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EU-EAEU Cooperation and the ‘Common Neighbourhood’

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Policy Memo Presented at the Moscow BEAR Policy Conference

“Evaluating the Potential for Cooperation: the EU and the Eurasian Economic Union”

Moscow State Institute of International Relations (MGIMO)

September 16-17, 2019

¹EU-EAEU Cooperation and the ‘Common Neighbourhood’

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*Prepared for a policy workshop of the BEAR Network (Between Europe and Russia) on
“Evaluating the Potential for Cooperation: the EU, the EAEU, and the CSTO”
Moscow State Institute of International Relations (MGIMO), Sept. 16-17, 2019*

Executive Summary: The conclusion of a free trade agreement between the European Union (EU) and the Eurasian Economic Union (EAEU) could offer benefits to both sides, at least in the long-term. However, a significant obstacle is reluctance on the part of the EU to embark upon serious negotiations, in part due to the ongoing conflict between Russia and the West over Russia’s annexation of Crimea in 2014 and subsequent interference in eastern Ukraine. While negotiations between the EU and the EAEU would potentially provide one avenue to mitigate this conflict by reestablishing an alternate vehicle for restoring otherwise ‘frozen’ relations between the EU and Russia, one obstacle to the EU engaging in such negotiations may be the possible impact any agreement reached could have on countries in the ‘common neighbourhood’ that are not part of the EU or EAEU, particularly those countries that have concluded Association Agreements (AA) and Deep and Comprehensive Free Trade Areas (DCFTA) with the EU since 2014 (i.e., Ukraine, Moldova and Georgia).

Since the eruption of the Ukraine crisis in 2014 and conclusion of the AAs and DCFTAs, a process of differentiation has occurred in the strategies of the six ‘common neighbourhood’ countries in dealing with their position between the EU and EAEU. As EAEU members, Armenia and Belarus would be at the table in EU-EAEU negotiations and directly partake of any benefits. On the other hand, the other four countries would not, as they are not members of either union. Remaining outside of the process could exclude their interests of these countries from consideration and indeed worsen the current status quo.

Attenuating these risks may be a key to the successful initiation of negotiations. The options examined in the policy brief include: (1) to bring Ukraine, Georgia, and Moldova into a Customs Union with the EU so that they could partake of some benefits of an agreement; (2) to establish parameters for the negotiation designed to protect the vital interest of these countries; or (3) to invite these countries, plus Azerbaijan, to join in the negotiations as independent actors.

¹ Support for travel to the policy workshop in Moscow was provided by the Jean Monnet BEAR Network, which is funded by the Erasmus+ Programme of the European Union. The European Union does not constitute an endorsement of the contents of this publication, which reflect the views only of the author; the European Union cannot be held responsible for any use which may be made of the information contained therein.

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Option (3), it is argued, would best protect the interests of all parties involved and any resultant agreement would be a significant step closer to a common economic area from Lisbon to Vladivostok, due to its expanded scope. The main disadvantage of this option is that it would likely introduce additional complications into the negotiating process, including those related to the Ukraine crisis or to other frozen conflicts in the region. However, at a minimum, a forum for discussing the problems would be established.

Negotiations between the European Union (EU) and the Eurasian Economic Union (EAEU) could offer benefits to both sides, at least in the long-term. However, a significant obstacle is reluctance on the part of the EU to embark upon serious negotiations due to the ongoing conflict between Russia and the West over Russia's annexation of Crimea in 2014 and subsequent interference in East Ukraine. To this point, Russia's fulfilment of its obligations under the Minsk II agreement has been set as a precondition for lifting of EU sanctions, but little progress has been achieved in reaching a common understanding and response to the obstacles to the agreement's implementation. While negotiations between the EU and the EAEU regarding trade (and possibly investment) matters would potentially provide one avenue to mitigate this conflict by reestablishing an alternate vehicle for interaction regarding economic cooperation between the EU and Russia (Khitakhunov Mukhamediyev, and Pomfret, 2017), so far the EU has not been willing to take this route.³ Reasons for this reluctance are beyond the scope of this policy memo but considerations might include uncertainty about shared objectives of such dialogue, a preference for bilateral relations with individual countries, a suspicion of Russian motives (i.e., using negotiations as a backdoor to normalization without fulfilling the requirements of the Minsk II agreement), or doubts about the long-term viability of the EAEU. On the other hand, as the EU has generally been supportive of regional economic integration initiatives (such as MERCOSUR), once these political obstacles regarding Crimea and Ukraine are removed, one might expect the EU to be receptive to negotiations with the EAEU.

Because of the importance of the Ukraine situation as an obstacle to such negotiations, it would be important to consider the potential impact that EU-EAEU negotiations could have for

³ Linkage between EU readiness to cooperate with the EAEU and fulfilment of the Minsk was referenced by Federica Mogherini on behalf of the European Commission on April 6, 2016 in response to a question in the European Parliament, "Parliamentary Questions, April 6, 2016, Question reference E-015055/2015, http://www.europarl.europa.eu/doceo/document/E-8-2015-015055-ASW_EN.html?redirect

countries in the ‘common European neighbourhood’, namely those European post-Soviet countries that now are independent states. Structuring the terms of interaction between the EU and the EAEU in such a way as to avoid harm, or better, to bring benefits to countries that are part of the EU’s Eastern Partnership (EaP) policy (Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine, hereafter referred to as NIS6 [newly independent states 6]) might help to mitigate the situation. Benefits for the EU might include encouragement of liberal democratic reforms as well as improvements in the socio-economic status of partner countries. The purpose of this policy memo is to explore possible risks and benefits to the EaP countries posed by conclusion of or negotiations on a trade agreement or other economic agreement between the EU and EAEU and how these risks might be mitigated so as to make the EU more willing to engage in negotiations.

The analysis in this policy memo is rooted in several assumptions. First, it is assumed that it would be in the long-term interests of both the EU and EAEU member states to normalize economic relations, in line with the long-stated goal, articulated both by EU officials as well as Russian officials, on creating a common economic space ‘from Lisbon to Vladivostok’. It is also assumed that both actors, the EU and EAEU, would be supportive of such a goal under the right circumstances (Vinokurov, 2017, p. 66), e.g., if the Ukraine issue could be resolved to mutual satisfaction. Accordingly, it is assumed that it is in the interests of both actors to remove obstacles to the initiation of a process, and that compromise may be required on both sides to achieve this. In line with this, this memo aims to provide guidelines that might govern such a compromise, while protecting the interests of the NIS6.

How is the position of the NIS6 relevant to discussion of EU-EAEU negotiations, in particular trade discussions? To understand the reasons, we must examine more closely the nature of linkages that these countries have to each of the two integration bodies. Following the formation of the Eurasian Customs Union in 2010 by Russia, Belarus, and Kazakhstan, then the Eurasian Economic Union in 2015, several NIS6 countries (most notably Armenia, Ukraine, and Moldova) were encouraged to join. Since the eruption of the Ukraine crisis in 2014, a process of differentiation in the strategies of the NIS6 countries in dealing with their position between the EU and EAEU has become clear. The events of fall 2013 and winter 2014, when Armenia, Georgia, Moldova, and Ukraine were faced with a decision on whether to sign an Association Agreement with the EU, crystallized the choice facing these countries. At the same time, leaders of both the EU and Russia argued that the other side was forcing a choice of allegiance, at the same time

contesting the accusation made by the other party. While Russian officials had previously engaged in a consistent effort to persuade the Ukrainian leader, Viktor Yanukovich, to support Ukraine's accession to the EAEU, even this relatively pro-Russian leader resisted and appeared to be preparing to sign an Association Agreement (AA) with the EU. Incentives were also offered to Moldova and Armenia to accede to the EAEU while presumably the Russian leadership had little hope of persuading Georgia, which had previously left the Commonwealth of Independent States and seemed quite clearly set on a Westernizing path.

Joining the EAEU would, for all three of these countries, imply foregoing the Deep and Comprehensive Free Trade Area (DCFTA) with the EU, which was on offer with the signing of the Association Agreement. This is because the EAEU is a Customs Union, and member countries would therefore need to coordinate their external trade policies with one another, and thus would not be free to sign a free trade agreement on their own. To that extent, the NIS6 countries were indeed faced with an either/or choice, i.e., either accession to the EAEU or an AA and DCFTA with the EU. As the DCFTA does not involve a customs union with the EU, the choice is asymmetrical, i.e., it involved either membership in a customs union (the EAEU), on the one hand, or something short of that with the EU in the form of a deep and comprehensive trade area. All of the EaP countries except Georgia are part of an already existing CIS free trade agreement, which could continue to operate simultaneously with the signing of a DCFTA with the EU. Thus, at least in theory, the other five countries of the NIS6 grouping (excluding Belarus, which was already in the Eurasian customs Union) would have the possibility of being a member of a free trade agreement with the EU and as well as continuing the CIS free trade agreement; alternatively they could forego the DCFTA with the EU and join the EAEU (as Armenia did). Another option, adopted by Azerbaijan, is to maintain distance from both organizations (See Table 1).

For the two countries that have joined the EAEU, Belarus as a founding member and Armenia joining in 2015, the conclusion of a trade agreement between the EU and EAEU could offer additional advantages. Furthermore, both of these relatively small countries would be represented in the negotiation process through the EAEU, and could potentially gain leverage through being part of a larger entity. Currently Armenia seems committed to developing positive and constructive relations with the EU alongside its EAEU membership (Marakov, 2018), but it is restricted in its capacity to negotiate reciprocal trade arrangements with the EU due to the customs commitments of EAEU membership, while the EU has granted some unilateral preferential trade

arrangements to Armenia, conditional on fulfilment of certain political reform efforts. Belarus has not been able to negotiate preferential trade arrangements with the EU and is not yet a member of the World Trade Organization (WTO). Any gains achieved through an EU-EAEU agreement would be a net gain for Belarus. From the EU perspective these gains could reduce the effectiveness of EU conditionality requirements on these countries, however, unless these were built into an EU-EAEU arrangement itself. Therefore the EU might insist on a ‘human rights’ clause in any trade agreement, which has become the common EU approach. This could be objectionable to some EAEU members, including Russia.

Table 1: The Status of EU/EAEU Relation for NIS6 Countries

| Country | Status with EU | Trade relations with EU | Status with EAEU | Trade relations with EAEU |
|-------------------|---|---|--|--|
| Armenia | EaP member Comprehensive and Enhanced Partnership Agreement CEPA (June 1,2018) ⁴ | Preferential access granted by the EU under conditionality requirements | Member (2015) | Customs Union and free trade area |
| Azerbaijan | EaP member Partnership and Cooperation Agreement (1999) | No preferential access, trade quotas eliminated ⁵ | Non-member | N/A (bilateral) |
| Belarus | EaP member | No preferential access | Founding member | Customs Union and free trade area |
| Georgia | EaP member Association Agreement (2014) | Free trade agreement (DCFTA, 2014) | Non-member | N/A (bilateral) |
| Moldova | EaP member Association Agreement (2014) | Free trade agreement (DCFTA, 2014) | Observer state (May 14, 2018) ⁶ | CIS Free Trade Agreement ⁷ |
| Ukraine | EaP member Association Agreement (2014) | Free trade agreement (DCFTA signed, 2014; in effect Jan. 2016) | Non-member | CIS Free Trade Agreement, suspended by Russian Jan. 1 2016 |

⁴ Provisional application

⁵ European Commission, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/azerbaijan/>

⁶ Eurasian Economic Commission, <http://www.eurasiancommission.org/en/nae/news/Pages/14-05-2018-3.aspx>

⁷ Signed Oct. 18, 2011; in force Sept. 20, 2018. Accession of various countries occurred on different dates.

The situation for Azerbaijan is also not so complex. Azerbaijan maintains close political ties with Russia and other EAEU members. Despite conclusion of a Partnership and Cooperation Agreement with the EU in 1999 (which has not since been successfully updated) and the lifting of some trade quotas⁸, Azerbaijan does not have preferential trade arrangements with the EU. This situation leaves Azerbaijan free to negotiate bilaterally with both parties. While Azerbaijan would not partake of any benefits from an EU-EAEU agreement and would not be represented in negotiations on it, its freedom of action would not be impinged. The most serious effect for Azerbaijan would be exclusion from benefits of trade that would accrue to some other NIS6 countries, such as Armenia and Belarus. This could, theoretically, increase pressure on Azerbaijan in the direction of EAEU membership. (Conclusion of an AA and DCFTA with the EU would be a more complex matter, given EU conditionality requirements, and there is no indication of an appetite for that path in Azerbaijan.) Accession of Azerbaijan to the EAEU could pose some concern for the EU, given the importance of Azerbaijan as an energy partner, but this would depend on the overall nature of relations in the region.

For those countries that have signed an AA and DCFTA with the EU, the situation is potentially problematic. Unlike Armenia and Belarus, these countries (Georgia, Moldova, and Ukraine, hereafter referred to as the AA3) would not be directly represented at the negotiating table because they are not a member of either Union. Possibly the EU would see itself as responsible to represent the interests of these countries in negotiations. However, such an informal arrangement might smack of paternalism (the patron interpreting the client's interests) or, worse, of 'great power bargaining', in which larger actors define the interests of less powerful states. On the other hand, remaining outside of the process could exclude the interests of these countries from consideration and indeed worsen the current status quo. All of these outcomes might be considered unacceptable to the EU and breed disappointment in the AA3; on the one hand, the EU has embarked on ambitious partnership relations with the three countries, and, on the other, these countries have in turn taken on significant political and conditionality requirements to gain the benefits of the DCFTA. The result has been a shift in trade toward the EU since 2015,⁹ in addition

⁸ European Commission, Trade, "Countries and Regions: Azerbaijan, <https://ec.europa.eu/trade/policy/countries-and-regions/countries/azerbaijan/>

⁹Eurostat, <https://ec.europa.eu/eurostat/web/products-eurostat-news/-/EDN-20180709-1?inheritRedirect=true>

to other benefits such as visa waivers, but does not involve membership in a customs union or an EU membership perspective.

Exclusion from an EU-EAEU negotiation process could, as with Azerbaijan, under some circumstances, possibly fuel the existing level of support for EAEU accession in Moldova. The impetus for EAEU accession in both Azerbaijan and Moldova could be reinforced by the fact such membership imposes few if any political conditions and does not challenge existing tendencies to corruption (in the case of Moldova) or semi-authoritarian rule (in Azerbaijan). Alternatively, exclusion from EU-EAEU negotiations could increase pressure for an EU membership perspective in Ukraine, Georgia, or Moldova. The attractiveness of the EAEU in Ukraine and Georgia is weak, so stronger adherence to the EU would be the more attractive option, which would be an unfavourable development for Russia. To attenuate these various risks, not only for NIS6 countries, but also for the EU and Russia, seems to be substantially tied to finding a compromise approach. Various options might be considered;

Option 1: The EU could propose a customs union (and possibly also a provide a membership perspective) for Georgia, Moldova, and Ukraine, on the model of the relationship with Turkey. This would reduce the asymmetry in terms of their relationship with the EU compared to that of Belarus and Armenia with the EAEU.

Option 2: The EU could set parameters for the negotiations designed to protect vital interests of Georgia, Moldova, and Ukraine.

Option 3: Georgia, Moldova, and Ukraine, as well as possibly Azerbaijan, could be included in the negotiations as independent actors..

This section outlines the advantages and disadvantage of each approach:

Option 1: *Advantages:* This option would bring these countries closer in their association with the EU and might seem to foreshadow a move to a membership perspective. While at first glance it might seem that this option could also assure the AA3 countries of the same trade advantages from the negotiations as the EU, this would not necessarily be the case, as discussed below. ***Disadvantages:*** The first problem with this option is its minimal feasibility in terms of gaining acceptance by EU member states. Second, to be meaningful, such a union would need to assure application of benefits to the AA3 by third party partners. As the EAEU would only be signing an agreement with the EU and not with the AA3, the AA3 would be obliged to honour

tariff benefits for EAEU imports (by virtue of being in a customs union with the EU), but the EAEU would not be obliged to reciprocate for AA3 benefits imports. This has been a problem with the Turkish Customs Union (Hakura, 2018); Turkey has also complained about inadequate influence on EU trade policy. Finally, this approach would likely also antagonize Russia, as it could be interpreted as an additional step moving these countries closer to EU membership. .

Option 2: *Advantages:* This option would involve unilateral EU demands (presumably discussed with AA3 countries) in setting the parameters for negotiations with the EAEU. As such, while potentially irritating to Russia or other EAEU countries, if agreed, they could provide clarity from the outset of the process. One important condition might be, for example, that neither the EU nor the EAEU (nor their respective member states) could discriminate against other countries in terms of trade relations based on their membership in the other union. This would, for example, require Russia to lift its suspension of the benefits to Ukraine under the CIS trade agreement (imposed by Russia when the EU-Ukraine DCFTA went into effect). Lifting this suspension could serve to reduce tensions between Ukraine and Russia, as well as offering economic advantages to both parties, in exchange for the benefit of opening EU-EAEU negotiations. While not giving these countries representation in the process, these parameters could guard against adverse effects such as trade discrimination. *Disadvantages:* This option would still leave the AA3 excluded from the negotiation process, and thus they could suffer disadvantages by not gaining the benefits of any agreement reached. Any conditions set by the EU at the outset intended to protect AA3 interests would be difficult to enforce; not only would it be technically difficult to establish discrimination but it would be difficult to gain agreement on sanctions for violation of the agreement. Once an EU-EAEU agreement was in place, it could gain a momentum of its own that might not be affected by such sanctions. There would be no clear follow-up action to protect the interests of the AA3 countries.

Option 3: *Advantages:* Under this option the AA3 (and potentially Azerbaijan) would gain a seat at the table and be able to represent their own interests. Any resultant agreements would be a significant step closer to a common economic area from Lisbon to Vladivostok, as the scope would be expanded. This option would also involve an implicit affirmation, by Russia as well as the EU, of the sovereignty of the AA3 countries. This might obviate the need for an ‘either-or’ choice between the EU and EAEU. *Disadvantages:* This approach would complicate the negotiating process and could, in effect, introduce contentious elements related to the Ukraine

crisis into the negotiations. The status of frozen conflicts within the AA3 countries could introduce additional complications.

beyond the additional parameters set. This option might be resisted by Russia or other EAEU countries because Russia might prefer to negotiation with a partner of an equal status (the EU) rather than giving potential leverage to smaller actors.

Table 2: Relative Costs and Benefits of the Options for Various Parties

| Option | Relative cost/benefit to | | | | Feasibility |
|--------|--------------------------------|---------------|-----------------|-------------------|-------------|
| | <i>The EU</i> | <i>Russia</i> | <i>The EAEU</i> | <i>The AA3</i> | |
| 1 | Ambiguous | Negative | Neutral | Possibly negative | Low |
| 2 | Neutral | Negative | Neutral | Mildly positive | Low-Medium |
| 2 | Mildly positive | Ambiguous | Ambiguous | Positive | Medium |

Conclusion

Based on an analysis of the relative costs and benefits to the parties involved, Option 3 seems the most promising. While all three options have more negative than positive implications for Russia, the ‘gain’ involved in winning EU agreement to EU recognition of the EAEU and the initiation of negotiations might be adequate to offset this. This would be the fundamental core of the compromise solution, i.e., an elevated status for the EAEU in exchange for a more ambiguous negotiating environment for Russia. Whether this trade-off would be convincing for either the EU or the EAEU could be tested only in practice. While the difficulties of negotiations under this option might prevent conclusion of any easy or ambitious agreements between the parties involved, a process of dialogue and interaction would be initiated that could be an important step in easing current tensions and finding compromise solutions.

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