What caused the end of the convergence episode for Ukraine in 2009?

Daopu Zhang

Abstract:

The convergence theory posits that low-income and middle-income countries tend to catch up with developing nations as they can replicate advancements observed in developed countries. Several factors influence the convergence of economies, with globalization affecting both convergence and divergence processes. Political instability and social-structural factors can end convergence, as was the case for Ukraine in 2009. Given the economic trend before and after 2009, it is possible to pinpoint when Ukraine's convergence episode ended. The heavy reliance on unfinished product exports meant that Ukraine was more vulnerable to external economic shocks from the US banking crisis. It also meant the country had low foreign exchange reserves to cushion it from external shocks. Events surrounding Ukraine's end of convergence show how the decline of large countries, such as the United States and China, could easily affect its trading partners. It reveals how underdeveloped nations could face severe economic shocks when relying entirely on industrialized economies.

Keywords: Convergence Theory, Ukraine, subprime mortgage crisis, financial crisis.

1. Introduction

From 2000 to 2008, Ukraine's GDP (current) increased from US$32.38 billion to US$148.73 billion (Ukraine Trade Summary 2007 | WITS | Text, n.d.). In 2007, Ukraine's primary exports to the global market predominantly comprised semi-finished metal goods, such as pig iron, steel billets, steel slabs, and chemicals and fuels. Ukraine's exports encompassed various categories, including semi-finished products valued at US$ 2,010,483.65 million, semi-finished iron or steel products valued at US$ 1,717,589.46 million, petroleum oils (excluding crude oil) valued at US$ 1,560,044.75 million, bars and rods valued at US$ 1,503,122.63 million, and flat rolled products valued at US$ 1,458,619.19 million. The overall trade value of metals in Ukraine amounted to US$ 20,777, accounting for 42.15% of the nation's economic output. (OEC, 2021). The producer price index by commodity for cold rolled steel sheet and strip had an upward trajectory, reaching 242.300 by June 2007 (Unguru, n.d.).

From 1991 to 2008, Ukraine's GDP annual growth had a growth spurt, albeit temporary, due to positive shock with 11.8% in 2004 before receding to 2.2% in 2008 (Debts and Budget Deficits in Ukraine, n.d.). The GDP annual growth rate jumped from -0.2% in 1999 to 5.9% in 2000. In 2007, Ukraine's GDP annual growth rate reached 8.2% before declining to -15.1% in 2009 (Debts and Budget Deficits in Ukraine, n.d.). Between the years 1991 and 2008, Ukraine's Gross Domestic Product (GDP) underwent significant fluctuations. The subject experienced phases of notable expansion and formidable obstacles. In 2004, a significant increase was observed in the Gross Domestic Product (GDP), with an impressive annual growth rate of 11.8%. This substantial surge can be primarily attributable to positive economic shocks. Nevertheless, this rise was transient, as the growth rate experienced a significant decline, reaching a modest 2.2% in 2008. The 2008 global financial crisis hurt Ukraine, resulting in a sharp decline in GDP growth. In 2009, the country's economy contracted by a staggering -15.1%, highlighting the fragility of its economic landscape during turbulent times. This period's fluctuations in GDP growth rates demonstrate Ukraine's resilience in the face of economic challenges.

2. 2009- End of convergence episode

2008 Ukraine's gross domestic product (GDP) reached US$ 188.11 billion. However, it declined in the subsequent year, with the GDP falling to 121.55 billion in 2009. Before the onset of the 2008/09 financial crisis, Ukraine had been through a period of accelerated economic expansion attributed to the convergence process (Debts and Budget Deficits in Ukraine, n.d.). Nevertheless, the nation saw a severe impact from the crisis, resulting in substantial repercussions. At the domestic macroeconomic level, the Ukrainian government encountered a liquidity crisis and credit crunch, currency devaluation, and substantial account deficits due to external economic shocks leading to a decline in commodity prices. Political instability within the nation constituted an additional domestic political component that exacerbated the prevailing conditions within the country (Ukraine Population 1950-2021, n.d.).

During the period spanning from 2007 to 2009, Ukraine

had a decline in the overall value of its exports, with figures dropping from 49,294 million in 2007 to 39,696 million in 2009. During the same period, there was a decrease in the total value of imports from 60,601 million in 2007 to 45,413 million in 2009 (Ukraine Trade Summary 2007 | WITS | Text, n.d.). A reduction in overall imports subsequently accompanied the decline in commodity prices, underscoring the adverse effects of the commodity price drop on the trade balance of Ukraine. The price of steel had a significant decline from below US$300 per ton to slightly above US$100 per ton during 1992 and 2008. The total steel exports from Ukraine exhibited a modest increase between 2000 and 2008, followed by a significant decline in 2009 (Edilberto L. Segura, Olga Pogaska, 2006).

2.1 Banking Crisis in 2000s (U.S)

The events in Ukraine were initiated by a banking crisis that originated in the early 2007s due to bankruptcy filings by subprime lenders. The crisis originated from relaxed and careless lending rules, facilitating a credit surge within the financial markets. This, in turn, contributed to the formation of a housing bubble inside the United States real estate market. Subprime mortgage borrowers endeavored to capitalize on more affordable mortgage rates, which ultimately contributed to the emergence of the housing price bubble. The bursting of the housing price bubble resulted in banks being burdened with mortgage-backed securities with significantly less value. This occurrence instigated a downward cycle within the financial markets (Aisen & Franken, 2010). The erosion of trust in prominent financial institutions further exacerbated the crisis. In Ukraine, the repercussions of subprime mortgages prompted the government to increase its borrowing to mitigate the impact of external economic shocks and restore stability to domestic markets. According to the World Bank, Ukraine saw a significant decline in foreign direct investment from 2000 to 2009, with a reduction of 78%. This decline decreased from US$ 11.2 billion in 2000 to US$ 2.5 billion in 2009. Due to this prevailing pattern, the Ukrainian government experienced a reduction in financial resources allocated towards the upkeep of internal macroeconomic indicators, leading to an escalation in sovereign debt levels (Aisen & Franken, 2010).

2.2 Conclusion of Direct Impact of Banking Crisis

The financial crisis led to an internal increase in the inflation rate in Ukraine, as the country implemented a strategy of raising interest rates to mitigate the impact of rising commodity prices on consumers. Ukraine's national debt experienced a significant rise from US$12.5 billion in 2000 to US$37.5 billion in 2009. The rise in the unemployment rate has resulted in a decrease in tax revenue. In contrast, a decrease in export revenue has led to a trade deficit in Ukraine, mostly caused by an imbalance between exports and imports (Debts and Budget Deficits in Ukraine, n.d.). An economic recession precipitated an increase in the unemployment rate, thus causing a decline in tax revenue for the government. Moreover, the worsening of Ukraine's economic woes was further compounded by a decrease in export earnings, adding to the expansion of its trade deficit. The nation's economic situation was further stretched by the trade imbalance, principally caused by inequalities between exports and imports. During this period of financial instability, Ukraine faced a complex array of interrelated and mutually reinforcing issues.

2.3 Before the Subprime Mortgage Crisis (GFS)

Even before the financial crisis that hit the United States, Ukraine was struggling with the repercussions of the fall of the Soviet Union, which included rampant misappropriation of public funds and a shortage of foreign investment. Even though it was on the cusp of convergence with developing countries, Ukraine's industries were not yet fully industrialized. This meant that the country could not capitalize on the full value of its raw materials and, hence, could not survive the great recession (Singh, 2023). Despite the potential for convergence with developing nations, Ukraine's industries have not fully industrialized. The repercussions of this predicament were extensive since the nation could not effectively use the potential of its plentiful raw materials. Therefore, Ukraine had significant challenges navigating the economic downturn when the Great Recession occurred. The nation's susceptibility to external shocks was exacerbated by its limited industrial diversification and underdeveloped sectors, hence intensifying the repercussions of the global economic downturn. The economic difficulties faced by Ukraine were thus rooted in underlying factors, rendering it more vulnerable to the challenges posed by the financial crisis.

3. Conclusion

The Global Financial Crisis had a significant impact not only on Ukraine but on practically all of the countries globally. This economic disaster negatively impacted almost 80% of the world's countries. In light of this, it is simpler for stronger economies to lend a hand to less developed nations like Ukraine so that the latter can make it through the current economic crisis. I believe

that countries worldwide should focus less on their own interests and more on the interests of others since this may be the only way to stop the wars going on in the world.

Acknowledgments

If any, it should be placed before the references section without numbering.

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