

2014

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## [EPC SPECIAL COLLECTION]

## Ukraine on the edge

*Amanda Paul*

During the past six months Ukraine has been through a revolution, its Crimean peninsula has been annexed by Russia and its territorial integrity continues to be challenged. With ongoing unrest in three Eastern regions, a peace deal recently agreed in Geneva hangs by a thread as pro-Russian separatists continue to occupy numerous public buildings and international actors remain divided over how long to wait for Russia to implement the accord before placing new sanctions. While the West accuses Russia of provoking and influencing the unrest, Russia points the finger at Ukraine's interim leadership which it claims is illegal and "fascist".

Unless the unrest can be halted there is a serious risk it may increase, jeopardising crucial Presidential elections scheduled for 25 May. It is important that the election goes ahead as the new President will have democratic legitimacy thereby ending Russian claims that Ukraine has no legitimate or constitutional leadership. While it is also possible that Russian troops may cross into Ukraine on the pretext of "protecting" Russian speakers, this seems less likely as the current state of affairs suits Moscow leaving the situation open to interpretation. Thereby Russia seems more likely to maintain a covert approach.

The international community's response to the most serious challenge to the post-Cold War order has been inadequate. The 'price tag' for annexing Crimea was little more than visa bans and asset freezes on a limited number of Russians. Despite the US and EU threatening to move to tougher economic sanctions if Russia failed to de-escalate, including pulling back the some 40,000 troops it has on Ukraine's eastern border, nothing happened. Furthermore, the fact that 58 states abstained from voting for Ukraine's territorial integrity at the UN General Assembly on 27 March indicates that either many states do not want to vex Russia, or alternatively are far from displeased that Russia is challenging the West, particularly the US.

This response is serving to make Russia more resolute in pursuing its stated goal of a neutral and federalized Ukraine. Federalization would not only give regions the right to block crucial decisions, including future moves towards EU integration, it would also allow Moscow to increase its influence and possibly lead to the de facto disintegration of Ukraine.

Today, much of Ukrainian society is afraid of Russia's intentions, concerned that their leadership is unable to hold the country together and disappointed by the international community's failure to turn its tough statements into actions. They are waking up to the reality that the West does not care that much about Ukraine.

### **A legacy of corrupt governance**

Ukraine's leadership is in a weak position. This is not simply a consequence of the crisis but stems from the past 22 years of Ukrainian history. Corrupt governance and a society that has never been integral explains Ukraine's weak statehood and vulnerability. With decentralization having been perceived as a threat to territorial integrity, Ukrainian governments have excessively centralized power, extracting too much money from the regions which left local populations bitter, no more so than in the industrial Russian speaking East. While deposed President Viktor Yanukovich hailed from Donetsk, he and "his family" continued looting the region rather than improving its socio-economic situation. Yet while many residents were not "upset" by Yanukovich's fall from power, they were nevertheless sceptical of the new "Western oriented" leadership in Kyiv, not least as consequence of Russian propaganda.

Furthermore, the majority of the oligarchs that dominate Eastern Ukraine have not been as influential as they could be in defusing the situation. With the exception of the newly appointed governor of Dnipropetrovsk, Igor Kolomoisky, others have been careful not to openly blame Russia. While oligarchs have a firm interest in maintaining the sovereignty of Ukraine, Russian President Vladimir Putin holds sway over the Russian business interests of many.

Despite the efforts of Prime Minister Arseniy Yatsenyuk, much of the new government is inexperienced, reacting too slowly without strategic foresight, including failing to be sufficiently visible in the East. The new government also inherited an inept, corrupt and often disloyal military and police not capable of defending the country or upholding the rule of law.

Yet despite these weaknesses and Russian propaganda, a recent survey by Donetsk National University concluded that presently, two thirds of Donetsk's population wants the region to remain as part of Ukraine, while large majorities in all eastern regions do not support federalization, nor joining Russia.

## Geneva – The peace deal that never was?

Hope that the 17 April four party talks in Geneva would result in a peace deal seemed to be a case of the EU-US grabbing at straws to keep diplomacy alive. On the day, the talks were trumped by President Putin, doing a live Q&A during which he called Eastern Ukraine Novorussia, threatening to take it back. The final agreement stresses that all sides refrain from any violence, intimidation or provocative actions; that illegal groups must disarm and vacate illegally occupied streets, squares and buildings. As of today this has not happened and violence and criminality are spiralling. This 'deal' opened the door for Moscow to blame the government's anti-terrorist operation as the perpetrators of violence. The fact that new sanctions were not agreed and brought to Geneva meant there was no leverage on Moscow to implement the deal. Rather the 'if you do not do this we will place sanctions and isolate you' narrative was repeated, which Russia does not take seriously. The ongoing instability will be used by Moscow to say Ukraine's leadership is incapable of running the country.

The EU has been particularly weak and shortsighted. The three-stage approach – threat of sanctions, targeted sanctions after the Crimean referendum, and tough economic sanctions if Russia did not deescalate – has not been adhered to. EU Member States are increasingly divided, dithering, and fearing the possible costs to their own economies, energy security and retaliation from Russia. A 'if the dog is barking why provoke it further' approach is now being taken by from some states.

There is disagreement over when and what could trigger new sanctions. While some states want new sanctions immediately, others want new sanctions dependent on a further military intervention into Ukraine. While the European Commission is drafting a risk assessment analysis of the potential impact of sanctions at a time of economic austerity there is little appetite to damage economic ties. Business deals with Russia continue. This approach sends the message that the EU is more interested in protecting national interests than defending the values and principles that the EU claims to stand for.

### Next steps

There should be no more 'talks for the sake of talks' as it sends a very wrong signal about the West's commitment to sanctions. As long as Russia upholds its current approach the EU and US must place new economic sanctions that include trade restrictions and other measures targeted at Russia's elite. If they do not Putin will believe that he has been given 'carte blanche' to redraw Europe's borders. Furthermore, while Washington failed to convince Saudi Arabia to increase oil production which had the potential to negatively impact the Russian economy, the US should remain open to using its strategic reserve and increase its oil production by some 500-700 barrels per day. While there is now an agreement to increase the number of OSCE monitors in Ukraine from the present 100 to 500, it is important that the majority are deployed in the East, which will make the OSCE more visible and better able to monitor events on the ground.

The EU must also stick to its commitments regarding financial assistance and the final signature of the Association Agreement (AA) with Deep and Comprehensive Free Trade Area (DCFTA). As of today only the political section has been signed. While the first tranche of finance – some €600 million – is due to be delivered in the coming days, it is also important that signature of the economic part of the AA happens as quickly as possible after the Presidential elections, as it will send a strong signal of EU support.

The Ukrainian government also needs to push ahead with urgent political, judicial and economic reforms as well as the Presidential elections. The appointment of a new President opens the road for everything else including early parliamentary elections and the adoption of an amended "inclusive" constitution which is crucial for Ukraine's future governance. On 15 May draft constitutional amendments will go to a broad public consultation, which needs to be an inclusive and legitimate exercise other it will be an irrelevant exercise, risking the legitimacy of the amended constitution. Once adopted (possibly early autumn), it will be possible to move ahead on a number of key issues including decentralization of Ukraine's regions giving them a high degree of autonomy related administrative and financial matters, education and culture with people able to elect and control their regional governors.

Ukraine is passing through the most traumatic and difficult period in its 23 years of independence. This crisis can still be resolved but only if the West is resolute in its support of Ukraine and ready to take the necessary actions to counter Moscow. Failing to do this will signal that the West is allowing Moscow to revert back to the Cold War era of defined zones of influence which will have very dangerous consequences that will go well beyond the borders of Ukraine. If we do not act today, we are certain to pay the price tomorrow.

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## Ukraine and the EU: turning the Association Agreement into a success story<sup>1</sup>

*Kataryna Wolczuk*

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### BACKGROUND

It is paradoxical and symbolic that it has taken Ukraine two waves of mass protests to conclude a new agreement with the EU. One of the concessions to Ukraine following the Orange Revolution of 2004 was to open negotiations on the Association Agreement (AA) in 2007. It took a second revolution, with over 100 killed, to pave way for the signing of the AA after deposing President Viktor Yanukovich in February 2014.

The Association Agreement (AA) with Deep and Comprehensive Free Trade Area (DCFTA) between Ukraine and the EU is the longest and most detailed agreement of its kind. It contains detailed and binding provisions on Ukraine to align its laws and policies with those of the EU (*acquis*). Under the DCFTA, advanced economic integration is not just about tariffs but, above all, legal and regulatory convergence with EU standards. The AA goes beyond purely 'trade issues', also influencing the quality of democracy, governance and the rule of law. Therefore the agreement carries a promise of a major transformative effect on the Ukrainian state and economy.

The concerted 'export of the *acquis*' through association is modelled on the pre-accession agreements which envisaged the alignment of candidate countries' legal framework with the *acquis*. In essence, the implementation of the DCFTA would make Ukraine a 'shadow member state'. However, the modelling has been very sketchy: both the *finalité* and operationalisation are missing for this 'shadowing scenario'.

First, no membership is envisaged even in the long term. This means that the rationale for Ukraine to approximate the *acquis* is different from the accession countries. Therefore the scale and pace of approximation envisaged by the AA must be under-written by sustainable benefits in modernisation, economic growth and welfare generation.

Second, the process of approximation has not been fully operational. There is no road map to facilitate Ukraine's economic integration even though the AA envisages Ukraine's approximation of 80-90% of the *acquis*.

#### Why no strategy so far?

The lack of strategy reflects the lack of a political blueprint for relations with the eastern neighbours. The formula of 'political cooperation and economic integration' left many EU officials with the challenge of translating ambitious yet vague proclamations into practical arrangements. As Helen Wallace observed, the neighbourhood policy 'has been developed without the benefit of a solid template based on previous experience, not least given the lack of workable and tested alternatives to a membership perspective'. In practical terms, the EU officials lacked a 'guiding framework' to indicate clearly what elements of internal market legislation are essential to its functioning, both from the perspective of new participants and existing ones and which elements can be left aside by new participants to facilitate their integration. Hence, EU officials preparing the AA were confronted with two risks of getting it wrong: either over-regulation and

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overburdening new participants, or 'hollowing out the internal market' by inadequately prepared participants. Faced with this conundrum, the EU officials opted for a low-risk strategy for the EU, but at the same time increasing the risk of 'regulatory overload' of the Eastern partners, such as Ukraine.

This strategy is not surprising from a practical point of view. In terms of trade alone, the EU has little interest in concluding DCFTAs with the eastern partners. Even Ukraine – the largest of the countries in the Eastern Partnership – is rather insignificant as a trade partner for the EU (accounting for 1.4% of EU exports) to justify such an agreement. The DCFTA appears to be being extended to the eastern neighbours primarily for political reasons, rather than reflecting their trade salience for the EU. Nevertheless, the DCFTA negotiations were approached in terms of what the single market can absorb rather than focussing on the interests and needs of the partner country to make integration into the single market a feasible prospect.

The long and wide-ranging negotiations on the AA were not preceded nor accompanied by screening or analysis of the likely sectoral impact. There were no estimates of the overall or sectoral cost to Ukraine of the implementation of the AA. Without this, the practical sequencing of integrating the partner countries into the single market has not been worked out. This is a major weakness in the EU's strategy, which could undermine the AA as a tenet of EU's approach to the eastern partners, especially against the backdrop of Russia's own policy in the region.

### **Why is the strategy needed?**

The lack of an effective strategy for implementation undermines the EU policy in the eastern neighbourhood for two key reasons: first, the sheer scale the approximation required from eastern partners and, second, the wide gap between the EU's regulatory framework and partner countries' actual needs and capacities in the short- to medium term.

Under the DCFTA, eastern partners are to approximate the bulk of EU trade *acquis* (80-90%). So the DCFTA envisages wide-ranging, far-reaching and costly approximation. In exchange, the eastern partner countries are offered the promise of access to EU markets. In the long-term, this provides a clear template for reforms. If and when implemented, the AA agreements would not only integrate Ukraine with the EU in economic terms but also anchor the reforms of the economy and the state institutions.

However, the *acquis* was not devised as a blueprint for the modernisation of non-member states. The intricate and dynamic system of EU rules was developed for market economies in the process of formation of the single market and not as a blueprint for reforming the countries at a lower level of development. This issue was already raised during eastern enlargement but the imperatives of membership justified the wholesale convergence with the *acquis* to new member states. Needless to say, this rationale is much weaker *vis-à-vis* the eastern neighbours.

The Agreement is asymmetric in favour of Ukraine as Kyiv will open its borders to EU goods in a progressive way. This is a positive feature, but asymmetry is not sufficient to ensure Ukraine's readiness to withstand competitive pressures from the EU once the transition periods are over. After all, the DCFTA is not so much about tariffs as 'deeper' governance issues.

It is argued that the Association Agenda is a form of operationalised plan for approximation. Yet in practice, like its predecessor – the Action Plan – the Agenda remains too vague to guide the approximation process. For example, the monitoring of state aid, which is one of the most complex and intricate parts of the *acquis*, requiring the creation of a robust and effective system controlling the politically-sensitive process of granting and recovering state aid, is addressed in very general terms in the Association Agenda: 'The Parties shall cooperate in the establishment of an effective system of state aid control and monitoring in Ukraine'.

There is no doubt that the prospect of integration into the EU single market offers the best chance for the neighbouring countries, including Ukraine, to modernise and foster economic growth. But the *acquis* is not easily transposed to the eastern partners, given their political, economic and administrative context. Using the AA-DCFTA as a template for reforms in Ukraine raises some formidable challenges, at the very time when successes and failures have high-profile political geopolitical stakes, owing to Russia's efforts to undermine European integration as a viable option for all the eastern partner countries in general and Ukraine in particular.

## **STATE OF PLAY**

### **Key Challenges**

#### ***Political and Economic Costs***

The DCFTA requires considerable short-term and medium-term efforts and impose noteworthy costs on Ukraine, while tangible benefits are expected to accrue in the longer term. Regulatory approximation with EU *acquis* requires Ukraine to bear up-front political and economic costs (which the new Ukrainian authorities may not be able to afford nor cope

with the domestic and external ramifications) as they embark on challenging reforms in pursuit of long-term benefits from modernisation.

For example, to meet EU requirements in the area of food safety (SPS), Ukraine has to create laboratories, introduce inspections and carry out extensive training. The costs of implementing the DCFTA in a comprehensive way are likely to be prohibitively high for the Ukrainian state agencies, especially given their current low capacity, inadequate staffing and lack of resources. Moreover, the costs of approximation are borne not only by state authorities but also by non-state actors, i.e. business. It is estimated that during enlargement around half of the overall costs of legal harmonisation was incurred by non-state actors who needed to adjust to new regulations (e.g. SPS standards by introducing the HACCP system).

### ***Expertise and Capacity***

The very nature of the negotiations – secretive and technical, requiring an advanced level of insights into the *acquis* – did not stimulate public discussions and understanding amongst key stakeholders and the wider public. An information campaign was only launched in September 2013, i.e. two months before the Vilnius Summit, thereby leaving vacuum for stirring fears and anxiety about costs and losses amongst Ukrainian businesses. Despite the profound implications of the AA for state institutions and business, so far there has been little engagement with these key stakeholders inside Ukraine. For example, the Ukrainian state officials so-called 'in-line ministries' often have little, if any, understanding of what is required of their ministries under the AA and any related cost. Smaller food producers are concerned about the new SPS standards. The secretive, complex and highly technical approach of the EU has created something of a barrier and disincentive for the key stakeholders in Ukraine to engage with the process and grasp the significance and opportunities arising from the DCFTA.

### ***Assistance***

The actual costs of implementing the *acquis* are not reflected in the current EU level of assistance to Ukraine, even with the extra funds made available to Ukraine since March 2014.

Access to the market needs to off-set the costs of approximation. But, as it is, the costs of approximation in the agricultural sector are not reflected in the quotas and tariffs for key agricultural products which Ukraine exports to the EU. For example, Ukraine is to adopt EU SPS for all dairy production, whether for domestic consumption or for export to the EU. Adopting such standards is clearly desirable from the point of view of food safety, but is not feasible for all domestic producers. At the same time, access to the single market remains restricted, as the EU offered relatively low quotas in the AA for these products, in light of Ukraine's capacity.

### **The Russian 'factor'**

The implementation of the AA is a challenge on its own. But Russia's policy towards Ukraine increases the challenge immensely. Russia can and will work to undermine Ukraine's European choice while depicting the AA as a 'suicidal pact' for Ukraine. The extent to which Russia is prepared to go to 'punish' Ukraine for its westward orientation is already evident. Therefore, above-mentioned challenges, omissions and risks now have acquired a particular geopolitical salience.

Russia endeavours to build the Eurasian Economic Union by 2015 and create a single Eurasian market. This development presents Ukraine with the prospect of being increasingly excluded from this market. Russia is and will remain an important trading partner: Russia attracts 20.7% of Ukrainian exports (just below the EU, 21.8%). Russia will utilise a full spectrum of punitive measures to exploit Ukraine's dependency on the Russian market, aside from any other forms of direct intervention.

Re-orientation away from Russia will be politically painful and economically costly for Ukraine. This poses a major challenge for the EU's strategy in the eastern neighbourhood. What was a technical matter is now a political and geopolitical matter. The temporary lifting of tariffs for most Ukrainian products till November 2014 by the EU is certainly a step in the right direction. But the current level of quotas for Ukraine, especially for agricultural products, needs further revising on a unilateral basis. For instance, in cases where the EU restricts market access for key agricultural products (such as, for example, dairy products) from Ukraine, the Ukrainian producers have no choice but to rely on access to the Russian/Eurasian market, despite arbitrary restrictions imposed by Russia. Not only they will be forced to adapt to regulations of the Russian/Eurasian market but will remain highly sensitive to the political aspects of relations with Russia. The economic and social costs for the electorate in eastern and southern Ukraine will have repercussions for Ukrainian domestic politics.

Like the EU, the Eurasian project entails deep economic integration and relies on *ex-ante* approximation. This means that at least in the short term, the Ukrainian producers find themselves already caught in two different regulatory regimes. To

prevail, European integration has to be attractive and feasible to compensate for the loss of the Russian market and punitive energy pricing.

Russia is well positioned and highly determined to undermine Ukraine's European integration in three respects. First, Russia can draw upon a much broader spectrum of instruments than the EU and, unlike the EU, does not hesitate to deploy punitive measures, even by transgressing domestic and international law. Second, Russia exploits the above-mentioned weaknesses in the EU strategy by stressing the short-term costs and benefits from integration with the Eurasian regime, as opposed to the long-term benefits derived from integration with the EU. Russian officials refer to the DCFTA as a 'suicidal' for the Ukrainian economy and will miss no opportunity to highlight any losses and disruptive effects. Third, Russia exploits specific needs and vulnerabilities of the countries in the 'near abroad'. Russia carefully selects its instruments from the wide array at its disposal to target specific countries, domestic actors, regions, sectors etc. As a result, the price imposed by Moscow for 'moving away' from Russia further increases the already high costs of closer economic integration with the EU for Ukraine.

During the DCFTA negotiations with Ukraine, the role of Russia was not factored in to any significant extent. In essence, the EU had glossed over not only the political and economic costs that the EaP countries had to pay for complying with EU's own offer *but also the costs imposed by Russia for moving towards the EU*. The new political context in the eastern neighbourhood needs to be fully reflected in the EU's strategy and the adoption of Autonomous Trade Preferences is a very good first step in this direction.

## PROSPECTS

The EU needs to refine its approach to ensure that the AA-DCFTA actually works in and for Ukraine. The conclusion of the AA is just a first step in terms of economic integration of Ukraine with the EU. The EU should focus on the following aspects:

First, while the DCFTA is being concluded, the attention ought to be on facilitating cost-effective implementation. This requires careful sequencing and prioritisation of the implementation process to avoid overburdening the Ukrainian state with unnecessary or excessively costly regulations in the short-to-medium term.

The EU needs to promote institutional and interim regulatory solutions which are most attuned to the current needs and context of Ukraine and hence likely to result in actual, rapid, though selective, implementation in order to make the DCFTA not only desirable but also a feasible prospect.

Second, an effective and wide-ranging information campaign needs to be launched. The EU must work to ensure that the substance and importance of AA and DCFTA is known beyond a narrow group of officials and experts and reaches out to key stakeholders: state officials, business and civil society.

Third, the current level of assistance is clearly inadequate to facilitate the implementation of the DCFTA. It is unlikely to be significantly increased. So, in practice, Ukraine needs to adopt vast sways of regulations with a fraction of the assistance that accession countries receive. It is at the time when Ukraine's trade with the EU has just started to recover after a sharp decrease in 2009 as a result of the global financial crisis. Limited funds means they have to be spent in the most efficient way through appropriate sector-specific sequencing and prioritisation of approximation process. Focusing on selected sectors would help turn them into early successes of Ukraine's integration into the single market.

The AA-DCFTA carries great transformational potential, but to ensure that it lives up to expectations, the EU cannot afford to gloss over the domestic and geopolitical context in the eastern neighbourhood. In so many respects, success will depend on crafting a detailed and viable strategy for cementing these countries pro-European orientation.

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## Will Crimea herald a new post-Cold War era world?

*Rosa Balfour*

The end of the Cold War twenty-five years ago brought about a difficult but manageable world in which Russia, the US, and European countries cooperated to manage common problems. There have been difficult times, with the break up of former Yugoslavia, the NATO intervention for Kosovo, and in 2008 when Russia's intervention in Georgia's breakaway regions of South Ossetia and Abkhazia nearly led to a head to head with the West. On the whole, the cooperation between old foes which framed the end of the Cold War, resisted these tests. The Helsinki Final Act of 1975 and the agreement not to redraw the map of Europe was never so evidently ignored as today.

Has Crimea changed this for good? As the United Nations General Assembly confirmed on 27 March, the annexation of Crimea is interpreted as a fundamental breach of international law, without the shades of uncertainty that other cases have had. Russia only managed to get 11 countries to support its position (though the 58 countries which abstained should raise some concern).

Putin's speech to the Duma on 18 March also suggests that Russia's position is backed by an ideology based on the protection of Russian interests outside Russia in the name of ethnic, historical and even religious ties. His disregard of both European diplomatic attempts and of the threat of sanctions suggests that Moscow no longer sees cooperation with the West as a value in itself, as most in Europe had assumed. Putin's nationalist assertiveness seems coupled with a fundamental challenge to the West's legitimacy.

Russia's next steps could define the end of the post-Cold War era. While Putin has accepted the Special Monitoring Mission to Ukraine by the Organisation for Security and Cooperation in Europe (OSCE), the Russian military is increasing its presence on the borders with Eastern Ukraine, and trouble in the East of the country has started. It increasingly looks like Crimea is just the beginning of yet another sad chapter in the history of Eastern Europe.

But will these events push Europe to take a leap as an international actor? Can Crimea be interpreted as a 'fall of the Berlin Wall' moment which will drive the EU to take a strong lead in foreign policy?

The EU has been praised for managing to agree both to a package of sanctions and to supporting Ukraine through various financial and political means. It rapidly put together a substantial financial package of 11 billion Euros, a significant amount if compared to what it managed to provide to support the revolutionary changes in the Arab world though still far from meeting Ukrainian needs. It also pledged to accelerate the signing of the political and trade agreements with the Kiev. Indeed, it was the failure of ousted Ukrainian President Viktor Yanukovich to sign the agreements which had sparked the Maidan protests after the Vilnius summit at the end of November 2013. A crisis induced by contested relations with the EU, requires EU solutions.

In addition, it has not forgotten the regional dimension by committing to accelerate the process of signing these agreements with Moldova and Georgia, two small countries with breakaway regions under Russian control which are now particularly vulnerable to whatever Putin's next steps will be.

The other side of the coin is the relations with Russia. How the EU will manage these in the months to come will be the real test case for the future of the Union as a global actor. Pursuing its policy of signing these agreements with Eastern European countries will continue to antagonize Russia. Is the EU prepared to stick to this line?

Given that EU-Russia relations have always developed through the prism of national European capitals, one needs to trace the shifts within the EU countries. Here it really depends on which country you look at, as perceptions of Russia and expectations from the EU as a global actor colour the interpretation of the degree of change.



The German press has closely followed a mutation in German Chancellor Angela Merkel's perception of Putin. Merkel was no friend of Putin, but Germany is a strong partner of Russia, so much so that Putin even referred to Germany's understanding of his motivations in annexing Crimea in his speech to the Duma. Coming from East Germany, thus understanding the world in which Putin too grew up, and fluent in Russian, Merkel has been observing Putin's recent behaviour. At the 20 March summit she told European leaders that Putin could no longer be trusted.

Merkel has pushed a tougher line in her Parliament too. This shift is not to be taken lightly. The Chancellor is known for having a special instinct in following public opinion – one of the reasons her popularity continues to be so high after so many years in office. In this case, German public opinion and the business sector are not with her, and have explicitly said so. Opinion polls show that the majority of Germans believe that Ukraine should belong to the Russian sphere of interest and do not see the Crimean annexation to Russia as a big deal; big business have warned of the costs of economic sanctions and the risks that Russian retaliation to economic sanctions would have a disastrous impact on the German industry and economy.

This shift on Russia also fits in with other recent developments. Last January the German President Joachim Gauck, another Eastern German, gave an unprecedented speech at the Munich Security Conference calling his country to take greater responsibility in global affairs critically arguing that 'while there are genuine pacifists in Germany, there are also people who use Germany's guilt for its past as a shield for laziness or a desire to disengage from the world'.

This speech was taken seriously. The Defence Minister spoke about a stronger commitment to Common Defence and Security Policy. The Foreign Minister has been liaising with his French colleague and fellow socialist on foreign policy. Together with the Polish Foreign Minister, this trio showed entrepreneurship and crisis management when it flew to Kiev to negotiate a deal back in February. The deal did not last more than 24 hours, but it stopped the killing which had shocked to world into action. All these suggest that a shift in Germany is taking place, even if it continues to move at a slow pace compared to the rapidity with which Russia acted in Crimea.

However, seen from Tallinn or other parts of Europe, especially in Central Europe, this is simply not enough – just a 'slap on the wrist', according to Estonian President Toomas Hendrik Ilves. He is not alone in criticizing the EU's response for being too soft; below expectations; too slow and not incisive enough. The compromise found around Merkel's three-pronged approach (threat of sanctions, targeted sanctions after the Crimean referendum, and a stage three of economic sanctions only if Russia further destabilizes Ukraine) was a compromise, not a synthesis.

Germany is not the only country with a tradition of strong relations with Moscow: Italy, France, Belgium, Bulgaria, and Hungary all see Moscow through different lenses. The informal meeting of Foreign Ministers organised last week by the Greek Presidency of the EU showed that the preference for keeping an open dialogue with Moscow remains. Finding the right balance between condemnation and diplomatic dialogue focused on resolving security and sovereignty issues in Eastern Europe will be the key challenge, in the short and long-term.

On a positive note, it is clear that the EU member states have moved closer together, on Eastern Europe in particular, but also on Russia. The pessimist will remark that this is still not enough. But agreeing on how to deal with this newly assertive Russia is an imperative. While Europeans think about how to deal with Russia, Putin seems quite content to deal directly with super power US rather than with these fastidious European states. The moment of Europe may be yet to come.

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## Historic turning point or just another chapter? The results of a foreign-policy summit

*Janis A. Emmanouilidis*

### Summary

The March 2014 European Council could enter the history books as a turning point, not only in the EU's relations with Russia but also in its role as a foreign policy actor. Events in Ukraine inevitably dominated the Summit, with EU leaders adopting a balanced approach aimed at achieving three key objectives – de-escalation, containment/deterrence and cooperation – based on political and economic support for Ukraine, increased but limited pressure on Russia, and moves to strengthen ties with other EU neighbours. The Summit also discussed a range of economic and environmental policy issues, with the situation in Ukraine casting a long shadow over the discussion on energy policy, but failed to reach agreement on the EU's climate goals to 2030, or to put more flesh on the bones of calls for a European "industrial renaissance". However, two other developments were particularly significant: the creation of the second pillar of the future banking union, establishing a single regime for winding down failing banks; and changes to the savings tax directive, bringing years of negotiation to an end.

### Full report

Following a number of unspectacular EU Summits since the end of 2012 and the cooling off of the 'euro crisis', the European Council meeting on 20-21 March 2014 has a chance to make it into the history books.

The political agenda in the weeks and days before the Summit and at the meeting itself were dominated by the crisis in Ukraine and its wider implications for future relations between the EU/'West' and Russia. In reaction to the recent escalation of the crisis, EU leaders adopted a balanced approach based on three main pillars: (i) political and financial support for Ukraine, including the signing of the political provisions of the Association Agreement, financial support and the unilateral abolition of custom duties on products from Ukraine; (ii) increased but limited pressure on Russia by adding more names to the list of Russian and Ukrainian citizens subject to asset freezes and visa bans, and measures designed to isolate Moscow internationally; and (iii) accelerated association of other neighbouring countries with the EU, with a special emphasis on Moldova and Georgia, by bringing forward the target date for signing Association Agreements with both countries – a signal directed also towards Moscow.

All of this is designed to avoid a further escalation of the crisis while at the same time signalling to the Russian leadership that EU leaders are determined and ready to keep the door open to diplomatic solutions. It is too soon to judge whether this approach – based on de-escalation, containment/deterrence and cooperation – will work. But one thing seems clear: the EU and its members will have to deal with the wider implications and consequences of the crisis for some time to come, and it remains to be seen what impact the events of recent weeks will have on the Union's role as a foreign policy actor.

Besides Ukraine, EU leaders addressed a number of other issues: the European Semester, Europe 2020, industrial competitiveness, energy/climate, taxation and banking union (the Single Resolution Mechanism).

The European Council concluded the first phase of the 2014 **European Semester**, but without taking any concrete policy decisions: the heads of state and government simply had an exchange of views regarding the economic situation. They also had a first discussion on the implementation of the **Europe 2020** strategy ahead of the planned mid-term review at the Spring 2015 European Council.

With respect to **industrial competitiveness and policy**, EU leaders highlighted the need to strengthen Europe's industrial base and supported the European Commission's call for a "European Industrial Renaissance". However, they failed to present any concrete measures or a well-defined strategic plan for the long-term development of a new industrial policy, with the Summit Conclusions remaining vague and lacking specific policy substance on this point.

On Day Two of the Summit, deliberations between the heads of state and government focused on issues related to **energy dependency** and **climate change**. The spirit of, and concrete results emerging from, the March European Council indicate that EU governments are determined to promote energy security and to reduce dependence on individual suppliers such as Russia. Regarding climate policy, EU leaders could not reach a compromise on new targets because of divisions between Member States and simply set themselves a deadline of October 2014 for a final decision on the new policy framework.

After many years of negotiations, and following a decision by Luxembourg and Austria to give up their veto, the EU-28 were finally able to strike a compromise on changes to the Directive on the **taxation of savings income**. This opens the way for an automatic exchange of tax information between EU countries by 2017 and strengthens the Union's negotiating position on savings taxation *vis-à-vis* third countries (including Switzerland).

After months of intense discussions, the Council and European Parliament also reached a deal on the second pillar of the future banking union – the **Single Resolution Mechanism (SRM)** – which establishes a single regime for winding down failing banks. Following pressure from MEPs, the final deal is better than the original proposal, but the system remains highly complex and doubts persist about whether the SRM will be enough in practice and whether it will ultimately help to break the link between banks and sovereigns.

### **Ukrainian crisis – a turning point in EU foreign policy?**

Day One of the Summit, which started with the traditional meeting with European Parliament President Martin Schulz, was almost totally dominated by the crisis in Ukraine after Russia had occupied and annexed (or "re-unified" – as Moscow argues – with) Crimea in the week of the European Council meeting – a move condemned by the EU and its members as illegal and illegitimate.

In reaction to the escalating crisis, EU leaders adopted a balanced approach based on the three main pillars: political and financial support for Ukraine; increased but limited pressure on Russia; and accelerated association of other neighbouring countries with the EU.

#### ***Political and financial support for Ukraine***

Following recent events and the ratcheting up of tensions, the Union and its members were eager to move Ukraine closer to the EU. In a move designed to intensify relations and show solidarity and support for Kiev, EU leaders and Ukrainian Prime Minister Arseniy Yatsenyuk signed – in a ceremonial act before the start of Day Two of the Summit – the political provisions of the Association Agreement; the very issue that sparked the crisis last November and eventually led to the revolution in Ukraine.

EU leaders also reiterated their commitment to sign the remaining economic parts of the agreement, establishing a Deep and Comprehensive Free Trade Area between the EU and Ukraine, probably after Ukrainian elections scheduled for 25 May. The first meeting under the political dialogue established through the signing of the agreement's political provisions will take place in April.

In addition, the heads of state or government reaffirmed their readiness to provide immediate financial support (€1.6 billion) to Ukraine once the International Monetary Fund (IMF) and the Ukrainian government have agreed on the conditions for a support programme. To increase pressure on Kiev to embark on economic and political reforms, certain conditions have already been attached to this support. EU leaders stressed the need for Kiev to ensure the inclusiveness of governmental structures, reflect regional diversity and protect national minorities, undertake constitutional reforms, fight corruption, enhance the transparency of fiscal operations, and investigate all human rights' violations and acts of violence. The latter includes an investigation into the circumstances which led to the bloodshed on Maidan square in February 2014.

Finally, the EU decided to unilaterally abolish custom duties on products from Ukraine which, according to European Commission estimates, will save the country around €500 million a year.

### ***Increased but limited pressure on Russia***

After lengthy discussions, the heads of state and government decided to increase pressure on Moscow while at the same time leaving the door open for diplomatic initiatives aimed to de-escalate the crisis. In the words of European Council President Herman Van Rompuy: "In a situation like this we all must remain cool-headed. The goal is de-escalation and a political solution, while respecting international law."

Condemning the "illegal annexation" of Crimea and Sevastopol to the Russian Federation and in reaction to Russia's refusal to take steps to de-escalate the crisis, EU leaders decided to increase pressures on Moscow by: (i) imposing asset freezes and visa bans on 12 more Russian and Ukrainian citizens, added to the original list of 21 people agreed on 16-17 March (unlike Washington, which blacklisted senior Russian figures and even a Russian bank – Rossiya Bank – with close links to President Putin just as EU leaders were gathering in Brussels, the EU's list of additional names does not include people in Putin's inner circle); (ii) cancelling the next EU-Russia Summit and announcing that Member States will not hold bilateral summits/meetings with Moscow for the time being; (iii) further isolating Russia internationally by not involving Moscow in the next meeting of the G7 and suspending negotiations on Russia joining the Organisation for Economic Cooperation and Development (OECD) and the International Energy Agency (IEA).

While EU leaders increased their pressure on the Russian leadership, they refrained from more severe sanctions going beyond the so-called 'stage 2' level. However, the Summit Conclusions warn that any further steps by the Russian Federation to "destabilise the situation in Ukraine" would have "additional and far reaching consequences" for the relationship between the EU and Russia.

In more concrete terms, the European Council has asked the Commission and Member States to "prepare targeted measures", without giving any details of when this list of potential measures will be ready and what it might contain. In his press conference after the Summit, British Prime Minister David Cameron was more explicit when he mentioned "finance, military, energy" as areas being considered. Asked which Russian actions might trigger more severe reactions, German Chancellor Angela Merkel said that economic sanctions would 'only' be imposed if Russia sought to occupy parts of Ukraine beyond Crimea.

The fact that EU governments decided not to impose harsher sanctions signals a number of things. First, a vast majority of Member States want to avoid a negative spiral of escalation and mutual retaliation, which could easily spin out of control, with severe economic and political costs on both sides. Russia could even raise the stakes by halting cooperation with the 'West' on the civil war in Syria, Iran's nuclear programme or the fight against international terrorism. Second, Europeans do not want to enter 'stage 3' too quickly, thus giving themselves more room to intensify the pressure on the Russian leadership if the crisis escalates still further. Third, EU leaders fear the imposition of severe sanctions from which neither side would be able to backtrack even if the situation de-escalates. Fourth, EU governments are (compared, for example, to the US) much more subject to legal constraints which make it more difficult for them to target individuals not directly involved in the incident that triggered the sanctions – in this case, the annexation of Crimea. Last but not least, there was a heated debate between the EU-28 behind the scenes about whether to impose tougher sanctions in response to the

annexation of Crimea. Some countries – including Poland, the Baltic states, Belgium, Bulgaria, Denmark, Ireland, Luxembourg, Romania, and Sweden – wanted a more robust response to send an even stronger signal to the Russian leadership, while others – including Cyprus, Finland, France, Germany, Greece, Hungary and Spain – were (very) reluctant to go further because of strong economic, financial, historical or even religious ties. (See also Paul Ivan, [“EU’s sanctions against Russia – the need for clear goals”](#), *EPC Commentary*, 21 March 2014).

### ***Accelerated association of other neighbouring countries***

Another development at the EU Summit which attracted much less attention in European and international media was the decision by EU leaders to speed up the process of strengthening political and economic ties between the EU and Moldova and Georgia. The European Council agreed to bring forward the target date for signing Association Agreements with both countries, including a Deep and Comprehensive Free Trade Area, from August to June 2014.

This is a clear response to the increased pressures Moscow has been putting on Moldova and Georgia in an attempt to avoid a further strengthening of ties between these countries and the EU. The main concern here is Moldova, which has to cope with separatist tendencies in Transnistria and which is particularly vulnerable to Russian political and economic pressures (for more, see Paul Ivan, [“Transnistria – where to?”](#), *EPC Policy Brief*, March 2014).

### ***What comes next? Uncertainties and difficult choices***

As things stand now, EU governments and institutions are clearly intent on avoiding a further escalation of the crisis while at the same time signalling to the Russian leadership their determination and readiness to return to a cooperative environment despite the loss of trust.

The decisions taken at the Summit indicate that EU leaders want to contain the crisis, amid fears that it could pose the most severe security challenge in Europe since the end of the Cold War if events spiral out of control. First and foremost, they want to avoid a military conflict in their direct neighbourhood, which could, for example, be triggered by an (even accidental) incident between Russia and Ukraine.

EU leaders (and the US) also wanted to signal to Russian President Vladimir Putin and his associates that they will not simply tolerate the annexation of Crimea and infringement of the territorial integrity of Ukraine, although they are aware that there is little they can do but accept that Crimea is probably a lost case and now part of the Russian Federation. The EU and its members want to signal that they will not accept such breaches of international law in future and are determined to contain Russia and to increase pressures if Moscow decides to further escalate the situation in the eastern or southern part of Ukraine. EU governments seem confident that Moscow will not, in the end, prevail if it decides to embark on a path of continuous provocation/confrontation.

However, at the same time and for good reasons, EU governments do not want to return to the mind-set of Cold War confrontation in today’s fundamentally different world. The global and regional environment has become much more complex and interdependent, and it makes no sense to return to the past given that current and future challenges require cooperation among global actors and regional partners to find solutions rather than outdated rituals and actions. However, the events of recent months and weeks have undermined trust between Moscow and the EU, and it will be more than difficult to restore the minimum level of faith in each other that will be necessary to return to a logic of cooperation.

But will an EU approach based on de-escalation, containment/deterrence and cooperation work to serve this purpose? It is too early to give a definite answer to this question now because of a number of uncertainties:

- There still is a danger that the stand-off between Ukraine and Russia could escalate, although the fact that the Russian government finally agreed, on the day after the Summit, to a mission by the Organization for Security and Cooperation in Europe (OSCE) to monitor the security situation in Ukraine might be a first signal that Moscow is ready to de-escalate after annexing Crimea.

- Ukraine's future is by no means certain as long as the country's internal coherence remains under threat. In the immediate future, much will depend on the outcome of the upcoming elections and the readiness and ability of the future Ukrainian leadership to unite the country by accommodating regional diversities, including different political forces and protecting the rights of national minorities. Following the annexation of Crimea, the stand-off between Kiev and Moscow has already shifted to eastern Ukraine and it remains to be seen how the situation will develop in this part of the country and whether the Russian leadership might pursue actions aiming to (further) destabilise the situation.
- It is highly uncertain how Russia will react to a closer association between the EU and Ukraine if the new leadership in Kiev decides to sign and implement the remaining parts of the Association Agreement. Moscow might argue that the agreement 'violates' Ukraine's neutrality and impose sanctions on the new leadership in Kiev claiming that new economic ties between the EU and Ukraine breach Russia's accords with its western neighbour.
- Even if Russia decides to refrain from a further escalation, the conflicting parties, the EU and the US may all have to cope with Crimea becoming another frozen conflict like those in Nagorno-Karabakh, Transnistria and South Ossetia, and thus one more source of instability at the heart of Europe. This can only be avoided if Ukrainian and Russian authorities decide to get round the negotiating table to define the conditions of a new *modus vivendi*, which would be very difficult given recent events and the high level of distrust between the two sides.
- Even if one assumes that the current crisis will de-escalate (one way or another), it cannot be ruled out that the current leadership in Moscow might decide to continue playing the role of 'guardian of Russian ethnic minorities' in other parts of Europe, especially now that President Putin has seen his popularity ratings rise sharply in Russia in recent weeks.

All these potential challenges and uncertainties underline the volatility and complexity of the current situation. However, one thing is clear: whatever happens, the EU is now under much greater pressure than in the past to rise to the challenge, especially as it has become an active player in a multifaceted crisis right on its borders which is not likely to be solved/overcome any time soon.

As a consequence, the Union and its members will have to do many things in parallel while constantly considering the long-term consequences of their actions. The EU will have to: (i) keep up the pressure on Moscow while at the same time trying to avoid a further deterioration of the economically and politically significant bilateral relationship between the EU and Russia; (ii) support Ukraine without pushing the country to choose between the 'West' and the 'East', which could eventually tear it apart; (iii) explore ways to bridge the political gap between Moscow and the EU while learning from mistakes committed in the past; or (iv) if relations deteriorate still further, identify ways to manage the consequences of a severe and long-term stand-off with the Union's biggest neighbour to the East.

These are issues that the EU and its members may have to wrestle with for months and even years. From today's perspective, it is almost impossible to judge the potential long-term consequences of the 'Ukrainian crisis'. Future historians may well come to the conclusion that the developments in Ukraine and the wider implications of the crisis for the relationship with Russia were a turning point in the Union's role and self-understanding as a foreign policy actor. Jan Techau might be right in his assessment that "Ukraine is the first real strategic test of EU foreign policy" (see ["Ukraine, the Birthplace of Strategic Europe?"](#), *Carnegie Europe*, 18 March 2014).

Taking this one step further, future historians may well judge that shortly after the worst of the 'euro crisis' appeared to be behind the EU, the foreign policy crisis triggered by events in Ukraine made it even more necessary to further deepen cooperation between the countries of the Union – although this is a bold thesis at this point in time.

Besides the crisis in Ukraine and future relations with Moscow, the European Council addressed the following issues: the European Semester, Europe 2020, industrial competitiveness, energy/climate, taxation and the Single Resolution Mechanism.

## European Semester and Europe 2020 strategy – many words, but no concrete decisions!

The March European Council concluded the first phase of the 2014 **European Semester** by taking stock of the current economic situation and reiterating the policy priorities for this year. EU leaders had already decided, in December 2013, to put particular emphasis on policies enhancing competitiveness, supporting job creation and fighting unemployment (particularly among young people) and on the follow-up to reforms aimed at improving the functioning of labour markets.

EU leaders stressed that for the first time since the European Semester was launched a few years ago, the overall economic outlook seems more positive and promising. But they simply had an exchange of views with European Central Bank President Mario Draghi and did not take any concrete decisions. The Conclusions merely state that National Reform Programmes and Stability and Convergence Programmes should “respond in a concrete and ambitious manner” to last year’s Country Specific Recommendations and address the issues identified in the Commission’s recent analysis in the context of the Stability and Growth Pact and the macroeconomic imbalances procedures.

As expected, the heads of state and government did not discuss how to step up the economic coordination process in the framework of the European Semester. There was, for example, no debate on the idea of introducing “contractual arrangements” between individual Member States and the Commission to promote the implementation of structural reforms in the framework of the Semester by enhancing national ownership and providing specific financial incentives.

The European Council also had their first discussion about the implementation of the **Europe 2020 strategy** ahead of the planned mid-term review scheduled for the Spring 2015 Summit, which will be based on the results of a Commission communication. In the Conclusions, EU leaders acknowledge that progress towards meeting the strategy’s key goals has “slowed down” because of the crisis and that the long-term challenges affecting growth in Europe have “not gone away”. At a press conference during the Summit, President Van Rompuy and President Barroso acknowledged that the EU had fallen behind on some of its social targets, especially those relating to unemployment and poverty. However, EU leaders did not adopt any new measures and the Summit Conclusions merely state that efforts should be stepped up to reach the Europe 2020 targets and that the European Council “looks forward” to the planned review in 2015.

### Industrial competitiveness – renaissance without strategy

A lengthy section of the Summit Conclusions (three pages) is devoted to industrial competitiveness and policy, calling for a “European Industrial Renaissance”. The message from EU leaders is clear: industry is a key element of Europe’s economic competitiveness and the Union needs a “strong and competitive industrial base” as a key driver for economic growth and jobs. However, they did not present concrete measures to achieve this or agree a well-defined strategic plan for the long-term development of a new industrial policy (for more, see Claire Dhéret, [“Sharing the same vision – the cornerstone of a new industrial policy for Europe”](#), *EPC Discussion Paper*, March 2014).

On the contrary, the Conclusions are vague and lack substance when it comes to enhancing Europe’s industrial competitiveness. Here some illustrative examples: “industrial competitiveness should be systematically mainstreamed across all EU policy areas”; “efforts must continue to complete and fully exploit the potential of the internal market in goods and services”; “infrastructure networks...need to be developed and updated with intelligent and innovative technologies”; “smart specialisation should be promoted at all levels”, and “efforts should continue to improve market access around the world by facilitating the integration of European companies in global value chains”.

The most concrete proposal relates to promoting key enabling technologies, where the Conclusions call for the swift identification of projects aimed at strengthening key technologies, such as batteries for electro-mobility, intelligent materials, high-performance production and industrial bio-processes.

Regarding next steps, EU leaders have invited the Council, Commission and Member States “to continue work” and the European Council will come back to all these issues in the context of the Europe 2020 review in March 2015.

## Energy and climate – determination to reduce energy dependence; no decision on new climate targets (yet)

After the Ukraine Association Agreement signing ceremony, Day Two of the Summit concentrated on two issues: energy and climate. Against the backdrop of the latest developments in Ukraine, the discussions focused on the need to enhance energy security and reduce energy dependence, especially from Russia.

EU leaders committed themselves to intensify efforts to reduce **energy dependency** by developing an internal market for energy, enhancing the diversification of energy resources and reducing energy demand through increased energy efficiency. For as President Van Rompuy warned: “If we don’t take action now, by 2035 we’ll be dependent on foreign exports for up to 80% of our oil and gas.”

The spirit of, and concrete results emerging from, the Summit clearly indicate that EU governments are now much more determined to reduce energy dependence, which comes as no surprise given the Ukrainian crisis and the challenges it poses to Europe’s energy security. Russia provides around 30% of the EU’s natural gas and is its main supplier of crude oil (around 35%). Within the Union, Germany is the largest importer of Russian gas and some EU countries – including the Baltic states, Bulgaria and Finland – import almost all of their gas from Russia.

In recent years, the EU and its members have taken a number of steps to promote energy security and reduce dependence on individual suppliers. The Union’s gas network has become more integrated, the installation of interconnectors has progressed and reverse-flow technology, which allows gas to be transported in the other direction, has been extended. However, progress has been slow and much more needs to be done, given that despite all these efforts, EU energy imports increased from 63.4% in 2009 to 65.8% in 2012 (Eurostat) and the EU’s dependence on energy imports is predicted to grow still further given the expected decline of European sources of gas.

To reduce its energy dependence, the EU will have to take a holistic approach which aims to create an integrated energy market with a cross-border energy infrastructure, increase the share of renewables, diversify energy routes and imported sources of energy (including imports from the US, which has become a net producer of energy due to shale gas), add more reverse-flow corridors, enlarge storage reserves, pool the EU’s purchasing power by jointly negotiating contracts with energy suppliers and, last but not least, increase energy efficiency (for more, see also Annika Ahtonen, [“Russian belligerence and Europe’s energy security”](#), *EPC Commentary*, 19 March 2014).

The Summit Conclusions reflect the need to do all of this. However, the heads of state and government did not take any new or concrete policy decisions, but rather called on the Commission to conduct an “in-depth study of EU energy security” and present a comprehensive plan for reducing energy dependency by June 2014. This plan is supposed to reflect the EU’s need to “accelerate further diversification of its energy supply, increase its bargaining power and energy efficiency, continue to develop renewable and other indigenous energy sources, and coordinate the development of the infrastructure to support this diversification in a sustainable manner, including through the development of interconnections”. EU leaders also signalled that Member States will show solidarity in case of “sudden disruptions of energy supply”.

Regarding **climate policy** and the goal of reaching a compromise among Member States on the reduction of greenhouse gas emissions in preparation for the December 2015 Global Climate Conference in Paris, the heads of state and government launched the debate among themselves on the 2030 climate goals but could not reach a compromise now given significant differences in their positions.

Earlier this year, the Commission proposed to set a target for 2030 of reducing emissions by 40% from 1990 levels (up a 20% reduction by 2020). The Brussels executive wanted a political decision from EU governments by June, so the Union could go to the next United Nations summit in September with a joint position and thus spur other global powers to put forward their commitments, increasing the chances of a successful outcome of climate negotiations in Paris.



But the issue has split the EU into two camps. A number of eastern European countries – including Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia – are worried about both the timeline and the overall target. They are also asking for a fair ‘burden-sharing’ between the EU-28 based on national impact assessments. Only then will they agree on specific targets and dates.

Other Member States – including Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Slovenia, Spain, Sweden, Portugal and the UK – actively support the Commission’s proposal and want a quick agreement among EU governments. But the so-called “Green Growth Group”, which also supports an EU-wide commitment to a renewable energy target of 27% (up from an expected share in 2020 of 21%), could not convince their partners of this during the Summit. As a consequence, EU leaders have now agreed that they will come back to the issue in June to take stock of the progress made, with the aim of taking a final decision on the new policy framework no later than October 2014.

### **Taxation of savings income – finally, a compromise!**

After many years of negotiations and opposition from individual Member States, the EU-28 were finally able to reach a compromise on the revision of the Directive on the taxation of savings income. Following increased pressure from EU partners and at international level, especially from the US, Luxembourg and Austria became the last Member States to give up their veto on the revised Directive, which will increase transparency through automatic exchanges of tax information between EU countries by 2017. This will help tax authorities to identify and chase up cross-border tax evaders and close pension and investment fund loopholes, as the EU-28 do not currently exchange data on interest earned from financial products linked to investment funds, pensions, trust or foundations.

It is also hoped that the agreement on the revised Directive will strengthen the Union’s negotiating position on savings taxation *vis-à-vis* third countries such as Andorra, Liechtenstein, Monaco, San Marino and, most importantly, Switzerland. The EU aims to commit these countries to fully implement the new single global standard for an automatic exchange of information developed by the Organisation for Economic Cooperation and Development (OECD) and endorsed by the G20. The European Council calls on the Commission to move forward in negotiations with these countries swiftly, with a view to concluding them by the end of the year, and to report on the state of play at its December 2014 meeting. If there is no progress in these talks with third countries, the Commission should explore possible options to ensure compliance with the new global standard.

### **Single Resolution Mechanism and Single Resolution Fund – a deal with uncertainties**

After months of intense discussions and following a final marathon negotiation which lasted 16 hours and ended just hours before the start of the Summit, EU governments – represented by the Greek Council Presidency and the Eurogroup President, the European Parliament and the Commission (trialogue) – reached a deal on the Single Resolution Mechanism (SRM), the second pillar of the banking union to stand alongside the Single Supervisory Mechanism (SSM).

The agreement still requires final approval by the European Parliament and Council, before the Parliament closes down for the elections, so that it can enter into force on 1 January 2015. It establishes a single regime for winding down banks involving a complex decision-making process which will be triggered by the ECB as the supervisory authority, and a common fund (Single Resolution Fund) worth €55 billion provided by banks to cover some of the potential resolution costs, but only after bank shareholders, junior and senior bondholders as well as large banks’ savers and institutional investors will have been obliged to cover the losses of a failing bank (bail-in).

The final deal reached in the trialogue is better than the original proposal agreed between EU governments in December 2013, but the system remains highly complex and doubts persist about whether the SRM will be enough in practice and whether it will ultimately break the link between banks and sovereigns.

The SRM compromise involves a regulation covering the main aspects of the mechanism and an intergovernmental agreement on the creation of the Single Resolution Fund (SRF). Key decisions will be taken by a Single Resolution Board involving permanent members as well as the Commission, the Council, the ECB (as the supervisory authority) and national resolution authorities.

The compromise between the Parliament and Council has streamlined the decision-making process somewhat, with the role of EU governments and national resolution authorities reduced with respect to bank resolutions involving less than €5 billion from the Single Resolution Fund, which will be owned and administered by the Board. A resolution scheme prepared by the Commission, setting out how resolution tools and funds will be used in cases below €5 billion, will be adopted by a smaller group of Board members (meeting in “executive session”), including the Chair, the Executive Director and three other permanent members. This streamlined procedure is supposed to speed up the process and make it “less prone” to political interference. The whole Board will only come together in “plenary session” if it is deciding on a bank resolution involving more than €5 billion in a single decision. In such cases, the largest EU countries (such as Germany or France) will have almost enough votes to veto a decision.

Following pressure from MEPs, EU governments agreed that the €55 billion in the Single Resolution Fund, which amounts to 1% of covered deposits, will be fully capitalised within eight years instead of the ten originally envisaged. The money made available to the fund through contributions from banks will also be mutualised faster than originally planned: 40% of the funds, which banks will originally pay into “national compartments”, will have to be mutualised after the first year and another 20% after the second, with the rest spread equally over the remaining six years.

The compromise reached in the trilogue also foresees allowing the Single Resolution Fund to borrow on the markets if the Board decides to do this at a plenary session. This would allow the Fund’s firepower to be strengthened in the early years when it has not yet accumulated the full €55 billion. However, the details of the lending facility are still unclear.

The establishment of a Single Resolution Mechanism is a major step forward which would have been unthinkable some years ago, and the fact that the EU institutions kept their promise by striking a compromise before the European elections and before the ECB takes up its role as a single supervisory authority is likely to further strengthen market confidence. The new system is definitely an improvement on the past, as it limits the need for massive bailouts financed solely by taxpayers and goes beyond a simple network of national resolution authorities.

But despite the abovementioned improvements/benefits, there are some unresolved issues and doubts about whether the scheme goes far enough and whether it will work in practice, for a number of reasons:

- The €55 billion foreseen for the Single Resolution Fund is a rather small amount considering that potential losses in the European banking sector might be much bigger, maybe even amounting to hundreds of billion. This deficit is aggravated by the fact the Fund is not allowed to use the European Stability Mechanism (ESM) as a final backstop, which *de facto* means that primary responsibility for winding down banks may, at the end of the day, still remains and burdens their home countries. The fact that the SRM regime does not include the “appropriate and effective backstop arrangement” called for in previous European Council Conclusions could undermine the credibility of the new system and fail to break the negative feedback loop between banks and sovereigns.
- Although it has been streamlined, the SRM decision-making process still remains very cumbersome, complicated and subject to potential vetoes and political interference, which in practice could make it difficult to reach agreement on a resolution scheme within the 48 hours required if a decision to shut down a bank had to be taken over a weekend.
- The fact that the Single Resolution Fund will, following German pressure, be created on the basis of an intergovernmental agreement limits the power of scrutiny at European level, especially in relation to the European Parliament’s powers. Some MEPs have already suggested that the intergovernmental agreement should be challenged in the European Court of Justice.

- There is not yet an agreement on how the Single Resolution Fund will be filled by banks and a “real tug-of-war”, as German Finance Minister Wolfgang Schäuble put it, can be expected between EU governments and institutions over how the levy will be organised in concrete terms on the basis of a Commission proposal.

The above limitations and uncertainties as well as the fact that the established banking union does not include a single European deposit insurance scheme (the ‘third pillar’) means that the system now in place is still limited. However, the fact that the intergovernmental agreement on the Single Resolution Fund includes a ‘repatriation clause’ – which states that the substance of the agreement should be integrated into the legal framework of the EU within ten years, at most, of its entry into force – might provide an opportunity to reform the EU Treaties and move from a ‘limited’ to a ‘full banking union’ worthy of the name in the foreseeable future.

### **EU-Africa Summit and Sri Lanka**

Besides Ukraine, the European Council Conclusions refer to two other external relations issues: EU-Africa relations and Sri Lanka.

Ahead of the 4th **EU-Africa summit** on 2-3 April 2014 in Brussels, EU leaders stressed that the Union remains committed to building a partnership of equals with Africa. They want to emphasise cooperation in a number of key areas: trade and development, democracy and good governance, the rule of law and human rights, and migration and mobility, including irregular migration and the fight against the smuggling of migrants and trafficking of human beings. The European Council also stressed that the EU will continue to provide operational support through its civilian crisis management missions and military operations, and consider ways and means to strengthen the African peace and security architecture and help African partners prevent conflict and address crises.

Finally, following particular pressure from the UK, EU leaders support the UN High Commissioner for Human Rights’ recommendation and called for the adoption of a resolution on **Sri Lanka** at the Human Rights Council providing for an international investigation into alleged war crimes by both sides during the war.

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## EU's sanctions against Russia – The need for clear goals

### *Comments on the 20-21 March Council*

*Paul Ivan*

Over the last two decades, the European Union (EU) has increasingly relied on the use of restrictive measures in its external action. The EU has shown itself to be more open to the possibility of resorting to sanctions outside the United Nations, as well as in cooperation with other international actors, such as the United States. As a permanent member of the UN Security Council, Russia has blocked and is expected to block any efforts of using this international body to address the crisis in Ukraine so the EU cannot hope for a global sanctions regime and is forced to use a unilateral sanctions regime, in cooperation with some other like-minded players (US, Canada, Australia, Japan).

To understand the effectiveness of EU sanctions we provided a framework for their assessment in the EPC Issue Paper [“The effectiveness of EU sanctions - An analysis of Iran, Belarus, Syria and Myanmar \(Burma\)”](#) (authors: Francesco Giumelli and Paul Ivan), consisting of a four-step process of evaluation which looks at:

- i) the role of sanctions in an overall foreign policy strategy;
- ii) the purpose and goals of the policy in terms of coercing, constraining and signalling;
- iii) the impact of sanctions and the costs incurred by the EU;
- iv) and the sanctions' comparative utility.

The following paragraphs very briefly address the current crisis between EU and Russia through the lens of this four-step process of evaluation.

i) Sanctions clearly are one aspect of EU's policy towards Russia and the crisis in Ukraine. The EU leaders have laid-out a three-stage sanctions process. The first step has consisted of the suspension of a series of EU-Russia bilateral talks, the second step is the imposition of travel bans and asset freezes on a number of individuals while the third step, triggered by a continuing destabilization of Ukraine, would involve severe measures, including a broad range of economic sanctions.

Besides using the sanctions' tool, the EU has engaged and continues to try to engage Russia diplomatically, both bilaterally (through public appeals, meetings, phone calls etc.) and in the various multilateral formats (such as the UN and the OSCE). The EU has also adopted a series of decisions (such as suspending participation in the next meeting of the G8 and suspending various bilateral cooperation programmes) which do not fall under the heading of restrictive measures. In contrast, it has adopted a series of positive measures towards Ukraine, by supporting the Ukrainian economy through direct and indirect funding, pledging to sign the Association Agreement and the Deep and Comprehensive Free Trade Area agreement, and general political support. As the situation deteriorates, the role of sanctions in EU's foreign policy strategy towards Russia is likely to increase.

ii) What are less clear are the purpose and the goals of EU's policy. In the first round of sanctions against Russia the signalling element has been dominant. The restrictive measures imposed on the Russian citizens listed were far too weak to coerce or seriously constrain the activity of the Russian leadership. This was underlined even more by the fact that, one day after the imposition of sanctions, the Russian leader signed the treaty annexing Ukraine's Crimean peninsula to the Russian Federation. The second round of sanctions, just adopted last night, besides signalling elements such as the cancelling of the next EU-Russia summit, reinforces the constraining element by targeting individuals closer to president Putin but is, however, unlikely to be sufficient to coerce the regime to change course.

It is also less clear whether and how the differences among EU members states regarding the purpose of the sanctions, and the EU approach more generally, are to be overcome. If some member states see the purpose to be the withdrawal of Russian

forces back to their bases and the return of Crimea to Ukraine, others seem to believe that Crimea is already lost and that economic (*stage three*) sanctions should only be imposed if Russia intervenes in Eastern Ukraine. This latter view seems to be shared by a majority of member states, as proven by the most recent European Council decisions. Moreover, the exact trigger for *stage three* sanctions is also not clear, as Russian intervention in Eastern Ukraine can take diverse covert and over forms. The Ukrainian security services have already arrested several groups of armed Russian citizens operating in Eastern Ukraine.

iii) As in most cases, the impact of the sanctions will be very difficult to quantify. So far, the visible political impact has been negligible as Russia has not changed course, limit its provocative behaviour, or engaged in negotiations. The addition of officials closer to the seat of power will increase the constraints on the regime but is not likely to have a damaging direct impact. Unlike the US, where the president has a freer hand in deciding the targets for sanctions, the EU has to take into consideration the fact that listings have been and can be legally challenged in the General Court of the EU. The Court has reversed EU sanctions decisions by responding to complaints from individuals who have been added to lists of targets. Thus, it is more difficult for the EU to sanction the oligarchs supporting president Putin if they haven't been openly involved in the violation of Ukrainian sovereignty and territorial integrity. In the past, EU member states have been willing to list individuals even with insufficient backing and thus have cases vulnerable to an unfavourable (for the Council) Court ruling and even to relist individuals after they had received a delisting decision from the Court. Such listing has been done for their political impact and with the knowledge that a Court decision will arrive after several years, during which the person sanctioned will face the constraints imposed by the sanctioning regime. It remains to be seen if the member states will be willing to employ such tactics in what concerns the Russian oligarchs supporting the Putin regime.

EU leaders have also asked the European Commission to prepare an assessment of the potential impact of broad economic sanctions. If the EU would pass to economic sanctions, their impact, but also costs, could increase markedly, depending on the type of measures adopted. Russia is highly dependent on the European market, with 45% of its exports going to the EU. Moreover, more than half of Russia's budget comes from the sale of gas and oil to the EU. From the EU side, trade with Russia represents "only" 9.7% of the Union's total trade. The Russian gas imported represents about 30% of gas imports but less than 6% of the total EU energy mix. Even if there is significant geographical variation in what concerns EU Member States dependence on Russian gas imports, the picture we see is that of a Russia that is more dependent on its economic relations with the EU than the other way around.

Tougher economic sanctions would clearly also incur important costs for the EU, both as a direct result of sanctions but also as a result of the response expected from the Russian side. These potential costs are expected to lead to the gradual adoption of economic measures (*several steps three*) and will also play a deterring role, limiting the breadth of the economic sanctions to be adopted.

iv) The breach of international law in the case of Crimea is so serious and clear-cut that the EU could not ignore it. The EU has no legal obligation to intervene militarily or provide military aid to Ukraine and this option has been ruled out by the EU. Given the refusal of the Russian Federation to return to the *status quo ante*, the EU is being forced to use restrictive measures as the toughest policy it can employ in this case. The use of sanctions can ensure that the EU has some 'teeth' to carry out its foreign policy and stand by its values.

To sum up, there is clear need to carefully evaluate what sanctions are supposed to achieve in this case and what are the triggers for more sanctions, in order to build the proper expectations upon which their effectiveness can be judged. It is also essential that these policy goals and the consequences of any further violations are clearly communicated to the Russian side. Given that this crisis develops in the immediate neighbourhood of the EU and involves two of its biggest neighbours, this represents a major test for the EU. The way of handling this crisis will contribute to shaping the image of the EU and of its foreign policy for years to come.

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*Disclaimer: The views expressed in this Commentary are the sole responsibility of the author.*

## Russian belligerence and Europe's energy security

*Annika Ahtonen*

Recent Russian actions have unequivocally underlined that it does not play by the rules. This provides a wake-up call and should alert not only the countries of the former Soviet Union, but the EU as a whole. For the EU, this has one clear implication: it cannot continue to depend on an unreliable energy supplier, which is prone to use energy as a political tool.

Luckily for the EU, summer is approaching and Europeans will need less Russian gas for heating. However, potential gas supply disruptions remind Europe of its energy vulnerabilities, and of the 2006 and 2009 winters, when Russia's decision to stop the flow of gas to Ukraine led to supply crises in a number of EU Member States.

As the EU's heads of states and governments gather in the European Council on 20 and 21 March, the developments in Ukraine and the possible Russian illegal annexation of Crimea will undoubtedly dominate the discussions. Securing energy supply will figure on the agenda, but energy should also be seen as a means to pressure Russia. It is important that the Member States use the occasion to commit to working together on energy security. If this is addressed in a holistic way, it can also support European industry and climate policy – the other issues on the Council agenda that run the risk of being forgotten.

### **The EU has foolishly put all its eggs in one basket**

While the EU's energy policy has built on the objective to secure cheap and sustainable, reliable supplies of energy, its vulnerability is of its own making. The EU-28 import over 53% of their energy and, contrary to conventional wisdom, the EU has put all its eggs in one basket. Russia remains the main supplier of crude oil (35% of EU-27 imports in 2011). Member States have naively handed Moscow undue weight in the European gas market through their bilateral agreements. Russia is still the largest supplier of natural gas (30% of imports in 2011). It has also become the main supplier of solid fuels including hard coal to the EU (26% of imports in 2011). Germany is the largest importer of Russian gas in the EU, and in Member States such as Lithuania, Latvia, Estonia, Poland, Hungary, Slovakia, Bulgaria and Finland the share of Russian gas and/or oil in their national consumption is over 90%.

This vulnerability has been recognised and in the past years the EU has taken a number of actions to promote energy security. The 3rd energy package, adopted in 2009, aims to open up the EU's gas and electricity markets. The 2020 climate and energy objectives, especially those of increasing the share of renewables to 20% and energy efficiency by 20%, also supported this objective. Recent developments, however, remind Europeans that the progress has been too slow and much more needs to be done now.

The Member States should use the European Council meeting to commit to breaking this unhealthy energy dependency once and for all. The EU has a common energy policy on paper, but so far implementation has remained weak. European energy security has been undermined by an internal challenge: a patchwork of national mini-markets, bilateral deals with Russia, lack of political cohesion and solidarity. Recognising the implications of Russia's actions for the whole of Europe, and acknowledging the EU's vulnerability vis-à-vis this unreliable supplier should finally provide the needed momentum for a change.

### **Energy security starts with an integrated energy market...**

Europe needs a truly integrated energy market that will increase efficiency in the distribution and use of energy, thus security of supply. All Member States have agreed to complete the internal energy market by the end of this year, and they must commit to fulfilling this objective. European consumers should be allowed to switch suppliers for gas and electricity, national markets and network operation rules for gas and electricity should be aligned and further investments are needed in cross-border energy infrastructure. Member States must act now if they want to develop interconnections for gas and electricity by 2015. Strengthening infrastructure by integrating alternative sources and increasing lines of supply would help to ensure that no EU country is left alone in case of a disruption.

### **... benefits from a smarter approach with renewables and EU's own resources**

Developing greener sources of energy, seeking the best return on investment and making sure renewables are integrated to the network will help to make them more affordable and available for consumers across the EU. The first step is to create a functioning smart grid that will integrate both existing and new renewables in the electricity network. This would allow large amounts of different renewable energy sources, including new offshore wind capacities, to be connected to the grid, while providing an incentive for further investments. It would increase network security and reliability, and enable consumers to control their use of energy, thus encouraging

energy savings. Secondly, Member States should cooperate in placing production capacity where the sun shines and the wind blows, and stop expensive support schemes in sub-optimal places. Thirdly, it is time to be more creative and learn from each other: in Malmö, Sweden, 60% of heat is produced from its own waste, while in Lille, France, buses run on biogas produced from organic waste. Not bad alternatives for Russian gas.

### **... requires looking at other alternatives internally and externally**

Diversifying the EU's energy supply and reducing its dependence on Russian oil, gas and coal will require alternative sources of energy. While environmental and safety considerations must remain the highest priority, Member States should continue to explore possibilities with nuclear power and the potential with unconventional oil and gas within the EU.

Europe needs to find alternative sources of supply also from outside the EU. Some of the options include increasing liquefied natural gas (LNG) imports from Algeria, Qatar or Nigeria, increasing gas imports from Norway and exploring the possibility to export shale gas from the US. There is a great potential with Southern Gas Corridor. Azerbaijan has already committed to providing 10 bcm of gas, and there could be more also from Turkmenistan if negotiations on a Trans-Caspian pipeline are successful. The Trans-Anatolian Pipeline (TANAP) could bring this gas and potentially even more from Iran, Iraq, Israel and Cyprus to Europe. Negotiations on the South Stream pipeline must be put to a halt, and it should be permitted only if also other than Russian suppliers can use the gas transit route.

### **... calls for greater energy efficiency**

Increasing energy efficiency across the EU would not only help to decrease dependency on foreign energy imports, but would also reduce energy costs for consumers and bring down EU emissions. To get Europe going, a thorough review of the Energy Efficiency Directive is needed, and Member States must include energy efficiency measures in their national energy plans. The Union should use standards for buildings and consumer products, including all road vehicles, to promote greater energy efficiency.

### **... needs the commitment of one Member State more than others: Germany**

The EU can only succeed if all Member States stick together and start implementing a common energy policy worthy of the name. Germany, with questionable bilateral energy deals with Russia, has a special responsibility. The European Council is a good place for Berlin to raise its game and to show that it is willing to take a strong stance with rest of the EU vis-à-vis Russia.

A functioning, competitive and open energy market should be in the interest of Germany, German consumers and its industry. The *Energiewende*, Germany's attempt to move from nuclear and fossil fuels towards renewable energy is not working: expensive subsidies for renewables combined with an increase in coal power production is becoming extremely costly for its citizens, economy, its industry and they are not helping the climate either. Germany should show the way in opening its energy markets and investing in the smart grid. It should also delay the shutdown of its nuclear power plants rather than rely on coal and import nuclear energy from neighbouring countries.

### **A common EU approach to energy would come with great benefits**

Building a functioning energy market would bring enormous benefits for European consumers and manufacturing industries. Competition would lead to lower energy prices. All Member States could profit from diversified energy supply and enhanced security of supply. According to the European Commission, a fully integrated gas market could save Europeans up to €30 billion a year and an integrated electricity market up to €35 billion a year.

Closer European co-operation would strengthen the EU's hand in dealing with Russia on energy questions. It is good to remember: Russia needs the EU, its market and its investments more than Member States need Russia. It has an economy the size of Italy, with a GDP per capita ranked 58th in the world in 2012. It depends on its gas and oil exports to Europe, and a period of prolonged uncertainty would have serious implications for Gazprom and with it for Russia. The EU Member States have so far not been united vis-à-vis Russia, signing bilateral deals, fearing its reactions, and thus have continuously undermined EU's economic and political power. The European Commission's ongoing antitrust investigation of Gazprom's supposed abuse of its dominant position on the gas market provides a good basis for a stronger stance. It demonstrates that the EU is ready to challenge Russia to play by the rules. It is time for all EU Member States to recognise that they are stronger together than alone when dealing with Russia.

The EU need not depend on Russian energy as it does today, and it must take the needed steps now to reduce its dependency from this unreliable supplier. It must develop the alternatives necessary to stand up to Russia without worrying about its energy supply. If Member States are united and build an internal energy market together, this will not only benefit its citizens and industry, but it will demonstrate to Russia that it has exceeded the limits of the EU's toleration.

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## Transnistria – Where to?

*Paul Ivan*

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At the Vilnius summit of the Eastern Partnership in November 2013, Moldova initialled its Association Agreement (AA) with the EU, including a Deep and Comprehensive Free Trade Area (DCFTA) agreement, and is expected to sign the documents before the end of August 2014. Meanwhile, Russia has increased its presence and pressure in the region, as a consequence of which Armenia declined the AA and DCFTA with the EU, and Ukraine, after months of protests and political paralysis, now has part of its territory occupied by Russia. Moldova is no exception to Russian pressure. As the country gets closer to upgrading relations with the EU, Russia has increased its activities in Moldova, including in the autonomous region of Gagauzia and in the breakaway region of Transnistria. With encouragement from Moscow, on 2 February 2014, voters in Gagauzia (4,4% of Moldova's population) overwhelmingly voted in favour of closer ties with the Russia-led Customs Union in a referendum deemed illegal by the Chisinau authorities.

In late 2013, Dmitry Rogozin, Deputy Prime Minister of Russia and president Putin's special representative on Transnistria, threatened Chisinau that it would lose Transnistria if it continues moving towards the EU. Russia has also imposed an embargo on Moldovan wine, but not Transnistrian wine. At the same time, even though the "5+2" negotiations (Moldova, Transnistria as conflict parties, Russia, Ukraine and the OSCE as mediators and the EU and the US as observers) for the settlement of the Transnistria conflict continue, the number of incidents in and around this region have increased. The window of opportunity created by the involvement of Germany in the settlement of the conflict and the restart of the "5+2" negotiations in late 2011 seems to have closed. Given the recent events in the region and in Moldova/Transnistria, including the potential impact of DCFTA and visa liberalisation, Chisinau finds it increasingly difficult to manage the juggling act between its EU commitment and dialogue with Tiraspol. Thus, the Transnistria conflict is likely to continue to undermine Moldova's development and European aspirations and to remain an irritant in EU-Russia relations.

## BACKGROUND

### A story of talks and tensions

The June 2010 *Meseberg Memorandum*, signed by German Chancellor Angela Merkel and then Russian President Dmitri Medvedev, proposed the establishment of a EU-Russia Political and Security Committee on ministerial level, while also stating that the EU and Russia would cooperate towards a resolution of the Transnistrian conflict. After a six-year break, negotiations in the "5+2" format restarted in late 2011. In April 2012 the parties agreed in Vienna on the negotiating principles, procedures and agenda, the latter divided into three baskets: 1) socio-economic issues, 2) general legal and humanitarian issues and human rights, and 3) a comprehensive settlement, including institutional, political and security issues. Ten official meetings were held in 2012-2013 and one so far in 2014. Besides the "5+2" talks, the two parties in conflict have also continued direct bilateral negotiations. These negotiations have led to some achievements, including resuming the rail freight traffic, or other agreements on environment, social security and justice. However, while dialogue was maintained, no negotiations have taken place on the third basket concerning the political status of Transnistria. Moreover, periodic incidents and tensions have weakened trust between the involved parties and undermined further progress.





## Incidents in the Security Zone

Created at the end of the 1992 Transnistria war, the Security Zone is a 12-20 km wide buffer zone that generally follows the outline of the Dniester river, managed by a Joint Control Commission (Moldova, Transnistria, Russia and Ukraine) and monitored by a peacekeeping force. The peacekeeping force is in practice controlled by Russia and Transnistria which field two thirds of the approximately 1,200 military personnel of the force, with the rest formed by Moldovan troops and 10 military observers from Ukraine. Besides its peacekeeping contingent and despite its international commitments, Russia continues to station an additional 1,100 troops in Transnistria.

Inside the Security Zone, on the right bank of the Dniester and just across the river from Tiraspol (the self-proclaimed capital of Transnistria), lies the city of Bender, legally under the authority of the Joint Control Commission but *de facto* under administrative control of Transnistria. The lack of detailed rules and overlap of jurisdictions in Bender is mitigated by unwritten agreements between the two sides but not without periodic tensions. Both Chisinau and Tiraspol have law enforcement units in Bender but, on several occasions, Transnistria tried to change the *status quo* and gain full control over this strategically important bridgehead in the right-bank Moldova. In April 2013 the Transnistrian local authorities passed legislation to ban Moldovan policemen from Bender from wearing their uniforms and also cut the water, electricity and food supplies to two Moldovan penitentiaries situated in the city. A month later, Yevgeny Shevchuk, the 'president' of Transnistria, unsuccessfully attempted to move the Transnistrian 'parliament' from Tiraspol to Bender. While this can be viewed as a manifestation of the conflict between the president and the parliament, from Chisinau it was viewed as yet another attempt of strengthening Transnistria's hold over Bender. In 2013 the authorities in Tiraspol tried to enlarge the borders of the break-away republic by issuing a decree on the 'state border' of the 'country', including into its territory a number of Moldovan-controlled villages. This move raised tensions, with the Moldovan parliament condemning the actions taken by Tiraspol. As a reaction, Transnistrian security forces temporarily denied entry into Bender to Moldovan policemen who work there.

## Conflict over alphabets

For the past twenty years, a major contention has been the use of Latin-script in Moldovan-administered schools in Transnistria. The schools are also one of the levers used by Tiraspol to signal its displeasure and to occasionally spoil the negotiations process. In 1989, the Moldovan authorities renounced the Cyrillic script when writing in the Romanian language and reintroduced the Latin one. Rejected by Tiraspol, after the 1992 war, the schools that chose to use the Latin alphabet were pressured by the Transnistrian authorities to return to Cyrillic or risk their funding cut. In Transnistria, Romanian (sometimes called Moldovan in Moldova) and the Latin-script were associated with support for unity in Moldova (or worse, union with Romania) while Russian and the Cyrillic script were associated with separatist goals. Eight Latin-script schools managed however to remain under the administration of Moldovan authorities, six in Transnistrian-controlled territory. Since then, Latin-script schools have been under repeated pressure from the Transnistrian authorities. In 2004, four schools were closed by Tiraspol. After strong international condemnation, including EU sanctions, the schools were again allowed to function, but the pressure continued. Following a complaint put forward by 170 Moldovan parents and teachers the European Court of Human Rights ruled in 2012 that Russia violated the right to education of the complainants and ordered it to pay over one million euros to the victims. The Court found that Russia exercised effective control over the Transnistrian authorities by virtue of its continued military, economic and political support that it provides to them. Moscow, however, rejected the ECHR ruling and refused to pay the damages stated in the ruling. In early 2014, the Transnistrian authorities froze the bank accounts of a Latin-script high school from Tiraspol and temporarily detained the director and two of his colleagues, as well as six Moldovan peacekeepers who intervened during the incident. The European Commission and European Parliament condemned the increased pressure against these schools, while the Russian foreign ministry in turn criticised the EU's position.

Besides bilateral tensions, Moldova's progress in its association with the EU also raises important challenges and opportunities for relations between the two banks of the Dniester. The DCFTA, AA and visa liberalisation will have side effects on the status quo and are already influencing the relationship between Chisinau and Tiraspol.

# STATE OF PLAY

## Impact of the DCFTA: What trade regime for Transnistria?

As a part of Moldova, Transnistria currently benefits from an EU Autonomous Trade Preferences (ATP) regime that offers favourable access to the EU market. In order to benefit from this regime Transnistrian companies have to obtain a certificate of origin from Moldova, which most of them have obtained by registering with the Moldovan authorities. This favourable trade regime benefits the export-oriented Transnistrian economy with 30-50 per cent of exports now going to the EU market (in mainly textiles, metal products, energy and footwear).

However, the DCFTA regime will replace Moldova's ATP trade regime and this poses the problem of what trade regime will apply to Transnistria. Despite repeated calls from Brussels and Chisinau, Transnistria has refused to actively participate in the DCFTA negotiations. For Transnistrian companies, adapting to the DCFTA regime would involve more than just registering with the Moldovan authorities. The new trade regime would imply, *inter alia*, adopting significant pieces of EU/Moldovan legislation, abolishing/reducing tariffs, reforming competition policy and guaranteeing intellectual property rights. If Transnistria fully implements the DCFTA it is estimated<sup>1</sup> that its GDP could grow by 3.6 per cent. Moreover, now that Ukraine is expected to sign its DCFTA with the EU, the pressure on Transnistria will grow as it will be surrounded by territories having FTAs with the EU. However, DCFTA implementation would require a higher level of control and enforcement of rules by Moldovan authorities and this is politically objectionable for Tiraspol.

Transnistrian companies (many owned by Russians) would benefit from exporting to the EU under the DCFTA, however the region's political leadership and its budget depend on Russia's support. Transnistrian officials have claimed that the DCFTA would be harmful to the region's economy and would be against its policy of legal approximation with Russia. In December 2013, 'president' Shevchuk, keen to strengthen his Russia-credentials and partially as a reaction to the initialling of the EU-Moldova deal, submitted a bill to change the Transnistrian constitution in order to introduce Russian legislation and even to give it priority over Transnistrian legislation.

While Transnistria seems to have made up its mind, the EU has nevertheless agreed to allow Transnistrian companies to trade under the ATP regime until 2015 but after such date, a continuation of that regime would not be possible as the Union will not be able to apply for a longer period two different trade regimes (DCFTA and ATP) for the same country. If the DCFTA will not be applied in Transnistria, the EU might decide not to accept goods from this region at preferential conditions and apply instead a non-preferential regime. This would mean an important increase in EU import tariffs and an estimated 5.2 per cent decrease in the GDP of Transnistria<sup>2</sup>. This would not be in the interest of Transnistria or Brussels, as the EU does not want to lose the leverage it has achieved through its increased trade with Transnistria. While Moscow opposes Moldova's association with the EU, it is also not interested to significantly damage Transnistria's trade with the EU as it would be the one obliged to foot the bill of an economic downturn in Transnistria. Russia already massively supports the Transnistrian economy and budget through the (almost) free delivery of natural gas and social programmes. Transnistria's budget frequently registers high deficits and is only balanced through the non-payment of Russian gas and the revenues received from the sale of that gas and the electric energy produced with it.

### **Managing internal borders**

Given Moldova's internal fracture, its visa liberalisation process with the EU offers opportunities but also poses some challenges for relations with Transnistria. Besides obvious benefits for its citizens living in right-bank Moldova, the EU visa-free regime the country will benefit from in the next few months is also seen as a strong incentive for Transnistrians to ask for Moldovan passports and at least partially integrate in Moldova. However, managing borders in a divided country is not easy. In 2013, as part of the Moldova-EU Action Plan for Visa Liberalisation, the Moldovan authorities opened six territorial migration offices along the Dniester river in order to control migration coming through Transnistria whilst proving to the EU that it can have proper migration controls. At the same time, in order to make this more acceptable to Transnistrians, Moldova also changed its legislation to no longer fine residents of Transnistria holding a foreign passport (about 180,000 Transnistrians hold Russian passports and about 100,000 Ukrainian passports, with some carrying both) for what would legally be considered as overstaying on the territory of Moldova. In January 2014, against the background of Moldova's initialisation of its AA with the EU, the Transnistrian KGB used the installation of these migration offices as one of the reasons to demand Chisinau the removal of all its public administration institutions from Bender. Around the same time, using a different motivation, the Transnistrian KGB announced that it will curb access to the region to staff working for the OSCE Mission to Moldova.

## **PROSPECTS**

Given the current state of relations between the two banks of the Dniester, a settlement of the conflict seems unlikely during 2014 as the two sides do not agree on key issues regarding the final status of Transnistria and the divisions of power in a common state.

Yevgeny Shevchuk has managed to consolidate power since his election in December 2011, often at the expense of political liberties. However, without a majority in the Transnistrian parliament some of his bills remain rejected. Given that Transnistria is highly dependent on Russia and given that he personally was not Moscow's favourite in the 2011 elections which he ultimately won, Shevchuk often tries to convince Moscow of his loyalty. The fact that the opposition Renewal Party, the main party in the parliament sometimes attacks him from even more pro-Russian positions further

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1 Berlin Economics, *The Impact of the EU-Moldova DCFTA on the Transnistrian Economy: Quantitative Assessment under Three Scenarios*, June 2013.

2 Ibid.

reinforces his pro-Russian stance. While Transnistrian leaders declare their allegiance to Russia, Moscow is more interested in prolonging the *status quo*, as the conflict provides a lever on Moldova, although a decreasingly influential one. Opposing Moldova's European integration, Moscow will most likely attempt to outbid EU confidence-building projects by channelling substantial funds through various government organised NGOs promoting Eurasian integration. While Transnistria has committed itself to Eurasian integration and seems less and less interested in reaching a final settlement to the conflict, Chisinau is interested to maintain the dialogue with Tiraspol, while trying to manage any provocations and continue on its European integration path. However, the pro-European coalition in Moldova will face a challenging year as it gears up for parliamentary elections this November. The opposition Party of Communists remains dominant (scoring above 34 per cent in opinion polls) and, even though when in power it supported the European integration of the country, it has now switched to support Eurasian integration.

The Transnistrian conflict has never been just a conflict between Tiraspol and Chisinau. Even the 1992 ceasefire agreement the violent phase of the conflict was signed by the Moldovan President Mircea Snegur and Russian President Boris Yeltsin. A peaceful settlement of the conflict in a united Moldova will inevitably involve at least some sort of grand-bargain between Russia and the West. This is unlikely to happen soon, especially now, after Russia's offensive in Ukraine. On the contrary, Moscow's increasing assertiveness in the region and increased tensions between Russia and the West are likely to lead to a growing number of incidents and heightened rhetoric. With a Ukraine that looks towards electing a pro-European leadership, Russia will cling to its outpost on the Dniester. In the context of its military occupation of Crimea, Russia also put on high alert its armed forces based in Transnistria, while Deputy Prime Minister Rogozin has threatened that any attempt to curtail communication of Transnistria will be considered a direct threat to the security of Russian citizens living there. Save a toning down of tensions between Russia and the West, the Moldovan authorities could also expect in the coming months increased attempts to change the status quo in Bender or other antagonisms such as the blocking of the railroad to Ukraine, blocking of access to Moldovan-owned agricultural fields situated in areas controlled by the separatists, arbitrary arrests, or pressures on the Latin-script schools.

Given Russia's recent behaviour, the EU should make clear to Moscow that it will not allow further escalation in the region and the trampling of international norms. The EU is very close to offering Moldova a visa-free regime. It should do this fast and should step up its presence and visibility in the country. Though Moldova is among the highest recipients of EU funds per capita among the ENP countries, the EU is not very visible on the ground, partially because it channels its funds through international institutions such as UNDP. Moreover, EU Member States should go beyond their 'constructive ambiguity' formulas and offer a clear European perspective for both Moldova and Ukraine. Such a perspective could potentially change the dynamic of the Transnistrian conflict and offer a clear goal to the citizens and the political leaders of this region. The EU should also look into preparing working solutions for solving the issue of the trade regime that will apply to Transnistria in order to allow local companies retain the favourable conditions they enjoy now. One avenue would be to continue to use a system of certificates of origin that differentiates between goods produced in Moldova-proper and those from Transnistria, post 2015. In the meantime, the Moldovan government should try to maintain dialogue with Tiraspol but also continue on its European path, while trying to reform and improve the lives of Moldovan citizens, on both banks of the Dniester. Sooner or later, the people of Transnistria might notice.

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## Ukraine in deadlock - What next?

*Amanda Paul and Vasyl Filipchuk*

Some two months since Ukrainians took to the streets, a political solution to the standoff between the EuroMaidan protestors and the Ukrainian authorities remains out of reach, with the situation on the ground remaining volatile. As the clock ticks there is fear that further violence and instability could be on the horizon. Further turmoil risks Ukraine's territorial integrity, with talk of division and calls for Moscow to intervene coming from a number of Party of Regions speakers. It also increases the likelihood of new security threats going beyond Ukraine's border including refugees and asylum seekers. Furthermore, as the political crisis deepens, Ukraine's economic situation becomes more perilous with the chances of default on its debts rising.

### Unprecedented Violence

Ukraine has a history of peaceful demonstrations and moderate politics. The violence against activists and ordinary people break with tradition and are a direct consequence of the aggressive methods employed by the state. Seven protestors have been killed, hundreds more injured. Some 22 people remain unaccounted for with kidnapping remaining a regular occurrence. Dmytro Bulatov leader of AutoMaidan, a movement within the EuroMaidan protestors, was found badly beaten, after he had vanished a week earlier.

The violent acts carried out by the Ukrainian security forces, including "titushki" (hired thugs) and Berkut (elite riot police) towards protestors in Kyiv and the regions have been widely condemned. Unfortunately, not a single police officer or other security enforcement agent has been arrested despite the government promising a full investigation. However, the courts have systemically put activists in prison for up to sixty days. More recently the authorities switched to a more "selective" type of violence including burning protestor's cars, carrying out "repression from the shadows" and clamping down further on free media and civil society.

### Yanukovych – bruised but not broken

Ukrainian President, Viktor Yanukovych, miscalculated the reaction from the streets. While he is still surrounded by his inner circle, the Party of Regions is weaker with several MPs leaving and others signaling a readiness to support opposition bills in Ukraine's Parliament. Yet he is far from ready to "throw in the towel". He still has his local administrations network (although less powerful than before), the Berkut, support from key oligarchs who control large blocks of MPs and, of crucial importance, the backing of the Kremlin. The fact that the opposition remains rather weak also facilitates his political survival.

While Yanukovych started to be slightly more flexible in talks with the opposition, following international pressure, this seems to be little more than a tactical step to play for time rather than a genuine desire to compromise. Hence his concessions have not been concessions at all. The abolishment of "dictatorship laws" which were adopted on 16 January, and which caused bloody clashes on Hrushevskoho Street, does not represent a concession given it should never have been adopted in the first place. Neither could the resignation of Prime Minister, Mykola Azarov. Rather he used these steps to buy time. When it comes to key demands such constitutional reform, electoral reform and a genuine amnesty bill, Yanukovych has been far from ready to concede.

### Stuck in deadlock

As of mid-February there is a deadlock. The government does not have enough force to clear Maidan, while the opposition does not have enough power to mobilise the entire country. People are waiting with growing irritation and a feeling of betrayal. Russia is actively using its widespread networks, and leverage to influence the situation. It is impossible to predict which player may break the deadlock and where it may lead the country. Ultimately, the key question is whether there is any space for dialogue between the forces to find a political solution.

Each player has a very different vision. Yanukovych would like to remain in power, receive financial (and other) support from Russia to maintain a "stable situation" until elections which he wants to win by whatever means he can. The opposition wants to achieve a compromise that has a clear road-map for change. This would begin with constitutional reform, then the creation of a technical government for a transitional

period, together with electoral reform. Maidan wants to reestablish the state with Georgia-type reforms, which would make police and courts subordinate to communities, remove corruption with a top-down approach, put EU integration back at the top foreign policy agenda and have Yanukovich and his “family” gone.

For Russian President, Vladimir Putin, Ukraine is an indivisible part of Russia and the Eurasian Union project. The fact that Kyiv owes Moscow a substantial amount of money means that Moscow has significant leverage. However, it would be a mistake to believe that Russia is enamored with Yanukovich. In fact the Kremlin may dislike him as much as the West does. Their interest is to have somebody in power that will put in place a pro-Russian government and protect and promote Russian interests.

It seems unlikely that Ukraine’s leadership wants civil war as this could sweep away the ruling elites, leaving behind a massive security vacuum, and a Ukraine broken into ‘pieces’. Therefore, Yanukovich will probably aim for a “bad peace”, and demonstrate a readiness to proceed with a number of reforms, but try to drag out the process of bringing them into force or do it in a way that will divide the opposition. This will particularly be the case with constitutional and electoral reform which will neuter his power. Constitutional reform limiting the President’s power is important but a fair electoral law is even more as without it, the road will remain open for Yanukovich to become Prime Minister once the Constitution is reformed. While Yanukovich can use any constitution to remain in power, only a free and fair electoral law, which has open party lists, can allow Ukrainians to bring the country back under their control.

### **The role of the EU**

The EU must have a central role. The value of European integration for Ukraine is not only about reforms. It is first and foremost a mechanism to overcome regional divergences and offer a vision of a future state equally acceptable to all regions, thereby strengthening Ukrainian statehood.

In order to break the deadlock, the EU and US have indicated they are ready to put on the table a substantial financial aid package, which also involves a number of other partners including the IMF, to support economic and political change. It seems this money would be attached to a clear roadmap of deep and systemic reforms.

So far, despite the shuttle diplomacy and calls for political dialogue and compromise, the EU has been unable to influence Yanukovich to any great extent. This is partly because the EU has no clear strategy for Ukraine with divisions over how the EU should handle the crisis. One group, which is composed primarily of central and eastern Europe and the Baltics, are promoting a more robust response which goes beyond statements and calls for dialogue. A second group, which seems to include, Germany, France and the UK is more inclined to continue with a policy of waiting to see what Yanukovich – and Putin – do next. Unless there is substantial increase in violence and loss life, the majority of member states do not want to risk jeopardizing other interests, in particular relations with Russia.

However, if there is no end to the kidnapping, and shadow repression, and no genuine effort from the Ukrainian authorities regarding concessions, or fully investigate the deaths and kidnapping of protestors, the EU needs to be ready to shift up a gear. Hence the threat of targeted sanctions, including travel restrictions and the freezing of the substantial assets of certain political elites and oligarchs in some member states, may be an incentive for peace. It is also important that the EU and other international actors such as the UN and US continue to regularly visit Ukraine, as this helps reduce the likelihood of new violence.

Whichever new government eventually comes into power, Yanukovich’s successors will inherit a very difficult situation which will test them from the moment they come in office. The EU needs to develop a long-term strategy for Ukraine. The recent statement by EU foreign ministers on 10 February, which says the Association Agreement does not constitute the final goal in EU-Ukraine co-operation, is a positive development, yet far from enough. While it seems the EU does not have much space to do more with the current government, they need to be prepared for the day after Yanukovich leaves power, and be well prepared to respond to Ukraine’s new realities. Furthermore, the EU also needs to use this opportunity to engage with Russia. While Moscow’s actions should not be tolerated at the same time its worries must not be ignored. Given that EU and Russian leaders have long been talking of a common European economic space, or as Russia’s leadership define it ‘Lisbon to Vladivostok,’ now would seem an opportune moment to elaborate this idea further.

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*Disclaimer: The views expressed in this Commentary are the sole responsibility of the authors.*

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## Helping Moldova stay on the EU course Proposals for a real 'more for more' approach

*Cristian Ghinea, Amanda Paul and Victor Chirila*

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### BACKGROUND

At the Vilnius Eastern Partnership (EaP) Summit in November, Moldova initialled its Association Agreement including a Deep and Comprehensive Free Trade Area (DCFTA) with the EU, and became the first EaP country to meet all the requirements of their Visa Liberalisation Action Plan. It marked an important milestone in Moldova's integration process, after some three and a half years of negotiations, reflecting the serious reform efforts the country has made. In the words of German Chancellor, Angela Merkel, in the Bundestag on 18 November, "in spite of some domestic turmoil, the Republic of Moldova has perhaps demonstrated the greatest political will of all the Eastern partners to adopt and implement reforms".

Not surprisingly, Moldova's success story is welcomed by the European Union (EU). With the decision of Armenia and subsequently Ukraine to abort their Association Agreements following significant political and economic pressure from Moscow, the EU faces the prospect of losing credibility as an influential actor in the East if it cannot deliver a success story. Moldova, (as well as Georgia) offers the EU a light at the end of the tunnel. Moldova clearly has advantages over Armenia (less dependent on Russia, particularly in relation to security) and Ukraine (smaller share of exports towards Russia; an overtly pro-EU oriented government). But it also has a number of weak points. Instability is endemic due to political crises, caused by back-biting and feuding in the governing coalition, rank corruption within the dysfunctional political and legal systems and institutions, and a popular anti-EU Communist Party. The unresolved Transnistria issue, with Russia backing the authorities in Tiraspol, remains a huge challenge, impacting on Moldova's EU journey.

### STATE OF PLAY

The road ahead to the actual signing of the AA/DCFTA in autumn 2014 will not be easy. Moldova's coalition government remains fragile and susceptible to both internal and external pressure: it could fall from one month to the next. With every step Moldova takes towards the EU, political and economic pressure from Russia increases. As Russian Deputy Prime Minister, Dmitry Rogozin, recently warned, "Each country can of course develop relations with the EU – but without forgetting the implications".

Moldova is fully aware of the implications. In the run up to Vilnius, Russia gave Chisinau an early taster of what could be on the menu if Moldova continues down the EU road: Moldovan wine was embargoed, imports of fruit were selectively blocked and threats were made to cut gas deliveries during winter, along with menacing comments related to Moldovan workers in Russia and the Transnistrian frozen conflict. Such threats are nothing new. Moldova faced Russian hostility over its membership of the European Energy Community as it requires the adoption of the Third Energy Package,



something Moscow strongly opposes as it bars gas suppliers from controlling the transport infrastructure used to deliver their gas. Moldovans were forced to postpone adoption until 2020 due to Russian coercion. Ultimately, Russia's leadership wants Moldova to re-assess its European trajectory and consider Eurasian integration instead.

### **AA-DCFTA – not the only game in town**

The period following Vilnius should be a soul-searching time for the EU. Of the three pillars (AA, DCFTA, visa regime) of the Eastern Partnership, two are now being openly challenged by Russia. While EaP was not designed for such a competition, it now has to step up to the bar if it wants to remain attractive compared to Moscow's Euro-Asian Customs Union and its influence in the region.

The EU and Russia have different styles in engaging with partner countries. The EU mainly works with governments and is engaged in projects with long-term systemic benefits (such as institution-building). Therefore, ordinary citizens only feel the effects indirectly. Take competition policies, for example: effective anti-monopoly agencies and regulated state aid may bring prices down and generate better quality for citizens, but this does not happen immediately and the link with EU conditionality is not always visible. The same applies to almost every EU intervention: food and agriculture standards, justice and police reform, anti-discrimination laws. Russia, for its part, promises concrete short-term gains such as cheap gas, while also engaging in fictional tales about EU initiatives, over which the EU is reluctant to openly tackle Russia. The EU Delegation in Chisinau, for example, was for some time prohibited to officially dismiss the Communist's Party claim that Moldova could have a DCFTA while also being part of the Customs Union, while Russian officials openly depicted the anti-discrimination law as an attack on Moldova's fundamental values. Russian diplomacy has also been mobilised for the past few months in discrediting the EU and the packages it has offered to Moldova. To this, the EU's diplomatic system as a whole has not found appropriate credible responses, making its communication strategy uncompetitive.

While EU funding amounts to some 5% of GDP or €40 per capita, this is not visible to the population as, since 2009, the money mainly went on institution building. The latest trend in EU funding – direct budgetary support – is not helping either as Moldovans cannot distinguish between EU money and means coming from the national budget. Meanwhile, the Russians are making their financial contribution very visible. In Transnistria, for example, Moscow is spending €43 per capita on food supplies and pension supplements alone, branding it as a gift from 'mother Russia'. Add to that the cheap gas Transnistrian households receive, compared to the high prices paid by the rest of Moldova's population, and we see a battle for hearts and minds, in which the EU is a reluctant player.

## **PROSPECTS**

While the EU should not engage in a populist competition with Russia, it does need to adapt its actions to the realities on the ground. This means greater visibility, better public diplomacy and delivering tangible benefits to the Moldovan population as rapidly as possible. Not only will this help counter Russian activities, it will also help shore up support for pro-EU reformers in the country.

The European Commission's proposal of 15 November for visa liberalisation should be adopted by the EU Council and the European Parliament before the May 2014 European elections. This would help the current government keep the Communist Party at bay in Moldova's November 2014 parliamentary elections.

Given Moldova's size, its proximity to the EU and Romania's citizenship policies, visa procedures are rather futile as an instrument for controlling migration. But they increase frustration as Moldovans view them as humiliating. It would not be an undeserved reward, but late recognition of efforts made by the Moldovan government, with Chisinau way ahead of other EaP countries. Reaching this point has not been easy. The Visa Liberalisation Action Plan (VLAP) was the most coherent element of the EU-Moldova relations of the last few years. It had clear demands, regular monitoring missions and visible rewards (passing from Phase I to Phase II and final recommendations). It included difficult reforms and an institution-building process, which prepared Moldova for wider European integration, beyond the narrow visa issue. It even led Moldovan governments to assume serious political risks. The anti-discrimination law resulted in harsh criticism from the powerful Orthodox Church which claimed it would mean an unbridled "Islamisation and homosexualisation" of Moldova. Furthermore, the migration check points on the administrative lines with Transnistria made the government vulnerable to criticism from the opposition for enforcing an internal border Moldova does not recognise, while also providing Tiraspol with victimisation arguments. However, under the terms of the VLAP, Moldova is obliged to control the circulation of people on its territory, yet is unable to control its border with Ukraine as it borders Transnistria, making this a necessary step. These challenges notwithstanding, the VLAP proved to be a successful instrument thanks to its 'clear conditions – clear rewards' model. The AA and DCFTA should follow this model.

The DCFTA is more than a technical free trade agreement. It was originally created for Ukraine after the Orange Revolution to enhance economic integration, as an important step towards deeper EU integration. Therefore, the DCFTA should be communicated as the first step on the long path of EU integration. While the *ex-ante* assessment of the impact of the DCFTA on Moldova infers an estimated 5.4% increase of GDP, a 4.8% increase in wages and a 1.3% drop in prices, public debate has been dominated by saber-rattling and nightmare scenarios from the anti-EU camp. While it is never easy to communicate technical details, the fact that the EU only began to seriously promote the DCFTA in September shows there is a need to up its game.

Moldova negotiated five- to ten-year exemption periods for most economic sectors, which means that, for the same goods, Moldovan producers will export to the EU custom tax-free while EU producers will export to Moldova with the current tariffs. Previous economic integration, before the 2004-2007 enlargement wave, showed that states have a tendency to ask for such exemptions (given that EU rules allows it) but to ignore using this advantage in practice, losing the opportunity to prop up the economy for the lifting of tariffs. Moldova and the EU should learn from this experience and make the best of these periods. A serious five-year strategy for DCFTA implementation will be necessary after Vilnius. In the short term, the EU should consider a pre-emptive unilateral lifting of quotas for the products where Russia enforces embargos, as it already did with wine. Transnistrian companies should be able to export to the EU under the current conditions until 2015 and the EU should avoid raising this issue on the agenda, at least until AA/DCFTA is signed.

The EU's present approach to funding is inconsistent. In some cases, such as the Visa Action Plan, the EU has given clear benchmarks in order to receive finance, but this is frequently not the case. For example, new institutions created in Moldova to implement EU demands (Competition Council, National Agency for Food Safety, National Integrity Commission, and Anti-discrimination Council) lack proper resources, while old institutions, despite having criticised them for poor performances, continue to receive substantial funding.

The coordination of EU affairs within the Moldovan government remains problematic and is expected to further deteriorate after the AA/DCFTA is signed. The Foreign Affairs and European Integration Ministry employs only three people in its policy monitoring and evaluation section. The MFA should coordinate line ministries, but lacks the leverage. For the DCFTA alone, Moldova will have to adopt 95% of the EU's economic *acquis*, yet the Centre for Legal Harmonisation is understaffed and misplaced (under the Justice Ministry). There is no strategy to support them through EU funds, although some EU members (Finland, Sweden, Romania) try to address this problem through bilateral donations and administrative support. It would be beneficial to coordinate efforts into a coherent programme to link funding with EU demands.

Another challenge is state capture by rich businessmen who are politically active, including in the ruling coalition, using their position to block enforcement of new legislation, such as competition and anticorruption laws, that may affect their interests. The EU may be better placed to empower the technocrats in the Moldovan institutions who are genuinely interested in pursuing the EU trajectory. The EU reaction to Moldova's numerous political crises has been mediation amongst local politicians. Political dealings should not be able to undermine institutions and key reforms and the EU should use its influence with a more preemptive approach, making it clear to politicians what is acceptable and what is not (preferably before it happens). There are several examples of when the EU could have been bolder in its support for real reforms. For example, the reform of the Anticorruption National Centre (ANC) was hijacked by political interests. The reform, supported by the EU high level adviser's mission (a group of high-level policy advisers deployed to Moldova's main public institutions to assist and support the authorities in implementing and monitoring relevant policies), missed the opportunity to make the institution powerful by giving it clear competences and bringing it under the same umbrella with Anticorruption Prosecutors. Instead, the reform focused the debate on who appoints the head of ANC – Prime Minister or Parliament – starting scandal on this dilemma. Reform of the General Prosecutor's Office was similarly hijacked. The institution was openly integrated in 2010 in the Coalition Agreement (as belonging to the Democrat Party). Such an obvious disregard of good governance rules should not be allowed by the EU. Again, the focus of the debate was on who appoints the person instead of meaningful reforms. The EU provided €60 million on justice reform in Moldova, of which €58 million went on budget support and increasing the judges' salaries. The assumption was that the corrupt judges would stop taking bribes. However, public money will never be able to compete with the money paid as bribes, nor should it try. These institutions should firstly be reformed and afterwards rewarded.

Indeed, one of the key challenges facing Moldova is restructuring the dysfunctional political and legal institutions. Until now, the EU has focused too much attention on legislative reforms and not ascribed enough importance to structural challenges such as the public administration and judiciary, which are crucial for the country's effective functioning and transformation.

Following threats to cut off Moldova's gas, it would be helpful if the EU could rapidly invest in follow-up projects to the Iasi-Ungheni gas pipeline. The pipeline, financed by Romania and the EU, will ease the pressure on Moldova, providing



an alternative solution to Russian gas in case of emergency. However, in order to be commercially viable, the construction of a compression station is necessary, along with extending the pipeline from the Ungheni-Chisinau pipeline. These are costly investments. One possible method of financing could be to use a mix of assistance and loans from the European Bank for Reconstruction and Development (EBRD). Romania views the Iasi-Ungheni project as part of the EU common energy market integration process (similar pipelines with Hungary and Bulgaria are under way). The EU should consider adopting this approach given that Moldova will be part of the future common energy market.

Although it receives considerable attention, Transnistria has played a rather marginal role in the negotiations with the EU due to the Tiraspol authorities rejecting EU offers to be part of the process. The current 5 + 2 Chisinau-Tiraspol negotiations format is based on a step-by-step confidence-building approach, assuming that by working together on small problems, mutual trust will increase which may bring about a political settlement. Unfortunately, this assumption has not yet borne fruit and after several years, while many important confidence measures have been achieved, a political deal is still no closer and tensions are increasing. The mainstream view that it is impossible for Moldova to ever have an EU perspective until the Transnistrian problem is solved is not helping but rather increasing the leverage of Tiraspol. Given that Chisinau considers EU integration a national project, conditioning the offer of an EU perspective (although that is not yet on the table) on conflict settlement means, in practice, putting Tiraspol in the driver's seat. Moldova needs time and a European perspective to deal with the conflict. Having such a perspective and moving closer to the EU will change the region's dynamics. EU integration is the key to solving the Transnistria conflict, not the other way around. Ultimately, if all else fails, the EU may have to contemplate letting Transnistria go.

Despite often tricky and fragile domestic politics, pressure from Russia and no clear European perspective, Moldova continues to focus on a European future and is prepared to remain on the "train" in the hope that, one day, a destination will appear on its ticket.

2014 may prove to be a make or break year for Moldova, with Chisinau facing a number of serious challenges. From the EU's point of view, it could also prove to be a make or break year for the Eastern Partnership. As things stand, without Moldova there is little to show for the past ten years of EU engagement in the region. Yet, as we are witnessing on the streets of Kyiv, the EU remains attractive, offering the Union a unique opportunity to help transform the lives of millions of people. Therefore, despite the EU's internal problems and forthcoming changes in leadership, the Union needs to shake up and strengthen its Eastern Partnership policy if it is going to succeed in meeting the growing challenges in a region, which its leadership claims to be priority. Greater solidarity, engagement and flexibility with a more proactive and generous approach to partners – such as Moldova – which deliver, with greater efforts made to deepen ties with societies and grass root actors, would be a good start.

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