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Shaping Convergence with the EU in Foreign Policy and State Aid in Post-Orange Ukraine: Weak External Incentives, Powerful Veto Players

ANTOANETA DIMITROVA & RILKA DRAGNEVA

Abstract

This essay analyses convergence with EU rules in Ukraine in two policy areas—foreign and security policy and state aid regulation. Comparing the two, we find different levels of convergence, somewhat higher in foreign policy (but slowing down after 2010) than in state aid law regulation. We explain this by analysing the presence and actions of oligarchs as veto players that have had an extensive influence on policy in the Ukrainian political system in recent years. In policy areas where convergence with EU rules negatively affects the interests of oligarchs and their political allies, we see only limited convergence with EU legislation and policies.

DEBATES ABOUT THE INFLUENCE OF THE EUROPEAN UNION (EU) on its Eastern neighbours have gone from post-enlargement optimism to tempered realism. Based on the literature that has studied the effects of enlargement, the optimistic notes in this debate came from the understanding that the EU has, by and large, succeeded in transferring its norms and rules to candidate states from the East and contributed to their democratic and market transformations. The pessimism came as observers took note of the EU's enlargement fatigue and the diminished power of conditionality when membership was not a realistic prospect. The European Neighbourhood Policy (ENP) and the Eastern Partnership (EP) initiative were both instruments created in the aftermath of the EU's eastern enlargement to deal with aspiring members such as Ukraine and Moldova and to facilitate their transformations to democracy and the market economy. The ENP in particular drew on the experiences and expertise gathered by the Commission during the last enlargement in terms of both personnel and policy tools (Kelley 2006). However, it soon became clear that in the case of the EU's Eastern partners and especially potential candidates such as Ukraine and Moldova, the ENP was seen as both insufficient (from the perspective of aspirant members) and ineffective (from the EU perspective) in promoting further reform in the way enlargement conditionality had done. The weakening influence of the EU on Ukraine and

other neighbourhood states begs the question of whether the EU has lost its ability to inspire and guide reform in neighbouring states or even whether the Union's transformative power was only ever effective in combination with pro-European preferences of domestic actors, as it was in Central and Eastern Europe.

The EU's ENP partners are expected to converge with EU rules in a number of areas defined by the ENP's Action Plan, the EU's Progress Reports and partnership agreements between the EU and the ENP states.¹ This essay aims to examine the extent of convergence with EU rules, defined as policy change, either change of sector-specific legislation or rhetorical commitment to such a change, or ultimately, behavioural compliance with EU policies that do not fit domestic policy. The question of how the EU can stimulate convergence with its rules on markets, energy, foreign policy or other key areas in its neighbourhood can be answered better if we have a deeper understanding of the mechanisms that have influenced convergence so far. To determine convergence or the lack thereof, we examine the formal adoption or amendment of legislation, rhetorical commitments, especially in Common Foreign and Security Policy (CFSP), and behavioural change where evidence for such change is available with a clear indication that it is linked to EU policies.

We examine convergence in two different kinds of policy areas—namely, foreign policy and state aid regulation, the latter being part of the core of the internal market *acquis*. We argue that domestic factors and, more specifically, the positions of key veto players, can best explain a differential pattern of convergence where Ukraine makes policy changes in response to some of the EU's policy-specific requirements but ignores or resists others. To develop our argument, we focus on key formal and informal veto players and their role in shaping reforms or maintaining the *status quo* in an internal market-related area and in foreign policy.

The choice of these policy fields is led by the key question informing this collection, namely, why does policy change under EU guidance vary between policy fields. Furthermore, our two cases display different levels of institutionalisation of the EU *acquis*: CFSP and European Security and Defence Policy (ESDP) is an area with very few EU rules, and it can therefore be defined as weakly institutionalised, while state aid law is part of a core *acquis* area which has complex substantive and procedural rules. State aid has been an area of high delegation to the European Commission, which has sought to establish a technocratic approach to monitoring and controlling the provision of aid, and has the potential for hierarchical rule transfer in relation to substantive rules.

Building on arguments that stress the fact that the EU's credibility in enlargement has decreased due to both enlargement fatigue and the reluctance to offer Ukraine the prospect of accession, we find it important to offer a domestic perspective on convergence and examine the changed configuration of veto players and their preferences.

Recent analyses of Ukraine have been conducted in the context of a pro-Western configuration of veto players—the period of government of President Viktor Yushchenko after the Orange Revolution. In 2010, this came to an end with the inauguration of President Viktor Yanukovich. Throughout 2010 and 2011, Yanukovich made gradual but continuous changes, consolidating his hold on power and reversing the freedoms that gave Ukraine its democratic credentials. These dramatic changes require a new analysis of Ukraine's convergence with the EU that takes into account the role of a different set of domestic veto

¹We would like to thank one of the anonymous reviewers for this point.

players and the incentives offered by external actors (the EU but also sometimes others such as World Trade Organization, WTO).

More specifically, we argue that the presidential election of 2010 led to further enhancement of the power of oligarchs, especially those linked to the Party of Regions (*Partiya Regionov*) and to even less interest in convergence with EU rules. The general context of recent deterioration of democratic institutions and increased pro-Russian orientation makes a re-examination of the case of Ukraine and its convergence with EU rules especially interesting.

Before we proceed to investigate how specific policy areas have fared, in the next section we briefly address some influential theoretical approaches that have informed debates in this area.

Theoretical approaches to the explanation of convergence

The conceptualisation of the EU's influence on its neighbours, especially the states situated in South and Eastern Europe, has been strongly influenced by the literature on EU enlargement and its findings. The main conclusion from this literature, namely that the EU has been quite influential in supporting democratic consolidation and market reforms in post-communist states which have been involved in accession negotiations, has also now been taken on board by policy makers, to the extent that the EU started advertising enlargement as its most successful foreign policy tool (Rehn 2007). This literature also identified the most effective EU policy tool: conditionality and the mechanism behind it, namely external incentives and threats affecting domestic actors. The problem with enlargement-based policy tools and underlying mechanisms after the 2004–2007 enlargement of the EU is, simply, that the EU cannot continuously enlarge in order to influence its neighbours. Even before the accession of Bulgaria and Romania in 2007, there was a feeling that the EU and its older member states in particular were suffering from enlargement fatigue and would not engage in further expansion in the near future (Rehn 2006).

Analysis of the situation of Ukraine following the external incentives model (Schimmelfennig & Sedelmeier 2005; Vachudova 2005) would examine whether domestic actors adopt EU rules (leading to policy convergence in specific sectors) based on the ratio between the costs of compliance and the benefits from EU rewards. The problem with this, however, is that, in the ENP context, the benefits that the EU has been able to offer do not include membership. In our view, the membership perspective adds a critical edge to EU incentives which are not only material but contain an element of symbolism and identity (Dimitrova 2004; Steunenberg & Dimitrova 2007). Furthermore, the credibility of EU conditions is much diminished without an officially recognised candidate status.

Bearing these considerations in mind, the EU has tried to develop an incentive which replaces enlargement and which is sufficiently interesting for Ukraine (and other EP countries) to keep reforming and complying with its demands for change. Having refrained from giving an explicit membership perspective, the EU offered Ukraine a stake in its internal market instead (European Commission 2004, p. 3) or the possibility to create a Deep and Comprehensive Free Trade Area (DCFTA) between the EU and Ukraine as well as some sector-specific incentives. Thus any potentially effective EU conditionality must be seen in the context of the rewards offered by the DCFTA, the Association Agreement and the potential economic benefits from it. Provisions for regulatory convergence in the Partnership and Cooperation Agreement (PCA) and in the future Association Agreement embody the EU

approach of promoting its *acquis*-based regulatory framework as a model for third states. These agreements serve, to a great extent, to encourage third countries in their regulatory frameworks to converge towards the *acquis* of the Union as a way to reap the benefits of trade.

There are several authors who argue that, at the aggregate level, the incentives offered by the EU in the context of the ENP and the DCFTA are not strong enough to compensate for the possible losses of domestic actors that may result from adaptation to EU requirements (Melnykovska & Schweickert 2008, p. 446; Valasek 2010; Lange 2010). To evaluate convergence with the EU, we try to identify the actors which may be relevant as veto players able to stop changes in a particular sector. Before we do this, we put forward one general argument, namely that *a priori* the EU has less leverage in Ukraine than it did in Central and Eastern Europe. We will explain briefly why we consider this to be the case.

We find that the external incentives model and related explanations highlighting the EU's conditionality approach were the best explanatory frameworks for the success of Central and Eastern European states in EU rule adoption in the last enlargement. We believe, however, that some of the scope conditions necessary for the mechanisms described in this model to work are not present in Ukraine as they were in Central and Eastern Europe. On the EU supply side, EU conditionality was generally credible in the case of candidate states included in the Eastern enlargement. In the case of Ukraine, not only has the EU balked at ever giving a clear enlargement perspective, but the Union's general state of constitutional crisis in the post-Lisbon treaty era makes this unlikely to happen in the near future. As specified in the external incentives framework, when EU credibility is low, the likelihood of adoption of its rules is lower (Schimmelfennig 2001).

Why is the prospect of joining the EU so important? After all, the EU has adjusted its policies and offers incentives such as the DCFTA that may be sufficient for domestic actors that stand to benefit from the opening of trade. Still, we believe that next to the anticipated material benefits, the symbolic award of joining the EU was an essential component of the incentives offered by the EU in the last enlargement process and this is also the case for Ukraine. In the last enlargement, Central European leaders used a strategy of rhetorical entrapment, arguing that accession to the EU would be a return to the European community of democratic states for their countries. For EU leaders to refuse to accept them would be equal to challenging their own commitment to democracy (Schimmelfennig 2000), but the use of rhetoric applied in both directions—governments from Bulgaria to Poland had promised their electorates that they would lead their countries into the EU. The symbolic reward mattered to them and kept them on track even when specific sectoral costs of adjustment were high (Dimitrova 2004; Fink Hafner 1999; Henderson 1999).² Symbolism is also important in the case of Ukraine—for example, symbolic recognition of Ukraine's importance to the EU or European identity. The EU has, however, underestimated the symbolic aspects of its relationship with Ukraine (Popescu & Wilson 2009).

Not only is the EU failing to emphasise the symbolic aspects of its relations with Ukraine,³ but in Ukraine itself discourses of the 'return to Europe' are not very prominent

²As Fink Hafner (1999, p. 789) has noted, the symbolism of a successful 'return to Europe' or of joining the EU became an autonomous force for legitimising post-communist political elites in Central and Eastern Europe.

³Most recent evidence of this is provided by the attendance at the Eastern Partnership Summit in Warsaw in September 2011. Analysts have commented on the lower level representation by France and the UK (Rettman 2011).

(Popescu & Wilson 2009, p. 16). These differences lead us to suggest that, on the whole, the EU's incentives for domestic actors in Ukraine are much weaker across the board than they were in the last enlargement, even if there are specific sectoral gains to be made.

Another possibility is that the EU may be able to promote its rules in different sectors through networks as described by the so-called external governance approach. The key argument of the external governance literature (Lavenex 2008; Lavenex & Schimmelfennig 2009) is that the EU aims strategically to promote and export its own regulatory regimes to third countries and especially to neighbouring states. Furthermore, this approach suggests that the EU's rule promotion is, in the absence of enlargement incentives, conducted at the sectoral level through the horizontal contacts between actors and networks involved in applying the regulatory frameworks. The ENP is seen, in this context, as an instrument for cooperation in areas where the EU and its partners are looking for joint problem solving and where they establish cooperation in the economic sphere accompanied by horizontal ties between the public administrations of neighbouring countries and the EU.

This explanation expects that the EU would be better able to promote rules in areas which are highly institutionalised and enjoy high internal legitimacy in the EU (Lavenex & Schimmelfennig 2009, pp. 802–3). Based on this, we cannot make a clear prediction how partners would deal with the EU's state aid rules, as this is a highly institutionalised and still controversial area in which member states have not always complied with common rules.

More importantly, we find it misleading to focus on the EU's ability to promote convergence through technical or horizontal or network channels when the 'recipient' is a state with strong hierarchical organisation such as Ukraine. Analysts (Lange 2010; Valasek 2010; Wilson 2010, 2011) agree that the actions of President Yanukovich since he came to power have aimed at strengthening the vertical separation of power and diminishing the role of institutions such as the judiciary. Key administrative posts are often taken by business representatives or their supporters. We find that the context of a centralised administrative state is not conducive to forming effective horizontal networks that may promote convergence with the EU.

The centralising tendency visible in post-Orange Ukraine leads us to believe that we should look at key domestic veto players rather than transnational networks to explain the dynamics of convergence. Before proceeding to this analysis, we need to briefly consider how to conceptualise the role of Russia as an important regional player.

Dimitrova and Dragneva (2009) have argued that the effects of EU governance cannot be examined in a vacuum and need to be considered against the influence of Russia as a powerful regional hegemon. They have shown that interdependence with Russia is a significant factor when considering Ukraine's convergence with EU rules. They have also suggested that interdependencies with Russia differ in different policy areas: from high in energy and foreign policy to diminishing in trade. Based on this perspective, we can expect that Ukraine will take into account regional context and important geopolitical factors, among them Russia's very presence and power when aligning its foreign policy with the EU.⁴

⁴We use alignment with EU foreign policy as synonymous with convergence, as the Union's foreign policy does not require much regulatory adaptation. By contrast, internal market-related areas, such as state aid or company law, require more serious adaptation with a larger body of EU *acquis*. In those cases it makes sense to look for convergence by means of adopting concrete regulatory measures.

Russia's influence, however, cannot be understood without reference to domestic politics and its key role as the energy supplier for Ukraine's economy, providing gas for the metallurgical industry and other energy intensive sectors. We therefore aim to examine Russia's influence through the prism of domestic actors' preferences and how these may be influenced by Russia's strategy of linking geopolitical choices by its neighbours and the politics of gas.

Focusing on the domestic arena: veto players

By focusing on veto players, we build on two sets of explanations. The first is the above-mentioned external incentives model which placed domestic actors and their cost–benefit calculations at the centre of the explanation. We find, however, as argued above, that the EU's incentives are weak and less credible than they were in the last enlargement. Therefore, along with other existing studies that have explicitly pointed to the role of veto players in Ukraine (Melnykovska & Schweickert 2008), we examine developments in the domestic arena as the decisive factor influencing convergence.⁵

We suggest that reforms in Ukraine can be best analysed as changes in the *status quo* in a specific sector or policy area. As the incentive of enlargement is absent, the EU's influence is one among many that influence the strategic calculations of veto players. Veto players are defined as actors whose agreement is needed to change the *status quo* (Tsebelis 2002, pp. 17–19). Tsebelis, in his seminal work, defines two categories of veto players, namely institutional (for example presidency and parliament) and partisan (political parties and relevant majorities) (2002, p. 19). As he has suggested, analyses of individual veto players can include actors who are crucial for agreement in a specific area even if they are not institutional veto players (2002, p. 81).

As has been argued elsewhere, post-communist systems are characterised by the crucial role played by informal veto players, the so-called early winners of economic reform (Hellman 1998, p. 233). Ganev has shown that these post-communist entrepreneurs have created powerful networks that have captured the state and penetrated its structures (2007). An important consequence of state capture is that business interests play the role of veto players in government and parliament, which includes the possibility of vetoing EU-driven reform as well (Dimitrova 2010). In Ukraine, the influence of oligarchic clans on political power continues beyond the transition to democracy period and is characterised by a strategy for wealth accumulation dubbed 'power = money = power' by Melnykovska and Schweickert (2008). As they explain, access to state power allows oligarchs to secure their economic interests and make profits which they use to broaden their political power (2008, p. 448).

We expect, therefore, that sector-specific convergence effects in Ukraine will depend on the extent to which the policy change advocated by the EU affects the interests of these formal and informal veto players (Melnykovska & Schweickert 2008; Dimitrova 2010; Dragneva & Dimitrova 2010). We will examine how sector-specific configurations of formal and informal veto players and these players' interests may be affected by EU demands for convergence.

⁵See also Buzogány, and Ademmer and Börzel, in this collection.

In the next section we discuss briefly who the relevant actors are and what knowledge we already have of their preferences in EU-related issues such as market reforms or foreign policy.

Who are the important actors?

There is an extensive literature which discusses the nature of Ukraine's political institutions and, more specifically, the extent to which they have been penetrated and captured by oligarchic groups (Darden 2001; Puglisi 2003; Way 2004; D'Anieri 2007; Flikke 2008). Oligarchic groups and oligarchs, such as Firtash and Achmetov, can be considered informal veto players in the sense that they are not always empowered directly by the Ukrainian constitutional and institutional system, but are able to stop any policy change by virtue of their penetration of the state and close links with executive and parliamentary actors.

To understand this, we need to take into account that Ukrainian transition has resulted in the establishment of a stable system of rent-seeking and rent-giving between president, parliament (*Rada*), government and big business. The more important an institution has been, the more it has been targeted by non-state actors. The presidency has, throughout the 1990s, established itself as the institutional basis for the formation of a neo-patrimonial regime built on regional clan networks (Puglisi 2003; Way 2004). The powers of the president were somewhat limited by the *Rada* with the constitutional changes negotiated in December 2004, yet President Yushchenko did not break from this system, proceeding to promote his 'Orange' business supporters (Wilson 2009; Malygina 2010).

The *Rada* was also an important source of influence and indeed became a key target for big business to the extent that promulgation of legislation in the 1998 and 2002 parliaments became critically dependent on the fluid support of a number of loosely organised factions (Puglisi 2003). While big business was behind all political factions, the backers of the Party of Regions became key players during the 2006 and 2007 parliaments. This was due to the electoral success of the Party of Regions, but also because changes in the constitutional set-up led to a smaller number of factions in the *Rada*, hence a simpler bargaining process in law and policy making. Despite their critical role in the *Rada*, the Party of Regions and its parliamentary allies, the Communist Party (*Komunistichna Partiya*) and the Socialist Party (*Sotsialistichna Partiya*), were frequently locked in conflicts with the presidency during the Yushchenko period, which resulted in extensive constitutional and political battles (Wilson 2009).

The election of President Yanukovich in 2010 changed the political landscape in several important ways. It meant that the presidency was back in the hands of the Party of Regions, which also had a healthy parliamentary majority. Thus, the big businesses behind the governing party gained a firmer grasp on the political system. Further, reminiscent of the Kuchma presidency, we see the renewed importance of the president as an arbiter dividing and ruling between the different groupings within the Party of Regions. The political and constitutional changes initiated by Yanukovich have led to the reconcentration of power into the hands of the presidency. We see a closer similarity to a neo-patrimonial regime than in the preceding period (Malygina 2010).

Inside the Party of Regions, two different informal factions emerged as veto players. The first group was the faction around the Donetsk-based oligarch Rinat Achmetov, and the second, described as more a conservative and pro-Russian group, was formed around those

linked to energy companies such as Dmitry Firtash, former boss of RosUkrEnergo, and the Minister of Energy Yurii Boiko. The most important feature of this second group of informal veto players, the so-called 'gas lobby', is that they are closely connected to companies that thrive on 'market distortion, government manipulation, monopolies and administrative resources' (Lange 2010, p. 4). Furthermore, and crucially important for our analysis, Firtash has reportedly been the biggest financial backer of Yanukovich's electoral campaign (Wilson 2009; Marone 2010).

Preferences of key veto players

The formal, institutional veto players in the Ukrainian system are the parliament and especially the president. Due to his constitutional role in foreign policy, the president's preferences are central in foreign-policy decisions. Here it is useful to remember that President Yanukovich himself owed his electoral support to the Russian-speaking eastern part of Ukraine. In this sense, convergence with Russia may be expected to be one of the main factors ensuring continuous support from his electorate (White & McAllister 2009, pp. 231–32).

Next to the presidency, another set of key veto players are the partisan veto players with a majority in the *Rada*, currently the Party of Regions (*Partiya Regioniv*). This group, however, is not homogeneous. As the discussion in the previous paragraphs shows, within the Party of Regions different oligarchic factions play an independent role. They may pursue different interests and the president can act as an arbiter, balancing between them or deciding which one would dominate political and business life.

As for the informal actors, adding to the discussion in the previous sections we can expect, following Moravcsik (1998, pp. 38–41), that the structure of the economy and the importance of key sectors would lead to the aggregation of preferences of certain business and sector interests into the preferences of the government. The fact that Ukraine has been a weak or captured state means, however, that the domestic preferences which are aggregated at the government level would be mostly the preferences of oligarchs, defined by the key industries and assets that they own. A further complication is added by the efforts of the presidency to balance the interests of oligarchic factions in a process that is neither transparent nor predictable.

Bearing all this in mind, we can rely on empirical sources which have identified the interests of major factions and oligarchs in order to define their preferences. We can assume that oligarchs whose wealth is based on industries that export mostly to Russia, as well as gas oligarchs, will favour policies that will not damage relations with Russia. We also expect that oligarchs and supporting factions will resist regulatory changes that would limit state capture in general. This would be true of oligarchs favoured by the presidency of Yushchenko as well as of those oligarchs linked to Yanukovich and the Party of Regions.

There are some previous analyses supporting our expectations. In terms of substantive preferences, Wolczuk has pointed out that many sectors of the Ukrainian economy are characterised by technological backwardness and lack of competitiveness. This lack of modernisation of industry does not appear to hinder so much economic ties with Russia and the CIS (Wolczuk 2004, p. 7). Smolar similarly suggests that Ukraine's outdated industrial base has maintained its output based on low wages, low prices of energy and state subsidies. Ukrainian elites, according to him, have aimed to avoid the social costs of modernisation and therefore have continued to rely on low-quality exports for the Russian market.

If Ukraine were to give in to EU demands for elimination of state subsidies—as the required legislation in state aid would do—then Ukrainian exports could become too expensive for Russian markets (Smolar 2006).

The same is valid for gas imports. As Ćwiek-Karpowicz (2010, p. 262) has pointed out, the interests of oligarchs who have controlled energy-intensive sectors of Ukrainian industry were threatened by the high price of gas during the Yushchenko years. Their priority, as exemplified by President Yanukovich's pre-election promises, has been an agreement with Russia for cheaper gas imports. Despite some analyses (Melnykovska & Schweickert 2008, p. 454) which have argued that the opportunities for cheaper gas imports have been exhausted, the closing of the so-called gas-for-fleet deal in 2010 showed that both Ukraine and Russia were interested in continuing the symbiosis between energy policy and foreign policy.⁶ Furthermore, as Wilson (2010, p. 2) has specified, the business model of Ukrainian oligarchs has relied on gas arbitrage profits. Securing cheap Russian gas appears to be the key preference of gas and energy oligarchs.

Other analyses suggest that oligarchic clans have been changing and that their interests bring them closer to the EU. Melnykovska and Schweickert (2008) have argued that changes in the preferences of oligarchic clans from accumulation towards security and consolidation would become the key bottom-up force for institutional convergence between Ukraine and the EU. They have claimed that these oligarchs can become a force for greater alignment with European and international norms. Their analysis, however, is focused mostly on the oligarchs who supported Yushchenko and the Orange Revolution, and even in their case we believe that lack of convergence in a number of areas such as company law shows that policy-specific veto players and their interests prevail (Dragneva & Dimitrova 2010). Melnykovska and Schweickert cite as evidence the constitutional changes under Yushchenko moving the Ukrainian system towards a parliamentary republic (2008, p. 450). We must note, however, that these changes have been reversed under President Yanukovich and so has much of the progress in good governance which they base their arguments on.⁷

Substantive preferences on specific issues may differ between oligarchs; however, based on previous work we can confidently suggest that the oligarchs' main interests are determined by what maximises the preservation of their own autonomy in economic and political terms, property rights acquired during privatisation and influence upon political life.⁸ As a recent policy brief argues (Matuszak 2011), 'the introduction of free and honest competition on the Ukrainian market and the influx of foreign investments would pose a threat to the monopolistic position of oligarchs'.

⁶According to the agreement signed in April 2010 between President Yanukovich and Russia's President Medvedev, Ukraine extended the lease to station the Russian Black Sea Fleet in Sevastopol for the next 25 years in exchange for a 30% discount in the price of Russian gas deliveries (but not more than US\$100 per 1,000 m³). See Centre for Eastern Studies, available at: <http://www.osw.waw.pl/en/publikacje/eastweek/2011-09-07/ukrainianrussian-gas-dispute>, accessed 3 October 2011.

⁷According to Freedom House ratings, Ukraine dropped from the free to the partly free category in 2010. In a survey of economic freedom by the Heritage Foundations and the *Wall Street Journal*, Ukraine was rated 164th out of 179 countries in 2010—behind Russia, Belarus and Kazakhstan and in the lowest place among all European countries.

⁸A study of legal reform in the area of company law shows, for example, that oligarchs have aimed primarily at the preservation of privatisation gains and influenced accordingly the voting behaviour of the Party of Regions despite fairly constant external pressure for legislative alignment with EU norms in this field (Dragneva & Dimitrova 2010).

We argue therefore that the most important preference of oligarchs is the preservation of the regulatory and institutional *status quo*. This key assumption is at the core of our policy sector analyses.

In this sense, if EU-related legislation limits oligarchs' autonomy, it would be highly unrealistic to expect that they would allow it to reach the stage of implementation. State aid and other market-regulatory legislation clearly have the potential to limit access to subsidies and freedom of operation and thus would be particularly sensitive to convergence following this logic.

Not only are the preferences of another set of oligarchs represented by this presidency, as compared to the Yushchenko period, but, bearing in mind President Yanukovich's moves to strengthen his own position by balancing between the factions, his role may also become more important. In our view, there is evidence of a complex informal order through which business preferences are balanced at the level of the presidency.⁹ This means that when oligarchs do not have strong views on a policy area, the president's preferences will be crucial. This would be, according to us, the case with foreign policy.

Therefore our expectation would be to see diminishing convergence with the EU policies, based on the pro-Russian preferences of President Yanukovich, an important constitutional veto player. We also expect his preferences to converge with the interests of the dominant factions of the Party of Regions, which would be determined by the negative imperative of not angering Russia.

More specifically, the interests of the gas lobby faction within the Party of Regions, given their enrichment through the import of gas, can be assumed to be against foreign policy actions that affect negatively relations with Russia. During Putin's presidency and especially during his term as prime minister, Russia's strategy has been to create issue linkages between gas and foreign policy (Popescu & Wilson 2009, p. 44; Ademmer & Börzel, in this collection). Russia's concerns with relation to Ukraine are often geopolitical and foreign-policy related—such as the issue of the Russian fleet's stay in the Crimea (Ćwiek-Karpowicz 2010, p. 1; Popescu & Wilson 2009, pp. 41–44). Thus the preference of oligarchs linked to President Yanukovich for a gas deal with Russia leads to concessions on foreign-policy issues important to Russia such as NATO aspirations or the Black Sea fleet. As Puglisi has aptly noted, 'as long as Russia views Ukraine as the main battlefield in its zero-sum geostrategic game with the West, Ukrainian business representatives are likely to become Russia's willing instruments in this confrontation' (2008, p. 81).

In the following sections of the essay, we examine the actual convergence in foreign policy on the one hand and state aid on the other, and the role of political actors in this process.

Convergence and divergence in foreign and security policy

To determine whether Ukraine has converged towards EU policies and requirements in the area of foreign policy, we start from the observation that the demands of the EU in this area have not been extensive. While the ENP was partly created to manage relations with

⁹For example, President Yanukovich's December 2010 reorganisation formally cut the number of ministers, but other changes broadened the scope of influence of deputy prime ministers linked to the Donetsk group of oligarchs, balancing their influence with the influence of the gas faction (Centre for Eastern Studies, available at: <http://www.osw.waw.pl/en/publikacje/eastweek/2010-12-15/ukraine-s-president-balances-out-groups-influence>, accessed 26 September 2011).

neighbours so as to extend stability and security beyond the EU's borders, the Union's aspirations in terms of CFSP are surprisingly modest. This reflects the EU's traditional way of promoting stability through regional integration and trade rather than aiming to form alliances on foreign-policy issues. Furthermore, the EU's role in this part of the world has been subordinated to NATO. When we look at security issues, it has been the dispute over Ukraine's wish to join NATO under President Yushchenko that has overshadowed relations. The EU, true to its soft power *modus operandi*, has expected Eastern members of the ENP to consult and align with CFSP declarations and sanctions open for alignment. The EU's second biggest concern has been border security and containing regional conflicts such as the Transnistrian conflict. The EU has expected Ukraine to 'cooperate constructively with the EU' on all issues related to Transnistria settlement efforts (European Commission 2004, 2006, 2010a). Last but not least, the EU has encouraged the participation of Ukraine in peacekeeping operations in the Balkans and more recently in the EU naval operation Atlanta (European Commission, 2010a, p. 6).

On the whole, we must note that the EU's demands in the area of foreign policy are not high because this policy area is a weak spot for the Union itself. Institutionalisation is weak inside the EU, so while incentives may not be high, it looks as if convergence would not be very costly for Ukraine either. In this case we may expect low convergence based on low levels of policy activity in the EU itself.

The picture, however, becomes more interesting when we take into account rhetoric and symbolic actions and the fact that even symbolic commitments by Ukraine in some areas may matter to Russia as they concern a key state in its neighbourhood. Russia's adamant opposition to Ukraine's NATO entry is the best example of how sensitive it is to challenges in its 'near abroad'. Furthermore, as Popescu and Wilson (2009, p. 30) have argued, Russia has made the idea of Slavic brotherhood with Ukraine and Belarus a cornerstone of its post-Orange Revolution strategy to win influence among its neighbours.¹⁰ In such a context, and given Russia's discourse stressing common Eastern Orthodox Christian roots, Ukrainian actions to support EU sanctions against Belarus may be costly for the president.

Looking at Ukraine's convergence with EU foreign policy in this light we note some variation over time. Progress in aligning Ukrainian policies with the EU up to 2009 is noted in the Report on the Negotiations of the Association Agreement of Ukraine with the EU. The chapters dealing with cooperation and convergence in the field of foreign and security policy have been provisionally closed. According to one Ukrainian official, the least convergence had been achieved in the area of military cooperation:

Both Brussels and Kyiv failed to adequately assess all the potential difficulties of military cooperation. It took Ukraine too long to develop a comprehensive plan for utilising the hazardous legacy of the Soviet Army. The European Union underestimated the dependency of security and defence measures on the availability of funds. Today the parties understand how they should proceed but we wasted a lot of time. (Veselovsky 2008)

In terms of crisis management and peacekeeping under the EU's ESDP, Ukraine has been praised for taking part in several EU missions. Ukraine's contribution to the EU's

¹⁰ Another illustration of how Russia uses the symbolism of fraternity is the presentation of Presidents Yanukovich and Lukashenko with awards for contributing to the cause of Orthodox Christianity in January 2011.

border assistance mission at the Ukrainian–Moldovan border has been praised by the EU. Ukraine has also been seen as a valuable contributor to the EU police mission in Bosnia & Hercegovina and the EU police mission in the Former Yugoslav Republic of Macedonia (named EUPOL Proxima). Furthermore, already under the Yanukovich leadership, in October 2010 Ukraine expressed its intent to join two EU ‘battlegroups’ (established under ESDP) and made a list of assets that it might incorporate in these (Hale 2010).

In terms of the overall picture in foreign policy however, other analyses suggest domestic capacity for taking a unified stance in foreign policy was limited during the Yushchenko years. The internal strife between the president and the prime minister during that period has been reflected also in different visions on foreign policy. Thus, according to Stegnyi, different political players tried to adjust the foreign policy vision to their own needs and interests, pursuing ‘inconsistent and disparate foreign policy priorities’ (2011, p. 62). The institutional consolidation of power around the presidency which we have discussed above means that there has been less fragmentation in the formulation of Ukraine’s position, although this does not necessarily lead to coherent and one-directional foreign-policy orientation given Ukraine’s traditional balancing act (Wilson 2010).

It can be argued, however, that the concentration of power in the presidency together with the dominance of the Party of Regions in the *Rada* allows the president more room for manoeuvre for foreign-policy moves. This is a policy area in which we expected Yanukovich’s allegiance to Russia to produce a shift. A clear sign of this shift taking place has been the conclusion of the landmark agreement on Russia’s Black Sea fleet (much resisted by pro-Western Ukrainian politicians).

As mentioned above, in April 2010 Presidents Medvedev and Yanukovich signed the gas-for-fleet agreement, prolonging the stay of the Russian Black Sea fleet in Sevastopol for another 25 years after 2017, with the possibility of an extension for another five years (Lange 2010, p. 3). Analysts have commented that this deal shows the lack of effectiveness of EU foreign policy in Ukraine even if it does not affect formal EU demands defined by the Commission.¹¹ Even if EU demands for formal convergence in the CFSP are minimal and do not include such issues, the deal affects the EU’s prospects to develop a strategic role in the region. It also goes against the Union’s long-held wish to include the bilateral deal with Russia into a wider strategic framework.¹² It is indicative of the strength of the presidency that this long-term commitment, with serious geopolitical implications, was dealt with only briefly in the Ukrainian parliament. According to Lange, ‘the ratification of the Black Sea Fleet deal and the passing of the national budget in the parliament took only eight minutes’ (Lange 2010, p. 4).

The other significant development that signalled a change of direction in foreign policy was the formulation of new foreign policy guidelines by the president. President

¹¹*The Financial Times Brussels Blog* scathingly commented that Commissioner Füle’s indifference to this deal during his visit to Ukraine in the same week in which it was signed led to ‘surreal consequences’; available at: <http://blogs.ft.com/brusselsblog/2010/04/russia-teaches-eu-a-lesson-in-its-ukraine-gas-for-naval-base-deal>, accessed 26 April 2011.

¹²Pop (2011) reports a Commission proposal announced in September 2011 to enable the EU to negotiate strategic energy contracts with other countries and have a greater say when other countries strike bilateral deals with Russia.

Yanukovich presented the new set of foreign policy guidelines in March 2010.¹³ Introducing the new guidelines, the president suggested that the choice of Ukraine was to aim for 'maximally close collaboration without integration' with the Euro-Atlantic structures.¹⁴ He stressed the non-aligned status of Ukraine and the necessity to maintain it, which would appear to be a change from the firmly pro-EU line of the previous administration and a return to former President Kuchma's so-called 'multi-vector' policy which paid lip service to European integration, but focused on Russia.

A similar interpretation is offered by analysis from the Razumkov Centre, suggesting that the changed foreign policy guidelines must be interpreted as reorienting the country away from the EU and towards Russia, as especially evidenced by the claim that the new security architecture of Europe should be seen to consist not only of EU countries but also of 'neighbours and partners' of the EU such as Ukraine, Russia, Belarus and Moldova.¹⁵ Other analysts such as Wilson (2010) have interpreted Yanukovich's moves in foreign policy as a sequential balancing act.

While we agree with this assessment, it is worth noting that energy security is defined by the president as the most important aspect of security for Ukraine.¹⁶ Given our previous discussion of Russia's use of energy for foreign policy goals, this emphasis on energy security means that if Ukraine were to be faced with a choice between Russia and the EU, Russian interests would prevail.

The energy security priority also seems to lead to a search for additional partners in foreign policy. In October 2010, President Yanukovich received the President of Venezuela, Hugo Chavez, on an official state visit aiming to explore bilateral cooperation between Ukraine and Venezuela. The main issues of common interest were reported to be the export of Venezuelan oil and gas and possible arms deals. These steps for rapprochement between Venezuela and Ukraine resemble more the stance of Belarus than the position of a country aiming to align itself with the EU.

In addition to general analyses, we need to look at more specific and clear indicators for convergence or divergence with the EU in foreign policy. Barbé *et al.* (2009, p. 839) have used the rate of alignment with EU foreign-policy acts as an indicator for convergence with the EU. The most important EU foreign-policy acts are decisions, which have replaced the CFSP common positions, actions and decisions since the Lisbon Treaty came into force in December 2009.

Alignment with EU declarations can also be taken into account as a symbolic allegiance to EU policies. Barbé *et al.* have rightly noted (2009, p. 839) that alignment with declarations is not very costly for third countries and can be done easily, especially when countries do not have a position on the issue in question. If countries do have a position on an issue, however, we would see failure to align with an EU declaration as significant.

¹³Razumkov Centre, 'What is Hidden Behind the Change of Foreign Policy Guidelines?', available at: www.razumkov.org.ua, accessed 4 February 2011.

¹⁴Razumkov Centre, 'What is Hidden Behind the Change of Foreign Policy Guidelines?', available at: www.razumkov.org.ua, accessed 4 February 2011.

¹⁵Razumkov Centre, 'What is Hidden Behind the Change of Foreign Policy Guidelines?', available at: www.razumkov.org.ua, accessed 4 February 2011.

¹⁶As witnessed by the president's yearly report to the *Rada* in 2010 where the issue of energy security is discussed on an equal footing with relations with neighbours and regional integration. See the official report to the parliament (in Ukrainian), available at: <http://www.president.gov.ua/documents/>, accessed 7 September 2011.

Data from Ukraine's Razumkov Centre show that in 2007 Ukraine had aligned itself with 92% of CFSP statements (Dimitrova & Dragneva 2009, p. 862). The European Commission, in its last progress report on the implementation of Ukraine's ENP Action Plan, also expressed satisfaction that Ukraine had aligned itself with 'most CFSP declarations open for alignment' (European Commission, 2010a, p. 6).

The exceptions—the cases in which Ukraine has not aligned itself with EU sanctions—are telling as they are related to key EU measures, sanctions where Ukraine's stance could actually make a difference. In October 2010, for example, following the suppression of protest and the abuse of arrested protesters in Belarus in the aftermath of the presidential elections, the EU adopted Council Decision 2010/639/CFSP¹⁷ on sanctions for Belarus officials. Ukraine did not align itself with the EU's position in this case. In previous years, Ukraine has also refrained from joining EU sanctions on Belarus officials.

The situation in 2011 is already suggestive of a changing trend whereby Ukraine has aligned with fewer EU measures. Ukraine has not aligned itself with most of the EU's decisions on sanctions so far, as seen from Table 1.

To provide some basis for comparison of these results, we note that Moldova and Armenia, for example, have aligned themselves with EU decisions on restrictive measures on Tunisia, Zimbabwe, Cote D'Ivoire and Iraq, but not on Belarus.

To summarise, in foreign policy we find moderate convergence overall, with some important exceptions and a decreasing trend since 2010. This is evident at the level of rhetorical convergence and symbolism in high politics, based on the declared foreign policy

TABLE 1
ALIGNMENT OF UKRAINE WITH EU DECISIONS ON SANCTIONS WITH THIRD COUNTRIES IN 2011

| <i>Year</i> | <i>EU measures</i> | <i>Countries and persons targeted by sanctions</i> | <i>Ukrainian alignment</i> |
|-------------|--|---|----------------------------|
| 2011 | Council Decision 2010/656/CFSP; Council Decision 2010/801; Council Decision 2011/17/CFSP; Council Decision 2011/18/CFSP; and Council Decision 2011/71/CFSP | Cote d'Ivoire | No |
| 2011 | Council Decision 2011/69/CFSP; Council Decision 2010/639/CFSP | Belarus | No |
| 2011 | Council Decision 2011/70/CFSP updating the list of persons, groups and entities subject to Articles 2, 3 and 4 of Common Position 2001/931/CFSP on the application of specific measures to combat terrorism | List of persons on subject to measures combating terrorism | Yes |
| 2011 | Council Decision 2011/72/CFSP; Council implementing Decision 2011/79/CFSP | Tunisia, misappropriation of state funds | No |
| 2011 | Council Decision 2011/101/CFSP | Zimbabwe | No |
| 2011 | Council Decision 2011/100/CFSP amending Common Position 2003/495/CFSP on Iraq | Iraq | No |

Source: Compiled by the authors based on Council of Ministers data, available at: <http://www.consilium.europa.eu/App/newsroom/loadbook.aspx?BID=73&LANG=1&cmsid=257>, accessed 8 October 2011.

¹⁷Council Decision 2010/639/CFSP, *Official Journal of the European Union*, 26 October 2010.

priorities and the actions of the Yanukovich administration in 2010 and 2011, as well as at the level of convergence with specific EU measures towards third countries. In terms of behavioural convergence, Ukraine's participation in EU missions remains the same, even though we must note that the operations and Ukraine's part in them are quite small. Thus, we have a mixed picture that suggests less convergence at the level of rhetoric (and especially in high politics) under Yanukovich, combined with continued behavioural compliance at the operational level.

Our interpretation of this mixed picture of convergence with EU demands within foreign and security policy highlights two important factors, consistent with our framework. The first one is the existence of specific incentives for some informal veto players, such as gas and coal oligarchs, to accommodate Russia's position, and Russia's tendency to create issue linkages between gas and geopolitics. The second is that convergence with most of the EU's measures and actions in CFSP and ESDP is not very costly for the Ukrainian leadership in terms of electoral support or resources. Alignment with EU sanctions against Belarus, with which Ukraine has considerable ties in the context of Russia's symbolic Eastern orthodox community, would be however, even more costly for the president than it was to the previous administration (which also refrained from supporting these sanctions and declarations), and remains an area of divergence with the EU.

The next section will examine this situation in relation to state aid, an internal market-related policy where, arguably, a different actor constellation affects policy convergence.

State aid regulation

Demands for convergence in the area of state aid have been high on the list of the EU's priorities and have required extensive legal and institutional changes. Convergence in this field requires changes in legislation to establish parameters for lawful state aid as well as in institutional structures and administrative practices to ensure monitoring of the state authorities engaged in state aid, and the recovery of unlawfully granted aid.

Starting with the PCA, which entered into force in 1998, state aid has been one of the EU's priority areas for legislative convergence. The PCA required Ukraine not just to refrain from granting state aid that is likely to affect trade between Ukraine and the EU, but also the voluntary adoption by Ukraine of the EU's *acquis* in the area of competition law (including state aid). The EU–Ukraine Action Plan of 2005 similarly identified state aid as a key area for development.¹⁸ This is understandable given the centrality of state aid in the functioning of the internal market and the maintenance of competitive conditions in the EU as well as the definition of a 'stake in the internal market' as one of the key rewards of the ENP. In fact, state aid is one of the few areas where the Action Plan referred to the specific EU *acquis* and required measures such as the adoption of a definition of state aid compatible with that of the EU, the establishment of transparency mechanisms as regards the state aid granted, as well as an independent surveillance body and procedures for regular reporting on the aid granted.¹⁹ Importantly, state aid is one of the thematic areas for negotiation within the

¹⁸For an overview of the ENP instruments, including the Action Plans and other official documents, see: http://ec.europa.eu/world/enp/documents_en.htm#2, accessed 22 June 2012.

¹⁹Section 39 of the EU–Ukraine Action Plan.

Association Agreement²⁰ in relation to the DCFTA. Reform of state aid practices related to trade were also subject to reform in the context of Ukraine's preparation for accession to the WTO which took place in May 2008. A key aspect of this preparation was the elimination of subsidies prohibited under the WTO Agreement on Subsidies and Countervailing Measures.

Despite the high priority attached to the area of state aid and competition by the EU and WTO, however, progress in convergence has been slow.²¹ While our primary interest relates to the period marked by the arrival of Yanukovich's presidency, we look back and highlight some key steps in convergence since the early 2000s. This is critical given that later developments show important continuities and are arguably less about convergence and more about battles over the *status quo* (particularly in relation to control over the Anti-Monopoly Committee (AMC)).

First legislative convergence in the field remains very partial and highly fragmented (Table 2). The 2001 Law on Competition and the 2003 Economic Code are the key laws that deal with some of the EU requirements, yet they reflect EU norms only in part and lack detail. Furthermore, the norms of the Economic Code in particular have been embedded in a wider framework promoting the principle of state interference in the economy rather than limiting it (Shishkin & Drobishev 2007; OECD 2007). In fact, repealing the Economic Code has become an important pressure point for most external stakeholders and is a specific item in the EU–Ukraine Action Plan of 2005.

There have been two main legislative attempts to improve the legal basis of the regime, but both failed to be adopted by the *Rada*. Indeed, the failure to adopt a proper legislative framework is indicative of a persistent pattern. In April 2004, Yanukovich's government brought in a draft law on state aid. As the justification of the key drafter, the AMC, shows, the concern was to create a level playing field in the provision of state aid as well as to implement the undertaking for voluntary harmonisation in this field under the PCA.²² Expert opinion showed that the draft was closely based on EU provisions, despite some shortcomings (ICPS 2007; OECD 2008). Another draft seeking the amendment of the 2001 Law on Competition was submitted by Yanukovich's government in March 2007.²³

Secondly, there has been little progress in providing an adequate institutional framework for the *ex ante* and *ex post* monitoring of the granting of state aid. State aid, in principle, was granted by a range of agencies (central, local, sectoral or regional) according to various laws and secondary resolutions. Studies of the provision of state aid in Ukraine show that the largest part of state aid was sectoral (70% compared to the EU average of 24%) rather than regional, with steel manufacturing being the highest recipient in 2000, followed later by car manufacturing, pharmaceuticals and especially fuel and energy (crucially in 2003–2005)

²⁰The Association Agreement is to replace the expired Partnership and Cooperation Agreement (PCA). Association Agreement negotiations had been making little progress in 2010, and there was even the suggestion from some analysts that they were being sabotaged by influential oligarchs who had begun to realise the implications of the free trade area for their businesses (Valasek 2010, p. 5). At the end of 2011 the negotiations on the Agreement were finalised, yet its signing and completion remain stalled.

²¹'Evaluation of the State of Adaptation of the Legislation of Ukraine to the European Acquis until 2008', State Department for Legislative Adaptation, 27 January 2010, available at: <http://eurodocs.sdla.gov.ua/DocumentView/tabid/28/ctl/Edit/mid/27/ID/10006025/Lang/Default.aspx>, accessed 18 March 2011.

²²See Explanatory Note of the Anti-Monopoly Committee, available at: http://w1.c1.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=17983, accessed 20 May 2011.

²³Nonetheless, according to experts, the draft was lacking in a number of important ways, for example in relation to various notification requirements or the mechanisms for recovery of unlawfully granted aid (OECD 2008, p. 41).

TABLE 2
ALIGNMENT OF UKRAINIAN LEGISLATION WITH KEY EU ACQUIS ON STATE AID

| <i>EU legislation</i> | <i>Alignment</i> |
|---|--|
| Article 87 TEC | Partial: Article 15 Law on Protection of Economic Competition (2001), Article 26 European Code (2003) |
| Article 88 TEC | No |
| Article 89 TEC | No |
| Council Regulation (EC) No. 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal state aid | Partial: Sectoral secondary legislation |
| Council Regulation (EC) No. 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty | No |
| Commission Regulation (EC) No. 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to <i>de minimis</i> aid | No |
| Commission Regulation (EC) No. 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to state aid to small and medium-sized enterprises | Partial: Article 48 Economic Code (2003), Article 5 Law on State Support of Small Enterprises (2000), Part II Law on the National Programme to Promote Small Business Development (2000) |
| Commission Regulation (EC) No. 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to state aid for employment | Partial: Articles 2, 3, 5 Labour Code (1971) |
| Commission Regulation (EC) No. 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid | Partial: Selected provisions in various legal acts |
| Guidelines on national regional aid for 2007–2013, OJ C 54 | Partial: Article 2 Law on Stimulating the Development of Regions (2005) Article 9—contradictory provisions; Article 1 (2) Law on General Principles for the Creation and Functioning of Special (Free) Economic Zones (1992) |
| Commission Regulation (EC) No. 1628/2006 on the application of Articles 87 and 88 of the EC Treaty to national regional investment aid | No |

Source: Authors' compilation based on reports of the Ministry of Justice, available at: www.sdla.gov.ua/control/uk/publish/article?art_id=47553&cat_id=46959, accessed 18 March 2011.

(Gazizullin 2006). It was primarily implementing legislation that was the basis for such aid with no clear criteria spelt out for its provision.

Furthermore, while direct subsidies were used, such as to the coal mining industry or the steel industry (between 1999 and 2002) (Legeida 2002; WTO 2008), much of this aid has taken the form of indirect aid, which is opaque and difficult to quantify. Examples from the gas and electricity industry show the extensive and subtle forms of business support ranging from poor collection of cash (debt and tax) arrears to mispricing. While direct subsidies have a clearer connection with the institutional organisation of state aid, indirect subsidies often relate to the quality of governance and the general state of the rule of law in the country.

The WTO accession process gave a boost to some developments in the area of state aid, most notably in relation to the abolition of a range of privileges to the machine-building

industry and other industries in 2005 (IERPC 2011). Yet, state support in the form of direct transfers or state guarantees for loans remains high for other sectors, such as coal mining. Tax privileges also persist, as shown in recent budgets.

Even more importantly, the institutional framework for state aid has remained weak. According to the 2001 Competition Law,²⁴ state agencies were required to seek the view of the AMC on any draft decisions they planned to take that may affect competitive behaviour. Yet, the AMC had very weak powers in asserting prohibition or seeking recovery from an aid recipient if approval was not sought in advance. More importantly, neither piece of legislation sets up a system for recording or monitoring the granting of state aid or entrusts an independent body with the supervision of the process. The AMC could not be deemed to be independent. According to the 1996 Constitution of Ukraine, the Chairman of the AMC was appointed by the president with the consent of the parliament, while the remaining members of the AMC were appointed by the president. While this is not necessarily unique in international practice, certainly in the Ukrainian political context, this dependence matters.

Despite the start of the negotiations on the Association Agreement in 2009, legislative and institutional progress (other than at the level of strategy) is still lacking. An inter-departmental group, which was set up in July 2008 and received EU technical assistance for its work (OECD 2010), produced a Concept on the reform of state aid in January 2010. This act, adopted just before the 2010 presidential elections, sought to provide a framework for convergence of legislation and reform of the system within the next five years. The establishment of a system for monitoring of the state aid granted by central and local authorities was deemed to be a first step in this process, followed by the drafting of a new law on state aid.

During 2010 there was no visible progress in implementing the Concept.²⁵ In January 2011, Azarov's government adopted some amendments to it. Some of these amendments seem to be consistent with the progress in negotiating the state aid chapter in the Association Agreement, e.g. on the monitoring of state aid through the establishment of inventories of aid schemes (Biegunski 2010). It is clear that a working group has been preparing a new law on state aid for some time, yet, it is difficult to know when and whether this draft will turn into a law.

Given the complexity and sensitivity of state aid regulation, convergence in this field is bound to be difficult. Yet, the story of EU alignment in Ukraine is particularly instructive in showing the critical role of domestic veto players in obstructing it. The most visible aspect here is the opposition of vested interests—our informal veto players—that stand to lose from changes in policy. State support was an important aspect of the state planning paradigms promoted by the Communist Party or the Socialist Party (Wilson 2009), but also of the established oligarchic system of rent-seeking and rent-giving. This system extended state privilege to enterprise managers from non-privatised, 'sensitive' sector companies (e.g. extraction industries), as well as oligarchic groups acquiring such companies through privatisation (e.g. steel and energy distribution), that sought to block unwanted reforms or steer them on privileged terms. As discussed above, many of those oligarchs are represented

²⁴Article 15(2). For a more extensive discussion, see OECD (2008), pp. 39–41.

²⁵Indeed, the EU Progress Report on Implementation of the ENP in 2009, Brussels, 12 May 2010, SEC (2010) 524, notes the breakdown of the intra-departmental group amidst disputes between the ministries on the legal basis for a state aid inventory (available at: http://ec.europa.eu/world/enp/pdf/progress2010/sec10_524_en.pdf, accessed 21 March 2011).

in the Party of Regions, even if oligarchic backing is not unique to that party. Yet, the political representation of oligarchs from the Party of Regions has become even stronger post-2010 because of the Party's current dominance over the *Rada* as well as the presidency.

These oligarchs, have, as informal veto players, opposed legislative changes that could disturb their existing networks of patronage. One such arrangement was the control over and the powers of the AMC. This institution could potentially play a significant role in the alignment with EU norms as related to both drafting new legislation and exercising *ex ante* and *ex post* control over the system of delivery of state aid. Deliberations on the draft law on state aid on 22 December 2004 show that one of the main concerns across oligarchic factions was about the powers of the Committee.²⁶ Most oligarchic parties, in fact, did not vote in support of the bill. Given that the vote was taking place in the middle of the Orange Revolution, debates show that 'Orange' realignment might have also been a consideration in resisting changes with unknown implications. Indeed, some of the constitutional amendments negotiated in the context of the Orange Revolution, related to limiting the power of the presidency and empowering the *Rada* (based on the government's proposal) in appointing the AMC.

The battle for control over the AMC clearly continues in the recent reversal of the mechanism for appointing the chair of the AMC. The decision of the Constitutional Court of October 2010, the amendments to the Law on the Council of Ministers and the new Law on the Central Organs of Executive Power of 17 March 2011, led to the reversal of the 2004 constitutional settlement and have brought the appointment of the AMC chair back to the presidency. We can see the president and his administration concentrating further power and changing the domestic veto player configuration by changing the institutional rules of the political game. Given that the AMC will be under the control of oligarchic factions connected to the Party of Regions and the president, it is doubtful whether it will have the incentives to limit, or even make transparent, state aid practices.

Further, the importance attributed to controlling the AMC is well illustrated by the battle for its chairmanship. Oleksey Kostuev, who chaired it between 2001 and 2008, was a member of the pro-Kuchma oligarchic Labour Ukraine (*Trudova Ukrayina*) faction in the 1998–2002 *Rada* and switched later to the Party of Regions. As Timoshenko started her second term in government, she sought his replacement in January 2008. This was strongly opposed by the Party of Regions, which blocked several new appointments.²⁷ It was only in April 2010 (in the aftermath of President Yanukovich's victory and in the advent of Azarov's government) that a head of the AMC was formally appointed and that was again Kostuev.²⁸

What is less visible, but no less important, is the broader opposition to the change of a system of rent-seeking as such and the implementation of legal and institutional reform directed to greater transparency and good governance. Given the prominence of indirect subsidies this is certainly the more difficult aspect of EU alignment. For example, recent

²⁶See http://static.rada.gov.ua/zakon/sk14/6session/STENOG/22120406_57.htm, accessed 20 May 2011.

²⁷Timoshenko proposed David Zhvania in March 2008 and Volodimir Karetka in October 2009; see archive of the *Rada*, available at: <http://portal.rada.gov.ua>, accessed 10 September 2011.

²⁸Kostuev left in 2010 to become the Mayor of Odessa, and was followed by Vasil Tsushko from the Socialist Party, who was prior to that in charge of the Economic Ministry in Azarov's government. The 'Orange' parties, Block Yulia Timoshenko (*Blok Yuliyi Tymoshenko*) and Our Ukraine (*Nasha Ukrayina*), opposed both nominations.

media reports point to key oligarchs linked to the Party of Regions as the worst public debtors in Ukraine.²⁹

A final twist in the story of state aid legislation is provided by confusion as to what such legislation would actually mean and do. References to 'state aid' have sometimes been used as a substitute for 'state interference' and signified opposition to market-based reform. During the first reading of the draft law on state aid of 22 December 2004, for example, the representatives of the Communist Party supported the bill referring to its role in state support of businesses (even if within a framework of enhanced transparency and non-discrimination), and as a continuation of the principles set by the Economic Code.³⁰ Statements in this debate clearly view state enterprises rather than private business as the legitimate recipients of such aid. In reaction to this, Viktor Pynzenyk, a known reformer representing Our Ukraine's faction in this convocation of the *Rada*, delivered a damning evaluation of the law as legitimising a rent-provision mechanism, stating that the proper name of this law should actually be law 'about the legality of corruption'.³¹ To summarise, convergence with EU policy or EU demands on state aid and passing the appropriate legislation has not been a priority for reform in Ukraine for formal and informal veto players, and those who have been in favour of passing the draft law on state aid have actually misunderstood what it was meant to accomplish. Further, others, like Pynzenyk, did not view this law in relation to technocratic alignment with EU norms, but in the broader terms of how it affects the political and economic system of distribution of resources in the country.

Conclusions

In this essay we have presented a domestic, veto-player driven explanation of the limited convergence with the EU in two policy areas. Our explanation builds on existing Europeanisation approaches, especially on literature that emphasises domestic actors' cost-benefit calculations (Schimmelfennig & Sedelmeier 2005) and those who focus on specific sectors (Ademmer & Börzel; Buzogány; Langbein, in this collection). In contrast to the way veto-player explanations have been used in the Europeanisation literature so far, and following Dimitrova (2010), we explicitly focus on the role of informal veto players. Thus our analysis allows us to take into account key features of the Ukrainian political system, such as the interpenetration of economic and political elites. We argue that these elites have had preferences aimed at the preservation of the *status quo* which made convergence difficult when it affected their interests.

Our review of domestic developments in Ukraine in two sectors—foreign policy and state aid—has confirmed that oligarchic groups have indeed been critical in policy making in Ukraine, including convergence (or non-convergence) with EU norms. The two policy areas under investigation illustrate this point very clearly. In state aid, convergence with the EU

²⁹Certainly Aleksander Savchuk from the Party of Regions and Dmitri Firtash, one of its key backers, feature prominently on the list; see Dubinskii *et al.* (2010).

³⁰Interestingly, at the vote in May 2007 the Communist Party opposed the bill amending the Law on Competition, confirming the importance of 'grand narratives' to this party, i.e. 'competition' compared to 'state aid'.

³¹See records of parliamentary debates on 22 December 2004, available at: http://static.rada.gov.ua/zakon/skl4/6session/STENOGR/22120406_57.htm, accessed 21 March 2011.

acquis can be described more in terms of rhetorical commitment rather than comprehensive legal adoption and compliance. In terms of behavioural compliance, we see that specific parts of the administrative system, such as the state aid regulator, are captured by the rent-seeking system. Thus limited progress is a clear result of the continued opposition of partisan and informal veto players (oligarchic factions and their parliamentary allies). We find that their position is driven not so much by attitudes to EU integration in general, but by the potential losses from policy change.

Most of all, we find that their position is critically linked to control over the political system of rent distribution (or protection from rent losses), as illustrated in the battle for the AMC. This strategic interest can coincide with the ideological component in the preferences of other veto players, such as the Communist Party, resulting in the slow progress in this field. In other words, preservation of gains from state capture will take precedence over policy-specific gains. This suggests some limits to the impact that the EU could make on convergence with policy-specific conditionality.

As for foreign and security policy, there has been moderate progress in convergence in the past, mostly between 2004 and 2009. In this area the change of veto players has led to a clearer change in direction, as we can see by the somewhat increased number of cases where Ukraine avoided formal adoption of EU measures in 2011. In fact, there is so little alignment with EU decisions we can almost speak of a trend reversed. The key player that has been in a position to affect developments here is the president. The gas-for-fleet deal, the main geopolitical decision taken by Yanukovich so far in Ukraine's foreign policy, reflects the interests of informal veto players and the president's own electoral promises. Formal convergence with EU measures such as sanctions is absent when it comes to countries where Ukraine's convergence could really mean something—for example Belarus. We believe this is related to the costs that key actors perceive to be attached to aligning with the EU both in terms of trade and in terms of the symbolic relationship with Russia. The importance attached by Russia under Putin on the fraternity links between Russia, Ukraine and Belarus means that it matters to both Russia and Belarus whether Ukraine joins the EU sanctions on Belarus or not. For this reason, we consider support for the EU's sanctions against Belarus to be costly for Yanukovich. By contrast, participation in peacekeeping operations is relatively low cost for the Ukrainian government given that the EU's operations are relatively small and that Ukraine maintains significant armed forces anyway. This difference in domestic costs in convergence, political, electoral and economic fields, explains, according to us, the differential convergence in foreign policy and peacekeeping.

Based on the above comparison within and between policy sectors, we show that in policy areas where convergence with EU rules can affect negatively the interests of oligarchs and their political allies, we see only limited policy change. This is regardless of whether the area in question is part of the core EU *acquis* or not. The example of state aid makes this quite clear. Furthermore, even if substantive provisions of the *acquis* are formally adopted, the 'technocratic' external governance reforms can be effective only if the very core of the system dominated by rent-seeking and competitive oligarchy is also changed. There is no evidence that this is currently the case. The developments in 2010 and the spring of 2011 show further concentration of power in Ukraine's political system behind the president, the Party of Regions and the oligarchic factions mentioned above.

Ultimately, our findings confirm the importance of domestic actors' preferences and the weakened role of the kind of external incentives—economic and symbolic—that the EU

offers at this point. If the EU wants to be successful in promoting reforms in Ukraine in a particular direction, it needs to look at and deal with the relevant domestic actor constellations. In this sense, our conclusions reinforce the argument that the EU should offer specific and stronger incentives such as visa liberalisation and develop policy conditionality linked to progress in specific areas (Ademmer & Börzel; Buzogány, in this collection). Policy conditionality is defined, following Ademmer and Börzel (in this collection), as policy-specific positive and negative incentives. Provided that the rules the EU aims to promote do not affect state capture, targeted policy conditionality may be successful.

Alternatively, a more robust EU approach might aim to diminish the levels of state capture by stressing good governance reforms—a path which becomes increasingly problematic given the shape of Ukraine's political system at present. Even though it requires a level of commitment which the EU of today cannot achieve, this is ultimately the only path that will prevent informal veto players from using the Ukrainian state and political system for their own gain and from vetoing any policy change that may limit their autonomy.

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