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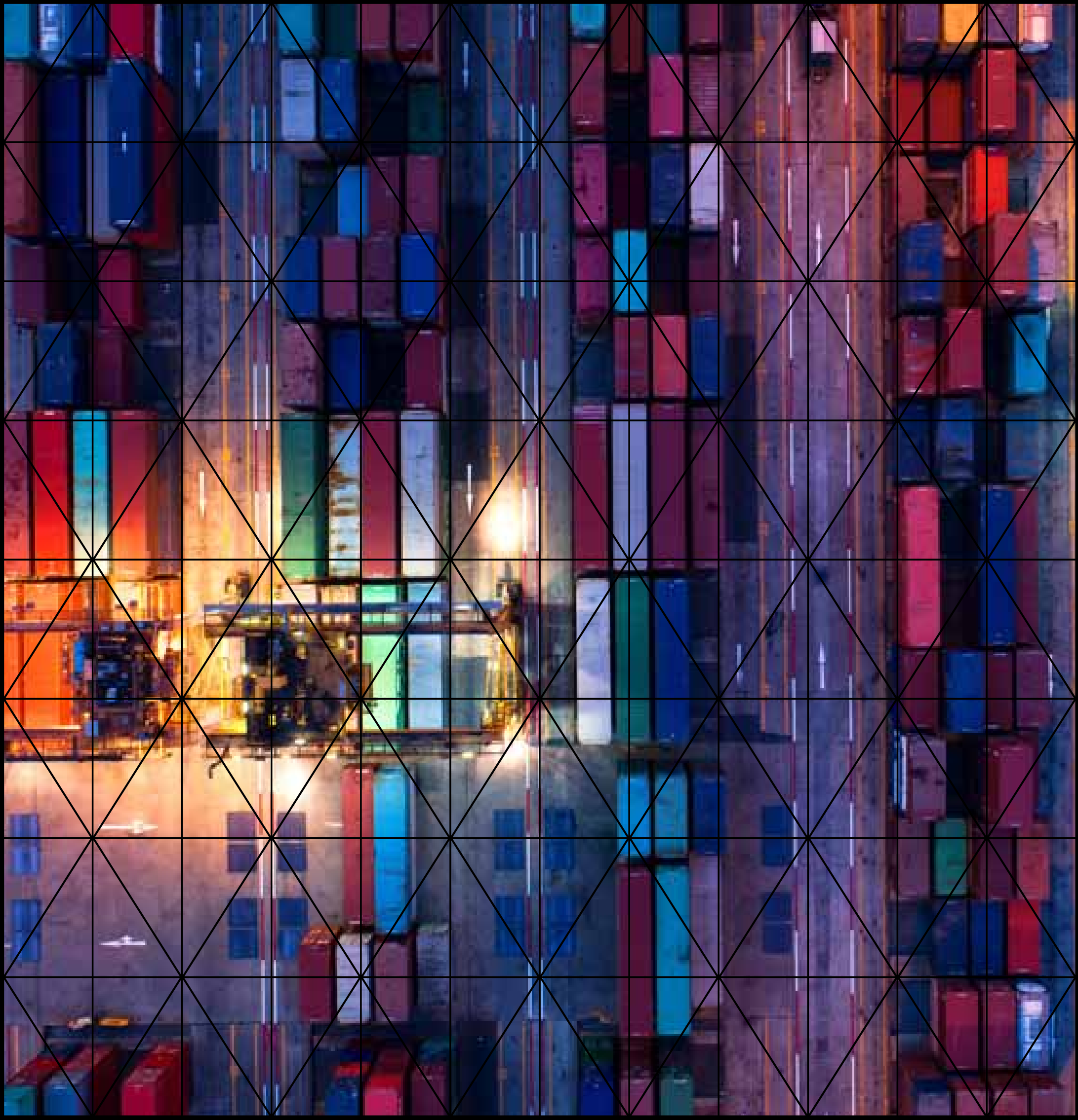

OSW

IN SEARCH OF NEW ROUTES

UKRAINE'S FOREIGN TRADE AFTER THE REVOLUTION OF DIGNITY

Sławomir Matuszak

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IN SEARCH OF NEW ROUTES
UKRAINE'S FOREIGN TRADE AFTER THE REVOLUTION OF DIGNITY

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THESES

- One of the main effects of the economic crisis in Ukraine provoked by Russian aggression was the collapse of foreign trade. Between 2013 and 2017, Ukrainian exports fell by 31%, and imports by 35%. Serious changes were seen in both the geographical and goods structure of Ukrainian trade in the same period. The European Union for the first time in history became Ukraine's main trade partner, and the post-Soviet countries lost their previous significance. Regardless of the improvement in the economic situation seen since 2016, Ukraine is still far from overcoming the consequences of this collapse.

- Until 2013, Ukrainian exports were based to a great extent on the sale of mineral raw materials (mainly iron ore) and low-processed goods (mainly products of the metallurgical industry) originating from companies controlled by representatives of big business, and agricultural products (around 60% of total exports). At a time when the prices on global markets were high, exports were highly profitable but also extremely sensitive to economic fluctuations. At present, Ukraine relies on exports of raw materials and low-processed products even more (an increase to 70%) than before the crisis; the only difference is that products of the agricultural and food sector (above all grain and vegetable oils) currently predominate in the export structure instead of metallurgical products.

- Until 2013, the Ukrainian foreign trade in goods was strongly diversified in geographical terms. Trade was more or less equally divided into three areas: Russia and other post-Soviet countries, the European Union, and the other countries. However, the diversity was very limited as regards goods structure. Dependent on the geographical region, different goods were exported and imported, which meant that a simple replacement of one market with another was very difficult and often impossible.

- The Kremlin's aggressive moves led to the loss of the greater part of Ukraine's market share not only in Russia but also in the remaining post-Soviet countries (in particular, Kazakhstan) and contributed to the collapse of the sale of the machine industry's products, the only item in Ukrainian exports with a high added value. Given the fact that Ukrainian-Russian relations are unlikely to improve in the medium term, the changes that have taken place in the geographical and goods structures of Ukrainian trade are durable.

- The Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU, binding since the beginning of 2016, has proven to be an effective tool enabling the Ukrainian economy to overcome the crisis and soften the consequences of the collapse of trade resulting from the Russian aggression. Owing to the DCFTA, the value of Ukrainian exports to the EU in 2017 exceeded the level reached in 2013. However, some representatives of the Ukrainian government had expectations that the EU market would quickly compensate for the lost post-Soviet markets, and this has proven to be unrealistic, especially as regards industrial production. However, the potential of the DCFTA has not been used to its full extent, and to be able to capitalise fully on the opportunities offered by the agreement, Ukraine should implement the EU norms and standards at a faster rate. Kyiv has recently increasingly been delaying the fulfilment of its undertakings to this effect. As a result, the opportunities of accessing the EU market has not been fully used.

- The reduction of trade with non-EU countries and the post-Soviet area (the so-called 'rest of the world') after 2013 has been an effect above all of the economic problems in Ukraine itself resulting from the Russian aggression, including the extremely strict restrictions on the currency market, which seriously impeded effecting transactions with foreign entities. Even though Ukraine increased the exports of food and agricultural products to these countries in 2013–2017, it was unsuccessful not only in finding new outlets as an alternative to the post-Soviet markets, but also in maintaining the previous sale volume, especially as regards exports of the production of the machine and chemical industries.

- Service trade is essential for Ukraine because of the regular positive balance that ensures a constant influx of foreign currency. Transport services account for more than a half of the exports value in this area. Income generated by some kinds of transport (for example, railway and maritime transport) has shrunk dramatically due to the conflict with Russia. However, the most important service – the transit of Russian gas via Ukrainian territory – has remained at a level existing before the crisis. Given the fact that it ensures almost one third of the income generated by service exports, the significant reduction of gas transit planned by Russia after the launch of the Nord Stream 2 gas pipeline will be very painful to Kyiv.

- Since the mid-2000s, the Ukrainian trade in goods has been characterised by a regular negative balance, which could only partly be compensated by the surplus generated by the trade in services. This phenomenon caused a drainage of the country's foreign currency reserves and was one of the major components of the crises in 2009 and 2014–2015, leading to the depreciation of the Ukrainian currency. The collapse of imports resulted in a positive trade balance in 2015. However, in 2017, Ukraine again had a trade deficit. If this trend intensifies, this will mean a serious challenge to the country's balance of payments, especially considering the fact that Ukraine's economic stabilisation is still fragile.

- Without thorough economic reforms and, above all, the creation of conditions for the influx of foreign investments that would lead to the economy being modernised, Ukraine will have no choice other than to continue the present model of exports based on the sale of raw materials and products with a low added value, and this is highly sensitive to global economic fluctuations and, in the case of agriculture, weather conditions. The policy of the government in Kyiv after 2014, regardless of some successes, especially in the area of deregulation, has not led to a radical improvement of the business climate, and there are no grounds to expect any improvement in this area in the short run.

INTRODUCTION

The multi-vector policy, i.e. manoeuvring between the West and Russia without becoming involved in integration projects with either of them, which Ukraine had been following since it regained independence also had an economic aspect. Trade with Russia and other post-Soviet countries, the European Union and the rest of the world was equally important for Kyiv albeit for different reasons. Ukraine's unwillingness to make binding decisions whether to establish closer co-operation with Russia or the EU was to a great extent an effect of its concern about the negative impact of this move on economic relations with the remaining areas. Ukrainian oligarchs, the main beneficiaries of income from exports, also failed to take a joint stance of integration processes in the region and were satisfied with the state of suspension in which Ukraine had found itself.

Over time, this manoeuvring became increasingly difficult. On the one hand, Moscow was applying increasing pressure on Ukraine to join the Customs Union which was replaced by the Eurasian Economic Union, while on the other hand, Brussels came up with the proposal of signing an Association Agreement with Kyiv, part of which was the Deep and Comprehensive Free Trade Area (DCFTA) agreement envisaging not only the removal of most customs barriers but also the deep harmonisation of Ukrainian law with the EU's *acquis*. President Viktor Yanukovych's decision not to sign the Association Agreement was the main cause of the Revolution of Dignity which led to the toppling of the government in Kyiv. In response to this, Russia launched its military aggression in Ukraine.

The conflict with Moscow was not only an immense shock to the Ukrainian political elite and public – it also turned out to be a kind of a shock therapy for the Ukrainian economy, including its energy and financial sectors. After 2014, very serious and deep changes were seen in Ukraine's foreign co-operation resulting from two factors: the Russian aggression and the effects the DCFTA with the EU began to bring.

This paper is aimed at showing the changes that took place in Ukraine's trade between 2013 and 2017, i.e. from the last year before the Russian aggression to when the DCFTA began to apply fully. The text is focused mainly on describing the trade in goods, since it has the greatest impact on Ukraine, but it also outlines the trade in services and the main problems concerning the balance of trade. This report analyses both the geographical structure of Ukraine's foreign trade and goods structure, which helps analyse the benefits and the losses that the changes seen over the past five years brought Kyiv.

Unless otherwise stated, all the figures provided in this text originate from the website of the State Statistics Committee of Ukraine (SSCU, http://www.ukrstat.gov.ua/) or are the author's own calculations based on statistical data from the SSCU. The data for 2013–2017 have been corrected and do not cover the territories of the Autonomous Republic of Crimea and the parts of Donetsk and Luhansk Oblasts which are not currently controlled by the government in Kyiv. Thus the annexation of Crimea and the military operation in Donbass have not had a direct effect on the changes in the trade volume described further in this text, even though their indirect impact (economic crisis in Ukraine, disruption of production chains, destruction of infrastructure) is significant[1].

[1] The real size of the consequences of the Russian aggression in Ukraine is extremely difficult to determine in precise figures. An attempt was made by Anders Åslund, who estimates in his report that Ukraine lost assets worth nearly US$100 billion as a result of the annexation of Crimea and the war in Donbass. A. Åslund, *Kremlin Aggression in Ukraine*, Atlantic Council, March 2018, http://www.atlanticcouncil.org/images/publications/Kremlin_Aggression_web_040218_revised.pdf

I. CHARACTERISTICS OF THE UKRAINIAN GOODS TRADE UNTIL 2013

After a period of recession which continued through the 1990s, starting from 2000, Ukraine entered a period of intensive economic development combined with very fast trade growth. In 2001–2008, the value of exports increased more than fourfold (from US$16.2 billion to US$67 billion). Imports grew even faster – by almost 550% (from US$15.8 billion to US$85.5 billion). The Ukrainian economy quickly became dependent on exports of raw materials (mainly metal ores and low-processed goods, above all products of the metallurgical industry). Given the oligarchic system and political instability existing in Ukraine, the export of such products was the simplest and the fastest way for representatives of big business to guarantee themselves profits. Exports were based to a great extent on privatised post-Soviet industrial assets and did not require any major investments, and at the same time were highly profitable, given the high prices of iron ore and cast iron and steel products. The fortunes of most Ukrainian oligarchs, such as Rinat Akhmetov, Viktor Pinchuk, Ihor Kolomoyskyi, Vadym Novinskyi or Kostyantyn Zhevago were built precisely on exports of metallurgical products.

This model of exports was very profitable during the global economic boom but turned out to be quite unstable and susceptible to external shocks which caused very strong fluctuations in trade dynamics. It can be concluded that the condition of the Ukrainian economy depended on steel prices to a similar extent as that of the Russian economy on oil and gas prices. Ukraine painfully realised the threats that such excessive dependence on the demand for raw materials on foreign markets pose during the global financial crisis in 2007–2008 which led to a breakdown of the Ukrainian economy in 2009 (Ukraine's GDP fell by 15.1% in this period), caused to a great extent by a heavy drop in exports (in 2009 exports fell by 41%). It is not so much the very fact that the falls took place which is surprising, but their scale. However, the shock that came at that time did not last long – Ukrainian exports went up 29% in 2010 to exceed the level achieved in 2008 already in 2011.

Regional division

In this paper, the countries across the globe have been divided into three regions:

- 28 EU member states;
- post-Soviet countries – members of the Commonwealth of Independent States;
- other countries.

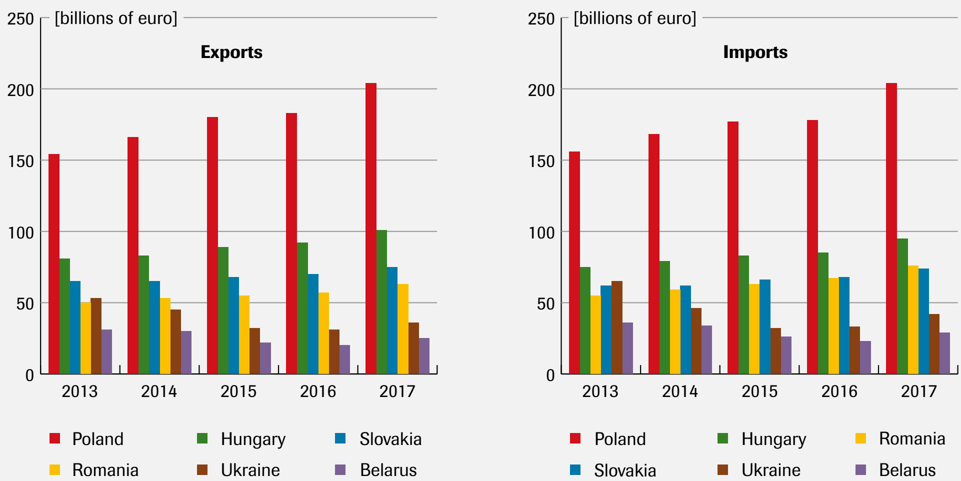
This division was used mainly because it is also used by the State Statistics Committee of Ukraine on whose data this paper is based. Alternative variants, for example, analysing the member states of the Eurasian Economic Union instead of the CIS or the European Economic Area or the EU's Customs Union instead of the EU-28 would provide very similar results as the division applied in this paper.

Until 2013, Ukrainian foreign trade was well diversified in terms of geographical structure. The key regions of trade were: the post-Soviet countries, the European Union (EU-28) and other countries, the most important of which were Middle Eastern countries, China and India. Each of these three areas accounted for around one third of Ukrainian trade volume. Ukraine regularly generated a negative trade balance which in 2013 reached -US$10.2 billion in the case of the EU and -US$5.9 billion in the case of post-Soviet countries. The deficit was only partly compensated by the surplus in trade with other countries (+US$2.5 billion).

Ukraine as compared to other countries in the region

Given the significance of the trade in goods for Kyiv as described above, it is worth comparing the results of trade generated by Ukraine and the neighbouring countries. Ukraine, after Moldova, is Europe's second poorest country. However, the scale of the differences in trade may be surprising.

Chart 1. Comparison of trade of Central and Eastern European countries (in billions EUR)

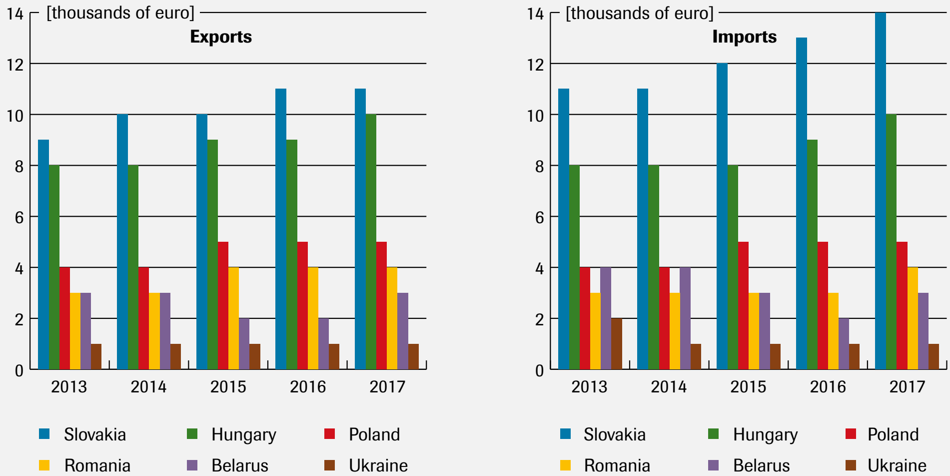


Source: Eurostat, State Statistics Committee of Ukraine, National Statistical Committee of the Republic of Belarus, National Statistical Office of the Republic of Moldova[2]

Among the neighbouring countries, Ukraine has a population similar to that of Poland. However, both Ukrainian exports and imports are five times smaller than Poland's. Ukraine's trade is half that of Slovakia which has a population of just 5.5 million. When compared with Romania, one of the least wealthy EU member states, the situation is similar. The only two neighbouring countries to have smaller trade than Ukraine are Belarus (it is worth bearing in mind that this country's population is more than four times smaller) and Moldova. The scale of Ukraine's backwardness as compared to the remaining countries in the region is even more evident, if one compares *per capita* incomes in trade.

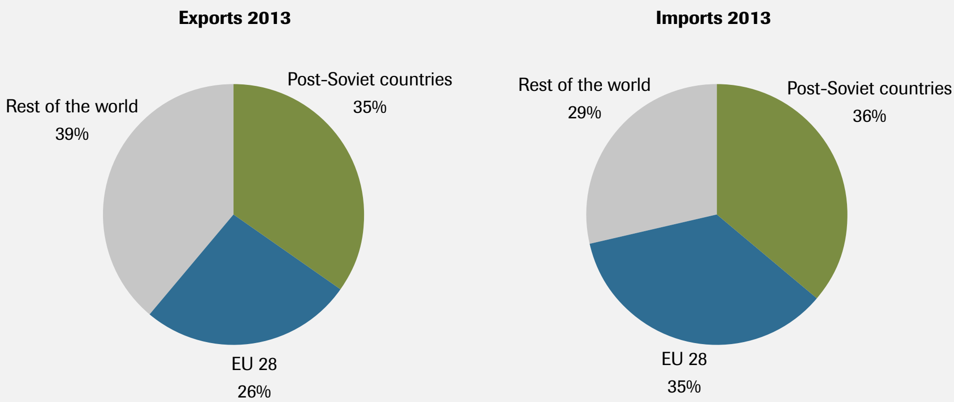
2 Data from Ukraine and Belarus have been calculated according to the US$/EUR exchange rate 0.85 of 11 June 2018; Bloomberg, https://www.bloomberg.com/quote/USDEUR:CUR

Chart 2. Comparison of *per capita* income in trade (in thousands EUR)



Source: Eurostat, State Statistics Committee of Ukraine, National Statistical Committee of the Republic of Belarus, National Statistical Office of the Republic of Moldova and Wikipedia

Chart 3. Geographical structure of Ukraine's exports and imports in 2013



Source: State Statistics Committee of Ukraine

When one takes into account the goods structure of foreign trade, it turns out that the diversification of foreign partners was to a great extent illusory. Depending on the geographical region, the structure of both exports and imports was significantly different. Metallurgical production predominated (38% in 2013) in exports to the EU, products of machine and electric machine industries were predominant in exports to the CIS, and food and agricultural products were the main exports to the other countries. One contributory factor to the increase of trade deficit was Ukraine's almost complete dependence on fuel imports (above all natural gas and also petroleum products) from Russia. In 2013, the value of fuel imports from the Russian Federation reached US$14.5 billion, accounting for 62% of total imports from this country and 68%

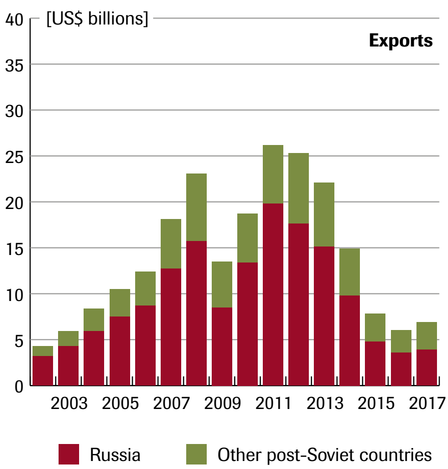
of the value of fuels imported by Ukraine. This meant that in the case of a crisis in Ukraine's relations with any of the key trade partners it would be an enormous challenge to find alternative outlets (in the case of exports) and sources of supplies (in the case of imports).

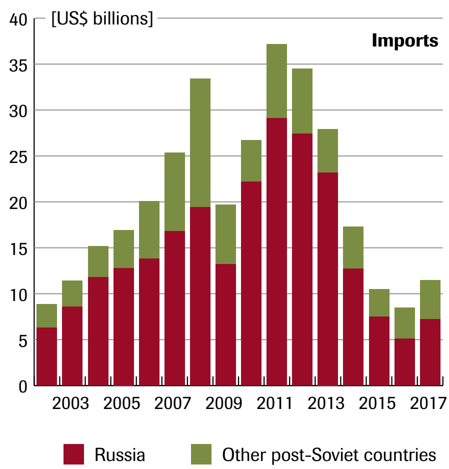
II. THE 2014–2015 CRISIS AND ITS CONSEQUENCES

While the crisis in 2009 was an effect of the economic slump on global markets, the collapse of Ukraine's economy in 2014–2015 (its GDP fell 15.4%) was caused above all by political factors. Negative trends in the Ukrainian economy could already be observed from 2012 but these were a result of the increasingly outdated economic model caused by the lack of reforms and corruption which had expanded to an enormous degree under Yanukovych's rule (even by Ukrainian standards). A continuation of this policy would have led to stagnation and probably a small recession. However, without the Russian aggression, both military (the annexation of Crimea and attempts to destabilise the south-eastern regions of Ukraine and the military operation in Donbass) and economic (major restrictions of access to the Russian market and the trade war – for more details, see below), Ukraine would not have experienced its worst economic crisis since the early 1990s.

Russia's moves have led to extremely deep changes in the geographical and goods structures of Ukrainian trade. These changes seem to be durable. As a result, the significance of the Russian market and those of other post-Soviet countries in Ukraine's trade has fallen dramatically (for more details see the chapter 'The Russian market – the collapse of trade').

Chart 4. Russia's share in Ukraine's trade as compared to other post-Soviet countries

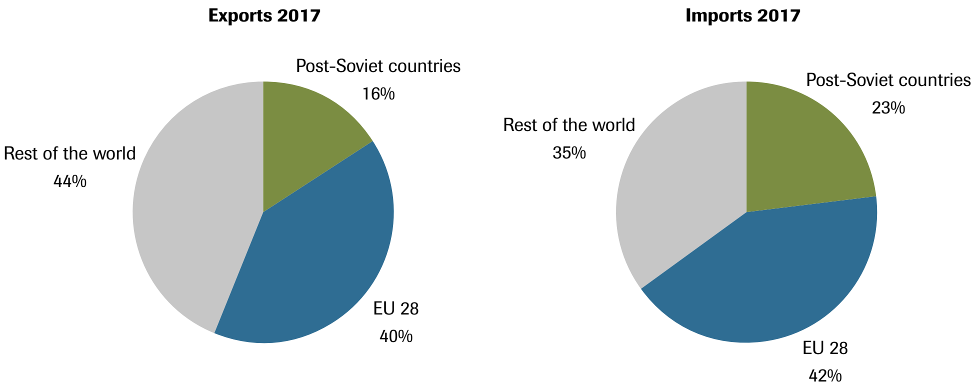




Source: State Statistics Committee of Ukraine

One effect of the Russian moves was the fact that the EU in 2016 for the first time in history became Kyiv's largest trade partner.

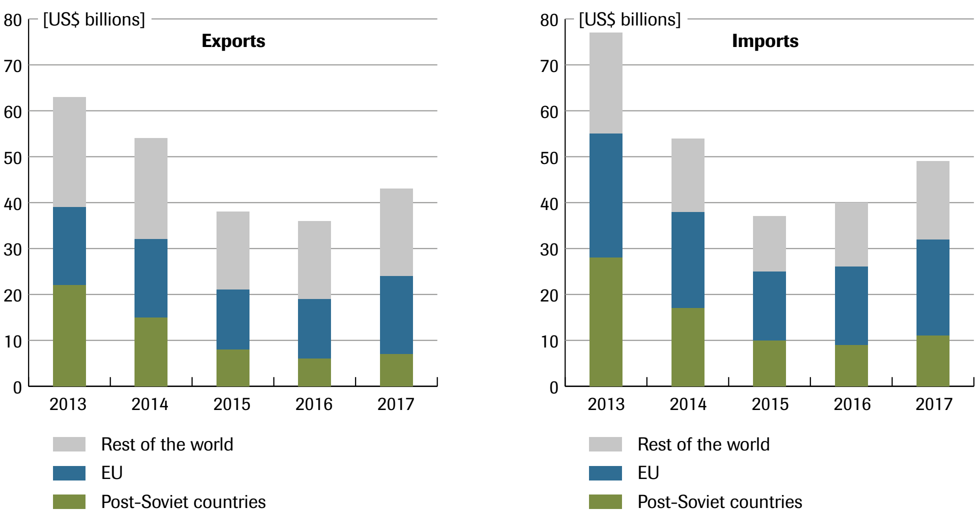
Chart 5. Geographical structure of Ukrainian exports and imports in 2017



Source: State Statistics Committee of Ukraine

However, most importantly, the deep economic crisis provoked by the military conflict led to a collapse of Ukraine's foreign trade as a whole. Even though the collapse of trade concerned relations with Russia and other post-Soviet countries to the greatest degree, it was also visible in the case of all of Ukraine's other partners.

Chart 6. Comparison of Ukraine's exports and imports in 2013–2017



Source: State Statistics Committee of Ukraine

The economic collapse in Ukraine reached such a high degree due to several factors. Until summer 2014, there was high instability in most south-eastern regions of Ukraine provoked by pro-Russian armed gangs, which later transformed into regular military actions in Donetsk and Luhansk Oblasts. Until February 2015 (when the second Minsk Accord ending the phase of large-scale fighting was signed[3]), it was not clear whether Ukraine would disintegrate as a country or not.

The external aggression adversely affected the economy. The strongest negative impact on foreign trade was had by the dramatic fall in the value of the Ukrainian currency which in 2014–2015 underwent an almost threefold depreciation. The National Bank of Ukraine imposed extremely severe restrictions on currency trade which seriously impeded the conducting of financial operations with foreign entities. The banking sector crisis caused mass bankruptcies starting from 2014 resulting in a reduction of the number of banks from 180 in January 2014 to 82 in May 2018 and almost prevented companies' access to loans; this has also had a strong impact[4].

Table 1. Comparison of dynamics of trade in goods

	Export dynamics y/y					Import dynamics y/y				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
Total	-8%	-15%	-29%	-5%	19%	-9%	-29%	-31%	5%	26%
Post-Soviet countries	-13%	-33%	-48%	-23%	15%	-19%	-38%	-39%	-18%	34%
EU	-2%	1%	-23%	4%	29%	3%	-22%	-27%	12%	21%
Rest of the world	-7%	-10%	-21%	-3%	12%	-8%	-27%	-27%	16%	28%

All these factors very negatively affected Ukrainian exporters and importers alike. As a result, in 2013–2016 Ukrainian exports in aggregate were reduced by 42% from US$62.3 billion to US$36.4 billion, and imports contracted by 48% from US$75.8 billion to US$39.2 billion. 2017 was the first year when a significant increase in trade was seen. However, as compared to 2013, the volume of exports was still lower 31% lower and that of imports 35% lower.

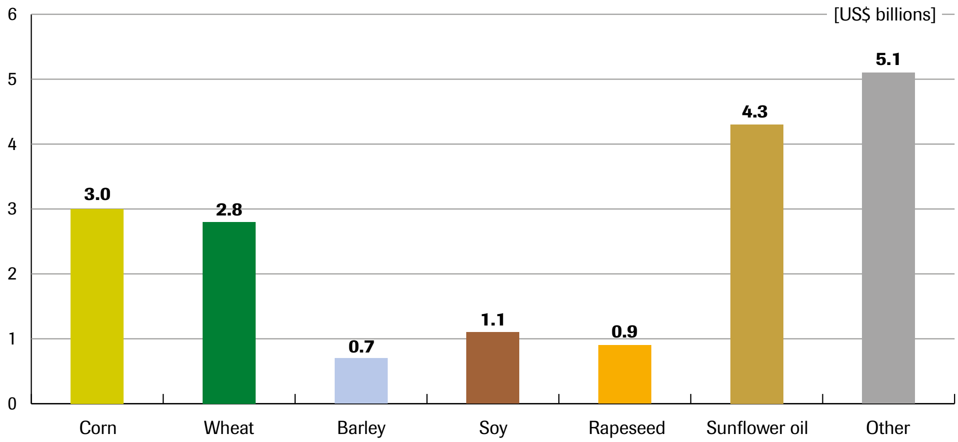
3 A. Wilk, T.A. Olszański, W. Górecki, *The Minsk agreement – one year of shadow boxing*, „OSW Analyses", 10 February 2016, https://www.osw.waw.pl/en/publikacje/analyses/2016-02-10/minsk-agreement-one-year-shadow-boxing

4 For more information on the crisis see R. Sadowski, *The aftermath of the crisis. An overhaul of Ukraine's banking sector*, „OSW Studies", 11 August 2017, https://www.osw.waw.pl/en/publikacje/osw-studies/2017-08-11/aftermath-crisis-overhaul-ukraines-banking-sector

Table 2. Changes of the key sectors of Ukrainian exports (in US$ billions)

	Food and agricultural sector		Metallurgy (ores+steelworks)		Machine industry	
	2013	2017	2013	2017	2013	2017
Value	16.9	17.8	21.2	12.7	10.1	4.9
Share in total exports	27%	41%	34%	29%	16%	11%

Chart 7. Key exports of the food and agricultural sector in 2017 (US$ billions)[5]



Source: State Statistics Committee of Ukraine

Even though falls were seen in almost all goods groups, their scale differed to a great extent. The falls were dramatic in the case of many key Ukrainian exports; for example, in 2017 as compared to 2013, the export of rail vehicles was reduced by 91%, and in the case of products of the machine industry – by 54%. The reductions were slightly lower in the case of the sale of cast iron and iron (-39%) and iron ore (-28%). Agriculture was the only sector that was not affected excessively, and in the case of two key exports volume grew (grain by 2% and oils by 32%). In effect, food and agricultural products for the first time in the history of independent Ukraine gained the dominant position in Ukrainian exports (41% of total exports in 2017), coming ahead of metallurgical products (29%), while the role of the machine industry was further marginalised.

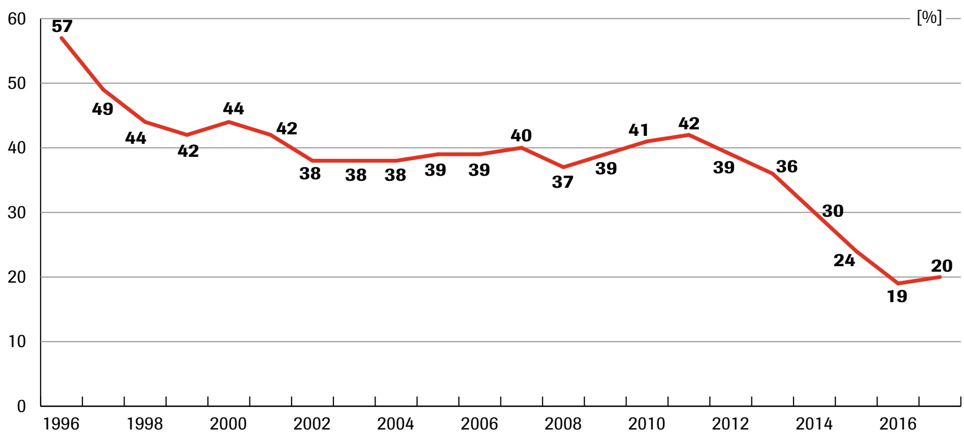
[5] Goods whose export value reached at least half a billion US dollars in 2017 are taken into account.

The boost in exports of agricultural products is in general a positive phenomenon that made it much easier to survive the most difficult period in 2014–2015, ensuring Ukraine an influx of foreign currency and partly compensating for the losses in the sale of products of the metallurgical and machine industries. However, it is worth noting that in the case of exports of food and agricultural products, non-processed and low-processed goods predominate. Three kinds of grain, two kinds of oil seed and sunflower oil account for as much as 71% of exports from this sector. Animal husbandry, fruit growing or more advanced food processing are developing slowly but still remain on a low level and are aimed at satisfying domestic demand and have marginal significance in exports. Such a high degree of dependence on several types of crops also poses potential threats to the stability of exports because it makes them sensitive to price fluctuations on global markets and weather conditions.

III. THE RUSSIAN AND OTHER POST-SOVIET MARKETS – THE COLLAPSE OF TRADE

Ukraine was an integral part of the Soviet economy until 1991. After the collapse of the USSR, the former Soviet republics, above all Russia, remained Ukraine's key trade partner for obvious reasons. The new customs borders, the introduction of the various currencies and the economic crisis in the 1990s in the entire post-Soviet area caused bankruptcies of a significant section of Ukrainian industrial plants and the break-up of the numerous co-operation bonds, although many of them survived, especially in the high-tech sector such as the space, aviation and arms industries. This had a decisive effect on the shape of the goods structure of trade. In the period between regaining independence and 2013, the significance of post-Soviet countries in Ukraine's foreign trade fell regularly, but it still remained high (36% of total trade).

Chart 8. The share of post-Soviet countries in Ukraine's trade



Source: State Statistics Committee of Ukraine

Trade with post-Soviet countries had two distinctive features. In the case of imports this was a very high share of fuels (mainly natural gas from the Russian Federation and petrol from Belarus) which in 2013 accounted for as much as 62% of Ukrainian imports from post-Soviet countries. In turn, exports were characterised by a significant share of production with a high added value, while in most cases Ukraine had very limited outlets for these goods. For example, the share of machine and electric machine industries' products in exports to post-Soviet countries reached 31% (which accounted for 66% of total Ukrainian exports from this sector), that of the chemical industry reached 8% (59% of total exports) and the paper industry was 4% (91% of total exports). The high degree of the dependence of industrial production exports on the Russian and other post-Soviet markets has severely affected the Ukrainian industry and economy as a whole during the Russian aggression ongoing since 2014.

The events that took place in 2014 and 2015 brought about a fundamental change in these dependencies. In June 2014, Russia withheld gas supplies to Ukraine. Unlike with the previous gas wars of 2006 and 2009, when the two parties had been able to reach a compromise albeit at the price of far-reaching concessions from Ukraine, this time Moscow's moves led to a total breakdown of co-operation. In September 2014, Ukraine reached an agreement with Slovakia on the launch of regular supplies via the reversed Vojany–Uzhgorod gas pipeline, which made it possible to rely solely on supplies of gas from the EU transported via the reversed gas pipeline starting from November 2015, when Gazprom withheld supplies. In effect, imports of fuels from post-Soviet countries were reduced from US$17.4 billion in 2013 to US$6.1 billion in 2017, of which US$3.2 billion accounted for diesel and benzene from Russia and US$2.2 billion from Belarus.

Table 3. Comparison of key Ukrainian imports from post-Soviet countries (US$ millions)[6]

	2013	2017	change
fuels and mineral oils	17 441	6 086	-65%
nuclear reactors; boilers; machines and mechanical equipment	1393	747	-46%
cast iron and steel	958	464	-52%
machines and electrical equipment	834	175	-79%
fertilisers	758	935	23%
non-rail vehicles	657	321	-51%
plastics	594	386	-35%

Until 2013, the Kremlin continued a trade blackmail policy with regard to Ukraine. On the one hand it was tempting it with the benefits of joining the customs union as part of the Eurasian Economic Union, while on the other it was

6 Goods whose import value reached at least half a billion US dollars in 2013 are taken into account.

gradually restricting co-operation bonds and reducing imports from Ukraine, employing non-tariff measures. One example was the withdrawal of certificates for Ukrainian carriages in October 2013[7] which used to be one of Ukraine's key exports (their export value stood at US$4.1 billion in 2012). The official reason provided were repeated failures, while the real intention was to protect the domestic market. Another example of pressure on Ukraine was the week-long blockade of all Ukrainian exports to Russia in August 2013 under the pretext of an amendment of customs regulations.

Since 2014, as part of its aggression against Ukraine, Russia has been reinforcing its military actions with pressure and sanctions in the area of trade targeted against Ukrainian exports. Since 2016, Moscow has imposed an embargo on imports of food and agricultural products from Ukraine. As a result of these moves, exports of dairy products to Russia were nearly discontinued (there was a reduction from US$382 million in 2013 to US$6,000 in 2017), and those of chocolate and cocoa products were reduced by 92% from US$337 million to US$27 million. The reductions were only a little less dramatic in the case of other post-Soviet markets (-79% and -81%, respectively).

The Kremlin also launched measures aimed at disrupting Ukraine's co-operation with other post-Soviet countries. The aforementioned problems with carriage certification intensified in 2014 when Russia ceased to recognise analogous documents for carriages made in Ukraine issued by Belarus and Kazakhstan[8]. In effect, the Ukrainian exports of rail vehicles to these countries (in fact the only buyers of these products apart from Russia) collapsed, as its value was reduced from US$2.3 billion in 2013 to US$144 million in 2017. Another example of Moscow's moves targeted against Ukraine was the introduction of new rules in February 2016 that significantly restricted the possibility of the transit of Ukrainian goods through Russian territory. This extremely severely affected trade with all Central Asian countries, especially Ukrainian exports to Kazakhstan, Kyiv's main trade partner in this region. As a result, in 2017 as compared to 2013 exports to the Kazakh market fell by 82% from US$2.1 billion

7 *Россия отказалась от вагонов украинского производства*, „Зеркало Недели", 29 October 2013, https://zn.ua/ECONOMICS/rossiya-otkazalas-ot-vagonov-ukrainskogo-proizvodstva-131818_.html

8 *Иск против России о запрете импорта вагонов: Украина ожидает решения ВТО в следующем году*, Unian, 11 July 2017, https://economics.unian.net/industry/2023606-isk-protiv-rossii-o-zaprete-importa-vagonov-ukraina-ojidaet-resheniya-vto-v-sleduyuschem-godu.html

to US$372 million, and Astana moved down from 7th to 33rd place in the ranking of the recipients of Ukrainian production.

Table 4. Comparison of key Ukrainian exports to post-Soviet countries (US$ billions)[9]

	2013	2017	change
cast iron and steel	2902	997	-66%
nuclear reactors; boilers; machines and mechanical equipment	2730	854	-69%
locomotives and rolling stock	2297	144	-94%
cast iron and steel products	1891	347	-82%
machines and electrical equipment	1351	318	-76%
inorganic chemicals	998	626	-37%
paper and cardboard	983	294	-70%
fuels and mineral oils	594	182	-69%
salt, sulphur, soils and stones	543	155	-72%
plastics	514	268	-48%

All Moscow's moves as described above have been aimed at escalating the economic crisis to the maximum extent and causing the downfall of the government in Kyiv. The Kremlin wanted to provoke public dissatisfaction and mass protests especially in the industrialised eastern regions of Ukraine. This did not happen not only because of the patriotic spurt and consolidation of the public in the face of the Russian threat, but also because the DCFTA began to bring effects.

9 Goods whose export value reached at least half a billion US dollars in 2013 are taken into account.

IV. THE EU, THE MOST IMPORTANT BUT DIFFICULT PARTNER

Before 2014, the European Union was an important but not a key trade partner for Ukraine. In 2013, 25% of Ukrainian exports went to EU member states, which was significantly less than in the case of the post-Soviet countries (35%) and other countries (39%). In the preceding years, the EU's share remained at a level slightly below 30%. At the same time, both Brussels and Kyiv were interested in intensifying economic co-operation. Ukraine was treated as a promising outlet. In turn, the Ukrainian business circles counted on the benefits which the removal of most customs barriers on the EU market would bring. For this purpose negotiations of the Association Agreement (AA) were launched in 2008. The Deep and Comprehensive Free Trade Area (DCFTA) agreement envisaging not only a reduction in customs duties but also a far-reaching harmonisation of Ukrainian norms and standards with those of the EU was to be part of the AA. The negotiations ended in December 2011, and the document was initialled in July 2012. This provoked fierce objection from Russia which feared (not unreasonably) that Ukraine's adoption of EU norms and standards would rule out Kyiv's engagement in any integration projects under the aegis of Moscow in the post-Soviet area in the future, which had been the Kremlin's strategic goal for years. President Viktor Yanukovych refused to sign the Association Agreement under Russian pressure in November 2013. This was the immediate cause of the outbreak of the public protests which led to the Revolution of Dignity and the toppling of Yanukovych in February 2014, which in turn provoked the Russian aggression against Ukraine.

The crisis triggered by the revolution and the Russian moves in eastern Ukraine caused the new government in Kyiv to sign the Association Agreement as late as June 2014. In April 2014, the European Commission introduced Autonomous Trade Measures (ATM) with regard to Ukraine, while Ukraine retained its customs tariffs on EU products. This was intended as a form of support for Kyiv during the escalating economic crisis. At the same time, trilateral negotiations in the EU-Ukraine-Russia format were being conducted during which Moscow insisted on a thorough revision of the DCFTA (including the change of tariffs for 2,800 groups of goods) and postponing the entry into force of the agreement. Given the de facto war with Russia and pressure from some EU member states, it was decided to postpone the entry into force of the DCFTA and to prolong the operation of the ATMs through 2015. The agreement became binding on a temporary basis from 1 January 2016 and to the full extent (after all EU member states closed ratification procedures) only from 1 September 2017. According to the document, the customs tariffs on most goods were reduced to zero, and in the case of all others, transition periods were introduced for a maximum of up to seven years. Tariff Rate Quotas (TRQ) were introduced for 36 groups of goods. Once the quotas have been used fully, Ukraine has to pay customs duty at the full rate. The TRQ apply with regard to goods which are recognised as especially sensitive in the EU. It is not incidental that part of them concerns products in the areas where Ukraine is competitive (for example, wheat and poultry).

The ATMs and later the DCFTA made it possible to essentially alleviate the consequences of the collapse of Ukraine's trade. Even though in 2014 and 2015 the reductions in trade with the EU were significant, they were still much lower than in trade with post-Soviet countries or third countries. Ukrainian exports to the EU fell only in 2015 (-23%), and imports in 2014–2015 (by 22% and 27%, respectively). Starting from 2016, the Ukrainian exports started growing, at the beginning at a small rate (5%) to grow by 29% the next year to US$17.5 billion, thus reaching a level higher than that in 2013 (US$16.8 billion). It is also worth noting that exports to the EU in 2017 were growing at a much faster rate than to post-Soviet countries (15%) and the remaining countries (12%) in the same period, which is one more proof of the DCFTA's effectiveness.

When one compares the data for 2013 and 2017, it appears that out of the eight key groups of goods exported by Ukraine to the EU (worth over US$500 million) three generated growth (and in the case of one of them, the growth was very significant – the value of the sales of fats and oils tripled), and only one saw a significant drop. The drop in sales of metallurgical products was to a great extent an effect of the problems this sector was experiencing in Ukraine (the disruption of numerous production chains as a result of the military operation). Some groups of goods which had previously been of minor significance generated impressive growth; for example, sales of meat products grew from US$1 million to US$136 million, dairy products from US$42 million to US$121 million, and furniture from US$145 million to US$418 million.

Table 5. Comparison of key Ukrainian exports to the EU (US$ millions)[10]

	2013	2017	change
cast iron and steel	4061	3190	-21%
metal ores	1759	1545	-12%
grain	1708	1677	-2%
machines and electrical equipment	1501	2043	36%
oleaginous seeds and fruit	1250	1095	-12%
fuels and mineral oils	924	524	-43%
wood and wooden products	611	834	36%
fats and oils	499	1 472	195%

In the case of imports from the EU the results were much poorer. This was above all an effect of the depreciation of the Ukrainian currency and, as a consequence, the reduction of the Ukrainian public's purchasing power. Even though in 2016 and 2017 imports from the EU grew by respectively 12% and 21%, they were still much lower than in 2013 (US$20.8 billion as compared to US$27 billion in 2017), and the value of imports in all but one key group of goods dropped.

Table 6. Comparison of key Ukrainian imports from the EU (in US$ millions)[11]

	2013	2017	change
nuclear reactors; boilers; machines and mechanical equipment	3413	2962	-13%
fuels and mineral oils	3018	3039	1%
non-rail vehicles	2757	2171	-21%
pharmaceutical products	2307	1287	-44%
machines and electrical equipment	1869	1573	-16%
plastics	1787	1275	-29%
paper and cardboard	1139	558	-51%

10 Goods whose export value reached at least half a billion US dollars in 2013 are taken into account.

11 Goods whose import value reached at least half a billion US dollars in 2013 are taken into account.

The first results after the DCFTA came into force provoked disappointment in Kyiv, where it had been expected that exports to the EU would increase at a much higher rate which would compensate for the loss of the Russian and other post-Soviet markets. However, it seems that these expectations were quite unrealistic, especially in the case of the Ukrainian industrial production. It was possible to directly and quickly replace the Russian market only in some cases and to a limited extent (for example, dairy products). In the case of some major (until recently) Ukrainian exports to the post-Soviet market, such as railway carriages, it seems impossible to find a buyer in the EU member states in the foreseeable future.

The difficulties of Ukrainian exporters selling goods to the EU result from several factors. One of the most important factors is that the EU market is very competitive and it is difficult to enter it with new products without spending much on marketing (something Ukrainian companies usually do not have sufficient funds for, nor do they know how to do this). One of Ukraine's advantages are low labour costs. However, in many cases this advantage is lost due to low efficiency, poor legal protection, poor infrastructure, and expenses caused by the omnipresent corruption. Furthermore, in the case of some goods, transition periods still apply when the customs rates are not fully reduced (which will happen within seven years of the entry into force of the document).

Another problem is the issue of norms and standards linked to technical barriers to trade (TBT) and sanitary and phytosanitary standards (SPS). The Association Agreement and the DCFTA mean that Ukraine has to adopt hundreds of directives, regulations and other legal acts harmonising Ukrainian law with that of the EU. While in the case of the TBTs, Ukraine has fulfilled most of its obligations, in the case of the SPS and the agricultural sector linked to it the implementation has hardly begun. As a total, as of June 2018, out of the 1,941 activities envisaged in the Association Agreement, Ukraine had implemented 112, and in the case of 386 it is behind the schedule[12].

Instead of focusing on the implementation of the norms and standards, the Ukrainian government has been actively lobbying to raise the customs quotas. Due to strong resistance from some member states fearing the competition of Ukrainian products, the lobbying was successful only to a small degree. In 2016, the European Commission suggested introducing the second ATM

12 Навігатор Угоди, „Європейська Правда", accessed on 10 June 2018, http://navigator.eurointegration.com.ua/tasks

programme in which the TRQs for selected products were temporarily increased (mainly grains) and customs duty was lifted in the case of 23 tariff lines (mainly products of the textile industry). The European Commission's proposal was accepted by the European Parliament to a limited extent and began to be binding from October 2017. However, according to preliminary estimates, the impact of ATM II on the increase of Ukrainian exports in 2018 will be marginal (0.6%)[13].

[13] V. Movchan, R. Giucci, *New autonomous trade measures by the EU: Impact on Ukrainian export*, German Advisory Group Ukraine, September/October 2017, http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2017/10/PB_09_2017_en.pdf

V. THE REST OF THE WORLD – THE UNSUCCESSFUL SEARCH FOR NEW OUTLETS

Countries outside the EU and the post-Soviet area, above all from North Africa and the Middle East (Turkey, Egypt, Iran, Saudi Arabia) and Asia (China and India) are among the key trade partners of Ukraine, especially as recipients of exports with which (with the exception of China) Kyiv regularly generated very high trade surpluses. However, the crisis in 2014–2015 adversely affected economic relations with these countries as well – exports fell from US$24.5 billion in 2013 to US$18.9 billion in 2017 (-23%), and imports fell from US$22 billion to US$17.3 billion (-21%). While in the case of the collapse of trade with Russia and other CIS countries, political factors were decisive, it appears that the reduction of trade with third countries has been caused by Ukraine's economic problems, in particular, restrictions on operations on the currency market and the difficulties companies experience with access to loans.

Table 7. Ukraine's key partners from third countries[14]

	Exports (US$ billions)			Imports (US$ billions)		
	2013	2017	change	2013	2017	change
Turkey	3.8	2.5	-33%	1.8	1.3	-28%
India	2.0	2.2	13%	0.8	0.6	-33%
China	2.7	2.0	-24%	7.4	5.6	-24%
Egypt	2.7	1.8	-33%	0.1	0.1	-43%

After 2014, since Ukraine lost a significant share of the post-Soviet markets, the main challenge for it was to find an alternative, especially for products of the food and agricultural and the industrial sectors. In addition to the attempt to enter the EU market as described above, another solution was to develop trade with its remaining trade partners. Analysing the data one may notice that Kyiv has partly succeeded in this. In 2017, as compared to 2013, sales of key groups of goods from the food and agricultural sector did not undergo any major changes or grew (grains, fats and oils). Furthermore, Ukraine managed

[14] Countries where total trade exceeded one billion US dollars in 2017 are taken into account.

to significantly boost exports of goods that were previously of marginal significance (tobacco – a 115% increase, meat and meat products – a 146% increase, groats – a 141% increase). However, in the case of industrial products, the previous export volumes not only failed to remain on their previous levels – they were even reduced significantly (the machine industry -37%, the chemical industry -86%).

Table 8. Comparison of key Ukrainian exports to third countries (US$ millions)[15]

	2013	2017	change
cast iron and steel	7357	4479	-39%
grains	4601	4799	4%
fats and oils	2783	3046	9%
metal ores	2082	1141	-45%
fuels and mineral oils	1348	85	-94%
fertilisers	989	81	-92%
nuclear reactors; boilers; machines and mechanical equipment	695	440	-37%
oleaginous seeds and fruit	692	901	30%
inorganic chemicals	543	77	-86%

15 Goods whose export value reached at least half a billion US dollars in 2013 are taken into account.

VI. TRADE IN SERVICES

The value of the trade in services is much lower than that of the trade in goods. In 2017, exports and imports of services were worth a total of US$15.4 billion, which was 17% of the total value of exports and imports of goods (US$92.9 billion). This proportion was similar in the preceding years.

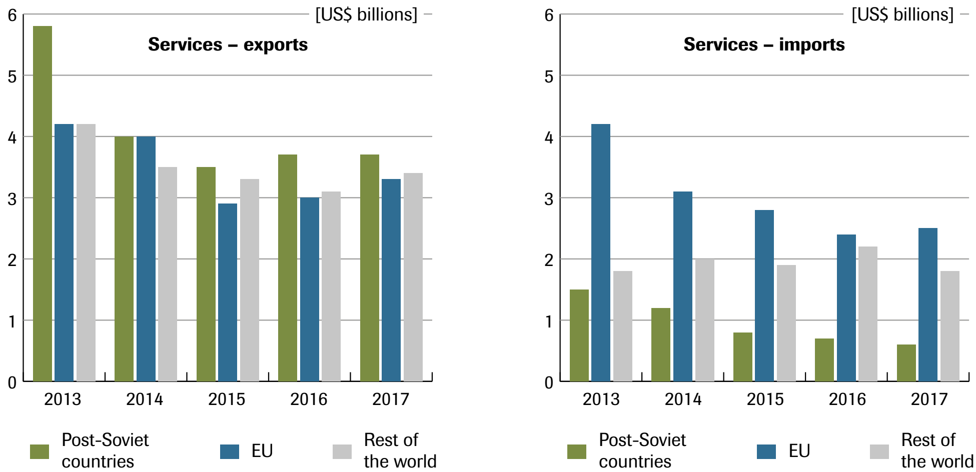
The trade in services has suffered as a result of the crisis to a slightly smaller extent than the trade in goods – in 2017 as compared to 2013 exports of services were 27% smaller, and imports were reduced by 29%. However, as compared to the trade in goods, the downward trend turned out to be much stronger, so the improvement of the economic situation in 2016 and in particular in 2017 affected the trade in services to a limited extent. Imports in 2017 were reduced by 7% year on year, and exports grew only 6% year on year (for comparison, imports of goods in the same period increased by 26%, and exports by 19%).

Table 9. Comparison of dynamics of trade in services

	Dynamics of exports y/y					Dynamics of imports y/y				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
Total	1%	-19%	-15%	1%	6%	13%	-15%	-13%	-4%	-7%
Post-Soviet countries	0%	-31%	-12%	5%	0%	18%	-18%	-30%	-20%	-5%
EU	12%	-5%	-27%	3%	11%	16%	-25%	-13%	-12%	3%
Rest of the world	-7%	-17%	-7%	-4%	8%	4%	10%	-4%	15%	-19%

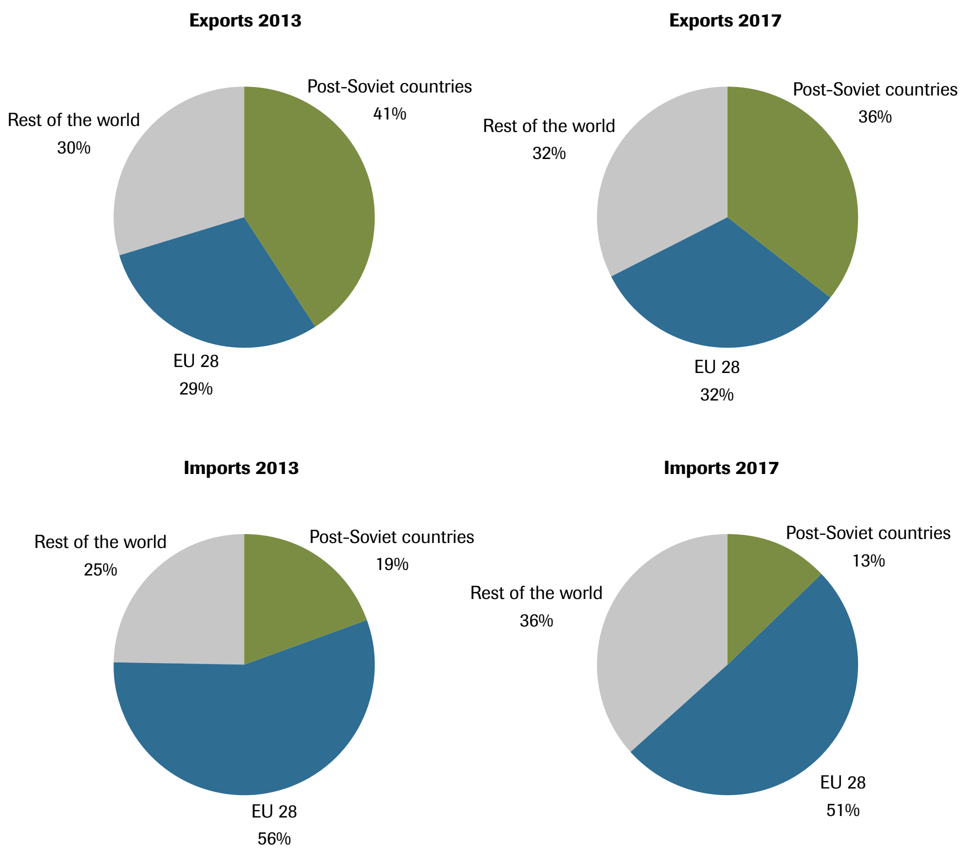
Unlike with the trade in goods, the share of EU and post-Soviet countries and the rest of the world in the Ukrainian trade in services did not change much. In 2017, as four years before, the EU remained Ukraine's main partner, and the share of post-Soviet countries was reduced a little but still remained high, above all in exports.

Chart 9. Exports and imports of services in 2013–2017 (US$ billions)



Source: State Statistics Committee of Ukraine

Chart 10. Comparison of the geographical structure of trade in services in 2013 and 2017



Source: State Statistics Committee of Ukraine

Another important feature of the Ukrainian trade in services is the stable and high trade surplus. This concerns partners from all geographical areas, however, an especially strong increase in the surplus can be observed in trade with the EU as it grew from a level of US$178 million in 2015 to US$827 million in 2017, which can also be treated as a positive effect of the DCFTA.

Table 10. Balance of trade in services (US$ millions)

	2013	2014	2015	2016	2017
Total	6710	5148	4214	4541	5500
Post-Soviet countries	4348	2830	2705	3055	3098
EU	-16	843	178	583	827
Rest of the world	2399	1716	1584	1261	1310

1. Geographical characteristics of the trade in services

As compared to the trade in goods, exports of services from Ukraine are much less diversified in geographical terms. Nearly 50% of services are exported to three countries: the Russian Federation, the USA and Switzerland. Other major partners are: the United Kingdom, Germany and Poland. Only in the case of Poland and the USA were exports of services higher in 2017 as compared to the last year before the crisis.

Table 11. Exports of services – key countries (US$ millions)

	2013	2017	Change
Total	14 233	10 447	-27%
Russia	5258	3404	-35%
USA	724	814	12%
Switzerland	1018	742	-27%
United Kingdom	753	573	-24%
Germany	681	523	-23%
Poland	218	275	26%

Unlike with exports, quite serious changes have taken place since 2013 in imports of services, above all a major fall in the role played by Russia (which in 2013 was Ukraine's main partner in this area).

Table 12. Imports of services – key countries (US$ millions)

	2013	2017	Change
Total	7523	5359	-29%
USA	362	570	58%
United Kingdom	1060	499	-53%
Russia	1233	424	-66%
Germany	622	370	-41%
Turkey	213	357	68%
Cyprus	1018	225	-78%

2. The most important kinds of exported services

Transport accounts for more than half of Ukraine's exports of services (US$5.7 billion in 2017), including US$3 billion pipeline transport (this concerns mainly the transit of Russian natural gas via Ukrainian territory). Over the past ten years, depending on the year, transit fees would differ significantly, from US$2.1 billion in 2009 to US$3.8 billion in 2011, still invariably remaining the largest source of income in the area of exports of services. The differences were caused above all by changes in demand for Russian gas on the EU market. Moscow has for years been regularly making efforts to reduce the significance of Ukraine as a transit country. The possible construction of the Nord Stream 2 gas pipelines and the expiry of the transit agreement between Russia and Ukraine at the end of 2019 for Kyiv will mean the loss of a major share of income in this area and will escalate problems with the payment balance (for more details see the text below).

While the Russian-Ukrainian conflict has had a small impact on income from pipeline transport, two other major items in Ukraine's exports of services, railway and maritime transport, have been affected very severely by it. The trade war and the restrictions and barriers introduced by Russia in the area of the transport of goods caused tangible losses. Income generated by maritime transport services in 2017 was US$608 million (a 41% fall in comparison to 2013), and railway transport was US$572 million (63% fall). In both cases the downward trend has continued over the past four years and, given the fact that there are no chances of improving relations with Russia in the coming years, it is unlikely that this trend will be reversed.

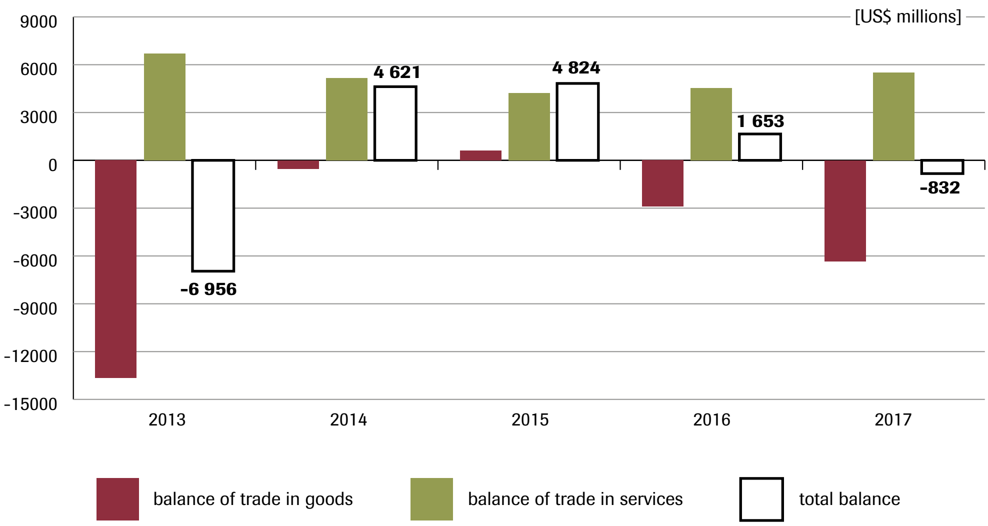
The only services in Ukrainian exports to have generated rapid growth are IT services. A rapid development in this area began already before the crisis – the value of exports of services in the IT sector grew from US$255 million to US$931 million between 2010 and 2013. The economic collapse did not affect the IT sector later on, and exports in 2013–2017 grew by 36%, reaching a value of US$1.3 billion. The key recipients are: the USA, Switzerland, the United Kingdom, Russia and Israel. However, it is worth emphasising that the dynamics of growth of IT service exports is gradually reducing – while in 2013 growth reached 44% year on year, in 2017 this rate was only 11%. This is most likely a result of the limitation of the development rate of the IT sector in Ukraine due to the unfavourable business climate affecting this sector to an increasing extent[16].

16 *IT Украины. Помогать нельзя мешать*, FINANCE.UA, 31 January 2018, https://news.finance.ua/ru/news/-/419649/it-ukrainy-pomogat-nelzya-meshat

VII. CHALLENGES LINKED TO THE BALANCE OF TRADE

The Ukrainian foreign trade in goods since 2005 has been characterised by an increasingly negative trade balance. This problem concerned both post-Soviet countries (mainly due to the imports of fuels) and the EU. The positive trade balance with other countries was unable to compensate for this growing disproportion and in 2008 the negative trade balance reached a record-high value of US$18.6 billion (the equivalent of 10.3% of the value of the then GDP). One of the side effects of the economic crisis in 2009 was an improvement of the balance (which still remained negative) and in 2013 the deficit in the trade in goods reached US$13.7 billion. As mentioned above, Ukraine has regularly generated a positive balance in trade in services. This allowed the trade deficit to be limited as a whole to a certain degree but not to eliminate it completely.

Chart 11. Ukraine's trade balance (US$ millions)



Source: State Statistics Committee of Ukraine

The negative trade balance caused a drain of the country's currency reserves and was one of the causes of the economic crisis in 2014–2015 and the depreciation of the Ukrainian currency. The collapse of trade affected imports to a greater extent than exports, which made it possible to counterpoise the balance of trade in goods. Owing to this, Ukraine in 2015 generated a trade surplus for the first time in eleven years. The continuing positive balance of trade in services in 2014–2016 ensured Kyiv a positive trade balance of almost US$5 billion, which seriously (apart from co-operation with the IMF) contributed to the stabilisation of the country's balance of payments and increasing currency reserves.

The improvement of the economic situation in Ukraine and the more rapid growth of imports than exports caused the phenomenon existing before the crisis to return in 2017. As imports grew, the negative balance of trade in goods was higher than the surpluses generated by the trade in services and, as a result, Ukraine closed the year with a trade deficit of US$832 million. This trend may intensify, especially if a significant share of the incomes generated by Russian gas transit is lost. This will mean a serious problem to the country's balance of payments, especially in a situation of de facto frozen co-operation with the IMF and the very low level of foreign direct investments which might have counterbalanced the increasing deficit.

CONCLUSION AND POSSIBLE DEVELOPMENTS

Very serious changes took place in Ukraine's foreign trade in 2013–2017 as regards both geographical and goods structures. This was an effect of the Russian aggression on Ukraine on the one hand and on the other of the beneficial influence of the DFCTA, owing to which the European Union became Ukraine's largest economic partner, and the role of post-Soviet countries was dramatically reduced. Even though in 2017 Ukraine's trade with Russia and the post-Soviet countries grew, this growth was much lower than in the case of the EU or other countries. It seems that this trend will only strengthen in the coming years.

As Kyiv will be implementing the provisions of the Association Agreement, in particular the part concerning norms and standards, Ukrainian firms will find it increasingly easier to gain access to the EU market. The significance of the rest of the world as a key outlet for Ukrainian food and agricultural products and, to a lesser extent, of industrial products will remain very high. In turn, the post-Soviet area has most likely lost its significance for good. Ukraine has no chance of regaining its lost positions on the Russian market without a radical improvement of political relations between Kyiv and Moscow, which is rather unrealistic in the coming years. Even if this happens, it is doubtful that Russia will want to rebuild the bonds of co-operation it was trying to weaken already before 2014.

It seems that the changes which have taken place in the goods structure of Ukrainian trade are irreversible. Even though the trend suggesting an increasing significance of agriculture and a decreasing role of metallurgy and the machine sector could already be observed before 2013, it accelerated rapidly in 2013–2017.

It can be assumed with a high degree of certainty that the significance of exports of food and agricultural products will continue to grow. This is a positive phenomenon in itself and, given Ukraine's climate and high quality of soil, it is in a way natural. It is worth noting that low processed or unprocessed products (grains, oleaginous seeds and vegetable oils) accounted for as much as three quarters of Ukrainian exports of agricultural products. This means a continuation of the approach which could be observed in the metallurgical industry: the desire to earn as much as possible with a minimal level of investments and high sensitivity to economic fluctuations on the global markets. Nevertheless, nothing suggests that this approach could change. On the contrary, 61 million tonnes of grain was harvested in Ukraine in 2017, of which 42 million tonnes were exported and, according to the president of the Ukrainian Grain Association, the total grain crops by 2020 may reach as much as 100 million tonnes[17]. Even if such rapid growth in such a short time is recognised as being unrealistic, nobody doubts that the surface and the intensity of crop cultivation will continue to increase. It is possible to indicate several reasons why Ukrainian agriculture is developing extensively to a large degree. One of the main reasons is the moratorium on the sale of agricultural land which means that tenant farmers do not care about soil quality, do not avoid overexploitation, and are not interested in major investments. This approach is changing slowly, and sales of processed food is beginning to grow slowly in Ukraine, but this is still a small share (around 3%) of exports.

Unlike with agriculture, the future of the Ukrainian machine industry looks very pessimistic. The loss of a major share of the post-Soviet market very severely affected the Ukrainian hi-tech industry. It seems impossible that such key companies as Antonov, Motor Sich (the aviation industry) or Yuzhmash (the space industry) could function in their previous forms. Thus Ukraine will not manage to regain its previous level of exports with a high added value.

It may be expected that in the case of the exports of services, the income generated by the IT sector will continue to grow, albeit at a slower rate. Maintaining the income from transport services at the existing level will be a challenge for Ukraine. It seems that, without improving relations with Moscow, Kyiv will not manage to return to the level of income it had in the area of maritime and railway transport in 2013. However, the greatest threat will be linked to the construction of the Nord Stream 2 gas pipeline and the loss of profits generated by Russian gas transit.

The future of trade will depend above all on the condition of the Ukrainian economy. However, macroeconomic and trade data for 2017 prove that the crisis is over. Nevertheless, economic growth is still disappointing and Ukraine is still far from achieving the level it had in 2013. The Ukrainian government after 2014 has not created conditions for the influx of foreign capital, and the business climate in Ukraine has not improved significantly. Meanwhile, without a thorough modernisation of industry, that would entail the influx

[17] *Украина к 2020 году будет выращивать около 100 млн. тонн зерна – УЗА*, АПКИНФОРМ, 17 December 2017, https://www.apk-inform.com/ru/news/1091014#.W-rmNeKNyHu

of foreign investments, Kyiv will not manage to increase exports of high processed products to EU countries, and will find it difficult to do so to third markets. This will mean that the significance of the machine industry will continue to decline in Ukraine and the reliance on the sale of agricultural and metallurgical products will grow.

SŁAWOMIR MATUSZAK