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Ukraine withdraws from signing the Association Agreement in Vilnius: The motives and implications

Wojciech Konończuk

On 21 November, the Ukrainian government announced its decision to suspend its preparations for signing the Association Agreement with the EU. According to media reports, President Viktor Yanukovych had already informed Štefan Füle, the EU Commissioner for Enlargement, of the decision two days earlier. In its statement, the Ukrainian government said the decision had been taken for 'reasons of national security', as well as the need to improve its declining trade with Russia and other CIS countries. At the same time, Kyiv suggested the creation of a tripartite commission of Ukraine, the EU and Russia, which would work to remove barriers in mutual economic cooperation and trade liberalisation. The government also announced a return to dialogue with the Customs Union. The Ukrainian government's withdrawal from signing the agreement with the EU has sparked the biggest public protests since 2004.

Ukraine's decision is not unexpected. Since at least the beginning of November, statements by the Ukrainian government have contained clear signs that Kyiv might opt out of signing the Association Agreement on the eve of the summit in Vilnius. The turnaround in Kyiv's cooperation with the EU results from the domestic situation, as well as increasing pressure from Russia in recent months. In the context of the upcoming presidential elections in early 2015, where victory is a priority for Ukraine's ruling elite, President Viktor Yanukovych's most important task is to stabilise the increasingly difficult economic situation. To this end, it is necessary to ensure Ukrainian goods' continued access to the Russian market, and to guarantee external financial support. The Ukrainian government is hoping that, in exchange for the postponement of its rapprochement with the EU, it will manage to come to an agreement with Russia on the issue of a stabilising loan and renegotiating the gas contract. A comprehensive Russian-Ukrainian agreement could be reached in the coming months, but its conditions are likely to be unfavourable for Kyiv. The turnaround in relations between Ukraine and the EU undermines Ukraine's negotiating position with Russia, and will result in the further destabilisation of the domestic political situation.

Kyiv's ambivalent policy towards the EU

The steps taken by the Ukrainian government since Viktor Yanukovych came to power in 2010 allowed observers to believe that Kyiv was determined to bring about the signature of an Association Agreement with the EU. According to opinion polls, this step was supported by a large part of the population (according to a poll in November by GfK, 45% of citizens

favoured moving closer to the EU, while 14% favoured membership in the Customs Union). Since September this year, the Ukrainian parliament began to rapidly pass the so-called 'European laws', which was Brussels' condition for signing the Agreement at the Vilnius summit. So far, the parliament has adopted key legislation (the law on the Prosecutor's Office is still awaiting a second reading). However, despite efforts and pressure from the EU member states and the EU's Cox-Kwaśniewski mission, the problem of Yulia Tymoshenko remained unresolved. Over the last year, the Ukrainian government made superficial efforts to solve the problem; however, everything indicates that from the very beginning it had no intention of releasing the former Prime Minister, even for medical treatment in Germany. Despite the apparent lack of progress on the Tymoshenko affair, however, the EU seemed likely to look favourably on signing the Agreement with Ukraine in Vilnius.

As the summit in Vilnius approached, pressure from Russia was rising; this culminated with the introduction in mid-August of an embargo on goods entering from Ukraine. As a result, a significant part of Ukrainian exports to Russia were blocked for a week. In this way, Moscow sent Kyiv a warning signal, indicating that signing the Agreement with the EU would significantly limit the access of Ukrainian products to the Russian market (which amount to a third of total exports from Ukraine). It seems that this was the key moment that determined the Ukrainian government's decision to revise its existing policy towards signing the Association Agreement.

Initially Kyiv hoped that the EU itself would decide to block the signing of the document in connection with the failure to resolve the Tymoshenko issue. However among the member states, voices favouring consent to Ukraine adopting the Agreement began to predominate, despite the lack of a resolution to this problem. At the turn of November, when it became impossible to blame the European Union and the opposition for any failure of the Association Agreement, the Ukrainian government began to publicly highlight the negative consequences that would arise from implementing the document, and to demand financial compensation from Brussels. On 21 November, in a surprisingly blunt manner, the Ukrainian government announced its decision to indefinitely postpone signing the Association Agreement with the EU.

Over the following days, the most important Ukrainian politicians criticised the Agreement. On 26 November, President Yanukovych called the EU agreement a 'dead end' for Ukraine, and made its signature at some point in the indefinite future conditional on 'agreement on normal conditions'. On the same day, Prime Minister Mykola Azarov criticised the EU for failing to offer financial compensation with regard to the limitation of the access of Ukrainian goods to the Russian market after signing the Agreement. He also stated that in order to protect its exports, Ukraine was proposing the start of trilateral talks with the EU and Russia. On 21 November the initiative was already supported by Vladimir Putin, which indicates that this was a joint initiative by Kyiv and Moscow.

The internal reasons for Kyiv's decision

Kyiv's decision should be seen not only in the context of increasing pressure from Russia, but mainly that of Ukraine's domestic conditions, including its difficult economic situation. Since mid-2012 Ukraine's economy has been in a deepening crisis; the continual decline in GDP (around 1% this year) and industrial production, reduced exports, and falls in

investment and domestic demand are evidence of this. At the same time, the arrival of the deadline to repay foreign debt (about US$10 billion this year, US$8 billion in 2014) led to a sharp reduction in foreign exchange reserves (from US$32 billion at the beginning of last year to US$20 billion today).

In the current economic situation, the Ukrainian government has stated that it cannot afford to sign and implement the provisions of the Association Agreement. According to available estimates, the agreement's impact on the Ukrainian economy in the initial period would be negative, in connection with the abolition of tariff barriers, opening up the market, and the need to adapt to EU norms and standards. The ruling elite in Kyiv fear that the difficult reforms that the Association Agreement requires would lead to a further decline in support for the government and destabilise the economy. The positive effects of adopting the agreement with the EU would in fact only be felt in the long term. Therefore, the best choice from the government's point of view is to maintain the current model of the state and the economy, and thus postpone the socially costly modernisation to the further future.

In order to stabilise the economic situation, Ukraine needs approximately US$15 billion of foreign credit. Negotiations with the IMF have been under way since last year. Kyiv may have been hoping that signing the Association Agreement with the EU would positively influence the Fund's ultimate decision. The IMF did not intend to abandon their most important conditions for granting the loan, but did express a readiness to spread them out over time. However, the government in Kyiv stated that these conditions were unacceptable because of their social costs. The most important problem is the IMF's demand that the price of gas be increased by 40% for individual customers, and that budget expenditures be reduced, which would mean the need for painful budget cuts in the pre-election period. As a result, it is highly unlikely that Ukraine will reach any agreement with the IMF in the current circumstances.

Negotiations with Russia

An alternative source of financial support could be a loan from Russia. Unofficial Ukrainian-Russian talks have been ongoing for about a year, but so far the conditions imposed by Moscow have been unacceptable to Kyiv. All indications are that, despite withdrawing from the Association Agreement with the EU, Ukraine has still failed to come to an agreement with Russia. However, the Ukrainian government expects that this will become possible in the coming months. Ukraine would like to obtain not only a stabilisation loan, which would be much easier to spend than subsequent tranches of possible IMF aid (which would be subject to strict conditions), but also lower gas prices. For the government, it is also important to obtain political support from Moscow before the upcoming presidential elections. Nevertheless, winning concessions from Russia will be very difficult, and would be associated with significant concessions by Kyiv, including handing over control of Ukraine's transit gas pipelines, and agreeing to the further expansion of Russian capital into the Ukrainian economy. As the presidential elections approach, Yanukovych's position towards Russia will weaken, and at the same time – as Moscow is counting on – he may become more susceptible to making far-reaching concessions.

Public reaction

The postponement of signing the Association Agreement with the EU caused the largest protests in Ukraine since the Orange Revolution. On 24 November the demonstrations peaked in the biggest Ukrainian cities, which totalled about 150,000 people, including the largest demonstration in Kyiv, which between 80,000 and 100,000 protesters attended. The scale of the protests is unsurprising. It is noteworthy that only some of them have been organised by opposition parties; the protests have largely arisen from grassroots social mobilisation. The government decided not to use force on a larger scale (although 'tent cities' in places including Odessa and Dnipropetrovsk were broken up); their hope is that after the summit in Vilnius ends, the protests will cease of their own accord. Indeed, it seems that the weak and divided opposition will be unable to maintain the mood of protest among the public, and within a few days the scale of the protests will drop off. The mistake the protest organisers made was to try and give the demonstrations a party-political character, even though the protesters demonstrated a clear aversion to opposition slogans and politicians. The protests have no natural leader (although this role could potentially be filled by Yuriy Lutsenko, a former head of the Interior Ministry, the leader of the Third Republic movement, and one of the organisers of the Orange Revolution, who is seen more as an activist than a politician), and their extent will be limited by differences within the opposition itself.

Forecast

All the indications are that the 'pause' in Ukraine's relations with Brussels resulting from Kyiv's decision will be long-lasting. The Ukrainian government's statements and actions clearly indicate that it has lost interest in signing the Association Agreement with the EU, which they see as a threat to the economic situation and the country's relations with Russia. It is also possible that Kyiv may revise its other programs of cooperation with the EU (including its membership in the Energy Community, which is one of the conditions Russia has set), as indicated in a statement by President Yanukovych on 26 November. The most likely scenario is that the adoption of the Association Agreement will be postponed to the post-election period. The future of relations between Ukraine and the EU, including the fate of the Agreement itself, primarily depend on how much the presidential elections in 2015 meet democratic standards. President Yanukovych is undoubtedly one of the most popular politicians in Ukraine, but the level of support for him is falling (it currently stands at about 19%). In addition, the economy is in crisis, which would make it difficult for him to win fair elections.

The decision to opt out of signing the Association Agreement has paradoxically weakened Ukraine's negotiating position with Russia. Any possible agreement between Kyiv and Moscow will be linked to the need to make significant concessions to Russia. The Ukrainian government will try to obtain a loan, as well as an agreement to renegotiate the gas contract, for what could be a low political price; this will include a rejection of Russia's efforts to move Ukraine closer to joining the Customs Union.

The real crisis in Ukraine's relations with the EU, the unclear prospects for help from Russia and its likely high political price, combined with the difficult economic situation and the rise in social activity, means that Ukraine has entered a period of political instability. This period

will last at least until the presidential elections, which will be the greatest test for Ukrainian democracy and determine the direction in which Ukraine develops for the next several years.