



## The EU and its Eastern Partners: Conditionality and Expected Benefits. How does the Russia Factor Matter?

**Zsuzsa Ludvig**

### Abstract

Slow progress within the EU Eastern Partnership (EaP) program and disappointment of all affected partners can be explained by both problems arising on the EU and the Eastern partners' side. Problems on EU side include some major deficiencies like the lack of incentive of EU membership or the slow progress in the visa-free movement of people, the a second major issue for most EaPs. All in all the "carrot" offered by the EU is a small one compared to the appetite of the targeted countries. Eastern partners can also be blamed since most of them delay in "doing their homework" to transform their political, juridical or economic systems. The paper argues that in some cases this "delay" is greatly influenced by a third factor, namely the forced choice on foreign policy orientation for which Eastern partners seem to be either not ready or not dedicated enough. The next EU-EaP summit (Vilnius, 28-29 November 2013) might become a milestone in this respect. The core of the problem roots in the EU "offer" of deep and comprehensive free trade agreements (DCFTAs) that institutionally exclude the possibility of the Eastern partner's parallel economic integration towards East. The first-ever EU EaP Association Agreement including a DCFTA is expected to be signed in this summit with Ukraine.

**Keywords:** *European Union / Eastern Partnership (EaP) / EU integration / EU enlargement / DCFTAs / Foreign trade / Foreign direct investments (FDI) / Migration / Russia*

## The EU and its Eastern Partners: Conditionality and Expected Benefits. How does the Russia Factor Matter?

by Zsuzsa Ludvig\*

### Introduction

Slow progress within the EU Eastern Partnership (EaP) program and disappointment of all affected partners can be explained by both problems arising on the EU and the Eastern partners' side. Besides recent economic difficulties, diverging member state interests and approaches including the "South versus East" problem,<sup>1</sup> shared competencies between EU institutions, uncertainties of conditionality,<sup>2</sup> problems on EU side include some major deficiencies like the lack of incentive of EU membership or the slow progress in the visa-free movement of people, the a second major issue for most EaPs. All in all the "carrot" offered by the EU is a small one compared to the appetite of the targeted countries. At the same time Eastern partners can also be blamed since most of them delay in "doing their homework" to transform their political, juridical or economic systems. The paper argues that in some cases this "delay", that is the lack of real commitment to doing the homework, is greatly influenced by a third factor, namely the forced choice on foreign policy orientation for which Eastern partners seem to be either not ready or not dedicated enough. The next EU-EaP summit to be held in Vilnius on 28-29 November 2013 might become a milestone in this respect. The core of the problem roots in the EU "offer" of deep and comprehensive free trade agreements (DCFTAs) that institutionally exclude the possibility of the Eastern partner's parallel economic integration towards East. The first-ever EU EaP Association Agreement including a DCFTA is expected to be signed in this summit with Ukraine.

Eastern partners can be divided into two groups. The first includes those partners that declared their willingness to become members of the European Union: Ukraine,

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<sup>1</sup> Visegrad countries and Sweden for instance are among major supporters of the Eastern partners, while France and other member states from the Southern Europe are more interested in the other direction of the ENP, that is in the Euro-Mediterranean Partnership. Germany's positions are of key importance.

<sup>2</sup> Belarus is a good example where the EU has been hesitating or has had problems when trying to establish conditionality for the past few years. Here on the one hand the EU would like to send clear and definite messages to the recent authoritarian Belarusian leadership, on the other it does not wish to put punishment on the population. A second problematic country is Ukraine, where conditionality got impetus due to the negative turn in domestic political developments, but where even most recent "conditions" of the EU are not clear. According to the Council conclusions on Ukraine, of 10 December 2012, the EU is ready to sign the already initialled Association Agreement in case Ukrainian authorities "address the cases of politically motivated convictions...", but the document does not mention the Julia Timoshenko case as a concrete condition. Relations with Azerbaijan also raise the problem of conditionality: the EU has been often blamed of being too tolerant with the country possessing huge energy sources in which the EU is interested.

Moldova and Georgia. These states have been expecting clear signs, reflecting worthy of their European choice from the EU. The European Neighbourhood Policy (ENP), and particularly the EaP, as the answer to these expectations on part of the EU is not convincing enough for them. Meanwhile, their domestic political landscapes have been changing as well. For instance, Ukraine has become a more reluctant or at least hesitating partner, while due to most recent domestic political events Moldovan commitment might become also uncertain in the future. Shifts in these two countries are important, since after the initial period when Ukraine was the pioneer country in the Eastern dimension of the ENP, for the past few years Moldova has been seen as the “best pupil in the class”, that is the most advanced in rapprochement to the EU. Definitely, now Georgia remains the most determined Eastern partner. Although members of the second group, Armenia, Azerbaijan and Belarus, have less definite goals and they intend to establish close ties without any real commitment to the EU, the forced choice might be relevant even for some of them in the future.

## 1. Eastern partners between the European Union and Russia

After a short period of co-operative approach at the beginning of the 2000's,<sup>3</sup> the EU and Russia evidently got involved into a competition or even rivalry over their common post-Soviet neighbours with a most obvious struggle for Ukraine evolving for the past few years. In 2003 the EU launched the European Neighbourhood Policy followed by a more targeted program within the Eastern Partnership initiative in 2009. EaP offers “deep and comprehensive free trade agreements” (DCFTAs) as a core economic element of the planned Association Agreements.<sup>4</sup> On its side, Russia also initiated an ambitious integration project in the post-Soviet space, namely the Customs Union (CU) within the Eurasian Economic Community in 2010 now called as “Single Economic Space” (SES), and with the final goal of creating an Eurasian Economic Union.

Both “offers” have their severe economic consequences making the choice for the EaPs hard. The necessity of the choice is due to the fact that the Russia-led CU/SES goes beyond the level of a free trade regime which makes the two parallel rapprochements impossible for institutional reasons. However, while economic benefits of the DCFTAs with the EU might be expected mainly in the long run (like the positive changes of the economic structure, more keen market competition leading to increased competitiveness, economic growth and increased welfare etc.)<sup>5</sup>, the economic disadvantages of rejecting the Russian offer will arise immediately.

<sup>3</sup> In 2002 the EU and Russia jointly worked out a “White Book” on their economic co-operation with a possible extension of the results of bilateral co-operation such as the planned Common Economic Space to other post-Soviet states. Ivan Samson, Xavier Greffe (eds.), *Common Economic Space: Prospects of Russia-EU Relations* (RECEP White Book), Moscow, Russian-European Centre for Economic Policy (RECEP), 2002.

<sup>4</sup> In fact, it is not possible to conclude the Association Agreement (AA) on political co-operation without signing the DCFTA and DCFTA cannot be applied without a signed AA, which is a major hampering factor in the whole process in both cases: either in a case when a country is politically determined (Georgia) or when it is ready for deeper economic co-operation but political conditions are still not satisfactory (the case of the finalised DCFTA of Ukraine).

<sup>5</sup> Long-term economic benefits have been predicted in several impact assessments studies made by up till now either for Ukraine or Georgia. See for example: Michael Emerson (ed.), *The Prospect of Deep Free Trade between the European Union and Ukraine*, Brussels, Centre for European Policy Studies (CEPS),

The European Union is not ready to offer the membership perspective to the Eastern partners in the foreseeable future and seems to be rather reluctant in providing visa free regime for them as well. Visa free movement has been linked to very strict, mainly technical conditions.<sup>6</sup> Reluctance on the EU part concerning the free movement of citizens of EaPs might turn to be a bad policy in this competition as well. Despite the strong pressure from some EaPs for visa-free movement of their citizens to the EU, visa free regimes can be expected only in the long term.<sup>7</sup> At the same time citizens of most post-Soviet countries can enter Russia without visa, with Georgia being the only EaP for which visa is needed. Georgia is not only the most distant post-Soviet partner regarding new post-Soviet integration projects, but belongs to the small group of two post-Soviet countries outside the CIS as well.<sup>8</sup> The visa regime introduced by Russia towards Georgia well illustrates its differentiated and presumably differentiating policy approach towards certain post-Soviet countries in the future.

Eastern partners face a challenging integration/orientation dilemma. Most of them still have very close ties to other post-Soviet economies, mostly to Russia, in several cases and sectors even with strong dependencies, while they are in the process of developing privileged economic links with the EU as well. Now they are or in the future they will be forced to choose between integration course to the West or East, between Russia or the EU, since in the EU approach integration to the EU Single Market excludes economic integration into other integration groups at the same time for institutional reasons.<sup>9</sup> While this choice, often considered to be a political one, does not seem to be a problem for some EaPs (like Georgia), it creates difficulties for others (at the time being the hottest for Ukraine) with serious short, medium or long term economic consequences.

The EU is a key economic partner for the European post-Soviet countries. The economic interests of the EU are most manifest regarding the energy sources of the post-Soviet region, although developing trade and investment opportunities are also on the agenda. The European Union is already a major trade partner for four of the

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2006, <http://www.ceps.be/node/1164>; Merab Kakulia, *Georgia: Eastern partners experiences and expectations with DCFTA*, Presentation at the international workshop "Developing trade and trade policy relations with the European Union: Experience of V4 countries and implications/lessons for EaPs", Budapest, 24 May 2013, [http://vki.hu/v4\\_eaps\\_developing\\_trade](http://vki.hu/v4_eaps_developing_trade). However, interestingly there are Ukrainian estimations, according to which Ukraine will not benefit from the DCFTA at all. One of them was made by the Institute for Economics and Forecasting of the Ukrainian National Academy of Sciences. See Volodymyr Sidenko, "Ukraine's Regional Integration Policies: The EU versus the Eurasian Community", in Zsuzsa Ludvig (ed.), *Eurasian Challenges. Partnerships with Russia and Other Issues of the post-Soviet Area*, Budapest, Institute of World Economics CERSHAS, 2013 (East European Studies No. 4), p. 11-29, <http://real.mtak.hu/6808>; Lidia Shynkaruk, *Foreign economic relationships between Ukraine and the EU countries*, Presentation at the international workshop "Developing trade and trade policy relations with the European Union: Experience of V4 countries and implications/lessons for EaPs", Budapest, 24 May 2013, [http://vki.hu/v4\\_eaps\\_developing\\_trade](http://vki.hu/v4_eaps_developing_trade).

<sup>6</sup> EU membership is a no. 1. priority for three countries (Ukraine, Moldova and Georgia), while visa free movement of citizens is key issue for all the six countries.

<sup>7</sup> EaPs argue that the state of their technical preparedness and the general level of migration "threat" they represent is not really worse than it was in some Western Balkan countries that were exempted from EU visa regime during the past few years, pointing to the political character of the decision instead of the technical one emphasized by the EU.

<sup>8</sup> Turkmenistan is the other one.

<sup>9</sup> A major problem originates from the lack of WTO-membership of Belarus and Kazakhstan.

European post-Soviet economies, except for Ukraine and Belarus (based on figures for 2010 and 2011). Here, Ukraine represents a major issue with its so-called “double ties” manifested also in foreign economic relations, a challenge which the country seemingly has not been able to address so far. Although the European Union is not ready to offer membership perspective to these affected countries, it intends to get these economies involved into its Single Market through its DCFTA idea. The idea is open to all EaP countries that are members of the WTO, that is Azerbaijan and Belarus, possessing only observer status in the organization, are at the moment out of the scope of the initiative.

Russia still constitutes the economic centre of the post-Soviet space. On the one hand, it is the major partner or can be found among most important economic partners for most post-Soviet economies. Russia constitutes a major trade partner, an important investor and an attractive centre for labour migration in almost all cases. Besides, the “Russia issue” cannot be neglected in the sphere of energy, neither in the case of energy exporters nor for energy importers of the region. Transit aspects also largely matter. On the other hand, it has the ambition to be the centre for them evidenced by its integration plans and ideas, already in the process. However, Russian ambitions and plans for integrating the analyzed countries face competition on part of other regional powers, like the EU (or Turkey). Even so, Russian intentions to achieve economic integration with other countries of the post-Soviet space by creating an independent power centre have rarely been taken seriously by the West so far. The argumentation behind this neglecting approach has been basically linked to the failures of different post-Soviet or Russian-led integration initiatives, the phenomenon of “institutions on paper”, treaties with thousands of exceptions, up till now. We argue that these new Russian projects, namely the Single Economic Space (SES) based on the Customs Union of Russia, Belarus and Kazakhstan and the dreamed Eurasian Economic Union the core of which is the Eurasian Economic Community (EurAsEC) including Kirgizstan and Tajikistan beside the three above mentioned states, deserve a deeper attention, as they have taken concrete forms and constitute one of the main focuses of Russia’s current foreign policy. Economic factors and economic methods are getting to constitute a more and more important dimension of competition between countries and regional powers. Russia intends to build up or rebuild a Russia-led economic power centre in the Eurasian continent, particularly in the post-Soviet space, which is naturally a “political plan” at the same time. This ambition has become manifest during the last decade when Russia experienced considerable economic growth (especially in the years 2000-2008) and political stability which allowed it to focus on projecting its power in the “near abroad”. Russia has both attempted to develop close and strong political relations with the countries in the region, and formulated a concrete economic integration plan in its neighbourhood. A basic question is whether Russia will be able to be a real and attractive gravity centre in its near abroad or not. Naturally the answer will be partly “yes” and partly “no”. Some post-Soviet countries (some EaPs) are likely to join or have already joined the Russian-led integration grouping, while others want to and may vote against this option.

The common post-Soviet European neighbourhood is evidently a most important issue in recent EU-Russian dialogue. It is even more: one of the main hampering factors in EU-Russian rapprochement. No significant development in EU-Russian relations can be achieved without arriving at a compromise on this issue. Although the EU has been

emphasizing that the EaP is not an anti-Russian project, the EaP created deep tensions between the two partners. It received a rather chilly welcome from Russia who considered it as an initiative in conflict with its own ideas. Beyond the general political motivations for being a gravity centre for the region, energy and trade issues constitute the most evident fields of clashing interests between Russia and the EU.<sup>10</sup>

## 2. The forced choice

Tensions between Russia and the EU over Ukraine became public during 2011 although they existed well before this year.<sup>11</sup> Ukraine followed its well-known multivectoral policy during the nineties, and tried to keep it even after its euro-integration priority had already been declared. ENP evidently targeted Ukraine as a no. 1. country in 2003-2004 (in 2003 within the Wider Europe concept), but as a slight shift from a balanced multivectorism Ukraine joined the Russian initiated Common Economic Space involving Russia, Ukraine, Belarus and Kazakhstan also in 2003, but leaving it soon after the orange revolution. Since these times Ukraine has been balancing between East and West, Russia and the EU, trying to collect benefits from both sides, but at moment the country is under high pressure to make a choice.

The EU's DCFTA plan has been most deeply elaborated in relation with Ukraine. The DCFTA is part of the EU-Ukrainian Association Agreement and is based on Ukrainian WTO membership and the declared Ukrainian commitment to the EU integration course. Although recent Ukrainian political leadership has been critical of the content of the DCFTA agreement basically negotiated under the previous Ukrainian government, negotiations were finalized at the end of 2011. The first ever EU DCFTA was initialled in Spring 2012, but its signing and ratification has been held up by domestic Ukrainian events, among others the imprisonment of the ex-prime minister, Yulia Timoshenko and the prosecution of other representatives of the opposition evidently on political ground. Although several conditions of the EU have already been met by Ukraine, the Timoshenko-case seems to be crucial point in the future of the Association Agreement.

Meanwhile, Russian ideas on post-Soviet reintegration have been also developing and getting concrete forms. Three economies established the Customs Union, a formula very similar to the Common Economic Space (CES) initiative launched in 2003. Ukraine's absence from the new organisation constitutes the difference between the two country groupings.<sup>12</sup> However, beside the importance of bilateral Ukrainian-Russian economic ties on the micro level, any post-Soviet integration grouping would need Ukraine, the second biggest and most advanced post-Soviet economy. Ukrainian

<sup>10</sup> Justin Vaïsse and Susi Dennison (eds.), *European Foreign Policy Scorecard 2013*, London, European Council on Foreign Relations (ECFR), January 2013, p. 50, <http://www.ecfr.eu/scorecard/2013/russia/18>.

<sup>11</sup> See for example Zsuzsa Ludvig, "Integration Prospects for Ukraine: SES and/or 'Deep Free Trade' with the EU?", in Gábor Fóti and Zsuzsa Ludvig (eds.), *The Ukrainian Economy in Europe*, Budapest, Institute of World Economics, 2007 (IWE HAS Working Papers No. 175), p. 42-45, <http://vki.hu/workingpapers/wp-175.pdf>.

<sup>12</sup> Ukraine participated in the CES at its starting phase, signed the basic agreement, but after the orange revolution the new Ukrainian leadership decided to leave the project, stating that Ukraine is interested only in a FTA level of the Russia-led integration. Both CES aimed and recent CU aims at a higher than FT stage of integration among members.

participation is evidently necessary to achieve the dream of a post-Soviet economic centre as an important pillar of the multipolar world. Moreover, the decisions of Ukraine, the largest and most influential country within the EaP, may have an impact on the course of other EaPs as well.<sup>13</sup> This is why for the past few years Russia has been making pressure on Ukraine to join the CU.

The EU argues that a potential Ukrainian membership in the Russian-Belarus-Kazakh Customs Union would not match with the planned EU-Ukrainian DCFTA and is definitely against Ukrainian WTO commitments. But Russia made it clear that without joining the Customs Union Ukrainian intentions to renegotiate principles of gas pricing, agreed under the Timoshenko-government, are only illusions. In exchange for the Ukrainian participation Russia offers not only cheap gas, but the elimination of export duties concerning its oil and oil products, providing compensation for potential Ukrainian payments due to WTO members' claims and the elimination of safeguard measures introduced against several Ukrainian producers. Altogether according to Russian calculations the Russian offer totals to about 6.5-9 billion dollar a year.<sup>14</sup> Furthermore, keeping distance from the CU threatens Ukraine with facing new product wars, a widely used tool for the past years by Russia, and as a counter measure by Ukraine, as well. This is how Ukraine became the object of a double mill game.<sup>15</sup> At the moment Ukraine is in an "either or" situation since none of its two major partners seem to seek compromise. Ukraine suggested having observer status in the CU, but it is not in Russian interests and plans to not have Ukraine fully. Although according to the basic document of the CU, in the long term Russia is thinking of a large Eurasian Economic Union linking the SES/CU to other states of the Eurasian continent in the longer run perhaps even with the EU,<sup>16</sup> in the short run the competitive element of the Russian approach seems to be stronger than the co-operative one. At least the officially stated Russian vision on a future Pan-European common economic area is not in accord with its strongly negative reactions to the EU DCFTA plans.<sup>17</sup>

Moldova and Armenia might also create tensions. Although, Moldovan economy with its small size and insignificance is not really crucial for any Russian plan, a definite Moldovan choice for the EU may lead to serious economic consequences in the

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<sup>13</sup> Olga Shumyola-Tapiola, "Ukraine at the Crossroads: Between the EU DCFTA & Customs Union", in *Russie.Nei.Reports*, No. 11 (April 2012), p. 20, <http://www.ifri.org/?page=contribution-detail&id=7104>.

<sup>14</sup> *Ibid.*, p. 21.

<sup>15</sup> On the significance of the CU Leonid Kozhara, head of the Ukrainian Ministry of Foreign Affairs, stated the following on 8 May 2013: "No country can obviously change its geography. This means there is no other option for Ukraine but to strive to maintain good, neighborly and partnership relations with Russia. [...] Russia and the Custom Union as a whole are key trade partners of Ukraine. Should Ukraine not aim at the most favorable trade regime with the Custom Union? Of course it should." See US Helsinki Commission hearing on "Ukraine's Leadership of the OSCE", Washington, 8 May 2013, [http://www.csce.gov/index.cfm?FuseAction=ContentRecords.ViewTranscript&ContentRecord\\_id=541](http://www.csce.gov/index.cfm?FuseAction=ContentRecords.ViewTranscript&ContentRecord_id=541).

<sup>16</sup> The final aim of the Russian projects is to "proceed towards creating the Eurasian Economic Union with other countries, international economic blocs, and the European Union, with the attainment of common economic space", that is Russian initiatives would make part of a broader integration process on the whole Euarasian space. Sidenko (2011)

<sup>17</sup> Though not so evidently, Russia launched a similar competition in another "common neighborhood", in the West-Balkans in 2011 when inviting Serbia and Montenegro, now both being EU candidates, to the Russia-led CU.

country. Russia would not welcome such a decision for political reasons.<sup>18</sup> Though Armenia at the moment is further from achieving a DCFTA with the EU than Ukraine or Moldova are now, a potential Armenian-EU DCFTA would be also painful for Russia and could lead to difficulties in both EU-Russian bilateral relations and Armenian-Russian relationship. Furthermore, although the country is not a formal member of the EurAsEC, neither of the Customs Union, it takes part in the Collective Security Treaty Organization (CSTO) and in some EurAsEC-operated entities as well, like the Anti-Crisis Fund and Innovation Fund which indicate its interests in post-Soviet initiatives aimed at (partial) re-integration of post-Soviet economies.<sup>19</sup>

**Table 1.** Relevance of the “forced choice” dilemma for the Eastern partners

EU membership wanted, declared		No EU membership but different benefits from the EU wanted	
the existence of integration dilemma (+ or -)		the existence of integration dilemma (+ or -)	
<b>Ukraine</b>	+	<b>Armenia</b>	- , but may turn: +
<b>Moldova</b>	- , but may turn: +	<b>Azerbaijan</b>	-
<b>Georgia</b>	-	<b>Belarus</b>	-

For three countries the orientation dilemma does not exist, at least not in the foreseeable future. Georgia surely has not been a target country for new Russian post-Soviet (re)integration intentions due to the political tensions between the two countries. On its side recently Georgia follows, probably, the most definite European course from among EaPs with full readiness to meet European expectations. Contrary to Georgia, Belarus’s path is just the opposite not only because without WTO-membership EU DCFTA offer is out of question, but for political reasons as well.<sup>20</sup> From among EaPs Belarus is represented in all Russia-initiated post-Soviet integration groupings. The third country, Azerbaijan is in a favourable situation not being dependent neither on Russia, nor on the EU due to its endowment in natural resources, the EU and Russia

<sup>18</sup> Although according to Moldovan expert calculations the potential balance of benefits and costs of an eventual membership in the CU/SES would be negative mostly due to the high Russian/CU import tariff rates leading to price increase in the country, in a situation of a concrete Russian offer Moldova could easily face similar to the current Ukrainian pressure. But evidently Transnistria constitutes the most sensitive issue. See Adrian Lupusor, *Moldova’s experiences on developing trade and trade policy relations with the European Union*, Presentation at the international workshop “Developing trade and trade policy relations with the European Union: Experience of V4 countries and implications/lessons for EaPs”, Budapest, 24 May 2013, [http://vki.hu/v4\\_eaps\\_developing\\_trade](http://vki.hu/v4_eaps_developing_trade).

<sup>19</sup> Volodymyr Sidenko, *The Customs Union and Common Economic Space of Belarus, Kazakhstan and Russia as a new reality for the European Union and its Eastern Partners*, Presentation at the international workshop “Russia between two worlds: achievements, failures of 20 years and prospects”, Budapest, 7-8 April 2011.

<sup>20</sup> However, a radical domestic political turn, not being likely right now, but cannot be excluded in the long run, would put the orientation dilemma on the agenda immediately.



are both interested in. Azerbaijan is most likely to follow its multipolar foreign (and foreign economic) policy in the foreseeable future.<sup>21</sup>

### 3. Foreign economic relations in the mirror of statistics: EU versus Russia and the Customs Union

When analysing the “in-between” situation of the Eastern partners and the attractiveness of the two gravity centres, concrete strength of foreign economic relations between the EU and EaPs on the one hand, and Russia and EaPs on the other should be taken into consideration as well. Trade, FDI and migration flows and tendencies are subjects to analysis in this chapter in order to evaluate the prospects and relevancies of economic integration initiatives with this or that partner.

From among EaP economies Ukraine is the most interesting one since the EU and Russia are almost equally important economic partners of the country. Trade figures for the past few years have been very close to each other. Regarding FDI, both actors have considerable influence on the economy, while Ukrainian labour migration also intensively targets the EU, Russia (and Turkey!) as well. For Belarus, the EU and Russia are major economic partners at the moment, but taking into consideration all kinds of economic links and dependencies, Russia is the dominant one. Belarusian economy is evidently dependent on Russia in several aspects. For Moldova and Armenia the EU is by far the most important economic gravity centre; however, these countries also have strong links to the Russian economy in some sectors even with deep dependency on it. Georgia and Azerbaijan represent the two special cases. Economic relations between Georgia and Russia were almost entirely cut due to the political tensions that led to the 2008 August war, but this cut caused serious harms to the economy. Furthermore, Russian capital is still present in key companies and Georgian sectors. The Azerbaijani economy is the only one being not dependent on Russia. The country enjoys economic benefits of being important partner both for Russia and the EU. However, in the post-crisis period a new tendency has appeared with the rise of influence and significance of third countries like China or Turkey. On their side, post-Soviet countries under the pressure of the forced choice make also efforts to develop or strengthen third pillars of their set of economic links. Next subchapters provide more detailed information on recent state and trends in the development of these economic ties based on statistics.

#### 3.1. Trade

International trade was hit strongly by the world economic crisis bottoming in 2009. 2010 and 2011 already showed growing tendency world wide and across Europe as well. In these two years the EU was a major partner for Moldova, Armenia, Azerbaijan and Georgia both in export and import side, while ranking first in Belarus exports also both in 2010 and 2011. Russia was the biggest export and import partner for Ukraine and ranked first in Belarusian imports during 2010-2011 with a share above 50%.

<sup>21</sup> Marius Mazziotti, Bastian Matteo Scianna and Djan Sauerborn, “Multipolarity is key: Assessing Azerbaijan’s foreign policy”, in *CESD Working Papers*, January 2013, <http://cesd.az/new/2013/01/multipolarity-is-key-assessing-azerbaijans-foreign-policy>.

**Table 2.** Ranking and share (%) of EU and Russia in EaPs exports and imports, 2010-2011

		2010		2011	
<b>Moldova</b>	Exports	1. EU (47.5)	2. Russia (26.2)	1. EU (51.6)	2. Russia (20.8)
	Imports	1. EU (44.4)	2. Russia (15.3)	1. EU (55.6)	3. Russia (8.8)
<b>Ukraine</b>	Exports	1. Russia (26.2)	2. EU (25.5)	1. Russia (28.9)	2. EU (26.5)
	Imports	1. Russia (36.2)	2. EU (31.3)	1. Russia (35.4)	2. EU (31.2)
<b>Belarus*</b>	Exports	1. EU (43.8)	2. Russia (31.5)	1. EU (37.9)	2. Russia (35.1)
	Imports	1. Russia (58.5)	2. EU (23.0)	1. Russia (54.7)	2. EU (19.0)
<b>Armenia</b>	Exports	1. EU (48.1)	2. Russia (15.4)	1. EU (45.5)	2. Russia (16.7)
	Imports	1. EU (27.5)	2. Russia (22.3)	1. EU (28.3)	2. Russia (21.5)
<b>Azerbaijan</b>	Exports	1. EU (47.9)	7. Russia (3.7)	1. EU (59.4)	3. Russia (4.5)
	Imports	1. EU (25.4)	2. Russia (17.4)	1. EU (32.4)	2. Russia (16.8)
<b>Georgia</b>	Exports	1. EU (18.3)	9. Russia (2.2)	1. EU (19.5)	18. Russia (0.5)
	Imports	1. EU (28.4)	6. Russia (5.6)	1. EU (29.1)	36. Russia (0.1)

\* Data for Belarus are for 2009 instead of 2010.

Source: Eurostat.

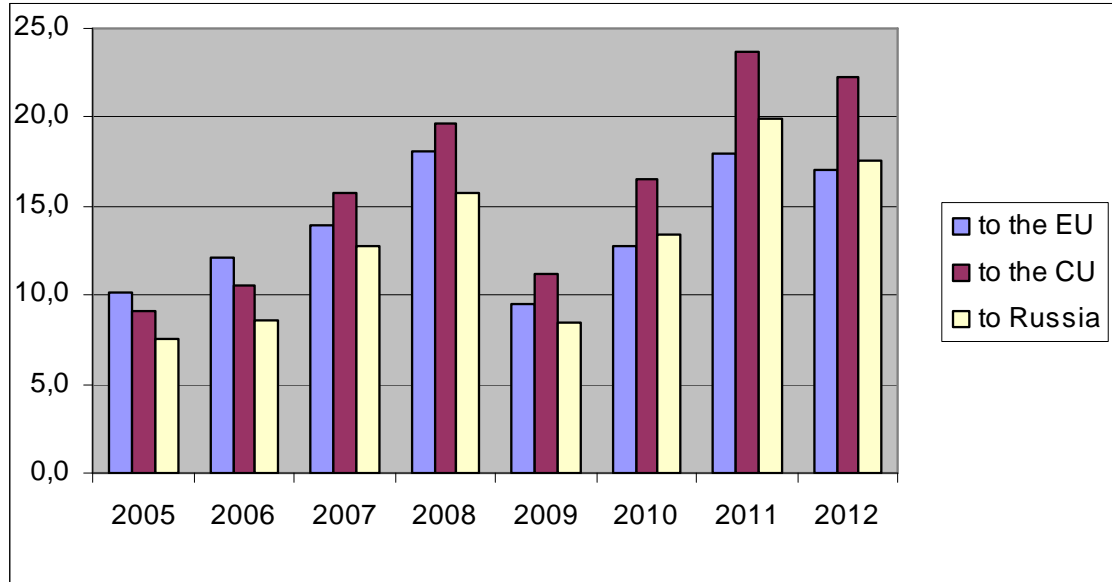
To conclude, the EU is by far the most important trading partner of the Eastern partners, with a slightly growing significance for the region as a whole. However, in Ukraine, the key country within the EaP framework Russia is the number 1. trade partner, while Russia ranks first in the second biggest economy, in Belarus as well. As a new element Eastern partners have started to develop trade relations with third countries heavily and this has been leading to strengthening positions on part of China and Turkey in the first line, but others as well.<sup>22</sup> These new tendencies can be linked both to intentions to reduce dependency on Russia and to EU internal economic problems. However, economic links with other than Russian post-Soviet economies are also strong and on rise among EaPs and with others like Kazakhstan, providing argumentation for thinking over joining new post-Soviet integrations.<sup>23</sup>

It is worth having a closer look at Ukrainian figures of the past years in order to have a deep insight into the Ukrainian orientation dilemma. Since 2007 exports to the three countries of the CU have been exceeding exports to the EU27, while Russian shares alone have been higher than EU ones since 2010. On the import side 2009 was the turning point for the CU and 2010 for Russia to have higher shares as compared to the EU ones.

<sup>22</sup> In 2011 Turkey represented the third most important export destination for Moldova and Ukraine, while it was third in Armenian imports. China ranked 3. in Moldovan, Ukrainian, Belarusian and Georgian imports. Iran was the third export partner for Armenia according to Eurostat data base.

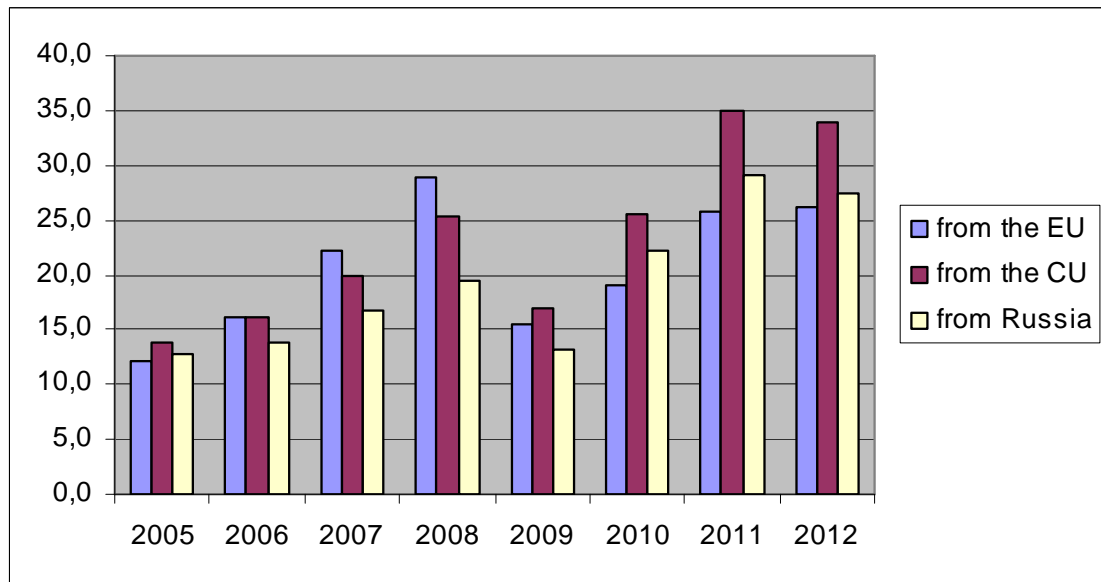
<sup>23</sup> Ukraine was the second import partner for Moldova and the third for Belarus, while the latter ranked 2. in Georgian import list in 2011. Exports from Georgia to Kazakhstan, the second top export partner, totalled to almost 20% in 2011.

**Figure 1.** Ukrainian exports to the EU, the CU and Russia, 2005-2012 (billion USD)



Source: State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua>).

**Figure 2.** Ukrainian imports from the EU, the CU and Russia, 2005-2012 (billion USD)



Source: State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua>).

## 3.2. FDI

Although due to methodological reasons it is not possible to show the exact EU and Russian shares in total FDI stock of individual EaPs, some major outlines can be formulated. EU companies have invested much more capital into these economies than Russia for the past one-two decades, but the significance of the latter is also to be emphasized.

According to official Russian statistics Belarus with 35.5 % share in total Russian OFDI stock in CIS, Ukraine (27%), Kazakhstan (12.7%) and Armenia (10.9%) are major recipient countries of Russian FDI, while in the statistics that tries to exclude the misleading phenomenon of “round-tripping” and “hidden Russian capital”,<sup>24</sup> the leading position of Ukraine (38%) is evident. Under this calculations Ukraine is followed by Kazakhstan (25.3%), Belarus (15.6%) and Uzbekistan (6.8%).<sup>25</sup> Although based on both statistics the first three countries are the same, the latter statistics highlight more the importance of Ukraine for the new post-Soviet, Russia-led integration groupings. Ukrainian-Russian economic links on company level are extremely strong.

**Table 3.** Russian and EU FDI stock in Ukraine, as of 31 December 2012

	Official Russian FDI (ORFDI)	EU	Cyprus (1. EU source)	EU-Cyprus	Germany (2. EU source)	Real Russian FDI (RRFDI) ORFDI < RRFDI < Russia+Cyprus
million USD	3785.8	42979.3	17275.1	25704.2	6317.0	3785.8 < RRFDI < 21060.9
% in total	7.0	78.9	31.7	...	...	...)

Source: State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua>).

Although based on official statistics the EU is by far the most important source of FDI in Ukraine, Russia as a country investor must be among leading ones when excluding the consequences of the “round-tripping” and “hidden origin” phenomena, with Russian sum being perhaps close to the figure for Germany, the biggest EU investor. Although due to lack of exact information on Russian and Ukrainian shares in FDI coming from Cyprus one must be very careful with these calculations it is obvious that real sum for FDI stock of Russian origin in Ukraine is higher than the official figure indicates. Recent events in Cyprus might have a major influence on this picture but these impacts are hard to be evaluated at the time being. Presumably, Russian investors will chose other channels for hiding their real identities. This phenomenon affects other post-Soviet economies as well, but its extent is the biggest one regarding Ukraine.

<sup>24</sup> “Round-tripping” means that a certain part of statistically inward FDI is not of foreign origin in reality, but domestic capital instead, that left the country for different, mainly tax-avoiding reasons and comes back as foreign. “Hidden origin” in this case refers to capital of Russian origin coming to Ukraine, also as Cyprian. According to assumptions the Ukrainian part is the dominant one, but Russian share is also not negligible.

<sup>25</sup> EDB Centre for Integration Studies, “Monitoring of Mutual Investments in the CIS”, in *EDB Centre for Integration Studies Reports*, No. 6 (October 2012), p. 8 and 31, [http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/invest\\_monitoring](http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/invest_monitoring). The statistical database built up and used by the authors’ is based on company level information instead of macro statistics.

Moreover, it is notable that newly launched post-Soviet Customs Union already now has strong positive impact on capital flows within its frames through the gradual introduction of national treatment. Regulations ease FDI flows from one member state to another even now.<sup>26</sup> This trend is due to maintain. As a conclusion one may state that the balance of FDI is evidently for the EU, but the influence of Russian capital should not be underestimated, neither.

### 3.3. Labour migration

The largest EU economies like Germany, Italy or Spain are naturally most frequently chosen as target countries by post-Soviet labour migrants. According to a study made for the Federal Office for Migration and Refugees (Germany) most of post-Soviet migrants lived in Germany, Italy, the Czech Republic and Spain in 2010, with Ukraine, (Russia) and Moldova being the main countries of origin.<sup>27</sup> As regards Ukraine, a major source of immigration, the number of persons with country of birth indicated "Ukraine" totalled to 191.9 thousand in Italy, 155.5 thousand in Poland, 116.4 thousand for the Czech Republic and 84.5 thousand in Spain in 2011, in all with a growth from 2010 except for the Czech Republic based on Eurostat database. Although figures for migration from post-Soviet countries to the EU are rather high and according to calculations approximately 1.5 million migrants from the CIS lived in the EU in 2010, post-Soviet migration targeting Russia and other CIS economies is also considerable, with Russia and Kazakhstan being on first places as destination countries.

Post-Soviet states still constitute the most important and even dominating sending country group for Russia. Based on figures of the 2010 census in Russia nearly 86% of all residents with foreign citizenship were citizens of any other post-Soviet state (see Table 4). Between 2000 and 2006 the top 10 sources were post-Soviet states (excluding only Turkmenistan out of the top list). CIS countries are also estimated to be the main source of irregular migration with these migrants in most cases belonging to the category of labour migration.<sup>28</sup> For citizens of Moldova, Ukraine, Armenia or other countries Russia offers a better living.

Contrary to the tendencies of the 1990's when massive ethnic migration could be observed, 2000's can be characterized by labour migration. The figures for labour migration have been increasing since mid 2000's to the start of the economic crisis. According to the figures of Russian Federal Service on Migration, the number of labour migrants decreased from 2.43 million in 2008 to 1.64 million by 2010 from which 1.25

<sup>26</sup> As a result a massive Russian FDI outflow has been observed for the past 1-2 years from Russia to Kazakhstan mainly due to the fact that "doing business" rating of Kazakhstan (and even of Belarus) is much better than that of Russia. Svetlana Glinkina (ed.), Евразийский интеграционный проект: эффекты и проблемы реализации [Eurasian integration project: effects and issues of implementation], Moscow, RAS Institute of Economy, 2013, [http://inecon.org/docs/Glinkina\\_Eurasia\\_2013.pdf](http://inecon.org/docs/Glinkina_Eurasia_2013.pdf).

<sup>27</sup> Susanne Schmid, "Das Migrationspotenzial aus der GUS in die Europäische Union", in *Federal Office for Migration and Refugees Research Reports*, No. 17 (March 2012), <http://www.bamf.de/SharedDocs/Anlagen/EN/Publikationen/Forschungsberichte/fb17-migrationspotenzial-gus.html?nn=1840754>.

<sup>28</sup> International Organization for Migration (IOM), *Migration in the Russian Federation: A Country Profile 2008*, Geneva, IOM, 2009, [http://publications.iom.int/bookstore/free/Russia\\_Profile2008.pdf](http://publications.iom.int/bookstore/free/Russia_Profile2008.pdf).

million arrived from the CIS.<sup>29</sup> This figure is very close to the figure of 1.5 million migrants from the CIS registered in the EU. From among EaPs Ukraine and Moldova belong to the biggest sending post-Soviet states. Remittances from work in Russia greatly contribute to the incomes of the sending countries and their population.<sup>30</sup> Even in Georgia Russian share is about 65% of all remittances, the latter constituting 6% of the GDP based on figures for 2011. Russian share is about 80% in Azerbaijan.<sup>31</sup> One should take into account that these two countries represent the most independent economies from the Russia from among EaPs.

**Table 4.** Top nationalities of immigrants to Russia (2010)

	Head	Share of nationality in total foreign immigrants (%)
Azerbaijan	67947	9.9
Armenia	59351	8.6
Belarus	27668	4.0
Ukraine	93390	13.6
Georgia	12077	1.8
Moldova	33884	4.9
<b>EaP together</b>	<b>294317</b>	<b>42.8</b>
<b>Post-Soviet together</b>	<b>590748</b>	<b>85.9</b>
Europe together (without post-Soviet)	16470	2.4
China	28382	4.1
Vietnam	11084	1.6
Turkey	5400	0.8
India	4489	0.7
<b>Persons with foreign citizenships together</b>	<b>686993</b>	<b>100.0</b>

Source: Results of census in Russia in 2010, Federal State Statistics Service

As an impact of the world economic crisis the level of Russian unemployment grew significantly leading to a new Russian migration policy aimed at limiting the number of labour migrants. But Russian migration policy turned not only into tightening but differentiation as well. For those post-Soviet countries ready to participate in new post-Soviet reintegration projects, mainly in the CU/SES not only recent visa-free regime,

<sup>29</sup> EDB Centre for Integration Studies, "Трудовая Миграция в ЕЭП" [Labour Migration in the CES], in *EDB Centre for Integration Studies Reports*, No. 3 (March 2012), p. 11, [http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/labour\\_migration](http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/labour_migration).

<sup>30</sup> The more than 30% share of remittances in Tajikistan and Moldova compared to the GDP is the highest in the world.

<sup>31</sup> Annamária Kiss, "Russia and the South Caucasus: Managing Contradictions", in Zsuzsa Ludvig (ed.), *Eurasian Challenges. Partnerships with Russia and Other Issues of the post-Soviet Area*, Budapest, Institute of World Economics, 2013 (East European Studies No. 4), p. 57. and 63, <http://real.mtak.hu/6808>.

but even a united labour market without any restrictions will be provided. Others not joining this integration grouping and getting into conflict over it with Russia might face tough quotas and potentially even newly introduced visa regimes in the future raising the “price list” of non-membership.

#### 4. Being part of the EU single market: challenges of DCFTA

According to the EU rhetoric the EU offer for integrating economies of the Eastern partners (i.e. those with WTO-memberships) into the Single Market is definitely a huge benefit for them. But seeing from the EaP side, this statement might raise questions. DCFTAs in fact represent a package of painful measures in the short and medium term while offering benefits (improving economic structure and competitiveness, welfare impacts etc.) mainly in the long term. Since the only DCFTA up till now is finalised with Ukraine, one may take the Ukrainian example to show its contradictions with both being “deep” and “comprehensive”.

Firstly, in principle “comprehensive” means gradual or rapid liberalisation regarding all products on both EU and Ukrainian side. In practice, according to the finalised negotiations on EU-Ukrainian DCFTA, opening up occurred to be limited to the industrial production with rather small impact on the Ukrainian economy at least in short and medium term. The limited benefits are closely connected both to the unfavourable structure of Ukrainian industrial exports and the low level of EU average import tariff rate for non-agricultural products (4% in 2010), while the similar Ukrainian average import tariff rate was even lower (3.8%) in 2010. The limited expectable impacts are partly due to the already performed Ukrainian liberalisation within the WTO-accession process. What is more important, lagging behind in technological level and in the production of goods with high added value, Ukraine would be more interested in the opening up of the EU agrarian market, in which the negotiated DCFTA offers a very modest progress leading to disappointment on the Ukrainian side.<sup>32</sup> According to the calculations made in the Institute for Economics and Forecasting of the National Academy of Sciences of Ukraine “all key items of Ukrainian agrarian and foodstuff exports (except sunflower seeds and rapeseed needed for bio energy) were practically excluded from the free trade regime, as free trade was granted for them only within minor tariff quotas set at the level sometimes less than 0.1% of the annual value of sales in the EU internal market. Outside these quotas, the EU has extremely high (actually prohibitive) import tariffs for many agrarian products and foodstuffs.”<sup>33</sup> These facts are crucial for an economy facing serious difficulties since the outburst of world economic crisis, leading to the conclusion that the expected and promised long-term economic structural impacts are simply not motivating enough.

Secondly, “deep” means not only classical opening up of markets but that a difficult process of legal approximation is expected to undertake causing potentially serious social costs. While Central East European EU candidates naturally undertook this burden, it is not so evident in the case of Eastern partners who are lacking the EU

<sup>32</sup> The EU argues that the limited offer regarding agricultural trade is due to the Common Agricultural Policy, which cannot be modified just for Ukraine.

<sup>33</sup> For more details see Volodymyr Sidenko, “Ukraine’s Regional Integration Policies...”, cit.

membership perspective. In their cases it is a crucial question what degree of adoption of EU trade acquis is reasonable and who decides on it. According to an Ukrainian expert: "Ukraine ended up having rather limited influence, with the EU having a clear, non-negotiable list of commitments demanded [...]".<sup>34</sup> It is not surprising that this led to the already mentioned disappointment in Ukraine. We argue, that the EU should be more flexible in the DCFTA negotiation process in order to be attractive enough for its Eastern partners. Fortunately, according to Georgian expert view, Georgia made "a better job" or the EU drew the conclusions. Georgian negotiators managed to influence the process of approximation in order to protect its national interest to a higher extent.<sup>35</sup>

### Conclusions: Attractiveness of the EU versus Russia in the light of the three Ms (market, mobility and money) and conditionality

Based on the analysis of trade flows between European post-Soviet states and Russia on the one hand, and with the EU on the other, we may draw the conclusion that although Russia still considers itself as the economic centre of the post-Soviet space, this role has been greatly challenged by the growing trade importance of the EU (and others like Turkey or China). Research on other kinds of economic ties such as FDI and labour migration may tincture this picture. While EU capital is dominating, Russia as a source of FDI is also considerable, however, not always so visible. Naturally, the picture is differentiated in individual country cases. Considering labour force movements from individual post-Soviet countries, the EU is a most reluctant partner, while Russia has recently launched a policy of differentiation with offering united labour market for some countries while formulating toughening limits to the others. Why are these facts important?

Based on recent strength of economic links between individual EaPs and Russia, it is obvious, that although they have been weakened to a great extent since the 1990's in several cases they are still strong enough to be a reasonable basis for joining Russia-led post-Soviet integrations. Therefore, the forced choice might be painful. The EU should take into consideration this fact to a greater extent than it does. The carrot offered to the Eastern partners aimed at involving them both into the political association and the economic integration should be attractive enough and given in due time. Political conditionality, uncertainties of economic benefits of DCFTAs in short and medium term, reluctance to provide mobility to the citizens of EaPs and the lack of really motivating amount of EU financial support may lead to an unexpected result: pushing some of the Eastern partners to look for other integration schemes and partners. Russia is ready to grab the opportunity. The three "Ms" does not seem to function well. Moreover, other major international players (like Turkey, the regional power Turkey or even China, the global player) have their economic interests in the region as well, with their "offers" often being without (hard) "conditions". For all the above reasons, the EU should be more pragmatic when formulating its Eastern Partnership policy, paying much more attention to the "Russia factor". Otherwise it might be a loser due to its slowness, cautiousness and strict set of both political and economic conditions.

<sup>34</sup> Olga Shumyola-Tapiola, "Ukraine at the Crossroads...", cit., p. 20.

<sup>35</sup> Merab Kakulia, *Georgia: Eastern partners experiences and expectations with DCFTA*, cit.



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