

Panagiotis Gavras



The Current State of Economic Development in the Black Sea Region

Policy Report I

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About this report

The Black Sea region is increasingly becoming a priority on the international agenda. In fact, a regional approach is emerging as actors understand that common problems need to be addressed jointly. Nevertheless, cooperation efforts are hampered by a number of factors, such as uneven economic and political development within and among countries, nationalist forces, and long-standing animosities between regional players.

In this context, it is imperative to foster sound policies aimed at strengthening dialogue and cooperation so as to contain and ultimately resolve conflicts with peaceful means. However, there is little policy-oriented research on the challenges and opportunities for cooperation in the Black Sea region.

The Commission on the Black Sea aims to redress this imbalance by presenting a series of four policy-oriented reports which reassess the economic, social, regional political and military developments in the region. This report is the first one, providing a better understanding of the parameters of the economic developments in the Black Sea.

The Commission on the Black Sea does not take a collective position with this paper. This text represents only the views of its author.

About the author

Panayotis Gavras has been with the Black Sea Trade and Development Bank (BSTDB) since its start-up in 1999. He is currently co-Head of the Policy and Strategy Department and has directed a variety of strategic and operational activities, including the preparation of country strategies, economic analysis of member countries. He has also directed the Bank's economic research on the Black Sea Region. Prior to the BSTDB, he worked at the World Bank and the National Foundation for the Reception and Resettlement of Repatriated Greeks. He holds a Bachelor of Arts degree from Princeton University, and a Masters in Public Policy from the Kennedy School of Government.

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Abbreviations

ASEAN	Association of Southeast Asian Nations
BSEC	Black Sea Economic Cooperation
BSTDB	Black Sea Trade and Development Bank
CEE	Central and Eastern Europe
COMECON	Council for Mutual Economic Aid
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ENP	European Neighbourhood Policy
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IIF	Institute of International Finance
IMF	International Monetary Fund
IMF-IFS	International Monetary Fund - International Financial Statistics
OECD	Organisation for Economic Co-operation and Development
US\$	United States Dollar
WEO	World Economic Outlook
WTO	World Trade Organization



Executive Summary

The financial crisis halted a period of robust growth in the Black Sea Region, which now faces significant challenges in returning to financial and fiscal health. Though regional economies are diverse, all would be well-served by strengthening financial and banking regulations, improving fiscal credibility and deepening regional cooperation.

After a tumultuous early 1990s, the Black Sea Region as a whole stabilized. The post-2000 period saw sustained high levels of growth, transforming economic and social structures. Formerly centrally planned systems have transformed into market-oriented economies. Poverty rates, health and education standards, and average wages have improved, although wealth distribution has been uneven. The region's economic orientation shifted toward the European Union, and stability helped lower country risk levels, improve sovereign credit ratings and encourage foreign direct investment.

The 2008 financial crisis stopped short the period of high growth. While banking systems have held up better than feared, national economies have been hobbled by the freezing up of global financial markets, the decline of international demand and slumping commodity prices. International financial flows have favoured countries with lower perceived external vulnerability and/or higher credit ratings, and most Black Sea nations have been forced to turn to international financial institutions (IFIs) for financing. None of the region's countries, save Russia, have been able to engage in meaningful fiscal stimulus policies.

The crisis has prioritised short-term crisis management, including support to the financial system, the restoration of credit flows, and dealing with economic recession over long-term challenges such as demographic pressures, and improving competitiveness and productivity. Individual country options are limited, but careful fiscal management and improvements in business and financial frameworks will help. Coordinated regional action is unlikely, due to lack of interest on the part of regional states, while external assistance has largely stemmed from IFIs, with some EU support for the region's EU member states. Post-crisis, EU influence in the region is likely to continue to grow. While the EU's engagement is mostly beneficial, its bilateral approach often undermines regional cooperation. More generally, regional cooperation has evolved haphazardly, and there is considerable room for improvement starting with deeper policy dialogue and policy coordination, and eventually leading to institutional harmonization, resource pooling, and other common projects.

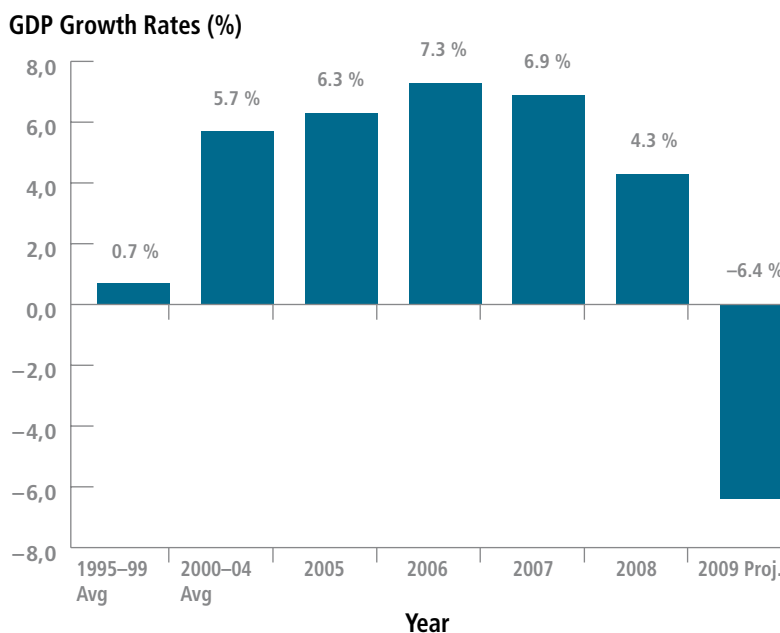
Generally, the Black Sea Region has cause for optimism. Its financial systems have so far weathered the crisis and it possesses a number of competitive advantages. However, much depends on the wider world's ongoing crisis response. It remains unclear whether regional growth rates can be restored to previously high levels, or whether growth will normalise at a lower level. The outlook for increased cooperation is less positive. The necessary political will and interest are lacking, and as regional economies are growing apart, they will likely evolve different priorities over time.

A The Historical Context of Economic Development in the Black Sea Region¹

The Black Sea Region has witnessed significant changes over the past two decades. One of the frontlines in the Cold War, it was in systemic terms a place where market economies encountered centrally planned ones. Subsequent events altered this state of affairs in a radical way. This was primarily due to the dissolution of certain states, which were replaced by a number of smaller states, and a universal shift towards market-based economic systems. In general terms, the region's economic performance after 1990 can be divided into four phases.

The first phase lasted until about 1995², and constituted the initial economic transition in eight of the ten Black Sea states. This was marked by a sharp decline that was the result of (i) the collapse of the old systems of production and distribution, (ii) the weak or non-existent legal frameworks, (iii) the non-functioning financial sector, (iv) the radical though often misunderstood and inconsistently

Figure 1: Black Sea Regional Growth



Source: National Statistical Agencies & IMF-IFS

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¹ Black Sea region data are based on BSTDB material supplied by the national statistical agencies of the countries of the Black Sea region, and by the International Monetary Fund IFS database. Other sources include the World Bank's Global Economic Prospects 2009 (and GEP 2008), the IMF's World Economic Outlook publications (plus updates), and the Economist Intelligence Unit.

² Since in many countries data for this period are unreliable and contradictory, no exact figure is given, though in the region the real average annual GDP growth rate was undoubtedly negative between 1990 and 1995.



implemented structural reforms, (v) the macroeconomic instability characterized by high inflation (and sometimes hyperinflation) and a lack of fiscal control, and (vi) in a number of cases the added challenge of establishing the structures and institutions of new sovereign states. Even in non-transitional states such as Greece and Turkey the early 1990s saw relatively high inflation, fiscal imbalances and weak or uneven growth.

The next phase, the second half of the 1990s, was one of stabilization and consolidation. Security and political stability improved, economic decline was arrested and in some cases reversed, the initial market-oriented structural reforms began to have a positive impact, and the macroeconomic situation, with one or two exceptions, stabilized. In terms of growth, Black Sea countries in general were better off and real annual GDP increases between 1995 and 1999 averaged 0.7% (See Figure 1). Furthermore, the Black Sea economies had to deal with shocks such as the increasing volatility of energy prices, the 1998 Russian financial crisis, the 1999 earthquake in Turkey, and the Kosovo crisis in 1999, which mainly affected the Western Balkans, but also had negative repercussions for the Black Sea region. Despite the adverse impact of these crises, there were also some benefits, for the local economies demonstrated their resilience under difficult circumstances. The crises (i) speeded up the introduction of structural reforms and (ii) helped to reinforce fiscal responsibility in those states that had already made an effort to reduce their deficits, and to emphasize its importance in those that had previously indulged in high levels of spending.

The third phase began in 2000 and continued into the third quarter of 2008. This was a period of high and sustained growth based on a series of factors which included

- adaptation to a market-oriented system and all that it entailed by the population at large, including improvements in the legal framework and its implementation;
- the fact that previous reforms, which had often been painful and expensive, began to pay dividends and have a positive impact, and that there was a robust response from industries which benefited from declining interest rates and earlier currency devaluations;
- vast improvements in macroeconomic stability, including the greater credibility of governments, declining inflation, smaller fiscal deficits, and reduced external debt and debt service coverage ratios;
- benign global economic conditions and enhanced trade and investment links with the wealthy markets of western and central Europe.

Real GDP growth between 2000 and 2008 averaged 6.0% per annum, which was equal to a cumulative economic expansion of 68%. Living standards rose, poverty rates dropped, trade and investment picked up, and the region's societies became increasingly sophisticated and integrated into the broader European and global economic context.

The fourth and current phase owes its origins to the financial crisis that broke out in late September 2008 and almost led to the collapse of financial markets worldwide. Its virulent impact on the Black Sea region resulted in a sharp halt to growth. The global financial turmoil spawned a regional economic crisis that affected all the Black Sea countries, and especially those which were most vulnerable on account of their need for ongoing inflows of foreign capital. Since external financing suddenly became either difficult or impossible to obtain, factors such as a sizeable current account deficit, a large amount of foreign debt, or high levels of foreign borrowing came to be seen as significant disadvantages (see also Section C).

B Overview. The Economic Transformation of the Black Sea Region

Despite the adverse impact of the current crisis and the uncertainties it has generated, the Black Sea region is now a very different place than it was in 1999, or, for that matter, in 1989. This is certainly true from an economic perspective, and perhaps even more so in political and social terms³.

First, there has been a fundamental change in the economic structures within which people live and work in most of the Black Sea countries, and a shift from state-run to market-oriented economic systems. This involved far-reaching economic liberalization and the creation of open markets. On the one hand the state sold off many assets and ceased to operate in many sectors of the economy and on the other hand the private sector grew rapidly to fill the vacuum left by the decline of the public sector. It also branched out into entirely new areas, particularly in the services sector. Economic institutions were overhauled, prices and exchange rates were liberalized, and as a result there was both greater freedom and uncertainty. While the extent of state involvement varies, all Black Sea countries now have market-oriented systems and focus to varying degrees on what are known as ‘second generation’ reforms which seek to preserve prospects for sustained growth (despite the current crisis) and to strengthen state institutions, the market, and civil society⁴.

A second feature is the greater degree of prosperity throughout the region. Between 2002 and 2008 all the countries concerned posted positive growth. Some of the smaller states maintained double-digit rates over much of the period and were also able to do a lot of ‘catching up’. To be sure, the benefits of this economic growth have not been evenly distributed. Indeed, there is evidence that income distribution is more unequal, and that geographical disparities have increased. Thus capital cities and major economic centres have reaped a greater share of the profits than rural or isolated areas. However, the robust growth in the decade leading up to 2008 resulted in declining

³ These are arguably more significant, although this paper does not discuss them for reasons to do with focus, length, measurability, and the far greater expertise of other analysts.

⁴ On the transition process and the ‘first’ and ‘second’ generation reforms see 1) Tanzi, V. and Tsibouris, G. (2000): Fiscal reform over ten years of transition. IMF, Working Paper No. 00/113, and 2) Conference on Second Generation Reforms, Washington, D.C., 8–9 November 1999 at www.imf.org/external/pubs/ft/seminar/1999/reforms/index.htm.



poverty rates in all of the countries in the region. In some cases this was rather impressive. Other key indicators such as health and education have also reflected the improvements in living standards. Despite the fact that it is difficult to obtain up-to-date and accurate information, the trend clearly applies to all Black Sea countries and is supported by data that are easier to ascertain, including average wage levels and per capita income levels.

All the countries have witnessed large increases in average wages, particularly since 1999. In the case of Greece and Turkey, the growth has been substantial, though wages were already at a relatively high level. However, in the case of former transition countries the changes have been dramatic, which is partly due to the low initial levels, with increases by a factor of 8–12 in nominal dollar terms. In real terms they have on average just about tripled. After a period of relative stagnation in the non-transition states, and precipitous decline in the transition states during the 1990s, per capita incomes have risen dramatically. Between 1999 and 2008 they increased nearly five times in dollar terms, from about US\$ 2,100 in 1999 to an estimated US\$ 10,300 in 2008.

The third area in which the Black Sea region has seen significant changes is in that of the regional economic configurations. In 1989 three countries were members of COMECON, Bulgaria, Romania, and the Soviet Union, to which six Black Sea countries belonged. The European Union (EU) was not contiguous with the Black Sea region, Greece was the sole regional state with EU membership, although Turkey had negotiated an EU Association Agreement. Both were also members of the OECD and other international organizations, though economic cooperation between them was at a low level. In the case of the COMECON countries, the structure and extent of economic cooperation was imposed hegemonically. There was no economic cooperation which included the entire Black Sea region.

Today there is a surfeit of organizations seeking to promote regional cooperation and economic integration. This plethora of initiatives testifies to the fact that there is a widespread understanding of the importance of regional cooperation, although so far it has manifested itself largely in formal terms. Many initiatives include non-regional countries, and only a subset of Black Sea region states. Most of them are supported by external actors. Even though they are not necessarily coercive, their value is questionable. Only one organization covers the entire Black Sea region and has been established and developed locally, the Black Sea Economic Cooperation (BSEC). However, while in theory there is a greater degree of 'ownership' in comparison with externally generated cooperation schemes, the extent to which BSEC has had an economic impact on the Black Sea region is also open to question.

If economic activity is defined in terms of the flow of goods, services, capital and people (and this does not only refer to labour), the European Union is by far the most significant of the regional economic cooperation groups. The reasons for this include its large membership, the degree of commit-

ment that EU membership implies, the extent to which its member states have entrusted to the EU powers that are normally in the hands of sovereign governments, and the ensuing economic clout and political importance of the EU.

Although this is primarily a political issue, the relationship of a European country⁵ to the EU has significant economic ramifications. It is influenced (i) by whether it is seeking membership or closer association with the EU, and (ii) by the extent to which the EU and its member states opt to engage and cooperate with it. Today the EU extends to the shores of the Black Sea, where three countries are EU member states, and Turkey is an accession candidate⁶. In these countries economic policy is primarily determined by their EU rights and obligations. Georgia, Moldova and Ukraine hope to obtain, but have not as yet received accession candidate status, and have been labelled 'Neighbourhood' countries along with Armenia and Azerbaijan, where the EU's relations are determined by its European Neighbourhood Policy (ENP). A key element of the ENP consists of deepening economic cooperation on the basis of EU rules and standards, and increasing trade and investment flows between the EU and the ENP countries. Though much maligned, and perhaps deservedly so, ENP nevertheless represents the most far-reaching degree of engagement by the EU in the Black Sea region to date with countries without an EU membership perspective. Thus in addition to growing economic relationships with EU members and accession candidates, the ENP countries are drawing closer to the EU, even though for the time being it seems unlikely that they will be able to join the EU. Even for Russia, the country with the fewest institutional links, the EU has become a significant economic partner, since roughly half of Russian trade is with the EU.

Apart from the increased prosperity resulting from the 2000–2008 period of high growth, the economies of the region are now more open, interact with each other and are more in touch with the global economy in general, and western Europe in particular. Flows of people, capital, goods and services have all increased, and the economic situation has been transformed in a significant and generally positive way. This is best seen in the business environment, which has grown in sophistication and now operates more smoothly.

In recent years a variety of systems has been devised to measure the state and the quality of the business environment⁷. Since they are trying to quantify something which is essentially qualitative, they are largely subjective with scores based on perceptions, observations that are often of little value in statistical terms, and relative weightings. As such the individual scores should not be taken out of context, and it is better to look at them collectively prior to coming to certain conclusions. In the countries of the Black Sea region, both individually and collectively, the indices pertaining to the business environment show that there has been an improvement over the last decade. In some cases

⁵ Despite the EU's ambivalence and the many and varied opinions on the matter, in this paper all the countries included in the Commission on the Black Sea are assumed to be part of Europe.

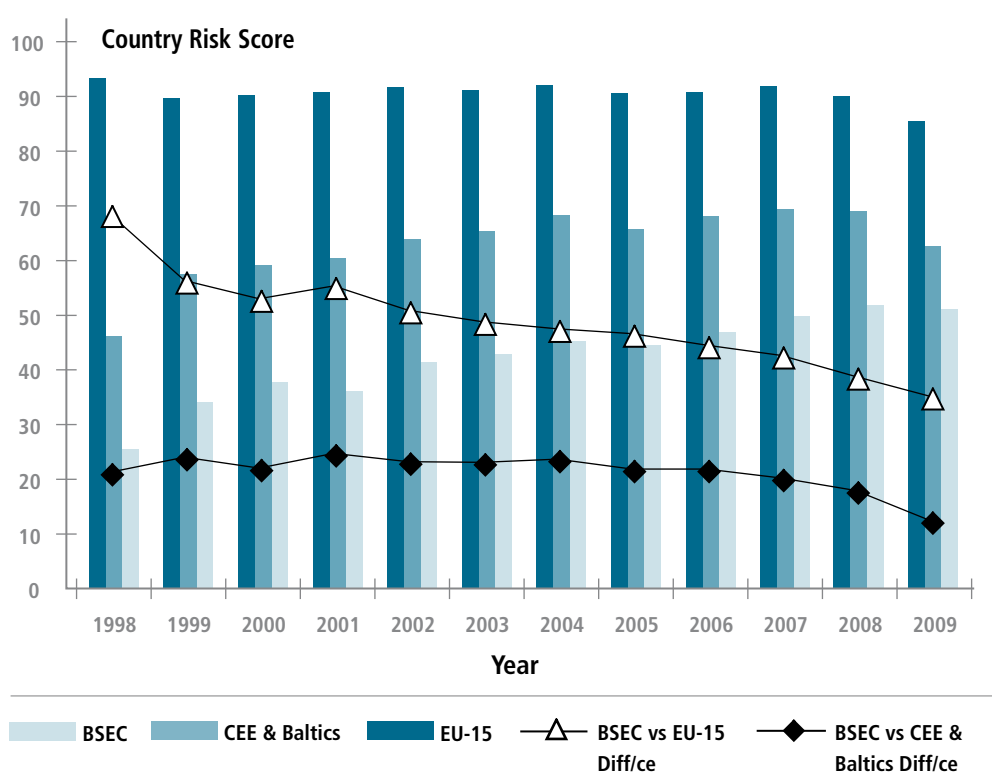
⁶ BSEC members Albania and Serbia, which are not included in this survey, are currently potential EU accession candidates.

⁷ An increasing array of publications lists and ranks the various countries. The most reliable ones include (i) the World Bank's Doing Business Reports, which measure the ease of doing business, (ii) Transparency International's Corruption Perceptions Index Reports, which measure the quality of transparency and the extent of corruption, and (iii) EBRD's Transition Reports, which focus on the business environment and the extent to which countries are seen to function as 'market economies'.



the improvements have been moderate, and largely in absolute terms, whereas in other cases they have been rather dramatic, not only in absolute terms, but also when compared to other countries.

Figure 2: Trends in Regional Euromoney Country Risk Scores and Relative Differences



Source: Euromoney Magazine

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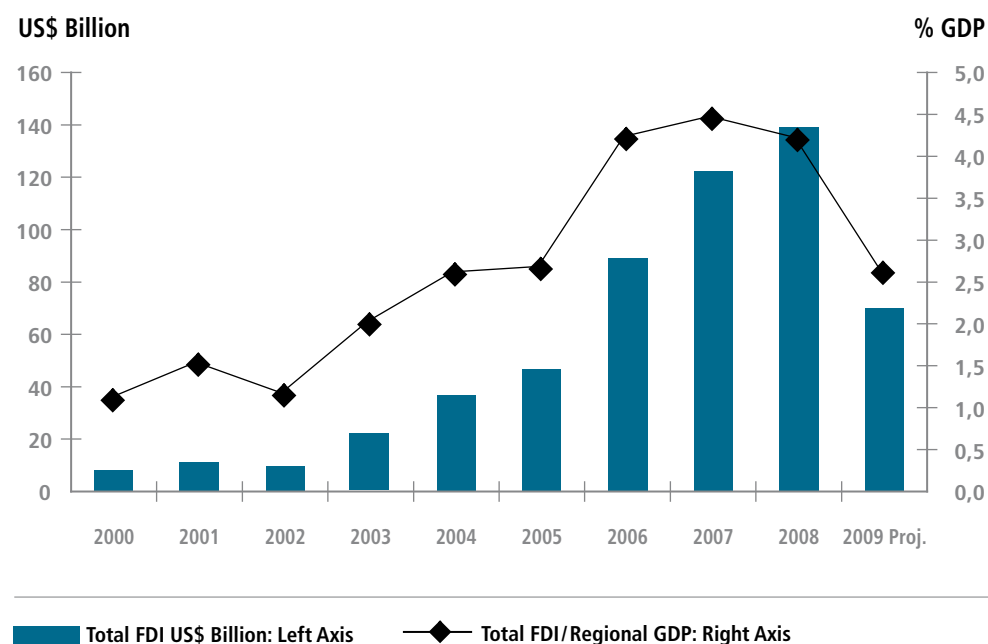
Figure 2 shows country risk scores based on Euromoney Magazine’s semi-annual Country Risk survey⁸. Country risk⁹ is a particularly useful way of evaluating the business environment, since it quantifies the possible occurrence of a non-business event or a non-business situation which might threaten (i) the normal operation of a company (ii) the value of certain assets, and/or (iii) the profitability of loans and investments. A decline in country risk correlates directly with an improving business environment.

⁸ Euromoney’s Country Risk survey is arguably the most comprehensive index and covers nine categories. Figure 2 provides simplified regional representations based only on arithmetic averages. They are not weighted to take into account the relative size of an economy or other factors. The figure was prepared solely for illustrative purposes, and shows the evolution of country risk scores over time. The bars show that an increased score signifies an improvement (i.e. decrease) in country risk. 100 represents the maximum (i.e. lowest) risk score. Declining lines indicate decreasing differences in country risk scores between the regions under comparison (i.e. the convergence of scores and country risk levels).

⁹ In the present context country risk is defined as the weighted sum of a collection of scores including (i) macroeconomic performance and stability, (ii) security, political and social stability, (iii) perceptions of public and private governance, including implementation capacity, transparency, and corruption, (iv) the quality and clarity of a country’s legal and tax framework, and the quality of its implementation, (v) and the general ability of economic entities to operate in a smooth manner.

The figure shows an upward trend in the Black Sea region and convergence during the last decade. In absolute terms, the region's score improved steadily between 1998 and 2008, with a setback in 2009 due to the global crisis. In relative terms, the difference between the Black Sea region and the original EU-15 on the one hand, and the Black Sea region and the Central European and Baltic countries¹⁰ that joined the EU in 2004 on the other hand, has continued to shrink in a consistent manner. Although the Black Sea region continues to lag well behind EU-15 levels, the trend is a positive one and has persisted during the first part of the current global crisis. Similarly, the trend based on the comparison with the CEE & Baltic countries has seen diminishing differences, even though most of the Black Sea countries were unable to reap the country risk benefits deriving from the EU accession process.

Figure 3: Foreign Direct Investment in the Black Sea Region 2000–2009



Source: National Statistical Agencies, IMF-IFS & Economist Intelligence Unit

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¹⁰ Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia. They are labelled 'CEE & Baltics' in the chart. These countries are frequently used for comparison with the Black Sea region since they are also former transition countries. However, they were more advanced in economical terms and are thought to have completed the 'transition' faster.



The improvement in the business environment is partly underscored by sovereign credit ratings¹¹. Whereas at the end of 1999 the Black Sea region had only one country with an investment grade rating, it now has four. Significantly, every country in the Black Sea region has now ‘entered the market’ and received sovereign ratings. This is an indication of growing maturity and economic progress, since such ratings enable them to raise loans on the international capital markets and set benchmarks for the development of the domestic financial markets. An even better and more easily measurable indicator of an attractive and favourable business and investment environment is foreign direct investment (FDI). After languishing at around 1.0% of GDP or even lower through most of the 1990s, between 2000 and 2008 FDI in the Black Sea region increased as a share of GDP from 1.1% to 3.9%. In dollar terms this is even more impressive, a sixteen-fold increase from U.S.\$8 billion to an estimated U.S.\$130 billion (see Figure 3).

C Implications of the Global Crisis for the Black Sea Region

As we have seen, the Black Sea region’s current economic phase began quite suddenly in the last quarter of 2008. Since the global financial markets were near collapse in September 2008, access to financing became virtually impossible and risk aversion reached panic proportions. There was no ‘decoupling’ between the developed markets of the West and the rest of the world, and in Eastern Europe the global contagion threatens to reverse years of economic progress.¹²

It is hardly surprising that the impact on the Black Sea region has been negative, although the extent of the damage varies from country to country. The financial systems remain under stress, lending to private companies is still limited, and in some countries there has been a painful process of deleveraging that has led to a downturn in economic activity. However, the financial systems have not collapsed, and they have managed to avoid the bank insolvencies that marked previous crises and led to panic in places like Russia in 1998 or Turkey in 2001. Despite fears about larger losses in the future as the effect of recession hits companies and consumers, and unless the economic downturn results in a sharp rise in non-performing loans, most of the banks in the Black Sea region seem to be well positioned to weather the storm, either on their own, or with the open or covert backing of their governments. Significantly, in many Black Sea countries much of the banking system was foreign-owned (mainly by west European entities), and there were fears that the parent banks might withdraw support for their local branches or subsidiaries. Hitherto this has not happened, and with the cautious return of investor appetite for risk in the second quarter of 2009,

¹¹ Long-term sovereign credit ratings, which define creditworthiness, are a useful measurement of the business environment despite (i) the justifiable criticism which has been levelled at them during the current global crisis, and (ii) their biased way of assessing emerging markets. They are easy to recognize and compare, and measure aspects of country risk. Investment grade refers to a sovereign credit rating of Baa3 or higher issued by Moody’s, and BBB- or higher issued by Standard & Poor’s or Fitch.

¹² See the IMF report “Crisis and Recovery,” in World Economic Outlook, April 2009, and many similar predictions for 2010.

parent banks have continued to support their local holdings or pledged to do so, thus maintaining their exposure and in certain instances injecting additional capital. Whilst the global crisis has certainly created dysfunctionality in the financial systems of the Black Sea region, it has not manifested itself as a full-scale financial crisis.

In fact, the impact of the global crisis has been felt most acutely as an economic crisis. As global financial markets were on the verge of collapse, bank lending to businesses and consumers dried up, thus reducing liquidity and demand and creating uncertainties that severely impeded investment. There was a drop in international trade flows, and the ensuing economic contraction in key western European markets led to a reduced demand for goods and resources from the region. The situation was exacerbated by a slump in commodity prices. An additional factor for certain countries was a decline in remittances from migrants and co-nationals living abroad, which also contributed to the reduction in domestic demand.

The nature of the crisis and the difficulties encountered in trying to deal with its root causes and agreeing on appropriate measures and their implementation point to the possibility of a lengthy period of economic decline or stagnation followed by a feeble and slow recovery. Recent forecasts have all predicted that in 2009 the Black Sea region will contract, with negative rates of GDP growth of -6%, a figure which will be determined to an important extent by output in Russia, which is the biggest economy in the region and has close links with a number of neighbouring economies. And while it is too early to say, there are concerns that the economic crisis may result in more 'bottoming out' before an upturn sets in. Most of the forecasts for 2010 also predict negative or close to zero rates of economic growth.

Furthermore, the global financial crisis reaffirmed that there is a hierarchy of access to financing based on perceptions of country risk which are determined by a combination of credit ratings, levels of development, and overall economic size. This has led to a global 'financial food chain' in which those with the highest ratings have the best seat at the table, and at a reduced price, while those with lower ratings have to scramble over the remainder and are forced to pay more. Thus, while the restoration of credit flows to the region represents a critical element in the recovery from the crisis, Black Sea countries, none of which enjoys an AAA or AA rating, and their companies face the real threat of being crowded out of credit markets by the record volumes of borrowing planned by countries with higher ratings as they try to stem the economic decline and stimulate their own economies. The increased competition for financial resources has resulted in higher interest rates for Black Sea countries. And a lower rating for a country automatically implies higher costs.



Currently the markets are still dysfunctional and risk averse, with disproportionately high spreads as one moves down the ‘financial food chain’, and for this reason official sources of financing represent the primary option for most Black Sea countries. In contrast to the United States or Western Europe, Black Sea countries are on the whole unable to adopt measures designed to encourage lenders to return to the market. Their economies are too small for capital injections to achieve the required degree of stimulus. Moreover, their currencies do not have reserve currency status, and as such they are unable to inject sufficient liquidity into the financial system without depleting the reserve levels and risking severe capital flight. Only Russia, by far the largest regional economy, has attempted to introduce a sizeable fiscal stimulus package, though in the process it experienced a large drop in reserves and increased rouble volatility.

D Challenges and Issues for the Black Sea Region

Because the countries of the Black Sea region are diverse in terms of size, economic structure, and the level of development, there may well be challenges which are peculiar to a particular country or a small sub-set of countries. For example, the EU members and Turkey are in general more developed and integrated into the global economy on account of their relationships with the EU and the greater openness of their economies. This allows them to benefit from greater global opportunities, but also means that there is a higher risk from economic shocks (such as contagion) which have their origins elsewhere. Moldova and the Caucasus countries are small and far less open, and while this has insulated them to some extent from the global economic turmoil, it is also a key aspect of their underdevelopment and persistently high poverty rates, particularly outside major urban centres. The two energy exporters, Russia and Azerbaijan, continue to face the challenge of diversifying their economies. Ukraine, for its part, faces a unique set of challenges resulting from its social diversity, political system, and economic structure, and is very much dependent on low value added ‘heavy’ industry.

Diversity and attitudinal differences in the various countries makes it difficult to identify issues which may be considered to be challenges for the region as a whole. Thus it is important to define general topics which may well manifest themselves in different ways and be determined by a country’s specific characteristics.

There are certain issues which represent important challenges for the countries of the region. However, they are either not particularly urgent, or in theory permit individual countries to exercise a greater degree of national control over their development.

These include

1. Long-term demographic trends and the threat they pose for the quantity and quality of the workforce, and the financial sustainability of social security programmes;
2. The need for ongoing economic reforms in order to improve the competitiveness and productivity of regional economies.

Two crucial issues are critical challenges for the Black Sea region both now and throughout the next decade. Whilst the region's countries will have some influence in this area, external factors and decision-making will also be important, possibly to an even greater degree.

They are

3. The current global economic crisis, how it affects individual states and the region as a whole, and the kind of policy responses which may emerge;
4. The long-term evolution of economic relations with important external players. For the Black Sea region, the future evolution of relations with the EU is by far the most significant parameter.

Finally, there is a fifth challenge, and that is the promotion of regional cooperation. This contains certain unique elements and will therefore be discussed separately.

Long-Term Demographic Trends and Economic Reforms

These issues are of secondary importance, at least for the time being. Demographic trends in the Black Sea region represent a 'time bomb' type of issue which will grow in the years to come and may well end up by becoming the principal challenge for most countries in the region. Birth rates have declined throughout the region, as in western Europe, and the actual population size is becoming smaller in a number of countries which, in addition to precipitate drops in the birth rates, have witnessed net emigration, and, in some transition countries, declines in life expectancy and rises in the death rates from the 1990s onwards which were stabilized only during the years of robust growth. The implications of such negative demographic trends are wide-ranging, and will affect the economy with regard to the quality and quantity of the workforce, the business environment, pension systems and government finances, and make themselves felt directly or indirectly in many other sectors of economic life. However, while demography-related issues will become more important



in the years ahead, they are not as pressing as the other challenges alluded to above, though of course individual countries can and should take them into account as a long-term trend.

The questions of competitiveness and productivity are key ‘second generation’ reforms for many countries of the region. They are required in order to safeguard what has already been achieved, to sustain growth in the long term, and to promote convergence with western European income levels and living standards. There is a need to (i) strengthen public and private governance, (ii) undertake difficult structural reforms in key sectors, with energy and agriculture ranking as the most difficult, and (iii) continue to invest in maintaining and expanding infrastructure, the current state of which is a key potential constraint on growth. It should be borne in mind that the fiscal capacity of Black Sea states is insufficient to meet such long-term goals. However, the ability to deal with these issues depends to an important extent on the impact of the current economic crisis, as well as the economic relationships with countries which determine factors such as policy limitations, obligations, privileges and prospects of access to decision-making forums and assistance.

Dealing with the Global Economic Crisis

The current global economic crisis has adversely affected the region in general, and certain countries in particular. The restoration of credit flows to the region is a critical element in its recovery from the crisis. And while it is certainly necessary, it is not sufficient. Yet even this may prove to be a major obstacle for Black Sea countries, since most of them do not have a currency with reserve status, and access to foreign currency is expensive. This leaves them with only limited options.

- **Individual country options.** Despite increased reserves and the high growth levels of previous years, the lack of reserve currency status and perceived external vulnerability limit the scope for options such as fiscal stimulus packages or the easing of monetary policy adopted by more developed economies. Thus for most Black Sea countries the most probable responses will include traditional austerity to restrict demand, maintain revenue flows, reduce debt servicing requirements and regain or increase the confidence of the markets. Countries can do a lot to help themselves by ensuring that there are domestic laws and frameworks designed (i) to improve the business environment, including the establishment of companies and their operation, (ii) to upgrade the transparency and quality of public and private governance, (iii) to facilitate rapid debt restructuring and corporate reorganization, including bankruptcy, (iv) to establish defined social security nets with the fiscal resources available, to assist unemployed workers and disadvantaged groups and to mitigate some of the worst effects of the crisis, and (v) to institute mechanisms to help restore the functionality of domestic financial systems, including measures

such as ensuring the capitalization of banks, improving regulatory supervision, enforcing rules fairly and objectively, establishing or improving credit and collateral registries, etc.¹³.

- **Regional options.** In theory the Black Sea countries could gather around a regional institution such as BSEC in order to seek ways in which to cooperate and coordinate their activities. This could begin with a policy dialogue and information exchange, and continue with institutional cooperation or policy coordination. And it could eventually embrace (i) institutional harmonization, (ii) organizational structures, and (iii) the commitment and/or pooling of resources, such as multi-lateral swap arrangements¹⁴. As yet there has been no such action on a regional level, apart from a financial sector dialogue within BSEC. Nor does there appear to be any discernible political will to do this which means that it is a highly unlikely scenario.
- **Externally supported options.** This covers official bilateral and international financial assistance as well as externally initiated institutional structures.

For many sovereign borrowers in the Black Sea region, official lending is the only realistic option when accessing external financing, and in the first half of 2009 only Greece, a Eurozone member, issued bonds for substantial amounts¹⁵. International financial institutions (IFIs) and donors, including the EU, have an important ‘counter-cyclical’ role to play by increasing lending levels when private sources are beginning to diminish. Thus IFIs significantly increased their commitments, which reached record levels. The International Monetary Fund (IMF) persuaded its members to quadruple the available resources early in 2009, and it has concluded agreements worth tens of billions of dollars with a number of Black Sea countries¹⁶. The World Bank, the European Investment Bank, the European Bank for Reconstruction and Development and others have also stepped up their lending. Nevertheless, even at this rate official flows fell far short of the levels of private financing provided in previous years. It is expected that for 2009 they reached only about 10–15% of the levels of private financing provided in 2007¹⁷. Assistance provided by IFIs is currently the main form of EU involvement. It has supported IFIs (as a key shareholder and funding provider), it has contributed an additional US\$ 100 billion to the IMF, and it has accelerated balance of payments facilities it offers to non-Eurozone EU members (for example, Bulgaria and Romania).

13 See also ‘Coping with the Crisis: Policy Options for Emerging Market Countries’ by Ghosh, Atish R. et al. 23 April, 2009, IMF Staff Position Note.

14 It would resemble ASEAN’s Chiang Mai Initiative—see <http://www.aseansec.org/17902.pdf>

15 During this period Turkey was the only other Black Sea country to float a couple of Eurobond issues for minor amounts.

16 At the time of writing Albania and Moldova are implementing IMF concessional programmes, while Armenia, Georgia, Romania and Ukraine are implementing non-concessional programmes.

17 See ‘Capital Flows to Emerging Market Economies’, Institute of International Finance Report, 11 June 2009; World Economic Outlook (WEO), April 2009; ‘Crisis and Recovery,’ IMF Report; and WEO update, 8 July 2009.



A distinct (though similar) measure would be the establishment of ‘swap lines’ between regional central banks and those central banks which control key reserve currencies (e.g. the European Central Bank for the Euro, the Federal Reserve for the dollar) in order to ensure that there is sufficient liquidity and access to foreign reserves whenever global liquidity is restricted¹⁸. However, no such scheme has been contemplated for any of the countries of the Black Sea region.

Indirectly, a related development has been observed in the case of Eurozone-based banks. They have accessed ECB facilities and used the money to support subsidiaries and branches throughout Eastern Europe, as well as to roll over loans. In theory the same effect could be achieved by sovereigns using Eurozone-based banks as intermediaries to purchase Black Sea bond issues through targeted placements. It is the strategy which Greece, a member of the Eurozone, has employed with Greek banks, which in turn have significantly increased their share of government bond purchases. However, this trick is more difficult for other Black Sea countries since they do not exercise regulatory control over Eurozone-based banks, and thus have no way of forcing anyone to make such purchases. They would have to give the banks special incentives, and the cost would be much higher.

As for institutional frameworks which might give support to the region, an assistance programme would work either bilaterally between a country and an assisting entity/ donor, or, if under the auspices of a multilateral framework, would probably be implemented by the EU, e.g. based in Brussels and with the participation of all 27 EU members, though it is highly unlikely that any other states would be involved. Any moves to include non-EU states would probably be on a ‘take it or leave it’ basis, with terms and conditions determined by the EU and little room for meaningful negotiation.

While such a framework might emerge if the downturn drags on and creates new crises, or a sudden wave of enlightened self-interest and prescient thinking strikes key EU decision-makers, as things stand at the time of writing there do not appear to be any supranational or multilateral financial support schemes in the offing that might include Black Sea countries¹⁹. During the current crisis the EU has in general treated eastern Europe (including the states of the Black Sea region) “as four groups: Eurozone members, where they intend states to back each other, without IMF help; EU members beyond the Eurozone, which will be supported in conjunction with the IMF rescue; future members which could win limited backing; and countries without membership prospects, notably Ukraine, which will receive even less attention.”²⁰. Thus even within the EU there is no institutionalized framework. and its support has come either in the form of (i) ad hoc assistance for EU members provided in conjunction with the IMF (e.g. Hungary, Romania) or (ii) implicit guarantees emanating from nebulous statements that Eurozone countries would support each other, and/or that they would support non-Eurozone EU members in need.

¹⁸ The model for this could be the dollar swap lines put in place by the US Federal Reserve for Brazil, Mexico, South Korea and Singapore in late October 2008. See “Currency swap eases emerging economy jitters”, *Financial Times*, 31 October 2008.

¹⁹ Despite this fact, there have been numerous proposals for a ‘European Financial Stability Fund’ (see http://shop.ceps.eu/BookDetail.php?item_id=1804) and for common Eurobonds (see http://shop.ceps.eu/BookDetail.php?item_id=1823). Nothing is in the offing at the time of writing.

²⁰ See Stefan Wagstyl, ‘Prospects hinge on global markets,’ *Financial Times*, 12 May 2009.

Once the markets return to functioning in a normal manner, both globally and in the Black Sea region, they will probably be more risk averse. It will then be possible to project how much ‘bottoming out’ still lies ahead, and to adopt the requisite measures and reforms needed to promote recovery, and to improve competitiveness and productivity. Once this stage has been reached, more traditional kinds of development assistance and support will probably play a role, though hopefully as time goes on they will no longer be required. As private sector risk aversion abates, private flows in the form of lending, direct investment, portfolio investment and remittances will probably pick up. However, a return to the rapid growth of the 2000–08 period would require foreign capital flows returning to the levels last seen at the peak of the boom. Such a reversal of current trends appears highly doubtful since net financial flows to emerging markets have fallen sharply, and those to ‘emerging Europe’ (including most of the Black Sea region) have dropped precipitously²¹. Furthermore, the recovery may take longer than anticipated because “recessions associated with financial crises have typically been severe and protracted, whereas recoveries from recessions associated with financial crises have typically been slower, held back by weak private demand and credit. In addition, highly synchronized recession episodes are longer and deeper than other recessions, and recoveries from these recessions are typically weak.”²²

The Evolution of Relations with External Players, and Especially Relations with the EU

From an economic perspective, the key external actors for the Black Sea region are, in order of importance, the EU, the US, China, the Middle East, and Central Asia. Of these, the EU is by far the most important actor in economic terms and dwarfs the rest. EU decisions have a major and direct impact on the Black Sea region, and often create an externality effect. Thus EU decisions have a significant indirect impact on non-EU countries in the region. Sometimes this is positive, but it can also be divisive or negative. The EU is also a critical market for the Black Sea region. It is the main destination for exports from the Black Sea region, and is its principal source of financing in the shape of lending, investment, and official assistance²³. A prolonged economic recession in the EU would have a negative effect on growth prospects for the Black Sea region, whereas a rapid recovery would be an undoubted boost.

Ever since the EU has expanded to the shores of the Black Sea as a result of the accession of Bulgaria and Romania, and the area has seen rapid economic growth, interest in the region has increased and can be expected to continue to increase. Despite the current economic crisis, and the varied interests and priorities of various EU member states, the EU and western and central European countries have steadily developed closer economic ties with the Black Sea region in recent years

21 See ‘Capital Flows to Emerging Market Economies’, IIF Report.

22 World Economic Outlook, April 2009, “Crisis and Recovery,” IMF Report, p. 106.

23 The EU is the largest external source of remittances, though Russia is far and away the largest overall source of remittances for a number of Black Sea countries.



in the process of seeking new opportunities for investment and expanding markets. In the long term this will remain an important driver of change helping to bring the Black Sea region closer to the EU. A key question concerns the terms on which this will happen, since the EU insists on ‘exporting’ its own rules, regulations and standards. In many cases the EU’s rules represent state-of-the-art best practices which allow sectors of the economy to develop and flourish with greater transparency, increased competition, clear legal frameworks, and cross-border inter-applicability. However, there are also EU practices which are discriminatory and actually create more problems than they solve, the most notorious of which is the common agricultural policy. The EU’s institutional relationship with Black Sea states has a profound effect on most of the countries concerned. Since 2000, after Greece joined the Eurozone, Bulgaria and Romania entered the EU, and Turkey became a candidate for EU membership there have been significant and positive economic developments. Trade with the EU has increased, investment has soared, and sovereign credit ratings have improved, thus reducing the cost of borrowing. More recently the introduction of the ENP has coincided with an increase in trade and investment in Moldova, Ukraine and the three Caucasus countries, although the degree of causality is open to question.

All in all the EU’s impact on cooperation in the Black Sea region has not been altogether beneficial, chiefly because its relations with Black Sea countries have developed bilaterally without taking into account the implications for regional cooperation. This, interestingly enough, is “in stark contrast to EU initiatives in other geographic regions, which were conceived from the very beginning in regional – rather than bilateral – format and have been partly institutionalized”²⁴.

The EU bilateral relationship which has turned out to be most contentious, and where the EU has been able to exercise the least influence, is the one with Russia. Although Russia’s economy is much smaller than that of the EU, and it depends on the EU for a much greater share of its trade than the other way round, Russia’s population is larger than that of any individual EU country (it amounts to nearly 30% of the EU-27 total), it is politically powerful, and it is rather disdainful about cooperation with (and even more so about integration into) the EU. While this is primarily a political question, it has obvious economic ramifications. There is also a spill-over effect with regard to other Black Sea Countries, particularly the ENP states. Closer relations between the EU and Russia would facilitate closer relations among all the Black Sea countries, while poor EU-Russia relations and political and economic distance would affect not just Russia, but would also create competing sources of influence in the case of the ENP states.

²⁴ Vasily Astrov and Peter Havlik, ‘Economic Developments in the Wider Black Sea Region’ in *The Wider Black Sea Region in the 21st Century: Strategic, Economic, and Energy Perspectives*, ed. Daniel Hamilton and Gerhard Mangott, Center for Transatlantic Relations, The Johns Hopkins University and the Austrian Institute for International Affairs, 2008, pp. 137–9.

Promoting Regional Cooperation

The issue of regional cooperation is rather unique. It represents a significant challenge in the face of the economic crisis, the influence of external actors, diverging national economies, and potentially competing agenda priorities. However, to an important extent it has already been dealt with in the context of the challenges discussed above. For this reason, and especially in view of the low level of regional cooperation, it seems more appropriate to see it as a secondary (though growing) challenge and not as a top priority.

On the one hand, the economic crisis has been an obstacle when it comes to allocating resources for new initiatives that could enhance cooperation, although in certain areas it could in fact encourage countries to pool resources, undertake joint schemes, or improve coordination in other ways. On the other hand, the European Union is the most powerful external influence on Black Sea regional cooperation, even though the EU sometimes makes a distinction between countries that are EU members or candidates, and those that are not, and at other times facilitates increased cooperation under the auspices of EU frameworks. Indeed, where there is evidence of greater regional cooperation, this tends to be incidental, either (i) emanating from a multilateral initiative inaugurated elsewhere (such as the EU), or (ii) deriving from a bilateral scheme that happens to contribute favorably to regional cooperation. However, as the energy pipelines issue has shown, bilateral (and trilateral) cooperation may exclude other regional countries and thus diminish overall regional cooperation even if it enhances collaboration among specific participants. Nevertheless, regional cooperation is becoming a more important issue since the evolution of relations among neighbours is always of relevance and there is a great deal of scope for mutually beneficial cooperation around the Black Sea, given that the starting point is on a rather low level.

One area in which there is a great deal of room for improvement is the enhancement and systematization of policy dialogue in key sectors. The current crisis has underlined the importance of a timely financial sector dialogue. There are numerous forums on a global level, although the EU dominates the debate on the pan-European level. In the Black Sea region the BSEC Working Group on Banking and Finance has conducted a regionally focused debate on a couple of occasions since the outbreak of the crisis. Its key challenge is to upgrade the level of participation and the timeliness and quality of the information exchanged within the forum so that the participants will perceive the relevance and usefulness of the dialogue, and continue to invest time and effort in the venture.

In addition to finance, sectors such as transport, energy, telecommunications, the environment and the facilitation of trade can become the subjects of debates and formal exchanges, and perhaps even coordination. 'Talking shops' for a range of sectors and issues already exist in various forms.



The most prominent of these are the approximately 20 BSEC working groups and specialized committees for key sectoral initiatives. Improving their effectiveness is an important issue, and here two of the principal challenges are maintaining their relevance and streamlining overlapping areas.

A step up from a regional policy dialogue is the adoption of more enhanced forms of cooperation such as (i) institutional measures that lead to the harmonization of legal rules and frameworks, (ii) informal or formal agreements on pursuing specific policies and courses of action, (iii) the establishment of specific-purpose institutions or organizations, (iv) the pooling of resources in order to achieve a common aim, and (v) the commitment to undertake joint projects in priority areas that may confer benefits upon all participants. Cross-border infrastructure development is an area with great potential for such cooperation.

Moreover, there is a powerful rationale for cooperation, which is the search for cost-effective solutions. The amount of funding that is needed is very high given the level of overall regional requirements, and for nearly all of the countries the mediocre or dilapidated infrastructure is a potential bottleneck that can hold up the post-crisis resumption of healthy economic growth.

E Concluding Remarks

One factor, albeit not the only one, which may determine the timing and extent of the resumption of post-crisis economic growth is the health of the financial system in Black Sea countries. Here there is cause for cautious optimism, for by and large they have avoided the worst of the turmoil in terms of insolvencies and bankruptcies, and in general the financial sector is small in comparison to Western Europe or the United States. In short, less damage has been done to the financial sector in Black Sea countries, which in any case was smaller to begin with, and has thus had a less dramatic impact on the overall economy.

If anything, the financial sector faces greater risks from the negative fall-out of the economic crisis, i.e. there may well be an increase in the number of bad loans due to the economic downturn, which in turn might put pressure on the capitalization of the banks. Another element of risk, which is most noticeable in countries where a large percentage of the banking sector is owned by foreigners, is that the foreign-based parent banks will lose confidence in the local market or face pressure to disengage. However, hitherto the opposite has tended to be true, with foreign banks re-affirming their commitment to their local subsidiaries and providing capital as well as rolling over loans.

Even if the financial sector in the Black Sea region has avoided the worst of the crisis, the region is mired in a painful economic slump and its most significant economic partner, the EU, has been hit hard by the financial turmoil. One concern in particular is the decline in revenues, which, unless it is arrested or reversed, may have adverse fiscal and debt implications in the years ahead, especially if unsustainable deficits persist and become structural in character. Furthermore, the great influence of extraneous factors generates a high degree of uncertainty concerning the long-term growth prospects of the Black Sea region. For example, one of the external risks facing the region's economies is whether or not the key decision-making countries in the world and the largest economies, such as the G20 states, can deal with the crisis and its key elements in an effective manner.

An inadequate response could result in delayed global stabilization and a level of economic activity well below the trends seen in recent years. Moreover, this would imply a 'compressed' financial sector, which in turn would signify a substantial decline in private capital flows, lower investment, lower levels of international trade, as well as restricted and more expensive financing as a result of the very large amounts of money that the governments of the developed economies would need in order to pay for their growing deficits, and possibly renewed inflationary pressures.

Nevertheless, despite the crisis and its immediate aftermath, the Black Sea region possesses a number of competitive advantages. These include (i) its proximity to the wealthy markets of the EU, (ii) the improved political and economic stability and favorable business environments, and (iii) the high quality of its competitively priced human capital (education, skills). Most countries can remember having to deal with crises during the 1990s, and this provides resilience, a wealth of experience upon which to draw, and a greater degree of flexibility in implementing policy responses than is sometimes observed in wealthier and more inflexible economies of western Europe.

Furthermore, the devaluation of most Black Sea currencies will boost the competitiveness of the region's exports, and may trigger an import substitution response from domestic manufacturers of the kind which occurred in the late 1990s in countries affected by the Russian financial crisis. These factors, combined with reasonably healthy sovereign debt situations, the high growth rates of recent years and the room for convergence with the prosperity levels of western Europe, suggest that the Black Sea region (i) may succeed in limiting some of the worst effects of the economic crisis as it 'bottoms out' and (ii) may manage to return to healthy rates of annual GDP growth within two to three years. It is an open question, and this will depend on global conditions and the influence of extraneous factors, whether such growth will be on the order of (i) 2–3% per annum, implying a slow recovery from the crisis, difficulties with the reduction of poverty rates and income redistribution to balance the gains conferred by growth, and a slow and lengthy process of convergence with western European income levels and living standards; or (ii) 4% or even higher, denoting a



return to the high growth of the 2000–2008 period, a rapid recovery in output, declining poverty levels, and a noticeable convergence with western European income levels, not to mention the possibility that the benefits of growth will be more widely shared.

Whereas the medium-term and long-term economic prospects are generally favourable as far as individual Black Sea countries are concerned, the prospects for economic cooperation on a regional basis are not nearly as promising. Beyond the prevailing external influence of the EU, which when all is said and done has hindered regional cooperation, there are lingering questions of geopolitics, and the pressures of the economic crisis. Furthermore, not only does the Black Sea region lack a strong history of economic cooperation, but it is also a diverse area in which the countries possess differing economic structures which if anything, are diverging.

There are things which the countries have in common, such as the long-term decline of the agricultural sector, the rapid growth of the services sector, and the fact that on the expenditure side the private sector accounts for most, if not all, of the incremental economic growth, led by consumer demand. However, in general terms the economies of the Black Sea region are probably drifting apart. Some are de-industrializing, while others owe much of their growth to industrial expansion. Most are energy importers, but there are also energy and (in more general terms) commodity exporters, who are increasingly dependent on these exports to fuel their growth. Even service sector growth tends to take different forms. In some cases construction and retail are more significant, though to differing degrees financial services, tourism, and transport and shipping also play important roles. This suggests that the areas of cooperation which countries will be most interested in will tend to reflect areas in which they either possess comparative advantages, or which they wish to develop. This may generate complementarities within which regional cooperation may develop, though it may also result in differing priorities.

Policy Recommendations for the Economic Development of the Black Sea Region

These recommendations are by no means exhaustive, and merely seek to give an idea of the wide range of measures that are available to policymakers as they try to improve the prospects for a return to economic growth during the current crisis.

A general rule of thumb for countries of the Black Sea region is that all of these measures should be viewed from the angle of the impact they may have on reducing country risk levels. This provides a yardstick for policymakers who are trying to assess new courses of action, since lingering high levels of risk aversion in global markets have had a particularly negative effect on Black Sea countries, and perceptions of weakness and vulnerability are exacerbated by the heightened level of risk aversion.

A Recommendations for the Countries in the Black Sea Region

1. Financial System/Monetary Recommendations

The goal is to have a sound and adequately capitalized system in which banks operate in a transparent and competitive environment.

(i) At the **systemic level:**

- Continue to enhance regulatory capabilities in order to reduce the risk of future systemic crises, and to monitor systemic and aggregate indicators;
- Establish guidelines which are both transparent and flexible in order to maintain the flow of liquidity, and ensure that payment systems are operating properly;
- As and when required, consider the adoption of prudent policies (which may well be temporary) designed to promote lending, for example, by increasing the level of deposit insurance, temporarily reducing reserve requirements, and offering guarantees for loans.

(ii) At the **individual bank level:**

- Establish stricter (greater) capital and liquidity requirements;
- Distinguish between banks which are viable and those which are not, and deal with them in a transparent, prompt and consistent manner.
 - Non-viable banks must be removed from the market and placed in either bankruptcy or special insolvency regimes designed to deal with their assets and liabilities, and then either shut them down, sell them, or restructure them without incurring expensive transactions costs.



- Viable banks should be regulated in an appropriate manner, and have (i) a clear ownership structure, (ii) appropriate capacity and governance processes, (iii) identification which loans are in good shape, which ones need to be restructured, and which ones are failing or likely to fail, for which recovery of exposures should be sought and (iv) adequate if not ample capitalization, being forced to raise equity in the markets or else accept government involvement.

2. Fiscal and Structural Recommendations

A key target must be the credibility of long-term fiscal policy, so that the markets will tolerate temporary deviations which may be required in order to mitigate the negative effects of the economic crisis.

- Articulate government expenditure priorities as clearly as possible.
- Consider measures to simplify and broaden the revenue base. When previous sources of revenue come under pressure during a crisis, this is particularly important in order to maintain long-term fiscal sustainability, and to improve the fairness of the taxation system.
- Countries with an image problem relating to deficit control and sustainable debt levels should try to achieve sizeable annual surpluses in the primary budget (before interest and debt repayments).
- Consider the appointment of an independent non-partisan fiscal review council to conduct objective reviews and assessments of budget policy and execution. Although fiscal decisions are (and should be) political, the review of fiscal decisions can be technocratic and they can be assessed against the background of stated goals and objectives. A seal of approval from an independent voice can supply additional credibility.
- Avoid excessive reliance on contingent liabilities, that is, promises which are free today, but lead to unavoidable expenditure in the future. It is essential to assess and report contingent liabilities in a transparent and open manner.
- Improve the business environment by (i) simplifying the creation and operation of firms, (ii) removing excess bureaucracy and improving the transparency and consistency of the way in which rules and regulations are applied, and (iii) facilitating the demise of non-viable firms through the creation of a legal framework for rapid debt restructuring and corporate reorganization, including bankruptcy.
- Establish specific social safety nets, within the fiscal means available, to assist unemployed workers and disadvantaged groups.

B Recommendations Designed to Promote Economic Development in the Black Sea Region Through Cooperation

- Identify sectors in which regional cooperation is both desirable and feasible. Selection criteria should include country development priorities, the need and opportunity to cooperate with other states, and cost-effectiveness. In the current crisis, the prospects for stimulus packages and short-term positive returns may be additional criteria. Promising areas include (but are not limited to) finance, telecommunications, transport, energy, and the environment.
- Since intra-Black Sea region trade, investment, and finance flows are relatively low, considerable potential exists to achieve mutual gains among the region's economies. Although free trade agreements may not be possible (given that some states have EU commitments, not to mention WTO issues), trade facilitation activities, investment agreements, elimination of dual taxation, and the abolition of visa requirements could be implemented as a way of removing obstacles that stand in the way of expansion and intra-regional economic activity.
- Identify and commit appropriate staff and officials to participate in cooperation initiatives as a part of their normal duties.
- Cooperation always begins with a dialogue devoted to exchanging information about the participants' priorities, needs, and challenges. If appropriate and desirable, it can subsequently examine (i) institutional cooperation or policymaking issues, (ii) institutional harmonization measures, (iii) policy coordination, (iv) the establishment of institutional entities for a specific purpose and/or (v) the commitment or pooling of resources to achieve certain stated objectives.



C Recommendations for a European Union Approach to the Black Sea Region

- Clarify the potential institutional confusion between Black Sea Synergy and the multilateral components of the Eastern Partnership. Where approaches are irreconcilable, prefer the maximally inclusive approach.
- On account of the strong external impact of EU policy decisions (both in a positive and a negative sense), try to systematize the policy dialogue in the key cooperation sectors. With regard to finance, this could mean a regular dialogue between the European Central Bank and certain Eurozone central banks and the central banks of Black Sea countries. A similar forum for Ministry of Finance issues might also be useful (i.e. annual meetings of ECOFIN and Finance Ministry officials from Black Sea countries to discuss issues of relevance and organize cooperation).
- Support regional cooperation initiatives, especially where local ownership exists, even if they have not been set up under the auspices of the EU.

The Commission on the Black Sea

The Commission on the Black Sea is a civil society initiative, jointly developed and launched in January 2009 by the German Bertelsmann Stiftung, Gütersloh; the Black Sea Trust for Regional Cooperation (BST - GMFUS), Bucharest; the Economic Policy Research Foundation of Turkey (TEPAV), Ankara; and the International Centre for Black Sea Studies (ICBSS), Athens.

Among members of the Commission on the Black Sea are a former vice prime minister, former ministers, current and former parliamentarians, public intellectuals and scholars from the whole Black Sea region, the European Union and the United States. The Commission's work has been supported and complemented by several individuals from different countries, who wish to remain anonymous due to their current official affiliations or for personal reasons. The names of those members who are willing to associate publicly are listed below. They all serve on the Commission in a personal capacity. Neither this report nor other publications of the Commission should be construed as reflecting the views of the states, governments, organizations or institutions with which the members are associated.

Erhard Busek

Former Vice Chancellor of the Republic of Austria; Coordinator, Southeast European Cooperative Initiative (SECI), Vienna

Sergiu Celac

Former Foreign Minister of Romania; Senior Adviser, National Centre for Sustainable Development, Bucharest

Daniel Daianu

Former Minister of Finance of Romania; former Member of the European Parliament; Professor of Economics, National School of Political Studies and Public Administration (SNSPA), Bucharest

Tedo Japaridze

Former Deputy Foreign Minister of Georgia; Alternate Director General, International Centre for Black Sea Studies (ICBSS), Athens

Suat Kınıklioğlu

Member of Parliament; Spokesperson of the Foreign Affairs Committee, Grand National Assembly of Turkey, Ankara

**Irakli Menagarishvili**

Former Minister of Foreign Affairs of Georgia, Tblisi

Rasim Musabayov

Vice-President, Centre for Economic and Political Research (FAR-centre); and former Adviser on Interethnic Relations to the President of the Azerbaijani Republic

Vartan Oskanian

Former Foreign Minister of Armenia; Chairman of the Board, The Civilitas Foundation, Yerevan

Volker Rühle

Former Minister of Defence of the Federal Republic of Germany, Hamburg

Özdem Sanberk

Former Ambassador and former Undersecretary of the Ministry of Foreign Affairs of the Republic of Turkey, Istanbul

Borys Tarasyuk

Former Minister of Foreign Affairs of Ukraine; Chairman of the Verkhovna Rada Committee on European Integration, Kiev

Mustafa Aydin

Director, International Policy Research Institute of Economic Policy Research Foundation of Turkey (TEPAV), Ankara

Armando García Schmidt

Project Manager, Bertelsmann Stiftung, Gütersloh

Alina Inayah

Director, Black Sea Trust for Regional Cooperation, Bucharest

Dimitrios Triantaphyllou

Director General, International Centre for Black Sea Studies (ICBSS), Athens

Franz-Lothar Altmann

Associate Professor for Intercultural Relations, Bucharest State University, Bucharest

Ireneusz Bil

Director, Amicus Europae Foundation of Aleksander Kwasniewski, Warsaw

Mitat Çelikpala

Deputy Dean, Graduate School of Social Sciences, University of Economics and Technology, Ankara

Johanna Deimel

Senior Expert on Southeastern Europe and Black Sea; former Deputy Director, Southeast Europe Association, Munich

Panayotis Gavras

Head, Policy & Strategy, Black Sea Trade & Development Bank (BSTDB), Thessaloniki

Peter Havlik

Deputy Director, The Vienna Institute for International Economic Studies (WIIW), Vienna

Jörg Himmelreich

Senior Transatlantic Fellow, The German Marshall Found of the United States, Washington D.C. and Berlin

Alexander Iskandaryan

Director, Caucasus Institute, Yerevan

Tim Judah

Correspondent of the Economist; Senior Visiting Research Fellow at the South East European Research Unit of the European Institute at the London School of Economics, London

Georgi Kamov

Project Coordinator at Bulgarian School of Politics; Member of the Executive Board at Economics and International Relations Institute (EIRI), Sofia



Alan Kasaev

Head of the CIS & Baltic Department, Russian State News Agency RIA NOVOSTI; Co-chairman, Association of the Russian Society Researchers, Moscow

Ian Lesser

Senior Transatlantic Fellow, The German Marshall Found of the United States, Washington D.C.

Andrei Lobatch

Senior Project Manager, Foundation for Effective Governance, Kiev

Artem Malgin

Counsel to the Rector, Moscow State Institute of International Relations (MGIMO), Moscow

Panagiota Manoli

Senior Research Fellow, International Centre for Black Sea Studies (ICBSS), Athens

Fabrizio Tassinari

Senior Fellow, Danish Institute for International Studies (DIIS), Copenhagen

Yannis Tsantoulis

Research Fellow, International Centre for Black Sea Studies (ICBSS), Athens

Andrei Zagorski

Associated Professor, Institute of European Law, Moscow State Institute of International Relations (MGIMO), Moscow

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Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
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Responsible
Armando García Schmidt

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Barbara Serfozo, Berlin

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Photo
Thomas Kunsch, Bielefeld

Address | Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
P.O. Box 103
33311 Gütersloh
GERMANY

Armando Garcia Schmidt
Phone +49 5241 81-81543
armando.garciaschmidt@bertelsmann-stiftung.de
www.bertelsmann-stiftung.de

www.blackseacom.eu

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