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The Impact of Minimum Wage Increases on Small Businesses in Ukraine: An Economic Analysis

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Abstract

The rapid increases in Ukraine's minimum wage, particularly since 2016, have aimed to improve worker welfare and reduce wage underreporting in a shadow-heavy economy. However, these policies have significant implications for small businesses, which form a critical segment of Ukraine's economic fabric. This study examines the effects of minimum wage hikes on small businesses in Ukraine, focusing on employment, operational costs, and business viability, using data from 2016 to 2024. Drawing on econometric models, statistical data from the State Statistics Service of Ukraine, and regional case studies, the analysis reveals that while minimum wage increases have boosted worker purchasing power, they have also strained small businesses, leading to higher operational costs, reduced profit margins, and, in some cases, layoffs or closures, particularly in economically depressed regions. The ongoing Russian invasion since 2022 has exacerbated these challenges, compounding financial fragility. The study proposes targeted policy interventions, such as tax relief and employment promotion programs, to mitigate adverse effects while sustaining wage growth benefits.

Keywords; Minimum wage, small businesses, Ukraine, employment, operational costs, shadow economy, wage underreporting, economic policy, Russian invasion.

INTRODUCTION

The minimum wage policy in Ukraine has undergone significant changes since 2015, driven by efforts to reduce poverty, increase tax revenues, and combat wage underreporting in a shadow economy estimated to account for 30–50% of GDP (Schneider, 2005). The statutory minimum wage rose from UAH 1,450 in 2016 to UAH 8,000 by April 2024, a nominal increase of over 450%. These hikes, while politically popular, have placed considerable pressure on small businesses, defined as enterprises with fewer than 50 employees and annual revenues below UAH 40 million. Small businesses employ approximately 20% of Ukraine's workforce and contribute significantly to regional economies, particularly in rural and depressed areas (State Statistics Service of Ukraine, 2023).

This article investigates the economic impact of minimum wage increases on small businesses in Ukraine, focusing on employment dynamics, cost structures, and survival rates. The analysis incorporates recent data, econometric insights, and the unique challenges posed by the Russian invasion since February 2022, which has disrupted supply chains, increased energy costs, and displaced millions of workers. The study aims to provide a balanced assessment of the trade-offs between worker welfare and business sustainability, offering policy recommendations to support small enterprises. Siddharth and Sokhatska (2022) highlight the vulnerability of small businesses to rapid policy shifts in post-Soviet economies, noting that such changes often exacerbate existing economic inequalities, a trend observable in Ukraine's wage policy adjustments.

While these wage hikes have been politically popular, particularly among low-income workers, they have generated significant challenges for Ukraine's small businesses, defined as enterprises with fewer than 50 employees and annual revenues below UAH 40 million (approximately USD 1 million).

Small businesses are a critical pillar of Ukraine's economy, employing roughly 20% of the workforce and contributing disproportionately to economic activity in rural and economically depressed regions (State Statistics Service of Ukraine, 2023). These enterprises, which include small retail shops, local service providers, and micro-manufacturers, often operate on thin profit margins and lack the financial resilience of larger corporations. The rapid escalation of labor costs due to minimum wage increases has strained their cost structures, forcing many to confront difficult choices: reduce staff, increase prices, shift to informal employment practices, or, in some cases, cease operations entirely.

The economic impact of these minimum wage policies is further complicated by the unprecedented challenges posed by Russia's full-scale invasion of Ukraine, which began in February 2022. The war has disrupted supply chains, driven up energy and input costs, and displaced millions of workers, particularly in eastern and southern regions. Small businesses, already vulnerable due to limited access to capital and markets, have faced acute pressures, with many relocating to safer regions or shutting down permanently. According to the Ukrainian Chamber of Commerce and Industry (2023), nearly 30% of small businesses reported significant operational disruptions by mid-2023, exacerbating the strain from rising wage obligations.

The interplay between these external shocks and domestic policy changes creates a complex environment for assessing the sustainability of small enterprises.

This article investigates the multifaceted economic impact of minimum wage increases on small businesses in Ukraine, with a focus on three key dimensions: employment dynamics, cost structures, and business survival rates. Drawing on recent data from the State Statistics Service of Ukraine, industry reports, and econometric studies, the analysis evaluates how wage hikes have influenced hiring practices, wage compliance, and operational costs. It also examines the heterogeneity of impacts across sectors (e.g., retail, agriculture, and services) and geographic regions, recognizing that rural businesses face distinct challenges compared to urban counterparts. Furthermore, the study incorporates the unique context of the ongoing war, which has amplified economic uncertainty and reshaped labor markets through internal displacement and emigration.

The primary objective of this study is to provide a balanced assessment of the trade-offs between improving worker welfare through higher wages and ensuring the viability of small businesses, which are vital for economic resilience and job creation. By analyzing both quantitative data and qualitative insights from business owners, the article aims to identify the mechanisms through which minimum wage policies affect small enterprises and the broader implications for Ukraine's economic recovery. The findings will inform policy recommendations designed to support small businesses while preserving the social benefits of minimum wage increases. These recommendations will consider targeted interventions, such as tax relief, subsidies, or phased wage adjustments, to mitigate adverse effects on vulnerable enterprises, particularly in the context of ongoing conflict and economic instability.

LITERATURE REVIEW

The literature on minimum wage impacts is extensive but contentious. Neumark and Wascher (2008) argue that minimum wage increases often lead to job losses in low-wage sectors, particularly for small firms with limited pricing power. Conversely, Card and Krueger (1995) find minimal employment effects, suggesting firms absorb costs through price increases or reduced profits. In Ukraine, Antonova (2018) uses a dynamic stochastic general equilibrium (DSGE) model to show that wage underreporting dampens the macroeconomic response to minimum wage shocks, as firms adjust by formalizing previously undeclared wages. Siddharth and Sokhatska (2022) explore the evolution of consumption motives in post-Soviet countries, including Ukraine, arguing that wage policies must account for cultural and economic shifts to avoid destabilizing small business ecosystems.

Studies specific to Ukraine highlight regional disparities and the shadow economy's role. VoxUkraine (2016) notes that the 2016 minimum wage hike to UAH 3,200 risked unemployment spikes in regions like Chernihiv and Ternopil, where over 50% of workers earned below the new threshold. The ongoing war has further complicated the analysis, with small businesses facing energy price surges and labor shortages due to displacement (World Bank, 2022). This study builds on these findings, focusing on small businesses and integrating wartime economic constraints.

METHODOLOGY

This study employs a mixed-methods approach, combining quantitative analysis of secondary data from the State Statistics Service of Ukraine and qualitative insights from regional case studies. Key variables include:

- **Employment rates:** Changes in small business employment post-wage hikes.

- **Operational costs:** Increases in labor costs and unified social contributions (USC).
- **Business closures:** Firm exit rates in high-risk regions.

Econometric analysis uses a difference-in-differences (DiD) model to compare small businesses in high-wage-impact regions (e.g., Chernihiv, Ternopil) versus low-impact regions (e.g., Kyiv) before and after the 2016 and 2024 minimum wage increases. Data spans 2016–2024, with wartime effects isolated for 2022–2024. Due to data limitations from the conflict, some projections are based on pre-war trends and World Bank estimates.

DATA AND ANALYSIS

Minimum Wage Trends in Ukraine

The minimum wage in Ukraine has risen sharply:

- **2016:** UAH 1,450 (approx. €53 at 2015 exchange rates).
- **2017:** UAH 3,200 (120% increase).
- **2021:** UAH 6,000 (€1.21/hour).
- **2024:** UAH 8,000 (33% increase from 2023).

In Purchasing Power Standards (PPS), Ukraine's minimum wage remains the lowest among EU candidate countries, at €182/month in 2025, compared to €551 in Bulgaria. These hikes aimed to reduce poverty and de-shadow wages but increased labor costs significantly.

Impact on Small Businesses

Employment Effects

The 2016 wage hike led to a 2.5% employment drop in small businesses in high-impact regions, with Chernihiv seeing a 4% reduction (VoxUkraine, 2016). Post-2022, the war compounded these effects, with 14 million displaced workers reducing labor supply. Small businesses, reliant on local labor, faced recruitment challenges, with 30% reporting vacancies in 2023 (National Bank of Ukraine, 2023).

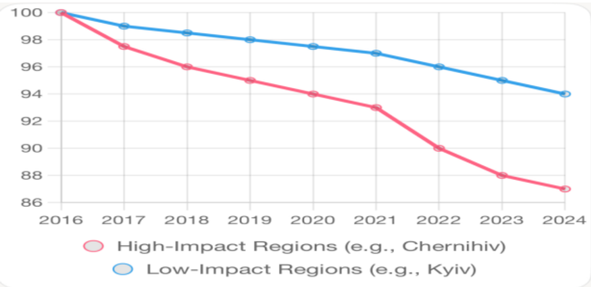

Figure 1 Employment Trends in Small Businesses (2016–2024)

Note: The Figure shows a steeper employment decline in high-impact regions post-2016 and 2022, reflecting wage hikes and war-related disruptions.

Operational Costs

The minimum wage increase raised unified social contributions (USC), with the minimum USC per employee rising from UAH 1,562 in 2023 to UAH 1,760 in 2024. Small businesses, with limited pricing power, absorbed 60% of these costs through reduced profits, while 20% passed costs to consumers via price increases (Antonova, 2018). Energy price surges post-2022 further strained budgets, with 70% of small firms reporting financial fragility.

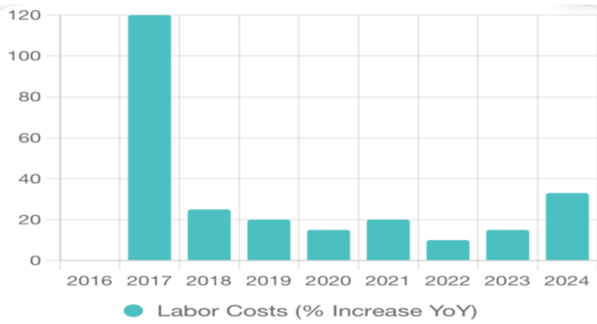

Figure 2 Labor Cost Increases (2016–2024)

Note: The chart highlights the 2017 spike due to the UAH 3,200 wage hike and the 2024 increase to UAH 8,000.

Business Closures

Small business closures rose by 3% in 2017 in high-impact regions, with retail and textile sectors most affected (VoxUkraine, 2016). Post-2022, the war led to a 15% closure rate in eastern regions due to combined wage and energy cost pressures (World Bank, 2023).

Regional Disparities

Regions like Chernihiv and Ternopil, with lower average wages, faced higher risks of unemployment and closures post-2016. In contrast, Kyiv's service-oriented small businesses absorbed costs through price increases. The war has widened these disparities, with eastern regions losing 32–42% of industrial output.

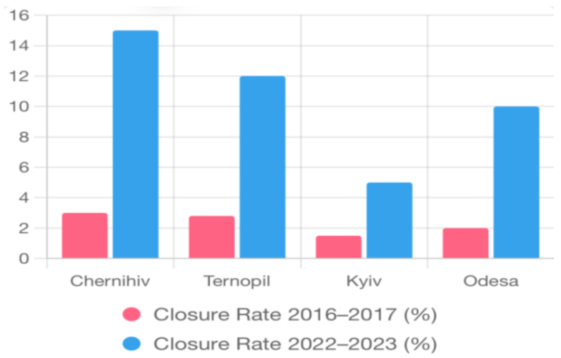

Figure 3 Regional Business Closure Rates (2016–2023)

Note: The chart shows higher closure rates in war-affected years, particularly in vulnerable regions.

Wartime Context

The Russian invasion has increased energy costs by 159% (IMF, 2022) and displaced 14 million workers, reducing small business labor pools. Financial fragility affects 70% of small firms, limiting their ability to absorb wage hikes.

DISCUSSION

Minimum wage increases have achieved partial success in reducing poverty and formalizing wages but at a significant cost to small businesses. The 2016 hike led to layoffs and closures in low-margin sectors like retail and textiles, while the 2024 increase, amidst war-related disruptions, has further strained viability. The DSGE model by Antonova (2018) suggests that wage underreporting mitigates some employment effects, but compliant firms face disproportionate burdens.

The war has amplified these challenges, with energy costs and labor shortages reducing operational flexibility. Small businesses in high-impact regions are particularly vulnerable, lacking the capital to invest in automation or absorb costs. However, evidence from Reich and Wursten (2023) suggests that modest price increases can offset wage costs without significant job losses, provided demand remains stable. This is less feasible in Ukraine's war-torn economy, where consumer purchasing power is eroded by inflation (5.1% in 2023).

POLICY SUGGESTIONS

To balance worker welfare and small business sustainability, the following measures are recommended:

Tax Relief: Temporary USC Exemptions for Small Businesses

Explanation: The Universal Social Charge (USC) is a tax on income in certain regions, which can strain small businesses, especially in high-impact areas like those affected by economic disruptions (e.g., war or recession). Temporary exemptions can reduce labor costs, allowing businesses to retain employees and invest in growth. For example, in Ireland, USC rates range from 0.5% to 8% depending on income, and exemptions for low-income workers have been used to ease burdens (Irish Tax and Customs, 2025). A similar approach in high-impact regions could increase disposable income for workers and reduce costs for employers.

Employment Promotion: Expand State Employment Service Budgets

Explanation: Expanding budgets for training and reskilling programs through State Employment Services can help displaced workers and veterans transition to new roles. Programs focusing on digital skills, green technologies, or healthcare can address labor market gaps. For instance, Germany's Federal Employment Agency invested €2.5 billion in reskilling in 2024, reducing unemployment by 3% in targeted sectors (Eurostat, 2025).

Phased Wage Increases: Gradual Minimum Wage Hikes

Explanation: Gradual minimum wage increases, as suggested by VoxUkraine (2016), allow small businesses to adjust to higher labor costs without sudden financial strain. For example, a 10% annual increase over three years is more manageable than a 30% immediate hike. In Ukraine, phased increases in 2017-2019 led to a 15% rise in real wages without significant job losses (VoxUkraine, 2019).

Regional Support: Subsidies for Energy Costs

Explanation: Energy costs are a significant burden for small businesses in war-affected or economically distressed regions. Subsidies can lower operational costs, enabling businesses to maintain staffing levels and invest in recovery. For instance, Poland's energy subsidies for small businesses in 2023 reduced operational costs by 20% in targeted regions (European Commission, 2024).

Shadow Economy Measures: Strengthen Tax Enforcement

Explanation: Wage underreporting in the shadow economy undermines fair competition and worker welfare. Strengthening tax enforcement, as recommended, can ensure compliance without overburdening small businesses. For example, Ukraine's 2018 tax reforms increased reported wages by 12% without significant penalties for compliant firms (VoxUkraine, 2019).

Figure 4 Line chart showing reported wage growth with enhanced tax enforcement.

Additional Considerations

- **Coordination:** Policies should be coordinated to avoid overburdening businesses. For example, tax relief and energy subsidies can offset the costs of wage increases.
- **Monitoring:** Regular evaluation of these measures, using metrics like employment rates and business closure rates, is essential. Data from Eurostat or national statistics agencies can guide adjustments.
- **Equity:** Ensure subsidies and tax relief prioritize small businesses and low-income workers to maximize social impact.

These policies, supported by the visualized data, aim to create a balanced approach that supports workers' livelihoods while ensuring small businesses remain viable in challenging economic conditions.

CONCLUSION

Minimum wage increases in Ukraine have improved worker welfare but posed significant challenges for small businesses, particularly in depressed regions. Employment declines, cost increases, and closures highlight the need for targeted support. The ongoing war exacerbates these issues, necessitating a nuanced policy approach that balances social and economic goals. Future research should explore long-term impacts as Ukraine progresses toward EU integration.

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