



Russia, the Eurasian Customs Union and the EU: Cooperation, Stagnation or Rivalry?

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Summary points

- Until recently regional integration in the post-Soviet space was largely declarative. But the Eurasian Customs Union (ECU), the latest initiative, appears more viable because of its better institutional framework, proven commitment to implementation and introduction of a system of rules harmonized with international norms and the WTO regime.
- This initiative, which offers a forward-looking, advanced form of economic integration, has serious implications for EU–Russian relations in general and the EU's strategy in the post-Soviet 'shared neighbourhood' in particular.
- Ukraine has turned into a normative battleground, with Russia trying to dissuade it from pursuing an Association Agreement with the EU containing the Deep and Comprehensive Free Trade Area and to join the ECU instead.
- Faced with this challenge, the EU needs to revisit its 'external governance' approach to its eastern neighbourhood in terms of short- and long-term opportunities and challenges.

Introduction

Ever since the break-up of the Soviet Union, various initiatives seeking to (re)integrate the newly independent republics into some kind of post-Soviet successor have been launched. These have generated high volumes of international agreements and top-level political meetings but failed to make much impact. Their weak institutional framework signalled the lukewarm commitment of their member states, rendering these regional regimes ineffective in binding domestic actors and institutions. The repeated bold but short-lived restarts of post-Soviet integration have bred a sense of fatigue and scepticism among external observers (both policy-makers and academics). Post-Soviet economic integration initiatives have been seen as vehicles for Russia's traditional power approach in the neighbourhood, expressed in a mix of crude power and institutional weakness, and wrapped up in discourses that are predominantly orientated to the past.

Against this background the European Union, which in the mid-2000s stepped up its engagement in the post-Soviet countries, has come to be seen by them as the primary source of modernization and improved governance in the region. The EU made alignment with its regulatory regime a key precondition for closer relations in the context of the European Neighbourhood Policy (ENP) and the Eastern Partnership (EaP). Thus it has sought to promote a rule-based, future-orientated regime modelled on the European governance model, while appearing not to be engaging in rivalry with Russia within this domain.

The formation of the Eurasian Customs Union (ECU), however, has the potential to change this situation.¹ Notwithstanding its weak economic rationale,² the grouping has a more robust institutional structure than any of its predecessors, and despite a range of transitional problems, it is actually being implemented. It functions

as a rule-based body, consistent with the World Trade Organization (WTO) regime and modern international norms. Importantly, the ECU is clearly seen by Russia as a vehicle for reintegrating the post-Soviet space, including the countries that fall within the sphere of the EU's eastern neighbourhood. Russia highlights the economic benefits of the union, which is itself underpinned by an ambitious institutional set-up. This framework is explicitly modelled on the EU, and is intended to offer a modernizing alternative to it. Integration is no longer justified by past-orientated discourses about 'shared values and history' but by economic pragmatism. The long-held perception of Russia's soft power in the post-Soviet states – one of manipulating such discourses and influencing elections – no longer fully captures its approach to the 'shared neighbourhood'.³ The latter term denotes the Soviet successor states covered by the ENP and the EaP (i.e. Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine).

The emergence of the ECU means that the EU is not the 'only game in town' and presents a normative challenge to it. This is particularly visible in Ukraine, where Russia has been actively promoting the ECU as an alternative to the EU integration mechanism, i.e. the Association Agreement. Given the viability of the ECU, which is bolstered by its centrality to Vladimir Putin's agenda, this 'normative rivalry' is likely to grow and will require the EU to adapt its approach to the eastern neighbourhood if it is to continue to be an influential actor there.

The Eurasian Customs Union: background and origins

The significance of the ECU can be more fully understood through a broad overview of previous integration initiatives, which illustrate the patterns of continuity and, most importantly, change.

1 Owing to its rapid formation and ambitious plans, the very name of the initiative is difficult to pin down. While the plans are to create the Eurasian Economic Union by 2015, what has actually been accomplished so far is the customs union (the full name of which is the Customs Union of the Eurasian Economic Community). This paper adopts the abbreviated term Eurasian Customs Union (ECU).

2 There are few independent studies of the ECU deploying robust methodology. In an early study, Vinhas de Souza (2011) argues that it would be 'a GDP-reducing framework in which the negative trade-diversion effects surpass positive trade-creation ones' (p. 1).

3 'Soft Power? The Means and Ends of Russian Influence Abroad', Chatham House, Seminar Summary, 31 March 2011, <http://www.chathamhouse.org/publications/papers/view/109675>.

The CIS formula

The first and best-known initiative was the Commonwealth of Independent States (CIS). When it was set up in December 1991 it was more a vehicle for channelling the orderly disintegration of the Soviet Union than for a fresh engagement among its former constituents. Nonetheless, the focus soon shifted to bringing together the 12 newly independent republics around a new-style economic project. In 1993 Russia proposed a full-blown Economic Union loosely modelled on the EU model, to be achieved in progressive stages. An agreement on setting up a free trade area (as a first stage in this process) was signed in 1994.⁴

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Yet sustained political will to engage in the multilateral project was lacking. The member states’ reluctance to be bound was reflected in the institutional framework. This resulted in a ‘pick and mix’ regime where agreements were signed and ratified selectively, and broad reservations were ubiquitous.⁵ It was not only the CIS-sceptics, such as Georgia or Azerbaijan, that were selective. Russia pioneered various initiatives and yet throughout the 1990s it was reluctant to proceed with what were in effect costly

economic obligations (in particular, it did not ratify key CIS economic cooperation agreements).⁶ Similarly, there was no effective binding mechanism to ensure compliance with the obligations undertaken. A permanent judicial body, the Economic Court of the CIS, was established. It was empowered to rule over inter-state disputes, yet its rulings have the status only of recommendations and its role has proved to be nominal. Furthermore, even where some progress was made in providing a common legal framework (such as in trade), the multilateral regime did not foster effective domestic implementation.⁷

Thus despite the rhetoric, the CIS multilateral framework ultimately relied on high-level diplomacy and traditional power mechanisms. Investing in the institutional design of CIS regional integration was clearly not at the core of Russia’s economic cooperation strategy. As President Vladimir Putin famously stated in 2005, ‘the CIS never had any super-tasks of an economic nature, any integration tasks in the sphere of economics’.⁸ As far as practical economic cooperation was concerned, Russia preferred to deal on a bilateral basis, capitalizing on its superior bargaining power.⁹ By the mid-1990s Russia’s focus shifted to investing in smaller, sub-regional groupings. These initiatives tended to replicate the CIS model in a smaller format, something the development of the ECU illustrates particularly clearly. The next section examines the origin of this project as well as the learning process in constructing it as a viable integration regime.

From the CIS to the ECU

The origins of the Eurasian Customs Union go back to January 1995, when Russia signed a treaty on the formation of a customs union with Belarus and Kazakhstan. (Kyrgyzstan later joined in 1996, followed by Tajikistan in 1997.) This initiative restated the ambition of a

⁴ Following these initiatives a number of bodies were established to manage the integration process, and various efforts were made to improve the institutional set-up of the CIS. For an overview see Dragneva (2004).

⁵ Dragneva (2004).

⁶ Most notably, the Agreement on the Principles of Customs Policy of 13 March 1992, the Agreement on the Free Trade Area of 15 April 1994 and the Protocol Amending the Agreement on the Free Trade Area of 2 April 1999.

⁷ The regime was fragmented over numerous agreements and suffered from unclear and imprecise norms. Dragneva and de Kort (2007).

⁸ Statement at a press conference of 25 March 2005, <http://www.kremlin.ru/text/appears/2005/03/85912.shtml>.

⁹ Dragneva and de Kort (2007).

progressive formation of an economic union.¹⁰ Yet in effect these remained declaratory initiatives with no change to the ineffective CIS institutional formula.

Putin's accession to the presidency soon added a new impetus to the project. In October 2000 the grouping was transformed into a fully-fledged international organization, the Eurasian Economic Community (EEC). The EEC improved on the CIS framework in a number of ways. For example, it aimed to bind all signatories to its agreements by seeking to coordinate ratification and prohibit reservations.¹¹ A permanent executive, the Integration Council, was created.¹² Importantly, the EEC founding treaty provided for improved dispute resolution through the setting up of a special court. It was clear also that the EEC was prioritized by Russia as a future centre of gravity and regarded as such by other post-Soviet states (e.g. Moldova and Ukraine became observers in 2002, followed by Armenia in 2003).¹³ Many commentators viewed the EEC as the most viable framework to emerge in the post-Soviet space.¹⁴

Despite the development of the institutional regime, old problems persisted, thus putting its effectiveness in question. The legal framework remained fragmented and based on multiple international agreements. The domestic effect of the decisions of EEC bodies remained uncertain as, like the agreements, they were subject to ratification.¹⁵ Russia's supremacy, despite the token use of qualified majority in the Integration Council, was protected by the voting rules. The planned EEC Court did not constrain the reliance on political solutions as its decisions were not made binding on member states. (As discussed in more detail below, the court was not set up until January 2012, with the CIS Court performing the task between 2004 and 2011.)

In fact, progress in achieving the planned trade and customs integration was limited. There were elements of free trade between EEC member states, but exemptions and quotas were maintained and special trade measures were applied on a unilateral basis. As Julian Cooper notes, the expansion of the EU and WTO provided an impetus for Russia to engage in a 'competitive multilateralism', yet it ultimately continued to rely on bilateral relations, even within the common framework.¹⁶

By the middle of the last decade, the situation had started to change, mainly because a vanguard group of states emerged. While the member states of the EEC were diverging more sharply, the leaders of Russia, Belarus and Kazakhstan appeared most committed to setting up a customs union. A decision to this effect was taken at the Minsk summit of the EEC in June 2006. This was followed in October 2007 by the signing of a treaty setting up a customs union. The three countries established a Customs Union Commission as its permanently functioning regulatory body and continued negotiating and drafting agreements necessary for the functioning of the ECU throughout 2008 and 2009. As of 1 January 2010, a common customs tariff was launched and the Commission formally started its work. In July 2010, the existence of a common customs territory was declared and the Customs Union Code, the key regulatory document, entered into force. In July 2011, the elimination of the internal physical border controls was announced.

The three member states' ambitions did not stop there. They were keen to place the ECU project within a wider framework for advanced economic integration – a single economic space, followed by an economic union. The former envisaged a common market of goods, capital and labour, and the operation of common macroeconomic,

10 Treaty on Deepening Integration in the Economic and Humanitarian Sphere of 1996, followed by the Treaty on the Customs Union and the Single Economic Space of 26 February 1999.

11 The commitment to be bound was also signalled by the provision for expelling a member in the event of violation of its obligations, Article 9 of the Treaty on the Founding of the EEC of 10 October 2000.

12 Important functions in managing the integration process were delegated to this body, which was empowered to adopt decisions by a two-thirds majority.

13 Uzbekistan became a member of the EEC in 2006 by virtue of the merger between the EEC and the Central Asian Cooperation Organization, which Russia had joined in 2004.

14 See, for example, Kononczuk (2007), Shadikhodjaev (2009).

15 Article 14 of the 2000 EEC Treaty.

16 Cooper (2008).

Table 1: Chronology of key ECU developments

6 October 2007	Treaty setting up the Eurasian Customs Union between Russia, Belarus and Kazakhstan signed.
1 January 2010	Common customs tariff launched. ECU Commission starts work.
1 July 2010 (6 July for Belarus)	Common customs territory becomes effective. ECU Customs Code enters into force.
1 July 2011	Internal physical border controls eliminated.
1 January 2012	Single Economic Space inaugurated. EEC Court is set up.
1 July 2012	Eurasian Economic Commission (replacing the ECU Commission) becomes effective.
1 January 2015	Planned start of the Eurasian Economic Union.

competition, financial and other regulation, including harmonization of policies such as energy and transport. The idea of setting up a Eurasian Economic Union was raised and soon gathered political momentum once Putin embraced the idea as Russia's priority.¹⁷ In November 2011, in their Declaration on Eurasian Economic Integration, the three heads of state announced that the Single Economic Space would be launched as of 1 January 2012. They also proclaimed the establishment of a new body, the Eurasian Economic Commission, which replaced the Customs Union Commission as of 1 July 2012, as the common coordinating institution to ensure the achievement of the agreed objectives. The legal basis of the ECU and the Single Economic Space are to be fully in place within three years so that the Eurasian Economic Union can be launched on 1 January 2015.¹⁸

Clearly, the ECU project is embedded in a fast-moving political agenda. Yet, this is not the first customs or economic union that has been announced in the post-Soviet space. Nor is it the first time that high-level political meetings have made bold pronouncements about the vital importance of Eurasian economic integration or set ambitious timetables for it to get under way. Nor are observers easily impressed by the volume of new international agreements signed or by the new bodies set up. Nonetheless, this latest project differs in significant ways

from its predecessors. This is not just in terms of the political will, which seems to be driving it forward, but also, crucially, in terms of its effectiveness, which contrasts with earlier poorly institutionalized regimes with little or no impact on the behaviour of state or private actors. In other words, unlike previous initiatives, the ECU has a growing effect on state and economic actors in its member states and beyond.

Integration with a difference?

While a degree of healthy scepticism should be retained about the future of the ECU as it transitions to the Eurasian Economic Union (see below), it can be argued that developments so far signal a pivotal change in integration patterns. Importantly, the ECU offers a future-orientated integration model in an institutional setting that is clearly improved both in terms of the design and its domestic effect. And the regime increasingly operates in the context of Russia's accession to the WTO.

Legal and institutional basis

While the legal and institutional regime of the ECU shows some continuity with its predecessors, there is evidence of real efforts to address key problems. While an extensive discussion is beyond the scope of this paper, it is worth giving several examples.¹⁹

¹⁷ Putin (2011).

¹⁸ In his much-cited article in *Izvestia*, Putin refers to a Eurasian Union (Putin 2011). The joint statement of the Heads of State of 18 November 2011, which set the 2015 date, refers to a Eurasian Economic Union. Discussions are currently under way with regard to the dissolution and transformation of the EEC, including the actual name of the new union.

¹⁹ Dragneva (2012).

First, like the CIS, the ECU relies on a large number of international agreements.²⁰ There has been an effort, however, to ensure that these agreements bind all member states through the practice of 'block' adoption of agreements and their simultaneous entry into force. The treaty basis of the CU has been more carefully defined and its constitutive agreements have been listed.²¹ Despite these improvements on past standards, the sheer volume of agreements has meant a complex, fragmented, and contradictory regime that is difficult to interpret and apply. In March 2011, in recognition of this problem, the Intergovernmental Council of the ECU decided to begin the codification of the legal regime.²² This has the potential to deliver a radical improvement of the legal framework.

Second, the decisions of the bodies of the ECU (the CU Commission in particular) have been given legally binding status and defined as directly applicable, i.e. effective in domestic law without the need of special legislation.²³ Similarly, the decisions of the new Eurasian Economic Commission are described as 'binding' and having a 'direct effect'.²⁴ This means that they will not have to be ratified to give them domestic legal force but will become part of the member states' legal systems 30 days after their official publication.

Third, effective dispute resolution has been an area where the CIS regime was found particularly lacking. The

ECU improves the situation in two key respects. In July 2010 a new Statute of the EEC Court was adopted, and entered into force a year later.²⁵ Significantly, the rulings of the Court are defined as 'binding' on the parties. This solution provides a strong incentive for compliance and, by comparative standards, indicates a highly legalized regime.²⁶ Also the provision that private parties (i.e. businesses) can bring an action before the EEC Court and appeal against acts of the bodies of the ECU represents another important breakthrough.²⁷ This provision is pivotal in ensuring the rule-based functioning of the ECU as it gives a useful remedy to private parties. However, it remains to be seen to what extent private parties, and foreign business in particular, will use the court to pursue grievances.²⁸ Similarly, the extent to which the court will remain independent from political interference and pressure from vested interests is not certain.

Thus, it is clear that despite some outstanding problems, significant institutional lessons have been learned over the years, and sustained efforts to improve the regime have been made.

Practical progress

In terms of scope and substance, the CU has developed beyond what had been achieved in previous integration efforts in many respects. For example:

20 From a comparative perspective, the CIS has opted for a regime explicitly based on international law. Compliance with international law, however, is a complex issue. In this paper we deal with legal 'bindingness' as a distinct problem. To date, according to the website of the CU Commission, there are 13 EEC agreements, 38 agreements 'directed to the completion of the treaty basis of the Customs Union', and 38 'other international agreements of the Customs Union'. The preparation for the Single Economic Space (launched in January 2012) has led to the further proliferation of agreements.

21 Two decisions of the Intergovernmental Council of 2006 and 2009 have listed these agreements. A third list is being drafted.

22 Decision No. 73 of 15 March 2011.

23 Art. 7 of the Agreement on the Customs Union Commission of 6 October 2007 and Decision No. 15/2009 of the Intergovernmental Council. The proposals for amendment of the Customs Union Code currently on the table also envisage the addition of a provision to this effect to clarify the legal status of the Commission's decisions. This new legal status of decisions does not in itself ensure compliance by the member states, but strengthens the likelihood of compliance.

24 Art. 5 of the Agreement on the Eurasian Economic Commission of November 2011.

25 As noted above, upon its launch, like the EEC, the ECU continued the reliance on the Economic Court of the CIS.

26 Yet the extent to which it is binding is not guaranteed and the aggrieved party can ultimately enforce its claim only by turning to the highest body of the organization, the Intergovernmental Council.

27 This possibility was discussed on several occasions in trying to reform the Economic Court of the CIS, but never materialized; see Dragneva (2004). An agreement to provide a procedure for such a mechanism was signed in 2010 (Art. 13 (3) of the Statute of the EEC Court, Agreement of 9 December 2010) and ratified in July 2011 by the three countries.

28 One of the problems is that the court is located in Minsk and, especially for foreign businesses, resort to it is affected by the overall dynamics of relations between Belarus and the rest of the world. For example, the chairman of the EEC Court is a Belarusian representative, Evgeny Smirnov, who is on the EU's list of Belarusian officials banned from travelling to the EU.

- A common import customs tariff was agreed. This in itself is an achievement given that only 2% of tariffs had been unified between 2000 and 2006.²⁹ The initial agreement was criticized for being very limited, given that it contained about 400 exemptions in relation to Kazakhstan. This reinforced the scepticism, as it was believed that this would be yet another selective regime thriving on exemptions. However, by the beginning of 2012 the list of exemptions had decreased to about 70 tariff positions.
- An ECU Customs Code, providing the bulk of the common customs regime, was adopted. Upon its entry into force it replaced the respective domestic legislation in the ECU member states. In conjunction with some other legal acts of the ECU, the code regulates customs valuation, rules of origin, customs forms and procedures, and other key elements of regulation. This is a very significant consequence in the sense that private actors have to apply the provisions of the code in day-to-day customs dealings.³⁰
- The Commission of the Customs Union has been seen as a functioning institution with more than 850 acts issued to date. A new Eurasian Economic Commission is currently being set up with significant staff and adequate budgetary resources.
- The removal of internal borders, despite transitional periods in relation to the Russia–Kazakhstan border, is also a powerful symbolic act.

Clearly, there are many outstanding problems. However, the progress achieved so far creates a certain momentum and cannot be reversed without cost. The ECU is therefore likely to stay.

Constrained hegemony?

As described, previous regional groupings were very asymmetric, allowing Russia to use its superior bargaining power and to avoid being bound by potentially costly decisions. Clearly, this is an area where – by historical as well as comparative standards – scepticism is justified. It is true that the ECU sought to signal a commitment to supranationalism by providing for certain decisions of the CU Commission to be taken by qualified majority. But the votes were weighted so that Russia had 57% and Belarus and Kazakhstan 21.5% each. In effect, this has meant that formally Russia always needs to act in agreement with at least one other member, yet even if Belarus and Kazakhstan act jointly, their votes still cannot outweigh Russia's. Furthermore, sensitive decisions still required consensus and were reserved for high-level diplomacy.³¹ In 2010, a dispute between Russia and Belarus regarding Russia's export duties was resolved not through the institutions of the ECU but by concluding a bilateral agreement.

Yet there are indications that Russia may be prepared to move towards greater multilateralism. This is evidenced in the arrangements regarding the new Eurasian Economic Commission, which replaces the CU Commission. The College, which will be the executive body of the commission, consists of three country representatives with one vote each. Thus, at least in theory, with regard to certain decisions Russia can be outvoted.³² Another negotiation point in response to sensitivities about sovereignty has been the seat of the Commission. While Kazakhstan's President Nursultan Nazarbaev agreed for it to be located in Moscow, it is clear that this is not seen as a permanent solution, at least by Kazakhstan.³³

²⁹ Golovnin (2008).

³⁰ The Customs Union Code has been criticized for the high number of referrals to national law it contains. Nevertheless the existence of debate is positive, and the revision of the code is under way.

³¹ Consensus is required, for example, on the adoption of lists of sensitive goods and exemptions from the common customs tariff. In addition, any dissatisfied country can take the decision of the Customs Union Commission to the Intergovernmental Council of the Customs Union to be reconsidered.

³² The rule is weakened by the provision that any dissatisfied member can bring an issue to the Council of the Eurasian Commission to be decided by consensus. Similarly, over 80% of the staff of the Commission will be Russian.

³³ Press conference with President Nursultan Nazarbayev, 18 November 2011, Kazinform, <http://www.inform.kz/kaz/article/2420302>.

The effect of the WTO regime

The dynamics of Russia's accession to the WTO have had an important effect on developments within the CU.³⁴ There has been much concern as to the interaction between the ECU and WTO regimes, especially in terms of avoiding conflict between rules as well as ensuring the implementation of WTO obligations.³⁵ After considering entry into the WTO as a customs union bloc back in 2009, Russia finally settled for individual accession negotiations. Yet the WTO looms large over the ECU.

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The interaction between the two regimes was addressed in the Treaty on the Functioning of the Customs Union in the Multilateral System, which entered into force in November 2011. It ensures that the provisions of the WTO agreement as set out in the Accession Protocol of a Customs Union state become an integral part of the legal framework of the Customs Union as of the date of the accession of that member state. Further, member states are obliged to ensure that existing as well as future ECU international agreements and decisions comply with

the WTO regime, even in case of non-WTO members (i.e. Belarus and Kazakhstan).

Thus the ECU rests on a direct and immediate connection with the rules-based regime of the WTO. In essence, the WTO will prevail over conflicting ECU provisions. This is different from any previous regional integration arrangements within the post-Soviet space. Many observers see it in highly positive terms because WTO membership has beneficial effects by fostering transparency and ensuring predictability of policy-making in member states.³⁶ At present, however, much uncertainty remains as to whether there will be such a beneficial and comprehensive impact on Russia. Nevertheless, the provisions of the WTO and the international customs regime (i.e. the Kyoto Convention) have become standard reference points in drafting agreements to improve the ECU regime. In the process of accession to the WTO, Russia has been modernizing its trade regime and embedding it in the ECU.

The expansion of the ECU

As noted, Russia has viewed the ECU as a core for the wider integration of its ‘near abroad’. This expansion has arguably diluted the organization and has required a two-tier progression. It is clear that the ambitious development of the ECU relates not just to its internal dynamics but also to its presentation as a functioning ‘centre of attraction’. Kyrgyzstan is one of the countries where accession to the ECU is high on the political agenda.³⁷ But, as argued in next section, the most important battleground is Ukraine. This is not the first time Russia has sought to include Ukraine in a regional integration initiative.³⁸ In fact, it is conceivable that the planned equality of votes in the Eurasian Economic Commission has as much to do with Kazakhstani and Belarusian pressure as with appeasing

³⁴ Cooper (2008).

³⁵ Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization of 17 November 2011, section 43.

³⁶ Aaronson and Abouhard (2011), Basu (2008). This expectation with regard to Russia was expressed, for example, during the second EU–Russia International Conference ‘Prospects for a Strategic Partnership’, Brussels, November 2011; see Final Report available at <http://www.eu-russia.eu/wp-content/uploads/2011/05/Final-Report1.pdf>.

³⁷ Another country that has expressed its desire to join is Tajikistan. However, it does not currently border a country member of the Customs Union, which is a precondition for membership. Thus its position is dependent on developments with regard to Kyrgyzstan. Importantly, it remains to be seen how membership will be defined in the context of the pending transformation of the EEC (to which both countries belong) into the Eurasian Economic Union.

³⁸ In 2003 Russia set up the Single Economic Space between Russia, Ukraine, Belarus and Kazakhstan.

potential sovereignty sensitivities in a planned expansion to Ukraine. As the following section shows, the approach to Ukraine illustrates most clearly the shift in Russia's policy as it uses the ECU as a 'governance-based' vehicle in direct competition to the EU.

Russia's export of governance in the 'shared neighbourhood'

The ECU is the vehicle through which Russia increasingly engages in 'normative rivalry' with the EU in the so-called 'shared neighbourhood'. As pointed above, this neighbourhood denotes the Soviet successor states covered by the ENP and the EaP – Ukraine, Belarus, Moldova, Azerbaijan, Georgia and Armenia. This means that Russia relies not only on 'soft' power, energy conditionality and military strength,³⁹ but also on an institutional, rule-based regime for asserting its position in the post-Soviet space. Russia has begun to compete in a domain where the EU has exercised a monopoly until now.

Through the ECU in particular, Russia offers a concerted response to the EU's export of governance through the ENP and the EaP. These initiatives are aimed at accelerating integration of the countries in the 'shared neighbourhood' with the EU, where integration means an offer of Association Agreements, Deep and Comprehensive Free Trade Agreements, Visa Facilitation Agreements and full visa liberalization in the long term – but not membership. As widely noted, the EU's approach projects the internal 'European order', combining norms and values related to democracy, human rights and the rule of law, as well as the economic model of governance, to the countries concerned.

While the aim may be commendable, the actual content of the EU's relations with its eastern neighbours is not necessarily easy to grasp, owing to the profoundly political and technocratic nature of these relations. The most ambitious mechanism for the export of EU governance to the post-Soviet countries is the Association Agreement. This is a new-generation agreement in terms of scope,

detail and comprehensiveness; the so-called Deep and Comprehensive Free Trade Agreement (DCFTA) is an integral part of it. The DCFTA goes beyond a 'standard' free trade agreement, entailing a profound impact on the regulatory framework of the country associated with the EU in a wide range of areas, such as the complex regulation of competition and sanitary and phyto-sanitary standards. The expected benefits of implementing such agreements are qualities that most of the eastern neighbours lack: the ability to sustain reforms or a degree of confidence in the economy thanks to the improved domestic institutions and the system of economic governance. Association Agreements, with the DCFTA, have been offered to all countries participating in the Eastern Partnership that are also members of the WTO.⁴⁰ Of all the developments in EU relations with the post-Soviet countries in recent years, these agreements are undoubtedly the most important, carrying the promise of a robust, legally binding framework for progressive integration.

The launch of the Eastern Partnership in the spring of 2009 provoked immediate concerns in Moscow.⁴¹ This was the first time that the Russian leadership had objected so vehemently to an EU initiative within the post-Soviet space (previously its protests had been reserved for NATO's engagement there). While Russia's stance seems to have softened over time, the launch of the EaP provided a strong impetus for a rethink of its strategy in the 'near abroad'. This is evident not only in the formation of the ECU but also in Russia's opposition to the new Association Agreements. This has also manifested itself in a normative competition over Ukraine, which has been until recently regarded as a regional frontrunner in terms of integration with the EU. Russia has been campaigning to persuade Ukraine to join the ECU while simultaneously dissuading it from concluding an Association Agreement with the EU (negotiations for which were completed in 2011). Russia's position is worth examining in more detail to illustrate the unfolding rivalry and its potential implications for the EU.

³⁹ See, for example, Lough (2011).

⁴⁰ Among the eastern partners, Georgia and Moldova have already opened negotiations on the DCFTA and Armenia is expected to do so shortly.

⁴¹ See Averre (2009) and Moshes (2012).

The functional cost-benefits argument

Russia's reaction to the EU–Ukraine Association Agreement has been uniformly negative, a stance that was communicated to Ukraine rather than the EU. The main Russian criticisms have been framed in terms of a pragmatic, economic cost-benefit analysis with the disadvantages of the DCFTA for Ukraine contrasted with the benefits of joining the ECU. This is despite the questionable economic rationale of the ECU for Russia and other member states.⁴² Moreover, given the expected limited economic impact of DCFTA on Russia, Russia's opposition to it does not seem to be premised on economic grounds. Yet while the justification might be questionable, a forceful economic argument is put across to Ukraine. The progress already made with the ECU and its enhanced institutional viability only add to the force of the argument.

Joining the ECU would apparently benefit Ukraine to the extent of \$219 billion of increased GDP between 2011 and 2030 (i.e. \$12.2 billion per annum at 2010 prices; in 2011, Ukraine's GDP was \$165 billion).⁴³ The ECU would allow Ukraine to maintain access to the Russian market, particularly for agricultural products. Russia emphasizes that some of the Ukrainian agricultural products would be subjected to quotas even under the DCFTA, while the ECU offers wider market access. As Putin put it, 'Nobody is letting Ukraine in; we are.'⁴⁴ Participation in the ECU would also enable Ukraine to accrue the benefits of the re-creation of a technological research and development complex, which would be modernized and made more competitive.⁴⁵ Russian officials and commentators highlight the prospects for equalization of technological levels, industrial cooperation and a common strategy of development. Therefore, according to this argument, joining forces in the ECU would bring a competitive advantage to Ukraine.⁴⁶ The ECU is not

promoted in terms of restoring disrupted economic links, or of preserving historical, cultural and linguistic commonalities. In contrast to previous initiatives in the post-Soviet space, it is a future-oriented, economic project with an emphasis on improving the performance of the Ukrainian economy (thereby mirroring the arguments of the EU).

At the same time, in this Russian perspective the DCFTA is depicted as a largely loss-making initiative for Ukraine, which has already been affected by the international financial crisis. In contrast to the projections by EU experts, Russian estimates of the impact of the DCFTA on Ukraine are widely circulated in the Ukrainian media. According to these, EU imports to Ukraine will increase by 10%, leading to a 5% deterioration in the trade balance and meaning that 'Ukraine stands to lose up to 1.5% of its GDP base volume'.⁴⁷ These estimates emphasize Ukraine's weak position *vis-à-vis* the EU, the financial and economic costs of convergence with the EU, and the apparent loss of sovereignty that comes with signing up to the Association Agreement. In particular, Ukraine's aviation and ship-building industries and agricultural sector would suffer. Russia's arguments emphasize the protectionist stance of the EU during negotiations on the DCFTA and the uncompetitiveness of Ukrainian goods on the EU market. More broadly, Ukraine would be required to align itself with EU rules without having any say in setting them, whereas the ECU would provide Ukraine with full membership rights and a voting system that favours multilateralism.

It is worth pointing out that the EU has not been responding in any concerted way and appears rather laid back about the anti-DCFTA campaign in Ukraine. It is no doubt relying on its 'power of attraction' and Ukraine's long-standing 'European choice'. Yet the negotiations on the Association Agreement have been highly technocratic,

⁴² With few independent studies of the Customs Union deploying robust methodology, its economic impact on the member states and key trading partners is yet to be examined. Vinhas de Souza (2011) concluded that, unlike the member states and the key trading partners, Ukraine was one of the countries that would actually benefit from the formation of ECU as long as it remains *outside* the grouping.

⁴³ See Eurasian Development Bank, 'Ukraine and the Customs Union', Centre for Integration Studies, Report 1 (2012).

⁴⁴ See 'Putin: Ukraina Prodast Evrope 2 Litra Moloka, A Tamozhenny Soyuz Dast Ey 9 Mil V God', *Zerkalo Nedeli*, 6 October 2011, http://news.zn.ua/POLITICS/putin_ukraina_prodast_evrope_2_litra_moloka_a_tamozhenny_soyuz_dast_ey_9_mlrld_v_god_-89118.html.

⁴⁵ See the resolution of the conference entitled 'Perspectives of the Eurasian Integration of Ukraine' which took place in Kyiv in December 2011, http://smi.liga.net/articles/2011-12-28/3693731-kuda_i_s_kem.htm.

⁴⁶ See 'Putin: Ukraina Prodast Evrope 2 Litra Moloka'.

⁴⁷ See Eurasian Development Bank, 'Ukraine and the Customs Union', p. 29.

conducted in narrow official circles, with little effort to win over the general public or inform business of the implications and benefits. In the negotiations themselves, a fair degree of EU protectionism has been evident, especially with regard to agricultural products. This is not new: the EU tends to approach any trade negotiations in terms of what the single market can absorb rather than focusing on the interests and needs of the negotiating party to make the cost-benefit analysis more favourable. Negotiations with Ukraine have not been different in that respect. The EU largely tabled its own positions on the scope of Ukraine's alignment with the EU with little acknowledgment of the importance of its economic ties with Russia and the CIS, thereby ignoring the particular economic (let alone political) costs of moving away from Russia.⁴⁸ It was this tough economic bargaining and protectionism that gained considerable attention in the Ukrainian media, with few members of the public in Ukraine fully understanding the overall significance of the DCFTA. Perhaps because of its recurring fatigue and disillusionment with the country, the EU has largely failed to promote this flagship and pioneering agreement effectively in Ukraine.

Raising the stakes for Ukraine: possible rewards and sanctions

Instead of relying only on listing the broad long-term developmental benefits and immediate economic gains for Ukraine, Russia uses instead a more traditional 'carrot-and-stick' approach. The additional incentive comes in the form of a reduced gas price, benefiting Ukraine by up to \$8 billion per annum.⁴⁹ One of the most important obstacles to joining the ECU is that Ukraine would have to raise its WTO-agreed tariffs to the ECU level, triggering demands for compensation from WTO members. Putin has promised to cover these costs, although the actual extent and

credibility of this pledge are uncertain. The punishment, in turn, would consist of economic sanctions against Ukraine, which would be primarily justified in terms of the negative implications of the EU–Ukraine DCFTA for Russia.

Russia's specific objections relate to the prospect of being flooded by Ukrainian products that have been displaced from the domestic markets by more competitive EU imports as a result of the DCFTA. Yet there is no sound basis for such economic predictions. The DCFTA is unlikely to have a significant impact on Russia in terms of impeded trade flows with Ukraine, and is therefore unlikely to affect the Russian economy.⁵⁰ If anything, the DCFTA will open new business possibilities for numerous Russian-owned companies in Ukraine, especially in the light of Russia's own adoption of international and EU norms. Nevertheless, in the event of detrimental effects on Russia, Putin threatened in April 2011 that the country 'will have to introduce protective measures'.⁵¹ Predicting that the Russian market would be flooded by goods from Ukraine, Putin warned: 'I'm confident that [...] both Kazakhstan and Belarus will immediately demand that Russia closes its customs border.'⁵² This type of rhetoric indicates that Russia is considering deploying a range of mechanisms to 'persuade' Ukraine of the 'benefits' of the ECU. This reinforces the perception of the initiative as a vehicle for projecting Russia's power, particularly as the Russian approach also makes it more difficult to resist the 'offer'.

The measures that Russia could introduce range from applying anti-dumping tariffs and limiting imports of Ukrainian food products through the application of phytosanitary standards to lowering the quotas for steel pipes – a key export for Ukraine.⁵³ It is noteworthy that Russia introduced trade sanctions against Ukraine in the summer of 2011 when some cheese products were blocked on the grounds of violations of food safety standards. Selective,

48 Many officials from the EU and its member states seem confident that Ukrainian oligarchs, precisely because they are so well represented in the government, are too afraid of Russia's economic domination to opt for an advanced form of integration with Russia.

49 This is in the context of Ukraine's efforts to revise the gas deal with Russia. For a background analysis, see Sherr (2010).

50 Very few analysts outside Russia consider the implications for Ukrainian–Russian economic relations, so no reliable, independent studies exist to verify various claims put forward by Russian officials. We are grateful to Veronika Movchan, from the Institute for Economic Research and Policy Consulting in Kyiv, for providing a preliminary analysis which indicates a relatively limited impact of the DCFTA on Russia in economic terms.

51 See 'Putin: Yesli Ukraina sozdast ZST s ES, Rossiya uzhestochit tamozhennyi kontrol', 12 April 2011, <http://podrobnosti.ua/power/2011/04/12/763729.html>.

52 Putin (2011).

53 See Sladkov, A., 'Rossiya meshaet zone svobodnoy trgovli mezhdu Ukrainoi i ES', 2 April 2011.

targeted sanctions have been repeatedly deployed by Russia *vis-à-vis* states such as Moldova or Georgia that are deemed to be pursuing an unfriendly policy.

How far can Russia go in 'punishing' Ukraine? Its impending membership of the WTO will preclude it from using certain punitive trade measures, and Ukraine, as an existing member, could resort to institutional mechanisms to address politically motivated trade sanctions (as it did in the spring of 2012 with regard to some further sanctions on cheese products). However, Russia may take extra-legal measures in contradiction of WTO rules. Ultimately, it is difficult for Ukraine to make a choice based on a prediction of Russia's propensity to violate the norms of the organization it is about to join.

This debate has highlighted a sense of uncertainty and confusion among various political and, especially, economic players in Ukraine, given the importance of the Russian market for Ukrainian industrial goods and food produce. This is reinforced by the arguments that the DCFTA is tainted with EU protectionism and involves high up-front costs for Ukraine.

Is the ECU a vehicle for European integration?

The ECU is being presented by Russia as an optimal choice for Ukraine.⁵⁴ The common strand that appears to run through the Russian statements and analysis is that the case for Ukraine joining the ECU and abandoning the trade agreement with the EU verges on self-evident. At the same time, it is argued that membership of the ECU will bring other benefits. In particular, it is presented as a scheme that in the long term would facilitate Ukraine's integration with the EU by reducing essential asymmetries. As Putin put it:

[S]oon the Customs Union, and later the Eurasian Union, will join the dialogue with the EU. As a result, apart from bringing direct economic benefits, accession to the Eurasian Union will also help countries integrate into Europe sooner and from a stronger position.⁵⁵

In essence, the argument is that Ukraine could 'join' Europe faster and on better terms if it does so 'together with Russia'.

Undoubtedly Russia has endeavoured to undermine the rationale for Ukraine's political association and free trade agreement with the EU. This campaign complicates Ukraine's already difficult relations with the EU. The signing of the Association Agreement with the DCFTA has been put on ice owing to the deterioration of democratic standards in Ukraine, evidenced above all by the political prosecution of a former prime minister, Yulia Tymoshenko, and a former minister of the interior, Yuriy Lutsenko. Their prosecution has been loudly condemned by EU institutions and member states as a clear breach of democratic standards and European values. With the Association Agreement being the key tool at the EU's disposal and the principled position it has adopted (much to the surprise of the Ukrainian authorities), there are no prospects for its conclusion until and unless the release of these political figures takes place. However, this clear juxtaposition of democratic conditionality and economic integration significantly raises the 'power costs' for the Ukrainian authorities. They have been seeking to consolidate power to render ineffective any challenge to their rule, while declaring a strong commitment to moving closer to the EU. Such a trade-off between relations with Europe and consolidating power means the pursuit of the Association Agreement carries direct political risks for President Viktor Yanukovych and the ruling Party of Regions. And it is worth remembering that, outside the context of enlargement, the EU has no stronger track record in changing the domestic political calculus of authoritarian regimes than other international organizations or any state. Thus although a quick resolution in the current impasse in Ukrainian–EU relations is possible, it is unlikely.

It is worth stressing that the ECU is free of democratic conditionality for the current and prospective member states. Ukraine is offered membership with no political conditions attached: all post-Soviet countries, regardless of their political regime, are welcome in the

⁵⁴ Overall, in the short term, there would indeed be higher initial costs for Ukraine associated with joining the DCFTA in contrast to the ECU. In the longer term, however, the DCFTA is expected to significantly boost Ukraine's trade and economic development while reducing dependence on Russia.

⁵⁵ Putin (2011).

ECU.⁵⁶ Indeed, the organization provided support to the regime in Belarus by speaking out against EU pressure and sanctions.⁵⁷ Russia's offer to Ukraine comes at a highly sensitive moment in Ukrainian–EU relations and thereby counteracts the EU's democratic conditionality.

The campaign to persuade Ukraine to abandon the DCFTA could be seen as a short-lived attempt to attract the country at a time when the authorities have declared their interest in concluding the Association Agreement rather than opting for the ECU.⁵⁸ No doubt, the pull of the ECU is weakened by the prospect of paying compensation in the process of renegotiating the tariffs agreed when Ukraine joined the WTO. However, this is not just a matter of a short-term choice but also a longer-term contestation.

Even if the Association Agreement is signed and ratified, its implementation will be prolonged, costly and highly sensitive in political and economic terms. There are myriad different preferences and stakes among Ukraine's domestic political and business players, many of whom have a strong interest in securing access to the ECU market. At the same time, Ukraine has a track record of signing international agreements but not implementing them.⁵⁹ Andriy Kluyev, an oligarch and Ukraine's chief negotiator on the Association Agreement, said in the spring of 2011 that 'Ukraine would participate in such economic unions from which it may benefit, such as cooperating on certain trade positions, while it would be more beneficial to be part of a free trade area with the EU on some other issues'.⁶⁰ Other officials and experts suggested that Ukraine should join the Customs Union on a temporary basis until the country was ready to develop the DCFTA. These statements demonstrate the continuing preference for a 'pick-and-mix' approach to economic integration that Ukraine has demonstrated over the last 20 years (an approach high on selectivity and low on commitment).⁶¹

Such a context provides plenty of opportunities for Russia to offer incentives and disincentives to various domestic Ukrainian players to slow down or jeopardize the implementation of the Association Agreement and other commitments *vis-à-vis* the EU, such as those related to Ukraine's membership in the European Energy Community. Integration with the EU is certainly premised on the lengthening of the time horizons of Ukraine's political class. These longer time horizons are needed to embark on political and economic reforms that would generate benefits in the medium to long term (5–10 years). Russia is well positioned to offer cross-conditionality to alter the stakes and shorten the horizons.

Conclusion

As widely noted, the notion of global competition – economic, military and normative – resonates strongly among the Russian political elites. This notion stems from the Hobbesian understanding of world politics as an arena where a constant battle of interests and struggle for domination are played out.⁶² A corollary of Russia's aspirations to 'great powerness' is its claim to hegemony in the 'near abroad'. Much doubt has been cast on its status as a rising power. To dispel these doubts, Russia has shifted its focus to a legal, rule-based domain of integration. This has no doubt been inspired by the EU's increased presence in the 'shared neighbourhood' and facilitated by Russia's accession to the WTO. Its encounter with the EU as a 'normative power' has taught Russia important lessons about the high stakes in the region. While both the EU and Russia endeavour to influence this space, 'what for Brussels is just one of its "neighbourhoods" is for Russia the crucial test case which will either prove or dismiss the credibility of the its Great Power ambitions'.⁶³

56 However, Putin's article in *Kommersant* of 6 February 2012, 'Democracy and The Quality of Government', shows his (at least pre-election) ambition to offer justification of an organic model that does not deny the importance of these values as such.

57 See Declaration No. 22 of 25 April 2012 of the Council of the Eurasian Economic Commission, <http://www.tsouz.ru/eeek/RSEK/RSEK/SEK3/Documents/ZV.pdf>.

58 See Shumylo-Tapiola (2012).

59 Langbein and Wolczuk (2012).

60 Korduban, P., 'Ukraine Sends Mixed Signals on Free Trade with the EU, Russia', *Eurasia Daily Monitor*, Vol. 8, No. 62, 30 March 2011.

61 Dragneva and Dimitrova (2007).

62 Averre (2009), Haukkala (2010).

63 Moshes (2012).

Since the mid-2000s, EU–Russian relations have remained in a prolonged impasse. At the official level the strategic partnership stalled on issues of equality and reciprocity.⁶⁴ Normative convergence as a key tenet of the EU’s approach to the post-Soviet countries became a major stumbling block in relations with Russia as the latter questioned the necessity and legitimacy of this approach. Thus Russia is unwilling to yield to what it perceives as the EU’s *diktat*, demanding greater reciprocity and partnership-like relations. As a result, there has been a ‘complete absence of progress on economic provisions’.⁶⁵ Yet, as Arkady Moshes argues, the vacuum characterizing the relationship – centred on ceremonial summits – over recent years has actually suited both parties.⁶⁶

While EU–Russian relations have remained static, the same cannot be said about their respective relations with the countries in the ‘shared neighbourhood’. To prevent its loss of influence across the post-Soviet space,⁶⁷ Russia has opted for reviewing its approach to regional integration by putting a premium on rule-based economic integration with robust institutional regimes. It is highly uncertain whether this rapid pace can be maintained to keep up with the declarations on the creation of the Eurasian Economic Union by 2015. Much of the progress so far has undoubtedly been dependent on the personalities of the leaders in the three countries, making the union vulnerable to any leadership changes. Expansion, especially to Ukraine, would significantly strengthen the union politically and economically (while the accession of Kyrgyzstan and Tajikistan would have mainly symbolic political value). Yet what has been achieved so far provides a firm institutional basis for economic integration. As such it means that a viable form of advanced economic integration, a worthy competitor to that offered by the EU, has emerged in the post-Soviet space. This has serious implications for

EU–Russian relations and represents a significant challenge for the EU’s strategy in the post-Soviet region.

The already proven viability of the ECU means that the EU is no longer the only source of effective governance in the region and that Russia’s role in the shared neighbourhood can no longer be defined only in terms of ‘soft’ and/or military power.⁶⁸ It has moved into a domain in which the EU so far has not been challenged. The union has acted as ‘a regional normative hegemon that is using its economic and normative clout to build a set of highly asymmetrical bilateral relationships that help to facilitate an active transference of its norms and values’.⁶⁹ This shift has multiple and far-reaching implications, not least because Russia explicitly presents the ECU as an alternative to EU-led economic integration, capitalizing on the EU’s political and economic crisis. But while the formation of a Russia-led regional integration bloc underscores the threats to the EU’s dominance, it also offers important new opportunities for cooperation.

The most immediate threat stems from competition over Ukraine. This rivalry between Russia and the EU is unlikely to cease even if and when Ukraine actually concludes the Association Agreement. Its implementation will be a costly and prolonged process with ample opportunities for delays, not least given the unfavourable domestic context in Ukraine. Ukraine’s dependence on the Russian market means that it will have to adapt simultaneously to two competitive integration regimes, the EU and the ECU.

At the same time, there are emerging opportunities for economic cooperation. Russia has been rapidly adopting EU and international standards in the context of creating the ECU and of accession to the WTO. In practice, this means better normative compatibility and offers greater scope for harmonization of the trade regimes, thereby facilitating work on the new, post-PCA (Partnership and Cooperation Agreement) agreement between the EU and Russia/ECU.⁷⁰ This would

64 Averre (2005, 2007), Haukkala (2008).

65 See the Second EU–Russia International Conference ‘Prospects for a Strategic Partnership’, Brussels, November 2011, Final Report available at: <http://www.eu-russia.eu/wp-content/uploads/2011/05/Final-Report1.pdf>.

66 Moshes (2012).

67 Nixey (2012).

68 For analysis of Russia’s soft power in Ukraine see Bogomolov and Lytvynenko (2012).

69 Haukkala (2010), p. 47.

70 However, it is important to emphasize that it makes no sense to negotiate trade issues between the EU and Russia so any new agreement on trade issues would need to be concluded between the EU and ECU.

mean that as the countries in the shared neighbourhood, such as Ukraine, move closer to EU economic standards this does not conflict with the rules that are accepted in Russia/ECU.⁷¹ There is not much clarity in the EU as to what the ECU entails, notwithstanding the overall optimism that WTO accession will improve cooperation. Nevertheless, much more attention needs to be paid to various forms of interaction between the respective normative regimes and their actual implementation.

Although drawing heavily on WTO rules as well as parts of the EU *acquis*, the ECU seems to be designed *in parallel* to the EU rather than *harmonized with* it. Ultimately Russia is intent on developing an economic regime in order to achieve its overarching policy objective, which Putin has spelled out:

Our integration project is moving to a qualitatively new level, opening up broad prospects for economic development and creating additional competitive advantages. This consolidation of efforts will help us establish ourselves within the global economy and trade system and play a real role in decision-making, setting the rules and shaping the future.⁷²

This negates rather than enhances the prospect of Russia being drawn into an EU-centred Europe.

During Putin's third presidential term, progression from the ECU to the Eurasian Union is likely to remain at the top of the political agenda for Russia. Even if the current speed of regional economic integration is unlikely to be maintained, the developments so far already entail profound consequences for the EU in its relations both with Russia and with the other post-Soviet countries.

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⁷¹ Moshes (2012), p. 23.

⁷² Putin (2011).

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