

ECIPE Bulletin No. 02/2014

## **Russia, Crimea – and Europe’s Foreign Economic Policy**

By Fredrik Erixon, Director and co-founder, ECIPE ([fredrik.erixon@ecipe.org](mailto:fredrik.erixon@ecipe.org))

**The European Union is the largest economy in the world. But it is not the most powerful. It has shown its capacity for economic statecraft by reshaping the regional conditions for peace, security, and economic development through its expansion – through greater economic and political interdependence manifested by EU membership. Yet its attempts in the past decade to use its economic size, or the attractiveness of having uninterrupted access to Europe’s consumers, for operative non-economic purposes have erred on the side of failure rather than success. Is this a good time to build up a new type of foreign economy policy in Europe?**

Russia’s invasion of Crimea has yet again put the spotlight on Europe’s capacity to use its own market and international economic policy for strategic purposes. The European Union, like the United States, has made it clear to Russia that there will be economic costs associated with its blitzkrieg in Crimea – and that the costs will increase if Russian troops move farther into Ukraine. Both the EU and the US have no doubt the capacity to wreck the Russian economy – and put the proverbial money where its mouth is. In fact, they could sink the Russian economy – highly dependent on its export revenues from hydrocarbons and good conditions for corporate external financing on Western markets – in a few months, if not weeks. The notion that the economic power balance between Russia and the EU is equal, that they can create the same magnitude of economic destruction by punitive economic measures, is a gross misrepresentation of the economic power relation.

But punitive economic sanctions are unreliable instruments. Just look at the effects of Europe’s sanctions against Belarus. Broad sanctions that create severe economic damage will have many casualties, most of which are innocent bystanders. The history of economic sanctions is diverse and most examples from the past actually has little to tell us about the appropriate course of action vis-à-vis Russia now. The general, but not universal, pattern from history is that broad sanctions rarely work as instruments that motivate the offending government to change its behaviour. The reaction can rather be that the offending government gets motivated to double down on its offending actions – and that electorates, to the extent they matter in such countries, support a misbehaving regime because people feel as if they are under attack.

Milder punitive actions than those under consideration now do not have an impressive record either – and it has become much more difficult for sizeable economies to get its way in world affairs by the threatening with punitive economic actions. The EU, for instance, has in the last years increasingly used its own economic power to persuade other countries to sign up to certain international agreements or to install new environmental policies. A few years ago the EU threatened to tax commercial air traffic outside the EU air space unless governments agreed to sign an agreement that would externalise the EU’s carbon fee on airlines. It has threatened to cut access to the EU market for countries that do not comply with rules on forestry and how fuels are produced. It has talked up a punitive scenario for countries like China (using access to public procurement or trade defence actions) if they do not dance to the tunes of Europe.

Most of these, and other, actions have failed, and the EU has often had to back down from its threats. Punitive economic actions are increasingly ineffective tools in trying to get other countries to follow a certain set of policies. Such measures often violate basic economic power logic – in many cases the cost to the EU from its threatened punitive measures would be greater than the cost to the country that would be punished. Generally, greater economic interdependence means that the cost of punitive measures is greater today than before.

Yet Russia's invasion of Crimea – and Russia's policy of destabilisation in territories close to the EU's eastern border – has ushered in a greater urgency for the EU and European governments to revisit their foreign economic policy. There are three elements missing in Europe's policy for strategic economic statecraft. First, Europe has an unfinished idea about what power structures that are necessary to uphold a world economy and world security based on rules and international law. After the end of the Cold War, Europe (writ large) has increasingly taken a post-modern view of international relations and, by accident or design, ended up in policies based on the presumption that the world can be shaped by the dynamics of economic interdependence. A strategy of economic interdependence is not a bad notion, but it is incomplete. For international rules and law to be respected there has to be an overall strategic arrangement based on power, preferably impressive power, manifested by one hegemon or several countries acting together. Europe's post-modern political personality, with its heavily reduced military expenditures and aversion to the discourse of measuring raw power, is not fit for a world of greater global equality in power.

Second, absent a better strategic dimension running through and guiding policy, Europe became blind to the texture of its economic integration with countries like Russia. Economic integration is a necessary element to build a peaceful and secure relation to Russia, but Europe has allowed this integration to be too much on non-market terms and arranged it in a way that disempowers the EU vis-à-vis Russia. Europe has allowed a Russian state gas firm with a monopolistic export status to build cartels and oligopolies in Europe, and – together with local firms – prevent a depoliticisation and a rational arrangement of energy in Europe. Energy might be the most obvious area, but the problem extends into several sectors and fields of policy. The non-market texture of the relation has created a dependency that has tied the hands of the EU and European governments. Increasing economic interdependence on non-market grounds is not compatible with the ambition to act as the guardian of international rules and law.

Third, the institutional complexities of European cooperation all too often prevent Europe from using foreign economic policy instruments in both a proactive and a reactive way. The EU does not have rules for when and how to act – and consequently has to negotiate new policy when events occur. Inevitably, such negotiations allow for special interests to get a disproportionate influence in the design of policy, sometime by preventing necessary policy reactions. For the EU to improve its economic statecraft, it needs better rules for policy and rules for instrument.

It is impossible to predict how the current standoff with Russia will end. Now that the EU has taken the route of economic sanctions, it has few alternatives than to increase the economic effect of the sanctions while avoiding a complete economic and political destabilisation of Russia. But of greater importance for Europe's own security is that it should fast-pedal reforms that empower Europe in its relation to Russia. Sweeping energy market is only the first step. Rules on corporate governance and, what companies that could be traded at European exchanges, is another area. They will not solve current problems with Russia. But they will help Europe to act with greater authority.