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**The EU-Ukraine relations: from partnership to  
'real' integration**

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# The EU-Ukraine relations: from partnership to 'real' integration

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The biggest wave of EU enlargement is over and the impact for Ukraine is not critically negative on the whole. The evidence reveals the decrease of trade flows with the new EU members and the difficulties for people-to-people contacts after the introduction of new border-crossing regime and stricter visa policy on Ukraine. On the other hand, sharing a border with the EU brought new opportunities for Ukraine. The EU-Ukraine relations developed from partnership of the beginning of 1990s to a more advanced form of cooperation. A number of steps made on both sides allow concluding that the parties are moving towards 'real integration'. The period of mutual dissatisfaction and disillusionment is over. The EU and Ukraine are concerned with bigger problems. The EU is facing the institutional crisis and the economic growth in a number of old member states is slowing down. Ukraine has yet to find a credible model for its political and economic transformation.

This article looks back at the EU-Ukraine relations of the beginning of 1990s up to the year 2004, which paved the way to 'real integration' between the two parties. It describes the new context, in which both the EU and Ukraine have found themselves and unpacks the main factors that have shaped the current relations and that will continue to influence the future EU-Ukraine relations. The concluding part provides an overview of possibilities that Ukraine's deeper integration with the EU may bring and speculates on how these possibilities may be turned into solutions for meeting the challenges of globalization and for solving internal problems on both sides.

## **The EU-Ukraine relations before 2004**

### *Being in a 'grey zone'*

From the very beginning of Ukraine's independence, the country found itself in a 'virtual isolation' from the West (Pavliuk, 1998). Its departure from the Soviet Union was perceived as a mistake or a temporary phenomenon, with Russia striving to maintain Ukraine's image as a satellite. With reforms lagging behind, Ukraine found itself being locked in a 'grey zone'. Being in Russia's sphere of interests informed the attitude of the West towards Ukraine. The reluctance of the EU to admit Ukraine on the track of accession helped prove Ukraine's place in a basket with Russia. As a result country's transformation was assessed through the one-size-fits-all approach applied to the 'grey zone' of the former Soviet Union (FSU).

### *Between East and West*

Ukraine's dependence on Russia's energy resources and exports markets made the former to always look back at Russia. Since 1991 Ukraine was dragged into different types of integration arrangements with Russia. At the same time, Ukraine has proclaimed a 'European choice', which forced it to seek deeper relations with the EU. However, despite the declared European choice and its geo-strategic importance, the EU has been reluctant to put Ukraine on accession track. Having two big partners on both sides, Ukraine was doomed to balance between them.

### *The PCA had not become a motor for anything very substantial*

Ukraine was one of the first former CIS countries to sign a Partnership and Cooperation Agreement with the EU in 1994. The agreement aimed at assisting the consolidation of country's democracy and the development of its economy. It regulated the political, economic and cultural relations and the bilateral trade between the EU and Ukraine. The PCA came into force in 1998 only, as it took the parliaments of the member states almost four years to ratify the agreement.

By and large the structure of the PCA resembled the structure of the Europe Agreements signed by the EU and the Central and Eastern European countries (CEECs). Nonetheless, the PCA did not become a motor for change in Ukraine. A few distinctive features informed the insignificant impact of the PCA on country's transition. The agreement was almost non-conditional. Hence, it did not provide incentives for reform. A membership perspective was excluded, while the major PCA 'carrot' – a free trade area – was foresaw only upon full implementation of the agreement. The implementation has been monitored by two sides separately and the results of these assessments differed dramatically. The Ukrainian side was claiming successful implementation and a significant degree of compliance with the EU acquis; whereas the European was accusing its partner in applying discriminatory measures affecting EU exports as well as for poor enforcement of PCA-related legislation. Only five years after the ratification, both sides agreed to make a joint assessment of PCA implementation. The report highlighted some positive developments on the Ukrainian side while emphasizing the need for more progress in a number of areas (e.g. political cooperation, judicial reform, economic reform).

Ukraine sought integration with the EU without Europeanization, i.e. without 'extensive change to institutions and policies at the domestic level in line with EU's more or less explicit targets' (Wolczuk, 2004). Given that Ukraine's non-compliance with EU requirements bear no costs, the ruling elites failed to find incentives for the implementation of the PCA and coherent domestic reforms. The fear of ruling elites to have much more limited policy choices in case of deeper integration with the EU overweigh the attractiveness of potential technical assistance and FDI flows, which could spring up if Ukraine was put on accession track.

#### *The impact of EU's technical assistance to Ukraine*

The EU's technical assistance has been granted to Ukraine since 1991 when the Tacis Programme was launched for Ukraine and other FSU countries. The programme aimed at enhancing the transition process in the countries. Although the TA was remotely mentioned in the PCA, it had no links with government's

reform agenda. The EU's assistance to the candidates has played a significant role in their democratic and economic transformation. Despite relatively similar amounts, the TA for Ukraine produced less tangible results for country's transition. Coupled with the lack of donor coordination, an ad hoc, non-systemic assistance in form of policy advice has resulted in a considerably slow transformation in any way (Nanivska V. and O. Shumylo, 2002).

The lack of unified strategy has created a technical assistance environment that was predominantly uncoordinated, untargeted, not monitored and non-collaborative. Receiving EU's aid was a new phenomenon for Ukraine. There was no necessary government and civil structures to ensure that aid was used effectively. Civil servants lacked skills to identify country's needs for TA as well as the lack of administrative capacity to partake in the development of donors programs. Furthermore, without a national strategy that would govern the design and implementation of TA in Ukraine, it was difficult to provide benchmarks against which project implementation, outputs, and outcomes could be measured. Such lack of criteria disabled technical assistance from achieving sustainable results.

#### *Trade cooperation and FDI*

The EU made a number of positive step in terms of granting Ukraine's goods a better access to its markets. Special agreements for trade in steel and textile have been signed in June 1996. Over the last decade the EU has become Ukraine's second largest trading partner, whereas Ukraine remains a small supplier of imports to the EU market. In 2003, the Ukrainian share of total extra-EU imports comprised only 0.7% (DG Trade, 2004). At the broad sectoral level, there are only two sectors where Ukraine's share of EU imports exceeds 1%: raw hides and skins, and iron and steel. Relative to other countries, EU imports from Ukraine are concentrated upon a small number of product lines. In 2003, an insignificant number of the available product categories were covered. The product structure of Ukrainian exports to the Commonwealth of Independent States (CIS) is considerably broader than that of exports to the EU.

European FDI flows towards Ukraine could also be improved. In 2004, FDI from the EU-25 was just more than \$465 million (National Bank of Ukraine, 2005). An improvement in the investment climate, notably through a more effective enforcement of adopted legislation and the completion of the reform process, is essential if Ukraine wants to attract more FDI. The main obstacles that investors have been facing (and still face) are frequent changes in regulations affecting foreign trade and investment, lack of transparency, incomplete enforcement of legislation, discriminatory regulations, corruption and red tape.

#### *Common Strategy – EU's vision vs. Ukraine's aspirations*

The next important milestone in the EU-Ukraine relations was the adoption of EU's Common Strategy on Ukraine in 1999. At that time the Ukrainian side has questioned the sufficiency of the PCA and sought EU's recognition of country's membership perspective (Pavliuk, 2001). However, the European side clearly pointed out that Ukraine should focus on domestic reform as well as on the PCA implementation. The Strategy aimed at supporting Ukraine's democratic and economic transition, and cooperating in order to meet common challenges (e.g. security, stability, environment, energy, nuclear safety). It acknowledged country's 'European aspirations' and welcomed its 'European choice'. However, it did not include a clause recognizing Ukraine's right to become a member of the Union pending its completion of the Copenhagen criteria.

The period before the 2004 enlargement was marked by EU's disillusionment with the lack of significant reform in Ukraine on the one hand, and by Ukraine's dissatisfaction with the lack of response to its membership aspirations on the other. As a result, the EU-Ukraine relations cooled down up almost up until the beginning of year 2004.

#### **New context for EU-Ukraine relations in the aftermath of 2004**

Both the European Union and Ukraine have found themselves in an absolutely new political and economic context of the recent years. A few major developments have influenced the EU-Ukraine relations.

The 2004 enlargement on ten new countries had significant implications for all Union's aspects, be they political, economic, budgetary, institutional, or social. At the same time the EU declared an objective of becoming a significant global player and one of the most competitive economies. However, the failure to ratify the Constitutional Treaty placed the EU in an institutional deadlock and incited to reflect about the Union's future. On top of this, the EU is facing the slowdown of economic growth as well as demographic crisis with the ratio of working age population to total population falling. Further enlargement to Romania and Bulgaria only diverts EU's attention from these internal problems. Moreover, the 2004 enlargement while moving the EU external border eastwards, urged the member states to thinking about the new neighborhood.

As far as Ukraine is concerned, the country has finally recovered from a deep economic recession of the beginning of 1990s. The world boom for steel coupled with a number of scattered economic reforms led to fast economic growth over the last few years. The country has been preparing itself for WTO accession, which by and large would be an important step forward in terms of integration into global economy. As far as democracy is concerned, the 2004 Orange Revolution clearly demonstrated the will of Ukrainians to make a break from the 'defective' to a real democracy. Further free and fair parliamentary elections in March 2006 re-confirmed the shift to democracy and market economy. However, these political breakthroughs resulted in breaking old ties with Russia. Having encountered the end of cheap energy imports from Russia and the decline of world steel boom, Ukraine was pushed into thinking about a new strategy for the economy.

#### *The impact of the EU enlargement*

The borders of the European Union has moved far eastwards after the 2004 enlargement. Given the unstable and underdeveloped neighborhood, the EU was forced to thinking about it. On the one hand, the EU was keen to keep membership of countries like Ukraine and Moldova off the agenda. On the other, there was a need to maintain stable and secure neighborhood, and to avoid the

emergence of dividing lines in Europe. For Ukraine the 2004 enlargement had a tangible passive leverage as it once again highlighted the benefits of inclusion and the costs of exclusion from the EU's circle.

#### *European Neighborhood Policy (ENP)*

The European Neighborhood Policy (ENP) was developed as a framework policy for the relations with the whole EU neighborhood, including Ukraine. The ENP was rather vague, albeit flexible, framework that stretched beyond existing relationships and offered a possibility for deeper political relationship and economic integration. The major 'carrot' of the ENP is a stake in the EU's Internal Market in response to significant reform on the Ukrainian side. By and large, this 'carrot' may serve as an incentive for Ukraine's compliance with EU's acquis. Although an accession perspective was not on offer, the ENP brought some positive tested developments through EU conditionality attached to bilateral Action Plans. The EU-Ukraine Action Plan (AP) was signed in spring 2005. It is a mutually agreed document that sets the agenda for country's economic and political reforms with clearly defined short and medium-term priorities. The implementation progress will be monitored and reported by the European Commission in the beginning of 2007.

Given the short time span of the ENP, it is difficult to assess the impact of its conditionality on Ukraine's transformation. However, it holds true that that the ENP laid the foundation for Ukraine's deeper integration with the EU. The inclusion of the political Copenhagen criterion into the AP paved the way for further democratization. Regular monitoring of the Action Plan's implementation in a manner similar to Commission's Regular Reports on accession countries may make noncompliance more costly for the Ukrainian side.

#### *The European Neighborhood and Partnership Instrument (ENPI) – assistance for compliance?*

The general EU's assistance to Ukraine is still provided under TACIS program. In terms of thematic programs it is covered by the European Initiative for

Democracy and Human Rights (EIDHR). The European Investment Bank is going to lend Ukraine and other TACIS beneficiaries around €500 million (1).

From the beginning of the new financial perspective in 2007, the assistance to Ukraine will be provided through the European Neighborhood and Partnership Instrument (European Commission, 2004). The EU claimed that the ENPI would be more flexible and policy-driven instrument. It should aim at assisting Ukraine and other ENP countries in the implementation of Action Plans' priorities. The new forms of TA, which proved to be successful in the accession countries, were offered to Ukraine. The Ukrainian side will receive a targeted expert assistance via the Technical Assistance and Information Exchange office (TAIEX) and long-term twinning arrangements with EU member states administrations. The new assistance priorities will be identified in cooperation with the Ukrainian side and linked to the priorities of the EU-Ukraine Action Plan.

The spread of the above-mentioned TA instruments is a positive step from the EU's side. However, at present, EU's technical assistance is not yet designed to directly support the implementation of the EU-Ukraine Action Plan. The coordination of ENPI objectives and the Action Plan priorities are envisioned only starting from 2007 (when the new EU financial perspective commences). Given that the Action Plan will be almost fully implemented by this time, it is important to redirect ENPI assistance for the fulfillment of further objectives, i.e. reforms needed to ensure Ukraine's compliance with the *acquis* and to help the country get an access to the EU's Internal Market.

#### *The consequences of Ukraine's Orange Revolution*

Although the Orange Revolution did not cause the dramatic shift in EU's attitude towards Ukraine, it informed the creation of a new plan for relations with the country. First of all, the EU introduced an additional conditionality for deepening the relations. Early consultations on an EU-Ukraine enhanced agreement would start as soon as the political priorities of the Action Plan have been addressed. Ukraine was invited to align itself with EU's positions/statements on international issues. Moreover, the country was invited for closer cooperation in the framework

of foreign and security policy and ESDP operations. The participation of Ukraine in settling Transnistria conflict is one of the examples of such cooperation. In May 2005 Ukraine scrapped visas for citizens of the EU, US and Japan. In response, the EU launched negotiations on visa facilitation for certain groups of Ukrainian society (e.g. students, university professors, businessmen, researchers) and continued negotiations on an EU-Ukraine readmission agreement. On the economic side, Ukraine received EU's support for WTO accession and a promise to start negotiations on an EU-Ukraine free trade agreement. On top of that, the instruments for EU's technical assistance for Ukraine would be borrowed from accession process (i.e. TAIEX and twinning), the financial assistance to Ukraine will be increased and the access to European Investment Bank (EIB) would be maximized up to €250 million (2).

*December Summit – first steps towards real sectoral integration*

The EU-Ukraine summit held in December 2005 was remarkable for summarizing the results of cooperation in the aftermath of the Orange Revolution and for defining priorities for sectoral integration. An excellent feature of the Summit was the number of specific results and agreements that came out of it (International Centre for Policy Studies, 2005).

The EU announced that it was granting Ukraine the so-desired market economy status. Furthermore, the two sides signed a Memorandum of understanding on cooperation in the energy sphere, which expanded the opportunities to export Ukrainian electricity to the EU. An Aviation Agreement was signed with the aim of opening up the Ukrainian market to all European airlines and establishing EU standards for civil aviation in Ukraine. An Agreement on civilian satellite navigation, which opened the door to Ukraine joining the GALILEO Satellite Navigation System, was also signed. The EU welcomed Ukraine's progress in the implementation of further democratic and economic reforms.

The EU presented a progress report on the implementation of the EU-Ukraine Action Plan in 2005 (European Commission, 2005). According to EU's assessments, the implementation, which encompassed a wide spectrum of areas

of cooperation, has demonstrated significant progress, especially in the political area and in terms of alignment with EU positions of regional and international relevance. Ukraine's steps towards consolidating the rule of law, such as reform of the customs services and removing pressure on the mass media were greeted. A significant progress was also admitted in various trade-related areas, such as automobiles, SPS and public procurement. However, the EU stressed on the need to improve systematic flaws (e.g. corruption, lack of real opposition, lack of independent judiciary), to create a clear-cut economic policy, and to improve the business climate. Last but not least, the EU confirmed its readiness to start consultations in a number of areas that ranged from free trade area to visa facilitation and readmission, and to a new enhanced agreement to replace the PCA.

### **What is in the future?**

#### *Focus on regional integration – a possible solution for both sides*

Not being a natural resource-based economy, Ukraine has little chance of becoming prosperous and competitive economy without openness and integration into regional and global arrangements (Emerson, 2006). Unfortunately, neither WTO accession nor the participation in the Common Economic Area with Russia, Belarus and Kazakhstan individually provides for such outcome. On the other hand, the EU could provide such model via a free trade agreement, if certain conditions are met on the Ukrainian side.

The decade of multidimensional foreign policy of Ukraine is over. No country can stay closed from the rest of the world and be immune from challenges of globalization. Ukraine must accept the challenges that are brought by globalization and identify country's transitional needs. For both tasks there is a need for proper instruments to be found. Regional integration or in other words, regional trading blocs, could be one of the solutions to challenges of globalization. During the last decades the forms of regional integration advanced from simple reduction of tariffs for trade in goods to more open arrangements that aimed at bolstering its members' economies (OECD, 2001). The evidence proves that

regional integration could help oppose risks of globalization and turn them to advantage.

However, a few caveats should be added to the debate. Both the EU and Ukraine should ask themselves a number of questions while thinking about the future of EU-Ukraine relations. The EU could assess its current and future needs and analyze how Ukraine could help meeting globalization challenges and turning them into advantages. For instance, Ukraine can become a reliable partner in promoting trade between the EU and Asia via inter-regional networks that will pass through Ukraine. Moreover, Ukraine could integrate into supply chains of European companies and become a rapid supplier of major inputs. Last but not least, Ukraine with its 40 million population presents an attractive market for goods and services produced by EU's companies.

Being a part of any regional arrangement Ukraine should seek the enhancement of country's security in relation to the rest of the world, the strengthening of its bargaining power and the 'lock-in' effect for domestic reform agenda. Moreover, while seeking deeper integration with an already existing regional arrangement or creating a new one, Ukraine should look at the depth and the width of integration within this arrangement and weigh them against feasibility and cost/benefit for the country.

*EU-Ukraine Deeper Free Trade – a tool for Ukraine's transition and an open door for EU's industries facing globalization challenges*

The evidence suggests that the combination of economic openness to the EU, convergence on EU standards and proximity to EU's Internal Market may lead to a sustainable growth path for Ukraine. The first step for Ukraine's deeper integration with the EU, i.e. WTO membership, is yet to be made. At the same time, WTO membership is not a panacea for the increase of trade flows between the EU and Ukraine as well as for the modernization of Ukraine's economy and for the improvement of country's economic governance. Despite relatively low tariffs on both sides, EU-Ukraine trade flows are hindered by non-tariff and non-border barriers, such as the administrative barriers to business activities and a dubious

investment climate. Given the limited degree of policy harmonization under the WTO accession rules, the majority of the barriers are still to be fixed with the help of other instruments (Shumylo, 2006).

In this case, the EU could help by signing a free trade agreement with Ukraine. The variety of existing EU's free trade agreements range from simple free trade (e.g. with the Mediterranean countries) to complete market integration (e.g. within the European Economic Area, EEA) (Shumylo, 2006). The former implies the abolition of customs tariffs for trade in goods, whereas the latter covers 'four freedoms' and entails full compliance with EU internal market acquis and mutual recognition. Since the membership perspective for Ukraine is not on EU's agenda, the country is free to choose how far or how fast to converge on EU regulatory rules and technical standards.

The compliance with EU's acquis also leads to the question of costs imposed by compliance. Therefore it is important to assess Ukraine's overall objectives, weigh them against the costs of compliance, and select the more efficient scope and sequencing for compliance with the EU acquis. The main caveat is that the alignment with EU standards should be driven by country's needs, i.e. modernization of economy and improvement of economic governance. When choosing an optimal format for an EU-Ukraine FTA, it is important to seek for a trade-off between the feasibility vs. the benefits for both sides.

A number of policy options for an EU-Ukraine free trade agreement were analyzed in a recent independent study on the feasibility and economic impact of an FTA (3). The conclusion was made that the most beneficial option, albeit not easiest in terms of its feasibility, would be a *deep free trade package*, that implies free trade in goods and services coupled with a large set of priority actions (4). If well-designed and fully implemented, a deep FTA may influence the rapid and sustainable growth and help Ukraine restructure into an energy-efficient economy. On the EU's side, the economic effect of the deep free trade will bring minor benefits. However, it may bring new opportunities for the EU industries that are

being confronted with the challenges of globalization and the competition from Asia.

*New enhanced agreement to replace the PCA*

It is quite early to speculate about the form and the content of the new enhanced agreement to replace the PCA. For the moment it is clear that the Turkish issue, the constitutional deadlock, and the fear of uncontrolled migration, will not allow the EU to take Ukraine outside of the ENP framework and offer it a membership perspective (so desirable by some Ukrainian politicians). It is most likely that the EU will seek for a formula that will be based on incentives for reform in Ukraine and economic benefits of cooperation coupled with more effective technical assistance. It is very likely that a free trade agreement will become the basis of the new agreement. Given the advanced cooperation in the area of foreign and security policy, it is hard to predict further width of the new agreement in this respect.

The formal recognition of Ukraine's membership perspective would not help country's transformation, whereas the 'real' integration, i.e. the compliance with EU norms and access to EU's Internal Market would bring significant benefits for Ukraine (Bobitski, 2006). In drafting a new agreement with the EU, Ukraine should set up the following goal: the agreement must help create a 'lock-in' effect for domestic reforms and cut the rent-seeking possibilities, whereas on the external side, it must send a signal to foreign investors and lower country's risk premium. On the European side, it is important that the new agreement ensures Ukraine's transformation into a credible full-fledged partner to help the EU achieve its goals and meet the challenges of globalization.

## End notes

1. [http://europa.eu.int/comm/external\\_relations/ceeca/tacis/index.htm](http://europa.eu.int/comm/external_relations/ceeca/tacis/index.htm)
2. The activities mentioned above were initiated by Javier Solana High Representative for the Common Foreign and Security Policy in the so-called 'ten points' for closer cooperation between the EU and Ukraine
3. Centre for European Policy Studies (Brussels), the Institute of World Economy (Kiel) and the International Centre for Policy Studies (Kyiv) prepared a report on feasibility and economic impact of an EU-Ukraine Free Trade Agreement. For full report please visit [www.ceps.be](http://www.ceps.be)
4. For example, reform of customs services, product standards, adoption of sanitary and phyto-sanitary rules, convergence of regulatory policies, financial services reform, civil aviation cooperation, road transport cooperation, complete openness of telecommunications sector, extensive compliance with acquis in the energy sector, adjustment of competition policy to that of the EU, etc

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