

# EASTERN MONITOR

## How to lose Russia in 10(0) days: Ukraine's delicate balance

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- **The Association Agreement is a bilateral agreement concluded between the European Union and Ukraine establishing their political and economic relationship, which entered in full force on the 1<sup>st</sup> of September 2017. The Agreement commits Ukraine to adopting high standards of governance, democratic political system, rule of law and free market. It symbolizes a strategic act of revolt against the regimes ruling Ukraine since 1991, which aligned with Russian interests, under the helm of Leonid Kravchuk, Leonid Kuchma and Viktor Yanukovich.**
- **The Agreement itself was initialled in March 2012 after several years of negotiations. It was brought to public attention during the Euromaidan protests in 2013 and later in 2014 when then-Ukrainian president Viktor Yanukovich refused to sign the Agreement that stands for, as James Sherr called it, "a civilizational choice".**



The Association Agreement<sup>i</sup> with Ukraine, as Stefan Füle put it in 2012, is considered “one of the most ambitious and complex agreements the European Union has ever negotiated with a third country”<sup>ii</sup>. Negotiated in parallel with the height of the European economic crisis, the Agreement and the Deep and Comprehensive Free Trade Areas (DCFTA) were perceived by all parties involved as a “now or never” opportunity<sup>iii</sup>. Despite never being offered EU membership, the Agreement has provided Ukraine with a vision of political association and economic integration based on common values, in line with its status as potential member and external border of the EU.

## When the sphere of influence leaks beyond the playground

Few bilateral agreements have gotten so much attention from third parties than the EU-Ukraine Association Agreement. Russia exerted considerable pressure on the government in Kyiv to halt its westward course for years since the negotiations on the Agreement started, offering its own form of close (Russia-supervised) cooperation, the Eurasian Economic Union (EAEU), launched in 2010. Unlike the DCFTA in which members can more or less freely negotiate new trade agreements with other potential partners, the EAEU does not allow for this freedom. If the EU wished to negotiate free trade agreements with Belarus or Armenia (or Ukraine if it had joined the EAEU), who are the members of the EAEU, it would have to hold talks with the EAEU as a whole. If Ukraine had joined the EAEU it “would have been forced to raise external tariffs with the EU, so creating a massive trade diversion.”<sup>iv</sup>

Once Ukraine asserted its post-Maidan independence by signing the political chapters of the Agreement in March 2014 and the economic chapters later

in June, Russia raised several complaints<sup>v</sup>, this time on economic consequences the DCFTA allegedly would cause to its economy<sup>vi</sup>. Under threat of further escalation of the military conflict in the Eastern part of Ukraine and implementation of economic sanctions on Ukraine, trilateral negotiations (European Commission, Ukraine and Russia) led to postponing the provisional implementation of the DCFTA until the end of 2015. In order to improve the political situation, and most importantly bring an end to the conflict in Eastern Ukraine, the EU's High Representative Federica Mogherini decided to re-open the prospect of trade talks. She proposed a dialogue within the trilateral context limiting any effects the Agreement could have on Russia.

Given this indirect invitation to interfere into the procedure of implementing the Agreement<sup>vii</sup>, Russia proposed several amendments to the Agreement and desperately fought to maintain influence over Kyiv's economic policy – among others.

***“By postponing the implementation of the DCFTA, the EU risked creating a dangerous precedent in which Russia were given the right to intervene in the relations of the EU with the countries in its (rather, former) sphere of influence, particularly the former republics of the Soviet Union.”***

Even after the partial implementation of DCFTA provisions, Russia maintained its position as a third party in this bilateral relation. The latest trade complaint against Ukraine was filed in the WTO in May 2017<sup>viii</sup>, due to a claimed “universe of restrictions, prohibitions, requirements and procedures from the Ukrainian government that adversely affect goods and services emanating from Russia”<sup>ix</sup>. Russia claimed, at the WTO's committee on

## České vize pro Evropu, evropské vize pro Česko Czech Visions for Europe, European Visions for the Czechs

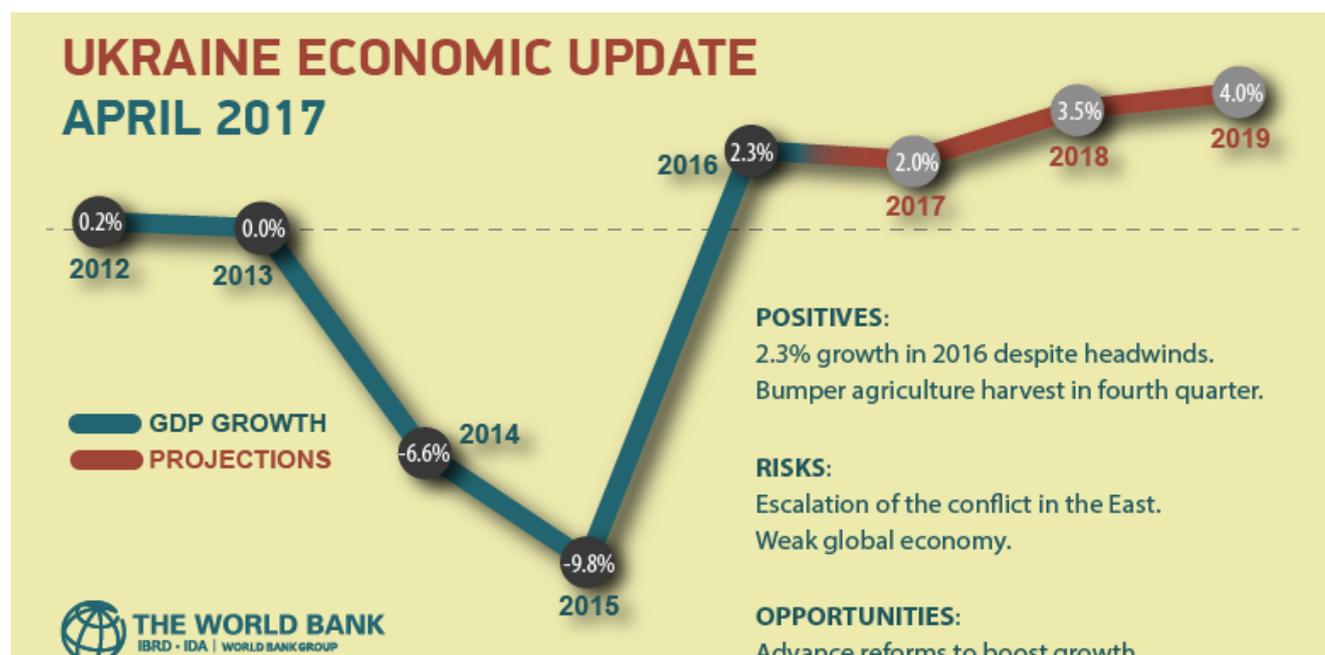
regional trade agreements held on 29 June 2017, that the DCFTA between the EU and Ukraine had been “an exemplary case of a situation where a free trade area worsened trade conditions for other trading partners”<sup>x</sup>. Its representative added that despite offering a number of proposals to resolve its concerns about the impact of the Agreement on Russia in a legally binding form, it was denied this “opportunity with reference to the inviolability of the Agreement that has been signed and ratified by only a few EU Member States.”<sup>xi</sup>

### When the provisional implementation is implemented provisionally

The Ukrainian economy only started its full recovery process in 2016 after 2 years of recession caused by the situation in the Eastern Ukraine. The fastest growth is found in sectors such as agriculture, construction, industry, trade and transportation. According to the National Bank of Ukraine, economic growth might however

decrease in 2017 to under 2 % (compared to 2.3 % of growth in 2016) due to the trade blockade imposed on territories held by separatists (see the table of World Bank update on Ukrainian economic situation below)<sup>xii</sup>. The Russian-backed conflict in the Eastern part of Ukraine has still overshadowed any positive efforts to implement reforms and stabilize the economy<sup>xiii</sup>.

*“The progress of reforms has slowed in the past year, due not only to the economic situation and Russia’s aggressive constant low-intensity warfare in the eastern regions in order to weaken the country economically, politically, socially and psychologically, but also due to the unstable political power, parliamentary opposition and vested interests of oligarchs embedded in every state structure.”*



Source: Ukraine Economic Update – April 2017 [online]. World Bank, 2017. Available at: <http://www.worldbank.org/en/country/ukraine/publication/economic-update-spring-2017>

The peak of reforms was reached in the first half of 2015 when Ukraine and the IMF agreed on a new financial support programme. Since then, reform regulatory acts have been reduced by 35 %, from 322 in 2015 to 208 in 2016<sup>xiv</sup>.

Significant progress in reforms has been observed in the banking legislation, energy, visa-free regime, and in the independence of the judiciary<sup>xv</sup>, anti-corruption and deregulation areas. Successful implementation of anti-corruption policy is one of the most important steps for the overall success of the Association Agreement and Ukraine's economic future. The National Anti-Corruption Bureau of Ukraine and the National Agency for the Prevention of Corruption created rules for more transparency in political culture<sup>xvi</sup>. In addition, the launch a new electronic declaration system for officials' incomes has had a positive impact on the anti-corruption efforts<sup>xvii</sup>.

The reforms of the pensions and tax systems, of the security sector, and privatization efforts have, on the contrary, have slowed due to bureaucratic and political resistance. In 2016, the Strategic Defense Bulletin, a key defense planning document<sup>xviii</sup> was developed and New Special Operations Forces were established. Also, reforms on territorial decentralization of power remain incomplete due to the lack of parliamentary consensus on amending the Constitution<sup>xix</sup>. Political opposition sees decentralization as a plan of President Poroshenko to gain more power over the regional and local councils via the election of close partners to these seats<sup>xx</sup>.

The DCFTA, which had been provisionally implemented since January 2016, represented the first trade agreement within the Eastern Partnership cooperation. It intends to remove both trade tariffs (apart from the agricultural products export quotas) and non-tariff

barriers (e.g. protection of intellectual property rights) and requires the country to adopt up to 70 % of EU standards in the area of trade, macroeconomic policy, consumer protection and labour market (among other areas). Ukraine started reducing its import and export duties in January 2016 and by January 2017 had managed to drop average import duties from 4,5 % to 1,7 %<sup>xxi</sup>. Progress was also made in industrial product and food safety, intellectual property rights protection and competition policy.

According to the German Advisory Group, the biggest success in implementing the DCFTA since its provisional application has been seen in public procurement. New legislation adopted created prerequisites for an open EU-Ukraine public procurement market. However, some companies still experience harassment from state institutions after winning tenders. The delay has been noted in the New Computerised Transit System adoption, which postponed the integration of the country into the common transit system of the EU.<sup>xxii</sup>

## Conclusion: When a symbol of European choice puts on more weight

The entry into force of the Agreement is now even more symbolic than it has ever been before. It is politically and economically fundamental for the future of Ukraine, its economy, political and trade relations with the EU and mainly its European direction.

***"The Agreement has been considered a symbol of the fundamental internal and external struggle of the country that paid high costs in terms of territorial, economic and political independence, and also human lives, in the past four years"***

So far, the negotiations and (provisional) implementation of the Association Agreement have triggered a crisis on eastern part of the European continent. Few were willing to see what Ukraine has been really facing, although Russia kept challenging not only Ukraine's independence but also the EU's credibility. The EU's reaction, inviting Russia to the negotiation table of the Association Agreement, was weak and incoherent and gave Russia too much leeway in deciding how and when the DCFTA would be implemented.

On top of this, the delay in the ratification of the Agreement by EU members has had negative economic and security consequences for both Ukraine and the EU itself, which full implementation of will not magically make disappear. So, what to expect once the Association Agreement has entered in full force?

also help starting reconciliation with Russia. Despite the current frozen relations between Moscow and Kyiv, Ukraine needs reconciliation with Russia now more than ever. If Russia maintains its aggressive policy, if the sanctions continue, if Ukraine's territory remains war-torn, the economic situation of Ukraine will never improve and Ukraine will never be able to benefit from the opportunities the full implementation of the Association Agreement offers.

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***"The Agreement will not cure the Ukrainian economic, political and security situation from one day to the other but it can nevertheless provide a new impetus for further reforms and help attract foreign and domestic investments. In a climate of ongoing war in Eastern Ukraine, the occupation of Crimea and distorted EU-Russia and Ukraine-Russia relations, the EU needs to offer some political risk insurance for these foreign investors in order to lift the burden they would bear."***

Particularly, foreign (meaning Western) investments is crucial in securing the economic, political and military security of Ukraine as they could act as a bumper, hinder Russia's expansionist policy and help Ukraine restore its economy and territorial integrity while



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- <sup>i</sup> The Association Agreement consists of four chapters, including Common Foreign and Security Policy; Justice and Home Affairs; the Deep and Comprehensive Free Trade Area; and a fourth chapter covering a range of issues such as environment, science, transportation, and education. Full text of the Agreement at [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22014A0529\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22014A0529(01)&from=EN).
- <sup>ii</sup> FÜLE, Stefan. Speech at the meeting of the EU-Ukraine Parliamentary Cooperation Committee. Available at: [http://europa.eu/rapid/press-release\\_SPEECH-12-448\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-12-448_en.htm).
- <sup>iii</sup> The Association Agreement has meant a way out of Russia's sphere of influence and paved the way to become an independent and democratic member of the "European family". Ukrainian representatives (even Viktor Yanukovich who came under pressure from Kremlin at the end of 2013) were aware that not signing the Association Agreement meant an end to "Ukraine's near-term prospects for a deeper relationship with the European Union" (PIFER, Steven. *The eagle and the trident: U.S.-Ukraine relations in turbulent times*. Washington, D.C.: Brookings Institution Press, 2017. ISBN 978-081-5730-408, p. 297). For Ukraine, the reduction (or elimination in some cases) of tariff and non-tariff barriers to bilateral trade will make the access to the EU market easier and increase its exports capacity. Liberalized imports, on the other hand, will make domestic industries more efficient. "The imposition of stricter EU requirements will lead to higher quality of products. Regulatory approximation is expected to result in a more supportive and stable business environment". (Benefits and Costs of DCFTA: Evaluation of the Impact on Georgia, Moldova and Ukraine. In: ADAROV, Amat a Peter HAVLIK. Joint Working Paper. The Vienna Institute for International Economic Studies Wiener Institut für Internationale Wirtschaftsvergleiche and Bertelsmann Stiftung, 2016. Available at: <http://dcfta.md/uploads/0/images/large/ez-studie-benefits-and-costs-of-dcfta-2017-eng.pdf>, p. 22). As James Sherr put it, "the EU is not operating in a vacuum. EU Association and the DCFTA are no longer the only viable integration projects on offer." (SHERR, James. *Russia and Eurasia 2013/05: Ukraine and Europe: Final Decision?* Chatham House, 2013, Available at: [https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0713pp\\_sherr.pdf](https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0713pp_sherr.pdf), p. 3). Therefore, despite its "governance and conditionality in negotiations with Ukraine", the EU did not have space and time to play "hard to get", it had to act fast and precisely not loose Ukraine to Russia and EEU.
- <sup>iv</sup> DE MICCO, Pasquale. *When choosing means losing: The Eastern partners, the EU and the Eurasian Economic Union*. 2015. ISBN 978-92-823-6744-5. Available at: [http://www.europarl.europa.eu/RegData/etudes/STUD/2015/549026/EXPO\\_STUD%282015%29549026\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/549026/EXPO_STUD%282015%29549026_EN.pdf), p. 62. On the other hand, the EAEU does not force its members to increase "its standards of governance, reform its system of justice, strengthen property rights or apply EU criteria of 'best practice' to the relationship between business, the consumer and the state. It is not a blueprint for either democratization or economic reform, and this gives it an elementary appeal to many who fear for their political power and economic dominance if the provisions of the DCFTA are applied. Yet for the same reason, entry into the ECU could be the death knell for those who for twenty years have worked to make Ukraine a 'full member of the European family of civilised nations'", argues James Sherr (SHERR, James. *Russia and Eurasia 2013/05: Ukraine and Europe: Final Decision?* Chatham House, 2013, Available at: [https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0713pp\\_sherr.pdf](https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0713pp_sherr.pdf), p. 4).
- <sup>v</sup> SAMOKHVALOV, Vsevolod. *Ukraine between Russia and the European Union: Triangle Revisited*. In: ADAROV, Amat a Peter HAVLIK. *Europe-Asia Studies*. The Vienna Institute for International Economic Studies Wiener Institut für Internationale Wirtschaftsvergleiche and Bertelsmann Stiftung, 2015, pp. 1371-1393. DOI: 10.1080/09668136.2015.1088513. ISSN 0966-8136. Available at: <http://www.tandfonline.com/doi/full/10.1080/09668136.2015.1088513>, p. 1380 – 1382.
- <sup>vi</sup> According to President Putin, Ukrainian adoption of EU standards would hinder Ukrainian – Russian trade relations due to different technical standards, even if this were not to be the case as such standards would apply only to goods exported to and from the EU, and not Russia. Another argument was that a free trade space between the EU and Ukraine would lead to a closure of the Ukrainian market to Russian goods and to the Russian market being flooded with low-quality Ukrainian goods and with (more competitive) EU goods labelled as "Ukrainian goods" and entering Russia due to the free trade policy between Ukraine and Russia. In this case, Russia deliberately ignored WTO rules of origin determining the national source of a product, since any goods crossing the EU-Ukrainian border would still be subject to import tariffs into a third country, applied to the exporting EU member state. Putin's full speech in Minsk: *Выступление на встрече глав государств Таможенного союза с Президентом Украины и представителями Европейского союза*. 2014. Available at: <http://kremlin.ru/events/president/transcripts/46494>.

- vii Amendments to the Association Agreement upon the request of a third side are unacceptable - Klimkin and De Gucht. Mission of Ukraine to the European Union, 2014. Available at <http://mfa.gov.ua/en/news-feeds/foreign-offices-news/28571-venesennya-zmin-do-ugodi-pro-asociaciju-na-vimogu-tretvoji-storoni-je-neprijnyvatnimpklimkin-ta-kde-gucht>.
- viii Since Russia became a member of WTO in August 2012, it launched six trade complaints, all of them either against the EU or Ukraine. More on particular disputes at General Overview of Active WTO Dispute Settlement Cases Involving the EU as Complainant or Defendant and of Active Cases Under the Trade Barriers Regulation. 2016. Available at [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154243.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154243.pdf).
- ix Ambassador DOUDECH, Walid. Note on the Meeting of 29 June 2017: Deep and Comprehensive Free Trade Area Concluded as a Part of the Association Agreement between the European Union and Ukraine (Goods and Services). 2017. Available at: [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-DP.aspx?language=E&CatalogueIdList=237813,237777,237542,237512,237496,237511,237501,237498,237145,237161&CurrentCatalogueIdIndex=5&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=False](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=237813,237777,237542,237512,237496,237511,237501,237498,237145,237161&CurrentCatalogueIdIndex=5&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=False).
- x Ibid.
- xi Ibid.
- xii Press Release: The National Bank of Ukraine revises its previous macroeconomic forecast considering the effects of the ban on trade with the certain areas of Donetsk and Luhansk oblasts. 2017. Available at: [https://bank.gov.ua/control/en/publish/article?art\\_id=45199781&cat\\_id=76291](https://bank.gov.ua/control/en/publish/article?art_id=45199781&cat_id=76291).
- xiii According to the figures by UKRSTAT, since the implementation of the Association Agreement, the share of the foreign trade turnover with Russia has decreased (from 20,8 % in 2014 to 11,6 % in 2016) while the trade share with the EU has grown by 8.1 % in 2016. More on European Union External Action: Latest statistics: Ukraine's trade with the EU boosted by the first full year of the Association Agreement. 2017. Available at: [https://eeas.europa.eu/headquarters/headquarters-homepage/21194/latest-statistics-ukraines-trade-eu-boosted-first-full-year-association-agreement\\_en](https://eeas.europa.eu/headquarters/headquarters-homepage/21194/latest-statistics-ukraines-trade-eu-boosted-first-full-year-association-agreement_en).
- xiv VoxUkraine. 700 Days of Monitoring Reforms in Ukraine: Ministries' Rating: Which ministries contributed most to the progress of economic reforms in the country. 2017. Available at: <https://voxukraine.org/2017/02/17/700-days-of-monitoring-reforms-in-ukraine-ministries-rating/#/>.
- xv LOUGH, John a Iryna SOLOMONENKO. Can Ukraine Achieve a Reform Breakthrough?. Ukraine Forum, 2017. Available at: <https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2016-04-05-ukraine-reform-breakthrough-lough-sononenko-final2.pdf>, p. 20.
- xvi UKRAINE REFORM MONITOR TEAM. Ukraine Reform Monitor: April 2017. Ukraine Forum, 2017. Available at: <http://carnegieendowment.org/2017/04/19/ukraine-reform-monitor-april-2017-pub-68700>.
- xvii Alternative Report from Evaluation of Effectiveness of Implemented State Anti-Corruption Policy. 2017. Available at: [http://pravo.org.ua/img/zstored/files/AZ\\_final.pdf](http://pravo.org.ua/img/zstored/files/AZ_final.pdf), p. 58 - 60
- xviii The document is based on the Military Doctrine of Ukraine and NATO-Ukraine Partnership Goals and "provides for the active participation in the implementation of the Common Security and Defense Policy of the European Union and active cooperation with NATO in the achievement of criteria necessary for the full membership in NATO " President approved Strategic Defense Bulletin of Ukraine. 2016. Available at <http://www.president.gov.ua/en/news/prezident-zatverdiv-strategichnij-oboronnij-byulet-en-ukrayin-37309>.
- xix Fight of Ukraine for Decentralisation. 2017. Available at: <http://www.kas.de/ukraine/ukr/publications/48204/>.
- xx Post-Maidan Constitutional Changes. 2016. Available at: <http://www.ucipr.org.ua/publicdocs/constitution%20site.pdf>, p. 9-11.
- xxi German Advisory Group Ukraine, DCFTA implementation in Ukraine: Assessment after one year. 2017. Available at: [http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2017/05/Newsletter\\_103\\_2017\\_German-Advisory-Group.pdf](http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2017/05/Newsletter_103_2017_German-Advisory-Group.pdf), p. 1.
- xxii Ibid.