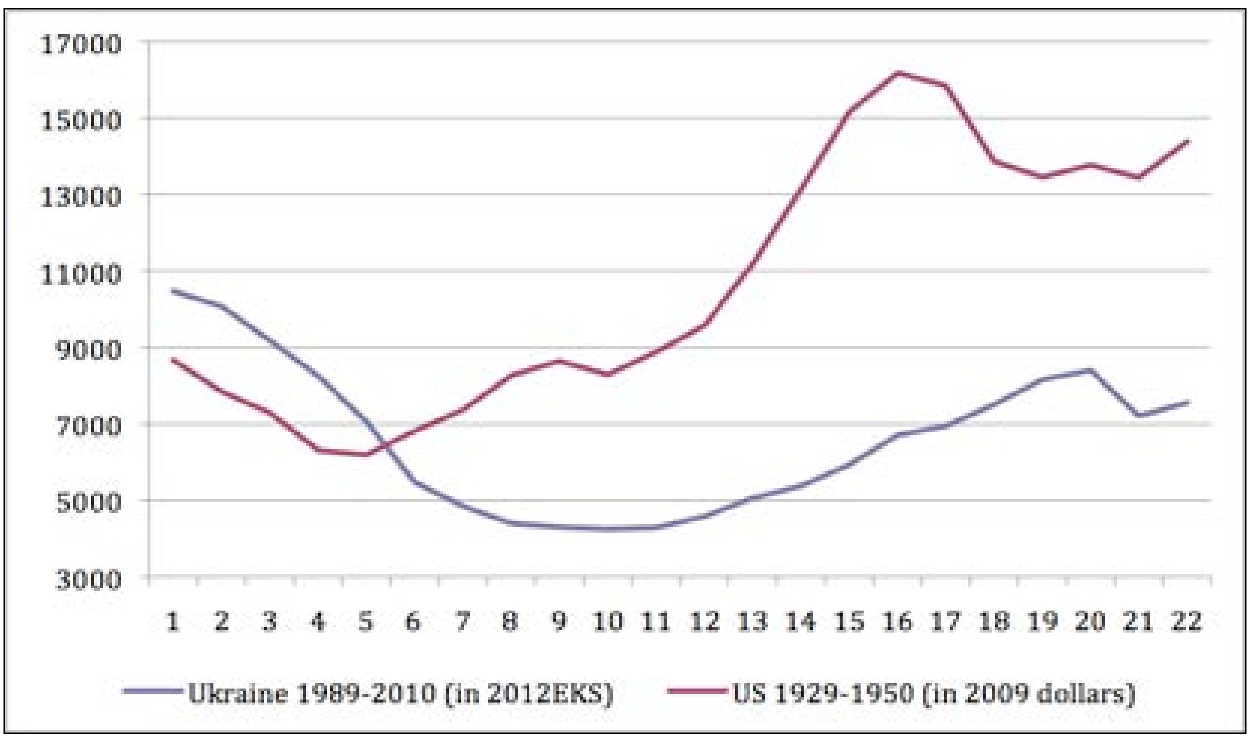
Ukraine's Economy: Which way forward?*

Rainer Kattel[1]

However we look at Ukraine's current quagmire, the country seems to be stuck between a rock and a hard place: both politically and economically it faces questions about which direction to take, join Russian-dominated Eurasian alliance or the European Union. This brief note offers some background and some lessons from Eastern European integration with the EU.

Ukraine's economic fortunes have been very poor for a long time. In fact, as even the World Bank admits, Ukraine's economy has been doing way worse than the US did in the aftermath of Great Depression. Figure 1 below compares over two decades GDP per capita development in post-1929 US and in post-1989 Ukraine.

Figure 1. Post-1929 US vs. post-1989 Ukraine

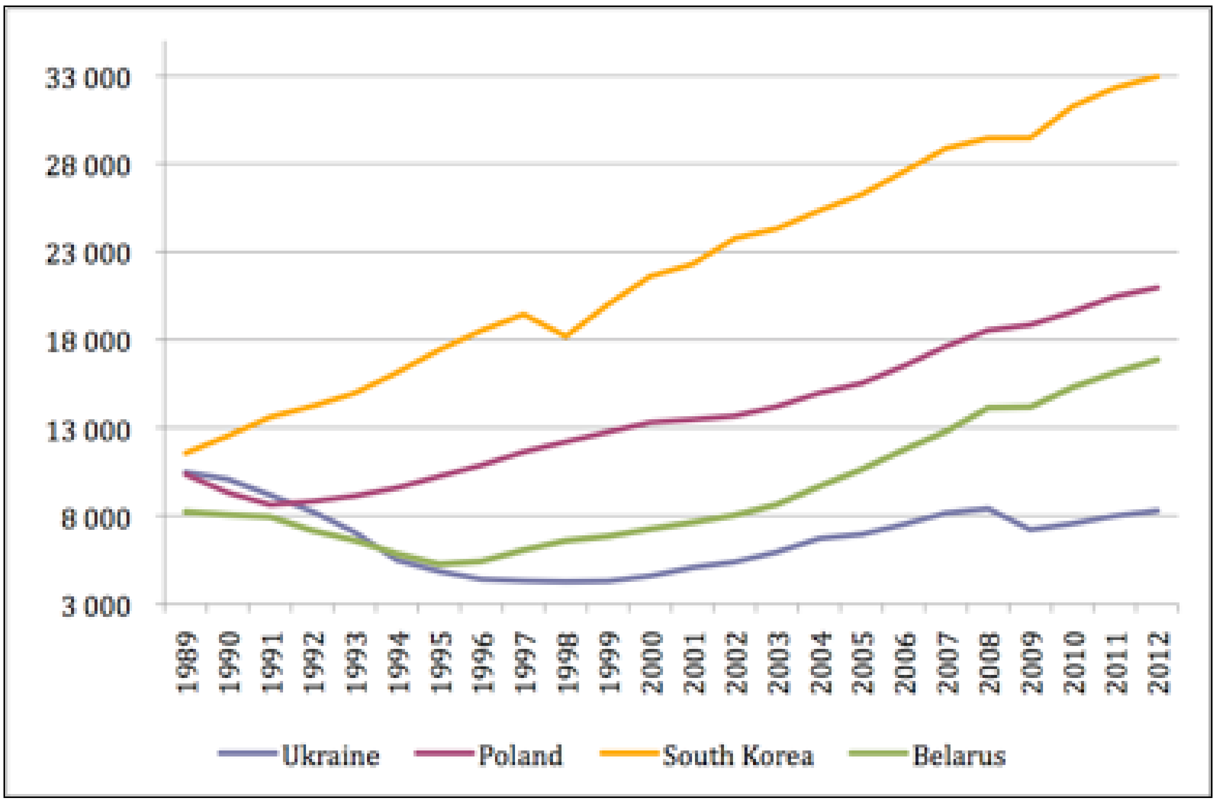


Source: *The Conference Board Total Economy Database* and *Samuel H. Williamson, Measuring Worth 2014*.

[1] *Ragnar Nurkse School of Innovation and Governance, Tallinn University of Technology, Estonia.*

As the usual argument goes, the US recovered because of the war effort that took away ideological blinders, the government invested massively into the economy, growth and jobs returned. The question Ukraine faces is whether the European Union or the Eurasian Union would offer a similar boost for the economy? History does offer as an interesting experiment here. As Figure 2 show, in 1989 Ukraine, and its close neighbors Poland (EU member) and Belarus (Eurasian Union member and close trading partner of Russia), and South Korea – developmental state par excellence – were in terms of GDP per capita very closely matched. However, the paths chosen have been clearly highly different.

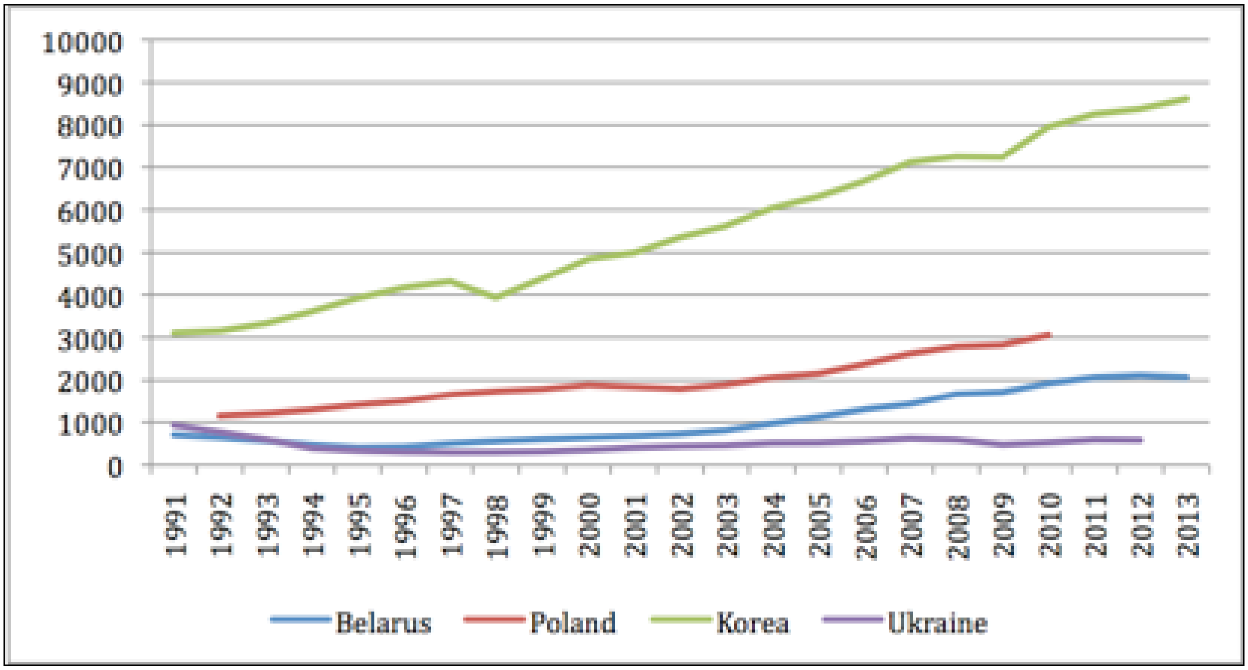
Figure 2. GDP per capita in Ukraine, Belarus, Poland and South Korea, 1989-2010



Source: *The Conference Board Total Economy Database*.

Clearly, Ukraine's economic policies have been particularly poor. In fact, its economic performance matches closely that of Serbia, a war ravaged nation. While Belarus and especially Poland have done much better than Ukraine, South Korean growth is on an entirely different scale. This becomes even clearer when we look at industrial productivity in these countries on Figure 3.

Figure 3. Industry value added per capita in Ukraine, Belarus, Poland and South Korea, 1991-2013 (in constant 2005 USD)

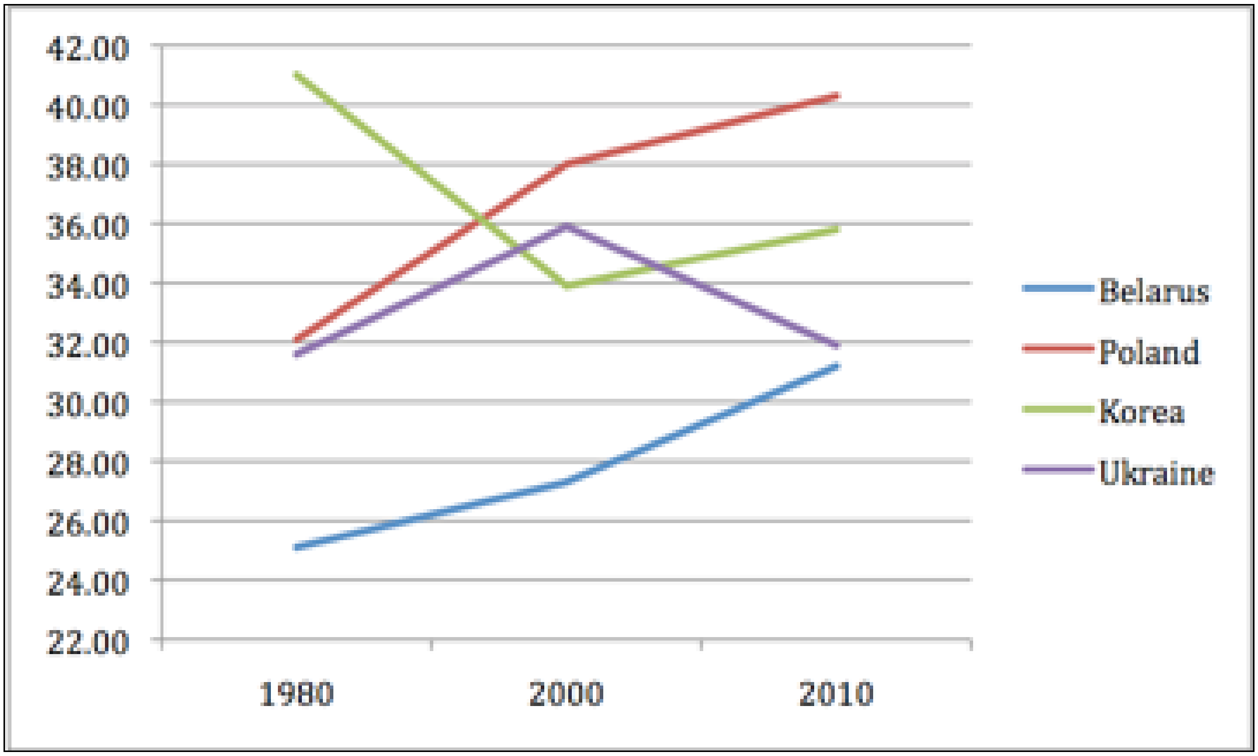


Source: *World Bank WDI online database; calculations by the author.*

There are well-known key lessons from South Korean development: wide industrialization (multiple and diverse industries), managing foreign direct investments and generally gearing financial structure towards industrialization (particularly in earlier stages of development); and guiding development processes by autonomous yet embedded bureaucracy. This is where Poland, and other Eastern European economies, have been weak and where current European Union is failing. European policy consensus is an incoherent shopping list of policies: exports are good, R&D is good, foreign finance is good. What is missing is an understanding of how these diverse policies could complement each other to deliver a Big Push a la South Korea. Linkages from export sector (towards domestic suppliers, universities and R&D sector), from the R&D sector (towards domestic industries) and from foreign owned banks (towards domestic industry and R&D sector) are almost entirely left untouched by policies and governance frameworks. This has its roots in a neoliberal mistrust in state's ability to coordinate and manage economic policy. The European Union invests at the same time a lot of money into new member states, creating an almost irresistible pull for elites to push European agenda without asking serious questions about how sustainable the current agenda is.

It seems, however, that one area where also South Korea exhibits especially since 2000s rather similar tendencies to Eastern Europe is income inequality, as shown by Figure 4.

Figure 4. GINI index of primary household income in Ukraine, Belarus, Poland and South Korea.



Source: UNDP, *Humanity Divided: Confronting Inequality in Developing Countries*.

However, following the UNDP's report *Humanity Divided*, from early 1990s to late 2000s income inequality has been in fact rapidly increasing in most developed economies as well. Thus, there are obviously common global drivers at work. At least gender wage gap is massively lower in (Eastern) Europe than in fast developing Asia (10% in Poland vs. 38% in South Korea).

In sum, the historical lesson seems to be that neither Eurasian Union nor the European Union offer Ukraine the best economic policy options; rather a bold agenda of managing or rather creating its own dynamic and competitive industry and gearing financial structure towards this industry is what Ukraine needs to focus on. The question is which economic and political alliance offers best options for such economic policies. What might make Ukraine's choices ever harder is, as Erik Reinert argues, that what makes sense politically, might not make sense economically – and vice versa.

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