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VLADIMER PAPAVA

THE ECONOMIC DEVELOPMENT COMPLEX IN THE BLACK SEA AREA:

THE IMPACT OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

MAY 2010
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*Dimitrios Triantaphyllou*

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PREFACE

Despite the widely divergent economies of the countries of the Black Sea region in terms of structure and levels of development, a number of common challenges concern them as a whole. Among these, the global economic and financial crisis has deeply affected the region collectively and each country individually.

Written by Vladimer Papava, a well-known economist and policy practitioner, this Xenophon Paper touches upon the consequences of the crisis on the countries of the Black Sea region in a specific analytical framework. Based on his own “theory of necroeconomics,” Papava assesses, in the context of the ongoing crisis, the key economic obstacles that the countries of the region face in achieving sustainable economic development. His analysis is based on two economic phenomena: the “necroeconomy” and the “zombie-economy.” A “necroeconomy,” which is created by uncompetitive industries (the “necrocompanies”) that are remnants of the command economy, differentiates the economy of post-Communist capitalism from all other models of capitalism. In times of economic crisis, though, “necrocompanies” can also appear in developed economies, as “zombie-firms,” creating a “zombie-economy.”

Following his theory, the author divides the countries of the Black Sea region in two groups: transition states (the “leaders,” to the extent they overcame their Communist past and the “outsiders,” for those that are enslaved by their Communist heritage) and non-transition states (Turkey and Greece). Thus, the key objectives and the means to achieve them differ for each country according to the category they belong. Based on the abovementioned categorisation, Papava’s analysis suggests that while most of the “outsider” countries are more vulnerable to the consequences of the crisis, non-transition states and the “leader” countries are likely to face better economic conditions in the post-crisis period.

In times when economic analysts employ various techniques to speculate about what the future might hold, the sobering reality is that these techniques become ineffective when the human factor is ignored. As the author suggests, in the post-crisis period, only states whose governments possess the political determination to cease managing the economy through zombie-ing mechanisms will eventually thrive. In this sense, Vladimer Papava’s paper is an important contribution to the better understanding of the economic forces at work in the Black Sea region.

Dimitrios Triantaphyllou
Athens, May 2010
INTRODUCTION

Currently, the Black Sea Region\(^1\) is not as integrated economically as to allow one to outline some common development trends of all regional economies. Nevertheless, bearing in mind the fact that most of the region’s nations (Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Moldova, Romania, Russia, Serbia, and Ukraine), except Greece and Turkey, are post-Communist countries, one can forecast to a certain degree of precision the ultimate outcome of the market-oriented reforms implemented in these countries.

It is hardly surprising that achieving high economic growth rates is not a key priority for the Black Sea countries. The problem is that the region is not homogeneous since it includes different economies like those of European Union (EU) member states (Bulgaria, Greece, and Romania), some post-Communist countries which are not EU members, and Turkey which is negotiating its accession to the EU. The key challenge for the post-Communist non-EU countries is to achieve some general European economic standards and, hence, to enhance their economic growth rates. Thus, in the post-Communist non-EU member countries, the enhancement of economic growth rates must be a result of properly planned and implemented market-oriented reforms.

More than twenty years have passed since the beginning of the period of post-Communist transition to a market economy. Naturally, this has resulted in the accumulation of a rather rich experience overall which allows us to make some generalisations. It may be asserted that market economies, as such, have been established in almost all of the countries of the former Socialist bloc with the period of transition over and the individual newly-independent states having passed through this period with varying degrees of success.\(^2\)

Some of the countries were so successful in moving towards a market economy that they even achieved EU membership, whereas others – in fact, all of the post-Soviet states with the exception of the Baltic states – became “prisoners” of their own product; that is, post-Communist capitalism, an idiomorphic phenomenon of modern times.

It must be emphasised in this respect that due to the contemporary global economic and financial crisis, the countries of the Black Sea Region have come to face the same general difficulties

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\(^1\) The term Black Sea Region encompasses the twelve member states of the Organization of the Black Sea Economic Cooperation (BSEC) – Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, the Russian Federation, Serbia, Turkey, and Ukraine.

\(^2\) Belarus is perhaps the only exception (see, for example, Rafal Antachak, Michail Guzhinski and Petr Kozarzhevski, eds., *Beloruskaia ekonomika: ot rynka k plany* [Economy of Belarus from Market to Planned Economy] Vol. II (Warsaw: CASE, 2001).
as the rest of the world and that if the desired end result is to successfully overcome the crisis, these could and should be addressed with common efforts. According to some experts, the economic growth rate across the countries of the region is expected to reach -6% in 2009. Unsurprisingly, the International Monetary Fund (IMF) and other international financial institutions have closely cooperated with various countries of the Black Sea Region during the global economic and financial crisis. 

The purpose of this paper is to highlight the economic development difficulties of the post-Communist Black Sea Region and to examine the key economic problems of all the countries encompassing it in the context of the ongoing financial crisis. Yet, before analysing the region's economic challenges, some general trends and threats present in practically all post-Communist countries will be touched upon. In fact, this is a logical standing-point because the economies of the post-Communist countries of the region suffer from the same basic problems as all the other post-Communist countries, with the global financial crisis having created some common threats for all the post-Communist countries of the world.

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4 Ibid., 7.

CHAPTER 1
THE POST-COMMUNIST ECONOMIES AND THE MAIN THREAT OF THE MODERN GLOBAL FINANCIAL CRISIS

Two Trajectories of Economic Transformation of the Post-Communist Economies

Almost two decades since the beginning of the historic process of the transition to the market economy, it is possible to draw a number of important conclusions about the path already traversed in transforming a Communist economy into a market economy. Although a plethora of scholarly publications exists on the subject of the transition period, there are no generally accepted criteria for determining its completion. However, the simplest formal answer to this question seemingly suggests itself: if the EU recognises a country as a transition economy ready to enter its ranks, then in all probability one should concede that the transition period in this country has been completed and that its functioning economic system for all practical purposes has become a market-based European one.

As is well known, the majority of the Eastern European as well as the three Baltic countries (Latvia, Lithuania, and Estonia) have become members of the EU. On the whole, one can interpret this as the completion of their transition period; that is, the period of transition to the European type market economy. In other words, these countries are “leaders” in passing through the transition period with success. Henceforth, the term “leaders” will refer to these countries. What about other post-Communist Black Sea Region countries like Albania, Armenia, Azerbaijan, Georgia, Moldova, Russia, Serbia and Ukraine, those who are “outsiders?” Are they still in transition phase? It is obvious that these countries, which were “outsiders,” are still far from emerging European capitalism. Capitalism by its nature is not homogenous. The transition period in “outsider” post-Communist countries has ended, but unfortunately the economic (and not only economic) system of some is far from a European style of capitalism. It is better to characterise it as “Post-Communist capitalism;” that is, a society which cannot be squeezed into the classic

6 See, for example, Anders Åslund, How Capitalism Was Built: The Transformation of Central and Eastern Europe, Russia, and Central Asia (New York: Cambridge University Press, 2007).
understanding of the word “capitalism” or within any other theoretically generalised model of capitalism.9 The logic of this problem appears to be rather simple: if the collapse of the Communist system was essentially simultaneous in the countries of Eastern Europe and the former Union of Soviet Socialist Republics (USSR), it follows that initially all were basically in the same situation and, consequently, the dragging out of the transition period to European capitalism is an artificial delay in reforming the economy (and society, more broadly). This all-inclusive answer in itself raises many questions about the causes of the artificial slowdown in the reform process which has resulted in post-Communist capitalism.

As the key to understanding the principal problems of post-Communist transformation in the “outsiders,” it is expedient to conduct a comparative analysis of these countries with the “leaders” described above.

The collapse of Communism in Eastern Europe and the former Soviet Union, together with the nearly simultaneous emergence of new independent states in lieu of the USSR and the Socialist Federal Republic of Yugoslavia, placed new issues on the agenda which transcended the classic explanatory framework of economics. Hence, economic scholarship proved virtually powerless to provide a theoretically grounded answer to such questions as: how should one make the transition from a centrally planned to a market economy?

It is not surprising that this process of transition, especially in its initial phase, proceeded under the well-known method of “trial and error.”10 Against this background of the inability of economic science to deal with the transformation processes, the presence of the institutions of statehood was undervalued from the very beginning of the transition period. In particular, the states that were formed as a result of the dissolution of the federal formations (the Soviet Union and the Socialist Federal Republic of Yugoslavia) and that were not the direct legal successors of these federal states lacked the institutions of statehood. As a result, their process of transition was compounded by the need to construct these institutions from the very beginning.11 Under these conditions, the implementation of economic reforms according to schemas that had


counted upon the utilisation of the corresponding institutions of the state (which were lacking in these countries) was foreordained to failure.

The advantage of the majority of the “leader” countries, compared with the “outsider” countries, was the presence of institutions of statehood which significantly simplified and, thereby, accelerated the resolution of tasks associated with the transition to a market economy. Nevertheless, this factor cannot be deemed decisive in delaying the transition process in all “outsider” countries, for there are the examples of Slovakia, Slovenia and the Baltic countries that are EU member states, or Croatia, having the status of an EU candidate country. Their example refutes the thesis about the fundamental impossibility of a rapid transition to a market economy amidst the process of creating these state institutions. As for the success of Croatia, Slovakia or the Baltic countries in reforming their economies and, simultaneously, constructing the institutions of statehood, this is fundamentally explained by the targeted thrust of measures adopted by the reformist governments in these countries. This, in turn, is explained by the human factor, which will be discussed below.

**Necroeconomy: The Legacy of the Communist Past**

In order to understand the essence of the economic foundations of post-Communist capitalism, one has to analyse one of the key peculiarities of a command economy: that is, the quality of its material and technical bases.

It is common knowledge that a command economy due to its very nature excludes any possibility for the existence of any forms of competitive relationships either domestically or internationally – inside any distinct economy or between different command economies. The majority of command economies used to be integrated into one big common economic space. The former Council of Mutual Economic Assistance (CMEA), which existed for approximately forty years and was governed by a coordinating organ, is perhaps the best example of this. Economic cooperation with market economies was maintained upon a very limited basis and exclusively at an inter-governmental level.

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15 See, for example, Jeffrey D. Sachs, “Reforms in Eastern Europe and the Former Soviet Union in the Light of the East Asian Experiences,” *CASE Network Studies and Analyses*, no. 39 (Warsaw: CASE, 1995).
The absence of competition in command economies quashed the only effective stimulus for economic development. As a result, the quality of products, as a rule, was very low – as were their prices – which were maintained artificially by means of national budgetary subsidies. The key sources of the former Soviet Union’s national budget revenues included the sales of alcoholic beverages and the export of raw materials (such as oil) which represented the only stable channel for the accumulation of foreign currency reserves.

In studying key aspects of the economic system of the Communist regime in Poland, Adam Lipowski came to the conclusion that when the whole world was divided between the “developed” and the “developing” countries, those with command economies could not qualify as belonging to either categorisation. He, thus, invented the term of “misdeveloped” countries specifically for command economies. In such cases of “misdevelopment,” Lipowski asserted that

- the share of industries in Gross Domestic Product (GDP) was too high because of a low percentage of domestic and foreign trade and services;
- a significant portion of industrial production accounted for manufacturing production as opposed to the comparatively small output of consumer goods;
- the volume of high quality competitive products capable of meeting international standards was very limited;
- the major part of industrial output included goods which were generally useless to customers; and
- the share of outdated products in industrial output was too high.

After the collapse of the Communist regimes and their command economies, the countries of the former Socialist bloc found themselves with only a very small amount of goods to supply to the global market. With few exceptions, such as some hydro energy outputs, oil and gas extraction and the primary processing of raw materials, manufactured goods failed to meet the high international standards as a result of their overall low quality and/or high prices. In fact, no markets existed for these particular products. Moreover, in principle, there was no way that they could have existed in that an economy of this type is nothing more than a corpse or a so-called “necroeconomy” or, similarly, a “virtual economy.” The economic theory which deals with this kind of economy is called “necroeconomic theory” or “necroeconomics.”

Lipowski uses the term “divesting” (as an antonym to “investing”) in order to describe the process of a command economy being “stripped.”\(^{20}\) This amounts to “liberating” the post-Communist economy from the list of pathologies characterising a “misdeveloped economy”\(^{21}\) which, in this author’s opinion, is the way in which a necroeconomy develops.

Naturally, even if one part of an economy is dead, the rest may still be alive which can be referred to as its “vital economy” or “vitaeconomy.” Accordingly, the economic theory which deals with this kind of economy is called “vitaeconomic theory” or “vitaeconomics.” By its substance, this is nothing more than economic theory itself – or economics in its common meaning – because economic theory, as such, is something which deals with the economy as a vital system. All of the aforementioned lead us to the following question: what does a necroeconomy have in common with a vitaeconomy and how do they differ?

In a necroeconomy, like in a vitaeconomy, some goods may be produced which in fact means that supply may exist. In contrast to the goods produced in a vitaeconomy, however, those emanating from a necroeconomy are in a situation of no demand owing to their low quality and/or high prices.

If any segment of an economy is “dead,” then theoretically there should be no problems within. Common sense tells us that a necroeconomy cannot have any influence over its vital parts. Under the conditions of a market economy, economic theory prescribes that uncompetitive production must disappear and, at the same time, should not create any significant problems for the rest of the economy. This explains the limited focus of economic theory on the problems of post-Communist market economies in which necrocompanies exist.

Specifically, in the countries which are still undergoing the process of post-Communist transformation – as well as those in which post-Communist capitalism has already been established – the necroeconomy has grown on top of the roots of the command economy’s material and technical bases. We can conclude, therefore, that the necroeconomy is exactly that which differentiates the economy of post-Communist capitalism from all other models of capitalism.

The economy of post-Communist capitalism consists of the following groups of necroeconomy and vitaeconomy:

- First group: necroeconomy in the public sector

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Second group: vitaeconomy in the public sector
Third group: privatised necroeconomy
Fourth group: privatised vitaeconomy
Fifth group: vitaeconomy developed by means of new private investments

The majority of the first group, as a rule, consists of large- and medium-sized processing industry enterprises (it must be taken into consideration that industry in countries with command economies has long been funded by “economising” expenditures made on agriculture, social needs, housing and transportation). Depending upon the types of goods produced, they are labelled “strategic” ones, even though they are dead under the conditions of a market economy owing to their lack of or low competitive powers.

On the other hand, the second group consists of enterprises within the energy sector (primarily, electricity generation and transmission, and the extraction and distribution of oil and gas), as well as those related to transport and communications constitute a basis for the vitaeconomy in the public sector. When privatised, they move to the fourth group comprising the privatised vitaeconomy which may also include some medium-although mostly small-sized industrial enterprises (prior to their privatisation).

The third group consists of formerly first group enterprises following their privatisation. The change in ownership by itself does not automatically entail the restarting of formerly idle enterprises in that a “corpse’s” status does not depend upon whether it is owned by the government or a private firm. Disregarding this fact is the key reason that the process of privatisation has been relatively discredited. Privatisation, especially during its initial phases – irrespective and taken separately of any investments – has often been believed to be a universal remedy capable of restarting any inoperable enterprise, dead or alive. As we will seek to demonstrate, the institute of private ownership alone is not able to create sufficient conditions for the abolition of necrofirms.

The fifth and last group embraces the “healthiest” segment of the post-Communist economy, which is based upon the principles of a market economy maintained by private investments. One of the problems discovered herein, however, is that through some foreign investments post-Communist countries receive relatively old technologies, which have become obsolete from the standpoint of modern international standards. These could be labelled as “second-hand investments” with goods manufactured by means of this capital only being competitive in “emerging markets” and only for a limited period of time until the arrival of highly competitive goods that meet all international standards.

Zombie-Economy: The Legacy of Financial Crises

As mentioned above, necrocompanies are found within the countries of post-Communist capitalism, but the question arises whether or not this is a problem confined to transition countries alone or if these sort of enterprises also exist in developed and/or developing economies.

International experience shows that dead firms exist and successfully function in developed economies as well, with Japan being the most obvious example. These insolvent and, in fact, bankrupt firms that continue to operate despite their “mortality” are commonly referred to as “zombie-firms.” The key source of sustainability for these zombie-firms is a system of continued lending with loans granted by the so-called “zombie-banks” which extend beneficial credits to the firms (in particular, interest rates for such loans are lower than average rates at market level). In full risk of stating the obvious, these unreasonable loans can only lead these banks to direct and inevitable losses. If, therefore, this is the maintenance plan for zombie-firms, how, one may ask, do zombie-banks manage to survive under such circumstances? As a rule, such banks receive, amongst other things, all kinds of governmental guarantees and reassurances for their deposits at the expense of taxpayers. To a certain degree, such a financial system even encourages “healthy” firms to turn into zombies.

As a result of the aforementioned relationship between zombie-firms, zombie-banks and their governments, a “zombie-economy” becomes a heavy burden for the “healthy” segments of the economy. In particular, the mere existence of zombie-firms that enjoy guaranteed beneficial loans from zombie-banks block the emergence of new, “healthy” firms in the market as they

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29 Hoshi, “Economics of the Living Dead,” 40.
30 Ibid., 33.
have to borrow at rather higher interest rates. 31 In addition, due to their access to guaranteed beneficial loans, zombie-firms fight for market shares, have the liberty to drop prices 32 and raise the salaries of their employees. 33 The limited market access for “healthy” and, even more so, productive firms eventually leads to the reduced productivity of the whole economy. 34

A zombie-economy takes its roots in times of financial crisis. 35 Under conditions of stagnation, the economy is characterised by low production and trade for a relatively long period of time which, in turn, gives rise to unemployment, a reduction in wages and salaries and the overall decline of living standards. During these times, governments, as a rule, are called to assist the economy to overcome such harsh conditions through the provision of bailouts and other attempts that could support the banking sector (in order to avoid a banking crisis) and the entire economy. When a financial crisis comes to an end, the economy receives its own lifeless portion as a legacy of the difficulties and continues to try to preserve the old system of the government's financial aid which was readily available to it during the crisis. A zombie-economy, therefore, can be viewed as a legacy of a financial crisis.

It must be emphasised that, as international experience has shown, a zombie-economy is a phenomenon peculiar not only to Japan and other developed market economies 36 but also to countries with developing economies. 37 One might have the impression that the terms necroeconomy and zombie-economy refer to the same phenomenon; that is, a dead economy which continues to subsist despite its status. In fact, such an impression is both superficial and misleading in that whilst the two “economies” do indeed share one commonality – there is no doubt that they are both dead – significant differences exist between them.

i) Both economies develop in essentially different economic systems; a necroeconomy in a command economy whilst a zombie-economy in a market economy.

33 Hoshi, “Economics of the Living Dead;” 33.
34 Ahearn and Shinada, “Zombie firms and economic stagnation in Japan;” 364.
37 See, for example, Kane, “Capital Movements, Banking Insolvency, and Silent Runs in the Asian Financial Crisis.”
ii) A necroeconomy, in fact, has no correlation with a financial crisis, whereas a zombie-economy is the immediate product of it. It is important to note once again that the existence of zombie-firms mainly depends upon zombie-banks, while necroeconomic agents subsist by means of immediate and direct subsidies from national budgets or tax exemptions.

iii) The differences between a necroeconomy and a zombie-economy also have to do with the sectors that they influence. A necroeconomy, therefore, generally expands to large- and medium-sized manufacturing industries as opposed to zombie-firms which show no traces of existence therein as evidenced by the situation in Japan’s economy. Moreover, there is a higher probability for large manufacturing enterprises in a post-Communist capitalist country to become part of a necroeconomy. As the Japanese experience demonstrates, most large-sized firms, due to their great financial power, are not zombie-firms, but may also often be encountered in those so-called small businesses that are relatively “larger” than others.

It is important to note that whilst all international financial institutions, such as the IMF and the World Bank, insist that the post-Communist capitalist governments should eliminate all kinds of national budget subsidies and tax exemptions, all lobbying efforts are mobilised towards pushing those bailout programmes into providing some extensive financial support to the national governments in order to enable them to build up some favourable lending systems in the context of the financial crisis. Therefore, one may arrive at the conclusion that even though necroeconomies and zombie-economies are related to each other, they still differ to a great extent as individual economic phenomena. Unfortunately, however, these differences are not always given proper consideration. In some studies, the peculiarities of a necroeconomy are overlooked and, as a result the problems of dead firms in the post-Communist countries (mostly China and Russia) are examined within the context of zombie-economies rather than necroeconomies.

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38 Hoshi, “Economics of the Living Dead.”
39 Ibid.
40 Kane, “Capital Movements, Banking Insolvency, and Silent Runs in the Asian Financial Crisis,” 163; Kane, “The Dialectical Role of Information and Disinformation in Regulation-Induced Banking Crises,” 288.
41 Despite its Communist ruling party, China’s market reforms fit more within the group of post-Communist market economies and, as such, enable us to call it a post-Communist entity.
42 See, for example, Kane, “The Dialectical Role of Information and Disinformation in Regulation-Induced Banking Crises,” 300-1; Brink Lindsey, Against the Dead Hand: The Uncertain Struggle for Global Capitalism (New York: John Wiley & Sons, 2002), 126, 153; Andrei Shleifer and Daniel Treisman, Without a Map: Political Tactics and Economic Reform in Russia (Cambridge, MA: The MIT Press, 2000), 106-7.
The Human Factor and Reproductive Mechanisms of a Necroeconomy and a Zombie-Economy

A key question with respect to a necroeconomy and a zombie-economy is what ensures their stable existence. The answer may be found in an evolutionary theory of economic changes where the basic tool is the concept of “routine” which implies a certain set of rules and procedures of a firm’s specific type of conduct that regulates the reproduction of this type of conduct, or which refer to a repetitive pattern of activity in an entire organisation. It is this very routine – developed over a period of several decades upon the roots of a command economy – that pushes dead companies in the countries of post-Communist capitalism to work in the no-longer-existing regime of a command economy. Without any special governmental support the warehouses of these companies become filled with uncompetitive goods for which there is neither demand nor a market. Given the fact that as a matter of principle these goods cannot be sold to anyone, the companies find themselves further and further in arrears as regards wages, salaries and debts to national budgets, social funds, energy sector industries and other businesses eventually creating a network of mutually indebted businesses.

It was a long-established tradition in command economies that when an enterprise accumulated – often very deliberately – huge debts, its director raised the question before his country’s superior governmental institutions (such as Communist Party governing bodies, the Gosplan, the Ministry of Finance, etc.) to write off the debts and, as a rule, such requests were usually granted. Consequently, due to the almost unlimited (or much rather guaranteed) opportunities to have one’s own debts removed, enterprise managers did not regard debt accumulation dangerous for their existence. Such a mechanism of writing-off debts represented a firmly established routine which, unfortunately, reappears constantly and within various forms, such as “tax amnesties,” in the countries of post-Communist capitalism.

45 Nelson and Winter, An Evolutionary Theory of Economic Change, 97.
47 The Gosplan was the most important organisation in the USSR’s economic administration system, responsible mainly for the government’s economic planning.
As for the “routine” of a zombie-economy, it develops under the conditions of financial crises wherein governments and banks collaborate with each other towards developing and implementing bailout programmes for insolvent firms and, thereby, avoiding greater economic decline and unemployment. During a relatively long period of stagnation, such collaboration grows into an established order that sets the rules of a firm’s conduct and, in turn, ensures its reproduction. In other words, the activities grow into a routine. Herein one must underline the continued stagnation that precedes the formation of routine; that is, it must have enough time to take hold. When a financial crisis comes to an end, the routine undertakes the mission to ensure the subsistence of a zombie-economy. The reason is that under all other equal conditions, and irrespective of the crisis, no government would tolerate the growth of unemployment which comes as an inevitable result of the closure of zombie-firms. Undoubtedly, “healthy” firms are never able to instantaneously react to the disappearance of zombie-firms and quickly address the problem of creating new jobs.  

A necroeconomy has such a negative influence over the countries of post-Communist capitalism that the development and utilisation of a mechanism which would solve the problem of necro-firms is necessary. This mechanism must enable the universal dissemination of the market-based principles of economic order. The key to the solution of this problem rests in the abovementioned evolutionary theory of economic changes.

Governments must pay particular attention to the fifth group of the abovementioned list of firms – those within a vitaeconomy developed by means of new private investments – within post-Communist capitalist economies. They must provide for the further strengthening and expansion of this group as well as for the development of a stable political and macroeconomic environment that will encourage private investments and the emergence of new healthy firms. Account must also be taken that routine formed in this group will be one which is market-based by its nature and, therefore, the community will not be exposed to any necroeconomic danger.

The narrowing of the areas of expansion of the first and third groups on the list – that is, necroeconomy in the public sector and privatised necroeconomy – must become a key priority for the economic policy of post-Communist governments. This process must come from the overall expansion of a vitaeconomy created through the inflow of new private investments. Despite the natural non-attractiveness of such firms which become established through so-called “second-hand investments,” they will not be able to create the necessary conditions for the emergence of necroeconomic agents under the conditions of an appropriate legal framework. Specifically, to the extent that such firms were created according to the principles of a vitaeconomy, their re-

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49 See, for example, Caballero and Kashyap, “Japan’s Indian Summer,” Wall Street Journal, 18 July 2002; Lindsey, Against the Dead Hand: The Uncertain Struggle for Global Capitalism, 235.
pective routine must ensure their painless disappearance from the market even if they have lost their competitive qualities.

With regard to the list’s second and fourth groups – a vitaeconomy in the public sector and a privatised vitaeconomy and irrespective of whether or not the owner is the state or a private individual after its sale – these economies will inevitably be in need of more investments which would be attracted through a partial sale of assets or, in the very least, the long-term concession of a company’s management to a strategic investor. Without these inflows, there is a strong probability that the vitaeconomies of the second and fourth groups will correspondingly turn into the same necroeconomies of the first and third groups.

As previously noted, privatisation alone does not result in the automatic elimination of a necroeconomy. Consequently, a government may have only one solution for solving the problem of ensuring the operation of the strategically important enterprises of the first group; that is, holding an open international tender with the purpose of choosing a strategic investor which may take over the management of a specific dead enterprise (or, much rather, obtain the right to start some strategically and domestically important production within it) upon a long-term basis. It should not be excluded that this step might not satisfy a strategic investor in which case the government would have to agree to privatise the enterprise even at a symbolic price given that a necroenterprise can naturally not be sold for a high price.

There is literally no future for the enterprises in the third group; that is, within a privatised necroeconomy whose only fair estimation of their material and technical base would be nothing more than scrap metal.

Theoretically, it must be made clear that the effective elimination of a necroeconomy is unthinkable without an effective bankruptcy law. As the experience of many countries of post-Communist capitalism has demonstrated, most attempts in the past to formally adopt bankruptcy laws have unfortunately produced only “stillborn babies.” In other words, they are “necro-laws” because the occurrence of factually bankrupt enterprises being proclaimed as legally bankrupt is something which happens only very seldom, if at all. In these countries, bankruptcy procedures are blocked by all possible means which, inter alia, may be explained by the assumption that bankruptcy does not “fit” into their institutional environments.

The “outsider” countries carry the heavy burden of a necroeconomy. At the same time, they provide infamous examples of the ineffectiveness of a post-Communist bankruptcy law in which new institutions are very often created through the immediate and shallow imitation of their

Western originals. As a result, many institutions of a developed market economy are often extremely ineffective in the countries of post-Communist capitalism. Moreover, they may also lead to some extremely negative consequences such as, for example, the frequent and deserved criticisms lodged against the IMF for its hasty and even simplified approaches towards institutional reforms in post-Communist countries which have ultimately harmed – rather than helped – the process of the establishment of a market economy.

The elimination of a necroeconomy may only be accomplished by establishing institutions that will boost the process of democratic reform and raise the efficiency of post-Communist transformation. The dying out of the phenomenon of a necroeconomy may be considered as an economic indicator of a country’s successful overcoming of the stage of post-Communist capitalism.

An effective bankruptcy law is another effective tool in the fight against zombie-firms and zombie-banks. Unfortunately, however, one has to admit that the situation in developed and developing countries is no better than it is in the countries of post-Communist capitalism. Specifically, there is a clearly observed tendency that the legitimate bankruptcy of many firms is not readily documented by means of appropriate legal procedures. At the same time, the European Commission makes efforts to improve the bankruptcy environment and wants to encourage those that go bankrupt to try again.


The human factor, as a rule, is a matter of decisive importance for practically all kinds of economic developments. At the same time, an economic approach, as such, may be applied to any spheres of human behaviour.58

The routine which reproduces a necroeconomy is conditioned by the behaviour of a human being who is in the middle of the transition from the state of a *homo etaticus*59 or *homo soveticus*60 – that is, one who is suppressed by the state and who totally depends upon it – to *homo economicus*61 or a human being whose driving force is to get a household’s maximum utility and a firm’s maximum profit which is typical of a market economy.

The type of human being who manages the process of post-Communist transformation or, in other words, one who is a “central character” in post-Communist capitalism is someone we call *homo transformaticus*; that is, a human being who failed to completely release himself from both the fear of the state and the habit of living at the government’s expense even though he gradually gets used to the situation owing to his private interest in obtaining maximum utility and profit.62

By analogy with Y. A. Levada’s concept of *homo adapticus*,63 *homo transformaticus* is a human being who gradually becomes accustomed to the imminent rules of a market economy and, furthermore, gets involved in the process of setting and developing those rules.

Because of the fact that the Communist regimes in “leader” countries ruled almost half as long as in the “outsider” countries, the type of person called *homo soveticus* did not have time to de-

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61 The modern understanding of the features of the *homo economicus* has undergone significant changes in the aftermath of Smith’s epoch (see, for example, V. S. Avtonomov, *Model cheloveka v ekonomicheskoi nauke* [Human Model in Economic Science] (St. Petersburg: Ekonomicheskaia shkola, 1998), 57-201; M. K. Bunkina and A. M. Semionov, *Ekonomicheskii chelovek* [The Economic Man] (Moscow: Delo, 2000).


velop fully. At the same time, *homo economicus* was not totally eradicated as this phenomenon took place in the "outsider" countries at the end of the 1930s. Consequently, in the "outsider" countries *homo transformaticus* was dominated by the characteristic features of *homo soveticus*; by contrast, in the "leader" countries, it was the features of *homo economicus* which prevailed. It is precisely this difference which explains the greater readiness of *homo transformaticus* in the "leader" countries to undertake the transition to a market in contrast to the situation in the "outsider" countries.

Albania and Serbia (along with some other countries of the former Yugoslavia) seemingly make certain exceptions to the explanation given for grouping "leader" and "outsider" countries. Actually, both Albania and Serbia have specific characteristics. In the case of Albania, for example, it was distinguished with the most brutality and autarky\(^\text{64}\) – even though the Communist regime was established there after the Second World War – which facilitated the creation of *homo soveticus* within a relatively shorter period of time. As for Serbia, the country falls under the group of so-called "outsider" countries primarily due to the fact that Serbia struggled for a rather long period after the disintegration of Yugoslavia in order to retain its former "empire" even in its diminished format. This significantly hampered a purposeful implementation of the reforms. The soundness of this provision is confirmed by the examples of former Yugoslav countries such as Slovenia and Croatia. After gaining independence, they managed to overcome the problems related to their territorial integrity relatively quickly and, now, Slovenia is a member of the EU and Croatia is candidate country for EU membership.

In business, *homo transformaticus* assumes a special form whose roots may be traced back to a command economy. Even in the times of a command economy’s reign, a market economy (or, much rather, certain elements of it) was not eradicated in its entirety. Simply, it was oppressed by the state to the degree that it could only subsist within a “shadow” sector.\(^\text{65}\) Under the conditions of a command economy, no director (perhaps with few exceptions) could possibly manage his enterprise without breaking a law adopted by the existing regime. In exceptional cases, therefore, elements of a market economy were actually applied. Such activities were referred to as “shadow activities” and the managers of such enterprises were called “shadowists.”\(^\text{66}\) Nevertheless, under the conditions of a command economy and given their suppression by the former Communist regime, such directors never became – and could not have possibly become –


\(^{65}\) See, for example, A. N. Shokhin, *Sotsial'nyeproblemy perestroiki* [Social Problems of Perestroika] (Moscow: Ekonomika, 1989), 57-83. It must be noted that unlike a command economy, whose "shadow" sector may make room for some elements of a market economy, the “shadow” sector primarily embraces such activities which enable tax evasion [see, for example, Bunkina and Semionov, *Ekonomicheskii chelovek*, 50-52; Bo Svensson, *Economisk kriminalitet* (Göteborg: Tholin/Larrson/Gruppen förlag, 1983)].

truly market-type entrepreneurs. For this reason, the directors that applied some elements of the market economy within their managerial practices were not called "entrepreneurs" but, rather, "del’tsy" (the plural of the Russian word "delets" which means "businessman" in its literal translation, but is typically rendered as "labourer" given its derogatory connotation).

Even after the collapse of a command economy, most of former del’tsy managed to preserve themselves as directors in public sector enterprises within various capacities. Moreover, after the privatisation of those particular enterprises, the same del’tsy exploited the rights of "labourers’ collectives" and became the owners of the same enterprises. At the same time, whether or not they hired professional managers – especially in the initial phases of the post-privatisation periods – they still tried to manage their enterprises according to their judgement, following a so-called delets way.

Just as homo transformaticus has not yet become homo economicus, so is the case with the former del’tsy that have not yet developed into entrepreneurs. Homo transformaticus, therefore, takes on the title of "post-delets" in his entrepreneurship.

It is exactly these post-del’tsy who make up the spine of a necroeconomy in both the public and private sectors as they are the carriers of the routine of a command economy. By using their old connections, the post-del’tsy manage to break into governmental organs (parliaments, executive offices, etc.) and use their influence to try to politically justify and prolong the existence of the necroeconomy.

It can be stated without any reservation that a necroeconomy best serves the interests of the post-del’tsy in that this type of economy will always enable the continuation of their existence.

until they are entirely replaced by true entrepreneurs through the means of appropriate institutional reforms.

The key to understanding a zombie economy's routine may be found in the theory of public choice by James Buchanan in which politics is interpreted as a special type of a market.\(^72\) During a financial crisis, a type of economic policy develops that proposes the government’s interference in the economy with its uppermost goal of rescuing it from a critical state, on the one hand, and encourages the addressing of the private interests of those economic agents who have found themselves on the verge of bankruptcy as a result of the said crisis, on the other hand.

As previously mentioned, a zombie-economy’s routine is the product of a market economy in a state of crisis. Consequently, it is not a simple \textit{homo economicus} who is the carrier of this routine but, rather said, a mutation which was formed in the process of his adaptation to the deformed conditions of the market economy as a result of the financial crisis. Conventionally, a \textit{homo economicus} mutant may be called \textit{zombie economicus}\(^73\) in that he is the carrier of a zombie-economy’s routine.

From \textit{zombie economicus}, as an already accomplished phenomenon, \textit{homo transformaticus} differs by the fact that he is still in the process of adaptation to a market economy and, as such, he has not yet been established as a type of human being. Because \textit{homo transformaticus} is still developing, one may ask whether or not it is possible for a \textit{homo transformaticus} to grow into a \textit{zombie economicus} in the context of the ongoing global financial crisis.

\section*{The Current Financial Crisis and the Threat of Zombie-ing the Necroeconomy}

The complex problems created by the current global economic and financial crisis\(^74\) could not leave the countries of post-Communist capitalism unaffected. It is precisely within this context that the attack of zombie-firms upon the global economy has become so topical an issue,\(^75\) re-

\begin{itemize}
\item[75] For example, George Cooper, \textit{The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy} (New York: Vintage Books, 2008); Harry S. Dent Jr., \textit{The Great Depression Ahead: How to
sulting in the emergence of numerous studies within the so-called new economic field of “zombie-nomics.”76 As many developed countries nowadays resort to certain special governmental bailout programmes in support of their financial institutions and real estate businesses,77 the threat of a new zombie-economic routine arises; a threat that may become real if the financial crisis continues long enough to enable the zombie-economic routine to establish itself.

If only a few years ago the existence of a zombie-economy in the United States of America (US) was categorically negated,78 nowadays talk about the emergence of zombie-firms as a direct result of the financial crisis has grown louder.79 As a consequence, the US government’s bailout plan has been referred to as a zombie-programme, whereas the US Treasury Department has been disparagingly called the “mother” of a zombie-economy.80 To be fair, however, one has to underline that the first signs of the zombie-ing of the US banking sector appeared long before the beginning of the present financial crisis, when the US government extended subsidies to American banks in order to stimulate their mortgage lending insurance plans for the benefit of

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low income segments of the population which failed to meet general banking standards. Remarkably, experts assert that an interesting difference exists between the emergence mechanisms of zombie-firms in Japan and those in the US. In the first case, for example, the government supports zombie-firms through zombie-banks, whereas the bailout plans envisaged in the US are intended to be implemented without the mediation of banks, even though the results in both countries are expected to be the same. Obviously, such an approach does not correspond to the reality which is being shaped in the US in relation to its government’s domestic zombie-banks’ bailout programme.

Likewise, the rise of a zombie-economy in Canada and some EU countries has become a possibility. In the countries of post-Communist capitalism, the present financial crisis favours the development of governmental programmes aimed at providing financial support to perishing banks and firms. Various proposals have been put forth which would establish some special governmental institutions (banks) and implement long-term beneficial lending and investing.

Although the economic theory has stood the test of time and global experience has also shown just how harmful governmental interventions into the economy can be when favourable lending plans – as well as subsidies to troubled industries, or the raising of the trade barriers – are introduced, both developed economies and those of post-Communist capitalism repeatedly re-
sort to the aforementioned remedy during a financial crisis.\(^8^9\) Unfortunately, however, as mentioned earlier, such a move eventually leads to the emergence of a zombie-economy routine.

The current financial crisis brings the principle of "privatisation of profits and nationalisation of losses" to the surface.\(^9^0\) During a financial crisis, developed economies are more vulnerable to the zombie-ing of the economy, compared to the countries of post-Communist capitalism, owing to the latter’s exposure to the necroeconomy.\(^9^1\) Under normal circumstances, post-Communist countries with a large-scale market experience the effects of a necroeconomy far less than those with relatively smaller ones. The reason for this is that large-scale markets create fertile ground for competition and governmental support,\(^9^2\) a combination that evokes the illusion that a necroeconomy does not exist. In smaller countries, however, this problem is rather severe due to the fact that many enterprises may have no domestic competitors at all.\(^9^3\)

This difference between large and small markets has an influence upon the governmental policies supporting a necroeconomy. In particular, the illusion of the absence of a necroeconomy caused by domestic competition hinders, to a large extent, a government’s will to get rid of a necroeconomy. In countries with small-scale markets, however, the absence of analogous enterprises eliminates the conditions for domestic competition, thus enabling the governments to retain a greater stimulus to fight necroeconomy, even though such a stimulus is not always utilised in a proper way.

Amid a financial crisis, the governments of post-Communist capitalist countries may retain far less illusions that a necroeconomy exists. It comes as no surprise, therefore, that they witness a catastrophic decrease in their industrial output.

In view of the fact that it is precisely the financial crisis which creates favourable conditions for the establishment of zombie-economy routines – that is, the zombie-ing of an economy – the zombie-ing of a necroeconomy is what happens in the countries of post-Communist capitalism. It, in fact, is even worse than the simple economic zombie-ing which takes place in developed

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economies. If in Japan, for example, the zombie-economy never touched the processing industries, then one of the qualities of the necroeconomy is to concentrate exactly upon this sector of the economy. Consequently, the zombie-ing of a necroeconomy inevitably amounts to the zombie-ing of this already dead sector as well.

Therefore, there is high probability that homo transformaticus will eventually grow into a zombie economicus, rather than into a homo economicus. This implies that the economic future of the post-Communist capitalist countries could be even more dubious than it is today.
CHAPTER 2
THE ONGOING CRISIS IN THE BLACK SEA REGION AND THE POST-CRISIS DIFFICULTIES

On the Current Global Financial and Economic Crisis

Given the complex character of the global financial and economic crisis, this chapter does not aim to engage in its detailed discussion, but to set out some elements of the crisis that will allow for the understanding of various economic difficulties that appear today in the Black Sea Region. The first sign of the crisis appeared in the US financial system in the summer of 2007. Later, it expanded to Western Europe and Japan and reached all developing countries and economies in transition by the end of 2008. The financial globalisation accelerated the spreading of the crisis worldwide. The evolution of the present financial crisis can simply be described through the following chain of transformations: it started with a mortgage crisis – as it should be expected – that grew into a banking crisis, which in turn led to an industrial crisis. The current financial crisis is also labelled as a demand crisis. Thus, it has been transformed into an economic or financial-cum-economic crisis, which is very important to understand the economic difficulties of the Black Sea Region.

While the overproduction of goods and services was the key cause of the economic crises in the 20th century, there is still no common ground regarding the nature of the current crisis. According to some, the present crisis (which is also defined as a “credit crisis”) should be connected to the overproduction of debts. Others suggest that the modern crisis is actually the result of the

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previous situation of an overproduction of goods and services fuelled by the expansion of “fiduciary money” and resulting in excessive supply which eventually led to the current level of consumption of goods and services at the expense of future incomes which sometimes were not received at all.100

It appears that both perspectives are correct and non-contradictory, depending on the period of time under consideration. Thus, in a short-term perspective, the overproduction of debts is apparent. Specifically, the crisis was preceded by the continued financing of the growing current consumption. The financing took place through loans which were extended on the account of some future – but not always realistic and reasonable – incomes. Moreover, due to their being tied-up with consumption in the past, the future incomes can hardly be used for consumption in the corresponding period of time. As a result, the cost of goods and services to be produced in the future is higher than the buying capacity of incomes raised in the corresponding period. Therefore, in a long-term perspective the effect of the overproduction of goods and services also becomes apparent.

As far as the anti-crisis programmes are concerned, the most common include the avoidance of protectionist measures, nationalisation and expansion of the public sector,101 even though it is not recommended that solutions to some substantial social problems be suspended for an indefinite period of time.102

The impact of the global financial crisis on the Black Sea Region has been felt in a different way compared to other regions, mostly due to the level of economic development or, more specifically, due to the extent of the development of its financial markets.103 Although financial markets in the post-Communist countries are not developed, these countries could not escape from any of the negative implications of the global financial crisis.104 It should also be underlined that despite the difficulties created by the global financial crisis, the financial systems in the Black Sea Region countries have not collapsed. Certainly, this can be seen as a very significant

101 Dabrowski, “Responding to Crisis: Core and Periphery,” 5
103 Gavras and Iorga, “The Impact of the Current Economic and Financial Crisis on the Black Sea Region.”
104 See, for example, Åslund, “Implications of the Global Financial Crisis for Eastern Europe;” Dabrowski, “Responding to Crisis: Core and Periphery.”
success story for these countries. Further down, each of the countries in the Black Sea Region will be considered individually in order to assess the impact of the crisis. It needs to be highlighted that the statistical information in the aforementioned countries is not uniformly structured. The countries of the region, which are also members of the EU, have more reliable statistical information than most of the other states in the region. Nevertheless, the information used in this paper is provided by the national statistical offices.

The Moderate Impact of the Global Crisis on Albania

In comparison with other Black Sea Region countries, Albania was the most closed economy of the Communist past, with its statistical data being confidential and unreliable. Nevertheless, against the background of the global financial crisis, the economy of Albania is quite stable and has not experienced an economic downturn yet. According to the estimates of the IMF, for instance, the annual GDP growth amounted to 6.8% in 2008 with the annual inflation rate measured at 3.4%, while the GDP was expected to increase by 0.7% in 2009 with the annual inflation rate down to 1.7%. For 2010, the GDP is expected to increase by 2.0% with inflation estimated at 2.0%. Thus, one may conclude that there is no crisis in Albania and the country only faces an economic slowdown. This is because Albania has been relatively less vulnerable to shocks of traditional low income countries; namely, those concerning exports, prices, remittances and Foreign Direct Investments (FDI). Albanian exports, for instance, account for just 25% of GDP. Thus, a decrease in exports owing to the global financial crisis cannot significantly influence the rate of its GDP growth, given that growth has been supported mainly by domestic demand. Also, the free floating exchange rate regime in Albania allows for the lek, the country’s national currency, to maintain its stability. Although the deposits flowed out of the Albanian


109 Ibid., 1.

110 Ibid., 2.


banking system due to the global financial crisis,\textsuperscript{113} the Albanian banking system, which is predominately foreign owned, is quite stable.\textsuperscript{114}

It is worth noting that in 2008 experts had predicted that the global financial crisis would have a moderate impact on the Albanian economy.\textsuperscript{115} As the memories of the financial crisis caused by the “financial pyramids” (Ponzi scheme) in 1996-97 were still fresh in the memory of the Albanians,\textsuperscript{116} the global financial crisis gave rise to a latent panic amongst the population. As a result, and in order to prevent serious complications, the government decided to use a deposit insurance system that insured deposits up to 700,000 Albanian lek (approximately US$7,000).\textsuperscript{117}

While no economic downturn is observed in Albania, the country’s industry is in a difficult state. The third quarter of 2009, for instance, witnessed a decrease in production volume by 4.5%.\textsuperscript{118} This comes as no surprise, if one recalls that considerable investments and assistance were provided to the Albanian industry by the Soviet Union and other Socialist bloc countries and, since the early 1960s, by China.\textsuperscript{119} Thus, Albanian industry was inefficient, structurally distorted,\textsuperscript{120}

\begin{enumerate}
\item[120] Zickel and Iwaskiw, eds., Albania: A Country Study.
and characterised by high resource-intensity and low productivity. In other words, similarly to the other post-Communist countries, a necroeconomy was created in Albania as a result of the collapse of the Communist regime.

With the current crisis, the necroeconomic plants in Albania face serious problems. An illustrative example is heavy industry where the metallurgical works continue without yielding any profit for the sole purpose of fulfilling obligations undertaken in contracts with clients from the former Yugoslav Republic of Macedonia, Kosovo, Montenegro, and Serbia. Taking into consideration that the Albanian government allocated US$300 million to support the country’s economy, it is apparent that its necroeconomy faces the threat of zombie-ing.

Economic Development in Armenia

In the absence of any serious deposits of natural resources, the global financial crisis had a very serious impact upon Armenia. This country was also gravely affected by the Russian-Georgian war. In particular, according to official sources, the direct and indirect damage caused to Armenia by the war is estimated to US$600-700 million.

In 2008, the annual inflation rate in Armenia was 9.0% and the GDP growth rate 6.8%. In January-November 2009, the GDP accounted for just 84.0% of its amount for the same period of 2008. National budget revenues in the first quarter of 2009 fell almost 10% lower than 2008 levels. In January-May 2009 industrial production shrank by 10.5% and construction by

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123 Ibid.

124 See, for example, Svante E. Cornell and S. Frederick Starr, eds., The Guns of August 2008: Russia’s War in Georgia (Armonk: M.E. Sharpe, 2009).


126 Ibid., 49.


According to the Central Bank and the government of Armenia, the country faced an economic decline of 6-8% in 2009.

The significant role played by the Armenian Diaspora in all spheres of Armenia’s development, mainly in investing and rendering economic aid, should be particularly emphasised. Private transfers, for example, made up 15-30% of GDP in the pre-crisis period. Attracting funds from non-residents, particularly Diaspora Armenians, into the Armenian banking sector as well as launching the All-Armenian Bank – which has the Armenian government as a major shareholder and aims at attracting the funds of Diaspora Armenians for investments in Armenia – is the main goal of the anti-crisis programme. As more than 70% of Armenian migrant workers are in Russia, the crisis might force some of the Armenians living abroad (mostly in Russia) to return home, a fact that might cause an even higher rate of unemployment and, as a result, more burden on the national budget. Due to the crisis, remittances from Russia dropped over 30%.

As expected, the crisis hit, in the first place, the country’s industrial sector – the branch where the enterprises of necroeconomy are concentrated. In 2008, the production rate in the metallurgical and chemical industries fell 9.6% and 14.8% respectively, compared to 2007. In this regard, it must be noted that only 98.7% of the total industrial production volume was sold in 2008 and, more remarkably, some 70% of those sales took place in the domestic market, indicating the necroeconomic nature of some key sectors of the Armenian economy. Thus, the main problems in the Armenian economy are concentrated in the real sector.

129 See, for example, Meri Yeranosyan, “Armenia and the Tremors of the Crises,” Turkish Policy Quarterly 8, no. 2 (2009): 128.


132 See, for example, Gerhard J. Libaridian, The Challenge of Statehood: Armenian Political Thinking since Independence (Watertown: Blue Crane Books, 1999), 119-48.


135 Ibid., 5.


138 Ibid.

139 Aris, “Armenian Banks Suffer at Hands of Real Economy,” 50.
In November 2008, the Armenian government came up with an anti-crisis programme which, *inter alia*, provides support for local industries through subsidising or issuing governmental guarantees to companies experiencing certain difficulties and even taking a stake in some of them.\(^{140}\) Within this framework, more than twenty companies have already received governmental assistance in the aggregate amount of US$67 million.\(^{141}\) Obviously, the Armenian economy is exposed to a critical danger of zombie-ing under the conditions of the global financial crisis.

**Azerbaijan: Dealing Adequately with the Global Crisis**

There is broad consensus among experts and international financial institutions like the IMF\(^ {142}\) that Azerbaijan has suffered the least from the global financial crisis compared to other countries of the post-Soviet world.\(^ {143}\) In 2008, Azerbaijan’s annual inflation rate was 20.8%\(^ {144}\) and its GDP growth rate 10.8% – the highest among members of the Commonwealth of Independent States (CIS).\(^ {145}\) In this regard, it must be noted that Azerbaijan’s economic growth during the same year was basically conditioned by a 7% growth in the oil sector and a 15.7% growth in the non-oil sector.\(^ {146}\)

Two factors have to be taken into account in order to understand Azerbaijan’s ability to cope with the global financial crisis better than any other post-Soviet country: i) the underdevelopment of its financial sector and ii) the domination of the oil and gas sector in the national economy.\(^ {147}\) The former is a typical phenomenon of practically all post-Soviet countries, although Azerbaijan is even weaker in this sector than countries like Armenia, Georgia, Russia or

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141 Ibid., 7.


147 See, for example, Hübner and Jainzik, “Splendid Isolation?” 12; Badalova, “Azerbaijan Can Withstand Global Crisis Better than Other Countries.”
Thus, the drawback of having an underdeveloped financial sector has turned into an “advantage” for Azerbaijan during the global financial crisis, for it has lessened the adverse impact on its economy. At the same time, it is noteworthy that the loans which were attracted from foreign financial markets did not exceed 25% of all banking liabilities in Azerbaijan’s banking sector. This explains why Azerbaijan’s relatively underdeveloped banking sector (like in Armenia and Georgia) has withstood the ongoing global financial crisis comparatively well.

The second factor – the national economy’s domination by oil and gas extracting industries – can be translated into the following figures: in 2008, their share in Azerbaijan’s GDP exceeded 60% making up 60% of all state revenues and almost 100% of all exports. Owing to the growing exports of its oil and gas, Azerbaijan secured stable inflows of significant foreign currency resources. As a result, foreign currency reserves of the National Bank of Azerbaijan grew eleven times from 2003 and reached US$18 billion in 2008, which is 6.7 times in excess of the country’s total internal and external public debts. In addition, the State Oil Fund of Azerbaijan (SOFAZ) has reserves of US$11 billion for the country. Although oil prices have significantly dropped due to the crisis, the country’s foreign currency reserves have alleviated its negative impacts. It is also important to note that the amount of Azerbaijan’s existing strategic currency reserves is enough to finance the country’s imports for twenty-seven consecutive months. Among the two aforementioned factors, Azerbaijan’s foreign currency reserves due to oil and gas exports that have created a so-called “safety cushion” for the country’s economy, is the most decisive one.

In late 2008, Azerbaijani banks had to pay off approximately US$1 billion of external debt. Furthermore, due to the scarcity of lending resources at world markets, banks reduced their lending programmes and some of them completely stopped providing loans to Azerbaijani households and enterprises. To maintain the national currency’s exchange rate stability, the country’s central bank spent some US$1.2 billion to buy manats in the first four months of 2009.

151 Ibid., 13.
155 Ibid.
156 Ibid.
158 Ibid., 15.
As expected, necroeconomic enterprises particularly in the steel, aluminium and chemical industries have undergone several hardships. According to official statistics, whilst the overall growth of industrial output in Azerbaijan was up 103.9% during the first eight months of 2009 as compared to the same period in 2008, the non-oil sector has demonstrated some decline; that is, the production rate for the same period of 2009 comprised only 94.3% of the similar indicator for the same period in 2008. Production during the first seven months of 2009 as compared to the same period in 2008 in the metallurgy industry dropped by 62%, in chemical industry by 53%, in furniture industry by 42.6%, in oil processing by 10% and in rubber and plastic materials industry by 19%.

The City of Sumgayit, Azerbaijan’s third largest populated city and famous for its military-industrial complex in the Soviet period, constitutes a classic example of a necroeconomic centre. Almost all of its enterprises – namely the state-owned chemical company Azerkimya plants, the state-owned Azerboru pipe factory and Azeraluminum – remain either completely idle or work at extremely low capacities. The same (or close to that) status is enjoyed by all steel and metal-rolling factories that were created during the years of Azerbaijan’s independence; namely, the Baku Steel Company, Baki Poladtekme JSC, and DHT Metal JSC.

One has to bear in mind that Azerbaijan’s economic management system still retains some of the old-fashioned institutional schemes such as the independent disposition by almost all state-owned large industrial and infrastructure companies of their material and financial resources, the availability for many of these companies of some large budget assignments and their privilege of enjoying some “tax holidays.”

In early 2009, the government of Azerbaijan came up with a package of anti-crisis measures that included:

- taking preventive measures against the artificial growth of prices on the consumer market;
- strengthening the anti-monopoly regulation of the economy;
- preventing illegal governmental interference in the economy;

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159 Ibid., 13.
• depositing the foreign currency reserves which are kept abroad in the most reliable local banks and ensuring reliable governmental control over the investing of these resources in the real sector of economy;
• improving the government’s investment policy;
• strengthening governmental control over the spending of budgetary funds;
• enhancing assistance to export-oriented enterprises;
• increasing the volume of privileged loans to businessmen; and
• intensifying the government’s support of agriculture.165

The existence of the large necroeconomic sector as well as the practice of financing businesses from public resources as one of the methods of combating the crisis, is a clear indication of the exposure of Azerbaijan’s economy (including the necroeconomy) to the danger of zombie-ing which was discussed above in the general context of the post-Communist countries.

The Case of Bulgaria

In 2008, Bulgaria – like many other countries – was quite optimistic and believed that the global crisis would not pose an immense threat to its economy.166 At the time, economic forecasts for Bulgaria were not very pessimistic,167 although some believed that the Bulgarian economy might encounter serious challenges in 2009-10.168 In fact, the global financial crisis affected Bulgaria rather significantly.169 Specifically, while GDP increased by 6.0% in 2008 as compared to 2007, it declined by 4.7% during the first nine months in 2009 as compared to the same period in 2008.170 At the same time, the annual inflation accounted for 7.8% in 2008 and 0.6% in 2009.171 In 2009, 95% of Bulgarian companies saw a drop in their sales.172

When examining the economic situation in Bulgaria, one should take into account that the country (just like Romania) joined the EU only in 2007 and, therefore, had not been fully integrated into the EU market when the global financial crisis hit. Additionally, Bulgaria’s monetary policy is being constrained by the fact that the currency board arrangement connects the lev, the Bulgarian national currency, to the euro. It is during the period of a financial crisis that the policy of a fixed exchange rate poses extraordinary difficulties, even though it is more of a problem to move towards a free floating exchange rate during the crisis in that foreign liabilities in the national currency will become significantly more expensive.

As in many other countries, the crisis significantly affected the industrial sector. In 2008, for example, the gross value added (GVA) increased by 3.0% as compared to 2007, whilst it dropped by 8.3% during the first nine months of 2009 as compared to the same period in 2008. In the first quarter of 2009, the total income of the five largest companies operating in the chemical industry sector decreased by 46.2% and 29,000 jobs were lost in the country’s machine building sector in 2009.

Using the national budget for salary supplements to company employees whose working hours have been decreased due to the crisis is one of the significant anti-crisis measures developed by the Bulgarian government. However, such an approach only keeps companies with poor management on the market. Also, state interference by artificially holding up the employment level is a populist measure that eventually distorts market mechanisms for employment. During the economic crisis, there was a clear temptation in Bulgaria to fund various types of businesses from the national budget. This trend, which is economically less justified and entirely

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173 See, for example, Petrova, “Implications of the current financial crisis on the new EU member states, Bulgaria and Romania,” 7.
populist, became a reality after the Parliamentary elections of July 2009, thereby facilitating the zombie-ing of the economy.

Most of Bulgarian banks are foreign owned and continue to meet their responsibilities in spite of the financial crisis. However, Bulgaria’s banking system has not escaped the zombie-ing process either. State subsidies in Bulgaria, along with other means of protectionism, are often used to assist various businesses with such measures becoming even more popular in light of the financial crisis.

The Bulgarian bankruptcy legislation, that was per se defective, has been suspended. In spite of it, Kremikovtzi AD, for example, – the country’s largest metalworking company that was established at the beginning of the 1960s – was subject to liquidation. On the one hand, this is an absolutely significant phenomenon as Bulgaria will not have one of its largest companies as a part of the necroeconomy. On the other hand, it may become the first step towards freeing Bulgaria from a necroeconomy, a fact that also justifies why Bulgaria is considered amongst the “leader” countries of the Black Sea Region.

After the elections, the government of Bulgaria is ready to share Georgia’s experience in the field of economic liberalisation. Unfortunately, Georgia – just like the programme of the new government of Bulgaria – has made a number of mistakes, due to which liberalism frequently happened to be the “façade” of the reforms rather than their content.

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Georgia and the New Economic Challenges

In the spring of 2008, even though signs of the upcoming difficulties were already apparent, the negative impact on Georgia of the then-still-developing US financial crisis was not expected to be high, owing to the underdeveloped and relatively isolated nature of Georgia's financial market.\(^{192}\) After the five-day Russian-Georgian war of August 2008,\(^{193}\) some new economic challenges have been added.\(^{194}\) These include, in particular, liquidating the economic damage that was caused by the war, avoiding a crisis in the banking sector, preventing any further growth of the relatively high inflation rate, and preserving exchange rate stability of the national currency, the lari.

Generally speaking, the Georgian economy stood the test of the five-day Russian-Georgian war, although it had to deal with a number of considerable difficulties in the aftermath.\(^{195}\) For instance, the country suffered huge direct economic damage consisting of ruined settlements and infrastructure combined with considerable environmental damage. In the course of 2008, all doubts regarding the negative impact of the global financial crisis upon Georgia's economy disappeared. It must be noted that the summary economic indicators for 2008 clearly reflect the implications of both the global financial crisis and Russia's military aggression.

In order to describe the present economic situation in Georgia, some official statistical data that, unfortunately, do not always correspond to real facts must be used. After the Rose Revolution, the Department of Statistics was incorporated within the Ministry of Economic Development; a move that clearly indicates a conflict of interests and has enabled the government to often manipulate statistical data for its own political benefit.\(^{196}\) According to the official statistics, the economic growth rate in Georgia amounted to as little as 2.3% in 2008 (it was 9.6% in 2005, 9.4% in 2006 and 12.3% in 2007),\(^{197}\) and the annual inflation rate stood at 5.5%.\(^{198}\) In this con-

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193 See, for example, Cornell and Starr, eds., The Guns of August 2008: Russia’s War in Georgia.
text, it must be noted that the apparent deficiency of Georgia’s GDP resides in the fact that the public administration represents the biggest segment of economy, with a 17% share of GDP.  

As far as Georgia’s economic crisis is concerned, it is important to stress that it also has its own domestic roots which can be found in the economic policy mistakes that the post-revolution government made in the aftermath of the Rose Revolution. Other factors that have contributed directly to the rise of the economic crisis in Georgia are the following:

i) vast amounts of FDI streamed into privatisations and acquisitions of real estate that led to an obvious imbalance in which the inflow of financial resources into the country substantially exceeded the sector’s real growth rates;

ii) the government’s lack of control over the developments in the construction sector has resulted in the industry becoming dominated by a Ponzi scheme (“financial pyramids”); and

iii) banks incremented their lending resources basically by accumulating cheap resources from European financial markets with the majority of such resources having been lent for construction and the acquisition of consumer goods, of which 100% are imported. Almost all of the imported lending resources, therefore, were used to finance the construction businesses infected by a Ponzi scheme and the import of consumer goods. Obviously, such developments could not positively influence the country’s economy.

The crisis has also badly affected the national budget. In June 2009, the parliament approved a US$300 million cut in tax revenues of the national budget which accounts for 10.5% of all tax revenues previously planned for the fiscal year of 2009. At the same time, the national budget grew due to international donor assistance.

In reply to the Russian aggression, the international community provided significant financial assistance to Georgia. At a donor’s conference held in Brussels under the aegis of the World Bank in October 2008, it was decided to allocate to post-war Georgia the amount of US$4.55 billion – of which US$2 billion is a grant and the remainder a loan – in financial aid. The country

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is to receive these funds during the 2008-10 period of which a large part is to be spent on the liquidation of the economic damage caused to Georgia by the Russian military aggression. The negative effects of the Georgian economic crisis might have been far more distressing had the international community not extended a helping hand. In other words, although war by essence is a negative phenomenon, it had a positive implication for Georgia, to the extent that the country received an enormous amount of international financial assistance. This creates a so-called “Paradox of War” or a situation wherein aggression entails not only negative but some positive consequences as well.

The year 2009 has been marked with an obvious decline in the Georgian economy. The year’s first quarter GDP rate accounted for only 94.9% of its 2008 level, and the second and third quarters stood at 89.9% and 98.8% respectively. Under such circumstances, the ten largest Georgian companies significantly reduced their production capacities and some stopped operating entirely, thereby creating favourable conditions for the succession of a necroeconomy. Although the government periodically buys large amounts of fertilisers from Georgia’s largest chemical factory, Azot, even this enterprise had to stop its production. Most surprisingly, however, these enterprises continued producing their products for the first months of 2009, in the “best” tradition of a necroeconomy and despite the obvious crisis in the Georgian economy, even though there was no demand for their output. They simply stopped their activities in April and May when the warehouses were completely filled with unwanted products.

To help the country overcome the economic crisis, the government developed a so-called “new financial package” that attempts to strengthen the banking and construction sectors. The government is planning to issue some treasury bills with an aggregate value of US$155 million which will be invested in infrastructure projects. In this way, it aims to provide some assistance to commercial banks which are going to be the key recipients of those treasury bills. In times of economic crisis, the treasury bills will enable the banks to raise some assured incomes from the national budget funds. In addition, the package provides for the weakening of the governmental regulation of banks. As a result, the government hopes that the banks will be able to attract some additional US$420 million in lending resources. Furthermore, the package envisages the issuance by Tbilisi City Hall of some financial guarantees to construction companies as a means of encouraging banks to lend them funds that will then be spent for the renovation of the old sections of the capital.

203 National Statistics Office of Georgia, “GDP.”
205 Ibid.
206 Ibid.
Although the problem of the necroeconomy during an economic crisis is a timely one, fortunately, the government’s anti-crisis plans have hitherto not given any indication that the government is going to finance necroeconomic facilities. However, one must bear in mind that no official bankruptcy proceedings have been initiated at this point with respect to any of the country’s necroeconomic enterprises. Furthermore, as was noted above, the government of Georgia is going to provide financial assistance to the construction companies many of which represent a Ponzi scheme. This is nothing less than a step towards the zombie-ing of the construction companies as well as of the banks which will be extending loans to them.

**Greece: The Case for a Non-Post-Communist Country**

Amongst the other countries of the Black Sea Region, Greece, like Turkey, has the advantage of not having a Communist past. Unlike Turkey, however, Greece is a member of the EU and is characterised by quite a high degree of EU market integration.

In spite of a relatively high level of economic development, Greece has not been able to avoid the negative impact of the global financial crisis. If in 2008 Greece’s GDP increased by 2.0% as compared with the previous year, it dropped by 2.0% in 2009 with this decreasing trend forecasted to be continuing in 2010. As for the inflation rate, the situation is more stable in this regard. Specifically, while in 2008 the annual inflation rate stood at 4.2%, it dropped to 1.3% in 2009. Overall, however, it can be said that Greece’s economy is faced with a rather difficult situation.

From the very beginning, optimism for the impact of the crisis was created due to the stability of Greece’s banking system as well as by the fact that it is not an industrial country and its

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211 Ibid.


The economy is not significantly dependent upon its exports (shipping and tourism are important for the country). Nevertheless, the global economic crisis affected Greek industry quite badly. Industrial production dropped by 6.0% in November 2009, as compared to the same period a year earlier, and the situation deteriorated at the beginning of 2010 with industrial production having declined by 12.8% as compared to the same period a year before.

Without a Communist past, Greece’s economy is not faced with the phenomenon of a necro-economy. Given the crisis, however, the threat of zombie-ing small- and medium-sized enterprises (SMEs) and related banks was created through the same scheme, which was applied some twenty years ago in Japan; that is, securing cheap loans with state guarantees. It was later revealed that Greece’s problem in the financial sector was most serious requiring major efforts by its government.

In contrast to the other countries of the Black Sea Region, only a small portion of the Greek banking system is owned by foreigners. Given the variety of financial instruments, not a single bank has gone bankrupt during the current crisis in Greece. In contrast, the national budget of Greece has encountered the most significant challenge. Greece was the only Eurozone country that issued bonds for substantial sums in the first quarter of 2009. Greece used to apply this instrument quite frequently in the past together with some other Eurozone countries (Spain, Italy, Ireland) and this could have posed serious problems for Greece and the Eurozone in general according to the experts. As it was expected, the situation deteriorated at the end of 2009, when the new government realised that the national budget deficit accounted for 12.7%, a figure higher than previously estimated for 2010. Under these circumstances and
since this can also pose a threat to other countries of the Eurozone, it is of paramount importance for the Greek government to carry out those reforms that will secure a decrease in the budget deficit and in public expenditures in general in order to overcome the debt crisis.

Moldova and Political Difficulties

For Moldova, by far the poorest country in Europe, 2009 proved to be rather difficult as the country experienced its thorniest political crisis as a result of the impact of the global financial crisis.

In 2008, the government turned a blind eye to the economic crisis and was inconsistent between its statements and concrete actions. As the political crisis sharpened in 2009, the effects of the economic and financial crisis were clearly beginning to emerge in Moldova. It is noteworthy that the economic crisis in Moldova has also been aggravated by the fact that significant economic reforms have hitherto not been completed.

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Although in 2008 the country underwent some difficulties (for instance, it was hit by a severe drought), the economy of Moldova was quite stable. Specifically, GDP increased by 7.8%. The situation changed quite drastically in 2009 when GDP decreased by 7.7% between January and September 2009 in comparison with the same period in 2008. While the annual inflation rate stood at 7.3% in 2008, it was only 0.4% in 2009.

Taking into consideration that remittances are very important for the population in Moldova, it is easy to understand that the drastic decline in consumption in 2009 was due mostly to a one-third decrease in remittances. Due to the global crisis, a significant number of working migrants from Moldova returned home (especially from Russia and Italy), thereby further exacerbating the unemployment problem.

The year 2008 was not optimistic for Moldova’s industry as the volume index of industrial production stood at 100.7% compared with 2007, while 2009 proved to be even worse since the index was at only 76.8% during the first eleven months. Moldova’s industry is characterised by the fact that most of its share, specifically more than 43%, comes from the production of food and alcoholic beverages. The shares of the chemical industry and metallurgy account only for 1.3% and 0.5% respectively of the country’s total industrial output. Also, a Russian embargo of Moldovan alcoholic products complicates the situation. At the same time, the key problem for the chemical industry and metallurgy is the necroeconomy which was created during the Soviet period.

It needs to be highlighted that Moldova has passed through various crises over the last twenty years and the current one does not have a significant impact upon approximately 30% of the companies as their representatives consider that they have always been in a crisis.

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236 Ibid.
237 Expert Group, Impact of the Global Financial Crisis on the Local Communities in Moldova, 54-5.
ing a constant crisis by the companies facilitates the formation of a zombie-ing routine. Moreover, if the companies are also necroeconomic, the zombie-ing routine is being formed in such companies upon the basis of a necroeconomic routine which is certainly even worse.

Under the ongoing crisis, 17.6% of Moldovan companies (mostly the ones in the retailing, industrial, agriculture and construction sectors) have accumulated debts to suppliers whilst 23.0% (mostly service companies) have accumulated debts from clients. Under such circumstances, tax slashing and making credits less expensive by cutting interest rates are desirable for most companies, whilst honest competition in the market, reducing corruption and diminishing number of state controls are important for a smaller number of companies.

In this context, the adoption and implementation of a targeted and effective anti-crisis programme is of crucial importance. In 2009, Moldova failed to elect a President due to contradictions within its Parliament (the Constitution of Moldova envisages the election of the President by the Parliament) thereby creating an unstable political environment for the government. In parallel, the government faces a significant challenge to strengthen its position to such an extent that it will be able to win the snap Parliamentary elections which may be called in 2010. This situation may give an impetus to the government to lead the country out of this economic crisis but, at the same time, it increases the threat of populism which has already been reflected in the disagreement amongst government members over the anti-crisis programme.

The Romanian Experience

As mentioned above, Romania and Bulgaria became EU member states only on 1 January 2007 and, therefore, they were not yet fully integrated into the EU market when the global financial crisis arrived on their doorstep. With significant foreign capital in Romania (nearly 90% of Romania’s banking sector is foreign-owned) the first indications of the negative impact of the crisis appeared in the autumn of 2008. This was due principally to the financial difficulties faced by the headquarters of these foreign companies. It is noteworthy to mention that even

238 Ibid., 59.
239 Ibid., 62.
242 See, for example, Petrova, “Implications of the current financial crisis on the new EU member states, Bulgaria and Romania;” 7.
before the mortgage crisis evolved into a global one there were enough warning bells regarding its impact on Romania.\textsuperscript{245}

Although the impact of the global financial crisis upon the annual indicators of the country’s economic growth was obscure in 2008, certain problems in the financial and budgetary spheres were quite discernible.\textsuperscript{246} Difficulties in the Romanian economy became apparent in 2009.\textsuperscript{247} For example, industry decreased by 7.7% during this period.\textsuperscript{248} In 2008, GDP increased by 7.1% compared to 2007 while in the first nine months of 2009, it decreased by 7.4%.\textsuperscript{249} Furthermore, the annual inflation rate in 2008 stood at 6.3\%\textsuperscript{250} whilst during the first eleven months of 2009, it was observed at 4.7%.\textsuperscript{251}

In 2009, significant difficulties became apparent in the country’s mining and quarrying sector. Specifically, its production level decreased by 10.9% in November against the same indicator for 2008 although industrial production as a whole increased by 4.4% during the same period.\textsuperscript{252} A significant decrease in production levels was also observed in some of other hard industry sectors at the same time.\textsuperscript{253}

Although the country’s economy was also burdened with the necroeconomy after the fall of the Communist regime, Romania comes under the group of “leader” countries since the efforts to remove this phenomenon were very impressive. Specifically, Romania has a greater bankruptcy rate than the average level in Eastern Europe.\textsuperscript{254}


\textsuperscript{253} Ibid., 6.

Under the conditions of the ongoing crisis, seven out of ten private SMEs in Romania have financial problems of which 15% are on the verge of bankruptcy. This situation puts pressure upon the government urging it to provide financial support to such enterprises.

It is noteworthy that at the beginning of 2010, the Romanian government guaranteed up to 80% of the loan agreement worth €400 million which was granted to Ford Romania by the European Investment Bank. In connection to this, Emil Boc, the Prime Minister, tasked the Minister of Finance to develop the legislative framework for extending the use of state guarantees to other sectors of the economy. In view of the tough challenges faced by the country’s banking system and the global financial crisis, the implementation of the aforementioned initiative may lead to the beginning of the zombie-ing process.

The Russian Economy and the Global Economic and Financial Crisis

Since the financial crisis of August 1998, Russia’s economy has developed at an impressive pace; GDP growth almost doubled over the past ten years, and the economy has become much more attractive to foreign investors. Also, given the global increase in oil prices, the country’s international reserves reached almost US$600 billion, lagging behind only those of China and Japan.

The impact of the global financial crisis on Russia’s economy was already visible in the summer of 2008. This can be explained by the fact that almost half of the assets on the Russian stock exchange came from non-residents (including a significant number of Americans) that started to withdraw their capital, a move that led to a significant drop of Russian securities prices. On

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256 Ibid.


260 Ibid.

top of that, oil, gas and metal prices in international markets plunged, causing a GDP growth rate decrease and, consequently, an increase in unemployment.262

In 2008, Russia’s GDP increased by 5.6% as compared to 2007263 whilst it increased only 1.2% in the fourth quarter of 2008 compared to the fourth quarter of 2007.264 In 2009, the situation deteriorated substantially: in the first quarter of 2009, GDP decreased by 9.8% as compared to the first quarter of 2008. This trend continued in the second and third quarters of 2009 where the decrease amounted to 10.9% and 9.9% respectively.265 Inflation in Russia stood at 13.3% in 2008 and at 7.4% in the first six months of 2009.266 As far as Russian industry is concerned, the industrial production index was 102.1% in 2008 while it dropped to 85.2% in the first half of 2009.267

With most of the necroeconomic enterprises concentrated in the industry sector, it comes as no surprise that this sector had the most significant decrease as a result of the economic crisis.268 As mentioned above, under normal circumstances the existence of a necroeconomy is less visible in the countries with large-scale markets, since competition within the country creates the illusion that the economy is not burdened with the necroeconomy. The best example of this is Russia.269

The Russian economic crisis can be attributed not only to foreign but, rather, to domestic factors, particularly to the accumulated unsolved problems characteristic of the country’s industry and its economy as a whole.270 The opinion, according to which national factors underlie Rus-

262 Ibid., 33.
265 Ibid.
269 See, for example, Schaffer and Kuznetsov,” “Productivity,” 12-34.
sia’s crisis and that the global financial crisis is only an additional one piled up in the financial, technological, economic, and political crises in Russia, should be considered to be true.\(^{271}\) Another key factor is the country’s technological backwardness,\(^{272}\) which places the share of energy resources (and other low-technological commodities) in Russia’s industrial export structure in a significant position.\(^{273}\) Stimulating this type of export has been at the top of all the economic policies that have been implemented by Russia’s government in recent years.\(^{274}\) For example, the government promoted a special state programme supporting the development of high technologies,\(^{275}\) but its implementation was hampered by the emergence of the economic crisis.\(^{276}\)

Undoubtedly, many Russian companies were able to get rid of their debts during the financial crisis without receiving governmental support.\(^{277}\) This situation led the government to work out a large-scale anti-crisis programme that envisaged providing state support to the economy by using a sizeable fiscal stimulus package.\(^{278}\) Specifically, the total cost of the programme’s activities, which were carried out in the first months of the crisis, amounted to 13% of total GDP\(^{279}\). However, it is the nature of the regime that allowed for the government to respond immediately to the economic crisis (although it has been criticised for its late response),\(^{280}\) as it showed great ability to provide money as a means of solving the problems quicker than any Western democratic process could envisage.\(^{281}\) Additionally, the crisis notwithstanding, Russia’s government has not abstained from incurring additional expenditures in various countries all over the world in order to achieve certain political goals.\(^{282}\)

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\(^{272}\) Ibid., 82.


\(^{275}\) Connolly, “The Structure of Russian Industrial Exports in Comparative Perspective,” 586-7.


\(^{279}\) OECD, “Ekonomicheskii’ obzor OESR po Rossii’eskoi’ Federatsii,” 57.


\(^{282}\) Ibid., 23-4.
Russia’s anti-crisis policy aimed at i) increasing the liquidity of the financial sector, ii) providing social support to the population and iii) supporting the country’s leading companies. Along with the tax cuts (for instance, the tax on profits was cut from 24% to 20% and the regions were allowed to decrease the small business tax from 15% to 5%), the government started to provide financial support to the pension funds, as well as guarantees for bank credits and direct financial support to large companies. If it were not for the financial support provided by the Central Bank and the government from the state budget (nationalisation, covering foreign debts, and securing governmental guarantees for bank credits), the banking system in Russia would have to confront an even more difficult situation. In certain cases, the funds allocated by the state were redistributed via bribes as evidenced by the low prices that were imposed by the government upon these deficit funds. The government made a list of so-called “system making” businesses that included up to 300 large companies to be assisted by the national budget as well as state banks. The regions also came up with a similar list of their own in order to provide support to relevant enterprises at the regional level.

In order to provide real support, the government started to implement measures characteristic for the process of zombie-ing the economy. Specifically, state banks started to carry out direct concessional lending of businesses, governmental guarantees were issued for bank credits and the interest rates on the credits were subsidised from the national budget. Notably, the beneficiaries that qualify for government support are actually businesses from all segments of the economy, amongst which there is a concentration of necroeconomic enterprises such as, inter alia, in the metallurgy, machine building and motorcar building industries.

As for the application of the Law on Bankruptcy in Russia, it is beneath criticism. Since 2007, for example, this law no longer applies to state corporations and if an enterprise is considered to be a strategic one, priority is given to its preservation. The management of state corporations, as

284 Ibid., 34-35.
287 Ibid.
288 Bulatov, “Skhodstvo i razlichiiia ekonomicheskogo krizisa v SShA i Rossii,” 34.
289 Ibid.
291 Ibid., 44-6.
a rule, is staffed by former employees of the Russian security service (KGB or its successor the FSB – Federal Security Bureau) and have no entrepreneurial know-how or experience leading, thus, to the insolvency of these corporations as a result of their lack of skills. In fact, the application of the Law on Bankruptcy significantly depends upon the political goals of the Kremlin. A vivid example of this is the well known case of the Yukos bankruptcy. Governmental influence upon the decisions taken in the bankruptcy sphere has increased since the end of 2008 due to the economic crisis.

It is apparent that the anti-crisis measures carried out by the government keep afloat enterprises with obsolete technology, thus negatively affecting Russia’s economic development in the post-crisis period. All in all, the anti-crisis programme is directed towards a comprehensive zombie-ing of the economy. Due to the large-scale of the necroeconomy in Russia, the zombie-ing process extends to the necroeconomic enterprises. The first symptoms of necroeconomic zombie-ing emerged in the immediate aftermath of the August 1998 crisis giving rise to the phenomenon of the post-Communist zombie-economy. The longevity of the current economic crisis could, therefore, have far more serious repercussions for Russia than previous crises.

**A Negative Impact on Serbia**

As early as December 2008, the Serbian government had warned of the possibility that the global financial crisis might negatively affect the country’s economy. Previously, however, some members of the government remained confident that the global financial crisis would bypass Serbia. Although Serbia’s banking system is mostly foreign owned and was well capi-

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297 Lindsey, Against the Dead Hand, 210.

298 Ibid., 211.


300 See, for example, Aija Kuge, “Kak global’nyi’ krizis skazalsia na ekonomike Serbii” [How the Global Crisis Affected the Economy of Serbia], Radio Svoboda [Radio Liberty], 10 June 2009, http://www.svobadanews.ru/content/transcript/1751510.html.
talised at the outset of the global financial crisis – a fact of paramount importance for maintaining financial stability – the country was negatively affected by the crisis. The impact became particularly apparent in 2009, while GDP increased by 5.5% in 2008 as compared to 2007, it is expected that it decreased by 2.9% in 2009 as compared to 2008. In 2008 and 2009, the annual inflation rates were observed at 8.6% and 6.6%, respectively.

Serbian industry faces an even more difficult situation as industrial output, which increased by 1.1% in 2008 as compared to 2007, fell by 12.6% in 2009. The decrease is caused mostly by the problems created in the manufacturing industry. As early as the initial stage of the economic crisis, it was clear that the crisis would mostly affect the metal producing and processing industry.

Privatisation is linked indirectly to the emergence and existence of a necroeconomy in Serbia. Given that it is practically impossible to undertake production in the newly privatised companies whose technologies have become obsolete, the new owners use these enterprises for covering the debts accrued before the privatisation process. In Belgrade, it should be noted, the main motivation for purchasing such enterprises with outdated technological infrastructures is simply to acquire real estate rather than putting any of them into operation.

As early as autumn 2008, concern was expressed that the government would have to enhance its role both in the financial and the real sector of the country’s economy due to the global fi-

310 Ibid.
financial crisis. Several months before the global crisis spread to Serbia, the country’s Presidential, Parliamentary and local self-government elections were held thereby allowing the government to work out anti-crisis measures under the conditions of political stability. However, the government was not consistent and did not manage to meet the conditionalities of the IMF; it failed to increase public sector salaries and to cut 8,000 state bureaucracy jobs, thus putting at risk the possibility of receiving further financial assistance allocated by the IMF. It should be noted that the practice established in Serbia envisages a partial subsidisation from the public budget of investment projects in various sectors of the economy, including the manufacturing sector.

Due to the crisis, the government subsidised the bank interest in order to support the real sector. At the end of 2008, it decided, on the one hand, that the financial sector would receive governmental guarantees as a basis for the implementation of certain incentive measures in the industrial sector. It was considered appropriate, for example, to issue sovereign guarantees to the benefit of the National Bank of Serbia which would approve loans to banks that would then offer loans to businesses upon favourable terms. The interest write-off for unpaid taxes and contributions – if they are settled on a regular basis – is to be used for decreasing the fiscal burden. On the other hand, the government imposed severe restrictions upon non-productive expenditures for the companies in which the majority ownership is in the hands of the state.

The Serbian government considers it necessary to give priority to the bankruptcy and liquidation process during the economic crisis. There is a lack of trust amongst creditors towards the

314 Dinkic, “Global Crisis in the Balkans: Serbia’s Fiscal Plans and Future EU Membership.”
317 Ibid., 11.
318 Ibid., 12.
319 Ibid., 10.
320 Ibid., 9.
existing bankruptcy procedures. The major problem is the so-called “implementation gap,” that is the situation when the implementation of the legislation on bankruptcy lags behind its quality. It should not come as a surprise, therefore, that Serbia needs faster and more efficient enforcement of bankruptcy procedures in order to support their viable implementation. Finally, given the low efficiency of the bankruptcy procedures, the anti-crisis measures developed by the government create a real threat of zombie-ing the economy.

**The Case of Turkey**

The impact of the global financial crisis upon the economy of Turkey was apparent as early as the fourth quarter of 2008 when GDP fell to 6.5% resulting in a moderate increase by 0.9% in 2008; in the first three quarters of 2009, GDP dropped further to 8.4%. The annual inflation rate was observed at 10.4% in 2008, where it was expected to be 5.9% in 2009.

While Turkey – like Greece – is free from a necroeconomy given that it was never a Communist country, its industrial output experiences a significant decrease mainly due to the decrease of demand on the international markets. It was expected that industry output would drop by 9.8% in 2009. The Turkish banking system has shown resilience to the global financial crisis as a result of reform measures that enabled its strengthening. After the 2001 crisis, economic reforms were carried out to correct past mistakes. This experience will hopefully give further impetus to Turkey to continue reforming its economy so that it will be properly prepared for any future crisis.

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321 Kuge, “Kak global'nyi' krizis skazalsia na ekonomike Serbii.”
327 CIA, “Turkey: Economy.”
The government's anti-crisis measures envisage its greater involvement in the economy. In March 2009, it issued the package of US$3.2 billion that focuses mostly upon a reduction in tax rates. The government divides the country's territory into four categories based upon their level of economic development (with the first category being described as the most developed and the fourth as the most undeveloped). Accordingly, the 20% corporate tax for the most developed region was halved while it was reduced to 8%, 4% and 2% for the second, third and fourth categories, respectively.

Of particular note is the government's support for the sizeable energy, automobile and mining sectors, alongside other large scale projects. Turkey undertook a series of initiatives such as a credit guarantee scheme for enterprises – with special attention to SMEs – in order to strengthen the real economy during the crisis. The government intends to preserve this policy for 2010-12. During this period it envisages to provide SMEs with a Treasury support guarantee in order to expand credit channels and to meet the collateral needs of SME financing. This decision in fact resembles the process of zombie-ing the Japanese economy. The government allows for unpaid taxes to be restructuring in order to lessen the social and economic effects of the crisis. Keeping in mind that the country's legislation foresees the postponement of bankruptcy, it is obvious that the restructuring of the unpaid taxes aims at maintaining the bankrupt businesses on the market for a certain period – a process that facilitates a possible zombie-ing of Turkey's economy.

According to the Governor of the Central Bank, economic recovery is expected to be gradual and slow in the aftermath of the crisis, as opposed to the rapid recovery of economic activity after the 1994 and 2001 crises in Turkey.

334 Ibid.
337 Ibid., 16.
A Three-Front Crisis for Ukraine

As the global financial crisis started to spread towards the Eastern European countries, rather pessimistic forecasts were made for Ukraine.339 Bearing in mind all recent developments having taken place in the country, these forecasts do not come as a surprise. Unfortunately, the turbulent political life that characterised the country for years had significant repercussions, thus leaving the Ukrainian economy extremely vulnerable to the ongoing crisis.340 The country's economic and financial situation has been aggravated by the continuous inactivity of its Parliament and, generally, by the inefficiency of the main governmental institutions.341 As a rule, political instability in Ukraine reflects mostly on the country's financial system.342 A clear example of this was the 20% drastic depreciation of the hryvnya – Ukraine's national currency – within a short period after the beginning of the crisis,343 eventually reaching 50%.344

Ukraine, therefore, is the country most affected by the global financial crisis,345 having experienced the worst economic downturn amongst the Black Sea Region countries. Compared to 2007, real GDP increased only by 2.1%346 in 2008 whilst the situation significantly deteriorated in 2009 with GDP decreasing by 20.3%, 17.8% and 15.9% during the first, second and third quarters respectively compared with the same period in 2008.347 It is expected that GDP will de-


crease by 14.1% in 2009 as compared to 2008. Ukraine's inflation was quite high in 2008 and 2009: it reached 22.3% and 12.3% respectively.

The country's industrial output also decreased significantly in 2009. Specifically, industrial output indices for this year were observed at 78.1% of 2008 rates. Industry also experienced difficulties in 2008 as the indices for industrial output stood at 96.9% of 2007 numbers. The mining and metallurgy, chemical and machine building industries – which are very low value-adding ones – encountered severe problems that can be attributed to the lack of technological innovation. Also, most of the steel producers' production is insufficient. Notably, the short term forecasts for the development of these industries are also unfavourable.

The abovementioned situation is to be expected considering that Ukraine's economy, especially its industry, is quite burdened with the necro-economy. The preservation of the necro-economy in Ukraine has been facilitated by significant long-standing industry subsidies, which were allocated both from the national budget and the energy sector (the government subsidised energy companies so that they would supply energy to industrial enterprises at a lower price). As a result, the process of openly subsidising the industrial sector was replaced by a hidden subsidisation.

The Ukrainian Parliament adopted anti-crisis laws several times since the harsh onset of the global financial crisis. The laws mainly provided for making changes in order to downplay the

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356 Åslund, How Ukraine Became a Market Economy and Democracy, 230.
359 Babanin, Dubrovskiy and Ivaschenko, “Ukraine: The Lost Decade... and the Coming Boom?” 87.
negative impact of the crisis. The first such law was adopted as early as autumn 2008. It envisaged, inter alia, the creation of a government stabilisation fund in order to help companies repay foreign debts and invest in domestic projects.\textsuperscript{360} Such an anti-crisis measure, however, only facilitates the zombie-ing of the economy. Moreover, the government has relatively scarce financial resources for carrying out large scale governmental programmes.\textsuperscript{361}

The World Bank recommended that the government works out completely different types of anti-crisis measures. These included: focusing upon the macroeconomic stability of the country; channelling the budget funds to the development of the infrastructure and the protection of the poor and vulnerable; working out a clear strategy to protect depositors and rehabilitate the banking sector; and making reforms for enabling business entry and attracting private investment.\textsuperscript{362} These recommendations, unfortunately, were not taken into consideration.

In spring 2009, the Parliament adopted the Farming Anti-Crisis Law in order to assist the country’s farmers. According to this law, lending to farmers is to be increased through governmental support, with the animal farmers (for meat production) and milk producers being subsidised through the value added taxes together with a moratorium on the sale of agricultural land.\textsuperscript{363} According to another anti-crisis law adopted in autumn 2009, the use of foreign currency in the country is limited and an additional control is introduced on foreign trade, amongst others. All investors, for example, are obliged to be registered and to make investments only in hryvnya and individuals are prohibited from providing loans in a foreign currency except for medical and educational purposes.\textsuperscript{364} International experience shows that such restrictions usually facilitate illegal currency operations. Consequently, in parallel to the legal exchange rate of the hryvnya, a much worse illegal exchange rate has been established. This will be quite an impending factor towards increasing the attractiveness of Ukraine’s economy for private investors.

Considering all of the above, the government’s anti-crisis measures are evaluated as being largely ineffective overall.\textsuperscript{365} The lack of effective bankruptcy law facilitates the zombie-ing of Ukraine’s economy and, specifically, that of its necroeconomy. As a result, even before the current crisis began, half of the industrial enterprises were experiencing losses whilst writing off

\textsuperscript{360} Korduban, “Ukraine Moves To Stabilize Financial System.”
\textsuperscript{361} Grigoriev, Agibalov and Salikhov, “Ukraina: razdvoenie transformatsii,” 139.
\textsuperscript{365} Gazizullin, “What has the Crisis Meant for Ukraine?” 1.
their debts and generally avoiding bankruptcy within alliances between the management of enterprises and governmental officials. 366

Although the legislation on bankruptcy was subject to a periodical update, 367 the current law, unfortunately, remains significantly flawed. 368 Ukraine's economy is, thus, mostly one of a necroeconomy with the activities of the government providing fertile soil for a zombie-ing of the economy (and, of course, a necroeconomy) under the conditions of the ongoing financial and economic crisis.

366 Babanin, Dubrovskiy and Ivaschenko, “Ukraine: The Lost Decade… and the Coming Boom?” 92.


CONCLUSIONS

Ten out of twelve countries in the Black Sea Region are post-Communist ones; only Greece and Turkey do not have a Communist past, whilst others are still burdened with the command economy to various extents. Of these, only Bulgaria and Romania can be regarded as successful cases. They joined the EU after having implemented significant reforms. The remaining eight countries are either not interested in EU membership (for instance, Russia) or have a long way to go before they reach EU standards (Albania, Armenia, Azerbaijan, Georgia, Moldova, Serbia and Ukraine). They can be placed, therefore, in the group of “outsider” post-Communist countries as opposed to Bulgaria and Romania which can be considered “leader” post-Communist countries of the Black Sea Region.

The post-Communist countries of the Black Sea Region shared common starting conditions and similar challenges twenty years ago and are currently encountering common problems under the conditions of the global crisis. Key objectives, however, and the means to achieve them differ according to the Communist or non-Communist pasts (Greece and Turkey), or to the extent they overcame the Communist past (as “leader” countries) or they are enslaved by their Communist heritage (as “outsider” countries).

Although the transitional period in “outsider” post-Communist countries has ended, unfortunately, the economic (and political) system of some is far from that of European style capitalism. The phenomenon of the “outsider” post-Communist countries can be explained by the human factor.

The dead enterprises which the “outsider” countries received as their legacy of the command economy have proven to be quite “tenacious of life.” As a consequence, the market economies of “outsider” countries have been hampered by the burden of a necroeconomy.

The occurrence of financial crises has encouraged the emergence of a kind of routine which guarantees the stability of a government’s bailout programmes implemented throughout the banking sector in support of de-facto bankrupt firms. As a result, a network of zombie-banks and zombie-firms develops upon which the entire system of a zombie-economy rests.

The threat of an economy’s zombie-ing is even greater in the “outsider” countries given that this process also has much to do with a necroeconomy which is a factor that will make it rather difficult to improve an economy’s health after the end of the financial crisis. The threat of zombie-ing the economy is more acute in the “outsider” group of countries given that the process of zombie-ing and the necroeconomy are interlinked. This is a factor that will obstruct economic recovery at the end of the financial crisis.

The only effective mechanism to get rid of both a necroeconomy and a zombie-economy is to adopt a sound bankruptcy law which, in turn, requires the strong political will of the ruling elite.
Certainly, there are more frequent cases of companies and banks becoming insolvent during an economic crisis although it is very difficult for a government to put into effect the bankruptcy legislation by initiating its activation. As a rule, governments are interested in artificially maintaining the employment level thereby facilitating the maintenance of insolvent companies and banks in business in times of economic crisis. It is of great importance, therefore, the extent to which a government will go to continue supporting insolvent companies and banks in the post-crisis period and to what degree it will facilitate simplifying bankruptcy procedures.

The degree of openness of the democratic institutions and the extent of the reformation and transparency of the public administration system will be of significant importance for the Black Sea Region countries in the post-crisis period.\(^{369}\) How the government of a country will be able to avoid zombie-ing the economy depends in part upon the aforementioned factors.

Under the conditions of the current financial and economic crisis, the anti-crisis measures of all the Black Sea Region countries contain the threat of zombie-ing the economy whilst those of “outsider” countries (except Georgia) could also lead to the zombie-ing of the necroeconomy – a much worse phenomenon.

The countries without a post-Communist past and the “leader” post-Communist countries of the region are likely to face better economic conditions in the post-crisis period. This optimism is founded upon the relatively higher effectiveness of the bankruptcy legislation. Despite the challenges arising from the current financial and economic crisis, the bankruptcy processes in these countries are more dynamic\(^ {370}\) compared to the other countries of the region. Amongst these, the situation is quite critical in Greece due to the country’s particular debt crisis.

A great majority of the “outsider” countries of the region encounter a real threat of zombie-ing the necroeconomy. In this respect, the situation is the worst in Russia and Ukraine whose governments significantly assisted and enabled necroeconomic enterprises before the financial and economic crisis began and have provided even more assistance since. A similarly difficult situation has developed in Albania and Moldova.

The political instability makes it difficult for any of the governments to say no to populist measures. This situation has severely impacted Moldova and Ukraine. Political stability, however, does not necessarily mean that a government will be free from populism as is the case, unfortunately, with the Serbian experience.

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\(^{370}\) Ramalho, Rodríguez-Meza and Yang, “How are Firms in Eastern and Central Europe Reacting to the Financial Crisis?”
In the post-crisis period, the state whose government possesses the political determination to cease managing the economy through zombie-ing mechanisms, will eventually thrive. This is particularly important for the “outsider” countries of the Black Sea Region, which are already “afflicted” with the necroeconomy.
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ANNEXES

ANNEX I

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His latest publications include:


ANNEX II

ABBREVIATIONS

CIS  Commonwealth of Independent States
CMEA Council of Mutual Economic Assistance
EU  European Union
FDI  Foreign Direct Investments
GDP  Gross Domestic Product
IMF  International Monetary Fund
SMEs  Small- and Medium-Sized Enterprises
US  United States of America
USSR Union of Soviet Socialist Republics
The International Centre for Black Sea Studies (ICBSS) was founded in 1998 as a not-for-profit organisation under Greek law. It has since fulfilled a dual function: on the one hand, it is an independent research and training institution focusing on the Black Sea region. On the other hand, it is a related body of the Organisation of the Black Sea Economic Cooperation (BSEC) and in this capacity serves as its acknowledged think-tank. Thus the ICBSS is a uniquely positioned independent expert on the Black Sea area and its regional cooperation dynamics.

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Written by Vladimer Papava, this Xenophon Paper touches upon the consequences of the crisis on the countries of the Black Sea region in a specific analytical framework. Based on his own “theory of necroeconomics,” Papava assesses, in the context of the ongoing crisis, the key economic obstacles that the countries of the region face in achieving sustainable economic development. His analysis is based on two economic phenomena: the “necroeconomy” and the “zombie-economy.” A “necroeconomy,” which is created by uncompetitive industries (the “necrocompanies”) that are remnants of the command economy, differentiates the economy of post-Communist capitalism from all other models of capitalism. In times of economic crisis, though, “necrocompanies” can also appear in developed economies, as “zombie-firms,” creating a “zombie-economy.”

Following his theory, the author divides the countries of the Black Sea region into two groups: transition states (the “leaders,” to the extent they overcame their Communist past and the “outsiders,” for those that are enslaved by their Communist heritage) and non-transition states (Turkey and Greece). Thus, the key objectives and the means to achieve them differ for each country according to the category they belong. Based on the abovementioned categorisation, Papava’s analysis suggests that while most of the “outsider” countries are more vulnerable to the consequences of the crisis, non-transition states and the “leader” countries are likely to face better economic conditions in the post-crisis period.