ECONOMY

General Characteristics of the Economy

Ukraine is a country rich in natural resources and mineral raw materials (iron and manganese ores, coal, natural gas, uranium ore, etc.) as well as being an exporter of electricity. The volume of steel production ranks seventh in the world, whilst iron smelting and machine building are important economic branches, also global in scale. Having inherited electronic industries, along with military and space technology from the former Soviet Union, its economy also possesses solid foundations in high-tech industries. Ukraine has always been amongst the main producers of agricultural output and remains today a breadbasket for the countries of the former USSR, supplying cereals, sugar, meat and dairy products. Based on the above factors, in combination with its highly trained workforce, the country should have gradually become a leading economy in Europe, but due to political, social and economic changes over the past two decades it has failed to meet expectations.

As a sovereign and independent nation, Ukraine has experienced 17 years of painful and controversial change in the sphere of its economy. Over this period, some of the key steps in the transformation process have been undertaken: the basic essentials of a free-market economy, i.e. financial, taxation and banking systems were established, tariff and customs regulations set up. Together they form the infrastructure of the Ukrainian national economy. Markets in real estate, commodities and financial services have emerged. A two-tier banking system, a currencies market and a securities exchange were established. A national system of payments for financial transactions was formed, utilising new and sophisticated technologies, based on a system of electronic transfers that enable banks to adopt global standards in information management for settlements between each other.

In the first phase of transition, macro-economic stabilisation and financial reform were the priorities and over four years (1992–95) a transitory domestic currency (*kupon*) was in use. Financial reform (with the introduction of a new currency: *hryvnia,* UAH) could only be carried out in September 1996, after the rate of inflation was brought down, price subsidies cut, and the budget deficit stabilised. Later on, the transformation was focused on institutional reforms, chiefly with regards to restructuring the economy.

In the course of economic reform, positive results have been achieved with the policy of macro-economic stabilisation, the Gross National Product (GNP) has been growing, the inflation rate was curbed considerably, and the exchange rate of the domestic currency is now moving towards stability (*Table 14*). A recent growth in production – generated by the reforms and mainly arising from the export of heavy-industrial goods – has only partly succeeded in compensating for the structural problems inherent in the national economy. About one third of industrial output is represented by coal mining, and iron and steel smelting, the latter contributing nearly half of Ukrainian exports. Though the country is an important exporter of electricity, it nevertheless relies on imports of oil and gas from Russia and Turkmenistan. Oil refinery capacity is in the possession of, and operated by Russian firms. A heavy dependency on Russian oil and gas has had a strong impact upon the economy and Ukraine's foreign policy.

A fundamental task during the period of transition has been **privatisation**, with the emergence of a mixed and diverse economy as its ultimate target. There has been a breakthrough in the reform of ownership structures with expanding corporate and private sectors. All available privatisation techniques were deployed: share issues, asset sales, tenders, buyouts, etc. The assumption was made that private ownership structures and the resulting new organisational/legal framework would – with the absence of price controls and the presence of competition – replace the role of state control over the economy. Only supervision of the tax policy, budgetary spending and customs

Table 14. ***Dynamics of macroeconomic indicators (1995–2006; in %)***

Indicators	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Real growth rate of GDP	-12.2	-10.0	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	2.6	7.0
Change in industrial output	-12.0	-5.1	-0.3	-1.0	4.0	12.4	14.2	7.0	15.8	12.5	3.1	6.2
Change in agricultural output	-4.0	-9.5	-1.9	-9.8	-6.9	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4
Growth rate of capital investment	-28.0	-22.0	-8.8	6.1	0.4	14.4	20.8	8.8	31.3	28.0	1.9	19.0
Retail trade turnover	-14.0	-5.1	0.2	-6.6	-7.1	8.1	13.7	15.0	20.5	21.9	23.4	26.4
Real income of population						4.1	10.0	18.0	9.1	16.5		
Income of population		52.1	24.2	8.6	13.8	40.5	25.9	17.1	16.5	27.2	39.1	25.7
Export of goods and services (trade balance)		19.1	0.0	-13.4	-7.9	17.9	9.5	10.7	24.0	42.6	7.5	13.2
Import of goods and services (trade balance)		17.4	2.0	-14.0	-19.1	18.9	14.1	5.0	28.7	31.3	20.4	22.0
Annual balance of current account (% of GDP)		-2.7	-2.7	-3.0	5.4	4.6	3.7	7.5	5.8	10.6	2.9	-1.5
Foreign indebtedness (% of GDP)						45.2	36.6	33.6	29.7	47.2	46.8	46.2
Inflation rate, December to December						25.8	6.1	-0.6	8.2	12.3		
USD exchange in Hryvnia*			1.86	2.50	4.26	5.51	5.38	5.49	5.51	5.47	5.17	5.22
Unemployment rate	5.6					11.7	11.1	10.1	9.1	8.6	7.2	6.8

Remark: * yearly average (www.oanda.com/convert/fxhistory)
Source: www.bank.gov.ua; www.cisstat.com; www.ier.kiev.ua; www.ukrsat.gov.ua

and tariff regulations have been retained at the state level. State control ceased to play a role in manufacturing and financial spheres, and newly privatised firms now operate solely with the interests of proprietors as their primary concern. It should, however, be added that in many cases the new owners are by no means interested in economic restructuring. Recent changes at an institutional level have led to tangible disparities in the benefits created by the new economic climate: parallel to the growing fortunes of the oligarchy, a great majority of the population is suffering from decreasing material wealth.

During the privatisation process, the number of entities in the Unified State Register of Enterprises and Organisations of Ukraine (the business register) increased by 66.2% – from 615,686 in 1997 to 1,023,396 in 2005. From the beginning of the privatisation process in 1992, until January 1st, 2005, 96,549 entities (of which 26% were public and 74% municipal) changed ownership, and the share of private ownership in the overall picture reached 88.2%. This process was most intensive in the oblasts of the largest urban and industrial centres (Kyiv, Donets'k, L'viv, Dnipropetrovs'k, Kharkiv) (*Figure 50*). Similar spatial patterns can be observed in the case of the privatisation of state housing stock. In 2004, 222,299 apartments and one-apartment building were privatised, 81.5% of them free of charge or with compensation attached.

Ukraine is presently attempting to steer a course of development that will lead to a model of a socially orientated market economy, with equal opportunities for its citizens, and tangible rule of law. Regrettably, over the period of time since independence was achieved, attempts to reach this aim have not led to the results hoped for, particularly in the social sphere. Ongoing social transformation has failed to strike a balance between economic, societal and political factors. Nevertheless, since the year 2000 Ukraine's economy has experienced a remarkable take-off. The rate of increase in the **Gross Domestic Product** (GDP) has been higher than that of its neighbouring states to both the west and east. This promising recovery in the Ukrainian economy is due to an inexpensive labour force, and a growing demand in both domestic and international markets for the commodities extracted and produced in Ukraine. In particular, the high GDP growth rate in 2004 (12.1%) was due, in part to

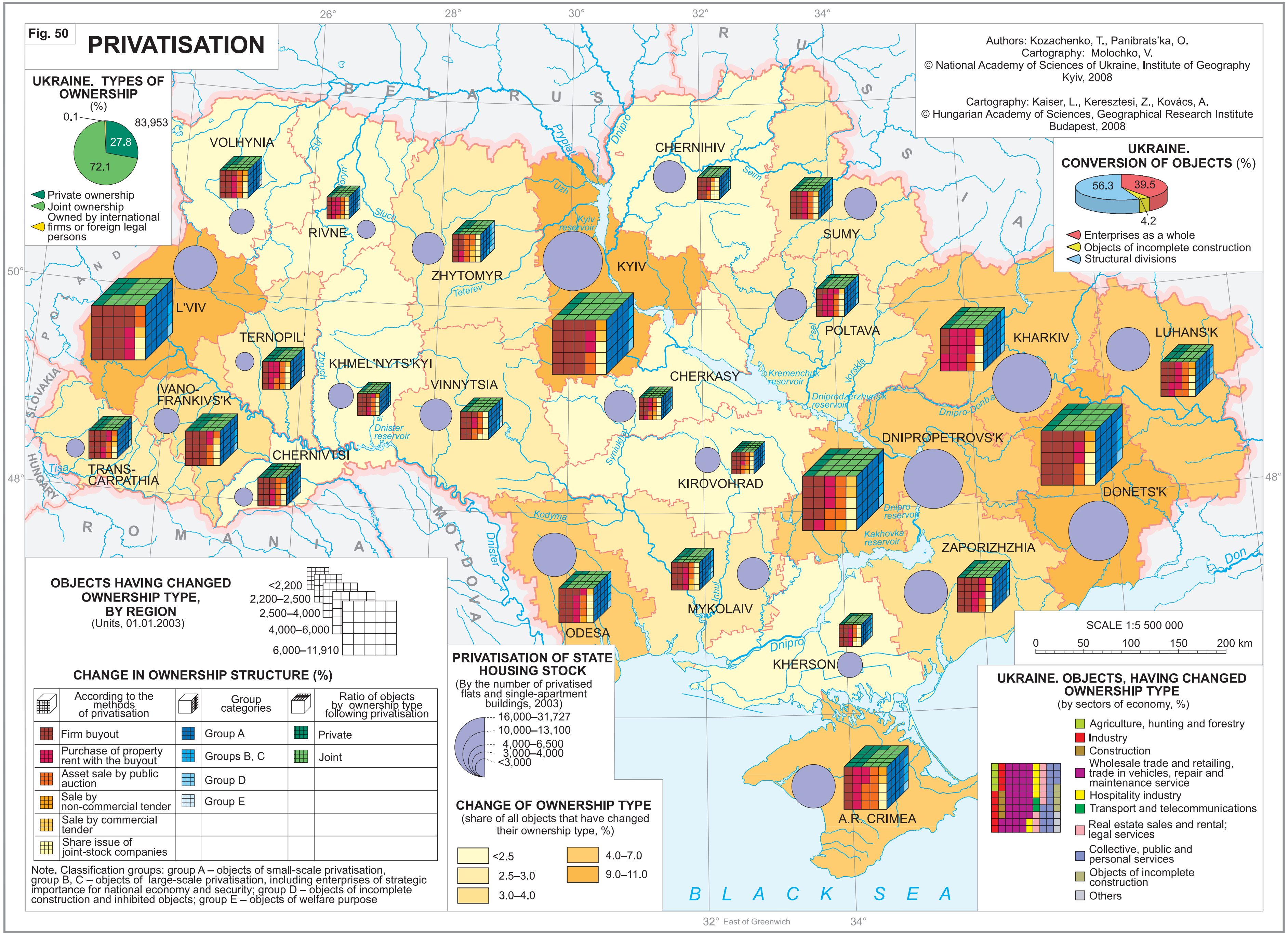
Fig. 50
PRIVATISATION
Authors: Kozachenko, T., Panibrats'ka, O.
Cartography: Molochko, V.
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Kyiv, 2008
Cartography: Kaiser, L., Keresztesi, Z., Kovács, A.
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UKRAINE. TYPES OF OWNERSHIP
(%)
0.1
83,953
27.8
72.1
Private ownership
Joint ownership
Owned by international firms or foreign legal persons
UKRAINE. CONVERSION OF OBJECTS (%)
56.3
39.5
4.2
Enterprises as a whole
Objects of incomplete construction
Structural divisions
VOLHYNIA
RIVNE
ZHYTOMYR
KYIV
CHERNIHIV
SUMY
POLTAVA
KHARKIV
LUHANS'K
L'VIV
TERNOPIL'
KHMEL'NYTS'KYI
VINNYTSIA
CHERKASY
IVANO-FRANKIVS'K
TRANS-CARPATHIA
CHERNIVTSI
KIROVOHRAD
DNIPROPETROVS'K
DONETS'K
ZAPORIZHZHIA
ODESA
MYKOLAIV
KHERSON
A.R. CRIMEA
Prypiat
Dnipro
Uzh
Kyiv reservoir
Seim
Sluch
Horyn
Styr
Teterev
Psel
Vorskla
Kremenchuk reservoir
Dniprodzerzhynsk reservoir
Dnipro-Donbas
Dnipro reservoir
Kakhovka reservoir
Zbruch
Dnister reservoir
Syniukha
Inhul
Kodyma
Dnister
Tisa
Don
BELARUS
RUSSIA
POLAND
SLOVAKIA
HUNGARY
ROMANIA
MOLDOVA
BLACK SEA
26°
28°
30°
32°
34°
50°
48°
32° East of Greenwich
SCALE 1:5 500 000
0
50
100
150
200 km
OBJECTS HAVING CHANGED OWNERSHIP TYPE, BY REGION
(Units, 01.01.2003)
<2,200
2,200–2,500
2,500–4,000
4,000–6,000
6,000–11,910
CHANGE IN OWNERSHIP STRUCTURE (%)
According to the methods of privatisation
Firm buyout
Purchase of property rent with the buyout
Asset sale by public auction
Sale by non-commercial tender
Sale by commercial tender
Share issue of joint-stock companies
Group categories
Group A
Groups B, C
Group D
Group E
Ratio of objects by ownership type following privatisation
Private
Joint
Note. Classification groups: group A – objects of small-scale privatisation, group B, C – objects of large-scale privatisation, including enterprises of strategic importance for national economy and security; group D – objects of incomplete construction and inhibited objects; group E – objects of welfare purpose
PRIVATISATION OF STATE HOUSING STOCK
(By the number of privatised flats and single-apartment buildings, 2003)
16,000–31,727
10,000–13,100
4,000–6,500
3,000–4,000
<3,000
CHANGE OF OWNERSHIP TYPE
(share of all objects that have changed their ownership type, %)
<2.5
2.5–3.0
3.0–4.0
4.0–7.0
9.0–11.0
UKRAINE. OBJECTS, HAVING CHANGED OWNERSHIP TYPE
(by sectors of economy, %)
Agriculture, hunting and forestry
Industry
Construction
Wholesale trade and retailing, trade in vehicles, repair and maintenance service
Hospitality industry
Transport and telecommunications
Real estate sales and rental; legal services
Collective, public and personal services
Objects of incomplete construction
Others

strengthening international (e.g. Russian and Chinese) demand for ferrous metals and rising prices for raw materials. This is an export oriented model based predominantly on mineral-extracting industries, metalworking, oil processing and the manufacture of chemicals. Ukraine has proven to be competitive on the world market with commodities of low added value (chemicals, metals, electricity, grain, etc). At the same time, the national economy is heavily dependent on high-technology imports from Europe and imports of energy – crude oil and natural gas. Future economic development of the country, towards a socially oriented market economy, is likely to be based on a long-term strategy of economic growth paired with a simultaneous rise in the living standards of the population.

Within Ukraine, a marked spatial differentiation has been shaped by the relationship between the core and peripheral. 40% of GDP (and 48.5% of gross value added) is produced by five regions (Kyiv and the oblasts of Donets′k, Dnipropetrovs′k, Zaporizhzhia and Odesa), which also share 59% of Foreign Direct Investment, produce 67% of total exports and consume 65% of imports (2004). They also have the highest figures relating to dynamics in the sphere of innovation and infrastructure networks (*Figure 73*). There is a tenfold difference in magnitude between the leading region and those that are lagging behind, and similar disparities are also common at the lower administrative level of division.

Examining the figures for **gross value added** (at current prices), the poorest regions are to be found in western Ukraine (e.g. Bukovina, Podillia, Volhynia and Transcarpathia) with 2.5–4.5 billion UAH (2003), lagging far behind Kyiv City's figure of 44 billion UAH and that of Donets′k oblast at 30 billion UAH. This economic disequilibrium (of a “poor West” contrasted with a “rich East” and Kyiv) is also reflected in the spatial patterns of gross value added per capita: western oblasts 2,700–3,500 UAH; Kyiv 17,000; eastern oblasts 5,400–6,400 UAH per capita (2003) (*Figure 51*).

Finance and credit. The first financial institutions had already appeared in Ukraine in the 18th century, but a genuine development of the system only started in the 1990s with the emergence of the independent Ukrainian state and its fledgling market economy. An important part of this system is the sphere of credit and banking. At the end of 2004 there were 182 banks in the country and of them 162 were in fact operating. A positive trend visible as a result of their operations is an increasing volume of capital and banking transactions. In the same year, commercial banks were operating in 20 cities. More than half the banks, capital and transactions are centered on Kyiv. Additionally there is a high spatial concentration of banks in Kharkiv, Dnipropetrovsk, Odesa, Donets′k, Zaporizhzhia and L′viv. The emergence and growth in the regional network of commercial banks is a twofold process. Firstly there is an emergence of branches and regional sections, as territorial units of large, so called 'system banks' , which have been organised along the lines of state banks. Second is the territorial expansion of the pre-existing network of large commercial banks. The focus of regional networks is on Kyiv, concentrating four fifth of all banking offices, but a substantial role in shaping regional networks belongs to Dnipropetrovs′k, L′viv and Kharkiv.

The infrastructure of the Ukrainian stock market is comprised of buyers and sellers of securities, those organising these transactions, depository institutions, mutual investment companies, etc. In 2003, 857 traders were active, chiefly on the secondary market for stocks and shares. 15.5% of them were commercial banks, 13.2% were investment companies, and 71.3% were stockbrokers. 46.4% of entities trading in securities (both legal and natural persons) are to be found in Kyiv oblast, 9.1% in Kharkiv oblast, 9.2% in Dnipropetrovs′k oblast and 7.8% in Donets′k oblast.

An important part of the investment market is the National Depository System. In early 2004 there were 364 registrars and 122 holders of securities. A majority of them (over 60%) operated in Kyiv, Kharkiv, Donets′k and Dnipropetrovs′k oblasts. A significant role in providing capital markets functions belong to investment companies, e.g. mutual funds. Most of them have been engaged in handling the issue and distribution of privatisation bonds. 137 investment funds were operational in Ukraine in 2003, along with 113 investment companies. They were concentrated in four industrially developed regions: Kyiv (including the City of Kyiv), Kharkiv, L′viv and Zaporizhzhia oblasts.

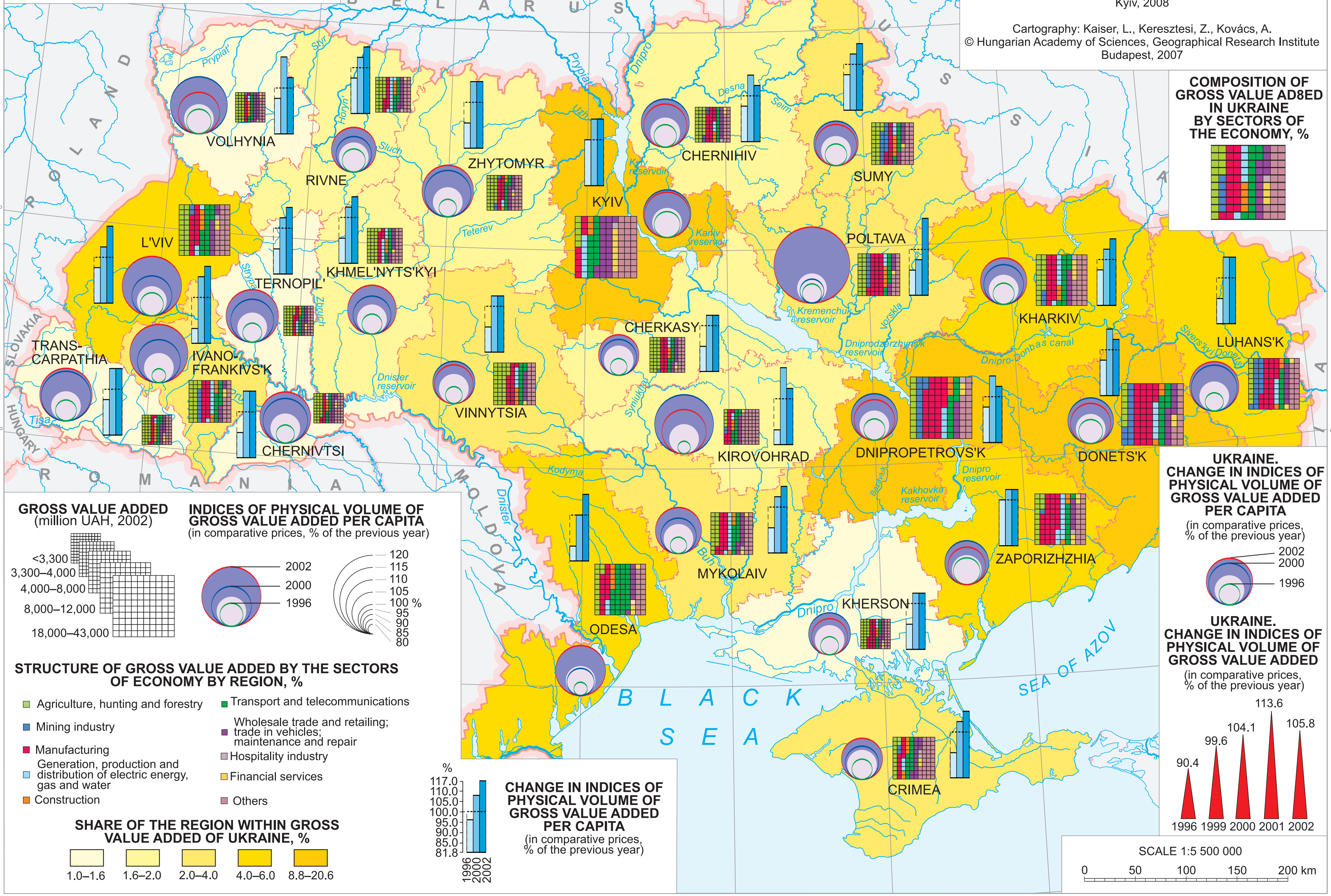
Investments. The transition of Ukraine towards a market economy has been accompanied by profound changes in the intensity and

Fig. 51

GROSS VALUE ADDED

Authors: Kozachenko, T., Panibrats'ka, O.
Cartography: Krizhova, N.

Cartography: Kaiser, L., Keresztesi, Z., Kovács, A.



structure of investment activities. Owing to its close interrelationship with the general financial and economic state of the country, a setback in the economy was reflected by changed activity in the investment sphere. The years 1991–1997 experienced a continual reduction in the volume of investment, but a turning point was reached in 1998. Since then capital investment has been on the increase and reached 125.3 billion UAH by 2006 (by comparison this volume was only 12.4 billion UAH in 1997).

Transformation processes were also visible in the sectoral distribution of investments during the period from 1998 to 2005. Despite a sharp reduction in investment in the farming sector (a drop from 21.3% to 3.5%), there has been a relative increase in the ratio of industrial (from 34.5% to 40.7%), and the transport and communications sectors (from 9.7% to 19.7%) within the total quantity amount of investment. The largest amounts of industrial investment occurred in the regions where this sector is particularly developed, such as Donets'k (63.1%), Zaporizhzhia (68.6%) and Luhans'k (64.2%) oblasts, whereas there is a reduced flow of industrial capital investment into Transcarpathian (26.8%) and Ternopil' (23.1%) oblasts (the latter two showing a dominance of the farming sector) and Crimea (27.0%). With regards to investment in the social and cultural spheres, no significant spatial disparities can be observed.

The shrinking volume of investment into the construction industry sector is contrasted by a growth in the relative weight of equipment assembly and major repairs which has given rise to a specific technological structure of investment. Over recent years the ratio of construction and manufacturing activities came to the fore and reached 40% of capital investment.

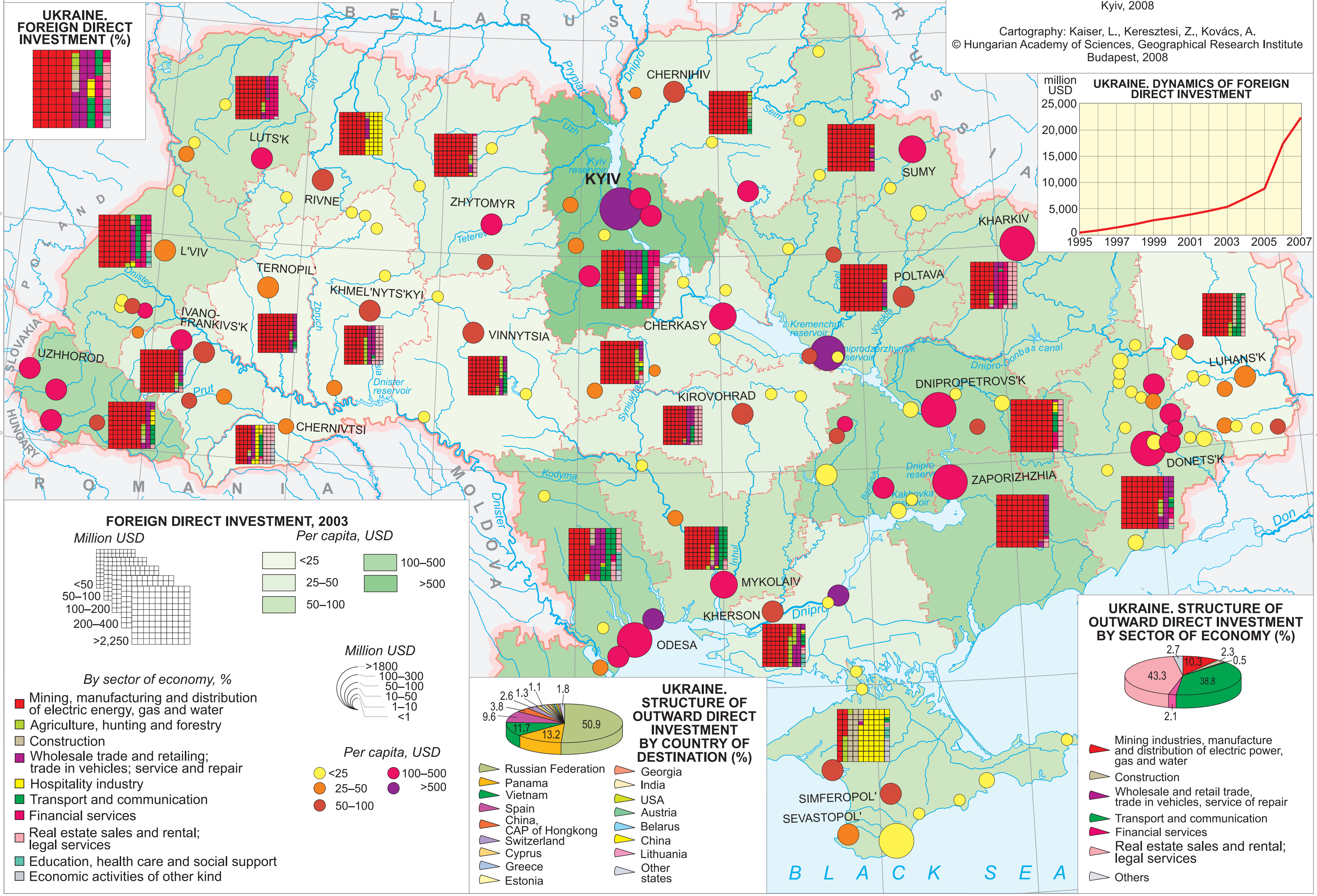
Significant shifts are evident in the structure of investment when broken down into sources of financing. The share of central (governmental) capital investment had dropped from 27% in 1990 to 5% by 2003. There is negligible fluctuation in this value across the regions of the country. The specific weight of capital investment by individual companies has been on the increase, reaching 70.1% during the same period.

A marked characteristic feature of investment activities in Ukraine has been their increasing spatial differentiation. One of the striking processes is the redistribution of capital between industrial regions (Donbas, industrial Dnipro Region or Pridniprovye, etc.), predominantly agricultural regions (Podillia, Central Ukraine and Ciscarpathia), and industrial-farming regions (territories adjoining the Black Sea and Sea of Azov). The share of the first group within invested capital had grown from 46.8% in 1990 to 59.2% by 2003, whilst the ratio of the third group (Crimea and Odesa, Mykolaiv and Kherson oblasts) dropped from 16.7% to 14.8% over the same period.

The amount and share of **Foreign Direct Investment** (FDI) reveals a trend of gradual growth, increasing from 483.5 million USD (1995) to 21.2 billion USD (January 1st, 2007). The increase in FDI skyrocketed following the "Orange Revolution", the elections in 2004 and the subsequent measures aimed at making the Ukrainian business environment more attractive (e.g. simplifying taxation, reducing the complexity of the regulatory framework, and fighting corruption). The most striking sign that reforms were succeeding in encouraging foreign investors (resulting in the sudden doubling of FDI) was the privatisation of the largest Ukrainian steelworks "Krivorizhstal" (for 4.8 billion USD) by the German Mittal steel group, and the purchase of Aval Bank (1 billion USD) by the Austrian Raiffeisen Bank at the end of 2005. By 2007, the member states of the EU had invested 16 billion USD into the Ukrainian economy. Besides the steel industry, finance and the real-estate/wholesale trade were the largest magnets for EU investors, attracting 1.2 billion and 1.1 billion USD respectively. Following Germany, the largest investor is Cyprus, another EU member, but investment from which is mainly made up of Ukrainian–Russian capital (similar to FDI from the British Virgin Islands) (*Table 15*). Parallel to the decrease in the share of the previous FDI leader, the USA, the ratio of many other EU member states is increasing (e.g. Netherlands, France, Poland and Hungary). The largest amounts of FDI arrived in Kyiv and in the oblasts of the most important regional, industrial centres (e.g. Dnipropetrovs'k, Donets'k, Zaporizhzhia, Odesa and L'viv) (*Figure 52*). Besides investment in heavy industry, FDI in the wholesale trade (e.g. Kyiv, Odesa and Donets'k) and in tourism (Crimea) is also important. The relatively high per capita FDI figure in the western border regions is not least a result of the presence of Polish and Hungarian capital. Despite promising developments, Ukraine's performance in attracting FDI is still poor, which is

Fig. 52

FOREIGN DIRECT INVESTMENT



Author: Kachaiev, Yu.
Cartography: Molochko, V.

Kyiv, 2008

Cartography: Kaiser, L., Keresztesi, Z., Kovács, A.

Budapest, 2008

Table 15. ***Foreign direct investment in Ukraine by country (2003–2007)***

	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
	In million USD					In %				
Total	5,604.6	6,946.5	8,797.4	17,399.2	22,433.7	100.0	100.0	100.0	100.0	100.0
USA	982.4	1,059.0	1,207.8	1,383.8	1,360.0	17.5	15.2	13.7	8.0	6.1
Cyprus	541.6	1,023.9	1,115.0	2,069	3,236.6	9.7	14.7	12.7	11.9	14.4
United Kingdom	533.3	723.2	938.6	1,341.4	1,699.9	9.5	10.4	10.7	7.7	7.6
Germany	414.2	448.7	603.5	5,466.2	5,690.1	7.4	6.5	6.9	31.4	25.4
Netherlands	401.1	485.4	564.9	888.8	1,692.2	7.2	7.0	6.4	5.1	7.5
Virgin Islands	359.3	318.3	684.9	678.0	883.7	6.4	4.6	7.8	3.9	3.9
Russian Federation	334.8	385.8	511.0	873.8	1,077.9	6.0	5.6	5.8	5.0	4.8
Switzerland	283.5	324.4	430.4	395.6	566.5	5.1	4.7	4.9	2.3	2.5
Austria	226.1	258.9	352.6	1,489.2	1,782.3	4.0	3.7	4.0	8.6	7.9
South Korea	172.1	172.4	172.4	172.2	..	3.1	2.5	2.0	1.0	..
Poland	..	..	198.6	235.2	380.0	..	..	2.3	1.4	1.7
Hungary	..	..	196.4	194.5	347.5	..	..	2.2	1.1	1.5
France	..	..	..	..	873.2	..	..	..	..	3.9
Other countries	1,356.2	1,746.5	1,821.2	2,211.0	2,843.8	24.1	25.1	20.6	12.6	12.8

Remark: Volume of direct investment as of 1st April of the given years.
Source: www.ukrstat.gov.ua

particularly apparent when expressed in FDI statistics in comparison with the neighbouring new EU member states: Ukraine 168, Poland 1,502, Hungary 3,693 USD per capita FDI inflow (2004). "European integration could help Ukraine to increase its attractiveness to foreign investors" (Mayhew 2007), along with a full implementation of the EU–Ukraine Action Plan and the stabilisation of democracy.