EU-Ukraine trade and investment relations and the impact of Russia’s war

- The **EU-Ukraine Association Agreement** is the main tool for bringing Ukraine and the EU closer together: it promotes deeper political ties, stronger economic links and the respect for common values. The Agreement was negotiated between 2007 and 2011, signed in 2014, and entered into force on 1 September 2017 after unanimous ratification by EU Member States.

- The Association Agreement includes a **Deep and Comprehensive Free Trade Area (DCFTA)** between the EU and Ukraine that has been provisionally applied since 1 January 2016.

- By 2020, the EU had become Ukraine’s most important export market and principal source of imports, dwarfing Ukraine’s second partner – China – and placing Russia a distant third.

- Since the Russian Federation launched its military invasion of Ukraine on 24 February 2022, EU-Ukraine trade and investment relations have started to experience constraints, with some European (car) manufacturers reporting disturbances and temporarily halting production due to a lack of Ukrainian components.

- Ukraine’s future trade prospects will depend not only on its trade partners, but also on rebuilding the physical damage the country has suffered, and on the status of its ports.

**Trade background**

The EU is Ukraine’s most important trading partner, accounting for more than 40 % of its total trade in goods in 2021. In return, Ukraine is the EU’s 15th largest trading partner, representing around 1.2 % of overall EU trade.

Trade between Ukraine and the EU has grown since the provisional application of the DCFTA in 2016. Between 2016 and 2021, Ukrainian exports to the EU grew by 87 %, reaching EUR 24.1 billion in 2021, with the total trade between the two partners valued at EUR 52.4 billion. Ukraine’s major exports include raw materials (iron, steel, mining products, agricultural products), chemical products and machinery. In 2021, agricultural products accounted for approximately one-third of the EU’s imports from Ukraine.

The EU’s major exports to Ukraine were worth EUR 28.3 billion in 2021, principally including machinery and transport equipment, chemicals, and manufactured goods. EU exports have grown at a similarly impressive rate as Ukraine’s: 74.9 % since 2016, leaving the EU with a EUR 4.2 billion trade surplus to Ukraine.

In addition, the number of Ukrainian companies exporting to the EU has increased at a considerable rate, from approximately 11 700 in 2015 to over 14 500 companies in 2019. The COVID-19 pandemic crisis led to a contraction in economic activities between EU and Ukraine, generally affecting Ukraine more than the EU.

In 2020, European Union foreign direct investment stocks in Ukraine reached a peak of EUR 25.8 billion, up from EUR 18.8 billion in 2018 and EUR 21.9 billion in 2019.
Regulatory issues predating the war

While trade with Ukraine has been upended by the war, a number of regulatory and other issues that existed before the war remain relevant, and would need to be addressed once trade resumes between the partners.

Whilst the EU has welcomed significant progress made by the Ukrainian government regarding public procurement regulation and alignment with EU regulatory and legal standards since 2016, more approximation was requested in phyto-sanitary measures, customs cooperation and trade facilitation. Other areas where the EU expect further improvements from the Ukrainian side are the protection of intellectual property rights, the alignment with EU’s state aid rules, and the enhanced adaptation of international standards in Ukraine’s national legislation.

On trade irritants, poultry imports from Ukraine in 2016 were found to be non-standard, which led to an amendment to the Association Agreement on import limitations. Other trade irritants in negotiations with Ukraine include a value added tax law enacted by Ukraine in 2018, which denies VAT refunds on exports of rapeseed and soybean. Furthermore, due to a lack of progress on a ban imposed by Ukraine on unprocessed wood export ban, the EU launched a request for bilateral dispute settlement consultations under the Association Agreement.

In 2018, the EU and Ukraine started work on trade and sustainable development in line with a 15-point action plan developed by the European Commission. Discussions focused on key areas such as trade and labour issues (labour inspection, modernisation of labour relations, social dialogue), as well as trade and environmental issues (sustainable forest management and related wood production, sales, processing and trade). The EU and Ukraine published operational conclusions, as well as a joint statement to civil society.

Disruption of EU-Ukraine supply chain networks since the war

The ongoing war in Ukraine continues to impact European supply chains. Major European car makers (including BMW and Volkswagen) have been forced to idle their plants across Europe after Russia’s invasion forced the temporary shutdown of Ukrainian wiring plants (which build harnesses that hold together electric cabling for automobiles). Ukraine accounts for about a fifth of Europe’s supply of harnesses, which also come from other parts of Eastern Europe as well as North Africa.

Equally important, Ukraine supplies about 50% of the world’s neon gas, which is used to produce semiconductor chips.

These dependencies may encourage European companies to look at the risks associated with international suppliers and consider buying more locally in the EU or EEA. Other strategic options for EU companies to avoid disruptions from Ukrainian supply chains would involve moving equipment from Ukraine to the EU (which would be difficult due to the security situation at border crossings), relocating production, or replicating goods and materials, which would all come at a high cost.

Inside Ukraine, agricultural production and food supply have been obstructed by Russia’s war on the country. This has led Ukraine to halt exports of key foodstuffs, including wheat and sunflower oil in order to safeguard domestic supply. The G7 countries’ agriculture ministers signed a joint declaration committing to keep food markets open and support food supply in Ukraine in an extraordinary meeting on 11 March.

Transport problems caused by the war

Global transport of goods from and into the EU is also being impacted by the war in Ukraine. In addition to the war-related destruction of transport infrastructure, maritime trade routes have been affected by the sanctions imposed on Russia (see also Geographical matters, below); tankers have been pulled from charter markets and ports blocked, leading imports and exports to stall.
Similarly, the disruption of railway infrastructure has further strained EU trade flow, as 50% of all EU-bound traffic using China-Europe rail freight enters the EU via Russia and Belarus. Air cargo is equally impacted, given that most flights between Europe and Asia are being rerouted, adding time and cost to conventional air trade routes.

Impact of physical damage

On 31 March, the International Monetary Fund’s Managing Director Kristalina Georgieva underscored the necessity of rebuilding Ukraine physically in order to rebuild trade: “Even if hostilities were to end right now, the recovery and reconstruction costs are already massive,” she said. “We are talking about ... massive destruction in the key cities ... as well as massive destruction of transport infrastructure.”

The Ukrainian government’s estimates of damage have quintupled in the past weeks: from EUR 100 billion on 10 March to EUR 500 billion on 31 March.

The need to rebuild Ukraine in order to re-establish healthy trade and economic development has been compared to the situation of Central European countries after World War II: analysts have compared the massive funds that will be required to the Marshall Plan, with an upswing in trade offsetting the costs only later.

Geographical matters

Assuming that Ukraine remains a sovereign partner for the EU in the future, the prospect of altered borders for the country would significantly impact the country’s ability to trade.

The port of Mariupol, devastated by bombing, has been strategically important for access to the Black Sea from the Azov Sea. Mariupol is also the site of major iron and steel works, and much of the steel – along with the coal and corn – that Ukraine exported to the Middle East passed through Mariupol.

The port of Odessa, located on the Black Sea in south-eastern Ukraine, is a major – and for now relatively unscathed – transport hub. The port has an annual capacity of 43 million tonnes of cargo – two and a half times the capacity of Mariupol. Maintaining control of the port of Odessa will be therefore be essential for Ukraine to preserve its future trade with partners in the EU and beyond.

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