2009

WORLD IN CRISIS:

Security Implications and Challenges for Wider Europe

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Ivanna KLYMPUSH-TSINTSADZE,
Executive Director
Open Ukraine Foundation

Dear Guests,

We are delighted to welcome you to the Third Kyiv Security Forum!

Tackling security challenges in the midst of a crisis is a bit like putting together a political jigsaw puzzle scattered around by economic wind. It takes patience, persistence, observation and logic. And given the scope of the various crises mankind has to deal with, it will take a whole lot of team work too.

The task of putting out the economic fire and restoring global confidence is more complicated today than ever before. Yesterday's crises were mainly local; today's economic crisis is global. Those of the past tended to spill over into major wars; now, we have institutions to prevent that from happening. But how long and how well can these levees hold? That is the question.

The one thing that the international crisis has taught us is that security can be illusory and prosperity, deceptive. Billions of people around the world can tell as many stories to illustrate this simple point, and Ukraine is no exception. For a number of reasons, including inefficient governing, the country has been among the hardest-hit in Europe. It would therefore be difficult to find a more appropriate place for this forum than Kyiv: nowhere in the world were security, openness and globalization more sought after than here over the last 5 years. No one has been more hopeful for a new era and new prosperity than the Ukrainians, with their historic hunger for success and recognition. For many, these are sobering times.

The global economic crisis has defined both the international agenda and the national priorities of governments around the world. Besides the urgent need for economic and financial reform, and the necessity of tackling everyday socio-economic challenges, the crisis has also given rise to new security concerns. That is why we are attempting to put the security implications of the crisis at the centre of today's discussions: Will the emerging superpowers seize the opportunity to attempt to redefine the world order? Will the existing regional frameworks continue to provide stability and security? Will the newly established democracies of Eastern Europe, threatened with social unrest and political instability, fall prey to populist pressure? Has the crisis discredited the American Dream and the European Idea as the foundations of security and prosperity? Are democracy and freedom no longer necessary preconditions for success in the modern world? Today in 2009, these questions are all open. And I strongly encourage you to tackle them head-on, although I truly hope and believe that freedom and democracy will win in the end.

The transition economies of the Black Sea-Caspian region and even the more stable economies of some EU members have been hard-hit by the crisis, and through the Kyiv Security Forum we want to make sure that these important regional voices are heard. Furthermore, in today's globalized system, any search for durable solutions requires the participation of a range of sectors and types of institutions. We firmly believe that governments are not the sole guarantors of the stability and prosperity of nations. That is why the Kyiv Security Forum operates as an informal platform where various actors can contribute their ideas on making wider Europe a more secure region.

It takes courage and persuasion to think outside of the box and propose new solutions to highly complex security issues. Open Ukraine is committed to serving this purpose, and it employs all available means to provide platforms for fresh and unbiased thinking. This year we have commissioned four position papers for the Forum. These papers provide an analytical overview of the major economic, social, political and security implications of the global crisis. While not exhaustive, they raise key questions in each of these areas. They are intended as starting points for discussions; speakers and participants are welcome to challenge their conclusions. You are all invited to express innovative ideas and to engage in constructive debates on practical responses to the challenges discussed at the Forum. We hope to foster a better understanding of the current situation, and to help put together a tool-box of instruments to mitigate the impact of this crisis.

For the Third Kyiv Security Forum, the Open Ukraine Foundation is proud to have established strong partnerships with European partners. I would like to take this opportunity to express our highest appreciation for the support and assistance provided by Chatham House and the European Policy Centre. It has also been a privilege for us to work with and receive financial support from the Black Sea Trust of the German Marshall Fund, Polish Aid and the Friedrich Ebert Foundation, without whose engagement and support this endeavor would not have been possible.

I wish you all dynamic and stimulating discussions.

Thank you.

Economic Crises and Regional Security: What Do We Know about the Past and What Does it Mean for European Regional Security Today

Stephan De Spiegeleire[1]
The Hague Centre for Strategic Studies

The current millennium is off to a rocky start. Even before it properly started excitement about the joyous event was interlaced with concerns about a potential major security threat – the 'Y2K crisis', also known as the millennium bug. This crisis fortunately turned out to be a non-event. But very soon relief about this false alarm mutated into genuine fear as the start of the first decade unleashed a spectre of frighteningly real global hyperterrorism (and its – in many ways almost as discomforting – policy responses) around the world. That first decade is now drawing to a close with a spectacular financial-economic storm, the true implications of which may not yet be visible.

In a real storm, people's first reaction is typically to take shelter against the unleashed forces of nature. When the storm appears to subside, the survivors start climbing out of their shelters, happy to emerge unscathed but surprised to find a barely recognizable landscape. The full impact of the storm, however, often takes awhile to sink in or even to become visible. And more people typically die after natural calamities than during – due to lingering debris, medical emergencies, social disruptions or various other ripple effects.

A similar 'delayed reaction'-dynamic may still apply to the global financial-economic storm the world has just survived. At first, countries (at least those who could afford it) took shelter behind enormous national rescue packages, the price of which remains to be paid. We seem at this very moment to be witnessing a return to sluggish growth, but the world is far from returning to 'normal'. As an article in The Economist recently wrote: "Many of the sources of today's growth are temporary and precarious... Across the globe spending is being driven by government largesse, not animal spirits. Massive fiscal and monetary stimulus is cushioning the damage to households' and banks' balance-sheets, but the underlying problems remain.... The world economy may see a few quarters of respectable growth, but it will not bounce back to where it would have been had the crisis never happened[2]",

And what will be the real security debris from this economic crisis? Is it possible that, as in an actual storm, real – maybe even larger – security dangers still lie ahead? This paper will address this basic question in 4 steps. First, it will summarize what we have learned about the historical link between economic crises and security. It will then describe the fundamental security trends of the past few decades – a historically quite remarkable success story on both the economic and security fronts that in many ways is not fully appreciated. The third section will assess how the current economic crisis may affect this positive historical trend. It will describe 4 concentric 'security' rings in and around the European Union that each has its own respective security dynamics after the crisis. Finally, the paper will end with some tentative policy implications for Europe, Ukraine and international organizations.

What do we know about the historical impact of economic crises on security?

The gap between economics and security

The deep linkages between economics and security remain poorly understood.

The deep linkages between economics and security remain poorly understood. At an intuitive level, it is generally understood that the two are intricately connected, but our knowledge about these precise interlinkages remains patchy at best. Much of this remarkable ignorance has to do with the various stovepipes that bedevil most communities that are engaged in these matters. In **academia**, economists and international security scholars may as well live on different planets. Economists have generally[3] not been very eager, to put it mildly, to complicate their elegant models with messy variables such as domestic, let alone international, politics. The international security crowd has been quite isolated even within the political science community, let alone the broader social science community – both methodologically and substantively. In the **policy** world, we find a very similar chasm, with unjustifiably deep cleavages within our national bureaucracies between the departments dealing with domestic issues (including 'homeland security') and those responsible for external affairs (including 'external security') – a division that globalization, both in economic and security matters, has increasingly made irrelevant, not to mention counterproductive. Enormous cleavages also persist within the outward-oriented parts of government – with frequent 'food fights' between our military, development aid and more traditional diplomatic structures. The same can be said for our **international institutions**, where until quite recently the most powerful and plentiful international financial and economic institutions (IMF, World Bank, OECD) shied away – and were often even explicitly prohibited – from touching anything that had to do with 'hard' security. At the same time, our very few 'hard' security organizations (especially NATO, but to some extent even the EU's ESDP[4]) have little or no affinity with international economics and seem – unlike their economic colleagues – predominantly stuck in the 'fire-brigade' model of international security assistance as opposed to building forward (security) resilience. They like to see themselves as the knights in shining armour who come in, take over, 'solve' the security problem, and then hand over the 'steady state'-issues of those countries (governance, economic development, etc.) to their colleagues. Truly pervasive (as opposed to punctuated) and comprehensive (as opposed to stovepiped) approaches to security problems remain extremely rare.

A number of trends now seem to be converging to bridge this gap. **Policy reversals** (some would say debacles) on both sides of the gap play a dominant role here[5]. In the security field most key actors are now recognizing in places from Columbia and the Balkans all the way to Afghanistan that truly comprehensive[6] approaches are needed to tackle the systemic fragility of a number of countries. That applies at the national level in those countries that try to actively contribute to international stability, where new interagency (in rare instances even truly entire government) coordination schemes are seeing the light of day. It also applies, however, to the international organizations that are starting to recognize that they need each other's expertise (and – importantly – that they each miss some important elements[7]). For the first time, we are starting to see a greater effort to harness the insights of all academic disciplines, rather than just defence or international security expertise, for the international community's security policy purposes. On the economic side, the current world crisis is triggering a fundamental rethink of the entire discipline of economics, one aspect of which includes an increasing openness to insights and methods from other disciplines.

But the gap, and the turf battle-mentality, is still very much with us. And so at this very moment when we need this integrated knowledge about the pathologies, diagnoses and pathways out of comprehensive 'fragility' more than ever, we unfortunately have a quite fragmented understanding of the systemic linkages between the islands of knowledge we do have. In order to assess where we stand in this area, The Hague Centre for Strategic Studies (HCSS) recently completed a study for the Dutch government[8] in which we synthesized what the scholarly and expert communities have learned about the consequences of economic crises on international security. To this end we analyzed over 100 analyses that specifically addressed this issue – 67 peer-reviewed academic sources and 42 analyses by policy experts. The following section of this paper will summarise what came out of this analysis.

What do we actually know? – Meta-analysis of existing studies

Little serious research

A first remarkable finding – very much in line with the stovepipes between 'security' and 'economics' that were just described – is that the number of studies specifically devoted to this topic is surprisingly small. After inspecting a vast array of literature on economic crises throughout the ages – from the Dutch 'Tulip Bubble' of 1637 to the present day global economic crisis – HCSS found that the bulk of the academic literature focuses on the inverse relationship: how international security affects economic performance. Our comprehensive search on all existing full-text academic databases did, however, identify 67 peer-reviewed academic articles (1943-2009) as well as 42 more policy-oriented sources containing expert opinion (1996-2009) on this precise topic[9].

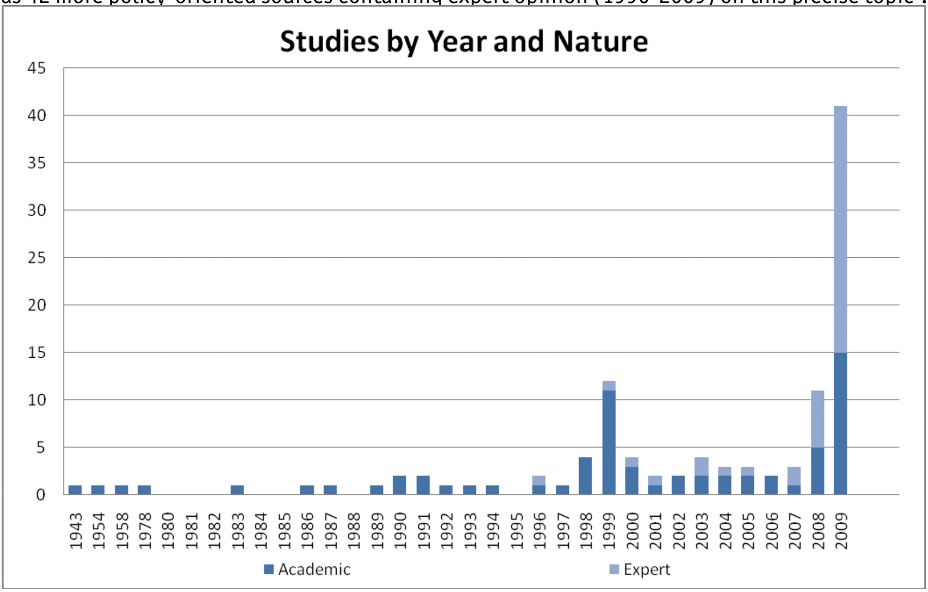


Figure 1 Trends in Studies on the Security Implications of Economic Crises

Figure 1 clearly illustrates that the security implications of economic crises have not received much attention in the specialized literature. We discern a very modest increase in interest in the topic after the end of the Cold War with peaks in periods of real economic crises such as the Asian Financial Crisis[10] (1998-1999) and the current crisis (2008-?).[11] We also observe that recent insights on the security implications of economic crises largely stem from expert opinion-based studies (what we would call 'публицистика' in Russian). Whereas some of these analyses can be quite perspicacious they do – as a rule – tend to be heavier on political pathos than on systematic analysis. In summary, we have to conclude that our knowledge on this issue remains incomplete. While much research is currently underway, the insights of this work are likely to be of more use for a subsequent crisis than for this one.

Three consistent consequences

Let us take a closer look at what these studies actually say. We will focus on the most 'consistent' findings – i.e. the security-related consequences of economic crises that are mentioned in the largest number of studies on this topic. Figure 2 provides an aggregated view of the security implications identified in the studies and their frequency of occurrence in both the academic and expert literature. They are presented in descending order and clearly illustrate that three security consequences really leap out from the literature:

- A shift in balance of power,
- Reduced defence spending, and
- Internal instability & political/social unrest.

These three will be described in more detail after the presentation of the data.

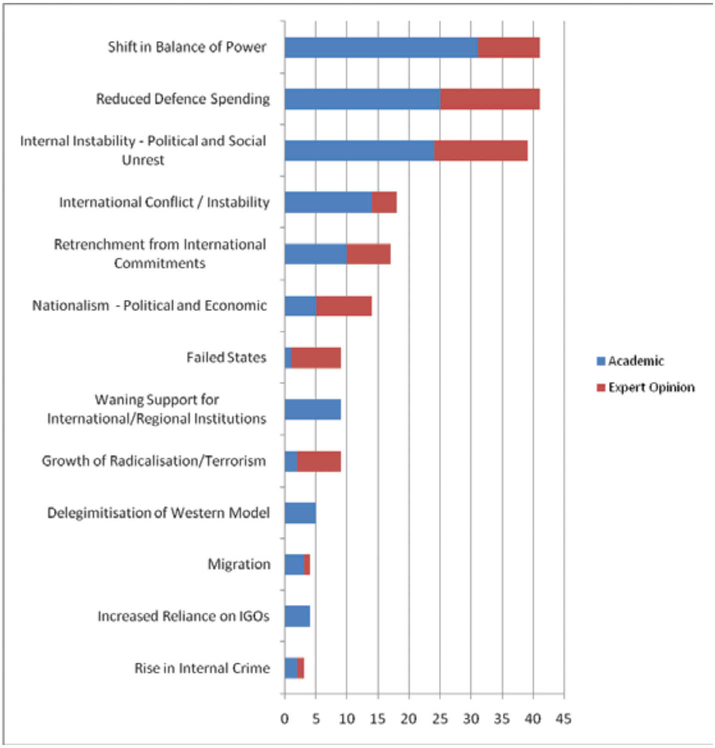


Figure 2 Frequency of Implications in Academic and Expert Literature.

Figure 3 depicts the same data but broken down over time. The size of the circle corresponds to the number of studies (the more studies, the bigger the circle), and the shades of blue represent the relative percentage of academic studies (the darker the shade, the more academic the study).[12]

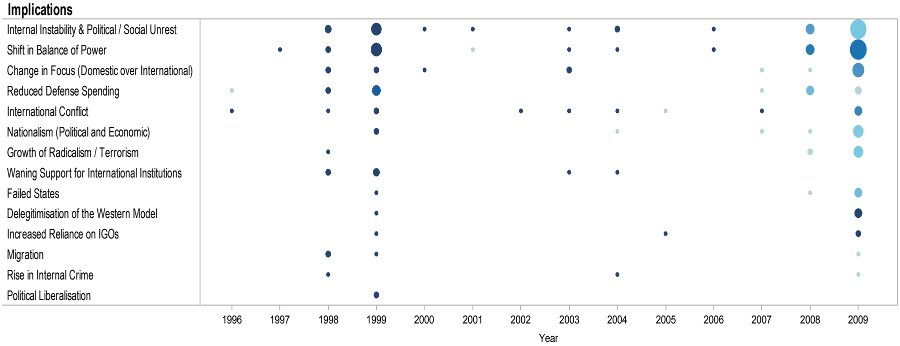


Figure 3 Yearly Trends in Studies by Implication (1996-Present).

Encouragingly, the implications that receive the most attention during periods of crises are quite similar to those that are discussed outside of such periods. In the latter studies, the discussion generally revolves around domestic instability and shifts in balance of power, whereas during times of crises, the range of implications is broadened. Failed states, nationalism, and growing support for radicalism/terrorism receive a great deal of attention in the current expert discourse[13], whereas other implications have robust academic support for the period between 1996 and 2009 (e.g., shift in balance of power). Delegitimisation of the Western Model is cited only in academic sources and only in periods of crisis. The absence of this implication during non-crisis years may suggest that displeasure with the Western model could be a transitory phenomenon[14].

Shifts in the balance of power

Power shifts can manifest themselves instantaneously, but they more commonly emerge gradually over a longer period of time

The first robust finding (and clearly the leading one in the academic literature) is that economic crises affect the balance of power – both regionally and globally. Economic crises create relative winners and losers. They also generate new threats and opportunities that the 'winners' of the crisis can attempt to capitalise on. Such power shifts can manifest themselves instantaneously, but they more commonly emerge gradually over a longer period of time as it becomes evident who the real winners and losers are. The combination of growing fiscal constraints with a more inward focus causes status-quo powers to retreat from their normal levels of outward engagement. While this need not result in full-blown isolationism (although it clearly can do so – as was the case during the interbellum) a number of stricken states may find themselves in weakened positions and open to challenge by regional non-status-quo powers. In cases where the leading power (or coalition of powers) is forced to retreat from its position, non-status quo powers that are (actually or imagined) less affected by the crisis may seize this opportunity to broaden their spheres of influence, leading to more friction in the system.

Changes in power shifts can also lead to an emergence of new economic and political power centres, as states gravitate towards a perceived ascendant power that has emerged from the crisis either unscathed or in an even stronger position. The ascendant state may feel confident in accepting higher levels of risk acceptance in its actions. This increases the probability of conflict and conflict escalation. The overarching effect is that economic crises alter the global distribution of power and produce more uncertainties about the future trajectory and stability of the system.

Reduced defence spending

The second consistent finding, which is as robust overall as the first, but with a smaller academic component, in our analysis is that economic crises reduce the availability of funds for defence and security – especially in the countries that are most severely affected. Emptied coffers force difficult decisions regarding how best to implement strategic plans – with both domestic and international consequences.

Economic crises reduce the availability of funds for defence and security – especially in the countries that are most severely affected

On the **domestic** side, the changed fiscal outlook of a state tends to have a strong impact on the part of the national budget devoted to national security. This pattern is of course dependent on the absence of any other overriding security concerns. As we have just seen, such new concerns may actually emerge out of the crisis itself, but they tend to manifest themselves only after some period of time. Therefore there is a serious danger of a time gap in which an already weakened potential target weakens itself even more – thereby possibly increasing the likelihood of hostile moves by non-status quo powers (a particularly pernicious variant of the security dilemma).

Democratic states tend to be particularly vulnerable to this potential danger, as the voices to sustain the standard of living of the population will tend to crowd out those arguing for sustained security efforts. This can lead to scaled back plans to modernise (or even sustain) forces as military planners can neither afford to purchase new materiel or to expand the numbers of their existing forces. Overall, falling defence spending abates military capabilities – and, importantly, it does so differentially, potentially giving relatively unscathed non-status quo powers a comparative advantage. The literature does not provide any timeline for the duration of decreased defence expenditures (i.e. whether this is directly correlated with the length or severity of the economic crisis), so a definitive long-term trend cannot be assumed.

The consequence of this reduction in security spending **internationally** is that the public good of 'international security' (e.g. through peace-supporting or even peacemaking efforts) gets provided in even smaller doses than usual. It erodes affected states' ability to project power into regions of strategic interest. This compels policymakers to reassess where and how to balance strategic risk. It also reduces their ability to meet alliance commitments and weakens their position in the international order, ultimately shifting the balance of power at both the regional and global level. Decreased military expenditures furthermore lowers demand for weapons procurement, negatively affecting receipts from arms exports and weapons transfers between allied states.

Internal instability and political/social unrest

The third consequence of economic crises that leaps out from the meta-analysis is the security effect at the state-societal level. Economic crises cause unemployment rates to rise concomitantly with lowered state expenditures for social services. This produces a dual strain on state budgets as government receipts from taxable incomes and traded goods are diminished while outlays for social security programs simultaneously increase. Prolonged durations of this predicament lead to persistent budget short falls. The literature suggests that cutting social spending programs tends to generate three potential main security effects:

- citizen discontent foments protests and riots against the government;
- crime rates track with rising unemployment rates and diminishing access to resources; and
- various cleavages within society (ethnic, religious, class, etc.) become more accentuated.

All three of these effects impose additional burdens upon the state and can challenge the government's legitimacy, leading to a potentially dangerous downward spiral. Especially when violence ensues from a government's attempts to quell social unrest (e.g. through clashes with police or other security agents) the situation may further spiral out of control. This can yield two different outcomes for change. The first outcome is a change in government and/or government structure, while the second outcome is a failed state. The key difference between the two outcomes is whether some sort of effective governing body remains in power, regardless of its form. The studies suggest that which of these two will prevail depends on a number of intermediate variables (such as the level of political stability and governing structure prior to the crisis, level of economic development, nature of the regime, extent of social cohesion, severity of the crisis, etc.) that vary on a case-by-case basis. Let us take a closer look at these two forms of crisis-induced political change and their security implications.

In the **first outcome** (**change in government**), citizen discontent may lead to either (1) an outright overthrow and replacement of the regime, (2) a gradual shift in support for an alternative regime, or (3) the mere replacement of the governing party while leaving the regime intact. In all these instances the status quo suffers a backlash from an enraged civil society but an effective government system remains or is (re-)installed. Options one and two (spontaneous regime change) have historically been routes taken in states with authoritarian or restricted democratic governments. Revolutions, coups, or peaceful abdications in the face of mass protests are the likely modes of bringing about this change. The complexity of underlying variables again complicates any predictions as to whether more authoritarian or democratic governing structures emerge from this contestation. The security implications of these regime changes are that they can produce (for better or for worse) a sudden and dramatic shift of domestic and international policy directions. By contrast, established and legitimate democracies tend to be more resilient against upheavals and follow the third path – replacing the governing party while leaving the structure intact. Replacing a governing party during turbulent times increases the likelihood of electoral volatility and can empower reactionary politicians. Although states that experience this type of backlash are susceptible to extremist or nationalistic politicians gaining footholds in the political process, they are more likely to have a constitution preventing the consolidation of power into one office. The significance of a constitution – both written and unwritten – is that it often functions to separate the powers of the state and thereby constrains policy options. This curtails the ability of reactionary politicians to drastically alter the course of the state and provides for a greater continuity of policy formation.

The second outcome, **a failed state**, is overwhelmingly cited in the expert sources and receives significantly less attention in academic sources. The pundits seem to fear that states already experiencing instability (see the intermediate variables mentioned above) before an economic crisis hits will only be further weakened by its effects. The main attributes of these states are low-level economic development, high unemployment rates, large social cleavages, and weak governments with little authority over most segments of the population. State failure, in their view, emerges along societal lines as the competition for diminishing resources increases crime and stokes societal fragmentation. Left unabated, this trend unleashes centrifugal forces which can tear apart the society. This not only precipitates the collapse of the government but also undermines the territorial control of the state. The likelihood of a failed state being left in the wake of this violence is elevated, especially if competing societal factions become increasingly polarized and entrenched. The current situation in Pakistan was cited numerous times in the expert literature as one case where this scenario is plausible. The September 11th attacks provide a lesson that even an isolated failed state can have a profound impact on international security.

Experts and scholars place greater emphasis for security implications within – rather than between – states

A final consistent finding that deserves mentioning is that our meta-analysis found that internal instability and political and social unrest is cited more than twice as much as international conflict/instability. This seems to suggest that the experts and scholars place greater emphasis for security implications within – rather than between – states.

HCSS analysis

Since we already pointed out that the literature on this issue is fairly limited, HCSS also conducted an internal separate brainstorm with both governmental and non-government experts and identified three themes that we did not find back in the studies. Particularly striking is the low number of occurrences for economic crises driving the growth of political and economic nationalism. This becomes even more poignant when considering the widely held belief that World War II was a result of fascist doctrines spurred on by the Great Depression. The likelihood of failed states and the growth in radicalism/terrorism were the remaining two areas where we were surprised by the absence of significant findings in the literature. Given the amount of attention they have received in general since the September 11th attacks, the meagre academic references to them is puzzling. Increased internal crime is an additional tenet affecting security that produced lower than expected numbers.

Putting it together: Possible pathways from economic crises to security crises

Whereas the previous section listed and described the security implications of economic crises, this section will attempt to reconstruct the implicit linkages between the various security implications that emerge from the studies. Many of these interconnections are made explicit within the literature, but a few are derived intuitively.

Economic crises produce a variety of effects that pose threats to security. While some threats originate at the interstate level, others find their genesis at the intrastate level and are then transmitted up to the international structure. Many of these threats are interconnected and parsing their relationship – given the current state of scholarship and general knowledge on the issue – proves to be difficult. As a visual aid, HCSS developed the following flow chart to demonstrate how, according to the literature, economic crises introduce instabilities into the system and in order to map their transmission through it[15].

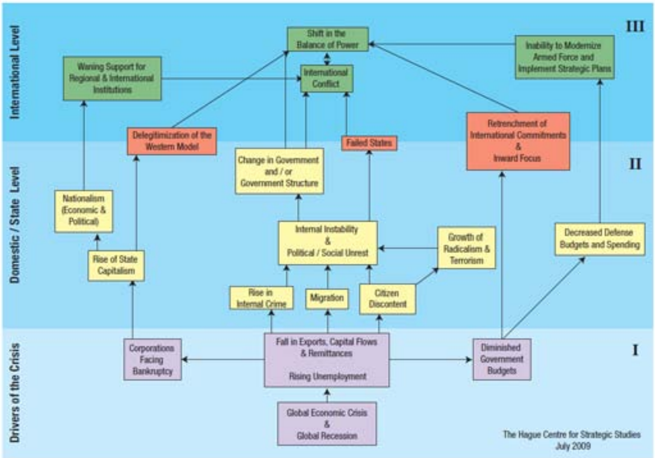


Figure 4 Pathways through which global crises can lead to insecurity

Statistical analysis of economic crises and their security implications (1800-2006)

Given the disappointing findings of our meta-analysis, HCSS decided to subject some of the key propositions derived from the literature to a battery of statistical tests[16] in an effort to verify the accuracy of the various claims regarding the security implications of economic crises. [The very fact that this has never been done in a systematic fashion before underscores our critique of the 'state of the art']. We tested the following three hypotheses:

- States undergoing an economic crisis act in a more belligerent manner[17]
- States enjoying relatively better economic circumstances lash out against those that are suffering during an economic crisis[18]
- States undergoing an economic crisis are more likely to experience domestic political instability (e.g. delegitimisation of the Western model, change in government and/or government structure, political liberalisation, etc.)[19]

Initially, HCSS performed statistical hypothesis testing the above propositions. This sort of testing examines the difference between the means of two datasets (e.g. number of wars fought per country in an economic crisis and number of wars fought per country not in an economic crisis). In doing so, the testing determines if the difference between the two datasets is statistically significant or if it is attributable to random chance. This allowed HCSS to ascertain if economic crises were legitimately associated with higher levels of conflict and political transitions. The downside to this sort of testing, however, is that it cannot determine if economic crises cause more conflict or political transitions. HCSS therefore also performed a regression analysis (either linear or logistical depending on the type of data), to establish whether the behavioural differences between states were the product of their economic climate.

Conflict proneness

The hypothesis testing performed by HCSS substantiates the claim that states experiencing an economic crisis tend to act in a more belligerent manner than if they are not. We could not, however, confirm that states in such a situation become more prone to attack. Specifically, the testing showed that states enduring a crisis instigate conflicts at a higher rate (5%), participate in more conflicts (5%), and if they engage in conflict, it tends to be more intense (21%). This, however, is the extent of the relationship. After regression testing, HCSS was unable to corroborate the notion that economic crises by themselves cause international conflicts on account of the fact that only a small portion of the data could be definitively explained by economic growth rates alone.

Instability

The hypothesis testing indicates that states undergoing economic crisis exhibit greater degrees of internal political instability (e.g. political liberalisation, transition to a more authoritarian regime, anarchy, state failure, etc.) than states in better circumstances. Specifically, those states in dire economic straits were 8.6% more likely to experience domestic political instability. Again, however, the regression testing showed that this was not a direct causal relationship since only a very small fraction of domestic political instability cases could be definitively attributed to economic crises alone.

HCSS assessment

The statistical testing confirms the suspicions identified in the meta-analysis. HCSS demonstrated that the scholars/experts are technically correct that in periods of economic crises there are moderately greater levels of international conflict and domestic political instability. The testing, however, does not corroborate that security implications are the direct product of economic crises[20].

In periods of economic crises there are moderately greater levels of international conflict and domestic political instability.

Where did we stand prior to the crisis?

The past few decades will in all likelihood be viewed by future historians as an unusually secure period in international relations. It has been widely noted that the Cold War (1945-1989) represented a historically quite unusually stable era in international relations. What has been less noted is that the post-Cold War period (1989-2009) saw an even more remarkable decline in various forms of international conflict and security fragility. In this section we will first show that the world had become more secure (both in terms of conflicts and in terms of security resilience) in this period and will then survey the three main factors that are likely to have played a key influence in this era of relative stability: 1) economic, 2) political and 3) international security factors.

Significant security gains

Contrary to popular perception, the past few decades have – by virtually all available measures –seen significant improvements in the overall global security situation. This may not fully have registered in our public opinion (especially in Europe) for a number of reasons. Conflicts – of which there continue to be many, some of which have been the most vicious variety – have become more sensationalised than ever before. The public may therefore feel that conflict is as rampant as ever – but the data we have tell a different story. Secondly, Europe's direct exposure to (and experience with) security threats has been so limited, that its sensitivity is probably higher than in any other part of the world. Europe, includingWestern, Central and Eastern, enjoyed extreme stability during the Cold War. When this sheltered Europe was once again exposed to the destructive gales of international conflict after the end of the Cold War – the Balkan wars, a number of other international crises in more distant places where it sent

Contrary to popular perception, the past few decades have – by virtually all available measures – seen significant improvements in the overall global security situation.

peacekeepers, and since 9/11 terrorism and the Western policy response it triggered – these conflicts may have registered disproportionally in the public perception. Let us therefore take a closer dispassionate look at the main trends in recent conflict and in the underlying global and regional security fragility.

Less conflict

All war and conflict datasets concur that the incidence of high-intensity interstate warfare has fallen to extremely low levels and that even intrastate conflict, while higher and more variable, has not shown any upward trend since 1980. This finding is robust across various measures of conflict or war. To illustrate: Figure 5 shows the latest data compiled by Monty Marshall of George Mason University in the US for the societal-systemic impact of wars and conflicts over time[21] and Figure 6 shows the data compiled by the Heidelberg Institute for International Conflict Research at the Department of Political Science, University of Heidelberg, just for the number of conflicts of different intensity observed in any given year.

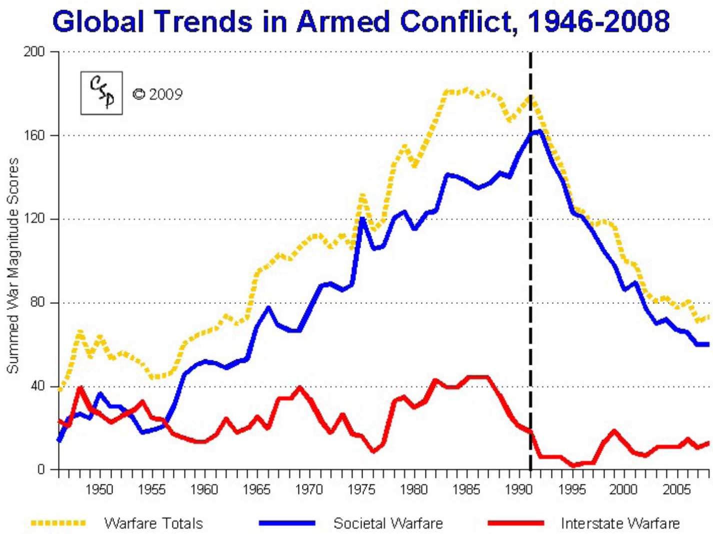


Figure 5 Global trends in armed warfare

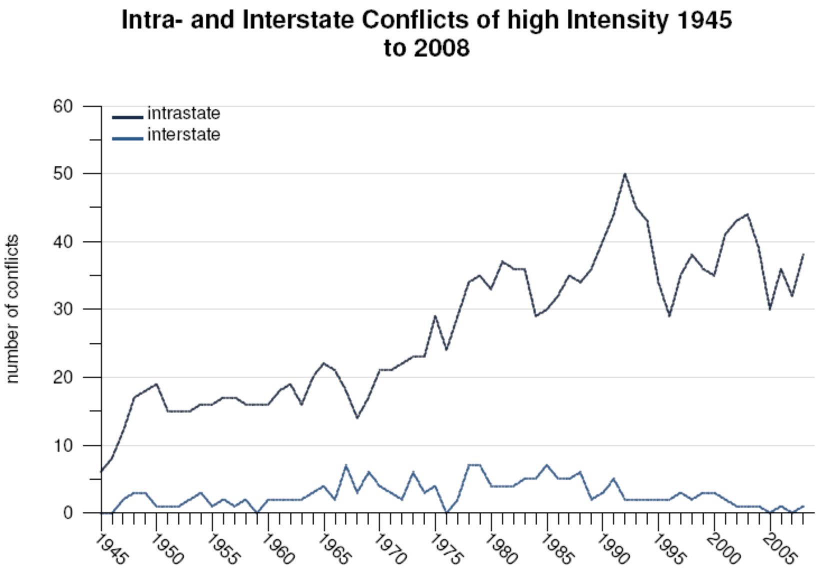


Figure 6 Intra- and Interstate Conflicts 1945-2008[22]

Resilience up, fragility down (but still there)

Conflicts are the peak events in international security, the eruptions of the volcano. In recent years, scientists and policy analysts have tried to find ways to also measure the underlying security fragilities that lead to conflict – in the volcano analogy, the underlying tectonic tensions that might lead to an eruption. The term 'fragility' and its antonym 'resilience' are relative newcomers in the security field. 'Fragile states' is a term increasingly used (since about 2006-2007) in the development community for countries facing particularly severe development challenges such as weak institutional capacity, poor governance, political instability, and frequently ongoing violence or the legacy effects of past severe conflict[23]. In this sense, the very term 'fragility' is an early indication of the international community's recent attempts to break through the stovepipes between security and economics that were described in the first section of this paper.

Fragile states are today's main 'problem children' of the international community –economically, socially, politically and security-wise. Fragile states account for one sixth of the world's population of 6.5 billion, but for half of all the world's infant deaths, and a third of all people surviving on less than US$1 a day. Despite major advances in overall poverty reduction during the past decade, progress in many fragile countries remains elusive[24]. The Global Monitoring Report of 2009 highlights the degree to which fragile states lag behind in meeting all Millennium Development Goals[25].

In many countries, fragility and conflict go hand-in-hand, reinforcing each other. Stepping out of this conflict trap remains an elusive goal for many post-conflict countries: an estimated 40 percent relapse into conflict within 10 years[26]. The president of the World Bank, Bob Zoellick, often focuses on the link between fragility and security risks: "Fragile states also run a higher risk of conflict than other developing countries. Fragility and poverty alone do not necessarily lead to conflict, but low and stagnant incomes, unemployment, and ineffective government can create an environment that sparks violence. They may increase the opportunity for predators to offer young, disconnected men the allure of achieving power and criminal gains through brutality[27]".

The datasets on fragility are much less sophisticated (and far less frequently updated) than the ones we have for economic performance or even conflict, but they nevertheless confirm a broad positive trend similar to the conflict data. Figure 7 shows the trends in fragility[28] in various parts of the world since 1997 as coded by Monty G. Marshall, Jack Goldstone, and Benjamin R. Cole from the Center for Systemic Peace and the Center for Global Policy at George Mason University. The figure shows that overall regional fragility was the greatest in non-Muslim Africa and the least in the North Atlantic area. The figure also shows that significant gains were made during the period of 1995-2008 in all regions – even if there was already a small slowing down of improvements in the post-9/11 period. It is also interesting to note that according to this coding scheme, the international fragility of the North Atlantic region deteriorated somewhat after 9/11, mostly because of the lower scores of the United States.

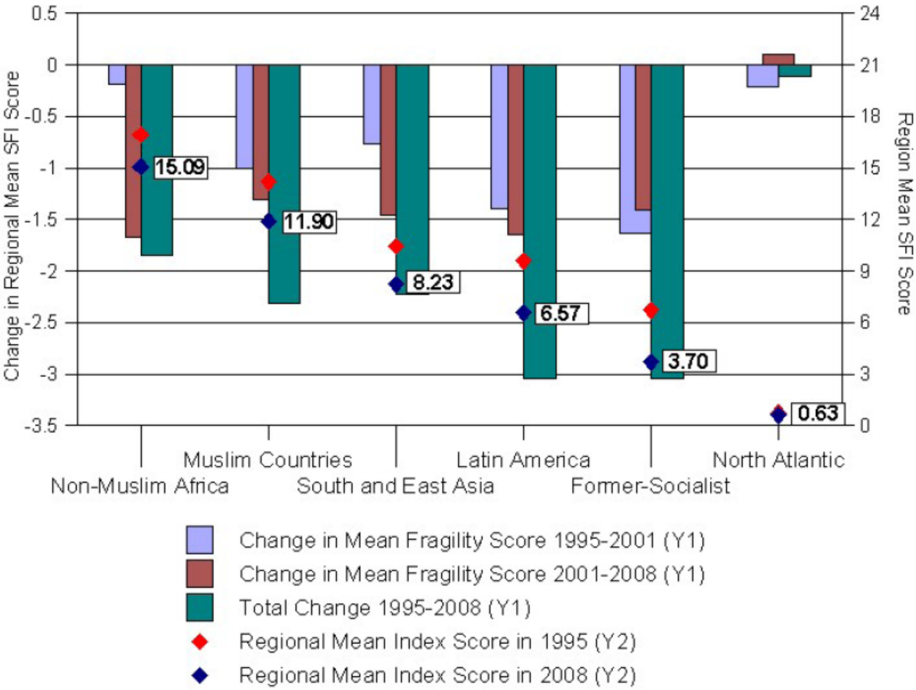


Figure 7 Changes in fragility 1995-2008[29]

Causes of the security gains

Why did this improvement in the security condition of the world occur during this period? We identify three main drivers here: 1) economic growth; 2) democratisation (democratic polities being more resilient than non-democracies); and 3) larger security efforts by the international community.

Economic growth, global trade and poverty relief

It is becoming increasingly clear, although against popular belief, that globalisation has helped to deliver extraordinary progress for people living in developing nations. The facts of a new globalization spurt in the few decades prior to the current economic crisis are uncontested. There are countless indicators that illustrate how goods, capital, and people have become more globalized:

Globalisation has helped to deliver extraordinary progress for people living in developing nations

- The value of trade (goods and services) as a percentage of world GDP increased from 42.1 percent in 1980 to 62.1 percent in 2007;
- Foreign direct investment increased from 6.5 percent of world GDP in 1980 to 31.8 percent in 2006.
- The stock of international claims (primarily bank loans) as a percentage of world GDP increased from roughly 10 percent in 1980 to 48 percent in 2006.
- The number of minutes spent on cross-border telephone calls, on a per-capita basis, increased from 7.3 in 1991 to 28.8 in 2006.
- The number of foreign workers has increased from 78 million people (2.4 percent of the world population) in 1965 to 191 million people (3.0 percent of the world population) in 2005[30].

Additionally, Central- and Eastern European countries (as well as CIS countries – the dark black line that starts in 1992) have very much been part of this trend, as illustrated in Figure 8.

Trade in Goods and Services (percent of regional GDP)

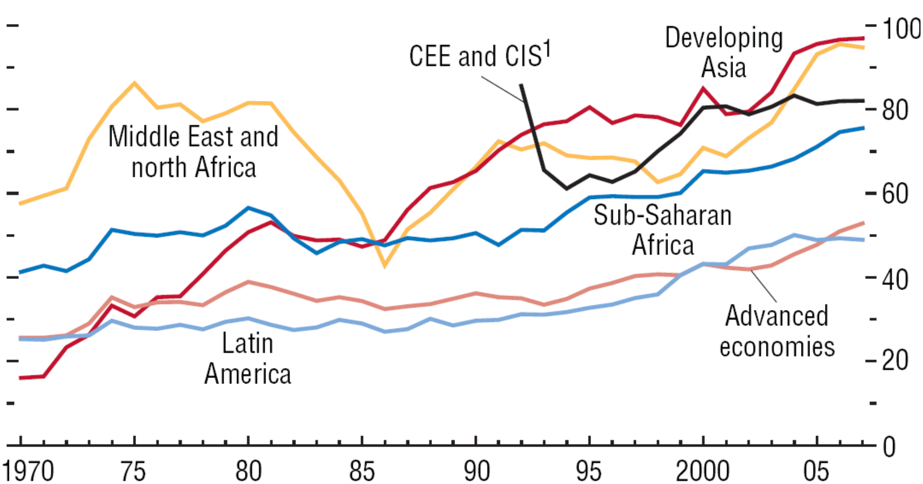


Figure 8 Trade growth 1970-2007[31]

The implications of this new globalisation spurt have been quite dramatic – even with respect to regional and national fragility. According to a few of the most authoritative studies of the subject carried out by World Bank economists David Dollar and Aart Kraay,[32] since 1980, globalization has contributed to a reduction in poverty as well as a reduction in global income inequality. They found that in globalising countries in the developing world, income per person grew 3.5 times faster than in non-globalising countries during the 1990s. In general, they noted, "higher growth rates in globalizing developing countries have translated into higher incomes for the poor". Dollar and Kraay also found that in virtually all events in which a country experienced growth at a rate of two percent or more, the income of the poor rose. It also has to be noted, however, that in this same period, income inequality has risen in most regions and countries.

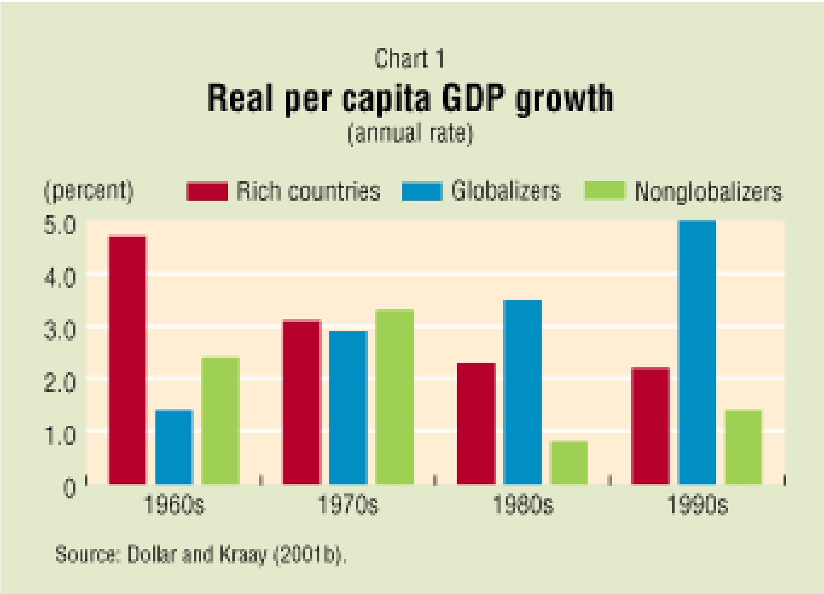


Figure 9 Globalisers have higher GDP/cap growth[33]

At the personal level, there is now substantial evidence, from countries of different sizes and different regions, that as countries become more globalised their citizens directly benefit, in the form of access to a wider variety of goods and services, lower prices, more and better-paying jobs, improved health, and higher overall living standards. It isno mere coincidence that over the past 20 years, as a number of countries have become more open to global economic forces, the percentage of the developing world living in extreme poverty – defined as living on less than $1 per day – has been cut in half.

But in relative terms, globalisation has been kinder to the relatively well off (especially to those with higher skills) than to the poor. So while the poor were seeing significant increases in their personal income levels, often lifting them above poverty thresholds, incomes for the relatively well off have increased at an even faster pace – thus leading to an increase in income inequality in most regions and countries. Turning our attention to Central and Eastern Europe, we see that – again against popular regional perception – income inequalities are large, but still significantly smaller than in many other parts of the developing and emerging world (and at a 'safe' distance from the truly fragile states).

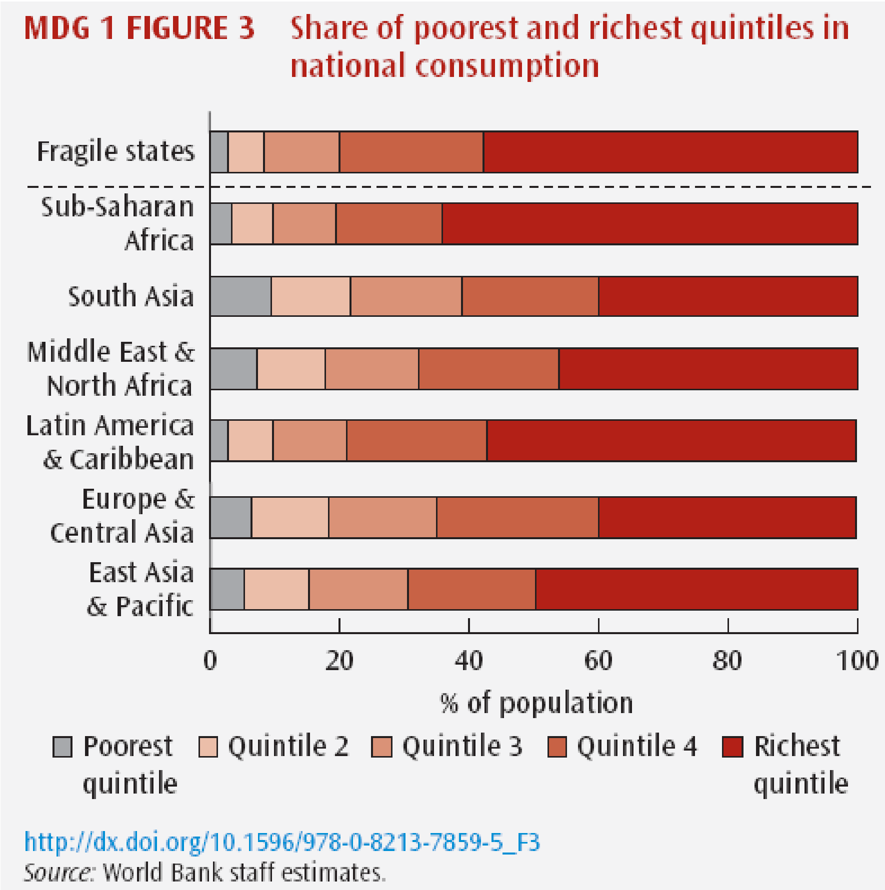


Figure 10 Inequality across regions[34]

Democratisation

A second historically unique feature of the past few decades that may have contributed to global security improvements was the dramatic increase in the number of democratic states within the international system. The Polity IV dataset[35] – to date the best coding scheme for the authority characteristics of states in the world system along a continuous scale ranging from fully institutionalised autocracies through mixed, or incoherent, authority regimes (termed 'anocracies') to fully institutionalised democracies – shows a dramatic increase in the number of democracies, an equally dramatic decline in the number of autocracies, and a stable number of 'anocracies'.

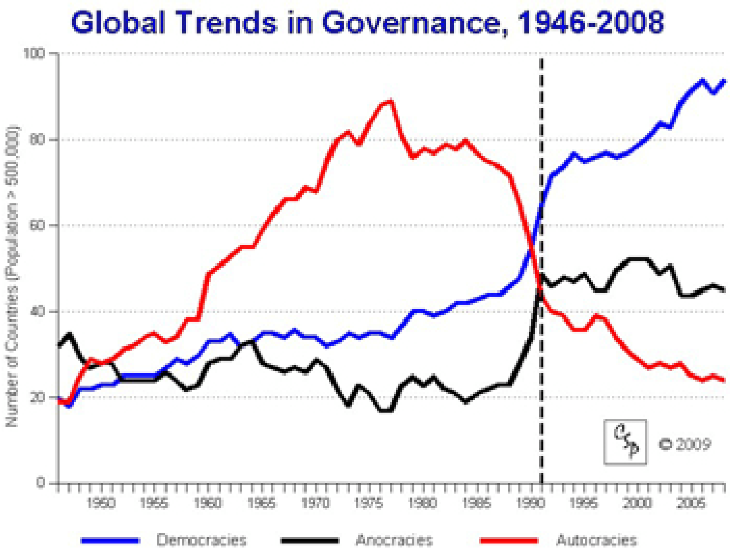


Figure 11 Global trends in governance (1946-2008)

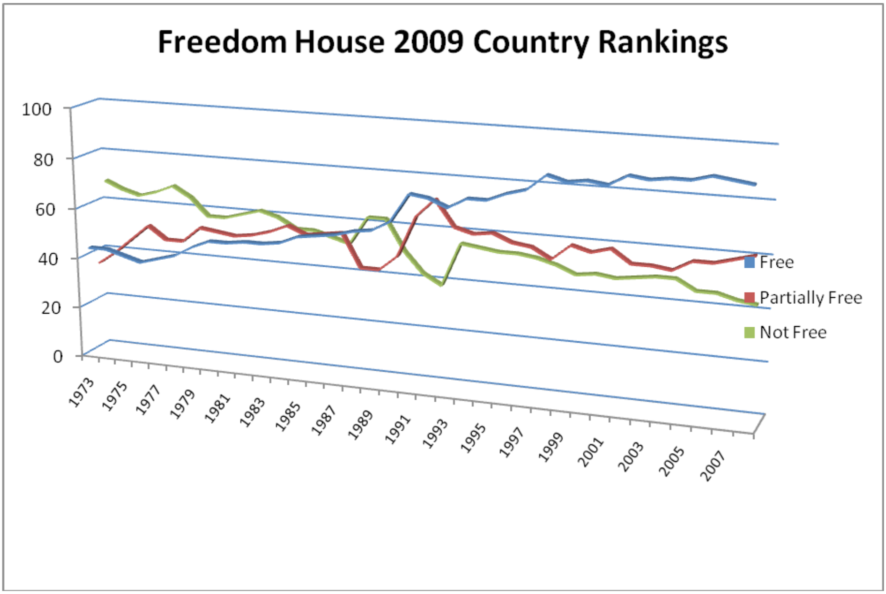


Figure 12 Freedom House Freedom Rankings (1973-2008)[37]

The Freedom House data set – using a somewhat different coding scheme – also confirms that the number of democracies has increased steadily over the past few decades. They do, however, note a modest retreat since 2006 (which seemed to slow down in 2008), with the biggest reversals occurring in sub-Saharan Africa and the non-Baltic former Soviet Union[36].

Democratisation has been on the rise for some time now, even though recent trends are somewhat more ambiguous

Both data sets show that democratisation has been on the rise for some time now, even though recent trends are somewhat more ambiguous[38]. This finding is important for security as well, because we know that democracies (and autocracies) are less likely to lead to manifestations of political instability than anocracies.

Provision of international security

The third important contributing factor to the increased stability of the past decades was the fact that the provision of the public good of international security, while often decidedly suboptimal, was still higher in this period than ever before. The most dramatic illustration of this is contained in the data of UN peacekeeping missions[39]. It is clear that many tragic conflicts around the world remain woefully unaddressed by the international community, but the overall trend – as depicted in Figure 14 - was still highly encouraging. It may also be worthwhile to point out that there is significant evidence that UN peacekeeping, as opposed to non-UN peacekeeping, actually works[40].

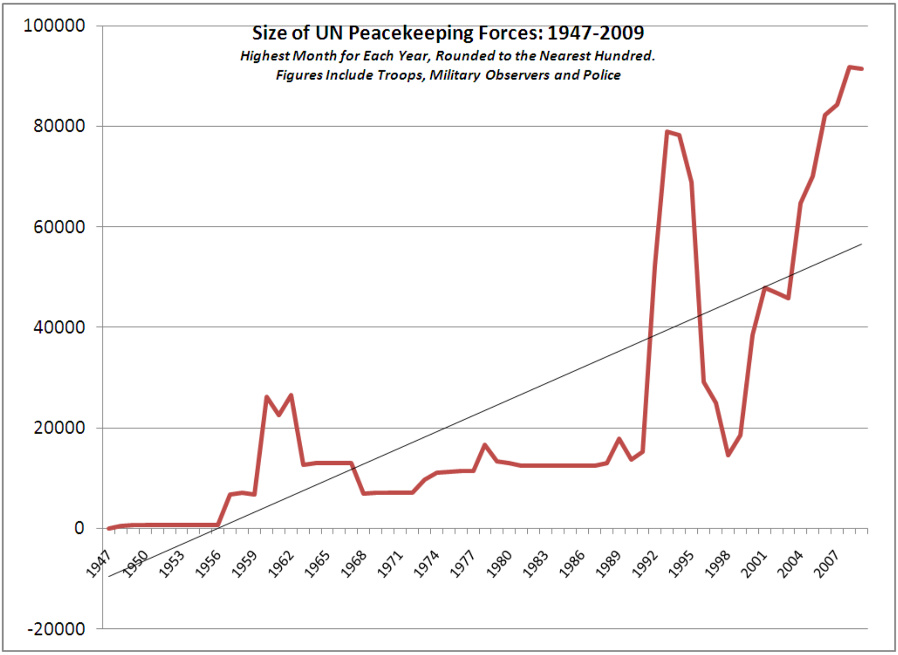


Figure 14 Size of UN Peacekeeping Forces (1947-2009)

Impact of the economic crisis

The economic crisis may be affecting all three above-mentioned drivers that are behind the relative stability of the past decades. Unfortunately, we do not have datasets of the same quality for the political and security drivers as we do for the economic drivers. But what we do know is that, for the first time in at least 25 years, world trade seems to be stalling (Figure 11), leading to new vulnerabilities across the globe (Figure 12) that could jeopardise some of the enormous gains – also in security – that have been made over the past few decades. It is important to highlight that the picture that emerges is not entirely bleak. The 2009 Global Monitoring Report, for instance, which reports on progress towards the Millennium Development Goals, clearly states that "although the first goal of halving extreme poverty by 2015 from its 1990 level is still reachable based on current projections, risks abound", We also find pockets of resilience in the economic realm even in a number of unexpected places – because we are looking for them.

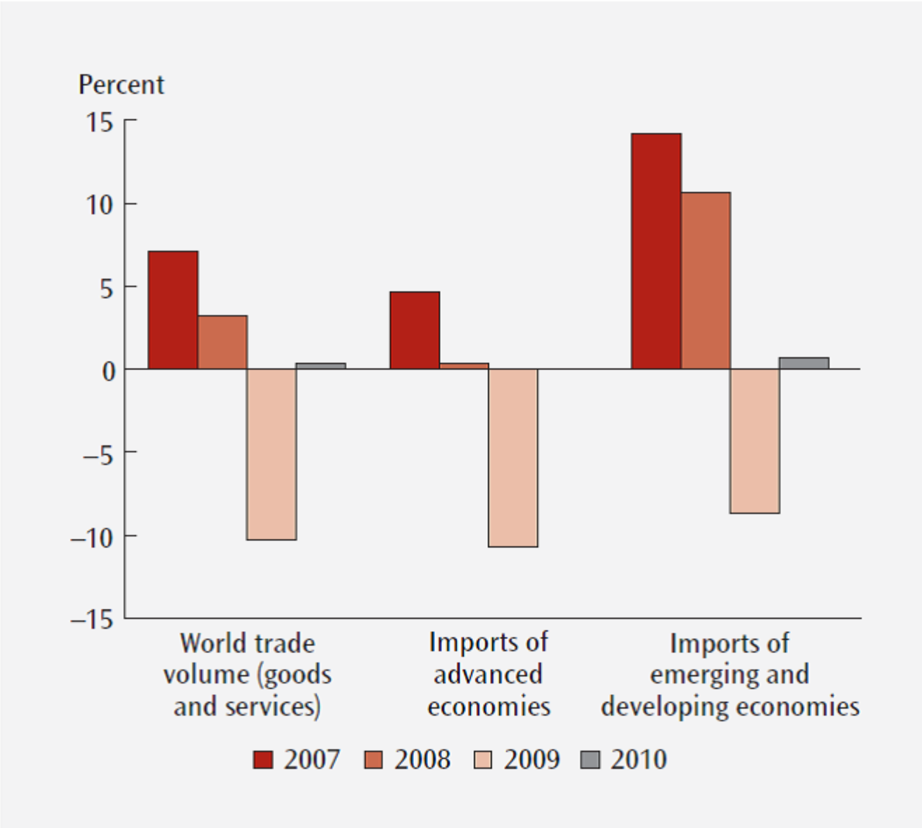
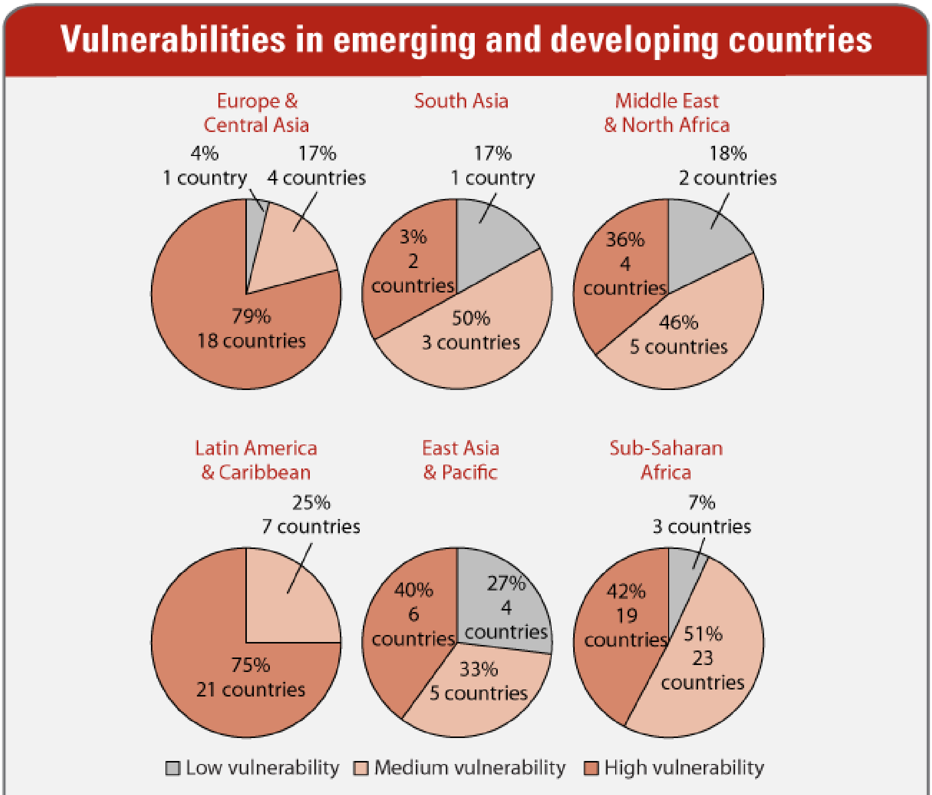


Figure 15 World trade in goods and services[41]



Source: Source: IMF.
Note: Vulnerabilities are measured on the basis of developments in exports, foreign direct investment, remittances flows, external debt ratios (emerging markets), and aid flows (low-income countries). For a detailed explanation of the methodology, see IMF 2009.

Figure 16 Increasing vulnerabilities

What then are the implications of all of this for European security today? This will be addressed in the next section.

The Impact of the Crisis on European Security – 4 Concentric Rings

Europe's current security environment can be seen as consisting of 4 concentric rings around the European Union (in which, for simplicity's sake, we also subsume the non-EU members that belong to EFTA). The rings are not strictly geographical, but rather four rings of declining resilience as we move away from Europe. Each ring has its own distinct security issues, and we will try to analyse how the current financial-economic crisis is likely to affect the security situation in all 4 rings. We immediately want to point out that there is no Greek tragedy quality to any of this. None of this is inevitable and much will depend on policy choices made by the key actors. But it may be useful to at least point out some of the potential dangers ahead in these four zones.

The Outer Ring – Fragile States

The outer ring consists of a large number of fragile states that have just in the past few decades reached some semblance of local/national/regional security resilience because of a combination of poverty alleviation/economic development with – in a number of conflict-ridden areas – direct international security support. As noted above, we know that the fragility of a number of states in this area improved over the past decade, even if progress slowed down somewhat after 9/11 (Figure 6). What we do not know is to what extent that improved security resilience will prove sufficient in light of the significant negative impacts these countries are enduring as a result of the world economic recession.

Figure 17 plots declines in GDP for both emerging/developing countries and advanced economies. It illustrates, just like in advanced economies, a large drop in GDP in this outer ring but unlike the advanced economies, there is still continued positive growth. Given the problems these countries are facing, it is questionable whether these modest growth rates will prove sufficient to ward off any further fragilisation – this also pertains to the security field.

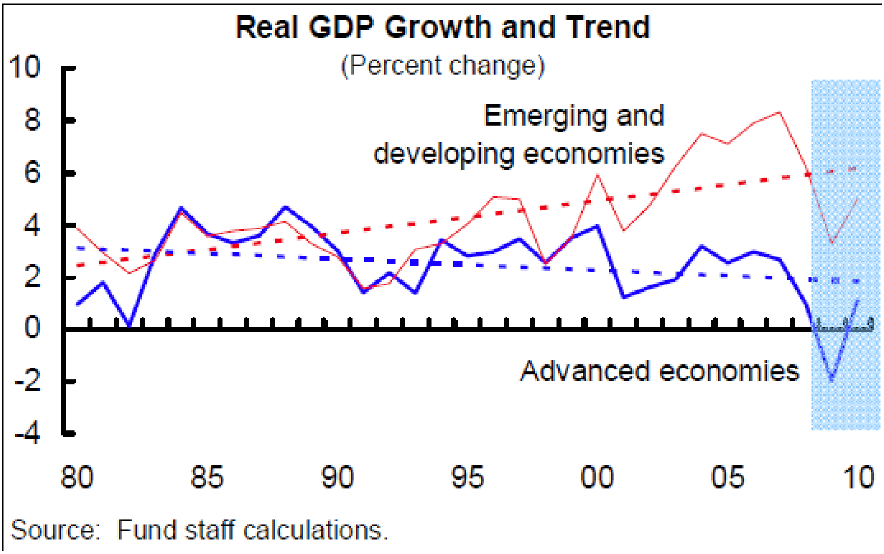


Figure 17 Real GDP growth and trend (% change)[42]

Many of the lowest income countries, especially in particularly conflict-prone regions such as Africa and the Middle East, never had much financial or administrative capacity for countercyclical measures. What little they had in place had furthermore already been severely weakened by the 2007-08 spike in global fuel and food prices. These countries have also been particularly badly hit by the dramatic recent decline in commodity prices (see Figure 18, which decreased their main export revenues. All other forms of income (remittances, foreign direct investment (FDI) and aid flows) are equally suffering sharp decreases – leading to severe strains on their economic and political stability[43]. The World Bank now estimates that the current global recession may put at risk core development aid spending of $11.6 billion (equivalent to about 1.1 percent of GDP) in the poorest countries in 2009. This confirms the finding in our literature review that countries tighten their budgets, including funds for development aid, as they struggle to rebalance their books after a crisis. Fragile states, including those in SSA and those emerging from conflict, account for 58 percent of this $11.8 billion[44]. The current economic crisis may thus very well re-fragilise the world's poorest and most vulnerable countries, leading to humanitarian crises and increased political instability in that part of the world that could spill over into renewed intra- or inter-state conflicts.

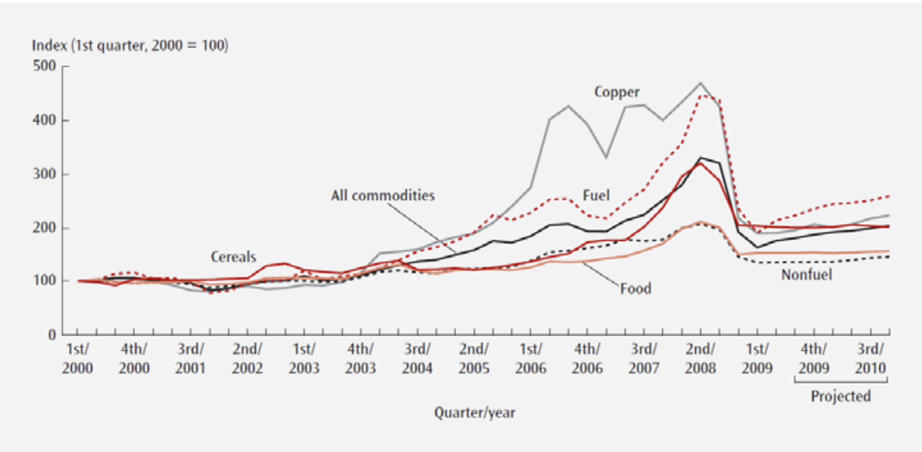


Figure 18 Commodity price indices (in USD)[45]

Figure 19 shows countries with extreme fragility: Somalia, Sudan, Dem. Rep. of Congo, Afghanistan, Chad, Myanmar (Burma), Nigeria, Rwanda and Sierra Leone. Even a cursory glance at a map reveals that most of these countries are at a relatively safe geographical distance from Europe, although significantly closer to Europe than to the United States or China.

Figure 19 State fragility index - World

The 2009 Global Monitoring Report by the World Bank and the IMF states clearly shows the potential dangers the current crisis carries for this part of the world: "[w]e are in the midst of a global financial crisis for which there has been no equal in over 70 years. It is a dangerous time. The financial crisis that grew into an economic crisis is now becoming an unemployment crisis. It risks becoming a human and social crisis—with political implications. No region is immune. The poor countries are especially vulnerable, as they have much less cushion to withstand events. This poses serious threats to the hard-won gains in boosting the economic growth of many developing countries, especially in Africa, as well as achieving progress toward the Millennium Development Goals (MDGs). It also poses a threat to global recovery, because developing countries can provide a growth platform to help the global economy pull out of the crisis[46]". We would immediately add that it also jeopardises international security.

For a long time the developed world essentially ignored most of those crises in complex and dangerous faraway countries, even those with which – at least in the case of Europe – it often shares troubled colonial histories. Beginning near the end of the previous millennium this neglect, whether benign or malign, started coming to an end. Economic globalisation began to spill over into security globalisation, as an ever more prosperous international community became increasingly involved in peacekeeping and even peacemaking across the globe. In the beginning of this millennium, Al Qaeda provided an even stronger push to security globalisation by putting the spotlight on some of the world's 'black holes,' even to the point of triggering muscular interventions in some of the most fragile parts of the globe.

The two main security challenges in this zone to emerge from the current crisis will in all likelihood be:

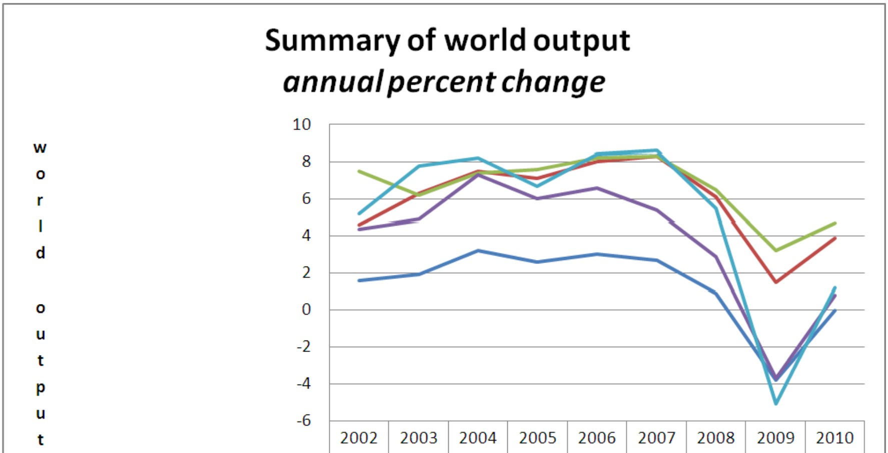
- the further fragilisation of a number of already fragile states, and/or
- a re-fragilisation of some states that had begun to acquire some security resilience

Security challenges in this outer ring are therefore face a high likelihood of increase.

The Second Ring – Europe's Direct Neighborhood

The second ring represents Europe's direct neighborhood – what some have called its 'Near abroad'[47]. In an arc ranging from Belarus, Ukraine, Moldova, and Georgia over Turkey to Egypt and Northern Africa, Europe's neighbors are also likely to be severely affected by the global crisis. While possessing significantly higher resilience than the 'bottom billion[48]'-countries, these countries are still emerging from a number of development issues that remain potentially rife with security problems.

If we just focus on the European Union's Eastern neighborhood, we observe that regional output in Central and Eastern Europe has plummeted deeper than any other part of the world (Figure 20). Whatever had gone right in certain parts of this zone during the past few decades apparently still obscured a number of more structural issues that the crisis now emphasizes.



	2002	2003	2004	2005	2006	2007	2008	2009	2010
Advanced Economies	1,6	1,9	3,2	2,6	3	2,7	0,9	-3,8	0
Emerging markets	4,6	6,3	7,5	7,1	8	8,3	6,1	1,5	3,9
Other developing countries	7,5	6,2	7,4	7,6	8,2	8,3	6,5	3,2	4,7
Central and Eastern Europe	4,4	4,9	7,3	6	6,6	5,4	2,9	-3,7	0,8
Commonwealth of Independent States	5,2	7,8	8,2	6,7	8,4	8,6	5,5	-5,1	1,2

Figure 20 Summary of world output (annual percent change)

The crisis has especially been brutal on the region's financial sector, leaving it in dire straits. Figure 21shows the enormous debt burden that the region international financial institutions now call 'Emerging Europe and Central Asia' will confront in 2010.

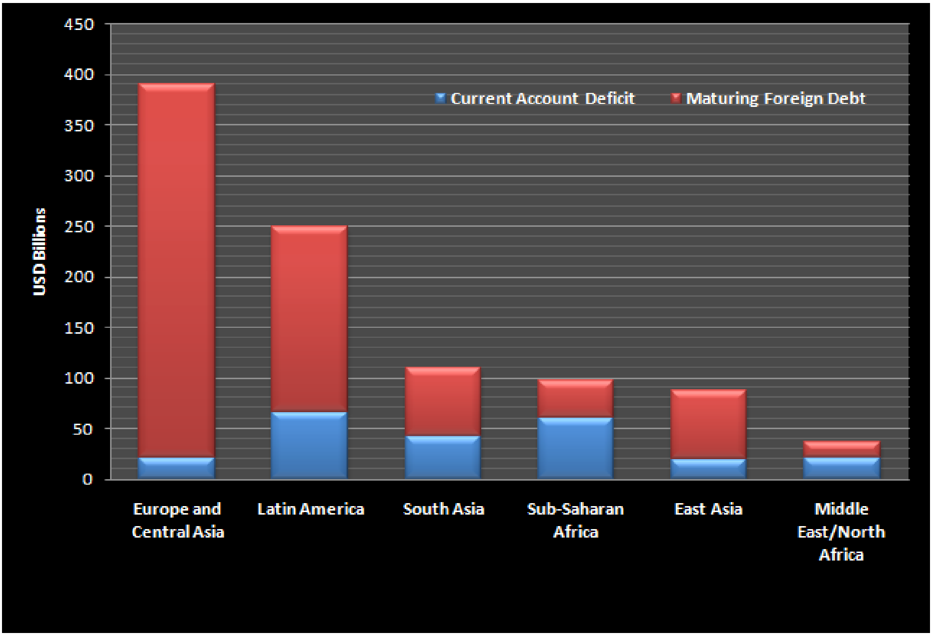


Figure 21 More than $350 billion of ECA's foreign debt matures in 2010

The financial crisis in this zone is also increasingly spilling over into a social and human crisis, as families are starting to feel the rises in unemployment and to have trouble making ends meet. According to The World Bank: "Today, rising poverty and unemployment are pushing households into poverty and making things even harder for those already poor. Already, unemployment in the region has increased from 8.3 million in 2008 to 11.4 million in 2009. Also, poverty is growing. Instead of falling by 15 million in 2009 as projected before the crisis, the number of people who are poor or vulnerable to poverty is expected to rise by about 15 million… The post-crisis world is likely to be more competitive. The very high inflows of capital of previous years are not likely to return to the same levels. Adjusting to this world will be a challenge for many countries in the world and certainly in the region".

The IMF's most recent Regional Economic Outlook for Europe is also quite somber about the region's prospects: "Emerging Europe is likely to face higher risk premiums and a more volatile environment in the aftermath of the financial crisis", "Emerging economies are expected to recover more strongly than advanced economies, with the notable exception of emerging Europe and the Commonwealth of Independent States, and this should support employment growth. In emerging Europe, the employment adjustment has been severe, and labor market flexibility will be key to the necessary reallocation and future job creation". "In emerging Europe and the CIS, the recovery may lag because of tighter external financial constraints that are bringing down very large current account deficits". "[R]ecovery in the Commonwealth of Independent States (CIS) and emerging Europe is likely to be difficult, especially for economies most affected by sharply falling capital flows and domestic financial sector turmoil". "Emerging Europe has been hit particularly hard by the drop in capital inflows. This led to major contractions in the Baltic economies, Bulgaria, and Romania, although exchange rates acted as a shock absorber in economies with flexible regimes. Bosnia, Hungary, Latvia, Romania, and Serbia are currently receiving IMF balance of payments support, whereas Poland has access to the IMF Flexible Credit Line in order to safeguard market confidence. In recent months, the pace of contraction has slowed dramatically in much of the region, with risk appetite returning, exports accelerating, and the inventory drawdown moderating, although private credit remains sluggish and unemployment is on the rise". "In emerging Europe, following a contraction in real GDP of 5 percent in 2009, a return to positive growth is expected in 2010 (Table 2.4). The recovery is expected to be slower than in other emerging regions because many economies will continue to face serious adjustment problems, given that cross-border capital flows will likely remain lower for some time. And the recovery will be uneven: some emerging European economies—notably the Baltics—will continue to contract in 2010, but sizable output gains are expected elsewhere, notably in Poland and Turkey",

What do these somber tidings mean for the security situation in this second security ring around Europe? Figure 22 depicts where the region stood in terms of security fragility on the eve of the crisis.

Figure 22 Fragility index around Europe

With the exception of Moldova, the region is not characterized by high degrees of structural fragility. It is worthwhile to point out, taking into account all of the caveats on the lack of security data, that Ukraine scores somewhat better on the state fragility index than Russia or than Georgia. [The current author tends to concur with this assessment]. This is essentially also the 'security picture' that most European policymakers see before them – that the real security challenges lie elsewhere, i.e. in the described outer ring, rather than in this one. Yet nobody would deny that security problems remain relevant in this zone. Many uncertainties surrounding the future of the Russian Federation cloud the region's future prospects for security and stability. The economic data show that the entire post-Soviet area, including Russia, is becoming more fragile because of the current crisis. But it also shows a differential fragilisation (both real and perceived – with these two not necessarily correlated) in which, as was also noted in the overview of the literature, new power (im)balances are emerging that could lead to new security problems. Whether accurate or not, the Russian Federation seems to perceive itself as emerging out of the crisis less affected than most of its neighbors. Some of its recent activities and statementszia, Sout, MolodvaMoldova, KyrgystanKyrgyzstan, etc.) can be interpreted as representing the non-status quo revanchist winner in a post-crisis region as described in the literature.

A second important caveat that can be inferred from the current body of knowledge about the links between economic crises and security lies in the domestic arena. This ring of (in)security around Europe contains a number of relatively weak and imperfect democracies and anocracies with profound internal cleavages that may deepen under the current crisis (with Ukraine and Georgia being two examples). Irrespective of any 'external' involvement, this could lead to a number of direct security consequences as described above. Needless to say, external involvement may very well throw additional fuel on the flames.

Intra-EU

For the purposes of this conference (which focuses on Central and Eastern Europe), we can deal fairly summarily with the intra-EU security dynamics that result from the crisis. Although the European Union may look like a fortress to outsiders, the view is distinctly different from within. The economic crisis has clearly not spared the European Union. All EU countries have been severely struck by the current crisis. All countries have also resorted to massive rescue packages (whether national or in some cases international), the fiscal reverberations of which will be with us for a very long time to come.

On the one hand, the European anchor has played a greatly stabilising role for EU countries (and a fortiori for Eurozone-countries). On the other hand, tensions within the EU are still increasing – most strikingly between a (given the circumstances) remarkably stable core and some form of 'inner near abroad' with an interesting group of potentially major problem cases. These include a number of new entrants, but also a new category of EU problematic -countries that have become known under the irreverent acronym 'PIIGS' (Portugal, Ireland, Italy, Greece and Spain). This is clearly leading to the fragilisation of the European Union itself, which at best may lead to a diversion of increasingly scarce political and financial resources away from other challenges (including security) and at worst lead to a new era of institutional paralysis. The main point to be made here, however, is that these inner two rings are much more resilient –politically, socially, economically, and also in the security realm – than any of the outer rings. Crises will clearly happen, but it is hard to envisage the kind of security issues in these two rings that one can easily see occur in the outer two rings.

In summary, , if strategic diversion (from the extra-EU security issues that may in the longer term be much more important for European security than the intra-EU ones) is the main strategic danger resulting from the current economic crisis in the broader EU, the main danger in the core can probably best be summarized as strategic neglect – a core Europe that is so obsessed with its own problems that it ignores any challenges beyond its borders.

Conclusions

The international analytical and policy community today clearly does not know enough about the link between economic crises and international or regional security to make any firm claims, let alone predictions about the likely impact of the current crisis on European security. However, this background paper has tried to piece together what little we do know – some of which goes against the grain of popular wisdom:

- The surprisingly sparse literature on the implications of economic crises for international or regional security suggests a number of pathways that have historically – at times – linked the two. Whilst there is clearly no foolproof logic at work here, we do see some evidence for three main findings that have proven themselves to be robust across time, across countries, and across the scientific and expert communities:
    - Economic crises can lead to a shift in the balance of power;
    - They tend to lead to reduced defence spending; and
    - They can trigger internal instability and political/social unrest.
- A broad-brush statistical analysis of the historical record suggests there is a weak link between economic crises and security implications – whether national or regional/international. This reinforces the insight from the analytical literature that there is no Greek tragedy quality to any of this. Economic crises can, but need not, lead to security crises.

Economic crises can, but need not, lead to security crises.

- Judging by the best datasets we currently have at our disposal on economic, political and security development, the international community made great progress prior to the crisis. Contrary to popular perceptions about the 'Washington consensus' (now being discredited beyond what seems empirically or even deductively legitimate), the world made enormous strides thanks to globalization on almost all fronts – including the security front.
- The crisis has painfully revealed that despite this progress, many problems remain – including in the economic/security development nexus.

We have also described 4 concentric rings in and around Europe, each with their own security dynamics, both pre- and post-crisis:

- **Outer ring:** containing a set of truly fragile states that represent the intrinsically most dangerous and difficult security challenges and will – barring any upsets in the third ring – most likely demand the most policy attention and resources from the more advanced countries. The main new security challenges here are a) the further fragilisation of some of the international community's most incalcitrant (and thus dangerous) 'problem children,' and b) the potential refragilisation of a number recent relative success stories.
- **Third ring**: The European Union's own 'Near Abroad' looks to be in much better overall shape, but three key security issues remain on its Eastern front, and they have been aggravated by the current crisis: a) the uncertain future of Russia; b) various dangers connected to the current differential fragilisation (whether real or perceived) within this region; and c) domestic weaknesses and/or collapse.
- **Second ring**: the crisis may reopen a number of the most fragile seams (some old, some

new) within the European Union itself. If these problems escalate into a genuine political crisis within the EU, intra-EU cohesion will inevitably become the predominant preoccupation of all EU countries, and of course of the EU itself. This carries in itself the danger of strategic diversion – whereby one of the current pillars of international stability would be partially diverted from the world's broader security challenges. Many of these global challenges would continue to affect it directly or indirectly, but the EU would, most likely, remain focused on its internal challenges.

- **Core**: the EU 'hard core', one of the most spectacular success stories in forging security resilience nearly across an entire continent, may, under certain circumstances, become vulnerable to the enormous danger of strategic neglect. Just like fairly powerful currents in the US foreign policy establishment have at times pleaded for a strategic retrenchment from the dangerous entanglements of world politics that only blemish what could (and in their view should) be a 'shining city on the hill', so too could some Europeans revert to this quintessentially European (Roman) vision, holding up the EU as the only contemporary post-modern political entity that has to be defended from various modern states, such as the US or Russia, or even 'pre-modern' entities .

Finally, this paper will attempt to draw out a number of policy implications for the key players involved:

- For the European Union
  - be aware of the twin dangers of strategic diversion and strategic neglect – and instead strive for a careful balance between maintaining internal cohesion and still remaining an active and responsible force for good in world affairs;
  - stay true to the genuinely structural and comprehensive approach to security that lay at the heart of the creation of the European Union, and increasingly apply some of these tenets beyond current EU boundaries;
- For Ukraine
  - "Never waste a good crisis". This mantra, frequently repeated by US President Obama's administration, probably applies with even greater force to Ukraine. Ukraine needs genuine reform.
  - Do not weaken yourself more than is absolutely necessary. The economic crisis has hit Ukraine badly. Overly simplistic (and artificially inflated – sometimes even by Ukrainian politicians) views of Ukrainian internal cleavages, both real and imagined, can lead to self-fulfilling prophecies that have the potential to greatly undermine Ukraine's security.
- For the international community
  - the international community has to shift its development paradigm in a number of ways:
    - from the current 'stovepiped' approach to development (whereby economic development and security development are too often still seen as separate issues) to a more genuinely comprehensive and integrated approach;
    - from the current 'firebrigade model' to a 'building resilience' model
  - more attention to what some have called 'defence development'

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Endnotes

1 The author thanks Tim Sweijs from HCSS for his insightful comments on a previous draft of the paper.

2 "A "new normal" for the world economy."

3 There are some exceptions here such as Kenneth Boulding, Thomas Schelling, etc.

4 Despite all of the rhetoric to the contrary, the cleavages between the first and second 'pillars' of the European Union remain enormous (maybe even larger than within national governments).

5 Besides the external triggers described in the text (to which one could add a number of others such as the disciplining effects of fiscal strictures), there are also a number of powerful endogenous triggers at work here – such as some developments in science itself (e.g. the emergence of complexity theory in the social sciences) and maybe even a new turn in the philosophy of science because of our increased ability to pierce much more deeply into the phenomena around us ("Bits, Atoms, Neurons, and Genes") generating vast new possibilities for more inductive instead of deductive scientific methods.

6 These were first very much defined as the integration of the external economic and security policy tools (known as the '3D'-approach with a closer integration of the defence, development aid and diplomatic tools of statecraft), but are now in most countries defined as truly whole-of-government efforts, as much of the knowledge and know-how in critical areas such as justice, agriculture, education, etc. lie within the domestic departments.

7 To give but one example: in the economic realm, organizations like the OECD, the World Bank and the IMF constantly engage in very impressive analytical exercises to analyse what is happening, collect the right data, distil lessons learned, benchmark policies, build true knowledge and then also disseminate it to their stakeholders etc. There is no equivalent effort in the security realm.

8 De Spiegeleire et al., "Economic crises - the security implications."

9 While peer-reviewed academic articles typically provide more substantiated analysis, expert opinions often are more useful for timely assessments of the current situation.

10 The crisis (better known by the term 'Asian flu') itself hit in July 1997, but there was a lag of about a year between the start of the crisis and the first real publications devoted to the links between such crises and national, regional or international security.

11 The slight increase in 2003-2004 is due to the American economic slowdown following the September 11th terrorist attacks.

12 Since roughly 90% of the studies occur between 1996 and 2009, we only show those data for visual presentation reasons.

13 These consequences seem to lack an established academic base of support, but since the academic base merely in essence boils down to two studies from the Asian Financial Crisis (which, interestingly enough, are cited over and over in the current expert papers) and the same number from the current crisis. The reader is therefore encouraged not to read too much into this lack of 'academic' support.

14 If the security implications of economic crises were as profound as those claimed by the scholars/experts, then it stands to reason that the expert community would examine this topic with greater interest outside of the periods leading up to and during an economic crisis. For instance, although interest in the security implications of a CBRN (chemical, biological, radiological, and nuclear) attack might spike during periods of crises (e.g. Able Archer, Cuban Missile Crises, 9/11, etc.), the scholarly community shows continuous interest because of the enormous

potential impact of such crises.

15 There are two notes concerning the flow chart. First, the theme "Increased Reliance on IGOs" has been omitted from the flow chart as it was only mentioned in four instances and both its security implication and its linkage to the system was never made explicit. Second, "Inability to Modernize Armed Forces and Implement Strategic Plans" has been broken out from "Decreased Defense Budgets and Spending" in order to demonstrate its transmission from the state level to the international level. In our analysis it was treated as a subcategory of the latter.

16 In general, the tests were being run from 1800 until 2009; however, the length of economic data for countries varies largely based on region. The developing world encompasses 1950 to 2006, whereas the developed world largely extends from 1800 to 2006. All tests are run with a natural 1-year lag, which comes from the growth rate.

17 The data for this test comes from Maddison, "Statistics on World Population, GDP and Per Capita GDP, 1-2006 AD."; Ghosn, Palmer, and Bremer, "The MID3 Data Set, 1993–2001."

18 Ibid.

19 The data for this test comes from Maddison, "Statistics on World Population, GDP and Per Capita GDP, 1-2006 AD."and Marshall, "Polity IV Project: Home Page." Specifically, HCSS combined state failure and regime transition variables to ascertain if there was a notable internal political change.

20 Time-series logistical regressions would have been preferable to a logistical regression. However, owing to some problems with establishing the fit of the time-series logistical regression, HCSS decided to use a simple logistical regression. Despite this flaw, HCSS accepts that since the model fit was so poor for the logistical regressions, it practically could not improve to an acceptable level.

21 Marshall, "CSP Global Conflict Trends."This indicator includes multiple factors such as state capabilities, interactive intensity (means and goals), area and scope of death and destruction, population displacement, and episode duration. See Marshall, "CSP - Warfare Coding Guidelines."

22 Heidelberger Institut fu r Internationale Konfliktforschung, "Conflict Barometer 2008. Crises - Wars - Coups d' tat - Negotiations - Mediations - Peace Settlements."

23 For the background of this term, see International Development Association Operational Policy and Country Services (OPCS) and Resource Mobilization Department (FRM), "Operational Approaches and Financing in Fragile States," 2-3.

24 OECD-DAC International Network on Conflict and Fragility, "Ensuring Fragile States Are Not Left Behind. Summary report."

25 World Bank and International Monetary Fund, Global monitoring report 2009.

26 Collier, The bottom billion.

27 Zoellick, "Fragile States: Securing Development."

28 In this dataset, the Fragility index is a composite index consisting of scores for each country on both Effectiveness and Legitimacy in four performance dimensions: Security, Political, Economic, and Social. See Marshall, Goldstone, and Cole, "State Fragility Index and Matrix 2008."

29 Ibid.

30 International Monetary Fund, "Issues Brief - Globalization: A Brief Overview."

31 International Monetary Fund, World economic outlook, April 2008, 191.

32 Dollar and Kraay, "Growth is Good for the Poor"; Dollar and Kraay, "Trade, Growth, and Poverty"; International Monetary Fund, "Issues Brief - Globalization: A Brief Overview."

33 International Monetary Fund, "Issues Brief - Globalization: A Brief Overview."

34 World Bank and International Monetary Fund, Global monitoring report 2009, 223.

35 Marshall, "Polity IV Project: Home Page."

36 Puddington, "Freedom in the world 2009: setbacks and resilience."

37 Freedom House, "Freedom in the World Comparative and Historical Data."

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39 Global Policy Forum, "Peacekeeping Tables and Charts."

40 Fortna, "Does Peacekeeping Keep Peace?."

41 World Bank and International Monetary Fund, Global monitoring report 2009, 24.

42 International Monetary Fund, World economic outlook: Sustaining the Recovery, 4.

43 International Monetary Fund, "Implications of the global financial crisis for low-income countries."

44 The World Bank, "Impact of the Global Financial and Economic Crisis on Fragile and Conflict-Affected Countries."

45 World Bank and International Monetary Fund, Global monitoring report 2009, 26.

46 World Bank and International Monetary Fund, Global monitoring report 2009.

47 Christiansen, Petito, and Tonra, "Fuzzy Politics Around Fuzzy Borders."

48 Collier, The bottom billion.

49 World Bank and International Monetary Fund, Global monitoring report 2009, 27.

50 These include all of the countries that used to belong to the 'Soviet bloc' plus Turkey (Albania, Armenia, Azerbaijan, Belarus, Bosnia & Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Republic of Kosovo, Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Russian Federation, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan).

51 Source: World Bank, DEC Prospects Group.

52 The World Bank, "Global Crisis Hits Home in Emerging Europe and Central Asia."

53 International Monetary Fund, "Regional Economic Outlook. Europe - Securing Recovery," 51.

54 International Monetary Fund, World economic outlook: Sustaining the Recovery, 17.

55 Ibid., 29.

56 Ibid., 67.

57 Ibid., 76.

58 Ibid., 77.

59 New insights on the nature of complex and adaptive systems may even push the field further away from any type of deterministic statements, let alone predictions, about the international system.

60 Mead, Special providence American foreign policy and how it changed the world.

61 Cooper, The post-modern state and the world order.

62 Gompert, Oliker, and Timilsina, Clean, lean, and able.

EU/ BSR: Searching for an Adequate Economic Policy Response

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The unprecedented scale of the current crisis requires the reconsideration of the very meaning of traditional economic and political ideas and to implement unprecedented anti-crisis measures

The world has been going through an unprecedented (since World War II) economic crisis. This crisis is truly global, because it has directly or indirectly affected almost all countries, although the dynamics and magnitude of the negative effects of such a crisis vary from country to country.

In a pure economic sense, this crisis requires unprecedented steps from national governments and international institutions in order to minimize its negative economic effects and to renew normal economic activities as a source of further progress for national economies.

One can rightly assume that the current crisis has turned out to be the first crisis in the era of globalisation; perhaps not surprisingly, the crisis started in the markets of developed countries. Chronologically the crisis first hit the financial sector and quickly spread throughout the economy, while the global nature of the crisis necessitated a reconsideration of the concept of national economic security and stability in principle and the resistance of national economies to external shocks in particular.

National governments and the EU as an integrated community faced the need to actively and quickly respond to the crisis by providing unprecedented aid to private business and consumers at the expense of budgetary funds, i.e. taxpayers' money. The world has thus been challenged to reconsider the meaning and format of state aid to the private sector as well as the ways of state interventions in commercial activities. In particular, the world has been challenged to regard the arguments in favour of such an intervention and the ways of state intervention. In fact, governments have been forced to assume the entire burden of "market failures", because otherwise there has been a very high probability of the collapse of the national economy.

Developed countries have resorted to a wide set of fiscal measures to stimulate the economy and in doing so they have been relying on their own financial capabilities. At the same time a number of countries, including EU members (Poland, Latvia, Romania, Hungary) and Black Sea countries (Georgia, Ukraine), asked for IMF assistance because they did not have sufficient internal resources to counter the crisis.

It should be mentioned that alongside "pure" anti-crisis measures, G20 (G8) countries also have a number of strategic decisions to make regarding the nature of the reform of the international system of economic policies coordination in different fields and, above all, in the field of financial regulation in order to minimize the risk of future crises. The above-mentioned countries assumed leadership in this field. In fact, today's discussion centers around the topic of a new world financial architecture to be established after the crisis. It should be noted that so far the countries have been successful in defining the values and principles that should underlie the functioning of the transformed international monetary and financial system, but at the same time, a detailed vision of a new financial architecture has yet to be formulated. Given the scale and complexity of the problem, there is a high probability that the process of reforming the international monetary and financial system will be very difficult and accompanied by a number of conflicts.

Free Market, Economic Nationalism or Protectionism: Can We Talk About "Crisis Protectionism"?

The global financial crisis has intensified the debate on the ability of the traditional market mechanism to self-regulate and the limits of state intervention in economic processes. It is worth noting that the existing system of regulation, specifically with regards to the financial markets regulatory framework, demonstrated significant flaws, while the development of financial innovations resulted in the emergence of completely new risks, which were among the factors that triggered the current crisis. There is wide consensus that the global crisis demonstrated the need for massive state intervention in the economy which included in some cases de facto nationalisation of some financial institutions. This situation clearly contradicts the well-established thesis that "the state is a bad manager".. However, it is clear that the discussion of the role and functions of the state in times of globalisation and the liberalisation of economic activity will be very active, and its findings will determine the ideology and the content of national economic policies in the near future. In times of crisis, trade policy deserves special attention. At the same time the world community has managed to minimise the manifestations of the most acute forms of national egoism and the protectionist measures taken by some countries have not transformed the crisis into a kind of "crisis protectionism".

The global financial crisis has intensified the debate on the ability of of the traditional market mechanism to self-regulate as well as the limits of state intervention in economic processes.
At the same time the world community has managed to minimise the manifestations of the most acute forms of national egoism and the protectionist measures taken by some countries have not transformed the crisis into a kind of "crisis protectionism"

Developed countries have mostly used trade instruments such as subsidies and various fiscal measures to manage the crisis. Developing and CIS countries have used (albeit to different degrees) almost all of the instruments of trade protection. However, one cannot rule out that the post-factum analysis of current anti-crisis actions will show that protective measures were significantly stronger than it is thought today.

It is clear that devotion to the ideals of free trade requires from governments the refrain from future temptations to resort to short-term solutions to support domestic producers through trade restrictions. It is very important, however, to avoid using anti-crisis measures (emergency steps by nature) as protectionist tools. Experience shows that trade restrictions can intensify economic crises (though they are not the primary cause of economic decline).

Taking into account the fact that the economic recovery will take quite a long time and that the process itself will not be easy for many countries, the question arises whether there will be the temptation to resort to protectionist measures to support the post-crisis renewal of economic activities and to support national producers during the stage of economic recovery.

In practical terms, it is the intensification of the Doha Round of multilateral negotiations within the WTO (begun in 2000) that will test the determination to further the process of trade liberalisation. However, there is a danger that despite numerous statements from political leaders these problems will not be at the center of attention given the need to overcome the aftereffects of the global economic crisis.

It should be noted that on June 9, 2009, three countries - Russia, Kazakhstan and Belarus - declared their intention to join the WTO as a single trilateral customs union. These countries plan to join the WTO in 2010. Given the historical experience of the accession of various countries and quite obvious political component of this decision, we can assume that WTO accession of these countries has been postponed for an indefinite period of time, while such an influential trade player as Russia still remains outside the world trading system.

Nevertheless, these three countries recently decided to resume bilateral negotiations on WTO accession. This step means that the idea of joining the WTO together as a Customs union was mostly a political one and that the countries would like to move to the WTO in a traditional way. At the same time the countries agreed to join WTO more or less simultaneously (leaders will wait for countries that are lagging behind). This idea of coordinated efforts has been traditionally supported by Russia. Such policy changes are detrimental to the accession negotiations.

The Feasibility of Fiscal and Monetary Stimuli: The Consequences for Monetary Stability and Public Finances

National anti-crisis policies have been predominantly aimed at the stabilisation of financial systems. Implementation of such measures have been accompanied by an increase in public debt; therefore the problem of state debt management becomes very acute.

The key component of national anti-crisis measures is a set of steps to stabilise the financial system. Virtually all countries have been focusing their efforts on establishing additional guarantees on deposits, guarantee or redemption of bank debts and capitalisation of the banking institutions. Two countries – the USA and Great Britain - have used various instruments to stabilise their banking systems in the most active way when compared to other states.

An important component of current policies in OECD countries is the realisation of so-called fiscal measures to stimulate economic activity (so-called fiscal packages). Most OECD countries have developed broad programs of fiscal stimulus envisaging significant changes in taxation as well as in budget expenditures. In doing this a majority of countries preferred to reduce taxes rather than to increase expenditures. At the same time Japan, France, Australia, Denmark and Mexico acted in a completely different way. The ration between these two components - changes in taxation and adjustment of expenditures – may vary depending upon general vision of anti-crisis measures.

The analysis of measures that have been announced by now shows that crisis-related financial injections will take place primarily in 2009, while some countries have different schedules of actions. For several countries (the United States, Finland, New Zealand, Germany and Canada), the sizes of fiscal packages in 2009 and 2010 are broadly comparable, implying a more or less continued pace of fiscal injection into 2010; a few countries (notably Denmark) plan to have significantly larger packages in 2010. For most other countries, the fiscal injection tapers off in 2010.

According to OECD estimates the implied effect on GDP is largest from the fiscal packages in Australia and the United States at between 1.2 and 1.6% of GDP over 2009 and 2010, although the effect is about 1% of GDP for Poland and Spain in 2009, as well as Canada and New Zealand in 2010. For other countries the likely impact of the fiscal packages is small, particularly when judged against the magnitude of the impending output gap. These estimates do not take into account cross-country spillovers, such as when, for example, Belgian activity benefits from stimulus in Germany.

Assessment of the efficiency of any anti-crisis measure presents a very complicated task. Apparently such an assessment can be done only post-factum when economic recovery takes place. Besides, analysis of the efficiency of fiscal stimuli requires an account of a number of aftereffects such as state debt increase.

According to OECD, OECD gross government debt as a share of GDP is projected to increase sharply, from 75% of GDP in 2007 to about 100% of GDP in 2010, reflecting substantial budget deficits and off-budget spending in many countries. Increases in the debt ratio of this magnitude have usually occurred in conjunction with banking crises, such as in the Nordic countries in the early 1990s, Mexico in 1994 and Japan during the 1990s. The projected increase in OECD gross debt reflects a combination of two factors - loss of previous exceptional revenues, mostly associated with the collapse of financial assets and house prices, and the operation of automatic stabilisers as well as discretionary fiscal measures, notably the stimulus packages described above. It also includes debt incurred to finance capital injections into banks and financial institutions as well as purchases of financial assets.

This situation prompts the question of how successfully this debt can be managed by national governments.

Major Policy Responses to the Crisis Within the EU and Black Sea Region

The unprecedented character of today's crisis requires that unprecedented steps be taken by central banks and governments both in terms of scope and intensity. At the same time the specific content of national anti-crisis programs and the scope of funds allocated to help the private sector and restore economic activities have varied from country to country. These specific features have been determined by the magnitude of the influence of the crisis upon the country in question, as well as its financial and other resources.

The specific content of national anti-crisis programs and the scope of funds allocated to help the private sector and restore economic activities have been determined by the magnitude of the influence of the crisis upon the country in question, its financial and other resources.

Chronologically the first signs of crisis appeared in the financial and banking sector, resulting in the "traditional" lowering of interest rates by central banks and the lowering of reserve requirements as the first reaction to the crisis. The key component of national anti-crisis programs was a set of measures to stabilise the financial markets. The USA and the EU resorted to these measures earlier, while Asian economies began to use them only in 2009.

Governments view state support to systemic banks and troubled financial institutions as an important element of anti-crisis measures. Such aid is provided in different ways:

a) crediting at the expense of (state) budgetary funds,

b) recapitalisation with state participation,

c) the provision of guarantees (for a fee) for the value of past investments by banks which can bring losses,

d) deposition of state funds in commercial banks, and

e) the state purchase of securities guaranteed by the given credits.

The necessity to help financial institutions is explained by the fact that a stable financial system in fact presents a public value, because its normal functioning forms a necessary precondition for normal business operations resulting in new jobs and the growth of wealth. It should be mentioned that this factor – helping the financial system – is the largest component in many countries. At the same time virtually all countries render assistance with very explicit conditions: the assistance is term-limited in character and there is protection for taxpayers, whose money is used.

In Great Britain in order to receive financial resources from the state banks must sign a special lending agreement envisaging the provision of credit to consumers and businesses. France established a special institution of credit ombudsmen whose task is to control how banks use state financial aid and to ensure the transparency of credit provision to enterprises.

A number of states announced their readiness to support certain sectors of real economy. Russia, for example, decided to support agriculture, machine-building and agricultural machine-building, military industrial complex, extractive industry and transport. This assistance will be rendered primarily through the granting of subsidies to compensate interest rates for credit provided in 2009-2009, recapitalissation, the extension of guarantees to depositors, and tariff protection.

Against the background of economic downturn many countries have adopted long-term action packages focused on stimulating household consumption and investment demand. Most countries adopted such plans at the end of 2008 and the beginning of 2009. All of them envisage a substantial increase of state financing of infrastructure projects, programs of credit provision for enterprises and financial institutions, and social support.

One of these measures is the reduction of tax pressure on both households and enterprises. The list of countries which opted for tax decreases is rather long: Germany (health insurance payments, income tax, taxes on new cars which meet modern ecological requirements), France (income tax), Great Britain (VAT by the end of 2009 year, tax privileges and credits), USA (increase of the sum exempted from alternative minimum tax, tax credits for families, exemption of unemployment payments from taxation).

One important reason for long-term measures is to increase investment in new technologies and R&D, especially related to energy efficiency and environmental protection. These plans envisage investments to re-equip old (residential) buildings in order to increase energy efficiency and construction of environmentally friendly houses; the reduction of CO2 emissions and the wider use of alternative energy sources; the modernisation of energy networks; and the creation of "green collar" jobs in order to reduce the cost of the utilisation of traditional energy resources and to reduce the harmful impact of human activities upon the biosphere.

National anti-crisis programs also contain plans to modernise social, technical and transport infrastructure. In China, for example, the key component of anti-crisis measures is to support construction, the development of transport infrastructure, and to increase the number of medical and education institutions.

It should be mentioned that the scope of national anti-crisis measures was determined by the availability of financial resources, while the ratio between current and long-term measures shows the determination of government to ensure future economic growth.

Global and Regional Economic Policy Coordination: Successes and Failures.

This crisis is taking place in a world of highly interdependent national economies, thus demonstrating how rapidly a crisis spreads throughout the world economy and becomes global with all of the obvious results. Because of this, the global crisis has become a real test for the efficiency of existing mechanisms of economic policy coordination both at regional and international levels.

The current crisis is taking place under the conditions of an extremely high level of interdependence between national economies. It has therefore become a serious test for the efficiency of the acting mechanisms of economic policy coordination at regional and international levels.

The crisis has proved the necessity of increasing the efficiency of existing forms of economic policy coordination, which is why one can argue that the G20 format has begun to dominate over the G8 approach. It was at the Washington G20 summit where the decision was adopted to introduce the broadest possible programs of fiscal stimulation, and there was agreement on the main component of the Doha round of multilateral trade negotiations. At the April 2, 2009 London G20 meeting, a number of highly important decisions related to the financial system were adopted that are to set up a new institutional structure – the Financial Stability Board. This institution will have stronger powers (mandate) and will replace the Financial Stability Forum. The Financial Stability Board will include all G20 members as well as Spain and the EU Commission.

What this showcases is the intention to establish an international mechanism to be used by national governments and financial supervisory bodies to determine standards of financial activities meant to ensure the stability of financial systems through elaboration and implementation of efficient policies in the field of financial supervision.

At the same time it is too early to say that the G8 format of economic policy coordination has exhausted its potential.

As far as the EU is concerned, the critical decision taken by the European Commission was the development of the so- called "European Economic Recovery Plan", adopted by the EU Council in December 2008. The euro area summit declaration for a concerted action plan of October 12, 2008 may also be considered an important element of action coordination within the EU, along with other EU decisions adopted in various formats. In general, the total financial incentives volume, including automatic stabilisers' effects, amounts to about 5% of EU GDP.

Changes in IMF activity also took place. An agreement to increase IMF capital was achieved in order to extend possibilities of granting aid to countries. At the same time, the IMF made the conditions for granting such aid more flexible. However, the reformation of the IMF should also be viewed in the context of the reshaping of the world financial system, the necessity for which has been evidenced by the world crisis. Although such a necessity is recognized today by nearly everybody, there is no clear vision yet as to the direction of such transformation. Nevertheless, it may be said for sure that all views on the reformation of the world financial system available today necessarily preview a certain transformation of the IMF role in the new conditions.

At the same time, it is worthy of attention that the necessity of combating the crisis in the territory of the former USSR has stipulated the emergence of such an initiative as the establishment of the special Anti-crisis Fund of the Eurasian Economic Community (EurAsEC). It is expected that this fund, with the statutory capital of 10 bn USD, will start functioning after the ratification of certain agreements (The Treaty on the Establishment of the Anti-crisis Fund of the Eurasian Economic Community and the Agreement on Costs Administration of the Anti-crisis Fund of the Eurasian Economic Community) by the EurAsEC member states (Armenia (observer), Belarus, Kazakhstan, Kyrgyz Republic, Russia, and Tajikistan) and the payment of their contributions to the fund. The Fund will be administered by the Eurasian Bank of Development, which was created at the initiative of Russia and Kazakhstan in January 2006.

It is currently difficult to forecast the prospects of the EurAsEC anti-crisis fund activity, but the very initiative should be assessed as the first attempt in post-Soviet space to create a supranational structure which would specifically provide financial aid to the EurAsEC member-states.

At the same time, the CIS as a structure hasn't demonstrated any kind of activity in terms of efforts coordination by member states in the field of combating crisis. The same may be said about the Organization of the Black Sea Economic Cooperation.

New challenges: exit from the crisis

Despite early encouraging signs, suspension of anti-crisis programs is premature and the timing for such suspension should also depend on the progress of the regulatory and other reforms, the necessity of which has been revealed by the crisis

It may be considered today that the lowest point of the crisis has already passed and that the first sprouts of economic stabilisation have appeared. It is therefore necessary to focus on the efforts directed at the recovery of economic growth.

At the same time it should be particularly noted that the current process of economic recovery is rather weak and sensitive to new shocks. Hence, it is obviously premature to raise an issue on the rollback of anti-crisis programs. Under such conditions the anti-crisis programs (although somewhat modified) may be operating for a relatively long period of time.

Growth of the fiscal deficit and public debt has been a fiscal consequence of the crisis and of anti-crisis measures. According to estimates of the IMF experts, the ratio of total public dept to the GDP of developed economies during 2008-2014 will rise from 75 to 115%.[1] Therefore, one of the key problems of post-crisis economic recovery will be normalising public finances. It is evident that this situation also implies some potential for inflation. In practice, stabilisation of governmental measures requires at least a mid-term money saving strategy and, in the case of the EU, a return to the Stability pact fiscal parameters. There is a consensus that economic recovery will go along with a high unemployment rate. Therefore, the situation in the labor market will be one of those problems on which significant efforts at national and international levels will be focused. Defining the proper time-table for implementing a crisis exit strategy will have great importance. And we can only agree with those experts who think that the timing should also depend on the progress of regulatory and other reforms, the necessity of which has been revealed by the crisis.[2] However, it should be stressed once more that until now only a general vision of the directions and principles of such reforms has been more or less clearly formulated, while concrete contents and format of the necessary changes have not yet been defined.

Therefore, we can conclude that reforms will take place when the G20 and EU countries are able to define their contents and demonstrate a true aspiration for change. It is evident that countries that are outside of these two groups will, in general, passively join the agenda to be defined by the G20 and the EU. These countries will certainly have opportunities to express their point of view in international organisations, but their influence on making key decisions will hardly be significant. Therefore, the key world powers should be conscious of the importance of their decisions and actions for defining the contours and contents of the global financial architecture, which will be embraced by the whole world.

It is clear that the contents and format of the crisis exit strategy and the move to economic recovery should contain some schemes for reimbursement of taxpayers' money, which has been used for providing assistance to private business. This was one of the key points in working out anti-crisis strategies. We can certainly assert that such reimbursement of public expenditures will prove a rather complicated problem for national governments and, in particular, for the Black Sea region countries (most of all for former Soviet republics).

On the whole, it will only be possible to assess the effectiveness of crisis exit strategies when such exit strategies are more concretely outlined both at international and national levels.

The Pittsburgh G20 summit (September 24-25, 2009) was another major step in the direction of the development of a new format of economic policy coordination and marked the process of replacing the G8 as the leading body of world economic management. The countries at this summit agreed on a number of issues which can be taken as reference points for further changes:

a) A stronger regulatory framework and macro-economic policy is necessary for the sustainable and balanced growth of the world economy;

b) The G20 pledged to shift 5% of the International Monetary Fund's quota share to emerging economies from over-represented countries with the goal of improving the organisation's effectiveness by increasing voting shares and access to IMF loans for developing countries. Additionally, at least 3% of the World Bank's shares will shift to these emerging countries.

c) Although no cap has been adopted on banking bonuses as was requested by many European governments, tighter regulations will be enforced on financial systems, such as enforcing new guidelines for financial pay schemes, in order to limit risk-taking and build up new capital.[3]

At the same time, specific measures to implement these tasks are yet to be defined.

Endnotes

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The Political Implications of the Global Crisis for the European Union and the Black Sea Region: Is Democracy at Risk?

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Crises by definition portend systemic adjustments and instabilities. At the same time, however, they – by and large – provide opportunities, be it structural economic and political changes, omestic reforms or cooperation with other states and non-state actors at the regional and international level. The global economic crisis exemplifies this duality. To begin with an assessment of the crisis, one needs to prioritise the different levels of analysis it impacts. That is to say, the crisis is at the same time economic and geopolitical in scope. Within each of the aforementioned analytical frameworks, a number of interrelated indicators or factors come into play to better define the analysis. The current crisis also introduces a time element as its likely duration and span are uncertain.

The economic effects lie beyond this analysis albeit it is safe to say that the relevant economic and social models of choice applied by governments to cope with it impact their political instruments and policy choices. This is particularly true given the pressure and demand for the state authorities to assume a more intervening role in the functioning of the market.

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The international order has entered a new era characterised by dramatic changes both in terms of structure and process, thus resulting in the emergence of a precarious new world balance. To date, the highlight of this new era has been undoubtedly the 2008 election of a new administration in the United States led by Barack Obama and his being awarded the Nobel Peace Prize for his efforts to strengthen international diplomacy and cooperation between peoples and his vision of a world without nuclear weapons – in other words, for the aspirations and hope he inspires. Since his inauguration, one can already observe the dismantling of a number of Bush-era policies leading to rising expectations across the globe. At the same time, however, an ongoing, ever-growing international financial and economic crisis with projected negative growth in 2009 for the industrial world and predictions for a very limited recovery in 2010 creates a bleaker picture adding new challenges to the agenda; in terms of magnitude it is considered to be the worst economic crisis of its kind in 75 years. If one also takes into account the persistent security dilemmas deriving from the aftermath of the killing fields of Gaza (and South Ossetia), the situation in Afghanistan, the 2008 terrorist attacks in India combined with the tense relations with Pakistan and the 'Iranian enigma', to name a few, it becomes obvious that the international (security) agenda is highly charged. In parallel with these political and security shifts, another ongoing process is the transformation of international organisations that are struggling to discover their role on the world stage as the current set up (whether institutional or policy) does not reflect the variable balance of power and the new realities of the world today. At the same time, some states are trying to adjust their political and economic agendas in order to deal with the financial crisis while others are simultaneously facing long standing structural socio-economic and political problems and (security) dilemmas as well. Overall, the international order seems to be in flux dominated by a number of actors that have at their disposal a variety of instruments of influence.

Regarding the Black Sea region in particular, the global economic crisis has undoubtedly impacted it as much as it has other parts of the world, with the possible exception of the English Premier League where foreign investors continue buying football clubs at exorbitant prices[1]. In fact, the sustained economic growth of the region over the last decade was halted abruptly by the crisis. In other words, while real GDP growth from 2000-2008 averaged 6.0% per annum denoting a cumulative real economic expansion of 68% during this period, it is forecasted that that GDP growth fell to 4.3% in 2008 and that it is bound to be even lower in 2009 (projected at -6.4%) and 2010 (Gavras and Iorga).

Nevertheless, the Black Sea Region in 2009 is radically different from what it was two decades ago, both economically and politically. As it will be explained below, while all of the economic indicators over the said period have demonstrated a tremendous rise, indicative to a certain extent of the transformation processes in the former communist space in the post-Cold War period and the advent of globalisation and regionalisation, the changes in relations between the West and Russia have intruded on the political environment; a turn for the worse has occurred almost simultaneously with the incursion of the economic crisis.

The dual nature of the crisis shows how governments have to cope both with the challenges the crisis has posed and to seize the opportunities it has presented in terms of domestic and foreign policy rethinking.

The dual nature of the crisis shows how governments have to cope both with the challenges the crisis has posed and to seize the opportunities it has presented in terms of domestic and foreign policy rethinking. Faced with the threat of a democratic backlash in new democracies such as Georgia and Ukraine and with Russia's renewed determination to regain its lost influence in its "near abroad," the EU needs to rethink its regional role and to assume a greater leadership role.

The Democracy Backlash

Before one assesses specifically the impact of the crisis on the Black Sea Region, it is necessary to look at the debate on the relationship between governance and economics in Central and Eastern Europe and even in the more firmly established democracies of Western Europe. In other words, the strengthening of the state or public sector in order to regulate unregulated financial institutions and the like could have an immediate impact on the evolving processes of democratisation of the states of the Black Sea Region. As such, leaders of the countries of the region whose authority has been disputed could use the crisis and the remedies of greater intervention to hold on to power or stop democratic reforms or even worse violently curb street protests whenever they break out. In the 'relatively new' democracy of Latvia, not only did mass protests and riots break out in late 2008/early 2009 but a young academic was arrested with the charge of allegedly spreading rumours and untruthful information because he warned his compatriots about the dangers of keeping money in the bank, especially in his country's currency. While street riots are common in 'established' democracies such as France, Great Britain and Greece, there is a concern among democracy scholars about the ability of newer and less consolidated democracies to avoid political breakdowns as sharp drops in income and increases in unemployment occur (Zielonka, 2009). There is an ongoing debate in The Journal of Democracy, for example, to assess the ascent of populism in East-Central Europe over the last few years, raising alarm about whether the region is backsliding. The transition-era consensus where tough economic reforms were being implemented occurred at a time of weak civil society and low political participation. New political and economic elites emerged thriving "by consolidating democratic institutions without participation and by forming a policy consensus at the expense of politics" (Rupnick, 2007). The populist backlash that ensued has targeted the new political class that has come to be viewed as corrupt and self-interested; there is thereby growing dissatisfaction with democracy across East-Central Europe and, at the same time, the appearance of "charismatic leaders capable of mobilizing public anger" (Krastev, 2007).

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The Union's Dilemmas

For the European Union, a sui generis political actor and a unique institution of the formation of shared sovereignty among 27 democratic states, the democracy paradigm is part and parcel of its raison d'tre. Having resolved 'the centuries-old problem of war in western Europe', the EU's approach to international relations has an ideational quality which contains elements of an 'ethical foreign policy' linked with its growing responsibility for the post-Cold War security order (Hill and Smith, 2005). As such, the new global puzzle is challenging for the Union as the future of the international system, in the sense of whether the international order is multipolar or non-polar. The future of global governance and the future of democracy will define the nature and ability of the Union to pull its weight on the continent, as well as within its immediate neighbourhood and across the globe, in the years to come (Gnesotto and Grevi, 2006). In this regard, the democratic tribulations of its new members, which have increased as a result of the economic crisis, cannot but trouble it. The same applies to its immediate neighbourhood, its geographic space of responsibility, where the political upheaval in Georgia, Moldova and Ukraine give rise to the appearance of 'illiberal' democracies, to use Fareed Zakaria's terminology.

The shaken credibility in Ukraine and Georgia (and in particular their current political leaderships) to bring about the requisite transformation inspired by the Orange and Rose revolutions, respectively, has placed their eventual Euro-Atlantic integration on the back burner. The question remains whether this also implies the end of European integration for Ukraine in particular, or a renewed effort to integrate – based not on the undelivered promises of reform but on clear conditionalities such as cooperation with all its neighbours (read: Russia).

A clearer assessment of integration driven by interests and measurable benchmarks, including effective and responsible uses of power by the governments of the region, are gaining greater weight today. Nevertheless, the economic crisis might have undermined the Union's ability to influence the process of adaptation of European norms of democracy, open markets and the rule of law by its eastern neighbours. A case in point is the EU's latest initiative towards the region – the Eastern Partnership launched officially in May 2009. With many EU member states wary about further enlargement and the continued attempt to factor in its future relationship with the Russian Federation especially since the August 2008 war in Georgia, the European Union has seen its influence wane in the east (Valasek 2009). While the Eastern Partnership could be disputed due to the confusion it creates with regard to another recent policy – the Black Sea Synergy – many of its key provisions, including the easing of travel restrictions through the implementation of easier visa regimes and the expansion of mutual trade, find few supporters within the EU as the prevailing mood is one of rising nationalism and protectionism due to the economic crisis. Furthermore, the 600 million (for the period of 2010-13) targeted for the six countries (Ukraine, Georgia, Armenia, Azerbaijan, Moldova, and Belarus) that the Eastern Partnership targets are deemed to be 'candy' by its recipients that receive considerable support from the IMF and Russia. Consequently with the EU's power of attraction toward the east waning, the democratic backlash a reality, the economic crisis persisting and the Russia card on the monitor, the European Union needs to serious rethink its priorities and policies towards the Black Sea states.

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For the European Union, the crisis is also one of soul searching in terms not only of its role, presence and responsibility in Europe but also across the globe. The crisis has implied the relative decline of US dominance in terms of relative power and influence, especially vis-a-vis emerging powers and the need to reframe or redesign the global system. The growing role of the G20 and the perceived twilight of the G7/G8 model or the continued calls for a revamped UN Security Council are cases in point. Consequently, the challenge for Europe would be to rise to the test of global governance by increasing its share of the transatlantic economic and security burden sharing. Another issue is the pressure of introversion – the crisis gives rise to economic protectionism and an increased concentration on national affairs with plans for bailouts of national champions, greater state intervention and renewed calls for the politicisation of the economy through the introduction of protectionist measures. According to WTO director Pascal Lamy, "[t]here is another spectre lurking in the mist which could make this already bad situation even worse – the threat of a return to the isolationist policies of the 1930s". As a result, "a new battle of ideas within and among countries about what kind of policies are 'right' or 'wrong'" is emerging (Emmanouilidis 2009).

The drawn out process of ratifying the Lisbon Treaty (on the heels of the failed ratification of the Constitutional Treaty) also compounds the Union's woes as it raises doubts about the political will for change, particularly with regard to its role in the world. It questions the Union's ability to maintain wise and reliable leadership whether this comes in the form of the debate surrounding Barroso's re-election at the helm of the European Commission and his handling of the financial crisis or in terms of who will be chosen to fill the new leadership positions created by the Lisbon Treaty. Additionally, the tug of war among its member states, especially between France, Germany and the United Kingdom, suggests confusion rather than cohesion with regard the future direction and content of the Union's role. Thus in these uncertain times, the state of the Union's relations with its neighbours to the East reflects or mirrors its state of mind – somewhere between the perseverance of national egoisms and prerogatives and the need for more joint coordinated strategies. While Andrew Moravcik tells us that the crisis has taught Europeans "that if they want to protect their prosperity, there is no alternative to tighter policy coordination", the protracted crisis is nevertheless severely testing even the most committed supporters of the Union (Moravcik 2009).

What kind of Russia?

The economic crisis has only augmented the debate and doubts remain about its impact on Russia's foreign policy behaviour. Russia watchers do not deny the severe impact of the crisis on the country's economy and how it has weakened it. The differences apply as to its external behaviour – has the crisis acted as a restraint (as the rationalists would argue) as a decline in state resources would compel the country to scale down its international obligations? Or is the crisis perceived by the country's political establishment as an opportunity and test to set and implement Moscow's international agenda on the basis of a proactive foreign policy aimed to enhance its great power status and independent centre in a multipolar or non-polar world (Secrieru 2009)? If we were to assume that the economic crisis has weakened Russia, what kind of impact will it have on Russian foreign policy? What is the impact of the crisis on regime stability (with its brand of semi or soft authoritarianism) in Russia?

The 2008/2009 winter energy gridlock between Russia and Ukraine has also led to a more balanced, less ideological and subjective analysis regarding Russia and its role in the world. In other words, the muckraking, whether periodic, systematic or inherent, a propos Russia and its current regime (which was particularly in fashion during the August 2008 conflict) has given way to more realist analyses, especially in western media outlets and among researchers about the foreign policy and role of the countries of the region. Concepts such as the inevitability of a 'soft war' with Russia have gradually been replaced by concerns about the ability of Ukraine (and Georgia) to be reliable partners. Nevertheless the prevailing vestiges of ideological or bloc divisions (whether these come from Moscow or Western capitals) remain a challenge.

The redefinition of US-Russia relations could and would seriously define whether the region's cooperation will be enhanced or the existing divisions will be strengthened. The problem has been the lack of hard and unbiased analysis of Russia. As a result, western thinking on Russia is often short on analysis. Nevertheless, a growing consensus is emerging that Russia's elite believe that the biggest threat to freedom in Russia is weakness in the face of foreign influence rather than authoritarianism at home (Leonard 2009).

The point here is that to date the regime does not feel threatened by the crisis. The Russian elite feel that the political system is resilient albeit the fact that the crisis has, inter alia, almost depleted the country's current account and budget surpluses, led to falling gas prices and to a plunge of its GDP by 10 percent after an average annual economic growth of 7 percent since 1999. The legitimacy of the current regime "is not based on relatively abstract concepts such as rule of law, probity and transparency, but on two things: the regime's capacity to deliver political stability and economic growth; and the ability to hold its nerve in the event of growing socio-economic tensions" (Lo 2009). In this context, the ruling elite is helped by the fact that Russia's revolutions

The ruling elite is helped by the fact that Russia's revolutions historically have been "elite affairs", and popular discontent, to the extent that it manifests itself, lacks an obvious focus or alternative to the regime. Thus, the regime is able to focus blame on external forces for Russia's woes and to promote the sovereignty paradigm as the only credible reaction to the imported crisis.

historically have been "elite affairs", and popular discontent, to the extent that it manifests itself, lacks an obvious focus or alternative to the regime. Thus, the regime is able to focus blame on external forces for Russia's woes and to promote the sovereignty paradigm as the only credible reaction to the imported crisis. This course is also relevant with regard to the country's place among emerging powers as, in stark contrast, the GDPs of both China and India are both expected to grow by over 6 percent this year.

In this context, while the economic base and material power of the regime faces erosion, its ideological foundation has become stronger with 'sovereignty' being at the heart of the regime's social contract with the people and 'sovereign globalisation'[2] being the strategy of choice for its dealings in the international arena. Thus, the reversion of Russia to its exigent self as an indispensable global power with a droit de regard in the former Soviet Space seems the most plausible course albeit irrespective of the financial crisis. For the Black Sea states, this implies that in the new global environment great power arrangements count more than their individual trials and tribulations. This is compounded by the fact that the 'reset diplomacy' between Washington and Moscow, and Russia's great power aspirations and the strengthening of the uneasy status quo between Russia and Turkey in the region undermine the importance of EU-Russia relations. In other words, the more ethical and value driven approach by the EU coupled with the emergence of the national egoisms and divergences among its member states (see previous section) is reduced to that of second fiddle and therefore less able to defend the interests of the other Black Sea states. It should however be noted that 'Russian style' authoritarianism might face an uncertain future when, at some point, it would have to open up partly in order to encourage continued investment and its accoutrements (technological innovation, investments in green growth, etc.) as the sustainment of the economy based on raw material is rapidly reaching its limits (Burrows and Harris). If the policy response is "to subject ordinary Russians to tax rises, to increased bribes, and to further deprive them of their rights and opportunities to be heard, more citizens may start to wake up" (Ordzhonikidze 2009).

Turkey's Role

For Turkey, the financial crisis parallels a marked change in its foreign policy rhetoric as a regional soft power.

For Turkey, the financial crisis parallels a marked change in its foreign policy rhetoric as a regional soft power. Turkey's proactive foreign policy today towards the assumption of a regional or even global "soft power" role has generated heated debate. This development may be explained as the result of the Europeanisation of Turkish political culture (leading to a democratic opening, the enhancement of a cooperative culture, and an increase in the participation levels of the civil society) and its impact on foreign policy behaviour, as a globalisation trend, as a bargaining card towards the West or even as an alternative foreign policy option. Arguably, the ideas of Ahmet Davutoglu, Turkey's new Foreign Minister, have contributed at the level of rhetoric; meanwhile, the emphasis of the country's foreign policy on its Eastern neighbourhood seems to have less to do with the ruling party's religious premises, but comes more as a rational choice towards the development of an independent foreign policy agenda. Some indications of such an aspiration include its mediation efforts between Syria and Israel, Afghanistan and Pakistan, and the United States and Iran, its "Caucasus Stability and Cooperation Platform" initiative during the Russian-Georgian crisis of 2008, the rapprochement with Armenia, warming relations with Russia, steps taken towards resolution of the Kurdish issue, its role in Sudan, its accusations against China of committing "genocide" against the Uighurs, its co-chairmanship of the "Alliance of Civilisations", and its contacts with Hamas, and Iraqi Shiite clerics.

While it remains to be seen whether this will transform Turkish foreign policy from a changing rhetoric into a substantially shifting practice, the crisis is perceived to contribute to the de-legitimisation of Western leadership in general and American predominance in particular. As such for Turkey, the crisis has enhanced its more diversified foreign policy approach (Lesser 2009).

In combination with Turkey's alienation from the EU negotiation process due in part to the public positions of the leaders of some EU member states and the impact of Ahmet Davutoglu, the crisis has also resulted in a discourse on Turkey's independent path towards democratisation. The Turkish leadership today emphasises the need for Turkey to pursue its political and economic reforms independently from the demands from the West. In this respect, to address the political and economic criteria and requirements set by the European Union, a number of amendments have passed since 2000 which have led to a transformation of the Turkish society. Given that democratisation processes are always destabilising because they require a change among the elite in power, Turkey's democratisation course has triggered a power struggle between the secular elite and the governing religious AK Party. As such for Turkey, this has led to the radicalisation of the discourse related to secularism and Kemalism, but more importantly, to the transformation of the Islamic-oriented ruling party towards a moderate and mainstream political force and to the process of internal negotiation towards a new liberal civic consensus, the outcome of which will eventually consolidate democracy in the country.

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Energy and Energy Security in Times of Crisis

The energy feud between Russia and Ukraine during the winter of 2008/2009 is a clear indicator of the importance of energy security for the region and its customers, especially the European Union. Oil and natural gas – together with their exploration, production, and transport – are commodities that flow across borders, however tenuous these might be. Overall, energy has become a major national and regional security concern and in the case of the Black Sea Region – the principal transport route of energy resources from the Caspian Sea and Russia to the West – it is also a testing ground for the pattern of relationships among the producer (e.g. Russia, Azerbaijan, Turkmenistan, etc.), the transit (Russia, Georgia, Turkey, Ukraine, etc.) and the consumer countries. Ultimately, the energy security issue is a "proving ground" for EU-Russia energy cooperation in particular and EU-Russia relations in general. On the other hand, with the financial crisis there has been a return of realpolitik. Regional heavyweights such as Russia and

Turkey have been forcefully pursuing their traditional objective of assurance that this region could potentially become part of their respective spheres of influence.

In other words, the correlation between energy, pipeline wars, the restrictions imposed by the Montreux Convention regarding the tonnage of military ships allowed access to the Black Sea and a perceived Russian-Turkey condominium (bigemony) concerning influence in the Black Sea, contribute to enhancing fault lines in the region as energy security seems to be hostage to great power competition. As a result both other Black Sea states and the European Union stand to lose if there is no redress of the situation.

Looking ahead

The crisis brings to the forefront the need for coordination among nation states and organizations within the current global financial architecture, while it also generates debate on the design of a new global mechanism or structure. This raises the question of how to turn the negative effects of the crisis into an opportunity. In the post-crisis world, will the EU's Black Sea neighbours demand to establish closer relations with the EU, thus promoting integration? Will the EU have the requisite policies in place to accommodate its eastern neighbours? Can Russia and the West develop a more sober relationship, profiting from their shared bitter experience in confronting the crisis?

The crisis conceivably provides the opportunity for a new paradigm, a new strategy in the relations between the European Union and the Black Sea Region which accommodates the interests of regional hegemons like Russia and Turkey as well as those of their smaller and less powerful neighbours.

The crisis conceivably provides the opportunity for a new paradigm, a new strategy in the relations between the European Union and the Black Sea Region which accommodates the interests of regional hegemons like Russia and Turkey as well as those of their smaller and less powerful neighbours. A coordinated common approach very well follows the logic of the promotion of "effective multilateralism" which was highlighted in its 2003 European Security Strategy (Emanouilidis 2009). With all EU initiatives towards the East (European Neighbourhood Policy, Eastern Partnership, Black Sea Synergy) having their own set of problems, a rethink of policy is necessary. In order to maintain stability in the region, the focus needs to be on stopping neighbouring states from collapsing into deeper crisis (the opportunity) and to curb the return of spheres of influence in the region (the challenge) (Leonard 2009). In order for this to work, the formulation of a new regional dimension enhancing existing policies might be necessary.

This implies work on two fronts. Internally, the EU and its institutions have to regain the upper hand in building solidarity for joint action; externally, the Union needs to regain its lost power of attraction. Much depends on political will and the promotion of policies where the Union has taken the lead, such as environmental policies on climate change and energy use; nature and biodiversity; air pollution and health impacts; water use and pollution; and waste generation and use of resources that impact the populations of all EU and Black Sea countries including those of Russia and Turkey. Such an approach has worked well within the context of the Northern Dimension with the Northern Dimension Environmental Partnership, which isa result-focused initiative responding to calls from Russia and the international community for concerted action to tackle some of the most pressing environmental problems in the Northern Dimension Area. This model can and should be replicated in the Black Sea Region. Other logical sectors for cooperation include finance, transport, energy, telecommunications, and trade facilitation.

The rationale for cooperation is to seek cost-effective solutions among neighbouring countries since the expected costs for infrastructure development are very high as is the need to work together. In this regard, coordinated cross-border projects could provide the requisite stimulus in the short term. The same applies over the long term in order to deal with the "challenge of poor or worn out infrastructure that represents a potential bottleneck to the post-crisis resumption of healthy economic growth for most Black Sea countries" (Gavras and Iorga 2009).

Joint action could also be taken in exploring the feasibility and limits of President Sarkozy's call for a 'joint economic community' on a continental scale between Europe and Russia and President Medvedev's idea of a European Security Treaty. In both cases, the EU reasserts itself as an economic heavyweight by taking the lead and begins to assume its responsibilities for the stability, security and prosperity of the continent while insisting that the interests of its smaller eastern neighbours will be accommodated.

In other words, the financial crisis has highlighted the problems of the current financial order and the need for its repair; it has also magnified the political implications of inaction as populism, jingoism and nationalism are on the rise. The crisis therefore provides an opportunity for a leap forward through the mobilisation of leadership, the pooling of resources, and concerted action. The European Union, through its emphasis on solidarity and cumulative joint action, is well placed to take this lead, to absolve itself from the shackles of perennial treaty ratifications, and to assume its share of responsibility in managing the European continent accounting for its interest, those of other great powers and its smaller, democratic neighbours that need to be assured that their integration is on track.

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Endnotes

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1 The latest example being the buyout of F.C. Portsmouth by an investor from Dubai for 60 million in October 2009.

2 The attempt to have a say in the global economy through the promotion of national state-owned champions such as Gazprom.©

Similar problems, No Single Solution: The Social Costs of the Global Crisis

International Centre for Policy Studies

In January 2009, protesters took to the streets of Reykjavik, Iceland, to denounce their "incompetent government." By the end of the month, that government had fallen. This is what happens when recessions have major social consequences – which they always do.

Background of the Recession

The Geography of the Crisis

Europe has been in an economic crisis since the second half of 2008, when the European Union lapsed into a "technical recession." For the most advanced economies of EU25, this is the deepest recession since the Great Depression of the 1930s. In emerging Europe – New Member States, as well as the Balkans and the Black Sea countries – the magnitude of the shock has been large, although of a different nature. As a result, economic declines in Eastern and Southern Europe have generally been worse than in the advanced economies. These downturns, however, are not comparable to the transitional recessions of the early 1990s.

For EU members, this is the deepest recession since the Great Depression - and the Black Sea region is faring even worse

While the economies of European countries differ in structure, the main negative effects of the crisis can generally be attributed to the following factors:

- the sudden cessation of capital deleveraging;
- a drop in demand for exports;
- unsustainable current account deficits.

After starting in the United States, the crisis quickly spread to Europe through a host channels. In some countries banks owned large quantities of the devaluating U.S. assets (Belgium, Germany, Switzerland); others had their own housing-market bubbles (Ireland, Spain, UK); still others (Austria, Greece, and Sweden) were home to banks with large subsidiaries in some of the regions hardest hit by the crisis. In Russia and countries of Central and Eastern Europe (CEE) banks and companies were highly dependent on global capital markets, which dried up. A number of countries have suffered from large declines in remittances, which until the crisis had been a significant component of their GDP (Armenia, Georgia, Macedonia, Moldova and Serbia). Europe has also suffered from reduced exports, falling commodity prices and declining tourism.

Due to structural differences, not all CEE and Black Sea Region countries entered the crisis simultaneously. For example, Russia and Ukraine enjoyed relatively high GDP growth over the first half of 2008, thanks to high commodity prices. These differences have also had an impact on the nature and extent of GDP drops in these countries. Because of its highly open economy and excessive reliance on export revenues from a single commodity group – ferrous metals – Ukraine has suffered the worst GDP contraction among emerging economies. As for the Baltic States, their problems are mainly due to the outflow of foreign capital.

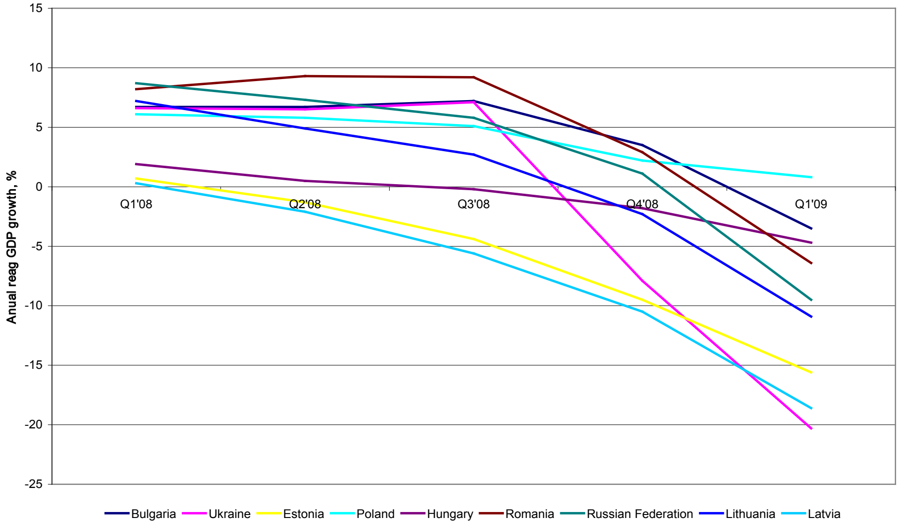

Chart 1. Annual real GDP growth (%)

Sectors Affected

Worst-hit sectors:
- *construction and real estate*
- *banking and financial services*
- *manufacturing, especially automotive*
- *retail trade*
- *export-oriented industries*

The crisis has not impacted all European states evenly. Some sectors have obviously suffered more than other. The most heavily affected sectors of the European economy have been construction and real estate, banking and financial services, manufacturing (namely the automotive sector), retail trade, and export-oriented industries.

The construction sector has contracted notably in all eastern European countries, and state support, which has been provided in most of them, has proven only partially effective in cushioning the blow. However, the state of the European construction sector cannot be compared to that of the US', which was at the core of the crisis. With a few exceptions (namely Spain), European countries are experiencing only a slight downturn in construction. This phenomenon is partly explained by differences in habits and attitudes toward housing between European nations. For instance, most British and German citizens prefer to lease flats, whereas home ownership is crucial to most Spaniards, Russians, and Ukrainians.

With the deepening of the crisis, it was investment in capital goods and consumer spending on durables that declined the most. Therefore industrial production in general and manufacturing in particular were especially hard hit. In February 2009 industrial production was down 18.4 per cent year-on-year in the Euro zone, and 17.5 per cent in the EU as a whole – a record decline. The largest declines occurred in Estonia (-30.2%), Hungary (-29.0%), Latvia (-24.2%), Spain (-22.0%), Slovenia (-21.2%), Italy (-20.7%), Germany (-20.6%), the Czech Republic (-20.3%), Sweden (-20.3%), and Finland (-19.9%). In the Black Sea Region, industrial production also declined dramatically, falling 34 per cent in Ukraine, 21 per cent in Turkey and 16 per cent in Russia.

The decline in manufacturing activity has been particularly large in the advanced economies. In January 2009 new orders in the Euro zone were down 34 per cent year-on-year, the largest monthly decline since Eurostat began compiling this data in 1996. Especially hard hit were European exporters of manufactured capital goods such as Germany, the world's largest exporter of manufactured goods. In Ukraine, the decline in steel and metal production has been especially large: 43.3 per cent in the first quarter of 2009.

The automotive sector has been among the hardest hit. This is due to the fact that cars have a relatively long potential life, and therefore represent a discretionary expenditure that can be postponed in uncertain times. In addition, cars are mostly purchased on credit – and the collapse of credit markets has made financing hard to come by. To a large extent, the declining demand for cars was also driven by the deterioration of consumer confidence across Europe. In the final quarter of 2008 European new car sales were down 19.3 per cent. In the EU, automobile production, which accounts for 6.5 per cent of the manufacturing sector, has declined significantly.

Some governments have provided various types of support. Germany is by far the largest producer of automobiles, but in February production was down 65 per cent year-on-year. Car production per capita is even higher in several New Member States (namely Slovakia, Slovenia, and the Czech Republic), where it accounts for a sizeable proportion of industrial production. By January 2009 automobile production had declined by 60 per cent in Turkey. In March 2009 car sales were down 47 per cent in Russia.

The expansion of the financial services sector over the last two decades, especially in economies such as that of the UK, probably came at the expense of the manufacturing sector. As their financial sectors grew, these countries underwent a process of "deindustrialization," such that by 2007 manufacturing accounted for only 13 percent of total value added in these economies; this was almost 10 percentage points less than in Germany. The crisis is likely to result in a decline in the size of the financial industry, and as a result it is expected that manufacturing, and especially its human capital aspects, might shrink.

This will have wide-ranging repercussions. Geographically speaking, manufacturing is generally more widely dispersed than are financial services. More manufacturing may therefore slightly alter the geographical distribution of jobs and hence reduce some of the geographical inequalities that have developed in these economies. In addition, since manufacturing provides relatively high-wage jobs for workers without university degrees income inequality between the educated and the less educated may also increase.

As is usual in an economic downturn, world commodity prices have declined considerably. As a result, commodity exporters have suffered a large decline in export earnings. The decline in energy prices has been especially large, and this has had major repercussions for Russia.

World trade has declined significantly over the last year, generally declining by 25 to 50 per cent. This has been due both to a decline in national incomes and consumption and to the collapse of trade financing as credit markets seized up. In January 2009 EU exports were down 24.8 per cent year on year, and imports down 22.1 per cent. In February 2009 Russian merchandise exports declined by 47.5 per cent and imports fell 36.5 per cent.

Social Challenges Driven by the Recession

Falling Revenues

The crisis led to rising budget deficits across the board. This is because shrinking economies reduced budget revenues while increasing the need for state spending.

Ireland, Greece, Spain, France, Latvia and Romania had already exceeded the maximum 3% deficit in 2008, and the European Commission envisages a further worsening in 2009. In the case of Romania, the budget deficit in 2008 reached 5.2% of GDP which is almost twice as much as in 2007. Ireland posted a 6.5% deficit last year, (after a 0.2% surplus in 2007), while Latvia's deficit stood at 3.5%, Greece's and Spain's at 3.4%, and France's at 3.2%. This undermines the ability of these states to meet their social obligations and ensure the sustainable wellbeing of their citizens.

Boosting spending at a time in which revenues are contracting for an uncertain period is a complicated matter. Policymakers should be aware that there is no "free lunch" and that budget deficits can inflate debt to unsustainable levels.

No "free lunch": budget deficits push state debts to unsustainable levels

Hard Choices for the Baltic States

Four emerging markets - the Baltic States and Bulgaria – are planning to join the European monetary union (EMU) in the near future. As part of this process, they have created and maintained the Currency Board Arrangement (CBA).

Under the CBA, for each unit of local currency (at a fixed exchange rate), a corresponding value of hard currency must be kept in the central bank's reserves. The supply of local currency can be increased only if reserves have grown. While their currencies were pegged to the Euro, inflation in these four countries was notably higher than in EMU countries; as a result, their real effective exchange rates were constantly appreciating. Today Latvia, Lithuania, Estonia and Bulgaria face a difficult choice: either devalue their currency, or reduce wages and incomes paid in it.

Latvia has chosen to cut wages. The government has imposed cuts of 15% across the public sector as part of a deal on a loan package with the IMF and the European Union. In June 2009, wages in the country were down 9.5% year-on-year in the public sector and up 0.4% in the private sector. In July 2009 Lithuania's lawmakers also approved a second revision to the 2009 budget plan that includes 10% public sector wage cuts, after earlier slashing spending by 7% of the gross domestic product in H1'09.

However, in most Eastern and Southern European countries debt-to-GDP ratios are low enough and fiscal sustainability is not really an issue. The main problems have instead to do with external balances. In Central Europe current account deficits are mostly driven by the deficits on the income account. Thus the new member states not in the Euro zone faced, in the last months of 2008 and in 2009, sizable depreciations of their national currencies against the Euro.

The real incomes of many Europeans have fallen

This problem is even more significant for the countries of Black Sea Region. Russia and Ukraine, Moldova and Turkey have also experienced substantial devaluations of their currencies, combined with a decline in their own purchasing power.

In other words, the real incomes of many Europeans have fallen.

The Bulgarian Economy Blows Up

Bulgaria's main problem is its excessive current account deficit, which reached 25% of GDP in 2007-2008, the highest of the 80 emerging markets around the world tracked by Fitch Ratings. Gross external debt, needed to finance the deficit, reached 102% of GDP.

Low-income small country, Bulgaria, especially after getting EU membership, attracted quite a bit of foreign investment. Much of this capital was attracted by the real estate market. In 2007 Bulgaria was indeed one the most popular destinations for Britons buying property overseas. It is also the number-one destination for Russian buyers. Bulgaria's economic prospects attracted many international companies, which resulted in rising demand for real estate, especially in Sofia.

There was speculation on the existence of a property bubble in Bulgaria at least as early as 2006. As it has been the driving force behind GDP growth in Bulgaria most players in the market, including government, have been satisfied with the situation. However since late 2008, there has been sharp drop in the real estate market.

A Decline in Employment

The economic downturn is affecting the European labor market very profoundly. The EU27's unemployment rate rose to 7.6% between October 2008 and January 2009. However, according to recent data on unemployment rates in large European economies (Great Britain, Spain, France, and Germany), the crisis has not had a uniform effect on employment. Germany and France both continue to enjoy declining unemployment rates. In contrast, Spain, where the global credit crunch has pummeled the construction sector, is experiencing a substantial rise in unemployment. Britain has experienced a moderate rise.

In general, the highest rates of joblessness have been observed in those countries (Iceland, Ireland) most dependent on industries especially affected by the crisis, or in those with profound structural problems (Greece, Hungary, the Baltic countries). In the states of Black Sea Region both of these factors have led to strong declines in labor markets. However, the real situation here is not very accurately described by the official statistics, which are less reliable in non-EU countries.

The crisis affects the job prospects of socio-economic groups differently

Relatively modest increases in unemployment in Europe do not give the whole story, especially when it comes to the social consequences of the crisis. There can be a major split between well-educated people, who can relatively easily find new jobs in growing sectors, and the socially vulnerable, such as blue collar workers, young people and those living outside major cities.

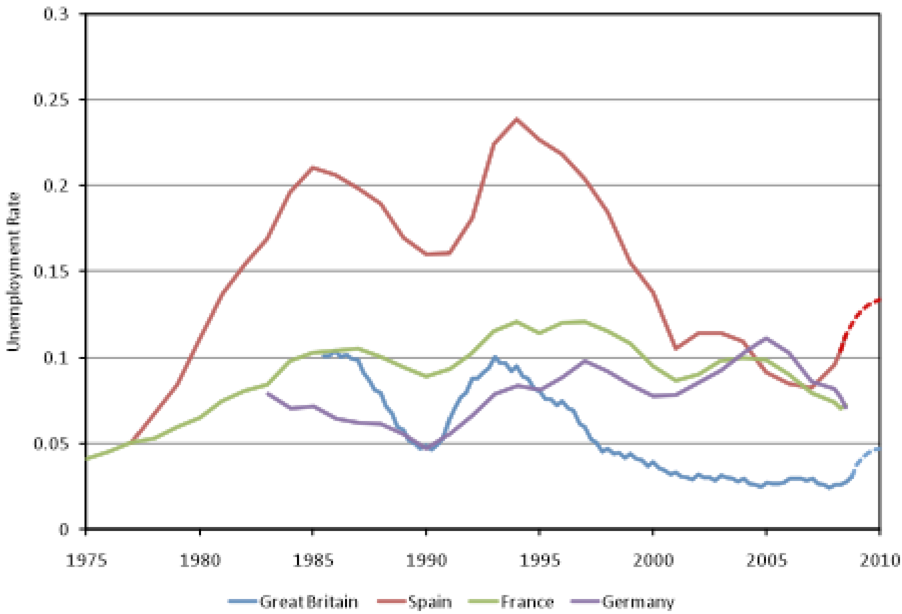

Chart 2. Unemployment rates in Britain, Spain, France and Germany

Jobless Youth in Moldova

The economic crisis has led to increased unemployment in Moldova, with youth (aged 15-24) unemployment rising to 16 percent in the first quarter of 2009 (compared to 14 percent in 2007). Young people will be hardest hit by the crisis, with the number of unemployed youth expected to increase to between 11 and 17 million by the end of 2009.

Moldova is already among the poorest nations in Europe (26 percent of the population officially considered poor), with about two-thirds of the poor living in rural areas. The situation in the labor market is complicated, with Moldovan working migrants unable to find jobs in crisis-stricken Europe, and therefore returning to Moldova. Consequently Moldova suffers not only from excess labor, but also from a drying of cash flows: indeed, up to 60% of Moldova's GDP was based on remittances.

Another explanation for the different unemployment rates between European countries lies in the fact that most advanced economies have reacted to the crisis by squeezing immigrants from less developed states (Eastern and Southern Europe, the Balkans and the Black Sea Region) out of their labor markets. Forced to return home, these migrants have put additional pressure on the labor markets of their home countries, while at the same time easing it in the countries where they used to work. This artificially distorts variations in both the supply and demand of labor.

The Migration Whirlpool

While new migrants are arriving, some are returning home

The global crisis has reshaped migration trends in Europe. Due to a drop in business activity and therefore in demand for labor, many working migrants, especially those working illegally, are returning home. Thus along with new waves of migrants moving from Eastern and Southern Europe to the more prosperous EU economies in search of jobs, there is a reverse flow of those unable to find work abroad.

The crisis has increased the risk of irregular work – and hence of the loss of work/residence permits – not only for newcomers, but also for migrants who have been legally settled for years. Irregular migrants usually have less to lose than legal migrants if they return home, but they will find re-entry very difficult.

The current labor migration situation in Europe cuts both ways. It creates social challenges not only for less-developed New Member States, the Balkans, and the Black Sea Region, where emigrants are returning home, but also for the traditional destination countries, which have to deal with large numbers of jobless foreigners.

In Spain, for instance, unemployment has risen to 17% in the general population, but to 27% among foreigners. In addition, new irregular migrants are still arriving in Spain to seek employment in the shadow economy. The situation in Italy is very similar, as the unofficial economy continues to provide a safety net for migrant workers.

While the UK appears to have been hard-hit by the recession it remains unclear whether migrants are leaving the country or still arriving. Incentives to register are very low for short term migrants; it is therefore impossible to accurately count the number of migrant workers in the country today. Migrants from new EU member states, most of whom are there legally, may be temporarily going home to check out the job situation in their countries of origin, while migrants from developing countries, namely the Balkan states and those of the Black Sea Region, are most likely staying put because employment prospects in their own countries are worse than in the UK. At the same time, the number unemployed in the UK has reached 3 million. It is expected that there will be an increase in irregularity among currently legal migrants that have been in the UK for a longer period of time, as it will become increasingly difficult to secure a job in the formal labor market.

The situation in Greece varies for different categories of migrants. As regards employment in the countryside, migrants will stay where they have networks to help them find employment, instead of circulating through different areas to look for jobs. More recent arrivals are likely to consider returning, but those who are in Greece on a long-term basis are not likely to return. In fact, the main impact of the crisis on the migration situation in the country has been to further slow the social and economic integration of immigrants who, forced to seek employment in the shadow economy, lose their residence permits and hence have to start all over again. Employers seem to be taking advantage of the crisis to pressure workers by lowering their wages, refusing to pay overtime, and not paying welfare contributions.

Russia and Ukraine are among the world's four top destinations and countries of origin

In the Black Sea Region, the crisis has both intensified existing migration challenges and revealed new ones. As the region is a major transit zone for EU-bound migrants, social and economic conditions there are greatly affected by changes in migratory patterns. Significantly, according to a 2008 World Bank report the Russian Federation and Ukraine rank simultaneously among the top four destinations and countries of origin for migrants.

Also essential is the importance of remittances to the economies of many Black Sea Region countries. As measured by the proportion of GDP, Moldova is the world's most remittance-dependent country – followed closely by Armenia, Georgia and Romania.

Countries in the Black Sea Region tend to play similar roles in European migration processes. As they are simultaneously countries of origin, transit countries and destinations for working migrants, they require strong and efficient policies. However, when the crisis hit none of them had an adequate regulatory framework – and as their governments have had their hands full dealing with the immediate effects of the recession, migration policy reform has since moved further down their to-do lists.

Chain Reactions

Consumer and business confidence indicators, which have sunk to record lows, are revealing symptoms of the crisis' depth in the EU and the Black Sea Region. In March 2009 EU Economic Sentiment Indicators were at their lowest since their creation in 1985. Surveys of consumer confidence in the Russian Federation and Ukraine during Q1'09 also showed a steep decline.

The direct economic and social consequences of the crisis were followed by further negative social phenomena, such as pessimism and anxiety. This has caused a considerable increase in the consumption of alcohol and antidepressants, especially in those countries most heavily hit by the crisis (Iceland, the Baltics, etc.). The rise in joblessness, which was extremely sharp in several vulnerable social groups, such as youth and visible minorities, led to higher crime rates. However, the relatively short duration of the recession has spared Europe a major increase in such social threats.

The relatively short duration of the recession has spared Europe a major increase in crime rates

Social unrest is also a natural reaction to governmental failures. During the recession unrest has occurred in many European countries, both rich and poor. For instance, in Latvia over 10,000 people joined a January 2009 demonstration against their government's economic policies, making it the biggest since the country's independence in 1991. The reason for these mass protests was reduced wages. Indeed, the government has imposed 15% cuts across the public sector as part of a deal on a loan package with the IMF and the European Union. The situation in Iceland was even worse, as the government collapsed in the wake of an unprecedented season of protests.

Anti-crisis Governance and the Policy Debate

Investment VS Consumption

The economic and financial crisis has prompted the states of the EU and the Black Sea Region to adopt new anti-crisis packages. Although dealing mostly with the improvement of economic conditions, they are also designed to reduce the social impact of the recession. Still, only a few of these initiatives have direct social implications.

No consensus has emerged on whether to stimulate investment or consumption

Currently, the measures envisaged are largely focused on encouraging demand based on fiscal incentives and support to certain sensitive economic sectors. However, there is no consensus between European states on whether to stimulate investment or consumption. The national plans of several old and new member states, as well as of Black Sea Region countries, are summarized below.

Recovery Plans in Europe[7]

<table>
<tr><th>Consumption Stimuli</th><th>Investment Incentives</th></tr>
<tr><td colspan="2">Germany: emphasis on investment</td></tr>
<tr><td colspan="2">50 billion in total for the recovery plan
470 billion for the financial sector, of which 400 billion consists of guarantees subject to uncertainty
Given its strong fiscal position, Germany should enjoy a balanced budget with the recovery plan
The financial rescue plan’s short-term fiscal impact could be large, but with low interest rates, high dividends, and capital gains from privatization, government debt should not increase in the medium term</td></tr>
<tr><td>Tax cuts in depreciation, travel costs deductibility for commuters, special designations for families
Investments in infrastructure, housing; structural programs for specific regions
Credit to SMEs, CO2-savings and energy-efficient innovation by companies</td><td>Loan guarantees, recapitalizations or equity support, and assumptions of risky assets
Equity support
Several banks applied for loan guarantees, limited attention for capital support</td></tr>
<tr><td colspan="2">France: protectionism and social responsibility</td></tr>
<tr><td colspan="2">26 billion for the recovery plan and another 6 billion for the automobile industry
360 billion for the financial sector, of which 320 billion are guarantees
The recovery plan will raise the deficit to 4% of GDP, despite its economic benefits
Government debt should rise to 67.5% of GDP, mainly due to the financial sector plan</td></tr>
<tr><td>Fund investment projects in automobiles, housing, construction (i.e. infrastructure and public facilities) and public debt
SMEs will get tax breaks
Unemployed persons will be retrained
Rescuing the automobile industry</td><td>Recapitalization and buying up troubled banks’ assets by a state-owned company
Credit guarantees for the medium term, to stimulate financing for businesses (especially SMEs)</td></tr>
<tr><td colspan="2">United Kingdom: rescue the financial sector at any cost</td></tr>
<tr><td colspan="2">Initially 20 billion for the recovery plan; additional guarantees for firm lending (but these are not immediately materializing)
Additional 50 billion for recapitalization, and 450 billion in guarantees
The newly announced plan may cost up to an additional 50 billion in assets bought and even more in guarantees
Total debt is expected to rise from 41.2% to 48.2% in 2009, increasing thereafter. The fiscal deficit will increase from 5.4% to 8.1% but will decrease after 2009
30% devaluation of the national currency against the USD</td></tr>
</table>

<table>
<tr><td>• Reduction in VAT
• Postponing corporate tax increases, and small firms can defer payments
• Advancing investments in housing, energy, infrastructure, and schools
• Home owners' support package
• Guarantee 50% of small and medium-sized firm lending up to 20 billion</td><td>• Nationalization of two banks
• Bank recapitalization
• Special liquidity scheme
• Additional debt guarantees
• Buying up assets and guarantee some top-rated asset-backed securities</td></tr>
<tr><td colspan="2">Belgium: substantial support for the banking sector plus special social initiatives</td></tr>
<tr><td colspan="2">• 2 billion for the recovery package
• 19.9 billion for bank bail-outs and guarantees, and a further 90 billion in guarantees in the inter-bank market and liabilities and assets guarantees
• The fiscal deficit will be 2.6% in 2008, and a balanced budget in 2009
• The public debt will rise from 84.9% to 88.3% by the end of 2008</td></tr>
<tr><td>• Tax cuts including lower VAT on construction, delaying VAT payments for companies and energy rebates for households
• Higher unemployment benefit
• Food and energy vouchers for workers
• Credit guarantees for SMEs
• Accelerating infrastructure projects</td><td>• Nationalization of one bank
• Capital injection into banks
• Stabilizing the inter-bank market
• Borrowing guarantee</td></tr>
<tr><td colspan="2">Spain: mighty policy reply for housing challenge</td></tr>
<tr><td colspan="2">• 50 billion for the recovery plan
• 250 billion for the financial sector, of which 200 billion consists of guarantees
• The Spanish government intends to fund this mainly by borrowing, making the impact on the deficit fairly small</td></tr>
<tr><td>• Public infrastructure investments, environmental projects and investment in R&D
• Stimulus for the auto industry
• Credit to SMEs
• Income tax deduction
• Extension of housing construction support
• Abolition of wealth tax</td><td>• Buy up healthy assets to provide liquidity
• Provide bank debt guarantees
• Enlarge deposit insurance coverage</td></tr>
<tr><td colspan="2">Italy: consumption is the only hope</td></tr>
<tr><td colspan="2">• 80 billion injection in the market over the next two to three years
• 110 billion in public spending expected over the coming years, given the European resources and the Italian regional cohesion fund
• Italy's economy is stagnating and its public debt exceeds its GDP</td></tr>
</table>

<table>
<tr><td>• Bonus for low-income families in the form of tax credit
• Tax deductions and an increase in the funds for technical unemployment</td><td>• Capital injections banks
• Stabilizing the inter-bank market</td></tr>
<tr><td colspan="2">Slovakia: efficient policies to minimize the impact of the recession</td></tr>
<tr><td colspan="2">• Transition to the Euro eliminates certain risks, such as the risks related to exchange rates
• Streamlining of administrative procedures and a cut in the bureaucracy companies have to deal with
• Small companies will have to apply only primary accounting</td></tr>
<tr><td>• Reduction of taxes paid by employees
• Financing line for SMEs, jointly with the commercial banks
• The deadline for recovering the VAT has been reduced from 60 to 30 days for monthly VAT payers
• Focus on stimulating internal demand and accelerating the implementation of structural funds
• Stimulus for the auto industry</td><td>• Enlarge deposit insurance coverage
• Credit guarantees to stimulate financing for SMEs</td></tr>
<tr><td colspan="2">Hungary: controversial fiscal policy in the grip of the recession</td></tr>
<tr><td colspan="2">• $ 25.1 billion support package from the International Monetary Fund</td></tr>
<tr><td>• Higher taxation of consumption and properties
• 4% “solidarity” tax on the earnings of companies and persons with high incomes to be applied
• Value-added tax will grow from 20% to 23%
• Employees’ contribution to social insurance will be reduced by 5%, from 32% to 27%, in two stages</td><td>• Enlarge deposit insurance coverage
• Borrowing guarantee</td></tr>
<tr><td colspan="2">Turkey: banking stability</td></tr>
<tr><td colspan="2">• Banking sector in good condition
• 30% devaluation of national currency against the USD
• Unsustainably high state debt</td></tr>
<tr><td>• Temporary tax cuts on automobiles, home appliances and housing
• Cut budget spending between $5.1-$6.39 billion</td><td>• Stabilizing the inter-bank market
• Credit guarantees to stimulate financing for SMEs</td></tr>
<tr><td colspan="2">Russian Federation: massive injections undermine sustainability</td></tr>
</table>

<table>
<tr><td colspan="2">• $43 billion paid off on corporate debts
• An additional $50 billion to be made available
• 6.7% of GDP spent on anti-crisis measures
• 34% devaluation of national currency against the USD
• Sharp drop in foreign exchange/gold reserves</td></tr>
<tr><td>• Fiscal support focused on the financial sector and enterprises, rather than on households
• Taxation incentives to support development of the real economy</td><td>• Banks received substantial financial resources to overcome the liquidity crisis
• Special liquidity scheme</td></tr>
<tr><td colspan="2">Ukraine: the hardest hit and the weakest response</td></tr>
<tr><td colspan="2">• $ 16.4 billion support package from the International Monetary Fund
• $ 0.75 billion loan from the World Bank
• 60% devaluation of national currency against the USD</td></tr>
<tr><td>• Rising fiscal pressure on businesses
• State redemption in housing
• Duties on cars and refrigerators temporarily increased</td><td>• Bank recapitalization
• Enlarge deposit insurance coverage</td></tr>
</table>

Most European countries have taken steps to bail out banks through capitalization, by providing state guarantees, or simply by taking them over. France, Germany, Italy, Slovakia, Spain and the UK, as well as Ukraine, have also chosen to provide aid to the automotive industry, one of the industries worst affected by the crisis. Many member states are providing tax cuts and consumption stimuli. However there is a risk that these funds will be saved rather than spent. Germany, France, Hungary, Russia and Ukraine are focusing on stimulating private and public investment and providing very few consumption-related measures.

The stability of the banking system is linked to social and political stability

Banks all over Europe have received substantial financial resources to help them overcome the liquidity crisis. On the one hand, these measures have been aimed at supporting production activity. This is especially important for emerging European economies (Russia, Ukraine, etc), as the availability of lending resources, not the stock market, is a source of growth in the real sector in these states. On the other hand, the stability of the banking system is directly linked to social and political stability. The loss of individual bank deposits will be much more painful and politically dangerous than any loss in the stock market could be.

Populism VS Pragmatism

"In the UK everyone is a social democrat now," read a headline in The Financial Times on October 7, 2008. Indeed, the political demand for non-liberal policies is always heightened during economic crises and social cataclysms, and today's situation is no exception. Two such non-liberal trends have survived the last 150 years: socialism and populism.

Both models were tested in the 20th century, and both failed to live up to expectations. Socialism was mostly attempted in Europe and Asia, while populism was tried in Latin America. The results are well known: both experiments flopped. Socialism solved the task of industrialization (at an enormous cost), but it did not succeed in supplying the internal resources necessary for further development. As for populism, it drove flourishing countries, like Argentina, to economic and social disaster.

When the financial system is about to collapse, it seems natural to turn to non-market policy approaches

When the financial system is about to collapse and people are apprehensive about reduced incomes, it seems natural to turn to non-market policy approaches, however unrealistic they may be, to maintain quality of life. Populist tendencies tend to go hand in hand with socialistic policies.

Recessions cause unemployment, and several through the help of budgetary injections. However this will only worsen the situation: countries overwhelmed by the crisis will have to spend vast amounts of money to support liquidity in the economy and bring stability to the lending system. Nevertheless, many countries – not only in the Black Sea Region (Russian, Ukraine), but also advanced EU states (Hungary, Greece, Iceland) – have chosen to go down this path.

Risk buyouts and financial aid to distressed corporations also come with unintended consequences. As the government saves debtors, recapitalizes the banks and increases guarantees on private deposits, it assumes the risks inherent to the decisions of all major economic actors – bankers, investors and borrowers. This process begins in the banking sector and spreads to other corporations and sectors through bank guarantees all over Europe, from Russia and Ukraine to UK and France. In fact it means the nationalization, whether explicit or not, of these entities.

State support and ineffective investment form a vicious cycle

Government decisions regarding the activities of these de facto nationalized institutions are be the next logical step. And if politically-motivated investments go wrong, the state will have to provide assistance to the implementing banks. Hence state support and ineffective investment form a vicious cycle. Unfortunately, the European Commission itself called for just this type of measure in the autumn of 2008.

Migration VS Unemployment

Migration policies have been toughened up in an attempt to alleviate pressures on labor markets

Southern European countries have been among the worst-hit by unemployment. As they are popular destinations for working migrants, some of these countries have tried to alleviate the pressure on their labor markets by toughening up their migration policies.

In Spain, the number of sectors in which foreign workers can be invited to work has been drastically reduced. Thus opportunities for legal employment have declined correspondingly. The proposed reform restricts the right to family reunification: the period of legal stay required for migrants to bring their families has been increased from 2 to 5 years.

A scheme encouraging legal migrants to return home has also been introduced. Under this system, unemployment allowances are paid in two installments: the first in Spain, second at the country of origin. Migrants who participate in this scheme undertake not to return to Spain for the next three years. However, fewer than 3,000 migrants – out of over 4 million – have chosen this option.

In Italy, labor inspection offices have been ordered to apply the law while "accommodating" the needs of the labor market. This means turning a blind eye to irregular employment. The situation is thus a function of increasingly difficult legal entry into the country and of labor market dynamics, rather than of government policy per se. These changes have made migrant workers, both legal and undocumented, even more vulnerable.

In Greece the number of work permits has been steadily decreasing. This has made the legal status of migrants very uncertain, as the lack of legal work has made it increasingly difficult for migrants to collect the welfare stamps necessary for the renewal of their work permits.

Concerns about working migrants returning back were unfounded

As for the Black Sea Region, it would not be an overstatement to say that there have been hardly any migration policy responses to the crisis. Indeed, concerns about masses of working migrants returning to their home countries appear to have been unfounded, as most have preferred to risk wage cuts and the possibility of irregularity to the even tougher employment situations at home. Devalued currencies in migrants' home countries have made the prospect of returning less appealing; in addition, many migrants work in households (where personal relationships can prevent job loss) or in occupations unattractive to the local labor force, and as such enjoy a certain degree of job security. However, men, a high proportion of whom rely on the more sensitive construction sector for work, often find themselves in more vulnerable situations. In addition, most Black Sea Region countries have been busy attempting to rescue their economies rather than developing comprehensive migration policies.

To sum up…

The economic crisis has raised similar social challenges throughout much of Europe

… The economic crisis has raised similar social challenges throughout much of Europe. From the Baltic to the Mediterranean and from the Pyrenees to the Caucasus, people are suffering from declines in standards of living and rising unemployment. However, the intensity of these symptoms varies from country to country. There are also specific social issues especially relevant to the less-developed countries of Eastern and Southern Europe, including the Black Sea Region. Labor migration is among the most significant of these.

To tackle the recession, European states have been implementing a vast array of economic policies. Generally speaking, although the shock was smaller in Europe than in the US, the European policy response was delayed and considerably weaker than that of the US. As a result, GDP declines have been as large, and sometimes even large. This is especially true for the emerging European economies, which have been unable to implement counter-cyclical macroeconomic policies.

The European economies have responded to the crisis with unprecedented fiscal stimuli and monetary easing. However, it is generally believed that the response has been inadequate, in both advanced EU states and the less-developed Black Sea Region. Only after the crisis will it be possible to fully assess whether the more aggressive response of the US was preferable to the more cautious European approach.

Endnotes

1 ICPS calculations

2 The poorest European Union population per capita

3 The Association of International Property Professionals.

4 Here and further in the sections statistics refer to EurActiv.com

5 Data from voxeu.org: “Unemployment in the current crisis”

6 Here and further in the sections statistics refer to CLANDESTINO project (http://clandestino.eliamep.gr)

7 Most of the data refers to the article “Banking rescue and economic recovery plans in the Netherlands and other EU Member States: Why the Dutch should do more” by Sylvester Eijffinger available at voxeu.org

8 Section based on the materials of “Russia in Global Affairs”

Comments on
Similar Problems, No Single Solution: The Social Costs Of The Global Crisis

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The global economic crisis took economists and policymakers by surprise. For months after September 14, 2008, when Lehman Brothers collapsed, they were focused on understanding the causes of the crisis and the economic policy response to it. While mass media was quick to present gloomy pictures of the social cost of the crisis, governments were more focused on tackling the crisis itself. Now, as the economy starts to recover, it is time to focus on social issues and to develop a policy framework that will help to mitigate the social costs of future cyclical crises.

In my opinion, policy research on the social costs of the crisis should take into account the following principles:

- Social costs should be the highest priority;
- Analysis of social impact of anti-crisis economic policies should be included;
- Positive examples should be highlighted.

1. Social costs should be the highest priority

Researchers have put too much emphasis on the analysis of the economic crisis itself as well as on policies to curb the crisis. While some believe that once economies start to grow, the social situation will improve on its own, I think that analysis should be more focused on the social impact of the economic crisis. Governments should be more prepared for future cyclical crises in order to be able to prevent the most drastic social effects.

I recommend considering the following groups of social implications of the crisis:

1.1 Those that create imbalances and tensions between social groups

- **Youth unemployment.** According to a *Business Week* report, in H1'2009 about 20% of under-25 EU citizens were looking for jobs compared to an 8.9% unemployment rate for the EU as a whole. In some countries, the situation is really dramatic; nearly 37% of Spain's Gen Y-ers can't find work, and in France, 24%. As history shows, youth unemployment poses significant security risks for society, bringing civil unrest, delinquency and high crime rates, as well as undermining lives for an entire generation. As some countries are more successful in coping with this issue and others have obvious policy flaws and structural inefficiencies, further research could focus on determinants of youth unemployment and recommend a set of policies based on available best practices.

- **Geographically concentrated crisis.** The depth of the current economic crisis varies significantly between sectors. Moreover, the sectors that were the fastest growing are the most hurt now (e.g. automotive, real estate). Because of this, there is an increased probability that some cities, towns and regions will feel a much stronger negative impact compared to others if they have a high concentration of the negatively impacted economic sector. This is especially true for emerging economies that are less balanced when compared to developed ones. Economic crises result in double trouble for such locations: residents lose their jobs and the local budget loses taxes and cannot smooth over social costs. This forces residents either to migrate (even if they do not want to) or to drastically lower their standard of living.

1.2 Those that create imbalances and tensions between countries

Data shows that new EU members from the last accession wave were among the worst affected by the crisis. This could be attributed to the post-accession economy overheating that was roughly stopped by the crisis (while Central European countries were luckier as their pre-crisis landing was much softer). Situations such as when Q2'09/Q2'08 real GDP growth varies from -20.2% in Lithuania to +1.1% in Poland undermine the EU as the most powerful regional institution. Unrest in many new member states (additional summarized information will be helpful) proves that there is a need in new policy mechanisms that could level the social impact of such crises. Instead, what we saw were pure ad hoc decisions, many of which were ineffective.

1.3 Those that are common but are not directly economical

In modern society, an overwhelming amount of information puts a lot of pressure on citizens. The media does not help in producing a clear picture; on the contrary, it exaggerates trends, especially negative ones, playing on fear as one of the strongest emotions. This means that even if a citizen is not hurt by the crisis himself, he may be depressed and distressed because of the doom and gloom in the media. This undermines the quality of life as well as the physical and mental health of affected groups. Public communication policies should take this into account, especially in those societies that lack traditional values (faith, family, etc.) which could be positive anchors in crisis time.

2. Analysis of social impact of anti-crisis economic policies should be included

During this stage researchers should concentrate on the potential social implications of an anti-crisis policy response. This is especially important for emerging economies which have low trust in the national currency and cannot afford to have high fiscal deficits. Finding the right balance between stimulating the economy, mitigating social costs and maintaining financial stability is a very complicated task. Further, crisis pushes governments to move fast, and anti-crisis policies are often under-researched and create ineffective stimuli.

3. Positive examples should be highlighted

In many cases, the research focuses only on negative examples, which does not help in bringing about vision for how to deal with the crisis and its social costs.

Having a regional focus in mind, additional analysis is needed on:

- Positive economic policy examples (e.g. Poland, Czech Republic), and
- Positive social cost minimization examples.

It has been shown that there was a correlation between the level of consumer confidence in the country before the crisis and the depth of the crisis itself. For instance, in Poland, the consumer confidence index during the summer of 2008 was two times as high as that in Hungary. Further research could increase understanding of the common determinants that influence consumer confidence, GDP growth and the social impact of the crisis.

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