

**World and European Economy**

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**FOREIGN-ECONOMIC ACTIVITY
OF UKRAINE IN THE CONTEXT
OF INTEGRATION PROCESSES****Abstract**

The article considers the importance of Ukraine's foreign-economic activity in creation of preconditions for realization of its integration into the European economic structures. The author analyzes the conditions of international cooperation in development of Ukraine's foreign trade and investment activity, outlines opportunities of implementation of German practice of external economic policy, basic problems in the way of Ukrainian goods to the markets of the EU, and formulates propositions on promoting the national interests of Ukraine on the international market.

Key words:

Foreign economic policy, foreign trade activity, foreign trade, investment cooperation, euro-integration, competitiveness, competitive advantages, national interests.

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Today, the development of cooperation with the European Union and joining the World Trade Organisation (WTO) are the foreign-economic priorities of Ukraine. The final position of Ukraine on its participation in formation of the Common Economic Space (CES) in the east is of great importance as well.

The efficiency of the realized course of Ukraine's integration into the European Union is highly dependent on the development of the external economic component. While the increase of efficiency of the trade and economic relations with the EU countries, in its turn, is one of the most important components of the strategy of the Ukrainian economy's integration into the world economy, as well as of its Euro-integration course. Thus, the accumulation of trade, investment and cooperative relations with the leading countries of the EU become the priority.

The data on the dynamics of Ukraine's external-economic turnover, as well as the amounts of foreign investments attracted to the Ukrainian economy, demonstrate the level of development of such relations. According to the official data of Ukraine's Derzhkomstat, the volume of external-economic turnover of Ukraine made \$61.7 bln. in 2004 and grew by 33.8% compared to previous year. The share of the CIS in it was almost 38%, of the European countries – over 35%, and of the USA – only 3.7%. The balance of foreign trade of Ukraine was positive, making almost \$3.7 bln. (5.9% of foreign trade turnover-FTT) [1]. In 2005, the share of the CIS made 39.5%, of the European countries – 33.5%, and of the USA – 2.4% [2]. The trade balance was negative and made over \$1.8 bln (2.6% of FTT)¹ for the first time in the recent years. It is obvious that the EU market remains to be one of the most important export markets for Ukraine. However, the share of Ukraine in the EU trade turnover makes only about 0.4%, while the share of the EU reaches 35%. For the efficient integration with the European Union, it has to reach no less than 60%.

Currently, the foreign trade of Ukraine with the EU is concentrated on a small group of countries. Specifically, over 60% of Ukrainian trade with the EU-countries accounts for Federative Republic of Germany, Italy and Great Britain. A similar situation takes place in trade with the new EU members. In particular, Poland, Slovakia and Hungary account for more than 62%-65% of foreign trade of Ukraine with the new EU members.

Worth noting is the fact that the priority of Ukrainian cooperation with the European Union (EU) and its separate members is connected with the fact that

¹ One reason for such dynamics was the change in the exchange rate realized by the National Bank of Ukraine on April 21, 2005. Thus, the official UAH/USD rate set by the NBU made 5.3054 UAH on 31.12.2004, 5.3054 UAH on 1.03.2005, 5.2806 UAH on 1.04.2005, 5.19 UAH on 20.04.2005, and 5.05 UAH from 21.04.2005 till the end of the year [3]. These measures of the NBU also influenced the dynamics of export-import operations of Ukraine. When in 2004 the year-on-year growth made 41.6% for exports and 25.9% for imports, in 2005 the growth was 4.96% for exports and 24.6% for imports.

this group will determine the directions of economic progress and political stability in the region over the long-run.

Trade and economic relations of Ukraine with the EU-countries are regulated both by the common EU trade principles and by the tools applied to countries with non-market economy, as well as countries-non-members of the World Trade Organization. Even though at the end of 2005 Ukraine received the status of the market economy from the EU countries, the absence of its WTO membership preserves the effect of the determined regulatory mechanisms with regard to its foreign trade.

Considering the advantageous geographical location, rich natural resources, trained experts, on the one hand, and high interest of foreign capital in deepening of economic relations on the other, Ukraine is considerably motivated to enter the system of the European division of labour, and thus, into the sphere of economic interests of the EU members.

In this situation, the development of cooperation between Ukraine and the Federative Republic of Germany, as one of the most powerful EU members, may become the benchmark and the locomotive for speeding-up the Euro-integration processes in our country.

Firstly, the FRG is one of the most influential members of this community, it forms more than a half of the common European budget, it is the most powerful state of Europe in terms of economic development, and it takes the first place among the world countries by the volume of foreign trade turnover.

Secondly, German economy is one of the most open in Europe. It is oriented at external markets, and every third workplace here depends on foreign trade to some extent.

Thirdly, the FRG is one of the most consecutive advocates of the EU enlargement to Central and Eastern European countries; this is proved by the specific sums of the capital invested in these countries (over 30 bln. Euro) and by powerful lobbying of the EU expansion to the East;

Fourthly, Germany is the second trade partner of Ukraine in terms of volume of trade turnover in bilateral trade.

Besides, the implementation of the German experience in the sphere of external economic policy oriented at expansion of German goods onto the world markets, accumulation of German capital in the banking sphere and in world investments plays a significant role in production and realization of the Euro-integration measures of Ukraine. Therefore, one of the key-questions of external-economic policy of Germany is both the solution of the unemployment problem and reduction of the unemployment level in Germany. The latter is true for all of the EU countries.

Concerning the indicative data of economic development of the EU countries, it should be noted that the growth of industrial production volumes under modern conditions may not always be an objective indicator, as far as its realiza-

tion may also be carried out abroad. The components of external-economic policy acquire new features in connection with the EU enlargement and acceptance of the new countries to the European Union.

This influences the competitiveness and export capabilities of the Federative Republic of Germany. It is high time to distinguish between the competitiveness of the German industry and the competitiveness of German employees. Owing to the reliable protection in the countries of Eastern and Central Europe, German enterprises are still able to remain competitive in the world markets, while German employees have already lost their competitiveness in most cases. A decrease in employment in German industry is observed. The phenomenon of «imports of German exports into the country» is showing itself more and more today, in particular due to industrial production on commission based outside of the FRG. For example, an automobile «AUDI», the engine of which is produced in Hungary, is counted in the export statistics of the Federative Republic of Germany. The mark on the label «Made in Germany» acquires a quite different semantic and pragmatic undertone.

In connection with the EU enlargement, the borders of which approach Ukraine, German enterprises and investors get more interested in the expansion of cooperation with Ukraine, as well as employment of highly-trained, but considerably cheaper than in the FRG, Ukrainian labour force.

The analysis of bilateral Ukrainian-German trade and economic relations² affirms that Ukraine succeeded to achieve the needed results in cooperation with Germany, although we cannot state that the level of bilateral relations corresponds to the needs and potential of the Ukrainian economy. Therefore, Ukraine, in striving to stay its ground on the European market, has the following competitive advantages:

- high export and scientific-technological potential;
- advantageous geographical location;
- relatively low production costs.

At the same time, the reasons **that restrain the dynamic development** of the Ukrainian foreign trade with the EU countries may be divided into three groups:

² The mentioned 2001-2004 analysis was realized by the author according to his responsibilities of the Deputy Head of the Trade and Economic Mission at the Embassy of Ukraine in the FRG. The analysis resulted in preparation of more than 400 analytical and informational documents, which were subsequently sent to the Ministry of Economy and European Integration (reorganized into the Ministry of Economy of Ukraine), Ministry of Foreign Affairs of Ukraine, Cabinet of Ministers of Ukraine, other ministries and departments. At that, the objects of analysis was not only the bilateral trade and economic relations of Ukraine and the GDR, but also the relations of Ukraine and the countries of the EU and other countries of Central and Eastern Europe.

1. *Commonly-framed conditions*; the absence of the membership in the World Trade Organization (WTO), slow implementation of the principles of the Agreement on Partnership and Cooperation between Ukraine and the EU;

2. *Internal factors*; firstly, the impediments to VAT reimbursement to exporters, weak mechanisms of state support to exports, organizational and structural weakness of the Ukrainian producers of exportable goods;

3. *External factors*; here, we should focus on non-harmonized European and Ukrainian standards, insufficient informational support to exports in Ukraine, weak infrastructure of foreign-economic offices. Therefore, for comparison, if currently there are only 9 offices of Ukrainian enterprises functioning in the FRG, mainly in the services sphere, there are 140 Chinese offices functioning in Hamburg. The comparison with the German network of offices established by Poland, Hungary, Russian Federation and others is not in favour of Ukraine.

The analysis of the character, specifications and factors of foreign trade of Ukraine that reflects the competitive capabilities of the Ukrainian economy affirms **the insufficiency of foreign trade effectiveness**. This predominantly concerns the unfavourable structure of foreign trade from the standpoint of expansion of Ukrainian presence at the EU markets.

It is worth to be noted that the market of the European Union is liberal by its nature and approximately one-fourth of imports is conducted without imposition of the imports duty. This effect is, to some extent, strengthened by the operation of the Common System of Preferences. Ukraine can also use this customs regime.

Along with this, in certain, important for Ukrainian exporters, market segments, specifically in metallurgy, agricultural production and some others, the EU implements protectionist measures. Specifically, in agricultural production over 15 types of tariffs are used, that reach the level of 75%. Some qualitative restrictions in the form of quotas are used with regard to Ukrainian steel exporters (plane and profile rolling, tubes).

At the same time, there are no doubts about the fact that the development of foreign-trade cooperation of Ukraine with the EU countries is hampered by the absence of positive changes in the branch structure of the Ukrainian economy.

High-technology goods and services constitute a rather modest share in the Ukrainian exports to the European Union. At that, **the available advantages of formation of high-technology type of competitiveness are used insufficiently**. The competitiveness of the Ukrainian economy in foreign trade relations with the EU is mostly based on the price factors and comparative advantages of low labour costs, as well as exports of natural resources.

The development of trade and economic relations of Ukraine and the EU is restrained by the unsolved problems connected with the EU market admission regime for Ukrainian exporters. The unsettled problem of harmonizing the standards and certification procedure of Ukraine and the EU is one of the greatest

obstacles to organization of cooperation between industrial enterprises of Ukraine and the European countries, namely Germany, and thus, transition to a completely new state of trade relations between the states.

There still remain export quotas on the produce of ferrous metallurgy. The situation gets even more complicated due to imposition of the quota system on imports of ferrous metallurgy produce by the new EU member-countries. According to the data of the Ministry of Economy, if the issue remains unsettled, Ukraine can lose a share of the European steel rolling market. Losses can reach \$50 mln. per year [4].

During 2005, there were some consultations with participation of Ukrainian representatives and profile departments of the European Commission held according to the Ukraine-EU Action Plan. There was an expert working group created to work on questions of assessment of the effect produced by the EU enlargement on the trade between the EU and Ukraine. The following issues were discussed:

- The access of Ukrainian produce to markets of the enlarged EU (including metallurgical, chemical, pharmaceutical, equipment- and machine-building branches, agriculture, food industry, electrical power engineering);
- The influence on trade relations produced by introduction of technical barriers in trade, growing use of protectionist instruments (namely, antidumping measures) with regard to Ukrainian imports to the new EU members.

A step towards future development of trade and economic relations with the EU was the signing of the EU-Ukraine agreement on trade in some steel produce for 2005–2006 was [5], which provided for the following:

- To increase quotas on imports of Ukrainian planes and profile rolling to 980 thou. tons (earlier this quota was 740 thou. tons) by the end of 2005;
- To increase the level of quotas to 1004.5 thou. tons in 2006 given the actual rate of export duty on scrap of ferrous metals is 30 Euros per ton in Ukraine;
- To increase the quotas in proportion to reduction of the export duty on scrap of ferrous metals. Besides, in view of the complete annulling of this duty by Ukraine, the quota should be increased by 43%;
- To supply the EU free of quota with Ukrainian plane and profile-rolling used in the shipbuilding industry for construction and maintenance of drilling and production platforms, etc;
- To realize complete liberalization of trade in steel produce since the date of WTO membership acquisition.

This Agreement enhances the negotiating positions of Ukraine in the dialogue on the access of national metal production to the EU market. Besides, the positions secured in the Agreement, as well as the new level of cooperation between the Ukrainian industry and that of the EU, will help Ukraine negotiate on exports of scrap of ferrous metals on the way of Ukraine's movement to the WTO.

The existing tariff, non-tariff and technical trade restrictions remain to be the unsettled problem in the development of trade and economic relations between Ukraine and the EU. Among the leading groups of Ukrainian goods that are discriminated against in the European market are the metallurgical produce, tubes, chemical produce.

The basic instrument used to resist the expansion of the mentioned Ukrainian products on the European market are **the antidumping investigations** which, by definition of European experts, are **pure protectionist measures, whereas their procedure is far from being transparent.**

We cannot but overestimate the expectation that after Ukraine got the market economy status and joins the WTO, all the antidumping measures and quotas imposed on exports from it will be automatically eliminated. The practice of revolving trade conflicts among the members of the WTO proves their active use of antidumping instruments, subsidies, quotas, compensatory duties, etc. The membership does not mean complete elimination of import duties, only their settlement at a certain maximum level. Proof to this are the occasional mutual complaints of the EU and the USA about exports and imports of metallurgical produce, the EU and China disagreements about trade in textiles, or disagreement among the EU countries about trade in cattle meat. Yet, this happens even when all parties are the WTO members and have the market economy status.

In view of this, we can and should challenge the protectionist measures used by other countries against Ukrainian exports in the following ways:

firstly, by refining the bilateral agreements that touch upon limitations of Ukrainian supplies to the European market;

secondly, by implementing **preventive measures** with regard to introduction of new antidumping investigations by means of **providing information support to Ukrainian exporters and coordinating their actions on foreign markets**;

thirdly, the Ministry of Economy of Ukraine together with other ministries and departments should elaborate suggestions about initiation of counteractions and antidumping investigations with regard to supplies of certain products of European origin.

Unfortunately, the practice shows that political declarations of western public officials about deepening economic cooperation with Ukraine do not always coincide with harsh reality. This is true for those branches and enterprises where Ukraine has certain advantages and is highly competitive in the respec-

tive market segments. For example, our Western partners were very interested in the joint production of the military and transport plane AN-70. According to its specifications, it has no analogy in the world. However, the undertaking ended up with duplication of the active Ukrainian sample. (In fact, it turned out that not everything could be copied. That is why the twin-plane was never delivered to this world, and because of lacking financial resources, delivering it may take quite a time). However, when the Ukrainian side asked whether there would be the continuation of cooperation with Ukraine in this project, the public official of the level of the head of ministry answered that the respective public officials of the EU were primarily concerned with creating workplaces in their countries.

On the way European market, Ukrainian products come across many impediments, such as technical, sanitarian and other barriers. In particular, the trade in agricultural products with the EU countries is connected with the need of complying with high, sometimes superfluous standards. Certain agricultural raw materials **can be delivered only under special import licenses, while the trade is regulated by the request to comply with price parameters** established annually by the European Commission. This is important for Ukraine, especially in view of the fact that after the EU enlargement to the east, the terms of trade in Ukrainian agrarian produce on the European markets have good chances of becoming even more complicated.

Thus, a so-called «breakthrough» in the foreign trade of Ukraine on the European market and proliferation of cooperative relations can become the precondition for subsequent integration into the European structures, which can only be realized under condition of simultaneous introduction of the system of state assistance measures and protectionism, *on the one hand*, and radical expansion of Ukrainian presence on this market, *on the other*. It is unreasonable to consider the thesis about the expansion of presence of Ukrainian enterprises on the European market as ungrounded intentions. Thus, already at the end of 2001, the Trade and Economic Mission at the Embassy of Ukraine in the FRG, having monitored the German market and basic items of imports to Germany from Poland, Russian Federation, Slovakia, Hungary, and Czech Republic, informed the Ministry of Economy and European Integration of Ukraine, as well as correspondent regional departments, about the potential possibilities of increasing Ukrainian exports (by specific commodity groups) to FRG. As a result of measures taken by the Ministry of Economy of Ukraine, the volume of milk and processed milk products exported from Ukraine to Germany (according to Federal Statistics Department of the FRG) grew from \$4.5 mln. in 2001 to \$29.6 mln. in 2002, that is more than 6.5 times. Ukrainian exporters also took consideration of the recommendations developed by the Trade and Economic Mission, as well as conclusions regarding the potential niches that could be occupied at the German commodity elaborated by economic forums and cooperative exchanges organized by it. The 2002 yearly results (as well as German statistics) showed that 17 new items appeared in the structure of exports of finished products from Ukraine to Germany: «equipment for electrical appliances» (export volume of \$12.0 mln.), «means of railway transport» (\$7.9 mln.), «furniture» (\$8.2 mln.),

«bearings, gears, cogged transmissions» (\$5.7 mln.), «mining and building machines» (\$3.3 mln.), «sport equipment», «medical and orthopedic equipment», «automobile spare parts», etc. The exports of these commodities to Germany has been increasing since 2003.

Proceeding from the EU's concept of relationships with eastern and southern countries, the following directions of economic activity can be considered as the most perspective in terms of Ukraine's European integration:

1. Elaboration of the system of preferential trade relations and market openness;
2. Development of legal migration;
3. Integration into the transport, energetic and thermal-communication network, as well as European research space;
4. Implementation of protection instruments, promotion of investments, and integration into the global trade system.

Ukraine may consolidate its competitive advantages in the sectors sensitive to price competition, since new EU member-states experience an increase in production costs due to introduction of social and ecological standards.

We believe that the process of approaching the free trade regime between Ukraine and the EU should be gradual and asymmetric. The liberalization of the EU market should surpass the liberalization of imports to Ukraine. This is important for the Ukrainian economy, which is not ready yet for severe international rivalry.

Another no less important sector of foreign economic activity between the countries is investment cooperation. According to the analysis of foreign-economic cooperation of Germany with Poland, Slovakia, Czech Republic, and other countries of Eastern and Central Europe³, the volumes of foreign trade between the partner countries directly depend upon the investment capital attracted from the FRG. The accumulated German investments became the catalyst for rapid accumulation of trade contacts of the mentioned countries with Germany.

In 2004, the volume of FDIs in Ukraine grew by 24.8%, and in 2005, it exceeded \$8.3 bln. On October 1, 2005, their volume exceeded \$9.5 bln. (growth of 14% as of 1.01.2005), in particular, the EU countries accounted for 45% of invested capital [6]. As of January 1, 2006, the FDI inflows in Ukraine reached \$16 375. 2 mln., 73% of which from the EU countries [7].

In view of the considerably high potential and competitive advantages, we should note to the great interest of German business for the Ukrainian market. According to the data of 2004, Germany was the 4th largest investor into the Ukrainian economy (in 2002 it was only 7th), and in early October 2005, it was

³ See ².

the 5th. On October 1, 2005, the volume of FDIs from the FRG to Ukraine made \$628.2 mln. (6.6% of all FDIs to Ukraine). The number of economic subjects formed with German capital in Ukraine reaches 1116 enterprises. The privatization of *Kryvorizhstal* (\$4.8 bln.) on October 24, 2005, at open auction by the Mittal Steel Germany GmbH (Duisburg), Germany became the leading investor in the Ukrainian economy - as of 1.01.2006, the total value of German investments made \$5.5 bln., that is 33.6% of total capital invested in the Ukrainian economy. At the same time, during 2005, Ukraine invested in the economy of Germany only \$371.3 thou. (0.2% of total Ukrainian investments abroad). Moreover, there are only 6 economic subjects with Ukrainian capital operating in the FRG [8].

The following proves the relative effectiveness of German investments in Ukraine:

- The realization of the investment project in production of on-board cable networks for passenger cars by «Leoni AG» (FRG) in Stryj, Lviv region (project value is nearly €40 mln.; when brought to its maximal capacity, it will employ 5 thou. workers);
- The cooperation with *Skoda (Folkswagen AG)* on preparation of the second turn of the *Eurocar* factory in the Transcarpathian region. «VW Passat», «VW Bora», «VW Golf» and «VW Polo» are assembled at the factory.
- The cooperation with the German automobile-building companies *Daimler Chrysler* and *Opel AG*, which are involved in major-component assembly for passenger cars together with *Auto ZAZ* in Zaporizhzhya («Mercedes» and «Opel»);
- The realization of the investment project by *Metro AG* which deals with expansion of a small wholesale network in Ukraine, which will be oriented at the goods produced in Ukraine. The total value of investment in the given project makes almost \$100 mln.. In August 2003, the first wholesale trade centre in Kyiv – *Metro Cash&Carry* – was opened in Ukraine. In 2004, *Metro Cash&Carry* successfully realized its trade format in Kharkiv and Dnipropetrovsk and opened its second centre of wholesale trade in Kyiv. The third wholesale trade centre in Kyiv and two more in Odessa and Donetsk were opened in 2005.

However, when facing the problems at the Ukrainian market, German businesspeople suggest that there should be the mechanism in the Ukraine's system of executive power that would provide for an unbiased and objective expertise of investment activity and assisted foreign investors in solving their specific problems.

In our opinion, the best way to do it would be to implement the experience of the countries of Central and Eastern Europe, specifically of Poland and Slovakia, where self-supporting agencies for foreign investments are created and

operating. Their principle task is to provide a complex of services to foreign investors intending to realize or realizing projects in the country.

For successful attraction of foreign investments and trade and economic cooperation, the level of contract and payment discipline of the partners is of great importance. In fact, this is especially true for the Ukrainian part. Unfortunately, there are several cases of irresponsibility of the Ukrainian enterprises. These facts abound, which spoils the investment image of Ukraine, as well as slows down the process of European integration.

The deepening of foreign economic relations from the standpoint of Euro-integration in the short- to middle-term should rest upon the principles of promoting the national interests of Ukraine and using its actual and potential political and economic levers for this purpose. In our relations with the FRG, the national interests of Ukraine can be characterized as follows:

1. To ensure Germany's support of Ukraine's strategic course of the integration to the European Community, in particular, by implementing all clauses of the Agreement on Partnership and Cooperation, forming a free trade area, and consolidating the contractual and legal base of the EU-Ukraine relations;

2. To get Germany's assistance to Ukrainian efforts on its way to integration into the European and world economic structures, primarily joining the WTO, by liquidating existing tariff, non-tariff and technical barriers for Ukrainian exports and eliminating the discriminative trade practice, especially in the sphere of anti-dumping investigations;

3. To form Germany's positive position regarding Ukraine in the international financial organizations for the purposes of external debt restructuring on acceptable terms, getting financial and technical assistance to realize structural reforms, support the balance of payments, and overcome the effects of Chernobyl accident;

4. To attract financial, technological and scientific potential of the FRG in order to intensify economic reforms, enter the world system of labour division, as well as increase the competitiveness of Ukrainian production;

5. To expand cooperation between the two countries and to rationalize the Ukrainian-German trade by means of increasing Ukrainian exports of products of high degree of reprocessing and optimizing imports from Germany by increasing the share of investment goods and reducing the negative trade balance of Ukraine;

6. To improve investment cooperation by drawing leading German concerns to close cooperation with Ukraine, to use their influence and authority in order to form the positive attitude of German small- and middle-business towards Ukrainian market so that to increase private investment, as well as create pre-conditions for amalgamation of the German and Ukrainian banking, financial and industrial capital;

7. To consolidate Ukrainian-German economic cooperation on the regional level by developing partner relations between German federal lands and Ukrainian regions, as well as twin cities, within the frames of common use of trade potential of the pre-Danube countries, by attracting Germany to development of transit transport corridors located in Ukraine;

8. To use and realize rationally and in full the projects of technical, economic and consultative assistance elaborated for our country by the government of the FRG.

For the executive power of Ukraine, the basic instruments of realization of the Ukrainian interests with regard to its Euro-integration in the nearest perspective could become:

- *the information and analytical support* to foreign economic activity, which in particular should include the monitoring of German commodity markets and elaboration of recommendations for raising of Ukrainian commodity exports, the realization of advertising, imaging, and propagandist campaigns to popularize the development of economic relations with Ukraine, the assistance in realizing the perspective plan of participation in exhibition activities in Germany;
- *elaboration of incentives* to raise the presence of the Ukrainian economic subjects on the German market by means of introducing the system of credit support to Ukrainian exports, promoting the penetration of the German market by the Ukrainian capital, as well as creating joint entrepreneurial, banking and insurance structures;
- *introduction of complex branch programmes* to stimulate Ukrainian exports, reduce the power-intensity of production, encourage to form big national financial and economic groups, and provide political and economic support to development of foreign economic activity.

The aforementioned problems in the sphere of foreign economic cooperation of Ukraine are not only the specific issues to be realized in the future, they are the independent objects for scientific research. The effectiveness of their solution will determine whether Ukraine will achieve its aim of successful integration into the European economic structures.

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