns of participation in the Arctic Council (and other international institutions) to understand the state of regional governance. This paper argued that the current political situation has not affected the Council profoundly; Russia scaled back some of its outward shows of Council support, but overall participates in the Council more than ever before. The breakdown in Russian-United States relations has not had an immediate impact on the Council, raising hope that a new Cold War is avoidable. From 1998 until 2000, Russia participated in the Council, though at a level close to the Nordic countries and with a greater focus on domestic affairs than the other Council countries. From 2007 until 2009, Russia increased its participation in the Council to a level comparable to Canada and the United States. Its work focused on domestic affairs more than did the work of the other Council countries. Russia also focused more on projects to improve the economic prospects of the Arctic region. From 2013 until 2015, as relations worsened, Russia made fewer comments at Council meetings and sent smaller delegations. However, Russia sponsored more Council work than ever before, on a broad range of international projects. Its work has become broader in focus, with an emphasis on domestic, international, economic and environmental matters. Russia, Canada and the United States frequently work together on environmental projects through the Council.

This work contributes to this literature by considering the role of broader relations in the Council’s attempt to provide regional governance. Earlier work, such as previously mentioned works by Oran Young and others, examined the role of the institution and did not strongly consider its durability. It is clear that the Council can weather changes in the international political climate. The fact that it is fairly small and under the radar is beneficial, as it does not attract great attention.

This work considers whether Russia and the United States can collaborate effectively in some areas while relations deteriorate in other areas. It is clear that this situation is the case. The picture of United States-Russian relations is more complex than during the Cold War. Russia and the United States work together in the Arctic Council. It is clear the Council has done something to facilitate co-operation.

Furthermore, as Table Four shows, Russia is the only Council country to increase its participation in Council meetings in a significant way.

Table 4: Summary of Meeting Behaviour

Country	Comments 1998–2000	Comments 2007–2009	Comments 2013–2015	Agenda Items 1998–2000	Agenda Items 2007–2009	Agenda Items 2013–2015
Canada	62	21	30	29	10	21
Denmark	25	15	10	20	13	7
Finland	21	10	6	18	7	6
Iceland	30	10	1	19	10	1
Norway	56	34	16	32	24	11
Sweden	22	19	5	15	12	4
U.S.A.	24	31	8	18	20	7
Russia	21	47	11	18	30	6

As per Table Five, Russia's sponsorship of projects and delegation size is fairly consistent with other countries.

Table 5: Russia and the Council, 1998–2000

Country	Average Delegation Size, 1998–2000	Average Delegation Size, 2007–2009	Average Delegation Size, 2013–2015	Project Sponsors, 1998–2000	Project Sponsors, 2007–2009	Project Sponsors, 2013–2015
Canada	16	10.8	9	7	18	29
Denmark	6.5	8	5.7	2	3	11
Finland	5.5	5.5	3.7	3	4	8
Iceland	2.5	3	2.3	2	6	3
Norway	7.75	17.5	3.3	10	16	29
Sweden	2	5.3	4	1	2	5
United States	37.5	10.5	5.7	7	18	32
Russia	4.75	11.8	1.7	4	13	21

Why has antagonism between Russia and the United States not greatly affected the Council? The remainder of this paper provides directions for further research on causality. None of these explanations are definitive, and new research is required. Neorealists might predict that Russia would scale-back its activity in the Arctic Council, as balance-of-power considerations, relative gains and international positions motivate international relations [Waltz, 1979]. Neorealists might explain that Russia is attempting to move away from the United States and assert itself as an international power. Collaboration with the United States in the Arctic would run contrary to this goal. Clearly, neorealism does not provide an adequate explanation for Council activity.

An analysis based on the work of Robert Putnam would examine how domestic politics in Russia and Putin's international goals clash in the Arctic [Putnam, 1988]. However, it does not appear that Russia is attempting to appeal to domestic audiences in the Council, based on its varying behaviour. The RAIPON example shows that Russia has been antagonistic toward its major Arctic domestic actors. Based on this example, it is questionable how much Russia, a democratically imperfect country, cares about appealing to domestic interests.

Functionalism provides a good explanation. Functionalists predict that collaboration on areas of low politics, such as environmental protection, encourages trust between states and encourages collaboration [Haas, 1976]. Russia's activity in the Council has generally increased as Russia built relationships with other countries in the institution. Russia has built trust with the other Council countries; it continues to work with the institution, even as trust fades in other institutions and areas.

Russia is likely participating in the Council because it suits national interests. Earlier research has revealed that the Arctic Council is undergoing evolution, driven by the region's economic potential [Chater, 2015]. In 1996, the Council was a weak intergovernmental forum that facilitated the creation of environmental research. The institution did not facilitate the creation of formal policy. By 2014, that fact had changed. It had served as a venue to create two international agreements, one on search and rescue⁸ and another on response to oil spills.⁹ These treaties help facilitate economic development in the region, because they provide plans to respond to the types of emergencies that might arise in resource production, such as offshore oil. Insurance companies have cautioned against investment in Arctic resources due to high potential liability [Emmerson et al., 2012]. Russia holds 80 percent of the Arctic's natural resources [Alexeev, 2013]. These agreements did not solve every liability issue, but they help create a consistent regional legal regime that makes investment safer. The Council also completes important environmental work. Many environmentalists participate in the Council, which earlier research has shown is a key group in favour of democracy in Russia, as opposed to Putin's authoritarian tactics [Chater, 2015, p. 62–63]. Thus, Russia may participate in the Council because it provides benefits that serve the interests of member states. Future research must confirm the results.

In future research, interviews with Council policy makers could help establish causality. Arctic policy makers can draw on experience to confirm the hypothesized explanation proposed in this article.

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⁸ Agreement on Co-operation on Aeronautical and Maritime Search and Rescue in the Arctic. Nuuk, Greenland: Arctic Council, 2011.

⁹ Agreement on Co-operation on Marine Oil Pollution Preparedness and Response in the Arctic. Kiruna, Sweden: Arctic Council, 2003.

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Appendix A: Data Sources and documents

Data Sources – Meeting Minutes

Arctic Council Meeting of Senior Arctic Officials, Tromsø, Norway, 12-13 April 2007. Tromsø, Norway: Arctic Council Secretariat.

Arctic Council SAO Meeting, Whitehorse, Canada, 4-5 March 2015, Final Report. Tromsø, Norway: Arctic Council.

Arctic Council SAO Meeting, Yellowknife, Canada, 22-23 October 2014, Final Draft Report. Tromsø, Norway: Arctic Council.

Meeting of Senior Arctic Officials Final Report From The Meeting 19 February 2009, Copenhagen, Denmark. Tromsø, Norway: Arctic Council.

Meeting of Senior Arctic Officials Final Report, 19-20 November 2008, Kautokeino, Norway. Tromsø, Norway: Arctic Council.

Meeting of Senior Arctic Officials Final Report, 23-24 April 2008, Svolvær, Norway. Tromsø, Norway: Arctic Council.

Meeting of Senior Arctic Officials Final Report, 28-29 November 2007, Narvik, Norway. Tromsø, Norway: Arctic Council.

Meeting of Senior Arctic Officials, Whitehorse, Yukon, Canada, October 22-23, 2013, Plenary Meeting, Final Report. Tromsø, Norway: Arctic Council.

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Senior Arctic Officials Meeting Highlights, November 17-19, 1999. Washington, D.C., U.S.A. Tromsø, Norway: Arctic Council Secretariat.

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Senior Arctic Officials Meeting, Fairbanks, Alaska, April 27-28, 2000. Tromsø, Norway: Arctic Council Secretariat.

Sixth Ministerial Meeting of the Arctic Council, 29th April 2009, Tromsø, Norway, Agenda. Tromsø, Norway: Arctic Council.

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Arctic Council Senior Arctic Officials Meeting, April 26-28, 2000, Fairbanks, Alaska, Delegation List. Tromsø, Norway: Arctic Council Secretariat.

Arctic Council Senior Arctic Officials/Sustainable Development Working Group Meeting, Washington, D.C., USA, November 17-19, 1999, Participant List. Tromsø, Norway: Arctic Council Secretariat.

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SAO Meeting, Svolvær, 23-24 April 2008, List of Participants. Tromsø, Norway: Arctic Council.
Sixth Ministerial Meeting of the Arctic Council, 29th April 2009, Tromsø, Norway, Final List of Participants. Tromsø, Norway: Arctic Council.

Data Sources – SAO reports

Annex 2, Iqaluit 2015 SAO Report to Ministers, Amarok: Arctic Council Tracker (AAC), Iqaluit, 24 April 2015. Tromsø, Norway: Arctic Council.
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Agreement on Co-operation on Aeronautical and Maritime Search and Rescue in the Arctic, 2011. Nuuk, Greenland: Arctic Council.
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Economic Integration and New Export Opportunities for the Eurasian Economic Union¹

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At a time when oil prices are low, non-oil exports are important for the members of the Eurasian Economic Union (EEU). This study assesses the effects of the EEU's economic integration on the development of new exports.

EEU countries are far behind global export leaders in several categories according to the revealed comparative advantage, used by the Hausmann-Klinger method to assess national export baskets. Belarus exports the most products, and Russia and especially Armenia and Kazakhstan export notably fewer.

The comparative advantages of Kazakhstan and Russia are concentrated mainly in minerals, chemical products and metals. The export structure for the other EEU countries is more diverse, with a high share of foodstuffs in Armenia and textiles in Belarus. Kazakhstan and, to a greater extent, Belarus and Russia show a rather complex export basket, significantly ahead of Armenia according to this indicator. For the EEU as an independent participant, its trade complexity index is higher than that for its member countries individually.

This article uses the Hausmann-Klinger methodology to identify the future comparative advantages of the EEU countries. These are product groups, towards which a structural transformation of the EEU exports most likely occurs. The research focuses on the integration aspect of possible non-oil exports, seeking to identify goods, including chemicals and textiles, that can eventually provide a comparative advantage for the EEU as a whole. Most of the products considered have a greater economic complexity than those in the EEU's current export basket, so would improve its overall export structure.

Key words: Eurasian Economic Union (EEU); trade integration; comparative advantage; Hausmann-Klinger methodology

Introduction

A clear understanding of the costs and benefits associated with regional trade and economic integration is essential to ensuring the sustainability of regional blocs. At the early stages of the creation of the Customs Union (CU) between Belarus, Kazakhstan and Russia, the economic

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benefits of this enterprise were questioned, and they continue to be. For example, the main reason for doubt in Kazakhstan was the growth of its import tariffs after entry into the CU. In order to implement the Common Customs Tariff in the CU, Kazakhstan almost doubled its average tariff, from 5.3% to 9.5% [Shepolyto, 2011, p. 88] during the first year of its accession.

In 2015, the Customs Union was transformed into the Eurasian Economic Union (EAEU), and two new members joined it – Armenia and Kyrgyzstan. The new member states of the EAEU have prior international obligations as WTO members: Kyrgyzstan joined the WTO in 1998, and Armenia did so in 2001. In 2014, the simple average import tariff rate under the most favored nation status in Armenia was 3.7%; in Kyrgyzstan this figure is 4.6%. Due to differences between the obligations of Armenia and Kyrgyzstan to the WTO and the tariff schedules of the EAEU, these new members do not apply the full Common Customs Tariff of the EAEU. The accession of Armenia and Kyrgyzstan to the EAEU leads to numerous exceptions to the Common Customs Tariff. Additionally, these new EAEU member states started a procedure to correct their WTO obligations.

Despite the adverse effects of higher import prices being caused by the implementation of the Common Customs Tariff of the EAEU, Armenia and Kyrgyzstan stand to enjoy benefits that will compensate for the costs of being EAEU members. The importance of remittances from the countries of the EAEU to Kyrgyzstan and the benefits associated with the free movement of labor within the EAEU could eclipse the cost of increased import tariffs in terms of importance. Armenia also benefits from the free movement of labor, receiving Russian gas without export duties, and is interested in keeping the military guarantees provided by Russia through the Collective Security Treaty Organization.

In this period of high energy prices, the benefit to Belarus of participation in the CU was evident as high Russian export taxes on oil and gas were waived for it.

Within the framework of the EAEU, Kazakhstan's ambition is to be a safe haven for FDI in the production of goods and services for all five countries in the regional block.

The decrease of energy prices could significantly alter the balance of costs and benefits of being part of the EAEU for all five member states. In our opinion, it is important to understand whether there are other potential benefits (not mentioned above) to the deep integration of the five countries.

This study quantifies EAEU economic integration in terms of the development of new exports outside the Union. The benefits of the integration are defined as additional opportunities that the Union as a whole has in comparison with those of individual countries. We compare prospects for the non-oil exports of individual countries with the potential exports of the EAEU as an integrated single player in the global market for goods and services. The current state of the export basket of the EAEU is determined by summing up the exports of the member states to third countries and disregarding internal trade within the EAEU. The difference between the developed export opportunities of integrated associations and the total capacities of individual countries determines the potential benefits of the integration. It is worth mentioning that the importance of the new exports increases significantly when energy prices are low, and when other sources of benefits from regional integration that have been relevant in a time of high prices are exhausted.

The rest of the paper is organized as follows: in part 2 we describe the data; part 3 contains a description of the methodology; part 4 discusses the results, and is followed by a conclusion.

Data

The following data are used in our calculations.

The UN COMTRADE database (2014) provides data on the value and volume of export flows from the EAEU member states to every country in the world using HS2012 6-digit classification <http://comtrade.un.org/data/>

The World Bank database contains data on GDP per capita and population figures <http://databank.worldbank.org/data/home.aspx>

Due to the lack of data on Kyrgyzstan's exports in the COMTRADE database for 2014, it is excluded from the analysis. Thus, the calculations are carried out for four EAEU countries – Armenia, Belarus, Kazakhstan and Russia.

Methodology

Our analysis of the prospects for the economic integration of the EAEU countries is carried out on the basis of the method proposed in a series of articles by Hausmann and Klinger [Hausmann, Klinger, 2006, 2007]. This method suggests a possible evolution of exports for each country. Usually, such evolution moves from technologically simple products, which are usually produced by poor countries, to more sophisticated products, which tend to be sold by rich countries. This process is called a structural transformation.

The method is based on a stylized fact consistently observed in empirical data: the structural transformation of national export baskets usually follows a certain pattern. The crucial observation is that over time, the country starts to export products, which are in some sense “close” to the basic products of the current export basket.

Hausmann and Klinger's notion of the proximity of goods is based on the concept of “product space” they proposed along with Cesar A. Hidalgo, and Albert-László Barabási in 2007 (see detailed description in [Hausmann et al., 2011, pp. 44–55], which attempts to visualize trade networks and spatially depict the comparative advantages and relatedness of products traded in the global market. The product space is a graph consisting of vertices (product groups) and edges whose length reflects the proximity of goods; related products requiring similar production capacity are depicted as being closer together and more central in the trade network.

The theoretical model estimates the profitability of a company from the new goods it produces. Switching to a new product is fundamentally different from the expansion of an existing product and involves certain costs. The costs of the structural transformation from one product to another depends on their relative proximity; in particular, on how the human capital of the employee applies in the new environment and how effective the producer is at re-purposing whatever was used in the production of the old goods.

The production of any good depends on such specific factors as human capital, fixed assets, intermediate goods, regulatory and infrastructure requirements, as well as ownership structure and other factors that are not always observable. The proximity of goods is determined by the aggregate proximity of factors required for their production. Since the space of factors is not always possible to specify explicitly, as not all of its components are observable and measurable, one can use the export basket of a country to guess to what extent it is supplied with all necessary factors. The logic behind this is the idea comes from the Heckscher-Ohlin model, where the comparative advantage of a country depends on factor abundance and demand for factors by production.

As a measure of proximity of two products, Hausmann and Klinger suggest using the frequency of their simultaneous appearance as products of revealed comparative advantage (RCA) in the export baskets of various countries. Moreover, the proximity of goods empirically estimated with the procedure described above is interpreted as proximity of the production factors required for the effective production of these goods. Consequently, if there are some goods which are close to those contained in the export basket of a country and at the same time not contained in it themselves, one can expect that the probability of a structural transformation in the direction of these goods is higher than that it would be for the production of other, more 'distant' products.

The product space is not uniform; it has a densely filled central area where each commodity group has many close neighbors (i.e. many products in which direction a structural transformation is probable) and a much more sparse periphery, where the number of possible opportunities for expedient transformation is more limited.

The degree of proximity between goods reflects variation in specific factors of production, the speed of structural transformation depends on how sparse or, alternately, densely populated the product space is next to the existing country's revealed comparative advantage.

The density of the product space significantly influences the probability of the emergence of new comparative advantages. Some countries are in a sparse area of the product space, and some, on the contrary, in a much more densely-filled area. Structural transformation may slow down or stop in the event of a local price peak, when firms have no incentive to switch to the production of new goods, or if economically more advanced (and therefore more expensive) products are far away in the product space.

To formalize the model, Hausmann and Klinger introduce a few concepts. The presence of revealed comparative advantages in the country with exports of good i at time t is determined by the Balassa index. It is believed that there is a revealed comparative advantage, if the share

of this product in country's exports $xval_{c,i,t} / \sum_i xval_{c,i,t}$ exceeds the share of this product in global trade $\sum_c xval_{c,i,t} / \sum_i \sum_c xval_{c,i,t}$, i.e. the Balassa index is greater than 1.

In determining the affinity between any two commodities, Hausmann and Klinger assume that similar products are exported to most countries at the same time. The proximity between the goods i and j is defined as the smallest of the conditional probabilities of having a revealed comparative advantage in good i , if good j is exported as well, and vice versa (RCA of good j , if good i is exported as well):

$$\phi_{i,j,t} = \min \left\{ P(x_{i,t} | x_{j,t}), P(x_{j,t} | x_{i,t}) \right\},$$

where $P(x_{i,t} | x_{j,t})$ – is the conditional probability of exporting good i , provided that good j is exported at the time t . Conditional probabilities are calculated for all countries in year t [Hausmann and Klinger, 2007, p. 16].

The measure of "price", reflecting the attractiveness of transition to the production of new good, is a measure of profitability of goods i – $PRODY_{i,t}$. This measure was proposed in [Hausmann and Klinger, 2006, p. 17]. $PRODY$ of good i is defined as a weighted sum of GDP per capita in countries exporting good i , with weights equal to value of Balassa RCA of good i :

$$PRODY_{i,t} = \sum_c \left[\frac{\frac{xval_{c,i,t}}{\sum_i xval_{c,i,t}}}{\sum_c \left(\frac{xval_{c,i,t}}{\sum_i xval_{c,i,t}} \right)} \times GDPpercapita_{c,t} \right]$$

This measure is used to calculate the level of complexity of the country's export basket, $EXPY_{c,t}$, as the $PRODY_{i,t}$ for each component of exports, weighted on its share in exports:

$$EXPY_{c,t} = \sum_i \left(\frac{xval_{c,i,t}}{\sum_i xval_{c,i,t}} \times PRODY_{i,t} \right)$$

Hausmann and Klinger's methodology has been used in a variety of studies of countries' structural transformation of revealed comparative advantage with the help of historical data (see [Abdon and Felipe, 2011; Jankowska et al., 2012; Bayudan-Dacuycuy, 2012; Stafforte and Tamberi, 2012]).

There are also a number of studies that examines possible changes of RCA to product groups that are close to existing exports in a probabilistic sense. This transition is named diffusion of revealed comparative advantage (see [Hidalgo et al., 2007, pp. 5–6]).

In order to determine commodity groups, which could be the results of the diffusion process for the EAEU countries, it is necessary to study product groups that are close enough in the product space to the revealed comparative advantages of EAEU countries. To do this, we chose a proximity threshold of 0.7 and noted all the product groups, which are within this distance of the existing goods with RCA. It seems worth mentioning that this is a high level of proximity: as a rule, in other studies authors consider the values within the range 0.55–0.65 as a threshold level (see [Hidalgo et al., 2011, p. 6; Bayudan-Dacuycuy, 2012, p. 4]). To account for the possible structural transformation of the country's exports, a similar procedure was carried out five times. We have also performed the sensitivity analysis of the results to the choice of the number of steps and the proximity threshold.

Results of the Study

Within our study (based on GDP per capita data and COMTRADE export data at the 6-digit product disaggregation for 2014) we consider two variants for the product space, a real-world one and a hypothetical one with the EAEU member countries combined into a single agent of world trade.

For real-world product space, we consider product groups with RCA for the EAEU member countries and with the help of the 5-step diffusion procedure define the groups where RCA could appear due to the structural transformation of national exports in the future.

Then the similar diffusion procedure is applied to the hypothetical product space, that occurs if the EAEU is considered as a single agent of foreign trade. Thus we obtain five sets of perspective goods: four sets for the countries included in the research (Armenia, Belarus, Kazakhstan, and Russia) and one for their hypothetical union (EAEU).

Finally we compare the prospective goods for the four national export baskets with those for the EAEU, focusing on those product groups that, while not offering RCA prospects for

each separate country of the union, could benefit the EAEU in terms of their RCA as a single agent of foreign trade.

At the first step of our study, we identify product groups for which the EAEU countries had RCA in 2014, i.e. whose contribution to national exports was higher than the overall contribution of this product to global trade. According to the results obtained, the EAEU countries significantly lag the world export leaders in terms of the number of product groups with RCA. The largest number of products with comparative advantage is observed in the export basket of Belarus – 621 six-digit commodity groups, while in case of Russia and especially Armenia and Kazakhstan, this number is notably less – 377, 230 and 193 product groups respectively. As can be seen from the data presented in Table 1, the number of product groups with RCA in Armenia and Kazakhstan are almost an order of magnitude less than the respective figures for such world trade leaders as China and the United States.

To get some insight about the economic complexity of the national export baskets of the EAEU countries, one can use EXPY, the index of the sophistication of exports (see the definition in the Methodology section). Our estimates suggest that Belarus, Kazakhstan and Russia demonstrate relatively high values of economic complexity of national export baskets, significantly ahead of Armenia in this indicator. In the case of international comparisons, the complexity of the exports of the EAEU countries is close to China's level (around USD 20,000–22,000), albeit far behind the successful exporters of high-tech products, specifically the USA (over USD 26,000).

It is also worth mentioning that the complexity level of exports of the EAEU as an independent market engaged in foreign trade is higher than that of the separate member countries. This indicates that the EAEU members' exports to third countries are more sophisticated than exports within the Union's borders.

Table 1: Characteristics of products with revealed comparative advantage for the EAEU member countries, China and the US

Index	Armenia	Belarus	Kazakhstan	Russia	EAEU	China	USA
Number of product groups with revealed comparative advantage (RCA)	230	621	193	377	325	2196	1749
Export complexity (EXPY), USD	12345	20217	19383	21296	22625	22720	26560

Source: Authors' calculations on UN COMTRADE data.

If we talk about the involvement of member countries in trade within the EAEU, the country which is most dependent on its partners' markets is Belarus, with 45% of its exports sent to EAEU countries (primarily Russia). Armenia sends 22% of its exports to its EAEU partners. The exports of oil-producing Kazakhstan and Russia are much more likely to be sent to countries outside the EAEU; these countries' trade with other EAEU members accounted only for 8% and 7% of exports, respectively.

With regard to the range of export baskets of the member countries, it may be noted that almost a third of all 6-digit commodities exported from Belarus are completely targeted at the EAEU countries. For other member countries, the share of goods traded exclusively within the union is lower, about 10% for Russia and Armenia, and 22% for Kazakhstan. Over 80% of the types of products Belarus exports are sent to fellow EAEU states more often than not (for these

products, 50%+ of exports are to EAEU members). More than 55% of the types of products Russia exports are primarily sent to its EAEU partners. Some integration figures are shown in Table 2.

Table 2: Indicators of economic integration within the EAEU

Country	The share of trade within the union in total exports, %	The share of goods exported only to EAEU countries EAEU, %	The share of export goods predominantly (50%+) bought within the EAEU, %
Armenia	22	10	23
Belarus	45	31	81
Kazakhstan	8	22	49
Russia	7	10	56

Source: Authors' calculations on UN COMTRADE data.

Products with Revealed Comparative Advantage

An analysis of the sectoral structure of comparative advantages suggests that Kazakhstan and Russia's export benefits are concentrated mainly in the production of mineral and chemical products as well as metals, while the RCA structure of other member countries is more diverse, with a high share of food products in Armenia and textiles in Belarus (Fig. 1). It should also be noted that Belarus has more goods with revealed comparative advantage in the group "machinery and electronics" (about 80 product groups).

For the EAEU as a consolidated participant in global trade (net of internal trade flows between the countries of the union), the sectoral distribution of RCA reflects those of Russia and Kazakhstan, with a predominance of metal production as well as chemical and mineral products.

Furthermore, we estimate how close, or, alternately, how far the effective part of the export basket of the EAEU countries is from the rest of the commodities (we call the product groups without RCA the "opportunity set"). In other words, we try to understand the likelihood of the structural transformation of exports from current goods with RCA towards those that are currently not produced efficiently. This can be done using the indicator "the distance to the current export basket", which is calculated as the inverse of average proximity between a product from the opportunity set and all existing products with RCA. This indicator measures how close in terms of the Hausmann-Klinger method products are from the opportunity set to the current effective part of the national export basket.

The diagram below presents the opportunity spaces for each of the four countries included in the research (Fig. 2). For each product group from the opportunity set, the dependence is shown between the distance to the most effective part of the country's export basket and the relative complexity of this product (the complexity is defined as the logarithm of the product complexity index (PRODY), normalized to the value of the total complexity of the effective part of the national export basket (EXPY)). Thus, more complicated products (whose complexity is greater than the average complexity of the effective part of the national export basket) are located above zero on the vertical axis. In terms of another variable, distance, the closer the goods are to the vertical axis, the more likely it is to expect their appearance as a commodity of comparative advantage in the export basket of the country.

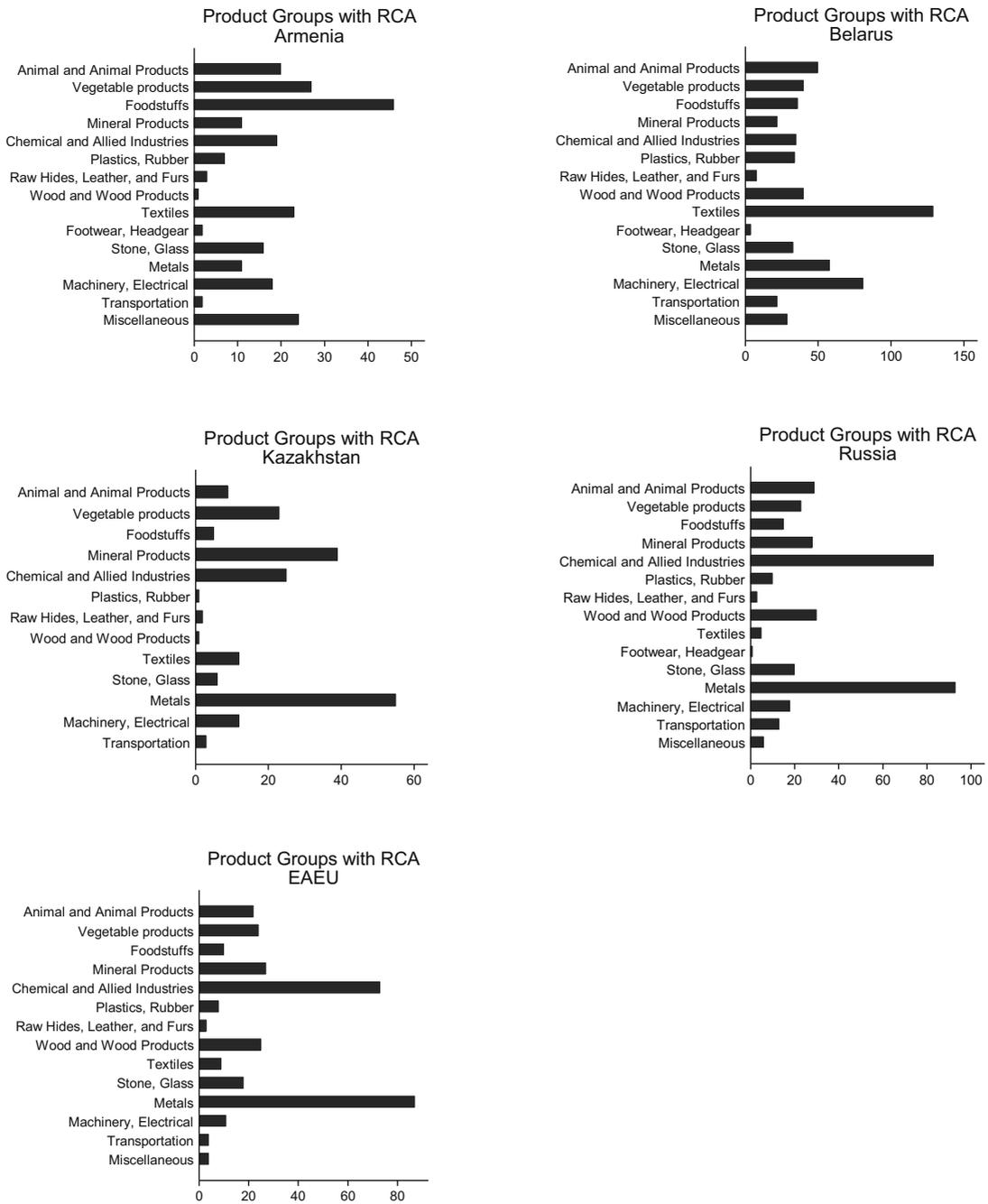


Figure 1: Product groups with revealed comparative advantage (RCA) for the member countries and the EAEU as a single agent of foreign trade

Source: Authors' calculations on UN COMTRADE data.

Among the countries of the EAEU, the closest distance from the opportunity set of products to the most effective part of the actual export basket is observed for Belarus (6.0). For Russia, Armenia and especially Kazakhstan, this distance is significantly higher: 12.7, 14.1 and

24.3, respectively. Thus, we can conclude that the high diversification of the export basket of Belarus, as well as the favorable location of its RCA groups in the central, densely filled part of the product space, facilitates the future structural transformation of the country's exports in comparison with Armenia and Russia. At the same time, the prospects of a successful structural transformation of Kazakhstan's export are small. It is also worth mentioning that some upward shift of the opportunity set for Armenia reflects the relatively lower complexity of the current effective part of the national export basket.

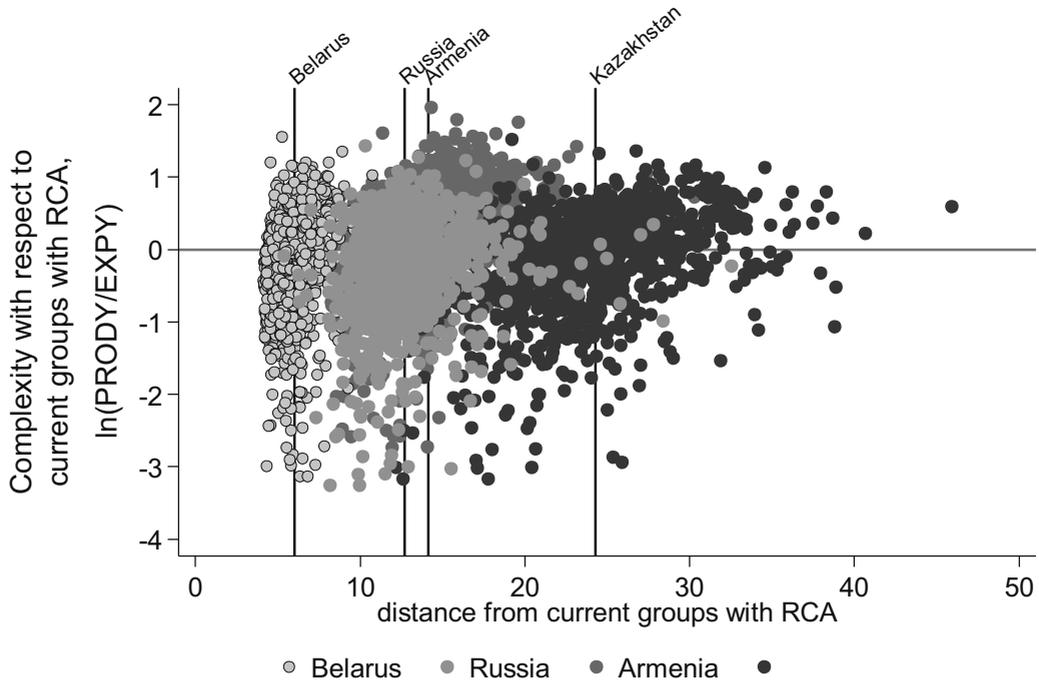


Figure 2: The relative complexity of the goods without RCA, depending on the measure of the probability of their appearance in the effective part of the national export basket for EAEU countries, 2014

Source: Authors' calculations on UN COMTRADE data.

Expected Groups with RCA

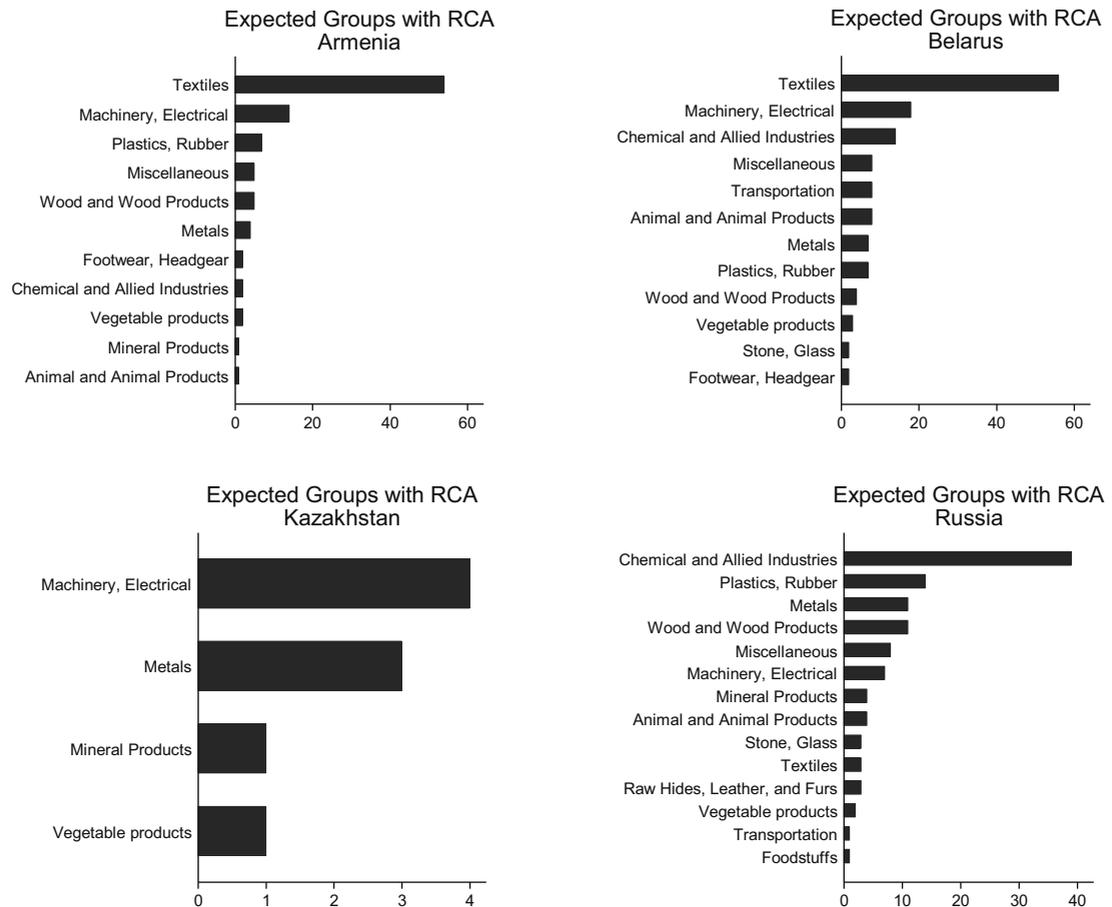
During the analysis for each country we generate a list of product groups which are close to the current products and possess revealed comparative advantage (we also call them expected product groups with RCA). These items were defined with the help of a 5-step diffusion procedure with a proximity threshold equal 0.7 at each step. The probability of appearance in the export basket of new products with revealed comparative advantage depends on how easily the country's current capacity can be adapted to the production of new goods. Most expected products for Armenia and Belarus can be categorized as light industry, and Russia's production capacity could allow it to excel in the chemical industry as well as the production of plastics and metals (Fig. 3). Note that the number of such groups for Kazakhstan is significantly less (9 as compared to 97 for Armenia, 137 for Belarus, and 111 for Russia), and their relationship with current products with RCA is weaker. This can be explained by the fact that current goods with RCA

in the export basket of Kazakhstan belong to the minerals and metals group, and are mainly located on the periphery of the product space, where the density of groups falls significantly.

With regard to the EAEU's prospects as a consolidated participant in global trade, the sectoral structure of the expected product groups with RCA resembles Russia, as in the case of current products with RCA. However, there would be a EAEU predominance of chemical products and markedly lower share of plastics and machinery products; one notable exception is that the expected RCA of light industry would grow significantly. One can assume that it is due to a large density within the textile and clothing cluster of the product space, which includes many products from the effective parts of the Armenian and Belorussian export baskets.

In order to evaluate the effect of economic integration in the sectoral structure of expected groups with RCA for the EAEU as a consolidated participant in global trade, we have focused on the products that are not expected products with RCA for any of the EAEU countries separately.

Figure 4 shows the distribution of products, from the perspective of the EAEU as a consolidated participant of foreign trade. The white areas of the bars on the chart correspond to the groups whose transition to the status of the products with RCA is expected for the union as a whole, the green – only for Belarus, the blue – only for Russia and the dark blue – for several countries within the EAEU. The most interesting, in terms of cooperation, are white areas corresponding to the 6-digit commodity groups. There you find anticipated products with RCA only for the EAEU in general, and not for any of the member countries separately.



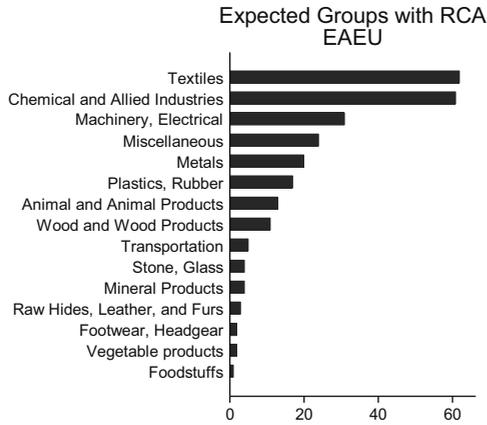


Figure 3: Sectoral structure of prospective product groups for EAEU countries' exports

Source: Authors' calculations on UN COMTRADE data.

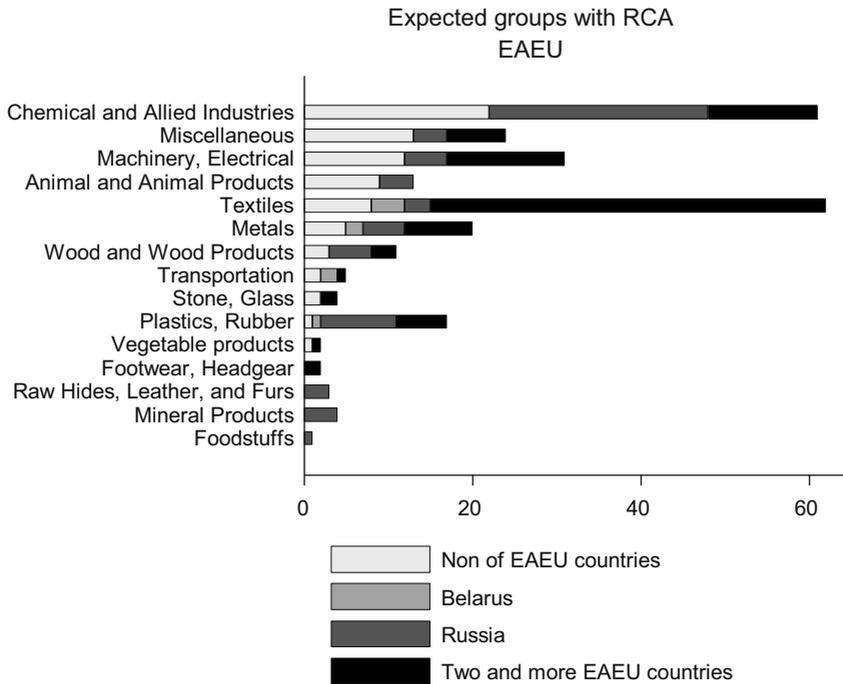


Figure 4: The sectoral structure of expected groups with RCA for the EAEU as a consolidated participant in foreign trade

Source: Authors' calculations on UN COMTRADE data.

The total number of expected product groups with RCA is 78. Most often they are related to chemicals (22 products), other products (13 products), as well as machinery and engineering (12 items). Most of these products (62 out of 78) have greater economic complexity than the average complexity of the export basket of the EAEU, and therefore their export growth will

improve the overall export structure. Groups of goods selected by the diffusion procedure are presented in the table below (Table 3).

Table 3: Expected product groups with RCA only for the EAEU as a whole (i.e., that are not expected for any of the EAEU countries individually)

Field	HS4 (2012)		Balassa index	PRODY	World trade, bln USD, 2014
Wood and Wood Products	481830	Tablecloths and serviettes, of paper pulp, paper, cellulose wadding or webs of cellulose fiber	0.0153	19026	1.21
Wood and Wood Products	482040	Manifold business forms and interleaved carbon sets made of paper or paperboard; albums for samples or for collections and book covers made of paper or paperboard	0.0207	19026	0.11
Wood and Wood Products	440890	Other articles of wood, sawn lengthwise, sliced or peeled, of a thickness not exceeding 6 mm, including planed, sanded, spliced and end-jointed	0.4020	19026	1.86
Animal and Animal Products	30473	Frozen fillets of pollock (<i>Pollachius virens</i>)	0.0092	19026	0.18
Animal and Animal Products	30561	Herrings (<i>Clupea harengus</i> , <i>Clupea pallasii</i>), salted but not dried or smoked and fish in brine, other than edible fish offal	0.9429	19026	0.03
Animal and Animal Products	20311	Pork, fresh or chilled, carcasses and half-carcasses	0.0000	19026	2.63
Animal and Animal Products	30224	Flat fish Turbot (<i>Psetta maxima</i> , <i>Scophthalmidae</i>), fresh or chilled, excluding fish fillets and other fish meat of heading	0.0015	19026	0.13
Animal and Animal Products	40310	Yogurt, including concentrated, containing added sugar or other sweeteners as well as flavored or containing added fruit, nuts or cocoa	0.1384	19026	2.35
Stone, Glass	700800	Multiple-walled insulating units of glass	0.0283	19026	1.56
Stone, Glass	711011	Platinum, unwrought or in powder form	0.1450	19026	8.83
Machinery, Electrical	846711	Hand tools, pneumatic tools, and rotary-type tools (including combined rotary-percussion)	0.0295	19026	0.9
Machinery, Electrical	851521	Machines and apparatuses for the resistance welding of metal, fully or partly automatic	0.0455	19026	1.88
Machinery, Electrical	847981	Other machines and mechanical appliances, for treating metal, including electric wire coil-winders	0.1195	19026	1.76
Machinery, Electrical	850730	Electric accumulators, as well as separators, whether or not rectangular (including square), nickel-cadmium	0.2099	19026	0.96
Machinery, Electrical	844530	Textile doubling or twisting machines	0.0019	19026	0.23
Machinery, Electrical	846593	Grinding, sanding or polishing machines	0,0268	19026	0,29
Machinery, Electrical	842129	Other filtering or purifying machinery and apparatuses for liquids	0,0665	19026	8,57
Machinery, Electrical	842420	Spray guns and similar appliances	0,0197	19026	1,71
Machinery, Electrical	844842	Reeds for weaving machines (looms), heddles and heddle-frames	0.0343	19026	0,06

REGIONAL INITIATIVES

Field	HS4 (2012)		Balassa index	PRODY	World trade, bln USD, 2014
Machinery, Electrical	840310	Central heating boilers	0.0425	19026	5.09
Machinery, Electrical	841360	Other rotary positive displacement pumps for liquids, whether or not fitted with a measuring device	0.0808	19026	6.35
Machinery, Electrical	842511	Pulley tackle and hoists other than skip hoists or hoists of a kind used for raising vehicles, powered by electric motors	0.0392	19026	1
Metals	741011	Foil (whether or not printed or backed with paper, paperboard, plastics or similar backing materials) of a thickness not exceeding 0.15 mm, of refined copper	0.0574	19026	1.45
Metals	722100	Bars and rods, hot-rolled, in irregularly wound coils, of stainless steel.	0.0005	19026	1.9
Metals	722720	Bars and rods, hot-rolled, in irregularly wound coils, of silico-manganese steel	0.5832	19026	0.44
Metals	721250	Flat-rolled products of iron or non-alloy steel, of a width of less than 600 mm, otherwise plated or coated	0.0013	19026	0.57
Metals	820340	Pipe-cutters, bolt croppers, perforating punches and similar tools	0.0097	19026	0.18
Plastics, Rubbers	390740	Polycarbonates	0.0577	19026	7.75
Vegetable products	120510	Low erucic acid rape or colza seeds	0.3277	19026	10
Miscellaneous	900319	Frames and mountings for spectacles, goggles or the like, and parts thereof, of other materials	0.0032	19026	2.03
Miscellaneous	902720	Chromatographs and electrophoresis instruments	0.0141	19026	1.84
Miscellaneous	950440	Table or parlor games: playing cards	0.0018	19026	0.76
Miscellaneous	900653	Other cameras, for 35mm roll film	0.0112	19026	0.06
Miscellaneous	901850	Other ophthalmic instruments and appliances	0.0317	19026	4.03
Miscellaneous	902990	Revolution counters, production counters, taximeters, mileometers, pedometers and the like; speed indicators and tachometers; stroboscopes: parts and accessories	0.0303	19026	1.54
Miscellaneous	902519	Thermometers and pyrometers, not combined with other instruments, other	0.0718	19026	2.4
Miscellaneous	902230	X-ray tubes	0.2294	19026	1,57
Miscellaneous	903082	Other instruments and apparatuses for measuring or checking semiconductor wafers or devices	0.0007	19026	3.09
Miscellaneous	901390	Parts and accessories for liquid crystal devices; lasers, other than laser diodes; other optical appliances and instruments	0.1101	19026	5.76
Miscellaneous	940600	Prefabricated buildings	0.2133	19026	8.98
Miscellaneous	950639	Golf clubs and other golf equipment	0.0000	19026	1.11
Miscellaneous	940360	Other wooden furniture	0.0844	19026	26.22
Textiles	540744	Other printed woven fabrics, containing 85 % or more by weight of filaments of nylon or other polyamides	0.3462	19026	0.15

Field	HS4 (2012)		Balassa index	PRODY	World trade, bln USD, 2014
Textiles	610451	Women's or girls' skirts and divided skirts of wool or fine animal hair	0.0080	19026	0.05
Textiles	630259	Other table linen of other textile materials	0.8066	19026	0.14
Textiles	551642	Dyed woven fabrics of artificial staple fiber, containing less than 85 % by weight of artificial staple fiber, mixed mainly or solely with cotton	0.0009	19026	0.06
Textiles	620312	Men's or boys' suits of synthetic fiber	0.0075	19026	0.77
Textiles	620899	Women's or girls' other clothing articles of other textile materials	0.0182	19026	0.2
Textiles	620590	Men's or boys' shirts of other textile materials	0.0048	19026	0.74
Textiles	610690	Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted of other textile materials	0.0042	19026	0.52
Transportation	871639	Other trailers and semi-trailers for the transport of goods: other	0.1039	19026	8.86
Transportation	860730	Hooks and other coupling devices, buffers, and parts thereof for of railway or tramway locomotives or rolling-stock	0.3129	19026	0.85
Chemical and Allied Industries	381511	Supported catalysts with nickel or nickel compounds as the active substance	0.0012	19026	1.07
Chemical and Allied Industries	381519	Other supported catalysts	0.3505	19026	4.4
Chemical and Allied Industries	292219	Other amino-alcohols, other than those containing more than one kind of oxygen function, their ethers and esters; salts thereof	0.0987	19026	2.28
Chemical and Allied Industries	291229	Other cyclic aldehydes without other oxygen functions	0.0000	19026	0.45
Chemical and Allied Industries	292149	Other aromatic monoamines and their derivatives; salts thereof	0.0001	19026	1.04
Chemical and Allied Industries	382430	Non-agglomerated metal carbides mixed together or with metallic binders	0.0142	19026	0.7
Chemical and Allied Industries	293321	Hydantoin and its derivatives	0.0000	19026	0.17
Chemical and Allied Industries	291429	Other cyclanic, cyclenic or cycloterpenic ketones without other oxygen function	0.0005	19026	0.82
Chemical and Allied Industries	290539	Other diols	0.0000	19026	1.72
Chemical and Allied Industries	292529	Other imines and their derivatives; salts thereof	0.1325	19026	0.73
Chemical and Allied Industries	290522	Acyclic terpene alcohols	0.0017	19026	0.26
Chemical and Allied Industries	291639	Other aromatic monocarboxylic acids, their anhydrides, halides, peroxides, peroxyacids and their derivatives	0.0002	19026	0.72
Chemical and Allied Industries	292990	Other compounds with other nitrogen function	0.1182	19026	0.62
Chemical and Allied Industries	290920	Cyclanic, cyclenic or cycloterpenic ethers and their halogenated, sulphonated, nitrated or nitrosated derivatives	0.0003	19026	0.08

Field	HS4 (2012)		Balassa index	PRODY	World trade, bln USD, 2014
Chemical and Allied Industries	291469	Other quinones	0.0003	19026	0.4
Chemical and Allied Industries	293369	Other compounds containing an unfused triazine ring (whether or not hydrogenated) in the structure	0.3902	19026	1.54
Chemical and Allied Industries	290899	Other halogenated, sulphonated, nitrated or nitrosated derivatives of phenols or phenol-alcohols	0.0013	19026	0.12
Chemical and Allied Industries	290329	Other unsaturated chlorinated derivatives of acyclic hydrocarbons	0.0000	19026	0.12
Chemical and Allied Industries	291539	Other esters of acetic acid	0.0865	19026	1.55
Chemical and Allied Industries	330290	Other preparations based on odoriferous substances, of a kind used for the manufacture of beverages	0.0077	19026	7.82
Chemical and Allied Industries	291100	Acetals and hemiacetals, whether or not with other oxygen functions, and their halogenated, sulphonated, nitrated or nitrosated derivatives	0.0020	19026	0.11
Chemical and Allied Industries	291823	Other esters of salicylic acid and their salts	0.0001	19026	0.21

Note. * – 2015, exports of this group has increased significantly, reaching USD 2 mln (for comparison, in 2014 – USD 5,000)

Source: Authors' calculations on UN COMTRADE data.

Conclusion

According to the results of our research, the EAEU member countries are far behind the world export leaders in terms of number of product groups with revealed comparative advantage (RCA), which within the Hausmann-Klinger method are interpreted as the most effective part of the national export basket. The largest number of products with comparative advantage is observed in the export basket of Belarus, while in the case of Russia and especially Armenia and Kazakhstan, their number is notably less (however, it must be kept in mind that over 4/5 of the products Belarus exports are shipped predominantly (50% and more) to Russia). The export baskets of Belarus and Russia are highly complex, as measured by the EXPY (export sophistication) index, followed by Kazakhstan, which, in turn, is significantly ahead of Armenia in terms of this indicator. EAEU if seen as a consolidated participant in global trade, the EAEU's complexity index is higher than that of member countries separately. The comparative advantages of exports from Kazakhstan and Russia are concentrated mainly in the production of minerals, chemical products, and metals, while the export structure of the effective part of exports for other member countries is more diverse, with a high share of foodstuffs in Armenia and textiles in Belarus.

Within the analysis we defined a list of product groups, within which one can expect the occurrence of revealed comparative advantage in the future. According to the results, groups in Armenia and Belarus groups which should expect RCA are mostly related to light industry, and Russia should expect RCA from chemical production and related industries. For Kazakhstan, the number of potential comparative advantages is much smaller due to the peculiarities of the sectoral structure of the current effective part of the national export basket: these goods (mainly

minerals and metals) are located on the periphery of the world product space, where the density of the product groups significantly drops, casting doubt on the success of structural transformation in the future.

In the sectoral structure of the EAEU as a consolidated participant in foreign trade, chemical products and light industry products stand to offer the best RCA. The marked increase in the importance of textiles and clothing for the EAEU can be attributed to the development of this sector in Armenia and Belarus, as well as the high density of the textile cluster in the world product space, where the current products with RCA are located in the tight environment of other product groups in the sector.

To estimate the possible effect of economic integration within the EAEU, one must consider commodities that are not promising in terms of comparative advantage for any of the EAEU countries individually, but are nonetheless promising for the EAEU as a consolidated participant in global trade. According to our calculations, most often such goods belong to the chemical industry (22 products), other products (13 products), as well as machinery and engineering (12 items). Most of these products (62 out of 78) have greater economic complexity than that of the current EAEU export basket, so one can assume that their export growth will improve the overall export structure of the EAEU countries.

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