

Ukraine's European Integration and Its Current Challenges

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Abstract. The article shows the importance of Ukraine's development within the framework of the European integration project. A positive impact of European integration on Ukraine's development dynamics has been revealed. European integration accelerated after signing and implementing the European Union-Ukraine Association Agreement 2014. The main achievements of Ukraine's European integration are related to the improvement of its institutions, as well as the growth of trade between Ukraine and the EU. It is found out the most serious challenges of European integration of Ukraine are related to the problems of economic growth, deindustrialization, foreign trade structural distortions, macro-financial stability, as well as the slowdown in a convergence between Ukraine and the EU. It is stated that Ukraine needs to restructure its national economy in line with the European and global context.

Keywords: *economy, institutions, convergence, threats, EU enlargement.*

Introduction

The integration project of the European Union launched in 1957, has been recognised as a success at the regional level for several decades and is attractive to many European countries, and they have been working for years to meet fairly strict criteria for readiness to become full participants. The signing of the Maastricht Treaty, which for the first time enshrined the EU's multidimensional economic and political integration, became the institutional foundation for the large-scale expansion of the European project in 2004, as well as subsequent waves of European integration. External and internal crises continue to test this foundation for strength, and the unresolved institutional and socio-economic contradictions of the European Union reinforce the need to transform the current European integration model.

The imperfection of this model is reflected in the significant intensification of Euroscepticism and disintegration in a united Europe, culminating in Brexit, the UK's exit from the EU, which officially ended in January 2020. There are other serious challenges to which the EU is forced to respond.

This is the resumption of the process of real convergence, in other words, the progressive convergence of economic and social parameters, reducing inequality among "strong countries" and "weak countries" (Eurofound, 2020). The World Bank has previously drawn attention to this problem, calling the European Union a successful socio-economic model a "convergence machine" in need of modernisation (World Bank, 2018).

The Association Agreement between the European Union and Ukraine (hereinafter the Agreement) signed in 2014 can be considered as a detailed roadmap for the large-scale work that needs to be done by Ukraine to practically approximate the prospects for EU membership. The achievement of the goals of the Agreement crucially depends on overcoming the existing trends of divergence and launching convergence processes between Ukraine and the European Union.

Obvious signs of growing divergence of their socio-economic systems, primarily on the traditional convergence criteria of welfare and productivity, have been observed since 2014, marked by the military

conflict in Donbass and a deep crisis in the economic and social development of Ukrainian society, the overcoming of this crisis took several years.

During the 7-years period of European integration reforms and the Government-approved Action Plan for the implementation of the Association Agreement, Ukraine instead of the expected convergence with member states, according to authoritative international institutions, became one of the leaders in Europe in terms of poverty, corruption, and large-scale labour migration abroad, which is not typical of any of the EU member states. This indicates the existing significant shortcomings of the system of state regulation in Ukraine and the need to correct them, based on the relevant scientific basis. This indicates the existing major deficiencies of the State regulation system in Ukraine and the necessity to correct them, based on the relevant scientific basis. Given the above, the *relevance* of the article is due to the need for Ukraine to achieve the goals of the ratified 2014 Association Agreement with the European Union, which will allow it to bring closer the prospects of full European integration.

Although the problem of Ukraine's European integration is characterised by a fairly high level of research, *some aspects remain insufficiently disclosed* in the scientific literature. Namely, there is a question of *consideration of the problem of European integration of Ukraine through the prism of processes of convergence (divergence)* between social and economic systems of Ukraine and the EU. Thus, barriers to Ukraine-EU economic convergence, as well as clear social divergence between them, create new challenges in the process of European integration. These new challenges exacerbate the pressing problems of macro-financial stability and the distorted structure of Ukraine's foreign trade, as well as hinder its consolidation on the path to European integration.

Thus, in the present article, we seek to consider the *scientific problem* of identifying obstacles and main challenges to Ukraine's European integration, as well as clarifying ways to overcome these obstacles with the help of state policy instruments.

The object of our study is the processes of European integration of Ukraine.

The aim of our study is to reveal the achievements and identify key challenges to the European integration of Ukraine. Challenges related to the development of both Ukraine and the EU, as the processes of their integration and convergence, involve bilateral cooperation.

To achieve this aim, we need to involve *the following objectives*: analytically assess the main macroeconomic and institutional indicators of the implementation of the Association Agreement between the EU and Ukraine; to find out the crucial factors that determine the processes of convergence and integration at the level of Ukraine-the European Union in the long run; to characterise the key challenges facing Ukraine in the process of its European integration.

Methodology. This study was conducted using the following general and special methods and scientific approaches: *method of ascending from the abstract to the concrete* (to identify the essence and concretisation of contradictions accumulated in the institutional architecture of the EU); *logical-historical approach* (to understand in the logic of historical development the need to reconstruct a united Europe in order to restore its own identity and the Self to be); *statistical and graphical methods of analysis* (for the study of time series of indicators that new insights and inspirations for further scientific research and possible solutions to boost Lithuanian economy new insights and inspirations for further scientific research and possible solutions to boost Lithuanian economy the European integration process); *method of comparative analysis* (to assess the processes of European integration of individual EU member states and Ukraine).

Theoretical foundations

The authors' research is based on several economic theories and approaches. *First*, the study is based on the postulates of neoclassical economic theory. *Second*, our paper uses the results of calculations for Ukraine based on the concept of convergence, grounded in the econometric models outlined in the fundamental work of Barro R.J. and Sala-i-Martin (1992). In particular, our results concerned the process of σ -convergence, which is observed in cases where the gap in real income levels in the economies of different countries is constantly narrowing. In the econometric sense, the convergence of economies that meets the criterion of σ -convergence should mean a reduction in the variance of the per

capita output of different countries or regions during the convergence period. Importantly, the σ -convergence parameter characterises the presence of a trend in reducing the gap between “leading countries” and “outsider countries”. *Third*, in our study, modern processes of European integration are considered from the standpoint of the theory of *Neofunctionalism*. By general definition, neofunctionalism represents integration as a political process that requires the reconciliation of social contradictions and the balance of interests within the society. *Fourth*, in our study, within the framework of institutional theory, the approach of separately-joint labour developed by Ukrainian theorists (Gritsenko, 2016) was applied.

Brief literature overview

Many fundamental scientific papers are devoted to the study of modern processes of international integration, and, in particular, European integration. The theoretical foundation for such scientific research was laid by such world-famous scientists as Jan Tinbergen, who revealed the principles and essence of economic integration on a state-by-state basis. Ernst Haas, who laid the foundations for a non-functional approach to regional integration by analysing the experience of European unification in 1950–1957, and Béla Balassa, who developed the classical gradation of the process of bilateral regional integration. The theory and practice of European integration processes through the prism of socio-economic convergence of EU Member States are considered in the works of Kolodko G.W. (2000), Gräbner C. *et al.* (2017), A. László (2019) etc.

Empirical studies of integration processes in the European region, in particular, in relation to post-socialist states, are of considerable interest. According to the forecast of the Vienna Institute for International Economic Studies (WIIW, 2017), the socio-economic convergence of the CEE countries and the EU, in general, will take more than 30–35 years, if the start of this process is considered to be 1995.

An analytical assessment of the impact on the processes of EU integration and disintegration of the crisis phenomena related to Brexit is given in the comprehensive studies of Menelaos Markakis (2020) and researchers from the European Policy Centre (2020). Experts from the European Parliamentary Research Service highlighted the problems and structural risks for the European integration project caused by the consequences of the COVID-19 pandemic.

Existing economic challenges, opportunities as well as risks associated with the implementation of the Association Agreement between the EU and Ukraine, have been comprehensively studied by experts from the Institute for Economics and Forecasting of NAS of Ukraine.

Achieved results and findings

Institutional and macroeconomic achievements of European integration of Ukraine.

The ratification by the Ukrainian Parliament in September 2014 of the Association Agreement with the European Union initiated a rapid acceleration of European integration processes in Ukraine. At the same time, its work was intensified within the framework of special EU integration initiatives, first of all, Eastern Partnership, Trans-European Transport Network (TEN-T), Horizon 2020, Euratom Program, Erasmus +, Creative Europe, House of Europe in Ukraine, etc. (European Parliamentary Research Service, 2020, pp. 19–27).

Today, Ukrainian-European cooperation is effective and has good prospects. Thus, in a Joint statement following the 22nd EU-Ukraine Summit held on 6 October 2020, the European Union noted Ukraine’s readiness to join the future EU Programme “Horizon Europe” and the EU4Health Programme, which will be an important factor for Green Deal and digital recovery after the COVID-19 pandemic. The EU also welcomed the Agreement on gas transit to the EU after 2019, which consolidated Ukraine’s role as a strategic energy transit country, and reaffirmed its commitment to conclude a Common Aviation Area Agreement with Ukraine in the near future¹.

¹ Joint Statement following the 22nd EU-Ukraine Summit, 6 October 2020, available at <https://www.president.gov.ua/en/news/spilna-zayava-za-pidsumkami-22-go-samitu-ukrayina-yes-64321>

It should be noted that several years of implementation of the Agreement (one of the most important components of this process is the harmonisation of Ukraine's legislation with the *acquis communautaire*), opening in January 2016. The Deep and Comprehensive Free Trade Area between Ukraine and the European Union, granting Ukrainian citizens the right to visa-free entry to member states since June 2017, as well as significant financial and credit assistance from the EU have had a significant positive effect on the Ukrainian state. But today its scale does not meet both the macroeconomic potential of Ukraine and its expectations, formed on the basis of the successful European integration experience of the Baltic States and the Visegrad Group.

In our opinion, in order to objectively assess the situation, it is necessary to note, on the one hand, the achieved advantages of EU integration, and the serious challenges that hinder this process, on the other hand. An effective response to these challenges is one of the necessary conditions for ensuring Ukraine-EU convergence and should be an integral part of domestic public policy.

The obvious advantages achieved from 2014 to 2019 during the European integration of Ukraine are related to its institutional development and the formation of civil society. Throughout this period, Ukraine has significantly strengthened its position (in fact, the country has made a "jump") in international rankings, in particular, the indicators of Democracy Index, World Press Freedom Index, Corruption Perception Index, Doing Business Index and Global Competitiveness Index.

In 2014–2019, Ukraine slightly worsened its position on the indicators Legatum Prosperity Index and Human Development Index. The reasons for this are the crisis in the social sphere of Ukraine and the formation of a threatening trend of its social divergence with the European Union (Borzenko *et al.*, 2020). We can find confirmation of this thesis in the Resolution of the European Parliament of 11 February 2021, dedicated to the implementation of the Association Agreement between Ukraine and the EU (AA / DCFTA)². In particular, the Resolution notes that "... whereas the AA / DCFTA pursued the goal of approximating the national law of Ukraine and its national standards to those of the EU, including in the social area; whereas, despite these commitments, the implementation of the AA / DCFTA in the social sphere remains dissatisfactory; whereas Ukraine has ratified the main international instruments, but continues to fail to implement them".

In the foreign economic sphere, Ukraine has gained obvious advantages due to European integration, in other words, due to the growth of trade with the European Union. First of all, it testifies to the effectiveness of the Deep and Comprehensive Free Trade Area, which since its opening on 1 January 2016 has contributed to an increase in Ukraine-EU trade turnover by more than 1.5 times and the transformation of the EU into Ukraine's largest trading partner. According to the State Statistics Service of Ukraine, the share of the EU-28 in Ukraine's exports of goods and services increased from 31.8% to 37.7%, and imports – respectively, from 39.8% to 42.4%.

In general, during 2014–2019, Ukraine increased exports of goods and services to the EU by USD 3.8 billion (from USD 20.4 to 24.2 billion), and imports – by USD 4.5 billion (from USD 24.2 to 28.7 billion). These trade dynamics could have been even better if it had not been affected by the socio-economic crisis in Ukraine in 2014–2016.

Paying tribute to the positive changes provided by European integration in the Ukrainian economy and society, it is very important to adequately take into account the existing challenges and threats that may require state intervention through appropriate regulatory instruments.

Key challenges of Ukraine's European integration.

Challenges of economic growth. At the present stage, one of the main challenges of Ukraine's European integration is to ensure the country's entry into the trajectory of sustainable economic growth (after overcoming the crisis caused by the COVID-19 pandemic) and overcoming existing macroeconomic imbalances that limit the sustainability of public finances and international competitiveness of Ukraine.

² European Parliament resolution of 11 February 2021 on the implementation of the EU Association Agreement with Ukraine (2019/2202(INI)), available at https://www.europarl.europa.eu/doceo/document/TA-9-2021-0050_EN.html

Due to a number of reasons, such as the ongoing military conflict in the Donbas region, the slowdown in reforms and degradation of the state economic management system, Ukraine has seen declining dynamics of a key macroeconomic indicator – GDP per capita. This indicator in Ukraine increased one and a half times during 1991–2016, and reached a maximum in 2013 (3969 U.S. dollars), then decreased significantly and is projected to return to these positions only in a few decades. According to the IMF forecast, Ukraine’s GDP per capita in 2022 will be 3967 U.S. dollars, and by the end of 2023 will reach 4312 U.S. dollars (IMF, 2020).

The comparative assessment shows that in 2019 the volume of GDP per capita of Ukraine was 5.3 times less than that of Lithuania, the Czech Republic – 5 times, Poland – 3.7 times, Bulgaria – twice. According to the IMF forecast, in 2020 Ukraine’s gap with these EU countries in terms of welfare will become even more significant: the gap between Ukraine and the Czech Republic will reach 6.7 times, Lithuania – 5.9 times, Poland – 4.5 times, Bulgaria – 2.7 times (IMF, 2020).

Challenges of deindustrialization. Significant obstacles to Ukraine’s full integration into a united Europe may arise as a result of the processes of the deindustrialisation of the Ukrainian economy that have intensified since 2014. According to official statistics, the index of physical volume of gross value added (based on the level of 2016) in the Ukrainian mining and quarrying decreased from 137.9 in 2013 to 94.8 in 2019; in the manufacturing industry from 124.5 to 107.1; in the field of electricity, gas, steam and air conditioning supply from 122.9 to 92.0.

Foreign trade challenges. The increase in annual exports of Ukrainian goods to the EU during 2014–2019 does not cover the loss from the catastrophic decline in annual trade in goods with the CIS over the same period. Thus, according to the State Statistics Service of Ukraine, Ukraine’s merchandise exports to the EU increased by USD 3.8 billion from USD 17.0 billion in 2014 to USD 20.8 billion in 2019. At the same time, the reduction in exports of Ukrainian goods to the CIS countries reached USD 8.2 billion from USD 14.9 billion in 2014 to USD 6.7 billion in 2019. Thus, the “net loss” of geographical reorientation of Ukraine’s exports for this period amounted to USD 4.4 billion.

In addition, the structure of Ukraine’s trade with the European Union is dominated by raw materials and goods with low added value. According to the State Statistics Service of Ukraine, in 2019, in the structure of Ukrainian exports of goods to the EU, grain crops accounted for 12.7%, seeds and oilseeds – 7.4%, fats and oils of vegetable or animal origin – 7.4%, ores, slag and ash – 8.5%, ferrous metals – 15.2%. These structural and dynamic imbalances cause long-term challenges for Ukraine’s foreign trade and balance of payments.

Macro-financial challenges. The insufficiently stable state of the Ukrainian monetary and financial system has a negative impact on the maintenance of integration and convergence processes between Ukraine and the EU. It is largely related to the incompleteness of financial sector reforms and the low level of development of financial services markets in Ukraine; low efficiency of the country’s financial integration into the European and global space; the vulnerability of the national monetary and financial system to the external impact of crisis phenomena (Borzenko *et al.*, 2020, p. 16).

Ukraine’s Western partners have repeatedly drawn attention to the need to overcome the existing challenges of its post-crisis development. Thus, in July 2019 the IMF member noted that Ukraine, if it wants to catch up with the world in economic development, needs a new business model, which “should supply goods, not people to Europe”, and the implementation of this model is impossible due to the continuation of large-scale corruption and inadequacy of institutions (Ukrinform, 2019, July 2). This remark obviously concerns the problem of large-scale labour migration of Ukrainian citizens. In 2018, the Ministry of Social Policy of Ukraine estimated seasonal labour migration from Ukraine at 9 million people and permanent migration at 3 million people.

The arguments mentioned above give us reason to believe that the challenges that currently arise in the process of Ukraine’s European integration are not fleeting. They have a deep institutional nature and affect the very model of its macroeconomic development, encouraging its effective transformation.

Challenges of slowing down convergence and deepening social divergence between Ukraine and the EU. Researchers of the Institute for Economics and Forecasting of the NAS of Ukraine based on econometric methods estimated the dynamics of the GDP per capita indicator, which shows the formation since 2014 the trends of socio-economic divergence of Ukraine and the EU and its

strengthening in recent years. To avoid a negative scenario for the long-term deepening of socio-economic divergence between Ukraine and the EU, Ukraine must adopt a relevant European experience in overcoming divergence (see, for example, László, 2019) to its own realities.

The main ways of such adaptation for Ukraine today are as follows: settlement of the conflict in Donbas, restoration and reintegration of the occupied and affected by the conflict territories; the implementation of an effective anti-crisis policy to overcome the consequences of the COVID-19 pandemic; carrying out effective institutional transformations, in particular, reducing the level of corruption; recovery of the industrial profile of the state; acceleration of innovation and investment modernization and structural and technological renewal of production; overcoming the debt dependence of the state; strengthening social protection and improving the quality of life; refracting the negative demographic trend and the trend of rapid labour migration abroad of Ukraine. None of these paths is easy for Ukraine due to the lack of political will, highly professional managers and the necessary resources, which can make overcoming the socio-economic divergence of Ukraine-EU a task for the next decades (Borzenko *et al.*, 2020, pp. 16–17).

Institutional Challenges: the EU-Ukraine Association Agreement. As already mentioned, over the past few years in Ukraine there has been a trend of deindustrialisation, structural degradation of the economy and foreign trade, steady growth of debt dependence on foreign lending, large-scale outflow of labour abroad. These reasons have largely prompted Ukrainian officials to initiate a revision of the Association Agreement with the European Union in late 2019 (it is only a revision of the annexes to the Association Agreement, as amendments to its text will require ratification of the updated version by all 27 EU Member States), which is politically difficult and require a long time). Therefore, the parties agreed that the renewal in the specified format of the Association Agreement between Ukraine and the European Union will take place in 2021.

Conclusions

The Association Agreement between the EU and Ukraine, signed in 2014, outlines the large-scale work that Ukraine needs to do to bring the prospects of EU membership closer. Achieving the goals of the Agreement crucially depends on overcoming the existing trends of divergence and launching convergence processes between Ukraine and the European Union.

Currently, Ukrainian-European cooperation is effective and has good prospects, which is confirmed in the Joint Statement following the 22nd EU-Ukraine Summit held on 6 October 2020. However, it is necessary to take into account not only the existing achievements of Ukraine's European integration but also the serious challenges that hinder this process and should be the focus of the national government. The advantages achieved during the period 2014–2020 during the European integration of Ukraine are related to its institutional development and the formation of civil society. Another significant achievement is the considerable increase in trade with the EU. This is evidenced by the impact of the Deep and Comprehensive Free Trade Area (DCFTA) that has been in place since 1 January 2016.

The most serious challenges to European integration are related to the problems of economic growth, deindustrialization, structural and dynamic disparities in foreign trade, macro-financial stability, as well as slowing down convergence and deepening Ukraine–EU social divergence. Challenges initiated by the institutional development of Ukraine and the EU have a significant impact on the integration process.

At the current stage, Ukraine needs to reconstruct its economy according to the new financial architecture in Europe and the world. It seems expedient for the State to move along the path of reconstructive economic development. This will help to strengthen its competitiveness and ensure socio-economic convergence and full integration with the European Union.

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