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Introduction and overview

The ECE region entered in 2008 what is forecast to be the worst economic downturn since the Second World War. Each of the sub-regions of the ECE is either experiencing or expecting to experience negative growth in 2009. The decline in growth has been accompanied by rising unemployment, and especially large declines in international trade and capital flows. Government fiscal positions have deteriorated significantly. The global slowdown and ECE-wide recession resulted from a financial crisis which began in the US but quickly spread to western Europe, and then to the periphery regions of the ECE as well as the rest of the world. In fact, the declines in economic growth in the emerging economies of the ECE are likely to be greater than in the advanced economies where the crisis originated. Due to tight integration and interconnected financial markets, the potential for adverse contagion in emerging Europe is viewed to be quite high. Although relatively small, there remains a non-negligible possibility that there could still be a systemic financial meltdown throughout the European emerging markets that would have significant and long-lasting global implications. In addition, if the consequences of the crisis are not properly addressed, social and political instability could arise in some of the ECE emerging economies.

The ECE region which is composed of 56 economies is a very diverse area with advanced, emerging and a few rather poor developing countries. The nature of the crisis in terms of how it entered and impacted these different economies varies considerably, and the policy options available to these countries also vary considerably due to differing economic circumstances and institutional constraints.

This adds to the difficulties of forecasting the recovery for the region. I leave this difficult task to you.

However, we believe the global crisis will have a host of long term implications both for institutional developments, for UN global initiatives, and UNECE projects and activities. I wish to attract your attention on a number of issues raised by the crisis which I put on the table for discussion.

1. Institutional implications: regional integration.

One of the peculiarities of the current situation is that what started as financial turmoil in the United States quickly paralyzed major parts of the world financial system with devastating effects on the global economy. The most efficient way to counteract a widespread slowdown that affects at the same time the entire global economy is **a coordinated international response**. International economic cooperation, including at the regional level, can be an important building block to such a response.

The major economies of the region were involved in the G-20 process which required a number of compromises as their initial positions often varied. In early 2009, EBRD (€6 billion), EIB (€11 billion), and the World Bank (€7.5 billion) put together a €24.5 billion package of support for the European emerging economies. The EU enlarged its balance of payments assistance fund for non-euro economies to €25 billion in early 2009 and then doubled it to €50 billion in March.

There has been only limited regional cooperation or coordination in addressing the crisis amongst the CIS. Russia, despite its own serious economic situation, nevertheless has increased its financial support for neighboring economies. In early 2009 it proposed an anti-crisis fund within the framework of the Eurasian Economic Community (EurAsEC) of about $10 billion to aid primarily the other CIS economies. This fund is supposed to work with the Eurasian Development Bank in isolating joint projects that can help these economies response to the crisis. Even Ukraine, which had been having rather tense relations with Russia, especially in the winter of 2009 over gas pricing and transit issues, has turned to Russia (in addition to the US and EU) for assistance.

As recession hits and unemployment queues lengthen, protectionist voices grow louder. Regrettably, we observe increasing signs of such myopic policy reactions, especially among some of the industrialized countries. For many of the Eastern and Southern European and Central Asian countries, exports account for 80-90 per cent of GDP. By far the biggest market for all of them is the eurozone. Any protectionism in Western Europe would hit the East hard.

2. Raising finance for sustained growth: Small and Medium Enterprises, Innovation, Infrastructure

Two of the key ingredients to the phenomenal economic success of Central and Eastern Europe since the 1990s have been their integration into the EU single market and financial liberalization. Now this process of opening up seems to have left the East European countries exceptionally vulnerable to the global downturn. The crisis has thus exposed the weakness of relying on external capital for developmental finance; without significant reform of the international monetary system, countries (especially South Eastern Europe countries) are likely to avoid this development model in the future and this will have a detrimental effect on global development.

New sources of finance are needed.

The credit markets squeeze has serious implications for the long term growth perspectives of emerging economies; in particular funding for key factors of economic growth like innovation, entrepreneurial abilities, and vital infrastructures risk to be curtailed in response to budget constraints.

The ongoing financial crisis has rendered financing more difficult and harder to secure through bank lending; typically more so for small and medium enterprises (SMEs) and innovative start-up firms which already encounter difficulties in raising finance for their development and growth.

In such an environment there exist non-negligible risks of destruction of much of the entrepreneurial capital and of the future engines of economic growth.

Successful enterprises are fundamental to an economy development: they constantly adapt and rise to the challenges and opportunities of a fast changing world economy. Small and medium enterprises, in particular, can increase the flexibility of the national economies to address these challenges. Facilitating the development of entrepreneurship nurtures the main forces of innovation and change.

Fostering innovation, which influences the medium-term growth prospects, can be part of the response to the crisis. In this new, more challenging environment, new models of collaboration between specialized financial intermediaries and the public sector may be required.

The public sector has a special role to play in the provision of education and infrastructure, which are critical for the generation and diffusion of innovation as well as for the survival of the real economy. Collaboration with the private sector in these fields can secure that public policies pay due consideration to business needs. Innovative financing arrangements such as **Public-Private Partnerships (PPPs)** can promote domestic and foreign private investment, while providing a way to transfer technology, upgrade skills in countries and increase economic integration.

The current economic crisis, however, threatens its extended application, and puts at risks these benefits. Overall, the credit crunch is more severe for low income developing countries and those countries embarking on PPPs precisely where the infrastructure needs are most concentrated.

Infrastructure investments, traditionally considered as an antidote for economic downturn, could increase employment, stimulate new entrepreneurship, innovation and economic growth and alleviate inflationary pressures by removing supply-side constraints, and restore the general public’s confidence in the private sector.

The potential demand for social infrastructure such as public lighting, hospitals, and schools, is amplified in volatile times when financial and economic crisis negatively affect low-income people’s life.

The social infrastructure can not only serve as a safety net but also generate economic flow-on effects with increased human resource- and science and technology investment.

Reflationary policy, including higher government spending and tax cuts, has raised government deficits to an alarming level. Public-Private Partnerships could be a potential solution for public sector deficit, fulfilling the need for infrastructure investment and at the same time giving government flexible cash flows.

3. Climate change/energy efficiency

It is not clear if the crisis will have a positive or a negative effect on addressing climate change. On the one hand there are the green new deal expenditures as part of the fiscal packages but on the other hand governmental support for action generally is being cut back given budgetary concerns; the attempts to tax carbon emissions are being retarded due to a decision not to implement tax increases during the recession.

At the moment it seems that both the EU and the US will rather rely on a cap and trade system. In principle, emission taxes and tradable emission permits are equally effective at limiting pollution. In practice, cap and trade has some major advantages, especially for achieving effective international cooperation. It is easier to determine if a country's emissions are below agreed-upon levels rather than to verify that it has implemented a promise to tax carbon emissions.

South-Eastern European, Eastern European and Central Asian countries are confronted with a wide range of economic and environmental problems caused by their inefficient and polluting energy systems. At the same time, their energy economies provide some of the most promising opportunities for reducing global greenhouse gas emissions. This will require the use of cost-effective energy efficiency improvements and renewable energy technologies - the main self-financing methods to implement climate change mitigation.

The investment potential for energy efficiency is so large in these countries that only the private sector can provide the capital needed to achieve meaningful results. This in turn will require a market for energy efficiency in which large investments can be made with low transaction costs at an acceptable ratio of risk to returns within a reasonable period of time. At present, private investors do not often finance energy efficiency projects in these countries because dedicated sources of financing are lacking and local banks are generally unfamiliar with such investments. Another obstacle in financing energy efficiency projects is the absence of policy and institutional support for their implementation. The lack of knowledge and experience of how to select and formulate energy efficiency investment projects is often a challenge for local experts.

The current global economic and financial crisis has also brought to the forefront the vulnerabilities related to an excessive reliance on the extraction and export of hydrocarbons and other natural resources in countries that are specialized in such exports. The crisis has demonstrated that such economies are more susceptible to external shocks and have greater difficulties in putting in place policy responses and mechanisms of counteracting the negative effects.

4. Millennium Development Goals

The current crisis has already and will further retard or even reverse the recent progress in achieving the Millennium Development Goals (MDGs) in the ECE region. For the ECE region, extreme poverty had almost been eliminated by the end of 2007 but with higher food prices, falling employment opportunities, reduced remittances, and strained safety nets, it is estimated (by UNDP) that already another 10 million people in the region have been pushed back into extreme poverty.

One of the MDGs for which progress has been disappointing has been in controlling HIV/AIDS and tuberculosis in the European emerging markets.

Another MDG objective that is likely to be reversed is the progress recently made on improving gender equality in the region. Since women are more likely to be in the informal sector, they receive few benefits when laid off, and thus the rate of poverty for them or single parent households will increase.

An important financial flow for a number of the European emerging economies has been remittances; for some, these are the largest external financial inflow and are larger than either capital inflows or official developmental assistance (ODA). Remittances are expected to decline significantly in the next two years. In Moldova, remittances fell from 35 per cent of GDP in 2006 to 25 per cent in 2008 and are likely to fall further in 2009 and 2010. The Central Asian economies, especially the poorest of them like Tajikistan are particularly dependent on remittances and will especially feel the impact of their decline.

5. Housing and Land Management

As the financial crisis was generated by turmoil in the real estate market and triggered initially by the sub-prime mortgage crisis in the USA, this sector needs special attention. Every developed country's economy is underpinned by their real estate and property market, thus addressing this specific issue would assist the recovery towards more sustainable economic systems.

Indeed, changes in valuations of land and property have been materially responsible for this current financial crisis with individuals being enabled and encouraged to borrow excessively against the perceived value of their property. These variations were the outcome of a speculative bubble and of easy access to credit that increased abnormally the demand. The crisis would not have been so acute and serious if the housing value increase would have been caused by the demand and offer dynamics and not only of fake expectations of price increase. It is therefore also the real estate and property market that can help to bring some relief to the current crisis, as well as obviously all the Government help and interventions. This is indeed also a real estate crisis, not only a financial one.

The real estate market contributes for a large share of GDP of many developed countries and it is deeply interconnected with the financial world: for instance in the EU27 in 2005 according to a study commissioned within the Lisbon Agenda, the real estate transactions involved an average of 16% of EU27 GDPs, with a yearly consistent number of related mortgages and financial products diffused worldwide.

UNECE is promoting the dialogue across the region not only on the mere financial aspects of the crisis, but also on the real estate market as a sector that also need regulation and proper advice to government.

The real estate sector, if well regulated and based on a transparent real estate and financial market could be a driving force for development, producing social, economic and environmental benefits to member States. It could indeed sustain the recovery towards more sustainable economic systems and more sustainable production and consumption patterns. Moreover, housing represents an important shelter asset for families, which under normal market conditions protects from the risk of inflation and of loss of purchasing power.

Conclusions: a crisis is what you make of it

At present, West European GDP looks like falling by perhaps 4-5% in 2009, in Central Eastern Europe the drop may be even larger, perhaps 6%. In both cases, the falls in output were so large in the first quarter of 2009 as to cast doubt on whether any annual estimate could be anything other than a partly informed guess.

Speed of recovery will depend on the extent to which the recession has damaged growth potential. Most importantly, this covers the scale of human and physical capital (both private and public), shortage of finance and the cost of public debt.

Against this background, the global crisis may be an opportunity for increasing the focus on energy efficiency, social infrastructure, housing and technological innovation. The economic downturn creates an environment in which the society is prepared to accept radical and sometimes painful changes if it sees that these are likely to improve the long-term economic prospect.

International economic cooperation grows in importance during the global crisis. It is more productive for all partners in the global economic community to look at the current situation in a positive way, as a source of new opportunities. The fact is that the crisis creates a need for immediate action and the measures to be taken may also become an opportunity for the global community, especially when they address long term concerns. To achieve knowledge-based, innovative, equitable, and sustainable development is a widely shared objective where internationally coordinated policy actions could have positive economic effect for all parties concerned, would shore up confidence in the short run and, probably even more important, will be beneficial to all of them in the long run.