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of FTA between Ukraine
and the European Union**

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Annotation

This study examines modern state of economic relations between Ukraine and the EU, describes current negotiations on a deep and comprehensive free trade area. Special attention is paid to the costs and benefits of implementation of EU's *acquis communautaire* in the field of corporate law and competition policy, liberalization of capital flows, regulation of financial intermediation and harmonization of environmental standards. Comparative analysis of certain free trade agreements with EU participation is an important part of the study.

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FOREWORD



Globalization of economic relations and intensified regional integration processes determine world economic development in recent decades. The impact of the mentioned phenomena on the development of national economies is currently widely debated issue. Therefore it is important to determine economic policy that is to bring maximum benefits from potential opportunities and minimize risks related to globalization and regional economic integration.

From the standpoint of international cooperation regional trade agreements are one of the essentials of global multilateral trading system. As of July 31, 2010 474 regional trade agreements have been notified to the WTO, with more than 90% of them on free trade in goods and services. Thus, free trade agreements have become widely used trade policy instrument, allowing to pursue national economic interests on regional and world markets.

Clearly the content and format of regional trade agreements has changed rather dramatically over time. Modern free trade agreements go far beyond the traditional liberalization of trade in goods. Today, such agreements provide for free movement of services, determine basic principles of capital flows, envisage protection of competition and enforcement of labor standards, etc. All those elements fully apply to a deep and comprehensive free trade area between Ukraine and the EU, which has been negotiated since 2008. In fact this is to be a new generation free trade agreement, covering all trade-related areas of economic policy and regulation.

We should also take into account that the parties to such agreement are Ukraine, a sovereign state, and the EU – economic union, which is the highest form of economic integration with established principles and mechanisms of functioning. In practice in negotiations we are to determine the level of Ukraine's integration into the system of rules and norms, regulating the EU internal market. Therefore Ukraine should clearly understand the nature and scale of costs and benefits at different levels of integration and legislative approximation/

harmonization, which could be achieved in the free trade area. After all, efficiency of the agreement with the EU will among other be determined by how consistently and completely the parties will meet their obligations. Therefore, this study, which examines various scenarios of agreement between Ukraine and the EU, is of high importance for development of adequate strategy and tactics of economic cooperation.

***Deputy Minister
of Economy of Ukraine,
Candidate of Economic Sciences,
Associate Professor***

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, characteristic of a cursive signature.

Pyatnitskiy Valeriy

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LIST OF ABBREVIATIONS

EU	European Union
GSP	Generalized System of Preferences
MFN	Most Favored Nations
EBA	Everything But Arms
SPS	Sanitary and Phytosanitary Measures
TRIM	Trade-Related Investment Measures
HS	Harmonized System
ACAA	Agreement on Conformity Assessment and Acceptance of Industrial Products
NBU	National Bank of Ukraine
NAAU	National Accreditation Agency of Ukraine
GMO	Genetically Modified Organism
SME	Small and Medium Enterprises
AMC	Anti-Monopoly Committee
IPR	Intellectual Property Rights
DCFTA	Deep and Comprehensive FTA
FTA	Free Trade Agreement
CTM	Community Trademark
IAS	International Accounting Standards
PCA	Partnership and Cooperation Agreement
UWWT	Directive on Urban Wastewater Treatment
IPPC	Directive on Integrated Pollution Prevention and Control
WFD	Water Framework
EU	European Union
GATT	General Agreement on Tariffs and Trade
WTO	World Trade Organization
GDP	Gross Domestic Product
Yoy	year-on-year
FDI	Foreign Direct Investments
IFRS	International Financial Reporting Standards

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1. INTRODUCTION

Bilateral negotiations between the EU and Ukraine on the establishment of Deep and Comprehensive Free Trade Area were launched in February 2008, immediately after Ukraine concluded the WTO accession talks. The negotiated FTA will be the first of a new generation of deep and comprehensive free trade agreements, covering all trade-related areas including the dispute settlement mechanism. Deeper economic integration calls for higher degree of alignment with the EU's legislative framework. The FTA will tackle the so-called «beyond the border» obstacles through deep regulatory approximation with the trade-related EU *acquis*.¹

Several studies have been already initiated and financed by the European Commission and the Ukraine's Government to assess the impact of the deep FTA on macroeconomic development of the country, and on particular sectors. To name the few, IER (2006) assessed the impact of the establishment of deep FTA with the EU focusing primarily on liberalization of trade in goods, including relaxation of tariffs and reduction of non-tariff measures. It was estimated that the deep FTA could bring around 10% increase in welfare over medium-term horizon, and also positively affect the real GDP growth. Also, IER (2006) discussed the general impact of trade liberalization on sectors development, including output, employment, and trade flows.

CEPS (2006) study was aimed to assess the most welfare-beneficial level of regional integration within the FTA, choosing between simple and deep FTA. The estimations showed that only deep FTA would provide significant welfare gains at 4–7%. Also, key FTA topics were overviewed, though no deep costs and benefits analyses were conducted. ECORYS, CASE (2007) estimated welfare gains from deep FTA at 2.3–5.3% depending on simulation horizon, and also provided estimates for sector-level impacts of the deep FTA. Moreover, the study included sustainability impact assessments for several horizontal issues that could be tackled within the FTA, namely competition policy, government procurement, and technical standards. This study also contained no costs and benefits analysis of the harmonization with particular chapters of the 35 EU's *acquis*.

1 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/ukraine/index_en.htm

Abovementioned studies confirmed the generally positive impact of the deep FTA agreement on Ukraine's economic development. However, their results did not provide much insight on how 'deep' the deep FTA should be, and what the costs and benefits arise in conjunction with wide range of legal approximation issues. As a result, the main question of negotiations – what level of integration is optimal for Ukraine in each specific area of economic/trade policy – remained to be answered.

By concluding association agreements, the candidate countries should in all areas of the *acquis* bring their institutions, management capacity and administrative and judicial systems up to EU standards, both at national and regional level. The depth of Ukrainian approximation of the legislation defines the necessity and depth of structural adjustments and the costs, which arise in this connection. The current study provides a conceptual framework regarding costs and benefits of various levels of integration and legal approximation/harmonization that could be achieved within the FTA.

The rest of the report is organized as follows. Section 2 gives the overview on the EU-Ukraine economic relations. Section 3 is devoted to the current FTA negotiation rounds and process. Section 4 contains stock taking on implementation of existing Ukraine's commitments in the framework of the WTO and cooperation with the EU. These commitments are assessed from the viewpoint of their relevance for the FTA between EU and Ukraine. Section 5 contains costs and benefits analysis of several specific topics of the potential FTA, namely implementation of company law and competitions policies, liberalization of capital flows, financial intermediation issues, and harmonization across environmental standards. Section 6 briefly discusses several EU FTA agreements aiming at identification of issues, on which the EU could insist. Next Section concludes the study.

2. CURRENT UKRAINE-EU ECONOMIC RELATIONS: BRIEF OVERVIEW

2.1 TRADE IN GOODS AND SERVICES, AND CAPITAL MOBILITY

Trade in goods

Trade in goods between the EU and Ukraine had steadily grown until 2009 (Figure 1). Between 1999 and 2008 trade turnover increased by 5.5 times. In 2009, world financial and economic crisis adversely influenced trade and it dropped almost twice (Figure 1). In particular, exports reduced by 45.7% yoy and imports by 44.6% yoy. Notwithstanding this downturn, the EU as a single customs territory remains the biggest trade partner of Ukraine. In 2009, 29.0% of Ukrainian commodity trade turnover accounted for the EU: 23.6% of exports and 33.8% of imports². Though, the peak value of the EU's share in foreign trade of Ukraine was achieved in 2003, when 35.9% of commodity trade turnover was accounted for the EU countries.

It should be noted that Ukraine has remained net importer in trade with the EU for the last 10 years. The commodity trade deficit has increased from EUR 0.7 bn in 1999 to EUR 6.0 bn in 2009³. And it is likely to be preserved since Ukraine features stable demand for sophisticated machines and durables made in the EU.

Structure of commodity trade between the EU and Ukraine has changed in the last decade against the general background of total exports increase (by 139.4%). Ukraine has increased exports of food products and live animals, animal and vegetable oils fats and waxes, as well as machinery and transport equipment to the EU (see Annex A, Table 1). Crude materials, chemicals and related products, and miscellaneous manufactured articles now account for relatively smaller shares in total export of Ukraine to the EU. In 2009, Ukraine exported mostly manufactured goods (27.6%), crude materials (21.1%), machinery and transport equipment (12.1%), and mineral fuels lubricants and related materials (11.5%).

2 State Statistics Committee of Ukraine

3 In 2008 commodity trade deficit was EUR 10.6 bn.

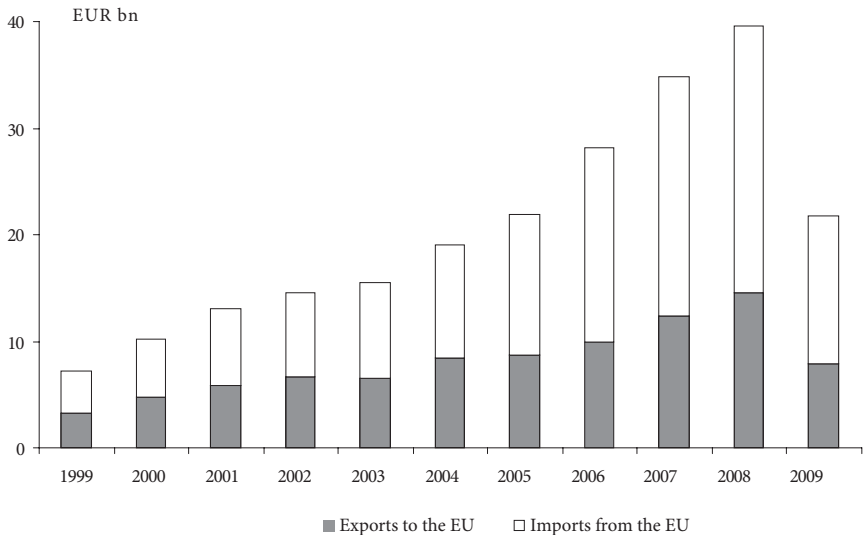


Figure 1 Trade in goods between Ukraine and the EU-27

Source: Eurostat

Regarding imports from the EU, here more substantial increase in volumes over the last 10 years can be seen – by 252.2% (see Annex A, Table 2). Commodity structure of imports has also slightly changed: major changes affected commodity groups, which account for the largest shares in imports of Ukraine from the EU. In particular, shares of chemicals and related products (19.5% in 2009) and machinery and transport equipment (32.4%) have increased, and shares of manufactured goods (17.8%) and miscellaneous manufactured articles (13.5%) have slightly decreased over 1999–2009.

Thus, trade in goods between Ukraine and the EU flows within the same commodity groups, except for crude materials and mineral fuels lubricants and related materials (see Annex A, Table 1,2).

Geography of commodity trade is concentrated on three major partners, namely Germany, Italy, and Poland. They account for 38.8% of exports and 46.5% of imports in 2009.

Trade in services

Trade in services between the EU and Ukraine repeated trends of commodity trade (Figure 2). Between 1999 and 2008 services trade turnover increased by 7.3 times. In 2009, trade in services between Ukraine and the EU declines, but milder than in trade in goods. In particular, in 2009 exports reduced by 26.5% yoy and imports by 21.7% yoy. Nevertheless, the EU has remained the biggest partner of Ukraine in trade in services. In 2009, it accounted for 40.8% of total services trade turnover of Ukraine, with 31.4% of exports and 58.1% of imports.

In contrast to commodity trade balance, Ukraine had remained net exporter of services to the EU during the period of 1999–2008. However, due to faster decrease of exports, situation changed in 2009, and services trade balance turned to negative: deficit constituted USD 13.8 m (in 2008 positive balance was USD 229.5 m).

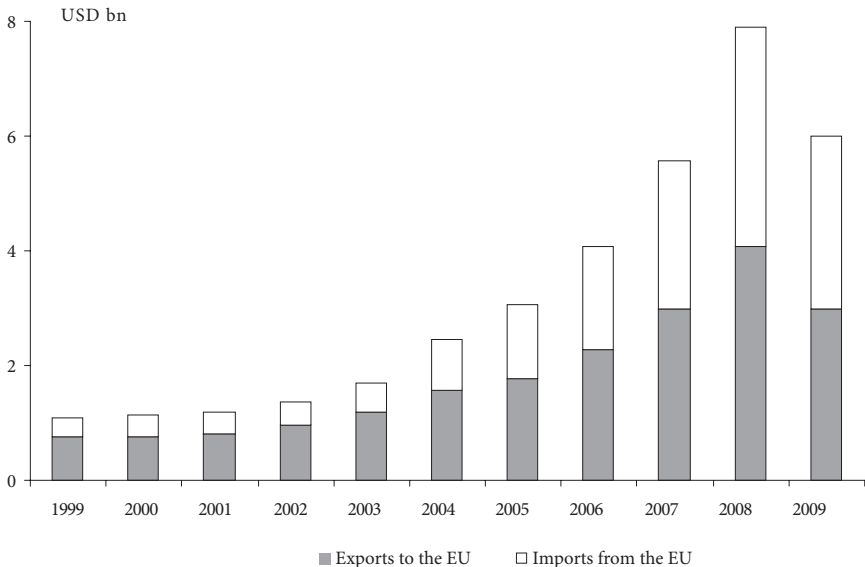


Figure 2 Trade in services between Ukraine and the EU

Source: State Statistics Committee of Ukraine

The structure of service trade has changed over the last years (see Annex A). Earlier (2002) Ukraine concentrated primarily on exports of transport services: they accounted for 80.9% of total services exports to the EU. In 2009, the share of transportation dropped to 58.6% of service exports to the EU. The volumes of exports of miscellaneous business, professional, and technical services substantially increased and reached 18.5% of exports compared with 8.3% in 2002. The structure of service imports also changed. The share of transportation and miscellaneous business, professional, and technical services reduced to 12.8% and 17.8%, respectively (see Annex A). At the same time, financial services became the main service that Ukraine imports from the the EU: its share reached 37.3% of imports in 2009.

The main partners of Ukraine in trade in services are United Kingdom, Cyprus, Germany, Austria, France and Belgium.

The review of trade in goods and services between the EU and Ukraine proves that the EU has remained the main trade partner of Ukraine for a last decade.

Capital mobility

During the last years, the EU has been the key foreign investor to Ukraine. The EU share in inward FDI stock was 78.3% in 2009. As of January 01, 2010, the inward stock of the FDI from the EU reached USD 31.4 bn compared to USD 28.1 bn a year before. The major bulk of investments Ukraine received from five EU countries: Cyprus, Germany, Austria, Great Britain and Netherlands that account for 77% of total FDI stock from the EU (Figure 3).

As of the beginning of 2010, the FDI were mostly concentrated in the field of industrial production and financial sector (22.6% and 22.1% of total inward FDI stock, respectively). Thanks to high share of European capital in Ukrainian banking system, the FDI from the EU continued to come during the crisis due tp recapitalization of Ukrainian subsidiaries by their EU mother banks.

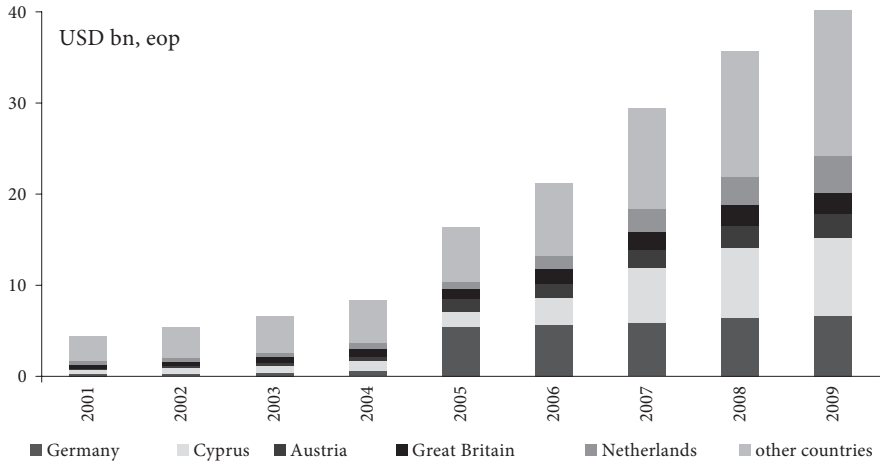


Figure 3 Geographical structure of FDI stock

Source: State Statistic Committee of Ukraine

2.2. PERSONAL MOBILITY

The EU is one of the main destinations for Ukrainian migrants. According to State Statistic Committee of Ukraine survey on labor migration, between 2007 and 2008 six European countries (Italy, Check republic, Poland, Hungary, Spain and Portugal) accounted for around 42.9% of 1.3 m Ukrainian labor migrants.⁴ The Ukrainians are largely employed at low-skilled jobs; most of them work illegally and their salaries are lower than those paid to local population. The main obstacles for legal employment are those associated with getting visa and recognition of diplomas.

Problems with acquiring visa also negatively affect tourist flows between Ukraine and EU as well as possibilities for business trips. In its turn, this hinders development of trade in goods and services between countries. For the first time Ukraine-EU visa regime was liberalised in 2007⁵. This led to increase in visas issuance including those for long-term stay.

4 Зовнішня трудова міграція населення України. Український центр соціальних реформ та Державний комітет статистики. К. 2009.

5 The major changes were the following: the price for visa was reduced, for several groups it was abolished at all, the conditions for long-term visa were simplified, etc.

In April 2010 EU Visa Code entered into force which would allow fostering migration even further.⁶ The Code foresees the common visa policy for all EU-members. However, the legislation in relation to the issuance of visas for the purpose of long stays (beyond 90 days), which is of crucial importance for Ukrainian labor migrants, remains of national competence. It should be noted that the majority of consulates and embassies are geographically remote from migrants; most of them are situated in Kyiv, while management of applicants' flows is weak with increases indirect costs of getting visas for Ukrainians.

The EU is also considering to grant visa-free regime to Ukrainians if Ukraine meets obligations on Visa Roadmap⁷. It is expected that Ukraine would have to introduce unified list of Ukrainian citizens' documents, provide Ukrainians with biometric passports as well as to pass the framework law on migration, which is still in process of development.

Currently higher degree of personal mobility with several EU countries was achieved. In early 2009, Ukraine ratified two agreements on small border movement with Poland and with Slovenia in early 2009. This allowed free border movement of citizens, who live in 30 km border zone. The importance of these agreements is difficult to overestimate, as previously migration of these citizens including that for business purposes was really active, while was treated as inactive.

Another question of high concern from the side of EU is illegal transit migration. As for now Ukraine and EU have a lot of joint programs aimed at strengthening border control and illegal transit migration reduction. Among them are BOMUK-4 and Huremas-2 directed on better borders' management⁸. Ukraine had several readmission centers in Kyiv, Chernihiv and Lutsk, while a part of EUR 2 m were provided by the EU to Ukraine in order to open another 5 mobile centers for readmitting persons. The next step is the development of integrated system of borders' regulation in accordance with Schengen border Code.

6 http://ec.europa.eu/delegations/ukraine/press_corner/all_news/news/2010/2010_04_02_01_en.htm

7 <http://euobserver.com/9/29680>

8 Мовчан В., Кобилянська А., Сисенко Н. «Економічна інтеграція і кооперація: Україна та ЄС. Підсумки 2009 року». – International Review, # 4, 2009. – www.dipacadem.kiev.ua/assets/files/bullets/Review-4_Ukr.2009.doc

It should be mentioned that during crisis some EU members provided tighter migration policy. Several European countries reduced quotas for external laborers; some strengthened sanctions for illegal stay in country and imposed additional visa requirements. The tightening was aggravated by slower progress in dialog on facilitation of labor movement. Despite this, the crisis did not seriously affect geographical distribution of Ukrainian migrants. Moreover, it seems that the number of official departures to the EU from Ukraine even increased⁹.

Summing up, the Ukraine-EU cooperation in the field of migration is rather extensive with broad possibilities for its further deepening, which is explained by mutual interests in the sphere and scope of Ukraine-EU migration flows.

9 Мовчан В., Кобилянська А., Сисенко Н. «Економічна інтеграція і кооперація: Україна та ЄС. Підсумки 2009 року». – International Review, # 4, 2009. – www.dipacadem.kiev.ua/assets/files/bullets/Review-4_Ukr.2009.doc

3. CURRENT EU-UKRAINE TRADE REGIME AND ONGOING FTA NEGOTIATIONS

3.1. TRADE REGIME

The framework documents, defining trade regime between EU and Ukraine, are Partnership and Cooperation Agreement having entered into force in 1998 and provisions of Generalized System of Preferences (GSP).¹⁰ Recent economic developments and financial and economic crisis in particular did not affect Ukraine-EU trade regime.

According to PCA parties apply to one another Most Favored Nation (MFN) treatment and limit the possibility of imposing restrictions on imports and exports, while the GSP allows for lower duties than the MFN rates on over 6000 products. The existing scheme foresees high proportionate reduction in duties for most industrial products, but relatively low proportionate reductions for agricultural products. Currently EU applies GSP+¹¹ and EBA¹² to some countries, while Ukraine is not qualified for either of them¹³.

Ukraine-EU trade regime was further liberalized when Ukraine joined World Trade Organization (WTO) organization in 2008. The quotas on rolled metal export to EU were cancelled and currently there are no quantitative restrictions on trade between Ukraine and the EU.¹⁴ Ukraine became much more open for trade thanks to lower and bounded import tariffs, elimination

10 <http://www.delukr.ec.europa.eu/page36090.html>

11 GSP+ is a special incentive arrangement for sustainable development and good governance which offers additional tariff reductions to support vulnerable developing countries in their ratification and implementation of international conventions in these areas.// <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/>

12 EBA («Everything But Arms») grants duty-free access to imports of all products from LDCs, except arms and ammunitions, without any quantitative restrictions (with the exception of bananas, sugar and rice for a limited period).// <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/everything-but-arms/>

13 Veronika Movchan, Ricardo Giucci, Kateryna Kutsenko. Trade policy in Ukraine: Strategic aspects and next steps to be taken. IER Policy Paper 02/2010

14 Except those restrictions that are applied to all Ukrainian exports or imports regardless country of origin/destination.

of export restrictions, and commitment to conduct technical regulation reform.

Ukraine committed to WTO free market access and national treatment regime for 11 core sectors of services supplied under the first three modes. The fourth mode of supply has remained unbound except for horizontal limitation that the entry and temporary stay in Ukraine of a foreign supplier require a permit for temporary stay or a work permit. Some sectors such as telecommunications, maritime transportation, notary services and others have additional restrictions for market access. Thus, trade in services between Ukraine and EU could be liberalized further.

Other important components of Ukraine-EU trade regime are antidumping and special measures applied by countries to different commodity groups of reciprocal import. As in 2005 Ukraine was given a market economy status, possible anti-dumping investigations against Ukrainian exporters to the EU are conducted applying normal value of exports based on the prices paid or payable in Ukraine, and not in the third country, as it is required for non-market economies. As of April 2010, EU applies six antidumping measures against Ukraine. In its turn, there are three anti-dumping measures against products from selected EU countries, and six safeguard measures concerning all trade partners including the EU.

The standards and technical regulations remain the stumble block for Ukrainian trade with the rest of the World. Ukraine committed to WTO to conduct a considerable technical regulation reform, including alignment of Ukrainian technical regulations with relevant international, more specifically European, standards by the end of 2011. All existing national and regional standards in Ukraine should be voluntary, except those intended *inter alia* to protect national security interests, prevent deceptive practices, etc¹⁵. The technical regulation reform will allow avoiding mandatory certification of a broad list of products and, thus, facilitate external trade.

To sum up, Ukraine and the EU have rather favorable trade regime; however, further improvements are definitely necessary. A lot of other countries benefit from wider preferences, thus having better competitive positions as compared to the Ukrainian producers on the EU market. The FTA+ negotiations started in 2008 are expected to mutually eliminate the most

15 The Report of the Working Party on the Accession of Ukraine to the World Trade Organisation WT/ACC/UKR/152, 25 January 2008. – www.wto.org

of imports tariffs and adjust the Ukrainian legislation to the EU rules and norms, generating substantial welfare gains for Ukraine.

3.2. ONGOING EU-UKRAINE FTA NEGOTIATIONS

In March 2007 Ukraine and the EU launched negotiations on a new enhanced agreement in order to replace the Partnership and Cooperation Agreement effective since 1998. The two parties agreed that the new agreement would be based on the principles of political association and economic integration. Therefore, it was decided to qualify this document as Association agreement providing for the establishment of a deep and comprehensive Free Trade Area with the EU.

Since WTO's General Council had approved Ukraine's accession package on the February 5, 2008, the EU and Ukraine immediately launched negotiations on an agreement on a deep and comprehensive free trade area. Previous consultations between parties started much earlier. As part of the future Association Agreement, the FTA is intended to deepen Ukraine's access to the European market and to encourage further European investment in Ukraine.

The FTA will be an integral part of the future Association Agreement. This FTA is supposed to become the first of a new type of «deep and comprehensive» trade agreements. It will cover a wide array of trade-related issues and aims at eliminating 'behind the border' obstacles to trade through processes of regulatory approximation, thus partially opening the EU internal market to Ukraine. The Agreement must be compatible with WTO rules and take into account possible outcome of the Doha Round of WTO negotiations.

The parties agreed that negotiations would be conducted in regular rounds to be held every eight weeks alternately in Kyiv and Brussels and in parallel thematic groups. Three main sets of subjects had been defined by the parties: trade in goods; trade in services and trade rules.

Currently discussions take place in the following working subgroups: (1) Trade in goods, (2) Trade and Sustainable Development, (3) Rules of

Origin, (4) Services, capital and establishment (5) Intellectual Property Rights (6). Geographical Indications, (7) Customs and Trade Facilitation, (8) Public Procurement, (9) Competition: anti-trust, (10) Competition: state aid, (11) Sanitary and Phytosanitary Standards, (12) Trade related energy issues, (13) Tariff offer, (14) Dispute Settlement, (15) Transparency, (16) Fraud counteraction , (17) Instruments of trade protection, (18) Technical barriers to trade.

From February 2008 to May 2010, 10 rounds of the FTA negotiations between Ukraine and the EU took place, leading to substantial progress in discussions on most issues. During initial rounds the parties agreed the general structure and format of the agreement. Following rounds were more detailed and focused on a large range of specific issues of the agenda. During the latest rounds the parties discussed, in particular, specific conditions of access to relevant markets, including schedules of adaptation of Ukrainian legislation to the *acquis*, as well as the scope of the necessary institutional changes in Ukraine.

As of May 2010, negotiations concerning chapters on customs and trade facilitation, public procurement, transparency, and intellectual property rights have been provisionally completed. The chapter on rules of origin has already been finalized. Regarding the chapter on trade in goods the parties have agreed the gradual approach to the harmonization of the Ukrainian legislation on conformity assessment.

However, discussions on regulatory approximation, for instance concerning sanitary and phytosanitary standards, or technical barriers to trade, trade related energy issues (transit, transportation, price formation), dispute settlement, trade and sustainable development are still ongoing and mutually acceptable arrangements have not yet been found.

In March 2010 Viktor Yanukovich, the newly elected president of Ukraine, reaffirmed the strategic importance of pursuing further economic integration with the European Union through establishing a deep and comprehensive free trade area and expressed determination to successfully conclude negotiations before the end of 2010. Prime Minister Mykola Azarov said that the government had fixed the objective of signing the Association agreement with the EU in the course of 2010 and would make all the necessary efforts in order to achieve it.

In May 2010 Sergiy Tigipko, Vice Prime minister supervising negotiations, urged two negotiating parties to draft a clear and coordinated action plan on establishing an FTA between the EU and Ukraine. On the Ukrainian part this plan should include such actions as preparation of relevant bills on public procurement procedures, gas market functioning, technical regulation, phytosanitary control, etc. Passing these bills along with other legislative acts adapted to EU standards will help Ukraine to be effectively and as rapidly as possible integrated into European economic space.

The Reform Program 2010–2014¹⁶ of the Government fixed establishment of the FTA+ with the EU and integration to EU internal market as a strategic goal for Ukraine, to be ensured via respective reforms and approximations of the legislative framework. The President's Draft Law on the principles of Internal and external policy¹⁷ provides for Ukraine's deep integration to the EU environment with the goal to obtain membership perspective as a principle of external policy. This clearly indicates political will for Ukraine's actions in the nearest future.

16 http://www.president.gov.ua/docs/Programa_reform_FINAL_1.pdf

17 http://gska2.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=37809

4. STOCK TAKING ON IMPLEMENTATION OF EXISTING TRADE-RELATED COMMITMENTS

4.1. BRIEF OVERVIEW OF UKRAINE'S WTO COMMITMENTS

Ukraine has become a member of the WTO since May 16, 2008. Ukraine reached mutual understanding on the trade in goods and services with 52 countries-members of the Working Party after 15 years of negotiations. Prolonged negotiations period resulted in gradual implementation of certain Ukraine's commitments. Before official WTO accession, however, a number of commitments have yet to be implemented, because transition periods were envisaged for them and some changes need time for implementation.

Import tariffs

The country shifted to new tariff schedule adjusting the applied import duties to its bound levels set in the Tariff Schedule of Ukraine, which became the part of national legislation. However necessary adjustments of internal Ukrainian Customs Code haven't been done yet.

Ukraine committed to join 16 of the 19 sector initiatives. After the WTO accession import tariffs were put into accordance with the majority of initiatives. The exceptions are the initiative «civil aviation», which Ukraine joins in 2010, and also «distilled spirits» initiative – where Ukraine should impose zero duty rates in 3 years after the WTO accession.

Transition periods are set up 320 tariff lines that are about 3% of the total trade classification of Ukraine. They include some sorts of meat, fish, seeds, spirits, polymeric materials and rubber, metals, furniture, also products of engineering including some kinds of vehicle. The maximum of transition period is 5 years till 2013, although the majority of them terminates in 2010–2011.

After transition periods the average weighted rate of the applied custom tariff will be 5.1% in 2013 (10.1% for agricultural products and 4.8% for industrial products). Also, Ukraine will have zero tariffs for 10% of

agricultural products' tariff lines, and for 35.2% of industrial products' tariff lines. Maximum bound rates can be applied on sugar (50%) and sunflower seed oil (30%) .

Quantitative restrictions

Ukraine will not further introduce, reintroduce or apply quantitative restrictions on import or non-tariff measures such as licensing, prohibitions, permissions, requirements of prior validation and other restrictions with the same effect that could not be substantiated according to the WTO agreement. The only tariff rate quota was set for raw cane sugar (260,000 tonnes annually, and increasing to 267,800 tonnes by 2010). The quota distribution will be set on a first-come first-served basis within three years of the date of WTO accession.

Ukraine committed to abolish export prohibitions except for gold, silver and diamantes. All requirements for export licensing and other export restrictions and control are to be applied according to the WTO rules.

Export tariffs

Before Ukraine's WTO accession export duties were applied to some commodities, in particular, to oilseeds, livestock, leather raw materials, nonferrous metals and ferrous metals scrap. Ukraine committed to gradually reduce them to 10%, 10%, 20%, 15% and 10 Euro/t, correspondingly. However, Ukraine preserved its right to impose export duties on other goods. Also, Ukraine will not apply any mandatory minimal export prices.

Subsidies

Ukraine obligated not to use export subsidies. Industrial subsidies should be introduced only in accordance with the Agreement on Subsidies and Countervailing Measures.

Technical norms and standards

From the date of accession, Ukraine would give priority consideration to international (over regional and other countries' national) standards, guidelines and recommendations, as a basis for Ukraine's own standards,

technical regulations and associated conformity assessment procedures. By December 30, 2011.

From the date of accession, all existing national and regional standards are voluntary, except those referred to or set out in technical regulations intended *inter alia* to protect national security interests, prevent deceptive practices, protect the life and health of people, animals or plants, as well as to protect the environment. By March 16, 2010 there 30 technical regulations were adopted and approved by corresponding Regulations of the Cabinet of Ministers of Ukraine. Further development and adoption of technical requirements follows.¹⁸

Thus, there are no any transition periods for appliance of the Agreement on Technical Barriers to Trade.

Ukraine would continue to reduce further the number of categories of products subject to mandatory third party certification with a view to the broadest possible acceptance of manufacturer's supplier's declaration of conformity (SDOC). Ukraine would notify the revised list of products subject to mandatory certification to the WTO by 31 January 2012.

Sanitary and phytosanitary measures

From the date of accession Ukraine committed to apply all its sanitary and phytosanitary measures in conformity with the requirements of the WTO Agreement, including the Agreements on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) and Import Licensing Procedures, without recourse to any transitional arrangements.

Ukraine will not forbid the use of antibiotics and hormones to enhance the growth rates of livestock within Ukraine, and Ukraine committed to allow the import of all meat and meat products treated with growth promoting hormones. From the date of accession Ukraine generally applies only those maximum residue limits based on standards set by the Codex Alimentarius.

Trade-related investment measures

From the date of accession Ukraine applies its investment regime in compliance with the WTO Agreement, including the Agreement on Trade-Related Investment Measures (TRIMs), without recourse to any transition

18 Вероніка Мовчан, Оксана Кузяків. Україна та СОТ: двадцять місяців членства. 16.03.2010

period in a non-discriminatory manner – to imports from all WTO Members and to domestically produced goods.

Intellectual property rights

Ukraine obligated to fully follow the Agreement on Trade-Related Aspects of Intellectual Property Rights upon the accession without any transition period.

Trade in services

Ukraine has bound itself with commitments regarding market access and national treatment in 11 key sectors and several other services. Additional commitments exist for certain communication services, maritime transport, pipeline transport services. For the services included in Ukraine's Schedule of Specific Commitments Ukraine would ensure that its licensing procedures and conditions would not act as independent barriers to market access.

The MFN exemptions are production and sale of audio-, video-, cinema and TV products; services of computer reserve systems in aircrafts. Road, rail, inland waterways and related auxiliary services are not fully covered in the Schedule of Specific Commitments, because they are regulated by bilateral and multilateral intergovernmental agreements. Existing MFN exemptions in inland waterways transport will be gradually eliminated within 8 years upon accession to the WTO.

In banking, from the date of accession foreign banks are allowed to open branches in Ukraine. Foreign insurance firms are allowed to open branches after five-year transition period.

Public procurement

Ukraine has not joined the WTO Agreement on Government Procurement. According to the commitments, the country is to launch negotiations to join it after accession. In the interim, procurement should be conducted in a transparent manner and MFN treatment should be applied. The Parliament adopted the new version of the Law on Government procurements with President's amendments, which are in line with EU requirements and World Banks recommendations. The Law is for the signature of the President.

Summing up, Ukraine's WTO accession resulted in considerable trade liberalisation while a lot of changes occurred before or immediately from the date of accession. There are a lot of trade-related issues that remained outside the framework of the WTO negotiations and thus would require special attention during the FTA negotiations. In addition to further liberalisation of customs duties, the following topics seem to require additional consideration:

- The degree of convergence and compatibility of technical regulations, conformity assessment procedure, accreditation and market surveillance with the EU regulations;
- The degree of convergence and compatibility of sanitary and phytosanitary standards;
- Further modernisation and simplification of customs procedures and their alignment with the EU standards;
- Further adjustments in areas related to free trade in services, intellectual property rights protection, public procurement, etc.

4.2. BRIEF OVERVIEW OF UKRAINE'S PROGRESS IN THE IMPLEMENTATION OF THE EUROPEAN NEIGHBOURHOOD POLICY

Apart from trade liberalisation within the framework of the WTO accession, bilateral relations with the EU – and in particular an implementation of the EU-Ukraine Action Plan within the framework of the European Neighbourhood Policy – create other foundations for the FTA negotiations. Below we provide an overview of the progress in the implementation of the European Neighbourhood Policy in Ukraine as of 2009 regarding selected economic clauses considered important for the FTA.

Customs-related issues

The progress in the implementation of the Action Plan aimed at modernization and simplification of the customs procedures was assessed by the EU as limited in 2009¹⁹. Though, there are currently no major delays

19 Implementation of the European Neighbourhood Policy in 2009. Progress Report Ukraine// http://ec.europa.eu/world/enp/pdf/progress2010/sec10_524_en.pdf

at border crossing points, partly due to improved border infrastructure and better cross-border cooperation, but also due to a decrease in trade flows. In 2009 the Verkhovna Rada adopted legislation on border control, introducing the rules to be applied at the Ukrainian border crossings. Some amendments were presented to the parliament to harmonize the national customs legislation with the Revised Kyoto Convention on the Simplification and Harmonisation of Customs Procedures, to which Ukraine has not yet formally acceded. Work is under way on concepts of E-customs and E-declarations. Ukraine still does not fully respect WTO rules on customs valuation. The formal adoption of the updated version of the Harmonised System for the classification of goods (HS system) has been delayed. Customs control procedures remain cumbersome and are not based on risk analysis.

Free movement of goods and technical regulations

Despite the fact that since 2005 Ukraine has been officially moving towards an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), actual progress could be assessed as very limited according to the European Commission²⁰. The adoption of some technical regulations in the priority sectors (machinery, electrical equipment and simple pressure vessels) continued in 2009. Further significant efforts are necessary in the areas related to product safety and liability and quality control system. No progress was achieved towards the institutional reform of the Ukrainian infrastructure for quality, except for sphere of accreditation. In November 2009, the National Accreditation Agency of Ukraine (NAAU) signed the Agreement on Mutual Acceptance of Personnel Certification Certificates with Signatories of the European Accreditation Multilateral Agreement. Development of Ukrainian legislation on technical regulation, standardization, conformity assessment, market surveillance, metrology and accreditation in line with the EU *acquis* is ongoing.

Sanitary and phytosanitary measures

Ukraine pursued efforts towards gradual approximation with EU sanitary and phytosanitary standards. The Law on the monitoring of

20 Implementation of the European Neighbourhood Policy in 2009. Progress Report Ukraine// http://ec.europa.eu/world/enp/pdf/progress2010/sec10_524_en.pdf

residues of veterinary medicinal products and contaminants in live animals, products of animal origin and feed and food was adopted. By the end of 2009, Ukraine is in the list of countries with approved residue monitoring plans for poultry, aquaculture, equidaea, milk, honey and eggs²¹. The country is aiming to further expand this list. Listing is an important step towards the authorisation of exports to the EU. Currently, Ukraine is authorised to export various animal products to the EU for animal feeding and for technical purposes.

Rights of establishments and company law

Some progress was achieved in the area of establishment during Plan implementation period. For instance, the unified state register of legal persons and physical persons-entrepreneurs companies was established in 2004. Ukraine committed to allow operation of foreign branches in banking and insurance sectors (latter after five-year transition period) under national treatment regime. Moreover, Ukraine committed to ensure national treatment regime for a wide range of services²². According to the European Commission²³, the practice of company registration is quite transparent in Ukraine but there are a lot of problems as regards liquidation of companies. The law on joint stocks companies entered into force in 2009. In 2009 the Government also adopted a law on simplifying business conditions in Ukraine. It aims in particular at facilitating the establishment and development of companies by easing the issuance of permits and reducing the quantitative requirements for the statutory capital of limited liability companies. Further efforts are needed to promote corporate governance. The investment climate in Ukraine is assessed negatively by EC as having one of the most burdensome regulatory systems in Eastern Europe²⁴.

21 Commission Decision of 30 October 2009 amending Decision 2004/432/EC on the approval of residue monitoring plans submitted by third countries in accordance with Council Directive 96/23/EC// <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:285:0043:0048:EN:PDF>

22 Report of the Working Party on the accession of Ukraine to the World Trade Organisation (WT/ACC/UKR/152)// http://www.wto.org/english/thewto_e/acc_e/a1_ukraine_e.htm

23 Implementation of the European Neighbourhood Policy in 2008. Progress Report Ukraine// http://ec.europa.eu/world/enp/pdf/progress2009/sec09_515_en.pdf

24 Implementation of the European Neighbourhood Policy in 2009. Progress Report Ukraine// http://ec.europa.eu/world/enp/pdf/progress2010/sec10_524_en.pdf

Free movement of capital

The National Bank of Ukraine (NBU) actively works on improving the legislation on the unified state currency policy, streamlining legislation in the sphere of foreign investment and improving the system of information exchange between public bodies that carry out controls in the area of foreign trade. In the institutional aspect, further efforts are needed to ensure the NBU's independence and to increase the quality of the supervisory system. The supervision of non-bank financial institutions remains problematic. Further efforts are needed to ensure free movement of capital in particular as regards the repatriation of profits abroad, the purchase and transfer of currency by Ukrainian debtors to non-residents.

Competition

Although Ukraine has a well-designed competition law and acting Anti-Monopoly Committee (AMC), further modernization of the institution is required as regards to its administration, authority and independence. According to the Accounting Chamber of Ukraine, competition policy in Ukraine was not conducted in effective manner in 2008–2009²⁵. Also, the country lacks comprehensive state aid law and thus transparent and efficient regulation of these issues.

Intellectual property rights

The adoption of the revised Copyright law and the new laws on Industrial Property Rights is still pending and the National Coordination Council in charge of enforcement activities has not yet been established. The widespread practices in Ukraine are counterfeiting and piracy and other breaches of IPR obligations. Further efforts are urgently needed to enforce deterrent measures against IP crimes.

Public procurement

Ukrainian legislation used to contradict European and international standards in particular as regards appeal mechanisms, transparency and non-discrimination principles. In December 2009, the Cabinet of Ministers

25 Антимонопольний комітет сам у полі не воїн// <http://www.ac-rada.gov.ua/control/main/uk/publish/article/16726560>

introduced changes to the Regulation on public procurement of goods, works and services for public funds. These are now procured from domestic producers only, thus excluding non-resident producers from the bids. If endorsed and effectively implemented, this new legislation will create a serious barrier to trade and undermine the business climate.

The Law on Public procurement was adopted on June 01, 2010. It respects most of the requirements on transparency and completion, set in the EU. However further implementation and enforcement of the Law is needed.

Summing up, the implementation of the EU-Ukraine Action Plan was the additional stimulus for approximation of the Ukrainian regulatory and administrative system towards the EU standards. However, taking into account a limited implementation progress in economic areas, the most of the topics seems to be postponed to the Deep and Comprehensive FTA (DCFTA) negotiations.

In particular, technical barriers to trade require special attention within the framework of the DCFTA negotiations. Here, issues associated with standards are of paramount importance as the reduction in tariffs moves these non-tariff measures to the front stage among trade impediments. The situation is expected to change in terms of comparability of Ukraine's and EU technical regulations somewhat after 2012 when all of Ukraine's technical regulations will use relevant international standards as a basis. As Ukraine seems to move towards voluntary standards, though the system of mandatory certification is not completely abolished. However, problems with conformity assessment procedure, accreditation and market surveillance are expected to persist, and should be addressed within the DCFTA negotiations.

5. COSTS AND BENEFITS OF HARMONIZING ACROSS THE CHAPTERS OF THE ACQUIS

The discussion of benefits of the establishment of the FTA with the EU cannot be separated from estimation of costs, incurred in this connection. First of all, potential costs of implementation of Ukraine's commitments, including potential costs of regulatory adjustments. It is obvious that Ukraine will have to carry out significant changes in its policies and institutions to ensure agreed degree of alignment of domestic legislation with the of the EU *acquis*. The experience of other countries has proved that the budgetary implications of the changes cannot be underestimated. The financial burden may vary from country to country but the full implementation costs of accession are not negligible. This aspect requires special attention because in Ukraine administrative and enforcement capacity is rather low.

This raises serious questions regarding the main elements of implementation costs and the orders of magnitude of these costs, and thus about the issues as institutions and regulations that have to be picked up and adjusted as the first priority, second priority, etc.

The *acquis communautaire* consists of an entire framework of European Community legislation accumulated and systematically amended over the last 45 years. There were 31 chapters of the *acquis* established for 10 countries that joined the EU in May 2004 as well as for Bulgaria, Romania, but they will become 35 for the future applicants such as Croatia, FYROM, etc. The 35 chapters of the *acquis* such as the free movement of people, goods, services, capital; Sectoral policies, SME's, Regional Policies, monetary Union, Justice and Home affairs, to mention a few, entail the foundation for negotiations between the EU and the candidate member states.²⁶

In all areas of the *acquis*, the candidate countries must bring their institutions, management capacity and administrative and judicial systems up to EU standards, both at national and regional level. This will allow them to implement the *acquis* effectively upon accession and, where necessary, to

26 Aristidis Bitzenis, Andreas Andronikidis. Costs and benefits of integration in the European Union and the Economic Monetary Union (EMU). http://www.denbridgepress.com/emfm_abstract.php?a=18

be able to implement it well in advance of the accession. At the general level, this requires a well-functioning and stable public administration built on an efficient and impartial civil service, and an independent and efficient judicial system.²⁷

Clearly the FTA with the EU could not and should not cover all chapters of the *acquis*. Instead, the chapters should be grouped according to benefits and costs of its adoption into hierarchy that balance importance of any particular issue for the country and costs of its implementation. For Ukraine the first priority should become those *acquis*, which directly influence and are connected with trade. However certain sectors are to be harmonized with the *acquis* in advance, because effects of such harmonization have more long-lasting effect or domestic legislation requires modernization or on the contrary is in the infant stage (f.e. GMO legislation). In these sectors correspondence to EU standards is for the interest of Ukraine. Tentative hierarchy is presented below, and costs and benefits of several selected chapters are consequently discussed.

Although today we do not speak about association with a membership perspective, for the better understanding of checkpoints of adaptation we've chosen principles and priorities of legal approximation, which were defined for candidate countries. This would allow to get the full panorama view of policy priorities and EU framework in the sectors and to better assess the level of necessary efforts and changes from the side of Ukraine.

5.1. FTA: 'MENU OF OPTIONS' FOR UKRAINE

In order to establish the hierarchy of the issues associated with the FTA and present a menu of options, we divided the relevant economic/trade areas into four major categories²⁸:

- (i) those areas that would require little extra work beyond enforcing WTO and Ukraine ENP action plan commitments already made (but where implementation capacity could, of course, remain an issue);

²⁷ http://ec.europa.eu/enlargement/enlargement_process/accesion_process/how_does_a_country_join_the_eu/negotiations_croatia_turkey/index_en.htm

²⁸ In line with the structure proposed in the TOR

- (ii) those areas where deeper integration under an FTA would seem clearly to be in the best interest of Ukraine and thus the furthest possible legal approximation would be the goal;
- (iii) those areas where experience has shown that there are significant costs of regulatory approximation and a careful analysis of costs and benefits of deeper integration is required to determine the appropriate level of legal approximation;
- (iv) those areas that without a clear membership perspective might best be excluded by Ukraine for the foreseeable future.

Accordingly, below we present and firefly discuss tentative ‘menu of option’ for Ukraine basing on the list of chapters of the *acquis*.

Option 1: ‘Little extra work’

Ch.3: right of establishment and freedom to provide services

We identified only one Chapter of the *acquis*, the implementation of which seems to require ‘little extra work’ beyond the enforcement of the WTO and Ukraine ENP action plan commitments. The conclusion is based in the recognition of significant progress achieved by Ukraine in liberalisation of services trade within the framework of the WTO commitments. Also, we base on the conclusion of the EC that Ukraine achieved a progress in the rights of establishment and that the company registration in the country is quite transparent. Though, further regulatory and implementation efforts are definitely necessary in the field of liquidation of the company (EC, 2009).

Option 2: Deeper integration is in the best interest of Ukraine

- Ch.1: free movement of goods
- Ch.2: freedom of movement for workers
- Ch.4: free movement of capital
- Ch.18: statistics

We identified four chapters of the *acquis* in which the deep integration seems to satisfy the best interest of Ukraine. These chapters include

free movement of goods, workers and capital. This conclusion seems to correspond with the findings of Messerlin (2009) that the deep integration is desired in trade-related matters and also in pro-growth policies while the rest of norm-setting regulations should be carefully studied and their benefits and costs weighted taking into account differences in interest of countries with different income per capita.

Alongside with further reduction of tariff barriers for all goods beyond Ukraine's WTO commitment, the FTA should encompass considerable adjustment in regulatory framework, especially in the sphere of technical barriers, and in customs clearance procedures. Though complete harmonisation of technical barriers envisaged into the chapter 1 could be rather costly for Ukraine, the adjustment of the Ukrainian system to the EU norms and then mutual recognition of standards, conformity assessment procedures, and accreditation would definitely be beneficial for the trade and result in important welfare gains.

As of free movement for workers, it is a very sensitive issue for the EU. From Ukraine's standpoint it would be beneficial as allows more transparent and thus higher socially protected labour mobility. However, the establishment of mechanism of national social security provisions' coordination is required.

The benefits and costs of the free movement of capital, in particular foreign direct investments, are discussed in Section 5.4.

As of statistics, the harmonisation of statistical infrastructure would bring higher reliability, transparency, and comparability of data ensuring better understanding of various processes in the country and thus development of better policies.

Option 3: Significant costs exist

Ch.6: company law

Ch.7: intellectual property rights

Ch.8: competition policy

Ch.9: financial services

Ch.12: food safety, veterinary and phytosanitary policy

Ch.11: agriculture and rural development

Ch.13: fisheries
Ch.14: transport
Ch.15: energy
Ch.19: social policy and employment
Ch.20: enterprise and industrial policy
Ch.21: Trans-European networks
Ch.23: judiciary and fundamental rights
Ch.26: education and culture
Ch.27: environment
Ch.28: consumer and health protection
Ch.32: financial control

Seventeen chapters of the *acquis* were defined as potentially attractive, but require further study of the pros and cons, and then careful choice of the degree of adjustment/harmonisation.

Below we have discussed costs and benefits of three chapters: company law, competition policy (state aid aspects), financial services (specifically Basel II) and environmental issues (Sections 5.2, 5.3, 5.5 and 5.6).

As of food safety, veterinary and phytosanitary standards, and well as consumer and health protection, these issues are extremely important for Ukraine as the country's exporters of animal-related products suffer from restricted access to the EU market exactly because of non-adjusted standards. However, the complete harmonisation of standards might be too costly for Ukraine as according to Messerlin (2009) high mandatory food safety standards belong to norms that impose additional costs on consumers, and thus are more on demand in richer countries. The balance of interest of various economic agents in the country should be identified in this case.

The same arguments relate to company law, employment policies, environmental standards etc. There are clear benefits of better developed regulatory framework. However, there are also high costs in obeying all norms and rules, and not all of those rules are actually pro-growth in the short-term. Thus, further study is required in each case.

Option 4: Clear membership perspective is needed

Ch.5: public procurement
Ch.10: information society and media
Ch.16: taxation
Ch.17: economic and monetary policy
Ch.22: regional policy and coordination of structural instruments
Ch.24: justice, freedom and security
Ch.29: customs union
Ch.30: external relations
Ch.31: foreign, security and defense policy
Ch.33: financial and budgetary provisions
Ch.34: institutions

Yet other eleven chapters of the *acquis* were identified as such that would require clear membership perspective to be implemented. These chapters deal with ‘behind-the-border’ topics related mostly to macroeconomic policies, customs union, securities issues, etc.

Below we consider costs and benefits of implementation of several chapters of the *acquis* in Ukraine in greater details.

5.2. COSTS AND BENEFITS OF THE IMPLEMENTATION OF COMPANY LAW

Company law is considered to be one of the «building-blocks» for the operation of market economy²⁹. The White Paper also states, that the Central and East European Countries have put in place a basic form of company law as part of their transition to market economies. This usually followed the model of one or other of the Member States and is therefore broadly in line with Community requirements, but coverage is in most cases incomplete. The non-discriminatory treatment of foreigners and foreign companies has in most cases been dealt with satisfactorily, given the interest in attracting foreign investment. The picture is broadly the same for financial reporting

²⁹ White Paper. Preparation of the associated countries of Central and Eastern Europe for integration into the internal market of the Union, Brussels, 03. 05. 1995 COM (95) 163 final

where many of the requirements of the three principal EU directives are in place.

The harmonization of the company law in the framework of the EU was to promote further economic integration of the member states, which started in 1961 with abolition of all the restrictions for the freedom of undertakings. The main goal of the harmonization is the realization of the main freedoms of the EU law – freedom of movement of goods, services, capital and labor, which are to ensure the effective functioning of the internal market.

The legal foundation for the harmonization of the company law is Chapter 2 «Right of establishment», articles 56–60 «Capital and Payments» for the investment related issues of the Treaty establishing the European Community. According to the Article 48 of the Treaty «‘Companies or firms’ means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making». The European Commission admits, that the names and forms of companies in every member state have its historic tradition and classification and primarily their activity should be primarily regulated by national legislation and the company law of the Union covers the widest circle of companies.

Thus the main goal of the harmonization in this sector is not the unification of the legal forms of the companies in the Communities but ensuring of the equivalent level of protection of the interests of shareholders, entrepreneurs, creditors and third parts in the Communities in order to create a favorable environment for concluding trans-border agreements and support effective functioning of the internal market.

Overview of the Chapter

The chapter of the *acquis* on Company Law covers five legislative fields:

1. Company law in the strict sense (e.g. directives on the public disclosure on the identity of those empowered to represent a company, its financial situation, raising, maintenance and alteration of capital of public liability companies);
2. Accounting law (the *acquis* specifies rules for the presentation of annual and consolidated accounts, including simplified rules for small- and medium-sized enterprises. The application of

International Accounting Standards is mandatory for some public interest entities.);

3. Intellectual and industrial property rights;
4. Recognition and enforcement of judgments in civil and commercial matters (Regulation replacing the Brussels Convention on jurisdiction and the enforcement of judgements in civil and commercial matters);
5. Contractual obligations (Rome Convention on the law applicable to contractual obligations).

The main issues at stake for the EU accession countries are:

1. the protection of industrial property rights for pharmaceutical products within the enlarged Union,
2. enforcement of Intellectual property rights (IPR), in particular the fight against piracy and counterfeiting, and
3. Community Trademark (CTM) where the Union has proposed an automatic extension of the existing CTM to the territory of the Candidate Countries.

Administrative aspects of the adoption of the Company law acquis

Legislative approximation in the field of company law presupposes *inter alia* the existence of a register for undertakings capable *inter alia* to operate in electronic environment;

national Gazette (in paper or electronic form) for the publication of certain company information;

administrative or judicial authority which will ensure the control of the incorporation of a company (alternatively, it might be stipulated that the instrument of constitution, the company statutes and any amendments to those documents should be drawn up and certified by a notary);

Accounting and auditing

a country standard setter either in the form of private body and/or in the form of a public authority body (often the Ministry of Finance, Justice or Economic Affairs) responsible for issuing accounting standards further to the basic law;

enforcement mechanism of the correct application of the accounting standards (not introduced in every Member State) which should enable users of annual accounts to submit complaints for non respecting accounting law, regulations and standards. The tendency is to base accounting standards for big companies listed on the stock exchange, on the international accounting standards (IAS).

professional bodies for auditors representing the interest of the audit profession (not as such required to implement the acquis). These can be private bodies but also semi-public bodies with the competence of issuing by-laws.

Intellectual property law

courts and tribunal must be staffed with sufficient judges and prosecutors familiar with IPR legislation; cases should be handled without delays.

police and custom authorities, including border authorities, need to get adequate training in the field of IPR;

the responsible structures dealing with IPR in the competent Ministries and other state bodies must be adequately staffed and trained.³⁰

Framework of EU-Ukraine actions

The Chapter II of the Partnership and Cooperation Agreement between the European Communities and their Member States and Ukraine is devoted to the questions of company law – Conditions affecting the establishment and operation of companies.

It sets the MFN treatment for the establishment and operation of Ukrainian companies and branches and national treatment for the subsidiaries of Ukrainian companies (with reservations in mining, fishing, real estate purchase and audiovisual services sectors), established in the territories of EU Member States and MFN or National treatment for the establishment and operation of Community companies, subsidiaries and branches in the territory of Ukraine (with reservations in financial services, brokerage, agriculture, telecom and some other areas).

³⁰ http://ec.europa.eu/enlargement/pdf/enlargement_process/accesion_process/how_does_a_country_join_the_eu/negotiations_croatia_turkey/adminstructures_version_may05_35_ch_public_en.pdf

The exceptions are companies of air transport, inland waterways transport and maritime transport. For them the PCA presupposes the right of commercial presence in the territory of Parties of the agreement.

Notwithstanding the provisions of Chapter I, a Community company or a Ukrainian company established in the territory of Ukraine or the Community respectively shall be entitled to employ, or have employed by one of its subsidiaries or branches, in accordance with the legislation in force in the host country of establishment, in the territory of Ukraine and the Community respectively, employees who are nationals of Community Member States and Ukraine respectively, provided that such employees are key personnel («intra-corporate transferees»), and that they are employed exclusively by companies, subsidiaries or branches. The residence and work permits of such employees shall only cover the period of such employment.³¹

According to the paragraph 2.3.2 of the EU-Ukraine Action Plan, Ukraine is entitled:

a) Operation of companies:

- Establish a suitable environment for companies, e.g. adopt and implement effectively competition and bankruptcy legislation.
- Abolish discriminatory measures affecting the operation of EU and Ukrainian companies.

b) Establishment:

- Ensure full and effective implementation of most favoured nation and national treatment.
- Ensure that the conditions under which companies invested are maintained.
- Ensure that EU and Ukrainian subsidiaries or branches receive a treatment not less favourable than that granted to its own nationals (national treatment). Ukrainian companies established in the new Member States are also able to open branches in other EU Member States. For investors, high standards of protection are applicable throughout the enlarged EU.
- Complete a review by Ukraine of national legislation to identify barriers to establishment with the aim of abolishing them.
- Remove progressively restrictions on establishment.

31 Partnership and Cooperation Agreement between the European Communities and their Member States and Ukraine

- Ensure effectiveness of a central co-ordinating body facilitating establishment.
- d) Company law:
 - Improve the competence and independence of auditors.
 - Converge with and ensure effective implementation of key principles in relevant international and EU rules and standards.
 - Create the unified state register of legal persons and physical persons-entrepreneurs companies and ensure publication of information on the organisation and financial situation of companies. Define and ensure effective activity of an administrative authority, which ensures the control of the incorporation of a company or the legality of certain acts.
 - Encourage adoption of a Code on corporate governance.³²

The issue of the approximation of Ukraine's legislation to that of the Community is considered in the Article 52 of the PCA, which recognizes approximation as an important condition for strengthening the economic links between Ukraine and the Community and sets the company law as one of the areas for approximation.³³

Level of adaptation of the EU acquis in Ukraine

State Program on the adaptation of Ukrainian legislation to the EU's was adopted in march 2004.³⁴ The Program sets out priority fields and phases of adaptation and administrative framework. The first phase of the adaptation was prolonged till the determination of the PCA.

The Ukrainian legislation on the entrepreneurship is in line with the *acquis communautaire*. The large number of the *acquis* are considered in the field of corporate governance, protection of rights of minority shareholders and contract law.

According to the annual report of the execution of the Adaptation Program, the development of the company was much progressed with the adoption of the Law «On the joint stock companies»³⁵, which entered

32 EU/Ukraine action plan

33 Partnership and Cooperation Agreement between the European Communities and their Member States and Ukraine

34 Law of Ukraine «On the State Program on the adaptation of ukrainian legislation to the legislation of the European union» from March 18, 2004 No. N 1629-IV

35 Law of Ukraine «On joint stock companies» from 17.09.2008 № 514-VI

into force in April 2009. The adoption of the Law allowed to consider the positions of the Second EU Directive No. 77/91/EEC, especially concerning the rights of minority shareholders.

In December 2009 the the Law of Ukraine on simplifying business conditions, aiming at facilitations the establishment and development of companies by easing the issuance of permits and reducing the quantitative requirements for the statutory capital of limited liability companies was adopted. Simplification of establishment rules and procedures should contribute to the improvement of the investment climate of Ukraine.

Further consideration and approximation include issues of bankruptcy, accounting and auditing. The next necessary step in the approximation is the development and adoption of the Law «On the Limited liability companies»³⁶ and bringing to the consistency of the positions of economic and civil codes on the company law.

The legislation on the Limited liability companies should cover the provisions of the First Council Directive № 68/151/EEC on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, of the Fourth Directive No. 78/660/EE on the annual accounts of certain types of companies, of the Seventh Directive No. 83/349/EEC on consolidated accounts, of the Eleventh Council Directive 89/666/EEC on Disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State as well as provisions of the Twelfth Council Company Law Directive 89/667/EEC on single-member private limited-liability companies .

Certain amendments of the existing legislation are needed in the field of bankruptcy. Thus, the approximation should be reached with the European Convention on Certain International Aspects of Bankruptcy (1990) and Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

Company law refers to the areas of economic and sectoral cooperation, which could be provisionally closed by the FTA negotiations.

36 http://www.sdla.gov.ua:8080/control/uk/publish/article?art_id=49860&cat_id=46962

Costs and benefits for Ukraine

From the *acquis*, it is suggested that the benefits from integration and approximation are multidimensional: political, economical, social and cultural for the EU country members, the accession countries and the ones potential for acceding.³⁷ Meanwhile, the compliance with EU's *acquis* also leads to the question of costs imposed by compliance.

	Costs	Benefits
State	High administrative costs for creation of the publicly open national registration system for companies, specialised court for intellectual property matters ³⁸ . Competitive disadvantage from lower disclosure requirements in foreign competitors' home countries. High costs of legal cooperation in some international aspects of bankruptcy.	More effective allocation of capital and FDI growth. Access to the lower cost of capital and more liquid financial instruments. Enhanced efficiency from competition. Increased integration to the European social and economic system. Greater confidence of investors in the stable framework on the Ukrainian market.
Companies	Competitive disadvantage from the own informative disclosure. High costs of introduction of IAS, IFRS and their permanent following ³⁹ . High costs of statutory audit and all the due diligence checks ⁴⁰ . Bargaining disadvantage from the disclosure to suppliers and customers.	Lower average cost of capital. Access to more liquid markets. Avoided litigation alleging inadequate informative disclosure. Bargaining advantage from customers' and suppliers' informative disclosure. Higher level of property rights protection due to international cooperation.
Social costs	Realization and protection of the human right for freedom of undertakings.	The consumer protection provided by informative disclosure

In case of the adoption of company law *acquis*, we should consider the administrative costs for companies following from EU company

37 Aristidis Bitzenis, Andreas Andronikidis. Costs and benefits of integration in the European Union and the Economic Monetary Union (EMU). http://www.denbridgepress.com/emfm_abstract.php?a=18

38 Administrative costs for creation of the publicly open national registration system for all companies will include costs associated with obtaining and storing information that is not currently held in the public register (listing, financial reports etc.) and making information available electronically.

39 Introduction of the IFRS starts from UAH 100 000 depending on the firm size and program used

40 International audit of the top audit firms would cost from UAH 80000 (middle size company, one-two core activity, simple structure).

law. The benefits of EU company law rules are not in all cases outweigh the administrative costs to Ukrainian companies. Furthermore, for the assessment, we also tried to consider costs to creditors and consumers (social costs).

Certainly most of the costs in the adoption of the Community *acquis* fall on companies that should introduce accounting and reporting standards and new disclosure procedures. Moreover, the company face the risks, introducing the necessary disclosure standards in the quite unstable environment with the raised number of raiding attacks.

5.3. COSTS AND BENEFITS OF THE IMPLEMENTATION OF COMPETITION POLICIES

Competition policy is increasingly important in the EC's relations with FTA states, gradually replacing trade policy, e.g. anti-dumping measures. One of the policies negotiated during negotiations between the EU and Ukraine on Free Trade Agreement are competition policies. Ukraine may take obligations to harmonize its legislation to the one the EU uses in competition policies (Chapter 8 of the *acquis*).

The adjustment may include elimination of contingent protection that goes beyond the WTO agreement in some important respects as particular requirements for industrial policy. In particular, the main areas of EU competition policy are:

- antitrust policies,
- merger and acquisition control,
- liberalization, and
- state aid

The competition *acquis* includes rules and procedures to fight anti-competitive behaviour by companies (restrictive agreements between undertakings and abuse of dominant position), to scrutinise mergers between undertakings, and to prevent governments from granting state aid which distorts competition in the internal market.

The EU competition rules are provided in The Rome Treaty established by the European Economic Community in articles 81 and 82. Article 81 prohibits

any agreements, concerted practices amongst all entities (no matter public or private) and any decisions of the associations of the entities that may affect trade between the member states or distort competition within the common market. Article 82 prohibits any abuse of dominant position of an entity within the whole or substantial part of the common market as long as this abuse may affect trade between the Member States.

Antitrust. It is illegal for European businesses to collude with each other to fix prices or carve up markets between them. The European Commission fines companies for all such practices. Some exceptions are allowed: cooperation in developing a single technical standard for the market as a whole; cooperation of smaller companies if this strengthens their ability to compete with larger ones. Some types of cooperation deal need specific Commission approval.

Since 1989, the **mergers and acquisitions** of the undertakings are controlled by the European Commission to prevent any concentrations made for the distortion of the competition in the common market. According to the Merger Regulation, all mergers and acquisitions above a certain threshold need notification to the European Commission for the clarification in regard to the possible harm to the competition in the common market.

Liberalisation. The Commission pays particular attention to ensure competition between older players and new entrants to the gas and electricity markets is fair and brings prices to consumers and business down. If infrastructure constitutes a natural monopoly, like gas pipelines and some telecommunications infrastructure, then everyone must be allowed to use it on the same terms. If there is no natural monopoly, then the process of selecting a company to provide the service must be transparent.

State aid is the other competition issue to be applied in the EU. According to the Treaty the state aid is not allowed since it is harmful to competition. Particular types of state aid, which are listed as exceptions, are allowed.

As each of abovementioned topics is complex, we focus below on one aspect of the competition policy, namely state aid.

State Aid: EU rules

The EU state aid law is quite simple: it explicitly states that state aid distorts competition and that's why it's not allowed. However, aid granted through state resources that does not distort or threaten to distort competition by favoring certain establishments or the production of certain goods is allowed. The following types of state aid comply with the EU competition rules:

- aid that have a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- aid to compensate the damage caused by natural disasters or exceptional occurrences;
- aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- aid to promote the execution of an important project in the interest of Ukraine;
- aid to facilitate the development of certain economic activities or of certain economic areas;
- aid to promote culture and heritage conservation where such aid does not adversely affect trading conditions.

The EU legislation defines the principles of the state aid as *laissez faire, adequate institutions, accountability, transparency, and limited continuity and scope*.⁴¹

Since the EU legislation explicitly states that aid distorts competition, substantial efforts are devoted to minimization of state aid. Lisbon European Council Conclusions (March 2000) admonished EU countries to «reduce the general level of State aid, shifting the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, such as employment, regional development, environment and training or research».

According to the EU rules there should be an independent institution that regulates and controls provision of state aid. Procedures should be

41 See details in the IER Analysis Paper A 10/2003.

transparent and clear. Granting authorities as well as recipients of state aid should be accountable to the regulatory institution.

It is crucial to evaluate the need for state aid, the effectiveness of its use, and the effect on economic welfare of the society and on competition. EU members states and the Commission perform *ex post* as well as *ex ante* analysis of aid cases in order to assess how funds are used and determine more efficient forms of state support and optimize its structure. In order to facilitate implicit state aid accounting and comparability, *Net Grant Equivalents*, i.e. the direct subsidy money equivalents, are used.

Public access to the information on provision and using of state aid should be provided. The Commission demands comprehensive and detailed annual reports on all approved schemes of state aid from the Member States. In case when state aid is suspected to be incompatible with common market, the Commission publicly discusses conditions of aid provision with interested parties and Member States.

State aid should be limited in its amount, duration, and coverage of support. The limits of using public funds in the entrepreneurial activities should be defined. The availability of aid to a specific recipient should be constrained. Degressive principle of aid provision should be applied: amount of state aid is decreasing over time.

State Aid in Ukraine

Ukraine lacks clear regulations of state aid. There is neither single law nor a package of regulations that clearly define objectives, principles, instruments and means of control of the state aid. The state aid is currently regulated by single article of the Commercial Code and partly by the law On protection of economic competition. There is no separate independent institution that regulates and controls the state aid; the state aid is regulated by an antimonopoly authority – the Antimonopoly Committee of Ukraine (AMCU).

As a result, until recently state aid in Ukraine was provided to the wide range of separate enterprises and separate industries (that were considered to be of «special importance») through various instruments, i.e. tax privileges, state guarantees for loans, direct transfers etc. Agriculture, coal mining, machine building (i.e. automobile construction, shipbuilding, aircraft

construction) and steel production⁴² were the biggest state aid recipients. Most support was given in a form of different tax privileges, often through special regimes in special economic zones and technological parks.

Neither amount of beneficiaries of state aid, nor selection principles of them, nor instruments of the state aid were comparable with EU standards.

In Ukraine there is a strong bias towards ad hoc and sectoral state aid, which distorts competition and thus does not comply with EU competition norms. In 2006 it comprised about 70% of the total state aid. Regional aid is 25–27% of the total aid in Ukraine, while horizontal aid is almost non-existent. The state aid in Ukraine is also heavily biased towards implicit subsidies (mostly, tax privileges), which are less transparent and more distorting than direct grants. In the EU the major part of state aid went into infrastructure (transport and communication), in Ukraine a half of total amount of state subsidies (direct and implicit) was directed to industry, energy sector and construction.

In 2005 there was a major change in the state aid practice. Most privileges for machine building⁴³, coal-mining and other industries, as well as, privileges in special economic zones, technological parks and special regimes for investment activities were abolished. Such step of the Government was motivated by fiscal reasons and desire to reduce ineffective state aid. Besides, the change in the state aid policy was part of the WTO commitments of Ukraine. However, the policy as such has not been reconsidered and still needs appropriate legislation and institutional capacity for the state aid provision.

According to the State Budget Law for 2009 the state support remains high. The government provided with significant state support certain branches of economy, in particular, coal and agricultural sectors. The large share of funds is spent in the form of direct transfers to enterprises. It is foreseen that certain sectors (including machine building, coal mining, aircraft construction, construction enterprises) were eligible to receive state guarantees for the loans. Though the tax privileges were reduced in 2005,

42 Until 2005 steel production received significant and different kinds of state support. Mainly the industry was supported by tax privileges in the framework of an economic experiment in steel industry. The practice of subsidizing steel industry finished with the end of the economic experiment in 2003, privatization of the biggest steel plant and abolishment of the main privileges in special economic zones and technological parks in 2005.

43 e.g., auto industry, shipbuilding, aircraft construction

they still are high (see Table 1). The main recipients of the tax privileges are coal mining, ship construction, activities in space industry⁴⁴. Besides usual support, in 2009 the state decided to support the industries that suffered the most from world financial crisis, i.e. steel, chemical, machine building and construction and construction materials and industries⁴⁵. The support in mostly quasi fiscal, the state has frozen the railway and utility tariffs for the enterprises of the industries. In construction, the government promised to transfer funds to finish construction of some unfinished buildings.

Table 1. Structure of State Aid in 2007–2009

Type of State Aid	2007		2008		2009	
	UAH, b	% GDP	UAH, b	% GDP	UAH, b	% GDP
State support to agriculture	9.6	1.1	13.5	1.5	9.3	1.0
State support to coal mining sector	5.7	0.8	7.2	0.8	13.7	1.5
Tax privileges	13.5	1.9	17.9	2.0	11.5	1.3

Source: IER calculations on the basis of Treasury reports on State budget execution in 2007, State budget Law 2008, State Budget Law 2009, Explanatory note of the State Budget Law 2009.

Summing up, Ukraine still needs to elaborate appropriate legislation on the state aid and conduct a full state aid reform. The legislation should comply with the main principles of the state aid that are pursued in the EU and not distort competition. To do this, Ukraine policy makers have to do substantial efforts to reconsider state aid policy as such and to receive public support in relevant sectors, which were highly dependable from the state aid. Support of separate sectors or enterprises in principle is unacceptable in the EU laws. State aid is justified if it has social benefits, if it is horizontally beneficial to the whole economy.

⁴⁴ Privileges for space industry end in December 2009

⁴⁵ CMU Order No 1107 On overcoming the impact of world financial and economic crisis and sustainable development, 20.12.2008, Law Of Ukraine No 694 On amending of some laws on minimization of impact of world financial and economic crisis on domestic industry, 18.12.2008, Law of Ukraine No 800 On preventing the impact of world financial and economic crisis on the development of construction industry, 25.12.2008.

Impact of applying the EU state aid rules on Ukraine

Legal and institutional changes. Adjustment to the EU rules on state aid will require a complete rethinking of the policy by government. The EU definition of the state aid is cast very widely to include areas such as special tax regimes, government guarantees given to individual companies or sectors, as well as the more easily understandable question of subsidies given to firms. Adjustments in this area will require legal and institutional changes as well as a complete change of practice in key government ministries and in the large enterprises. The costs of the harmonization of legislation and setting up a new state aid system will lay on the state budget. Ukraine will have to adopt separate law On State aid. The instruments and principles of choice of the beneficiaries of state aid will have to be reconsidered also. On the other hand, in the mid term Ukraine's economy will benefit from adopting EU acceptable rules of the state aid.

Investments. The important thing is to understand that having harmonized the competition rules to the European ones Ukraine will be able to report to have internationally trusted and certified rules. It means that Ukraine will have the rules that are clear for international (western) investors; the rules that the investors got used to, know how to play with. That's why, it is expected that adoption of the EU competition rules as a whole will benefit domestic business in general through higher foreign investments.

Households. Harmonization the competition rules will benefit household as enhancing competition and obeying the competition rules results in lower prices and higher quality of goods and services.

Agriculture. As state aid to the agriculture is considered an exemption to the general EU rules, thus Ukraine's agriculture will not be affected. On the contrary, agriculture will benefit from enhanced competition in its inputs sectors.

Industries. Reforming state aid will primarily have a negative impact on industry. A large number of strategic sectors in Ukraine that were traditionally the main beneficiaries of state aid will have to adjust to the circumstances of lower or no state aid. Such industries will have to experience serious restructuring to adjust to the new competition conditions. However, the state can always reserve possibility to support regions with high

unemployment and to assist companies to put together clear, transparent restructuring programs. Finally, limits on the amount of assistance can be partly compensated by improving its effectiveness. Changing the structure of state aid will mean a shift from financial support to specific companies and sectors towards regional and horizontal types of support.

Coal mining. Currently coal mining is the second largest beneficiary of the state aid in Ukraine. This support is, in principle, does not comply with the EU competition rules. If Ukraine harmonizes its legislation to the EU rules of the state aid it will be difficult to preserve the amount of support to coal mining. Most probably such aid will have to be reduced or reconsidered. For example the state aid to the coal mines can be changed with regional aid to the coal mining regions. Anyway, current beneficiaries – coal mines – will lose.

Infrastructure, energy, public utilities. State aid to these sectors is common in the EU and in principle is encouraged because of the positive effect of their high quality on the whole economy, environment and energy efficiency. These industries will benefit from applying the EU rules of the state aid in Ukraine since facing conditions of having to minimize sectoral aid Ukraine will be able to provide state support through other acceptable instruments e.g. through state aid to infrastructure, energy, public utilities.

Machine building. Since almost all privileges to the industry were abolished while fulfilling WTO commitments state aid policy change will have little effect on machine building. Moreover state aid to aircraft or ship building can be justified as R&D facilitation.

State. The state will benefit from harmonizing competition rules with the EU ones since it will result in more tax revenues from abolishment of tax privileges and less cost from reduction in state subsidies.

Summing up, harmonization of the Ukraine's legislation in the area of competition policy with European one will definitely benefit Ukraine in the mid and long term. We expect declines in the most currently subsidized industries after harmonization of the legislation on the rules of state aid since subsidies will be reduced. The negative impact however can be eased by move to other kinds of state aid, e.g. horizontal, regional etc. Plus, significant positive effect on the state revenues is expected. Thus aggregate effect will be positive.

	Costs	Benefits
State	Costs for institutional establishment of the State aid control and monitoring system Development of new horizontal and regional state aid system	FDI inflow Enhanced competition and market Increased tax revenues Free funds to be directed for social purposes, research and development
Companies	Certain industries-recipients of state aid will have to adjust to the lower amounts or absence of the state aid.	Transparent rules of doing business in the country
Social costs	Certain groups of excessive workers employed in the industries subject of state support might be released in the process of efficiency improvements by those industries after elimination of the state aid.	Lower prices and higher quality of goods through enhanced competition

5.4. COSTS AND BENEFITS OF CAPITAL FLOWS LIBARELISATION

While concluding FTA agreement with EU, most of the countries seeks trade flows liberalization, while for Ukraine this is not the only issue of high concern. Nowadays, Ukraine is more and more integrated into international capital flows- the process of investing into Ukraine (started in late 90-ties and significantly precipitated in 2005 with Krivorozhstal sale to foreign investor) has been continuing up to financial crisis 2008. Despite a number of effort to reform institutional component and to attract international investors, the amount of investment and scope of investment programs is significantly lower in Ukraine than those of Ukrainian neighbors – EU members. Thus, Ukraine seeks deeper cooperation with European community in the field.

Actually, general EU FTA agreement⁴⁶ includes such positions of financial flows facilitation as: 1) free capital movement (safeguard measures should be applied for the period less than one year only in exceptional cases, while schedule of their removal should be presented as soon as possible), 2) all payments for current transactions should be made in freely convertible currency, 3) FDI should move freely as well as yields from such investments and any profit. Temporary and limited restrictions on capital transactions could be adopted in accordance with GATT Articles VIII and XIV only

⁴⁶ Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Republic of Chile, of the other part.

in serious balance of payments difficulties or under their threat. Party should also provide other counterparties with information, identify and disseminate investment rules and opportunities between them. The content of such position could differ from country to country, while position on non-implementation of restriction on capital flows with some exceptions is fixed in all agreements. So it is evident that Ukraine-EU agreement will contain the same positions. However, already now Ukraine obeys some of the rules.

Ukrainian intentions to achieve greater liberalization of capital flows were defined in base document – Ukraine-EU Action Plan. Among other things, the document states the necessity of legislation approximation and opening of both Ukrainian and EC economies so as to stimulate investment and economic growth. Investment climate was expected to be improved thanks to greater transparency of business conditions and administrative procedures. Ukraine also committed to ensure free capital flows related to FDI and other investment, protection or, in case of company liquidation, repatriation of any investment or profits from its use. At the same time, according to Partnership and Cooperation Agreement between Ukraine and European Community and its members (10 of October, 1994⁴⁷), imposition of any restrictions on capital flows between EU and Ukraine is permitted only in case of threat of serious difficulties of foreign exchange or financial policy in EC or Ukraine for the period of no more than six months in case it does not hamper FDI, does not hinder repatriation of any profits from FDI use or realization of payments on current account balance operations.

Part of such obligations was already realized through Ukraine WTO accession. According to GATT 1994 Ukraine can not impose any capital restriction with an exception for cases of serious problems of balance of payment or threat of it. However, facilitation of capital flows as to foster investment in and out of Ukraine is still in process. Liberalization of capital account was highly dependent on flexibility of exchange rate. Thus, under fixed exchange rate regime capital controls were needed in order to avoid speculative capital movements. And recent Ukraine's decision to move to flexible exchange rate contributed to capital liberalization. From the other side, under conditions of flexible exchange rate foreign investors are interested in normal functioning of derivatives market to offset currency risks, while it

47 which is in force since 1st of March, 1998.

is nowadays underdeveloped in Ukraine. The other cornerstone of Ukraine participation in international capital movement is rather restrictive licensing rules for international companies which would like to establish their business in Ukraine.

Concerning legislative reflection of Ukrainian commitments we could first mention such laws as «On international economic activity», «On investments», «On regime of foreign investments», NBU resolution «On protection of foreign investments».

Among other things current legislation foresees:

1. non-discriminatory treatment of foreign investments;
2. state guarantees for possibility of capital management, repatriation of investments and any profits from their use;
3. prohibition of foreign investment nationalization.

Current legislation also does not restrict Ukrainian nationals to shift their investment abroad. Besides, there is a range of bilateral agreements on joint protection of investments. Moreover on 28 of January, National agency of Ukraine on foreign investment and development begun functioning.

While, as it was already mentioned investment climate in Ukraine remains unfavorable. This means, first of all, rather complicated procedure of company establishment and low level of protection of property rights (including those of shareholders), including protection against takeovers. Feeble practice of financial accounting and external audit and widespread cases of overvaluation of companies makes investment too risky.

Another key obstacle for free capital movement is the requirement to get NBU license to perform some types of cross-border currency operations, while the procedure of license obtaining is unclear and difficult; some complicated cross-border transactions are not regulated at all and, thus, could be prohibited; the rule of foreign cash purchase and reinvestment are complicated; licensing the operations which foresee foreign currency receipts with period more than 180 days is required. In addition, foreigners could by foreign currency only within limits of unused hryvna, while purchased hryvna could be only for expenditures inside Ukraine or reinvestment. The other question of Ukrainian financial market liberalization is concerned with improvement of banking governance including better transparency and protection of minority shareholders rights. As EU generally does not limit movement of capital other than for anti-money-laundering purposes it

will not be able to offer reciprocal concessions. Thus reduced capital controls may be used as bargaining chips to reach agreement in other areas.

The question which follows is the economic effect of financial liberalization on country state. Generally, financial integration has two major economic benefits: economic growth and risk-sharing. First goes through facilitation of the allocation of capital to its most productive use and promoting the development of financial system. The second goes through investment portfolio diversification and, therefore, sharing of risks across countries. Thus, the section will follow with consideration of cost and benefits of such process. We will separately investigate economic effects of capital liberalization related to EU FTA agreements including evaluation of effects of possible FTA agreement on Ukrainian economic performance, overall effects of financial integration on macro stability of the country and effects of financial intermediation integration (implementation of Basel II) on banking system.

Capital liberalization as a source of economic growth which is especially important for Ukraine under conditions of lack of internal capital to finance some projects. While considering financial integration, one often distinguishes between different forms of capital movement: FDI, portfolio investment, credits and between countries lending, as the effect of such types of investment on macroeconomic situation could be different. However, there are similar consequences which imply the liberalization of all the types of capital flows.

For example, in accordance with CEPS estimations⁴⁸ Ukraine will benefit from both trade and capital liberalization by around 10% of GDP growth in the long run. Price of capital is assumed to fall by 16.7% in the case of low elasticity between capital and labor and by 17.1% in the high elasticity case, while the wages in Ukraine will rise by 8.9–9.7%. In sum, liberalized capital flows will lower costs for Ukrainian firms as well as risk premiums, thus increasing total welfare by 4.5–4.8% in addition to the trade gains identified in presented general equilibrium (GE) model.

According to *Djankov and Hoekman (1995)*, free capital movement may also positively affect external trade and thus to avoid balance of payment imbalances. Greater competition from imports means higher need in

48 Emerson, M. (2006). »The Prospects of Deep FTA between EU and Ukraine,« CEPS Paperback Series (CEPS Paperback Series), №1, pp. 1–248.

FDI from the side of newly entering countries, as they are, in most of the cases, less developed and seek infrastructure developments, but have less financial resources for their realization. Thus, subsequent or parallel with trade opening of capital markets is necessary.

The other significant bonus of financial integration in Europe or other countries joining FTA with EU, besides economic growth, is upgrade and harmonization of local practices of financial system functioning, including accounting, tax treatment and regulation and supervision. These institutional upgrades add to economic development. Moreover, as Stiglitz says, «the capital account imposes «discipline»⁴⁹, meaning good economic policies in place.

There is a range of other costs as well as benefits of capital movement liberalization, all of them are summarized in the next table⁵⁰.

	Costs	Benefits
State and economy in whole	<p>Excessive vulnerability to external shocks in case of adverse capital movements.</p> <p>Risk of outflows overpassing inflows in case of economical feebleness.</p> <p>Loss of independent economic policy, in case international financial institutions set different policy goals in exchange for financial help.</p> <p>Greater discrepancies between poor and rich countries.</p> <p>Complicating of policy actions and deepening of problems associated with weak currencies.</p> <p>Increase in adverse selection problems in case of underdeveloped financial system of investment importing countries.</p> <p>Problems with fund raising.</p> <p>Reduced possibilities for monetary policy.</p>	<p>Increased liquidity, lower capital costs and stimulation of investment resulting in economic growth.</p> <p>Increased credibility to the country.</p> <p>Fostering financial sector reforms.</p> <p>Financial market deepening.</p> <p>Portfolio diversification resulting in higher risk-adjusted rates of return.</p> <p>Better external trade development.</p> <p>Wider sources to cover budget deficit (e.g. governments and private companies could borrow at Euro-markets).</p>

49 Stiglitz, J. E. 2000. «*Capital market liberalization, economic growth and instability*,» World Development, Elsevier, № 28(6), pp. 1075–1086.

50 Based upon Aizenman, 2003; Bhagwati, 1998; Dehejja and Gatti, 2002; Henry, 2003; Fischer, 1997; Lucas, 1990; Lipschitz et al., 2002; Mishkin, 2005; Prasad et al., 2007; Reddy, 2007; Stiglitz, 2000; Torre and Shmulker, 2005; .

Companies	Reduction of revenues of incumbent firms and increased bankruptcies of small firms due to increased competition. Inadequate credit allocation if regulation of domestic financial markets is inefficient or trade barriers exist. Excessive risk taking by banks due to the lack of expertise to manage credit risks and rapid lending expansion ⁵¹ .	Increased competition. Channeling of financial funds to the most efficient companies due to improved accountability standards and disclosure requirements inherited from international firms. Know how diffusion associated with FDI ⁵² .
Social costs	Increase in gap between wages of skilled and unskilled workers in industrialized countries. Short-run disruptions e.g. job losses and income declines, disproportionately hitting the poorest people.	Increased lending to households due to increased supply of capital. Reduction of poverty level and use of child labour thanks to easier access to credit. Consumption smoothing.

Thus, international capital flows are highly sensitive to the macroeconomic policies, soundness of domestic banking system and political and economic developments. Thus, market forces should exert a disciplining influence on countries macroeconomic policies.

To sum up financial integration has several benefits for specific country reflecting in GDP increase, consumption smoothing, development of financial markets, improvement of internal policies and business practices, increase in level of competition. While there are also some cons and challenges associated with the process of capital account liberalization, among which: high vulnerability of economy to external shock in case of short-term capital movement facilitation, high degree of dependence of financial integration results on country features (labor productivity, potential to allocate financial resource effectively, exchange rate regime) and fact of liberalization of other relationships (e.g. trade). However, in fact the biggest part of challenges associated with financial liberalization is explained by market imperfections

51 As banks play one of the crucial roles in gathering information on industries and households, banking decision to cut lending results in less information on real sector and, thus, higher risks. So firms are unable to find attractive investment opportunities and, therefore, reduce their activities and spending. The prevention measure in this situation is to prudential regulation and supervision of banking system to take excessive risks.

52 while the scope of such benefits depends on the level of human capital in host country. In some cases capital exporters export not the very new technology so the difference in the level of technological development is frozen.

and, thus, could be avoided. Another part of negative consequences is incumbent specific and, in fact, means higher level of competition. Thus it could not be considered as cons of capital account liberalization. Despite an existence of all difficulties, most of them could be easily overcome through the development of effective financial system.

It should be mentioned that a biggest part of both positive and negative consequences of financial market liberalization is between medium-term and long-term. This follows from the very nature of FDI as a main component of capital account liberalization discussed in FTA agreements. In particular, the time is needed for know-how diffusion, adjustment in rates on return and labour costs. More or less immediate market response is failure of uncompetitive local market players, who do not possess needed financial resource to conduct aggressive growth strategies. While all in all more liberalized capital flows result in higher market efficiency. Thus, further financial market liberalization should be one of the priority strategies for Ukraine.

5.5. COSTS AND BENEFITS OF FINANCIAL INTERMEDIATION INTEGRATION (IMPLEMENTATION OF BASEL II)

The development of financial intermediation is contributing to savings and thus, foster economic development. Ukrainian banking system, which is one of the most fast developing system in the World, proved itself to be one of the triggers of Ukrainian economic development. The main problem so far was excessive, somehow unjustified financing of consumer expenditures. Nevertheless, nowadays Ukraine is a rather big market with high potential to growth. Despite record high number of the banks functioning at the market, the level of competition is rather low. Maybe thanking to the fact, regardless incompleteness of Ukrainian financial market (rather underdeveloped market of Forex derivatives, imperfect Interbank markets for crediting and foreign exchange), Ukraine has shown itself being of great interest for foreign investors.

For the moment there are no significant limitations on international banks and other financial non-banking institution access to Ukrainian

market⁵³. At the same time EU is currently still in the process of financial market integration. The main steps are stated in Financial Services Action Plan and aimed to ensuring secure prudential environment in which financial institutions can trade in EU members' market. The key areas of alignment includes prudential, mortgage, savings, anti-laundering, insurance, pension measures, open wholesale markets and other regulations directed on providing companies with competitive environment and equal opportunities inside EU.

For now, integration of Ukraine to EU single market in financial services is unlikely due to the different levels of development of financial markets and low progress of integration with EU. In trade in financial services negotiations are also likely to preserve status quo. On the one hand Ukraine made commitments to liberalize trade in financial services during WTO accession. On the other hand, EU members have disparate laws limiting trade in financial services with non-members. Therefore the key question of financial sector liberalization is appliance of Basel II rules⁵⁴.

Ukraine commitment to apply rules on capital adequacy assessment in accordance with Basel II requirements are generally considered as a factor improving Ukrainian banking system in the eyes of potential financiers and rating agencies. However, the fact is that the implementation of Basel II recommendations will, in addition to the necessity of rather sophisticated changes in internal regulation, worth Ukraine billions of dollars, which is rather difficult to realize under current conditions.

Concerning increase in banking risk sensibility and, thus, improving of risk-management, capital adequacy ratio should account for weighted sum of three types of risks⁵⁵: market, credit and operational risks, while the market one is given the highest priority. In its turn, supervisory improvement supposes the responsibility of national supervisory authorities to ensure capital adequacy of banks. To fulfill the task national authorities are assigned

53 Burakovskiy et al. Ukraine's WTO accession: service sectors. March 2010

54 Basel II represents a three pillar system: risk sensitive capital requirements, a strengthening of the supervisory review process and increased publication commitment by banks to enforce market discipline. In fact, Basel II was developed by regulators of developed economies, thus meaning somewhat higher level of banking performance and higher possibilities to switch to new methods of capital adequacy computation.

55 Current legislation foresees assets weighing in accordance with its level of risk (all assets are divided into five risk-groups).

to different rights, including the right to revoke bank operating limits and the right of bank closure in case of negative evaluation. While the third pillar obliges banks to disclose wide range of information, in particular risk assessment models they use, capital calculations, etc.⁵⁶

General costs and benefits of financial sector integration, and more specifically of Basel II rules' usage, could be represented in the following table⁵⁷.

	Costs	Benefits
State and economy in whole	<p>Encouragement of banks to lend more in the good times and discouraged from lending in hard times while using Basel II. That means that economic cycles are more severe⁵⁸.</p> <p>Increasing capital requirement under Internal Ratings Based (IRB) during recession and decreasing during expansion meaning pro-cyclist character of Basel II.</p> <p>Concentration of credit risks in one sector of economy, e.g. through mortgage and retail lending.</p> <p>Need of time to incorporate IRB methodology in banks⁵⁹.</p> <p>Need of money to incorporate Basel II.⁶⁰</p>	<p>Greater competence of national financial market.</p> <p>Lower credit risks and higher need for better accounting standards and disclosure requirements.</p> <p>Specialization of financial services, development of incentives for innovation and productivity improvement thanks to higher level of competition.</p>
Financial and real sector companies	<p>Increased level of competition and increased risks of switching to other financial institutions.</p> <p>In short-run domestic banks are replacing by international ones due to their competitive advantage.</p> <p>Possibility to over evaluate borrower state resulting in increase in active interest rates⁶¹.</p> <p>Structural effects of Basel II- banks concentrate their lending on borrowers with high ratings.</p> <p>Incentives to move low-risk instruments off balance sheet and retain high-risk instruments due to failure to distinguish among commercial loans with different risk level.</p>	<p>Wider possibilities to get financing for operation purposes.</p> <p>Avoidance of misevaluation of banking risks and provision institutions with higher stability.</p> <p>Enabling banks to arbitrage differences between regulatory and economic capital while using Basel II.</p> <p>Minimization of allocative inefficiency in lending markets.</p>

56 BIS, 2004

57 Based upon Gordy and Howells, 2006; Griffith-Jones, 2007; Jones, 2000; Metzger, 2003; Mitnik and Schüller, 2007; Reddy, 2007.

58 Alan Greenspan speech on May 7, 1998.

59 At least 5 years should be devoted to identification of main risk components and for implementation of system of internal rating for capital assessment.

60 Ukrainian banks need on average several tens million of USD dollars to update its technical and information base. For example, big European and American banks planned USD 0,5–1 bn for these purposes <http://news.finance.ua/ua/orgtrg/~2/1/341/110334>

61 Spread between debtors (especially within one debtor category) will wide and average credit costs for developing countries increase. In addition, as banks are to use assessments of credit agencies while evaluating borrower, this makes them too dependent on agencies mistakes either premeditated or not and causes financial troubles http://www.mbka.ru/price/basel_.doc

As last financial crisis showed Basel II contains some requirements of pro-cyclical nature. reserve requirements on mortgage operations were unjustifiably low leading to failures of some giant financial companies.

Basel II also means immediate reevaluation of banks' assets. While under conditions of crisis when assets are undervalued or priced incorrectly their reevaluation is questionable. The reevaluation will lead to balances' gaps widening, which makes satisfaction of Basel II requirements rather complicated⁶². In addition Basel II indirectly encourages use of hedging instruments (such as credit-default swaps, swaps, options on credit spreads etc.), while risk assessment is performed through weighing of counterparty risk coefficient. Thus, credit risk was undervalued which allowed banks to satisfy capital adequacy requirements and leads to active securitization of low quality assets. In this case financial authority should take on responsibility in setting up upper bounds of credit-default swaps prices and take over them in cases financial institution could not do this by their own.

In sum, despite potential gains from better risk-management, Basel II has its implications. The problems mentioned above became even more acute nowadays under conditions of anyway unstable Ukrainian banking system, lack of internal and external financing for capital rising purpose and persistent attacks of rating agencies on Ukrainian banks and country in whole.

5.6. Costs and benefits of harmonisation across environmental standards

The EU developed one of the most rigorous environmental regulations in the world that set strict environmental standards and regulations in different spheres of economic activity. EU environment policy aims to promote sustainable development. It is based on preventive action, the polluter pays principle, fighting environmental damage at source, shared responsibility and the integration of environmental protection into other EU policies.

62 http://www.prostobankir.com.ua/mezhibankovskiy_biznes/intervyu/viktor_marchenko_ne_razmyvat_a_kontsentrirovat

Overview of the Chapter

«Environment Acquis» is the body of European law focused on the environment; it is the second largest thematic body of legislation after agriculture⁶³. Approximation of the acquis into national legislation is a process involving adoption of specific binding legal measures (quality and technical standards, testing and notification requirements, etc.) and country-specific decisions on discretionary and suggested legal measures. The EU environment *acquis* includes more than 200 legislative acts under the following 8 broad categories⁶⁴. The EU introduced several Framework Directives as a first step to integrate laws across environmental media. Now countries will need to design national administrative structures that support integration, which rarely correspond directly to the thematic clusters of the legislation.

The EU carefully examines their trade agreements for their potential effects on the environment and also uses its trade policy to support measures that favour environment-friendly behavior of all agents. Therefore, EU-Ukraine DCFTA negotiations might include commitments on environmental standards and sustainable development and on effective implementation of internationally agreed standards in the environmental domain. Below we focus on three fields which are likely to be considered during DCFTA negotiations.

63 Paula F. Lytle, Karin J. Shepardson. Journey To A Cleaner Future. BNPP.TF055049//<http://siteresources.worldbank.org/INTECAREGTOPENVIRONMENT/Resources/5111168-1191448157765/CleanerFutureRoadmap.pdf>

64 These are: **Horizontal** (environmental impact assessments, access to information, strategic environmental assessment, public participation, and environmental liability); **Air Quality** (ambient air, VOCs from petrol stations, SO₂, NO_x, particulate and lead emissions; Sulphur content in Fuel, Vehicle emissions, Emission Trading, Emission Ceilings, Ambient Ozone); **Waste Management** (hazardous waste, packaging waste, sewerage sludge, waste oils disposal, PCBs/PCTs, battery disposal and labeling, landfill of waste, incineration of waste, disposal of vehicles, waste electronics disposal, hazardous substances); **Water Quality** (Urban Wastewater, Drinking Water, Nitrates, Bathing Water, Groundwater, Dangerous Substances to water, Mercury, Cadmium, HCH Discharges, Surface Water Abstraction, Shellfish water, Fish water); **Nature Protection** (Habitats, Wild Birds, Zoos); **Industrial Pollution Control** (Pollution Prevention and Control, Solvents, Large Combustion Plants); **Chemicals** (Dangerous Substances, Release of GMOs, Animal Experiments, Asbestos, Biocides); and **Noise** The number of directives is large—but in practice, many functions can be integrated and use common management systems.

Atmospheric pollution

Air quality legislation is broad-based in scope and addresses traffic emissions, fuel quality control, large combustion plants, volatile organic emissions from industry, and so forth; air quality legislation governs both local and transboundary effects and contains targets for greenhouse gas and carbon emissions. For product control, material handling, and emissions standards the EU establishes technologically and economically feasible standards (that are not always easy to achieve). For ambient air quality standards (limit values and guide values) the EU uses the following principles: (a) effects-based approach (ambient air quality standards for pollutants are set according to their scientifically observed or estimated effects on human health and/or on the environment and are not based on the technological or economic feasibility of achieving them); (b) universality (the same standards apply throughout the EU); (c) practicality (the difficulty of achieving compliance with standards within a short time leads to the concept of Margins of Tolerance or timescales for compliance). In the context of air quality management, the EU seeks a balance between using state of the art techniques to minimize emissions, and practical considerations such as the cost. Potential emitters of air pollutants should bear the full costs of carrying out their activities in an environmentally sound manner i.e. taking air quality (and other issues) into account. In the domain of international cooperation partners of the EU are required to take into account the effects of their own emissions on other countries even when those emissions have no significant adverse effects within their own frontiers (Convention on long-range transboundary air pollution). Also, they are expected to inform the public about air quality issues.

Water pollution

The EU established a series of water quality standards and set standards for the discharge of dangerous substances into the aquatic environment. However, the quality standard approach proved insufficient and the EU started to focus on the sources of pollutants. This led to the Directive on Urban Wastewater Treatment (UWWT) which requires Member States to invest in infrastructure for collecting and treating sewage in urban areas while the Nitrates Directive requires farmers to control the amounts of

nitrogen fertilisers applied to fields. And the Directive on Integrated Pollution Prevention and Control (IPPC) adopted a few years later aims to minimise pollutants discharged from large industrial and agricultural installations. The latter ones also are obliged to have a permit to do their activities that is issued only if certain environmental conditions are met.

In 2000 the EU adopted the Water Framework Directive (WFD) creating a global and unified approach to water legislation. The directive establishes an innovative approach for water management based on river basins, the natural geographical and hydrological units, and sets specific deadlines for Member States to achieve ambitious environmental objectives for aquatic ecosystems. Article 10 details the directive's «combined approach for point and diffuse sources» and refers to several related directives⁶⁵. The directive regards implementation of these other directives as a minimum requirement. The measures to implement them must be integrated into river basin management planning (Article 11.3(a)). The WFD also seeks to progressively reduce emissions, discharges and losses of 33 priority substances to waters. To achieve this goal a broad range of economic instruments (e.g. charges for use of water as a resource or for the discharge of effluents into watercourses) is used.

In international context, within the framework of Helsinki Convention the EU strives to ensure cooperation on research and development activities regarding effective techniques for preventing, controlling and reducing trans-boundary impact on watercourses and international lakes (methods of evaluating the toxicity of hazardous substances, development of environment-friendly technologies or manufacturing methods, etc.).

Chemicals and Generically modified organisms regulation

In 2007, REACH, a new chemical legislation, entered into force. In the coming decade, REACH will place the burden of proof on industry, which has to collect or generate the data necessary to ensure the safe use of chemicals. This data will be publicly available through the central database. REACH also provides rules for phasing out and substitution of the most

65 There are the directives on: Bathing Water (76/160) (now replaced by 2006/7), Drinking Water (80/778, as amended by 98/83), Urban Wastewater Treatment (91/271), Nitrates (91/676), Integrated Pollution Prevention & Control (96/61, codified as Directive 2008/1/EC), Sewage Sludge (86/278).

dangerous chemicals. REACH is complemented by the new Regulation for Classification, Labelling and Packaging of Substances and Mixtures. This Regulation incorporates the classification criteria and labelling rules agreed at UN level⁶⁶. It is based on the principle that the same hazards should be described and labelled in the same way all around the world.

The EU also seeks to address international trade with dangerous chemicals. It implements, within the Community, the Rotterdam Convention on the Prior Informed Consent Procedure (PIC) for certain hazardous chemicals and pesticides in international trade. The basic principle of the Convention is that the export of a banned or severely restricted chemical that is included in Annex III to the Convention can only take place with the prior informed consent (PIC) of the importing Party.

In the sphere of food safety and production the EU follows Coexistence policy that pursues the aim to achieve a sufficient segregation between GM and non-GM production⁶⁷. The EU endeavours to strictly control GMOs circulation on the market. Public consultation and GMO labelling are made compulsory. Registers are to be established for the purpose of recording information on genetic modifications in GMOs and on the location of GMOs. The labelling requirement does not apply to foods containing GMOs in a proportion no higher than 0.9 per cent of the food ingredients considered individually, provided that this presence is adventitious or technically unavoidable.

The GMOs Regulation provides for a single authorisation procedure, «one door – one key», for all food and feed containing GMOs. Under the «one door – one key» procedure, the industrial operator submits a single application for food and feed uses and for cultivation. The Regulation also aims to set up a common system for notifying and exchanging information on transboundary movements of GMOs to third countries. Exporters of GMOs intended for deliberate release into the environment must notify the competent national authority of the country of import or transit prior to the transboundary movement⁶⁸.

66 The so-called Globally Harmonised System of Classification and Labelling of Chemicals (GHS)

67 http://ec.europa.eu/agriculture/gmo/coexistence/index_en.htm

68 Also, the Commission or the State which took the decision must notify the Biosafety Clearing House (BCH) (set up by the Cartagena Protocol) of any decision regarding the use, including the placement on the market, of GMOs intended for food or feed, or for processing, that may be subject to transboundary movements.

According to the general rules for organic production, GMOs are prohibited in all their forms. The Commission authorises the use of a limited number of products and substances in organic farming. From 1 July 2010, the use of the European Union logo on organic food products will be mandatory, as will an indication of the provenance of raw materials used in the product.

Framework of EU-Ukraine actions

The EU-Ukraine ENP Action Plan sets out a comprehensive set of priorities in areas within (such as Environment) and beyond the scope of the EU Ukraine Partnership and Cooperation Agreement. Among the ENP Action Plan the environmental dialogue has been upgraded, visible particularly through intensified technical contacts in the areas of waste management and water, as well as by the reactivation in 2006 of the Ukraine-EU Working Group on Climate Change (initially launched in 2002).

In the EU-Ukraine Association Agenda the Parties agreed on cooperation to prepare for implementation of EU environment acquis and to support Ukraine in development, adoption and implementation by Ukraine of the National Environment Strategy for the period till 2020 and the National Environment Action Plan for 2009–2012; further development and implementation of Ukrainian environmental legislation, strategies and plans, in particular on environmental impact assessment, strategic environmental assessment, access to environmental information, and public participation; development of national implementation instruments in line with multilateral environment agreements signed and ratified by Ukraine and the European Community.

Level of adaptation of the EU acquis in Ukraine

Ukraine gradually approximates its environmental legislation to the norms of the EU, making steps in both updating principles and toughening environmental standards.

At the moment, Ukrainian horizontal legislation comprises several laws which in general are in line with the EU environment acquis: On the environmental protection, On nature reserve fund of Ukraine, On protection of atmospheric air, On flora, On fauna, On the State Programme of Development of Water Resources, etc. Ukraine is also a signatory to a number

of international conventions and legal successor to certain conventions signed by the former USSR. All of them make an integral part of the legislation.

According to the State Department for Legal Approximation at the Ministry of Justice of Ukraine, the system of environmental legislation is based on the principles of international law. However, at this stage likeness comes to the end. Ukrainian legislation does not provide for direct legal consequences. Apart from general laws there are a plenty of sectoral legislative acts and regulations adopted by various authorities at different levels. As a result, the main problem is that environmental regulation in Ukraine is a diffuse and disorganized mass of secondary legislation. This leads to multiple interpretations of basic legislation and an unclear division of powers among the national, regional and sectoral levels. At the moment Ukrainian law lacks such EU principles like precautionary principle, basin water resources management, integrated approach to environmental policy, and «polluter pays principle».

To overcome this gap, further adapt Ukrainian law to the EU acquis and to adopt the National Environment Strategy for the period till 2020, the Cabinet of Ministers adopted an order on Concept of national environmental policy of Ukraine for the period till 2020 which is to enforce above mentioned principles. The next steps must include enlargement of a range of natural objects and pollutions sources under control and monitoring; harmonization of environment standards (including establishment of environment quality standards); implementation of European economic instruments into environment policy (including cost recovery); composition of the list of the most dangerous pollutants; strengthening institutional capacity.

Costs and benefits for Ukraine

A major challenge of approximation of Ukrainian legislation to the EU *acquis* is obviously financing. The costs of implementation of the environment *acquis* are considered as the most substantial⁶⁹. Naturally, the state will bear tremendous costs since Ukraine needs capacity for effective

69 The costs of implementing the environmental *acquis* in the ten new Member States were estimated at EUR 50–80 bn and investments required from these countries were estimated at 2 to 3 per cent of GDP// Kremlis G. and Dusik J. The challenge of the implementation of the environmental *acquis communautaire* in the new Member States// http://www.inece.org/conference/7/vol1/Kremlis_Dusik.pdf

	Costs	Benefits
State	<p>Administration costs related to establishing administrative structure and permitting system; setting up an authorisation system and licensing procedures.</p> <p>Establishing implementation programs including investment for new infrastructure: upgrading or construction</p> <p>Preparing plans and programs to achieve compliance with quality limits</p> <p>Establishing and maintaining a network of monitoring stations for environment quality standards and associated quality assurance equipment, and reporting the monitoring results.</p> <p>Preparation and publication of codes of good practice.</p> <p>Establishment of data collection system and inventory (e.g. GHG emissions)</p> <p>Establishment of laboratory facilities (if not already available).</p> <p>Enforcement costs, including inspection and sampling programmes, training and recruitment of inspectors and veterinary staff</p> <p>Establish data collection system</p>	<p>Benefits to the natural environment and avoided global warming</p> <p>Increased tax revenues (e.g. from recreation and tourism companies)</p> <p>Increased revenues from environmental fees (e.g. for violation of stricter environment rules)</p> <p>Participation in the environment programs financed by the EU</p> <p>Increased employment through environmental investments</p> <p>Better balance of payment and trade effects (e.g. through reduced imports of primary materials as more waste is reused and recycled)</p> <p>Attracting investment given locational quality.</p>
Companies	<p>Additional costs of compliance with environment standards</p> <p>Modernization costs (e.g. construction of improved industrial waste water treatment facilities if necessary);</p> <p>Costs of trials to satisfy regulatory requirements (e.g. payments for lab tests, costs to obtain permits)</p> <p>Higher input prices</p> <p>Costs to industries whose products or production technologies will be prohibited or under stricter control</p>	<p>Benefits to parts of environment used commercially (e.g. forestry and fisheries)</p> <p>Higher profits from sales of more advanced products with higher value added (which are likely more expensive)</p> <p>Eco-efficiency gains: increased economic efficiency and higher productivity as a result of modern technology (e.g. reduced primary materials use and therefore operation costs)</p> <p>Revenues from sales of emissions quotas</p>
Households	<p>More expensive natural resources and products and services (e.g. water)</p>	<p>Direct benefits for public health (e.g. reduction of diseases) as</p> <p>Wider recreational opportunities</p> <p>Societal learning and the development of civil society (due to increased information provision, consultation and involvement).</p> <p>Social cohesion due to support for employment in environmental activities</p>

environmental policy to be created. However, companies and households also will be forced to comply with much stricter environmental rules and therefore bear additional costs. At the same time, they consider different types of benefits while tightening environmental rules and standards, such as health, resource, ecosystem, social and wider economic benefits⁷⁰.

Thus, Ukraine needs substantial efforts to be made on the path of approximation to EU environment *acquis*. Notwithstanding obvious benefits for the environment, costs are absolutely cumbersome for Ukrainian economic agents. Hence, during the DCFTA negotiations Ukraine should seek for reasonable timescales for compliance with the EU environment *acquis*.

70 Patrick ten Brink and Samuela Bassi. Assistance in the implementation and monitoring of the environmental components of the European Neighbourhood Policy (ENP) Action Plans to cover small capacity building and progress monitoring activities. IEEP // http://ec.europa.eu/environment/enlarg/pdf/methodology_report.pdf

6. HOW CAN A TYPICAL AGREEMENT WITH THE EU BE IMPROVED UPON

6.1. CONCISE OVERVIEW OF ECONOMIC/TRADE AREAS OFFERED BY THE EU IN TYPICAL FTA

Besides trade in goods facilitation measures, general FTA agreement includes positions which regulate other side of cooperation between EU and third countries. Among them are provisions both of economic nature, such as competition, economic cooperation, rights of establishment, capital flows management, financial cooperation, and of non-economic nature, such as social life, cultural cooperation, migration. Some articles of transitional character are also included. The transition character of such position means that they do not directly aimed to economic fostering, but realization of the recommendations help to achieve it. Among these measures we could mark cooperation in standardization⁷¹, science, public administration development and some other issues.

In the section we will try to explore experience of four, rather different with respect to state of economy up to the date of negotiation process beginning, goals, needs and possibilities in completion of FTA agreement, countries: Poland, Estonia, Chile and Morocco.

Poland

Poland is the first country among four which entered a free trade area with EU. The entrance was finished with Poland EU accession. The general statements of an FTA agreement with EU almost in any area included approximation of Poland standards, legislation, ways of doing business, competitive environment etc. to EU ones. While analyzing content of EU-Poland FTA agreement, we could see that from the very beginning it was structured so as to ensure future Poland accession to European Community.

71 Positions on alignment of standardization rules to EU ones are presented as separate provisions of the Agreement and as clauses in agricultural cooperation, cooperation in banking or financial sector, technological cooperation etc.

An interesting feature of the agreement is that it, among other things, covered entire fields of national economic policy, such as monetary policy directed towards its approximation to European, economic policy concerned with small and medium enterprises (SME) as a base for economic development. Specific attention was also paid on incorporation of Poland telecommunication, transportation systems, and energy networks into European systems. Programs of regional development directed on balanced economic development of Poland and programs of cross-border regional cooperation with EU countries also represent one of the key positions of EU-Poland agreement. Moreover, environmental cooperation also tries to cover joint interest of the country and European community.

It is needed to be mentioned that the agreement was directed on development of country specific strengths. Besides already mentioned development of SMEs, a very broad cooperation in agriculture (which includes not only requirements on alignment of standards and norms, but positions on cooperation in modernization of equipment, infrastructure, and increase in agricultural production quality) was stated. As Ukraine and Poland have a lot in common, from industrial structure to border character of Ukrainian territory with respect to EU, the Poland experience could be of big use for Ukraine.

Specific highlight was made for labor migration, which in fact entered agreement twice: firstly in section on «movement of workers» and secondly as «right of establishment and services». According to the agreement, legally employed workers should be treated as native population with all related consequences (family allowances, pensions etc.). It should be noted that for Chile the position on migration is concerned only with illegal migration and do not cover any specific treatments of worker migrants. The section Poland FTA agreement nowadays is of specific interest for Ukraine as number of Ukrainian migrants in EU is large.

EU-Poland agreement also foresaw some improvement in custom operations such as use of single administrative document (norm similar to Morocco and Chile provisions) and increasing of the publicity of governmental aid provision procedures – the trade related non-tariff measures which could be of use for Ukraine taking into account large trade flows between Ukraine and EU. The agreement also gives Poland the prerogative to use G-24 and EIB financial resources provided it had enough reasons for this. At the

same time Poland could realize measures related to BoP corrections only in GATT framework and its IMF status so that Ukraine could.

Thus, FTA EU-Poland agreement is concentrated on incorporation of Poland economy towards European one and fostering of economic and the infrastructural reforms in this aim.

Estonia

Estonia joined the EU simultaneously with Poland, but succeeded in economic reforms even better⁷². The chapters of the EU-Estonia FTA agreement are very similar to those of Poland ones, that is why it is especially important to investigate what drove Estonian out-performance.

One of the differences between Poland and Estonian FTA agreements is liberalization of capital flows- EU-Estonian FTA agreement is not restricted to FDI liberalization, but also foresees free movement of portfolio investment and loans. It is difficult to judge whether such an extent of capital flows liberalization was of particular benefit for Estonia, while we could assume that in light of up to the moment stable financial situation it was not damaging.

The second difference is EU help in reforming Estonian social insurance system. In addition EU-Estonia FTA agreement foresees alignment of a broader list of legislation than EU-Poland FTA does.

The very specific feature of EU-Estonia FTA agreement is concentration on three Estonian leading economic spheres wood industry, fishery and maritime transportation, meaning provision with support for their development.

The other question of the agreement concern is development of audit procedures in the country in line with EU standards. The latter strategy alongside with abolishment of discriminative state aid represents common EU-Estonia efforts to tackle with corruption and unfair take-overs which have been common for the country.

EU-Estonian FTA agreement also stresses necessity to develop inter-Baltic economic relationships as the precondition for Estonian progress.

Summarizing, we could point out such key-triggers of Estonian progress as: specific attention to Estonian leading industries and intraregional

72 Messerlin. 2009.////

links, broader reform of Estonian legislation and specific efforts toward improvement of companies' information transparency.

Chile

We will consider Chile next as it represents an example of one of the broadest agreement between EU and third country, while it is structured a little bit differently from that with Poland or Estonia. Such an interesting feature (the number of fields an agreement covered) could be explained by the fact that EU-Chilean relationships in fact were built from nothing, so agreement included as many positions as it was possible.

Special attention was made for non-tariff barriers. Agreement described in detail anti-dumping measures, customs operations, prohibition of non-tariff barriers such as quantitative composition of some goods, simplification of customs operation and improvement of custom valuation, some sanitary, phytosanitary norms and technical standards alignment so that to avoid non-tariff barriers to trade. However, some exceptions to these rules were foresaw (protection of morals, of human life and health, issues related to importation and exportation of gold and silver, protection of national treasures etc.)

Special attention in Chile-EU FTA agreement was paid toward maritime transportation services and boosting of economic cooperation in Mercosur region. The implementation of the recommendations would have expanded cooperation between EU and Chile and economic relationships within region.

Besides general norms directed on prohibition of current account and capital flows control for more than 1 year and norms on approximation of Chilean technical standards, statistical methodologies, sanitary and other norms to those of EU, which are rather similar for this kind of agreement, EU-Chile agreement also included positions related to country specific features. A lot of attention was devoted to protection of vulnerable groups, improvement of market conditions and educational and training programs. The latter reflects the Chilean particular needs. Some of the ideas could be also of value for Ukraine.

In cultural matters FTA agreement recommendations were directed on preservation of cultural heritage of Chile, while for Poland it was concerned more with cultural collaboration of the country into euro-area.

Agreement concentrated specifically on drug, money laundering and protection of intellectual rights matters, recommending Chile to incorporate into its own practice a list of international agreements already in place.

All in all, we could conclude that in whole measures were directed to establishment of transparent and efficient economic environment in Chile.

Morocco

We conclude with considering Morocco example. An agreement with this country is one of the most general and narrow.

The specifics of the country are waste use of governmental aid and widespread presence of state monopolies of commercial character. Thus, agreements foresaw the gradual prohibition of such practices. The other feature was illegal migration and labor migration, thus, several positions were directly devoted to the solution of the problems. Special attention was also paid to improvement of health care system, fostering of family planning and increasing tolerance towards Moroccans in EU. The document also presumed development of almost new fields of economy in Morocco-tourism, high-tech technologies.

The biggest attention was devoted towards educational and scientific cooperation, modernization of energy networks and industry, roads, rails and transportation network in whole. Another most important part of agreement regulations was concerned with standardization, legislation approximation, use of single administrative custom document etc.

6.2. HOW CAN THE TYPICAL AGREEMENT BE IMPROVED TO FIT UKRAINE'S INTERESTS

It is obvious that EU FTA agreements significantly differ among partner countries depending on the level of existing and targeted future cooperation, the level of partner country development, priorities of cooperation, etc. Among the issues on which the EU is likely to insist are:

- Preservation of the right to conduct anti-dumping investigations and introduce anti-dumping measures;

- Convergence of technical regulations, sanitary and phytosanitary measures to the EU practices;
- Enforcement of the national treatment in the trade of selected services;
- Special treatment of agrifood sector;
- Movement of workers as an area largely regulated by separate (bilateral) agreements;
- Significant level of convergence in ‘behind-the-border’ regulations that concern company law, competition policies, industrial policies, environmental issues, etc.

Presuming that Ukraine aims to eventually join the EU it seems necessary to facilitate the convergence towards to the European rules and practices. However, careful staging is definitely required until Ukraine’s gets clear-cut membership perspective that seems to be very far-away discussion. The staging of regulatory changes was already discussed in Section 5.1. Here, we would like to briefly consider several conceptual aspects related to the agreement.

First, the global economic crisis is very likely to change regulatory framework in the world and in the EU in particular. It concerns financial intermediation primarily, but regulations in other sectors also could be revised. Thus, excessive stickiness/adjustment to current regulation may not be worthwhile. For instance it is the case with Basel II as discussed in Section 5.5.

Second, as correctly noted by Messerlin (2009) there is significant number of norms in the EU, a pro-growth impulse of which is questionable. For emerging countries like Ukraine the implementation of such norms might result in undesirable growth-hampering effect, at least in the short term period. Thus, any regulatory adjustment should be carefully examined as ‘one-size-fits-all’ policy is inappropriate here.

Third, as Ukraine will undergo substantial reforms implementing the FTA commitments, it is in the best interest of Ukraine to ensure the EU commitment in providing financial and technical support in these reforms in the country.

CONCLUSIONS

As it was shown by a number of previous studies like IER (2006), CEPS (2006), CASE (2007) the deep FTA agreement between the EU and Ukraine is beneficial in the long-run perspective stimulating real GDP growth and improving households' welfare. In this report we estimated costs and benefits of various levels of integration and legal approximation/harmonization that could be achieved within the FTA, in particular of adaptation of the main regulatory principles laid in the EU *acquis*.

Although the WTO and the implementation of the EU-Ukraine Action Plan in the framework of the European Neighbourhood Policy created a solid foundation of trade liberalisation, there are a lot of issues that would require elaboration within the framework of the FTA negotiations. In particular, close attention should be given to achievement of free movement of goods, capital (direct investments), and labour force between partners.

To ensure that the country captures full gains from the FTA, the attention should be shifted from tariffs to non-tariff issues, in particular on technical barriers to trade, trade facilitation issues, intellectual property right issues etc. The survey conducted by IFC (2008) showed that technical barriers are considered by entrepreneurs as major impediment to business. Moreover cumbersome technical regulation hampers innovations, trade and growth. Therefore close approximation in standards, conformity assessment procedures, accreditation, and market surveillance with the EU practices is definitely among priority topics for the FTA negotiations. Though, it should be emphasized that important progress in this area was already achieved under the WTO auspices as Ukraine committed to base all its technical regulations on relevant international standards. Moreover according to the WTO (2008) from the date of accession, all Ukraine's standards are voluntary, except those referred to or set out in technical regulations intended *inter alia* to protect national security interests, prevent deceptive practices, protect the life and health of people, animals or plants, as well as protect the environment.

The development of the hierarchy of issues associated with the FTA showed that the most of issues require further deeper costs and benefits analysis as their associated regulations could entail significant costs of the economic agents in Ukraine as the country with much lower income per

capita than the EU. The choice of the depth of approximation should be evaluated from growth-enhancing perspective (see Messerlin, 2009).

Although taking into account Ukraine aim to eventually joint the EU, the facilitation of the convergence towards to the European rules and practices should be carefully staged. Several issues should be taken into account:

First, the global economic crisis has changed regulatory framework in the world and in the EU in particular. The adjustment to the EU norms should take these changes into account.

Second, as Ukraine will undergo substantial reforms implementing the FTA commitments, it is in the best interest of Ukraine to ensure the EU commitment in providing financial and technical support in these reforms in the country.

We have analysed costs and benefits of harmonisation / adjustment towards several chapters of the *acquis* in greater details, and we found that:

(a) Harmonisation over company law and over state aid regulations would imposes rather high costs on specific companies, but seems to be beneficial for the society as a whole;

(b) Capital flows liberalisation seems to beneficial for the country though there are risks of liberalisation linked to market imperfections;

(c) There are high costs associated with the introduction of Basel II in Ukraine making approximation towards this regulation highly questionable. It is even more questionable currently as the global crisis showed significant flows in the system;

(d) Imposition of stricter environmental standards would be most difficult for firms that previously have positioned themselves in the low-cost segments or produced inferior goods.

Although regulatory adjustments raise high costs as it requires regulatory, institutional and administrative changes. At the same time benefits cover the costs in the long term perspective in all the sectors. Although adaptation of the EU *acquis* should be carefully scheduled and adjusted to Ukraine's reality.

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ANNEX A

Table 1 Exports of Ukraine to the EU

	1999		2009		Growth over 1999–2009, %
	EUR m	%	EUR m	%	
Food and live animals chiefly for food	91.4	2.8	647.4	8.2	608.5
Beverages and tobacco	7.1	0.2	24.2	0.3	241.0
Crude materials inedible except fuels	812.5	24.7	1668.1	21.1	105.3
Mineral fuels lubricants and related materials	442.8	13.4	907.2	11.5	104.9
Animal and vegetable oils fats and waxes	3.3	0.1	327.6	4.2	9907.9
Chemicals and related products nes	309.1	9.4	423.8	5.4	37.1
Manufactured goods classified chiefly by materials	913.3	27.7	2176.9	27.6	138.4
Machinery and transport equipment	240.3	7.3	955.3	12.1	297.6
Miscellaneous manufactured articles	371.1	11.3	476.6	6.0	28.4
Commodities and transactions not classified elsewhere in the SITC	33.7	1.0	85.4	1.1	153.2
Total	3295.1	100	7889.9	100	139.4

Source: <http://comtrade.un.org/>

Table 2 Imports of Ukraine from the EU

	1999		2009		Growth over 1999–2009, %
	EUR m	%	EUR m	%	
Food and live animals chiefly for food	275.9	7.0	993.7	7.1	260.1
Beverages and tobacco	73.3	1.9	119.6	0.9	63.3
Crude materials inedible except fuels	85.9	2.2	269.9	1.9	214.1
Mineral fuels lubricants and related materials	179.6	4.5	579.3	4.2	222.5
Animal and vegetable oils fats and waxes	21.2	0.5	50.4	0.4	137.9
Chemicals and related products nes	589.5	14.9	2709.8	19.5	359.6
Manufactured goods classified chiefly by materials	821.9	20.8	2472.3	17.8	200.8
Machinery and transport equipment	1158.4	29.3	4500.7	32.4	288.5
Miscellaneous manufactured articles	625.2	15.8	1874.7	13.5	199.9
Commodities and transactions not classified elsewhere in the SITC	61.2	1.6	174.3	1.3	184.7
Total	3948.1	100	13903.4	100	252.2

Source: <http://comtrade.un.org/>

**Table 3 Geographical structure of commodity trade
between Ukraine and the EU**

	1999				2009			
	Exports		Imports		Exports		Imports	
	USD m	%	USD m	%	USD m	%	USD m	%
EU-27	3647.4	100	3452.6	100	9504.43	100	15392.7	100
Austria	139.8	3.83	133.4	3.86	328.7	3.46	612.2	3.98
Belgium	188.6	5.17	100.9	2.92	279.6	2.94	464.0	3.01
Bulgaria	294.5	8.07	67.5	1.96	395.5	4.16	151.8	0.99
Cyprus	42.3	1.16	58.1	1.68	130.8	1.38	49.1	0.32
Czech Republic	141.4	3.88	131.4	3.81	340.7	3.58	622.1	4.04
Denmark	23	0.63	59.4	1.72	122.4	1.29	219.4	1.43
Estonia	45.5	1.25	59	1.71	77.5	0.82	135.3	0.88
Finland	18.1	0.50	82.2	2.38	37.4	0.39	421.5	2.74
France	85.1	2.33	236.9	6.86	442.3	4.65	971.5	6.31
Germany	560.1	15.36	942.9	27.31	1248.1	13.13	3852.1	25.03
Greece	75	2.06	54.5	1.58	100.3	1.06	82.8	0.54
Hungary	278.2	7.63	123.6	3.58	730.2	7.68	678.3	4.41
Ireland	250.3	6.86	53.7	1.56	4.2	0.04	102.1	0.66
Italy	459.4	12.60	276.5	8.01	1227.6	12.92	1139.8	7.40
Latvia	49.1	1.35	55.4	1.60	178.0	1.87	110.1	0.72
Lithuania	72.4	1.98	82.5	2.39	193.5	2.04	410.3	2.67
Luxembourg	3	0.08	2.2	0.06	2.4	0.03	18.6	0.12
Malta	20.3	0.56	0.5	0.01	31.4	0.33	7.7	0.05
Netherlands	83.6	2.29	133.6	3.87	594.9	6.26	677.5	4.40
Poland	301.4	8.26	258.5	7.49	1213.1	12.76	2170.3	14.10
Portugal	13.4	0.37	4	0.12	63.6	0.67	41.9	0.27
Romania	75.6	2.07	52.3	1.51	319.5	3.36	488.1	3.17
Slovakia	199.2	5.46	131.6	3.81	433.7	4.56	306.0	1.99
Slovenia	8.9	0.24	33.3	0.96	11.0	0.12	185.4	1.20
Spain	105.8	2.90	60.6	1.76	570.4	6.00	372.2	2.42
Sweden	5	0.14	114.5	3.32	81.1	0.85	451.3	2.93
United Kingdom	108.4	2.97	143.6	4.16	346.3	3.64	651.1	4.23

Source: State Statistics Committee of Ukraine

**Table 4 Dynamics of structure of service trade
between the EU and Ukraine**

	2002				2008			
	Exports		Imports		Exports		Imports	
	USD m	%	USD m	%	USD m	%	USD m	%
Total	973.6	100.0	394.2	100.0	4066.3	100.0	3836.8	100.0
Transportation	787.7	80.9	102.1	25.9	2366.0	58.2	752.8	19.6
Travels	31.3	3.2	23.1	5.9	111.1	2.7	144.3	3.8
Communication	22.4	2.3	33.8	8.6	132.6	3.3	73.7	1.9
Construction	1.9	0.2	8.2	2.1	34.3	0.8	74.8	2.0
Insurance	4.2	0.4	22.5	5.7	88.7	2.2	145.1	3.8
Financial	6.6	0.7	34.5	8.8	260.1	6.4	1180.8	30.8
Computer	4.3	0.4	6.6	1.7	93.9	2.3	180.6	4.7
Royalties and licence fees	1.2	0.1	1.1	0.3	7.8	0.2	183.3	4.8
Other business services	8.6	0.9	10.2	2.6	78.0	1.9	100.5	2.6
Miscellaneous business, professional, and technical services	80.6	8.3	90.5	23.0	798.6	19.6	737.4	19.2
Personal, cultural and recreation services	2.1	0.2	2.6	0.7	23.2	0.6	151.5	3.9
Government services, not included elsewhere	0.8	0.1	51.2	13.0	2.2	0.1	97.4	2.5
Repair	21.8	2.2	7.7	2.0	69.7	1.7	14.5	0.4

Source: State Statistics Committee of Ukraine

**Table 5 Geographical structure of service trade
between Ukraine and the EU**

	1999				2009			
	Exports		Imports		Exports		Imports	
	USD m	%	USD m	%	USD m	%	USD m	%
EU-27	766.6	100.00	382.2	100.00	2989.5	100.00	3003.3	100.00
Austria	55.4	7.23	16.8	4.39	163.0	5.45	226.3	7.54
Belgium	60.4	7.88	21.1	5.52	228.5	7.64	67.0	2.23
Bulgaria	27.6	3.60	67.9	17.76	30.6	1.02	19.0	0.63
Cyprus	63.4	8.27	14.3	3.73	457.7	15.31	668.3	22.25
Czech Republic	9.8	1.28	7.0	1.83	30.9	1.03	66.2	2.20
Denmark	5.0	0.65	1.0	0.26	66.5	2.22	18.0	0.60
Estonia	3.4	0.44	3.2	0.84	108.1	3.62	12.0	0.40
Finland	3.3	0.43	5.6	1.48	39.0	1.30	18.5	0.62
France	26.3	3.44	12.8	3.34	86.5	2.89	301.5	10.04
Germany	99.9	13.03	58.1	15.21	369.5	12.36	362.9	12.08
Greece	36.1	4.71	8.1	2.11	83.1	2.78	27.6	0.92
Hungary	32.4	4.22	6.8	1.77	67.6	2.26	43.8	1.46
Ireland	32.6	4.26	3.3	0.85	33.7	1.13	7.5	0.25
Italy	40.2	5.25	7.0	1.84	120.2	4.02	48.1	1.60
Latvia	17.8	2.32	8.9	2.33	41.7	1.39	22.5	0.75
Lithuania	3.9	0.51	4.2	1.10	27.4	0.92	17.0	0.57
Luxembourg	2.0	0.26	0.1	0.02	31.8	1.06	1.8	0.06
Malta	26.5	3.46	1.3	0.35	103.8	3.47	1.5	0.05
Netherlands	21.4	2.79	23.7	6.19	118.1	3.95	125.5	4.18
Poland	34.8	4.54	12.8	3.34	82.6	2.76	114.9	3.83
Portugal	0.7	0.09	0.4	0.11	11.3	0.38	9.7	0.32
Romania	5.8	0.76	3.4	0.89	14.2	0.47	21.9	0.73
Slovakia	9.0	1.18	5.8	1.52	47.3	1.58	15.9	0.53
Slovenia	1.0	0.13	0.8	0.21	7.2	0.24	3.4	0.11
Spain	7.9	1.04	6.1	1.61	28.6	0.96	12.0	0.40
Sweden	2.4	0.31	7.4	1.93	52.1	1.74	129.3	4.31
United Kingdom	137.6	17.94	74.5	19.48	538.5	18.01	641.2	21.35

Source: State Statistics Committee of Ukraine

