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### **Julia Langbein: Transnationalisation and Change in Economic Institutions: The Case of Ukraine and Industrial Standards Regulations**

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## Abstract<sup>1</sup>

This paper explores the dynamics of change in economic institutions in a developing market economy based on a case study of changes of industrial standards regulation in Ukraine. I show that change in this case is slow and selective but nevertheless constant. I argue that this pattern of institutional change in the Ukrainian case cannot be explained solely by domestic factors. This is because neither the domestic demand for institutional change nor its supply has the incentives *and* the capacity to induce change at all. While I maintain that the source for change is of non-domestic nature, I reveal the limits of the Europeanisation scholarship that emphasises the power of political conditionality and would hence not expect change in the Ukrainian case because of the lack of accession conditionality. Further, I show the limits of structural accounts that emphasise the power of the market to induce rapid change in economic institutions. Instead, I argue that the slow, selective but constant change can be explained by the piecemeal transnationalisation of the Ukrainian political decision-making process regarding industrial standards regulations that alters the incentives and capacities of domestic supply but not of demand.

## 1. Introduction

This paper explores the dynamics of change in economic institutions in a developing market economy based on a case study of the change of industrial standards regulation in Ukraine. I seek to explain why economic institutions in this policy field change, and why they do not change rapidly but instead slowly and selectively, albeit constantly?

### 1.1. Social and Scientific Relevance

From a social perspective, the analysis of institutional change in a developing country like Ukraine aims to contribute to question, relevant to both politics and economics, of how Western market institutions can be reproduced in developing market economies in order to foster economic prosperity and stability. More specifically, the Ukrainian case is of particular relevance for EU policymakers. The analysis shows that change in a country without the prospect of membership happens despite the fact that accession conditionality cannot be applied; at the same time, it also reveals the limits of market incentives in promoting alignment with the European model.

From a more academic perspective, the analysis contributes to theories of institutional change by advancing the concept of transnationalisation as an explanatory variable for why and how institutions change. The analysis challenges standard approaches that treat external factors as being separate from the domestic fields of action. The paper instead shows that non-domestic actors become part of domestic fields of action and can thus shape domestic processes of institutional change.

### 1.2. Outline of the Paper

The paper is structured as follows: in section 2, I present the dependent variable of this paper. In section 3, I discuss the relevant literature in order to develop an analytical framework that will explain change in economic institutions regulating industrial standards in Ukraine. In section 4, I briefly discuss the methods used for the analysis. In section 5, I present the main results of my study. In the concluding section, I summarise my arguments.

## 2. Specification of the Dependent Variable: What Is Changing and How?

In my definition of economic institutions, I follow Peter Hall who conceives them as ‘the formal rules, compliance procedures, and standard operating practices that structure the relationships between various

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1 Please do not cite or quote without the permission of the author.

units of the polity and the economy.<sup>2</sup> The anchor for the change of economic institutions regulating the field of industrial standards in Ukraine is the EU model of industrial standards regulations. This is because access to the EU market has been promoted as an integrationist choice for Ukraine in the Partnership and Cooperation Agreement of 1996<sup>3</sup> and more recently in the EU Action Plan for Ukraine in the framework of the European Neighbourhood Policy (ENP).<sup>4</sup> Change in Ukraine's institutions regulating industrial standards is necessary to reduce barriers to the trade of industrial products between the EU and Ukraine because the current Ukrainian model applies different product standards and regulatory arrangements to monitor manufacturers' compliance. Against this background, I operationalise the dependent variable along two dimensions: 1) the harmonisation of Ukrainian with European industrial standards and 2) the alignment with the European model of monitoring manufacturers' compliance with industrial standards that imply the decentralisation of Ukraine's regulatory body.

In terms of alignment with the EU regulatory model of monitoring manufacturers' compliance, Ukraine will need to adopt and implement four laws to comply with EU requirements.<sup>5</sup> With respect to the harmonisation of product standards, I will only look at those four priority sectors that the Ukrainian government selected for the negotiations of an Agreement of Conformity Assessment of Industrial Products (ACAA) with the EU, which is supposed to be concluded by 2011.<sup>6</sup> As early as 2000, five years before the EU and the Ukrainian government agreed to prepare ACAA negotiations, Ukraine started to harmonise standards for ACAA relevant products with the corresponding EU technical norms and to come into line with the relevant EU legislation. Empirical evidence, based on secondary literature and document analysis, suggests that change in this policy field has followed a slow and selective but constant pattern from 2000 to 2007, as can be seen from the summary in table 1.<sup>7</sup>

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2 Hall, Peter: *Governing the Economy*, Cambridge: Polity Press, 1995, here p. 19.

3 European Commission: *Partnership and Cooperation Agreement between the European Communities, and their Member States and Ukraine*, June 1994, [http://ec.europa.eu/external\\_relations/ceeca/pca/pca\\_ukraine.pdf](http://ec.europa.eu/external_relations/ceeca/pca/pca_ukraine.pdf), accessed 12 January 2007.

4 European Commission: *The EU-Ukraine Action Plan*, 21 February 2005, [http://ec.europa.eu/world/enp/pdf/action\\_plans/ukraine\\_enp\\_ap\\_final\\_en.pdf](http://ec.europa.eu/world/enp/pdf/action_plans/ukraine_enp_ap_final_en.pdf).

5 These include a) the Law of Standardisation, b) the Law on Assurance of Conformity Assessment, c) the Law on Accreditation of Authorities of Conformity Assessment and d) the Law on Market Surveillance.

6 European Commission: *Ukraine: Action Plan for the Free Movement of Industrial Products*, 21 February 2006, [http://www.dssu.gov.ua/control/en/archive/docview?typeId=87519&sortBy=1&orderBy=1&docId=87520&docs\\_stind=1;](http://www.dssu.gov.ua/control/en/archive/docview?typeId=87519&sortBy=1&orderBy=1&docId=87520&docs_stind=1;) The four priority sectors include Low voltage equipment (73/23/EEC, as amended by 93/68/EEC), Simple pressure vessels (87/404/EEC, as amended by 90/488/EEC and 93/68/EEC), Electromagnetic compatibility (89/336/EEC, as amended by 92/31/EEC and 93/68/EEC), and Machinery (98/37/EC, as amended by 98/79/EC).

7 UEPLAC: *Regulatory impact analysis of the transposition and implementation of the EC Low Voltage directive into Ukrainian legislation*, Kyiv, Ukraine, 2008, [http://ueplac.kiev.ua/downloads/ria/lvd\\_full\\_ria\\_for\\_ukraine.pdf](http://ueplac.kiev.ua/downloads/ria/lvd_full_ria_for_ukraine.pdf) accessed 10 April 2008.; AFNOR-SWEDAC-UNI Consortium: *The European Union's programme 'Application of a Foreign Trade Regime – Standards, Technical Regulations and Conformity Assessment in Ukraine'*, Final Report, 2004; European Business Association, *Barriers to Investment in Ukraine*, Kyiv, Ukraine, August 2007, [http://www.eba.com.ua/files/Investment\\_paper/Inv\\_Paper\\_2007\\_ENG.pdf](http://www.eba.com.ua/files/Investment_paper/Inv_Paper_2007_ENG.pdf) accessed 16 November 2007.

Table 1: Change of Economic Institutions Regulating Industrial Standards in Ukraine in Order to Conclude an ACAA with the EU, 2000–2007.

Year	Standards	Regulating manufacturers' compliance
2000	4 technical norms: not harmonized	4 laws: not aligned
by 2007	2 technical norms*: major part harmonized 1 technical norm**: partly ok 1 technical norm***: not ok	1 law†: adopted, partly compliant, not implemented 1 law††: adopted, partly compliant, partly implemented 1 law†††: adopted, compliant, partly implemented 1 law††††: draft law compliant, waiting for first reading

\* The Low Voltage Directive and the Electromagnetic Compatibility Directive.

\*\* The Simple Pressure Vessels Directive.

\*\*\* The Machinery Directive.

† The Law on Standardisation.

†† The Law on Assurance of Conformity Assessment.

††† The Law on Accreditation of Authorities of Conformity Assessment.

†††† The Law on Market Surveillance.

### 3. Theorising Change in Economic Institutions

#### 3.1. Domestic Factors: Incentives and Capacities of Domestic Actors

This paper follows the notion that institutions 'do not change of their own accord; they are changed.'<sup>8</sup> Since change in economic institutions alters the power relations between the polity and the economy,<sup>9</sup> domestic agents of institutional change are situated on the demand and the supply sides and must have the incentives and capacity for change.<sup>10</sup> The task of the supply side, government officials or other state actors, is to promote measures for regulation, and to influence market regulation directly through law making or other forms of regulatory activity.<sup>11</sup> The incentive for the supply side is rent seeking, e.g. through the attraction of voters for upcoming elections, whereas its capacity to change is of a structural (the strength of party affiliation among legislators to adopt new laws) and administrative nature (knowledge, skills and resources). On the demand side, companies or business associations may address the need for institutional change through lobbying. In order to do so, the demand side must not only have incentives for change, which is the increase of profit, but also the capacity to shape the political decision-making process by getting access to the supply side. It can be assumed that institutional change is rapid where there are strong incentives and capacities on both the demand and the supply side. Since the Ukrainian case reveals slow and selective but constant change, the following hypothesis can be formulated in order to test whether domestic factors can serve as explanatory variables:

8 McFaul, Michael: State Power, Institutional Change, and the Politics of Privatization in Russia, in: World Politics, 1995 (Vol. 47), No. 2, pp. 210–43; See also: Streeck, Wolfgang/ Thelen, Kathleen: Introduction, in: Streeck, Wolfgang/ Thelen, Kathryn (eds.): Beyond Continuity, Oxford: Oxford University Press, 2005, pp. 1–39.

9 Hall, Peter: Governing the Economy, Cambridge: Polity Press, 1995; Bruszt, Laszlo: Making Markets and Eastern Enlargement: Diverging Convergence, West European Politics, 2002 (Vol. 25), No. 2, pp. 121–140.

10 Milhaupt, Curtis/ Pistor, Katharina: Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development Around the World, Chicago: Chicago University Press, 2008.

11 Martin, Lisa (ed.): International Institutions in the New Global Economy, Cheltenham: Edward Elgar, 2005.

### Hypothesis 1 (domestic factors hypothesis):

If domestic actors induce slow and selective but constant change, then either domestic actors on the supply or on the demand side for institutional change must have the incentives *and* the capacity for change without any non-domestic influence.

## 3.2. External Factors: Market Incentives and Political Conditionality

If neither the supply nor the demand side has the incentives or capacities to change institutions, scholars emphasise the role of external factors in explaining change.

The dominant approach when explaining the influence of external forces on institutional change in developing market economies emphasises the power of the market and economic incentives.<sup>12</sup> Market integration will make the demand side realise the great potential for trade and profit. As a result, economic actors pressure their governments for institutional improvements or will undertake change themselves.<sup>13</sup> Supporters of the market argument would expect fast institutional improvement in a field like industrial standards regulation due to pressures from the demand side. However, I have shown in the previous section that change of Ukraine's industrial standards regulation is not happening rapidly but rather slowly and selectively albeit constantly, thus reducing the explanatory power of the market argument.

Another important approach stresses the importance of political factors and the significance of hierarchy to institutional change. This notion is particularly widespread among students of Europeanisation who stress political conditionality, defined as EU accession conditionality, to be the most effective EU strategy for promoting domestic change in member and candidate countries. This leads them to assume that political conditionality has no effect on compliant behaviour among EU neighbouring countries because of the missing prospect of membership.<sup>14</sup> However, even if we take the fact into account that some Ukrainian political elites anticipate that they will join the EU,<sup>15</sup> political conditionality seems to have little explanatory power for institutional change. As with the market argument, political conditionality does not tell us anything about how domestic actors start to incorporate external incentives and how they help to build the structural and administrative capacity to induce change.<sup>16</sup>

## 3.3. Transnationalisation and Institutional Change

The previous discussion reveals a tendency in the literature on institutional change to identify externally induced or imposed incentive driven change as an explanatory variable for domestic change. I distance myself from this approach and draw upon various works from the emerging scholarship on transnationalisation by stressing the importance of interactions between non-state and state actors across national borders in explaining institutional change.<sup>17</sup> I, however, advance the concept by defining transnationali-

12 Aslund, Anders: *The Impact of the Outside World*, in: Aslund, Anders: *How Capitalism Was Built*, Cambridge: Cambridge University Press, 2007, pp. 281–304.

13 Mansfield, E.D. and H.V. Milner (eds.): *The political economy of regionalism*, New York: Columbia University Press, 1997.

14 Bauer, Michael W./ Knill, Christoph/ Pitschel, Diana: *Differential Europeanization in Eastern Europe: The Impact of Diverse EU Regulatory Governance Patterns*, in: *Journal of European Integration*, 2007 (Vol. 29), No. 4, pp. 405–424. See also Sedelmaier, Ulrich: *Europeanisation in new member and candidate states*, *Living Review on European Governance*, 2006 (Vol.1), No. 3, <http://www.livingreviews.org/lreg-2006-3> accessed 12.02.2007; Schimmelfennig, Frank: *Europeanisation beyond Europe*, *Living Review on European Governance*, 2007 (Vol. 2), No. 1, <http://www.livingreviews.org/lreg-2007-1> accessed 12.01.2008.

15 Kelley, Judith: *New Wine in Old Wineskins: Promoting Political Reforms through the New European Neighbourhood Policy*, in: *Journal of Common Market Studies*, 2006 (Vol. 44), No. 1, pp. 29–55.; Fischer, Sabine: *Die Ukraine und die ENP*, in: *Forschungsstelle Osteuropa der Universität Bremen (eds.): Ukraine-Analysen No. 36*, 2008, pp. 2–5.

16 Easterly, William: *The White Man's Burden. Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, New York: Penguin Press, 2006.

17 Djelic, Marie-Laure/ Sahlin-Andersson, Kerstin (eds.): *Transnational Governance. Institutional Dynamics of Regulation*, Cambridge: Cambridge UP, 2007.; Orenstein, Mitchell/Schmitz, Hans-Peter: *The New Transnationalism and Comparative*

sation as a process that describes how these regular interactions lead to the ‘endogenisation’ of non-domestic actors: they become part of the domestic realm, e.g. the political decision-making process, and alter the incentives for *and* capacity of domestic actors to support change. I identify three mechanisms through which transnationalisation effects institutional change:

The first concerns *fostering appropriate behaviour*. Non-domestic actors such as the EU or the World Bank aim to reproduce the regulatory model governing liberal market economies.<sup>18</sup> By addressing the ‘shortcomings’ of specific domestic institutional arrangements in developing market economies which deviate from the common ‘way of doing things’ and ‘best practice’ in advanced liberal market economies, non-domestic actors try to foster appropriate behaviour among domestic policymakers.<sup>19</sup>

The second mechanism is *lobbying*, which means that non-domestic actors such as foreign companies try to get access to the supply side of institutional change in order to convince national policymakers to reform domestic institutions. Non-domestic actors thus become part of the domestic context by acquiring a political voice in domestic decision-making processes.

The third mechanism is the *transfer of knowledge, skills and financial resources* and addresses the lack of capacity on the demand and supply side to pursue change.<sup>20</sup> Transfer can happen through international assistance programs or through transnational government networks in which the component institutions of governments – regulators, judges and legislators – increasingly cooperate with their non-domestic counterparts.<sup>21</sup>

Whereas transnational forces may alter the incentives of domestic demand and/or supply by fostering appropriate behaviour and through lobbying, the transfer of knowledge, skills and financial resources alters their capacities to change institutions.

Since change in Ukraine is slow and selective but constant, it is hence possible to hypothesise that the transnationalisation of the political decision-making process affects the incentives and capacities of the demand and supply for institutional change in a rather piecemeal manner.

Hypothesis 2 (transnationalisation hypothesis):

If piecemeal transnationalisation of the political decision-making process alters the incentives and capacity for change on the demand or supply side, then slow and selective but constant change is likely.

## 4. Methods

The analysis of the case study is based on the method of process tracing in order to ‘identify the intervening causal process – the causal chain and causal mechanisms – between an independent variable (variables) and the outcome of a dependent variable’<sup>22</sup>. The process tracing is achieved through document analysis and 24 semi-structured interviews with EU officials, experts, Ukrainian government officials and regulators, representatives of business associations and Ukrainian companies conducted in Brussels be-

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Politics, in: *Comparative Politics*, 2006 (Vol. 38), No. 4, pp. 479–500.

18 Djelic, Marie-Laure: *Marketization: From intellectual agenda to global policy-making*, in: Djelic, Marie-Laure/ Sahlin-Andersson, Kerstin (eds.): *Transnational Governance. Institutional Dynamics of Regulation*, Cambridge: Cambridge UP, 2007, pp. 53–73.

19 March, James/ Olson, Johan: *The Institutional Dynamics of International Political Orders*, *International Organization*, 1998 (Vol. 52), pp. 943–969.

20 Keck, Margaret/ Sikkink, Kathryn: *Activists beyond borders. Advocacy networks in International Politics*, Ithaca and London: Cornell UP, 1998.

21 Slaughter, Anne-Marie: *A New World Order*, Princeton: Princeton UP, 2004.

22 George, Alexander/ Bennett, George: *Case Studies and Theory Development in the Social Sciences*, Cambridge: MIT Press, 2005, here p. 206.

tween September and October 2007 and in Kyiv and other Ukrainian cities between January and March 2008.

## 5. Main Results

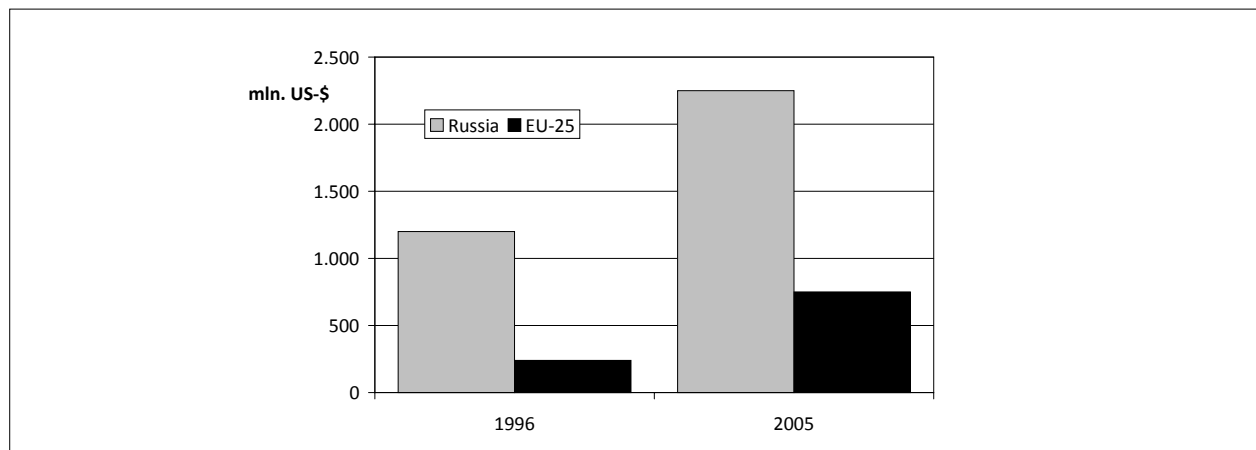
In the following paragraph I will assess the explanatory power of the two hypotheses stated above.

### 5.1. The Domestic Factors Hypothesis

The *demand side* for institutional change in the field of industrial standards regulations consists of *Ukrainian companies* that already export to the EU market, as well as companies that produce for the domestic and CIS market. Although the importance of the EU-25 as an export destination for machinery and equipment increased slightly from 1996 to 2005, the majority of Ukrainian producers still export to Russia (Figure 1) and lack incentives to support change because the reforms do not concern them.<sup>23</sup> The group of Ukrainian companies producing for the domestic market is small, because European companies dominate the market for ACAA relevant products; the exports of European machinery and equipment to Ukraine rose four times between 1996 and 2005 (Figure 2). Ukrainian companies producing for the domestic market do not have incentives to demand institutional change because the reforms would impose adjustment costs on them due to the fact that European product norms will have to be applied on the Ukrainian market as well.

The group of Ukrainian exporters to the EU who have incentives to support the reform because they would no longer have to pay for double conformity assessment procedures on both the Ukrainian and the EU market is in contrast much smaller (Figure 1). Still, they might be able to pressure the Ukrainian government into changing the current regulatory framework of industrial standards regulations. However, the exporting companies lack the capacity to do so because they do not possess the knowledge about how the EU model works and are shaped by a mentality which makes them believe that government agencies should do everything in their favour and, when faced with the opposite reality, think that someone else, e.g. a business association, will help write favourable laws. At the same time, it is not common among Ukrainian companies to provide financial and other resources in order to fund business associations and think tanks that would defend and advance their interest (interview 10, 11,18).<sup>24</sup>

Figure 1: Ukraine's Exports of Machinery (million US\$)

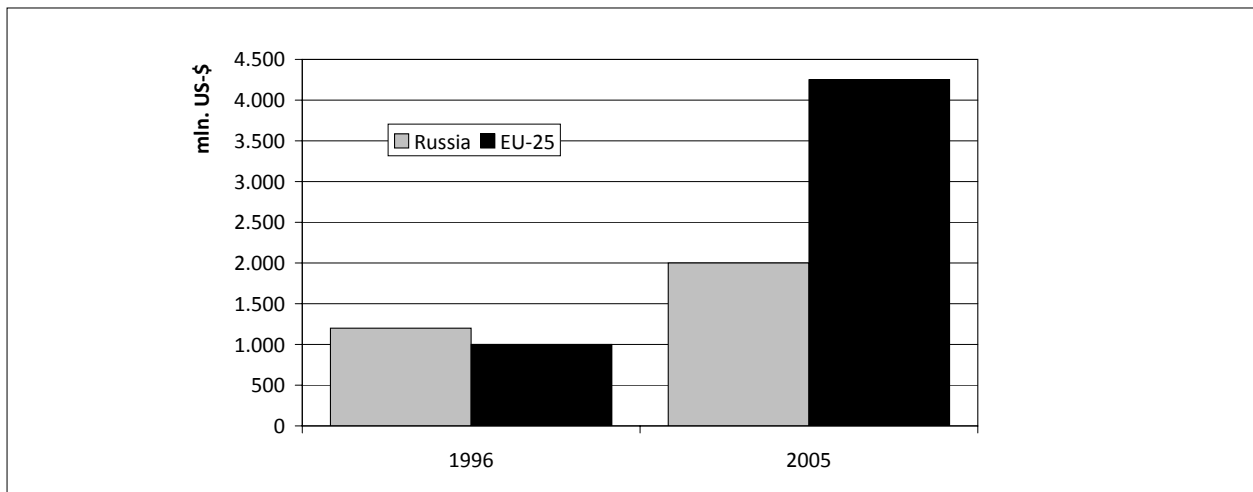


Source: Movchan, Veronika/ Sysenko, Nataliya: Mezhdru rynkami Rossii i EC, in: Otechestvennye zapiski, 2007 (Vol. 34), No. 1, <http://www.strana-oz.ru/?numid=34&article=1410> accessed 25 January 2008.

23 Ukrainian exporters to Russia can continue applying old Ukrainian standards called Gosstandards because these are also applied on the Russian market.

24 These characteristics do not only apply to Ukrainian companies exporting to the EU market but to Ukrainian companies in general.

Figure 2: Ukraine's Imports of Machinery (million US\$)



Source: Movchan, Veronika/ Sysenko, Nataliya (2007): *Mezhdru rynkami Rossii i EC*, in: *Otechestvennye zapiski*, 2007 (Vol. 34), Vol. 1, <http://www.strana-oz.ru/?numid=34&article=1410> accessed 25 January 2008.

In terms of incentives for the *supply side*, the *Ukrainian regulator DSSU* lacks incentives to change the current Ukrainian model because it will lose a lot of its power (interview 5, 20). DSSU is currently in charge of all tasks relating to industrial standards regulations in Ukraine.<sup>25</sup> While the regulator will still be in charge of standardisation after the reforms have been pursued, other tasks will be divided upon various public or private bodies that need to be founded. As far as the *Ukrainian executive* is concerned, in particular the Ministry of Economy and the Ministry of Industrial Policy have to reform, re-organise and develop the whole infrastructure for industrial standards regulations. This will cause high adjustment costs because re-organisation will involve large training programmes for the employees of DSSU (interview 16). Rent-seeking opportunities in terms of winning electoral votes for both the *Ukrainian executive* and *legislative* are low because only a small number of Ukrainian constituencies are on the demand side for institutional change, namely Ukrainian exporters to the EU who would benefit immediately from the reforms. Consequently, the Ukrainian executive and legislative lack the incentives to promote institutional change.<sup>26</sup>

In sum, neither the demand nor the supply side has both the incentives and capacity to promote institutional change in Ukraine's industrial standards regulations. According to hypothesis 1, the Ukrainian model of industrial standards regulations will not under these circumstances change. Since we have instead observed slow and selective but constant change, domestic factors cannot serve as explanatory variables.

## 5.2. The Transnationalisation Hypothesis

With the beginning of WTO negotiations in 1995, the ratification of the Partnership and Cooperation Agreement between the EU and Ukraine in 1998 and the conclusion of the Action Plan in the framework of the ENP in 2005, Ukrainian executives became increasingly exposed to the influence of Western experts and politicians (interviews 16, 17, 23). Organisations such as the World Bank and the EU have criticised Ukraine's existing standards regime because it '[...] adds to the cost of doing business in Ukraine and hinders the country's integration into the world economy.'<sup>27</sup> Further, World Bank studies emphasised the low

25 These are standardisation, certification, conformity assessment and market surveillance.

26 There is no need to analyse the extent to which the capacity of the supply side to change institutions explains the change of economic institutions in the Ukrainian case because actors will not use their capacities without incentives.

27 World Bank: *Ukraine Trade Policy Study (In Two Volumes)*, Volume II: Main report, Poverty Reduction and Economic Management Unit Europe and Central Asia Region, 16 November 2004, pp. 126.; European Commission: Barrier Fiche [0689] Industrial Standards and Conformity Assessment in Ukraine, Market Access Database provided by DG Trade, date of entry: 8 March 2006, [http://mkacdb.eu.int/madb\\_barriers/barriers\\_details.htm?barrier\\_id=970170&version=2](http://mkacdb.eu.int/madb_barriers/barriers_details.htm?barrier_id=970170&version=2).

quality of Ukraine's business environment, not only when compared to OECD countries, but also when compared to the average for the transition economies in Europe and Central Asia.<sup>28</sup> As a result, Ukrainian executives and regulators have started realising that they must show commitment to reform if they do not want to be seen as backward oriented policymakers by the West (interviews 2, 5, 6, 7, 12, 16, 17). The Ukrainian executive started several initiatives to signal support for the reforms from 2000 onwards, despite a lack of domestic-driven incentives as previously discussed.<sup>29</sup> Even the Ukrainian regulator DSSU responded to the international criticism and published a Green Paper in 2006, in which it discussed its past efforts to harmonise technical norms and legislation with EU and international requirements, and committed itself to continue its work in order to spur alignment (interview 23).<sup>30</sup>

### 5.3. The Laws on Standardisation, Conformity Assessment and Accreditation of Conformity Assessment Bodies

After President Kuchma ordered the drafting of laws on standardisation, conformity assessment and accreditation of conformity assessment bodies in a Presidential Decree of 2000, European TACIS experts served as legal advisors to the Ukrainian regulator and representatives of the Ukrainian Ministry of the Economy. Due to the resistance of the Ukrainian regulator, the draft laws on standardisation and conformity assessment in the end did not comply fully with EU requirements because they did not foresee the unbundling of DSSU (interviews 17, 18). However, European experts could still convince the Ukrainians to draft a EU compliant law on the accreditation of conformity assessment bodies by arguing that some evidence for progress would be helpful for future negotiations with the EU and the WTO. The Ukrainian Parliament adopted the three draft laws in 2001. There have been some modest attempts to implement them, but to a certain extent the laws are still contradicted by existing national law.<sup>31</sup> For example, existing laws still assign the tasks of accrediting conformity assessment bodies to DSSU and not to a separate public body. As a result, only DSSU's own certification body, Ukrmetrteststandard, has an accreditation. Despite the Ukrainian regulator's lack of incentives to pursue the reforms, its certification body has been acquiring the capacity to pursue the tasks of conformity assessment in line with EU requirements for one technical norm selected for the ACAA in 2006.<sup>32</sup> This is due to the fact that its staff is interacting with international and European standardization organisations<sup>33</sup>, and is familiarising themselves with internationally recognised concepts of conformity assessment and market surveillance (interviews 9, 20).

28 World Bank: Ukraine Trade Policy Study (In Two Volumes), Volume II: Main report, Poverty Reduction and Economic Management Unit Europe and Central Asia Region, 16 November 2004, pp. 142.

29 President Leonid Kuchma issued several decrees regarding the alignment of technical regulations in 2000 and 2001. In 2001, a Council of Ministers resolution demanded that the Ukrainian regulator DSSU draft a law on market surveillance. In 2005, President Yushchenko approved the agreement on the ACAA in the framework of the EU and issued a Presidential Decree on measures improving activities in the technical regulation and consumer policy sphere in order to facilitate preparations for ACAA negotiations.

30 State Committee of Ukraine for technical regulation and consumption policy: Green Paper on Adapting Domestic Legislation on Technical Regulation and Consumer Policy to European Standards, Kyiv, Ukraine, 2006, <http://www.icps.com.ua/doc/Green%2009%20-%20Technical%20Regulation%20Committee%20E.pdf> accessed 15 November 2007.

31 AFNOR-SWEDAC-UNI Consortium: The European Union's programme 'Application of a Foreign Trade Regime – Standards, Technical Regulations and Conformity Assessment in Ukraine', Final Report, 2004.; European Business Association, Barriers to Investment in Ukraine, Kyiv, Ukraine, August 2007, [http://www.eba.com.ua/files/Investment\\_paper/Inv\\_Paper\\_2007\\_ENG.pdf](http://www.eba.com.ua/files/Investment_paper/Inv_Paper_2007_ENG.pdf) accessed 16 November 2007.

32 This concerns the Low Voltage Directive. The problem, however, is that Ukrmetrteststandard is still part of the Ukrainian regulator DSSU. In order to meet EU requirements, Ukrmetrteststandards has to be separated from DSSU.

33 Since 1993, Ukrainian regulators have been cooperating with the International Standards Organization (ISO) and the International Electrotechnical Commission (IEC) due to the start of WTO negotiations. Cooperation with the European Committee for Standardization (CEN) and the European Committee for Electrical Standardization (CENELEC) started only in 2004 due to efforts by European experts working for the mentioned TACIS projects between 2003 and 2004. As a result, DSSU acquired the status of a partner authority with CEN, and the status of an associate with CENELEC, in 2005.

The lack of full compliance with EU requirements and slow implementation efforts have attracted a lot of criticisms by from the European Business Association in Ukraine (EBA). As an organisation for the defence the interests of more than 700 European companies operating in Ukraine since its founding year 1999, the EBA also represents about 50 European companies which represent 60% of the market share of European exports on the Ukrainian market for ACAA relevant products in 2006.<sup>34</sup> These European companies would directly benefit from the reforms in industrial standards regulations due to decreasing expenditure on double conformity assessment procedures on the EU and Ukrainian market. The EBA's efforts to challenge the status of the three laws under scrutiny were supported by the advisory work undertaken by World Bank experts for the Ukrainian Ministry of the Economy.<sup>35</sup> As a result, the Ministry requested World Bank and local experts to draft respective amendments to the existing laws on standardisation and conformity assessment in 2006 to make them more compliant with EU requirements. After the draft laws had been discussed and approved by a working group consisting of World Bank and local experts, Ukrainian state officials and the EBA in summer 2007, the Presidential Secretariat handed the amendments over for approval to the Ukrainian Parliament in January 2008.

On 8 April 2008, the amendments were rejected by the majority of the Parliament due to the lobbying efforts of the current chair of DSSU's public council, Leonid Shkolnik. He lobbied through Yuriy Karmazin, who is the head of the Party of Motherland Defenders, which is a part of President Yushchenko's 'Our Ukraine – Popular Self-Defence' party bloc. Reforms are thus also hampered because the Ukrainian executive lacks the capacity to promote institutional change due the weakness of the Ukrainian party system and political struggles (interview 18).

#### 5.4. The Law on Market Surveillance

In 2001, the Ukrainian Council of Ministers came up with a resolution that mandated the Ukrainian regulator DSSU to draft a law on market surveillance.<sup>36</sup> Only five years later, in September 2006, did the Ukrainian regulator DSSU present the draft law at its public council; the delay came about because the Ukrainian executive had not placed any pressure on it to act faster. DSSU's public council consists of its own staff, members of the Ukrainian Parliament, Ukrainian business and consumer associations and the European Business Association in Ukraine (EBA). The EBA heavily criticised DSSU's draft law because it did not foresee the decentralisation of the regulator's tasks as required by EU internal market rules. The business organisation called upon its members to send protest letters to DSSU and the Ministry of the Economy. The EBA also asked the European Commission to put pressure on the government to refuse this draft law. Since the Head of the Trade and Economic Section of the EC Delegation to Ukraine is a member of the EBA's board and sits on a number of EBA's committees, the European Commission addressed the EBA's issues during meetings with Ukrainian government officials (interview 12). In an interview, a representative of the Ukrainian Ministry of Economy mentioned that he and his colleagues did not want to support DSSU's draft law on market surveillance anyway because it did not meet EU requirements. However, protest by European importers and the European Commission accelerated their decision to initiate the drafting of a more compliant market surveillance law (interview 17). Again, IFC and local experts developed the new draft on market surveillance, which was then discussed by the above-mentioned working group consisting of Ukrainian executives, local and international experts and the EBA in summer 2007. After its approval, the Presidential Office handed the draft law over to the Ukrainian Parliament in January 2008. The Presidential Office, however, keeps postponing the first reading of the law by the Ukrainian Parliament

34 UEPLAC: Regulatory impact analysis of the transposition and implementation of the EC Low Voltage directive into Ukrainian legislation, Kyiv, Ukraine, 2008, [http://ueplac.kiev.ua/downloads/ria/lvd\\_full\\_ria\\_for\\_ukraine.pdf](http://ueplac.kiev.ua/downloads/ria/lvd_full_ria_for_ukraine.pdf) accessed 10 April 2008.

35 In 2001, the World Bank Group launched a project aimed at improving Ukraine's business environment coordinated by the International Finance Cooperation (IFC).

36 The law is supposed to disentangle the pre-market control of industrial products from the regulatory body and assign it to the manufacturers. It further released the regulator from pursuing inspections and assigns these tasks to separate public or private bodies.

in order to save it from the aforementioned fate of the amendments to the laws on standardisation and conformity assessment (interview 18).

## 5.5. Standards Harmonisation

Apart from changing the regulatory framework for industrial standards regulations in Ukraine, the country also needs to harmonise its product standards with the corresponding EU standards.

The Ukrainian regulator DSSU is in charge of standards harmonisation and is the main partner on the domestic supply side for international experts to support reforms in this field of action. The first TACIS project that aimed explicitly at promoting industrial standards harmonisation took place from 2003 to 2004.<sup>37</sup> Training courses were conducted where differences between existing Ukrainian standards and EU standards were identified and guidance to implement the technical norms was provided.<sup>38</sup> Further, the projects provided financial assistance for the translations of relevant EC directives (interview 8), but Ukrainian regulators criticise that the resources provided do not cover the costs which led to divergent results with respect to standards harmonisation as described in section 2 (interview 17). While European experts note that the majority of the regulator's technical staff are actively participating in the training courses and understand the complexity of the needed changes, the Ukrainian executive does not seem to have the incentive to change things fast. There are no attempts to change the current status of the Ukrainian regulator DSSU as a ministry, which leads to frequent changes of the head of the regulatory body after every election. In addition, the persons appointed heads of DSSU are not always reform friendly or lack technical expertise. As a result, progress has been impeded (interview 9).

## 5.6. The Forgotten Demand Side

Whereas piecemeal transnationalisation has altered the incentives and capacities of parts of the supply side in favour of the reforms, the incentives and the capacities of the domestic demand side have not been altered. This is because negotiations between Ukraine and the EU or the WTO are happening on an intergovernmental level. Consequently, the criticisms and advice expressed by the EU or the WTO only become part of the governmental decision-making process regarding institutional reforms in Ukraine. Further, European business associations working at the European level lack contacts to their Ukrainian counterparts (interviews 1, 3, 4). Even the EBA in Ukraine does not invest a lot of effort in building ties with Ukrainian companies or business organisations (interviews 12, 13). As a result, transnational forces do not seem to alter the incentives of the demand side for institutional change. In terms of altering its capacities, previous EU TACIS and World Bank projects did not focus on Ukrainian companies or business associations. As a matter of fact, they have, for example, not adequately addressed the above-mentioned inactivity of Ukrainian companies to lobby for their interest. However, the European Commission plans to address Ukrainian companies through a number of TACIS projects in order to disseminate information from 2008 onwards (interview 8).

## 6. Conclusion

This paper has presented evidence that the slow and selective but constant change in Ukraine's industrial standards regulations cannot be explained by domestic factors alone because actors on the domestic demand and supply sides lack the incentives and capacities to support and induce institutional change.

37 These include all 16 technical norms under the EU's New Approach. For the 'New Approach' directives, the EU demands pre-market control by the manufacturer and only post-market control by regulatory bodies which have to be accredited by the state but can have a private or public ownership status. See: European Commission: Guide to the implementation of directives based on the New Approach and the Global Approach, Brussels, 2000, <http://europa.eu.int/comm/enterprise/newapproach/newapproach.htm> accessed 8 February 2008.

38 AFNOR-SWEDAC-UNI Consortium: The European Union's programme 'Application of a Foreign Trade Regime – Standards, Technical Regulations and Conformity Assessment in Ukraine', Final Report, 2004.

Instead, I have shown that transnational forces have altered the incentives and capacities of the domestic supply side in a piecemeal way. Change is being pursued *gradually* because of three mechanisms: first, the incentives for the supply side have been altered by organisations such as the World Bank and the EU, which have fostered appropriate behaviour among Ukrainian state actors by criticising the shortcomings of the current Ukrainian model in terms of competitiveness. Second, the incentives for the supply side have been altered due to the lobbying efforts of European companies, who dominate the Ukrainian market for ACAA relevant product groups. Since the European Business Association in Ukraine uses its participation in government councils and its close links to the European Commission to criticise Ukraine's current model of industrial standards regulations, it has become more costly for Ukrainian policymakers to resist the reforms. Third, international and European experts are taking part in the domestic decision-making process by providing knowledge and resources as well as assistance in drafting EU compliant legislation. They have thereby altered the administrative capacity of the domestic supply side.

The *slow and selective* character of the change can be also explained by three factors: first, the benefits of transnational forces to the domestic supply side, i.e. that the recognition as rule followers and the transfer of knowledge and resources neither cover the adjustment costs nor increase the rent-seeking of domestic actors on the supply side. Second, transnational forces have only focused on altering the administrative, but not the structural, capacity of the executive to increase support among Ukrainian legislators. Third, transnational forces have until now failed to alter the incentives for and capacities of the domestic demand side to pressure their government or build institutions themselves.

Apart from the specificity of the Ukrainian case, this paper makes a more general argument by showing that any analysis of change in economic institutions in developing market economies has to take into account that external forces of institutional change such as foreign experts and companies become endogenised by participating in national government councils and working groups. They are fulfilling the traditional tasks of the domestic supply side (e.g. drafting legislation) and of the domestic demand side (e.g. lobbying for institutional change). As a result, the incentives and capacities of the domestic demand and/or supply side alter in favour of the reforms. The analytical framework used in this paper may be also applied to other cases: if the analysis of domestic factors alone cannot explain change in developing market economies, the role of the transnationalisation of the domestic decision-making process as an explanatory factor should be explored. The concept may be better suited to explaining diverging outcomes than the power of the market or of political conditionality because these factors might not be able to explain the endogenisation of incentives promoted from the outside and the building of capacity necessary to pursue the reforms.

## Interviews

### In Brussels (September/October 2007)

- 1) Representative of the European Round Table of Industrialists, 19 September 2007.
- 2) Official, DG Trade, 20 September 2007.
- 3) Representative of Business Europe, 1 October 2007.
- 4) Representative of Eurochambers of Commerce, 2 October 2007.
- 5) Official, DG Enterprise, 5 October 2007.

### In Kyiv (January–March 2008)

- 6) Ukrainian expert (a), 24 January 2008.
- 7) Official, Delegation of the European Commission to Ukraine, 1 February 2008.
- 8) Project Manager, Delegation of the European Commission to Ukraine, 1 February 2008.
- 9) European expert (a), 8 February 2008.

- 10) Representative of a big Ukrainian company exporting household appliances to the EU, 6 February 2008.
- 11) Representative of a medium-sized Ukrainian company exporting electrotechnical devices to the EU, 6 February 2008.
- 12) Representative, European Business Organisation in Ukraine, 11 February 2008.
- 13) Representative of a Ukrainian business association (a), 15 February 2008.
- 14) European expert (b), 15 February 2008.
- 15) Representative of a Ukrainian business association (b), 20 February 2008.
- 16) Two state officials, Ukrainian Ministry of Industrial Policy, 25 February 2008.
- 17) State official (a), Ukrainian Ministry of Economy, 28 February 2008.
- 18) Ukrainian expert (b), 18 March 2008 and written comments by the same expert, 14 April and 24 April, 2008.
- 19) Representative of Ukrainian regulator DSSU (a), 18 March 2008.
- 20) Representative of Ukrmetrteststandard (DSSU's conformity assessment body), 18 March 2008.
- 21) State official (b), Ukrainian Ministry of Economy, 18 March 2008.
- 22) State official (c), Ukrainian Ministry of Economy, 18 March 2008.
- 23) Two representatives of Ukrainian regulator DSSU (b), 19 March 2008.
- 24) Representative of a Ukrainian subsidiary of a European company exporting electrotechnical products to Ukraine, 25 March 2008.