EUROPEAN PARLIAMENT

STUDY

When choosing means losing

The Eastern partners, the EU and the Eurasian Economic Union

Author: Pasquale DE MICCO
Policy Department
Directorate-General for External Policies

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Abstract

The six countries in the EU's Eastern Partnership are sandwiched between two large, potent trading blocs: the EU to the west, and the Russian-led Eurasian Economic Union (EAEU) to the east. Most of the six have chosen to pursue a deeper alliance with one or the other bloc – a tough choice, reflecting both political and economic factors.

Georgia, Moldova and Ukraine signed Association Agreements with the EU on 27 June 2014. The Associations Agreements – which commit the countries to adopt high standards of governance, democracy, free markets and the rule of law – include 'Deep and Comprehensive Free Trade Areas' (DCFTAs). These free trade areas simplify exchanges of goods and services between the EU and the three countries, and they should – when coupled with reforms of governance – significantly improve growth in the countries over the long run.

Yet their move towards a closer alliance with the EU has come at a price. This price – not always calculated or even foreseen – is not the result of explicit obligations imposed by the EU; signatories of AAs and DCFTAs are free to pursue other covenants. But the countries' commitments to the EU may impede fluid trade with the Eurasian Economic Union – and Moscow has reacted strongly to the agreements, imposing new trade measures that have damaged the countries' short-term economic prospects.

The outlook for Armenia and Belarus is different: having chosen to accede to the Eurasian Economic Union (belatedly, in the case of Armenia), the two countries have lost their right to negotiate their own trade agreements and diminished their prospects for trade with the West. Yet they have also been spared the damaging trade measures that Moscow imposed on the signatories of the EU agreements.

For all these countries, a choice for east or west has meant a loss: a loss of trade policy sovereignty – and likely the growth that comes with open trade policies – for some; a loss of the vital and once-fluid exchanges with the EAEU for the others. (And this is to say nothing of the extraordinary political and military fallout in Ukraine.)

The trade and economic separation between the EU and EAEU has not aided the Eastern partners. In fact, the division is not simply a commercial one: it has been drawn – and deepened – by political and geopolitical considerations. But from a purely trade perspective, all the partners – the countries choosing one or another alliance, as well as the dozens composing the EU and EEAU – would benefit from a new and more constructive approach.

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AUTHORS:

Pasquale DE MICCO, with contributions from:
Dovydas BLAZAITIS (Chapter 2 and 4),
Pamela VALENTI (Chapter 5),
Ilze EGLITE and
Giulio SABBATI of the European Parliament Research Service (statistics).

European Parliament
Directorate-General for External Policies of the Union
Policy Department
SQM 03 Y 072
Rue Wiertz 60
BE-1047 Brussels

Editorial Assistant: Aysegul UNAL and Elina STERGATOU

CONTACT:

Feedback of all kinds is welcome. Please write to:
pasquale.demicco@europarl.europa.eu.

To obtain paper copies, please send a request by e-mail to:
poldep-expo@europarl.europa.eu.

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Table of contents

This paper provides a trade and economic analysis of Eastern Partners' economies with regards to the regional models of integration proposed by the EU and by the Eurasian Economic Union (EAEU). The analysis focuses on economic aspects and does not take into consideration the broader political and strategic aspects.

1 Key issues and developments

Background and overview of trade

- In the decade following the collapse of the Soviet Union, the six countries of the Eastern Partnership (EaP) – Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine – were active in signing trade treaties within post-Soviet area. Two forms of regional integration were simultaneously developed: the Commonwealth of Independent States' Free Trade Area (CISFTA) in 2011 and the Eurasian Customs Union (EACU) in 2010. The EACU evolved into today's Eurasian Economic Union (EAEU), unveiled on 1 January 2015.
- In general, Georgia, the Republic of Moldova and Ukraine have adopted a pro-Western outlook, signing Association Agreements (AAs), including Deep and Comprehensive Free Trade Areas (DCFTAs), with the EU. Moldova and Ukraine have also maintained their membership in the CISFTA. Georgia withdrew from the CISFTA several years ago, although the country maintained a bilateral trade agreement with Russia.
- Armenia and Belarus have joined the EAEU and maintained their existing memberships in the CISFTA.
- Azerbaijan has decided not to pursue economic integration with either bloc.
- While choosing closer integration with the EU, Georgia, Moldova and Ukraine committed themselves to reforming their economic and legal structures. Association Agreements with the EU include commitments to an inclusive and democratic political system, and to reforming the judiciary, improving governance and adopting a free market. All these developments should also improve the business climate and enhance human and economic development.
- The EU is the first trading partner of Armenia, Azerbaijan, Georgia, the Republic of Moldova and Ukraine.
- Russia is the first trade partner of Belarus. Significantly, Russia is also the second partner of Armenia, the Republic of Moldova and Ukraine, the third of Azerbaijan and the sixth of Georgia. None of these Eastern Neighbourhood countries has an interest in diminishing trade with Russia. Armenia, Georgia and the Republic of Moldova receive substantial remittances from their workers in Russia. Armenia, Belarus, the Republic of Moldova and Ukraine are also dependent on Russia's energy supplies.

Two models of economic integration

- The EAEU and the DCFTA are fundamentally different types of agreements. The EAEU is a customs union – like the EU – and its members may not independently negotiate new free trade agreements with other potential partners. The DCFTA, on the other hand, does not impose exclusivity on its members, who are free to enter into separate covenants.
- Nonetheless, both the EAEU and the DCFTA include elements that may undermine

smooth trade relations with the members of the other agreement.

- In the case of the EAEU, this risk derives from the union's high tariffs and from the loss of trade policy sovereignty inherent in membership. If the EU wished to negotiate a free trade agreement with a member of the EAEU – Belarus or Armenia, for example – the talks would have to be held between the EU and the EAEU. Such discussions are, for the moment unlikely. In addition to the prevailing political obstructions, there is a technical impediment: neither Belarus nor Kazakhstan is a member of the World Trade Organisation (WTO), while the EU's currently policy is to negotiate full free trade agreements only with WTO members (to allow negotiations to build on WTO rules).
- Membership in the CISFTA, the 'light' form of Eurasian integration, is compatible with membership in other free trade areas, including the EU´s DCFTAs. A safeguard clause in the CISFTA allows parties to suspend preferences if an increase in imports from one party causes injury to its domestic industries.
- DCFTAs include a wide range of provisions related to the internal market, including on industrial standards, services, investments, competition, energy and intellectual property rights. Several sections of the texts are adapted to the signatories; the agreements take into account the economic specificities of the country signing. Some measures that may have an economic impact, such as visa liberalisation for workers, are implemented separately from the AAs.
- While DCFTAs do not prevent signatories from entering into preferential trade agreements with other countries, they do require that signatories eventually adopt EU standards for their own domestic markets. This may cause difficulty for imports that fail to meet these standards, or that require certification. Certain non-energy products from Russia, for example, might no longer meet the EU-level standards to be adopted in Ukraine, the Republic of Moldova and Georgia.
- The problem of standards, while real, is a long-term one and does not affect all Russian products. The DCFTAs do not include a deadline for adapting the domestic standards of the signatories' markets. A long period of dual standards – one for exports to the EU, and one for the domestic market – can therefore be expected.

General results of economic analysis

- Trade and economic analysis of the Eastern Partnership countries shows that their GDP growth rates have largely converged in the last few years, as have their trade deficits. (The exception is Azerbaijan, whose trade surplus has grown proportionately greater than the others'.)
- The economic results of Eurasian integration have been mixed since the process was launched: trade grew in the first two years (2010-2012), then declined. Despite the ambiguous economic results, many post-Soviet states are equally interested in other advantages the process brings. Freedom of movement for workers is vitally important, as is an inexpensive energy supply.

Results for countries aligned with the EU

- For all Eastern Partners that signed Association Agreements, the reforms required in the agreement will result in short-term costs related to increased domestic competition, mitigation costs for increased unemployment, compliance costs of new legal obligations and standard obedience costs.

- In the long run, however, the countries will benefit. According to projections:
  - Ukraine's Association Agreement should cause the country's gross domestic product (GDP) to grow by 11.8 %. Had the country acceded to the EAEU, it would have lost 3.7 % of GDP.
  - The Republic of Moldova's GDP is expected to see growth of between 5.4 % and 6.4 % as a result of the Association Agreement. Had Moldova joined the EAEU, it would have lost 9.7 % of GDP.
  - Georgia will gain an estimated 4.3 % of GDP over the long run. The country has not considered becoming part of the EAEU in recent years.
- The studies that have quantified these gains have assumed that 'all else is equal' – *ceteris paribus* – and did not consider the possibility that Russia would react against countries for signing Association Agreements. In fact, Moscow has done just that in a number of ways, including by removing (or threatening to remove) existing trade preferences, threatening to obstruct the movement of workers to Russia, and introducing trade bans on meat and agriculture products. The legality of several Russian food bans is being debated in the WTO.
- Russia's trade preferences may be suspended for Ukraine once the Ukrainian DCFTA takes effect. Russian trade preferences have already been suspended for the Republic of Moldova. Russia and Georgia are discussing a possible suspension of the trade preferences instituted under their 1994 bilateral treaty.
- The cost of suspending trade preferences is likely to be significant. In the case of Ukraine, estimates suggest the loss may be at least USD 3 billion per year. (Moscow has declared that its suspension of trade preferences is likely to cost Ukraine EUR 165 billion over 10 years – EUR 31 billion more than Ukraine's GDP – but many consider this estimate vastly inflated.) The cost of Russia's measures to the Republic of Moldova has not been fully estimated, although a reduction in Russia's energy exports to the country could inflict serious damage on the local economy. In the case of Georgia, while trade with Russia represents only 6.6 % of the country's total, a suspension of trade preferences could also have severely deleterious effects.
- The issue of remittances is important, as Armenia, Georgia, the Republic of Moldova and Ukraine benefit from substantial remittances from their citizens working in Russia: respectively, 9.1 %, 4.5 %, 9.3 % and 2.3 % of GDP (see Figure 18). Any Russian effort to clamp down on them would prove genuinely harmful.
- Some of the loss from remittances could be partially offset by alternative EU arrangements: the DCFTAs foresee limited working permits of up to three years for 'key personnel' and graduate trainees. The full free movement of persons, however, could only result from EU accession, which is not – for now – foreseen by the EU. (Only the European Parliament has spoken of a 'European perspective' for the Eastern partners.)
- DCFTAs could lead – in the long run, once reforms are fully implemented – to diversification and restructuring. This, in turn, could allow exporters to seek out new markets – where demand is strong –and rebalance the countries' longstanding trade

deficits.

General conclusions

- The nature of the Eastern Partner countries' trade flows with Russia differs qualitatively from their trade flows with the EU. For the Republic of Moldova and Ukraine, it is unlikely that increased trade with the EU would offset the loss of trade with the Eurasian Economic Union, at least in the short term.
- The Eastern Partnership countries would be best served by maintaining fluid trade flows with both the EAEU and the EU. For those that are members of the CISFTA – all except Georgia – the economic data suggest that CISFTA membership should be maintained.
- Choosing either the EU or the EAEU has meant damaging trade ties with the other bloc for Eastern Partnership countries. The damage is not solely the result of economic factors; geopolitical reactions have significantly affected the economic processes.
- Reopening trade talks to create a wider economic space extending from the Atlantic to Pacific and solving the regulatory conflicts that divide the EU and the Eurasian Union through dialogue would benefit all parties. Admittedly, this would require not only economic efforts, but political will.
- The first signs of political will to alter course have appeared in recent months – in, for example, the Minsk Agreement of 12 February 2015 and the joint consultation paper titled 'A new European Neighbourhood policy', released by the European Commission on 4 March 2015.

2 Eastern Partnership: Trade agreements with the EU and with ex-Soviet countries

Many former Soviet republics face a choice between European and post-Soviet integration.

The trade policy of EaP countries depends on their trade pattern, as analysed in Chapter 3. Being in between Russia and the West, and having roughly the same level of trade with the two blocs, they have tried to retain market access to both of them. Contrary to the countries that acceded to the EU in 2004, they did not follow a clear path towards integration with the European Community, and continued to take advantage of the existing infrastructure, legal standards and economic ties with Russia and other post-Soviet states.

Post-Soviet integration has continued for nearly two decades.

As Figure 1 shows, the first decade of independence was marked by a clear preference for integration within the post-Soviet space. All of the six countries that are today in the EaP signed both bilateral and multilateral trade agreements. The Commonwealth of Independent States (CIS) Treaty of 1991 mentioned the forthcoming launch of an FTA, but a treaty of this kind – the CIS-FTA – was not signed until 19 years later, on 18 October 2010.

In 1998-99 these states began to look at the European Community, signing partnership and cooperation agreements (PCAs) with it, without trade preferences[1]. From this moment on they tried to open trade with both trading blocs, the EC and the CIS.

Diverging interests have led to different choices.

This double-track trade policy was never aimed at opting exclusively for one or the other camp. Given their geographical position, these countries were trying to keep both trade relationships open through free trade agreements rather than mutually exclusive custom unions.

Fig.1 shows the main trade agreements of the EaP countries on a single timeline: it makes it clear that, after an initial decade of being CIS-oriented, they slowly opened up to trade agreements with the EC, and shows that they followed this dual track at the same time.

Figure 1:
Trade treaties concluded by post-Soviet countries

	Armenia	Azerbaijan	Belarus	Georgia	Republic of Moldova	Ukraine
1992	• Russia (30/09)	• Russia (30/09)	• Russia (13/11) • Ukraine(17/12)			• Belarus (17/12)
1993	• Republic of Moldova (24/12)				• Armenia (24/12) • Russia (9/02)	
1994	• CIS, Kyrgyz Republic (4/07) • Ukraine (7/10)	• CIS (15/04)	• CIS	• CIS (15/04), Russia (3/02)	• CIS	• CIS, Armenia (7/10) • Russia (24/06)

[1] Trade preferences were subsequently granted by the EU to Ukraine, Moldova, Armenia and Georgia on an autonomous basis.

						• Kazakhstan (17/09) • Uzbekistan (29/12) • Turkmenistan (5/11)
1995	• Georgia(14/08) • Turkmenistan (3/10)	• Ukraine (9/01)	• Customs Union (20/01)	• Armenia (14/08), Ukraine (9/01)	• Kyrgyz Republic (16/05)	• Georgia (9/01) • Kyrgyz Republic (26/05), • Azerbaijan (28/07)
1996		• Georgia (8/03)	• Customs Union (29/03)	• Azerbaijan(8/03), Turkmenistan (20/03)		
1997				• Kazakhstan (11/11)		
1998					• PCA with EU (28/05)	• PCA with EU (26/01)
1999	• Kazakhstan (2/09) • PCA with EU (31/05)	• PCA with EU (31/05)		• PCA with EU (31/05)		
2000						
2001						• Tajikistan (6/06) • FYR Macedonia (18/01)
2003			• CES (19/09)		• Ukraine (13/11)	• CES (19/09) • Republic of Moldova (13/11)
2006					• CEFTA (19/12)	
2007				• Turkey (21/11)		
2010						• FTA with EFTA (24/06)
2011	• CISFTA (18/10)		• CISFTA (18/10)		• CISFTA (18/10)	• CISFTA (18/10) • Montenegro (18/11)
2014				• EU AA (18/12)	• EU AA (13/11)	• EU AA (16/9)
2015	Eurasian Union		Eurasian Union			

Source: Policy Department DG EXPO with data from: MPRA.

The two blocs in the east and the west offer two competing models of economic integration.

It is worth comparing Figure 1 with the timeline for the negotiation and signing of the EU-backed trade agreements (AAs). This shows that Ukraine concluded negotiations with the EU for its AA in October 2011, and **in the same month signed** the Free trade Agreement with the CIS area. The negotiations on the two FTAs were thus conducted in parallel, but the signing of the EU agreement did not come until 2014 owing to the well-known internal and external resistances.

The Republic of Moldova and Armenia started negotiations with the EU only four months after signing the CISFTA, making it clear that they did not regard having trade relations with the two blocs as incompatible. Georgia withdrew from the CIS in 2008 and never signed the CISFTA, like Azerbaijan. However, it never renounced the 1994 bilateral trade agreement with Russia, still in force even after the signing and ratification of the AA with the EU.

This demonstrates that, from the Armenian, Moldovan, Ukrainian and even Georgian point of view, the two trade areas were not considered incompatible. The same can be said, legally speaking, for the two free trade areas, the CISFTA and the AA.

Figure 2:
Eastern Partnership Association Agreements, including DCFTAs

Country	Negotiations (from/to)	Initialling	Signature	Provisional application	Ratification[2]	EP consent[3]
Belarus						
Republic of Moldova	Feb 2012 – June 2013	29 Nov 2013	27 June 2014	1 Sep 2014	18 July 2014	13 Nov 2014[4]
Georgia	Feb 2012 – July 2013	29 Nov 2013	27 June 2014	1 Sep 2014	18 July 2014	18 Dec 2014
Azerbaijan	(*requires WTO membership*)					
Ukraine	18 F Feb 2008 – 19 Oct 2011	19 July 2012	27 June 2014	31 Dec 2015	16 Sep 2014[5]	16 Sep 2014
Armenia	Feb 2012 – 24 July 2013	-		-	-	

Source: Official Journal of the European Union (except for ratification)

What would have made a choice exclusive was membership of a customs union, where the external common tariff implies joint management of trade policy. While EU membership was never offered to the EaP countries, the Russian-proposed Eurasian Customs Union, launched on 1 January 2010, appeared to be aimed at balancing the proposed EU trade pacts. The latter

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[2] The Ukrainian AA has to be ratified by all the national parliaments, but full ratification by the EU 28 is yet to come. So far ratification of all three AAs has only been notified to the EU Council by Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia. Parliament gave its consent to the Ukrainian, Moldovan and Georgian DCFTAs in September-December 2014. In the case of Moldova and Georgia, provisional application began on 1 September 2014.

[3] The European Parliament gave its consent to the Ukrainian, Moldovan and Georgian DCFTAs between September and December 2014.

[4] See EP consent.

[5] On 21 March 2014 only the political part of the AA was signed by the heads of state of the EU28. See the Statement by President of the European Council Herman Van Rompuy on the occasion of the signing ceremony of the political provisions of the Association Agreement between the European Union and Ukraine, 21 March 2014.

Ukraine's shift towards the EU was not welcomed by Moscow.

Ukraine's provisional application of its Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU was postponed to December 2015.

went into provisional application on 1 September 2014 in the case of the Republic of Moldova and Georgia. In the case of Ukraine – by far the largest of the EaP countries – provisional application of the DCFTA has been postponed until 31 December 2015, while the political part of the Association Agreement entered into force on 1 November 2014. A meeting that took place on 12 September 2014 – before Parliament ratified the agreement – between EU Trade Commissioner Karel De Gucht, Ukrainian Minister of Foreign Affairs Pavlo Klimkin and Russian Minister of Economic Development Alexei Ulyukayev resulted in the postponement of the application to January 1, 2016. During this period of suspension, the EU continues to grant Ukraine unilateral autonomous trade preferences, allowing duty-free access to the EU market for a significant range of Ukrainian products. The Ukrainians also requested more time to prepare for the provisional application, so they are currently enjoying market access to both the EU and Russia, while keeping duty barriers to the EU in force.

Russia's concerns were the reason for the postponement.

The rationale for the postponement was the need to cope with 'concerns raised by Russia'.[6] Indeed, on several occasions[7] Russian interlocutors pointed out that DCFTAs with the EU would jeopardise strategic Russian interests by:

- forcing signatory countries to acquire NATO membership in order to join the European Union (a blatantly false argument);
- flooding the Russian market with EU products channelled through Ukraine (a risk that could be avoided by means of sound rules of origin and customs cooperation);
- forcing signatory countries to accept EU standards, which differ from standards applied in the CIS FTA (an argument that may be valid).

Russia is taking measures against the three signatories of Association Agreements (AAs), including DCFTAs, with the EU – Georgia, the Republic of Moldova and Ukraine.

With the aim of punishing their pro-European choice, Russia has applied, or threatened to apply, a series of retaliatory measures politically based, compatibility of which with WTO is debatable

- **cancellation of trade preferences** under the CIS FTA that apply to the relevant countries the most-favoured-nation duties agreed in the WTO;
- application of stricter veterinary and phytosanitary controls, thereby in effect imposing **food bans**;
- cancellation of **simplified procedures** for entering Russia **for citizens** of Ukraine, the Republic of Moldova and Georgia;
- **restrictions on employment** for citizens of these countries (affecting potentially 436 000 Georgians, 285 000 Moldovans and 2.9 million Ukrainians);

Russia's trade preferences with the Commonwealth of Independent States (CIS)

[6] See EU Commission, Joint Ministerial Statement on the Implementation of the EU-Ukraine AA/DCFTA

[7] See For Ukraine, Moldova, and Georgia Free Trade with Europe and Russia Is Possible, Carnegie Moscow Center, 3 July 2014.

were withdrawn for Moldova and threatened with withdrawal for Ukraine.

- **limits on investments** in and from Russia.

Concerning the cancellation of trade preferences, on 31 July 2014, the Russian government issued a decree unilaterally withdrawing the preferences in the CISFTA following Moldova's ratification of the AA/DCFTAs. In doing this, Moscow invoked the safeguard clause included in Annex 6 of the CISFTA. The measures entered into force at the end of August 2014. For Ukraine, the suspension of trade preferences has been postponed to 1 January 2016. For Georgia, discussions started on 30 July 2014 regarding the suspension of trade preferences established by a bilateral FTA signed in 1994. (In Chapter 6 of this paper, these decisions are argued to be in breach the CIS-FTA treaty and to be more based more in politics than economics.)

Russian bans on Ukrainian and Moldovan exports have been discussed in the WTO, and two formal disputes have been introduced by the EU concerning Russia's bans on EU exports.

Russian bans have targeted exports from Ukraine, Moldova and the EU as a whole. The EU considers these bans illegal and introduced two cases before the WTO's Dispute Settlement Body (DSB) in October 2014[8]. In a formal WTO meeting on sanitary and phytosanitary (SPS) measures on 15 October 2014, the EU also raised concerns about eight Russian bans. The DSB has yet to rule on their legality.

In the year running from September 2013 to September 2014, the Russian Federation introduced a very high number of emergency measures – 27 SPS measures, representing 28 % of the total, and more than any other WTO member. Russia has officially recognised that some of these measures had a political basis[9].

Other Russian measures are considered to create unnecessary obstacles to trade. Ukraine challenged them before the WTO's Technical Barriers to Trade (TBT) Committee on 4 November 2014. Those measures of particular concern to the country concern its juice, beer, confectionery and dairy products[10]. Russia's bans of Moldovan and Ukrainian goods are described in Chapters 3.6 and 3.7 respectively.

Armenia chose not to sign the AA, and instead joined the Russian-led Eurasian Economic Union (EAEU).

Unlike the other three republics, Armenia decided not to sign the AA, even though its negotiations were fully completed in July 2013. On 3 September 2013 Armenian President Serzh Sargsyan declared that his country would rather join the Eurasian Economic Union, along with Kazakhstan and Belarus. Possibilities for further EU-Armenia cooperation are being explored but without tangible results.

The countries are not best served by choosing one of two exclusive options.

The analysis that follows explores how the economic interests of the EaP countries has influenced their respective trade policy orientations in a scenario of incompatibility between the EU-led and the Eurasian trade

[8] See DS475 on Pigs imports and DS 485 on Agricultural and Manufacturing Products on WTO website.
[9] 'In its exchanges Russia acknowledged the political background to some of the issues. It called for cooperation, rather than confrontation and said political disagreements spoil the environment for finding a solution'. See WTO-SPS formal meeting of 15 October 2014.on WTO website.
[10] See WTO-TBT committee of 4 November 2014

models of relationship. A detailed analysis of the DCFTAs and the regional integration project of the Eurasian Economic Union will help with understanding the thorny issue of (in)compatibility between DCFTAs/CISFTA and DCFTAs/EAEU. It is not only trade elements that have to be taken into consideration, but also economy-related facts such as free movement of workers, personal remittances and energy supply.

3 Economics of the Eastern Partnership countries[11]

3.1 Joint economic analysis

A comparison of Eastern Partnership economies shows similarities as well as differences

The economic situation of the EaP countries shows some specificities and some elements of convergence in the short and long term. All these economies experienced a transition crisis following the collapse of the USSR in 1991, and all were affected by the global economic and financial crisis in 2008-2009.

Figure 3: Population and per capita GDP in Eastern Partner states, 2013

Country	Population (million)	GDP per capita (EUR)	GDP nominal (EUR billion)
Armenia	3.2	3 355	7.9
Georgia	4.5	3 689	12.1
the Republic of Moldova	3.6	2 218	6.0
Azerbaijan	9.4	5 882	55.4
Ukraine	45.2	4 015	133.6
Belarus	9.5	5 704	54.0

Source: European Commission estimates[12]

Although the six countries have different economies and different trade structures, a joint analysis points to some important common elements.

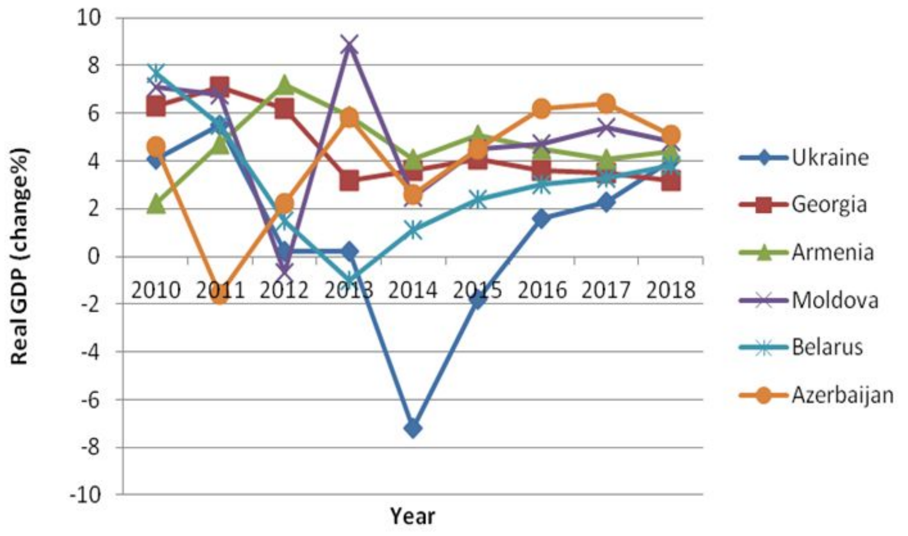
Starting in 2018, the Eastern Partnership economies are expected to grow by 3-5% annually.

In the longer term (starting in 2018), the GDP growth trend for all EaP countries is expected to converge to a value of 3-5 %. Some of the countries (Ukraine, Belarus) have recently experienced a severe recession, while others have enjoyed either a sudden and short-term period of growth (Republic of Moldova) or a more or less stable growth trend (Georgia, Armenia, Azerbaijan). Ukraine experienced a severe macroeconomic crisis in 2014 precipitated by the conflict in the east and the deepening of the trade deficit following a Russian ban on Ukrainian food exports.

[11] Where not otherwise specified, sources for this chapter come from IHS Connect/Country Reports Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine.

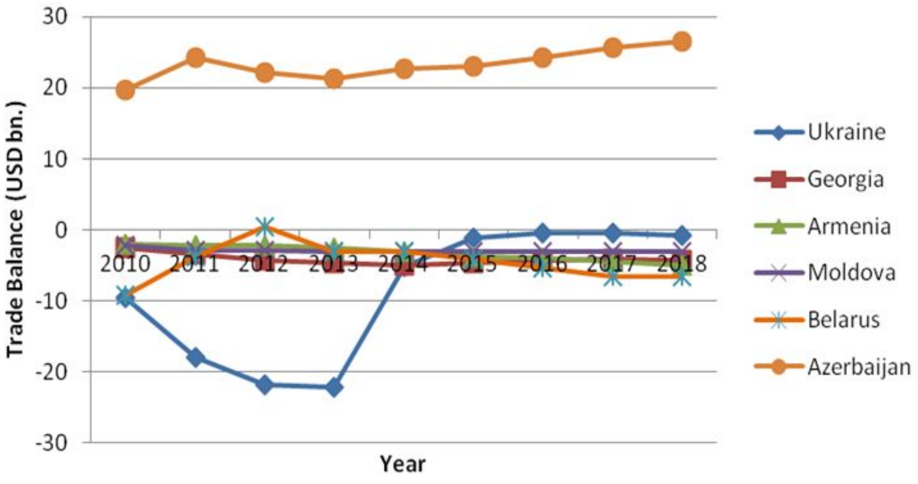
[12] See Emerson, Countdown to the Vilnius Summit: the EU´s trade relations with Moldova and the South Caucasus, European Parliament, 2013.

Figure 4:
GDP change among Eastern Partnership countries, 2010-2018 (projected)



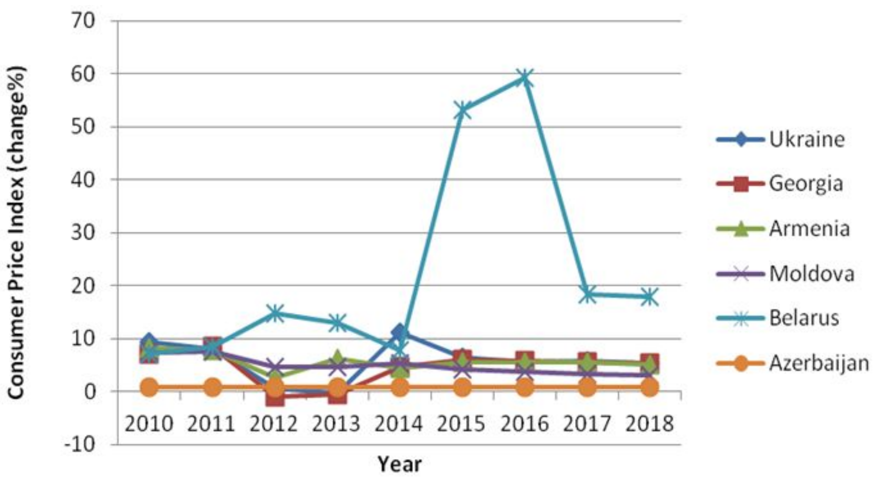
Trade balance figures show a relevant trade deficit for all EaP countries except Azerbaijan. This is partially offset in the cases of Armenia, the Republic of Moldova and Georgia by remittances from nationals living abroad, especially in Russia.

Figure 5:
Trade balances of Eastern Partnership countries, 2010-2018 (projected)



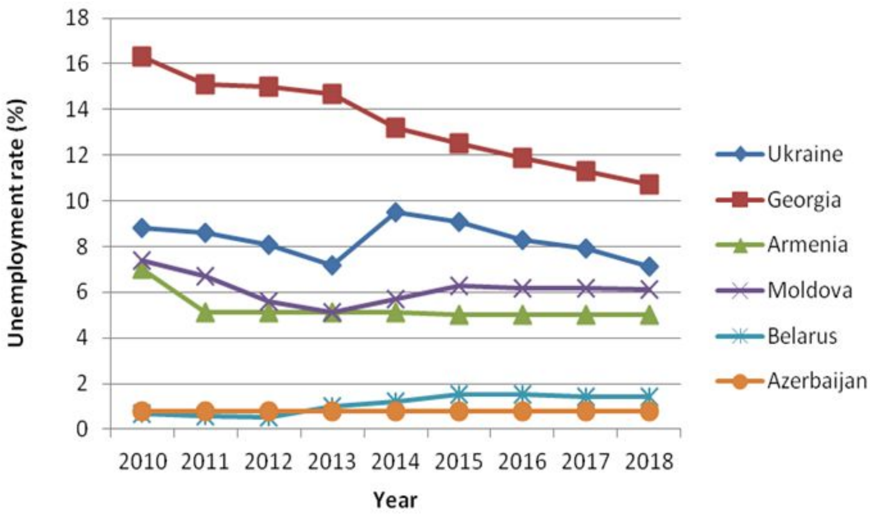
Except for Belarus, inflation rates are due to stabilise at between 0 % and 8 %.

Figure 6:
Inflation rates for Eastern Partnership countries, 2010-2018 (projected)



Projections show that the unemployment rate is expected to decline in Ukraine and Georgia and to remain stable in the other four countries (at a virtually zero level in Belarus and Azerbaijan).[13] Of the six, Georgia and Ukraine had the highest levels of unemployment in 2014 (at 13 % and 9 % respectively).

Figure 7:
Unemployment rates for Eastern Partnership countries, 2010-2018 (projected)



Before going into a more detailed analysis of these economies, a common element needs to be stressed: all six have their origins in the highly integrated and centralised Soviet economy, and all have retained relevant trade and economic ties with Russia and the CIS area. Moreover, they use the same industrial standards – the GOST standards of the CIS[14] –, recognised by the ISO. Again, the infrastructure and energy networks in the area are quite extensive and integrated. These factors notwithstanding, trade with the EU bloc has in the past decade surpassed trade with the CIS area, owing in part to a stronger demand from the EU, in part to the 2004 and 2007 eastward enlargements of the EU.[15]

In view of these competing trends, these countries should not be faced with the need to make a choice between East and West, as an exclusive choice in

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[13] Unemployment below 2% cannot be offset by demand policies but is a frictional level of unemployment called NAIRU (Non-Accelerating Inflation Rate of Unemployment).

[14] GOST (Russian: ГОСТ) is an acronym for **go**sudarstvennyy **st**andart (Russian:государственный стандарт), which means state standard. Serving as the regulatory basis for government and private-sector certification programmes throughout the Commonwealth of Independent States (CIS), the GOST standards cover energy, oil and gas, environmental protection, construction, transportation, telecommunications, mining, food processing and other industries. The following countries have adopted GOST standards in addition to their own, nationally developed standards: Russia, Belarus, Ukraine, Moldova, Kazakhstan, Azerbaijan, Armenia, Kyrgyzstan, Uzbekistan, Tajikistan, Georgia, and Turkmenistan See IHS Connect and ISO website.

[15] EU enlargement produced a statistical growth in trade since Ukrainian and Moldovan trade with Romania and Bulgaria was suddenly considered as 'trade with the EU'.

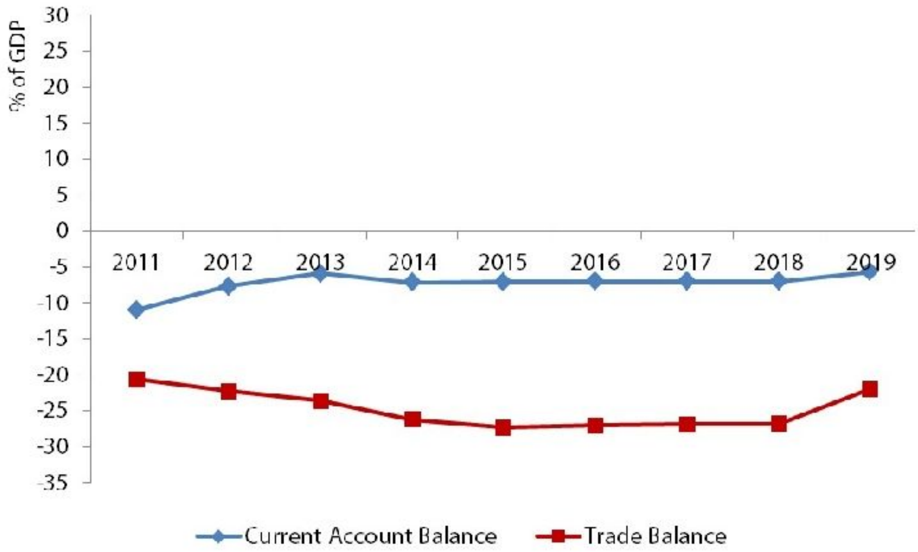
favour of one or the other of the two trade blocs could jeopardise the countries' economic wealth. It should instead be made possible to develop free trade relations with both areas. Losing one of the two markets is potentially harmful to their wealth.

3.2 Armenia

Remittances from Armenians living abroad are vital to the country's economy.

Growth in **Armenia** in 2012 was an impressive 7.2 %, signalling the country's recovery from the crisis of 2009. In 2013 the growth rate fell to 4 %, and it is expected to stabilise at 4-5 % in the medium term. The economy is fragile owing to a 2014 GDP trade deficit of -26.2 % (expected to reach -27.3 % in 2015). The trade deficit is partially offset by international aid (IMF lending has reached USD 33.56 million) and by contributions from the Armenian diaspora. More Armenians live abroad – mainly in Russia, the USA and France – than in the country itself (8 million, as compared to 3.2 million), and their remittances from Russia accounted for 9.1 % of the country's GDP in 2013 (USD 718 million).[16] Personal remittances stabilise the current-account balance deficit, which bottomed out at -7.2 % of GDP in 2014 and is expected to stand at -7.1 % in 2015. Remittances also cover most of the gap between the current account and the trade balances (see Figure 8).

Figure 8
Armenia: trade and current account balances, 2011-2019 (projected)



[16] Source: World Bank, Russian Central Bank. See Chapter 5.7.

Figure 9:
Armenia's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	Origin	€ million	%	#	Destination	€ million	%	#	Partner	€ million	balance	Share of total (%)
1	EU	892	26	1	EU	381	33.5	1	EU	1.273	-511	27.9
2	Russia	852	24.8	2	Russia	256	22.6	2	Russia	1108	- 596	24.3
3	China	296	8.6	3	Iran	73	6.5	3	China	349	- 243	7.6
4	Ukraine	174	5.1	4	USA	68	6	4	Iran	225	-79	4.9
5	Turkey	162	4.7	5	Canada	67	5.9	5	Ukraine	185	- 163	4.1
All imports:		*3 433*			*All exports:*	*1 135*			*Balance of trade:*		*- 2 298*	

Source: EU Commission, DG Trade

For Armenia, the importance of remittances, energy supply and security concerns prevailed over the benefits of a DCFTA.

Trade with the EU and with Russia is roughly on a par. The EU is Armenia's first trading partner, accounting for 27.9 % of trade. Russia comes in second place with 24.3 %. There are other factors that come into play, however. The decision taken on 3 September 2013 not to sign an AA with the EU, and to join the Eurasian Union instead, also took into consideration the vital need for remittances from Armenians living in Russia, security concerns and the country's energy dependence on Russia. Armenia imports nearly all of its gas and oil from Russia, while electricity needs are satisfied by domestic production (mainly nuclear power). Russia has offered Armenia a preferential price in the order of USD 189 per thousand cubic meters of gas. Armenia shares a gas pipeline with Iran, which is capable of supplying all of the country's gas needs, but the pipeline is not being used.

Armenia suffered collateral damage from the collapse of the Russian rouble.

Such strong ties with Russia have exposed the Armenian economy to the ongoing Russian turmoil (see Chapter 5.6.3.): following the rouble, the dram has fallen drastically against the dollar, and the current account deficit has risen in response to the fall in remittances from Russia. According to Armenian Central Bank Governor Arthur Javadyan, contagion from the rouble does not depend on economic dependency but on the activity of speculators. The government is introducing a set of administrative measures in an attempt to avoid a surge in consumer prices.[17]

3.3 Azerbaijan

Hydrocarbon exports make the Azeri economy very different from the rest of the Eastern Partnership.

Azerbaijan has recovered from a strong recession (-2 % of GDP in 2011), with a good performance in 2013 (+6 % growth), expected to stabilise in the medium term. Growth is reflected in a trade surplus based on hydrocarbon

[17] See Armenia's close ties to Russia will not change, The Oxford Analytica Daily Brief, 19 December 2014.

exports. This makes the Azeri economy totally different from other EaP countries[18] and explains its lack of interest in becoming a WTO member or in signing trade agreements with the EU.

Azerbaijan's main setback is the fall in oil prices, which may endanger the government's regional development plans and strengthen the political opposition.

Figure 10:
Azerbaijan's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	Origin	€ million	%	#	Destination	€ million	%	#	Partner	€ million	balance	Share of total (%)
1	EU	2758	32.5	1	EU	9383	50.1	1	EU	12141	+6625	44.6
2	Turkey	1339	15.8	2	Indonesia	2087	11.1	2	Indonesia	2105	+2069	7.7
3	Russia	1195	14.1	3	Thailand	1390	7.4	3	Russia	1990	-400	7.3
4	China	510	6	4	India	828	4.4	4	Turkey	1720	-958	6.3
5	Ukraine	476	5.6	5	Russia	795	4.2	5	Thailand	1408	+1372	5.2
All imports:		***8491***			***All exports:***	***18738***			***Balance of trade:***		***10247***	

Source: EU Commission, DG Trade

3.4 Belarus

Belarus has a subsidised economy that is highly integrated with Russia's.

Belarus is a centralised state-run economy, relying on low-price energy and raw materials imported from Russia. The economic and financial crisis of 2008-2009 and the unsustainable central government deficit spending resulted in a widening current account gap and an exceptionally high inflation rate in recent years. Given the impossibility of its being rescued by world financial markets, the Belarusian economy was saved from complete collapse by Russia in 2011. Tiny signs of liberalisation, privatisation of companies, reduction of bureaucracy and stabilisation of state spending give some hope of an IMF programme already agreed in 2009 being reopened.

Belarus is completely dependent on Russian gas, as Russia is not only the main supplier of gas, but the owner of the Belarusian pipeline network. Belarus receives gas from Russia at the preferential price of USD 167 for 1 000 cubic metres. Oil, which is essential to the Belarusian economy given its huge refining industry, is imported from Russia at a price significantly lower than the market price.

[18] Unlike the other five Eastern partners, Azerbaijan is an energy-exporting country and therefore not dependent on Russia for its energy needs. The TAP/TANAP connection is seen as an important route for future EU gas supply, so that cooperation on energy matters is in the interests of both Azerbaijan and the EU.

However, Belarus remains totally dependent on Russian trade and financial rescue.

Figure 11
Belarus's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	**Origin**	**€ million**	**%**	**#**	**Destination**	**€ million**	**%**	**#**	**Partner**	**€ million**	**balance**	**Share of total (%)**
1	Russia	17550	53.2	1	Russia	12905	45.3	1	Russia	30455	-4645	49.5
2	EU	8060	24.4	2	EU	8050	28.2	2	EU	16109	-10	26.2
3	China	2169	6.6	3	Ukraine	3217	11.3	3	Ukraine	4794	+1577	7.8
4	Ukraine	1577	4.8	4	Kazakhstan	666	2.3	4	China	2522	-1816	4.1
5	USA	452	1.4	5	Brazil	398	1.4	5	Kazakhstan	729	603	1.2
	All imports:	***32972***			***All exports:***	***28496***				***Balance of trade:***	***-4476***	

Source: EU Commission, DG Trade

3.5 Georgia

Georgia succeeded in reducing its reliance on Russia, but at a cost.

Like other ex-Soviet countries, Georgia suffered from a structural crisis in the early 90s, then started to recover in the ten years from 1995 to 2006, with growth rates oscillating between 2 % and 11 %. In 2008 it was affected by the double shock of the war with Russia and the global financial crisis. Structural reforms are needed in order to diversify its export base, and to fight corruption and the unofficial economy. After the war with Russia, Georgia managed to reduce its energy reliance and trade relations with that country, even though this effort was reflected in lower economic growth.

The DCFTA is likely to be highly beneficial for Georgia, but remittances from Russia might be at stake.

As the country has adopted an unorthodox trade policy with complete elimination of import duties, the trade agreement with the EU is likely to prove highly beneficial, especially for its Mediterranean-type agricultural exports. The trade balance showed a huge deficit of 23.2 % of GDP in 2014, expected to be slightly reduced in the medium term (-18 % in 2017). This is partially offset by remittances, especially from Russia, which contributed to reducing the current account deficit to 8.2 % of GDP in 2014 (Fig. 12). Remittances reached 12.1 % of GDP in 2013[19] and are visible in the gap between the current account and trade balances. Remittances originating in Russia amounted to USD 801 million in 2013, equivalent to 4.5 % of GDP.[20] More than 100 000 families in Georgia live on money transfers from Russia.

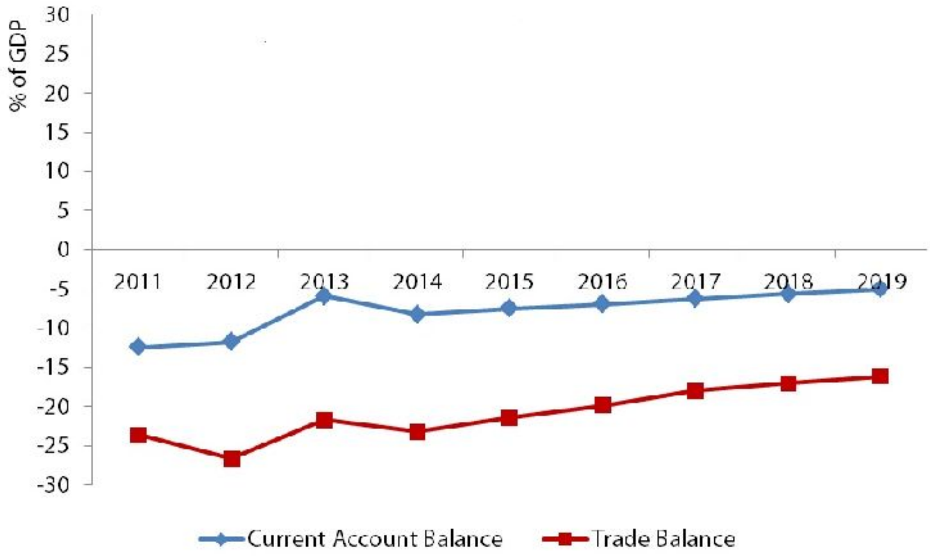
However, the economic crisis in Russia and possible political retaliation may endanger this valuable source of wealth, further exposing the country´s

[19] See World Bank, Personal remittances, received (% of GDP).
[20] Source: World Bank, Russian Central Bank. See Chapter 5.7.

fragility.

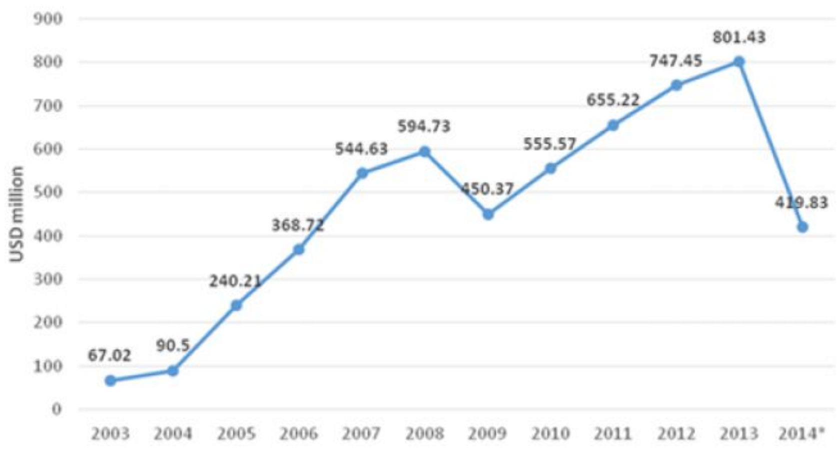
Georgia no longer imports gas from Russia owing to the strained relations between the two countries. Currently, most of Georgia's gas and oil comes from Azerbaijan.

Figure 12: Georgia: trade and current account balances, 2011-2019



The progressively converging trend of trade and current account balances risks being reversed by the drying up of Russian remittances, due to the financial crisis in Russia. The National Bank of Georgia records this decreasing trend (Figure 13).

Figure 13: Georgia's personal remittances from Russia.



Source: National Bank of Georgia[21]

[21] See Factcheck.ge, 15 September 2014.

Figure 14:
Georgia's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	Origin	€ million	%	#	Destination	€ million	%	#	Partner	€ million	balance	Share of total (%)
1	EU	1826	29.3	1	Azerbaijan	2060	24	1	EU	2284	-1332	27.5
2	Turkey	1037	16.6	2	EU	494	22.2	2	Turkey	1179	-883	14.2
3	China	514	8.2	3	Armenia	458	8.9	3	Azerbaijan	946	-1608	11.4
4	Ukraine	461	7.4	4	Ukraine	184	7.5	4	Ukraine	614	-277	7.4
5	Azerbaijan	452	7.3	5	Turkey	154	6.9	5	China	550	-478	6.6
	All imports:	***6232***			***All exports:***	***2060***				***Balance of trade:***	***-4172***	

Source: EU Commission, DG Trade

3.6 Republic of Moldova

Trade patterns and remittances have enhanced Moldova's ties with Russia.

In 2014 **the Republic of Moldova**, like Ukraine, experienced a currency devaluation, which resulted in a depletion of national reserves in the unsuccessful attempt to limit it. The trade deficit reached -37 % of GDP in 2013, and the economic downturn is widely perceived as mirroring the Russian crisis and the rouble collapse.

While Russia is only the second trading partner of Moldova, there are close economic ties deriving from personal remittances, energy dependency, market proximity and similar industrial standards.

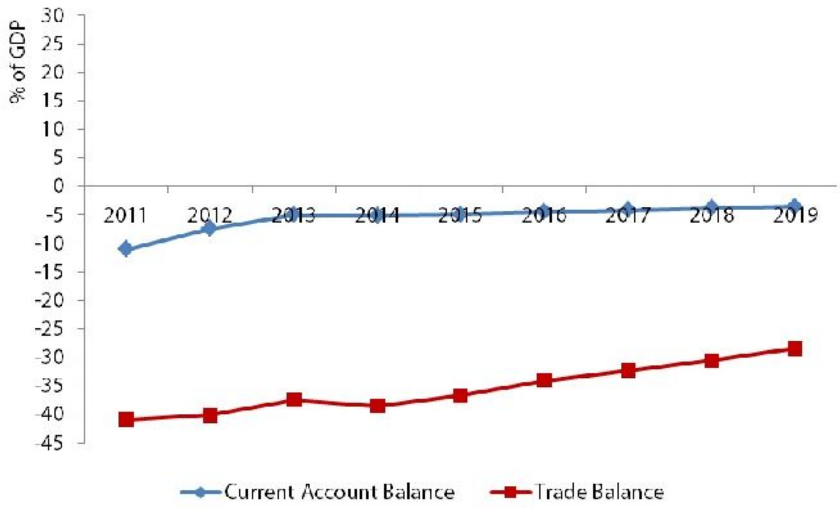
Personal remittances from Moldovan workers in Russia represent 9.3 % of the country's GDP.

Dependence on workers' remittances from Moldovans resident in Russia is considerable: they accounted for 9.3 % of Moldovan GDP in 2013.[22] Likewise, the relevance of the Russian market for Moldovan exports (around 20 % of trade) made this country quite vulnerable to Russian reactions to the Moldovans' decision to sign and shortly afterwards ratify the Association Agreement with the EU in the summer of 2014. The threats came true when Russia imposed a ban on Moldovan wine in September 2013, on processed pork meat products (8 April 2014), on canned vegetables (July 2014), on fruit imports (July 2014) as well as the suspension of trade preferences granted by the CISFTA on 19 products (31 August 2014). The doubtful legality of these trade bans, politically based, is discussed in Chapter2.

A restriction on Moldovan immigrants complemented Russian actions against Moldova. The role of remittances is immediately visible in Figure 15 as the main component in the difference between trade balance and current account balance.

[22] Source: World Bank, Russian Central Bank. See Chapter 5.7.

Figure 15:
Moldova: trade and current account balance



Most Moldovan trade is with the EU, Russia and Ukraine.

The EU and Russia represented Moldova's main trading partners in 2013. Moldovan export to CIS countries accounted for 42.9 % of total exports in 2012, quite close to the level of exports to the EU in the same year (46.8 %).

Figure 16:
The Republic of Moldova's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	Origin	€ million	%	#	Destination	€ million	%	#	Partner	€ million	balance	Share of total (%)
1	EU	2390	45.2	1	EU	887	49.8	1	EU	3277	-1503	46.4
2	Russia	1214	23	2	Russia	330	18.5	2	Russia	1544	-884	21.9
3	Ukraine	761	14.4	3	Turkey	182	10.2	3	Ukraine	833	-590	11.8
4	Turkey	233	4.4	4	Ukraine	171	4.0	4	Turkey	415	-51	5.9
5	Belarus	224	4.2	5	Belarus	64	3.6	5	Belarus	288	-160	4.1
All imports:		***5281***			***All exports:***	***1781***			***Balance of trade:***		***-3500***	

Source: EU Commission, DG Trade

The Republic of Moldova should diversify its trade structure.

The trade structure of the Republic of Moldova is over-dependent on wine and agricultural produce, and a vigorous diversification effort is needed. EU and IMF structural aid is needed to reduce the trade deficit and overreliance on remittances. A new loan from the IMF (the previous one came to an end in early 2013) is expected to be negotiated by the new government, elected in November 2014.

Trade with the EU has intensified in recent years.

The evolution and composition of the trade structure are the key elements in assessing a better trade strategy for Moldova.[23] In 2006 Moldovan exports to the EU overtook exports to the CIS, thanks to duty-free access to the EU

[23] See Moldova's trade policy: Strategy, DCFTA and Customs Union. German Economic Team Moldova, June 2013.

market (under the general scheme of preferences) and the Russian embargo on Moldovan wines. The accession of Romania to the EU in 2007 further increased the EU trade ratio. The main products exported to the EU are agricultural products such as sunflower and cotton seeds, nuts, fruit juices, cane sugar, wine and grapes (23.6 %), electrical wires, cables and electric conductors (16 % of total exports to the EU in 2012), women's and men's suits (6.5 %), and airplane and terrestrial vehicle seats (5.3 %).

Trade with the CIS is mainly composed of grape wines (11.5 % in 2012), pharmaceuticals (9.6 %), fresh fruit (7.4 %), cognac (5.4 %), and carpets. The main CIS export countries are Russia (which represents two thirds of the total), Belarus and Ukraine.

The Republic of Moldova is entirely dependent on Russia for its energy.

The Republic of Moldova imports 100 % of its gas from Russia and serves as a transit country for Russian gas exported to Romania and Bulgaria. A pipeline between Romania and the Republic of Moldova was completed in 2014, but Romania is not expected to start exporting gas to the Republic of Moldova until 2019. Moldova's geographic position makes its energy supply dependent on the supply situation of its neighbours – Ukraine and Romania.

Structural differences between exports to the EU and those to the CIS mean that being excluded from the EAEU market would be a problem the EU market could not easily repair.

It is of key importance to note that exports to the EU and the CIS are structurally different even in the area of agriculture. The CIS imports fresh fruit, wines and spirits, the EU dried fruit (nuts, seeds) and sugar. Industrial products are different as well: the EU imports cables and seats, while the CIS imports pharmaceuticals, vehicle accessories and carpets. **A question therefore arises: can the Republic of Moldova afford exclusion from the EAEU market? Will it find a healthy demand for its products previously exported to the CIS on the EU market?**

As for Ukraine, it can be concluded that a reorientation of trade towards the EU would require a thoroughgoing production conversion, huge market-oriented investments, a stable economic environment and strong demand from the EU (at present weakened by the eurozone crisis). Reforms required by the DCFTA, better governance, democracy and respect of fundamental rights are likely to improve the business climate, but actual investments can only derive from private companies aimed to catch a potential demand in the domestic or export markets. In other words, investments are largely demand-driven and improving the business climate can only favour them.

Keeping both markets open – the EU and the EAEU – is likely to be the best solution.

3.7 Ukraine

The help offered by the International Monetary Fund (IMF) to Ukraine came with conditions.

Ukraine has by far the largest economy of the EaP countries. The main causes of imbalance are the considerable budget and trade deficits. The latter accounted for 12.2 % of GDP in 2013 (USD 22 billion), while the fiscal balance was 4.4 % of GDP, and the external debt 78.1 % of GDP, in the same year. Devaluation of the Hryvnia prompted Ukraine to ask the IMF for a two-year stand-by arrangement, granted to a value of USD 17.5 billion in April 2014, of which USD 5 billion have already been disboursed. The loan was provided on the basis of a conditionality agreement on a multi-year reform plan. Fiscal consolidation and a severe limit to energy subsidies for households, resulting in a 5time increase in the domestic price of gas, will probably contribute to shrink the economy in the short run. To this figure, the IMF has recently added USD 5 billion, a figure that, very optimistically, may turn into USD 40 billion, should other international donors increase their commitments to Ukraine[24].

Conflict with Russia is taking its toll.

Austerity measures are leading to timid economic growth, deepened by the war in the east and by Russia's move to raise the gas price sharply in March 2014. The payment of the outstanding debt to Gazprom resulted in a further depletion of the country's international reserves.

The EU and the US are also contributing to save the Ukrainian economy.

The EU and the USA have added guarantees worth USD 1.6 and USD 1 billion, respectively, to the IMF loan, and the EU has made a consistent support package available, composed of:[25]

- Overall development assistance grants, EUR 1 565 million
- Macro financial assistance (MFA), EUR 610 million (based on decisions from 2002 and 2010) + EUR 1 billion (based on a decision of April 2014) + EUR 1.8 billion (proposed by the Commission on 8 January 2015)
- EUR 8 billion available in assistance programmes (including EUR 5 billion from the EBRD and up to 3 billion available from the EIB).
- Support for decentralisation and regional policy reforms of EUR 55 million.

EU commitments to Ukraine may reach more than 13 billion.

The total EU package may amount to EUR 13 030 million once the latest MFA has been approved and if the all resources allocated by the EIB and the EBRD on co-financed projects are utilised.

An additional USD 3 billion were requested from the EU at the end of 2014 to replenish the declining international reserves and to pay the Ukrainian utility Naftogaz's debt to Gazprom.

Trade with Russia is too important for Ukraine to abandon.

Meanwhile the EU continues its autonomous trade preferences, until the AA is brought into force (its application has been suspended until 1 January 2016).

Ukraine's GDP is expected to fall by an estimated 7.2 % as a result of declining exports to Russia and the ongoing war in Donbass, precipitated in turn by Russian trade sanctions and collapsing industrial production.

[24] See Ukraine's new bail-out. The austerity to come. The Economist, 12 February 2015
[24] See Russia-Ukraine Gas Crisis: Implications over Energy Security in East Europe
[25] See European Commission, SUPPORT PACKAGE FOR UKRAINE and Economic and Financial Affairs, Ukraine.

Figure 17:
Ukraine's main trading partners, 2013

Origin of imports				Destination of exports				Trade partners				
#	Origin	€ million	%	#	Destination	€ million	%	#	Partner	€ million	balance	Share of total (%)
1	EU	20734	35.1	1	EU	12855	26.5	1	EU	33589	-7879	31.2
2	Russia	17.816	30.2	2	Russia	11552	23.8	2	Russia	29368	- 6264	27.3
3	China	6058	10.3	3	Turkey	2918	6	3	China	8149	- 3967	7.6
4	Belarus	2765	4.7	4	China	2091	4.3	4	Turkey	4339	- 1497	4
5	USA	2125	3.6	5	Egypt	2086	4.3	5	Belarus	4286	- 1244	4
All imports:		*59017*			*All exports:*	*48546*			*Balance of trade:*		*-10471*	

Source: EU Commission, DG Trade

While the EU's weight as a trading partner to Ukraine increased, Ukrainian exports to Russia declined dramatically in 2014.

Figure 17 shows the official trade figures for 2013. In the first nine months of 2014 Ukrainian exports to Russia declined dramatically (-27 %), while exports to the EU experienced a small but positive increase. In particular according to COMEXT trade data, the growth of exports from Ukraine to the EU over the period April-October 2014 (i.e. linked to the unilateral suspension of duties) was +3 %. In the same period, Russian exports to Ukraine dropped by 11 % compared with the same period in 2013.

A long list of Russian bans on imports from Ukraine and the war in the east provoked this decline.

This drop is resulted from the war in the east and the Russian bans on Ukrainian products, namely: a ban on imports of Ukrainian confectionary products (July 2013); enhanced border controls for imports from Ukraine (August 2013); a ban on imports of Ukrainian railcars (September-October 2013); a ban on imports from a large Ukrainian poultry producer (February 2014); a ban on imports of selected cheeses (April 2014); a ban on imports of potatoes from Ukraine (June 2014) and a ban on imports of raw milk and dairy products from Ukraine (July 2014). Concerns on many of them have been raised in WTO committees (see Chapter 2).

If this trend is confirmed, the relative weight of Ukrainian exports to the EU and Russia, which represented 26 % and 23.8 % of the total respectively in 2013, would change to 32 % and 19 %.

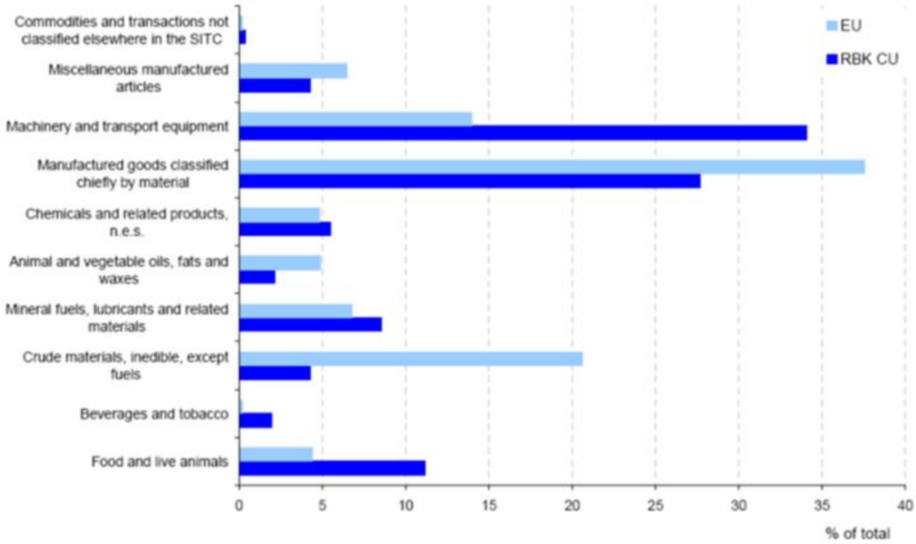
Diverting all Ukrainian exports from the EAEU to the EU is inconceivable.

Some have raised the hope that trade losses in the Russian market will be offset by trade gains in the EU market. This is certainly possible in the long term, but the differences in the structural composition of trade and the proximity of the Russian market for the Eastern Ukrainian regions means there cannot simply make a substitution of destination markets. Ukraine's exports to EAEU countries consists mainly in machinery and transport equipment (34 % of the total), while railway vehicles and equipment account for 41 %. This is a production profile inherited from Soviet times, and it is unlikely that such exports could be diverted to the EU, given the lack of demand for these products and the differences in standards and quality. Conversely, Ukraine exports to the EU consist mainly in metal, scrap, iron ore, seeds and wood.

Adopting EU standards in Ukraine may add, in the long run, a certification burden for Russian exports to the country.

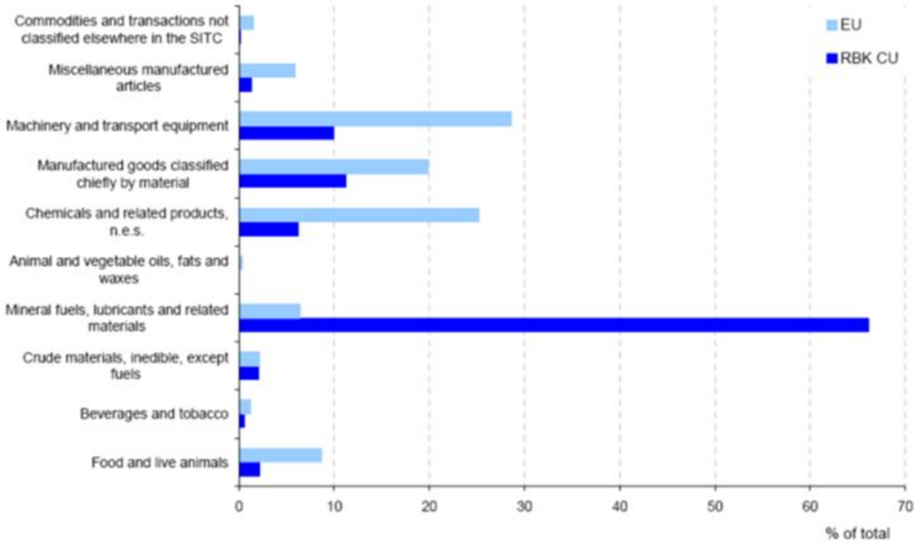
On the import side, the adoption of EU standards in Ukraine, as foreseen in the DCFTA (see Chapter 4.2.), could result in regulatory conflicts which might exclude some non-energy Russian exports (mainly of machinery, manufactured goods, chemicals and high-technology products) from the Ukrainian market. This is one of Russia's concerns about its trade ties with the EaP countries. However the rescindment of CIS standards from the Ukrainian market is not immediate, and Ukraine benefits from a long period of flexibility as regards adherence to EU standards.
The differing structure of Ukrainian trade with the Eurasian Union (indicated as RBK CU) and the EU is shown in Figure 18.

Figure 18:
Comparison of Ukrainian exports to the EU and the EAEU



Source: *German Advisory Group and Institute for Economic Research and Policy Consulting. November 2011*

Figure 19:
Comparison of Ukrainian imports from the EU and the EAEU



Source: *German Advisory Group and Institute for Economic Research and Policy Consulting. November 2011*

Ukraine is dependent on Russian gas imports but is trying to diversify its supply routes.

Ukraine is heavily dependent on Russia for its gas supply. In 2013 the country imported 25.1 bcm from Russia – still more than half of its shrinking domestic consumption. However, there has recently been a shift in this trend. In response to a complete cut in the gas supply by Russia in June 2014, Ukraine has been diversifying its sources – mainly by using the already established pipeline system with Europe for imports through reverse flows.

Smooth energy relations with Russia are of key importance for Ukraine.

The legal feasibility of reselling Russian gas to Ukraine via other routes is contested by Gazprom and risks being unstable in the medium term.[26]Reverse flow cannot supply Ukraine in the peak demand period. This is the main reason behind the 'winter package' brokered between Gazprom and Naftogas, thanks to the mediation of the EU, in October 2014.[27]. The country's energy relations with the EU and Russia are of the utmost importance, as it is the main transit country for EU imports of Russian gas.

Personal remittances from Ukrainian workers in Russia provided between USD 3 and 4 billion in 2013 – a not insignificant boost for the Ukrainian trade deficit.

Another element of dependency on Russia is the role of personal remittances. Ukrainian workers in Russia (2.9 million in 2012[28]) sent home USD 3 billion in 2013[29] (according to the World Bank), or USD 4 billion (according to the Central Bank of Russia).[30] When expressed as a GDP ratio, this represents 'only' 2.3 - 3.1 % of GDP, very much less than the levels of Armenia and the Republic of Moldova (respectively 9.1 % and 9.3 %[31]).

However, this figure in absolute value surpasses all the other CIS countries (the second is Tajikistan, with USD 3.9 billion) and cannot be disregarded in the current situation of economic decline.

A comparative analysis of personal remittances in EaP countries is carried out in Chapter 6, taking account of the collapse of personal remittances following the Russian economic crisis and the devaluation of the rouble.

4 The Deep and Comprehensive Free Trade Agreements

4.1 Comparison with other EU trade agreements

DCFTAs are the trade and economic part of the Association Agreements (AAs) signed by Moldova, Georgia and Ukraine.

An interesting categorisation[32] breaks down EU trade agreements into four models, three of them symmetric, one asymmetric:

Model 1: traditional FTAs, with removal of tariffs and quantitative restrictions. WTO principles on industrial standards and SPS are recalled in these agreements (e.g. EU-Mexico, 1997, EU-South Africa, 1999)

Model 2: second-generation FTAs, with a reduction of technical barriers to trade for key industrial sectors (electrical, automotive, pharmaceutical, etc.),

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[26] See A cold winter to come? The EU seeks alternatives to Russian gas. European Parliament, DG External Policies, Policy Department, October 2014.
[27] See The Russian-Ukrainian gas deal: Taking the bite out of winter? European Parliament, DG External Policies, Policy Department, November 2014.
[28] United Nations, Trends in International Migrant Stock: Migrants by Destination and Origin, 2013.
[29] Estimated by combining data from Figures 18 and 19 and European Commission Country trade statistics
[30] See Personal Remittances from Russia to CIS countries, Central Bank of Russia, 2013.
[31] Source: World Bank, Russian Central Bank. See Chapter 5.7.
[32] See M. Emerson, Trade policy issues in the Wider Europe – that led to war and not yet to peace. CEPS, July 2014.

with increased reliance on international standards. These are feasible between economies with high technical standards (e.g. EU-Korea, 2010).

Model 3: negotiation on convergence of regulatory standards for service sectors and elimination of non-tariff barriers for trade in goods. The aim is progressive approximation of technical standards among regulatory systems which have similar objectives but diverge in practice (e.g. Transatlantic Trade and Investment Partnership- TTIP).

Model 4: asymmetric agreements between the EU and its much smaller neighbours, further divided into 3 categories:

Model 4.1: customs union (e.g. EU-Turkey), with a high level of convergence on regulatory standards. Convergence is stimulated by the prospect of accession.

Model 4.2: European Economic Area (EEA): Norway, Iceland and Liechtenstein have accepted a dynamic system to incorporate into their domestic law the entirety of the EU single market. They do not participate in EU decision-making but are free to reject internal market developments if they find them incompatible with their interests. This is consistent with countries (Norway and Iceland) having been offered EU membership but having decided not to pursue it.[33]

The Swiss model, based on a network of extensive internal-market-related bilateral agreements, has many points in common with the EEA, but without the institutional structure.

Model 4.3: the new Deep and Comprehensive Free Trade Agreements, included in the AAs, signed by Georgia, the Republic of Moldova and Ukraine on 27 June 2014, an asymmetric system 'evolving gradually but incompletely over quite a long transition period towards the EEA model'.[34]

DCFTAs promote free movement of goods, services and capital between the EU and signatory countries.

DCFTAs are not limited to the removal of trade tariffs, but they have reshaped the economies of these countries, bringing them more closely into line with the EU internal market in relevant areas. By doing so, they foster three of the EU's four freedoms of movement: goods, services and capital will move freely between the EU and the AAs' signatories once the agreements are implemented.

The free movement of persons is promoted in the Visa Liberalisation Plans included in the Association Agreements.

The freedom of movement of persons is not addressed as such by the DCFTAs, but they deal with temporary establishment of service providers falling under the categories of key personnel and graduate trainees. They can work in a company of a party member for up to 3 years (provided the Member State in question did not pose reservations). Moreover, Visa Liberalisation Action Plans (VLAPs), which are included in the AAs, provide for short term travel permit.

[33] See: Outside and Inside. Norway's agreements with the European Union. Official Norwegian Reports NOU 2012: 2
[34] See: M. Emerson, July 2014, cit.

A visa-free regime has been in force in the case of the Republic of Moldova since April 2014. Ukraine, Georgia, Armenia and Azerbaijan have already signed Visa Facilitation Agreements (VFA) and Readmission Agreements. Belarus is expected to sign a VFA at the next EaP Summit in Riga, in May 2015.

DCFTAs include requirements for substantial trade-related reforms as well as for removing trade tariffs....

DCFTAs require internal reforms in the fields of trade-related technical barriers to trade, as well as regulation of service sectors and infrastructure networks for communications, transport and energy.[35] By signing AAs, Ukraine, Georgia and the Republic of Moldova agreed to implement significant internal reforms and to progressively adopt the EU *acquis*, as well as international standards. Signatories bear the heavy burden of modernising their regulatory system to make it more appropriate to participate openly in international trade and attract foreign investment. However, convergence with EU standards is gradual and the extent to which they are binding varies from area to area: the core issues that are legally enforceable are tariff and non-tariff barriers, services, public procurement, intellectual property rights and competition policy, while environment, transport, company law, consumer protection and labour market policies are sectors only of cooperation.

...however, the timing for implementation of the different chapters varies greatly.

Despite the common historical roots of Ukraine, the Republic of Moldova and Georgia, the provisions included in the agreements differ enough to ensure that vulnerabilities vis-à-vis the EU economy are taken into account.

4.2 Market access for goods

All three DCFTAs include a clause on removing customs duties on imports and exports of goods in line with the WTO GATT Agreement. All import duties on goods, with minor exceptions, will be removed as soon as the AA enters into force. Export duties will also be prohibited as from the entry into force of the AA. As regards non-tariff barriers, the DCFTAs include fundamental WTO rules such as 'national treatment' – a prohibition on applying unjustified barriers to trade based on sanitary or phytosanitary rules or technical requirements for industrial goods. It also disciplines state trading enterprises.

When it comes to the removal of customs duties, all three DCFTAs aim at an extensive liberalisation of trade. Ukraine will gradually remove 99.1 % of duties in trade value, while the EU in return commits to removing 98.1 %; the Republic of Moldova and the EU will, over time, remove 99.2 % and 99.9 % of their import duties respectively. The situation with Georgia is different, as the country takes an unorthodox approach to trade, not applying customs duties on any of its imports, regardless of origin; in practice, therefore, the EU will be removing 99.9% of its duties unilaterally.

Regarding imports of industrial products, the Georgian DCFTA stands out in

[35] See Emerson et al., The Prospect of Deep free Trade between the European Union and Ukraine, CEPS.

that it includes the immediate and bilateral removal of all duties on imports of such products. The other two agreements, on the other hand, include exceptions to protect sensitive branches of industry such as textiles and clothing in the case of the Republic of Moldova (gradual liberalisation over 5-10 years) and the automotive sector of Ukraine's heavy industry (10 years). Once more, the differences between the provisions for Georgia and the other two treaties lie in the fact that Georgian tariffs were non-existent even before the implementation of the DCFTA, making the removal of EU tariffs excessive.

The biggest difference between the DCFTAs is in the field of trade in agricultural products. The Georgian AA will immediately liberalise trade in agricultural goods, with the exception of garlic, for which a duty-free tariff-rate quota will be established. The other two AAs provide for gradual trade liberalisation in the sector. Gradual liberalisation (generally over ten years), as well as partial liberalisation through duty-free quotas for sensitive products such as pig meat, poultry meat, dairy products and garlic will be applied. This approach will give producers in particularly sensitive sectors time to adjust to the free trade conditions while giving consumers access to a wider range of products at competitive prices.

4.3 Standard approximation and other provisions

In addition to provisions on market access for goods, all three DCFTAs cover trade remedies (trade defence instruments), technical barriers to trade, sanitary and phytosanitary measures, customs and trade facilitation, establishment, trade in services and electronic commerce, current payments and movement of capital, public procurement, intellectual property rights, competition, trade-related energy, transparency, trade and sustainable development and dispute settlement.

Provisions on trade defence instruments are common to all DCFTAs, with some exceptions.

Provisions concerning **trade defence instruments (TDIs)** are common to all the DCFTAs and cover anti-dumping, anti-subsidy and global safeguards. Cooperation on trade remedies will be deepened, with a focus on transparency and public interest (tests to determine public interest may be carried out before imposing any measures). It is important to note that only the Moldovan DCFTA leaves the door open for either party to temporarily reintroduce its general tariffs for WTO members if increased imports pose a significant threat of injury, as the Moldovan economy is considered to be the most vulnerable of the three. Ukraine, being the only one of the three states with a considerable automotive industry, retains a right to apply a specific safeguard measure for 15 years to protect this branch of heavy industry.

Technical standards are to be harmonised with the EU's, but deadlines are not mandatory for Ukraine and Moldova.

Provisions on **technical barriers to trade (TBTs)** are similar in all three DCFTAs, with no significant exceptions. They aim to simplify, and prevent unnecessary divergences between technical requirements for industrial products, and to facilitate trade with the EU. According to the DCFTA, Ukraine is to align its legislation with the EU *acquis* in five framework areas and in 27 sectors or products (vertical legislation), following a precise timetable.[36] However, as stated in Article 56.4 'Where actions listed in the timetable in Annex III to this Agreement have not been implemented within the applicable time frame, Ukraine shall indicate a new timetable for the completion of such action.' This implies significant flexibility in the application of the deadline. As regards the corpus of European technical standards, Ukraine is committed to transposing them as national standards under the DCFTA but, importantly, the commitment is not linked to a precise deadline.

The same flexibility can be found in the Agreement with **the Republic of Moldova**, Article 173.6,[37] according to which Moldova, where approximation measures have not been implemented within the deadline (defined in Annex XVI to the agreement), can indicate a new schedule for its completion.

Flexibility for **Georgia** is slightly different. Schedules for approximation are indicated in Annex III-B for horizontal standards and in Annex III-A for vertical standards. The former is 'indicative' and does not indicate deadlines, the latter is rather rigid; it lays down deadlines and cannot be unilaterally modified. A decision by the Association Committee in trade configuration is needed to modify them.[38]

Once EU standards are adopted, the countries must withdraw conflicting CIS

In all three cases, it is important to stress that the alignment to EU legislation (in terms of both adoption and enforcement) represents a more stringent and

[36] See, for Ukraine, Annex III to the ASSOCIATION AGREEMENT between the European Union and its Member States, of the one part, and Ukraine, of the other part, OJ L 161/3 . It defines **horizontal** and **vertical standards** to be adopted by a precise deadline measured from the entry into force of the DCFTA. Vertical standards concern the following specific products: Machinery (2 years), Simple pressure vessels (2 years), Pressure equipment (3 years), Transportable pressure equipment (2 years), Lifts (2 years), Toys (2 years), Electrical equipment designed for use within certain voltage limits (2 years), Hot-water boilers fired with liquid or gaseous fuels (2 years), Appliances burning gaseous fuels (2 years), Personal protective equipment (2 years),Household electric refrigerators and freezers (2 years), Non-automatic weighing instruments (3 years), Measuring equipment (5 years), Marine equipment (2 years), Medical Devices including in vitro diagnostic (3 years), Equipment and protective systems for use in potentially explosive atmospheres (3 years), Radio equipment and telecommunications terminal equipment (4 years), Cableway for passengers (3 years), Recreational craft (4 years), Construction products (end of 2020), Packaging and packaging waste (3 years), Explosives for civil uses (3 years), **High-speed railways** (5 years).

[37] See ASSOCIATION AGREEMENT between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Moldova, of the other part, OJ L 260/47, Article 173.6. *Where actions listed in Annex XVI to this Agreement have not been executed by the time set therein, the Republic of Moldova shall indicate a new schedule for the completion of such actions. Annex XVI to this Agreement may be adapted by the Parties*.

[38] See ASSOCIATION AGREEMENT between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part, OJ L 261/4, Article 47. *A list of the measures for approximation is set out in Annex III-A to this Agreement, which may be amended by a decision of the Association Committee in Trade configuration, as set out in Article 408(4) of this Agreement*.

standards.

time-bound commitment than that related to the body of EU standards, where the DCFTAs only provide for progressive transposition. In line with the principles of the European standardisation organisations (CEN, CENELEC), once EU standards are adopted in any of the countries, conflicting national standards have to be withdrawn. The Ukrainian agreement explicitly mentions the withdrawal of interstate 'GOST' standards, the CIS standards still valid in all EaP countries[39] in addition to their country-specific standards

Once a country signs an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) with the EU, Eastern Partnership products will be fully integrated with the EU's in terms of standards.

Note that it is only when conflicting (GOST) standards have been withdrawn from the body of national standards and replaced with (more modern) European standards (CEN-CENELEC) that products exported to Ukraine, the Republic of Moldova or Georgia will have to comply with the latter set of standards. Non-compliant exports, whether from countries where the GOST standards prevail or of any other origin, will not be allowed onto the market, without undergoing prior certification procedures,

While adopting CEN-CENELEC standards, EaP countries will easily export and import to and from the EU. On the other hand they will be free to use different standards for exporting in other countries. E.g. they will use GOST certification for exports aimed at CIS market.

In terms of long-term integration into the European market for industrial products, the DCFTAs open up the possibility for the signatory countries of negotiating Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAAs). These agreements will allow trade in the sectors covered to take place under the same conditions as between EU Member States. In terms of facilitation of trade, the ACAAs offer the highest possible integration into the EU market for non-EU members. A prerequisite for the negotiation of the ACAAs is not only full alignment with the EU *acquis* of all sectoral and horizontal legislation, but also transposition of the relevant standards and effective functioning of the institutional TBT-related systems. Once these conditions are met, the negotiations on for the ACAA can start, and ultimately the relevant ACAA will be added to the AA and will be fully operational.

Standards are an element of exclusivity as compared with Eurasian trade agreements. Nevertheless, their economic impact is not expected to be significant.

The long (extendable) implementation period for the DCFTAs, particularly in terms of alignment with EU legislation and transposition of the body of EU standards, and their flexibility in terms of choice of sectors in which to proceed with future negotiations for ACAAs, coupled with the fact that Eurasian exports to the DCFTA countries are mainly (but not exclusively) composed of energy commodities (i.e. not subject to technical regulations), **is an element of exclusivity but is not expected to result in a significant negative impact on EAEU trade.**

Rapid-alert and early-warning systems are

Provisions concerning **sanitary and phytosanitary measures (SPS)** are common to all three countries and aim at facilitating trade in animals and plants, as well as products of animal and plant origin, while ensuring that the

[39] See Chapter 3.1.

to be established for sanitary and phytosanitary goods.

parties' level of protection is maintained. The parties will seek a common understanding on animal welfare standards that reflects EU norms and World Organisation for Animal Health developments. This should allow for products currently not admitted for SPS reasons to be allowed to enter the EU and to be marketed on an equal footing with EU domestic products. Furthermore, all three DCFTAs include rapid consultation mechanisms to address trade irritants in SPS-related goods and rapid-alert and early-warning systems for veterinary and phytosanitary emergencies, which will be set up.

Rules of origin should counter concerns about breakaway regions.

The DCFTAs also seek to enhance cooperation in **customs and customs-related matters** and to simplify customs requirements and formalities, while at the same time preventing fraud. Unlike the Ukrainian AA, the Georgian and Moldovan AAs place emphasis on the origin of products, as the inclusion of the breakaway regions of Transnistria, South Ossetia and Abkhazia might create the conditions for the advantageous trade relationship to be exploited by third parties. Additionally, the Georgian and Moldovan agreements provide for the establishment of special Customs Sub-Committees to monitor the implementation and administration of the abovementioned provisions.

Equal access to service markets is to be guaranteed.

Provisions on **establishment, trade in services and electronic commerce** introduce new opportunities for businesses of both parties in all three AAs and provide for deeper integration of the three EaP states into the EU services market. They also cover freedom of establishment in both service and non-service sectors. All three agreements include 'negative lists' of sectors excluded from liberalisation, thus guaranteeing automatic coverage for new services and providing for a self-running integration mechanism for the sector. In addition, all three AAs share the same provisions on domestic regulation, postal and courier services, financial services and telecommunication services, which will improve transparency and legal certainty for EU investment in those states. The service provisions include a commitment on the part of the EaP states to align their legislation on financial, electronic commerce, postal and courier, and international maritime services with current and future EU legislation. This may grant further access to the EU services market for Georgian, Ukrainian and Moldovan service providers. It will also mean that EU investors in those sectors will find the same regulatory environment in the three states as in the EU.

Fair access to public procurement will also be ensured.

Provisions on **public procurement** are, in general, the same for all three states; they are closely related to the basic rules on fair competition and aim to provide suppliers and service providers from the EU and the three states with equal access to each other's procurement markets over several years. However, there are two main differences: the first one, again, puts Georgia and the Republic of Moldova on the same page by including a clause on minimum rules on public procurement, to be applied from the first day, while no such clause is mentioned in the Ukrainian AA. In addition to that, the provisions for Ukraine in this field exclude defence, as competition from EU suppliers could negatively affect the Ukrainian industry, which is of the utmost importance to the country.

The provisions on **intellectual property** are common to all the states and

Counterfeiting will be countered by provisions on intellectual property rights (IPRs).

complement the WTO TRIPS Agreement. The chapter has a strong section on Intellectual Property Rights (IPR) enforcement based on the EU's internal rules, including a requirement to ensure that no counterfeit products or products which otherwise infringe IPRs move across the borders. Provisions on geographical indicators (GIs) are another important part of this section, covering as they do products ranging from wine to cheese. The Georgian and Moldovan agreements on GIs signed in 2012 and 2013 respectively are also incorporated into the new provisions.

State-controlled enterprises are be covered by provisions on competition.

Provisions on **competition** prohibit and commit to addressing certain practices and transactions that could distort free competition and trade, such as cartels, abuse of a dominant position and anti-competitive mergers, which will be subject to effective enforcement action. The three states will align their competition law and enforcement practice to that of the EU *acquis* in a number of fields. Competition law will apply to state-controlled enterprises. As mentioned before, this complements the chapter on public procurement.

Parties are to remove distortions to competition caused by subsidies.

The provisions covering **subsidies** differ slightly from state to state, as the Ukrainian and Moldovan agreements exclude agriculture and fisheries. The Parties agree to remedy or remove distortions of competition caused by subsidies where these affect trade, and to subject these commitments to the dispute settlement mechanism. A bilateral reporting system on subsidisation is part of all three AAs.

The agreements include energy provisions based on market-based pricing, non-interruption of transit and early warning mechanisms.

Provisions on **trade-related energy** cover crude oil, gas and electricity and share the same three clauses: the Parties commit to market-based pricing and prohibition of dual pricing; removal in transit or interrupting it is illegal, and a 'fast track' mechanism to settle these types of dispute, as well as an early warning mechanism for diplomatic consultations, is to be established; a legally distinct and functionally independent regulator to safeguard competition and the efficient functioning of the gas and electricity markets will be set up. In addition to that, the Ukrainian AA includes a fourth clause on non-discriminatory access to the exploration and production of hydrocarbons. The other two states did not require a provision such as this as the issue is unlikely to arise in practice. Furthermore, the Ukrainian and Moldovan AAs leave open the possibility of imposing price regulation measures for a fixed term, affecting industrial consumers only.

As is apparent from the comparison above, most differences in the DCFTAs derive from the industrial and agricultural specificities of the states, the Georgian non-tariff trade regime and the fact that the Ukrainian Agreement, as a flagship for the DCFTAs to follow, was drafted and initialled earlier.

5 The Eurasian Union: Origin, ambition and possible outcome

5.1 Plans for Eurasian integration

In October 2011 a plan for a 'Eurasian Union' was presented. It encompassed three phases of integration.

On 3 October 2011 the then Prime Minister of the Russian Federation, Vladimir Putin, published in the newspaper *Izvestia*[40] a plan to create a Eurasian Union, to be developed after the kick-off of the latest Russian-led regional integration project – the Single Economic Space of Belarus, Kazakhstan and Russia (SES). In the article, the Single Economic Space was presented as the natural prosecution of Russia's previous efforts towards integration in the region. Potentially open to all countries of the post-Soviet space, the SES would have deepened and brought together a number of economic integration processes started after the collapse of the USSR – the Commonwealth of Independent States (CIS, 1991), the CIS Free Trade Area (CISFTA, 1994 and 2011), the Eurasian Economic Community (EAEC or EurAsEC, 2000) and the Eurasian Customs Union (EACU or Customs Union of Belarus, Kazakhstan and Russia, 2009).[41]

The plan for a Eurasian Union was to be accomplished in three steps. Firstly, the CES would create a vast internal market based on freedom of movement for goods, persons and capital, drawing on the experience of the European Union and the Schengen Agreement. Secondly, the gradual merging of the Customs Union and the Common Economic Space would lead to the creation of a Eurasian Union, a single and comprehensive supranational association able to transform the post-Soviet area into one of the poles of the modern world. Lastly, the membership of the Customs Union and the CES would expand by the inclusion of Kyrgyzstan and Tajikistan.

5.2 Re-integration in the post-Soviet space after the breakup of the USSR: The Commonwealth of Independent States

After the breakup of the USSR in 1991, a number of initiatives for the re-integration of post-Soviet space were launched.

Since the breakup of the Soviet Union in 1991, the newly independent states in the post-Soviet area have taken part in a number of integration/reintegration processes. Based on historically established ties and on the similarity of their socio-economic models, all the countries –

[40] Vladimir Putin, 'Novyi integratsionnyi proekt dlya Evrazii – budushchee kotoroe rozhdaetsya segodnya', *Izvestia*, 3 October 2011. Available at: http://www.izvestia.ru/news/502761. English version: http://www.russianmission.eu/en/news/article-prime-minister-vladimir-putin-new-integration-project-.eurasia-future-making-izvestia-3-

[41] Regional arrangements were also established in the political and military field. In the political field: the **Commonwealth of Independent States** (CIS, 1991); the **Union State of Russia and Belarus** (1997); the **Georgia -Ukraine - Azerbaijan - Moldova Organization for Democracy and Economic Development** (GUAM, 2001). In the military field: the **Collective Security Treaty Organization** (CSTO, 1992); the **Union State of Russia and Belarus** (1997).

In 1991 Belarus, Ukraine and Russia signed the CIS Agreement.

except the three Baltic republics – aimed to maintain and further develop their economic and trade relations through new regional arrangements. For most of the newly independent states, the motivation to participate in regional initiatives was access to the large Russian market, which remains important for the structure of their foreign trade.

On 8 December 1991, the heads of the Republic of Belarus (Stanislav Shushkevich), the Russian Federation (Boris Yeltsin) and Ukraine (Leonid Kravchuk) signed the **Agreement on the establishment of the Commonwealth of Independent States (CIS)**, dissolving the Soviet Union and founding a new Commonwealth with the purpose of coordinating legislative regulations, trade policies and security to provide a transitional formula for multilateral cooperation between sovereign states.[42] On 21 December 1991, eight additional more Soviet republics (Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, Tajikistan, Turkmenistan and Uzbekistan) agreed to join the CIS by signing the **Alma-Ata Protocol** together with the three founding signatories.[43]

The 1993 Charter of the CIS established that a member of the CIS is 'a country that has ratified the Charter'.

The Agreement on the establishment remained the main constituent document of the CIS until 22 January 1993, when the **Charter of the CIS** was adopted in Minsk by the eleven CIS signatories 'with firm resolve to realise the provisions of the Agreement establishing the CIS and the Protocol to the Agreement'.[44] The Charter defined and formalised the purposes and principles of the CIS; the spheres of joint activity, coordination and cooperation; the rules on membership (under Articles 7 and 41, a member country is a country that has ratified the CIS Charter); the institutional framework (which had to remain strictly intergovernmental); the decision-making process (based on consensus); the rules on financing.

Ukraine was a founding member of the CIS but never ratified the Charter; its CIS status has therefore remained in limbo.

Georgia joined the CIS in December 1993, although it withdrew its membership in 2008[45] following the war with Russia over the Georgian breakaway regions of South Ossetia and Abkhazia.

Turkmenistan never ratified the CIS Charter, therefore not fulfilling the formal rules for membership.[46] The Turkmen President for Life, Saparmyrat

[42] Agreement on the establishment of the Commonwealth of Independent States, signed on 8 December 1991 in Belovezhskaya Pushcha (Minsk, BY) by Belarus, the Russian Federation, and Ukraine.
[43] Protocol to the Agreement establishing the Commonwealth of Independent States, signed on 21 December 1991 in Alma-Ata (Kazakhstan) by Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.
[44] Charter of the Commonwealth of Independent States, signed on 22 January 1993 in Minsk (Belarus) by Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.
[45] Under Article 8 of the CIS Charter, the withdrawal became effective in 2009 (i.e. one year after notification of the decision to the depositary of the Treaty).
[46] Article 41 of the Charter (Chapter IX, 'Final Provisions') established that 'the Charter shall be ratified by the signatory states, in accordance to their respective constitutional processes. […] The present Charter shall come into force for all signatory states upon

Nyýazow, continued to participate in the CIS Summits with non-official standing until 26 August 2005, when he changed the status of the country into 'associate member' of the CIS to be consistent with the country's UN-recognised neutral status.[47]

Ukraine, despite being one of the three founding members of the Agreement establishing the CIS, did not ratify the 1993 Charter either.[48] Ukrainian leaders have maintained an ambiguous stance in the CIS since then, taking part in the summits without ever formalising the official status of their country.

5.3 The goal of economic reintegration in post-Soviet space after the CIS (1993-2003)

After 1992, trade liberalisation created powerful incentives for developing trade relations further within the post-Soviet space. In fact, significant imbalances in prices on goods between Russia and the newly independent states stimulated external trade, which became the most dynamically developing sector and the only source of foreign currency inflow in the first years of reform.[49]

Economic cooperation took place in three frameworks between 1993 and 2003: the CIS Economic Union, the Eurasian Economic Community (EuAsEC) and the Single Economic Space (SES).

Between 1993 and 2003 post-Soviet regional cooperation in the **economic field** took place in three formats: the CIS Economic Union, the EurAsEC and the Single Economic Space.

On 24 September 1993 Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Russian Federation, Tajikistan and Uzbekistan signed the **Agreement on the Creation of Economic Union of the CIS,** which **was** aimed at the future establishment of an economic union through the formation of a multilateral free trade area, a customs union, a common market and a currency union.[50] Georgia and Turkmenistan signed it by the end of the same year. Ukraine remained the only CIS state not to sign this agreement, although it joined as an associate member in 1994.[51] However, the Economic Union Treaty was only a framework agreement, to be put into practice by a number of more specific agreements that were expected to follow.

A free trade agreement (FTA) was signed in 1994 as a first step towards the creation of

the deposit of ratification of all the signatory states, or for signatory states which will have their ratifications deposited one year after the present Charter has been adopted.'

[47] See CIS: Turkmenistan Reduces Ties To 'Associate Member', Radio Free Europe (August 2005). The country's status was changed at the 2005 CIS Summit in Kazan (Russian Federation) under Article 8 of the CIS Charter.

[48] See Centro Studi sul Federalismo – International Democracy Watch.

[49] G. Idrisov, B. Taganov, Regional Trade Integration in the CIS Area, MPRA - Munich University, September 2013.

[50] Agreement on the Creation of Economic Union, signed on 24 September in Moscow (Russian Federation) by Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Russian Federation, Tajikistan and Uzbekistan.

[51] See O. Sushko, 'The dark side of integration: ambitions of domination in Russia's backyard', The Washington Quarterly, Vol. 27, No. 2, 2004.

an economic union.

However, long lists of exemptions, disagreements about the customs union, and the Russian Parliament's failure to ratify the FTA prevented it from being implemented.

One of them, the **CIS Agreement on the Creation of a Free Trade Area**, aimed at reducing trade barriers and fostering economic integration, was signed on 15 April 1994 by Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Ukraine and Uzbekistan.[52] The agreement covered mainly trade in goods, opened the door for liberalisation of service markets (Article 17) and provided for the removal of customs duties, taxes, charges with equivalent effects, and quantitative restrictions on trade of goods within the CIS (Article 3).[53] The preamble defined the establishment of the FTA as an act towards the successive implementation of provisions of the 1993 Agreement on the Creation of Economic Union. More specifically, Article 21 stated that the FTA 'shall be considered a transitional stage to the formation of a customs union'. However, the realisation of an FTA as a first step in the stage-by-stage creation of the Economic Union[54] faced three main hurdles.

Since Russia failed to ratify the FTA, the CIS countries regulated trade relations through a network of bilateral preferential trade agreements (PTAs) and FTAs.

First, the signatories failed to work out a single list of **goods to be exempted** from the customs-free regime and therefore agreed to identify exceptions to free trade in bilateral documents (to be gradually abolished).[55] Second, the provisions foreseeing the transition to a Customs Union, an essential step towards the economic and currency union, were dropped from the text as a result of amendments introduced by a protocol of 2 April 1999. Third, and most important, all signatories ratified the Free Trade Area agreement and protocol except for the Russian Duma, because of the Russian Federation's insistence on establishing a long list of unilateral exclusions from the FTA – particularly oil and gas – and introducing restrictive quotas for sensitive exports such as metallurgy, chemical and agricultural products.[56]

In theory, the 1994 multilateral FTA coexisted with bilateral PTAs. In practice, however, intra-CIS trade was regulated through bilateral agreements, which did not lead to genuine regional trade integration.

Under Article 23 on 'Entry into force', the 1994 FTA entered into force 'for the Parties that ratified it, from the date the ratification instrument from the third member state is received by the depositary'. However, since Russia's failure to ratify prevented a multilateral FTA encompassing all members from being implemented, trade among CIS states has been regulated in practice through a web of **bilateral preferential / free trade agreements**.

The multilateral FTA therefore virtually coexisted with bilateral PTAs/FTAs, providing a legal framework for trade between countries with no bilateral agreement. Both the multilateral FTA and the bilateral PTAs/FTAs had

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[52] Agreement on the Creation of a Free Trade Area, signed on15 April 1994 in Moscow (Russian Federation) by Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Ukraine and Uzbekistan.
[53] Agreement on the Creation of a Free Trade Area (1994).
[54] See the Preamble to the Agreement on the Creation of a Free Trade Area (1994).
[55] Article 3.2. of the Agreement on the Creation of a Free Trade Area, 1994.
[56] See O. Sushko, 'The dark side of integration: ambitions of domination in Russia's backyard', The Washington Quarterly, Vol. 27, No. 2, 2004.

many provisions with similar substance and scope of commitments; in the event of conflict, the multilateral FTA nominally prevailed.

The multilateral FTA was without prejudice to the right of its parties to an independent external trade policy vis-à-vis non-party countries, and to the rights and privileges of its parties under economic associations, frontier trade, preferential treatment for developing countries, and free economic zones[57] (e.g. the Republic of Moldova became a member of the Central European FTA – CEFTA). Moreover, the provisions of the multilateral FTA did not contradict WTO rules. Indeed, even though most CIS countries had not joined WTO at that point, the parties of the multilateral FTA agreed to rely on the GATT/WTO agreements for the sake of interpretation of the Agreement.[58]

The initial idea of creating a CIS customs union that would lead to an economic union failed to materialise.

Bilateral agreements within the CIS have indeed introduced some generally recognised mechanisms of free trade, such as cancelling import tariffs and quota restrictions between states, while enabling parties to adopt protective measures (e.g. countervailing measures to protect internal markets from subsidised imports) in case of necessity, in accordance with the norms and principles of the WTO.[59] However, this network of bilateral treaties did not result in genuine regional trade integration.

All the bilateral PTAs/FTAs concluded in the CIS area shared common features:

As a consequence, regional economic cooperation unfolded at 'diverse speeds' with Belarus, Kazakhstan and the Russian Federation leading the integration process.

- They included, in a separate protocol, an open and relatively wide range of asymmetric exemptions. Such exemptions were expected to be phased out under an agreed timeline; however, there were no penalties if deadlines were not met.
- Bilateral PTAs/FTAs were not seen as permanent; they could have been reviewed and substantially amended in line with political developments.
- The agreements left room for imposing trade remedies, antidumping and countervailing duties, and quantitative trade restrictions on virtually any pretext. This led to a number of trade wars in the CIS area in the years that followed.[60]

Therefore the idea of creating a CIS customs union, as initially envisaged in

[57] Article 20 of the Agreement on the Creation of a Free Trade Area, 1994. In fact, Article 20.1 of the Agreement on the Creation of a Free Trade Area states: 'Nothing in this Agreement prevents any of the Contracting Parties from implementing the obligations under other international agreements of which this Contracting Party is a signatory or can be a signatory, *provided these obligations do not contradict the provisions and objectives of this Agreement*' [emphasis added].
[58] Article 1.3 of the Agreement on the Creation of a Free Trade Area, 1994.
[59] Some bilateral agreements also contain exceptions and restrictions on the most sensitive goods and services.
[60] G. Idrisov, B. Taganov, Regional Trade Integration in the CIS Area, MPRA - Munich University, September 2013.

the Economic Union Treaty, failed to materialise as a result of long lists of exceptions to free trade, lack of progress in harmonising external commercial policies, and differences in the CIS countries' view of prospects of mutual cooperation.[61]

In 2000 the five countries established the Eurasian Economic Community (EurAsEC), which entered into force on 30 May 2001.

Regional economic cooperation in the post-Soviet space then continued through 'diverse speed' integration, where each consecutive stage of integration would involve only those countries that were most prepared to accept it.[62] The notion of 'diverse speed' eventually led to different integration trends in the region, largely spurred by the bulk of the three countries most committed to deep (re)integration: the Russian Federation, Belarus and Kazakhstan.

In January 1995 Belarus, Kazakhstan and the Russian Federation signed a trilateral **Customs Union Agreement**.[63] The Kyrgyz Republic and Tajikistan acceded to the agreement in 1996 and 1999 respectively. On 26 February 1999 the five countries concluded the **Treaty on the Customs Union and Single Economic Space**, envisaging the completion of a single customs territory and the establishment of a common market in goods, services, capital and labour as the two consecutive stages of integration to be implemented.[64]

In 2003 Belarus, Kazakhstan, the Russian Federation and Ukraine tried to relaunch the SES project.

On 10 October 2000 the Presidents of Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation and Tajikistan gathered in Astana to sign the **Treaty on the Foundation of the Eurasian Economic Community (EurAsEC/EAEC)**, which entered into force on 30 May 2001.[65] Uzbekistan entered the EurAsEC in 2006, but withdrew its participation in 2008.

The Eurasian Economic Community had all the attributes of an international organisation (treaty-based international personality, membership consisting of sovereign states, organisational structure and decision-making system) and produced hundreds of agreements constituting the bulk of 'EurAsEC law'. Content-wise, the three most noteworthy features of the EurAsEC were:

However, Ukraine remained uncompromising about the need to make economic integration with CIS countries compatible with its

- The objective of creating a full-scale regime of free trade in goods 'with no exceptions and restrictions';[66]
- The notion that granting more favourable treatment to a third

[61] See: S. Shadikhodjaev, Trade Integration in the CIS Region: A Thorny Path towards a Customs Union, Journal of International Economic Law, 2009.
[62] Ibid.
[63] The signatories of the *trilateral* Customs Union Agreement (20 January 1995) assumed the rights and obligations accruing under the *bilateral* Customs Union Agreement signed by Belarus and Russia on 6 January 1995.
[64] Treaty on Customs Union and Single Economic Space, signed on 26 February 1999 by Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation and Tajikistan.
[65] Agreement on Foundation of Eurasian Economic Community, signed on 10 October 2000 in Astana (Kazakhstan) by Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation and Tajikistan.
[66] Article 8 of the Treaty on Customs Union and Single Economic Space, 1999.

goal of European integration.

Since a country cannot belong to two different customs unions at the same time, the SES would have prevented Ukraine from ever joining the EU.

Domestic opposition to the SES was strong; public protests against the agreement erupted in western Ukraine.

Ukraine's withdrawal from the project following the Orange Revolution put an end to the implementation of the SES agreement.

country than that provided to other EurAsEC members was not allowed (a provision normally associated with customs unions). This was an embryonic form of common trade policy;

- The goal of harmonisation of indirect taxation.

Despite its nominal ambitions, the EurAsEC remained for the most part an incomplete free-trade area regime unable to develop provisions for a customs union, and it failed to eliminate the problems related to trade discrimination among the member states.[67]

Two years after the launch of the EurAsEC, therefore, the presidents of Belarus, Kazakhstan, the Russian Federation and Ukraine signed the **Agreement on the formation of a Single Economic Space** (CIS Summit in Yalta, 19 September 2003). The concept of a single economic space introduced in the document was very similar to that of the EurAsEC; it appears then that the new project was launched mainly in order to induce Ukraine into more intense integration with the other three countries.[68] Although drafts of the agreements were initially agreed between Belarus, Kazakhstan and the Russian Federation, Ukraine ultimately approved them by introducing a clause stating that the Single Economic Space must adhere to the Ukrainian constitution and to Kiev's strategic goal of European integration.[69] In Ukraine's understanding, post-Soviet space integration would only be achievable if compatible with EU-space integration.

Ukraine and the Russian Federation had adopted different approaches to the scope of the Single Economic Space even at the drafting stage. The Russian leaders declared that the ultimate objective of the SES was to create a monetary union based on a common currency, but Ukraine rejected the idea. Since no country can join two customs or monetary unions at the same time, Ukraine also had to face strong domestic opposition to the creation of a customs union which would prevent the country from ever joining the EU. In fact, after Ukraine's President Leonid Kuchma and Prime Minister Viktor Yanukovich agreed to sign the SES agreement in Yalta, the head of the People's Movement of Ukraine party (Rukh), Boris Tarasyuk, called for Kuchma's impeachment. Moreover, public protests against the agreements erupted in the largest cities of western Ukraine in September and October 2003.[70] In the aftermath of the presidential election in December 2004 and the subsequent 'Orange Revolution' that brought Viktor Yuschenko to power, Ukraine radically changed its stance towards the Single Economic Space: the Verkhovna

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[67] See O. Sushko, 'The dark side of integration: ambitions of domination in Russia's backyard', The Washington Quarterly, Vol. 27, No. 2, 2004
[68] See: S. Shadikhodjaev, Trade Integration in the CIS Region: A Thorny Path towards a Customs Union, Journal of International Economic Law, 2009
[69] See O. Sushko, 'The dark side of integration: ambitions of domination in Russia's backyard', The Washington Quarterly, Vol. 27, No. 2, 2004
[70] Ibid.

Rada ratified the agreement with the reservation that this and subsequent agreements would not be in breach of the Ukrainian constitution.[71]

In August 2005 President Yuschenko declared to the summit of heads of state of the Single Economic Space that his country wished to sign only the 15 documents related to the free trade regime and that, in accordance with the Constitution of Ukraine, he did not intend to approve the agreements related to the creation of supranational bodies and a customs union. The Single Economic Space could thus ultimately not be implemented mainly because of Ukraine's lukewarm attitude towards integration beyond a free trade area.[72]

5.4 Dual-track integration in the post-Soviet space: The CISFTA vs the Eurasian Economic Union (EAEU)

Ukraine's step back led Belarus, Kazakhstan and the Russian Federation to think about the future of integration in post-Soviet space.

Ukraine's reluctance to proceed towards a customs union forced the leaders of Belarus, Kazakhstan and the Russian Federation to think about how to move forward, which eventually led them to agree on the need to deepen integration among themselves. We could call this driver the **first track** of Eurasian integration.

The result has been two simultaneous processes of integration in the region since 2010.

In parallel, a second track for regulating trade relations with Ukraine and other CIS countries needed to be found. On 18 October 2011 Russia, Ukraine, Belarus, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, Armenia and Tajikistan signed a new **CIS Free Trade Zone Agreement (CISFTA)** focused on compliance with international law.[73]

The first involved deepening economic integration among Belarus, Kazakhstan and the Russian Federation (the Eurasian process).

The second involved strengthening trade relations in the wider CIS

The 2011 CISFTA covers only trade in goods and eliminates export and import duties on a host of goods; however, the agreement also contains a number of exemptions, some of them to be phased out:

- The agreement established that all import tariffs, except those on sugar, would be eliminated by 1 January 2015. Pending a future agreement, Belarus, Kazakhstan, the Republic of Moldova and Russia would maintain import duties on sugar from Belarus, Kazakhstan and Russia;
- Negotiations to address the phase-out of remaining export tariffs would be launched no later than six months after the entry into force of the CISFTA;
- The agreement is not expected to liberalise the unofficial quota regime regulating bilateral trade in meat, poultry, dairy and sugar

[71] Article 4 of Ukraine's constitution at the time directly prohibited any part of the state's sovereignty being delegated to an external actor.
[72] See: S. Shadikhodjaev, Trade Integration in the CIS Region: A Thorny Path towards a Customs Union, Journal of International Economic Law, 2009
[73] Agreement for a Free Trade Zone, signed on 18 October 2011 in St. Petersburg (Russian Federation) by Armenia, Belarus, Kazakhstan the Kyrgyz Republic, the Republic of Moldova, Ukraine and Tajikistan.

area (the CISFTA process).

products between Russia and Belarus. The only CIS bans / quantitative restrictions subject to cancellation relate to trade in Kyrgyz alcohol.[74]

In 2011 Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Ukraine and Tajikistan established a CIS Free Trade Area.

The CISFTA replaced the 1994 FTA, as well as some other multilateral agreements and about a hundred previous bilateral agreements in the CIS.[75] Many bilateral agreements, however, remain in force. The following table provides an overview of existing PTAs/FTAs in the CIS area (as of 2013):

[74] USDA Foreign Agricultural Service, Assessment of the CIS Free Trade Agreement, 2012

[75] USDA Foreign Agricultural Service, Assessment of the CIS Free Trade Agreement, 2012.

Figure 20:
PTAs in the CIS area

	Arm	Aze	Geo	Kir	Mol	Taj	Uzb	Bel	Kaz	Rus	Tur	Ukr
Arm	X	NO	95-curr: FTA (bl)	94-11: FTA (bl)* 11-curr: FTA CIS*	93-11: FTA (bl) 11-curr: FTA CIS*	11-curr: FTA CIS*	NO	00-11: FTA (bl)* 11-curr: FTA CIS*	01-11: FTA (bl) 11-curr: FTA CIS*	04-11: FTA (bl)* 11-curr: FTA CIS*	96-curr: FTA (bl)	96-11: FTA (bl) 11-curr: FTA CIS*
Aze	NO	X	96-curr: FTA (bl)	NO	NO	NO	NO	NO	NO	93-curr: FTA (bl)*	NO	96-curr: FTA (bl)
Geo	95-curr: FTA (bl)	96-curr: FTA (bl)	X	NO	NO	NO	NO	NO	97-curr: FTA (bl)*	94-curr: FTA (bl)*	96-curr: FTA (bl)	95-curr: FTA (bl)
Kir	94-11: FTA (bl)* 11-curr: FTA CIS*	NO	NO	X	95-11: FTA (bl) 11-curr: FTA CIS*	99-11: FTA (bl)*[02] 11-curr: FTA CIS*	96-curr: FTA (bl)*	99-11: FTA (bl) 11-curr: FTA CIS*	95-11: FTA (bl) 11-curr: FTA CIS*	92-11: FTA (bl) 11-curr: FTA CIS*	NO	95-11: FTA (bl) 11-curr: FTA CIS*
Mol	93-11: FTA (bl) 11-curr: FTA CIS*	NO	NO	95-11: FTA (bl) 11-curr: FTA CIS*	X	11-curr: FTA CIS*	NO	93-11: FTA (bl) 11-curr: FTA CIS*	11-curr: FTA CIS*	93-11: FTA (bl)* 11-curr: FTA CIS*	NO	11-curr: FTA CIS*
Taj	11-curr: FTA CIS*	NO	NO	99-11: FTA (bl)*[02] 11-curr: FTA CIS*	11-curr: FTA CIS*	X	NO	98-11: FTA (bl) 11-curr: FTA CIS*	95-11: FTA (bl)*[95] 11-curr: FTA CIS*	92-11: FTA (bl)*[95] 11-curr: FTA CIS*	NO	01-11: FTA (bl) 11-curr: FTA CIS*
Uzb	NO	NO	NO	96-curr: FTA (bl)*	NO	NO	X	NO	NO	92-curr: FTA (bl)*	NO	NO
Bel	00-11: FTA (bl)* 11-curr: FTA CIS*	NO	NO	99-11: FTA (bl) 11-curr: FTA CIS*	93-11: FTA (bl) 11-curr: FTA CIS*	98-11: FTA (bl) 11-curr: FTA CIS*	NO	X	97-10: FTA (bl) 10-curr: CU 11-curr: FTA CIS* 12-curr: CES	92-10: FTA (bl)*[95] 10-curr: CU 11-curr: FTA CIS* 12-curr: CES	NO	92-11: FTA (bl)* 11-curr: FTA CIS*
Kaz	01-11: FTA (bl) 11-curr: FTA CIS*	NO	97-curr: FTA (bl)*	95-11: FTA (bl) 11-curr: FTA CIS*	11-curr: FTA CIS*	95-11: FTA (bl)*[95] 11-curr: FTA CIS*	NO	97-10: FTA (bl) 10-curr: CU 11-curr: FTA CIS* 12-curr: CES*	X	92-10: FTA (bl)*[95] 10-curr: CU 11-curr: FTA CIS* 12-curr: CES	NO	94-11: FTA (bl) 11-curr: FTA CIS*
Rus	04-11: FTA (bl)* 11-curr: FTA CIS*	93-curr: FTA (bl)*	94-curr: FTA (bl)*	92-11: FTA (bl) 11-curr: FTA CIS*	93-11: FTA (bl)* 11-curr: FTA CIS*	92-11: FTA (bl)*[95] 11-curr: FTA CIS*	92-curr: FTA (bl)*	92-10: FTA (bl)*[95] 10-curr: CU 11-curr: FTA CIS* 12-curr: CES*	92-10: FTA (bl)*[95] 10-curr: CU 11-curr: FTA CIS* 12-curr: CES*	x	92-curr: FTA (bl)*	93-11: FTA (bl)* 11-curr: FTA CIS*
Tur	96-curr: FTA (bl)	NO	96-curr: FTA (bl)	NO	NO	NO	NO	NO	NO	92-curr: FTA (bl)*	X	95-curr: FTA (bl)
Ukr	96-11: FTA (bl) 11-curr: FTA CIS*	96-curr: FTA (bl)	95-curr: FTA (bl)	95-11: FTA (bl) 11-curr: FTA CIS*	11-curr: FTA CIS*	01-11: FTA (bl) 11-curr: FTA CIS*	NO	92-11: FTA (bl)* 11-curr: FTA CIS*	94-11: FTA (bl) 11-curr: FTA CIS*	93-11: FTA (bl)* 11-curr: FTA CIS*	95-curr: FTA (bl)	X

(bl) - bilateral agreement
[99] year of the signing the protocol on the complete abolition of exemptions from the free trade
*PTA with exemptions
CU - Customs union
CES - Common economic space

In force
Signed, but inactive
No agreement

Source: MPRA.

The multilateral CISFTA significantly reduced exemptions from free trade among its members.

The conclusion of a new multilateral FTA between CIS countries marked a significant step forward compared with the preferential trade relations in force in the post-Soviet space in the previous 20 years. The volume of exemptions from total trade turnover between CISFTA members decreased significantly in comparison with the limitations previously imposed by bilateral agreements and by the failed 1994 CISFTA. The reason behind this shift mostly lies in Russia's changed economic standing over the past two decades. In the early and mid-90s, the list of goods subject to export duties in the Russian Federation was relatively long, which was explained by the need to curb the growth of domestic prices. In the late 90s and early 2000s the list was significantly reduced (finally comprising mostly fuel, energy resources and metals).[76]

Today about 90 % of intra-CISFTA trade is carried free of import and export duties.

90 % of the intra-CIS trade covered by the 2011 multilateral free trade agreement is now carried out free of import and export duties. This substantial reduction in the level of exemptions boosted trade relations between CISFTA members.[77]

In the meantime, Belarus, Kazakhstan and the Russian Federation have been deepening the integration of their trade and economic policies in a restricted, three-country format (first track).

In parallel, Belarus, Kazakhstan and Russia worked between 2006 and 2009 on the preparation of a customs union (the Eurasian track).

At an informal meeting held in Sochi in August 2006, the leaders of the EurAsEC countries decided that Belarus, Kazakhstan and Russia would focus on establishing a Customs Union, temporarily leaving out the lagging-behind Kyrgyz Republic and Tajikistan. The **Treaty on the establishment of the Common Customs Territory and Creation of the Customs Union between Belarus, Kazakhstan and the Russian**

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[76] G. Idrisov, B. Taganov, Regional Trade Integration in the CIS Area, MPRA - Munich University, September 2013.
[77] The CIS-FTA liberalises 88.7 % of internal trade among parties. Article XXIV GATT requires, for Preferential Trade Agreements (PTA), that 'substantially all trade' among the parties be liberalised. The EU interprets this provision in a 'quantitative way', regarding as WTO-compatible a PTA surpassing the threshold of 90 % of all existing trade. The USA has a 'qualitative approach', which requires all sectors to be liberalised at the same time. CIS-FTA is very close to the EU threshold and it is probably in line with the US threshold. It is a relevant step forward compared with previous ex-Soviet agreements, hostages of 'trade wars', and long lists of exceptions and trade defence measures protecting strategic industries. G. Idrisov, B. Taganov, Regional Trade Integration in the CIS Area, MPRA - Munich University, September 2013.

Federation was signed in October 2007. In June 2009, the timeline for the creation of a single customs union area was defined: the **Eurasian Customs Union (EACU)** between Belarus, Kazakhstan and the Russian Federation would be established on 1 January 2010. At the kick-off ceremony, the leaders of the signatory countries (Lukashenko, Medvedev, Nazarbayev) declared their intention of moving towards the establishment of a Eurasian Single Economic Space on the basis of the Eurasian Customs Union.[78]

On 1 January 2010 the Eurasian Customs Union (EACU) between Belarus, Kazakhstan and the Russian Federation was launched.

From 1 January 2010 Belarus, Kazakhstan and Russia implemented a single customs tariff and commodity nomenclature and delegated the regulation of their foreign trade to the **Commission of the Customs Union** (which was transformed into the Eurasian Economic Commission as of 1 February 2012).

The Commission of the Customs Union was in charge of regulating their foreign trade from 2010 to 2012, when it became the Eurasian Economic Commission.

The Commission of the EACU was in charge of changing import duty rates, introducing the commodity nomenclature, establishing tariff preferences and quotas, introducing non-tariff regulatory measures, conducting investigations and undertaking antidumping, countervailing and safeguard measures with respect to goods originating from third countries, drafting and adopting technical regulations, and coordinating policy with the aim of standardising safety requirements for consumer goods entering the EACU. In July 2010 the Unified Customs Code entered into force.[79]

The import customs duties collected by the EACU are allocated to the budgets of the three states in the following ratio: Belarus 4.7 %; Kazakhstan 7.33 %; Russia 87.97 %. As of 1 July 2011, all customs checks at the internal borders between the three states were supposed to be abolished, transferring customs control and clearance to the external borders of the EACU.[80]

On 1 January 2012, the EACU mutated into a Single Economic Space consisting of Belarus, Kazakhstan and the Russian Federation.

The SES is based on 17 agreements covering a wide range of policy fields.

On 1 January 2012 the Customs Union mutated into a **Single Economic Space (SES)** consisting of Belarus, Kazakhstan and Russia, based on 17 basic agreements that entered into force on the same day. Six of those agreements introduced unified principles and rules regarding: competition, state support to agriculture, granting industrial subsidies, protecting intellectual property rights, technical regulations, and regulating the activities of natural monopolies. The remaining 11 agreements cover the following areas: access to rail transport; trade in services and investments; state procurement; legal status of migrant workers and their family members; cooperation to counter illegal labour migration from third countries; coordination of macroeconomic policy and

[78] See: Eurasian Economic Integration: Facts and Figures, Eurasian Economic Commission (2013).

[79] DG Trade, Custom Code of the Customs Union between Belarus, Kazakhstan and Russian Federation

[80] See: Eurasian Economic Integration: Facts and Figures, Eurasian Economic Commission (2013).

principles of currency policy; free flow of capital on financial markets; access to the services of natural monopolies in the power industry; rules of access to the services of natural monopolies in pipeline gas transportation; administration, operation and development of unified oil and oil product markets. Each agreement had to be implemented by 2015; to reach this goal, several dozen documents had to be approved.[81]

On 29 May 2014 the leaders of the three countries signed the treaty establishing the Eurasian Economic Union (EAEU).

The most recent project aimed at establishing fully fledged regional integration is the **Eurasian Economic Union (EAEU)**. The EAEU agreement was signed in Minsk by **Belarus, Kazakhstan and Russia** on 29 May 2014. The Treaty enlarging the EAEU to **Armenia** was signed – together with an agreement on the termination of the Eurasian Economic Community (EurAsEC) – on 10 October 2014. The Treaty on the accession of **Kyrgyzstan** to the EAEU was formally endorsed by the Presidents of Belarus, Kazakhstan and Russia on 23 December in Moscow, but still needs to be ratified by the national parliaments. The EAEU entered into force on 1 January 2015 among four countries. According to Kyrgyzstan's President Almazbek Atambayev, his country´s membership will enter into force on 1 May 2015.

Armenia joined in October 2014, and the EAEU entered into force on 1 January 2015.

5.5 The decision-making and institutional framework of the Eurasian Economic Union (EAEU)

The EAEU borrows its institutional framework from the EACU.

The Eurasian Economic Union borrows from the Customs Union its institutional framework and organisational structure, which were expanded and adapted to the new project ahead of the 2015 kick-off. Its legal basis is the Eurasian Union Treaty signed in May 2014.

Within the Customs Union, the decision-making process was initially based on a **weighted voting system** with decisions taken by qualified majority of 2/3 of the votes. Russia had 55 % of the votes while Belarus and Kazakhstan had 22.5 % of the votes each, meaning that Russia could not impose its preferences alone but also that no decision could be reached without its consent.

The unanimity rule is likely to hamper the EAEU if it is further enlarged.

At the insistence of Kazakhstan and Belarus, weighted voting was subsequently dropped in favour of a purely intergovernmental system with decision-making ruled by the principle of **unanimity**. This is widely believed to have resulted from the efforts put in in 2012-2013 to make the Eurasian Union more attractive for Yanukovych's Ukraine at that time.[82] However, the shift towards unanimity is likely to hamper decision-making, should the EAEU enlarge further.

The organisational structure of the EAEU draws on the European Union, but its

Even though the institutional set-up of the Eurasian Economic Union is

[81] See: Eurasian Economic Integration: Facts and Figures, Eurasian Economic Commission (2013).

[82] See: N. Popescu, Eurasian Union: the real, the imaginary and the likely, European Union Institute for Security Studies (EUISS), Chaillot Paper n.132, September 2014.

governance is more hierarchical.

largely inspired by that of the European Union, its governance structure is more pyramidal.

Executive power is vested in the **College of the Eurasian Economic Commission**, which is composed of nine board members (three per member state) and presides over 23 departments.[83] The chair of the Eurasian Economic Commission is Viktor Krishtenko, former Russian deputy prime minister.

The physical headquarters of the Eurasian Economic Commission is located on Vivaldi Plaza in Moscow and houses some 1 000 staff members.

Figure 21: Structure of the Eurasian Economic Commission

Chairman of the EEC Board

- Organisational Support and Protocol Department
- Finance Department
- Legal Department
- IT Department
- Administrative Department

Member of the Board – Minister in charge of the Development of Integration and Macroeconomics

- Macroeconomic Policy Department
- Statistics Department
- Integration Development Department

Member of the Board – Minister in charge of Economy and Financial Policy

- Financial Policy Department Business Development Department

Member of the Board – Minister in charge of Industry and Agroindustrial Complex

- Industrial Policy Department
- Agricultural Policy Department

Member of the Board - Minister in charge of Trade

- Tariff and Non-Tariff Customs Regulation Department
- Department for Internal Market Defence
- Trade Policy Department

Member of the Board – Minister in charge of Technical Regulation

- Technical Regulation and Accreditation Department
- Sanitary, Phytosanitary and Veterinary Measures Department

Member of the Board – Minister in charge of Customs Cooperation

- Customs Regulations and Law Enforcement Practice Department
- Customs Infrastructure Department

Member of the Board – Minister in charge of Energy and Infrastructure

- Transport and Infrastructure Department
- Energy Department

Member of the Board – Minister in charge of Competition and Antitrust Regulation

- Department for Antitrust Regulation
- Department of Competition Policy and Public Procurement

Source: http://www.eurasiancommission.org/en/Pages/structure.aspx.

The **Council of the Eurasian Economic Commission oversees the executive**. Modelled on the EU Council, it has an annual rotating

[83] As the accession of Armenia is expected to lead to a reshuffle, the Eurasian Commission is likely to be reduced to eight board members (two per country). See: N. Popescu, Eurasian Union: the real, the imaginary and the likely, European Union Institute for Security Studies (EUISS), Chaillot Paper n.132, September 2014.

presidency and is composed of three serving deputy prime ministers from the member states.

At political level, the highest rank of decision making is occupied by the **High Eurasian Economic Council**, which can be convened either in the format of prime ministers or among presidents only.

5.6 The future of Eurasian integration: New opportunities or greater difficulties ahead?

Closer integration with Russia is expected to benefit smaller countries while increasing their dependency on Moscow's funds.

Closer integration with Russia should in theory bring benefits to smaller countries such as Belarus, Kazakhstan, Armenia and the Kyrgyz Republic, given that Russia accounts for 59 % of Belarus's imports and 35 % of its exports; 49 % of FDIs in Armenia come from Russian companies; remittances sent home by Kyrgyz workers in Russia account for roughly 30 % of Kyrgyzstan's GDP. However these benefits risk being offset by isolation from the rest of the world and increased dependence on Russian subsidisation and cheap energy. Indeed, in 2012, FDI from Russia represented 62 % of the total in Belarus, 49 % in Armenia, 22 % in Moldova, 7 % in Ukraine, 5 % in Georgia and 4 % in Azerbaijan and only 1 % in Kazakhstan.[84]

The Eurasian integration process gave them access to a market of 173 million people.

The Eurasian Economic Union represents the world's sixth trading bloc in terms of total GDP.

The process of Eurasian integration has given their manufacturers access to a market of 173 million people (i.e. more than 10 times the size of each of their countries), representing the 6th trading bloc per GDP and covering 15 % of the world's land surface (over 20 million square meters). In 2012 the EACU/SES area was the first producer worldwide of natural gas, oil and gas condensate, sunflowers and sugar beet; the second of mineral fertilisers; the third of electrical energy, cast iron and potatoes; and the fourth of coal, steel and wheat.[85] However, the Eurasian Economic Union is likely to face a number of challenges in the near future as well as in the long term.

The record of the Customs Union's first years has been rather mixed. Trade between Belarus, Kazakhstan and Russia has grown by some 40 % since 2010. Yet some Belarusian and Kazakh companies have complained that the removal of tariffs has made it easier for Russian businesses to compete locally, while Russia has raised non-tariff barriers to imports of their goods. Others have claimed that the lower prices resulting from the removal of tariffs have made it possible for lower-quality Russian products to crowd out rival exporters, thus making it too expensive for local businesses to buy the components they need for their products.[86]

Belarusian and Kazakh

According to data released by the Eurasian Economic Commission on 25

[84] Financial Times, Russia's neighbours: Primary colours, 9 June 2014.
[85] See: Eurasian Economic Integration: Facts and Figures, Eurasian Economic Commission (2013).
[86] Financial Times, Russia's neighbours: Primary colours, 9 June 2014.

companies have claimed that Russia has introduced non-tariff barriers for imports of Belarusian and Kazakh goods.

August 2014, trade exchanges among EACU members declined in 2013-2014, after an initial boost in trade in 2010-2012. Intra-EACU trade fell by 5 % in 2013 and by nearly 12 % in the first half of 2014.[87] Belarus seems to be the country that has benefited the most from the EACU since 2010, while Kazakhstan is on the losing side. In October 2013 Kazakhstan President Nursultan Nazarbayev complained that the EACU had a negative impact on the trade balance of the country, as its exports to Belarus and the Russian Federation dropped by 4 % (USD 7 billion in absolute terms), while imports increased by USD 17 billion. Moreover, Nazarbayev raised concerns over the persistence of obstacles to exports of Kazakh meat products and the lack of free access to the Russian electricity market.[88] The reason of the decline is mainly in the recession of the Russian economy (See Chapter 5.6.3.)

5.6.1 Persistence of intra-EAEU restrictions

Intra-EACU trade increased significantly in 2010-2012 but started to decline from 2013.

Eurasian integration still presents a number of flaws.

Despite the successful abolition of customs border, the adoption of a common customs code and the creation of a common labour market with freedom of movement of persons, the EACU/SES regulations adopted by the members still include a wide range of tariff restrictions on intra-EAEU trade. As the leaders of Belarus and Kazakhstan pointed out at a meeting of the Supreme Eurasian Economic Council in October 2013, freedom of movement of goods covers only two thirds of all product types and the common customs tariff includes over 100 exemptions for Belarusian and Kazakh goods.[89] Both Aleksander Lukashenko and Nursultan Nazarbayev pushed for the removal of barriers to energy cooperation. Lukashenko specifically demanded lifting of the requirement to pay the export duties on the sale of petroleum products made in Belarus from Russian oil into the Russian budget. Nazarbayev insisted particularly on allowing unrestricted transit via Russia of energy and electricity from Kazakhstan.[90]

5.6.2 Risk of compensation claims and retaliation from WTO members

The common customs tariff still includes several exemptions for Belarusian and Kazakh goods.

Intra-EAEU trade is not the only area of concern for smaller members, however. As regards trade with third countries, the EACU largely took Russia's tariff levels – which are higher than those previously applied by Kazakhstan and Armenia – as a basis for common external tariff provisions, meaning that other EACU member states had to raise their external tariff barrier. In practice, raising the tariffs not only makes importing from the EU and China more expensive for those countries, it also complicates the accession of Kazakhstan to the WTO and breaches Armenia's and

[87] Ibid.
[88] See: N. Popescu, Eurasian Union: the real, the imaginary and the likely, European Union Institute for Security Studies (EUISS), Chaillot Paper n.132, September 2014.
[89] OSW, The Customs Union summit: crisis instead of success, 30 October 2013.
[90] Ibid.

The EACU common external tariffs are higher than the ones previously applied by Kazakhstan and Armenia.

Kyrgyzstan's existing commitments to the WTO, triggering compensation claims and retaliation from other WTO members[91].

Average tariff of the EAEU seems however to be progressively declining in recent years: arithmetic mean rate of the Common Customs Tariff in 2012, 2013 and 2014 was respectively 10 %, 9.5 %, 8.7 %[92] as per Russians´ WTO commitments. However, while the EurASec was duly reported to WTO by Russia, its WTO compatibility is not to be taken for granted. Its respect of art.XXIV GATT, and in particular of the criterion of liberalising 'substantially all trade' can only be recognised by a DSB decision in case a dispute is raised (see Chapter 5.4).

For Armenia – and Kyrgyzstan in the near future – raising tariffs may lead other WTO members to claim compensation and retaliation.

Russia has offered to provide Armenia (and Kyrgyzstan in the near future) with subsidies to compensate for losses deriving from WTO members' compensation claims and retaliation following the application of higher external tariffs. Moreover, such promises have been matched by deals and **investment** in key industry sectors.

Russia has offered to make up for such losses through direct compensation and investment in key industry sectors.

The Russian state-controlled gas company Gazprom took full control of Armenia's and Kyrgyzstan's indebted state gas companies in the first half of 2013. Rosatom, the state nuclear power company, announced in September 2013 its intention of helping to extend the life of Armenia's outdated Metsamor nuclear power station. Rosneft, the state-controlled oil company, has announced plans to build a synthetic rubber plant in Armenia and made an offer to the Kyrgyz Republic to buy a major chain of petrol stations, to supply fuel to the airport in the city of Osh and to take a leading stake in the main airport. Russian Railways announced the investment of USD 500 million in upgrading Armenia's train network. Rushydro and Inter RAO, the Russian state electricity companies, are building hydroelectric power plants in the Kyrgyz Republic.[93]

Whereas Russia can afford at present to compensate for higher tariff losses for a few small countries such as Armenia and Kyrgyzstan, it is not certain that such a policy would prove sustainable in the long run (and particularly in the event of further EAEU enlargement).[94]

5.6.3 Russia's economic recession: Pulling down other EAEU countries?

The value of the rouble against the dollar fell dramatically in 2014,

In the first two weeks of 2015 alone, the rouble fell by 17.5 % against the dollar. The price of oil, Russia's main export, has slid to below USD 50 per barrel. According to Russia's Finance Minister, Anton Siluanov, the fall in oil prices will cost the state budget, which was calculated on the basis of USD

[91] See N. Popescu, Eurasian Union: the real, the imaginary and the likely, European Union Institute for Security Studies (EUISS), Chaillot Paper n.132, September 2014.
[92] See Eurasian Economic Commission.
[93] Financial Times, Russia's neighbours: Primary colours, 9 June 2014.
[94] See N. Popescu, 2014.

dragging down national currencies throughout the EAEU.

100 a barrel, 20 % of planned revenues (i.e. around USD 45 billion). Russian GDP is now expected to contract by between 3 % and 5 % in 2015.[95]

Russia's shrinking economy may also hit other EAEU countries.

Russia's shrinking economy is likely to drag down the other EAEU countries, and not only because the Kremlin may become less enthusiastic in subsidising countries such as Belarus and Armenia, which have been very dependent on Russian financial aid in recent years. In a context of high regional interdependence, the fall of the rouble is taking down other currencies in the post-Soviet area.

Armenia's economy has already slowed.

In Armenia, the economy has slowed down as Armenian products priced in dollars have suddenly lost their competitiveness in the Russian market following the slip of the rouble. Yerevan seems to have joined the Eurasian Economic Union with an inauspicious start: according to the Armenian newspaper *Aikakan Schamanak*, the country's exports of manufactured goods to Russia dropped by 6.3% as a result of the fall in the rouble.[96] Since fewer foreign earnings entered the country, the Armenian *dram* fell by 12 % against the dollar in 2014.[97]

The same goes for Kazakhstan.

In Kazakhstan, the falling rouble makes it hard for Russian customers to afford Kazakh goods. Moreover, the government in Astana also has to protect its own industrial and agricultural sectors from low-cost Russian imports flooding the market. Being both a major trading partner of Russia and an oil producer, Kazakhstan has been badly hit by the collapse of the rouble and the price of oil. Rather than trying to protect the value of the Kazakh *tenge*, the government decided to devalue the national currency by 9 % in February 2014.[98]

For Belarus, the collapse of the Russian rouble has reduced revenues from its refineries that sell oil products to the Russian market.

The situation is not much better in Minsk. The Belarusian rouble has dropped by 14 % since the beginning of 2014. One of the reasons is that the fall of the Russian rouble has reduced revenues from Belarus's two largest refineries, which convert Russian crude oil into gasoline and other goods for the Russian market.[99]

Drops in currencies make it more expensive for EAEU countries to import from the west and to service their foreign debt.

For each of these countries, the drop in currency makes it **more expensive to import** badly needed products **from the West and to service their foreign debt**. Moreover, it means they must spend some of their scarce foreign currency reserves to slow down the devaluation rate of their currency.[100]

Similar problems are also being experienced in other countries across the post-Soviet space in connection with remittances from citizens working in

[95] The Economist, Russia's battered economy, 17 January 2015.
[96] Deutsche Welle, Russia's neighbours feeling the pain, 13 January 2015.
[97] Radio Free Europe, Money Troubles: Russia's Weak Ruble Pulls Down Neighbors' Currencies, 11 December 2014.
[98] Ibid.
[99] Radio Free Europe, Money Troubles: Russia's Weak Ruble Pulls Down Neighbors' Currencies, 11 December 2014.
[100] Ibid.

Russia (see Chapter 5.7.). For instance, the fall of the rouble has brought the Georgian *lari* down by 9 % against the dollar since the beginning of 2014, although Russia is not Georgia's major trading partner. The reason lies in the fact that roubles sent home by Georgians working in Russia contribute far less than before to the Georgian economy.[101]

All in all, much of the future economic performances of EAEU members – and, to a lesser extent, of non-EAEU neighbouring countries – will depend on Russia's ability to cope with the current recession.

Much will depend on Russia's ability to overcome the crisis.

The Russian economy still counts on its reserves to emerge from the crisis, as it did in 2008-2009 when the government succeeded in counteracting a GDP contracted by 7.5 % by saving indebted firms and increasing public spending to stimulate demand. However, the current recession may be harder to overcome, since some say Russia's reserves may last for a year and a half at best.[102] Others estimate that the level of foreign reserves (excluding gold) in Russia (USD 469.6 billion in 2013) will not fall in the coming years (reserves expected to be USD 466.3 billion in 2018), the ambitious domestic recovery plan notwithstanding.[103]

Russia can still count on foreign currency reserves for some time...

Faced with capital outflows and falling oil prices, lack of access to foreign markets and demographic problems, Russia is likely to need more time to recover this time.[104]

...but it badly needs to restructure and modernise its economy, particularly if oil prices continue to fall.

To overcome the crisis, Russia most probably needs to restructure the economy via deep structural reforms in order to restore the role of the markets. This is quite a hazardous stance for a country with a very low innovation rate: Russia is at the 44th world ranking for European patent applications in 2013, with two patent applications per million inhabitants (compared with 832 from Switzerland and 129 from the Republic of Korea)[105]. However, in a potential long-term scenario of energy scarcity and rebounding oil prices, the Russian Federation would be well placed to regain strong relative growth.

5.6.4 Discrepancies in EAEU members' application of bans on products from third countries

The EAEU also needs to coordinate the application of bans on foreign products.

The pressure exerted by Russia's recession on its partner countries is also likely to increase tensions over the uneven application of bans on foreign goods among EAEU members. In late 2014 the Russian Federation engaged in a trade war with Belarus on the basis of allegations that Minsk was acting as a hub for channelling banned EU milk and meat products into Russia.

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[101] Ibid.

[102] The Economist, Russia's battered economy, 17 January 2015.

[103] See IHS Connect. Country Reports: Country outlook: Economic - Russian Federation, February 2015.

[104] The Economist, Russia's battered economy, 17 January 2015.

[105] See European Patent Office, Annual report 2013: European patent applications.

When the Kremlin stopped agricultural imports from the EU in 2014, Belarus became a hub for channelling banned products into Russia.

A similar situation had already arisen earlier in the year, when Russia introduced a ban on Moldovan meat imports, starting from October 2014, allegedly because of a supposed lack of product controls on the Moldovan side.[106] Belarus, which had called on the Kremlin to end pressure on the Republic of Moldova, initially refused to apply the same ban and became a backdoor for Moldovan products to be re-exported to the Russian Federation. The Kremlin then withdrew its CISFTA preferences for Moldova (see Chapter 6), removing the 'zero duty' for 19 products[107] and urging Belarus to enhance controls on the quality of meat imported from the Republic of Moldova to be re-exported to Russia.[108] Shortly afterwards Minsk imposed a ban on imports of meat products from the Republic of Moldova as of 1 November 2014.[109]

Russia had already suspended imports of Moldovan fruit and vegetables since 11 July 2014 and of wine and alcoholic beverages since 11 September 2013. In 2013 Russia imported 43 % of Moldovan agricultural exports and, in particular, 90 % of Moldovan apples. As reported by the EUBAM Mission, Moldovan fruit exports to Belarus increased 24-fold following the Russian ban, meaning that the surplus was probably being re-exported to the Russian Federation.[110]

In November 2014 the Moscow-Minsk trade dispute led Russia to impose a temporary ban on Belarusian meat products coming from Belarus, as well as on food shipped to Kazakhstan but sold in Russia.

In November 2014 the bilateral dispute between the two EAEU members was re-ignited by Belarus's non-adoption of bans on EU agricultural products, resulting in Russia's temporary ban on imports from 23 Belarusian meat processors and on Belarusian food transit to Kazakhstan. According to the Russian authorities, phytosanitary controls had discovered coliform bacteria, salmonella, listeria and excessive antibiotics in Belarusian meat products. However, according to the Russian newspaper *Vzglyad*, the ban against Belarus followed the results of monitoring by the Rosselkhoznadzior – the Russian agricultural control and oversight body – which uncovered 11 000 tonnes of fruits and vegetables from Europe intended for Kazakhstan but eventually sold in Russia.[111]

Intra-EACU trade disputes disrupt the common external customs barrier.

Regardless of the reasons behind reciprocal bans and trade wars, the Eurasian Economic Union will surely need to tackle the uneven application of restrictions on foreign imports among its members, which harbours a

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[106] The Moscow Times, Russia bans meat imports from Moldova, 27 October 2014..
[107] The expected loss owing to the cancellation of the CIS Free Trade Agreement is around USD 31 million for the remainder of 2014. Source: European Policy Centre, Moldova: Heading into a hot autumn, 6 October 2014.
[108] ITAR-TASS, Russia may ban Belarus meat suppliers using Moldovan raw materials, 24 October 2014.
[109] MoldPres State News Agency, Belarus suspends meat products imports from Moldova, 1 November 2014.
[110] The Moscow Times, After Russia's Ban, Belarus Ramps Up Apple Imports From Moldova, 25 September 2014.
[111] Jamestown Foundation, New Trade War Erupts Between Russia and Belarus, 3 December 2014.

highly disruptive potential for the common external customs barrier.

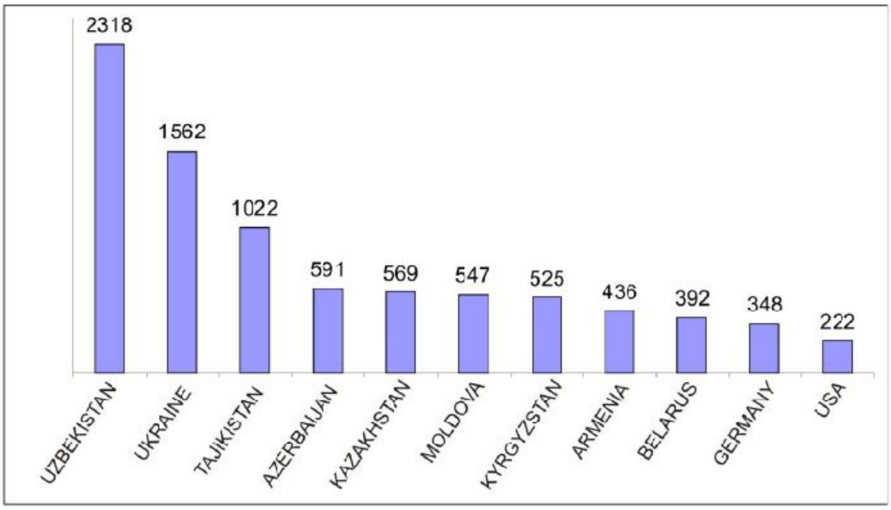
5.7 Free movement of persons: An attractive feature of the Eurasian Economic Union

Freedom of movement to Russia is an attractive prospect for many post-Soviet states.

In purely economic terms, the EAEU does not seem to be entirely attractive in its current composition. However, the prospect of attaining (or maintaining) **free movement of workers** with Russia is one of the most attractive features of the Eurasian Union for many post-Soviet states. Remittances from workers employed in the Russian labour market are crucial to the economic stability of many of these countries. In some cases – particularly that of poorest Central Asian countries – it is a question of survival.[112]

Figure 22 presents the number of foreign residents in Russia as of February 2014 and Figure 23 the level of remittances they send back to their countries. Neither figure takes account of illegal workers, a problem the Eurasian Union treaties were intended to tackle.

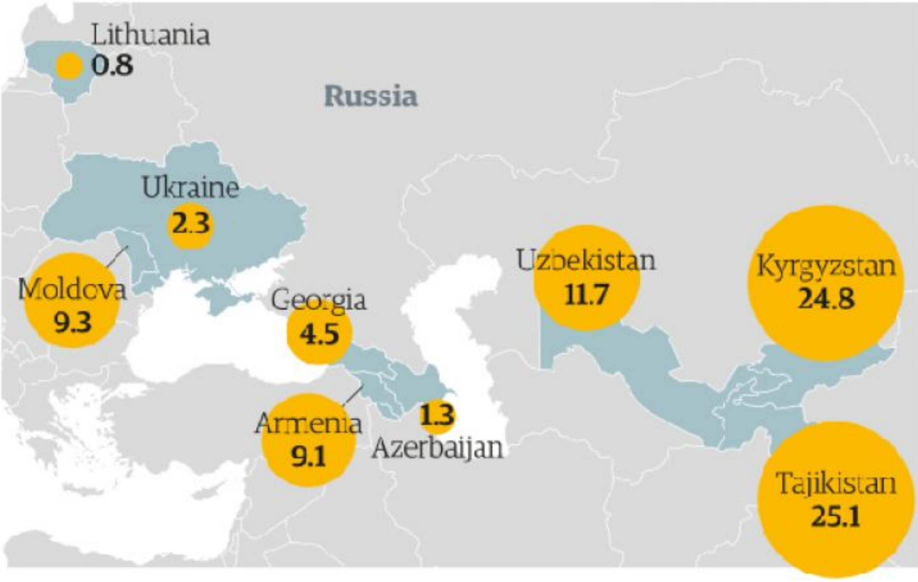
Figure 22:
Number of foreign citizens in Russia, February 2014, in thousands.



Source: Eurasian Development Bank [113].

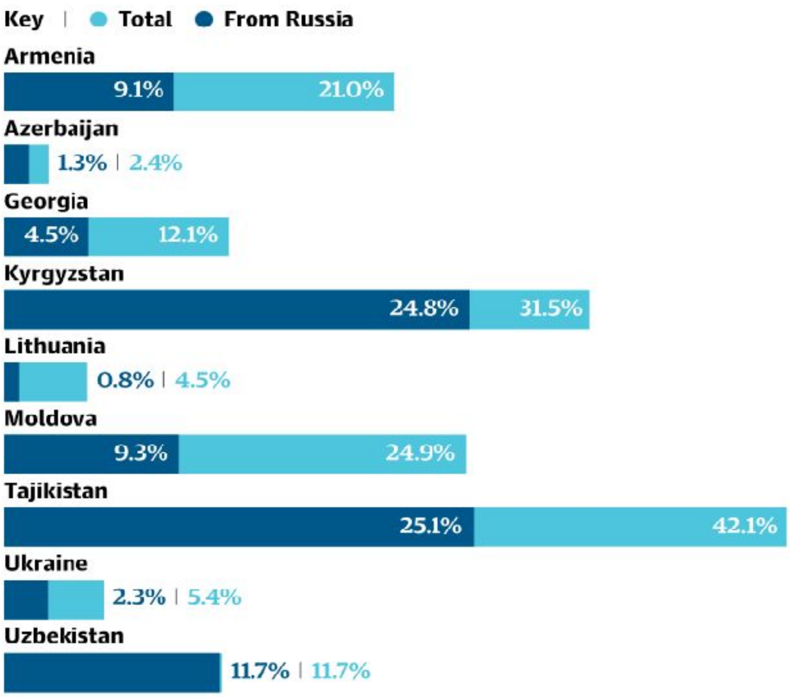
[112] Referring to Eurasian integration, Kyrgyz President Almazbek Atambayev stated in December 2013 that 'Ukraine has a choice, but unfortunately we do not have much of an alternative [to the Eurasian Union]'. See EUISS.
[113] See Pension Mobility within the Eurasian Economic Union and the CIS. Eurasian Development Bank, 2014

Figure 23:
Personal remittance,2013, as a % of GDP[114]



Source: The Guardian, based on data from the World Bank and the Russian Central Bank

Figure 24
Remittances from Russia vs total, 2013, in % of GDP[115]



Source: The Guardian, based on data from the World Bank and the Russian Central Bank

Labour mobility provisions in the EAEU mean that workers and their families do not require work permits.

The issue of **labour mobility** would certainly seem to be Russia's strongest means of leverage to attract post-Soviet states to the Eurasian project. Freedom of movement is based on the Agreement on the Legal Status of Migrant Workers and Members of Their Families, signed by Belarus, Kazakhstan and Russia in November 2010. It surpasses the visa-free regime

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[114] See Russia's rouble crisis poses threat to nine countries relying on remittances. The Guardian, 18 January 2015.
[115] See Russia's rouble crisis poses threat to nine countries relying on remittances. The Guardian, 18 January 2015.

already granted by the CIS treaty by providing for the elimination of work permits for workers from the other three countries (Article 3). Workers are allowed social protection (Article 11) and medical assistance (Article 13) under the law of the host country and these rights extend to their families. This advanced level of integration (which mirrors the free movement of persons in the EU) does not include pension rights and it contains a vague clause on respect for laws and cultural traditions (Article 15), a provision which could be turned in an arbitrary obstacle.

An ambitious proposal for harmonising pensions in the EAEU may attract new members...

Including pensions in EAEU law is perceived as an important issue, and a Eurasian Development Bank study advocates its introduction.[116] Almost one third of migrants working in Russia are close to retirement age, and the pension systems of the four members have different schemes and different retirement ages. The proposal takes into consideration the EU system, where common principles such as no double allowances and allowance portability are established, but where the pension´s burden is borne by the country of application. In the EAEU this system would put an excessive burden on Russia and Kazakhstan, so preference is given to proportionate pension accrual. This is a quite advanced integration proposal since it requires close coordination among state pension funds. This proposal will result in a more advantageous regime than the one agreed in 1992 at CIS level and is probably a strong incentive to accede to the Eurasia Union for states with a high remittance income, the first among them being Tajikistan (see Fig. 24).

...but it could also result in social tensions.

However, immigration of workers could turn into a disruptive element in the longer term. It seems relatively easy for Russia to open its borders to workers from Belarus, Ukraine or Kazakhstan. However, this does not necessarily apply to Central Asian countries, which are the source of an influx of poor rural Muslim migration into Russia.[117] Anti-immigrant resentment has recently become more of an issue in Russia, where 82 % of public opinion seems to be in favour of introducing visas for Central Asian countries.

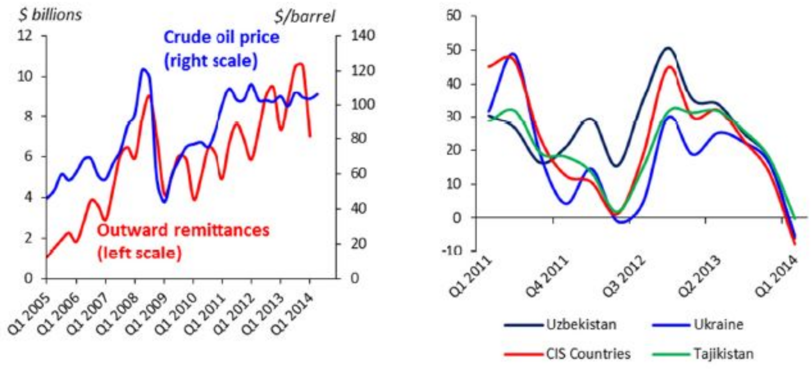
Further thought must be given to the evolution of remittances from Russia. They show a clear correlation with oil prices (Fig. 25 left) and a collapse of growth in 2014, first quarter.

[116] See Eurasian Development Bank, 2014

[117] Most post-Soviet states enjoy visa-free regimes with Russia, which do not imply an automatic right to work. However, millions of workers (primarily from Central Asia) work illegally without work permits after legally entering Russian territory.

Figure 25:
Correlation of oil prices with remittances from Russia (left), and

deceleration of Russian remittance growth (right)



Source: World Bank[118], based on data from the IMF and the Bank of Russia

Decreased remittances from Russia as a result of the economic crisis may mean the EAEU is less attractive to workers.

After growth of 7.5 % in 2013, remittances from Russia are expected to further decrease as a result of :

- Decreased turnover and lower salaries of immigrants working in the construction sector, one of the sectors most affected by the Russian economic downturn.
- Rouble depreciation against the dollar (14 % since the beginning of 2014), remittances being measured in dollars.
- Food price increases owing to the food ban affect lower-income groups disproportionately, so lowering the amounts migrants will be able to send home.

The outcome of the Russian economic crisis is expected to have an impact on immigration from EaP countries in the short term, so reducing the attractiveness of the Eurasian Economic Union for migrants. This is likely to further increase the balance of payment deficit for the Republic of Moldova, Ukraine, Georgia and Armenia. A comparison between the attractiveness of EU and Russian markets for EaP workers is made in the following chapter.

6 Costs and gains of the two forms of trade integration

Implementing the DCFTA is expected to increase Ukraine's GDP by 11.8 % in the long run.

A rough estimate of the advantages of integrating with the EU market rather than the EAEU is suggested by CASE 2012.[119] Comparing EU GDP in purchasing power parity (USD 15.65 trillion) with that of the EAEU (USD 2.76 trillion), this study suggests how much more advantageous it would be to accede to a larger trade area. Exports are driven by external demand, and eliminating tariffs and harmonising standards in a larger trade area would boost this.

Another study forecasts growth of 1.3 % in the medium term and 4.6 % in

[118] See Migration and Remittances: Recent Developments and Outlook. Special Topic: Forced Migration. The World Bank, October, 2014
[119] See EU-Ukraine DCFTA: the Model for Eastern Partnership Regional Trade Cooperation, CASE Network Studies and Analyses, October 2012.

the long term for **Ukraine** on implementation of a simple FTA, and growth of 4.3 % in the short term and 11.8 % in the long term as a consequence of the DCFTA.[120]

These expectations are probably more accurate than the impact analysis performed by Ecorys at the request of the Commission, dating back to 2007.[121] This study could not foresee the financial crisis of 2009, nor the Russian-imposed trade bans and the military escalation in Donetsk and Lugansk. This study forecast a welfare increase of 5.285 % if Ukraine signed an ambitious FTA and acceded to the WTO.

The short-term costs of DCFTA implementation should be partially compensated for by EU assistance, and will derive from:

Short-term costs will derive from increased competition, standards, legal reforms and labour reallocation.

- increased **domestic competition** owing to the elimination of tariff and non-tariff barriers with a consequent reallocation of factors of production;
- **mitigation costs** related to the DCFTA, primarily for the implementation of an active labour market policy that will be needed to mitigate effects associated with labour reallocation in the process of economic restructuring;
- increased **standard obedience costs**, as EU standards are generally more stringent, so that compliance with them would require more effort and expense. This relates to both TBT and SPS standards, as well as 'social' standards such as occupational safety requirements, environmental standards and social security;
- costs associated with **immediate legal and administrative adjustments** (establishment of independent regulatory bodies, introduction of new – probably technologically more advanced – procedures, etc.).

Had it joined the EAEU, Ukraine would have lost 3.7 % of GDP as a result of the higher external tariff.

On the other hand, in the event of accession to the EAEU, Ukraine would lose 0.5 % of GDP in the short term and 3.7 % in the medium term.[122] The difference between the short and medium terms does not relate to time but to a factor allocation (static in the short term and dynamic in the long term). This model takes into account the compatibility between the EAEU and the DCFTA, and assumes that, if it had entered the EAEU, Ukraine would have been forced to raise external tariffs with the EU, so creating a massive trade diversion. This would also require compensation for other WTO members.

However, this model assumes that trade with Russia will continue on the

[120] See Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan, German Advisory Group Institute for Economic Research and Policy Consulting, May 2011.
[121] See Trade Sustainability Impact Assessment for the FTA between the EU and Ukraine within the Enhanced Agreement, Ecorys December 2007.
[122] See German Advisory Group Institute for Economic Research and Policy Consulting, May 2011.

Economic analyses did not take into account Russia's politically-based retaliation.

basis of the 2011CISFTA, the second track of Eurasian integration, but this is likely to be discontinued because of a strong political reaction to the pro-European choice of Ukraine and Moldova. In August 2014 President Putin declared that the free trade regime for Ukraine would be suspended when it implemented the DCFTA, ostensibly to avoid Russia being invaded by EU products in a massive circumvention of the EAEU external tariff. According to him, CISFTA suspension would cost Ukraine EUR 165 billion over the next 10 years (surpassing the entire annual GDP of the country in 2013).[123] This figure can be quite inflated: more precise calculations on a total suspension of the CISFTA show an average duty increase of 7.8 % which could result in a USD 3 billion reduction in exports from Ukraine. This would represent 17 % of Ukraine´s total exports to Russia, equal to 1.7 % of GDP[124].Products with high elasticity (e.g. luxury products) are likely to experience a dramatic demand reduction; staple products with high rigidity (e.g. crops) may result in a stable export quantity. As in the case of Moldova (see infra), such a suspension is not based on the legal and economic provisions of the CISFTA.

The impact of potential suspension of trade preferences for Ukraine cannot be quantified with precision.

This threat was one of the reasons behind the postponement to 1 January 2016 of the enforcement of the Ukraine AA. [125]

In fact, the aforementioned studies do not provide precise measurements of the short-term costs deriving from adjustment nor of potential retaliations by the Russian Federation. Ukraine risks losing preferential treatment on a substantial part of its trade. Exports to the Russian Federation were 23.8 % of the total in 2013 and dropped to 19 % in 2014 as a result of the ongoing conflict and Russian bans on Ukrainian exports. This drop and a further reduction owing to the possible suspension of trade preferences is unlikely to be easily compensated for by trade creation with the EU, at least in the short term (see Chapter 3.7).

While Ukrainian exports to Russia has decreased in 2014, and at present ‘only’ represent 19 % of total Ukrainian exports, they cannot easily be

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[123] See Ukraine’s transition to EU trade will cost €165bn – Putin, RT 26 August 2014.
[124] See Russia´s punitive trade policy measures towards Ukraine, Moldova and Georgia, CEPS, September 2014. The figure may be increased adding possible Russian retaliations on Ukrainian workers and gas pipelines bypassing Ukraine with an alternative southern route (see infra in this chapter). Lost remittances may amount to USD 3.6 billion and lost gas transit fees to USD 3 billion per year. In any case total is largely below Pres. Putin declaration.
[125] ‘EU Trade Commissioner De Gucht, Minister of Foreign Affairs of Ukraine Klimkin and Minister of Economic Development of the Russian Federation Ulyukayev agree on the importance of promoting trade liberalisation in support of growth and greater prosperity, in line with their WTO obligations. **They concur on the need to ensure that the EU-Ukraine AA/DCFTA and the CIS FTA both contribute to a more integrated economic space in the region**. To be able to fully support the stabilisation of Ukraine, the Commission is ready, in the event that Ukraine ratifies the Association Agreement with the EU, to propose additional flexibility. Such flexibility will consist in delaying until 31 December 2015 the provisional application of the DCFTA while continuing autonomous trade EU measures for the benefit of Ukraine during this period’. See EU Commission, Joint Ministerial Statement on the Implementation of the EU-Ukraine AA/DCFTA

Reorienting Ukrainian and Moldovan exports to the EU is an option but would require strong investment, the conditions for which are lacking at present.

replaced by exports to the EU. Ukraine exports different goods to the EU and Russia, matching its regional specialisation and market proximity to the two markets. It therefore appears vital for the country to keep both trade export markets open unless a profound EU-oriented production conversion is launched. But this would require market-oriented investment, a safer economic environment (currently disrupted by corruption and military operations) and a strong demand from the EU (at present weakened by the eurozone crisis). In the long run, should Ukraine deeply reform they opaque economy, as required by the DCFTA, and should private companies envisage new market opportunities, new investments are likely to boost growth.

Completely losing the Eurasian markets would be a disaster for the country, as recognised by Prime Minister Arseniy Yatseniuk in his recent appeal to the Russian authorities not to drop CISFTA trade preferences.[126]

A recent study on **the Republic of Moldova**[127] quantifies adjustment costs. It estimates a quite modest overall increase in imports from the EU, amounting to 2.2 %. However, the increase will particularly affect sensitive sectors such as sugar, meat, textiles and apparel, and fruit and vegetables; imports of carpets, a strategic sector for the Republic of Moldova, would probably increase by 22 % and imports of sugar by 13 %. A sharp import increase could create concerns where the industry in question is a major contributor to Moldova's economy. Adjustment costs may derive primarily from increasing frictional unemployment (non-accelerating inflation rate of unemployment – NAIRU), mostly in the sectors of leather products, textiles and bricks.

Some Moldovan exports to Russia are unlikely to be redirected to the EU market in the short term.

However, the main problem arises from the mutually exclusive choice between East and West, exclusivity inherent to the Eurasian Economic Union project. As discussed in Chapter 2, the composition of Moldovan exports to the CIS area and to the EU is different. Can 'new demand' for Moldovan pharmaceuticals, fresh fruit, wines and spirits be created in the EU? This is quite unlikely, especially in the short term. EU standards are profoundly different, and competition created by southern EU countries is very strong. 5.4 % of Moldovan exports to Russia are accounted for by cognac. Would Moldovan cognac be welcomed on the EU market?

This leads to an incomplete assessment. Moldovan **gains** from the implementation of the AA are estimated at **between 5.4 %[128] and 6.4 %[129]** of GDP in the long term; **if it acceded to the EAEU, the Republic of Moldova would lose 9.7 % of GDP.** The latter estimation can be considered reliable since it takes into consideration the incompatibility of the Eurasian

[126] See Yatseniuk says CIS free trade agreement should not turn into 'zone of banned trade' under Russian pressure. Interfax Ukraine, 30 December 2014.
[127] See The DCFTA between Moldova and the EU – A Risk Assessment, September 2012.
[128] See Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova, CASE-Ecorys October 2012.
[129] See Moldova's trade policy: Strategy, DCFTA and Customs Union. German Economic Team Moldova, June 2013.

Customs Union with the EU market and its high tariffs. However, the gains from the treaty with the EU are probably inflated since they overlook the loss of trade eastwards, which is unlikely to be redirected to the EU given the lack of demand. Elimination of trade preferences with the CIS area, deriving from a political decision and a safeguard clause within the CISFTA, were not taken into consideration in the analyses available.

The Russian decree of 31 July 2014 established unilateral withdrawal of preferences under the CIS FTA safeguard clause, which entered into force at the end of August 2014. As a consequence, 22.5 % of Moldovan exports to Russia and Belarus will face high EAEU duties, putting the Republic of Moldova in the same MFN condition as all the other WTO partners.

Russia justified its suspension of trade preferences to Moldova as a safeguard measure, but the move does not appear fully in line with the CISFTA treaty´s provisions.

However, the application of the CISFTA safeguard clause does not seem to be in line with Annex 6 CISFTA,[130] which requires, in order to suspend CISFTA preferences, that one of the parties to the agreement gives rise to an increase in imports in other parties in quantities that harm or threaten to cause injury to an industry of the CISFTA members. Once an increase in imports is confirmed, Russia should only have the right to impose duties on specific Moldovan goods: a general suspension of preferences for Moldovan goods is not in line with the wording of the treaty. It could be based on the Vienna Convention of 1969, Article 60 (Termination or suspension of the operation of a treaty as a consequence of its breach), but only if the Russian Federation were able to demonstrate that the Republic of Moldova, when signing the AA with the EU, was in breach of the CISFTA treaty. It is hard to provide such a demonstration since the CISFTA parties are not prevented from concluding trade agreements with other States or Customs Unions (see Article 18 CISFTA).

This is likely to result in a dramatic loss of wealth which has not yet been fully estimated. Furthermore, it is likely to be worsened by a loss or reduction in remittances (workers´ remittances from Russia to the Republic of Moldova were equivalent to 9.3 % of GDP in 2013) should the tense situation not de-escalate.

Trade between Georgia and Russia is limited.

As regards **Georgia**, the impact analysis requested by the European Commission is more recent and reliable and estimates growth equivalent to 4.3 % of GDP in the long term, with a welfare increase of EUR 292 million arising from an export increase of 12 % and an import increase from the EU of 7 %.

Trade with Russia, compared with Ukraine, Armenia and the Republic of Moldova, is rather limited (6.6 of the total) and regulated by a bilateral trade agreement of 1994. Withdrawal from CIS was unilaterally decided by Georgia when the war with Russia started in 2008. Discussions on a possible suspension of Russian trade preferences with Georgia under the bilateral

[130] See Text of the Annex 6 (safeguard clause) of the CIS Free Trade Zone Agreement (CISFTA), signed on 18 October 2011 by Russia, Ukraine, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Armenia and Tajikistan.

FTA signed in 1994 started on 30 July 2014.

The accession of Armenia to the EAEU will result in higher duties on imports from the rest of the world.

Armenia decided to be part of the EAEU. Trade creation with the area is not deemed to be relevant, since it already benefits from a bilateral FTA with the Russian Federation. On the other hand, Armenian exports to the EU benefit from large trade preferences, deriving from GSP+ and a bilateral trade agreement, but trade diversion of EU exports is expected to be significant. The 56 % of imported products that come from extra-EAEU countries will be subject to higher duties, and imports will decrease in accordance with the price increase. Not all products are available in the EAEU, so the substitution effect will be limited. Positive trade effects of EAEU membership are not yet assessed in the studies available.[131]

Should it accept the DCFTA, it would experience a growth of 2.3 %.

On the other hand, the EU assessment[132] of signing an AA foresaw benefits in the form of a 2.3 %, increase in GDP, an export increase of 15.2 % and an import increase of 8.2 %. Once again, as in the previous cases, the EU analysis did not take into consideration external events such as losing CISFTA trade preferences on exports to Russia, equal to 22.6 % of Armenian exports. Moreover, as previously mentioned, remittances from Russia play a key role in stabilising the trade balance, and represented 9.1 % of Armenian GDP in 2013. Again, in the event of Russian retaliation, Armenia risks losing the favourable price of the energy supplies received from Russia and, last but not least, it risks losing Russian protection vis-à-vis Azerbaijan in the Nagorno-Karabakh conflict.

More workers are in the EAEU than in the EU (and their remittances are higher) as a result of more relaxed labour policies...

However, the costs and benefits to EaP Countries cannot be limited to trade. The retaliatory costs of a breakup with Russia also include the impact of migration/remittances and energy dependency.

The following table compares remittances and migrants for the Republic of Moldova, Armenia, Ukraine and Georgia in the EU and in Russia in 2012 (last available data for the EU).

...but Russia's economic crisis may change this situation.

Remittances from Russia largely surpass the ones from the EU, except for Moldova, and their role in stabilising EaP economies cannot be disregarded. However, owing to the current Russian economic crisis, their importance is due to decrease in the short run (see Chapter 6).

[131] See Armenia Economic report 2014: Eurasian Integration and Trade. Economic Development and Research Center (EDRC), November 2014

[132] See Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and the Republic of Armenia, Ecorys-CASE, September 2013.

Figure 26:
Migrations flows, 2012

2012	Migrants in RF (thousands) [133]	Migrants in the EU (thousands) [134]	Remittances from Russia (USD mln.) / % of GDP[135]	Remittances from the EU (USD mln)/ % of GDP[136]	Total remittances (USD mln) / % of GDP[137]	GDP (USD mln)[138]
Moldova	285	294	671/10.3	484/7.4	1170/18	6500
Ukraine	2939	1143	3628/2.3	1087/0.7	6500/4.1	156930
Armenia	511	68	827/9.1	122/1.4	1449/16.0	9020
Georgia	436	109	663/4.7	107/0.8	1061/7.6	14040

Source: EPRS, based on data from UN, World Bank, European Commission

The energy dependence of Moldova and of Ukraine differ.

Taking into account energy dependency and possible politically-based retaliation from Russia, the situation is different for the three signatories of AAs with the EU (see Chapter 3).

While Georgia does not import gas from Russia (see Chapter 3.5.), the Republic of Moldova and Ukraine are dependent on Russian imports, but the former could in theory be supplied by Romania, while Ukraine is already able to receive Russian and Norwegian gas via EU countries in 'reverse flow'. More details are needed in order to define the Moldovan and Ukrainian energy outlook.

Ukraine depends on Russian gas and survived the 2014-2015 winter thanks to 'reverse flow' and a 'winter package' brokered by the European Commission.

Ukraine's energy relations with Russia used to be defined by preferential pricing and transit revenue, but since the gas cut of June 2014, there has been a shift towards more diversification and security. The present 'winter package', serving as an interim agreement to resume gas supply to Ukraine and secure transits, only covers supplementary Ukrainian imports until 31 March 2015. Meanwhile, the country is mostly surviving the winter thanks to reverse flow from the EU, an action deemed to be illegal by Gazprom but tolerated in practice. Although Ukraine is managing to survive the current winter, the vulnerability it demonstrated suggests that, in terms of security of supply, the state is not ready to break free from energy dependence on Russia.

Higher gas prices and the IMF loan may drive Ukraine to increase its energy efficiency.

Up to the Vilnius summit, gas pricing was one of the key determinants for Ukraine in making its choice between the EU and EAEU. However, given the

[133] United Nations, Trends in International Migrant Stock: Migrants by Destination and Origin, 2013
[134] United Nations, Trends in International Migrant Stock: Migrants by Destination and Origin, 2013
[135] World Bank, Bilateral Remittance Estimates for 2012
[136] World Bank, Bilateral Remittance Estimates for 2012
[137] World Bank, Bilateral Remittance Estimates for 2012
[138] European Commission, Country trade statistics

tense situation and the outstanding debt cumulated by Ukraine, it is now highly unlikely that Russia will offer a preferential price to Ukraine in the future. Another important factor diminishing the significance of the Russian gas is the availability of natural gas from Europe. Although the quantities of European gas available at the Ukrainian border are limited, the price of gas Norway's Statoil proposed to Ukraine was around USD 100 below the Russian asking price (364-375).[139] Finally, Ukraine may reduce its energy dependency by increasing energy efficiency, fighting against corruption and terminating subsidies for the households, as required by the EU and IMF[140].

If Russian gas bypasses Ukraine through the 'Turkish stream', Ukraine would lose gas transit fees.

The highest-capacity pipelines bringing Russian gas to Europe go through Ukraine. The transit fees bring in significant revenue for Ukraine (around USD 3 billion per year), and stopping this would represent a significant loss. For the time being, therefore, it is highly unlikely that Russia will give up on around half of its European exports in order to put pressure on Ukraine. Russia is even prepared to invest heavily in order to gain an alternative route, bypassing Ukraine from the south, as the Nord Stream Russia-to-Germany pipeline bypasses Ukraine from the north. After dropping South Stream, a Black Sea route, Russia is now working on another project for the same purpose – an underwater pipeline to Turkey[141]. If an alternative route for Russian gas to reach Southern Europe becomes available, Ukrainian transits are very likely to be stopped or significantly reduced. As the transit fees account for around 10% of the national budget,[142] this would represent a heavy cost for Ukraine.

Moldova is dependent on Russian gas but could potentially get its supply from Romania.

The Republic of Moldova, including Transnistria, consumes around 3.5 bcm of gas each year, but only 1.5 bcm is consumed in the Chisinau administered territory. Currently Moldova's gas demand is fully supplied by Russia. However, in 2014 a pipeline connecting the Republic of Moldova to Romania, and therefore to the EU market, was built. Romania, which extracts 11 of the 12.5 bcm consumed yearly domestically, is said to be ready to export to the Republic of Moldova in 2017. The capacity of the pipeline is 1.5bcm – sufficient to fully supply the dropping domestic demand (not counting Transnistria). The pipeline should not only help to diversify Moldova's gas supply in the long term, but also provide security in the short- to mid-term, by largely neutralising the effects of a possible Russian gas cut. The price of Russian gas exported to the Republic of Moldova is higher than the estimated price that of gas imported from the EU. Russian energy relations are unlikely to end, as the Republic of Moldova serves as a transit country for Russian gas, and it is in the interests of both sides to continue. However, Russian gas supply and transit through the Republic of Moldova is fully dependent on the energy relations between Russian and Ukraine. If

[139] See Ukraine buys Norwegian gas in October for $265 per thousand cubic meters, 23 December 2014.
[140] See Ukraine's new bail-out. The austerity to come. The Economist, 12 February 2015
[141] Russia says it will shift gas transit from Ukraine to Turkey, Euractiv, 15 January 2015
[142] See Russia-Ukraine Gas Crisis: Implications over Energy Security in East Europe, 7 November 2014.

Russia opens an alternative supply route (the so-called Turkish stream), transit through Ukraine may be stopped, naturally putting a stop to Moldovan transit and incurring a heavy cost for the national budget.

7 Conclusion and policy options: Choosing, connecting, cooperating

The countries of the EU's Eastern Partnership have faced difficult choices, economic and political.

In deciding whether to pursue Eurasian or European integration, they have followed different paths[143]: Georgia, the Republic of Moldova and Ukraine have signed treaties with the EU, while also attempting to remain in the CIS free trade area. Belarus and Armenia have entered the Russian-led Eurasian Economic Union. Azerbaijan has chosen for neither.

As this study shows, these countries have had to sacrifice when opting exclusively for one of the two trading blocs. For those countries joining the EAEU, the economic results have been mixed. For those countries signing DCFTAs, there will also be losses as well as gains. The benefits of trade integration with the EU, estimated in a number of reliable studies, will be significant. Yet the path towards EU integration has led to retaliation from Russia – not economically grounded[144] and unforeseen in early impact analyses – and may possibly lead to a decline in trade with other EAEU members[145].

Today the question is whether and how to offset the loss resulting from the Eastern Partner's choices.

The question today is whether and how this loss can be remedied for those countries that have signed Association Agreements, including DCFTAs, with the EU – as well as for those countries that have joined the Eurasian Economic Union.

In general, policy-makers today have three options for shaping the economic and trade environments of the Eastern Partnership countries.

One option is to accept the *status quo*: the Eastern Partners that signed the Association Agreements pursue EU integration.

1. **The first option is to continue on the current path, maintaining the existing policy.**

   Those Eastern Partnership countries that have signed Association Agreements will progressively implement them, adopt EU internal legislation and standards, and pursue integration with the EU market. New business opportunities will arise over the long term from the countries' efforts to fight corruption, improve governance, and respect

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[143] In the case of Ukraine, the EU declared that it is not forcing the country to choose its camp, see Joint statement by the President of the European Commission José Manuel Barroso and the President of the European Council Herman Van Rompuy on Ukraine 25 November 2013.
[144] Russian trade measures on food bans are discussed in Chapter 2, and the suspension of trade preferences is discussed in Chapter 6.
[145] The price paid by signatories in their loss of trade preferences with Russia, remittances and cheap energy supply are substantial.

democracy and fundamental rights.

This is a commitment 'for better and for worse'.

However, if Russia suspends trade preferences, these countries will also lose significant trade with the east. Other retaliatory measures could affect freedom of movement in the EAEU and workers´ remittances. The loss of remittances from the east might as well be partially offset by those from the west, sent by workers benefitting from the EU's three-year working permits for 'key personnel' from Moldova, Ukraine and Georgia[146]. But the countries face other risks, particularly on short-term energy supply disruptions and – for Moldova and Ukraine – a loss of income from energy transit fees over the longer term. All these factors could exacerbate the current economic crisis.

For Ukraine, already financially supported by the EU and the IMF, the crisis would also burden western finances. If Russia's sanctions continue, the economic situation in the country will further deteriorate. The war in the east risks becoming a protracted conflict, interrupting industrial and business activities, and preventing the development of new opportunities offered by the implementation of the Association Agreement.

Russia's reactions could seriously harm Georgia and Moldova too: limits on Georgian and Moldovan workers in Russia may be more expensive in the short-term than the long-term gains from trade with the EU[147].

A second option would involve making the DCFTA and CISFTA compatible, so countries could remain in both.

2. **A second option would be to work towards enhancing the compatibility of the DCFTA and the CISFTA free trade areas, so that the Eastern Partner countries could more easily remain in both. There would be no choosing … and therefore no losing.**

From a trade perspective, this would involve implementing the FTAs more flexibly and smoothing out potential regulatory points of friction – a feasible proposal. This would not be the first example of overlapping FTAs with east and west. Serbia, for example, has FTAs with both the EU and Russia.

For the Eastern Partnership countries, the EU's Association Agreements permit this. Article 39 of the Ukrainian Association Agreement, Article 36 of the Georgian Association Agreement and Article 157 of the Moldovan Association Agreement state that the agreement 'shall not preclude the maintenance or establishment of customs unions, free trade areas or

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[146] In the long run, only the free movement of persons between these countries and the EU could offset the remittances currently coming from Russia – but this would occur only with accession to the EU. The EP has stated that these countries **'may apply to become a member of the European Union'** in his resolutions of 13 November 2014 on the AA with the Republic of Moldova, of 18 December 2014 on the AA with Georgia, of 14 January 2015 on the AA with Ukraine.
[147] In fact, the economic downturn is Russia has already reduced workers´ remittances to Moldova and Georgia, which means that the impact of any retaliatory measures would be lessened.

arrangements for frontier traffic except insofar as they conflict with trade arrangements provided for in [the EU AA].'

The CISFTA also includes a compatibility clause (Article 18): 'the current treaty does not preclude participating states from taking part in customs unions, free trade or arrangements for frontier traffic that correspond to WTO rules'.

However, there are hurdles to be cleared – technical as well as political.

The issue of standards poses a potential hurdle, but could be cleared through negotiations.

One potential technical obstacle involves standards. Each free trade area has a set of own standards. In the case of the EU, these are the 'CEN-CENELEC' standards; for the Eurasian Union these are 'GOST' standards[148]. If one set becomes obligatory for a country, trade with countries using the other set may become more difficult. Goods that meet one set of standards might need supplementary certification (a potentially cumbersome process) to enter markets with another set.

But the problem of standards is a hurdle that can be cleared through negotiation. Both parties – the members of the DCFTA and the CISFTA – could make their industrial standards compatible.

While Moscow has worried about the effect of overlapping FTAs on the Russian market, safeguard clauses would prevent EU goods from flooding Russia.

Political hurdles are less predictable, and leaders have expressed contradictory positions on this prospect. At one point, Moscow argued that allowing countries to join both free trade areas would create the risk that the Russian market would be flooded with European goods circumventing the EAEU's external tariffs. In such a scenario, EU goods would enter Ukraine or the Republic of Moldova duty-free thanks to the DCFTA, then continue on to Russia, duty-free through the CISFTA.

In fact, this fear is unfounded, as both treaties provide clear rules of origin (quite strict in the DCFTA) that prevent trade circumvention and fraud. Both treaties also include safeguard clauses to re-impose the WTO's most favoured nation (MFN) duties in the event of injury to domestic industry created by increased imports – or by the threat of increased imports – from one of the parties[149].

Both Russian and EU leaders have begun to broach the

Russia has given some indication it is willing to negotiate on this issue: Russian Economy Minister Aleksei Ulyukaev stated that trade conflict is not inevitable, and that Russia could and should try to avoid it: 'Yes, we need to try to combine the logic of Ukraine being in the CIS free trade zone and Ukraine's possible participation in the European Union's free

[148] GOST interstate standards (acronym for **go**sudarstvennyy **st**andart, or 'State Standards') are common to Russia, Belarus, Ukraine, Moldova, Kazakhstan, Azerbaijan, Armenia, Kyrgyzstan, Uzbekistan, Tajikistan, Georgia, and Turkmenistan (See chapter 3.1).

[149] This clause has been invoked to justify the suspension of CISFTA preferences to Moldova. For an evaluation see Chapter 6.

topic of compatibility.

trade zone … [although] it is a very complex task' he has said. 'You always have to look for possibilities. Politics is the art of the possible.'[150]

Any opening depends in large part on what happens in Ukraine, and what role Russia plays there.

For the EU too, an improvement in the political situation – and most importantly an end to the war in Ukraine, with Russia's support of the Minsk agreement – could re-open the prospect of trade talks. The EU's High Representative/Vice President Federica Mogherini made a first practical step in this direction, proposing a dialogue – specifically concerning Ukraine – 'limiting a perceived negative effect of EU-UA association on Russia'[151]. A clear condition of this dialogue was Russia's compliance with the Minsk Protocol of 5 September 2014.

The second Minsk protocol, of 12 February 2015, also officially endorsed 'trilateral talks between the EU, Ukraine and Russia in order to achieve practical solutions to concerns raised by Russia with regards to the implementation of the Deep and Comprehensive Free Trade Agreement between Ukraine and the EU.'[152]

If political and technical considerations can be addressed, such talks on trade cooperation would respond to multiple needs. Significantly, they would benefit the Eastern Partnership countries, sparing them the losses resulting from alignment with one or another trade bloc.

A third possibility would be to pursue a larger partnership between the EU and the EAEU.

3. **A third option – the most challenging – would be to extend negotiations beyond the two free trade areas and to work towards creating a real partnership between the two customs areas – the EU and the EAEU.**

In this case, the Eastern Partnership countries would not choose to pursue the programme of one or the other bloc; a move towards one would *de facto* mean a move towards the other.

Such a partnership could be pursued without establishing a new free trade agreement between the two unions (although that might be theoretically feasible in the very long run[153]). A process of regulatory

[150] See For Ukraine, Moldova, and Georgia Free Trade with Europe and Russia Is Possible, Carnegie Moscow, 3 July 2014.
[151] HR/VP Mogherini's proposal was contained in an Issues paper on relations with Russia presented to the Foreign Affairs Council on 19 January 2015 (*Financial Times* website).
[152] See Declaration of the President of the Russian Federation, the President of Ukraine, the President of the French Republic and the Chancellor of the Federal Republic of Germany in support of the 'Package of Measures for the Implementation of the Minsk Agreements', adopted on 12 February 2015 in Minsk. UN Security Council, 7384th Meeting (PM)
[153] Creating a free trade agreement between the two blocks would be extremely difficult. A customs union imposes a common external tariff, and its members negotiate preferential agreements with third countries as a single bloc. Trade rules apply to all members in order to avoid trade diversion and fraud. Aligning the EU and the EAEU with a free trade agreement would require that:

- A comprehensive agreement between the EU and EAEU be concluded.

dialogue – 'cooperation' – between the EU and the EAEU could be launched. This would try to establish compatibility between the two unions' customs procedures and standards – notably industrial, sanitary and phytosanitary standards.

Similar negotiations were launched in the past, but halted by Russia’s annexation of Crimea.

Dialogue on this was attempted in the past. In 2008, the EU and Russia launched discussions on a 'New Agreement' which includes trade issues but structurally differs from a WTO-based FTA. Talks were paused two years later for lack of progress. They remained on hold until being officially suspended by the European Council in March 2014, after Russia illegally annexed Crimea.

Over the following months, EU policy makers appeared unanimous in their condemnation of Moscow. But since then, some have come to advocate negotiations with Russia as the only way to quell the violent conflict in Ukraine and advance the Eastern Partnership generally. In January 2015, German Chancellor Angela Merkel referred to the ‘possibility for cooperation [with Russia] in a common trade areas’ at the World Economic Forum in Davos[154]. Although her words seemed radical at the moment, they were reflected in the Minsk Declaration on 12 February 2015, which declared that '*Leaders remain committed to building a common humanitarian and economic space from the Atlantic to the Pacific Ocean on the basis of full respect for international law and OSCE principles* '[155].

This option has gained traction among Member States leaders and the European Commission.

Since then, this notion has gained traction. On 4 March 2015, the European Commission circulated an official joint consultation paper to spur discussion on the reform of the European Neighbourhood Policy[156]. The aim was to transform the policy into 'a more effective vehicle for

The importance of negotiating with Russia is increasingly apparent.

- All members of the EAEU become members of the WTO (not currently the case).
- Zero duties be extended to all members of both customs unions.
- Countries within the EAEU applying the EAEU’s high duties to non-EAEU/non-EU WTO members pay compensation to those third countries. (This compensation would be high – as high as the average duties imposed by the EAEU.) Imports from third countries would be *de facto* prevented so long as the high duties are maintained.

All these conditions are unlikely to be met in the short term. To be fulfilled in the long term, they require extensive negotiations, as well as a prolonged period of political good will.

[154] See Ukraine crisis: Angela Merkel ‘offers Russia free trade deal for peace’. The Telegraph, 27 January 2015. http://www.telegraph.co.uk/news/worldnews/europe/ukraine/11365674/Ukraine-crisis-Angela-Merkel-offers-Russia-free-trade-deal-for-peace.html

[155] See Declaration of the President of the Russian Federation, the President of Ukraine, the President of the French Republic and the Chancellor of the Federal Republic of Germany in support of the ‘Package of Measures for the Implementation of the Minsk Agreements’, adopted on 12 February 2015 in Minsk. UN Security Council, 7384th Meeting (PM)

[156] See European Commission, Joint Consultation Paper 'Towards a new European Neighbourhood Policy', 4 March 2015.

promoting both the EU's interests and those of its partners'. And the answer? 'Taking into account, or in some cases co-operating with, the neighbours of neighbours.'

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While none of the policy options outlined above guarantee economic success, each would – to a different extent and in a different time frame – compensate for some of the initial losses incurred by the Eastern Partnership countries in choosing to move east or west.

In all cases, trade negotiations between the EU and Russia – which seemed unthinkable months ago – appear increasingly desirable, even necessary, and the question of trade has become undeniably linked with the broader political and security situation. The economic, political and military surprises of the past 16 months have demonstrated the necessity that the EU and the Eastern Partners address Russia's concerns as partners moving closer together.

The final form of the Eastern Partnership is in question.

This may also have ramifications for the final form of the partnership. For the European Parliament – but not for the European Council – the Eastern Partners have a long-term 'accession perspective' – a chance to apply for candidacy to the EU[157]. If the aim of the Partnership is to improve the economies, governance and socioeconomic situation in the EU's eastern neighbourhood, then confirming this perspective would serve as a more convincing reward for the difficult reforms – and short-term economic losses – the countries are asked to absorb.

Ex ante economic studies have proved short-sighted.

The trade and economic analysis provided in this study cannot provide leaders with a definitive answer for how to proceed. If anything, economists have been proven short-sighted by the events of the past 15 months: none of the *ex ante* impact analyses treating the Association Agreements for the Eastern Partnership anticipated the events and reactions – civil and military strife in Ukraine, Russia's response and sanctions – that so dramatically upended numerical predictions.

This study offers material to help leaders make well-informed choices, although no choice will be obvious or easy.

In complementing those earlier analyses, this study confirms how difficult the choices have been for the Eastern Partnership countries: all alternatives involve losses as well as gains from a trade point of view. Politicians, who must now direct the trade policies, are faced with equally thorny choices – political rocks and economic hard places in all directions. The information in this study will hopefully provide additional material for leaders to consider as they move forwards, with one the proposals outlined above –– or yet another.

[157] See the above mentioned EP non legislative resolutions of 13 November 2014 on the AA with the Republic of Moldova, of 18 December 2014 on the AA with Georgia, of 14 January 2015 on the AA with Ukraine.