

Ukrainian 'Black Hole' Weighs Heavy On European Business in Russia

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German Foreign Minister Frank-Walter Steinmeier in a file photo.

Politics took front stage at the flagship conference of the Association of European Business, or AEB, on Tuesday, where foreign companies with committed interests in Russia grappled with the economic fallout of the unfolding crisis in Ukraine.

Business as something relatively immune to political vacillations is a thing of the past in Russia for now, and the meeting of business leaders, government officials and leading economists was pervaded by an uneasy sense that the current crisis is just one reflection of a wider shift in Russia's position on the global stage.

The subject of the conflict in Ukraine came up repeatedly, so often in fact that David Grey, managing partner of PwC in Russia and a session moderator, jokingly termed it the "black hole" to which all questions led.

"I do have to say it clearly — the annexation of Crimea has brought the cooperation between the EU and Russia to a temporary, I hope, halt," Gunnar Wiegand said, laying bare the topic on everyone's mind. Wiegand, who represented the viewpoint of the European Union throughout the session, is director for Russia, Eastern Partnership, Central Asia, Regional Cooperation and the OSCE at the European Union's European External Action Service.

Looming large over the event was the threat of a third round of EU sanctions against Russia, which could extend the measures from visa and assets freezes on individuals to restrictions on entire economic sectors. Ukrainian President Petro Poroshenko in a telephone conversation with French President Francois Hollande on Monday night called for sector-wide sanctions if Russia continues to take destabilizing actions in Ukraine, Interfax reported, while German Foreign Minister Frank-Walter Steinmeier on Tuesday said that the EU may discuss the subject at its meeting of heads of state next week, Reuters reported.

The AEB did its best to find a middle ground between clear economic interest and political allegiances. In a public declaration of the association's stance, newly appointed chairman of the board Philippe Pegorier said that the association opposes sanctions but will submit to any further measures taken by the EU.

Business Reacts

Despite the geopolitical pressures, economists and representatives of foreign companies repeatedly underscored the impossibility of severing or diminishing economic ties between Russia and the EU.

"The European Union's exports to Russia are approximately \$132 billion, while exports to Ukraine are \$26 billion. So you can see where our interests are," Pegorier said. The EU is Russia's single largest trade partner, with 50 percent of total Russian trade, while Russia is the EU's third-largest trade partner, with 10 percent of EU trade, according to the European Commission.

Representatives from multiple sectors expressed their companies' intentions to continue developing operations in Russia. "We, as Volvo, have been in the market for 40 years; we have seen bigger political issues in those 40 years than what we see right now. When you make a commitment to customers in the market, you stay," said John Stech, president of Volvo Cars Russia. Volvo has no factories in Russia, but claims to have about 80,000 customers and intends to add 10 additional dealerships this year. Similarly, Edgars Puzo, the general director of Atos IT Solutions and Services, said that his company is committed to remaining in the market, even though growth rates in the Russian IT market fell behind global growth rates for the first time in 2013.

Although companies are remaining firm in the choice to do business in Russia, their confidence in the short-term prospects of the Russian economy has fallen drastically this year. A study released late last month by AEB and market researcher GfK Rus found that the political crisis in Ukraine and Russia's domestic economic slowdown have contributed to a drop in the percentage of companies expecting increases in foreign investment from 59 percent in 2013 to 31 percent this year, while the number of companies expecting decreases in investment went up from 12 percent to 40 percent.

The political situation is only the latest of concerns for foreign business in Russia. "It would be wrong to reduce the situation to the Ukrainian crisis. We have been in a difficult economic situation for a while already, and this adds to that uncertainty and volatility," said Joerg Bongartz, chairman of the board of Deutsche Bank Russia. Economic forecasts for 2014 oscillate at close to 0.5 percent, while the devaluation of the ruble has put a strain on many arms of foreign business. Add to that the political uncertainty and businesses have little means to make effective predictions: in the automobile industry, the market is expected to contract by anywhere from 6 to 20 percent this year depending on who you ask, Stech said.

Nonetheless, the businessmen looked hopefully to a future with long-term economic growth prospects. Volvo's Stech put faith in the growing middle class, while Bongartz emphasized the importance of successful economic reform.

"Our analysts expect 2.2 percent growth for the Russian economy in 2015, which would be good news for the banking sector ... but that obviously depends on a number of factors, including the ability of the Russian government to really diversify away from dependency on natural resources," Bongartz said.

Economic Development Minister Alexei Ulyukayev was expected to speak at the conference but bowed out at the last minute, citing an unexpected government summons. In his place, Deputy Economic Development Minister Nikolai Podguzov underscored the gap between the high-level political rhetoric of isolation and the reality of continuing economic relationships. Preparations for Russia's accession to the Organization for Economic Cooperation and Development, for instance, are in fact continuing, even if the results cannot currently be publicized due to the political climate, Podguzov said.

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