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Building a Closer Black Sea: Promoting Regional Trade and Economic Interdependence

Paskal Zhelev

Introduction

The Black Sea area has historically been of significant geostrategic importance as a connecting link between Europe, Asia, and the Middle East and a transit point on global East-West and North-South trade routes. However, its location has not made the region a vibrant zone of commerce, transport, energy, tourism, or cultural exchange. Rather, it has become a theater of struggle for dominance and competing geopolitical and geo-economic interests.

The dissolution of the USSR laid the foundations for today's Black Sea region,¹ but it also created new challenges and caused longstanding tensions to resurface. Ethnic confrontation, historical remnants, and the emergence of new, independent players pursuing their own sovereign interests — often contrary to those of their former metropolitan state — have triggered antagonism and major conflicts, with Russia's steady participation.

Russia has found it difficult to adapt to the reality of neighboring countries being attracted to other geopolitical and economic actors and models. Unable to retain these countries within its sphere of influence, Moscow has adopted aggressive policies toward those post-Soviet Black Sea countries (BSCs) aspiring to NATO membership and EU integration. This began in 2008 when Russia invaded Georgia and backed separatists in South Ossetia and Abkhazia. Then in 2014, after Kyiv chose European over Eurasian integration, Russia violated Ukraine's territorial integrity with the unprecedented act of annexing the Crimean Peninsula.

A large number of mostly developed countries, led by the United States and the European Union, have imposed international sanctions on Russian businesses and individuals. While these sanctions have slightly weakened the Russian economy, they have done little to reverse

¹ In this paper the most straightforward approach is used to identify the Black Sea region by looking at the geographical area determined by the Black Sea catchment as a center of gravity and the six riparian states (Bulgaria, Georgia, Romania, Russia, Turkey and Ukraine). Furthermore, the terms "Black Sea area," "Black Sea region," "Black Sea space," "Black Sea zone," and "Black Sea countries" are used interchangeably.

the seizure of Crimea. Russia has responded with countersanctions, including a total ban on food imports, which in addition to achieving foreign policy goals, have served as a successful import-substitution protectionist measure. Furthermore, since 2014, Russia has significantly increased its military presence in the Black Sea, turning it into a highly militarized area.

These developments have dire consequences for regional security and stability, disrupting political and economic ties in the Black Sea area and beyond. The current status quo serves no one. But open confrontation, compounded by a lack of trust and mutual understanding, has resulted in escalation that makes resolving conflicts in the region inconceivable for the foreseeable future. Managing these conflicts, however, is absolutely crucial and will require huge efforts from the BSC political elites and influential external players.

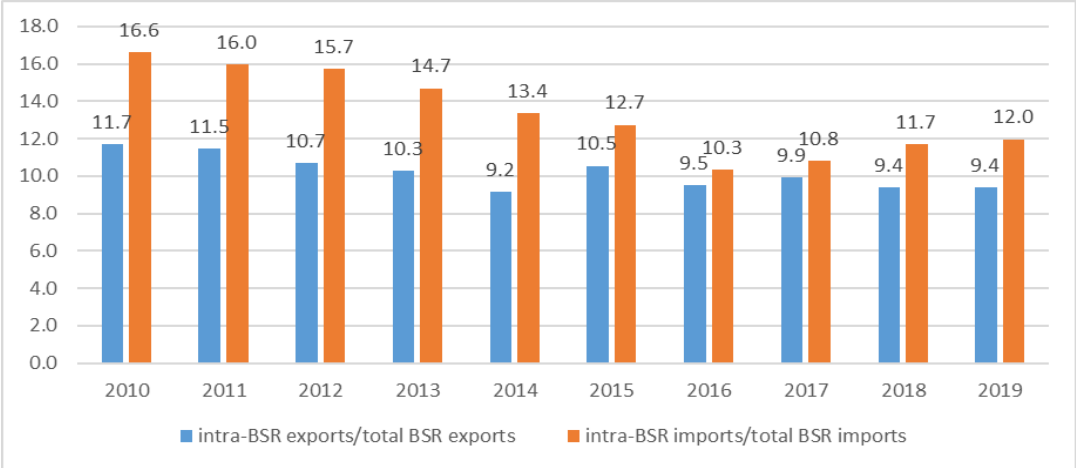
A long-term solution to the security issues of the Black Sea region could be based on intensifying trade relations and increasing economic interdependence between the states. This paper first identifies major barriers toward closer trade and economic cooperation among BSCs, before outlining ways to overcome them.

Challenges for Black Sea regional economic cooperation

In 2010, BSCs exported goods worth more than \$634 billion. A decade on, total exports from the region globally have grown by almost 20% to more than \$757 billion. However, a different trend has occurred with intra-regional exports, which contracted from \$11.7 billion in 2010 to \$9.4 billion in 2019. The same dynamic has played out in terms of imports to the region, which have increased from international partners but decreased within the region. This indicates that over last decade, there has been a tendency toward trade disintegration. That is, BSCs prefer to trade more intensively with third countries at the expense of their regional partners. The share of intra-regional exports in total exports dropped from 11.7% in 2010 to 10.4% in 2019, while that of intra-regional imports in total imports fell from 16.6% to 12%.²

² Only one BSC can be considered as highly integrated and dependent on the region. For Georgia, the BSR is the main export market (a share of almost 49% in 2019) and the largest source of imports (nearly 41%). The least dependent on the regional market is Russia. Just 5% of its imports and around 8% of its exports are realized in the BSCs. Source: own calculations based on ITC data

Figure 1: Shares of intra-regional exports and imports in total BSR's exports and imports (2010-19, %)



Source: Author's calculations based on ITC data

Regional cooperation in the Black Sea has faced a number of barriers. Active and frozen conflicts currently pose the greatest challenge not only to bilateral trade and economic relations, but also to future regional development. But there is another important barrier to regional economic cooperation: the heterogeneity of countries in the region.

Countries of the Black Sea are tied together by geography but are different in so many other ways — territorial size, population, economic structures, and political orientation. In this sense, it is difficult to view the Black Sea as a region at all. Regional cooperation is greatly facilitated when participating countries possess a high degree of economic, political, geographical, or cultural similarities. The heterogeneity of BSCs have prevented them from engaging in a closer economic relationship.

Economics

To start with, there is a high level of divergence in terms of economic characteristics, signifying a great deal of bilateral asymmetries. Russia, the region's largest country, is home to almost half of the region's total population (47.8%) and represents almost 58% of the total output. On the other end, Georgia is home to just 1.2% of the region's population and accounts for a mere 0.6% of its GDP. Romania is the region's most economically advanced country with an income

per capita of almost \$13,000. This makes it 3.5 times richer than the poorest economy of Ukraine, which in 2019 had an income per capita of just \$3,700.³

Second, a major impediment to closer cooperation within the Black Sea region (BSR) is a divergence in terms of geopolitical and geo-economic orientation. The *existence of competing regionalisms* — that is, of alternative regional integration projects — prevents the establishment of a free trade area among the BSCs and a true regional economic bloc. The major dividing line is between EU-oriented states (members Bulgaria and Romania; membership candidate Turkey; and associate countries Georgia and Ukraine) and Russia, which has initiated its own regional integration project: the Eurasian Economic Union (EAEU).

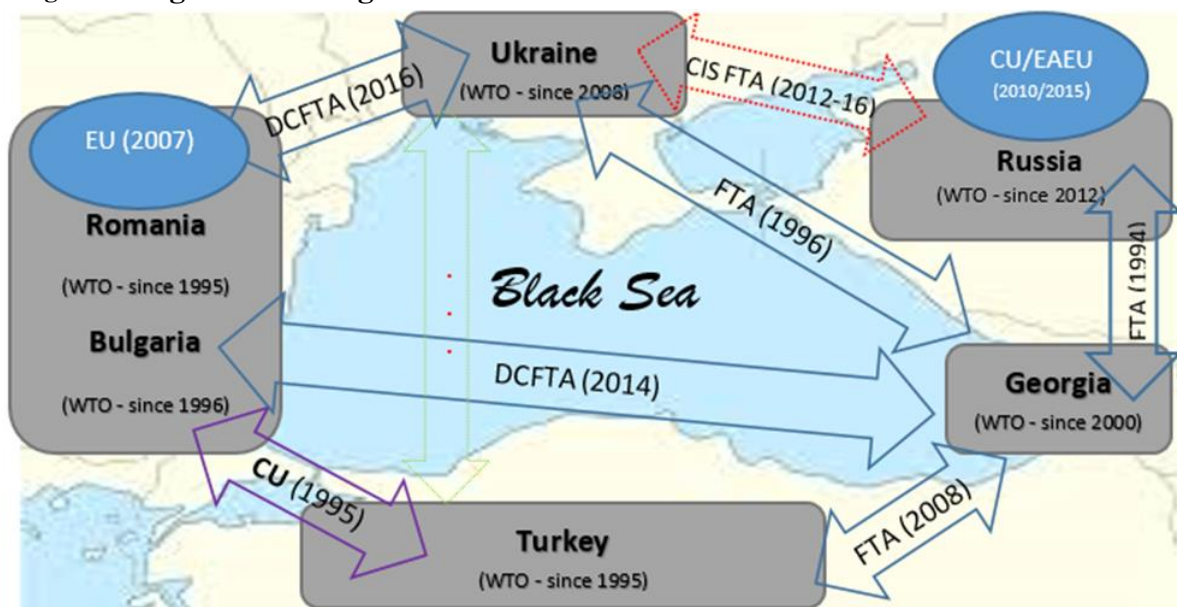
Since both the EU and the EAEU represent advanced forms of regional economic integration, simultaneous participation in both is impossible. States are therefore forced to choose which bloc they wish to engage with while sacrificing membership in the other. Armenia, which has needed to factor in security considerations as well as economic ones, made the decision that forgoing relations with Russia represented too much of an opportunity cost, and so has abandoned association agreement negotiations with the EU in order to join the Russian-led EAEU. In contrast, despite geopolitical and economic pressures from Russia, Ukraine preferred to bind its economy with the much more technologically advanced EU by signing a Deep and Comprehensive Free Trade Agreement (DCFTA) in 2014. Having lost a geo-economic competition with the EU to attract Ukraine to the EAEU, Russia felt its geopolitical interests existentially threatened, possibly triggering its aggression in Crimea. [1]

In theory, the EU-Ukraine DCFTA gives Ukraine an opportunity to maintain independent preferential trade relations with both the EU and the EAEU. However, Russia has argued that tariff-free imports from the EU into Ukraine could be easily re-exported, flooding the Russian market and posing a threat to its economy. The implementation of the DCFTA was initially delayed but after unproductive trilateral talks between the EU, Ukraine, and Russia in 2015, it eventually entered into force on Jan. 1, 2016. In response, President Vladimir Putin signed a federal law unilaterally suspending the Free Trade Agreement (FTA) between Russia and Ukraine that had entered into force in 2012 and was ratified by eight members of the Commonwealth of Independent States (CIS) — Armenia, Belarus, Kazakhstan, Kyrgyzstan,

³ Data taken from World Bank Development Indicators Database

Moldova, Russia, Tajikistan, and Ukraine. Ukraine retaliated immediately by abolishing trade preferences for goods from Russia. Both countries have since continued the mutual abolition of trade preferences to the point where there are now no trade preferences between Russia and Ukraine. Instead, there is an increasing number of restrictions in bilateral trade relations. [2]

Figure 2: Regional trade agreements within the BSR



Note: Number in brackets within the arrows indicates the year the FTA went into force; the CIS FTA between Russia and Ukraine was suspended in 2016; Ukraine and Turkey are currently negotiating an FTA.

Source: Own elaboration based on WTO Regional Trade Agreements database.

Georgia is the only country to currently enjoy free trade access to the markets of all Black Sea littoral states. This has been the case since 2012, when dialogue between Georgia and Russia led to a restarting⁴ of bilateral travel and trade through a process they termed “normalization” [3]. Georgia’s FTAs with Russia, Ukraine, Turkey, and the EU entered into force in 1994, 1996, 2008, and 2014 respectively. The smallest Black Sea country is also the only one in the region to have established a free trade area with China (since Jan. 1, 2018).

With the exception of Russia, all BSCs have entered into regional trade agreements with the EU. Bulgaria and Romania joined the EU and became full members of its internal market in 2007, while Turkey established a customs union in industrial goods with the EU back in 1995. More recently, Georgia and Ukraine signed DCFTAs with the EU in 2014. This saw an alignment of both countries’ trade legislation with the EU, including in terms of competition,

⁴ Prior to that (in 2006-12) Russia had imposed economic sanctions on Georgia banning a large part of its exports to the Russian market.

technical barriers to trade, sanitary and phytosanitary standards, customs and trade facilitation, and protection of intellectual property rights.

The EU has always played a crucial role in Black Sea (sub)regionalism. Recognizing the importance of building effective partnerships with and between its neighbors for stability, resilience, and prosperity, the EU has strongly supported intra-regional cooperation. In 2007, as part of its European Neighborhood Policy, the EU launched the Black Sea Synergy Initiative with the aim of promoting cooperation between the EU and the countries surrounding the Black Sea. At the same time, the EU has deterred more intensive cooperation between the BSCs. This is because BSCs have always prioritized relations with the EU over intra-regional cooperation, which is perceived as less advantageous and secondary to European economic integration. BSCs have been reluctant to engage in a more advanced form of regional integration, prioritizing a “return to Europe” instead of creating a common Black Sea regional identity.

In June 1992, BSCs embarked on regional cooperation when the leaders from Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, the Russian Federation, Turkey, and Ukraine signed the “Summit Declaration on Black Sea Economic Cooperation” and the Bosphorus Statement. On May 1, 1999, the Charter on the Organization of Black Sea Economic Cooperation (BSEC) entered into force, giving the body legal status and transforming the BSEC into a regional economic organization. However, with the establishment of the BSEC, member states also declared that their mutual collaboration will be carried out in a way that does not contravene their obligations in other international organizations and prevent the promotion of relations with third parties. [4]

The BSEC has never aspired for regional economic integration; it has limited itself to economic cooperation. While trade is at the core of the BSEC, it has never become a trade bloc that institutes a free trade area and provides preferential access to member states’ markets. Most BSCs have achieved this through association with the EU or on a bilateral basis. After finalizing Turkish-Ukrainian negotiations on a regional trade agreement, all littoral states (except for Russia) will trade free of tariffs. Even now, through the Turkey-EU customs union and the DCFTA, Ukraine enjoys duty-free access to the Turkish market for industrial goods, but some high tariff barriers remain for agricultural trade.

The BSEC has established various working groups in areas such as trade and economic development, customs, agriculture, banking and finance, energy, transport, tourism, ICT, science and technology, small and medium-sized enterprises, education, and culture. Despite its comprehensive and ambitious agenda, the BSEC has been unable to advance beyond the level of exchanging views and declarations. It has not fostered the creation of a common political, economic, and cultural identity in the BSR. The BSEC discussions and technical consultations have been hindered for several reasons, including a failure to reach consensus among the 13 member states, lack of coordination and absence of oversight bodies, scant financial resources, and low administrative capacity.

Anti-corruption and rule of law

Another obstacle to the economic development of the region and closer economic relations between BSCs relates to the governance processes, rule of law, and anti-corruption measures of each country. Building effective democratic institutions and establishing good governance have been significant challenges for the BSCs. Endemic corruption, dependence on oligarchs, and nepotism are characteristic for the entire region. Even after 15 years of EU membership, Bulgaria and Romania have not fully managed to reform their governance systems, ensuring transparency, accountability, efficient functioning of the judiciary, and critically, elimination of corruption.

Table 1: Scores of BSCs according to the Worldwide Governance Indicators

	Control of corruption		Rule of law		Government Effectiveness	
	2010	2019	2010	2019	2010	2019
<i>Bulgaria</i>	53.3	50.5	53.1	54.8	59.3	65.4
<i>Georgia</i>	57.1	74.0	47.9	62.0	65.1	76.9
<i>Romania</i>	52.4	51.4	56.4	64.4	45.9	40.4
<i>Russia</i>	13.3	21.6	27.0	25.0	39.7	58.2
<i>Turkey</i>	58.6	44.7	58.8	44.7	64.1	54.3
<i>Ukraine</i>	16.2	26.4	25.1	25.5	24.4	39.9

Note: Percentile rank among all countries [ranges from 0 (lowest) to 100 (highest) rank]

Source: The Worldwide Governance Indicators, 2020 update

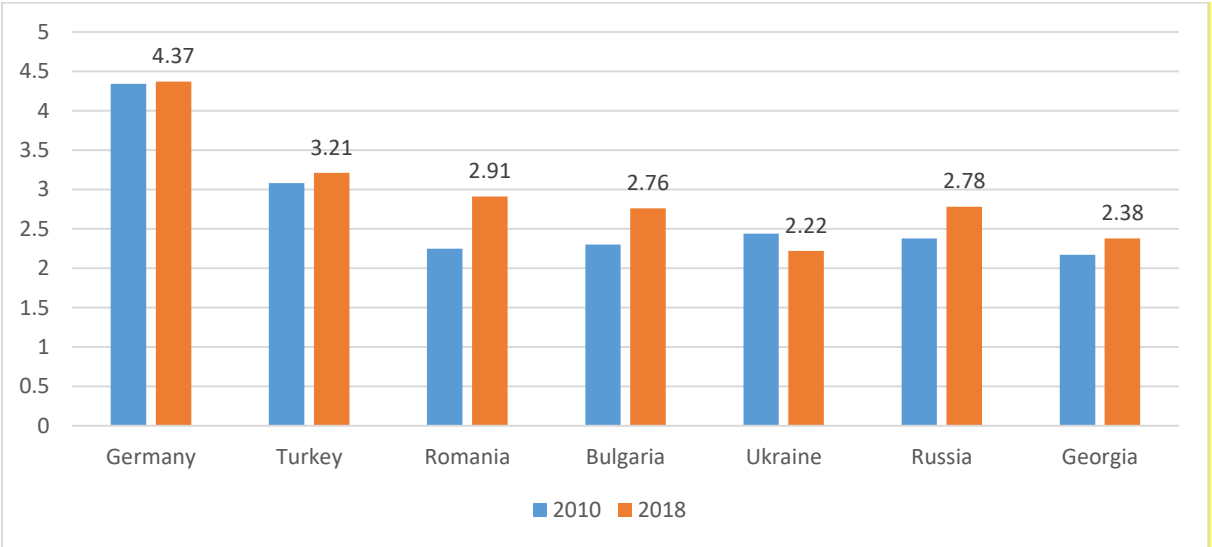
The World Bank Worldwide Governance Indicators confirm the above conclusions. Bulgaria, Romania, and most notably Turkey, have fallen back in controlling corruption over the past

decade. Despite some progress made by Russia and Ukraine, both countries also fall well below global and regional standards. Georgia appears to be the only country registering improvement in terms of control of corruption, rule of law, and government effectiveness.

Interconnectivity

Finally, a major hurdle to economic development, trade, and investment in the BSR is its poor intra-connectivity. The Black Sea separates, rather than connects, the states. In addition, road infrastructure is relatively substandard and does not stimulate trade flows. Developing a modern intermodal transport and logistics system could trigger a significant boost to intra-regional trade. Data on the World Bank Logistics Performance Index key dimension of quality of trade and transport related infrastructure show that despite some improvement over the years, BSCs still lag significantly behind best standards regarding ports, railroads, roads, and information technology.⁵

Figure 3: Scores of BSCs and the best performer from the wider region Germany according to the Logistics Performance Index key dimension on Quality of Trade and Transport Infrastructure



Note: scores range from (1) “very low” to (5) “very high”
 Source: World Bank Logistics Performance Index

⁵ World Bank Logistics Performance Index, 2020, <https://lpi.worldbank.org/international>

Conclusion and policy recommendations

The current situation in terms of regional cooperation in the Black Sea area reflects the wide political, economic, social, and cultural divergences of the BSCs, which are increasingly shaped by various frozen and active conflicts. Divergences have not just prevented the region from tapping into its huge socio-economic potential and establishing strong economic interlinkages that take advantage of geographical proximities, but have turned the area into one of growing antagonism and military build-up. There is an urgent need for greater cooperation between local and international stakeholders and a new approach in addressing security concerns that prevents escalation of political tensions into armed conflicts. It is in nobody's interest that a region serving as a link between Europe, Asia, and the Middle East is unstable and insecure.

While security and mutual understanding are crucial for enhanced regional economic cooperation, there is also a reverse causality — the latter contributes to the former. Intensifying trade and economic interdependence could be the most effective strategy toward achieving long-term stability and security in the region. Taking steps to facilitate economic cooperation could help with a rapprochement between some countries with worsening relations. But can dialogue and mutual trust among bitter foes be restored, and how?

Undoubtedly, overcoming the stalemate will require great political will, mindset changes, and a willingness to make constructive compromises. This process could be greatly facilitated by a mediating influential player. Best positioned for this role is the EU — the region's largest export and import partner, largest foreign investor, and most important source of technical assistance for all countries in the Black Sea area. The EU must engage more fully in the region by trying to reestablish dialogue and build confidence, taking into account the interests of various states, and sustaining a principle of inclusiveness.

Normalization of trade relations with Russia could represent a strong impetus for the Ukrainian economy and serve as an indispensable first step toward ensuring security and stability in the BSR. A restoration of trade relations requires adopting a pragmatic approach recognizing the economic benefits for all. The Georgian-Russian normalization policy is a useful experience that could serve as an example for Ukrainian-Russian relations. The two countries began a straight dialogue on trade and economic topics unrelated to their conflict, deliberately leaving aside intractable security and political issues. While this approach has not resolved

confrontational issues, dangerous escalation of tension was curbed and trade ties were reinstated to pave the way for incremental breakthroughs in other areas.

The most comprehensive indigenous intergovernmental organization that could serve as a tool to facilitate economic interaction among the BSCs is the BSEC. With a history of almost 30 years, it was originally conceived as a platform for promoting trade and economic relations among its members and ensuring the security of the region. To advance beyond rhetoric and technical consultations, the BSEC requires greater administrative capacity and more funding. One or more member states will need to act as a locomotive and pull the agenda forward and try to establish common consent. That role could be played in tandem by Romania and Bulgaria. Both countries are relatively more advanced than the other BSEC states, both are members of the EU and NATO, and both participate in other regional initiatives such as the “Three Seas Initiative” and “17+1,” which makes them interested and able to look for possible synergies among the various frameworks for cooperation in the wider Black Sea area. The active involvement of various non-state actors (civil society, businesses, academia) at a national and local level is also important for the sustainability of cooperation.

Of critical importance is identifying a few priority projects in areas of common regional interest and focusing efforts on achieving tangible results and turning them into success stories. Possible areas for cooperation that can have a tangible effect on regional identity and relationships include:

- the environment (blue economy and green transition);
- digital transformation and e-governance;
- transport connectivity (developing ferry links between Black Sea ports);
- trade facilitation (coordination between border authorities; deployment of “single window”; establishing an online portal with trade intelligence information for SMEs);
- people-to-people bonds (establishment of research, educational, and cultural exchange programs such as Erasmus+ or Central European Exchange Program for University Studies).

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