

## A Fork in the Road?

### UKRAINE BETWEEN EU ASSOCIATION AND THE EURASIAN CUSTOMS UNION

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The drama has accelerated over Eastern European integration projects. The EU announced that comprehensive Association Agreements are ready to be signed with Ukraine and initialed with Moldova, Georgia, and Armenia during this November's EU Eastern Partnership (EaP) summit in Vilnius. In parallel, Russia has increased pressure on Ukraine and other EaP states to join the Eurasian Customs Union, which is expected to be transformed into the Eurasian Union by 2015. At the time of writing, Armenia has accepted the Russian deal while the others appear to be staying on the EU track. What are the details, limits, and expected outcomes of these two offers? Can Ukraine and other post-Soviet states progress in their European integration bids while maintaining good relations with Russia?

#### **Europe's Offer**

The EaP summit is scheduled for November 29-30 in Vilnius, Lithuania. It is supposed to open up a new era in the EU's relations with six of its eastern neighbors – Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. The most optimistic assessment is that Ukraine will sign an Association Agreement at the summit, with Moldova, Georgia, and Armenia all initialing agreements (i.e., initiating the accession process). The summit could mark an important threshold: if substantial progress is demonstrated, the entire EaP policy will gain new energy. If not, the policy is likely destined for failure.

The Association Agreements, which include Deep and Comprehensive Free Trade Areas (DCFTAs), are intended to promote the gradual integration of signatories into EU market structures, albeit lacking formal EU membership prospects. This model of engagement, including political association and economic integration, has been developed throughout the negotiation processes, beginning with Ukraine as a pilot country in 2007, even before the official launching of the EaP program.

The EU-Ukraine Association Agreement is currently the only one that has been fully leaked<sup>1</sup> and afterwards officially released. Full texts of the other agreements are currently not publicly available, but the main elements are the same as the Ukrainian one.

The Association Agreement is the most extensive international legal document in the entire history of EaP states and the most extensive international agreement with a third country that the European Union has ever concluded.<sup>2</sup> The scope of EU legal aspects (the *acquis*) contained in annexes to the EU-Ukraine Association Agreement and which are to be incorporated into Ukrainian legislation, above all the DCFTA, is unprecedented. The wording and requirements are very close in nature to the documents that candidates for EU membership have been required to fulfill. The EU-Ukraine Association Agreement could become a beacon for socially significant reforms ensuring the irreversibility of Ukraine's European integration.

The implementation of the Association Agreement will contribute to the convergence of the regulatory frameworks of Ukraine and the EU, resulting in the elimination of not only customs duties but also non-tariff barriers to trade. This will facilitate Ukraine's integration into the European economic and legal space, in particular the EU's internal market and the European Economic Area.

Ukraine's Association Agreement was initiated in July 2012. Unfortunately, the deteriorating atmosphere of EU-Ukraine relations has cast doubt on the prospects that the agreement will actually be signed. In December 2012, the EU Council stipulated that Ukraine needs to meet certain conditions in order for the Association Agreement to be signed.<sup>3</sup> These include ending selective justice (including, essentially, the release of former prime minister Yulia Tymoshenko from jail), improving election legislation (based on the judgments of the Council of Europe's Venice Commission), and implementing reforms in line with previously adopted commitments.

The EU will be able to sign the Association Agreement only by agreement of the Council of the European Union, i.e., by unanimous decision of the governments of EU member states. As of August 2013, there is a lack of consensus within the EU on the matter of signing the Association Agreement with Ukraine. There is a real chance that one or member states will not agree to the agreement being signed. The next few months will be decisive.

### **Russia's Offer**

The Russian Federation has been promoting the Eurasian Customs Union as its main strategic initiative in the post-Soviet space, aiming to structure the region in line with its updated vision of Russia's own regional and global role. The existence of the Customs

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<sup>1</sup> "Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part"

([http://glavcom.ua/pub/2012\\_11\\_19\\_EU\\_Ukraine\\_Association\\_Agreement\\_English.pdf](http://glavcom.ua/pub/2012_11_19_EU_Ukraine_Association_Agreement_English.pdf)).

<sup>2</sup> See "EU-Ukraine Association Agreement: Guideline for Reforms," KAS Policy Paper 20, Konrad-Adenauer-Stiftung, 2012 ([http://www.kas.de/wf/doc/kas\\_32048-1522-2-30.pdf?120911173352](http://www.kas.de/wf/doc/kas_32048-1522-2-30.pdf?120911173352)).

<sup>3</sup> Council conclusions on Ukraine 3209th FOREIGN AFFAIRS Council meeting, Brussels, December 10, 2012 ([http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/EN/foraff/134136.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/134136.pdf)).

Union “means that the EU is not the ‘only game in town’ and presents a normative challenge to it.”<sup>4</sup>

The Customs Union came into existence on January 1, 2010, with Belarus, Kazakhstan, and Russia as members. It was launched as a first step toward forming a Eurasian economic alliance of former Soviet states. In 2015, it is supposed to be transformed into an entity called the Eurasian Union.

Ukraine is the principal target of the Russian policy aimed at continued Customs Union expansion. During recent visits to Ukraine, Russian President Vladimir Putin has made the Customs Union the keystone of his dialogue with Ukrainian President Viktor Yanukovich. During his last visit to Ukraine at the end of July, Putin unexpectedly attended a “pro-Eurasian” NGO conference in Kyiv and spoke of the “pragmatic need” for Ukraine to join the Customs Union in order to solve Ukraine’s economic problems. These latest efforts by Russia’s leadership were spurred by the fact that Ukraine has a real chance to conclude an Association Agreement. Russian presidential aide Sergey Glazyev told the conference in Kyiv that Ukraine would not be able to participate in the Customs Union, or be an observer in the future Eurasian Economic Union, if it signed an Association Agreement. Some days later, Glazyev openly threatened to disrupt Russia’s existing free trade agreement with Ukraine if the latter were to sign an Association Agreement.<sup>5</sup> The Kremlin clearly sees real danger in the Association Agreement and is trying to derail it by any means.

Armenia became the first EaP country to (probably) be derailed from the EU-led Association track. Despite the fact that Association Agreement talks were finalized by Armenia and the EU in July, President Serzh Sargsyan announced after meeting with his Russian counterpart Vladimir Putin in Moscow at the start of September that Armenia was willing to join the Eurasian Customs Union and subsequently take part in the Eurasian Union. The EU reacted to this development by cautioning that Armenia’s inclusion in such integration processes was incompatible with its Association Agreement offer. According to media reports, Armenia’s decision is a “political boost for Putin, who is struggling to stop Ukraine from turning towards the European Union.”<sup>6</sup>

Under these circumstances, Kyiv’s hopes to build free trade regimes with both Russia and the EU—beginning with integration in the EU market while “partially” integrating in the Customs Union—appear naïve and disconnected from reality.

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<sup>4</sup> Rilka Dragneva and Kataryna Wolczuk “Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?” Chatham House Briefing Paper, August 2012 ([http://www.chathamhouse.org/sites/default/files/public/Research/Russia%20and%20Eurasia/0812bp\\_dragnevawolczuk.pdf](http://www.chathamhouse.org/sites/default/files/public/Research/Russia%20and%20Eurasia/0812bp_dragnevawolczuk.pdf)).

<sup>5</sup> Liga.net, “Rosiya zahrozhuje vlashtuvaty Ukraïni ekonomichnu katastrofu,” Liga.net, Sept. 17, 2013 ([http://news.liga.net/ua/video/politics/878148-ros\\_ya\\_zagrozhu\\_vlashtuvati\\_ukra\\_n\\_ekonom\\_chnu\\_katastrofu\\_v\\_deo.htm](http://news.liga.net/ua/video/politics/878148-ros_ya_zagrozhu_vlashtuvati_ukra_n_ekonom_chnu_katastrofu_v_deo.htm)).

<sup>6</sup> Euronews, September 4, 2013 (<http://www.euronews.com/2013/09/04/armenia-set-to-join-russia-led-customs-union-in-blow-to-eu>).

### **Memorandum of May 31 and “Observer” Status for Ukraine**

The debates regarding the extent of the possible entrance of Ukraine into the Customs Union finally led to a provisional agreement that led both Moscow and Kyiv to feel like they achieved their objectives. Last May in Minsk, Ukrainian Prime Minister Mykola Azarov signed a memorandum of cooperation between Ukraine and the Eurasian Economic Commission—the executive body of the Customs Union. It calls for the establishment of a permanent Ukrainian representative in the Customs Union, access for Ukraine to copies of the Customs Union’s documents (including drafts), and the right to submit its own proposals to the Commission. Further, it promises Ukraine future status as an *observer* in the Eurasian Union without clarifying the substance of this status. This gives both parties room to maneuver. In particular, Russia interprets this uncertain status as a temporary arrangement for incipient Customs Union members, while Ukraine perceives it as a long-term status implying no definite obligations.

Subsequently, informal negotiations regarding Ukraine’s possible selective implementation of certain Customs Union provisions and regulations began. This despite the fact that current Customs Union rules do not provide any form of selective implementation, only full-fledged membership. Ukraine declares it has no intention to violate its obligations to the WTO or the provisions of the Association Agreement. However, Russia has no interest in selective steps if they do not disrupt a future agreement with the EU. Finally, it was disclosed on August 26 after Ukraine-Russia intergovernmental consultations in Moscow that Russia would consider any form of selective integration with the Customs Union inappropriate if Ukraine signs an Association Agreement with the EU.

### **The Issue of Compatibility**

According to definition, a customs union is a trade bloc with a free trade area and a common external tariff and trade policy. Therefore, a country participating in any customs union cannot sign a free trade deal with a third country or group of countries separately from the rest of the union’s members. This means that only the customs union as a whole may conclude free trade agreements with external partners. Accordingly, if Ukraine or any other EaP state becomes a full member of the Eurasian Customs Union, this should mean that it would not be able to sign an Association Agreement/DCFTA, since the latter specifically regulates external tariffs.

But is it really true that Customs Union members cannot negotiate trade agreements with third countries? Within the framework of the WTO an interesting precedent occurred. Russia negotiated its WTO accession without Belarus and Kazakhstan, even though Russia was a Customs Union founding member. This was possible because Russia’s WTO accession and Customs Union formation processes were synchronized, so that tariffs accepted as part of Russia’s WTO obligations became the official external tariffs of the Customs Union. This procedure is impossible to replicate in the case of a DCFTA, unless Customs Union members are willing to reconsider all Customs Union tariffs. This would be an especially problematic task if a state were to

first sign a DCFTA and then start negotiations to join (fully or partially) the Eurasian Customs Union.

As stipulated by the Association Agreement, signatories will be obliged to “refrain from acts that would deprive the agreement of its object and purpose.” According to experts’ interpretation, this means that “Ukraine will have to refrain from participating in any integration formations the format of which would run counter to this legal obligation. These formats that are contrary to the Association Agreement include any formation of customs unions, economic unions, or common markets. At the same time, Ukraine’s participation in free trade area level formations with any third parties does not conflict with the Association Agreement.”<sup>7</sup>

However, Article 39 of the EU-Ukraine Association Agreement draft entitled, “Agreements with other countries” is more ambiguous:

*(1) This Agreement shall not preclude the maintenance or establishment of customs unions, free trade areas or arrangements for frontier traffic except insofar as they conflict with trade arrangements provided for in this Agreement.*

*(2) Consultations between the Parties shall take place within the Trade Committee concerning agreements establishing customs unions, free trade areas or arrangements for frontier traffic and, where requested, on other major issues related to their respective trade policy with third countries.*

Therefore, there is no direct ban on negotiations to join any customs union. At the same time, even a brief analysis of basic Eurasian Customs Union documents, especially “The single external tariff of the Customs Union,”<sup>8</sup> demonstrates deep differences between its norms and rules and those of the EU-Ukraine Association Agreement. Whereas according to the Association Agreement more than 98 percent of tariffs should be reduced to 0 percent within 10 years, the Customs Union maintains rather high tariffs with the EU, something previously negotiated in the EU-Russia bilateral protocol that preceded Russia’s WTO accession. In particular, the average aggregated customs tariff of the Customs Union in 2011 was about 8.51 percent. According to updated norms adopted in 2012, 29.12 percent of all tariffs were at 5 percent; 16.06 percent were at 10 percent; 18.89 percent were at 15 percent; and 4.89 percent of all tariffs were at 20 percent.<sup>9</sup> Considering that neither the Customs Union as a whole nor its members are negotiating trade agreements with the EU, these tariffs are unlikely to be changed in the foreseeable future.

This puts into question the practical compatibility of the Customs Union and an Association Agreement. The parties involved need to clarify whether the requirements

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<sup>7</sup> Konrad-Adenaur-Stiftung, “EU-Ukraine Association Agreement: Guideline for Reforms,” KAS Policy Paper 20, 2012 ([http://www.kas.de/wf/doc/kas\\_32048-1522-2-30.pdf?120911173352](http://www.kas.de/wf/doc/kas_32048-1522-2-30.pdf?120911173352)).

<sup>8</sup> Single Customs Tariff of the Customs Union (in Russian) (<http://www.tsouz.ru/db/ettr/ettwto/Pages/default.aspx>).

<sup>9</sup> Interfax-UA, August 23, 2012 (<http://interfax.com.ua/news/economic/115042.html>).

of the Eurasian Customs Union contradict those of the Association Agreement/DCFTA and, if so, to what degree.

In any case, even if in November Ukraine signs an Association Agreement (and one or more states initial an Association Agreement), Russia will not stop trying to undermine the integration of EaP states into EU-led frameworks. Ratification takes time, Ukraine's financial challenges are growing, and the country's political situation is unpredictable in advance of its February 2015 presidential elections. Other EaP countries have their own issues which cannot be solved without Russia's involvement.

The key question that remains is whether it is possible for post-Soviet Eastern European states to cultivate good relations with both Europe and Russia simultaneously? At the moment, there are no grounds to answer positively. This will pose an ongoing challenge to regional stability over the next decade.

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