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# **DEVELOPING TRADE AND TRADE POLICY RELATIONS WITH THE EUROPEAN UNION**

**Experience of Visegrad Countries and  
Implications/Lessons for Eastern Partners**

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## UKRAINE'S EXPERIENCES ON DEVELOPING TRADE AND TRADE POLICY RELATIONS WITH THE EUROPEAN UNION

*Lidia Shynkaruk – Irina Baranovska  
– Olena Herasimova*

Since 1991, when Ukraine gained independence, the European Union and Ukraine have developed an increasingly dynamic relationship. Ukraine is a priority partner country within the European Neighbourhood Policy (ENP) and the Eastern Partnership.

Relations between the EU and Ukraine are currently based on the Partnership and Cooperation Agreement (PCA) which entered into force in 1998. At the Paris Summit in 2008 the leaders of the EU and Ukraine agreed that an Association Agreement should be the successor agreement to the Partnership and Cooperation Agreement. The EU-Ukraine Association Agreement is the first of a new generation of Association Agreements with Eastern Partnership countries. Negotiations on this comprehensive, ambitious and innovative Agreement between the EU and Ukraine were launched in March 2007. In February 2008, following confirmation of Ukraine's WTO membership, the EU and Ukraine launched negotiations on a Deep and Comprehensive Free Trade Area (DCFTA) as a core element of the Association Agreement.

At the 15th Ukraine-EU Summit of 19 December 2011, the EU leaders and President Yanukovich noted that a common understanding on the text of the Association Agreement had been

reached. On 30 March 2012 the chief negotiators of the European Union and Ukraine initialled the text of the Association Agreement, which included provisions on the establishment of a DCFTA as an integral part. In this context, chief trade negotiators from both sides initialled the DCFTA part of the Agreement on 19 July 2012. Both the EU and Ukraine expressed their common commitment to undertake further technical steps, required to prepare conclusion of the Association Agreement.

Since it will take some time until the EU-Ukraine Association Agreement can enter into force, the sides decided to adopt the EU-Ukraine Association Agenda.

The key parts focus on supporting core reforms, economic recovery and growth, and governance and sector cooperation in areas such as energy, transport and environment protection, industrial cooperation, social development and protection, equal rights, consumer protection, education, youth and cultural cooperation.

The Agreement also puts a strong emphasis on values and principles: democracy and the rule of law, respect for human rights and fundamental freedoms, good governance, a market economy and sustainable development.

The Agreement will be enhancing cooperation in foreign and security policy and energy.

It includes a Deep and Comprehensive Free Trade Area – this will go further than classic free trade areas, as it will both open up markets and also address competitiveness issues and the steps needed to meet EU standards and trade on EU markets.

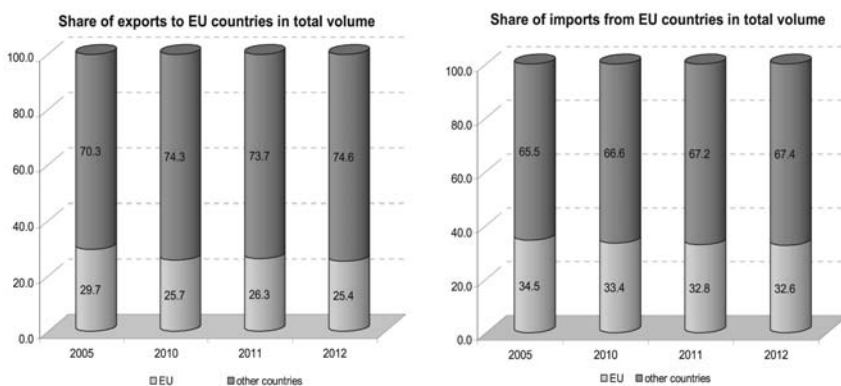
Ukraine's results of the European integration processes will be largely dependent on its external and internal macroeconomic policy and the situation in the national economy.

In this context, it is advisable to consider such specific aspects as the structural characteristics of some components of the economy, the individual components of the agreement on a DCFTA between the EU and Ukraine, the cooperation within the Eastern Partnership and the potential opportunities and risks of the agreement on free trade with the EU.

The European Union is a major trading partner of Ukraine, with about 30.0% total share in goods and services. However, as it ap-

pears from figure 1, the share of the EU-bound Ukrainian export decreased from 29.7% to 25.4% between the years 2005 and 2012, thus reducing Ukrainian presence at the EU markets (see figure 1). The share of imports of goods and services in the total volume of Ukrainian trade tends to be decreasing, although it is a threat-provoking fact that the share of imports dominates the share of exports by 7% in terms of payment balance.

Figure 1.  
Foreign trade of Ukraine in goods and services

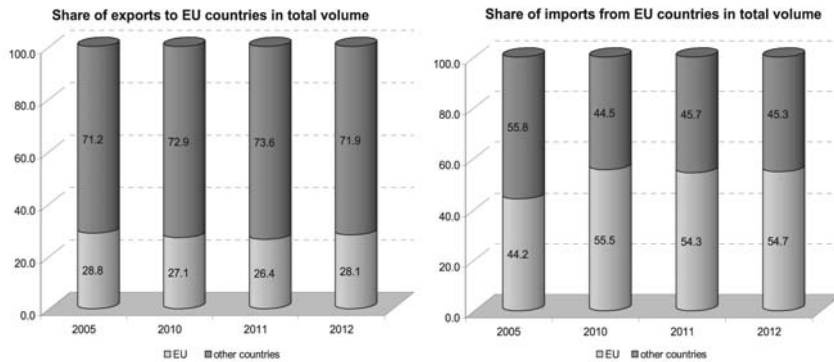


Source: State Statistic Service of Ukraine.

Trade relations with the EU are characterized by decreasing both the import and the export shares of goods and these being replaced by other countries as well as the loss of markets consequently for Ukraine and the EU. Ukraine is currently experiencing trade disbalance which manifests itself in the prevalence of EU imports over exports share (by 6.0%), which reduces the production capacity of the national economy (*see figure 2*).

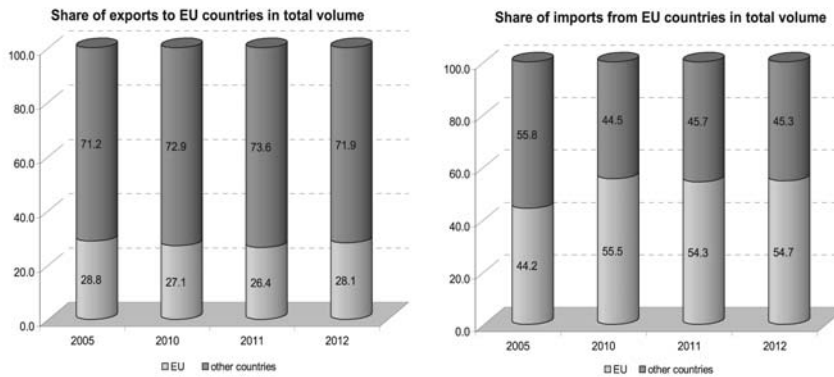
Another insecure structural peculiarity in the domain of foreign trade relations between Ukraine and the EC is a high services import share (54.7%) in the import structure of Ukraine (*see figure 3*).

Figure 2.  
Foreign trade of Ukraine in goods



Source: State Statistic Service of Ukraine.

Figure 3.  
Foreign trade of Ukraine in services



Source: State Statistic Service of Ukraine.

The bulk of services falls on the financial services sector, taking into account the shortfall of funds within the EU jeopardizes the banking system stability. Despite substantial scientific evidence provided by numerous research institutions that the imported financial services are predominantly of Russian and Ukrainian origin, hardly does it alleviate any risks for the economy of Ukraine.

The positive constituent of the trade services structure is a high proportion of transport services both in exports (55%) and in im-

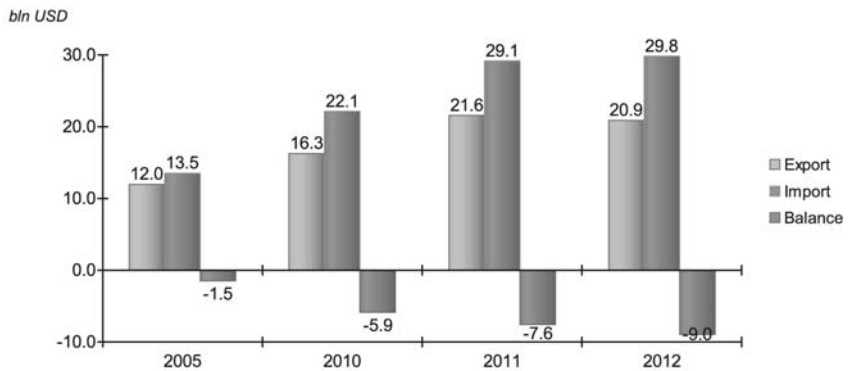


ports (22%), which allows us to consider infrastructure projects as priorities in the cooperation with the EU.

Of current interest is the research tackling not only the structure of foreign trade with the EU but also that of absolute volumes, demonstrating the following features within the time period from 2005 to 2012 (*see figures 4-6*).

Figure 4.

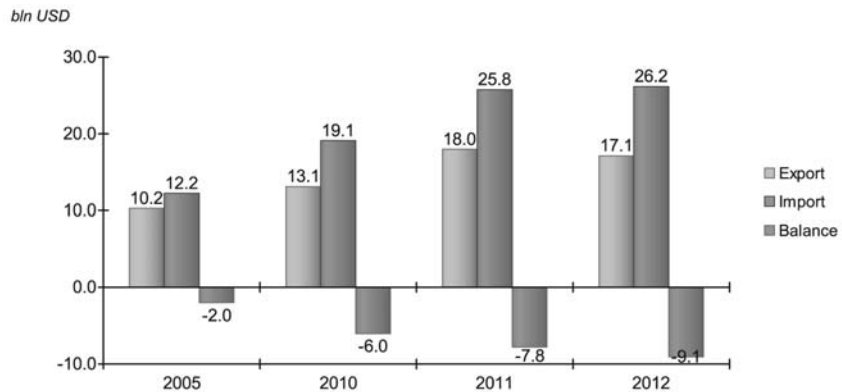
Foreign trade of Ukraine in goods and services with EU countries



Source: State Statistic Service of Ukraine.

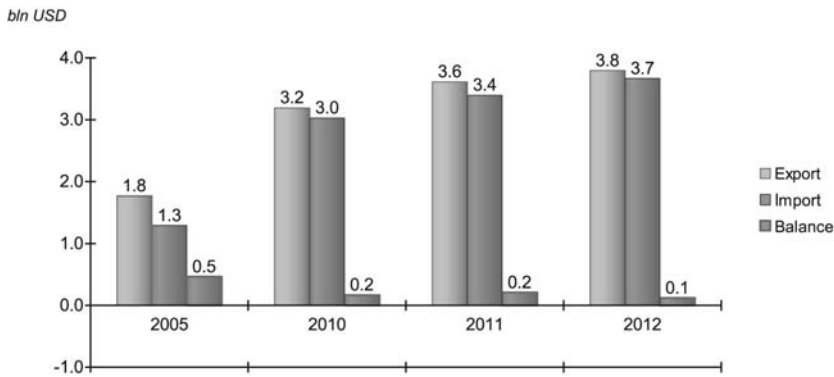
Figure 5.

Foreign trade of Ukraine in goods with EU countries



Source: State Statistic Service of Ukraine.

Figure 6.  
Foreign trade of Ukraine in services with EU countries



Source: State Statistic Service of Ukraine.

Firstly, the formation of a negative trade balance of 9.0 billion US dollars as well as a decline in the foreign currency earnings constitutes certain risks for the payment balance of Ukraine.

Secondly, a negative balance of trade was formed due to excessive imports from the EU. Under the conditions of extreme openness of the Ukrainian market and a small proportion of domestic goods at the domestic market it increases its vulnerability to global crises and reduces the possibility of increasing domestic industry presence at the local market.

Thirdly, the trade balance with the EU in terms of services is positive, implying the flight of funds from Ukraine, the shortage of investment resources and the need to update industry capital (depreciation rate above 50%) raises the issue of the very existence of increasing productive capacities.

Ukrainian producers should modernize their enterprise and improve the quality of their products, so as not to lose in the long run existing and potential niche in both foreign and domestic markets.

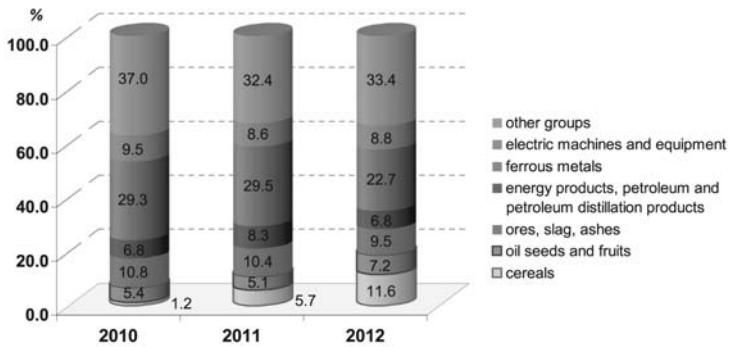
*Structural features of trade with the EU are as follows:*

- as far Ukraine's exports to the EU are concerned, predominant are the goods with low added value: ferrous metals, constituting about 23% corn – 12%, ore – 10% , that is foreign trade is rep-

resented mainly by raw materials thus preventing Ukraine from joining a global innovation value chain in industry (*see figure 7*);

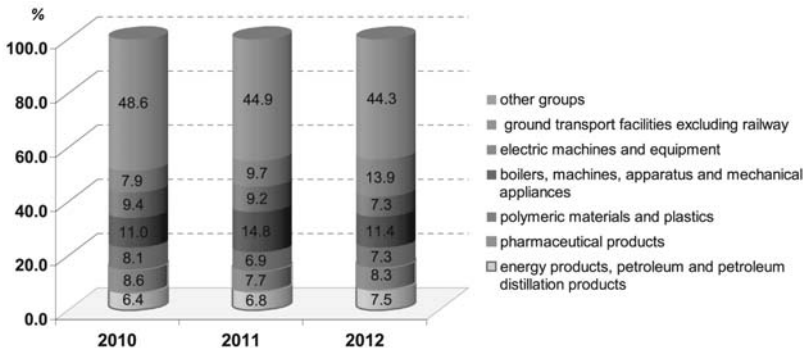
- on the other hand EU imports are represented by the goods with high added value: mechanical (14%) and electrical machinery (7%), pharmaceutical products (8%) which under the conditions of integration processes with the economically strong EU countries represent a major threat to the development opportunities of national producers (*see figure 8*).

Figure 7.  
Commodity pattern of Ukraine's foreign trade to EU countries



Source: State Statistic Service of Ukraine.

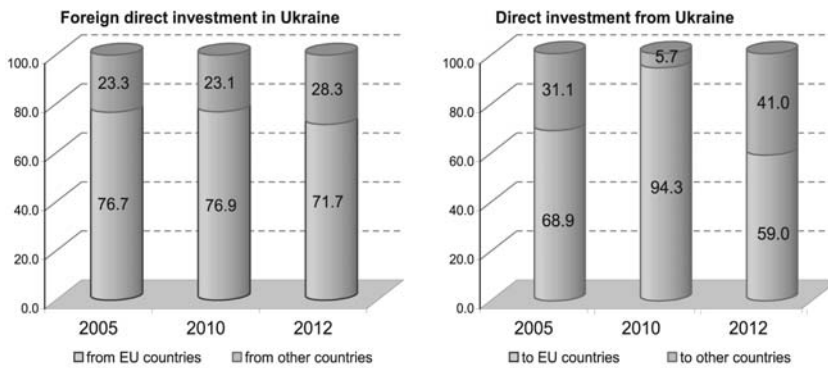
Figure 8.  
Commodity pattern imports from EU countries



Source: State Statistic Service of Ukraine.

The volume of the EU countries’ direct foreign investments to Ukraine has amounted nearly to 43 billion dollars, accounting for over 70% of total direct foreign investments in Ukraine (see figure 9). The main investors are Cyprus, Germany and the Netherlands. Service sector bound investments make up 56%, in industry – 34%, thus reducing the possibility of Ukraine in terms of the import policy implementation.

Figure 9.  
Foreign investments



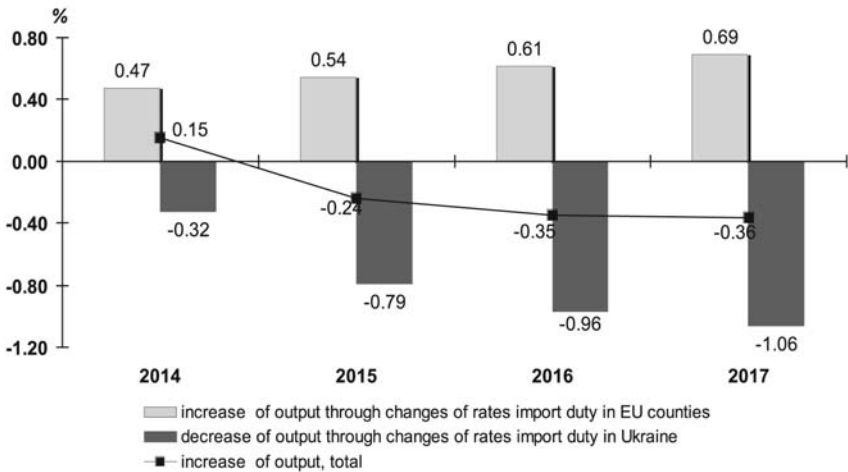
Source: State Statistic Service of Ukraine.

According to the interindustry balance model we have made a prediction of the introduction of tariff rate changes on consumer goods up to 2017 (see figure 10). According to the forecast of the positive impact of reduced rates on the EU bound export goods in the early years will be balanced by more considerable growth in imports from the EU to Ukraine in the coming years.

That is, the trade effects only from the free zone introduction with the EU will not significantly affect the growth of GDP and the volumes of production in Ukraine. They should be complemented by progressive institutional changes, investment effects and the effect of technological convergence.

Figure 10.

The contribution of tariffs changes in the increase (decrease) of output on integration scenario, percent of base scenario



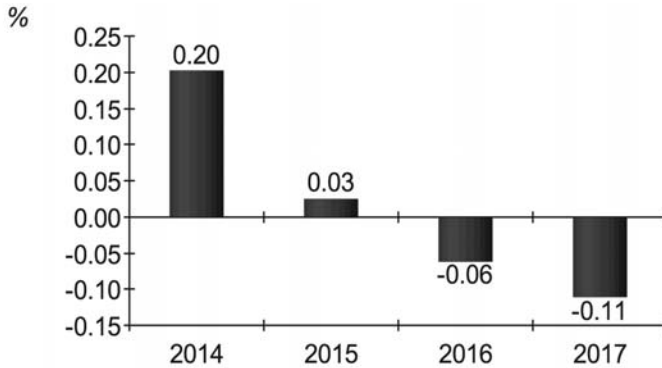
Source: Own calculations on the basis of database of State Statistic Service of Ukraine.

Calculation of the integration effects is performed according to the structure of foreign trade on the basis of 2010-2011. Input-output equation is based on input-output tables on the basic prices in 2010. Elasticities of export and import are calculated by means of econometric equations obtained from the data on foreign trade in Ukraine in 2006-2011.

Calculation results show that the effect of changes in rates of customs duties on imports into Ukraine from the EU is almost entirely balanced by the change of these rates on imports into the EU from Ukraine. Since most rates on imports into the EU for Ukrainian exporters have been cancelled simultaneously in the first year of the Agreement, the trade effect for of most domestic exporters and manufacturers who are suppliers of products for export, will be maximized in 2014 (*see figure 11*).

Figure 11.

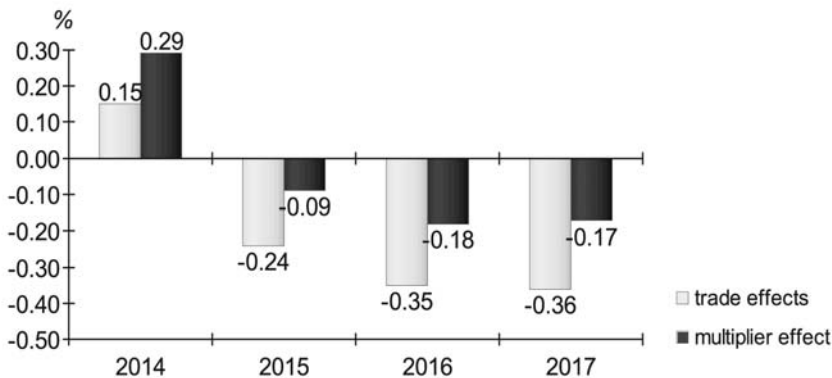
The contribution of changes tariffs in increase (decrease) of output on in-  
tegration scenario, percent of 2013



In addition to the direct impact of changes in tariffs, the change in the income of exporters will affect to the amount of output. This will lead to a redistribution of consumption and gross accumulation. However, although the multiplier effect and improvement in the performance of production and consumption of products as a whole and for individual sectors it does not change the principle regarding trends prevailing. So in the overall economy in the first year of the Agreement, taking into account the multiplier effect as a result of trade and the effects of changes in export revenue production will be increased by 0.29% (*see figure 12*).

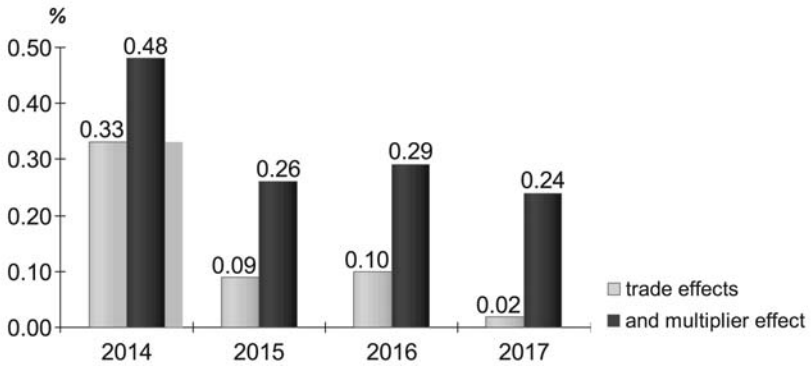
Figure 12.

The change in output due to trade effects and multiplier effect



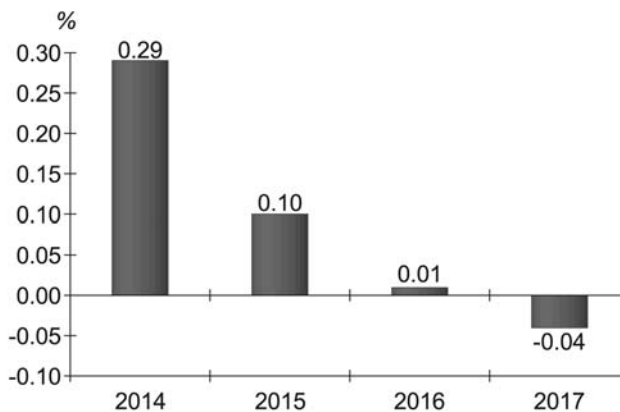
Final consumption of households will increase based on the multiplier effect 0.48% in 2014, followed by reduction effect to 0.2% in 2017 (see figure 13).

Figure 13.  
Change in final household consumption through trade effects  
and multiplier effect



The trend of reducing the total cumulative production growth in 2013 remains based on multiplier effect, the cumulative gain is zero in 2016-2017 (see figure 14).

Figure 14.  
Total cumulative production increase based on the multiplier effect,  
as a percentage of 2013



Calculations by dynamic input-output model suggests that in the early years of the Agreement certain negative consequences associated with replacement chemicals, mechanical engineering and metallurgy, partly reimbursed by the new opportunities that due to lower rates of customs duties emerge for light industry agriculture and some of the food industry. In general, a positive cumulative effect of the Agreement for the first year (2014) offset reduced production in the 2015-2017, and causes negative indicators in 2017. In general there is a slowdown an average of 0.15% per year in production for the years 2015-2017.

However, it should be noted that if the domestic producers of machinery, metallurgy and chemical industry will not take effective measures to modernize production, disproportions of the technological structure of production will be deep and cause further loss on domestic and foreign markets.

In accordance with the provisions of the «Agreement» it is stipulated that import duties on consumer goods for Ukrainian exporters can be expected (*see Table 1*) and import duties for particular goods imported to Ukraine from the EU remain unchanged (*see Table 2*).

It might sound impressive at first sight that the import duties for agricultural products, metallurgy, machine building industry products, food remain unchanged, but taking into consideration the application of EU non-tariff regulation methods as well as the EU countries higher levels of economic development, the risks for the Ukrainian industry remain significant.

Major funding for the specific projects of the Eastern Partnership implemented by NGO in Ukraine fall into three platforms:

- 1) democracy, good governance and stability;
- 2) contacts between people;
- 3) energy security (*see Table 3*).



Table 1. – Expected changes of import duty rates in EU countries for Ukraine produced goods (percent)

Types of economic activity	2013	2014	2015	2016	2017
Agriculture, hunting, fishing and forestry	14.0	0.0	0.0	0.0	0.0
Mining of coal and lignite; extraction of peat; mining of uranium and thorium ores	2.0	0.0	0.0	0.0	0.0
Extraction of crude petroleum and natural gas	2.0	0.0	0.0	0.0	0.0
Mining of quarry, except energy producing materials	0.0	0.0	0.0	0.0	0.0
Manufacture of food products, beverages and tobacco	12.4	0.4	0.4	0.4	0.0
Manufacture of textiles and textile products; manufacture of wearing apparel; dressing and dyeing of fur	10.0	1.5	1.2	0.8	0.3
Manufacture of wood and wooden products; manufacture of pulp, paper and paper products; publishing and printing	2.0	0.8	0.5	0.3	0.0
Manufacture of coke products; processing nuclear fuel	2.0	0.0	0.0	0.0	0.0
Manufacture of refined petroleum products	2.0	0.0	0.0	0.0	0.0
Manufacture of chemicals and chemical products; manufacture of rubber and plastic products	5.0	1.0	0.8	0.5	0.3
Manufacture of other non-metallic mineral products	4.0	1.0	0.7	0.4	0.1
Manufacture of basic metals and fabricated metal products	2.7	2.2	1.5	0.7	0.0
Manufacture of machinery and equipment	2.7	2.2	1.5	0.7	0.0
Manufacturing n.e.c.	2.7	2.2	1.5	0.7	0.0

Source: Own calculations on the basis of database of State Statistic Service of Ukraine and EU-Ukraine Association Agreement.

Table 2. – The expected changes of import duty rates  
from EU countries (percent)

Types of economic activity	2013	2014	2015	2016	2017
Agriculture, hunting, fishing and forestry	10.0	7.0	5.0	3.0	3.0
Mining of coal and lignite; extraction of peat; mining of uranium and thorium ores	1.0	0.0	0.0	0.0	0.0
Extraction of crude petroleum and natural gas	1.0	0.0	0.0	0.0	0.0
Mining of quarry, except energy producing materials	4.0	2.0	1.3	0.7	0.1
Manufacture of food products, beverages and tobacco	10.0	5.0	3.5	1.3	0.7
Manufacture of textiles and textile products; manufacture of wearing apparel; dressing and dyeing of fur	6.0	1.0	1.0	0.5	0.3
Manufacture of wood and wooden products; manufacture of pulp, paper and paper products; publishing and printing	0.0	0.0	0.0	0.0	0.0
Manufacture of coke products; processing nuclear fuel	1.0	0.1	0.1	0.1	0.1
Manufacture of refined petroleum products	1.0	0.2	0.1	0.1	0.1
Manufacture of chemicals and chemical products; manufacture of rubber and plastic products	3.0	0.7	0.3	0.1	0.0
Manufacture of other non-metallic mineral products	10.0	7.0	5.0	3.0	3.0
Manufacture of basic metals and fabricated metal products	10.0	7.0	5.0	3.0	3.0
Manufacture of machinery and equipment	10.0	7.0	5.0	5.0	5.0
Manufacturing n.e.c.	10.0	7.0	5.0	3.0	3.0

Source: Own calculations on the basis of database of State Statistic Service of Ukraine and EU-Ukraine Association Agreement.

Table 3. – The specific projects of the Eastern Partnership implemented by NGO in Ukraine

Projects and programs of the Eastern partnership platforms	Percent of the total projects (%)	Quantity	Estimate (EURO)
<b>2013</b>			
Energy security	0.0	0	0.0
Contacts between people	0.0	0	0.0
Economic integration and convergence with EU policies	0.0	0	0.0
Democracy, good governance and stability	100.0	1	2070.0
Total for the year:	100.0	1	2070.0
<b>2012</b>			
Energy security	6.1	3	48721.0
Economic integration and convergence with EU policies	14.3	7	111441.0
Contacts between people	16.3	8	86347.0
Democracy, good governance and stability	63.3	31	294613.0
Total for the year:	100.0	49	541122.0
<b>2011</b>			
Energy security	1.8	1	13233.0
Economic integration and convergence with EU policies	14.6	8	97872.0
Contacts between people	20.0	11	79099.0
Democracy, good governance and stability	63.6	35	340670.0
Total for the year:	100.0	55	530874.0
<b>2010</b>			
Economic integration and convergence with EU policies	0.0	0	0.0
Energy security	8.4	6	64420.0
Contacts between people	34.7	25	164494.0
Democracy, good governance and stability	56.9	41	362903.0
Total for the year:	100.0	72	591817.0

Source: Delegation of European Union to Ukraine ([http://ccas.europa.eu/delegations/ukraine/projects/list\\_of\\_projects/projects\\_en.htm](http://ccas.europa.eu/delegations/ukraine/projects/list_of_projects/projects_en.htm)); European Union Border Assistance Mission to Moldova in Ukraine (<http://www.eubam.org>);

European Space: portal for pro-European civil society of Ukraine (<http://eu.prostir.ua/themes/rada.html>).

Major funding for the projects implemented in Ukraine by EU funds fall into: governance, democracy, human rights and support for economic and institutional reforms (24.1%); infrastructure, communications and transport (21.9%); trade and regional integration (16.5%) (see Table 4).

Table 4.  
Projects implemented in Ukraine from EU funds

Sector	Quantity	Estimate (EURO)	Percent of the total projects
Rural development, territorial planning, agriculture and food security	1	1200000.0	0.4
Social cohesion and employment	3	1929430.0	0.6
Multi-sectors	3	3207146.0	1.0
Human development	7	3533752.0	1.1
Conflict prevention	2	26500000.0	8.4
Water and energy	24	39764470.0	12.7
The environment and the sustainable management of natural resources	6	41542972.0	13.2
Trade and regional integration	5	51747500.0	16.5
Infrastructure, communications and transport	4	68944166.0	21.9
Governance, democracy, human rights and support for economic and institutional reforms	36	75859860.0	24.1
<b>Total:</b>	<b>91</b>	<b>314229296.0</b>	<b>100.0</b>

Source: Delegation of European Union to Ukraine ([http://ec.europa.eu/delegations/ukraine/projects/list\\_of\\_projects/projects\\_en.htm](http://ec.europa.eu/delegations/ukraine/projects/list_of_projects/projects_en.htm)); European Union Border Assistance Mission to Moldova in Ukraine (<http://www.eubam.org>); European Space: portal for pro-European civil society of Ukraine (<http://eu.prostir.ua/themes/rada.html>).

The initiative "Eastern Partnership" has become a reality. It transferred from phase of discussions – from the wording of the provisions in the phase of discussions over its content and practical projects and undertakings.

We realize that the "Eastern Partnership" is neither a guarantee to achieve the full integration of the Eastern partners into the EU nor a path to EU membership. It is a mechanism, a set of complementary features, tools, whose effective use will bring Ukraine closer to its strategic goal.

Disadvantages of the «Eastern Partnership»:

- lack of funding for the ambitiously stated objectives in multilateral – format forces the EU and partner countries to focus on the implementation of several projects;
- difference between strategic objectives and national interests of the partner countries – might lead to a slowdown in the implementation of multilateral dimensions of the initiative;
- the declared thematic platforms and flagship initiatives do not reflect all major worries of the majority of the partner countries.

Main problems and expectations concerning the Association Agreement between Ukraine and the EU, and in particular to establish DCFTA, are identified based on the research Institute for Economics and Forecasting National Academy of Science of Ukraine.

## **The labor market:**

### **Potential benefits:**

- approximation of the labor legislation of Ukraine with the requirements and standards of the EU;
- making the rules, regulations and labor standards in line with international standards;
- creation of new jobs in export-oriented sectors of the economy;
- improving the investment climate and business environment;
- increasing the competitiveness of the labor force and productivity;

- implantation of a new corporate culture, assimilation of population market labor values and attitudes;
- increasing motivation to content work and the possibility of achievements and value orientation to initiative and success.

### **Potential threats:**

- closing or curtailment some part of non-competitive and production without perspective can lead to tension in the labor market;
- layoffs during restructuring of enterprises;
- loss of jobs because of lower competitive workforce, unwillingness to work with higher intensity on European standards;
- deepening asymmetry in the labor market, from which employers receive benefits;
- deforming economic consciousness, clash of opposing values, difficulties adaptation period;
- increasing the number of young Ukrainian, who will leave for training in universities of EU countries.

### **Trade regime:**

#### **Potential benefits:**

- according to the conditions of free trade agreements by WTO, in particular: full liberalization is covering at least 95% of tariff lines and volume trade between the sides depend on what of that from two indicators was reached first reducing the number of tariff lines excluded from free trade by making the number of sectoral initiatives to "0.0";
- rejection of the use EU export subsidies in bilateral trade with Ukraine;
- provision of Ukraine duty-free market access for the most sensitive EU products within tariff quotas, tariff quotas of compliance for most tariff lines Ukraine export capacity and interests of domestic producers to expand the range of product export;
- protecting markets of the most sensitive goods of Ukraine due to their partial liberalization and tariff quotas for duty-free imports from the EU in a small volume;

- agreement on Ukraine's right to apply special protective measures or additional terms of trade liberalization on the most sensitive products.

**Potential hazards:**

- significantly lower current level of tariff and non-tariff protection in Ukraine than in the EU creates discriminatory initial conditions for regional integration;
- FTA with the EU only partially eliminates asymmetrical trade regimes. From 9699 EU tariff lines only 8674 will be liberalized immediately after the introduction of the FTA, 732 - over a period of 1 to 7 years and tariff quotas will be established in 362 tariff lines, including the vast majority, namely 339 lines, which represent agricultural products. It means that the tariff quotas are set on 15%;
- current inability of most of the domestic producers to satisfy the technical, sanitary and phytosanitary conditions for exporting their products to the EU markets, that will prevent increasing of exports of domestic products under the tariff quotas frame allocated to Ukraine;
- small volumes of the EU tariff quotas of duty-free import products from Ukraine (with some exceptions) and not full coverage commodity nomenclature of agricultural products; in case of renegotiation of the Agreement the substantial reduction of the number of exclusions from the FTA with the EU and the increase of tariff quotas for the remaining tariff lines (especially corn, soybeans, barley, poultry) must be defended.

**Metallurgy:****Potential benefits:**

- eliminates the possibility to initiate trade restrictions on steel production in Ukraine;
- the opportunity to continue the integration processes at steel companies is created;

- expanding of the presence in the EU market through further integration capacities;
- augmentation of the investment flows, including through joint implementation projects (Kyoto Protocol);
- modernization of metallurgical facilities.

### **Potential hazards:**

- cost increasing on reduction of the harmful effects of metal production on the environment;
- dramatically increase the cost of production due to higher costs for raw materials and environmental measures compared to EU companies;
- zero tariffs on steel import will increase competition in the domestic market;
- changes in tariff policy and state aid will lead to a redistribution of income between the sectors of mining, metallurgy and energy;
- reduced subsidies;
- reduced revenues from export duties.

### **Energetics:**

#### **Potential benefits:**

- expanding exports of electricity, and medium and heavy distillates. The economic benefits from expanding exports are valued at no more than \$ 50 million while maintaining exports in 2012;
- according to present active legal documents in the case if the signing of the Association Agreement of Ukraine with the EU occurs, any sanctions or trade restrictions imposed by the Customs Union towards Ukraine as a third party are not expected.

#### **Potential hazards:**

- signing of the association agreement between Ukraine and the EU will not affect the terms of energy trade with third countries, because the terms of the agreement are largely repeated commitments of Ukraine to the Energy Community. Potential risks



such as reducing transit, loss of integrity of the technical energy systems, the formation of monopoly industry structures, the transfer of powers to supranational regulators, etc. are largely politically motivated and depend on the method (consistency and coordination) of liabilities.

## **Machinery:**

### **Potential benefits:**

- acceleration of the modernization of domestic engineering by facilitating access to scientific and technological achievements of the European countries;
- raising of the technical level and competitiveness of Ukrainian products due to the adaptation of domestic production to technological and environmental standards of the European countries;
- abolition of the outdated regulations, which have no analogues in the EU, and the continuation of the development and adoption of the technical regulations subject to the provisions under the EU regulatory framework (*acquis communautaire*), national standards and requirements environmental protection, harmonized with international and European standards;
- reduction of the rates (average about 30%) on importable duty vehicles that come from Ukraine will contribute the increasing of the competitiveness of domestic products;
- the possibility of applying some safeguarding measures in the form of higher tax rates on cars originating from the EU countries (heading 8703), if the quantity of goods imported into the territory of Ukraine, causing a significant damage to domestic industry;
- establishing zero rates importable duty on investment types engineering products, which will accelerate the technological modernization of the Ukrainian industry.

### **Potential hazards:**

- an increase of the competing imports on the domestic market of Ukraine, including cars, tractors, combine harvesters;

- relatively high barriers for entry of domestic producers on the European market, because Ukraine is on a lower level of technological development than the EU;
- increasing dependence of Ukrainian machinery on imported high-tech equipment on both - as end-use products and components used in the assembly of well-known foreign brands;
- a decline in export to the countries of the Customs Union by introducing safeguards to the internal market.

## **Food and Beverage:**

### **Potential benefits:**

- significant reduction or gradual abrogation of tariff rates on industrial food (about 85% of tariff lines) that are not covered by tariff quotas;
- receiving the eligibility for duty-free access to European markets of milk powder and condensed milk, cream, yogurt, butter and milk paste, sugar, syrups, juices, starch, flour and certain other types of food as well as cigars and cigarettes under established tariff quotas;
- harmonization of national standards with the international and the European standards;
- adaptation of the national technical regulations, sanitary and phytosanitary measures in the European and international requirements.

### **Potential hazards:**

- weakening of the competitive position and reduction of the revenues for small and medium-sized domestic food processing enterprises due to increasing competition in the domestic market;
- possible reduction of the amount of production of oil and fat industry due to the elimination of export duties on sunflower seeds;
- risk of significant loss of Ukrainian wineries and cognac food industry market products, which were shaped by the system of protection of geographical indications and industrial products;

- the risk of loss of food industry markets products in the Customs Union.

## **Agriculture:**

### **Potential benefits:**

1. FTA has advantages for agriculture due to:
  - rapid increase in domestic agricultural exports (by 26% in the structure of merchandise exports against 18.7% in 2011), which shows that Ukraine is a net exporter of agricultural products, including in the EU;
  - dynamic growth of exports of agricultural products in the EU: in 2012 the value of agricultural exports from Ukraine to the EU increased by 54% (from \$3.18 billion in 2011 to \$4.92 billion in 2012). Agricultural export to the EU is developing more rapidly than export to the countries of Customs Union. Value of agricultural exports to the EU in 2012 is 1.8 times higher than the value of agricultural export to the EEA.
2. Expanding trade opportunities for agriculture in Ukraine according to FTA is created by partial reduction of asymmetric modes of trade in agricultural products between the EU and Ukraine by:
  - duty-free access for Ukrainian agricultural products under the tariff quotas. The tariff quotas sizes correspond to the traditional imports from Ukraine to the EU on certain goods quotas taken into account the expected trends of domestic production in the country. Ukraine will provide 1.6 million tons of grain duty-free to the EU, with a gradual increase in quotas for 5 years to 2 million tons;
  - rejection of the use of EU export subsidies for agricultural products for export to Ukraine;
  - consolidation of the right for Ukraine to use the protective measures;
  - facilitation for Ukraine under the FTA with the EU of the customs tariff applicable EU agri-food products;

- high probability of an increase in export of certain types of agri-food products, including those that are growing set quota;
- facilitating access to quality inputs (seeds, pesticides, machinery, etc.);
- upgrading and modernization of domestic agricultural and food production.

### **Potential hazards:**

- small amount of import quotas to the EU duty-free importation of goods from Ukraine and not full coverage of the commodity nomenclature of agricultural products. In the case of reviewing the terms of the Agreement, it would be good to defend the significant decrease in the number of exceptions to the FTA with the EU and to promote the increase in tariff quotas for the remaining tariff lines (especially corn, soybeans, barley, poultry);
- current inability of most of the domestic producers to satisfy the technical, sanitary and phytosanitary conditions for exporting their products to the EU markets, that will prevent increased exports of domestic products under the tariff quotas frame allocated to Ukraine;
- weakening domestic producers of meat and meat products, fruits and vegetables as a result of increased imports from the EU. In particular, the establishment of a tariff quota on pork imports from the EU will lead to an increase in imports of pork for a maximum of 8%;
- increasing the competing import in the domestic food market of Ukraine if the restrictions under domestic exports to the EU are active;
- lower revenues for small and medium-sized agricultural enterprises as a result of increased competition in the domestic agricultural markets;
- increasing domestic consumer prices of products that meet the requirements of European and international regulations due to high costs of harmonization;
- increase in the share of low-quality products in the Ukrainian agro-food import that have not found sales on the EU market;

- increasing dependence of domestic agricultural producers on imports of inputs for domestic limited alternative sources of replenishment;
- slight reduction in oil and fat production with all the attendant consequences due to gradual abolishment of export duty on sunflower seeds;
- worsening the problems in dealing with the countries of Customs Union and the likely effect of introducing it in import tariffs for Ukraine;
- the need for additional financial resources for technical and technological re-equipment of enterprises to ensure their competitiveness in the new environment.

For certain groups of agro-food production *potential advantages* can be:

- the introduction of zero tariffs on imports of a large number of products from Ukraine, not only of raw materials (dried peas, oilseeds), but also for deep processing products (oils, some types of canned products);
- temporary storage agreement with the EU (albeit with a gradual decline over 10 years) export duties on sunflower seeds and flax;
- under the FTA with the EU should also be imposed export duties on rapeseed (10 years with a phased reduction).

In the case of integration with the EU on the above mentioned products can be expected *following hazards*:

- gradual strengthening of the European products on the domestic market such as tomatoes, cucumbers, apples, butter, canned and processed vegetables, fruit and vegetable juices;
- application restrictions for Ukrainian exports from the Customs Union.

### **State aid:**

Potential advantages of regulating state aid under the Association Agreement between Ukraine and the EU are as following:

- increasing of the transparency of decision-making on state aid;
- reduction of the state aid and corresponding reduction in budg-

et expenditures due to the abolition of measures which have a negative impact on trade between Ukraine and the EU;

- monitoring of the impact of state aid on competition and the abolition of most adverse to competition of aid;
- control over the legality of state aid stipulates that in case of granting illegal aid granted to the company is obliged to return the money the state and offset other losses in the form of penalties and interest on capital.

### **Potential hazards:**

- narrowing of the space for the application of state aid (primarily industry and to support individual businesses). Potentially, under the frame of abolition or limitation may fall the public support for the coal industry, aerospace, shipbuilding, etc.;
- negative impact on the economy of the elimination of state aid measures for businesses that previously received it;
- loss of the support tool for managing of domestic producers that compete with higher quality products in the EU;
- complexity of bureaucratic procedures in the approval process of the new measures of the state aid. The need for a new level, controlling the provision of such assistance;
- increasing of the budget expenditures related to the control of the state aid;
- terms of the Agreement require amending the rules of the European legislation regarding the recognition criteria in public spending state aid.

## **Conclusions**

Calculations by dynamic input-output model show, that in the early years of the Agreement the negative consequences of the replacement of chemicals, machinery and metallurgy partly can be compensated by new opportunities for enterprises of light industry, agriculture and for a number of food companies. These opportunities arise as a result of lower rates of customs duties. Generally, cumulative positive trade effects of the Agreement for the first year (2014) partly will be leveled by the reducing production

between 2015 and 2017, and will turn to negative in 2017. The slowdown of growth in production is estimated to be 0.15% per year on average between 2015 and 2017. Since trade effects have their positive impact only in a short-term, a technological re-equipment of industries will be necessary, and it is possible only if the implementation of investment programs allows domestic enterprises to upgrade to a modern technological level.

It should be noted, that if the domestic producers of machinery, metallurgy and chemical industry does not take effective measures to modernize production, there will be deep disparities in the technological structure of production, and a possible losing of further domestic and foreign markets will happen along with potential losses in trade with the countries of the Customs Union, especially if they continue the policy of import substitution and the mechanisms of tariff and non-tariff barriers previously declared.

In case of decreasing economic activity there are significant risks for the industries in the commitment to implementation of technical regulations and other acts of the EU in terms of 2-3-5-7 years, due to the problematic implementation of such significant legislative material in the above terms. It is important in the adaptation of legislation to determine the necessary sources and devote significant financial resources for the process of implementation.

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