“EU Accession: What’s next? Macroeconomic policy for integration, security, and growth”

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Disclaimer

This paper builds on insights from the high-level discussion *“EU Accession: What’s next? Macroeconomic policy for integration, security, and growth”*, organized by the KSE Institute with participation from representatives of the Government of Ukraine—namely the Ministry of Finance and National Bank of Ukraine—as well as international financial institutions, the European Commission, and other distinguished experts. The discussion focused on how Ukraine’s EU accession path reshapes long-term growth prospects, macroeconomic policy choices, and reform priorities under conditions of prolonged uncertainty.

As Ukraine advances toward EU accession, the design of a durable growth model based on structural reforms, regulatory alignment, and productivity gains will present a significant challenge. EU integration raises the bar for institutional quality and policy credibility, making implementation capacity a binding constraint on progress.

The discussion during the event was centered on two interlinked questions: how structural reforms and EU alignment can generate sustained productivity-led growth, and how macro-fiscal frameworks must evolve to support convergence in the face of heightened security and financing risks.

The event was conducted under the Chatham House Rule. Accordingly, the paper does not attribute specific views to individual participants, but draws on the substance of the discussion to develop an integrated analytical perspective.

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Abstract

Ukraine’s key economic challenge is convergence with the EU, both in terms of macroeconomic and institutional aspects. The war is a permanent level shock, implying that reconstruction demand alone cannot close the income gap with the EU. GDP per capita relative to the EU provides the disciplining benchmark: convergence requires sustained growth outperformance,

with demographics ruling out labor as a key driver and shifting the burden to capital accumulation and productivity. Productivity emerges as the outcome of an ecosystem shaped by institutions, competition, finance, and value chain integration, while sectoral composition determines exchange rate pressures, inflation dynamics, and external balances. EU accession matters less as a one-off boost than as a mechanism for reducing risk premia, reallocating capital, and raising returns through regulatory alignment and credibility. Elevated debt reflects war shocks rather than fiscal indiscipline, making growth, financing composition, and concessionality central to sustainability. Accession reshapes external financing through expectations, triggering re-rating well before formal entry and gradually shifting inflows from official support to private capital. The paper presents ideas on an integrated long-horizon framework that connects growth, debt, financing, institutions, and EU conditionality, aiming to foster realism about capacity, sequencing, and sustainability in Ukraine's convergence path.

Economic Activity, Convergence, and Growth Constraints

The war represents a permanent level shock, not just a temporary shift that will be overcome during reconstruction. Destruction of capital, loss of labor and human capital, and prolonged uncertainty mean that post-war recovery cannot be equated with convergence. Even strong reconstruction activity does not automatically generate sustained catch-up with EU income levels.

GDP per capita relative to the EU average was repeatedly cited as the relevant benchmark during the discussion. Starting from a very low base of 12.5-13%, convergence even to the 25% threshold requires many years (from 10 to 30) of growth outperformance rather than a short post-war surge. Historical experience suggests that without a deliberate policy-driven acceleration, inertia dominates, and the income gap closes slowly.

Growth drivers are expected to be uneven and constrained, with demographics serving as a binding limitation. Even with a partial return of refugees, labor input is unlikely to become a source of growth, according to the discussion. This shifts the focus decisively toward capital accumulation and productivity as the main engines of expansion. Consequently, the policy focuses in the labor sector should be to match the supply of labor with the level needed to fully utilize growing capital, and to ensure the level of education to match technological advancements.

Productivity was discussed as an outcome of a complex ecosystem. Institutional quality, competition, access to finance, governance, and integration into value chains were repeatedly emphasized as determinants of how effectively capital and labor are combined. The same activity can generate very different productivity outcomes depending on the surrounding environment thanks to network effects.

Sectoral composition also matters for macroeconomic dynamics. Export-oriented growth paths generate different exchange-rate pressures, financing needs, and external balances than reconstruction led by domestic demand sectors. These differences affect inflation dynamics, import leakage, and the sustainability of capital inflows; therefore, they must be treated explicitly, especially during the recovery phase, which may significantly undermine macroeconomic indicators due to sectoral distortions.

EU accession contributes to growth through more than a one-off boost. Temporary gains from improved market access and confidence effects exist, but they are not sufficient to close the war-induced gap. The more important channel operates through sustained reductions in risk premia, better allocation of resources, and higher returns on investment as regulatory alignment and institutional reforms take hold.

Investment, Institutions, and the Foundations of Growth

Capital accumulation was consistently described as the primary driver of growth in the coming decade. Reconstruction needs are exceptionally large, while defense spending absorbs a significant share of resources. This combination makes the efficiency of investment and the ability to mobilize private capital central to Ukraine's economic growth outlook.

Private investment cannot be treated as a residual. Public resources and partner support are insufficient to finance reconstruction and convergence on their own, especially in the likely absence of reparations from Russia. Mobilizing domestic and foreign private capital, therefore, becomes a necessary condition rather than a policy choice.

Institutional quality shapes investment decisions more than moral calls to action and messages of international political support.. Predictable enforcement, protection from arbitrary losses, and credible anti-corruption mechanisms were highlighted as key determinants of risk premia. Without these conditions, neither domestic nor foreign investors commit long-term capital, regardless of the availability of financing.

Tax system distortions were identified as a concrete obstacle to scaling and productivity enhancements. Size-based regimes that favor small businesses discourage formalization and investments, reduce the bankability of projects, and further incentivize tax avoidance via the simplified tax regime. Reform priorities emphasize neutrality over preferential treatment, with a focus on simplification that enhances administrative efficiency.

The role of the state in the economy remains a constraint. Weak governance of state-owned enterprises distorts competition and crowds out private activity. Improving SOE governance in line with international standards, alongside selective privatization, was discussed as a means to enhance efficiency, mitigate fiscal risks, and attract private investment.

Financial intermediation remains a bottleneck despite wartime stability. Tight regulation and weak project pipelines limit credit expansion during the recovery. Improving project bankability through governance reforms, risk-sharing mechanisms, and deshadowing efforts was seen as essential to shift banks from balance-sheet preservation toward financing productive investment.

Large investment inflows create new macroeconomic risks. Volatile capital flows can lead to overheating and exchange-rate pressures if not carefully managed. Coordinated use of monetary policy, macroprudential tools, and capital-market development is required to ensure that inflows support productive capacity rather than speculative cycles.

The Defense Industry as an Economic and Strategic Sector

Defense spending was framed as more than wartime consumption. Further discussion emphasized that military investment can support industrial capacity, innovation, and productivity if it is embedded in a broader European framework rather than being treated as an isolated sector.

It was also highlighted that Ukraine had developed specific advantages in defense-related activities: rapid innovation cycles, operational feedback, and cost-effective solutions, which emerged under extreme conditions. These strengths create opportunities for cooperation, but translating them into durable industrial capacity requires effective governance, adequate financing, and sufficient scale.

Ultimately, integration into European defense structures was presented as a strategic opportunity. Joint production, shared standards, and interoperability matter more than trade in finished goods. Participation in EU defense programs and joint procurement mechanisms were seen as a way to anchor investment within predictable, rules-based frameworks.

Another topic for discussion was localization models, which were considered to be particularly effective. Financing domestic production rather than external procurement strengthens firm-level capabilities, builds track records, and supports future export potential once domestic demand stabilizes and export restrictions are relaxed.

Yet, scalability was identified as the binding constraint. Adaptability alone is insufficient as production volumes and supply chains become decisive factors. Addressing this requires moving beyond merely making funding available and toward measures that improve firm bankability, access to long-term capital, and integration into European production networks.

Public Finance Management

Ukraine's fiscal position reflects war-driven structural stress rather than a lack of policy discipline. A narrow revenue base, exceptionally high spending needs, and elevated debt jointly constrain fiscal space. External support remains essential to sustain defense, social spending, and reconstruction.

Defense and social expenditures dominate the budget. While external financing has preserved short-term stability, it has reduced fiscal flexibility and increased vulnerability to shifts in partner support. Additionally, high levels of defense and social spending reduce government resources devoted to other critical capital expenditures, undermining long-term growth. Revenue mobilization and spending prioritization are Ukraine's core adjustment mechanisms. Broadening the tax base, reducing informality, strengthening administrative efficiency, and reallocating spending toward growth-enhancing investments were repeatedly emphasized as necessary for sustainability.

Public financial management (PFM) was highlighted as a binding constraint. Absorbing EU funds and partner financing depends on having robust internal controls, effective procurement systems, adequate audit capacity, and a multi-year budgeting approach. Weak PFM does not merely delay spending; it weakens growth multipliers and credibility.

Fiscal frameworks must reflect persistent security risks. Medium-term projections should embed structurally high defense spending and conditional external support rather than optimistic normalization assumptions. The explicit testing of alternative financing mixes, including their implications for debt dynamics and refinancing risks, will be necessary for reconstruction.

Debt Sustainability

Debt sustainability is a critical instrument in long-term frameworks. High debt affects risk premia, interest rates, investment decisions, exchange-rate stability, and the likelihood of self-fulfilling crises. The explosive dynamic of the debt ratio is costly, with output losses that can rival a full year of GDP. Debt management becomes a key indicator and target in the fiscal framework.

However, Ukraine's debt burden must be interpreted in context. The sharp increase is the result of war-related shocks, not prolonged fiscal mismanagement. Before the full-scale invasion, fiscal indicators were comparatively prudent: the deficit, primary balance, and debt-to-GDP ratio were all within comfortable ranges for a developing economy. This distinction is crucial for effective policy design and partner engagement. Thus, restoring debt sustainability cannot rely solely on domestic adjustment. Given the scale of the war-induced shock, the design, maturity, and concessionality of external support play a decisive role in whether post-war debt paths remain manageable.

There is no single safe debt threshold. Sustainability depends on credibility, growth prospects, financing terms, and the composition of creditors. The same debt ratio can be stable in one environment and destabilizing in another. This further reinforces the notion that context matters for Ukraine, as it has a high debt-to-GDP ratio, yet a steady flow of concessional support that will continue for several years, given some existing commitments.

The composition of financing is therefore critical. Official concessional loans, grants, and market borrowing have different implications for risk, rollover, and credibility. Large future repayments to official creditors imply that refinancing and restructuring strategies matter as much as primary balances. The debt servicing burden has to be restructured in a way that will not corrode growth.

Loan-heavy support can become binding even under strong policy performance. The discussion cautioned against mechanically layering additional large loans onto the framework without confronting medium-term feasibility. Debt-neutral instruments and sustained concessionality are essential scenario dimensions.

Risk premia respond to expectations. Credibility also depends on consistent macroeconomic policy, a clear fiscal path, monetary stability, and external backstops, not just debt trajectory. These elements must be modeled endogenously rather than treated as exogenous shocks.

External Sector and Capital Flows

EU accession reshapes external financing through enhanced credibility and adherence to rules. Progress toward EU accession acts as a credible signal to markets, reshaping investor expectations beyond formal regulatory changes. Over time, this shifts external financing away from emergency official support toward private capital and foreign direct investment (FDI), lowering the economy's cost of capital. Importantly, this re-rating process begins well before formal accession, as markets price in credible progress toward EU alignment rather than waiting for legal completion.

Access to the EU single market expands the effective market size and supports integration into value chains. Historical experience shows that this can significantly impact investment patterns, although the transition is gradual rather than immediate.

Capital inflows create both opportunities and risks. Without sufficient depth and governance, improved perceptions can translate into volatility rather than sustained investment. Managing appreciation pressures and reserve accumulation requires treating these dynamics as endogenous policy challenges.

External adjustment occurs in stages. Early re-rating attracts more volatile portfolio flows, while deeper integration supports long-term commitments in FDI over time. Official financing and private inflows coexist for extended periods, especially under continued security uncertainty.

Monetary Policy and Exchange-Rate Regime

Price stability remains the core nominal anchor. A credible inflation-targeting framework supports confidence, limits risk premia, and aligns policy with EU standards. This role becomes more important, not less, during convergence.

Convergence brings real appreciation pressures. Faster productivity growth raises wages and prices through familiar mechanisms, reflecting income catch-up rather than loss of competitiveness. The pace depends on the composition of investment and sectoral transformation.

Policy trade-offs intensify during recovery. Balancing inflation control with competitiveness requires the combination of a flexible exchange rate and disciplined interest-rate policy. This allows the currency to absorb shocks and supports reserve rebuilding.

Euro adoption was discussed as a strategic objective from the start rather than a vague policy option far in the future. Early preparation, reduced volatility, and stronger nominal anchors matter more than formal timing. Interim instruments, including cooperation with European monetary institutions, can support credibility during Ukraine's transition to the Euro. At the same time, the framework must acknowledge the loss of policy flexibility and treat adoption as a sequencing question.

Reforms and EU Accession as a Policy Engine

Institutions determine whether reforms translate into growth. Rule of law, competition policy, and regulatory predictability shape investment, productivity, and credibility. Weak implementation undermines even well-designed reforms.

EU accession provides a structured reform engine. Chapters, clusters, and benchmarks create a sequenced agenda linked to financing and market access. Progress is comprehensive rather than selective, and credibility depends on implementation across the EU acquis.

The National Programme for the Adoption of the Acquis plays a central operational role. It links legislation, capacity building, timelines, and accountability, and feeds directly into monitoring and disbursement decisions. This makes it a natural anchor for macroeconomic modeling.

Absorptive capacity and sequencing constraints are macro-relevant. Implementation lags, underspending, and administrative overload affect growth outcomes and financing effectiveness. These constraints must be modeled explicitly rather than assumed away.

Governance improvements feed into risk assessments. Better PFM, procurement, and tax administration lower risk premia and support private capital inflows, strengthening the macro-financial transmission of reform progress.

Conclusion

The discussion converged on a clear conclusion: Ukraine's EU accession path cannot be treated as a background assumption in macroeconomic forecasting. It is a structural regime shift that reshapes growth drivers, financing conditions, debt dynamics, and policy credibility.

Convergence is not a rebound. Reconstruction demand alone cannot close the income gap created by the war. Sustained catch-up requires investment- and productivity-led growth under tight demographic, fiscal, and security constraints. The solution lies in a clear reform path and agreements with international partners.

Financing, credibility, and partner support jointly determine whether growth paths are feasible or destabilizing. Debt sustainability becomes a pillar of credibility, and the corresponding analysis, which includes the Ukrainian context of war pressure, is a key target of the framework.

EU accession functions as a policy engine. Conditionality, NPAA milestones, and absorptive capacity establish a rule-based link between reforms, financing, credibility, and growth. Modeling these links explicitly is the only way to assess trade-offs and identify viable long-term paths.

The value of the framework lies in its ability to force realism. Growth ambitions must be paired with financing strategies. Reform sequencing must reflect capacity. Support instruments must respect sustainability. Only by integrating these elements can Ukraine chart a credible path from recovery to durable convergence.