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# Eurasian Union: a Challenge for the European Union and Eastern Partnership Countries

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## ABBREVIATIONS

GDP – Gross Domestic Product
EC – European Community
EBRD – European Bank for Reconstruction and Development
EEC – Eurasian Economic Commission
EU – European Union
EFTA – European Free Trade Association
GATS – General Agreement on Trade in Services
GATT – General Agreement on Tariffs and Trade
ITO – International Trade Organization
CSTO – Collective Security Treaty Organisation
MFN –Most-Favoured-Nation
CU – Customs Union
CIS – Commonwealth of Independent States
OECD – Organisation for Economic Co-operation and Development
WTO – World Trade Organisation

## Introduction: the Eurasian Economic Union – a parallel European integration?

Following the dissolution of the Union of Soviet Socialist Republics (USSR), there have been various attempts over the past two decades by the Commonwealth of Independent States (CIS) to promote deeper economic integration; however these initiatives included clauses allowing member states to choose the depth of integration. This can be explained by the fact that for many countries the motive behind the establishment of the CIS was not in fact a search for a format for (re)integration, but was rather a means to ensure conditions for the former members of the USSR "to part" in an orderly manner.

The CIS trade regime basically consisted of bilateral trade agreements periodically supplemented with exemptions. Meanwhile, the multilateral agreements within the CIS framework generally coordinated specific issues: unification of customs procedures, rules for determining the origin of goods, etc. All of these multilateral agreements had to be ratified by national parliaments and this was an additional safeguard for those countries that were cautious regarding deeper integration. As a result, commitments of CIS members under these agreements were very limited.[1]. **The large number of legally non-binding bilateral agreements, the systematic application of exemptions, and the intergovernmental nature of the integration determined that the CIS failed to evolve into a highly integrated economic entity with elements of supranationalism and prevented an opportunity for a political union to be formed within the CIS framework**.

Failure to push integration under the "umbrella" of the CIS framework forced the (re)integration architects of the post-Soviet space (whose driving force has always been Russia) to rely on the "multi-speed" formula whereby those countries that are willing or motivated in various ways form a core and integrate in one or another policy sector. The practical manifestation of such an approach is the Collective Security Treaty Organisation (CSTO) and the economic Customs Union (CU) of Russia, Belarus and Kazakhstan. **The logic of "multi-speed" integration can be summarised as follows: the core countries deepen their mutual integration, strengthen their bargaining powers with respect to non-member states and thus encourage/force other countries to join a project initiated by the core**.

Unlike free trade agreements that had previously existed in the CIS, the CU of Russia, Belarus and Kazakhstan launched on 1 January 2010, is a qualitatively different, deeper stage of integration, as it introduced not only a free trade area, but also a common import duties structure and common external tariff, as well as launched a harmonization of product quality, sanitary and other standards. On the other hand, CU is still not the final target of integration, because on 1 January 2012, at least formally, this structure entered its second stage of integration, the Common Economic Space, and the final goal of integration is the Eurasian Economic Union to will become functional in 2015. **In theory, this three-stage integration system repeats the classic scheme of integration stages: from the CU to the common market, which operates on the basis of the "four freedoms", and which then leads to the most integrated monetary and economic union.**

Obviously, the architects of the Eurasian Economic Union want to create within five years what took almost 40 years in European Union integration process. The question is whether this is merely a facade/theoretical construct or whether after all it contains a specific content?

Along with the process of integration, the institutional architecture of the Eurasian Economic Union started to emerge. Its most important link is a supranational Eurasian Economic Commission (EEC). This commission has the mandate of member states in such areas as trade policy, customs, external tariffs and non-tariff barriers, trade protection instruments, technical regulations, etc. It is planned that the EEC mandate in the long term (up to 2015) may expand to the areas of energy policy, public procurement, sale of services, competition and investment. It should be noted that the EEC architects are learning from the past mistakes of failed integration projects particularly in the area an institutional framework –

[1] "Kodėl Ukraina negali tapti ES nare?" [Why the Ukraine Cannot Become an EU Member?"], analytic survey 1 (1), 2009, Eastern Europe Studies Centre, Centre for Eastern Geopolitical Studies.

strengthening the legal status of decisions taken by supranational institutions on member states. Institutional decisions will be applied directly, without any additional internal legislation or ratification.[2]

Another important question is what the relationship between the EU and this supranational institution to which Russia, Belarus and Kazakhstan assign increasingly more powers should be? **What should the model of the EU's relations with the Eurasian Economic Union (and the EEC representing it) be, given the negotiations of the EU with Russia for a new strategic agreement and the EU negotiations with Kazakhstan for an enhanced Partnership and Cooperation Agreement? Should the Eurasian Union be recognised as a legitimate regional bloc? And what would the implications of such recognition be?**

These problematic issues are related to the broader field of EU interests: **what is the potential impact of the Eurasian Economic Union on the EU's capacity to expand the security and stability space in its neighbourhood, as well as on the functionality of the EU's Eastern Partnership initiative which provides for the involvement of partner countries in the EU's economic integration space, and on the EU's external trade policy which focuses on the reduction of protectionist barriers in the international environment, etc**.

The analysis of the development model selected by the emerging Eurasian Economic Union should provide an answer to the question of (1) whether this is a project of natural regional economic integration (modelled on the EU example) which may eventually create conditions for a common economic space "from Lisbon to Vladivostok" or (2) whether this is an alternative space for integration whose relationship with the World Trade Organisation (WTO) is problematic (due to non-equal membership of the states in the WTO, introduction of protectionist barriers) while the aim of this integration project is geopolitical: Russian efforts to limit the opportunities of post-Soviet states to join the EU economic integration space, to take over strategic sectors of the economy of these countries and to split Europe into two competing political and economic blocs.

Thus, the objective of this study is to carry out an analysis of the possible impact of the emerging Eurasian Economic Union on the EU (and the EU's Eastern Partnership initiative) and the Eastern Partnership countries and to provide recommendations for EU policy with respect to the Eurasian Economic Union. The following are the objectives of this study:

– to analyse the institutional architecture of the Eurasian Economic Union and the most important mandates of supranational institutions; to suggest an answer to the question of what the final vision of this economic integration project is;

– to assess the place of the Eurasian Union in Russia's domestic and foreign policy. Is this yet another attempt to reinforce integration within the CIS space or a project of new quality of supranational integration? What are the possibilities and limits of Eurasian Union integration?

– to analyse the relationship between the Eurasian Economic Union and EU external economic policy and its potential effect on the EU's Eastern Partnership initiative;

– to examine political and economic risks of the negotiations between the EU and the Eurasian Economic Union as an integrated regional structure;

– to assess the advantages and disadvantages, strengths and weaknesses of the project and determine potential winners and losers of the Eurasian Economic Union;

– to analyse development opportunities of the Eurasian Economic Union, i.e. analyse the pros and cons (costs and benefits) of the membership of the Ukraine and Moldova as key targets for the expansion of the Eurasian Union;

[2] Rilka Dragneva and Kataryna Wolczuk, "Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?", *Chatham House Briefing Paper*, No. 1, 2012, 6, available at: <http://www.chathamhouse.org/sites/default/files/public/Research/Russia%20and%20Eurasia/0812bp_dragnevawolczuk.pdf >.

– to assess whether the Eurasian Economic Union can become an instrument for Russia to control the relationship between the EU, as an alternative centre of economic integration, and the countries of the Eastern Neighbourhood;

– to provide guidelines for what EU policy should be in respect of the Eurasian Economic Union: what should the EU's response to deepening integration trends within the framework of the Eurasian Economic Union be?

## I. The institutional architecture of the Eurasian CU

The development of both the Eurasian CU and the institutions of the emerging Eurasian Economic Union reflect the character of economic integration in the region.

There is little doubt that integration of Russia, Belarus and Kazakhstan, the development of CU, and the declared ambitions to deepen integration leading to the Eurasian Economic Union arise from political decisions by the heads of these states. The driving force of the process is the current Russian president, Vladimir Putin, who used to head the Russian Council of Ministers and was most adamant, particularly when speaking with representatives of third countries, about the launching of the Eurasian CU.

On the other hand, the development of the Eurasian CU is publicly compared to voluntary delegation of national sovereignty under the European integration model. **Yet the functioning of the institutional framework and the type of decision-making can show to what extent this process is equal and to what extent it is a forced integration model consolidating asymmetry among member states in decision-making**.

The most important Eurasian authority is the Supreme Eurasian Economic Council which acts both at the level of heads of states/presidents and prime ministers of the three member states. This institution determines the strategy and goals of integration.

The practical side of the integration process of Russia, Belarus and Kazakhstan is best reflected by the EEC, which formally came into being on 1 February 2012 and *de jure* took over the functions of the hitherto CU Commission. The Commission was established on 18 November 2011. The EEC is a supranational, uniform, permanently operating CU institution for the emerging common economic space. Its main functions are to ensure the operation of the CU and to make proposals concerning further economic integration leading to the creation of the common economic space. In light of these goals, the list of the EEC's areas of activities is long and quite ambitious:

1. Tariff and non-tariff trade regulation.
2. Customs administration.
3. Laying down mandatory standards through technical regulations.
4. Control of sanitary, veterinary and phytosanitary measures.
5. Collection and allocation of import duties.
6. Setting of trade regime with third countries.
7. Collection of statistics on mutual trade and trade with third countries.
8. Macroeconomic policy.
9. Competition policy.
10. Industrial and agricultural subsidies.
11. Energy policy.
12. Natural monopolies.
13. State and local government procurement.
14. Mutual trade in services and investment regimes.
15. Transport and transportation.
16. Currency policy.
17. Protection of intellectual property.
18. Labour migration.
19. Financial market regulation (banking, insurance, foreign exchange market and stock markets).

The list of the EEC areas of competence above shows that the first seven areas are related to the functioning of the currently operating CU. The remaining areas of competence should reflect the aspirations of the countries to deepen their economic integration. One must recall that the current EEC has taken over the CU functions and ensures continuity of activities; thus the EEC activities in the areas related to the functioning of the CU have now become more obvious. **However, even in these areas the influence of government authorities (ministries) of individual CU members (first of all Russia) is nonetheless noticeable**. This is primarily visible

through the preparation of initiatives and draft technical regulations, application of sanitary and phyto-sanitary measures, and even through active involvement and the projects on import duties. During negotiations regarding the trade regime with third countries, conferences and other meetings on this subject, the most visible figure so far is that of Maxim Medvedkov, director of one of the departments of Russia's Economic Development Ministry and the former chief negotiator for Russia's accession to the WTO.

**Limited EEC activities, even in ensuring daily functioning of the CU, may both be due to objective reasons, such as the lack of personnel and expertise, and the unwillingness of CU countries, particularly Russia, to assign competences to the supranational authority**. Objective reasons that restrict the more pro-active EEC cannot be excluded because, as it has been mentioned, the EEC has formally existed for less than a year. According to the decision adopted at the end of 2011 by the CU heads of state (Supreme Eurasian Economic Council), from 2012 to the beginning of 2013, EEC departments should employ more personnel and the number of employees would increase from 600 to 1,071.

**As far as other areas of EEC competence related to further economic integration (movement towards an economic union) rather than only ensuring functioning of the CU, are concerned, there is no notable agenda yet**, although in some of these areas – competition regulations, natural monopolies, protection of intellectual property, and transport – some sporadic decisions involving attempts to identify and define further activities have been adopted. In these areas too, the work of the EEC will directly depend on cooperation with institutions of the current CU countries and their goodwill in exchanging information and gradually assigning their competence to the supranational authority.

The EEC consists of the Council and the Board. Members of both the Council and the Board are appointed by CU member states. Candidates are approved by the Supreme Eurasian Economic Council operating at the level of heads of state/presidents. They also approve the EEC rules of procedure. In addition to the Council and the Board, other structural units include 25 (23) departments. The treaty regarding the Eurasian Economic Commission states that the EEC may set up its offices in CU countries, third countries, and at international organisations.

**The EEC adopts decisions which have direct effect and are legally binding**. The EEC may also adopt non-binding recommendations. EEC decisions take effect in 30 calendar days after their official publication. In cases that require immediate response, EEC decisions may take effect within a shorter time, but not earlier than 10 calendar days after their official publication. The Supreme Eurasian Economic Council may empower the Commission to sign international treaties that fall within the EEC's competence. In this case, the power to sign the treaty is granted to the Chairman of the EEC Board and the power to negotiate is granted to one of the members of the EEC Board depending on the type of policy. EEC decisions are adopted by consensus in the EEC Council. **Decisions in the EEC Board are adopted by consensus or a 2/3 majority vote**. Each member of both the Council and the Board has one vote.

The EEC Council consists of deputy prime ministers of the three current CU countries – Russia, Belarus and Kazakhstan. Belarus is represented in the EEC Council by Sergei Rumas, Kazakhstan – by Kairat Kelimbetov and Russia – by Igor Shuvalov. The main tasks of the EEC Council are control of common integration processes and general management of EEC activities. EEC Council meetings are lawful only if all three members of the Council take part. The Council Chairmanship is a rotating position and the term of office of the Chairman is one year. During the year in office, the Chairman is in charge of the agenda formation and preparation of issues for discussion, however the other two members of the Council always retain the right to initiate a Council meeting or propose additional issues in the planned agenda. Council meetings are usually attended by the Chairman of the EEC Board. Other members of the Board may also be invited.

Unlike the Board, the EEC Council adopts decisions only by consensus. Should members of the Council fail to agree, the issue is passed to the Supreme Eurasian Economic Council. In addition, each country of the CU has the right through its member

of the EEC Council to withdraw or amend the decision adopted by the EEC Board within 10 calendar days from the date of adoption of the decision. In this case, within 5 calendar days, the Board provides all the documentation relating to the disputed issue to the Council which takes a decision within 10 calendar days. Should any of the CU countries continue to express dissatisfaction over the decision, the Prime Minister of that country may, within 30 calendar days after public announcement of the decision, request the EEC to submit the decision on the repeal/amendment of a legal act for review to the Supreme Eurasian Economic Council. In certain cases, the Prime Minister of a CU country may request the EEC to submit the issue regarding an adopted decision which has not taken effect for review to the Supreme Eurasian Economic Council. **In both cases, the EEC decisions will not take effect until they are reviewed by presidents of the countries and the final decision is made by consensus**.

The EEC Board is the executive body which prepares proposals for further development of the CU and economic integration of the union. The Board consists of nine members, one of whom chairs the Board. Members of the Board are nominated in equal proportion by each CU country (three members from each country). According to qualification requirements for the Board members, they must have at least seven years experience in the particular field in which they will be working and at least one year experience in the civil service of the nominating country. Members of the EEC Board are appointed for a four-year term by the decision of the Supreme Eurasian Economic Council (at the level of prime ministers). The Council (at the level of presidents) has the right to extend the term of office of members of the Board. The Chairman of the EEC Board is also appointed for a four-year term. Chairmanship is a rotating position. The status of the members of the Board is equal to that of the nominating country's (federal) minister's status.

The EEC Board makes decisions, provides recommendations, and implements decisions by the Supreme Eurasian Economic Council and the EEC Council. Board meetings take place at least once a week and decisions are adopted by consensus or a 2/3 majority vote. The functions of the Board include monitoring of the implementation of the treaty on establishment of the CU and economic union, control of the implementation of the decisions adopted by the Commission in CU countries, prepare written expert reports on the specific proposals received from institutions of CU countries, mediate between CU countries in resolving their disagreements, represent the EEC in the Court of the Eurasian Economic Union, prepare the draft EEC budget, and annual reporting to the EEC Council on the progress in the main areas of the implementation of the integration. The Board would also manage offices of the EEC in third countries.

The EEC Board manages the EEC departments. Departmental directors and deputy directors are elected through open competition for a four-year term. Other employees of departments are also appointed through open competition procedures. The EEC rules of procedure set quotas for positions and employee position levels for nationals of each CU country. In addition, the Board establishes consulting bodies that include representatives from government institutions of CU countries. These consulting bodies usually prepare proposals in their respective fields of competence for subsequent decisions of the EEC Board.

**The court of the Eurasian Economic Union hears disputes between CU countries regarding implementation of legal acts**. Economic entities of countries which dispute EEC decisions and their compliance with legal acts of higher legal force, provided such EEC decisions have negative (financial) consequences, also are entitled to bring a direct action before this court. **On the other hand, there are many doubts as to whether this court, given the specific political system (business-politics nexus and type of political decision making) of the countries of the Eurasian Economic Union, will be able to act as an independent controlling body**.

The rule of qualified majority voting entrenched in the initial phase of integration (according to which Russia had 57% of votes; Belarus and Kazakhstan – 21.5% of votes each), in the course of deepening integration has been more frequently replaced by

the unanimity rule[3] and this transition to unanimity shows the domination of intergovernmentalism. This seems to attest to the declining power asymmetry between member states (as well as entrenchment of the principle of equality); however changes raise the question of whether the structures of the supranational union are only an institutional facade for some member states to relocate their national interests to the supranational level regardless of the rules.

Moreover, some authors argue that Russia's agreement to amend previously valid rules under which Russia's vote accounted for 57% while the votes of Belarus and Kazakhstan accounted for 21.5% and give equal weights to votes **is associated with intentions to provide a response in advance to the potential concerns of the Ukrainian government regarding restrictions of sovereignty by accessing the Eurasian Union**.[4]

Summing up, it is doubtful that member states of the Eurasian CU, which in their domestic and foreign politics rely on the provisions of sovereignty and non-interference in their internal affairs, would grant powers to the supranational institutions that would limit the decision-making autonomy of member states. So far, only the formal side of both institutions and decision-making rules can be evaluated as too little time has passed to allow for an evaluation of specific cases, where, for example, in the event of a dispute, supranational powers would be put to practice or in the event of failure to implement decisions, sanctions would be imposed against any of the countries.

## II. Eurasian CU: economic and/or geopolitical project?

Assessing the motives behind the establishment of the Eurasian CU and the planned economic union, many analysts emphasise political and geopolitical considerations. Some highlight the instrumental importance of this structure to increase Russia's (and its partners') importance in international politics and quote Putin's aspiration to create "a powerful supranational structure" which would speak with the U.S.. China or such regional structures as the EU on an equal basis.[5] Other studies note that the economic impact of the launch of this regional union has not been assessed properly by its initiators. Therefore, the conclusion is made that this process is dominated by political motives, although it is also emphasised that this process is much more complicated than it appears to many Western analysts and that the economy plays an important role in it.[6]

**As shown by many other examples of regional integration, including the EU, politically or geopolitically motivated initiatives can have a strong economic impact and broader political goals may be sought by economic means**. We should remember that the Baltic countries formally applied for EU membership without conducting any further detailed evaluation of the economic impact of membership. This was undertaken only when EU membership negotiations were underway. In addition, as shown by the crisis of public finances and competitiveness of some Eurozone countries, often even after extensive expert debate, regional integration projects may be implemented differently than proposed by analysts or declared by political leaders while inadequate implementation may be the consequence of lobbying-interest groups, prevalence of short-term political interests (re-election of heads of states) and unforeseeable changes in the external environment.

### *Geopolitical aspects of the Eurasian CU*

So what could be the geopolitical motives behind the establishment of the Eurasian Economic Union?

[3] Steven Blockmans, Hrant Kostanyan, and Ievgen Vorobiov, "Towards a Eurasian Economic Union: The challenge of integration and unity", *CEPS Special Report*, No. 75, 2012, available at: <http://www.ceps.be/book/towards-eurasian-economic-union-challenge-integration-and-unity>.

[4] Dragneva and Wolczuk, 8.

[5] See Uwe Halbach, "Vladimir Putin's Eurasian Union. A new integration project for the CIS?", *Stiftung Wissenschaft und Politik, SWP Comments*, 2012; Hannes Adomeit, "Putin's 'Eurasian Union': Russia's integration project and policies on Post-Soviet space", *Neighbourhood Policy Paper*, No. 4, 2012; Iwona Wisniewska, "The Customs Union of Belarus, Kazakhstan and Russia: a way to strengthen Moscow's position in the region", *ISPI Analysis*, No. 146, 2012.

[6] Shumylo-Tapiola, Olga, "The Eurasian Customs Union: Friend or Foe of the EU?", The Carnegie Papers, 2012, 6.

It should be noted that so far the advance of Russia's influence in the post-Soviet space was based on effective instruments of "soft" (preferential gas prices, strengthening the position of the Russian language, etc.) and "hard" (deployment of military bases in the separatist conflict zones, the function of the geopolitical arbiter, etc.) power, yet weak binding international agreements did not provide leverage for Russia over the relations of post-Soviet states with alternative integration spaces.

These weaknesses in the network of dependence relationships of post-Soviet states created by Russia were put under the spotlight by the EU's "integration without membership" concept in the EU's external relations, which through the Eastern Partnership started offering the following relationship formula to post-Soviet states: in exchange for adoption of European rules, partner countries get access to the EU internal market. **Therefore, this formula offered rewards in exchange for participation in the EU's inclusive space and adoption of European rules**.

It is within this geopolitical context that the Russian initiative emerged to establish an integration model of a new quality which would offer an alternative to the set of regulations exported by the EU. **Thus, the underlying geopolitical objective of the Eurasian Economic Union is to create an alternative power centre for integration to the EU's normative power, which would offer post-Soviet states more favourable conditions of access and participation**.

In the absence of an alternative power centre, the stimulus offered by the EU for integration into the EU internal market (participation of partner countries in the Eastern Partnership initiative, an enhanced free trade regime and facilitated movement of people) restricts Russia's opportunities to retain political control over the CIS space. For instance, if an enhanced free trade regime takes effect between the EU and Ukraine, Ukraine would be harmonising it's economic and trade standards (customs duties, technical specifications, standards, public procurement, etc.) with the EU, rather than with Russia. Meanwhile, setting up the CU of Russia, Belarus and Kazakhstan (and the prospect of the Eurasian Economic Union) led the states located between the EU and Russia to being in an area where different institutional frameworks overlapped and at the same time offered them an alternative to the incentives proposed by the EU.

From now on, the decision of the states located between the two integration spaces will depend on the cost-benefit balance between these competing political and economic integration spaces. In this case, Russia's strength lies in two factors: a) in addition to similarity of regulatory norms based on former Soviet standards there are informal rules and practices (business-politics nexus characteristic to the post-Soviet space, corporate culture, oligarchic trends) which act as a kind of "adhesive" material for the post-Soviet space and b) Russia's capabilities to combine economic integration with integration in the energy sector, more specifically, the possibility for Russia to supply energy to partner countries at Russian domestic market prices and Russia's credit resources available for neighbouring countries. Based on these factors, functioning of the Eurasian Economic Union may reduce the advantages of the EU as a centre of attraction and undermine the functioning of such initiatives as the European Neighbourhood Policy and the Eastern Partnership.

In exchange for preferential prices for energy resources, provision of credits and access to its domestic market, Russia may take over strategic areas of economy of other members of the Eurasian Union and therefore strengthen its influence in these states. **By integrating energy sectors, Russia may, in exchange for gas supply at domestic market prices, use mechanisms of the Eurasian Economic Union as a means to take over the partner countries' energy infrastructure, establish joint ventures; develop energy corridors favourable to Russia, etc**. The same processes may take place in the transport sector, where joint businesses could be established by Russia, Belarus and Kazakhstan (such as a common railway company) to control the main Eurasian transport flows.

Russia's political leaders emphasise that the Eurasian Economic Union is an opportunity for post-Soviet countries to strengthen their bargaining power in developing a common economic space with the EU. It is argued that by strengthening the integration of post-Soviet space, countries of the region will have more leverage to create a free trade area "from Lisbon

to Vladivostok" together with the EU according to the rules of the game beneficial to these countries. Despite the EU's and Russia's operations within the common WTO framework, differences between the rules and standards of the EU and the emerging Eurasian Economic Union shows that European integration and its new project in the post-Soviet space are two parallel processes, but they are not, at least so far, characterised by regulatory convergence. Thus, it would be appropriate to speak about competition of two alternative spaces of integration and power centres, but not their harmonisation.

The Eurasian Union may encounter obstacles that were not typical to, for example, EU integration. One of them is the normative approach of Eurasian countries (and Russia itself) to cooperation in international organisations, particularly those of a supranational character. Within the EU, particularly close relations of interdependence exist, that give rise to the principle of voluntary delegation of sovereignty. Meanwhile Eurasia is a geopolitical space with a dominant "realpolitik" approach to international relations where the states follow the "golden" rule of non-interference in internal affairs. **Such strategic approach restricts the process of voluntary delegation of sovereignty, devolution of powers to supranational institutions and turns the entire integration process into a geopolitical/economic exchange policy**.

Because of the decision-making procedure agreed within the framework of the Eurasian Economic Union such a scenario should not be excluded. Decisions of the CU Commission operating from 1 January 2010 were supposed to be taken by qualified majority voting (Russia had 57% and Kazakhstan and Belarus – 21.5% of the votes each) which meant that support of at least one member state was sufficient for Russia to take a decision. **Such a system makes it possible to "buy" and "sell" one's support for one or other initiative in favour of deepening of integration**. Certain coincidences allow us to speak about such a possibility. Shortly after the presidents of Belarus, Russia and Kazakhstan signed the documents for the establishment of the Eurasian Economic Union on 18 November 2011, information appeared about Russia-Belarus agreements concerning granting of more than USD 1 billion in credit and halving of the gas price (from USD 300 to USD 150/1,000 $m^3$). These signs may indicate a trend whereby Russia's grants to the Belarusian economy may be linked to the ongoing support from Minsk to deepen integration of the Eurasian Economic Union. **It should be noted that with the strengthening of the unanimity principle in the institutional architecture of the Eurasian Economic Union, conditions for "trading" political support for integration have not been abolished – formally reduced domination of one state will have to be replaced by "behind the doors" agreements or consensus on nondecisionscharacteristic to the CIS.** Application of the rule of qualified majority voting at least made influences more transparent, while the transition to intergovernmentalism suggests a return to the "passive consensus" typical to the CIS and integration through bilateral pressure. Such a scheme can lead to higher integration costs to Russia, because unlike in the case of a qualified majority, Russia will need to "acquire" not one, but two voices with every round of decision making.

### *Economic aspects of the Eurasian CU*

Recognising the importance of geo-political motives, it is also important to discuss economic elements of the Eurasian CU (and the economic union)[7] in greater detail – the main measures for integration, their (already visible or expected) effects, and cost-benefit sharing between different actors. First, economic aspects of such regional integration structures related to aligning of foreign trade policy measures and analysed in economic literature will be discussed. It is assumed that the Eurasian CU can be analysed using the same analytical tools as any other CU and therefore the benefits of trade liberalisation or the costs of the increased trade protection measures can be assessed and countries and societal groups which

[7] A customs union is a common commercial zone with the free movement of all goods regardless of whether they are produced in the CU or imported from other countries. An economic and monetary union is a further phase of the economic integration. The economic union involves
1. A customs union (common external tariffs to third countries and the common commercial policy)
2. A single market (common product regulations and free movement of goods, capital, labour and services)
3. Coordination of the economic policy between member states.

benefit or experience costs can be identified.[8] The second important element is to identify factors on which a long-term (dynamic effect) rather than one-off (static) integration effect is based. A third related issue is to discuss not only the elements of economic integration, but also political economy factors provided in the literature explaningthe establishment of such regional trade arrangements , and to assess their importance in the case of the Eurasian CU (and the economic union).

***Short-term CU effects: changes in customs duties***

Assessment of the direct effect of the CU usually involves the analysis of the expected benefits related to the elimination of cost and non-tariff barriers to trade among members of the union (the so-called trade creation effect) and harm due to increased duties on imports of goods from third countries (trade diversion).[9]

The Eurasian CU, as authors who assess its effects note, compared to the previously signed CIS free trade agreements, is an important step towards deeper integration between Russia, Kazakhstan and Belarus. The CU embraces the steps that have already been initiated and related not only with the elimination of customs duties on trade between member states, but also with the elimination of non-tariff barriers to trade between member states (simplification and elimination of customs clearance procedures at internal borders, harmonisation of quality standards) and unification of the external trade policy (especially import duties) mostly on the basis of the rules applied in Russia. **So far, the CU has not been fully implemented, but plans are in progress on how to move forward and deepen integration, remove barriers to provision of services and capital and labour movement, and harmonise such policy areas as competition (the Eurasian Economic Union to be created by 2015)**. Since many of these intentions are only on paper or still pending, only decisions that have already been adopted and conditions for the implementation of the intentions or the risks involved in their implementation can be assessed at this point.

Thus, in assessing the CU effect on the countries that have established it, it can be said that the most visible negative effect has been on Kazakhstan. This country had to increase nearly half of its tariffs on the import of goods from third countries (excluding CIS). The common external tariff was essentially aligned to Russian customs duties and coincided with approximately 80% of tariffs applied in Russia. Kazakhstan had therefore to raise the overall level of duty from 6.2% to 10.6% of the weighted average rate. [10] **The European Bank for Reconstruction and Development Bank (EBRD) estimates that because of the increase of duty on goods imported to Kazakhstan, there is a noticeable increase in trade diversion by replacing cheaper products from China with goods from Russia**.[11] The study states that a 0.5 percentage point increase of import duty most likely led to a 2-3% reduction on imports to Kazakhstan from the EU or 1-2% from all third countries.[12] **It is therefore observed that implementation of the CU has complicated Kazakhstan's prospects of accession to the WTO**. In order to reduce the negative impact of increased duties, Kazakhstan (and in some cases Belarus too) negotiated exemptions for the common external tariff of the CU for around 400 products until 2015. Other authors make similar

[8] Many studies referred to in this work analyse the Eurasian CU on this assumption, for example, one of the most recent assessments of the Eurasian CU is provided in: European Bank for Reconstruction and Development: *Transition Report 2012* "Integration Across Borders", London: EBRD, 62–78.

[9] It is usually assumed that reduction of the level of trade protection provides a one-off benefit to consumers (which usually outweighs the adjustment pressures due to increased competition, forcing restructuring and leading to dynamic benefts of more efficient production by previously protected domestic producers) while the increase of duties raises prices, reduces competitive pressure and may eventually lead to replacement of cheaper products from third countries with more costly local production. Non-tariff protection measures, such as product quality or safety standards, may also have a similar effect although it is more difficult to assess it.

[10] Iwona Wisniewska, "The Customs Union of Belarus, Kazakhstan and Russia: a way to strengthen Moscow's position in the region", *ISPI Analysis*, No. 146, 2012, 1.

[11] *European Bank for Reconstruction and Development: Transition Report 2012* "Integration Across Borders", London: EBRD, 2012, 69.

[12] Ibid., 70.

conclusions and suggest that trade diversions due to the implementation of Eurasian CU measures should have exceeded trade creation effects for Kazakhstan, while acknowledging that long term economic benefits could be gained from the liberalisation of services and access to the Russian market.[13]

In the case of Russia and Belarus, a slight reduction of duties on products from third countries has been noted, even though, in Belarus, some import duties were increased (for example, for second-hand cars, therefore imports to Belarus from third (non-CIS) countries fell by about USD 1.1 billion).[14] **Assessing the impact of trade liberalisation within the Eurasian CU, a considerable (2/3) growth in trilateral trade in 2010-2011 was observed, although as the EBRD notes, this is partly due to the general global economic recovery after the financial crisis.** The CU and the reduction of import duties on trade with third countries, according to the EBRD estimates, have been most beneficial for Russia. Eventually, Belarus should implement Russia's WTO accession commitments, which would mean a reduction of import duties. It would be beneficial to consumers, but would also create competitive pressure and serious economic difficulties in the country's vital industries – production of trucks, tractors and other agricultural machinery, refrigerators, electronic goods, building materials, fertilisers and other products (about 50 types of products).[15] Most-favoured-nation tariffs, which came into effect in Russia on its accession to the WTO, will not be applied with respect to exports from Belarus. **In addition, opening of the Russian market to manufacturers from third countries will create additional pressure on Belarusian enterprises to compete in the CU. This may lead to a wave of corporate bankruptcies or restructuring in Belarus and to the political pressure concerning the reverting to trading restrictions or requests of financial compensation from Russia**. Such a situation would facilitate further penetration of Russian state companies into the Belarusian economy.

Assessing the overall impact of CU, according to the EBRD analysts, changes in tariffs related to the implementation of the CU have so far had little impact on the overall trade flows. On the one hand, this can be explained by the period assessed, which is short. Corporate response to changing economic conditions takes time, moreover, many businesses respond in advance on the basis of the expectations formed by the proposed policies. In addition, the exploitation of economies of scale in a larger common trade space is also a long-term process and its effects may depend on the structure of the economy and other factors. **The fact that natural resources (including energy) account for the major portion of Russia's and Kazakhstan's economies and trade structures, while in Belarus, these resources are important as a (re)exported product, has reduced the economic development potential offered by integration**. Trading of energy resources (such as oil) is still subject to exceptions from the CU regime (for example, an export tax).

It should be noted that other analysts, modelling changes in duties on the basis of the general equilibrium model, critically assess the impact of the Eurasian CU, although they rely on other data about tariff changes in Kazakhstan (smaller number of tariff increases and greater reductions than those in previously cited studies). **Their conclusion is that the CU measures reduce the overall economic development of its members, because the trade diversion effect should be greater than that of trade creation**.[16] Estimates also show that due to external tariff harmonisation, Kazakhstan would incur economic losses, but could also have an economic benefit from the removal of non-tariff barriers, although there has

[13] Asel Isakova and Alexander Plekhanov, "Customs Union and Kazakhstan's Imports", *CASE Studies*, No. 442, 2012.

[14] Irina Tochitskaya, "The Customs Union between Belarus, Kazakhstan and Russia: an overview of economic implications for Belarus", *CASE Studies*, No. 405, 2010.

[15] Kamil Klysinski, "Consequences for the Belarusian economy of Russia's entry into the WTO", *East Week*, 29 (305), 2012, available at: <http://www.osw.waw.pl/en/publikacje/eastweek/2012-09-12/consequences-belarusian-economy-russia-s-entry-wto>.

[16] Lucio Vinhas De Souza, "An initial estimation of the economic effects of the creation of the EuraAsEC Customs Union on its members", *Economic Premise*, No. 47, 2011.

been very little progress in this area.[17] Despite that, Russian representatives have announced that the CU will contribute to the faster economic growth of all three countries, which by 2015 will contribute to an increase of gross domestic product (GDP) by around 14-15%.[18] Such assessments are inconsistent with the findings of independent analysts, therefore it is likely that they are based not only on overly optimistic assumptions, but also that estimates include the benefits of elimination of various non-tariff barriers though it is still too early to speak about their practical implementation.

### *The CU effect: elimination of non-tariff barriers*

So far, the relatively limited effect of the CU on the countries involved in it may show a relatively low importance of duties (tariff barriers) to trade as compared to non-tariff barriers. Elimination of non-tariff barriers to trade is an important factor which is difficult to assess primarily because it relates to more general economic policy measures such as business environment, institutional quality, corruption level, etc. It is true that, as the EBRD study states, one extra day in transit (in the queue at customs) may increase the price of a product by around 0.6–2.3%.[19] It is considered that elimination of barriers *did* have a positive effect on trade flows and economic development of CU member states. However, at this stage it is best to speak about the untapped potential of eliminating non-tariff barriers in the CU, which can be illustrated by such comparison: should problems of external customs procedures be addressed, exports could increase by about 44%.[20] In other words, the effects of trade liberalisation, particularly in the long-term, would be significant, if proper institutional conditions for this were created.

In this respect, it is useful to recall other aspects of the formation of regional integration arrangements. In addition to traditional explanations of the development of regional economic unions which analyse the ratio between trade creation and trade diversion, changes in terms of trade with third countries, and opportunities for economies of scale, investment attraction, and growth in the effectiveness of competition, analysts often identify political economy or "non-traditional" effects which may also be important for the development of regional integration structures.[21] **Of such motives, the impact of regional agreements on domestic reforms and the consistency of economic policy in general, "locking-in" trade liberalisation so that interest groups seeking protection would find it more difficult to revert to a higher level of protection in foreign trade, and the ensurance against "trade wars" with the main partners which is especially important to smaller countries may be mentioned. Finally, strengthening of the bargaining power of all countries involved in regional integration in dealings with third countries may be important driver for regional integration.**

### *Political economy factors in developing the CU*

In assessing each of these motives briefly, it should be noted that the effect of the Eurasian CU on reforms in the CU member states, at least in the coming years, will not be significant because, unlike the Central and Eastern European countries, which simultaneously implemented economic reforms and liberalised trade both with the EU and with each other, countries of the Eurasian Union do not implement any significant structural reforms. **Furthermore, given the political regimes in these countries and the powers their leaders hold, it is questionable whether they are in need of additional safeguards capable of reducing the influence of interest groups**

[17] World Bank, "Assessment of Costs and Benefits of the Customs Union for Kazakhstan", *Report*, No. 65977-KZ, 2012. It should be noted that if all three countries were members of the WTO, other WTO members could ask for compensations for increase of duties for external imports, because this is inconsistent with the WTO regional trade agreement conditions.

[18] RIA Novosti, "Customs Union to increase Russia, Belarus, Kazakhstan's GDP by 15 percent – Duma speaker", Moscow, 2010, available at: <http://en.rian.ru/exsoviet/20100104/157463375.html>.

[19] European Bank for Reconstruction and Development, 71.

[20] Ibid. 71.

[21] See Raquel Fernandes and Jonathan Portes, "Returns to Regionalism: An Analysis of Non-traditional Gains from Regional Trade Agreements", *The World Bank Economic Review,* Vol 12, No 2, 1998, 197–220.

**seeking trade protection and thus achieving the "tied hands" effect.** On the other hand, even after Russia's WTO accession, both the country's policy and criticism by the EU and U.S. concerning trade protection measures incompatible with WTO rules show the influence retained by interest groups and their ties with the country's political leaders.[22] In addition, in recent years, several trade disputes occurred among the members of the Eurasian CU, which indicates limited effect of the agreement on trade liberalisation and on the establishment of a stable business environment.[23] Inconsistency in fulfilling trade liberalisation obligations also weakens the positive CU "signalling" function, which should send a message to foreign investors that this regional agreement will contribute to economic development and will later lead to realisation of further integration plans.

A broader factor related with the benefit of suchregional agreements is the quality of institutions and an opportunity to strengthen the quality by introducingliberal trade rules and an open competitive environment. Institutional quality in the economic literature has long been referred to as one of the key factors in economic development and it can be evaluated using such criteria as competitiveness, economic freedom, quality of governance, perception of corruption, etc. which allow international comparisons and benchmarking of different countries. Looking at the three countries discussed in light of these indices, it can be noted that, according to the estimates of the World Economic Forum, in the 2012–2013 Global Competitiveness Index, Russia is ranked 67th (66th the previous year), Kazakhstan is ranked 51st (72nd the previous year), and Belarus is not ranked; in the 2012 Index of Economic Freedom of the Heritage Foundation, Russia is at 144th, Kazakhstan – 65th, and Belarus – 153rd place; according to the World Bank's Doing Business 2013 report, Russia ranks 112th , Kazakhstan – 49th, and Belarus – 58th; in the Transparency International 2012 Corruption Perception Index, Russia and Kazakhstan share 133rd place, while Belarus is in the 123rd place; and according to the 2012 Bertelsmann Transformation Index, Russia ranked 60th, Kazakhstan – 79th, and Belarus – 101st.[24]

In the competitiveness ranking, Russia and particularly Kazakhstan are rated better than, for example, Greece, but in many other international comparisons, all three countries are ranked significantly worse than the EU or the countries of the Economic Co-operation and Development Organisation (OECD). **When the integration of similarly poorly assessed countries takes place, it is difficult to expect that their mutual integration may give a boost to the growth of institutional quality of the Eurasian Union, because it is hard to find good practice models to be followed by other members of the union**. It is important that these weaknesses in the institutional environment in the future will limit the benefit of the customs and economic union to its current and potential members, unless such essential conditions for economic activities, and transparent competitive environment are established and implemented in practice.

Another possible scenario is higher quality activities of supranational institutions (EEC, court), which would serve as a model for national authorities of member states. This can be realised in different technical areas, for instance, by streamlining customs procedures with respect to third countries. **As for more general competences of supranational institutions and the quality of their decisions, their superiority in an increasing number of economic policy areas could weaken the influence, particularly informal, of the heads of state, therefore such scenario, given the specific political system of all three CU members, seems unlikely at least for now**.

[22] As the EU Trade Commissioner Karel De Gucht said in early December 2012 referring to the new rules introduced in Russia restricting the import of a variety of products (cars, pork, wood) from other WTO members, "after Russia's accession to the WTO, they are doing everything contrary to what they should be or what they have committed themselves to". See Joshua Chaffin, "Europe cools on Russia's WTO accession", *Financial Times*, 2012,
available at: <http://www.ft.com/cms/s/0/ff524424-3eff-11e2-9214-00144feabdc0.html#ixzz2EM4PGKDC>.

[23] Shumylo-Tapiola, 11.

[24] Available at: <http://www.weforum.org/>; <http://www.heritage.org/>; <http://www.doingbusiness.org/>; <http://www.transparency.org/>; <http://www.bti-project.org/index/status-index/>.

Finally, one of the most common reasons for the development of regional structures is the strengthening of bargaining power in dealings with third countries (and other regional structures). The Eurasian Union is undoubtedly associated with the larger bargaining power of Russia and other member states in their relations with the EU, China and other WTO members. As has already been mentioned, **this is probably one of the main motives behind the creation of the union, particularly from the point of view of the Russian leadership and this motive may in the future manifest in attempts to persuade the EU to move from bilateral relations, particularly in trade with Russia and other Eurasian countries, to relations with the regional organisation**. One of the actual signs that show Russia's and Belarus' desire to exploit the Eurasian economic space format in their relations with the EU, is the common statement of all three members of the union on 11 March 2012 concerning the unacceptable sanctions of the EU and U.S. imposed on Belarus.

Moreover, further increase in bargaining power is one of the reasons to continue enlargement of the Eurasian Union to Kyrgyzstan and Tajikistan, and possibly also Uzbekistan and Turkmenistan. Armenia, Azerbaijan and Moldova are also considered potential members of the Eurasian Union, although the major issue for the development of this regional group is over Ukraine, the country of the Eastern Partnership most advanced in negotiations with the EU regarding the association agreement and trade liberalisation. According to some analysts, Ukraine has turned into a "normative battleground" between the EU and Russia.[25] **If Ukraine decided to join the Eurasian CU (and economic union), the importance of this organisation in international relations would significantly increase**.

[25] Dragneva and Wolczuk.

## III. (In)compatibility of the Eurasian CU with WTO rules

### *Relationship between regional economic integration and international trade liberalisation*

**The issue of compatibility between the regional economic integration** seen through preferential/free trade agreements or a CU **and the rules of international trade has existed since the establishment of the international system of regulations**. In the post-war period, 1947–1948, during the negotiations on the International Trade Organisation Charter, the U.S. opposed the exemptions from universal rules of international trade that Great Britain and other European countries wanted to retain in their former colonies. At that time, Lebanon and Syria suggested possible exemptions applicable to a free trade area, where the countries of the area would eliminate trade barriers for each other, but would maintain an independent trade policy regime in respect to third countries outside the free trade area and this idea was strongly supported not only by other developing countries, but also by France which was considering a CU with Italy.[26]

The ITO Charter never took effect, because the U.S. Congress refused to ratify it. However, since 1948, provisional application of the General Agreement on Tariffs and Trade (GATT) started and included exemptions that the countries could apply establishing a CU or a free trade area.[27] Perhaps the most important principle of contemporary international trade requires non-discrimination between different trading partners. One of the elements of this principle is the so-called Most-Favoured-Nation Treatment (MFN) regime entrenched in GATT provisions.[28] Naturally, when two or more countries create a free

[26] Regionalism and the World Trading System.

[27] Many authors agree and treat Article XXIV of GATT as a special exemption from the general principles of international trade as compared to the general exemptions provided for in Article XX of GATT or security exceptions provided for in Article XXI of GATT. For more details see Peter Van Den Bossche, "The Law and Policy of the World Trade Organisation: Text, Cases and Materials", *World Trade Law: Text, Material and Commentary*.

[28] GATT.

trade agreement or a CU (which is even a deeper form of regional economic integration, because in addition to the elimination of trade barriers between CU countries they also adopt a common trade regime for third parties), the MFN principle is violated. As has already been mentioned, the international trade rules allow doing this, but at the same time, GATT provides a number of important requirements to be met by the countries which selected a certain form of regional economic integration.

In 1995, following the establishment of the WTO, trade rules and principles of traditional trade in goods were extended to trade in services and protection of intellectual property. The General Agreement on Trade in Services (GATS) also recognises the right of countries to deeper economic integration and in parallel to GATT establishes similar requirements for the said two forms of regional integration.[29] An integral part of the agreement establishing the WTO is the Memorandum of Understanding on the Interpretation of Article XXIV of GATT, which clarifies and supplements some of the provisions of this article that took effect in 1948.[30]

Detailed analysis of the requirements set out by the WTO for free trade areas or CU agreements shows that there are internal and external requirements.[31] First of all, under Paragraph 8 of Article XXIV of GATT, **countries concluding economic integration agreements must eliminate duties and other restrictive trade measures for substantially all trade.**[32] **In addition, CU countries are required to apply the same duties and other trade rules vis-a-vis third countries**. In addition to the said requirements for mutual trade under Paragraph 8 of Article XXIV of GATT, some authors argue, that **the regional integration exemption can only be used by WTO members, while compliance of such agreement with WTO rules can be questioned when a preferential trade agreement is concluded between a WTO member and a non-WTO-member country**.[33] This is not really a strong argument in analysing conformity of a specific regional integration agreement with WTO requirements, because **so far, the discussions of the WTO Committee on Regional Trade Agreements regarding preferential trade agreements between WTO members and non-WTO members predominantly focus on the quality of such agreements rather than membership**. Such agreements also exist between the EU and third countries. For instance, in 1997, the WTO Committee on Regional Trade Agreements discussed free trade agreements between the then European Communities (EC) and Lithuania (as well as two other Baltic states) and the Japanese delegate noted that although the three Baltic states were not members of the WTO, it was expected that requirements of Article XXIV of GATT and Article V of GATS would be respected. At the same meeting, Australian and U.S. delegates also wondered how the EC free trade agreements concluded with non-WTO members eliminated trade barriers for substantially all trade between the contracting parties.[34]

Other requirements of Paragraph 5(a) of Article XXIV of GATT establish that **forming a CU, duties for third countries shall not on the whole be higher or more restrictive than prior to the formation of such union**. The Memorandum of Understanding on the Interpretation of Article XXIV of GATT explains that evaluation of the requirements of Paragraph 5(a) of Article XXIV shall be based on the changes in weighted average tariff rates and customs duties collected.[35] Paragraph 6 of Article XXIV states that **if one of the members of the CU increases the rate**

[29] GATS.

[30] See Understanding on the Interpretation of Article XXIV of the General.

[31] See "The World Trade Organization and Regional Trade Agreements: bridging the constitutional credibility gap".

[32] It should be noted that there is no consensus among the WTO members regarding a more explicit definition of "substantially all the trade" specified in Paragraph 8(a)(i) of Article XXIV of GATT.

[33] Legal problems of making regional trade agreements with non-WTO-Member States.

[34] 3 October 1997, WT/REG1/M/1, WT/REG2/M/1, WT/REG7/M/1 WT/REG8/M/1, WT/REG9/M/1 and WT/REG18/M/1.

[35] Understanding on the Interpretation of Article XXIV of the General.

**of duty above the frozen level,**[36] **compensatory adjustments must be arranged for the remaining members of the WTO according to the procedure provided for in Article XXVIII of GATT**. Finally, one of the last provisions of Article XXIV of GATT is that **the transitional period for the formation of a CU or concluding free trade area agreements cannot exceed 10 years**.

The WTO so far has received 511 notifications (assessing trade in goods and services separately) about regional preferential trade agreements, 319 of these agreements are in force. Many countries around the world are parties to one or more agreements and only Mongolia has not entered into any such agreement.[37]

***The place of the Eurasian Economic Union in the WTO architecture***

Russia's free trade and CU agreements discussed in the report of the working group for Russia's accession to the WTO note bilateral free trade agreements with CIS countries; the bilateral free trade agreement with Georgia; the agreement on CU between Russia and Belarus dated 6 January 1995, the agreement on CU and the Single Economic Space dated 26 February 1999 as well as the agreement on the establishment of the Eurasian Economic Community with Belarus, Kazakhstan, Tajikistan and Kyrgyzstan dated 10 October 2000, the agreement on establishing a union state with Belarus dated 8 December 1999, the agreement on establishing the Single Economic Space with Ukraine, Belarus and Kazakhstan dated 19 September 2003; and the agreement on a common customs territory and establishment of the CU of Belarus, Kazakhstan and Russia dated 6 October 2007, according to which **on 1 January 2010, the CU and its institutions were launched together with a common external tariff, and starting July 2010, the CU Customs Code came into force and customs inspection inside the CU was abolished**.[38]

Many of these agreements have not been fully implemented and have been replaced with new agreements serving similar purpose, however it is evident that integration of Russia, Belarus and Kazakhstan began back in 1995 while the establishment of the Eurasian Economic Community, which seeks to achieve free movement of goods, services and capital on the basis of agreements, started in 2000. To this end, in 2003–2006, a few more agreements were concluded or decisions of the leaders of the Eurasian Economic Union were made. Finally, in 2000, the Treaty on the establishment of the Eurasian Economic Community was amended by the 2007 agreement on the establishment of the CU with three of the five original parties to the agreement.

**Since the start of the integration process, a trend has been observed that the declared date of implementation is in practice delayed**. The delay may vary from a few months to several years. Thus, for example, the introduction of the common customs area took place between 1 January 2010 and 1 July 2011 when the customs treatment of goods was finally moved to the external borders of the CU, but even after that date, Russia tried to retain mandatory customs clearance procedures for individual groups of products exported even to other CU countries.[39] Further integration and the founding of the Single Economic Space as well as taking effect of the relevant agreements was declared starting 1 January 2012 and one tangible result of this was noticed a month later, i.e. in February 2012, the EEC came into operation which is a legal successor of the CU Commission rights. The aim of the Eurasian Economic Space is not only free movement of goods, but also of services, capital and labour, coordinated tax and fiscal policies, common economic regulations, and common infrastructure. There seems to be political will in place and efforts have been made in certain cases to achieve these goals, but on the other hand, it is clear that the process will take more than

[36] According to the requirements of Article II of GATT, all WTO member states freeze their import duties at a certain level in line with the outcomes of the Uruguay Round and the WTO accession negotiations. Import duties are frozen for a specific product (tariff line) and provided in the so-called lists of obligations for opening the commodity market.

[37] Available at: <http://www.wto.org/english/tratop_e/region_e/region_e.htm>.

[38] WT/ACC/RUS/70.

[39] See the ruling of 5 September 2012 of the Court of Eurasian Economic Community.

a few years. **Therefore, the declared goal that the Eurasian Economic Union with common external trade rules and common general macro-economic and fiscal policies will come into operation in 2015 is primarily a political goal and aspiration rather than a realistic date, particularly considering the level of integration achieved so far**.

The analysis of the conformity of the current CU of Russia, Kazakhstan and Belarus with WTO requirements, particularly with the provisions of Article XXIV of GATT, shows that the final common external tariff will take effect after a five-year transition period. For example, for some goods the common external tariff will take effect beginning in 2014, for other goods – beginning in 2015. **Still, after the CU had taken effect, the common external tariff covered 95% of all tariff lines. Import duties were eliminated in trade between the CU countries, but Russia eliminated export duties only on goods for Kazakhstan, but retained them for oil and petroleum products exported to Belarus**. According to the 2009 statistics, this accounted for 19% of total CU trade and as much as 27% of Russian-Belarusian trade turnover. **Different export duties are also applied in respect of third countries by all three CU states**. According to the 2009 data, this should account for 35% of total CU external trade.[40] It can be stated that **today's Eurasian CU does not fully comply with the requirements of Paragraph 8 of Article XXIV of GATT, but given the objectives of ongoing integration, it is likely that within the 10-year transitional period allowed by the WTO, compliance with WTO requirements can be achieved**.

**Assessing the relationship and cooperation between the CU or emerging Eurasian Economic Union and the WTO, cooperation within the framework of the WTO will take place with each CU country separately**. The finalisation of the negotiations regarding membership of Kazakhstan in the WTO can be expected in the next few years, but the situation with Belarus is much more complicated.

Potential membership of the CU or the Eurasian Economic Union as an economic structure in the WTO should be analysed on the basis of the requirements of Article XII of the Marrakesh Agreement which established the WTO.[41] **According to these requirements, an independent economic structure, particularly consisting of several countries, must have not only common rules for trade in services, including rules on the establishment and investment regime, but also a common legal framework for intellectual property protection and common public procurement regulation**. The Eurasian CU has not reached such integration; only the EU meets such requirements.

It should be remembered that the EC was among the founding members of the WTO and this exclusive status is marked in Article XI of the Marrakesh Agreement. At the same time, all EU Member States are members of the WTO individually and the EU membership did not guarantee automatic membership in the WTO. On the contrary, countries accessing the EU had to become members of the WTO. It should also be noted that representation of common interests of the EU in daily activities of the WTO within the framework of multilateral negotiations and WTO dispute resolution is regulated under EU law, primarily Article 207 of the TFEU,[42] rather than under the WTO rules. But even this allows individual EU Member States to speak individually at the WTO Budget, Finance and Administration Committee.[43]

**Such a model for operation within the WTO should be applied to the emerging Eurasian Economic Union, after all its member states become members of the WTO**. Moreover, there is an established tradition among members of the WTO to form groups or coalitions for stronger representation of their interests in negotiations. Although some of these groups seem to be established on a regional basis, primarily they

[40] WT/ACC/RUS/70.

[41] Marrakesh Agreement.

[42] Treaty on the Functioning of the European Union, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:lt:PDF

[43] http://www.wto.org/english/thewto_e/countries_e/european_communities_e.htm>.

represent a particular economic interest in some area of bargaining.[44]

In assessing participation of Kazakhstan in the CU and the emerging Eurasian Economic Union it is obvious that this process has complicated Kazakhstan's negotiations for WTO membership.

Kazakhstan's WTO accession negotiations ran into complications on the issue of the opening of the market for goods on the basis of bilateral negotiations with individual WTO members (negotiations have been completed with many members). **However, when the common CU external tariffs came into effect, Kazakhstan's import duties changed (mostly increased). Given that Kazakhstan fulfilled its commitment on import duties under the bilateral agreement with the WTO before the establishment of the CU,**[45] it is clear that a complex period of new negotiations is expected during which Kazakhstan's bilateral commitments will have to be adjusted against the valid CU common external tariff.

Modelling EU policy concerning the recognition/non-recognition of the Eurasian Economic Union or planning scenarios for cooperation with the Eurasian Economic Union, it is necessary to take into account the WTO rules governing activities of such economic structures. According to these rules, **as long as there are members of the Eurasian Economic Union, which have not joined the WTO, and cooperation is maintained, according to the WTO framework, with each of these members individually, the EU should develop its relations *not* with the Eurasian Economic Union as an independent unit, but with individual member states**. There is an additional argument – current integration level achieved by the Eurasian Economic Union does not allow the structure, as an independent economic unit, to establish membership in the WTO.

## IV. Reasons for participation in the Eurasian Economic Union

### *Russia's motives*

Assessing the relationships between members of the Eurasian Union and reasons for participation in the union, it should be noted that Russia, for various reasons performs the role of the main initiator and integration engine. Russia's economy accounts for the largest portion of the region. For Kazakhstan and especially Belarus, Russia is important as an export market and source of import. Meanwhile, for Russia, the market of these two countries is relatively insignificant. This gives Russia greater bargaining power in solving issues of CU economic regulation and the Single Economic Space. **It is likely that the dominant decision-making behaviour during joint agreements will become the transfer of rules and principles applicable in Russia to the other two countries of the union**. Given that Russia has already become a member of the WTO, this process may have a positive impact on the economy of Kazakhstan and Belarus, but the strengthening of regulatory and institutional quality will take place only if Russia fully respects WTO principles and agreements in force (which, as we have mentioned above, raises serious doubts).

It is also likely that the supranational institutions of the Eurasian Union (EEC, the Court of the Eurasian Economic Union) will primarily focus on the position of Russian institutions and current policy, because this will decrease the likelihood of non-compliance with their decisions. Although formally all states involved are equal and are represented in the Supreme Eurasian Economic Council, also the Eurasian Commission should act independently from CU states, certain appointments, such as the Chairman of the EEC Council, show that Russia's leaders attribute great importance to these institutions and probably will seek that their activities would be consistent with Russia's interests.

After assessment of literature analysing regional trade arrangements, particularly the works that emphasise the importance exerted by one dominant regional union member on joint agreements and

[44] Available at: <http://www.wto.org/english/tratop_e/dda_e/negotiating_groups_e.htm>.

[45] Available at: <http://www.wto.org/english/thewto_e/acc_e/a1_kazakhstan_e.htm>.

integration process,[46] it can be stated that **even if the importance of geopolitical motives and ambitions is disregarded, the Eurasian Union is primarily a process supported by the Russian leadership and should be regarded as a tool for realising its policies and interests.** Since the creation of the Eurasian Union will inevitably necessitate consensus among all countries on issues of economic regulation and possibly taxation, any such arrangements are likely to be formed on the basis of Russia's proposed solutions. Russia's importance stems not only from the asymmetry of economic interdependence, but also from its ability to finance joint initiatives or to allocate money for countries participating in the union, as shown by the financial assistance to Belarus provided through Eurasian institutions. The participation of Belarus in the union is important to Russia not only for economic reasons, including transit to Kaliningrad and the EU market, but also for geopolitical and security reasons.

Finally, the fact that by choosing establishment of the CU, Russia complicated its bilateral trade and economic relations with the EU and other countries, should not be overlooked. Due to launch of the CU, Russia's WTO membership was postponed for a few years while the EU-Russia post-PCA negotiation stagnated.

Russia has always been an important strategic partner for Europe, but by choosing regional integration as its priority and at the same time increasing confrontation in trade with the EU, Russia may be seeking to avoid dialogue with the EU, which after the Lisbon Treaty started speaking with one voice, because this would allow returning to bilateral relations with separate "friendlier" EU Member States. This assumption can be made on the basis of Russia's statements that the negotiations with the EU should be conducted not on the bilateral EU-Russia grounds, but on the inter-regional EU-Eurasian Economic Union grounds (in view of the political and economic systems of the states which constitute the Eurasian Economic Union, there is no ground to assume that the inter-regional negotiations would take place any easier than bilateral). CU initiators and authors may have estimated that Russian economy is not yet ready to compete on equal terms with the countries of the EU, especially knowing the opinion of the majority of EU countries that Russia's WTO membership should only be the first step towards further liberalisation of trade and investment. In this case, the CU idea might be just a smokescreen for Russia realising that it will not be able to respond equally to a trade liberalisation offer from the EU.

***Belarus' motives***

Participation of Belarus in this regional integration process seems to be motivated, on the one hand, by relatively low adjustment costs, because most standards were already in place as a result of previous intensive Russian-Belarusian economic cooperation. **Furthermore, Russia is not only the supplier of energy resources (oil and natural gas) at lower prices to Belarus and to its businesses, but also the main market for core Belarusian export goods (around 90% of food products and around 70% of equipment produced in Belarus are sold in Russia)**.[47]

On the other hand, the A. Lukashenka has a strong incentive to use this process as a counterweight to the countries and organisations in the West which have applied sanctions to the regime. Financial assistance to Belarus, probably not coincidentally, provided not as abilateral Russian support but as support through institutions of the Eurasian Economic Community (which consists not only of Russia, Kazakhstan and Belarus, but also of Kyrgyzstan, Tajikistan and Uzbekistan) is one of the main reasons for the Belarusian elite. It is probably no coincidence either that in the run-up to the 2010 presidential elections in Belarus, its leader, after initial reluctance, finally agreed to sign the tripartite CU Code. It was in the same year that Russia decided to reduce the price of oil sold to Belarus to the level of the Russian domestic market price and later Putin announced that he would

[46] See Richard E. Baldwin, "The Causes of Regionalism", *The World Economy*, Vol. 20, No. 7, 1997, 865–888; Mattli Walter, *The Logic of Regional Integration*, Cambridge: Cambridge University Press, 1999.

[47] Iwona Wisniewska, "The Customs Union of Belarus, Kazakhstan and Russia: a way to strengthen Moscow's position in the region", *ISPI*, No. 146, 2012, 5.

apply the same pricing for natural gas, calling it an "integration discount".[48]

It is obvious, however, that the Belarusian president, although having agreed to sell shares of some infrastructure companies of Belarus to Russian companies, is not enthusiastic about moving towards deepening regional integration. **Further integration with other members of the Eurasian Union would increasingly restrict his capacities to retain his power and the current Belarusian regime, especially when initiatives such as a monetary union are implemented, which would directly limit his possibilities to manipulate the monetary policy to create an illusion of welfare growth for the population.** However, to maintain his power, when faced with the choice between further integration within the Eurasian Union as well as Russia's advance in the Belarusian economy and the renewal of relations with the EU, which is associated with political reforms, he may choose the first option. However, in this case, the claim that Belarus was a voluntary participant in the formation of the Eurasian Union and that the Eurasian economic integration is based on a bottom-up principle is hard to maintain.[49]

In summary, it can be said that due to interests of the political regime and the unwillingness to lose complete economic sovereignty, Belarus is not interested in the transformation of the Eurasian CU into a fully-fledged economic and monetary union. However, the demand for economic concessions and financial resources from Russia might make the current political regime extend its support for further deepening the integration of the Eurasian economic space.

As far as the democratic choice is concerned, it should be noted that in the case of Belarus, Kazakhstan, and Russia it is difficult to talk about independent decisions in the same sense as the EU member states. None of the countries of Eurasian union can be attributed to a free society,[50] which means there is absence of the rule of law and fair trials. Naturally, all these attributes should be transferred to the regional structure. In addition to the likely democracy deficit and power asymmetries within the Eurasian union as an organisation (as mentioned above), it is a union of nondemocratic regimes also when judged by OSCE election monitoring reports only[51].

***Kazakhstan's motives***

**In the case of Kazakhstan, the economic motivation to participate in the tripartite CU is relatively weakest among the three; specifically, at least so far, the negative economic effects of membership appear to be greater than the positive ones.** In the longer term, the creation of a common space can attract more foreign direct investment at the expense of the other two countries, particularly since Kazakhstan gets better rankings in the areas important to investors. Moreover, agreement provides better conditions for export to the Russian market important to Kazakhstan. However, the main explanation for the participation of Kazakhstan should be associated with political motives – **a strategic partnership with Russia, balancing between Russia and China and possibly the personal desire of the country's leader to make a mark in the history of the country (back in 1994, he proposed creating the Eurasian Union, although composed of more CIS countries)**.

In summary, it can be said that although creation of the Eurasian CU can today be seen as the first significant step towards practical regional integration in the CIS territory, its implementation has so far been accompanied by the institutional inconsistency and uncertainty of the final goal, while the motivation of the countries involved is quite different. There are even more uncertainties about the further in-

[48] Hannes Adomeit, "Putin's 'Eurasian Union': Russia's integration project and policies on Post-Soviet space", *Neighbourhood Policy Paper*, No. 4, 2012, 4.

[49] Belarus' energy dependence on Russia (90%–nearly 100%) in the natural gas and oil sectors, in the past two decades, drove Belarus to various economic and political integration projects with Russia – from the Collective Security Treaty Organisation, to the creation of the Union State, however the integration has been essentially on the exchange basis (lower energy price/loan in exchange for integration/ownership of strategic objects).

[50] Freedom in the World 2012, <http://www.freedomhouse.org/report-types/freedom-world>.

[51] OSCE Office for Democratic Institutions and Human Rights, <http://www.osce.org/odihr/elections>.

tegration plans of the Eurasian Economic Union. As has already been mentioned, the formation of the Eurasian Economic Union, which started at the beginning of 2012 on the basis of the CU, should include implementation of all "four freedoms", i.e. establishment of a single market. As Putin mentioned in his statements, in the long run, other economic policies should be aligned and a "complete economic union" should be created, which would be equivalent to the Economic and Monetary Union, and finally would be able to become a political union.[52]

***Why is it difficult to follow in the footsteps of the EU?***

The vision of the Eurasian Economic Union quite clearly echoes stages of the EU's development. In the course of developing the CU, the creation of a single market started. In some areas, such as the labour movement, the three countries have already liberalised and agreed the rules and workers from partner countries are treated like nationals. In other areas, however, there are a number of obstacles, including non-tariff barriers to movement of goods. Barriers to free movement of capital should be phased out by 2020.[53] The services market also remains fragmented and, despite intentions to apply the principle of mutual recognition in some areas, some services (audio-visual, air transport) will be exempted from it. As a result, regulatory differences in each country are likely to remain, creating discriminatory restrictions. As shown by some assessments, **although the synchronisation of business cycles among the three members of the CU is growing, significant differences of business cycles remain and the economies are not sufficiently flexible to respond through internal adjustment to external shocks**.[54] This restricts opportunities for the realisation of a successful monetary union, though there are even more barriers to such an integration project in the political field, primarily due to the political regime in Belarus, which is reluctant to give up its chances to manipulate the independent monetary policy and currency exchange rate.

So while the process of the creation of the Eurasian Economic Union, which gained momentum at the beginning of 2010 with the declaration of the CU of Russia, Kazakhstan and Belarus and later with the preparation of new agreements for the Eurasian Economic Space, proceeds at a fairly rapid pace, it is too early to talk about smooth functioning of the CU let alone of other freedoms of the common market. **Further integration process by removing barriers not only to movement of goods, but also to services, capital and labour will inevitably be confronted with the issue of common regulations, their enforcement, dispute settlement procedures and compliance with judicial decisions**. In addition to elimination of trade barriers, harmonisation of market and, in particular, economic regulations, the greatest challenge to this process may be a new major attribute (compared to previous integration initiatives among CIS countries) – formation of supranational institutions and enforcement of their decisions. It should be noted that decisions of the Eurasian Economic Commission are binding and do not even have to be transposed into the national law of the Eurasian Union states (like in the case of EU directives). Like in the EU, companies can bring actions into court against institutions of the union member states and court rulings are binding.

When supranational institutions responsible for the preparation of the regulations for the union and control of their implementation start to function, questions arise as to which parties involved in the union will have the biggest influence on the content of general "rules of the game" and how all parties involved will comply with the agreements, particularly given concerns about the rule of law and judicial independence in these countries regularly expressed by international observers. **If decisions of the EEC and other supranational institutions are not observed, the Eurasian Union will not function and will remain a fragmented free trade area with elements of common external trade policy**. The possibility of such a scenario is exacerbated by the fact that Kazakhstan and Belarus are not members of the WTO and the latter's chances of becoming a member

[52] Adomeit, 1.

[53] Wisniewska, 2.

[54] Yulia Vymyatnina, "Customs Union of Russia, Belarus and Kazachstan – economic interdependence and resource curse influence", *BOFIT seminar*, European University at St. Petersburg, 2012.

of the WTO are remote. As noted, Russia's progress in implementing the conditions agreed at accession to the WTO, as observed both by the EU and other WTO members, is questionable and therefore raises doubts as to how smooth the implementation of the rules of the Eurasian Union will be.

Given the motives of member states of the Eurasian Union for participation in this project, it is possible to formulate the following three scenarios for further formation of this regional structure:

**Scenario 1. The rapid and relatively successful integration of the Eurasian Economic Union** (yet much later than the scheduled 2015).

This scenario would mean integration "on paper", i.e. political decisions (to remove barriers to services, capital and labour movement, harmonisation of such policy areas as competition), however, postponing implementation of the decisions for decades; can be in place in the next two years. Such a scenario is realistic, if Russia succeeded in finding the "key" which would encourage Kazakhstan to treat integration within the framework of the Eurasian Union as a security guarantee (perhaps post-2014 instability in Afghanistan, increase of China's influence, etc.). Such a scenario would be the most disadvantageous with respect to EU's interests:

- Possible expansion of the Eurasian Union – Ukraine's membership in the Eurasian Union becomes real under the economic pressure (supply of energy resources at Russian domestic market prices) and the unfavourable domestic political environment for European integration. This would mean fundamental challenges to the agreements with the EU already reached within the Eastern Partnership format and perhaps even their suspension.
- Negative effect on Kazakhstan's negotiations for accession to the WTO: from sluggish negotiation schedule to suspension of negotiations.
- Negative effect on the EU's leverage on Belarus – risk of serious challenges to applicability of economic sanctions, since EU - Belarus sanction policies become a matter of the whole Eurasian economic bloc.

In this scenario, members of the Eurasian Union will keep pressing the EU to move from bilateral to inter-regional cooperation, given that regression of bilateral cooperation is expected.

**Scenario 2. The Eurasian Union as yet another stagnating project of the CIS area**.

This scenario describes the situation where implementation of the goals of integration is achieved neither by 2015 nor even over the next two decades and not even "on paper", i.e. the goals are implemented inconsistently, only in some areas and completely depending on the electoral and economic cycles, which traditionally in the CIS space mark the strengthening of Russia's influence. This is the most realistic scenario, which would allow member states (in particular, Belarus) to exchange their support for deepening of integration. On the other hand, such exchange also has its limits, because, as it is clear now, the Eurasian monetary union would not be favourable to Lukashenko's regime, because the regime would lose an opportunity to "lift" its backward national economy by using monetary means. While this scenario would mean stagnation of the Eurasian Economic Union, it does not eliminate threats to the implementation of the Eastern Partnership: Ukraine may also have to regularly trade certain elements of integration with Russia in exchange for prices of energy resources, but without departing too far from the EU. Further consequences will depend entirely on the domestic political and economic situation in Ukraine – to what extent the ruling elite will be willing to and be able to afford to take the adjustement cost of integration with the EU as compared to certain sovereignty waiver to Russia.

This would mean selective cooperation for Eurasian relations with the EU: dealing with issues both on the bilateral level and the inter-regional level, as appropriate. Depending on how beneficial the cooperation with the EU would be for Eurasian Union countries, this format could be used as a tool for not accepting liberalisation requirements of the EU.

**The fundamental problem with both scenarios is as follows: despite possible pressure to move to inter-regional cooperation between the EU and**

**the Eurasian Union, such cooperation would not be justifiable for the EU**:

- In the case of both scenarios, the Eurasian Union will still lack essential elements that would allow it to be seen as a balanced and voluntary regional integration project leading to the transformation of the member state economies; rather it will remain a non-liberal project for simplification of the trade regime between non-democratic regimes. The transition to the inter-regional cooperation would mean that the EU would legitimise decisions of undemocratic regimes on delegation of sovereignty.
- There is no reason to believe that the inter-regional cooperation would be more productive than bilateral formats, in which the EU has considerably more leverage.

**Scenario 3. Reverting to bilateral cooperation and rejection of the idea of the Eurasian Economic Union.**

The necessary driving force behind this scenario is Russia's decision to withdraw. This would be symptomatic of fundamental political changes in Russia or emergence of other instruments that would allow Russia to continue its domination in the region. Another possible option is that for some reason Belarus and Kazakhstan would become a burden intervening with Russia's objectives (perhaps in seeking the bilateral visa-free regime with the EU or because of the position of Russia's internal interest groups disagreeing with continuous subsidising of the Belarusian economy). From the EU's point of view, this would be quite a positive scenario and would mean a better environment for the Eastern Partnership initiative, recovery of leverage in respect to Belarus, and the return to a more acceptable bilateral dialogue with Russia.

## V. (In)compatibility and competition between the EU and the Eurasian Economic Union

### *Why is a Single Economic Space "from Lisbon to Vladivostok" unlikely?*

As observed by various authors, from the beginning of the EU's Eastern Partnership initiative, Russian leaders viewed it with suspicion, as an attempt to limit Russia's influence, an initiative against Russia.[55] It should be noted though that after Putin had set out the vision of the Eurasian Economic Union in greater detail, there were no public hints about competition of this regional structure with the EU and the resulting dilemmas to the countries involved in the Eastern Partnership. Moreover, Putin stated, "entry into the Eurasian Union allows each of its participants to, more quickly and from a stronger position, integrate into Europe".[56] This can be linked to the pronouncement of another Putin vision a decade ago about "a Single Economic Space from Lisbon to Vladivostok". Despite these visions, however, **there is considerable doubt about the relationship between this regional structure and the EU, in particular regarding the possibility for Eastern Partnership countries to harmonise liberalisation of economic relations and adoption of regulations in both directions**. An interesting coincidence that should be mentioned is that Putin announced the visions of the Eurasian Union about a week after the Eastern Partnership Summit in Warsaw.

**Leaders of the Eurasian Union and its member states declare their intentions to adopt EU regulations, but this is still a theoretical possibility rather than an advanced process. Adoption of the EU's product quality, particularly production regulations, will cost businesses of Eurasian countries and increase end-product prices**. Income levels in these countries are much lower than those in the EU and the transposition of stricter regulations will be too costly, given that there is no prospect of EU membership which was the key motive for Lithuania and other Central and Eastern European countries to introduce more stringent EU norms. The main motive for the countries of the Eurasian Union to adopt EU standards would be the need for exporting companies in these countries to sell their products on the EU market. If adoption of EU rules is not directly related to the interests of exporters (when we speak about the standards governing manufacturing

[55] Ingmar Oldberg, "Russia's great power strategy under Putin and Medvedev". Stockholm: Swedish Institute of International Affairs, 2010, 6.

[56] Adomeit, 2.

process – environmental standards, but not about product quality standards) this will undoubtedly be a long process and it is not clear that it will ever be completed. **Thus, it is hardly possible to talk about Putin's advocated vision of Europe "from Lisbon to Vladivostok"**. A less costly solution would be an agreement with the EU on mutual recognition of regulatory differences, encompassing only more prominent regulatory differences than those existing between EU Member States. This, however, is hardly likely due to traditional EU external policy based on the extension of EU regulatory norms and common democratic and market economy principles to other countries.

The EU has consistently observed this principle not only with respect to candidates and countries negotiating for membership in the EU, but also with respect to neighbouring states pursuing closer relationship without a membership perspective as well as all WTO members where removal of non-tariff barriers to trade is negotiated. **The concept of a deep and comprehensive free trade area is based not only on removal of tariff barriers between the EU and a neighbouring country, but also on the adoption of a large part of EU regulations by that country.** The EU's objective to transpose regulatory norms not directly related to trade to Eastern Partnership countries incurs costs on businesses and increases their product prices, but this has become a condition for such agreements. This EU policy, which is subject to criticism, was most obvious with respect to Georgia when it implemented far-reaching economic reforms in 2005–2008. Georgia's economy was liberalised more than economies in many EU Member States, but the EU insisted that Georgian authorities would not only carry out privatisation, deregulation and liberalisation reforms, but would also adopt EU regulations on competition, labour relations and other areas not directly related to trade.

**This indicates that any significant liberalisation of EU trade with Eastern neighbours and movement of people, capital and services will inevitably be associated with adoption of EU regulations by neighbouring countries**. Since old GOST or national technical standards and regulations are valid in the countries of the Eurasian Union, differences in regulations will remain for quite a long time and will function as non-tariff restrictions on trade between the EU and members of the Eurasian Union. **Certainly, theoretically, it is possible to imagine a free trade, tariff-free area between the EU and the Eurasian Union, but such a free trade area would be fragmented and limited to certain products that may be of no interest to Eurasian countries**. Similarly, because of the pressure of interest groups in the EU countries, liberalisation of trade with Central and Eastern European countries took place and there is a reason to believe that in this case interest groups would exert influence, given current rather complicated economic situation in some, particularly southern European countries.

### *The "Wider Europe" scenario or the development of the Eurasian Economic Union?*

If the EU accepted Russia's proposal to move from bilateral relations to EU relations with the Eurasian bloc, negotiations with a member of the Eurasian CU regarding free trade with the EU would be difficult because they would have to be conducted through the EEC and the agreement would be valid for all CU states. Considering EU policy towards Belarus, one of the members of the Eurasian Union, any intense dialogue, even outside the issue of trade liberalisation, is unlikely for political reasons. Thus, other members of the Eurasian Union, which tend to link observation of democratic principles and intensification of economic relations, would become hostages of Belarus' domestic policy stance in relations with third countries. At the same time, Belarus would have a theoretical opportunity to restore relations with the EU without any policy change through the back door, i.e. through the Eurasian Economic Union as a single economic unit.

**In any case, it is likely that the EU will not (and should not) treat the Eurasian Union as an equal partner until all its members become members of the WTO**. So far it seems that in a few years, Kazakhstan could become a WTO member and the prospects of Belarus joining the organisation are still very unclear. Kazakhstan's and Belarus' commitment to fulfilling Russia's WTO accession conditions may facilitate their preparation for membership in the WTO, but it will take time and the willingness of the Belarusian political regime to accept certain restrictions, preventing the possibility to manipulate economic regulation.

However, the offering of new types of trade agreements to Eastern Partnership countries based on the adoption of regulations and the progress in negotiating the DCFTA with Ukraine show that the EU is likely to disagree with the signing of a more simple free trade agreement. Considering the unlikely adoption of EU norms by the countries of the Eurasian Union, at least in the next few years, Eastern Partnership countries would inevitably have to choose between two different regulatory spaces. **Therefore, despite the rhetoric of Russian leaders about the pan-European economic space, it does not match either Russia's or the EU's policies, which leads to the current dilemma for Eastern Partnership countries to choose between integration into the EU or closer relationship with the Eurasian Union**.

The first option, the **"Wider Europe" scenario**, for Eastern Partnership countries would mean a fair number of commitments to EU principles of democracy and the application of relatively strict regulatory standards in exchange for access to a market with a population of 500 million, rapid growth opportunity and a possible promise of the prospect of membership. The second option – **development of the Eurasian Economic Union** – could mean lower energy prices for some time, freer trade in the Eurasian space with a population of 170 million with significantly lower purchasing power than in the EU, lower potential for exchange of best practices, slower economic restructuring and strengthening of oligarchic and authoritarian management habits.

***Towards competition between two alternative integration spaces***

Thus, the countries of Eastern Europe and Southern Caucasus participating in the Eastern Partnership programme have ended up between two integration spaces: European economic integration (through a network of enhanced free trade agreements with the EU) on the one hand and the Eurasian CU on the other hand. **Through enhanced free trade agreements the EU in principle does not preclude further integration of these countries with each other, but once they become parties to the CU, they are deprived of the opportunity to have bilateral agreements with the EU. Thus, in practice, these countries must inevitably make a choice**.

The European Neighbourhood Policy (together with the Eastern Partnership initiative) provides that in exchange for political, economic and legal reforms (adoption of European rules), neighbouring countries of the EU will be offered preferential terms of participation in the EU internal market.[57] The EU decision to expand a network of free trade agreements will eventually transform the trade of all EU and partner countries by removing tariff barriers, unifying standards and customs procedures. **Thus, participation in another CU, which involves countries which have not harmonised their legislative framework with EU requirements or their product standards, border control systems with EU standards, etc., becomes an objective that cannot be met,** unless the Eurasian CU takes over an identical regulatory treatment.

Meanwhile, the free trade regime that has so far been in place in the post-Soviet space, left the control of the depth of integration to each country and has not prevented CIS countries to join the EU economic space. The situation changed only in 2010 with launch of the CU of Russia, Belarus and Kazakhstan. This union established not only a free trade area, but also a common structure of import duties and international trade procedures as well as started harmonisation of sanitary and other standards. **Therefore, countries participating in the Eurasian CU are prevented from participation in the EU economic space (through enhanced free trade agreements), because in this case the tariff policy and trade standards would have to be reviewed**. The involvement of the countries of Eastern Europe and Southern Caucasus (participating in the Eastern Partnership programme) in the Eurasian project would mean that they cannot plan a free trade space with the EU, because any such agreements should become the matter of the whole Eurasian Union.

The following are the reasons why membership in the Eurasian CU is incompatible with participation in

[57] Marius Vahl, "A privileged partnership: EU-Russian relations in a comparative perspective". *DIIS Working Paper*, 3, 2006, 9–11, available at: <http://www.diis.dk/graphics/Publications/WP2006/3_m_vahl_privileged_partnership.pdf>.

the enhanced free trade regime with the EU:[58]

- **Countries who become members of the Eurasian CU lose independence in external trade policy**. CU member states must not only agree on a common customs tariff, but also to develop a joint trade regime with third countries. Given the specific characteristics of the Eurasian institutions, in order to pass a decision or seek to develop a more favourable trade regime with the EU for any member of the CU, Russia's approval is required. Thus, Russia gains leverage to control external trade policies of CU countries and their relations with the EU, for example, to block negotiations with the EU on an enhanced free trade agreement. It should be noted that the collaboration formula "3 +1", which provides for a standard free trade regime without a common external tariff (which would meet Ukraine's commitments to the WTO and the enhanced free trade agreement with the EU) and was suggested by Ukraine to Russia and other CU states was rejected. The same happened with the 2011 standard free trade agreement initiative within the CIS framework, when Russia found ways to block the agreement, which would have allowed Ukraine access to the CIS markets and participation in the enhanced free trade regime with the EU, from taking effect.[59] **On the one hand, this means that the traditional multivectoral policy of Ukraine and other Eastern European countries has reached its limits. On the other hand, it shows Russia's interest in a model of the relationship with Ukraine and other Eastern European countries, which would allow Russia to control their policy with respect to the EU**.

- **If Eurasian CU would be recognised by the EU, it would generally mean that as soon a country becomes a member of the Eurasian CU, the EU can no longer continue a dialogue or negotiate a mutual free trade agreement with that country, because the partner of both the dialogue and the agreement changes**. From the moment a country becomes a member of the CU, the EU cannot negotiate an enhanced free trade agreement with it, because it has to negotiate it with the rest of the economic bloc (in this case, the Eurasian CU). Bearing in mind that the essential precondition for any negotiations with the EU on a free trade agreement is the country's membership in the WTO, while at least two countries of the Eurasian CU (Belarus and Kazakhstan) are not members of the WTO, the scenario for EU–Eurasian CU negotiations on the enhanced free trade regime is unlikely. If a country becomes a member of the CU after the enhanced free trade agreement with the EU takes effect, the agreement (or an integrated association agreement) would have to be denounced.

**On the other hand, the incompatibility of the two integration spaces lies both in the mechanisms for setting the external tariff and the competition of different standards and regulations**. It should be borne in mind that the EU seeks to model neighbouring countries according to its own pattern. Thus, the internal integration model within the EU creates a strong barrier for partner countries seeking to join the EU internal market. It should be noted that the EU's support for the international deep and comprehensive free trade agreements is strongest when it comes to the expansion of EU regulatory standards outside the EU in order to maintain the EU's competitive advantage in international markets.[60] As a result, free trade agreements proposed to EU's partner countries are no longer based solely on the tariff reduction logic, because they cover a broader range of issues, such as removal of non-tariff barriers, liberalisation of the

[58] Guillaume Van der Loo, "Ukraine's regional economic integration: stuck in the middle of its neighbours? A legal and polical analysis". *Eastern Partnership Community*, 2011, available at: <http://www.easternpartnership.org/publication/economy/2011-11-04/ukraine-s-regional-economic-integration-stuck-middle-its-neighbours-l>.

[59] Olga Shumylo-Tapiola, "Ukraine at the Crossroads: Between the EU DCFTA & Customs Union", *Ifri Russia/NIS Center*, 2012, 22.

[60] Thomas Diez, "Normative Power as Hegemony". Conference presentation *2011 EUSA Biennial International Conference*, Boston, accessed on 3–5 March 2011, <http://euce.org/eusa/2011/papers/7l_thomas.pdf>.

services sector, elimination of the state's protectionist measures, favourable conditions for foreign direct investment, etc. So the agreements acquire the comprehensive nature[61] and partner countries have a status of a "political successor". Thus, by offering free trade agreements, the EU requires from partner countries economic modernisation, furthermore, modernisation with high EU standards in such areas as sanitary and phyto-sanitary standards, technical regulations, public procurement, competition policy and state aid.

Partner countries can get access to the EU internal market only when they adopt EU standards, rules of origin, certification procedures, etc.[62] In other words, **first, they have to adopt the standards, because this is a condition for access to the EU market.** In addition, in exchange for the free trade regime, countries will be required to transpose the required EU reform package. It provides for the state grant systems and abandoning of protectionist measures, implementation of which would inevitably change interaction between the state and business. Meanwhile, many economic sectors of post-Soviet countries are still characterized bystate protection, and they are very sensitive to international competition. Bearing in mind that there is the business-politics nexus in the post-Soviet space and therefore the political system in the post-Soviet space is strongly influenced by oligarchic business groups, the EU rules may become too high a bar for the integration of post-Soviet countries into the EU internal market (because essentially all requirements – from adoption of technical standards to fundamental structural reforms – must be implemented simultaneously).

The importance of different standards and regulations becomes particularly apparent **when the bar of the rules for adapting to an alternative centre of gravity to that of the EU (in this case, the Eurasian CU) is much lower than EU requirements**. GOST standards still dominate in the Eurasian CU as one of the main categories of standards of the former USSR. Today this is the cross-border standard for the CIS.[63] This system includes Ukraine and other Eastern Partnership countries. This indicates that adaptation to Eurasian CU standards for these countries would not create any barriers or convergence costs. In other words, **if the EU offers convergence towards high standards that can cause "shock therapy" to business groups operating under old business patterns and schemes, so the CU does not require any fundamental reorganisation or adaptation to high quality standards and regulations**.

In addition, post-Soviet countries share not only the common formal system of standards, but also informal rules (the business-politics nexus, oligarchic tendencies, etc.). Membership in the Eurasian CU, unlike the enhanced free trade regime with the EU and its requirements, does not encourage giving up these informal rules. **This shows that participation of partner countries in the enhanced free trade regime proposed by the EU is incompatible with membership in the Eurasian CU not only because of the integrated external tariff policy, but also because of the relationship between different standards and regulations of the system and the informal and formal rules in these different integration areas**.

## VI. Development opportunities of the Eurasian CU: Ukrainian and Moldovan cases

### *Ukraine – at the crossroad of economic policy and geopolitical choice*

The most important issue concerning the choice by Eastern Partnership countries between integration into the EU and participation in the creation of the Eurasian Union may be illustrated by the case of Ukraine. Ukraine, unlike Belarus,

[61] Enrique Valerdi Rodriguez, "The European Union Free Trade Agreements: Implications for Developing Countries". *RIE Working Paper*, 8, 2009, 5–6, available at: <http://www.realinstitutoelcano.org/wps/wcm/connect/a85925004f018b93b9dafd3170baead1/WP8-2009_Valerdi_EUFTA_Developing_Countires.pdf?MOD=AJPERES&CACHEID=a85925004f018b93b9dafd3170baead1>.

[62] Veronika Movchan and Ricardo Giucci, "Quantitative Assessment of Ukraine's Regional Integration Options: DCFTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan", Institute for Economic Research and Policy Consulting, Berlin/Kyiv, 2011, 5.

[63] Shumylo-Tapiola, "The Eurasian Customs Union: Friend and Foe of the EU?", 14.

which has essentially determined its direction of integration, remains at the geopolitical crossroads of choice, and the choice will determine not only trade flows with neighbours, but also the pace and direction of structural reforms. Ukraine is the most important country in the EU Eastern Partnership programme, the first to have received an invitation to economic integration and to have completed negotiations concerning an enhanced free trade agreement (DCFTA). On the other hand, Ukraine is strategically important to Russia, which seeks to restore its lost influence in the region and to ensure stability for its new quality economic union.[64]

In 2008, Ukraine became a member of the WTO and started negotiations with the EU on the Association Agreement and the Deep and Comprehensive Free Trade Area Agreement. These negotiations indicated Ukraine's intention to adopt around 70% of the EU's legal regulations governing not only trade, but also energy, transport, environmental and other areas related with the EU Single Market. **At the end of 2011, when the time to sign EU–Ukraine agreements approached, Putin announced the vision of the Eurasian Union. Meanwhile, the EU suspended the signing and ratification of agreements with Ukraine due to Ukraine's domestic political situation and the legal action against Yulia Tymoshenko as well as against some other members of the previous government**. As EU–Ukraine relations began to deteriorate, Russia significantly intensified its efforts to use energy links, primarily because of the dependence of Ukraine industry on Russia for supplies of less expensive natural gas and oil and the significant income from transit of Russian products through Ukraine, in order to convince the Ukrainian leadership to reconsider its position on participation in the Eurasian Union. Launching of the Nord Stream and particularly the planned South Stream may also be exploited as bargaining tools, threatening to cut natural gas transit through Ukraine along with Ukraine's transit income. Russia also offered a variety of sectoral agreements to enhance cooperation with Ukraine, although Ukraine may not be joining the Eurasian Union immediately, but creating conditions for its gradual integration. In other words, rapid development of the Eurasian CU prior to the completion of the first EU negotiations with Ukraine on the association and trade liberalisation agreements shows that the EU is no longer "the only game in town".[65]

Ukraine's political leaders continue their support for the EU Partnership project; however, the final decision of the country will be determined by the cost-benefit analysis of the large corporate groups that form a nexus with the political elite. Big business in Ukraine is fragmented – the majority wants to preserve its privileged trade relations within the CIS space, others focus on the EU market. **This reflects in Ukraine's attitude: it has tried to maintain its current non-obliging position and cooperate with both integration spaces. However, the comprehensive free trade regime with the EU and membership in the CU are incompatible**. Ukraine tried to manoeuvre through the "3 +1" integration model with the CU (proposing a standard free trade agreement), but Russia rejected the proposal and thus restricted the traditional Ukraine multi-vectorial policy.

### *Trends in Ukraine's trade with the EU and the Eurasian Economic Union*

The EU and CU countries are the biggest trade partners of Ukraine and account for about 2/3 of all Ukrainian trade turnover. The dynamics of the past decade show that prior to the 2008 economic crisis in Ukraine, the role of the EU in trade increased while that of today's Eurasian countries decreased. Later, however, increasing energy prices and the change in the demand of the recovering economy determined the turn to the current Eurasian CU market. In 2000–2010, exports to the EU fell by 7.7% (to 25.4%) and the share of imports from the EU – by 5.3% (to 31.4%), while exports to and imports from CU countries increased by 5.9% (32.3%) and 9% (42%) respectively.[66]

[64] Shumyla-Tapiola, "Ukraine at the Crossroads: Between the EU DCFTA & Customs Union", 4.

[65] Dragneva and Wolczuk, 2.

[66] Veronika Movchan and Ricardo Giucci, "Quantitative Assessment of Ukraine's Regional Integration Options: DFCTA with European Union vs. Customs Union with Russia, Belarus and Kazachstan", Berlin/Kyiv, 2011, 2.

Ukraine exports energy, agricultural products, chemicals, and iron and steel to the EU and imports a variety of machinery, vehicles and equipment, agricultural products, textiles, and clothing.[67] Trade with CU countries is much less diversified and covers mainly natural resources (imports) and machinery and vehicles (exports). Traditional business dependency relations with the CIS markets are of vital importance to this direction of trade. The volumes of trade in services with both unions are almost the same, but the most telling indicator is that of high technology trade which is almost two times higher in the EU direction than the CU (40.2% and 23.9%).[68] **Differences in the structure of trade with the EU and the Eurasian Economic Union partially reflect the choice of integration direction: in the short-term choose either costly economic and technological modernisation or preservation of the existing domestic economic structure**.

***Comprehensive free trade with the EU vs. membership in the Eurasian CU***

Evaluation of the effect of the comprehensive free trade agreement with the EU on Ukraine usually focuses on advantages. *First*, welfare growth – trade with the EU means a greater variety of products to consumers, although due to stringent safety requirements products will be more costly, and new business opportunities, which in the long term mean the growth of income per capita. *Second*, the agreement would guarantee duty-free access to the world's largest market –**EU's GDP at purchasing power parity is 5.67 times that of the Eurasian Union, while the acceding country's economic benefit depends on the size of the host market**. *Third*, harmonisation of the national legislation with EU regulations would create a legal environment for business acceptable to foreign (primarily Western) investors.

On the other hand, the comprehensive free trade with the EU may lead to problems caused not so much by the EU, but by economic backwardness and the economic structure of Ukraine. Elimination of tariff barriers (around 95 % of all EU tariffs) and reduction of non-tariff barriers would increase competition in the domestic market, which would pose a threat to local producers enjoying protectionist support. It is true that the transition to free trade would take place by phasing out tariff barriers and retaining annual export quotas for Ukraine for strategically important production: 1.6 million tonnes of grain, meat, sugar and their products.[69] **Adoption of EU standards and EU legal framework will inevitably result for Ukraine in high adjustment costs, because the EU will require adapting to its rules and quality standards prior to opening free trade**. It would be easier for Ukraine to adjust if the EU was primarily focusing on the development of free trade, and then transition phases would be established for adoption of European rules and quality standards. High EU internal standards increase the cost of adaptation for Ukraine, especially in the short term.

The prospect of membership in the Eurasian Union also has its own advantages and disadvantages. As far as disadvantages are concerned, first, the prospect of losing an independent trade policy should be emphasised. The Eurasian Economic Commission would conduct negotiations with third countries and other trading blocs bypassing the member state capitals (which *de facto* would mean Russia's leverage in controlling Ukraine's trade policy). Furthermore, **while establishment of the free trade zone with the EU implies modernisation by adopting costly EU quality standards and legal framework, membership in the Eurasian Union would mean higher costs for investment from countries outside the union and subsequently smaller investment and innovation flows**.[70]

[67] DG Trade, "Ukraine. EU Bilateral Trade and Trade with the World", 2012, available at: <http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf >.

[68] Veronika Movchan and Ricardo Giucci, "Quantitative Assessment of Ukraine's Regional Integration Options: DFCTA with European Union vs. Customs Union with Russia, Belarus and Kazachstan", Berlin/Kyiv, 2011, 2.

[69] Veronika Movchan and Volodymyr Shportyuk, "EU-Ukraine DCFTA: the Model for Eastern Partnership Regional Trade Cooperation", Warsaw: Center for Social and Economic Research, 2012, 12–13.

[70] Veronika Movchan and Ricardo Giucci, "Quantitative Assessment of Ukraine's Regional Integration Options: DFCTA with European Union vs. Customs Union with Russia, Belarus and Kazachstan", Berlin/Kyiv, 2011, 9.

Another economic disadvantage of Ukraine's accession to the CU is the WTO factor. Unlike Eurasian CU countries (Kazakhstan, Belarus), Ukraine is a member of the WTO. Membership in the WTO means that Kiev is committed to reduce tariff rates to the level negotiated with the WTO. Ukraine also joined various sectoral agreements on the reduction on tariffs for many product groups. **By joining the CU, Ukraine would have to review its tariff commitments agreed in the negotiations with the WTO and align them with those that CU countries (Belarus, Kazakhstan) will negotiate during their accession to the WTO**. Because of adjustment of WTO commitments, Ukraine will have to compensate the loss incurred by other WTO members. The estimated amount of compensations would be USD 1.9 billion.[71] This leads to the conclusion that **the option of Ukraine's membership in the Eurasian CU should be considered only when all CU countries become members of the WTO or rely on the assumption that USD 1.9 billion would be covered by Russia interested in Ukraine's accession**.

***Eurasian Economic Union: what incentives does Russia offer to Ukraine?***

The majority of the arguments encouraging Ukraine to choose membership in the Eurasian Union are related to possible elimination of the domestic market protection measures by Russia and the sale of Russian oil and gas to Ukraine without export duties. On the other hand, membership in the CU does not guarantee energy supplies at Russian domestic market prices, because exemptions from the CU regime (for example, export duty) still apply to trade in energy resources. **Elimination of export duties in the trade in energy resources can only be a discount or an incentive offered by Russia on a bilateral basis (as in the case of Belarus), but not a direct consequence of CU membership**.

After Ukraine's accession to the CU, Russia will have an opportunity to eliminate export duties on energy resources for Ukraine, but the sale of natural resources to Ukraine at Russian domestic market prices would be a daunting decision for Russia. On the one hand, discounts in trading energy resources would be a truly effective tool, because energy imports in 2010 accounted for 67% of the total imports from Russia and, according to Ukraine's minister of economy, would allow Ukraine to save USD 3–3.5 billion per year only on elimination of export duties on gas.[72] However, it is more realistic to speak about a 10% discount which would make the price for gas equal to that paid by Russia's big EU buyers and amounting to USD 400/1,000 $m^3$ compared to USD 426/1,000 $m^3$ paid by Ukraine for gas in Q3 2012.

On the other hand, **Russia itself is stuck with a *dilemma* over its desire to maximise profits from oil and gas exports and to lure Ukraine to the Eurasian Economic Union dominated by Russia**. It should be noted that intern al Russian business interest groups, in particular, interest groups in Gazprom, may be disinterested in the implementation of Russia's geopolitical interests at the expense of export profits. Ukraine is too big a market to allow tangible discounts without major economic loss. Practice shows that Putin also gives priority to profit. In the gas sale agreement for Ukraine concluded in 2009, high gas prices turned even relatively pro-Russian Ukrainian political elite groups against Russia.[73] Moreover, given that the 2009 agreement on gas prices was concluded because Russia had cut gas supplies to Ukraine and, therefore to Central and Southern European countries, the complexity of energy and political dynamics becomes even more evident.[74]

[71] Ibid., 9.

[72] "Решение об интеграции в Таможенный союз нужно принимать уже в первой половине 2011 года", available at: <http://kommersant.ua/doc.html?docId=1615189>; quoted in Maksim Bugriy, "Strategic Flexibility a Key Issue for Ukraine in Trade Relations with Russia and the EU", *Foreign Policy Journal,* 2011, available at: <http://www.foreignpolicyjournal.com/2011/04/09/strategic-flexibility-a-key-issue-for-ukraine-in-trade-relations-with-russia-and-the-eu/>.

[73] Andreas Umland, "ES-Ukrainos-Rusijos trikampis, 'Šiaurės srautas' ir Rytų Europos ateitis" [The EU-Ukraine-Russia triangle, Nord Stream and the future of Eastern Europe"], Kyiv, 2011, available at: <http://www.geopolitika.lt/?artc=4956>.

[74] Laurynas Jonavičius, "Dujos vėl teka, bet padėtis Ukrainoje nesikeičia" [Gas flows again, but the situation in Ukraine does not change], Vilnius: Eastern Europe Studies Centre, 2009, 1.

**The role of Ukraine as an energy transit country is not only conditioned to its membership in the Eurasian CU, but certainly also associated with the penetration of Russian capital to strategic sectors of Ukraine's economy**. For example, the Ukrainian gas pipeline system remains in the hands of the state-owned enterprise and for the past decade has been a perfect target for investment for the Russian gas giant Gazprom. In other words, the status of Ukraine as a transit country and its dependence on Russian raw materials may eventually be incompatible with interests of sovereign Ukraine.

The 2012 analysis conducted by the St. Petersburg Centre for Integration Studies and the Eurasian Development Bank states that the scenario of Ukraine's accession to the Eurasian CU by 2030 promises a 6-7% higher GDP growth than in the case of the *status quo* scenario. **Such growth is based on an increase in exports to the countries of the Common Economic Space (primarily Russia and in transit traffic as well as less costly raw materials for Ukrainian industry**.[75] These benefits that do not directly result from membership in the Eurasian Economic Union, but from possible Russia's rebates and incentives, are essential in many calculations stating the advantage of the Eurasian Union.

It can be said that the Ukrainian choice between the enhanced free trade regime with the EU or the membership in the Eurasian union is basically a choice between long-term and short-term gains. **The comprehensive free trade with the EU would not only mean adaptation to more expensive EU standards (costs in the short term), but also modernisation of Ukrainian economy and a qualitative leap in economy and trade in the medium and long term**. The Eurasian Economic Union does not require major changes in Ukraine and higher standards, but promises Russian discounts in the energy sector. These potential discounts and incentives should be viewed by Ukraine through the prism of national sovereignty.

### *Moldova's integration dilemmas*

In terms of choice of direction of economic integration, Moldova is in a similar situation to that of Ukraine. The country has long sought a balance between free trade with the EU and better trading terms with the CIS space. For nearly a decade (2001–2009), Moldova was ruled by the Communist Party that had all the leverage (including the constitutional majority) to turn the country's integration eastward, but this scenario has not been selected.[76] Moreover, it was under the Communist rule in 2005, that Moldova's parliament announced integration into the EU as a strategic goal. Thus, European integration has been formulated as a strategic goal of both domestic and foreign policy and further developments in Moldova became an integral part of the progressive and irreversible process of European integration.

Since 2009, when the majority in the parliament was won by the Alliance for European Integration, the pro-European political orientation was openly declared. In October 2011, Moldova signed a protocol on accession to the EU Energy Cooperation Agreement and since 2012, requirements of the EU Third Energy Package (unbundling of the vertically integrated monopolies) have been applied. These specific steps showing sovereignty and aspirations for European integration are unacceptable for Russia. As a result, Russia has demanded from Chisinau to denounce this agreement in order any negotiations for less costly Russian gas import prices could be possible. These negotiations for a 30% less expensive gas illustrate most vividly the dead end of the policy pursued hitherto – it is no longer possible to combine European integration and pragmatic interests in Russia today. The incentive offered to Moldova by Russia – less costly gas – also has its price. This is best known by the Belarusian political regime which is gradually losing control of the country's gas pipelines and other strategic objects, and eventually –sovereignty.

[75] Eurasian Development Bank's Saint Petersburg Centre for Integration Studies, *Ukraine and the Customs Union. Report 1*, 2012, 29.

[76] Leonid Litra, "European Integration of the Republic of Moldova – Is It Still a National Consensus?", *Moldova's Foreign Policy Statewatch*, Issue 39, 2001, 3.

### *Comparison of two integration alternatives*

When assessing economic integration alternatives available to Moldova, it is important to compare macroeconomic indicators of the EU and the Eurasian CU (2011):[77]

| Criterion | CU (USD) | EU (USD) |
|---|---|---|
| Number of consumers | 165 million | 503 million |
| Total GDP/GDP per capita | 2.74 trillion/14.866 | 15.39 trillion/34.000 |
| Foreign trade volumes | 1.021 trillion | 3.791 trillion |
| Annual domestic investment | 603 billion 22% GDP) | 2.88 trillion (18.7 % GDP) |
| Home credits | 854 billion | 29 trillion |
| Annual R&D expenditure | 15.3 billion | 239.7 billion |
| Foreign Direct Investment | 435.38 billion | 7.972 trillion |

The comparative analysis shows that the Eurasian CU offers Moldova a consumer market that is three times smaller, a total GDP that is 5.6 times lower and twice as little GDP per capita, 3.7 times smaller foreign trade volumes, 4.7 times lower domestic investment, a 34 times smaller credit market, 15.6 times lower annual R&D expenditure, 18 times lower foreign direct investment. In addition, unlike the multi-centred EU, the CU is economically and politically dominated by Russia. Russian citizens account for 83.6% of the CU population, its GDP accounts for 86.8% of the total CU GDP, foreign trade volumes – 79.2%, foreign currency reserves – 93.4%, and domestic trade - 65.2%.

The attractiveness of either alternative to Moldova is determined by other economic circumstances partly coinciding with the factors already discussed in the case of Ukraine. In the event of an enhanced free trade regime with the EU, Moldova would have to carry out an expensive process of modernisation and adapt to EU quality standards, a legal framework for business, and production standards for export. **Agricultural sector is likely to require a most costly modernisation, as adoption of sanitary and phyto-sanitary standards according to various estimates will increase production costs by 1.5–8%.**[78] **However, even under the maximum estimate of costs, the benefit of the EU market access remains beneficial**[79]**, even taking into account that the enhanced free trade regime with the EU is unlikely to cover full liberalisation of trade in agricultural products**.[80]

Moldova is entirely dependent on a single supplier of energy resources; thus European integration and implementation of the EU Third Energy Package are required for modernisation of its energy sector.[81] At present, Gazprom holds 50% of the shares in Moldova's largest gas company Moldovagaz supplying Russian gas on Moldova's territory. Moldova's debt to Gazprom reaches USD 4.1 billion (together with the debt of the separatist Transnistria regime also assigned to Moldova). The debt to Gazprom is higher than that of any republic of the former USSR. The debt settlement is still one of Russia's conditions before negotiating gas price discounts for Moldova. **Thus, in Moldova's case, Russia has even more leverage in the energy field than in Ukraine as far as the direction of the country's economic integration is concerned**.

Moldova's accession to the Eurasian CU would mean increased external tariffs and therefore declining competitiveness of Moldovan exports. Moldova is a very open economy and accession to the CU would cause a major change in the tariff regime, much more than the enhanced free trade regime with the EU would do. **Trade restrictions**

[77] Victor Chirila.

[78] Prohnitchi Valeriu, "Strategic Comparison of Moldova's Integration Options: Deep and Comprehensive Economic Integration with the EU versus the Accession to the Russia-Belarus-Kazakhstan Customs Union", *Economic Analysis and Forecast Paper*, No. 3, 2012, 12.

[79] Under current production costs, Moldovan agricultural production is 36% less expensive than the EU average.

[80] FAOSTAT, available at: <http://faostat3.fao.org/home/index.html#DOWNLOAD>.

[81] Ana Popa et al., "A free trade area between the Repbulic of Moldova and the European Union: feasibility, perspectives and potential impact", Chisinau, 2009, 86.

**would reduce exports in all directions, production capacity and consumption, as well as funds available for technological development**. Most importantly, Moldova, a member of the WTO since 2001, by becoming a member of the CU would have to breach its economic commitments and therefore to pay compensations. In addition, due to withdrawal from the agreed commitments, other countries may respond by raising import duties for goods from Moldova and the EU may be forced to denounce unilateral tariff preferences. [82] Assessing the 30% discount on Russian gas supplies as a bureaucratic and hardly likely stimulus, negative consequences of membership in the CU could not be outweighted by any positive incentives arising directly from membership in the Eurasian CU.

## VII. The issue of recognition and non-recognition of the Eurasian Economic Union

Since the declaration of a new phase of integration and launch of EEC by Eurasian CU, the issue of recognition of the EEC and the emerging Eurasian Economic Union has been raised vigorously. It was first mentioned by Russian officials, however, there has been hardly any detailed analysis **on the meaning of the very fact of the recognition of such supranational structure**.

There are no major doubts or discussions about the fact of the emerging structure in the EU's eastern neighbourhood, which may currently be described as the emerging CU. It can be defined by the following objective criteria. *First*, there is a common external tariff, although it does not apply to all goods. *Second*, there is a common CU Customs Code, which should guarantee common import procedures, classification of goods, customs valuation, and other similar aspects. *Third*, development of common CU standards and technical regulations is in progress. *Fourth*, CU countries gradually abolish mutual cross-border controls and other restrictions on the movement of goods within the CU.

**At the same time, creation of the CU is still in progress and member states still apply export duties for trading certain products within CU; the countries do not apply unified export duties to third countries**. In addition, national standards for certification of imported goods remain valid next with newly prepared standards. For example, it is still possible for a single CU country to introduce a new utilisation/recycling charge on imported cars, etc.

In 2012, the supranational Eurasian Economic Union Commission was formed. Despite that, the countries are still analysing further integration opportunities and possible trajectories in macroeconomic and perhaps fiscal policy areas. The beginning of the new and further mutual integration phase is set for 2015, when the economic union will be launched. From the very beginning, this deadline seemed unrealistic as to whether this regional integration structure will succeed to achieve in just a few years what took the EU a few decades to reach. Clearly **this date will only mean a beginning of a new integration phase or perhaps just the final consolidation of the CU integration phase**. The fast approaching deadline means a necessity to codify and organise dozens of currently valid mutual agreements which regulate activities of the Eurasian CU. Before this date, legal acts in such areas as competition law, intellectual property protection and public procurement currently valid in CU countries will need to be analysed. Over the next two years until 2015, the work will be continued by analysing in greater detail not only possible areas of further economic integration, but also models for further procedures; possible common platforms will be proposed, draft agreements and legal acts will be prepared.

The decision regarding the main areas of the integration process by the Supreme Eurasian Economic Union Council confirms the above action plan. This decision obliges governments of all the three CU countries together with the EEC to prepare a Draft Treaty on the Economic Union by 1 May 2014. In addition to several other aims, this document also stipulates the aim to entrench the status of the Eurasian Economic Union as a fully-fledged international organisation. **It follows that the aim of the ongoing integration process is not only economic, but also political integration of the countries of this union. Furthermore, while**

[82] Valeriu Prohnitchi, "Strategic Comparison of Moldova's Integration Options: Deep and Comprehensive Economic Integration with the EU versus the Accession to the Russia-Belarus-Kazakhstan Customs Union", *Economic Analysis and Forecast Paper*, No. 3, 2012, 12.

**the limits of the potential political integration are not yet clear, efforts of both the representatives of Russia and the EEC to achieve and consolidate political recognition of the emerging structure have become more intense**.

***Practical aspects of recognition of the Eurasian Economic Union***

When discussing the underlying motives for gaining international recognition of the Eurasian Economic Union, it is necessary to answer the following questions: **is the creation of the Eurasian Economic Union also a political process leading to establishment of a new object of international relations** which needs recognition and support from third countries and international organisations? **Or perhaps the creation of the Eurasian Economic Union is just another example of deeper regional economic integration**, so recognition of this structure is necessary for further rational and pragmatic communication with third countries and international organisations?

Recognition of this regional structure has been very actively pursued of late. It should be noted that the first such attempt as Russia suspended negotiations regarding WTO accession in 2009, and would only continue accession as a member of the CU – failed. Later, the EEC signed cooperation protocols with the United Nations Conference on Trade and Development and the United Nations Economic Commission for Europe, which shows that the new structure has already taken its first steps towards political recognition. In addition, at its 67th session, the UN General Assembly unanimously adopted a resolution prepared by Russia, which proposes to establish cooperation between the United Nations and the Eurasian Union, and efforts to strengthen regional integration within the framework of the Eurasian Customs Union have been recognised.

**This recognition by the organisations of the UN system has hardly made any essential difference, because all three current CU countries were already members of these organisations**. It is also unclear which model will be used to represent these three CU countries in further work of these international organisations and to what extent the EEC will participate in it too.

**At the same time it should be emphasised that the new economic structure will in the future influence the WTO accession process of the other two CU countries**. As for Kazakhstan, as has already been mentioned its participation in the emerging CU not only delayed, but also complicated WTO membership. This was due to Kazakhstan's membership in the CU and because it was forced to raise import duties and will continue to be forced to introduce other protective measures, primarily reflecting Russia's interests. These actions taken by Kazakhstan and the planned economic integration will affect areas of the economy negotiated at the time of accession to the WTO; such areas include trade in services, investment regime, protection of intellectual property, public procurement, etc., Kazakhstan's WTO membership may be delayed from a few years to the longer-term.

If Belarusian negotiations on WTO accession were to begin, there will be many more unanswered questions and problems concerning participation in the CU. The accession process has not taken place for many years, while declarations of Belarusian officials that they will quickly meet formal requirements of the WTO because Russia has become a member of the WTO and its commitments are already implemented on the CU level will definitely not be sufficient. To provide such impetus to the accession process a **favourable or at least a neutral attitude of the international community towards Belarusian membership in the WTO is required, not to mention the country's significant efforts to carry out economic reforms. Increased institutional capacities are required to negotiate, or at least try to copy Russia's WTO membership commitments, and also capacity to implement these obligations.**

On the other hand, as Belarus actually starts to pursue WTO membership, there is no grounds to assume that copying current Russia's WTO commitments will suffice for Minsk. **On the contrary, the EU should use both Belarus and Kazakhstan WTO accession negotiations for further opening of the entire market of the Eurasian Economic Union for goods and services and reduction of existing trade barriers (conditions agreed by Russia must not become a common smallest denominator, while the**

**negotiations must be viewed as a-country-at-a-time process)**.

It should be highlighted that if the Eurasian CU or Economic Union would continue to strengthen measures of market protection (or apply measures inconsistent with the WTO), accession of any new members to the Eurasian Economic Union, primarily of Kyrgyzstan, Tajikistan, Moldova, and Ukraine, which are or will soon become full members of the WTO, will immediately mean renegotiation/review of their conditions and commitments assumed during negotiations for WTO membership and/or requirement to pay considerable compensations.

The relationship between the Eurasian Economic Union regulation and the Energy Charter Treaty is none-the-less interesting, as energy policy is expected to be a field of joint coordination in the future. **Before the EU proceeds with recognition of the Eurasian Economic Union, the position of Eurasian Economic Union towards the Energy Charter must be inspected, and recognition of Eurasian Economic Union should be at least partially conditional on Russia's return to the regulatory sphere of the Energy Charter**.

**The supranational EEC has not been representing the CU countries jointly so far, and is not likely to be engaged in negotiations in the near future**. Russian Federation seems to remain the main negotiator. This is evident from the course of the ongoing free trade negotiations between Russia (and/or the Eurasian CU) and the European Free Trade Association (EFTA) countries, New Zealand and Egypt. Despite the fact that the negotiation started to include only Russia, the EFTA and New Zealand opted to continue negotiations with all three partners later in the course. However, Russian negotiators continue to represent Russia and the Eurasian CU, rather than vice versa. Furthermore, Russia's disapproval to market opening and several other conditions related to the liberalisation of the agricultural sector have prevented the Eurasian CU from completing negotiations with New Zealand.

Free trade talks with Vietnam that will begin next year will pose a new challenge to the EEC's institutional capacity. Strengthening of the administrative capacity of EEC might also imply increased interest for technical cooperation with EU institutions (Commission directorates and other agencies). This can be seen as a risk (even technical cooperation should not be performed "automatically", as it implicitly legitimises activities of the Eurasian Economic Union, although there has not been any political decision on legitimisation yet). **It is crucial that political or technical cooperation with the Eurasian Union as an organisation** (by EU member states or EU institutions, e. g. directorates of the European Commission, etc.) **are properly monitored and kept down to the minimum required for the dissemination of principles and norms which are the basis of the EU law.**

**Russian officials have suggested that negotiations on a new EU-Russia Partnership and Cooperation Agreement should be replaced by negotiations of a regional agreement between the EU and the Eurasian Union. By adopting such a position Russia is showing its objective to scale down the content of negotiations, to postpone decision-making, and to "dilute" the content of its commitments.**

In light of the repeated statements by Russia that it will not negotiate regarding the transfer of commitments undertaken during the WTO accession negotiations (known as "WTO-plus" obligations) to a bilateral agreement with the EU, it is unlikely that negotiation could be more successful. **First of all, it must be clarified to what extent Russia is ready to open its market of services or public services to the EU. While there are no answers to these questions, EU foreign ministers should not bother looking to solve the dilemma of who to negotiate with – Russia or the EEC.**

Since the entry into force of Russian WTO membership the EEC seems to be instrumental in cases there is an interest *not* to fulfil Russian obligations under WTO membership negotiations (for example, by introducing a common external tariff). The EEC does not seem capable of affecting new protectionist measures introduced by Russia (for example, the vehicle recycling/utilisation charge) or, furthermore, fails to fulfil its functions *de jure* and has not yet taken over competences from Russian authorities (for example, a ban on livestock imports from the EU).

## VIII. What should the EU strategy be with respect to the Eurasian Economic Union (recommendations)

The EU and the Eurasian Economic Union are two very different economic and political regimes and systems of regulations, rules, and even values. These alternative integration projects differ not only by their standards or technical requirements, but also by the characteristics of their political and economic system: unlike the EU, the Eurasian economic area has particularly strong vertical politics and oligarchic business trends and extremely prominent political-business nexus. Therefore, every project of economic integration in the post-Soviet space must be seen and viewed through the prism of geopolitical interests, as politics and economics in this space are strongly bound.

The Eurasian CU in Russian foreign policy (specifically relations with the EU) architecture is an institutional instrument to control the agenda of its member states that have renounced their autonomy in external trade policies and economic relations with the EU. All the recent Ukrainian initiatives to maintain access to the CIS markets through standard free trade agreements that do not require a uniform common external tariff and therefore do not conflict with the country's participation in the enhanced free trade regime with the EU, have been blocked by Russia. **This means that Russia does not leave room for any intermediate options that would enable countries to combine their European orientation and traditional relations with the CIS countries. Expansion of the Eurasian CU into the European Neighbourhood region (i.e. membership of Ukraine or Moldova in the CU) can weaken EU regulatory power in these countries**. Development of the Eurasian CU is a serious challenge for the EU's Eastern Partnership initiative, whose main pillar is the access to the EU internal market through free trade agreements.

In other words, expansion of the Eurasian Economic Union to the EU Eastern Partnership countries would prevent the EU from applying its traditional formula in external relations: to expand the area of European regulations and rules in exchange for the opportunity to participate in the EU internal market. This might put a halt on political and economic reforms in the Eastern neighbourhood countries, thus leaving them within the post-Soviet space development trajectory with characteristic features of vertical politics and the political-business nexus.

It is important to emphasise that the external tariff of the Eurasian CU (essentially reflecting Russia's external tariff) is higher than that agreed with the WTO by some countries of the EU Eastern Partnership (first of all Ukraine)[83] currently seeking to strengthen the free trade agreement with the EU, which should provide for even greater reduction of the tariff than the WTO tariff. **This indicates that the Eurasian CU may produce a protectionist effect and therefore barriers for EU products in the EU Eastern Partnership markets**.

The general pattern of the EU's external relations is extension of European regulations and rules in the neighbourhood countries. However, changes to the EU external relations and enlargement policies ("enlargement fatigue") hinder this process [84] in turn weakening the neighbourhood policy. The EU membership prospect is the cornerstone of the EU's regulatory power, which can be defined as the EU's ability to change the internal political and economic *status quo* of partner countries. However, the EU enlargement is increasingly becoming a process not necessarily leading to the ultimate goal – the full-fledged EU membership. As a result a non-ending spiral has formed in the EU's external relations: no EU membership prospect and no motivation for partner countries to reform (internalise the EU regulations and rules).[85]

[83] Shumylo-Tapiola Olga, "Ukraine at the Crossroads: Between the EU DCFTA & Customs Union", 21–23.

[84] Otto Schily, "If the EU reneges on Balkan it's at its own peril", *Europe's World*, 2009, available at: <http://www.europesworld.org/NewEnglish/Home_old/Article/tabid/191/ArticleType/articleview/ArticleID/21490/language/en-US/Default.aspx>.

[85] Gabriella Meloni, "Is the same toolkit used during enlargement still applicable to the Countries of the New Neighbourhood? A problem of mismatching between objectives and instruments". Presentation at the workshop "The European Neighbourhood Policy: A Framework for Modernisation?" Badia Fiesolana, 2006.

In the context of the "enlargement fatigue" the concept of integration without membership has been formulated, i.e. an intermediate option, which provides an opportunity to participate in the EU internal market (through enhanced free trade agreements) without formal membership in the EU. Thus today the EU seeks to expand its regulatory boundaries without expanding legal and institutional boundaries.

**Models of integration without membership also face challenges due to non-compliance of the internal *status quo* of partner countries with EU rules and standards (which is a barrier to their access to the EU internal market).** A partner country can participate in the EU internal market only when it adopts the EU rules and high European standards. EU's focus on high standards means that when harmonising the regulatory framework with that of the EU, all costs are borne by the partner country (unlike in the accession negotiations in the EU, where part of the adaptation costs is borne by the EU).[86] In addition, the EU standards may cause reduction of competitiveness of the partner country outside the EU and this is particularly important for those countries which have naturally strong dependency relationships with non-EU markets.

The pressure to transpose regulations which are only indirectly related to trade – technical standards that regulateproductive activities– require increased investment and ultimately result in higher prices for consumers. This has been concluded by a variety of studies, including the studies conducted during Lithuanian EU accession. Transitional periods for the transposition of environmental, and other regulations as well as excise duties were based on this conclusion. Therefore, in terms of the goals of transformation and modernisation, it is necessary to assess the difference between the purchasing power of Ukraine, Moldova and Georgia and the EU average. The EU regulates product and production norms in agriculture and food production particularly actively which affects the prices of food. Partly because of this, EU maintains high import duties on agricultural products from third countries and usually does not include them in free trade agreements. Notably, these products account for major portion of consumer basketsof less well-off households in Eastern Neighborhood countries. Therefore fast transposition of EU rules that are indirectly related to trade is not only expensive, but also raises the issue of social justice. Looking from a broader perspective, pressure for fast harmonisation of regulations without offering the benefits of membership or at least of the European Economic Area, might result in discouragement from integration in the EU. Therefore it can be counterproductive to the strategic objectives of the EU in its neighbourhood.

It should be noted that **even adoption of EU regulations and standards does not yet ensure the access the EU internal market to the partner country. Certain measures of EU market protection may prevent offering favourable conditions for the partner (even if the standards are in place)**. This is very important to partner countries where the European internal market access is in the interest of influential business groups. Those business groups of partner countries that wish to access the EU internal market could potentially become driving forces for the country's adaptation to EU rules and regulations, but due to certain protective measures may have no stimulus to take on such a role.

Meanwhile, the Eurasian CU does not require convergence to high standards; furthermore, it may offer additional incentives – politically controlled but cheaply available credit resources and energy supplies at Russian domestic market prices.

**So what should the EU strategy be with respect to the Eurasian CU?** The dynamics of the Eurasian Union are incompatible with the core principles of the EU's external policy: the Eurasian CU lacks essential elements of a rules based regional integration project leading to the transformation of the economies of its member states; rather it remains a non-liberal project for trade simplification between non-liberal regimes. Development of the Eurasian CU has a negative impact on the EU-Russia relations (procrastination of negotiations on a new Partnership and Cooperation Agreement), the EU's leverage with

[86] Anna Kolesnichenko, "Institutional Harmonization and Its Costs and Benefits in the Context of the EU Cooperation with Its Neighbours". *CASE Network Studies & Analyses*, 387, 2009, available at: <http://www.case.com.pl/upload/publikacja_plik/25197237_sa387.pdf>.

respect to the Belarusian regime and possibly on the efficiency of the EU's Eastern Partnership policy.

**Therefore, the EU's strategy vis-à-vis the Eurasian CU should be as follows:**

a) no inter-regional negotiations or other cooperation initiatives (in order not to legitimise potential power imbalances between member states and not to create loopholes for authoritarian regimes such as the one in Belarus); b) bilateral approach and the European Neighbourhood Policy must remain an unequivocal priority and cannot become hostage to regional integration among the three countries; c) regular monitoring of the development of the Eurasian Customs Union, support for the rule of law, judicial independence, political and economic freedoms and other elements of liberal democratic order, assessment as well as neutralisation of potential risks to the aforementioned priorities must be in place; and d) the EU must constantly strengthen visibility and accessibility of the advantages of the EU's political and economic model in the Eastern Neighbourhood.

This objective should be pursued in the following ways:

The first thing is to understand clearly that Russia has initiated creation of a regional economic, and perhaps eventually political integration model which is an alternative to the EU. **In this context, the EU must continuously enhance visibility and accessibility of the advantages of the EU political and economic model in the Eastern Neighbourhood.**

*First,* **the "Russia first" principle whereby all EU initiatives are first implemented with Russia and only later become available to countries in the Eastern Neighbourhood must be abandoned**. The EU will find it difficult to prove the advantages of the Eastern Partnership Initiative to partner countries, if Russia, which is not part to the EaP, gets access to the EU internal market (or visa-free regime) prior to EaP countries. This weakens the role of the EU as a regulatory power centre in the region.

*Second,* **the EU has to find a formula for how to reduce the cost of access of partner countries to the EU internal market.** The EU must offer a clear reward to a partner country in the EU internal market in exchange for the adoption of European rules and high standards. Issues of technical standardisation are at the moment a serious obstacle to the exercise of the EU's normative power, especially when they are not directly linked to trade and rather have to do with production processes and other business activities. The EU should show understanding and sensitivity to the challenges of regulatory approximation, especially when they lead to the increase of product prices and might be important for the consumers with considerably smaller purchasing power than in the EU. Otherwise either the EU norms might be legally adopted but left unimplemented, incentives for shadow activities might increase or these countries might find the regulatory environment of the Eurasian Union more attractive due to lower adjustment costs. The DCFTA process is crucial along with further tangible deliverables to increase cost-effectiveness of EU orientated market liberalisation to Ukraine and other EaP countries.

*Third,* **the EU must learn to offer incentives to major business structures of partner countries interested in accession to the EU markets**. These structures can become "locomotives" of the partner country's EU integration. In other words, the EU tariff reduction scheme and export quotas offered to its partner countries must respond to the interests of major business groups operating in the country. This could be an incentive for them to take on the role of an engine of Europeanisation.

*Fourth*, **the EU must upgrade its tools in the Eastern Partnership operation field to effect on strategic sectors of the economy** – particularly on energy and transport policies. Extension of the Connecting Europe Facility to embrace Eastern Partnership could be an option. This would allow the EU to directly participate in the development of the energy and transport infrastructure of the Eastern Neighbourhood countries, which has a significant impact on the geopolitical gravity of these countries.

## Conclusions and recommendations for further research

The Eastern Partnership and related partnership agreements cover not only the harmonisation of

technical regulations by adopting EU rules, but also extend to implementation of the principles of a democratic political system. **The EU is interested in maintaining the incentive of EU integration for Eastern Partnership countries in order to expand the space of free society, governance based on the rule of law, and a liberal economy**.

The best scenario in terms of the development of trade relations and mutual benefit would be the liberalisation of trade between the EU, the Eastern Partnership countries and the Eurasian Union and reciprocal removal of customs duties on trade. **However, such a scenario is very unlikely due to Russia's inability to develop a binding contractual relationship with the EU, the influence of interest groups, different political and geopolitical objectives associated with trade liberalisation and the great importance of non-tariff barriers to trade. Such a free trade area would be fragmented and limited to certain products that may be of no interest to either party.**

Since removal of non-tariff barriers related to the adoption or recognition of EU regulations in the Eurasian countries is either highly unlikely or will be slow and selective, the **Eastern Partnership countries will have to choose between the regulatory spaces of the EU or the Eurasian Union**. Membership in the Eurasian Union would mean lower short-term adjustment costs for businesses, but integration into the EU would have greater economic development potential.

The attractiveness of the EU to Eastern Partnership countries has been diminished by the prolonged crisis in the Eurozone countries, which Russia employs to strengthen its positions. The relationship between Eastern Partnership policy and the Eurozone crisis is indirect and rather distant, but leaders of Lithuania and other EU countries should bear in mind that structural reforms and other measures to enhance competitiveness and economic development would have not only a direct positive effect on the EU and its Member States, but would also strengthen the EU's power of attraction and the appeal of integration. **The revision of EU regulations in order to simplify them and reduce administrative burdens for business, which the European Commission has launched within the framework of the Lisbon Strategy, would be beneficial, but in recent years this has been given little attention.**

So far, many of the elements of the Eurasian Economic Union are in an early or preparatory stage of implementation, **therefore it is imperative to assess the conditions for realisation of these plans, potential risks for the implementation of the planned integration measures, and possible implications for the EU and Lithuania in greater detail in the future**. Further research in the following areas would be most relevant to Lithuania and EU:

- Outlines of energy policy coordination within the Eurasian Union and its compatibility with EU interests.
- Free movement of labour in the Eurasian Union, security implications in the region and EU-Russia visa dialogue.
- The Eurasian CU transport policy – implications for Lithuania and the Baltic Sea region.
- Russia, Belarus and Kazakhstan – business interests beyond the Eurasian Union project.
- Ukrainian business elites and the EU (a bottom-up evaluation of interests of Ukrainian business groups and their expectations with respect to the EU integration).
- Eurasian Economic Union – are Kyrgyzstan and Tajikistan potential newcomers? (These countries have been particularly actively "invited" recently, in the case of Kyrgyzstan, an accession action plan has been prepared).

**Why the EU cannot officially recognise the Eurasian Economic Union:**

Valid Partnership and Cooperation Agreements between the members of the Eurasian Union and the EU, as well as WTO membership must be essential prerequisites for recognition of the Eurasian Union.

Recognition of the Eurasian Union from Russia's point of view **basically means rejecting the EU-Russia negotiations on the post-PCA agreement and replacing them with the EU's negotiations with the Eurasian Economic Union**. *However*, the inter-regional agreements are not a substitute for

partnership and cooperation agreements.[87] Russia's expectations that the negotiations between the EU and the Eurasian Union will be limited to commercial elements, leaving out the issues of the rule of law, political reforms and human rights in all three countries have no grounds. At the political level such expectations have been rejected by the European Parliament resolution of 13 December 2012 containing the European Parliament's recommendations to the Council, the Commission and the European External Action Service on the negotiations of the new EU-Russia Agreement (2011/2050 (INI)), **which prioritises obligations of the Partnership and Cooperation Agreement and WTO membership over any other agreements and sets forth the necessity to ensure not only economic, but also political modernisation as a precondition for these agreements**.[88] Cooperation or negotiations between the EU and the Eurasian Union may become possible only when all countries of the Eurasian Union have concluded valid Partnership and Cooperation Agreements with the EU.

Similarly, in terms of a stable trade regime, negotiations between the EU and the Eurasian Union are possible only when all members of the Eurasian Union become **WTO members**. Otherwise, Russia, which has completed its WTO accession negotiations, indirectly, gets an opportunity to renegotiate the terms at the expense of other members of the Eurasian Union; in addition, only membership in the WTO (and, ideally, the end of transition periods) can ensure a more transparent settlement of disputes between the otherwise non-liberal political and economic regimes and with them. Otherwise, a dilemma will inevitably arise in relations with the EU due to the different WTO status of the three members of the Eurasian Union. Ignoring these differences could lead to the legitimisation of the Belarusian regime (may provide conditions for Belarusian entry to the EU's internal market through the "back door") and further reduce potential measures directed against the regime. The EU also needs a clearer action strategy concerning Russia's protectionist measures and ignoring of WTO rules.

**Deepening of Eurasian Union integration (free movement of labour) and the visa dialogue with the EU: risks to the European Union.** Russia has visa-free travel arrangements with most CIS countries (with high indicators of both economic migrants and political refugees). According to the current regulation, a person can become a naturalised citizen of Russian Federation after three years of marriage to a citizen of Russia, after passing the Russian language and constitution examinations, on the condition of having a legitimate income; it is not necessary to live in Russia permanently for five years. This has certain implications to the EU-Russia visa dialogue in the light of an open Eurasian labour market. The EU should pay attention to the scenario of Russia as a possible intermediate stop for migrants of other CIS countries to the EU. The experience of the Balkan countries, specifically with Turkish migrants to the EU attests to this, as Turkey has a visa-free regime with the Balkan countries. In addition by creating the Eurasian Economic Area, which includes Russia, Belarus and Kazakhstan, a common visa policy will

[87] Partnership and Cooperation Agreements is the format of EU relations in the Eastern Neighbourhood. Furthermore, all members states of *Mercosur* have framework partnership agreements with the EU, which set forth the foundation for democratic cooperation, respect for human rights and other political principles (except for Venezuela, whose membership in Mercosur has essentially become the end-point of the Mercosur-EU negotiations on regional free trade agreement).

[88] The European Parliament resolution of 13 December 2012 containing the European Parliament's recommendations to the Council, the Commission and the European External Action Service on the negotiations of the new EU-Russia Agreement (2011/2050 (INI)): "Regarding the issue of economic cooperation, to insist on a bilateral agreement between the EU and Russia, while making it clear that the possibility of an agreement between the EU and the Russian-led Customs Union can be envisaged only in the long run and once the bilateral agreement has entered into force"; "to encourage our Russian counterparts to manifest a clear political will to reach an agreement on legally binding 'trade and investment' provisions, which should be based on the provisions already included in the PCA and should be compatible with WTO accession; recall that the EU's objective in this area is to improve and stabilise the business environment, since this would be beneficial to both parties and would further promote the objectives set by the Partnership for Modernisation launched in 2010"; "the EU continues to be committed to further deepening and developing its relations with Russia, and to the principles enshrined in the Partnership for Modernisation, which are based on common interests and a deep commitment to universal values and democratic principles, respect for fundamental human rights, and the rule of law".

also be sought. Thus, the internal border controls will be abolished. For these reasons, the risk of illegal migration may increase at the EU external borders. In order to mitigate possible risks of illegal migration, the EU could raise (as a condition in the negotiations with Russia on a visa-free regime) the necessity to conclude readmission agreements with all countries of the Eurasian Customs Union. Given the functions delegated to the Eurasian Union, and the negotiations with Russia on a visa-free regime, a connection between the entrance of the visa-free regime in force and the conclusion of the readmission agreement with Belarus (and other countries of the Eurasian Economic Union) should be made.

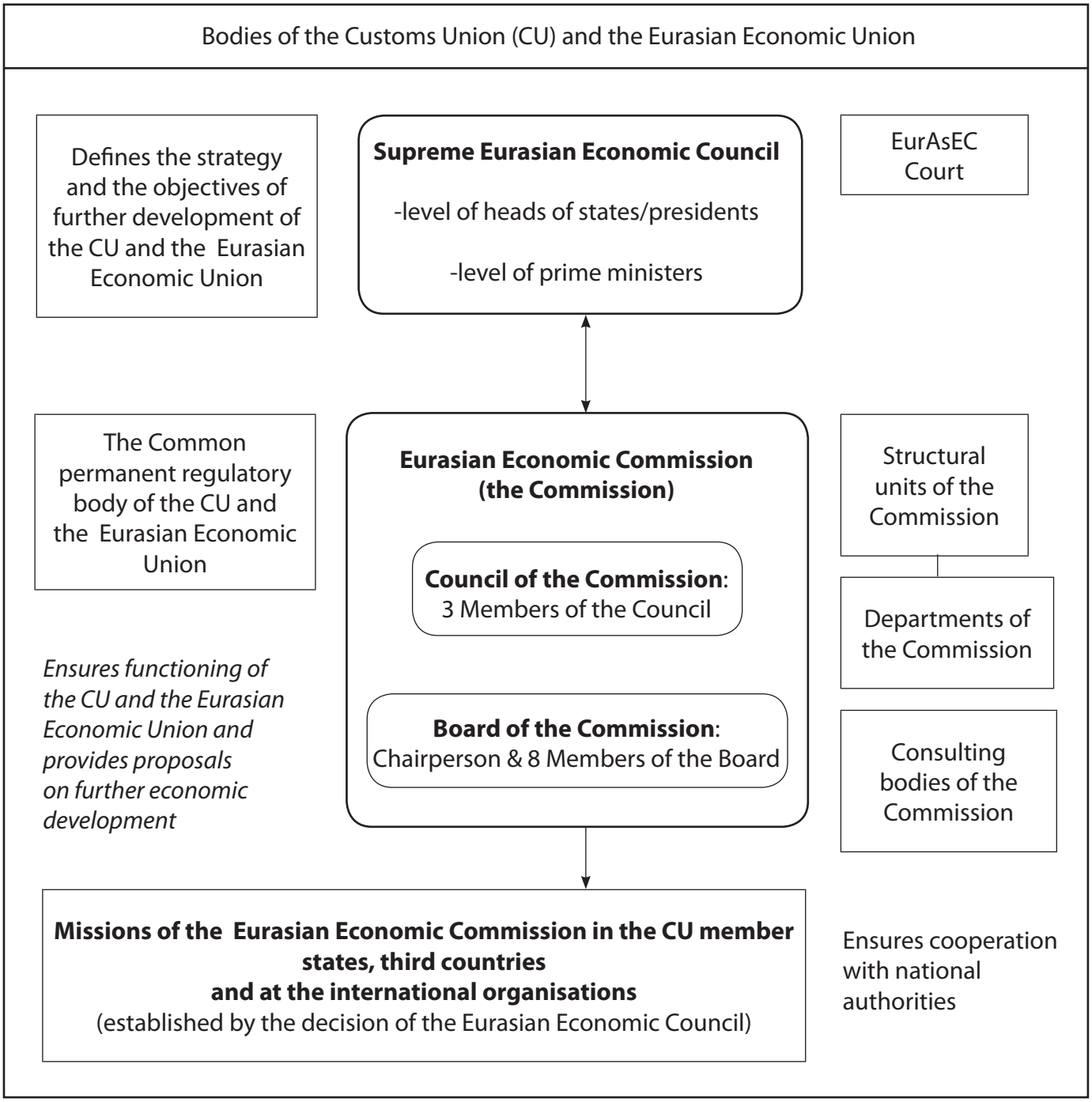
Creation of the Eurasian Union (and any other economic regional bloc for that matter) should in theory be an economically viable internal process among the three countries – Russia, Belarus and Kazakhstan. This is, however, not the case – it is counterproductive with respect to Kazakhstan's negotiations on accession to the WTO and the general liberalisation trends in the region. The Eurasian CU may in fact produce a protectionist effect and therefore barriers for EU products in the EU Eastern Partnership markets.

It is necessary to take the **EU's strategy in the Eastern Neighbourhood into account**. Recognition of Eurasian Union by opening negotiations or any other formal interaction before making further decisions on Belarus would essentially mean loss of any independent EU strategy towards Alexander Lukashenka's regime, passing all economic instruments in the hands of the Eurasian Union. In addition, recognition of the Eurasian Union and negotiations with it would provide premises for the Belarusian regime to renew relationship with the EU through the "back door".

The same applies to the Eastern Partnership Initiative – **as long as the EU itself has not answered the question as to "what is next?" after the implementation of the DCFTA and the visa dialogues, dialogue with the Eurasian Union would lead to further confusion in the regional dynamics**. Ukraine, Moldova and other Eastern Neighbourhood countries must see a clear EU position – EaP is a clear priority and greater convergence with the EU is only possible through the European Neighbourhood Policy and the contractual relations with the EU.

**In this light, it is crucial that political or technical cooperation with the Eurasian Union as an organisation** (by EU member states or EU institutions, e. g. directorates of the European Commission, etc.) **are properly monitored and kept down to the minimum required for the dissemination of principles and norms which are the basis of the EU law.** The EU's position must be unified and coherent – the Partnership and Cooperation Agreement and WTO membership are necessary preconditions to any dialogue – political and technical.

**The following dimensions of the Eurasian Union, which have not yet been clearly defined, should be closely monitored: energy policy coordination, free movement of labour, and transport policy**. Development of these policies will inevitably have implications for the region, and the EU's energy and economic interests.


Bodies of the Customs Union (CU) and the Eurasian Economic Union
Defines the strategy and the objectives of further development of the CU and the Eurasian Economic Union
Supreme Eurasian Economic Council
-level of heads of states/presidents
-level of prime ministers
EurAsEC Court
The Common permanent regulatory body of the CU and the Eurasian Economic Union
Eurasian Economic Commission (the Commission)
Council of the Commission: 3 Members of the Council
Board of the Commission: Chairperson & 8 Members of the Board
Structural units of the Commission
Departments of the Commission
Consulting bodies of the Commission
Ensures functioning of the CU and the Eurasian Economic Union and provides proposals on further economic development
Missions of the Eurasian Economic Commission in the CU member states, third countries and at the international organisations
(established by the decision of the Eurasian Economic Council)
Ensures cooperation with national authorities

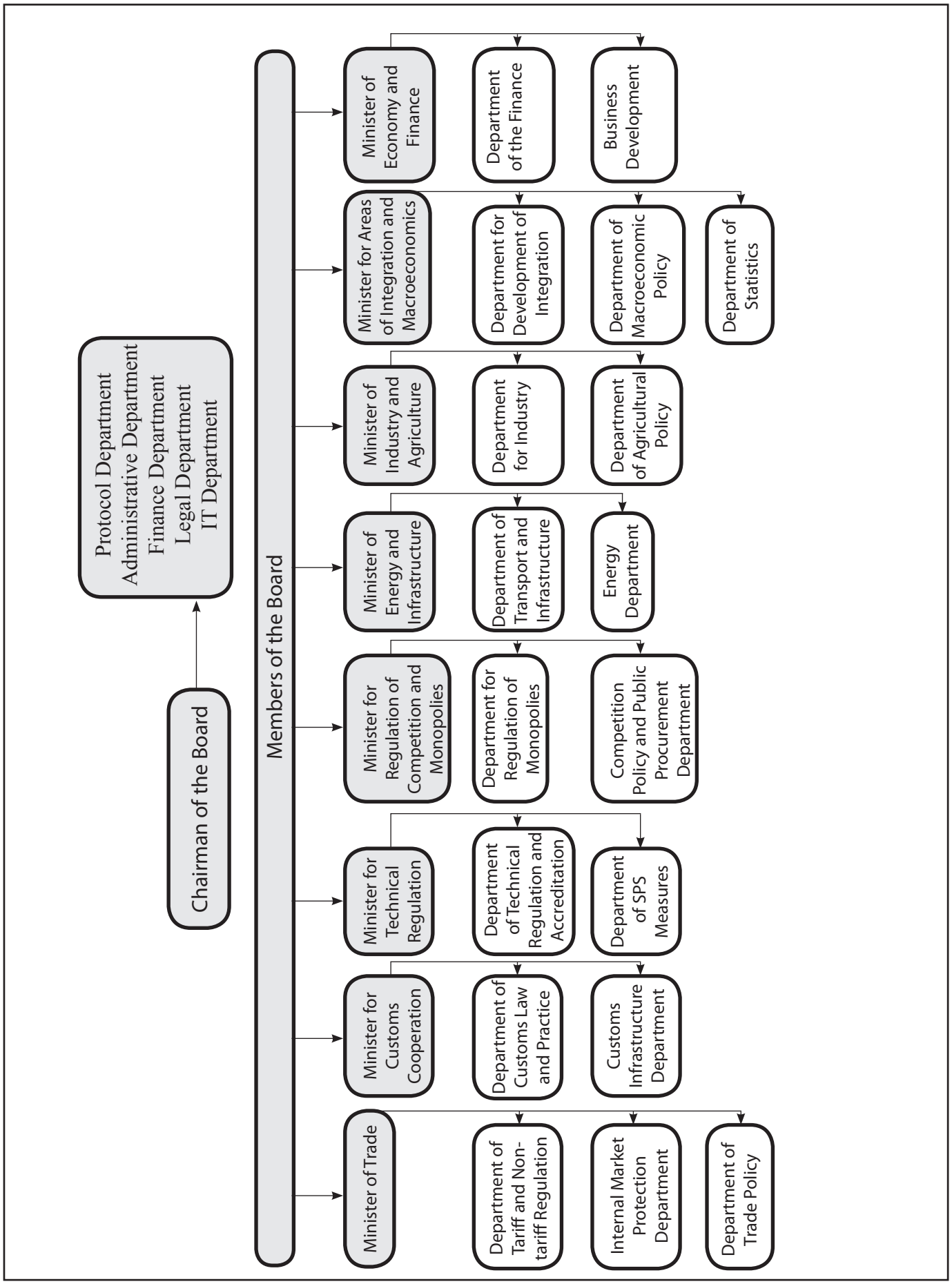
## Eurasian Economic Commission

**Board of the Commission**

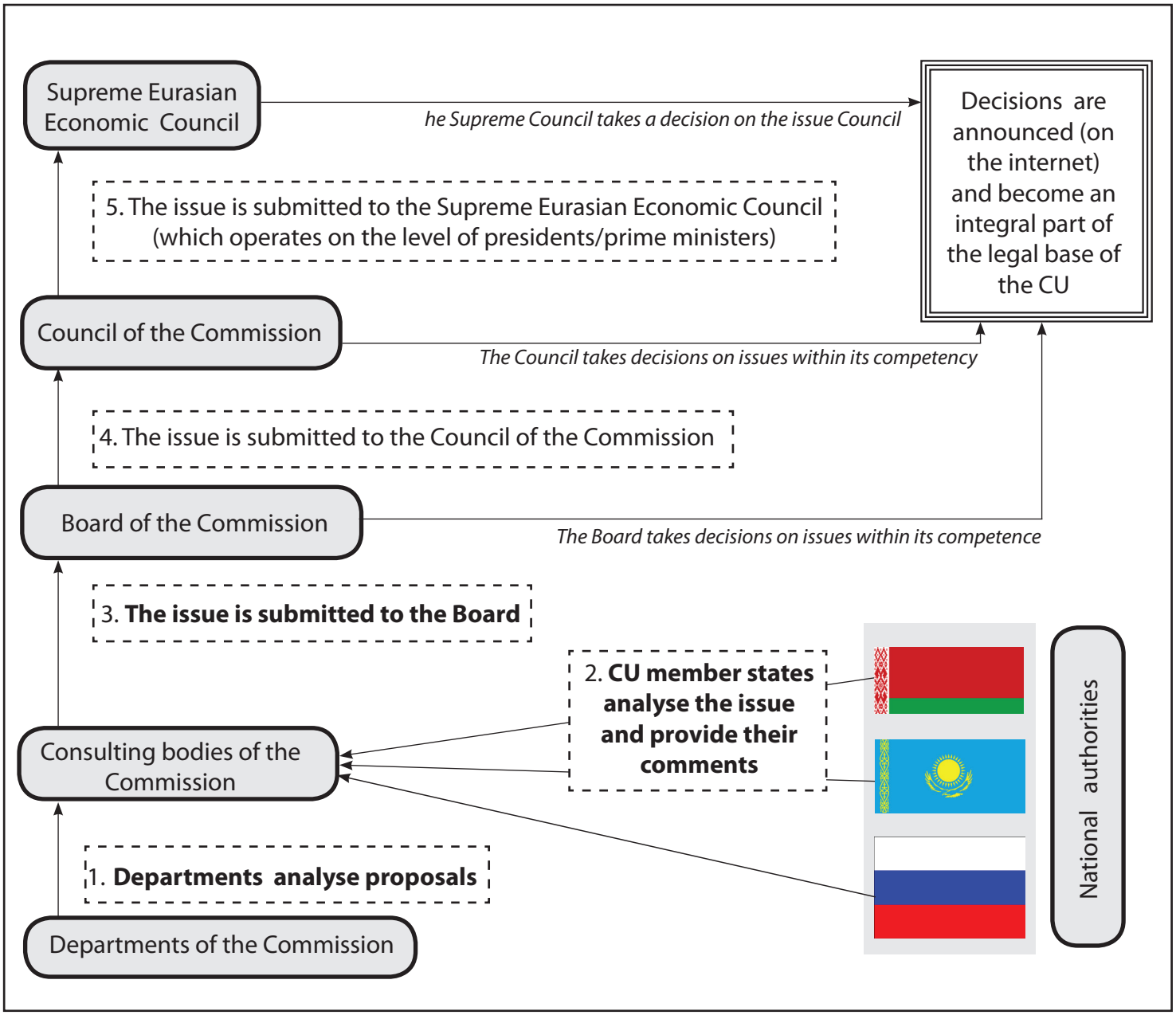
Chairman of the Board
**Viktor Khristenko**

| | | | |
|---|---|---|---|
| **Tatiana Valovaya**<br>Member of the Board-Minister in charge of development of integration and macroeconomics | **Valery Koreshkov**<br>Member of the Board-Minister in charge of technical regulation | **Andrey Slepnev**<br>Member of Board-Minister in charge of trade | **Danial Akhmetov**<br>Member of the Board-Minister in charge of energy and infrastructure |
| **Sergey Sidorsky**<br>Member of the Board-Minister in charge of industry and agriculture | **Nurlan Aldabergenov**<br>Member of the Board-Minister in charge of competition | **Vladimir Goshin**<br>Member of Board-Minister in charge of customs cooperation | **Timur Suleimenov**<br>Member of the Board-Minister in charge of economics and financial policy |

## Eurasian Economic Commission



## Decision making process within the CU and the Eurasian Economic Union



## Composition of the Board of the Eurasian Economic Commission and allocation of functions:

- **Viktor Khristenko (representative of Russia), EEC Chairman of the Board.** Carries out general coordination of the activities of the Board; ensures implementation of activities related to the financial, legal, and personnel matters of the Board; co-ordinates and controls compatibility of the main directions of integration; ensures the preparation and conducting of the meetings of the Supreme Eurasian Economic Council and the EEC Council; prepares the budget of the Council and monitors its implementation; and ensures the supply and provision of information necessary for the activities of the Board.

- **Tatiana Valovaya (representative of Russia), member of the Board (Minister) in charge of the main directions of integration and macroeconomics.** Main functions: integration policy; codification of the contractual-legal base of the customs union and the Eurasian Economic Union; macroeconomic issues, including matters related to the fundamental issues of economic development and coordination of the countries' macro-economic policies; monitoring and analysis of the countries' economic development situation; statistics.

- **Andrej Slepnev (representative of Russia), member of the Board (Minister) in charge of trade.** Main functions: tariff and non-tariff regulation; implementation of the single customs nomenclature for goods; market protection instruments (anti-dumping, application of countervailing/anti-subsidy and protectionist/security measures); unification of trade regimes and conclusion of free trade agreements with third countries; strategic goods and technology export control.

- **Vladimir Goshin (representative of Belarus), member of the Board (Minister) in charge of customs cooperation**. Main functions: customs legislation and practical implementation; implementation of customs procedures and customs controls; development of customs infrastructure and IT installation for customs.

- **Valery Koreshkov (representative of Belarus), member of the Board (Minister) in charge of standards/technical regulations**. Main functions: technical regulations; accreditation; sanitary, veterinary and phyto-sanitary measures.

- **Sergey Sidorsky (representative of Belarus), member of the Board (Minister) in charge of industry and agriculture.** Main functions: industrial development policy; agricultural policy; cross-border programmes and projects; industrial and agricultural subsidies.

- **Timur Suleimenov (representative of Kazakhstan), member of the Board (Minister) in charge of economics and financial policy**. Main functions: regulation of conditions for business and investment; tax policy; collection and distribution of duties; financial markets; monetary policy; banking and insurance services sector; stock market; protection of intellectual property; labour migration.

- **Danial Achmetov (representative of Kazakhstan), member of the Board (Minister) in charge of energy and infrastructure.** Main functions: energy policy; natural monopolies; transport and transportation, including issues related to rail services and regulation policy of transportation tariffs; general infrastructure.

- **Nurlan Aldabergenov (representative of Kazakhstan), member of the Board (Minister) in charge of competition.** Main functions: competition policy and assurance of common competition conditions; sanctions and penalties for violations of competition; introduction of state price regulation and control; procurement by state and local governments, including uniform procurement rules and cancellation of the national public procurement regime; investigation of infringement of public procurement rules and procedures.

## SUMMARY

Theoretically, liberalisation of trade between the EU and the Eastern Partnership countries as well as across the emerging Eurasian Economic Union, by removing customs duties on trade, would be beneficial both to the EU and Lithuania. However, such a scenario is very unlikely due to Russia's inability to develop a binding contractual relationship with the EU, the influence of interest groups, different political and geopolitical objectives associated with trade liberalisation and the great importance of non-tariff barriers to trade. Such a free trade area would be fragmented and limited to certain products that may be of no interest to either party. **Despite the rhetoric of Russian leaders about the pan-European economic space, Eurasian Customs Union (CU) and a broader free trade neighbourhood with the EU remain incompatible, first of all due to regulatory differences, and cannot be regarded as complementary. Given the current dynamics the Eurasian CU may in fact produce a protectionist effect and therefore barriers for EU products in the EU Eastern Partnership markets**. **This gives rise to the current dilemma of the countries of the Eastern Partnership on whether to choose integration into the EU or a closer relationship with the Eurasian Union and eventual membership in it**.

**The nature of integration of the Eurasian Union forces Eastern Partnership countries to choose between the regulatory areas of the EU or the Eurasian Union**. Membership in the Eurasian Union would mean lower short-term regulatory adjustment costs for businesses, but integration into the EU would have greater economic development potential (EU's GDP at purchasing power parity is 5.67 times that of the Eurasian Union).The Eurasian Union project is associated not only with competition in the Eastern Neighbourhood. Cooperation between the EU and the Eurasian Union from Russia's point of view should replace the EU-Russia negotiations on the post-PCA agreement (accordingly refusing all elements related to democratisation, reforms in the energy sector and economics, and human rights).

The Eurasian Customs Union in Russia's foreign policy architecture is an institutional instrument to control its member states external trade agenda and relations with the EU. All the recent Ukrainian initiatives to maintain access to the CIS markets through standard free trade agreements that do not require uniform common external tariff and therefore do not conflict with the country's participation in the enhanced free trade regime with the EU, have been blocked by Russia. This means that Russia does not leave room for any intermediate options that would enable countries to combine their European orientation and natural economic relationship with the CIS countries.

Therefore, it can be said that expansion of the Eurasian CU to the EU neighbourhood region (for instance membership of Ukraine or Moldova in the CU) is a serious challenge to the EU's Eastern Partnership initiative whose main pillar is access to the EU internal market through free trade agreements.

Key challenge to fundamental EU policies in the Eastern neighbourhood: as countries join the Eurasian CU, they lose independence in external trade policy. CU member states must not only agree on a common customs tariff, but also develop joint a trade regime with third countries. Given the characteristics of the Eurasian institutions, in order to pass a decision or seek to develop a more favourable trade regime with the EU for any member of the CU, Russia's approval is required. Thus, Russia gains leverage to control external trade policies of CU countries and their relations with the EU, for example, to block negotiations with the EU on an enhanced free trade agreement.

Furthermore, the aim of the ongoing integration process of the Eurasian Union is not only economic, but also political integration. While the limits of the potential political integration are not yet clear, efforts of both the representatives of Russia and the EEC to achieve and consolidate political recognition of the emerging structure have become more intense.

Ukraine is the most important target for the development of the Eurasian Economic Union. In the current situation, "freezing" of the enhanced free trade agreement, its association with political requirements in the field of the rule of law on the EU side, and incentives offered to Ukraine by the Eurasian CU (more precisely – Russia) may make Kiev opt for the alternative integration project.

**What should the EU strategy be with respect to the Eurasian CU?** The dynamics of the Eurasian Union is counter productive with respect to principles of the EU's external policy: the Eurasian CU lacks essential elements of a rules based regional integration project leading to transformation of economies of its member states; rather it remains a non-liberal project for trade simplification between non-liberal regimes. This makes the question of independent decision making very sensitive. None of the countries of Eurasian Union can be attributed to a free society, which means there is absence of the rule of law and fair trials. These attributes extend inevitably to the regional structure. Besides the "democracy deficit" and power asymmetries within the Eurasian union as an organisation, it is very much a union of non-democratic regimes.

Development of the Eurasian CU has a negative impact on the advance of EU-Russia relations (procrastination of negotiations on a new Partnership and Cooperation Agreement), the EU's leverage with respect to the Belarusian regime and possibly on the efficiency of the EU's Eastern Partnership policy.

**Therefore, the EU's strategy vis-à-vis the Eurasian CU should be as follows: a) no inter-regional negotiations or other cooperation initiatives (in order not to legitimise potential power imbalances between member states and not to create loopholes for authoritarian regimes such as the one in Belarus); b) bilateral approach and the European Neighbourhood Policy must remain an unequivocal priority and cannot become hostage to regional integration among the three countries; c) regular monitoring of the development of the Eurasian Customs Union, support for the rule of law, judicial independence, political and economic freedoms and other elements of liberal democratic order, assessment as well as neutralisation of potential risks to the aforementioned priorities must be in place; and d) the EU must constantly strengthen visibility and accessibility of the advantages of the EU's political and economic model in the Eastern Neighbourhood.** This objective should be pursued in the following ways.

*First*, **the EU has to find a formula for how to reduce the cost of access of partner countries to the EU internal market.** The EU must offer a clear reward to a partner country in the EU internal market in exchange for the adoption of European rules and high standards. Issues of technical standardisation are at the moment a serious obstacle to the exercise of the EU's normative power, especially when they are not directly linked to trade and rather have to do with production processes and other business activities. The EU should show understanding and sensitivity to the challenges of regulatory approximation, especially when they lead to the increase of product prices and might be important for the consumers with considerably smaller purchasing power than in the EU. Otherwise either the EU norms might be legally adopted but left unimplemented, incentives for shadow activities might increase or these countries might find the regulatory environment of the Eurasian Union more attractive due to lower adjustment costs. The DC-FTA process is crucial along with further tangible deliverables to increase cost-effectiveness of EU orientated market liberalisation to Ukraine and other EaP countries.

*Second*, **the EU must learn to offer incentives to major business structures of partner countries interested in accession to the EU markets**. These structures can become "locomotives" of the partner country's integration in the EU. In other words, the EU tariff reduction scheme and export quotas offered to its partner countries must respond to the interests of major business groups operating in the country and better use of competitive advantages of these economies.

**Why cannot the EU officially recognise the Eurasian Economic Union?**

**Valid Partnership and Cooperation Agreements between the members of the Eurasian Union and the EU, as well as WTO membership must be essential prerequisites for recognition of the Eurasian Union.**

Inter-regional agreements are not a substitute for partnership and cooperation agreements.[1] Russia's expectations that the negotiations between the EU and the Eurasian Union will be limited to commercial elements, leaving out the issues of the rule of law, political reforms and human rights in all three countries have no grounds.[2] **Cooperation or negotiations between the EU and the Eurasian Union may become possible only when all countries of the Eurasian Union have concluded valid Partnership and Cooperation Agreements with the EU (like other eastern EU neighbours)**.

**Similarly, in terms of a stable trade regime, negotiations between the EU and the Eurasian Union are possible only when all members of the Eurasian Union become WTO members**. Otherwise, Russia, which has completed its WTO accession negotiations, indirectly, gets an opportunity to renegotiate the terms at the expense of other members of the Eurasian Union. In addition, only membership in the WTO (and, ideally, the end of transition periods) can ensure a more transparent settlement of disputes between the otherwise non-liberal political and economic regimes and with them.

Considering the issue of recognition of the Eurasian Union, the following aspects must be considered:

- **Deepening of Eurasian Union integration (free movement of labour) and the visa dialogue with the EU: risks to the European Union**. Russia has visa-free travel arrangements with most CIS countries (with high indicators of both economic migrants and political refugees). According to the current regulation, a person can become a naturalised citizen of Russian Federation after three years of marriage to a citizen of Russia, after passing the Russian language and constitution examinations, on the condition of having a legitimate income; it is not necessary to live in Russia permanently for five years. This has certain implications to the EU-Russia visa dialogue in the light of an open Eurasian labour market. The EU should pay attention to the scenario of Russia as a possible intermediate stop for migrants of other CIS countries to the EU. The experience of the Balkan countries, specifically with Turkish migrants to the EU attests to this, as Turkey has a visa-free regime with the Balkan countries. In addition by creating the Eurasian Economic Area, which includes Russia, Belarus and Kazakhstan, a common visa policy will also be sought. Thus, the internal border controls will be abolished. For these reasons, the risk of illegal migration may increase at the EU external borders. In order to mitigate possible risks of illegal migration, the EU could raise (as a condition in the negotiations with Russia on a visa-free regime) the necessity to conclude readmission agreements with all countries of the Eurasian Customs Union. Given the functions delegated to the Eurasian Union, and the negotiations with Russia on a visa-free regime, a connection between the entrance of the visa-free regime in force and the conclusion of the readmission agreement with Belarus (and other countries of the Eurasian Economic Union) should be made.

- Creation of the Eurasian Union is not an economically viable internal process. It is counter productive with respect to Kazakhstan's negotiations on accession to the WTO and the general liberalisation trends in the region. The Eurasian CU may in fact produce a protectionist effect and therefore barriers for EU products in the EU Eastern Partnership markets.

[1] Partnership and Cooperation Agreements is the format of EU relations in the Eastern Neighbourhood. For comparison – all members states of *Mercosur* have framework partnership agreements with the EU, which set forth the foundation for democratic cooperation, respect for human rights and other political principles (except for Venezuela, whose membership in Mercosur has essentially become the end-point of the Mercosur-EU negotiations on regional free trade agreement).

[2] The European Parliament resolution of 13 December 2012 containing the European Parliament's recommendations to the Council, the Commission and the European External Action Service on the negotiations of the new EU-Russia Agreement (2011/2050 (INI)) **prioritises obligations of the Partnership and Cooperation Agreement and the WTO membership over any other agreements and sets forth the necessity to ensure not only economic, but also political modernisation as a precondition for these obligations.**

- It is necessary to take the **EU's strategy in the Eastern Neighbourhood into account**. Recognition of Eurasian Union by opening negotiations or any other formal interaction before making further decisions on Belarus would essentially mean loss of any independent EU strategy towards Alexander Lukashenka's regime, passing all economic instruments in the hands of the Eurasian Union. In addition, recognition of the Eurasian Union and negotiations with it would provide premises for the Belarusian regime to renew relationship with the EU through the "back door".

- The same applies to the Eastern Partnership Initiative – **as long as the EU itself has not answered the question as to "what is next?" after the implementation of the DC-FTA and the visa dialogues, dialogue with the Eurasian Union would lead to further confusion in the regional dynamics**. Ukraine, Moldova and other Eastern Neighbourhood countries must see a clear EU position – EaP is a clear priority and greater convergence with the EU is only possible through the European Neighbourhood Policy and the contractual relations with the EU.

- **In this light, it is crucial that political or technical cooperation with the Eurasian Union as an organisation** (by EU member states or EU institutions, e. g. directorates of the European Commission, etc.) **are properly monitored and kept down to the minimum required for the dissemination of principles and norms which are the basis of the EU law.** The EU's position must be unified and coherent – the Partnership and Cooperation Agreement and WTO membership are necessary preconditions to or any dialogue – political and technical.