December of 1991 serves as the beginning of an evolution in Eastern Europe. On Christmas day of that year, the flag of the Soviet Union was lowered and Ukraine was founded, introducing a new era of self-reliance and freedom. The country of Ukraine prevailed in world news with a seemingly constant wave of challenges throughout its development of new and unfamiliar concepts of independence. With every establishment of a new country there is significant struggle in finding its true identity within the world. Prior to independence, Ukraine primarily relied on the Soviet Union, never having exact individuality until the end of the reign of communism. Since freedom, Ukraine has both struggled and succeeded in managing its economic sectors, establishing a political system, and forming relations with the European Union and with Russia. As the country works toward advancement in an already developed world, while also experiencing conflict due to the recent secession of Crimea, economists continue to watch Ukraine’s actions in order to forecast the country’s economic position.

This research paper highlights what was found to be the most important aspects of independent Ukraine’s economy. Starting with the economic sectors, the paper describes industry in Ukraine, the energy sector, and the job market along with unemployment. Section III includes international relations with the sub sections of Ukraine as a small open economy, relations with the European Union, and an explanation of foreign investment in the country.
Section IV describes conflicts in the country since independence, containing information regarding Russian aggression and the annexation of Crimea in 2014. Following this material is Section V which outlines Ukraine’s economy post 2014. Section VI then goes on to summarize forecasts that have been made for the future of the country’s economic success and/or failure. Finally, Section VII summarizes the paper with conclusion remarks.

II. Economic Sectors

i. Industry

Industrial development is a critical component of a developing economy. Currently, “The nation's major industries are coal and electric power, ferrous and nonferrous metals, machinery and transport equipment, chemicals, and food-processing” ("Ukraine - Overview of Economy" 1). The nation’s economy can be broken down into 14.4% agriculture, 26.3% industry, 59.3% services ("Ukraine GDP and Economic Data” 1). This break down is very similar to what it was when Ukraine was under Soviet Union rule. The economy does not seem to be transitioning well, as the country’s government continues to support outdated industries. The largest backing from the government goes to the agricultural industry, which remains a smaller sector of the country’s overall economy. With high potentials in energy and service, the government needs to re-evaluate the choice of subsidy allocation because presently “[i]t still pays subsidies to the agricultural, transport, telecommunications, and housing sectors” ("Ukraine - Overview of Economy” 1). However, these subsidies are preventing the growth of privatization, which can have many benefits by potentially giving assistance to the energy sector of the economy. These benefits include improved efficiency, lack of political intrusion, and increased competition in the potential market economy.
ii. Energy

Ukraine’s economy is currently characterized by state-owned monopolies, causing many problems in the country’s energy sector. For example, Naftogatz is the “national gas and oil supplier (with a debt of almost 8 billion US dollars)” (Greta, Pakosz 5). This is a critical sector because the transport of energy resources has become one of the most important activities in Ukraine’s economy. According to World Bank, energy imports in Ukraine represented about 15.7% of GDP in 2004. In fact, exporting energy, “is a vital source of budget revenues and a guarantee of energy supplies,” but state monopolies such as this are leading to increased public debt. If the monopoly is owned by the state and runs up an extremely large debt of close to 8 billion dollars, public debt will also rise because the government owns the monopoly. Leaving the energy transport sector in the hands of one state monopoly allows for the monopoly to benefit over the people of Ukraine (Chukhay 35).

Ukraine’s main energy transport business has been able to import the large amounts of oil and gas resources by negotiating extremely low prices with Russia. Ukraine then exports a large amount of Russian energy resources to countries around Europe. The oil and natural gas pipelines in Ukraine allow Russia access to the European market, so the country exports oil and natural gas to Ukraine at extremely low prices in order to reach this large energy market. Due to this trade in the energy sector, the country will more than likely have negative net exports every year unless something is done. This is a result of the fact that Ukraine only covers about 60% of its energy needs with its own resources and chooses to instead import 100% of nuclear power energy sources from Russia (Chukhay 34).

Initially, it is easy to think that the negotiated cheaper gas prices will be very beneficial to Ukraine’s developing economy. However, this has caused Ukraine to become dependent, both
economically and politically, on the countries that it imports its energy resources from (mostly Russia). The country has also become very dependent on the EU countries to which it exports Russian oil and natural gas to. Ukraine cannot effectively stand alone as a free country if it continues to rely on Russia and the EU to keep the economy afloat. Also, because of the artificially low gas prices, Ukrainians demand for gasoline is too high (Chukhay 34). As basic economics suggests, a low price will lead to an increase in the quantity demanded of a good. Given that the price of this good is set artificially low, the market is no longer efficient. In the long run, given that oil and natural gas are nonrenewable resources, the quantity supplied may not be enough to meet future demand. Ukraine has the available resources to cover its energy needs, but remains in a very inefficient system for energy development with a large reliance on energy imports and exports as part of the economy. If this continues, the country will continue to struggle to become a more self-reliant economy. If the energy sector can be boosted by promoting oil and gas development within the country, this will allow for a boost in the job market for Ukrainians and increased domestic economic development.

iii. Job Market and Unemployment

With every economic crisis comes a domino effect on many other aspects of a country, such as society and politics. In a study implemented by the World Bank Group, results from interviews suggest that the economic crisis post independence led to a sharp decrease in employment opportunities for all population groups. The low employment in 2011 was consistent with unemployment statistics from many years ago when Ukraine was still part of the Soviet Union and dealing with high levels of government intervention in the work force. However, now, even with these high rates of unemployment, the people of Ukraine still feel relatively optimistic in a life change somewhere in the future. It was also found that one of the
major issues of employment was the hesitation of employers to hire local citizens, probably with availability to higher cheaper labor from other countries, creating an even more competitive situation making it harder to decrease rates of unemployment ("Assessing the External Trade Policies of the EU...” 1). Ukraine has been slow to further technological growth, because of the need to focus on basic infrastructure before moving forward to more advanced strategies of development. Because Ukraine seems to be relatively stuck in the past technologically, compared to developed nations, the information on available jobs is outdated, many companies use newspapers, word of mouth, etc. With the new digital age, it seems as though an online job website would be a great match for the country in an effort to lower unemployment, which will ultimately better the country’s economy.

Unemployment is not the only thing affected by the economic crisis, “[h]ealth care has deteriorated and life expectancy has plummeted. In 1997 the World Economic Forum ranked Ukraine 52d out of 53 countries in terms of overall competitiveness” (Dean 94). If people cannot afford health care, they are less likely to go to the doctor when they are sick because the price of a trip to the hospital is extremely expensive without health care. As of 2000, “[p]er capita GDP is now about $600, at the level of Bolivia's or Zimbabwe's” (Dean 94). With such a low per capita GDP, something as easy as eating healthy or buying medicine can become extremely difficult. The inability to maintain a healthy lifestyle and access proper care will ultimately lead to the lower life expectancy levels that Ukraine was experiencing in 2000.

In line with the theme of low investment in human capital, education in Ukraine has not gone unscathed. This is “for the simple reason that the average teacher earns about $30 per month” (Dean 94-95). Lack of incentive for people to become teachers will cause quality of education to decrease, someday leading to considerable economic issues. According to World
Bank. “[t]o promote success in today’s labor market, one needs to invest early, and then invest in the relevant skills” (Patrinos 1). Yet, for Ukraine, “here is a paradox: A typical Ukrainian still receives a more rigorous and disciplined early education than his or her American counterpart. The average person is as poor as the average Bolivian, but better educated than the average American” (Dean 95). This oddity further contributes to Ukraine’s inability to effectively use its own resources, and allocate them properly. The country seems to be focusing on the incorrect industries most likely due to issues in government structure and allegedly corrupt political leaders, causing economic suffering for Ukrainians.

III. International Relations

i Small Open Economy

A small open economy is characterized by a country that does not have a significant influence on world prices. Ukraine falls into this category mainly because of low international interactions and the goods the country chooses to trade. Nazriy Lypko breaks down the construction of trade in Ukraine and how it plays into a small open economy concept:

The commodity structure of Ukraine’s export has a strong raw materials character. The country exports mainly commodities with a low value added. Such commodities are characterized by unstable demand and prices on international markets. As a result, the country is very vulnerable to fluctuations in international trade. For instance, the export of grain has always played an important role in Ukrainian economy. In general, both the conditions of Ukraine’s balance of payments and its national economy depend significantly on weather conditions. This is not the right path for a country with such resources as Ukraine. (Lypko 162)
With Ukraine focusing more on agricultural raw materials instead of energy/oil/gas, the country limits itself in trade and its ability to set its own interest rate and price. According to the CIA World Factbook, in 2016 Ukraine exported an estimated $38.3 billion worth of commodities such as metals, fuel and petroleum products, chemicals, machinery and transport equipment, and foodstuffs. A majority of these exports do not allow for much room for revenue because the resources are not as highly demand as oil and natural gas. The commodities currently exported are not doing much to benefit to economy as a whole. Because Ukraine is a small open economy, not only does it not have an effect on world price, but also any dramatic change in the world price can potential cause turmoil in an already unstable economy.

ii. **European Union Relations**

Since Ukraine’s break away from Russia/Soviet Union, the European Union has gained a chance to seek a closer relationship with Ukraine. At present, Ukrainian relations with the EU are shaped through the European Neighborhood Policy (ENP). This policy, created in 2004, aims to promote reforms in neighboring countries of the EU, allowing these countries to flourish and find stability. The countries within the ENP are expected to follow target goals that serve to promote a more prosperous economy that also promotes environmental and social coherence across countries that border the EU (Soimu, Trofimov, Urquijo 130). With the ENP, the European Union hopes to achieve a level of peace both within the EU as well as neighboring countries. Doing so will allow the EU to help the developing nations within Europe by providing aid and advice. However, the aid provided does not come without a price, which follows the economic concept of “no free lunch.”

In 2012, the Council of the European Union met in Brussels to discuss the EU’s potential growth of interactions with the country of Ukraine. The Council then adopted ten conclusions.
The conclusions include expectations that Ukraine establishing a stable political system. They also reiterate concerns regarding politically motivated convictions, with expectations of judicial reform in Ukraine and the need for efforts to fight against corruption and reform public finances. The EU also expects Ukraine to avoid implementing protectionist policies. The EU has also indicated that they would provide a Macro-Financial Assistance Program if Ukraine manages to demonstrate less corruption and more economic growth. The document also reaffirms support for modernization, commitment to visa-free travel, and outlines a future of positive cooperation between the EU and Ukraine ("Council Conclusions on Ukraine" 1). The future of relations between the European Union and Ukraine are dependent on whether or not Ukraine can live up to the requirements outlined by the Council.

The future of relations between the European Union and Ukraine are dependent on whether or not Ukraine can perform the needs and conclusions created by the Council. This Association Agreement in 2007 and it was officially announced in 2012. Time and effort spent on these conclusions really affirms the EU’s want to seek a closer relationship with Ukraine, allowing for Ukraine to more fully propel forward with such a powerful backing. The EU has also dangled a Macro-Financial Assistance Program if Ukraine manages to cooperate in a way of less corruption and more growth ("Council Conclusions on Ukraine” 1). The price that the EU is making Ukraine pay for stronger relations is really a win-win for the country, because the steps it must take are a step away from the times of the Soviet Union and toward self-reliance and freedom.

iii. Foreign Investment

Foreign direct investment is extremely beneficial for a developing economy, because it demonstrates confidence in a growing economy. When a company or country invests in another
country, it shows support of established markets and potentially good projects for the future of the developing country. However, “since 1991, Ukraine has attracted less foreign direct investment (FDI) per capita than any country in Eastern and Central Europe, even Romania and Moldova” (Dean 94). Typically, “[c]ountries fail to attract direct investment because they are deemed unproductive, because they are unattractive places for foreign managers to live, or both” (Dean 94). The country has been hindered in growth by only “[mustering] almost $54.5 billion FDI. Mostly Ukraine gets foreign direct investments from Cyprus (31.7%), Germany (11.6%), Netherlands (9.5%) and Russia (7%)” (Lypko 166). With this fact, it is easy to assume that Ukraine has fallen into a simple pattern of reliance on Russia and other European nations. This is proven through “a small but persistent current-account deficit that has been plugged partly with loans from the IMF and the World Bank and partly with short-term private capital” (Dean 97). The inability of the country to rely on itself and utilize its resources provides the main reasons for slow growth both on a domestic and international level.

Reputation also plays a role in the success or failure of an economy. “In the decades after World War II, Ukraine was arguably the most productive of the Soviet republics” (Dean 94). Ukraine has the ability to be a contender, as proven by the productivity demonstrated under the rule of the Soviet Union. Many countries seem to find that investing in Ukraine is a risk that is not worth the reward due to large amounts of corruption and a large reliance on the black market. Ukrainians also choose the option of low risk, by “[investing] their money mainly in Cyprus (89.2%) and Russia (5%). The overall amount of Ukraine’s investments abroad for the period of its independence is only $6.5 billion” (Lypko 166). If Ukraine is neither investing, nor being invested in, then there is an immensely low flow of money going in and out of the country, demonstrating Ukraine’s low economic growth.
IV. Conflicts since Independence

i. Russia

Russia, formerly known as the Union of Soviet Socialist Republics, included Ukraine as part of its territory prior to 1991. Post-independence, Ukraine continues to rely on Russia as a source of financial stability. This is demonstrated by the fact that “Russia is Ukraine’s leading trade partner according to the Governmental Bureau of Statistics for 2013, [accounting] for 23.02% of Ukraine’s exports [and] for 29.31% of Ukrainian imports, (Lypko 164). As previously mentioned, Ukraine heavily depends on Russia for energy resources as well, making the country susceptible to the ebbs and flows of the Russian economy, as well as Russian politics. “In fact, Ukraine’s dependence on the import of [natural] gas from Russia is among the leading factors deterring development of the Ukrainian national economy,” ultimately leaving many Ukrainians unsure of the future economic status to come for its citizens and international relations (Lypko 161).

Russia also still holds a relatively powerful political influence over Ukraine. However, “[a]s a result of the revolution started in November 2013 in Maidan, Kiev, Ukraine redefined its orientation from pro-Russian to pro-European [even though] not all residents of the country have accepted the new direction” (Przygoda 63). A divide was created. The “[s]outhern and eastern Ukrainian territories, inhabited to a great extent by Russian-speaking population, were strongly in [favor] of staying in the zone of Russian influence and of keeping the order of things unchanged” (Przygoda 63). Ukraine’s movement toward a pro-European status, such as supporting the European Union’s Council’s conclusions from 2012, led to the direct interference from Russia on Ukraine. Their aggressive response included the annexation of Crimea in 2014.
ii. Crimea and 2014

Crimea is a territory located on the southern border of the former USSR. It was a part of Ukraine until Russia invaded and annexed the territory. The area has a large “‘Russian’ population [that] has constituted a strong local minority or a regional majority” (Bebler 198). Some argue that the territory was never consulted on whether they wanted to be part of Russia or Ukraine when the USSR dissolved, making Crimea a prime place for Russia to come in and take over.

In 2014, Russian annexed Crimea and Crimea seceded from Ukraine, causing a major disruption in Ukraine’s development. The official annexation of Crimea was a military operation on the part of Russia, and many Ukrainian officials felt their lives were in danger and chose to flee the country temporarily. With the loss of the Crimean territory, “Ukraine lost about 3 percent of its state territory, about 5 percent of its population and about 3.6 percent of its GNP. Also lost were a good part of Ukraine’s territorial waters, and of its exclusive economic zone which potentially contains rich oil and gas deposits” (Bebler 208). In addition to a large loss of resources, the “hryvnia dropped nearly 50% against the [US] dollar in 2014” (“Worse to Come” 1). The entire operation was planned by Russia in part to gain these economic benefits. Another key reason that Russia wanted Crimea was Ukraine’s possible future membership in NATO. Russia views this as a potential security threat to Southern Russia (Bepler 214). The issue can be traced back to 2008 when the United States offered Ukraine a membership in NATO, causing a higher level of threat in Russia’s eye. If Ukraine chose to join NATO, then “the annexation prevented Crimea’s conceivable inclusion into the North Atlantic Treaty area” (Bepler 214).

While the Russian Federation was in a sense punishing Ukraine in February 2014 by sending soldiers into the country, it should be noted that NATO chose not to get involved
initially. It was not until “April 1, 2014, [when] the foreign ministers of NATO member states
condemned the annexation of Crimea and qualified it as illegal and illegitimate. They also
approved a number of measures negatively affecting NATO’s relations with the Russian
Federation” (Bebler 215). Trade sanctions were placed on Russia, showing support for Ukraine
by both the United States and NATO. While this does limit Russia as far its international
economy, Ukraine’s economy was also negatively impacted as was stated earlier.

The 2014 crisis in Ukraine was instigated by Russian military action, but truly it is the
effect of two decades of poor management by the government. Ukrainian independence is
identified with years of corrupt leadership with promised reforms postponed again and again that
never accomplished anything. It has been shown that “freedom” from Russia has “left the
average Ukrainian about 20% poorer than she was when the Soviet Union collapsed” (“Worse to
Come” 1). The Crimean annexation should serve as a wakeup call for Ukraine to fix the wrong
doings of almost 20 years of poor quality administration and authoritative decisions.

V. Post 2014

In the years following Russian invasion and the annexation of Crimea, Ukraine’s
economy has suffered in the face of war. The IMF has provided Ukraine with a financial lifeline
that has allowed the country to remain afloat so far, lending $11 billion at the beginning of 2014
with plans to lend another $11 billion by the year 2019. In the year after the Crimean crisis, the
Ukrainian economy has diminished into one-fifth of what it once was. The hryvnia is continuing
to drop, due to a high risk that the government may potentially self-destruct. Many consumers
are also struggling, with wages decreasing during high rates of inflation. Positive aspects coming
out of 2015 are that unemployment has fallen from 11% to 9%, meaning that more firms are
choosing to hire Ukrainians, and that the government is finally implementing dramatic spending
cuts (“Still on Edge” 1).

In 2016, there are a few positive trends in Ukraine. While it should be noted that the
country is currently at war, some parts of the overall economy are doing better, depending on
geographic location. Most of the war is being fought on the eastern half of Ukraine, allowing the
west to perform on a higher level “In the first three quarters of 2015 Lviv, [a city in the west,] had one of the biggest jumps in employment of any province in Ukraine” (“The Ukrainian
Economy is Not Terrible Everywhere” 1). Much of the west has had lower drops in GDP than
the east. Overall, although the economy in Ukraine is doing very poorly, some parts are doing
better than others and it is reasonable to hope that the government can build on these
improvements.

There are some impediments that exist, however. In late 2013, Ukraine’s leader, Viktor
Yanukovych, made a decision for which the consequences are being realized in 2017. The
president borrowed a $3 billion bond from Russia. Not long after, Yanukovych was thrown out
and Russia and Ukraine went to war, leaving the money unpaid. Russia has decided to take legal
action against Ukraine. The hearing began in January 2017 in London, because the bond was
made under English law. When Russia annexed Crimea, the country initially made it harder for
Ukraine to pay back its debt. Russia also chose to change gas supplies and institute trade
sanctions on Ukraine, ultimately causing a 15% drop in GDP. The question at stake now is
whether or not Russia is responsible for Ukraine’s economic turmoil. This lawsuit comes about
as Ukraine is beginning to look slightly stronger, with higher exports and a building boom in the
capital city. If Russia is successful in this lawsuit and Ukraine has to pay back the $3 billion,
then the hryvnia would continue to drop and many Ukrainian people would be extremely angry.
The country also has other international debts to pay off, and the IMF is behind schedule, leaving Ukraine with many unanswered questions on what the next move is for the future success of the economy (“Ukraine’s conflict with Russia is also financial” 1).

VI. Forecasts

Due to conflict with Russia and decades of financial crisis, the future of Ukraine’s economy remains uncertain. Economists have analyzed trends and events in the country and have made a few predictions on what is to come regarding the economy. The lack of focus on potentially high-growth industries has caused and will continue to cause many problems for the country. “Ukraine will be forced to change its specialization in the near future in order to avoid further fluctuations in its balance of payments and increase the overall competitiveness of its national economy” (Lypko 163). The need for increased competitiveness also applies to the state-owned monopolies. They contribute to the slow growth due to the lack of a competitive market. If Ukraine chooses to break up these monopolies, it could be a step in the right direction for a more competitive and efficient industry, from an economic standpoint.

Furthermore, economists believe that Ukraine will choose to update guidelines for businesses to follow in hopes of expanding FDI. These “[i]mprovements to institutions and business rules will influence the volume of investment, both domestic and foreign, that the country is able to draw in, and will be especially important for attracting the foreign direct investment (FDI) that is needed to fuel faster economic catch-up” (“Ukraine’s Economy II: What’s Next?” 1). FDI in Ukraine is extremely low, and if leaders can find a way to bring it up, then the country has a chance at changing its global position. Higher investments in Ukraine from other countries shows not only stable growth in the economy, but also confidence in that stable growth.
None of these changes will be easy though. It is projected that “by 2020 Ukraine's GDP will still be around one-third lower than in 1990” (“Ukraine’s Economy II: What’s Next?” 1). Under the USSR, the Ukrainian economy thrived. Without support from a larger governmental and economic system, the country has struggled for the past 26 years. “Russia's more aggressive foreign policy on Ukraine [that] will contribute to a slowdown in its growth trajectory [and] weigh on Ukraine's medium-term outlook” (“Ukraine’s Economy II: What’s Next?” 1). Russia has made it clear that the country does not wish to be very friendly anymore, as proven with the annexation of Crimea. For economic growth, Ukrainians will be forced to develop their own oil resources, rather than relying on Russia, and focus their economy in a forward-moving direction in a way that is self-sustaining.

VII. Conclusion

Not too long ago, Ukraine was just a gear working to hold together a relatively massive machine. This machine, the USSR, eventually arrived at the end of its shelf life, and Ukraine became its own machine. The transition from gear to machine has been rough for the country, as it continues to face problem after problem while trying to build a nation and a successful economy. As a gear usually does, Ukraine relies heavily on others to hold itself up. Dependency on Russian oil and natural gas to provide for the country’s demand of energy resources has led to and economically destructive focus on different industries, such as agriculture. Ukraine’s excessive support of agriculture over energy development has led the quantity demanded of energy to significantly exceed the quantity supplied domestically. As a consequence of this, the citizens are suffering due to high rates of unemployment because of lack of opportunities in the job market.
On an international level, the Ukrainian economy has a poor reputation due to its insufficient growth and instability. This is worsened by extremely low amounts of FDI from other countries. There is hope nonetheless, with the European Union’s recent conclusions to place Ukraine under its European Neighborhood Policy to help the country find its way as a small open economy. The Council’s conclusions will give Ukraine incentives to discover the best policies to boost its economy. However, friendly relations with the EU have caused conflict with Russia and the two countries are now in armed conflict since Crimea’s annexation in 2014. This year brought on the loss of Crimea for the Ukrainians, worsening a downward spiral effect in the economy. Although it is not as bad in parts of the country that are not considered a warzone, the years post 2014 have proven to be a trying time for Ukraine. Some economists predict that things will have to get worse for the country before they can get better. Anticipation of policy changes and better guidelines for economic development will help transform Ukraine from a gear into a fully functioning, strong, and capable machine.
Works Cited


