



**European Neighbourhood Policy: the Case of
Ukraine**

*Edited by
Nathaniel Copsey and Alan Mayhew
Sussex European Institute
2006*

SEI Seminar Papers Series No 1

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First published in January 2007
by the **Sussex European Institute**
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Wider Europe: European Neighbourhood Policy, Ukraine and the European Union

Introduction

European Neighbourhood Policy (ENP) is the child of the eastern (and to a much lesser extent, southern) enlargement of 2004. It was designed to provide coherence to the EU's external policy towards its eastern and southern neighbours, by establishing a ring of security and friendship around the Union's new borders. Whilst the form and structure of ENP have much in common with the machinery set up to deliver the big bang enlargement of 2004, its final aim is deliberately vague. It is unclear whether the Union desires those neighbouring countries that are targeted by ENP to become full Member States, or whether the policy is intended to produce an institutionalised buffer zone of security around the Union. Despite this ambiguity, ENP has found fortune amongst the EU's neighbours and since 2003 it has developed considerably and appears to be achieving the policy coherence that was originally envisaged.

Sussex European Institute's Wider Europe Programme has followed the growth and development of the European Neighbourhood Policy since its inception. Our aim over the past few years has differed slightly from a conventional academic research project in that we wanted to build an interdisciplinary network of scholars and practitioners working in this field. Thus the Wider Europe Network includes economists, lawyers, civil servants, political scientists and politicians. In essence, they share an interest in those countries that are targeted by European Neighbourhood Policy and a normative will to build better relations between the European Union and its neighbours.

During the first few years of the Wider Europe Programme, we have focused our attention on Ukraine. We decided to do so as a result of that country's size – both geographically and demographically – its enthusiasm for European integration, its steady progress in democratization, and its pivotal strategic position between Russia and the Union. Over the past three years we have held three large annual conferences on the subject of European Neighbourhood Policy in general and Ukraine in particular: in 2004 at Sussex University, in 2005 in Warsaw at the College of Europe, and in 2006 at the *Verkhovna Rada* in Kyiv. These large annual events have been interspersed with smaller seminars, held at Sussex University and in Ukraine, to review Ukraine's progress in European integration bi-annually.

The symposium of papers that this introduction precedes is the product of our most recent annual conference in Kyiv in October 2006. In keeping with the interdisciplinary nature of the Wider Europe programme, the six papers include law, political science and economics.

First, Nathaniel Copey's paper provides a contextual overview of political events in Ukraine in the run-up to and following the most recent parliamentary elections, the first to be contested under the new rules that came into force following the constitutional changes brought by the Orange Revolution of 2004. The paper argues that Ukraine's parliamentary elections in 2006 marked considerable progress on the path towards democratization and analyses the results together with what they mean for European integration.

Second, Marise Cremona and Christophe Hillion explore the potential and limitations of the European Neighbourhood Policy from a legal perspective. They argue that although the cross-pillar nature of the policy provides some coherence for ENP, this is to some extent undermined by the wholesale adoption of many of the pre-accession mechanisms without the explicit aim of membership for those states participating in the project. Ultimately, this is a serious flaw in the fundamental design of the policy. Nonetheless, they conclude that a continued effort to reform and rework the policy in order to enhance the coherence between objectives and instruments would make a significant contribution to global security and governance.

Third, Sarah Whitmore looks the role of the Verkhovna Rada in European integration, with a focus on its institutional capacity and legislative process. The subject of this paper is crucial not only given the over-arching importance of an efficient and transparent parliament in fulfilling the Copenhagen criteria for consolidated democracy, but also as result of the significant increase in parliament's powers following the constitutional reforms that came into force in early 2006. She concludes that two particular areas will require significant improvement if parliament is to begin to function more effectively. First, the party system needs to be strengthened (the move to a single party list system in the 2006 elections aimed to redress this, but neither the spirit nor the letter of this reform seem to have been respected). Second, a parliamentary majority needs to be secured to ensure a more predictable legal process. Some progress appears to have been made in this area, although it is hard to see how the present coalition of the Party of the Regions, Communists and Socialists will reach agreement in passing through much of the legislation needed for accession to the WTO without the Party of the Regions having to rely on the opposition Our Ukraine and the Bloc Yulia Tymoshenko.

Fourth, Roman Petrov examines the progress made by Ukraine in approximating Ukrainian legislation to that of the EU before and since the Orange Revolution. He concludes that particular attention needs to be paid to the training Ukrainian judiciary in EU common values and general principles. Enforcement of court decisions also requires more effort, taking into account the experiences of existing EU Member States.

Fifth, Igor Burakovsky, Andrii Goncharov and Alan Mayhew look at the current economic relationship between Ukraine and the European Union. It examines the issues of WTO accession, energy relations with Russia, the Action Plan and the role of Europe in the modernisation of Ukraine's economy, before making recommendations on future action.

Sixth, Alan Mayhew's paper looks at the role of foreign direct investment (FDI) in the modernisation of Ukraine's economy. He briefly charts the recent economic history of Ukraine to provide an explanation for the relatively poor performance of the Ukrainian economy in the 1990s. Subsequently, his paper analyses why Ukraine's economy has improved its importance so dramatically since 2000. Of particular importance has been the rolling back of the insider economy creating the conditions for greater competition. As a result of this Ukraine has attracted a larger amount of FDI, although it still has a very long way to go. The Ukrainian government should now focus on improving the quality of the business regulatory environment and

cutting corruption as well as providing more stability both institutionally and in terms of the economic policy framework.

These papers are work in progress and have been placed in the public domain prior to their absolute finalization in order to stimulate further debate and discussion on this topic.

We are always looking to expand our network. If you would like to contribute to the Wider Europe programme, please contact Alan Mayhew or Nathaniel Copsy.

Europe and the Ukrainian Parliamentary Elections of 2006¹

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Key Points:

- The parliamentary elections consolidated Ukraine's democratisation, moving still further away from the managed democracy of the Kuchma years.
- The elections were the first to be held under the new constitutional arrangements that came into force on 1 January 2006.
- The Party of the Regions made a spectacular comeback to win first place by a large margin.
- No one party won a decisive victory, which complicated coalition building.
- Patterns of voting by region are largely unchanged since the presidential elections of 2004.

Introduction

Ukrainians went to the polls to elect a parliament (*Verkhovna Rada*) for the fourth time since independence from the Soviet Union in 1991 on 28 March 2006. The elections were the first to be held under the new constitutional arrangements that came into force on 1 January 2006, which have transferred many powers away from the President in favour of parliament. For the first time, the conduct of the elections met with the approval of the OSCE, and this marked a considerable improvement on the presidential elections of 2004, and the dramatic events of the Orange Revolution which followed the disputed second round of polling.²

The 2006 elections were also the first to be held in Ukraine under the party-list system of proportional representation, with a single nationwide electoral district and votes being allocated to parties or electoral coalitions as a whole, rather than to individual candidates. Previously, 50 per cent of *Verkhovna Rada* deputies were elected in single mandate constituencies, with the rest of the seats allocated on a proportional basis.

Ukraine's newly-elected deputies in the *Verkhovna Rada* elected in the 2006 elections exercise considerably more powers, including the right to nominate and dismiss the prime minister and most of the cabinet (except the foreign and defence ministers, the head of the Security Service and the prosecutor-general – although parliament still has to approve presidential nominees for these posts). Moreover, the prime minister reports directly to the *Verkhovna Rada* and not the president. Nonetheless, the president retains the power to call for new elections if the *Verkhovna Rada* fails to

¹ I am indebted to the Britain-Ukrainian Legal Association, whose financial support made the research on which this project is based possible.

² See Nathaniel Copsey 'Europe and the Ukrainian Presidential Election of 2004' EPERN Election Briefing No 16. Available at <http://www.sussex.ac.uk/sei/1-4-2-8.html>.

form a majority within 30 days or fails to choose a new prime minister and cabinet within 60 days of dismissing the old one.

This briefing paper has four sections. First, it examines the background and context of the Ukrainian parliamentary elections of 2006. Second, it looks at the campaigns mounted by the political parties competing, with the emphasis placed on the five parties that gained the necessary three per cent of the popular vote – the threshold for gaining seats in the Verkhovna Rada. Third, it tabulates and interprets the results, with a focus on what they mean for coalition forming. Fourth, it briefly analyses the European dimension of the elections. Finally, it reiterates the main arguments and concludes. The material on which this election briefing is taken comes from three main sources: reportage in the Ukrainian and international press; the author's own observations as an election monitor³ in the 2006 parliamentary elections; and, interviews with 12 Ukrainian voters carried out in Kyiv over the weekend of the parliamentary elections.

1. Context and Background

Ukraine's parliamentary elections of 2006 attracted relatively little attention on the part of the international media, in marked contrast to the contested presidential elections of 2004 that led to the 10-day Orange Revolution. The peaceful settlement of the Orange Revolution that signalled the end of the ten-year Kuchma era was brokered in exchange for a series of constitutional reforms that transferred considerable power from the presidency to the parliament – most notably the right to nominate the prime minister and government. As such, these were the first elections to take place under the new constitutional arrangements, which came into force on 1 January 2006. Ukraine had therefore moved away from the post-Soviet camp of presidential republics of dubious democratic repute towards a more pluralist democracy.

The 15 months between Viktor Yushchenko's [official] swearing in as president in January 2005 and the election of the new parliament in March 2006 were tumultuous. The sacking of Ukraine's outspoken and populist prime minister, Yulia Tymoshenko, best known outside Ukraine as the co-leader of the Orange revolutionaries together with Viktor Yushchenko, in September 2005, caused a serious split in the Orange camp, largely composed of two electoral blocs: the Bloc Yulia Tymoshenko (BYUTY) and Our Ukraine (*Nasha Ukraina*). The appointment of a new government led by Our Ukraine's Yuri Yekhanurov was supposed to restore confidence in President Yushchenko, following an exceptionally tough first few months in office, however, the new government's popularity continued to wane in late 2005 and early 2006.

Declining public trust in Viktor Yushchenko and Yuri Yekhanurov was evident for some time. This seemed to be the result of four factors.

First, the worsening economic climate in Ukraine in 2005 and 2006, as economic growth falling from around 12 per cent per annum in 2004 to 2.6 per cent in 2005

³ Particular thanks are due to my good friend and colleague Mariusz Sielki of Sciences-Po in Paris, without whose kind assistance this project would never have been possible.

meant that there was a sense of economic malaise. Annual GDP growth in 2006 slowed further to 1.5 per cent year-on-year in the first three months of 2006. Inflation also plagued Ukrainian consumers with food prices fluctuating wildly over 2005 and 2006, accounting for over two-thirds of consumer price index inflation, a particular problem for pensioners living on low incomes. Sugar prices, for example, rose by a vast 56.6 per cent year-on-year in February 2006. Growth in Ukraine's previously booming metallurgy industry slowed considerably in 2005 as world steel prices fell by about 22 per cent between January 2005 and January 2006. The effects of the doubling of gas prices on the economy have yet to be seen. On the positive side, the achievements of Yulia Tymoshenko's administration in increasing the government's effectiveness in tax collection have been consolidated with the Ukrainian government running a budget surplus of \$4.8 billion in the three first months of 2006, in comparison with the \$6.8 billion deficit inherited in 2004. Moreover, Ukraine was awarded market economy status by both the United States and the European Union, and this was a crucial step along the road to WTO membership, a move that will greatly ease the flow of Ukrainian exports onto world markets.

Second, relations with Russia worsened considerably since the Orange Revolution, reflected most obviously in Russia's decision in December 2005 to increase the price of the gas it sells to Ukraine by 460 per cent from \$50 to \$230 per 1,000 cubic metres. The crisis was exacerbated by Russia's decision to cut off supplies of gas to Ukraine – in turn triggering a reduction in gas supplies to western Europe – in the middle of the coldest winter since the 1940s. Although the deal struck between Russia and Ukraine at the beginning of 2006 introduced an interim price of \$95 per 1,000 cubic metres valid until June 2006, upward pressure on gas prices were expected to continue year-on-year until 2009 when the world price of around \$230 is reached. Ultimately, Russia's decision to increase the price of gas to Ukraine seemed to be in some sense understandable as the previous pricing arrangements amounted to a Russian subsidy of Ukrainian gas prices of around \$135 per 1,000 cubic metres. The issue at stake was rather more the way in which the price hike was introduced and the crude way in which gas supplies were abruptly cut off in the middle of negotiations. Tellingly, in the context of the 2006 parliamentary elections, not even the pro-Russian Party of the Regions led by 2004 presidential candidate Viktor Yanukovich promised to renegotiate the old price of \$50 per 1,000 cubic metres – he merely signalled that a better deal could be reached.

Dissatisfaction with the handling of the gas dispute led to the sacking of the government of prime minister Yuri Yekhanurov on 10 January 2006 by the *Verkhovna Rada*. Although the constitutional changes giving parliament the right to sack the prime minister and government, had come into force on 1 January 2006, the government remained in office since it did not have the power to remove the government until after the March parliamentary elections.

Third, the eruption of a corruption scandal in September 2005, triggered by the resignation of Oleksander Zinchenko, then head of the presidential secretariat had important implications for the election. Zinchenko alleged that Petro Poroshenko, then head of President Yushchenko's National Security Council, had been involved in a number of unspecified ethically-dubious dealings. None of the allegations were proven yet Yushchenko's failure to handle the situation in a visibly strong-armed

manner made him appear weak in the public eye – electorally fatal in post-Soviet politics.

Fourth, the government's mishandling of public expectations in the wake of the Orange revolution played a role in the election result. In brief, there was not the 'new dawn' that many had hoped for in the post-Kuchma era. Whilst the age of electoral fraud, government sponsored murders, distorted privatisations, tight media control and 'managed democracy' or 'virtual politics' in the words of Andrew Wilson⁴ came to an end, the lives of most Ukrainians had not improved. Indeed for many Ukrainians, the combination of low economic growth and erratic inflation brought lower living standards in 2005 and 2006 after the relative prosperity that characterised the last years of the Kuchma presidency. There was no real breakthrough in negotiations with the European Union. The Yushchenko administration failed to secure even the very vaguest of commitments on the part of the European Union to eventual Ukrainian accession in the period before the election. This is not to deny that progress was made in foreign policy. Ukraine appeared close to NATO membership, yet accession to NATO was a highly divisive issue in Ukrainian politics, with the bulk of public opinion remaining squarely opposed to this as it has done since 1991, seeing the alliance as an unnecessary encumbrance likely to sour relations with Russia – where many Ukrainians have family members living – even further for little gain.

Thus overall, disappointment and disenchantment with the government of Viktor Yushchenko was running high at the time of the parliamentary elections on 28 March 2006. Of the 12 Ukrainians that we interviewed in Kyiv, eight said that they were disappointed with the government of Viktor Yushchenko, describing him as 'weak and ineffective'. All identified the economic situation as worse than previously, and only two remarked that in their opinion it would take more than a year to bring serious improvement to Ukraine's situation economically and politically. These qualitative results were gathered in Kyiv – the heart of the Orange Revolution – a city that voted overwhelmingly for Yushchenko in the presidential elections of 2004. Yet it was not inevitable in late 2005 that Yushchenko's Our Ukraine would be pushed from first place in the parliamentary elections of 2002 and the presidential elections of 2004 to third place in the parliamentary elections of 2006, as the following section explains.

2. Campaign

Campaigning in the Ukrainian parliamentary elections began officially on 13 January 2006 and ran through to 24 March 2006, although some would argue that campaigning really began with the dismissal of Yulia Tymoshenko in September 2005, or even with the agreement to shift power to the parliament brokered at the height of the Orange Revolution on 8 December 2004. This section is divided into three sub-sections: opinion polls, manifestoes and campaign issues.

It is worth noting at the outset, that in contrast to previous election campaigns in Ukraine, there was no attempt by the government to exploit the 'administrative resources' of the state (i.e. the considerable advantages of incumbency in the drawing up of voter lists, control of state-owned media, putting pressure on government

⁴ Andrew Wilson, *Virtual Politics: faking democracy in the post-Soviet World*, Yale, 2005.

employees and so on) during the campaign. As noted above, this election built considerably on the achievements of Ukraine's last national poll – the (repeat) second round of the 2004 presidential elections – and in the opinion of the OSCE conducted a free and fair election.

Opinion Polls

Despite the unpopularity of Viktor Yushchenko and the government of his prime minister, Yuri Yekhanurov, according to the Razumkov Centre, at the end of 2005, Our Ukraine at 13.5 per cent was not too far behind the Party of the Regions' 17.5 per cent support, with the Bloc Yulia Tymoshenko on 12.4 per cent. Following the gas crisis, the Party of the Regions leapt to 24.7 per cent support in January 2006. Our Ukraine's campaign did little to improve its support, ultimately losing out to Bloc Yulia Tymoshenko, and trailing in third place on election day.

Manifestoes

The broad policy outlines on which the main parties and blocs fought the 2006 parliamentary elections did not differ on many issues. The party manifestos of the 'big two' at the outset of the campaign were very similar at the outset of the campaign.

The manifesto of the Party of the Regions – *Welfare to the People! Power to the Regions!* – promised non-aligned status, a referendum on NATO accession, promotion of European integration, improved relations with Russia (including the completion of the Single Economic Space), the elevation of Russian to an official second state language, devolution of power to the regions and tax cuts. Our Ukraine's manifesto – *We have one Ukraine* – offered voters European integration as the main foreign policy goal, WTO accession in 2006, deregulation of business, simplification of the tax system, devolution of power to regional government, reform of the judiciary, war on corruption, and the formation of a professional army by 2010. Essentially, the differences between the two main contenders for power boiled down to disagreements on NATO and relations with Russia and the status of the Russian language in Ukraine.

Yulia Tymoshenko's manifesto was by contrast decidedly vague. Her pledges included 'understanding people's problems', 'making morality and spirituality the country's main development priority' and a more 'humane' tax system. Characteristically populist Bloc Yulia Tymoshenko also promised regular referendums and the abolition of VAT.

Oleksander Moroz's Socialist Party manifesto – *We will Build Europe in Ukraine* – promised a more left agenda, including control of prices, the creation of one million jobs, an end to privatisation of strategic industries, the restoration of state funding for health and education, as well as a referendum on NATO accession.

The Communist Party of Ukraine's manifesto – *Power and Ownership to the People of Ukraine!* – committed the party to the abolition of VAT, to set a single price nationwide for food, medicine and necessities, an end to price increases, opposition to NATO accession, better relations with Russia and the CIS, official status for the

Russian language, a nationalisation programme, together with the introduction of state monopolies on tobacco, alcohol and foreign trade.

Campaign Issues

Campaigning was dominated by the Party of the Regions and Bloc Yulia Tymoshenko. The extraordinary comeback of Viktor Yanukovich – leader of the Party of the Regions – since his defeat in the 2004 presidential elections was one of the big stories of this election. Yanukovich greatly benefited from the experience and skill of a group of American election strategists. Instead of fumbling or falling over his words, his campaign was slick and professional. On one notable occasion, he spoke in Chernivtsi⁵ in western Ukraine, apologising for his inability to address the crowds in Romanian – this was the first attempt to pitch his Party of the Regions as the voice of all Ukraine’s regions and not simply a Donetsk-based⁶ union of Russian-speaking oligarchs or Soviet nostalgics. The Party of the Regions broadcasts focused primarily on the worsening economic situation of Ukraine. Reportage was relentlessly negative, filmed in black and white, depicting under-funded, crumbling hospitals or struggling pensioners.

Our Ukraine’s election campaign was poorly handled, coming on top of January’s gas price hike, it comes as little surprise that the party limped into third place on polling day. In terms of campaign strategy, Our Ukraine’s first mistake was to emphasize the spirit of the Orange Revolution, urging Ukrainians not to ‘betray the Maidan’. This move backfired when it became evident that most Ukrainians blamed Our Ukraine and its chairman, Viktor Yushchenko, for the political infighting and corruption scandals of the post-Kuchma era.

Yulia Tymoshenko’s campaign was distinctly understated in the first weeks of the campaign, with the emphasis on billboards and television placed on the image of Yulia Tymoshenko – the Madonna of Ukraine and martyr of the Revolution – looking dignified and strong. It is possible that her strategists had calculated that their best move would be to say little, in the hope of distancing Yulia Tymoshenko herself from the failures of the present administration (it should not be forgotten that Tymoshenko as prime minister from January to September 2005 was responsible for many of the mistakes of the post-Orange regime). In later weeks, her campaign appealed with greater success to the spirit and principles of the Orange Revolution asking for faith in Yulia and Bloc Yulia Tymoshenko, the true heirs of the Orange Revolution. Her campaign was distinctly short on concrete promises, but this seems to have served to place her ‘above’ the petty squabbles and disputes that divided the other two main parties.

One bright light on the campaign trail was provided by the Communist Party of Ukraine, whose supporters have deserted it in droves since the 2002 parliamentary elections. In 2002, the party came in second place with around 20 per cent of the votes. In 2006, as the table below shows, it polled just 3.66 per cent, barely enough to

⁵ A city on the Romanian border that had been part of Romania between 1918 and 1940.

⁶ Donetsk is a large almost exclusively Russian-speaking city in eastern Ukraine, dominated by a large steel industry. The wealth of the steel industry gave Donetsk’s businessmen the resources to enter the political arena both locally and nationally. The Donetsk ‘clan’ under the Kuchma regime was perceived as one of the most influential – and ruthless – regional business clans on the Ukrainian political scene.

secure representation in parliament. Most of its supporters have passed their support in recent years to the Party of the Regions, particularly since its rhetorical lurch to the left.⁷ Its response in 2006 was to rebrand communism as cool. Out with Stalin and Brezhnev, and in with Neruda and Castro. South American dance and bodybuilding were both exploited as cool activities in which communists excel. Although the campaign failed to lift the communists off the electoral floor, it certainly provided an interesting backdrop to an otherwise (by Ukrainian standards) tame election.

In conclusion to this section, the Party of the Regions' spectacular comeback was made possible by its relentless focus on the discontent of Ukrainian voters with the failure of the Orange Revolution to deliver the sweeping changes it promised. Ukraine's economic woes also greatly aided the Party of the Regions, particularly since its leader had presided as prime minister of Ukraine from 2002–04 over a period of strong economic growth. Our Ukraine was campaigning from a position of weakness at the outset of the campaign, and exacerbated its position with a clumsy campaign that annoyed and alienated many voters who transferred their support to Yulia Tymoshenko. Smaller parties that might have been expected to gain seats in the new *Verkhovna Rada* – notably the Lytvin bloc or the Natalia Vitrenko bloc – were squeezed out by the abolition of single mandate constituencies and the feeling amongst many voters that casting a ballot in their favour would be a waste. The Lytvin bloc aimed to build a new electoral bloc based on the popularity of Volodymyr Lytwin, former speaker of the *Verkhovna Rada*, and perceived by many as an 'honest broker' in the Orange Revolution. The Natalia Vitrenko bloc ran on a Leninist programme with a strongly nationalist 'socialism in one country' theme, promising to liberate Ukraine from its dependence on foreign energy.

⁷ The Party of the Regions – like all Ukrainian political parties with the exception of the Communists – is a party of the rich, the only difference in this instance is that the Party of the Regions boasts the support of Ukraine's very wealthiest, including Rinat Akhmetov, Ukraine's richest man and now a Party of the Regions deputy.

3. Results

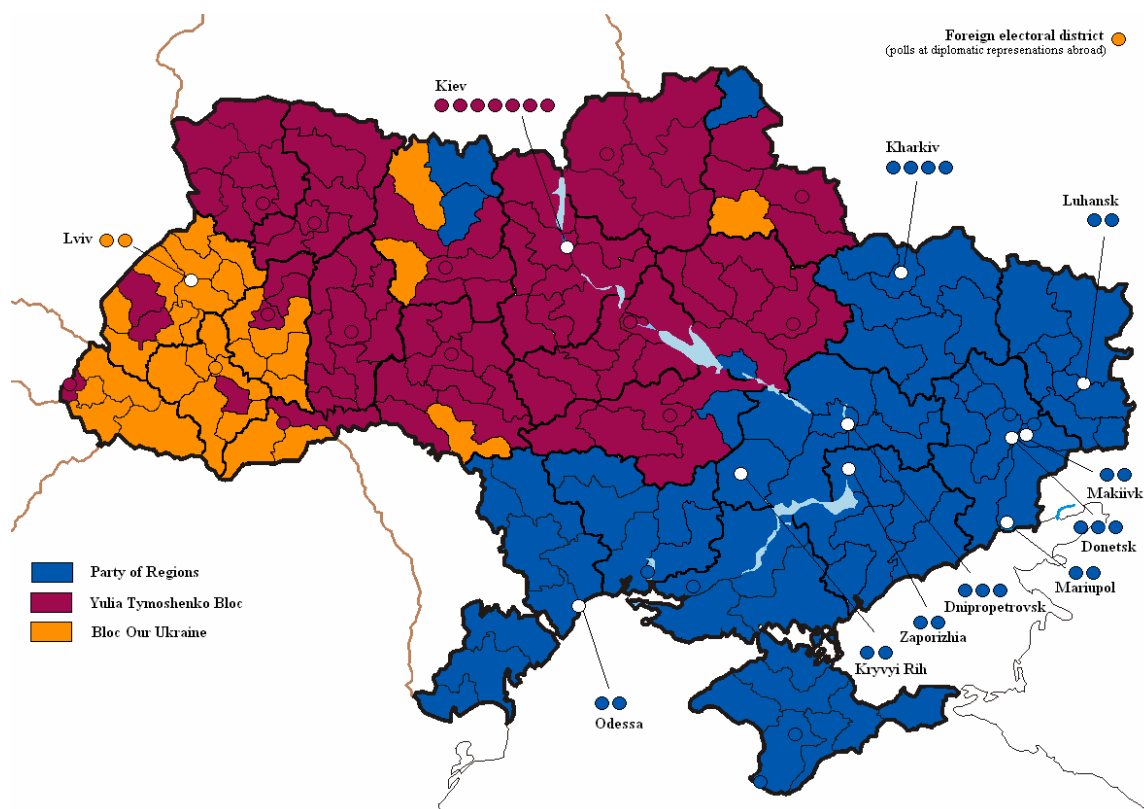
Table 1: Results from the Ukrainian Elections to the *Verkhovna Rada* in 2006

	Total Votes	% of Vote 2006	% of Vote 2002	Seats 2006
Party of the Regions	8,148,745	32.14	11.8	186
Bloc Yulia Tymoshenko	5,652,876	22.39	7.2	129
Our Ukraine	3,539,140	13.95	23.6	81
Socialist Party of Ukraine	1,444,224	5.69	6.9	33
Communist Party of Ukraine	929,591	3.66	20	21
Natalia Vitrenko Bloc	743,704	2.93	3.2	0
Lytvyn Bloc	619,905	2.44	0	0
Kostenko-Plyushch Bloc	476,155	1.87	0	0
Viche	441,912	1.74	0	0
Pora-Reforms and Order Bloc	373,478	1.47	0	0
Opposition Bloc 'Ne Tak'	257,106	1.01	0	0
Others below 1%	1,785,299	7.04	n/a	n/a
Against all	449,650	1.77	n/a	n/a
Spoilt ballots	490,595	1.9	n/a	n/a
Totals:	25,352,380	100	n/a	450
			Turnout:	67.30%

Source: Central Electoral Commission of Ukraine. <http://www.cvk.gov.ua/>

Turnout for the parliamentary elections at 67.3 per cent was considerably down on the 77 per cent mean turnout in the three rounds of the 2004 presidential elections, but not markedly lower than the 69.4 per cent recorded for the parliamentary elections of 2002. Overall these results are not particularly surprising, presidential elections traditionally attract more public attention than parliamentary elections – although it is just possible that this may change once it becomes more immediately apparent to voters where the real power in Ukraine now lies, i.e. with parliament and not with the presidency.

Map 1: Voting by Region in Ukraine



Source: Central Electoral Commission of Ukraine. <http://www.cvk.gov.ua/>

Regional patterns of voting showed little change on the presidential elections, with support for Yanukovich being concentrated in the east and south of the country. Tymoshenko's gained most votes in western and central Ukraine, although the concentration of die-hard supporters of Our Ukraine in the western region around Lviv turned out in sufficient numbers to make the front runner in a few regions as the map above indicates. As a point of interest for those with an interest in history – in a similar pattern to Poland – divisions in voting patterns in Ukraine in 2006 still run along the lines of the partitions of seventeenth century Ukraine between the Polish-Lithuanian Commonwealth of the Two Nations and the Russian Empire in the Treaty of Andrusovo of 1667. Overwhelmingly, in Ukraine this is a reflection of the degree of Russification, particularly linguistically – rather than Sovietisation – of the different regions of Ukraine.

As the above table demonstrates, the Party of the Regions was the undisputed victor of the elections, gaining 32.14 per cent of the popular vote and 41.3 per cent of the seats in the *Verkhovna Rada*. Yet this position of strength is deceptive, since it does not have an obvious coalition partner, despite rumours of a possible 'grand coalition' between the Party of the Regions and Our Ukraine.

Yulia Tymoshenko ruled out the possibility of entering into a coalition with the Party of the Regions and made it clear in the campaign that she would expect Our Ukraine to do the same. It is likely that her position on this won over many wavering erstwhile Orange voters. Returning to the issue of remaining 'true to the spirit of the Maidan', it could potentially be electoral suicide in the future for Yushchenko's Our Ukraine to

enter into coalition with the Party of the Regions, the present home of many of the Kuchmisti who tried to steal the 2004 presidential elections, triggering mass protests and the Orange Revolution that swept Yushchenko to power. Thus an Our Ukraine-Party of the Regions Coalition, with a majority of 84 seemed unlikely.

In the post-election, coalition-forming stage, Our Ukraine and its parliamentary leader, Yuri Yekhanurov, found itself in a very awkward position as the weakest of the big three political parties, yet the only one of the three willing to enter into a coalition with one of the other two. There was no dream solution of a return of the January–September 2005 Orange coalition plus Oleksander Moroz’s Socialists, with a majority of 36, since this would entail the appointment of Yulia Tymoshenko. Interestingly, much of the post-electoral speculation centred on what Viktor Yushchenko intended to do – despite the removal of the presidential right to nominate the prime minister, he still appeared the key player behind the scenes in Ukrainian politics, meeting with Yanukovych and Tymoshenko to discuss possible coalition deals.

4. European Dimension

European issues were represented in the campaign in the question of Ukrainian accession to the European Union. Ukraine has long had a clear majority of about 56 per cent in favour of European integration, with 16 per cent against.⁸ This largely due to its association with higher living standards and the rule of the law. The same is not true for NATO membership, which a majority of Ukrainians against joining. This section discusses the implications of the 2006 parliamentary election results for Ukraine’s integration into the EU and NATO. NATO membership was important as part of the European dimension of this election, since at the time of the poll, many Ukrainian politicians considered that NATO accession represented a staging post on the road towards EU accession.

As noted above, there is a broad consensus amongst the three main political parties in Ukraine about the need for European integration. Although the Yulia Tymoshenko bloc tended to remain silent on the EU integration issue during the campaign, there is little doubt that the bloc remains committed to that goal. The only question is whether Tymoshenko would be willing – if chosen as prime minister – to make the kind of tough policy choices that will be needed to integrate Ukraine into the western European structures. Our Ukraine is fully pro-European and promised to make the early achievement of EU associate member status a foreign policy priority. The Party of the Regions remains slightly more ambiguous in its European policy, promising both closer ties with the EU and better relations with Russia, particularly through the completion of the Single Economic Space. However, the pro-Russian policy of the Party of the Regions seems to be more about appealing to certain sections of the eastern Ukrainian electorate than about serious foreign policy realignment – after all, EU integration was the main foreign policy goal of the Kuchma era. The reason for this lies largely in the Party of the Regions’ position as the political choice of many of Ukraine’s richest businesspeople who see closer integration with the EU as desirable in opening up new markets in western Europe. Given that full integration into the

⁸See: Joanna Konieczna, *Polska-Ukraina Wzajemny Wizerunek*, Instytut Spraw Publicznych, Warsaw, 2001, p. 71.

Russian-dominated Single Economic Space is not compatible with EU membership, there is little question that Ukraine will continue to push for closer relations with the EU.

Ukraine should not have expected any more of a warm welcome from within the EU in its membership ambitions that it received after the Orange Revolution. It may have proved its democratic credentials and have made the fateful 'European choice' that former President of the Commission, Romano Prodi, urged Ukrainian voters to make several years ago. Substantially, however, the conditions affecting the enlargement debate within the Union had not yet shifted since the French and Dutch referendums on the European Constitutional Treaty in May 2006 and this represented the major obstacle to EU integration for Ukraine. Ukraine's main ally in its quest for European integration Poland had lost the confidence of many of its European allies since the election of a populist government and president in autumn 2005 and their combined implementation of a clumsily anti-European policy.

Yet Ukraine's European outlook is not as bleak as it perhaps appears. Ukrainian membership of the Union by anyone's reckoning is a very long way off anyway. In 2006, Ukraine is likely to join the WTO which will win easier access to the Single Market and lift the burden of potential anti-dumping measures being imposed on Ukrainian businesses exporting to the Union. Ukraine would be better advised to seek a new form of agreement with the EU – perhaps something akin to associate membership – when its current agreement comes up for review in autumn 2006. In this, Ukraine should focus more on winning concrete access to the Single Market and perhaps some relaxation of the visa restrictions for Ukrainian citizens travelling to the Schengen area, rather than pushing for a symbolic pledge to recognise Ukraine's right to membership of the Union. In the run-up to the 2009 presidential election, Ukraine would then have plenty of time to approximate much of the *acquis communautaire* and prepare for accession in the longer term – in any case, many of these reforms would be beneficial to Ukraine politically and economically in any case.

NATO membership is highly unpopular amongst Ukrainians. According to a Democratic Initiatives Poll conducted in February 2005, only 15 per cent of Ukrainians were in favour of accession, with 48 per cent against and 36 per cent undecided.⁹ Yet this poll is misleading in that it does not take into account the opinions of the military, who after all will be most affected by the decision to join. The Ukrainian military is largely in favour of membership and of professionalisation of the armed forces – which Our Ukraine has promised to achieve by 2009.¹⁰ Moreover, there are several concrete benefits that Ukraine would reap by joining NATO in the next two or three years. First, Ukraine – in contrast to, for example, Slovakia, the Czech Republic or the Baltic States – has much to offer NATO in terms of firepower and equipment, especially military transport aircraft. Second, Ukraine has already participated in peacekeeping missions around the world, most recently in Iraq and its role as a regional exporter of security would be bolstered by the decision to join NATO. Third, and in a sense most importantly, Ukraine's reputation as a

⁹ Source: Democratic Initiatives Foundation. Methodology: Interviews to 2,040 Ukrainian adults, conducted from Feb. 4 to Feb. 15, 2005. Margin of error is 2.3 per cent.

<http://foreignpolicy.org.ua/eng/headlines/society/opinion/index.shtml?id=4244>

¹⁰ Author interview with Pavlo Klimkin, deputy head of mission, Ukrainian Embassy, London, 24 January 2006.

respectable 'western' power in the eyes of Madrid or Paris would rise, thus supporting its claims to EU membership. There is a minor risk that Ukraine could be seen as another American Trojan horse within the Union like the UK or the eight ex-communist Member States, but this is a risk worth taking, and in any case it is better to be perceived as pro-US European state than as a province of Russia.

If the unpopular move towards joining NATO could be linked to the popular idea of abolishing conscription it is possible that public opinion could be brought around. Joining NATO would nonetheless prove a major hurdle for any Ukrainian administration, both in terms of hostile public opinion and in terms of deteriorating still further relations with Russia. Ukrainian politicians may reflect to themselves, however, that once Ukraine is paying the world price for its oil and gas supplies, there largely remains little else that Russia could do to hurt Ukraine beyond introducing a visa for Ukrainians travelling to Russia. The question of NATO membership should be resolved one way or another before the presidential elections in 2009 since the issue is likely to divide the electorate.

Conclusions

What is remarkable about the 2006is Ukrainian parliamentary election is how uneventful it proved to be. In contrast to previous elections, there was no vote rigging, ballot stuffing, government censorship of the media, intimidation of voters, political murders or similar undemocratic behaviour. It is true that some voters had to queue for a couple of hours to cast their ballot, but in the opinion of the OSCE and the author this was not an attempt to rig the election so much as administrative oversight. Moreover, there was no attempt on the part of the Russian government to influence the election by endorsing a particular political party, either through favourable reportage on the Russian channels that many eastern Ukrainians prefer or through the personal intervention of President Putin in a state visit timed to coincide with the elections. The peace and calm of the Ukrainian elections were all the more obvious when compared to what took place in the presidential elections in Belarus in March 2006.

The parliamentary elections of 2006 further consolidated Ukraine's democratisation and gave a sense of a move away from the managed democracy of the Kuchma years. Power was more effectively dispersed between the presidency and the parliament, although it remained to be seen how the new constitutional set up will actually work in practice.

On the policy front, two of the three main political parties or blocs – the Party of the Regions – share a broadly similar policy agenda, despite their opposing positions during the Orange Revolution. Ukraine's path towards European integration will certainly be slow, but it is highly unlikely that it will abandon this course. The third main political force – the Yulia Tymoshenko bloc – did not have a clear policy agenda and seemed likely to remain something of a loose cannon in the subsequent legislature, whether within government or without.

EU and NATO accession will be pursued, although the latter is likely to be achieved far more quickly and in the face of strong public opinion against membership. The economy is unlikely to recover the dizzy heights of the double-digit growth GDP

growth it clocked up around the turn of the century, but once the shock of the increase in energy prices is absorbed, it should rise with continuing programme of government reform.

Looking back at the events of the Orange Revolution 16 months on, or the ‘spirit of the Maidan’ that was so often invoked for different reasons during this quiet election campaign, a few observations may be made. First, given the tidal wave of expectations on which the Orange revolutionaries were swept to power, the revolutionaries inevitably disappointed in government. Ukraine changed radically, but there was no ‘new dawn’. Second, the opposition made a spectacular comeback and abandoned its old anti-democratic habits. Yet this should be welcomed since the government will need a strong – and loyal – opposition. Third, since the ‘spirit of the Maidan’ was less about political personalities or policies than the rule of law, all Ukrainians, but especially those who protested on the Maidan should be proud of the way in which the 2006 parliamentary elections were conducted. That Ukraine is becoming a ‘normal country’ is more a result of the temerity and fortitude of its citizens than any amount of strong leadership on the part of Ukrainian politicians or US-funded democracy programmes. Ukraine may still be a poor country, but it is a democratic one. Ukrainians need only look over the border at their neighbours to the north to realise just how far they have come in so short a period of time.

L'Union fait la force? Potential and limitations of the European Neighbourhood Policy as an integrated EU foreign and security policy*

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Introduction

The external policies of the European Union may be viewed as the outcome of the interaction between the Member States, the European Community (acting in the context of the 'first pillar') and the European Union (acting on the basis of the second and third pillars). This tripartite interaction, which involves a large number of actors, operating within different institutional logics, makes it challenging for the Union to conduct coherent policies, or to fulfil its objective of affirming its identity on the world stage (Article 2 TEU).

Complex legal arrangements and institutional practices have developed over the years in order to promote coherence between the Member States and the Community (vertical coherence), mixed agreements being a case in point. Increasingly, attention has also been given to the challenge of ensuring coherence between the three EU pillars (horizontal coherence).¹¹ Thus far, in the absence of a complete collapse of the pillar structure, the solution has been to attempt to integrate the pillars within the framework of one policy. The European Neighbourhood Policy (ENP) is a particularly developed expression of such a policy.

This is no coincidence. In fact, the need for a coherent over-arching policy with a security dimension towards its neighbours, especially the eastern European States of the former Soviet Union, has been recognised and prioritised by the EU since well before the formal establishment of the ENP. The first Common Strategies to be adopted were with Russia and Ukraine,¹² Common Strategies having been introduced by the Treaty of Amsterdam into Title V TEU in order to provide a framework for coherent policy-making across the pillars.¹³ The Vienna European Council, discussing the implementation of the Amsterdam Treaty in December 1998, accepted the Council's recommendation to draft the first Common Strategies on relations with the EU's neighbouring countries: Russia, Ukraine, the Mediterranean and the Western

* Thanks to Anne Myrjord for her suggestions and comments.

¹¹ On coherence, see e.g. Gauttier, 'Horizontal coherence and the external competences of the European Union', (2004) 10 *ELJ* 23.

¹² At the Cologne European Council in June 1999 and the Helsinki European Council in December 1999 respectively.

¹³ Hillion, 'Common Strategies and the interface between EC external relations and the CFSP: lessons of the Partnership between the EU and Russia' in Dashwood and Hillion (eds.) *The General Law of EC External Relations* (Sweet & Maxwell 2000); Maresceau, 'EU Enlargement and EU Common Strategies on Russia and Ukraine: An Ambiguous yet Unavoidable Connection' in Hillion (ed.) *EU Enlargement: A Legal Approach* (Hart 2004).

Balkans.¹⁴ The Council had argued that it was with the neighbours that ‘the EU has the greatest long-term common interests and the greatest need for coherence and effectiveness.’¹⁵ As Maresceau has said, the Common Strategy as an instrument designed to facilitate cross-pillar activity within existing decision-making frameworks, seemed destined to have a promising future.¹⁶ However that potential was not fulfilled, for a number of reasons including the Common Strategy’s firm positioning within Title V of the TEU. The ENP, as an alternative mechanism designed to offer coherent policy-making in the cross-pillar context of relations with the EU’s strategically important neighbours, does not rely on new instruments but rather offers a way of integrating existing instruments via ‘soft’ frameworks (European Council and Council Conclusions and Commission policy papers among others).

The EU appears to have great faith in the potential of the ENP both as an instrument of an integrated foreign policy for the EU and as a framework for increasing stability and security within the EU’s neighbourhood. Indeed, since the Commission published its first policy papers on ‘Wider Europe’ in 2003-04,¹⁷ the EU Council has decided to widen the geographical scope of the Policy to embrace Armenia, Azerbaijan and Georgia,¹⁸ in addition to the initial ‘ENP countries’ in Eastern Europe (Belarus, Moldova and Ukraine) and the Southern Mediterranean (Israel, Jordan, Morocco, the Palestinian Authority and Tunisia). The Council has also invited the Commission, in cooperation with the High Representative for CFSP, to continue talks already engaged with Egypt and Lebanon.¹⁹

As well as widening the ENP, the EU has also deepened its policy in relation to its initial addressees, Ukraine in particular. As a supplement to the Action Plan for Ukraine adopted in 2005,²⁰ a list of specific measures to intensify EU-Ukraine cooperation was approved by the Council in 2005, following the ‘Orange Revolution’.²¹ In addition, the Commission has proposed to start negotiations for an enhanced agreement with Ukraine to reinforce the Partnership and step up EU-Ukraine cooperation.²² All these initiatives cover the whole breadth of bilateral relations, from closer cooperation in the area of foreign and security policy and visa policy to cooperation in key sectors including energy, transport, environment and health.

¹⁴ Conclusions of the European Council, Vienna 11-12th December 1998, para 74.

¹⁵ Report from the Council to the European Council on Common Strategies, 7 December 1998, doc.13943/98.

¹⁶ Maresceau, note 3, at 182.

¹⁷ Communication from the Commission to the Council and the European Parliament, ‘Wider Europe—Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours’, 11 March 2003, COM(2003) 104; Communication from the Commission, ‘European Neighbourhood Policy – Strategy Paper’, 12 May 2004, COM(2004) 373.

¹⁸ Council Conclusions of 14 June 2004 on the ENP; 10189/04 (Presse 195), see in particular pt. 12 of the Conclusions. See also the Conclusions of the European Council on the ENP of 17/18 June 2004.

¹⁹ General Affairs and External Relations Council Conclusions of 25 April 2005, 8035/05 (Presse 86).

²⁰ Recommendation No. 1/2005 of the EU-Ukraine Cooperation Council of 21/02/2005 on the implementation of the EU/Ukraine Action Plan.

²¹ GAERC 21 Feb 2005, Conclusions on Ukraine.

²² See Press Release IP/06/1184,

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/06/1184&format=HTML&aged=0&language=EN&guiLanguage=en>

The present paper aims to analyse the ENP as a contribution to the EU's efforts to evolve a more coherent external action. Ukraine will serve as an example, as the advanced implementation of the ENP towards this country offers the best illustration of the policy, in both its potential and its shortcomings. It will be shown that the ENP is a cross-pillar security policy (1), which draws heavily on the specific methodology developed within the framework of the EU pre-accession strategy (2). It will be argued that, while this new formula of external action carries the potential of fostering the coherence of EU external action, its effectiveness, in policy terms, may be hampered by several inherent paradoxes and tensions (3).

1. A cross-pillar security policy

The ENP is broad in its coverage, addressing issues dealt with under all the pillars of the Union, ranging from human rights and the rule of law to economic integration and environmental protection. Underpinning the Union's engagement is its concern with security (a). More specifically, the ENP may be regarded as a regional implementation of the European Security Strategy, thus reflecting the Union's ambition to provide coherence in its relations with the outside world (b).

a) Comprehensive security as a driving force

The idea of a European Neighbourhood Policy was formally launched by the joint Solana/Patten letter of 7 August 2002,²³ which put security high on the agenda:

'What are our interests and what do we want to achieve? There are a number of overriding objectives for our neighbourhood policy: stability, prosperity, shared values and the rule of law along our borders are all fundamental for our own security. Failure in any of these areas will lead to increased risks of negative spill-over on the Union.'

Indeed, the security dimension of the ENP is not merely an incidental component, it is fundamental to the policy as a whole. At the launch of the first ENP Action Plans in December 2004, Commissioner Ferrero-Waldner outlined what she saw as the three main benefits to the EU:

'The EU gains the benefits of a stable neighbourhood. Our assistance will support countries in their own economic and political reforms to spread the benefits of prosperity and democracy. This is good for us as well as our neighbours.'

The EU gains improved security around its borders. Increased cross border cooperation will help us to tackle problems from migration to organised crime.

The EU gains because our partners sign up to stronger commitments on the fight against terrorism, non-proliferation of WMD, and to the peaceful resolution of regional conflicts.'

²³ Joint letter by EU Commissioner Chris Patten and the EU High Representative for the Common Foreign and Security Policy on Wider Europe. 7 August 2002.
http://www.europa.eu.int/comm/world/enp/pdf/0130163334_001_en.pdf

This emphasis on security as the basis for the ENP overall, and relations with Ukraine in particular, is not surprising. Nor is it new. For instance, the Common Strategy with Ukraine adopted in December 1999 identified as the second ‘strategic goal’ of the Strategy, ‘the maintenance of stability and security in Europe and the wider world’.²⁴ The political dialogue established under Article 6 of the Partnership and Cooperation Agreement²⁵ with Ukraine also has among other objectives,

‘- to bring about an increasing convergence of positions on international issues of mutual concern thus increasing security and stability, - that the Parties endeavour to cooperate on matters pertaining to the strengthening of stability and security in Europe.’

However the idea of security as underpinning EU policy towards the region more generally, rather than one goal among several, is more recent. It can be traced to a number of factors. It is linked to the terrorist attacks on the US on 11 September 2001, leading to a greater concern with terrorism and its links to organised crime and the regulation of cross-border movement. It is also related to the impact of EU enlargement, the moving eastwards of the EU’s borders, which runs parallel to the efforts to remove internal border controls within the EU, thus placing increased emphasis on the security of external borders. Indeed, enlargement entails the creation of new ‘dividing lines’ within Europe, and the ensuing risk of economic and political instability at the EU’s doorstep. Further, for the eastern dimension of the ENP, the concern for security may be traced to the size, strategic importance and economic potential of Ukraine, and its potential as a regional leader. Finally, the European Security Strategy, adopted by the European Council in December 2003, puts neighbourhood security as a key strategic objective of the Union, as shall be seen below.

It should be noted that ‘security’ is a broad concept in the ENP. In June 2004 the Council defined the objective of the European Neighbourhood Policy as being

‘... to share the benefits of an enlarged EU with neighbouring countries in order to contribute to increased stability, security and prosperity of the European Union and its neighbours.’²⁶

Security is here linked to stability and prosperity, and indeed stability and prosperity are not only objectives in their own right but are designed to lead through political and economic development to security. Different dimensions to security are emphasised: internal stability, cooperation between the enlarged EU and its neighbours (avoiding the creation of new dividing lines) and in particular ‘mutual commitment’ in relation to specific matters of concern to the EU’s security policy: terrorism, non-proliferation and WMD, regional conflict resolution and justice and home affairs and border control issues (immigration and organised crime in

²⁴ See also the Common Position defined by the Council on the basis of Article J.2 of the Treaty on European Union on the objectives and priorities of the European Union towards Ukraine [OJ 1994 L313/1].

²⁵ OJ 1998 L 49.

²⁶ GAERC 14 June 2004.

particular).²⁷ Thus, security is taken to imply security within the neighbouring States, security within the region, security at the external borders of the EU, and security within the EU itself, each of these impacting on the others. Also, and as High Representative Javier Solana has argued, security extends beyond the purely military to include broader political, economic, social and even environmental aspects:

‘It is a long time since security was thought of only in terms of military force. We all know that security is far broader today, that it includes economic, environmental, and social issues. Indeed, non-military threats to security loom much larger in the mind of most people . . . These non-military security threats are not adequately dealt with by any of our international institutions. . . . This is where the European Union must take up the challenge.’²⁸

The ENP’s cross-pillar dimension is thus an important aspect of its security basis. Its objectives can be related to the first pillar (economic development and closer economic integration, environmental protection, energy policy, border control); the second pillar (enhanced domestic political stability, cooperation in regional conflict prevention, alignment to EU policy on WMD) and the third pillar (cooperation on organised crime and terrorism), while all contributing to the overall security objective. The ENP thus epitomises the emerging role of security in EU external policy. No longer is security just one aspect of the Common Foreign and Security Policy. Rather, it has become a cross-pillar policy in its own right, creating a potentially more coherent EU external action which integrates the three poles of decision-making: the Member States, the Community pillar and the EU pillars, but which also carries the potential for inter-pillar boundary disputes.²⁹

b) Regional implementation of the European Security Strategy

The comprehensive approach of the ENP to security is best understood within the wider framework of the European Security Strategy (ESS), adopted by the European Council on 12 December 2003.³⁰

The elaboration of the ESS was triggered by the US decision to invade Iraq.³¹ US policy, and the consequent divide between the EU Member States, gave rise to the need to articulate, for the first time, a distinctively European approach to security (which would nevertheless emphasise the ‘irreplaceable’ nature of the transatlantic relationship).³² The EU sees its responsibility for global security³³ as based on its own

²⁷ See also GAERC 13-14 Dec 2004.

²⁸ Javier Solana, ‘The EU–Russia strategic partnership’, speech delivered 13 October 1999, Stockholm.

²⁹ See for example case C-91/05 *Commission v Council*, pending.

³⁰ Available on <http://ue.eu.int/uedocs/cmsUpload/78367.pdf>

³¹ Toje, ‘The 2003 European Union Security Strategy: A Critical Appraisal’, (2005) 10 EFA Rev. 117 at 119.

³² At the Informal GAERC at Kastelorizo, Greece, 2-3 May 2003, it was agreed to ask HR Solana to draw up what was referred to as a ‘European strategic concept’ and specific proposals ‘on how to project and deepen ESDP’ (see Presidency Press Statement available on <http://www.eu2003.gr/en/articles/2003/5/3/2662/>); the draft ESS was presented to the Thessaloniki European Council, 20-21 June 2003. There are obvious analogies with the NATO Strategic Concept, adopted in 1999, and the US National Security Strategy of 2002; on this see Duke, ‘The European Security Strategy in a Comparative Framework’ (2004) 9 EFA Rev 459.

³³ ‘Europe should be ready to share in the responsibility for global security and in building a better world’, ESS, 1.

achievements in terms of peace and integration.³⁴ In addition to supporting multilateralism and strengthening international and regional institutions, the EU presents itself as a model for conflict resolution, for regional conflict prevention,³⁵ and – based on its enlargement practice – as having a great deal of experience in state building.³⁶ Enlargement has been an important instrument, and still is: as far as the Balkans are concerned, for example, the ESS claims that ‘[t]he European perspective offers both a strategic objective and an incentive for reform.’³⁷

There is thus a strong regional dimension to the ESS and, in spite of its title and references to global security, the main emphasis is on security in the neighbourhood and at its borders:

‘It is in the European interest that countries on our borders are well-governed. Neighbours who are engaged in violent conflict, weak states where organised crime flourishes, dysfunctional societies or exploding population growth on its borders all pose problems for Europe.

The integration of acceding states increases our security but also brings the EU closer to troubled areas. Our task is to promote a ring of well governed countries to the East of the European Union and on the borders of the Mediterranean with whom we can enjoy close and cooperative relations.’³⁸

There are several reasons for this emphasis on the neighbourhood. It is a security objective which the Member States can all agree to support; it is in the EU’s neighbourhood that a distinctively European contribution to security, based on State-building, is most feasible; moreover, the security concerns within the neighbourhood both demand and provide a focus for a deliberate attempt by the EU to build a coherent cross-pillar policy.

Thus the ESS puts neighbourhood security as one of its strategic objectives, and stresses the importance of the regional dimension: ‘Coherent policies are also needed regionally, especially in dealing with conflict. Problems are rarely solved on a single country basis, or without regional support.’³⁹ But it goes deeper than that. The ENP is one of the first examples of a policy that in its priorities, especially as set out in the Action Plans, deliberately reflects the threats identified by the ESS, its overall approach to security and its strategic objectives. A contrast can be drawn between the ENP objectives of stability, security and prosperity and the ‘cycle of conflict, insecurity and poverty’ in which, as the ESS argues, a number of countries and regions are trapped.⁴⁰ The five threats identified in the ESS (terrorism, proliferation of WMD, regional conflicts, state failure and organised crime) as well as the strategic objectives designed to combat those threats (building neighbourhood security, and a commitment to effective multilateralism, the ‘development of a stronger international

³⁴ Duke, ‘The European Security Strategy in a Comparative Framework’ (2004) 9 EFA Rev 459 at 463.

³⁵ Kronenberger and Wouters (eds.): *The European Union and Conflict Prevention* (2004, Asser Press).

³⁶ Roles which are indeed codified in Article III-292 of the Treaty establishing a Constitution for Europe.

³⁷ ESS, 8.

³⁸ ESS, 7. Duke, ‘The European Security Strategy in a Comparative Framework’ (2004) 9 EFA Rev 459 at 464.

³⁹ ESS, 13.

⁴⁰ ESS, 2.

society, well functioning international institutions and a rule-based international order'⁴¹) are all strongly reflected in the Action Plans of the ENP. Thus we can find in these Action Plans an emphasis on good governance and state-building through support for economic and social transition; the use of trade and assistance programmes to promote economic and political reform; an emphasis on the importance of a rule-based international system, with references to the need for the partners to subscribe to international legal and soft law instruments and to participate in international and regional institutions. Hence, for example, in encouraging a Ukrainian contribution to and participation in EU-led crisis management and conflict prevention policies the ENP also seeks to co-opt the EU's partners into sharing and helping to achieve its ESS objectives.

In seeking to realise those objectives, the ESS reaffirms the existing approach, methodologies and instruments of EU external policy in general and the ENP in particular. It emphasises the role of international institutions, regional organisations, international legal instruments (such as arms control treaties and the establishment of the International Criminal Court), improvements of governance (especially the rule of law, fighting corruption, the protection of human rights) through 'assistance programmes, conditionality and targeted trade measures' and the use of conditionality against countries that 'have placed themselves outside the bounds of international society'.⁴² Security policy is thus to be achieved not solely through the development of the military and civilian dimensions of the emerging security and defence policy (such as military operations, police missions, crisis management, and peacekeeping) but also uses traditional first-pillar instruments such as trade policy, international agreements, technical assistance programmes and conditionality.⁴³ The ENP reflects a desire to improve coherence in the use of instruments, to bring together under one policy umbrella a number of instruments including bilateral agreements, assistance programmes and Action Plans.⁴⁴ There is a greater attempt to integrate the JHA dimension into the wider external relations picture.⁴⁵ This is not only about making the EU more efficient, but as pointed out in the ESS:

'In contrast to the massive visible threat in the Cold War, none of the new threats is purely military; nor can any be tackled by purely military means. Each requires a mixture of instruments. ... The European Union is particularly well equipped to respond to such multi-faceted situations.'⁴⁶

The range of instruments at the Union's disposal can indeed be seen as an opportunity to create a coherent security policy, but also raises challenges both in identifying appropriate instruments and in managing a strategy which seeks to combine the EU's own security agenda with a concept of joint ownership.

⁴¹ ESS, 9.

⁴² ESS, 10.

⁴³ Whitman, 'Road Map for a Route March? (De-)civilianizing through the EU's Security Strategy' (2006) 11 EFA Rev. 1.

⁴⁴ 'The challenge now is to bring together the different instruments and capabilities: European assistance programmes and the European Development Fund, military and civilian capabilities from Member States and other instruments. All of these can have an impact on our security and on that of third countries. Security is the first condition for development.' ESS, 13.

⁴⁵ See also the Strategy on the external dimension of JHA, agreed by the Council in December 2005.

⁴⁶ ESS, 7.

2. A methodology inspired by the integrated EU enlargement policy

The EU desire to provide a coherent policy towards its immediate environment is not only reflected in the *issues* covered by the ENP. It is also visible in the *methodology* established to implement the policy. Highly reminiscent of the practices developed within the framework of the EU pre-accession policy since the mid-1990s onwards (a), the ENP methodology (b) contains elements which challenge the ‘pillar politics’ that have often characterised the development of the EU system of external relations.⁴⁷

a) EU enlargement policy: An efficient external policy transcending ‘pillar-politics’

The EU enlargement policy was developed by the EU institutions and Member States particularly in relation to the countries from Central and Eastern Europe with a view to preparing those states to become members of the Union. Its efficiency has been remarkable, mainly due to an unprecedented system of multilayered conditionality, backed up by unique institutional practices demonstrating a high level of integration and coherence in the Union’s policy towards the candidate states. Indeed, the very *nature* of enlargement necessitates an integrated approach. It entails the promotion of the *EU acquis* as a whole vis-à-vis a third state having applied to become member. The applicant state should not only be ready to observe EC norms, it should also accept those of the other sub-orders of the EU, namely CFSP principles and measures, as well as all the rules related to the JHA/PJCCM. The division of the EU into sub-orders therefore does not matter in the accession process because the latter is all-encompassing by definition.

The comprehensive character of the EU enlargement process has been articulated particularly in the ‘pre-accession strategy’.⁴⁸ This strategy relied notably on the so-called ‘accession partnership’,⁴⁹ which not only transformed the existing bilateral ‘Europe agreements’ into a key pre-accession instrument,⁵⁰ but which also led to the emergence of a system whereby the candidates would adapt to all *EU* standards under close scrutiny by the EU institutions.⁵¹

Under this ad hoc system, the Commission drafts, in consultation with each of the candidates, individual accession partnerships setting out a list of principles, objectives and priorities on which the candidate’s adaptation efforts should focus with a view to

⁴⁷ See e.g. Timmermans, ‘The uneasy relationship between the Community and the second pillar of the Union: back to the Plan Fouchet?’ (1996) 1 LIEI 66

⁴⁸ For a detailed analysis of the pre-accession strategy, see Maresceau, ‘Pre-accession’ in Cremona (ed), *The enlargement of the European Union* (OUP, 2003) 9.

⁴⁹ Council Regulation No 622/98 on assistance to the applicant States in the framework of the pre-accession strategy, and in particular on the establishment of Accession Partnerships (OJ 1998 L85/1).

⁵⁰ Maresceau and Montaguti, ‘The relations between the European Union and central and eastern Europe: a legal appraisal’ (1995) 32 *CMLRev* 1327.

⁵¹ On Accession Partnership, see Grabbe, ‘A Partnership for Accession? The Implications of EU Conditionality for the Central and East European Applicants’, *Working Paper no. 99/12* (EUI Robert Schuman Centre for Advanced Studies, 1999); Inglis ‘The pre-accession strategy and the accession partnerships’ in Ott and Inglis (eds), *Handbook on European Enlargement* (TMC Asser, 2002) 103; Hillion, ‘Enlargement: a legal analysis’ in A. Arnulf and D. Wincott (eds), *Accountability and Legitimacy in the European Union* (OUP, 2002) 403.

meeting fully the EU accession conditions, i.e. the ‘Copenhagen criteria’.⁵² Candidates’ performance in meeting all those targets is assessed by the Commission in annual progress reports,⁵³ On the basis of the Commission’s comprehensive reports,⁵⁴ the Council determines the evolution of the relationship with each candidate, and in particular the pace of accession negotiations, as well as the allocation of pre-accession financial assistance. Indeed, the Accession Partnership Regulation establishes a system whereby the Council, on a proposal from the Commission, can *review* the pre-accession financial assistance, if progress in meeting the Copenhagen criteria is held insufficient.⁵⁵ The Council then reports to the European Council, acting as the final political arbiter on the matter.⁵⁶

The management of the accession partnership thus typifies the development of new roles for the institutions, and novel forms of interaction between them. In particular, the Commission has been granted a pivotal role in implementing the *Union* enlargement policy, as broadly defined by the European Council. It promotes, and controls the progressive application of the wider *Union’s* *acquis* by the potential future members, thereby acting well beyond its traditional role of ‘guardian of the [EC] Treaty’ vis-à-vis the current Member States.⁵⁷ It also becomes clear that both in substantive and institutional terms, the enlargement process is characterised by a high level of integration. It involves a *de facto modus vivendi* between the institutions and the Member States for conducting what is essentially an *EU* policy towards third states, in *casu* the candidate states. Unsurprisingly, this precedent has been taken, notably by the Commission, as a model for developing, beyond the enlargement context, an integrated organisation of EU external policies in general, and of the neighbourhood policy in particular.

⁵² Further on the Copenhagen criteria: Hoffmeister, ‘Earlier enlargements’, in Ott and Inglis (eds), *Handbook on European Enlargement* (TMC Asser, 2002) 90.

⁵³ The 1997 Luxembourg European Council decided that ‘[f]rom the end of 1998, the Commission will make regular reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and Eastern European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the *Union acquis* ... The Commission’s reports will serve as the basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States’ ability to meet the economic criteria and fulfil the obligations deriving from accession’ (see pt. 29, Presidency Conclusions). Annual Reports can be consulted at: http://ec.europa.eu/enlargement/key_documents/index_en.htm

⁵⁴ The Commission always provides an assessment of the candidates’ progress in meeting all the Copenhagen criteria, including the political conditions, such as the protection of minorities. As regards more particularly the scrutiny of the political conditionality, see Williams, ‘Enlargement of the Union and human rights conditionality: a policy’ (2000), 25 *ELRev* 601; Smith, ‘The evolution and application of EU membership conditionality’ in Cremona (ed), *The enlargement of the European Union* (OUP, 2003) 105.

⁵⁵ Art. 4 of Council Regulation 622/98.

⁵⁶ For instance, at its meeting on 9 November 1998, the General Affairs Council, ‘took note of a presentation by the Commission of its first regular reports on progress towards accession by Cyprus, the ten candidate States of Central and Eastern Europe, and Turkey, in line with the conclusions of the European Council at its meetings in Luxembourg and Cardiff. In a broad exchange of views, Ministers made preliminary comments on the Commission’s progress reports. The Council asked the Permanent Representatives Committee to examine the documents submitted by the Commission and to present a report to the Council for its meeting on 7 December 1998, with a view to preparing the Vienna European Council’.

⁵⁷ The Commission also supervises the progress made by the candidate in adopting the *acquis* in Justice and Home Affairs, and CFSP; see chapters 24 and 27 of the regular reports for each candidate country.

b) A methodology penetrating the ENP

Perceived as a successful policy, the institutional routines which were established in the context of this pre-accession process have inspired the ENP methodology.⁵⁸ Although not designed to prepare for membership, the ENP implants key features of the enlargement *methodology* in the development and implementation of the existing bilateral agreements with the 'ENP countries', which in the case of Ukraine is the Partnership and Cooperation Agreement (PCA). For instance, as happened with pre-accession in relation to the Europe Agreements, the ENP sparks a 'political re-orientation' of the PCA.⁵⁹ Without being formally renegotiated, the terms of the Agreement have been further articulated to fit in the overall policy framework set out by the new encompassing policy.

Moreover, in substantive terms, the ENP involves the projection of various EU principles and standards vis-à-vis the neighbours. Such projection does not only concern Community norms, but relates also to standards of the Union *as a whole*.⁶⁰ Indeed, the Commission has emphasised that the ENP is 'a comprehensive policy integrating related components from all three 'pillars' of the Union's present structure'.⁶¹ It offers 'a means for an enhanced and more focused policy approach of the EU towards its neighbourhood, *bringing together the principal instruments at the disposal of the Union and its member States*. It will contribute to further advancing and supporting the EU's foreign policy objectives' (emphasis added).⁶²

The projection of the Union as an integrated normative whole towards the ENP countries is not only reflected by the list of objectives of the ENP. It is also evidenced in the 'action plans' (APs), which constitute the key element of the European neighbourhood policy.⁶³ Like the individual accession partnerships, the APs are intended to set out political and economic priorities for action by the ENP country. They provide for 'a benchmarked roadmap in bringing about needed reforms',⁶⁴ and

⁵⁸ Kelley, 'New Wine In Old Wineskins: Policy Adaptation In The European Neighbourhood Policy', (2006) 44 *Journal of Common Market Studies* 29.

⁵⁹ Maresceau and Montaguti, 'The relations between the European Union and central and eastern Europe: a legal appraisal' (1995) 32 *CMLRev* 1327; Inglis, 'The Europe Agreements compared in the light of their pre-accession reorientation' (2000) 37 *CMLRev* 1173.

⁶⁰ While offering the ENP countries 'the prospect of a stake in the internal market', subject to legislative and regulatory approximation by the partner country to EU standards, the ENP also emphasises the neighbours' commitment to shared values in the field of fundamental rights (political and social), as advocated by the Union, and derived from various international norms to which the Member States are committed. In addition, it promotes a more effective political dialogue with the partners, inspired by CFSP objectives and principles. It also foresees possible involvement of the partner countries in aspects of CFSP and ESDP, and participation in EU-led-crisis management operations. On Justice and Home Affairs, the ENP promotes effective functioning of public administration, ensuring high standards of administrative efficiency, particularly as regards border management (European Commission, Communication on the European Neighbourhood Policy – Strategy Paper; COM(04) 373).

⁶¹ COM(04) 373, 6.

⁶² COM(04) 373, 8.

⁶³ COM(04) 373, 3.

⁶⁴ Address by Javier Solana, 'The role of the EU in promoting and consolidating democracy in Europe's East' at the Common Vision for a Common neighbourhood Conference (Vilnius, 4 May 2006). Further on the APs, Hillion, 'Thou shalt love thy neighbour': the draft European Neighbourhood Policy Action Plan between the EU and Ukraine' in Mayhew and Copsey (eds.) *Ukraine and European Neighbourhood Policy* (Sussex European Institute, 2005), 17.

fulfilment of these priorities is meant to ‘bring [the neighbour] closer to the European Union’. The APs are comprehensive, covering ‘political dialogue and reform; trade and measures preparing the partner for gradually obtaining a stake in the EU’s internal market; justice and home affairs; energy transport, information society, environment and research and innovation, and social policy and people-to-people contacts’.⁶⁵ Indeed, the priorities set out in the AP take account of prior ‘country reports’ compiled by the Commission and containing an assessment of bilateral relations between the EU and each of the ENP countries, as well as an overview of its political, economic, social and legislative situation. In the case of Ukraine, the report assessed the progress made in implementing the PCA, and ‘describe[d] the current situation in selected areas of particular interest for this partnership’, namely ‘the development of political institutions based on the values... underlined in the [PCA], regional stability and cooperation in justice and home affairs, and economic and social reforms... and further liberalisation of trade and for gradual participation in the Internal Market’.⁶⁶ The AP thus seeks to support and stimulate Ukraine’s fulfilment of its obligations under the PCA, which remains a ‘valid basis of EU-Ukraine cooperation’, but in the all-encompassing perspective of the neighbourhood policy. The AP does not replace the Agreement, rather it sets out concrete steps, targets and priorities ‘covering a number of key areas for specific action’⁶⁷ with a view to giving practical guidance to the Ukrainian authorities to further their compliance with the rules of the Agreement, in the light of the ENP objectives.⁶⁸

Adopted as a Recommendation of the PCA Cooperation Council,⁶⁹ the AP does not have a legally binding effect, but remains essentially a soft law instrument, like the individual accession partnerships drafted by the Commission.⁷⁰ It means that the AP’s

⁶⁵ Communication from the Commission to the Council on the Commission proposals for Action Plans under the European Neighbourhood Policy (ENP). COM(2004) 795, 2.

⁶⁶ ‘‘Commission Staff Working Paper ‘European Neighbourhood Policy - Country Report – Ukraine’. SEC(2004) 566.

⁶⁷ COM(04) 373, 3.

⁶⁸ Further: Hillion, note 58,

⁶⁹ Recommendation No. 1/2005 of the EU-Ukraine Council of 21/02/2005 on the implementation of the EU/Ukraine Action Plan; Recommendation No 1/2005 of the EU Moldova Cooperation Council of 22/02/2005 on the implementation of the EU/Moldova Action Plan. In the case of the Mediterranean Partners, the APs were endorsed. In the Commission proposal [for a Council Decision on the ‘position to be adopted by the Community and its Member States within the cooperation Council established by the [PCA]... with regard to the adoption of a Recommendation on the implementation of the EU-Ukraine Action Plan’ (COM(2004)791)] the legal basis of the AP combines Art. 2(1) of the Council and Commission decision on the conclusion of the PCA, but also refers to Art. 15 TEU on CFSP Common positions; thereby confirming the cross-pillar dimension of the AP. The draft decision contains a single article which provides that the position to be adopted by the Communities and their Member States within the Cooperation Council shall be based on the draft Recommendation of the Cooperation Council, which is annexed to the Decision. The recommendation is based on Art. 85 PCA establishing the Cooperation Council. It contains a sole Article whereby the Cooperation Council recommends that the Parties implement the AP annexed, insofar as such implementation is directed towards attainment of the objectives of the PCA. Art. 85 PCA Ukraine provides that ‘A Cooperation Council is hereby established which shall supervise the implementation of this Agreement. It shall meet at ministerial level once a year and when circumstances require. It shall examine any major issues arising within the framework of the Agreement and any other bilateral or international issues of mutual interest for the purpose of attaining the objectives of this Agreement. The Cooperation Council may also make appropriate recommendations, by agreement between the Parties.’

⁷⁰ The Mediterranean APs were also adopted as recommendations by the Association Council established by the Euro-Mediterranean Association Agreements, despite such Councils having a power to adopt binding decisions (e.g. Art. 83 of EMEA with Morocco; OJ 2000 L 70/2). Had they been

'entry into force' is not subject to a process of ratification, and can thus be implemented immediately after its endorsement by the Cooperation Council. In addition, the non-legally binding nature of the ENP, also an essential feature of the pre-accession strategy, prevents long competence discussions and 'pillar politics' from stalling and undermining policy development and coherence.

While not legally binding, each AP makes it clear that the deepening of the existing relationship is subject to the neighbour's fulfilment of the *commitments* set out in the Action Plan. For instance, the Council, in speaking of a possible future enhanced agreement with Ukraine, predicated the opening of discussions on Ukraine addressing the political priorities of the AP, e.g. strengthening the rule of law, democracy and respect for human rights.⁷¹ Such multilayered conditionality is reminiscent of the evolution of the Copenhagen political criteria into an 'admissibility' condition, i.e. precedent for opening accession negotiations.⁷² The deepening of the relationship is also subject to the Partner's commitment to promote market oriented economic reforms and cooperation on key foreign policy objectives such as counter-terrorism and non-proliferation of weapons of mass-destruction. The fulfilment of the AP priorities by the ENP partner equally influences the allocation of EU *funds*, under the present assistance programmes, but also in the future under the new European Neighbourhood and Partnership Instrument.⁷³ Article 28 of the draft ENPI Regulation provides that where a partner country fails to observe the principles set out in the ENPI, the Council, acting by a qualified majority on a proposal from the Commission, may take appropriate steps in respect of any assistance granted to the partner country under the ENPI Regulation.⁷⁴ The ENPI thereby represents a financial incentive for global reform of the ENP countries,⁷⁵ but also embodies a system of sanction in case

adopted in the form of a decision, APs would have formally become part of the Community legal order, with potentially far reaching legal implications, notably direct effect (see see Case C-192/89 *Sevince* [1990] ECR I-3461).

⁷¹ The Joint Statement of the EU-Ukraine Summit of December 2005 includes the following paragraph: 'EU leaders confirmed their commitment to initiate early consultations on a new enhanced agreement between EU and Ukraine to replace the Partnership and Cooperation Agreement, as soon as the political priorities of the Action Plan have been addressed'; see:

<http://europa.eu/rapid/pressReleasesAction.do?reference=PRES/05/337&format=HTML&aged=0&language=EN&guiLanguage=en>

⁷² Further: Cremona, 'Accession to the European Union: Membership Conditionality and Accession Criteria' 25 *Polish Yearbook of International Law* (2002) 219 at 234-8.

⁷³ Proposal for a Regulation laying down general provisions establishing a European Neighbourhood and Partnership Instrument, 29 September 2004, COM(2004) 628.

⁷⁴ Such conditionality is without prejudice to the provisions on the suspension of aid in partnership and cooperation agreements which provide that respect for human rights and democratic principles constitute an essential element of the Agreement. Any violation of such an essential element may lead to the immediate suspension of the PCA. Further: Cremona, 'Human rights and democracy clauses in the EC's trade agreements' in Emiliou and O'Keefe (eds), *The European Union and world trade law* (Wiley, 1996) 62; Hillion, 'Introduction to the partnership and cooperation agreements' in Kellermann, de Zwaan and Czuczai (eds), *EU enlargement – The Constitutional Impact at EU and National Level* (TMC Asser Press, 2001) 215.

⁷⁵ This new Instrument seeks to foster coordination and coherence between the distinct financial instruments which hitherto have operated separately [Currently, INTERREG (part of Structural Funds) covers cross-border and transnational cooperation among Member States, whereas operations within Eastern neighbouring states are covered by TACIS, with no particular synergy between them being sought]. Intended to replace existing instruments such as TACIS [Council Regulation (EC, Euratom) 99/2000 of 29 December 1999 (TACIS) concerning the provision of assistance to the partner States in Eastern Europe and Central Asia, OJ 2000 L 12/1] and MEDA [Council Regulation 1488/96/EC on financial and technical measures to support the reform of economic and social structures in

progress in meeting the AP objectives is lacking, a system which was foreshadowed on the basis of the Accession Partnerships.

The ENP thus embeds existing relations with the neighbouring States into a new policy framework within which the Union further promotes its trade, economic, social and political standards and principles. This development is reminiscent of the re-orientation of the Europe Agreements that took place in the context of the pre-accession strategy. Like the Accession Partnership, and despite its non-legally binding nature, the AP introduces further conditionality in the relationship. Through a blend of incentives and potential sanctions, it makes the deepening of links and the financing of the ENP countries' rapprochement with the Union as a whole, subject to the fulfilment by them of the standards it advocates.

The Neighbourhood Policy does not only import various policy tools of the pre-accession strategy, it also imitates its institutional set up. The emerging ENP is not based on any specific Treaty provisions. Rather, it is the product of informal interactions between the Commission (particularly DG external relations) and the Council (including the HR for CFSP) together with the European Council.⁷⁶ These informal interactions are particularly evident in the *conduct* of the policy, and notably at the level of the *elaboration* and *suivi* of the APs. In the case of Ukraine, the Commission started the elaboration of the AP 'in close coordination with the Member States', following the publication of its country report.⁷⁷ Once that country report was endorsed by the Council, the Commission started drafting the Action Plan in cooperation with the HR for CFSP, and in consultation with the country concerned,⁷⁸ while Member States were kept informed of this consultation and of the development of the AP.⁷⁹ Following its adoption by the Commission,⁸⁰ the AP was swiftly

Mediterranean non-member countries and territories (MEDA) in the framework of the Euro-Med Partnership OJ 1996 L 189/1 as amended by Reg. 2698/2000/EC OJ 2000 L 311/1 and Reg. 2112/2005/EC OJ 2005 L 344/23] from 2007, the Instrument is set to taking a new approach to border issues and cross-border cooperation. It will also operate alongside two other general instruments, one for pre-accession (to include the Western Balkans) and one for development, and will cover 2007-2013. Before the entry into force of the new Instrument, coordination of existing programmes is to be fostered and ensured through introduction of Neighbourhood Programmes, in the form of single projects operating on both sides of the border; Communication to the Commission by Commissioner Ferrero-Waldner, Implementing and Promoting the ENP, 22 November 2005, SEC(2005) 1521.

⁷⁶ On the initiation of the 'Wider Europe' and subsequently ENP, see e.g. Lannon and van Elsuwege, 'The EU's emerging Neighbourhood Policy and its potential impact on the Euro-Mediterranean partnership' in Xuereb (ed), Euro-Med Integration and the "ring of friends": The Mediterranean's Europe Challenge (European Documentation and Research Centre, VOL. IV, 2003), 21

⁷⁷ Commission Staff Working Paper 'European Neighbourhood Policy - Country Report - Ukraine'. SEC(2004) 566.

⁷⁸ Successive presidencies, the Council Secretariat and representatives of HR Solana participated in all consultations with partners (Communication from the Commission to the Council on the Commission proposals for Action Plans under the European Neighbourhood Policy (ENP); COM(2004) 795, 3). In particular, the representative for the HR was involved on all discussions 'regarding the political dialogue and cooperation, and CFSP issues'. Indeed, this participation is recurrently emphasised in all policy documents of the Commission related to the ENP. It follows the formula envisaged by the Council.

⁷⁹ The Council has insisted on the Member States' being kept 'fully informed of the progress of [the Commission's] consultations' leading to the drafting of the [future] Action plans. General Affairs and External Relations Council Conclusions of 25 April 2005, 8035/05 (Presse 86)

⁸⁰ See the press-conference given by Commissioner Ferrero-Waldner on the launch of the first seven APs under the ENP, Brussels, 9 December 2004.

endorsed by the Council,⁸¹ before its final presentation to the Cooperation Council of the PCA for formal approval.⁸² As regards the *suivi*, the ENP foresees that it is the responsibility of the Commission to draw up periodic progress reports on the implementation of the AP,⁸³ in cooperation with the HR for CFSP on issues related to political dialogue and cooperation, and the CFSP.⁸⁴ These reports should then be transmitted to the Council which should decide, in tandem with the European Council,⁸⁵ on the development of the Partnership, on the potential review of the financial assistance, and as the case may be, on opening negotiations with a view to establishing a ‘European Neighbourhood Agreement’.

It thus becomes apparent that the methodology underpinning the ENP heavily draws on the techniques of the pre-accession strategy. Aimed at handling the multi-faceted external implications of the 2004 enlargement, the neighbourhood policy is equally comprehensive in that it involves the Union as a whole. Furthermore, the deepening of the EU relationship with the neighbours on the basis of the ENP is made conditional upon the neighbours’ ability to meet the priorities defined in the AP, and thus relies extensively on benchmarking and monitoring. Finally, the institutional set up of the ENP reproduces, to a considerable extent, the institutions’ interactions developed in the context of the pre-accession strategy, outside the ordinary EU constitutional *modus operandi*. By borrowing several features of the pre-accession policy, the ENP takes advantage of the immunity from ‘pillar politics’ that has characterised that policy, thus enhancing the coherence of the EU action towards its neighbours. At the same time, transplanting the pre-accession mechanisms into a policy aimed at embodying an alternative to accession may also put at risk the overall

⁸¹ The GAER Council adopted the APs on 13 December after the Commission had adopted them on 9 December. This swift adoption by the Council can be taken as evidence of the earlier involvement of the HR for CFSP. The APs were transmitted to the European Parliament, the Economic and Social Committee, and the Committee of the region for information.

⁸² The Council invited the Committee of Permanent Representatives to prepare the necessary decisions enabling the Co-operation Councils with the respective ENP partners to confirm these action plans and to launch their implementation. As pointed out by the Council, it is only a *confirmation*. The APs were in practice already ‘agreed’ with the partner countries concerned even before the Commission, as a college, had formally adopted them on 9 December 2004.

⁸³ It should be noted that 2003 Accession Treaty has partly maintained this extraordinary role for the Commission, by endowing it with the power to adopt specific safeguard measures in the field of Justice and Home affairs, with no equivalent in the context of the TEU; see Art. 39 of the Act of Accession (OJ 2003 L236/33). Further: Inglis, ‘The Unions fifth accession treaty New means to make enlargement possible’ (2004) 41 CMLRev 937, Hillion, ‘The European Union is dead. Long live the European Union... A Commentary on the Accession Treaty 2003’ (2004) 29 ELRev 583.

⁸⁴ At its meeting on 13 Dec. 2004, the GAER Council recalled its intention to undertake a first review of the implementation of the action plans at the latest two years from their adoption, on the basis of assessment reports to be prepared by the Commission, in close co-operation with the Presidency and the SG/HR on issues related to political cooperation and the CFSP, and with the contribution of ENP partners. At its meeting on 16/17 December 2004, the European Council also invited the Commission and the High Representative to report regularly on progress accomplished. This joint exercise by the Commission and the HR, which contrasts with the enlargement policy, seemingly prefigures the ‘double-hatting’ system introduced by the Constitutional Treaty.

⁸⁵ It should be pointed out that the Cooperation Council, Committee and sub-committees are endowed with the monitoring of the implementation of the AP. Such use of the institutional framework of the Agreement again draws on the enlargement methodology; see Council Regulation 622/98 establishing the Accession Partnership which emphasises that ‘the role played by the bodies set up by the EAs is central to ensuring the proper implementation and follow up of these action plans’, see 11th Recital of the Preamble (OJ 1998 L85/1).

efficiency and *raison d'être* of that policy. The next section will shed light on the inherent systemic weaknesses of the ENP.

3. Inherent systemic weaknesses of the ENP

Various criticisms have been formulated with respect to the ENP. This section does not aim to recall all of them, but to shed light on some of the tensions that are inherent in the ENP, in particular those that arise out of the ENP's attempt to use a cross-pillar enlargement-based methodology to achieve security objectives.

a) The increasing pressure for differentiation within a widening ENP

The ENP was initially designed as a 'proximity policy' towards Eastern neighbours, namely Moldova, Russia, Ukraine, and potentially Belarus.⁸⁶ It was only at a later stage that Mediterranean neighbours were included in the new policy; while Russia made it clear that it would favour a bilateral strategic partnership. Since its launch, the ENP has been widened still further. At the same time as the first Action Plans were finalised with respect to Ukraine, Moldova, Morocco, Tunisia, Israel and the Palestinian Authority, the EU extended the ENP to the South Caucasian States.

The decision to include southern Mediterranean countries and East Europeans in the same one-size-fits-all framework had already been perceived by Ukraine as an indication that it may not have better chance of acceding to the Union than Morocco.⁸⁷ Extended to the South, the ENP has thus become less palatable for the first-chosen 'neighbours' and, arguably, the inclusion of south Caucasian states might further reduce its attractiveness.⁸⁸ In other words, lengthening the list of ENP beneficiaries may eventually dilute the political value of the new Policy, pushing neighbours such as Ukraine to require further differentiation, either in the form of a distinct future agreement, and/or more generous objectives in terms of integration.⁸⁹

⁸⁶ See the Joint letter by EU Commissioner Chris Patten and the EU High Representative for the Common Foreign and Security Policy on Wider Europe. 7 August 2002; http://www.europa.eu.int/comm/world/enp/pdf/0130163334_001_en.pdf

Prior to this letter, Jack Straw, then Foreign Secretary, sent a letter to the then Spanish Presidency of the EU calling for 'special neighbour status' to Ukraine, Belarus and Moldova, meaning 'free trade rights with the EU and a close relationship on border, justice, home affairs, security and defence issues' (*The Independent*, 16/04/2002; *The Financial Times*, 15/04/2002).

⁸⁷ In May 2004, the Commission had published its Country Report on Ukraine that triggered consultations with the Ukrainian authorities with a view to drafting the Action Plan (COM(2004)373, 12 May 2004). The discussions however stalled over disagreement about the evolution of the relationship after the expiry of the AP. In particular, Ukraine wanted the differentiation principle to be reflected in a statement of Ukraine's position, in particular the difference between Ukraine and the Mediterranean ENP partners. Discussions resumed following the EU-Ukraine summit in July 2004.

⁸⁸ The southern Mediterranean neighbours have not been happier with the ENP. The latter has been regarded as diminishing the spirit of 'Partnership' underpinning the Euro-Med relations since the Barcelona declaration; increasing instead the unilateral nature of the EU relationship with its Mediterranean neighbours. further Lannon and van Elsuwege, above note 71.

⁸⁹ That phenomenon appeared with the extension of the Europe Agreements' network in the nineties. While this type of specific association was initially negotiated with Czechoslovakia, Hungary and Poland, increasing the list of potential associated states reduced its attractive character for the first signatories which then redoubled efforts to have their accession prospect recognised. See in this regard: Raux, 'Les instruments juridiques de la Communauté avec les Etats de l'Europe de l'Est' in Gautron (ed), *Les relations Communauté européenne – Europe de l'Est* (Economica, 1991) 41.

This factor, with its emphasis on differentiation, raises the question of the ultimate *goal* of the ENP and what relationship is ultimately envisaged for the neighbour States, and increases the pressure on the EU to define those goals more explicitly. Unlike the enlargement process, there is no clear mutually agreed objective applying to all partner States.

b) Limits of the enlargement methodology

As we have seen, in spite of having different aims, the ENP has been influenced by enlargement methodology, and one factor in this development is undoubtedly the desire to build on and repeat the success story represented by enlargement – success in effectively managing a hugely complex process of approximation to the EU *acquis* over the entire range of Union policy areas. However the use of this methodology creates its own difficulties and tensions in the different context of the ENP.

In the first place, it sends contradictory signals to the Partners: if the ENP is separate from the question of membership, as the EU claims,⁹⁰ why use pre-accession techniques? Lynch argues that this approach has led to a focus by the EU on *tactics* (i.e. techniques) at the expense of *strategy* (i.e. the long-term goal of the relationship).⁹¹ Thus, to the extent that the ENP incarnates the initial EU differentiation between central and eastern Europe,⁹² it is unsustainable. The better it succeeds, the less the ENP can legitimately be disconnected from the membership prospect of the eligible partners, because the conditions for membership are *de facto* being met. In other words, if it works, the ENP will *create* candidates.⁹³

On the other hand, if the ENP is not about membership, then we can question the rationale for insisting that the partner countries adopt so much of the EU *acquis*. Although one can see the advantages for the EU itself, the latter has not yet succeeded in convincing its Partners of the merits for them of the adoption of the *acquis* at this level, and the appropriateness of EU standards, in the absence of a membership perspective. Thus the use of enlargement methodology adds to the uncertainty as to the EU's long-term goal for the relationship, it does not adequately explain the choice of short-term objectives, and puts into question the content and objectives of a possible future ENP agreement.

⁹⁰ For example: 'Let's be clear about what ENP is, and what it is not. It is not an Enlargement policy. It does not close any doors to European countries that may at some future point wish to apply for membership, but it does not provide a specific accession prospect either.' Commissioner Ferrero Waldner, Press Conference to launch first seven Action Plans under the European Neighbourhood Policy, Brussels, 9 December 2004; SPEECH/04/529.

⁹¹ Lynch, 'The New Eastern Dimension of the Enlarged EU' in *Partners and Neighbours: A CFSP for a Wider Europe*, Chaillot Papers No.64 (Institute for Security Studies, 2003) 39.

⁹² Further on this differentiation, Maresceau 'On association, partnership, pre-accession and accession' in Maresceau, M (ed), *Enlarging the European Union* (1997, Longman) 3.

⁹³ At the same time, the EU, arguably more boldly than ever, refuses to make any connection.

Commissioner Ferrero Waldner has made the point on several occasions that the two policies are distinct. 'Let's be clear about what ENP is, and what it is not. It is not an Enlargement policy. It does not close any doors to European countries that may at some future point wish to apply for membership, but it does not provide a specific accession prospect either. '; Commissioner Ferrero Waldner, Press Conference to launch first seven Action Plans under the European Neighbourhood Policy, Brussels, 9 December 2004; SPEECH/04/529.

Moreover, we have seen that the ENP has used, as its institutional basis, the institutional frameworks created by existing bilateral agreements, such as the PCAs. This approach, modelled on the use of the Europe Agreements in the enlargement process, reflects a degree of continuing ambiguity over what kind of institutional framework is necessary or appropriate for the ENP, going to the heart of its nature as bilateral or multilateral. In his December 2002 speech on what was then being called a Proximity Policy, Prodi uses the phrase that has become a catch-phrase of the ENP: ‘sharing everything with the EU but institutions’.⁹⁴ What does this say about the institutional basis of the ENP? The Solana-Patten letter is also cautious about shared institutions:

‘we could foresee a gradually evolving framework for an economic and political space surrounding the Union, which would nevertheless stop short of full membership or creating shared institutions.’⁹⁵

Prodi himself makes it clear a little later in the same speech that he meant that existing EU institutions could not be shared – that would require full membership. But other joint institutions might be created:

‘The idea of “sharing everything but institutions” itself applies to existing EU institutions. But this does not exclude the possibility of developing new structures with our neighbours at a later stage, if necessary.’

At present, the institutional structure of the bilateral relationships within the ENP is provided by the bilateral agreements, emphasising the essentially bilateral nature of the ENP. There is no multilateral institutional basis. While this could change, there is no proposal for the creation of institutional links between the ENP States, such as the EEA with its EFTA Court and Surveillance Authority. A new type of agreement will create its own institutional structures, although there is no indication that these will be qualitatively different from existing Cooperation or Association Councils or what decision-making powers they might have. If the policy is to develop into something substantial and long-term, thought needs to be given to the nature of its institutional framework, and in particular whether to maintain the essentially bilateral approach (which is based on the enlargement model) or to seek to establish either a two-pillar approach (like the EEA) or a multilateral/regional framework (more like the Barcelona Process) that would supplement the bilateral institutional framework. The European Conference might have promised the basis for such a framework, but although attempts were made to broaden its membership beyond the candidate States,⁹⁶ it has not managed to create for itself an identity separate from the accession process.⁹⁷

⁹⁴ Prodi, ‘A Wider Europe – A Proximity Policy as the key to stability’, speech to the Sixth ECSA-World Conference, Brussels, 5-6 December 2002, SPEECH/02/619.

⁹⁵ Joint letter by EU Commissioner Chris Patten and the EU High Representative for the Common Foreign and Security Policy on Wider Europe. 7 August 2002.

http://www.europa.eu.int/comm/world/enp/pdf/0130163334_001_en.pdf

⁹⁶ See in this regard the Declaration adopted on 17 April 2003 by the ‘enlarged European Conference and Russia’: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/misc/75487.pdf

⁹⁷ Maresceau, ‘Pre-Accession’ in Cremona (ed.) *The Enlargement of the European Union* (Oxford 2003) 27-30.

c) The gap between the neighbours' expectations and the EU capacity to deliver

The ENP Strategy Paper evokes the establishment of a 'European Neighbourhood Agreement' that would replace the present generation of bilateral agreements,⁹⁸ for those ENP countries that fulfil the Action Plan objectives. The EU has however remained unclear as to what this new Agreement would be in terms of its nature, objectives, and content. In the case of Ukraine, it points out only that 'its scope would be defined in the light of progress in meeting the priorities set out in the AP',⁹⁹ and 'the overall evolution of EU-Ukraine relations'.¹⁰⁰

With respect to its *nature*, one could anticipate that, in the absence of the Constitutional Treaty,¹⁰¹ the 'enhanced agreement' would be an association agreement based on Article 310 EC, thus establishing a privileged relationship, potentially close to the Europe agreements concluded with the CEECs or the Stabilisation and Association Agreements with the Western Balkan States. Indeed, any agreement below association would not be perceived as an 'enhanced' contractual relationship, particular given the already existing association agreements with the Mediterranean countries. The terminology used in the introductory section of the AP with Ukraine hints at the progressive establishment of a relationship that includes various features of association agreements as defined by the European Court of Justice's *Demirel* judgment.¹⁰² Particularly, the ENP perspective of moving beyond cooperation to a significant degree of integration and the possibility for Ukraine to participate progressively in key aspects of EU policies and programmes, seems to echo the formula used by the Court.¹⁰³

Given the cross-pillar dimension of the AP, and to a lesser but still real extent of the PCA, it can be assumed that the enhanced relationship will also cover the whole gamut of EU activities. Indeed, the agreement could take the form of an association-like agreement between the *EU* and its partner.¹⁰⁴ Beyond the question of its nature, the new agreement's content will have to be substantial if it is to constitute a credible and attractive alternative to accession. This is particularly true for those countries such as Ukraine that have a membership agenda, but is also important for the credibility of the ENP as a whole.

The difficulty in establishing such an ambitious agreement, both in terms of scope and objectives, lies notably in the procedural requirements connected to its negotiation,

⁹⁸ COM(04) 373, 5. Some ENP documents only refer to 'enhanced agreement' (cf Action Plan with Ukraine), or to a 'new contractual relationship'/'arrangement' (cf Action Plan with Moldova).

⁹⁹ COM(04) 373, 4.

¹⁰⁰ Pt. 1 (Introduction) AP.

¹⁰¹ Which envisaged in Art. I-57 the possibility of specific agreements with the Union's neighbours.

¹⁰² In its judgment, the Court considers at para 9 that an 'association agreement creat[es] special, privileged links with a non-member country which must, at least to a certain extent, take part in the Community system'; Case 12/86 *Meryem Demirel v Stadt Schwäbisch Gmünd* [1987] ECR 3719.

¹⁰³ The importance of the nature of the agreement, and its label should not be exaggerated, as suggested by the case law of the European Court of Justice, see in particular Case 265/03 *Simutenkov* [2005] ECR I-2579.

¹⁰⁴ Further on Association agreements of the EU, see Raux, "Towards a pan-Euro-Mediterranean strategy: association of proximity" Maresceau, and Lannon (eds), *The EU's enlargement and Mediterranean strategies* (Palgrave, 2001) 42; Raux, "Association et perspectives partenariales" in Christophe-Tchakaloff, M-F (ed), *Le concept d'association dans les accords passés par la Communauté: essai de clarification* (Bruylant, 1999) 89.

conclusion and implementation. For instance, concluding an Association-like agreement would require a unanimous vote within the Council.¹⁰⁵ Furthermore, assuming that it would cover most areas of EC external relations, the agreement would be mixed (EC/Member States), and would therefore require the ratification by all 27, if not more, Member States of the Union, at a rather inauspicious moment. Indeed, if it were to cover all EU external dimensions as suggested earlier, the enhanced agreement could be ‘doubly mixed’ (EC/EU/Member States), thus potentially involving intricate procedural squabbling, and leading the EU institutions and Member States back to the pillar-politics that the ENP has, to some extent, managed to keep at bay. On the whole therefore, it appears that the Union may be in a difficult constitutional position to offer an agreement that would match the neighbours’ expectations. A bundle of bilateral sectoral agreements could thus be explored as an alternative to an all-encompassing agreement, although this arrangement would need to be spearheaded by an overall institutional framework.

Another promise the Union might have difficulty in delivering relates to the financial support it advertised for the implementation of the ENP. The finalising of the ENPI, its budget and thus its ability to be a genuine incentive are determined by the agreement reached within the EU on the overall financial framework for 2007-2013. In this respect, it appears that the Commission’s initial ambitions¹⁰⁶ have not been followed by the European Council, the latter having envisaged a more restricted funding for the ENPI.¹⁰⁷

Alongside the more modest financial package that the Union is committing to support the ENP, it remains to be seen whether the new Member States, struggling to get what they may have expected from the EU budget (agriculture, structural funds...), will be willing to share the pot with an increasing number of ENP countries.

d) The inherent tension between joint ownership and conditionality

The financial issues just mentioned are rather starkly illustrative of one of the more fundamental questions raised by the ENP: to what extent is this policy really one of mutuality and joint ownership? The EU has presented joint ownership based on mutual interests as one of the ENP’s key characteristics.

‘Joint ownership of the process, based on the awareness of shared values and common interests, is essential. The EU does not seek to impose priorities or conditions on its partners. The Action Plans depend, for their success, on the clear recognition of mutual interests in addressing a set of priority issues. There can be no question of asking partners to accept a pre-determined set of priorities. These will be defined by common consent and will thus vary from country to country.’¹⁰⁸

¹⁰⁵ See Article 300 (2) EC.

¹⁰⁶ Commission proposal for a Regulation establishing a European Neighbourhood and Partnership Instrument COM(2004) 628 final.

¹⁰⁷ See ‘Heading 4’ of the Financial Perspectives 2007-2013 <available at: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/misc/87677.pdf> agreed by the European Council on 15/16 December 2005 (see pt. 6).

¹⁰⁸ Commission Communication, European Neighbourhood Policy Strategy Paper, COM(2004) 373 final, 12 May 2004, 8.

We can speak of shared values and aims, mutual interests, a common project, of burden sharing and the perception of common tasks, all consonant with the security basis of the ENP. Joint ownership emphasises the (potential) equality in the relationship, or at least the idea that both the EU and the partner state will contribute to shaping a policy and identifying common responses to common problems, as well as carrying them out. This approach to the EU's neighbours could be characterised as one of solidarity (as well as equality). The EU and the neighbours have certain interests in common (such as border control, environmental protection or regional security) and agree to work together to achieve those ends; there is thus a level of inter-dependence as well as cooperation. It is perhaps a view of the ENP which is most likely to offer a credible alternative to membership, a possibility of progress in the relationship which is not based on the debate about accession but rather on concrete actions which build trust; a relationship built on 'doing together what can be done together' rather than on fulfilling conditions. It might be contrasted to a view of the ENP that is based on a deal or bargain, whereby each party has something to offer that the other wants (but they are not necessarily the same).¹⁰⁹

However there are a number of difficulties with this model. First, the ENP is essentially a *unilateral policy* aimed at changing the Union's environment.¹¹⁰ This point is emphasised in fact by the use of the word 'policy' to describe the ENP: it is not a 'space' (c.f. the four common spaces being developed with Russia), nor an 'area' (c.f. EEA), nor a 'process' (c.f. the Barcelona Process or the Stabilisation and Association Process in the Western Balkans), nor a 'partnership' (c.f. the Euro-Mediterranean Partnership) although the current agreements with the eastern neighbours are Partnership and Cooperation Agreements. A policy is driven by the policy-maker. The ENP is clearly and unambiguously an *EU policy* directed at its neighbours rather than the creation of something new (a space or an area) or a shared enterprise (a process or partnership). Although drafted in consultation with the neighbours, the Action Plans are first and foremost a vehicle for the EU to *project* a corpus of norms and practices considered to be appropriate for political and economic reform.

Indeed, brief comparison of the shaping of the ENP and the parallel development of the EU-Russia 'Common Spaces' brings additional support to the proposition that, despite the consultation of the neighbours, the ENP remains essentially unilateral. In particular, the creation of the Common Spaces was, in contrast to the ENP, launched

¹⁰⁹ At the launch of the first Action Plans in December 2004, Commissioner Ferrero-Waldner characterised the ENP as *not* an enlargement policy, but as a *deal*, incorporating an offer from the EU 'A substantial offer ... of much deeper cooperation and progressive integration into certain EU policies and programmes, depending on the fulfilment of commitments.' She sets the ENP out in terms of a *deal in the interests of both sides* explaining what the EU gets out of it, and what the neighbours get. Ferrero-Waldner, 9 December 2004, Speech 04/529.

¹¹⁰ In December 2004, the Council adopted a Final Report on its Common Strategy on Ukraine, which expired at the end of December 2004, taking the view that from 2005, the Action Plan would replace the Common Strategy as the basis for cooperation. See Council report to the European Council on the implementation of the Common Strategy of the European Union on Ukraine, 15 December 2004, 15989/04. The Common Strategy was adopted in 1999 and was one of the only three such Common Strategies to be adopted under Article 13(2) TEU (the others being on Russia and the Mediterranean).

by the Parties in the context of the EU-Russia Summit.¹¹¹ In the same vein, the conceptualisation of the Common Economic Space was the task of an EU-Russia High Level Group consisting of an equal number of Russian and EU representatives,¹¹² rather than the exclusive job of the Commission and Council services.¹¹³ Thus, joint ownership appears to have a different connotation in the development of the Common Spaces, and in the ENP.

Second, this notion that the ENP, and the Action Plans in particular, are inherently unilateral rather than based on the spirit of partnership and joint ownership, is epitomised by the highly specific conditionality that these instruments envisage.¹¹⁴ Conditionality, which is at the heart of the ENP, is essentially based on the idea of a deal, or a bargain ('if you will do this, then we will do that') and implies an assessment of the performance of one party by the other. Whereas conditionality may be an appropriate mechanism for achieving results in the case of trade-related objectives, and possibly also for achieving the political criteria (democracy, rule of law) for further integration, it undermines the claim to joint ownership of the process. Kelley refers to the 'intentional ambiguity' in the relationship between joint ownership and conditionality within the ENP.¹¹⁵ It is hard to reconcile true joint ownership with the unequal relationship implied by conditionality.

This ambiguity is exemplified by the use of differentiation as a principle underlying the ENP. On the one hand differentiation is justified by reference to the principle of joint ownership – hence the need to identify common targets, to recognise differing starting points, circumstances and priorities:

¹¹¹ EU-Russia summit, 31 May 2003, St. Petersburg, Joint Statement, Press release No. 9937/03; The idea was further worked out at the EU-Russia summit in Rome in November 2003.

¹¹² The HLG was established by the Brussels EU-Russia summit of October 2001 (EU-Russia Summit, Joint statement. Brussels, 3 October 2001. Press release No. 12423/01) in accordance with Art. 93 PCA. Meeting twice a year, the HLG was co-chaired by representatives of the Russian Federation and of the European Union. In practice, vice-Prime Minister Khristenko and External Relations Commissioner Patten, later replaced by Enlargement Commissioner Verheugen, chaired the HLG. The decision to establish the HLG was taken by the Russia-EU summit meeting in Moscow in May 2001 (EU-Russia Summit, Joint statement. Moscow, 17 May 2001. Press release No. 8853/01) following a meeting in Stockholm in March 2001 between the Heads of State and Government of the European Union and the President of the Russian Federation, where the idea of the CEES was reinvigorated. The HLG submitted various reports; i.a. *The Common European Economic Space (CEES) – Concept Paper*, submitted to the EU-Russia summit in Rome, 6 November 2003, Press release No. 13990/03.

¹¹³ Further: Vinokurov, 'The making of the concept of the EU-Russia Common Economic Space', *Chair Interbrew – Baillet Latour Working Paper no. 22* (2004b, K.U. Leuven), www.soc.kuleuven.ac.be/pol/docs/docs_ibl/WP22-Vinokurov.pdf; Hillion, 'The Russian Federation' in Blockmans & Lazowski (eds), *The European Union and its Neighbours* (TMC Asser Press – CUP, 2006).

¹¹⁴ 'action plans [are] to be agreed jointly with the neighbouring countries concerned. They should have a minimum duration of three years and be subject to renewal by mutual consent. Such action plans should be based on common principles but be differentiated, as appropriate, taking into account the specificities of each neighbour, its national reform processes and its relations with the EU. Action plans should be comprehensive but at the same time identify clearly a limited number of key priorities and offer real incentives for reform. Action plans should also contribute, where possible, to regional cooperation.' Council Conclusions 14 June 2004. See also Commission Communication on Commission Proposals for Action Plans under the ENP, 9 December 2004, COM(2004) 795 final.

¹¹⁵ Kelley, above note 51, 36.

‘The intensity and level of ambition of relations with each ENP partner is differentiated, reflecting the degree to which common values are effectively shared, the existing state of relations with each country, its needs and capacities, as well as common interests.’¹¹⁶

As we have already seen, the widening of the ENP is likely to lead to a greater emphasis, on the part of the partner States, on the need for differentiation as to ultimate objectives (‘level of ambition’). On the other hand, differentiation is linked to conditionality, the differentiation that results from differing levels of progress made in meeting conditions, as judged by the EU. The policy will be structured around ‘a differentiated framework, which responds to progress made by the partner countries in defined areas’.¹¹⁷ Although there is a tension between these two aspects of differentiation, both demonstrate the risk that existing differences between the neighbours in their relations with the EU will grow wider rather than narrower: creating new dividing lines and undermining rather than supporting the principle of joint ownership.

Apart from these ambiguities in the notion of joint ownership, a real difficulty in achieving true joint ownership flows from the nature of the Community/Union legal order. Who will really make the policy? The EU finds it difficult to allow anyone else a seat at the table where internal laws or rules are being adopted. As Lavenex points out, external governance may imply an expansion of the EU’s ‘legal borders’ without an expansion of its institutional borders,¹¹⁸ while Lynch asks ‘can membership of the Union be blurred?’¹¹⁹ Maybe one solution might be found in the use of bilateral agreements (such as some type of new Neighbourhood Agreement) and other instruments, such as codes of conduct, which can be jointly agreed. Another solution would be the upgrading of the PCA institutional framework to allow (binding) decisions to be taken by the PCA Cooperation Council, although it is notable that while the Euro-Mediterranean Association Councils, unlike the PCA Cooperation Councils, do have the power to take binding decisions, all the ENP Action Plans were none-the-less adopted as recommendations.¹²⁰ Were the institutional framework in the existing and/or future bilateral agreements to be enhanced in order to provide a real impetus to the development of the ENP, a decision-making power would need to be accompanied by specific areas of decision-making competence, giving the institutions a field in which to act. In other words, there is a need for institutions with real capacity if joint ownership is to be tangible and meaningful.

e) The lacking regional dimension of the ENP

Enlargement (absorption into the Union) is of course a deep form of regional integration and the pre-accession period thus saw for the accession States a staged process of gradually increasing integration into EU norms, structures and policies.

¹¹⁶ Commission Communication on Proposals for Action Plans under the ENP, 9 December 2004, COM(2004) 795 final, p.3.

¹¹⁷ Council Conclusions on Wider Europe – New Neighbourhood, 16 June 2003, para 5.

¹¹⁸ Lavenex, ‘EU External Governance in Wider Europe’, (2004) 11 (4) *Journal of European Public Policy*, 680 at 683; Myrjord, ‘Governance Beyond the Union: EU Boundaries in the Barents Euro-Arctic Region’ (2003) *EFARev* 239.

¹¹⁹ Lynch, ‘The New Eastern Dimension of the Enlarged EU’ in *Partners and Neighbours: A CFSP for a Wider Europe*, Chaillot Papers No.64 (Institute for Security Studies, 2003) 37.

¹²⁰ See note 65.

Inevitably, this process entailed a closer integration of the candidate States between themselves, but this was largely a by-product of their rapprochement with the EU rather than becoming a goal in its own right. Outside the enlargement context, the EU sees itself as a champion (and model) of regional integration, particularly regional integration as a mechanism for economic development and conflict resolution.

How do these concepts of regional integration relate to the ENP? The Union's policy documents on the ENP suggest that the promotion of regional cooperation and the peaceful resolution of conflict is a central aspect of the ENP, being part of its central security dimension. The promotion of good neighbourly relations is one of the common values underpinning the proposed relationship and the peaceful settlement of disputes is said to be one of the 'essential aspects of the EU's external action' on which commitments will be sought.¹²¹ Specific examples of this focus are increased EU involvement in the Transnistria problem in Moldova and the way it has encouraged Ukraine and Moldova to engage in a joint border management project.¹²² However, as we have seen, the ENP does not provide for any institutionalization of the regional dimension, and although the Barcelona process provides a regional dimension for the south,¹²³ there is no equivalent for the eastern neighbours. Rather the contrary: such regional initiatives that exist (such as the CIS Eurasian Economic Community (Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan) and the Single Economic Space (Belarus, Kazakhstan, Russia and Ukraine)) have been seen as in some sense rivalrous to 'EU integration' goals.¹²⁴ In practice, the institutional focus is centred on the Partners' bilateral relations with the EU, and the structures are designed to further the possible ENP goal of each neighbour becoming 'as close to the EU as possible without becoming a member'.¹²⁵

It could well be argued that a regional framework created (or imposed) by the EU will have no substance and that it needs to come from the partner States themselves, as for example the Western Balkans have eventually done by proposing to transform their network of bilateral agreements into a south-east European FTA. It could also be argued that insofar as a regional dimension is the creation of the EU, this is best achieved through concrete projects, whether trans-European networks such as road-building projects, cumulation of origin rules in trade policy, the extension of the Energy Community Treaty to include the ENP States, or the creation of a common aviation area. Here, the ENPI emphasis on cross-border cooperation is important.

¹²¹ Commission Communication, European Neighbourhood Policy Strategy Paper, COM(2004) 373 final, 12 May 2004, p.3.

¹²² A Memorandum of Understanding has been signed between the EU, Ukraine and Moldova on 7 Oct. 2005, providing for an EU Border Mission aimed at assisting Ukraine and Moldova on border management, customs and issues of border security. The Mission was launched on 30 Nov. 2005 and will operate along the Ukraine-Moldova border, including Transnistria; IP05/1448, 29 November 2005. Council Joint Action 2005/776/CFSP of 7 November 2005 amending the mandate of the European Union Special Representative for Moldova, OJ 2005 L 292/13. The Memorandum of Understanding is available on <http://www.eubam.org/>

¹²³ It has indeed been argued that the ENP may dilute the Barcelona *acquis*, notably in terms of its regional dimension; See Lannon and van Elsuwege, note 71, 55.

¹²⁴ On these regional integrations, see Petrov, "Regional Integration in the Post-USSR Area: Legal and Institutional Aspects", 10(3) *Law and Business Review of the Americas* (2004) 631.

¹²⁵ Prodi, 'A Wider Europe – A Proximity Policy as the key to stability', speech to the Sixth ECSA-World Conference, Brussels, 5-6 December 2002, SPEECH/02/619.

However to the extent that, as we have argued, security is a core ENP objective, this carries implications for the EU in approaching the regional dimension of the ENP. Security is difficult to manage on a bilateral basis. It will require not only a pan-ENP approach but also a consideration of how ENP objectives require working together with other major players, especially Russia. Not only has Russia chosen not to be a part of the ENP. The absence of any reference to Russia in the EU's ENP strategy papers is striking, as is the absence of any mention of the ENP in the EU-Russia Road Maps for the four 'common spaces' which it was decided to set up at the St Petersburg Summit in May 2003.¹²⁶ And yet Russia is very much there, of course, both for the neighbours themselves complicating their relations with the EU and dividing their own societies in some cases, and for the EU and its Member States, who have historically diverse relations with Russia. It is arguable that the dominance of Russia in the region and the legacy of its empire, together with its importance for some Member States, has made it difficult for the EU to develop an effective autonomous policy towards the region.¹²⁷ Cooperation on external security is one of the 'common spaces' in the EU-Russia Partnership and both sides appear to strongly support this aspect of their bilateral relations; but progress has been slow.¹²⁸ How does this affect the ENP security dimension? Would greater involvement by the EU in neighbouring conflicts (even by proxy) such as Transnistria, South Ossetia, Abkhazia and Nagorno-Karabakh be seen by Russia as a threat to its own security interests in its own 'near abroad'?¹²⁹ The Commission has called for a more coherent, robust and concrete relationship with Russia.¹³⁰ However we appear to have many more questions than answers, and the longer term development of both the ENP and the EU-Ukraine relationship will depend on establishing a clear basis for Russia's relations with the EU, its role vis-à-vis European Security Policy and its position towards the ENP.

Concluding remarks

The ENP is a contribution to the EU's efforts to evolve a more coherent external action. It was designed to offer integrated policy-making in the cross-pillar context of

¹²⁶ The four 'spaces' are a Common Economic Space, A Common Space of Freedom, Security and Justice, a Common Space of Cooperation in the field of External Security, and a Common Space on Research Education and Culture. Road Maps for the Common Spaces were adopted at the EU-Russia Summit on 10 May 2005. The Road Map on the Common Space on External Security is largely focused on joint support for international initiatives and Conventions rather than envisaging any concrete joint initiatives.

¹²⁷ As Lynch says, the eastern neighbours are 'European-plus', and the *plus* factor includes their Russian, Slavic links; Lynch, 'The New Eastern Dimension of the Enlarged EU' in *Partners and Neighbours: A CFSP for a Wider Europe*, Chaillot Papers No.64, Institute for Security Studies, 2003, 35.

¹²⁸ Forsberg: 'The EU-Russia Security Partnership: Why the Opportunity was Missed' (2004) EFA Rev. 247. Forsberg summarises the difficulties in the way of progress as the primacy of the USA (both sides taking the view that this relationship is the more important), ignorance and bureaucratic inertia, different strategic culture and values (in particular the EU emphasis on common values and the Russian emphasis on common interests as the basis for a relationship), and the absence of a shared understanding of the parties' relative power and status.

¹²⁹ Andrei Zagorski, 'Russia and the Shared Neighbourhood' in Dov Lynch (ed.) *What Russia sees*, Chaillot Paper n° 74, January 2005, available on <http://www.iss-eu.org/chaillot/chai74.pdf>

¹³⁰ Commission Communication on relations with Russia, 09/02/04, COM(2004) 106, 6.

the Union's existing relations with its strategically important neighbours, with a view to enhancing security and stability at its periphery. The degree of coherence actually achieved derives not only from the over-arching security dimension to the ENP, but also from the 'soft law' methodology that it embodies. In particular, the neighbourhood policy incorporates several elements of the pre-accession strategy, with the result that so far it has shared the latter's relative immunity from 'pillar politics'.

Transplanting pre-accession routines into a policy otherwise conceived as an alternative to accession and intended to enhance the security of the Union, may however undermine both its current effectiveness and its longer-term viability, if not its rationale. The current "soft" instrumental framework which borrows from the pre-accession model may avoid inter-pillar questions, but a substantive development of the policy would require the negotiation of new agreements. Unlike the Accession Treaties (the end of the pre-accession process) these agreements will not be purely intergovernmental, and issues of legal base and demarcation between pillars will re-emerge. Using techniques specifically designed to prepare third States' entry into the Union, the ENP is in fact prone to fuel accession claims rather than offering a genuine alternative to entry, notably for countries like Ukraine. Conversely, as an alleged substitute for membership, the ENP lacks clarity as to its ultimate aims, and credibility as to what the Union can deliver, thereby undermining the rationale, as far as its partners are concerned, for their adoption of EU standards. Indeed, while its professed basis in 'joint-ownership' is the key to its success both as a security policy and as a genuine alternative to accession, that basis is damaged by the essentially unilateral character of the ENP, epitomised by reliance on conditionality and its negligible institutional component. Although explained by the need to differentiate each partner according to its specificity and merits, the lack of a substantiated regional dimension to the ENP also weakens its capacity to foster stability and security at the Union's periphery.

Thus, in using some of the pre-accession techniques, the ENP as it stands seems systemically flawed both as a substitute for accession and as a policy aimed at fostering shared security in Europe and beyond. Does this mean that the Policy should simply be abandoned? Certainly serious thought needs to be given to addressing some of these weaknesses, tensions and ambiguities in order to enhance the coherence between objectives and instruments and (most important) to adapt the ENP more adequately to the specific needs of the neighbourhood. This is an effort worth making; the ENP remains a valuable model of an integrated approach to EU external action, particularly from a policy making point of view. Indeed the ENP, like the Common Strategies, can be seen in the context of the evolution of EU-NIS instruments, illustrating that the development of EU relations with eastern European countries, given their strategic importance for the Union, is a work in progress and a laboratory for testing new EU external relations methodologies and instruments. As the Security Strategy argues, it is precisely in its neighbourhood that the EU can most clearly make a contribution to global security and governance; the ENP provides a testing ground for the ways in which it can take up that challenge while recognising and building on its own unique constitutional character.

Ukraine's European Integration and the Role of Parliament

SARAH WHITMORE

Introduction The Rada and EU integration?

At first glance, parliaments are not a 'central site' for European integration in current, candidate or aspiring members. Indeed, policy making is a realm that regardless of specific constitutional arrangements has increasingly become the preserve of the executive due to the growing complexity of government, the concomitant growth of the bureaucracy and globalisation (Norton 1990). European integration has been seen as contributing to this process due to the delegation of substantial legislative functions 'upwards' to the EU and the limited capacities of national parliaments to hold executives to account over their role in EU policy formation (Judge 1995). Furthermore, given that much of the literature of post-Soviet politics has pointed to the dominance of presidential executives over weakly institutionalised parliaments (e.g. Ishiyama and Kennedy 2001), it would be expected that in these 'neighbouring' states the legislature would have an even more marginal role to play in shaping the pattern and pace of integration with European (and other international) structures. As Protsyk (2003: 437-9) argues, this was the case in Ukraine under President Kuchma, where the parliament (Verkhovna Rada) was willing to accept presidential leadership in European matters.

But I argue that parliament does and will have if not a central then an important role in shaping the pace and nature of EU integration in Ukraine for three reasons:

- The implementation of the EU-Ukraine Action Plan (signed on 21 February 2005) requires the adoption of a large raft of legislation by the Rada in conjunction with the government. Therefore, the Rada's legislative capacity is likely to impact on this process (the shenanigans over the WTO legislation discussed below offer strong evidence of this).
- After the constitutional reforms adopted on December 8 2004 came into force at the beginning of 2006 the Rada's formal policy influence increased, including on European issues.
- A parliament able to perform its constitutionally-designated functions is necessary for Ukraine to meet the political aspects of the Copenhagen criteria: 'stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities' (Sweeney, 2005). This is not only because the Rada adopts the necessary legislation to support these political criteria, but also by *being* a stable democratic institution itself.

So, I am arguing that the Rada matters to Ukraine's democratic and European development in both the narrow and broad senses.

If we accept this premise, then understanding the Rada's institutional capacity and legislative process will provide insights into the some of the domestic factors affecting Ukraine's prospects for European integration. Therefore, this paper will examine the Rada's legislative capacity by first looking at internal institutions and structure and then its interactions with the government of Yulia Tymoshenko

(February-September 2005). Although progress in institutionalising the legislative process was made, the main obstacles to constructive interaction between the branches remained rooted in the weakness of the party system in the context of a semi-presidential system that did not create clear lines of accountability. How far the constitutional reforms that came into force in 2006 are showing signs of ameliorating these problems will be considered in conclusion.

Legislative Capacity in Ukraine

Ukraine's further European integration depends to certain extent on the adoption of legislation necessary for the implementation of the Action Plan and a continuation (acceleration) of the process of harmonising Ukraine's legislation with that of the EU's. Clearly, Ukraine's ability to do this is intimately connected to the Rada's legislative capacity. Initially, we can note the growing legislative capacity of the Rada as with each convocation the Rada adopted more laws: for 1994-8 there were 752 laws passed (compared to 471 1990-4); for 1998-2002 the figure was 1131, and for the 2002-6 convocation 1250 (Apparat of the Verkhovna Rada, 2006: 96). Although this broadly suggests an increasing capacity to draft, scrutinize and adopt legislation, this is rather a crude measure that does not indicate the importance or quality of legislation. Indeed there were serious concerns about the quality of legislation adopted in terms of its internal consistency and its compatibility with existing legislation (Lytvyn 2003).¹³¹ Contradictory legislation was a symptom of broader problems in the Rada: a lack of institutionalisation of norms and procedures in this relatively new institution;¹³² the fragmented, relatively unstructured and clientelistic composition of the deputy corpus; and a constitutional arrangement that provided relatively few incentives for cooperation between the executive and legislative branches. These factors were not significantly altered by the 'orange revolution' and the advent of President Yushchenko's administration and will be examined below.

Inside the Verkhovna Rada

Although internally the Rada did make significant progress in institutionalising norms and procedures concomitant with a modern democratic parliament, adopting for example standing orders (1994) and the law 'on standing committees' (1995), internal divisions prevented these from being brought into line with the subsequent constitution (1996) and their implementation remained patchy.¹³³ This meant that more controversial legislation tended to be examined and adopted by *ad hoc* procedures which regularly sidestepped the formal rules.¹³⁴ At the same time, the Rada built a committee system which formally resembled its western counterparts – permanent, paralleling government, comparatively well-resourced and (loosely) representative of the parent chamber, which enabled committees to process and scrutinize a growing volume of legislation. Although this did lead to a shift away from examining legislation on the floor of parliament, thus enhancing the

¹³¹ The case of tax legislation was notorious. For example, the State Tax Administration Order on VAT refunds contradicted the law on VAT, giving the tax administration the scope to choose which to adhere to. See Bidai, Frensch and Leschenko (2004, p.7, footnote 26).

¹³² Although the Verkhovna Rada was in fact created in 1937, it was not until 1990 that it began to assume genuine law-making and representative functions.

¹³³ To bring parliamentary procedures into line with the constitutional changes that came into force in January 2006, new standing orders were adopted in March 2006.

¹³⁴ For example, the first reading of the bill to amend the constitution on December 24 2003 was passed using a highly irregular voting procedure by a show of hands. Also see Whitmore (2004: 86-90, 145).

parliament's legislative capacity, the structure of committees remained sub-optimal, with significant workload variations because all attempts at reform were blocked by the cross-cutting interests of parliamentary factions (party and non-party based caucuses) seeking resources and influence in specific policy areas (Whitmore 2006).

Moreover, the orange revolution and creation of a new administration proved disruptive to committees' operations as eight committee chairs were appointed to the government and these positions were left vacant. Although this indicated that the Rada had become a genuine pool for elite socialisation and recruitment, it also meant the Rada was deprived of some of its most experienced deputies. The failure to make new appointments was largely due to the fragmented distribution of political forces in the Rada, who each sought to control these valuable positions.

The elusive parliamentary majority

A multi-party system emerged relatively late in Ukraine, after the semi-free elections of 1990 and the system of political caucuses¹³⁵ (party-based factions and non-party deputy groups) did not become formally institutionalised until after the 1994 elections (Verkhovna Rada, 1994). Until the 2006 elections, the Verkhovna Rada was characterised by a large and fluctuating number (usually 12-15) factions and deputy groups with a rapid turnover of membership. For example, during June 2005 there were 12 factions in the Rada, although in the aftermath of the presidential elections, the frequency of members switching factions was high (around 2 per week in May-July 2005). Figure 1 shows the composition of the Rada on 24 June 2005.

¹³⁵ I have used the term 'political caucuses' instead of the more usual 'party caucuses' to denote the non-party basis of many of these bodies. As well as deputy groups, which could be formed by any 14 deputies, factions that were based on political parties often included a considerable (and fluid) number of non-party members, while party members sometimes chose to join factions or groups outside of their party affiliation.

Figure 1: Composition of the Verkhovna Rada, 24 June 2005

Faction/Deputy Group	Number of members
<i>Pro-Yushchenko/government</i>	194
Our Ukraine	88
Ukrainian People's Party (Kostenko)	24
Bloc of Yulia Tymoshenko	40
Party of Industrialists and Entrepreneurs	15
Socialist Party of Ukraine	27
<i>'Centrists'</i>	89
People's Party (Lytvyn)	40
Democratic Ukraine (Sharov, Pinchuk)	20
United Ukraine (Hubs'kyi)	21
Democratic Initiatives (Havrysh)	10
<i>Opposition</i>	126
Regions of Ukraine	50
SDPU(o)	20
Communist Party of Ukraine	56
Non-affiliated	40

Source: www.rada.gov.ua

Although the factions of Tymoshenko, the Socialists and Volodymyr Lytvyn's People's Party were initially able to swell their ranks as deputies deserted the former pro-Yanukovich factions and sought to realign themselves with the new administration, and the opposition factions were disorientated by their new status and rarely able to coordinate their actions,¹³⁶ a parliamentary majority to support the government did not emerge. Even ostensibly 'pro-administration' factions were less than whole-hearted in their commitment to support the government. Deputy Prime Minister Anatoliy Kinakh's Party of Industrialists and Entrepreneurs did not vote in support of the government's budget, while the Socialists and Yuriy Kostenko's People's Party announced their unwillingness to support government bills where they did not coincide with their principles (Lymar' 2005 and Action Ukraine Report, no. 507, 22 June 2005). Thus, bills were passed by situational majorities formed around each piece of legislation, some of which gained in excess of 300 votes as the pro-government and centrists plus part of the so-called opposition voted in favour. At the same time however, the process was rendered unpredictable and the government could not always rely on a majority to enact key legislation. This was clearly illustrated by the failure to adopt key amendments to the law on intellectual property (i.e. concerning laser disc piracy) on May 31, which was required for Ukraine's entry to the WTO and for the lifting of US sanctions. The bill failed by just 17 votes as the government did not get the full support of deputies from 'its' factions – Our Ukraine and the Party of Industrialists and Entrepreneurs (Kuzio 2005).

This situation was not unusual for the Rada. The lack of a parliamentary majority characterised most of the post-Soviet period. Twice, from January 2000 until January 2001 and from November 2002 until September 2004, President Kuchma was able to

¹³⁶ For example, the voting on the budget on 25 March demonstrated this, as Regions of Ukraine refused to participate, while SDPU(o) and the Communists voted in favour.

generate pro-presidential majorities with the help of loyal deputy-oligarchs by a combination of blackmail (using *kompromat* from Ukraine's extensive surveillance system inherited from the Soviet period, or various inspections of deputies' businesses) and bribery. For limited periods, Kuchma's 'blackmail state' was efficient at producing a relatively compliant parliament to enact legislation,¹³⁷ although because of the artificial nature of such majorities, their cohesion and life-span was limited. The creation of artificial majorities was facilitated by the large number of deputy-entrepreneurs¹³⁸ who had business interests to protect (and advance) and were also potential clients for executive patronage (Protsyk and Wilson 2003). At the same time though, this engendered a proliferation of attempts to pass 'lobbyist laws', particularly in the sphere of tax legislation.¹³⁹ Initially under Yushchenko, the bribery and blackmail tactics to put together a majority were not in evidence (Syrotiuk 2005, Riabchenko 2005, Ter'okhin 2006), but unfortunately this meant that insufficient incentives existed for a majority to form, an issue that haunted the administration until the parliamentary elections were held in March 2006.

Semi-presidentialism in Ukraine: Explaining inter-branch conflict and the absence of a majority

Ukraine's semi-presidential system did not create incentives for a parliamentary majority. The 1996 Constitution created a president-parliamentary system where the president and parliament had 'competing political legitimacies, rigid terms of office and differing electoral bases' (Protsyk 2003a: 1078) while the powers of parliament and president overlapped in terms of oversight and dismissal of the government, the organisation of other executive bodies and law-making. This design created the potential for inter-branch conflict or deadlock also seen in presidential systems as well as a few incentives for the formation of a parliamentary majority (Mainwaring 1992, Linz 1990). In many ways the president had precedence over parliament regarding the formation, control and dismissal of the government and the Rada had limited opportunities for influencing the government. There were no provisions for the Verkhovna Rada to play a role in appointing the government or in taking responsibility for its actions. Parliament was simply required to confirm the president's nomination for Prime Minister (art.85.12) and the government's annual programme (art.85.6). This formally implied that there was no role in the constitution for a parliamentary majority and thus, no incentives for factions to form and maintain a coalition that would enact the government programme and take responsibility for its actions (see Protsyk 2003a). Yushchenko's decision to form a coalition government allocating proportions of posts to the parties in the 'Force of the People' coalition and those that backed him in the second round of the presidential election (i.e. the Socialists and Party of Industrialists and Entrepreneurs) broke with the tradition of appointing non-partisan 'technocratic' governments and clearly attempted to give

¹³⁷ Such 'efficiency' was however at best partial as since the mid-1990s the proportion of government legislation enacted has tended to decline, contrary to trends in Western democracies where the '90% rule' (90% of legislation is initiated by the government and 90% of it is passed) operates. See Whitmore (2004:151-2), Pavlenko (2002) and Protsyk (2003a: 1083). Nevertheless, during 1998-2002, factions which belonged to the 2000-1 majority voted along with executive initiatives 83% of the time (Protsyk and Wilson, p.715). For more on the mechanisms of a 'blackmail state', see Darden (2001).

¹³⁸ 364 (of 450) in 2000 according to Mykola Azarov, then head of the State Tax Administration (*Holos Ukrainy*, 25 April 2000, p.2). However, this figure increased after the 2002 elections.

¹³⁹ Evidence for this was provided in accounts by parliamentary deputies and staff in interviews with the author, March 2003. Also see Hellman, Jones and Kaufman (2000:10).

various parliamentary factions a stake in the government in the hope that this would lead to the emergence of a majority, but this was not a sufficient ‘carrot’ to overcome disparate interests and squabbling. Therefore, when Tymoshenko’s government was dismissed by President Yushchenko in September 2005, it was replaced by a more ‘traditional’ technocratic government led by Yuriy Yekhanurov.

In the context of a weak party system, semi-presidentialism in Ukraine produced cabinets more closely reflecting presidential preferences, unable to rely on a parliamentary majority to enact their legislative programme. Indeed, 1994-2006 figures indicate a declining capacity of governments to get their legislation passed (Protsyk 2003a: 1079 and author’s calculations from Apparat of the Verkhovna Rada, 2006: 100). The absence of institutional mechanisms to resolve disputes over policy between parliament and the executive (i.e. the president and/or the government) means that inter-branch conflict was built into Ukraine’s political system and became one of its defining features, along with an ongoing debate about constitutional reform.¹⁴⁰

Inter-branch relations in the new administration

Initially after Yushchenko became president, relations between the president and Rada became less confrontational than under Kuchma, largely as a product of a management style different from his predecessor and based on the desire to maintain good relations with speaker Lytvyn and other allies in the Rada in the run up to the March 2006 parliamentary elections. During 2005, Yushchenko refrained from making the kind of trenchant criticism of the Rada’s operation that Kuchma frequently made and from utilising Kuchma’s ‘divide and rule’ tactics, but at the same time he did by-pass the Rada on several occasions, using presidential decrees to regulate areas properly in the jurisdiction of the Rada (Rakhmanin 2005) and rarely using his right of legislative initiative. In sum, Yushchenko stood aloof from the legislative process.

Turning to the government, under Kuchma in general legislative-executive relations were persistently confrontational – as indicated by the prolonged battle by the president to increase his competences vis-à-vis the Rada, firstly via the constitutional process and subsequent enabling legislation, then via various attempts to amend the constitution (Whitmore 2004). At a more micro-level, relations with the Rada’s committees were characterised by frequent contacts and generally seen by deputies as constructive. However, successive governments (including Yushchenko’s (2000-2001)) tended to consult factions and committees only on an *ad hoc* rather than routine basis (Pavlenko 2002: 152). Effective cooperation over legislation was also impeded by the high turnover of ministers and the dependence on personal relations due to the lack of a regulatory framework (a consequence of the failure to adopt the law ‘on the Cabinet of Ministers’).¹⁴¹ There was also a tendency for ministries to send

¹⁴⁰ On the constitutional debate see Christensen, Rakhimkulov and Wise (2005), pp.207-230. For elaboration on the incentive structures and interactions between the three actors: president, parliament and government, see Protsyk (2003) and Pavlenko (2002).

¹⁴¹ This meant that the activity of the Cabinet of Ministers and the authority of the Prime Minister were regulated by a large number of laws. In 1997, 440 laws formed the legal framework for the operation of the Cabinet, while 250 laws framed the Prime Minister’s activities (*Holos Ukrainy*, 9 April 2005, pp.8-9). Although these figures may have changed somewhat, the overall situation has not, though in autumn 2006 both president and the government of Viktor Yanukovich each renewed initiatives to

low ranking officials to committee meetings, which did not inspire deputies' confidence. Deputies also consistently complained about the quality of bills emanating from the Cabinet of Ministers and it remained common for the Rada to pass the committee's 'alternative' bill rather than the government's draft (Whitmore 2004: 173-4).

Interactions between the coalition government under Tymoshenko and the Rada initially looked promising. The government was confirmed by a record number of votes as was the government's budget in March 2005. However, the institutional context had not altered, so ministers - seeing the Rada as largely unable to sanction them - lacked incentives to routinely engage with parliament during the legislative process. Therefore, like its predecessor, the Tymoshenko government struggled to get its legislation through the Rada. During the 7th session (Feb-Jul 2005), only 31% of bills initiated by the government were enacted.¹⁴² Familiar frustrations were vented by speaker Lytvyn about flawed and rushed government bills sent to the Rada at the last minute and ministers not coming to the Rada themselves, but sending 'their ten deputies' (Riabchenko 2005). That contacts between the government and parliamentary committees remained *ad hoc* according to the needs of the government was illustrated by the emergency situations minister failing to meet with members of the relevant committee to discuss planned reforms to the Chernobyl policy, so that the chair complained that the committee found out about this via the media (*Holos Ukrainy*, 13 April 2005: 2). Dissatisfaction was also expressed on the government side, with a sharply worded article in *Ukrains'ka Pravda* by Deputy Prime Minister Mykola Tomenko (2005) in which he lambasted the Rada for excessive lobbyism on behalf of their business interests, adopting unrealistic, unworkable laws and the leadership of the Rada for violating the standing orders to further their personal interests. By the end of summer 2005, an exchange of increasingly sharply-worded statements between the government and the Rada indicated that patterns of inter-branch relations had reverted to type (e.g. *Holos Ukrainy*, 14, 15 July 2005 and Syrotiuk 2005a).

To bring into sharp relief how difficult inter-branch relations and Ukraine's fragmented political caucuses can impact on Ukraine's implementation of the Action Plan and broader integration into European structures, the process of adopting the legislation required for WTO entry provides an appropriate illustration. WTO entry (along with gaining market economy status) was considered a key precondition for Ukraine's further European integration and Yushchenko made entry in autumn 2005 a clear priority (Action Ukraine Report no.505, 20 June 2005). However, this necessitated the adoption of 21 priority laws by the end of July 2005, yet the government allowed insufficient time for these to pass through the usual legislative process. By June 20, less than a month before the end of the session, only 16 of these bills had been passed to the Rada for examination (although the president promised the other 5 would follow within a week). The Rada leadership expressed serious doubts about parliament's ability to adopt these bills in such a short period (Riabchenko 2005 and 2005a). Prime Minister Tymoshenko's response was to ask the

adopt the law on the Cabinet of Ministers, and the Rada adopted the government's bill in first reading on 16 November 2006.

¹⁴² For comparison, on average during 2002-5, 39% of government legislation was enacted. Calculations by independent NGO Laboratory F-4 on the basis of official figures made available on the Rada website (www.rada.gov.ua), supplied to the author by Edward Rakhimkulov.

faction leaders to adopt 14 economic bills in a single package, by-passing the normal legislative process of committee scrutiny, first and second readings (Action Ukraine Report no.507, 22 June 2005). Yushchenko supported the Prime Minister's move, stating: 'There is little to discuss [in the draft laws], they should just be approved' (Action Ukraine Report no.505, 20 June 2005). While the executive's haste in order to facilitate joining the WTO as soon as possible was understandable, it also intimated a disregard by its two most senior politicians for due process.

In the Rada, the situational position of factions with representatives in the government was highlighted as, perhaps unsurprisingly, faction leaders reacted badly to the request for 'package voting': the Socialists flatly refused while Kostenko's People's Party attempted to leverage some concessions for their various constituencies in exchange for compliance (Action Ukraine Report no.507, 22 June 2005) and the opposition of the Party of Regions and Communists successfully disrupted several plenary sessions by blocking the rostrum, brawling and refusing to vote on WTO legislation ostensibly in protest at around 30 members of the executive illegally retaining their deputy's mandates. However, such procedural wrangles merely served to obscure elements of broader opposition to the WTO (in some cases in principle, in others to specific pieces of legislation linked to their business constituencies) that ran across institutions and threatened to split the government coalition. For example, the minister of agriculture, socialist Oleksandr Baranivskyi, publicly opposed the government's WTO legislation relating to agriculture. Eventually 8 of the 14 economic bills were passed by the summer recess, including the crucial intellectual property bill which enabled the lifting of US sanctions. This became possible after the president belatedly engaged in the process, met with faction leaders and demonstrably supported the government by attending key plenary sessions, but in the aftermath the Prime Minister and speaker engaged in bitter recriminations over who was to blame for the WTO debacle (*Holos Ukrainy*, 14, 15 July 2005 and *Zerkalo Nedeli*, 16 July 2005). Yushchenko vowed that the remaining WTO legislation would be passed in autumn 2005. However, the impending parliamentary election campaign made factions less likely to compromise on legislation that might affect their business and electoral constituencies, so this task was only returned to in autumn 2006 under the new government of Viktor Yanukovich, with the working deadline of WTO entry officially shifted to February 2007.¹⁴³

Ineffective cooperation between the Tymoshenko government and the Rada was compounded by the large number of executive structures responsible for Euro-Atlantic integration and the unclear and contested division of competences between them. These included the Ministry of Foreign Affairs, the newly upgraded National Security and Defence Council, the Deputy Prime Minister for European Integration and the Presidential Secretariat (Kuzio 2005). In the absence of a law 'on the Cabinet of Ministers', 'on the president' and on other executive organs, it remained uncertain which bodies or officials parliamentary committees and the Rada leadership should be coordinating their activities with over the issue of WTO legislation. If we recall the aforementioned internal problems that factions and committees within the Rada have

¹⁴³ Movement was made on adopting this legislation during the autumn 2006 session due to a complete about-face of the Party of Regions, whose role in disrupting the attempts of summer 2005 had been prominent. However, despite the existence of a formal parliamentary coalition, legislation was adopted by *ad hoc* coalitions of the Party of Regions and Socialists together with Our Ukraine and the Tymoshenko bloc.

in coordinating *their* activities, then the fate of much of the WTO legislation during 2005 seemed overdetermined.

Conclusion and Prospects

Ukraine's legislative process is an important domestic factor in the process of European integration both in terms of fulfilling the Action Plan and in the broader sense. Although the Rada made significant progress in institutionalising the procedural basis for a functioning democratic parliament and in raising its legislative capacity through greater structuring via parliamentary factions and committees, serious impediments to effective law-making remained, which contributed to Ukraine's convoluted, patchy, occasionally contradictory and difficult-to-implement legal framework. The most fundamental problems were:

- Weakness of the party system, leading to a fragmented and clientelistic deputy corpus where factions lacked cohesion and promoted individualistic agendas
- The absence of a parliamentary majority, which rendered the legislative process unpredictable, leaving governments struggling to enact their policy programme even after its parliamentary approval.
- Inter-branch cooperation was *ad hoc* and relations were often confrontational, tendencies that grew out of the incentive structure created by the semi-presidential system.

On December 8 2004 parliament adopted changes to the constitution and a new fully proportional electoral law which together re-shaped the division of powers in Ukraine when they came into force in 2006. These changes ostensibly sought to address the problems listed above by creating incentives for the formation of a parliamentary coalition (the president is able to dissolve the Rada if it does not form one), which then appoints the government and can dismiss ministers unilaterally, so that ministers are more likely to respond to the Rada as their principal. Technically, these changes sought to replicate the incentive structures between the branches found in parliamentary systems.¹⁴⁴ Furthermore, the move to a 100% proportional representation electoral system on the basis of party lists aimed to strengthen the role of parties in the political system, which form the basis for the parliamentary coalition. In principle, more cohesive parliamentary caucuses were also encouraged by the inclusion of the so-called 'imperative mandate' into the constitution – deputies now lose their mandate if they leave the party faction on whose list they were elected.

However, early indicators suggest that the constitutional and electoral law changes may not resolve fully the problems they were intended to address, and indeed have created new problems. This is predictable to a certain extent as formal institutional arrangements have typically told us little about the actual structure and operation of power in Ukraine as the 'rules gap' between legal norms and elite behaviour has been substantial, making the outcomes of reforms difficult to predict (Whitmore 2004). Furthermore, the constitutional amendment bill 4180 was vague in key areas (Koliushko and Tymoshyk 2004) and required further enabling legislation, including specification of the parliamentary coalition and the long-overdue law on the Cabinet

¹⁴⁴ It is worth remembering that the changes were pushed by Kuchma primarily as a means of reducing the impact of a potential presidential victory for Yushchenko and retaining power for his allies in parliament, thus minimising the impact of the 'orange revolution'.

of Ministers, on the president and on other executive bodies. Such bills in Ukraine have always been the object of a struggle over the division of powers and thus difficult to adopt (see below). This leaves considerable room for manoeuvre in terms of the operation of informal practices and will also potentially prolong institutional uncertainty in Ukraine, and thus to fulfilling the political aspects of the Copenhagen criteria. More generally, transferring powers to the Rada will not necessarily make the authorities in Ukraine more responsible or accountable because a key mechanism for popular accountability in consolidated democracies is a stable party system, which has not yet emerged in Ukraine.

Early evidence suggests that the new electoral law may not do as much as hoped to encourage a more structured parliament. Formally, the new structure is much clearer: only five parties and blocs passed the 3% threshold in the March 2006 elections (Party of Regions, Bloc of Yulia Tymoshenko, Our Ukraine, Socialists and Communists), there were only five factions in parliament and deputies were not allowed to switch membership. However, as the 1998 and especially 2002 elections demonstrated party list seats can be bought, this practice was reportedly even more widespread in 2006 across all parties. A secure place on a party list cost an estimated \$2-8m (Paskhover, 2006: 32) and was easier to 'buy' than a constituency. So the change to party lists did not necessarily strengthen parties *per se* or reduce the number of 'deputy-entrepreneurs' seeking a deputy's mandate to further their own business interests, who in turn would be susceptible to executive pressure on their businesses to vote 'correctly'. Moreover, the imperative mandate included in the constitutional amendments is not likely to lead to more cohesive factions, just less disciplined ones when it comes to voting. Early indicators in the new parliament bear this out, as during key votes such as the first reading of the 2007 budget or the dismissal of Interior Minister Yuriy Lutsenko, despite a strict voting decisions neither Yulia Tymoshenko Bloc or Our Ukraine were able to hold the faction together. By December 2006, eight deputies had been expelled from their factions for breaking party discipline, but either sat as independents or joined the coalition as despite the constitutional change, there was no clear mechanism to remove their deputies' mandates.

In the first instance, the new constitutional arrangements did not clarify the division of powers or bring greater stability to Ukraine's political system. Due to the fragmentation of political forces and uncertain rules of the game, it took over four months to form a coalition and a government. From August 2006 the 'anti-crisis coalition' of the Party of Regions, the Socialists and Communists supported a coalition government headed by Viktor Yanukovich. The new arrangement fundamentally altered the structure of principal-agent relations in the political system: as previously, the Prime Minister was subject to two principals – president and parliament – but after the constitutional reform, it was the parliament (or rather the coalition) that was decisive in the appointment and dismissal of both the government and individual ministers. This created powerful incentives for the government to work closely with the Rada¹⁴⁵ and left the president isolated and struggling to assert his remaining prerogatives, including in the sphere of foreign policy (for example, see *Zerkalo Nedeli*, 23 September 2006). Nevertheless, the anti-crisis coalition was a

¹⁴⁵ For example, this was immediately visible in plenary sessions, where the government lobbies in the Rada were well-staffed on a daily basis, which had often been far from the case in previous convocations (author's observations, 2000, 2003, 2006).

rather heterogeneous body, and many bills were adopted by situational majorities where Our Ukraine or the Tymoshenko Bloc voted with part of the coalition. A case in point was the voting on seven bills required for WTO accession on November 2 2006 (see roll-call votes on www.rada.gov.ua).

At the same time, the gaps in the new rules rapidly engendered inter-branch conflict. Although such conflict has been a defining feature of Ukrainian politics, the new constitutional rules shifted the dimension from president-parliament to president-government, with the latter backed by the coalition. As well as the aforementioned struggle over the prerogative to form foreign policy, the president and prime minister became embroiled in disagreements over the role of the prime minister's counter signature on presidential decrees, over the discretion of the president in accepting no-confidence votes in governors taken by oblast councils and over the right of the parliament to dismiss the foreign and defence ministers, who were appointed by the president. Attempts to adopt enabling legislation to clarify these issues, in particular a law on the Cabinet of Ministers, embodied this conflict with both president and government each initiating their own draft laws that attempted to frame the government's operation to their own advantage. Consequently, the chances for this law to be enacted remained small, but during autumn 2006 the debate about 'completing' the constitutional reform with either further changes to the constitution or by overturning the changes of 2004 gained momentum.¹⁴⁶ This meant that uncertainty about Ukraine's political system was likely to continue in the short to medium term.

Yet Ukraine's altered political landscape after the 'orange revolution' is a source of possible optimism. Lines of accountability should be enhanced under the new arrangement as it is clearer to the electorate who is responsible for policy decisions (i.e. the government and the parliamentary coalition). The new constitutional framework could in the longer term facilitate the realisation of Bagehot's 'efficient secret' of a strongly linked parliament and government that engenders more effective and predictable law-making. Until then, the legislative process and the relatively low level of parliamentary institutionalisation present significant challenges for the implementation of the Action Plan and other legislation that will facilitate Ukraine's greater integration with Europe. Overcoming them will require a commitment to clarify the responsibilities between executive organs and between the branches of power. At the same time, the EU can contribute to improving the quality of bills by providing increased technical support to the government and parliamentary committees on the preparation/harmonisation of legislation along the lines of that offered to EU candidate states (Ukrainian Monitor 2004). Plans to re-launch and substantially expand the activities of UEPLAC should be welcomed in this light.

¹⁴⁶ During autumn 2006, the Ukrainian national television news and press were full of items concerning the need to either overturn or 'improve' the constitutional reforms. For example, see *Den*, 3 November 2006 and *Ukrains'ka Pravda*, 3 November 2006 and 8 November 2006.

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Past and Future Action on Approximation of Ukrainian legislation to that of the EU*

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The approximation of Ukrainian legislation to EU law has been launched on March 1st 1998 when the Partnership and Cooperation Agreement (PCA) between Ukraine and the EU came into force. Article 51 of the PCA circumscribes priorities within which the approximation process must take place and explicitly states that the approximation of Ukrainian legislation is “an important condition for strengthening the economic links between Ukraine and the Community. Ukraine shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community”.¹⁴⁷ Since that the process of approximation of Ukrainian legislation has been gradually evolving and declining in line with tempo of EU-Ukraine relations.¹⁴⁸

The “Orange revolution” gave fresh impetus to long-cherished Ukrainian aspirations to join the EU. New political elite headed by extremely popular opposition leader Viktor Yuschenko encouraged fresh pro-European sentiments among the Ukrainian nation. Emotional victory of Viktor Yuschenko in dramatic presidential race created impressive worldwide wave of sympathy towards Ukraine. Everyone in Ukraine expected that the EU may reconsider its prudent policy towards Ukraine and recognise the Ukraine’s perspective to join the EU sooner or later. One has to admit that these expectations were mutual. The European Parliament voted on 13 January 2005 in favour of a non-binding resolution calling for Ukraine to be given “a clear European perspective, possibly leading to EU membership”. MEPs said it was now time to consider other forms of association with Ukraine besides the Neighbourhood Policy. Also the Resolution advocated relaxing visa requirements for Ukraine, recognition of Ukraine's market economy and support for the country joining the World Trade Organisation. This positive message from the European Parliament was warmly welcomed by leaders of some EU Member States. Polish President Kwasniewski acted as a strong advocate of immediate enhancement of relations between the EU and Ukraine. President Victor Yuschenko decided to catch the unique political momentum and pushed all efforts towards the objective of Ukraine’s full EU membership. In speech at the European Parliament in February 2005 President Yuschenko promulgated Ukraine’s objective to complete the EU full membership negotiations by 2007. However, Ukraine’s European aspirations have been quickly cooled off at the top EU level. On January 2005 President of the European

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¹⁴⁷ Article 51(2) of the EU-Ukraine PCA states that approximation of Ukrainian legislation to that of the EU must take place within the following areas: customs law, company law, banking law, company accounts and taxes, intellectual property, protection of workers at the workplace, financial services, rules on competition, public procurement, protection of health and life of humans, animals and plants, the environment, consumer protection, indirect taxation, technical rules and standards, nuclear laws and regulations, and transport.

¹⁴⁸ Petrov R., “Recent developments in the adaptation of Ukrainian legislation to EU law” 8(5) EFARev. 125-141 (2003).

Commission Jose-Manuel Barroso clearly stated that there is no perspective for Ukraine to join the EU in the nearest future. Commissioner Danuta Hubner intentionally dropped any mention about the possibility of Ukraine's membership in the EU by 2015 during her speech at the University of Sussex (UK) in February 2005. Instead, EU officials repeatedly articulated that the fulfilment of the EU-Ukraine Action Plan (AP) must be a priority for EU-Ukraine relations for the immediate future. Consequently, the effective implementation of the AP by Ukraine could lead to the enhancement of the EU-Ukraine relations in political, economic and legal domains.

On February 21st 2005 the AP was signed by the European Commission President Jose-Manuel Barroso and by Ukrainian newly appointed Prime-Minister Julia Timoshenko. One has to be aware, that the AP is not a document that was inspired by the "Orange revolution". On the opposite, the AP is a product of negotiation between the Prodi's Commission and former President Kuchma government headed by Viktor Yushenko's opponent Viktor Yanukovich in 2004. For these reasons, the new Ukrainian government pushed the EU towards more advanced document, which could either approve or just mention Ukraine's chances to join the EU. In response to such emphatic strategy of the Ukrainian government, and following active mediation of High Representative in CFSP H. Solana, the EU added some non-binding changes to the document, which envisaged the conclusion a "new enhanced agreement, whose scope will be defined in the light of the fulfillment of the objectives of this Action Plan and of the overall evolution of EU – Ukraine relations" and a possibility of preparing for future negotiations on a visa facilitation agreement.

The signing of the AP was welcomed by political elite in Ukraine though in somewhat skeptical way. It became clear that Ukrainian pro-European prognoses must be reconsidered in line with more pragmatic objectives of the AP. To support that view the EU side reiterated that the AP is the major framework document that shapes the format and the character of the EU-Ukraine relations in the nearest future. In order to enhance these relations Ukraine is expected to acknowledge and to implement the AP. The approximation of Ukrainian legislation to that of the EU constitutes one of the top AP priorities.

The objective of this article is to discuss contemporary issues of approximation of Ukrainian legislation to that of the EU in the aftermath of the so called "Orange revolution". In the beginning we emphasise major priorities of the approximation of laws process envisaged in the EU-Ukraine Action Plan. In the second part of the article we analyse gains and setbacks of the approximation of laws process in the "after Orange revolution" era. In the final part of the article we examine major difficulties of the EU-Ukraine approximation process, which might occur in the immediate future.

Approximation of laws objectives in the EU-Ukraine Action Plan

The AP envisages the approximation of laws as a foundation for further economic integration between the Parties including the establishment of an EU-Ukraine Free Trade Area and Ukraine's accession to the WTO. It means that the AP does not limit the scope of the approximation process by EU laws and standards but encompasses the export of wider area of economic and trade-related rules and regulations including

the WTO laws. This also includes the adoption of EU regulatory methods: convergence of economic legislation; the opening of economies to each other; and the continued reduction of trade barriers, which will stimulate investment and growth between the EU and Ukraine. The AP is explicit in stating that the approximation process of Ukrainian legislation to that of the EU includes the reinforcement of Ukrainian administrative and judicial capacity.

Directions of approximation process in the AP comprise several blocks. The first block covers adoption by Ukraine of internationally established standards of democracy, rule of law, human rights and fundamental freedoms. In particular, the AP states that Ukraine must continue its internal reforms based on strengthening democracy, rule of law, respect for human rights, the principle of separation of powers and judicial independence, democratic election in accordance with OSCE and Council of Europe norms and standards (political pluralism, freedom of speech and media, respect for the rights of persons belonging to national minorities, non discrimination on grounds of gender, and on political, religious and ethnic grounds). Special attention is paid to democratic conduct of presidential (2004) and parliamentary (2006) elections.

The second block encourages Ukraine to improve cooperation with the EU in areas including combating terrorism, non-proliferation of weapons of mass destruction and illegal arms exports. Consequently, Ukraine is expected to adhere to fundamental international conventions in these areas (mainly the UN and FATF documents).

The third block focuses on area of economic and social reform and development in Ukraine. Therein the AP explicitly states that Ukraine is expected to advance in gradual approximation of basic legislative and regulatory framework to that of EU, and ensure its effective implementation. These efforts must include ensuring transparency, predictability and simplification of national regulatory frameworks and their effective application. The AP emphasizes that full application of relevant GATT provisions is important precondition of further liberalisation of trade regime between the EU and Ukraine. It relates to issues of movement of goods, customs legislation, implementation of the GATT the most favored nation and national treatment principles. Legislative reforms must also include alignment of Ukrainian legislation with EU laws in consumers safety and sanitary and phytosanitary standards.

The fourth block deals with social situation, employment, poverty reduction in Ukraine. It is stated that Ukraine must ensure a closer approximation of national legislation to EU standards and practices in the area of employment and social policy.

The fifth block covers sectoral cooperation between the EU and Ukraine. The AP envisages implementation by Ukraine of tax systems and their institutions based on international and European standards; adoption of state aid and competition laws that are compatible with EU laws. The Parties agreed to ensure a level of protection of intellectual property rights similar to that in the EU. Also Ukraine must continue approximation to EU legislation on public procurement in order to ensure effective implementation of the key principles of transparency, nondiscrimination, competition and access to legal recourse. These principles should apply to procurement for goods, services and works across all relevant public bodies at all levels. Sectoral cooperation envisages adoption of statistical methods fully compatible with European standards in

relevant areas. Besides the AP calls Ukraine to align own legislation and regulatory frameworks in areas of transport, energy, information society and environment, science and technology, education, training and youth, culture and audio-visual issues, civil society cooperation, public health and cross-border cooperation.

The AP pays special attention to the Ukraine's adherence to the vague concept of European common values. The AP does not specify the scope of these values. However they could be deduced from the draft of the Constitution for Europe.¹⁴⁹ The Ukrainian commitment to common values shall be closely monitored by the EU and will directly influence "the pace of progress of the relationship" between the EU and Ukraine. Therefore, the AP induces significant approximation commitments on Ukraine. In general, the EU wants Ukraine to commit to the process of voluntary harmonisation of national legislation to the EU acquis.

Approximation of laws efforts by the Ukrainian government in the aftermath of the "Orange Revolution"

The signing of the AP marked the new stage of the approximation of laws process in Ukraine. Below we shall consider major gains and mishaps of this intrinsic process for Ukraine.

In area of protection of human rights and fundamental freedoms the Ukrainian government took efforts to join multilateral conventions, which have not been signed by Ukraine yet. Ukraine became a Party to the European convention of remedies to victims of crimes. The Verkhovna Rada ratified the Council of Europe Civil Law Convention on corruption. Through ratifying this convention Ukraine obtained membership in the GRECO group (Council of Europe group of countries against corruption). Legislative measures have been taken to involve public into decision making. Public Boards and expert groups (on price making and salaries) were established within the Cabinet of Ministers and local governments. Regulation on public monitoring of the Cabinet of Ministers and local governments was approved by the government of Ukraine. However, the long-awaited reform of judiciary did not succeed. The concept of judicial reform was debated in the Verkhovna Rada but without any effective measures adopted.

Year 2005 has been marked by the acceleration of the EU-Ukraine cooperation in foreign affairs and security issues. The EU and Ukraine signed the Agreement on the security procedures for exchange of classified information and the Agreement establishing a framework for Ukraine's participation in EU crisis management operations. Also Ukraine joined so called "Australian group" that is responsible for control over trade in dual goods. National lists of dual goods have been adopted by the Ukrainian government in accordance with recommendations of the "Australian group". Access of EU nationals to the Ukrainian territory was considerably liberalised. Ukraine voluntarily abolished the visa regime for EU and Swiss national from 1 May 2005 in remote hopes of adequate measures on behalf of the EU.

¹⁴⁹ Article 1-2 of the EU Constitution provides: "The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail".

Following reiterating requests from the EU the Ukrainian government started negotiations on the EU-Ukraine readmission agreement.

In economic and social areas the Ukrainian executive and legislature made serious efforts to liberalise national services market and to accelerate structural reforms. The Verkhovna Rada of Ukraine adopted for consideration and plenary debates draft laws on mortgage securities, stock market as well as laws on opening domestic markets to foreign banks and auditors and the draft law on liberalisations and permissions and approvals in commercial activities. Furthermore, the Verkhovna Rada adopted a package of laws aimed at dismantling discrimination of foreign investors in Ukraine. In particular, 5 years moratorium on setting new tax privileges was introduced. Tax privileges in free economic zones were abolished. In area of fiscal control the government of Ukraine eliminated the mandatory selling of 50% of foreign currency income by enterprises.

The Ukrainian government and the Verkhovna Rada achieved positive results in preparation of the Ukrainian membership in the WTO. By the end of 2006 the Ukrainian government signed all bilateral protocols on mutual access of goods and services (apart from Kyrgyz Republic and Taiwan) with members of the WTO working group on accession of Ukraine. It means that the Ukrainian government agreed 98% of national consolidated tariff nomenclature with other countries – WTO members. The EU and the USA have granted to Ukraine the status of the market economy country. Furthermore, the USA recognised democratic and market economy reforms in Ukraine by lifting notorious Jackson-Vanik amendment, which imposes discrimination on goods from the former USSR republics. The government of Ukraine adopted new regulations to liberalise the access of foreign investors to domestic markets and to protect their intellectual property rights. Privileges of national producers in car making industry were abolished. Ukrainian sanitary, phytosanitary and technical standards have been further aligned with EU relevant standards. The Verkhovna Rada of Ukraine decreased export and import tariffs on agricultural products and iron scrap. Besides, the Verkhovna Rada adopted a package of laws, which allowed the liberalisation of national insurance, audit and banking services in 5 years time after accession into the WTO. As a result of these legislative reforms the Ukrainian government claimed that the WTO ministers may consider the issue of the Ukraine membership in February 2007. However, the eventual WTO membership could only be considered possible after the Verkhovna Rada adopts the package of the liberalisation of trade laws. Frequent changes of government in Ukraine hinder this possibility thereby leaving Ukraine's chances to join the WTO before the Russian Federation under question. In area of environment protection the Ukrainian government confirmed its adherence to objectives of the Kyoto Protocol and took first steps to implement Kyoto Protocol requirements. In area of education Ukraine joined the Bologna Process in May 2005.

The Ministry of Justice continues to play an important role in the approximation of laws process. More than 3000 pages of the EU acquis have been translated by the Ministry of Justice in 2005 and 2006. Only in the first half of 2005 experts of the Ministry of Justice approved 121 drafts of legal acts as confirming EU law standards. About 100 legal drafts were sent back to responsible ministries for further improvement in accordance with EU acquis. Besides, the Ministry of Justice assisted to the Verkhovna Rada in reviewing compliance of legislative drafts with EU laws.

However, the process of the AP implementation encountered significant problems and setbacks in the “after Orange revolution” period. The first, and in our opinion the major problem is that the implementation of the AP did not tackle the reform of judiciary. Hitherto, judiciary remains the most non-transparent branch of power in Ukraine. In opinion of Ukrainian public the judiciary is associated with sophisticated corruption. Access to judicial profession is extremely limited and, therefore, suspected in nepotism. In 2005 and 2006 some Ukrainian judges issued conflicting and perplexing judgments that suited interests of specific political groups. As a result, the Ukrainian judiciary gained negative image and disrespect with Ukrainian public opinion. This disappointing situation could be explained by several reasons. The first reason is lack of professionals who could personally initiate the reform of judiciary. Unfortunately, neither any of “after Orange revolution” Ministers of Justice nor any of prominent judges took courage to launch urgently needed reforms. The second reason is political pressure on the Ukrainian judiciary on behalf of the Ukrainian government. Some members of the “Orange revolution” team were accused in pressing judges to issue decisions, which suited political interests of the government. Important change in sphere of judiciary which must be highlighted is opening for Ukrainian public case practice of Ukrainian courts. It is hoped very much that this reform will encourage further reform of the Ukrainian judiciary towards transparency and democracy.

The second problem of the approximation of laws process in Ukraine is that the Verkhovna Rada kept many legislative drafts required by the AP in pipeline without approval. For example, the Verkhovna Rada approved the first draft of law on equal opportunities for men and women. Issue of public television and radio channel as well as amendments related to protection of rights of imprisoned who are in custody for a long time were debated but not approved by the Verkhovna Rada of Ukraine.

The third problem is overall stagnation of the Ukrainian economy in the “after Orange revolution” era. In our opinion this factor negatively influenced the tempo of the approximation of laws process in Ukraine. The impressive growth of 2004 economy has stalled due to the disappointment of foreign investors from inconsistent and unpredictable policy of the Ukrainian government. Foreign investors called the Ukrainian government to ensure two major guarantees: 1) certain degree of predictability of the governmental policy towards investors, and 2) high standards of equality between all players on the market.¹⁵⁰ However, the Ukrainian government headed by Julia Timoshenko ignored these calls. One of its first actions was the dismantlement of numerous free economic zones in Ukraine thereby infringing upon interests of foreign investors already operating in Ukraine. Also, the Ukrainian government embarked upon the policy of active interference into national economy. Facing the eminent rise of Russian export tariffs on gas and oil the government of Ukraine revalued the Ukrainian hryvna. The objective of this interference was to compensate losses of petroleum importers in return of keeping petroleum prices at the fixed level. However, these efforts led to almost total deficit of petroleum and 50% rise in petroleum prices in Ukraine. In area of privatisation the government of Ukraine launched the notorious campaign of re-privatisation. It means that the government questioned the legality of privatisation of earlier privatised companies. However the

¹⁵⁰ Speech by Paul Ostling, head of the “Ernst & Young Global” (USA), at the meeting with the President of Ukraine on 20.10.05.

new government was accused in political lustration and redistribution of private property to new owners who are loyal to the ruling political elite. As a result of these events the economic growth in Ukraine has lost its dynamic and even fall down. Forecasted 7% GDP growth turned to less than 4% GDP growth in 2005.¹⁵¹

Furthermore, Ukraine went through serious institutional crisis in area of European integration. The Ukrainian government did not manage to solve the issue of separation of competences within the executive in area of European integration. Former Vice Prime-Minister in European Integration Oleg Rybachuk's efforts to establish the Ministry of European Integration, which could be responsible for intergovernmental coordination and control in issues including the approximation of laws, failed. It appeared that Vice Prime-Minister Rybachuk encroached into competences of other ministries, in particular, the Ministry of Foreign Affairs. In the end, not only plans to set up the Ministry of European Integration were dropped but the position of Vice Prime-Minister in European Integration was eliminated.

Future action on Approximation of Ukrainian legislation to that of the EU

The above mentioned setbacks of the approximation of laws process in Ukraine were engendered by several problems. The prime problem was caused by the lack of experienced professionals in the early "after Orange revolution" governments. Very few professionals have been promoted to top positions in the government in the aftermath of the "Orange revolution". In general, top executive positions were distributed to politicians who either directly or indirectly supported the "Orange revolution". As a result, these governments lacked bold initiative professionals who were able to accelerate the approximation of law process and to initiate far reaching political, economic and legal reforms in Ukraine. Another problem was caused by lack of effective cooperation between the Ukrainian government and the Verkhovna Rada in issues of aligning Ukrainian legislation in line with EU standards. Many of the government bills have been blocked by the Verkhovna Rada not only because political clashes but also because of insufficient and ineffective exchange of information between the government and the Verkhovna Rada. For instance, this problem appeared during the adoption of the package of laws needed for the Ukraine's accession to the WTO. Furthermore, the Ukrainian government failed to be transparent to the Ukrainian nation. Many of seminal decisions have been taken "behind closed doors" without involvement of general public into the decision making. Ukrainian journalists protested against the absence of fairness in the Ukrainian media and presence of nepotism in top appointments.

The approximation of laws programme in Ukraine came through several serious internal and external challenges. The first challenge is associated with results of Ukrainian parliamentary elections on March 26th 2006 which displayed growing dissatisfaction of the Ukrainian population with the progress of European integration. More than a third of votes was casted in favour of pro-Eastern oriented parties (Party of Regions, Communist Party). In other words, significant part of the Ukrainian nation expressed their wiliness for deeper economic integration with former Soviet republics through closer involvement into the Single Economic Space (SES)

¹⁵¹ Information of the Ukrainian Institute of Evolution Economy, <<http://iee.org.ua/ru/detailed/prognoz/319>>, last visited 20th October 2005.

initiatives. Nevertheless, results of the 2006 parliamentary elections could hardly change priorities of the Ukrainian foreign policy in the immediate future. Both possible coalitions in the Verkhovna Rada (“democratic coalition” headed by charismatic Julia Timoshenko and “anti-crisis coalition” chaired by pro-Russian Viktor Yanukovich) confirmed continuation of pro-European course of the Ukrainian foreign policy. It means that, at least in the foreseeable future, new Ukrainian government will continue further rapprochement with the EU through participation in the “Wider Europe” initiative with hope to set up a free trade area between the EU and Ukraine and to open sectors of the EU internal market to Ukrainian undertakings.

Realising the need to provide more backing to pro-European parliamentary coalition in Ukraine the European Parliament issued non-binding resolution on the parliamentary elections in Ukraine.¹⁵² In this resolution the European Parliament praised “democratic and transparent manner” of Ukrainian elections and asked “the new government formed after these elections to consolidate Ukraine’s exposal of common European values and objectives”. The most importantly, this resolution “calls on the Commission to begin to negotiate an Association Agreement” with Ukraine. It means that the European Parliament urged the Commission to start negotiations on a new agreement, which should substitute the outdated Partnership and Cooperation Agreement (PCA) between the EU and Ukraine (came into force on 1st March 1998 and it is due to expire in 2008). Mere reference to the need to conclude an association agreement with Ukraine does not imply that objective of this agreement will be either the full membership of Ukraine in the EU or even remote perspective of that. However, a new association agreement between the EU and Ukraine might lead to closer political and economic rapprochement between the Parties through establishment of a customs union/a free trade area and liberalisation of mutual trade. In case if “anti-crisis coalition” will form majority in the Verkhovna Rada and form a new government the Ukrainian foreign policy will return to the multi-vector foreign policy that was actively employed by former President L. Kuchma. It means that while maintaining participation of Ukraine in the ENP the “anti-crisis coalition” will reinvigorate Ukraine’s participation in the Russia led integration project, which might lead to eventual establishment of customs union in the former USSR area. In return, Ukraine could get access to cheaper energy supplies from Russia and its satellites. The newly appointed Prime-Minister Victor Yanukovich advocates an idea of coordination and synchronisation of Ukrainian and Russian policies in relation to joining the WTO and closer rapprochement with the EU. This strategy could have significant implications for Ukraine. Taking into account that the Russian government is not keen on accepting “democratic and human rights clauses” in future agreement with the EU¹⁵³ one may predict a possibility application of similar pragmatic policy by the Ukrainian government during negotiations on new EU-Ukraine Neighbourhood Agreement. Hitherto, the new government in Ukraine confirms its support for pro-European foreign policy of Ukraine and need to enter into new level neighbourhood relations with the EU and acceptance of common democratic values with the EU. The second challenge is related to the recent political and economic crisis in the EU, which handicaps all EU intentions to reward Ukraine for possible successes of its approximation programme. Facing continuing constitutional crisis and further wave of enlargement the EU is

¹⁵² 6 April 2006, P6_TA-PROV(2006)0138.

¹⁵³ <http://euobserver.com/?aid=22654>

keen to safeguard its public opinion by adding so called “absorption” or “integration capacity” in addition to well known Copenhagen criteria for any countries which wish to join the EU.¹⁵⁴ This dubious situation might bring the EU-Ukraine approximation process to the standstill.

Future action on approximation of laws in Ukraine must undergo serious revisions in order to achieve objectives of the AP. There is an urging need to shift from mere legislative approximation of laws towards more close involvement of judiciary into the approximation of laws process. The Ukrainian judiciary must pay more attention to applying EU general principles in the process of taking decisions. References to EU general principles and EU common values could drastically accelerate the process of approximation of laws on all levels of power in Ukraine. The Ukrainian judiciary may serve the role of catalyst of the whole approximation of laws process in Ukraine by actively applying European legal heritage in own decisions. Work of law enforcement bodies in Ukraine need drastic reform too. Many of court decisions can not be enforced due to lack of efficiency and sufficient competence of law enforcement officials. Experience of reform of law enforcement bodies in EU Member States and former candidate countries must be taken into account. Therefore, the priority of the approximation of laws process must be given to the reform of judiciary and law enforcement bodies.

¹⁵⁴ The European Commission Communication “Enlargement Strategy and Main Challenges 2006-2007”, COM(2006)649.

Foreign Direct Investment and the modernisation of Ukraine's economy

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The economic history of Ukraine since the break-up of the Soviet Union has been characterised by missed opportunities for reform and economic stagnation. It is only since the financial crisis of 1998 that economic management has improved and recovery began.

Table 1: Real Economic Growth in Ukraine 1990-1999: % year on year

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
UKR	-4.0	-8.7	-9.9	-14.2	-22.9	-12.2	-10.0	-3.0	-1.9	-0.2
PL		-7.0	2.6	3.8	5.2	7.0	6.1	6.9	4.8	4.1

Source: State Statistics Committee of Ukraine and EUROSTAT

According to official estimates the economy at the time of the crisis was only 40% of its size in 1990.¹⁵⁵

This measure is undoubtedly an over-estimate of the real loss of output. The base level data produced in the lifetime of the Soviet Union overestimated the output of the economy compared to a calculation at market prices. And GDP is not the most sophisticated measure of welfare. Nevertheless it is clear that economic policy over this period did not produce the same recovery as was observed in neighbouring Poland, where output began to rise in the second half of 1992.

Ukraine suffered the additional problem of separation from the Soviet Union, of which, unlike Poland, it had been an integral part. It was saddled with a large armaments industry, with a stock of nuclear warheads and many other remnants of the Soviet empire.

However Ukrainian reforms in the 1990s were never thorough, producing a situation which favoured the establishment of financially integrated groups (FIGs) based on the old state industries and effectively eliminating competition. With little competition and with comfortable relations with the Government, these FIGs had no incentive to innovate or even to invest in new technologies. Their relations with Government also allowed them to ensure that the business environment in Ukraine remained opaque and geared to the elimination of competition. Hence, whereas in Poland, and even more so in Hungary, foreign investors entered the economy, in Ukraine foreign direct investment (FDI) remained extremely sparse throughout the decade.

¹⁵⁵ State Statistics Committee of Ukraine

The result of the lost 1990s for the average citizen was a standard of living which deteriorated considerably and which ended in the financial crisis of 1998. Real GDP per capita in 1999 had fallen to only 52% of that in 1992 (SSC).

The Ukrainian economy subsequently recovered strongly. Between 2000 and 2004 the average annual real growth rate of GDP was 9%; in 2004 it reached 12.1%. This was partly a result of the macro-economic stabilisation policy put in place after the crisis. The hryvnya was strongly devalued and anchored to the dollar. The government deficit which had been almost 7% of GDP in 1997 was brought down to reach a small surplus in 2000. Financial constraints in the economy were made to bite. Pension and budgetary arrears were successfully tackled and inflation, which had been chronic up to the currency crisis, was brought down quickly into single figures.

Table 2: Real Economic Growth in Ukraine 2000-2005: % year on year

	2000	2001	2002	2003	2004	2005
Ukraine	5.9	9.2	5.2	9.6	12.1	2.6*
Poland	4.2	1.1	1.4	3.8	5.3	3.2*

Source: State Statistics Committee of Ukraine and EUROSTAT
* provisional

The recovery was also due to the strength of foreign demand for the products of Ukraine's metallurgy industries. Export prices rose and demand remained strong up to the end of 2004, notably from China. Energy exports also expanded.

However at the same time that macro-economic management was improved, measures were also taken to make the domestic business environment more attractive. Taxation was simplified for small businesses and the complexity of the regulatory framework was reduced by the elimination of a substantial number of laws which had had the effect of discouraging entrepreneurship. Competitive pressures inside Ukraine also increased considerably as a result of Government policy.

The extremely high growth rates registered in the period 2000-2004 could not be sustained, partly because they were due to positive factors which gradually faded as growth stimulants (strong demand and high export prices for metals and a strongly undervalued exchange rate for instance). Nevertheless the performance in 2005 was poor and growth is only now beginning to recover.

The sudden decline in growth coincided with the triumph of the Orange Revolution. The two events were linked but only very partially. The main determinants of lower growth in 2005 (apart from the statistical problem of a high base level in 2004) were the sharp declines in exports and investment (consumption remained buoyant thanks to government social expenditure). Exports were affected by falling demand and prices for metals on world markets (subsequently reversed), while investment was affected both by failing growth and by government policy.

The Orange forces, which were appointed by President Yushchenko to form a new government, pursued economic policies which were confusing. Disputes between the Prime Minister's Office and that of the President led to different policies being announced on important issues affecting investment. The most widely reported of these issues was that of the number of firms to be re-privatised following the corrupt insider-privatisations which had characterised the Kuchma era. It was reported (though never substantiated) that the Prime Minister wanted to reopen 3000 such deals while the President intended to tackle only a few major deals. This created uncertainty of ownership across the economy and particularly in the privatisation process, one significant factor in the under-performance of investment. At the same time policy was made without sufficient consultation of interested parties. This was the case in the abolition of the privileges offered in special economic zones, a decision implemented with no transitional measures to ease in the change.¹⁵⁶

These disputes culminated in the dismissal of the Government by the President in September 2005. The combination of the handover of substantial Presidential powers to the Parliament, the long and tough election campaign for the March 2006 legislative elections, followed by extremely complex coalition negotiations and the European Union's completely mixed messages on Ukraine's future integration with the Union have also not helped to create a propitious atmosphere for investment, both domestic and foreign.

Nevertheless the achievements of the Orange Revolution, even during the difficult year 2005, hold much promise for economic development in Ukraine in the coming years.

The Presidential election in December 2004 ushered in a more open society and economy. This may sound optimistic in the light of the extremely obscure and bizarre negotiations on energy prices with Russia. However a good indication is that Ukraine held its first election free of major corruption and vote-rigging in March 2006. Another is that the media is now free, although media ownership is still a rather opaque matter. Ukraine also now has a far more critical public, prepared to get involved in important matters of state policy. These are all signs that democracy has become entrenched in Ukraine in a way which is favourable for the country's integration into international economic institutions. This creates confidence amongst investors too.

Concrete achievements were also made in 2005 in policy directly affecting the economy.

One of the most crucial achievements was to make a start in rolling back the insider economy. The modernisation of Ukraine's economy has been held back by isolation from external competition and by the power of the 'insider economy'. The insider economy is especially well developed in Ukraine, where large financial industrial groups (FIGs) dominate industrial output. These groups maintain strong connections with Government and other state institutions, allowing them to circumvent the normal operating rules of the market economy.

¹⁵⁶ World Bank, The debate on elimination of free enterprise zones in Ukraine, December 2005

The existence of these negative factors has led foreign investors to shy away from investing in Ukraine. The new government began to tackle the problems of the insider economy and corruption in 2005 immediately after the Presidential elections. It has done its best to reduce the scale of the insider economy over recent months, with some success. The World Bank reports that there has been a marked decrease in insider deals concerned with privatisation of state-owned firms and state contracts. The greatest success in this field was the privatisation at the end of 2005 of Kryvorizhstal, the largest steel plant in Ukraine for \$4.8bn to Mittal Steel. This had previously been sold by the Government for only \$800 million.

Another hopeful sign is that some of the FIGs are now beginning the transition to open, law abiding companies, with an international status. As these companies begin to invest abroad, they will be compelled to abide by international standards of corporate governance.

Steps were also taken in 2005 to clear up smuggling and corruption in customs clearance. This campaign showed some success and led to a rise in customs receipts for the Government. The budget agreed in March 2005 also eliminated many tax privileges and exemptions. Together with improvements in tax collection, this led to a rise in tax revenues and helped to keep the Government deficit in reasonable limits. Government debt is at an extremely low level.

Investment should benefit too from the measures taken in the direction of the liberalisation of currency movements, particularly the abolition of the compulsory 50% sale of export revenues to the National Bank.

Finally on the international level, although WTO accession was not achieved, progress towards it was made, so that accession in 2007 is likely. Strenuous attempts were also made to realise the aims of the President's 'European Choice' but here the Government came up against the unwillingness of the Union to consider, under any circumstances, the accession of Ukraine to the Union.

Accelerating Ukraine's integration into the international economic community must be one of the new Governing Coalition's tasks if it is to succeed in raising the standard of living of Ukraine's population. Together with the improvement of the business environment, including further reductions in the level of corruption, this will improve Ukraine's chances of attracting much-needed FDI.

FDI and the modernisation of Ukraine's economy

The literature on the relationship between economic growth and FDI in transitional economies is vast and controversial. The majority of studies suggest that FDI was an important factor in GDP growth in central Europe in the 1990s, working through its impact on capital formation, the introduction of superior technology and the improvement of management skills and techniques. While FDI is affected by the quality of the business environment, once established it has a beneficial impact on that environment helping to make it more open and transparent.

The relationship between FDI and capital formation is not simple.¹⁵⁷ In the case of certain privatisations, it may lead to no increase at all or even a reduction.

This could be the case for instance where a firm was sold to a foreign investor, who rationalised the production process before selling the firm on, the original purchase price being absorbed into the Government account. Green-field investments on the other hand usually imply a significant increase in capital formation though the relationship may not be 1:1. Across the whole economy in the transition countries of central and eastern Europe however FDI has been an important source of additions to the capital stock.

The relationship of FDI to productivity has also been questioned. Generally the productivity of foreign investments (privatisation or green-field) is higher than that of the general economy in transition economies. This is the result of both better technology and improvements in management. Old state enterprises have frequently employed large numbers of workers at low levels of productivity, the rational result of a centrally planned system. This overcapacity is usually reduced rapidly at privatisation without a corresponding loss of output, especially when foreign buyers are involved. FDI contributed to the doubling of the level of productivity in Poland between 1990 and 1999.

However theory tells us that productivity also rises in local firms through knowledge spillovers from foreign-owned companies. This frequently occurs when foreign-owned companies require minimum quality standards from local suppliers at the same time as putting pressure on input prices through encouraging competition. Research suggests that such spillover effects from backward linkages do exist, though more strongly in FDI aimed at supplying the domestic market than for export-oriented FDI.¹⁵⁸

Finally through competition FDI tends to raise productivity horizontally in domestic companies competing with the foreign company. This effect is somewhat difficult to disentangle from the other factors bearing on productivity growth.

Economic and institutional reforms encourage FDI. However it is also true that FDI tends to support reforms once it is established. Foreign owners and their local management staff will support initiatives to create transparent business conditions and to push forward other reforms, which underpin democracy and the market economy. In the early years of the transition, this is not always the case, when foreign investors have the power to demand that governments create protected markets for them (by raising tariffs for their products for instance). However once FDI reaches a substantial volume, quasi-monopolistic practices give way to competitive markets and foreign investors will tend to support economic and institutional reforms.

Finally a substantial level of foreign direct investment offsets the trade deficit as high investment draws in imports of capital goods. In transitional economies foreign direct investment may account for a large proportion of total foreign trade as foreign

¹⁵⁷ Libor Krkoska, Foreign direct investment financing of capital formation in central and eastern Europe, EBRD 2001.

¹⁵⁸ Beata Smarzynska, 2002, 'Does Foreign Direct Investment Increase the Productivity of Domestic Firms', World Bank Policy Research Working Paper 2923.

firms import inputs and export a part of their production. As local supplies of inputs rise, imports may begin to decline.

Factors determining FDI

Much has also been written about the factors which attract foreign companies to invest and circumstances which militate against FDI.¹⁵⁹

Four main factors appear to explain a large part of the FDI which has taken place in the EU's new Member States:

- The size of the market
- The costs of production
- The business environment
- EU integration

The size of the market has been of considerable importance in these countries. Early investors after 1989 predicted a rise in the consumption propensity and invested to ensure that they could supply this growing demand. The majority of foreign investments were made to serve domestic markets rather than for export. The heavy investments of companies such as Metro, Tesco and Carrefour in retailing were obviously responses to potential local markets. This of course would suggest that large economies, such as Poland, benefited over-proportionally, simply because of the large domestic market. However with the liberalisation of trade, not simply bilaterally with the EU but between the countries of central Europe themselves (CEFTA), companies could serve the whole region from any country in the region. Nevertheless it is probably true that Poland, Hungary and the Czech Republic benefited in attracting foreign consumer goods and services companies because of the size of their domestic market.

Some research points to production costs being a relatively unimportant factor in FDI to the transitional economies in central Europe. However though not necessarily being the predominant explanatory variable, production costs are likely to have been an important component of most investment decisions. The establishment of the car industry in the Slovak Republic and in Poland certainly resulted partly from the cost savings which European car-makers could achieve by relocating production there. High profile 'delocalisation' cases in western Europe were also mainly explained by relative labour costs, even though the overall impact in the west has been at best marginal. Indeed the long-standing trading arrangement for EU producers to export textile materials for processing into finished goods and to re-import these goods in to the Union free of duty (outward processing) was established to allow EU producers to reduce overall wage costs.

Wage costs can however change rapidly as a combination of wage cost increases (wages and non-wage costs) and exchange rate changes. The new member states have seen their costs rise as a combination of these factors. Wages will rise because

¹⁵⁹ Bevan, AA and Estrin, S. (2004) 'The determinants of foreign direct investment into European transition economies', *Journal of Comparative Economics* 32(4):

of the rapid increases in productivity in the new member states and because of skill shortages. More traditional sectors, where productivity is rising less rapidly will be affected by the general upward wage trend and investors will begin to look elsewhere for production sites. Ukraine has already benefited in a small way from a further relocation of output from the new member states as costs here have risen.

Theory suggests that a real revaluation of exchange rates in the new member states should occur. This has already partially taken place and in the longer term will continue to do so. The competitive position of these countries has therefore been affected. Undervaluation of the hryvnia in Ukraine is also beginning to be corrected and this will affect its position as a host to FDI.

The quality of the business environment is often quoted as a reason why Ukraine has not attracted FDI. There are obviously more or less favourable tax regimes, flexible and less flexible labour codes and more complex and less complex administrative procedures. All of these technical issues affect the choice of locational decisions by multi-national companies. However what is important above all is the predictability of the business environment. While in transition there is an operational necessity for decisions to be taken rapidly, they must be undertaken in the context of an economic policy strategy which has been well-thought-out and is understood by the international business community.

A business environment polluted by corruption is lethal for both economic development and FDI. For foreign-owned business corruption severely reduces the stability and reliability of the business environment. There is no guarantee that the investment will not ultimately be stolen by government or other government-near business. Far less radical problems such as abusive inspections, discriminatory use of regulation, payments which amount to protection or worse, bribes to ensure that the business is not excluded from the market all consume resources, which make many investments simply not worth doing.

Essentially most foreign investors want to be given a sort of 'national' treatment, where they are treated in the same way as national companies in an environment which is as free as possible from corruption.

That a European country is engaged in a process of serious EU integration is important for foreign investors because it gives a certain guarantee that the business environment will become progressively more transparent and open. It also suggests that reforms which are carried out will be embedded and irreversible. But beyond this, deeper integration with the Union promises reductions in costs as the adoption of EU regulation leads to significant cost savings and progressively protection from the EU's trade defence mechanisms (although this is only achieved at a high level of integration of the EEA type).

The performance of Ukraine in attracting FDI

While the new member states of the Union have attracted large amounts of foreign direct investment, Ukraine has been unable to do so even though it has serious advantages even over its western neighbours (table 3).

Table 3: FDI in central and eastern Europe, 1989-2004
(EBRD 2005)

Country	Cumulative FDI inflows 1989-2004	FDI inflows per capita 1989-2004
	US\$mln	US\$
Hungary	37,294	3,693
Poland	57,352	1,502
Russia	7,843	54
Ukraine	7,924	168

It is true that 2005 saw a massive jump in FDI in Ukraine, so that according to the Ukrainian Statistical Service investment in 2005 alone equalled the cumulative FDI from 1995 to 2004. This was however the result of two very large deals. The re-privatisation of the Kryvorizhstal steel works raised \$4.8 billion when sold to the Mittal steel group. Raiffeisen also bought into the Ukrainian banking sector (Aval Bank) for over \$1 billion. Without these two deals 2005 FDI was around 10% higher than in 2004.

However there has been a considerable acceleration of FDI in the first three quarters of 2006 (estimated at \$4.5bn for the year) but it is too early to say that there has been a fundamental reassessment of Ukraine as a destination for FDI in the future. Much of this foreign interest appears to be in the banking sector.

Several factors seem to be involved in this development, some of which will continue to influence the situation in the coming years.

- The Orange Revolution and the fundamental changes which this brought to the political and economic culture of Ukraine certainly played a role, in spite of some of the less than optimal policy decisions taken afterwards. These changes were considered to reduce the risk of investing in Ukraine, increase predictability in political decisions and also to improve the longer-term economic outlook for the country.
- The first key foreign investments, such as Mittal or Raiffeisen, encourage competitors to consider investments in the country more seriously. In the early stages of FDI competition between foreign investors plays an important role.
- As costs rise in the new member states, some investors look for lower costs in Ukraine. This tends to be a sector specific effect and concerns businesses with relatively high labour input.

The source of the foreign investment which has been made in Ukraine is also telling. The largest investor at the end of 2005 was Germany but this was essentially because it was legally Mittal Deutschland which bought the Kryvorizhstal steel works. If we look at cumulative FDI at the end of 2004, the picture changes as shown in table 4.

Table 4: Sources of FDI in Ukraine at 1.1.2005

Country	FDI as of 1.1.2005 (\$mln)	Percentage of total FDI
Total	8353.9	100
USA	1153.7	13.8
Cyprus	1035.6	12.4
UK	895.9	10.7
Germany	631.6	7.6
Netherlands	548.3	6.6
British Virgin Islands	543.8	6.5
Russia	457.5	5.5
Switzerland	411.3	4.9
Austria	345.6	4.1
Poland	192.3	2.3
Hungary	179.1	2.1
South Korea	172.4	2.1

Source: State Statistics Committee

The striking fact of this table is the weight of normally insignificant investors like Cyprus and the Virgin Islands. It is of course probable that it is Ukrainian and perhaps also Russian capital which is being invested. If both these states' shares of FDI are added to that of Russia, the latter accounted for just under 25% of Ukraine's FDI. Almost 40% came from the EU-25 and 14% from the USA. FDI coming from the 'West' is in general of more value to Ukraine than that from Ukrainian foreign capital or Russia as it is globally associated with more advanced technology and management techniques.

If the factors affecting FDI considered in the previous section are analysed, Ukraine has clear advantages in both the size of the market and relative labour costs.

Ukraine is a large and populous country.¹⁶⁰ The GDP per capita however is only around EUR 1400, less than 15% of its neighbour Hungary. Nevertheless there is clearly a domestic market which is likely to grow rapidly if Ukraine follows the pattern of development of the new member states. Already in the richer regions, the disposable income is well above the national average. This applies especially of course to the Kyiv region and that around the industrial centres in the east of the country.

In terms of labour costs too Ukraine has clear advantages. The average wage is around EUR 150/ month compared to EUR 700 /month in Poland, its western neighbour. In terms of unit labour costs the situation is less favourable owing to lower productivity. However productivity could be expected to rise rapidly in future years. Foreign investors can also expect far higher productivity either in new greenfield sites or as new management methods turn around privatised enterprises.

¹⁶⁰ Ukraine has an area two and a half times that of the UK with a population of 46 million (UK 60 million)

Against these advantages however there are major disadvantages in the business environment and it is here that the main barriers to FDI in Ukraine arise.

The business environment

The recently published SIGMA Governance Assessment Report analysed a wide spectrum of legal and administrative structures and procedures in Ukraine.¹⁶¹ While praising the reforms undertaken in 2005-6, it nevertheless comes to fairly damning criticism of the political system and by inference of the political class:

‘The understanding of the rule of law does not appear to reflect the fundamental notion that law is how society constrains authority – not the other way round’.

‘An inadequate system of law opens the door to corruption and arbitrariness; it reduces the economic development potential of the country’.

Such a situation of course does not attract serious investors. It is especially negative for small and medium-sized companies which do not have the legal capacity to fight injustice.¹⁶²

Corruption

Ukraine ranks poorly in world comparisons on corruption. This is demonstrated by the indices of the EBRD, in which Ukraine scores badly even in comparison to the average for the CIS countries.¹⁶³ This average itself is well above scores for the new EU member states. However the EBRD notes significant progress having been made between 2002 and 2005 in bribe taxes and the frequency of bribes.

High level corruption is of course part of the ‘insider’ economy in Ukraine. The World Bank described the impact of this phenomenon succinctly in its 2004 Country Economic Memorandum:

‘the insider economy hinders fair competition, encourages low transparency and corruption, discourages foreign investment, restricts the adaptability of the economy to changing market conditions, limits the realisation of genuine comparative advantage, and complicates processes associated with access to foreign markets and world economic integration’ (WB; SEM August 2004).

The insider economy

The prevalence of the insider economy is therefore one of the major hindrances to the modernisation of the Ukrainian economy. Its impact in limiting competition, both domestically and through foreign direct investment, means that there is little incentive for the Financially Integrated Groups to invest in the modernisation of plant or to improve management methods. Lack of competition slows innovation. The result is

¹⁶¹ OECD-SIGMA: Governance Assessment, Ukraine. Paris July 2006

¹⁶² Foreign SMEs, especially from Germany, have been more important in the development of neighbouring Hungary and Poland than is reflected in the statistics on the volume of investment.

¹⁶³ EBRD, Transition Report, 2005.

that Ukraine has one of the technologically most backward capital stocks in Europe. This is particularly noticeable in the all-important metals sector.¹⁶⁴

Many operators in Ukraine are thriving from the economic rents they derive from the lack of a transparent and competitive environment. They make super-normal profits and have little incentive to change the system. Their resistance to change often persuades their employees that their jobs will be protected for life. This, together with investments in local facilities, often leads to public appreciation even though in the medium-term the public is being condemned to work in low quality jobs at a very poor standard of living. The status quo seems less risky than change.

The Government of Ukraine has been fighting corruption, especially high-level corruption, with some success since the Presidential election of 2004. The World Bank acknowledges the progress made here, especially in the weakening of business links with the Government. However the challenge is very great and requires the continued attention of the Government in the medium-term. The situation is not made easier by the fact that many businesses have bought their way into the Parliament to protect their interests.

Apart from Government efforts to fight the 'insider' economy, a natural process of development in the FIGs themselves is leading to the establishment of a more open and transparent system. The largest groups are now beginning to invest abroad. Industrial Union of Donbass has taken over the Częstochowa steel works in Poland while SCM has invested in Italy (Ferriera Valsider). As these groups look for opportunities abroad, so they are forced to become more open and transparent to conform to regulation in the EU and elsewhere. There are also good financial reasons. As these groups need to borrow money for investment they find that by transforming themselves into honest and transparent companies their borrowing costs are sharply reduced. Today these arguments are being discussed in the boardrooms of many Ukrainian companies. These developments promise a future for Ukrainian business in which the insider economy is progressively transformed into a competitive and open environment.

Nevertheless the perception that corruption is widespread in Ukraine pervades the thinking of foreign companies considering investments abroad. The new Government will have to reinforce measures to fight against corruption and to make sure that its successes are publicised abroad.

Business regulatory environment

The need to improve the business regulatory environment is evident from business surveys carried out with domestic and foreign companies.¹⁶⁵ The complexity of dealing with the public authorities nationally and regionally, difficult and sometimes corrupt customs procedures, the low security of property rights, the enforcement of contracts and the lack of security for minority shareholders all persuade foreign investors not to move into Ukraine in spite of all its advantages in terms of costs and proximity to markets.

¹⁶⁴ World Bank, 2004, Country Economic Memorandum Ukraine

¹⁶⁵ World Bank, Doing Business in Ukraine, 2005.

The EBRD describes Ukraine as one of the most difficult locations in which to deal with the Administration in the central and eastern European region.¹⁶⁶ In terms of time spent dealing with public officials, managers rated Ukraine only marginally better than Albania, Serbia and Macedonia and well behind the new member states. Overall Ukraine is classed by EBRD in the lowest category in terms of compliance with international standards of corporate governance.

The outlook for the business environment is not however as black as this might suggest. The Government has been active over recent years in trying to tackle some of the worst problems for business in Ukraine. These problems have been analysed by SigmaBleyzer staff in a recent publication.¹⁶⁷ They group them into nine different categories:

1. public governance
2. macroeconomic stability
3. a stable and predictable legal environment
4. business liberalisation and deregulation
5. corporate governance
6. liberalisation of foreign trade and international capital movements
7. a healthy financial sector
8. minimising corruption
9. minimising political uncertainty

Macro-economic stability has not been a major problem recently partly because of the highly responsible and professional behaviour of the National Bank of Ukraine. Fiscal policy has shown signs of strain under political pressure, especially just prior to the Presidential election in 2004. Nevertheless this is not likely to be a major factor acting against FDI.

The problems of public governance are raised in the recent SIGMA report mentioned above. These are serious problems because they affect the efficiency of policy-making as well as the implementation of policy. Inefficiencies of the bureaucracy, overlapping responsibilities, inadequate pay in the public sector all contribute to make reform complex. OECD-SIGMA suggests that progress can only be made step-by-step, because the situation is too difficult to make a wholesale reform feasible.

Minimising political uncertainty was a hope associated with the recent legislative elections, which promised four years of stable government. The unclear outcome unfortunately looks like maintaining uncertainty over the coming months and years.

In many of the other areas mentioned in the study however progress has been made even though serious problems still remain.

The legal environment for business was an area where the government was determined to make progress. It has made great efforts to achieve improvements. New civil and commercial codes were adopted in 2004 as part of this policy.

¹⁶⁶ EBRD, 2005, Transition Report

¹⁶⁷ Segura, Ustenko, Pogarsak and Bilan, Ukrainian Odyssey: Economy 2006 and Investment Climate, SigmaBleyzer, Kyiv 2006

Unfortunately there is considerable overlap in these codes, which are in part contradictory. This underlines one of the major problems in Ukraine – the inability of the Government to control the passage of its draft legislation through Parliament. A combination of lack of party discipline in the Rada and members who have very specific business or other interests means that there is no guarantee that a draft law which enters the Rada will be recognisable when it finally becomes law.

The judiciary poses another set of problems which affects foreign investors. Legal inefficiency costs investors financial losses and takes up large chunks of valuable management time. This results from the massive under-financing of the judiciary and the great need for the training of judges especially in areas like company law, tax law, and intellectual property law.

Corporate governance is another area where although the Government has attempted to speed up reform, many problems still remain. Above all transparency has still not been achieved in matters of ownership structure, as was obvious in the question of the ownership of RosUkrEnergo, the company at the heart of the 2005 gas dispute with Russia.

Finally in 2005 the Government made a major effort to simplify regulation and to deregulate, introducing a 'regulatory guillotine'. It also attempted to make the opening of a business somewhat less cumbersome.¹⁶⁸

Foreign Direct Investment and European Integration

European integration can help Ukraine increase its attractiveness to foreign investors, depending on the depth of integration that is achieved. It acts in two ways:

- European integration raises the credibility of the country and suggests greater stability to foreign investors
- the EU-Ukraine Action Plan includes many measures which are essential to improving the business environment in Ukraine

The evidence from the new member states in central Europe suggests that foreign investors' perception of country risk changed many years before actual accession. It is true that these countries set their eyes on full accession early in the 1990s but the explosion of FDI in Hungary came in the first half of the decade, long before it was clear that accession was a realistic option.

The situation with Ukraine is different in various respects from that of Hungary or Poland. Notably Ukraine has not received any sort of commitment from the Union to its accession to the Union. The European Commission proposed to the Council in September 2006 that it should be allowed to negotiate 'an enhanced agreement' with Ukraine but even that is uncertain.

Nevertheless the implementation of parts of the Action Plan does give Ukraine the chance to integrate with the EU in a quite meaningful way. It is important to show at

¹⁶⁸ see SigmaBleyzer, op.cit page 40

every step that Ukraine and the Union are working constructively together and that integration is progressing. This will already have an impact on the perception of Ukraine by foreign investors, as it did fifteen years ago in Hungary. The aim of the President of Ukraine is full accession to the Union. However even in the relatively short-term, confidence of investors can be increased by constructive engagement with the Union.

However visible EU integration must go hand in hand with perceived stabilisation of democracy, the functioning of the Constitutional Court, civilised behaviour in the Verkhovna Rada and many other elementary characteristics of a functioning state.

Full implementation of the Action Plan would make Ukraine a much more attractive location for foreign investors. It includes a wide range of measures which would lead to a massive improvement in the business environment:

- regulatory reform
- strengthening banking regulation and supervision
- adoption of a new Joint Stock Company law
- adoption of international standards in customs application
- approximation to EU standards in technical regulations and conformity assessment including the negotiation of an Agreement on Conformity Assessment and Acceptance of Industrial Products
- improved sanitary and phyto-sanitary standards with the aim of reaching new agreements with the EU
- reforms in the company law area
- fully implementation of PCA commitments on the movement of capital and current payments
- transparency in the granting of state aid
- ensuring that public procurement is open and transparent

Progress in some or all of these areas would allow Ukraine to capitalise on its existing advantages for FDI.

Realistically it is most doubtful that Ukraine can fulfil all the expectations of the EU – it is also probably not desirable from a Ukrainian perspective. What is needed is a National Strategy for European Integration to replace that which was produced several years ago. Such a Strategy would prioritise actions on the Ukrainian side to implement the Action Plan so that reforms in the business environment which the Ukrainian Government considers necessary can be underpinned by the objective of European integration.

To some extent the Ukrainian administration has given the impression that the Action Plan contains ‘instructions’ which have to be carried out. This is wrong for two reasons:

- it makes people suspicious that actions by government will not be followed up with implementation
- it may mean that measures are taken which are unhelpful for Ukraine’s economic development

There is little doubt however that progressive integration with the EU will help to accelerate the growth of FDI on which Ukraine's economic and political future partly depends.

Conclusion

Foreign direct investment was crucial to economic expansion in the new Member States of the EU and it is likely to be so for Ukraine as well. So far Ukraine's performance in attracting FDI has been poor, although two large investments in 2005 resulted in an almost doubling of cumulative FDI since independence, and the 2006 performance appears quite promising.

The key problems which must be tackled to remedy this situation are those linked to the quality of the business regulatory environment, corruption and stability of policies and institutions.

European integration, even short of accession, promises to improve the attractiveness of Ukraine to foreign investors, as it leads both to a reduction in perceived country risk and to the underpinning of Government efforts to improve the business environment.

UKRAINE'S ECONOMY AND EU INTEGRATION¹⁶⁹

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Background

Ukraine's Economy and EU Integration

The current economic relationship between Ukraine and the European Union – trade and integration

Contractual economic relations between Ukraine and the EU are at present determined by the terms of the **Partnership and Cooperation Agreement (PCA), which entered into force in 1998**. The PCA establishes trade between the parties on a Most Favoured Nation basis (MFN), with the possibility of establishing a free trade area (FTA) when Ukraine has completed its accession to the World Trade Organisation (WTO). Ukraine also benefits from the EU's Generalised System of Preferences (GSP), although many agricultural products do not benefit from GSP.

Sectoral agreements have been made in textiles and steel. The textile agreement eliminates quantitative restrictions, while the steel agreement, though not eliminating quotas, does allow certain types of steel to enter the Union relatively freely.

The EU has already signed off on its bilateral agreement with Ukraine in the context of WTO entry. This will commit Ukraine to eliminating most controls on exports and to binding its tariffs. **Together with the conclusion of the agreement with the United States in March 2006, and subsequently with Australia, this makes Ukraine's entry into the WTO more likely this year**, but the problem of harmonisation of legislation of Ukraine in accordance with WTO rules and procedures is still outstanding and depends on the Parliament of Ukraine. Considering the experience of the events of summer 2005 when discussion prior to voting on the laws related to WTO accession resembled a battlefield, and in the context of the general elections held on March 26, 2006, **it is difficult to predict whether the accession process can be concluded this year**, though recent progress leads one to be optimistic.

The granting of market economy status by the EU (and the USA) is above all a political boost for exporters. A positive decision could also have been expected in the current investigation against the Ukrainian producers of seamless pipes and tubes but

¹⁶⁹ this paper was prepared for the new Ukrainian Government in July 2006 by Igor Burakovsky, Andrii Goncharuk and Alan Mayhew in the context of a project of the EastWest Institute (EWI) and funded by the Swedish International Development Agency (SIDA)
http://www.ewi.info/pdf/EWI_EU_Ukraine_TF_Report_2006_ENG.pdf

hopes have not been realised. Proposed duties have reached 26% and are in practice prohibitive for exports estimated at \$100 mln. EU trade defence policies have also been applied to Ukrainian chemicals, fertilizers and grain. Such measures have a negative impact on Ukraine's major exporting sectors. In this context, Commissioner Mandelson's intention to reconsider the way the EU uses its trade defence mechanisms is a good message for Ukraine.

The current situation of trade relations between the EU and Ukraine is nevertheless far more liberal than a decade ago. Ukraine now trades with the Union on much the same basis as other countries, a far cry from the regime of autonomous measures, which prevailed before the trade articles of the PCA became binding. **As a result, trade has expanded and the EU now makes up around 35% of Ukraine's foreign trade.**

▪ **European Neighbourhood Policy (ENP) and the Action Plan (AP)**

Economic relations have moved on to a different plane with the introduction of ENP and the agreement in February 2005 of the Action Plan between the EU and Ukraine.

The headlines of ENP promise greater trade liberalisation and a stake in the internal market of the Union through increased regulatory harmonisation. Participation in Community programmes and additional financial assistance through a new European Neighbourhood and Partnership Instrument (ENPI) are also promised.

ENP operates essentially as a bilateral policy – differentiation is the key expression. Bilateral relations are organised around Action Plans agreed between the Union and participating states in ENP. The Ukrainian AP has been agreed for a period of three years and will end at the same time as the initial phase of the PCA in 2008. **Thus the design of 'an enhanced agreement' to replace these existing arrangements is an urgent task.**

In the economic sphere, the AP emphasises actions to liberalise trade and improve the business environment. It underlines the objective of negotiating a FTA once WTO accession has been completed. The integration of Ukraine into the internal market of the Union is to be achieved by a high level of regulatory harmonisation, leading eventually to the negotiation of an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) in key sectors. Measures in the Action Plan are also designed to create a more predictable and stable business environment.

Although Ukraine has accepted ENP conditions and requirements, the government has stressed on many occasions that Ukraine is aiming for a different relationship with the EU. Ukraine is prepared to take additional commitments and to comply with EU standards and requirements, even if the EU remains unwilling to reconsider its position regarding Ukraine.

▪ **WTO accession and the Free Trade Agreement**

The first priority of Ukraine's international economic policy must be membership of the WTO. This will not only ensure that Ukraine can be part of fair and open trading on world markets, strengthening the country's position against trade protectionism, but it will also open up the way to negotiate a free trade area with the Union and, more importantly, will lead to 'an enhanced agreement' to follow on from the PCA and Action Plan.

A free trade agreement with the Union would be a significant boost to the Ukrainian economy, but the extent will depend on the range of products covered by

the Agreement. In the past the Union has frequently excluded agriculture and some heavy industry from the agreement. Such actions now would of course reduce the value of the agreement to Ukraine. Nevertheless opening up the possibility of trade should encourage both domestic and foreign investment and help with the modernisation of the economy.

A liberalisation of Ukraine's trade regime vis a vis the EU and the rest of the world will encourage Ukrainian business to diversify exports and will also lead to a broader use of GSP. It will also stimulate trade in services.

The modernisation of Ukraine's economy

Typically, the basis for increased investment and thus higher sustained economic growth is a macro-economic policy predicated on long-term economic stability. Part of this policy should be the establishment of a mid-term financial framework for government expenditure, which would go some way to ensuring financial stability.

However, the government should not ignore the micro-economic aspect.

Ukraine's economy has suffered from an insider economy and the ensuing lack of competition. The result is an economy heavily dependent on a few low value-added sectors, with poor productivity and high sensitivity to small movements in prices and exchange rates and to external shocks.

An example of this sensitivity to external shocks was the reaction of Ukraine's industry to the sudden rise in gas prices – a sector that has been cosseted by low energy import prices. While Ukraine's economy is heavily dependent on cheap energy, it is one of the least efficient producers of energy because of an outdated energy industry.

The modernisation of Ukraine's economy will rely on heavy investment in modern equipment, especially in the manufacturing and energy sectors. Much of this investment will come from foreign sources.

Foreign direct investment (FDI) has played a significant role in the modernisation of the economies of the new member states of the Union.

FDI brings not only capital into the country, but perhaps more importantly new management and technical skills as well as new technology and production methods. Through its requirement of high quality production from its suppliers, FDI leads to a modernisation of local business, which will now have to work to internationally acceptable quality standards. Foreign acquisitions in the banking sector, which are now progressing rapidly in Ukraine, also lead to more competitive credit offerings and will improve the supply of bank finance to small and medium size business.

The factors which attract FDI include the size of the market, the business regulatory environment, the absence of corruption and non-transparent business relations and the relative cost of production factors. In Ukraine a market exists, albeit with a low purchasing power, though this may accelerate rapidly in the coming years. The relative cost of production factors is very attractive to EU and American companies. In order to attract substantial FDI, Ukraine must overcome the widespread perception among foreign investors that the country suffers from an inconsistent regulatory environment and corruption.

The government has been trying to tackle these issues over the last 18 months with some success though there is a long way to go before the quality of the business environment reaches the levels of the new member states.

The need to improve the business regulatory environment is evident from business surveys carried out with domestic and foreign companies. Despite Ukraine's advantages in terms of lower production costs and proximity to markets, a number of factors discourage foreign investors from investing in Ukraine. They include: the complexity of dealing with the national and regional public authorities; difficult and sometimes corrupt customs procedures; the low security of property rights; the lax enforcement of contracts; and the lack of mechanisms to protect minority shareholders.

The EBRD notes that, of all the countries in central and eastern Europe, Ukraine's Administration is one of the most difficult to deal with. Overall, Ukraine is classed by the EBRD in the lowest category in terms of compliance with international standards of corporate governance, together with Tajikistan and Belarus.

Another important aspect of the regulatory environment is the predictability of government actions. If government policy is continually changing, investors, domestic and foreign, cannot be sure of the profitability of their investment and they are liable to stay away. Part of the problem is that different authorities in Ukraine have not necessarily been saying the same thing and this has caused confusion. Recently there were several contradictory statements on the number of companies likely to be taken back into state ownership in order to be reprivatised. Another example was the sudden change in the law regarding Special Economic Zones, through which honest and serious companies, which had established plants in the Zones, suddenly found themselves in a completely different financial environment from the one they had been attracted to invest in.

The modernisation of Ukraine's economy has been held back by isolation from external competition and by the power of the 'insider economy'. The insider economy is especially well developed in Ukraine, where large financial industrial groups (FIGs) dominate industrial output. These groups maintain strong connections with government and other state institutions, allowing them to circumvent the normal operating rules of the market economy.

Many operators in Ukraine are thriving from the economic rents they derive from the lack of a transparent and competitive environment. They make super-normal profits and have little incentive to change the system. This, together with investments in local facilities, often leads to public appreciation even though in the medium-term the public is being condemned to work in low quality jobs and have a very poor standard of living. The status quo seems less risky than change.

The existence of these negative factors has led foreign investors to shy away from investing in Ukraine. Between 1989 and 2004 cumulated foreign direct investment averaged \$3,700 per capita in Hungary, \$1,500 in Poland but only \$170 in Ukraine (source: EBRD). **The new government should continue to tackle the problems of the "insider economy" and corruption and introduce a realistic programme to simplify the legal business environment and to give more protection to investors. The decision to integrate with the European Union will also be an important step in the struggle to attract more foreign investment.**

There are however several hopeful signs. The government has done its best to reduce the scale of the insider economy over recent months, with some success. The World Bank reports that there has been a marked decrease in insider deals concerned with privatisation of state-owned firms and state contracts. The greatest success in this field was the privatisation at the end of 2005 of *Kryvorizhstal*, the largest steel plant in Ukraine for \$4.8bn. The government had previously sold this company for only \$800,000.

The other hopeful sign is that some of the FIGs are now beginning to transition to open, law-abiding companies, with international status. The most successful companies are beginning to realise that they will gain from the application of international standards of governance in Ukraine, as these will protect them from aggressive and shady companies. As these companies also begin to invest abroad, they will be compelled to abide by international standards of corporate governance.

Energy policy and relations with Russia

Ukraine today faces the danger of a serious external shock to its economy due to drastic price increases in Russian gas supplies.

The decisions taken by Russia were not entirely based on economics but were also based on political calculations. The solution to the short-term problem lies therefore also in the political/security sphere.

In the medium and longer term, economic policies which improve energy efficiency in Ukraine and impose hard budget constraints will be necessary as energy prices move towards world market prices.

On the domestic front Ukraine needs to improve its performance as an energy producer and as an energy transit country. There is considerable scope for improvement in the area of domestic gas extraction but it is in being a reliable and high quality transporter of energy that Ukraine will gain most. Higher returns from transit will help offset to some degree the rise in energy import prices.

Having experienced the first serious problems with Russian supplies and prices this January, the government of Ukraine has recently prepared a concept paper outlining the long-term development of the energy sector of Ukraine up to 2030. The document foresees a 5-fold decrease in energy dependency and a 3-fold increase in local energy production.

Reducing the inefficient consumption of energy of the economy will require the government to pursue policies which lead to full-cost recovery from consumers. This policy will need to be consistently pursued, while ensuring that domestic consumers are given time to adjust to higher prices.

Today the World Bank reports that Ukraine uses 22 times more energy to produce each unit of GDP than Germany. Reducing reliance on high levels of energy consumption is the most important longer-term challenge. It will only be met by hard budget constraints and considerable investment in industry.

EU Integration as a channel for modernisation

EU integration will help the modernisation of Ukraine's economy in a variety of ways:

- Deeper integration with the EU, and especially the negotiation of a new Treaty with clear obligations on both sides will reduce the perceived risk of investing in

Ukraine. Better credit ratings will reduce the cost of borrowing and will therefore reduce the costs of operating in the country and of international loans.

- Implementation of the Action Plan will introduce a much improved business environment from a legal perspective; it will be difficult for Ukraine to roll this back.
- Integration leading to more liberal trading rules will allow domestic industry to develop further and attract FDI.
- Contractual relations with the EU will anchor reforms.
- The proposed European Neighbourhood and Partnership Instrument (ENPI) will provide a degree of financing for Ukrainian reforms. The Ukrainian authorities should carefully consider their priorities in the use of these funds.

The Action Plan is an ambitious programme of reform. Implementing the measures in the Action Plan would go a long way towards achieving the necessary reform objective of modernising the economy. If Ukraine makes good progress in Action Plan implementation, it could consider a very ambitious 'enhanced agreement' with the EU in 2008.

Ukraine should now concentrate on implementing the agreed Action Plan and preparing for 'an enhanced agreement' with the EU.

This 'enhanced agreement' could be an enhanced association agreement, going beyond the normal agreements by laying emphasis on integrating sectors of the economy with the EU's internal market.

Recommendations

Ukraine's Gross Domestic Product per capita is only 14% of that of its neighbour Hungary and 21% of that of Poland. The main aim of any Ukrainian government must therefore be to ensure that the economy expands rapidly in an environment of macroeconomic stability.

Ukraine has lost a decade of opportunity since the collapse of communism. The inconsistencies in economic policy over this decade have led to Ukraine falling far behind its neighbours.

However trade liberalisation and modernisation of the economy leading to higher productivity and economic growth can produce significant improvements in the standard of living.

The government should:

1. Pursue **trade liberalisation** with the aim of joining the WTO in 2006 and then proceed to negotiate **a free trade agreement with the EU**;
2. Continue **the fight against the 'insider' economy and corruption** at all levels: the government should concentrate on building interest groups in business and the state which have an interest in openness and transparency. Greater powers should be given to the competition authority and state aid should be made more transparent;

3. Implement measures to guarantee **‘national’ treatment to foreign investors and improve the quality of the business environment**. High standards of corporate governance are essential to the modernisation of the economy;
4. Take measures to **reduce the economy’s dependence on energy** and impose hard budget constraints in the sector. Maximise the value of transit facilities;
5. Pursue EU integration through implementation of the EU-Ukraine Action Plan, with the aim of integrating with the internal market of the Union in those areas of specific value to the Ukrainian economy.