

# Ukraine's Regional Integration: Reasonable Diversification

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In October Ukraine made an important step towards establishing tighter regional ties with its major neighbours, the EU and the CIS. On one hand, officials announced the completion of negotiations on deep and comprehensive free trade agreement (DCFTA) between the EU and Ukraine. On the other hand, Ukraine signed a Free Trade Agreement with the CIS states.

If both agreements are successfully ratified and implemented, they will definitely benefit Ukraine facilitating its trade with key partners that together account for more than two thirds of its foreign trade.

The ratification of the CIS agreement depends mostly on the political will of the signatory parties. The previous FTA agreement in the framework of the CIS was signed in 1994, but it never worked properly as several signatory parties including the Russian Federation had not ratified it. The destiny of the DCFTA with the EU is related to at large the completion of talks on the Association Agreement (AA) between the EU and Ukraine, in which the DCFTA is embedded. At present, it is hard to say when the AA talks will be completed.

Both agreements formally provide the same level of regional integration, providing for free trade. However, de-facto they are quite different.

The FTA between the CIS countries signed by all CIS members excluding Azerbaijan, Uzbekistan and Turkmenistan can be tentatively characterised as a framework agreement, as it adds little to the existing status-quo. At present, trade regimes within the CIS are defined by a network of bilateral FTAs. These FTAs focused on trade in goods, and are aimed at establishing duty-free trade with certain exemptions. None of these bilateral FTAs covers the services sectors or the majority of other trade-related topics. The same is true about the Agreement signed in October 2011, which is a purely trade-in-goods agreement with most of the exemptions contained in bilateral FTAs are to be retained in the CIS FTA.

There are two key benefits for Ukraine from signing the CIS FTA. Firstly, it postulates that the trade in goods within the CIS will be governed by the WTO principles and practices. For instance, it envisages that technical regulation within the CIS FTA will be based on the WTO Technical Barriers to Trade Agreement, thus giving impetus to a new phase of technical regulation harmonisation within the CIS on the basis of international, including European, practices. The adoption of a unified regulatory platform for trade among countries, some of which are not members of the WTO, will help reduce costs associated with non-tariff trade measures and thus facilitate trade flows. Secondly, this Agreement by reconfirming the interest of the member countries in free trade can potentially serve as an additional guarantee against building up trade barriers within the CIS.

The DCFTA with the EU is much more ambitious. This treaty not only envisages much better access for Ukraine's exports to the largest regional market, but also has important institutional and regulatory consequences, ensuring harmonisation of Ukraine's trade-related regulatory norms and practices with the European ones. The significant changes are foreseen in such spheres as the competition policy, state aid, public procurement, sanitary and phyto-sanitary measures, technical regulation and SPS measures, protection of intellectual property rights, sustainable development (ecological issues, labour and social issues), etc. When implemented, the DCFTA with the EU will bring a range of important benefits, including:

- Improved welfare of Ukrainian people through better access to a wider variety of products, stricter safety requirements for products on domestic market, and higher incomes thanks to new business opportunities and improved domestic resource allocation. The CGE modelling showed that the establishment of the DCFTA will result in 4.3% improvement in welfare in the medium term;
- Duty-free access to one the world's largest market for vast majority of products, which will create

considerable opportunities for Ukraine's exports;

- Improved access to markets of the third countries through harmonization of standards with the EU and thus acquisition of internationally acceptable standards;
- Better domestic investment climate, as the adjustment to the EU regulations will trigger changes in the national legislation. In turn, these changes should result in the establishment of a transparent set of rules familiar to foreign investors, therefore making the domestic environment more attractive and stimulating investment inflow and economic growth.

These gains, however, will come at important short-term costs, including:<sup>1</sup>

- Increased competition on the domestic market due to the elimination of tariff barriers and significant reduction of non-tariff measures resulting in market restructuring and reallocation of production factors. Although higher competition is definitely beneficial for the country in the medium-term, short-term effects of reallocations could be painful;
- Higher costs of standard obedience, as the EU standards are generally more stringent and thus compliance with them will require more effort and expenses. The experience of Poland shows that higher standards can even drive some business out of specific market segments;
- Spending associated with legal and administrative adjustments like the establishment of independent regulatory bodies, introduction of new – likely technologically more advanced – procedures, etc.

For Ukraine, the DCFTA with the EU and the CIS FTA complement each other, and their successful implementation will ensure that the country gains preferential access to markets of its major trading partners without having to undertake much more binding trade policy commitments associated with the membership in any customs union.

<sup>1</sup> Movchan V., Guicci R. (2011) "Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan" Policy Paper 05, November 2011. Available at: [www.ier.com.ua](http://www.ier.com.ua)