

## Organizing Regulatory Convergence Outside the EU: Setting Policy-Specific Conditionality and Building Domestic Capacities

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WORKING PAPER

**KFG**  
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# ORGANIZING REGULATORY CONVERGENCE OUTSIDE THE EU

Setting Policy-Specific Conditionality and Building  
Domestic Capacities

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Julia Langbein

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# ORGANIZING REGULATORY CONVERGENCE OUTSIDE THE EU

## SETTING POLICY-SPECIFIC CONDITIONALITY AND BUILDING DOMESTIC CAPACITIES

**Julia Langbein**

### Abstract

Why is regulatory convergence towards EU rules more successful in some policy fields than in others within one EU neighboring country? By comparing Ukraine's convergence towards EU rules in the field of shareholders' rights and technical standards, I challenge prominent explanations for policy change outside the EU that emphasize misfit and adaptational costs, the institutionalization of EU rules or policy-specific conditionality. In order to deal with the shortcomings of these explanations, it is necessary to disaggregate incentives and capacities of various domestic actors within the particular policy fields. I argue that regulatory convergence in EU neighboring countries is more likely if external actors combine the application of policy-specific conditionality, such as access to the European market, with multiplex capacity-building measures that diversify demand among domestic state regulators and firms and empower them to make their claims.

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## 1. Introduction<sup>1</sup>

During the past two decades students of European integration have dealt extensively with the question how European Union (EU) member states or candidate countries adapt to EU rules. However, we still know relatively little about the specific factors driving (non-)convergence towards EU rules in EU neighboring countries (ENCs) (Schimmelfennig 2009; Börzel 2010). This paper seeks to fill this theoretical and empirical gap by investigating why regulatory convergence is more successful in some policy fields than in others in the ENCs.

Drawing on a detailed analysis of post-Soviet Ukraine from the mid-1990s onwards,<sup>2</sup> this paper advances a “backward-looking research design” (Scharpf 1997). I begin with mapping variation on the dependent variable and subsequently trace factors accounting for cross-policy variation in regulatory convergence towards EU rules, i.e. the decreasing distance of national regulatory practices and governance arrangements towards the EU’s regulatory model applied in the single market.<sup>3</sup> More precisely, I will examine regulatory convergence along two dimensions: rule adoption, i.e. the transposition of EU legislation into national law, and the presence of forms of public-private governance arrangements based on internal rules that correspond to formal EU rules.<sup>4</sup> The latter dimension is crucial since interventionist forms of regulation through public actors, as practised in most ENCs during state socialism, no longer constitute the most frequent governance arrangements within the EU single market or beyond. Private actors increasingly participate in the setting, monitoring and enforcement of rules and standards (Héritier 2002; Jordana/Levi-Faur 2004; Cafaggi 2006). Examining the existence of public-private governance arrangements that correspond to EU rules allows me to assess the progress achieved in particular policy fields in a more nuanced way given that the adoption of EU rules rarely lead to a straight implementation in the ENCs (Freyburg et al. 2009; Langbein/Wolczuk 2011).

The comparison will focus on two market-related policy fields with diverse outcomes in terms of regulatory convergence: shareholders’ rights and technical standards. In the field of shareholders’ rights, Ukraine transferred respective EU rules to its legal system in 2008. Further, the corresponding governance arrangements needed for the enforcement of these rules, i.e. the establishment of a Securities Commission and a stock exchange which shall cooperate in monitoring the application of shareholders’ rights, have been set

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2 This starting point for the analysis was chosen because Ukraine and the EU formally signed their Partnership and Cooperation Agreement (PCA), the first official agreement between both parties to envisage the approximation of Ukrainian legislation to the EU *acquis*, in 1994. The PCA came into force only in 1998 as it took EU member states four years to ratify the document. Notwithstanding, Ukraine’s then President Leonid Kuchma announced EU membership as a strategic goal as early as 1996 in order to accelerate ratification (Wolczuk 2004).

3 This definition of regulatory convergence corresponds to what Heichel et al. have termed “delta-convergence”, which describes a “decreasing distance of policies towards an exemplary model, for example, a model promoted by an international organization or a frontrunner country” (Heichel et al. 2005: 833).

4 For reasons of scope, I do not analyze two other dimensions of regulatory convergence, namely whether public and private actors possess regulatory capacities needed for the regulation of the policy field and rule implementation (for more on these issues, see Langbein 2010).

up. By contrast, in the field of technical standards, which entails the setting, monitoring and enforcement of standards for industrial products, only some selective adoption of EU rules took place in the time period under scrutiny. Furthermore, the corresponding governance arrangements have only been partially set up. Ukraine's state standardization body, the State Department for Technical Regulation and Consumer Policy (DSSU), is still pursuing most of the regulatory tasks relating to technical standards, while EU rules prescribe the cooperation of state regulators, private certifiers and firms for regulating technical standards.

So far, the literature on policy change in the European neighborhood has largely ignored cross-policy variation within one country and rather focused on cross-country comparisons. In this respect, authors usually distinguish between "most-likely" and "least-likely" cases for convergence towards EU rules in the region. Among the Eastern neighborhood countries Ukraine, Moldova and Georgia are widely considered to be the most willing EU partners given their membership aspirations and highly asymmetric relationship with the EU. By contrast, Armenia and Azerbaijan are considered to be more resistant to convergence towards EU rules (Börzel 2010; Franke et al. 2010; Gawrich et al. 2010). Yet, macro-level comparisons overlook a great deal of cross-policy variation occurring even within assumed "frontrunners" among the ENCs, such as Ukraine, thereby making the distinction between most-likely and least-likely cases for convergence with EU rules in terms of countries obsolete.

Having said this, some recent studies have taken a cross-sectoral approach and focus on meso-level factors to explain diverse outcomes in terms of regulatory convergence. The most prominent explanations in this respect concern 1) various degrees of misfit between national and European policies resulting in different adaptational costs for domestic actors (Börzel 2010), 2) the degree of institutionalization of a particular policy in terms of precision, legally binding rules and legitimacy (Lavenex/Schimmelfennig 2009; Freyburg et al. 2009), and 3) different degrees of policy-specific conditionality, i.e. specific rewards tied to convergence within a particular policy field (Gawrich et al. 2010; Langbein/Wolczuk 2011; Ademmer/Börzel forthcoming). This paper challenges these existing approaches in order to explain cross-policy variation within one EU neighbor. I will show that these approaches cannot sufficiently explain the variation observed in the Ukrainian case as they are constant across the two cases or because their predictions are at odds with the observed outcomes.

By deploying qualitative methods of process tracing, this paper advances a different argument. I show that policy-specific conditionality is, indeed, necessary to trigger at least partial regulatory convergence by increasing the incentives of domestic actors to support policy change. At the same time, the form of capacity-building measures has a decisive impact on the level of regulatory convergence as it shapes the capacities of domestic actors to make their claims. I draw upon Bruszt and McDermott (2009) and distinguish between multiplex and dyadic forms of capacity-building measures. Multiplex forms of capacity-building measures provided by external actors target multiple public and private domestic actors who are needed to demand, set and enforce externally promoted rules and norms in a particular policy sector. These multiple domestic actors can include government agencies, regulatory authorities, business associations, firms or experts. By contrast, dyadic forms of capacity-building measures only occur between two actors, such as the target government and an international organization. Against this backdrop, I argue that the likelihood of strong regulatory convergence increases if policy-specific conditionality is flanked by multiplex capacity-building measures. The combined effects of these mechanisms increase the incentives and capacities of domestic

public *and* private actors to support policy change. Yet, if policy-specific conditionality is only flanked by dyadic capacity-building that targets public authorities, but neglects private actors such as firms and their business associations, convergence towards EU rules is likely to reach lower levels.

This argument dovetails with the findings of students of institutional change and regulatory governance. The first group argues that market access alone, here defined as a form of conditionality, does not suffice to foster institutional development (Rodrik et al. 2004; Bruszt/McDermott 2009). As mentioned earlier, the latter stresses that international markets, including the European single market, are based on governance arrangements in which public and private actors cooperate in the setting, monitoring and enforcement of rules and norms (Héritier 2002; Jordana/Levi-Faur 2004; Cafaggi 2006). Consequently, any capacity-building initiated by external actors needs to target both public and private domestic actors as both are needed for the governance of markets.

The paper proceeds in the following steps. Section two maps the divergent outcomes in the two policy fields under scrutiny. I show that despite equally high misfit between national and EU rules in the early 1990s, regulatory convergence towards EU rules has progressed more successfully with regard to Ukraine's shareholders' rights than with regard to technical standards. Section three presents the puzzle in more detail. I show that prominent explanations for differential policy change cannot explain the observed variation. Using insights from the existing literature on institutional change in the context of EU enlargement and the European Neighbourhood Policy (ENP), I hypothesize that the combined effects of policy-specific conditionality and the type of external capacity-building shape domestic incentives and capacities for policy change and account for cross-policy variation in regulatory convergence. Sections four and five present my empirical data: Based on an in-depth analysis of primary documents, expert interviews and secondary literature, I trace the process leading to various policy changes in Ukraine's shareholders' rights and technical standards for over a decade. Section six discusses alternative explanations. Finally, the conclusion summarizes the major findings and key arguments and discusses implications for policy change in the European neighborhood.

## **2. Mapping Divergent Outcomes: Initial Misfit and Policy Change in Ukraine's Shareholders' Rights and Technical Standards**

In the mid-1990s, the misfit between Ukrainian and EU rules in the fields of shareholders' rights and technical standards in terms of rule adoption and the presence of public-private governance arrangements was high:<sup>5</sup>

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<sup>5</sup> The initial misfit between Ukrainian and EU rules and the diverse outcomes in the fields of shareholders' rights and technical standards are discussed in-depth elsewhere (Langbein 2010).



## 2.1 *Shareholders' Rights*

In the mid-1990s, Ukraine did not have any regulations that allowed shareholders to raise their “voice”, i.e. the ability to express their interests guaranteed through the transparent flow of information and disclosure policies, as prescribed by respective EU directives.<sup>6</sup> Further, shareholders lacked the right to “exit”, i.e. to “liquidate their holdings by selling shares in case they are not satisfied with the way a company is managed” (Pistor 2000: 72) through share redemption at the market price. With regard to public-private governance arrangements, securities commissions and stock exchanges are defined as crucial regulators safeguarding the protection of shareholders’ rights on the European single market (ESME 2007). Yet, none of the Ukrainian laws foresaw the establishment of a regulatory body that would initiate, implement and monitor compliance (EBRD 1999). Furthermore, none of the Ukrainian laws at that time required stock exchanges to introduce listing requirements for the admission of their companies (Okunev 2005). In 1994, Ukraine thus lacked forms of public-private governance that would monitor or enforce the protection of shares. Unsurprisingly, the earliest available general assessment of corporate governance regulation in Ukraine found “very low compliance” with international standards (EBRD 1999).

Since then, regulatory convergence has made significant progress in the field of shareholders’ rights. As far as the adoption of EU rules by the Ukrainian parliament is concerned, the legislative changes pursued in the field of shareholders’ rights in 2008 resulted in full compliance with EU rules (European Commission 2009, 2010). Further, in the field of shareholders’ rights public-private governance arrangements exist as prescribed by respective EU directives. Not only did Ukraine establish a Securities Commission in 1996, which has the task to adopt and enforce shareholders’ rights, but, in the same year, a market-owned stock exchange began to operate, which is needed to introduce listing requirements and monitor the application of the market price when shares are traded (European Commission 2004).

## 2.2 *Technical Standards*

In the mid-1990s, Ukraine’s public authorities required mandatory technical standards for producers of industrial products due to the country’s Soviet past. In contrast, on the European single market, public authorities were supposed to solely develop mandatory requirements regarding the safety and quality of industrial products, while the standards for technical solutions to meet these requirements were voluntary. Furthermore, the Ukrainian system of technical standards was governed by a centralized regulatory body, the DSSU, which was in charge of all regulatory tasks, ranging from standardization, accreditation, conformity assessment to market surveillance in 1994 (Palianytsia 2005). The monopoly over regulatory power contradicted the decentralized governance arrangements applied in the EU, which prescribed that the regulatory tasks shall be distributed among different organizations, both public and private (AFNOR-

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<sup>6</sup> Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing; Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listings and on information to be published on those securities; Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids; Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

SWEDAC-UNI Consortium 2004; European Commission 2008; UEPLAC 2008). Hence, public regulation through the DSSU was the main form of governance in the field of technical standards in Ukraine in the mid-1990s. Manufacturers did not have any regulatory responsibilities. On the European single market, certain regulatory tasks are, however, delegated to private actors, i.e. manufacturers who are in charge of enforcing specific safety and quality requirements before the product is placed on the market. Public authorities only carry out sample inspections after the products are placed on the market.

Despite an equally high misfit as in the field of shareholders' rights, Ukraine has only yet reached partial convergence in terms of rule adoption and the presence of governance arrangements in the field of technical standards. In 2001 and 2010, Ukraine adopted some laws which were supposed to increase compliance with EU rules by decentralizing regulatory power in the field of technical standards. However, existing national legislation either contradicts these laws or the adopted laws have not come into effect due to the lack of secondary legislation needed for the implementation of these laws. The regulatory authority DSSU is still in charge of setting, enforcing and monitoring technical standards, even though EU rules prescribe the distribution of these tasks across different public authorities or private actors. Ukraine has only established a separate public authority for the accreditation of conformity assessment bodies, which is the National Agency for Accreditation (NAAU).

As the next section will show, prominent approaches to explain cross-policy variation in regulatory convergence towards EU rules in the European neighborhood cannot account for the diverse outcomes in Ukraine's shareholders' rights and technical standards.

### **3. Puzzling Policy Change in Ukraine**

Early research on the EU's neighborhood considered policy change in the region as being doomed to failure due to the absence of membership conditionality, which is conceived of being the key mechanism the EU employed to foster policy change in the Central and East European candidate countries (Kelley 2006; Schimmelfennig/Scholtz 2008). Yet, even across and within candidate countries convergence with EU rules varied despite the reward of EU membership (Jacoby 2004; Epstein 2008). Consequently, more recent accounts on policy change beyond the EU have called for a more nuanced analysis to explain the diverse domestic changes happening beyond the EU's borders (Lavenex/Schimmelfennig 2009; Freyburg et al. 2009; Börzel 2010; Langbein/Wolczuk 2011).

#### **3.1 *Misfit and Adaptational Costs***

Drawing upon the Europeanization scholarship dealing with EU member states and candidate countries, some authors emphasize misfit between national and EU rules and adaptational costs for domestic actors to explain policy change in the ENC (Börzel 2010). While similar degrees of misfit do not necessarily result in similar outcomes, the presence of veto players and their adaptational costs are a crucial mediating

variable for domestic change (see also Börzel/Risse 2003; Dimitrova/Dragneva 2010). If the adaptational pressures, which emanate from variation in national and EU rules, are congruent with the preferences and capacities of domestic veto players, EU rules do not represent a constraint, but rather an opportunity and require low adaptational costs (Börzel/Risse 2003; Börzel 2010). Therefore, it can be hypothesized that the higher the adaptational costs for domestic actors, the less likely that convergence with EU rules will reach high levels, and vice versa.

In the context of Ukraine's privatization of state-owned enterprises, which took place largely throughout the 1990s, transparent shareholders' rights and disclosure policies would have caused high adaptational costs for Ukrainian businessmen. Their dominant interest was not to attract investments, but to seize control of assets, which was much easier in the absence of shareholders' rights (see also Heinrich et al. 2007). Ukrainian businessmen maintained close ties with legislators and state officials, preventing any support for policy change from these groups. As for technical standards, the EU introduced a massive reduction of import tariffs for Ukrainian machinery through the General System of Preferences (GSP) in 1993. Due to the existence of alternative markets in the former Soviet Republics and financial constraints in the context of Ukraine's economic crisis throughout the 1990s, the costs of convergence still exceeded the benefits of access to the EU market. Further, the centralized regulatory body, the DSSU, was not willing to hand over certain tasks to other public bodies or private entities. The bureaucrats in the Ministries of Economy and Industrial Policy feared the costs of re-organizing a whole new institutional framework for technical regulation in the absence of pro-reform constituencies. Finally, the Ukrainian parliament was infiltrated with representatives of Ukraine's heavy machinery industry and was therefore hardly interested in initiating legislative reforms (for a detailed analysis, see Langbein 2010).

Summing up, in Ukraine's shareholders' rights and technical standards, the adaptational pressures resulting from the initial "misfit" between national and EU rules created equally high adaptational costs for domestic state regulators and firms in the mid-1990s.<sup>7</sup> Explanations emphasizing initial misfit and adaptational costs do thus not solve the puzzle why Ukraine has so far achieved better results in terms of regulatory convergence towards EU rules in shareholders' rights than in technical standards.

### 3.2 *Institutionalization of EU Rules*

Lavenex and Schimmelfennig (2009) argue that different levels of institutionalization of EU rules can account for differential policy change in the ENCs. The stronger external rules are institutionalized, i.e. precise, legally binding and legitimate, the more likely that third countries will adopt and implement these rules (Lavenex/Schimmelfennig 2009: 802f; 808). From this perspective, convergence in technical standards

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<sup>7</sup> The preferences of Ukrainian consumers are not analyzed since civil society movements, for example in the form of consumer organizations, are not well developed and passive in post-communist states, and even less so in post-Soviet countries like Ukraine (Howard 2003; McFaul 2002). Even the mass demonstrations during Ukraine's so-called "Orange Revolution" in 2004-2005 can be seen as the result of spontaneous protests against the political regime rather than the product of an organized and well-established civil society (Melnykovska/Schweickert 2008).

should have reached higher levels since EU rules are more institutionalized in that area than in shareholders' rights: Both fields involve an *acquis* and their regulation is based on directives, regulations and harmonization. However, in the case of technical standards, the European Commission and Ukraine have in addition agreed on a separate Action Plan for the Free Movement of Industrial Products in 2005 (European Commission 2006). This separate Action Plan outlines a schedule for domestic policy reforms and lists the EU directives that Ukraine must comply with in order to achieve regulatory convergence. In technical standards, EU requirements are thus formulated more precisely than in shareholders' rights, where a separate Action Plan does not exist.

When considering the legitimacy of EU rules, the number of infringement cases being opened by the European Commission against EU member states as well as the international acknowledgment of European rules and standards are good indicators. From this perspective, too, EU technical standards are more institutionalized than EU shareholders' rights. While EU technical standards and shareholders' rights are internationally acknowledged standards, legitimacy within the EU is higher in technical standards than in shareholders' rights considering that infringements against EU member states occur more often in corporate law, which includes shareholders' rights, than in trade related fields such as technical standards (Börzel et al. 2011). These findings would suggest that third countries like Ukraine align more easily with highly institutionalized EU technical standards than with less institutionalized EU shareholders' rights. The theoretical expectation is, however, at odds with the real outcomes as discussed in section 2 and therefore cannot explain the Ukrainian puzzle.

### 3.3 *Policy-Specific Conditionality*

Finally, some scholars underline that policy-specific conditionality explains policy change in the ENCs. In the absence of EU membership conditionality in the ENCs, the EU and other international actors tie other rewards to convergence with EU rules. For instance, Vachudova stresses that the "promise of greater participation in the internal market will be the catalyst for any reform momentum that develops within the ENC process" (2007: 98). Gawrich et al. (2010) detail that access to the EU single market as well as international markets is likely to trigger convergence towards EU rules in fields of economic regulation, while visa facilitation is likely to increase domestic incentives in the ENC for convergence in Justice and Home Affairs (see also Langbein/Wolczuk 2011; Ademmer/Börzel forthcoming). These expectations dovetail with students of international political economy, who would expect that countries are more likely to take on (even costly) international rules and standards where markets are liberalized (Vogel/Kagan 2004). Accordingly, sectoral variation in market liberalization is expected to explain differential policy change.

However, the economic incentives tied to regulatory convergence in Ukraine's shareholders' rights and technical standards are equally high and cannot sufficiently explain cross-policy variation. In both fields, convergence towards EU rules would facilitate immediate access to the European and international markets. Ukrainian firms should thus have great incentives to take on European norms and standards: With regard to shareholders' rights, the economic incentive that is at stake for Ukrainian firms amounts to access to European and international capital markets and investments. EU directives lay down that stock

exchanges must adopt the protection of shareholders' rights as a requirement for being listed. Accordingly, stock exchanges in London or Frankfurt, and more recently in Warsaw, refer to transparency, disclosure practices and fair treatment of shareholders as listing requirements (see e.g. Warsaw Stock Exchange 2007; London Stock Exchange 2010). Similar requirements hold for other international stock exchanges. In the case of shareholders' rights, Ukrainian firms and state agencies can thus expect increased investments from the capitalization of assets on European capital markets in exchange for convergence with EU shareholders' rights.

The situation in technical standards is similar: The EU market has been relatively open for Ukrainian machinery, which is the most affected industrial sector of convergence in technical standards. Since 1993, the EU has been offering Ukraine's machinery sector unilateral trade concessions through the so-called Generalised System of Preferences. In this context, the EU set a considerably lower tariff for Ukrainian machinery and equipment than for other product groups, such as agriculture. In addition, EU technical standards are internationally acknowledged standards. If Ukrainian producers comply with these standards, they will also have access to international markets.

Thus, policy-specific conditionality exists in both policy fields under scrutiny and can be expected to be a necessary condition for at least some progress with regard to regulatory convergence, despite high initial misfit and adaptational costs. The argument does not, however, explain why convergence in Ukraine's shareholders' rights progresses more successfully than in technical standards.

### 3.4 *Multiplex and Dyadic Capacity-Building*

In order to explain cross-policy variation, this paper builds upon the argument that capacity-building measures provided by external donors in the form of assistance and the inclusion of local actors in transnational networks are likely to shape policy change in the ENC (Börzel 2010; Gawrich et al. 2010; Langbein 2010). Assistance encompasses the externally sponsored transfer of knowledge, skills and financial resources through seminars, trainings or exchange of experts and empowers domestic actors to build or change their regulatory institutions (Andonova 2003; Jacoby 2006). The participation in regulatory networks facilitates lesson-drawing through which domestic regulators, who have become dissatisfied with a particular situation at home, may become acquainted with new solutions to domestic policy problems as a result of the interaction with their peers in regulatory networks (Rose 1991; Slaughter 2004). With regard to dynamics in the European neighborhood, Freyburg et al. (2009) argue that increasing participation in regulatory networks that promote the transfer of EU rules is likely to increase the adaptation of EU rules.

Students of Europeanization have already underscored the importance of assistance and lesson-drawing through regulatory networks in the context of EU enlargement. However, they have not acknowledged the dyadic or multiplex nature of these mechanisms and therefore ignore the root cause for differential domestic empowerment for institution building in the context of accession and non-accession countries. According to Bruszt and McDermott (2009), interactions between external and domestic actors can be "dyadic" and only occur between two actors, such as the target government and an international organization.

Interactions can also be “multiplex”, however, and involve and empower more state and non-state actors, like domestic and foreign firms, business associations, experts and regulatory bodies.

Drawing upon Bruszt and McDermott’s line of argumentation, I hypothesize that assistance provided by external actors is particularly effective in fostering domestic change if interactions are multiplex, i.e. if knowledge is disseminated to both public and private actors. External donors, foreign companies and business associations can diversify the range of non-state actors by providing on-site training for domestic companies (Gereffi/Wyman 1990). Further, they can organize meetings for domestic business associations and their foreign counterparts to coordinate and bind interests for lobbying and monitoring activities (Yakova 2005/06). I further hypothesize that the participation of domestic actors in regulatory networks is particularly effective if it facilitates lesson-drawing of both private and public actors.

The following two sections explore policy change in the fields of shareholders’ rights and technical standards in Ukraine from the mid-1990s onwards on the basis of process tracing. Special attention will be given to the combined effects of policy-specific conditionality and capacity-building measures on the incentives and capacities of domestic state regulators and firms to promote or hamper regulatory convergence towards EU rules in the two policy fields.

#### **4. Policy Change in Ukraine’s Shareholders’ Rights**

The privatization of state-owned assets dominated large slices of Ukraine’s political and economic life from the early 1990s onwards. At that time, Ukraine’s securities trading business was not a flourishing sector given that 67 percent of the newly privatized companies had not opted to trade their shares publicly on stock markets (SSMSC 1998). As mentioned earlier, Ukrainian businessmen were first and foremost interested in acquiring assets rather than capitalizing them. Back then, the benefits of maintaining messy ownership structures and weak protection of shareholders outweighed the reward of market access despite the fact that the protection of shareholders’ rights was and is an important requirement in order to get listed on European stock exchanges.

Notwithstanding domestic opposition to reforms of Ukraine’s shareholders’ rights, international donors became active promoters of change. In this respect, the United States Agency for International Development (USAID) sought to create domestic demand among Ukrainian brokers and dealers through various training sessions and seminars. This group soon understood that the image of Ukraine’s market must improve in order to attract more capitalization among Ukrainian companies as well as foreign investment. For Ukrainian brokers and dealers, the policy-specific conditionality that tied the protection of shareholders’ rights to access to the European and other international financial markets created a strong incentive for the support of respective domestic reforms. In order to improve the organization of these pro-reform forces, USAID initiated the creation of the *Persha Fondova Torghova Systema* (PFTS) Association, a self-regulatory organization for securities traders in Ukraine, in 1996.<sup>8</sup> In the same year, USAID provided the PFTS Association

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<sup>8</sup> Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November 2008.

with the technical assistance to create the PFTS Trading System, which was the first market-owned stock exchange in Ukraine. Thanks to the PFTS' modern technology and a slow but gradual re-orientation among some of Ukraine's Joint-Stock Companies (JSCs) towards the capitalization of their assets, PFTS quickly became the most important Ukrainian stock exchange.<sup>9</sup> In 1998, the PFTS accounted for 65 percent of the market (SSMSC 1998).

As far as the public side for the regulation of shareholders' rights is concerned, USAID and the International Finance Cooperation (IFC) criticized the lack of stock market regulation in Ukraine, leaving this task very much to the market which resulted in illegal takeovers and share dilution.<sup>10</sup> As mentioned earlier, parts of Ukraine's state administration profited from the lack of regulation and subsequent rent-seeking. However, as a result of the economic downturn that hit the country during the 1990s, the government changed its position and began to support the creation of regulatory arrangements aimed at attracting foreign investment and creating a flourishing Ukrainian capital market. In 1996, the Ukrainian government established the Securities and Stock Market State Commission (SSMSC) as an independent agency under the President of Ukraine, accountable to the Ukrainian parliament.

Capacity-building measures by external actors to promote regulatory convergence in Ukraine's shareholders' rights became increasingly multiplex. Since its establishment, Ukraine's Securities Commission SSMSC has been the recipient of wide-ranging external assistance and its members quickly started to participate in transnational networks. As early as 1996, USAID and the IFC prompted SSMSC's membership in the International Organisation of Securities Commissions (IOSCO). The IOSCO develops numerous regulatory principles for Securities Commissions, for example that the owners of securities in a company should be treated fairly according to the Principles of Corporate Governance of the Organization for Economic Co-operation and Development (OECD). The SSMSC's membership in the IOSCO has not only facilitated exchange and knowledge transfer between Ukrainian and international securities' regulators, but has also increased the capacities of the SSMSC's staff to draft legislation in accordance with international and European standards (SSMSC 2000).<sup>11</sup>

Another priority of external capacity-building concerned the drafting of a Joint-Stock Company Law (JSC Law), which should prescribe the protection of shareholders' rights according to European and international best practice. External donors were particularly keen to ensure "voice" for all shareholders. The JSC Law should lay down detailed prescriptions on the information policy regarding general shareholders' meetings and financial reports. In terms of "exit", donors wanted to make sure that the law would prescribe share redemption at market prices in cases of mergers or takeovers, and transparent disclosure policies concerning changes in ownership in order to protect minority shareholders from share dilution.<sup>12</sup>

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9 Interview with staff member from Persha Fondova Rynka, Kyiv, 25 September 2009; Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009.

10 Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November 2008; Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009; Interview with Ukrainian expert on corporate governance (C), Kyiv, 22 October 2009.

11 Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November 2008; Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009.

12 Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November



In 1998, a “Corporate Governance Task Force” was created to oversee the drafting of the law. The task force included various domestic private and public actors in support of regulatory convergence who had come into being or were empowered to make their claims as a result of the multiplex capacity-building measures initiated by international donors. The Head of the SSMSC chaired this task force. Apart from SSMSC staff members, the task force also comprised Ukrainian lawyers, a PFTS representative, and experts working for USAID, the IFC, as well as for diverse EU programs (Dragneva/Dimitrova 2010).<sup>13</sup> At first, European experts provided the IFC with respective EU directives, which were then translated into Ukrainian, with a view to their serving as a template for the draft law. On that basis, SSMSC began drafting a JSC Law. A Kiev-based expert working for an international donor organization explains why the use of EU rules as a template for Ukraine’s shareholders’ rights did not contradict the interests of the IFC or USAID:

“The EU market is Ukraine’s closest market. Moreover, Ukraine committed itself to approximate its legislation to the EU *acquis* in the context of the PCA (Partnership and Cooperation Agreement; J. L.). Despite the fact that the organization I am working for is not European, we still try to provide advice that does not contradict EU rules or European practices since we believe that European integration is in Ukraine’s biggest interest.”<sup>14</sup>

While external donors placed more emphasis on the legal protection of “voice” and “exit”, the PFTS Association was also interested in abolishing the legal form of Closed Joint-Stock Companies (CJSCs) in order to increase transparency and the number of official transactions. In this respect, the PFTS suggested that only public JSCs and companies with limited liabilities shall be allowed to exist. This would force an increasing number of CJSCs to publicly trade their shares on the stock market and respect the rights of shareholders in terms of “voice” and “exit”.<sup>15</sup> By the end of 1999, the SSMSC presented the first draft law. After having received the approval of the Task Force, the draft law was submitted to the Ukrainian parliament. In 2001, the JSC Draft Law was, however, rejected by the legislator since managers and owners of CJSCs dominated the Ukrainian parliament (Dragneva/Dimitrova 2010). They were still more interested in maintaining full control of their companies than in capitalizing their assets on international markets. At that time, the reward of market access was thus not strong enough to overcome domestic opposition to regulatory convergence among large parts of Ukrainian business and state bureaucracy.

The recovery of Ukraine’s economy from 2000 onwards, however, increased the costs of non-convergence for various Ukrainian businessmen and greatly facilitated the promotion of shareholders’ rights through international donors. Slowly but surely, a small yet increasing number of Ukrainian company owners started to break with their image of “roving bandits” who had stolen state assets during Ukraine’s early transition period without a thought for social costs. Following Mancur Olson (2000), they turned into so-called “stationary bandits”, who are interested in protecting their property rights and therefore seek to contribute to welfare and growth by improving the business climate. As a result, these “stationary bandits” understood

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2008; Interview with Ukrainian expert on corporate governance (B), Kyiv, 13 October 2009.

13 Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November 2008.

14 Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009.

15 Interview with staff member from Persha Fondova Rynka, Kyiv, 25 September 2009; Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009.



that the violation of shareholders' rights would harm their efforts to capitalize assets on international markets (see also Puglisi 2008; Melnykovska/ Schweickert 2008).

International donors anchored the growing interest of Ukrainian firms in international capital markets by setting up training programs and further initiatives to develop Ukraine's corporate law. In 2003, following an initiative by the IFC, ten Ukrainian companies from the energy, telecommunications and banking sectors as well as Western consultancy firms operating in Ukraine began to promote self-regulation regarding the protection of shareholders' rights. They approached the SSMSC with a request to develop voluntary Corporate Governance Principles on the basis of the OECD Code of Corporate Governance (Mycyk et al. 2007; Onyschuk-Morozov/Ryabota 2008). IFC experts helped SSMSC staff to familiarize themselves with the OECD Code and respective codes in EU member states.<sup>16</sup> Within a few months, the SSMSC issued Ukraine's Corporate Governance Principles, which were subsequently adopted by the ten companies. Their motivations for supporting voluntary Corporate Governance Principles were varied: While some were interested in improving their reputation among international donors, others were interested in promoting the protection of shareholders' rights in the face of constant violations happening on the Ukrainian market.

From the mid-2000s onwards, this voluntary commitment to the protection of shareholders' rights spread beyond the initial adopters of Ukraine's Corporate Governance Principles thanks to encompassing public awareness campaigns financed by the ten initial adopters as well as additional corporate governance training of Ukrainian companies set up by the IFC.<sup>17</sup> An increasing number of Ukrainian firms were striving to capitalize their assets on international markets and wanted to get listed on stock exchanges in Warsaw, Frankfurt or London, or to issue Eurobonds on international stock exchanges (Khisanov et al. 2006).

Around the same time, the distribution of property rights had more or less come to an end with private ownership reaching 88,2 percent in 2004 (Dubrovskiy et al. 2007; Paskhaver/Verkhovodova 2008). Consequently, even Ukraine's big industrial holding companies, who had acquired most of their assets during the "wild" 1990s and 2000s, began to transform into "stationary bandits" in order to capitalize their money on international markets (Shinkarenko 2007; Puglisi 2008). The reward of market access started to outweigh the costs of non-convergence towards European and international shareholders' rights for some powerful Ukrainian businessmen. The holdings started to hire Western managers, who began to restructure the holding companies and disclose ownership structures and began to publish financial reports on the basis of international accounting standards (Puglisi 2008). As a result, one of them, Konstantin Zhevago's "Finance and Credit", placed an initial public offering (IPO) on the London Stock exchange with his firm Ferrexpo. Others successfully invested in metallurgy or shipbuilding sectors in Eastern Europe (Goshovskii 2008).

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16 Interview with Ukrainian expert on corporate governance from a Western donor organization (B), Kyiv, 13 October 2009.

17 Two IFC projects focusing on corporate governance took place from 1997-2002 and from 2002-2007. During the first project, the IFC trained about 13 percent of Ukraine's active corporations on corporate governance, provided over 5000 consultations and advised 67 pilot enterprises on sound corporate governance. According to the project reports, 50 percent of the pilot enterprises saw greater success in initiating negotiations with investors, attracting investment, finding partners, and obtaining financing. The report of the first project is available at [http://www.ifc.org/ifcext/tatf.nsf/AttachmentsByTitle/Chapter\\_4.pdf/\\$FILE/chapter\\_4.pdf](http://www.ifc.org/ifcext/tatf.nsf/AttachmentsByTitle/Chapter_4.pdf/$FILE/chapter_4.pdf); 1 September 2011.

Although the mid-2000s witnessed the emergence of “stationary bandits”, they still saw many experiences of “roving bandits” for whom the reward of market access did not outweigh the costs of regulatory convergence. Instances of share dilution, the blocking of shareholders’ meetings and corporate raiders were still characterizing Ukraine’s corporate life. Some of the same industrial holdings that tried to polish their image for international investors were also involved in share dilution by almost 40 percent in some of their subsidiaries (Mycyk et al. 2007).

Several of these incidences directly harmed Western firms who had increasingly entered the Ukrainian market in the early 2000s. Consequently, foreign investors mobilized the two major business associations representing the interests of Western firms in Ukraine, the European Business Association in Ukraine (EBA)<sup>18</sup> and the American Chamber of Commerce (AMCHAMB),<sup>19</sup> to become more actively engaged in promoting the protection of shareholders. As a result, a “window of opportunity” opened up for a renewed attempt to adopt the JSC Law. In late September 2006, the IFC and USAID initiated another Corporate Governance Task Force at the SSMSC in order to prepare a new draft law that would take various interests into account. This time, the task force also comprised AMCHAMB and EBA representatives. In addition to the earlier demands raised by international donors and the PFTS Association concerning “voice” and “exit” for shareholders and the abolishment of CJSCs, the two Western business associations wanted the JSC Law to prohibit the transfer of shares through gifts. They also called for a provision stating that general shareholder meetings would only be allowed to take place at the JSC’s registered address since Western firms had suffered from arrangements “behind the scenes”.<sup>20</sup> In February 2007, the Cabinet of Ministers under Prime Minister Viktor Yanukovich submitted the JSC Draft Law to the Ukrainian parliament, which had been prepared by the SSMSC in the framework of the Task Force on Corporate Governance. The law was then adopted at the first reading, with the condition that the Parliamentary Committee on Economic Policy would thoroughly revise the draft law taking into account the comments of Members of Parliament. The fact that the JSC Draft Law was not immediately axed by the parliament after the first reading is owed to the fact that some of the owners of the aforementioned industrial holdings held seats in various political fractions. As mentioned earlier, they had now become “stationary bandits” and changed their attitudes towards the protection of shareholders’ rights accordingly. In this respect it is telling that Yuri Voropaev, the former lawyer of one of Ukraine’s leading Ukrainian businessmen, Rinat Akhmetov, headed the Parliamentary Committee on Economic Policy. The fact that this committee was now in charge of revising the JSC Law for the second reading underlines the growing interest among some powerful industrial holdings in the adoption of the JSC Law.

In order to accommodate the important interests of various business groups, the Parliamentary Committee did, however, make some important changes to the JSC Draft Law. The most crucial one concerned the provision stating that all CJSCs must become public JSCs that fall under the jurisdiction of the JSC Law,

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18 EBA Ukraine was founded in December 1999 on the initiative of the Delegation of the European Commission to Ukraine (see <http://www.eab.com.ua>).

19 AMCHAMB Ukraine was founded in 1992 (see <http://www.chamber.ua>).

20 Interview with Ukrainian expert on corporate governance from a Western donor organization (A), Kyiv, 13 November 2008; Interview with staff member from Persha Fondova Rynka, Kyiv, 25 September 2009; Interview with Ukrainian Expert on Corporate Governance from a Western donor organization (B), Kyiv, 13 October 2009; Interview with Ukrainian expert on corporate governance (C), Kyiv, 22 October 2009.

as demanded by the PFTS association of local brokers and securities dealers and others. Instead, the Committee proposed that only CJSCs with more than 100 shareholders must turn into public JSCs in order to gain the support of influential members of the Ukrainian parliament who represented the interests of big industrial holdings with a few shareholders. Yet, all other propositions by the task force remained part of the draft. On 17 September 2008, Voropaev presented the draft before the parliament, where it was adopted by 358 of 450 votes. On 22 October 2008, President Yushchenko signed the JSC law. The law entered into force in April 2009 but existing JSCs were granted a two-year transitional period, during which they must be brought into compliance with the JSC Law.

It is therefore too early to judge to what extent the JSC Law will truly promote the *de facto* protection of shareholders. Further, it needs to be seen to what extent the SSMSC and the PFTS stock market turn into viable regulators who possess sufficient capacities to enforce the law.

Notwithstanding, the previous analysis shows that a complex interplay of policy-specific conditionality based on economic rewards, i.e. access to European and international capital markets, and multiplex capacity-building targeted at both state regulators and firms helped decreasing adaptational costs, thereby weakening the domestic opposition against policy reforms. At the same time, both mechanisms helped diversify and empower domestic supporters to demand more transparent and predictable treatment of shareholders. If it had not been for external actors creating and empowering the domestic pro-reform coalition of securities regulators, brokers and firms from the mid-1990s onwards, increasing market pressures to enter Western capital markets in the early 2000s would not have been anchored by existing regulatory arrangements. Further, it is unlikely that the adopted law would have contained any provision forcing CJSCs into public JSCs without the pressure from the association of local brokers and securities regulators. In turn, the failure of legislative reforms in the early 2000 showed that multiplex capacity-building is unlikely to do the job if policy-specific conditionality applied by external actors is not based on economic rewards that outweigh the costs of regulatory convergence for powerful domestic actors.

## 5. Policy Change in Ukraine's Technical Standards<sup>21</sup>

Unlike in the case of shareholders' rights, the EU, rather than international donors such as USAID or the IFC, diversified and empowered reform-minded groups in the field of Ukraine's technical standards by initiating major assistance projects upon enforcement of the PCA in 1998. In 2000, European experts began to serve as legal advisors for the Ukrainian state regulator, the DSSU, and the Ukrainian Ministry of Economy. To ensure adoption of EU compliant laws and the creation of regulatory arrangements as prescribed by EU directives, the European experts recommended to introduce the concept of voluntary standards and to break-up the monopoly of the DSSU by stipulating the institutional separation of standardization (setting standards) from conformity assessment (enforcing the standards).

European experts were able to ally themselves with a small group of regulators within the DSSU working for the department charged with the accreditation of conformity assessment bodies. This group of regulators

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<sup>21</sup> A slightly revised version of the following case study analysis is published in Langbein/Wolczuk (2011).

understood the necessity of these reforms for Ukraine's future integration into world markets and the attraction of foreign investments. In addition, these regulators could expect an increase in their regulatory power since EU legislation foresees the establishment of a separate public agency for accreditation.<sup>22</sup> Thanks to their support and lobbying activities, the Ukrainian parliament adopted a law that led to the establishment of the National Accreditation Agency of Ukraine (NAAU) in 2002. However, DSSU's leadership ensured that another law, which assigns the power to appoint conformity assessment bodies to the DSSU, was not scrapped (AFNOR-SWEDAC-UNI Consortium 2004; Palianytsia 2005). Owing to this contradictory legislative framework, DSSU could duplicate the NAAU's tasks and thus weaken its regulatory power, while at the same time demonstrating its will towards policy reforms vis à vis the European partners.<sup>23</sup>

The other proposals of the European experts did yet not find their way into the final versions that were submitted to the Ukrainian parliament for approval. The monopolist regulator DSSU was simply not willing to share its regulatory powers with other public and private entities. Further, Ukraine's reliance on public control rather than public-private coordination (as functioning on the EU single market) allowed DSSU's staff to take bribes from Ukrainian producers and importers who desired faster service and fewer inspections (IFC 2008). In essence, DSSU's opposition prevented full adoption of EU rules and practices.<sup>24</sup> The sources for DSSU's power are threefold:

First, DSSU's staff did not have to fear any sanctions for opposing convergence with EU rules from superior bodies, such as the Ukrainian Ministry of Economy. Ukraine's aspirations for membership were mere political rhetoric. In reality, the political elite did not sanction inertia or opposition against policy reforms (Langbein/Wolczuk 2011).

Second, possible political gains from convergence with EU technical standards were low. The main constituencies, Ukrainian machinery producers, had mixed interest in policy reforms despite the application of policy-specific conditionality based on access to the European market in exchange for regulatory convergence. On one hand, small and medium-sized enterprises (SMEs) were beginning to see the benefits of Ukraine's economic growth from 2000 onwards. For them, the GSP, through which the EU lowered its import tariffs for Ukrainian machinery as early as 1993, became a strong reward in exchange for regulatory convergence. SMEs turned to specializing in the export of parts and components of machinery to the EU since the costs of upgrading represented only four percent of total production costs given the low value of these commodities. On the other hand, producers of heavy machinery and equipment were not interested in convergence with EU technical standards. They mainly sold their products on the Ukrainian market or exported to former Soviet republics where Ukrainian standards and certifications were accepted. Similar to the dynamics shaping the case of shareholders' rights until the early 2000s, parts of Ukrainian business,

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22 Interview with EU Official from DG Relex, Kyiv, 1 February 2008; Interview with European expert on technical standards, Kyiv, 24 January 2008.

23 Interview with EU Official from DG Relex, Kyiv, 1 February 2008; Interview with European expert on technical standards, Kyiv, 24 January 2008.

24 Interview with EU Official from DG Relex, Kyiv, 1 February 2008; Interview with European expert on technical standards, Kyiv, 24 January 2008.

i.e. the producers of heavy machinery, did not consider access to the EU market as a sufficient reward for policy reforms. Unlike SMEs, they would need to spend a higher percentage of production costs (12.3 percent) in order to be eligible for export to the EU (ECORYS/CASE 2007). In addition, Ukrainian producers of heavy machinery feared their limited competitive advantage on the EU market and increasing imports from Europe should EU rules become mandatory in Ukraine (Pindyuk 2006).<sup>25</sup>

Third, in the context of state capture, these producers of heavy machinery were represented either in the Ukrainian parliament or occupied crucial positions in Ukraine's state bureaucracy. Therefore, the legislator acted as an extension of big machinery producers and the DSSU. Members of Parliament made no efforts to increase regulatory convergence when respective legislative initiatives were discussed in the Ukrainian parliament in 2001. Instead, the parliament accepted the continued use of mandatory standards and the system of public regulation through the monopolist state regulator DSSU.

Notwithstanding domestic opposition against policy change, the EU continued to diversify domestic support by targeting its assistance at the state regulator DSSU. Following the launch of another assistance project in 2003, the Ukrainian Institute for Testing and Certification of Electric Equipment (UkrTest), which is subordinated to the DSSU and is in charge of certifying conformity assessments for electric equipment, sought to acquire the capacity to perform conformity assessments according to EU requirements for certain product groups. These were particularly relevant for SMEs producing parts and components. If successful, Ukrainian exporters to the EU would be able to use test results provided by UkrTest when applying for the CE mark from European certification bodies.<sup>26</sup> Interactions with international and European standardization organizations in regulatory networks further increased the incentives and capacities of the UkrTest for carrying out conformity assessments according to EU rules. In accordance with theoretical arguments that have been made concerning the effects of lesson-drawing through participation in regulatory networks (Rose 1991; Slaughter 2004), UkrTest's regulators became dissatisfied with their domestic policies and began to study the experiences of their counterparts within the framework of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC). Information from within UkrTest suggests that cooperation with European regulators was crucial to develop much needed capacities for finally being awarded the right to perform conformity assessment for some product groups in 2006.<sup>27</sup>

The launch of the ENP gave new impetus to domestic change from the mid-2000s onwards. In the aftermath of the Orange Revolution, Viktor Yushchenko, who became President of Ukraine in early 2005, issued the first comprehensive decree with regard to technical regulation in order to meet the obligations laid down in the EU-Ukraine Action Plan. Faced with stronger political pressure, the DSSU had little choice but to show its commitment to convergence. As mentioned earlier, in December 2005 the DSSU and DG Enterprise and Industry therefore signed a special Action Plan for the Free Movements of Industrial Products. Being

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25 Interview with European expert on technical standards, Kyiv, 24 January 2008; Interview with representative of an Ukrainian business association, Kyiv, 15 February 2008; Interview with Ukrainian state official from Ministry of Industrial Policy, Kyiv, 25 February 2008; Interview with Ukrainian state official from Ministry of Economy, Kyiv, 28 February 2008.

26 The CE mark is needed to place industrial products on the EU market.

27 Interview with representative of UkrTest, Kyiv, 18 March 2008.

empowered by the political changes in Ukraine, the Ministry of Economy turned to the IFC in order to start a new legislative initiative to break up the monopoly of the DSSU. Similar to the situation in the early 2000s, the working group came up with draft laws that envisaged the reduction of mandatory standards for industrial products as well as the gradual break-up of the DSSU. However, in April 2008, the Ukrainian parliament rejected the draft laws due to lobbying efforts of leading DSSU regulators and big producers of heavy machinery, which had remained strongly represented in Ukraine's parliament.

It was only in December 2010 that one of the aforementioned draft laws, the law "On state market surveillance over non-food products" got finally adopted by the Ukrainian parliament. As a consequence of Ukraine's entry to the WTO in 2008 and intensified negotiations with the EU on the Deep Free Trade Agreement, economic and political pressures to reform Ukraine's system of technical standards increased. The adopted law challenges DSSU's oversight of products. It foresees that market surveillance, which encompasses the public monitoring of products placed on the market and the removal of unsafe products from the market, shall be pursued institutionally separate from conformity assessment (certification) (ICPS 2011). The law was supposed to come into effect in April 2011. However, persistent resistance by the DSSU and big producers continues to prevent the drafting of secondary legislation for the implementation of the laws. At the time of writing, DSSU still performs most tasks related to the setting and enforcement of technical standards.

The previous discussion suggests that in the field of technical standards, the combined effects of policy-specific conditionality based on economic rewards and dyadic capacity-building measures have only resulted in selective rule adoption and only partial set-up of public-private governance arrangements as applied in the EU single market. The EU applied policy-specific conditionality in the field of technical standards, but the reward of market access was not strong enough for all Ukrainian firms: While SMEs that produce low-value added products benefit from market access, Ukrainian producers of heavy machinery considered market access not a sufficient reward for regulatory convergence. Consequently, they used their political influence to obstruct policy change. Further, in technical standards, external donors, here the EU, have only targeted their capacity-building measures at some state regulators. By contrast, assistance projects have not been set up to empower reform-minded SMEs to make their political claims. In a similar vein, assistance programs or regulatory networks have not been used to diversify demand among Ukrainian producers of heavy machinery who had political influence, but opposed policy change owing to their fear of growing Western importers. Due to a dyadic form of capacity-building, which was solely targeted at state regulators, demand among firms has not been diversified and reform-minded private actors have not been empowered.

## **6. Alternative Explanations**

The comparative study of regulatory convergence towards EU rules in two policy fields in Ukraine has shown that the combined effects of policy-specific conditionality and multiplex capacity-building measures have increased incentives and capacities of domestic firms and state regulators to support policy reforms in shareholders' rights resulting in comparatively high levels of regulatory convergence. By contrast, policy-



specific conditionality combined with dyadic capacity-building did not sufficiently diversify domestic demand for policy change in technical standards, resulting in partial regulatory convergence in this policy field.

A competing interpretation of the diverse outcomes could argue that Ukraine's economic dependence on Russia was higher in the field of technical standards. Russia's share in Ukraine's total exports of machinery averaged at 42 percent in the six years between 2001 and 2007. In contrast, the EU's share averaged 29 percent during the same period.<sup>28</sup> As far as the field of shareholders' rights is concerned, Ukraine's economic dependence on Russia does not, at first glance, seem to be so high. For instance, in 2005, the general share of foreign direct investments (FDI) flows from Russia to Ukraine was only six percent, while FDI flows from the EU stood at 35 percent (Vahtra 2005). Hence, Dimitrova and Dragneva (2009) would argue that lower dependence on Russia means a weaker constraint on EU rule transfer. However, it is important to note that a major part of Russia's total investments in Ukraine come from offshore companies in Cyprus, the Virgin Islands and the Netherlands (Vahtra 2005; Blyakha 2009). Taking this into account, roughly 31.5 percent of Ukraine's FDI stock came presumably from Russian investors in 2005. Accordingly, the EU's share in Ukraine's FDI stock is likely to be smaller than 35 percent, making the share of FDI from Russia in Ukraine's total FDI stock at least equal to the share of the EU. Considering the significance of the Russian market for Ukrainian machinery producers and the significance of Russian investors for Ukraine's capital market, we should thus expect equally low levels of regulatory convergence towards EU rules in Ukraine's technical standards and shareholders' rights. This expectation is, however, at odds with the observed empirical outcome.

An alternative explanation by students of regulatory competition would expect that regulatory convergence to internationally acknowledged rules and norms progresses faster and more comprehensively in shareholders' rights relating to export competing sectors such as financial services.<sup>29</sup> By contrast, convergence is expected to be less progressive in technical standards relating to import competing sectors like machinery (Vogel/Kagan 2004; Murphy 2004). Regulatory convergence in shareholders' rights is likely to put domestic firms in a better position to attract foreign investors as well as to gain access to international capital markets. By contrast, domestic firms in an import competing sector like machinery may be less interested in regulatory convergence in technical standards. This is because convergence will result in increasing imports of more competitive products, thereby crowding local producers out of the market (Murphy 2004). However, my empirical analysis shows that this approach has its limits in explaining the specific timing and character of policy change resulting in diverse outcomes across the two policy fields. While regulatory convergence in shareholders' rights has, indeed, progressed more comprehensively than in technical standards, theories of regulatory competition cannot explain why Ukraine harmonized its national legislation with EU shareholders' rights as late as 2008 despite the export competing character of financial services. Ukrainian firms could have attracted more foreign investment and would have been able to access European and international capital markets already in the 1990s if they had supported regulatory convergence in the field of shareholders' rights. By contrast, in the field of technical standards we observe at least some progress in terms of rule adoption and the creation of regulatory arrangements as early as

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<sup>28</sup> Own calculation based on Emerson (2006), Russian Federal Customs Service, State Statistics Committee of Ukraine and Eurostat.

<sup>29</sup> I thank David Levi-Faur and Gary Marks who brought this to my attention.

2001. Further, and in contrast to the aforementioned assumptions of students of regulatory competition, not all machinery producers in Ukraine oppose regulatory convergence and fear to be crowded out of the domestic market. Following Vogel and Kagan (2004), the more developed an economy is, the more complex it becomes and large aggregate groups such as capital or labor lose their meaning. Therefore, we need to disaggregate domestic interests of a policy field and analyze how incentives and capacities of various producer groups and regulators for regulatory convergence can be increased (see also Börzel/Langbein forthcoming; Langbein/Wolczuk 2011).

## 7. Conclusion

This paper has shown that policy change in the European neighborhood is not doomed to failure despite the absence of an EU membership perspective. Instead, my findings suggest that there is a great deal of variation across policy fields even within one neighboring country. Contrary to prominent accounts in the literature on policy change in the European neighborhood, I show that cross-policy variation in regulatory convergence towards EU rules cannot be fully explained by making reference to misfit and adaptational pressures, or policy-specific conditionality (Börzel 2010; Gawrich et al. 2010; Ademmer/Börzel forthcoming). Further, the empirical analysis revealed that the institutionalization of EU rules cannot explain the observed cross-policy variation. In contrast to Lavenex and Schimmelfennig (2009), I find that third countries like the ENCs are not necessarily more inclined to take on EU rules if these rules are highly institutionalized, i.e. precise, legally binding and legitimate (see also Börzel/Langbein forthcoming).

To overcome the shortcomings of existing explanations, this paper engaged in a more nuanced analysis of the domestic incentives and capacities for taking on EU rules in a particular policy field and how such incentives and capacities are shaped by external factors. I have shown that the likelihood of regulatory convergences increases in policy fields where policy-specific conditionality is combined with multiplex capacity-building targeted at those public and private domestic actors needed to demand, set and enforce EU rules in the particular policy. By contrast, in policy fields where policy-specific conditionality is combined with dyadic capacity-building, regulatory convergence is less progressive.

In both policies under scrutiny, Ukraine's shareholders' rights and technical standards, policy-specific conditionality was equally strong: Ukrainian state regulators and firms could be certain that regulatory convergence would be rewarded with access to European and international markets. In both cases domestic actors did not, however, immediately consider market access as sufficiently beneficial to outweigh adaptational costs. The costs of convergence in the two policies decreased for export-competing Ukrainian firms only when Ukraine's economy started to recover in the early 2000s.

However, in the field of shareholders' rights international donors had diversified domestic demand among Ukrainian bureaucrats, firms and brokers through multiplex capacity-building measures since the mid-1990s. In the early 2000s, the distribution of property rights came to an end, resulting in growing interests of Ukrainian business to take on shareholders' rights and capitalize their assets on foreign capital markets. At that time, multiplex capacity-building by external donors had already facilitated the creation of the



needed governance arrangements and continued to empower reform-minded Ukrainian businessmen and state regulators to make their claims. By contrast, in the case of technical standards, the economic rewards of market access were only flanked by dyadic capacity-building measures that diversified demand among some state regulators and empowered them to enforce certain policy changes. At the same time, external actors did not set up capacity-building measures for those Ukrainian producers for whom market access remained an insufficient reward for policy change (i.e. producers of heavy machinery), or for reform-minded producers for whom market access became increasingly beneficial (i.e. SMEs producing low-value added machinery), thereby disempowering the reformers to turn their interests into political claims.

My findings dovetail with critics of conditionality-based approaches, arguing that the latter ignore the politics of institution building as a process aimed at empowering public and private actors to demand, set and enforce regulative institutions (Bruszt/McDermott 2009; Easterly 2006). The two cases presented here do not allow us to draw generalizations about the factors shaping cross-policy variation in regulatory convergence in ENCs. Still, the findings have two implications for future research on policy change in countries outside the EU and their integration in European and international markets.

First, in view of the wide-ranging variation within one country, cross-policy comparisons seem to be more suited to explain the dynamics leading to regulatory (non-)convergence. The focus on macro-level factors such as membership aspirations or democratic development is not fruitful to explain policy change in the region. From this perspective, Ukraine would be a most likely case for regulatory convergence considering Ukraine's membership aspirations and Ukraine's relatively democratic political regime, if compared to other ENCs (Börzel 2010). Despite these favorable macro-level conditions, we observe diverse outcomes ranging from progressive to partial policy change. Hence, my findings imply that convergence towards EU rules can even occur in ENCs which do not seek EU membership or are less democratic than Ukraine. Instead, the impact of policy-specific conditionality and capacity-building on the configuration of domestic incentives and capacities in the various policy fields is key in explaining cross-policy variation in regulatory convergence towards EU rules. The findings of this analysis can thus provide important insights into the dynamics resulting in cross-policy variation in all other neighboring countries.

At the same time, the focus on regulatory convergence does not limit the generalizability of the findings to market-related fields. Even in non-market-related fields, such as anti-corruption, migration or human rights, convergence towards EU rules is more likely if the combined effects of policy-specific conditionality and multiplex capacity-building measures increase domestic incentives and capacities for policy change. Market access is unlikely to be the key incentive in non-market-related fields, unless external actors explicitly tie market access to policy reforms in these fields. Alternatively, other incentives, such as visa facilitation or direct payments, may facilitate convergence in non-market-related fields if they are flanked by capacity-building measures targeted at relevant public and private rule takers.

The second insight of this paper concerns the fact that the EU is not the only external force that is shaping policy change in the European neighborhood, nor is it always the most active one, as suggested by some studies on the region (Lavenex 2008; Wolczuk 2007; Gawrich et al. 2010). Donors like USAID or the IFC often promote convergence towards EU rules in countries where EU leverage is generally weaker due to the lack of an EU membership perspective. In fact, they have been the most active external promoters of

convergence in the field of shareholders' rights, while EU activities have been rather modest in comparison. In areas like technical standards, it is rather surprising that the IFC supports convergence towards EU product standards. These are actually conceived as a countermovement to globalization since they protect EU producers from competition with the non-EU markets (Lyngaard 2008). These findings imply that students of the European neighborhood should not limit their analysis to the EU's impact on policy change in the region, but shall increasingly take into account the impact of international donors or multinational companies (for a similar argument see Börzel/Langbein forthcoming).

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