

INEXPEDIENCY OF UKRAINE'S PARTICIPATION IN THE CUSTOM UNION OF BELARUS, KAZAKHSTAN AND RUSSIA: EXPERTS ARGUMENTS

Policy paper

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More info at <http://eu.prostir.ua/themes/rada.html>.

The aim of the project "The creation of the Ukraine's EU integration policy analysis platform within the Civic Expert Council within the Ukrainian Part of the EU-Ukraine cooperation Committee" being implemented by "Centre UA" NGO with the support of the International Renaissance Foundation (IRF) European programme is to provide organizational support and analytical covering of the Civic Expert Council activity. The aim of the IRF European programme is to facilitate Ukraine's EU integration through financial and expert support of civic initiatives.

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EXECUTIVE SUMMARY

Fierce debates on possible membership of Ukraine in the Customs Union of Russia, Belarus and Kazakhstan generate professional expert arguments. In this respect we need independent economic and juridical analysis devoid of political bias. Gas prices question requires separate consideration and explanation. The authors of the given analytical material focused on these very issues.

The main conclusions are:

1. In legal terms Ukraine's possible participation in the Customs Union involves international agreements that violate the Constitution of Ukraine. It is referred to the withdrawal of certain powers from the Verkhovna Rada and violation of legal decision-making procedure in Ukraine. According to Art. 92 of the Constitution of Ukraine:
 - the customs foundation is exclusively established by the laws of Ukraine (the issue of accession to the CU Customs Code);
 - the State Budget of Ukraine, taxes and charges are exclusively established by the laws of Ukraine (the issue of establishing a common customs tariff within the CU, the procedure for duties collection and transfer to the state budget).

Moreover, mandatory membership in the EurAsEC and supranational, legally-binding decisions taken by this international organization without the consent of individual States Parties threaten the sovereignty and independence of Ukraine as a country.

2. The author of economic analysis unequivocally explains why Ukraine should make the most of existing trade regime between Ukraine and the Russian Federation, Belarus and Kazakhstan, these are - the Free Trade Agreement (signed in early 1990s) and rejects the offer to participate in the Customs Union.

Foremost, this is due to the fact that Ukraine is a member of the WTO and, therefore, committed itself to bound import duties. The commitments' review is theoretically possible, however, it is quite expensive. Secondly, comparison of the average import duties in the Customs Union and Ukraine points to a lower protection level in Ukraine. Finally, the possible membership in the Customs Union is not going to create significant additional competitive advantages or new product niches for Ukrainian exporters.

3. In the context of gas prices one should understand clearly that they are not mentioned in the agreement to create the Customs Union between Russia ,Belarus and Kazakhstan. Accordingly, these issues will be regulated by separate agreements that can be made without the Customs Union membership. In the next place, Russia is planning to change regulation system of energy prices on the domestic market, leading to their significant growth, and thus eliminating the potential benefits of Ukraine when accepting “Russian domestic prices”. Moreover, the extension of understated energy prices period in Ukraine does not stimulate energy saving, and thus negatively affects the country’s possibility to adapt to the future energy prices changes.

The authors distinguish the following basic principles:

- ▶ Members of the Civic Expert Council believe that the process of Ukraine's preparation to sign the Association Agreement with the European Union is the single option, which includes extended and comprehensive free trade area (FTA +) between the EU and Ukraine. This position is reflected in strategic documents of Ukraine, European integration course of Ukraine is determined by the official development rate of Ukraine which no one can question;
- ▶ Ukraine's European integration process - is not its foreign-political activity, but the internal reforms implementation process;
- ▶ the process of meeting the EU norms is not a project aiming to counter Russia, it is an obvious process chosen by the four countries of the Eastern Partnership and three other CIS countries.

I THE ANALYSIS OF CERTAIN LEGAL ARGUMENTS OF DISCOURSE ON THE FEASIBILITY OR INEXPEDIENCY FOR UKRAINE BEING INVOLVED IN A CUSTOMS UNION OF BELARUS, KAZAKHSTAN AND RUSSIA

A number of legal arguments appear when considering the expediency or in expediency of the CU membership for Ukraine. The purpose of this analysis is the argument's systematization of and its close scrutiny.

First, we should establish the legal nature of CU. Furthermore, we should define the very participation of Ukraine in the CU (or a form of cooperation between Ukraine and MS, such as FTA, "3+1 Formula"). After that we can consider whether Ukraine's participation in CU or a form of cooperation corresponds to the existing principles of law.

Complexity of the legal analysis on the possibility of Ukraine to participate in CU means close interweaving of the two legislations - International (existing international legal obligations of Ukraine in international trade) and Internal (existing constitutional and legislative restrictions of the Government of Ukraine on the conclusion of international agreements).

CU LEGAL NATURE AND THE GIST OF "CU PARTICIPATION"

It is quite difficult to define the legal nature of CU, as there is no consistency in building CU legal foundation which includes more than fifty documents.

One can distinguish at least four stages of CU establishment, which are politically, economically as well as legally justified. As a result we have four packages of documents with four different CU regulations. The following international treaties laid the foundation of each of them:

1. two CU agreements concluded in January 1995 between Belarus, Kazakhstan and Russia which consolidated the steps for creating a customs union, subsequently joined by Kyrgyzstan (1996) and Tajikistan (1999);
2. Agreement on CU and CES 1999 between Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan which identified measures to complete the CU and form CES on its basis, created an integration management system;
3. Treaty on establishing the Eurasian Economic Community (EurAsEC) in 2000 between Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan which **created an international organization with its own international legal system** and institutions, within which Member States provide CU and CES. Since then, direct indication of the EurAsEC founding treaty has been fixed in agreements in respect of CU . In 2006 Uzbekistan joined the Eurasian Economic Community;
4. it was resolved in 2006 that CU and the CES will initially be carried out by three countries - Belarus, Kazakhstan and Russia, subsequently joined by other states - members of the EurAsEC. On this basis, in 2007 the three States concluded an agreement establishing a single customs territory and the formation of CU. Tens of agreements were concluded during 2007-2010, including The CU Customs Code of the CU. Customs union started to operate in July 2010.

The key problem of establishing the legal nature of CU is that all these documents do not only coexist, but are also used as a standard array. However, they have different MC status, manifested even in terminology.

For instance, you can encounter different names of MS: "Customs union", "customs union" and "Customs Union within EurAsEC", as well as different names of countries participating in the CU: these are mostly the parties to the agreement, but sometimes they are called "participating countries to an agreement about CU", "countries - members of CU".

Analysis of the contractual CU framework provides the following conclusions as for its legal nature:

- **CU does not have (and never did) the international legal personality and is not an international organization. Implications:**
 - incorrect use of terms "membership in CU" and "state - a member of CU, seeing that it is not an international organization. "Participation in the CU is correct.
 - the lack of CU subjectivity explains nonjustified capitalization (Customs Union or Customs union). "customs union" is correct.
 - possible FTA between Ukraine and the CU can not be concluded as an agreement between Ukraine and the CU.
- **CU has always been a form of multilateral cooperation between its member countries.**

After creating EurAsEC CU became a kind of enhanced cooperation within this organization on the basis of its incorporation (analogues in the EU - the euro zone, Schengen Area). Implications:

- legally correct name CU - "customs union within the EurAsEC, which sometimes occurs in official documents (for example, the Statute of the Court EurAsEC).
- **An obligatory prerequisite for participation in the CU is the EurAsEC membership**, contract with its member states to accede to the Treaty establishing the EEC 2000 (precedent Uzbekistan). Accordingly, there should be clear understanding in Ukraine that "CU participation" means EurAsEC membership.
- The CU is served by the Eurasian Economic Community and operates on the basis of the EurAsEC Memorandum.
- Functions of the EurAsEC Court are assigned to the CIS Economic Court. Therefore it is necessary to investigate the issue whether the accession to the constituent documents of CIS Economic Court (Charter of the CIS, "Status of the Economic Court) is the condition of the CU participation.
- Within the EEA and CU decisions can be made on the basis of supranational, legally-binding decisions are taken without the consent of individual States Parties.

In addition to the EEC membership, the second prerequisite of the CU participation is an agreement (agreements) with Belarus, Kazakhstan and Russia to accede to the whole (!) set of international agreements that make the legal CU base.

As for other forms of cooperation between Ukraine and the CU (eg, FTA), they should be documented as an agreement (agreements) between Ukraine, on one hand, and all the CU countries - participants (and possibly EurAsEC), on the other hand.

DOES UKRAINE'S PARTICIPATION IN THE CU CONFORM TO THE CONSTITUTION OF UKRAINE?

In the legal aspect this question has two independent dimensions: substantive and procedural one.

In substantive terms it is about competence, Will Ukraine's participation in the CU result in separate powers deprivation, conferred by the Constitution of Ukraine (hereinafter - CoU), as well as compliance with the form of making these decisions.

First of all, the Parliament of Ukraine might be deprived of certain powers and certain decisions in the form of law in Ukraine might be violated. According to Art. 92 CoU:

- the foundations of customs are established by the laws of Ukraine (the possibility of accession to the Customs Code CU);
- the State Budget of Ukraine is established by the laws of Ukraine , taxes and charges (the issue of establishing a common customs tariff within CU, the procedure for duties' collection and transfer to the state budget). Moreover, according to art. 67 CoU "Everyone has to pay taxes and levies in the manner and extent established by the law".

In this context there arises the question to limit the jurisdiction of judicial bodies of Ukraine (including the jurisdictional powers of the Court of EurAsEC, which can provide legally binding interpretation of agreements on CU). It is necessary to mention that the Constitutional Court of Ukraine recognized the Rome Statute of the International Criminal Court incongruous to CoU (2001).

Another issue in substantive terms – the violation of Ukraine's sovereignty and independence as a result of CU participation (in the context of legally-binding decisions for Ukraine without their consent within the CU Commission and EurAsEC Court).

There were made some allegations regarding procedural and legal aspects, especially in terms of the possible completion timing of the constitutionality issue.

Only the Constitutional Court of Ukraine can define whether the decision of Ukraine's participation in the CU is appropriate according to CoU. It is important to understand that the Court operates under clearly established procedures, because the CoU and the law clearly define who, how and on what grounds can appeal to the Court to clarify this issue.

- Only the President of Ukraine or the Cabinet of Ministers of Ukraine can call to conclusions on the CoU of the international treaties of Ukraine or the international treaties submitted to the Verkhovna Rada of Ukraine and consent to their obligation. (Article 151 CoU).
- The Constitutional Court does not respond to abstract questions, even if they are important or interesting. Therefore it can not answer the question of the constitutionality of Ukraine's accession to the CU until the relevant international agreements are signed.
- Article 9 of CoU clearly establishes the Constitutional Court decision on the inconsistency of the international treaty CoUG: "The conclusion of international treaties that contravene the Constitution of Ukraine is possible only after introducing relevant amendments to the Constitution of Ukraine.

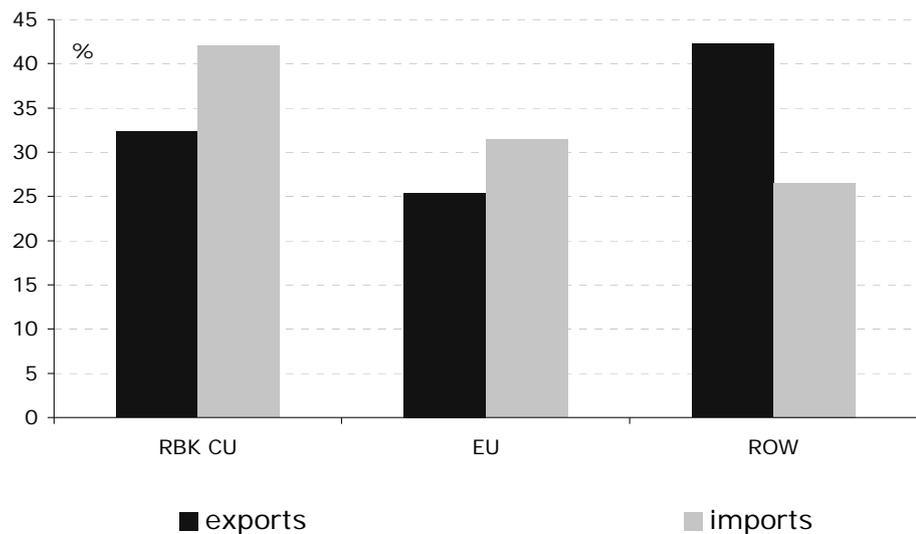
Based on the mentioned above we can make the following conclusions:

- ▶ The issue of the agreements' correspondence to CoU on Ukraine's participation in the CU involves three-set question analysis: (1) whether the constitutional powers of certain authorities of Ukraine will be limited, (2) whether the established CoU form of decision making will be maintained, (3) whether the sovereignty and independence of Ukraine as a country will be limited;
- ▶ There are strong reasons to believe that international agreements on Ukraine's participation in CU can be considered as not corresponding to CoU;
- ▶ Constitutional Court of Ukraine can define the constitutionality only after such agreements are signed;
- ▶ if these agreements are found to be unconstitutional, Ukraine's participation in the CU is going to involve amendments of CoU.

II MEMBERSHIP OF UKRAINE IN THE CU - THE PRICE ISSUE: ECONOMIC ASPECT

Ukraine is a country with a poor open economy which primarily relies on foreign trade. Exports amounted 50,2% of nominal GDP in 2010, while the imports ratio to GDP reached 53.0%. Recently created Customs union of Russia, Belarus and Kazakhstan (RBC MT) and the EU-27 are the largest trading partners of Ukraine. These two customs unions accounted for about two-thirds of total external trade turnover of Ukraine in 2010.

Figure 1. The geographical structure of trade in goods of Ukraine in 2010



Source: Ukrainian State Committee on Statistics (USCS), IER estimates

The trade regimes between the EU and Ukraine and Ukraine and RBC CU are different. Trade with the EU implies favourable treatment as well as tariff discounts offered by the EU under the Generalized System of Preferences. Trade with Russia, Belarus and Kazakhstan has existed under terms of the free trade agreements for nearly two decades. These agreements mainly relate to fees and provide exclusion from the free trade regime. Non-tariff measures are of primary importance in commodity trade both with RBC CU and the EU.

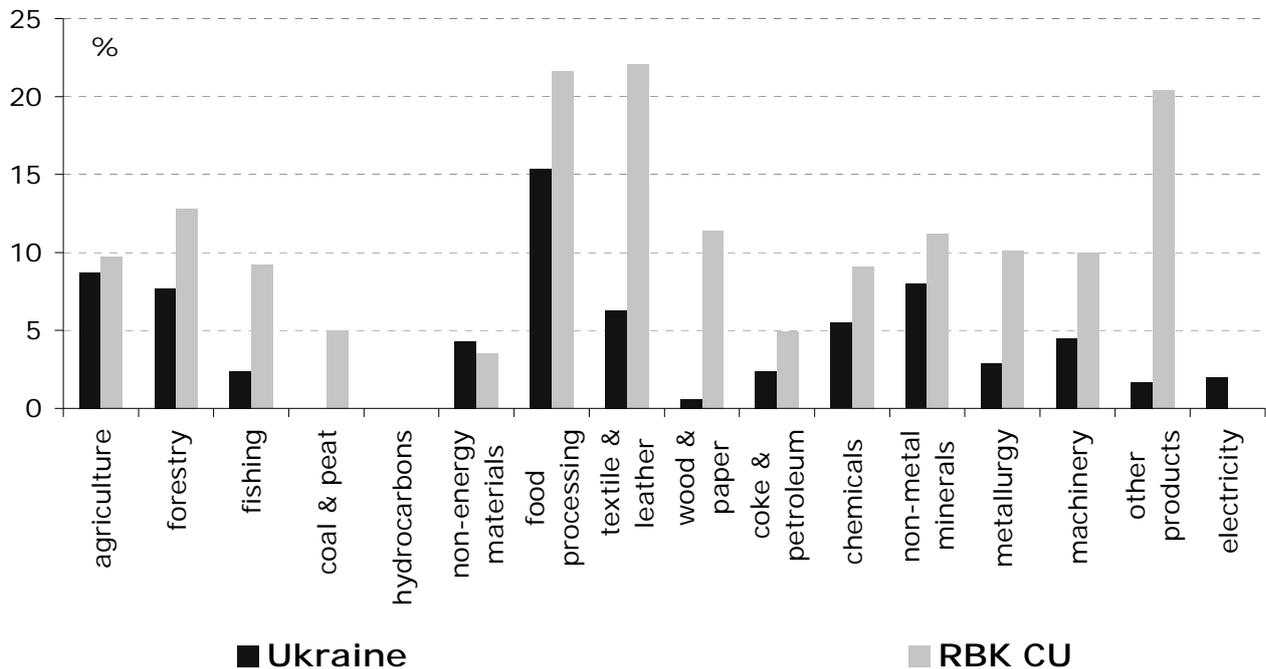
REVISION OF IMPORT DUTIES: WTO COMMITMENTS

Ukraine joined the WTO and, accordingly, committed itself to import duties.

Review of these commitments is theoretically possible, however, it is expensive, as other Member States have the right to claim compensation in the form of equivalent concessions or to establish additional duties for Ukrainian goods to offset the losses associated with obligations changes.

Comparison of average import duties of RBC CU and average bound duty of Ukraine shows a significant difference of tariff protection level. Security level is higher in the case of RBC MC for thirteen of the sixteen sectors (Figure 2).

Figure 2. Rate of import duties in Ukraine and countries of the Customs Union



Sources: Calendar of bound import duties of Ukraine (www.wto.org), "The indicative level of tariff protection in Kazakhstan: before and after the Customs Union establishment (Part I)" Article № 5.3, March 2011. ANGLE Center for Economic Analysis

Dispute settlement mechanism, including the tariff commitments revision, involves several stages. Foremost, the contracting party intending to modify or withdraw the concession has to:

- negotiate with parties that have immediate negotiating rights, i.e. the countries that have the concession agreed upon bilateral discussions with respect to adequate tariff policy according to information from the tariff commitments calendar
- negotiate with major suppliers, i.e. the countries which are primarily concerned
- consult with other parties interested in the concessions.

There might be several options for the decision adoption according to the results of negotiations and consultations:

- The primarily concerned parties reached the consensus, and the interested ones came to an agreement. Alterations are being introduced in the concession calendar;
- The primarily concerned parties reached the consensus, while the interested ones are not satisfied. Subsequently, the latter have the right to withdraw substantially equivalent concessions;
- The parties did not reach an agreement. In this instance, the party that wants to change or withdraw the concession is entitled to do that. However, every other parties have the right to withdraw substantially equivalent concessions.

It is worth mentioning that the requirements for equivalent concessions and their withdrawal involve party's most important trading positions.

NON-TARIFF COMMITMENTS OF UKRAINE: THE INABILITY TO CALCULATE IN ADVANCE THE VALUE OF THE NEGATIVE CONSEQUENCES WHEN VIOLATING WTO COMMITMENTS

As WTO member Ukraine has to fulfill its Agreements which make a part of the country's regulatory framework. Meanwhile, Russia, Belarus and Kazakhstan are negotiating only on WTO membership, therefore they are not bound by WTO rules. The difference of regulatory framework creates additional barriers to join RBC CU.

Within the framework of joining WTO Ukraine has made a number of commitments as to non-tariff regulation of trade in goods (quantitative restrictions, technical regulations, sanitary and phytosanitary control, etc.), as well as trade in services, intellectual property rights and so on.

In areas where appropriate regulation should be made consistent for all participating countries RBC MC there appear the questions on the commitments' coordination within the WTO principles and rules operating under the CU.

IMPACT OF THE CU MEMBERSHIP ON THE COMPETITIVE ADVANTAGES OF UKRAINIAN EXPORT

The trade regulations between Ukraine and the Russian Federation, Belarus and Kazakhstan are governed by the provisions of Free Trade Agreements signed in the early 90s of the last century. We should emphasize that similar bilateral agreements remain in force with other CIS countries. The attempt to sign the free trade agreement among all the CIS participants failed - some countries, including Russia, did not ratify the agreement. Free Trade Agreement within the CIS was officially ratified in Ukraine on October 6th, 1999 and entered into force on December 15th, 1999.

All the tenors of Free Trade Agreements within the CIS, including agreements with participating countries of CU are quite similar. Agreements provide duty-free trade in all categories of goods, but with the possibility to advance unidentified seizures. Most Favored Regime is applied to the products, withdrawn from the free trade regime.

Reciprocal withdrawal from the Free Trade is being practiced in response to the export duties, quotas and licensing established by a trading partner. Thus, in 2010 exclusion list consisted of about 115 items of Russian exports, including fish products, mineral products, fertilizers, etc., and some Ukrainian export products, including cattle, hides and scrap metal. Withdrawals may also be set by individual protocols.

Potential benefit of regional integration with the CU could be a withdrawal repeal from the Free Trade Regime, which is now in force between the countries. However, the same effect can be achieved under the Free Trade Regime, having agreed to abolish the withdrawal and limitations.

Customs control elimination within the CU generates some benefits, but a similar benefit can be gained from the Customs Service reform of Ukraine, in case the reform is successful. Moreover, customs reform is going to stimulate the trade with all countries and that means no trade diversion.

Trade pattern of the CU participating countries is oriented to the market outside the CIS, despite the existing free trade agreement and relatively high tariff protection. For example, Russian export to Ukraine is about 5% of total exports, while imports from Ukraine - about 6% of total imports. There is no economic reason to anticipate a significant change in these proportions in the context of Ukraine's CU membership.

It is interesting to have a look at trade in high-tech goods, which are a source of economic modernization. Russia imports only 2% of the goods from Ukraine, another 1% from the rest of CIS countries, including Belarus and Kazakhstan, 35% from the EU countries and 62% from all the rest countries of the world. Moreover, RBC CU participating countries are not the major consumers of high-tech exports even for Ukraine. Nearly two-thirds of Ukrainian high-tech exports are sold to the countries outside the RBC CU, including 37% - in the EU-27.

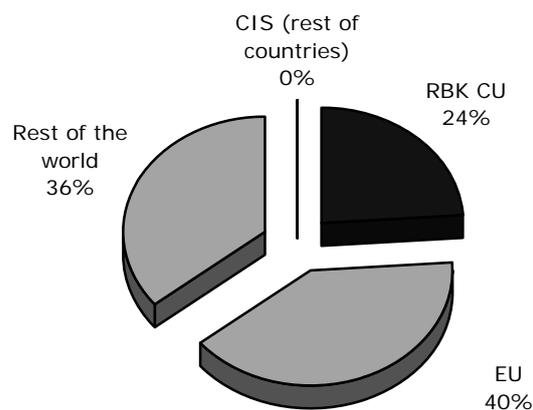
Consequently, the very CU membership creates neither significant additional competitive advantages nor new product niches for Ukrainian exporters, and existing trade barriers with the CU participating countries might be eliminated in other forms of regional integration.

INCREASING EXTERNAL BARRIERS - IMPLICATIONS FOR BUSINESS

Higher import duties in RBC CU imply the fact that if Ukraine joins the CU, it is going to face increased imports costs that will result in trade diversion towards Russia, Belarus and Kazakhstan.

Higher import duties of RBC CU on chemicals, machinery and equipment will force Ukraine to pay higher price for the access to new technologies and innovative products, coming from other countries. This is particularly important as the RBC CU countries are not the primary source of imported high-tech goods in Ukraine. Ukraine imports about 40% of the goods from the EU countries and 36% of the rest countries of the world (Figure 3).

Figure 3. Geographic structure of high-tech imports to Ukraine



Source: UN Comtrade, OECD, IER estimates

WHICH FORMAT OF COOPERATION WITH THE CUSTOMS UNION (CU) IS BENEFICIAL FOR UKRAINE AMID UKRAINE FTA + BETWEEN UKRAINE AND THE EU?

For and against arguments analysis leads to the conclusion that the advanced FTA with the EU is undoubtedly a more profitable option from an economic point of view. Closer economic ties with the EU offer Ukrainian exporters better access to the rich and populated market with transparent and predictable business environment. In addition, deep FTA introduction will lead to the regulatory environment harmonization in Ukraine, provide better business environment that is important for investors and economic development in general.

At the same time CU membership with Russia, Belarus and Kazakhstan might lead to short-term controversial benefits in terms of getting cheap energy. In the long term net outcome could be Reorientation of trade flows and slow technological modernization can be regarded as long-run prospect, as investment goods import is going to become more expensive.

The strategic interests of Ukraine consist in deep ties in terms of the free trade zone. The experience of Chile might be useful for Ukraine, as this country is carrying out diversified trade policies, having created a network of various regional trade agreements around the world.

III ENERGY PRICES ARE NOT THE ARGUMENT

The current direction of the Russian political leadership to involve Ukraine in CU is fairly the continuation of the traditional accumulative strategy and Kharkiv agreements between Ukraine and Russia in 2010. Russia is trying to create the foreign policy vacuum around Ukraine in order to make the Russian post-Soviet integration and security projects (CIS, EurAsEC Customs Union, CEA, CST) a single option for Kyiv. "Economic integration should stay abreast with the security of the Collective Security Treaty Organization and the like institutions", this approach is being laid by the apologists for post-Soviet integration.

Joining CU involves a number of treaties and agreements in different formats, and the EurAsEC above all. This structure is a kind of a nested doll for SES and CU formats: *"Eurasian Economic Community is being created for the effective promotion of the Customs Union Contracting Parties and Common Economic Space, as well as other goals and objectives determined in the above-mentioned agreements on the Customs Union, the Treaty on Deepening Integration in the economic and humanitarian spheres and the Agreement on Customs Union and Common Economic space in accordance with the targeted stages in the documents."*¹

One should take into consideration the off-balance trade relations of the three countries when involving Ukraine into the negotiation process. The official statistics of the CU Commission is quite explicit. None of CU members, apart from Russia, neither Kazakhstan nor Belarus has positive cash flow in trade with CU members. Therefore CU is beneficial primarily for Russia.

Table 1. Export-import operations of Belarus with the CU countries (2009), million USD

Countries	Export		Import		Balance		Percent to 2008	
	2008	2009	2008	2009	2008	2009	Export	Import
Kazakhstan	365,2	313,4	171,8	74,9	193,4	238,5	86	44
Russia	10551,9	6713,9	23507,4	16717,1	-12955,5	-10003,2	64	71
Total	10917,1	7027,3	23679,2	16792,0	-12762,1	-9764,7	64	71

¹ http://www.tsouz.ru/Docs/IntAgrmnts/Pages/Dogovor_EvrAzES.aspx

Table 2. Export-import operations of Kazakhstan with the CU countries (2009), million USD

Countries	Export		Import		Balance		Percent to 2008	
	2008	2009	2008	2009	2008	2009	Export	Import
Belarus	170,8	54,7	396,2	367,1	-225,4	-312,4	32	93
Russia	6228,1	3547,0	13765,6	8896,6	-7537,5	-5349,6	57	65
Total	6398,9	3601,7	14161,8	9263,7	-7762,9	-5662,0	56	65

Table 3. Export-import operations of Russia with the CU countries (2009), million USD

Countries	Export		Import		Balance		Percent to 2008	
	2008	2009	2008	2009	2008	2009	Export	Import
Belarus	23507,4	16717,1	10551,9	6713,9	12955,5	10003,2	71	64
Kazakhstan	13298,6	9146,5	6379,5	3684,9	6919,1	5461,6	69	58
Total	36806,0	25863,6	16931,4	10398,8	19874,6	15464,8	70	61

Energy prices, gas in particular, serve a lure to involve Ukraine into the CU, therefore the pricing strategy of Russian suppliers is regulated by their corporate guidelines, approved by relevant documents. Consequently, the Russian gas monopolist "in relations with the CIS and Baltic States adheres to the strategy of gradual transition to the contract terms and pricing mechanisms in the field of gas supply and transit services similar to those used in Europe ... Likewise in Europe, the final consumer is a major constituent of Gazprom's strategy in the markets of the former Soviet Union"². "In accordance with the decision of the Russian Government to bring the regulated wholesale gas prices to economic levels, regulated wholesale gas prices in Russia were increased by 15,7% in 2009 compared with 2008. In 2010 the rise of wholesale gas prices in Russia averaged 26.3% compared with 2009."³

Thus, there is no need to expect any changes as for gas price. Except for the scenario when Ukraine agrees to merge, however, under such circumstances Gazprom is going to absorb Naftogaz Ukraine, which is tantamount to sovereignty loss in the energy sector.

² <http://www.gazprom.ru/marketing/>

³ <http://www.gazprom.ru/marketing/russia/>