

## **Academic Conference “Towards the Vision of a Common Economic Space from Vancouver to Vladivostok: Connectivity, Trade and Economic Cooperation”, Linz, 15-16 May 2017**

### **Background Note by Peter Havlik and Michael Landesmann (WIIW)**

This conference on “Connectivity, Trade and Economic Cooperation” which spans a wide geographic space is already the third event in a series of academic conferences jointly organized with the Austrian, German and Swiss ministries of foreign affairs in the framework of their OSCE engagements. The Vienna Institute for International Economic Studies (WIIW) has been involved from the very beginning in drafting the academic programs and providing logistic support for these events.

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The first conference which explored the concept of ‘economic connectivity’ and the role which the OSCE could play within its mandate took place nearly one year ago (Vienna, 1 July 2016). It dealt with economic connectivity in European conflict regions, particularly those in the EU and Russian neighbourhood. Some of these conflicts last now for nearly three decades and have been nearly forgotten, being essentially ‘frozen’ while others have been suffering from recurring outbursts of violence, or even frequent military infighting. In all these conflict contexts the associated economic costs and human suffering have been substantial. The workshop explored the differentiated nature of these conflict contexts and the ways how economic connectivity via trade, cross-border infrastructure, utility provision, energy transit and access to social infrastructure such as health, pensions and mobility could help to mitigate associated costs. There have been neither clear answers nor ready-made solutions available how to deal with different conflicts within the OSCE area. Since all these conflicts are related to the break-up of the Soviet Union and the subsequent extension of the ‘West’, the reorganization of the European space and at least ‘unfreezing’ of the conflicts will not be possible without a constructive dialogue between the EU and Russia which both have a special responsibility in enhancing economic connectivity.

The second conference (Vienna, 15-16 December 2016) dealt with **connectivity in Central Asia** (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan). Again, the various dimensions of economic connectivity such as trade, energy, transport, migration, border controls and environmental issues were discussed by both academic experts from the region as well as high level representatives from international organizations and diplomats involved in the region. Although there is currently no open conflict in this vast, land-locked and complex region, the degree of economic connectivity is low and the region remains underdeveloped and fragmented. Central Asia has an important geo-strategic position for both the EU, Russia and China. However, its economic connectivity is hampered also by

the security situation in Afghanistan. The region will play an important role in a broader EU-EAEU-China economic cooperation along the Silk Road which could help to develop economic connectivity in Central Asia as well. However, the obstacles are significant: widespread corruption, diverging regulations, outward migration and deteriorating skills of the local labour force, distorted economic structures, etc. Once again, without a coordinated strategy of major external players (EU, Russia and China) the prospects for enhancing connectivity in Central Asia are not very encouraging.

The **Linz conference** (Linz, 15-16 May 2017) will broaden the exploration of connectivity, trade and economic cooperation in both geographic and thematic areas. The conference will discuss the vision of a '**Common Economic Space from Vancouver to Vladivostok**', thus covering all parties in the original OSCE process and, besides trade and other economic cooperation connectivity issues, adding also aspects of environment, infrastructure, innovation and digitalisation.

What are the stakes? More than 40 years after the adoption of the OSCE Final Act in Helsinki, Eurasia – that is Europe and Asia - is again facing formidable security and cooperation challenges. Following the deep economic and financial crisis, the Brexit referendum and the refugee influx, the EU is confronted with a multi-layered crisis. Relations between the EU and Russia are at their lowest point since the end of the Cold War, possibly even worse than they used to be in 1975 when the Helsinki Final Act was adopted. There was no 'hot war' at that time. Moreover, the transatlantic partnership between Europe and the USA has also been exposed to unprecedented tensions recently. The European and Eurasian economies are slowly recovering from the crisis; both are facing unprecedented demographic, labour market and environmental challenges. In this situation, the thematic focus of the Linz Academic Conference – exploring the 'Vision of a Common Economic Space from Vancouver to Vladivostok' – has an utmost urgency and practical relevance.

The Conference will explore various political, institutional, economic and practical challenges and opportunities for connectivity, trade and economic cooperation on the Eurasian continent as well as taking in the wider international context. The panellists and speakers will present their views on the subject, providing insights from varying country-specific and thematic perspectives and experiences. The speakers will act in their personal capacity, not necessarily reflecting positions of countries or institutions which they represent. In this way, not only different views will be presented, but also a better mutual understanding of diverging positions can be reached and proposals towards the Common Vision elaborated.

The **Opening Panel** on 15<sup>th</sup> May will present views on the Common Economic Space as seen from the perspective of Austrian OSCE Chairmanship, the European Union, Russia, Ukraine and the USA. Forward-looking visions of the Common Economic Space from the business and scientific community will be presented as well.

We ask the speakers to present their experiences regarding existing obstacles to connectivity in the current geo-political and economic context and to outline their views regarding the feasibility, prospects and possible approaches to the establishment of a Common Economic Space from Vancouver to Vladivostok.

The **Session 1** will deal with **trade and economic connectivity: prospects and challenges for economic cooperation between the EU and EAEU**, providing alternative views from the EU, Russia and Ukraine regarding ways and prospects for overcoming economic barriers in the OSCE area.

From **Peter Balas'** point of view – who has been a high ranking EU trade negotiator - there are a number of additional obstacles: The EU side considers that in particular Russia's (and to a much lesser extent, other EAEU members') present policies are in contradiction with the rules and

obligations Russia has undertaken on behalf of the whole EAEU. Thus, irrespective of the political conditions these policies should move back towards multilaterally accepted rules and norms to see improvement in economic and trade relations. Goals are different, and sometimes in conflict between the two sides. The EU expects qualitative improvement in the business-investment environment, more liberal economic-trade policies, lessening of the state's role and influence on economic decisions. But Russia is more interested in just stopping mutual sanctions and having again access to EU financial resources, technology, and a bigger influence on the EU's energy market. According to Peter Balas, at the present stage Russia clearly refuses economic-trade liberalization.

It is clear that solving these major contradictions can happen only gradually, in small steps, involving technical work among experts. In this respect the IIASA's<sup>1</sup> Eurasian Futures Project and its planned next phase intends to show how such gradual re-engagement could happen, what steps could be taken by both sides.

The idea of a Common Economic Space seems at present to be distant. But, in fact, there is no reasonable alternative according to **Ruslan Grinberg**, the Research Director of the Institute of Economics of the Russian Academy of Sciences in Moscow. In this century, the US and China will determine an agenda both in politics and the economy. Russia and the EU may become adequate players, provided they perform jointly. Mutual trust is currently at a very low level but it will hopefully be restored when/if the current conflict can be resolved. If this happens complex issues will emerge about the formation of the Common Economic Space. A coordination of the rules of economic interactions of both regional blocs will be necessary in the format of a free trade zone. Economic cooperation between the EU and the Eurasian Union should become a reality in the interests of the citizens of the countries involved.

Ukraine faced a sharp change in the configuration of trade barriers within the region. On the one hand, there was the launch of the AA/DCFTA liberalized trade between Ukraine and the EU. On the other, economic relations with Russia are at their lowest level for many years. Barriers were exerted not only in trade between Ukraine and Russia, but also in trade with Central Asia countries. Is it possible to overcome these newly emerged barriers? According to **Veronika Movchan**, the Academic Director of the Institute for Economic Research and Policy Consulting in Kyiv, Ukraine, in the short-term only a very partial solution could be aimed at as the introduction of barriers were mostly for political reasons, and thus the solution depends largely on political, rather than economic policy decisions.

In this situation, the WTO plays the crucial role in limiting the further extension of trade restrictions. For instance, the WTO dispute settlement mechanism could help to remove transit limitations introduced by Russia. Also, the bound MFN rates make tariff levels predictable. The launch of the WTO Trade Facilitation Agreement could further help to reduce uncertainties related to moving goods across borders.

The role of the WTO and the challenges the world trading system is currently facing are outlined by **Gabrielle Marceau**, Senior Counsellor in Legal Affairs at the WTO and Professor at the University of Geneva: Non-respect of the rules; Non-compliance with the dispute settlement body (DSB) conclusions; Bilateral agreements that ignore the multilateral functions; The image of the WTO after 16 years of inconclusive Doha Round negotiations; The lack of and even interest in leadership, etc.

Regarding the European-Eurasian context, not all countries that the OSCE covers are members of the WTO. Azerbaijan, Belarus, Bosnia and Herzegovina, Serbia, Turkmenistan and Uzbekistan are missing. These countries have applied for accession, some of them already in the early 1990s with

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<sup>1</sup> IIASA stands for the International Institute for Applied Systems Analysis which is located in Laxenburg, Austria.

different levels of activity regarding negotiations over the years. And there are two countries (Turkmenistan and Uzbekistan), that have not yet filed a formal application for membership.

However, one should emphasise that accession often triggers the most fundamental reform process. WTO membership stands for transparency, for predictability and for legal certainty. The dispute settlement system offers Members the possibility to resolve their trade disputes initially through consultations and eventually by way of litigation. It is the stronghold against trade wars.

Yet trade does not exist in a political vacuum. As stressed by **Alexander Mattelaer**, Director of European Affairs at the Royal Institute for International Relations in Brussels, it is no coincidence that high density of trade links geographically overlaps with dense networks of political institutions. The key element is arguably the existence of the rule of law, as it allows businesses and customers to have confidence in contracts, have access to neutral arbitration mechanisms etc. The EU has pursued FTAs with many parts of the world, in its immediate neighbourhood as well as beyond. And there has been quite a bit of misunderstanding about this, especially in the case of the Ukraine dispute.

With Brexit, we see what unravelling the EU means: uncertainty over future trade, the possibility of reinstating custom controls, a risk of regulatory divergence etc. These are all negative elements, with fear of economic stress and chaos as a result. If one wants to overcome barriers, one needs to invent new mechanisms. The recipe should not be 'take it or leave it'; new mechanisms can be invented and proposed, even if that is never easy, and in many respects Brexit is an opportunity for doing so.

**Session 2** will cover additional **challenges of connectivity, especially those emanating from conflict contexts** ('hot' and 'frozen' ones), analysing potential channels of economic cooperation, such as maintaining and developing business links, allowing cross-border mobility of persons and reconstructing other linkages, such as utilities and environmental cooperation.

During the last couple of years, the Challenges of Eurasian Economic Integration have been explored at IIASA and Professor **Pavel Kabat**, Director-General of the International Institute for Applied Systems Analysis (IIASA), will report on this work. A major advantage of IIASA's work is that it is neutral as shown by continued joint work of EU and Russian/EAEU representatives under very unfavourable political circumstances. Still, political conditions, while falling outside of research work, greatly influence the overall relationship, including conditions and possibilities of cooperation in the economic-trade area. The focus of IIASA's Phase II Eurasian project are economic cooperation, and potentially integration, in the region, creating conditions for making progress towards the Lisbon-to-Vladivostok Economic Space idea. The research has shown while there is overall agreement that economically all sides lose from the present situation, major differences exist between EU and Russia/EAEU about the assessment, underlying reasons, and necessary steps to achieve a gradual improvement.

The case of the connectivity experiences in Moldova-Transnistrian Region will be discussed by **Ricardo Giucci** from Berlin Economics, Germany, who will also address the question whether this model can be used for conflict resolution in other areas. Currently Transnistrian goods are exported duty-free to the EU in the context of the EU-Moldova DCFTA. This is important for the Transnistrian economy, but also promotes a dialogue between the two conflicting sides. Keeping duty-free access to the EU requires, however, the implementation of measures and Berlin Economics, running a project financed by the German Foreign Office, supports the implementation process of the DCFTA in Transnistria, involving decision-makers on both sides. The example of Transnistria thus shows a positive experience of economic cooperation in conflict contexts, but also the positive role the international community (in this case the EU) can play.

Ricardo Giucci will also discuss the impact of the breakdown of economic connectivity in the case of the linkages between the Ukraine and the 'non-controlled territories' (NCT). Despite the conflict, trade was going on until recently between the two sides. However, recently it came to a stop of trade, following the seizure of assets ('nationalisation') in NCT. Berlin Economics evaluated quantitatively the impact of this break-down of economic connectivity both for the NCT and the Ukraine.

Economic connectivity has, as Professor **Kataryna Wolczuk** from the University of Birmingham, United Kingdom, will elaborate, a dual functionality: (i) improve welfare in the conflict contexts and alleviate humanitarian suffering and (ii) contribute to conflict resolution. Frozen or active conflicts have very different dynamics so no 'one-size-fits-all' solution is available. What is feasible and attractive can only be worked out on a case-by-case basis. Different strategies can be worked out on the basis of thorough empirical analysis.

An example of attempted connectivity represents the recently concluded EU AA/DCFTA agreements with Georgia, Moldova and Ukraine. **Peter Havlik** from the WIIW and IIASA, Austria, will report on a recent study evaluating the costs and benefits of DCFTA implementation in these three countries. Due to the very recent first phase of implementation time is too short to evaluate DCFTA impact; the results so far have been mixed. There is an uneven distribution of costs and (potential) benefits (short vs medium and long term) for DCFTA signatory states. Some barriers to trade, particularly tariff-rate quotas, as well as TBT and SPS hindering exports from DCFTA countries, remain. For the EU implications are mainly geopolitical and economic effects are minimal. Policy recommendations related to a 'success' of DCFTA implementation address background conditions (including a resolution of 'frozen' conflicts), the reform sequencing and increased EU assistance while maintaining strict conditionality.

Finally, we shall also hear in this session **Nenad Djurdjevic** from the Chamber of Commerce and Industry of Serbia, on conflict resolution attempts and experiences in the Western Balkans. In particular, he will inform on the latest developments in the trade facilitation initiatives of trade chambers from Serbia and Kosovo as well as on the remaining open issues. Since 2013, numerous technical level expert meetings and activities on connecting business communities have contributed to a recent increase in mutual trade exchanges.

**Session 3** will address specific aspects of **trade facilitation, economic impacts of trade integration in Wider Eurasia**, as well as the effects of regional integration arrangements, covering specifically transport and other infrastructure bottlenecks. Professor **Gabriel Felbermayr** from the Ifo Centre for International Economics in Munich, Germany, will present results from the recent study 'Free Trade from Lisbon to Vladivostok' that estimated economic effects of a free trade zone between the EU and EAEU. The study shows that there are considerable economic benefits from a more intensive EU-EAEU (+CIS) cooperation. Although tariffs still play a role in trade relations, non-tariff barriers dominate. In another study, Ifo examined the Trade Facilitation Agreement of the WTO and this study showed the role of infrastructure as a central element in reaping the welfare benefits from trade. Finally, Felbermayr will discuss the role of the countries of the Eurasian Union as a transit region for economic linkages between the EU and China and which chances and risks could result from this.

**Philipp Isler** is Director of the Global Alliance for Trade Facilitation (based at the World Economic Forum in Geneva) and has twenty years of experience in the implementation of trade facilitation projects by the private sector in developing countries around the world. He will report on the evolution of technology in international supply chains with a particular focus on latest developments. Philipp Isler while working in Africa had developed programmes that aimed at the computerisation of Customs and port operations. He developed expertise in the computerisation of supply chains, traceability programmes and the use of analytics and of big data for trade facilitation. He will report on these

programmes as well as discuss the most interesting points from the 2016 WEF Global Enabling Trade Report, and give an outlook on future developments.

**Susanne Aigner**, Head of the Unit Customs Legislation at the European Commission, Brussels (in charge of general legislation in customs matters including transit and the Common Transit Convention), will report on EU customs cooperation with countries like Russia, Ukraine, Belarus, Serbia, China, Switzerland and Turkey. These are at various stages, like the EU-China Smart and Secure Trade Lanes project or the cooperation with Russia on 'green corridors'. She will discuss the EU approach on transit including cooperation with other transit systems in the region and the Common Transit Convention (that comprises EFTA countries, but also Serbia and Turkey). Ms. Aigner will also report on EU policy on rail, in particular transit.

**Dita Nowicka**, the Director of the OSCE Border Management Staff College, located in Dushanbe, Tajikistan, will first discuss the activities of the Border Management Staff College. The College aims to strengthen economic ties between Europe and Asia through the training of mid and senior officials of border management agencies, and strengthening the Customs Administration of Central Asia (through training partnerships with European countries). The Border Management is a forum for exchange of information between government and private sector representatives (OSCE BMSC cooperation with UNECE) focussing on trade and transport facilitation.

From a business perspective, **Uwe Leuschner**, Senior Vice President of DB (Deutsche Bahn) Cargo AG responsible for business development Eurasia as well as General Manager of DB Cargo Russia in Moscow, will report DB Cargo activities in Eurasia. He will discuss the challenges facing infrastructure connectivity with the example of railways connections thereby drawing on the experience of DB Cargo in Eurasia: Economic and political constraints to EU-Russia trade; Cooperation with other EAEU partners and China, Competition between road and rail transport in Eurasia; Technical barriers and capacity/efficiency constraints in EU-China rail connections.

Finally, **Session 4** will deal with important **new technological developments that affect global patterns of technological competition**, but which can also contribute to overcome economic barriers. It will focus particularly on digitalization, IT and related innovations, and look at these technological developments within the specific institutional and policy contexts of the USA, the EU, Russia and China. How will these developments affect the relationships between the major powers within the wider geo-strategic but also more regionally confined contexts?

Professor **Alois Ferscha**, Chairman of the Institute for Pervasive Computing at the Johannes Kepler University in Linz, Austria, will discuss the concept of 'key enabling technologies' and its relevance for 'smart' economic growth. He will refer to the co-evolution of the explosive increase in processing power and in data, as well as the inroads made in the evolution of artificial intelligence and the early signs of cognitive systems currently in development. Professor Ferscha has a vast background in development activities of information, communication and navigation systems, both within academia but also interfacing with businesses (e.g. Siemens).

**Hannes Leo**, Director of Community based Innovation Systems GmbH, Austria, sees digital technologies not only seen as another bunch of generic technologies that create technological opportunities for products and services innovations but also as a disruptive force that strongly impacts on (national and international) security issues, the working of political systems and the long-term evolution of economic systems. Thus, it has led to a segmentation of ecosystems along the dominant power blocks: US platforms dominate all countries that applied a laissez-faire approach while China and Russia build their own ecosystems. In Europe, US dominance is increasingly seen as a major challenge. However, despite these different ecosystems, the base technologies, services and products

are largely compatible and help to eliminate physical separation and skip borders easily. It is no longer astonishing to see workers, technicians and scientists from across the globe join forces, e.g. bringing together the email list builder from Bangladesh with the copywriter in Berlin, the server specialist in New York, and the programmers in Belarus. This likewise applies to the formation of value chains or the spread of counterfeited products. Globalisation, which was exclusive to large companies, has now arrived at the individual level.

**Bettina Vogl-Lang** is Vice-Chair of the Europe Chapter of the World Customs Organisation and is Director of Customs at the Austrian Ministry of Finance, Vienna. This function includes the international cooperation within the European Customs Union and worldwide in Customs. She initiated projects exploring the possibility of a Compatible Electronic Transit system for the European Region. Customs administration plays a vital role in international trade by facilitating trade and determining the speed of customs procedures. An understanding of trade hindrances and of the potential for trade involves a careful examination of barriers to trade such as tariff and non-tariff measures, embargos or prohibitions and restrictions, government regulations and market protection. Ms. Vogl-Lang argues that digitalisation and innovation plays a very important role to overcome barriers and further economic growth: "Digitalisation and innovation are essential parts to create an investment economic friendly environment. The fast cross border exchange of data, service oriented applications, high speed internet connections and state of the art infrastructure are big economic triggers. The reactivation of the silk road by high speed trains, in future perhaps by hyperloop technologies, will create new transport methods ...Self-driving cars, self-ordering machines and 3D printing will create new challenges. At the end intellectual property will probably count more than production."

**Agnes Streissler-Führer**, Member of the Executive Board of the Austrian Union of Private Sector employees and responsible for innovation management and digitisation, works on policies addressing the changes caused by digitalisation, for firms and workers alike. On the one hand, it is a dramatic phase in terms of technological change, on the other hand, it is a rationale for fundamentally new business models. Ms. Streissler-Führer is particularly interested in the implication for the work environment and the quantity and quality of work. There are good reasons why there is a need for rules, a structuring framework for the labour market and a pro-active management of the expected changes on all levels of economy and society.

One has to distinguish between digitisation as technological change and digitisation as rationale for new business models. Technology can overcome physical barriers, but there are good reasons why there is the need for rules and a structuring framework for the labour market and working environment. It is not so much the quantity than the quality of work which is at risk. Digitisation is a massive change process – in firms and in the economy. This calls for proactive change management on all levels of economy and society.

**Klaus Steinmaurer**, Vice President International Regulatory Affairs at Deutsche Telekom, Germany, is responsible for developing and implementing Deutsche Telekom's public and regulatory affairs strategy vis-à-vis governments, regulatory authorities (both at national and EU levels) and other stakeholders. He worked as a lawyer for over 20 years in the Telecommunication Industry and was strongly involved in developments in the Balkan region. He writes: "Having a lot to do in the Balkan Region I got the feeling that digitalization is an extraordinary chance for this part of Europe to catch-up to the rest of the continent soon and successfully if there is a strong political will to do so. The awareness and the basic preconditions are already there in most of the countries of the region, the question is, how to bundle all forces to stem the upcoming challenges. To overcome the still existing economic barriers by new technologies and innovation means for the Balkan region to develop and align a cross border digital market strategy and agree on a common legal and regulatory framework to attract investors for the necessary infrastructure investments. It will be such investments that will pave

the way for future innovation and growth in the region. Digitalization means collaboration and is therefore a chance but also a challenge for the responsible political stakeholder in the region and in the EU.”

The **Closing High Level Panel** should provide guidelines how to overcome the current political and economic obstacles to connectivity, expanding trade and economic cooperation, how to move from the current confrontational to a more cooperative stance among the individual players involved. Indeed, deliberations at the Linz Conference should provide valuable inputs to shaping the Vision of a Common Economic Space from Vancouver to Vladivostok.