Polski Instytut Ekonomiczny

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Despite many challenges, accession is the best possible scenario for both Ukraine and the EU, a report by the PEI and the CES shows

On 14-15 December, EU leaders will decide whether to start accession negotiations with Ukraine. In this context, Kyiv faces a number of challenges, as set out by experts from the Polish Economic Institute and the Ukrainian Centre for Economic Strategy in a joint report entitled *Stronger Together: Present and Future Challenges on Ukraine's Road to EU Integration*. In the short term, the greatest challenge is to ensure stable sources of financing, especially for significant needs linked to conducting military operations. In the medium term, Ukraine will need to overcome infrastructure problems and attract investments. In the long term, the primary change will be successful reforms that will build strong institutions that will ensure the country's socio-economic development and allow Ukraine to join the European Union.

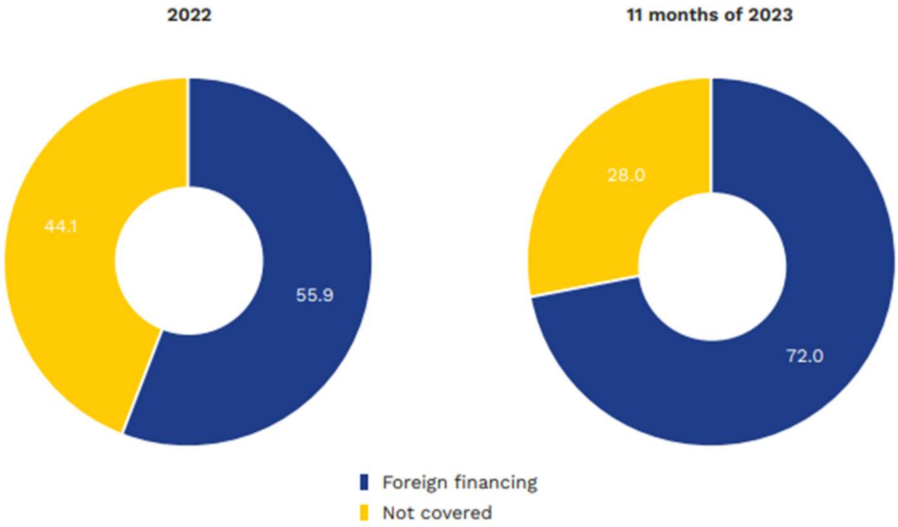
Short-term challenges

As a result of the Russian invasion, Ukraine had to redirect more than half its budget in 2022 and 2023 to war purposes. In the face of the loss of market sources of financing and 30% of GDP, financial assistance from the West was — and is — necessary. Since the start of the war, Ukraine has already received USD 68.5 billion, 62% of it in the form of direct subsidies, and 38% in the form of grants.

In 2022, Ukraine's budget deficit and debt servicing costs reached USD 55.6 billion. Foreign financial support helped cover PLN 31.1 billion, leaving a gap of USD 24.5 billion. In 2023, Ukraine will receive enough global aid to avoid this kind of gap: a total of USD 42 billion in financial aid over the course of the year.

"In the first year of the war, Ukraine encountered problems in securing financing for state activities. In the second year, especially thanks to the EU and its member states, which together provided EUR 18 billion in aid, this was avoided. However, we are now once again entering a period of uncertainty, with problems on the part of Ukraine's two most important allies, the US and the EU. Almost as important for Ukraine as the consent to start the negotiations will be the European Council's decision to launch the Ukraine Facility programme with a budget of EUR 50 billion to support Ukraine in 2024-2027," says Marek Wąsiński, head of the PEI global economy team.

Figure 2. Coverage of the budget deficit and debt repayment needs with foreign financing in 2022 and in first 11 months of 2023 (in %)



Source: prepared by CES based on data from the Ministry of Finance of Ukraine and the National Bank of Ukraine.

The medium-term challenges include reconstruction, attracting investments and the modernisation of infrastructure on the Polish-Ukrainian border

Ukraine faces a huge challenge in rebuilding the country destroyed by the Russian invasion. One particular challenge will be the reconstruction of the economy: since the wear began, it has lost its ability to function normally and its development prospects have been limited significantly. Foreign direct investment (FDI) in Ukraine was already lower than in other Central and Eastern European countries before the war, but when the war began, it halted completely.

“For Ukraine’s reconstruction to be a success and to ensure its stable, sustainable and long-term economic development, it is necessary to attract private capital. While it is mostly a challenge to convince investors to invest in Ukraine now, it may prove easier in certain sectors. One example is the arms sector, where, as a result of military operations, production in Ukraine is increasing and local start-ups are developing. In connection with the great reconstruction project, the necessary public-private partnerships in the field of infrastructure, construction, building materials and logistics will also be an opportunity," says Iana Okhrimenko, a senior economist at the Centre for Economic Strategy.

Since the start of the war in Ukraine, the Polish-Ukrainian border has become one of the most important EU borders for military, humanitarian and economic reasons. The blockade of the Black Sea ports has made it the main route for the export of Ukrainian goods. However, the border infrastructure has turned out to be ill-prepared for such high traffic intensity. First of all, it is necessary to improve railway connections. The tracks in

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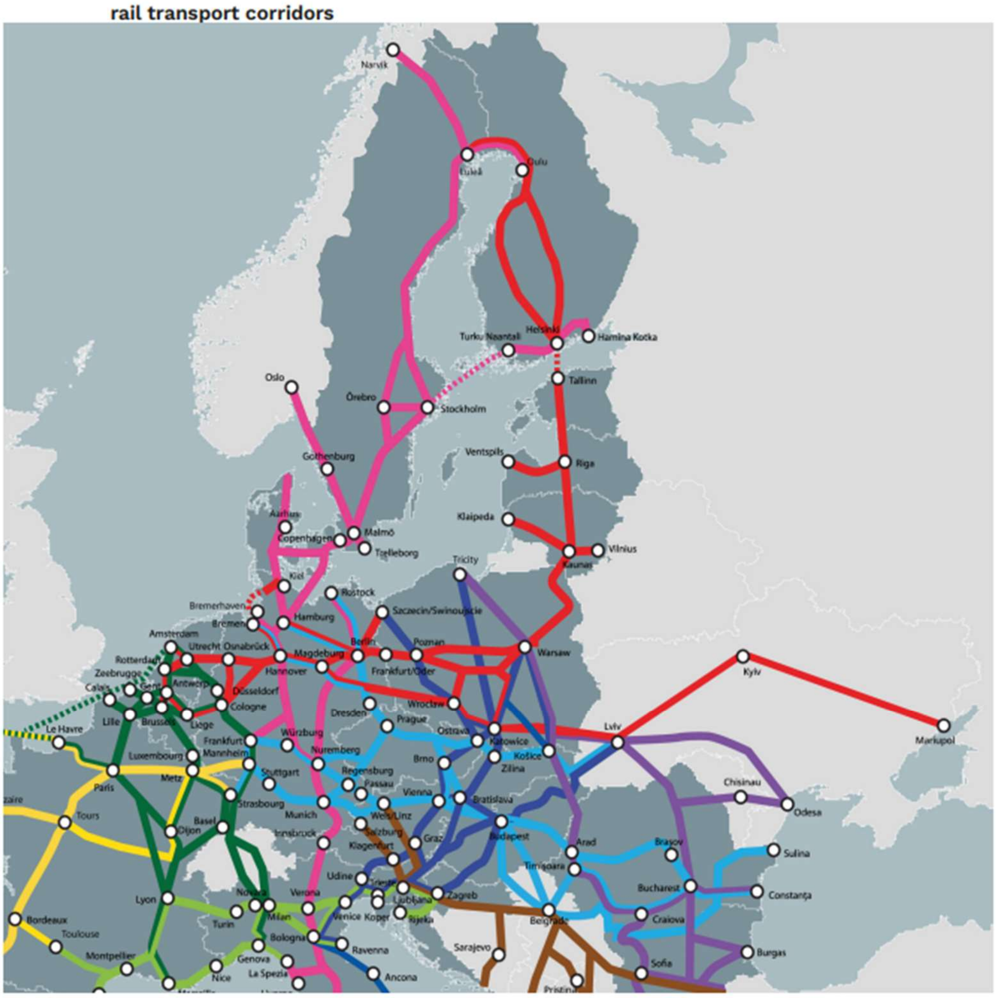
Poland have a gauge of 1,435 mm, compared to 1,520 mm in Ukraine. It is also necessary to build transshipment terminals and increase the existing number of connections that Ukraine needs fight Russia and develop its economy, integrating it more and more closely with the EU.

“Ukraine needs to rebuild its transport infrastructure to develop its economy and integrate with Europe. The involvement of the European Commission as part of the Connecting Europe programme creates an opportunity to secure financing for transnational infrastructure projects. Including Ukraine in them will also benefit current EU members; for example, by building new connections between Poland and Romania. Multimodal transport solutions are needed that will allow us to become independent from crowded road transport. It would be beneficial in Ukraine to extend the TEN-T trans-European transport network by the shortest route from Ukraine to Poland via Lublin, among other things,” says Jan Strzelecki, deputy head of the PEI global economy team.

Figure 8. European Commission's proposal to include Ukraine in TEN-T rail transport corridors



Source: European Commission, Map Finder Chart for European Transport Corridors, https://transport.ec.europa.eu/system/files/2022-07/Revised%20corridors%20to%20include%20Ukraine%20and%20Moldova.pdf [accessed: 28.11.2023].

In the long term, Ukraine will face many reforms, including the fight against corruption

In addition to economic issues, Kyiv must introduce a number of reforms; above all, fight corruption effectively to attract FDI, which will enable technology transfer and create conditions for fair competition in the internal market for both private and state entities.

"In the long term, Ukraine's effective integration with the EU will be the main factor influencing the pace and quality of post-war reconstruction. Integration may be accelerated by investments. Adaptation to the rules of the EU single market could become the foundation for Ukraine's economic growth. To achieve this goal, Kyiv must adopt EU regulations, modernise national law and implement instruments to protect investments, including providing greater exchange rate flexibility. Poland's experience in introducing an independent monetary policy, building strong local institutions, creating effective public procurement mechanisms and well-developed capital markets could be a valuable point of reference for Ukraine. The Ukrainian political system also requires decentralisation," says Dominik Kopiński, a senior advisor in the PEI global economy team.

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The Polish Economic Institute is a public economic think-tank dating back to 1928. Its research primarily spans macroeconomics, energy and climate, the world economy, economic foresight, the digital economy and behavioural economics. The Institute provides reports, analyses and recommendations for key areas of the economy and social life in Poland, taking into account the international situation.

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