



# The Russia-Ukraine trade spat

by Nicu Popescu

In mid-August, Russia blocked virtually all imports from Ukraine. Although the cross-border flows between the two countries have since resumed following a week of heightened tension, the issue is far from over. On the contrary, the trade spat was probably just the first warning shot in what could escalate into a full blown trade war, the ultimate aim of which would be to prevent Ukraine from signing an Association Agreement with the EU at the Eastern Partnership summit in Vilnius in late November, thereby preventing further economic integration with the European Union and steering it in a Eurasian direction instead.

It is in Ukraine's political interest to sign the Association Agreement, containing a free trade component, with the EU, while maintaining the existing free trade agreements it has with other post-soviet states, including Russia. Although a country can have multiple free trade agreements and such an arrangement would be a win-win situation for Ukraine, Russia is adopting a more zero-sum stance towards the matter. This is primarily due to the fact that, once Ukraine signs the Association Agreement with the EU, it will no longer be able to join the Russia-led Customs Union - or the proposed Eurasian Economic Union - due to the differing standards and tariffs in place. An EU-Ukraine free trade deal will mean greater access for Ukraine to the EU market through lower customs and non-tariff barriers, higher export quotas for certain sensitive goods, and the adoption of EU standards in a wide range of domains.

Until recently, Russia was relatively at ease, feeling secure in its belief that the EU would not sign the

already finalised and initialled Association Agreement with Ukraine as long as former Prime Minister Yulia Tymoshenko remained in jail, and that President Yanukovich was unlikely to release his main political rival a year and a half before the next presidential elections, due in early 2015. However, in the last few months there has been some progress made, with the European Commission putting forward a proposal for a Council decision on the signing of the Agreement, and the EU and its member states working more actively to seal the deal with Ukraine in Vilnius.

## Moscow's move

The fear that existing obstacles to improved EU-Ukraine relations could be put aside, or overcome, galvanised Russia into action. The Ukrainian weekly *Dzerkalo Tyzhnia* recently published a purported Russian strategy to prevent Ukraine from signing the Association Agreement, although a Putin aide claimed that it was not an official document, but simply recommendations sent to the Russian presidential administration by outside experts. In any case, Russian actions and official statements seem to be quite in tune with the 'strategy', which advocates the mobilisation of Ukrainian oligarchs (virtually all of whom have business interests in Russia to varying degrees) in order to start lobbying more actively against the Association Agreement with the EU. In addition to targeting the government directly, these oligarchs would be expected to employ the media resources at their disposal in order to sway public opinion, or run the risk of having their pockets hit hard by trade restrictions with Russia.



Another element of the strategy would be to emphasise to President Yanukovich, whose popularity is shaky, the extent of the impact that Russian-induced economic difficulties could have on the already fragile Ukrainian economy, potentially costing him the presidency in a year and a half when his first term expires. Such sticks would also be complemented with carrots, with the strategy speaking of the need to provide more opportunities for business groups that take heed of the Russian message and start working against the Association Agreement, and the need to incentivise Yanukovich's family and inner circle by offering them specific money-making opportunities on the Russian market.

Russia's warning shot was interestingly designed and was neither a blockade nor a trade embargo. Russian customs officials simply decided overnight to apply thorough and lengthy checks on Ukrainian exports to Russia, replacing the normal practice of selective checks with 'carpet' checking, bringing the flow of goods across the border to a near standstill. Sergei Glaziev, an advisor to President Putin, explained in plain terms that the tough application of customs procedures was a pilot test for future customs practices, should Ukraine decide to make the 'suicidal step' of signing the Association Agreement with the EU.

### Kiev's head-down tactics

For all the harsh and politicised tactics employed by Russia, it must be said that the Ukrainians have not played their cards perfectly either. In March this year, Ukraine introduced higher taxes (ranging from 6-13 per cent) for car imports that irked all car exporters to Ukraine. Turkey responded by introducing a 23 per cent tax on Ukrainian walnut exports, and Russia hit back even harder by blocking the import of Ukrainian chocolates from Roshen, a company that ranks 18th place among chocolate makers in the world by turnover. The company is also owned by Ukrainian oligarch-cum-politician Petro Poroshenko, who is believed to have lobbied for - and possibly benefited from - the higher car tax (he used to have shares in a Ukrainian car maker and was formerly minister of trade and economic development).

Besides political concerns, Russia also has genuine trade-related worries. It fears that with the EU-Ukraine free trade deal in place, Ukrainian goods will face even tougher competition from EU goods in their domestic market, and since many of these do not meet

the standards to be exported to the EU, they will be 'dumped' on the Russian market, thereby undercutting Russian producers. Russia also fears that EU products would be re-branded as Ukrainian and re-exported to Russia under Ukraine's favourable trade access regime. Paradoxically, although Russia would welcome greater access to Ukrainian goods as a result of a closer economic and geopolitical Eurasian alliance in its favour, it would not if Ukraine moves towards a free trade deal with the EU.

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In these times of tension, Ukraine is not in a position to retaliate, as

it would certainly suffer disproportionately from any additional trade conflicts with Russia. The only thing Ukraine can hope for is to weather the storm, and potentially take action in the World Trade Organization (WTO), a move which in any case would not produce rapid results.

### The boomerang effect

Yet, Moscow's actions might prove, once again, self-defeating. The trade dispute may have made Ukrainian oligarchs sit up and count how many millions they would personally lose from disrupted trade relations with Russia, but it is also sure to have sparked visions of the even worse prospects of being isolated and left to rely on such a ruthless partner.

Russian tactics are also a reminder to many in the EU that the EU-Ukraine relationship is underpinned by serious geopolitical considerations and is about more than just the political and trade issues of the day between Brussels and Kiev. It is also a reminder that time is of the essence, and although Ukraine might be able to hold out - and not give up on the Association Agreement - for a few months, it may not be strong enough to resist sustained pressure in the medium or long run.

In other words, following the latest trade spat, it looks as if Russia is doing its best to ensure that Ukraine and the EU will indeed be compelled to sign the Association deal in Vilnius.

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