Where Will Europe End? Observations on Ukraine and the Limits of European Integration

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Abstract: In an exploratory essay, two geographers assess long-term prospects for Ukraine's integration into European economic and political structures, most notably the European Union. The analysis is based on an examination of such commonly cited yardsticks as economic reform, political liberalization, and efforts to combat corruption ("internal obstacles") as well geographic factors such as relative location, production structure, and commercial relations ("external obstacles"). Efforts to upgrade and, to some degree, reorient transportation linkages to facilitate connection with Europe are investigated as well. *Journal of Economic Literature*, Classification Numbers: F40, O10, O18. 3 figures, 3 tables, 43 references.

INTRODUCTION

In the past year, the question of the expansion of the European Union (EU) to include the former communist states of Central and Eastern Europe (CEE) has become increasingly important, both politically and economically, not only with respect to the security and aspirations of the countries of CEE but also as a pressing economic and political issue within the EU itself. On the one hand, Euro-sceptics across Europe worry about their own national structures and democratic practices, while students, activists, and anarchists from Nice to Trieste to Brussels to Genoa have literally rebelled against European and global governance and capitalism, protesting what they perceive to be the emerging hegemonic power and anti-democratic practices of multinational and multilateral organizations such as the EU and Group of 8 (G8) industrialized countries. In May 2001, the new Italian Prime Minister Berlusconi indicated that there will be no accession of eastern states until the problem of southern Italy is addressed (*La Repubblica*, May 18, 2001, p. 16) while, after a massive electoral victory, Tony Blair in Britain told those pressing for quick entry into the Euro Zone to "cool it" (*International Herald Tribune*, May 18, 2001, p. 5). At the same time, and as the Euro continued its decline and despite explicit condemnation of the war in Chechnya, EU leaders were pushing Russia to adopt the Euro for exports payments (currently paid in dollars), arguing that it ". . . would help strengthen trade, attract new investments, and balance Russia's hard currencies reserves" (ibid.).

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In the context of this rapid geopolitical and economic rethinking of the EU, it becomes important to ponder the question of "where Europe will end." In a general sense, what are the limits to European Union expansion, and more specifically, what will be the limits of eastward expansion of the EU after accession of the 10 central European candidate countries (assuming that accession occurs)?[2]

In this paper we explore the limits of EU expansion and European integration by considering one specific facet of the issue: the open question concerning the post-Soviet future of Ukraine and prospects for that country's future integration into European structures. Ukraine provides an interesting case, because it borders on four of the countries currently being considered for EU accession (Hungary, Poland, Romania, Slovakia), thus representing an Eastern frontier of sorts for an expanded EU. For much of its recent history, it also has been viewed as divided between two regions—one oriented toward Eurasia/USSR in the east and one toward Central Europe in the west. Leonid Kuchma, Ukraine's current president, has stated Ukraine's intention to align its legal and economic structures with those of the EU, to attain EU membership, and to forge a unitary geo-economic and geo-political space based on democracy, non-discriminatory rule of law, and a market economy.[3] Therefore, on the outermost horizon of Ukraine's post-Soviet future is at least the possibility of its entry into the EU. This paper explores the factors shaping Ukraine's future geopolitical and economic status, whether this be as part of Europe or of another territorial entity.

This question of Ukraine's status is complicated by an apparent discrepancy between official statements regarding the country's alignment and actual decisions and practices implemented in Kyiv. The EU requires countries that are candidates for accession to develop democratic institutions and a market economy. Ukraine's post-Soviet performance in both of these areas has until quite recently been weak, especially in regards to law enforcement, legislation, corruption among officials, and the pace of economic reform. In this kind of institutional environment, anti-democratic practices have emerged. For example, in the 1999 presidential elections President Kuchma seems to have used the government's quasi-monopoly over the media and his control over the state budget and state structures to support his own electoral campaign,[4] while imposing obstacles to press freedom and replacing the pro-reform premier Viktor Yushchenko with the caretaker Anatoliy Kinakh in May 2001. There is also the widely reported scandal surrounding the murder of the journalist Georgiy Gongadze and secretly taped conversations of President Kuchma, which are not elaborated here.

Ukrainian scholars (e.g., Honcharenko, 1999) have refered to the "immaturity" of the Ukrainian political class, which uses the concepts of Europeism and reform as a slogan during electoral campaigns, but is not able to express a coherent political line or actually pursue the policies proposed. The struggle of lobbies in the framework of a weak state does not produce conditions that favor coherent policy-making practices. Among the more powerful such

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[2]Over the period 2003–2005, the following countries on the Continent are expected to accede to the European Union: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, and the Slovak Republic. Cyprus and Malta are also expected to enter the EU over this same period.

[3]Other possible scenarios exist. Ukraine could continue to occupy a position between the EU and Russia, the latter being another pole of attraction, by adhering to a loosely defined and adaptable set of values. In such a case there is the possibility that Ukraine might be reduced to a simple "cushion state," or it may attempt to organize its own geopolitical space, through subregional organizations (as the Black Sea Economic Council or Central European Initiative) in order to create an alternative form of European integration complementary to the EU (see Honcharenko, 1999).

[4]For more, see Finberg (2000) and Matsuzato (2001).

groups have been the oligarchs of the fuel and energy complex, who via state contracts obtained hydrocarbon fuels at relatively cheap prices from Russia and Turkmenistan, selling them domestically at steep mark-ups.[5] The oligarchs are organized in regional monopolies, an organizational structure that negates the competitive advantages to be had from efficiency and scale economies, keeps prices high, and results in a multitude of "foreign energy policies" between the oligarchs and Russian oil and gas suppliers. One consequence is that government policies intended to consolidate the independence of the Ukrainian state are undermined by the actions of energy oligarchs of both Russia and Ukraine.

Another important pressure group within Ukraine consists of the directors of former state enterprises, together with officials of the most important group of trade unions (FPU: Federation of Ukrainian Trade Unions) (Kubicek, 1996). Within the Soviet Union, enterprise directors, members of the Party's and state's executive branches, and major trade union officials were part of the same elite, all having membership in the Communist Party, and moving readily from one post to another within these institutions during their careers. In general, even after the disappearance of the CPSU, these interconnections remain.[6] The persistence of the old, inherited structures and practices of a corporate elite is slowing the entrance of "new blood" into the Ukrainian ruling class, and is one reason for the slow pace of reforms in Ukraine.

These and a number of other problems led U.S. National Security Adviser Condoleeza Rice to issue a strongly worded warning to Ukraine during talks with Kuchma and other top Ukrainian officials in Kyiv on July 25, 2001. Rice stressed that the integration of Ukraine in Europe depends on democratic reforms, and that economic and political reforms must be pursued simultaneously; she also demanded a full investigation into the murders of journalists Georgij Gongadze and Igor Aleksandrov. In reference to the upcoming 2002 parliamentary elections, she warned that "the world will be watching the elections in 2002, and not just on the day of the election but throughout the campaign to be sure that all voices have the opportunity to be heard" (*RFE/RL Weekday Magazine*, July 26, 2001, http://www.rferl.org/nca/features/2001/07/25072001113035.asp).

Despite these problems, the situation is not totally bleak, as recently there have been some signs of improvement. In 2000, Ukraine's GDP increased by almost 6 percent, the first such increase in the post-Soviet period, and increased by a further 10 percent in the first 10 months of 2001 (Åslund, 2001, pp. 313-314; Tabernacki, 2001, p. 43). It appears that the increase, fueled largely by growth in industrial output and in personal consumption in

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[5]After 1997, reforms aimed at reducing state debt transferred the control of energy imports into private hands (Balmaceda, 1998). The result was the growth of a very powerful class of businessmen responsible for energy deliveries. Another problem has been that oil and gas delivered to Ukraine (from Russia and Turkmenistan) is transported via Russian pipelines, effectively giving Russia extraordinary leverage in hydrocarbon markets in Ukraine. After independence Russia increased prices for its oil, while gas from Turkmenistan varied wildly in price with frequent interruptions of the deliveries (e.g., Sagers, 1999). The result has been a reduction in Ukrainian imports, with consequent shortages of energy for the whole economy, and mounting debts with Russia and Turkmenistan that the country has not been able to liquidate. In the autumn of 2000, Russia agreed to facilitate the transport of Turkmen gas across Russia to Ukraine, as part of a broader agreement involving the restructuring Ukraine's natural gas debts, estimated at $1.5 billion, and the Russian gas monopoly Gazprom's participation in the privatization of Ukraine's gas pipeline system (Fallon, 2000; *Vremya MN*, December 8, 2000, p. 4).

[6]This is clearly manifest in the composition of the most important association of entrepreneurs, the USPP (Ukrainian Union of Industrialists and Entrepreneurs). Directors of the former state enterprises comprise about half of the membership, and they exercise sufficient political influence and connections to control the organization. Under their control, the association struggles to obtain privileges and subsides for the former state enterprises, and supports a kind of privatization that allows the former directors to become entrepreneurs (see Kubicek, 1996).

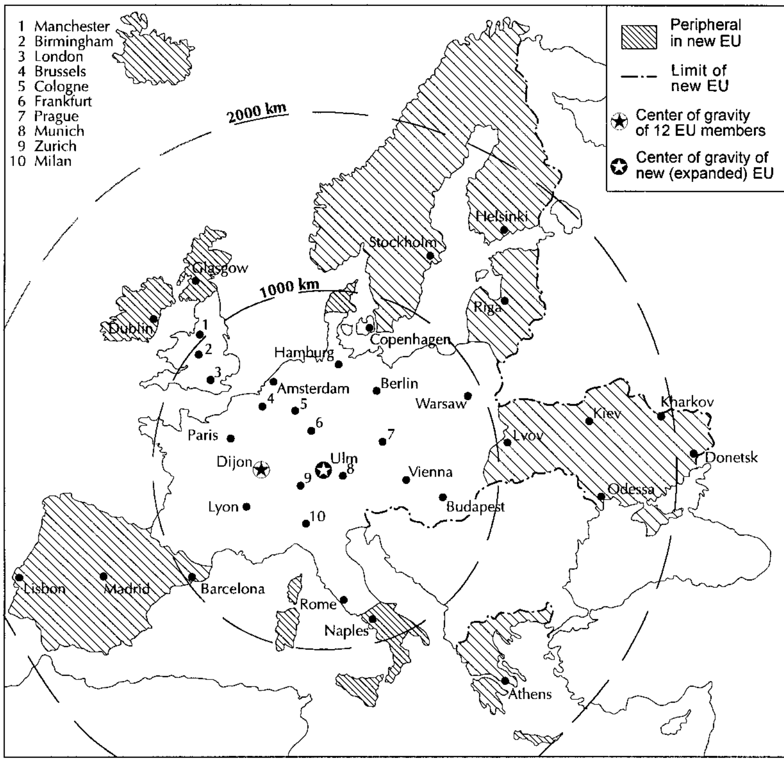

Fig. 1. Scenario for EU enlargement (adapted from Cole and Filatotchev, 1992).

services, reflects the success of outgoing Deputy Prime Minister Yulia Timoshenko in curbing the powers of the energy oligarchs, in combination with other reforms spearheaded by Prime Minister Yushchenko in 2000 to delineate and streamline decision-making authority, eliminate superfluous decrees, simplify tax codes, slash government spending and subsidies, eliminate barter and offsets in favor of cash payments, and accelerate privatization of industrial enterprises (ibid.) Whether the momentum generated by these actions can sustain economic growth going forward under Kinakh is open to question.

THE VIEW FROM 1992

Before proceeding further, it is useful to place the present views concerning the feasibility of Ukraine's integration into European economic structures in historical perspective. In a study of this question soon after the disintegration of the USSR, Cole and Filatotchev (1992) argued that, from a purely economic and geographic perspective, Ukraine was not well placed to enter the EU, but that broader geopolitical issues might open new possibilities for Ukrainian accession. At the core of their analysis was an assumption that transition in Eastern Europe and in FSU would take place fairly rapidly, with the Nordic countries entering the EU in 1995 and those of the northern part of Central Europe (Poland, Hungary, Czech Republic, and Slovakia) joining around the year 2000 (Fig. 1). Under this scenario, the Balkan Peninsula was excluded from enlargement because ". . . it is assumed here for simplicity that Bulgaria and Rumania (both too slow to change politically), all parts of the formerYugoslavia (too unstable) and Albania, are out of the running, and that Turkey is rejected for demographic and cultural reasons" (Cole and Filatotchev, 1992, p. 2). Ukraine, on the other hand, was assumed to have an economy that ". . . is as healthy and advanced as that of the more backward Member States of the EC, and it has developed a democratic approach to politics and human rights" (ibid.).

From hindsight, it is perhaps easy to view such assesments as optimistic,[7] as the mechanisms of transition were oversimplified in many early studies of post-Soviet transition (see Pickles and Smith, 1998 for a similar argument). In the early nineties, most policymakers believed that price liberalization and privatization of state-owned enterprises alone were enough to support the development of a fully operative market economy, but in the following years, it became clear that these two features were insufficient, and that many other conditions are involved in successful or unsuccessful transition, such as historical and geographic proximity to the West and the development of norms, institutions, and enforcement mechanisms adapted to regulation of markets.[8] As a consequence, in these early analyses there was an overestimation of the role of politics and legislation, and a lack of consideration for the necessity of developing human resources and new theories to guide policymaking.

In their analysis, Cole and Filatotchev (1992) assumed that Ukraine would develop a democratic approach to politics and human rights, but did not specify what this might mean. At the time, such propositions could be very general, but now, for the candidate countries seeking accession to EU, the requirements have assumed a very specific character—the adoption of the *acquis communautaire*. Before being accepted, the candidate countries must adopt *and enforce* all of the European Union's norms and regulations adopted since the Treaty of Rome.[9] Included among these norms are those dealing with environmental protection and the reduction of pollution levels, requiring levels of investment beyond the capabilities of most post-communist countries. Ukraine's GDP is estimated to be only some 30–40 percent of the pre-transition level, and (as noted above) economic output has only recently begun to recover after a decade of dramatic contraction, characterized by deficits in both its

[7]See, for example, subsequent more pessimistic analyses by Kahn (1994), Kahn and Gicqiau (1995), Broclawski (1997, 1998), OECD (1997), Duchene (1999), EBRD (1999), Economist (1999).

[8]These issues have been studied by the European Bank for Reconstruction and Development (EBRD) in various "Transition Reports." A complete review of the first decade of transition appears in the proceedings of the UN/ECE Third Spring Seminar, held in Geneva on May 2, 2000 (UN/ECE, 2000).

[9]The Treaty of Rome was signed on March 25, 1957 by Belgium, the Federal Republic of Germany, France, Italy, Luxembourg, and Netherlands and entered into force on January 1, 1958. It was one of the earliest and most important steps in the formation of the European Union, being preceded only by the Treaty of Paris (effective July 23, 1952), establishing the European Coal and Steel Community (ECSC). Actually two treaties were signed in Rome: one established the European Economic Community (EEC), and the other instituted the European Atomic Energy Community (Euratom). The EEC created a common market and a customs union among the member states, extending the provisions embodied in the ECSC to all the aspects of the economy. The first example of such economic coordination was a common agricultural policy. Another step involved in building the EU included the admission of new members (Denmark, Ireland, and the UK in 1972; Greece in 1981; Portugal and Spain in 1986; Austria, Finland, and Sweden in 1995); currently (late 2001) 12 candidates have started the process of accession to the EU: 10 Central and East European countries, Cyprus, and Malta. In addition to "broadening" the EU, there is a process of "deepening"—the progressive devolution of power from the member states to the common institutions via additional treaties: the Single European Act (SEA), signed in Luxembourg and The Hague and entering into force on July 1, 1987; the Treaty on European Union (Maastricht, November 1, 1993); the Treaty of Amsterdam (May 1, 1999); and the Treaty of Nice, signed on 26 February 2001 but not yet in force. More extensive information on the treaties constituting the EU can be found on the official EU website (www.europa.eu.int) at the URL address http://www.europa.eu.int/abc/treaties_en.htm.

budget and trade balance.[10] Although the situation has been improving since early 2000 (Åslund, 2001; ICE, 2001), the country currently cannot afford such investments.

Cole and Filatotchev could not have foreseen the levels of economic decline that beset Ukraine during the 1990s nor did they anticipate the persistence of strong Russian opposition to the enlargement of Western structures (EU and NATO). They projected the accession of Ukraine together with the Baltic states as part of a later wave of EU enlargement around 2005 (Cole and Filatotchev, 1992, p. 4). Instead, speedy and successful transition (Korhonen, 2001) has allowed at least some of the Baltic countries to be considered among those most prepared for EU accession,[11] although Ukraine only just now may be starting to extricate itself from a state of "economic involution" (Burawoy, 1996), in which the economy experiences prolonged decline, and is forced to consume its own depreciating resources rather than investing in new productive capacities and practices.

OBSTACLES TO UKRAINIAN ACCESSION

Internal Obstacles

In considering the obstacles to Ukrainian accession in the EU, Cole and Filatotchev focused on external factors, the relations between Ukraine and the EU, and did not consider the socio-cultural divisions within the country. These continue to generate contrasting visions of the preferred future orientation of the country.

Historically these divisions have been manifest in a gravitation toward Russia in eastern Ukraine and toward Poland (and Austria-Hungary) in the west. Moreover, the current westernmost oblasts of Rivne, L'vov, Ternopil', Chernivtsi, Ivano-Frankivsk, Zakarpattya, and Volyn were annexed to the Soviet Union only in 1945 (see Fig. 2). As a result of the different economic and social policies implemented by the Russians in the East and the Central European powers (especially Poland) in the West, contemporary Ukraine has a distinctive regional structure, a highly generalized summary of which is presented below.[12]

The East has experienced a process of linguistic Russification and immigration from Russia for a longer period than have other areas of Ukraine. Programs of accelerated industrialization directed by the Russian Empire (and subsequently USSR) since the 19th century were predicated on the abundance of industrial raw materials such as coal and iron ore and the collectivization of agriculture, resulting in large collective farms throughout the region.

In the West, the majority of the population are culturally and linguistically Ukrainian, with Polish elements. Here there was no mass immigration from Russia, the basis for industrialization was not as compelling, and agriculture is still organized in smaller plots than in the East. In these areas, at least among the elderly, there are still memories of Austrian and/or Polish administration, with their ostensibly greater commitments to democratic practices.

The Central region of the country represents a zone of transition between these extremes. Here, agricultural production has developed to support the food processing industry, and concentrations of high-tech industries (such as the aerospace) have emerged. The

[10]It is only within the last year (since 2000) that budget and trade accounts appear to have been balanced (Åslund, 2001, pp. 315, 316), although statistical data concerning the trade balance of Ukraine vary among the different sources.

[11]Estonia is considered to be among those countries (along with the Czech Republic, Hungary, Poland, and Slovenia) nearest to meeting EU standards.

[12]Whether the country has four or five major regions is the focus of debate (see O'Loughlin, 2001, p. 5). For a sampling of research on regional differences in Ukraine, see Hesli (1995), Nemir'ya (1995), Raynaud (1996), Balmaceda (1998), and Aberg (2000).

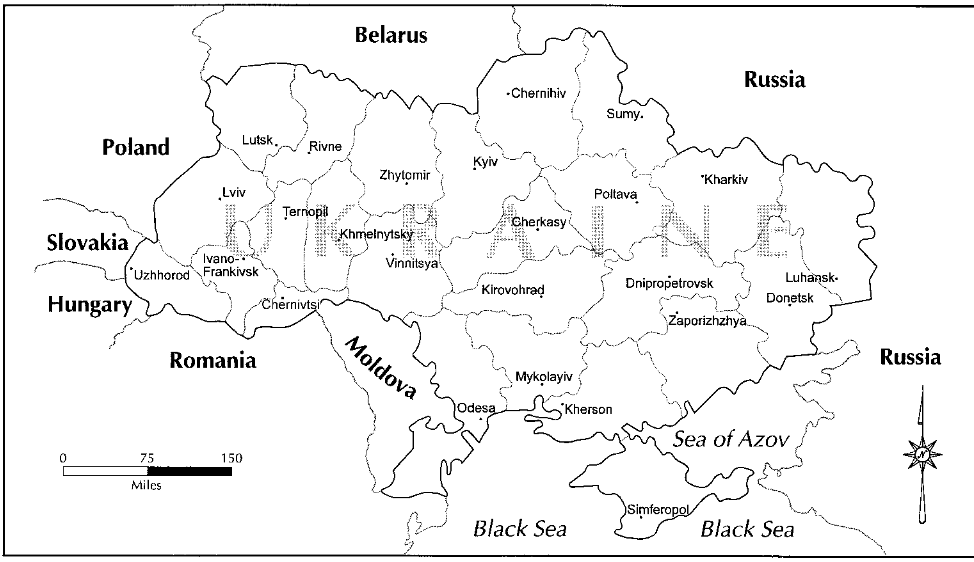

Fig. 2. Major political administrative divisions of Ukraine.

greatest concentration and development of higher-order services, such as the financial sector, is in the capital city, Kyiv, where the restructuring of industrial production has been quicker and more effective than in other regions. Here one finds the highest rate of tolerance and ethnic stability between Russians and Ukrainians (Bremmer, 1994, p. 281). While most indicators of political opinion reveal differences between citizens of Ukraine who are ethnically Ukrainian and Russian, the amount of Russian support for what would generally be considered "pro-Ukrainian" positions is considerable here.

In the South, Russification policies were also strong, but because of its location on the Black Sea its economy is more oriented toward trade and shipbuilding than to heavy industry. The Crimea is distinctive in this regard: it was the last region annexed to Ukraine, when in 1957 the Supreme Soviet of the USSR decided to transfer it from Russia to Ukraine, as a "gift" to celebrate the 300th anniversary of the reunion of the two countries by Bogdan Khmelnitskiy. Here Russians and Russophones constitute 90 percent of the population. As a result, the Kyiv Government has had to be attentive to the emergence of secessionist tendencies. The peninsula was claimed by Russia, for its strategic position and as a base for the Black Sea Fleet. An agreement between the two countries (the Treaty of Friendship and Cooperation) was reached in 1997, in which Russia recognized Ukrainian sovereignty on Crimea and obtained the right to rent the fleet base of Sevastopol for 25 years.

These regional differences also reflect internal political and economic distinctions,[13] but in a way that is rapidly evolving (O'Loughlin, 2001). In fact, in the early years of independence, regional differences were probably more important than they are today. In the intervening years, successive governments have worked to reduce regional, ethnic, and language divisions in Ukrainian society, and have managed to avoid violent conflicts by managing regional tensions and fractures. In the political sphere, nationalist movements remain firmly

[13]On the relation between regional distinctions and political behavior in Ukraine, see Bremmer (1994), Birch (1995), Hesli (1995), Holdar (1995), Barrington (1997), Bell and O'Loughlin (1999), Craumer and Clem (1999), and Kubicek (2000).

opposed to links with Russia and support policies for a rapid transition to a western-style capitalist system. The most important of these has been the nationalist movement Rukh, strongly based in the western oblasts, and one of only two Ukrainian parties (the other being the Communist Party) that can be defined as a mass party, with broad and active support. At the other extreme are those who support stronger links with Moscow and the maintenance of as much as possible from the old economy. These are the leftist parties, the most important of which remains the Communist Party of Ukraine. Like similar parties throughout the FSU, the CPU has a strong capillary network throughout the country. The third political force—a kind of strategic realism—is represented by the current government. Recognizing the strong interdependence of the two economies, the government has opted to maintain good commercial relations with Russia, in order to generate the economic growth necessary to develop stronger relations with the Western countries. This position is supported by a loose coalition of center and center-left movements. In the 1998 parliamentary elections, these parties together obtained roughly 37 percent of the vote (with the leftist movements taking 38 percent and nationalists roughly 16 percent), but the parties are divided and only the Greens and the People's Democratic Party received 5 percent of the vote (Craumer and Clem, 1999, p. 6).

These electoral patterns have resulted in a struggle between a pro-reform government and a conservative (leftist) parliament that has tended to impede the rapid implementation of reforms. However, more recently it seems that both the parliament and government have agreed on a moderately pro-reform position (see Åslund, 2001, pp. 322-325), and if this situation is sustained a more effective and Western-oriented politics may emerge. Nonetheless, as O'Loughlin (2001, pp. 5-6, 23, 25-29) has suggested, the political question of whether to develop closer ties with Moscow (which he defines as the "Slavic choice") or with the West (the "European choice") remains strongly affected by broad regional distinctions, while the economic choice (the commitment to develop a market economy or return to a planned economy) is not significantly influenced by regional differences, but more directly by the improvement or worsening of the economic condition of the population.

External Obstacles

Cole and Filatotchev's analysis of the conditions necessary for Ukrainian accession to the EU is in one sense still viable 10 years later. Because it concentrates on the aspects of geographic position, production structure, and commercial interactions, it still speaks to conditions that will be necessary for Ukraine's accession and that would bring Ukraine closer to the European Union.

Crucial in this regard will be the way in which the structure of Ukraine's economy is transformed. Ukraine is a major producer of coal, steel, and foodstuffs (Fig. 3), all goods that the European Union produces in excess. Particularly in the agricultural sector, the entrance of Ukraine into the EU would create a political crisis. Agricultural reform, for example, would require massive reductions in Ukrainian production of foodstuffs, which would in turn make it necessary to subsidize Ukrainian producers from EU communitarian structural funds, resulting in competition between Ukraine and the other less-developed areas of the European Union.[14]

[14]Within the EU, the recipient areas of the communitarian structural funds are located mainly in the Iberian Peninsula and southern Italy. After enlargement, such assistance likely also will be extended to countries in the Balkans and, for a shorter period, also to the new member countries in Central Europe. The possible contraction of EU funding to the southern Italian region is part of the basis for criticism of plans for EU enlargement voiced by officials in the Berlusconi government in Italy. For more on EU Structural Funds, and the regional networks being designed for their dissemination by Central European countries seeking EU accession, see Jordan (2001).

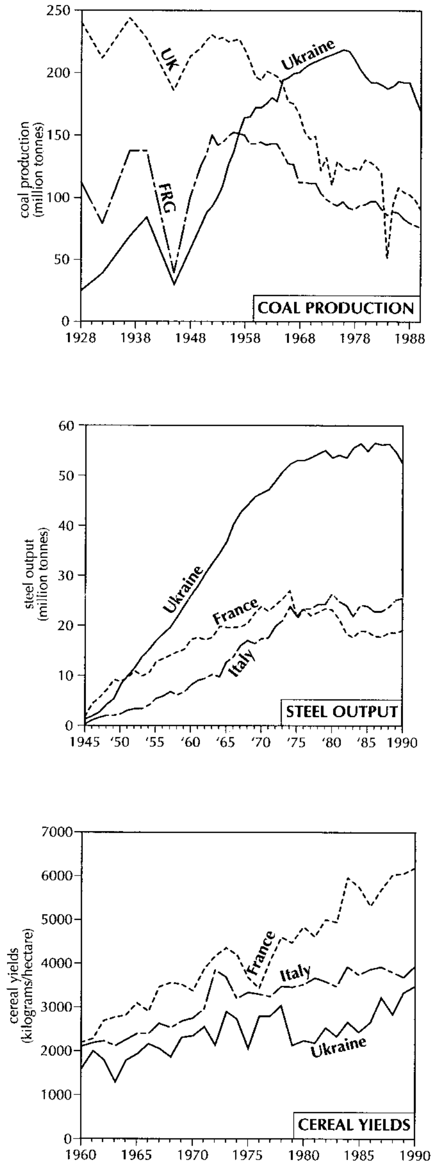

Fig. 3. Comparison of coal production, steel output, and cereal grain yields between Ukraine and selected Western European states, various years (adapted from Cole and Filatotchev, 1992).

Of course, even as an EU member, Ukraine would be located on the Union's eastern periphery,[15] but according to Cole and Filatotchev (1992, p. 8), this would affect only some aspects of its economic life:

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[15]The distinction between "central" and "peripheral" areas of the EU is calculated by Cole and Filatotchev considering both the distance of an area from the most populated part of the European Union and its distance from conurbations that have a centralizing effect at a local scale.

> With regards to the assembly of fuel (energy) and of raw materials at industrial establishments, central and peripheral locations should be equally placed. In contrast, for the distribution of products, both industrial and agricultural, over the EC market, any producer with customers *over the whole market* (e.g. a car manufacturer but not a bakery) on the periphery could have delivery costs roughly twice as high as one at the centre.

However, Ukraine's "peripherality" is heightened by the continued underdevelopment and deterioration of the transport network that links the country with the West. The need for improvements in road and railway networks in all the former communist countries means that road and railway linkages are poor not only within Ukraine, but throughout the entire belt of states that separates it from the West. The problem is made more complex by the fact that the structure of command economies led to the overdevelopment of the railway system at the expense of the road system, making it necessary to devote special efforts to expand the road network while at the same time dismantling sections of rail track that no longer serve an economically viable purpose in a market economy. Consequently, the entire transport network needs to be reorganized and operated according to new criteria. Such changes require heavy financial commitments that, at the present time, cannot be made without painful social costs, costs that many of the new governments cannot bear politically. In Ukraine, this looming problem presently is masked by sharp declines in traffic levels during the transition, but pressures on the aged transport system are likely to re-emerge to the extent the economic recovery continues (e.g., Pavlinek and Pickles, 2001).

Furthermore, efforts to reduce transport linkages with the states of the former USSR in order to draw closer to Europe do not always conform with the country's current trading patterns, which still bear the imprint of Soviet-era trade flows. In the Soviet period, less than 20 percent of Ukrainian products were exported beyond the borders of the USSR. Exports were managed by central organizations operating in Moscow and payments were subsidized by cheap energy. During the transition, Ukraine has made considerable efforts to re-orient its trade toward the West, with some success. Nevertheless, a large part of the external trade of Ukraine still depends on Russia (24.1 percent of exports and 41.7 percent of imports in 2000),[16] and it has been difficult for trading companies to break their dependence on Moscow.

To change this situation and to bring the country into line economically with EU requirements, it would be necessary to undertake major investments in the restructuring of industry, transport infrastructure, and domestic and international trade, to consume less energy, and to produce more competitive goods.[17] Cole and Filatotchev estimated that these investments would cost $1,240 billion to reach the EU average level of infrastructure and industrial development.[18] Adoption of EU anti-pollution norms would require substantial additional investment. In 1992, Ukraine's GDP was less than $300 billion, compared with $970 billion for Italy and $1,540 for Germany. As noted earlier, Ukraine's GDP is now estimated to be

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[16]Based on author calculations using data from the Italian Institute for Foreign Commerce. See also Tabernacki (2001) for a similar picture.

[17]In fact, the collapse of the distribution system and the underdevelopment of the wholesale market are some of the factors contributing to the pronounced decline of certain sectors of the economy (most notably agriculture).

[18]They obtained this result by comparing the 1992 projection of costs for the restructuring of the former GDR ($700 billion), increasing it in terms of the larger Ukrainian population and modifying it in accord with the different state of infrastructure and production sectors in the two countries.

about one-third the 1992 level; the country attracts only low levels of foreign capital investment and depends for financing from international financial institutions, mainly the International Monetary Fund and World Bank. From a purely economic point of view, therefore, prospects for Ukrainian accession to EU are not good.

PROSPECTS FOR UKRAINIAN ACCESSION TO THE EU

From a broader point of view, however, prospects for Ukrainian accession may improve, a point also argued by Cole and Filatotchev. They observed, perhaps somewhat naively, that regional proximity and a sense of community might also become a factor in accession.

> On the world map, Europe, especially without European Russia, is a tiny area, and compared with, for example Japan, Australia, or even the USA, Ukraine is very close to Western Europe. What is more, now that world affairs are no longer dominated by the East-West Cold War conflict and confrontation, a North-South confrontation with cultural as well as demographic implications of some other realignment of interests could replace it. While the population of Europe will hardly change in the next 3-4 decades, the population of the third world is expected to double during that time. Could it be that some politicians in EC countries feel that it is time for Europe to get its house in order and its act together ready for a new global confrontation. From this unpalatable view of the geopolitical situation of the next century, Ukraine is a country of considerable importance in spite of all [its] immediate drawbacks. . . . (Cole and Filatotchev, 1992, p. 25)

Such geographic and geopolitical issues may have become more salient in the past decade, and particularly at the end of 2001. Expansion of the EU to include countries such as Ukraine can be supported by arguments other than those focused strictly on the economic qualifications of the individual countries seeking accession.

First, international economic competition in many sectors, such as the automobile industry, require growing levels of investment and economies of scale. Countries with population sizes of 50-80 million (Italy, France, Great Britain, Germany, and Ukraine) do not have markets of sufficient size to generate such scale economies. Enterprise restructuring alone cannot solve the problem of small markets and/or the costs of operating in different (foreign) markets. As a result, enterprises engaged in automobile manufacturing and other activities have been forced to become trans-national in order to increase their market size to levels necessary to compete and generate new investments. An example is the wave of mergers and joint operating agreements that have typified the activities of trans-national companies in 1999 and 2000 (e.g., AOL and Time Warner, Fiat and General Motors), lowering unit production costs, eliminating redundant branches, and providing a steadier cash flow and and larger labor pool for research and development. Nonetheless, operation at a global level entails enormous costs both for enterprises, as they adjust to different norms and fiscal regulations and to uneven standards of law enforcement, and for states, which struggle to fully regulate enterprises fiscally and legally. From this perspective, the enlargement of an economic space that has a single currency and common norms brings advantages to its member countries globally.

Second, in the last 40 years, most Western Europeans have become used to living very well. Salaries are relatively high, social protection systems (although reduced in recent years) offer broader coverage than in the United States, and the wealthiest European countries are reducing the work week to 35 hours. However, at the same time pressure is mounting for adjustments to the European social contract and for improvements in economic performance. While employment rates in Europe remain high (e.g., Ireland, UK, Netherlands) and workers are now being imported from the former GDR, there also are signs of job loss. An example is the outsourcing of the apparel industry to Eastern Europe (e.g., Begg et al., 1999). Expansion of the EU may provide a means of minimizing this job loss to cheaper labor markets, thus maintaining the aforementioned social achievements if such achievements can be underwritten by a larger market of six or seven hundred million people, with the attendant increased scale economies mentioned above.[19]

How this space could be organized in a socioeconomic sense is a matter of concern in the EU. Proponents of a federalist position within the EU see the adoption of a model similar to that followed by Germany after re-unification. In this model, Western-style social protections and salaries would be transplanted slowly, to permit Eastern Europe to maintain its competitive advantage as a source of skilled human resources at a low price. As the GDP of Eastern Europe attains EU levels, the costs of transition would be compensated by the stronger purchasing power of internal markets in the Eastern European countries. If, however, Europe develops as an economic (but not political) union, the adoption of common economic rules and regulations, and the development of a standard level of enforcement will be possible. In this case, it will not be necessary to transplant the Western "social contract" (social safety net and salary levels).

A third possibility now being discussed in the framework of the regular political dialogue regulated by the Partnership and Cooperation Agreement between the EU and Ukraine is the development of a free trade zone that comprises both EU and Ukraine (Joint Press Communique, 1999). It is the weakest form of the three forms of association, and for this reason the easiest to realize. In the latter two cases, the economic future of Ukraine is more likely to be the source of cheap labor and raw materials for Western countries, as it also seeks to strengthen economic linkages with former USSR trading partners and with developing World markets, where its products that are not competitive in the West may find buyers.

Over the near term, the most likely scenario for integration focuses first on normalizing political life, establishing the rule of law, and fighting corruption. This process is sustained by the Partnership and Cooperation Agreement between Ukraine and the EU (European Commission, 1998) and by the EU-sponsored TACIS program. The objectives are to develop strong political relations through regular dialogue; develop exchanges, investments, and harmonious economic relations; establish economic, social, financial, scientific, technological, and cultural cooperation; sustain Ukrainian efforts to strengthen democracy; and foster the process of transition to a market economy. The Partnership and Cooperation Agreement provides the political framework for EU-Ukrainian cooperation, while TACIS provides grants for the transfer of know-how to the newly independent states of the FSU (*Evaluation*, 1998).[20]

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[19]The implementation of the Uruguay Round agreements within the World Trade Organization and the subsequent removal of tariff barriers and quotas for goods entering the EU is already generating serious discussion within the EU about the need for reciprocal opening of markets elsewhere in the world.

[20]Although TACIS-funded projects generally have been well conceived and successful, the overall influence of TACIS on Ukrainian decision making and institutions appears to be slight; financial resources have been limited and a comprehensive vision and long-term strategy have been lacking.

Table 1. Cumulative FDI in Ukraine of EU Member States, 1994–2000 (million U.S. dollars)

Country	1994	1995	1996	1997	1998	1999	2000
Austria	8.2	16.4	21.5	44.8	77.9	87.9	126.3
Belgium	5.7	24.9	9.5	17.2	17.2	22.4	23.3
Greece	4.1	4.8	11.8	14.7	25.7	25.9	25.3[a]
Denmark	0.7	3.7	4.9	6.0	13.8	17.9	10.9[a]
Ireland	14.2	25.2	31.5	42.5	61.5	56.2[a]	94.0
Spain	12.2	13.6	14.2	16.7	17.9	18.4	29.1
Italy	14.6	19.2	31.4	51.5	60.4	69.9	72.3
Luxembourg	0.4	1.0	1.7	7.0	4.8[a]	6.1	10.7
Netherlands	11.8	46.5	119.6	213.1	270.2	302.9	361.8
Germany	101.3	156.9	166.5	179.2	229.6	228.5[a]	237.9
Portugal	—	0.1	0.05[a]	0.05	0.9	0.9	0.9
United Kingdom	33.8	53.9	100.3	151.4	201.3	246.1	299.4
Finland	0.3	0.8	1.7	6.0	8.5	9.2	8.9[a]
France	9.6	11.3	13.6	18.1	18.6	33.7	40.9
Sweden	3.6	19.1	22.1	40.8	59.1	64.8	74.0
EU total	220.4	397.4	550.3	809.1	1067.5	1190.8	1415.7

[a]Cases in which a country's cumulative investment decreases relative to a preceding year apparently reflect downward revision of estimated cumulative FDI based on more recent information. The data presented here therefore should be used more as an indication of general trends than as an exact accounting of cumulative FDI.
Source: Compiled by the author from data of the Italian Institute for Foreign Commerce, Kyiv office (www.ice.it); see Tabernacki (2001) for information on FDI from all sources.

Political stabilization and normalization are thus viewed as a prerequisite for taking the next step, economic integration. A good indicator of progress of the latter is the level of foreign direct investment.

Foreign Direct Investment

The level of foreign direct investment in Ukraine following its independence has been discouragingly low (ca. $3.9 billion),[21] especially compared to the estimated cost of economic restructuring ($40 billion; OECD, 1997, p. 8) and the level of FDI in countries such as Poland over the same period ($30 billion). The low levels of FDI reflect some of the same obstacles that Ukraine must overcome in order to forge a stronger association with the EU countries: weak enforcement of existing laws, high levels of taxation, frequent changes in norms and regulations, and corruption (OECD, 1997; EBRD, 1999; Economist, 1999).

The EU countries in aggregate appear to provide the bulk of the foreign direct investment in Ukraine, accounting for an estimated $1.4 billion in cumulative FDI by the year 2000 (Table 1).[22] Integration efforts, frequent political contacts, and European economic aid

[21]The data concerning FDI and foreign trade presented in this section of the paper, unless otherwise specified, are estimates made by the Italian Institute for Foreign Commerce and published under the link "Guida paese Ucraina" (available online at www.ice.it), and data from PlanEcon, Inc. of Washington, DC (Tabernacki, 2001).

[22]The estimates of FDI by country vary widely by source, so the numbers presented here should be considered crude estimates only.

Table 2. FDI in Ukraine by Selected Major Sources, 1992–2000

Country	1992–1995	1996	1997	1998	1999	2000	Cumulative[a]
United States	201.0	62.0	118.2	124.6	83.7	46.3	635.8
Cyprus	64.6	21.4	39.5	23.3	47.5	176.3	372.6
Netherlands	46.9	72.7	94.4	50.9	36.1	60.8	361.8
Russia	42.1	64.1	44.2	34.3	103.0	26.6	314.3
United Kingdom	59.3	40.9	49.6	57.7	35.9	56.0	299.4
Germany	140.4	26.0	18.3	44.8	—	8.4	237.9
Virgin Islands	—	—	—	—	—	176.8	176.8
South Korea	—	—	—	169.4	1.0	—	170.4
Switzerland	26.5	13.1	29.8	20.4	—	79.5	169.3
Liechtenstein	9.7	16.9	26.8	31.6	—	—	85.0
Italy	31.4	—	20.1	8.8	9.4	2.6	72.3

[a]Cumulative total investment 1992–1 January 2001.
Sources: Compiled by the authors from Ministry of the Economy of Ukraine, unpublished data, 2001.

guided by the Partnership and Co-operation Agreement have all produced a climate that has begun to encourage FDI. Among individual countries, the United States appears to be the largest investor in cumulative terms according to data from Ukraine's Ministry of the Economy ($635 million since independence; Table 2). A remarkable phenomenon in recent years is the growth of offshore investments. Cyprus, the Virgin Islands, and Switzerland are prominent in this regard; these investments probably represent the repatriation of domestic capital extracted by the shadow economy (Table 2).

A combination of Russia's limited financial resources, sporadic levels of FDI from the United States, the collapse of Asian investments after 1997–1998, and the fact that many important investors that appear to be foreigners are in fact domestic leave the EU in a dominant position in terms of FDI in Ukraine. This situation may indeed have important implications for future Ukrainian membership of the EU, especially if obstacles to FDI are removed and flows increase sufficiently to permit effective restructuring of the economy.

Foreign Trade

With respect to foreign trade, the overall direction of the trade balance has remained relatively stable during 10 years of independence. The country ran negative trade balances throughout the period 1992–1999, apparently managing a small surplus of $600 million only in 2000 (e.g., see Åslund, 2001, p. 316; Tabernacki, 2001, p. 61). There has been a constant deficit with the CIS countries, at least partially compensated by a surplus with the rest of the world. The transit of goods (and most importantly of Russian oil destined for the Western European market) is an important source of incomes for Ukraine: in 1996, three-quarters of the $4.3 billion deficit in the trade balance was covered by oil transit fees (Economist, 1999, p. 32).

Ukrainian imports dropped roughly one-third between 1997 and 1999 (according to one source from $17.1 billion to $11.9 billion [Tabernacki, 2001, p. 61]), but recovered in 2000 (the first year of GDP growth since 1990) to $13.9 billion. Russia remains the leading purchaser of Ukraine's 10 principal export commodities (Table 3), but this role is declining as

Table 3. Ukraine's Most Important Foreign Trading Partners, 1995–2000 (mill. U.S. dollars)[a]

Source/destination	1995	1996	1997	1998	1999	2000
Exports from Ukraine (mill. $U.S.)						
Russia	5,579.6	8,781.5	6,936.6	5,155.2	2,396.4	3,515.6
Germany	549.9	493.5	687.1	768.7	560.1	741.4
China	398.3	771.0	1125.9	767.5	730.4	628.9
Turkey	229.2	453.7	728.1	755.7	673.4	868.5
United States	610.0	444.6	443.3	634.2	435.9	725.3
Italy	216.0	380.4	443.9	600.8	459.4	638.9
Belarus	447.7	769.2	864.2	575.6	345.7	272.1
Poland	149.4	366.7	418.1	349.6	301.4	417.9
Hungary	201.0	363.5	362.5	293.0	278.1	327.3
Total	13,014.9	14,061.2	14,231.9	12,637.4	11,581.5	14,572.6
Imports into Ukraine (mill. $U.S.)						
Russia	6,058.7	9,049.7	8,182.8	7,376.9	5,641.4	5,824.9
Germany	630.6	1037.0	1386.8	1342.5	942.9	1,134.4
United States	349.6	569.3	934.1	887.6	401.6	360.4
Poland	248.6	510.1	567.2	511.4	258.5	312.5
Italy	148.2	346.0	414.5	422.4	276.4	346.0
Belarus	295.4	389.3	410.5	374.3	343.5	601.9
Kazakhstan	61.6	161.4	411.0	352.1	164.8	412.8
France	89.5	248.4	324.2	311.9	236.9	236.1
Total	12,004.0	18,203.4	17,127.6	14,675.5	11,846.1	13,956.0

[a]????????

Sources: Compiled by the authors from unpublished data from the Italian Institute for Foreign Commerce (www.ice.it); Tabernacki, 2001, p. 61.

trade links with the West and former CMEA partners are increasing. The American presence in Ukraine is diminishing in terms of exports as well as FDI. In 2000, the United States was the only country listed in the table whose exports to Ukraine diminished significantly, by roughly 10 percent.

Ukraine's exports, thanks to favorable situation as a result of the devaluation of the hryvnia, registered remarkable growth in the year 2000, leading to a positive trade balance of $616 million after many years of deficit. The value of exports in 2000 (ca. $14.5 billion) was the highest since independence.[23] Ukrainian exports seem to be expanding in many areas of the world. In 2000, the main importers from Ukraine, after Russia, ordered by the value of their imports, were Turkey, Germany, the United States, Italy, and China (Table 3). The

[23]The efforts to reduce Ukraine's commercial dependence on Russia were more successful in exports than in imports. Exports to Russia remain important, but to a lesser extent in terms of absolute value, relative weight, and the percentage of goods traded. In absolute terms, $3.5 billion of goods were exported to Russia in 2000, while the value of imports was $5.8 billion (Table 3). In terms of relative weight, 24 percent of Ukraine's exports in 2000 went to Russia, while 41 percent of Ukraine's total imports were from Russia. These data suggest that Russia was more capable of substituting goods once imported from Ukraine with domestic products than Ukraine was in substituting Ukrainian goods for items imported from Russia.

strongest growth of export revenues in the year 2000 was registered with the Western countries: the United States (+66 percent), Italy (+39 percent), and Germany (+32 percent).

Transport Links and Infrastructure

A third, essential step for the integration of Ukraine within European economic structures such as the EU is the construction of proper physical connections with Western and Central Europe. In addition to the aforementioned problems of railway and road maintenance and their unbalanced development, the domination of the FSU in Ukrainian trade resulted in only limited development of routes linking Ukraine with countries beyond the Soviet border. To further strengthen the new commercial relations with the non-CIS countries, it is becoming increasingly important to remove bottlenecks at border crossings and customs posts. Most notable in this regard are Pan-European efforts for the reorientation and rebuilding of transport infrastructures. One such initiative is the Pan-European Transport Network, which involves all European countries (the EU, Central and East European countries, and the FSU eastward to the Urals), and which has convened three Pan-European Transport Conferences (Prague, 1991; Crete, 1994; and Helsinki, 1997) to identify problems and coordinate efforts to meet the following major objectives: (1) to ensure physical interconnections among the transportation networks of individual countries; (2) to promote the development of information systems (GALILEO, EGNOS) using satellites to monitor transport flows; (3) to improve the inter-operability of networks and equipment through technical harmonization; and (4) to promote environmentally friendly development of new transport networks.

Consequently, the main goal of the project is not the construction of new roads or railways, but the adoption of common standards and harmonization of traffic flows through the removal of bottlenecks. The components of the Pan European Transport Network include: (1) the trans-European Network (TEN) within the EU; (2) 10 transport corridors—10 routes (comprising roads, railways, and intermodal connections at ports and airports) throughout Central and Eastern Europe and the former Soviet Union; (3) 4 Pan-European Transport Areas (PETRAs), to standardize and strengthen maritime routes;[24] (4) and the TRACECA (Transport Corridor Europe-Caucasus-Asia) to link the European transport network with Asia; this is a mixed route, involving railways, roads, and ferries that run from the ports of Costanza, Romania and Odessa, Ukraine to Georgia (port of Poti), then by land through the Caucasus to Baku, then by ferry throughout the Caspian Sea to Atyrau (formerly Shevchenko), Kazakhstan and Turkmenbashi (formerly Krasnovodsk), Turkmenistan and the landlocked countries of Central Asia. Ukraine will be linked with Europe by three corridors, and to TRACECA by the port of Odessa.

Several transport corridors in the Pan-European Network will traverse Ukraine. Corridor III will begin in eastern Germany (Dresden), pass through southern Poland (Wroclaw and Katowice) to western Ukraine (L'viv) and then to Kyiv. Corridor V will link Venice and Trieste with L'viv and Kyiv via Ljubljana and Budapest. Some branches will also be added to connect this corridor with ports on the Adriatic Sea and with Bratislava. Corridor IX will be the longest corridor. It will run from Helsinki to St. Petersburg, then will divide in two branches, the western one extending to Pskov and Vitebsk in Belarus, and the eastern one to Moscow. The two branches will reunite in Kiev. At Liubashevka (south of Kiev) it will

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[24]The four PETRAs are: Barents Euro-arctic Area, which encompasses the countries bordering the Baltic Sea, Norway, and some Russian provinces (Murmansk, Arkhangel'sk and the Republic of Karelia); the Black Sea Area; the Adriatic-Ionian Area; and the Mediterranean Area.

divide: one branch will run to Odessa and the Black Sea, and the other through Moldova (Chisinau), Romania (Bucharest), and Bulgaria (Dimitrovgrad) to the Greek port of Alexandroupolis. These corridors will provide east-west links between Ukraine and Europe on both the north (Corridor III) and south (Corridor V), in addition to a north-south link (Corridor IX).

The Pan-European Transport Network is scheduled for completion in 2015, but, considering current delays, a more likely date will be 2025. Projects that must be implemented to complete the Ukrainian part of the aforementioned transport corridors are as follows (*Status*, 2000, pp. 3-11, 35-39, 48-53, 65-75): (1) for *Corridor III,* the focus is on the restoration and modernization of existing transport infrastructure, and particularly the reconstruction of the rail line from the Polish border to L'viv to adapt it to the Western European gauge; costs of projects in this corridor in Ukraine are 261 million EUR for railroads and 91 million for automobile roads; (2) for *Corridor V,* Ukraine already possesses functioning railways and roads, but the roads in particular need to be repaired and improved; total costs in Ukraine are projected at 61 million EUR for the road network, whereas the cost of railway modernization has not yet been estimated; and (3) for *Corridor IX* existing railway lines satisfy international standards, except in terms of speed, so only work on technical standards and transport procedures is necessary; however, the road network requires a massive program of infrastructure upgrading and repair;[25] total costs in Ukraine are estimated at 204 million EUR for roads and 245 million EUR for railways. The total cost for completion of the Pan-European Transport Network is estimated at 72.8 billion EUR.

CONCLUSIONS

We began this essay by raising serious questions about the prospects for Ukraine's future accession to the EU and by noting the emergence in Europe of strongly sceptical views concerning the advisability of EU expansion to the east. Nonetheless, as also is the case in the former Soviet Bloc countries in Central and Eastern Europe, the political and economic restructuring currently under way within the EU entails a complete realignment of all aspects of economic and political life (albeit at different rates and with different specific outcomes). At present, the Common Foreign and Security Policy of the EU on Ukraine (European Council, 1999, annex 5, point 6) contains the following statement: "The EU acknowledges Ukraine's European aspirations and welcomes Ukraine's pro-European choices." The Ukrainian commitment to EU accession was officially announced by the Presidential Decree "On the Integration Strategy of Ukraine into the EU" of 11 June 1998.[26]

Therefore, in principle at least, the international preconditions for the future integration of Ukraine into the EU are established, although in practice such official statements are not always followed by coherent actions, and agreements are not always respected. Indeed, EU representatives have expressed public concerns regarding "the persistence in Ukraine of certain legislative measures affecting foreign trade and investment" (Joint, 1999). Nonetheless, the appropriate institutional transformations in Ukraine, combined with economic

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[25]It is also necessary also to improve the network of service stations along roads in the corridor, as well as the port infrastructure at Odessa.

[26]A full text of this decree is available online (in Ukrainian only) at http://www.rada.gov.ua/laws/opravo/all/mdpn.htm (no. 584 of the list). As noted earlier, the intention is to align Ukraine's legal and economic structures with those of the EU, to attain EU membership, and to build a common geo-economic and geopolitical space with EU countries.

reorientation and increased transport connectivity and inter-operability might yet make this question a matter of serious consideration in the future.

Over the near term, however, the most constructive steps toward integration would appear to involve the reconfiguration of institutional practices and a restructuring of economic geographies within Ukraine. Restructuring will be a prolonged process, with some actions yet to be taken, such as the application of hard budget constraints (e.g., stricter application of bankruptcy law, non-tolerance of arrears, especially of salaries and utility bills; EBRD, 1999), but for political and economic reasons they can only be applied gradually. Rapid imposition of such regulations could create a chain of bankruptcies, destroying both profitable and unprofitable firms, because of the high levels of inter-related arrears. This would also have serious regional impacts, because of the geographies of production noted above.

The development of an economy in Ukraine that is compatible with that of the EU will require generational change, in which the relations among actors are shaped less by personal linkages and favoritism, and in which regional patterns of industrialization and orientation are reworked both economically and politically. In this process, the outcomes are uncertain. Over the next two to four years, we should witness the accession into the EU of 10 Central and Eastern European candidate countries. A period of consolidation will follow, during which there may be sufficient time for Ukraine to adjust its structures and practices more fully toward Europe. In any event, the goal of, and efforts toward, integration are transforming the geopolitics and economic geography of Ukraine in complex and interesting ways. Perhaps equally interesting will be the kind of EU that Ukraine encounters when it is ready to embark formally upon the accession process, and the effects of this effort on the country's internal politics and economic performance.

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