



Brussels, 6 July 2016  
(OR. en)

12919/06  
DCL 1

PESC 872  
COEST 231  
NIS 109  
JAI 448  
WTO 150  
ENER 210

### DECLASSIFICATION<sup>1</sup>

---

of document: ST 12919/06 RESTREINT UE

dated: 18 September 2006

new status: Public

---

Subject: Recommendation from the Commission to the Council authorising the Commission to open negotiations with Ukraine for a new Enhanced Agreement – Impact Assessment and Summary of the Impact Assessment

---

Delegations will find attached the declassified version of the above document.

The text of this document is identical to the previous version.

---

<sup>1</sup> Document declassified by the European Commission on 5 July 2016.

# RESTREINT UE



**COUNCIL OF  
THE EUROPEAN UNION**

**Brussels, 18 September 2006**

**12919/06**

**RESTREINT UE**

<b>PESC</b>	<b>872</b>
<b>COEST</b>	<b>231</b>
<b>NIS</b>	<b>109</b>
<b>JAI</b>	<b>448</b>
<b>WTO</b>	<b>150</b>
<b>ENER</b>	<b>210</b>

## **COVER NOTE**

---

from: Secretary-General of the European Commission,  
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 18 September 2006

to: Mr Javier SOLANA, Secretary-General/High Representative

---

Subject: Recommendation from the Commission to the Council authorising the  
Commission to open negotiations with Ukraine for a new Enhanced Agreement  
– Impact Assessment and Summary of the Impact Assessment

---

Delegations will find attached Commission documents SEC(2006) 1110 and SEC(2006) 1156.

---

Encl.: SEC(2006) 1110 and SEC(2006) 1156



**RESTREINT UE**  
COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 13.9.2006  
SEC(2006) 1110

EU RESTRICTED

COMMISSION STAFF WORKING DOCUMENT

**RECOMMENDATION FROM THE COMMISSION TO THE COUNCIL**

**authorising the Commission to open negotiations with Ukraine for a new Enhanced Agreement**

**IMPACT ASSESSMENT**

{SEC(2006) 1105 final}  
{SEC(2006) 1156}

DECLASSIFIED

# RESTREINT UE

## TABLE OF CONTENT

<a href="#">Introduction</a>	3
<a href="#">1. Issues that the proposal is expected to tackle</a>	3
<a href="#">2. Main objective that the proposal is expected to achieve</a>	5
<a href="#">3. Main policy options available to achieve the objective</a>	6
<a href="#">4. Expected impacts from the selected option</a>	8
<a href="#">4.1. Impact assessment methodology</a>	8
<a href="#">4.2. Sources available for impact assessment</a>	8
<a href="#">4.3. Results of the impact assessment</a>	9
<a href="#">4.3.1. Starting point – overall political and economic assessment of the present situation</a>	9
<a href="#">4.3.2. Possible impact of a comprehensive Enhanced Agreement (Option One)</a>	14
<a href="#">4.3.2.1. Economic impact</a>	14
<a href="#">4.3.2.2. Social impact</a>	15
<a href="#">4.3.2.3. Environmental impact</a>	16
<a href="#">4.3.3. Summary of the expected impact of the selected option on factors</a>	16
<a href="#">5. How to monitor and evaluate the results and impacts of the proposal after implementation?</a>	17
<a href="#">6. Commission proposal</a>	17

# RESTREINT UE

## INTRODUCTION

This impact assessment refers to a Commission Recommendation to the Council to authorise the Commission to open negotiations with Ukraine on a new Enhanced Agreement. This Recommendation contains negotiating directives, on the basis of which the Commission would be authorised to negotiate a comprehensive agreement which reflects the existing wide range of economic and political cooperation and develops these areas further, including the establishment of a deep and comprehensive Free Trade Area (FTA).

As such, the proposal covered by this impact assessment does not constitute a legislative proposal and does not prejudge the exact text of the agreements to be negotiated. In particular, the level of commitments included in the agreement will ultimately depend on the outcome of the negotiations. This impact assessment will therefore be based on the assumption that the negotiations will be successful and that the agreement will be drawn up according to the proposed negotiating directives. In application of the principle of proportionality, it will only give a first outline of what the impact of such an agreement could be. A more complete assessment of the impact of such an agreement, notably in the economic and trade area, will not be possible until negotiations have started and each side has a better idea of potential commitments. This assessment will take the form of a Sustainability Impact Assessment (SIA), which will be launched during the start-up phase of the negotiations and to which all relevant Commission services will be closely associated.

This report takes account of the Commission Communication on impact assessment, the Commission's internal guidelines on the impact assessment procedure and the Commission's 2006 work programme. In the economic and trade area it also takes into account a recently finalised report on the possible impact of an FTA between the EU and Ukraine (the CEPS 2006 report)<sup>2</sup>.

### 1. ISSUES THAT THE PROPOSAL IS EXPECTED TO TACKLE

The existing legal basis for the EU's cooperation with Ukraine is the Partnership and Cooperation Agreement (PCA), which entered into force on 1 March 1998 for an initial 10-year period and will be automatically renewed if no party requests otherwise. While it is comprehensive in its scope, covering all traditional areas of cooperation, including political dialogue, trade in goods and services on a non-preferential basis, business, investment, and various sectoral policies (such as transport, energy, environment), "new areas", such as JFS, are

---

<sup>2</sup> "The prospect of deep free trade between the European Union and Ukraine"; Centre for European Policy Studies, Brussels; Institut für Weltwirtschaft, Kiel; International Centre for Policy Studies, Kiev; Brussels 2006.

## RESTREINT UE

only partially covered, and the ambition in the traditional areas is somewhat limited.

The Enhanced Agreement between the EU and Ukraine is envisaged as a comprehensive agreement, both in economic and political areas and on sectoral policies, and further develops these areas. Wherever possible, it will go above and beyond the existing PCA commitments.

The proposal is that the Enhanced Agreement should provide for:

- a firm commitment to and institutionalised dialogue on common values, notably democracy and the rule of law, sustainable development, respect for human rights and fundamental freedoms, including the rights of persons belonging to national minorities, good governance and a market economy;
- enhanced cooperation in foreign and security policy, with the focus on regional issues, WMD, non-proliferation and disarmament, conflict prevention and crisis management;
- a comprehensive and deep FTA with the EU: the FTA will aim to improve market access for goods and services, covering substantially all trade, and will provide for enhanced provisions on trade in goods and services, including binding provisions on gradual approximation with the EU in regulatory areas relevant to mutual trade and investment, with standards and conformity assessment, sanitary and phytosanitary rules, intellectual property rights, trade facilitation, public procurement and competition. The FTA should also include strong provisions on trade-related energy aspects, including on investment and transit. The FTA will be fully WTO-compliant, will build upon the EU-Ukraine Action Plan, and will bring Ukraine's regulatory system as close as possible to the EU's;
- enhanced cooperation in key areas of overall economic relations, business cooperation, sustainable development, public finance, macroeconomic stability, and employment and social affairs;
- enhanced relations in energy (including nuclear safety), building on the existing EU-Ukraine Memorandum of Understanding, with particular attention to issues concerning security of supply and the gradual approximation and integration of energy markets;
- enhanced cooperation in other key sectoral policy areas, including transport, environment and public health, science and technology, education and culture, and information society and media;
- enhanced cooperation in the field of justice, freedom and security, based on the JFS Action Plan, covering the rule of law, data protection, migration,

## RESTREINT UE

money laundering and financing of terrorism, illicit drugs, the fight against organised crime and counter-terrorism;

- commitments of Ukraine regarding the implementation of the Agreement; in particular ensuring that Ukraine's administrative and institutional infrastructure will be able to deliver and enforce what has been agreed; and
- institutional structures, which will build on and further develop existing structures that are working well.

Existing and future sectoral agreements (for example, on civil aviation) will be legally linked to the overall framework provided by the Enhanced Agreement. Accordingly, the Agreement will go substantively beyond existing cooperation and trade agreements. It will be innovative in that it will develop binding, rules-based provisions and cooperation arrangements further than in traditional agreements. And it will be comprehensive in that it will cover all areas of interest. The Enhanced Agreement will provide a long-term basis for future EU-Ukraine relations, but stop short of offering the prospect of accession, without prejudging any possible future developments in line with the Treaty.

In terms of timeframe of the Enhanced Agreement, it is proposed to have in principle unlimited duration of the agreement. At the same time, a review clause and the possibility of termination after notification will provide for the necessary room for manoeuvre.

### 2. MAIN OBJECTIVE THAT THE PROPOSAL IS EXPECTED TO ACHIEVE

In line with the European Neighbourhood Policy, the underlying objective of the proposal is to enhance links between the EU and Ukraine across the board through deeper political, economic, cultural, security and sectoral policy cooperation, thereby strengthening stability, security and well-being for all concerned.

The approach is founded on shared values and joint ownership. It will support Ukraine's objective of further integration into European economic and social structures.

The proposal relates to the conclusions on Ukraine adopted by the General Affairs and External Relations Council (GAERC) on 21 February 2005, which decided "to initiate early consultations on an enhanced agreement between EU and Ukraine, to replace the Partnership and Cooperation Agreement at the end of its initial ten-year period, as soon as the political priorities of the ENP Action Plan have been addressed." It was understood that free and fair parliamentary elections in 2006 were a key factor in this context. The conclusions also referred to "an early start of negotiations [on a Free Trade Area] once Ukraine has joined

## RESTREINT UE

the World Trade Organisation". The wording of these conclusions was reflected in the statement by the EU-Ukraine Summit in December 2005.

The proposal also responds to one of the priorities of the EU, which is also part of the annual political priorities set for 2006 in the Annual Policy Strategy (APS) Decision of the Commission (COM(2005) 531), where under neighbourhood policy it is clearly stated that the Commission "will prepare the ground for a renewed institutional arrangement with...Ukraine, including looking towards a free trade agreement with Ukraine" (ref. No 2006/RELEX/019).

### 3. MAIN POLICY OPTIONS AVAILABLE TO ACHIEVE THE OBJECTIVE

There are four possible options which could enhance the links between the EU and Ukraine, albeit at different levels:

- Negotiation of an Enhanced Agreement, including a deep and comprehensive FTA and comprehensive cooperation in political, economic and sectoral policy areas, as proposed by the Commission.
- Negotiation of an Enhanced Agreement, including a shallow FTA and less ambitious cooperation provisions.
- Negotiation of a general enabling framework agreement.
- Extension of the PCA, including upgrading of cooperation under the existing framework.

The first option corresponds to the proposal as described above. It is therefore the scenario which is analysed in most detail.

The second option would focus on the possible impact of a shallow FTA, which would cover only free trade in goods and services, without as much emphasis on regulatory approximation as the first option. Political, economic and sectoral policy cooperation would be reduced, following broadly the existing PCA framework and extending not much further than the cooperation under the EU-Ukraine Action Plan, including the JFS Action Plan.

Compared to option one, a less ambitious enhanced agreement would continue to have a positive economic impact, but of a much more limited nature. The immediate, short-term gains for the EU would most likely be insignificant, while positive dynamic effects in the medium term may stem from an increase in bilateral trade. Compared to option one, the loss of the regulatory approximation process would entail still positive, yet substantially reduced economic effects for Ukraine since there would be no need for reforms to be put into place in order to implement the agreement. The degree of economic integration resulting from



## RESTREINT UE

this option, therefore, will be significantly lower than from option one. The same goes for social and environment aspects. Under this option, overall cooperation in environmental and social areas would be scaled down compared to option one. Therefore, the limited impact in the economic and trade area would be compounded by the decrease in cooperation activities.

The third option would be a further reduced agreement, which would only focus on an overall enabling framework without any more detailed provisions. Cooperation would be largely based on joint documents drafted after the entry into force of the agreement. Some aspects (such as trade) would need to be negotiated later. This type of agreement would be a kind of “shell” in essence, providing flexibility but lacking in commitment.

The fourth option would leave the existing PCA untouched, enabling both Parties to continue cooperation on this basis. It would make full use of the various evolutionary clauses that the PCA contains. It could include negotiations of a separate FTA at a later stage. The present Action Plan would be regarded as a sufficient basis for cooperation within the overall legal framework provided by the PCA and would be developed and upgraded on the basis of the PCA.

The impact of options three and four would be, at least in the short to medium term, very similar since in both cases the EU and Ukraine would continue their bilateral relations without any additional legally binding commitments. In terms of economic and trade impact, the current EU trade regime, based on a combination of the most favoured nation regime and the General System of Preferences (GSP), would be extended. Once Ukraine becomes a WTO member, the bilateral legal framework for trade and economic issues would be outdated; it would not have significant added value and would have very limited economic impact.

In terms of social and environmental impact, both options would build on existing cooperation, which has been deepened since the adoption of the EU-Ukraine Action Plan. However, neither option would include any significant new initiatives, in areas such as energy, regulatory reforms and environmental and social standards. The impact compared to option one would therefore be much reduced, particularly in the medium to long term.

Although options two to four could be seen theoretically as valid alternatives to option one, the fact of the matter is that due to political commitments, including the GAERC conclusions of February 2005 and the statement of the EU-Ukraine Summit in December 2005, they are not politically realistic, especially the third and fourth options. The assessment therefore analyses option one only, which forms the proposal for the negotiating directives.

# RESTREINT UE

## 4. EXPECTED IMPACTS FROM THE SELECTED OPTION

### 4.1. Impact assessment methodology

According to the Commission Communication on impact assessment, the type of impact which a policy proposal has on particular groups, sectors or regions should be expressed as far as possible in economic, social and environmental terms. As explained in the introduction, the proposal to be assessed does not consist of a fully-fledged normative text, but of negotiating guidelines. Therefore, it is difficult at this stage to prejudge the level of commitments the parties are likely to undertake. Given the proposed unlimited duration of the agreement, with the possibility of termination after notification, and the intention to hold regular reviews, the Enhanced Agreement will offer an in-built flexibility, which makes it even more difficult to foresee at this stage detailed commitments for a specific period of time.

The assessment is mostly based on a qualitative methodology, but it also takes account of the quantitative conclusions of the CEPS 2006 report. It systematically analyses the economic, social and environmental consequences of the selected option. It compares the impacts of the first two options in a matrix and summarises the reason why the Commission has chosen option one in its recommendation to the Council.

Stakeholder consultations have been limited, due to the confidential nature of a draft negotiating directive. In addition to the regular dialogue with Member States in the context of the Council Working Group and informal contacts with Ukraine, exchanges on the general nature of a successor agreement to the PCA have been held in seminars and conferences organised by think tanks and research institutions.

### 4.2. Sources available for impact assessment

General sources include regular political and economic reports on Ukraine, existing and draft Country Strategy Papers and an assessment of the implementation of the Action Plan. Furthermore, the results of cooperation and dialogue with Ukraine in the Summit, the Cooperation Council, the Cooperation Committees and the various Subcommittees provide important background material for the analysis. The experience of previous negotiations (the PCA) is also useful when assessing the practicalities of the various options considered. The economic, environmental and social impacts of liberalisation of trade in goods, services and investment have been the subject of many studies, whether in the academic field, in the framework of multilateral/regional institutions (the WTO, the World Bank, the OECD) or in the context of the Sustainability Impact Assessments (SIAs) launched by the Commission for all its major negotiations.

In the more specific case of Ukraine, the CEPS 2006 report assessed the impact of an FTA and economic cooperation. Other reports, including, for example, the

# RESTREINT UE

May 2006 report on the EU Justice, Freedom and Security Assessment Missions to Ukraine, have provided useful input for the assessment.

Finally, feedback from stakeholders has been useful for this impact assessment. In particular, informal consultations with the Ukrainian mission and talks with Ukrainian experts on political, economic and sectoral policy matters have given good insight into the positions of the Ukrainian counterparts. More general consultations with European and Ukrainian business representatives have contributed to a better understanding of general and particular concerns (e.g. in the area of intellectual property rights and public procurement). Further consultations are foreseen in parallel to the negotiations, including with NGOs and research institutes, in particular when carrying out the Sustainability Impact Assessment.

## **4.3. Results of the impact assessment**

### *4.3.1. Starting point – overall political and economic assessment of the present situation*

Ukraine's political and security situation is influenced by its geographical location between Poland, Romania and Moldova in the west, Belarus in the north and Russia in the east. Russian political, economic and cultural influence has remained strong since the country gained independence in 1991, after the break-up of the Soviet Union. Russian influence is particularly marked in the eastern regions, where most of the Russian community, which makes up about 20% of the Ukrainian population, live.

The Orange Revolution has paved the way for significantly stronger relations between the EU and Ukraine and, most importantly, put Ukrainian foreign policy firmly on track towards "Euro-integration". Ukraine's efforts to help Moldova settle the Transnistria conflict, which continues to call into question Moldova's territorial integrity and also challenges Ukraine's security, are helping significantly to enhance the security of the neighbourhood of the EU.

Substantial progress has been achieved by Ukraine in areas covered by the EU-Ukraine Action Plan, such as freedom of the media, freedom of expression, further development of civil society and the holding of the first truly free and fair parliamentary elections in Ukraine on 26 March 2006. Nevertheless, there are a number of outstanding issues which need attention: continuation of economic and judicial reforms, strengthening of the rule of law and the fight against corruption, this being closely connected to the need to improve the business and investment climate.

The Ukrainian economy declined dramatically after independence but economic output began to recover in 2000, thanks both to a favourable external environment and to a number of improvements in government policy. However, Ukraine's growth lacks sustainability and reveals the weak underlying economic

## RESTREINT UE

and institutional structures. Problems include various inflationary pressures caused by loose macroeconomic policies, a poor business environment, significant regional disparities and incomplete structural adjustment. In 2005, the situation was worsened by a drop in steel prices and higher energy costs. In addition, cutbacks in public investment together with continuing uncertainty about policy interventions caused a substantial fall in investment demand.

On the positive side, macroeconomic stability has been helped by sound fiscal policies, as the large budget spending was offset by higher than expected budget revenues. Also, the privatisation of large companies in the steel and banking sectors provided inflows for the budget. Inflation slowed down despite a pessimistic expectation of accelerating CPI growth but will remain a challenge in view of high money growth and the increase in gas prices.

<b>UKRAINE - Main Economic Indicators</b>			
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Real GDP growth (%)	9.6	12.1	2.6
Nominal GDP (USD billion)	49.5	65.1	82.9
Inflation (period average)	5.2	9.0	13.5
Unemployment (ILO definition)	9.1	8.6	7.2
Population (millions)	47.6	47.3	46.9
General government balance, % of GDP	-0.9	-4.4	-2.9
Total fiscal revenues, % of GDP	35.9	35.0	39.7
Gross public debt, % of GDP	27.7	25.1	19.0
Exports of goods and services (USD billion)	28.9	41.3	44.4
Imports of goods and services (USD billion)	27.7	36.3	43.7
Net foreign direct investment, % of GDP	3.0	2.6	9.0
Current account balance, % of GDP	5.8	10.6	3.1
Gross international reserves (months of imports)	2.4	2.6	4.9
Sources: DG ECFIN / national authorities			

## RESTREINT UE

The 2004 enlargement has brought Ukraine considerably closer to the EU in geographical and economic terms. Ukraine's external trade volumes have increased appreciably in recent years. In particular, trade turnover increased by 32 and 34% y/y in 2003 and 2004, respectively, and by 14% y/y in 2005. Over that period, Ukraine's main trading partners were Russia and the EU-25. However, while the share of the latter has grown rapidly over the past three years (from 23% in 2003 to 30% at the end of 2005), Russia's share remained unchanged at 28-29% of Ukraine's total external trade.

### EU trade with Ukraine in 2005: EU imports

Products by order of importance	(Site Sections)	€ million	%	Share of total EU imports
TOTAL		7 666	100.0	0.7
Manuf. goods classif. chiefly by material		2 415	31.5	2.1
Crude materials inedible, except fuels		1 171	15.3	2.6
Mineral fuels, lubricants and rel. materials		1 048	13.7	0.4
Machinery and transport equipment		588	7.7	0.2
Miscell. manuf. articles		582	7.6	0.3
Chemicals and related prod., n.e.s.		499	6.5	0.5
Food and live animals		445	5.8	0.8
Animal and vegetable oils, fats and waxes		160	2.1	3.9
Commodit. and transactions n.e.c.		49	0.6	0.2
Beverages and tobacco		15	0.2	0.3

## RESTREINT UE

EU trade with Ukraine in 2005: EU exports

Products by order of importance	(Site Sections)	€million	%	Share of total EU exports
TOTAL		13 033	100.0	1.2
Machinery and transport equipment		5 765	44.2	1.2
Manuf. goods classif. chiefly by material		2 087	16.0	1.6
Chemicals and related prod., n.e.s.		1 997	15.3	1.2
Miscell. manuf. articles		1 489	11.4	1.2
Food and live animals		507	3.9	1.4
Crude materials inedible, except fuels		209	1.6	1.1
Mineral fuels, lubricants and rel. materials		165	1.3	0.4
Commodit. and transactions n.e.c.		155	1.2	0.5
Beverages and tobacco		109	0.8	0.7
Animal and vegetable oils, fats and waxes		26	0.2	1.1

In general, sustainable economic growth is linked to the success of the government in implementing much needed reforms, and increasing credibility in the eyes of both investors and consumers. The government's failure to accomplish reforms would also keep Ukraine vulnerable to external political and economic pressure, thereby threatening the prospects of growth sustainability. In this context, Ukraine's accession to the WTO will be an important step towards further enhancing trade and attracting investment.

Growth prospects for the near future will vitally depend on the rise in gas prices. Given that real GDP growth in January-May 2006 was 4 percent year-on-year, real growth forecasts for 2006 range around 2.6 percent. As the 2006 budget was built on unrealistic expectations of 7% GDP growth and unchanged gas prices, the budget deficit may go beyond the projected 2.5% GDP in 2006. The medium-term prospects of economic growth depend to a large extent on the government's success in steering structural adjustment away from large-scale heavy industry towards medium/smaller-scale manufacturing and services. In addition, a process of regulatory approximation with the EU would allow Ukraine to maximise the success and sustainability of its economic transition.

## RESTREINT UE

Radical improvements in the business environment are needed to encourage small businesses to develop within the formal rather than the shadow economy, thereby raising tax revenues. The creation of new jobs, for example in the services sector, is needed to balance the long-term decline of the heavy industry, particularly in the eastern regions. Investment in resource-efficient technology, with the focus on energy efficiency, must be seen as a top priority.

Unfortunately, Ukraine also faces a number of social, demographic and environmental challenges in its effort to achieve sustainable development. The sharp decrease in the birth rate (aggravated by increased infant and child mortality since the break-up of the USSR) worsens the consequences of the current age pyramid, and the financing of the pension system is a major challenge which threatens to derail the entire public budget. Ukraine also suffers from HIV/AIDS spreading at a high rate, which threatens Ukraine's socio-economic growth and could undermine the entire health system. Health and education systems need reform and modernisation.

Although poverty has been reduced appreciably since 1999,<sup>3</sup> Ukraine has not yet managed to fully address the social consequences of the transition from the Soviet regime and some parts of Ukrainian society still remain very vulnerable. If economic growth does not achieve a sufficient level in 2006, poverty may stop decreasing or even rise again, notably within the most vulnerable layers of society.

The key environmental issues in Ukraine relate to air and water quality, waste management, nature protection and radiation contamination in the north-eastern part of the country. Air pollution is becoming a health and social problem. With regard to water quality, the Dnieper, which supplies three quarters of Ukraine's fresh water, is heavily polluted. The Crimea suffers from water supply shortages. International cooperation to address environmental concerns in the Azov Sea and the Black Sea areas needs to be enhanced. Existing waste water collection and treatment infrastructure needs to be upgraded and new capacity constructed. Waste management is a serious problem, including prevention, collection, treatment, recovery and final disposal. Large amounts of hazardous waste have been generated, in particular mining waste. As regards nature protection, deforestation and illegal logging are giving rise to economic and health costs.

As regards global environmental issues, Ukraine has shown a keen interest in climate change, in particular the possibilities of using the flexible mechanisms under the Kyoto Protocol, which Ukraine ratified in April 2004. Ukraine has entered into a binding commitment to freeze its greenhouse gas emissions at the 1990 reference level by 2008–2012.

---

<sup>3</sup> The percentage of the population living under the poverty threshold declined from 30% in 1999 to 19% in 2003 /WB Study, 2005 *Ukraine: Poverty and Inequality in a Growing Economy*.

## RESTREINT UE

### 4.3.2. Possible impact of a comprehensive Enhanced Agreement (Option One)

#### 4.3.2.1. Economic impact

It should be noted that Ukraine will accede to the WTO on the basis of rather open conditions concerning access to its domestic market for goods and services.

Overall, the EU is also very open to Ukrainian goods and services. Consequently, from a general standpoint and as indicated above, a classical FTA limited to market access in goods and services would add relatively little to the general trade conditions which both the EU and Ukraine offer to their trading partners on a non-preferential basis.

The CEPS 2006 study indicates, on the basis of recent research on transition economies, that removing wider categories of trade barriers, especially those of a regulatory nature, can have significant beneficial effects, going much beyond those accruing from 'traditional' trade liberalisation. This is essentially because the regulatory approximation process would lock in sound economic and institutional reforms, leading to an improvement in the investment climate, investor and consumer confidence and lower cost of capital. On this basis, as assessed by the CEPS 2006 study through economic modelling, Ukraine stands to gain very significantly from a deep and comprehensive FTA. The CEPS 2006 study concludes that improved institutional quality can result in GDP increases in the range of 20 to 30%.

The effects for the EU economy as a whole of a deep and comprehensive FTA would be positive, albeit much smaller than for Ukraine. The biggest gains would essentially stem from trade creation and regulatory approximation, in two main ways:

- Firstly, a selective yet ambitious process of alignment on the EU *acquis* would allow Ukraine to integrate better in the EU supply chain. This, in turn, would offer several EU industries the opportunity to improve competitiveness vis-à-vis competitors in other third countries.
- Secondly, Ukraine stands to gain very significantly from a deep integration FTA. Stronger economic growth in Ukraine, i.e. based on sound economic reform, would lead to dynamic welfare gains for the EU, stemming from a robust increase in bilateral trade and investment opportunities. EU producers would also gain from increased access to the public procurement market and from better protection in the field of intellectual property rights.

Deep integration is also important in terms of limiting possible risks for EU industries. For example, opening the EU internal market to a wide range of Ukrainian goods without any related requirements for Ukraine to meet EU environmental and energy requirements could be problematic.



## RESTREINT UE

According to the CEPS 2006 study, a deep FTA would require huge progress in implementation, and drastic reform of Ukraine's economic governance. The combination of economic openness, alignment on modern European and international standards of economic regulation and corporate governance (including addressing the key corruption problem), and proximity to EU markets could lead to a sustainable high growth path for Ukraine and a rebranding of Ukraine's reputation. This would be of value to the EU economy, which would gain from the enhanced integration.

Wide-ranging cooperation in the areas of justice, freedom and security, energy, transport, environment, consumer protection, social cooperation, education, etc., will have a positive impact on the sustainable economic development of Ukraine. The more ambitious this cooperation is and the more the relevant stakeholders are actively and constructively involved on both sides, the more effective the outcome of this option will be.

Strengthening cooperation on justice, freedom and security will be key to favouring economic development and commercial ties between the EU and Ukraine. Beyond the issue of corruption, this means respect for the rule of law, a thorough reform of the judiciary system, and the development of an efficient commercial jurisdiction in Ukraine. Furthermore, a reinforced EU-Ukraine partnership, based on legally binding commitments to fighting illegal migration, trafficking and organised border crime, will add substantial benefits.

The main challenge of this option, as compared to the other options, is the need for political commitment to implement this ambitious agenda.

### 4.3.2.2. Social impact

The social impact of the agreement would depend to a large extent on the economic impact. In particular, in the case of Ukraine, stronger economic growth, accompanied by more and better paid jobs and better distribution of income, could have very beneficial wider impacts.

The deep FTA option would also involve an increase of trade in services between the EU and Ukraine, including labour-intensive services, which could have net positive social effects on both sides. Furthermore, the deep FTA option could also lead Ukraine to improve its labour legislation, including in aspects of implementation.

Regarding the effects of enhanced cooperation in sectoral policies, for example improved means of transport and infrastructure, increased drinking water supply, more stable energy supply (heating for houses) and improved air quality would have overall positive consequences for the population at large.

Furthermore, it should be noted that Ukraine's human capital is highly qualified and skilled in several sectors, providing a good basis for the expansion of

## RESTREINT UE

knowledge-intensive industries. Integration with the EU economy, with greater cooperation in areas such as education, can thus be expected to have quite a positive social impact.

The risks of this option are potential transitional social problems that could emerge from trade opening and industrial restructuring. The planned Sustainability Impact Assessment will analyse these issues in depth.

### 4.3.2.3. Environmental impact

Option one would include a sustainable development and environmental dimension. Adequate focus on environmental standards, liberalisation of trade in environmental goods and greater cooperation on environmental issues would entail a positive environmental impact. The general modernisation of Ukraine's economy, which is a key objective of option one, notably through EU investments and transfer of know-how and technology, will include the take-up of new, more modern technologies, which will result in enhanced eco-efficiencies, savings of resources and less pollution per unit of output.

Environmental pollution does not respect borders and can therefore be best addressed through a mix of international, regional and national action. Enhanced environmental protection in Ukraine will bring benefits to citizens and businesses both in the EU and in Ukraine. Greater cooperation in environmental areas would tackle the policy framework, improve the institutional set-up and advance regional development. Increased awareness of environmental issues among citizens would, in the medium to long term, create demand for more environmentally sound products and services.

The risks of option one are linked notably to further trade opening, greater volumes of exports and imports, and increased levels of economic activities, including transport of goods and people, which will put further pressure on air quality, waste management, water quality, and nature protection, etc. However, these risks can be eliminated or mitigated through suitable policy choices and accompanying measures. This will be covered by the planned Sustainability Impact Assessment.

### 4.3.3. *Summary of the expected impact of the selected option on factors*

The biggest barriers to trade and investment in Ukraine after WTO accession will be the well-documented problems of economic governance (lack of transparency in business relations, lack of predictability in government policies, pervasive corruption). Option one would therefore tie in best with the reform agenda Ukraine needs and would result in more significant economic integration of Ukraine into the EU economy; it is therefore also the preferred option for Ukraine, as borne out by the informal consultations. But its feasibility will depend in large measure on the capacity and will of the Ukrainian government, parliament and business interests to work towards this end.

## RESTREINT UE

Impact	Economic	Social	Environmental
EU	++		+
Ukraine	++++	++	++

### 5. HOW TO MONITOR AND EVALUATE THE RESULTS AND IMPACTS OF THE PROPOSAL AFTER IMPLEMENTATION?

As explained in the introduction, the proposal considered is not per se a fully-fledged text. Implementation of the proposal in the strict sense (i.e. the recommendation for a Council decision authorising the negotiations) will consist of launching, and then concluding, negotiations with Ukraine. This increases the need to monitor and evaluate the results and impacts of the proposal after the start of negotiations.

In this regard, an SIA on the economic and trade aspects of the Enhanced Agreement, which will be launched by the Commission in the start-up phase of negotiations, will be a very useful tool. It will also entail further consultation with the stakeholders concerned.

During negotiations, emphasis will be put on the ability of the Ukrainian authorities to implement the agreement. In particular, Ukraine will have to develop its administrative and institutional infrastructure to be able to enforce what has been agreed.

Finally, the implementation phase of the agreement will see institutional structures put in place, which will be based on existing structures under the EU-Ukraine PCA (Summit, Cooperation Council, Cooperation Committee, Subcommittees), but developed further and include, for example, a platform for civil society dialogue. In this context, special arrangements will be agreed to monitor, report and evaluate on the implementation, taking due account of the respective responsibilities of all levels of government that will be involved in the implementation.

### 6. COMMISSION PROPOSAL

In line with the above preliminary analysis, the Commission proposes that option one should be taken and negotiations on a comprehensive Enhanced Agreement, including a deep FTA, should be entered into. Further consultation and an in-depth analysis will be undertaken as soon as the Council has adopted

## **RESTREINT UE**

the negotiating directives and the Commission starts negotiations with Ukraine. There will be thus ample opportunity to discuss, fine-tune and review, if appropriate, the approach proposed in the draft negotiating directives.

---

DECLASSIFIED



**RESTREINT UE**  
COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 13.9.2006  
SEC(2006) 1156

EU RESTRICTED

COMMISSION STAFF WORKING DOCUMENT

**RECOMMENDATION FROM THE COMMISSION TO THE COUNCIL**

**authorising the Commission to open negotiations with Ukraine for a new Enhanced Agreement**

**Summary of the Impact Assessment**

{SEC(2006) 1105 final}  
{SEC(2006) 1110}

DECLASSIFIED

# RESTREINT UE

## Summary of the Impact Assessment

This impact assessment refers to a Commission Recommendation to the Council to authorise the Commission to open negotiations with Ukraine on a new Enhanced Agreement. The impact assessment is based on the assumption that the negotiations will be successful and that the agreement will be drawn up according to the proposed negotiating directives.

The impact assessment is mostly based on a qualitative methodology, but it also takes account of the quantitative conclusions of a feasibility study on the possible impact of an FTA between the EU and Ukraine. The assessment analyses four possible options which could enhance the links between the EU and Ukraine. The options chosen are:

- (1) Negotiation of an Enhanced Agreement, including a deep FTA and comprehensive cooperation in political and economic areas, as proposed by the Commission.
- (2) Negotiation of an Enhanced Agreement, including a shallow FTA and less ambitious cooperation provisions.
- (3) Negotiation of a general framework agreement, leaving more detailed economic, trade and sectoral agreements to be negotiated later.
- (4) Extension of the PCA, including upgrading of cooperation under the existing framework.

The first option provides the most comprehensive response to the main barriers to trade and investment in Ukraine after WTO accession, which will be the well-documented problems of economic governance. Option one would tie in best with the reform agenda Ukraine needs and would result in more significant economic integration of Ukraine into the EU economy. Wide-ranging cooperation in the areas of justice, freedom and security, energy, transport, environment, consumer protection, social matters, education, etc., will have a positive impact on the sustainable economic development of Ukraine. In terms of social and environmental impact, this option offers wide ranging opportunities for improvement of the situation, but also entails a number of risks, notably in the short- to medium term. The main challenge of this option, as compared to the other options, is the need for political commitment to implement this ambitious agenda.

The second option would focus on the possible impact of a shallow FTA, which would cover only free trade in goods and services, without as much emphasis on regulatory approximation as the first option. Compared to option one, a less ambitious enhanced agreement would continue to have a positive economic impact, but of a much more limited nature. The limited impact would be compounded by the decrease in cooperation activities.

The third option would be a further reduced agreement, which would only focus on an overall enabling framework without any more detailed provisions. The fourth option would leave the existing PCA untouched, enabling both Parties to continue cooperation on this basis. Neither option would include any significant new initiatives, in areas such as energy, regulatory reforms and environmental and social standards. The impact compared to option one would therefore be much reduced, particularly in the medium to long term.

## **RESTREINT UE**

An in-depth Sustainability Impact Assessment focussing on the economic and trade aspects of the Enhanced Agreement will be launched by the Commission in the start-up phase of negotiations. It will also entail intensive consultation with the stakeholders concerned.

In line with the analysis, the Commission proposes that option one should be taken and negotiations on a comprehensive Enhanced Agreement, including a deep FTA, should be entered into.

DECLASSIFIED