

## Ukraine: Door Closed?

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Throughout its period of independence, Ukraine has defined itself as a European state. Although the country has many points of division, it distinguishes itself from its proverbial “elder brother,” Russia, in lacking either a Eurasian ideology or consciousness. At the same time, geopolitics, economic interests and regional differences have dictated a careful balancing act between East and West for much of the past 22 years.

Over the same period, the Russian Federation has made no secret of the fact that it equates its own security with the limited sovereignty of its neighbors, especially those whose citizens it regards as a branch of the Russian people. Between May 31, 1997 (the date of the Russia-Ukraine State Treaty) and February 27, 2014 (the start of Russia’s military intervention in Crimea), it respected Ukraine’s territorial integrity as well as its *nezavisimost’* (Ukrainian *nezalezhnist*), its juridical independence. But it has never accepted its *samostoyatel’nost’* (Ukrainian *samostiynist’*), its ability to determine its own course, either as a norm or a fact. Since 1992, Russia has made willingness to integrate the litmus test of friendship, and it sees a direct connection between “strengthening economic links” and “secur[ing] political loyalty.”<sup>1</sup>

It should, then, cause little surprise that the Ukraine’s leaders and the majority of its political class have long regarded Russian integration projects with disquiet. What is more surprising is the paucity of steps taken to diminish Ukraine’s vulnerability to Russian pressure. Many Ukrainians who are most ardent about overcoming the Soviet legacy and “resuming Ukraine’s rightful place in Eu-

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<sup>1</sup> Dmitriy Trenin, “The CIS Project – The New Priority of Russian Foreign Policy?,” [*Proyekt SNG– noviy prioritet rossiyskoy vneshney politiki?*], February 2004 (author’s manuscript copy).

rope” have simply failed to grasp that the EU is neither, in essence, a geopolitical project nor an ethno-cultural one, but a values-based and rules-governed enterprise that seeks to deepen norms of administration, jurisprudence and business that Ukrainian governments have learnt to mimic rather than observe. While elections (most impressively the presidential election on May 25, 2014) have to various degrees passed the “free and fair” benchmark, modes of governance have been arbitrary and conflicted, modes of administration rigid and unaccountable, the legal order negotiable and the relationship between money and power opaque. These norms bind Ukraine to those who share neither its national aspirations nor its interests.

Nevertheless, the *Euromaidan* (the second *Maidan* in ten years) is a reminder that there is a counter-dynamic: a civic literacy and courage that makes the future a contest, rather than a Groundhog Day reiteration of disappointments and betrayals. Less obviously (as this author wrote in 2002), “the growth of civic instincts is [not only] sharpening the divide between state and society, it is also creating points of friction within the state and hence, a process of evolution inside it.”<sup>2</sup>

Today that evolution is dramatic, but its course is uncertain. Russia’s shadow war against Ukraine is also evolving and changing its shape. Its interest in Ukraine joining the Eurasian Customs Union (ECU) and Eurasian Union is not. As Arkady Moshes wrote a full year before these events: “The stagnation of Eurasian integration is a realistic medium-term scenario. In this case, Ukraine’s accession to the Customs Union may appear to the latter’s architects to be more critical than ever.”<sup>3</sup>

### **Economic Consequences of ECU Membership**

The balance of economic costs and benefits attendant upon Ukraine’s membership of the ECU is highly conjectural. In 2012, Ukraine’s trade turnover with the ECU was €43.8 billion (€33.7 billion with Russia) and with the EU €33.7 bil-

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<sup>2</sup> James Sherr, “Ukraine’s Euro-Atlantic Future: Is Failure Inevitable?,” (paper prepared for Danish Institute of International Affairs, September 20, 2002).

<sup>3</sup> Arkady Moshes, “Will Ukraine Join (and Save) the Eurasian Customs Union?,” Policy Memo 247, PONARS Eurasia, April 2013.

lion.<sup>4</sup> However, current trade figures provide a poor measure of future economic impact.

Joining the ECU would have immediate implications for Ukraine's terms of trade with the WTO, to which Ukraine acceded in May 2008. Ukraine's WTO import tariff is set at 5.8 percent, whereas the Common External Tariff of the ECU was notionally 10 percent in 2013 (in Russia's case 11.5 percent) and, by agreement with the WTO, is set to fall to 7.8 percent before 2020.<sup>5</sup> Whereas Russia negotiated this transitional arrangement before acceding to the WTO in August 2012, the WTO has flatly ruled out a similar transition for Ukraine. Therefore, Ukraine would find itself in violation of WTO provisions from the moment of its entry into the ECU. Moreover, the impact on its terms of trade with 159 WTO members, including the EU and China, would be stark. This would be true even if Ukraine failed to conclude an Association Agreement with the EU and establish the Deep and Comprehensive Free Trade Area (DCFTA).

Were the ECU an economic powerhouse and the WTO a zone of stagnation, the tradeoff might have merit. Yet this is hardly the case. In 2011, the ECU's first year of operation, trade between Russia, Belarus and Kazakhstan grew by 34 per cent, a figure largely explained by recovery from the 2008-9 economic crisis and the nine percent fall in Russia's 2009 GDP. In the second half of 2012, internal trade in the ECU grew by only three percent. Moreover, the impact of membership on bilateral trade has been anything but striking. As Arkady Moshes has noted, in 2011 Belarusian trade with Russia increased by 40.7 percent and Ukraine's by 36.1 percent. Both experienced a sharp decline in 2012 (by 9.4 and 10.8 percent respectively).<sup>6</sup> Membership of the zone (or independence from it) would appear to be less important than broader secular factors affecting bilateral trade.

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<sup>4</sup> European Commission, Directorate-General for Trade, "European Union: Trade in Goods with Ukraine," April 16, 2014, [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113459.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf).

<sup>5</sup> "Working Party Seals the Deal on Russia's Membership Negotiations," World Trade Organization, November 10, 2011, [http://www.wto.org/english/news\\_e/news11\\_e/acc\\_rus\\_10nov11\\_e.htm](http://www.wto.org/english/news_e/news11_e/acc_rus_10nov11_e.htm).

<sup>6</sup> Moshes, *op.cit.* p 2.

These desultory trends arise from a dissonance between “normative principles” and reality that is all too familiar in the former Soviet Union. In aspiration and appearance, the ECU is the most ambitiously institutionalized and rules-based integration project established in the former USSR since 1992.<sup>7</sup> Yet in practice, as Kazakhstan’s President Nursultan Nazarbayev observed at the October 2013 summit, it is subject to “clear politicization.” The Russian Federation accounts for 90 percent of ECU GDP, and its tariff lines provide the baseline of harmonization—to Kazakhstan’s pronounced disadvantage and potentially Ukraine’s. In contrast to the EU’s decision-making bodies, which provide a system of checks and balances, the ECU’s regulatory bodies are Russian-dominated and organized on the vertical principle. A major component of internal trade, hydrocarbon products, is excluded from the ECU provisions and continues to be negotiated on a bilateral basis. Thus, the stunning 26 percent fall in trade between Belarus and the EU in 2013 derived far less from ECU membership than the terms of the Belarus-Russia gas discount, which have brought a halt to the country’s substantial re-export of Russian oil products.<sup>8</sup>

These factors alone would explain why Ukrainian decision makers regard Russian statements about the benefits of accession with suspicion. Sergei Glazyev’s claim that Ukraine’s economy would gain \$9 billion per year is a charitable extrapolation of benefits that do not derive from ECU accession at all but from assurances that Ukraine’s energy tariffs would fall from an extortionate \$480 per tcm high to a more friendly sum—though Belarus only secured its \$165 price after ceding ownership of its gas transit system (something Ukraine has no intention of doing), and Ukraine’s previous \$100 discount, secured in April 2010, had only a momentary effect on the upward trend in prices. Until Yanukovich concluded his final bilateral trade deal with Russia on December 17, 2013, Ukraine was paying one of the highest gas prices in Europe.

That economic sectors dependent on the Russian market will benefit from ECU membership is undeniable. But to what extent and for how long? Much of Ukraine’s higher-tech and defense-oriented industry is at a competitive disad-

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<sup>7</sup> Rilka Dragneva and Kataryna Wolczuk, *Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?*, Chatham House Briefing Paper REP BP 2012/01, August 2012.

<sup>8</sup> *Belarus Digest*, 27 May 2013 <<http://belarusdigest.com/story/other-pole-13977>>

vantage to the EU, and the chairman of *Motor Sich* has stated that Ukraine's entry into the EU's Deep and Comprehensive Free Trade Area would mean "instant death."<sup>9</sup> Yet the fact remains that Ukraine's higher-tech sectors are not high-tech sectors, and it is the EU and other OECD economies that are sources of new technology, modernization and long-term growth. In contrast, the ECU represents the accelerated integration of declining markets, and that could prove to be a fatal attraction.

### Guile and D eb acle

The corollary to the December 1991 Belovezhskie Accords establishing the CIS—which Ukraine's first president, Leonid Kravchuk termed a "civilized divorce"—was Ukraine's determination to become a "full member of the European family of civilized nations."<sup>10</sup> Yet it was Kravchuk's successor, Leonid Kuchma, who gave this "strategic challenge" institutional coherence. Unlike Viktor Yushchenko, who viewed European integration as a "civilizational choice," Kuchma and Yanukovych viewed it in pragmatic terms: as an economic opportunity and geopolitical necessity. Both Kuchma and Yanukovych believed that a multi-vector policy was necessary to this end.

But there the comparisons end. For Kuchma, the multi-vector policy (and a "strategic partnership" with Russia) was a dynamic policy intended to secure Russia's gradual consent to a Euro-Atlantic course designed by stages to integrate Ukraine with NATO and the EU. It was also intended to buy time for Ukraine to establish the *samostiynist'*—the political, economic, institutional and civic effectiveness—to advance a course that Russia deeply opposed. For Yanukovych, it was a policy of equidistance, a key component of which, the "non-bloc policy," ruled out NATO membership. Despite the "subjective" (i.e. corrupt) interests inside the Kuchma system, the focus of Kuchma's policy was the Ukrainian national interest, and his first term (1994-99) was marked by a pace and intensity of state building that impressed Ukraine's Western partners. Under Viktor Yanukovych, the national interest was simply a variable in the

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<sup>9</sup> Robert Coalson, "Oligarchs Give Ukraine's President Crucial Support in EU Drive," *RFE/RL*, September 12, 2013.

<sup>10</sup> Volodymyr Horbulin, Secretary of the National Security and Defence Council of Ukraine, 1996-9, "Ukraine's Place in Today's Europe," *Politics and the Times* (journal of the Foreign Ministry of Ukraine), October-December, 1995, p. 15.

quest to consolidate power. Whereas Yushchenko partially de-professionalized the state he inherited—and did so errantly rather than consciously—Yanukovych commercialized the state and hollowed it out. In other words, whereas Kuchma sought to link internal and external goals, Yanukovych's internal and external goals were contradictory and, in the end, incompatible.

It was on this narrow and specific basis that Yanukovych, following his election in February 2010, grasped the opportunity provided by the EU's Eastern Partnership to negotiate an Association Agreement and DCFTA, which the EU and Ukraine duly initialed in December 2011. Yet on November 21, 2013, Yanukovych abruptly terminated preparations, by then well advanced, to sign the Agreement at the impending Vilnius summit. Instead, on December 17, he concluded a broad range of accords with Moscow. This *volte face* has led many to conclude that Yanukovych from the start had cynically used the Association process as a means to secure favorable terms from Moscow.

Yet the policy record in Kyiv and Moscow does not support this conclusion. Yanukovych viewed the Kharkiv accords and the law on non-bloc status of April and July 2010, respectively, as pre-emptive steps to remove Russia's major points of grievance against Ukraine and diminish pressure upon it. Instead, they had the opposite effect, intensifying Russian pressure, in Medvedev's words, to "synchronize the development of socio-economic relations."<sup>11</sup> Instead of drawing Ukraine closer, Russia's insistence that the accords were "only the beginning" provided an impetus for the EU Association negotiations and, more discreetly, for reopening channels of communication with NATO.<sup>12</sup>

That Yanukovych adopted a cynical approach to the Association Agreement is not in question. For him, Association was a "political resource rather than a blueprint for change," and implementation was something to be pursued *à la carte*.<sup>13</sup> Far from intending *not* to sign, he believed that Western geopolitical interest and the time-honored practices of maneuver and moral blackmail would secure EU signature and ratification. He also believed, despite the firmest ad-

<sup>11</sup> Vladimir Socor, "Medvedev's Second Visit Pulls Ukraine Closer to Russia," *Eurasia Daily Monitor*, vol. 7, issue 99, May 21, 2010 (Washington, D.C.: Jamestown Foundation).

<sup>12</sup> James Sherr, *The Mortgaging of Ukraine's Independence* (REP BP 2010/01, Chatham House, August 2010), p. 10 *passim*.

<sup>13</sup> James Sherr, *Ukraine and Europe: Final Decision?* (Russia and Eurasia 5/2013, Chatham House, July 2013), pp. 8-9.

monitions from both Brussels and Moscow, that EU Association would be consistent with partial adherence to the provisions of the ECU. His inner circle, whose insularity, ignorance and servility cannot be overestimated, fed these illusions until close to the end.

Consistent with these objectives, Ukraine secured ECU observer status in June 2013. In its proposed text, Ukraine's MFA included all the established safeguards: "equality and mutual respect," amendment "by mutual agreement," entry into force "upon ratification" (rather than signature), provisions for withdrawal and publication of the agreement in the two state languages, Russian and Ukrainian. All of these provisions were summarily rejected by Moscow.<sup>14</sup> These fresh reminders of brotherly sentiment accelerated efforts to bring Ukrainian legislation into line with EU requirements.

Only in October 2013 did the learning curve catch up with reality. The immediate reality was Ukraine's exclusion from capital markets and imminent risk of default.<sup>15</sup> The second was the flat contradiction between IMF hard conditionality and the system of power (which made efforts to soften EU conditionality beside the point). The third was Russia.

Russia's terms of assistance, accepted on December 17, were a vise. The package, \$15 billion dispersed over three years, superficially resembled the IMF package in size, in obligations for repayment and a mechanism of review. Superficially, it was also more generous, since it provided what the EU and IMF could not: a one-third discount on gas prices. But fundamentally, the two packages differed. "When a country borrows from the IMF, it agrees to adjust its economic policies to overcome the problems that led it to seek funding in the first place."<sup>16</sup> When Ukraine borrowed from Russia, it agreed to co-management of the commanding heights of Ukraine's economy. To state the obvious, the December 17 accords were not customs agreements, but integration agreements that

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<sup>14</sup> For a line-by-line comparison of the texts (in Russian), see *Zerkalo Nedeli* [Mirror of the Week], June 1, 2013, <http://zn.ua/ECONOMICS/kabmin-obnarodoval-tekst-memoranduma-s-tamozhennym-soyuzom-123301.html>.

<sup>15</sup> On Yanukovich's culpability, see Anders Åslund, "Ukraine's President Yanukovich Opts for Robber Capitalism," Peterson Institute blog, November 21, 2013, <http://blogs.piie.com/realtime/?p=4107>, and James Sherr, "Ukraine is in a Dangerous Situation," *Kyiv Post*, December 23, 2013.

<sup>16</sup> "Factsheet: IMF Stand-by Arrangement," <http://www.imf.org/external/np/ext/facts/sba.htm>

well exceeded the ambit of the ECU. Why did Yanukovich find these conditions less onerous than the reforms mandated by the IMF and EU?

Part of the answer is pressure. In August 2013, the Kremlin leaked the summary of a report drawn up by Sergei Glazyev on the vulnerabilities of Ukraine's economy.<sup>17</sup> At their November 12 meeting in Sochi, Putin described what would follow in practice if Yanukovich signed the text in Vilnius, highlighting the consequences for financial interests closest to him personally.<sup>18</sup> For its part, Russia was offering terms that would finance Yanukovich's re-election and leave most of his patronage network intact. Accepting this poisoned chalice was a historic miscalculation, and its consequences are now history. Had Yanukovich signed the Vilnius accord and agreed the IMF package, he probably would be in power today.

### Division and Consensus

At no point in Ukraine's 22 years of independence has support for integration with Russia or its CIS partners commanded a plurality of national support. Yet, as one would expect, the issue has brought out pronounced regional divergences. They are not the only ones that matter. A poll taken by the Kyiv-based Razumkov Centre in April 2013 revealed a stronger preference for ECU accession amongst Russian speakers, the elderly, the less prosperous and less educated.<sup>19</sup> Even adherents of ECU accession regard it as a way of "restoring what had been lost" rather than modernizing the country and its institutions.<sup>20</sup>

Public opinion has been geopolitically sensitive as well. Historically, NATO polarized the country, and the EU did not. Before the EU became an issue in Ukraine's relations with Russia, support for accession ran well above 50 percent, with a large proportion of the remainder favoring closer integration with both

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<sup>17</sup> "The Complex of Measures Required to Enmesh Ukraine in the Eurasian Integration Process: Internal Policy" [*O komplekse mer po vovlecheniyu Ukrainiy v evraziyskiy integratsionniy protsess – vnutrennyaya politika*] *Zerkalo Nedeli* [Mirror of the Week], August 10, 2013, [gazeta.zn.ua](http://gazeta.zn.ua).

<sup>18</sup> See *inter alia* Inna Bogoslovskaya interview with *Ekho Moskvii*, December 5, 2013.

<sup>19</sup> Rikna Dragneva-Lewrs and Kataryna Wolczuk, "Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?," *National Security and Defense*, no. 4-5, 2013, [http://www.razumkov.org.ua/eng/files/category\\_journal/Zhrnl\\_EC\\_2013\\_e\\_site\\_rdc\\_94-132.pdf](http://www.razumkov.org.ua/eng/files/category_journal/Zhrnl_EC_2013_e_site_rdc_94-132.pdf), p. 104.

<sup>20</sup> *Ibid.*, p. 103.

the EU and Russia. But by April 2013, the proportion favoring EU accession had dropped to 42 percent, with 33 percent favoring the ECU and 12 percent opposing either option.<sup>21</sup> Russia's "hybrid war" appears to have shifted these polarities. In March 2014 a consortium of four opinion research centers put support for EU integration at 52 percent (up from 45-47 percent in January) and support for ECU accession at 27 percent (down from 36 percent in January).<sup>22</sup>

The position of Ukraine's oligarchs is rather different. With few exceptions, they are widely perceived to be the most formidable obstacle to the establishment of a rules-based and open market economy in Ukraine.<sup>23</sup> Rinat Akhmetov, Dmytro Firtash, and Ihor Kolomoyskiy are key stakeholders in the system of informal government-business ties that characterize the prevailing economic system. Justly or otherwise, they have often been accused of devious and brutal measures to expand business holdings and maintain them.

Nevertheless, the majority of Ukraine's oligarchs support closer ties with the EU and oppose ECU membership.<sup>24</sup> Their businesses are overwhelmingly export orientated, and their horizons are global. Metals and minerals, which make up 50 percent of Ukraine's exports, are not subject to customs fees under WTO rules which, as already noted, would be breached if Ukraine entered the Customs Union. Moreover, Russian competitors, who benefit from subsidized energy and interest free loans, do not operate on a level playing field in Ukraine, and it is widely perceived that entry into the ECU would remove the safeguards that currently restrain predatory behavior. Rightly or wrongly, the oligarchs

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<sup>21</sup> *Ibid.*, p 103.

<sup>22</sup> "Rezultaty Sotsiologichnoho Doslidzhennja Elektoralni Orijentatsiji Ukrajintsiiv," SO-CIS, March 26, 2014, <http://www.socis.kiev.ua/ua/press/rezultaty-sotsiologichnoho-doslidzhennja-elektoralni-orijentatsiji-ukrajintsiiv.html>.

<sup>23</sup> Amongst the partial exceptions are Viktor Pinchuk (Kuchma's son-in-law, founder of Interpipe and a supporter of PM Arseniy Yatseniuk), Serhiy Taruta (former co-chairman of the Industrial Union of Donbas and, since March 2014, Governor of Donetsk Oblast) and Petro Poroshenko himself.

<sup>24</sup> Exceptions can be found inside the defence-industrial complex and those, like Oleksandr Yefremov (former governor of Luhansk Oblast and leader of the Party of Regions parliamentary faction 2010-13). A more arguable exception is Dmytro Firtash, whose energy interests benefit from arbitrage, and whose chemical industries benefit from cheap energy. See Margarita Balmaceda, *The Politics of Energy Dependency: Ukraine, Belarus and Lithuania Between Domestic Oligarchs and Russian Pressure, 1992-2010* (University of Toronto Press, 2013).

perceive that their informal rule-setting prerogatives will survive EU Association.<sup>25</sup>

### A Fresh Start?

It would be presumptuous to give voice to the millions of Ukrainians who elected Petro Poroshenko with an absolute majority on the basis of a 60.3 percent national turnout.<sup>26</sup> After three months of interim (and often conflicted) authority, economic crisis and insurgency, it would be rash to assume that the only thought on voters' minds was to fulfill the aspiration of the Euromaidan and change the system of power in Ukraine. In systemic terms, Poroshenko distinguished himself by his personal, financial and media support of the Maidan, by his absence from the February 21, 2014, EU-brokered negotiations with Yanukovich and by his unequivocal stance on Europe. Yet he came to prominence in the 1990s with the backing of Mykola Azarov, who appointed him chairman of the National Bank in December 2012, and for reasons that have yet to be explained, his March alliance with Vitaly Klychko was secured with the blessing of Dmytro Firtash, whose extradition from Austria is sought by the United States. Although he will govern on the basis of the parliamentary-presidential constitution of 2004, his inaugural address left little doubt of his decisiveness and authority.

Especially decisive, and perhaps surprising, was his announcement that the remaining chapters of the EU Association Agreement should be signed by June 27, 2014. This will end all appearance of delay and equivocation (the political chapters signed on March 21 comprising but two percent of the whole). By taking this step, Poroshenko wants Europe, Russia, and his domestic opponents to know that Ukraine no longer sits on two stools and that the door to ECU accession is now closed. Yet it also would appear to be the opening move in what will be a tenacious struggle for authority with Rinat Akhmetov, for whom two

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<sup>25</sup> Slawomir Matuszak, "How Ukrainian oligarchs view integration with the EU and Russia," Centre for Eastern Studies (OSW), Warsaw, September 9, 2011.

<sup>26</sup> However, the "national" figure excludes those constituencies where elections did not take place, specifically 17 of 22 constituencies in Donetsk and 8 out of 12 constituencies in Luhansk. Tadeusz Olszanski and Agata Wierzbowska-Miazga, "Poroshenko, President of Ukraine," OSW, May 28, 2014.

stools have been as important as two lungs.<sup>27</sup> The question today is whether the national interest will guide that struggle or be hostage to it.

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<sup>27</sup> Hennadiy Lyuk, "The Games of Putin and Akhmetov," *Ukrainska Pravda*, May 16, 2014, English version at <http://euromaidanpr.com>.