

Russia's Concerns for the EU-Ukraine Association: Myths and Realities

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Abstract Reaction of Russian Federation to the EU-Ukraine Association Agreement and the Deep and Comprehensive Free Trade Area (DCFTA) as a part of it is a significant challenge for Ukraine. A great majority of Russia's concerns can be questioned or be easily solved by legal instruments. Instead Russia practiced hard negotiations in a form of economic war against Ukraine. Hypothetical and practical concessions to Russia related to the Association Agreement implementation are discussed. We pay special attention to raising competition for Russian exports as a possible motivation for actions of Russia. The paper studies two possible motivations in details. The first one is the possibility of increased competitive pressure of Ukrainian exports to the EU on Russian exports to the EU because of the EU preferential treatment for Ukraine (competition in the EU market). And the second one is the possibility of increased competitive pressure of the EU exports to Ukraine on Russian exports to Ukraine because of Ukraine's preferential treatment for the EU (competition in Ukrainian market). We compare trade structures of bilateral exports of the three countries to estimate the possibility of such motivations. Our calculations show that increase in competitive pressure on Russian exports is rather low. Our research provides the evidence in favor the presumption that economically the EU-Ukraine DCFTA is only a minor challenge for the Russian economy, and hard approach to Ukraine is rather a political decision of Russian authorities. Return to non-confrontation regime can be mutually beneficial for Ukraine, the EU and Russia.

Keywords Economic integration - European integration - Free trade
Trade diversion - Third country effects

JEL classification F15

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1. Introduction

The EU-Ukraine Association Agreement (AA) and the Deep and Comprehensive Free Trade Area (DCFTA) as a part of it became a milestone in European integration process of Ukraine. Despite Ukrainian economy is disproportionally smaller than the EU economy, Ukraine is one of the biggest European nations, and the EU is one of the two main trade partners of Ukraine. Being a large and detailed document AA combines free trade area (FTA) in goods and incompletely increases freedom for movement of services, capital, intellectual property rights, and labor. Under normal and optimistic scenarios with investment inflows and territorial integrity benefits of AA for Ukraine offset costs for restructuring its economy at least in the middle and long-term perspective. But a significant challenge for DCFTA implementation is the reaction of Russian Federation, Ukraine's another traditional main trade partner.

In this article we aim at defining main specific features of DCFTA, reaction of Russia on DCFTA preparation and perspective implementation, and possible future scenarios. We also estimate and compare possible losses of Russia in case of DCFTA implementation and costs of its hard treatment of Ukraine in order to prove or reason away economic motivation for Russia's position and its evolution.

2. Previous research review

There several previous studies of this issue. M. Dabrowski and S.Taran (2012) expected that despite DCFTA would offer net benefits for the EU and Ukraine, potential gains and adjustment costs would be larger for Ukraine as a smaller and more open economy than the EU.

In Oxford Economics (2012) they consider possible effects of various scenarios of European integration of Ukraine (classic FTA, DCFTA, customs union). Their estimation shows that DCFTA is the most beneficial scenario for Ukraine (the GDP gains would amount to around 4.3% partially because of greater regulatory harmonization). They also discuss four potential economic effects of DCFTA on Russia:

- an increase in competition for Russian firms exporting to Ukraine;
- an increase in competition between Russian and Ukrainian goods in EU markets;
- a change in the direction of flow of Ukrainian exports;
- a change in direction of capital flows.

According to their estimations, Russia accounted for 10.5% of the EU imports in 2010, while Ukraine accounted only for 0.8%. And the only Russia important industry that may face increased competition under DCFTA is metallurgy. As for the Ukrainian market, around 230 categories of products of 4700 imported ones by Ukraine can be affected by the DCFTA, but they accounted for only 5% of Russian total exports to Ukraine. They

include some food products (coffee and chocolate, some types of pastry, margarine, canned food, etc.) and some industrial products (hair care materials, pneumatic tires, oxide magnesium, copper wire, distribution plates etc.).

O. Shnyrkov (2013) in its previous research argues that Russia has significant trade influence on economic development Ukraine, and even can cause an economic crisis. Thus the positive effects of DCFTA with the EU would not compensate in full the losses of the Ukrainian economy under restrictive trade measures by Russia during the first 3-4 years. The main factor of possible negative impact is a gas price. Without solving this problem, launching AA in 2013 might be delayed. But effects of DFTA would depend on the depth of the integration with the EU, forms of reactions, the effectiveness of adaptation of the Ukrainian economy. FTAs with the EU and the CIS are treated as the first best choice, while other models of regional integration without AA are considered as the second best scenario, which would restrain the restructuring and modernization of the economy, especially in the medium and long term.

M. Emerson (2014) states that fears expressed by Russian leaders about DCFTA's harmful nature for Russia seem unfounded, but still they intended to provide a legal basis for punitive action against Ukraine. Hypothetical Pan-European FTA (PEFTA) is discussed. It can be an agreement between the EU and the Eurasian Economic Union, which may also include DCFTA and EFTA states. Arguments of Russia that this would disproportionately benefit the EU are contested. Despite the fact that the EU uses lower tariffs on its main commodity imports from Russia than the tariffs that Russia uses for imports from the EU, this agreement is relatively more important for Russia and may stimulate its modernization, while it would be of marginal benefit for the EU.

P. Havlik (2014) argues that if Russia uses trade barriers as a punishment for Ukraine it would hit more advanced part of Ukrainian economy, such as transport equipment and machinery, which is located largely in the eastern part of the country, immediately and disproportionately, while this part of Ukrainian exports is largely not competitive on the EU markets. Alternative EurAsEC Customs Union (CU) integration of Ukraine would help those industries to survive but would leave them without restructuring and modernization pressure.

S. Berenda (2014) states that DCFTA uses functional approach unlike the EurAsEC institutional approach. Under DCFTA Ukraine partially joins *acquis communautaire* and thus obtains partial EU membership *de-facto* without ordinary institutional mechanisms of membership. He also argues that the EU-Russia relations would depend more likely upon the concept of establishment of the Trans-Atlantic FTA and not upon the FTA from Lisbon to Vladivostok. Thus Russia tries to keep Ukraine within its area of influence. He also questions the primacy of historical specialization and cooperation determining economic integration in the Post-Soviet area advocated by Yu.S. Glaziev. The optimal

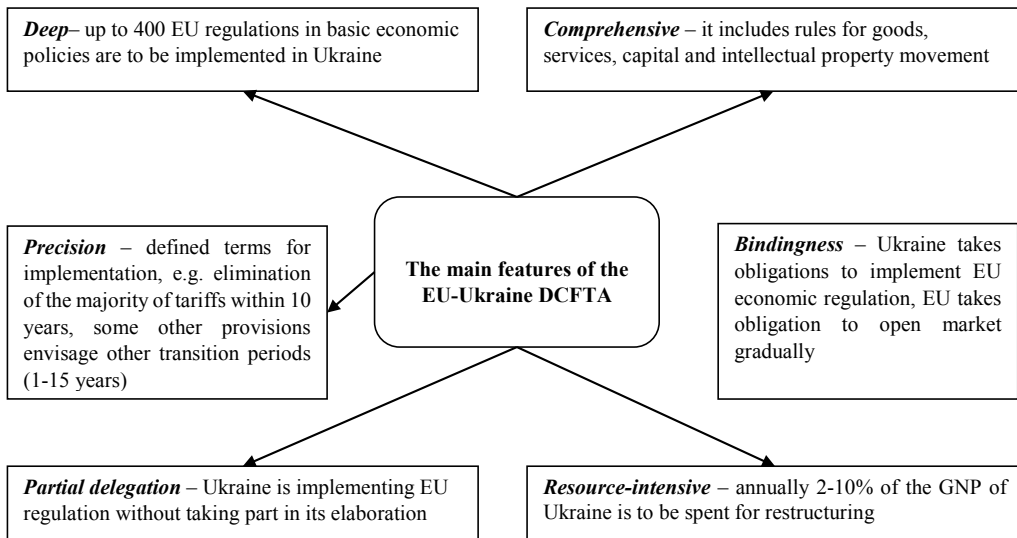
scenario for Ukraine would be establishment of Eurasian economic area from Atlantic to Pacific ocean, but with preserving sovereignty and without domination of any single center. Deepening cooperation of Ukraine with the EurAsEC CU without membership in it can be achieved by better customs cooperation and liberalization of trade in services. Signing AA is necessary at least with step-by-step implementation of its components.

S. Kulik et al (2014) argue that under further worsening of economic relations with Russia and the EurAsEC CU, Ukraine's losses may reach \$33 billion annually in the next years. Russia's losses would be high as well. They state that the advantages of DCFTA would appear mostly only in the long-term perspective and the previous estimated effect should be recalculated considering new conditions. They also consider dependence of Ukraine on the EurAsEC CU markets, rapid transition to the EU technical regulations as a barrier to the EurAsEC originating FDI, threats for labor migration and other trips. They claim that substitute markets can be found for 48% of 14 largest categories of Russian exports to Ukraine.

3. Legal basis and trade negotiations

The economic part of the EU-Ukraine AA has been delayed until the beginning of 2016 because of the Russia's opposition. The possible future options of the DCFTA could be revealed upon analysis of the main features of the EU-Ukraine DCFTA (see figure 1).

Figure 1 The main features of the EU-Ukraine DCFTA



Starting from August 2013 Russia clearly objected to AA and DCFTA. We can summarize Russia's concerns and provide counter-arguments:

1. Russian economy is risked being flooded with goods from the EU, which would formally be considered as Ukrainian and thus be subject to the CIS FTA preferential

treatment. But, first, this statement ignores the rules of origin applied by WTO members. Second, fraudulent use of certificates of origin can be effectively tackled. Legal provisions can be introduced to punish a party within a FTA for non-cooperation in this field. E.g. in AA the Article 37 means that a Party may suspend preferential treatment for the respective product for 6 month if another Party fails to cooperate and imports of goods exceed the usual level of production and export capacity of the other Party. Third, cheaper inputs for Ukrainian products would have a marginal effect, significantly smaller that of e.g. devaluation of Ukrainian currency. Fourth, practice in other FTA shows that sometimes companies (especially small ones) do not benefit from the preferential treatment, because proving the origin is too costly.

2. Russian economy may be flooded by Ukrainian goods uncompetitive with the European ones. But within WTO rules any country facing increase in import threatening national industries may protect them by imposing safeguard measure in a form of duties, quotas etc. and there is no need to stop the existing FTA. Moreover, transition periods for tariff reduction in Ukraine exist for a significant part of products.

3. If Ukraine adopts EU technical product standards it would hinder traditional trade flows between Russia and Ukraine. But these standards should be applied to sales on domestic market or to the EU only, while sales to Russia should meet Russian technical standards. Also as the EU regulations largely provide better quality, any country is interested to ensure better quality for its citizens as its economy advances. We also show below that only minor part of Russian products are currently exported to Ukraine because of non-compliance with the EU regulations. Even if it is a problem a simple solution may be launched for Russian goods exported to Ukraine: an agreement for mutual recognition.

4. DCFTA would mean an erosion of Russia's goods competitiveness at the Ukrainian market. But at the beginning of 2015 there are more than 600 FTAs notified by 159 WTO members, and most of the countries practice cross-membership in multiple FTAs. DCFTA only eliminates the trade diversion effect existing due to the CIS FTA. Moreover most of Russian and the EU exporters are non-competitors because of different trade structure.

5. Ukraine should not grant any competences to the EU national or international institution. This statement is partially true: DCFTA is based upon partial delegation. But entering Eurasian Economic Union as an alternative integration direction also means partial delegation.

6. The last concern is of great and principal importance for Russia: the DCFTA implementation makes it impossible for Ukraine to join the EuroAsian Economic Union / Customs Union. We may say that DCFTA doesn't preclude Ukraine to sign other classical FTAs and it does not conflict with Ukraine's membership in the CIS FTA. Moreover the CIS FTA may be supplemented with the economic integration agreement (free trade in services) and thus become an FTA+ agreement with Ukraine's membership. As for joining the EAEU CU, despite the Article 39 of AA allows joining customs unions, de-facto this or other developed forms of international integration are possible for Ukraine only upon quitting DCFTA. The options for simultaneous membership of

Ukraine in the DCFTA and Customs Union (EAEU) are rather hypothetical. It could be possible if the Customs Union conclude a similar DCFTA with the EU. Also this scenario possible if Ukraine keeps tariffs within a transitional period smaller (or zero level) than the CU tariffs for a large share of goods where it is committed to keep them low according to the DCFTA or WTO commitments. In this case the mechanism of conditional release of imports may be practiced (it is envisaged by the Article 200 of the CU Customs Code). But this may conflict with the paragraph 8(a) of the Article 24 of the GATT providing definition of custom union, when it states that “substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union” and can be considered as a precedent.

Since that time Russia launched a real economic war against Ukraine. Aggression, war, discrimination, sanctions, blackmailing, blockade are the terminology describing current economic relationship of Russia with Ukraine. Ukraine faced more than 40 trade wars, 4 gas wars in 2004-2015. According to V. Sidenko (2014) only in January – October 2014 up to 90% (tariff lines) of Ukrainian exports to Russia were discriminated (32.4% Ukrainian exports to Russia declined by 10-20%; 41.2% – by 20-40%; 13.7% – by more than 40%). Figure 2 Shows the main aspects of the Russia’s economic hybrid war against Ukraine.

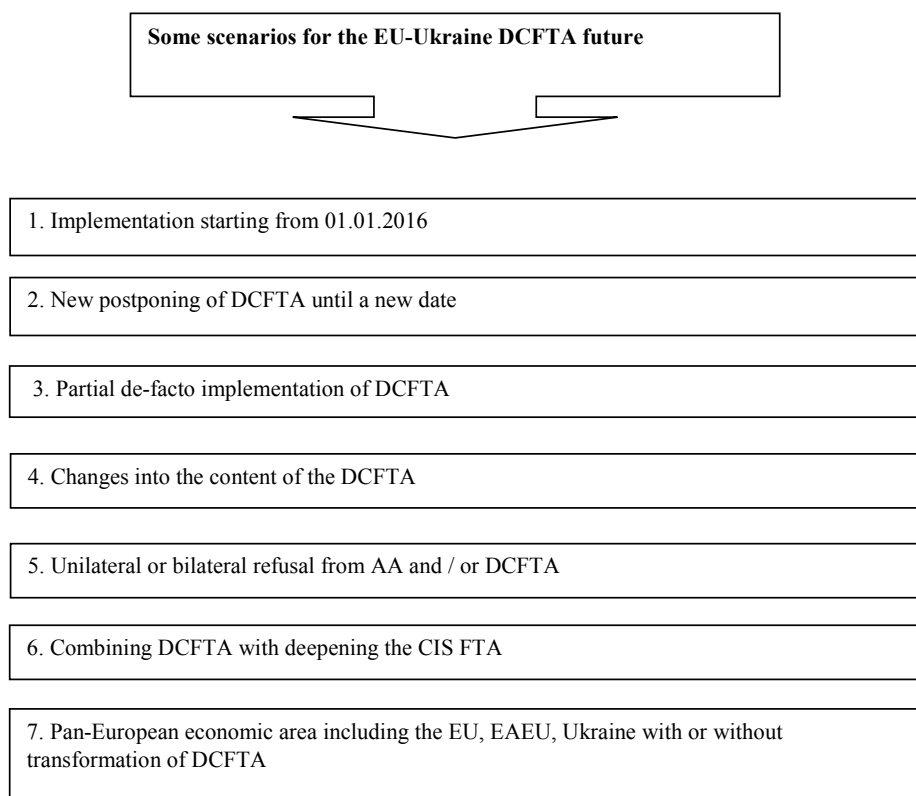
Figure 2 The Russia’s economic hybrid war against Ukraine



Many analysts believe that the destruction and occupation of Donbass was intended to stop Ukraine's European integration. Renewal of the destroyed objects may cost \$1.5 bln. Risk of military actions renewal is the main factor for blocking national and foreign investments. Ukraine has to bear high military expenditure (17 % of state budget expenditures) instead of solving social, infrastructural and other problems.

Modeling impact of DCFTA and Russian retaliation on consumption in Ukraine shows that the opening of the EU market to Ukrainian exports would not compensate the losses in the Russian market. And the depth and duration of the economic crisis in Ukraine depend upon the effectiveness of the adaptation process and a whole range of internal and external factors. Under the military aggression against Ukraine the EU and Ukraine had to concede to Russia in the DCFTA implementation. There are several options for the EU-Ukraine DCFTA future (see figure 3). Each of the options has its own assumptions.

Figure 3 Some scenarios for the EU-Ukraine DCFTA future



New postponing of DCFTA until a new date is less likely because Russia does not insist on it anymore. It could be with two options: a new fixed date or date depending upon AA ratification by the EU member-states. Scenario with changes into the content of the DCFTA also has two options: minor changes with protocols or additional agreements

or transforming DCFTA into a classical FTA. As for the last scenario Pan-European economic area, it would be a good option for Ukraine, but Russia may be less interested in it as a large energy and raw material exporter.

As for now the EU-Ukraine DCFTA concessions to Russia include:

- delay of implementing the economic part of AA until 01.01.2016;
- the ratification process for AA slowed down in the EU: 18 EU countries ratified it as of 01.06.2015;
- the Crimea, Sevastopol, and some districts of Donetsk and Lugansk regions are de-facto outside the territory which is covered by AA (Minsk-2 agreement);
- these territories are de-facto parts of the EAEU;
- trilateral talks (the EU, Ukraine, Russia) on the practical solution of the question under the Russia's concerns regarding DCFTA implementation started.

On May 18, 2015 these trilateral talks on the implementation of the EU-Ukraine Association Agreement took place in Brussels. These were the third meeting at the ministerial level (the previous ones took place in July and September of 2014). According to European Commission (2015) the parties decided to improve efforts to deal with the following concerns raised by Russia:

Customs cooperation:

- improvement of customs data exchange and electronic verification of origins;
- tackling additional issues (e.g. fighting against fraud);
- revising rules of origin of the CIS FTA;
- customs cooperation between the EU and Russia, technical support and expert advice by the EU.

Technical barriers to trade:

- establishment of a working group for harmonizing process in order to minimize the impact of regulatory changes, recognizing importance of convergence of technical regulations and standards;
- extending transition periods for regulatory alignment for specific sectors and products.

Sanitary and phytosanitary issues: updating arrangement between Ukraine and Russia on bilateral acceptance of veterinary certificates.

At the meeting between Russian President V.Putin with the Government on May 20, 2015 the Minister for Economic Development A.Ulyukayev (Ministerstvo ekonomicheskogo razvitiya Rossiyskoy Federatsii (2015)) announced that 5 remaining issues are subject to concerns by Russia:

- tariff liberalization between the EU and Ukraine (establishment of transition periods);
- technical regulations (right to choose the EU or CIS countries rules by companies);

- sanitary and phytosanitary measures (Ukraine's joining certification within the EAEU);
- customs administration (electronic documents, rules of origin, information exchange);
- energy (parallel operation of unified energy systems of Ukraine and Russia).

It was decided that these issues were to be dealt within working groups by July and should result in a form of protocols to AA or separate agreements. At the same time Russia no more insists on suspension of AA implementation. Thus Russia came to a political decision not to object to the implementation of AA.

In case Russia finds the solutions to be suggested by the working groups unacceptable it may use the provisions of the Government Regulation of Russian Federation No 959 (Pravitelstvo RF (2014). It envisages elimination of free trade regime for imports of specific products from Ukraine. Instead of that the CU MFN tariffs are to be applied. These products include selected agricultural, food, beverages, tobacco chemical, textile, metal products, electric appliances, road vehicles, ships, furniture, and construction materials.

On June 4-5, 2015 trilateral consultations continued to discuss Ukraine's adoption of the EU technical regulations and customs cooperation. Russia suggested that Ukraine should implement technical regulations only after 10 years. But Ukraine had already adopted 21 out of 24 technical regulations, and many of them have already become operative (Ekspres onlain (2015)). Also during October 2014 – March 2015 Ukraine adjusted 8848 (out of about 29 600) technical standards (Ievropeiskaya Pravda (2015).

4. Estimation results

Further we study two possible motivations of Russia's opposing implementation of the EU-Ukraine DCFTA in details. The first one is the possibility of increased competitive pressure of Ukrainian exports to the EU on Russian exports to the EU because of the EU preferential treatment for Ukraine under autonomous preferential trade regime and later under FTA (competition in the EU market). And the second one is the possibility of increased competitive pressure of the EU exports to Ukraine on Russian exports to Ukraine because of Ukraine's preferential treatment for the EU under FTA (competition in Ukrainian market). The first motivation is a possible trade diversion effect caused by DCFTA, and the second one is disappearance of possible trade diversion effect existing under the CIS FTA. We also should say that certain trade discrimination of third parties caused by establishment of new preferential trade agreements is a normal outcome. And the normal practice to solve this problem is to sign similar agreements with the third parties (in this case establishing the EU-Russia FTA is possible).

In order to estimate the possibility of such motivations, first we compare

trade structures of bilateral exports of the three countries (economies). We use the UNCTAD data (<http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx>) – Merchandise trade matrix - detailed products, imports in thousands of dollars, annual. The latest available data was as of 2013. Despite the time lag in publishing this information, considering the 2013 data in our research has some advantages – it reflects trade volume and structure under non-confrontation regime, which existed prior to the instability in mutual international relations in 2014-2015 and which still may take place in future under the most favorable scenario.

We use the next formula to estimate whether exports are structurally different, and thus are mutually non-competing, or structurally similar, and thus there is a threat, that DCFTA can increase competitive pressure on Russian exports:

$$IESD = \sum abs(S_{ia} - S_{ib}) / 200\%$$

Where IESD – index of exports structural difference, % (0% means that exports structures of two exporting countries (economies) to the third one, are perfectly similar, and 100% means that they are perfectly different);

S_{ia} – share of the product group i in exports of country a to the third country;

S_{ib} – share of the product group i in exports of country b to the third country.

The results show that increase in competitive pressure on Russian exports is rather low. The IESD for Ukrainian and Russian exports to the EU is 86%. And since we used the data about 255 product groups for our calculations instead of the data about specific individual products the true value of IESD calculated under more precise method should be bigger than 86%. Thus only less than 1/7 of Russian exports to the EU may face increased competition from the Ukrainian exports. The IESD for the EU and Russian exports to Ukraine is 65%. In this case competitive pressure increase is somewhat bigger, but even in this case at least 2/3 of Russian exports to Ukraine face no competition from the EU entities. Again these are the maximum estimates of threat to Russian exporters as we have not considered the existing tariffs which are to be eliminated in the EU-Ukraine mutual trade. In some cases the tariffs have already been 0% or close to 0%, and thus the EU and Ukraine will not provide preferential treatment to each other in such cases. Let us further determine the most sensitive Russian industries that may face increased competitive pressure. Table 1 shows Russian exports to the EU that presumably may be sensitive to the EU-Ukraine DCFTA. We used two criteria to select the product groups: the value of export is at least \$100 mln (otherwise the export of such a product is too inessential to determine strategic political decisions);

the ratio of the share of Ukraine in the EU imports to the share of Russia in the EU imports is at least 0.3 (otherwise Ukraine is either non-competitor or inessential

competitor to Russian exporters).

Table 1 Russian and Ukrainian exports to the EU, and the tariff preferences under DCFTA.

Sensitive product group	Exports from Russia to the EU, mIn dol, 2013	Share in total exports from Russia to the EU,	Share of Russia in the EU imports, %, 2013	Share of Ukraine in the EU imports, %, 2013	The EU MFN import tariff, %, 2014
[044] Maize (not including sweet corn), unmilled	117	0.04	3.5	56.9	0 or Non-AV, TQ in AA
[081] Feeding stuff for animals (no unmilled cereals)	584	0.21	3.9	3.9	0-12 or Non-AV
[247] Wood in the rough or roughly squared	400	0.14	34.2	11.3	
[248] Wood simply worked, and railway sleepers of wood	717	0.26	20.7	6.2	0-10
[281] Iron ore and concentrates	1013	0.37	6.2	10.3	0
[351] Electric current	413	0.15	13.7	11.1	0
[421] Fixed vegetable fats & oils, crude, refined, fractio...	594	0.21	22.3	22.6	0-16 or Non-AV
[611] Leather	161	0.06	4.1	2.6	0-6.5
[671] Pig iron & spiegeleisen, sponge iron, powder & granu...	1701	0.61	17.3	9.7	0-2.2
[672] Ingots, primary forms, of iron or steel; semi-finis...	1668	0.60	37.4	45.9	0
[673] Flat-rolled prod., iron, non-alloy steel, not coated	1479	0.53	27.6	18.7	0
[676] Iron & steel bars, rods, angles, shapes & sections	633	0.23	14.4	7.9	0
[679] Tubes, pipes & hollow profiles, fittings, iron, steel	107	0.04	2.0	4.7	0-3.7
[778] Electrical machinery & apparatus, n.e.s.	188	0.07	0.6	0.4	0-14
[791] Railway vehicles & associated equipment	165	0.06	8.2	7.1	0-3.7

We see that only 15 product groups out of 255 may be considered as politically important, and their total share in Russian exports to the EU is only 3.6%. But we also should consider the absolute shares of Russian and Ukrainian exports in the EU imports and the EU MFN tariffs that are to be eliminated or decreased under the autonomous preferential trade regime or DCFTA. For the MFN tariff data we use the WTO data (Tariff download facility – <http://tariffdata.wto.org/Default.aspx?culture=en-US>). We also consider the

Annex 1-A of the EU-Ukraine AA in case additional details should be mentioned (tariff quotas, non-ad valorem tariffs or incomplete tariff elimination). Since we do not have the data about trade in specific products, we cannot calculate the weighted average tariffs. Thus we show the range using minimum and maximum tariffs in the product groups. If we further exclude Electrical machinery & apparatus, n.e.s. (both Russian and Ukrainian share in the EU imports is less than 1%) and those product groups, where MFN tariffs are 0%, only 9 product groups would remain which account for only 1.6% of Russian exports to the EU. These are maize, feeding stuff for animals, some wood products, vegetable oils etc., leather, some iron products, and railway machinery and equipment. If we calculate tariff preferences under DCFTA, the direct losses for the 8 industries (we exclude maize because of tariff quota) are estimated as from \$0 to \$324 mln. Even if we add minor exports groups, the possible negative effect of competitive pressure on Russian exports to the EU should be somewhere between several dozens and several hundreds million dollars, which is very much less than the losses from international political confrontation. No non-tariff barriers will be established by DCFTA because Russian exports to the EU already satisfy the existing technical and other non-tariff regulations. We used similar methodology to select Russian exports to Ukraine that may be sensitive to the EU-Ukraine DCFTA (see table 2). In this case we see that only 18 product groups out of 255 may be considered as politically important, but their total share in Russian exports to Ukraine is quite substantial (18.9%). If we exclude those product groups, where MFN tariffs are 0%, 15 product groups would remain which account for 16.8% of Russian exports to the EU. These are primarily petroleum oils or bituminous materials (8% of exports), and also chocolate, tobacco products, perfumery, polymers of ethylene, rubber tyres, some construction materials, some metal products, some electric machinery products, and railway equipment (their exports were \$3.9 bln).

Table 2 Russian and the EU exports to Ukraine, and the tariff preferences under DCFTA

Sensitive product group	Exports from Russia to the EU, mln dol, 2013	Share in total exports from Russia to the EU, %, 2013	Share of Russia in the EU imports, %, 2013	Share of Ukraine in the EU imports, %, 2013	The EU MFN import tariff, %, 2014
[073] Chocolate, food preparations with cocoa, n.e.s.	121	0.52	59.5	36.0	5-15, some items - 20% decrease in 5 years in the AA

Sensitive product group	Exports from Russia to the EU, mln dol, 2013	Share in total exports from Russia to the EU, %, 2013	Share of Russia in the EU imports, %, 2013	Share of Ukraine in the EU imports, %, 2013	The EU MFN import tariff, %, 2014
[122] Tobacco, manufactured	105	0.45	58.9	21.0	10-20 or Non-AV
[334] Petroleum oils or bituminous minerals > 70 % oil	1859	8.00	29.0	30.5	0-10
[553] Perfumery, cosmetics or toilet prepar. (excluding soaps)	217	0.93	26.1	60.6	6.5
[571] Polymers of ethylene, in primary forms	136	0.58	23.2	35.6	0-5
[625] Rubber tyres, tyre treads or flaps & inner tubes	150	0.65	26.5	23.2	0-10
[641] Paper and paperboard	228	0.98	20.5	67.3	0
[661] Lime, cement, fabrica. constr. mat. (excluding glass, clay)	110	0.47	58.0	22.9	Mostly 2-10
[671] Pig iron & spiegeleisen, sponge iron, powder & granu...	104	0.45	29.3	9.3	5
[675] Flat-rolled products of alloy steel	151	0.65	27.5	13.9	0
[684] Aluminium	129	0.55	37.8	35.0	0
[699] Manufactures of base metal, n.e.s.	236	1.01	29.5	43.0	Mostly 0-10
[716] Rotating electric plant & parts thereof, n.e.s.	161	0.69	38.8	36.2	
[772] Apparatus for electrical circuits; board, panels	106	0.45	13.1	60.3	Mostly 0-10
[775] Household type equipment, electrical or not, n.e.s.	113	0.49	11.4	34.1	
[781] Motor vehicles for the transport of persons	221	0.95	7.4	47.3	5-20
[784] Parts & accessories of vehicles of 722, 781, 782, 783	100	0.43	14.6	47.2	0-10
[791] Railway vehicles & associated equipment	158	0.68	47.0	24.6	0-10

If we calculate tariff preferences under DCFTA, the direct losses for the 15 industries are estimated as from \$40 to \$400 mln. Even if we add minor exports groups, the possible negative effect of competitive pressure on Russian exports to the EU should be somewhere between several dozens and several hundreds million dollars too.

We should mind, that in case of exports to Ukraine also new non-tariff barriers may arise because of DCFTA, which effect is more difficult to predict. But we can estimate

maximum vulnerability of Russian exports of specific product groups to Ukraine by calculating the ratio of the value of Russian exports to Ukraine to the value of Russian exports to the EU. If the ratio is bigger than 1, then presumably Russian exporters originally avoided stricter EU technical regulations by choosing to sell mostly to such countries as Ukraine, where technical regulations are different (before it joins the EU technical regulations). We also consider only main exports product groups (more than \$100 mln). The table 3 shows the information about presumably sensitive Russian exports to Ukraine considering changes in non-tariff regulations in Ukraine because of DCFTA. Their total value in 2013 was \$2.3 bln, which account for 10% of Russian exports to Ukraine. If we apply stricter condition (the ratio of 2) but consider all the products group regardless their value of exports, then the value of presumably sensitive exports would be \$2.7 bln which account for 11.6% of Russian exports to Ukraine. Thus roughly speaking only every 1/9 of Russian exports to Ukraine can be vulnerable because of the necessity to comply with new non-tariff regulations. And this is the upper estimate for possible losses because of the DCFTA, considering that investment for adjusting to new regulations is presumably smaller. Moreover the share of Ukraine in total exports from Russia was only 4.5% in 2013 and decreased to 3.4% in 2014 according to International Monetary Fund Direction of Trade Statistics (<http://data.imf.org/?sk=9D6028D4-F14A-464C-A2F2-59B2CD424B85>).

Table 3 Russian exports to the EU and Ukraine

Sensitive product group	Exports from Russia to the EU, mln dol, 2013	Exports from Russia to Ukraine, mln dol, 2013	Ratio: Russian exports to Ukraine / Russian exports to the EU
[073] Chocolate, food preparations with cocoa, n.e.s.	22	121	5.6
[122] Tobacco, manufactured	3	105	38.7
[553] Perfumery, cosmetics or toilet prepar. (excluding soaps)	57	217	3.8
[571] Polymers of ethylene, in primary forms	112	136	1.2
[661] Lime, cement, fabrica. constr. mat. (excluding glass, clay)	57	110	1.9
[716] Rotating electric plant & parts thereof, n.e.s.	47	161	3.4
[718] Other power generating machinery & parts, n.e.s.	595	619	1.04
[761] Television receivers, whether or not combined	7	324	48.4
[772] Apparatus for electrical circuits; board, panels	60	106	1.8
[775] Household type equipment, electrical or not, n.e.s.	43	113	2.6
[781] Motor vehicles for the transport of persons	31	221	7.2
[784] Parts & accessories of vehicles of 722, 781, 782, 783	73	100	1.4

On the other hand, because of internal economic problems and international political confrontation Ukrainian foreign trade with Russia significantly decreased (see table 4). We use the data provided by the State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua/>). Despite the data already is provided without the Crimea and Sevastopol (and in 2015 also without uncontrolled territories in the South-East), some incomparability across the periods remains. In 2013 Donetsk and Lugansk accounted for 5.3% and 2.4% of total Ukrainian imports. Nowadays only part of these regions is under the Ukrainian government control, on the other hand Kyiv-city nominally accounted for 34.7% Ukrainian imports, but in reality part of it were for other regions. Also statistics for Ukrainian regions is provided regardless foreign exporting or importing countries. Thus we adjust for territorial integrity changes only roughly.

Table 4 Bilateral foreign trade of Ukraine with Russia

Year	Exports, mln dol	Imports, mln dol
2013	14787	23098
2014	9798	12700
2015, I quarter	1044	1448
2015 forecast (adjusting for seasonality and territorial factor)	5000	6700

Thus only in the Ukrainian market (partially because using political confrontation approach and partially because of internal economics and political trends in Ukraine) the losses of Russian Federation were about \$10 bln in 2014 and will be about \$16 bln in 2015 in its exports revenues and about \$5.5 and \$6.5 bln, respectively, in trade balance surplus (we should mind that implementation of the DCFTA will start only since 2016). This is several times larger than our estimates of possible losses of Russia because of the EU-Ukraine DCFTA implementation. Moreover our estimates of the latter based on 2013 show rather upper limits because of decrease of mutual trade between Russia and Ukraine in 2014 and 2015.

Besides deterioration of Russia's image, trade conflicts, destruction of infrastructure, decrease of purchasing power of population, one of the mechanisms of transmission of internal problems and external factors into decreasing Russian exports in Ukraine is devaluation of hryvnia (it also increases price competitiveness of Ukrainian exports in the EU market). We used the data of the National Bank of Ukraine (http://www.bank.gov.ua/control/uk/publish/article?art_id=65162&cat_id=36674) and the Central Bank of Russia (<http://www.cbr.ru/statistics/>) to calculate bilateral real exchange rate of Ukrainian hryvnia to Russian ruble. In January 2014 – April 2015 this exchange rate decreased by 14% (nominal devaluation was 40%, but higher inflation in Ukraine partially offset it). This is several times larger than tariff preferences for Ukrainian or the EU exporters in their mutual trade. But we must admit that the effect of hryvnia devaluation may have only middle-term effect.

We also must mention the large losses of Russia because of sanctions and worsening its image as a reliable and predictable partner. E.g. Russian central bank has lost more the \$150 billion dollars in reserves. Foreign investment and opportunities for borrowing decreased. Energy and defense companies have problems with importing key technologies (Ruptly (2015)). GDP growth in 2014 slowed down to 0.6%, and is expected to be -3.8% in 2015. Total exports of

goods and services decreased by 1% (after growth in previous years), imports decreased by 6.6% raising inflation to 11.4% (International Monetary Fund World Economic Outlook Database April 2015 <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>).

5. Conclusions

To sum up, our research work provides the evidence in favor the presumption that economically the EU-Ukraine DCFTA is only a minor challenge for the Russian economy. Even though some minor exports may face negative impact, this is a normal practice, when any FTA is established. An additional option to avoid possible trade diversion effect for Russia is to establish a similar FTA with the EU. Before it happens Russian exporters may also choose to invest in Ukraine to benefit from the EU preferential treatment.

At least the negative economic consequences of the EU-Ukraine for Russia are substantially less than the losses caused by using hard approach to Ukraine. Thus it is a political decision rather than an economic one of Russian authorities, which wishes to see Ukraine as a member of its own regional economic bloc. But return to non-confrontation regime in international political and economic relations can be mutually beneficial for Ukraine, the EU and Russia.

Cross-membership of such a relatively big country in the region as Ukraine in both the CIS FTA and DCFTA with the EU may be a unique framework for Europe. Under the scenario, which envisages territorial integrity, sovereignty, security of Ukraine are guaranteed, the AA and DCFTA effective implementation is under doubt.

Acknowledgements

We are grateful to Professor Giorgio Dominese for valuable comments and advice, and Olga Zalisko for technical issues.

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