

Ukrainian-Russian Trade and Economic Relations Under Global Integration*

SERGIY PYLYPENKO**

ANNOTATION. Examining Ukraine's trade and economic cooperation with the Russian Federation (RF), as they integrate their economies into the world economy, the author of this article focuses on the integrative priorities of both countries: cooperation within the framework of CIS, BSEC, SES, EU, WTO and other organizations. Moreover, the author considers the possibility of converging the actions of Ukraine and Russia within the context of their accession to the WTO or coordinating with Russia the accession of Ukraine to the WTO. In analyzing the integrative priorities of Ukraine and Russia, the author offers his scenarios for the development of Ukrainian-Russian relations.

KEY WORDS. international economic integration (IEI), Commonwealth of Independent States (CIS), Single Economic Space (SES), Black Sea Economic Cooperation (BSEC), World Trade Organization (WTO), European Union (EU), European Free Trade Association (EFTA).

Introduction

As dominant factors in the development of international relations at the current stage, global integrative processes also impact on the evolution of trade and economic relations between individual countries. The nature of the impact depends, first of all, on the place of one or another country in the global integrative processes as well as on the specifics of the interrelationship between them in the past and what they can be in the future. As regards Ukrainian-Russian economic relations, it can be argued with sufficient reliability that the impact of the first factor will be negligible, because so far these countries have a low level of integration into the world economy. This is confirmed, in particular, by the following observations:

According to the theory of international economic integration, countries are divided into large and small ones. The underlying criterion of this division is not so much the size of a country and its population as its influence in the world economy and, specifically, in international trade. This actually determines the level of a country's global integration. One of the indicators that is taken into consideration in this case is the country's share in world exports¹. Although by its area and population Ukraine is one of the largest countries in Europe, its share in

* This article was translated from its original in Ukrainian.

** *Sergiy Pylypenko* is a Head of the Division of Cooperation and Negotiations with International Organizations and Institutions at the Ministry of Economy of Ukraine.

¹ *Ukraina i svitove hospodarstva: vzaiemodia na mezhi tysyacholit*. [A. Filipenko. Ukraine and the World Economy: Interaction at the Turn of the Millennium. Kyiv, Lybid Publishers, 2002].

world exports is a negligible 0.3 %, which means that, first, its impact on world economic processes is practically zero and, second, it has not yet integrated sufficiently enough into the globalized world economy. Russia's exports exceed almost six times Ukrainian exports, and therefore the world's share of the former is 1.8 %, which obviously is also not enough to affect the processes in the world economy. For this reason we believe that neither Ukraine nor Russia have sufficiently objective levers (factors) of economic influence on each other.

Ukrainian-Russian economic relations are to the largest degree affected by the second factor — the high economic interdependence of the two countries. The former USSR actually achieved the highest known level of integration based on what was called the single national economic complex. This is confirmed by the following facts: by different estimates, the Ukrainian SSR manufactured only 20—30 % of products in a closed cycle. The remaining 70—80 % were either parts of products assembled at enterprises in other republics, or else finished products made of parts mostly delivered from other Soviet republics, Russia primarily². Relations with other Union republics were about the same. Proceeding from the theory of global integrative processes, the integrative links that existed within the former USSR should have been retained and developed at the macro and micro levels.

In one or another degree both countries are now involved in world integrative processes, including those related to regional economic integration, and this makes it possible to examine the integration interests of Ukraine and Russia and evaluate them from the viewpoint of the impact on the economic relations between countries.

Main Areas of International Economic Integration of Ukraine and Russia

Evaluating the main areas of the international economic integration (IEI) of Ukraine and RUSSIA, we should first of all point out that both countries are taking part in a number of regional organizations — the Commonwealth of Independent States (CIS), the Black Sea Economic Cooperation (BSEC) — and have concluded agreements on cooperation with the European Union (EU). But their IEI orientations are somewhat different. Ukraine's IEI is Europe-oriented. It holds consultations to conclude agreements on free trade with the European Free Trade Association (EFTA), a number of Ukrainian oblasts cooperate with border regions; Ukraine is also a member of the GUAM Association that includes Azerbaijan, Georgia and Moldova. Russia is a member of the Eurasian Economic Cooperation, the Shanghai Organization of Cooperation (SOC), and the Asian-Pacific Economic Cooperation that has 21 member countries.

² *Ukraina i Rossiya: 15 postimperskikh let.* [Ukraine and Russia: 15 Post-Imperial Years. *Delovoy* magazine, 2006, No.10(38)].

But even when Ukraine and Russia participate in one and the same integration associations, their motivations are markedly different.

Of fundamental importance is the correlation of economic and political aspects of integration, relative to which Ukraine and Russia's interests are at variance. In our opinion, this is exactly the main hindrance to the development of the integrative processes in the CIS. Russia is mostly interested in the political aspects of cooperation, while for Ukraine the principal concern is economic³.

Exactly this circumstance can explain why Russia actually blocks the establishment of a free trade zone within the borders of the CIS. Hence the conclusion, at which more and more politicians and experts arrive: the CIS as it is today can be viewed as a geopolitical entity that is fading into the past. To some extent this also concerns the Agreement on the Establishment of a Single Economic Space which Ukraine signed with reservations, making its participation strictly formal, since for Ukraine most of the Provisions of the Agreement and the Concept of the Establishment of the SES either lose their binding nature or their implementation becomes impossible⁴. Moreover, Ukraine's participation in the SES raises the issue of the compatibility of the extended agreement on free trade with the EU. What is only possible is a regime of free trade both with the SES and the EU, but not a customs union.

The economic motives of developing cooperation with the BSEC are related primarily to the need to arrange transport communications not only for the Black Sea maritime countries, but also for quite a few other nations concerned. The best-known sectoral economic projects of the BSEC are in transport infrastructure and energy, because a higher output of oil and gas in the Caspian region is predicted. The BSEC countries display an intense interest in this area and in the pipeline transportation routes. However, among the BSEC countries, specifically between Ukraine and Russia, there is no unanimity on this issue⁵.

An impromptu analysis of the integrative priorities of Ukraine and Russia makes it possible to arrive at the conclusion that they are markedly different. This impacts negatively not only on the interrelations of the countries within these associations, but also on their operation as a whole. In the future, it would be advisable for the economic relations between Ukraine and Russia to be based mainly on a bilateral basis.

³ Vasily Astrov in collaboration with Zdenek Lukas and Josef Poschl «The Ukrainian Economy between Russia and the Enlarged EU: Consequences for Trade and Investment» // WIIW Current Analyses and Country Profiles (March 2006)/ The Vienna Institute for International Economic Studies.

⁴ Materials of the Laboratory of Legislative Acts for the Draft Law of Ukraine *On the Ratification of the Agreement on the Establishment of the SES*. e-mail: info@laboratory.kiev.ua

⁵ Reference about cooperation in the BSCE by the Ministry of Economy of Ukraine, 2006

Current Status of Bilateral Trade and Economic Relations between Ukraine and Russia

In Ukraine's overall foreign trade, its share in the commodity turnover with Russia (goods and services) is as follows (in %):

years	1998	1999	2000	2001	2002	2003	2004	2005	2006
Export	31.3	30.0	30.8	29.0	25.0	23.8	21.6	24.9	25.7
Import	45.8	45.0	39.2	35.5	35.5	36.6	39.2	34.0	29.5
Total	38.5	37.0	34.7	32.0	30.0	29.8	29.5	29.4	27.6

Source: State Statistics Committee of Ukraine

Russia's share in Ukraine's foreign trade turnover is declining. In the period from 1998 to 2006, the share of Russia in Ukraine's commodity turnover went down by 10.9 percentage points. Russia's share in exports compared with 2005 went up by 0.8 percentage points, although when compared with 1998 it dropped by 5.6 percentage points.

The **indicators** of Ukraine's bilateral trade (in goods and services) with Russia for 1998—2006 are presented in the following table:

(US \$million)

	Total	Export	Import
1998	12,532.2	5,155.2	7,377.0
<i>1998 / 1997 (%)</i>	<i>82.9</i>	<i>74.3</i>	<i>90.2</i>
1999	10,406.8	4,564.7	5,842.1
<i>1999 / 1998 (%)</i>	<i>83.0</i>	<i>88.5</i>	<i>79.2</i>
2000	11,574.3	5,564.7	6,009.6
<i>2000 / 1999 (%)</i>	<i>111.2</i>	<i>121.9</i>	<i>102.9</i>
2001	11,751.2	5,741.0	6,010.2
<i>2001 / 2000 (%)</i>	<i>101.5</i>	<i>103.2</i>	<i>100.0</i>
2002	12,069.3	5,499.4	6,569.9
<i>2002 / 2001 (%)</i>	<i>102.7</i>	<i>95.8</i>	<i>109.3</i>
2003	15,441.2	6,505.2	8,936.0
<i>2003 / 2002 (%)</i>	<i>127.9</i>	<i>118.3</i>	<i>136.0</i>
2004	20,350.0	8,197.9	12,152.1
<i>2004 / 2003 (%)</i>	<i>131.8</i>	<i>126.0</i>	<i>136.0</i>
2005	23,350.5	10,070.3	13,280.2
<i>2005 / 2004 (%)</i>	<i>114.7</i>	<i>122.8</i>	<i>109.3</i>
2006	26,171.5	11,787.7	14,383.8
<i>2006 / 2005 (%)</i>	<i>112.1</i>	<i>117.1</i>	<i>108.4</i>

Ukraine's commodity turnover (goods and services) with Russia for January-December 2006 amounted to US \$26,171.5 million and compared with January-December 2005 increased by 12.1 % or US \$2,834.2 million.

The total export of goods and services for January-December 2006 was US \$11,787.7 million and compared with January-December 2005 increased by 17.1 % or US \$1,724.4 million.

The import of goods and services for January-December 2006 amounted to US \$14,383.8 million and compared with January-December 2005 increased by 8.4 % or US \$1,109.8 million.

The negative balance of trade with Russia for January-December 2006 was US \$2,596 million against the negative balance of US \$3,210.7 million for January-December 2005.

In January-December 2006, trade in services and goods in the structure of total trade turnover accounted for 14.3 %, including 26.6 % in total exports and 4.1 % in total imports.

Structure of total exports to the Russian Federation

(US \$million)

Total exports to RF	11,787.7	100 %
Services, works	3,137.0	26.6 %
Goods	8,650.7	73.4 %
<i>including:</i>		
Mechanical engineering products	2,930.5	24.9 %
Metallurgical products	2,710.6	23.0 %
Chemical industry products	923.8	7.8 %
Food products	887.1	7.5 %
Timber, paper, cellulose	441.2	3.7 %
Mineral products and ores	197.4	1.7 %
Products of stone, building plaster, cement	138.6	1.2 %
Other products	150.2	1.3 %
Light industry products	104.8	0.9 %
Energy sources	97.1	0.8 %
Instruments and devices	69.5	0.6 %

In the structure of Ukrainian exports for January-December 2006, goods accounted for 73.4 % (74.4 % in January-December 2005).

Among the exports in January-December 2006, the most important commodity groups (compared with January-December 2005) were the following:

	January-December 2006	January-December 2005
Mechanical engineering products	33,9 %	29,2 %

Metallurgical products	31,3 %	27,6 %
Chemical industry products	10,7 %	10,0 %
Food products	10,2 %	18,5 %
Timber, paper, cellulose	5,1 %	4,3 %
Mineral products and ores	2,3 %	3,3 %
Other products	1,7 %	1,4 %
Products of stone, building plaster, cement	1,6 %	1,5 %
Energy sources	1,1 %	2,0 %

Structure of total imports from the Russian Federation

(US \$million)

Total imports	14,383.8	100 %
Services, works	596.6	4.1 %
Goods	13,787.2	95.9 %
<i>including:</i>		
Energy sources	6,939.8	48.2 %
Mechanical engineering products	2,606.4	18.1 %
Metallurgical products	1,469.0	10.2 %
Chemical industry products	1,193.1	8.3 %
Food products	486.5	3.4 %
Timber, paper, cellulose	368.7	2.6 %
Products of stone, building plaster, cement	191.8	1.3 %
Mineral products and ores	166.7	1.2 %
Other products	140.9	1.0 %
Light industry products	116.2	0.8 %
Instruments and devices	108.1	0.8 %

Among the imports in January-December 2006, the most important commodity groups (compared with January-December 2005) were the following:

	January-December 2006	January-December 2005
Energy sources	50.3 %	56.9 %
Mechanical engineering products	18.9 %	15.5 %
Metallurgical products	10.7 %	8.7 %
Chemical industry products	8.7 %	7.8 %

Food products	3.5 %	3.5 %
Timber, paper, cellulose	2.7 %	2.5 %
Mineral products and ores	1.2 %	1.6 %

Proceeding from the above information, we can argue that the structure of Ukraine's exports to Russia and of Ukraine's imports from Russia is distinguished for its stability. Traditionally, Ukraine exports to the Russian market food products as well as products of the chemical and metallurgical industry and mechanical engineering. Ukraine imports from Russia energy sources, their share accounting for over 50 % of Russian exports to Ukraine, and products of mechanical engineering and the chemical industry.

Also, analyzing the structure of Ukrainian exports to the Russian market, it should be noted that they are more diversified than the structure of Russia exports to Ukraine. Energy sources actually predominate in the structure of Russian exports to Ukraine. What should also be pointed out is the high share of services in the structure of Ukrainian exports to Russia, which to a certain extent can be viewed as a positive aspect. However, the services have been gradually declining during the past few years. The worldwide trend shows that the growth rates of services in international relations are higher than the growth rates in foreign trade in goods. A relatively high share of services in foreign trade is an indirect evidence of a country's high economic development. However, in Ukraine's exports to Russia predominate transport services (transportation of Russian oil and gas to European countries), while in the world the share of transport services has a downward trend owing to a more intensive development of new types of services: information, banking, financial, tourism, and the like.

On the positive side, Ukraine exports to Russia goods with a higher level of machinery than are imported from Russia. Also, in 2006, as compared with 2005, there was an increase in the share of mechanical engineering products in all Ukrainian exports to the Russian market.

A) Cooperation in production

The Agreement between the Cabinet of Ministers of Ukraine and the Government of the Russian Federation on Cooperation in Production was signed on April 24, 1998 and is implemented by annually signing intergovernmental protocols listing the products and their volumes supplied by the parties within the framework of the agreement throughout a year.

The supply of the products within this cooperation during the past few years was negligible and did not exceed 2.0 % of the total commodity turnover with the Russian Federation⁶.

B) Future areas of cooperation and main joint projects

⁶ According to the data of the State Customs Service of Ukraine for 2006, turnover of the products under the Agreement on cooperation in production was about US \$210.9 million, i.e. 65 % of the indicators of the year before. The decline is explained by the considerable delay in signing the intergovernmental protocol for 2006.

Cooperation in the aerospace industry:

- development of the turbojet regional passenger airliner AN-148;
- renewal of serial production of the modified versions of transport aircraft AN-124-100M-150 and AN-124-100M-30 on the basis of the military transport aircraft AN-124 Ruslan;
- retention of cooperation relations in the production of aircraft engines (produced by PJSC Motor Sich).

Cooperation in agricultural machine-building:

- continued cooperation in the joint manufacture of grain and fodder harvesters.

Cooperation in the oil sector:

- use of the Odessa-Brody oil pipeline in the reverse regime, with Russia meeting its commitment of pipeline charging;
- technical re-equipment and modernization of Ukraine's oil refineries to deepen oil refining, increase output of light oil products, and raise their quality to European standards.

Cooperation in railroad machine-building:

- promotion of freight rail cars of Ukrainian manufacture (PJSC Azovmash and PJSC Kriukove Rail Car Building Plant) on the Russian market;
- cooperation between CJSC Transmashholding and the Luhanskteplovoz Holding Company for the development and joint manufacture of trunk electric locomotives.

C) Main negative factors impacting on Ukraine's trade and economic cooperation with Russia

on the part of Russia

- a) Reorientation of a substantial share of the Russian market toward products from the rest of the world;
- b) narrowing of certain sectors of the Russian market (pipes, rolled metal, meat and dairy products, etc.) for Ukrainian exporters by special and antidumping investigations relative to Ukrainian products.

on the part of Ukraine

- a) considerable diversification of Ukrainian exports to third countries because of the reorientation of a substantial share of the Russian market toward products from the rest of the world;
- b) poor promotion by Ukrainian commodity producers of national products on Russian markets, specifically as regards establishment of joint venture and participation in exhibitions and fairs.

D) Priority areas of Ukraine's foreign economic policy relative to the Russian Federation

- regulation of issues on the application of protective measures in compliance with the provisions of the Memorandum between the Government of Ukraine and the Government of the Russian Federation October 4, 2001 on

the principles of applying special measures relative to the imports originating from the customs territories of the parties of;

- resolution of the issue of lifting Russia's ban on the import of meat and dairy products of Ukrainian origin;
- resolution by the Russian party of the issue of establishing on Russian railroads a single tariff system for export-import and internal freightage regardless of the routes of freight transit;
- implementation of the Actions to the Program of Economic Cooperation between Ukraine and the Russian Federation for 1998-2007 and the Actions and Program of Inter-Regional and Border Cooperation with the Russian Federation for 2001-2007 up to the year 2010;
- more energetic exhibition and advertising activity in Russia by Ukrainian economic entities, establishment of joint ventures, expansion of the network of representative offices of enterprises, more thorough research of commodity markets and new trading partners in a competitive environment;
- more energetic investment, involvement of Ukrainian capital in the development of Russia's fuel and energy industries, and Russian capital in Ukraine's agro-industrial, mechanical engineering, metallurgical and chemical complexes.

Ukrainian-Russian Trade and Economic Relations in the Context of the Countries' Accession to the WTO

Accession to the WTO is an essential factor of shaping Ukraine's attractive image in the international arena, which will affect its economic development and also shape an efficient business environment for both national and foreign companies. WTO membership lends reliability as well as predictability to a country's business environment and investment climate, which guarantees the protection of investors' rights in Ukraine and stimulates national production with allowance for better accessibility of Ukrainian products to the markets of the 150 WTO member countries⁷.

A) Possibility of converging the actions of Ukraine and Russian in the process of WTO accession

Ukraine has repeatedly stated its political and economic decision to accede to the WTO independently. There are a number of reasons why Ukraine cannot accept the Russian Federation's tariff proposals and requirements to services within the framework of Ukraine's accession to the WTO.

First, Ukraine has already completed negotiating with all the member countries of the working group considering Ukraine's application for WTO accession. Therefore, the acceptance of Russia position would imply recalling the signed protocols, which would worsen very much Ukraine's negotiation

⁷ Information and analytical material for the session of the National Security and Defense Council on ensuring Ukraine's accession to WTO.

positions. During the entire existence of GATT/WTO there have not been any precedents of protocols being recalled. There were only individual requests of countries to raise already agreed tariff rates, but judging from practice, in response these countries had to reduce five times more tariff rates and other positions.

Second, the structure of production and foreign trade of Ukraine and Russia are essentially different⁸. Therefore, the most important positions of the tariff negotiations for Ukraine and Russia are also different, while the acceptance of the Russian tariffs proposals are economically disadvantageous for Ukraine.

Moreover, in the course of the negotiations Ukraine undertook to accede to sectoral agreements and initiatives, which aroused Russian concern. The overwhelming majority of sectoral agreements and initiatives include not consumer products (end products), but sets of equipment and raw materials for the manufacture of technological products. So acceding to these agreements will increase investment imports⁹.

As to the Russian party's concern over Ukraine's accession to the «civil aviation» sectoral initiative, it should be emphasized that Ukraine intends to do so only in 2010¹⁰. The manufacturers of aircraft and aviation equipment in Ukraine supported this position. Moreover, Ukraine already has zero tariff rates on airplanes, helicopters and other finished aviation equipment.

Speaking about Ukraine's commitments in the area of services, it should be pointed out that they are based 99 % on operative legislation. When deciding on its stance at the negotiations on the access to the market of services, Ukraine used the investment model of obligations and judiciously approached the issue of liberalizing access to the market of services, thereby creating conditions for the development of the market and enhancing competition. Ukraine's commitments concern, in the main, «qualitative» restrictions, such as confirmation of professional qualification (availability of necessary professional training, knowledge of languages, etc.) in the sectors of medical and educational services, requirements of accreditation (specifically, registration of legal entities in Ukraine) in the sectors of professional, financial and transportation services, and restrictions on pursuing certain types of services (financial, legal, audiovisual, transportation, recreational and cultural services)¹¹.

Such restrictions, ensuring the inflow of foreign investment, also effectively protect those sectors of the market of services that are sensitive for

⁸ Reference about the status of trade and economic co-operation between Ukraine and Russia for 2006. Ministry of Economy of Ukraine, 2007.

⁹ Analytical reference about the impact of the Russian factor on accession to WTO. Ministry of Economy of Ukraine, 2006.

¹⁰ Information and analytical materials for the parliamentary hearings on Ukraine's accession to WTO. Ministry of Economy of Ukraine, 2006.

¹¹ Interview with the Director of the Department of Cooperation with WTO, Ministry of Economy. *Invest Gazette* No.25, 2005.

Ukraine. Thus, we believe that it is wrong to compare commitments by the number of restrictions, because the quality of these restrictions can be different.

The main restrictions of accessibility to Russia's markets of services consist of restricting forms of commercial presence, i.e. bans of types of activity or establishment of affiliates, limited list of provided services; limitation of share of foreign capital, limitations as to citizenship and number of employed at enterprises. In quite a few sectors there are restrictions on the activity of natural monopolies. Russia's commitments concern restrictions that make services unattractive for the inflow of foreign investment and this is at variance with the strategic priorities of Ukraine's economic development.

When determining the possible limits of its concessions and terms of access to the national market of goods and services, every country negotiating for accession to the WTO proceeds from the structure and priorities of development of its own economy and its own national interests. Therefore, a complete agreement on tariffs proposals prior to accession to the WTO is absolutely impossible because of the different structures of economies, size of markets, different structures of foreign trade and, accordingly, trading partners who also have different and, occasionally, opposite interests.

To date Ukraine and Russia have about the same status as far as the completion of the negotiation process is concerned. At this stage there is little sense in changing the tactics of negotiations and revising the earlier assumed commitments.

In the negotiations Ukraine applies the investment model of development of its economic system and abides by the course of further liberalizing and actively integrating into the world division of labor. But the Russian Federation is in favor of a protectionist model of economic development and for this reason tries to retain the substantial level of tariff and non-tariff protection of its market. Moreover, Ukraine's economy is now operating approximately 80 % according to the WTO principle and is sufficiently open. In its negotiations Ukraine is stoutly standing up for the already competitive or conditionally developed industrial sectors and services in order to preserve and build up its production and export potential¹². The sectors that are insufficiently developed or simply do not exist in the country have to be stimulated through liberalization so as to attract foreign investment and enhance their level of competitiveness. Ukraine's stance in the negotiations has to stimulate «technological import,» i.e. import of technologies, equipment, sets of parts,

¹² Accession to WTO will positively affect all sectors and branches of the economy. According to forecasts, volumes of trade will go up and infrastructure will see a lot of improvements. In the short-term outlook, there will be difficulties for individual sectors due to the liberalization of access to the domestic market. It has been agreed that these sectors will be granted an adaptation period of five to 10 years. Membership in the WTO will create for industrial enterprises the best possible balance of foreign trade operations, such as access to the market of imported parts and raw materials with the possibility of building up the competitiveness of export products.

and raw materials instead of inexpensive products that will compete with domestic goods¹³.

There is yet another fact meriting attention. Though there is close cooperation between the Russian Federation and the Republic of Belarus and both seem to want to be united in one state, each of them is individually involved in the negotiations on WTO accession proceeding from its own needs.

B) Necessity of coordinating with Russia Ukraine's accession to the WTO

We can very well understand the concern of the Russian Federation when its leadership logically argues that Ukraine should coordinate its accession to the WTO with Russia because of the possibility of a sharp rise in legal re-export to Russia of duty-free EU products through the territory of Ukraine. But the preliminary analysis by Ukraine's representative office in the EU has revealed a number of factors that, as we see it, will hinder, first, the uncontrolled increase in legal supplies of products that predominate in the structure of Ukraine's exports to Russia (metallurgical and agricultural products) and, second, the sharp change in the commodity structure of Ukraine's exports to Russia for account of the re-export of new goods from the EU¹⁴.

1. The increase in re-exports of metallurgical and agricultural products is hindered, as we believe, by a well developed legal framework and mechanisms of cooperation of the agencies of authority concerned. The legal framework of Ukraine-RF trade relations consists of multilateral trade agreements within the CIS, the laws and standard provisions of the involved agencies of both parties as well as the mechanisms of bilateral removal of obstacles in trade, including those caused by the re-export of goods originating from third countries. Russian agencies can trace and apply corresponding measures under the pretext of protecting Russian consumers, as was the recent case of banning the import of meat and dairy products of Ukrainian origin. Moreover, the clearly spelled out rules within the EU prohibit from delivering agricultural products to Russia without proper certificates.

According to the Agreement between Russia and the EU of January 1, 2005, all livestock products imported into Russia from the EU have to meet Russia requirements to imports and have attached veterinary certificates. Moreover, livestock or products thereof supplied from one EU country to another that intends to export them to Russia must have a pre-export certificate of the country of the products' origin. A pre-export certificate makes it possible for the EU veterinary services to establish the conformity of the exported

¹³ Information-analytical material for the parliamentary hearings on Ukraine's accession to WTO. Ministry of Economy of Ukraine, 2006.

¹⁴ *Analitichni materialy shchodo okremykh pytan torhovo-ekonomichnykh stosunkiv Ukrainy ta RF v umovakh vstupu Ukrainy do SOT. Predstavnytstvo Ukrainy pry Yevropeiskykh Spivtovarystvakh*. [Analytical Materials on Some Issues of Trade and Economic Relations of Ukraine and Russia Concerning Ukraine's Accession to the WTO. *Representative Office of Ukraine in the European Communities*, 2006].

products to Russia requirements to imports. During export of beef through other EU countries, the EU trade rules require additional certification, apart from the issue of a pre-export certificate. Typical Russian certificates do not permit re-export to Russia of products imported from third countries¹⁵.

2. Manufacturers in the EU countries should set their sights on increasing imports to Russia, for which a certain time will be needed. The balance of trade between Russia and the EU is positive only because of Russian export of energy sources, while by all the other indicators EU imports considerably exceed Russian exports.

Since 2001 the balance of trade in goods (without energy sources) between Russia and the EU-25 countries has been negative and is growing at a brisk pace: € -5,505.58 million in 2001, and € -21,799.88 million in 2005¹⁶.

The high growth rates of imports to Russia from the EU countries show a normal saturation of the production capacities of Europe's manufacturers of products imported into Russia. Therefore, the increase in EU output and a corresponding increase in the re-export of products from the EU through Ukraine into Russia occurs with a delay in time. Russia could use this interval to introduce additional protection measures against the sharp increase of re-exports through Ukraine. In our opinion, the time factor needs to be additionally studied.

3. EU officials believe that the simultaneous establishment of free trade zones (FTZ) between Ukraine and Russia as well as Ukraine and the EU is a factor that will promote the development of trade relations between countries. An example of effective trade exchange within FTZ is the trade between the EU and Mexico. An analysis of this trade shows that there is no increase in the legal re-export to the EU of goods of US manufacturing (the main trading partner of the EU) through Mexico¹⁷.

4. The problem of avoiding an increase in re-exports to Russia from Ukraine after its accession to the WTO can be easily resolved by Russia applying its trade practices with Finland that is a member of the EU and the WTO. Judging from the analysis of commodity turnover between Russia and Finland, a sizable share of products is re-exported from Finland to Russia.

An analysis of the National Research and Development Foundation of Finland (NRDF) under the Finnish Parliament shows that in 2004 the share of re-exported products in Finnish exports to Russia was about € 1.1 billion, i.e. 25 % of all exports¹⁸.

Another analysis of trade between Finland and Russia proves that the re-exports of most commodities have a high added value, specifically products of the electronic, pharmaceutical, chemical and automotive industries. Finland is the main country, through which large manufacturers of mobile

¹⁵ According to the materials of the Trade and Economic Mission of Ukraine in the Russian Federation.

¹⁶ According to the materials of the Trade and Economic Mission of Ukraine in the Russian Federation.

¹⁷ Information of the Representative Office of Ukraine in the European Communities.

¹⁸ Materials of the Trade and Economic Mission of Ukraine in the Russian Federation.

telephones re-export their products to Russia. Among the factors that occasion the advantage of such re-export is the high level of safety of transport routes between Russia and Finland, the European quality of services at customs and other warehouses, and the presence of an infrastructure for transporting commodities with high added value. In the commodity turnover between Ukraine and Russia, the infrastructure, in our opinion, needs to be improved for re-exporting costly freight of European commodity producers through the customs territory of Ukraine. The issue of Ukraine's possibilities (transport and warehousing capacities, etc.) for an energetic re-export of EU products with high added value to Russia needs to be additionally studied.

6. The example of trade between Russia and Finland, the re-exports from Finland to Russia included, could be used to step up the re-export to Russia of EU goods through the customs territory of Ukraine after its accession to the WTO before Russia's accession, and could have positive implications for Ukraine. It will promote the development of its transport infrastructure, raise its reliability and safety to European standards, and create new jobs for Ukrainian specialists in servicing traffic flows.

Moreover, the special customs regime between Ukraine and Russia for duty free re-exports of EU products does not pose any problems for Russia today. Any legal exports, re-exports included, through the customs territory of Ukraine cannot very much worsen the situation with the illegal imports to Russia. The total «gray» imports into Russia are not that very large. According to the estimates of the Central Bank of Russia, Eurostat, OECD and NRDF, imports into Russia in contravention to the existing customs rules accounted from 22 % to 31 % of all imports in 2005.

In view of the aforesaid, we can arrive at the conclusion that the FTZ has a high degree of protection against sharp increases in any Ukrainian imports, and for Ukraine there will be some positive implications in case of an increase of re-exports through its customs territory after it accedes to the WTO before the Russian Federation and concludes an agreement on the FEZ between Ukraine and the EU. Therefore, we see no urgent need to coordinate the actions of the parties concerned in this area.

At the current stage there is practical confirmation that the economy is ready for Ukraine's accession to the WTO and so are the fixed intentions of taking pragmatic steps that accord the best with the country's interests.

An extremely important evidence of Ukraine's readiness to take an equal part in international trade agreements is the firmness and clearly determined stance of positioning itself in the international trading arena, in particular in building up its trade relations with Russia.

Ukraine's Trade and Economic Cooperation with the European Union

Cooperation with the European Union is among the principal priorities of Ukraine's foreign economic policy.

The legal basis of Ukraine's relations with the EU is a treaty on partnership and cooperation that was signed in Luxembourg on June 14, 1994 and came into force on March 1, 1998, as well as the Ukraine-European Union Action Plan endorsed by the parties at Brussels on February 21, 2005.

The Treaty on Partnership and Cooperation (TPC) sets out the legal scope of Ukraine's cooperation with the EU as well as the area of Ukraine's institutional and structural reforms to create conditions for the efficient operation of a market economy, which foresees definite steps, the main ones in the economy being the following:

- ensure conditions for the liberalization of reciprocal trade, including the possibility of establishing a FTZ between Ukraine and the EU;
- approximate Ukrainian legislation to EU legislation and set up an effective system for execution of the laws;
- establish a system of encouraging and protecting investment, capital flows and exchange of information about investment opportunities;
- set up in Ukraine an effective system of intellectual property protection.

A) Ukraine-EU Action Plan

The enlargement of the European Union in May 2004 and, in consequence, the appearance of a common land border became an essential impulse for developing relations between the parties. The European Union introduced in relation to its eastern and southern neighbors the European Policy of Neighborhood, the result of which for Ukraine became the design of a corresponding Action Plan.

This document sets up the strategic framework of cooperation between the parties for 2005-2007 and aims to build up relations between Ukraine and the EU on the basis of common European values. The Action Plan establishes a comprehensive list of priorities within and beyond the framework of the TPC.

B) Establishment of a free trade zone between Ukraine and the EU

The issue of setting up a FTZ is among the strategic objectives of cooperation and plays today an important role in building up bilateral trade and economic relations with the parties in the medium-term outlook.

The establishment of a FTZ between Ukraine and the EU would promote the achievement of the following:

- considerably reduce non-tariff restrictions on trade in goods by harmonizing and/or reciprocally recognizing the evaluation of conformity of technical standards to EU standards;
- cover as much as possible all sectors by services and align the rules of domestic market regulation with European and international standards;
- approximate domestic policy in the area of competition, corporate governance and domestic market regulation to the generally accepted rules of European practice;

- create conditions for encouraging investment to build up infrastructure, and attract technical assistance.

To date the European party relaxed the restraint it exercised during the previous years. When during the Ukraine-EU Summit (December 1, 2005) the EU granted Ukraine the status of a country with a market economy within the context of antidumping legislation, the road was opened for intensifying the dialogue between the parties, specifically as to the establishment of a FTZ.

The official negotiations between the parties will be launched immediately after Ukraine's membership in the WTO, which is one of the main preconditions for concluding a treaty on the FTZ and for the European Commission receiving from the EU Council the corresponding mandate to hold official negotiations.

C) Invigorating trade and economic cooperation between Ukraine and the EU

In 2006 the European Union was the largest foreign trade partner of Ukraine, its share accounting for 32.3 % against 30.3 % in 2005. Thus, to date one-third of Ukraine's foreign economic activity is centered on the EU.

In 2006 the turnover of foreign trade in goods and services with the EU countries was US \$30.6 billion, i.e. 26.9 % or US \$6.5 billion up on 2005.

Ukraine's exports of goods and services to the EU, as compared with 2005, came to US \$13.1 billion, i.e. 19.8 % up on 2005, while the imports of goods and services from the EU in 2006 increased by 32.9 % and amounted to US \$17.5 billion.

The balance of trade in goods and services in 2006 was negative US \$-4.4 billion against US \$-2.2 billion in 2005.

In 2006 foreign trade turnover of goods with the EU was US \$26.5 billion, which was 25.7 % more than for the same period the year before. In 2006, export of goods amounted to US \$10.9 billion, i.e. 18.1 % up on 2005. Imports from the EU came to US \$15.6 billion, which was 31.5 % more than in 2005. The balance of mutual trade in goods for 2006 was negative in the amount of US \$4.7 billion (against the negative balance of US \$2.7 billion in 2005).

The main trading partners, as regards both exports and imports (about a half of all trade with the EU countries), were Germany, Italy and Poland.

In 2006 mineral products dominated the commodity structure of Ukraine's exports to the EU (21.4 % of all exports to the EU), followed by base metals and products thereof (32.2 %), textiles and products thereof (6.8 %), as well as machines, equipment and gear (6.5 %).

Machines, equipment and gear held the traditionally leading positions in the overall commodity structure of imports from the EU countries (27.3 % of all imports of goods from the EU), followed by products of the chemical industry (14.6 %), textiles and products thereof (4.8 %), as well as land, air and water vehicles (14. %).

2006 saw a growing trend of the Ukrainian market's dependence on European imports and an insignificant weakening of the export positions of Ukrainian products.

The critical issue today is the accessibility of Ukrainian products to EU markets, specifically metallurgical products and textiles.

D) Trans-border cooperation, within the Euro regions included

Ukraine's trans-border relations with the EU countries with a common border with Ukraine are built with allowance for implementing the European neighborhood policy on the external borders of the EU.

To date all border oblasts of Ukraine (of the 25 oblasts 19 border on EU countries) are involved in trans-border cooperation. Over 30 % of Ukraine's territory is part of the Euro regions and inhabited by more than 30 % of the country's population. Six of the Euro regions include 8 oblasts, 149 rayons, and 141 cities of Ukraine, as well as administrative-territorial units of nine European countries.

Today there are 4 Euro regions on Ukraine's borders with the new EU countries:

- Carpathian Euro region (Ukraine, Poland, Slovakia, Hungary, Romania);
- Bug (Ukraine, Poland, Belarus);
- Lower Danube (Ukraine, Moldova, Romania)
- Upper Prut (Ukraine, Moldova, Romania).

In the composition of the Euro regions are the following oblasts of Ukraine: Volyn, Transcarpathian, Ivano-Frankivsk, Lviv, Odessa, Chernivtsi, Chernihiv and Kharkiv.

Work is underway to set up new Euro regions. For instance, the oblast state administration of Vinnytsia is discussing the issue of establishing the «Dniester» Euro region with the participation of Vinnytsia oblast, Odessa oblast, and the border regions of Moldova. The state oblast administration of Sumy is actively cooperating with Kursk oblast of Russia to set up the «Yaroslava» Euro region. The oblast state administration of Zhytomyr asked the managers of the «Dnipro» Euro region to have the oblast included in that region.

The aim of the cooperation is to combine efforts to improve economic performance, develop the social, information and production infrastructure, build and modernize the border infrastructure, develop the transport network, and cooperate in science, culture, and environmental protection.

The cooperation is based on agreements and international treaties, cooperation agreements and decisions between bodies of local self-government and local bodies of the executive with the administrative-territorial units of other countries.

Taking into account the results achieved within the framework of the Euro regions (more active mutually beneficial trade and economic cooperation and foreign investment growth), we can expect an increase in the total trade turn-

over of Ukraine's oblasts with neighboring countries, which will positively impact on Ukraine's integrative intentions.

Moreover, European business is interested in integrating into a single European market the neighboring countries that have not yet acceded to the EU. As to the interest of these countries themselves, trade relations with the EU, attraction of investment, a more favorable business climate, as well as a regulatory policy aligned with European standards are important factors of their economic development. Although the Russian Federation is the largest neighboring market of the EU, Ukraine demonstrates a greater eagerness in introducing European standards, as evidenced by its «European choice».

Prospects for Developing Ukrainian-Russian Relations

Proceeding from the analysis of the integrative priorities of Ukraine and the Russian Federation, we can single out four basic options of Ukraine's socioeconomic development¹⁹, which are directly related to the essence of Ukrainian-Russian relations and determine the main trends of their development in the future:

1. Decisive action plan of integration into the EU system;
2. Reintegration, i.e. final affiliation with Russia as the dominating nation in the Eurasian economic system and center of geopolitical influence;
3. «Interim status» between different socioeconomic centers, reliance on its own powers and situational changes in foreign political and economic priorities;
4. «Multi-linear evolution» as well as multi-tier and multi-channel targeted development, which relies on the maximum support and development of a distinctive national socioeconomic system and opportunely combines the political and economic factors of any other regional pole of growth.

Ukraine's European choice should be viewed as a strategy and general methodology of reforming and developing our country. The European choice should be understood not so much as direct entry into certain European structures, specifically the EU, but as Ukraine's recognition of Western European norms and standards as model conceptual criteria of reforming all areas of public and civic life. As a matter of fact, Ukraine has no other choice: the Western European model of development on our continent is the most progressive in terms of high economic performance and social effect. The majority of the Russian society accepts the European principles, because, just like Ukraine, it is in a stage of transformation and by all of its indicators of development lags very much behind the West European countries. Thus, there is

¹⁹ *Ukrainсько-російські відносини: проблеми визначення*. [O.Vusatiuk. Ukrainian-Russian Relations: Issues of Identification. National Institute of Ukrainian-Russian Relations]. <http://www.niss.gov.ua>

nothing unusual in that Ukraine and Russia try to adopt the very same principles of organizing public life and the mechanisms of socioeconomic development that have been successfully tested in the West. Ukraine's European integration should in no way be viewed as an alternative to Ukrainian-Russian relations and, first of all, its economic component. Notably, the European countries are absolutely not interested in seeing the accumulation of the conflict potential in the relations between Russia and Ukraine. On the contrary, the EU views friendly Ukrainian-Russian relations as a guarantee of political amity and stability in the region. A rather long and complex process of reform should precede accession to the EU. In our opinion, European integration should in no way be an obstacle to the development of Ukrainian-Russian relations that can be effectively used to promote the process of integration. The contraposition of the European and Russian vectors of Ukraine's foreign policy doctrine is artificial and is frequently used by different political parties both in Ukraine and in Russia simply to angle for and gain votes during election campaigns.

The second option of socioeconomic development would perhaps be the most attractive for Russia and this is exactly the underlying idea of the Concept of setting up the Single Economic Space. Should Ukraine agree to all the provisions of this Concept, as Russia insists, it would mean in the long run reintegration into a part of the post-socialist space and the establishment of a body politic dominated by Russia, i.e. the reanimation of a mini USSR. Russia has quite a few powerful leverages, what with its attractive economic and, especially, financial status. With the unprecedented rise in gas and oil prices worldwide, the Russian Treasury is receiving sizable amounts of «oil dollars» that may generate a budget surplus of US \$57 billion in 2007, which is several times more than Ukraine's budget²⁰. So Russia has a real opportunity, without any risk for itself, to grant the SES member countries, Ukraine in the first place, substantial economic preferences, such as preferential prices for oil and gas, more liberal treatment of Ukrainian exports, and the like. But in exchange, Ukraine would have to surrender a large part of its political and economic sovereignty and, without any doubt, sweep away all illusions about European integration. Such a development of events is hardly probable. It has not future not only in the political sense (actual loss of sovereignty), but even in the economic for all its outward attractiveness. Such integration will promote the conservation in the SES of old technologies, equipment, management, and the like. As to Ukraine's participation in the SES within the limits of free trade, we believe that it will not have any practical outcome. Under no circumstances will Russia agree to abide by all the principles of free trade

²⁰ *Rossiyskaya ekonomika; prognozy i tendentsii. Tsentri analiza dannykh Gosudarstvennogo universiteta Vyshei shkoly ekonomiki*. [The Russian Economy: Forecasts and Trends. Center of Data Analysis of the Higher School of Economics State University, No.2, 2007].

without any whatsoever reservations and restrictions, because it will have little benefit from such trade. *De jure* the referred to zone exists between the countries, but *de facto* it does not operate. It is reasonable to ask why Russia should agree to set up a zone of free trade between Ukraine and the EU countries, if it states unambiguously that it will not take any part in the continued integrative processes within the framework of this union?

The principles of the third option have actually been applied in the Ukrainian-Russian trade and economic relations with certain modifications throughout the entire period of the two countries' bilateral relations. It could be viewed as a so-called multi-vector model, when Ukraine has several strategic vectors of foreign policy — European and Russian — that was pursued depending on internal and external circumstances. Although it has certain flaws, this strategy has played a positive role in Ukrainian-Russian economic relations, making it possible to avoid a lot of crisis situations. But the multi-vector model has considerably exhausted its positive possibilities. It could be used effectively only in the first years of our country's evolution as an entity of international economic relations and be perceived by our partners, Russia included, as something like a «malaise of growth.» In the sixteenth year of Ukraine's existence such an indefinite stance is no longer acceptable either within or without the country. Judging from the repeated statements of President Yushchenko on Ukraine's foreign policy, Ukraine has rejected such a model of development.

In our opinion, the most pragmatic in Ukrainian-Russian relations is the adherence, in one way or another, to the main principles of the fourth option of development, namely the «multi-linear evolution» toward European norms and standards with the continued development and improvement of relations with other countries, primarily with Russia, which so far is Ukraine's principal trading partner and by our analysis will retain this status at least in the immediate outlook. But it should be taken into consideration that maintaining these relations on the principles of respect for «exclusively Russian» or «exclusively Ukrainian» interests, at the same time disregarding the interests of the other party or ignoring the general interests and the final interests of our continued development will ruin the relations as a whole.

In the opinion of the author, the Ukrainian-Russian economic relations have to be radically modernized with allowance for the current trends in world development. One of the features of Ukrainian-Russian relations is that most of it was shaped at the macro level and specified in inter-state, inter-ministerial and other agreements. The list of these agreements numbers over 300 titles, but most of them do not operate or they operate inefficiently.

In the long-term outlook, the bilateral economic relations between Ukraine and Russia should be built proceeding from general world processes, namely a more active integration of both countries into the globalized system of the world economy. Proceeding exactly from these positions, both countries could find a lot of common interests. This concerns, first of all, overcoming

the economic lag behind the industrially developed countries, the restrictions of the domestic market, decline in industrial consumption, and sizable outflow of capital abroad. Developing economic relations on such a basis will make it possible to speed up the entry of Ukrainian and Russian products into the Western countries, of Europe in the first place. In the opinion of the author, there is an urgent need to design a joint Ukrainian-Russian strategy of economic cooperation that would take into account both the national interests of both countries and the general trends in the integrative development of the world economy. Its underlying basis should be extensive attraction of Russian capital for the modernization and development of Ukrainian enterprises with the simultaneous penetration of Ukrainian capital into the Russian economy. If this process will be carried out on the basis of the idea mentioned above — accelerated integration into the system of the world economy — both countries would stand to gain from it.

Literature

1. *Ukraina i svitove hospodarstva: vzaiemodia na mezhi tysia-cholit*. [A.Filipenko. Ukraine and the World Economy: Interaction at the Turn of the Mil-lennium. Kyiv, Lybid Publishers, 2002].
2. *Ukraina i Rossiya: 15 postimperskikh let*. [Ukraine and Russia: 15 Post-Imperial Years. *Delovoy* magazine, 2006, No.10(38)].
3. Vasily Astrov in collaboration with Zdenek Lukas and Josef Poschl «The Ukrainian Economy between Russia and the Enlarged EU: Consequences for Trade and Investment» //WIIW Current Analyses and Country Profiles (March 2006)/ The Vienna Institute for International Economic Studies.
4. Materials of the Laboratory of Legislative Acts for the Draft Law of Ukraine *On the Ratification of the Agreement on the Establishment of the SES* e-mail: info@laboratory.kiev.ua
5. Reference about cooperation in the BSEC by the Ministry of Economy of Ukraine, 2006
6. Data of the State Statistics Service of Ukraine.
7. Information and analytical material for the session of the National Security and Defense Council on ensuring Ukraine's accession to the WTO.
8. Reference about the status of trade and economic cooperation between Ukraine and Russia for 2006. Ministry of Economy of Ukraine, 2007.
9. Analytical reference about the impact of the Russian factor on accession to the WTO. Ministry of Economy of Ukraine, 2006.

10. Information and analytical materials for the parliamentary hearings on Ukraine's accession to the WTO. Ministry of Economy of Ukraine, 2006.

11. Interview with the Director of the Department of Cooperation with the WTO, Ministry of Economy. *Invest Gazette* No.25, 2005.

12. [Analytical Materials on Some Issues of Trade and Economic Relations of Ukraine and Russia Concerning Ukraine's Accession to the WTO. *Representative Office of Ukraine in the European Communities*, 2006].

13. Materials of the Trade and Economic Mission of Ukraine in the Russian Federation.

14. [O.Vusatiuk. Ukrainian-Russian Relations: Issues of Identification. National Institute of Ukrainian-Russian Relations] — [http:// www.niss.gov.ua](http://www.niss.gov.ua).

15. *Rossiyskaya ekonomika: prognozy i tendentsii*. Tsentri analiza dannykh Gosu-darstvennogo universiteta Vyshei shkoly ekonomiki. [The Russian Economy: Fore-casts and Trends. *Center of Data Analysis of the Higher School of Economics State University*, No.2, 2007].

16. *Perspektyvy ekonomichnykh vidnosyn mizh Ukrainoiu ta Yevropeiskym Soiuzom*. Tsentri sotsialno-ekonomichnykh doslidzhen. [Prospects of Economic Relations between Ukraine and the European Union. Center of Socioeconomic Studies — CASE Ukraine, Kyiv, 2006].

The article was received by the editorial board on 26.03.2007