



EXCERPT FROM THE EUROPEAN UNION EASTWARD: CONSEQUENCES FOR UKRAINE



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The beginning of official negotiations between the EU and the first wave of countries applying for membership(1) in this most powerful integration union in the world, and the determination of contenders for the second wave of membership(2), have placed complex problems before Ukraine. What will the economic and political consequences of EU enlargement to the east be? How will this influence the prospects for Ukraine's European direction of development? Will the selective process of enlargement to the east not lead to a new economic division of Europe, and the construction of a veritable economic barrier on Ukraine's western borders? These questions are well-founded, given that the Common Strategy of the European Union toward Ukraine, actually denied Ukraine pretensions for rapid integration into the structure of the EU, despite all the diplomatic gestures contained in its language. For the foreseeable future, Ukraine will have to resolve far less ambitious issues — achieving membership in the World Trade Organisation (WTO), and fulfilling all the obligations appropriated according to the Agreement on Partnership and Co-operation of Ukraine with the EU and its member-states. Only then will it become possible to begin negotiations on the creation of a free trade zone, and Ukraine's admission as an associate member of the European Union.

Clearly, it is very difficult today to provide exact and detailed answers to all of the questions posed. One can only make an approximate assessment, and mostly with respect to the direct, short-term factors of this process. Even a perfunctory analysis of this problem indicates that we will have to deal with a rather complex process which combines both positive and negative aspects for Ukraine.

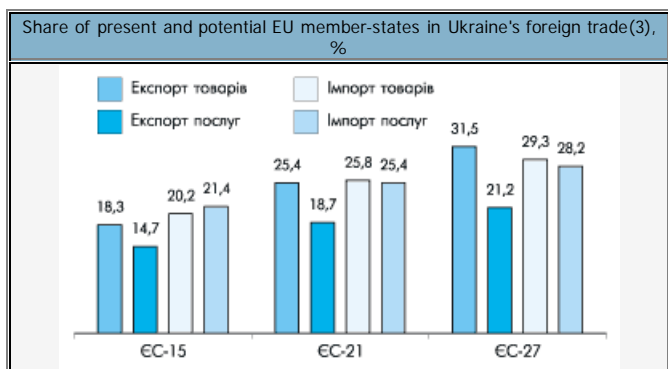
The positive influence of EU enlargement to the east lies, above all, in that it will definitely lead to a substantial strengthening and increasing the trade potential between Ukraine and the EU (see Diagram).

Calculations demonstrate that after the first wave of EU enlargement, the share of its member-states in Ukraine's foreign trade would grow by 38.8% for the exports of goods, while for the exports of services, the figure would be 27.2%. For imports, the figures would be 27.7% and 18.7%, respectively. The second wave of enlargement might increase the share of the EU in Ukrainian exports of goods by another 24%, while for services, the figure would be 13.4%; with respect to imports, this additional increase would amount to 13.6% and 11%, respectively. In general, as a result of the enlargement, the EU goods market has all chances of becoming Ukraine's main market, while the market of the CIS countries will take the second place.

(1) This group includes Cyprus, the Czech Republic, Estonia, Hungary, Poland, and Slovenia.

(2) The second wave is comprised of Bulgaria, Latvia, Lithuania, Malta., Romania, and Slovakia.

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However, the effect of the enlargement on the services market will be significantly smaller(4).

Second, the implementation of a single trade regime in the new EU member-states will lead, in most instances(5), to a lowering of import tariffs for the new EU members, since the latter should introduce a single European customs tariff rate in their countries. In addition, these countries will introduce the current EU General



System of Preferences. The overall results will be improved conditions for the entry of Ukrainian exporters into the markets of the new EU members.

Third, EU enlargement will lead to introduction in the new EU member-states of more developed institutions of market regulation which will result in an increase in trade. Inclusion of those countries into the system of European Law will, without a doubt, ease conditions for the commercial activity of Ukrainian exporters and importers on their markets, decrease expenditures on implementing foreign trade agreements and, therefore, increase competitiveness of domestic goods. On the other hand, the introduction of a better defined system of regulation can lead to a partial decrease in smuggling, illegal migration(6), and other shadow activities, which would have a definite positive influence on Ukraine's state budget.

Fourth, the enlargement of the EU along with a single currency system would lead to the increase in the use of the Euro in Ukraine's foreign economic relations and, therefore, to a partial weakening of the one-sided dependence of Ukraine's Hryvnia on the U.S. dollar. A more active use of the Euro (focusing on that currency when deciding exchange rate policy) can become the factor that ensures greater predictability in Ukraine's currency policy, and a decrease in currency risks for Ukrainian companies that trade with EU countries. Also, this would be a clear sign of Ukraine's greater orientation toward the norms and requirements of the EU.

Fifth, given the tighter political ties between Ukraine and its neighbours(7), as compared with the majority of present-day EU members, Ukraine can achieve greater influence over the process of approving EU decisions that are advantageous to it. This applies, in particular, to the assessment of Ukraine's fulfillment of the obligations it has taken upon itself under the Agreement on Partnership and Co-operation, and its easier access to European funds.

At the same time, enlargement of the European Union to the east will also have certain

(3) The Diagram is based on Ukrainian foreign trade data for 1999, and does not take into account the future creation of additional possibilities for trade with the EU and the overall tendencies over the last years toward increasing the share of current EU members and decreasing the CIS share and, to some extent, the countries of Central and Eastern Europe in Ukraine's trade.

(4) This is connected with the dominant position of the export of transport services to Russia which comprises 60% of all exports of services

connected with the dominant position of the export of transport services to Russia which comprises 60% of all exports of services. Such a positive effect is clear, particularly with respect to Poland where through agreements reached at the Uruguayan round of negotiations within the framework of the WTO, an average import tariff of 9.9% was implemented at the time when the average rate for the EU should not exceed 6.6%, even with the system of protectionism measures taken into account. There will be, however, virtually no positive effect from the lowering of tariffs in trade with the Czech Republic and Slovakia since, even without this, they have low import tariffs. Trade with, say, Estonia, will have the opposite effect, whereby the import regime can become significantly tougher, besides, since Estonia had introduced an unusually liberal national import regime with a 0.5% customs duty level, and its membership in the EU can mean that its agreement on free trade with Ukraine may lose its validity.

(6) The last is mostly related to requirement to candidates for EU membership to introduce visa regimes in their countries with respect to non-member states (which is a necessary precondition for their participation in the Schengen Agreement on unrestricted movement of citizens within the European Union, and the introduction of European standards for labour force regulation).

(7) Poland can play a special role in this instance, as one of Ukraine's true, rather than declarative, strategic partners.

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negative effects for Ukraine's economy. Among them, the following ones can be expected.

- With the admission of new EU members, EU regulatory norms with respect to individual "sensitive" sectors of the economy will apply to them: metallurgy, the textiles industry, where at present, quantitative limitations (quotas) are in use, and the agricultural sector, with its developed arsenal of protective measures and collective subsidising. Therefore, increasing the level of non-tariff protectionism will have its definite effect. However, the influence of these measures on Ukraine's economy will be limited due to the following reasons: (a) the general tendency toward the liberalisation of import regulations in the EU as a result of measures within the framework of the WTO, including with respect to the agricultural sector; (b) the tendency toward the greater application of current European quotas with the prospects of having a significantly more liberalised regime for the trade of metals and textiles on the EU market as early as 2002.
- The admission of new EU members can increase their competitiveness in comparison to Ukrainian suppliers to separate EU markets, such as the metals market (Poland, Slovakia), textiles (virtually all contender countries), agricultural production (Hungary), foodstuffs (Poland, Hungary, Bulgaria), beverages (virtually all contender countries). Furthermore, given the high rates of restructuring the machine-building sector in Poland, Hungary, the Czech Republic, and Slovenia, the prospects for Ukraine entering the corresponding EU markets can worsen significantly, if no measures are taken to establish co-operation with new EU member-states.



(8) In 1999, in Ukraine's exports into Poland, iron ores and concentrates made up 28.1%, 9.6% fell on gas and gaseous hydrocarbons, 6% — electricity (these three export items accounted for 43.7% of total commodity exports); in exports to Hungary, 16.1% fell on crude aluminium, 11.1% — electricity, 9.2% — timber (three items accounted for 36.4% of total commodity exports); in exports to the Czech Republic, 43.3% were iron ores and concentrates.

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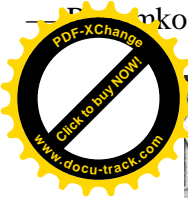
for foreign investors, and lead to the reorientation of foreign direct investments, from Ukraine to new EU members.

Ukraine's trade volumes with present-day contenders for EU membership have lately shown a tendency to decrease. This should be taken into consideration when planning new mechanisms which could potentially limit mutual trade, as well as when evaluating the possible positive consequences of EU expansion. For instance, in 1999 alone, as compared to the previous year, Ukraine's exports to Estonia decreased by 11.1%, to Poland — by 3.7%, to Slovenia — by 25.1%, to the Czech Republic — by 17.5 %, while the same indicators for imports were 38.9%, 46.8%, 38% and 37.1%, respectively. To this should be added that imports from Hungary decreased by 36.2%. The significant asymmetry in the trade decrease points to the fact that the positions of the countries of Central and Eastern Europe on the Ukrainian market are far more vulnerable than Ukraine's positions on the markets of Central and Eastern European countries.

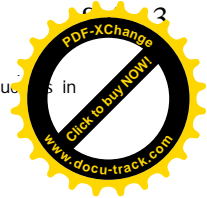


- With the entry of new members into the EU, a single system of European technical standards and consumer safety standards will come into place in these countries. This, without a doubt, will complicate the supply of machinery, equipment, any high-tech products, including components for joint assembling, from Ukraine to the indicated markets.
- EU membership will also mean that the anti-dumping rules and practices will be introduced in the new member-states, which (under conditions of the retention of Ukraine's present status of a non-market economy) would mean the greater application of anti-dumping proceedings and restrictions to Ukraine.
- The introduction of visa regimes in contender countries with respect to Ukraine's citizens (and, respectively, the introduction of a visa regime on the part of Ukraine) can limit the number of private business trips between countries, and increase expenditures for implementing foreign economic agreements, which can negatively impact the volumes of mutual trade and investments. At the same time, Ukrainian export with its present structure is unlikely to suffer significantly, since Ukraine has been concentrated on those positions which make up, using the Ukrainian terminology, the critical imports of our foreign partners(8). Meanwhile, the competitiveness of companies from contender countries on the Ukrainian market can become, to a large extent, weakened, since their significant share is taken up by relatively inexpensive (as compared with Western European) consumer goods. Thus, the existing deficit of trade with Ukraine for our Central European partners can increase. But this will, evidently, also do injury to Ukrainian small business which is active in the area of import trade, and with this, also creates a significant number of jobs.
- With their entry into the EU, new member-states will take on the obligations of granting privileges to developing countries according to the General System of Preferences effective within the European Union. That is, developing countries will gain greater access to these markets, which will improve their competitive positions. Considering that such privileges will be higher than Ukraine can take advantage of, in the end, this can lead to the weakening of the competitive positions of Ukrainian suppliers.
- The membership of the new members in the EU, and the related liberalisation of their investment regimes, will make them more attractive

- Will the enlargement process be successful, and will it be possible to avoid the negative effects of this process for the EU? Clearly, serious complications will have an apparent negative influence not only on Ukraine's prospects for EU membership, but also on its possibilities to utilise European funds and credit lines for financing structural reforms. Ukraine can be kind of pushed aside by the EU's new members, who will "eat up" the greater share of EU funds that are meant to accomplish the goals of structural adaptation and regional development.
- What kind of structural evolution will the economies of the new EU members see, and in what areas will these countries be able to increase their competitiveness? In the event of an increased pace in the development of high-tech branches and industries, new possibilities appear for deepening co-operation between them and Ukraine, with the active reliance on the advantages of intra-branch co-operation.
- What model for future mutual relations will the EU propose to Ukraine for what will clearly be a long period until Ukraine acquires EU membership? If the discussion concerns only a free trade zone, this will evidently have a limited (and not always positive) influence on Ukraine's economy. The positive effect will be far greater if Ukraine is involved in European sectoral co-operation projects, including in science-intensive branches.
- What will be the new geo-economic and geopolitical balance of power on the European continent after plans of EU expansion are implemented? The discussion



of European integration. This, however, directly depends on Ukraine's success in reforming its economy based on market principles.



The more long-term consequences of the EU's eastward expansion will depend on a number of important factors whose impact is hard to predict today. The following issues are the most significant in this respect.

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