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THE NINETEENTH PLENARY SESSION OF THE PABSEC GENERAL ASSEMBLY

ECONOMIC, COMMERCIAL, TECHNOLOGICAL AND ENVIRONMENTAL AFFAIRS COMMITTEE

REPORT

ON

"ECONOMIC INTEGRATION IN THE BSEC REGION: CURRENT STATE AND FUTURE PROSPECTS"

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I. INTRODUCTION

1. On 25 June 1992, the eleven founding states of the BSEC expressed their intention to develop economic cooperation as a contribution to the establishment of a Europe - wide economic area as well as with the aim to achieve higher degree of integration of the participating states into the world economy. Opening up the economies of the BSEC countries and deepening their integration with each other and with the rest of the world is critical for strengthening long-term prospects for sustained economic growth and political stability.

2. Since its establishment the Parliamentary Assembly of the BSEC has coordinated its actions on facilitating and deepening regional economic cooperation. Integration may be defined by trade and investment indicators, migration flows, infrastructure, societal forces and environmental concerns. The PABSEC has constantly addressed those aspects of regional integration and adopted relevant Recommendations.[1]

3. This Report focuses on trade and investment flows as the main driving forces of regional economic integration in an effort to assess the level of economic integration achieved in the region during the period following the establishment of the BSEC. The focus is on integration at three levels: at the intra-regional level, with the European economies and the world economy.

4. The Report draws on numerous sources of information. Several PABSEC national delegations have provided information: Armenia, Bulgaria, Greece, Romania, Ukraine. The Rapporteur has drawn on assessments made by international organisations, particularly the IMF, World Bank, OECD, the EU and the UN/ECE.

II. THE CURRENT STATE OF ECONOMIC INTEGRATION

5. In the case of BSEC as in other cases of regional integration involving transition economies, the main purpose of regional integration has been to consolidate the autonomous trade liberalisation process undertaken by these countries and by promoting trade and investment links within the regional context, to foster their gradual integration into the world economy.

6. The BSEC participating states have agreed to promote cooperation by contributing to "… *the expansion of their mutual trade in goods and services and ensuring conditions favourable to such development by continuing their efforts to further reduce or progressively eliminate obstacles of all kinds, in a manner not contravening their obligations towards third parties*". Thus the BSEC does not represent a preferential trade agreement as such but aims at establishing an open trade regime.

7. The pace of regional integration in the BSEC is closely linked to the pace of domestic political and economic evolution in its member states. A large number of the BSEC countries are at a process of major political and economic policy changes aiming at the liberalisation of both their political and economic regimes. Overall, the BSEC countries face a variety of challenges for more effective integration at three levels; intra-regional, with the EU and with the rest of the world.

8. The BSEC states have intensified their economic links with their neighbours and the rest of the world. Some CIS countries have increased trade relations among them, by signing FTAs and Customs Union. At the intra-regional level, bilateral agreements are still the dominant tool of intra-regional relations. BSEC countries

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[1] The PABSEC has adopted among others the following Recommendations on: 'Development and cooperation in the field of trade and business among the BSEC member countries' (16/1996), 'Improvement of customs regulations of the BSEC Participating States' (20/1997), 'BSEC Free Trade Area: Part of the New European Architecture' (22/1997), and 'Plan of Action for the establishment of the BSEC Free Trade Area' (26/1997), 'Trade development in the Black Sea region' (37/1999) and 'Promotion and protection of investments in the Black Sea region' (38/1999).

have concluded bilateral agreements on promotion of investments, (e.g Armenia has signed agreements with Bulgaria, Georgia, Greece; Moldova with Azerbaijan, Bulgaria, Georgia, Greece; Russia and Romania with almost all BSEC countries etc), on avoidance of double taxation and on trade promotion. Free Trade Agreements apart from the CIS countries have been concluded by Romania with Moldova, Turkey and Bulgaria and by Turkey with Romania and Bulgaria. Ukraine has an extensive web of economic agreements particularly with Russia and Moldova. Bilateral agreements between border regions on cross-border cooperation such as those concluded between Ukraine-Moldova and Romania-Moldova as well as cross-border agreements between Bulgaria and Greece are also expanding.

9. Integration within the European structures has been boosted by the prospects of EU accession by three of the BSEC members (Bulgaria, Romanian and Turkey) which have embarked upon a process of harmonisation with the European *acquis*. The fact that one of the BSEC founding members i.e. Greece is also an EU member bears very important consequences for the liberalisation of economic relations within the BSEC region. Other bilateral agreements have been reached between the EU and BSEC states; Albania has a duty free access to EU markets (2000); Azerbaijan, Armenia, Georgia, Moldova, Russia and Ukraine have signed Partnership and Cooperation Agreements.

10. A positive development in the region, has been the membership of Albania (2000), Georgia (2000) and Moldova (2001) in the WTO which now brings the number of the BSEC states that are WTO members up to seven. However, four countries with significant economic weight have still an observer status; Armenia, Azerbaijan, the Russian Federation and Ukraine. Such a variation hinders integration with the global economy.

a) Intra-regional trade

11. A common development across the BSEC region at the beginning of the transition process was the decline of trade volume of the New Independent States as well as Albania, Bulgaria and Romania while another characteristic was the geographical reorientation of their trade towards other European markets. Since then, regional trade has been boosted both in terms of the volume of the exchanges and in terms of the institutional, legal and policy framework established. In many cases, the IMF, the World Bank, the EU have actively supported such policy measures. However, the BSEC region compared to the rest of Europe still lacks behind in both fields.

12. For the period 1993-99, intra-regional trade accounted for 16% of the foreign trade of the BSEC group. Following 1995 when intra-regional trade represented almost 28% of the total foreign trade of BSEC, this percentage decreased and didn’t exceed 14% until 1999. *Since 1993 commercial exchanges for all eleven countries with their BSEC partners have increased at an average rate of 23,4%* overcoming a significant decline between ’98 and ’99 -that has to be linked primarily to the Russian economic crisis- but the speed at which this shift has taken place differs significantly from one country to another (see table 1). Following 1999 the growth rate increased again by almost 24%. However, the total volume of intra-regional trade remains low as it accounts only for 48 000 million USD (in 2000).

13. Internal flows are dominated by the trade volumes of Russia and Ukraine which together represent approximately 60% of intra-regional trade. The main BSEC trading partners of Russia is Ukraine (representing around 70% of its trade with the BSEC) and Turkey followed by Bulgaria and Romania. For Ukraine, the main BSEC trading partners is Turkey and Bulgaria. However more than three quarters of Ukraine’s trade in the region is still contacted with Russia but within the last five years its share has been steadily decreasing (from 88,76% in 1996 down to 83,43%

in 2000). Turkey has the third biggest share in intra-regional trade (12%) followed by Bulgaria (8%), Greece (6%) and Romania (5%). The rest of the BSEC countries (Moldova, Azerbaijan, Albania, Armenia and Georgia) altogether account for less than 10% of the intra-regional trade (see graph 1).

Table 1: Growth rates of intra- BSEC trade (imports and exports) 1993-2000 Per cent (%)

Country	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	93-2000
Albania	95,8	31,1	-24,8	-24,2	39,7	12	13	20,4
Armenia	34,9	39,5	4,4	27,7	-13,2	-10,3	21,6	14,9
Azerbaijan	-25,9	-7,3	55,6	10,8	2,6	22,5	…	9,7
Bulgaria	10,3	63,8	1	-21,5	-4,9	-8,7	52,9	13,3
Georgia	-0,9	73,3	50,8	13,8	20,5	-14,9	8,3	21,5
Greece	39,5	20,6	8	3,5	-9,5	-3,3	30	12,7
Moldova	13,9	21	9,1	7	-28,1	-14	8	2,4
Romania	11,1	27,5	-4,1	6,8	-13,9	-10,6	28,1	6,4
Russia	…	22,4	4,3	-8,4	-27,7	-27	37,8	0,2
Turkey	6	68,8	1,5	26,2	-15,1	-8,9	21,9	14,3
Ukraine	…	43,1	6,8	-15,8	-13,5	-17,9	9,7	2,1
Total	134,9	34,9	4,3	-4,9	-15,5	-14,3	24,4	23,4

Source: Data based on the *Direction of Trade Statistics*, IMF, 1998 and 2000 and on the Contributions of national delegations

14. On the export side, opportunities have been restricted because of the lack of economies of scale and the high cost of transport to major world markets. While geographic proximity has been a positive, important factor in trade flows, the low demand in the area is a restraining factor that has been changing the direction of trade. Increasingly thus, trade flows are reoriented towards west European and other international markets. The fastest growing export markets for Romania and Bulgaria have been the western European ones. This trend is also manifested by a steady decline of Armenia's exports to Russia from 73.3% in 1994 to 36.1% in 1998. In Georgia, where Turkey and Russia are the largest trade markets for Georgian products, the fastest growing export markets in recent years were again the EU and the US. Sea routes have facilitated trade links with Bulgaria and Romania on the opposite edge of the Black Sea but still the volume of trade remains very low (e.g. total trade with Bulgaria in 1998 accounted for 4.7% of Georgia's foreign trade).[2]

15. An interesting aspect is the direction and contact of unregistered economic activities that take place in the region. Cross-border economic transactions tend to be outside the control of the state authorities and the registered economy. In general, informal economy in some cases represents even 50% to 60% of the official GDP. Trade is taking place, unrecorded in many parts of the region through the large volume of 'luggage trade' especially between Turkey and the CIS countries, with Russia, Ukraine and Romania listed at the top. Istanbul city alone accounts for 70% of this trade. The 'luggage trade', which is largely unrecorded and untaxed, is estimated to range from USD 5 to 20 billion depending on the source.[3]

16. While examining the dependence of individual countries to the BSEC trade as the ratio of the intra-regional trade and the trade with the rest of the world, we can conclude that the countries most sensitive[4] to intra-regional trade are: Moldova (e.g. 70% in 1998), Georgia, Azerbaijan and Ukraine. The countries which are less sensitive to intra-regional trade are: Romania, Russia, Turkey and Greece. In the case of Russia, we have to notice that it is the BSEC group which is sensitive to the

[2] These figures are based on registered data.
[3] Turkey's Foreign Economic Relations Board (DEIK) estimates in 1995 that the suitcase trade was $10 billion.
[4]Countries for which BSEC trade accounts for more than 50% of their foreign trade.

Russian flows rather than vice - versa. In the middle lie the countries of Albania, Armenia and Bulgaria.

b) Trade Integration with Europe

17. The European Union has become the main commercial partner of the BSEC group. For the period 1993-1999, the EU represented more than 39% of the total commercial exchanges of the BSEC group, 38% of their exports and 48% of their imports. The trade balance of Russia and Azerbaijan with the EU has a surplus for the Black Sea countries due to their exports of hydrocarbons while trade balance for all other BSEC countries has a deficit.

18.The growth rate of trade volume between BSEC and the EU is accelerating. The average growth rate of the BSEC exports to the EU for the period 1992-95 was 8% and for imports was 11%. For the period between 1995-1997 trade with the EU increased faster by almost 14%.

19. The significance of the individual BSEC countries in total BSEC-EU trade varies. By 1995, just five countries (Russia, Romania, Turkey, Bulgaria, Ukraine) absorbed 96.87% of total EU exports to the BSEC region and similar conclusions can be drawn regarding the total EU imports from the region where 99.27% of total BSEC exports to the EU came from the same five countries. Russia is by far the most important country with regard to export and import trade levels with the EU as it realises 35% of the EU-BSEC trade, followed by Turkey with approximately 27% and Greece with 20%.

20. According to a recent survey of the European Commission, the BSEC countries may be divided in three groups according to the level of their integration with the EU measured by their trade exchanges. *The first group* consists of countries for which, the share of the EC in their overall foreign trade represents more than 50%: Albania (91%), Greece (63%), Romania and Turkey (55%). *The second group* includes Bulgaria (45%) and Russia (38%). *The third group* consists of Ukraine, Moldova, Azerbaijan (16%), Georgia (17%) and Armenia (20%).

21. The BSEC group is not a major trade partner of the EU as for the period 1993/99 at an average it represented approximately 3% of EU's total commercial exchanges, or 3,2% of its exports and 2.6% of its imports. In 2000, this percentage increased to more than 7,5% of EU's total exports and 7.4% of total EU's imports (excluding Greece). From the side of the EU, during the period 1993-99, Germany realised 30% of the exchanges between the EU and the BSEC group, followed by Italy (18,5%). If we add to those two countries Austria (3%) then we can easily conclude that three Central European countries represent 50% of the EU trade with the BSEC group. Greece by realising 14% of its exports towards Bulgaria, Russia and Turkey becomes the fourth closest EU partner.

22. In conclusion trade integration between the EU and the BSEC is not yet at a significant level that would suggest a type of regional integration. Although flows are increasing, the absolute level of trade is still very low approximately 113 000 million USD in 1998, just 80 000 million USD in 1999 and 144 237 million Euro in 2000 (excluding Greece).

23. As a recent study of the European Community (DG REGIO, 2002) showed, the openness of the trade regimes[5] of the BSEC countries continues to differ significantly. There are countries with relatively significant openness such as Bulgaria (122.1% of the GDP in 2000), Ukraine and Moldova but whose open trade regime is attributed to their weak trade structures rather than to their extensive export capacity. Albania (59.3% of the GDP) and Armenia are in the same category as Moldova.

[5] Trade Openness is measured as exports plus imports (including services) scaled by GDP.

Greece and Turkey form another category with more effective and open trade regimes, while Romania (73.7% of the GDP) and the Russian Federation lie in the middle. According to the same EU study the countries with the less open trade regimes are Azerbaijan and Georgia, however there have been more favourable tendencies noticed.

24. Market liberalisation covers three areas: domestic transactions (price liberalisation and abolition of state trading monopolies), external transactions (elimination of export controls and taxes, substitution of low to moderate import duties for import quotas and high tariffs, current account convertibility) and entry of new firms (privatisation). In those terms, the three Balkan countries (Albania, Bulgaria and Romania) belong to the first speed group.

25. During the period 1993-1999, the overall foreign trade of the BSEC countries represented 2.85% of the world trade. From 1993 to 1999, the foreign trade of BSEC states increased by 43%, at a pace of more than 5% per year, reaching the volume of 309 942 million USD in 2000.

26. As a conclusion, from the trends indicated above, the future prospects of trade integration between the BSEC and the EU will depend on the trade policies that both sides will apply. It will increase as long as the privatisation policies continue, the European and the BSEC GDP increases and the population and its purchasing power increases also. In BSEC countries, trade is an important factor in the formation of GDP and this indicates that there is enough space for furthering integration between the BSEC and the EU. Building of a transport infrastructure that decreases distances between the EU and the BSEC will be critical.

c) Investment Driven Integration

27. Despite substantial progress made by BSEC countries in developing FDI - related legislation and liberalisation, they have not succeed in attracting foreign capital neither from their BSEC partners nor from other countries. During the last couple of years, market liberalisation has improved access of foreign investors to BSEC enterprises. FDI however, remains below its potential reflecting economic volatility and political uncertainty. Low capital inflows represent missed opportunities in modernising the region's capital stock, in channelling modern know-how to BSEC countries and facilitating access to export markets. With respect to competitiveness, this represents a significant disadvantage.

28. Data shows for the period 1993/1996, FDI expanded rapidly with respect to the number of the enterprises with foreign capital while in terms of value, flows of foreign capital have increased at a slower pace and remained low. In 2000, the total *inward* FDI to the BSEC region (excluding Greece) accounted for 7.7 billion USD. The main destination of the FDI was by far Russia that attracted 2.7 billion USD, followed by Bulgaria (1,1 billion USD), Turkey (1 billion USD) and Romania (900 million USD).

Table 2: FDI Inflows (USD billion)

Inflows				**Stock**	
	1994	**1995**	**2000**	**1995**	**2000**
BSEC states*	2.4	4.8	7.7	14.6	48.8
World	…	….	1270.8	…	6314.3

* Greece not included Source: *World Investment Report*, UNCTAD, 2001

29. Regarding intra-regional flows, the number of intra-regional investments at least among some of the countries seems significant but the volume of investments remains very low. It is estimated that Turkey is the main investor in the area, followed by Greece and Russia. Companies among those countries have been among the top five BSEC investors in Bulgaria, Moldova, Romania, Russia and Ukraine. The weight of Albania, Armenia, Azerbaijan and Georgia in intra-regional FDI flows remains low.

Turkish companies were top investors in Romania (in 2000) representing 50,3 % of committed capital originating by BSEC countries while they were the third largest BSEC investor in Russia and Ukraine (21.715 million USD in 1999). In the case of Bulgaria until 1998 Turkey occupied the first place by number of investments (1651 investments) but for the period 1992-2001 it comes just 12th in terms of the volume of investments. Russia ranks 9th in terms of volume of investments (particularly in the petrochemical industry) in Bulgaria. Greece occupied the 4th place by volume of investments in Bulgaria until 2000 but in 2001 became the second among foreign investors following Germany. The weight of intra-regional investment among the BSEC countries has tended to grow over the period but the speed at which this shift has taken place differs from one country to another. In Moldova, intra-regional foreign investment from other BSEC countries has increased substantially particularly due to investments from Russia that account for 30% of its inward FDI stock.

30. The limited and heterogeneous FDI outflow data available for two countries of the region tend to confirm the growing weight of intra-regional foreign investment among BSEC countries. Western countries, transition economies and BSEC countries, as aggregate destination countries, were major destinations of FDI from Ukraine and Turkey in 1994 and 1995. They accounted for respectively 41%, 48% and 37% of Ukrainian FDI stock abroad by the beginning of 1996. When compared with the end of 1992, the share of BSEC countries in Turkish FDI stock abroad increased from 3% to 5% by the beginning of 1996.

31. In terms of the number of investments, the weight of BSEC countries was more apparent. At the beginning of 1995, 94% of the Ukrainian investments abroad were in the BSEC region while only 1.6% toward Western Europe. In the case of Turkey 25% of the total number of investments was in the BSEC area in the beginning of 1996. Russia and Romania in both cases attracted the largest share of foreign capital. Greece has today 3009 investments in the BSEC region mainly in Albania (capital of 200 million USD), Bulgaria (750 million USD) and Romania (500 million USD).

32. EU countries have accounted for a major part of the total value of foreign capital in the BSEC countries. In particular the shares of the EU countries on the total FDI stock in the BSEC region is approximately 40%. In Bulgaria, only 22% of the FDI in the year 2000 originated from outside the EU against more than half just in 1999. In 1999, in Romania EU accounted for 56.8% of inward FDI stocks, in Russia for 24.7% and in Ukraine 28.1%. In terms of individual countries, Germany, UK, France and Italy are the major investors from the EU.

33. Data show an upward tendency of FDI inflows and the expectation is that in the future investments from privatisation and joint ventures will increase. Geographical distribution of investments clearly shows that there is a direct link between investments and trade as the major trade partners are also main FDI partners.

III. OBSTACLES TO ECONOMIC INTEGRATION

34. What is interesting in the BSEC case is that unlike conventional trade theory, the primary barriers to trade in the region are not tariff and non-tariff measures but *structural* barriers that have been formed over long periods of time: lack or inefficiency of channels for trade, differences on business contact and business attitudes, unpredicability and inefficiency of governmental policies, and poor infrastructure. At the same time, integration has been constrained by the existence of political divides resulting in the fragmentation of preferential arrangements and the interruption of trade. Economic sanctions and trade blockades have hampered the development of economic relations as well as the realisation of joint projects particularly in the Caucasus.

35. The institutional framework is not yet complete in all BSEC countries. Market liberalisation for example, differs from country to country. Great variation in terms of international obligations (particularly as far as EU and WTO membership) hinders a more effective institutionalisation of regional economic integration. The overall economic and business environment has conditioned the dynamism of economic integration. The BSEC countries have made progress towards macroeconomic stabilisation, growth has resumed and exports have increased. GDP growth has been witnessed in the region for the last two years (Moldova had the highest increase with 31,3% and Georgia the lowest with 2%). Governments have launched structural reforms, notably in the areas of privatisation and energy. However, the still fragile macroeconomic environment (there are still serious economic imbalances with high inflation and a difficult social environment), the uncertain legal framework and the poor administrative capacity hinder the development of the private sector without which economic integration is not possible. Slow convergence among the national economies (in fiscal regimes, investment incentives, monetary regimes, exchange rate volatility and inflation rates) inhabits regional economic integration

36. The insufficiency of the legal framework regarding property rights, privatisation, labour legislation, licensing, is also a negative factor. Most of the legal framework of a market economy typically is already in place in most of the BSEC countries; however, the institutions to implement and enforce it are either weak or have not been yet established. The main problem with the legal framework is its lack of transparency, its constant change and the inability of the state authorities to implement it efficiently. Regulations are frequently changed and public officials often interpret them in a discretionary manner. This provides fertile ground for corruption, which has hampered the development of the private sector significantly. Customs regulations and customs administration need to be reformed with a regional perspective and substantial investment has to be made in upgrading the border infrastructure and in purchasing equipment for customs enforcement and control.

37. A dimension that will increasingly become important is that of the financial and banking systems in the region. The financial system is very underdeveloped and it cannot provide effective service for the investors. As a result, capital inflow in the BSEC region is very limited although it thrives at a global scale.

38. BSEC region lacks sufficient physical capital. Inadequate communication facilities, energy problems, bad transportation networks and high transport tariffs are some of the most important problems often cited by businessmen in the region. By coordinating investment in physical infrastructure on a regional basis (Infrastructure Investment Coordination) BSEC countries will gain from substantial cost savings, integrate faster in European networks and will more successfully attract international financing for the implement regional projects.

39. Non-Tariff Barriers. Economic integration will not be realised unless not only tariffs are reduced but non-tariff barriers will be reduced. Non tariff barriers affect production, trade and investments. They are in general related to: import and export prohibitions; import and export quotas; tariff rate quotas; licensing requirements; business registration requirements; customs valuation rules and practices and other customs related matters; requirements related to standards; technical regulations and conformity assessment; phytosanitary and veterinary rules.

40. Monetary and Payment Barriers. Those are the two most significant barriers to trade. Exchange controls are perhaps the single most decisive binding barrier to market unity as such controls often result in inconvertibility. The extend to which internal inconvertibility limits intra-regional trade is partly measurable through the amount of unrecorded trade that occurs in parallel markets. High transaction costs involved in the exchange of foreign currencies or uncertainties about future currency movements is another obstacle.

41. Production Barriers. A lack of uniformity in national technical standards and regulations affects production and limits entry to a market or restricts competition. Of the non-tariff barriers to production are the costs of different national product or service regulations and standards in transport, health and safety. These add to costs of production, distort production patterns and discourage business cooperation. Another barrier to achieving production efficiencies through regionalisation is the pervasiveness of parastatals: state owned enterprises and trading monopolies. The protection of labour markets resulting from pressures to fight chronic unemployment can be another barrier as it affects competitiveness and intra-regional investment flows.

42. Barriers to Cross-Border Investment. First, exchange and licensing controls apply. Second, domestic capital is scarce and capital markets are not fully developed. Third, tax regimes are often unnecessarily complex and poorly administered with the burden of business taxation often being negotiable (in practice) rather than rule-based.

IV. MEASURES AND INITIATIVES WITHIN THE BSEC FRAMEWORK

43. The BSEC institutions have allocated most of their resources on realising the economic conditions for the consolidation of the integration process. Economic integration through trade and investments is a process that requires measures to be taken not only within the strictly defined trade policies, but also in the field of macroeconomic stability, infrastructure, the financial system, training, marketing and business attitudes. The overall political climate is the strongest probably foundation upon which economic integration is based. That is the centrepiece of *the BSEC Economic Agenda for the Future,* which sets up the long -term strategy of the BSEC.

44. A Strategy evolves. *The BSEC Economic Agenda for the Future* adopted in 2001, is the most recent and comprehensive document defining the new priorities and the implementation mechanisms for the economic integration of the region. It states that trade, as a key determinant of overall economic activity, will influence the future of the BSEC itself as a regional economic Organisation. The *Agenda* envisages a two-tier strategy within the BSEC framework: first, past trade relationships have to be thoroughly re-examined and to the extent that they are effective, be encouraged and supported, and second serious efforts be made to establish new trade relationships based on present and future comparative advantages. On the other hand, the main political document adopted by the BSEC in 1999 on its relations with the EU, called the *Platform for Cooperation between the BSEC and the EU* is in its entirety directed towards the establishment of a common economic space.

45. **Infrastructure Networks**. Within this framework, integration of the BSEC states into the European infrastructure networks has been facilitated through the adoption of common Action Plans and the realisation of specific projects. Particular reference has to be made to *the Transport Action Plan,* the elaboration by the BSEC of the concept of the Black Sea Ring Corridor, and the inclusion of several BSEC countries into the PETrA and TRACECA. With a view to respond to the communication needs of the region, three projects are completed: ITUR (Italy-Turkey-Ukraine-Russia), KAFOS (Turkey-Bulgaria-Romania-Moldova), TBL Trans Balkan Line (Italy-FYR of Macedonia-Albania-Bulgaria-Turkey). *Interconnection of Electric Power Systems Encompassing All the Member States* is another project under progress guided by the Ministers of Energy of the Member States whose objective is to bring about a rational and more effective production and utilization of electric power in the region.

46. Trade Liberalisation. A landmark of the economic integration process is the *'Declaration of Intent for the Establishment of the BSEC Free Trade Area'* adopted by the BSEC of Ministers of Foreign Affairs with the participation of the Ministers responsible for Economic Affairs on 7 February 1997 in Istanbul. The document declared that it is timely to start the examination of the ways to establish progressively a BSEC FTA as part of the European architecture through free trade arrangements between the members of the BSEC. The creation of a BSEC Free Trade Area is an ambitious objective, which has been perceived by the BSEC countries as a gradual process. The project of the BSEC FTA is not only important for the direct economic benefits it is expected to provide to the member countries (increased intra-regional trade, foreign investment and efficiency among the productive sectors of the BSEC countries), but also as a step that will prepare BSEC to become an integral part in a larger European economic space. Different approaches however, regarding the timing, method and reasoning of establishing the BSEC FTA have delayed any further action. The significant variations regarding the foreign trade commitments of the BSEC states (resulting from the EU membership in case of Greece, the accession negotiations by Bulgaria and Romania and Turkey's Customs Union with the EU) have made the BSEC Free Trade Area a practically impossible endeavour for a short-term period. Consequently the Action Plan for the BSEC FTA which was discussed in the past within the BSEC has not been finalised yet.

47. Within this framework the BSEC Working Group on Trade and Economic Development has set the following priorities for its future work:
- to finalise a Plan of Action
- to focus on problems related to the liberalisation of the intra-regional trade, paying particular special attention to the existing non-tariff barriers and border-crossing procedures
- to assist the members in the completion of the process of accession to the WTO for those BSEC states that have not done so far as this would help the process of trade liberalisation in the BSEC region.
- to develop a common approach of the BSEC states towards harmonisation of their national standards and procedures as well as their foreign trade regimes.

With the aim of dealing adequately with the main obstacles of further integration, the WG on Trade and Economic Development has been preparing '*An exemplary list of quantitative restrictions and measures with equivalent effect on trade'* where non-tariff measures which are applied to other BSEC countries will be treated.

48. Attracting Investments. The establishment of the BSEC itself and the institutionalisation of the regional affairs that has thus followed, is a major contribution to the reduction of political risk, which has prohibited large-scale investment in the region. With a view to attract foreign capital the BSEC adopted on 25 October 1996, the '*Basic Principles of Investment Collaboration in the BSEC Region'*. The role of the business community has been crucial and the BSEC Business Council has taken up practical steps for the actual improvement of the business climate in the region. The BSEC BC in partnership with the OECD has generated *the Black Sea Investment Initiative* (BSII) which is a framework of policy reforms to eliminate the business disincentives in the region particularly as far as the SMEs is concerned. The BSII complements the work of the Investment Compact for South East Europe and its key features are the active involvement of the private sector, the region-wide approach, the harmonisation and partnership with related initiatives and actions for the implementation of reforms. The initiative concentrates in eight main policy areas:
- Foreign Direct Investment (FDI) Policies and Promotion Strategies
- Small and Medium – sized Enterprises Support Structures
- Fiscal Reform and Taxes, Corporate Governance, Competition Law and Policy

- Financial Sector Development, Corporate Anti-Corruption and public governance

One of the latest initiatives of the BSEC is the establishment of a *Project Development Fund* for the purpose of facilitating the elaboration and promotion of projects with high regional development and cooperation impact in the BSEC area.

49. Business Environment. Highly restrictive regulations and heavy bureaucratic formalities on borders including the way visas are issued are major obstacles to the development of economic relations. With a view to ameliorate business environment, the BSEC has considered a draft Agreement on *Simplification of Visa Procedures for Businessmen National of the BSEC Member States*. The *Declaration on the Promotion of SMEs* adopted in 2001 envisages the SMEs as the primary engine for the realisation of cross-border economic cooperation. Improvement of border crossing facilitates the free movement of goods, people and services thus enhancing integration. Appreciating that, the Heads of Black Sea Ports Authorities coming from the six coastal states of the Black established the Black and Azov Seas Association of Ports (1999) which carries out its activities under the auspices of the BSEC. The BSEC has also addressed the issue of economic crime and corruption through the *Agreement on Combating Crime in Particular in its Organised Forms* signed in 1998.

50. A Regional Bank for Trade and Investment Promotion. The establishment of *the Black Sea Trade and Development Bank* has been the single most significant project ever conceived and implemented by the BSEC states. One of the distinguishing aspects of the BSTDB's activities is its emphasis on intra-regional trade promotion and financing. The Bank's Trade Finance Program includes pre-export finance, single /multiple buyer credits and single/multiple refinancing programs. In 2000, 12 operations were approved by the Bank with the portofolio reaching USD 105 million. Of these projects, six were trade finance operations for USD 23.3 million. The distribution of approved trade finance facilities by country is as follows: 33% for Turkey, 20% for Russia, 17% for Greece, 10% for Bulgaria, 8% for Romania, 5% for Ukraine, 4% for Moldova and 3% for Georgia.

V. OVERALL ASSESSMENT AND FUTURE PROSPECTS

51. The BSEC countries have made an encouraging progress in strengthening economic integration. There is a real progress made in terms of trade and investment flows and there are signs of a deeper and broader consensus on both the goal of integration and on the policy means to achieve it.

52. Significant obstacles persist. The Report identified several common challenges: designing sound macroeconomic policies, creating competitive environment, investing on physical capital, encouraging the role of the private sector, adopting and enforcing anti-corruption laws, legislation and rules that meet the world standards. In all those areas specific work has already begun. Many of the achievements so far, have mainly been on the legislative front but actual implementation is still weak. Most countries have liberalised their trade regimes (through their EU or WTO negotiation processes and membership).

53. Given the macroeconomic divergence, which still characterises the BSEC economies and their relative states of political flux, movement on a market integration agenda will necessarily need to be more deliberate and cautious. The foremost responsibility for continued progress rests with the authorities of the countries to design and implement the right policies. Governmental capacity is thus decisive. Additionally, for regional integration to be accelerated in the BSEC, the roles and functions of different regional bodies (PABSEC, BSEC Business Council, BSTDB, ICBSS) have to be reconsidered and co-ordinated. It is encouraging that there are a number of multilateral institutions with global functions (World Bank, specialised UN agencies and other IFIs) which contribute to the burgeoning of BSEC integration.

54. Lasting success will however depend on the ability of the private sector (domestic and foreign) to invest in the region. Foreign investment particularly is a measure of the credibility of macroeconomic and structural policies. Foreign investors are attracted by the large domestic market particularly in terms of the increasing GDP (at an average growth of 5% in 2000, compared to 1% in 1999) and in terms of an increasing population. Energy potential in the region and the relevant investment potential on energy transport infrastructure is expected to attract more international capital.

55. With the gradual establishment of market economies in the region and the improvement of the political climate, the first steps towards regional economic integration have been taken. Trade and investment opportunities are going to expand, as the economic and political environment in the region is improving. A recent example is that of Bulgaria whose trade with its BSEC neighbours grew even more rapidly (52.9%) than with the EU (38%) during the last year following the overall improvement of the situation in the Balkans.

56. A breakthrough in the area of regional economic integration will depend substantially on the ability of the BSEC to promote cooperation primarily with the EU which is the dominant economic partner. Developing relations with EU would increase the gains from regional economic integration. Trade, investment, exchange and payments support, are areas in which new arrangements for cooperation could be explored between the BSEC and the EU. The increase of credibility that EU-BSEC cooperation might engender could be crucial for attracting inflows of FDI into the BSEC member states.

57. Further economic integration will bring not only prospects of prosperity but of durable peace, security and stability. The process of closer regional integration will help states to deal with their domestic economic, political and social problems better than they otherwise could. However, political determination to move on with regional integration is of outmost importance. Whatever the economic potential for deriving gains from BSEC might be, it is the political determination to capture them, which will eventually decide the success of BSEC.