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THE RELEVANCE OF EAP WITH REGARD TO REGIONAL ECONOMIC RESILIENCE CAPACITY BUILDING

Sergey LISNYAK*

Abstract: *Currently, the Eastern Partnership (EaP) develops in a very difficult political and economic conditions that may substantially affect the prospects for its existence and building of regional economic resilience capacity. We argue that the nature and pace of previous structural reforms in EaP countries is largely determined by their national institutions, history and economic conditions. It should be clearly understood that the development of this large-scale project in terms of geopolitics involves a number of difficulties and deep reforms in the participating countries. This paper aims to the previous experience and the prospects for further economic cooperation in the framework of EaP as well as to explore the relevance of EaP with regard to regional economic resilience capacity building. According to the result, we state that the formation of such important projects is possible only under favourable economic conditions and a stable political climate. Addressing the regional resilience capacity building and the world as a whole is only possible if the integration units are not created for the purpose of confrontation and isolation, but in the interest of deepening global cooperation and expanding markets.*

Keywords: resilience; economic resilience; Eastern Partnership

JEL Classification: F6; O1

Introduction

Currently, the Eastern Partnership (EaP) develops in a very difficult political and economic conditions that may substantially affect the prospects for its existence and building of regional economic resilience capacity. The concept of EaP initiative implies a fairly extensive development in the area of economic cooperation among member countries. We argue that the nature and pace of previous structural reforms in EaP countries is largely determined by their national institutions, history and economic conditions. The political situation also played an important role in determining the direction of reforms. It should be clearly understood that the development of this large-scale project in terms of geopolitics involves a number of difficulties and deep reforms in the participating countries.

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The purpose of this article is to analyse the previous experience and the prospects for further economic cooperation in the framework of EaP, as well as to explore the relevance of EaP with regard to regional economic resilience capacity building.

1. Methodology

This study is based on qualitative research methods to address the research questions and objectives. The research methodology is based on the principles of evolution and determinism.

Depending on these research questions the methods of literature review, SWOT analysis, historical and logical analysis as well as content analysis and comparative analysis will be used. Different methods will allow the different research objectives and questions to be fully explored.

2. Milestones of EaP building

Development of common objectives in the direction of Eastern Europe and South Caucasus were the first attempt of teamwork for European Union member states. The Eastern Partnership project was presented to the Minister of Foreign Affairs of Poland R. Sikorski, 26 May 2008 at the European Council.

The Eastern Partnership is based on four thematic platforms (European Council, 2009):

- Democracy, good governance and stability;
- Economic integration and convergence with EU sectoral policies;
- Energy security;
- Contacts between people.

The Partnership foresees stronger political engagement with the EU, namely:

- The prospect of a new generation of Association Agreements;
- Integration into the EU economy with deep free trade agreements;
- Easier travel to the EU through gradual visa liberalization, accompanied by measures to tackle illegal immigration;
- Enhanced energy security arrangements;
- Increased financial assistance;
- Deeper cooperation on environment and climate issues;
- Increased people-to-people contacts and greater involvement of civil society.

The Joint Declaration of the Eastern Partnership Summit in Warsaw, held in September 2011, emphasized the strategic importance of the Partnership as a way to deepen and strengthen relations between the EU and the partner countries, to speed up their political association, economic integration and approximation towards the EU and to support their modernization efforts (European Council, 2011). Later on, during the Third Eastern Partnership Summit held in Vilnius (European Council, 2013), it was scheduled to conclude the Association Agreements / Deep and Comprehensive Free Trade Areas with interested parties before autumn 2014. In fact, Association Agreements / Deep and Comprehensive Free Trade Areas with Georgia, Republic of Moldova and Ukraine were concluded on June, the 27th of 2014.

For both Georgia and the Republic of Moldova, the provisional application of the DCFTA has already led to the successful development of trade with the EU in 2014. The provisional application of the DCFTA for Ukraine was postponed until 1/1/2016. In the meantime, the EU unilaterally granted trade preferences to Ukraine (EEAS, 2015).

The Declaration of the Eastern Partnership Summit held in Riga in 2015 states that citizens of Ukraine and Georgia may be exempted from visa requirement only after the progress report (to be carried out by the end of 2015) on implementation of the 2nd phase of the Visa Liberalization Action Plans by Ukraine and Georgia respectively (European Council, 2015). A visa-free regime has already been in place since April 2014 for citizens of the Republic of Moldova holding biometric passports.

Regarding the other three countries, namely Armenia, Azerbaijan and Belarus, the Association Agreements / DCFTA were not concluded with the EU. The signing of the AA excludes the possibility of the participation of the Eastern Partnership countries in regional economic associations in the CIS, in particular, in the Customs Union. For instance, Belarus and Armenia have chosen a different integration project –the Eurasian Economic Union. Five post-Soviet countries are currently members of the Eurasian Economic Union: Russia, Kazakhstan, Belarus, Armenia and Kyrgyzstan.

One of the consequences of the EU–Russia rivalry is that the “common neighbourhood” now seems deeply divided between those countries that have joined the Eurasian Economic Union and those that have signed the AA and the DCFTA offered by the EU under the Eastern Partnership (Delcour, 2015).

3. The concept of regional economic resilience

Throughout the evolution of economic theory, the scientific community was not able to give an exhaustive answer to the question: what measures can lead to well-being of society? Following each

crisis, new theory appeared, hoping to find a solid foundation for sustainable growth as well as identifying new tools of regulation of the economic sphere, and so on until the next crisis.

Resilience (resiliency, resile) has a long history of multiple, interconnected meanings in art, literature, law, science and engineering. Some of the uses invoked a positive outcome or state of being, while others invoked a negative one. In synthesis, before the 20th century, the core meaning was “to bounce back”. Mechanics, aided by politics, had already started to change that: in both the literal and the figurative sense, under the aegis of the resilience concept, ductility had been added to elasticity (Alexander, 2013, p. 2710).

Crawford Stanley Holling was the first to transform the concept of resilience in independent theory. In his conceptual work, Holling (1973, p. 14) defined the concept of resilience as “a measure of the persistence of systems and of their ability to absorb change and disturbance and still maintain the same relationships between populations or state variables”. Originally his concept of resilience was applicable to ecological issues.

Most of the scientific literature refers to resilience as the ability of any system to recover from an external shock or to absorb against downturns (Briguglio *et al.*, 2009; Rose and Krausmann, 2013; Brock *et al.*, 2002; Gunderson and Holling, 2002). Thereby, resilience includes the ability to deal with external factors and reduce vulnerability, and one of its main tasks is to minimize losses and, as a result, to ensure the economic recovery in the shortest terms.

Economic resilience is a concept that is often used, but it is not always determined in detail. Pendall *et al.* (2009) determined two main concepts that conceptually define the concept of “economic resilience”. Equilibrium analysis is based on the concept of the possibility of the economic system to return to a previous state including respective indicators of economic performance. The second determines the resilience as the complex concept of adaptation in the conditions which meant adapting and changing the system, taking into account external shocks and factors.

Economic resilience means not only preserving the positive level of its economic performance, but also includes a development which manifests itself in the economic growth, that is, the trend of positive changes in aggregate indicators of economic and financial development of the system over time. In order to characterize the economic growth it is preferably to use both general and particular indicators and definitions.

Hill *et al.* (2008) argues that regions that experience negative economic shocks may experience three different kinds of responses and respectively may economically refer to the following type of regions according to their ability to be resilient:

- “resilient” regions - regions that have returned to or exceeded their previous growth path within a relatively short period of time;
- “shock-resistant” regions - regions that have been thrown off their growth path at all;
- “non-resilient” regions - regions that have been unable to rebound and return to or exceed their previous path.

As a conclusion we note that the term “regional economic resilience” is a capacious concept carrying strong semantic load. Thus, regional economic resilience can be defined as a state of the region in which its characterizing parameters (financial, operational, organizational or any others) tend to make a region “economically resilient” and at the same time capable of harmonic development and improvement at any changes of the external environment.

4. Main obstacles and background of economic reforming in EaP

In general, the nature and pace of structural reforms in the EaP is largely determined by their national institutions, history and economic conditions. The political situation also played an important role in determining the direction of reforms. In addition, the experience of transition reform suggests that the process of liberalization and structural reforms is not supported by relevant institutions, including the active and organized civil society are unlikely to yield successful results, and respectively it leads to the slowing of the process of economic resilience building.

4.1. Soviet institutional heritage

Breakup of the Soviet Union (USSR) provoked enormous economic and institutional problems of the transition period during the 90-ies of XX century. In general, countries are faced with an unprecedented challenge of creating a new and at the same time political, and economic order (i.e. the creation of new institutional mechanisms). Many of the new independent states or sovereign has never been before, and / or have had a complex history, with the result that they find themselves in an even more difficult position.

A new economic order was required by the countries of the former USSR, and not returning to the pre-existing state. The principles of planning were practiced in the former USSR, which left its

mark on the institutional structure. The negative effects of the application of these principles for many decades still continue to affect the post-Soviet countries and their ability to implement systemic reforms.

The Soviet system virtually stifled all the elements of a market economy, resulting in generations of Soviet citizens never directly confronted with the markets and institutions that ensure the functioning of a market economy. Ignorance of the market mechanism and its supporting institutions significantly affected the reform process. Of course, we cannot underestimate the scale of the tasks and deadlines required for the transition from the mentality that assumes full care of the state for the welfare of citizens "from the cradle to the death" to the conditions characterized by competition, instability and uncertainty. However, the difficult task of state-building and the novelty of the emerging-market capitalism were not the only obstacles to systemic changes in the post-Soviet space.

4.2. Military conflicts and political instability

Apart from the struggle with a heritage of the past, the new independent states emerged after the collapse of the Soviet Union were to set up and support the sovereignty and solve complex geopolitical problems. However, the collapse of communism and its state institutions has created unprecedented opportunities for the redistribution of power and influence. The combination of these factors led to the outbreak of several wars and a brutal struggle for territorial integrity. In addition, many cases of internal power struggles, which were in part a reflection of the weakness of government institutions, have led to violent confrontation over the right to make policy decisions on behalf of the community. Territorial conflicts manifested in various forms, ranging from the war between neighbouring countries and ending unilateral steps by the separatist regions of disconnect. Armenia, Azerbaijan, Moldova, Tajikistan and Ukraine have faced violence or civil strife.

Breakaway regions in Ukraine, Georgia and Moldova also turn into significant economic costs and creating obstacles to the implementation of reforms. Georgia's secessionist regions of Abkhazia and South Ossetia are the bases for smuggling activities, which leads to a decrease in government revenues and thus reduces the ability of the state to provide public goods and, in particular, to carry out institutional reforms. Similarly, the territory of Transnistria detached from the Republic of Moldova, is being used to obtain profits due to evasion of taxes and duties (as well as drugs and arms trafficking). The annexation of the Crimea in 2014 led to the subsequent escalation of the conflict between Ukraine and Russia.

4.3. Bureaucratic and corruption institutional lock-ins

The bureaucratic lock-in is caused by the specific interests of officials and of the system of government in targeted countries, its vertical structure and subordination, the fear to suggest solutions, the desire to avoid conflicts, the limited horizons and knowledge.

There is an opinion that the strategy of partial reforms implemented in almost all post-Soviet countries makes it more likely getting governments under the influence of narrow interest groups. Such interested and influential groups benefit from market distortions and corruption associated with the partial implementation of the reforms, when, for example, dismantling the old command system is functional without the proper development of market institutions, including effective judicial system.

From the standpoint of systemic reform, the existence of corruption in EaP countries is a clear symptom of improper operation of the institutional mechanisms. In this regard, the post-Soviet countries inherited institutions that do not have experience in regulating markets and, more importantly, which were formed over decades in the grip of tyranny and justice. As a result, many of EaP countries are still characterized by unaccountable public institutions and poorly functioning legal systems. The existence of corruption, which is the result of institutional shortcomings, in turn, can be a one of the main reasons for failures in the implementation of institutional reforms. Corruption undermines public trust in democratic institutions and legitimacy of the state.

As part of the transition process, corruption is especially harmful, reducing government revenues and undermining the ability of state institutions to carry out basic functions, such as the establishment of law and order. In other words, it weakens the functions of the state in areas that require strong state institutions. With the increase in the informal sector of the economy even further narrows the tax base, which adversely affects the ability of the government to provide public goods, including the implementation of structural reforms.

4.4. Educational lock-in

Educational lock-in consists in the fact that system of education established in the 90-ies of previous century was accompanied with anti-leadership in the quality of education. Low quality of education of the large part of graduates is the result of corruption for admission to universities in conjunction with low-skilled young professionals. Thus, this is one of the most serious obstacles in heading to a knowledge economy.

The main danger of this lock-in is that unmotivated students begin to be perceived as a social norm that enhances and supports the corrupt and bureaucratic lock-ins. It devalues education as such. Consistent implementation of the Bologna system, increasing the responsibility of universities for the quality of their management knowledge of the graduates will reduce the costs out of this lock-in.

Taking into account analysis of these obstacles we are about to try to present possibility of providing more objective conclusions and recommendations for further development in EaP countries in the long term (see Figure 1).

Figure 1 - SWOT analysis of economic resilience building in EaP countries

| | Helpful to achieving the objective | Harmful to achieving the objective |
|------------------------|--|--|
| Internal origin | <p><i>Strengths</i></p> <ul style="list-style-type: none"> • foundations of an independent sovereign state • deviation from the old soviet political and economic system • qualitatively different system of values and a new type of human relations based on freedom and private-individualistic outlook • main asset is the quality of human resources, a highly educated population with a high level of scientific and creative potential • rich natural resources | <p><i>Weaknesses</i></p> <ul style="list-style-type: none"> • construction of the state is still far from completion • the goals of large-scale social, political and economic reforms have not yet been achieved • during the transition period, the majority of citizens have suffered a lot • the need for new and more civilized conditions for human development • many difficulties and there is a deliberate strategy of using natural resources • the hardships of the transition period is still very sensitive • corruption • institutional lock-in effect |

| | | |
|------------------------|---|--|
| External origin | <p><i>Opportunities</i></p> <ul style="list-style-type: none"> • the geographical position at the crossroads in the Euro-Asian region • support for reforms from foreign states and donor organizations | <p><i>Threats</i></p> <ul style="list-style-type: none"> • the mentality in the spirit of Communist principles. Slowly addiction to the changes, people waiting for help from the state • reduced income and standard of living of the majority of citizens. Small middle class • new large scale of poverty and unemployment and, as a consequence, crime, drug abuse, depression and social potential of social instability • demographic depopulation, lack of qualified specialists • incompleteness and instability of legislation |
|------------------------|---|--|

Source: author's representation

5. Current state and prospects of resilience capacity building in EaP

The theoretical analysis with application of the qualitative and quantitative methods enabled scientists to justify the use of ranking method based on assessing the significance of each economic factor to rank the economic resilience capacity of socio-economic systems. Advantages of economic resilience indices assessment caused by the fact that they allow to develop the information-analytical methodology for monitoring, taking into account the most important aspects and indicators of the socio-economic systems, as well as to establish not only the results of existing activities, but also to track trends in their appearance. In addition, such approaches to the assessment are characterized by flexibility and the possibilities of taking into account the conditions and characteristics of the operation and development of specific systems.

Presented here is the 2015 FM Global Resilience Index (Table 1). Complete rankings are provided for the overall composite index and for each of its component factors: economic, risk quality and supply chain. The index is produced for 130 countries and territories: 126 countries and three regions each for China and the US.

Analysis of indicators of the EaP countries shows a quite low level of economic resilience capacity in targeted region. Only in Georgia due to complex institutional and economic reforms carried out after 2004 (after coming to power of Mikhail Saakashvili) country showed positive tendency of economic resilience capacity building and as the result was ranked 54. In turn, 55th

place of Azerbaijan can be explained by high oil prices in recent years, but taking into account the latest oil crisis, there are forecasts to further decrease of the country's rankings (for instance, as the result currency devaluation has been carried out at the beginning of 2016). Ukraine, ranked 107, dropped more places in 2015 than any other country; a fall of 31 places. Unsurprisingly, for Ukraine, the worsening political risk, combined with poorer infrastructure, was to blame. This in turn reveals a fairly high level of risks and their impact on economic resilience as a whole.

Table 1 - FM Global Resilience Index in countries of EaP

| Country | Factors | | | | | | | |
|------------|-----------|------|-----------------|------|---------------------|------|---------------------|------|
| | Composite | | <i>Economic</i> | | <i>Risk Quality</i> | | <i>Supply Chain</i> | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Georgia | 54 | 68 | 70 | 77 | 15 | 54 | 69 | 74 |
| Azerbaijan | 55 | 72 | 67 | 78 | 15 | 54 | 78 | 87 |
| Armenia | 83 | 105 | 124 | 125 | 15 | 54 | 74 | 82 |
| Ukraine | 107 | 76 | 116 | 80 | 84 | 76 | 93 | 77 |

Source: FM Global Resilience Index, available at: https://www.fmglobal.com/assets/pdf/Resilience_Methodology.pdf

It appears that many of the shortcomings of the presented index arise from the fact that the indicators relate only to general economic characteristics rather than specific institutional component. Many of these indicators are contained in vulnerability indices, and the implicit assumption seems to be that resilience is just the flip side of vulnerability. At the same time institutional economics suggests that as the complexity of internal and external communications between market participants has increasingly significant impact on the economic resilience.

The experience of transition in countries of EaP shows that systemic reforms that are not grounded in suitable institutions, including an active and well-organized civil society – are unlikely to deliver successful outcomes. The choice and speed of reforms in individual countries appear to have been closely related to their national institutions, history, economic circumstances and political conditions. In some cases, the consequent failures to establish a system of political contestability and to institute an effective rule of law, have resulted in partial and stalled reforms, where those who gained from the initial wave of reforms block further progress.

Conclusions

To summarize, we note that the term “regional economic resilience” is a capacious concept carrying strong semantic load. Thus, the regional economic resilience can be defined as a state of

the region where its characterizing parameters (financial, operational, organizational or any others) tend to make system “economically resilient” and at the same time capable of harmonic development and improvement, at any changes of the external environment.

Among the most important prerequisites for advancement of economic resilience should include not only the choice of models of economic and legal institutions, but also the transition to a more efficient system of enforcement of private property rights and contractual rights and overcoming the incompleteness of the emerging market system, including real equality of ownership, "deepening" of the financial structure and the development of new financial markets.

Thus, the main task of the current economic reforms in EaP is the development of progressive system of updated institutions forms of non-market and market-based character. The value of institutions for enhancing economic resilience capacity of the country has become a universally recognized fact of modern economic science.

Analysis of indicators of the EaP countries shows a quite low level of economic resilience capacity in targeted region. For Georgia and Azerbaijan, the economic indicators show a relatively stable economic resilience. With regard to Azerbaijan, taking into account the decline in energy (oil and gas) prices on international markets, a slowdown of the economy is expected. Only in Georgia due to complex institutional and economic reforms carried out in recent years, country showed positive tendency of economic resilience capacity.

Given the fact that the Association Agreement / DCFTA with three countries of the partnership were signed only last year, it is still early to draw concrete conclusions on the actual economic effects of these agreements on the economic development of the EU’s Eastern Partnership countries. However, in the long term, this partnership maintains its relevance and significance for the EU and the EaP countries. The radical structural changes, much needed in the economy, require the formation of an institutional environment that provides high efficiency and economic growth, rapid economic agents adaptable to ever-changing challenges.

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