

Transatlantic Trade Politics Network Policy Brief

Navigating the Storm: Ukraine's Trade Relations in Times of War

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Navigating the Storm: Ukraine's Trade Relations in Times of War

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The Russian Federation's full-scale invasion has inflicted immediate, medium, and long-term disruptions on Ukraine's trade capacity, challenging its ability to sustainably engage in international commerce. This policy brief aims to explore Ukraine's pre-war trade landscape, assess the immediate, medium, and long-term impacts of the conflict on its trade capacity, and contemplate the defining factors that will shape the road ahead for Ukraine's trade trajectory amidst the backdrop of the ongoing geopolitical turmoil.

Ukraine's participation in international trade before February 24, 2022

After the collapse of the Soviet Union, an independent Ukraine was heavily dependent on trade with the Russian Federation.² Two aspects of this dependency played an outweighed role in the later developments: unparalleled dependency on the energy resources supplied by the Russian Federation and significant dependence on the Russian market for exports of some categories of goods.

Ukraine's accession to the World Trade Organization (WTO) finalized in 2008 and the declared political aspirations for closer political and economic cooperation with the European Union did not alter the aforesaid trends. Before 2014, the Russian Federation was Ukraine's most significant trading partner.³ However, the Russian Federation's illegal annexation of the Crimean Peninsula and financing of a military conflict in Eastern Ukraine paved the way for the drastic political as well as economic transformations.

As a result of the conflict, Ukraine's economy suffered a significant decline in 2014-2015: "Ukraine's real GDP is estimated to have contracted by 15.8% in the first three quarters of 2015 compared with the same period in 2014".⁴ Trade relations with the Russian Federation deteriorated and the products most affected by this decay were "gas, oil and petroleum products; iron and steel; tubes, road vehicles and other transport equipment (including railway rolling stock); machinery, notably electric and power generating machines; and dairy products."⁵

² Bogdanova, Iryna. 2021 "Turning Crisis into Opportunity: Unfolding Ukraine's Trade Potential with the Canada-Ukraine Free Trade Agreement." *East/West: Journal of Ukrainian Studies* 8(2) 151-191.

³ Ibid.

⁴ WTO, Trade Policy Review Body. 2016. *Trade Policy Review of Ukraine*, WTO Doc. WT/TPR/S/334, at para. 1.21.

⁵ Ibid, at para. 1.26.

Harnessing the benefits of the Deep and Comprehensive Free Trade Agreement signed between Ukraine and the European Union, which entered into force on January 1, 2016, Ukraine's trade has been partly redirected to the EU Member States.⁶

Regarding the political metamorphosis, since late 2013 Ukraine followed the path of closer integration with the European Union and the EU's recent decision to open accession negotiations with Ukraine epitomizes the political transformations that occurred in Ukraine in the last decade.⁷

Economic transformations, as they are exemplified by Ukraine's trade flows, result in significantly decreased trade with the Russian Federation contrary to the growing trade with the EU-27, China and other states (Turkey, India, etc.) and significant changes in the composition of trade. Regarding the latter aspect, Ukraine's exports of semi-finished and manufactured goods dropped in contrast to its exports of agricultural products.⁸ To be more specific, Ukrainian exports of railway and tramway locomotives, nuclear reactors, boilers and machinery, mineral fuels and oils, articles of iron and steel, and fertilizers considerably decreased in 2012-2018.⁹

Turning to the question of Ukraine's energy dependency, in its 2020 report, the International Energy Agency emphasized that Ukraine, despite producing all fossil fuels and having a relatively diversified energy mix, is heavily dependent on the imports of oil, natural gas and coal.¹⁰ Ukraine's considerable coal resources have been lost since 2014 due to the Russian Federation's illegal occupation of the parts of Donbas, where most of the country's coal mines are located.¹¹ Furthermore, in the petroleum sector, Ukraine was heavily relying on supplies from Belarus and the Russian Federation. Data from 2020 shows that these two countries "were responsible for 65 percent of diesel, 40 percent of petroleum, and 49 percent of liquefied

⁶ Bogdanova, 2021; recent data from the World Integrated Trade Solution (WITS) also confirms this.

⁷ Council of the European Union. Council conclusions on Enlargement as approved by the Council on 12 December 2023, Doc. 16707/23. <https://data.consilium.europa.eu/doc/document/ST-16707-2023-INIT/en/pdf>

⁸ WTO, Trade Policy Review Body. 2016.

⁹ Dabrowski, Marek, et al. 2020. "Six Years after Ukraine's Euromaidan: Reforms and Challenges Ahead." *Policy Contribution Bruegel* no. 14. www.bruegel.org/2020/06/six-years-after-ukraines-euromaidan-reforms-and-challenges-ahead/

¹⁰ International Energy Agency. 2020. Ukraine Energy Profile. <https://www.iea.org/reports/ukraine-energy-profile>

¹¹ Prokip, Andrian. 2024. "The State of Ukraine's Energy Sector after Ten Years of War." *Insight & Analysis: Focus Ukraine*, blog of the Kennan Institute, Wilson Center. <https://www.wilsoncenter.org/blog-post/state-ukraines-energy-sector-after-ten-years-war>; the 2020 report of the International Energy Agency notes that: "Most coal in Ukraine is in the Donbass region (Donetsk Coal Basin) in eastern Ukraine in the regions of Donetsk, Luhansk and Dnipropetrovsk. There are two other smaller basins, the Lviv-Volyn Coal Basin in western Ukraine (this basin extends into Poland) and the Dnieper Coal Basin, a lignite basin in central Ukraine." (at p.15)

petroleum gas consumed in Ukraine.”¹² Ukraine is not only critically dependent on imported natural gas¹³ but also receives stable revenue as a transit country: the Ukrainian gas transmission system was and is still used to supply Russian gas to European consumers.¹⁴ The current transit contract runs to an end in December 2024, and the prospect of it being extended remains unclear.¹⁵ Renewables do not play a significant role in Ukraine: the 2020 report underlines that “renewables accounted for only 5% of the energy mix in 2018, and for 9% of electricity generation in 2019.”¹⁶

The immediate, medium- and long-term impact of the war on Ukraine’s trade capacity

The full-scale invasion sent shock waves across the globe: soaring commodity and energy prices hit the most vulnerable countries and their populations, instigating a heated debate on food security and the means through which it can be achieved.¹⁷ For Ukraine, the most obvious and immediate consequence of the full-scale invasion was a significant drop in economic activities. This drop is also vividly reflected in trade statistics: in 2022, exports plummeted from 68 billion USD to 44.4 billion USD, constituting a 35% year-over-year decrease, while imports deteriorated by a bit more than 24% year-over-year from 72.8 billion USD to 55.2 billion USD.¹⁸ It should be noted that the more drastic decline in exports than in imports aggravates the pre-war tendency of Ukraine’s negative trade balance. In 2022, this negative balance reached 10.8 billion USD.¹⁹

In the first months of the invasion, the Russian blockade of the Black Sea prevented Ukraine from exporting its agricultural products through its ports. This economic blow was hard to wither

¹² Prokip, Andrian. 2021. “30 Years of Ukrainian Independence and Energy Dependence.” *Insight & Analysis: Focus Ukraine*, blog of the Kennan Institute, Wilson Center. <https://www.wilsoncenter.org/blog-post/30-years-ukrainian-independence-and-energy-dependence>

¹³ “Aware of the Kremlin’s practice to use energy as a hybrid weapon, Ukraine has been implementing a range of measures to reduce dependence on Russia for almost a decade. Cross-border pipeline projects created the possibility to import natural gas from EU countries (Poland, Slovakia, Hungary, and Romania). Since 2015, Ukraine has not purchased natural gas from Gazprom, satisfying its needs through its own production (75-85% of consumption) and imports from Europe.” Sukhodolia, Oleksandr. 2023. “Ukrainian Energy Sector under Military Attack: Lessons for Resilience.” in *War and Energy Security: Lessons for The Future*. Jermalavičius, Tomas (ed.).

¹⁴ International Energy Agency. 2020.

¹⁵ Топалов, Микола. 2024. “Нульовий транзит: чи готова Україна зупинити транспортування російського газу.” *Економічна правда*. <https://www.epravda.com.ua/publications/2024/02/13/709812/>

¹⁶ International Energy Agency. 2020.

¹⁷ Kryvetska, Olesia. 2022. “Russia’s Aggression Against Ukraine: Global trade implications after 7 months of war.” *IISD Trade and Sustainability Review* 2(3). <https://www.iisd.org/articles/policy-analysis/russia-ukraine-trade-implications>

¹⁸ Data provided by the project Trade Map, International Trade Center. <https://www.trademap.org/Index.aspx>

¹⁹ Ibid.

down, considering that in recent years agricultural production and export have become one of the key drivers of Ukraine's growth and around 90% of these exports were transported by sea.²⁰

In July 2022, with the help of the United Nations and Turkey, the Black Sea Grain Initiative was brokered, which enabled exports of Ukrainian agricultural products through the country's ports.²¹ The arrangement lasted for almost a year (July 2022-July 2023) and allowed food and fertilizer exports to be shipped from three Ukrainian ports – Odesa, Chornomorsk, Yuzhny/Pivdennyi.²² The Black Sea Grain Initiative achieved some positive results, despite reported bottlenecks such as the duration of ship inspections and increased transportation costs, yet it could hardly avert negative repercussions faced by the Ukrainian agricultural sector.²³ Increased production and transportation costs as well as loss of agricultural lands due to the occupation or mining might result in the erosion of Ukraine's leading position as a global agricultural exporter.²⁴

The medium-term consequences of the war would most likely entail fundamental changes in Ukraine's economy. The country has already re-directed its energy supplies,²⁵ yet this move came with a price tag that was passed on to the producers and consumers. From an international trade perspective, it implies more expensive exports and a potential loss of a market share or even certain markets. Considering destroyed and damaged infrastructure and other war-engendered damages,²⁶ in the coming years Ukrainian economy will most likely witness some

²⁰ European Council. 2023. Infographic: How the Russian invasion of Ukraine has further aggravated the global food crisis. <https://www.consilium.europa.eu/en/infographics/how-the-russian-invasion-of-ukraine-has-further-aggravated-the-global-food-crisis/>

²¹ United Nations. Black Sea Grain Initiative Joint Coordination Centre. <https://www.un.org/en/black-sea-grain-initiative>

²² Ibid

²³ Kostetsky, Bogdan and Häberli, Christian. 2023. *MATS Report: Year Three of Russia's Aggression. Production and Trade Risks for Global Food Security*. https://www.wti.org/media/filer_public/c5/00/c5002144-3247-49a2-9005-51ea78078dd4/final_wti_12122023.pdf

²⁴ Ibid.

²⁵ Prokip, Andrian. 2024.

²⁶ The most recent estimate prepared by the Government of Ukraine, the World Bank Group, the European Commission, and the United Nations states that "as of 31 December 2023 the total cost of reconstruction and recovery in Ukraine is \$486 billion (€452.8 billion)". European Commission. 2024. Updated Ukraine Recovery and Reconstruction Needs Assessment Released, Press Release. https://ec.europa.eu/commission/presscorner/detail/en/ip_24_801

form of restructuring; not only economic production will change but also regional distribution of production will most probably change.²⁷ Some relocation of businesses has already occurred.²⁸

The long-term impact of Russian aggression on Ukraine's trade relations would be defined by several factors. In my opinion, there are three essential factors that will define Ukraine's position in international trade in the long run. The first factor is the post-conflict reconstruction of Ukraine, which encompasses a broad range of activities ranging from the reconstruction of destroyed and damaged infrastructure to de-mining and rehabilitation of the agricultural lands that lost their value. The second factor is the timeline and conditions upon which Ukraine would become a member of the European Union. The last, but definitely not the least, factor is the country's energy transition which should take into account not only the supply aspect but also the demand side and aim at reducing energy consumption. It is hard to deny that these factors are intertwined.

As it becomes evident from the analysis above, the Russian full-scale invasion had and will have significant detrimental effects on the Ukrainian economy in general and its international trade relations in particular. This being said, several positive developments have also occurred since February 24, 2022. First and foremost, Ukraine reduced to zero its energy dependence on the Russian Federation and Belarus, thus depriving the former of the major economic leverage, which it weaponized for a long time.²⁹ It is reported that during the winter 2023-24 heating season, Ukraine relied exclusively on domestic gas.³⁰ Although this apparent success can be explained by a number of factors such as significantly reduced demand and a relatively warm winter, it demonstrates a strategic shift in the country's energy self-reliance.³¹ Second, the aggression gave a new impetus to closer economic and political integration with the European Union. To be more specific, Ukraine benefits from enhanced market access to the EU single market and could potentially benefit from a streamlined accession to the European Union. Third, in the course of this military confrontation, various types of unmanned aerial vehicles (UAV) demonstrated their outsized potential as an alternative to the conventional weapon systems.³²

²⁷ The abovementioned tendencies have already gained some traction: "Given that most eastern enterprises lowered or stopped production, the central and western regions began playing a more important role in Ukraine's economy." Boston Consulting Group and the European Investment Bank. 2023. *Supporting Ukraine: A Study on Potential Recovery Strategies for Ukraine*, <https://media-publications.bcg.com/Supporting-Ukraine-Potential-Recovery-Strategies-Feb-2023.pdf>

²⁸ Ibid.

²⁹ Prokip, Andrian. 2024.

³⁰ Business Ukraine. 2024. "For the first time ever, Ukraine has passed the winter heating season relying exclusively on domestic gas." <https://businessukraine.ua/for-the-first-time-ever-ukraine-has-passed-the-winter-heating-season-relying-exclusively-on-domestic-gas/>

³¹ Топалов, Микола. 2024. "Україна вперше в історії не купувала газ для проходження зими. Чи можна назвати це перемогою?" *Економічна правда*. <https://www.epravda.com.ua/publications/2024/03/6/710814/>

³² Bielineskov, Mykola. 2024. "Outgunned Ukraine bets on drones as Russian invasion enters third year." *Atlantic Council*. <https://www.atlanticcouncil.org/blogs/ukrainealert/outgunned-ukraine-bets-on-drones-as-russian-invasion-enters-third-year/>

Since Ukraine bolstered its UAV R&D and production, it could become in future a major player in the global market.³³

What will define the road ahead?

As the war in Ukraine rages on and its end remains undetermined, uncertainty persists. However, it is already evident that any discussion of the post-war reconstruction of Ukraine hinges on the Russian Federation's payment of reparations, although its willingness to compensate Ukraine and the means by which it will do so are subjects of intense debate. The potential utilization of the immobilized Russian Central Bank assets to finance Ukraine's reconstruction, a move that could alleviate some financial burden, requires bold political steps.³⁴

Meanwhile, the future reconstruction of Ukraine hinges not only on financial compensation but also on geopolitical dynamics such as the intensifying economic competition between the United States and China, the EU's strategy of an 'open strategic autonomy', and the diminishing influence of multilateralism. To rebuild its economy, Ukraine must focus on diversifying its economy and enhancing integration into regional and global supply chains, which could lead to a more favourable trade balance. Looking forward, an export-led growth strategy might offer a path to economic recovery and stability amidst uncertain geopolitical circumstances.

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³³ Ibid.

³⁴ Bogdanova, Iryna. 2023. "Use of the immobilized Russian Central Bank assets to rebuild Ukraine: between political will and legal hurdles." *Trading softly: How central banks are addressing current global challenges. ECB Legal Conference 2023*, 134-145. <https://www.ecb.europa.eu/pub/pdf/other/ecb.ecblegalconferenceproceedings2023~c72d6d7c84.en.pdf>

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