



CENTRE FOR EUROPEAN REFORM

policy brief

Ukraine's European choice

By Kataryna Wolczuk

- ★ October's presidential election will determine the extent to which Ukraine will be pro-Western and pro-reform or Russia-focused and reform-averse. But whoever is the next Ukrainian president, he will struggle to open up the economy, fight corruption and streamline the state administration. Change in Ukraine will remain slow.
- ★ The EU's new neighbourhood policy is a welcome attempt to help stabilise and modernise countries that are not lined up for EU membership. But its incentives – mainly gradual access to the single market – are not strong enough to affect policy choices in countries such as Ukraine.
- ★ Ukraine has called for an EU 'membership perspective'. But it has not undertaken the reforms needed for accession. Nevertheless, the EU's refusal to even talk about the possibility of membership looks untenable.

During the 1990s, the EU was busy completing its single market, introducing the euro and helping the Central and East European applicants get ready for accession. It paid little attention to the countries beyond its new eastern borders, such as Ukraine, Belarus and Moldova. Most EU policymakers saw the former members of the Soviet Union – with the notable exception of the Baltic states – as a fairly homogenous lot. So the EU offered them all more or less the same treatment: a Partnership and Co-operation Agreement (PCA) for closer trade and political ties, and financial aid and expert advice under the Tacis assistance programme.

But the former Soviet countries have differed greatly in their approach to the European Union. Russia has sought a broad-based relationship of equals, or 'strategic partnership', while jealously guarding its national sovereignty. Belarus has shunned closer ties with Western Europe, preferring re-integration with Russia as a way of propping up its ailing economy. Ukraine, by contrast, has left little doubt that it wants to integrate with the EU and eventually become a fully fledged member of the

club. It has repeatedly asked the EU to provide it with a 'membership perspective'. It has not, however, pushed through the political and economic reforms that would make its demands credible. Perhaps not surprisingly, the EU has shown little enthusiasm for Ukraine's membership aspirations. 'Don't ask us for candidate status', the EU has long insisted 'because the answer would be No.'

Meanwhile, the EU has offered little to help keep Ukraine on a pro-European, pro-reform path. The PCA between the EU and Ukraine that came into force in 1998 committed both sides to gradually opening their markets for goods, services and capital. Ukraine also promised to bring its rules and regulations more in line with those of the EU and the World Trade Organisation (WTO), which Ukraine has long sought to join. Yet, six years later, trade between the EU and Ukraine still does not flow freely. The EU boasts that its average import tariff is only 3 per cent, but it still imposes tight restrictions in those sectors where Ukraine is most competitive, such as food and steel. The EU officially supports Kiev's WTO bid, but it has not upgraded the country to 'market

economy status' for trade policy purposes. (The upgrade would change Ukraine's WTO accession terms and make it harder for the EU to impose anti-dumping duties on Ukrainian goods.) Ukraine is particularly miffed because the EU granted market economy status to Russia in 2002, although Russia's economy is hardly more liberal than Ukraine's.

Similarly, the EU and Ukraine are a long way from the PCA's other stated objective, to promote a political dialogue on democratic values and human rights. Over the last six years, Ukraine's democratic development has suffered numerous setbacks, without the EU being able to do much about it. The regular EU-Ukraine summits have resembled stiff rituals, with little open discussion and even less substantive agreement. A plethora of bilateral expert meetings and commissions has achieved some notable results in sectoral co-operation, but has done little to improve the overall political relationship. The EU's assistance under Tacis has dwarfed other multilateral aid programmes, making the EU Ukraine's largest donor. But – poorly targeted and at times badly managed – EU assistance has had only a limited impact on Ukraine's transition process. Overall, the EU's policy towards Ukraine has lacked a clear vision, and its instruments have been rather blunt.

Potential for partnership

It is clear that EU-Ukraine relations have not lived up to their potential. The EU needs a stable and prosperous Ukraine, and Ukraine needs the EU as an open and reliable economic and political partner. Already, the enlarged EU is Ukraine's most important trading partner, accounting for more than one-third of the country's imports and exports. EU-based companies are also the biggest foreign investors in the Ukrainian economy – although the amounts Ukraine has attracted have been tiny compared with the sums that have flowed into the East European accession states. Perhaps most importantly, the EU can act as an anchor for Ukraine's economic and political reform efforts, emulating the success of other post-Communist countries such as Poland and Hungary. Ukrainian politicians and intellectuals have always cited their country's 'Europeanness' as the key reason for leaving the Soviet Union and aspiring to democracy and an open market economy.

For the EU – with its vastly bigger economy – Ukraine is only a minor trading partner (accounting for around 1 per cent of EU external trade). But it is an important neighbour nonetheless. With a population of 48 million, Ukraine is the most populous non-EU country

on the continent, after Russia and Turkey. Following the EU's eastward enlargement in May 2004, Ukraine now shares a long common border with three EU member countries, Hungary, Poland and Slovakia. Given the presence of ethnic minorities on both sides of the common border, historical cross-border ties and the large volume of shuttle trade going back and forth, the EU cannot and should not try to cordon off Ukraine. (Ukrainians were incensed when Hungary, Slovakia and Poland imposed EU visa requirements on them ahead of accession.) Instead, the EU should help Ukraine to achieve stability and prosperity, and not only in the border region. An unstable Ukraine could become a major transit route for weapons, drug and people trafficking coming from further east. Moreover, Ukraine's stability also matters for the EU's energy security, since much of the EU's oil and gas comes from Russia and is shipped through Ukrainian pipelines. By responding to Ukraine's request for closer ties, the EU could help to build a reliable partner in a potentially unstable region. The EU's nascent common foreign and security policy needs reliable partners. For example, Ukraine could help EU attempts to resolve the 'frozen' conflict in Transdnistria, a breakaway region in Moldova adjoining Ukraine that has become a hotspot for smugglers and other criminals.

A clear choice in the election?

Ukraine's economy is doing well now, with real GDP growth averaging 8 per cent a year since 1999. The recovery came after years of severe recession and a collapse in the Ukrainian currency in 1989, which gave local industries a competitive boost. The economic reforms pushed through by Viktor Yushchenko during his brief tenure as prime minister in 2000-01 laid the foundations for the current boom. Strong external demand also helped. However, the sustainability of economic growth is in doubt. Economic restructuring and the liberalisation of markets have been slow and patchy since 2001. Foreign and local businesses continue to struggle with masses of red tape, a crumbling infrastructure, rampant corruption, powerful local 'oligarchs' that seek to keep competition at bay and an inefficient court system that cannot be relied upon to enforce property rights. If Ukraine wants to get into the WTO and take advantage of closer economic integration with the EU, it will have to redouble its efforts to open and restructure its economy.

But it is in the political arena where most of the challenges lie. An overbearing president, Leonid Kuchma, and a handful of well-connected oligarchs dominate Ukraine's political scene. Their vested interests regularly take priority over what would benefit the country as a whole,

leaving large parts of the population in poverty. President Kuchma and the oligarchs have tightened their grip on the state apparatus to keep potential opponents at bay. They have prosecuted opposition leaders, such as Yulia Tymoshenko, through dubious court cases. They have sent tax inspectors to harass businesses that back the opposition. They have ordered journalists to write nice things about the government and revoked the licenses of media businesses that have taken a more a critical line. Worried about Ukraine's fragile democracy, the EU has taken a more cautious approach, especially after President Kuchma was alleged to have ordered the murder of Georgy Gongadze, a critical journalist in 2000.

Many in the West hope that the forthcoming presidential election, scheduled for October 31st, will halt these pernicious trends. Many westerners regard the election as the most important political event since Ukraine's independence in 1991 – a choice that will shape the country's future and determine its place in Europe. President Kuchma, the man held responsible for creating today's corrupt and inequitable regime, will not stand for re-election. Instead, the election will most probably culminate in a second-round run-off between the current prime minister, Viktor Yanukovich, and the former prime minister turned opposition leader, Viktor Yushchenko, in mid-November.

Western observers tend to present the election as a clear choice between good and bad, between Yushchenko, the pro-western reformer who will throw open Ukraine's economy and lead the country closer to Europe; and Yanukovich, the Russia-friendly, anti-reformist Kuchma-crony, who will perpetuate the current corrupt regime.

However, Ukraine's choice is less clear-cut than it may appear. Undoubtedly, Yushchenko's victory would promise much greater change, not least because of his track record of market reforms and pro-western policies during his spell as prime minister in 2000-01. Yushchenko's victory would mean closer ties with the West and put an end to the semi-isolation that Ukraine endured during most of Kuchma's second term in office. However, despite all his good intentions, Yushchenko would need a more efficient public administration and excellent political management skills to deliver on his promises. He would need to push through a series of difficult and painful economic reforms. He would have to trample on deeply entrenched vested interests (including those of his supporters), overcome bureaucratic inertia and curb widespread corruption. Even under a Yushchenko presidency, change in Ukraine would remain slow, and setbacks would be inevitable.

While Yushchenko's victory would not be a panacea for Ukraine's ills, Yanukovich as president would be unlikely to push Ukraine into the arms of Russia and halt all reform efforts. Although Yanukovich is the regime's favoured candidate, many of Ukraine's powerful politicians and oligarchs support him only half-heartedly. They see him primarily as a representative of narrowly defined industrial interests from Ukraine's eastern region of Donbas and fear that his victory would upset the country's fragile balance of regional interests. Yanukovich's bid for the presidency is backed by a disparate group of people who only have two things in common: their dislike of Yushchenko and their determination to hang on to the spoils and privileges they enjoy in Kuchma's Ukraine. Yanukovich would probably continue with reforms, but slowly and haphazardly, for fear of upsetting his supporters.

The industrialists who back Yanukovich would also make sure that he does not pursue a foreign policy that is too overtly pro-Russian and thus undermines their business opportunities in the West. But while Yanukovich would most likely continue to make overtures to the EU, the EU would find it much more difficult to respond in a positive fashion. This is because Yanukovich has been trying to get ahead of his more popular rival by violating the kind of democratic standards the EU likes to uphold in dealing with its neighbours. Yanukovich, as the 'official' candidate, relies heavily on the state institutions, especially at the local level, and the state and oligarch-controlled media to conduct his campaign. When asked "Can Yanukovich win free and fair elections?" a US diplomat replied "We will never know." Yanukovich's victory would confront the EU with the tricky question of whether it wants to deepen its relationship with a country headed by a president who emerged from less than free and fair elections and lacks democratic legitimacy.

Ukraine's foreign policy after the election

Ever since leaving the Soviet Union in 1991, Ukraine has sought to pursue a pro-European course, and successive governments have declared membership of the EU a long-term strategic objective. Neither of the front-runners in the presidential race is likely to discard the country's medium to long-term foreign policy strategy: achieving closer integration with the EU while safeguarding the economic benefits that flow from Ukraine's close links with Russia. In the short term, however, Yanukovich may well distance himself from the EU, seeking a more narrowly defined co-operation agreement rather than full candidate status. By doing this, he would reduce the EU's leverage over Ukraine and

avoid coming under pressure to implement the economic and political reforms that the EU would inevitably demand before accepting Ukraine as a potential candidate for membership.

Whoever is president will also face the challenge of maintaining good relations with Russia. The Kremlin leaves little doubt that it wants to call the shots in the regions and it prefers its neighbours to follow a broadly pro-Russian course. Whether the leaders of neighbouring countries uphold democratic standards or implement market-oriented reform is secondary. Although disagreements between Russia and Ukraine still flare up occasionally, the two countries have left the antagonistic and angry relations of the early 1990s behind. Kuchma – ostracised by the international community – has moved closer to Moscow, particularly in election times. But even under Kuchma, Ukraine has sought to limit the degree of political and economic integration with its north-eastern neighbour. In 2003, Ukraine signed up to the creation of a ‘single economic space’ with Russia, Belarus and Kazakhstan. But a series of similar trade and economic agreements in the past has had limited, if any, practical impact. Ukraine, even under Yanukovich, is likely to oppose the building of a CIS-based alternative to the EU.

Although Russia is now less important for Ukrainian exports (accounting for 18 per cent of the total, half of what it was in the mid-1990s), Russia’s influence over Ukraine’s economy has grown in other areas. Ukraine’s all important industrial sector is heavily dependent on Russian energy supplies, and Russian businesses have acquired direct ownership of large chunks of Ukraine’s economy. Russian politicians and advisors also play a growing – and thinly disguised – role in Ukrainian domestic politics.

Under Putin, Russia opted to woo rather than coerce Ukraine into co-operation. But elsewhere in its neighbourhood, in particular in Georgia, Russia has recently sought to increase its influence through threats and direct interference. It is unclear how Russia would react if Ukraine tried to weaken bilateral links and instead concentrated on getting EU candidate status. Russian policymakers tend to see Ukraine’s rapprochement with the West as a zero-sum game, arguing that the country cannot integrate with the EU and Russia at the same time. But although the Kremlin watches Ukraine’s attempts to gain EU candidate status with scepticism, it has never voiced outright opposition – perhaps because Russians know that accession negotiations and preparations would be a drawn-out affair with an uncertain outcome.

While Russia’s attitude towards Ukraine’s EU ambitions is unclear, there is little doubt that the Kremlin is against Ukraine joining NATO. There was no open outcry in Moscow when Ukraine announced its intention to join the military alliance in 2002. But Russia is working hard behind the scenes to pre-empt such an outcome. Many suspect Russia’s hand behind the recent dismissal of Ukraine’s defence minister, Yevhen Marchuk, who had prepared the ground for a modernisation of Ukraine’s military forces. Russia might consider other covert tactics, such as instigating border disputes or keeping its own soldiers stationed in Crimea. Russia has also long been suspicious of Ukraine’s ties with the US. The US has traditionally been more active in Ukraine than the EU, seeing the country as a key western ally in a region dominated by Russia. The US backed off in 2002, following allegations that Ukraine had sold anti-aircraft radars to Iraq. A year later, Kuchma at least partly rehabilitated himself by sending a sizeable contingent of Ukrainian troops to help post-war stabilisation in Iraq. The US carries considerable clout in Kiev, but has used its influence mainly to advance its own geo-strategic objectives, rather than help Ukraine move closer to the EU.

Weak incentives for EU neighbours

The EU has so far discouraged Ukraine from lodging an official application for membership. But it has failed to develop a clear and effective alternative policy to accession. As a result, the EU has had only very limited leverage over the country’s internal developments. Although Ukraine may not share Poland’s or Hungary’s steely determination to push through difficult reforms, Ukraine’s elite and most of its people do aspire to reap the benefits from European integration and to re-assert the country’s ‘Europeanness’. These aspirations provide the EU with a chance to influence the country’s internal development.

However, the EU’s new European neighbourhood policy (ENP) – launched to coincide with eastward enlargement – does not provide sufficiently strong incentives. The stated aim of the ENP is to promote “prosperity and stability in Europe” by creating a “ring of friends” around the EU’s external border. The basic idea is this: the EU offers its neighbours better access to its €10 trillion internal market and stronger bilateral political ties. In return, the EU demands that the neighbouring countries implement political and economic reforms. Concrete reform steps are to be spelled out in ‘action plans’ that each country would draw up together with the EU. (See also Heather Grabbe, ‘How the EU should help its neighbours’, CER Policy Brief, June 2004).

The ENP mainly relies on economic rewards – single market access and aid – to persuade neighbouring countries to open and reform their economies, uphold democratic standards and protect human rights. However, for the rewards to be appealing they must look attainable. At present, they do not. Given the EU's past behaviour, Ukrainians will be forgiven for questioning the EU's willingness to remove trade barriers, in particular in the 'sensitive' sector where Ukraine's exports are concentrated.

Moreover, the EU's offer of gradual single-market opening may be generous, but it does not take into account the weakness of state institutions in countries such as Ukraine. The EU insists that neighbouring countries can only gain access to the single market if they take over and enforce EU product standards, as well as certain EU rules for enforcing competition, limiting industrial subsidies, protecting the environment, modernising customs and so on. Ukraine's young and still evolving state will struggle to enact and implement such an extensive legislative programme. Entrenched business interests will oppose the greater openness and transparency that would come with these changes. Parliament will probably water down many of the EU rules. The inefficient and often corrupt bureaucracy will not be up to the job of implementing EU rules. Last but not least, the EU's complex and often cumbersome rules and regulations would impose costs on the country – on businesses and the state apparatus alike – that may outweigh the economic benefits flowing from EU integration, at least in the short term.

Similarly, the offer of more financial aid – coming from the EU's 'new neighbourhood instrument' – is too vague to provide a strong incentive for policymakers. The EU will only set up the new fund during its next budget period, which will run from 2007 to 2013. So its size, objectives and operation remain uncertain. And again, some Ukrainians are sceptical about the value of EU aid, given that past programmes have not always achieved their stated objectives. If EU aid is to have any impact on Ukraine's development, it needs to be better targeted, in particular on supporting the reforms and investments that are necessary for Ukraine's integration with the EU, and on strengthening the domestic institutions needed to take advantage of the EU's offer of single market access. The ENP should also include new 'twinning' programmes, under which experienced bureaucrats from EU countries help their Ukrainian counterparts to implement EU rules. To help sustain Ukraine's reform momentum, the EU should provide immediate and appealing rewards for clearly defined reform steps. Currently, the ENP spells out

tough conditions for Ukraine, but it does not provide clear and enticing incentives for Ukraine to take the necessary steps.

A membership perspective?

Even if the EU's idea of integrating neighbouring countries into the single market was successful, it is not clear whether this kind of economic integration and technical co-operation would be enough to sustain Ukraine's enthusiasm for the EU. Ukraine and the EU have made much progress in negotiating the action plan, which is at the core of the ENP strategy, and the EU is keen to sign it off as early as possible (although it should wait until after the presidential election). However, few Ukrainians, apart from a few experts, have heard of the plan. The appeal of economic integration with the EU may increase as Ukraine's reform process gains momentum. But for now, it only excites a small number of Ukrainian businesses that have already gained a foothold in the EU market. If European integration is to become a key driver for reform, 'Europe' needs to become, above all, a political project. The prospect of integration with the EU needs to engage the minds of the political class and citizens in order to push through comprehensive reforms in the name of 'Europe'. The action plan should focus more on issues that affect the lives of Ukrainian citizens, such as visas and the legal emigration of workers. Otherwise, EU-Ukraine relations – as envisaged by the ENP – will remain highly technical, with little significance for the country's domestic political debates.

The ENP does not offer the prospect of EU membership. Accession has been the EU's most successful foreign policy tool, helping Central and Eastern Europe along the path of economic and political transition. But EU enlargement has its limits. In particular, the EU's neighbours in Northern Africa, including Algeria and Morocco, do not fulfil one of the key pre-conditions for EU membership, that of being a European country. And with 29 members – once all current candidates have joined – the EU may have little appetite for further enlargement. Therefore, the EU needed an alternative policy tool. The ENP is such a tool, offering deeper integration without the prospect of eventual membership.

Ukraine, however, argues that, unlike Morocco or Israel, it is a European country and should therefore be given a 'membership perspective'. The EU will find it difficult to argue with this, particularly now that it is about to start accession talks with Turkey. Even though Ukraine falls far short of EU political and economic standards, there is no doubt about its 'Europeanness' in geographical, cultural and historical terms.

Ukraine initially wavered over whether to take part in the ENP at all, and it now does so with a degree of political resentment.

The best way for the EU to engage Ukraine's political class and its citizens would be to rethink its categorical refusal to talk about membership. Most Ukrainians are aware that membership is not on the cards for the time being. Clearly, neither the EU nor Ukraine is ready. But it is not in the EU's interest to exclude Ukraine forever. The EU has already changed significantly through the last enlargement, which not only raised the number of members from 15 to 25 but also vastly increased the diversity within the Union. By the time Romania, Bulgaria, Croatia and, eventually, Turkey have joined, the EU will no longer resemble the cosy, coherent club that it once was. A larger, diverse and flexible Union should be able to accommodate a modern and reformed Ukraine. EU leaders should therefore stop sending negative messages to Ukraine. The EU's reluctance to offer a 'membership perspective' – even in the very long-term – significantly weakens its leverage over Ukraine's development. It also undermines the position of pro-reform forces that advocate the 'European' model of development for Ukraine. The EU should not underestimate the impact

that even a symbolic gesture may have on Ukraine's development. A more positive EU stance would signal to Ukraine that it is welcome in Europe and it would mitigate the prevailing sense of exclusion and the suspicion of EU double standards.

The quality and scope of the EU-Ukraine relationship will ultimately depend on Ukraine's willingness and ability to reform itself. But the EU can help by motivating policymakers and voters. The EU's current half-hearted approach to its eastern neighbours could undermine the goals it has set itself: to promote democracy, stability, prosperity and the rule of law in the wider Europe and beyond. Ukraine's presidential election could prepare the ground for long overdue reforms. If so, the EU could use a revamped ENP to bolster a reformist drive. A more effective ENP needs to offer a clear, comprehensive vision for Ukraine's place in Europe, as well as more specific interim rewards. If the EU wants Ukraine to be part of a "ring of friends", it needs to come up with a more courageous and effective policy towards Ukraine.

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