

# Promoting the rule of law through free trade agreements: the case of public procurement reform in Ukraine

Сприяння розвитку верховенства права шляхом торговельної лібералізації: приклад реформи публічних закупівель в Україні

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## Key words:

EU, rule of law, free trade, development economics, public procurement, Ukraine.

## Ключові слова:

ЄС, верховенство права, економіка розвитку, публічні закупівлі, Україна.

## Introduction

The history of the U. S. state-sponsored and private agencies' ambitious effort to reform substantive legislation, judicial systems and legal education in Asia, Africa and South America dates back to the Law and Development Movement of the 1960s. Since that time donor institutions worldwide have been promoting what T. Carothers (2010) called the standard "RoL reform menu", offering the reforms of substantive laws; law-related institutions and "increasing government's compliance with the law"<sup>1</sup>. As the "Community, based on the rule of law (RoL)"<sup>2</sup>, the EU is not an exception to this rule. While the EU emphasizes the RoL in its Enlargement Strategy<sup>3</sup> and actively promotes it to third states, the EU's RoL promotion activities are broadly criticized in scholarship. The first deficiency of the EU Enlargement Policy and external RoL promotion is the lack of clear standards, leading to the fact that the Candidate countries and Neighbours have to "comply with the unknown"<sup>4</sup>. Second, the EU tends not to go beyond the 'menu', enshrined by Carothers. Finally, the set of the legal and implementing instruments the Union uses to promote the RoL barely changes over time, notwithstanding the external challenges.

Although the EU vision of the RoL-to export is fuzzy, the textual analysis of the respective policy and legal instruments allows to establish that the Union views the RoL as a primarily political or legal matter. At the same time, the Union underlines the importance of the RoL for economic development in its Enlargement Strategy; mentions legal certainty and property rights among the RoL components and promotes the observance of the RoL through the GSP+ and "essential elements" clauses. Nevertheless, the EU does not either conceptualize the RoL from the development economics view point or elaborate a vision of systemically using its economic cooperation instruments to promote the RoL. Thus, the paper seeks to distinguish the key components of the RoL, peculiar to the development economics approach and highlight the prospects of applying the EU FTAs to promote the RoL.

## The Rule of Law: Development Economics Viewpoint

For ages, economists have been struggling to single out the determinants of the nations' prosperity. The voluminous research on this topic includes three major strands<sup>5</sup>. While the first and second focus on geography<sup>6</sup>

<sup>1</sup> Carothers T. Promoting the Rule of Law Abroad. In search of Knowledge / T. Carothers. – Washington, D. C. : Carnegie Endowment for International Peace, 2010. – P. 7–8.

<sup>2</sup> Case 294/83. Les Verts v Parliament [1986]. ECR 1339, para. 23.

<sup>3</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "EU Enlargement Strategy", 10/11/2015, COM (2015) 611 Final.

<sup>4</sup> Kochenov D., De Ridder E. (2011). Democratic Conditionality in Eastern Enlargement : Ambitious Window Dressing / D. Kochenov, E. De Ridder // European Foreign Affairs Review. – Vol. 16. – P. 592.

<sup>5</sup> For an in-detail review of literature on the determinants of economic growth, see: Rodric D., Subramanian A., Trebbi F. (2002). Institutions rule : the primacy of institutions over geography and integration in economic development / D. Rodric, A. Subramanian, F. Trebbi. – NBER Working. – Paper № 9 305. Retrieved from : <http://www.nber.org/papers/w9305>.

<sup>6</sup> Diamond J. Guns, Germs and Steel / J. Diamond. – New York : W.W. Norton and Co, 1997.

and a country's integration into the world trade structures<sup>7</sup> respectively, the third one link socio-economic development with the quality of institutions and the RoL<sup>8</sup>.

Considering the links between the RoL law and economic growth, it is to mention that the RoL is often seen as a prerequisite for the emergence of competitive private sector within a country. The Global Competitiveness Index associates the RoL with the protection of property and IP rights; judicial independence; burden of governmental regulation; transparency of policy-making etc. In private institutions' domain, strong private sector requires ethical behavior of firms; developed auditing and reporting standards and the effective protection of minority shareholders' interests<sup>9</sup>. Naturally, apart from facilitating the growth of domestic private sector, the state of the above RoL components in a country influences its attractiveness for foreign direct investment (FDI) and international trade. In this regard, the key issues deal with company law, enforceability of contracts, investor protection, foreign entities' access to public procurement and the transplantation of the international environmental, sanitary and technical standards into the state's legislation. While the RoL creates prerequisites for free trade, the process of trade liberalization also conditions the RoL improvements<sup>10</sup>.

A number of reasons make it insightful to study the EU-Ukraine trade liberalization's impact on the RoL in the latter. Foremost, given its ambitious goal of integrating Ukraine into the EU Single Market, the DCFTA addresses a range of the RoL-related areas, such as competition, IP rights protection, public procurement, as well as environmental standards etc. Moreover, the broader EU-Ukraine Association Agenda touches upon further competitiveness and RoL-related domains, such as the judicial sector, public administration and deregulation. Finally, as a notable international promoter of norm sand structures, the EU supports the implementation of the EU-Ukraine DCFTA with a range of technical and financial assistance instruments, whose legal design and implementation can be replicated to support the competitiveness-RoL nexus worldwide.

### **Public Procurement Reform in Ukraine: History and the Key Targets to Achieve**

According to the WTO (2016), public procurement accounts for 10–15 percent of a state's GDP on the average<sup>11</sup>. There fore, the opportunities of participation in tenders for state-funded projects attract attention of both domestic and external actors, serving as "*the litmus test for aspects of democratization and good governance, such as fairness, transparency and efficiency of public spending*"<sup>12</sup>. Given the fact that the public procurement is nowadays an essential area of the WTO law and EU FT. As, the rules on foreign enterprises' access to tenders and their implementation determine the external perceptions of the business climate. Moreover, in view of the reciprocity principle, the liberalization of public procurement rules influences the domestic companies' opportunities to participate in foreign tenders and their international competitiveness.

Addressing the history of public procurement reform in Ukraine over 2000 to 2009, Stewart (2013) argues that, despite several amendments of the framework legislation, the system has become increasingly dysfunctional<sup>13</sup>. The new public procurement law was adopted in Ukraine in 2010 and was to significant extent harmonized with the *acquis*.<sup>14</sup> However, the subsequent "*flood of amendments*"<sup>15</sup> led to the fact that many economy sectors were exempted from the application of the Law. Thus, starting its diplomatic relations with the new Ukrainian government in 2014, the EU faced a challenge of framing a strategy of public procurement reform in Ukraine. For the time being, the officially defined targets of the reform address the transparency of procurement, its competitiveness, professionalism of procurers and Ukraine's joining the WTO Agreement on Public Procurement (GPA). The roadmap for harmonizing Ukrainian public procurement legislation with the EU *acquis* is contained in the Chapter 8 of the Title IV of the EU-Ukraine DCFTA.

<sup>7</sup> Frankel J., Romer D. Does Trade Cause Growth? / J. Frankel, D. Romer // American Economic Review. – 89 (3). – P. 379–399.

<sup>8</sup> The prominent example of emphasizing institutions' role in growth is Akemoglu D., Johnson S., Robinson A. (2001). The Colonial Origins of Comparative Development: An Empirical Investigation // American Economic Review. – 91 (5). – P. 1 369 – 1 401.

<sup>9</sup> Mia I. (2009). The Rule of Law as a Factor for Competitiveness / I. Mia. – Lessons from the Global Competitiveness Index 2008–2009. Retrieved from : <http://www.oecd.org/gov/regulatory-policy/50480995.pdf>.

<sup>10</sup> For a discussion of the links between trade liberalization and the RoL, see : Anderson R. (2005). Linking rule of law and trade liberalization in Jamaica // Berkeley Journal of African-American Law and Policy. – 7 (1). – P. 49–91.

<sup>11</sup> WTO (2016). Government Procurement Gateway. Retrieved from : [https://www.wto.org/english/tratop\\_e/gproc\\_e/gproc\\_e.htm](https://www.wto.org/english/tratop_e/gproc_e/gproc_e.htm).

<sup>12</sup> Stewart S. (2013). Public Procurement Reform in Ukraine : the Implications of Neopatrimonialism for External Actors. *Demokratizatsiya*. – Vol. 21(2), – P.198.

<sup>13</sup> *Ibid*, p. 202.

<sup>14</sup> *Ibid*, p. 210.

<sup>15</sup> *Ibid*, p. 206.

## EU Support for the Public Procurement Reform in Ukraine: Combining Action and Regulation

The means the EU uses to support public procurement reform in Ukraine in view of the DCFTA implementation can be distinguished into two groups. First, trade and association instruments serve as the framework for the EU's RoL action. Second, the binding nature of the EU-Ukraine DCFTA allows it to directly regulate limited issues related to public procurement in Ukraine.

### 1) The Association Agreement and DCFTA as a Framework for EU Action

The public procurement reform is mentioned as one of Ukraine's key priorities under the EU-Ukraine Association Agenda<sup>16</sup>. Subsequently, the present multilevel institutional structure<sup>17</sup> of the EU-Ukraine association relations is employed by the Parties to discuss the reform progress. In terms of the political dialogue regarding the EU financial aid to Ukraine, the Union repeatedly set public procurement reform criteria as positive conditions for getting further aid tranches<sup>18</sup>. Next, the core of the EU support is formed by its strong legal technical assistance component. Since 2013, the EU has been funding the project "Harmonisation of Public Procurement System in Ukraine with EU Standards"<sup>19</sup>. The project focuses on the enhancement of public procurement and state aid from the regulatory, institutional, as well as transparency and accountability standpoints<sup>20</sup>. Fourth, the Union tends to empower stakeholders, interested in the reform's success, such as the representatives of business and civil society.

### 2) The DCFTA as a Source of Regulations in the Field of Public Procurement

Chapter 8 of the Title IV of the EU-Ukraine DCFTA *"envisages the reciprocal and gradual access to public procurement markets on the basis of the principle of national treatment"*<sup>21</sup>. The envisioned reciprocal opening of the Parties' public procurement markets was addressed as *"an unprecedented example of the integration of a non-EEA Member into the EU Single Market"*<sup>22</sup>. *The key tools the DCFTA employs to achieve the ambitious finality of the Chapter are the approximation of Ukraine's legislation to respective *acquis* and the "common market conditionality"*.

The scope of the *acquis* to be approximated is defined by the Art.148 DCFTA and Annex XXI to the Agreement. Noteworthy, the "Basic Provisions" that constitute the core of the approximation process contain a range of the RoL-related requirements related to the publication of information regarding the planned procurements and establishing non-discriminatory rules for the contracts' award<sup>23</sup>. To ensure smooth approximation process, Annexes XXI-A and XXI-B-N connect the progress of approximation to the particularities of respective market openings.

### Success Story of the Reformed Public Procurement

The EU reports and media sources praise public procurement as the flagship reform field under the AA/DCFTA. The key achievements, mentioned in the sources are as follows. First, in 2016 Ukraine adopted the Public Procurement Reform Strategy and the new Public Procurement Law. The Strategy highlights the key steps to be taken by the Government of Ukraine to complete the five-stage legislative approximation process, and addresses a number of complex issues, varying from the improvement of institutional infrastructure of public procure-

<sup>16</sup> EU-Ukraine Association Council (2015). EU-Ukraine Association Agenda to prepare and facilitate the implementation of the Association Agreement. Retrieved from : [http://eeas.europa.eu/archives/docs/ukraine/docs/st06978\\_15\\_en.pdf](http://eeas.europa.eu/archives/docs/ukraine/docs/st06978_15_en.pdf)

<sup>17</sup> The institutional infrastructure of the EU-Ukraine cooperation under the AA includes the Association Council, Association Committee, Parliamentary Association Committee and Civil Society Forum.

<sup>18</sup> Shatkovskiy A., Stuart E. (2014). Report on the Improvement of Annual Reporting on the Public Procurement System of Ukraine / A. Shatkovskiy, E. Stuart. Retrieved from : <http://eupublicprocurement.org.ua/wp-content/uploads/2015/01/REPORT-on-PP-ANNUAL-REPORTING-ENG.pdf>, p. 8.

<sup>19</sup> For more information, please, visit the website of the project : <http://eupublicprocurement.org.ua/?lang=UKR>.

<sup>20</sup> Gordienko O., Antonovych M. (2015). Putting an end to Ukraine's corrupt public procurement system. Retrieved from : <https://www.kyivpost.com/article/content/legal-quarterly/putting-an-end-to-ukraines-corrupt-public-procurement-system-399818.html>.

<sup>21</sup> Van der Loo G. (2016). The EU-Ukraine Association Agreement and Deep and Comprehensive Free Trade Area. Leiden : BRILL. – P. 270.

<sup>22</sup> European Commission (2014). EU-Ukraine Free Trade Area. Retrieved from : [http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc\\_150981.pdf](http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150981.pdf).

<sup>23</sup> EU-Ukraine Association Agreement, Title IV "Trade and Trade-related Matters" – Art. 151. Retrieved from : [http://eeas.europa.eu/archives/docs/ukraine/pdf/5\\_ua\\_title\\_iv\\_trade\\_and\\_trade-related\\_matters\\_en.pdf](http://eeas.europa.eu/archives/docs/ukraine/pdf/5_ua_title_iv_trade_and_trade-related_matters_en.pdf).

ment to enhancing the procedures' flexibility<sup>24</sup>. The Strategy and the 2016 Public Procurement Law created the basis for launching the electronic tender system called ProZorro. The fact that ProZorro evolved "from a volunteer project" to the core of the "nation-wide procurement reform" can be used to argue that the EU managed to influence not only the substance of the reform, but effectively support the "bottom-top" approach to reforms<sup>25</sup>. The praised features of ProZorro include data openness (all the publications are available in English) and serving the forum of cooperation between the government, businesses and civil society<sup>26</sup>. In August 2016, the Government reported that ProZorro already helped to save UAH 8 billion, and is expected to facilitate the savings of up to UAH 50 billion annually<sup>27</sup>. The launch of ProZorro helped Ukraine bring the public procurement system into conformity with the requirements, contained in the WTO GPA. Following Ukraine's joining the GPA, Ukrainian enterprises got access to the public procurements markets of 45 Members to the Agreement. Ukraine's reciprocal opening of its public procurement market shall also contribute both to the openness of the system and enhanced competitiveness in the public procurement domain.

### **Challenging Aspects of the Reform or "20 Ways to Cheat ProZorro"<sup>28</sup>**

Multiple successes of Ukraine's public procurement reform may create an impression that all the challenges of change are behind. Nevertheless, the analysis of current legislation and media publications demonstrates the need for strengthened scrutiny of both the contents of public procurement-related legislation and its practical application. To exemplify this statement, it is worth referring to the controversial Art.7 and Art. 6(2) of the Law of Ukraine "On State Aid"<sup>29</sup>, containing exemptions from the obligation to report new state aid. As noted by Stuart, Cemnoloskins and Roginska (2014), the above exemptions create "the real risk that the Law would become unworkable and a virtual certainty that it will fail to comply, in practice, with the EU standards"<sup>30</sup>. A range of controversies surround the application of ProZorro. As reported by Open Data Bot, the companies, blacklisted by the Antimonopoly Committee of Ukraine, won more than UAH 460 million through ProZorro<sup>31</sup>. Moreover, for the time being, experts distinguish more than twenty means to cheat the system, hiding its inefficiencies<sup>32</sup>. In many cases, local state administrations and public companies misuse formalities to deny competitive propositions and create the room for 'kickbacks' and money laundering<sup>33</sup>. The potential harm of misusing ProZorro is multiplied by the deficiencies in the institutional aspect of ensuring procurements' transparency. Among them one can mention the lack of a single mechanism of monitoring procurements and distribution of functions between a variety of institutions, involved therein. Under institutional uncertainty, DoZorro remains a forum for discussions, not capable of influencing the outcomes of "suspicious tenders".

### **Conclusion**

The EU development cooperation is characterized by the ever strengthening links between profound trade liberalization (requiring ever more significant convergence of parties' legislation) and the promotion of fundamental values. The key areas, where the liberalization of trade intersects with the RoL include functioning competition and state aid regulations, transparency of public procurement, and the modernization and observance of envi-

<sup>24</sup> Cabinet of Ministers of Ukraine (2016). Decree "On the Strategy of Reforming the System of Public Procurement (Roadmap) of 24 February 2016. Retrieved from : <http://zakon5.rada.gov.ua/laws/show/175-2016-%D1%80?test=4/UMfPEGznhhb5N.Zi.Q86bGHI4GMs80msh8le6>.

<sup>25</sup> Bugay Y. (2016). ProZorro : How a Volunteer Project Led to Nation-wide Procurement Reform in Ukraine / Y. Bugay. Retrieved from : <http://www.open-contracting.org/2016/07/28/prozorro-volunteer-project-led-nation-wide-procurement-reform-ukraine>.

<sup>26</sup> Ibid.

<sup>27</sup> Nefiodov M. (2016). ProZorro Has Already Saved More Than 8 Billion From the Public Funds / M. Nefiodov. Retrieved from : <https://www.slovovidilo.ua/2016/12/02/novyna/ekonomika/prozorro-vzhe-zaoshhadyla-byudzhetu-ponad-8-milyardiv-hryven-nefiodov>.

<sup>28</sup> Kropivnitsky D. (2016). There are minimum twenty ways to cheat ProZorro system / D. Kropivnitsky. Retrieved from : [http://ru.golos.ua/ekonomika/suschestvuet\\_minimum\\_20\\_metodov\\_obmana\\_sistemyi\\_roorro\\_ekspert\\_0660](http://ru.golos.ua/ekonomika/suschestvuet_minimum_20_metodov_obmana_sistemyi_roorro_ekspert_0660).

<sup>29</sup> Verkhovna Rada of Ukraine (2014) Law of Ukraine "On State Aid to Business Entities". Retrieved from : <http://zakon5.rada.gov.ua/laws/show/1555-18>.

<sup>30</sup> Stuart E., Cemnoloskins S., Roginska I. (2014). Report on State Aid Mapping for Ukraine / E. Stuart, S. Cemnoloskins, I. Roginska. Retrieved from : <http://eupublicprocurement.org.ua/wp-content/uploads/2014/12/Report-on-Regional-mapping-ENG.pdf>.

<sup>31</sup> OpenDataBot (2017). Companies from the Backlist of the Antimonopoly Committee Won More Than 460 million UAH Through ProZorro. Retrieved from : <https://opendatabot.com/blog/25-prozorro-black-list>.

<sup>32</sup> Bilinska N. (2016). How the Assurances in the Transparency of Public Procurement can be Converted into the Competition with Pre-defined Results / N. Bilinska. Retrieved from : [http://zib.com.ua/ua/125413-yak\\_zapevnennya\\_v\\_prozorosti\\_tendernih\\_zakupivel\\_mozhna\\_pere.html](http://zib.com.ua/ua/125413-yak_zapevnennya_v_prozorosti_tendernih_zakupivel_mozhna_pere.html).

<sup>33</sup> For exploring the ways to manipulate ProZorro, see: Andiruchenko P. (2016). The Dark Side of ProZorro. Available at : <http://www.epravda.com.ua/rus/columns/2016/10/24/608798>;

ronmental and sanitary legislation. As demonstrated by the case of public procurement reform in Ukraine, the EU-Ukraine DCFTA is capable of directly regulating the RoL-related issues (e.g., the publication of information about the upcoming procurements; contract award procedures) in third states through the mechanisms of legislative approximation and “market access” conditionality. Importantly, the above mechanisms are inseparably linked with the EU reform support tools that range from political dialogue to large-scale legal technical assistance project.

The combination of the EU ‘market access conditionality’, legal technical assistance and local volunteer initiative “ProZorro” led to improvements in Ukraine’s public procurement domain and budget savings to report. Nevertheless, multiple ways to misuse of ProZorro, dysfunctional DoZorro and the lack of institutional infrastructure to monitor “suspicious” tenders and prevent their realization do not allow to call the new public procurement system a doubtless success.

## Summary

Based on the development economics approach to the rule of law, the article explores the EU rule of law promotion through free trade agreements, using the ongoing public procurement reform in Ukraine as a case study. The paper concludes that free trade agreements serve as the Union’s important (yet, underestimated) instrument of promoting rule of law in particular business-related sectors.

## Анотація

Аналізуючи феномен верховенства права з погляду економіки розвитку, стаття фокусується на діяльності Європейського Союзу щодо сприяння розвитку верховенства права за допомогою торговельних угод. Стаття використовує приклад реформи публічних закупівель в Україні як приклад. Правовий аналіз підтримки реформи публічних закупівель в Україні дозволяє дійти висновку, що торговельні угоди є важливим, однак, недооціненим інструментом сприяння розвитку верховенства права в Україні.

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