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Which Priority for Ukraine's Trade Policy?
"Single Economic Space" (SES) vs. World Trade Organization (WTO)

1. Summary

Recently, Ukraine's President signed an agreement on the formation of a Single Economic Space (SES) between Belarus, Kazakhstan, Russia and Ukraine. This agreement foresees implementation of a Free Trade Agreement (FTA) and eventually transformation towards a Customs Union (CU). We first discuss the corresponding legal aspects and stress the contradiction with Ukraine's standstill commitment in the ongoing negotiations on World Trade Organization (WTO) accession. Therefore, forming the SES and completing negotiations on WTO accession <u>at the same time</u> is not possible. Moreover, if both objectives are to be implemented <u>sequentially</u>, it appears that WTO membership – regardless of whether it will be initiated before of after initiation of the SES – will impose strong disciplines on Ukraine's foreign trade system. This will make it difficult for Ukraine to finally achieve the intended level of integration within the SES. Against this background, the strategy chosen by policy makers should be based on a thorough and careful assessment of economic costs and benefits.

Expected benefits from WTO accession are improved market access for exports via the Most Favored Nation mechanism, access to the dispute settlement mechanism, further stimulus for domestic economic reforms through commitment to international standards and practices, and an increase in foreign direct investment.

On the other hand, present trade relations between Ukraine and Russia are already fairly liberal, mainly due to an FTA among all CIS countries signed in 1992. Furthermore, we argue that expectations of significantly lower prices for oil and gas from Russia are rather unrealistic and not conducive to the sustainable development of Ukraine's economy. Finally, Russia's practice of VAT taxation on oil deliveries by 'country of origin' can also be tackled by direct negotiations. Thus, we conclude that insisting on the formation of the SES means either achieving only insignificant results if the SES does not go beyond the existing FTA, or to forgo benefits from WTO membership in case a CU is to be established (as is intended by the official agreement).

With regard to the observed diversification of Ukraine's trade flows and increased importance of trade partners other than Russia during Ukraine's current period of strong growth, establishing reliable conditions for global trade is of crucial importance. WTO membership offers such perspectives. Therefore, we strongly recommend focusing on **WTO accession without further delay**.

Outline:

1. Introduction

In September 2003 the Presidents of Belarus, Kazakhstan, Russia and Ukraine signed an agreement on the establishment of a Single Economic Space (SES) between the four countries. Currently, the parliaments of the respective countries are considering the ratification of this agreement. This has provoked an intense discussion among Ukrainian policy-makers and experts regarding the nature of this arrangement and its economic and political implications for Ukraine.

In general, Regional Trade Arrangements (RTAs) are considered by economists to be only second-best options for trade liberalization. Nevertheless, different types of RTAs can generate positive benefits for their member states. While every country has the sovereign right to determine its trade policy and relationships, the scope for new strategic alliances is limited by the international agreements with other countries and organizations which a country has already approved. In the present case of entering into an SES with three members of the Former Soviet Union, most criticism has focussed on contradictions with Ukraine's foreign policy, in particular the 'European Choice' and accession to the World Trade Organization (WTO). However, the discussion so far has been characterised more by emotional rather than by objective economic arguments. Against this background, we attempt to shed light on the legal and economic implications of this strategic choice. We believe that this is crucial for a discussion that so far has been complicated by a serious misunderstanding of important economic terms and concepts.

2. Types of Regional Trade Agreements (RTA)

Understanding the distinctions between different types of RTAs is a precondition for understanding their pros and cons in general and those of the SES in particular. Typically, RTAs are distinguished by the degree of integration into:

i) Preferential Tariff Agreements,

ii) Free Trade Agreements,

iii) Customs Unions,

iv) Common Markets,

v) Economic Unions, and

vi) Economic and Political Unions.

Not all existing RTAs can be placed squarely in one of these categories, and intermediate forms are possible. The European Union (EU), for example, is probably best characterized as lying somewhere between a Common Market and an Economic Union, and is even experimenting with some elements of Political Union. Because they are most relevant to our discussion on the SES, we explain in detail the main characteristics of Free Trade Agreements (FTAs) and Customs Unions (CUs):

Free Trade Agreement (FTA): Within an FTA (sometimes called Free Trade Zone or Free Trade Association Agreement) no duties are levied on imports from other FTA members, but different rates of duty may be charged by each member on its imports from non-member countries in the rest of the world. Hence, FTA members remain free to independently elaborate their trade policies toward third countries. Hence, FTAs are a limited form of integration and institutional agreements are not extensive.
An FTA is considered to be a reasonable option for countries embarking on economic integration and at the same time unwilling or unable to engage in higher levels of integration. However, FTA members must also agree on rules of origin (ROO) to determine which products can be transferred duty-free. Otherwise, imports would always enter the FTA via the member with the lowest external protection, thereby circumventing the higher protection imposed by other members. As a result, border controls are necessary for commerce between members in an FTA, and arguments over interpretation of ROO can lead to delays and disputes.

Customs Union (CU): In a CU, in addition to free trade among the members, members agree on a common system of tariffs and import quotas vis-à-vis non-members. The adoption of a common external tariff (CET) and joint quotas necessitates closer co-operation, especially when it comes to sharing the customs revenues collected on imports from non-members. ROO are no longer necessary as each member imposes the same tariff on imports from third countries. Hence, there is no incentive for transshipment of imports between members, as the CET effectively creates 'destination-neutrality' for all imports into the CU.
A CU involves a degree of institutional commitment and capacity that may be beyond the reach of some potential member states. In effect, enforcing a CU requires not only the implementation of a CET but also the enforcement of common policies in the realm of customs administration and defense against unfair trade practices. Furthermore, a sharing rule for the customs revenue must be established. This is

particularly difficult if the fiscal importance of tariff revenues differs from member to member. Thus, the demands for harmonization posed by a CU are considerably more complex than those posed by an FTA, as they require convergence in the performance of national institutions. Where such institutions are weak and disparate, convergence may be difficult to attain.

Today, the FTA is the most widespread type of RTA. Examples include NAFTA (Canada, USA, Mexico), the US-Israel FTA, a number of bilateral FTAs between the EU and countries such as South Africa, Tunisia, Morocco, Mexico, and several CEECs (Hungary, Poland, Bulgaria, Romania, Estonia, Latvia, Lithuania, the Czech Republic, the Slovak Republic and Slovenia), the Australia-US FTA, etc. Analysis of these and other agreements shows that they often go far beyond trade issues. For example, while NAFTA is primarily about trade policy, an underlying motivation was the desire on the part of both the Mexican and US governments to lock in the broad range of economic reforms that the Mexican government has undertaken in the preceding years. The implicit agreement was that if Mexico maintained these policies it would gain access to the US market and also would have more general claim on U.S. assistance. The US government was interested in encouraging economic growth in Mexico in order to curtail Mexican emigration to the United States.

Experience shows that establishing a CU is generally a much more ambitious task than establishing an FTA. In particular, the more disparate or heterogeneous its members – in terms of economic development and structure – the greater the degree of institution building and convergence that is required to establish a working CU. And the greater the potential for friction and efficiency loss. A particular danger (and one that e.g. the EU experienced when establishing its Common Agricultural Policy) is that the members of a CU will only be able to agree on a 'highest common denominator' external tariff that is higher than the average tariff that prevailed in the individual members prior to formation of the CU. In this case, the CU leads to a net increase in protection world-wide coupled with trade diversion and a reduction in growth and welfare.

Against this background, how can the SES be classified? The main intentions of the SES are to establish free trade between the four countries, to implement common policies for trade, competition, regulation and standardization, to ensure free movement of production factors, and to harmonize macroeconomic policy and network regulation. It is envisioned that all of these objectives are to be implemented gradually, where each country determines the speed of integration independently (so-called 'multilevel and multispeed integration'). Eventually, all policies are to be governed by a single commission in which each member state will have a voting weight proportional to its economic size. Hence, the concept of the **SES** foresees the immediate implementation of a **FTA** with the intention of eventually creating a **CU** that may even include some elements of higher integration levels. In the following, we describe legal implications and economic prospects of the formation of such an RTA for Ukraine.

3. Compatibility with the WTO

For Ukraine, the agreement on formation of the SES raises a number of legal concerns. For example, it is unclear to which extent Ukraine's constitution allows for shifting responsibilities for trade and competition policies to the foreseen commission. Beside this primarily political and judicial question, the most important issue from an economic point of view is the degree to which Ukraine's obligations within the process of forming the SES are in line with its position and already signed agreements in the ongoing negotiations on WTO accession. Like any other country that negotiates its WTO membership, Ukraine has signed a so-called 'standstill agreement' in which it commits itself to refrain from substantial changes in its foreign trade policy (including formation of RTAs) during its negotiations on WTO accession. Therefore, ratification of the agreement on formation of the SES is currently not possible without bringing Ukraine's WTO accession process to an abrupt stop. In simple terms: **Formation of the SES and WTO accession cannot be undertaken at the same time.** Rather, policy makers have to decide what to do first, establish the SES or continue the process of WTO accession. Whichever of these two options is chosen, it will have a strong impact on perspectives for realizing the other.

1) First WTO, then SES:

If Ukraine decides to join the WTO first, then it will enter the SES as a WTO member. However, the WTO allows its members to enter FTAs or CUs only under specific conditions (see box 1), since it generally considers them as a departure from the guiding principle of non-discrimination.[1] Generally, entry is only permitted if the FTA or CU in question is expected to further stimulate rather than to restrict trade flows. This is only the case if the RTA does not lead to higher protection levels at external borders (typically measured by weighted average tariffs). Furthermore, the RTA is expected to cover "substantially all trade"; in other words it should not exclude any products or product groups.

Will these requirements make it difficult for Ukraine to join the SES? In principle not during the initial phases of implementation when each country still determines its own tariffs. In this case, Ukraine's commitments to the WTO will simply form the benchmark for further integration within the SES. This integration is likely to become a major problem, however, for several reasons. First, total weighted average tariffs in Russia are almost twice as high as in Ukraine (10.5% and 5.5%, respectively) and with the exception of equipment and food products, Russia's tariffs levels exceed those of Ukraine for all other main commodity groups (figure 1). For the SES to eventually fulfill WTO requirements, its common external tariffs would have to be no higher than the current weighted average of Russian and Ukrainian (and Belarussian and Kazakh) tariffs. This average would clearly lie below current levels in Russia, so Russia would have to agree to lower its tariffs vis a vis non-SES countries. However, the proposed distribution of votes in the commission according to economic importance (Russia would dominate as its GDP accounts for around 80% of aggregate GDP in the SES) makes this highly unlikely.

Second, it is unlikely that the SES would cover "substantially all trade" as required by the WTO. Russia and Ukraine (and the other two prospective SES member states) apply quite different levels of tariff and other policy tools on agricultural trade. It is difficult to envisage agricultural products, which have consistently been excluded from past trade agreements (or for which the prospective SES members have repeatedly ignored existing trade commitments), being included in the SES trade regime. However, failure to include agriculture would contravene WTO requirements.

[1] Defined in Article I of GATT, Article II of GATS, and elsewhere.

In summary, first joining the WTO would impose disciplines on the subsequent formation of the SES, disciplines which it appears the SES members would have a very difficult time respecting.

Box 1 Conditions for approving RTAs according to WTO rules[2]

Trade in goods:
Article XXIV of GATT, paragraphs 4 to 10 (as clarified in the Understanding on the Interpretation of Article XXIV of the GATT 1994) allow the formation and operation of CUs and FTAs covering trade in goods if their purpose is to facilitate trade between the partners rather than to raise barriers to the trade with others (paragraph 4). This is the case if:

- The proposed agreement covers substantially all trade and does not exclude trade in any specific goods.
- Duties and other regulations of commerce (measured by weighted average tariffs and custom duties collected and computed according to WTO standards) imposed by each constituent of a FTA or by a CU (or an interim agreement leading to a formation of FTA or CU) are on the whole not higher or more restrictive than the general incidence of duties and regulations applicable in the territory prior to the formation of the RTA (paragraph 5a (CU) and 5b (FTA)).
- Any interim agreement referred to in paragraph 5a and 5b shall include a plan and schedule for the formation of an FTA or a CU within a reasonable length of time, which should exceed 10 years only in exceptional cases (paragraph 5c).

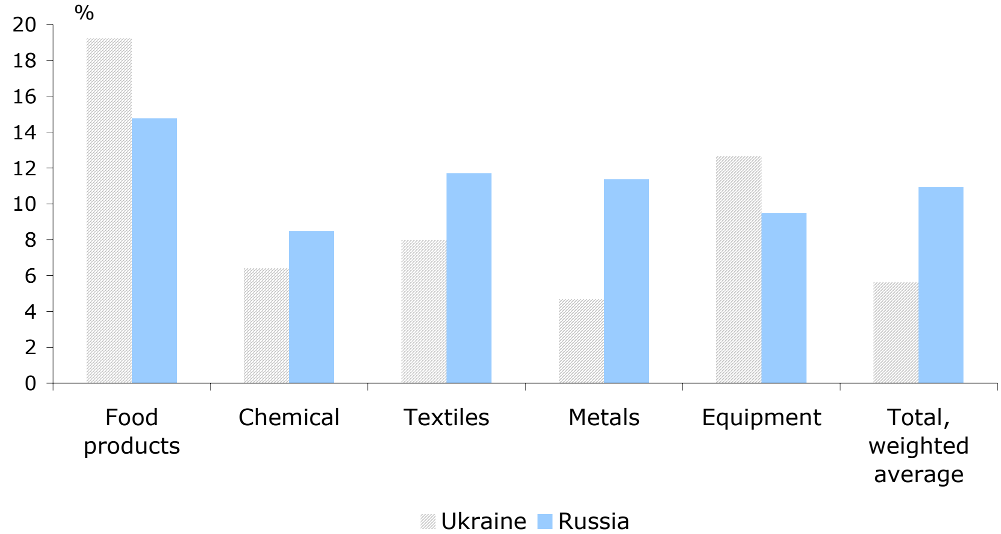
Furthermore, if in fulfilling of paragraph 5a the common regulations imposed by a CU require a certain country to increase a duty that is bounded according to Article II, then this has to be re-negotiated according to Article XXVIII (paragraph 6). This procedure has to be commenced before tariff concessions are modified or withdrawn, and it should aim at offering compensating tariff concessions to affected WTO members.
Finally, paragraph 7 requires all countries intending to enter into a RTA to notify the Council for Trade in Goods by submitting a report concerning the respective agreement. The council will check this report and—if necessary—give further recommendations to all members. In case of an interim agreement, the report must include a schedule until formation of the RTA.

Trade in services:
According to Article V of GATS, WTO members are free to enter into an RTA liberalizing trade in services provided that such agreement has substantial sectoral coverage, and provides for absence or elimination of all discrimination between the parties (either immediately or within a reasonable timeframe). In evaluating whether those criteria are met, special consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization. Similar to trade in services, the agreement shall not raise overall levels of barriers to trade in services with members outside the agreement compared to the level applicable prior to the agreement. Finally, members of the proposed agreement have to indicate their intention to the Council for Trade in Services. For the labour market, full integration is granted if all citizens of parties to the agreement are exempted from requirements concerning residency and work permits.

Source: www.wto.org

[2] In addition to the criteria mentioned in box 1, the so-called Enabling Clause (i.e., the 1979 Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries) refers to preferential trade arrangements in trade in goods between developing countries.

Figure 1 Average weighted tariffs in Russia and Ukraine in 2001



Source: Ukrainian Ministry of Economy and European Integration, www.wto.ru.

2) First SES, then WTO:

Alternatively, Ukraine might decide to first enter the SES and only afterwards the WTO. This is the sequence that is proposed in the agreement on SES formation. However, since forming the SES changes the benchmark for negotiations on WTO accession, basically all points would have to be renegotiated on the basis of a new standstill agreement. Note that Ukraine has already completed bilateral agreements with 15 members of its WTO working party, hard-fought and significant progress that would be sacrificed if Ukraine unilaterally moves the benchmark. During the initial phase of the SES in which Ukraine still determines its tariffs independently, and if Ukraine does not substantially raise its tariffs from present levels when joining the SES, Ukraine could in principle continue its bilateral negotiations with WTO members. Nevertheless, disadvantages for Ukraine would be first, that the accession process would be delayed and would have to be coordinated with the other SES countries (according to SES statutes), and second, that compensation would have to be granted to WTO members who can demonstrate that they suffer losses as a result of any trade diversion caused by the SES. Furthermore, WTO membership would make subsequent moves to higher levels of integration within the SES (as it is clearly stated in the official documents) difficult to achieve, because – as outlined above – the specification of common external tariffs in a way that satisfies both WTO requirements as specified in box 1 and the aspirations of the four member countries, in particular Russia, will be difficult to achieve.

To sum up, due to its legal commitments in the ongoing process of Ukraine's WTO accession, formation of the SES and WTO accession cannot be realized in parallel. Thus, **policy makers have to decide which option to pursue first**. Whichever option they choose, the implications of this choice will have a strong impact on the degree to which the second option remains feasible. In particular, it appears that WTO membership – regardless of whether it will be initiated before of after formation of the SES – will impose strong disciplines on Ukraine's foreign trade system. As we argue, this will make it difficult for Ukraine to finally achieve the intended level of integration within the SES. Hence, the strategy chosen by policy makers should be based on a thorough and careful assessment of economic costs and benefits. Benefits from WTO accession such as improved market access for exports via the Most Favored Nation mechanism, access to dispute settlements, further stimulus for domestic economic reforms through commitment to international standards and practices, and an increase in foreign direct investment have been widely discussed in Ukraine.[3] For purposes of comparison, we attempt to present evidence on the potential benefits of the SES in the following section.

4. Economic impact of the SES

We concentrate on the two main arguments in favor of establishing the SES from an economic perspective, Russia's importance as a trade partner and energy prices.

4.1 Russia as a trade partner

During the last years of strong economic growth in Ukraine, trade flows have also increased substantially. However, since 1998 changes in exports to - and imports of goods from Russia have fallen significantly short of corresponding changes in trade flows with other regions (table 1).

Table 1. Ukraine's exports and imports of goods (1998 and 2002)

	1998	2002	Change (in percent)
total Exports (USD)	13699	18669	+36%
to Russia	2877	3174	+10%
to EU25*	4521	7654	+69%
to RoW**	5617	7468	+33%
total Imports (USD)	16283	17959	+10%
from Russia	7165	6465	-10%
from EU25*	4885	5567	+14%
from RoW**	3582	5388	+50%

* EU 25 includes the EU15 plus its current accession candidates

** RoW is the Rest of the World

This can be further demonstrated by changes in the pattern of Ukraine's trade flows with major trading partners in 1998 and 2002 (figure 2). During the last years of strong growth, **Ukraine's economy has diversified its trade flows away from Russia** towards its Western neighbors and the rest of the world:

[3] The IER and GAG have also initiated several studies and conferences on this topic. See Beraterpapier S14, "Ukraine´s WTO Accession: Forgotten Challenge and Benefit", or "Вступ України до СОТ: новий виклик економічній реформі." За редакцією Ігоря Бураковського, Ларса Хандріха та Лутца Хоффманна. Видавництво Альфа-Принт, Київ, 2003.

- Ukraine's exports to Russia constituted 21% of total exports in 1998 and dropped to 17% in 2002. This decline was compensated by exports to the EU and its accession candidates, whose shares increased from 33% in 1998 to 41% in 2002.
- In 1998, 44% of all Ukrainian imports came from Russia. By 2002 this figure had fallen to 36%. Over the same period, the share of imports from the rest of the world (RoW: Asia, Middle East, North/South America, Africa) increased substantially, while aggregate shares of imports from the EU and its accession candidates practically remained unchanged.

Can the decreasing position of Russia be explained by trade barriers imposed by two countries against each other? The structure of Ukraine's commodities trade with Russia is quite diverse (figure 2). Ukraine sells mainly machinery, food and metals as well as chemical products. Major imported items are fuel and energy resources as well as machinery. Due to an FTA between Ukraine and Russia (signed in 1992) most goods are already traded duty free. Nevertheless, there are also exclusions from the free trade regime:

- **Imports from Russia:** Oil deliveries to Ukraine (almost 12% of total imports from Russia) are taxed in Russia. Furthermore, the VAT taxation on oil exports to Ukraine is based on the 'country of origin' principle so that Russian oil is essentially double taxed in Ukraine. However, consumption of oil in Ukraine has increased substantially in recent years (by about 5% yoy), almost 90% of which is imported from Russia. Thus, this does not explain the dramatic reduction of Russian imports from 44% to 36% of total imports during the last 5 years.
- **Exports to Russia:** Exports of metal pipes from Ukraine to Russia are limited by a quota. Furthermore, Russia charges tariffs on imports of sugar, spirits and cigarettes (table 2).[4] Should all tariffs be removed we expect exports of pipes, spirits and cigarettes to increase.[5] However, among all those items only metal pipes account for a significant share of Ukraine's total exports to Russia (about 5.2% in 2002).

All this does not support the hypothesis that only trade barriers can explain the declining importance of Russia as a trade partner for Ukraine, especially because most goods between Russia and Ukraine are already traded duty free, which is not the case for other countries (such as the EU and its accession candidates) with whom trade has been increasing. Rather, it seems that **Ukraine's economy has diversified as a result of recent economic growth** and that in light of this development **other trading partners have become more important**. This assertion is further supported by empirical results from a gravity model that suggest that Ukraine's current exports to CIS are above their long-run potential level.[6]

4.2 Energy prices

Another expected benefit from the SES is the intended 'leveling' of internal prices for energy, which are significantly higher in Ukraine than in Russia. In particular, gas sells

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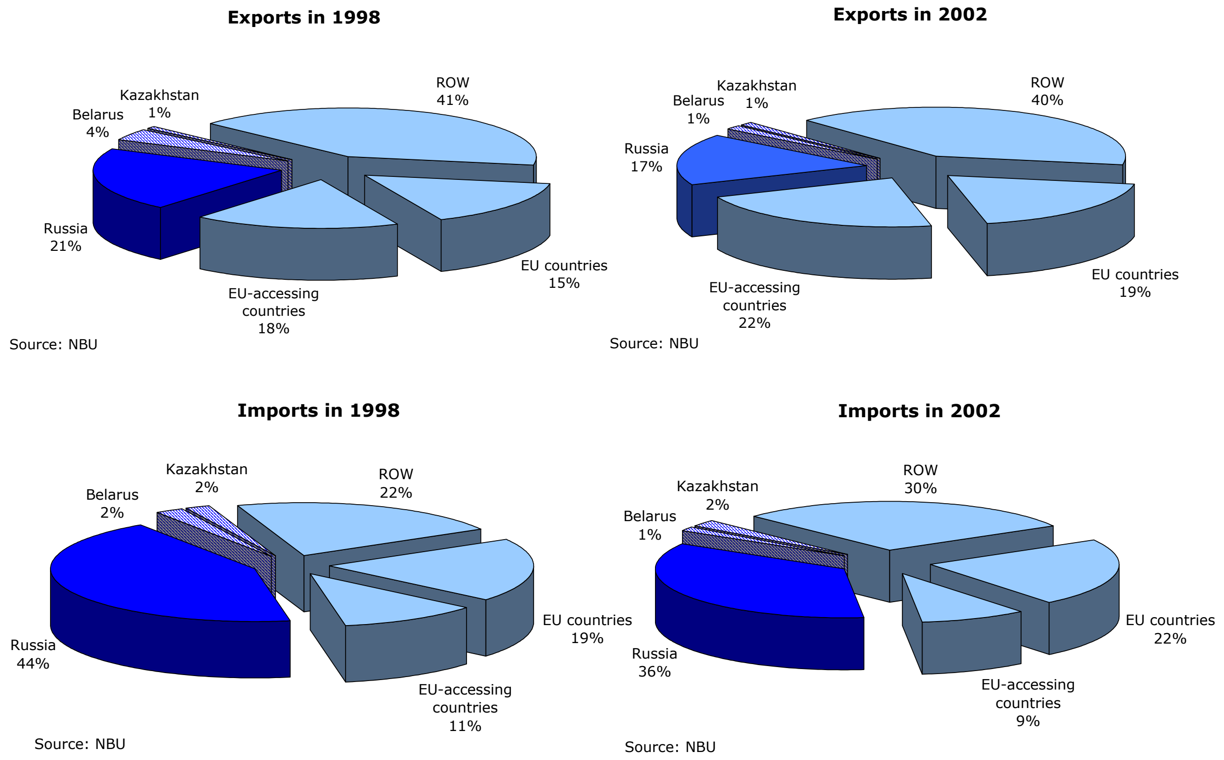
[4] Russia has also initiated several antidumping investigations against Ukrainian goods, including galvanized rolled metals, several agricultural products (poultry, caramel, sugar syrup), and a few other items.
[5] For sugar, domestic prices in Ukraine are higher than in Russia so that exports will remain at its present level close to zero.
[6] For more details see "Ukraine's WTO Accession: Challenges for Domestic Economic Reform" Edited by Ihor Burakovsky, Lars Handrich and Lutz Hoffmann, Alfa-Print, Kiev, 2003.

at prices between USD 35 to 60 per tcm in Ukraine while the average price in Russia is below USD 20 per tcm, and oil is traded at the Ukrainian Interbank Currency Exchange for roughly USD 27 per barrel (similar to the prices at New York and London Exchange) while the domestic price in Russia is slightly above USD 10 per barrel.[7] Hence, the expectation is that 'leveling' prices for energy fuels will lead to a significant drop in energy prices in Ukraine thereby increasing the competitiveness of Ukraine's economy.

Figure 2 Exports and Imports (of goods) of Ukraine by trade partner



[7] See www.gasukraine.com.ua, Ukrainian Interbank Currency Exchange, and IEA: Russia Energy Survey. Paris, 2002.

Figure 3 Commodity structure of Ukraine's trade flows with Russia

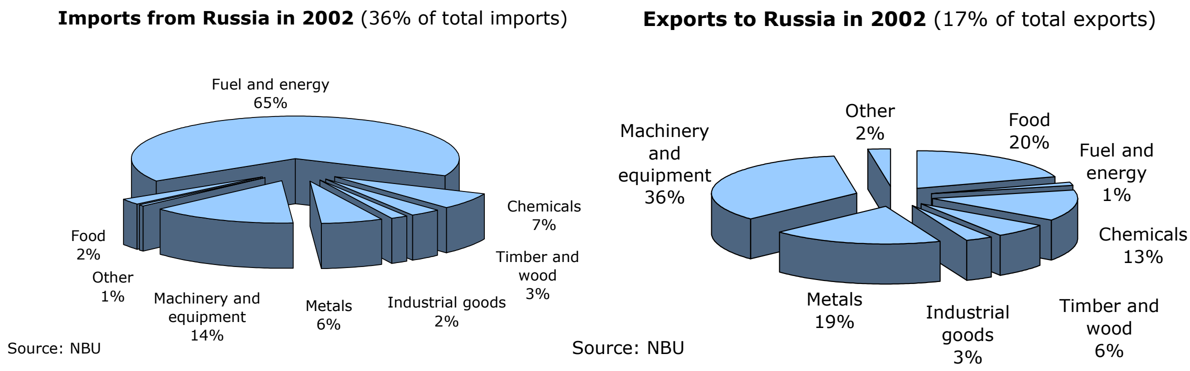


Table 2. Ukrainian exports subject to import tariffs in Russia

	Exports, 2002, th, USD	% of total exports to Russia
Steel pipes	166 955	5.24
Sugar	0	0.00
Spirit	6 879	0.22
Cigarette	925	0.03
Total	174 759	5.49

Source: Letter of State Customs Service of Russia Federation from 21.01.2003 # 01-06/1843 "About tariff exclusions from free trade", Ukrainian Ministry of Economy and European Integration.

While this might sound extremely promising, it is far from being realistic, because low domestic prices in Russia are determined by the cross-subsidization of Russia's energy sector in favor of industry and consumers rather than by competitive market forces. Thus, any leveling of prices at Russia's current level would amount to a further tax on Russia's energy sector, in this case to the benefit of Ukraine.[8] However, it appears very unlikely that Russia would be willing to impose this tax on its own energy sector to the benefit of Ukraine, especially in the light of repeated statements by the Russian government that it intents to reduce cross-subsidization in order to strengthen the global competitive position of its energy firms.[9]

Moreover, even if Russia is prepared to temporarily provide the Ukrainian economy with a subsidy in the form of fuel at domestic Russian price levels, is it in Ukraine's best interests to accept this 'gift'? Probably not. First, Ukraine's economy would become even more dependant on purely political decisions reached by a foreign government. No country is completely free or sovereign in its economic policy making, and surrendering some economic sovereignty is a worthwhile price to pay for the benefits of economic integration and specialization. But this would make Ukraine dependent in an extremely lop-sided manner, and make Ukrainian policy making exceedingly susceptible to external pressure (of the sort, for example, that is now being applied in connection with the Odessa-Brody pileline).

Second, accepting this dubious gift would completely diminish incentives for Ukraine's economy to reduce its unreasonably large energy consumption. A simple comparison

[8] Minister of Finance M. Azarov estimates the corresponding losses/forgone income of Russia's energy sector at USD 1.2b.

[9] For example, the targeted price for gas amounts for between USD 35 and 45 per tcm.

demonstrates this point: the production of one dollar of GDP in Ukraine requires the energy from 3.15 kg of oil, while in Russia it takes only 1.7 kg and the average for all OECD countries is only 190 g.[10] Against this background, artificially low prices for energy fuels cannot be seen as a blessing, especially if they are the result of foreign largesse that could be withdrawn at any time.

Nevertheless, a part of the difference in fuel prices between Ukraine and Russia is due to taxation of VAT on Russian oil exports to Ukraine based on the 'country of origin' principle. This is due to a special regulation in Russia that contradicts international practice and applies only to Ukraine (another example of the dangers of one-sided dependence). Eliminating this special procedure is certainly a legitimate expectation of Ukraine. However, this requires specific negotiations rather than forming a CU or another FTA.

5. Summary and conclusions

All in all, we find present trade relations between Ukraine and Russia to be fairly liberal, mainly due to an FTA among all CIS countries signed in 1992. Thus, the need for a second FTA between the four CIS countries is not clear. A possible intention might be to overcome the frequent failures of the existing FTA such as disputes over Ukrainian exports of steel pipes or taxation of oil imports from Russia through the ambitious level of intended integration within the SES, which amounts to formation of a CU. However, costs and benefits of such an agreement must be carefully considered in any case.

Because the already existing FTA covers almost all trade between Russia and Ukraine, we expect only modest increases in trade flows. Furthermore, we argue that expectations of significantly lower prices for energy fuels from Russia are rather unrealistic and not helpful for a sustainable development of Ukraine's economy. As for the costs, we demonstrate that the formation of such a CU and accession to the WTO <u>at the same time</u> are definitely not possible, and that the possibility of a <u>sequential</u> integration of a SES-CU within the WTO is highly unlikely. Thus, insisting on the formation of the SES means either achieving only insignificant results if the SES does not go beyond the existing FTA, or to forgo benefits from WTO membership in case a CU is to be established (as is intended by the official agreement). But, with regard to the observed diversification of Ukraine's trade flows and increased importance of trade partners other than Russia during Ukraine's current period of strong growth, establishing reliable conditions for global trade is of crucial importance. WTO membership offers such perspectives, e.g. through improved market access for exports via the Most Favored Nation mechanism, access to dispute settlements, further stimulus for domestic economic reforms through commitment to international standards and practices, and an increase in foreign direct investment. Therefore, we strongly recommend focusing on **WTO accession without further delay**.

I.B., F.P., I.E. Lector: S.v.C.-T.

Kyiv, October 2003.

[10] The International Energy Agency: Key World Energy Statistics, Paris 2002.