

CASE Network Studies & Analyses

EU-Ukraine DCFTA: the Model for Eastern Partnership Regional Trade Cooperation

Veronika Movchan
Volodymyr Shportyuk

No. 445/2012



Warsaw Bishkek Kyiv Tbilisi Chisinau Minsk



Materials published here have a working paper character. They can be subject to further publication. The views and opinions expressed here reflect the author(s) point of view and not necessarily those of CASE Network.

This paper is based on the presentation delivered at the CASE 2011 International Conference on “Europe 2020: Exploring the Future of European Integration” held in Falenty near Warsaw, November 18-19, 2011.

Keywords: EaP, DCFTA, Regional Integration, Ukraine

JEL Codes: F15

© CASE – Center for Social and Economic Research, Warsaw, 2012
Graphic Design: Agnieszka Natalia Bury

EAN 9788371785726

Publisher:

CASE-Center for Social and Economic Research on behalf of CASE Network
al. Jana Pawła II 61, office 212, 01-031 Warsaw, Poland
tel.: (48 22) 206 29 00, 828 61 33, fax: (48 22) 206 29 01
e-mail: case@case-research.eu
<http://www.case-research.eu>



Contents

Abstract	4
1. Introduction	5
2. Current status of economic relations between EU and EaP	6
2.1. Trade links	6
2.2. Trade regime	8
3. EU-Ukraine DC FTA: main provisions, expected benefits and costs	11
3.1. Key points of the DCFTA	11
3.2. Benefits and costs of the DCFTA	16
3.3. Stages of enactment of the of the Agreement	18
4. Implications for EaP: status of regulatory reforms and path ahead	19
5. Conclusions	23



Veronika Movchan: *Academic Director, the Institute for Economic Research and Policy Consulting – IER (Kyiv, Ukraine); graduated from the National University “Kyiv-Mohyla Academy” (Ukraine). Research interests: trade policy, including WTO-related issues, regional integration, non-tariff measures, quantification of trade policy instruments, and impact assessment of policy changes.*

Volodymyr Shportyuk: *Docent, Department of Finance, Economic Faculty, National University “Kyiv-Mohyla Academy”; graduated from the Shevchenko National State University (Ukraine); candidate of science in mathematics and physics. Research interests: economic modeling and impact assessment, random processes, game theory.*



Abstract

The EU has been one of the largest trade partners for so called Eastern Partnership (EaP) countries, namely Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Commodity turnover of these countries with the EU vary between 30% and 50% of total, but their access to the EU market is less preferential than for many other neighboring countries. They trade with the EU on the basis of MFN regime, and five EaP countries, with exemption of Belarus, use privileges provided by Generalized System of Preferences (GSP) or the GSP+ or autonomous trade preferences (Moldova).

With the launch of EaP initiative in 2009, relations between the EU and the Eastern European countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) have received new impetus for development. The EaP offers upgrade of relations within three major dimensions, namely (a) the Association Agreement (AA), (b) Agreement on a Deep and Comprehensive Free Trade Area (DCFTA), and (c) Visa Facilitation and Readmission agreements.

The AA talks have been launched with all EaP countries except for Belarus, and four of them have been involved in the DCFTA talks. Ukraine has progressed the most, as after five years of negotiations the EU-Ukraine Association Agreement with embedded DCFTA has been initialed in 2012.

The aim of this study is to assess gains and losses that could arise from the DCFTA with the EU for the EaP countries, using information about EU-Ukraine DCFTA as model case for EaP regional trade cooperation.

The focus of the paper is on non-tariff (regulatory) component of the EU DCFTA and potential implications of regulatory approximation. Also, current level of harmonization of EaP countries' regulatory framework with the EU acquis in the areas related to the DCFTA is analyzed.



1. Introduction

Former Soviet Union (SU) countries could be tentatively grouped into four categories depending on peculiarities of their relations with the EU. Estonia, Latvia and Lithuania form the first category of countries that have been already integrated in the EU. The second category comprised of six countries – Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine – could be tentatively labeled “neighbors”. These countries, except for Belarus, have signed Partnership and Cooperation Agreements (PCA) with the EU, and are involved in the European Neighborhood Policy (ENP) and, recently, in the Eastern Partnership (EaP). The Russian Federation is categorized separately as “special neighbor”. Its relation with the EU features New Agreement talks and dialog on the Common Economic Space. Finally, Central Asian republics of the former SU – Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan, Turkmenistan – constitute the fourth category of countries that are currently “not in focus” of the EU foreign policy in the region. These countries have only PCA with the EU (except for Turkmenistan).

In this paper, we focus on the EaP countries. The EaP initiative¹ was launched in 2009 in Prague, creating additional opportunities for cooperation between the EU and its Eastern neighbors. The EaP offers upgrade of relations within three major dimensions, namely:

- Association Agreement (AA),
- Agreement on a Deep and Comprehensive Free Trade Area (DCFTA), and
- Visa Facilitation and Readmission agreements.

The AA talks have been launched with all EaP countries except for Belarus, and four of them have been involved in the DCFTA talks. Ukraine has reached the most, as after five years of negotiations the EU-Ukraine Association Agreement with embedded DCFTA has been initialed in March 2012.

The aim of this study is to assess gains and losses that could arise from the DCFTA with the EU for the EaP countries, using information about EU-Ukraine DCFTA as the model case for EaP regional trade cooperation.

¹ See details at: http://eeas.europa.eu/eastern/index_en.htm



The focus of this paper is on non-tariff (regulatory) component of the EU DCFTA and potential implications of regulatory approximation. Also, current level of harmonization of EaP countries' regulatory framework with the EU acquis in the areas related to the DCFTA is analyzed.

The rest of the paper is organized as follows. Section 2 reviews current status of economic relations with the EU and the EaP countries. Section 3 provides details of the EU-Ukraine DCFTA as well as analyses benefits and costs of the agreement. Section 4 is focused on how other five EaP countries are prepared for regulatory approximation with the EU acquis in spheres related to the DCFTA assuming that the same scheme is applied as in the case of Ukraine. Section 5 concludes.

2. Current status of economic relations between EU and EaP

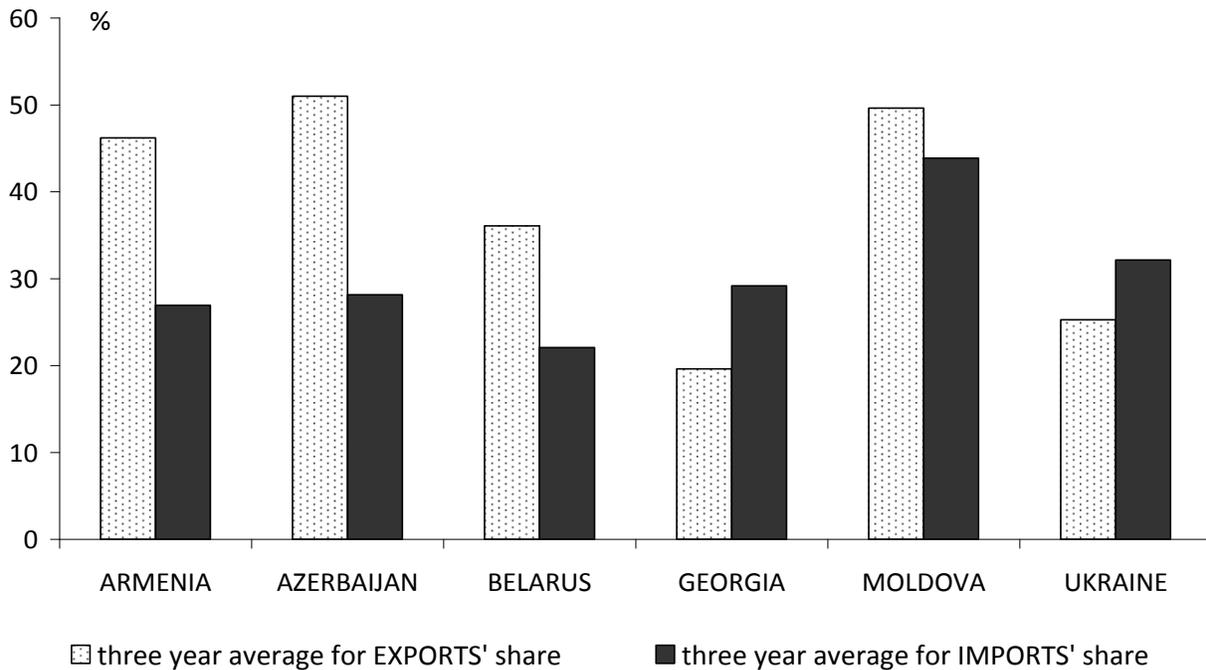
2.1. Trade links

The EU – the largest regional market – has been important trade partner for all the EaP countries.² In 2010, the EU-27 was “number one” partner in both merchandize exports and imports for four EaP countries (Armenia, Azerbaijan, Georgia and Moldova). For Belarus and Ukraine, the EU was the second largest trade partner after the Russian Federation.

On average, merchandize trade turnover with the EU constitutes about one third of total EaP countries' turnover. Exact figures vary between 19% and 51% of total for merchandize exports and between 21% and 43% of total for merchandize imports (Figure 1), with the highest EU merchandize trade orientation observed in the case of Moldova and Azerbaijan, and the lowest in cases of Belarus and Georgia.

² Movchan V. “Trade in Goods, Services and FDI: Current State” // European Integration Index for Eastern Partnership Countries. International Renaissance Foundation, May 2012. Available at: <http://www.eap-index.eu/>

Figure 1. Role of the EU as merchandize trade partners for the EaP countries, average for 2009-2011



Source: DG Trade, <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries-and-regions/>

Analysis of merchandise structure of exports to and imports from the EU shows that intra-industry trade has quite small share of trade flows, and thus the structures of exports and imports significantly differ. The EaP exports to the EU are dominated by primary (non-processed) products and semi-manufactures, like energy or metals, while the EaP countries import mostly final products from the EU.

The high share of final products in exports to the EU is observed only in Moldova (over 50%), largely because of high share of textile and clothing in exports. For other EaP countries respective shares vary between zero and 15%. The exports of machinery and transport equipment to the EU occupy noticeable share only for two EaP countries, namely Ukraine and Moldova.

On the contrary, shares of final products, especially machinery and transport equipment, in the EaP countries' imports from the EU vary from 40% to 70% of total. The EU plays important role in modernization of the EaP economies, supplying capital equipment and organizational know-how associated with them.



The highest share of primary products exports to the EU is registered for Azerbaijan (over 99% of total exports) and Georgia due to high energy product exports.

Weight of the EU as service trade partner is less homogeneous across EaP countries. Service trade turnover between the EU and total for four smaller EaP countries: Armenia, Azerbaijan, Georgia and Moldova. The respective shares for two larger countries – Belarus and Ukraine – are over 40%.

While the EU occupies leading positions in trade structures of EaP countries, these countries play very moderate role as the EU trade partners. Altogether, six countries of the region account for about 2% of EU merchandize trade turnover and 0.4% of EU service trade turnover.

Ukraine has been the largest trade partner for the EU among the EaP countries. It accounts about 1.0% of EU merchandize trade turnover (2009-2011 average) and less than 0.3% of EU service trade turnover. Armenia has the lowest weight in the EU merchandize and service trade turnover.

Apart from trade links, the EaP countries, especially Moldova and Ukraine, heavily rely on the EU investments. The share of the EU in total inward stock of foreign direct investments (FDI) of the EaP countries varies between 30% and 80%.

2.2. Trade regime

Trade regimes between the EaP countries and the EU are determined by several categories of normative acts, namely bilateral PCAs (for Belarus, Trade and Economic and Commercial Cooperation Agreement), WTO rules and practices (except for Belarus and Azerbaijan), and unilateral trade preferences provided by the EU.

In line with the PCAs provisions and WTO rules, the EU and EaP countries accord each other the most favored treatment in merchandize trade. Furthermore, the most of the EaP countries enjoy additional preferences in access to the EU market, being eligible either to the Generalized System of Preferences (GSP)³ or even the GSP+.⁴ These preferences are non-reciprocal, and provided by the EU to developing countries with primary aim to contribute to the reduction of

³ The GSP is an autonomous trade arrangement through which the EU provides non-reciprocal preferential access to the EU market. The system allows exporters from developing countries to pay lower duties on some or all of what they sell to the EU. It envisages duty-free access for non-sensitive products, and a reduction in import duties for sensitive products. See details at <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/>

⁴ The GSP+ constitutes additional preferences available to vulnerable Developing Countries as an incentive for them to ratify and effectively implement a set of key international conventions. These represent widely recognized international standards in the fields of core human rights and labor standards, sustainable development and good governance. See details at <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/>

poverty and the promotion of sustainable development and good governance in these countries.⁵

Five EaP countries – Armenia, Azerbaijan, Georgia, Moldova, and Ukraine – are eligible for the GSP. Preferences to Belarus were temporary withdrawn in December 2006 in response to a systematic and serious violation of the core principles of the International Labor Organization.⁶

Armenia, Azerbaijan, and Georgia enjoy preferences provided by the GSP+, while Moldova has been entitled to Autonomous Trade Preferences (ATPs) above the level of GSP+ starting as of March 2008. The ATPs have provided unlimited and duty free access to the EU market for all products originating in Moldova, except for certain agricultural products.⁷

Table 1. EU Generalized System of Preferences, 2008

	ARMENIA	AZERBAIJAN	BELARUS	GEORGIA	MOLDOVA	UKRAINE
Share of trade with EU under MFN, % including	45.33	99.76	99.63	64.62	27.01	80.85
= 0 tariff rates	43.20	99.60	91.54	58.32	19.82	73.11
> 0 tariff rates	2.13	0.16	8.09	6.30	7.19	7.74
Share of trade with EU eligible for GSP/GSP+ % including	54.66	0.23	0.00	34.31	15.80	18.41
= 0 tariff rates	53.74	0.19	0.00	34.31	15.71	9.54
> 0 tariff rates	0.92	0.04	0.00	0.00	0.09	8.87
Total share of zero-tariff trade	96.94	99.79	91.54	92.63	89.15	82.65
Level of preference utilization,%	96.21	71.25	0.00	92.52	90.78	84.89

Source: Mid-term Evaluation of the EU's Generalised System of Preferences. Available at: http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146195.pdf

⁵ Movchan V. "Trade Policy" // European Integration Index for Eastern Partnership Countries. International Renaissance Foundation, May 2012. Available at: <http://www.eap-index.eu/>

⁶ See details at: <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/belarus/>

⁷ See details at: <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/moldova/>



All the EaP countries except Belarus features rather high level of GSP utilization (Table 1).⁸ However, the share of trade with the EU eligible for GSP/GSP+ varies significantly for these countries. Georgia and Armenia enjoy the highest eligibility level, while Azerbaijan faces the lowest share (due to its energy exports not covered by the GSP). As said above, Belarus is temporarily withdrawn from the GSP preferences.

The actual level of tariff protection faced by the EaP countries in the EU is determined by the EU Import Tariff Schedule, eligibility to existing EU unilateral preferential schemes, bilateral agreements, as well as the merchandize structure of the country's exports to the EU.

Among the EaP countries, Moldova's exporters face the lowest level of tariff protections in the EU thanks to the ATPs, while Belarus and Ukrainian exporters face the highest (Table 2). In turn, the EU exporters have to deal with the highest tariffs in Belarus (reciprocity principle) and in Azerbaijan. The lowest imports tariffs on the EU products are applied in Georgia. Both the EU and the EaP countries tend to have higher import tariffs on agricultural products as compared to industrial goods.

Table 2. Applied tariffs in trade between the EU and the EaP, 2011

	ARMENIA	AZERBAIJAN	BELARUS	GEORGIA	MOLDOVA	UKRAINE
Applied tariff rate on goods exported to the EU						
agricultural tariff rate	5.22	5.22	9.97	5.22	2.36	7.42
industrial tariff rate	0.11	0.11	2.86	0.11	0.01	1.19
Applied tariff rate on goods from the EU						
agricultural tariff rate	7.15	10.92	13.57	5.57	8.87	6.12
industrial tariff rate	2.26	6.49	7.74	0.45	1.97	2.45

Source: Market Access Map <http://www.intracen.org/marketanalysis/MACMap.aspx>

Azerbaijan, Belarus and Ukraine apply export tariffs that affect also exports to the EU. The list of products subject to export tariffs includes metals and metal scrap (Azerbaijan and Ukraine), mineral products (Belarus and Ukraine), and selected other sensitive raw materials like oil seeds and skins (Ukraine), wood (Belarus). The EU doesn't apply export tariffs.

⁸ CARIS (2010) Mid-term Evaluation of the EU's Generalised System of Preferences. Available here: http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146195.pdf



Trade defense measures have been rarely used in trade between the EU and the EaP countries.⁹ Among the EaP countries, majority of currently registered cases are between Ukraine and the EU. These measures were adopted mostly a decade ago, that is before the EU granted Ukraine market economy status, and Ukraine became the member of the WTO.

3. EU-Ukraine DC FTA: main provisions, expected benefits and costs

3.1. Key points of the DCFTA

According to publicly available information,¹⁰ the DCFTA Section of the Association Agreement contains 15 chapters and over 20 protocols, annexes, addendums and declarations. These Chapters concern:

1. National treatment and access to market of goods
2. Trade defense measures
3. Technical barriers to trade
4. Sanitary and phyto-sanitary measures
5. Customs issues and trade facilitation
6. Right of establishment, services, e-commerce
7. Current payments and capital movement
8. Public procurement

⁹ See details at: <http://ec.europa.eu/trade/tackling-unfair-trade/trade-defence/>

¹⁰ The text of the DC FTA agreement is closed to public. Our analysis is relied on open sources, mainly on interviews with representatives of negotiating teams, including the following sources:

<http://delo.ua/ukraine/o-chem-dogovorilas-ukraina-s-evrosojuzom-otnositelno-zony-svobod-167053/>;
http://dt.ua/POLITICS/valeriy_pyatnitskiy_duzhe_hochetsya_schob_tsia_ugoda_vidbulasya-90518.html;
http://news.dt.ua/ECONOMICS/ukrayina_i_es_domovilisya_pro_kvoti_na_bezmitniy_eksport_agroproduksiyi-88464.html

Also, we use information provided in “EU-Ukraine Association Agreement: Guideline for Reforms” Edited by O.Sushko. KAS Policy Paper No.20, Kyiv, 2012; Zarembo K. (2012) EU-Ukraine DCFTA: What do oligarchs think? Policy Brief #1/2012. Institute of World Policy, available at: www.iwp.org.ua; Dabrowski M., Taran S. (2012) The Free Trade Agreement between the EU and Ukraine: Conceptual Background, Economic Context and Potential Impact. No.437/2012. CASE Network Studies & Analyses. Available at: http://www.case-research.eu/sites/default/files/publications/CNSA_2012_437.pdf; Oxford Economics (2012) Ukraine-EU Trade Relations (forthcoming)



9. Intellectual property
10. Competition policy (anti-monopoly measures, state aid)
11. Trade relations in energy
12. Transparency
13. Trade and sustainable development
14. Dispute settlement
15. Intermediation mechanism

Below we discuss main provisions of the Agreement between Ukraine and the EU.

Liberalization of trade in goods

The DCFTA envisages major liberalization of import duties. It is expected that about 95% of tariff lines will be set at zero in bilateral trade, while for the rest of tariff schedule duties will be reduced or tariff quotas with zero tariffs inside introduced.

Import duties and tariff quotas: Full liberalization will be achieved in industrial goods trade. The EU committed to apply zero duties on all industrial products imported to the EU from Ukraine from the date when the Agreement comes into force. Ukraine will gradually reduce its import duties on industrial products over transition periods. After expiration of transition periods and special regime periods, that is in 15-year period from the date when the Agreement comes into force, final import duties in Ukraine will be set at zero for all industrial products.

Special regimes are applied to imports of several industrial goods to Ukraine, namely to passenger cars (HS 8703) and second-hand clothing. In case of passenger cars, a gradual reduction in import duties could be temporary counterweighted by introduction of import surcharge. In the case of second-hand clothing, special estimated customs value will be introduced, and the value of imported second-hand clothing is to be above this estimated customs value.

As of trade in agricultural products, trade will be significantly liberalized but some import duties will be preserved. However, the EU agreed to provide substantial quotas on duty-free exports of key Ukrainian agricultural products.¹¹ In particular, the parties agreed on:

¹¹ According to information provided by Mykola Prysyzhnyuk, Minister of Agrarian Policy and Food of Ukraine. Available at: http://news.dt.ua/ECONOMICS/ukrayina_i_es_domovilisya_pro_kvoti_na_bezmitniy_eksport_agroproduktiyi-88464.html



- Duty-free quota for grain exports amounted to 1.6 million tons in the first year of the Agreement implementation, with gradual increase to 2.0 million tons in the fifth year. The composition of quota will be the following: wheat – 0.950 million tons in the first year (1.0 million tons in the fifth year), corn – 0.250 million tons in the first year (0.350 million tons in the fifth year), barley – 0.400 million tons in the first year (0.650 million tons in the fifth year).
- Duty-free exports for meat and meat products amounted to 20 thousand tons of frozen fowls (not cut) and 16 thousand tons of other fowl meat products (20 thousand tons in the fifth year), 3 thousand tons of eggs and 3 thousand tons of egg products, 12 thousand tons of meat of bovine animals, and 40 thousand tons of swine meat.
- Duty-free exports of sugar and sugar products, including 30 thousand tons for sugar and 27 thousand tons for molasses and sugar syrup.

Tariff quotas with duty-free exports within quota are envisaged for a number of other agricultural products including some dairy products, cereals, honey, selected vegetables and juices.

In turn, Ukraine will gradually liberalize import duties on agricultural products within quite long transition periods. For majority of agricultural products, zero import tariffs are envisaged in the end of transition.

Export duties: Elimination of export duties by Ukraine was among red tapes for the EU in the DCFTA talks. Parties agreed that Ukraine will eliminate its export duties over the 10-year period. At the end of transition, there would be no export duties in EU-Ukraine bilateral trade.

At the same time, the Agreement introduces temporary surcharge on several products currently subject to export duties. These surcharges will be applied to sunflower seeds, skins and non-ferrous metal scrap over the first 15 years of the Agreement implementation. The surcharges will be different for each product.

Export subsidies: Currently Ukraine doesn't apply export subsidies and – according to the WTO commitments – will not be able to apply them in the future. To remove trade distortions, the EU committed to remove agricultural export subsidies in the trade with Ukraine by changing respective EU acquis.

Trade defense measures

The Agreement allows applying all standard trade defense measures like anti-dumping, safeguard and countervailing measures in EU-Ukraine bilateral trade in line with the WTO rules and practices. These measures will be applied in accord with the respective WTO Agreements,



in particular Articles VI and XIX of GATT 1994, Agreement on Safeguards, Agreement on Implementation of Article VI (antidumping), and Agreement on Subsidies and Countervailing Measures.

In addition, Ukraine and the EU agreed to establish transparency requirements, mechanisms for revision and consultations, as well as to apply 'lower rate' rules for antidumping and safeguard duties.

Special trade defense measures could be applied to imports of passenger cars over 15-year period from the date when the Agreement comes into force. If imports of passenger cars from the EU surpass two specific thresholds, namely 45 thousand cars per year and 20% (later on, 25%) share of the domestic market, trade defense measures could be implemented in form of surcharge.

Establishment of Businesses, Trade in Services and E-Commerce

Establishment of business, trade in services and e-commerce related issues constitute important part of the Agreement, building upon already quite liberal service trade regimes applied both in the EU and Ukraine.

According to available information, the DCFTA envisages mutual liberalization of business establishment and cross-border service provision in majority of sectors, excluding mining, manufacturing and processing of nuclear materials, manufacture and trade of weapons, audiovisual services and various service sectors related to air transportation. Major liberalization is expected in financial sector and communication.

Also, the DCFTA contains provisions liberalizing entry and temporary stay for certain categories of service providers. Currently in Ukraine the fourth mode of service supply has remained unbound except for horizontal limitation that the entry and temporary stay in Ukraine of a foreign supplier requires a permit for temporary stay or a work permit.¹²

Protection of intellectual property rights

In the sphere of intellectual property rights (IPR) considerable reforms are envisaged, aimed at establishment innovation-conducive and efficient level of IPR protection. The DCFTA contains Ukraine's commitment to approximate its IPR protection legislation with the EU acquis.

¹² Report of the Working Party on the Accession of Ukraine. Addendum. Part II - Schedule of Specific Commitments in Services. Available at: https://www.wto.org/english/thewto_e/acc_e/a1_ukraine_e.htm



During the DCFTA talks particular public attention had been paid to geographical indications, the special legal identity given to products that are closely linked to a particular place and tradition of production. According to available information, Ukraine committed to abandon usage of geographical indications that belong to the European producers. It means that Ukraine will refrain from usage of approximately 3000 names of products including nearly 15 ones currently used by Ukrainian producers (for example, cognac, champagne, certain brands of cheese - feta, Roquefort, etc.). However, 10-year transition period is envisaged for implementation of commitment regarding geographical indications. Moreover, the EU will provide compensation package to the Ukrainian producers that would suffer from these provisions of the DCFTA.

Reforms in TBT and SPS spheres

The DCFTA envisages considerable convergence of Ukraine's regulatory framework in TBT and SPS area, including approximation to EU procedures in standardization, metrology, accreditation, and conformity assessment. Ukraine committed to implement principles and practices embedded in a number of TBT and SPS related EU Directives.

Ukraine committed to conduct administrative and institutional reforms required for implementation of the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA). The Parties agreed to include the ACAA as addendum to the DCFTA.

In TBT sphere, the country will gradually embed European standards into national standards, eliminate national standards that contradict European standards, including intrastate standards (GOSTs) adopted before 1992.

In SPS sphere, the DCFTA envisages an establishment of the Committee on SPS Management for regular monitoring of approximation progress and development of recommendations. Also, the Committee on SPS Management will officially approve an equivalence of SPS measures in Ukraine and the EU, after this equivalence will be tested in accordance with specially designed procedures described in the annex of the Agreement.

Ukraine will ensure participation of its public bodies in European and international organizations dealing with standardization, metrology and conformity assessment. In particular, Ukraine will fulfill all requirements necessary to become a full-fledged member of the European Standards Organizations.



Other Regulatory changes

Strong regulatory component is a distinguishing feature of the DCFTA. Already at the beginning of the talks, it was stated that the deepness of the DCFTA is to be achieved by elimination of 'behind the border' obstacles to trade through processes of regulatory approximation, thus partially opening/extending the EU internal market to Ukraine.¹³ Apart from TBT, SPS and IPR spheres, major regulatory reforms are expected in Ukraine's competition policy, state aid, public procurement, and sustainable development covering ecological, labor and social issues.

The DCFTA doesn't contain exact details of legal approximation, but makes references to the respective EU Directives. The Ukrainian government is responsible for embedment of key principles and parameters of the Directives into the national legislation and for their proper implementation.

For Ukraine it is important that that the country will receive EU technical and financial assistance to implement these reforms, lowering associated fiscal and administrative burden.

3.2. Benefits and costs of the DCFTA

Analysis of benefits and costs of the implementation of the DCFTA with the EU shows that the DCFTA would bring important benefits for Ukraine including:¹⁴

- **Improved welfare** through better access to higher variety of products, stricter safety requirements for products on domestic market, and higher incomes in long-run thanks to new business opportunities and more efficient domestic resource allocation;
- **Duty-free access to the largest world market** for vast majority of Ukrainian products creating significant business opportunities. The EU GDP measured in purchasing power parity (PPP) reached USD 15.65 trillion in 2011, while same indicator for the custom union between Russia, Belarus and Kazakhstan (RBK CU) was USD 2.76 trillion; the potential economic gains from any regional integration project are positively correlated with the size of the market with which this integration occurs;
- **Better access to the third-countries markets** through harmonization of standards with the EU and thus acquisition of internationally acceptable standards;

¹³ See at: http://ec.europa.eu/delegations/ukraine/eu_ukraine/trade_relation/free_trade_agreement/index_en.htm

¹⁴ Movchan, Giucci and Kutsenko (2010) "Trade policy in Ukraine: Strategic aspects and next steps to be taken", Policy Paper 02, April 2010. Available at: www.ier.com.ua; Movchan V., Guicci R. (2011) "Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan" Policy Paper 05, November 2011. Available at: www.ier.com.ua



- **Better domestic investment climate** thanks to embedment of the EU acquis into national legislation. These changes would result in creation of regulatory environment familiar to foreign investors and thus more attractive for them.

However, these benefits would come at important costs that include:

- **Higher domestic competition** due to elimination of tariff barriers and a significant reduction in non-tariff barriers resulting in market restructuring and reallocation of factors of production. Although higher competition is definitely beneficial for the country in the medium-term, short-term effects of reallocations could be painful;
- **Increased standard obedience costs**, as the EU standards are generally more stringent and thus compliance with them would require more efforts and expenses. It relates both to TBT and SPS standards, as well as “social” standards like occupational safety requirements, environmental standards, social security;
- **Costs associated with legal and administrative adjustments** taking into account that immediate costs could be rather high (establishment of independent regulatory bodies, introduction of new – likely technologically more advanced – procedures, etc.);
- **Mitigation costs** related to the DCFTA, primarily for implementation of an active labor market policy that will be needed to mitigate effects associated with labor reallocation in process of economic restructuring.

Summing up, the DCFTA with the EU seems to have important medium- to long-term benefits for Ukraine, but is likely to bear short-term costs. However, some of these costs are likely to be shared with the EU as it is ready to provide necessary technical assistance.

Economic impact of the establishment of the DCFTA between the EU and Ukraine could be demonstrated by computable general equilibrium (CGE) modeling results.

According to IER studies,¹⁵ the EU-Ukraine FTA results in net welfare gains for Ukraine both in case of simple FTA (mutual elimination of import tariffs) and in case of the DCFTA (mutual elimination of import tariffs plus regulatory approximation and improvement of customs and other procedures modeled as reduction in border dead-weight costs on trade). Specifically, in case of

¹⁵ IER (2011) Ukraine's trade policy choice: pros and cons of different regional integration options. Analytical Report. Available at: www.ier.kiev.ua; Movchan V., Giucci R. (2011) “Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan”, Policy Paper PP/05/2011, November 2011. Available at: www.ier.kiev.ua; Movchan V., Shportyuk V. (2011) “Between two unions: optimal regional integration strategy for Ukraine” Presented at the Thirteenth Annual Conference of the European Trade Study Group (ETSG) September 8-10, 2011, Copenhagen, Denmark



the establishment of simple FTA with the EU the total welfare of Ukraine increase by 1.3% in the medium run and by 4.6% in the long run *ceteris paribus*, while for the DCFTA welfare increase would be 4.3% and 11.8% respectively.

These results are comparable with other studies of the impact of trade regime changes in Ukraine. According to the CEPS,¹⁶ the simple FTA would lead to negligible welfare gains, while for the deep FTA results in gains at 4-7%. Also, CASE researchers concluded that the positive welfare effects are largest in the extended FTA between Ukraine and the EU.¹⁷ They estimated that the integration leads to 2% increase in welfare for Ukraine using static model formulation.

3.3. Stages of enactment of the of the Agreement

Technical completion of the EU-Ukraine DCFTA negotiations was announced in October 2011. In December 2011, the parties made official announcement regarding the completion of negotiations on Association Agreement in general, including its DCFTA component.

Officially, the Association Agreement was initialed in English in March 2012. However, de-facto the process of initialization was prolonged till summer as although technical editing of the DCFTA and economic cooperation sections of the Agreements has been continued after March.

After the text is initialed, there are several more steps needed for its enactment. First, it has to be signed. Next, it has to be ratified. There are different procedures for ratification of the DCFTA and economic cooperation sections of the Association Agreement and the rest of the text. The ratification of the DCFTA and several other economy-related issued will be in the competence of the European Parliament, while the rest of the Association Agreement will undergo process of the ratification by the national parliaments of the EU member countries. Therefore, it is quite likely that the DCFTA component could be enacted well before the entire Association Agreement is ratified.

¹⁶ CEPS (2006). *The Prospect of Deep Free Trade Between the European Union and Ukraine*. Report prepared by Centre for European Policy Studies (CEPS), Brussels; Institut für Weltwirtschaft (IFW), Kiel; International Centre for Policy Studies (ICPS), Kyiv

¹⁷ CASE (2007). *Global Analysis Report for the EU-Ukraine TSIA*. Ref: TRADE06/D01. Concept Global Analysis Report prepared by ECORYS and CASE



4. Implications for EaP: status of regulatory reforms and path ahead

As discussed in Section 3, the level of applied tariff protection between the EU and the EaP countries (except for Belarus) is quite low, and thus impact of tariff liberalization will be relatively small on average, although definitively some industries will experience significant impact. Still, it is expected that the most of benefits and costs associated with the DCFTA will be generated by elimination of non-tariff barriers that is by regulatory approximation.

To understand the level of the EaP countries' readiness for the DCFTA negotiations and implementation, we compare the level of regulatory approximation to the EU *acquis*. The analysis has been done on the basis of information collected by experts within the project "European Integration Index for Eastern Partnership Countries" funded by the International Renaissance Foundation and Open Society Institute.¹⁸

WTO membership

The WTO membership is the prerequisite for the DCFTA negotiations with the EaP countries. The most of the EaP countries have already joined this international organization, including Armenia, Georgia, Moldova and Ukraine. Azerbaijan and Belarus are negotiating accession.

Trade defence measures

Almost all of the EaP countries have been prepared for proper implementation of trade defense measures. The members of the WTO (Armenia, Georgia, Moldova and Ukraine) have joined respective WTO Agreements and obliged to apply the WTO rules. Also, these countries as well as Belarus have necessary national legislation and national authority responsible for investigation.

However, Azerbaijan doesn't have necessary national legislation and national authority responsible for investigation of antidumping and unfair competition practices related to foreign trade.

Summing up, approximation of legislation in the sphere of trade defense measures should not create major problems for all the EaP countries except for Azerbaijan.

¹⁸ See at: <http://www.eap-index.eu/>



Protection of intellectual property rights

General framework for the trade-related protection of the intellectual property rights has been already established in the EaP countries. All of them are the members of the WIPO and participate in the WIPO-administered treaties. All EaP countries - WTO members are obliged to obey TRIPS that created common minimal ground for intellectual rights protection enforcement in the countries.

Although implementation of protection of intellectual property rights has been traditionally quite low in the region, only Moldova has been in the list of the countries with low protection of the intellectual property rights. Thus, the EaP countries are relatively well prepared for the intellectual right protection talks.

But negotiations related to geographical indications could be the most sensitive for the EaP countries as it was in Ukraine. All the EaP countries have national legislation on geographical indications, but there are a limited number of registered geographical indications in the countries and in the most of these countries there are conflicting EU geographical indications used by national producers. In Ukraine, Moldova and Georgia national producers voluntary or on the basis of international agreements have been phasing out the use of the EU GIs. There is no process like this in other EaP countries.

Reforms in TBT and SPS spheres

Approximation of national legislation and practices in the TBT and SPS spheres is expected to be one of the most necessary and, at the same time, the most costly for the EaP countries.

The EaP countries - WTO members signed respective WTO TBT and SPS Agreements that created a common denominator for national regulation, although proper implementation of the Agreements' provisions remains a reason for concern.

In the TBT sphere, issues of approximation/harmonization of national technical regulations and standards with international regulations and practices as well as conformity assessment procedures and market surveillance have been on reform agenda for all the EaP countries.

According to information collected by project "European Integration Index for Eastern Partnership Countries" funded by the International Renaissance Foundation and Open Society Institute, a number of New Approach Directives implemented in the EaP countries is very limited. Ukraine is the leader with 5 Directives, while in Belarus, Armenia and Azerbaijan no directives



have been implemented so far. Three of out of six EaP countries – Belarus, Azerbaijan and Ukraine¹⁹ - have mandatory implementation of standards.

Apart from Ukraine, no EaP countries have even started negotiations on the ACAA with the EU.

Market surveillance mechanism is non-compliant with the EU practices and rules. In all the EaP countries, the requirements towards national market surveillance authority are non-complaint with the EU legislation.²⁰ Also apart from Ukraine, the national market surveillance legislation is incompatible with the EU aquis.

In the SPS area, situation has been even more difficult. The EU doesn't have mutually recognized equivalence of requirements applied to any sector or product with any the EaP country. The EU doesn't recognize (in the official opinions of DG SANCO or other authorities) that national food safety authority of any the EaP country is compatible with EU requirements. The same statement is truth for compatibility of general national food safety legislation with EU requirements.

Very limited number of the EaP countries' establishments has a right to export to the EU products of animal origin. In Ukraine, 96 national establishments obtained this right, in Belarus – 66, in Moldova – 15, and in Armenia – 5. Georgian and Azeri national establishments have not received this right.

In majority of the EaP countries, implementation of the HACCP (Hazard Analysis and Critical Control Points) is not legally binding for national producers. Only in Ukraine, the HACCP implication is legally binding, although de-facto its implementation is very limited. Also Armenian fish producers are obliged to implement the HACCP.

Summing up, all the EaP countries have to implement extensive reforms to approximate/harmonize its national legislation and practices with the EU aquis in the spheres of TBT and SPS. However, these reforms are most crucial for getting better access to the EU market and for gathering expected DCFTA benefits. Without these changes, benefits of the DCFTA related to non-tariff barriers reduction would be foregone.

¹⁹ Formally, rule about obligatory application of standards is not repealed.

²⁰ Requirements to institutions, set out in Decision No.768/2008/EC of the European Parliament and of the Council of 9 July 2008 on a common framework for the marketing of products, and repealing Council Decision 93/465/EEC (OJ L 218, 13.8.2008, p. 82–128) and Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93 (OJ L 218, 13.8.2008, p. 30–47).

Other Regulatory changes

All the EaP countries seem to be quite highly prepared to DCFTA talks related to customs regulation and trade facilitation issues. All six countries are members of the World Customs Organization. Majority of countries ratified necessary international treaties and conventions (Table 4).

Table 4. International treaties and conventions ratified by the EaP countries in the sphere of customs regulation and trade facilitation

	ARMENIA	AZERBAIJAN	BELARUS	GEORGIA	MOLDOVA	UKRAINE
Framework of Standards to Secure and Facilitate Global Trade	Yes	yes	yes	yes	yes	yes
Istanbul Convention on temporary admission	No	no	yes	yes	yes	yes
HS Convention	Yes	yes	yes	yes	yes	yes
UN TIR Convention	Yes	yes	yes	yes	yes	yes
1982 Convention on harmonization of frontier controls of goods	Yes	yes	yes	yes	yes	yes
Revised Kyoto Convention on the simplification and harmonization of customs procedures	Yes	no	yes	no	no	yes

Source: database for European Integration Index for Eastern Partnership Countries. Available at:
<http://www.eap-index.eu/>

Three EaP countries – Ukraine, Moldova and Georgia - carry out assessments of its customs authority according to the EC Customs Blueprints, and Armenia made official declaration to implement these Blueprints in its national practice.

In the sphere of competition policy and state aid, the EaP countries are far less prepared. Although all countries have established national authority responsible for protection of economic competition in the country, in two countries – Azerbaijan and Belarus – the authority is not fully independent.

Only in two EaP countries – Ukraine and Georgia – the national legislation on competition is broadly compatible with EU law²¹, and only in Georgia national legislation on control and prohibition of state aid is compatible with the EU acquis.²²

²¹ Articles 101 and 102 of Treaty on functioning of the European Union

²² Article 108 of Treaty on functioning of the European Union



Summing up, regulatory approximation of competition policy and especially state aid with the EU laws would be required in the course of the DCFTA implementation.

5. Conclusions

The EU has been one of the largest trade partners for so called Eastern Partnership (EaP) countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine). Commodity turnover of these countries with the EU vary between 30% and 50% of total, but their access to the EU market is less preferential than for many other neighboring countries. They trade with the EU on the basis of MFN regime, and five EaP countries, with exemption of Belarus, use privileges provided by Generalized System of Preferences (GSP) or the GSP+ or autonomous trade preferences (Moldova).

With the launch of the EaP initiative in 2009, relations between the EU and these countries have received new impetus for development. The AA talks have been launched with all EaP countries except for Belarus, and four of them have been involved in the DCFTA talks. Ukraine has progressed the most, as after five years of negotiations the EU-Ukraine Association Agreement with embedded DCFTA has been initialed in 2012.

The implementation of the DCFTA between Ukraine and the EU would bring important benefits for Ukrainian economy including duty-free access to the largest world market for vast majority of products creating considerable opportunities for Ukraine's exports; improved access to markets of the third countries through harmonization of standards with the EU and thus acquisition of internationally acceptable standards; and better domestic investment climate as the adjustment to the EU regulations would mean changes in national legislation. Total welfare of Ukraine is estimated to increase due to the DCFTA.

However, the DCFTA implementation will require significant costs, associated mostly with implementation of regulatory approximation in TBT and SPS spheres, protection of intellectual property rights, competition policy and state aid.

In other EaP countries, similarly to Ukraine, regulatory approximation is expected to bring the most of gains in case of the DCFTA with the EU. As Ukraine, these countries have limited approximation to the EU acquis in TBT and SPS, competition and state aid policies. These spheres are likely to be the most sensitive in DCFTA talks and in implementation period.