



Understanding the EU's Association Agreements and Deep and Comprehensive Free Trade Areas with Ukraine, Moldova and Georgia

Should Ukraine aim to join the EU's customs union?¹

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Executive summary

This note takes up the question how possibly to build on Ukraine's Association Agreement (AA) and Deep and Comprehensive Free Trade Area (DCFTA) with the EU through some fresh initiative to give renewed political and economic momentum to Ukraine's European integration process. A perspective for full membership of the EU would be highly welcome on the Ukrainian side, but there is no consensus for this on the EU side, hence the question whether there are alternative ideas.

Four hypotheses are examined: (i) faster and deeper implementation of the DCFTA, (ii) acceding to the European Economic Area (EEA), (iii) acceding to the EU's Customs Union, and (iv) acceding to the Pan-EuroMediterranean (PEM) Convention for preferential rules of origin.

The customs union hypothesis, now advocated by President Poroshenko, is examined in some detail. It would represent a further development of either the DCFTA or (hypothetically) the EEA options, and would be largely an alternative to the PEM Convention, which however Ukraine recently began to implement.

The customs union hypothesis could only realistically come in after successful implementation of the DCFTA at the end of its transition periods of 7 to 10 years for eliminating tariffs, and even 15 years in the important sector of automobiles; unless Ukraine wanted to accelerate the process.

The customs union proposition is well founded in economic theory and practice, but its application can raise costs as well as benefits. For maximum benefits trade with the customs union should be predominant, there should be a common land border, and the external trade policy of the customs union should not be less liberal than that of the acceding economy.

Today, these key conditions for success are only partly valid for Ukraine's hypothetical accession to the EU's customs union. In particular Ukraine has major trading interests globally, which would be constrained by joining the EU's customs union. Accession to the customs union would also require a very high level of trust between the customs services of the two parties, which in turn requires that corrupt and inefficient practices on the side of Ukraine's customs services be comprehensively corrected.

1. Introduction

With the Association Agreement and Deep and Comprehensive Free Trade Area (AA/DCFTA) between the EU and Ukraine now in force thought is being given to what the next stages of Ukraine's integration with the EU might consist of.

Accession negotiations for full membership, or the perspective for this, is one obvious and clear answer in principle, but this is not something that the EU side is currently prepared to embark upon, arguing that neither side is ready for it. A question then is whether there are other important but less difficult milestone objectives that can be usefully identified to stimulate further reform and transformation.

There may be several hypotheses for discussion:

- i) A first conventional argument would be to concentrate on *'full implementation of both the actual provisions and potential of the AA-DCFTA'*, given that the expected time horizon for existing commitments stretch many years ahead, and that several chapters are open-ended for substantive development of cooperation (as for example in the area of foreign and security policies). But this would not be a fresh initiative, except if there were a qualitative upgrade in the speed and depth with which Ukraine implemented the AA/DCFTA.
- ii) A second idea might be accession to the *European Economic Area (EEA)*, alongside Norway and others. This would involve complete integration into the single market, without however joining the EU's customs union. For practical purposes of policy design this could follow logically from the AA/DCFTA, since the content of EEA has basically the same chapters as the AA/DCFTA, but implementation has to be fully undertaken to a legally impeccable standard. This would imply a major upgrade in Ukraine's economic governance. This scenario would not be considered by EEA states until a highly successful implementation of the DCFTA was demonstrated. In addition if Ukraine achieved this level of success with the DCFTA, it would presumably press anew for the *'membership perspective'* with a much enhanced degree of credibility.
- iii) A third idea could be to join the *EU's customs union*, which could in principle build logically on, and add value to, either of the two preceding ideas. This is now being proposed by President Poroshenko and discussed publicly². If pursued it would imply a quite complex set of economic and political costs and benefits. The main purpose of this note is to set these out.

² "Ukraine's intentions in the long term to join the Customs Union with the EU, integrate into the Schengen zone, become part of the digital market or energy union are a powerful incentive for the implementation of [the country's] economic and social sectoral and other reforms, as well as for the growth of our joint trade and investment", Poroshenko said at a joint press conference with the EU leaders following the plenary session of the EU-Ukraine summit in Kyiv on Thursday, July 13, 2017, <https://www.unian.info/politics/2027046-ukraine-intends-to-join-customs-union-with-eu-poroshenko.html>; and Anders Fogh Rasmussen, *"The Case for an EU-Ukraine Customs Union"*, Project Syndicate, July 14, 2017.

- iv) A fourth 'cousin' to the customs union idea would be for Ukraine to extend its set of free trade agreements with the economies of the European neighbourhood with which the EU has FTAs (EEA/EFTA, Turkey, CEFTA/Balkans, South and East neighbours), and to complement this with accession to the *Pan Euro-Mediterranean (PEM) Convention for preferential rules of origin*, permitting in particular 'diagonal cumulation' of value added between participating countries. Ukraine's accession to the Convention was foreseen in the DCFTA and its implementation began on 16 May 2017, when Ukraine was formally invited to accede to the Convention. Ukraine has already signed FTAs with EFTA, Macedonia and Montenegro, and negotiates with Turkey and Israel.

Technically, the customs union and PEM Convention are largely alternative propositions, and their relative qualities are commented on further below.

2. The customs union in economic theory and integration models

The customs union has a noble place in European history, since establishment of the Zollverein in 1834, which was a major milestone in the process of German unification, and an early example of economic integration preceding, but leading to, political integration.

There are many customs unions in the world today. One study by the World Bank identifies 24 cases 'selectively', mainly in Europe, Africa, southern and central America³.

The customs union has a well-established place in economic theory, having been subject to landmark academic contributions many decades ago⁴. The key argument about whether the customs union will be beneficial has been argued to hang essentially on the question whether it would involve an increase or decrease in their prior tariffs with third countries, and of course the relative importance of trade with the customs union compared to the rest of the world. If joining a customs union means raising the external tariff, this would impose an economic cost in terms of trade diversion, which might outweigh the benefit of freer trade with the customs union members.

For Ukraine the EU is the largest single destination for its exports, but at 37% this does not amount to a predominant share – although as DCFTA implementation continues, the EU share is likely to rise further. If Ukraine joined the EU's customs union its external tariff regime would be marginally raised (see Tables 2 and 3 below for details).

The classic literature cited needs to be updated for the more recent development of international supply chain economics and the related growth of intra-industry trade, as compared to simple exchanges based on comparative advantages, for example trading commodities against manufactures. This is highly relevant to the Ukraine case, looking ahead

³ Soamielt Andriamananjara, 'Custom Unions', World Bank, <http://siteresources.worldbank.org/INTRANETTRADE/Resurces/C%.pdf>.

⁴ Jacob Viner, 'The Custom Union Issue', Carnegie Endowment for International Peace, New York, 1950; James Meade, 'The Theory of Customs Unions', Amsterdam-North Holland, 1953; Jacob Viner, 'The Custom Union Issue', Carnegie Endowment for International Peace, New York, 1950.

for the next decades, contrasting with that of Russia. Russia is an extreme example of a commodity exporter and importer of manufactures and services. Ukraine on the other hand, with limited natural resources, needs strategically to modernize and expand its diversified industrial sector. Located directly on the EU's borders, an industrial strategy of this kind could benefit from adding a customs union to complement the DCFTA. Reference is made below to the Slovakian example of supply chain integration with the EU, which Ukraine could view as having some model qualities.

The customs union also has its place in theoretical schema for the different and successive stages of economic integration, as set out in Table 1 below:

Table 1. Different stages of economic integration

Different stages of economic integration between countries	No Internal Trade Barriers	Common External Tariff	Factor and Asset Mobility	Common Currency	Common Economic Policy
Free Trade Area	X				
Customs Union	X	X			
Single Market	X	X	X		
Monetary Union	X	X	X	X	
Economic Union	X	X	X	X	X

Source: <http://www.tutor2u.net/economics/reference/customs-unions-and-single-markets>

This sees the customs union's place in the hierarchy of economic integration systems, coming after the free trade area, but before the single market, with full monetary and economic union coming later still.

However this standard view does not sit comfortably with the current realities of the EEA or DCFTA. In particular the EEA states have fully joined the EU's single market without joining the customs union. Why? The answer returns to the key argument about the common external tariff of the customs union. The EEA and EFTA states (essentially Norway and Switzerland) prefer a somewhat more liberal trade policy with third countries than the EU, or at least wish to retain the power to do so. They are implicitly saying that the known bureaucratic costs of customs controls with the EU are a lesser problem than forfeiting the right to independent trade policies with their parties.

But would this argument apply to Ukraine as well? The DCFTA already goes extensively in the direction of integration with the EU's single market, without joining the customs union, and is thus heading in the same direction as the EEA model. But is it in Ukraine's interests to stick to this position, or rather to catch up with the standard model of combining the customs union with the single market? We return to this key issue in more detail in section 4 below.

3. Current political context for customs unions in the wider European and Eurasian space

There is quite a lot of customs union activity or debate currently in the wider European and Eurasian economic space.

The EU's main current experience of participation by non-EU member states in its customs union comes from its 1995 **Turkey** agreement. This has been an economic success but a source of political tensions. The economic success factor is seen in the huge expansion and deepening of trade relations between the EU and Turkey over the last decade. The political tensions have arisen on the Turkish side through the obligation for Turkey to apply the EU's external tariff regime, including the terms of its preferential free trade agreements with third countries. Ankara has complained about its exclusion from the EU's trade policy making in relation to third countries. Concretely, while Turkey has to apply the EU's import tariff regime including free trade preferences with third countries, the counterpart for Turkey's exports to the EU's free trade partners is not automatic, and has to be negotiated with each of these countries which can be highly problematic (see the box below on the Turkish-Mexico case).

On the other hand, given the *de facto* suspension of Turkey's accession process, interest has since December 2016 switched to the search for a renewed positive impetus under the official heading of 'modernisation of the customs union'. The only point of substance mentioned so far is that agriculture, currently excluded from the EU-Turkey customs union, could be brought into it. Ukraine will of course watch how this develops with close interest.

The EU-Turkey-Mexico customs union imbroglio

The EU has a free trade agreement with Mexico, which Turkey is obliged to follow in granting tariff-free access to its imports from Mexico. However Mexico has not reciprocated in granting tariff-free access to its market for Turkish exports. This is because the EU-Mexico agreement contains no legally binding commitments with regard to third countries, while the EU-Turkey customs union agreement requires Turkey to implement the EU's external tariff regime, including preferential free trade conditions.

Turkey asked Mexico to reciprocate, and the EU supported this request as this would be only fair. However when Mexico refused there was no legal basis to enforce the request.

Turkey has responded to the EU with arguments that it should be party to such agreements, or have the EU support its interests at the stage of its negotiations through inclusion of obligations to customs union partner states. However the EU has been unable to do this, citing legal and institutional arguments concerning its legal autonomy in such matters. It remains to be seen whether EU-Turkey negotiations over 'modernisation' of the customs union could improve on this state of affairs. There is no reason to suppose that Ukraine could secure better treatment of its interests than Turkey.

This illustrates why – if no amendments are made – to be part of the EU's customs union is less advantageous for a non-member state than for the regular member state.

Another big debate been going on in the **United Kingdom** in the context of Brexit, where the issue whether or not to leave the customs union has been fiercely fought over within the government and in public debate. Economists are largely of the view that for the UK to quit the customs union would be a big mistake, creating new and costly customs procedures and disrupting complex supply chains that have been built up over the last decades between industries in the UK and on the continent. The government has opted to quit the customs union, based on the argument that UK could do better and more liberal trade deals with the rest of the world, compared to the EU. However the validity of this argument is seriously contested, and there is a vocal constituency especially among business interests that would prefer, if Brexit has to happen, to remain in the customs union and single market.

These developments in the cases of Turkey and the UK, in addition to that of Ukraine, lead into an important new systemic feature of the European landscape, in which there will be three large European countries neighbouring the EU-27, together accounting for a population of 189 million people, compared to the 440 million of the EU-27. All three have changing relationships with the EU; all see themselves as being unique cases; but all are seeking to define new optimal and deep relationships with the EU. Necessarily there will be many common features in these new relationships with the EU, and various precedents of one to be used by another. The EU for its part will have to think about a new kind of neighbourhood policy for its 'big neighbours', differing no doubt from its first vintage neighbourhood policy for its many smaller neighbours. Ukraine may thus be in a position to make a category switch from the first to a second (not yet shaped, but inevitable) neighbourhood policy.

For completeness it should be mentioned that the EU's customs union has been enlarged recently to include two micro-states: Andorra, San Marino. Both are land-locked within EU territory, and overwhelmingly dependent on trade with the EU. So for these cases membership of the customs union is easily justified, but without significant relevance for the purpose of this paper.

Much more important is the case of the customs union of the **Eurasian Economic Union**. Ukraine's decision not to join this customs union was the proximate cause of the conflict with Russia. For the existing members of the Eurasian customs union the story is hardly a positive one. This returns again to the crucial issue of whether the customs union's external tariff corresponds to the interests of all member states. The standard economic argument is that joining a customs union with an important trade partner can be beneficial, as long as this is not outweighed by imposition of a higher external tariff with third countries. In practice Kazakhstan, Kyrgyzstan and Armenia have all been pressed to raise their external tariffs to higher levels than their prior preference, as revealed by the terms of their WTO membership. All three countries have wanted more liberal trade relations with the rest of the world, for example with the EU and China. As a result the Eurasian customs union has been created on the basis of political and security considerations pushed by Russia, contrary to the economic interests of Kazakhstan, Kyrgyzstan and Armenia. As Ukraine knows full well, if it had joined the Eurasian Union its DCFTA with the EU would have been excluded.

4. More on economic and political costs and benefits for Ukraine

Of the four hypotheses set out in the introduction, the customs union adds a classic integration factor that is missing in all the other three options listed at the outset. However any presumption that it would be the most advantageous next step for Ukraine has to be carefully analysed, since there are both costs and benefits to be assessed.

As already remarked above some of the primary conditions for a beneficial assessment are not really present: the EU is Ukraine's first trade partner, but it is not overwhelmingly predominant given the more substantial trade flows with the rest of the world (Table 2).

Table 2. Destinations of Ukraine's exports in 2016

	\$, billions	% of total
EU	13,498	37
Russia	3,592	10
Rest of world	19,273	53
Total	36,363	100

In addition Ukraine's average tariffs would see a modest but still noticeable increase (Table 3). These are the most-favoured-nation (m.f.n.) tariff schedules applied for trade with other WTO member states with which there are no preferential tariff concessions.

Table 3. Average external tariffs (m.f.n./WTO) of the EU and Ukraine, %, 2016

	Ukraine	EU
Agricultural products	9.2	11.1
Industrial products	3.7	4.2
Total, all products, average	4.5	5.2

On the other hand a positive argument is that with its territorial contiguity with the EU, and its substantial industrial tradition, Ukraine is well positioned to develop rich supply chain and direct investment linkages with the EU, which a well-functioning customs union would certainly favour.

Importantly, the customs union scenario presupposes that Ukraine would first have completed its trade liberalisation with the EU, for which there are still substantial transitions periods for implementation, notably in the range of 7 to 10 years for quite a number of significant products. For the important automobile sector Ukraine insisted on including in the DCFTA a safeguard clause that can even continue for 15 years. This sector is of particular relevance to the customs union idea. It is a prime sector for generating major benefits from inclusion in the customs union, through development of complex supply chain linkages requiring however seamless cross-border movements. The example of Slovakia illustrates this, with major direct investments by EU automobile companies having invested heavily in such

supply chains, with some components crossing borders in and out several times before the final product is marketed. In Western Ukraine there is now the beginnings of a cluster of investments in component parts for the automobile industry.

In a long-term vision for Ukraine, this same model could be envisaged, multiplied several times in scale compared to Slovakia, but the argument is clearer if accession to the customs union were combined with full accession to the EU. In any case this scenario would imply a real revolution in the conditions for doing business in Ukraine. Customs controls would in principle be eliminated, which would be a huge improvement over the present situation where major frontier bottlenecks with Hungary, Poland and Slovakia still are prevalent, and associated with inefficient and corrupt customs services. The EU would have in due course to be convinced that Ukraine's management of its part of the external border of the customs union would be absolutely up to normal European standards of integrity. As an example, Georgia a decade ago made the big step change to establishing efficient and de-corrupted customs services, which Ukraine has yet to emulate.

In addition Ukraine will with the DCFTA adopt comprehensively EU technical standards and regulations for industrial and agri-food products in accordance with the chapters of the DCFTA dealing with technical barriers to trade (TBT) and sanitary and phytosanitary regulations (SPS) respectively. Importantly for industrial standards the DCFTA envisages that Ukraine will make Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAAs), which are an advanced form of mutual recognition agreement. This would eliminate the need for checks on cross-border trade with regard to technical standards, and thus become equivalent to the conditions of full membership in this respect.

The major potential complications and costs relate to Ukraine's trade relations with third countries. These come in several logically distinct categories with different cost/benefit implications:

- First, countries with which both the EU and Ukraine currently trade on the basis of WTO/mfn tariffs;
- Second, countries with which the EU has preferential or free trade agreements, but Ukraine does not;
- Third, countries with which both the EU and Ukraine have free trade agreements;
- Fourth, countries with which Ukraine has preferential or free trade agreements, but the EU does not;
- Fifth, countries with which Ukraine might want to make free trade agreements ahead of the EU.

For the first category, which includes the major cases of the United States and China, there is some cost for Ukraine, since its current WTO/mfn tariff rates are somewhat lower than for the EU (as reported above in Table 3).

The second category involves the EU's very numerous preferential and free trade agreements, with some important new ones that are in the course of being concluded, such as with Japan. But it is here that the 'Turkey-Mexico' type of problem can arise, unless it could be overcome

in an upgraded EU-Turkey customs union. How far the 'Turkey-Mexico' would emerge with similarly uncooperative and costly (for Ukraine) outcomes cannot be known in advance. To take the case of Japan, it might be feared that Japan would not be willing to open its agricultural market to the very competitive Ukraine, whereas Ukraine would have to be open to Japan's highly competitive manufacturing industries.

The third category, where both sides already have free trade agreements, is where Ukraine's accession to the customs union would pose no problems, but neither would it deliver additional advantages. This category includes EFTA, Canada and the other two DCFTA states (Georgia and Moldova).

As for the fourth category, this raises the issue of Ukraine's existing CIS free trade agreements, where the EU has no such agreements. This clearly concerns Belarus, Armenia, Kazakhstan and other Central Asia states, where membership of the EU's customs union would require that these CIS free trade agreements be discontinued. This would imply economic as well as political costs for Ukraine. On the other hand Ukraine's most important CIS free trade agreement with Russia is already suspended on both sides, so for this case there would be no change, except that joining the EU customs union would exclude re-starting the Ukraine-Russia free trade agreement. A further twist however would be in the event that the EU made a 'Lisbon to Vladivostok' free trade agreement with the Eurasian Economic Union, which is not currently on the official political agenda, but could become relevant if current political obstacles were overcome. In this case the CIS states move into the third category above.

As regards the fifth category, this can only be a speculative matter at present, since Ukraine is not actively pursuing free trade deals with countries where the EU has none. However it should be remembered that Ukraine has a major interest in exporting agricultural produce, and some of these markets such as the Gulf states and Mercosur are cases where the EU has difficulty in making its own free trade deals, and Ukraine might progress faster.

The overall synthesis of these five categories of third country trading partners is somewhat negative for Ukraine, with a mix of cases, with some pose clear-cut costs, others where there are probably or possible costs, and others where the outcome would be neutral. On the other hand, the main positive value of the customs union in dealings with third countries would be for Ukraine to profit from the EU's indisputable bargaining power in opening up third country markets, especially if the 'Turkey-Mexico problem' could be solved.

The apparent EU preference in relation to the options listed at the beginning would be to favour a combination of the DCFTA with the PEM Convention, i.e. concentrate on full implementation of the DCFTA, adding to this full development of the Pan Euro-Mediterranean (PEM) system of preferences for rules of origin, which formally began in May 2017 and whose implementation will take years to complete. The PEM system and customs union are largely alternatives, although to a secondary degree complementary to the DCFTA⁵. The PEM option

⁵ The customs union and PEM Convention are largely alternatives, in that to take the Turkish case their exporters do not have to go through the costly bureaucratic procedures to demonstrate conformity with the 'rules of origin'

has certain advantages. It works towards a wider European economic space with multilateral features, and avoids obligations of the partner states to follow the EU's common external tariff. However the PEM system is complex and bureaucratically costly for both business and customs services. The customs union on the other hand sweeps away these costs.

The high political profile of the customs union question hardly needs underlining, given that Ukraine's decision not to join the Eurasian customs union has indirectly led to war, losses of territory and enormous economic costs, losses of human life and hardship for displaced persons.

Would the EU view the prospect of Ukraine acceding to its customs union as further aggravating relations with Russia? Maybe today yes, but the time horizon for accession to the customs union would in any case be many years away, by which time the political context may have changed. Possible objections that this would harden trade barriers between Ukraine and Russia are in any case rebutted by the fact that Russia has suspended its CIS free trade agreement with Ukraine in 2016, with the result their trade relations in principle (i.e. apart from other sanctions) have reverted to WTO m.f.n. terms. So nothing would be lost by joining the EU's customs union in this respect.

On the other hand the uncertain future status of the currently occupied territories of the eastern Donbas would raise further questions in relation to the customs union hypothesis, given the high sensitivity of the border between Kyiv-controlled and separatist-controlled territory, as well as of the border regime between the separatist-controlled territory and Russia. Hopefully the conflict should be resolved by the time of Ukraine's potential accession to the customs union.

5. The other DCFTA cases – Georgia and Moldova

The Moldovan case has some similarities with that of Ukraine, given its common border with the EU, and its interest in expanding supply chain linkages with the EU economy. But Moldova's trade dependence on the EU is of a much higher order than for Ukraine, and so the economic case for Moldova to join the EU's customs union is much stronger. However there might be a serious political complication, in that the newly elected President Dodon speaks in favor of joining the Eurasian customs union, and repealing the AA/DCFTA. Given Moldova's very high dependence on trade with the EU, Dodon's ideas look like being catastrophic for the Moldovan economy. Dodon does not have the constitutional power to do this at present, but he looks forward to parliamentary elections in 2018 when he hopes to see a parliamentary majority elected that would support his position, with pro-Russian sentiment in the population very pronounced. The best scenario that can currently be hoped for is that Moldova would

for tariff-free access to the EU market. However Turkey is still a member of the PEM Convention and can make use of it for Turkish exports of intermediate products to (say) Georgia, where the goods would be further processed before being exported tariff-free to the EU under the DCFTA, thus benefitting from the 'diagonal cumulation' provisions of the PEM Convention.

keep open its free trade agreements with other CIS states, and improve their functioning especially with regard to Russia.

The Georgian position is completely different. It has no common border with the EU, and has adopted the most liberal free trade regime unilaterally for the whole of the world, so for it the EU's customs union would mean re-introducing tariffs, albeit mainly low ones, for third countries. Strikingly, Georgia has this year signed a free trade agreement with China, with a view to securing Chinese direct investment that would be attracted by the DCFTA's access to the big EU market. This would be excluded by joining the EU's customs union. So for Georgia the customs union idea is a non-starter.

Overall therefore, neither of the other two DCFTA states would be candidates today to accede to the EU's customs union, for completely different reasons.

6. Conclusions

The idea of an initiative to give renewed momentum to the EU-Ukraine relationship has several hypothetical variants beyond the issue of membership perspective, for which there is no consensus on the EU side. These hypotheses here considered are: i) faster and deeper implementation of the DCFTA, ii) acceding to the European Economic Area (EEA), iii) acceding to the EU's Customs Union, and iv) acceding to the Pan-EuroMediterranean (PEM) Convention for preferential rules of origin.

The customs union idea, in particular, follows a well-established economic concept and practice, which could in principle be built up upon either the customs union or the EEA, and is largely an alternative to the PEM Convention.

The costs and benefits of joining a customs union can vary, with significantly different results according to the circumstances. The most beneficial customs union proposition will be under multiple conditions:

- where the customs union is the acceding economy's predominant trade partner,
- where the acceding economy's external tariff would be replaced by a lower common tariff of the union,
- where it has territorial contiguity with the union, and
- where it is structurally well-placed to develop deep intra-industry trade and investment with rich cross-border supply chain linkages.

Ukraine in principle is currently favourably placed under the last two conditions, but not so much under the first two.

The main economic benefit would be through elimination of customs paper work (notably for proof of rules of origin), and this gain would be multiplied if it went with radical improvements in the efficiency and de-corruption of Ukraine's customs services.

The main costs can arise with regard to the customs union's trade policies with third countries, first of all where the customs union's external tariff is higher than that of an acceding

economy's prior regime, and secondly in relation to the customs union's free trade regimes with third countries. For Ukraine this would mean both a somewhat higher level of external tariffs, and probable difficulties in securing the full benefits of the EU's free trade agreements (because of the 'Turkey-Mexico' type of problem, as detailed above). The latter consideration means that to be part of the EU's customs union is more advantageous for the full member state than for the non-member state.

Ukraine would also have to discontinue several CIS free trade agreements. However in the case of the Russia-Ukraine (CIS) free trade agreement, this has already been suspended by Russia, and so in relation to the status quo nothing would change. If at some stage the 'Lisbon-to-Vladivostok' idea translated into a proposition of free trade between the EU and Eurasian Union, this would dissolve the problem for Ukraine. However under present circumstances the political tensions around the EU-Ukraine-Russia triangle might be further aggravated, should the idea of Ukraine's accession to the EU customs union become officially developed.

For these various reasons Brussels could be expected, as its priority, to favour concentrating on full implementation of the DCFTA, and to complement this with exploitation of the potential of the PEM Convention, which is beginning now to be undertaken in any case - i.e. to back options (i) and (iv) together.

In any case Ukraine's accession to the EU's customs union can only be seen as a long-term objective. It would require first that the Ukraine's trade liberalisation obligations under the DCFTA be completed, which will take up to ten years still, and even as much as 15 years in the important case of automobiles – unless Ukraine chose to move faster. It would also require that a very high level of trust between the customs services of the two parties be assured, which in turn means that corrupt and inefficient practices on the Ukrainian side be comprehensively corrected.

At a more strategic and systemic level the idea of Ukraine's accession to the EU customs union should also be viewed alongside other customs union developments that are shaping up in the EU's immediate neighbourhood, notably with regard to Turkey and the seceding UK. Turkey now embarks on negotiations with the EU to 'modernise' its customs union agreement, although it is not evident that this will dissolve the 'Turkey-Mexico' type of problem. The UK government has decided that in seceding from the EU it will also to quit the EU customs union, although business interests have strongly favoured remaining within it even as a non-member state. Ukraine of course retains the long-term objective of accession to the EU as full member state.

For Moldova and Georgia certain conditions are quite different to the case of Ukraine. Georgia has already scrapped tariffs unilaterally almost completely for the whole of the world, and would not want to re-introduce these through the EU's common external tariff. For Moldova the economic case for joining the customs union is strong since its trade is predominantly with the EU, but the country is currently caught in a fundamental political divide between those supporting the AA/DCFTA versus those favouring Russia and the Eurasian Union, itself a dysfunctional customs union.