

The EU-Ukraine
Association Agreement and Deep and Comprehensive
Free Trade Area

What's it all about?



Current issues of EU-Ukraine relations

Overview

Ukraine is a priority partner country for the European Union. Close political dialogue started in 1994 with the signature of the Partnership and Co-operation Agreement (PCA). Both the EU and Ukraine want to move further towards economic integration and deepening political association, as a key part of the EU's Eastern Partnership policy.

In March 2007 negotiations on a new **EU-Ukraine Association Agreement**, including a Deep and Comprehensive Free Trade Area, were launched. The negotiations ended in December 2011 and the agreement was initialed on 30 March 2012. The new agreement envisages the political association and economic integration of Ukraine with the EU. The EU intends to sign and ratify the Association Agreement as soon as possible, but this will depend on developments in Ukraine as set out in the Foreign Affairs Council conclusions of 10 December 2012. On 15 May 2013 the Commission decided to initiate the formal procedures for the signature of the Association Agreement with Ukraine. (This step by the Commission is a technical one and the EU continues to call on Ukraine to demonstrate progress in the three areas requested by the Council conclusions - elections, selective justice, and overall reforms as set out in the Association Agenda- in order for the signature to be possible.) If the proposal gets the green light from all 28 Member States then the signing might take place already at the Vilnius Summit of the Eastern Partnership at the end of November, 2013. After signature both Ukraine and the EU must ratify the agreement. In the case of the EU ratification involves not only the European Parliament, but all national parliaments of the Member States, too.

Trade and economic relations

The Deep and Comprehensive Free Trade Agreement (the DCFTA) is an integral part of the Association Agreement. It will build on Ukraine's membership of the World Trade Organisation (WTO) since 2008 and will further deepen the economic partnership between the EU and Ukraine.

The AA/DCFTA will provide a legal and political framework for an improved business climate to the benefit of both Ukrainian and EU business which will stimulate the competitiveness of the Ukrainian economy, a key driver for sustainable economic growth for Ukraine.

Trade in goods

The EU was Ukraine's second largest trading partner: in 2011, with 28% of all Ukrainian exports and 32% of Ukrainian imports. EU-Ukraine trade was worth €38 billion in 2012 (up slightly from 2011).

The main goods Ukraine exports to the EU are relatively low-value: ferrous metals, iron ore, electric machinery and cereals. The main goods the EU exports to Ukraine are relatively high-value: machinery, transport equipment, chemicals, textile and clothing, and agricultural products.

Ukrainian exports to the EU are to a large extent already liberalised thanks to the Generalised System of Preferences (GSP), which the EU granted to Ukraine in 1993. In 2011, total preferential exports to the EU under GSP amounted to 16.8 % of overall Ukrainian exports by volume. Preferential imports include machinery and mechanical appliances, plants, oils, base metals, chemicals and textiles. Furthermore, there are sectors where the Most Favoured Nation (MFN) duty applied by the EU is already zero (around 42% of all agricultural products can be sold duty-free by Ukrainian exporters on the EU market).

Existing quantitative import restrictions on steel and textiles were cancelled on May 16, 2008 when Ukraine acceded to the WTO. Since then Ukraine enjoys unrestricted exports of steel and textiles to the EU.

The Deep and Comprehensive Free Trade Agreement (the DCFTA) is an integral part of the Association Agreement) will build on Ukraine's membership of the World Trade Organisation (WTO) since 2008 and will further deepen the economic partnership between the EU and Ukraine.

The EU already accounts for about one third of Ukraine's external trade. The EU believes that closer economic integration will stimulate greater competitiveness and be a key factor in economic growth for Ukraine. The AA/DCFTA will provide a legal and political framework for an improved business climate to the benefit of both Ukrainian and EU business.

The EU-Ukraine Association Agreement (AA)

- AA will **deepen political and economic relations** between Ukraine and the EU, and provide the legal framework for the integration of Ukraine into the **European economic, social and environmental space**.

- the AA is therefore a **reform agenda for Ukraine**, around which the EU and other donors can align themselves to focus their assistance.

The AA will provide a new legal framework for EU-Ukraine relations, replacing the existing Partnership and Cooperation Agreement (which entered into force in 1998). The negotiations have now been completed and the AA was initialled on 30 March 2012. If signed at the Vilnius summit in November 2013 the Ukraine Association Agreement will be the first of a new generation of Association Agreements with Eastern Partnership countries.

This Agreement will exploit the dynamics in EU-Ukraine relations, focusing on support to core reforms, on competition and competitiveness, on economic recovery and growth, governance and sector co-operation in areas such as energy, transport, environment protection, industrial and small and medium enterprise (SME) cooperation, social development and protection, equal rights, consumer protection, education, training and youth as well as cultural cooperation.

The Association Agreement can also be seen as a reform agenda for Ukraine, based around a comprehensive programme of regulatory approximation, around which Ukraine's partners can align themselves and focus their assistance.

Closer economic integration through the DCFTA will be a powerful stimulus to the country's economic growth. As a core element of the Association Agreement, it will create business opportunities in Ukraine and will promote real economic modernization and integration with the EU. Higher standards, better services to citizens, and above all Ukrainian companies' ability to compete effectively on domestic and international markets should be the result of this process. Such a DCFTA, linked to the broader process of legislative approximation, will contribute to further economic integration with the EU Internal Market. In the longer-term the AA will provide the framework for Ukraine to catch up with the countries of the EU economically, socially and environmentally.

People will come closer together, not just governments. The Agreement also provides for more co-operation on the world stage on global issues such as anti-terrorism and peacekeeping; also on technical issues such as environment and energy, and above all in sharing and maintaining essential values - human rights and fundamental freedoms.

Finally, the Agreement also recognises the importance of the introduction of a visa-free travel regime for the citizens of Ukraine in due course, provided that the conditions for well-managed and secure mobility are in place.

Increased people-to-people contacts between EU and Ukrainian citizens and the benefits of economic development and trade for EU and Ukrainian economic operators will contribute enormously to the fostering of political association and economic integration between the European Union and Ukraine.

Technical and Financial Cooperation

- The European Union is the largest donor to Ukraine. Since 1991, the EU has committed over €3 billion to Ukraine.
- Current agreed priorities for EU assistance include 1) political dialogue, 2) justice, freedom & security, 3) economy & trade, and 4) Energy
- As from 2007, the European Neighbourhood and Partnership Instrument (ENPI) already raised EU- financial assistance to a new level (nearly €1 billion for 2007-2013) enabling more substantial and focused support to reforms.

To support reforms, ENPI uses the following financial tools:

- Budgetary support: Ukrainian government receives direct support (to the state budget), upon achievement of jointly agreed targets for reforms in a specific sector.
- Twinning, TAIEX and technical assistance provide EU expert help to Ukraine's reform process
- Construction and equipment projects to help Ukraine's reforms
- Grants to civil society and non-state actors to promote EU integration and reforms.

The national ENPI programme is complemented by Eastern Partnership multi-country programmes, regional projects and Cross Border Co-operation (CBC), in which Ukraine works together with neighbouring countries.

The EU is financing projects to improve nuclear safety in Ukraine. In addition to assisting in the management of radioactive waste and spent nuclear fuel and the control of nuclear materials, the EU is building the largest training centre for off-site preparedness in the Zaporizhya plant. The EU is also the biggest donor and partner to help close Chernobyl and replace the aging protective sarcophagus of the disastrous reactor 4.

Last but not least, the EU supports people-to-people exchange in education. Tempus, Erasmus Mundus and the Jean Monnet programme, help reform Ukraine's higher education system, provide scholarships, and support university partnerships and academic activities in European affairs.

Attitudes of Ukrainian citizens towards the European Union and the Customs Union

The latest research commissioned by the Foundation "European Council (Evrorada)" and conducted by the Rating Agency (one of the most reliable ones in Ukraine) shows that 50 percent of Ukrainians are in favour of the accession of Ukraine to the European Union and only 37 percent are against.

The idea of a joint state with Russia and Belarus would be supported by 42 percent of the respondents, while 47 percent are against. The public support for this hypothetical joint state has decreased in 2012.

When asked to make their choice between the EU and the Customs Union: 41% of the respondents were in favour of the EU, 38% in favour of the CU, 20% could not answer this question.

The highest support for the EU is:

- among voters of Svoboda (79%), Batkivshchyna (72%), UDAR (67%) - compared with 6% of CPU and 20% of the Party of Regions;
- in the Western Ukraine (72%), Northern part of Ukraine (54%) - compared with the South (17%) and the East (without Donbas - 33%) and Donbas (18%);
- among young people (18-29 years: 53%);
- among people with university degrees: 52%.

The support for the EU is almost the same in cities (41%) and in the countryside (42%).

The EU is associated with:

more opportunities for travel (55%), job opportunities (53%), increase of investments in Ukraine (51%), democracy development (41%), possibility to obtain a better education (41%), decrease of poverty (39%), decrease of corruption (39%).

Questions and answers:

GENERAL

Q: The EU-Ukraine AA needs a clear European perspective, which moves Ukraine closer to EU membership

The EU understands that membership is a strategic goal for many in Ukraine. However, what is on the table is an ambitious Association Agreement which offers the prospect of political association and economic integration with the EU rather than full membership

The Agreement will significantly deepen cooperation in all aspects of our relationship and will provide extensive access to the EU internal market. At the same time we are making progress towards the establishment of a visa free regime for short-stay travel to the EU. EU experts are closely working with Ukrainian authorities on the legislative reforms that should

be put in place in the framework of the Visa Liberalisation Action Plan jointly agreed between the EU and Ukraine.

By taking full advantage of the opportunities provided by the Association Agreement and with the support of the Eastern Partnership and the European Neighbourhood Policy Instrument, the EU and Ukraine will come significantly closer together. This is what is on the table today, and what can be implemented if the Association Agreement is signed.

A successful implementation of the AA will improve the quality of life, modernization and reform of all spheres of state and society, improving competitiveness of Ukrainian producers and more. This is the goal of European integration and not EU membership per se.

Q: What relevance has the experience of the new Member States for Ukraine?

The scope and obligations of the parties by far exceeds European Association Agreements of 1990s, and in some aspects - the Western Balkan Agreements on Stabilization and Association of 2000.

The experiences of the New Member States show that the ever-closer relations with the EU are beneficial. The pessimistic scenarios of a collapse of the Visegrad or Baltic countries' economies after opening up their markets (rise of inflation, unemployment, mass bankruptcies etc.) did not materialise. Instead, we have witnessed a relatively high rate of GDP growth in the region during the last 15 years, albeit with ups and downs in some countries. The other positive sign was a rise in exports. Interestingly even exports to Russia grew due, among other reasons, to a rise in the level of quality of technical products produced in these countries and productivity. As a result of integration, interest rates diminished and price convergence was observed. The reduction in interest rates was the result of free movement of capital, while the second resulted from the free movement of goods and services. We have also witnessed a rise of entrepreneurship among the young generation, an increased belief in education. The bottom line is that countries such as Poland now have far higher income levels than Ukraine – which was not the case 25 years ago.

Q: What is the EU position on the trials and conviction of opposition leaders and former members of the Tymoshenko government?

The EU has continuously voiced its strong concern regarding the politically motivated convictions of members of the former Government after trials which did not respect international standards. We regret that, as a consequence, opposition leaders were prevented from standing in the parliamentary elections in 2012. The Council decision on 10 December 2012 expects the authorities to address these cases without delay as well as to take further steps to reform the judiciary to prevent any recurrence. In this context the European Union welcomed the pardoning of former Interior Minister Yuriy Lutsenko in April 2013 as an important step, but we still look forward to Ukraine addressing Yulia Tymoshenko's case and preventing any recurrence of selective justice by a comprehensive judicial reform in line with European standards. The EU also commends the efforts undertaken by the European Parliament's monitoring mission to Ukraine headed by former Presidents Cox and Kwaśniewski.

ON THE ASSOCIATION AGREEMENT

Q: Why it is advantageous for Ukraine to sign AA/DCFTA?

The new Association Agreement will establish an “association” between the EU and Ukraine, moving on from the previous “partnership”. This is expressed by the formula “political association and economic integration”. With the exception of the European Economic Area and candidate countries, the EU has never opened up the Internal Market to participation by a 3rd country to such a degree. This is possible because Ukraine commits itself to take over the EU acquis (meaning the adoption and implementation of EU rules and standards in the Ukrainian economy). In return for effective implementation of the acquis, Ukraine will gradually become part of the Internal Market.

Q: What is the political significance of the initialling of the Association Agreement?

The Association Agreement was initialled by Ukrainian and EU chief negotiators on the 30th of March, 2012. This was an important technical step that sealed the text which had been negotiated since 2007. However it is not a political act: the text of the agreement was initialled at working level, without direct involvement of the political leaders of both sides.

Q: What is the significance of the 15 May Commission Decision?

The EU has done necessary preparatory step in order to be technically ready for the possible signing of the Association Agreement at the Eastern Partnership Summit in Vilnius. This decision technically enables the EU to move ahead with the required preparatory arrangements without pre-empting any decision. The signing of the Agreement remains conditional on progress by Ukrainian authorities on the benchmarks set out by the Council conclusions of 10 December 2012 and to be assessed by the Member States before the Vilnius Summit later this year.

Q: When will the Association Agreement be signed?

Ukraine’s performance will determine the date. It will be assessed on the basis of progress in three areas: the compliance of the 2012 parliamentary elections with international standards, as well as Ukraine’s progress in addressing the issue of selective justice, and in implementing the reforms defined in the jointly agreed Association Agenda. Both during the December 2012 Foreign Affairs Council and the February 2013 EU-UA Summit the EU reaffirmed its commitment to the signing of the already initialled AA/DCFTA, as soon as the Ukrainian authorities demonstrate determined action and tangible progress in the three areas above, possibly by the time of the Eastern Partnership Summit in Vilnius in November 2013.

Q: What about provisional application of the Association Agreement?

Concerning possible provisional application of the Agreement, no decision has been taken yet, but the 10 December 2012 Foreign Affairs Council decision declares that the signature could be accompanied by opening for provisional application of parts of the Agreement. Moreover the Commission has initiated the necessary EU procedures to allow for provisional application, subject to Member States' unanimous agreement..

The concrete decision on this would be announced by mutual agreement before the signing of the Agreement. Provisional application is only possible after signature.

We would consider that any early application of the Agreement should be based on a balanced approach between economic elements and the values-based parts of the Agreement (respect for human rights etc).

Q: How can Ukraine pave the way for the implementation of the Association Agreement?

The EU will continue to work closely with Ukraine to realize the Association Agenda, which was created precisely to lay the foundations for the Association Agreement, including its DCFTA part. We welcome civil society monitoring of our progress in this work, which needs to be accountable to the public.

The EU is ready to assist in this process. Both the EU National Indicative Programme for Ukraine (€470 million) and the EU Comprehensive Institution Building Programme for Ukraine (€43 million) have as a main focus on the preparation of the AA-DCFTA. The EU will soon begin to discuss with Ukraine its priorities for financial support in the period after 2014, and will obviously give a very high priority to Ukraine's institutional readiness to implement the commitments in the Agreement.

Q: Association with the EU will hurt Ukraine's relations with Russia.

The reform and modernisation of Ukraine in line with the Association Agreement is in the best interests of all parties, including Russia. It is about growing confidence in Ukraine as a stable, democratic and prosperous international partner, about strengthening the rule of law and about predictability. This affects all investors and business, including Russian, positively.

Moreover, under the DCFTA Ukraine can become a vital trade link and economic bridge between Brussels and Moscow, and later a unique platform for the development of beneficial relations between the EU and members of new integration projects at the post-Soviet area.

ON DCFTA

Q: What will be the concrete benefits of DCFTA for UA?

The signature and implementation of the DCFTA will completely revolutionise not only the economic, trade and investment relationship between Ukraine and the EU but the whole economic landscape of the country. As it has been already mentioned, the DCFTA is the most ambitious bilateral agreement that the EU has ever negotiated with a trading partner. It will not only open up our mutual markets by removing and reducing tariffs and quotas; it will also result in an extensive harmonisation of laws, norms and regulations across all economic sectors.

The DCFTA offers Ukraine a framework for economic modernisation and development that will positively affect many aspects of day-to-day economic life both for all businesses and citizens. Let us give you some examples.

- When the DCFTA is fully implemented, about 95% of tariff lines will be set at zero, and for the rest, tariffs will be reduced. So for 95% of trade flows between Ukraine

and the EU market access for exporters will open up. This will be particularly important for Ukraine in the agricultural sector, and in the metals sector, where Ukraine is traditionally strong, and where we can expect to see increased exports to the EU.

- Lower tariffs will lead to more competition, which will lead to lower prices for consumers.
- In the field of services, the DCFTA will result in liberalisation and alignment of Ukrainian and EU practices. This should have a particularly positive impact in Ukraine on distribution services and the communication sector.
- Free capital movement will also enhance economic growth by allowing easier access to capital and allocation of capital to its most productive use. The financial sector in Ukraine should benefit greatly.
- One of the most important problems that Ukrainian and European companies face today is the problem of different technical norms and standards, which makes cross-border trading more difficult. The DCFTA foresees widespread alignment between Ukrainian and EU standards, both for industrial goods and agricultural products. Over time, this alignment will reduce costs for companies that currently have to comply with two different sets of norms and regulations and apply for different certificates. There will also be indirect positive effects for Ukrainian producers as the new regulations will provide incentives for businesses to modernise and improve their production processes and invest in new technologies.
- Just to mention some other impacts briefly: alignment of rules on public procurement, competition policy, and intellectual property rights – all these changes will improve the business environment here by tackling corrupt practices, opening up new investment possibilities, and modernising the economy, leading to enhanced competitiveness.

Q: The Association Agreement and DCFTA will destroy whole sectors of the Ukrainian economy.

The early years of adaptation to deep and comprehensive free trade area may be difficult in some areas. This is not surprising, because systemic transformations always lead to short-term losses for some. However we are convinced that over time, new technologies will lead to higher productivity; higher wages and growth, together with new employment opportunities as we have seen, for example, in Poland and the Baltic states. Thanks to the DCFTA Ukrainian manufacturers will be able to compete effectively and win a place in the European market, find their niche and promote high-quality Ukrainian products – at a good price. Domestic consumers, in turn, will have access to high-quality European goods in Ukraine at lower prices.

Of course, there will be a struggle for economic survival for some sectors currently protected from competition. But this is a struggle, where the citizens of Ukraine, its economy and the country as a whole will be the winners as the resources currently tied up in those inefficient, uncompetitive sectors are released to higher value-added uses elsewhere in the economy. The

most sensitive sectors of the Ukrainian economy will have transitional periods that will allow the necessary time for this adaptation..

Moreover the AA signing will significantly increase the investment attractiveness and inflows of foreign direct investment in new factories and other facilities, which will directly help to modernise the economy..

Q. The DCFTA offers little more than other agreements with third countries such as South Korea, Chile, Morocco and Mexico.

The Agreements with these countries are of a totally different nature. They concern only a classical Free Trade Agreement, cover only trade in goods and do not include a regulatory approximation component which will eventually provide for the economic integration of Ukraine with the internal market of the EU.

The agreement with Ukraine would be unprecedented in terms of ambition and depth. The main difference is that it will lay the foundation for political association and economic integration between the EU and Ukraine and will make the modernization of the country based on the European model a legal obligation. Unlike a conventional FTA, it will also condition a comprehensive adaptation of European regulatory legislation in the areas of transport, energy, services, agriculture and so on by Ukraine. It will unify a significant share of legal frameworks of the two parties, eliminate non-tariff (technical) barriers in trade and provide enhanced access to the EU Single Market for Ukrainian exporters.

It is also important that the EU-Ukraine AA will be based on the recognition of Ukraine's European identity. This spirit of kinship and geographical proximity plays an important role in a gradual deep integration in key sectors, since in a number of practical areas such as energy security or transportation capabilities, Ukraine has great potential – unlike South Korea, Chile, Morocco or Mexico.

Q: The AA/ DCFTA will just mean a flood of imports into Ukraine

Many businesses in Ukraine fear that all the AA/DCFTA will do is open Ukraine's door to a flood of imports from the EU and mean increased competition with Ukrainian products. However this is not the case.

Firstly, the agreement is reciprocal so that there are equal opportunities for Ukrainian business in the EU market as there are for EU companies in the Ukrainian market. Secondly, EU products are already widely accepted in the Ukrainian market with de facto few barriers to entry to the market except for tariffs. Even for tariffs, the barriers are relatively low with average tariffs on imports from all markets (including the EU) 2-5% for non-agricultural and 11% for agricultural products. Average applied tariffs on actual imports from the EU are even lower so this means the impact of tariff liberalization for EU products will be very limited.

Q: The EU wants the AA/DCFTA more than Ukraine

Whilst Ukraine and the EU are equally committed politically to the conclusion of a deep and meaningful FTA, economically, an FTA is far more significant to Ukraine than to the EU. This is due to the huge disproportion existing between these two markets – the EU with 500

million consumers, the world's largest market, the nominal value of whose GDP in 2011 reached US\$ 20 trillion compared with the Ukrainian market, which is less than one-tenth times the size in terms of the number of consumers, and which generated a GDP less than 1 percent of the EU's (US\$165 billion). 2% of EU exports go to Ukraine whereas one third of Ukrainian exports go to the EU.

Q: There are no opportunities for Ukrainian businesses in EU markets

The European Union is the largest single market in the world with 27, soon to be 28, countries and a population 11 times that of Ukraine at 500 million consumers, each with average income of US\$ 39,000/year (compared with only US\$ 3,000 in Ukraine). For Ukraine to easily and effectively sell to this market, product regulations and health standards must be aligned with those of the EU. Following the implementation of a comprehensive and deep FTA, closer economic integration to this market will provide Ukrainian products with open access to an EU market 130 times greater than its own, valued at US\$ 20,000 bn .

Q: The AA/DCFTA Agreement will only benefit large agricultural and industrial manufacturers in Ukraine

Although there will be huge opportunities for large producers in Ukraine, aligning Ukraine's laws with those of the EU will mean that all businesses will have to adopt and apply these rules. On a longer term it would also help small and medium sized producers to be competitive and trade into the European market. Moreover, the agreement will also cover other areas which will provide further opportunities such as access to EU services markets for Ukrainian businesses. In addition, harmonisation in areas such as public procurement will provide opportunities for Ukrainian businesses to participate in EU works, supply and services public tenders directly at an EU, national and regional level - which total almost EUR 2,000 bn per year.

Q: Implementing the AA/DC FTA will simply mean changing some Ukrainian laws

Many people believe that to implement the FTA, Ukraine will just have to change some of its laws. However, Ukraine will have to change its laws, administrative procedures and restructure some of its institutions so that it mirrors some of the rules and regulations of the EU. By doing this, the EU will accept the judgement and authority of selected Ukrainian institutions and treat them as if they were EU institutions. This means, a product approved in Ukraine will be accepted without any further checks in the EU market.

Q: Only those who export or want to export to the EU will be affected by the AA/DCFTA

Many people think that the AA/DCFTA will not affect them as they are not involved, and do not want to be involved in trade with the EU. However, a comprehensive FTA and closer links with the EU will affect all businesses and consumers as Ukraine adopts many EU laws and procedures and then applies these nationally throughout Ukraine.

This will have a number of benefits for all businesses in Ukraine. Firstly, it will establish the clear and transparent business laws and procedures in many areas which are currently onerous. This means that all Ukrainian businesses will have a less uncertain business environment enabling them to effectively plan and grow their businesses. Also, because the laws will be transparent and be implemented with systems similar to those used in the EU,

there will be less scope for unfair abuses in the system which simply raises the costs for legitimate business.

Moreover, better health and safety standards will benefit Ukrainian consumers as they will be assured of the quality and hygiene of the products on sale and reduce the risk of harm to all.

Q: My business will not benefit from the AA/DCFTA

It should be recognised that there will be winners and losers amongst Ukrainian businesses as a result of the DCFTA with the EU. However, there will be more winners than losers, especially among more dynamic, growth-oriented businesses.

Moreover, the Government of Ukraine and business also need to work together to identify areas of opportunities and ensure that business makes the most of the opportunities provided within the DCFTA – these benefits do not come automatically and Ukrainian business will have work at it to take advantage.

Q: Ukraine will no longer be able to protect itself from unfair competition

It is often reported that by entering into an DCFTA with the EU and adopting its laws, Ukraine will lose some of its “policy space” and will no longer be able to protect against unfair competition, especially from EU companies. This will absolutely NOT be the case. In situations of unfair competition such as dumping, illegal subsidies and fraudulent claims of origin, Ukraine will be able to use its existing policy instruments, as provided by the WTO, to stop such trade or impose countervailing measures.

Q: After conclusion of negotiations, Ukraine’s commitments will apply immediately

It is often believed that Ukraine will have to adopt all the EU rules immediately after conclusion of the negotiations which will lead to huge costs to both the Ukrainian government and Ukrainian business. However, this is not the case. The DCFTA will be implemented progressively, with Ukrainian business rules changing gradually over a period of time, at least 10 years and for some areas, this could be longer. Therefore, Ukrainian business will have time to adjust and adapt its operations before it has to comply with new rules.

Q. The EU approach on agriculture is inadequate

The EU agricultural policy is very complex and this is reflected in international and bilateral negotiations. The approach we want to apply in the FTA with Ukraine is to liberalise substantially all imports of agricultural and food products. Therefore the agreement proposes 0% customs duty from on the date of entry into force of our agreement and improved market access for the rest (the most sensitive goods) by granting Ukraine 0% duty for certain quantities of imports, so called Tariff Rate Quotas (TRQs).

Q. The DCFTA should offer Ukraine the four freedoms

The aim of the DCFTA is to bring Ukraine as close as possible to the internal market. The extent to which this happens will depend on the ambition and capacity of Ukraine to achieve a reciprocal deep liberalisation through regulatory approximation with the EU acquis in selected areas. The four freedoms (free movement of goods, services, capital, and people) are pillars

of the EU's Internal Market. The circulation of goods, services, and capital will be thoroughly addressed in the DCFTA. As regards **movement of people**, this is being addressed through the visa dialogue towards the establishment of a visa free regime (for short stay travel). **Movement of workers** remains within the remit of our Member States and we have no mandate to aim for further liberalisation in this field (we have to recall that even our newer Member States have had long transition periods of their own).

Q. The EU wants Ukraine to take on board costly approximation; we should get compensation for this.

The way for Ukraine to integrate into the EU internal market goes via approximation to the *acquis*. So far Ukraine has been very enthusiastic about this and asked for a very comprehensive list of approximation, especially in the cooperation part of the Association Agreement. This, together with approximation to trade-relevant parts of the *acquis* in the DCFTA, will help Ukraine to anchor internal reforms. The payment for these efforts will be an opening of our market in areas where you fulfilled your commitments on legal and institutional alignment. It goes without saying that some technical and financial assistance will be offered horizontally in order to help Ukraine in the necessary reforms.

Q. Ukraine will lose 20% of its revenues when signing the AA/DCFTA

A free trade agreement generates more economic activity by boosting the trade flows between the two partners. Based on experience increased economic activity has the potential to promote increased public revenue. Furthermore both duties and VAT are part of state revenues and the VAT will not at all be touched by the DCFTA (increased trade will provide a higher overall amount of VAT).

DCFTA VERSUS CUSTOMS UNION

Q: Would it not make a lot of economic sense for Ukraine to rather join the Customs Union? And be less costly than the AA/DCFTA with the EU?

Indeed, Ukraine has important trade interests with the members of the Customs Union, mainly with Russia. Intuitively, this would speak for joining the Customs Union.

However, initial evidence of the trade and economic effects of the CU are not so clear cut. Most research has shown that very little new trade, or economic benefits, have been created by the CU. The rather limited coverage of the CU in terms of sectors (energy is largely excluded, so are services) explains this. Also, the CU focuses on tariffs so far. To really make a difference, so called non-tariff barriers (regulations, standards) would need to be eliminated.

The Customs Union seems to come with immediate monetary benefits – the promised lower gas price for Ukraine to begin with. These are important but are not part of the Customs Union competence – energy prices are not covered by the Customs Union.

The AA/DCFTA does not come cheap – this is true. It requires serious commitment to reform from Ukraine. But it is these reforms which will bring most gain, even if only in the medium term. They will transform the Ukrainian economy, make it more competitive and present a level playing field for all domestic and foreign economic operators, based on the gradual introduction of EU norms and standards. In return, the EU offers very significant market access, upfront, and almost without exception. The DCFTA with the EU will provide access to a larger (500 million consumers in the EU versus 170 million in the Customs Union) and predictable market with a much higher purchasing power of consumers.

It will also contribute to improving the business climate in Ukraine, ensuring the transition from Soviet to European "rules of the game" in the Ukrainian domestic market. In other words, we talk about strengthening of the rule of law and guaranteeing equal opportunities for investors. The European Union has a rich heritage of common standards in many areas such as food quality, health care, social protection, environment, road safety, business climate, opportunities for young people and so on. Most importantly, these standards are actually implemented, not only just declared.

Economic integration with the EU is the path to modernization. Look at the progress the European countries of the former socialist camp made in the last 20 years. The vast majority of them are already members of the EU, while Russia's economy continues to be based on commodity-driven exports. Russia itself is in need of radical modernization, the proof of which is the launch of a special initiative with the EU under the telling title Partnership for Modernization.

All in all the Customs Union is driven by political, not economic forces. By joining it, Ukraine would lose its sovereign power to decide for itself on its future trade and economic policy, and subject itself to the influence of the CU's strongest member: Russia. This would be step back to the past. Contrary to this the Association Agreement with the EU provides explicit legal and political guarantees of sovereignty, independence and territorial integrity of the Ukrainian state.

Q. During the meeting of the Russian and the Ukrainian Presidents in March 2013 Vladimir Putin argued that Ukraine could increase its GDP by 1,5 - 6,5% annually after joining the Custom Union

As far as we are aware, Russian figures and promises originate from a research sponsored by the Bank for Eurasian Development. And it seems to us that the "business cooperation/technological rapprochement assumption" used in this study is based on the idea that Russian business and technological structures are far advanced compared to Ukraine's and that by joining the CU Ukraine would somehow be uplifted to this "advanced" level thereby producing GDP gains. The figures are based on a "theoretical" model of what the CU might become, rather than what it actually is.

On the other side there is a joint study of the German Advisory Group and the Ukrainian Institute for Economic Research and Policy Consulting, according to which the accession to the Customs Union will reduce the welfare of Ukraine by 0.5% in the medium term and by 3.7% in the long term, while the DCFTA with the EU will increase this indicator by 4.3% in the medium term and by 11.8% in the long term.

Q: Can Ukraine join the CU and enter into an AA/DCFTA with the EU?

The answer is no, it cannot. A member of a customs union cannot have an independent trade policy. Joining the CU would mean for Ukraine to transfer its ability to set tariffs and have its own independent trade policy to the Customs Union Commission, a supranational body established by the CU members. It will simply not be able anymore to implement the tariff dismantling agreed with the EU in the context of the DCFTA. It will not be able to decide on its own its trade policy.

It would also not be able anymore to regulate areas such as food standards, or technical product standards which are already being determined by the CU Commission. Ukraine cannot harmonise its food standards, or any product standards, with the EU and the Customs Union at the same time.

Q: But the example of Turkey shows that being a member of a customs union – in that case with the EU – does not prevent Turkey from signing FTAs with other countries?

True – but only to a certain extent. Turkey in fact can only sign an FTA with another country if the EU has already signed an FTA with that country BEFORE, and it has to 'negotiate' the same tariff for the products covered by the customs union between the EU and Turkey – to ensure that the external tariff of the customs union including Turkey is always the same – towards all trade partners.

Q: But Ukraine already signed the FTA of the CIS countries? Why is that not a problem?

True, Ukraine is already participating in the CIS Free Trade Area. Ukraine has significant trade relations with Russia and the other members of the CIS. It is only logical that Ukraine wants these trade relations to be as free as possible. It would in fact be unwise of Ukraine, and contrary to its economic interests, not to be participating in freer trade with its CIS partners.

However, from a purely legal perspective, free trade agreements can easily exist side by side as each participant remains free to continue implementing its own independent trade policy. The EU itself (as most other countries in the world) has a wide network of free trade agreements with its partners.

Q: Will there not be trade problems with traditional trade partner Russia (and Kazakhstan and Belarus) once the DCFTA with Ukraine enters into force?

No, the DCFTA in itself will not lead to any trade or investment obstacles with Russia. Any such arguments have a political character. The EU with its 27 Member States have a strong and dynamic trade relationship with Russia, which is now governed by WTO rules with its dispute settlement mechanism. This is also the case for Ukraine. In case of sudden, politically motivated trade difficulties Ukraine could always insist on the application of WTO rules.

One more word about WTO rules: The WTO allows customs unions – if they meet the requirements set by the WTO (Article XXIV(8) of GATT). Ukraine, however, would have to re-negotiate its WTO-bound tariffs with the other members – since many of its current tariffs are significantly lower than the ones of the Customs Union, and would have to be raised if it joins. This would imply a major adjustment process – significantly larger than the one

currently attempted by Ukraine in WTO (where it is trying to re-negotiate its tariff commitments after just 4 years of membership)

Q: So what if the legal problems could be avoided for example through a 'partial participation' – would it still not make sense for Ukraine to consider joining the CU, if only partly?

It is not clear at all what 'partial participation' would mean, and how it should work. Participating – even only partially, for example only for some industries – in a customs union without implementing the common customs tariff is difficult to imagine. There is no precedence for such 'partial customs union' among WTO participating states, nor do they foresee such a case. And this brings the argument back to the legal question.

As long as Ukrainian authorities do not clearly explain what a 'partial participation' or 'cooperation with the CU' ('3+1') means, we cannot reply to this question.

But even if it were somehow possible, a 'partial' membership in the CU and implementing the AA/DCFTA, which is based on comprehensive obligations to take over EU acquis, would create contradictions in various policy areas. As the stated and formally agreed aim of the CU is to transform into a more ambitious 'Single Economic Space'/Eurasian Economic Union', the more economic policy, regulations and standards outside the 'hard core' trade policy area will be harmonised among its members. Ukrainian policy makers would therefore be confronted with the impossibility to fulfil both the obligations of gradual and dynamic approximation to the EU acquis in the AA/DCFTA and the growing body of norms and standards of the emerging Eurasian Economic Union.

But is this whole issue really about trade policy alone? Can Ukraine afford to move away from Russia?

Ukraine made a strategic choice in 2008 when it entered into negotiations for a AA/DCFTA with the EU – a choice for political association and economic integration with the EU, which is based on a large consensus between all main political forces.

This choice was made by the previous Ukrainian government, but has been fully endorsed by the current authorities. In fact, it is enshrined in Ukrainian law¹).

Recently, the Ukrainian Ambassador to the EU, K. Yeliseiev, in an article published in the Ukrainian Pravda², spoke even about a 'civilisational choice' which Ukraine is taking. In his expert opinion the choice between the EU and the CU is a choice between clear and hypothetical, between proven and risky. The EU has recognised and welcomed this European choice in the preamble of the AA, and the AA/DCFTA is an instrument designed to realise this option.

¹ Law on the Fundamentals of Domestic and Foreign Policies, adopted on 1 July 2010, Article 11, which mentions as a principle to ensure the integration of Ukraine in the European political, economic and legal space with the aim to acquire membership of the European Union

² Ukrainska Pravda, 09.01.2013 (online edition), <http://www.pravda.com.ua/articles/2013/01/9/6981110/>

Q: Ukraine should stay away from both the EU and CU

Of course, Ukraine might also decide to continue its current, unaligned path, not moving in any direction. Probably it would be reasonable to say that this would be huge mistake: Ukraine would lose an opportunity to modernise its economy and take a leap forward in its position in the world.

This political, strategic choice – for political association and economic integration with the EU, for the modernisation of Ukraine based on the European Union model – is not compatible with joining the Eurasian Customs Union, whose members have the stated objective to move towards a Eurasian Economic Union. Both membership in the Customs Union, and a DCFTA with the EU, are deep economic integration processes, requiring the alignment of the legal and regulatory framework for trade and related areas. The strategic choice made by Ukraine (and other countries, like Armenia, Georgia, Moldova) to integrate with the EU economically would therefore not be compatible with membership in the Eurasian Customs Union or future Eurasian Economic Union – for legal and political reasons.

The EU does not make a judgement on the merits of the CU or the future Eurasian Economic Union. The EU has always welcomed regional economic integration schemes as long as they fully comply with WTO rules, and do not create trade barriers and are open for countries to join as a result of an autonomous choice. But countries have to choose whether to seek association with the European Union or forming part of the emerging Eurasian Union.

Q: Do Kazakhstan and Belarus benefit from the Custom Union?

After three years in the CU, both the Kazakh and the Belarusian economies and population faced previously unpredicted negative consequences. According to expert estimates, Kazakhstan is rapidly losing its position in international trade, even with its CU partners. Compared to a USD 3.4bn trade deficit with CU partners in 2011, the figure hit USD 4.7bn in the first six months of 2012, while the amount of trade with its CU partners shrank by 4%. The recent World Bank report indicates that as a result of common external tariff implementation in Kazakhstan (weighted average of customs duties in Kazakhstan shifted from 5-7% to the Russian average of 16%) “the cost of imported goods to businesses and consumers has increased, and resources shifted to areas of inefficient production under the tariff “umbrella”.

The hardest hit were local producers importing raw materials to manufacture goods. The situation has become absurd: for instance, laminate flooring made in Kazakhstan using Belgian equipment is more expensive than laminate flooring imported from Belgium. But the worst outcome of CU integration in Kazakhstan is the steep increase in the price of basic consumer goods, despite the fact that the government has already implemented price regulation. As customs duties on some goods grew three to four-fold (and several times over for cars), it has sent retail prices for many groups of goods on the domestic market soaring. Price for buckwheat has grown 2.5 times, beef by 40%, and mutton by 33%. Sugar and oil prices have doubled.

The customs union has depressed real wages by 0.5%. Kazakhstan trades less with the rest of the world and more with Russia, Belarus, resulting in less imported technology from the more technologically advanced European Union and other countries — leading to a loss of productivity in the long run.

Concerning Belarus, President Lukashenka said recently that his country did not benefit in any way from joining the CU and called this Eurasian entity “useless”. Direct investment into the Belarusian economy dropped fourfold in 2012 compared to 2011, although it should have grown, given the logic of the CU benefits claimed by Russia. Over January-November 2012, its current account deficit was USD 1.1bn. Trade deficit with Russia has grown by more than USD 3bn. A slight trade surplus with Kazakhstan is more the result of shrinking imports from Kazakhstan to Belarus than of Belarus’ skyrocketing exports. In fact, the positive dynamics of selling “good quality and inexpensive” goods made in Belarus on the markets of its CU partners is mostly a result of dumping, the devaluation of the Belarusian currency, cheap fuel and direct subsidies from Russia, which cannot last forever. Similar consequences, i.e. restriction of Belarus’ exports at dumped prices, are likely after Russia and Kazakhstan predictably enter the WTO. Belarusians could then face a very likely economic collapse similar to that in spring 2011.

ON MOBILITY ISSUES

Q: Why countries like Albania do already have visa-free regime and Ukraine not? Is Ukraine worse than Albania? Or does the EU use double standards?

The criteria for visa-free regime with the EU are in principle the same for all countries (1. document security, including biometrics; 2. illegal immigration, including readmission; 3. public order and security; 4. external relations). At the same time, the process with the Western Balkan countries had a specific context (Stabilisation process).

When comparing other countries (from Western Balkans) with Ukraine, it should be remembered that:

- the goal of visa liberalisation for the **Western Balkan countries** was set already in 2003 (Thessaloniki Summit Agenda);
- specific benchmarks for all 5 countries were defined in 2008;
- a technical (i.e. non-political) process of evaluation followed; once the criteria were met, the Commission proposed the lifting of the visa obligation (for Serbia, FYRoM and Montenegro in 2009, for Albania and Bosnia in 2010);
- the countries also implement readmission agreements

Concerning **Ukraine**, a visa dialogue was opened in 2008. The jointly adopted Action Plan foresees two phases – first to put in place legal reform and second to ensure that these legal reforms are implemented. Most of the necessary legal acts have been already adopted, though some laws are still missing. The EU has also voiced concerns over recent legislative developments in Ukraine which affect lesbian, gay, bisexual and transgender (LGBT) fundamental rights. We would like to see advances towards progressive, serious improvements on this field, too. We hope, the necessary corrections will be adopted soon, so that we could move to the second phase.

Q: The Visa Facilitation Agreement has failed to improve the situation for Ukrainian citizens wishing to travel to the EU

The Visa Facilitation Agreement with Ukraine, in force since 2008, has already benefited Ukrainian citizens in many ways. According to Commission figures, the number of EU visas issued to Ukrainians rose by 33.8% between 2009 and 2011, with a large share of multiple-entry visas.

Nevertheless we know that visa procedures are often perceived as an obstacle. The EU has therefore revised and modernised its *acquis* in this area. The visa facilitation agreement was also amended in 2013 and it further simplifies requirements for documents proving the purpose of the journey for a wider category of applicants, including representatives of civil society organisations, journalists and their technical crews, members of professions participating in international exhibitions, conferences and seminars. It abolishes visa fee for the same categories of individual, clarifies provisions on the duration of multiple-entry visas and includes an exemption from the visa requirement for short stays for Ukrainians who hold biometric passports issued to government officials.

ON ENERGY

Q: Would the EU be ready to participate in EU-Ukraine-Russia tripartite consultations on gas transit?

Three parties have an interest in the future of the Ukrainian GTS – namely Ukraine, Russia and the EU. Russia's gas supply to the EU is still transited mainly through Ukraine. Out of the 138 bcm of gas that was exported to Europe in 2012, around 84 bcm transited Ukraine. We should therefore all discuss together the concerns of each party and try to find the optimal, mutually beneficial solution rather than for one or other party to promote a bilateral approach that excludes one of the interested parties.

The possible options for co-operation on the Ukrainian GTS is something that should be discussed between the three parties concerned - namely Ukraine, the EU and Russia – bearing in mind the sovereign interests of Ukraine and its Energy Community membership. The EU is prepared to continue facilitating the involvement of interested EU companies. We are aware that some European companies could potentially be interested, provided that a robust, non-discriminatory, transparent and legally-enforceable framework is put in place in Ukraine.

Q: Modernisation of Ukrainian Gas Transmission System

The EU attaches high importance to ensuring the reliability and transparency of the Ukraine Gas Transmission System (GTS) - a key part of the European grid network.

The Commission will continue to work closely with the Ukrainian authorities to facilitate support from International Financial Institutions for the modernisation of the Ukrainian Gas Transmission System (GTS), conditioned on Ukraine continuing with gas sector reforms in line with its Energy Community commitments. The May 6 Joint High Level Roundtable on Gas Market Developments in Ukraine in Brussels gave further impetus to this process and underlined the expectation that 2013 will be a year of making decisions on the GTS.

We understand that both the EIB and EBRD are in close contact with the UA concerning loans, including the first loan for the priority investment project (Urengoy-Pomary-Uzhgorod gas pipeline). The EU is actively engaged in facilitating a first loan and the EU can make its voice heard in both banks involved of which one is an EU institution.

But the Commission only intervenes as a coordinator of the International Financing Institutions; the decisions on possible loans will be taken by each of the International Financing Institutions according to its own rules and procedures.

Q: What is the advantage for Ukraine of having joined the Energy Community Treaty?

The Energy Community Treaty is an essential part of overall EU-Ukraine relations. The negotiated Association Agreement/Deep and Comprehensive Free Trade Area in its energy provisions builds on and complements the Energy Community rules.

By joining the Energy Community Treaty, Ukraine entered into a process of approximating its energy legislation to the EU norms and standards, thus facilitating internal market reforms and putting in place a framework favourable to investments. Ukraine would thus be fully integrated into a large energy market with greater opportunities for energy exchanges.

Membership in the Energy Community is an engagement to work towards economically viable, open, transparent and integrated energy markets that will attract the necessary investments. Energy sector reforms have already attracted a number of foreign energy investors to the country. It is now important that Ukraine makes sure that these investors are able to do business as foreseen and that further investment is encouraged.

Energy Community membership will also protect Ukraine's energy security. The work on reverse flows of gas from the EU to Ukraine is a clear example of this.

The Energy Community Treaty does not impose any restrictions on Ukraine on who owns or operates/manages its GTS. What it does is to provide certain rules of how gas transmission systems are operated in order to achieve essential requirements of the EU's internal energy market such as non-discriminatory network access. This will be to the advantage of Ukraine in terms of its energy security and to both the EU and Russia, notably in ensuring the reliability of the transit of Russian gas to the EU. We believe that a pragmatic solution to ensure the transparent and non-discriminatory management of the Ukrainian GTS can be found in the framework of Ukraine's membership of the Energy Community.

Q: Recently Gazprom accused Ukraine that reverse gas deliveries for Europe to Ukraine are only paper and not legal. What is your assessment on this?

From an EU legislative point of view is that gas can flow freely within the EU and the Energy Community and nothing prevents EU Member States to install physical bi-directional capacity with non EU countries and sell gas beyond EU borders.

Also virtual reverse flows are perfectly in line with the EU and the Energy Community. They are a way of optimising gas transport and trading within the EU's (and Energy Community's) internal market, and can be executed as swaps between different downstream buyers. This is possible all over the EU and has for example also been implemented in Poland on the Yamal-Europol pipeline.

Q: What is the relation between AA/DCFTA and the Energy Community Treaty?

AA/DCFTA energy provisions and Energy Community membership are linked. Regulatory convergence under the Energy Community Treaty creates a single regulatory space, attracting investment in gas and electricity networks and power generation. The AA/DCFTA energy provisions refer to, build on and complement these Energy Community Treaty provisions ; they will further strengthen current and potential future EU-Ukraine energy trade and investment .