Russian-EU summit produces few agreements

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5 June 2010

Russian President Dmitry Medvedev hosted a summit with leaders of the European Union (EU) in the southern city of Rostov-on-Don. The summit, held May 31-June 1, produced no significant agreements, as both sides attempted to shore up their relative positions in the face of Europe's deepening financial crisis.

To coincide with the summit, around 1,000 demonstrators gathered in Triumfalnalya Square in central Moscow to protest the anti-democratic methods of the government of Medvedev and Prime Minister Vladimir Putin. Chanting "Freedom" and "Russia without Putin", the mainly young crowd was brutally attacked by riot police. Several protesters were badly beaten and required hospitalisation. Others were arrested.

Police claimed they acted to prevent the protesters from disrupting a nearby gathering of the pro-government youth movement Nashi.

Smaller demonstrations in St. Petersburg and other cities were also met with police violence. EU leaders issued pro forma statements opposing Russian police brutality, but the business of the summit went ahead uninterrupted.

These demonstrations, and the response meted out by the authorities, are only the latest expressions of growing popular hostility toward the government and the deterioration of living conditions across Russia. Last month, special OMON paramilitary police units beat back dozens of miners in the Kemerovo region of Siberia, who had come onto the streets to protest the complicity of mine owners and government officials in the deaths of scores of their co-workers at the Raspadskaya mine.

President of the European Commission José Manuel Barroso and President of the European Council Herman Van Rompuy led the EU delegation at the summit, which was promoted as a new, more pragmatic phase in EU-Russia relations. In the run-up to the meeting, both sides expressed hopes of boosting trade and economic growth. The leaders and their foreign policy representatives also discussed climate change, terrorism and the Iranian nuclear programme.

Despite pre-summit claims, the only firm agreement reached in Rostov-on-Don regarded information exchanges between EU and Russian organisations. European leaders also expressed general support for Medvedev's so-called "modernisation" campaign and efforts to develop the high-tech industry in Russia. However, no concrete promises of major investment were issued.

Discussions on easing visa restriction produced no agreement, with Medvedev offering to lift restrictions on EU citizens traveling to Russia but EU officials declining to agree to a reciprocal offer. On the contrary, across the EU, member states are resistant to any easing of border restrictions; European governments are utilising anti-immigrant chauvinism to distract from the economic crisis that is causing mass unemployment.

While sections of the media and Russian officials have insisted that the country is well positioned to withstand the shocks reverberating from Europe's financial crisis because its banks do not hold large volumes of bad European debt, Russia remains highly dependent on the European market for the export of energy resources.

The EU is Russia's largest trading partner, and the recipient of 70 percent of its gas exports and 88 percent of its oil exports. While exchange between the two had grown steadily for years, since 2008 the trade volume between Russia and the EU has declined by 40 percent. The Russian economy is highly vulnerable to any further decrease in the consumption of Russian energy products, as well as industrial goods, that could arise from the deteriorating economic climate in Europe.

Due to the massive bailouts of Russian banks and major industry in 2008 and 2009, as well as a significant decline in energy prices, the oil revenue that Moscow has relied upon to finance whatever remains of the welfare state—including pensions, health care, public education, and local subsidies to boost employment—has been largely depleted. Even Putin has hailed the Russia's emergence from recession this year; the government has issued warnings of looming high unemployment and been preparing the implementation of austerity measures.

While Russian growth is expected to reach 4.0-5.5 percent in 2010, this is mainly due to a strong rise in the price of light crude oil from the Urals and Siberia during the first quarter of the year, a trend that could quickly go into reverse. Meanwhile, crude oil prices have fallen below $70 a barrel, the price that Putin recently claimed was the bottom “comfortable” point for the Russian economy. Reflecting fears for the global and Russian economies, the ruble has fallen in value recently, last week hitting its lowest rate since September 2009.

On May 26, Russian stocks fell by more than 5 percent, the largest one-day drop since October 2009, amid concerns that the EU debt crisis would derail Russia’s fragile economic growth this year. The main Russian MICEX index has fallen by more than 20 percent since the eruption of the Greek debt crisis in April, when Athens had its debt rating reduced to junk status.

“Investors fear that the debt crisis may lead to a double dip scenario, and Russia is one of the most exposed economies in that scenario since it is so dependent on exports due to the lack of success in diversifying its economy,” said Chris Weafer, chief strategist at UralSib, a financial services company.

Looking to expand foreign direct investment (FDI) in Russia, Medvedev hosted a meeting of several large venture capitalist companies in Moscow on May 27, seeking to promote what the president called “Russia’s balanced tax system”, the deregulation of capital movements and licensing laws, and preferential rules for new foreign investments. One US attendee was quoted by the Itar-Tass news agency praising Russia’s 13 percent income tax rate as “the dream of every American.”

Speaking during the meeting, Medvedev complained that “There exists no problems with where to invest money.… We are so rich in resources that nobody is in a hurry to make risky investments. All want to invest in oil and gas.”

This is the “Catch 22” of Medvedev’s plans: global investors are reluctant to put money into non-oil and gas industries in Russia in part because the country’s dilapidated industrial base has left the economy reliant on energy exports and therefore at the mercy of fluctuating oil prices.

In addition, FDI has been held at bay by the crony-capitalism of the Russian elite, who have used criminal methods to vastly enrich themselves, primarily through looting formerly nationalised industries rather than investing in the productive forces. Many powerful figures in Russia are hostile to Medvedev’s modernisation plans, fearing that increased foreign investment could undermine their dominant positions.

While EU-based FDI in Russia peaked in 2008, this flow went into reverse in 2009, as foreign capital retreated from higher-risk “emerging markets” internationally. FDI in Russia has increased in the first quarter of 2010, with EU-based capital constituting the overwhelming majority of investments; however, the deepening financial crisis in the EU has placed a question mark over the continued growth of capital flows from Europe into Russia.

The EU hoped to use this past week’s summit to gain Moscow’s support for European financial and monetary stability. Medvedev responded to the EU’s appeals by stressing his support for the euro currency.

However, Russia’s actual ability to support may be increasingly strained, as the European currency continues to fall in value. The country’s currency reserve fund fell in value by 3 percent in May, a drop attributed to the weakening position of its euro holdings.

The Kremlin relies on this fund to finance budget shortfalls, and any decline in its value will force Russia to increase borrowing from international markets. The cost of such borrowing is likely to increase, as these markets look at Russia’s structural weaknesses and dependence on fluctuating oil prices as sources of risk. Were Russia to sell off a large portion of its reserve of euros in an effort to protect the value of its currency reserves, this would place renewed downward pressure on the euro.

“For now,” dumping euro assists in favor of other currencies “isn’t happening,” said chairman of Russia’s Central Bank Sergei Ignatiev on May 27.