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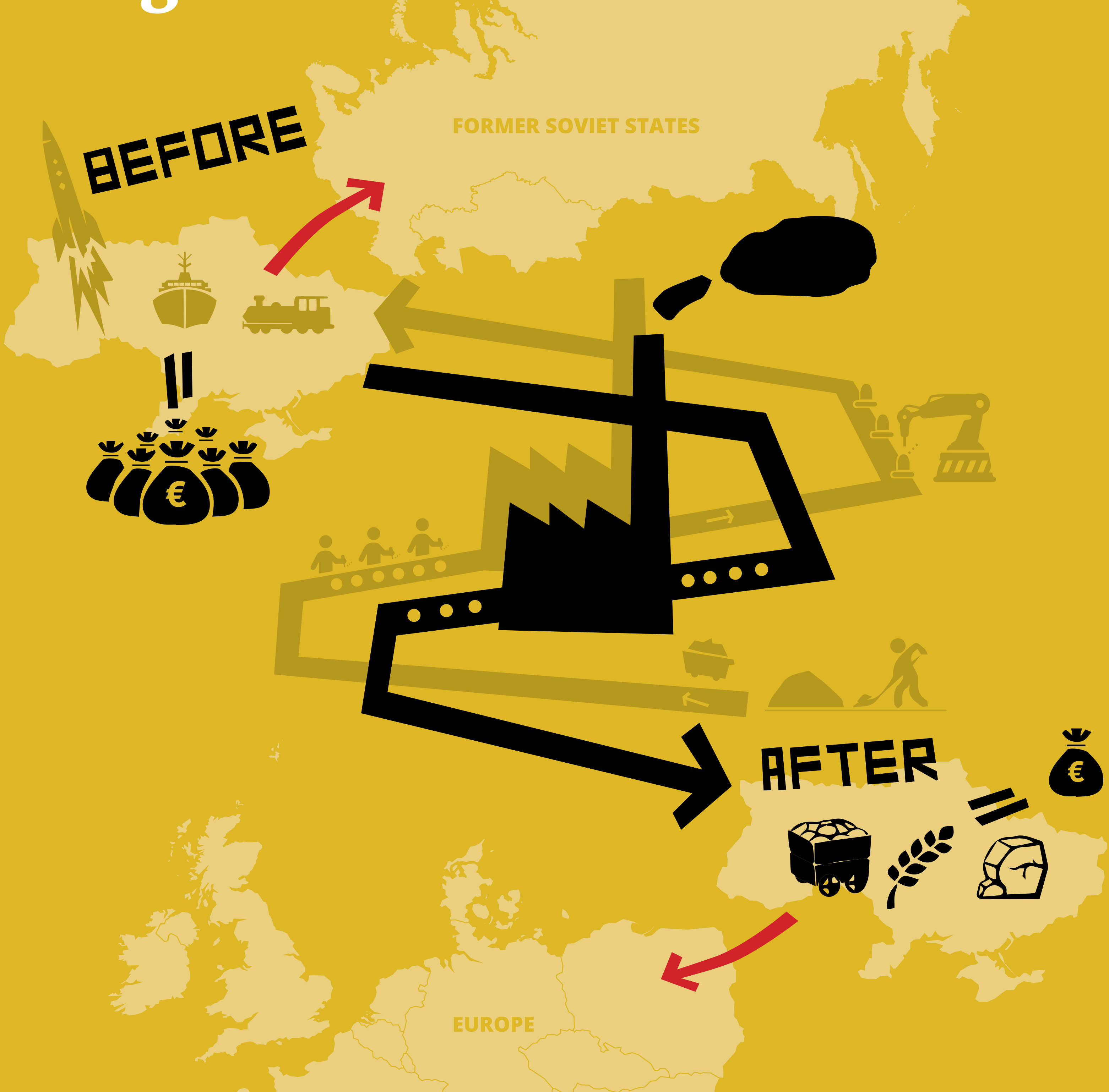
The expected impact of the EU-Ukraine Association Agreement



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Introduction

On 6 April 2016, the Netherlands voted in a referendum on the EU's Association Agreement(AA) with Ukraine. The referendum was a special democratic event – 427,939 signatures of citizens were collected to make it possible. With a turnout of 32.2%, just above the 30% threshold, the vote was valid. The deal was rejected by 61.1% of votes, compared with 38.1% in favour.
The Transnational Institute conducted a background analysis that explains why, from an economic point of view, the Association Agreement would be a bad deal for ordinary people, both in Ukraine and the EU.

No to a trade deal for the 1%

The projected economic and social costs of the Association Agreement for Ukrainians

- Enriches an oligarchic economy where large sectors of the economy's wealth are siphoned off into offshore trusts
- Contributes to deindustrialising Ukraine, because its industrial producers will struggle to meet EU standards and lack sufficient capital and technology to compete with EU multinationals
- Reinforces a Ukrainian economy based on agro-exports and raw commodities, with less value-added benefits for the population
- Harms Ukraine's critical small business sector that constitutes 99.8% of all Ukrainian enterprises and accounts for 67.8% of employment
- New jobs created by EU investments are unlikely to compensate for losses by Ukraine's domestic business sector and EU investors will exploit Ukraine's lower and frequently unenforced social and environmental standards
- Contributes to the ongoing brain drain as highly educated workers migrate to the EU. Between one third and one quarter of the Ukrainian work force is currently already working abroad

There are many reasons to be concerned about an Association Agreement with Ukraine, but this report focuses on one area, which is the impact that it will have on the Ukrainian economy and therefore its people at a particularly delicate political moment in the country's history. We focus on this area as the bulk of the Agreement is made up of a deep and comprehensive trade agreement, even if it is also accompanied with other agreements on foreign and security policy, financial cooperation and so on.

In preparing this report, TNI worked closely with Ukrainian researchers based at the Center for Social and Labor Research in Kiev. They have provided the original research for this report as part of a more comprehensive study that was drafted in close collaboration with the Rosa Luxemburg Foundation in Brussels. The Center for Social and Labor Research shares with the Rosa Luxemburg Foundation and TNI a strong concern for democratic, social and labour rights. Since 2013, the CSLR have been documenting growing levels of state repression of peaceful protests by Ukrainians fighting for social, economic and civil rights[1].

In our collective view, the Association Agreement's core component, the Deep and Comprehensive Free Trade Area (DCFTA), is premature and problematic and will only benefit a number of Ukraine's elite at a cost to the majority.

The DCFTA demands almost full abolition of tariffs for trade in goods, extensive liberalisation to allow for enhanced market access for European service providers, and enhanced protection for foreign investors and liberalisation of capital flows. What this means is a complete opening up of Ukraine's economy to competition from powerful European multinationals, at a time when Ukraine's domestic economy is in no condition to hold its own.

Many key sectors in Ukraine, notably industrial production, are traditionally oriented towards exporting to Russia and the other states of the Eurasian customs union, based on Russian standards of production. These sectors will struggle to reorient themselves towards exporting to the EU because standards differ widely. The economy as a whole suffers from a crisis in innovative development and requires urgent injections of capital to pay for new technologies and to modernise existing equipment. However, domestic prospects for innovative development remain limited because of cuts to research and development budgets.

While Ukraine's exports used to mainly comprise of high-tech goods destined for the Russian market, the new orientation towards the EU is already leading to a rise in the export of raw materials and agro-food products. The exports to the EU only partially compensate the loss of exports to the former Soviet states, because of the larger share of lower value added unprocessed goods . Deindustrialisation of the economy looms. The balance of payments is set to worsen, as is Ukraine's gross external debt, which rose from 88% in 2014 to 155% of GDP in 2016.

Equally, the Association Agreement is likely to harm the small business sector (SME) that constitutes 99.8% of all Ukrainian enterprises and accounts for 67.8% of employment.[2] This sector, which contains many microenterprises that cater solely to local markets, will struggle to compete with the influx of EU imports. Without access to affordable finance, they will be unable to make the transition to adapt to the rules and regulations of the EU. Here too, a foreign takeover of Ukraine's economy appears imminent.

While European companies' increased involvement in the Ukrainian economy will create some jobs, it is likely they will also be based on low wages and low social and environmental standards – that are not only below minimum standards in the EU but also frequently unenforced by the Ukrainian government.

The Association Agreement, while talking about promoting core labour standards and endeavouring to improve environmental and labour legislation, at the same time stresses that 'labour standards should not be used for protectionist trade purposes' and that the 'comparative advantage [of the Parties to the agreement] should in no way be called into question'.[3]

At the same time, both the closure of industrial enterprises as well as opening up services markets such as infrastructure, energy, transport, postal services, and other public services, will, in the short and mid-term, lead to mass layoffs that will not immediately be compensated by the creation of new jobs elsewhere. Indeed, a whole generation of older and not easily re-trainable workers may be lost, at a high social cost to society.

It is important to be aware that per capita income in Ukraine is roughly nine times lower than in Greece. Because of the significant difference in wage levels between Ukraine and the EU member states, between one third and one quarter of the Ukrainian work force is currently already working abroad. There are concerns in Ukraine that the Association Agreement will increase the outflow of highly educated workers to the EU.

So what looms is a far-reaching foreign takeover of Ukraine's economy, with European trans- and multinational corporations using Ukraine as a cheap production platform for exports back into Europe, while gaining a firm foothold in a potentially interesting future growth market.

In conclusion, the Association Agreement will benefit the 1% at the expense of the 99%, enriching a small clique of all-powerful oligarchs and a handful of multinational corporations, at the expense of ordinary people. Huge volumes of Ukraine's wealth are already siphoned off into offshore accounts: offshore capital outflow particularly to Cyprus, is estimated at hundreds of billions of dollars per annum, reaching volumes commensurate with the state budget. The Netherlands issued figures to show that the country is a large investor in Ukraine, with investment flows reaching 5.2 billion euros. However, half (!) of that amount can be traced back to mailbox companies used by one of Ukraine's biggest oligarchs to evade paying taxes at home.

Not only will the Association Agreement fail to do anything to address the systemic problems of the Ukrainian economy, plagued by dependence on exports of raw materials, high levels of tax evasion and a massive fall in investment and research, it will negatively impact on many Ukrainians who will see their wages fall and their employment becoming more precarious, while the income divide grows. These effects will be most acutely felt within Ukraine itself, but the EU-Ukraine Association Agreement adds to the cumulative pressures emanating from other controversial trade agreements the EU is concluding around the globe, including with major economic actors such as Canada and the US, that follow an entirely similar logic and have cemented the power of corporations globally.

Neither the EU nor Ukraine needs another neoliberal trade agreement benefiting corporate elites.
We need new forms of cooperation that seek to support the building of a socially just and sustainable economy for the benefit of all rather than for a select rich and powerful few.

The expected economic impact of the EU–Ukraine Association Agreement

This paper describes the current status and nature of Ukraine's economy and models the possible consequences of the Free Trade Area (FTA) that is a core component of the Association Agreement between the EU and Ukraine. The projections build on an overview of Ukraine's economic development since the early 1990s up until the signing of the Association Agreement.

A structurally weak economy

Twenty-five years of capitalist economic development, since the collapse of the USSR, have not brought Ukraine the projected benefits. Macroeconomic analysis shows that the country is in a state of constant decline: During this time, the country has lost 10%of its population, while its GDP has declined by 31%. The economy is increasingly dominated by the production of raw materials, with low levels of processing and value-added production. In the 1990s, for example, machinery and metallurgy accounted for 10 and 30 per cent of GDP respectively. But by 2000, that ratio was reversed.

The economy suffers from a crisis in innovative development, which undermines Ukraine's ability to design and introduce new technologies into the production process. Industries are increasingly operating on the basis of outdated technologies. A case in point is the ferrous metals processing industry, where outdated open-hearth steel making processes still account for 45% of production, as opposed to 20% in Russia and 7% in China.

The Ukrainian economy is also plagued by a chronic lack of investment, which has deepened in recent years: In 2014 the share of savings in fixed assets decreased to 14.2%. A healthy ratio would be 20-25%, increasing to 40% in cases of accelerated development as witnessed in modern China, or even in Belarus, where investment in tangible fixed assets in recent years reached about 37% of GDP.

An oligarchic economy

The main cause of the economy's chronic decline lies in the Ukrainian oligarchs syphoning off the country's resources through offshore zones, thus gradually increasing the external debt of both the state and the private sector. Cyprus in particular has become a preferred destination for Ukrainian oligarchs: Over the past ten years, the share of Cyprus in the structure of foreign direct investment in Ukraine increased from 14.1% to 31.7%. Ukraine's leading financial-industrial groups (FIGs) all maintain dozens of Cypriot companies, which, in their turn, own almost all large and medium industrial enterprises of Ukraine. The Netherlands are also a preferred destination for Ukraine's oligarchs. Over the last ten years, the share of direct investments from the Netherlands increased from 11% to 17% in 2015. The bulk of 'Dutch' foreign direct investments in Ukraine is made up of Ukrainian offshore capital that is partially returned to the Ukranian economy. Structuring exports through offshore firms makes it possible to legally avoid paying any income tax in Ukraine. The volume of the offshore capital outflow is estimated at hundreds of billions of dollars per annum, reaching volumes commensurate with the state budget. Losses in tax revenues are crippling.

In early 2016, Ukraine's gross external debt stood at 155% of GDP ($US 118 billion). Public debt accounted for 55.2% of the total debt. The maintenance ($US 99.1 billion) and repayment ($US 135.2 billion) of external and internal public debt will consume 35.1% of Ukraine's total expenditure in 2016. This is locking Ukraine ever deeper into a vicious circle, where repayment of outstanding loans becomes imperative to taking out new ones. At the same time, the credit rating of the state continues to fall. In December 2014, credit rating agency Standard & Poor downgraded Ukraine to the CCC-category, which includes countries with a high threat of default and with low chances of recovery.

The structural degradation of the Ukrainian economy, with its high levels of imports of goods and declining exports (made worse by the Russian Federation's inflating of energy prices by linking them to world market prices), and offshoring of capital investment has resulted in a chronically negative balance of trade: According to Ukraine's State Statistics service , the trade deficit in goods and services from 2006 to 2013 was $US 49.9 billion. This trade gap has been paid for out of gold and foreign exchange reserves, as well as through increased foreign borrowing.

This trend notably intensified after the economic crisis of 2008-2009. During the years 2014-2015 the negative balance in trade decreased to US$ 3.3 billion, but still

The role of the Netherlands in tax evasion in Ukraine

The EU plays a direct role in the high levels of Ukrainian tax evasion, albeit done entirely "legally". Two countries in particular, Cyprus and the Netherlands facilitate the channelling of funds from and to Ukraine and thus help Ukrainian oligarchs evade taxes in a 'legal' manner. In 2014 roughly half of Ukraine's FDI came from five minor nations: the Netherlands, Cyprus, Switzerland, Belize and the British Virgin Islands. These Investments equalled nearly half of Ukraine's GDP.

The Netherlands is an attractive country for foreign investors as the tax on royalties is very low. Moreover, the Netherlands has more bilateral tax treaties than any other nation, which means that companies residing in the Netherlands can transfer funds to other countries without making significant tax payments.

The Netherlands is such a popular destination for Ukrainian oligarchs to start "mailbox companies" that it is now the third biggest investor in Ukraine. In 2012, 95% of the "Dutch" investments made in Ukraine were made by these 'Special Financial Institutions'. And the Dutch Embassy in Ukraine has been unabashed in actively promoting this variant of tax evasion, organizing events for the big Ukrainian companies where they can learn how to do taxes the 'Dutch' way.

Several prominent Ukrainian oligarchs are availing themselves of Dutch mailbox companies to escape taxes at home. Rinat Akhmetov, one of Ukraine's richest businessmen, has some 7.5 billion euro lodged in Dutch mailbox companies. Akhmetov registered steel and mining giant Metinvest and energy giant DTEK – which controls 70 per cent of Ukraine's energy supply – in the Dutch city of The Hague. Alexander Janoekovitsj, the son of Ukraine's former president Viktor Janoekovitsj, who is heavily involved in public procurement contracts in Ukraine, also maintains a shell company in the Netherlands.[4]

Trade agreements like the trade section of the Association Agreement also typically arrange for freedom of capital that allows foreign investors and corrupt oligarchs alike to siphon off Ukraine's wealth and engage in tax-dodging practices, without any obligation to productively reinvest any of their gains in Ukraine itself. In fact, trade agreements by rote forbid such stipulations.

remained negative due to the decline in production and the volume of Ukrainian exports.

An economy vulnerable to external shocks

Ukraine has been engaged in recent years in opening up its economy, in particularly to the EU. This has made the Ukrainian economy more vulnerable to external shocks, as analysis of the current state of economic relations between Ukraine and the EU shows. After the formation of the Eurasian customs union and the introduction of the FTA with the EU, Ukraine's economy became increasingly trade-oriented: The share of imports and exports in the total output of goods and services in Ukraine increased significantly, from a third of GDP in the early 90s to two-thirds of GDP in the early 2000s, and still remains very high, with imports accounting for 55.4% and exports for 46.9%.
For Ukraine, which lacks the developed consumer markets of the EU member states, this has meant an overall decline in demand for Ukrainian products on the domestic market and an increasing reliance on international trade, and vulnerability to a sometimes volatile foreign economic climate. The proportion of Ukraine's steel destined for exports, for example, increased from 73% to 79%. The figures for the engineering sector are even higher. Here, the proportion of production dependent on exports increased from 49% to 74%. Ukraine's exports to the EU have increased significantly, bringing exports to the EU to a level similar to Ukraine's exports to the Russian Federation. In 2013, the share of CIS countries

Ukraine's national debt, IMF and the EU

There has been a dramatic increase in Ukraine's national debt since 2014, with the debt rising from 40.7% to 94.9% of GDP. In February 2015 the IMF stated it would loan Ukraine $17.5 billion over a four year period, as part of a bigger $40 billion financial package. This $40 billion loan package, together with an economy in free fall, augmented the Ukrainian national debt. The question remains if the Ukrainian national debt is tenable and if such a debt can be solved by additional loans.

However the debt has given significant leverage to major lenders to lead on the direction of economic policy in Ukraine. The IMF is currently the main driving force behind economic and political reforms in Ukraine. The EU together with the US has a deciding voice in the IMF and in this manner can influence the conditions the fund sets for its loans. A significant part of the IMF funds (31%) comes from EU member states. Moreover, in 2014 the European Commission stated it would only provide Ukraine with financial assistance ($15 billion), if the Ukrainian government came to a loan agreement with the IMF. Ultimately, the measures the EU requires Ukraine to comply with in the Association Agreement do not differ much from the demands made by the IMF. The politics of the IMF should thus not be considered in isolation.

accounted for about 35% of total trade volume ($US 22.1 billion of exports and $US 27.9 billion of imports), the European Union – 26.5% ($US 16.8 billion of exports and $US 27 billion of imports). The growth in exports is offset, however, by the fact that import growth rates from the EU have accelerated even faster. In the last two years, the EU overtook CIS countries as the principal trading partner. It now makes up 31.8% of Ukraine's total trade volume ($US 10.5 billion of exports and imports $US13.2 billion); CIS countries now make up 26.5% ($US 7.7 billion in exports and imports $US 11.9 billion).

It is important to note that Ukraine's exports to the EU and CIS countries are very different in structure. Exports to the CIS countries generally comprise of high-tech goods with high added value. Engineering products account for around one third. This is primarily due to the persistence of certain production chains between Ukrainian and Russian enterprises, common technical standards in aircraft, car manufacturing and heavy industry in general. The share of metallurgy, the food industry and agriculture also remains significant: Despite a number of trade wars, Ukrainian food producers still hold a significant share in various segments of the Russian market. Over half of the exports to the EU, by contrast, consist of metal products and agro-food products, in approximately equal shares. Exports of Ukrainian machinery to the EU market stand at a mere 13% of total exports. One important reason for this is the difference in the standards used in Ukraine and the EU.

Ukraine as a provider of raw materials to the EU

The structure of imports from the EU and the CIS countries to Ukraine is also very different. Imports from the CIS mostly consist of mineral products; in the imports from the EU, the largest share is taken up by machinery and chemicals. Ukraine is dependent on the supply of mineral products, especially energy resources from Russia, which constitute the majority of all imports from the CIS. Chemical products (9%) and products for machine building (10%) are also being imported in large quantities.

So as long as Ukraine agrees to engage in a dialogue on the matter, it is free to export its products to the EU. As the Association Agreement removes virtually all tariffs to free up the trade in goods between Ukraine and the EU, this opens up an attractive shortcut for transnational corporations, seeking to use Ukraine as a cheap production base where they can avoid stringent EU standards.

Engineering products and transport equipment (33%) and chemicals (28%) top the list of imports that the EU supplies Ukraine with. There has also been a noticeable increase in imports of agricultural products. Following the liberalisation of the Ukrainian market with the state's accession to the World Trade Organization in 2008, these agricultural imports rose significantly to 13%. (At the same time, the volume of agro-food imports from CIS countries increased by 23.3%).

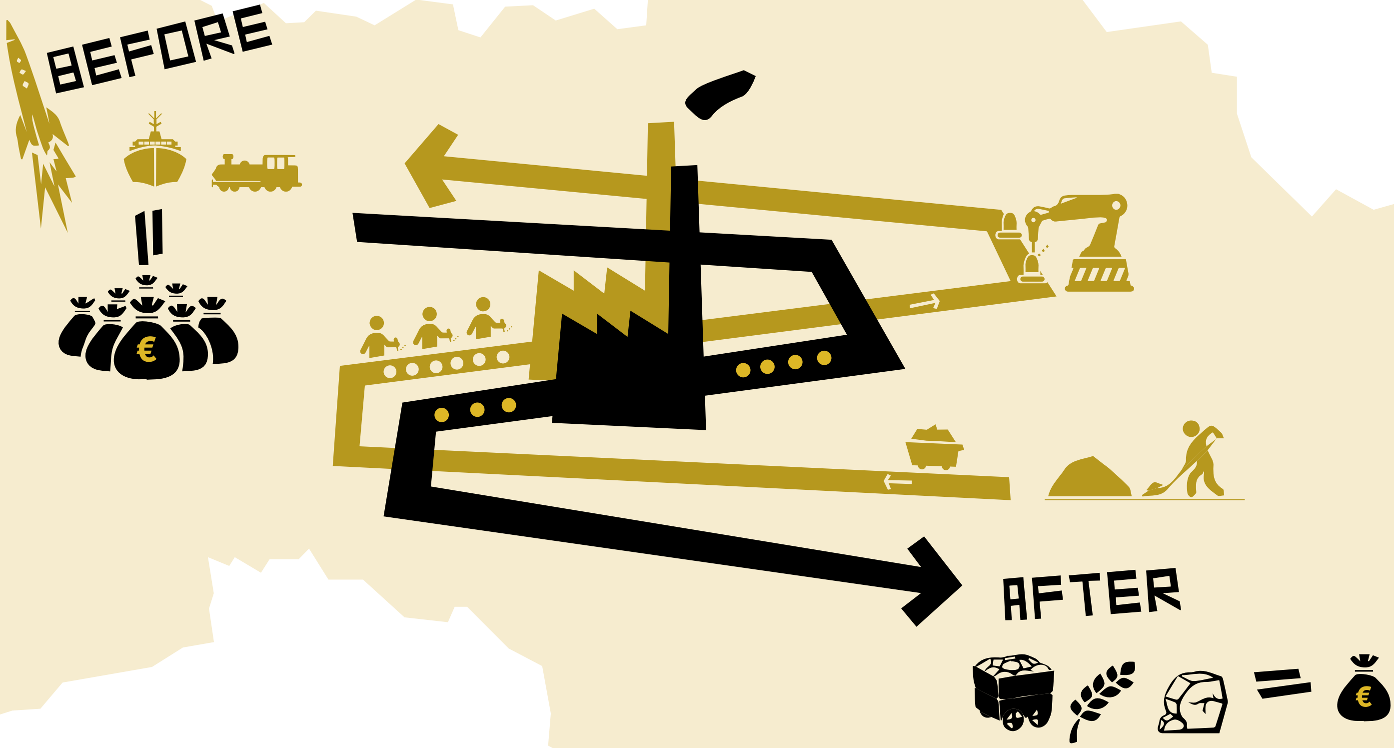
In general, the trade between Ukraine and the EU is characterised by Ukraine supplying mainly raw materials, which, after processing in the EU, partially return to Ukraine in the form of finished products. Trade relations with the CIS countries are somewhat more sophisticated, due to the persistence of established industrial relations and interdepartmental cooperation. This does not mean, however, that Ukraine can continue to rely on the preservation of these links as a long-term development strategy.

Except for a few sectors, Ukraine's CIS trade relies on the exports of Ukrainian equipment that is increasingly outdated. With the launch of large-scale import substitution programs in Russia, and in the absence of major investments to innovate Ukraine's export-oriented machine-building enterprises, the industry's decline will be only a matter of time.

Furthermore, Ukraine signing the Association Agreement with the EU has significantly aggravated tense political relations with the countries of the Eurasian Customs Union (CU), leading to dramatic changes in the volume of trade. Between 2014 and 2015 Ukraine reduced the total volume of exports to Belarus, Kazakhstan and Russia from $US 19.2 to 6.4 billion. Imports from the region also declined threefold to 62.6% (from $US 27.5 to 10.3 billion). This has only been partially compensated by growth in trade with the EU following the introduction of unilateral trade preferences in May 2014. The overall decline in exports to the two regions amounted to $US 16.5 billion Moreover , the changes threaten whole branches of Ukrainian industry, particularly the engineering sector. Exports of machinery, equipment and tools have dropped by 45%, while exports of food products to the Russian market have virtually ceased.

Imports from the Eurasian Customs Union, in particular Russia, also fell. The greatest decline was noticeable in fuel imports: the total market fell from $US17.3 to 5.8 billion. Steel imports from the CU fell fourfold (to $230m); reactors, boilers and machinery fell by 38.5% (to $851m).

It must be noted that the decline felt by Ukraine's industrial sector was aggravated by the fact that 15% of industrial production in Ukraine is located in the Donbas area, outside the control of the central government. Whether Ukraine is able to recover from this setback and how trade relations will develop remains an open question. The drastic change in political relations and the reduction of foreign trade with key trading partners has impacted negatively on domestic producers, who have lost significant markets and who, faced with conditions of weak domestic demand, will have to overcome stiff competition in the global markets to survive this crisis and stabilise production.



Impact of an FTA on Ukraine

A closer look at the potential impacts of the introduction of the free trade agreement (FTA) between Ukraine and the EU shows that the key sectors of the EU's economy remain protected against penetration by Ukrainian products. There will not be a pervasive abolition of tariffs. The FTA introduces a limited number of preferential tariff quotas – in line with the EU's approach to FTAs in association agreements. Domestic producers in Ukraine will be given a duty-free quota that will not change the current negative trade balance with the EU. In fact, several of these quotas are set far below the current volume of shipments. For corn, Ukraine's key agricultural export product – a quota of only 400 thousand tons is allocated. For comparison, the actual volume shipped in 2013 was 19 times bigger: about 7.2 million tonnes. High quotas are granted to Ukraine mainly in areas where shipments are small because domestic products are either not competitive or where the EU already imports Ukrainian products.

At the same time, Ukraine retains little opportunity to protect its domestic markets. In relation to exports, the only available tool for protection for Ukraine is to impose additional fees on import duties on raw materials for a period of up to 15 years after the Agreement's entry into force in order to encourage processing of these materials within Ukraine. However this option is available for only three product categories: raw leather, sunflower seeds and scrap. An uncontrolled growth of exports of raw materials and, consequently, production volumes, could undermine Ukraine's manufacturing industry dependent on these important raw materials. Uncontrolled growth of primary commodities can also have other costs too: for example, increasing the acreage for sunflower may lead to irreversible land degradation.

But in fact, even here the opportunities for regulating exports remain limited, because the additional charges may be levied only when the export volume exceeds the thresholds specified in the Agreement. The only real opportunities to limit exports are for raw leather, for which an adequate export quota is defined. As for sunflower seeds, the export volume threshold is set at

A new land grab

Ukraine boasts 32 million hectares of very fertile agricultural land – the equivalent of roughly one third of total arable land in the EU – that is being eyed greedily by the EU's agricultural enterprises who consider the agricultural sector as underdeveloped. The market opening for foreign investors envisaged in the Association Agreement will facilitate this. Ukraine's agricultural sector runs the risk of being taken over by foreign investors – via land lease constructions and acquisition of shares in the agricultural companies run by Ukraine's oligarchs, as well as by acquisitions in the agricultural infrastructure and processing industry. This is likely to intensify when the moratorium on outright purchase of land by foreign companies is lifted. Meanwhile, the European Bank for Reconstruction and Development (EBRD) and others are already pushing for regulatory change to make agricultural investments easier.These changes will be at the detriment of Ukrainian farmers and domestic food security, making Ukrainian consumers more dependent on imports .

They will also impact on European consumers as standards for animal welfare and so on are lowered or unenforced. EU producers are obliged to meet high animal welfare standards, for example in relation to the number of chickens that can be kept per square metre, the requirement to allow daylight into stables, etc. Ukraine does not maintain similar standards. The Association Agreement merely mentions an endeavour towards reaching a consensus on animal welfare standards, without mentioning any concrete obligations or commitments. So as long as Ukraine agrees to engage in a dialogue on the matter, it is free to export its products to the EU. As the Association Agreement removes virtually all tariffs to free up the trade in goods between Ukraine and the EU, this opens up an attractive shortcut for transnational corporations, seeking to use Ukraine as a cheap production base where they can avoid stringent EU standards.

100 thousand tonnes, which is unacceptably high, given that the actual exports to the EU stood at 54,000 tonnes in 2012, at 19,000 tonnes in 2013 and at 27,000 tonnes between January and November 2014.

Computer modelling shows costs of FTA compared to current trade arrangement

Computer modelling of the FTA implementation effects between Ukraine and the EU by industry was performed on the basis of the GTAP computable general equilibrium model, which analysed two different scenarios: unilateral market opening by the EU and a bilateral FTA between the EU and Ukraine on the terms stipulated in the agreement.

The outcomes show that unilateral market opening by the EU would benefit Ukraine in a number of ways, including: a 0.5% increase in GDP, a rise in economic welfare t of $US 253 million dollars, and expansion of exports of 0.33%, accompanied by a simultaneous increase in imports by 0.43%. However, if both sides engage in trade liberalisation under the conditions stipulated by the Agreement, the Ukraine ends up worse off. The model predicts that in the medium term, due to a significant deterioration in Ukraine's trade terms, imports will increase by 4.5%, GDP would decline by 0.8%, and the balance of trade would deteriorate by up to $US 0.5 billion dollars in 2007 prices.

Under the conditions of a bilateral FTA, only the most competitive industries would thrive. Respectively, according to the modelling results, the highest growth in Ukraine – up by 22% - is to be expected in crop production (cereals and oilseeds) and the textiles industry – +18%. This scenario has already been borne out by the actual impacts of the EU's unilateral market opening to Ukraine in 2014.

An increasing domestic demand for services has a significant limiting effect on overall exports to the EU. Under the conditions of unilateral market opening, if service consumption rises in Ukraine, this would cause a decrease in their exports to the EU (by 1.3-1.4%). Under a full (bilateral) FTA, it is quite the opposite. The increased shipments from the EU to Ukraine of meat and dairy products (+80%), seeds (+33%, although in absolute terms, we're talking small amounts, as grain imports by Ukraine are low), processed food products (+42%), light and heavy industry commodities (+27% and +32% respectively) would increase the demand for and boost the growth of services, service utilisation, utilities, etc.

The modelling results show that the largest increase in production and exports respectively due to the opening of borders in Ukraine is observed in the textiles industry – from 8.5% to 19.04% and in crop production – from 0.6% to 0.8%. For all other sectors of the economy, a recession is observed.

GTAP Model

The GTAP model is based on neoclassical micro- and macroeconomic theory. The database combines the data of bilateral trade between the two countries in 2007, and measures levels of protectionism, tariffs, transport and other indicators characterising economic relations between the regions. The main value of the model is that the basic formulas and relationships are based on the structure of economies and their comparative advantages, which makes it possible to avoid significant external factors (changes in world prices, falls in harvest, speculative movement of capital, etc.) and allows for simulating changing certain parameters in relative and absolute terms

Under a full bilateral FTA, only four sectors will experience an increase in production: crop growing, + 0.6%; textiles, + 19%; light industry, + 2.8%; and the services sector, + 0.8%. The largest decline is observed in the livestock sector: down by 1.8%. In the EU-25, the largest increase is expected in livestock (+ 0.05%), the food industry (+ 0.01%), and heavy industry (+ 0.0045%). A small decline in the output may occur in crop production (-0.023%), the extractive industry (-0.03%) and the textiles industry (-0.02), primarily due to the possible increase in imports of cheaper Ukrainian goods.

The results of our modelling exercise coincide with the major trends and predictions made by other social scientists. Practically all the known studies predict that the full (two-way) FTA (based on the draft of the actual agreement) will have a much larger impact compared with the simple (one-sided) market opening. Most of the models indicate a high competitiveness of the textiles industry, agriculture and metallurgy.

The general perspectives for agriculture and mining look more pessimistic, where only one study sees opportunities for a slight increase in output, while the other two predicting a decline, which, in one case, would be substantial.

Overall, the analysis of the results of our own computer modelling and the findings of other studies into the potential effects on macroeconomic dynamics and socioeconomic development of the Agreement's coming into force leads to the following conclusions:

1. **An FTA will lead to significant short-term losses for Ukraine.** Long-term gains would only be possible if Ukraine manages to increase its productivity and its efficient use of inputs through increased imports of new technologies and the modernisation of existing equipment. Only in such conditions could better access to high-developed market of the European states contribute to the further development of Ukraine. Equally, the assessment of the Association Agreement's impacts on general welfare does not take into consideration either the possible aggravation of Ukraine's structural economic crisis, nor the further increase in income inequality and income differentials, that would increase social tension and cause further instability in society.

2. **The dominance of raw materials and low-processed goods in the structure of Ukrainian exports will increase.** Given that the global demand for commodities tends to volatility within the global business cycle and, in the case of agricultural crops, depends on harvests in other countries, the vulnerability of the Ukrainian economy will increase. Fluctuations in external demand create instability and make it difficult to predict the export revenues for specific sectors and the economy as a whole. Ukraine would do well to channel a large part of capital incomes from the exports of raw materials and semi-finished products to strengthen the position of its existing businesses through the modernisation of old plants and the construction of new plants, production lines, and elevators and the purchase of high-tech equipment, such as combines, cranes, etc., as well as to invest in other sectors, including electrical equipment manufacturing, precise measuring instruments, and the development of space industry.

3. **The projected increase in welfare for Ukraine is far from certain.** It depends on three main factors: Ukraine's success in improving quality & product safety standards to the European level; an increase in exports and production volumes in certain sectors (plant products, textiles); and a decrease in market prices for imported goods. However, this projected increase in socioeconomic wellbeing would be counteracted by significant losses in other sectors and the bankruptcy of a large number of enterprises.

4. **Trade liberalisation under a FTA would not solve the core problems of the Ukrainian economy, which include a structural and technological innovation crisis, the persistent rise of a class of oligarchs and offshore looting.** Instead, the FTA is likely to exacerbate the existing structural problems. The prospects of innovative development, involving advanced European technology, remains limited, and the stagnation of Ukraine's domestic scientific-technological progress reduces the chances of a successful turnaround of the economy. The agreement does nothing to limit the continuation of the plundering of the country through offshore constructions and only serves to satisfy EU and Ukrainian elites.

Opening the gates to investment lawyers and dirty energy

Ukraine sits on Europe's third-largest shale gas reserves, but exploration has come to a grinding halt with companies like Shell and Chevron pulling out as the Ukrainian civil war escalated. However, they have been granted lucrative concessions and are likely to be back as soon as circumstances allow. The Association Agreement focuses to a very large extent on energy, and it is likely with the major energy companies in mind, that the agreement contains a clause (art. 89) that makes it possible that, at a later date, an investor-state dispute settlement clause could be added to the agreement. Energy, oil and mining companies are among the most frequent users of the controversial investment dispute settlement system that allows corporations to unilaterally sue sovereign states to the tune of many millions of euros if new laws and regulations threaten to impinge on their bottom line.

Ukraine currently already maintains bilateral investment agreements with 24 of the 28 EU member states. However, these at least contain windows of opportunity to periodically renegotiate or unilaterally terminate that are lacking in investment agreements that are part of a wider trade agreement. Ukraine could be slapped with crippling investment claims as it seeks to bring, as the AA stipulates, its rules and regulations in line with the trade rules of the EU acquis.

The recent Micula-case – where Romania discontinued certain business incentives to bring its regulations in line with EU rules on state aid, but was subsequently sued and sentenced to pay compensation amounting to $US 250 million under an investment agreement - creates a precedent. In a bizarre twist of events, Romania was then ordered by the European Commission not to pay this award, because that would amount to illegal state aid.[5] Ukraine's oligarchs, who have lodged vast amounts of their capital abroad, can easily avail themselves of the opportunities offered by such investment agreements to issue claims against their own authorities.

	POSITIVE EFFECTS	NEGATIVE EFFECTS
UKRAINIAN PRODUCERS	Expansion of markets Improvement in the quality of products Increased efficiency of production Improved access to financial markets (including foreign)	Increased competition for certain types of goods Bankruptcy of enterprises as a result of changes in demand and prices for products Additional costs to increase production, promote diversification, and improve the quality of the goods
EUROPEAN PRODUCERS	Rising capital incomes from exports of goods and services Expansion of markets as a result of rising incomes in Ukraine	Increased competition in the long-term
UKRAINIAN CONSUMERS	Increased consumer choice Better quality of products in some categories More efficient use of public funds to support individual sectors (agriculture, mining industry) Expansion of export of products with high added value (long-term perspective)	Possible increase in the prices of domestic goods that are export-oriented Grains, oilseeds, ferrous metals are products with low added value; an increase in exports to the EU does not contribute to improving the structure of exports
EUROPEAN CONSUMERS	Increased consumer choice, price reduction for products (long-term perspective)	Would require increased technical assistance to Ukraine to achieve appropriate quality standards
UKRAINIAN GOVERNMENT	Gradual implementation of European principles and norms in the judicial, legislative and executive sphere Reduced government spending, due to the increasing requirements of the targeted funding	Large expenditures on the harmonisation of laws, regulations, standards, etc. Erosion of public trust in the authorities resulting from failure to prevent the negative effects of the FTA

The expected impact on the labour market and reform of the social system due to the EU-Ukraine Association Agreement

This research examines the impacts of the implementation of the Association Agreement between Ukraine and the EU on the Ukrainian labour market, labour rights and labour mobility in the context of the migration crisis. The research takes a critical perspective on the official position of the Ministry of Economic Development and Trade of Ukraine (MinEDT, 2014), which predicts economic recovery and the creation of new jobs in Ukraine.

Composition of the workforce

Ukraine's total labour force at the end of 2013 came to 22.2 million people, roughly the same as the working population of Spain. 46% of the economically active population of working age is female, 54% is male; about 70% of the workforce lives in urban areas and 30% in rural areas. The registered unemployed are 53% female, 47% male.

Over the past fifteen years, Ukraine has witnessed significant changes in the structure of employment. In 2000, industry, at 23%, was dominant in providing employment. Trade generated only 15% of jobs. But by the end of 2013, these roles were reversed, with trade now accounting for 22% of jobs, while the share of industry had declined to 16%. The share of the agricultural sector in employment also saw a slight decrease over this period, with employment figures declining from 22% to 18%. At the same time, the percentage of people employed in education (8%), health (6.7%) and in government (5.6%) remained relatively stable over the last 15 years.[6]

A significant change in Ukraine's employment structure over the last 25 years is the notable decrease in the number of trained scientists, that dwindled from 313,000 in 1990 to a mere 77,000 in 2013.

Labour market effects

Modelling of the impacts of the free trade agreement (FTA), that is an integral part of the Association Agreement with the EU, predicts a positive impact in terms of welfare gains (including real wages) in the long run, but only if the precondition of improving efficiency of production is met.

Massive layoffs are likely to occur as a result of the closure of industrial enterprises, and as a result of the implementation of the privatisation of strategic industries and infrastructure. The arrival of private capital in sectors such as power supply, transport, postal services and public services provision, may also initially result in mass layoffs. Even the experts of the Ministry of Economic Affairs admit that there is a possibility of cuts in personnel in the postal network USEP "Ukrposhta". Layoffs will also be felt in the railway services if Ukrainian railways are privatised. Similarly, an outflow of skilled labour from a number of sectors should be anticipated, with skilled professionals and managers from Ukraine trying their luck abroad.

Labour laws

Violation of labour laws is rife in Ukraine's labour market. According to the Ministry of Economic Development, 85% of inspected employers violate labour laws. About a third of employers violate the norms for working hours and employees' annual paid leave entitlements; a significant number of employers fail to conclude contracts with employees; one in six entrepreneurs do not comply with compulsory state social insurance schemes. The state is consistently unable to enforce the law, which means that basic rights, such as the right to strike, are not guaranteed and the risk of labour law violations is infinitely higher than in the EU.

Undeclared wages

Wage payments on a 'cash in hand' basis, or even on a debit card but labelled 'transfers not related to business', constitute the most widespread form of labour law violation. Employers widely engage in such practices to avoid paying taxes.
Most common is a combination of regular wages and cash in hand payments, where an employee is officially

Conditionality and austerity politics: a coherent IMF and EU approach

The IMF attaches strict conditions to its loans, requiring radical cuts on state expenditures such as social security and healthcare combined with the liberalisation of trade and its markets opening its borders to foreign investors. To ensure Ukraine truly implements the reforms the IMF pays its loan in parts and stalls its payments if progress is not sufficient. For example, one condition Ukraine has to comply with before the IMF will transfer the third payment is the reduction of its national debt, This forced Ukraine to make a deal with the private creditors for debt relief.

The final deal involved a discount of $2.9 billion and a four year delay in payments in exchange for a 0.5 higher interest rate (from 7% to 7.5%) and Value Recovery Instruments (VRI). These VRI mean that if Ukraine were to experience economic growth in the near future, investors could claim a percentage of that growth. Specifically, if between 2021 and 2040 Ukraine's GDP grows by more than 3 per cent, investors can claim 15 per cent of that growth. If Ukraine would grow by more than 4 per cent, they would be entitled to up to 40 percent.

The budget in 2016 continues the line of austerity demanded by the IMF. Its main components are austerity, reforming the tax system and "promoting a climate of entrepreneurship". Accordingly the government has raised excises on tobacco and alcohol as well as taxes on lower incomes from 15% to 18%. However at the same time they abolished the import tax and halved the social security payments required of corporations.

The biggest cuts were made in education, healthcare and social security; the only categories in which expenditures rose were administrative costs, defence and interests payments. The politics of the IMF have sparked considerable popular resistance. In fact, the Poroshenko government was initially unable to pass the 2016 IMF-inspired budget in parliament. It took the pressure of the G7 and the IMF, who threatened to stop their financial aid, to finally pressure the Ukrainian parliament to approve the budget.

employed at the minimum wage, which is topped up with regular undeclared payments that often greatly exceed the employee's official wage earnings.

Natalia Jaresko, Ukraine's Minister of Finance estimates the amount of undeclared payments at around 200 billion Ukrainian Hryvnia (UAH) per annum (equivalent to $US 7.6 billion)[7]. For comparison, the total official payroll in 2013 was only 398 billion UAH. A quick calculation thus shows that the "black" payroll in Ukraine makes up at least 30% of the total payroll.[8]

The figures for completely illegal employment in Ukraine are estimated at 8% (ILO) to 20% . This indicates that the practice of combining legal and illegal wages is much more widespread - and may significantly exceed 50% for certain categories. For example, an estimated 75% of white-collar office employees receive "black" money.[9]

SMEs

The Association Agreement is unlikely to trigger a rapid development of small and medium-sized Ukrainian businesses. To withstand increased competition from large EU producers of goods and services (supermarkets, dry-cleaners, used cars sellers), Ukrainian business will need money to invest. The promised benefits of a reduced administrative burden on businesses is a false one: the transition to conform to the rules and regulations of the EU will be time-consuming and costly. Small and medium-sized businesses do not have sufficient access to cheap credit to successfully complete this transition. Production costs are likely to rise and producers are expected to shift these costs onto consumers, thus eroding their earnings and offsetting any welfare gains from the Association Agreement. While administrative barriers may be reduced, the reduction in purchasing power of Ukrainian citizens as a result of the FTA with the EU will erect new economic barriers to business.

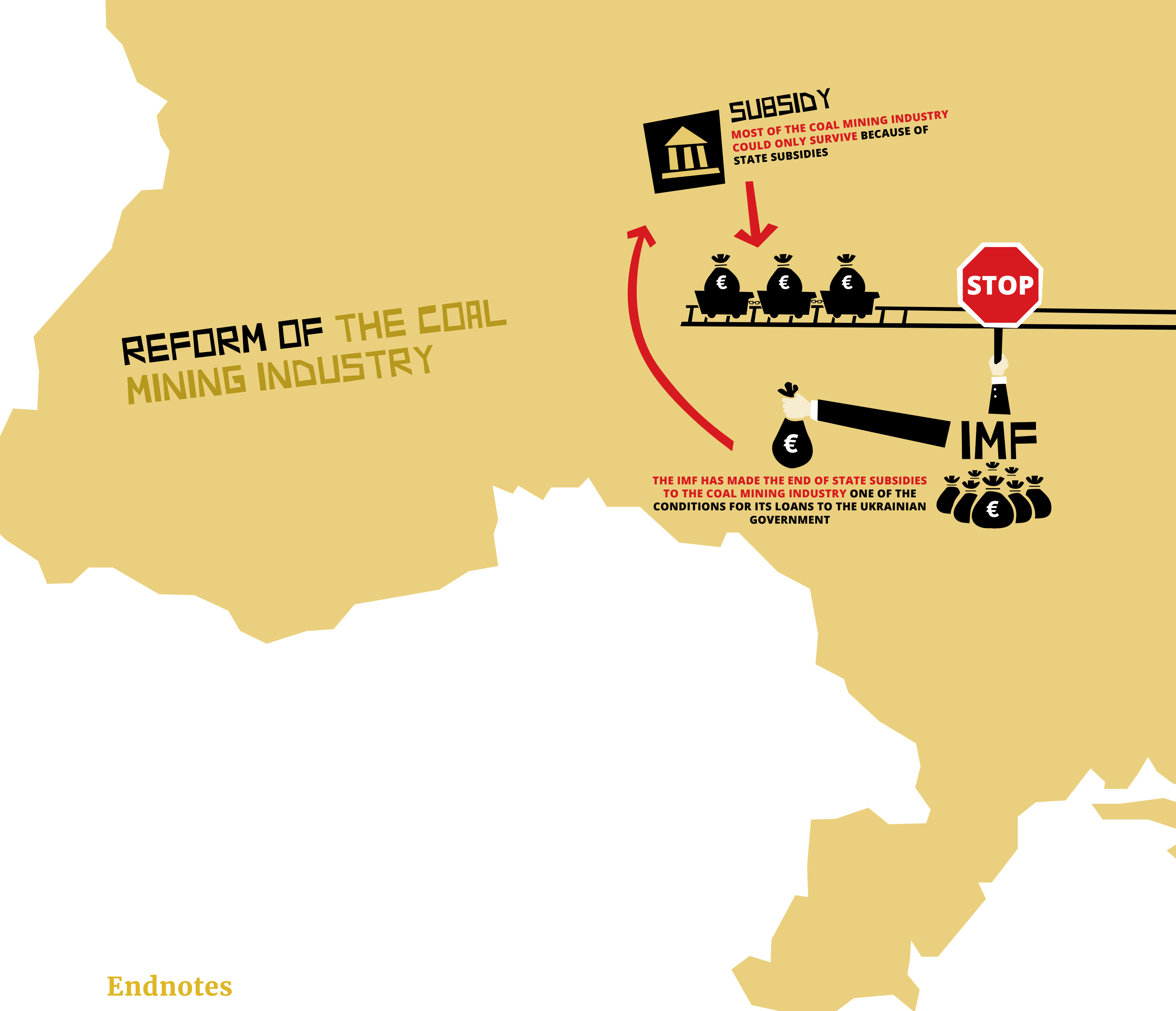
Migration

According to the International Organization for Migration and the World Bank, between 6.5 and 8 million Ukrainians are currently working abroad. That amounts to roughly one-third of the working population. Making it easier for Ukrainians to travel to and from the EU, is likely to set in motion additional waves of migration, as workers, attracted by the large differences in wage levels or driven away as large industrial enterprises go bankrupt, try their luck abroad. Many of these migrants could end up as illegal workers in the EU member states.

Labour rights

The EU prides itself that the Association Agreement will improve social conditions in Ukraine, because Ukraine will have to adopt EU standards.
Ukraine will be required to implement EU Directives that: ensure the adequate protection of workers' rights under an employment contract; prescribe informing and consulting employees; regulate the protection of employees in companies that change owners; provide protection of safety and health of workers on fixed-term contracts, as well those on temporary contracts or fully employed; protect against discrimination in the employment sphere on the basis of religion, sexual orientation, age, or gender, including in relation to access to social security services; and finally protect against discrimination of legal persons based on race or ethnic background.
However, there are a number of caveats. Close analysis shows that the bulk of the EU's social clauses are phrased as aspirations and endeavours, and only a few would actually improve domestic labour laws. Moreover, the EU directives allow for the collective dismissal of workers; reduce supervision over and regulation of the activities of non-state pension funds; as well as weaken provisions for the health and safety of pregnant women and nursing mothers and provisions regarding parental leave, setting the provisions at a lower level than stipulated by Ukraine's current legislation.

Maintaining that incorporation of the EU directives into Ukraine's national legislation as stipulated by the Association Agreement would constitute across the board improvement of Ukraine's existing social and labour standards seems to be more a projection of belief and propaganda by the EU than an issue of fact. Instead, Ukraine would appear to be better off by maintaining its current provisions and incorporating only those EU rules and regulations that would actually and specifically improve current levels of protection.



Endnotes

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CLOSED
DUE TO CUTS IN STATE SPENDING SCHOOLS AND MINES ARE FORCED TO CLOSE
MINERS LOSE THEIR JOB
SOCIAL EXPLOSION
IN MANY REGIONS THE WAGES OF THE COALMINERS ARE THE MOST IMPORTANT SOURCE OF INCOME THAT KEEP THE LOCAL ECONOMY AFLOAT. WITH THESE GONE, THERE WILL BE DRAMATIC CONSEQUENCES FOR THE REGIONS INVOLVED.

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