

DCFTA Implementation: Opportunities and Challenges for Ukrainian Entrepreneurs

Oleksandr KUBATKO*, Tetyana PIMONENKO**

Abstract

The paper deals with the analysis of Ukrainian entrepreneurs readiness for implementation of Deep and Comprehensive Free Trade Area (DCFTA). The authors analyzed the ongoing condition for running business in Ukraine, and results were in favor negative industrial business tendencies combined with macroeconomic instability. Moreover, the military confrontation in the East of Ukraine has had negative consequences for the social, moral and economic situation in the country. Authors have estimated the chances and goals of Ukrainian entrepreneurs to be achieved using the DCFTA. Thus, the effect of DCFTA implementation could provide 6 % of the additional GDP in the medium term. The share of export to EU in total Ukrainian export of goods and services has increased from 26.7 % in 2013 to 32.8 % in 2015. The entrepreneurs of agriculture sector and textile industry are expected to receive the most positive effect of DCFTA implementation. Thus, the export of the cereal crops has increased by 3 % in 2015 compare with 2013. In addition, the export of Electrical machinery and equipment also has increased by 3% in 2015 comparing to 2013. Moreover, DCFTA implementation allowed opening new boundaries and opportunities for entrepreneurs in IT sector. At the same time, the machine building industry is expected to be very sensitive to the DCFTA implementation due the low competitiveness.

Keywords: DCFTA, entrepreneur, European Union, integration, running business.

1. Introduction

The ongoing situation in Ukraine can be characterized as not stable, and within such conditions it very difficult to work and develop business sector. A lot of problems in economic, political, social spheres restrain its development. From the other side Ukraine has already started the European Union (EU) integration process, and the first steps have been done by Ukraine. Thus, starting the first of January, 2016 the economic part of Associated Agreement had started its operation and domestic entrepreneurs have already felt the first benefits and barriers.

* Oleksandr KUBATKO, PhD, Associate Professor, Department of Economics and Business-Administration, Sumy State University Sumy, Ukraine okubatko@ukr.net

** Tetyana PIMONENKO, PhD, Senior Lecturer, Department of Economics and Business-Administration, Sumy State University Sumy, Ukraine.

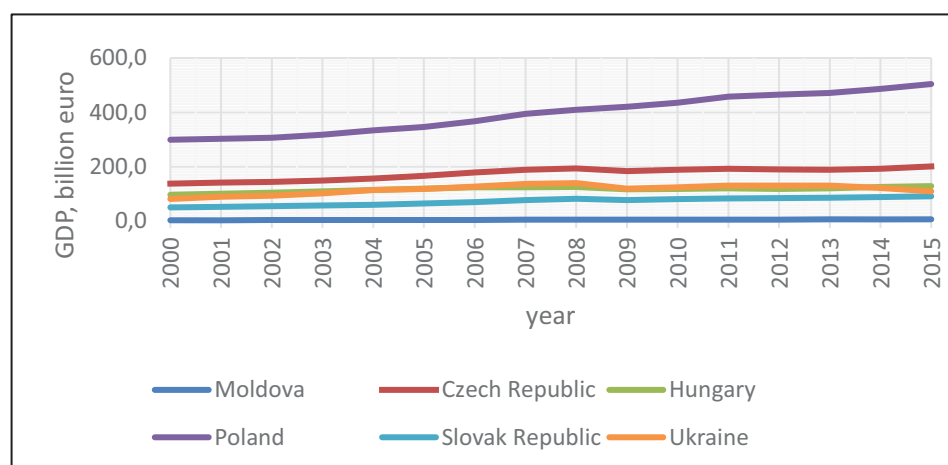
E-mail: Tetyana.pimonenko@gmail.com

The main purpose of this article is to analyze the new conditions of business running which were created by EU integration processes. Moreover, the systematization of opportunities and challenges for Ukrainian business sector and development of recommendations are important part of research.

2. Main part

The results of GDP dynamics in Ukraine before the EU integration process and after first major steps are shown in (figure 1).

Figure 1. Dynamic of GDP in Ukrainian, Moldova and Vysegrad Group (2000-2015), bln euro



Source: Data from database: World Development Indicators

It is clearly seen that GDP was decreasing during 2014-2015. Official statistics states that GDP declining in 2014 in comparison to 2013 was about 7% in the decline was 9% in 2015 in comparison to 2014. The above-mentioned results are usually explained by military confrontation at the East of Ukraine and process of reorientation from Russian market to EU market. On the other side, according to Ukrainian Statistics the GDP of second quarter of 2016 is about 18.9 billion euro, which is higher than in the second quarter of 2015 by 18.9%. If we analyze the dynamics of GDP in Visegrad group countries (Czech Republic, Hungary, Poland, Slovak Republic) we can see that the GDP after EU integration (2004) has been increasing compare to 2000. The same results we can see in Moldova. That is why we may predict that GDP will increase in the medium or long run perspective.

Table 1. Comparison dynamic of GDP in Ukrainian, Moldova and Vysegrad Group; (compare to 2000), %

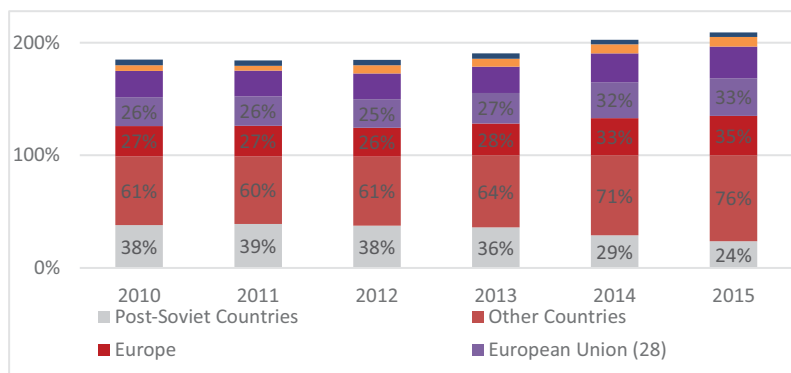
Country	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Moldova	6%	14%	22%	31%	41%	48%	52%	64%	54%	65%	76%	74%	91%	100%	99%
Czech Republic	3%	5%	9%	14%	21%	30%	37%	40%	34%	37%	39%	38%	37%	40%	46%
Hungary	4%	9%	13%	18%	23%	28%	29%	30%	21%	22%	24%	22%	24%	29%	33%
Poland	1%	3%	6%	12%	16%	23%	32%	37%	41%	46%	53%	55%	57%	63%	68%
Slovak Republic	3%	8%	14%	20%	27%	38%	53%	62%	53%	61%	65%	68%	70%	75%	81%
Ukraine	9%	15%	26%	41%	45%	55%	68%	71%	46%	52%	60%	60%	60%	50%	35%

Colour means the period after EU integration

Source: Data from database: World Development Indicators, 10.04.2016

From the January 1, 2016 the DCFTA has been come into power and this also can make the positive influence on economic situation in Ukraine. The main DCFTA goals are to boost trade in goods and services between the EU and Ukraine by gradually cutting tariffs and bringing Ukraine's rules in a line with the EU's in certain industrial sectors and agricultural products (Countries and regions, 2016). According to the official statistics, the export of products and services to Post-Soviet countries has decreased by 40% in 2015 from 2014. Moreover, the share of export goods and services to Post-Soviet countries has been decreasing from the 2013 year. Thus, in comparison to 2013 there was decreasing in 2014 about 7%, in 2015 it was 12%. From the other side the share of the export to EU has been increasing from year to year. Thus, compare to 2013 the increasing in 2014 was 5%, in 2015 was 7% (figure 2).

Figure 2. Share of export by country in total Ukrainian export products and services; (2010-2015), %



Source: Data from database: State Statistics Service of Ukraine

The results of import dynamics to Ukraine has showed that the import from Post-Soviet countries is also slowly decreasing, and import from EU is increasing from year

to year. The main Ukrainian exports are raw materials (iron, steel, mining products, agricultural products), chemical products and machinery. Unfortunately, the export of products has decreased in 2015 by 7,0%. Most of export reductions were brought by falling of mineral fuels, lubricants and related materials selling. It is necessary to underline that the import of food, drinks, tobacco and live animals has increased. In addition to that the import of animal, vegetable oils, fats and waxes had already increased in 2015 by 3.9% in comparison to 2014 (table 2). All of these testify that the entrepreneurs in the agriculture sector can receive the most positive effect of DCFTA implementation. Thus, the export of the cereal crops has increased by 3 % in 2015 comparing to 2013. Also, the export of electrical machinery and equipment also has increased by 3% in 2015 comparing to 2013.

The results revealing the structure Ukrainian import to EU were not heavily changed (table 2).

Table 2. Ukrainian exports to EU

Indicators, million euro	Import to EU from Ukraine			Share in total		
	2014	2015	Changing	2014	2015	Changing
Total - all products	13 733	12 766	-7,0%	100%	100%	
Manufactured goods classified chiefly by material	3847	3505	-8,9%	19%	27%	8%
Crude materials, inedible, except fuels	2604	2388	-8,3%	19%	19%	0%
Food and live animals	2495	2592	3,9%	18%	20%	2%
Machinery and transport equipment	1417	1412	-0,4%	7%	11%	4%
Mineral fuels, lubricants and related materials	1005	519	-48,4%	7%	4%	-3%
Miscellaneous manufactured articles	630	652	3,5%	4%	5%	1%
Animal and vegetable oils, fats and waxes	616	622	1,0%	4%	5%	1%
Chemicals and related prod, n.e.s	551	505	-8,3%	4%	4%	0%
Other	516	511	-1,0%	0%	4%	4%
Commodities and transactions n.c.e.	33	31	-6,1%	0%	0%	0%
Beverages and tobacco	19	29	52,6%	0%	0%	0%

Source: Eurostat

The main Ukrainian export to EU do include small portion of machinery and transport equipment, chemicals, and manufactured goods (Countries and regions, 2016). On the contrary, the share of Manufactured goods classified chiefly by material was 27% which was higher by 8% in comparison to 2014.

It seen from table 3 that the import volume of Miscellaneous manufactured articles didn't change – 22%. Increasing per 1% was by the following indicators: Chemicals and related prod, n.e.s, Crude materials, inedible, except fuels, Miscellaneous manufactured articles.

The trading balance between Ukraine and EU is presented on the figure 3. According to the results after the starting the EU integration process the difference of the trading balance has started to change to the positive side. If in 2012 the balance was €-10.01 billion, in 2013 was €-11.31 billion, so in 2014 was €-4.47 billion and in €-2.54 billion.

Of course, it is connected to the decreasing of trading volume with EU, but from the other side the reduction of trading balance is consequences of opening boundaries to EU market for Ukrainian entrepreneurs.

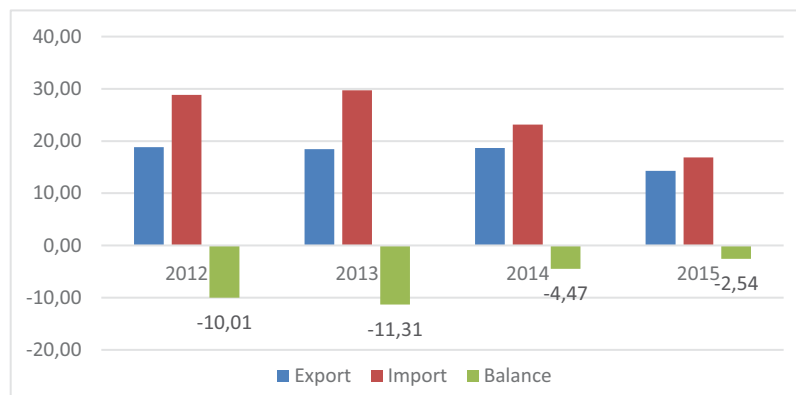
Table 3. Ukrainian import from EU

Indicators	Export, million euro		Share in total, %	
	2014	2015	2014	2015
Total - all products	16 986	13 924	100%	100%
Manufactured goods classified chiefly by material	4923	4248	29%	31%
Miscellaneous manufactured articles	3676	3105	22%	22%
Chemicals and related prod, n.e.s	2599	2174	15%	16%
Mineral fuels, lubricants and related materials	1870	1308	11%	9%
Machinery and transport equipment	1677	1300	10%	9%
Food and live animals	1309	972	8%	7%
Crude materials, inedible, except fuels	417	403	2%	3%
Other	191	117	1%	1%
Beverages and tobacco	187	176	1%	1%
Commodities and transactions n.c.e.	83	83	0.5%	1%
Animal and vegetable oils, fats and waxes	54	38	0.3%	0.3%

Source: Eurostat

The EU is a large investor in Ukraine. EU investors held investments worth around €30 bn in Ukraine in 2015. It was 76.2% of total sum of investments in Ukraine. In 2015 through EU the largest investors were Cyprus (27%), the Netherlands (13%) and Germany (12%). Moreover, in 2015 year the structure of the main investors didn't change.

Figure 3. Dynamic in trade of goods between Ukraine and EU; (2012-2015), bln euro



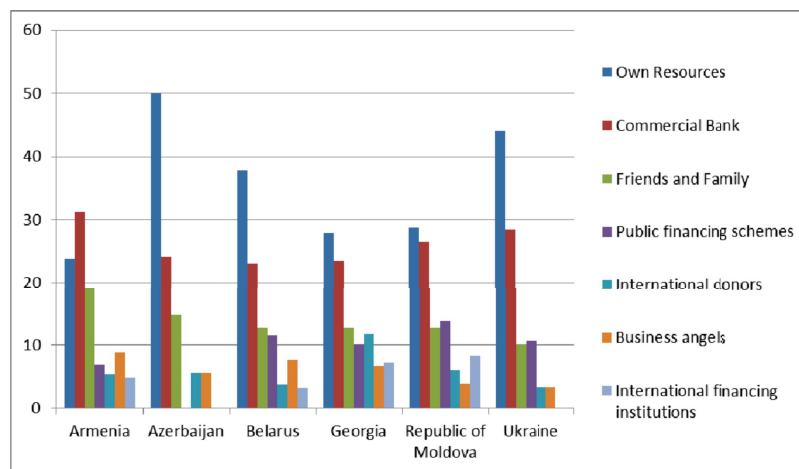
Source: Data from database: State Statistics Service of Ukraine

Unfortunately, the process of EU integration and market reorientation were not properly forecasted. In this case, Ukrainian entrepreneurs could not feel fast benefits from integration process and DCFTA implementation. In general, Ukraine has already harmonised a lot of its norms and standards in industrial and agricultural products and the last should stimulate better integration with the EU market. In addition, Ukraine has already aligned a lot of its legislation to the EU's in trade-related areas such as:

- competition;
- public procurement;
- customs and trade facilitation;
- protection of intellectual property rights;
- trade-related energy aspects, including investment, transit and transport (Countries and regions, 2016).

It should be underlined that the share of Ukrainian GDP generated by the entrepreneurs is increasing from year to year, but it is the less share of GDP compare with EU. Furthermore, according to the EU investigation (EU support to SMEs) the developing of Ukrainian business sector is kept down by the lack of financing, inadequate legal and regulatory framework; lack of knowledge base/business skills; limited access to markets (local and international). Moreover, the main resources of running business in Ukraine are own resources, then commercial bank and friends or family. The share of business angels and international donors are the smallest (figure 4).

Figure 4. Primary financing resources for SMEs



Source: East Invest Survey 2012

According to the Summary Report of EU Support to the Private Sector in the context of Association Agreements/DCFTAs the main constraints which limited the development of Ukrainian entrepreneur' sector are as following:

1. Cost of finance.
2. Availability of finance (willingness to lend).
3. Political instability.
4. Corruption

5. Tax rates (EU Support to the Private, 2015).

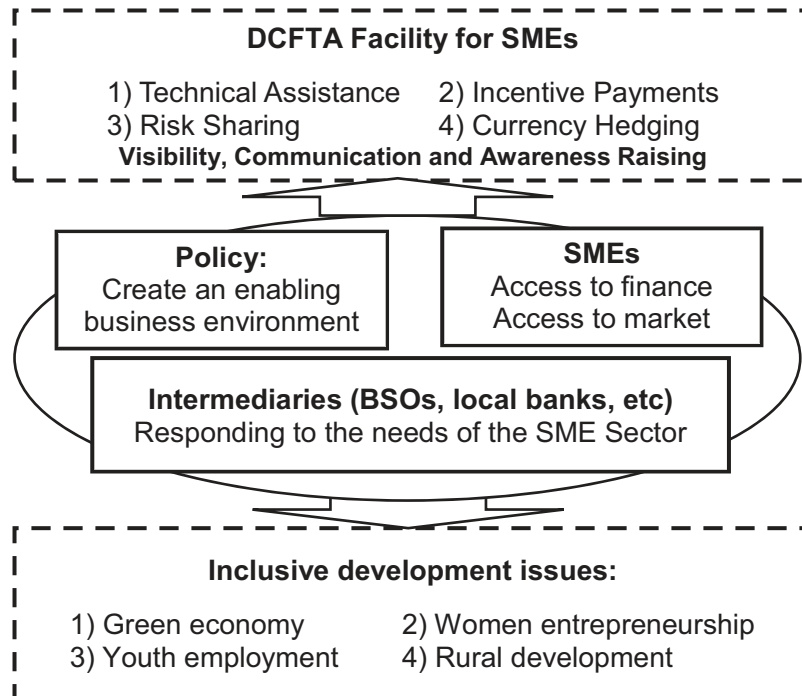
The DCFTA implementation is called not to remove the market boundaries only, however the new mutual opportunities for EU and Ukraine should arise. As a result Ukrainian Small and Medium sized Enterprises (SMEs) have got opportunity to receive funding from the EU's SME Flagship Initiative. The main objectives of this Initiative for Ukraine are:

1. Help SMEs to seize new trade opportunities with the EU and within the region which have been opened up thanks to the DCFTA;
2. Improve access to finance for SMEs to make the necessary investments to comply with the provisions of the DCFTA;
3. Allow SMEs to take advantage of the increased inflow of foreign direct investment triggered by the DCFTA;
4. Enable SMEs to comply with new sanitary, phytosanitary, technical and quality standards, as well as with environmental protection measures, thereby benefiting local customers and boosting exports to the EU and beyond.

The working mechanism of EU's SME Flagship Initiative combine and harmonize three main

directions (policy, intermediaries and SMEs) with purpose to solve the inclusive development issues and to provide Visibility, Communication and Awareness Raising are presented at the figure 5.

Figure 5. The structure of intervention the EU's SME Flagship Initiative



Source: Created by authors on the Eastern partnership, 2015

According to the main policy of EU's SME Flagship Initiative, the DCFTA Facility for SMEs will receive approximately € 200 million of grants from the EU budget, which are expected to unlock at least € 2 billion of new investments by SMEs in the three countries (Ukraine, Moldova and Georgia), largely coming from new EFI loans supported by the Facility.

Such investments will transform the business fundamentals. The local banking sector, business services to SMEs, trade and quality infrastructure, and the overall business climate will highly benefit from the Facility, creating hereby a virtuous cycle of growth and contributing to significant job creation (Eastern partnership, 2015).

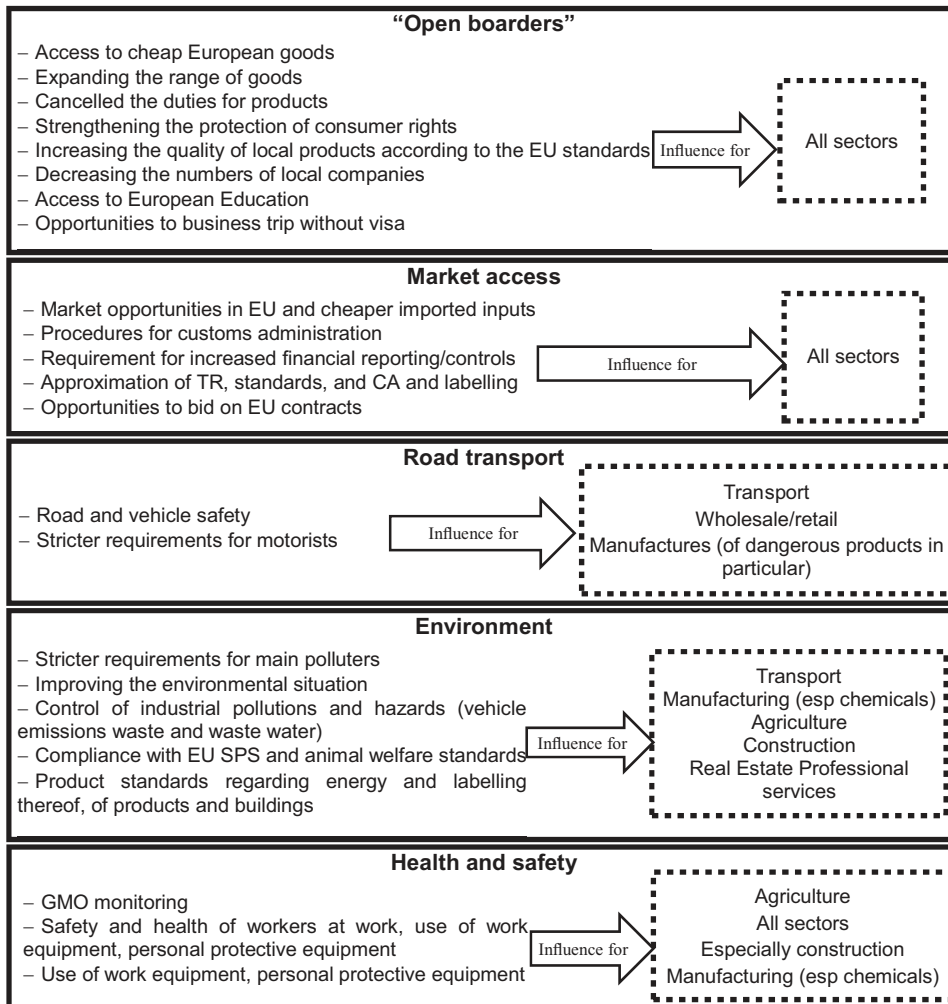
Thus, first of all the import and export duties and tariff quotas will be eliminated. From one side it means new opportunities for exports into the EU and enlarging the quality and range of products. At the same time, it is the threats for local entrepreneurs which are not ready to work in international market according to the EU standards. As a consequence, it will be stimulating the local entrepreneurs to become competitive or loose the business. The following consequence is reducing tariff and, most importantly, non-tariff barriers to entering the EU market, which is currently the largest regional market and one of the two largest trade partners of Ukraine (EU-Ukraine, 2015). The improving and adaptation of legislation according to EU standards allow creating the favourable domestic business climate. The increasing of compliance costs with "social" standards stipulates improvement of labour conditions, increases salary to enlarge the work opportunities in EU. In addition DCFTA is considered to be one of engines to stimulate sustainable development. That is why the requirements for main polluters will be stretched (Kubatko O., Pimonenko T., 2015).

Taking into account the current situation in Ukraine the perspectives of DCFTA implementation for Ukrainian entrepreneur's sector can be improved by the following activities:

- 1) to decrease the gaps in the Ukrainian legislation in comparison to EU. At the same time Ukrainian entrepreneurs should quickly adopt to new conditions. That is why they should continuously improve their knowledge;
- 2) to create the national mechanisms for cooperation and participation in international markets. Ukrainian entrepreneurs must participate and be represented at international level.
- 3) to create and implement new procedures and systems needed for customs officers in issuing certificates of origin and for MEDT on administration of TRQs. And also, Ukrainian entrepreneurs should learn how to work in such requirements;
- 4) to create new independent non-governmental body responsible for standardization and transfer of the functions of the Secretariat of 30 technical committees on standardization. In this direction, Ukrainian entrepreneurs must prepare for the certification process;
- 5) to adopt and harmonize the customs administration procedures including risk assessment, post clearance controls and company audit methods according to the EU requirements.
- 6) to learn how to write grants and project to receive the financing support from EU sources;
- 7) to create administrative system for air and water quality monitoring. In such directions Ukrainian entrepreneurs should change their thinking from mainly

economics results, to the environmental problems and future generation challenges. They must be ready to spend money for innovative green technologies.

Figure 6. Systematizing the perspectives of DCFTA implementation for Ukrainian entrepreneur's sector



Source: Compiled by the authors on the basis of the literature sources (Eastern partnership, 2015), (Kubatko O., Pimonenko T., 2015)

Conclusion:

In order to receive economic benefits for domestic entrepreneurs from DCFTA implementation it is needed to perform several major changes and adaptations. First

new (innovative) mechanisms and approaches have to be implemented to stimulate entrepreneurs' competitiveness in solving urgent economic and social issues. Moreover, these mechanisms should be harmonized and provide the implementation of the best European practice.

It is expected that Ukrainian entrepreneurs could provide up to 6 % of the additional GDP in the medium term using the DCFTA opportunities. Among the main challenges of DCFTA implementation are modernization of Ukrainian machine building and other technological industries to be competitive on the EU market. In any case, closer links with EU companies would decrease the number of local companies. The research statistics states that portion of manufactured goods classified chiefly as material in the Ukrainian export to EU is growing from year to year, the last is a serious challenge for Ukraine, since it means the deterioration of technological potential of domestic producers.

Among the main opportunities of DCFTA implementation is SMEs development through EU institutions and funds, which could be good since the share of Ukrainian GDP generated by the entrepreneurs is increasing from year to year. In addition, entrepreneurs of agriculture sector are receiving vivid positive effect of DCFTA implementation.

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Угода про асоціацію між Україною, з однієї сторони, та

Європейським Союзом, Європейським співтовариством з атомної енергії і їхніми державами-членами, з іншої сторони