



What the economic crisis means for the EU's eastern policy

By Tomas Valasek

★ In May 2009 the EU is launching its 'eastern partnership', an enhanced version of the neighbourhood policy that is specifically tailored to those East European countries that are seeking closer ties with the Union. The aim of the new initiative is to draw countries such as Armenia, Belarus and Ukraine closer to the EU and encourage them to adopt European norms of democracy, open markets and the rule of law.

★ But the economic crisis risks undermining the eastern partnership before it gets going in earnest. Protectionist pressures in Western and Eastern Europe could frustrate the plans for deeper economic integration and easier visa regimes that are central to the EU's new eastern policy.

★ The EU governments should persevere with the eastern partnership, but complement the initiative with additional short-term loans to help those East European countries worst affected. They should also do a better job of co-ordinating their assistance to the region.

The unfolding economic crisis will make it more difficult for the European Union to draw its neighbours in Eastern Europe closer. The EU's eastern policy has encouraged neighbours to align their economies and political systems with its own. The Union uses the prospect of partial integration or full EU membership to spur the necessary reforms. Its latest attempt to forge tighter links with its neighbours, the 'eastern partnership' (EaP) for Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, is due to be launched in Prague in May 2009. This promises, among other things, to increase EU assistance to the region, open the EU's markets to the neighbours' goods and simplify visa requirements.

But the economic crisis is undermining the eastern partnership even before it gets off the ground, for several reasons. The downturn has spurred a rise in protectionism and nationalism on both sides of the EU's border. This has reduced the appetite for closer trade relations – the main pillar of the eastern partnership. Also, some partnership states have wrongly come to view the EaP's (relatively modest) offers of financial support as the EU's main response to their economic woes. The amounts compare unfavourably with those offered by other actors like the IMF or Russia, which hurts the EU's image in the region. Lastly, many of the member-states most supportive of the eastern partnership and other assistance programmes for Eastern Europe, like the Baltic states, are among the

countries worst hit by the crisis. They will have less money available to assist their neighbours.

This policy brief argues that the eastern partnership remains the right vehicle for the EU's eastern policy, and that the economic crisis has not diminished its importance. But it ought to be complemented with additional measures to address the neighbours' economic woes. The EU should accelerate the disbursement of grants under the EaP, and it should expand its macro-financial loan scheme to help Eastern Europe (and other neighbours) to stave off default. The EU member-states most active in assisting the eastern neighbours should also make a greater effort to co-ordinate or pool their assistance programmes.

The eastern partnership

For much of the post-Cold War period, the EU's eastern policy had rested on the assumption that all East European countries wanted to emulate the EU's economic and political model. Given enough time, EU money and attention, it was thought, countries from Belarus to Azerbaijan would adopt European norms. For the past six years, the European Union has treated the eastern neighbours little differently from other countries on its borders, lumping them all under one 'European neighbourhood policy'. It counted on the

East Europeans' self-interest to drive them to adopt EU rules and standards.

But such assumptions are no longer valid for two reasons. First, the EU has lost some of its attraction. Much of its 'soft power' in the east rested on its holding out the prospect of membership. But so many EU governments have cooled on the idea of further enlargement that none of the eastern neighbours now realistically expect to join the EU in the foreseeable future. This has made it harder to encourage the neighbours to align their political and economic systems with those in the EU.

Second, the August 2008 war in Georgia has complicated the EU's task in Eastern Europe. The conflict has made it clear that Russia will actively oppose western influence on its borders. East European countries now have a reason to worry that a pro-western course may provoke Russian wrath. While Moscow's concerns focus primarily on NATO's enlargement, it increasingly views the EU as a competitor for influence. For example, Russia strongly criticised an EU-Ukrainian deal in April 2009 to modernise Ukraine's ageing gas pipeline network. And Moscow's pressure seems to be working: in March 2009, the Azeri government signed a memorandum of understanding to sell its future gas exports to Russia – this could indicate a reversal of Azerbaijan's long-standing goal of diversifying energy exports away from Russia and towards Europe.

The EU has responded to its waning influence in Eastern Europe by drawing up plans for a new eastern partnership for the region. The initiative was first mooted in 2007 by the Swedish and Polish governments and speeded up after the war in Georgia. The EaP rightly targets the weak points of the EU's eastern policy to date. First, it starts treating Eastern Europe as a region in its own right, separate from the rest of the EU's 'neighbourhood' in North Africa and the Middle East. This change may appear bureaucratic but it will matter. The EU's previous policy of lumping together all neighbouring states, including many which never had any prospect of joining the EU, infuriated the Eastern Europeans. They saw it as a signal that they should give up aspiring to EU membership.

The eastern partnership also seeks to ease travel restrictions. Few EU policies damage its reputation in the east more than the expensive and gratuitously complicated visa application process. If this is simplified, the EU's image in the region will improve (although the Ukrainian government complains that the changes offered by the eastern partnership do not go far enough).

The EaP would also substantially expand mutual trade. Its 'deep free trade' provisions would not just abolish most tariffs but remove many non-tariff barriers, too. Laws regulating everything from the safety certification of electrical goods to health standards for dairy products would be harmonised. This would remove the need for Belarusian tractors, for example, to be re-tested for safety within the EU.

The eastern partnership programme also increases EU assistance to the region (to €600 million in 2010-13, up from the €250 million previously set aside for the six states) and targets aid at improving governance and the rule of law. This is important because corruption and incompetence among East European administrators have undermined many assistance programmes for the region.

The eastern partnership will work better for some countries than for others – Ukraine, for example, is already working on a deep free trade agreement with the EU, so from Kyiv's point of view, the initiative brings little that is new. Azerbaijan and Armenia are less keen than the other partners to join the EU, so even with the eastern partnership, the EU will never feature highly among their foreign policy priorities. Also, what the EaP cannot do is change the fundamental weakness of the EU's eastern policy: the member-states' waning desire to maintain a credible enlargement process.

But its provisions represent a significant improvement on the EU's current policy towards the eastern neighbours. They will change the EU's image in the east for the better and give the neighbours stronger reasons to align their economies with those of the EU. The eastern partnership is probably the best the Union can offer Eastern Europe for now.

But the initiative as well as the EU's overall policy for the eastern neighbourhood is in jeopardy because of the economic crisis. The downturn is rapidly changing the political calculations of governments on both sides of the EU's eastern border.

The impact of the economic crisis

The crisis has hit Eastern Europe hard. Four of the six eastern partners have received IMF bailouts and before the end of the year more will be forced to seek emergency assistance. Ukraine's GDP in January this year was down 20 per cent compared with a year earlier and economists warn of a possible default. Belarus, too, is in trouble. Much of the economy is driven by exports of machinery to Russia but demand in the Russian market has collapsed. Armenia is equally badly affected by the downturn in Russia. Moldova's economy relies heavily on remittances from abroad, but they dropped by a third year-on-year in January 2009, because Moldovans in Romania, Ukraine and Russia are earning less than they used to.

The mood across the region is changing quickly. Unemployment has risen sharply, and so has popular unrest. The survival of several governments in Eastern Europe is at stake. This is not just due to the economic crisis; other factors are at play. The Ukrainian government, for example, is deeply unpopular at home because of infighting between the president and the prime minister. The Moldovan government made it difficult for the opposition to compete on an equal

footing in recent elections, triggering violent protests in early April. And the Georgian government is under pressure because the population is growing frustrated with President Mikhail Saakashvili's policy of curtailing political freedoms. These factors alone would produce political instability. But the economic crisis is adding fuel to the fire. It makes people anxious about losing jobs and homes. And anxious people are far less tolerant of their governments' failings, and far quicker to take to the streets.

The elites' views are changing, too. Those countries which were keenest on EU integration, like Ukraine or Moldova, have downgraded it on their list of priorities. The governments most affected by the economic downturn have gone into full crisis mode. To escape the voters' wrath, they have set about cushioning the social impact of the crisis or, failing that, finding scapegoats for, or distractions from, its social consequences. Nationalist rhetoric is rising across the region. The Ukrainian president is in a war of words with the Russians, as is the Moldovan president with the Romanians. The thinking of many governments has become short-termist; long-term goals like building EU-compatible political and economic systems matter much less than political survival.

Unless the EU adjusts its approach to the region to take account of the economic crisis, the eastern partnership is likely to face serious problems. Three factors in particular would undermine the EU's policy in the region:

★ Less interest in free trade and easing travel

Rising nationalism and protectionism on both sides of the EU's eastern borders is thwarting plans for economic integration. The European Union and Ukraine have been negotiating a new free trade agreement since 2008 but senior EU officials say that Ukraine's commitment to a deal seems to be flagging. Its insistence on keeping a number of controversial tariffs in sectors like the car industry and fisheries has caused the talks to stall.

¹ *European Commission, 'Eastern Partnership', Communication from the Commission, December 3rd 2008.*

The EU has also become less open to eastern workers and travellers. The Commission's original proposals for the eastern partnership had called on EU governments to consider gradually removing visa requirements altogether.¹ But in subsequent negotiations, Germany and many other EU governments, fearing an influx of illegal workers, successfully lobbied to drop references to a visa-free regime.

² *'Declaration by the European Council on the Eastern Partnership', March 19th-20th 2009.*

The EU's March 2009 declaration on EaP only offers the partners a simplified visa application system, and even this only on a case-by-case basis and as a 'long-term' goal.²

★ The neighbours think the EU is stingy

The second risk stems from the perception that the EU

is not doing enough to help the eastern partners through the crisis. President Vladimir Voronin of Moldova recently dismissed the eastern partnership-related financial assistance as "candy", suggesting it was not serious enough to warrant attention.

The criticism is unfair to the EU – its governments are giving considerable support to their eastern neighbours through other institutions like the International Monetary Fund. The IMF is giving \$15 billion of emergency loans to Ukraine alone. Belarus, Georgia and Armenia have also had IMF credits. European leaders represented in the G20 agreed in April to treble the IMF's crisis budget, to which the EU countries would contribute \$100 million. The ailing economies of Eastern Europe are among the most likely recipients of this expanded aid programme.

True, the EaP funds are relatively limited but their purpose is not to finance external or budget deficits in Eastern Europe. The money is meant to help improve governance and expand people-to-people contacts. But Voronin's words draw attention to a real problem for the EU's eastern policy: the East European governments see the IMF and Russia putting up billions in loans, but they do not see the EU as such assisting its neighbours. And perceptions are important: if some of the eastern partners think that the EU is not helping them at the time of their greatest need, the EU will find it hard to achieve its goal of drawing these countries closer.

★ Less money for direct aid from EU governments

The third risk is only indirectly related to the eastern partnership but it suggests that a new problem has emerged for the EU's broader approach to the east. The economic crisis has hit many of the new EU member-states especially hard. And it is they who, along with Sweden, have most strongly advocated greater EU engagement in Eastern Europe. Besides lobbying for the EaP, the new member-states have been directly funding non-governmental organisations in the neighbouring countries, financing training for local administrators, and paying for advisers to provide on-the-ground expertise across the region.

This kind of work, though often mundane and behind the scenes, is important for strengthening civil society, improving the quality of governance and helping build an independent press. Cumulatively, the myriad small assistance programmes expand the circle of people who have a vested interest in a better relationship with the EU. But many now risk falling victim to recession-related budget cuts. Some governments, like that of Latvia, are reducing overall government spending dramatically in order to bring budget deficits under control.

Seeing past the crisis

There are ways of minimising the damage or even turning it into an opportunity. The EU member-states

should re-affirm why the EaP and Eastern Europe in general matter to the European Union. Some EU governments are reluctant to engage with Eastern Europe at all. Many have tired of the continual political instability in places like Ukraine and will argue that EU countries are in enough economic trouble as it is without squandering money and attention on what seems like a hopeless region.

But the economic crisis has not changed Europe's geography. Eastern Europe – with its instability and poverty, but also large markets and a yearning (if somewhat diminished, and not equally shared) to be a part of the EU project – remains an immediate neighbour. The EU is not immune to the consequences of instability in the region, as the Austrian and Italian banks, which invested heavily in places like Ukraine and now face dramatic losses, are finding out. At the same time, the EU is well placed to capitalise on the future growth in Eastern Europe when the crisis passes. The member-states should benefit from the partnership's focus on improving governance and expanding trade links.

This is not to say that the eastern partnership alone will change Eastern Europe's underlying problems – it will not reconcile the Ukrainian prime minister and the president, or turn Azerbaijan into a perfect democracy. But it would strengthen the EU's influence in the region, and give it more ability to lean on the neighbours to respect their own laws. The EU remains, along with Russia, the strongest actor in the region, and in the past it successfully intervened on behalf of democracy and the rule of law (as when it pressured Ukraine's then president, Leonid Kuchma, to re-run what had been a fraudulent presidential election, or when its mission to the Ukrainian-Moldovan border cut smuggling from the unrecognised Transdnistria enclave). It is in the EU's self-interest to maintain and expand its ability to steer Eastern Europe towards democracy and stability.

The EU governments should persevere with the EaP despite the crisis, but they need to adjust their approach. The crisis has dented the appeal of western economic systems in the eyes of some eastern neighbours.

So when talking to eastern partners about economic reform, EU officials will need to tread carefully, acknowledging the weaknesses of market economies but pointing out that without them, East European countries will not close the income gap with Western Europe.

The EU governments should also take steps to ensure that the Union gets recognition for the strong role its member-states are playing in helping Eastern Europe to cope with the crisis. The EU itself should consider expanding macro-financial assistance to Eastern Europe. It has been providing limited balance-of-payments loans to Eastern Europe for years, even before the economic crisis. Past EU loans helped

Georgia cope with the impact of the Russian ban on the imports of Georgian wine, for example. But these loans were usually small – tens of millions of euros. The EU should consider expanding its macro-financial assistance, and use it to help the partnership states (and other countries in trouble) in coping with the economic crisis, as the European Commission proposed in April 2009.³ As with the past macro-financial loans, the EU should insist that recipients of its aid follow IMF-imposed reforms, to make sure that EU loans generate long-term economic benefits.

³ *European Commission 'Supporting developing countries in coping with the crisis', Communication from the Commission, April 8th 2009.*

The eastern partnership's grants, while far smaller than IMF (or possible future EU) loans, could also be used to mitigate the impact of the crisis. The EU should consider accelerating the disbursement of grants, and using a portion of the funds to finance job retraining programmes. This aid should focus on the regions hardest hit by the crisis, like the Donbass region in Ukraine.

Lastly, the EU member-states should do a better job of co-ordinating their national assistance programmes to Eastern Europe. Too often, EU governments do their own thing without regard to each other. Some of these programmes will inevitably fall victim to the economic crisis. But the cuts in aid from various Central European governments' training or advisory programmes could be mitigated if assistance was pooled. For example, rather than recalling advisors who are helping to reform key Ukrainian ministries, the new member-states could agree to withdraw some and co-finance the remaining ones. In fact, some of this rationalisation is already taking place. Diplomats from Latvia say that they are moving away from running purely national programmes to co-financing or co-managing their assistance with the Swedish, Polish and other EU governments.

These proposed measures will not end Eastern Europe's economic woes. Nor, taken alone, will they induce the eastern neighbours to adopt EU laws and standards. That will require the EU governments to find ways to overcome the current impasse on enlargement.

But the above proposals might help to safeguard the main objectives of the eastern partnership: namely, the strengthening of the EU's standing in the region, and the prospect of greater political and economic integration. In addition, they might lessen the East Europeans' hardship and protect investments by EU companies in the region.

*Tomas Valasek is director of foreign policy and defence at the Centre for European Reform.
April 2009*

The CER is grateful to the German Marshall Fund of the United States (GMF) for supporting this publication.