



THE POLISH INSTITUTE
OF INTERNATIONAL AFFAIRS

materiały studialne

PISM

research papers

Trade Relations between the Russian Federation and Ukraine

ANDRZEJ SZEPTYCKI

No. 8, JANUARY 2008

Introduction

Trade cooperation represents an important element of relations between the Russian Federation and Ukraine. The specificity and significance of this sector results from three different reasons. Firstly, both countries are each other's important, even if not the very top of the list, trade partners. Secondly, trade affairs were on numerous occasions the essence of the disputes between Russia and Ukraine, even if their background was both economic and political. Thirdly, trade relations between both states are of vital importance in the context of Russia's attempts at reunification of the post-Soviet area (CIS, CEE) and the World Trade Organization membership aspirations of both Ukraine and Russia.

The purpose of this paper is to present the current state of affairs in terms of trade exchange between Russia and Ukraine, describe legal and institutional conditions that were designed to support bilateral cooperation and problems that both states face, as well as to discuss these problems in the international context, notably in the context of both countries' relations with the European Union and the WTO. Owing to the scope of this paper issues and specific features of some trade areas, such as energy resources,¹ Ukraine-Russia cooperation in the defence sector,² exchange of services, or the problem of intellectual property protection, are not tackled in detail here.

The main arguments of this paper are the following:

- Ukraine is largely dependent on the exchange with Russia, and the dependence is not bidirectional. The present situation largely results from: Ukraine's dependence on energy resources imported from Russia or via Russia from Central Asia and difficulties with finding supply markets other than Russian for some sectors of the Ukrainian economy.

- Russia uses or wishes to use trade links existing between the countries as a tool of pressure on Ukraine: it argues that the development of trade cooperation is conditional upon Ukraine's political concessions, and simultaneously limits bilateral exchange when the relations between the countries happen to deteriorate. At the same time, Russia attempts to protect domestic suppliers from competing Ukrainian businesses, which hinders effective utilisation of the trade tool for political purposes.

- Ukraine attempts to ensure steady and easy access to the Russian market either by means of agreements with Russia, or by unilateral support to Ukrainian suppliers, but rejects political and economic terms quoted by Russia as the necessary condition for a more liberal bilateral exchange. In addition, aware of Russia's use of trade links for political purposes, Ukraine seeks to diversify its foreign trade exchange, in particular by cooperating more closely with the EU states.

- Since the objectives of Russia and Ukraine are fundamentally divergent, both states have failed to build lasting foundations for bilateral trade relations. For both economic and political reasons, Russia prevented the establishment of an effective free trade zone. On the other hand, Ukraine actually refused to participate in post-Soviet reintegration projects that stipulated trade cooperation as well.

- No lasting foundations for bilateral cooperation and the presence of disputes resulting from this loss of common ground loosen trade links between the states. The situation may change if Russia and Ukraine join the WTO. This organisation should, at least in theory, impose transparent rules of cooperation and facilitate mutual access to the markets.

A serious problem that hampers the discussion on Russia-Ukraine trade relations is the shortage of reliable statistics, in particular on the first half of the nineties. As a result, figures quoted here should be construed as a rough estimate, primarily intending to show trends in foreign trade. The lack of the statistics results from two primary reasons. Firstly, it was the lack of reliable statistical methodologies. Initially, following the collapse of the USSR, statistics on foreign trade were obtained from questionnaires addressed to state enterprises. As a result, they failed to cover small, private companies on the one hand, and big defence enterprises on the other. Another complication was the retention by authorities of centrally-fixed currency exchange rates, combined with the inflation (at over 10,000% in Ukraine in 1993), which, in practical terms, rendered a reliable estimation of

¹ On the subject, e.g. "Stosunki pomiędzy Federacją Rosyjską i Ukrainą w sektorze gazowym," in: E. Wyciszkievicz (ed.), *Geopolityka gazociągów. Współzależność energetyczna a stosunki międzypaństwowe na obszarze postsowieckim*, Warszawa: Polski Instytut Spraw Międzynarodowych, 2008, pp. 97–135.

² See В.М. Бегма, *Оборонно-промислові комплекси України та Росії: співробітництво, партнерство, конкуренція*, Київ: Національний інститут українсько-російських відносин, 1998.

the actual trade exchange impossible.³ Secondly, of importance was also the grey zone present in the economies of post-Soviet states. Detailed statistics on this phenomenon are obviously not available. Based on the 1999-2000 estimates, it represented 46.1% of Russia's and 52.2% of Ukraine's gross domestic product.⁴ Legal realities of Russia and Ukraine are conducive to the development of unrecorded foreign trade. In the past, state enterprises were underestimating their export figures because otherwise they would be required to resell exchangeable currency being the revenue on exports to state agencies.⁵ At present, exporters overestimate their turnover to claim VAT back, while importers underestimate it to evade customs duties and taxes.⁶ These problems, combined with different methodologies used to calculate exports and imports, the former being calculated based on FOB prices, while the latter based on CIF, contribute to the presence of significant differences between Russian and Ukrainian figures on trade exchange balance between Ukraine and the Russian Federation (see Annex 1).

Ukraine-Russia trade relations still reflect links immersed in the USSR realities. To a large degree, the Soviet economy was centrally governed, autarchic and ineffective. As a result, strong economic links emerged between the Russian Federation SSR and the Ukrainian SSR. Both republics were each other's most important trade partners in the Soviet Union area, although their relations lacked symmetry. Owing to the difference in economic potentials and the fact that Ukraine's economic development was managed from Moscow and served the interest of the entire USSR, the Ukrainian Soviet Republic relied much more on the exchange with the RFSSR. In 1988, approx. 39% of the Ukrainian gross product and some 18% of the Russian gross product were deliveries to other Soviet republics.⁷ The RFSSR's exports to Ukraine were mainly energy resources, while the imports primarily covered machinery and metal and chemical industry products. The pricing system in the inter-republic trade was economically favourable to the Ukrainian Soviet Republic, as fuel was underpriced in the Soviet Union, while some other product groups were overpriced. It is estimated that in 1990, the Ukrainian SSR's profits resulting from this system design represented 3.6% of its gross domestic product. The corresponding RFSSR's loss was similar.⁸

The collapse of the USSR led to a consequent disintegration of the common economic space which, combined with the aggravating economic crisis and mounting conflicts of interest among the individual republics, caused the trade exchange balance in the post-Soviet area to slump. What the new states faced was the need to work out alternative terms of trade cooperation that would incorporate their particular interests and the cost-benefit factor, previously ignored by the centrally planned system.

Volume and structure of trade balance

The volume of trade balance between Ukraine and Russia in 2006 totalled some USD 23.2 bn.⁹ Bilateral exchange is on the systematic rise. In 2002–2006, the trade exchange growth was at 39% on average annually. This results from the improving economic situation in both countries following the crisis of the late nineties, rising prices for Russian energy resources, Ukrainian exporters' difficulties in third country markets and improving relations between the countries in 2000–2004.¹⁰

Ukraine is still largely dependent on Russia, although it has managed to diversify its trade exchange since the fall of the USSR. In 2006, trade exchange between Ukraine and Russia represented 26.9% of Ukraine's foreign trade exchange turnover and a mere 5.5% of Russia's foreign trade balance.¹¹ The above

³ R. Antczak, "Handel zagraniczny i bilans płatniczy Ukrainy w latach 1992–1995," in: M. Dąbrowski, R. Antczak (eds.), *Ukraińska droga do gospodarki rynkowej 1991–1995*, Warszawa: Centrum Analiz Społeczno-Ekonomicznych Fundacja Naukowa, Wydawnictwo Naukowe PWN, 1996, pp. 145–147, 149; G. de Menil, "Deficyt budżetowy a inflacja w latach 1992–1995," in: M. Dąbrowski, R. Antczak (eds.), *Ukraińska droga do gospodarki rynkowej 1991–1995*, op.cit., p. 79.

⁴ F. Schneider, R. Klinglmair, "Shadow Economies around the World: What Do We Know?," *IZA Discussion Paper* [Institute for the Study of Labor, Bonn], no. 1043 (2004), p. 10, www.worldbank.org.

⁵ R. Antczak, "Handel zagraniczny i bilans...", op.cit., pp. 146–147.

⁶ *Ukraine's Trade Policy. A Strategy for Integration into Global Trade*, Washington, D.C.: The World Bank, 2005, pp. 30–35.

⁷ "Ukraine," in: *Eastern Europe and the Commonwealth of Independent States*, London: Europa Publishing, 1992, p. 518.

⁸ L.T. Orłowski, "Indirect Transfers in Trade among Former Soviet Union Republics: Sources, Patterns and Policy Responses in the Post-Soviet Period," *Europe-Asia Studies* 45, no. 6 (1993), p. 1006.

⁹ This and the following figures as in Annex 1.

¹⁰ This and the following figures as in Annex 1.

¹¹ Author's own calculations based on *Ukraine's Trade Policy*, op.cit., p. 3; *Географічна структура зовнішньої торгівлі товарами за 2006 рік*, www.ukrstat.gov.ua; *Экспорт и импорт России за период 1992–1998 г.г. Распределение по странам*, www.rusimpex.ru; *Социально-экономическое положение России*, Москва: Федеральная служба государственной статистики, 2007, www.securities.com.

asymmetry is a consequence of the difference in economic potentials of both states, and of Ukraine's being more dependent on foreign trade than Russia. In 2006, foreign trade volume represented over 100% of the Ukrainian GDP, while it accounted for 67% only of Russia's GDP in the corresponding period.¹²

The structure of trade exchange between Ukraine and Russia is largely shaped by the USSR legacy. Ukraine's primary exports to Russia are machinery, in particular locomotives and rail cars as well as other vehicles, turbines, cranes and other electrically powered machinery, metal industry products, both ferrous and non-ferrous (iron and iron alloys, aluminium, copper, nickel, zinc and lead), and their products, notably pipes; agricultural products and foodstuffs, such as meat, dairy products, sugar, alcohol beverages, canned food; chemical products, notably ammonia and other nitric products; plastics, tyres and cleaning agents. Some branches of the Ukrainian industry are markedly dependent on their supply markets in Russia. This applies in particular to the machinery and transportation, wood processing and paper as well as agricultural and foodstuff industries.¹³ This is most acutely felt in the latter sector as Russia is the receiver of 99.9% of Ukraine-exported meat and its intermediates, 74.9% of milk and milk products volume and 73.9% of alcohol and soft beverages volume. The dependence of some industries on exports to Russia is relatively lasting and primarily exists in the machinery and electrical machinery industries (48.2% of its exports went to Russia in 2005) and wood and paper industry (33%). The remaining branches of the Ukrainian economy (agriculture and food industry, chemical industry) have managed to find receivers from other markets.¹⁴ The permanence of trade links in some areas results from the fact that Ukrainian goods are not too popular in other markets (primarily the EU) owing to their poor quality as well as the presence of customs barriers that act as effective guardians for those markets.¹⁵

The structure of Russian exports to Ukraine is relatively stable. It primarily comprises energy resources, in particular gas, oil and oil-based products as well as fuel for nuclear power plants. In 2005, they accounted for 56.8% of Russian exports to Ukraine. In addition, Russia sells to its Ukrainian neighbours boilers, machinery and mechanical devices as well as means of transportation, in particular passenger cars as well as locomotives and rail cars, metal industry products, notably ferrous metals and their products, chemical products, in particular plastics, rubber and its products.¹⁶

Ukraine's dependence on energy resources imported from Russia (in 2005, it represented 68.4% of total fuel imports) is one of the key problems in Ukraine-Russia relations, the significance of which reaches far beyond trade relations. Although not the specific subject of this paper, it is argued that a more detailed look at this issue here is entirely relevant. The economy of Ukraine is very energy-consuming.¹⁷ In addition, Ukraine imports a sizeable portion of its total energy resources requirement, mostly from Russia or from Central Asia through the Russian territory. In 2005, Ukraine's imports of natural gas totalled approx. 54 bn m³ (74% of the requirement) and of oil at 14.6 million tons (85%).¹⁸ Finally, Ukraine imports the Russian and Central Asian gas at prices that are well below the price that European countries pay, which makes the country even more dependent on Russia.

Russia has used Ukraine's dependence in the energy sector on numerous occasions, in order to win concessions of both economic and political nature. This was the reason behind the RF's price manipulation with exported energy resources, or cuts in deliveries to Ukraine. In the trade dimension, Ukraine's dependence on the imports of Russian fuels combined with Ukraine's simultaneous diversification of import sources and the rising prices of Russian oil and gas are the primary drivers of Ukraine's deficit in commodity exchange with Russia.¹⁹ In 2006, it totalled some USD 5.4 bn.

¹² Author's own calculations based on *The World Factbook* (on-line version), Washington, D.C.: Central Information Agency, 2007, www.cia.gov.

¹³ Figures from 2005. For details see Annex 9.

¹⁴ Author's own calculations based on 2005 figures, Державний комітет статистики України, www.ukrstat.gov.ua.

¹⁵ V. Astrov, Z. Lukas, J. Pöschl, "The Ukrainian Economy between Russia and the Enlarged EU: Consequences for Trade and Investment," *WIIW Current Analyses and Country Profiles*, The Vienna Institute for International Economic Studies, no. 23 (2006), p. 1.

¹⁶ For details see Annex 8.

¹⁷ Per 1 dollar of gross domestic product, the Ukrainian economy uses 20% more energy than the Russian economy, 60–70% more than the Polish and 8–10 times more than G7 economies – С.І. Пирожков (ed.), *Забезпечення енергетичної безпеки України*, Київ: Рада національної безпеки і оборони – Національний інститут проблем міжнародної безпеки, „Стилос”, 2003, p. 5.

¹⁸ *Итоги работы топливно-энергетического комплекса в январе – декабре 2005 года*, Минтопэнерго Украины, www.energo.net.ua; *Quantifying Energy. BP Statistical Review of World Energy*, London: BP, 2006, pp. 24, 27.

¹⁹ V. Astrov, Z. Lukas, J. Pöschl, "The Ukrainian Economy between Russia and the Enlarged EU," *op.cit.*, p. 1.

The commodity exchange deficit is largely compensated for by the exchange of services. The latter represents an important component of trade relations between Ukraine and Russia, mainly owing to Ukraine's transit location, and its role as a transit country for the bulk of the Russian gas (currently, some 80%²⁰) and oil delivered to European countries. According to Ukrainian sources, the value of Ukrainian services rendered to Russia in 2006 totalled USD 3.137 bn,²¹ which accounted for 26.6% of all Ukrainian exports to Russia.

Despite the substantial share of services in exports to Russia, they are unable to compensate for the Ukrainian deficit entirely. In 2006, considering both goods and services, it totalled USD 2.6 bn. This further increases Ukraine's debt to the RF, an argument which the latter attempted to use in order to take over the Ukrainian energy sector. The goal was only marginally achieved. It should also be noted that the Russian Federation attempts to reduce its disadvantageous dependence, both in financial and political terms, on Ukraine for transit, which may cause Ukraine's deficit in trade with Russia to grow even more.

Another characteristic feature of the trade and economic cooperation between Ukraine and Russia is the strong dependence of some economy sectors on deliveries from the other country, owing to the USSR-inherited lack of closed production cycles. Accurate statistics on this problem are not available, but it is nevertheless known that, at the beginning of this decade, the Ukrainian defence sector was dependent in 70-80% on deliveries from the RF, while the Russian defence sector was dependent in 50-60% on deliveries from other CIS countries, notably Ukraine.²²

To conclude, it should be noted that the structure of Ukraine-Russia trade balance is unfavourable to Ukraine. The state's commodity imports from Russia are strategic goods (energy resources) and at the same time Russia is an important receiver for some industries in Ukraine. The problem is virtually non-existent in Russia as the state could sell fuel to other receivers (being only dependent on Ukraine as a transit country) and use the income thus generated to buy the required commodities from other suppliers.²³

Failed attempts at institutionalised cooperation

Both Ukraine and Russia invested some effort to reach an agreement to govern their trade cooperation, specify clear rules and warrant relatively free access to the respective markets. However, economic and political interests of the countries were divergent and therefore most of the initiatives have failed to bring a desired effect. Ukraine's primary goal was to regain the Russian markets. The purpose was to be served by liberalised bilateral trade exchange. However, Ukrainian authorities were rather consistent in rejecting proposals for closer bilateral and multilateral trade cooperation that could restrict Ukraine's independence and hamper its cooperation with other partners (notably the EU). Russia, in turn, sought to protect its domestic suppliers and still use Ukraine's dependence in trade as a tool of pressure, as well as made the liberalisation of trade exchange dependent on Ukraine's concessions in the political dimension.

Bilateral cooperation. In June 1993, Russia and Ukraine signed an agreement on free trade. It stipulated that its parties would not impose duties, taxes and other levies of similar effect on exports to and imports from the partner state. Another obligation was to refrain from introducing requirements/restrictions other than those covering domestic or third country-originating goods. Quota restrictions (or similar) could be used only in the case of a serious deficit of a given commodity on the local market, a serious payment balance deficit, or a threat to local manufacturers resulting from the quantity or terms of bilateral exchange. Restrictions could also be introduced following the annually-held consultations. Separate documents were to define exclusions from free trade. A protocol was annexed to the agreement, specifying opt-outs from the free trade regime. They comprised commodities subject to Russian and Ukrainian legislation on export duties, licenses and export quotas. These commodities were to be covered by "top privileged commodity" clauses.²⁴

Practical difficulties emerged as regards the implementation of this agreement, related both, to its individual clauses and the absence of political intent do so on the part of Russia. The agreement of June

²⁰ A. Łoskot-Strachota, *Rosyjski gaz dla Europy*, Warszawa: Ośrodek Studiów Wschodnich, October 2006, p. 4.

²¹ *Географічна структура зовнішньої торгівлі послугами з країнами-найбільшими партнерами за 2006 рік*, www.ukrstat.gov.ua.

²² В.А. Вашанов, Г.Ю. Бровчук, *Экономическое сотрудничество России и Украины*, Москва: СОПС, 2004, p. 100.

²³ П. Д'аньєрі, "Асиметрія міжнародних економічних відносин: дилеми незалежності," in: Г. Перепелиця, О.М. Субтельний, *Асиметрія міжнародних відносин*, "Стилос," Київ 2005, p. 170; А.С. Філіпенко, В.С. Будкін, А.С. Гальчинський (and others), *Україна і світове господарство: взаємодія на межі тисячоліть*, Київ: Ливідь 2002, pp. 246-248.

²⁴ Протокол до Угоди між Урядом України та Урядом Російської Федерації про вільну торгівлю від 24 червня 1993 року, Київ, 24 червня 1993 року, www.rada.gov.ua.

1993 did not contain any provisions on the effective dates of the free trade regime, allowed unilateral restrictions in bilateral trade exchange, and failed to establish a dispute-solving mechanism which, in case they did emerge, left no other option to the parties except lengthy negotiations.²⁵ Of top importance was the provision allowing opt-outs from the free trade regime. Appropriate protocols on the issue were signed thrice, the last signature taking place in October 2001. Their primary effect was the exclusion from the free trade system of such Ukraine's exports as sugar, ethyl alcohol, alcohol beverages and cigarettes and, for Russia's exports, of sugar, sweets (including chocolate and sweet bakery products) and cigarettes.²⁶ Symmetrical as they appeared at first glance, they were in practice unfavourable to Ukraine in the first place, owing to the existing trade structure.

The efforts taken primarily by Ukraine to implement in real life the free trade system has failed to bring tangible effects. In February 1995, an agreement was signed on the launch of the free trade regime. It stipulated that both parties would take actions to expand the free trade zone and subsequently contribute to the development of integration processes between both states. This provision suggested that the establishment of the free trade zone would be the first state of integration, to be followed by the customs union, or perhaps even more integrative developments. The provision, even though not legally binding, suited Russia. The agreement failed to solve any fundamental problems that stalled the realisation of the free trade regime, because it still permitted opt-outs from it based on bilateral arrangements.²⁷

In May 1997, along with the treaty on friendship, cooperation and partnership, an agreement was signed on main directions of long-term economic, technical and scientific cooperation. It stipulated that 1997–1998 would see the abolition of tariff and non-tariff restrictions in trade exchange, as well as the introduction of the common customs tariff in relations with third countries.²⁸ As such, the agreement not only stipulated the establishment of the free trade zone, but even a customs union. The document was never ratified by Ukraine and never implemented. It could be argued that Ukraine agreed to sign this agreement as it was one of Russia's conditions to sign an inter-state treaty. However, it did not want to implement it because the agreement contained solutions that reached too far, such as e.g. the customs union.

In February 1998, Russia and Ukraine signed an agreement on economic cooperation in 1998–2007. The annexed cooperation programme stipulated the liberalisation of the existing free trade regime by the quickest-possible introduction of common rules on the imposition of indirect taxes in mutual trade, gradual removal of the existing barriers and the bringing closer, rather than the former harmonisation, of customs systems of Russia and Ukraine (simplification of procedures, introduction of the common customs clearance form) and the exchange of statistics. Bringing the rules on imposing indirect taxes closer was to take place in 1998–1999. However, no deadlines for the implementation of other provisions were specified.²⁹

In June 2001, Ukraine and Russia initiated talks on the new agreement on free trade between the states, to allow the liquidation of the existing restrictions to mutual exchange. A preliminary agreement was reached in autumn of the same year.³⁰ Bilateral negotiations continued until summer 2002. However, they failed to result in a new agreement to replace that of June 1993. Subsequent attempts in the same respect were made in 2005. In November, an agreement was signed on the gradual removal of free trade opt-outs. The agreement covered limitations to both Russia's and Ukraine's exports. For the former, the majority of limitations are to be lifted in 2006 while for Ukraine, the planned date is 2009–2010.³¹

²⁵ O.V. Rjabokon, "Trade Liberalisation for the Second Largest Country in Europe: Going West or East or Can it be both?," *Journal of the World Trade* 40, no. 1 (2006), pp. 100–103.

²⁶ Протокол про внесення змін та доповнень до Протоколу про вилучення з режиму вільної торгівлі до Угоди між Урядом України та Урядом Російської Федерації про вільну торгівлю від 24 червня 1993 року, підписаного 24 червня 1993 року, Київ, 4 жовтня 2001 року, www.rada.gov.ua. V. Astrov, "Ukraine: Current Economic Situation and Future Prospects," *WIIW Research Reports* [The Vienna Institute for International Economic Studies], no. 331 (2006), pp. 12–13.

²⁷ Угода між Урядом України та Урядом Російської Федерації про реалізацію режиму вільної торгівлі, Київ, 8 лютого 1995 року, www.rada.gov.ua.

²⁸ Угода про Основні напрямки довгострокового економічного та науково-технічного співробітництва Російської Федерації і України на 1997–2000 роки і на період до 2005 року, Київ, 28 травня 1997 року, www.rada.gov.ua.

²⁹ Договір між Україною та Російською Федерацією про економічне співробітництво на 1998–2007 роки, Москва, 27 лютого 1998 року, www.rada.gov.ua.

³⁰ "Ukraine and Russia to create Free Trade Zone in the beginning of 2002," *IntelliNews – Ukraine Today* of 30 November 2001, www.securities.com.

³¹ Протокол про узгодження термінів поетапного скасування вилучень з режиму вільної торгівлі до Протоколу від 4 жовтня 2001 року про внесення змін і доповнень до Протоколу про вилучення з режиму вільної торгівлі до Угоди між Урядом України та Урядом Російської Федерації про вільну торгівлю від 24 червня 1993 року, підписаного 24 червня 1993 року, Москва, 25 листопада 2005 року, www.rada.gov.ua.

To sum up, it should be argued that Ukraine and Russia have so far failed to introduce a genuine free trade regime to their bilateral trade relations. This results both, from the discussed deficiencies of the June 1993 agreement (no date of entry into force, opt-outs), unilateral attempts of Russia and Ukraine that impose periodical restrictions on the trade in selected goods (more on the problem below), as well as from the specific features of trade in some commodities that are important for both countries (natural gas), regulated by bilateral agreements between the states and/or Russian and Ukrainian enterprises.

Multilateral cooperation. Russia and Ukraine were co-founders of the Commonwealth of Independent States. Based on the conditions adopted in December 1991, its members were to develop fair and mutually beneficial cooperation in many areas, including trade.³² In practice, the signatories had conflicting views on both the future of the CIS and the shape of trade cooperation it should practice. Russia treated the Commonwealth as a tool of re-integration of the post-Soviet area and economic cooperation was planned to be used for bringing the states closer politically. Ukraine initially perceived the CIS as a tool for a “civilised divorce” of the republics of the former USSR. Only over time did it become interested in economic cooperation under the Commonwealth, seeking to regain former supply markets, notably the Russian market.³³ Ukrainian authorities were reluctant towards the majority of Russian initiatives on closer cooperation under the CIS both in political, trade and economic dimension, as they feared that the consolidation of the Commonwealth could increase Ukraine’s dependence on Russia (which was undoubtedly Russia’s objective) and hamper the former’s cooperation with the EU.

In September 1993, nine CIS states signed an agreement on the establishment of the CIS Economic Union. It was a framework agreement, as it provided for the establishment of the free trade zone, customs union, common commodity, service, labour and capital markets, and finally the monetary union. However, it failed to specify dates for the subsequent stages. Similarly to Turkmenistan, Ukraine joined the agreement only as an associated member, emphasising that economic cooperation under the CIS may not pose a hindrance to the development of cooperation with other states and organisations, which in practice meant primarily the European Union.³⁴ The decision later turned out to be important primarily in the political dimension, as the agreement of September 1993 was hardly being implemented and the CIS countries failed to go beyond its signing (April 1994).³⁵ In 1995–1996, Russia and Belarus initiated actions to establish the customs union,³⁶ later to be joined by Kazakhstan and Kyrgyzstan. Ukraine was not interested in the initiative and did not ratify other agreements on trade and economic cooperation under CIS, concerning e.g. the rules of operation of the Commonwealth Economic Court, or simplification and unification of customs procedures.³⁷ The agreements could actually facilitate Ukraine’s access to the markets of other CIS states, primarily to the Russian market, but also link Ukraine with its post-Soviet neighbours too strongly.

In terms of the free trade agreement, both Russia and Ukraine expressed their scepticism, as reflected by their failure to ratify the document. Russia took this position for two reasons. Firstly, there were concerns that the establishment of the CIS free trade zone might result in a tangible budget loss for Russia (in 2000, it was estimated at USD 600M – 1bn³⁸). Secondly, in practical terms, Russia made the emergence of the CIS free trade zone with Russia as its member dependent on the consent of other countries to establish more advanced forms of cooperation. Non-ratification of the April 1994 agreement was therefore a tool of pressure on other CIS countries (Ukraine in particular) to accept the Russian concept of reintegration for the Commonwealth area. Russia’s position has not changed significantly until today. Russia abstains from ratifying the free trade agreement and applies it “only temporarily,” that is “at its own discretion.”³⁹

It appears that Ukraine refused to ratify the said agreement for three reasons. Firstly, the agreement of April 1994 failed to bring any material change to Ukraine-Russia agreement on free trade. It also failed to

³² Угода про створення Співдружності Незалежних Держав, Мінськ, 8 грудня 1991 року, www.rada.gov.ua.

³³ P. Anieri, “Dilemmas of interdependence,” *Problems of Post-Communism* 44, no. 1 (1997), www.epnet.com.

³⁴ Договір про створення Економічного союзу, Москва, 24 вересня 1994 року, www.rada.gov.ua.

³⁵ Угода про створення зони вільної торгівлі, Москва, 15 квітня 1994 року, www.rada.gov.ua.

³⁶ See Соглашение о таможенном союзе между Республикой Беларусь и Российской Федерацией, Минск, 6 января 1995 года, www.pravo.by.ru.

³⁷ Соглашение об упрощении и унификации процедур таможенного оформления на таможенных границах, Москва, 8 июля 1994 года, www.rada.gov.ua; Регламент Экономического Суда Содружества Независимых Государств, 5 июля 1994 года, www.rada.gov.ua.

³⁸ S. Novoprudsky, “We will and won’t have free trade within the CIS,” *WPS – What the Papers Say* of 20 March 2000, www.securities.com.

³⁹ O.V. Rjabokon, “Trade Liberalisation for the Second Largest Country in Europe,” *op.cit.*, pp. 103–104.

supersede bilateral agreements between the signatories. Secondly, the agreement made reference to the plans for the economic union, the emergence of which was not in the interest of Ukraine. Thirdly, the agreement was not ratified by Russia, either. Ukraine's position changed following the adoption of the protocol that amended and complemented the free trade agreement (April 1999).⁴⁰ In October 1999, Ukraine ratified the agreement.⁴¹ The evolution of Ukraine's position may be explained in two ways. Firstly, the protocol of April 1999 was in general terms beneficial to Ukraine, as it removed some references to the plans for the economic union from the free trade agreement, replaced the provisions on coordination of trade and economic policies with the obligation to cooperate in that respect, and subordinated the free trade zone to the WTO principles. It also contained provisions seeking to facilitate the implementation of the free trade zone (no monopoly arrangements and ban on using the dominant position on the market, requirement to apply the same technical requirements to third countries' commodities as those in place for domestic commodities). A certain exception here was the provision on the recognition of the role Interstate Economic Committee of the CIS in implementing the free trade zone. Previously, Ukraine refused to participate in the proceedings of this body, concerned that the Commonwealth may become too much of an institution. Secondly, in view of the disputes in trade relations between Ukraine and Russia (in particular the difficulties in introducing the free trade regime), Ukrainian authorities decided to take double action, trying to convince Russia to implement bilateral arrangements and at the same time supporting the establishment of the free trade zone within CIS. President Leonid Kuchma regarded the establishment of the CIS free trade zone as an important component of Ukraine's actions under the strategy for social and economic development in 2002–2011.⁴² This declaration had its economic overtones (importance of post-Soviet markets) as well as political ones (closer ties between Ukraine and Russia at the beginning of this decade).

In 2000–2007, the problem of implementing the free trade zone was a permanent fixture on the agendas of meetings of the CIS bodies, which adopted a number of new agreements in this respect, in most cases with no practical consequences. The question also periodically rekindled disputes between Ukraine and Russia. Ukrainian authorities accused Russia in particular of the failure to observe its obligations on free trade under the CIS.⁴³ The argument holds water in the political dimension, but it doesn't in legal terms, as the decision to ratify agreements signed is made by the sovereign authority of the state concerned. It should be underscored that, following the Orange Revolution, despite deterioration in the relations between Ukraine and Russia and the declared redefinition of Ukraine's foreign policy, the establishment of the free trade zone under the Commonwealth has been demanded by the representatives of both the president's camp and the members of the "anti-crisis" coalition, co-ruling since August 2006. The former even sent their warning that if the country's proposals were not met, Ukraine could leave the CIS.⁴⁴ This prompts two conclusions. Firstly, Ukraine still attaches substantial importance to its trade balance with the CIS countries, primarily with Russia. Secondly, it seeks to depoliticise its trade cooperation with the Russian neighbour.

In turn, Russia still makes the liberalisation of trade with Ukraine dependent on the latter's concessions in other fields, that is makes yet another proposal for a peculiar "package deal": free trade for deeper cooperation. At the beginning of the present decade, the objective appeared impossible to reach. Ukraine was consistent in seeking to improve its position in the Russian market. Starting from 2000, Ukraine-Russia relations became markedly closer, which resulted from the weakening position of president Kuchma domestically and deteriorating Ukraine's relations with states of the West.

In February 2003, leaders of Russia, Ukraine, Belarus and Kazakhstan convened to discuss the establishment of the Common Economic Space. One of the goals of the initiative was to develop the provisions of the free trade agreement of April 1994. It was assumed that a coordinated economic policy would be pursued under the CES, combined with the harmonisation of laws and the appointment of the

⁴⁰ Протокол про внесення змін та доповнень до Угоди про створення зони вільної торгівлі від 15 квітня 1994 року, Москва, 2 квітня 1999 року, www.rada.gov.ua.

⁴¹ Закон України Про ратифікацію Угоди про створення зони вільної торгівлі та Протоколу про внесення змін та доповнень до Угоди про створення зони вільної торгівлі, Київ, 6 жовтня 1999 року, www.rada.gov.ua.

⁴² Address of the President of Ukraine to the Verkhovna Rada of Ukraine. European choice. Conceptual grounds of the strategy of economic and social development of Ukraine for 2002–2011, *Welcome – Investment Magazine* of 30 June 2002, www.securities.com.

⁴³ "Kinakh: Russia Blocks Free Trade Agreement," *Kyiv Post Daily* of 8 July 2002, www.securities.com.

⁴⁴ "Yushchenko: Ukraine can quit CIS without losses," *Ukrayinska Pravda On-line* of 13 May 2006, www.securities.com; "Yanukovych Calls On CIS Countries To Speed Up Formation Of Free Trade Zone," *Ukrainian News – on-line* of 24 November 2006, www.securities.com.

Commission for trade and tariffs, independent of individual states. This was planned to give birth to a regional integration organisation.⁴⁵ Such provisions represented an important concession by Ukraine, which had never before been interested in solutions reaching beyond the free trade zone concept, and could be a proof of president Kuchma's weakness and the intent to consolidate his position by supporting closer cooperation with Russia, even at the expense of limited sovereignty for Ukraine. In September 2003, an agreement was signed on the establishment of the Common Economic Space. The CES was to be the "economic space covering the customs area of its member states, where the economy management mechanism exists, based on common principles, ensuring a free flow of goods, services, capital and labour, and where common external trade policy is pursued." The Common Economic Space was to be implemented gradually, by initially establishing the free trade zone with no opt-outs and restrictions, then harmonising technical and sanitary standards, and then the macroeconomic policies, and conditions for free flow of goods, services, capital and labour, and uniform competition policy standards, notably for "natural monopolies."⁴⁶ The agreement was criticised by the Ukrainian opposition and experts, who considered its provisions inconsistent, incompliant with the Ukrainian constitution (as they infringed on e.g. exclusive competencies of the supreme state authorities in Ukraine), potentially threatening to Ukraine's integration with the EU (it may not be at the same time member to two customs unions) and serving the purpose of Ukraine's subordination to Russia.⁴⁷ Addressing this criticism, the Ukrainian Supreme Council expressed their consent to the ratification of agreement on the establishment of the CES, provided that it is implemented to the extent that is compliant with Ukraine's constitution. It was not made specific, however, what the official interpretation of that expression should be.⁴⁸ Russia ratified the agreement with no reservations.

Following the revolution of 2004, Ukraine still participated in the efforts to establish the CES, both for political (care not to antagonise Russia too much) and economic reasons (hope for continued deliveries of cheap energy resources and access to Russian markets). Nevertheless, the actual establishment of the CES does not stand a good chance of success, notably because Russia and Ukraine advocate different concepts for its future. According to Russian plans, the CES is to be a customs union with some components of an economic union. Ukraine, both before and after the orange revolution, supported the CES as a tool for the establishment of the free trade zone without restrictions and opt-outs, that would not conflict Ukraine's policy of European integration.⁴⁹ At the same time, it defied the concept of the CES as reaching beyond the established free trade zones, as this would prevent deeper cooperation between Ukraine and the EU, and additionally require the establishment of a supranational body within the CES, namely the Commission, where, in accordance with the agreed principles, Russia would have the strongest say owing to its economic potential.⁵⁰

In 2005, Ukraine refused to sign agreements concluded under the CES on e.g. common rules for transit and common commodity nomenclature, arguing that such agreements sought to lay the foundations for the customs union. This argument is only partially true. The solutions referred to above are by all means necessary in a customs union and may facilitate the operation of the free trade zone. Initially, Russia criticised Ukraine's position, opposing the *à la carte* integration concept. Over time, however, its position became more relaxed, most likely because it was aware that Ukraine could take the decision on leaving the Common Economic Space.⁵¹ After the "anti-crisis" coalition was formed, Ukraine's position on the CES also grew more supportive. In December 2006, Prime Minister Viktor Yanukovich was even quoted as supporting

⁴⁵ Заявление Президентом Республики Беларусь, Республики Казахстан, Российской Федерации и Украины, Москва, 23 февраля 2003 года, www.rada.gov.ua.

⁴⁶ Угода про формування Єдиного економічного простору, Ялта, 19 вересня 2003 року, www.rada.gov.ua.

⁴⁷ More in: Єдиний Економічний Простір: геополітичний проект під економічними лаштунками, „Український Монітор”, Липень 2005, www.cpcfru.org.ua.

⁴⁸ Закон України Про ратифікацію Угоди про формування Єдиного економічного простору, Київ, 20 квітня 2004 року, www.rada.gov.ua.

⁴⁹ Strategy of the economic and social development of Ukraine (the years 2004–2005). Towards European Integration, National Institute of Strategic Studies, Institute of Economic Forecasting of the National Academy of Sciences of Ukraine, Kyiv : Ministry of Economy and Issues of European Integration, 2004, p. 329.

⁵⁰ V. Astrov, Z. Lukas, J. Pöschl, "The Ukrainian Economy between Russia and the Enlarged EU," *op.cit.*, pp. 29–32.

⁵¹ O.V. Rjabokon, "Trade Liberalisation for the Second Largest Country in Europe," *op.cit.*, pp. 107–108.

the unification of customs tariffs in Moscow, and thus the establishment of the customs union under the Common Economic Space.⁵² So far, however, the position has failed to translate into any specific actions.

To sum up, it should be argued that Russia and Ukraine have failed to develop lasting and mutually beneficial terms of trade cooperation. Russia prevented an effective implementation on the agreement on free trade of June 1993 and the agreement on the free trade zone of the Commonwealth of Independent States of April 1994, fearing its resultant economic cost and making the implementation of the documents' provisions dependent on the acceptance by Ukraine and other CIS states of Russian reintegration concepts. Ukraine was not interested in economic integration under the Commonwealth (the majority of proposals in this respect have not been implemented in any case) and currently blocks the development of CES space, since the purpose of the state is only to establish the free trade zone. The lack of lasting foundations for bilateral cooperation is one of important reasons behind frequent trade disputes between Ukraine and Russia.

Selected trade problems

The cooperation between Ukraine and Russia in the area of trade is strongly dependent on political circumstances. Bilateral problems of non-economic nature often result in the escalation of trade disputes and restrictions in Ukraine-Russia exchange. The situation primarily results from Russia's actions, as the state treats Ukraine's trade dependence as a tool of pressure and, depending on the current needs, changes the terms of delivery for Russian energy resources, or restricts Ukrainian exporters' access to the Russian market. Bilateral cooperation is further hampered by instability marring legal systems of both states. Among primary problems of purely trade nature there are the enforcement of anti-dumping procedures, often for no material reasons and only to protect the domestic market,⁵³ as well as other administrative curtailments in trade (quotas, licenses), the question of VAT tax collection, relatively weak enterprise-level,⁵⁴ inter-regional and cross-border links, which immerses trade and economic relations in the political dimension, as well as an entire array of issues related to energy (prices for Russian fuels, Ukrainian debt, security of transit in Ukraine, ownership of the Ukrainian energy sector, etc.).

In the first half of the nineties, the pervasive problems were those resulting from the collapse of the (post)Soviet economic area and the economic and social crisis in both countries. Breaking off the previous economic ties hit back at Ukraine more than at Russia. In January 1992, the Russian Federation lifted the official prices system, treating the move as the initial stage of economic reforms. Prices of energy resources exported to the CIS states were raised as well (still much lower than prices for other receivers). This deteriorated Ukraine's terms of trade and increased its deficit in foreign trade with Russia. Supply problems surfaced as commodities, notably food and agricultural products, were shipped to Russia, where prices were higher. Along with rising prices in trade with Russia, Ukraine started to run short of Roubles. In response, Ukrainian authorities also freed the prices. For economic and political reasons, in order to emphasise independence from Russia, restrictions in trade with the Russian Federation were imposed and the decision was made on the introduction of the republic's own, interim currency, the Karbovanets. In late 1992, Ukraine left the Rouble zone. The demise of economic ties under the USSR and the CMEA, and the subsequent administrative curtailments exerted an adverse impact on the Ukrainian economy and aggravated the economic crisis in the country. Many enterprises lost their suppliers and/or receivers in Russia, and, owing to the lack of appropriate raw materials or intermediates (previously imported from Russia), low competitiveness and world recession, they were unable to find receivers in other post-Soviet or European states. From January 1992 to December 1993 alone, industrial production volume slumped by over 35%.⁵⁵ It is estimated that 50–80% of the drop resulted from the diminishing foreign trade exchange, notably with Russia.⁵⁶

⁵² "Russia and Ukraine wish to achieve a strategic breakthrough in their relations," *WPS – Russian Business Monitor* of 13 December 2006, www.securities.com.

⁵³ More on anti-dumping procedures in Russia and Ukraine in В.А. Вашанов, Г.Ю. Бровчук, "Экономическое сотрудничество России и Украины," *op.cit.*, pp. 57–60, 74–77.

⁵⁴ Based on official statistics, at the beginning of 2006, the aggregate value of Russian direct investment in Ukraine totalled merely USD 797.7M, while the corresponding figure for Ukraine was USD 102.5M. The figures are not fully reliable, though, as some investment projects are carried out through third countries, such as Cyprus.

⁵⁵ "Ukraine. Recent economic developments," *IMF Staff Country Report* [International Monetary Fund] 109, no. 97 (1997), p. 12.

⁵⁶ R.S. Kravchuk, "Kuchma as Economic Reformer," *Problems of Post-Communism*, 52, no. 5 (2005), pp. 51–52.

In early 1993, Ukrainian authorities took actions to stimulate trade exchange with Russia. Ever since, Ukraine has been seeking to develop closer trade cooperation with Russia. The effort brought limited success. Firstly, Russia was keen on protecting domestic manufacturers and made the development of trade cooperation conditional on Ukraine's concessions in the political dimension. Ukraine did not want to agree and, as a result, the agreement on free trade of June 1993 has never been fully implemented. Secondly, Ukrainian suppliers had problems, especially at the outset, with meeting their obligations under intergovernmental agreements. In 1993, only 50-59% of ordered meat products, steel pipes, trucks and tractors were delivered. Russia also failed to meet their obligations, although to a smaller degree. In the same year, the state supplied only 79% of the ordered gas and 75% of oil with gas condensate.⁵⁷

From mid-nineties onwards, trade conflicts between Russia and Ukraine were breaking out regularly. Their purpose was to support domestic manufacturers, protect them against unfair practices of the other state and, for Russia, to undermine the position of the Ukrainian partner and convince them to offer concessions in other areas.

In 1995–1998, the most serious dispute revolved around the VAT issue and exports of Ukrainian sugar to Russia. From 1993, Russia imposed VAT on goods exported to other CIS countries. Other Commonwealth states followed shortly. However, starting from 1995, Ukraine decided to impose VAT on imported goods and, towards the end of the same year, lifted VAT on exported goods. As a consequence, Ukrainian goods imported by Russia had no tax duty attached, which made them more competitive and triggered off dumping accusations. Russia decided to counteract and, in August 1996, took a decision on imposing a 20% VAT on goods imported from Ukraine, which caused the situation of Ukrainian exporters to the Russian market to deteriorate.⁵⁸

At the same time, Russian authorities made an effort to limit imports from Ukraine of two important (from Ukraine's perspective) commodity groups, namely alcohol and sugar. In January 1996, excise duty was imposed on alcoholic drinks imported from Ukraine. Ukrainian exporters started to send them to Russia through Belarus, linked with Russia by means of a customs union. As a consequence, Belarusian authorities also introduced curtailments in trade with Ukraine.⁵⁹ The effects of restricted sugar imports were much more important, as the commodity was one of Ukraine's important exports to Russia. Russia's annual requirement for sugar in half-decade was at approx. 4.5-5 million tons, of which 2.5 million tons were imported from Ukraine. In 1996, accusations were voiced that Ukraine underpriced the exported sugar. As a result, in April 1997 Russia imposed 25% duty on the imported sugar and introduced quotas for sugar imports from Ukraine.⁶⁰

Towards the end of 1997, talks commenced between Russia and Ukraine to resolve the problem. In February 1998, new rules on VAT were introduced. Both states were to levy VAT on imported goods at their sale. As regards other issues, asymmetrical solutions were introduced, favouring Russia. The country still imposed taxes on goods imported from Ukraine, while Ukraine lifted them. The situation was then more advantageous for Russian exporters. Additionally, while Ukraine imposed zero VAT on most of its exported goods, Russia levied a 18-20% VAT duty. In theory, the solution hit the Russian exporters, but in practice was primarily used to increase the proceeds from the exports of Russian energy resources to Ukraine.⁶¹

As regards sugar, Russia agreed to lift the customs duty in exchange for quotas. It was agreed that Ukraine would export to Russia 600,000 tons of the product. This was markedly less than the export volumes from the previous years. Nevertheless, in September 1998, Russia again imposed a 3% customs duty and, temporarily, 20% duty on sugar. In practice, only 53.9 thousand tons of Ukrainian sugar (a 97.8% drop as compared to 1995) were imported in 1998.⁶²

⁵⁷ R. Antczak, "Handel zagraniczny Rosji w 1993 roku i pierwszym kwartale 1994 roku," *Studia i Analizy* [Centrum Analiz Społeczno-Ekonomicznych], no. 25 (1994), pp. 14–15.

⁵⁸ В.А. Вашанов, Г.Ю. Бровчук, "Экономическое сотрудничество России и Украины," *op.cit.*, pp. 48–51; С.І. Пирожков, А.І. Сухоруков, (eds.) *Експортний потенціал України на російському векторі: стан і прогноз*, Київ: Національний інститут українсько-російських відносин, 1998, chapter II, www.niurr.gov.ua.

⁵⁹ Р.Я. Евзеров, *Украина: с Россией или врозь?*, Москва: Весь Мир, 2000, pp. 56–57.

⁶⁰ *Ibidem*, pp. 55–56; С.І. Пирожков, А.І. Сухоруков, (eds.), "Експортний потенціал України на російському векторі," *op.cit.*, chapter II.

⁶¹ O.A. Smolansky, "Fuel, Credit, and Trade. Ukraine's Economic Dependence on Russia," *Problems of Post-Communism* 46, no. 2 (1999), p. 50–51. More on VAT problem in C.R. Shiells, "Imperfect Competition and the Design of VAT Regimes: The Case of Energy Trade Between Russia and Ukraine," *IMF Working Paper* [International Monetary Fund] 235, no. 2 (2002).

⁶² А.С. Філіпенко, В.С. Будкін, А.С. Гальчинський (and others), "Україна і світове господарство: взаємодія на межі тисячоліть," Лівідь, Київ 2002, p. 96.

Trade disputes of 1996–1998 and the Russian crisis contributed to the diminishing trade exchange between Russia and Ukraine. The effects were more acute for Ukraine, dependent on the exchange with Russia, all the more that the Ukrainian trade deficit with Russia also grew.⁶³ Russia's actions were partially economy-driven. The issue of VAT distorted bilateral trade relations and the exchange with Ukraine in some cases was simply unprofitable. For instance, Ukrainian suppliers of sugar were replaced in the Russian market by non-CIS suppliers, whose products were 50% cheaper than Ukrainian.⁶⁴ A certain role was also played by political factors. Restrictions imposed by Russia did not cover CIS states-members of the customs union. Russia wanted to show to Ukraine (and other countries outside the union) that their decision was wrong. In addition, the conflict discussed here overlapped in the temporal dimension with the talks on Ukraine-Russia interstate treaty and the division of the Black Sea Fleet (May 1997). Russia was able to use the trade dispute as a tool of pressure on Ukraine and agreed on its resolution only when the negotiations on the treaty and the BSF division finished and the Russian objectives were met.⁶⁵ Finally, in February 1998, the already mentioned agreement on economic cooperation for 1998–2007 was signed, which enabled Russia to relax the pressure on the Ukrainian partner.

Another wave of trade disputes surfaced at the turn of 2000. Their background was primarily economic. Both Ukrainian and Russian authorities wanted to protect their markets to a certain degree and negotiate more advantageous terms in trade relations. New Russia's President Vladimir Putin attached much greater importance to economic aspects of foreign policymaking than his predecessor. Ukrainian and Russian manufacturers and their associations that demanded relevant actions from the authorities also contributed significantly to the imposition of those restrictions. They were justified both in Ukraine and Russia by the significant growth of imports from the other country of a given commodity (the growth partially resulted from the economic recovery) and the falling turnover of domestic manufacturers. However, specific anti-dumping procedures were probably not used.⁶⁶

It cannot be ruled out that both parties were also motivated by political reasons. Russia wanted to convince Ukraine that only closer cooperation and endorsement of the Eurasian Economic Commonwealth concept, and subsequently the CES, were able to ensure access to Russian markets to Ukrainian exporters. Ukraine, in turn, attempted to push for the introduction of the free trade regime. Unlike in the previous period, it is hard to present a clear chronological account of events and their overall economic outcome, as Ukraine and Russia were involved in numerous debates on various product groups in the first half of the present decade.

Ukrainian restrictions first covered electrical lamps imported from Russia (August 1999), then new passenger cars, cement, soda, mineral fertilisers, chloride, selected paints and lacquers, cotton wear and rail switches. Also in 1999, Russia imposed restrictions on starch molasses imported from Ukraine. In 2000–2002, similar actions were taken in relation to the imports of e.g. corn and potato starch, caramel, bird meat, pipes, compressors for cooling devices and zinc-plated steel.

The subject of top level talks was the export of Ukrainian pipes to Russia. Russia initiated an anti-dumping procedure against Ukraine as regards pipes in March 2000, and subsequently demanded that the latter should agree to quotas, threatening that, if rejected, it will impose a 40% customs duty on the pipes.⁶⁷ In May 2001, Ukraine accepted Russia demands. It was agreed that the upper limit of its pipe exports to Russia would be 620,000 tons.⁶⁸ It is not easy to assess the effects of these actions. The agreed-upon quotas were only by 150,000 smaller than Ukrainian exports in 2000. In 2001, Ukraine used only 56.5% of the quota (350,000 tons), and 85.5% in 2002 (530,000 tons).⁶⁹ The dispute over Ukrainian pipes was used by Russia for at least two reasons. Firstly, the disagreement struck directly at the interest of two Ukrainian clans out of the top three, namely the Dnepropetrovsk clan, with President Leonid Kuchma

⁶³ See Annex 1.

⁶⁴ А.С. Філіпенко, В.С. Будкін, А.С. Гальчинський (and others), "Україна і світове господарство," *op.cit.*, p. 203.

⁶⁵ O.A. Smolansky, "Fuel, Credit...", *op.cit.*, pp. 54–55. More on the resolution of the Black Sea fleet issue in: J. Sherr, "Russian-Ukraine Rapprochement?: The Black Sea fleet accords," *Survival* 39, no. 3 (1997), pp. 33–50.

⁶⁶ В.А. Вашанов, Г.Ю. Бровчук, "Экономическое сотрудничество России и Украины," *op.cit.*, pp. 64–74, 77–85.

⁶⁷ "Ukraine does not agree to Russia's demand to limit import of Ukrainian pipes," *WPS – Russian Business Monitor* of 1 November 2000, www.securities.com.

⁶⁸ Соглашение о регулировании поставок труб из черных металлов, Москва, 10 апреля 2001 года, www.rada.gov.ua.

⁶⁹ "Ukraine and the Eurasian Economic Community: Integration Or Co-Operation?," *National Security and Defence* (Ukrainian Centre for Economic & Political Studies named after Olexander Razumkov, Kyiv), 36, no. 12 (2002), 12, p. 25; Ф. Вінценц, Н. Легейда, *Оцінка ризиків для експорту чорної металургії*, Березень: Інститут Економічних Досліджень та Політичних Консультацій в Україні, Німецька Консультативна Група з Питань Економічних Реформ, 2002, no. Q20, pp. 8–9.

and his son-in-law Viktor Pinchuk, the owner of the group Interpipe, whose core business is the production and exports of steel pipes and, to a lesser degree, the Donetsk clan, represented e.g. by the then Prime Minister Viktor Yanukovich and the energy minister Vitali Hayduk. It can be assumed that the pipe issue was used as a handy tool of pressure on the representatives of Ukrainian authorities, to secure Ukraine's concessions at the time of the political rapprochement between the countries. Secondly, Russia probably counted on the weakening of the Ukrainian metal processing sector as a result of limited deliveries, which will facilitate the takeover of the still state-owned pipe factory in Hircitsik (Donetsk district), a CIS-wide monopoly holder in the production of large diameter pipes, used e.g. by the Russian Gazprom.⁷⁰ The objective was not achieved as the factory was finally purchased by the Donbas Industrial Association (ISD).⁷¹

The Russia-Ukraine conflict was dying down at the turn of 2003, which does not mean that the restrictions imposed in 1999–2002 were lifted. Rather, Russia and Ukraine reduced the number of new restrictions. Some of those imposed in the previous period simply expired, while others continued to apply (Ukraine introduced duties and quotas on the selected goods usually for 4-5 years⁷²). As far as some commodities exported by Ukraine are concerned, the established practice has become the determination of quotas through bilateral arrangements. This primarily applied to Ukrainian pipes and zinc-plated steel. Ukraine did not oppose this development, which was related both to the country's weaker bargaining position towards Russia and the fear of losing Russian markets.

Trade exchange played a certain role in the period preceding the presidential elections of 2004. In January, Russia agreed to increase the export quota for Ukraine pipes up to 715,000 tons.⁷³ In the summer of the same year, it abandoned the 18% VAT for gas and oil exported to Ukraine and other CIS countries. The decision was to bring approx. USD 800M to the Ukrainian budget annually, which could be used before the elections by Prime Minister Viktor Yanukovich.⁷⁴ The price for the concessions towards Russia was, however, its growing dependence on the RF both in the political (removal for the military doctrine of the provisions on the aspirations for NATO and EU membership) and economic dimension (new agreements on energy cooperation).

Following the Orange Revolution, Ukraine-Russia relations deteriorated. Under the circumstances, Russia attempted to use Ukraine's dependence on the mutual exchange to maximise its profits, weaken Ukraine in economic terms and, consequently, destabilise it politically and persuade into the resumption of cooperation with Russia. Russian attempts were primarily justified by economic reasons, although in December 2004, Yevgeniy Primakov, the RF's former Prime Minister and the chairman of Russia's Commerce and Industry Chamber, said when commenting on the developments in Ukraine: "many will come to the conclusions than in order that such situations can be avoided in the future, the screw must be tightened."⁷⁵

At the turn of 2006, Russia introduced anti-dumping procedures for five years, to cover the pipes exported from Ukraine. It also banned the imports from the country of meat and dairy products, justifying it by sanitary considerations.⁷⁶ As a result, in Q1 of 2006 alone, the export of Ukrainian food products fell by 27.6%, in comparison with the corresponding period of the previous year (growth by 21% the year before).⁷⁷ Despite talks held between the parties, by November 2007 the RF did not entirely lift the ban on imports from Ukraine of meat and dairy products. In February 2007, Russia announced tightened controls for meat

⁷⁰ R.M. Butler, "Euro-Caspian energy and the political crisis in Ukraine," *Alexander's Gas and Oil Connections* 6, no. 10 (2001), www.gasandoil.com.

⁷¹ See A. Sarna, "Ukraińska metalurgia: gospodarcze ogniwo oligarchicznego systemu władzy," *Prace OSW. CES Studies*, no. 5 (2002), pp. 29–40.

⁷² "Ukraine. Select Issues," *IMF Staff Country Report* [International Monetary Fund] 173, no. 3 (2003), p. 55.

⁷³ "Russia signed an agreement on supplies of Ukrainian pipes to Russia," *WPS – Russian Business Monitor* of 12 January 2004, www.securities.com.

⁷⁴ A. Sarna, "Rosyjska ofensywa naftowo-gazowa z ukraińskimi wyborami w tle," *Komentarze OSW* of 28 August 2004, www.osw.waw.pl.

⁷⁵ D. Hemi, M. Wągrowaska, P. Żurawski vel Grajewski, *Ukraina bliżej Zachodu*, Warszawa: Stowarzyszenie Euroatlantyckie, 12 February 2005, www.sea-ngo.org.

⁷⁶ R. Bryl, "After Gas Dispute Ukraine, Russia Start Trade War. Long Live WTO?," *IntelliNews – Ukraine This Week* of 6 February 2006, www.securities.com.

⁷⁷ "Problems And Prospects Of Ukraine-Russian Cooperation," *National Security and Defence* [Ukrainian Centre for Economic & Political Studies named after Olexander Razumkov, Kyiv] 77, no. 5 (2006), p. 17.

from Ukraine, in order to prevent re-exports to Russia of meat products from Poland.⁷⁸ In terms of dairy products, their manufacturers from Russia make it clear that they want to use the present situation to drive Ukrainian competitors out of the Russian market.⁷⁹

In January 2006, Russia stopped gas deliveries to Ukraine. The gas crisis was to the serve a number of important economic and political objectives. Russia wanted to secure Ukraine's consent to higher gas prices (to USD 220-230 for 1,000 m³) as it did not intend to subsidise the Ukrainian economy following the victory of Viktor Yuschenko. In addition, it counted on the weaker international position of Ukraine as a result of the crisis and that the developments would undermine the credibility of the new government. These objectives were only partially met. Ukraine did not agree to the gas price rise offered by Russia. Both countries signed, however, agreements on cooperation in the gas sector (January 2006) that did not suit any party. The gas crisis destabilised the Ukrainian political scene but also increased the reluctance of some members of the Ukraine society towards the Russian neighbour.

Conclusions and prospects

For the last sixteen years, Ukraine and Russia have failed to work out lasting and satisfactory (to both countries) terms of trade cooperation. Ukraine has not managed to secure access to the Russian markets under the bilateral or multilateral free trade zone. Russia has failed to convince Ukraine that it should agree to its greater dependence on Russia in the political and economic dimension in exchange for the free trade prospects. Both countries signed a number of agreements on trade and economic cooperation, yet they have not been fully implemented.

The present situation has two fundamental consequences. Firstly, it is conducive to the emergence of Ukraine-Russia trade disputes, seeking primarily to protect domestic suppliers, force the partner to accept concessions and, as regards Russian actions, also to destabilise the situation in Ukraine. Secondly, it loosens trade ties between the countries and causes them to redefine the directions of their trade exchange. In 1995, the exchange with Russia accounted for 45.3% of foreign trade with Ukraine, and for 26.9% in 2006. In the corresponding period, the share of the exchange with the EU grew from 12.6% to 31.7%. Russia's exchange with Ukraine accounted in 1995 for 11% of its foreign trade balance, and for 5.5% in 2006. The exchange with the EU rose in the corresponding period from 35.4% to 52.7%.⁸⁰

From Ukraine's viewpoint, the above developments have various effects. On the one hand, Ukraine reduces its economic dependence on Russia, while on the other it gradually loses its traditional supply market. From the standpoint of Russian authorities, the loosening of trade ties is assessed as an adverse development, as Russia loses one of its tool of pressure on its Ukrainian neighbour. If Russia agreed to the establishment of the free trade zone, appointed under bilateral agreements or under the CIS, it would probably result in the growth of the mutual trade exchange and, as a result, also in closer political relations between Ukraine and Russia.⁸¹ Problems in the area of trade relations undoubtedly contribute to the loosening of the ties in other areas as well. Relative permanence of trade links between Ukraine and Russia, despite the lack of satisfactory legal regulations and frequent trade disputes, is primarily the effect of the interdependence of the states in the energy sector, and of the Ukrainian (and Russian to a certain extent) difficulties with gaining access by their manufacturers to European markets.

Of vital influence for bilateral trade relations will probably be the accession of both countries to the WTO. Ukraine hopes for the WTO membership in 2007. Russia also expects that it will join the organisation in the near future. It should be emphasised that the date of the accession of each state has already been rescheduled several times. The membership in the WTO will secure the various benefits for both states, also as regards their bilateral trade relations, as it will facilitate their access to the partner's market, restrict the

⁷⁸ "Russia to tighten control over deliveries from Ukraine to keep out Polish meat," *Interfax Ukraine Business Panorama* of 19 February 2007, www.securities.com.

⁷⁹ "Russian Dairy Union Says Russia's Milk Market Holds No Promise For Ukraine," *Ukrainian News – on-line* of 26 February 2007, www.securities.com. According to Russian statistics, the share of Ukrainian products in the Russian imports fell in 2005–2006 from 50% down to 19% for cheese, and from 27% to 7% for butter.

⁸⁰ Details in Annexes 3 to 6.

⁸¹ The scenario is to an extent being developed in Belarus. The country's exchange with Russia accounted in 1995 for 44.4% of its total exports, and for 47.1% in 2004 (A. Eberhardt, *Stosunki handlowe między Federacją Rosyjską i Republiką Białoruś* (copied material), p. 27). For comparison, the figures for Ukraine were at 43.2% in 1995 and only at 18% in 2004.

use of anti-dumping procedures and other tariff and non-tariff barriers, as well as provide an appropriate procedure for dispute solving.

Ukraine attaches great importance to its accession to the WTO, as it hopes that this will restrict the employment by Russia of discriminating practices against Ukrainian exporters, consolidate their position in the EU and allow deeper cooperation of the country with the organisation.⁸² For similar reasons, Russia is not a proponent of a speedy accession of Ukraine to the WTO. Russian authorities fear in particular that if Ukraine joins the WTO before Russia, it could demand from Russia the solutions that suit its interest (e.g. on the supply of energy resources), or even theoretically block its admission to the WTO (Georgia warned that it would use such steps). In practice, the scenario does not appear too likely, as it involves substantial political cost.⁸³ Russia suggests that both countries should take actions to “synchronise” their accession to the WTO.⁸⁴ At the same time, Russian authorities emphasise that if Ukraine joins the World Trade Organisation before Russia, they will be forced to review the free trade regime existing between both states. They argue that following the accession to the WTO, the supply of Western commodities will increase in Ukraine, which will in consequence stimulate the supply of Ukrainian products in Russia.⁸⁵ This line of thinking does not appear reasonable, also because Ukraine’s accession to the World Trade Organisation is unlikely to result in the growth in the purchasing power of the Ukrainian society, which is a precondition for a substantial increase of demand for relatively more expensive Western commodities.

Representatives of Ukrainian authorities reject Russian proposals, stating officially that the accession of one of the states to the WTO does not threaten the interest of the other state.⁸⁶ However, it should also be noted that Russia seems to possess certain tools that allow it to delay the accession of Ukraine to the World Trade Organisation. The main problem that hampered the accession in 2007 was the lack of agreement on the mutual access to markets with Kyrgyzstan (Ukraine signed a corresponding agreement with all the remaining members of the Working Group of the World Trade Organisation on Ukraine.) Kyrgyzstan first demanded that Ukraine should pay debts of the Soviet times, and later that its customs duties on food and agricultural products be significantly reduced.⁸⁷ It cannot be ruled out that Kyrgyzstan’s actions were inspired by Russia. The final agreement between Ukraine and Kyrgyzstan was signed in mid-November 2007.⁸⁸

⁸² О. Мальський, “Аналіз перевах членства у СОТ та рекомендації щодо їх збільшення,” *Вісник Львівського Університету*, Серія міжнародні відносини, 2004, Випуск 13, р. 189–190.

⁸³ A. Gradziuk, “Proces akcesji Ukrainy do Światowej Organizacji Handlu,” *Biuletyn (PISM)*, no. 367 (2006).

⁸⁴ “Ukraine, Russia should agree on NATO, EU, and synchronize joining WTO, Russian Premier says,” *Interfax Ukraine Business Panorama* of 29 October 2006, www.securities.com.

⁸⁵ “Росія може переглянути режим вільної торгівлі з Україною через різні умови вступу до СОТ,” *Український Монітор*, 25 квітня 2006 року, www.crcfpu.org.ua.

⁸⁶ В. Пятницькій (interview), *СОТ: новий етап шляху*, 23 лютого 2007 року, www.kmu.gov.ua.

⁸⁷ А. Сахно, *ПоВТОрене пройденого*, 19 июня 2006 року, www.podrobnosti.ua.

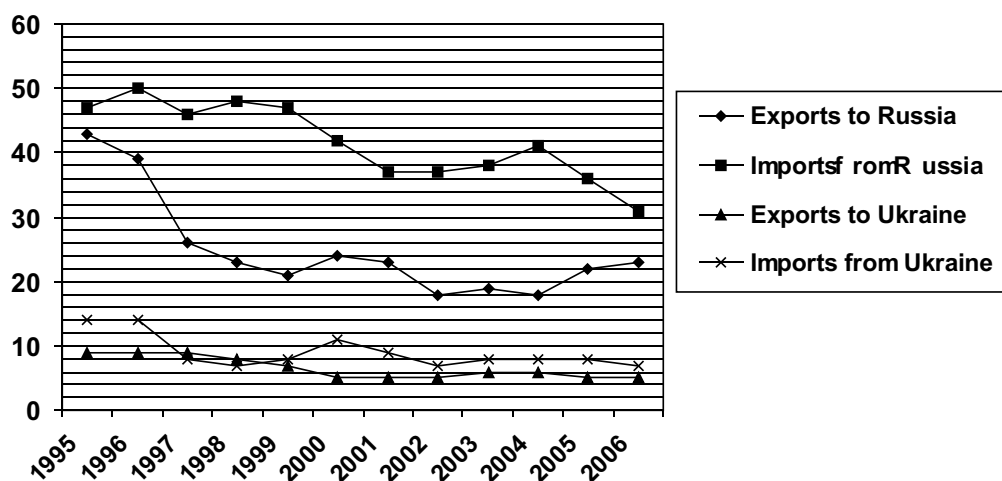
⁸⁸ *Ukraine confirms deal signed with Kyrgyzstan for WTO accession of 14 November 2007*, www.rian.ru.

Annex 1 Russia-Ukraine trade exchange in 1993–2006

Year	Exports to Russia (in USD bn)			Exports to Ukraine (in USD bn)			Turnover (average)	Annual growth in turnover (in %)	Ukraine's deficit (average)	Annual deficit growth (in %)
	Russian figures	Ukrainian figures	Ukrainian/Russian figures	Russian figures	Ukrainian figures	Ukrainian/Russian figures				
1993	3912	4165	0.94	6262	7901	0.79	11120	b.d.	3043	b.d.
1994	4404	4659	0.95	7478	6701	1.12	11621	4.51	2558	-15.94
1995	6617	5698	1.16	7544	7149	1.06	13504	16.20	1189	-53.52
1996	6294	5577	1.13	8817	7547	1.17	14118	4.54	2247	88.94
1997	3983	3723	1.07	7838	7240	1.08	11392	-19.31	3686	64.08
1998	3267	2906	1.12	7064	5560	1.27	9399	-17.50	3226	-12.49
1999	2528	2396	1.06	5592	4792	1.17	7654	-18.56	2730	-15.36
2000	3651	3516	1.04	5825	5024	1.16	9008	17.69	1841	-32.56
2001	3845	3679	1.05	5813	5282	1.10	9310	3.35	1786	-3.01
2002	3230	3189	1.01	6317	5585	1.13	9161	-1.60	2742	53.54
2003	4438	4311	1.03	8646	7598	1.14	12497	36.42	3748	36.70
2004	6100	5889	1.04	11812	10770	1.10	17286	38.32	5297	41.33
2005	7777	7496	1.04	12843	12403	1.04	20260	17.21	4987	-5.85
2006	9218	8651	1.07	13787	14979	0.92	23318	15.09	5449	9.27

Source: Державний комітет статистики України, www.ukrstat.gov.ua;
Федеральная служба государственной статистики, www.gks.ru.

Annex 2 Share of mutual exchange in trade between Ukraine and Russia in 1995–2006 (in %)



Sources: Author's own calculations based on: as above.

Annex 3 Main trade partners of Russia (2006)

Exports (% of total)		Imports (% of total)	
Netherlands	11,9	Germany	13,4
Italy	8,3	Ukraine	6,7
Germany	8,1	China	9,4
China	5,2	Japan	5,7
Ukraine	5,0	Belarus	5,0
Turkey	4,8	South Korea	4,9
Belarus	4,3	United States	4,7
Switzerland	4,0	France	4,3
Poland	3,8	Italy	4,2
Great Britain	3,4	Finland	2,9

Source: Author's own calculations based on: *Внешняя Торговля Российской Федерации со странами дальнего зарубежья*, www.gks.ru; *Внешняя торговля Российской Федерации со странами СНГ*, www.gks.ru.

Annex 4 Main trade partners of Ukraine (2006)

Exports (% of total)		Imports (% of total)	
Russia	22,5	Russia	30,6
Italy	6,5	Germany	9,5
Turkey	6,2	Turkmenistan	7,8
Poland	3,5	China	5,1
Germany	3,3	Poland	4,7
Belarus	3,2	Italy	3,3
United States	3,1	Belarus	2,8
Hungary	2,5	France	2,2
India	2,2	Kazakhstan	2,1
Kazakhstan	2,2	South Korea	2,1

Source: Author's own calculations based on: *Географічна структура зовнішньої торгівлі товарами за 2006 рік*, www.ukrstat.gov.ua.

Annex 5
Russia's trade exchange with its main partners
in 1995–2006
(in million USD)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Rest of the world	52638	58720	59441	50141	48078	63507	63881	70804	88222	93546	111227	143272
EU ¹	44238	43829	47776	39741	36035	48035	52151	56207	69144	125482	177040	231619
CIS ²	14381	16603	19635	16185	11730	16753	16692	17059	21601	21334	31382	40436
Ukraine	13766	13841	11223	8827	7320	8675	9127	8815	12036	16870	20180	24197

Source: Author's own calculations based on: Федеральная служба государственной статистики, www.gks.ru.

Annex 6
Ukraine's trade exchange with its main partners
in 1995–2006
(in million USD)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Rest of the world	8561	9058	10759	9924	8915	10756	12135	14021	18173	19623	21511	24071
EU ¹	3702	4365	5136	5289	4518	5235	6398	7568	10362	18275	21083	26481
CIS ²	3714	4187	3904	2130	2007	3196	4015	3839	4595	6064	7431	10412
Russia	13242	14394	11561	9970	7988	9341	9492	9506	12957	17701	20339	22438

Source: Author's own calculations based on: Державний комітет статистики України, www.ukrstat.gov.ua.

¹ EU 15, since 2004 EU 25.

² Except Russia.

Annex 7
Structure of Ukraine's exports
in 1997–2005
(in thousand USD)

Commodity group	1997	1998	1999	2000	2001	2002	2003	2004	2005
Food and agricultural products	786 773	47 1448	528 463	611 673	673 760	667 986	853 275.1	1 131 811	138 206
Mineral products (including energy resources)	139 291	144 453	83 312	75 175	98 149	95 015.25	108 779.9	178 639	399 177
Chemical industry products and rubber	494 299	456 838	386 918	595 396	518 661	385 034.3	430 206.5	538 715	750 382
Leather and fur, and their products	5347	6569	3305	6680	7215	6282	1735.592	2153	2476
Timber, wood, cellulose and paper products	75 662	78 979	95 981	136 905	188 974	181829	247 747.5	274 597	325 907
Textiles, footwear	41 840	35 481	35 992	54 153	38 981	30 886.5	40 779.8	56 674	78 998
Metals, precious stones and their products	1 200 698	896 221	643 280	1 149 139	1 048 810	669 120.3	1 166 227	1 713 748	2 221 599
Machinery, plant and means of transportation	935 355	791 211	591 835	830 627	1 023 793	1 080 940	1 289 600	1 876 427	2 236 213
Other	44 233.8	24 287	27 294	55 839	81 193	67 357	81 747.05	113 476	92 147

Source: С.І. Пирожков (and others), *Українсько-російські відносини: економічний аспект*, Національний інститут українсько-російських відносин, Київ 1998, www.niurr.gov.ua; С.І. Пирожков, А.І. Сухоруков (eds.), *Експортний потенціал України на російському векторі: стан і прогноз*, Національний інститут українсько-російських відносин, Київ 1998, chapter II, www.niurr.gov.ua; С.І. Пирожков (and others), *Україна-Росія: проблеми економічної взаємодії*, Національний інститут українсько-російських відносин, Київ, 2000, www.niurr.gov.ua; А. Жаліло (ed.), *Конкурентоспроможність економіки України в умовах глобалізації*, Національний інститут стратегічних досліджень, Київ 2005; V. Astrov, Z. Lukas, J. Pöschl, "The Ukrainian Economy between Russia and the Enlarged EU: Consequences for Trade and Investment," *WIIW Current Analyses and Country Profiles* [The Vienna Institute for International Economic Studies], no. 23 (2006).

Annex 8
Structure of Russia's exports
in 1997–2005
(in thousand USD)

Commodity group	1997	1998	1999	2000	2001	2002	2003	2004	2005
Food and agricultural products	48 328	101 814	58 336	96 151	142 503	133 826.8	349 856.7	286 625	443 783
Mineral products (including energy resources)	5 503 025	5 312 043	4 156 087	3 950 149	3 566 787	4 142 006	5 641 143	7 935 867	7 501 057
Chemical industry products and rubber	423 031	341 187	291 612	355 827	375 408	380 975.3	518 689.5	729 575	1 004 717
Leather and fur, and their products	5550	5068	3593	4429	3555	2903.36	3169.831	4483	3980
Timber, wood, cellulose and paper products	135 444	133 654	127 246	136 187	203 928	180 824.9	179 057	248 465	318 086
Textiles, footwear	42 902	46 851	46 418	72 592	71 208	85 195.47	77 888.3	84 087	99 591
Metals, precious stones and their products	325 889	291 344	213 005	319 183	394 529	448 296.9	612 641.3	947 345	1 357 329
Machinery, plant and means of transportation	1 033 228	814 149	680 666	869 525	1 008 526	912 108.7	1 234 853	1 822 408	2 033 951
Other	40 918	18 184	13 493	20 872	47 035	31 392.58	34 242.1	69 045	74 440

Source: As above.

Annex 9
Structure of Ukraine-Russia exchange
in the international context
(2005)

Commodity group	Ukrainian exports to Russia (USD K)	% of the commodity's share in total Ukrainian exports	% of the commodity's share in total Russian imports	% of Ukrainian exports to Russia	Russian exports to Ukraine (USD K)	% of the commodity's share in total Russian exports	% of the commodity's share in total Ukrainian imports	% of Russian exports to Ukraine
food and agricultural products	1 383 203	32.12	7.94	18.47	443 783	9.78	16.53	3.46
mineral products	399 178	8.48	13.22	5.33	7 501 057	4.81	64.84	58.41
including energy resources and oil-based products	150 294,8	4.49	12.2	2.01	7 298 078	4.77	68.45	56.83
chemical industry products, rubber	750 382	21.05	4.61	10.02	1 004 717	7.00	19.95	7.82
leather and fur, and their products	2476	1.17	0.90	0.03	3 980	1.21	3.58	0.03
timber, wood, cellulose and paper products	325 907	32.98	9.94	4.35	318 086	3.83	26.42	2.48
textiles and footwear	78 998	6.37	2.18	1.05	99 591	10.66	4.52	0.78
metals and their products	2 221 599	15.70	29.04	29.66	1 357 329	3.32	50.40	10.57
machinery, devices and means of transportation	2 236 213	48.20	5.15	29.86	2 033 951	15.06	20.20	15.84
other	92 147	19.19	0.21	1.23	74 441	2.95	12.98	0.58

Source: Державний комітет статистики України, www.ukrstat.gov.ua; Федеральная служба государственной статистики, www.gks.ru. Exchange volumes based on Ukrainian statistics.