
CREATION OF THE EURASIAN UNION AND ITS IMPLICATIONS FOR THE EUROPEAN NEIGHBOURHOOD POLICY

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Abstract

This article is based on “The Eurasian Union: a Challenge for the European Union and Eastern Partnership Countries”, a broader study carried out by experts from the Eastern Europe Studies Centre in 2012. The purpose of the study was to analyse the potential impact of the emerging Eurasian Union on the EU and the Eastern Partnership countries, and to provide recommendations for EU policy with respect to the Eurasian Union. This article provides a deeper look into the geopolitics of creating the Eurasian Union: the political and economic interests of both Russia, the leading member of the Eurasian Union, and the EU. It explains how the integration model of the Eurasian Union is challenging the EU’s Eastern Partnership initiative, and raises the question of whether to recognise the Eurasian Union as a legitimate regional block.

Introduction

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

The CIS trade regime basically consisted of bilateral trade agreements periodically supplemented with exemptions. Meanwhile, multilateral agreements

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coordinated specific issues, such as unification of customs procedures and rules for determining the origin of goods. All of the multilateral agreements had to be ratified by national parliaments, and this was an additional safeguard for those countries that were apprehensive about deeper integration. As a result, the commitments of CIS members under these agreements were very limited.¹

Failure to achieve deeper integration forced the architects of (re)integration of the post-Soviet space (whose driving force has always been Russia) to rely on the “multi-speed” formula, whereby countries that are willing or motivated in some way to do so form a core and integrate in a given policy sector. The practical manifestation of such an approach can be witnessed in the Collective Security Treaty Organisation (CSTO) and the Customs Union of Belarus, Kazakhstan and Russia (CU).

Unlike the free trade agreements that had previously existed in the CIS, the CU, which launched on 1 January 2010, is a qualitatively different and deeper stage of integration, as it introduced not only a free trade area, but also a common import taxation structure and a common external tariff, as well as the harmonisation of product quality, sanitary and other standards. On the other hand, the CU is still not the ultimate goal of integration: on 1 January 2012, at least formally, the members launched the Single Economic Space (SES), and the Eurasian Union (EAU) is foreseen to come into effect by 2015.

Obviously, the architects of the Eurasian Union intend to take five years to create what took almost 40 years in European integration. The question is whether this duplication is a facade, or whether it does, after all, contain mutually assured interests, including the goal to integrate.²

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

¹ “Kodėl Ukraina negali tapti ES nare?” [‘Why is Ukraine Unable to Become an EU Member?’], Eastern Europe Studies Centre, Centre for Eastern Geopolitical Studies, *Analytic Review*, No 1 (1), 2009, <<http://www.eesc.lt/uploads/news/id451/Analitine%20apzvalga%202009%20Nr%201.pdf>>.

² Hoffmann K., “Eurasian Union – a new name for an Old integration idea”, *Russian Analytical Digest*, No. 112, 20 April 2012, <<http://www.css.ethz.ch/publications/pdfs/RAD-112.pdf>>.

striving to create an institutional framework where decisions taken by supranational institutions would be legally binding for the participating states, and would be applied directly, without any additional internal legislation or ratification.³

Another important question is what kind of relations the EU should have with this supranational institution to which Russia, Belarus and Kazakhstan are assigning increasingly more power. What model should the relationship between the EU and the Eurasian Union (and the EEC representing it) be based on, given the EU negotiations with Russia for a new strategic agreement, and with Kazakhstan for an enhanced partnership and cooperation agreement? Should the Eurasian Union be recognised as a legitimate regional bloc? And what would the implications of such recognition be?

These problematic issues are related to the broader field of EU interests, and how the Eurasian Union could potentially impact them: for example, the EU's capacity to expand security and stability in its neighbourhood, the functionality of the EU's Eastern Partnership (EaP) initiative, which is meant to strengthen relations with partner countries through economic integration, and the EU's external trade policy, which focuses on the reduction of protectionist barriers in the international environment.

Analysis of the emerging Eurasian Union should provide an answer to the question of whether this is a project of natural regional economic integration (modelled on the EU example) which may eventually create conditions for a common economic space "from Lisbon to Vladivostok", or whether this is an alternative space for integration, whose relationship with the World Trade Organisation (WTO) is problematic (due to unequal status of its members in the WTO and the introduction of protectionist barriers), and whose aim is geopolitical, i.e. Russia's efforts to limit the opportunities of post-Soviet states to join the EU economic integration space, to take over strategic economic sectors of these countries, or to split Europe into two competing political and economic blocs.

³ Dragneva R., Wolczuk K., "Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?" *Chatham House Briefing Paper*, No. 1, 2012, p. 6, <http://www.chathamhouse.org/sites/default/files/public/Research/Russia%20and%20Eurasia/0812bp_dragnevawolczuk.pdf>.

1. The geopolitics of the Eurasian Union

Assessing the motives behind the establishment of the CU and the planned Eurasian Union, many analysts highlight the instrumental importance of this structure in increasing the influence of Russia and its partners in international politics, and quote Putin's aspirations to create "a powerful supranational structure" which would speak with the U.S., China or such regional structures as the EU on an equal basis.⁴ At the same time, other studies note that the economic impact of the launch of this regional union has been undervalued.

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

These weaknesses were challenged and put into use by the EU's "integration without membership" concept, which, through the EaP initiative, started offering access to the EU internal market in exchange for the adoption of European rules.

Russia was aware that the stimulus offered by the EU would restrict Moscow's opportunities to retain political control over the CIS space, and aimed to establish an alternative integration model with more favourable conditions of access and participation. It should be noted, though, that after Putin outlined the vision of the Eurasian Union in greater detail, there were no public allusions to competition of this structure with the EU and the EU's EaP initiative. Moreover, Putin stated, "entry into the Eurasian Union allows each of its participants to, more quickly and from a stronger position, integrate into Europe."⁵ This can be linked to the

⁴ Halbach U., "Vladimir Putin's Eurasian Union. A new integration project for the CIS?" *Stiftung Wissenschaft und Politik*, SWP Comments, 2012, <http://www.swp-berlin.org/fileadmin/contents/products/comments/2012C01_hlb.pdf>; Adomeit H., "Putin's 'Eurasian Union': Russia's integration project and policies on post-Soviet space", Center for International and European Studies (CIES) at Kadir Has University, *Neighbourhood Policy Paper*, No. 4, 2012, <http://www.khas.edu.tr/cms/cies/dosyalar/files/black_sea_04%281%29.pdf>; Wisniewska I., "The Customs Union of Belarus, Kazakhstan and Russia: a way to strengthen Moscow's position in the region", *ISPI Analysis*, No. 146, 2012, <<http://www.ispionline.it/en/publicazione/customs-union-belarus-kazakhstan-and-russia-way-strengthen-moscows-position-region>>.

⁵ Adomeit H., "Putin's 'Eurasian Union': Russia's integration project and policies on post-Soviet space", p. 2.

pronouncement of another Putin vision a decade ago about “a common economic space from Lisbon to Vladivostok”.

However, despite Putin’s visions, there is considerable doubt about the relationship between the Eurasian Union and the EU – especially the possibility for EaP countries to harmonise liberalisation of economic relations and adoption of regulations in both directions.

Leaders of the EEC and its member states declare their intentions to adopt EU regulations, but this is still a theoretical possibility rather than an advanced process. Adoption of EU product quality regulations – particularly regarding production – will be a costly process for businesses in this region. The main motive for them to adopt EU standards would be the need to sell their products on the EU market. If this motive is not strong enough, the adoption of EU rules might stumble, with no guarantees of ever being completed. Thus, it is hardly possible to talk about Putin’s advocated vision of economic integration “from Lisbon to Vladivostok”.

EU practice indicates that any significant liberalisation of EU trade with its eastern neighbours and movement of people, capital and services will inevitably be associated with the adoption of European regulations. However, if the countries of the Eurasian Union continue to follow technical standards and regulations dating back to the Soviet era (GOST), differences in regulations will remain for quite some time and will function as non-tariff restrictions on trade between the EU and members of the Eurasian Union. Theoretically, it is certainly possible to imagine a free trade, tariff-free area between the EU and the Eurasian Union, but it would be fragmented and limited to certain products that may be of no interest to Eurasian countries.

2. (In)compatibility and competition between the EU and the Eurasian Union

At the moment, the countries of Eastern Europe and Southern Caucasus participating in the EaP programme are finding themselves caught in the middle between European economic integration (through a network of enhanced free trade agreements with the EU) and Eurasian integration. Though the enhanced free trade agreements with the EU do not preclude further integration of EaP countries with each other, the countries would, however, be deprived of the opportunity to have bilateral agreements with the EU if they were to join the CU. Thus, the members of the EaP will inevitably have to make a choice.

The EU seeks to model neighbouring countries according to its own pattern. Therefore, the internal integration model within the EU creates a strong barrier for partner countries seeking to join the EU internal market. It should be noted that the EU's support for the Deep and Comprehensive Free Trade Agreement (DCFTA) is strongest when it comes to the expansion of EU regulatory standards outside the EU and contributes to maintaining the EU's competitive advantage in international markets.⁶ As a result, the DCFTA proposes that EU partner countries no longer be based solely on the logic of tariff reduction, but also on such issues as the removal of non-tariff barriers, liberalisation of the services sector, elimination of protectionist measures, and favourable conditions for foreign direct investment. In this way, the agreement acquires a comprehensive nature⁷ and partner countries gain the status of a "political successor".

It should also be taken into consideration that implementation of the EU reform package would inevitably change interaction between the state and business. Meanwhile, many sectors of the economies in post-Soviet countries are sensitive to international competition and rely on the protection of the state. Finally, bearing in mind the nexus between business and politics that exists in the post-Soviet space, which results in the political system being strongly influenced by oligarchic business groups, EU rules may become too high of a bar for integration, especially since all EU requirements – from adoption of technical standards to fundamental structural reforms – must be implemented simultaneously.

The importance of different standards and regulations becomes particularly apparent when the bar of rules for joining the Eurasian CU is set much lower than EU requirements. The CU is dominated by the same GOST standards that were used in the USSR. These standards are also used in regulating cross-border relations within the CIS.⁸ This indicates that adaptation to CU standards would not create any barriers or convergence costs for EaP countries. In other words, while the EU requires convergence towards high standards that may result in "shock therapy" for business groups operating under the old business patterns and schemes, the CU

⁶ Diez T., "Normative Power as Hegemony", conference presentation *2011 EUSA Biennial International Conference*, Boston, <http://euce.org/eusa/2011/papers/71_thomas.pdf>.

⁷ Rodríguez E. V., "The European Union Free Trade Agreements: Implications for Developing Countries", *RIE Working Paper*, No. 8, 2009, p. 5-6, <http://www.realinstitutoelcano.org/wps/wcm/connect/a85925004f018b93b9dafd3170baead1/WP8-2009_Valerdi_EUFTA_Developing_Countires.pdf?MOD=AJPERES&CACHEID=a85925004f018b93b9dafd3170baead1>.

⁸ Shumylo-Tapiola O., "Ukraine at the Crossroads: Between the EU DCFTA & Customs Union", Ifri Russia/NIS Center, 2012, p. 14, <<http://www.ifri.org/?page=contribution-detail&cid=7104>>.

does not necessitate any fundamental reorganisation or adaptation to high quality standards and regulations.

In addition to the cost-benefit analysis of integration into the European or Eurasian economic spaces, the Russian factor must also be taken into account. Russia's strength, which is directly related to CU integration, lies in two factors: 1) informal rules and practices (the business-politics nexus, corporate culture, oligarchic trends, etc.) which can be used to "cement" the post-Soviet states together, and 2) Russia's ability to combine economic integration with integration in the energy sector (or more specifically – its option to supply energy to partner countries at Russian domestic market prices) and the credit resources it has available for neighbouring countries. Based on these factors, functioning of the Eurasian Union may diminish the advantages of the EU as a power centre and undermine the functioning of initiatives such as the European Neighbourhood Policy and the EaP.

In exchange for preferential prices for energy resources, provision of credit and access to its domestic market, Russia may take over strategic areas of the economy of other members of the Eurasian Union, and thereby strengthen its influence among EaP states. By integrating energy sectors, Russia may, in return for gas supply at domestic market prices, use the Eurasian Union as a means to take over the energy infrastructure in partner countries, establish joint ventures, develop energy corridors favourable to Russia, and so on. Something similar could also take place in the transport sector, where joint ventures could be established by Russia, Belarus and Kazakhstan (such as a common railway company) to control the main Eurasian transport flows.

Russia's political leaders emphasise that the Eurasian Union is an opportunity for post-Soviet countries to strengthen their bargaining power in developing a common economic space with the EU.⁹ It is argued that by strengthening the integration of post-Soviet space, countries of the region will have more leverage to create a free trade area "from Lisbon to Vladivostok" together with the EU in a playing field favourable to them. Despite the actions of the EU and Russia within the common WTO framework, differences between the rules and standards of the EU and the emerging Eurasian Union cannot be ignored. Thus, it would be appropriate to speak about competition between two alternative spaces of integration and centres of power, rather than their harmonisation.

⁹ Putin V., "A new integration project for Eurasia: The future in the making", *Izvestia*, 3 October, 2011, <[http://www.russianmission.eu/en/news/article-prime-minister-vladimir-putin-new-integration-project-eurasia-future-making-izvestia-3->](http://www.russianmission.eu/en/news/article-prime-minister-vladimir-putin-new-integration-project-eurasia-future-making-izvestia-3-).

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

The decision-making procedures within the framework of the Eurasian Union also explain the existence of realpolitik in the CU. Decisions of the commission of the CU, which was launched on 1 January 2010, were planned to be taken by qualified majority voting (Russia had 57% voting weight and Kazakhstan and Belarus had 21.5% each) which meant that support of at least one member state was sufficient for Russia to take a final decision. Such a system makes it possible for countries to “buy” and “sell” support for any initiative which would deepen CU integration, and certain coincidences have provided grounds for such speculation. For example, on 18 November 2011, the presidents of Belarus, Russia and Kazakhstan signed an agreement for the establishment of the Eurasian Union; shortly after, information emerged about agreements between Russia and Belarus concerning the grant of more than USD 1 billion in credit, and a 50% decrease in gas prices (from USD 300 to USD 150 per thousand *cubic metres*). Signs such as these may indicate an on-going trend whereby Russia’s assistance to the Belarusian economy may be linked to support from Minsk for the further integration of the Eurasian Union. It should be noted that even though the principle of unanimity in the institutional architecture of the Eurasian Union has been strengthened, conditions for “trading” political support for integration have not been abolished. As long as Russia will not be ready to treat former republics as partners rather than objects of its ambitions and executors of its orders¹⁰, agreements will be taken behind closed doors. The use of qualified majority voting at least made influence more transparent, while the transition to intergovernmentalism suggests a return to the “passive consensus” typical of the CIS, and integration through bilateral pressure. Such a scheme can lead to higher integration costs for Russia, because

¹⁰ Korejba J., “Will Putin Restore the USSR?” *New Eastern Europe*, 26 February, 2013, <<http://www.neweasterneurope.eu/node/670>>.

unlike in the case of a qualified majority, Russia will need to “acquire” not one, but two voices with every round of decision making.

3. Caught between two models of integration: Ukraine’s decision

Ukraine’s decision of whether to establish free trade with the EU or join in the creation of the Eurasian Union will determine not only trade flows with its neighbours, but the pace and direction of structural reforms as well. Ukraine is a key country in the EU EaP programme: it was the first to receive an invitation for economic integration and to complete negotiations for an enhanced DCFTA. On the other hand, Ukraine is strategically important to Russia, which seeks to restore its lost influence in the CIS region and to ensure stability for the Eurasian Union.¹¹

In 2008, Ukraine became a member of the WTO and started negotiations with the EU on the Association Agreement and the DCFTA. The negotiations indicated Ukraine’s intention to adopt some 70% of the EU’s legal regulations governing trade as well as other sectors, such as energy, transport, and environmental protection. When EU–Ukraine agreements were about to be signed at the end of 2011, Putin announced the vision for the Eurasian Union. Meanwhile, Ukraine’s domestic politics and legal actions against Yulia Tymoshenko and other members of the former government resulted in the signing and ratification of EU agreements with Ukraine being suspended. As EU–Ukraine relations began to deteriorate, Russia significantly intensified its efforts to use energy – particularly the dependence of Ukrainian industry on Russia for supply of less expensive natural gas and oil, as well as the significant income that transit of Russian products through Ukraine generates – as an argument to convince the Ukrainian leadership to reconsider its position on participation in the Eurasian Union. The newly-inaugurated Nord Stream pipeline and, in particular, the planned South Stream pipeline, may also be exploited as bargaining tools, threatening to cut natural gas transit through Ukraine along with the income that comes with it. Although Ukraine may not be joining the Eurasian Union immediately, Russia also offered a variety of sectoral agreements to enhance cooperation with Ukraine and thereby create conditions for its gradual integration.

¹¹ Shumylo-Tapiola O., “Ukraine at the Crossroads: Between the EU DCFTA & Customs Union”, p. 4.

Ukraine's political leaders continue their support for the EU partnership projects; however, the final decision will be determined by a cost-benefit analysis of the large corporate groups that form a nexus with the political elite. Ukrainian business is fragmented: the majority want to preserve privileged trade relations within the CIS space, while others focus on the EU market. Ukraine has tried to manoeuvre by proposing a "3 +1" integration model with the CU (Ukraine would have a standard free trade agreement with the CU), but this was rejected by Russia.

3.1. Ukraine's trade with the EU and the Eurasian Union

The countries of the EU and the CU are Ukraine's biggest trade partners, accounting for approximately two thirds of Ukrainian turnover. The dynamics of the past decade show that prior to the 2008 financial crisis, the EU's role in trade with Ukraine increased, while the role of CU countries decreased. Later, however, increasing energy prices and changes in the demands of the recovering economy resulted in Ukraine turning to the CU market. From 2000 to 2010, the share of Ukrainian export to the EU fell by 7.7% (to 25.4% of total export) and the share of import from the EU fell by 5.3% (to 31.4%). At the same time, export and import from CU countries increased by 5.9% (to 32.3%) and 9% (to 42%) respectively.¹²

Ukraine exports energy, agricultural products, chemicals, iron and steel to the EU, and imports a variety of machinery, vehicles and equipment, agricultural products, textiles, and clothing.¹³ Trade with CU countries is much less diversified, limited primarily to natural resources (imports) and machinery and vehicles (exports). In order to maintain the existing direction of trade, traditional business relations with the CIS markets are vital. The volume of trade in services with both unions is similar, but the most telling indicator is in the technology sector, where trade with the EU is almost double that of with the CU (40.2% and 23.9% respectively).¹⁴ In a sense, these differences illustrate the choice Ukraine will be

¹² Movchan V., Giucci R., "Quantitative Assessment of Ukraine's Regional Integration Options: DFCTA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan", German Advisory Group, Institute for Economic Research and Policy Consulting, Berlin/Kyiv, 2011, p. 2, < http://www.beratergruppe-ukraine.de/download/Beraterpapiere/2011/PP_05_2011_en.pdf?PHPSESSID=1cd210cedc1658ddf3540f1f77b8035d>.

¹³ DG Trade, "Ukraine. EU Bilateral Trade and Trade with the World", 2012, <http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf>.

¹⁴ Movchan V., Giucci R., "Quantitative Assessment of Ukraine's Regional Integration Options: DFC-TA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan", p. 2.

making: either urgent economic and technological modernisation or preservation of the existing domestic economic structure.

3.2. Effects of free trade agreement between the EU and Ukraine

Evaluation of the impact the DCFTA with the EU has on Ukraine usually focuses on advantages. Firstly, growth and welfare – trade with the EU means a greater variety of products for consumers (although stringent safety requirements will make products more costly), as well as new business opportunities, which in the long term will generate per capita growth. Secondly, the agreement would guarantee duty-free access to the world's largest market – the EU's GDP at purchasing power parity is 5.67 times that of the Eurasian Union countries. Thirdly, harmonisation of national legislation with EU regulations would create a legal environment of business acceptable to foreign (primarily western) investors.

On the other hand, comprehensive free trade with the EU may lead to problems caused not so much by the EU, but by the backwardness and structure of the Ukrainian economy. Elimination of tariff barriers (approximately 95% of all custom duties applied for the EU) and reduction of non-tariff barriers would increase competition in the domestic market, which would pose a threat to local producers enjoying protectionist support. Only annual export quotas for strategically important production – 1.6 million tonnes of grain, meat, sugar and its products – would be retained.¹⁵ Adoption of EU standards and EU legal framework would inevitably result in high adjustment costs, especially as this has to be done before entering into free trade. It would be easier for Ukraine to adjust if the EU was primarily focusing on the development of free trade, in which case transition phases would be established for adoption of European rules and quality standards.

The prospect of membership in the Eurasian Union also has its advantages and disadvantages. As far as disadvantages are concerned, the prospect of losing an independent trade policy should be emphasised. The Eurasian Economic Commission would conduct negotiations with third countries and other trade blocs, bypassing the capitals of the member states (which de facto would mean Russia's leverage in controlling Ukraine's trade policy). Furthermore, while

¹⁵ Movchan V., Shportyuk V., "EU-Ukraine DCFTA: the Model for Eastern Partnership Regional Trade Cooperation", CASE - Center for Social and Economic Research, October 2012, No 445, p. 12–13, <<http://www.case-research.eu/en/node/57857>>.

establishment of a free trade zone with the EU implies modernisation by adopting costly EU quality standards and legal framework, membership in the Eurasian Union would mean higher costs for investment from countries outside of the union, and subsequently smaller investment and innovation flows.¹⁶

Another economic disadvantage of Ukraine's accession to the CU is the WTO factor: unlike Kazakhstan and Belarus, Ukraine is a member of the WTO. By joining the CU, Ukraine would have to review its tariff commitments agreed in negotiations with the WTO and align them with those that Kazakhstan and Belarus negotiate during their accession to the WTO. Adjustment of WTO commitments would require Ukraine to compensate the losses incurred by other WTO members, an amount estimated at USD 1.9 billion.¹⁷ This leads to the conclusion that Ukraine should only consider membership in the CU when all of the union's member countries have acceded to the WTO, or under the assumption that USD 1.9 billion would be covered by Russia in exchange for Ukraine's accession.

3.3. Russian discounts as bait to join the Eurasian Union

The majority of the arguments in favour of Ukraine choosing membership in the Eurasian Union are related to possible elimination of domestic market protection measures on behalf of Russia and the sale of Russian oil and gas to Ukraine without export duties. On the other hand, membership in the CU does not guarantee energy supplies at Russian domestic market prices, because CU policy exemptions (for example, regarding export duty) still apply to energy trade. Export duties for energy trade can only be eliminated as a discount or as an incentive offered by Russia on a bilateral basis (as in the case of Belarus).

If Ukraine were to join the CU, Russia would have the opportunity to eliminate export duties on energy resources for Ukraine, but selling them at domestic market prices would be a daunting decision for Russia. On the one hand, discounts in energy trade would indeed be an effective tool. In 2010, energy imports accounted for 67% of total imports from Russia; according to Ukraine's minister of Economic Development and Trade, elimination of export duties on gas alone would allow Ukraine to save USD 3–3.5 billion per year.¹⁸ However, it is more realistic to speak

¹⁶ Movchan V., Giucci R., "Quantitative Assessment of Ukraine's Regional Integration Options: DFC-TA with European Union vs. Customs Union with Russia, Belarus and Kazakhstan", p. 9.

¹⁷ *Ibid.*, p. 9.

¹⁸ "Решение об интеграции в Таможенный союз нужно принимать уже в первой половине

about a 10% discount, which would make the price equal to that paid by Russia's large-scale EU buyers, at USD 400 per thousand *cubic metres*, compared to the USD 426 Ukraine paid in Q3 2012.

On the other hand, Russia itself is caught on the horns of a *dilemma* over its desire to maximise profits from oil and gas exports and to lure Ukraine to the Eurasian Union. It should be noted that internal Russian business interest groups, in particular, those with ties to Gazprom, may not be interested in the implementation of Russia's geopolitical interests at the expense of export profits. Ukraine is too big of a market to provide tangible discounts without major economic loss. Practice shows that Putin also gives priority to profit. In the gas sale agreement concluded with Ukraine in 2009, high gas prices turned even relatively pro-Russian Ukrainian political elite groups against Russia.¹⁹ Moreover, given that the 2009 agreement on gas prices was concluded because Russia had cut gas supplies to Ukraine, and thereby to central and southern European countries, the complexity of energy and political dynamics becomes even more evident.²⁰

A 2012 analysis conducted by the Saint Petersburg Centre for Integration Studies and the Eurasian Development Bank states that the scenario of Ukraine's accession to the Eurasian Union by 2030 promises a 6–7% higher GDP growth than in the case of the status quo scenario. Such growth is based on an increase in exports to the countries of the Single Economic Space (primarily Russia) and traffic in transit, as well as less costly raw materials for Ukrainian industry.²¹ These benefits, which are the product of potential Russian rebates and incentives rather than the direct result of membership in the Eurasian Union, are essential in many calculations supporting the advantages of the Eurasian Union.

In conclusion, Ukraine's choice between an enhanced free trade regime with the EU or membership in the Eurasian Union is basically a choice between

2011 го́да”, <<http://kommersant.ua/doc.html?docId=1615189>> quoted in Bugriy M., “Strategic Flexibility a Key Issue for Ukraine in Trade Relations with Russia and the EU”, *Foreign Policy Journal*, 2011,

<<http://www.foreignpolicyjournal.com/2011/04/09/strategic-flexibility-a-key-issue-for-ukraine-in-trade-relations-with-russia-and-the-eu/>>.

¹⁹ Umland A., “ES-Ukrainos-Rusijos trikampis, ‘Šiaurės srautas’ ir Rytų Europos ateitis” [‘The EU-Ukraine-Russia triangle, Nord Stream and the future of Eastern Europe’], *Geopolitika*, 2011, <<http://www.geopolitika.lt/?artc=4956>>.

²⁰ Jonavičius L., “Dujos vėl teka, bet padėtis Ukrainoje nesikeičia” [‘Gas flows again, but the situation in Ukraine does not change’], *Eastern Europe Studies Centre*, 2009, p. 1.

²¹ Eurasian Development Bank's Saint Petersburg Centre for Integration Studies, Ukraine and the Customs Union, Report 1, 2012, p. 29, <http://www.eabr.org/general/upload/reports/Ukraina_doklad_eng.pdf>.

long-term and short-term gains. Comprehensive free trade with the EU would not only mean adaptation to “expensive” EU standards (short-term costs), but also modernisation of the Ukrainian economy and a qualitative leap in economy and trade in the medium and long term. The Eurasian Union does not require major structural changes or higher standards, but promises Russian discounts in the energy sector. These potential discounts and incentives should be viewed by Ukraine through the prism of national sovereignty.

4. Whether or not to recognise the Eurasian Union

Though the creation of the Eurasian Union is still in progress, the issue of its recognition has been raised vigorously. However, before discussing the underlying motives for international recognition, a pivotal question must be answered: is the creation of the Eurasian Union a political process leading to the establishment of a new entity of international relations, or is it just another example of deeper regional economic integration?

There are no major doubts or discussions about the fact of the emerging structure in the EU’s eastern neighbourhood, which may currently be described as the emerging CU. It can be defined by four objective criteria. Firstly, there is a common external tariff, although it does not apply to all goods. Secondly, there is a common CU Customs Code, which is meant to guarantee common import procedures, classification of goods, customs valuation, and other related issues. Thirdly, development of common CU standards and technical regulations is in progress. Fourthly, CU countries are gradually abolishing mutual cross-border controls and other restrictions on the movement of goods within the CU.

It should be noted that the new economic structure will have an effect on the future accession to the WTO of two CU countries – Belarus and Kazakhstan. For example, Kazakhstan’s decision to join the CU has not only delayed, but also complicated, its WTO membership. Due to its membership in the CU, Kazakhstan was forced to raise its import duties and will have to continue introducing other protective measures, primarily reflecting Russia’s interests. Such actions on behalf of Kazakhstan and the planned economic integration will affect areas of the economy negotiated for accession to the WTO (trade in services, investment regime, protection of intellectual property, public procurements, etc.) and may delay Kazakhstan’s WTO membership for a few years or even much longer.

If Belarusian negotiations on WTO accession were to resume, there would be many more unanswered questions and problems. The accession process has been stalled for many years, and the declarations made by Belarusian officials, promising to meet the formal requirements of the WTO because Russia has become a member and its commitments are already implemented on the CU level, are not sufficient. To provide an impetus to the process of accession, a favourable – or at least neutral – attitude of the international community towards Belarusian membership in the WTO is required. Belarus must also make efforts to carry out economic reforms and allocate required capacities to not only duplicate Russia's WTO membership commitments but also to negotiate and implement the ones of its own.²²

Negotiations between the EU and the Eurasian Union are possible only when all members of the Eurasian Union join the WTO. Otherwise, Russia, which has completed its WTO accession negotiations, will have authority to renegotiate the WTO terms at the expense of other members of the Eurasian Union. Furthermore, differences in the WTO status of the three members of the Eurasian Union could lead to legitimisation of the Belarusian regime (i.e. may provide conditions for Belarus to enter the EU's internal market "through the back door") and further reduce potential measures directed against the regime.

So what should EU strategy be with respect to the Eurasian Union? Russian officials keep suggesting that negotiations on a new partnership and cooperation agreement between the EU and Russia should be replaced by negotiations on a regional agreement between the EU and the Eurasian Union.²³ Russia also continues refusing to transfer the commitments undertaken during WTO accession negotiations (known as "WTO-plus" obligations) to a bilateral agreement with the EU. It is unlikely that negotiations would be more successful even if the EU would agree to start a dialogue with the EEC. It appears that before deciding whether or not to recognise the Eurasian Union, EU foreign ministers should first clarify to what extent Russia is ready to open its markets to the EU. Until this question is answered, EU officials should not waste their time solving the dilemma of who to negotiate with – Russia or the EEC.

Therefore, the EU's strategy vis-à-vis the Eurasian Union should be based on the following: a) no inter-regional negotiations or other cooperation initiatives (so

²² Klysinski K., "Consequences for the Belarusian economy of Russia's entry into the WTO", Centre for Eastern Studies, EastWeek 12 September, 2012, <<http://www.osw.waw.pl/en/publikacje/east-week/2012-09-12/consequences-belarusian-economy-russia-s-entry-wto>>.

²³ "Putin to visit Brussels as 'Eurasian Union' leader", *EurActive*, 4 December, 2012, <<http://www.euractiv.com/europes-east/putin-comes-eu-eurasian-union-le-news-516419>>.

as not to legitimate potential power imbalances between member states or create loopholes for authoritarian regimes such as the one in Belarus); b) maintenance of a bilateral approach and the European Neighbourhood Policy as an unequivocal priority that cannot become hostage to regional integration among the three countries; c) regular monitoring of the development of the Eurasian Union, support for the rule of law, judicial independence, political and economic freedoms and other elements of liberal democratic order, and assessment and neutralisation of potential risks; and d) a commitment on behalf of the EU to constantly strengthen visibility and accessibility of the advantages of the EU's political and economic model in the eastern neighbourhood.

This final objective – to cultivate eastern neighbours' interests in entering the EU economic space – should be pursued in the following ways:

Firstly, the EU should abandon the “Russia first” principle whereby all EU initiatives are first implemented with Russia and only later become available to countries in the eastern neighbourhood. The EU will find it difficult to prove the advantages of the Eastern Partnership initiative to partner countries if Russia, which is not part to the initiative, gets access to the EU internal market (or visa-free regime) before they do. This weakens the role of the EU as a regulatory power centre in the region.

Secondly, the EU has to find a formula for how to reduce the cost for partner countries to access the EU internal market. A clear reward in the EU internal market must be offered to partner countries in exchange for the adoption of European rules and high standards.

Thirdly, the EU must learn to offer incentives to major business structures in partner countries that might profit from access to the EU markets. These businesses might serve as “locomotives” for EU integration of the partner countries.

Fourthly, the EU must use its capacities to support the strategic economic sectors of the EaP countries – particularly those of energy and transport. For example, extension of the Connecting Europe Facility to embrace EaP countries would allow for direct EU participation in development of the energy and transport infrastructures.

Conclusions

The EU and the Eurasian Union are two very different economic and political systems, with different sets of regulations, rules, and even values. These alternative integration projects differ not only by their standards and technical requirements, but also by the characteristics of their political and economic system: unlike the EU,

the Eurasian economic area has particularly strong vertical politics and oligarchic business trends, as well as an extremely prominent nexus between politics and business. Therefore, every project of economic integration in the post-Soviet space must be seen and viewed through the prism of geopolitical interests, as politics and economics in this space are strongly bound.

Participation in the Russian-dominated CU does not leave room for any intermediate options that would enable countries to combine their European orientation and natural relations with the CIS countries. Expansion of the CU into the European Neighbourhood region (i.e. membership of Ukraine) could weaken EU regulatory power in these countries. Development of the CU is a serious challenge for the EU's EaP initiative, as its main pillar is access to the EU internal market through free trade agreements.

The EaP countries find themselves caught in the middle between two integration spaces - the EU and the Eurasian Union - and will eventually have to choose between them. Membership in the Eurasian Union would mean lower short-term adjustment costs for businesses, but integration into the EU presents greater economic development potential.

Cooperation or negotiations between the EU and the Eurasian Union may become possible only when all members of the Eurasian Union have concluded valid partnership and cooperation agreements with the EU and have acceded to the WTO. Recognition of the Eurasian Union prior to this would give the CU countries a pretext to further procrastinate in implementing WTO commitments; it would also provide conditions for Belarus to enter the EU internal market "through the back door", which would essentially equal legitimization of the Belarusian regime.

In this light, the EU should be cautious about making any decisions regarding political and technical cooperation with the Eurasian Union, and should avoid random mistakes that might lead to indirect legitimization of the CU institutions. The same awareness is required in bilateral relations with the CU member states. Finally, certain dimensions of the Eurasian Union, such as energy and transport policies, should be closely monitored. Development of these policies will inevitably have implications for both the EaP countries and the EU's energy and economic interests.