

# PECULIARITIES OF WORLD FINANCIAL CRISIS AND STRATEGIC DIRECTIONS FOR ANTI-CRISIS REGULATIONS IN UKRAINE

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## ***Abstract***

*The article is dedicated to the analysis and systematization of the key transformations in international economic relations that have changed because of the world financial crisis and to the assessment of the depth of their influence on social-economic development of Ukraine.*

*It is defined that the peculiarities of the modern financial crisis are: unprecedented spread of neoprotectionism in advanced countries and the accumulation of the symmetrical measure potential among the countries with emerging economies; deformation of competition environment in the world market; the world financial market reformation; accumulation of the default potential among strong corporations and certain countries; twisting of information component of the world market that leads to misbalance of the world situation.*

***Keywords:*** financial crisis, strategic directions, financial market.

***JEL Classification:*** P<sub>34</sub>, N<sub>24</sub>, O<sub>11</sub>.

## **Introduction**

Today we take the financial crisis with some degree of faintness and indifference. However, the depth of transformation, made by the crisis, will inevitably become apparent in the nearest future. The peculiarity of the crisis's development is that its impact on different economies is specific, its pressure on the national economies is made in different vectors and as a result there is no universal method or experience to overcome it. Today all nations are learning how to stabilize the economy in real time processing. Under such conditions for Ukraine the most expedient option is strategic formation of the national economy development priorities rather than "fire extinction" of the whole spectrum of negative outcomes and copying the methods of other countries.

## 1. Peculiarities of the world financial crisis

It is obvious that the crisis is making dramatic changes in the nature of modern economic processes. Today it is possible to distinguish several key transformations or peculiarities that define the logic of international economic relations development. Certainly they should be taken into account by Ukraine while elaborating a new anti-crisis and post-crisis economic policy.

1. A new wave of protectionism has spread in the world with it being based not on classical tariffs and quotas raising in the world trade. A hidden layer of protectionist measures is masked under the plans of saving the economy and envisages huge state financial injections and guarantees (Table 1) mainly to the bank, insurance and automobile sectors.

*Table 1*

*Headline support for the financial sector and upfront financing needs  
(in percent of GDP)*

	Capital Injection	Purchase of assets and Lending by Treasury	Central Bank Support Provided with Treasury Backing	Liquidity Provision and other support by Central Bank	State Guarantees	Total
Canada	0	8,8	0	1,6	11,7	22,1
United States	4	6	1,1	31,3	31,3	73,7
Austria	5,3	0	0	0	30	35,3
Belgium	4,7	0	0	0	26,2	30,9
France	1,2	1,3	0	0	16,4	18,9
Germany	3,7	0,4	0	0	17,6	21,7
Greece	2,1	3,3	0	0	6,2	11,6
Ireland	5,3	0	0	0	257	262,3
Italy	1,3	0	0	2,5	0	3,8
Netherlands	3,4	2,8	0	0	33,7	39,9
Norway	0	13,8	0	0	0	13,8
Portugal	2,4	0	0	0	12	14,4
Spain	0	4,6	0	0	18,3	22,9
Sweden	2,1	5,3	0	15,3	47,3	70
Switzerland	1,1	0	0	10,9	0	12
Great Britain	3,5	13,8	12,9	0	17,4	47,6

Australia	0	0,7	0	0	0,7	1,4
Japan	2,4	6,7	0	0	12,9	22
Korea	2,5	1,2	0	0	14,3	18
<b>Emerging Economies</b>						
Argentina	0	0,9	0	0	0	0,9
Brazil	0	0	0	1,5	0	1,5
China	0,5	0	0	0	0	0,5
India	0	0	0	5,6	0	5,6
Indonesia	0	0	0	0	0,1	0,1
Hungary	1,1	0	0	4	1,1	6,2
Poland	0,4	0	0	0	3,2	3,6
Russia	0,1	0,4	2,9	3,2	0,5	7,1
Saudi Arabia	0,6	0,6	0	8,2	N/A	9,4
Turkey	0	0	0	0,2	0	0,2
<b>Average</b>						
G20	1,9	3,3	1	9,3	12,4	27,9
Advanced economies	2,9	5,2	1,3	13,9	19,7	43
Emerging Economies	0,2	0,1	0,3	1,6	0,1	2,3

Source: Outlook and Medium-Term Policies After the 2008 Crisis, IMF

The consequences of these measures will be systematic and long-term, in particular:

- competitive relations are being twisted in the national markets. It is happening because of motivation decreasing for effective work of the companies with subsidies;

- market situation is deteriorating for the companies that do not have subsidies and that is why they are forced to leave the market. They suffer from dumping and hostile takeovers by subsidized companies;

- structural unemployment is being spread, the reason for that is the subsidies are spent to satisfy the production demands or to subsidize the cost of the loan but not to support the interests of employees;

- competition is being twisted in many industrial world markets. It is the result of non-proportional subsidizing in countries with advanced economies. Considerable negative potential of counter corresponding measures and contradictions during negotiations in the framework of the WTO and G20 as for further prospects of the world trade are being accumulated gradually.

2. The world financial market is being restructured. The governments of leading countries solve the problems of “bad” or “toxic” bank assets, that appeared after their revaluation during the process of reduction of prices under crisis conditions. It causes unprecedented strengthening of state participation in financial institutions and, respectively, state influence on the financial processes. As a result, it is possible to notice two trends. The first one envisages saving of the resources of limited circles of private investors at the expense of taxpayers. The second trend deals with a wide range of financial institutions that appear in the world market and that are direct carriers of government interests and correspondingly they have protectionist advantages relative to financial competitors.

3. The problems, caused by the lack of international regulation of transnational financial institutions activity, are sharply aggravated. It is crucial to solve such problems as hedge-funds activity, share funds and other financial institutions, whose activity has not been regulated before. It is obvious that the speculations in the local markets are harmful for certain national economies and such activity should be restricted. The problem is that till present time regulation has been done on the national level while the main activity of those institutions was concentrated in the international markets. To solve this problem it is necessary to create a certain international body or collegiums of regulating organs of leading countries. Such an institution does not exist yet.

4. The trend of accumulating budget and private debts is getting stronger. Necessity of stabilizing measures provokes significant part of the budget to be aimed to support financial sector. As the result – budget income is significantly reduced. Together with a general reduction of the world commodity prices, it forms a disproportion of the external balances of the countries with emerging economies. Such development leads to the accumulation of negative potential of possible default of certain countries.

The countries with advanced economies have certain problems in this sphere as well. In particular, sharp reduction of assets process is a serious problem for them because under the condition of population ageing the possibilities to finance provision of pensions are limited. The fiscal balances of G-20 advanced countries are projected to weaken by 6 percentage points of GDP on average, and government debt is projected to rise by 14½ percentage points of GDP in 2008-2009.

It is possible to distinguish typical effects that will complicate budget performance:

- Housing prices decline. The IMF predicts that 10 percent decline in housing prices leads to a 0,27 percent of GDP decline in cyclically-adjusted fiscal revenues in the following year. The fall of fiscal revenues arising from house price declines would make 0,1 percent of GDP for G-20 countries in 2009.

- Financial sector profits decline. In many countries financial sector profits are an important source of corporate income tax revenue. Over one-quarter of corporate income tax revenues in the United States and United Kingdom during 2000-2007 came from the financial sector. Hence, the decline of the financial sector profits has led to a 0,2 percent of GDP additional revenue decline in 2008-2009.

- Commodity prices decline. The effect on fiscal revenues of the decline in commodity prices could be sizable in 2009 for some emerging economies (Table 2). For the G-20 countries the figures are smaller but still significant (0,7 percent of GDP in 2009), largely reflecting the impact on Russia, Saudi Arabia and Brazil.

*Table 2*

*Loss of Fiscal Revenue Due to Commodity Price Movements, 2008–09  
(in percent of GDP)*

	2008	2009
Argentina	0	-0,3
Australia	0	-0,4
Brazil	1	-2,8
Canada	-0,1	-0,3
Indonesia	0,2	0
Mexico	0,3	-0,1
Russia	1,3	-6,4
Saudi Arabia	15	-26,8
South Africa	0,2	-0,1

Source: IMF staff estimates

5. Information component of the world market is changing dramatically. These changes provoke an extensive information twist on real prices, demand, supply and stock. It has a number of negative consequences, in particular, the speculative component in price formation in trade markets is increasing; uncertainty in needs and reserves is getting stronger; intermediate link redistribute revenues in its favor; it is difficult to formulate production and sales strategy for a producer. As a result, consumers suffer, that is why it is necessary to find a solution for this problem.

## 2. Present state of anti-crisis measures of certain countries

The IMF analysis proves that the European countries that actively attracted foreign loan during the pre-crisis period are facing stronger impact of the world financial crisis<sup>1</sup>. Net private capital flows to emerging market countries are projected to decline from an inflow of 600 billion US dollars in 2007 to an outflow of 180 billion US dollars in 2009.

Net financial sector support of G-20 countries, according to the IMF, will make 5,5 percent of GDP in 2009-2010<sup>2</sup> (in 2007 G-20 deficit was 1,1 percent of GDP, in 2010 it will make 6,6 percent of GDP<sup>3</sup>). Anti-crisis programs aimed to support the economy, are estimated at 820 billion US dollars in 2009 (2 percent of GDP) and as a minimum, at 660 billion US dollars in 2010. The rest of the anti-crisis programs are included into the budget as “automatic stabilizers”, for example, an increase in unemployment payments, partial direct support of the financial system and so on. The IMF estimates the overall amount of potential financial sector support by G-20 (including government guarantees) in 32 percent of net GDP (projection is increased by 3,25%), among advanced countries – 50 percent of GDP (projection is increased by 5,25 percent of GDP).

Direct injections into financial sector, that envisage direct fiscal outlay, will make 6,3 percent of net GDP in advanced countries, and 3,4 percent of GDP in G-20 countries.

The IMF projects deterioration of the CIS countries’ development (Table 3) as a result of the access cut to foreign funding, decline of advanced countries demand for emerging countries exports and a decline of commodity prices. GDP reduction by 5% in the CIS countries will be the worst index among emerging countries of the world. In 2010 the economy of the CIS will increase only by 1%.

Table 3

*The Dynamics of GDP of the CIS countries for 2009-2010  
(in percent of GDP)*

	2009	2010
CIS	-5,1	1,2
Russian Federation	-6	0,5
Ukraine	-8	1
Kazakhstan	-2	1,5
Turkmenistan	6,9	7

<sup>1</sup> Special IMF report “Coping with the crisis: Policy Options for Emerging Market Countries”

<sup>2</sup> Hereinafter – net G-20 GDP

<sup>3</sup> Deficit of the IMF budget is calculated with PPP of corresponding countries’ currency

Azerbaijan	2,5	12,3
Armenia	-5	0
Georgia <sup>1</sup>	1	3
Kyrgyz	0,9	2,9
Moldova	-3,4	0
Tadzhikistan	2	3
Uzbekistan	7	7

Source: IMF

The most popular instrument for coping with the crisis for G-20 countries is fiscal stimulus plan that consists of expenditure (increase of spending for priority development programs) and revenue measures (revenue cuts through fiscal stimulus). On average, G-20 countries have adopted (or plan to adopt) stimulus measures amounting approximately 0,5 percent of GDP in 2008, 1,5 percent of GDP in 2009 and 1 percent of GDP in 2010.

Almost two thirds of the fiscal stimulus has so far been represented by expenditure measures with emphasis spending for infrastructure; revenue measures are targeted primarily at households through cuts in personal income and indirect taxes. Key measures are presented in the Table 4.

Table 4

*G-20 Stimulus Measures 2008-2010*

	Argentina	Australia	Brazil	Canada	China	France	Germany	India	Indonesia	Italy	Japan	Korea	Mexico	Russia	Saudi Arabia	Spain	UK	USA
<b>Measure</b>																		
<b>Expenditure</b>																		
Infrastructure investments	T	T		T	T	T	T	T	T		T	T	T		T	T	T	T
Support to SMEs and farmers							T				T	T	T					
Safety nets	T	T	T	T	T	T	T		T	T	T	T	T		T	T	T	T
Construction support		T	T	T	T	T	T				T		T		T	T		

<sup>1</sup> Georgia is given as a member of the CIS

Strategic industry support			T	T		T	T							T		T		
Other		T		T	T	T	T	T			T	T	T			T	T	T
<b>Revenue</b>																		
Corporate income tax reduction		P	P	P		P	P		P		P	P	P	P				P
Personal Income tax reduction/exemption			P	P		T	P		P		P					P	P	P
Indirect tax reductions/exemption			T		P		P	T	P							T	T	
Other											P						P	

T - temporary measures, P – permanent measures

It is obvious, that Ukraine does not have enough financial capacity to overcome the negative impact of the crisis comparing to capacities, used by our close neighbors. Inefficiency of so-called “mobilizing” program of coping with the crisis is becoming evident because real sector does not have even one tenth of the money needed for financial sector support with its trillions surrogate turnover. That is why the “mobilizing” model of anti-crisis regulation makes it possible to compensate financial losses selectively, only to those subjects of the financial market that have an influence on decision making on state financial help directions. Hence, the probability exists that instead of the noble slogan of saving main banks with taxpayers’ money, the financial losses of certain persons will be recovered.

### 3. Present state of Ukraine’s economy

The financial crisis outlined the key “painful points” of the national economy. Below is the data that gives us the possibility to see its present state. Its analysis allows us to make a conclusion that the negative impact of the world financial crisis on the real economic sector, recorded in the middle of 2008 is not yet overcome; moreover, its depth is still unclear (Figure 1).



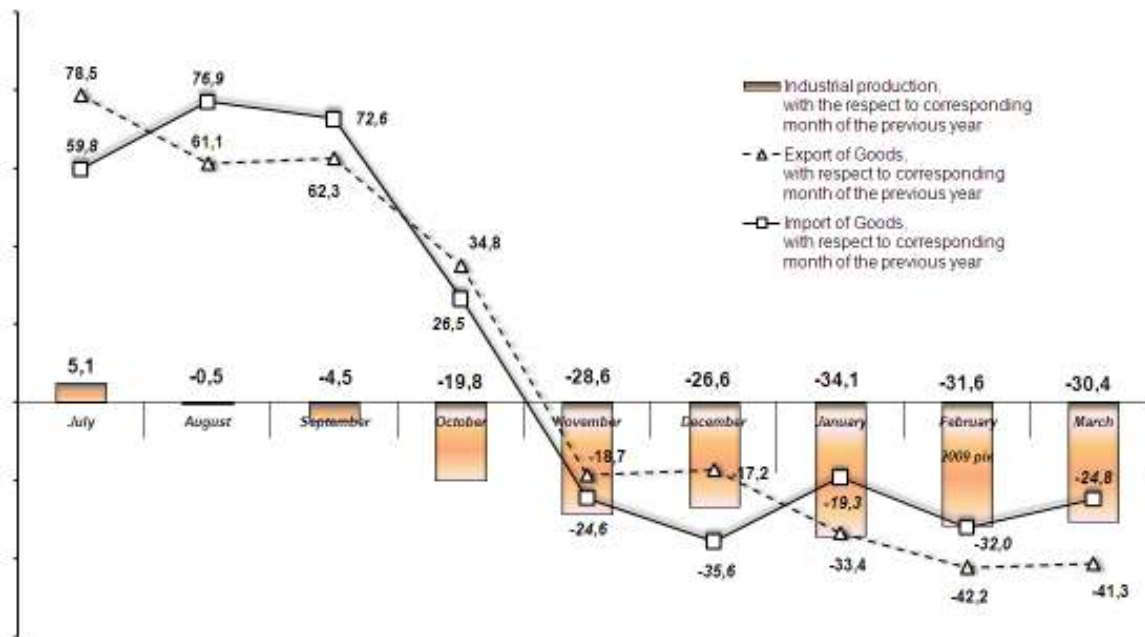


Fig. 1. The Dynamics of Industrial Production, Commodity Export and Import in Ukraine in 2008-2009, with the respect to corresponding month of the previous year

In March the industry situation seemed to be slightly better than in February (Figure 2). However, comparing to March 2008 a certain fall is noticeable, it makes us think about the essential seasonal component as the foundation of such an increase. Balance of payments of Ukraine in March ranges around zero and it allows us to speak about its stabilization. The number of bank deposits has increased by UAH2-3 billion. This is a good development, but comparing to UAH90 billion, withdrawn from the bank sector during the crisis, this number is too small to talk about a renewal of population trust to banks. On average, according to the total numbers for Q1 2009, the industry production index made 68,1% with respect to the corresponding period in 2008 (Figure 2).

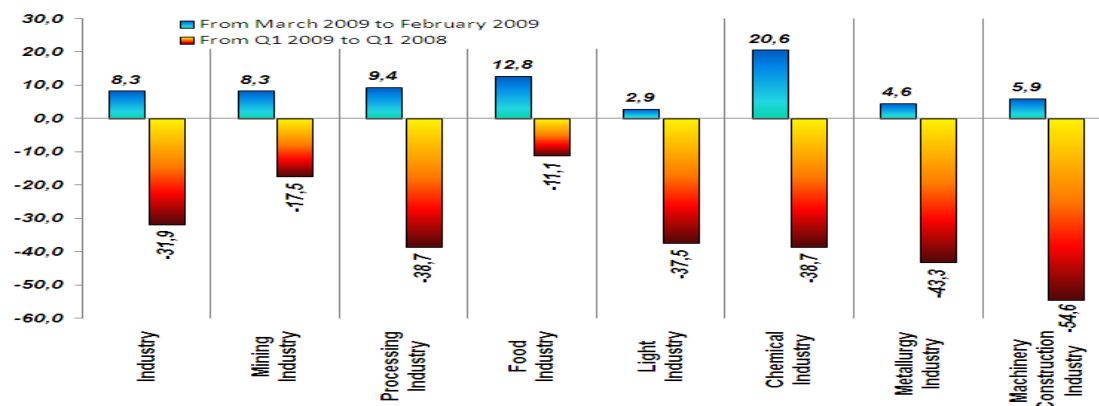


Fig. 2. The Dynamics of Industrial Production Index in Q1 2009

Sale of industrial products has been reduced essentially (Figure 3). According to the total number for Q1 2009 the amount of sold industry products comparing to the corresponding period in 2008 has decreased by 16,3 percent and in process industry this number is 26,9 percent (Figure 3).

Machine construction industry is suffering from the heaviest losses (especially motor car production) that almost stopped because of sharp output decline. The locomotives of the national economic system – metallurgical and chemical industries – are also suffering from severe losses.

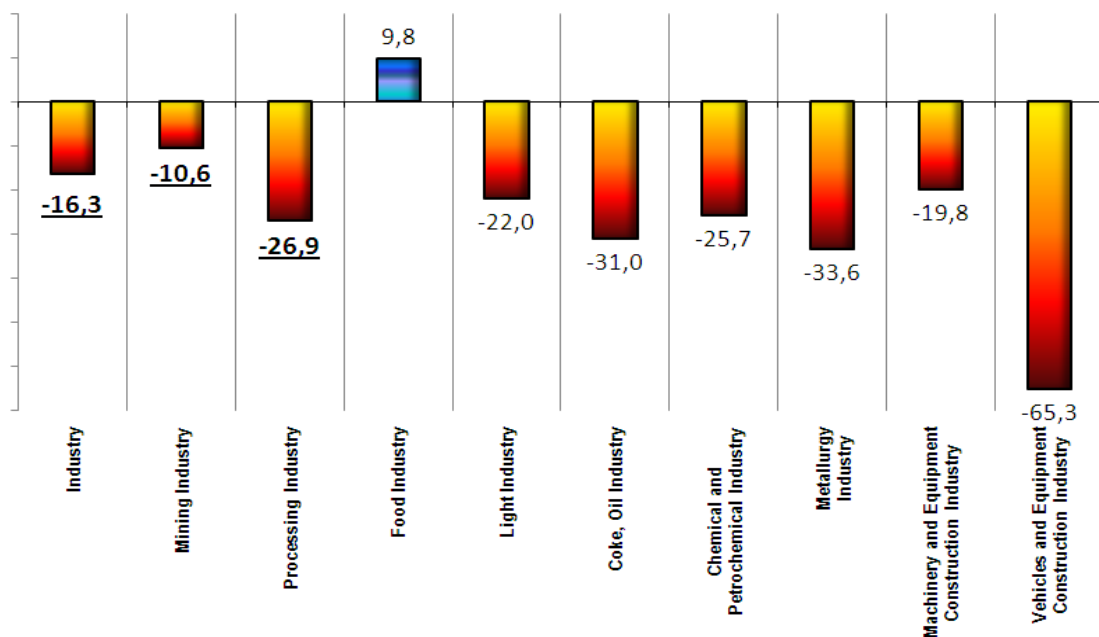


Fig. 3. The Dynamics of Sold Industry Products in the Key Industries, Q1 2009 to Q1 2008, in percent

The reduction of capital investments continues. To counterbalance the increase of this index, in 2008 it was reduced by 2,6 percent of corresponding investments while in 2007 the growth made 29,8 percent. The importance of those investments is principal taking into account the needs of economic development. Unfortunately direct foreign investments for the years of their dynamical injection into Ukraine's economy have not become the alternative source of accumulation because they were aimed at distribution of corporate rights, but not at the real economic sector.

The only one advantage in Q1 2009 is positive dynamics of agriculture production. Agriculture managed to obtain positive dynamics of growth (101,7% in Q1 2009) though it

suffered crisis negative impact. However, this sphere is very sensitive to world price fluctuation though price formation in the markets of agricultural products is largely defined by speculation plots.

It is worth mentioning some words about foreign trade dynamics. Export is essentially reduced and it is really painful for Ukraine because during the whole period of its independency it adhered to export strategy development and has not developed domestic markets. Negative export goods dynamics, that showed itself in Q4 2008 kept its strength to Q1 2009 (Figure 4).

It is possible to see that excluding the food industry and agriculture, the reduction of export of all commodity items comparing to Q1 2008 is noticeable. It is important that the reduction of the cost amount of export receipt goes along with the reduction of its physical amount. It is the evidence of low positive effect of hryvnia devaluation that was not able to make up for the general fall of world commodity prices.

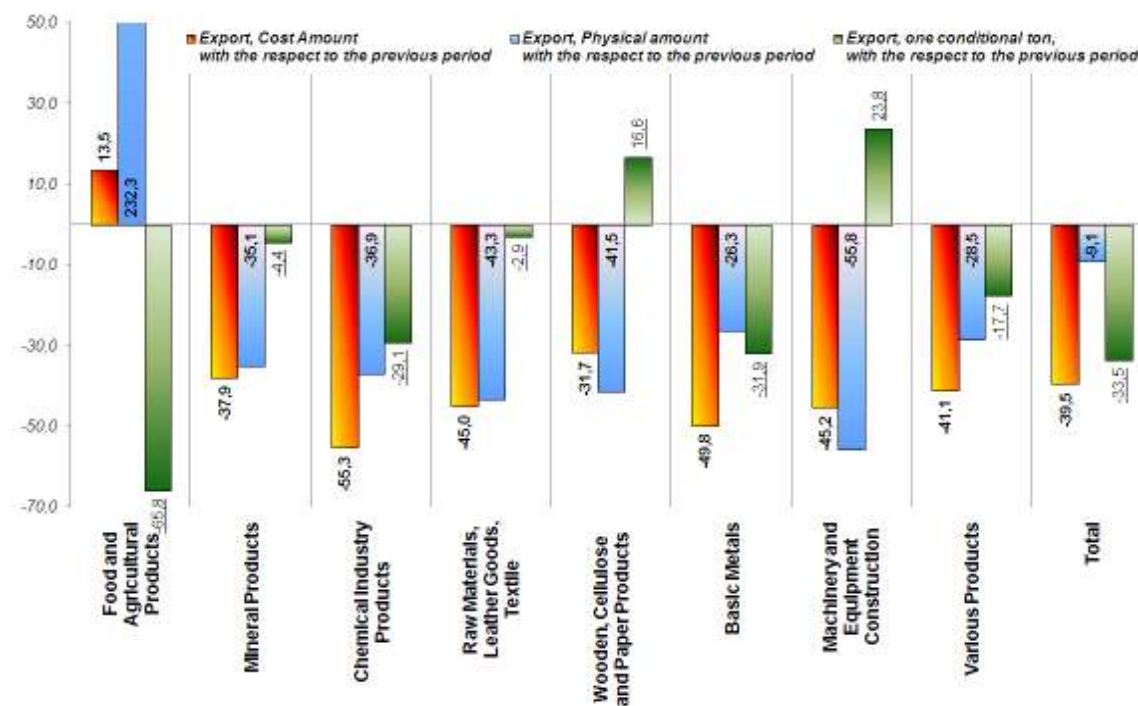


Fig. 4. The Dynamics of the Commodity Export of Ukraine by the Main Groups of Goods for Q1 2009

Export patterns are changing in Ukraine. Fluctuation of the world situation and change of the character of consumption demands in international markets make amendments in the

national export (Figure 5). The key changes are: decline in metallurgy industry, invariable leader in export (from 42% to 35% of export output), further reduction of chemical industry ratio in export structure (from 11% to 8%) and essential growth of food industry and agriculture ratio (from 13% to 24%).

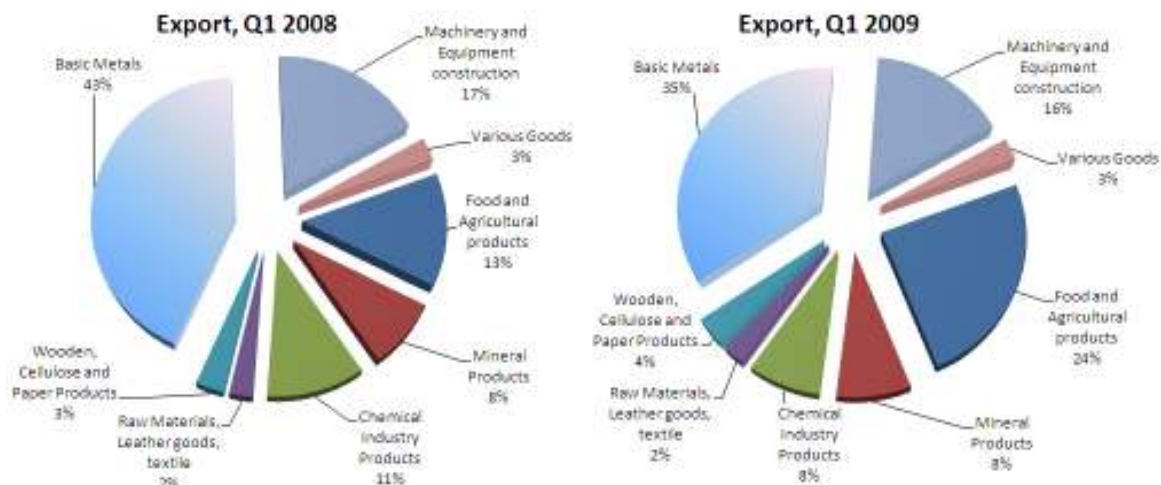


Fig. 5. Comparison of the National Export Patterns According to Q1 2008 and Q2 2009

Under such conditions it is possible to support payment balance only due to essential reduction of import commodity deliveries (Figure 6).

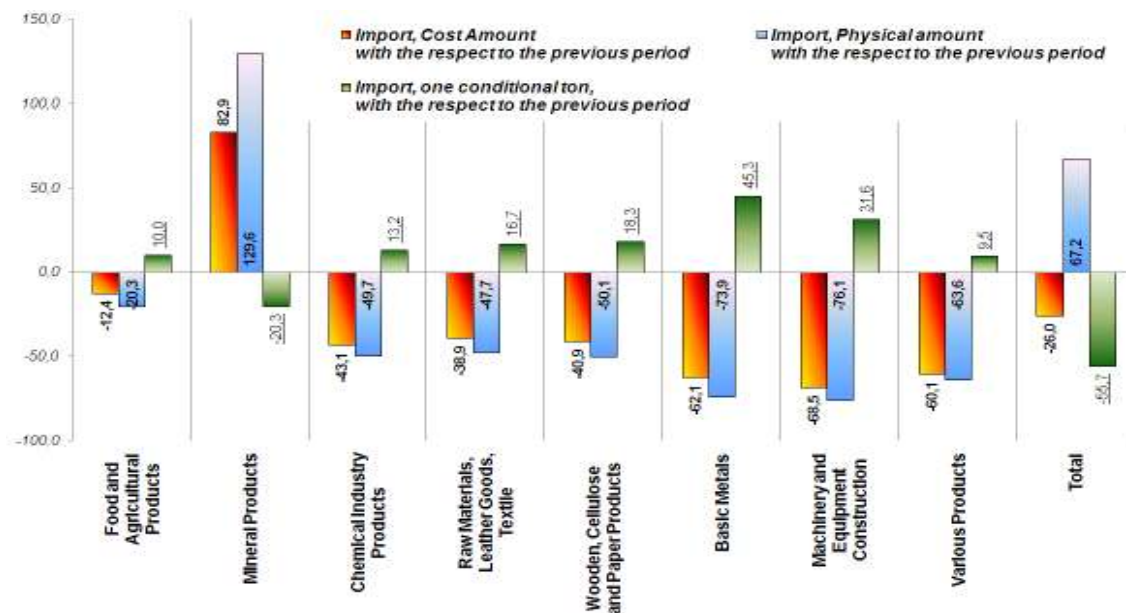


Fig. 6. The Dynamics of Commodity Import of Ukraine by the Main Groups of Goods for Q1 2009

During Q1 2009 nominal as well as physical volumes of commodity import have declined sharply. However, the price of one conditional ton of import goods is increasing. Such phenomenon should be considered as the result of hryvnia devaluation. Only the import of mineral raw materials is growing dynamically (in the main energy sources), that is not understandable in the context of catastrophic fall of production output. Nominal output has increased by 82,9 percent (physical – by 130%) and the ratio of corresponding goods in import patterns has increased by 52%.

As the result, import patterns of Ukraine are changing dramatically (Figure 7). The leader of import deliveries for 2008 – machinery construction production – has decreased by 68,5 percent in 2009. Here the fall of actual demand (as the result of hryvnia devaluation and closure of automobile loan programs) overlapped a new law on a 13% custom clearance fee.

In total, according to the data of the State Custom Service, a considerable negative foreign trade balance remains in goods trade. In Q1 2009 it made 3,6 billion US dollars (in Q1 2008 – 2,4 billion US dollars). It is formed mainly by the trade of mineral products, while last year it was formed by machinery construction products.

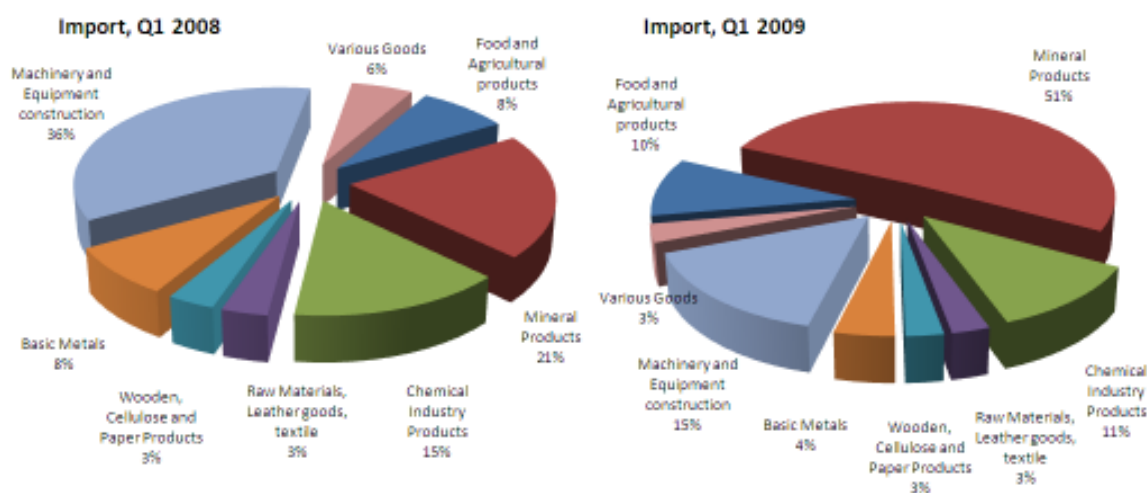


Fig. 7. Comparison of the National Import Patterns for Q1 2008

Thus the dynamics of the real sector of Ukraine remains disconsolate. In this situation critical threats to the real economic sector are:

- high and growing dependency on the foreign sources of development;
- low speed of modernization of the real sector, lack of modern technology introduction, low speed of labor productivity growth, lack of capital investment sources;

- temporary closing down of non-perspective economic structures.

Structural specialization of Ukraine in the foreign as well as in the domestic markets is forming spontaneously. We do not have a strategic plan for the national economy development that would clearly define its geoeconomic specialization. As the result, we have a passive subordinate of the national economy to the aims of speculation capital. We do not talk about long-term national economic interests here.

Ukraine also has certain competitive advantages that should be used. They are:

- relatively receptive domestic market with significant segments of unsaturated demand;
- considerable industrial potential, that need modernization on the base of new technological components;
- essential agriculture potential, in particular grain sector.

However under the condition of passive observing crisis processes they are simply wasted.

What should be done in this situation:

1. First of all it is necessary to formulate clear and understandable priorities of rebuilding the economy of the post crisis period. We should re-orient ourselves in the direction of the potential of the domestic market. We know that providing the needs of the domestic market of the national industries had been building for years. Today this is the key landmark for correcting structural deformations in the industry. It is crucial to choose priorities while formulating the budget for the next years. Under the condition of a reduction of budget revenues we should combine providing social commitments with fiscal stimulation of the national producers and budget support of strategic enterprises. In this regard cooperation with international financial institutions postpones the solution of these problems. Government debt is getting bigger and the problems are shifted to the budgets of the following years.

2. A new paradigm of foreign economic strategy is needed. We should clearly realize that the national market is too open on non-parity basis. It should be reinterpreted. Our participation in the international economic organizations has to provide a symmetrical presence in the foreign markets. Today a new doctrine of economic cooperation with Asian countries is needed. It is necessary to create a barrier to their trade expansion in the national market and to direct our relations into scientific and technical cooperation.

3. The locomotive for coping with the crisis might be the development of the grain potential of Ukraine and expansion of grain export. This direction has been actualizing in the conditions of the world food crisis. However, Ukraine will not be able to use its grain potential without strong state participation in it. Here we are talking about stimulation of

grain production as well as organizing and economic support, in particular, the development of corresponding infrastructure.

4. Regulation of the national financial market should be intensified. The financial sector is the most sensitive to the foreign influence that directs national finance to strengthening of financial discipline (especially the bank sector). The aim of regulation is counteraction to speculations, speculative capital outflow and centralization of superprofit that is withdrawn from the real economic sector.

It should be reminded that according to the data of the State Tax Administration of Ukraine, during 2008 banks acquired almost 17,5 billion US dollars that were illegally exported or used for speculative operations in the currency market. Thus, according to the scheme of calculations, for the import of goods and services (which were not imported in fact), 2,7 billion US dollars were transferred from Ukraine, according to the scheme of portfolio investments and direct investments return – 4,6 billions of US dollars, of currency purchase for currency bank positions formation 9,8 billions US dollars are acquired (from which 7,5 billions US dollars – in Q4 2008).

Ukraine should join the discussion of the problem of international regulation of financial organizations (hedge funds, insurance companies), especially those that act on the territory of our state.

5. A modern conception and international transit cooperation development is needed in Ukraine. Ukraine did not work up sufficiently the models of transport-logistic joining the world area, as the result, we receive less revenue. Being lagged behind in this sphere and having low implementation of modern technology makes us gradually lose prospective target markets of world transportation and logistics. We should take into account that there are real international consortium projects where we can apply the national recourse and industrial potential.

6. Effective support of the national business (small, media-sized and big businesses) is needed. In order to make this process less declarative, it should be based on corresponding regulatory and legal framework. It is, first of all, government and business partnership plan and also legislative enablers.

In practice it is expedient to begin with a common solution of the problem of super high debts of national companies and with overcoming the situation of possible corporate defaults. Ukraine has low credit ratings and vague prospects of export revenue renewal. As a result, access of national companies to international capital market is limited. Thus, independent restructuring of leading Ukrainian companies' debts is next to impossible. The Government should join negotiation in order to regulate the problem of international debts and to avoid

corporate defaults, sometimes by giving government guarantees with the condition of restructuring the debts.

7. Finally, it is necessary to remember that labor resources are the most sensitive under crisis condition, as the result of crisis they gradually lose value. The government should preserve and guarantee high level of life and labor and to protect jobs, created in Ukraine. Without it we will not have a domestic market of full value and our hopes of coping with the crisis will be vain.

#### **4. Conclusions**

It is obvious that passive waiting for the way out of the crisis will inevitably bring heavy losses for the national producers in the domestic as well as foreign markets. Only hard and purposeful work on anti-crisis measures implementation can minimize the national economy losses and help to avoid catastrophic losses of social standards.

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