SAINT PETERSBURG STATE UNIVERSITY

Elena Kašťáková
Kristína Drieniková
Ľubica Zubaľová

IMPACT OF THE GEOPOLITICAL CHANGES ON THE EU FOREIGN TRADE RELATIONS WITH SELECTED TERRITORIES

IMPLICATIONS FOR THE SLOVAK ECONOMY

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Authors: *Elena Kašťáková, Kristína Drieniková, Ľubica Zubaľová*

Reviewers: *T.M. Isachenko*, Ph.D. (Economics), prof.
(MGIMO University, Moscow);
P. Baláž, Ph.D. (Economics), prof.
(University of Economics, Bratislava)

Science editor: *S.F. Sutyrin*, Ph.D. (Economics), prof. (Saint Petersburg State University, St. Petersburg)

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The current geopolitical changes taking place in the world economy exert great influence on the EU (and Slovakia's) foreign trade relations. This monograph examines the impact of geopolitical changes on the EU foreign trade relations with the countries of the Western Balkans, Ukraine, Russia and Kazakhstan, assesses the impact of the mutual EU and Russia sanctions on the EU foreign trade with the countries selected, and points out the potential for development of Slovakia's foreign trade relations with these countries. The uniqueness of this monograph lies in the primacy and complexity of the EU foreign trade relations with the countries under consideration and the impact of the mutual EU and Russia sanctions on the EU and Slovakia's foreign trade with Russia. The outcomes of the conducted research can be of great use to business and government institutions, as well as to European institutions and organizations, teachers, scientists or R&D agencies and others.

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In memory of Professor Peter Baláž,
long-term Head of the Department of
International Trade and
the reviewer of this monograph.

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Introduction

A decisive factor in the current global economy is an increasingly active interference of the globalization processes that are directly or indirectly present in almost all types of economic activities. The development of the world economy over the past three decades has led to significant qualitative changes, the intensity of which is increasing today. This phenomenon also applies to the development of foreign trade relations between Slovakia and Russia.

The current geopolitical situation is characterized by a high volatility. There are significant and often unexpected changes that affect the players involved in international trade in a globalized economy. The EU, as one of the most important integration groupings in the world, has a significant impact on the enforcement of its foreign trade interests, but their implementation is difficult because of the changing geopolitical situation.

These changes are also strongly reflected in the Slovak economy which is characterized by a high degree of openness. The need to increase the external competitiveness of countries is therefore pressing. In the Slovak economy foreign trade has a significant position as it contributes a lot to the economic growth of the country, the gross domestic product, and at the same time it forms a substantial part of the foreign exchange reserves of the state.

The economic recession in Russia, the rouble devaluation, the state support of domestic producers, the introduction of phytosanitary measures for food imports, especially from the EU countries, have limited the export of goods to this market from the EU countries, which has also influenced Slovak enterprises. At the same time, the current stabilization of world oil production and its prices on world markets is influencing Slovakia's foreign trade relations with third countries. An important role in the development of trade and economic relations between Slovakia and Russia is played by interregional cooperation. Such mutual relations are of great importance in mutual Slovak-Russian foreign trade cooperation.

The Russian-Ukrainian crisis, which occurred at the end of 2013, significantly affects Slovakia's foreign trade relations with Russia. The EU, the US and other Western countries began to apply trade sanctions against Russia, and Russia introduced anti-sanction measures as well. The solution to such a situation is still out of the question, and the reciprocal application of sanctions damages bilateral foreign trade and economies of the players involved.

The current evolution of external economic relations strongly affected the development of the EU foreign trade policy and its negative impact on Slovakia's foreign and investment relations with Ukraine and led to the destabilization in the region of Ukraine. These attributes respond to the development of the global economy that has a significant impact on both the developed and developing economies to which Ukraine belongs. These geopolitical risks and the war conflict which is Ukraine facing, pose an important threat to the recovery not only of the Ukrainian but also of the world economy. A very significant impact of these impacts is low direct foreign investment and rising unemployment causing a wave of migration. These phenomena have resulted in poverty and excessive indebtedness, as well as worsening of the regional and global security in Ukraine.

The eastern European region itself is very important for the EU's foreign trade relations and for Slovakia as such. Natural wealth and a large unsaturated market represent great potential for foreign trade of the Slovak Republic. Slovakia's foreign trade relations with Ukraine and other Eastern European and Central Asian countries will depend on the development of the EU's strategic foreign trade and integration tendencies, but above all on the resolution and the end of the Russian-Ukrainian conflict in Eastern Europe.

On the other hand, the Western Balkans also plays an important role in the strategic development goals of the EU's foreign trade relations. After years of hesitation, the EU launched the Stabilization and Association Process in 1999 offering the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, North Macedonia, Montenegro, Serbia and Kosovo. Slovenia is considered a central European country, though it was a part of Yugoslavia until 1991, therefore, it did not take part in the process aimed at stabilisation and recovery of the post conflict countries of the former Yugoslavia plus Albania) a framework for promoting peace, stability and economic development with possibility to access the EU in the future. The Stabilization and Association Process specified political and economic targets and instruments for their achievement. The foreign trade policy is conducted by bilateral stabilization and association agreements creating a free trade area, financial instruments for pre-accession assistance (IPA) providing with financial help, political dialogue, visa liberalization and regional cooperation. Since 2016 the bilateral agreements with the Western Balkans have been in force, and a visa free regime is provided for citizens from Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. The promise of the EU membership was a powerful tool for launching reforms, but after enabling East-European countries to join the EU in 2004, the enlargement fatigue uncovered the EU's inability to accept new members in the near future. Since 1999 of the Western Balkan countries only Croatia has entered the EU. Slow reforms, both political and economic, corruption, weak institutions and rule of law, political tensions — all these slowed the enlargement process, distorted confidence, and weakened the EU position in the region. The EU is still the largest trade partner, investor and donor to the Western Balkans but positions of other players are strengthening.

The EU monitors growth of trade and investment activities of Russia (in Montenegro and Serbia), China and Turkey (in Albania, Bosnia and Herzegovina and Kosovo) and Saudi Arabia (in Albania, Bosnia and Herzegovina and Kosovo). Russia's influence is notable in the energy sector in Serbia, Macedonia and Bosnia and Herzegovina covering almost 100% of their gas demand. Remarkable are investments in Montenegro and political and economic connection with Serbia confirmed by the free trade agreement. Trade with Turkey is growing, and Ankara has launched trilateral consultation mechanism between Turkey, Bosnia and Herzegovina and Serbia to discuss investments and common projects, including an interconnecting highway. Until now, activities of Turkey were in line with the EU strategy, but recently, when the likelihood of Turkey's joining the EU is low, the strategy has become different and is potentially disruptive. China included the Western Balkans (with exception of Kosovo, China did not recognize Kosovo independence) into the 16+1 cooperation platform and the Belt and Road initiative that presupposes infrastructure building for facilitating the movement of Chinese goods from south to north Europe. Chinese projects could undermine European agenda on reforms — Chinese development aid and cooperation project does not contain conditionality.

The EU popularity varies among the Western Balkans and it is clear that the promise of future membership is not satisfactory. Therefore, in February 2018, the EU adopted a renewed strategy: «A credible enlargement perspective for the enhanced EU engagement with the Western Balkans» with increased budget and priorities.

At present, Kazakhstan and the entire region of Central Asia play an important role in the current geopolitical relations of Russia, China, the

EU and other regional players such as Iran. For China, Kazakhstan is particularly interesting because of its rich oil and gas supplies and as a transit country through which goods from China pass through a project of the New Silk Road heading to the Middle East and the EU. Russia is striving to strengthen its political and economic influence in the country. For the EU, Kazakhstan is an important importer of energetic materials, but it also is a country that ensures safety and stability in the region. Iran focuses on economic cooperation and offers its territory as a transit territory for oil transport to Turkey and the EU.

The EU and Kazakhstan have established a close economic and trade partnership since the independence of Kazakhstan. The cooperation between the EU and Kazakhstan is developing not only in field of trade, but in the last years it covers political, cultural or technical cooperation too. Such cooperation is also of great importance to the Slovak economy, as Kazakhstan is one of the most important business partners of the SR among Central Asian countries.

The objective of this scientific monograph is to examine the impact of geopolitical changes on the EU's foreign trade relations with the countries of the Western Balkans, Ukraine, Russia and Kazakhstan, evaluate the impact of EU-Russia trade sanctions on EU foreign trade with selected countries, and point out plausible potential for mutual development of foreign trade relations of the Slovak Republic with these countries.

To achieve the goals set for the scientific monograph, several theoretical methods were used, including abstraction, analysis, synthesis, deduction, and induction methods, but also a comparative method for country comparisons and graphical illustrations. The empirical calculations of Complementarity Index and Trade Intensity Index, Intra-industry Trade, Revealed Comparative Advantages, as well as correlation and regression analyses play an important role in the evaluation of the results of the research. A Linear Regression Model was used in the forecast of the development of mutual Slovak-Russian foreign trade. The main sources of research were the statistical databases of the EU, Slovakia, but also the UNCTAD, WTO, OECD, World Bank databases that provided data used for the research of the foreign trade relations of the countries surveyed. The foreign trade commodity structure of the countries surveyed was classified according to Harmonized System and SITC nomenclature and several statistics of international organizations. The authors also made use of the materials presented in scientific monographs both domestic and foreign, in foreign scientific journals registered in the Web of Sciences and SCOPUS databases and other publications from the domestic and foreign academic sphere.

1
IMPACT OF THE GEOPOLITICAL CHANGES ON ENFORCEMENT OF THE EU STRATEGIC FOREIGN TRADE INTERESTS WITH FOCUS ON SLOVAKIA

The current state of the international business environment is the result of long-term effects of several factors that have brought about immense changes that are unprecedented in the history of mankind. Increasing liberalization of international trade combined with the development of international division of labour, the impact of transnational corporations, growing interdependence and the integration of economies, advancing science and technology, and the need for cooperation and synergy or threat of global problems have been fundamental determinants of social, economic and political development of entities operating in the global economy [Baláž, 2010]. The previous decades could be characterized as a period of relative security, prosperity and economic growth where the principles of globalization predestined international success. Globalization tendencies in recent decades have yielded undeniable benefits in the advanced market economies of the Western world but have also brought new opportunities for countries that have not yet had a developed market economy. Typical examples are the countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Slovakia) or the Baltic countries (Estonia, Latvia, Lithuania). After the breakup of the USSR, they have been able to integrate into European structures after the initial problems associated with the transformation of the economies and currently belong to relatively developed world economies and are fully integrated into the global economy.

However, in recent years we can observe an increasing incidence of events which undermine the globalization tendencies themselves and have a significant impact on the development of the world economy. Among the most apparent ones, we can mention increasing tensions on the Korean Peninsula, the South Caucasus disputes, instability of the Middle East countries, but also ceaseless threat of terrorist attacks, environmental problems, or an increase in extremism in individual countries. Even on the basis of a brief overview of current global issues, it can be said that the imaginative degree of perceived risk and uncertainty has been rising in recent years. As a result of the already mentioned tight linking of economies operating in a globalized economic environment, each negative impulse will be reflected in statistical indicators of the international, foreign trade, which we observe also in Slovakia's foreign trade with its trading partners.

1.1 Geopolitical changes affecting the EU foreign trade relations

The current geopolitical situation is characterized by a high volatility. There are significant and often unexpected changes that affect the subjects involved in international trade in a globalized economy. The European Union, as one of the most important integration groupings in the world, has a significant impact on promotion of its foreign trade interests, but their implementation is difficult because of the changing geopolitical situation. These interests are named in the document adopted by the European Commission in 2015 on the EU’s trade and investment strategy [European Commission, 2015]. The EU is cooperating within the Eastern Partnership Initiative with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. The EU aims to conclude deepened and comprehensive Free Trade Agreements (DCFTAs) with these countries. On the other hand, efforts are being made in this region to integrate Russia in the Eurasian Economic Union. These changes are also strongly reflected in the Slovak economy, which is characterized by a high degree of openness. The need to increase external competitiveness of countries is, therefore, quite significant.

The issue which is currently affecting the economic and political situation in the EU and the Slovak Republic is the Ukrainian crisis that broke out at the end of 2013. This crisis has also contributed to a significant deterioration of relations between the EU and Russia. The EU, the US and other western countries began to impose economic sanctions against Russia, and Russia has subsequently introduced anti-sanctions. It is difficult to find a solution to this situation, and the reciprocal application of sanctions negatively influences trade relations and the economy of these global players.

The region of Eastern Europe is very important for the EU’s foreign trade relations. In 2018 Russia was one of the EU’s most important trading partners with a share of 6.4%. Russia’s share in EU exports was 4.4% and in imports it was 8.5%. Russia’s share in Slovakia’s foreign trade in the same period was 3.5%. After China, Russia was trading its most important trading partners outside the EU. Natural resources and a large, unsaturated market represent a great potential for foreign trade of the EU and the Slovak Republic. EU relations with Ukraine and with Russia will depend on the development of integration tendencies but, above all, on the resolution of the Ukrainian conflict.

Geostrategic position and natural resources characterize the importance of the region of Central Asia. In addition, the EU is an economic bridge to China. The importance of the Central Asian region will increase because of the construction of the New Silk Road project as a strategy for developing cooperation between the EU and Asia (China).

The EU's foreign trade cooperation with third countries in the future may also be influenced by the EU–US Trade and Investment Agreement (TTIP). Discussions about this agreement are currently frozen, but the conclusion of TTIP would mean in practice the creation of the largest free trade area in the world. The removal of tariff and non-tariff barriers to trade will have a positive impact on the growth of EU and US GDP and will also create a number of new export opportunities for these global players from which high-open countries such as Slovakia can benefit.

The influence of third countries on the EU's and Slovak Republic's foreign trade interests is seen mainly in the case of China. China as the world's largest exporter is one of the EU's main trading partners. China's investment in Western and Central Europe has reached the highest levels in recent years, which creates a potential also for Slovakia. The importance of the Chinese economy for the world economy is indisputable — the implications of the current slowdown in China's economic growth are reflected in the slowdown in the global economy.

The EU is an important element in the global system. The impact of the external environment, therefore, plays an important role in its direction. For both the EU and the Slovak Republic it is, therefore, very important to be flexible to incoming changes and to take steps that will lead to sustainable growth of their economies.

Globalization is a phenomenon that affects every active player in the world economy. It is connected with mutual rapprochement and common orientation of the national and economic individualities of individual sovereign states. Globalization and involvement of individual actors in it brings deepening liberalization of international trade, intensification of cooperation, growth of world wealth and technological advancement of society. Globalization is linked to a series of positives, negatives, opportunities and risks that, however, can only be related to the complexity and enormity of this phenomenon. As a result of globalization trends in the world economy, it is necessary for individual countries to engage in the International division of labour. The decisive factor influencing the development of international trade is its direct interaction with the development of the global economic environment. The involvement of countries in international economic groupings is very important for them today, the smaller the size of the country, the greater the need for engaging in international trade (Baláž, 2010). The importance of engaging countries in international trade is a direct axiom in today's globalized world.

In recent years we can observe the existence of occurrences which affect globalization tendencies and have a significant impact on the development of the world economy. At the same time, there are events that negatively affect the principles of democratic functioning of developed market economies, and, in many cases, we are witnessing violations of international and human rights. The global economic crisis, the collapse of economic growth in China, the debt of South American countries, the cumulation of the financial and economic problems of the EU and its Member States, the increase in protectionism in international trade or uncertainty about the further economic growth of developed market economies are among the worst economic problems. World economic players are currently confronted with other urgent problems. The migration crisis, the conflict in Syria, war against the Islamic state, global threats of terrorist attacks, and the South China Sea dispute are also the issues of potential global influence. We cannot ignore the challenges of a climate change and the rise and existence of extremism. The potential of these problems forces individual countries to take measures that consist in a combination of rationalization, compromises and preservation of the principles of democracy. However, it is not always possible to combine these needs efficiently, which is reflected in increasing discrepancy in bilateral and multilateral political, trade or diplomatic relations.

In recent years, there has been a conflict in the European continent the outcomes of which may be somewhat similar to the Cold War. In 2013 protests in Ukraine broke out aiming to decide on the future character and direction of the country's development. After Russia's involvement in this conflict, the crisis acquired an international character. Western states, headed by the EU and the US, condemned the conduct of Russia and described it as illegal. In order to force Russia to withdraw from its position towards Ukraine, the Western states began to apply trade sanctions against Russia. Russia decided to apply countersanctions. The consequences of the ongoing sanction war lie not only in the weakening of international trade, but also in an atmosphere in the relations between Russia and the West which is similar to that of the Cold War period — an atmosphere of uncertainty, political tension and suspicion.

The European Union today faces several acute problems at the same time. The result of the Brexit referendum by which the UK decided to step out of the EU has the potential to strengthen similar tendencies in the other member states. It is important to mention also the negative implications for the EU economy. The migration crisis, indebtedness of some states, or the possible trade war with China are currently the most pressing problems which the EU is facing. Their existence has made the conflict between Russia and Ukraine less important. The conflict in Ukraine not only has far-reaching consequences for Ukraine and Russia, but also it potentially endangers the fragile recovery of economic growth in the EU. The sanctions applied by the EU and Russia's anti-sanctions in the form of a prohibition on imports of agri-food products are not just symbolic. The period of positive development of relations between the West and Russia seems to have been over for a few years to come. These and other limitations harm the stable foreign trade relations between the EU and Russia, resulting in damage of the economies of the participating countries. Slovakia as a member of the EU is a direct, though involuntary, participant in the Ukrainian conflict.

Russia is an important trading partner not only for Slovakia, but also for the EU, both as an important trade partner and as a supplier of energy raw materials. The Russia-Ukraine conflict is undoubtedly negatively affecting any of the parties involved. It is currently questionable to what extent they will be affected, which may require a long-term research.

1.2 Geopolitical changes affecting the strategy of external economic relations of the Slovak Republic

Pro-export policy plays a crucial role in the field of the export support of the Slovak Republic. This policy defines strategy of the trade relations development with both foreign state and private sector entities by identifying concrete tools and proceedings directly and exclusively influencing export output volume at the level of the export entrepreneurial field. Furthermore, pro-export policy determines the basic principles of trade relations coordination and defines the institutional support basis. This policy creates a space for coordination with non-state sector pro-export activities with which it creates an integral national export support system [MH SR, 2014].

Pursuant to the Decision of the Governmental Council of the Slovak Republic on the export and investment support of March 25rd, 2013, the Strategy of the External Economic Relations of the Slovak Republic for the term of 2014–2020 was drafted. The drafted strategy is a natural continuation of the principles defined by the Pro-export Policy of the Slovak Republic for the term of 2007–2013, though it broadens its framework by widening on the Strategy of External Economic relations (EER). Following the main goal defined as enhancement of the competitiveness and of the export output volume of the Slovak Republic by means of the state's participation in international economic relations, the drafted strategy encloses the fields of investment inflow support, cooperation with foreign entities in the field of innovations, and the field of unified state promotion. Simultaneously, the drafted strategy is in conjunction with other sectional economic goals of the state (mainly with the investment and innovation goals) and with strategic documents stating priorities in the corresponding fields.

The subject of the drafted strategy is defined as the system of external economic relations of the Slovak Republic, by means of which the state participates in the international division of labour. Despite the fact that the setting of the external economic relations system strongly influences the state competitiveness, the solution of the competitiveness development issue in the context of the economic development strategy by means of measures influencing formation of the economic structure is not a subject of the drafted strategy. Thus, the Strategy on the External Economic Relations (EER) focuses mainly on higher efficiency of the national export support system and on its harmonization with the mid-term trends of the external economic environment until 2020 and with the entrepreneurial sphere interests. Taking into consideration the differentiated needs of various groups of enterprises, the national export support system is to focus mainly on the requirements of medium-large and large-sized enterprises, on the one hand, and on the requirements of small and medium-sized enterprises. on the other.

The objective of the EER strategy is to ensure a stable position of the Slovak Republic in international economic relations that would support the economic and social development of the country, raising the living standards of the population and promoting economic interests abroad, including ensuring the fulfillment of economic security requirements. The objectives of the EER strategy consist of partial objectives in four areas:

1. Political-economic objectives,
2. Pro-investment goals,
3. Objectives in the field of research and innovation cooperation with foreign countries,
4. Objectives in the field of a unified presentation of the Slovak Republic.

The variety of business objectives includes:

- increase in exports;
- increase in the number of exporters;
- ensuring stable delivery of strategic goods;
- diversification of the territorial structure of exports — increase in the share of exports to non-European markets;
- diversification of the export commodity structure — increase in the share of exports in commodity groups except for HS85 and HS87;
- increase in the export share of small and medium-sized enterprises (SMEs);
- increase in the share of export of services (including tourism).

In the sense of the government's declaration, the pro-investment objectives are in particular:

- to increase the inflows of investments, especially in areas with higher added value and in less developed regions;
- to increase the export performance through investment;
- to increase the investment in industrial research and development;
- to provide support for established investors in expanding their activities in the Slovak Republic.

In the field of research and innovation cooperation with countries abroad, the following objectives must be met:

- to increase involvement of Slovak business and research entities in international research cooperation projects;
- to increase internationalization of domestic research and development results;
- to increase interest of foreign venture-capital funds in projects of Slovak subjects;

- to increase interest in setting up research centres of foreign companies in the Slovak Republic.

In the area of a unified presentation of Slovakia abroad, two goals must be fulfilled:

- to create a functional model of coordination of actors involved in the presentation of Slovakia abroad;
- to create a credible, specific and attractive presentation identity of Slovakia.

As a result of geopolitical changes, territorial strategies were gradually adjusted to support foreign trade of Slovakia. The support of exports to the countries reflected in the Strategy of external economic relations of Slovakia for the period 2014–2020 followed up on the previous territorial strategy for the years 2007–2013, in which the territorial priorities were divided into three groups. The first category of importance included the EU and EEC countries. The second category included countries with high export growth potential — Russia, Ukraine, the Balkans, East and Southeast Asia (especially China, India, South Korea). The third category included countries with developing export potential (the USA, Canada, Japan, the CIS countries and MERCOSUR).

Currently, as part of the partial update of the previous strategy and under the influence of geopolitical changes, territorial priorities have also been adjusted in the set document of the Slovak Export Policy Priorities for 2018-2020. The territories that represent important challenges for the development of Slovak exports include the countries of the Western Balkans (especially Serbia and Northern Macedonia), the CIS countries (mainly Russia, Belarus, Ukraine, Kazakhstan and other Central Asian countries), followed by Southeast Asian countries (China, Vietnam, Indonesia) and, last but not least, countries such as India, the USA, Canada, Brazil and Cuba.

The EER strategy foresees that an evaluation report will be drawn up for the entire 2014–2020 reporting period. The lessons learned from the implementation of the export policy of 2018–2020 can be used to develop this evaluation report, which will be the starting point for the program-based follow-up to the new strategy Slovakia's pro-export policy after 2020 — Export Policy of the Slovak Republic 2020+.

2
EU TRADE POLICY TOWARDS SELECTED TERRITORIES

The developments in the global economy under the constant influence of globalization processes pose a new challenge for the European Union foreign trade policy. It is increasingly clear that the increase in the EU's competitiveness and economic growth will depend on successful deepening its cooperation with third countries.

There are prospective opportunities to increase the EU's engagement, deepen its economic, trade, investment or even integration ties in the East European or Central Asian countries. Similarly, the Western Balkan region is important for the EU as well — not only in terms of trade but also in terms of trade routes, security and stability. Both regions offer a high degree of economic complementarity, untapped economic potential, new export markets and investment opportunities.

2.1 EU trade policy towards the Western Balkans

Geographically, the Western Balkans are located in south-eastern Europe, from the point of view of EU foreign trade policy it is a territory targeted by the EU enlargement policy, which includes: Albania, Montenegro, the Republic of North Macedonia and Serbia as candidate countries to EU access and Bosnia and Herzegovina and Kosovo as potential candidates.

The Rome Treaties, which came into force in 1958, determine that any European country may apply for EU membership. The treaties did not specify the accession process; the entry conditions were modified later in 1978 requiring candidate countries to respect principles of democracy and the consent of the European Parliament. In 1992 the adoption of the EU legislation was included into the entry preconditions, later, in 1993, the pre-accession criteria were supplemented by "Copenhagen criteria" consisting of [European Commission. 2018a]:

- Political criteria — stable institutions guaranteeing democracy, the rule of law, human rights, respect for and protection of minorities.
- Market criteria — a functioning market economy, capacity to cope with competition in the EU.
- Ability to adopt and implement acquis communautaire and implement the obligation of membership.

The Western Balkans is a priority for the EU in term of further enlargement. After the Balkan conflict ended, the EU launched the Stabilization and Association process in 1999 in order to restore the destroyed economy, promote domestic reforms, develop bilateral co-operation and associate Western Balkans as full members. The stabilization and association process is considered to be the most effective EU foreign policy instrument in the region in the process of conflict prevention, peacekeeping and stability preserving and increasing the economic growth.

Chapter 2.1 examines EU trade policy in the Western Balkan region and reviews the geopolitical interests of the main influential partners: Russia, China and Turkey in the Western Balkan region.

2.1.1 Western Balkan region characteristics

To evaluate the EU trade policy in the region, the economic situation of the Western Balkans is to be analysed. Table 2.1 Western Balkans GDP development gives information on GDP per capita growth (GDP per capita, purchasing power parity in international dollars) and GDP growth (constant prices, in %) within the period of years 2010–2017.

Table 2.1: **Western Balkans GDP development (2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Albania								
GDP per cap., PPP, int. dollars	9383	9850	10 198	10 502	10 914	11 308	11 833	12 521
GDP change in %, current prices, PPP, USD	3.7	2.5	1.4	1.0	1.8	2.2	3.3	3.8

	2010	2011	2012	2013	2014	2015	2016	2017
Bosnia and Herzegovina								
GDP per cap., PPP, int. dollars	9438	9810	10038	10579	11023	11581	12149	12784
GDP change in %, current prices, PPP, USD	0.8	0.9	–0.7	2.4	1.2	3.1	3.2	2.9
Kosovo								
GDP per cap., PPP, int. dollars	3.3	4.4	2.8	3.4	1.2	4.1	4.1	4.2
GDP change in %, current prices, PPP, USD	7786	8273	8499	8921	9281	9948	10396	10949
North Macedonia								
GDP per cap., PPP, int. dollars	11561	12064	12225	12781	13473	14128	14672	14976
GDP change in %, current prices, PPP, USD	3.6	2.3	–0.5	2.9	3.6	3.9	2.8	0.2
Montenegro								
GDP per cap., PPP, int. dollars	2.7	3.2	–2.7	3.5	1.8	3.4	2.9	4.7
GDP change in %, current prices, PPP, USD	13563	14273	14139	14884	15421	16104	16749	17833
Serbia								
GDP per cap., PPP, int. dollars	12755	13387	13617	14326	14435	14924	15674	16386
GDP change in %, current prices, PPP, USD	0.7	2.0	–0.7	2.9	–1.6	1.8	3.3	2.0
EU								
GDP per cap., PPP, int. dollars	33723	34959	35425	36076	37344	38514	39624	41394
GDP change in %, current prices, PPP, USD	2.0	1.8	–0.3	0.3	1.9	2.4	2.1	2.7

Source: our own elaboration based on data from: [IMF, 2017].

After the promising acceleration in Albania in 2010, economic growth slowed from 2.5% in 2011 to 1% in 2013. GDP increased by 1.8% in 2014 and continued to grow constantly up to 3.8% in 2017. GDP per capita in Albania grew from 9383 int. dollars to 12521 intl. dollars in 2017.

GDP per capita development in Bosnia and Herzegovina progressed in the same way as in Albania (from 9438 to 12 784), while overall economic grow was minimal during the first 2 years, even negative in 2012. As of 2013, modest economic revival is enregistered.

Kosovo GDP growth rates are between 2.8% to 4.4% with exception in the year 2014 when the progress slowed down to 1.2%. Kosovo territory is the least developed in the region, with GDP per capita as low as 10 949 int. dollars. Overall development in Albania, Bosnia and Herzegovina, and Kosovo is underperforming and GDP, increased by 3000 int. dollars in each country, is very low compared to EU average.

GDP per capita in North Macedonia increased by 3415 int. dollars to 14 976 int. dollars. The economy growth slowed down over the last two years to 0.2% in 2017. In Serbia GDP growth rates were between 1.8 to 3.3% over the last three years, GDP per capita raised by 3631 (28%) int. dollars from 12 755 int. dollars in 2010 to 16 386 int. dollars in 2017.

Montenegro increased GDP per capita from 12 755 int. dollars in 2010 to 16 386 int. dollars in 2017, highest within the Western Balkans. However, it is still not approaching EU GDP per person average of 41 394 int. dollars. Montenegro GDP growth 4.7% in 2017 was also the highest within the Western Balkans. Otherwise the GDP growth rates were comparable to the other Western Balkans in the region.

Following table 2.2 The Western Balkans — basic macroeconomic data contains information on population, GDP per capita and unemployment rates in 2017.

Serbia with over 7 mln inhabitants is the most populous country; Montenegro has the highest GDP per capita. On the other hand, the underperforming economy from the point of view of GDP per capita is Kosovo, where information is not even available and IMF data are only rough estimates. The highest share of unemployed population is estimated in Bosnia and Herzegovina (20.5%) and in Kosovo (30.5).

Labour market in the Western Balkans is typical, with low employment rates (particularly among women) and high unemployment with large share of long-term unemployment (over 80% in some countries). Youth unemployment reached 23.5%, in Kosovo, in Albania and Bosnia and Herzegovina even 26–30%. Unemployment has recently slightly decreased in the whole region except for Kosovo. In 2017 the average

Table 2.2: **Western Balkans — basic macroeconomic data (2017)**

	Population in mln	GDP/capita. intl. dollars (PPP)	Unemployment %
Montenegro	0.624	17 833	n.a.
North Macedonia	2.075	14 976	22.4
Serbia	7.021	16 386	14.1
Albania	2.876	12 521	13.8
Bosnia and Herzegovina	3.507	12 784	20.5
Kosovo	1.799	10 949	30.5

Source: [IMF, 2017].

unemployment rate for the region was 16.2%. Informal employment was in 2017 high in Albania (37.4%, but dropped form 50% in 2014), Bosnia and Herzegovina (30%), Kosovo and Montenegro (23%). In North Macedonia and Serbia share of informal employment is constant at 20% — young people and poorly educated people are the most affected [The World Bank Group, 2018].

The whole region is facing aging problems and emigration of young skilled people. 56% of people from Bosnia and Herzegovina live actually abroad. Emigration of working-age population worsens the economic situation and reinforces nationalist moods in a home country [Petritsch, Freund, 2018].

Poverty dropped by 2% in all countries of the region except for Bosnia and Herzegovina (from 2013 to 2016). 240 000 people escaped from poverty during this period, however, 25% of Albanians live on less than 2 USD a day, over 30% of people in Kosovo lives below the poverty line; over 15% of inhabitants of Bosnia and Herzegovina, one third of North Macedonians, 10% of people in Montenegro and a quarter of Serbians are affected by poverty (in 2016) [European Western Balkan. 2017].

In foreign trade Bosnia and Herzegovina, Macedonia and Serbia recorded growth in exports, driven by the increase in EU demand and commodity prices, however, growing consumption and construction works increased the import, which led to negative trade balance. Average export of only 40% of GDP is limiting their growth potential. Table 2.3 «Share of export and import of goods and services in GDP» examines the share of export and import in GDP of individual Western Balkan countries. The highest share of import in GDP is in North

Macedonia 54% and Serbia 49%, however, even it is below 66% EU 11 average. Import of Kosovo is very small and accounts for only 19% of GDP. In import the higher share of import in GDP is in North Macedonia 69% and Montenegro 64.5%, however, still few points below 70.6% EU 11 average. The data in table 2.3 prove that the trade of the Western Balkans is below its potential. The data were compared to the EU 11 countries with an economic level close to that of the Western Balkans (Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia and the Slovak Republic).

Table 2.3: **Share of export and import of goods and services in GDP (in %, 2017)**

	Export	Import
Montenegro	42.1	64.5
North Macedonia	54.0	69.0
Serbia	49.4	56.6
Albania	29.7	45.2
Bosnia and Herzegovina	36.3	53.2
Kosovo	19.2	43.5
EU 11	66.4	70.6

Source: [The Economist Intelligence Unit, 2018].

More information on trade in goods with the EU is in chapter 3.2 EU foreign trade with the Western Balkans.

Export of services is important for Albania (forms 13% of GDP) and Montenegro (20% of GDP). More information on composition of Western Balkans service as a share in GDP is in table 2.4 Share of the Western Balkans service export in GDP. Data for Kosovo are not available.

Table 2.4: **Share of Western Balkans service export in GDP (2018, in %)**

	ICT	Transport	Tourism	Total
Albania	6	2	13	20
Bosnia and Herzegovina	3	2	4	9
North Macedonia	8	3	2	14
Montenegro	4	5	20	29
Serbia	7	3	3	12

Source: [The World Bank, 2018].

Foreign direct investments per capita are limited (2 600 EUR in 2016) to one-seventh of the EU average. In Macedonia and Kosovo foreign direct investments are below 5% of GDP, the share in Kosovo declined from 4% in 2017 to 1.9% in 2018. The highest share is in North Montenegro 9.3%. Average foreign direct investments are around 5% of GDP. The inflow of remittances is between 1% in North Macedonia and 11.9% in Kosovo. External debt is estimated at 80.5% of GDP in 2018 [The World Bank, 2018].

All the countries of the Western Balkans are facing corruption on both low and high level. Corruption is widespread, systemic and the governmental steps addressing the issue are inadequate. People do not believe the judiciary is independent (60%) and 80% is sure, this segment is the most corrupted [Marovic J., 2018].

2.1.2 EU — Western Balkans relations development Relations during the conflict in the Balkans

After World War II, the Socialist Federal Republic of Yugoslavia became a federation of six republics, with mixed economy and relatively successful economic growth and political stability. Later, in the 90s socialist government lost power and the region was affected by the democratization movement in Eastern Europe in 1989. Within 1991–1992 four republics announced sovereignty. However, it was the Bosnian independence referendum in 1992 that played the major role in the uprising of conflict. The war, which resulted in over 100 000 victims and 2 mln people losing their home, ended in 1995 by signing the Dayton agreement. Nevertheless, the armed conflict continued in Kosovo in 1998–1999.

The EU is criticized for a very timid and slow response to the conflict, inability of a common foreign approach, lack of diplomatic force and insufficient military capacity to intervene. The inconsistency showed up after Slovenia and Croatia had declared independence — Germany recognized their sovereignty, the other countries refused to do so for fear of the Balkan conflict escalation. Finally, in 1992 the EU acknowledged their independence. The EU hesitation to use military capacity could be explained by the fact that the EU had no legal obligation for military intervention; the framework for joint action was adopted in the Maastricht Treaty under the EU's Common Foreign and Security Policy. Nevertheless, the EU confined itself to declarations and organizing peace conferences, communication with international organizations

(NATO), the USA and Russia. The most successful instrument the EU used was humanitarian aid and financial support. The EU provided financial support of 213 mln EUR and food and medical help for the former Yugoslavian state in 1992, 20 mln EUR for the Bosnian government and 60 mln EUR for infrastructure in 1995 [Arikan, 2018].

In 1993 the European Council endorsed the "Stability Pact" that was supposed to lead to peace and stability in Europe and was signed by 50 countries. It was an effort for diplomatic conflict prevention within the Common Foreign and Security Policy, but the Western Balkans were already in the war. Finally, it became clear that stronger diplomacy and military intervention is necessary for the conflict termination and NATO launched air attacks against the former Yugoslav Army in 1994. As a result, peace negotiations were initialized, and the Dayton agreement was signed (1995). However, this agreement failed to guarantee peace, and the conflict broke out in Kosovo in 1998.

Shortly before signing the Dayton agreement five states-successors from the former Yugoslavia, and the USA, Russia with the EU (represented by Italy) agreed upon a meeting in Royaumont and adopted the "Declaration on the Process of Stability and Good Neighborliness" or Royaumont process. The objective of the Royaumont process was to support stability, peace and good neighborliness in South–Eastern Europe; it was a political process without intention to provide financial assistance or funds for reconstruction. The initiative also lacked instruments for its effective functioning and failed to protect human rights and prevent a further conflict in Kosovo in 1995 [Ehrhart, 1996].

In 1996 the Council adopted the concept "Prospects for the Development of Regional Cooperation between the Countries on the Territory of the Former Yugoslavia and the Community Resources Available to Promote this Cooperation" to be used primarily for the countries without mandate to negotiate an association agreement: Albania, Croatia, Bosnia and Herzegovina, Macedonia and Federal Republic of Yugoslavia. The aim of the concept was to promote democracy, built governmental structures and promote rule of law; from economic point of view to help reconstruction and renovation of the destroyed economies and support their transition to market economy. The regional cooperation was supposed to be organized on three levels [Ehrhart, 1996]:

- Within the countries of the Western Balkans.
- Between the Western Balkans and the neighboring countries.
- Between the Western Balkans and the EU.

The EU divided the Western Balkans into two groups [Ehrhart, 1996]:

- Albania and Macedonia — countries without participation in war and with closer relations with the EU; Albania concluded a non-preferential trade agreement in 1992 and Macedonia in 1996.
- Bosnia and Herzegovina, Croatia and the former Republic of Yugoslavia — countries, in which war conflicts were taking place and where it was impossible to negotiate a similar agreement as that with Albania and North Macedonia. The future agreements with this group of countries had to include human and minority clause, had to deal with the returning of refugees, building of democratic institutions, economic reforms and full observance of the peace treaty. Some of the instruments to be used were the PHARE program, a political dialogue, a "development" clause, a "suspension" clause that could discontinue the agreement in case the rule agreed are unfulfilled, reviewing and monitoring the system.

In 1997 Council developed a strategy paper with a detailed scheme on conditions to be accomplished by the Western Balkans to achieve autonomous trade preferences, funds from the PHARE instrument etc. The strategy paper was the most detailed project so far for the region.

Relations after 1999

The Royaumont initiative did not work as expected, it lacked support of western countries, the insufficient financial sources reduced its effectiveness, and the targeted countries had difficulties to meet the political criteria. It was already clear in 1999 that an effective initiative needs financial sources, cooperation of all the conflicting parties and instruments for conflict solving and peacekeeping.

The EU initiated (1999) the formation of "The Stability Pact for South Eastern Europe" with similar aims as the Royaumot initiative: strengthening peace, democracy, human rights and economy in the post conflict countries of the Balkans. Over 40 countries joined the pact including Russia, Turkey, the USA and various international organizations (the International Monetary Fund, the World Bank, the European Investment Bank, and others). A better political stability of the Western Balkans was to be achieved by gradual approach through:

- Deeper integration with Western economic and security structures,
- Regional integration and cooperation.

Project under the Stability Pact for South Eastern Europe reached various degrees of success. Unfortunately, delays in funds disbursement, instability in the region and fear of regionalism prevented the overall success of the project.

Under the German presidency in 1999, the EU proposed to give South-Eastern countries commitment for the EU access in case they fulfil all the necessary conditions. This commitment was supposed to motivate the countries to undertake economic and political reforms. In 1999 the EU launched "The Stabilization and Association Process", targeting primarily the post-conflict region (Albania, Croatia, Bosnia and Herzegovina, Macedonia and Serbia and Montenegro), which established the aim of eventual EU accession. "Weak states" was a common characteristic for the targeted countries of the Western Balkans — countries unable to secure rule of law, functioning social and health care, economic development, proper banking system, etc.

The Stabilization and Association Process goals were:

- Short-term: recovery of damaged economy, economic reform, democratization and political stability.
- Medium-term: EU membership.

The EU required under the Stabilization and Association Agreements, compliance with the peace agreement, reconciliation, return of refugees and cooperation with the International Criminal Tribunal for the Former Yugoslavia. In case of association agreements EU preferred the bilateral approach to regional agreements. Since 2001 the progress of the Western Balkans in the association process is annually monitored through the Annual Progress Reports issued by the European Commission. Among the first, Croatia applied for membership in 2003, followed by North Macedonia in 2004, Montenegro in 2008, Serbia in 2009, Albania in 2009, and Bosnia and Herzegovina in 2016. Croatia is the only country in the region that was granted a full EU membership (2013).

Eastern European countries association was less problematic and entry costs were acceptable. In 2006 the European Council declared that the EU absorption capacity must be reviewed before new membership is granted.

As the association process in the Western Balkans is very slow, Germany proposed a new "Berlin Plus Process" (2017) initiative with additional funds to speed up the process. The European Commission came with the adopted strategy "A Credible Enlargement Perspective for and Enhanced EU Engagement with the Western Balkans".

Stabilization and accession process was introduced in 1999 and is definitely a very powerful policy; regrettably, within 20 years only Croatia was granted full EU membership. No wonder that candidate and potential candidate countries are worried if the EU promise that all countries reaching entry condition would be accepted is still valid. Especially in a situation when the EU tends to focus on other problems: Brexit and migration.

To assure the Western Balkans that the EU is counting on them, the European Union Commission adopted a new strategy "A Credible Enlargement Perspective for and the Enhanced EU Engagement in the Western Balkans", confirming that enlargement process continues and the EU doors are open for new future members when they meet the criteria. Accession talks are under way with Serbia and Montenegro. Montenegro needs to improve the rule of law and fight against corruption and organized crime, Serbia needs to accomplish reforms on the rule of law and economy, promote reconciliation and normalize relations with Kosovo, including conclusion and implementing of the agreement on normalization.

The talks with North Macedonia and Albania were supposed to be open in June 2019, but the EU decided to postpone a decision concerning the date for opening talks until later in 2019. The opinion on Bosnia and Herzegovina membership application is under preparation. Candidate countries could enter the EU in 2025 the earliest, but this is not a fixed or targeted date. Whether it will be or not achieved depends on each country.

The new strategy contains the Action Plan with six initiatives targeting specific problems in 2018–2020 [European Commission. 2018f]:

- Strengthen the rule of law — assessment of reform implementation, trial monitoring, case-based peer-review missions and advisory missions.
- Reinforce engagement on security and migration — fighting against organized crime, terrorism and extremism, border security, migration management, joint investigation teams, etc.
- Enhance support for socio-economic development — expanding investment framework, establish guarantee funds, support starts-up, finance SMEs, research and innovation, development of Regional Economic Area, employment, social reforms, education (doubling of ERASMUS+ funds) and health.

- Increase connectivity — increase funding in transport, energy, and digital economy. The EU's Energy Union should be expanded over to the Western Balkan territory.
- Digital agenda — lowering roaming costs, deployment of broadband, eGovernment, eHealth, eProcurement and digital skills development. Building digital trust and security, enhancing digitalization in industries, adoption and implementation of acquis communautaire.
- Support reconciliation and good neighborhood relations — transitional justice, missing person, cooperation in education, youth and sport.

As the next step the European Commission approved increased funding under the IPA instrument (Instrument for Pre-Accession Assistance). The budget for 2007–2017 reached 9 Bn. EUR, for 2018 a sum of 1.07 Bn. EUR was allocated. The EU enlargement strategy is part of the large strategy to strengthen the EU by 2025.

2.1.3 EU foreign trade policy instruments towards the Western Balkans

The main instruments for implementing EU foreign trade policy towards the Western Balkans are:

- The Stabilization and Association Process.
- EU accession process.
- Visa policy.

A. The Stabilization and Association Process

The Stabilization and Association Process is performed in the form of: autonomous preferences, stabilization and association agreements (SAA), political dialogue, financial assistance and regional cooperation.

The legal bases for the Stabilization and Association Process and EU accession are [Nctm2018]:

- Title 5 of the Treaty on the European Union (the EU external action),
- Article 207 of the Treaty on the Functioning of the European Union (the international trade agreements),
- Article 49 of the Treaty on the European Union (the criteria on application and membership).

Autonomous preferences were introduced in 1999 as a temporary instrument for liberalization of the Western Balkans access to the EU market for all products with the exception of sugar, wine, certain fish products and veal. They were designed for the countries without a valid association agreement. The autonomous measures are asymmetrical allowing the Western Balkans to protect their imports from the EU. The autonomous preferences were supposed to be valid until the end of 2010, but the EU extended their validity until 2015, because Kosovo had not the association agreement at that time. The trade preferences were last renewed in 2015 and are valid until 2020. The trade preferences are activated as to allow more favourable import into the EU than the provisions of stabilization and association agreements. The countries can benefit from the autonomous preferences if the following conditions are met [Kaščáková et al., 2011]:

- Products imported in the EU must comply with the rules of origin.
- Country may not impose new custom duties or quantitative restrictions on imports form the EU territory.
- Country must cooperate with the EU to fight fraud.

Bilateral relations are based on the Stabilization and Association Agreements on Political and Economic Cooperation. They are a revised version of association agreements that include more detailed political conditionality. The Stabilization and Association Agreements oblige the contracting country to respect peace and security, develop neighborhood relations, apply principles of democracy, respect international law and the rule of law. The agreements are flexible — adapted to the situation in a particular country. One of the main aims of the agreements in trading is to gradually create a free trade area. The Stabilization and Association Agreements are the third generation of agreements. Before coming into force, each of them must be ratified by all the member states and the European Parliament. According to the evolution clause, the Stabilization and Association Agreement confirms the status of a potential candidate country for EU membership. Signing an agreement obliges the Western Balkans be committed to economic reform and gradual approximation of the EU laws and standards, which increase security and confidence for domestic and international investors.

At present, all the Western Balkans have the valid Stabilization and Association Agreement. Ratification procedures with Kosovo differed from the others in the region in order to avoid possible refusal of the agreement by five countries that do not recognize sovereignty of Koso-

Table 2.5: **The Stabilization and Association Agreements (2017)**

	SAA signed	SAA implemented	Membership application	Status
Montenegro	2007	2010	2008	Candidate — 2010
North Macedonia	2001	2004	2004	Candidate — 2005
Serbia	2008	2013	2009	Candidate — 2012
Albania	2006	2009	2009	Candidate — 2014
Bosnia and Herzegovina	2008	2015	2016	Potential candidate
Kosovo	2014	2016	no	Potential candidate

Source: [European Commission, 2017f].

vo (the Slovak republic, Greece, Spain, Cyprus and Romania) — the agreement was signed by the EU as a single entity [Collaku, 2015].

The list of the Western Balkans, the year of signing the Stabilization and Association Agreement (SAD) and the year of its implementation, the year of EU membership application and the current status of each Western Balkan country is in table 2.5 The Stabilization and Association Agreements. Out of the Western Balkan countries Montenegro, North Macedonia, Serbia and Albania are candidate countries, Bosnia and Herzegovina and Kosovo are potential candidates.

Financial help is carried out within the Instrument for Pre-Accession Assistance (IPA). The Stabilization and Association Process was initially financed from [European Commission, 2003]:

- The PHARE program, which was originally intended for Central and Eastern Europe; the Western Balkans were beneficiary until 2000. The total budget of the PHARE reached 11 Bn. EUR (2000–2006).
- The CARDS (Community Assistance for Reconstruction, Development and Stability in the Balkans) was used as of 2001.
- The ISPA (Instrument for Structural Policies for Pre-Accession) for environmental and transport infrastructure. Aid amounted to 1 Bn. EUR (2000–2006). Balkans could benefit from this fund as of year 2003.
- The SAPARD (the Special Accession Program for Agriculture and Rural Development) had an annual budget of 520 mln EUR and was active until the end of 2006.

- In 2007 IPA replaced the PHARE, the CARDS, the SAPARD and the ISPA for the period between 2007 and 2013. Later on, IPA II replaced IPA for the period of years 2014–2020.

IPA II addresses specific objectives, such as political reforms, social, economic and territorial development, strengthening regional integration, employment, etc. The budget is 11 698.87 mln EUR for 2014–2020 and the largest beneficiaries are Turkey, which also holds the candidate country status (4453.9 mln EUR), and Serbia (1500 mln EUR) [European Parliamentary Research Service Blog. 2017]. The detailed breakdown of the IPA II allocation for 2014–2020 is in Table 2.6: EU Financial assistance within IPA II.

Table 2.6: **EU financial assistance within IPA II (mln EUR, 2014–2020)**

	IPA II
Montenegro	270.5
North Macedonia	664.2
Serbia	1500.0
Albania	649.4
Bosnia and Herzegovina	165.8
Kosovo	645.5

Source: [European Commission, 2013].

Financial assistance is provided also by the European Investment Bank, the leading international financier in the Western Balkans that has financed project for a total of 6.4 Bn. EUR [Nctm. 2018] since 2006. While the majority of contracts were focused on reconstruction and infrastructure building, the European Investment Bank plans to increase its support to health care and education and lend more financial means to a private sector. The other financial institutions active in the region, the European Bank for Reconstruction, the World Bank and the Council of Europe Development Bank, are cooperating under the Western Balkans Investment Framework and are providing grants and lending facilities. To improve access to middle and small companies, the joint initiative of the European Investment Fund and the Western Balkan Enterprise Development and Innovation Facility was launched in 2012.

The regional cooperation supports cooperation between the countries of the region among themselves and the integration to the European infrastructure networks (transport, energy, border cooperation, etc.). Within the framework of regional cooperation, the Balkans are participating in the Central European Free Trade Agreement (CEFTA). The CEFTA was created in 1992 by Czechoslovakia, Poland and Hungary to stimulate their development and the EU accession agenda. Later, Slovenia (1996), Romania (1997), Bulgaria (1999) and Croatia (2003) joined. When those countries became EU members, they left the CEFTA. In 2006 the CEFTA replaced all bilateral agreements and was amended to the CEFTA 2006 — a new free trade agreement with the following signatories: Albania, Bosnia and Herzegovina, North Macedonia, Moldova, Montenegro, Serbia, Kosovo and Croatia that withdrew in 2013 after EU accession. To become a CEFTA member country must be a WTO member (or compliance to the WTO rules), conclude the Stabilization and Association Agreement with the EU and a free trade agreement with all CEFTA members.

The CEFTA is focusing on four priorities:

- Trade facilitation (trade barriers and non-tariff measures elimination, full cumulation duty drawback and regional value chain development),
- Trade in services,
- Investments (cooperation on investments),
- Transparency (transparent rules, regulations and trade related information) [CEFTA, 2018a].

The commercial exchanges of the CEFTA increased by 15% in 2007 — 2015. The extra-CEFTA exports volume reached 28.9 Bn. EUR and import 45.5 Bn. EUR in 2017. The main CEFTA trade destination for goods and services is EU (30%); intra trade formed 19% of the CEFTA trade and 10% of the Western Balkans trade [CEFTA, 2018b]. Trade in goods is liberalized, but services face various trade barriers. Almost half of intraregional export of goods originates from Serbia, share of intraregional export in GDP is the highest in Macedonia (12%), followed by Serbia 8%. On the contrary, Kosovo’s share is 2% [The Economist Intelligence Unit, 2018].

Table 2.7: The Western Balkans intra-regional shares compares intraregional shares of the Western Balkans in 2008 and 2017. Only Montenegro increased the share of intra-regional trade in their total trade from 30.7 to 31.7%, the others' share stagnated or declined. The average share of the Western Balkans as a region increased from 10.4% to 11.1%. Among main obstacles for further growth are non-tariff barriers and bad connectivity in the region.

Table 2.7: **The Western Balkans intra-regional shares (% of total trade, 2008 vs. 2017)**

	2008	2017
Montenegro	30.7	31.5
North Macedonia	16.8	10.8
Serbia	8.4	8.9
Albania	6.8	6.8
Bosnia and Herzegovina	18.2	14.7
Western Balkans	10.4	11.1

Source: [The Economist Intelligence Unit, 2018].

The Western Balkans are also participating in the following regional and EU initiatives:

- The European Common Aviation Area Agreement (ECAA) — between the EU, the Western Balkans, Norway and Iceland (2009). The agreement came into force in 2017 and creates a common aviation area with the same safety standards and rules, covering 36 markets and 500 mln people [European Commission. 2018d].
- The South East Europe Transport Observatory (SEETO) — a regional transport organization of the Western Balkans and the EU (2004). The main aims of the organization are: to develop the indicative extension of TEN-T network, to harmonize regional transport policies and technical standards, etc. [SEETO, 2019].
- The Energy Community — an international organization (2005) for the integrated pan-European energy market. Members are the EU and neighboring states. The main ambition of the organization is to extend the EU internal energy market rules and principles, create an energy market allowing cross-border energy trade, increase energy security, solve environmental issues related to energy, etc. The members are the EU, the Western Balkans and the Black sea region [Energy Community, 2019].
- The Migration, Asylum, Refugees Regional Initiative (MARRI) — an initiative for better and more effective management of migration (2004).
- Academic and youth mobility: Erasmus+ (EU program for education, training, youth and sport), short-term 3–12 months mobility between the EU and other parts of the world. Erasmus

Mundus Joint Masters Degrees offer a full-degree 1–2 years scholarship for master students.
- The Prum Convention Agreement for cross border police cooperation (2018) and many others.

B. EU Accession process

Article 2 of the Treaty on the European Union specifies the conditions a country must fulfil to become a member state: «any European state which respects the common values of the Member States and undertake to promote them may apply to become a member of the Union. These values include human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities» [European Commission, 2019b].

The official application is submitted to the Council and European Parliament and the parliaments of the member states are notified. The European commission is required to assess if all the conditions, including the Copenhagen Criteria are met. If all criteria are fulfilled the framework for negotiations is prepared. The accession negotiation can only start if all the member states agree. The requested country obtains the candidate country status. The negotiation process includes 35 policy areas of the EU legislation, which are gradually opened and closed when the EU legislation is adapted. The European Commission issues annually the screening report on the preparedness of the country to access the EU. When all the reforms are applied and the negotiations are completed, the country signs an Accession treaty and joins the EU.

The framework for the Western Balkans offers each country potential membership and promise of the EU access when the country is ready for the EU entrance, but in 2007 «enlargement fatigues» replaced the excitement after the 5th round enlargement that admitted 10 post-communist countries to the EU. Within the relations between the EU and the Western Balkans the following issues showed up:

- The European Council pointed out that the enlargement must take in to the account the EU's absorption capacity. The European Parliament issued a special report on the EU capacity to integrate a new member states and pointed out on the necessity of an EU institutional reform by the next enlargement.
- The EU member states had divergent views on accepting new members.

- Discrepancies emerged between individual EU countries and the Western Balkans.
- Problems inside the Western Balkans (instability and internal crisis in North Macedonia, Greater Albania concept, the Kosovo–Serbia territory disputes, etc.).
- The crises (2009) turned the EU's attention to other, more acute issues.

To end long dispute with Greece over its name, the former Yugoslav Republic of Macedonia has changed its name to the Republic of North Macedonia to unblock their ambitions to become a EU and NATO member. Greece claims the name Macedonia for its territory of the same name and has long vetoed the country's effort to negotiate accession to the EU. North Macedonia reached the provisional promise to start talks to join the EU as a full member. The membership talks should start later in 2019.

Among the Balkans candidate countries negotiations are proceeding with Serbia and Montenegro. The EU decided to delay negotiations with North Macedonia and Albania until later in 2019. Albania, blocked by Holland over serious problems with corruption, commenced the pre-negotiation screening process. Bosnia and Herzegovina and Kosovo have not yet reached the status of candidates. At present, the accession process is very slow and the tentative date for the next enlargement is 2025 at the earliest, but it is clear already now that Serbia's accession to the EU in 2025 is unrealistic due to some main obstacles:

- Serbia has only opened 16 negotiating chapters out of 35 and closed only two.
- Normalization of the Serbia–Kosovo relations seems to be in stagnation and negotiations between Serbia and Kosovo will not continue until Pristina lifts its 100% tariffs on Serbian import.
- Problems connected with the rule of law, security and foreign policy. In foreign policy Serbia harmonized only 28 out of 54 foreign policy declaration articles [Simić, 2019].

Accession of Montenegro in 2025 is more probable. Montenegro has opened all but one negotiation chapters (Chapter 8 Competition).

Fixing accession dates creates a problem: the Western Balkans insist on accession process and fulfilling the criteria, but not on political and institutional transformation; state consolidation should be the main accession prospect.

C. Visa policy

The dialogue with the Western Balkans "Visa liberalization Roadmap" included various requirements: document security, border management, migration and asylum, public order and security, etc.

Visa free travel to and through the Schengen area, Romania, Bulgaria and Cyprus are granted to all citizens (holders of biometric passports) from the Western Balkans except for Kosovo. North Macedonia, Montenegro and Serbia fulfilled the conditions for visa-free regime with the EU in 2009, with Albania and Bosnia and Herzegovina in 2010. Visa-free regime is not applicable to the Great Britain and Ireland as they do not apply the regulation Nr. 539/2001.

In 2017 the European Commission adopted a revised visa suspension mechanism that gives a possibility to temporarily suspend visas to the third country under special occasions:

- Increase of irregular migration by more than 50%,
- Increase of asylum applications by more than 50%,
- Decrease in cooperation in readmission,
- EU security risk [European Commission. 2018e].

Kosovo has fulfilled almost all the visa-liberalization requirements, but should do more on fighting organized crime and corruption. Visa-free regime is to be decided in 2020.

2.1.4 The positions of Russia, China and Turkey in the region

The slow accession process, conditionality in the EU foreign policy, increasing distrust in the EU, economic underperformance in the Western Balkans, stagnation in economic reforms, etc. lead to geopolitical changes in the region. Tensions between Slavs and Albanians, Christians and Muslims, efforts to create the "Greater Albania" consisting of Macedonia, Kosovo and Albania, insufficient economic development — these all can endanger stability of the fragile region.

Economic and political influence of Russia, China, Turkey and partly of the Gulf states are more visible and fill the gap that the EU left. The EU trade dominance is indisputable yet (analyzed in chapter 3.2 EU foreign trade with the Western Balkans), but the Western Balkans governments are slowly turning towards external actors.

The region has had long-standing relations with **Russia** since 19^{th} century, the Western Balkans are, however, only a marginal territory in its overall strategy, even if the region has its importance in a "near abroad" approach.

For Russia, the Western Balkans are a buffer zone between NATO and the Russian territory [Rey, 2018a], Russia consents with the EU integration process but opposes further NATO enlargement.

Russia has powerful economic tools to offer, above all:

- Alternative integration in the Eurasian Union,
- Oil and gas supplies,
- Slavonic roots, historical and religious ties (orthodox church).

Only Serbia, Albania and Bosnia and Herzegovina have bilateral trade agreements with Russia:

- Albania: Trade and economic cooperation agreement and Treaty for the avoidance of double taxation,
- Bosnia and Herzegovina: Trade and economic cooperation agreement,
- Serbia: Free trade agreement.

Russia has especially deep ties with Serbia; the countries organize annual military exercises and the trade exchange is most visible. Political influence in Serbia is promoted through:

- Backing Serbia's claims on the territory of Kosovo and rejecting Kosovo's declaration of independence. Russia's position, as a permanent member of the UN, is influential. In its turn, Serbia refuses from the western sanctions on Russia,
- Historical, cultural and political ties and Orthodox Christian tradition,
- Energy supplies [Beckman — Dierkes, 2018].

Serbs believe (wrongly) that Russia is their main aid donor. Russia helped to remove mines and ammunition which remained after the Balkan war, assisted in fire and floods damage control of the country and provided aid valued 40 mln USD in 2012–2014 [The Economist, 2017]. Besides Serbia, Russia is also visible in Montenegro (investments), and Bosnia and Herzegovina (Russia supports Serbians interests in Bosnia and Herzegovina). Bosnia and Herzegovina (Republika Srpska), Serbia and North Macedonia are highly dependent on Russian gas or crude oil deliveries; 75–95% of all imports consist of crude oil and natural gas [Hake, Radziner, 2019]. Bosnia and Herzegovina is fully dependent on energy imports from Russia. Energy dependence adds to the Western Balkans trade vulnerability.

In North Macedonia Russian presence is via orthodox Christianity, trade exchange is small and there is no military cooperation.

Russia has had minimal activities in Kosovo (Russia opposes the Kosovo declaration on independence) and Albania so far.

Russia acts as a flexible player in the Western Balkans, and its influence on the region is open. The Western Balkans is a transit region for Russian energy deliveries to the EU and, presumably, Russia will preserve this degree of influence and position on the Western Balkans.

China, unlike Russia and Turkey, has no historical ties with the Western Balkans, however, its influence in the region has steadily been rising to significant intensity since 2015. The Western Balkans and Greece are the final part of the Maritime Silk Road, a part of the New Silk Road.

China's One Belt One Road Initiative launched in 2013 and especially regional cooperation within Central and Southeast Europe 16+1 Formula introduced in 2012, which includes also the Western Balkan region, evokes moods of distrust among the EU member states. The EU suspects China of its counting on entering the EU through «the back doors — the Balkan region» via investing into large infrastructure projects connecting the port in Piraneus (owned by China) and central Europe. The Chinese strategy is based on the hopes that the Western Balkans will become EU members in the near future.

China announced (2017) further 3 Bn. EUR investments to be spent in the near future, which makes the total of 5.5 Bn. EUR. Investment projects are usually built by Chinese companies and with Chinese material delivered under favourable conditions, with Chinese workforce often engaged; projects and loans from China are unconditional, often overestimated and the risk of debt crisis and financial dependency in the Western Balkans seems to be real.

China does not follow the EU patterns on promotion of democracy, the rule of law and economic reforms [Hänsel — Feyerabend, 2018]. What is more, China does not hesitate to invest in countries with political instability.

China cooperates more closely with Albania, Serbia and North Macedonia. China has bilateral taxation treaties signed with Albania, Montenegro and Serbia. Serbia concluded with China the strategic partnership agreement (2009). China has minimal activities in Bosnia and Herzegovina and Kosovo. China's officials denied all the EU apprehensions on the position of China in the region and risk of destabilization, and declared clear support for the EU integration process in the Western Balkans. There is no visible political influence of China harming the EU efforts in the region, but China's presence is undermining the EU regulatory standards and democracy goals. It is clear that China has long-term strategic plans with the Western Balkans.

Turkey is also an important traditional player in the region (namely, in Albania, Kosovo, and Bosnia and Herzegovina), which was previously part of the Ottoman Empire. The Western Balkan is important for Turkey:

- In security policy (proximity and potential stability);
- In trade and investments, even if it is potential rather than factual at the moment.

Turkey's EU accession ambitions are fading (even if Turkey is still a candidate country for EU membership) as well as its political influence in the region. Turkey is currently playing the role of defender of Islam; presently it is not in its interests to destabilize the region, it officially claims its support for the association process in the Balkans. The aim of their "neo-Ottoman" policy is to create a sphere of interest using soft power together with cultural and religious ties. There are some concerns that Turkish authoritarian governmental system could be used as a model for Muslim countries in the Western Balkans, and if the accession process does not progress, the Western Balkans could turn towards Turkey,

Turkey provided the region with 128 mln EUR [Petritsch — Freund, 2018] in the form of development aid in 2015 and supported mainly cultural and educational projects.

Turkey focuses strongly on Muslim territories — Albania (investments, religious projects), Bosnia and Herzegovina, Kosovo (investments, training of Kosovan forces in Turkey and education), recently it has started trying to deepen relations with Serbia and North Macedonia (military, economic and cultural cooperation). Within a long-term vision, Turkey is planning to build of infrastructure connections between the Danube and the Adriatic sea.

The Western Balkans are questioning suitability of the EU model for the region, and EU preferences among populace are decreasing. Only 26% of Serbians, 31% of Bosnians, 54% of Macedonians and 44% of Montenegro citizens are in favor of EU membership. In contrast, 81% of Albanians think that joining the EU would be the best way for their country [Bonomi, 2018]. These moods are result of the enlargement fatigue and the long-term accession process without a clear date of full membership [Regional Cooperation Council, 2019]. The rule of law and democracy still hold the central place in the accession process, but the other benchmarks also gained importance, which indicates that the EU is compromising its conditions and has changed the rhetoric on the EU accession. Trade deficit with the EU is one of the deteriorating factors in the increasing Western Balkan's public debt, and the EU free trade policy led to reduction of jobs in previously protected state-owned companies.

It is also evident that the EU was overwhelmed by other serious internal problems — euro and bank crises, migration, Brexit — and paid less attention to the Western Balkans. The EU only woke up reacting to the increasing investment impact of China, political influence of Russia, Turkey and Arab countries.

China's influence is not purely political, China supports the EU integration process, and its intentions are long-term: huge infrastructure investments and rising trade exchange should stabilize China's position in the region once it becomes part of the EU. The possible risk lies in growing debt dependence of the region due to large long-term loans from China. Russia does not object to the Western Balkans EU accession either, its intentions are rather to prevent NATO's expansion in the region and to re-gain the sphere of influence. Economic and political ties are especially strong in Serbia and Republica Srbska, in Bosnia and Herzegovina. Turkey also does not object to the EU enlargement, Turkish influence is mainly visible in Muslim regions. The risk could be seen in an authoritarian model of governance which Turkey presents.

To retain its still strong and influential position in the Western Balkans, the EU policy needs:

- Flexible and differentiated approach,
- Reform of largement policy,
- Sector integration prior EU entrance,
- Sufficient resources to run the policy and motivate for reforms.

The EU also needs to take a closer look at the enlargement strategy — technical adding of new members without entire fulfilment of complex pre-accession conditions should be avoided. «True 'Europeanization' requires a process of socialization beyond administrative and political processes. It requires to enable the governments in the Western Balkans to step beyond local paradigms, as well as to engage them in EU societal, policy and political discussions beyond the formal accession talks» [Zweers, 2019]. However, the EU should give the Western Balkans certainty about future membership.

Finally, the EU should build good relations with Russia, Turkey and China, since Russia can easily increase its influence in the region;

relations with Turkey are fragile and problematic already now, and a further exasperation could lead to Turkey's diversion from the EU towards new regions.

2.2 EU trade policy towards the post-Soviet countries

The European Union's trade policy towards the post-Soviet countries is implemented primarily on a bilateral basis. The **Partnership and Cooperation Agreements** (PCAs) were the first legal frameworks concluded between the European Communities and their Member States, on the one hand, with the new independent former Soviet Union countries, on the other hand, during the 1990s. At the same time, according to Van der Loo [Van der Loo, 2016], the PCAs were the first international agreements, in which the EU imposed GATT/WTO obligations on the newly independent countries, although none of the post-Soviet countries was a member of the GATT agreement or the WTO when concluding the agreements.

The PCA agreements have been in many respects typical of all the newly independent post-Soviet states, including the Caucasus and Central Asia, which began developing relations with Europe in practically identical conditions.

The aim of the Partnership and Cooperation Agreements is to promote mutual political, economic, business and cultural cooperation. They cover a wide range of issues and areas (trade in goods, services, investment, energy cooperation, science and technology, education, etc.). The agreements envisage progressive regulatory approximation of the partner countries' legislation and practices to the most important EU trade-related standards, including technical regulations, sanitary and phytosanitary requirements, intellectual property rights protection and customs issues. This should bring about a better access to the EU markets for goods originating in those countries.

As for the countries concerned, according to Kembayev [2016], the contents of the PCAs might slightly vary, but all the agreements contain the classical components of the EU's relations with third countries, including a framework for political dialogue, supporting efforts to consolidate democracy; promoting trade and investment on the basis of the WTO principles; creating conditions for the future establishment of an FTA; establishing cooperation in economic, social, financial, technological and cultural fields. In addition, the PCAs foresee that the parties will respect the principles of international law and observe human rights. In terms of trade, these agreements are non-preferential, apply most-favored-nation (MFN) treatment with respect to tariffs and prohibit quantitative restrictions in bilateral trade.

The PCAs were typically concluded for an initial period of 10 years with the possibility of their automatic annual extension each year, provided no objections are raised.

With regard to further developments and geopolitical changes in the region, many provisions of these agreements have become obsolete. In some cases the PCA agreements were replaced by new bilateral frameworks. In relation to the Eastern European neighbors and the South Caucasus countries, in 2004 the EU launched a partnership-building project under its neighborhood policy (in 2009 specified in the Eastern Partnership initiative). These countries have been offered the opportunity to conclude new legal frameworks in form of **Association Agreements.**

Within Central Asia, the EU started and has successfully concluded negotiations with Kazakhstan and Kyrgyzstan on an Enhanced PCA agreement, which we can regard as a new generation PCA. Negotiations on a similar agreement were also launched with Uzbekistan in November 2018. With the Russian Federation, long-term negotiations on the new agreement have been suspended as part of the sanctions imposed by the EU.

In terms of the multilateral level of the EU trade policy, in particular, the rules of the World Trade Organization (WTO) apply to its member countries. Among the post-Soviet countries, Belarus, Azerbaijan, Turkmenistan and Uzbekistan are not WTO members as yet.

At the same time, some countries in this area are also subject to a unilateral level of EU trade policy in the light of the unilateral preferences granted under the Generalized System of Preferences (GSP), in particular Armenia, Kyrgyzstan, Tajikistan and Uzbekistan.

In terms of the EU trade policy, the post-Soviet countries can roughly be divided into three groupings, as shown in Scheme 2.1. Among them the individual position is occupied by Russia as the EU most important trading partner of the region and the only country in the region with which the Union has launched the concept of strategic partnership. The relation of strategic partnership occupies a special position besides other types of EU relations with third countries; the EU builds and maintains long-term relationships with key partners around the world to ensure that the EU's values and interests are preserved at the global level. However, the EU has not yet properly defined their use [Epthinktank.eu, 2012] and, according to Renard [2015], the term bears a symbolic value but no legal weight. According to Podadera Rivera and Garashchuk [2016], the term is increasingly used in international documents, negotiations, press or scientific literature; however, it is not researched to the fullest extent. It should be defined as the long-term collaboration at the international level of mutual gains and equality of rights between partner countries in what concerns reaching their common aims. Usually the term signifies just establishment of long-term friendly relations in the commercial field and economic contacts between governments.

The second group is formed by the East European and South Caucasus countries participating in the Eastern Partnership, the European Neighborhood Policy's initiative. Lastly, the third group is formed by the Central Asian countries.

Scheme 2.1 **The Post-Soviet countries in terms of the EU trade policy, including their share in the EU foreign trade in 2018**

Russia	Eastern Partnership	Central Asia
• *concept of strategic partnership*	• Armenia • Azerbaijan • Belarus • Georgia • Moldova • Ukraine	• Kazakhstan • Kyrgyzstan • Tajikistan • Turkmenistan • Uzbekistan
• **6.4%**	• **2%**	• **0.8%**

Source: our own elaboration.

Towards Russia, the EU's priority approach has consisted in creating and deepening the strategic partnership, however, this has been stagnating in the context of the current geopolitical developments and the situation in the region. Mutual tensions have crystallized around colliding integration projects on the sides of the EU (Eastern Partnership) and Russia (Eurasian Economic Union). The ambitions of both partners in the post-Soviet space are one of the main conflict lines in their partnership. Their differing approaches to the given countries — promoting their own values in the EU neighborhood against the promotion of national interests of Russia in the so-called near abroad —

has constituted the problem. In particular, the resultative choice of integration direction Ukraine made has become a key factor in the crisis outbreak. According to Casier [2019], «this choice radicalized the negative geopolitical reading» that the EU and Russia gradually developed of mutual behavior. In addition, the relationship between the EU and Russia has been deteriorated by the crisis in Ukraine in 2014 (and the subsequent imposition of sanctions). Increasing uncertainty and the risk of loss of mutual trust are among the main negative impacts of the deteriorated EU–Russia relations as well.

In the Eastern Partnership (EaP) countries, there have also been radical political and economic changes since the 1990s, including their foreign-policy and foreign-trade orientation vis-à-vis the EU. Especially in Ukraine, Georgia and Moldova, the tendencies towards closer economic integration with the EU have strengthened. Therefore, the priorities of the EU trade policy towards the EaP countries lie in political association and deeper economic integration (on the free trade area level in the form of the deep and comprehensive free trade agreements as part of the broader Association agreements).

The third group of countries is formed by the five Central Asian states. These are not among the priority trading partners for the EU, however, the region is of enormous geostrategic importance for the EU as a source of significant energy imports for the EU, and its importance is increasing regarding its role in the development of trade routes between Europe and Asia.

From the mutual trade relations point of view, the Russian Federation is the EU's most important trading partner of the post-Soviet region accounting for 6.4% of the EU external trade in 2018. The countries of the Eastern Partnership region represent in total 2% of the EU trade, and the Central Asian countries account for only less than 1% of the EU trade. More detailed data on each country's share in total EU exports and EU imports in 2017 in comparison to the figures of 2012 are provided in the following table.

According to the data, we can state that the Russian Federation's share in EU imports and exports significantly decreased over the period in question, regarding the overall weakening of mutual trade due to the worsened economic situation in Russia as well as to the overall deterioration in mutual relations. As far as the trade balance is concerned, trade with Russia (as well as with Azerbaijan and Kazakhstan) creates the highest deficit for the EU trade in the region. These are important energy exporters to the EU Member States' markets. On the

Table 2.8: **The post-Soviet countries' share in EU exports and imports — 2012 and 2017 comparison**

	Import % 2012	**Import % 2017**	**Export % 2012**	**Export % 2017**	**Trade balance mln EUR 2017**
Armenia	0	0	0	0	326.4
Azerbaijan	0.8	0.5	0.2	0.1	–7701.9
Belarus	0.3	0.2	0.5	0.3	2638.5
Georgia	0	0	0.1	0.1	1354.9
Kazakhstan	1.4	0.9	0.4	0.3	–12 525.5
Kyrgyzstan	0	0	0	0	127.7
Moldova	0.1	0.1	0.1	0.1	832.2
Russia	12.0	7.8	7.3	4.6	–58 905.1
Tajikistan	0	0	0	0	128.4
Turkmenistan	0	0	0.1	0	639.0
Ukraine	0.8	0.9	1.4	1.1	3513.2
Uzbekistan	0	0	0.1	0.1	1467.2

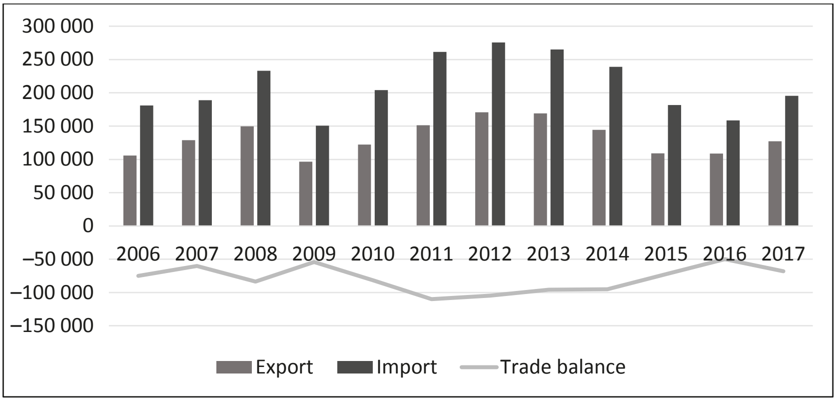
Source: our own elaboration according to the Eurostat [2019] data.

contrary, the largest trade surplus EU recorded is in trade with Belarus, Uzbekistan, Ukraine and Georgia.

Within the Eastern Partnership framework, Ukraine (together with Georgia and Moldova) is the EU's largest trading partner, however, the country's political instability and critical economic situation reduce the potential for mutual trade development. One of the biggest problems in establishing a deeper EU relationship with the Eastern Partnership countries through association and economic integration policy is the EU's penetration into the area of Russia's interests, which also seeks to gradually deepen and expand its integration ambitions to other CIS countries. This clash of interests does not contribute positively to the effective development of cooperation. Both Russia and the EU are two major players in the region, seeking to achieve their goals and protect their interests by expanding cooperation with the countries concerned, however, each side conducts its actions in a different way.

Overall, the region of the 12 post-Soviet countries accounted for 8.6% of the EU's external trade in 2017 (6.8% in exports, 10.5% in imports).

Figure 2.1: **EU trade with the post-Soviet countries' region** (mln EUR)



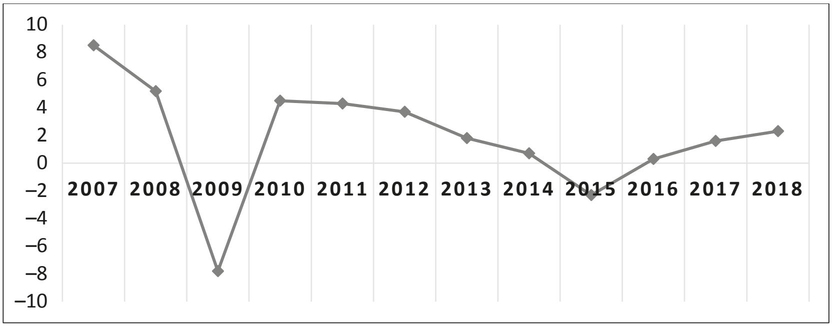
Source: our own elaboration according to the Eurostat [2019] data.

The development of EU trade relations with the region of the twelve post-Soviet countries is shown in Figure 2.1. The positive development of the trade was interrupted by the global financial and economic crisis in 2009. In 2012 mutual trade exchange between the EU and the twelve post-Soviet countries reached record values (446 billion euro). However, in the next period mutual trade plunged sharply due to the developments in the region caused by the crisis in Ukraine which has resulted in deterioration of the EU–Russia relations, as well as due to the worsened economic performance of the countries concerned (especially connected to oil export revenues fall). In 2017 mutual trade recorded a positive tendency, it grew both on the export and import sides. The growth of mutual trade continued in 2018 as well [Eurostat, 2019]. Given the EU's high dependence on imports of energy materials, its trade balance with the region remains passive.

2.2.1 EU trade policy towards Russia

The EU's foreign trade policy towards Russia has been based on the fundamental premise that both sides are strategic partners mutually dependent on a wide range of areas (particularly in the area of economy, trade, energy and security). The attribute 'strategic' has been given to the EU-Russia partnership at the beginning of the new millennium, when Russia, after the turbulent period of the 1990s, got back to the place of one of the world powers in terms of global security, foreign policy and economic importance.

Figure 2.2: **Russia's GDP growth (annual %)**



Source: our own elaboration based on Rosstat [2019] data.

Thanks to the positive development of the world market's oil prices, Russian economy recorded positive growth rates. It began to develop into one of the so-called 'emerging economies', predicted to experience rapid economic growth and progress towards the front lines of the world's largest economies. However, the global economic and financial crisis hampered the positive development of the Russian economy as well.

As a result, the long-overlooked or neglected issues, such as the demographic crisis, regional disparities, high level of poverty, practically non-existent middle-class population, poor transport infrastructure, let alone corruption, got fully reflected and even worsened. In 2009 Russia's economy plunged by 7.8%. Over the next period, also because of the significant increase in oil prices on world markets, there was a gradual recovery (Figure 2.2).

Since 2011 the economy grew annually by 4.3%, Russia, thus, became the third fastest growing economy after China (9.2%) and India (7.2%). The economy reached the pre-crisis level in absolute terms at the end of 2011 and at the beginning of 2012 it already exceeded the 2008 GDP levels. Russia overcame the consequences of the deep recession within two years. However, in 2013 and 2014, the economic growth slowed down again. Already in the second half of 2012, the deterioration in the external environment was supplemented by internal factors (poor cereal harvest, subsequent food prices increase, and investment activity decline). In 2013 weak demand in Russian raw materials and commodities persisted, while inadequate activity in the investment environment, a high degree of government involvement, lack of diversification and modernization of the economy, as well as high dependence on energy export revenues were the main factors that further worsened the economic performance [Obadi et al., 2015]. Strong decline in world oil prices since mid-2014 led to a sharp decline in the value of the Russian rouble against both the US Dollar and the Euro. The Ukrainian crisis together with the sanctions imposed by the EU, the US and other countries gradually added to the sharp downturn in the Russian economy, and led to recession in 2015.

In 2015 the economy shrank by 2.3%. The recession was caused by declining energy prices as well as by the impact of sanctions imposed by the US and the EU. In 2016 GDP grew slightly, by 0.3%, and the economy overcame the recession. In 2017 Russia's economic performance showed positive trends, with GDP growing by 1.6%. Russia's agriculture and mining industries also grew, helped by reciprocal sanctions imposed by Russia (food import embargo ban on a wide range of food imports from the EU). Another factor that helped to stimulate Russia's recovery from recession was the rise in oil prices to around 70 USD per barrel [Foy, 2018].

In 2018 the real GDP growth surpassed expectations, amounting to 2.3%. According to the World Bank [2019b], key risks to medium-term economic growth include the expansion of economic sanctions, renewed financial turmoil in emerging markets and developing countries, a dramatic drop in oil prices, as well as souring of the global trade environment.

Legal framework

The Partnership and Cooperation Agreement, which was in force since 1997, still constitutes the legal basis for political, economic, trade and cultural cooperation. However, this agreement no longer reflected the new facts and changes that had occurred not only in the economic development of both partners, but also in the mutual relations of the new millennium. With regard to the internal developments on both sides, some of the measures and articles of the agreement became obsolete and the both partners acknowledged that the agreement was already outdated. The level of bilateral cooperation began to be expanded beyond the provisions of the agreement.

Negotiations on the new agreement were launched in 2008, but no significant progress was made. In addition, in connection with the 2014 crisis in Ukraine, the EU decided to suspend negotiations on a new agreement with Russia as a first step in further sanctioning Russia for what EU perceives as military intervention in the Crimea [European Council, 2014].

It should be noted, however, that both parties had their own and completely different ideas as to the concept, the legal basis of the new agreement, the institutional framework and the binding nature of its individual provisions. According to experts, there was no agreement concerning the scope of the agreement: while the EU aimed at a comprehensive and detailed agreement, Russia preferred a relatively short framework document outlining general principles of cooperation supported by a series of sectoral agreements with detailed regulations [Zagorski, 2011].

The PCA set the principal common objectives and established the institutional framework for bilateral cooperation, although bilateral summits as the highest level of bilateral framework were frozen in 2014 as part of the EU sanctions against Russia.

Development of mutual relations

According to Lazareva [2013], relations between the EU and Russia have been developing with ups and downs. The early 1990-s was a period of great expectations of both sides about the prospects for mutual cooperation. In the second half of the 1990-s it became clear that both parties overestimated the potential of their relationship. Nevertheless, some positive actions of the West in relation to Russia were undertaken. For example, a more significant role in G7, the admission of Russia to the Council of Europe, and in 1999 the EU offered Russia a concept of strategic partnership [Flenley, 2014]. In the new century mutual relations have been negatively affected by several political and economic crises, mutual misunderstandings, increased uncertainty and a loss of mutual trust. One of the major points of friction has become the issue of shared neighbourhood.

The EU-Russia strategic partnership has been based on cooperation in the four common spaces (agreed in 2003) and roadmaps to their implementation (adopted in 2005). These spaces defined by both sides in 2003 have been a priority for their cooperation development:

- A common area of justice, freedom and security;
- A common space in the field of external security;
- A common area of research, education and culture;
- A Common Economic Space aimed to create an open and integrated market.

The idea of a common economic space between Russia and the EU became the most important element of mutual cooperation in this respect. The intention was to create a single market without trade barriers; however, no significant progress has been made in building it so far. After the initial phase of optimism in building a strategic partnership, differences in the visions of both sides about the future of mutual relations began gradually to emerge. Deepening misunderstandings, more frequent tensions in political relations took place, both in terms of the internal development of both partners and under the influence of constant changes in the conditions of the global economic environment. Uncertainty was also reflected in the development of mutual cooperation in the energy sector. As a result, the development of the EU-Russia partnership slowed down leaving many unresolved issues or conflicts at the end of the first decade of the 21st century.

In 2010, in order to break through the period of mutual cooperation stagnation, a new initiative in the form of the Partnership for Modernization (PfM) was launched. This could give a fresh impetus to the development of the partnership as it was based on efforts to modernize the Russian economy. However, in meeting its goals different approaches of the two parties clashed, the EU perceived modernization as new political and economic conditions, democratization of Russian society, while for Russia modernization meant an opportunity to gain access to European technologies.

Russia's accession to the WTO in August 2012 could provide an impetus for the development of trade relations. However, the overall economic effects resulting from it may be labeled as moderate at best. It was expected that the effects of Russia's membership in the WTO would stimulate business decisions, positively affect mutual economic and political ties, increase investment flows, deepen cooperation in science, technology, innovation. In addition, the WTO membership was to support domestic economic reforms in Russia, accelerate the process of its internationalization, strengthen the legal system and encourage entrepreneurship and the business environment itself. Despite initial enthusiasm and positive expectations, however, the EU was rather disappointed with Russia as a member of the WTO [Sutyrin, Trofimenko, 2014]. After less than a year (in July 2013), the EU requested consultations with the Russian government regarding the introduction of measures related to a charge, the so-called 'recycling fee', imposed on motor vehicles (imported passenger and freight cars) and later filed its first-ever case against Russia at the WTO. It was precisely in the context of the Eurozone crisis that Russia should become a major export market, especially for European carmakers. Even Russia later filed its first WTO complaint against the EU with regard to cost adjustment methodologies and certain anti-dumping measures on imports from Russia. In 2013 a period of mutual claims started. The overall effects of Russia's WTO membership gained less relevance in the context of the conflict in Ukraine and the deterioration of mutual relations resulting from the contrary involvement of both sides in its resolution.

In connection with accusations of Russia's political and military involvement in Ukraine, the EU introduced sanctions against Russia. The sanctions were imposed in several phases with different types of restrictive measures. At first, the sanctions covered diplomatic measures, and, later on, economic and trade cooperation. The first two phases were mainly related to individuals and companies (involved in destabilizing Ukraine). In the third phase, the EU already defined areas with export restrictions — dual-use goods and technology, sensitive technologies in the oil sector, restrictions on arms and military equipment exports, and restrictions on the EU capital market for Russia.

In August 2014 Russia responded by retaliatory measures in the form of a trade embargo on the import of several types of agricultural and food products (fruit, vegetables, milk, dairy products, meat, fish products) from the EU, as well as from the other countries that imposed sanctions against Russia (Norway, Canada, USA, Australia) [BBC.com, 2014].

Despite the diverse views on foreign policy or form of cooperation, mutual interest of both partners lies in a deeper cooperation and integration. The key area is the energy sector, as Russia is the largest supplier of energy resources for European countries. Although mutual partnership is characterized by tensions and mistrust, and is stagnating in many areas, it can still be called strategic. According to Podadera Rivera and Garashchuk [Podadera Rivera, Garashchuk, 2016], the strategic partnership will lose sense if mutual disagreements at the international level separate mutual trade and economic interests. There are several aspects which create and shape the strategic partnership:

- Geographical proximity — and at the same time five EU Member States share border with Russia and, thanks to the geographical proximity, there is a possibility of linking European markets with Asian ones (especially with China);
- Historical and cultural ties;
- Economic complementarity;
- High degree of trade interdependence and mutual interest in developing and deepening cooperation resulting from it. Russia and the EU are united by firm commercial relations, the EU is

the main trading partner for Russia (with 42.8% of the Russia's foreign trade in 2017), and, on the other hand, Russia is the fourth largest trading partner for the EU (accounting for 6.4% of the EU foreign trade in 2018). Following the massive decline in 2014–2016, mutual trade, both on exports and imports sides, started to grow again in 2017 [European Commission, 2018c], despite mutual sanctions. For the foreseeable future, the EU will remain Russia's most important trade partner;

- Interdependence in energy cooperation — Russia is the most important supplier of energy materials for the EU (33% of its oil needs and 34% of its gas consumptions [Podadera Rivera, Garashchuk, 2016], with some EU member countries being totally dependent on Russian gas. The EU is Russia's most important energy export market (88% of Russia's oil exports, 70% of its natural gas exports and 50% of its coal exports [European Commission, 2018c]);
- A wide range of opportunities to develop economic cooperation (energy, services, transport, telecommunications, financial services, environmental protection, technology, etc.), as well as cooperation in culture, education, science and research;
- The EU and Russia recognize each other as key partners on the international scene and cooperate on a number of issues of mutual interest (issues of bilateral and international concern, e.g. climate change, migration, drugs trafficking, counter-terrorism, non-proliferation, etc.). Russia as a permanent member of the UN Security Council, with nuclear potential and huge natural resources, is a key player at the international level and is considered as one of the world centers of regional influence;
- The possibility of developing mutual trade and economic cooperation under the Partnership for Modernization, e.g. in connection with the new challenges posed by the digital economy. Russia is a net technology importer and the European Union is one of the providers of key technology in Russia, accounting for 57% of import transactions and 33% of export transactions [Terebova, 2017].

In addition to these, the long-term aim has been a common economic space — creating a single market without trade barriers, reduction of barriers to investment, promoting reforms, creating new investment opportunities, increasing regulatory convergence. Representatives of both parties have repeatedly mentioned the possibility of creating a common economic space from Lisbon to Vladivostok. However, creating such a space will require to establish interactions between the EU and the Eurasian Economic Union (EAEU). In this regard, European businesses support this idea and develop initiatives to implement it [Eurasian Commission, 2018].

However, creation of a common economic space is a question of a long-term vision. There are several technical problems and reservations on the EU side. For instance, the establishment of trade relations between the two entities is conditioned on the implementation of the Minsk agreements [Rácz, Raik, 2018]. Another obstacle is the EU's requirement of WTO membership, which is not met in the case of Belarus. Mutual relations must get stabilized, and the EU-Russia cooperation should focus on addressing constructive and pragmatic issues, including, in particular, solution of the sanction regime issue and overall review of mutual cooperation and relations' nature, so that new strategic visions can be established for the future.

The EU's trade and investment strategy "Trade for all" presented in 2015 deals with "challenging relations" with Russia only very briefly. It notes that "the strategic interest of the EU remains to achieve closer economic ties, however, must be determined primarily by the course of Russia's domestic and foreign policy". The EU is also aware of the fact that it should reflect upon building up and develop relations with the Eurasian Economic Union [European Commission, 2015].

2.2.2 EU trade policy towards the Eastern Partnership countries

The Eastern Partnership forms the eastern dimension of the European Neighborhood Policy (ENP). The Neighborhood Policy uses a flexible exogenous integration as a privileged model of strengthening cooperation with 16 neighboring countries. It enables the EU neighboring countries to become fully involved in the Union's internal market, provides support programs and cooperation in different areas.

The ENP policy was the logical consequence of the EU enlargement in 2004 to maintain security and stability beyond the external borders of the EU and to avoid the potential negative side-effects of enlargement.

Following a political agreement between the EU Member States favoring cooperation with North African and Middle Eastern countries and Member States favoring cooperation with Eastern European countries, the EU launched an initiative with the intention to strengthen the EU relations with partners on the East. The division of the ENP into two main dimensions was also accelerated by the short military conflict between Russia and Georgia in August 2008, which encouraged the EU to further promote regional cooperation in the Eastern European region in order to strengthen democracy, stability and security at the external borders of the EU. The proposal to create a specific EU initiative for six East European neighbors — Ukraine, Belarus, Moldova, Georgia, Armenia and Azerbaijan — was endorsed by the Council and the European Parliament at the end of 2008. The new model of relations in the form of the Eastern Partnership (EaP) was officially launched on the first EaP summit in Prague on May 7, 2009.

The EU's aim is to create an ambitious partnership based on respect for fundamental values, including democracy, the rule of law, respect for human rights, principles of international law, good governance, respect for the principles of market economy and sustainable development.

The objectives and principles of the EaP

The main objective of the Eastern Partnership, as defined in the Joint Declaration of May 2009, is to create necessary conditions to support and speed up the political association and to strengthen the economic integration of the six partner countries with the EU internal market.

This objective has been also transformed to the EU's offer of new legal frameworks in the form of Association Agreements (AA), which include a wide range of political issues from visa facilitation to transport policy and the fight against terrorism. They replace the outdated PCA agreements. The EaP Association Agreements do not guarantee or even envision the prospect of EU membership, but they do not exclude it either. They will allow access to the partner's market, creating further opportunities for trade, economic cooperation and political stability. They cover the whole area of trade, including energy trading as well as mutual investment. As one of the EaP's objectives is to maximize liberalization of mutual trade, according to Koeth [2014], the most innovative part of the AA is not the political, but trade part in the form of a new instrument — the Deep and Comprehensive Free Trade Agreements (DCFTAs) as cornerstones of their future relationship.

The DCFTA agreements are based on the new generation of FTA agreements format. The new generation FTAs are comprehensive regarding trade liberalization in a number of fields, including traditional elimination of tariff and non-tariff barriers to trade in goods and services, further liberalization in services, provisions on competition, foreign direct investment, public procurement procedures, regulatory cooperation, protection of intellectual property, and so on. Their aim is to open up new markets and foster sustainable development. The start of DCFTA negotiations is subject on partner country's WTO membership.

With those EaP partners that do not wish to engage in the Association agreements with the EU, other forms of bilateral cooperation in mutually beneficial areas remain possible, which is the case of Armenia and Azerbaijan.

Among other EaP objectives are facilitating of travelling to the EU through gradual visa liberalization, together with measures to tackle illegal immigration; expanding energy security cooperation; financial support increasing; enhancing environmental and climate cooperation; increasing people-to-people contacts and greater engagement of civil society.

The Eastern Partnership is an important instrument of political, economic and legal approximation to the EU. In relation to the partner countries, the EU, in particular, aims to transfer its values and standards, to converge their key policies with the EU policies, and to promote stability, democratic development and security. Partner countries that have been advanced and successful in democratization efforts and approximation towards the EU (following the main objective) gain the possibility of greater participation in the EU internal market, notably, in the form of political association, economic integration (DCFTA) and increased mobility of citizens. These three major EU offers have been also the main motivation for partner countries to implement reforms.

At the third EaP summit in Riga in 2015 four key priority areas were agreed upon:

1. Economic development and market opportunities;
2. Strengthening institutions and good governance;
3. Connectivity, energy efficiency, environment and climate change;
4. Mobility and people-to-people contacts.

In order to support a more results-oriented approach towards the EaP, the EU identified 20 key deliverables for 2020 as an ambitious workplan which was endorsed at the fifth EaP summit in Brussels in November 2017. These are the commitments by the EU, EU Member States and the six EaP countries, and cover the four main EaP priority areas: stronger economy; stronger governance; stronger connectivity; and stronger society. In October 2018 the EU and EaP countries' representatives reviewed the progress achieved under the 20 deliverables. The key achievements include the launch of the EaP European School; strengthened support to small- and medium-sized enterprises; increase in mutual trade; and the finalization of an indicative TEN-T investment action plan which foresees 5.500 km road and railway projects by 2020 [EEAS, 2018c].

The EaP follows two main principles of cooperation. First, the principle of conditionality means 'more for more'. That means the EU's approach depends on the progress of each partner country's reform efforts (more support for more progress), e.g. increased funding for development or investment financing, greater access to the EU market. Conditionality should be motivating and, at the same time, positive.

Secondly, the concept of differentiation means 'tailor-made' approach, with the EU treating each partner country individually. It is based on the fact that each partner country has different ambitions and needs. According to Korosteleva, this principle bears an ambivalent meaning. In rhetoric it implies recognition of differing needs of the partner countries; in practice, however, it means reification of the EU norms and rules and their injection into the political space of the partner countries at a differing pace and level [Korosteleva, 2017].

The Eastern Partnership creates a long-term strategic framework of relations between the EU and six partner countries and works through bilateral and multilateral tracks. The bilateral level aims to develop closer relationship and cooperation between the EU and each of the partner countries. It involves mutual negotiations on the tasks in the areas of political association and economic integration with the EU (the Association Agreement and DCFTA), mobility (visa regime liberalization), sectoral cooperation (energy security, agricultural development, environment, social policy, etc.). Within the bilateral dimension, the implementation of the Association Agreements (including the DCFTAs) takes place, as well as of other legal frameworks with partners that do not wish to or cannot engage in AA/DCFTA agreements with the EU. Moreover, progressive visa liberalization negotiations, enhanced energy security cooperation, support for economic and social policies with a view to reduce disparities in partner countries and an institution building program with a view to improve the capacity of each country to adopt reforms are taking place.

The multilateral structure of the EaP, in turn, provides a framework for cooperation and exchange of partner countries' best practices (e.g.

from the economic transformation, reform and modernization of their economies). Four thematic platforms have been launched and allowed for open, target-oriented discussions and joint activities and projects.

The Eastern Partnership development has been also shaped by the changing geopolitical context, as the countries concerned are involved in the dynamics of regional competitions not only between the EU's and Russia's interests, but also interests of China [Pishchikova, 2019]. According to Kaczmarski et al. [2019], China aims at securing its political and strategic interests. It aims at gaining market access to the particular countries of the region, resources and technologies, as well as exporting its financial and productive overcapacity within the BRI framework.

Legal frameworks

From the EU trade policy point of view, the priority within the Eastern Partnership is primarily the issue of trade liberalization and economic integration that means by implementation of the DCFTA agreements. Through them, partner countries are gradually integrated into the EU single market by creating a comprehensive free trade area.

The most advanced EaP partner countries in terms of political association and economic integration are Ukraine, Georgia and Moldova with whom the EU concluded the association agreements, including the DCFTA agreements. We can state that the third EaP Summit in Vilnius in 2013, though it was not an originally planned milestone, and the events associated with it and leading to the so-called Ukrainian crisis helped to start the process of faster concluding the agreements with the countries concerned. All the three have made good progress in the process of adopting reforms, the European acquis and towards economic and political integration towards the EU and are interested in furthering relations with the EU.

An overview of the contractual frameworks between the EU and the EaP countries is outlined in the scheme 2.2.

In contrast to Ukraine, Moldova and Georgia, which lead the process of approximation with the EU, Armenia, Azerbaijan and Belarus have a more limited interaction with the EU. In 2010 the EU Council adopted directives to open negotiations on the Association Agreement with Azerbaijan, but the negotiations were suspended. Azerbaijan opted for more tailored bilateral agreement as for political and economic issues without the DCFTA. The Free Trade Agreement will not be considered, unless Azerbaijan joins the WTO. In February 2018 EU

Scheme 2.2: **Bilateral framework of the EaP in terms of legal frameworks (updated July 2019)**

Association Agreement including the DCFTA	Other agreements
• **Ukraine** – in force since September 2017 • **Moldova** – in force since July 2016 • **Georgia** – in force since July 2016	• **Armenia** – PCA in force since 1999; framework agreement CEPA provisionally applied since June 2018 • **Azerbaijan** – PCA in force since 1999; ongoing negotiations of a comprehensive agreement • **Belarus** – Trade and Cooperation Agreement from 1989

Source: our own elaboration according to European Commission data.

negotiations on a new comprehensive agreement with Azerbaijan were launched.

As for the EU bilateral relations with Belarus, these are technically still regulated by the trade and cooperation agreement concluded between the European Communities and the Soviet Union in 1989, which significantly limits participation of Belarus in the EaP.

Surprisingly, in 2013 Armenia suspended the process of Association Agreement's (including the DCFTA) conclusion and openly declared to be unwilling to integrate into the European structures. In September 2013 the Armenian President clearly expressed and confirmed the aim to participate in the economic integration processes in the Eurasian territory led by the Russian Federation. In January 2015 Armenia became the fourth member of the Eurasian Economic Union. In December 2015 negotiations on a new framework agreement between the EU and Armenia were open at the political level.

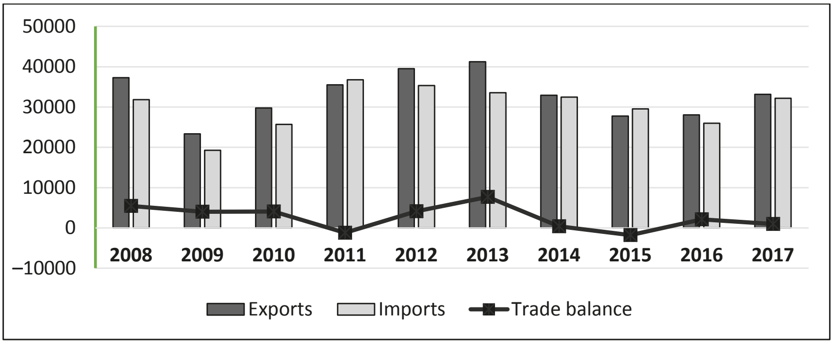
At the latest Eastern Partnership Summit on 24 November 2017, Armenia and the EU signed a new Comprehensive and Enhanced Partnership Agreement (CEPA). It represents a second chance for Armenia to deepen ties with the EU, after the four-year relationship limbo that followed Armenia's rejection of an Association Agreement in 2013. Therefore, the CEPA agreement should be considered as the first and successful example of the EU's new differentiation-based approach towards the partner countries [Poghosyan, 2018].

Due to Armenia's EAEU membership, the CEPA agreement excludes FTA provisions and focuses on creating opportunities to strengthen sectoral cooperation, on improving the investment climate and helping Armenia to diversify its economy. It contains a substantial amount of the previous AA content, especially regarding political dialogue, security, as well as justice and freedom, and includes a considerable part of the EU acquis (e. g. energy, transport, agriculture, banking sector).

Trade relations

Figure 2.3 shows the development of the EU-28 trade with the Eastern Partnership countries. Trade exchanges recorded a tendency to grow, despite the decline in the context of the global economic crisis of 2009. In 2012 and 2013 mutual trade reached the highest levels (74.8 billion euro). With the exception of 2011 and 2015, the EU trade balance recorded a surplus, the highest mark being reached in 2013 (almost 8 billion EUR). There was a significant decline in mutual trade in the period from 2014 to 2016 predominantly due to the impact of the crisis in Ukraine and the problems of the Ukrainian economy, as well as due to the world oil prices fall. In 2017 mutual trade recovered and increased, both in exports and imports.

Figure 2.3: **EU trade in goods with EaP, 2008–2017 (mln EUR)**



Source: our own elaboration according to the Eurostat [2019] data.

Table 2.9: **EU trade in goods with EaP countries — 2008 and 2017 comparison**

Partner country	EU exports (mln EUR)		EU imports (mln EUR)		Trade balance (mln EUR)	
	2008	2017	2008	2017	2008	2017
Armenia	669.9	717.4	318.4	391.0	351.5	326.4
Azerbaijan	2061.0	1709.0	10663.3	9410.9	–8602.3	–7701.9
Belarus	6388.9	6036.4	4724.9	3397.9	1664.0	2638.5
Georgia	1259.7	2018.3	735.6	663.4	524.1	1354.9
Moldova	1715.1	2447.4	753.8	1615.2	961.3	832.2
Ukraine	25158.6	20196.4	14642.1	16683.2	10516.5	3513.2
Total EaP	37253.2	33124.9	31838.1	32161.6	5415.1	963.3

Source: our own elaboration according to the Eurostat [2019] data.

Table 2.9 compares the EU trade with individual partner countries over the period of ten years (2008 compared to 2017). Mutual trade increased in terms of exports and imports in the case of Armenia and especially Moldova (EU exports increased by 42% and the value of imports more than doubled during the period under review).

Among the EaP countries Ukraine is the EU's largest trading partner in both imports and exports, it accounts for more than half (56.4%) of the overall EU trade with the Eastern Partnership. Azerbaijan and Belarus were the second and third largest EU trading partners among the EaP (17% and 14.5% respectively). However, the overall share of the partner countries in the total EU external trade is very low — Ukraine 0.8%, Azerbaijan 0.4% and Belarus 0.3%. Overall, the EaP accounts for about 2% of the EU external trade, and EU exports to this region account for just 1.7% of the total EU exports. With Azerbaijan as the only EaP country, the EU recorded trade deficit in trade with goods in 2017 (7.7 billion euro), as up to 98% of the EU imports from Azerbaijan are oil and petroleum products [European Commission, 2018b].

2.2.3 EU trade policy towards the Central Asian region

Bridging Europe with Asia, the Central Asia has for centuries (over 3000 years) been a region of strategic importance. At the same time, it is the only part of the Eurasian continent that has been in direct and close contact with major civilization centers — India, China, Europe and the Middle East. It is this region that created and 'operated' silk routes connecting these economies [Starr, 2017]. In the 21st century, the region has an enormous potential to regain the status of an important center between the two continents from political, security, economic, commercial, cultural and civilian points of view as an important crossroads of trade routes and political interests. Central Asia's strategic importance in international affairs is growing in connection with the gradual global economic power shift from the West to the East.

The region offers huge economic potential along with its strategic geographical location at the crossroads of important trade routes, however, it is also the space where different political interests of major world powers meet. The region's proximity to Afghanistan has increased the attention of major players, such as the EU, Russia, the United States and others, in view of the possible role the Central Asian republics can play in stabilizing the situation in Afghanistan and the region as a whole. The interests of Russia, China, the US, the EU, as well as of Turkey, Iran, India and Pakistan interfere here sharing their historical, cultural and linguistic links with the five republics. The Central Asian states play an important role today in a Caspian energy strategy, access to their natural resources and infrastructure have become soft power tools of the global powers that help them progressively increase their regional influence there [Makarenko, 2009].

The Central Asian Republics have moved away from their independence by turbulent development and are also a potential place for emergence of different kinds of conflicts. During the transformation period, they still face many obstacles that affect their socio-economic system. As part of the former Soviet Union (USSR), both economically and politically subordinated, their infrastructure and production capacities developed only as part of the USSR's internal market. The main problems of the region's economic development include cultural differences, high levels of corruption, law enforcement, economy's lack of clarity, absence of market economy conditions, and non-convertibility of the currency. The common elements shared by all the countries are the common history of the USSR and the continuing strong economic ties to the Russian Federation. Kazakhstan and Kyrgyzstan are members of the Eurasian Economic Union, an integration project under the auspices of Russia.

The five Central Asian republics represent a diverse region from upper-middle to low income economies with strategic importance due to their geographical location and natural resources endowments. Kazakhstan is the largest and the most advanced economy in the region, thanks primarily to its abundant natural resources, excellent transport links as well as strong position in the field of agricultural production. Uzbekistan is the second largest exporter of cotton in the world; agriculture employs up to two thirds of the population. Industry is also dominated by the mining and processing industries. Turkmenistan is also developing dynamically in relation to oil and gas reserves and their subsequent export to China. Half of the population is employed in agriculture, which accounts for 10% of GDP. However, economic growth is blocked by the high rate of corruption caused by the authoritarian government regime. Kyrgyzstan and Tajikistan do not possess rich natural resources, however, they are rich in water resources. Tajikistan has the lowest level of GDP among all the post-Soviet republics. The industry is underdeveloped, ores and aluminum industries predominate (supported by Chinese capital), but otherwise most of the industry is oriented towards food and consumer goods production. Kyrgyzstan is predominantly an agricultural country. Due to some important reforms, the export performance of the economy gradually increases.

Since gaining the independence of the Central Asian region, they have undergone a profound political and economic transformation towards a market economy. In less than two decades, Kazakhstan, and Turkmenistan likewise, managed to move from lower-middle income economy to an upper-middle income economy in 2006, according to the World Bank [2018]. According to Teleuova, the concentrated abundance of natural resources, especially in the form of hydrocarbons, is the primary factor for national development of individual republics of the region and has become one of their main foreign policy instruments [Teleuova, 2015].

The EU's position in Central Asia

When it comes to analyzing the EU's position in the Central Asian region, it must be said that the favorable geographic position and considerable amount of natural resources are the main reasons why the region is predetermined to create clashing interests and conflicts of the world powers. China seeks to engage in cooperation with the Central Asian countries, particularly favoring the use of huge natural gas reserves or in terms of building favorable transport corridors. The Russian Federation develops trade relations with the region, especially for strategic and military purposes. The United States' vision is to bring stability and democracy to the region, like that of the European Union, which is becoming more and more aware of the possible benefits of a deeper co-operation with Central Asia.

According to Peyrouse [2014], Russia is considered as the most influential and positive actor in Central Asia, especially in Kazakhstan, Kyrgyzstan and Tajikistan. In terms of influence, China comes second in Kazakhstan and Kyrgyzstan, whereas in Tajikistan this position is occupied by Iran. The European Union and the United States come in third and fourth place in these countries, respectively. However, in terms of cultural appeal, the linkages with Western partners are much stronger than with China. Paradoxically, Kazakhstan and Kyrgyzstan are the most oriented countries towards Europe, while Tajikistan, Turkmenistan and Uzbekistan seem to be more distant from Europe (and their cultural linkages to Russia are not so strong). As far as Russia is concerned, it did not have a clear policy for the region until the mid-1990s. With President Vladimir Putin's coming to power in 2000 Russia became aware of the geopolitical potential of the region and stepped up its involvement in Central Asia. That was also reflected in growing business and trade relations [Oliphant, 2013]. For Russia, Central Asia is still an area of its closest foreign policy interests, the so-called near abroad. Russia's main interests in the region are within the security area (network of military bases), energy and the economic cooperation. In terms of Chinese interests, the region with a once-marginal position has become one of the main priorities of China's foreign policy. Similarly, the main Chinese interests include security, energy and economic cooperation. China strengthens (consolidates) its economic and political interests mainly through the Shanghai Cooperation Organization (SCO), a regional intergovernmental security organization which includes Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan (as well as China and Russia). Gradually, it strengthens its position not only in terms of purchasing region's energy resources, but also as an investor in the region (primarily in energy, infrastructure and industrial sector). For the US, Central Asia is particularly important in terms of security interests (security and operational military bases; proximity to Afghanistan). US interests are concentrated on security, energy and democracy.

For centuries Central Asia has also maintained close foreign ties with India, the Indian subcontinent (for a long time, it has been Central Asia's largest trading partner). Although these links have weakened because of political issues, nowadays they are steadily being renewed and are bound to grow thanks to re-opening of the so-called Southern Corridor between the Indian subcontinent and Europe which will become an important milestone in mutual relations [Starr, 2017]. The International Northwest Transport Corridor (INSTC) is a new multimodal transport corridor that will accelerate logistics, reduce time and costs taken for transfer of goods from India to Northern Europe (linking the Indian Ocean, the Gulf and the Caspian Sea across Iran to St. Petersburg) [Chaudhury, 2017]. Central Asia will benefit as well as Kazakhstan, Kyrgyzstan and Tajikistan are among its members.

With regard to the gradual deepening of China's engagement in the Central Asian region, particularly in the area of security, energy or the economy, the concept of "Greater Eurasia" — from Shanghai to St. Petersburg has been promoted among Russian researchers and politicians, instead of the previous idea of "Greater Europe" from Lisbon to Vladivostok [Konopelko, 2017]. According to Cooley [2018], this concept means a common space between Europe, Russia and Asia where Russia could play the role of an integration center between rising Asia and stagnating Europe, whereby underlining the role of Central Asia. China's Belt and Road Initiative (BRI) strategy depends on cooperation with Central Asian economies as well [Starr, 2017]. Grieger [2015] highlights the growing competition between Russia and China in the region that can grow dynamically, especially in connection with the Chinese BRI project. According to Luzyanin [2018], this competition may also be affected by a potential rivalry with the US financial, security and economic interests in the region; however, with regard to the policy of the US president D. Trump, which focuses on protectionism and the development of domestic priorities, this possibility has been reduced.

The European Union, according to Konopelko [2017], is not a key player in the region, so it cannot compete with Russia, China or the US in terms of the hard power policy, based mainly on military or defense potential. The main areas targeted by the EU are the promotion of democracy, the protection of human rights, the rule of law, the fight against poverty and the promotion of education for the people of the region. According to Cornell and Engvall [2017], the EU may not be a major security actor in this region, but its importance as a region's economic partner is universally acknowledged.

The Strategy for a new partnership (adopted in 2007) was considered to be the most ambitious expression of the EU's increased interest in the region. The EU has started to consolidate its position in the region, expanding its economic interests. It has opened its delegations in the region, initiated several projects, increased funding, and established various formats for bilateral and regional cooperation [Boonstra, Panella, 2018]. For the EU, the Central Asian region is becoming increasingly important, especially because of its strategic position. The area is key for maintaining the stability of the Eurasian continent, as it is at the center of changing balances between Iran, Turkey, Russia and China. At the same time, it is an important area for the global energy market as a source of natural gas and oil attracting foreign investment [Wotewatch.eu, 2016].

While energy relations were a key driver of the EU–Central Asia cooperation in the early 1990s, the emergence of the region as a corridor for land-based trade between Europe and Asia is establishing itself as a new and main vector for the development of mutual economic relations (and gradually overtaking the energy sector) [Cornell, Engvall, 2017]. However, due to the region's considerable mineral resources (especially oil and natural gas), energy will still play its role, particularly in the context of the EU efforts to diversify its portfolio of energy suppliers and reduce its dependence on Russia. In this respect, Kazakhstan and Turkmenistan represent the region's priority countries for deepening cooperation with the EU.

Since 2014 the EU cooperation with the Central Asian countries has been affected by the Ukrainian crisis and deteriorating EU relations with Russia — the increased geopolitical tension between the EU and Russia has also become evident in the Central Asian region [Boonstra, 2015]. For example, the Kazakh economy was negatively affected by EU sanctions against Russia, oil price declines, higher import tariffs, weakening demand, and depreciation of the Russian rouble against the Kazakh tenge [Konopelko, 2017].

For the Central Asia's diplomacy the principle of balance between the main actors in the region is of key importance. The region's relations with China are being used to balance its relations with Russia; relations with the Western partners (especially the EU and the US), as the largest investors in the region, are helping to balance relations with Russia and China [Starr, 2017]. Therefore, the European Union can play a constructive role in Central Asia as an alternative to Russia and China.

For the EU, Central Asia is a region of strategic importance. As for the EU foreign trade policy, this region is perceived as an economic bridge between Europe and China.

Moreover, while being geographically remote from Europe, Central Asia lies within the demarcated spheres of Russia's and China's interests, and does not belong to the EU's top trading partners, according to Gast [2014], there are three main reasons for the EU to engage with it as well as to strengthen its position towards the region:

- The substantial energy and other natural resources endowments (to decrease the EU's dependence on Russian gas supplies and diversify its access to raw materials in general);
- The geostrategic importance of the region;
- Efforts to expand the EU sphere of influence and increase global "visibility" of the EU.

In addition, the region also offers significant agricultural potential due to the diversity of climate conditions and the possibility to grow a wide range of different crops. The most important are cotton, cereals — especially wheat, or fruit and vegetables. Nevertheless, mutual relations remain based mainly on trade in mineral or energy raw materials.

Boonstra and Panella [2017] as three broad reasons why Central Asia is important for Europe and, vice-versa, why would Central Asian states are interested in Europe, state that the EU is a values-driven alternative to Russia and China in the region (promoting good governance, respect for legal principles and human rights); social and economic development (the EU can be a useful partner in terms of job creation, in helping to increase local cross-border trade and to diversify the region's economies, as well as in terms of education); and promoting cooperation (the EU is a substantial donor to the region).

Since 2013 the economic development of the Central Asian region has increasingly been mentioned in connection with the Chinese project of the ancient Silk Road restoration — the Belt and Road Initiative (BRI) also known as One Belt — One Road. The aim is to re-establish trade channels between China and its trading partners in the West — Central Asia, the Middle East and Europe through a double-trade corridor. It encompasses of the land routes (the Belt) and maritime (the Road) routes, which aim to improve and strengthen trade relations, primarily through investment into infrastructure [Bruce-Lockhart, 2017]. Central Asia's geographic location, its huge and untapped economic potential predetermine its strategic position as the crossroads of trade routes and political interests. In particular, Kazakhstan should play an important role as a transit country as far as the growth of trade between Europe and China is concerned.

The European Union seeks to develop its relations with Central Asia both with the region as a whole (on regional level) and, on the other hand, with individual countries as outlined in the Strategy (the EU and Central Asia: New Partnership Strategy).

Security issues are the core of the EU's approach in the Strategy, since given the proximity of Afghanistan, the region can play a significant stabilization function. Besides, other key areas of cooperation are energy, trade and economic cooperation, transport, environmental management and water resources management, education, as the Central Asian countries need a skilled workforce to increase their competitiveness and attract foreign investment.

The EU Strategy for Central Asia was later slightly updated. In 2015 the fourth revision of the strategy took place. It highlighted the strategic importance of the region for the EU, with the need to build and develop a strong and stable partnership with Kazakhstan as well as with other Central Asian partners. In particular, the reviewed strategy focused on the promotion of sustainable development principles in all areas of mutual cooperation and on the creation of an attractive investment environment and bilateral partnerships [Apokins, 2015]. The EU pointed out that it has successfully established several institutionalized mechanisms for strengthening mutual relations, however, despite this, the EU's engagement in Central Asia is one of limited to no impact. The region has become more unstable; trade relations are minimal with the exception of EU–Kazakhstan trade, the assumption of increased gas deliveries to Europe (as a means of diversification and reduction of EU's dependence on Russia) has not been materialized; the region suffers from high levels of corruption and the EU pointed to the failure to observe democratic principles and frequent violations of human rights [Boonstra, Tsertvadze, 2016].

In June 2019 the EU presented its new Central Asia strategy (adopted by the Council on 17 June 2019) "The EU and Central Asia: New Opportunities for a Stronger Partnership". It focuses on three interconnected and mutually reinforcing priorities: promoting resilience, prosperity, and regional cooperation in Central Asia. The scope of the EU's relations to the countries is linked to their readiness to undertake reforms and strengthen democracy, human rights, the rule of law, independence of the judiciary, and to modernize and diversify their economies. It aims to promote sustainable, comprehensive and rules-based connectivity between both regions [EEAS, 2019; European Council, 2019].

As the previous one, the new strategy aims to support the remaining Central Asian countries in the World Trade Organization accession. Uzbekistan is the WTO observer country and Turkmenistan has not yet requested entry to the organization. Kyrgyzstan was the first country to become a WTO member in December 1998, Tajikistan joined in 2013 and Kazakhstan became a member on 30 November 2015. Support for WTO membership is one of its main trade policy objectives of the EU towards the countries concerned. As far as bilateral framework of the EU and the five countries is concerned, the EU is committed to conclude and implement ambitious Enhanced Partnership and Cooperation Agreements, which remain a cornerstone of mutual cooperation.

Legal framework

The new Strategy provides a new policy framework for EU engagement with Central Asian countries — regional approach in cooperation with the five republics.

From the EU trade policy's unilateral level point of view — as well as the Strategy — the EU provides preferential access to the EU market through reduced tariffs or zero import tariffs. Kyrgyzstan, Tajikistan and Uzbekistan take advantages from the EU Generalized System of Preferences. Uzbekistan and Tajikistan benefit from the Standard GSP level, Kyrgyzstan was granted the GSP+ status from the EU in 2016. This enhanced preference scheme offers Kyrgyzstan zero customs duties on over 6.200 EU tariff lines (agricultural products — fruits, processed and dried fruits, food products, tobacco, and textiles, felt products, clothing, including leather, and carpet). The scheme will allow the Kyrgyz Republic to diversify its exports and strengthen its economy. Kyrgyzstan, however, has to fully implement its commitments under 27 international conventions on human rights, good governance, labor and environmental standards [EEAS, 2018a].

Bilateral relations are, apart from Turkmenistan and Kazakhstan, governed by non-preferential PCAs (Partnership and Cooperation Agreement) are based on the most-favored-nation clause. Their aim is to promote political dialogue, economic, trade and cultural cooperation.

The PCA agreement with Turkmenistan was concluded in 1998, but did not enter into force. Mutual trade relations are governed by the 1999 Interim Agreement on trade and trade related issues, in force since August 2010, implementing the PCA provisions on trade and trade matters until the entry into force of the PCA. The other areas of cooperation remain based on the Trade and Cooperation Agreement signed between the EU and the Soviet Union in 1989 and subsequently endorsed by Turkmenistan.

Kazakhstan, the only country in the region, has managed to negotiate and conclude a new agreement with the EU that will replace the already obsolete PCA — the Enhanced PCA (EPCA). Negotiations on

Table 2.10: **Legal framework with the Central Asian countries**

	Kazakhstan	Kyrgystan	Tajikistan	Turkmenistan	Uzbekistan
PCA	in force since July 1999	in force since July 1999	in force since January 2010	signed in 1998 not yet ratified	in force since July 1999
EPCA	signed in December 2015 provisionally applied since May 2016	negotiations launched in November 2018, and concluded in July 2019	—	—	negotiations launched in November 2018

Source: our own elaboration according to European Commission data and [Boonstra, Panella, 2018].

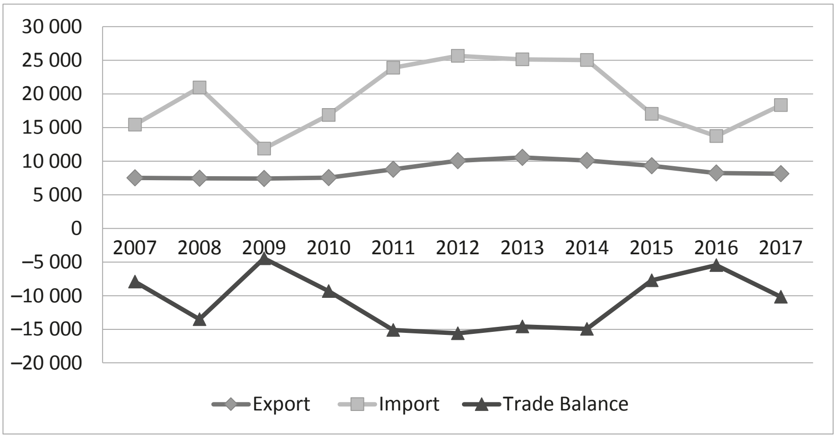
the EPCA agreement began in 2011 and the agreement was concluded in 2014. The Agreement was signed on 21 December 2015 in Astana and entered into provisional application on 1 May 2016. With Kyrgyzstan, the negotiations on a comprehensive agreement (EPCA) were concluded on 6 July 2019 and the text of the agreement was initialed by the representatives of the EU and Kyrgyzstan [European Commission, 2019a]. At the end of 2018 EU launched negotiations with Uzbekistan as well [EEAS, 2018c]. A new, more modern (new generation) agreements will replace the PCA agreements [EEAS, 2018a]. A closer look at the EU legal frameworks with the Central Asian countries is documented in Table 2.10.

The EU–Kazakhstan EPCA should contribute to a significant strengthening of political and economic relations in a wide range of areas. It emphasizes democracy, the rule of law, human rights, fundamental freedoms and sustainable growth, as well as cooperation in the field of civil society. As for the foreign and security policy issues, it emphasizes regional security, weapons of mass destruction, international cooperation on counter-terrorism, conflict prevention and crisis management. The trade part of the agreement covers the improvement of the regulatory environment in the area of trade in services, capital movements, energy sector, government procurement and intellectual property rights. It includes provisions on trade in goods, technical barriers to trade, sanitary and phytosanitary matters. At the same time, cooperation in 29 key areas including economic, financial, energy, transport, education, research, cultural and social will be improved [Drieniková, Kašťáková, 2016].

For the EU external trade relations, Central Asia represents an important region in terms of energy raw materials imports. This is reflected in the structure of mutual trade cooperation. Mineral fuels account for more than 85% of imports from the region. However, from the EU perspective, trade with the Central Asian countries accounts for only 0.7% of its foreign trade (26.5 billion euro in 2017).

EU trade with the Central Asian region developed at a relatively steady pace until the global economic and financial crisis in 2009, which brought about sharp cuts in EU imports value mainly due to a sharp decline in world oil prices. In 2011 mutual trade values returned to the pre-crisis level, reaching the highest value in 2012 (35.7 billion euro), and until 2014 the value of mutual trade was kept at about 35 billion euro, as documented in Figure 2.4.

Figure 2.4: **Development of the EU trade with Central Asia (mln EUR)**



Source: our own elaboration based on the Eurostat [2019] data.

In the following period, a sharp decline (up to 22 bln euro in 2016) is recorded, particularly on the import side. The overall share of the region in total EU imports fell from 1.5% in 2014 to 0.8% in 2016, underlining the deterioration of the EU's mutual relations with the Russian Federation (the imposition of mutual sanctions) and the decline in world oil prices (from almost 100 USD per barrel by half between June 2014 and June 2015). EU exports to the region also declined, and Central Asia's share in the total EU's exports decreased as well (from 0.6%

in 2014 to 0.4% in 2016). The reason could be found in Central Asian countries' strong ties to the Russian economy. Kazakhstan as an EAEU member state has been the most sensitive to the recession on Russian market. The EU is the main export market for Kazakh oil and petroleum products, however, the Russian territory is the main transit country for oil from Kazakhstan. And, therefore, the tension between the EU and Russia has negatively affected the EU-Kazakh economic and trade relations. Since 2016 the volume of EU trade with Central Asia has recorded growth again, associated to renewed increase in world oil prices.

The role of the EU for the Central Asian countries' trade relations is significant — as the region's largest trading partner accounting for 30% share in its overall foreign trade (however, the EU's share has declined in comparison with 40% in 2015), followed by China (20%), Russia (20%), Switzerland and Turkey. EU Member States are the largest export market for Central Asian goods (38% of exports); on the contrary, Russia is the largest trading partner in terms of imports, followed by China and the EU (19% in 2017) in terms of imports [European Commission, 2018a]. The development of mutual trade relations is also impeded by the fact that not all the Central Asian countries are members of the WTO; that the PCA agreement with Turkmenistan is still not ratified; as well as due to a large number of trade restrictions (especially in Uzbekistan and Turkmenistan).

From the commodity structure point of view, almost 93% of imports from the Central Asian countries consist of primary products, especially mineral fuels, lubricants and related materials (85.1%). Industrial goods account for less than 4% of import. In terms of exports, the structure of mutual trade is slightly more diversified, however, industrial products account for more than 89% of the EU export. Nearly half of exports (48%) consists of machinery and transport equipment, chemicals (21% of exports) and pharmaceuticals [European Commission, 2018a]. The EU dependence on mineral fuels from Central Asia generates the EU's long-term trade deficit with the region (more than 10 billion euro in 2017).

Kazakhstan is the EU's largest trading partner from the region, accounting for 63% of EU exports and up to 96% of EU imports to the region. In terms of imports to the EU, Kazakhstan is the second largest importer from the post-Soviet countries (following Russia), but with only 0.9% share in total EU imports. As for exports, it accounts for a fraction (0.3%) of the EU total exports as well. The share of the other Central Asian countries is negligible from the EU foreign trade point of view, with a maximum of 0.1% for Uzbekistan's share in the EU export.

Within the region, the EU relationship with Tajikistan is the least developed one. In 2017 Tajikistan accounted for only 0.8% of the EU trade with Central Asia, the value of mutual trade was 215 mln EUR. Besides Kazakhstan, the EU is also a major trading partner for Uzbekistan with its 7% share in EU trade with Central Asia.

In spite of the long-term deficit of the EU trade balance with Central Asia, as shown in Figure 2.4, with the exception of Kazakhstan, the EU shows a higher value of its exports to the other countries of the region than its imports value (the highest active trade balance in 2017 was with Uzbekistan). Imports from Kazakhstan greatly exceed EU exports to Kazakhstan (by over 12 billion EUR in 2017 and almost 15 billion EUR in 2018). Therefore, Kazakhstan is a priority for EU trade relations.

Economic cooperation

Economic cooperation between the EU and Central Asia (especially with Kazakhstan) has expanded into many areas, energy, transport, political dialogue, or the issues of justice and home affairs. In addition to energy cooperation (particularly in oil and gas projects), the Central Asian countries offer several opportunities to deepen trade and economic cooperation with the EU countries. Very promising is hydroelectric power sector. Energy from water is the main source of electricity production in Tajikistan (99.6%) and Kyrgyzstan (93.5%). Kyrgyzstan has more than 25.000 rivers; however, it cannot itself finance large-scale projects (such as the Naryn hydroelectric power plant) and is reliant on foreign investment. The inflow of foreign investment represents the possibility of a subsequent export of the produced electricity. However, only a small part of hydroelectric energy sources in Central Asia is used, thus, potential opportunities for cooperation in water management projects for Central and Eastern European countries [Kormany.hu, 2018] have been highlighted.

As for the development of transport and logistics, rail transport in particular appears to have the greatest potential for the development of continental trade within Central Asia. The countries of the region successfully undergo the reconstruction or construction of a new railway infrastructure. With the help of the EU, China, India, Russia, or the US, or within the framework of its own initiatives, the region will be able to re-engage in the world trade like during the historic Silk Road era, and boost its economic growth. The EU has been involved in Eurasian trade and transport development projects since 1993 under the auspices of the TRACECA program to strengthen the transport corridor from Southeast Europe via the Caucasus to Central Asia. However, the results are lagging behind expectations [Emerson, Vinokurov, 2009]. In 2007 another important West Europe-West China corridor connecting China, Kazakhstan, Russia and Western Europe was launched [Turezhanova, 2013]. Kazakhstan will have an important position and role, particularly with regard to the construction of railway interconnections and logistic hubs within them (e.g., Khorghos Gateway). In addition to the corridor connecting Europe with China through Central Asia, the Southern Corridor (INSTC) linking India, Pakistan with Europe and the Middle East is becoming more important. Its long-term potential is now much higher due to the demographic and economic forecasts of the Indian subcontinent compared to China [Cornell, Engvall, 2017]. Regarding the development of continental trade through transport corridors, including the Central Asian region, the potential for developing and strengthening cooperation with the region is huge.

From the Central Asian region point of view, the European Union is perceived as a relatively neutral actor, without significant geopolitical interests, while at the same time it is obvious that it has long-term economic interests in the region and is gradually seeking to increase its engagement there (mainly through investment). In cooperation with the EU, the Central Asian countries see the possibility of being recognized as attractive investment destinations or as important regional actors. In the field of socio-economic development (as well as in terms of investment), the EU is involved to the greatest extent in Kazakhstan. On the other hand, it provides development aid to the region, and can therefore be a useful partner for the region, for example in the field of job creation. At the same time, education is also one of the EU's priority development goals for the Central Asian region [Boonstra, Panella, 2018].

The specific features of the European Union's trade policy towards the post-Soviet countries can be seen in their division into three groups — Russia as the EU's most important partner, the Eastern Partnership countries and the countries of the Central Asia region. Until the outbreak of the crisis in Ukraine, the EU's priority approach towards Russia was the development of the strategic partnership. The authors argue that despite the enormous deterioration in the EU-Russia relations, there are several matters of fact thanks to which the partnership still should be perceived as a strategic one (among them the high degree of trade and energy interdependence, and wide range of opportunities to develop economic cooperation).

The main objective of the Eastern Partnership has been to create necessary conditions to support and speed up the political association and to strengthen the economic integration of the six partner countries with the EU. The evolution of the initiative has been shaped by the changing geopolitical situation as well. The countries of Eastern Europe and the Southern Caucasus are involved in the dynamics of regional competition, being at the intersection of interests (above all) of the EU (neighborhood concept) and Russia (near abroad concept). The EU managed to conclude the association and integration process for Ukraine, Georgia and Moldova with the Association Agreements (including the DCFTA) in force. With Armenia the EU found an alternative cooperation format (similar negotiations are ongoing with Azerbaijan).

In Central Asia the EU is perceived as a relatively neutral partner without significant geopolitical influence, if compared to Russia, China or the US; but has long-term economic, investment and security interests and seeks to increase its economic and investment engagement in the region. Therefore, it can play a constructive role in Central Asia as an important economic partner of the region and as an alternative to Russia and China. In the EU trade policy, Central Asia is perceived as an economic bridge between Europe and China. In this context, the emergence of the region as a corridor for land-based trade between Europe and Asia has established itself as a new major vector for the development of mutual economic cooperation (alongside the energy sector).

3
EU FOREIGN TRADE RELATIONS WITH SELECTED TERRITORIES

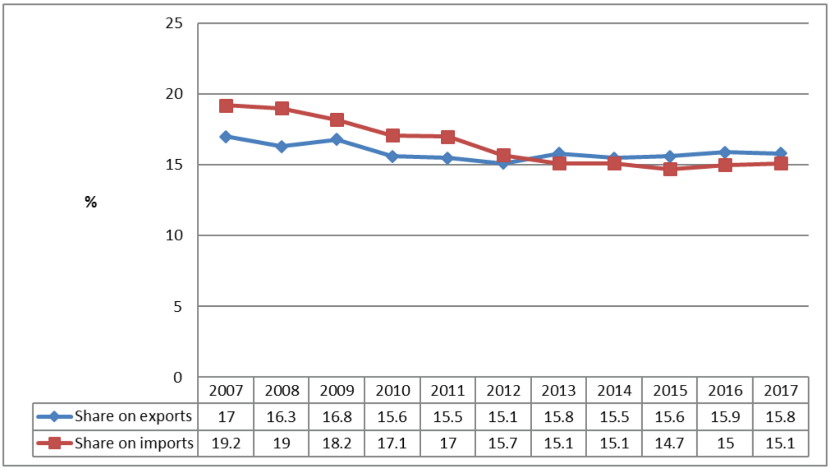
Within the selected countries, the countries of the Western Balkans, Russia, Kazakhstan and Ukraine are among the largest and most important trading partners of the EU. Although relations between the EU and Russia have significantly worsened and become tense, Russia still belongs to one of the most important partners of the EU, both in terms of trade, energy cooperation and security issues. Ukraine is in a deep economic crisis, but its strengthened pro-European orientation and the advanced application of free trade agreement measures create a great potential for developing and deepening trade and economic cooperation. Aa for Kazakhstan, the prospect of developing trade relations lies in its position as a transit country in the development of European-Chinese cooperation.

3.1 European Union foreign trade development

The EU is one of the major players in the global trade in goods. Its share of imports/exports on world total imports/exports (after elimination of the intra-EU trade) is the second largest in the world, lagging behind the China — the largest global exporter — and the United States — the largest global importer.[1] In 2017 the EU accounted for more than 15% of both world imports and exports. At the same time, the share of China in world exports approached 17% and the share of the United States in world imports exceeded 17% [Kittová, 2019]. Over a longer time period of 10 years, however, we can observe a slight decrease in the EU's share in world imports and exports (see Figure 3.1).

1 The trade of the EU member states with non-member countries may be referred to as the EU foreign trade, external trade or the extra-EU trade.

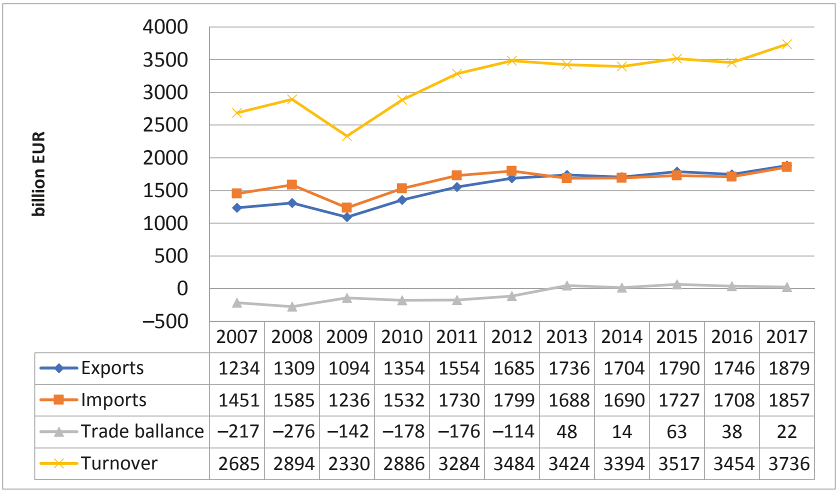
Figure 3.1: **EU share on global exports and imports (2007–2017)**



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Share on exports	17	16.3	16.8	15.6	15.5	15.1	15.8	15.5	15.6	15.9	15.8
Share on imports	19.2	19	18.2	17.1	17	15.7	15.1	15.1	14.7	15	15.1

Source: Data from [EUROSTAT, 2019].

Figure 3.2: **EU foreign trade developments (2007–2017)**

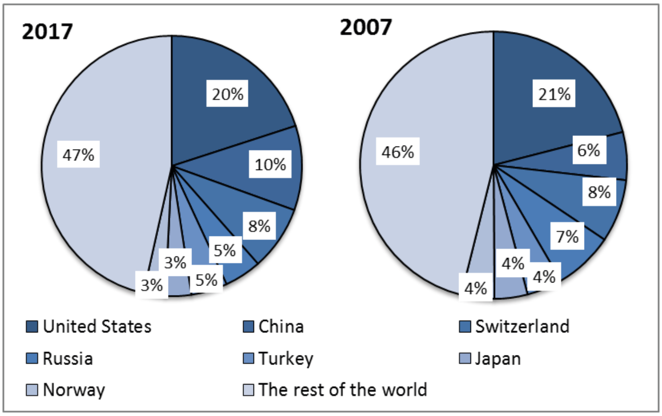


	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Exports	1234	1309	1094	1354	1554	1685	1736	1704	1790	1746	1879
Imports	1451	1585	1236	1532	1730	1799	1688	1690	1727	1708	1857
Trade ballance	–217	–276	–142	–178	–176	–114	48	14	63	38	22
Turnover	2685	2894	2330	2886	3284	3484	3424	3394	3517	3454	3736

Source: Data from [EUROSTAT, 2019].

Figure 3.2 gives a detailed overview of the EU trade in value terms during 2007–2017. The developments of four main trade indicators are presented, namely exports, imports, turnover calculated as the sum

Figure 3.3: **Share of EU exports by partner**



Source: Data from [EUROSTAT, 2019]

of exports and imports and trade balance expressing the difference between exports and imports. European trade values continued to expand at a moderate pace, with growth of 3.5% for exports and 2.5% for imports in 2017. At the same time, the world merchandise trade calculated as an average of exports and imports grew by 4.7% [WTO, 2018]. We can follow an increase of values of the EU foreign trade during the last eight years. Following a significant drop in trade flows in 2009 as a consequence of the global financial crisis, the EU foreign trade values returned to the pre-crisis levels in 2010.

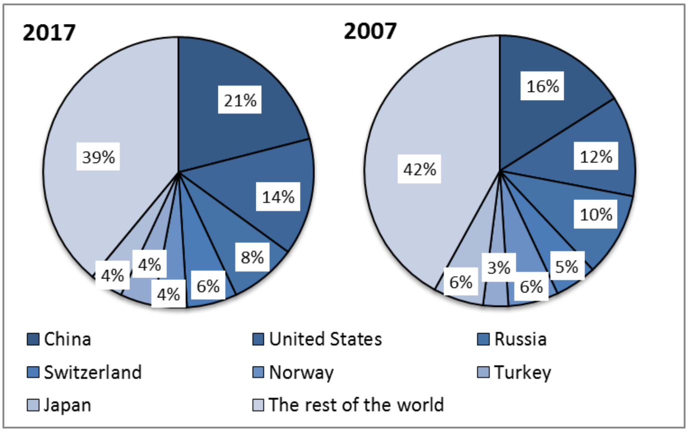
The EU recorded a trade surplus of about 22 billion EUR in 2017. The EU trade balance averaged –83.45 billion EUR from 2007 until 2017, reaching an all-time high of 21.4 billion EUR in December of 2016 and a record low of –347.66 billion EUR in January of 2008 [Trading Economics, 2019]. Since 2013 the EU trade balance is in a slight surplus.

Figures 3.3 and 3.4 show the main EU trading partners in goods in 2017 compared to 2007. The top 7 partners in 2017 are the same for both the export side and import side. However, the ranking is different. As far as EU exports are concerned, the United States maintain their leading position with the share of 20% in 2017. This share remained relatively stable over the last 10 years. China as the second largest export market for the EU goods in 2017 was gaining importance over the entire time period of 2007–2017. Its share is, however, only half of that of the United States. Switzerland is the third most important EU export partner since 2010 (except for the year 2011 when it got ahead of

China). The share of Russia in EU exports has dropped since economic sanctions on mutual trade entered into force in 2014. Currently Russia has the share of 5% on EU exports, followed by Turkey, Japan and Norway. From the remaining countries not presented in figure 3.3, the most important for the EU exports are: South Korea, the United Arab Emirates, India, Mexico, Canada and Hong-Kong. The share of each of these countries on EU exports reached at least 2% in 2017.

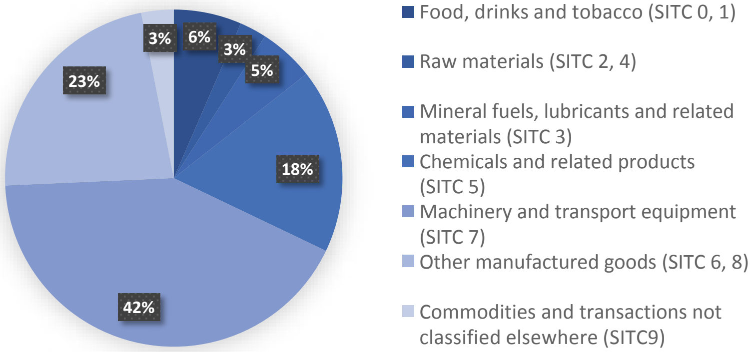
The largest share of goods imported into the EU originates in China. This share has been growing gradually since 2007. In 2017 it represented 21%. If the volume of EU imports from China is compared to the volume of EU exports to China, we can observe a deficit of the EU in the trade with China, being the highest among all the EU trading partners. In 2017 the trade deficit reached almost 178 billion EUR. In contrast to that, the EU trade balance with the United States — the second largest importer — is in surplus. The share of the United States on EU imports fluctuated between 11.2–14.6% in the last 10 years. The third place in EU imports belongs to Russia. Although the share of Russia in EU imports has declined since 2007, Russia holds its position due to the EU demand for mineral fuels. In 2017 the EU imported more than 29% of its total imports in SITC group 3 (e.g., mineral fuels, lubricants and related products) from Russia. The share of EU imports from the remaining partners presented in figure 3.4 (e.g., Switzerland, Norway, Turkey and Japan) is relatively balanced over the period under review. The shares of both the South Korea and India in the EU imports accounted for 2–3% in 2017.

Figure 3.4: **Share of EU imports by partner**



Source: [EUROSTAT, 2019], [Kittová, 2019].

Figure 3.5: **Share of EU exports by product group (2017)**

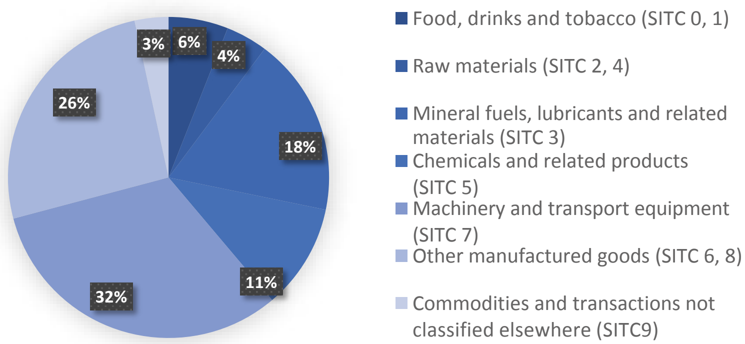


Source: Data from [EUROSTAT, 2019].

Between 2007 and 2017 the EU recorded the strongest increase of trade in goods with China. The exports to China almost trebled, the imports from China grew by 60%. «On the import side, between 2007 and 2017 the EU recorded a decrease in the value of its imports of goods from Japan (–13%), Russia and Norway (both –2%). For the latter two these changes reflect, at least in part, changes in the price of oil and gas» [EUROSTAT, 2018].

Figures 3.5 and 3.6 show the commodity structure of the extra-EU exports and imports per SITC in 2017. The biggest share of both exports and imports is created by machinery and transport equipment followed by other manufactured goods. Chemicals and related prod-

Figure 3.6: **Share of EU imports by product group (2017)**



Source: Data from [EUROSTAT, 2019].

ucts represent the third most important product group of the extra-EU exports. As far as imports are concerned, the third place belongs to mineral fuels, lubricants and related materials. The most important sub-items within the SITC group 7 (machinery and transport equipment) of the EU exports are automotive products, followed by other transport equipment and telecommunications equipment. Taken together, they account for 51.7% of the EU exports in SITC group 7 [WTO, 2019]. As far as the EU imports of the SITC group 7 are concerned, the largest share belongs to the telecommunications equipment, followed by automotive products and other transport equipment.

While being a net exporter of both SITC groups 7 (machinery and transport equipment) and 5 (chemicals and related products), the EU falls into a high deficit in trade with SITC group 3 (mineral fuels, lubricants and related materials). Similarly, the EU is a net importer of raw materials and other manufactured goods.

The share of individual commodity groups in EU exports/imports has remained stable over the last 10 years. Only the share of mineral fuels on EU imports has fluctuated more significantly along with the commodity price changes. The commodity structure of the extra-EU trade reflects the fact that the EU as a highly developed economy is fully integrated into the global value chains, it has diversified exports of industrial products with high added value and it is dependent upon imports of mineral fuels.

The EU foreign trade values and structures reflect geopolitical changes within the world economy. First, we can follow the growing economic as well as political importance of China. China has become the largest global exporter. At the same time, the share of China in EU imports has increased, and the EU has recorded the highest deficit in trade with China. Second, sanctions imposed on trade between the EU and Russia resulted in a decline in trade with Russia. Despite these developments, however, the EU has been able to maintain its position as one of the major players in the global trade.

3.2 EU foreign trade with the Western Balkans

The following chapter will examine development of EU trade with the Western Balkans and will compare the trade position of EU with other important trade partners: Russia, China and Turkey.

Table 3.1: **EU trade in goods with the Western Balkans (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2014	2016	2017
Import	9919	11690	11693	13769	15051	16150	17746	20262
Export	16617	18198	21912	22062	23368	24502	25967	29272
Total trade	26536	29888	33605	35831	38419	40647	43688	49534
Balance	6698	6508	10219	8293	8317	8352	8220	9010

Source: [European Commission, 2017a].

Western Balkan economies are, from a trade perspective, closely integrated within the EU and the EU is for the Western Balkans the biggest trade partner, both in terms of exports (83.4% in 2017) and imports (66.5% in 2017) in trade in goods. For the EU the trade with this region is not of such significant importance and accounts for 1.3% of the total EU foreign exchange in goods (1.1% for imports and 1.6% for export). The trade with the Western Balkans has doubled since 2006, totalling 49.5 Bn. EUR, up from 43.7 Bn. EUR the previous year, the export increased by 84%. Mutual trade relationships are beneficial also for the Western Balkans — the region increased their export to the EU by 142% since 2007 [European Commission, 2019a].

Table 3.1: *EU trade in goods with the Western Balkans* shows the development of EU export, import and balance within the period of years 2010 — 2017. Both EU import and export grew throughout the whole period. The EU import increased by 14.1 % and export is by 12.9 % greater than the year 2016 level. The trade surplus was 9010 mln EUR and the total trade had a growing pattern, except for the crises period in 2009 when a slight decline occurred. The growth of EU imports is driven by a higher demand in EU and increase in commodity prices.

In 2017 manufactured products made up 72% of EU exports to the Western Balkans and 76% of EU imports from the region. The most important items in EU export are machinery and appliances (19.5%), mineral products (11%) and chemical products (10%). In imports machinery and appliances (20%), base metals (14%) and chemicals (9%) are the main commodity items.

The Western Balkans export to the EU is not uniform, but varies from country to country: export from Bosnia and Herzegovina consists mainly of apparel, footwear and aluminium struts, North Macedonia and Serbia by machinery and transport goods — spare parts for cars, Serbia by agricultural products, North Macedonia by chemi-

Table 3.2: **EU trade in goods with the Western Balkans. trade shares (2017)**

	Share of country on EU total trade in %	EU share on trade of country in %	Total trade in mln EUR
Montenegro	0.03%	45.7%	1234
North Macedonia	0.24%	70.5%	8236
Serbia	0.59%	64.5%	22278
Albania	0.12%	66.2%	4768
Bosnia and Herzegovina	0.26%	65.1%	9642
Kosovo	0.03%	41.1%	1412

Source: own elaboration. based on: [European Commission. 2017a].

cal products, Montenegro and Albania export mainly other manufactured products. Thus, they do not compete with each other and their specializations give an opportunity for mutual cooperation and deeper regional integration.

As mentioned above, the EU is the biggest trade partner for the Western Balkans (73%), followed by China (5.7%), Russia (4.8%) and Turkey (4.3%) [European Commission, 2017a].

Table 3.2: *EU trade in goods with the Western Balkans, trade shares* gives detailed information on EU trade with individual countries in the region. Serbia is the largest EU partner and accounts for almost half of the total EU exports and imports to the Balkans. The second largest partners are Bosnia and Herzegovina and North Macedonia.

The EU is an important trade partner for all countries in the region, and most of the Western Balkans accomplish more than half of their total trade with the EU. North Macedonia's trade dependence on the EU has deepened, with the share of trade increasing from 65% in 2016 to 70.5% in 2017. Albania's dependence is also significant and increased from 65.4% to 66.2% in 2017. North Macedonia exported over 80% of their goods to the EU (4 Bn. EUR), Albania 77% (1.6 Bn. EUR), Bosnia and Herzegovina 71% (4 Bn. EUR), Serbia 68% (9.7 Bn. EUR), Montenegro 35% (0.1 Bn. EUR) and Kosovo 25% (54 mln EUR) in 2017. The share of EU imports reached 63% (4.3 Bn. EUR) in North Macedonia, 62% (2.9 Bn. EUR) in Albania, 61% (5.7 Bn. EUR) in Bosnia and Herzegovina, 59% (10.3 Bn. EUR) in Serbia, 47% (1.1 Bn. EUR) in Montenegro, and 43% (1.3 Bn. EUR) in Kosovo in 2017 [Eurostat, 2018a]. EU trade with each country has an increasing pattern.

The largest exporters to the Western Balkans among the EU states were Germany (16% of all EU exports to the region), Italy (14%), Slovenia (10%), Hungary (9%) and Croatia (8%) in 2017. The bulk of the Balkans exports flowed to Germany (23% of all EU imports from the Western Balkans), Italy (18%), Slovenia (9%), Hungary (7%) and Croatia (7%) [Eurostat, 2018a]. For Slovenia and Croatia, the Western Balkans are of especially great importance and their export to the region accounted for one third of the total extra-EU export of Slovenia and 45.7% in case of Croatia. The other EU member states with export exceeding 10% of their extra EU export were Greece (13.1%) and Bulgaria (12%). 18.5% of Slovenians' extra-EU imports comes from the Western Balkans, for Croatia the share is as high as 29.1% [Eurostat, 2018b].

Most EU countries reported trade surplus with the Western Balkans, the only exceptions were Luxembourg, Cyprus, Malta, Sweden and Lithuania in 2017.

The EU is also a significant source of foreign direct investments, European companies invested in the Western Balkans over 10 Bn. EUR within the past five years [European Commission, 2018a].

3.2.1 EU trade with Montenegro

Montenegro is one of the best performing country in the region. Montenegro's market is small and highly dependent on participation in international trading. Foreign trade accounts for 103% of GDP [Lloyds Bank, 2018]. For Montenegro the EU is the biggest import partner (47.7%) and export partner (34.5%). Montenegro is carrying out 45.6% of its trade with EU [European Commission, 2018b].

Table 3.3: *EU trade in goods with Montenegro* points to the development of EU import and export with Montenegro over the period of years 2010 — 2017. Even if EU imports have been on rise over the last 2 years, import values still do not reach those of 2012-2014. Exports have been growing since 2010, with 7.4% gain in 2017. EU trade with Montenegro totalled 1234 mln EUR and trade surplus amounted to 901 mln EUR.

EU imports consist predominantly of machinery and transport equipment (34%), manufactured goods (34%) and crude materials (20%). Over one third of EU exports consists of machinery and transport equipment, food and live animals (14.8%), mineral fuels (14.5%) and manufactured goods (12.8%). Except for 56.5% decline in trade with commodities, not a single item from SITC selection shows decrease.

Table 3.3: **EU trade in goods with Montenegro (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2014	2016	2017
Import	185	225	298	188	251	144	152	167
Export	715	786	893	912	973	877	995	1067
Balance	530	561	595	724	722	733	843	901

Source: [European Commission, 2018b].

The biggest EU export market for Montenegro is Hungary (9.4% of total export of Montenegro), Italy (6.4%), Germany (4.6%) and Slovenia (4.3%); the biggest EU importers are Germany (8.2%), Italy (6.5%), Croatia (5.3%) and Greece (4.6%) [OEC, 2019d]. Among other strong trade players, Serbia, China and Bosnia and Herzegovina are of the greatest importance. China is the third biggest trade partner (8.6% of the total trade of Montenegro) and the third most important import partner (9.6% of total import of Montenegro), Serbia is the second largest trade partner (21%), the second import partner (21.5%) and the second export partner (17.8%) [European Commission, 2018b].

To support its future development, Montenegro should change the “raw material export strategy” to more sophisticated product export and diversify trade partners.

Russia is the biggest foreign investor with investments exceeding 1.3 Bn. USD in 2016, 28% of all foreign direct investments in Montenegro. Russian investments are focused on tourism and real estate segment and help to boost tourism and construction sector. Russians are also the second most numerous nation visiting Montenegro as tourists. Good relations and investment activities do not translate into trade that is relatively small. Moreover, the EU-Russia economic sanctions even reduce the trade. The share of Montenegro’s trade to Russia dropped from 1% in 2011 to 0.7% in 2016, import declined from 1% to 0.2% [Szpala, 2017].

What is more, *China* has started to focus on Montenegro within the concept of the Silk Road, promising to invest into the infrastructure projects linking the Adriatic port of Bar with Beograd in Serbia. Various financial institutions warn Montenegro that Chinese credits can lead to serious debt problems.

Export of Montenegro to Turkey reached 6% of all Montenegro’s export, import 3.1%; 0.7% of foreign direct investments in Montenegro is from Turkey. Montenegro, as well as Serbia, are ‘the first zone of interest’ in Turkey’s foreign policy [kas.de, 2018].

Since membership in the WTO in 2002, Montenegro has implemented trade policy reforms in line with WTO and EU regulations. The preferential agreement with the EU provides duty free access for 95% of goods (wine, meet and steel are exceptions).

3.2.2 EU trade with the Republic of North Macedonia

Trade integration of North Macedonia with the EU is on a promising track . The Stabilisation and Association Agreement, which has removed trade obstacles, was fully implemented in 2011, with exception for sensitive products (mostly agricultural products — wine). For the Republic of North Macedonia, the EU is its main trading partner, with 81.3% of its exports and 62.4% imports. Overall, North Macedonia is conducting 70.5% of its foreign trade with the EU, which is a significant increase from 40% in 2000 [European Commission, 2018c].

Table 3.4: **EU trade in goods with the Republic of North Macedonia (mln EUR, 2010–2017)**

	2012	2013	2014	2014	2016	2017
Export	2110	2388	3019	3365	3713	4973
Import	3372	3396	3818	4114	4452	4238
Balance	1262	1008	799	749	739	735

Source: [European Commission, 2018c].

Based on the data in table 3.4 *EU trade in goods with Republic of North Macedonia*, we can conclude that both the EU export and the EU import have a rising tendency throughout the period under review. The total trade reached 9212 mln EUR and EU surplus was 735 mln EUR in 2017.

EU imports centre around a few products, mainly machinery and transport equipment (33.5%), chemicals (25.9%) and other manufactured products, including clothing (17.2%). The EU delivers to the Republic of North Macedonia materials (40.4%), machinery and transport equipment (23.6%), fuels (10.7%) and chemicals (10.6%). Among the SITS items, a decline in EU imports of animals and food (–6.3%) and fuels (–28.8%) was recorded, on the other hand, the EU reduced export of animal and vegetable oils by 56.7% in 2017 [European Commission, 2018c].

Among the EU countries, the top export destinations for North Macedonia are Germany (41%), Bulgaria (4.9%), the Czech Republic (4.8%) and Greece (4.1%). The main EU import markets are Germany (12%), the United Kingdom (10%), Greece (7.3%) and Italy (5.4%). The overall trade balance of Macedonia is negative [OEC, 2019c]. Non-EU important trade partners are Serbia, which is the second largest trade partner after the EU both in import and export (5.9% of all trade), China is the third most important import market with 7.1%, and Kosovo is the third large export market (3.8%).

Russia does not play a very active role in trade of North Macedonia, the total trade exchange between them amounted to 173 mln EUR in 2016. However, of bigger importance are investments of Lukoil into the oil segment, Protec group into the pharmaceutical, and Strojtransgaz into gas.

Presence of *China* in North Macedonia is evident in investments into infrastructure (highway Skopje–Štip and Kičevo–Ohrid and railways reconstruction) — all together should cost 17 Bn. USD. The trade exchange reached 425 mln EUR in 2016 [kas.de, 2018].

Turkey has built strong economic and cultural ties with North Macedonia, 1.6% of North Macedonia's export is shipped to Turkey, in import its share is 4.8%. Up to 4.9% of all foreign direct investments are from Turkey [Vyskočová, 2019]. Turkish investments are directed to construction, banking and private health sector. Turkey has also built a new airport in Skopje.

Foreign trade value equals 113% of GDP (2016). North Macedonia became a full WTO member in 2003, and since then has reformed its trade policy in line with the WTO and EU rules.

3.2.3 EU trade with Serbia

All custom duties and other trade obstacles of mutual trade between the EU and Serbia were abolished in 2014, except for sensitive agricultural products (butter, meat yoghurt, honey, some cheese, vegetable, flours), which will remain protected until Serbia's EU accession [The Delegation of the European Union to the Republic of Serbia, 2018]. Traditionally, the EU is for Serbia the most important trade partner accounting for over 64% of total Serbian foreign trade, with 67.6% of export and 62.3% of import in 2017. Serbian export to the EU tripled from 3.2 Bn. EUR in 1993 to 5.9 Bn. EUR in 2017. Both EU imports from and EU exports to Serbia rose by 14% compared to the previous year. The detailed data are in table 3.5: *EU trade in goods with Serbia*. Trade balance is positive for the EU throughout the whole period 2010–2017. Total value of mutual trade reached 23 407 mln EUR in 2017.

Table 3.5: **EU trade in goods with Serbia (mln EUR, 2010–2017)**

	2010	**2011**	**2012**	**2013**	**2014**	**2014**	**2016**	**2017**
Import	4349	5147	5053	6588	7110	7880	8732	9997
Export	7881	9116	9660	9927	10357	11154	11693	13410
Balance	3532	3969	4606	3339	3247	3274	2961	3413

Source: [European Commission, 2017e].

The main EU import articles by SITC are machinery and transport equipment (33%), materials (24.1%) and other manufactured articles (13.6%). The EU export is predominantly formed by machinery and transport equipment (33.8%), materials (20.7%) and chemicals (16.2%) [European Commission, 2017e]. The EU is for Serbia an important export destination for agricultural products, almost half of them are shipped to EU markets. Serbia also imports food and agricultural products form the EU, over 60% of all agricultural imports originate from the EU [The Delegation of the European Union to the Republic of Serbia, 2019].

The most important Serbia's EU trade partners are Italy (14%), Germany (4.4%), Romania (4.4%) and Slovenia (4%) in export, Germany (12%), Italy (9.5%), Hungary (5.4%) and Slovenia (5.4%) in import [OEC, 2019e]. From other trade markets Russia is the second most important (6.7%), Bosnia and Herzegovina (5%) and China (4.9%) [European Commission, 2017e].

If we compare the presence of China, Russia and Turkey in Serbia, the *Russian presence* in Serbia is the most visible. Serbia imports 75% of natural gas from Russia. But even if Serbians perceive Russia as a big trade partner, the value of total trade with Russia is incomparable to that with the EU (6.7% vs. 64.5%). Serbia's import from Russia totalled 1.4 Md. EUR and export 0.9 Md. EUR in 2017. After Russian Gazprom bought a national energy company, Russian investments have controlled domestic gas production. The overall share of Russian foreign direct investments in Serbia is 9.11%, those from the EU amount to 69.98% [The Delegation of the European Union to the Republic of Serbia, 2019].

Trade talks on a preferential trade agreement between Serbia and the Eurasian Economic Union that might boost mutual trade that is already now traded within free trade area with removed tariff barriers for 99% of products, should be completed in the near future. Serbia, as Russia's biggest military and religion ally in the Western Balkans, did not support EU sanctions against Russia. Russia objects to Kosovo's statehood by not recognising Kosovo as an independent state.

Chinese presence is not that visible, but as a part of the 16 + 1 strategy and the Belt and Road initiative, China is planning to build infrastructure worth 5.5 Bn. EUR [Ambrosetti, 2018]. Up to now the share in Serbian foreign direct investments is 2.65%, which is less than the Russian share. Chinese export to Serbia reached almost 1.6 Md. EUR, import 0.05 Md. EUR.

The presence of *Turkey* in Serbia is rather low, Turkey's investment share is as small as 0.68% — smallest of all the Western Balkans. Export of Serbia is only 1.8% (367 mln EUR) and import 3.7% (633 mln EUR). For Turkey, trade share of trade with Serbia reached 0.29% of all Turkey's foreign trade. Despite the small trade volumes, Serbia is the biggest trade partner both in import and export for Turkey from the Western Balkans. To support the growth of trade ties the Turkish–Serbian council for cooperation was created in 2018 [Vyskočová, 2019].

Even if foreign trade is mostly liberalised, Serbia is not yet the member of WTO. The reason behind the accession process freezing was the Serbian production and trade ban on the genetically modified organisms, which is inconsistent with the WTO rules. Finally, the accession might be terminated until the end of 2019. Membership in the WTO should also help the EU integration process.

The problem of a deeper integration with the EU (EU membership) lies in the problem of Serbia–Kosovo relationships. Serbia rejects Kosovo's declaration of independence (2008) and considers Kosovo its territory. The issue of northern Kosovo, inhabited by Serbs defying the Kosovo government, is particularly sensitive. Despite several rounds of negotiations, no agreement was reached.

3.2.4 EU trade with Albania

The development of Albania was different from that of its regional neighbours. After World War II Albania joined the group of countries with communist ideology leaning towards the Soviet Union. The trade with communist countries accounted for 90% of its total foreign trade, half of it with the Soviet Union. In 1991 the share of trade with the Soviet Union reached 54% and with China — 7%. Changing the political and business orientation in favour of China, the trading with the Soviet Union gradually ceased by 1964. Ultimately, the cooperation with China was interrupted in the late 1970s [Nationsencyclopedia.com, 2015]. Self-sufficiency and economic independence efforts led to isolation and rising poverty, and Albania became the poorest country in the region. The transition from a centrally planned economy to a market-oriented economy, which started after the first free elections in 1992, supported by international aid and assistance, helped to start growth, reduce poverty and transform from the low to middle income country.

Even before signing the Stabilisation and Association Agreement, which has eliminated trade barriers, the trade between the EU and Albania was relatively high.

For Albania, the EU is the most important trade partner both in export and import. Albania exports 77.2% of its goods to the EU and imports 61.5%. Overall share of the EU in Albanian trade was 66.2% and reached 4492 mln EUR in 2017 [European Commission, 2017b]. The trade dependence of Albania declined compared to the year 2000, when 93.2% of all Albanian exports ended up on the EU market, import from the EU was 80% [Muś, 2018].

Table 3.6: **EU trade in goods with Albania (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2014	2016	2017
Import	895	946	1118	1235	1246	1165	1291	1503
Export	2187	2330	2444	2326	2468	2520	2708	2989
Balance	1292	1384	1326	1092	1222	1355	1418	1486

Source: [European Commission, 2017b].

EU import is constantly growing, in 2017 the import rose by 16.4% to 1503 mln EUR. Export also has an increasing pattern with exception of the year 2013, when it dropped by 4.8%. In 2017 export rose by over 10%. EU trade balance is positive over long term. Since 2014 EU import has been gradually rising, in 2017 rose by 16.4% compared to the previous year EU trade balance is growing steadily. More data on import and export are in table 3.6: *EU trade in goods with Albania*.

In EU imports the major share is made up of manufactured articles (54.9%), materials (13.1%) and mineral fuels (10.1%). Materials (24%), machinery and transport equipment (21.9%) and other manufactured articles (1.6%) predominated in EU exports in 2017. Among all exported items in overall Albanian export the following ones prevailed: leather footwear, crude petroleum, footwear parts, chromium ore and clothes [OEC, 2019a] — all products with small added value. Most of Albanian producers are unable to face competition from the EU. The reason is an inadequate level of production capacity, an insufficient quality of final products, lack of managerial capabilities and the inability to place a product on the European or international market. Albanian suppliers are, for the most part, only subcontractors of international corporations and supply products with low added value. Insufficient infrastructure along with the lack of promotion of Albanian products abroad makes their export even more difficult.

Considering Albania's competition advantages, such as cheap labour and proximity to EU markets, it can further raise export in agriculture and mining [European Commission, 2017b]. Albania is also an important deliverer of medical herbs and spices to EU markets (mostly Germany) and is the world's largest exporter of sage. Germany imports 2 500 tons of medical herbs, and the USA — 130 000 tons [Doka, D. 2018]. Regrettably, this segment is shrinking due to privatization, migration of young people to richer countries, environmental issues, and the fact that the work is poorly paid.

The top export market for Albania within the EU is Italy (46%), Greece (5.9%), Germany (4.3%) and France (4.2%). Italy (29%) is also the biggest import partner, followed by Germany (9.6%) and Greece (8.1%) [OEC, 2019a]. Among the non-EU partners, Turkey is the most important (8.1%) as well as China (7.9%) in import, Kosovo (7.7%) and Macedonia (3.1%) in export [European Commission, 2017b].

If we compare the trade openness of the economy (import + export /GDP) in 1993 with the present day situation, a great change is evident. In 1993 the share was 26.6%, in 2017 the share increased to 63%.

Russian relations with Albania are limited with little economic exchange, small investments are made in education and culture.

Of the main regional players, *Turkey*'s presence with 7.8% share in all Albanian direct foreign investments (501 mln EUR) is the most visible and it is the fourth largest investor. Investments are placed in strategic segments like energy, infrastructure building, telecommunication and production. EU share is 59.4%. Albania exported goods totalling 21 mln EUR, import reached 342 mln EUR [Vyskočová, 2019]. Their historical relations come from the Ottoman heritage, and Turkey also supports religious projects, e. g., building mosques.

China is among the most important non-EU trade partners. Amount of investments from China reached 760 mln USD in 2016 [Invest in Albania, 2018]. China took over the two large investment projects: the international airport and the Bankers Petroleum, the largest oil company, and it has long-term economic goals in Albania related to One Belt One Road initiative. Their investments, therefore, flow into infrastructure development.

Albania has removed tariff barriers since joining the WTO in 2000 and has the lowest import tariffs in the region. There are no significant non-tariff barriers, except for administrative bureaucracy including the application of sanitary and phytosanitary measures.

3.2.5 EU trade with Bosnia and Herzegovina

The EU–Bosnia and Herzegovina Stabilization and Association Agreement was signed in 2008 but has been suspended due to the inadequate implementation of the European Court of Human Rights rules and the lack of cooperation with the Hague tribunal. It did not come into the force until 2015.

For Bosnia and Herzegovina the EU is the most important trade partner in both import and export, 72.3% of their export goes to the EU and 60.8% of their import in 2017. The total value of mutual trade reached 9642 mln EUR [European Commission, 2017c].

Table 3.7: **EU trade in goods with Bosnia and Herzegovina (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2014	2016	2017
Import	2488	2951	2990	3244	3330	3493	3786	4268
Export	4202	4746	4830	4777	5024	5075	5265	5925
Balance	1714	1795	1840	1532	1695	1582	1478	1657

Source: [European Commission, 2017c].

EU import and export from Bosnia and Herzegovina is constantly growing with 12.8% increase in 2017 compared to the previous year. EU trade balance is in surplus throughout the whole period under review. More detailed information on trade development is in table 3.7: *EU trade in goods with Bosnia and Herzegovina*.

The commodity structure of EU imports consists of various manufactured articles (31.7%), materials (22.5%) and machinery and transport equipment (17.5%). EU is exporting materials (26.5%), machinery and transport equipment (23.8%) and chemicals and related products (13.8%) [European Commission, 2017c]. Among the most important export items are: seats, leather footwear, electricity, raw aluminium and vehicle parts, fastest growing among export categories are mineral fuels and aluminium. Bosnia and Herzegovina has highly negative net exports and, therefore, trade deficit for mineral fuel and related products. Exports are only worth 30% of GDP, one of the nethermost in Europe, which is an indicator of poor competitiveness. The reason of such an underperformance is weak business environment, bad infrastructure — Bosnia and Herzegovina has no highways, apart from two short sections close to the capital, low productivity (31% of EU average) and high labour costs.

The top export destinations for Bosnia and Herzegovina within the EU are: Germany (13%), Italy (13%), Slovenia (12%) and Austria (8.5%). The most relevant imports origins of Bosnia and Herzegovina from the EU are: Germany (12%), Italy (11%), Croatia (11%) and Slovenia (6.3%) [OEC, 2019b]. Among other important partners the most relevant are Serbia (10.7%), China (4.2%) and Turkey (4.1%) [European Commission, 2017c].

Even if *Russia* is not among the top 10 trade partners, and imports from the EU are 20 times higher than those from Russia, export from Bosnia and Herzegovina to Russia is growing, even if still reaching mere 55 mln EUR (2016). The country is fully dependent on Russian gas, with oil being imported from various countries [CSD, 2018]. Russian investments are significant. In 2006 the Russian company Zarubezneff bought three petrochemical companies worth 970 mln EUR [MZV SR, 2019b]. Russia is the largest investor in Republika Srbska and the fourth largest in Bosnia and Herzegovina with 547 mln EUR invested within the period of years 2015–2016 (8.1% of total foreign direct investments in Bosnia and Herzegovina). Russian companies reached a turnover of 1 Bn. EUR in 2016, in Republica Srbska the Russian share of total foreign controlled revenues was 39% compared to 33% of EU companies [CSD, 2018].

Turkish share in foreign direct investments is 3.1%, which is 215 mln EUR (EU share is 64.9%); share in Bosnia and Herzegovina's export is 3.8% (224 mln EUR) and in import is 3.5% (322 mln EUR). Bosna and Herzegovina is the second biggest import market in the Western Balkans for Turkey. [Vyskočová, 2019]. The countries signed a new free trade agreement in 2018 that is designed to further enhance mutual foreign exchange.

China has invested in power generations that can lead to future commodity dependence. The mutual trade is small.

Foreign trade with the EU is liberalized, but Bosnia and Herzegovina faces several non-tariff barriers when exporting agricultural products to the EU (food safety regulation). Bosnia met the criteria to export milk and dairy products to the EU in 2018 and will probably fulfil the conditions to export poultry to the EU soon. Bosnia and Herzegovina lost a significant food export market after Croatia accessed the EU.

Bosnia and Herzegovina is not a WTO member, but accession process is in progress. The matter of Bosnia and Herzegovina access to the Russian market should be discussed and resolved (mainly in agriproducts) and energy sector — the bilateral talks with Russia are the last step to full membership in the WTO.

3.2.6 EU trade with Kosovo

The Stabilization and Association Agreement was signed in 2016 and went in to force during the same year. EU trade in goods with Kosovo is very small, especially import that reaches only 89 mln EUR, total trade in 2017 had value of 995 mln EUR. The EU, with 41% share in Kosovo's trade, is Kosovo's most important overall trade partner. Accordingly, the EU is also Kosovo's biggest import market with 43.1% share. The share of exports was less significant 25%.

Table 3.8: **EU trade in goods with Kosovo (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Import	149	140	124	125	96	104	73	89
Export	681	736	714	724	728	764	854	906
Balance	532	596	590	599	632	660	781	817

Source: [European Commission, 2017d].

EU trade with Kosovo is the lowest in the Western Balkans. EU Imports have fluctuated from 124 mln EUR to 73 mln EUR and even if the year 2017 brought 23 % increase, the trade did not reach original level of 2012–2013. EU exports are higher and were rising for a long time, in the last year — by 6.2% reaching 906 mln EUR. EU trade balance is positive. More information about EU–Kosovo trade data development in 2010–2017 is in table 3.8: *EU trade in goods with Kosovo*.

EU import commodity structure consists of crude materials (26.9%), manufactured products (24%) and food and live animals (15.9%). The EU is exporting machinery and transport equipment (27.8%), food and live animals (18.1%) and chemicals (16.1%) [European Commission, 2017d]. Majority of overall Kosovo's export to the EU consists of base metals (27.8%), mineral products (25.9%), prepared meat, food and tobacco products (7.9%) and plant products (7.4%) [Balkan Insider, 2018].

As it has already been mentioned above, the EU is the most important trade partner, followed by Serbia (12.1%) and Turkey (8.7%). Serbia is the second key importer (12.3%), followed by Turkey (9.6%). Except for the EU, Kosovo exports mainly to Albania (16%), India (14%) and Macedonia (12.1%) [European Commission, 2017d]. In February 2018 the main export partners from the EU were Germany (7.7%), Holland (4.8%), Bulgaria (2.3%) and Austria (2.1%). The main EU import territories were Germany (11.9%), Greece (6.5%), Italy (5.8%), Poland (2.4%) and Bulgaria (2.4%) [BusinessInfo.cz, 2018].

Share of *Turkey* on Kosovo import is 1.9% (238 mln EUR), export 9.6% (7 mln EUR), Turkey realised only 0.08% of their foreign trade with Kosovo in 2017. Foreign direct investments accounted for 12.9% — 457 mln EUR in 2017 (EU 33.7%) [Vyskočová, 2019], most of them were spent for investments in power company, airport and other infrastructure. Since 2008 327 mln EUR has flown to Kosovo as investments and this makes Turkey the fifth biggest provider of foreign direct investments. The countries signed a free trade agreement in 2018, but the agreement was not yet ratified by Kosovo as the free trade could significantly diminish Kosovo's income from duties.

China has no diplomatic relations with Kosovo and rejects Kosovo's independence [kas.de, 2018]. The Russian involvement in Kosovo is also very small.

Generally, foreign trade is liberalized even if Kosovo is not a member of the WTO and did not even apply for membership. After joining CEFTA and signing the Stabilization and Association Agreement with the EU, the country establishes trade rules in line with the WTO and EU standards. In November 2018 Kosovo decided to apply 10–100% import tax for imported goods from Serbia and Bosnia, after Serbia blocked Kosovo from joining the Interpol. This is a seriously disturbing step because Serbia's export to Kosovo accounts for 1% of Serbian GDP, in case of Bosnia it is 0.5%. The EU tries to promote economic cooperation on the former Yugoslavian territory, but the dispute between Serbia, Bosnia and Kosovo makes it harder.

With trade openness of 71.4% GDP [BTI, 2018], Kosovo is still not fully integrated in the international trade. The share of export in GDP is around 6% and has not grown since 2010. Imports shares on GDP are almost 50% [Grieveson, 2018]. Kosovo is heavily dependent on remittances from abroad and 80% of foreign direct investments come from overseas diaspora.

3.2.7 Trade presence of Russia, China and Turkey on the Western Balkans markets

As the trade between the EU and the Western Balkan region is growing, so is the trade impact of Russia, Turkey and China increasing every year. Russia, China and Turkey are the most visible trade partners of the Western Balkans that could endanger the EU trade position in the region.

Table 3.9: **Western Balkan trade with the EU, Russia, Turkey and China (mln EUR, 2017)**

	Trade in mln EUR	WB export in mln EUR	WB import in mln EUR
EU	31 244	20 264	29 244
Russia	3116	1019	2096
Turkey	2544	744	1800
China	1710	554	1156
WB trade with world	65 405	23 765	41 640

Source: [Vyskočová, 2019], [TRADE MAP, 2019].

Table 3.9: *Western Balkan trade with the EU, Russia, Turkey and China* indicates the significance of the abovementioned countries on the trade of the Western Balkans and proves that in 2017 the trade position of the EU was not endangered.

Table 3.10 *Free trade agreements of the Western Balkans with Russia, China and Turkey* shows free trade agreements of Russia, China and Turkey with individual countries of the Western Balkans. Turkey has signed the free trade agreement with all Western Balkans, however, the one with Kosovo territory is not valid yet. China has no free trade agree-

Table 3.10: **Free trade agreements of the Western Balkans with Russia, China and Turkey (2017)**

	Russia	**China**	**Turkey**
Montenegro	Not in force — renegotiations	no	2008
North Macedonia	no	no	1995
Serbia	2009	no	2001, 2018
Albania	no	no	2006
Bosnia and Herzegovina	no	no	2002, 2018
Kosovo	no	no	2013 [x]

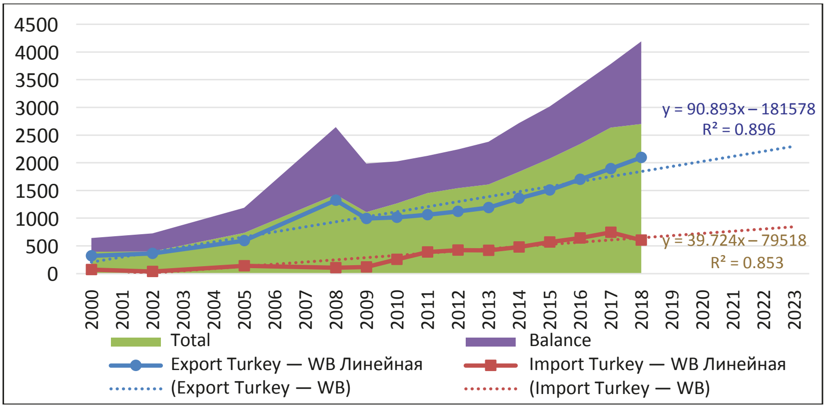
[x] not valid yet.
Source: [WTO, 2019].

ments with the region. Russia has valid agreement with Serbia. The EU has FTA with all the Western Balkans. Details on agreements with the EU are given in table 2.5 *The Stabilization and Association Agreements*. The free trade agreements are a powerful instrument for trade enhancement.

Russia is a traditional trade partner with a significant position in the region. For the region deliveries of energy, raw materials from Russia are vital, Bosnia and Herzegovina, North Macedonia and Serbia show a high degree of energy import (mainly natural gas) dependency. The biggest trade partner is Serbia (Russian share in Serbia trade is 6.7% and Russia is the second most important trade partner for Serbia), followed by North Macedonia. Trade with Albania and Montenegro is minimal. Imports to Russia do not exceed 100 mln USD, and they show declining trends since 2014 , even if recovery of imports was indicated in 2016. The decline was significantly affected by international sanctions against Russia and subsequent retaliatory sanctions of food imports into the Russian market with impact on commodity structure of export of the Western Balkans to Russia. Russian foreign direct investments in Montenegro make up 30% of Montenegro's GDP. One third of all companies in Montenegro were owned by Russian capital in 2016. In contrast to that, in North Macedonia foreign direct investments from Russia accounted for only 1%, in Serbia 9.11%, in Bosnia and Herzegovina 8% in 2017 [Andelkovic, 2018].

The trade exchange of Turkey with the Western Balkans, and, notably, import of Turkey from the Western Balkans, started to rise after the 2009 financial crisis, probably after the urge for territorial diversifica-

Figure 3.7: **Turkey trade in goods with the Western Balkans (2000–2023)**



Source: [Vyskočová, 2019].

tion of the Western Balkans, when the demand for their exports weakened in the EU. Turkey's import from the Western Balkans increased by 730% over the period of 2000–2018, export by 553% in relative values (absolute values are not that high). Turkey exported goods totalling 1800 mln EUR, import reached 744 mln EUR. Chart 3.7: *Turkey trade in goods with the Western Balkans* shows growing tendencies of trade of Turkey with the Western Balkans, and it is highly probable that the mutual exchange will grow in the following years — import in 2019 and 2020, export as of 2020 (confirmed by the extrapolation method[2]).

Turkey–Western Balkans trade is positively influenced by the lira depreciation, which makes Turkeys export more affordable for price sensitive markets of the Western Balkans. Turkey exports to the Western Balkans materials (35%), machinery and transport equipment (23%); import consists of materials (35%), food live animals (20%), machinery and transport equipment (13%) and oils and fats (11%). The biggest trade partner from the region is Serbia (49.3%). Turkey's trade involvement in trade with Kosovo and Montenegro is minimal. Foreign direct investments form Turkey totalled 1476 mln EUR in 2017, majority of them in Albania and Kosovo, in the countries with similar religious values [Vyskočová, 2019].

China is the second most important partner of Albania (6.5% or total Albanian's trade) and Montenegro (15.3%), the third biggest trade

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2 $y = \beta_0 + \beta_1$ year

y — estimation of the dependent variable values (import, export, turnover),

β_0, β_1 — estimated unknown parameters.

partner of Serbia (4.9%), North Macedonia (3.8%), and Bosnia and Herzegovina (4.2%). Chinese influence in the Balkans has been evident since 2012 when the 16+1 Platform was introduced. China's investments, within the Belt and Road initiative, flow mainly into infrastructure, steel and other sectors. Construction of highway connecting Montenegrin coastal area with Beograd in Serbia is to be financed by Chinese credits (even if feasibility studies state that the project is not bankable). Despite the fact that the Balkans are not of high interest for Chinese trading and investments intentions, China strongly supports integration of the Balkans in the EU, which is one of China's biggest trade partners, and the Balkans can serve as a bridge to the EU. For the EU, Serbia is the most important trade partner from the Western Balkans with a steady growth of trade on both sides. Albania and Kosovo are the smallest EU trading partners in the region. The EU tries to stabilize and support trade and investment cooperation both between the EU and individual countries of the Western Balkans, and as within CEFTA (Central European Free Trade Are), a free trade area with the Western Balkans and Moldova. This project does not fully flourish, because the problem of Kosovo–Serbia political relations has transformed into trade obstacles, insufficient trade competitiveness of the Western Balkans and the lack of sources for improvement. After 20 years of the EU–Balkan integration process the countries seem to be more fragile and dependent on the EU: all the Western Balkans liberalised trade with the EU within the Stabilization and Association agreements, though, unfortunately, this did not help to accelerate development and achieve stability. The Western Balkans question the suitability of the EU model for the region, and the EU preferences among the populace are decreasing. Only 26% of Serbians, 31% of Bosnians, 54% of Macedonians and 44% of people from Montenegro are in favour of EU membership. In contrast, in Albania 81% of Albanians think that joining the EU would be the best way for their country [Bonomi, 2018]. The EU policy towards the Western Balkans needs:

- Flexible and differentiated approach,
- Reform of enlargement policy,
- Sectoral integration prior EU entrance,
- Sufficient resources to run the policy and motivate for reforms.

The EU should react to rising positions of Russia and China (and partly Turkey), both in trade and geopolitics. Chinese 16+1 strategy and the Belt and road strategy can lead to a debt crisis in the region and weaken already unstable countries in the region. The EU is also worried that Chinese strategy can weaken the EU geopolitical position in the region and that China will build a gateway to the EU once the Western Balkans manage to access the EU as full members. Russian presence in the region is significant, especially in Serbia and Bosnia and Herzegovina and, from the point of view of investment, also in Montenegro, though the EU position of a strong trade partner has recently become expressive. Turkey is present in the countries with stronger historical, cultural and religious ties, which were historically part of the Ottoman Empire. Turkey's trade has not recently jeopardized the EU positions, and there is no indication this could happen in the coming years.

EU trade with the Western Balkans has a growing pattern with an annual increase over the whole period under review. Even if the presence of Russia, Turkey and China is visible, from the trade perspective the EU–Western Balkans trade links are very strong, far beyond the influence of other partners, so any dramatic reversions are hardly expected in the near future. The Western Balkan region is a large market of 18 million consumers with growing demand.

3.3 EU trade relations with Ukraine

For the EU, Ukraine is a priority partner within the Eastern Partnership. Ukraine is the second largest European country by area after Russia. It offers a large consumer market (one of the largest in Central and Eastern Europe), with population of approximately 44.8 million people; significant natural, mineral, petroleum, hydropower, and other resources of commercial importance[3]; huge agricultural potential thanks to its agricultural land (that is 71% of the country's land area, of which 32.5 million hectares is arable) [Dankevych et al., 2017] and famous black soils ("chernozem"), one of the most fertile soils in the world; a skilled workforce; as well as an energy transport infrastructure. The country has a strategic geographical position at the crossroads between Europe and Asia, it links the EU with Russia and the Central Asian region. At the same time Ukraine has a geostrategic position in which the EU's, Russia's and the US strategic security interests meet; it is also one of the main transit routes of Russian natural gas to European countries and therefore a key territory both for the Euro-

[3] Significant resources include iron ore, coal, manganese, natural gas, oil, salt, sulphur, graphite, titanium, magnesium, kaolin, nickel, mercury, as well as rare earth elements.

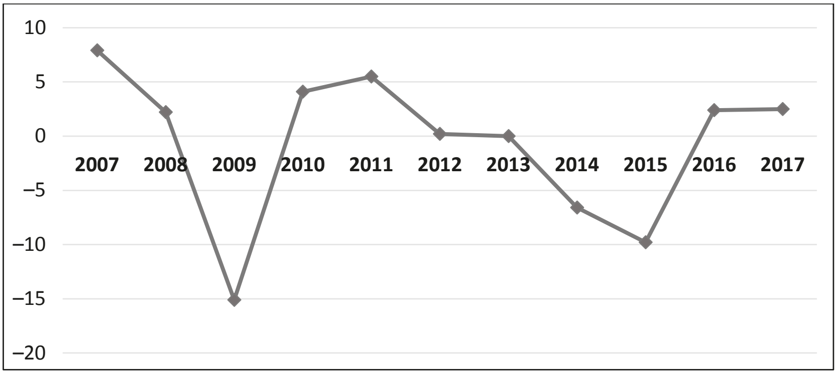
pean Union and for Russia [Pigliucci, 2018]. These facts create great economic potential for further deepening and expanding mutual cooperation with the EU.

On the other hand, its problematic areas include the economic situation, the unstable political situation and the historical "inheritance" (from the time of the Soviet Union), which are reflected in the persisting political and economic dependence on Russia.

Ukraine has experienced serious political, security, and economic challenges, several momentous events, including the outbreak of conflict in eastern Ukraine. In 2014 the performance of the Ukrainian economy decreased by 7% compared to the previous year, the adverse political situation was triggered by the events of November 2013, escalating conflicts in the east of the country led to the disruptions in major export industries and deteriorating trade (as well as political) relations with Russia. In 2015 economic recession deepened, the economy contracted by 9.8% (Figure 3.8). The main causes include a decline in activities, particularly in the financial, insurance and retailing sectors, national currency depreciation, decline of global prices for wheat (main export crop) and steel, as well as the persisting conflict with Russia.

In 2016 Ukrainian economy grew by 2.4% after a decline in previous years. According to the State Statistics Service of Ukraine, in 2017 the GDP growth remained at roughly the same level (2.5%). The Ukraine's growth outlook depends critically on the implementation of reforms on multiple fronts to achieve sustainable recovery and shared prosperity, according to the World Bank [World Bank, 2019b]. In 2018 the GDP grew by 3.3% [Ukrstat.org. 2019], the growth was driven by a good

Figure 3.8: **Ukraine's GDP growth, at constant prices (% over previous year)**



Source: own elaboration according to data of the State Statistic Service of Ukraine [Ukrstat.org, 2019].

agricultural harvest and by the sectors dependent on domestic demand (trade and construction) [World Bank, 2019c].

3.3.1 Legal framework

The EU and Ukraine Association Agreement (including the DCFTA agreement) was negotiated between 2007 and 2011 and signed in March 2014 (political part) and in June 2014 (trade part). General parts of the agreement (political and cooperation provisions) have been provisionally applied since November 2014. The measures of the AA trade part (DCFTA) have been applied provisionally since 1 January 2016.

The Association Agreement for Ukraine implies the adoption of European values, political commitments and the harmonization of legislation with the EU legislation (up to approximately 80%). Key sectors will be aligned with the EU standards. The Association Agreement came fully into force on 1 September 2017 and replaced the earlier frameworks for cooperation (Partnership and Cooperation Agreement).

The EU–Ukraine Association Agreement is a new legal framework, which establishes a unique form of political association and economic integration, therefore, it should be perceived as an innovative legal instrument providing for a new type of integration without EU membership. It is characterized by three specific features: comprehensiveness (covers the entire spectrum of EU-Ukraine relations), complexity (high level of ambition — the “deep” integration requires extensive legislative and regulatory approximation) and conditionality (the EU’s engagement is dependent on the country’s performance), as one of the principles of the Eastern Partnership [Petrov, Van Elsuwege, 2015].

The DCFTA as a major milestone in bilateral trade relations offers new economic opportunities. The agreement constitutes a comprehensive liberalization of mutual trade relations in a wide range of areas, both in the area of tariff and non-tariff trade. Ukraine can benefit from stable and predictable preferential access to the EU market, while European companies receive easier access to the Ukrainian market. The DCFTA foresees a gradual asymmetric trade liberalisation. The FTA will be established progressively within a period of 10 years. The EU immediately removed its import duties for most industrial goods (some products like motor vehicles, chemicals will be liberalised after a transitional period of 3–7 years). After a transitional period, the share of EU exports liberalised by Ukraine will increase to 96%. As for agricultural products, both parties negotiated transitional periods (10 years) and increased tariff rate quotas for meat (pork, beef, and poultry), specific types of cereals and sugar [Van der Loo, 2017]. Trade and trade-related legislation will be broadly harmonized. In addition to tariffs, other areas of liberalization include [Van der Loo, 2017]:

- Technical barriers to trade;
- Services, e-commerce;
- Sanitary and phytosanitary measures;
- Intellectual property rights;
- Trade-related energy and energy cooperation[4];
- Customs and trade facilitation;
- Competition;
- Public procurement;
- Sustainable development.

The DCFTA's implementation means Ukraine's gradual integration in the EU internal market. Both the EU and Ukraine continue to work to ensure the opportunities and benefits for their businesses within the framework of the agreement.

3.3.2 Mutual trade relations

The European Union and the Russian Federation are Ukraine's most important trading partners. However, their share in the Ukrainian trade has changed significantly, as documented in the following table.

Table 3.11: **Ukraine's trade in goods — trade with Russia and the EU comparison (billion EUR)**

	2013		**2015**		**2017**	
	Export	**Import**	**Export**	**Import**	**Export**	**Import**
Ukraine total	*63.3*	*77.0*	*38.1*	*37.5*	*43.3*	*49.6*
→ Russia	15.1	23.2	4.8	7.5	3.9	7.2
→ EU	16.8	27.0	13.0	15.3	17.5	20.8

Source: our own elaboration according to the data of the State Statistical Service of Ukraine [Ukrstat.org, 2019]

4 This is the first EU agreement with specific provisions on trade-related energy issues. It covers electricity, crude oil and natural gas.

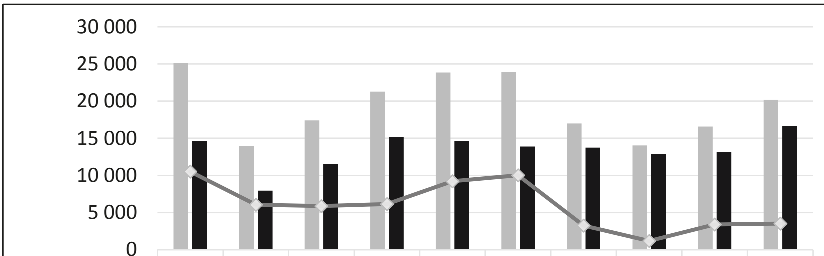
According to the data of Ukraine's foreign trade results from 2013 to 2017, Ukraine's foreign trade decreased, whereby in 2015 most significantly (export value decreased by almost 30% and the value of imports by 31%, as compared to 2014). In 2017, however, Ukraine's exports increased by 19% and imports by 24%, as compared to 2016. A similar growth trend was recorded in 2018 as well (exports by 9.4% and imports by 15.3%) [Ukrstat.org, 2019].

As far as the comparison of the development of trade with the EU and Russia is concerned, it is evident that Russia's share in Ukraine's foreign trade declined significantly — from 27% in 2013 to 12% in 2017. As for Ukraine's exports to Russia and imports from Russia in 2015, these fell by 50.7% and by 41.1% respectively (as compared to the previous year). In 2017 mutual trade increased, on exports side by 9.6% and by almost 40% on the imports side. On the contrary, the European Union's share of Ukrainian foreign trade increased to 41.2% in 2017, as compared to 31.2% in 2013. Among the main trade partners of Ukraine from the EU member states in 2014 were Germany, Poland, Italy, Hungary and the Netherlands [Bebiakova, 2016].

However, Ukraine is not among the EU's top trading partners, in 2018 it accounted for just 1% of the EU total trade and ranked 21st among the EU trade partners. Ukraine's share in the EU foreign trade declined, and while in 2008 total exports to the EU accounted for 1.9%, in 2012 it accounted for 1.4%, in 2018 falling to mere 1.1% of the EU total exports.

The EU foreign trade with Ukraine developed at a steady pace until the global financial and economic crisis, and in 2010 resumed its growth path. However, till 2017 the EU exports (as demonstrated in Figure 3.9) did not reach the export values it had before the crisis. In 2014 and 2015 mutual trade decreased sharply (by 18% and 29% respectively, in comparison to 2013). From 2016 EU exports (imports as well, at a slower pace) have continued to increase, overall trade increased by 24% in 2017 (compared to 2016) to almost 37 billion euro. This could be assigned also to the first concrete results of the DCFTA implementation [EEAS, 2018c]. The DCFTA helped Ukraine to increase exports to the EU in 2017, while the total volume of exports largely returned to pre-crisis levels [Jarábik et al., 2018]. At the same time, many European companies seized the trade and investment opportunities created by the agreement [Barber, 2018]. Moreover, Ukraine benefited also from unilateral preferential access to the EU market through autonomous trade measures for several industrial goods and agricultural products which came into force in October 2017 and supplemented the AA/DCFTA

Figure 3.9: **The development of the EU–Ukraine trade in goods (mln EUR)**



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Export	25 159	13 991	17 413	21 283	23 866	23 899	16 993	14 034	16 568	20 196
Import	14 642	7943	11 547	15 152	14 648	13 882	13 734	12 844	13 182	16 683
Trade balance	10 517	6048	5866	6131	9218	10 017	3259	1190	3386	3513

Source: our own elaboration according to Eurostat data.

concessions. The EU regulation on the measures exceeds the quantities of agricultural products that Ukraine can export to the EU without paying customs duties and accelerates the elimination of EU import tariffs for several industrial products, as foreseen in the EU–Ukraine Association Agreement [European Commission, 2019]. The impact of these measures on Ukraine's exports is positive, however, quite limited [Movchan, Giucci, 2017].

The EU continues to strengthen its position as the Ukraine's largest exports (40.7% of Ukraine's exports) and imports partner (42.2% of Ukraine's imports).

From the commodity structure point of view, for the EU exporters the Ukrainian market is particularly interesting in the industrial products sector, especially machinery and transport equipment, which account for up to 37% of the EU total exports to Ukraine. Next are chemicals (pharmaceuticals), other engineering equipment, agricultural products (food) and fuels.

On the other hand, Ukraine's exports to the EU are driven mainly by agricultural production (grain, unprocessed tobacco, seeds) accounting for 35% of exports to the EU; iron and steel (19%) and fuels and mining products (16% in 2017), other machinery [European Commission, 2018b]. The structure of Ukrainian exports has shifted significantly towards value added products, which in 2018 accounted for 43% of Ukrainian exports to the EU [Emerging Europe, 2019].

EU continues to strengthen its position as the Ukraine's largest trading partner accounting for more than 40% of its total trade, as well as its largest exports and imports partner. The EU–Ukraine Association Agreement should be perceived as an innovative legal instrument providing for a new type of integration without EU membership. Its trade part (DCFTA) as a major milestone in bilateral trade offers new economic opportunities — constitutes a comprehensive liberalization of mutual trade in a wide range of areas, foresees a gradual asymmetric trade liberalisation.

3.4 EU foreign trade with Russia

At the present time, development of international economic relations is a result of long-term impact of several factors causing global changes. Many of increasing challenges and tensions have developed in recent years, which ensue from the globalization trends and have a major impact on the development of the world economy. These include increasing tensions in the Korean Peninsula, disputes about the South China Sea, warfare in Eastern Europe, environmental problems, protectionist foreign policy of the United States of America, terrorism and the rise of extremism in several countries of Europe [Kašťáková, Baumgartner, 2017].

Tight linking of economies operating in the globalized world can be badly influenced by these problems and each negative impulse can be reflected in the statistical indicators of the international trade. This can be also observed in the EU's foreign trade with its major trading partners, including Russia [Grinberg, 2010].

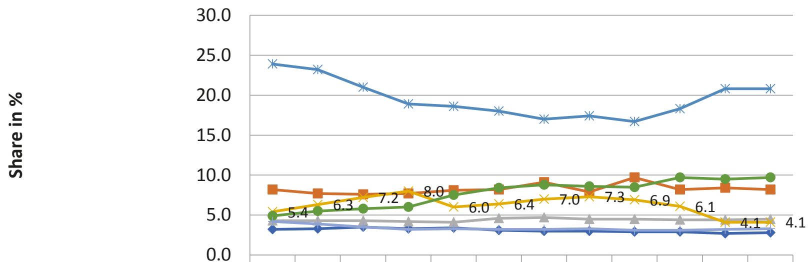
The current development of Russia, according to Bogomolov [2010], should preferably evolve in line with the principles of the market economy and not conserve the so-called democratic facade hiding the authoritarian regime. The strategies for the modernization of the Russian economy and their successful implementation should improve the long-term position and impact of Russia not only on world markets, but also on the interstate political scene [Šikula, 2010]. This process is negatively affected and, in particular, slowed down under the influence of the western sanctions that the Russian Federation has had to face since 2014. As follows from the nature of the sanctions that have persisted so far, at present there is an unrealistic scenario of a complete transformation of the nature of the Russian exports and, therefore, de facto the Russian economy. Despite the efforts to intensify trade relations with Eastern countries (mostly China and India), these countries cannot compensate the important role of the EU as a Russian trading partner. This modernization model is referred to as "Economy of innovation". Importantly, it will be necessary to evaluate the role that the country's energy sector will play in this transition.

With focus on the quality of the EU–Russia foreign trade relations in the energy sector, the EU does not see the risk of its energy dependence as life-threatening, even though it is aware of its importance. However, Russia is not the only source from which the EU acquires its strategic raw materials, such as natural gas and oil. The EU and Russia are long-term traditional trading partners, and their trade interdependence is not only due to energy dependency of the EU countries from Russia [Drieniková, Zubaľová, 2013]. The intensity of the EU's political partnership with the Russia is also an important part of the relationship, which is currently affected by sanctions. The success of Russia's economic relations with the Asian and OPEC countries can also have a significant impact [Baláž, Zábojník, 2010]. The fact that some countries are heavily dependent on Russian supplies of energy raw materials brings with it the fact that Russia is also dependent on its customers, especially from the EU, as well as on transit countries, such as Ukraine, Belarus and Slovakia. Therefore, Russia seeks to diversify its export markets to China and Japan. The US is not excluded in the future either in order to diversify the transit routes by building new gas pipelines and pipelines to new or old customers [Gonda, 2013].

There are many geopolitical changes and economic factors that affected the mutual trade between the EU and main trading partners in the years 2005–2016. After recording a significant and almost continuous fall until 2011, the share of the United States in the EU total trade in goods began to increase again reaching 17.7% in 2016. The share of China almost tripled since 2000, rising from 5.5% to 14.9% in 2016. Since 2013 the share of Russia in the total EU trade in goods nearly halved to 5.5% in 2016, as did the share of Japan since 2000, falling to 3.6% in 2016. As for Switzerland and Turkey, their share remained relatively unchanged over the entire time period.

In 2016 the United States (€610 bn, or 17.7% of the total EU trade in goods) and China (€515 bn, or 14.9%) continued to be the two main goods trading partners of the European Union (EU), well ahead of Switzerland (€264 bn, or 7.6%), Russia (€191 bn, or 5.5%), Turkey (€145 bn, or 4.2%) and Japan (€125 bn, or 3.6%).

Figure 3.10: **Share of the biggest trading partners in export of the EU (2005–2016)**



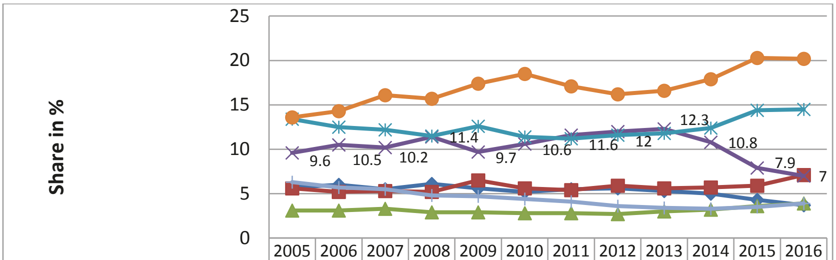
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Norway	3.2	3.3	3.5	3.3	3.4	3.1	3.0	3.0	2.9	2.9	2.7	2.8
Switzerland	8.2	7.7	7.6	7.7	8.1	8.2	9.1	7.9	9.7	8.2	8.4	8.2
Turkey	4.3	4.3	4.3	4.2	4.1	4.6	4.7	4.5	4.5	4.4	4.4	4.5
Russia	5.4	6.3	7.2	8.0	6.0	6.4	7.0	7.3	6.9	6.1	4.1	4.1
United States	23.9	23.2	21.0	18.9	18.6	18.0	17.0	17.4	16.7	18.3	20.8	20.8
China (except Hong Kong)	4.9	5.5	5.8	6.0	7.5	8.4	8.8	8.6	8.5	9.7	9.5	9.7
Japan	4.2	3.9	3.5	3.2	3.3	3.2	3.2	3.3	3.1	3.1	3.2	3.3

Source: data from [EUROSTAT, 2017].

Figure 3.10 and 3.11 show the share of the EU top trading partners in export and import in the years from 2005 to 2016. The figures prove declining position of Russia as the trading partner of the EU. In 2016 Russia was only fifth biggest export partner with 4.1 per cent in the total EU export. It was fourth biggest import partner for the EU with 7.0 per cent in the total EU import. In 2005, Russia was the EU's third biggest importer and third biggest export partner [Kašťáková, Baumgartner, 2017].

Figure 3.12 shows the trade balance between the EU and Russia in the years from 2005 to 2017. We can see fluctuation in mutual trade. There was an enormous decline in both export and import in 2009 due to the global financial and economic crisis. The decrease in export and import was about 30 per cent. Nowadays the trade is affected by mutual economic sanctions and declining of prices on oil and natural gas. Trade balance between the EU and Russia was passive all the time in the years 20052–017. The EU members have to import oil and natural gas, and this will not change in the near future. In 2017 the passive saldo of trade balance was 58.908 billion EUR. Decreasing of the passive saldo of trade balance between the EU and Russia was mainly due to low prices of oil and natural gas in 2017.

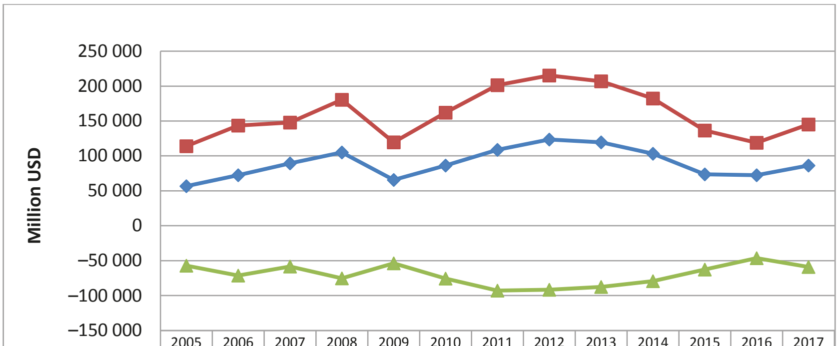
Figure 3.11: **Share of biggest trading partners in import to EU years 2005–2016**



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Norway	5.7	6	5.5	6.1	5.6	5.2	5.5	5.6	5.3	5	4.3	3.7
Switzerland	5.6	5.2	5.3	5.2	6.5	5.6	5.4	5.9	5.6	5.7	5.9	7.1
Turkey	3.1	3.1	3.3	2.9	2.9	2.8	2.8	2.7	3	3.2	3.6	3.9
Russia	9.6	10.5	10.2	11.4	9.7	10.6	11.6	12	12.3	10.8	7.9	7
United States	13.4	12.5	12.2	11.5	12.6	11.4	11.2	11.6	11.8	12.4	14.4	14.5
China (except Hong Kong)	13.6	14.3	16.1	15.7	17.4	18.5	17.1	16.2	16.6	17.9	20.3	20.2
Japan	6.3	5.7	5.5	4.8	4.7	4.4	4.1	3.6	3.4	3.3	3.5	3.9

Source: data from [EUROSTAT, 2017].

Figure 3.12: **Trade balance EU-Russia between years 2005–2017**



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Export	56 690	72 399	89 196	104 970	65 697	86 308	108 587	123 469	119 450	103 202	73 737	72 406	86 186
Import	113 981	143 602	147 734	180 446	119 569	162 079	201 329	215 131	206 972	182 418	136 406	118 782	145 094
Trade balance	–57 291	–71 203	–58 538	–75 476	–53 872	–75 771	–92 741	–91 662	–87 523	–79 216	–62 669	–46 376	–58 908

Source: data from [EUROSTAT, 2017].

The export structure of Russia to the EU has remained unchanged over the last 10 years. The most tradable products are energy raw materials, such as oil and natural gas, metals, logs and chemical products. The decline of trade in oil and gas with the EU has pressured Russia to find new customers in China and countries of APEC.

EU commodity structure and imports with Russia is calculated according to SITC in 2017. The biggest share of export of the EU to Russia lies in group 7 — Machinery and transport equipment with 42.2 percent. Group 7 is followed by group 5 — Chemical and related products with 17 per cent, while group 0 — Food and live animals accounts for 13 per cent and group 6 — Manufactured goods makes up 11.3 per cent. The EU mainly imports from Russia the products of group 3 — Mineral fuels with the share of 75.7 per cent in the total import. The export of the EU to Russia is more diversified and exported products have higher added value than the imported from Russia to the EU.

3.4.1 The evaluation of the EU trade with Russia based on the analysis of selected indices

Comparative advantage theory is one of the most important methods used in evaluating international trade. Revealed comparative advantage (RCA) was originally used by H. H. Liesner [Liesner, 1958]. The expression of comparative advantage was used in the Balassa index which shows the comparative advantages of the economy. According to this analysis, individual economies specialize in the manufacturing of those products where enough comparative advantages are reached, and these products are placed on foreign markets through international trade [Balassa, 1965].

The theory of comparative advantages was first developed and published by David Ricardo in 1817. The philosopher and economist John Stuart Mill further developed this area in the middle of the 19th century in the theory of reciprocal demand. After that Alfred Marshall applied the factors of demand and supply in the form of their reciprocal curves. Over time, neoclassical theories or models follow and extend these classical models of foreign trade. Mainly Heckscher–Ohlin–Samuelson's (H-O-S) model of comparative advantage enriched with factors of production [Baláž, 2010].

There are several ways to identify revealed comparative advantage. One of them is the Balassa index RCA which may be defined in several ways. One of the calculations says that it is as the ratio of the difference between the export and import of commodity groups and the sum of exports and imports of these commodity groups. This points to a comparative advantage in exports and thus its competitiveness [Balassa, 1965]. This method is frequently used and reported in literature.

$$\mathbf{RCA_1} = \frac{(xij - mij)}{(xij + mij)}. \quad (1)$$

Where x_{ij} stands for export of country j in commodity group i and m_{ij} import of country j in commodity group i. For RCA_1 apply: [Greenaway, Milner, 1993] $RCA_1 = -1$ if there is no export ($x_{ij} = 0$), $-1 < RCA_1 < 0$ indicates comparative disadvantage, $RCA_1 = 0$ indicates export = import ($x_{ij} = m_{ij}$), $0 < RCA_1 < 1$ denotes revealed comparative advantages, $RCA_1 = 1$ indicates there is no import.

The second expression reveals a comparative advantage logarithm of the share of exports and imports of goods categories of the countries in total exports and imports of the same country, which we will evaluate in this paper.

$$\mathbf{RCA_2} = \ln \frac{xij}{mij} \Big/ \frac{Xj}{Mj}, \quad (2)$$

Where xij is the value of export of i group products analysed in the sector of country j, m_{ij} the value of import of the country i products analysed sector of country j, X_j the value of total exports of country j and M_j the value of total imports into the country j. For RCA_2 apply: $RCA_2 > 0$ suggests that in the country there exists revealed comparative advantage for exports of the commodity group, $RCA_2 < 0$ induces revealed comparative disadvantage in the commodity group.

For more detailed identification of the revealed comparative advantage [Hinloopen, Merrewijk, 2001], possible values of the index can be classified into four categories (a-d) determining its size, respectively intensity:

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

The geopolitical and economic factors also caused changes in revealed comparative advantages. To calculate the values of revealed comparative advantages of foreign trade of the EU and Russia, we have used logarithmic formula. The results revealed comparative advantage of the EU in some groups of products and how strong this advantage is. The revealed comparative advantage in various group of products classified by SITC rev. 3 you can find in Table 3.12.

The results show that there is strong asymmetry in foreign trade between EU and Russia. It is caused by the specialization of the EU's

Table 3.12: **RCA$_2$ of EU—Russia years 2005 to 2015**

SITC	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
0	2.43	2.44	2.29	2.47	2.73	3.13	2.66	2.28	2.48	1.99	1.35
1	3.53	3.50	3.18	2.98	2.88	3.23	3.56	3.57	3.48	3.20	2.80
2	–1.39	–1.26	–1.29	–1.13	–0.55	–0.74	–0.53	–0.38	–0.29	–0.49	–0.52
3	–4.87	–4.85	–4.84	–4.90	–4.45	–4.59	–4.42	–4.29	–4.51	–4.66	–4.51
4	1.90	1.43	1.11	1.17	0.84	1.04	1.27	0.69	0.50	1.03	0.85
5	1.40	1.55	1.38	1.30	1.73	1.73	1.66	1.60	1.63	1.59	1.55
6	0.12	0.10	0.00	0.17	0.44	0.24	0.30	0.41	0.48	0.28	–0.01
7	3.70	3.92	3.77	4.02	3.76	3.91	3.96	3.91	3.83	3.64	3.12
8	3.27	3.46	3.48	3.79	3.85	3.97	3.97	3.81	4.00	4.06	3.68
9	–0.80	–0.97	0.09	–0.52	–0.70	–0.28	–0.28	–0.69	–0.17	–0.18	0.16

Source: own calculations.

Note: 0 — Food and live animals, 1 — Beverages and tobacco, 2 — Crude materials, inedible, except fuels, 3 — Mineral fuels, lubricants and related materials, 4 — Animal and vegetable oils, fats and waxes, 5 — Chemicals and related products, n.e.s., 6 — Manufactured goods classified chiefly by material, 7 — Machinery and transport equipment, 8 — Miscellaneous manufactured articles, 9 — Commodities and transactions not classified elsewhere int he SITC.

exporters in products with high added value in comparison to exporters from Russia. As you can find in the table 1 the EU has almost in all groups revealed comparative advantage in mutual trade with Russia. The exceptions are groups two and three (crude materials and mineral fuels). There were some negative changes for the EU in the year 2014 and 2015. These changes were in group 0 — Food and live animals, 1 — Beverages and tobacco, 4 — Animal and vegetable oils, fats and waxes and 6 — Manufactured goods classified chiefly by material. Small changes were in group 5 — Chemical products and 7 — Machinery and transport equipment. The EU has the revealed comparative advantage in these group of commodities, but the results show that the intensity of these advantages decreased. On the other hand, we can see that the EU has moderate comparative advantage in group 7 and 8. In group 7 there are products with high added value, and this is good signal for the structure of export of the EU to Russia.

Russia has a revealed comparative advantage in group 3 — Mineral fuels and in group 2 — Crude materials, inedible, except for fuels in the long term. In the year 2015 there was a small advantage registered in group 6 — Manufactured goods. There are not relevant reasons for changes by revealed comparative advantages for Russia in groups 2 and 3 in the near future. In group 6 it can be different. If the mutual trade sanctions will be dissolved, the advantage could be back to the EU in this group in the future.

The second index we will use is the Grubel Lloyd index. In 1971 and 1975, Grubel and Lloyd published the first book on intra-industry trade that pioneered a generation of research on IIT's empirical, theoretical and policy implications. Grubel and Lloyd were the first to analyse a potential anomaly that a high proportion of the country's trade consists of internal and external trade in the same group of products. Since that time, based on this index, it has been possible to express the current import and export of similar products in selected countries. This business which is defined as intra-industry trade GL index refers to products that are similar or slightly different and can be explained in different ways [Grubel, Lloyd, 1975].

The GL index measures intra-industry trade as a percentage of a country's trade under the assumption that trade was balanced, implying that exports and imports are equal. The index of intra-industry trade is defined:

$$\mathrm{GLI} = [(Xj + Mj) - (Xj - Mj)]/(Xj + Mj), \tag{3}$$

where Xj stands for export of commodity j and Mj for import of commodity j. The index's range is from 0 to1 but when GLI = 0, the country is a netto importer or exporter where there is no intra-industry trade. This means that the country takes in consideration either only exports or only imports of good i.

If GLI = 1, it means that there exists intra-industry trade between countries, i.e. that the country takes into consideration exports of goods as much as imports. The index values are expressed between 0 and 1. A higher index value identifies a higher level of specialization in intra-industry exchange, whereas, a lower value of GL index indicates that the foreign trade is closer to the interindustry trade [Egger, Greenaway, Egger, 2005].

The GL index shows us the size of intra–industry trade between the EU and Russia. Development of GL index of EU–Russia between 2005 and 2015 is in Table 3.13.

After the analysis of the results, we can assume that some changes are evident in intra–industry trade between the EU and Russia in the selected period of time. The biggest increase between 2014 and 2015 was

Table 3.13: **Grubel-Lloyd index of EU—Russia years 2005 to 2015**

SITC	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
0	0.28	0.26	0.25	0.21	0.20	0.14	0.22	0.28	0.24	0.36	0.60
1	0.10	0.10	0.11	0.13	0.17	0.13	0.09	0.09	0.09	0.12	0.18
2	0.24	0.28	0.32	0.37	0.52	0.43	0.51	0.59	0.64	0.55	0.53
3	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.01	0.01	0.01
4	0.43	0.58	0.64	0.61	0.83	0.76	0.65	0.89	0.98	0.73	0.83
5	0.62	0.54	0.53	0.56	0.45	0.47	0.49	0.49	0.48	0.50	0.52
6	0.77	0.78	0.82	0.91	0.97	0.85	0.88	0.96	0.99	0.90	0.74
7	0.09	0.07	0.06	0.05	0.07	0.07	0.06	0.06	0.07	0.08	0.14
8	0.13	0.10	0.09	0.06	0.07	0.06	0.06	0.07	0.06	0.05	0.08
9	0.40	0.36	0.86	0.59	0.46	0.70	0.61	0.47	0.69	0.68	0.82

Source: our own calculations.

Note: 0 — Food and live animals, 1 — Beverages and tobacco, 2 — Crude materials, inedible, except fuels, 3 — Mineral fuels, lubricants and related materials, 4 — Animal and vegetable oils, fats and waxes, 5 — Chemicals and related products, n.e.s., 6 — Manufactured goods classified chiefly by material, 7 — Machinery and transport equipment, 8 — Miscellaneous manufactured articles, 9 — Commodities and transactions not classified elsewhere int he SITC.

in group 0 (by 66 per cent) and group 9 (by 20.6 per cent). The biggest decline was shown by group 6 (by 17.7 per cent).

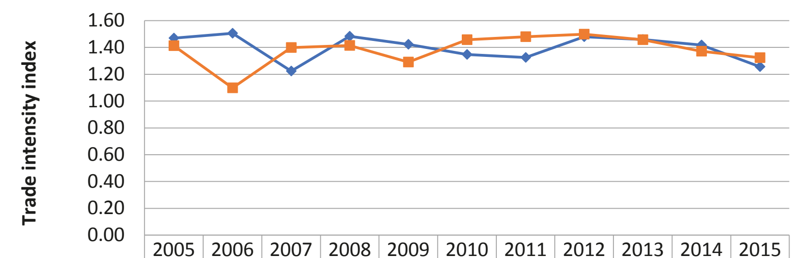
The highest values of intra–industry trade measured by Grubel–Lloyd index between the EU and Russia were by groups 4, 9, and 6 dues to mutual exports in these groups in the selected period. The lowest intra–industry trade was in groups 3 and 8.

The last index we will work with is the trade intensity index. This index is used to determine whether the value of trade between two given countries is greater or smaller than it would be expected based on their importance in the world trade. It is defined as the share of one country's exports going to a partner divided by the share of world exports going to the partner. It is calculated as [WTO, 2017]:

$$T_{ij} = \frac{\left(\frac{xij}{Xit}\right)}{\left(\frac{xwj}{Xwt}\right)}, \tag{4}$$

where xij is export of country i to partner country j, Xit total exports of country i, xwj the value of world exports to the country j and Xwt total world exports.

Figure 3.13: **Trend of trade intensity index Russia and the EU between 2005 and 2015**



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Russia-EU	1.47	1.51	1.22	1.48	1.42	1.35	1.32	1.48	1.46	1.42	1.26
EU-Russia	1.41	1.10	1.40	1.41	1.29	1.46	1.48	1.50	1.46	1.37	1.32

Source: our own calculations.

To evaluate the size of mutual trade between the EU and Russia we used the trade intensity index. Figure 6 shows the trend of trade intensity index of Russia and the EU ($TII_{Russia\text{-}EU}$) and of the EU and Russia ($TII_{EU\text{-}Russia}$) in 2005–2015.

In the years 2005–2015 $TII_{Russia\text{-}EU}$ was more than 1 and, therefore, we can claim big activity of exporters from Russia on the EU market. The biggest value of this index was recorded in the years 2006, 2008 and 2012. From 2013 to 2015 the index declined every year. Despite this decline, the index did not drop below 1 in the selected period.

$TII_{EU\text{-}Russia}$ as well as $TII_{Russia\text{-}EU}$ reached a value higher than 1 in the same period. It shows that the trade was more intensified than it was expected considering the position of the EU in the world trade. The average value of $TII_{EU\text{-}Russia}$ reached 1.38, and it was 0.02 below the average value of $TII_{Russia\text{-}EU}$. $TII_{EU\text{-}Russia}$ declined in 2006 and 2009 significantly. From 2013 to 2015 the index declined from 1.46 to 1.32. $TII_{Russia\text{-}EU}$ still has a relatively high rate and indicates intensive trade of exporters from the EU to Russia.

3.4.2 Impact of falling raw energy materials prices on their import from Russia to the EU

Economic dependence of the EU on oil and natural gas is mainly determined by the lack of its own raw material base and by the fact that demand significantly exceeds its own production. With population of more than 500 million people, the EU is one of the biggest world consumers of energy resources. With the gradual decline in domestic production of raw energy materials (except renewable energies), the European dependence on their import is still increasing. In 2018 import covers up to 90% of oil and 4.2% of natural gas consumption of the EU. A slightly more favourable situation is in the case of coal (42%) and nuclear energy (40%). As a result, the EU is one of the leading importers of energy resources in the world [Ružeková, 2016]. The European Commission estimates that the growing trend of import dependency on energy raw materials will continue in the following decades. Energy, therefore, belongs to one of the key subjects of the EU, and issues related to energy security and territorial diversification of energy sources are among the central issues of the negotiations within the EU.

Energy security of the EU, particularly in relation to oil and gas, is highly dependent on their imports from the third countries. High import dependency, however, entails potential risks to member states of the EU. The EU, therefore, devotes considerable attention to the issues of ensuring its energy security [Obadi, 2015]. The most important tool is the territorial diversification of import of energy resources. Nowadays, the biggest importers of oil to the EU are Russia, Norway, Nigeria, Saudi Arabia and Kazakhstan. The largest importers of natural gas to the EU are Russia, Norway, Algeria, Qatar and Libya.

An important part of trade in energy materials is their price, which is, then, the decisive determinant of consumption and demand. Development of energy prices is an important indicator for the member states of the EU since their impact on the economy is obvious. Since mid-2014, we are witnessing a unique situation when the oil price, which had been held above the level of 100 USD / barrel, recorded a sharp decline. Consequences consist in reducing the price of petroleum products themselves and commodities indexed to oil prices, such as natural gas. As oil and natural gas are among the main import commodities of the EU, the decline of their prices was also reflected in the foreign trade statistics.

The most obvious example is the European import from Russia. Russia, whose oil and natural gas reserves are among the largest in the world, is the largest importer of energy resources to the EU. Some of the EU member states are still highly dependent on supplies of oil and gas exclusively from Russia. These are the countries of Central and Eastern Europe that are associated with Russia energy corridors since the times of the former Soviet Union. The EU recognizes this high dependence and, in order to increase its energy security, is trying to diversify suppliers of energy resources [ec.europa.eu, 2017].

The total import of the EU, as well as its import of crude oil and natural gas from Russia, has declined sharply in recent years.

Russia has long been one of the most important trade partners of the EU. Based on the trade balance, Russia was the fourth largest trade partner of the EU and the EU was the largest trade partner of Russia. In terms of territorial structure of foreign trade of the EU, Russia was its third largest export partner and fifth largest import partner [Kašťáková, 2016].

Undoubtedly, a dominant position in mutual trade relations belongs to a trade with energy materials. The EU imports significant quantities of oil, natural gas, uranium and coal from Russia every year. In 2014, in terms of imports of energy materials, 30.4% of oil, 37.5% of natural gas and 29.0% of EU fossil fuels were imported from Russia. Besides the oil and natural gas, an important element of mutual foreign trade relations is nuclear power. In 2014 Russian uranium accounted for 18% of the European import of this commodity. Nuclear plants in Finland, the Czech Republic, Slovakia, Hungary and Bulgaria were built by Russians, while Slovakia, Hungary and Bulgaria are overwhelmingly dependent on imports of nuclear fuel from Russia. However, EU's dependence on Russia is not unilateral. The Russian economy is existentially dependent on the EU demand for its energy raw materials. Almost half of the Russian state budget, 70% of export revenues and 25% of GDP are generated by the energy sector [Baláž, Harvánek, Královičová, 2016].

As can be seen in Fig. 3.14, the price of USD 46.07 per barrel was not the bottom. The decline in prices continued until January 2016, when the lowest price reached USD 26.01 per barrel. The current price of Brent crude oil as of August 2019 is 59.79 USD per barrel. There are few reasons why there has been such a significant decline in oil prices. The first reason was the appreciation of the US dollar as a result of acceleration of the growth rate of the US economy and the markets expectations regarding interest rate increase. The second reason was disagreement of the OPEC member countries concerning the determination of production quotas. At its meeting in November 2015, the members did not agree to reduce production quotas aimed at reducing the supply and preventing further decline in oil prices. However, there are more reasons for oil prices decline. There was a faster growth of world oil production than demand. Previously high oil prices and the development of new technologies encouraged oil companies to open

Figure 3.14: **Development of BRENT crude oil spot price since 2010 (USD per barrel)**

Source: Macrotreds

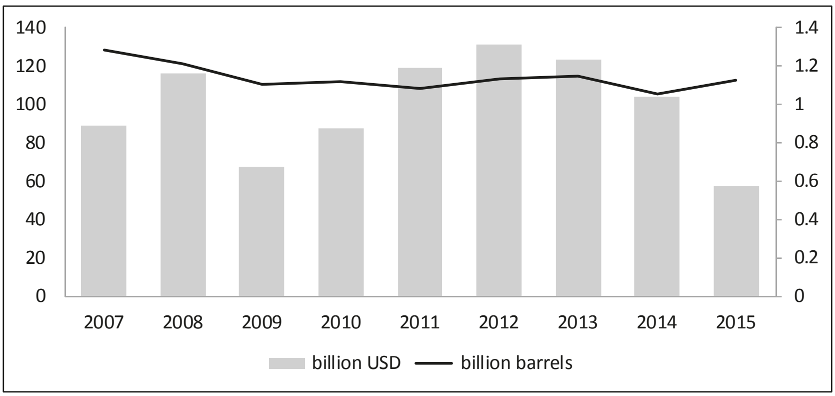
technologically and financially challenging drilling of unconventional oil deposits. Significant impact on the decline of oil prices is also attributed to the decline in oil demand of major economies, such as China, Japan and Europe [Tamvakis, 2015].

In 2018 oil price increased noticeably, continuing the readjustment witnessed in 2017amid a more stabilized global oil market. World oil demand experienced healthy growth last year, and its largest contributors were the US, China and India. World oil demand growth remains solid in 2019, however, we could spot slowing down.

A significant increase in oil prices is not expected in the near future. There are few reasons. One of them is the using of extraction method. In case of further increase of oil prices, the US mining companies will be motivated to increase their production as a result of higher profitability of this type of extraction. Another important factor is still slowing growth rate of the Chinese economy, which is reflected in lower demand for oil.

Significant change in oil prices is automatically reflected in total value of bilateral trade between the EU and Russia. Since energy raw materials from Russia make up more than 70% of the EU import, impact on statistical indicators will be relevant in this context. As a result of oil price decline, Russian oil has become cheaper for the EU. This has automatically echoed in the decrease of import volumes from Russia in the EU financial indicators (USD). So, the indicator does not reflect the real EU demand for oil from Russia. The real demand of the EU can be calculated on the basis of the quantitative volume of imported crude oil expressed in barrels. Figure 3.15 compares the EU import of oil from Russia in financial indicators (in USD) and in the quantitative indicators (in barrels).

Figure 3.15: **Comparison of EU import of oil from Russia in financial and quantitative indicators (2005–2015)**



Source: Processed by the authors according Eurostat data.

Figure 3.9 shows that the real EU demand for oil from Russia expressed in quantitative units is characterized by a high degree of indifference to changes in oil prices on world markets. It is mainly constant in the long term. In 2015 the EU imported 1.13 billion barrels of oil from Russia. In the period of 2007–2015, the total volume of oil imported from Russia declined slightly, which can be attributed to the EU's efforts to diversify its energy suppliers and an effort to reduce the consumption of fossil fuels. Import volume expressed in billion USD replicates the changes in oil prices on world markets to a much higher degree. If the world price for a barrel of oil increases, the value of the total EU import in financial indicators increases as well and vice versa. In 2015 the EU imports of oil from Russia reached the value of USD 57.38 billion. In the times of high prices of oil in the years 2011–2013 (ranging from 100 to 120 USD per barrel), the total import of oil in financial indicators was also high (118–131 bn. USD). By contrast, in the times of low oil prices in the years 2014–2016 the total import of oil in financial indicators is much lower [Locatelli, 2013]. The average monthly value of imports in energy rose from 17.7 billion per month in 2016 to 27.6 billion per month in 2018. Nevertheless, the energy bills are still lower than in 2014. [Eurostat, 2019]

As is the case of oil, the largest importer of natural gas to the EU is Russia. Russian share in total EU imports of natural gas is approximately 40%. Within the context of the previous analysis of falling oil prices in the previous part of the paper, the question is how it affects the gas prices and, thus, statistical indicators of foreign trade between the EU and Russia. The share of natural gas (SITC 34) in total imports of the EU from Russia amounted to almost 4% in 2015. It is, thus, relatively important commodity, whose price change may affect the overall mutual trade statistics between the EU and Russia. The exclusive importer of natural gas from Russia is semi-public company Gazprom.

To assess the impact of oil price changes on gas prices is rather challenging. Whilst oil markets are part of broader international markets [Kilian, 2009], natural gas markets remain essentially regional [Li, Joyeux, Ripple, 2014]. However, the relationship between the development of oil and natural gas prices has long been considered as an important and stable since in gas trading price mechanisms, most of the contracts were based on indexation to oil. Due to the gradual transition to alternative forms of contracts pricing (gas contract on gas), however, this relationship weakens. Even today, as in the case of some countries in Central and Eastern Europe (V4 counties, the Baltic countries and Finland) a significant portion of trade is still conducted through indexation to oil-based long-term contracts (in 2014 almost 20% of transactions). However, the EU seeks to liberalize the market, supports the development of hybrid financing structures and the growth of alternative forms of pricing mechanisms, contributing to the continuing decline in traditional long-term contracts indexed to oil [Bunn, Chevallier, Le Pen, Sevi, 2017].

In 2014, 32% of natural gas contracts in Central Europe were based on oil indexing. In Eastern Europe, this share was around 40% and in the south up to 60%. By 2010 wholesale gas prices in the EU were in the strong dependence on oil prices. The result of the dynamic development of spot transactions and the subsequent efforts of European suppliers of renegotiating long-term contracts with Russia has been that a significant proportion of the current long-term contracts are not directly linked to oil but to the development of a spot market. There are two types of gas pricing contracts in the EU nowadays — a spot price, which is much more volatile and reflects the immediate developments

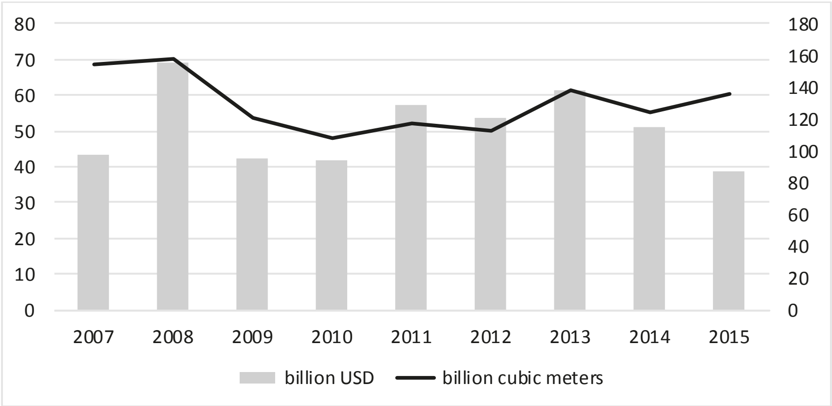
Figure 3.16: **Development of Gazprom average natural gas selling price to the EU (USD / 1000 m³)**

Source: Processed by the authors according Gazprom data.

in supply and demand and the price of long-term contracts based on the indexing of prices to oil prices. Gazprom exports gas to Central and Western Europe mostly under long-term contracts of up to 25 years, usually based on intergovernmental agreements [Stanová, 2016]. The recent development of average natural gas selling prices of Gazprom is presented in Fig. 3.16.

In 2015 the average European import price of natural gas from Russia was 245.6 USD/1000 cubic metres. Compared to 2014 and 2013, the average price fell respectively by almost 30% (2014), 36% (2013). The trend of gas prices liberalization is thus reflected in trade with Russia. Over the last years some countries in the eastern part of the EU have paid higher prices for their gas imports from Russia and have actively sought diversification. These countries lobbied the bridge within the EU institutions to launch an antitrust investigation against Gazprom in 2012: it was accused of abuse of its dominant position and price discrimination. Despite a few persisting divergences within the EU, the overall trend consists in the renegotiation of contracts and changes in indexation formulas, as the competition on the EU market increases. The drop of oil prices also lowers import prices in countries that have not been able to secure access to alternative sources of gas or renegotiate their long-term contracts with Russia (for example, Central European countries and Baltic countries). This suggests that while gas from Russia has become cheaper in the EU. Owing to structural adjustments, its affordability is still contingent on low oil prices [CIEP, 2016].

Figure 3.17: **Comparison of EU import of natural gas from Russia in financial and quantitative indicators**



Source: Processed by the authors according the UNCTAD and Gazprom data.

A major proportion of gas contracts between the EU and Russia is still indexed to oil, this fact will also be reflected in the statistics of foreign trade, which is shown in Fig. 3.17.

In absolute terms, the EU imports of the Russian gas (Carried out primarily through long-term contracts indexed on oil) have dropped since 2008 (–23 BCM in 2008–2015). This reflects the shrinkage in gas demand of the EU (–118 BCM in 2008–2015). When comparing the import of natural gas in the financial (USD) and quantity indicators (BCM), the parallel with the development of oil imports is obvious. The first decline in imports in financial indicators occurred during the crisis of 2009 and 2010. However, as a result of the overall decline in economic activity in the EU, there was also a significant decline in imports in quantitative indicators. More interesting, however, is the look at the years of 2013–2015, when there was a decline in oil prices due to the above-mentioned factors. Import in financial indicators, decreased from USD 61.45 billion in 2013 to USD 38.95 billion in 2015, as opposed to import in volume indicators, which, in turn, between 2014 and 2015 increased by 9.5% (124 BCM to 135.8 BCM). We may conclude that, as is the case of oil, the development of financial and volume indicators concerning import of natural gas from Russia are somewhat indifferent. To grasp the real import of the EU, it is, therefore, necessary to consider the import volume [Kašťáková, Žatko, 2017].

3.4.3 *Impact of the Russian embargo on its agri-food trade with the EU*

International economic relations are affected by various factors resulting from long-term global changes which distort globalization tendencies and have a fundamental impact on national economies [Kittová et al., 2014]. International trade in agricultural products is currently undergoing significant changes resulting from the weakening of state support and emerging protectionism in many states, especially in the European Union (EU) [Krivorotko, 2017]. The conflict between Russia and Ukraine has caused the sanction war between the EU and Russia. The high degree of interdependence of economies means that every negative impulse is felt in the mutual trade performance of countries [Grinberg, 2014]. At the beginning of the conflict, the EU imposed diplomatic sanctions against Russia, but these were limited to persons and companies. However, after the Malaysian commercial airplane was shot down in July 2014, the EU extended sanctions to the economy as a whole. Russia answered quickly and imposed retaliatory sanctions in the form of an embargo on selected agri-food products from the EU and other countries, including the US, Australia, Canada, Norway and Iceland. Agricultural products were chosen because of the easy reorientation of Russian imports from other countries [Zábojník, Hamara, 2015].

The EU is aware of the importance of its agri-food exports to the Russian market. Agriculture has been one of the EU's most important economic sectors since the beginning of modern integration tendencies on the European continent. This is confirmed by the concept of the EU Common Agricultural Policy, which was grounded in the 1962 Treaty of Rome and which, together with the EU's Common Commercial Policy, is one of the oldest EU policies.

Exceptional attention to the agricultural sector results from several factors. A key factor is the strategic importance of agriculture as it ensures the EU's food self-sufficiency and is one of the means of fighting against poverty. In addition to its economic, development, landscape, environmental and social functions, the importance of agriculture in the EU also underlines its symbolic significance — it was the first area to which most of the competencies were transferred from the European states to the EU institutions [Ružeková, 2013]. The Russian ban on EU agri-foods meant that EU agri-food exporters faced a serious challenge. The EU Commission applied various supportive measures in the form of financial aid and new regulations, but these measures were not effective in the short term. The exporters had to diversify their customer base and tried to sell their banned products to Russia through re-export operations. A key example of this was the effort to re-export through Belarus, due to its membership in the Eurasian Economic Union with Russia.

Agricultural production is very important for every country's view of food safety. The priority of the Russian economy is active development of the agricultural sector to make it competitive with the agricultural sectors of other countries [Tsyngueva, 2016]. During the next few years, Russia expects further changes associated primarily with its accession to the World Trade Organization (WTO). Reduction of budgetary support and restrictions (tariff and non-tariff) will affect the competitiveness of Russian agricultural and food products in both the domestic and international markets [Ishchukova, Smutka, 2013]. Given its ample natural and human resources, and with state intervention and agricultural reforms, Russia can increase the competitiveness of its agricultural sector [Sutyrin, Trofimenko, 2014].

At present, there are many researchers in the field of international sanctions. Authors such as M. Marinov [2005] and S. Chesterman [2003] consider international sanctions to be a sort of middle ground between diplomatic protest, which is often considered to be a weak expression of disagreement, and military conflict, which, on the contrary, may be too aggressive. According to Marinov [2005], the expected result of the application of sanctions is one similar to that which would come from war but with significantly lower economic and human losses. According to D. Baldwin [Baldwin,1998], sanctioning instruments used in diplomatic practice can generally be applied to economic, diplomatic and military sanctions, each of which is characterized by particular features.

Despite the general expansion of the use of sanctions as a policy instrument, there is no consensus in the theory so far about the rationale behind their introduction or their success in achieving their goals. Authors such as K. R. Nossal [Nossal, 1989] and M. Daoudi and M. Dajani [Daodi, Dajani, 1983] agree that the application of sanctions is an international policy tool that attempts to achieve required changes in the activities or policy of the sanctioned state through pressure techniques. Nossal is of the opinion that, in order to speak about international sanctions, it must be the case that they are implemented by legitimate actors in the international system and that they are implemented in response to serious violations of generally applicable international standards. Economic sanctions are comprehensively characterized by J. Galtung [Galtung, 1967] as measures by one or more international actors (shippers) taken against one or more other actors (recipients) for one or both two purposes: to punish the recipients by depriving them of any value or to force recipients to follow certain standards that senders consider important. G. Hufbauer et al. [Hufbauer et al., 2017] define economic sanctions as "deliberate, government-induced appeal, or the threat of recourse to trade in goods or financial relations." M. Golliard [Golliard, 2013] states that economic sanctions include non-tariff barriers to trade in the form of restrictions on the import or export of goods in order to compel another state to change its political decisions. Economic sanctions in the form of bans, quotas and licenses represent exogenous shocks that have negative consequences for trade. The main consequence of sanctions is trade diversion.

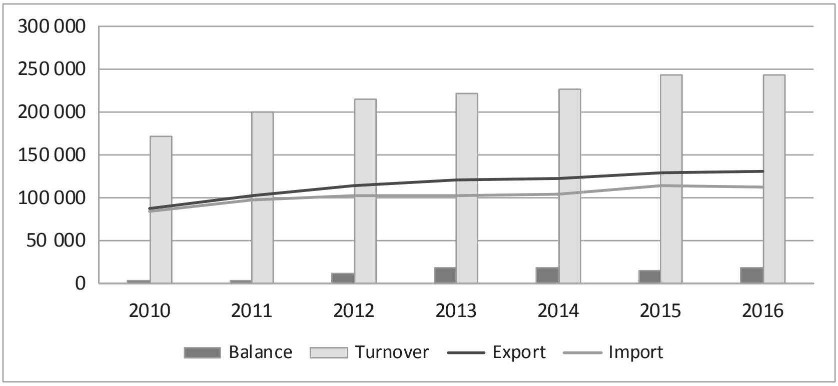
This monography assesses the impact of the Russian embargo on EU agri-food exports to Russia. Its scope is limited to the period from 2010 — one year after the crisis of 2009, during which the world economy was highly unstable and world trade declined on average by 30% — to 2016. This time period makes it possible to point out changes in agricultural trade between the EU and Russia. Mutual trade was strongly affected by the sanctions imposed by Russia. To assess these changes a revealed comparative advantage (RCA) index was used. These indices compare the competitiveness of sectors of the domestic economy with economic sectors of another country.

Until 2014 Russia was the fourth-largest export partner of the EU. However, it has sunk to fifth place in subsequent years. Its share of EU exports fell from 6.4% in 2010 to 4.1% in 2016. This negative development is mainly affected by the economic-political sanctions applied between the EU and Russia, and also by falling prices of oil and natural gas as they have a dominant position in mutual trade [Locatelli, 2013].

Agriculture has an important position in the foreign trade of the EU as well. The EU is a major world exporter of agri-food products. Export of agri-food products provides EU farmers additional income, but its potential dropouts can disrupt the fragile stability of this sector. The current Russian embargo potentially jeopardizes business relations valued at €5 billion and affects 9.5 million people working in the concerned sectors. The agri-food sector is an important, albeit not the most important, component of the EU's foreign trade. In 2016 foreign trade in agri-food products accounted for 7% of total EU foreign trade. Exports of agri-food products accounted for 7.5% of EU exports and 6.6% of all imported EU goods [European Commission, 2017].

The EU's agri-food trade turnover recorded an average annual growth rate of 6.2% between 2010 and 2016. Exports by the EU were higher than imports during the entire period, as reflected in the long-

Figure 3.18: **Development of Agri-food Trade of the EU with Third Countries, 2010–2016 (€ Million)**

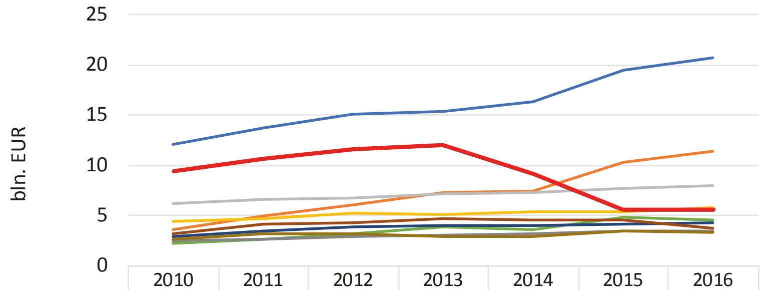


Source: Calculated by the authors based on the Eurostat database

term active balance of trade. In 2016 the EU's external trade indicators for agri-food products reached their highest value ever. Total turnover was €243.4 billion, exports reached €131.1 billion, imports reached €112.2 billion, and an active balance of trade reached €18.9 billion. In the context of this analysis, it is relevant to raise the question of the impact of the Russian embargo on EU agri-food exports. Figure 3.12 suggests that the growth of foreign trade indicators slowed down in 2014, when Russia levied its embargo. EU exports recorded only 1.5% growth in 2014, which represents a significant slowdown compared to previous years. In this case, however, the key point is that although there was a certain slowdown in the EU's external trade growth indicators in 2014, there was no decline. In 2015 and 2016, when the embargo became applicable for the whole year (in 2014 the embargo applied only from August), there was also no decline in foreign trade indicators.

Figure 3.19 shows the territorial structure of EU agri-food exports. Recent developments show that the dominant position is held by the United States. In 2016 EU exports to the U.S. reached €20.74 billion, representing 15.8% of total EU exports. The second-most important export territory in 2016 was China, reaching €11.39 billion and share of 8.7%. Among the most important partners are Switzerland, Japan, Russia, Saudi Arabia and Norway. Belarus is not among the top agri-food trade partners of the EU in the long term. In 2016 it was the 35th most important export territory of the EU. Its position has, however, improved recently. In 2016 EU exports to Belarus reached more than

Figure 3.19: **EU's Top Agri-food Export Partners, 2010–2016 (€ Billion)**



	2010	2011	2012	2013	2014	2015	2016
1. USA	12.1	13.74	15.11	15.36	16.37	19.4	20.74
2. China	3.61	4.92	6.07	7.29	7.44	10.34	11.39
3. Switzerland	6.21	6.58	6.71	7.08	7.21	7.67	7.9
4. Japan	4.35	4.7	5.21	5.11	5.32	5.35	5.77
5. Russia	9.33	10.58	11.53	11.97	9.13	5.54	5.54
6. Saudi Arabia	2.18	2.65	3.22	3.88	3.58	4.79	4.58
7. Norway	2.92	3.4	3.83	3.98	4.02	4.09	4.31
8. Hong Kong	3.17	4.1	4.25	4.66	4.53	4.49	3.71
9. Canada	2.42	2.55	2.85	3	3.13	3.42	3.45
10. Turkey	2.55	3.2	3.13	2.84	2.85	3.41	3.23

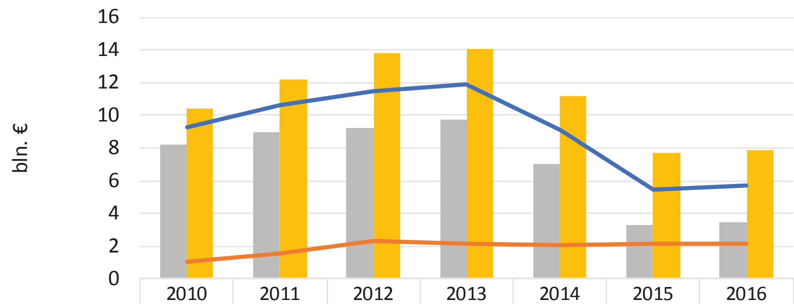
Source: Calculated by the authors based on the Eurostat database, European Commission, 2017.

€800 million, which accounted for a 0.5% share of EU agri-food exports.

Despite the limits placed by the embargo on EU exports of agri-food products and commodities, the position of Russia (€5.63 billion, or 4.3%) is still significant. However, there has been a significant drop compared to previous years. Russia was the second-most important market for EU agri-food exports with value of more than €9.33 billion in 2010. The application of the Russian embargo was reflected in 2014 in the form of a decline in EU exports. In 2013 the total value of EU agricultural exports to Russia reached almost €12 billion and imports reached only €2.19 billion. The years 2014, 2015 and 2016 are characterized by a steep decline in the total exports of the EU. The cause of the decline is obvious — the agri-food embargo applied by Russia on selected products. In 2016 agri-food exports fell by 52.6% compared to 2013 levels.

In 2013 the share of products banned by the Russian embargo reached 47.8% of the EU's total agri-food exports to Russia. During

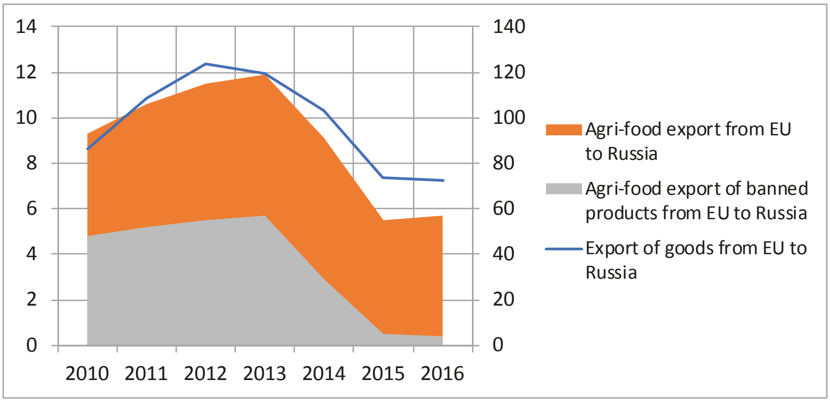
Figure 3.20: **Development of Agri-food Trade Between the EU and Russia, 2010–2016 (€ Billion)**



	2010	2011	2012	2013	2014	2015	2016
Balance	8.2	9	9.2	9.7	7	3.3	3.5
Turnover	10.4	12.2	13.8	14.1	11.2	7.7	7.9
Export	9.3	10.6	11.5	11.9	9.1	5.5	5.7
Import	1.1	1.6	2.3	2.2	2.1	2.2	2.2

Source: Calculated by the authors based on data from the EUROSTAT database.

Figure 3.21: **Comparison of the Development of Total Exports from the EU to Russia With Total Agri-food Exports from the EU to Russia and Exports of Groups of Goods Whose Import Has Been Banned by the Russian Embargo (€ Billion)**



Source: Calculated by the authors according to data from the EUROSTAT database

the last three years (2013–2016), there was a reduction in EU agri-food exports of more than €5 billion. The reason that exports of banned products did not fall to an absolute minimum is because the embargo contains a number of exceptions — in 2016, exports of banned agri-food products to the EU reached a value exceeding €400 million. In 2016 EU agri-food exports accounted for 7.9% of total EU exports to Russia, whereas in 2013 this share was 10%. The share of agri-food exports in total EU exports to Russia decreased by 2.1%. The group of products under the embargo accounted for 4.8% of total EU exports to Russia in 2013, while in 2018 it was only 0.3%.

In 2018 the largest decline occurred in the commodity group meat and edible offal. The export of this commodity is only 4% of the export value before sanctions were applied. The decrease within the group of fish and crustaceans represented 11% of the pre-sanction value. A further sharp reduction occurred within the group of fruits, nuts and peel of citrus fruits, 15% of the pre-sanction value. A significant reduction to 20% occurred in the commodity group of vegetables and some roots and tubers. Dairy products, eggs and honey reached only 30% of their value before sanctions were applied, and for meat, fish or crustaceans it was 31%.

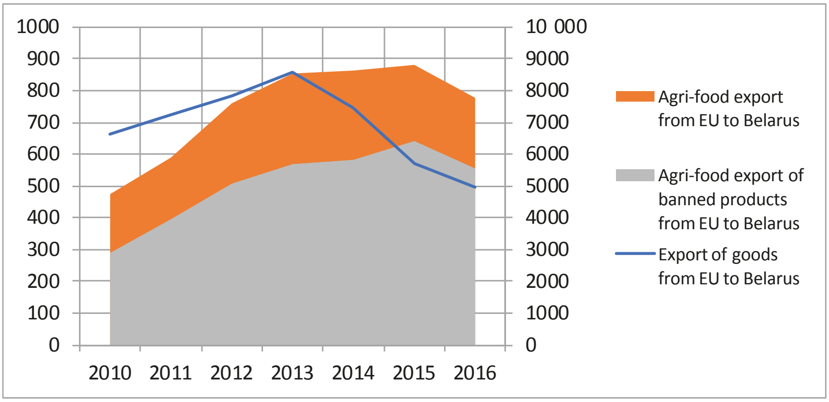
The embargo also caused problems in Russia. The process of substitution for imported products was quite slow at its beginning. The main reasons are that the demand for imported products fell in connection with the fall of the income of the Russian population, and domestic producers could not replace large volumes of import production in only one or two years [Kuznetsov, Iurkova, Shibaykin, 2016].

Another analysis shows that markets for milk and beef experienced serious problems. The main reasons for market volatility include a relatively low share of large enterprises with better adaptability to the conditions of the embargo and sanctions and underdeveloped market infrastructure [Borodin, 2016].

In order to mitigate the negative consequences of the Russian embargo, the EU Commission has applied various supportive measures to its agricultural sectors. EU producers, however, have also tried to find alternative ways to reach Russia through re-export operations. One of the most commonly used countries for agri-food re-exports from the EU to Russia has been Belarus. Against this background, it can be expected that EU exports of banned products to Belarus have increased significantly in recent years.

Figure 3.22 shows that despite the overall decrease in EU exports of goods to Belarus, exports of agri-food goods increased. Looking at the export development of products banned by the Russian embargo, the highest increase in exports to Belarus occurred between years 2014 and 2015. When the Russian embargo was applied in 2014, EU producers

Figure 3.22: **Comparison of the Development of Total Exports from the EU to Belarus With Total Agri-food Exports from the EU to Belarus and Exports of Groups of Goods Whose Import Has Been Banned by the Russian Embargo (€ Billion)**



Source: Calculated by the authors based on data from the EUROSTAT database.

tried to find alternative routes to Russian markets. In 2016 the export of banned products to Belarus decreased as producers had more time to adapt to the new situation and found new customers. Moreover, political steps were taken to prevent re-export, so this option became less viable. The recent development of EU agri-food exports to Belarus, however, clearly confirms the re-export tendencies, which have been mentioned across political and economic spheres. [Kašťáková, Baumgartner, Žatko, 2018]

In connection with the introduction of sanctions, the Russia has intensively presented support for the development of agriculture through the import substitution policy. We have shown that of agri-food products from the EU have decreased due to the introduction of sanctions. Following these events, the pricing of these products on the internal European market has been largely disrupted. For this reason, the question of re-export of these products through non-EU European countries or the mentioned above Belarus as an alternative route to the Russian market began to the questioned. In order to verify these assumptions, we decided to analyse the total import of the Russian Federation in selected commodity groups. From 2014 to 2018 there was an overall decrease in the volume of imports of agri-food products except for the fruit and nuts commodity group. Based on data from ITC, the most significant decrease in import in the commodity group meat and edible offal occurred in 2018 to 34% of 2013 value. It can be stated that this sector has started to develop in Russia, which could also contribute to reducing unemployment.

This research considered the 10 most important agri-food commodities exported from the EU to Russia in 2010 which have been banned by the embargo since 2014. The referential year is 2010 as trade in this year was not influenced by any sanction regime.

The biggest share of EU agri-food exports was group 0406 (cheese and ream) with 8.09% and group 0203 (pork, fresh, chilled or frozen) with a 6.54% share. A significant share was also recorded by groups 0808 (apples, pears and quinces) at 4.46% and 0209 (pig fat) with 2.13%. Table 3.14 points to the recent downward trend of shares of exports in all the selected product groups. Within these groups, EU exports fell to a minimum — mainly due to the Russian embargo on

Table 3.14: **Share of the Top 10 Agri-food Harmonized System Groups Affected by the Embargo on the EU's Exports to Russia, 2010–2016 (in %)**

HS		2010	2011	2012	2013	2014	2015	2016
0203	Meat of swine, fresh, chilled or frozen	6.54	7.32	6.72	8.01	0.49	0.00	0.00
0206	Edible offal of bovine animal etc.	1.74	1.90	1.80	1.39	0.76	0.13	0.16
0207	Meat and edible offal, of the poultry of heading 0105, fresh, chilled or frozen	2.08	0.61	0.75	0.65	0.50	0.00	0.00
0209	Pig fat, free of lean meat, and poultry fat etc.	2.13	2.65	2.74	2.21	0.27	0.05	0.00
0303	Fish, frozen, excluding fish fillets and etc.	1.49	1.06	0.81	0.76	0.71	0.15	0.31
0402	Milk and cream	1.48	0.47	0.29	0.68	0.38	0.00	0.01
0406	Cheese and curd	8.09	7.42	7.89	8.21	5.84	0.38	0.04
0709	Other vegetables, fresh or chilled	1.57	1.39	1.79	1.67	1.36	0.06	0.05
0808	Apples, pears and quinces, fresh	4.46	4.29	4.58	4.37	3.58	0.54	0.07
0809	Apricots, cherries, peaches (including nectarines), plums and sloes, fresh	2.08	2.27	2.38	2.08	1.97	0.08	0.06

Source: Calculated by the authors.

their imports. As the embargo contains some exceptions, EU exports of certain products have not fallen to zero. It is also important to consider the deteriorating purchasing power of Russian consumers; otherwise, EU exports of these agri-food products may have been higher. As a consequence of the embargo, the Russian government aimed its activity at regulation and the support of its agricultural sector [Maitah, Kuzmenko, Smutka, 2016].

Imposed sanctions have affected not only agri-food trade between the EU and Russia but have also had a negative effect on the revealed comparative advantages of EU exports. The RCA is calculated in order to assess the impact of the Russian embargo on the strength of the revealed comparative advantages of the top 10 agri-food product groups listed in Table 3.15.

Table 3.15: **RCA Value of the EU Agri-food Exports to Russia by Groups Most Affected by Sanctions, 2010–2016**

HS		2010	2011	2012	2013	2014	2015	2016
0203	Meat of swine, fresh, chilled or frozen	6.42	5.90	7.68	5.98	3.13	–	0.70
0206	Edible offal of bovine animal etc.	5.87	4.61	5.36	5.66	4.37	4.95	4.27
0207	Meat and edible offal, of the poultry of heading 0105, fresh, chilled or frozen	--	13.62	3.88	7.90	3.12	–1.95	–3.49
0209	Pig fat, free of lean meat, and poultry fat etc.	5.25	6.25	6.52	5.69	2.61	2.98	1.86
0303	Fish, frozen, excluding fish fillets and etc.	–1.54	–1.69	–1.58	–1.73	–2.07	–3.94	–3.33
0402	Milk and cream	5.32	4.93	7.57	5.35	3.02	–2.13	0.47
0406	Cheese and curd	6.72	7.92	8.47	4.56	4.66	2.24	1.51
0709	Other vegetables, fresh or chilled	1.22	0.46	1.11	0.36	0.81	–3.24	–3.31
0808	Apples, pears and quinces, fresh	6.61	6.44	6.81	6.88	5.89	3.02	2.93
	Apricots, cherries, peaches (including nectarines), plums and sloes, fresh	5.59	4.78	5.11	5.01	3.84	–	5.46

Source: Calculated by the authors.

The results show that the EU had strong comparative advantages in almost all verifying groups of commodities except group 0303 (fish, frozen, excluding fish fillets) and group 0709 (other vegetables, fresh or chilled). After the imposition of the embargo, the situation has rapidly changed. All analysed commodity groups of the EU's agri-food exports to Russia have declined. Russia has moderate comparative advantage in three product groups (0207 — meat and edible offal, 0303 — fish, frozen, excluding fish fillets, and 0709 — other vegetables, fresh or chilled). At present, the EU has strong comparative advantages only in groups 0206 (edible offal of bovine animal) and 0809 (apricots cherries, peaches, plums and sloes). However, it has to be mentioned that exports in group 0206 (edible offal of bovine animal) fell from €162 million in 2010 to €8.5 million in 2016.

Previous analyses have clearly highlighted the fact that the Russian embargo has caused a significant drop in EU agri-food exports to Russia. The key question is how long the embargo will be in force. It is probable that if the conflict in Ukraine remains unresolved, both the EU sanctions and the Russian agri-food embargo will remain in force.

To estimate the future development of EU agri-food exports to Russia, a simple linear model was used. Based on existing values, the model calculates or estimates the future value of the dependent variable(s) for a given independent variable value. The pair of numbers x and y are known numbers. The model estimates the new value using linear regression. The formula for calculation is:

$$y = a + bx, \tag{5}$$

where:

$$a = \bar{y} - b\bar{x} \tag{6}$$

and

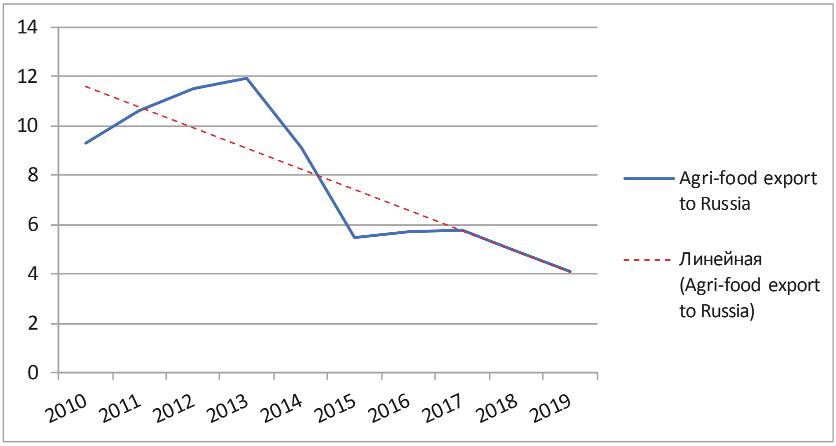
$$\mathrm{b} = \frac{\Sigma(\mathrm{x}-\bar{\mathrm{x}})(\mathrm{y}-\bar{\mathrm{y}})}{\Sigma(\mathrm{x}-\bar{\mathrm{x}})^2}, \tag{7}$$

where x and y are the mean values of the sample. Data for this research are from EUROSTAT statistics.

Based on the trend of the past EU agri-food exports to Russia, using a linear model, it is possible to predict EU export trends in the upcoming years.

Calculations point to the fact that while the sanctions are kept in place there will be a continuous decline in agri-food exports to Russia. Given that sanctions have the effect of trade diversion, it is reasonable to expect a gradual decline in trade of those agri-food products not covered by sanctions. EU exports may drop to 4 € billion by 2019. And in

Figure 3.23: **Forecast of the Evolution of Exports of Agri-food Products from the EU to Russia by 2019 (€ Billion)**



Source: Calculated by the authors based on data in the EUROSTAT database.

the long run they might decline further. If the EU-Russia sanctions are lifted in the future, a regrowth of EU exports can be expected.

However, the return to the export values of 2010–2013 will be difficult, as it will be difficult for the products that have lost their market share as a result of sanctions to win it back. In the meantime, the Russian government has decided to support domestic agricultural production, and, to some extent, it has been successful in its efforts. This will pose a problem for EU production. Moreover, EU producers have made considerable effort to push their production into alternative markets, which might reflect a decreasing interest in exporting to Russia [Kašťáková, Baumgartner, Žatko, 2017].

We can assume the EU and the RF will continue working closely together in the energy field. Demand for oil can in the coming years to decline, but this will be offset by an increase in demand for natural gas. An increase in geopolitical tensions may jeopardize trade relations between the countries. In addition, new technologies and innovations can cause changes in the overall energy raw material distribution system, thus opening new opportunities cooperation and reduce the interdependence of Russia and the European Union. Therefore, it is important for both countries to develop cooperation in the field of science and research and to look for alternatives' possibilities of cooperation. Based on the research, we can say that mutual relations are mutually beneficial, and the EU and the RF are interdependent in energy cooperation.

We can also say that intelligent sanctions have not proved effective in relation to Russia. On the contrary, the freezing of Russian assets in many Western countries has served as a tool to address Russia's internal problem — capital outflow. Harder sanctions could serve as a negotiating tool, but they remain questionable as they should be harsh. The escalation of the European Union's sanctions measures towards Russia would jeopardize its competitiveness. An important role was also played by the allies of Russia, who influenced the effectiveness of sanctions and compensated for deprivations that should result from them.

3.5 EU trade and economic cooperation with Kazakhstan

Kazakhstan is the ninth largest country in the world by area and at the same time the largest landlocked country and one of the most sparsely populated countries in the world (with population density only 6.6 inhabitants per km^2 in 2016). Among the former Soviet republics, it is the second largest oil producer[5] (78 million tonnes in 2016), with second-largest oil reserves (accounting for 3% of the world's total oil reserves) [KazMunaigas, 2018], after Russia. It also holds significant reserves of other non-ferrous metals, gold, uranium[6], is one of the world's suppliers of chromium, lead, zinc and coal. However, its huge potential should be considered not only in terms of natural resources abundance, but also in terms of its geostrategic location and thereafter possibilities of developing transcontinental transport routes — in particular as a transit country in the development of Euro-Asian trade and economic relations (especially between Europe and China).

In the Central Asia region Kazakhstan is the largest and most advanced economy, it has strong position not only in the energy sector, but also in the field of agricultural production (grain production[7]). It is a major regional exporter of crude oil, metals and wheat. Kazakh-

5 As for oil production in 2017 Kazakhstan ranked 16th in the world with a production of 1.835 mln barrels a day.

6 Kazakhstan's uranium reserves are considered to be the 2nd largest in the world (12% of the world's uranium resources) after Australia's; at the same time Kazakhstan has been perceived as the largest producer of uranium [World-nuclear.org., 2018].

7 Kazakhstan is one of the top world's grain producers, whereby wheat accounts for 70% of the total cereal production [FAO, 2019.]

stan actively participates in international organizations or integration groupings, for example, it is a founding member of the Eurasian Economic Union or the Shanghai Cooperation Organization.

With regard to the country's dependence on exports of energy and raw materials (oil and metals have traditionally the highest share — around 90 % — in country's exports), its strong ties to the nearest neighbours (Russia and China) are evident. One of the reasons for country's significant connection to Russia is not only a large number of Russian minorities living in Kazakhstan, but also strong linkages to the Russian energy sector. At the same time, both countries strive for close cooperation and deeper integration (as the EAEU members), as well as for strengthening cooperative relations in the region. Russia's interests in Kazakhstan overlap with interests of China. Kazakhstan is China's largest Central Asian trading partner. The European Union is Kazakhstan's main trading partner, and in recent years has contributed to nearly half of foreign direct investment to Kazakhstan. In addition, it is an important partner in sharing know-how, experience and technology.

Since its independence in 1991, Kazakhstan has been a presidential republic leaded by Nursultan A. Nazarbayev, who served as the first President of Kazakhstan for almost three decades. On 19 March 2019 he decided to resign and was succeeded by Kassym-Jomart Tokayev, who subsequently won the presidential election in June 2019 and became the President of Kazakhstan. In honour of N. Nazarbayev, Kazakhstan officially changed the name of its capital from Astana to "Nursultan" [BBC.com, 2019.].

3.5.1 Economic policy of Kazakhstan

From the economic transformation point of view, in less than two decades, Kazakhstan has transitioned from lower-middle-income to the upper-middle-income economy in 2006, according to the World Bank's rating. It continues to develop the industry. The country's strategic goal is to diversify and modernize the economy. The priority sectors include metallurgy, petroleum and chemical industry, mechanical engineering, food and construction industries. The State program of intensive industrial and innovative development (SPAIID) implemented between 2010 and 2014 highlighted innovative development and support of technological modernization. During the period of its implementation, the manufacturing industry became the main driver of the industry's growth (with its real growth it outstripped the mining sector) [Primeminister.kz, 2018].

The experience of its implementation is taken into account in the State Program for Industrial and Innovative Development (SPIID) for 2015–2019[8] as its logical extension. The SPIID program is part of Kazakhstan's industrial policy and is focused on the development of the manufacturing industry with a concentration of efforts and resources on a limited number of sectors, regional specialization using the cluster approach and effective industry regulation [Baiterek, 2015].

The program is complemented by the new economic policy "*Nurly Zhol*"[9] — "The Path to the Future" or the "Bright Path". Nurly Zhol has been developed to implement the state-of-the-nation address of the then President Nazarbayev on November 11, 2014. It aims at investing mostly in infrastructure development, and focuses primarily on the infrastructure in seven areas [Kazakhembus.com, 2014]:

1. *Development of transport and logistics infrastructure* — investment into highways, railways and airlines — with the aim of interconnecting the capital with macro regions as well among themselves according to the radial principle (main road projects include China–Western Europe, Astana/Nur-sultan–Almaty, Astana/Nur-sultan –Astrakhan and others). As an important part of transport and logistics infrastructure we have to mention the existing special economic zone "SEZ Khorgos–Eastern Gate", considered as a strategic facility to create a logistics hub connecting China, Central Asia and the Middle East.[10] It is one of the largest projects in the Central Asian region that can expand Kazakhstan's transit capacities, as well as an important part of the New Silk road (BRI) project.

2. *Development of industrial infrastructure* is related to increased demand for construction materials, products and services for transport, communication, energy, housing and utility areas due to the implementation of infrastructure projects. Investments are also aimed at the completion of work on the formation of infrastructure in existing spe-

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8 The new SPIID Program for the next five-year period 2020–2025 will take into account system problems of two previous industrialization plans [Government.kz, 2019].

9 The whole name of the program: State program of the infrastructure development "Nurly Zhol" for 2015–2019

10 SEZ Khorgos is located in the south-eastern part of Kazakhstan. It includes logistics and industrial zones, as well as transport and logistics complex "Dry port". It is the subject to special legal regime of special economic zone for implementation of priority activities [SEZKhorgos.kz, 2018]. The main aim the "Khorgos Gateway" dry port is to increase Kazakh export and transit potential in the Eurasian, to develop competencies in the field of global logistics, as well as to attract foreign investments [Islamjanova, 2017].

cial economic zones and at the construction of new industrial zones in regions aimed at the development of production facilities of small and medium-sized enterprises (SMEs). In connection with the Expo 2017 exhibition in Astana, investments were also focused on the development of tourist infrastructure, including the new job creation.[11]

3. *Development of energy infrastructure* — the focus is on the construction and expansion of high-voltage power lines. The aim is to create balanced energy supply from Kazakh power plants to all regions of the country.

4. *Modernisation of housing and public utilities infrastructure, and water and heat supply networks* — additional funds to the already budgeted for modernization in order to accelerate the upgrades.

5. *Strengthening of housing infrastructure* — aiming at construction of social housing to be available for long term rent with the right to buy it.

6. *Development of social infrastructure* — the focus is on reducing the deficit of pre-school organisations and additional funding of higher-education institutions.

7. *Supporting SMEs and business activities* — in particular by credit facilities. The aim is to increase the SME's share to 50 per cent of GDP by 2050.

The purpose of the state infrastructure development programme is to "create the unified economic market in Kazakhstan by means of macro regions of the country establishing and identifying of the cities Almaty, Astana, Aktobe, Shymkent and Ust-Kamenogorsk as national and international hubs equipped with modern infrastructure and integration of the transport infrastructure of the country into the international transport system" [Baiterek.gov.kz, 2018]. Nurly Zhol has been implemented since 2015.

In December 2012 President N. Nazarbayev announced and outlined a new strategy for Kazakhstan's development — *"Kazakhstan 2050"*. According to the strategic document, Kazakhstan should be among the 30 most advanced countries in the world by 2050. It is a new political course for the new Kazakhstan in a fast changing world, in which the sector of information and communication technologies is called "the future economy of Kazakhstan". The aim of the strategy is to create an economically developed, healthy, safe and educated country. It focuses on the seven main long-term priorities that aim to create a

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11 The opportunity to organize the exhibition brought many opportunities for the business sphere and the preparation of the premises was a positive impulse for the Kazakh construction sector.

strong state-based society and a developed economy with wider work opportunities [Strategy2050.kz, 2012]:

- The economic policy based on the principles of profitability, return on investment and competitiveness;
- Comprehensive support for entrepreneurship;
- New social policy principles — social guarantees and personal responsibility;
- A modern education system — focused on knowledge and professional skills;
- Consistent and predictable foreign policy — aimed at promoting national interests, strengthening regional and global security;
- Further strengthening of state sovereignty, development of democracy;
- New patriotism as a basis for a multi-ethnic and multi-religious society.

The new strategy follows the 2030 Strategy, adopted and implemented since 1997.

Thus, Kazakhstan's economic policy pursues two main objectives: the expansion of the industrial base and the development and construction of infrastructure. They are based on a diversification plan of the economy, with the intention of developing the sectors with the highest development potential in terms of the country's geographical location as well as the geopolitical risks in the region. Kazakhstan, as a large country with substantial fossil fuel reserves and other minerals, lacks access to the high seas. Therefore, it puts a great emphasis on its transit potential. It is one of China's major partners in building the New Silk Road (BRI) and strives to take over at least a tenth of cargo traffic between the EU and China. This will also increase its importance in terms of trade and economic cooperation with European countries.

As an example of an infrastructure development we can mention the ferry complex of the Kuryk Port, multimodal (railway-ferry-automobile) hub on the shore of the Caspian Sea (in Mangystau region[12]). It is a part of the Nurly Zhol infrastructure development programme. The port will link several Eurasian highway and railway transit corridors. The project will increase Kazakhstan's transit and logistics potential (determined to be the national strategy) and should contribute to increasing the competitiveness of the country when connecting to

12 Mangystau region is home to both of the Kazakhstan's Caspian Sea ports and is moving towards becoming a major logistics centre where aviation, railways, road and water transport networks are concentrated.

intercontinental transit routes in Eurasia thanks to its multiplier effect of transport infrastructure and the associated increase in trade flows as well as in regional cooperation [Altynsarina, 2018].

Another key factor in Kazakhstan's development and competitiveness has become the trend of digitization (the Internet of Things, Artificial Intelligence, 3D Printing Technology, and Blockchain), which was contextualised within the country's broader industrialisation efforts. The main innovation centre is to become the capital city thanks to the Astana Hub international technology park, opened in 2018, which will offer foreign investors a simplified visa regime, better conditions for job mobility, tax benefits, and expert start-ups. The main objective is to support a new generation of IT talents [AstanaTimes.com, 2018]. Besides, as an example of Kazakhstan's economic modernization the new development strategy of Shymkent city can be mentioned. In June 2018 it was declared country's third city of national significance alongside with Nur-Sultan (Astana) and Almaty. The aim is to create a large industrial, innovation, tourism, trade and logistics centre, which should become Central Asia's powerful economic centre.[13]

The newly elected President Kassym-Jomart Tokayev intends to ensure continuity of the strategic course of economic policy, plans and strategies aimed at modernising the country, and further strengthening the economic potential of Kazakhstan [Mfa.gov.kz, 2019].

3.5.2 Legal framework of EU-Kazakh relations

The main document governing mutual political relations, commercial, economic and cultural cooperation is the non-preferential Partnership and Cooperation Agreement[14], signed in January 1995. However, the ratification of the agreement was a long process, on the one hand, the PCA had to be ratified by the European Parliament and national parliaments of the EU member states, on the other hand, Kazakhstan experienced a political crisis in 1995. Nevertheless, the parties decided to conclude an Interim Agreement with the purpose to immediately put into effect most of the PCA provisions related to trade and economic is-

13 Shymkent is also an example for the production of eco-friendly fuels (including public transport systems) or efforts to digitize public services, and not exempting small and medium-sized enterprises [Satubaldina, 2018].

14 Partnership and Cooperation Agreement between the European Communities and their Member States, on the one part, and the Republic of Kazakhstan, on the other part.

sues [Kembayev, 2016]. The ratification process was completed within four years, and the PCA came into force on 1 July 1999 becoming the starting point for the development of mutual relations.

By concluding the agreement, Kazakhstan and the EU established a regular political dialogue and an institutional framework to conduct it. As one of its major provisions related to mutual economic cooperation, the PCA builds trade relations between the EU and Kazakhstan on the basis of the WTO principles (despite the fact that Kazakhstan became the WTO member only on 30 November 2015). The parties agreed to govern their relations on the basis of such principles as non-discrimination, including MFN and national treatment clauses. In 2009 the parties recognized that the PCA no longer reflected to the full extent neither the "mature partnership" which had developed in the past years (as well as new challenges that had emerged), nor Kazakhstan's growing relevance as a political and economic actor. Therefore, they decided to upgrade and enhance the relationship through the elaboration of a new agreement. The negotiations on the new enhanced partnership agreement started in 2011 and were completed in 2014. The *Enhanced Partnership and Cooperation Agreement (EPCA)* was signed on 21 December 2015 and since 1 May 2016 has been provisionally applied (two thirds of the agreement have been provisionally applied [European Parliament, 2017]. The EPCA agreement, once ratified by all Member States and the European Parliament, will replace the obsolete PCA. The main objective of the EPCA agreement is to lift up bilateral ties to a higher level.

Kazakhstan was the first Central Asian state which signed the "second-generation" agreement with the EU. The negotiations for the EPCA lasted about four years and were quite difficult, because the provisions of the agreement should have fully taken into account the WTO obligations as well as the Kazakhstan's obligations as the member of the Eurasian Economic Union.

The EPCA should contribute to significant strengthening of political and economic relations between the EU and Kazakhstan in a wide range of areas. It places emphasis on democracy, the rule of law, human rights, fundamental freedoms and sustainable growth, as well as cooperation in the field of civil society. In the area of foreign and security policy, emphasis is particularly on regional security, weapons of mass destruction, international cooperation on counter-terrorism, conflict prevention and crisis management.

The trade part of the agreement covers the improvement of the regulatory environment in the area of trade in services, establishing companies, capital movements, energy and minerals, public procurement and intellectual property rights. At the same time, cooperation in 29 key areas including those of economy, finance, energy, transport, education, research, culture and social issues will be improved [Drieniková, Kašťáková, 2016].

The EPCA agreement will allow for more favourable conditions for both parties' political and economic cooperation, while at the same time strengthening relations between Kazakhstan and individual EU member states. Both parties agreed that stepping up scientific, technological and educational cooperation under the auspices of the EPCA will contribute to the diversification of the Kazakh economy and thus increase the overall competitiveness of the domestic economy.

EU-Kazakhstan trade relations should be strengthened by Kazakhstan's WTO membership thanks to commitment to transparent rules and trade regulation, creating favourable conditions for foreign investors, which could also be an incentive for foreign investment to grow.

3.5.3 Economic cooperation

Since gaining independence, it has been one of the top priorities of Kazakhstan's foreign policy to establish and develop mutually beneficial political and economic cooperation with the European Union. Cooperation with the EU is perceived as an important factor in ensuring its independence and sustainable economic development. The establishment of diplomatic relations in 1993[15] has served as the foundation of a strong and growing relationship.

The European Union is also interested in developing relations with Kazakhstan. It is also the only state of Central Asia, for which the EU is the largest source of foreign direct investment (more than half) and the largest trading partner (up to a third of country's foreign trade). In addition to the important position as trade and investment partner, the EU perceives Kazakhstan as a partner for promoting peace and security in the wider region. Kazakhstan puts emphasis on security and stability (particularly in the Caspian region) [Haas, M. de, 2016], which successfully translates into the whole region. The country has peaceful and stable relations with all its neighbours. Similarly, of the Central Asian countries Kazakhstan particularly tends to deepen mutual rela-

15 The European Commission opened a representative office in Almaty — as the first in the Central Asian region — in November 1994. Kazakhstan opened its mission to the EU already in December 1993.

tions and cooperation with the EU, it is also the result of its efforts to increase openness and more active participation in international organizations and integration groupings.

Thanks to their mutual interest in cooperation, the EU and Kazakhstan could establish partnership based on devotion to principles of international public law, open and constructive political dialogue, as well as economic liberalization. Their relations have gained a dynamic character during the past period of over twenty years and have grown significantly both in depth and intensity, encompassing a whole range of political, economic, social and cultural ties at the present time [Kembayev, 2016]. Favourable conditions have been created for the growth of Kazakhstan's trade relations with European countries, technical regulations and harmonized standards are carried out in line with the EU requirements, and the country's interests are promoted in Europe.

Towards Kazakhstan the EU promotes not only pragmatic economic and political, but also ideological interests, it is trying to promote democracy and contribute to improving respect for human rights. The main obstruction, however, are its economic interests (especially in the energy sector) and different positions of its individual member states. Compared with Russia, China or the US, it has a lesser political influence in Kazakhstan but maintains significant economic influence [Peyrouse, 2014]. By a number of programs and projects (in particular — projects concerning the expansion of regional and local government capacities, supporting the reform of the judiciary, improving the capacity of the public sector to implement social and economic reforms) the EU has strongly supported Kazakhstan's economic, social and democratic development since the early nineties.

However, Kazakhstan's economic progress and investment potential significantly slowed down in 2014 due to the challenging external environment, weaker demand, fall in oil prices (and subsequent lower revenues of oil and other commodities exports) and economic recession. The mutual EU-Kazakh cooperation was affected also by the Ukrainian crisis and deteriorated EU-Russia relations — increased geopolitical tensions influenced the EU's cooperation with the Central Asian countries as well. The Kazakh economy has experienced the negative consequences of the EU sanctions against Russia, declining oil prices, higher import tariffs, weakening demand and depreciation of the Russian rouble against the Kazakh tenge. The Kazakh GDP growth fell in 2014 and further slowed down in 2015 (1.2% growth). Problems in economic progress were caused by a sharp decline in world oil prices as probably the most important factor, the inability of the Eurasian economic union to stimulate intraregional trade, and the tensions between the EU and Russia played important role as well. In 2017 the economic recovery was supported by more favourable terms of trade and increased oil production. The main challenge to achieving stable and sustainable development remains the country's vulnerability to external shocks, especially external demands from China and Russia, as well as global oil demand and prices, will continue to be the key external factors affecting its economic performance [World Bank, 2018].

Energy relations have been the driving force for cooperation since the establishment of mutual relations. Up to two-thirds of EU investments in Kazakhstan go directly to exploration and extraction of natural resources — oil, natural gas and metals [Konopelko, 2018]. In order to secure its energy supplies, the EU also strives to diversify its energy resources supply into the region of Caucasus and Central Asia, where Kazakhstan has a significant position. Several gas pipeline projects are currently known to diversify gas transit routes from the Caspian Sea and Central Asia to avoid transit through Russia.[16] Both the EU and Russia have their energy interests in Central Asia, and Kazakhstan wants to get the most out of both. While Kazakhstan's potential has not yet been fully exploited for the benefit of the EU, it is not negligible.

Besides energy, Central Asia's development as an important trade corridor has created a new major vector for mutual economic relations. There is a strong potential for the future of continental trade through transport corridors including the Central Asian region. In this respect, in terms of its geographical location, business environment and economic policy improvements, Kazakhstan is becoming more important in connection with the expansion of trade and transport links, especially in connection to the Chinese project of revitalizing the Silk Road trade routes. The Kazakhstan's role as a landlocked country will be particularly important in the construction of the "Silk Road Economic Belt." At the same time, through its participation in the International North-South Transport Corridor, it offers the EU a faster connection to the Indian subcontinent.

16 For example, the Trans-Caspian Gas Pipeline One of (Turkmenistan – Azerbaijan) would bring natural gas from the Caspian Sea to Europe (it will be the extension of the Southern Gas Pipeline to the east), it should be connected to the Kazakh Tengiz field.

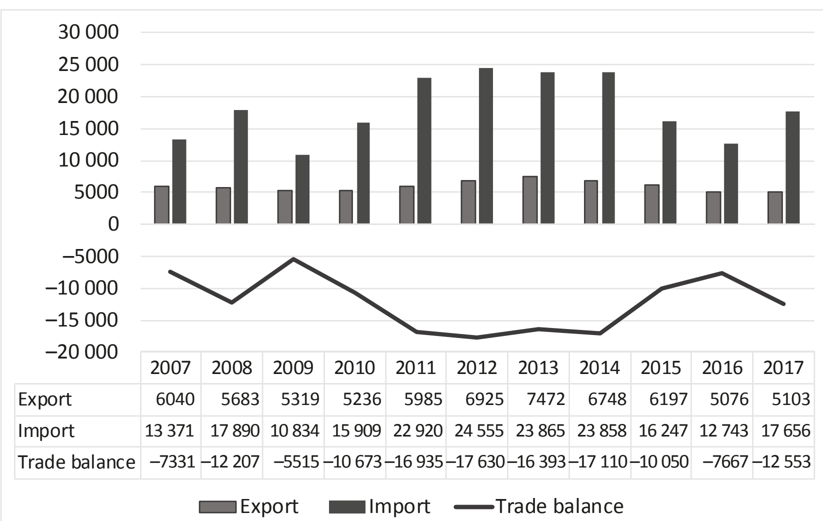
3.5.4 *Trade relations*

In the European Union's foreign trade relations, Kazakhstan has an important position as the EU main trading partner from the Central Asian region, accounting for up to 85% of EU trade with the region. For Kazakhstan, the EU is currently the largest trade and investment partner.

On the other hand, for the EU, Kazakhstan is not a priority trading partner, in 2017 it ranked 32nd largest trading partner with only 0.6% of the EU's external trade (1% of total EU imports and only 0.3% of EU exports).

Mutual trade in goods reached its highest value in 2012 (almost 25 billion euro), falling slightly over the next two years. However, in the following years (2015 and 2016) the volume of mutual trade was negatively affected by geopolitical tensions in the region caused by the Ukrainian crisis and deteriorated EU—Russia relations as well as due to declining world market oil prices. Due to the decrease in the value of Kazakh exports in the world market in 2016, the EU—Kazakh trade turnover in 2016 decreased by 42% in comparison to its 2014 levels. More detailed information about mutual trade development between 2007 and 2017 is provided in Figure 3.24.

Figure 3.24 **The development of the EU—Kazakhstan trade in goods (million euro)**



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Export	6040	5683	5319	5236	5985	6925	7472	6748	6197	5076	5103
Import	13 371	17 890	10 834	15 909	22 920	24 555	23 865	23 858	16 247	12 743	17 656
Trade balance	–7331	–12 207	–5515	–10 673	–16 935	–17 630	–16 393	–17 110	–10 050	–7667	–12 553

Source: our own elaboration based on Eurostat data.

The value of the EU imports from Kazakhstan was affected by the fall in world markets oil prices in 2015 and 2016. In 2017 EU exports to Kazakhstan recorded a modest growth (by 0.5%), but the value of imports increased by more than 38% in comparison to the previous year, mainly due to the increase in oil prices. An improved market situation, as well as a positive effect of the gradual implementation of the EPCA agreement have contributed to increase of mutual trade.

The dynamic development of Kazakh-European relations required the renewal of the legal framework for cooperation in conditions of global competition and taking into account the changing geopolitical and economic situation.

The main objective for both partners is to build up trade and, most importantly, ensure its comprehensive diversification. The dynamic development of mutual relations required the renewal of the legal framework for cooperation in conditions of global competition and the changing geopolitical and economic situation [Vassilenko, 2018] as well as international market conditions. In this regard, new elements of cooperation were included into the EPCA agreement. A positive signal in mutual trade cooperation was the growth of mutual trade in 2017 by 27 percent or by almost 5 billion euro (from 18 billion in 2016 to 23 billion in 2017), despite being caused mainly by the increase on the imports side. In 2018 mutual trade increased as well (exports by 14.6%, imports by 18.2%), however, it still did not reach the 2014 values [European Commission, 2019b].

The European Union remains a leader among Kazakhstan's trade partners, in 2018 it accounted for 40.6% of the total Kazakh foreign trade. Russia comes second (18.2%) followed by China on the third place (12.5%). It should be noted that the EU's share in total Kazakh external trade increased in comparison to the previous year (38.7%). The EU is the largest export market for Kazakh exports, accounting for more than 51% of all Kazakh exports. As for imports, the EU comes second after Russia (37.1% of all imports), with almost 21 percent share in the total Kazakh imports.

As regards the commodity structure of mutual trade, Kazakhstan strives to diversify its economy, as well as its trading partners, however, it is still very much reliant on hydrocarbons exports and European partners. The country's exports to the EU are limited to a few commodities, such as metals and oil. Likewise, the structure of EU imports is based on machinery, transport equipment and chemical products [Konopelko, 2018]. Oil is the most important item of mutual trade relations, accounting for up to 87.5% of EU imports from Kazakhstan. It is the third largest non-OPEC oil supplier to the EU, after Russia and Norway (in 2014 imports of Kazakh oil accounted for 6.4% of the EU total oil imports). Also, considering that Kazakhstan has to export, or transit, its oil to the EU market through the territory of Russia, tensions between the EU and Russia have to a great extent negatively affected the European-Kazakh economic and trade relations.

Industrial products (and especially chemical products) accounted for only 3.5% of the imports from Kazakhstan. On the other hand, the European Union exports to Kazakhstan mainly industrial products (more than 90% of exports), with transport and machinery having the largest share (more than 50% of exports), followed by products within manufacturing and chemical sectors.

Kazakhstan has been very successful in attracting funding from a wide range of partners, and in this regard the European Union is also the largest investment partner for Kazakhstan. In 2016 the EU direct foreign investment in Kazakhstan reached nearly 11 billion USD, just about half of the total annual value. Due to the favourable investment climate, more than 6.000 entities with European capital operate successfully in Kazakhstan in many fields, including EU-Kazakh joint-ventures, representative offices of companies and financial institutions [Vassilenko, 2018]. The EU has a strong interest in modernisation and diversification of the Kazakh economy. Even though the EU-Kazakh co-operation has expanded into many areas, including energy, transport and agriculture, there remains plenty of scope for further growth.

Kazakhstan is engaged in big modernisation efforts, with the aim of joining the top 30 most developed countries in the world in 2050. The EU has a strong interest in these efforts. Compared with Russia, China or the US, it has a lesser political influence in Kazakhstan but maintains significant economic influence. Currently, the EU is the largest trade and investment partner for Kazakhstan. While increased geopolitical tensions negatively influenced mutual cooperation, the improved market situation and positive effect of the gradual implementation of the EPCA agreement contributed to the mutual trade increase in 2017.

4
SLOVAKIA'S FOREIGN TRADE RELATIONS WITH SELECTED TERRITORIES

Slovak economy belongs to small economies, Slovakia does not have a sufficiently large market for efficient allocation of domestic production. Moreover, the country does not possess sufficient basis of raw materials. In case of Slovakia, the unquestionable axiom is that the smaller economic dimension the country has the more it must, if willing to increase its economic prosperity, be involved in the international distribution of labour and thus compensate for its lower economic power. In this context, present Slovak economy may be described as small and open.

The development of foreign trade of Slovakia has been strongly determined by historical, economic and political factors. Throughout the periods of the First Czechoslovak Republic since 1918, a common Czechoslovak Socialist Republic after the World War II and the Federal Republic since 1989, the production of Slovakia was characterized by high demand and lack of product finalization, which was indicative for the Czech Republic. After 1989 Slovakia adopted (still within the common Czech and Slovak Federative Republic) a strategy for economic reform, which was aimed at rapid creation of system conditions for building up of a market economy.

First actions within the economic reform in the process of transformation were the most radical and the riskiest. They were primarily aimed at the release of pricing policy, the abolition of foreign trade state monopoly, the liberalization of foreign trade and the related introduction of internal convertibility of the Czechoslovak crown.

After the peaceful split of Czechoslovakia (January 1, 1993) and the creation of two independent states (the Czech Republic and Slovakia), the new direction of both countries had a common goal — to build a market economy, to fulfil association criteria and subsequently to incorporate into the structures of the European Union. Both republics succeeded in this on May 1, 2004.

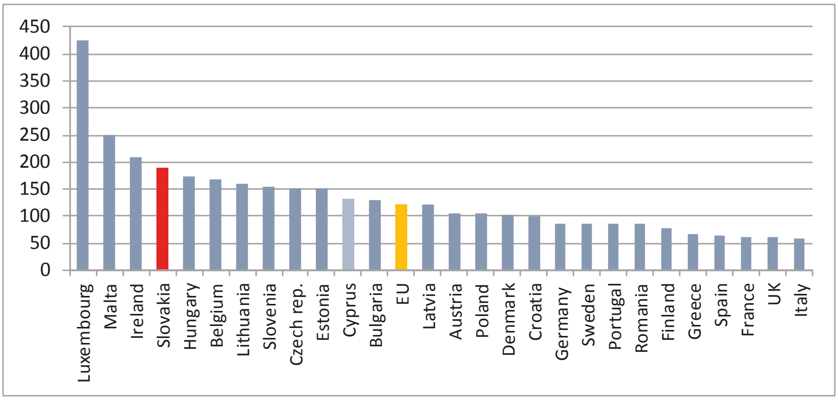
Nowadays the Slovak Republic (SR) is an industrialized country, highly dependent on the international exchange of goods mainly due to relatively small internal market (5 mln inhabitants). Therefore, the foreign trade has gained a prominent position. It largely contributes to the economic growth of the country, creates gross domestic product and is an essential part of state's foreign exchange revenue. Positive development of foreign trade significantly affects an efficient functioning of the entire economy. Therefore, the Government of the Slovak Republic in the framework of the fundamental objectives of its economic and trade policies focuses on increasing of performance, efficiency and competitiveness of the economy. Following these objectives, the foreign trade serves as an important tool to achieve these goals [Drieniková, Zubaľová, 2013].

Energy and material-demanding industrial production of the SR is dependent on imports of raw materials (with minimum resources from its own). On the other hand, because of the small internal market it is forced to look for demand of its excess production on foreign markets. The share of exports of goods and services in the gross domestic product has steadily upward trend and, as stated by the Slovak Statistical Office, its share increased from 57.8% to 95.4% between 1995 and 2014. The dramatic increase in the openness of the economy occurred mainly in the 2000s because of the introduction of economic reforms, economic conjunction in the world economy and confirmation of future EU member state status of Slovakia. Another significant increase was caused by the export of new foreign investors in the sectors of automotive and consumer electronics by Kittová [Kittová, 2014].

In 2017 Slovakia's export performance (measured as the share of exports of goods and services on GDP) reached the level of 88% after a slight fall from 95.1% in 2014. Import intensity in 2017 (as a share of imports of goods and services on GDP) reached 84.4%, when decreased from 88.4% in 2014. The involvement of the national economy in international trade reflects the rate of the openness of the economy and is set as a share of foreign trade turnover on its GDP. In 2017 the openness of the Slovak economy reached 189.18%. This indicator confirms a high level of external openness of the Slovak economy, which was the third highest in the EU. A greater degree of openness of the economy than Slovakia is reported only by Luxembourg and Ireland. Figure 4.1 presents the overview of economic openness of the individual EU states.

These data point to the sensitivity of the Slovak economy to the development of the global economic environment. A high degree of interdependence with individual trade partners has not only positive, but also negative consequences. In case of the negatives it is mainly the

Figure 4.1: **Economic openness of the EU states in 2017 (as % of export and import on GDP)**



Source: our own processing based on data of [Eurostat, 2018].

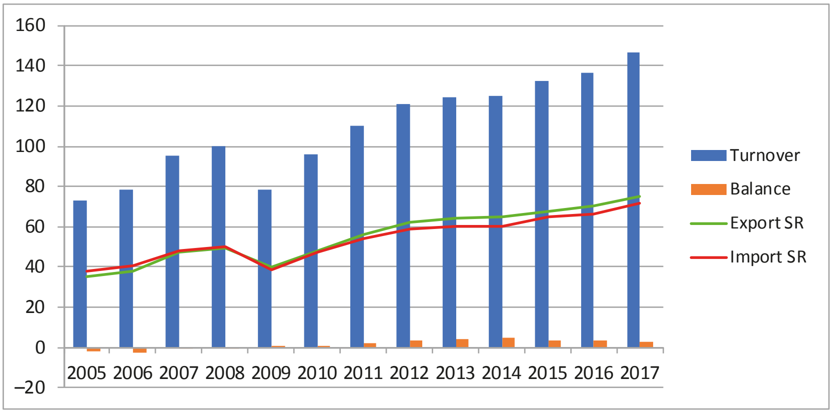
greater "vulnerability" of the Slovak Republic in terms of its deepening dependence on foreign demand.

4.1 Slovakia's foreign trade development

Since its establishment (1993) Slovakia's economy and its foreign trade had to deal with the inherited past — unilaterally oriented economic structure focused on the production of intermediate products and products with low added value (mainly metallurgy and chemical industry and heavy engineering) and the breakup of Czechoslovakia. Slovakia had to look for new opportunities to reach new markets and gain international competitiveness. The transition from a planned controlled economy to a market-oriented had a significant impact on trade of the Slovak Republic with foreign countries. The process of liberalization and de-monopolisation of foreign trade started, the national currency convertibility gradually strengthened and the international financial flows were released. It came to the liberalization of prices and the formation of its own foreign trade policy, which was forced to adapt to the new economic reality and its overall effort to convergence with the European integration environment. This was resulted in the territorial reorientation of Slovak foreign trade, which significantly reflected the aforementioned changes. Foreign trade has become a key accelerator of the entire transition process, as well as one of the important factors of development of the Slovak economy.

Slovakia joined the EU in 2004 and since then the development of foreign trade and its foreign trade relations have changed. Slovakia has started to apply the principles of the common commercial and agricultural policy and principles of the European Economic Area (EEA). In relation to non-member countries, the free market for Slovak exporters was extended. Under the new legislation, the importation of goods from the third countries has become a subject to EU tariffs, in the amount determined by the Common Customs Tariff of the EU. General Tariffs are the highest and apply to the goods without the country of origin or if a country is not subject to contractual and preferential tariffs. Imports from only some developed countries outside the member countries of the WTO are applied with contractual tariffs [Kašťáková, Ružeková, 2014]. More favourable are preferential tariffs, which applied to other territories. The development of foreign trade in the period after accession to the EU is specified in Figure 4.2.

Figure 4.2: **Foreign trade of Slovakia in 2005–2017 (in bn. EUR)**



Source: our own processing based on data from [MH SR, 2018].

Figure 4.2 shows a conspicuously increasing trend of total turnover of the Slovak foreign trade. The only exception is the year 2009 with the decrease of foreign trade turnover by almost 21.3% compared to the previous year. It was driven by sluggish world economy as a result of the global financial and economic crisis which continues to a lesser extent to these days. However, since 2010 the overall Slovak foreign trade has reached the annual growth rate on average of 9.23%. Export dynamics during the period reported an increase on average of 10.8% while the growth rates of Slovak imports were at an average of 8.83% [MH SR, 2018].

Until 2008 the Slovak foreign trade balance remained passive. The largest amount was recorded in 2006 (–2.6 bn. EUR). This fact was due to the influence of South Korean investments which required import of advanced equipment and technology into the automotive and electronics industries in Slovakia (mainly KIA and Samsung). This in turn accelerated the Slovak export, which has begun to show significant growth rates since 2007. Export growth has positively affected our balance of trade, which reached the first positive value in 2009. Moreover, in recent years there has been a consolidation of the positive balance of foreign trade, which in 2017 stood at 2.9 billion EUR and in 2018–2019 period continues to keep this positive trend [Kašťáková, Ružeková, Žatko, 2016].

4.1.1 Territorial structure

Territorial structure is being changed and influenced by emerging, changing and developing integration groupings, growing strength of TNCs, maturity and economic profile of individual economies, liberalizing trends and scientific and technical progress. These factors are also key determinants of changes in the territorial structure of Slovak foreign trade occurring gradually since 1993, when Slovakia signed the Association Agreement on association with the EU. The changes are also being influenced by the overall development of the world economy. The EU countries have become the most important trade partners of Slovakia during last 9 years. Their share on total Slovak exports in 2017 increased by 7% compared to 2016 and reached the level of 85.4% [MH SR, 2018]. Imports from the EU countries also increased by 7.8% and accounted for 66.9% of the total import of the SR. Another phenomenon affecting the territorial structure of foreign trade was that by joining the EU, Slovakia lost the benefit under the Generalised system of preferences (GSP) unilaterally provided by the USA, Canada, Japan, Australia and New Zealand. This fact has complicated the access of Slovak goods to these territories, as reflected primarily on the dynamics of export of the SR to the USA and Canada, in particular the fall in exports of automobiles and their parts (VW Touareg).

Since Slovakia has joined the EU, the first three positions among the most important trading partners belong to Germany, the Czech Republic and Poland. Other places are derived from the actual development of foreign trade. Among the most important trade partners in 2017 were Germany (with a share of 18.5% on the total foreign trade turnover of Slovakia), the Czech Republic (10.9%), Poland (6.4%), Hungary (4.8%), China (4.4%) and Russia (3.3%).

Among the most significant export trade partners of Slovakia are almost all the EU countries. In 2017, the top positions belonged almost traditionally to Germany, the Czech Republic, Poland, Great Britain and France, mainly due to the export of cars and electrotechnics. A detailed overview of the most important trade partners in exports in 2017, as well as their year on year comparison is shown in Table 4.1.

Table 4.1: **The most important partners of SR in export in 2017 (mln EUR)**

Country	Value	Share (%)	Index 2017/2016 (%)
1. Germany	15 423.8	20.62	100.7
2. Czech Republic	8599.8	11.50	103.9
3. Poland	5697.7	7.62	107.1
4. Great Britain	4701.2	6.28	108.9
5. France	4504.9	6.02	108.7

Source: our own processing based on data from [MH SR, 2018].

In relation to the most important trade partners of Slovakia in 2017, the volume of Slovak export increased in case of Germany (by 0.7%), the Czech Republic (3.9%), Poland (7.1%), the United Kingdom (8.9%), France (8.7%), Italy (32.8%), Spain (6.1%), Hungary (14.4%), Austria (12.3%), the United States of America (23.2%), Romania (15.3%) and the Russian Federation (7.6%).The volume of export decreased in case of the Netherlands (by 4.3%).

During the past decade, the most important import partners of Slovakia have traditionally included Germany, the Czech Republic and China. The Republic of Korea has significantly improved its position, due to the impact of its KIA and Samsung investments. The upward trend in the volume of realized imports was recorded in Poland, which concludes the first five of the largest importers to Slovakia in 2017. A detailed overview of the most important trade partners in imports in 2017 is shown in Table 4.2.

Table 4.2: **The most important partners of SR in import in 2017 (mln EUR)**

Country	Value	Share (%)	Index 2017/2016 (%)
1. Germany	11 835.4	16.48	104.8
2. Czech Republic	7339.0	10.22	102.5
3. China	5207.9	7.25	92.7
4. Republic of Korea	4063.7	5.66	103.0
5. Poland	3737.2	5.20	110.2

Source: our own processing based on data from [MH SR, 2018].

In relation to the most important trade partners of Slovakia in 2017, import increased in case of Germany (by 4.8%), the Czech Republic (2.5%), the Republic of Korea (3%), Hungary (8.8%), Poland (6%), Italy (5.2%), France (10.2%), Austria (3%), the United Kingdom (43.2%) and the Russian Federation (24.8%). Import from China decreased (7.3%).

During the whole observed period, Slovakia had a trade surplus with the EU countries. However, trade deficit was recorded by Russia and Southeast Asian countries such as China, South Korea, Japan, Malaysia, Taiwan and India. In 2017 Slovakia had the largest trade deficit with China (3 985.2 mln EUR), the Republic of Korea (3 972 mln EUR), the Russian Federation (1 845.4 mln EUR), Malaysia (522.2 mln EUR), Taiwan (443.5 mln EUR), Japan (438.8 mln EUR), India (233.2 mln EUR) and Ukraine (165.9 mln EUR).

In 2017 Slovakia had the largest trade surplus with Germany (3 588.5 mln EUR), the United Kingdom (2 730.7 mln EUR), Poland (1 960.5 mln EUR), Austria (2 243.1 mln EUR), France (2 4251 mln EUR), the United States of America (1 292.8 mln EUR), the Czech Republic (1 260.8 mln EUR) and Spain (1 121.1mln EUR) [MH SR, 2018].

4.1.2 Commodity structure

Commodity structure of foreign trade of Slovakia reflects changes in development of content, production processes and final consumption of population and is dependent on the economic size of the country. In the case of a small domestic market in the Slovak Republic, it is necessary to search for overproduction sales abroad. In 2017, amount of exported goods from Slovakia reached 74 813.3 million EUR representing sales annual growth by 6.8%. Up to 60% of exports accounted for exports of goods from only three chapters of HS, namely vehicles and their parts, electrical machinery and equipment and machinery. Significant export goods are also iron and steel with a share of 4.7% and mineral fuels and mineral oils with a share of 4.2% on total export of the SR [MH SR, 2018]. Such commodity structure points to the lack of diversification of Slovak exports and high vulnerability of the Slovak economy. Therefore, the Slovak Government defines a higher commodity and territorial diversification of foreign trade as the most important priorities in its strategy of external economic relations for 2014-2020. The goal of strategy is to eliminate potential territorial and commercial risks stemming from lack of diversification [Jamborová, Furdová, Pavelka, 2013]. A detailed commodity structure of foreign goods exchange of the most important commodities in the export of Slovakia in 2017 is shown in Table 4.3.

Table 4.3: **The most important export commodities of Slovakia in 2017 (mln EUR)**

Harmonized System Code	2017	Share (%)	In. 17/16 (%)
87 Vehicles other than railway	19 958.7	26.7	100.3
85 Electrical machinery & equip.	15 564.3	20.8	108.1
84 Nuclear reactors, machinery	9094.2	12.2	103.6
72 Iron & steel	3500.6	4.7	127.5
27 Mineral fuels, oil	3387.8	4.5	145.8
Total export from the SR	**74 813.3**	**100.0**	**106.8**

Source: our own processing based on data from [MH SR, 2018].

In 2017, the export of automobiles and other motor vehicles principally designed for transport of persons increased by 1 474.6 mln EUR; export of parts and accessories of motor vehicles increased by 582.6 mln EUR; export of new pneumatic tyres — by 360.7 mln EUR; export of vehicle bodies — by 304 mln EUR and export of telephones for cellular networks or for other wireless networks by 241.3 mln EUR. In the period observed, the largest decrease of export was recorded by petroleum oils and oils obtained from bituminous minerals, other than crude (433.8 mln EUR); flat-rolled products of iron or non-alloy steel (175.3 mln EUR); monitors and projectors, television receivers (166.8 mln EUR), parts and accessories of transmission apparatus for radio or television broadcasting (164.2 mln EUR); printing machinery used for printing by means of plates (159 mln EUR); transmission apparatus for radio or television broadcasting (143.5 mln EUR) and preparations for oral or dental hygiene (120.6 mln EUR) [MH SR, 2018].

In 2017 imports of goods to Slovakia reached 71 817.2 million EUR with the annual increase of 8.2%. The most imported commodities were electronics and electrical engineering with a share of 20.6% in total imports, followed by vehicles and their components (14.4%), boilers, machinery and other equipment (12.1%) and mineral fuels with a share of 8.7%. During the reported period, import of agricultural and food products of Chapters 1 to 24 (HS) amounted to 4 238 million EUR representing an annual increase of 3.3% (MH SR, 2018). An overview of the most imported commodities in SR 2017 is shown in Table 4.4.

Table 4.4: **The most important import commodities of Slovakia in 2017 (mln EUR)**

Harmonized System Code	2017	Share (%)	In. 17/16 (%)
85 Electrical machinery & equip.	14 778.9	20.6	110.0
87 Vehicles other than railway	10 322.4	14.4	102.9
84 Nuclear reactors, machinery	8679.8	12.1	103.5
27 Mineral fuels, oil	6235.1	8.7	140.8
39 Plastics and materials thereof	3011.9	4.2	102.6
Total import from the Slovakia	**71 817.2**	**100.0**	**108.2**

Source: our own processing based on data from [MH SR, 2018].

Compared to 2016, the largest increase was recorded in import of parts and accessories of motor vehicles (by 1 084.2 mln EUR); telephone sets including telephones for cellular networks or other wireless networks (by 621.9 mln EUR); automobiles and other motor vehicles principally designed for transport of persons (by 309.8 mln EUR); seats transformable to beds (by 260.3 mln EUR); monitors and projectors, television receivers (by 191.8 mln EUR); air or vacuum pumps, compressors (by 191.7 mln EUR) and self-propelled railway or tramway cars (by 161.2 mln EUR). In contrast, the largest decrease was recorded in import of petroleum oils and oils obtained from bituminous minerals, crude (by 725.1 mln EUR); petroleum oils and oils obtained from bituminous minerals, other than crude (by 179.9 mln EUR); petroleum gases and other gaseous hydrocarbons (by 174.7 mln EUR); iron ores and concentrates (by 123.1 mln EUR) and printing machinery used for printing by means of plates (by 114.6 mln EUR).

4.1.2 Revealed comparative advantages of Slovak export

The analysis of revealed comparative advantages enables us to identify comparative advantages of different sectors of the national economy. With the help of this analysis, individual economies make decisions on production of products, which have sufficient comparative advantages and can be placed on foreign markets. New theories of international trade bring new perspectives to the comparative advantage analysis, since they are based on comparative costs. It was [Krugman, 1986] who characterized the intra-sectorial trade as a typical form of trade on the basis factor endowment identity of the country, in contrast to the Heckscher-Ohlin theorem [Heckscher, Ohlin, 1991], which was based only on the bases of comparability or differences.

There is a number of ways to identify revealed comparative advantage. The most common tool is the indicator of RCA (Revealed Comparative Advantages), which can be expressed in various modifications [Obadi, 2004]. The formulation of the result depends, on the real value of the index. A country reveals comparative advantage in products for which the RCA indicator value is higher than 1. If the commodity index is less than 1, it is a comparative disadvantage [Vokorokosová, 2004]. It indicates that the export of such commodity of the country is lower than the average export of the reference group. This variation of the index has also some opponents [Greenaway, Milner, 1993], who refer to not taking into account the import of the tested country which may cause a problem in large economies. Therefore, there are several modifications of the above-mentioned variations of the original RCA [Štěrbová, 2013].

It should be noted that the term "index of revealed comparative advantage" is not quite correct. More appropriate would be the term "index of revealed competitive advantage". This is because it is not possible to assume precisely whether it is the comparative or respectively competitive advantage, meaning whether the export of selected commodity had not been supported, for example, by domestic export subsidies, dumping prices or other instruments or benefits provided by the government. These facts have impact on the objectivity of findings.

Table 4.5: **20 most important export commodities of Slovakia in 2015**

Code HS	Harmonized System Code	Value (mln EUR)	Share (%)
87	Vehicles other than railway	18 305.7	27.05
85	Electrical machinery & equip. & parts	13 954.2	20.62
84	Nuclear reactors, machinery	8293.2	12.25
72	Iron & steel	2822.5	4.17
27	Mineral fuels & mineral oils	2488.9	3.68
39	Plastics & articles thereof	2117.2	3.13
40	Rubbers & articles thereof	2055.6	3.04
73	Articles of iron or steel	1539.9	2.28
94	Furniture, bedding, lamps	1363.0	2.01
76	Aluminum & articles thereof	1046.4	1.55
64	Footwear, gaiters, & the like	1025.7	1.52
48	Paper & articled of paper pulp	781.4	1.15
44	Wood & articles of wood	723.4	1.07
90	Optical instruments & accessories	694.2	1.03

Source:our own processing based on data from [MH SR, 2016].

As a data source for this research we used statistics of the Slovak Statistical Office, which provided the data used for the analysis of foreign trade of Slovakia and UN Commodity Trade Database (International Trade Statistics Database). Commodity structure of foreign trade is classified under the Harmonized System HS 2012.

Export of 15 most important commodities in 2015 reached the value of 57.9 bln EUR with a share of 85.3% on the total export of the SR. A detailed overview of the most important Slovak export commodities in 2015 is shown in Table 4.5.

Table 4.6 shows 15 chapters of HS12, in which Slovakia achieved the highest values of revealed comparative advantage. Almost all of them (13 out of 15) belong to the most important export commodities of Slovakia. A detailed overview of products according to the intensity of their revealed comparative advantage is shown in Table 4.6.

Using the Balassa index of RCA, we found out that compared to the world, the most advantages of Slovakia are mainly concentrated in the

Tab. 4.6: **Revealed comparative advantages in Slovak export (2015)**

Code HS	Harmonized System Code	Index RCA	RCA Intensity
87	Vehicles other than railway	3.41	medium strong
40	Rubbers & articles thereof	3.03	medium strong
83	Miscellaneous articles of base metal	2.48	medium strong
72	Iron & steel	2.10	medium strong
64	Footwear, gaiters, & the like	1.79	weak
76	Aluminum & articles thereof	1.53	weak
85	Electrical machinery & equip. & parts	1.44	weak
44	Wood & articles of wood	1.38	weak
94	Furniture, bedding, lamps	1.36	weak
73	Articles of iron or steel	1.34	weak
17	Sugars and sugar confectionery	1.32	weak
48	Paper & articled of paper pulp	1.20	weak
84	Nuclear reactors, machinery	1.04	weak
39	Plastics & articles thereof	0.91	no
61	Articles of apparel & clothing access.	0.56	no

Source: processed based on data from Comtrade (2015) a Hinloopena, Marrewijka (2000).

export of vehicles and accessories, rubbers and articles thereof, articles of base metals and iron and steel. In these four chapters the commodity index reaches a value greater than two (2). According to the classification of Hinloopena, Marrewijk, there is a moderately strong comparative advantage.

Slovakia clearly has the most significant comparative advantage in the export of products of Chapter 87 — Vehicles other than railway or tramway rolling stock, and parts and accessories thereof with the index value of 3.41. The second largest comparative advantage have goods of Chapter 40 — Rubbers and articles thereof with an index value of 3.03 and the third place in exports include products of Chapter 83 — Miscellaneous articles of base metals, with an index value of 2.48. More or less stable position where Slovakia reached moderately strong comparative advantage are represented by areas tied to the automotive industry, as products of Chapter 72 — Iron and steel. Interesting are also the products of Chapter 64 — Footwear, gaiters and the like and Chapter 76 — Aluminium and articles thereof.

The results of the research also show that in the year 2015 Slovak goods which gained revealed comparative advantages were exported in total value of 52 784.9 million EUR, which represents more than 80% share of total Slovak exports (64 172.3 mln EUR). This confirms the relevance of these commodities in terms of Slovak export. Comparison of the results in Table 6 and 7 shows that the revealed comparative advantages were identified in 12 out of 15 major export commodities of the SR.

Based on the Balassa index of RCA, the authors of the submitted paper attempted to identify the most important export commodity of Slovakia that have sufficient comparative advantages in their penetration into foreign markets. The authors managed to do so by previous calculations. However, they considered it necessary to add that this analysis based on BI ignores safety and political risks on individual foreign markets does not respond to any disruptive innovation or sudden changes in demand, which are difficult to predict in real time. The Balassa index limits arise mainly since economic phenomena and processes in real time are dynamic and are somehow interlinked and mutually influenced.

For a more comprehensive assessment of the revealed comparative advantage, other facts should also be taken into consideration, namely:

1. Whether the product is already placed on a market, i.e. if its share on the target market corresponds to Slovak competence and has already fulfilled its export potential or if its share is negligible and in this case the product could appear to be suitable for export;
2. To assess market dynamics (e.g., what is the development of product imported into the partner country);
3. To monitor the development of comparative advantages in time.

This means that the selection of suitable export commodities for individual countries must be complemented by growth and unit indexes to which the ex-post data on foreign trade of the country could be used. The Lafay index (LFI)[17] of international specialization which not only measures the comparative advantage in relation to other countries but

17 LFI index quantifies the country's comparative advantage for a specific product by comparing the proportion of the turnover of the trade balance of the product to the share of total turnover on the trade balance of the country. Important then is the turnover of this product on the total trade turnover.

also shows a comparative advantage relative to the total structure of trade of the country is appropriate for monitoring the development of comparative advantages over time. Then, the positive values of LFI indicate a comparative advantage in the meaning that they refer to the degree of specialization of the item (i.e., the product). Such analyses, however, require the availability of a statistical reference base, which in many cases is not freely available.

4.2 Slovakia's foreign trade relations with Western Balkans

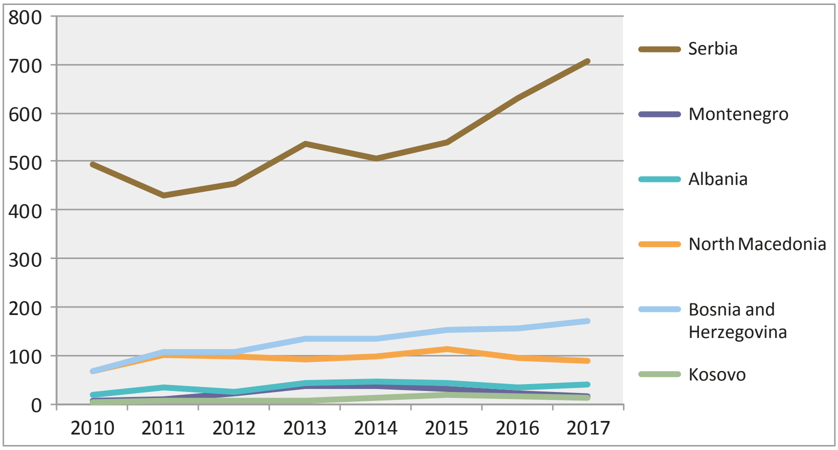
Slovakia and the Balkan countries long-lasting close relations stem from documented historical events: in 16th century Serbians helped the Slovakian city of Komarno to fight against the Osman incursion; and later Serbs populated certain parts of Slovakia and vice versa, 250 year ago a wave of Slovakian immigrants arrived at area around Vojvodina [Lorincz J., 2017]. Despite traditional social, cultural and economic ties of the Slovak republic with the Western Balkan countries, mutual trade exchange is not very significant. More intensive trade relations faded out after the collapse of the Soviet Union, political changes in the Slovak republic and trade orientation towards western countries, above all, the EU region. At present, economic and political relations are problem-free with the exception of Kosovo, where the deepening of the relations is limited by the fact that the Slovak republic did not recognize the Kosovo sovereignty.

The foreign policy is focused on supporting democracy, the rule of law, economic and political reforms and integrating the Western Balkans in to the NATO and the WTO. The Slovak republic is strongly supporting the Western Balkans integration in to the EU and together with Poland has appealed to the EU to take a more active approach towards the region.

The trade relations are regulated by the free trade arrangements within the Stabilization and Association Agreements signed between the EU and a particular Western Balkan country.

Following chart 4.3: *Foreign trade of the Slovak republic with the Western Balkans* indicates Slovakian foreign trade development with each Balkan country. Serbia is the most important business partner with trade totalling 705.8 mln EUR, followed by Bosnia and Herzegovina (171.73 mln EUR), the Republic of North Macedonia (89.34 mln EUR),

Figure 4.3: **Foreign trade of the Slovak republic with the Western Balkans (in mln EUR, 2010–2017)**



Source: our own elaboration based on data: [MZV SR, 2019].

Table 4.7: **Slovak republic export and import to the Western Balkans (2017)**

	Montenegro	**North Macedonia**	**Serbia**	**Albania**	**Bosnia and Herzegovina**	**Kosovo**
Export in mln EUR	15.81	59.9	349.9	33.89	100.68	13.35
Share on total export, %	0.029	0.084	0.38	0.041	0.11	n.a.
Import in mln EUR	0.15	29.39	355.9	5.45	71.05	0.17
Share on total import, %	n.a.	0.071	0.44	n.a.	0.12	n.a.
Total trade	15.96	89.34	705.8	39.34	171.73	13.52

Source: our own compilation based on data of: [OEC, 2018f] and [MZV SR, 2019].

Albania (39.34 mln EUR), Kosovo (13.52 mln EUR) and Montenegro (15.96 mln EUR) in 2017. As it is seen in the chart, the trade with Montenegro and Kosovo is at a minimum. The trade with all the Western Balkans has a rising tendency except for the decline in trade with Kosovo and North Macedonia in the last two years.

The Western Balkans do not belong to the biggest export and import markets of the Slovak republic, Slovakian trade with the region totalled an estimated 1035.69 mln EUR. The shares of the Balkans in Slovak export and import are in table 4.7: *Slovak republic export and import to the Western Balkans*. The table proves that the most important export and import market is Serbia (0.38% and 0.44% respectively) and Bosnia and Herzegovina (0.11% and 0.12%), import from Montenegro, Albania and Kosovo are negligible. The overall trade balance is positive in the long term, in 2017 it was negative only with Serbia.

4.2.1 Slovak republic trade with Montenegro

Slovak relations with Montenegro are developing dynamically with a great potential for future growth, namely in services — Montenegro is a sought-after destination of Slovak tourists, regretfully, the trade is very small and in 2017 totalled only 15.96 mln EUR. Not only import fell to 0.15 mln EUR and has had negative trends since 2014, but also export is in decline. The Slovak republic trade surplus is almost 15.7 mln EUR. More data on trade are in table 4.8: *Slovak republic trade in goods with Montenegro*. The share of Slovakia in Montenegro trade accounts for 0.3% of total Montenegro foreign trade.

Table 4.8: **Slovak republic trade in goods with Montenegro (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	4.98	7.95	17.91	33.65	36.43	29.39	20.61	15.81
Import	0.74	1.24	5.37	2.04	1.25	0.30	0.29	0.15
Total	5.72	9.19	23.28	35.69	37.68	29.69	20.89	15.96
Balance	4.24	6.71	12.54	31.61	35.18	29.08	20.32	15.66

Source: [Monstat, 2018] and [MZV SR, 2019].

The main items in Slovakian export are electrical machinery and equipment, vehicles, steel and iron products, others are indicated in table 4.9: *Slovak republic — Montenegro export commodity structure*.

Table 4.10: *Slovak republic — Montenegro import commodity structure* contains components of Slovakian import from Montenegro. The main imported commodities are minerals, debris and ash, plastics and plastic products and vehicles.

Table 4.9: **Slovak republic — Montenegro export commodity structure (mln EUR, 2017)**

	mln EUR
Electrical machinery and equipment	2.0
Vehicles	1.2
Steel and iron products	1.0
Rubber and rubber products	0.7
Machinery and mechanical equipment	0.6
Food products	0.3
Steel and iron	0.3
Various products	0.3
Furniture	0.3
Toys	0.2

Source: [Monstat, 2018].

Table 4.10: **Slovak republic — Montenegro import commodity structure (EUR, 2017)**

	EUR
Minerals, debris and ash	42 032
Plastics and plastic products	10 486
Vehicles others than railway, trams and spare parts	8563
Electrical machines, devices and their parts	3947

Source: [Monstat, 2018].

Despite very good political relations, trade exchange lags behind its potential. There are several reasons for that: geographical distance, Montenegro is a small market with weak purchase power, weak funding possibilities for Slovakian projects, administrative obstacles on the part of Montenegro and lack of investment interests from the part of Slovak companies. The potential sectors for investments and trading are:

- Energy — renewable energy: hydro, solar energy and biomass, energy infrastructure and consulting.
- Agriculture — bio production, food processing.

- Infrastructure — building and reconstruction of railways and highways.
- Environment — sewerage treatment building and recycling.
- Military — armed forces reform.
- Tourism — hotels privatisation and hotels building.
- Waste management — waste separation and waste treatment.

4.2.2 Slovak republic trade with the Republic of North Macedonia

The Slovak republic — North Macedonia relations are open and friendly without any problems that could burden cooperation. After downswing in 2012, export of the Slovak republic is constantly growing, import went up in the period of years 2013–2015, but as of 2016 a more pronounced decline is evident (–29.1%) that has negative impact on overall trade totalled 89.34 mln EUR. Slovakia exported goods worth 59.95 mln EUR, almost double compared to import that reached 29.39 mln EUR. The share of import from Slovakia on North Macedonian market is 0.86%. The balance of Slovak trade is positive over the last two years. The trade patterns are shown in table 4.11: *Slovak republic trade in goods with North Macedonia*.

Table 4.11: **Slovak republic trade in goods with North Macedonia (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	36.07	48.86	38.19	35. 81	42.45	50.71	52.78	59.95
Import	31.24	52.78	59.96	55.03	54.14	62.07	41.05	29.39
Total	67.31	101.64	98.15	90.84	96.59	112.78	93.83	89.34
Balance	5.46	–3.92	–21.77	–19.26	–11.69	–11.36	11.73	30.56

Source: our own elaboration based on: [MZV SR, 2019].

Over one third of commodity structure of Slovakian export to North Macedonia consists of telecommunication equipment (32.98%), followed by passenger cars (12.93%) and TV receivers (7.99%). The commodity structure of export (only most relevant items) in 2017 is in table 4.12: *Slovak republic — North Macedonia export commodity structure*.

Table 4.12: **Slovak republic — North Macedonia export commodity structure (2017)**

Commodity	mln EUR	Share, %
Telecommunication equipment	19.77	32.98
Passenger cars	7.75	12.93
Televisions	4.79	7.99
Packaging material from paper, cardboard, palp wadding or webs of knitted cellulose fibres	2.31	3.85
Monofilaments	1.79	2.99
Synthetic woven fabrics	1.38	2.30
Malt	1.36	2.27
Motor vehicle for freight transport	1.06	1.76
New rubber tires	1.03	1.71

Source: [MZV SR, 2018c].

Following table 4.13: *The Slovak republic — North Macedonia import commodity structure* contains the list of most relevant items imported by Slovakia to Macedonia. 26.18% of import consists of wires and cables, 14.18% of glass fibres and 10.17% of seats. In addition, Slovakia imports clothes, wine, various parts for locomotives and vehicles.

Table 4.13: **The Slovak republic — North Macedonia import commodity structure (2017)**

Commodity	mln EUR	Share, %
Wires and cables	7.62	26.18
Glass fibres (incl. glass wool) and products thereof	4.13	14.18
Seats	3.11	10.70
Clothes	1.80	6.18
Wine	1.40	4.81
Gentlemen's or boy's suits, ensembles, jackets, blazers, trousers	1.37	4.71
Parts of railway or tramway locomotives and vehicles	1.01	3.48

Source: [MZV SR, 2018c].

Even if relations between the countries are good, there are no larger foreign direct investments from Slovakia in North Macedonia and North Macedonia has no foreign direct investments in Slovakia.

Among the most important export deliveries from Slovakia were [Balkanalysis.com, 2019]:

- Deliveries of 150 freight wagons within the participation on renewal of North Macedonia's freight fleets,
- Supplies of military equipment for Macedonia's army
- Chemkostav Michalovce participation in reconstruction of prison at Idrizovo.

However, there is certainly room for trade improvement, above all in:

- Automotive industry — in sub-deliveries for car producers in Bratislava, Slovakia.
- Energy — production of biofuels.
- Tourism — hotel building and hotel management, even though there is a strong influence of Russian investments. There is a direct flight connection from Bratislava to Skopje, which may enhance the number of tourists on both sides.
- Agriculture, environment, waste management, military, transport and infrastructure.

Slovakia is actively supporting North Macedonia on its way to the EU and the NATO.

4.2.3 Slovak republic trade with Serbia

Slovakia and Serbia are strongly bonded by historical cultural and economic ties; mutual relations are based on linguistic and geographical proximity, and there is even Slovak minority living around Vojvodina. Slovakia is supporting the territorial integrity of Serbia, refusing Kosovo's unilateral declaration of independence and strongly supporting the future Serbia accession to the EU.

Serbia is Slovak republic's 31st most important partner with 0.45% share on Slovak export (increase from 0.38% in 2016). Slovakia ranks 13th most important export partner for Serbia (2.1% of Serbian export) and 15th most important import market with 1.5% of all Serbian imports [OEC, 2019e].

Serbia is Slovakian largest trading partner from the Western Balkan region and trade exchange totalled 705.8 mln EUR in 2017. Mutual trade is constantly increasing. Slovak import is growing smoothly throughout the period under review (2010–2017), however, in export fluctuation occurred in 2014–2016. Export in 2017 increased by almost 10%, import by 13.3% and total trade by 11.7% compared to 2016. As it is evident in table 4.14: *Slovak republic trade in goods with Serbia*. Slovak republic trade balance was for the first time negative in 2017 on account of the increased import of supplies of sub-delivering companies (Leoni: wires, cables and wires systems, Yura: cables and harnesses, Bratstvo Subotica: railways supplies, etc.) [MZV SRe, 2018e].

Table 4.15: *The Slovak republic — Serbia export commodity structure* indicates the top Slovak exports categories to Serbia in 2017: telecommunication equipment (16.7%), televisions (5.22%) and petroleum and bituminous oils (4.86%).

Table 4.14: **Slovak republic trade in goods with Serbia (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	368.3	301.2	296.1	342.8	288.3	290.7	317.6	349.9
Import	124.2	127.7	156.9	193.6	216.9	247.3	313.9	355.9
Total	492.5	428.9	453.0	536.4	505.2	538.0	631.5	705.8
Balance	244.1	173.5	139.2	149.2	71.4	43.4	3.7	–6.0

Source: [MZV SR, 2019].

Table 4.15: **The Slovak Republic — Serbia export commodity structure (2017)**

Commodity	mln EUR	Share, %
Telecommunication equipment	58.45	16.70
Televisions	18.27	5.22
Petroleum and bituminous oils	17.00	4.86
Wires, cables	16.54	4.73
Coal, Briquettes	10.63	3.04
Uncoated paper and cardboards	10.14	2.90
Military equipment	9.85	2.81
Motor vehicles parts and accessories	9.67	2.76
Strands, ropes, cables, loops	7.00	2.00

Source: [MZV SR, 2018e].

The Slovakian import is less diversified and is listed in table 4.16: *The Slovak republic — Serbia import commodity structure*. Slovak republic is mainly importing parts — sub-deliveries for automotive industry.

Table 4.16: **The Slovak republic — Serbia import commodity structure (2017)**

Commodity	mln EUR	Share, %
Wires, cables	170.93	48.05
Flat-rolled iron products or non-alloy steel	19.67	5.53
Ethylene polymers in primary forms	12.01	3.38
Electrical lighting and signalling equipment	8.96	2.52
Sunflower, borage and cottonseed oil	7.91	2.22
Acyclic hydrocarbons	6.83	1.29
Electric motors and generators	6.77	1.90

Source: [MZV SR, 2018e].

Slovakia is one of the 30 most significant investors in Serbia with foreign direct investments totalling 28.2 mln EUR in 2010–2016 and 2 mln EUR in 2017. The investments flowed mainly to engineering sector, energy and service sector and the most important investors were ENESCO, IMAO, CREDO AGENCE, Tatravagonka Poprad, etc. Nowadays 358 Slovak companies are registered in Serbia. Among the most successful projects were:

- Aquapark Báčsky Petrovec;
- Information system for electric energy sales support for JP Elektroprivreda Srbija;
- Two privatization projects in production of railways wagons, etc.

Serbia is considered to be a very perspective partner in the area of [MZV SR, 2018e]:

- Energy — on the ground of closing several technically unsuitable electric power stations: new technologies and green energy deliveries; services: maintenance and repair of existing power plants and network and future extension of energy network.
- Infrastructure building and repair.
- Environment — considering Serbia cleaning only 15% of wastewater: wastewater treatment plants building and small hydro-power building.

- Industrial production — boilers, fittings, breweries, mills, cement plants, etc.
- Petrochemical industry — if the South Stream is to be built.
- Agriculture — agricultural machines, irrigation systems, waste water systems.
- Research and development of nanotechnologies, biotechnologies and renewable energy.

Innovations are the next priority for both Slovakia and Serbia, and to support the cooperation «*The memorandum of Understanding on Co-operation*» between the Slovak Innovation and Energy Agency and the Innovation Fund of Serbia was signed [Rokovania vlády SR, 2018]. Serbians have been the most numerous foreign workers on Slovak market in 2017 (8500 people) [b92, 2018], and nowadays they are an important source of labour for industry.

4.2.4 Slovak republic trade with Albania

Trade exchange between the Slovak republic and Albania has been increasing for the last two years, but it has not yet reached the same figure as in 2013. Slovakian export increased by 12.4%, import by 27.38% and the total trade amounted to 39.37 mln EUR, by 14% more compared to year 2016. Albania is exporting to the Slovak republic 0.11% of all Albanian exports. The mutual trade is incomparable to that with Serbia and Macedonia, but is higher than with Montenegro. All data on export, import and balance development over the period of years 2010–2017 are in table 4.17: *Slovak republic trade in goods with Albania*.

Table 4.17: **Slovak republic trade in goods with Albania (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	18.24	30.23	22.71	40.62	40.05	38.78	30.19	33.89
Import	0.74	2.41	1.89	2.65	6.63	3.12	4.31	5.45
Total	18.98	32.64	24.60	43.27	46.68	41.90	34.50	39.34
Balance	17.50	27.82	18.82	37.97	33.69	35.62	25.88	28.44

Source: [MZV SR, 2019].

The following table (table 4.18: *Slovak republic — Albania export commodity structure*) contains the list of main commodities of the Slovak republic's export to Albania. Television receivers form the main share of Slovakian export to Albania (27.59%) and, together with telecommunication equipment (24.01%), account for over a half of the whole export. Other more significant items are: electric transformers, static converters and inductors, petroleum and bituminous oil and passenger cars. A significant part of Slovak export of mobile phones (in the category of telecommunication equipment) is in fact re-export; mobile phones are not produced on the territory of the Slovak republic but in Vietnam, and Samsung and Huawei and other re-export them via their Slovak subsidiaries.

Table 4.18: **The Slovak republic — Albania export commodity structure (2017)**

Commodity	mln EUR	Share, %
Televisions	9.35	27.59
Telecommunication equipment	8.14	24.01
Electric transformers, static converters and inductors	3.39	9.99
Petroleum and bituminous oils	2.47	7.29
Passenger cars	1.93	5.69
Shavers and shaving razor blades	1.02	3.02
New rubber tires	0.77	2.26
Artificial graphite, colloidal or semi-colloidal graphite	0.64	1.89

Source: Source: [MZV SR, 2018a].

The majority of imported items are footwear, clothes and agricultural products — production output with small added value. Albanian export is overall insufficiently diversified. The main import items of Slovakian import are in table 4.19: *The Slovak republic — Albania import commodity structure*.

Slovakia and Albania could find room for more intense cooperation in:

- Energy — the country is dependent on hydro-energy; the only thermal power plant is out of order and demand for electricity is expected to rise by 60% by 2020 [MZV SR, 2018a]. The government has launched an energy sector reform to modernize production, distribution and transmission.

Table 4.19: **The Slovak republic — Albania import commodity structure (2017)**

Commodity	mln EUR	Share, %
Footwear	2.36	43.29
Indentured ethyl alcohol, spirits, liqueur and other alcoholic beverages	1.65	30.07
Vegetables, fresh or cooled	0.31	5.65
Seeds of anise, badian, fennel, coriander, cumin and juniper berries	0.17	3.13
T-shirts	0.16	2.84
Cucumbers, fresh or cooled	0.09	1.58

Source: Source: [MZV SR, 2018a].

- Environment — green energy projects.
- Agriculture — bio production, production of medical herbs and spices — Albania is an important producer, but the segment is shrinking due to lack of labour and investments. The Slovak republic could also import technologies and participate in building of agricultural infrastructure.
- Tourism — underestimated but with great potential.

The Slovak republic has no foreign direct investments. The main reasons are: insufficient information on territory, various restrictions (weak law enforcement, tax burdens higher than in surrounding countries, etc.). Two important agreements are not yet concluded: the Agreement on double taxation avoidance and the Agreement on protection of investments.

4.2.5 Slovak republic trade with Bosnia and Herzegovina

Bosnia and Herzegovina and Slovakia are traditional trade partners and Slovakian companies have a good reputation. Bosnia and Herzegovina is a price sensitive market.

Trade exchange between the Slovak republic and Bosnia and Herzegovina increased by 11.37% in 2017, the growth in export (16.93%) notably contributed to the overall increment. Despite the growth in last years, the trade exchange is below potential. More information on foreign trade development in 2010–2017 is in table 4.20: *Slovak republic trade in goods with Bosnia and Herzegovina*.

Table 4.20: **Slovak republic trade in goods with Bosnia and Herzegovina (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	51.23	67.22	67.54	83.32	76.51	87.55	86.00	100.68
Import	15.87	38.76	39.61	51.10	57.60	64.02	69.14	71.05
Total	67.10	105.98	107.15	134.42	134.11	151.57	155.14	171.73
Balance	35.36	28.46	27.93	32.23	18.91	23.53	16.86	28.95

Source: [MZV SR., 2019].

Telecommunication equipment (17.58%) and televisions (7.58%) are the most important Slovakian export articles. The list some others export items are in table 4.21: *The Slovak republic — Bosnia and Herzegovina export commodity structure.* Export of telecommunication equipment includes export of Asian produced mobile phones exported via Slovak subsidies of Huawei and Samsung, which is in fact re-export.

Table 4.21: **The Slovak republic — Bosnia and Herzegovina export commodity structure (2017)**

Commodity	mln EUR	Share, %
Telecommunication equipment	17.70	17.58
Televisions	7.63	7.58
Processed leather	4.94	4.90
Chemical wood pulp, naphthenic or sulphate	4.49	4.46
Passenger cars	4.23	4.20
Iron or non-alloy steel flat-rolled products	4.07	4.05
Other products from natural fur or composition leather	2.80	2.78
Food preparations	2.73	2.71
Uncoated paper and cardboard	2.44	2.43

Source: [MZV SR., 2018b].

The Slovakian imports from Bosnia and Herzegovina are dominated by deliveries of shoes parts and footwear (28.55%), chemicals and sub-deliveries for automotive industry. The main import product groups are in table 4.21: *The Slovak republic — Albania import commodity structure*. Generally, majority of products exported for Bosnia and Herzegovina are of small added value.

Table 4.21: **The Slovak republic — Albania import commodity structure (2017)**

Commodity	mln EUR	Share, %
Parts of footwear	17.90	24.79
Toilet paper, towel paper and similar	13.92	19.27
Artificial corundum, chemically defined or undefined, alumina, aluminium hydroxide	10.28	14.23
Parts and accessories for motor vehicles	6.81	9.43
Carbonates, peroxycarbonates	2.87	3.97
Footwear	2.72	3.76

Source: [MZV SR., 2018b].

Potential trade opportunities for Slovak exporters and investors are:

- Mining industry — demand for industrial explosives, mining machinery and equipment.
- Liberalized telecommunications — technologies and know-how.
- Energy — remediation of obsolete thermal and hydropower plants, renewable energy strategy creates demand for biomass boilers.
- Waste management — demand for projects for wastewater treatment plants.

There are no important foreign direct investments of the Slovak republic in Bosnia and Herzegovina.

4.2.6 Slovak republic trade with Kosovo

Kosovo is on the 50th position among the trade partners of the Slovak republic. The trade in 2017 declined by 14.6% and reached 13.52 mln EUR, both import and export having dropped. The balance is positive for the Slovak republic. More data on trade development in 2010–2017 is in table 4.22: *Slovak republic trade in goods with Kosovo*.

The commodity structure of main items from Slovakian export to Kosovo is in table 4.23: *The Slovak republic — Kosovo export commodity structure*. Telecommunication equipment and televisions form over 64% of all the Slovakian export. The other products are electric machines and equipment, materials, measuring instruments, cars and some food products.

Table 4.22: **Slovak republic trade in goods with Kosovo (mln EUR, 2010–2017)**

	2010	2011	2012	2013	2014	2015	2016	2017
Export	4.76	3.42	4.79	5.16	10.33	18.11	14.96	13.35
Import	0.93	2.45	3.04	2.05	1.85	0.99	0.87	0.17
Total	5.15	5.87	7.83	7.21	12.18	19.11	15.84	13.52
Balance	3.83	0.97	1.75	3.11	8.48	17.12	14.09	13.18

Source: [MZV SR, 2018d].

Table 4.23: **The Slovak republic — Kosovo export commodity structure (2017)**

Commodity	mln EUR	Share, %
Telecommunication equipment	5.32	39.88
Televisions	3.23	24.21
Monofilaments, rods, sticks and profiles	0.80	5.99
Electric water heaters, electric equipment for room heating and soil	0.46	3.42
Cane or beet sugar and chemically pure sucrose	0.35	2.65

Source: [MZV SR, 2018d].

The import of the Slovak republic is very small (18 000 EUR in 2017) and consists of import of water, wine and chocolate products (71.92%) and rubber belts and similar products (16.68%). More information on structure of Slovakian import is in table 4.24: *The Slovak republic — Kosovo import commodity structure*.

Table 4.24: **The Slovak republic — Kosovo import commodity structure (2017)**

Commodity	mln EUR	Share, %
Water, incl. mineral water and sparkling water	0.09	51.63
Vulcanised rubber conveyor belts or propellers	0.03	16.68
Wine	0.03	15.28
Chocolate and chocolate products	0.01	4.74

Source: [MZV SR, 2018d].

The trade connections between the Slovak republic and Kosovo are limited but with potential in following sectors [MZV SR, 2018d]:

- Mining and metallurgy — demand for mining and construction machines for lignite on the other raw materials mines.
- Energy — the energy production is unreliable with power outages. Kosovo's two brown coal power plants are reaching the end service-life; one of them needs reconstruction, another remediation. Potential is also in renewable energy: geothermal, biomass and photovoltaic.
- Environment protection — drinking water production and distribution, waterworks reconstruction, there is market for filtering equipment, wastewater treatment plants and equipment.
- Agriculture — the segment is underdeveloped with demand for cooling and canning production lines and lines for food processing.

Significant deepening of cooperation is impeded by political barriers since the Slovak republic has not recognised the independence of Kosovo and is rather oriented towards Serbia. Other barriers such as corruption and need of personal engagement of exporter in the territory are also discouraging for potential exporters and investors. The Slovak republic has no foreign direct investments in Kosovo.

To compare the position of Slovakia in the Western Balkans trade, Serbia is the biggest trade partner in the region for the EU as a whole, Slovakia and Russia.

Table 4.25 *Serbians trade partners*, which follows, shows import and export of the above-mentioned partners to Serbia as well as the share in import and export. It is clearly evident that the share of Slovakia 2.2% in Serbian import remains law relative to Chinese 8.22%, Russian 7.17% and Turkish 3.37%. As an importer from Serbia, Slovakian share of 1.91% is bigger than those of China 0.4% and Turkey 1.83%, but does not reach the shares of Russia 5.87%.

Serbia has signed free trade agreements with Russia, Turkey and also with EU — this agreement is binding for Slovakia. A new free trade agreement between the Eurasian Economic Union and Serbia is to be signed in October 2019 and the agreement should enhance mutual trade with Russia (and other Eurasian Economic Union members) even further.

Overall trade of Slovakia with the Western Balkans is not very large, the interesting trade figures are only reached with Serbia and Bosnia and Herzegovina, countries with long historical and cultural ties with

Table 4.25: **Serbians trade partners (2017)**

	Export to Serbia in mln USD	**Share on Serbian's import**	**Import from Serbia in mln USD**	**Share on Serbian's export**
The EU	13 410.0	59.00%	9997.0	68.00%
Russia	1588.7	7.17%	995.5	5.87%
China	1819.4	8.22%	62.2	0.40%
Turkey	826.9	3.37%	310.2	1.83%
Slovakia	260.6	1.20%	323.3	1.91%

Source: [GlobalEDGE, 2019].

Slovakia. The Slovak republic, thanks to long-term contacts, cultural and language relatedness and geographical closeness, could build stronger trading ties to the region. Slovak Strategy of external economic relations for a period of 2014–2020 strongly encourage diversification of the territory and commodity structure of Slovak foreign trade to non-EU territory as 85% of Slovak exports and 68% of imports originate from the EU market. Even though mutual trade with the Western Balkans is slowly growing (by 6–7% both in import and export), especially since 2014, the overall trade with Balkans built only 0.7% of total Slovak foreign trade. Even if the trade with Serbia is promising and represents almost 69% of all trade exchange of Slovakia with the Western Balkans and is annually growing by around 10%, the Slovak republic is a relatively small partner and even if belonging to 13 biggest partners, Slovakia cannot compete with Russia and China and other EU countries (namely Germany and Italy) position. Of course, there is still room for increasing both trade volumes as well as foreign direct investments commitment on both sides. The trade with Albania and Kosovo is negligible, due to the low economic level and lack of trading and cultural tradition in relations. The increase in trade with Kosovo is not expected as the Slovak republic did not recognise Kosovo as a sovereign country and supports Serbia's official approach to Kosovo territory.

Even though Slovakia signed "The Agreement on the support and mutual protection of investments" with Serbia (2004), Bosnia and Herzegovina (2008) and Macedonia (2009), foreign direct investments are placed in Serbia only. The reason of investor hesitation to invest in other countries of the region is corruption, bad institutions, weak rule of law, low transparency and poor law enforceability. Involvement of Slovakia in foreign direct investments projects is weak, outweighed by interests of a stronger market player — Russia, the China's Belt and Road strategy and some bigger EU investors.

Definitely, Slovakia is influenced by the presence of Russia and China in region and, being a small country, is unable to compete with the players with strong ambition of geopolitical influence. Hopefully, Slovakia will be able to keep its position on the markets with long historical ties, namely Serbia and Bosnia and Herzegovina.

4.3 Slovakia's foreign trade with Ukraine

Under the pressure of global quantitative changes occurring in the world economy and from the time of Ukraine's independence, received in 1991, Ukraine has gradually moved from a planned to a market economy, which has led to a democratization of Ukraine. A process of carrying out necessary economic reforms have been painful, as in case of other post-communist countries of Central and Eastern Europe [Brzezinski, 1999]. These reforms in Ukraine were not always successful, because many of the basic economic and social issues were ignored. The main causes were the frequent changes of governments that pursued their political goals at the expense of meeting the expectations of society. Ukraine's development over the past decade has been associated with significant changes that started to develop since the Orange Revolution, which occurred in 2004 and through which there was an open space for new opportunities in terms of wider involvement of Ukraine into the world economy.

A democratic direction should have reflected the Ukraine's progress towards transformation of a pseudo-market to a more socially responsible, transparent and open economy. This progress from the formerly centrally planned economy has brought a profound democratic change that implies social, cultural, political and economic consequences. The transition from a centrally planned economy to a market economy is currently causing a restitution and privatization of state property [Nanivska, 2005].

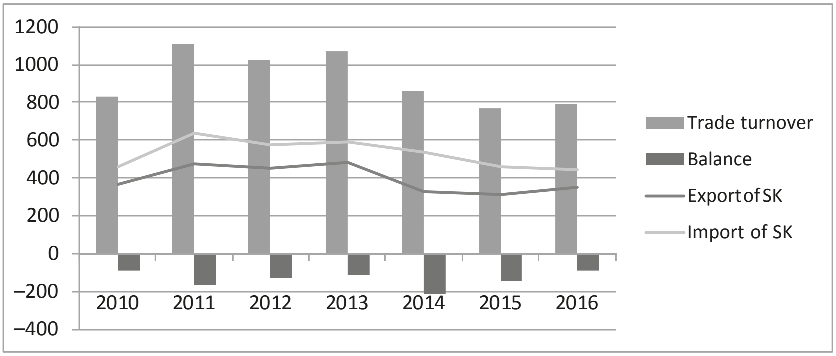
Before the Orange Revolution, Ukraine was more focused on economic cooperation with Russia, but after the Orange Revolution it has started to focus on Europe with an intention to become a member state of the European Union. However, since 2004 it has not got significantly closer to the European Union, but gradually began to stop relying on Russia. This procedure meant the slowing down of pace of growth in

Ukraine. On that basis, Ukraine faced a series of cultural, social and political problems, caused by globalization [Voytovych, 2011]. Since 2005 Ukraine has started to feel the dividedness of relations between the West and the East, influenced by the Agreements of 1992 and 1994 on the establishment of a separating zone between Russia, the EU and the US. Through this agreement, Ukraine was expected to gain a position of a significant separating factor between the East and the West. However, the confrontation of both sides — the East and the West — resulted in a significant escalation of tension in Ukraine through the still ongoing military conflict, where the contributing factor is also a package of economic sanctions imposed on Russia [Stanek, Ivanová, 2015].

4.3.1 Development of mutual foreign trade

The share of Ukraine in foreign trade of Slovakia is less than one percent, which is a very low compared to the share of Russia. Ukraine has a large market with untapped potential for the growth of mutual commercial and investment relations with Slovakia. Foreign trade relations between Slovakia and Ukraine are formed through close historical and business relations. Despite the military conflict taking place in Ukraine, the foreign trade turnover between Slovakia and Ukraine grew by 4% year-on-year in 2016 and reached EUR 788.98 mln Compared to the year 2013, when the mutual trade turnover reached EUR 1071.3 mln, there was a significant decrease in the turnover of foreign trade (almost by 26.3%).

Figure 4.4: **Development of foreign trade in goods between Slovakia and Ukraine in years 2010–2016 (mln EUR)**



Source: processed by the authors according Eurostat data.

Total export of Slovakia to Ukraine in 2016 reached value of EUR 347.88 mln. Compared to the previous year, export grew by 11%. Total import of Slovakia from Ukraine reached EUR 441.1 mln. Compared to the previous year, it slightly fell by 3.2%. In 2010 there came a post-crisis revitalisation of mutual trade. Since this year, however, the trade balance of Slovakia remained passive until the end of monitored period. In 2014 trade between Slovakia and Ukraine was marked by conflict in Ukraine. As a result of the established war regime in Ukraine, domestic consumption and production have decreased. Decline in domestic demand, rising unemployment, rising inflation rate, depreciation of the Ukrainian hryvnia and the associated low purchasing power of the Ukrainian population, rising indebtedness and the growth of corruption are the main consequences of the conflict. Moreover, the parts of Ukraine that declared their independence and the Crimean Peninsula belonged to the major industrial centres of Ukraine. It can certainly be assumed that the loss of such significant areas was also reflected in the statistical indicators of mutual foreign trade. In the context of these facts, in 2014 there was almost 20% decrease in the total turnover of trade between Slovakia and Ukraine from EUR 1071.35 mln in 2013 to EUR 862.7 mln EUR in 2014. As a result of the above-mentioned decline in purchasing power, there was a significant fall in Slovak exports. Import also recorded a decline, but not so significant, as its major part is natural gas supplied by Slovakia on a long-term contract basis with Russia.

In 2015 there was a further drop in mutual foreign trade, but not as steep as in the previous year (by 11%). Imports of Slovakia continued to decline as a result of the continuing risk that prevented the emergence, respectively, the termination of business contracts but also due to a fall in gas prices. In the case of the Slovak export, it can be seen that its development stabilized and even regained its growth. It can be said that the previous decline export was paradoxically eliminated as a result of conflict between Ukraine and Russia — Slovakia committed to helping and built up a reverse gas flow to Ukraine in case of reduced supplies from Russia, which contributed to the growth of Slovak exports to Ukraine. In 2016 it is possible to see the revival of mutual trade exchange between. Although the conflict still persists, the Slovak and Ukrainian subjects have been able to adapt to this situation.

A significant factor affecting the current foreign trade exchange between Slovakia and Ukraine is the DCFTA, which has practically been the cause of the conflict. The DCFTA was signed in April 2015 and has been in force since January 1st, 2016. Its role is to allow Ukraine a free entry into the EU internal market by eliminating customs and non-tariff barriers. This agreement allows Ukrainian manufacturers or traders to sell their products to European customers without paying tariffs for most products [Syvanenko, Toropkov, 2015]. It also supports the liberalization of the investment regime as well as the harmonization of trade and investments and includes the liberalization of trade in services. This agreement is an important step for the Ukrainian economy and gives it an access to a sizeable market. Based on various scientific studies, this agreement should support economic growth and growth in the volume of FDI in Ukraine.

Table 4.26: **Comparison of the commodity structure of foreign trade between Slovakia and Ukraine in years 2013 and 2016 (in mln EUR)**

	Slovak export to Ukraine			Slovak import from Ukraine		
	2013	**2016**	**% change**	**2013**	**2016**	**% change**
TOTAL	**479.58**	**347.88**	**–27.46**	**591.77**	**441.10**	**–25.46**
0	14.68	10.12	–31.04	2.89	3.06	5.90
1	1.92	3.87	101.29	0.10	0.02	–80.75
2	35.22	26.10	–25.90	317.21	181.76	–42.70
3	8.58	2.27	–73.60	67.48	28.94	–57.11
4	0.00	0.01	100	1.31	1.31	–0.25
5	54.08	48.66	–10.02	13.02	17.55	34.84
6	127.58	113.01	–11.42	99.96	97.34	–2.61
7	198.89	114.88	–42.24	69.85	89.18	27.66
8	38.63	28.20	–27.02	19.95	21.90	9.78
9	0.00	0.13	100	0.00	0.02	100

Source: processed by the authors according Eurostat data.

Note: SITC [0] Food and live animals; [1] Beverages and tobacco; [2] Crude materials; [3] Mineral fuels, lubricants and related materials; [4] Animal and vegetable oils, fats and waxes; [5] Chemicals and related products; [6] Manufactured goods; [7] Machinery and transport equipment; [8] Miscellaneous manufactured articles; [9] Commodities and transactions not classified elsewhere in the SITC.

Table 4.26 reflects and compares the commodity structure of trade between Slovakia and Ukraine in years 2016 and 2013. Individual groups of goods are categorized according to the SITC classification. Due to the nature of the Slovak industry, it is again not surprising that the most important export items were the items of group 7 — Machinery and transport equipment worth EUR 114.88 mln, 6 — Manufactured goods worth EUR 127.58 mln and 5 — Chemicals and related products worth EUR 48.66 million. On the side of Slovak import side dominated the items of commodity group 2 — Raw materials worth EUR 181.76 mln, 6 — Market products worth EUR 97.34 mln and 7 — Machinery and transport equipment worth EUR 89.18 mln.

From the Slovak import from Ukraine point of view, the most important commodities in the period between 2013 and 2016 have been the ones of commodity groups 2 — raw materials (cork and wood, crude fertilizers and raw minerals, metal ores and metal scrap), 6 — market products (iron and steel, non-ferrous metals, Cork and wood products except furniture, rubber products) and 7 — machinery and transport equipment (electrical equipment, apparatus and appliances, machinery and equipment, other industrial machinery and components, metal working machines, power generating machinery and equipment). Of this, import of energy commodities accounts for 80% of total Slovak import.

Based on this comparison, 2013 was the last year not influenced by the conflict, and, therefore, foreign trade and foreign trade grew at a more positive pace than at present. From this comparison, in 2016 there was a decrease in the volume of trade between Slovakia and Ukraine in most commodity groups. The overall decline in exports and imports was 27.46%, respectively 25.46%.

At present, the penetration of Slovak companies on the Ukrainian market is of strategic importance, given the size and breadth of the Ukrainian market, its relative unsaturation, geographical and linguistic proximity, the possibility of future market consolidation, as well as the promising opportunities to participate in integration processes of Ukraine and the EU. The Ukrainian market presents numerous opportunities for Slovak companies through a considerable economic potential, which depends on the implementation of economic reforms of the Ukrainian government and the pace of standardization of business and investment environment of the country [Negotiations, 2014].

Looking at the development of bilateral foreign trade of Ukraine and Slovakia, it is obvious that there has been a negative balance of foreign trade for the last years. This development is caused by the Ukrainian economy, which is not engaged in manufacturing and export of goods with high added value, but rather by means of obsolete technologies and production facilities it stays focused on the manufacture of products with low added value. On this basis, there is just a little chance to change the negative foreign balance to a positive value. This trend negatively influences the overall macroeconomic situation in Ukraine, which reflects the deteriorating economic situation in Ukraine. The size of the economic downturn shows that Ukraine's economy still remains in a difficult situation. On the other hand, the export-oriented industries react to this situation, while the prices of raw materials are high due to adverse developments in the foreign exchange market.

On that basis, the export-oriented industries of Ukraine are still struggling because the prices of raw material are still high for Ukraine in terms of adverse developments in the foreign exchange market. On the other hand, there is a considerable gradual growth in global demand, on which Ukraine with its open economy is highly dependent. In this context, the unfavourable development of the trade orientation is also related to the commodity structure of foreign trade, while Ukraine is focused on industries such as metallurgy, coal mining, chemical and heavy industry. The greatest significance presents heavy engineering, i.e. steel production, which is also important in terms of exports. These sectors are considered to be seriously vulnerable, and in recent years continuously deepening negative trends of foreign trade have been prevailing [Bebjaková, 2014].

4.3.2 Mutual intra-industry trade

In the context of the above-mentioned circumstances, we analyse their impact on the intra-industry trade indicator in years 2010–2016 in the following table.

Within the framework of trade flow analysis, we applied the index of intra-industry trade of Slovakia and selected countries. Intra-industry trade (IIT) represents export and import of the same type of goods, i.e. of the same industry, between two countries or regions. Within the IIT, vertical and horizontal trade can be distinguished. Vertical is a bilateral trade of vertically differentiated products that differ in quality and price (trade of the same products of different quality). Horizontal trade is mutual trade in the same products of the same quality [Gabrish, Abrish, Segnana, 2002]. If countries possess the same production factors, the liberalization of mutual trade will lead to the development of horizontal trade and, over time, to the real convergence (of productivity and revenues). With different production factors, trade liberalization leads to the development of vertical IIT and productivity and income divergence. In our case, we assume that Slovak structure of production factors is different from Russian and Ukrainian ones. We try to assess how the sanction (and, therefore, protectionist) measures have contributed to changing values of vertical trade.

When analysing IIT, we used the same index as in part 3.4.1. The primary data we used to calculate this index is the Eurostat European Statistical Office. Development of intra-industry trade between Slovakia and Ukraine in 2010–2016 we can see in Table 4.27.

Table 4.27: **Development of intra-industry trade between Slovakia and Ukraine in 2010–2016**

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
[0]	0.342	0.426	0.530	**0.329**	0.591	0.497	**0.464**
[1]	0.251	0.097	0.505	**0.101**	0.025	0.024	**0.010**
[2]	0.258	0.217	0.201	**0.200**	0.216	0.349	**0.251**
[3]	0.54	0.272	0.418	**0.226**	0.391	0.275	**0.145**
[4]	0.000	0.000	0.000	**0.003**	0.000	0.091	**0.112**
[5]	0.516	0.478	0.496	**0.388**	0.345	0.400	**0.530**
[6]	0.905	0.996	0.818	**0.879**	0.995	0.995	**0.926**
[7]	0.658	0.624	0.587	**0.520**	0.960	0.983	**0.874**
[8]	0.843	0.754	0.689	**0.681**	0.961	0.897	**0.874**
[9]	0.789	0.064	0.635	**0.250**	0.262	0.283	**0.267**

Source: processed by the authors according Eurostat data.

Note: SITC [0] Food and live animals; [1] Beverages and tobacco; [2] Crude materials; [3] Mineral fuels, lubricants and related materials; [4] Animal and vegetable oils, fats and waxes; [5] Chemicals and related products; [6] Manufactured goods; [7] Machinery and transport equipment; [8] Miscellaneous manufactured articles; [9] Commodities and transactions not classified elsewhere in the SITC.

The highest values of intra-industry trade index between Slovakia and Ukraine in 2010–2016 was achieved in SITC nomenclature commodity groups 6 — market products and 8 — Miscellaneous manufactured articles, followed by group 7 — Machinery and transport equipment whose IIT index decreased by 2.6% in 2016. However, the most noticeable decline was recorded in commodity group 1 — Beverages and tobacco which declined significantly by 58.33% in 2016. IIT values were also low for commodity groups 0 — Food and live animals and 3 — Mineral fuels, lubricants and related materials as well as commodity group 9 — Others, mainly because of higher import of these commodities from Ukraine to the Slovak Republic than Slovak exports. On the other hand, due to the higher export of Slovakia than import from Ukraine, IIT values were low in commodity groups SITC 2 — Crude materials and 5 — Chemicals and related products [Kašťáková, Bebjaková, 2016].

4.3.3 Prospects of Slovakia's foreign trade relations with Ukraine

The issue of the prospects of foreign trade relations between Slovakia and Ukraine is affected by the current changes in EU trade policy towards Ukraine. It is very demanding in terms of the ongoing conflict situation in eastern Ukraine. As a consequence, Ukraine's trade relations with Slovakia do not develop at a favourable pace. The issue of integration processes of Ukraine into the EU is on the table but from the perspective of mutual foreign trade relations with Ukraine and due to the conflict situation in Ukraine, it is very unfavourable.

The most important event in strengthening the foreign direct investments is the ratification of the political part of Association Agreement between the European Parliament and the Highest Council of Ukraine, which took place on June 27 and September 16, 2014. The economic part of the Association Agreement started to apply partially from January 1, 2016, through a deepened and comprehensive free trade agreement (hereinafter, DCFTA), not ratified by the Netherlands. On the basis of this Agreement, the Slovak business environment has expressed the interest in strengthening a mutual cooperation with Ukraine. This cooperation should include trade, economic and investment areas.

It is believed that in the above-mentioned areas the turnover will increase by more than 12.5% and in the area of Slovak investments by more than 47%. This establishment of a free trade zone on the basis of the DCFTA and the EU appears to be the prospect of strengthening the Ukrainian-Slovak investment cooperation [Samokhvalov, 2015].

Through the SWOT analysis, the strengths and weaknesses can be expressed, as well as the opportunities and risks of development of mutual business cooperation, through which attention to the assessment of potential prospects of foreign trade relations of Slovakia and Ukraine can be drawn. [Kašťáková, Bebjaková, 2016]

The strengths:

- Long-term export tradition, knowledge of the Ukrainian market;

- Good image of Slovakia and knowledge of Slovak products among Ukrainian consumers;
- Profile of the Slovak economy, corresponding with the needs of the Ukrainian market;
- Competitive goods with a favourable ratio between price and quality;
- A combination of export with higher forms of cooperation, including the production and technology; establishment of joint companies;
- As neighbouring countries, we are also a bridge between Ukraine and the EU.

The weaknesses:

- Insufficient capital of Slovak companies;
- Lack of knowledge about the possibilities of the Ukrainian market;
- Minimum effort of Slovak companies to form associations concerned with penetration to the Ukrainian market, with a focus on Ukrainian regions;
- The persistent prejudices about the situation on the market, as well as about the negative business experience.

Opportunities:

- Continuous unsaturation of the market and related dynamics of imports;
- Considerable growth potential in Ukraine, starting the process of structural reforms;
- Active promotion of European integration, harmonized with the EU regulations;
- Ukraine's membership in the WTO;
- Modernization of outdated production facilities, introduction of new technologies in virtually all sectors of the national economy (energy, mineral mining, metallurgy, metal production, heavy engineering, chemical industry, agriculture and food production);
- Improvement of the solvency of Ukrainian partners;
- Gradual development of transport and telecommunication's infrastructure;
- Efforts in development of renewable energy sources, in improving the energy effectiveness and in a reduction of energy consumption.

Risks:

- High level of corruption;
- Uncertainty, related to the political development and the inability to ensure the stability of the business;
- State intervention in the economy, promoting the interests of monopolistic structures linked to the government garniture;
- Unresolved privatization of enterprises;
- Differences between the cities, towns and villages in Ukraine;
- Low diversification of the economy;
- Insufficient protection of intellectual property rights;
- Low capital background of banking sector;
- High level of bureaucracy, import barriers, certification;
- An imperfect executive legislation and the associated poor law enforcement.

4.4 Slovakia's foreign trade relations with Russia

The long-term foreign trade relations between Slovakia and Russia fundamentally changed at the turn of the 90's after the collapse of the common market of the member countries of the Council for Mutual Economic Assistance (CMEA) and with the later entry of the Slovak Republic into the international integration structures, especially into the EU. This new development trajectory is progressively becoming evident in the extensive restructuring of its territorial and commodity priorities in mutual trade relations. However, despite the gradual reallocation of political and economic power in the world economy, which has fundamentally been influenced by the process of shaping of the multipolar structure of the world economy, Russia continues to play a prominent position in it [Baláž, Hamara, Sopková, 2015].

Russia's outstanding position in Slovak foreign trade as a monopoly supplier of raw materials and one of the main importers of Slovak production, has been rapidly reduced, but the degree of dependence on supply of energy inputs has remained high. At the end of the 1980's, the former Soviet Union took almost half of Slovak exports, but in 2000 it fell just under one percent. Since Slovakia's accession to the EU, its exports to the Russian Federation fell from 10% to 4% in 2016.

The development of foreign trade of the Slovak Republic as well as the structure of the Slovak economy's involvement in international business is influenced by many historical, economic and political factors. Its current positions are reflected by long-term comparative advantages that have arisen from previous development. These have recently diversified due to the expansion of foreign direct investments in the country [Brinciková Darmo, 2014]. The current development of the Slovak-Russian international relations is dependent not only on the extent, timing and success of the transformation processes taking place in both economies, but also on the extent of the direct and indirect globalization impacts transmitted from the world economy [Kuric, 2014]. Recently, among the most significant impacts have been the effects of the global financial and economic crisis that affected almost all sectors of the economies, the conflict taking place in Ukraine and related sanction measures between the Russian Federation and the EU (together with the US and other Western countries) and the long-term decline in world prices of energy raw materials in international markets [Baumgartner, Zubaľová, 2015].

The increasing importance of the economic factor in the development of mutual co-operation ensures a gradual improvement of the political climate, which greatly helps to find compromises in dealing with current issues of mutual relations. The presented analysis of the development and intensity of foreign trade between Slovakia and Russia creates certain room for improvment and broadening of the mutual trade-economic cooperation possibilities [Drynochkin, 2016].

The current foreign trade and economic relations between Slovakia and Russia are realized at governmental and local levels through regular meetings of intergovernmental and mixed commissions. The basis for mutual economic relations is the *Agreement between the Government of the Slovak Republic and the Government of the Russian Federation on Economic and Scientific-Technical Cooperation* signed in 1993, which established a contractual basis for the further development of mutual relations. After the accession of Slovakia to the EU, it was necessary to adjust mutual bilateral economic relations, and therefore a new *Agreement between the Government of the Slovak Republic and the Government of RF on economic, scientific, technical and cultural cooperation* was signed in Bratislava on February 25, 2005. Both parties took note of the rights and obligations of the SR arising from EU membership. Under this Agreement, the parties came to an agreement to promote the development, consolidation and diversification of mutually beneficial economic, scientific and technical cooperation in all sectors and sectors of the economy in accordance with their national laws and on the principles of equality.

The competent authorities of contracting parties shall aid economic operators of the state of the other contracting party in securing activities on the territory of their state in accordance with their national law. By this agreement, the parties have established an Intergovernmental Commission for Economic and Scientific Cooperation between the Slovak Republic and the Russian Federation. Its main tasks include [Slov-Lex, 2015]:

- Regular assessment of the condition and results of economic and scientific and technical cooperation;
- Preparation of proposals for the further development of economic and scientific-technical cooperation;
- Specification of the barriers limiting the development of mutual economic and scientific-technical cooperation and proposing of appropriate measures aimed at their removal;
- Consideration of the disputed issues related to the application or interpretation of this Agreement.

The last session of the 17th Intergovernmental Commission was held on May 6, 2015, at the Office of the Government of the Slovak Republic, which stated that, despite the unfavourable international political situation, the mutual Slovak-Russian relations will develop dynamically on the principle of mutual benefit. Also, the international political situation has a significant negative impact on our trade and economic relations [Kašťáková, Bebjaková, 2016].

4.4.1 Development of mutual foreign trade

Russia has always belonged to the strategically most important and largest trading partners of Slovakia. Since the formation of the independent Slovak republic, our bilateral relations have undergone various developmental tendencies. At the end of the 1990's mutual foreign trade fell, and in 1999 Russia's share in the Slovak foreign trade accounted for only 6.8%. The significant decline in mutual trade was influenced by the widespread financial crisis that hit Russia in 1998. A detailed overview of the recent development of foreign trade between Slovakia and Russia is presented in Table 4.28.

In 2008 Slovak export grew by 75% compared to the previous year and more than tripled compared to 2006. Although in 2009 there was a

Table 4.28**: Development of foreign trade between Slovakia and Russia in years 2009–2015 (EUR, mln)**

	2010	2011	2012	2013	2014	2015	2016
Export of Slovakia	1932.3	2070.7	2620.1	2547.2	2076.9	1461.0	1272.0
Import of Slovakia	4678.5	6183.4	5867.9	6147.7	4913.3	3486.1	2410.0
Turnover	6610.8	8254.4	8488.0	8694.9	6990.2	4947.1	3682.0
Balance	–2746.2	–4113.0	–3247.7	–3600.5	–2836.4	–2025.0	–1137.0

Source: processed by the authors according the data of [MH SR, 2018].

slight decrease in Slovak exports due to the global economic and financial crisis, in 2011 Slovakia reached the highest level of exports to Russia in the monitored period. In recent years, there has been a decline in exports to Russia. It is quite probable that the real values of Slovak exports were much higher over the monitored period. Many Slovak products enter the Russian markets in the form of re-export, and they are often traded across the EU.

The current development of the Slovak-Russian economic relations is marked by a sanction war between the EU and the RF, which has been negatively reflected in the bilateral foreign trade between the SR and the RF [Kashulin, Kuznetsov, 2016]. In 2014 Slovak foreign trade with Russia fell by 18.5%, with exports declining by 20.1% and imports by 19.6% compared to 2013. In 2015 foreign trade again reduced by almost EUR 2.04 bln., which represents a 29.7% drop. Slovak exports to Russia decreased by 30% and imports by 29%. The decline in mutual trade was caused not only by the EU-RF sanction policy but also by a significant drop in prices of energy commodities on world markets. These aspects have resulted into a significant drop in the Russian rouble, which has largely been offset by the insolvency of a large part of Russian companies operating in foreign trade [Faltsman, 2017]. In terms of business relations, a significant reduction of activity in both export and import activities can be observed since 2014. In 2016, compared to the previous year 2015, imports fell by 35% and exports by 7% [Fasungova, Radvansky, 2014].

In the analysed period, the decreased Slovak foreign trade activity was recorded not only with the Moscow region but also with other Russian regions. This fact also greatly affects the overall trade balance of Slovakia. The uneven share between the structure of Slovak exports and imports with Russia was influenced by the high dependence of our country on imports of Russian energy raw materials. A detailed overview of the development of the commodity structure of Slovak imports from Russia and exports to Russia is shown in Table 4.29.

Table 4.29: **Top 5 commodities of mutual foreign trade between Slovakia and Russia in 2016 (according SITC classification)**

SITC	Slovak export to Russia	Value in EUR	Share in %
78	Road vehicles (including air-cushion vehicles)	582 999 351	39.5
76	Telecommunications and sound-recording equipment	260 515 013	17.7
71	Power-generating machinery and equipment	103 187 481	7.0
74	General industrial machinery and equipment	93 850 755	6.4
84	Articles of apparel and clothing accessories	83 381 358	5.7
	Slovak import from Russia	**Value in EUR**	**Share in %**
33	Petroleum, petroleum products and related materials	1 501 445 686	56.8
34	Gas, natural and manufactured	621 940 887	23.5
28	Metalliferous ores and metal scrap	134 899 793	5.1
71	Power-generating machinery and equipment	93 849 499	3.6
32	Coal, coke and briquettes	62 649 177	2.4

Source: processed by the authors according the Eurostat database [Eurostat, 2018].

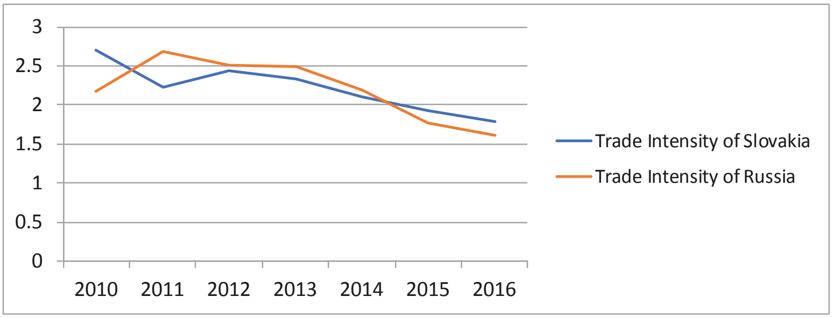
Goods of commodity group 7 dominate the Slovak export to Russia in the long term. In 2016, road vehicles accounted for almost 40% of Slovak export and with the value worth EUR 583 mln became the most important item of Slovak export. The second most important export commodity group of Slovakia in 2016 was Telecommunications and sound-recording equipment. Total export volume of this commodity group reached more than EUR 260 mln (17.7%). Among the top five export commodity groups are also Power-generating machinery and equipment (7.0%), General industrial machinery and equipment (6.4%) and Articles of apparel and clothing accessories (5.7%). The structure of Slovak import from Russia is quite different, as it is dominated mainly by crude materials. More than a half (56.8%) of Slovak import consisted of Petroleum, petroleum products and related materials. The total value of this import was worth EUR 1.5 billion. The second most important commodity group of Slovak import was Gas, natural and manufactured (EUR 621.9 mil, 23.5%). Another important commodity of Slovak import from Russia were Metalliferous ores and metal scrap (5.1%), Power-generating machinery and equipment (3.6%) and Coal, coke and briquettes (2.4%). A brief overview of Slovak import structure shows that energy raw materials account for more than 80% of Slovak import from Russia, which points to a high dependence of Slovakia on Russia [Balaz, Zabojnik, 2009].

4.4.2 Intensity of mutual foreign trade

In order to assess the volume of mutual trade between Slovakia and Russia, we used the calculation of the Trade Intensity Index (TII). TII assesses whether the value of the trade between assessed countries is bigger or smaller than could be expected based on their position in international trade. A detailed overview of mutual trade intensity between Slovakia and Russia between 2010 and 2016 is illustrated in Figure 4.5.

Figure 4.5 shows the development of the Trade Intensity Index (TII) in years 2010–2016. In the case of Slovak export to Russia as well as Russian export to Slovakia, the values of the TII were higher than 1, which points to high intensity of mutual foreign trade relations.

Figure 4.5: **Development of the TII between Slovakia and Russia in years 2010–2016**



Source: Processed by the authors according Eurostat data [Eurostat, 2018].

Value of trade intensity of Slovakia, respectively value of intensity of Slovak exports to Russia in 2016, reached 1. 92 points. Since the value is greater than one, this trade relationship can be described as intense. In the assessed time period, the highest trade intensity of Slovakia in relation to Russia was in 2010 (2.7). The long-term development of TII in this case is decreasing. View at the development of TII of Russia in relation to Slovakia is quite similar. In 2016 the value of trade intensity of Russia, respectively value of intensity of Russian exports to Slovakia, was 1.61. Based on this value, trade between Russia and Slovakia can be also described as intense.

However, the development trend of this indicator decreases in the long-term. In 2000 the TII reached value of almost 11 — it was a very intense trade relationship from the Russian export point of view. The cause of such decline consists in the faster growth of Russian export to world than to Slovakia, mainly in year 2000–2004. Another reason of such high values of TII from the beginning of the 21st century consists in persistence of relatively strong trade relationships between Slovakia and Russia since times of the Soviet Union [Kašťáková, Bebjaková, 2016].

4.4.3 Mutual intra-industry trade

In the context of the above-mentioned circumstances, we analyse their impact on the intra-industry trade indicator in years 2010–2016 in the following table. When analysing intra-trade trade, we used the same index as in part 3.4.1. The result of development of the intra-industry trade between Slovakia and Russia in 2010–2016 are in Table 4.30.

Table 4.30 contains the values of the intra-industry trade indicator between Slovakia and Russia following the individual commodity groups of the SITC classification. The highest levels of intra-industry trade in 2016 were achieved in commodity groups 6 — Manufactured goods (0.874); 5 — Chemicals and related products (0.808) and 1 — Beverages and tobacco (0.704). On the other hand, intra-industry trade virtually did not exist in commodity groups 3 — Mineral Fuels and 4 — Animal and vegetable oils, fats and waxes. The assumption that Russia's sanctions on agricultural commodities have a negative impact on intra-industry trade in a given commodity group has proven to be flawed. In the affected group 0 — Food and live animals, the value of intra-industry trade rose in 2016 (0.034 in 2013 compared to 0.161 in 2016).

Table 4.30: Development **of the intra-industry trade between Slovakia and Russia in 2010–2016**

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
[0]	0.142	0.109	0.055	**0.034**	0.039	0.058	**0.161**
[1]	0.282	0.422	0.219	**0.197**	0.211	0.150	**0.704**
[2]	0.062	0.067	0.072	**0.096**	0.110	0.191	**0.101**
[3]	0.005	0.004	0.002	**0.002**	0.002	0.000	**0.000**
[4]	0.000	0.030	0.023	**0.485**	0.183	0.000	**0.000**
[5]	0.899	0.903	0.957	**0.723**	0.809	0.914	**0.808**
[6]	0.671	0.819	0.732	**0.763**	0.897	0.997	**0.874**
[7]	0.089	0.119	0.135	**0.078**	0.160	0.156	**0.197**
[8]	0.126	0.081	0.103	**0.082**	0.082	0.084	**0.082**
[9]	0.000	0.755	0.023	**0.893**	0.214	0.519	**0.037**

Source: processed by the authors according Eurostat data [Eurostat, 2018].

Note: SITC [0] Food and live animals; [1] Beverages and tobacco; [2] Crude materials; [3] Mineral fuels, lubricants and related materials; [4] Animal and vegetable oils, fats and waxes; [5] Chemicals and related products; [6] Manufactured goods; [7] Machinery and transport equipment; [8] Miscellaneous manufactured articles; [9] Commodities and transactions not classified elsewhere in the SITC.

Slovak export of commodity group 0 to Russia used to be incomparably higher than the import of it. Due to the Russian embargo, Slovak export has decreased, and import has slightly increased (see Table 4.29), which caused the increase of IIT value. In 2016 there was a significant increase in IIT within commodity group 1 — Beverages and Tobacco (0.704) mainly due to the increase of Slovak import, which used to be very low in the previous years. Within the commodity groups 2 — Crude materials and 3 — Mineral fuels, lubricants and related materials, there exists almost no intra-industry trade. The reason is that while the SR imports significant quantities of these commodities from Russia, its exports are minimal. Slovakia is thus a relatively net importer of these commodities. In the case of the commodity group 4 — Animal and vegetable oils, fats and waxes, the trade was almost completely frozen. Mutual trade practically did not exist. Commodity groups 5 — Chemicals and related products and 6 — Manufactured goods are, in the long-term, the strongest items of intra-industry trade.

In 2013 their IIT values fell slightly, which can be attributed to the initial uncertainty associated with the emerging conflict between Russia and Ukraine. However, these commodity groups are not affected by sanctioning measures and represent a strong trade item on both the Slovak export and import sides. For group 7 — Machinery and transport equipment, the value of intra-industry trade increased. In the previous years within the given export group, exports of Slovakia significantly exceeded its import. With the decline in exports and the increase in imports, the value of intra-industry trade increased. IIT values of commodity groups 8 and 9 are very low in the long term. In the case of group 8 — Miscellaneous manufactured articles Slovak export is much higher than import. Slovakia is, then, a net exporter. Value of IIT of commodity group 9 — Commodities and transactions not classified elsewhere in the SITC in 2016 was also very low since Slovakia was net importer in this year.

Based on our calculations we can conclude that the sanction war between the EU and Russia has influenced mutual trade between Slovakia and Russia. The sanction war along with the other above-mentioned factors has caused changes in exported or imported goods of Slovakia in relation to Russia. In some commodity groups, there came a strong decrease in Slovak export to Russia, which was balanced by the increase in Slovak import. In the following part of the paper we analyse the impact of the current crisis on the mutual trade between Slovakia and Ukraine, which is also an important part of it [Kašťáková, Bebjaková, 2016].

4.4.4 Prediction of the development of mutual foreign trade and perspective areas of mutual foreign trade cooperation

The forecast based on the long-term trend of export and import development since 2000 with a view to 2025 was applied to the mutual trade between Slovakia and Russia. The prediction of the development of export and import of the SR was obtained through MS Excel software.

To estimate the future development of business relations between the Slovak Republic and Russia, we used the function of FORECAST software MS Excel. The function based on existing values calculates or estimates the future value of the dependent variable (s) for a given independent variable value. The pair of numbers x and y are known number values. The function estimates the new value using linear regression. The formula for calculating FORECAST is:

$$y = a + bx, \tag{5}$$

where:

$$a = \bar{y} - b\bar{x} \tag{6}$$

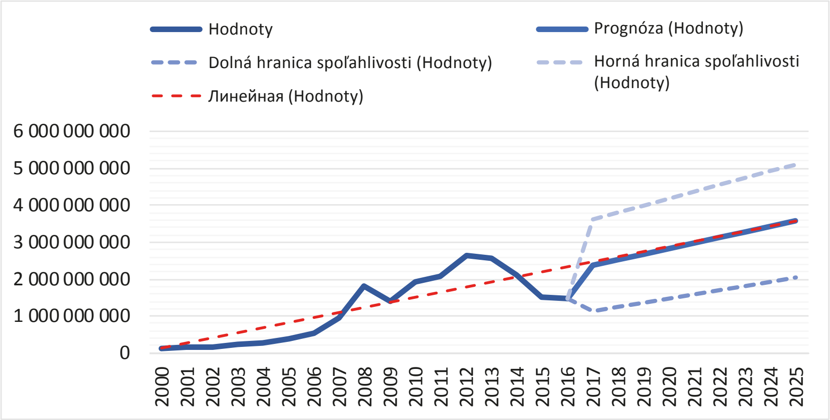
and

$$b = \frac{\sum(x-\bar{x})(y-\bar{y})}{\sum(x-\bar{x})^2}, \tag{7}$$

where x and y are the mean values of the sample AVERAGE (known x) and AVERAGE (known y).

Part of the FORECAST function is to determine the range of oscillation of future values of the observed development. For the forecast we worked with a 95% probability boundary spread. The results of these forecasts are shown in the following figures (figures 4.6 and 4.7).

Figure 4.6: **Prognosis of exports of goods from Slovakia to Russia by 2025 (EUR)**



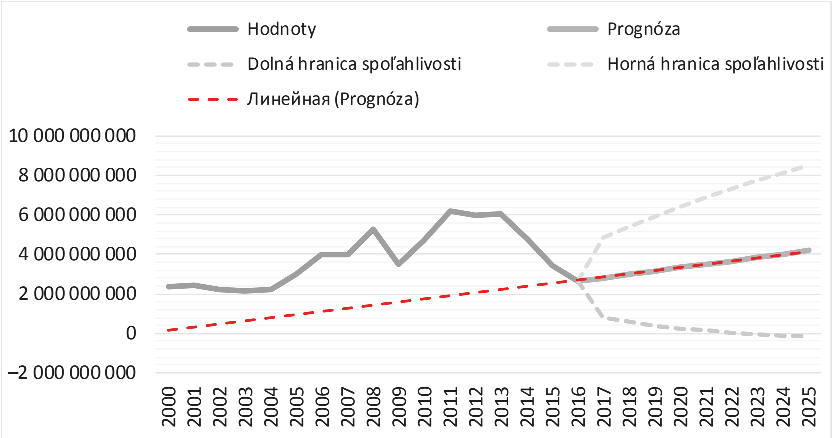
Source: processing via MS Excel based on data from [Eurostat, 2018].

Based on long-term development, we expect an upward trend in export trends from Slovakia to Russia by 2025. However, unlike the forecast, we do not expect a significant increase in the SR exports in 2017, although preliminary data suggest its growth. We expect that exports will evolve below the predicted linear values, and will, in the case of continuing application of the trade-policy sanctions, move closer to lower confidence limits. In the event of sanctions being terminated, we expect export values to be at the level of the forecasted ones with a tendency to move closer to the upper confidence limits. The rationale is the same as for the determinants of the projected development of EU exports.

Russia's energy imports from Russia play an even more important role than in the case of the EU. Products and technologies for the military industry make up a negligible part of the import of the SR, as a result, we can conclude that the direct impact of sanctions on the import of the Slovak Republic from Russia are minimal [Popova, Borisov, Rasulinezhad, 2017]. In the case of energy raw materials, the situation is different.

For the future development of SR imports from Russia, the development of oil and gas prices will be the most important factor. We assume that, under unchanged conditions, by the year 2025 there will be a slight increase in the SR import, with values oscillating around the linear predicted values. However, we do not expect a significant increase in imports for the same reasons as the EU. Our assumption of SR import is slightly more favourable than in the case of the EU as we consider the position of Russia as the dominant supplier of crude oil and natural gas to the Slovak Republic. In view of the position of the Slovak government towards Russia, we do not expect the trend of diversification of suppliers of energy raw materials to be established in the foreseeable future, as is the case in Western Europe.

Figure 4.7: **Prognosis of imports of goods from Slovakia to Russia by 2025 (EUR)**



Source: processing via MS Excel based on data from [Eurostat, 2018].

The most perspective areas of mutual cooperation include energetics, engineering, transport and agriculture. As we mentioned before, the Intergovernmental Commission for Economic and Scientific Cooperation plays a key role in regulation of mutual relations. The last meeting took place in October 2018 and discussed a list of current issues concerning economic cooperation. It has set energetics (including atomic), oil and gas, investment, transport, nanotechnology, innovation and military-technical spheres, agriculture and industry, and cooperation in the banking and financial sectors as priority areas of cooperation.

Cooperation in the sphere of the energy-fuel complex is the basis of the Slovak-Russian economic relations. Deliveries of Russian oil, natural gas and nuclear fuel meet up to 90 percent of Slovakia's needs. Natural gas deliveries for the Slovak Republic as well as transit through the territory of the Slovak Republic to Western Europe are carried out on the basis of long-term contracts. After an unstable situation in 2014, Slovakia managed to sign a key agreement with Russia on the supply of oil to Slovakia and transit of oil through its territory at the end of 2014. The agreement has to ensure a stable and reliable oil supply in the period from January 1, 2015, to December, 31, 2029. Based on this contract, Russia will supply Slovakia with six million tonnes of oil annually. The same volume is also intended for transit to Western Europe.

Among the best-known examples of cooperation between Slovak and Russian companies is cooperation between the Russian company Technopromexport, a.s., and the Slovak companies of SES Tlmače and Istroenergo Group. This cooperation is focused on seeking of joint participation in projects concerning the construction of new and modernization of existing energy objects in Russia and Slovakia as well as in third-party markets [MZVaEZSR, 2015]. In the field of nuclear power, long-term contracts for stable supplies of nuclear fuel for nuclear power plants Mochovce and Jaslovské Bohunice are successfully implemented. The Russian company Atomstroyexport participates in the completion of reactors 3 and 4 of the Mochovce nuclear power plant [Kalotay, Eleto, 2016].

Mutual cooperation is also intensive in the field of industry. Matador Automotive RUS, a subsidiary of Slovak company, is based in Nizhny Novgorod. The company focuses on the production of welded parts for the Russian automotive industry [Hinz, Morris, 2016]. Significant is also the cooperation between the Russian railways and the Slovak company I.Tran. The textile company produces uniforms for armies, police, firemen and rescue workers. Its largest buyer is the Russian Railways, with whom it plans to set up a joint venture [MZVaEZSR, 2015]. In the field of engineering, an agreement between the Russian group RSK-6 and the Slovak company CELOX, ps. r. o. was reached. Its aim is to develop the possibility of setting up a joint venture in Russia for the production of aluminium profiles. This Russian group has concluded agreements on cooperation in the field of energy-saving technologies used in construction. Intensive cooperation with Russia is also promoted by the Slovak company ELTEKO, s. r. o. which founded a subsidiary in the field of electrical engineering in Russia. There is also another Slovak company PROMA, which set its subsidiary in Moscow. PROMA is among the ten most important design and architectural companies in Slovakia, and it implements large projects for the construction and reconstruction of residential buildings in Reutov, but also in Moscow [Kašťáková, Žatko, 2018].

Russia proposes that Slovak companies with an interest in mutually beneficial cooperation should consider the possibility of becoming a resident of industrial parks located on the territory of the Russian Federation. New forms of cooperation accrue in the transport sector. Several mutually beneficial projects and other related programs are implemented. The project for the construction of a broad-gauge railway, which should lead the route Košice-Bratislava-Vienna, continues. The project also includes the construction of a logistics centre on the Danube. Tender for the construction of this project was won by a consortium of companies Bernard — Valbek — Obermeyer, a feasibility study of which has been undertaken by the Joint Venture of Russian, Ukrainian, Slovak and Austrian Railways (namely Breitspur Planungsgesellschaft). If the feasibility study does not prove, for example, enough material flows, Breitspur will not go into further technical studies and construction work will not begin. However, if the study demonstrates that the project is feasible and financeable, the project preparation will continue [SITA, 2015].

Agriculture also plays a significant role in the field of mutual cooperation. Residents of the Astrakhan region are discussing a project of the centre of cattle genetics that should be created in this region. At the same time, a cooperation agreement between the agricultural universities in Nitra and the Astrakhan region is under preparation. Slovak entrepreneurs plan to open many economic and livestock farms in the Astrakhan region, on the contrary, entrepreneurs from this area will establish companies in the fish industry of Slovakia. According to Slovakia, this area has more development potential than most European countries [Kittova, Steinhauser, 2016].

Although the crisis in Ukraine still persists, the trade balance between Slovakia and Russia increased in years 2017 and 2018. Slovak companies are searching for new ways to export their products to the Russian market. SARIO plays an important role in effort to internationalize Slovak SMEs through their presentation at fairs and exhibitions. One of the latest was the international construction fair in the Russian Federation MosBuild 2019 which took place in April 2019, Metalloobrabotka in May 2019 or INNOPROM Jekaterinburg in July 2019. On the other hand, the will of Russian exporters to enter the Slovak market can also be observed. Through the Russian Export Centre, Russian producers are looking for their partners, mainly from the food, furniture and paper industries. Many Russian exporters consider Slovakia to be a gateway to assert itself in Central European countries. However, for more viable interaction between Slovakia and Russia it is essential to remedy the geopolitical context of relations between the European Union and the Russian Federation.

4.5 Slovakia's foreign trade relations with Kazakhstan

The Kazakh republic is an inland state with an area of 2 724 900 km^2 and population of approximately 18.6 million [Czechtrade, 2018]. It is the most developed state of Central Asian countries. The country has experienced tremendous economic development over the last 25 years and undergone transformation to market economy. From the economy with lower middle income it has transformed into an economy with a higher average income.

In 2017 Kazakhstan's GDP was 158.2 billion USD [Veľvyslanectvo SR v Astane, 2018]. Although agriculture contributes only a small percentage to GDP, it employs up to 15% of the population. The country has a rich supply of minerals, mainly petroleum, natural gas, black coal, uranium, gold, silver, or copper. The most important area of industry is mining whose share in Kazakhstan's GDP in 2017 was 13.3%. Other major sectors are metallurgy, food, chemical, engineering, construction, metalworking and the pharmaceutical industries. Kazakhstan has been trying to diversify the structure of the economy in recent years and reduce its dependence on mining and exports of minerals. Services in Kazakhstan are represented mainly by wholesale and retail, real estate services and transport USD [Czechtrade, 2018]. Kazakhstan spends money on road and rail construction. The rail link connects China, Kazakhstan and other Central Asian states, leading to the One Belt One Road (OBOR) project.

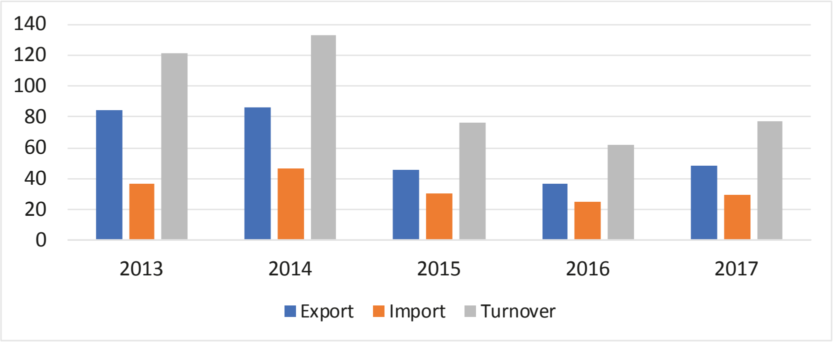
In 2012 Kazakhstan president Nursultan Nazarbajev promoted a new strategy called «The Strategy 2050» according to which Kazakhstan is to become one of the 30 most developed countries in the world. The new strategy is built on «The Strategy 2030», adopted and implemented since 1997. The new strategy focuses on seven long-term priorities which are expected support the development of the economy of Kazakhstan USD [Strategy2050.kz, 2018].

4.5.1 Foreign trade of Kazakhstan

For the last 18 years Kazakhstan has had an active trade balance. In 2017 Kazakhstan's total foreign trade turnover was 77.6 billion USD, of which 48.3 billion USD represented exports and 29.3 billion USD imports [Veľvyslanectvo SR v Astane, 2018]. The development of Kazakhstan's growth and foreign trade during the period 2014–2018 was negatively influenced by the decline of oil prices, EU sanctions against Russia, devaluation of the Russian rouble against the Kazakhstani Tenge [Konopelko, 2018]. As Kazakhsstan's economy is highly dependent on the export of oil and other raw materials, the decline in oil prices on the world markets caused the slow-down in the economic growth of Kazakhstan. As Russia is one of the three most important partners of Kazakhstan concerning foreign trade, the decline in the economic growth and foreign trade of Russia evocated by the EU sanctions against Russia effected negatively the foreign trade of Kazakhstan. Foreign trade of Kazakhstan in 2013–2017 is displayed in Figure 4.8.

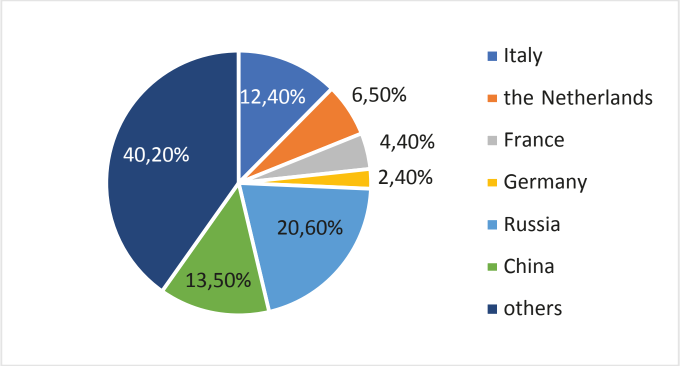
Kazakhstan's most important trading partner in 2017 was the European Union with a 38.7% share of Kazakhstan's foreign trade followed by Russia 20.6% and China 13.5%. Among the European countries, Italy (12.4%), the Netherlands (6.5%), France (4.4%), Germany (2.4%) had a significant share on Kazakhstan's foreign trade in 2017. From non-EU countries, Kazakhstan's most important trading partners were Russia (20.6%) and China (13.5%), Uzbekistan (2.6%), Turkey (2.4%), Ukraine (2.1%) [Zastupitelský úřad ČR v Astaně, 2018]. A detailed overview of Kazakhstan's most important foreign trade partners is shown in Figure 4.9.

Figure 4.8: **Kazakhstan Foreign Trade in 2013–2017 (bln. USD)**



Source: processed by the authors according the data from Veľvyslanectvo SR v Astane.

Figure 4.9: **Foreign trade partners of Kazakhstan**

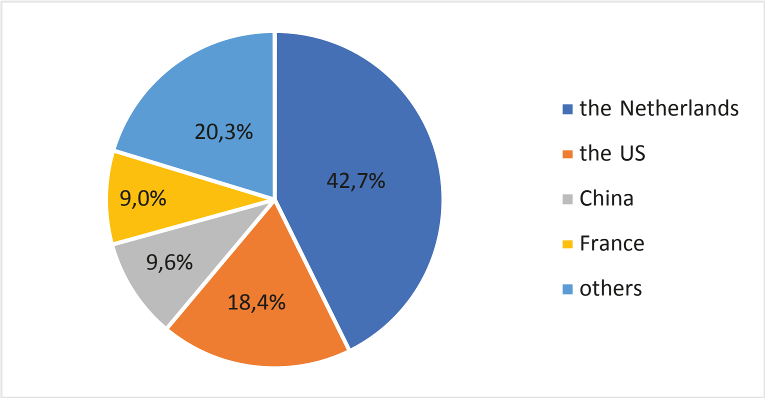


Source: processed by the authors according the data from Zastupitelský úřad ČR v Astaně.

In 2017 Kazakhstan's largest share in exports were mineral products 87.1%, base metals 3.8%, pearls and precious metals 3.8% and products of chemical industry 1.9%. The main import goods in 2017 were machinery and appliances 33%, products of chemical industry 19.7%, transport equipment 11.5%, optical instruments 6.2% and base metals 5.8% [European Commission, 2018].

By January 1, 2018, the amount of FDI in Kazakhstan was 147 064 million USD. Most of the investments came from the Netherlands (42.7%), the US (18.4%), China (9.6%) and France (9%) [Zastupitelský úřad ČR v Astaně, 2018]. Kazakhstan is trying to attract potential

Figure 4.10: **Foreign direct investments in Kazakhstan**



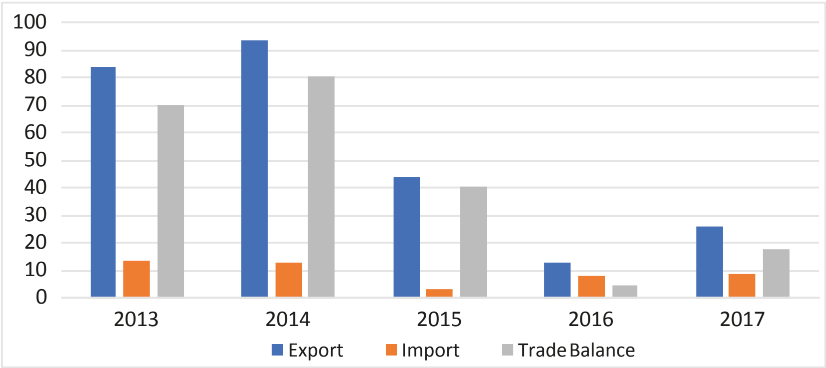
Source: processed by the authors according the data from Zastupitelský úřad ČR v Astaně.

investors by offering attractive conditions for investment. In 2014 the government of Kazakhstan adopted a new investment legislation including tax holiday, investment aid, exemption from custom duties and other. A detailed overview of Kazakhstan's FDI development for 2017 is shown in Figure 4.10.

4.5.2 Foreign trade between Slovakia and Kazakhstan

Slovakia's trade balance with Kazakhstan has long been active. The positive balance of mutual trade is affected by the fact that Slovakia is not a significant importer of energy raw materials from Kazakhstan. The development of foreign trade between Slovakia and Kazakhstan can be seen in Figure 4.11. In the years 2015–2016, trade between Slovakia and Kazakhstan was not very favorable, but already in 2017 Slovak export to Kazakhstan reached 25.9 mln EUR, which represented a double growth compared to the previous year. The decline in foreign trade in years 2015–2017 was caused by the EU sanctions against Russia which influenced also the economy of Kazakhstan. In 2017 Kazakhstan participated in Slovakia foreign trade with 0.024% and was the 66th most important export partner for Slovakia. In the same year, Slovakia participated in the foreign trade of Kazakhstan in the amount of 33.7 mln EUR, which represents 0.05% of Kazakh total trade [Ministerstvo hospodárstva SR, 2018]. The biggest volume of foreign trade of Slovakia with the countries of Central Asia belongs to Kazakhstan.

Figure 4.11: **Foreign trade between Slovakia and Kazakhstan in 2013–2017 (in mln EUR)**



Source: processed by author according the data from Veľvyslanectvo SR v Astane.

Table 4.31: **Top 5 commodities of mutual foreign trade between Slovakia and Kazakhstan in 2017 (according HS2 classification)**

HS2	**Slovak export to Kazakhstan**	**Value in mln EUR**	**Share in %**
87	Vehicles other than railway or tramway rolling-stock	8142	31.4
84	Nuclear reactors, boilers, machinery and mechanical appliances	4516	17.4
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus	4351	16.8
85	Electrical machinery and equipment and parts thereof	2742	10.6
40	Rubber and articles thereof	1211	4.7
HS2	**Slovak import from Kazakhstan**	**Value in mln EUR**	**Share in %**
27	Mineral fuels, mineral oils and products of their distillation	5775	65.7
74	Copper and articles thereof	1141	12.9
28	Non-organic chemicals; organic or inorganic compounds of precious metals	533	6.1
12	Oil seeds and oleaginous fruits;	529	6.0
72	Iron and steel.	481	5.5

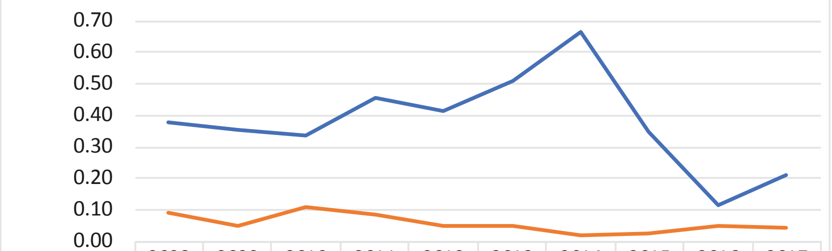
Source: processed by author according the data from Veľvyslanectvo SR v Astane.

Slovak export to Kazakhstan is diversified and represents the cross-section of the main sectors of the Slovak economy. In 2017 the most important groups of goods in Slovak exports to Kazakhstan under HS2 were vehicles, nuclear reactors, optical and photographic instruments, electrical machinery and rubber. Slovak imports from Kazakhstan were represented mainly by mineral fuels with almost 2/3 of total imports, followed by copper, nonorganic chemicals, oil seeds and iron and steel. The detailed information of Slovak exports to and imports from Kazakhstan is seen in Table 4.31.

4.5.3 Intensity of mutual foreign trade

To evaluate the size of mutual trade between Slovakia and Kazakhstan, we use the Trade Intensity Index (TII). TII assesses whether the value of the trade between assessed countries is bigger or smaller than could be expected based on their position in international trade. A detailed overview of mutual trade intensity between Slovakia and Kazakhstan between 2008 and 2017 is illustrated in Figure 4.12.

Figure 4.12: **Development of the TII between Slovakia and Kazakhstan in 2008–2017**



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
TII SR-KZ	0.38	0.35	0.34	0.45	0.41	0.51	0.66	0.35	0.12	0.21
TII KZ-SR	0.09	0.05	0.11	0.08	0.05	0.05	0.02	0.03	0.05	0.04

TII SR-KZ TII KZ-SR

Source: processed by the authors according the data from UNCTADSTAT.

In the years 2008–2017 TIISR-KZ was less than 1 which indicates small activity of Slovak exporters to Kazakhstan and that Kazakhstan is not an important trade partner for Slovakia. It indicates also not intense trade relationship. We can observe quite significant decline in the years 2015 and 2016 of TIISR-KZ which was caused by the slowdown of the Kazakh economy influenced by the EU sanctions against Russia and the drop of oil prices, which also resulted in a drop of imports from Slovakia. The increase in 2017 was influenced by a bigger activity of Slovak exporters. TIIKZ-SR in the years 2008–2017 was very low which shows that Slovakia is not an important partner for Kazakhstan.

4.5.4 Perspectives of the development of Slovakia's foreign trade relations with Kazakhstan

Slovakia has concluded following agreements: the Agreement between the Government of the Slovak Republic and the Government of the Republic of Kazakhstan on the Promotion and Mutual Protection of Investments; the Agreement between the Slovak Republic and the Republic of Kazakhstan on the prevention of double taxation; the Agreement between the Government of the Slovak Republic and the Government of the Republic of Kazakhstan on Economic and Scientific and Technical Cooperation. These three documents should support foreign trade and investments between these two countries.

The Ministry of Economy of Slovakia organizes regular intergovernmental conferences with Kazakhstan. These intergovernmental conferences are accompanied with a business mission that represents the opportunity for Slovak and Kazakh companies to find a new business partner.

An important event held in Kazakhstan was Expo Astana 2017. The main theme of EXPO Astana was «The Energy of the Future». As Kazakhstan has large hydrocarbon reserves, it focuses its energy policy especially on the use of these energy sources. Due to Kazakhstan's interest in exporting energy fuels in the future, the prospective area for Slovak companies could be cooperation in the modernization of power plants. There are several traditional exporters in Slovakia in this area. Kazakhstan has been investing a lot of funds in recent years particularly in the area of construction, road and rail development. Slovak companies can participate in PPP projects, which represent a form of cooperation of a Slovak company with a local partner, especially in the area of infrastructure development but also in healthcare or education. As the government of Kazakhstan has recently decided to promote afforestation and building-up green areas, specific opportunities are also offered to state-owned or private companies in the field of forestry.

Slovak Investment and Trade Development Agency organized two business missions at the Expo Astana in 2017, the Intergovernmental Commission in May 2018, the official visit of the Prime Minister Peter Pellegrini with business delegation in November 2018 and the visit of deputy minister of the Ministry of foreign affairs of Kazakhstan in February 2019. During these events, Kazakh companies showed interest in the cooperation with Slovak companies, especially in the field of energy, construction, aerospace and agriculture.

Several traditional Slovak companies are already engaged in exporting to Kazakhstan. These companies represent medical technology, energy, wastewater treatment. Based on demand from Kazakh companies, we also consider agriculture, energy, healthcare, wastewater treatment, ICT as one of the most promising sectors of cooperation between Slovakia and Kazakhstan. These are sectors where Slovak companies have a long tradition. To conclude, the trade potential that exists between Slovakia and Kazakhstan is untapped and there is a big potential to deepen cooperation between the two countries [Barinková, 2018].

Conclusions

The region of the Western Balkans, Eastern Europe and Central Asia is of great importance for the EU's strategic development interests and its foreign trade relations. Their importance lies in the natural richness, territorial dimension and size of the unsaturated market, which is a great potential for foreign trade of the EU and the Slovak Republic.

Even though the EU has signed The Stabilization and Association Agreement with each country of the region and liberalised mutual trade, the Slovak republic, as well as the EU, is facing other barriers that prevent from deepening trade and investment relations: corruption, weak infrastructure, law enforceability, rule of law, etc.

The Western Balkans has lost motivation on the path to EU membership, the enlargement process is too slow and within 20 years only Croatia reached the dream target in the form of EU accession. The EU policy did not help to accelerate development, and the Balkans is questioning suitability of the EU approach. If the EU does not want to lose its position in the region to the benefit of other partners (Russia, China, Turkey), the reformed enlargement policy and differentiated approach should be considered. The next EU accession is only possible in 2025, which is enough time to launch a new strategy and push at least some countries of the region, specifically Serbia, Montenegro and Macedonia, towards the EU integration and membership.

In terms of the EU trade policy, the post-Soviet countries can roughly be divided into three groupings. Russia occupies an individual position of the only country in the region with which the Union has launched the concept of strategic partnership. The second group is formed by the countries participating in the Eastern Partnership Initiative, and the third group is formed by the Central Asian countries. Within the post-Soviet states, Russia, Kazakhstan and Ukraine are among the EU's largest and most important trading partners. Although mutual partnership is characterised by tensions and mistrust and is stagnating in many areas, it is still possible to talk about the strategic importance of partnership, both in terms of trade, energy cooperation and security issues.

The main objective of the Eastern Partnership — political association and economic integration of the six partner countries with the EU internal market has been transformed into the EU's offer of new legal frameworks in the form of the Association Agreements and their innovative trade parts, the Deep and Comprehensive Free Trade Agreements as cornerstones of their future relationship. In contrast to Ukraine, Moldova and Georgia, where the Association Agreements are in force, Armenia, Azerbaijan and Belarus have a more limited interaction with the EU.

As for the EU's position in the Central Asian region, the region offers a huge economic potential along with its strategic geographical location at the crossroads of important trade routes, however, it is also a region where different political interests of major powers meet. The EU is not a key player or a major security actor in the region, but its importance as a region's economic partner is universally acknowledged — as the region's largest trading partner accounting for 30% share of its overall foreign trade. Mutual economic cooperation has expanded into many areas, energy, transport (particularly rail transport), logistics, political dialogue, or the issues of justice and home affairs.

Despite the growth of the EU trade with the Western Balkans, the region's share in the total EU trade in goods remains at 1.3% and the total trade volume 49.5 Bn. EUR remains weak considering geographic proximity and 20 years of the running Stabilization and Association Process. On the other hand, the dependency of the Western Balkans on the EU trade is growing reaching over 70% in case of Macedonia, 66.2% in Macedonia and 65% in Serbia and Bosnia and Herzegovina. Serbia is the biggest EU trade partner, far ahead of Bosnia and Herzegovina and Macedonia. The trade exchange with Kosovo and Montenegro is insignificant. The trade of the Slovak republic with the Western Balkans is based on long-lasting cultural and economic ties but the share of importance of a particular country on trading is similar to that in the EU trade. The most important trade partner of Slovakia is Serbia followed by Bosnia and Herzegovina and Macedonia, trade with Albania, Kosovo and Montenegro is negligible. Due to not recognising Kosovo as an independent country, Slovakia developed more intensive trade ties with Kosovo regardless of the political barriers.

Ukraine has strengthened its pro-European orientation, and the advance application of free trade agreement measures creates a great potential for developing and deepening trade and economic cooperation.

The Association Agreement including its trade part (DCFTA) came fully into force on September 1, 2017, and implied the adoption of European values and political commitments and the harmonization of legislation with the EU legislation and, therefore, gradual integration in the EU internal market. Both the EU and Ukraine continue to work to ensure the opportunities and benefits for their businesses within the framework of the agreement.

Six years have passed since the imposition of the mutual EU-Russia sanctions due to the Russian-Ukrainian conflict. As a result of this, trade has declined not only in the sectors that are directly affected by the sanctions, but, as a result of the economic multiplier, also in the sectors that are related to them. Trade has fallen almost in all items of goods, which has negative consequences for the EU producers. The impact of comparative advantages on the deepening of the EU's bilateral foreign trade relations with Russia is significant. The EU depends on Russia mainly in supplies of energy and non-oil raw materials. It has to be noted that in the near future, given the structure of the economy of the EU, enormous reductions in imports from Russia in this group of products are unlikely. To a larger extent, Russia imports finished products from the EU. Therefore, the EU should continue to focus more on increasing export output, where it has a comparative advantage (oils and fats, machinery and transport equipment, various ready-made and industrial products) in trade with Russia.

Geopolitical changes have also led to some changes in intra-industry trade. The reason was changing in proportion of export and import. The current situation has contributed to a mild 'balance of power' between the EU and Russia. Despite the difficult situation, Russia is still an important EU trading partner. On the one hand, Russia represents a significant export market for European producers, on the other hand, Russia is also an important supplier of raw and energy raw materials for the EU.

Mutual trade intensity continues, although a slight decrease is observed due to the sanctions and a fall in prices on energy raw materials. Despite the current tense situation, Russia is an important trading partner of the EU, and the EU needs Russian energy resources for at least next 20 years. If the EU wants to ascertain its energy security and not to lose such a major market, it should address the tension with Russia. Subsequently, the EU can strengthen its relations with Russia. Otherwise mutual trade relations can further deteriorate, and Russia may tighten its relationship with other partners especially with China.

Russia has always been an important trade partner of the EU. The major commodities in mutual trade relations are energy and raw materials. On the one hand, the EU is dependent on imports of oil, natural gas, coal and uranium from Russia, on the other hand, the EU is a major export market ensuring stable revenues to the state budget for Russia. The recent sharp decline in oil prices on world markets has brought both positive and negative consequences for operators in the global economy. The negative consequences of low oil prices were recorded in the oil-producing and oil-exporting countries (e. g., Russia) and the positive consequences for countries with high consumption and imports of oil (e. g., the EU).

Since oil and natural gas are one of the most important commodities of trade between the EU and Russia, the impact of the price changes is automatically reflected in the statistics of trade between the EU and Russia. Based on the comparison contained in this paper, it can be concluded that the effect of changes in oil prices does not affect the real demand of the EU as might be assumed on the grounds of financial indicators. Analyses of oil as well as natural gas imports to the EU from Russia in the quantitative terms show that the total quantity of imported oil and natural gas is independent from on the spot price of oil but, instead, is determined by the dependence of the EU economy on these energy materials. The analyses find that the decline in oil prices has a significant impact on the aggregate statistics of mutual trade expressed in financial indicators. In the quantitative volume, however, there was no decline in EU imports. These findings are important to consider when analysing the foreign trade between the EU and Russia, and they may be subject to deeper scientific research.

Despite the difficult situation, Russia remains among the most important trading partners for the EU. Over the coming decades, the EU will depend on imports of Russian energy commodities. To ensure energy security of the EU and to avoid losing access to this significant agricultural market, the EU has to consider how to solve disparities with Russia. The future development of the EU's geopolitical strategy toward Russia will determine whether mutual relations will improve and return to their pre-2010 terms or, instead, they will stagnate. If there is no resolution of the current problems between the EU and Russia, it will only help competitors from other countries, especially from Asia.

Kazakhstan has an important position as the EU's main trading partner from the Central Asian region accounting for up to 85 % of the EU trade with the region. For Kazakhstan, the EU is currently the largest trade and investment partner. In addition to the important position as a trade (up to a third of country's foreign trade), and investment partner (more than 50%), the EU perceives Kazakhstan as a partner for promoting peace and security in a wider region. Kazakhstan puts emphasis on security and stability, which successfully translates into the whole region. Kazakhstan was the first Central Asian state which signed the 'second-generation' agreement (EPCA) with the EU. The country's considerable energy resources can enable diversification of business partners and supply routes to ensure reliable energy supplies to the EU. Another important factor for the development of mutual cooperation is the improvement of Kazakhstan's business environment within the Central Asian region, a broad and unsatisfied market, currently not fully utilized for the benefit of the EU, offering several economic and trade opportunities for EU players. Moreover, Kazakhstan's economic policy pursues two main objectives: the expansion of the industrial base and the development and construction of infrastructure, based on a diversification plan of the economy. Thanks to its geostrategic location, Kazakhstan has a strong potential for the future of transcontinental trade and transport routes development.

As a result of globalization changes taking place in the world economy, technological advance, economic and institutional reforms enabled easier access to resources and markets which led to ever-increasing fragmentation of production processes. This process enabled more efficient use of comparative advantages of individual countries. Therefore, searching for opportunities in world markets, identifying perspective export commodities reaching a strong comparative advantage in foreign markets is one of the current economic trends. This is essentially important for open economies such as Slovakia, which is highly dependent on foreign trade exchange.

The comparative advantages of Slovakia lie in industrial production. Industry is the basis of the Slovak economy; it is not only an important 'driving force' of its growth and an important source of job creation, but also the driving force of productivity and innovation. In the structure of Slovak industry, manufacturing plays a dominant role in the long term and traditionally belongs to one of the key sectors of the Slovak economy.

Due to ongoing geopolitical changes, it will be necessary to implement a number of structural changes in the Slovak economy. Although the Slovak Republic belongs to the fastest growing economies within the EU, its gross domestic product per capita in purchasing power increased from 47% of the EU-27 average in 1995 to 77% in 2018. However, the competitive advantage is still primarily based on low taxes and low cost of labour. Therefore, the Government, in accordance with the agreed conclusions of the European Council and within the frame of the Europe 2020 strategy, is currently focusing on launching many innovations in intelligent policies to start up research and development (R&D) in the area of innovation and energy. For Slovakia in the future and in terms of intelligent specialization, it is appropriate to focus on a deeper development of complementary sectors related to research and production of automobiles and consumer electronics and increasing added value in the research of metallic and non-metallic materials.

An important priority should also be put on information and communication technologies that are becoming more applicable to the world markets, both as a separate export article and also as a complementary input in the production of automobiles and consumer electronics (e.g., navigation software, control systems, communication systems, etc.). Achieving the vision for 2020 should lead to the transformation of the Slovak economy towards a knowledge-based economy, to restructure the industry towards the production of goods with higher added value, so that in terms of product and process innovation the Slovak companies could be classified as globally highly competitive.

Slovakia's natural interest in Ukraine is part of the Strategy of external economic relations of the SR and its territorial priorities. Ukraine is the only neighbour of Slovakia that is not a member of the EU and, thus, it operates in another international legal and commercial regime. Slovakia has a long-term passive trade balance in trade with Ukraine. The share of Ukraine in Slovak foreign trade is less than a percent, which is a very low figure compared to the Russian Federation. It is also known that this large market has untapped potential for the growth of mutual commercial and investment relations, which has not been used in terms of Slovak business entities yet. Slovak-Ukrainian foreign trade relations are formed through narrow historical and business relations accompanied by cultural and linguistic similarity. The military conflict in Ukraine and the EU's sanctioning policy towards Russia caused a significant decline in trade between the Slovak Republic and Ukraine over the years 2014 and 2015. Within the commodity structure of exports and imports, this development has led to a decline in almost all commodity classes and their groups or subgroups, but the biggest drop was on the export side of Slovakia. Intra-industry trade was accompanied by a minimal decline in its value and was caused by a variable rate on the export and import side, whose values increased or decreased over the period under review. Nevertheless, intra-industry trade index values have been reduced to a minimum over the years. However, despite these developments, year-on-year turnover of mutual trade grew in 2016. This sudden turnaround can be attributed to the DCFTA, which, according to this development, will contribute to more positive prospects in the field of mutual trade.

Due to the sanction measures, current Slovak-Russian trade relations deteriorated especially in 2014–2016, as evidenced by decreases in import and export. The decrease in Slovak imports from Russia in 2016, which represented 23.2%, was much more significant than the decrease in Slovak exports to Russia (4.4%) compared to 2015. Such significant decrease in mutual trade was not caused by the fall in physical volumes of imports. It was caused by falling prices on raw energy materials which also contributed to weakening of the Russian rouble on world financial markets. To a large extent, the weakening of the domestic currency has led to insolvency of Russian companies and to decrease in the purchasing power of foreign products in Russia.

We can also say that the intensity of mutual trade between Slovakia and Russia was intensive in the monitored period. Based on the results of trade intensity indices, the intensity of Slovakia's foreign trade with Russia is higher than that of Russia's trade with Slovakia.

Slovakia perceives Russia as an important partner in energy supply as well as a country with the potential to place its automotive, mechanical, electrical and electronics products, supplies of capital goods for the construction of power plants as well as equipment for food industry. In the upcoming years, there will be an increasing demand for technologies related to environmental protection and water management in Russia. This concerns the so-called green technologies used in all areas of the economy, thus creating opportunities for Slovak companies which are active in the field of water protection and water management.

An important trading partner of Slovakia in the region of Central Asia has long been Kazakhstan. The potential for cooperation between Slovakia and the countries of Central Asia is quite large. The main prospective sectors of cooperation between Slovakia and the countries of Central Asia include agriculture, energy, wastewater treatment and health, and, in the case of Kazakhstan, construction and aviation.

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About the authors

Elena Kašťáková, Ph.D., Associate Professor

Elena Kašťáková is an associate professor at the Department of International Trade, Faculty of Commerce at the University of Economics in Bratislava. She focuses her research activities on issues of geopolitical changes that influence the development objectives of the EU foreign trade activities with implications for the Slovak economy. Her key specialisation concentrates on Ukraine, Russia and the Central Asian countries (Kazakhstan), international trade and business operations. She is an author of more than 100 scientific publications and 9 monographs which are focused mainly on foreign trade relations of the EU and Slovakia in connection with geopolitical changes.

Kristína Drieniková, Ph.D., Assistant Professor

Kristína Drieniková is a lecturer and researcher at the Department of International Trade, Faculty of Commerce at the University of Economics in Bratislava. Her research activities and interests cover the European Union trade policy, especially towards the post-Soviet countries (Russia, Central Asia and Eastern Partnership countries) and countries in Asia; international trade as well as management of international business.

Ľubica Zubaľová, Ph.D., Assistant Professor

Ľubica Zubaľová is a lecturer and researcher at the Department of the International Trade, Faculty of Commerce at the University of Economics in Bratislava. She focuses her teaching and research activities on the European Union trade policy towards Western Balkans and Africa, international trade and development of Sub-Saharan Africa.

Elena KAŠŤÁKOVÁ,
Kristína DRIENIKOVÁ,
Ľubica ZUBAĽOVÁ

IMPACT OF THE GEOPOLITICAL CHANGES ON
THE EU FOREIGN TRADE RELATIONS
WITH SELECTED TERRITORIES:
IMPLICATIONS FOR THE SLOVAK ECONOMY

Корректор *Е. Г. Андреева*
Компьютерная верстка *Ю. Ю. Тауриной*
Обложка *Е. Р. Куныгина*

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publishing@spbu.ru

publishing.spbu.ru

Типография Издательства СПбГУ.
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