

Europe and Russia: Up from the Abyss?

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The past year was the most contentious in Russia-Europe relations since the collapse of the Soviet Union. From differences over Kosovo's status, NATO enlargement, and missile defense in the spring, to the Georgia war in August, to another natural gas dispute between Russia and Ukraine that began at the end of the year, tensions and differences dominated 2008. And on many issues Europeans could not agree among themselves, or with the Bush administration, about how best to engage Vladimir Putin's recently resurgent Russia.

Yet, while political relations worsened, economic integration between Russia and the European Union continued to deepen and widen, as trade and investment volumes reached all-time highs. In the summer the Russian Ministry of Economic Development and Trade published a long report detailing Russia's economic goals through the year 2020. The most striking finding in that report is that Europeans especially, and the West more broadly, would be far and away the most important partners in helping Russia to achieve its best-case growth scenarios in the coming decade.

This combination of trends—deepening economic integration amid worsening political relations—did not seem sustainable in the summer of 2008, and now after the war in Georgia and the impact of the global economic crisis, it seems even less so. The question is: Will political relations between Europe and Russia continue to deteriorate?

Dmitri Medvedev was inaugurated as Russia's president in May 2008. Later in that month the Russian stock market hit its all-time high. And in July oil prices peaked at \$147 per barrel. The Russian government had more money than it knew what to do with, as foreign currency reserves peaked at nearly \$600 billion, with another \$200 billion put aside in a formal "stabilization fund." The Russian GDP (in nominal dollar terms) had increased by

a factor of six in less than a decade. The Ministry of Economic Development and Trade report on strategic economic goals through 2020 called for similar growth levels that would ultimately make Russia the fifth-largest economy in the world and larger than any in Europe. Kremlin officials talked about Russia possibly being a "safe haven" or "island of stability" as the impact of the US mortgage crisis widened to the world economy.

But how quickly things change. Russia's economic hubris has been smashed as its economy in the past few months has been perhaps the hardest hit of large emerging markets. By January 2009 the Russian stock market had lost about 80 percent of its value, the ruble had lost more than 30 percent, and reserves had fallen by one-third, with additional tens of billions promised in various bail-out and stimulus measures. Most prognoses for economic performance have predicted zero or negative growth for 2009.

All national economies are struggling to adjust to the deepest global slump in recent times, but the change in momentum for policy makers in Moscow is especially stark and challenging. Since so many millions of Russians have benefited from the prosperity of the past decade, the impact of the current crisis affects a far greater percentage of the population than the last economic crisis, in 1998. Prime Minister Putin's approach to governance, the so-called "vertical of power," will be tested like never before as prospects for social unrest and even bankruptcy become possible, especially if the slump endures for more than 12 to 18 months.

NEW DYNAMICS

What does this turnabout suggest for relations with Europe? Historically, since the first oil crisis in the early 1970s, there has been a powerful correlation between a high oil price environment and a more assertive and aggressive Soviet or Russian foreign policy. This dynamic corresponds to the later Brezhnev years and the Putin period, especially since 2003. Lower oil price environments,

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as during the Gorbachev and Yeltsin years, correlate with a more accommodating and moderate foreign policy from Moscow.

Also relevant to Europe's ties with Russia is this reality: In a world of higher oil and gas prices, Moscow, like other states that rely a great deal on hydrocarbon revenues, can make decisions about production, allocation, and distribution of energy resources on more political and less commercial terms. Not surprisingly, given the mountains of money coming into Kremlin coffers in recent years from oil and gas sales, Russians have engaged in a variety of intimidating behaviors that have particularly tended to put their neighbors in "New Europe" on edge.

At least in the short term, or however long this global recession lasts, the Russians will feel far more economically constrained than in the recent halcyon years. Even when global demand begins to recover, Russia will be competing for investment with all economies whose assets have dramatically declined in value—as opposed to 10 years ago, when Russia was more unusual as a large emerging market with undervalued assets.

A second major difference the Russians will face is that, for the near and middle term, prospects for growth in domestic production of oil and gas resources are grim. After the country's financial crash in 1998, Russian domestic oil companies, led by Yukos at the time, achieved remarkably rapid growth in production with the application of modern technologies to old Soviet wells. That feat cannot be repeated, and new production will have to come in geologically and climatically challenging conditions from greenfield projects that will be the most expensive and complicated of their kind in history.

Finally, there is another important new factor in the equation: the election of Barack Obama and the end of the George W. Bush era in the United States. While we must beware of excessive expectations regarding the new president, the Bush administration had unprecedentedly strained relations with much of Europe as well as with the Russians. Bush's deep unpopularity at home as well as abroad gave Moscow more leverage to split America's European allies, most notably over the Iraq War.

The Obama administration will bring a new dynamic to relations among the United States, Europe, and Russia. Some of the most neuralgic issues in Russia-West relations will be defused somewhat. For example, Kosovo's declaration of independence is past. Missile defense will be pursued more circumspectly. And NATO enlargement to include Ukraine and Georgia will also slow down—partly because key European allies are skeptical, and partly because a new administration in Washington will not be racing against the clock to cement its legacy.

REBALANCING RELATIONS

The Georgia war, although it has been overshadowed by the global financial crisis, was a watershed event that confirmed nearly 20 years after the fall of the Berlin Wall and the end of the cold war that we have not yet succeeded in making Europe "whole, free, and secure." There is increasing evidence, however, that Europeans are ready to take more initiative, despite their cleavages regarding Russia,

and rebalance responsibilities on security issues with Washington. The EU's decision to take the lead in mediating a ceasefire agreement between Georgia and Russia under the auspices of French President Nicolas Sarkozy testifies to this.

Likewise, the compromise last year on Georgia and Ukraine's requests for NATO membership action plans—essentially postponing the plans while reassuring the countries that they can eventually join the alliance—was reached by European initiative, prompted by German and other European objections to the Bush administration's approach. This too suggested a rebalancing between Europe and the United States in managing relations with Russia.

While it would be wrong to get irrationally exuberant about a new golden age in Russia-Europe relations and Russia-West relations more broadly, the coalescence of an economic downturn and a new political environment suggests that the structural environment for the relationship may be conducive to greater cooperation and less conflict than has been the case in the recent past. Hopefully we will be able to regard 2008 as the bottom of an abyss in Russia-West relations. ■

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