

## Understanding the situation in Eastern Europe

By Jordan Loh

It's trouble enough to understand the recent past, let alone predict the future. When seeking to grasp the salient issues of our day, there is truth in the aphorism, "past is prologue." Others can provide breaking updates regarding Russia's invasion of Ukraine, share predictions, and offer policy recommendations. Instead, let's look at the main factors at play in the crisis in Eastern Europe and recognize that the attendant investment risks and opportunities are not to be underappreciated. My hope is that this paper provides a lens through which to better understand and analyze this fluid situation as you position your portfolios.

### Background

Perceptions of strategic necessity are formed by geography and historical experience, and these perceptions drive geopolitics. In international affairs, where little is fixed, these forces are among the most stable.

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Russia has long relied on the concept of "strategic depth" as a safeguard of Russian security. The idea is that an invading force must march hundreds of miles to reach the cultural and industrial national core. Traversing broad expanses of hostile territory leaves the invaders exhausted and their overextended supply lines vulnerable to counterattack. And it has worked. From Bonaparte's pyrrhic victories at Borodino and Moscow to Hitler's defeat at Stalingrad, experience reinforces Russia's regard for the importance of buffer lands.

The dissolution of the Union of Soviet Socialist Republics (USSR) pushed Russian borders back behind those of Imperial Russia, which once extended past Warsaw; behind the post-World War I borders of the USSR, which encompassed most of modern Ukraine and parts of Belarus; and far behind the post-World War II borders of the USSR, which delimited only Soviet territory, and not the reach of the Red Army, which dominated Eastern Europe.

These retreating borders are perceived in the Kremlin as diminishing both Russian stature and security. The perceived threat is felt more keenly as the membership of the North Atlantic Treaty Organization (NATO), an alliance formed to counter Soviet aggression, expands eastward. NATO members now include not only former Warsaw Pact satellite states such as Poland and Romania, but also the Baltic states, which are former Soviet Socialist Republics (SSRs).

### Eastern Europe and Russia after the fall of the USSR

If the smaller independent states of Eastern Europe, historically dominated by Russia, are not content to be in Russia's orbit, then those nations and their Western allies face a classic catch-22.

Independent Eastern European states fear a revanchist Russia, so they turn to the West for cultural, economic, and most significantly, military ties. An already-covetous Russia sees this turn westward not as a defensive posture adopted by vulnerable democracies, but as a shrewd manipulation by the West to project western (American) power into Russia's historical sphere of influence, with nefarious intent. Russian desire to dominate its neighbors is reinforced. ("Oh, why can't all the former SSRs be more like Belarus!" laments Mother Russia.)

And so for two decades, Russian President Vladimir Putin has waited for opportunities to advance what, in his view, are Russia's vital security interests in Eastern Europe. The 2014 seizure of Crimea was notable. It saw Russia regain control of the warm-water naval port, Sevastopol, in the first forcible transfer of territory between major states in Europe since WWII. Since the seizure of Crimea, Russia has remained active in eastern Ukraine, waiting for another opportunity to expand its influence there, while simultaneously signaling to NATO that further eastward expansion will be resisted.

As the Kremlin moved troops to the border with Ukraine, it surveyed the world, and assessed that its patience since 2014 had been rewarded. Putin is an ex-KGB officer. As a former communist operative, he is surely studied in assessing the "correlation of forces." As Putin considered what deterrents (i.e.: costs) he would face arising from Russia's aggression in Ukraine, he saw:

- Rising tensions in the Strait of Taiwan;
- Listlessness in Germany and restlessness in Turkey (both NATO states); and
- A challenged withdrawal from Afghanistan by the United States.

### Afghan withdrawal: Provocative weakness

The doctrine of "provocative weakness" holds that while strength tends to deter attackers and thereby safeguard peace, weakness invites conflict, as opponents seek to capitalize on opportunity.

In a situation where neither potential belligerent desires conflict, some argue that strength may provoke fear and ultimately lead to an otherwise avoidable clash. However, in a scenario where a potential aggressor has adopted an opportunistic posture, as Russia has, weakness is always an invitation to conflict.

Unfortunately, the process and result of the U.S. withdrawal from Afghanistan do not enhance the credibility of American power in

foreign capitals. In its manner of leaving Kabul, the United States left allies more fearful and foes more emboldened.

### **NATO: Winter has come**

German industry and homes rely extensively on Russian gas, and winter has come. In Berlin, this is as true geopolitically as it is meteorologically. While Tallin and Warsaw will beg to differ, in Berlin the once-critical necessity of NATO cohesion might have seemed less vital today. Following WWII, the first Federal Chancellor, Conrad Adenauer, resisted the sirens' call of German neutrality as a ploy proffered by Stalin. Adenauer understood that the security of Germany and of Western Europe required that the Federal Republic become embedded in the West's economic and security structures, and party to the protection of the U.S. nuclear umbrella. But the heat that forged that cohesion has dissipated, and Germany has long been caught between East and West. In Berlin, improved relations with Moscow appeared to benefit Germany, and it was tempting to cozy up to Putin for the winter.

In Turkey, Recep Tayyip Erdoğan has sought greater leeway for himself, too – both in and outside of Turkey. While regional and domestic developments have sometimes put this NATO nation sideways with allies, Turkey has continued to emerge as a significant regional power in the Middle East. Moscow understood that for Ankara, a less adversarial relationship with Russia enhanced Turkish options in its own back yard.

In short, Russian-driven conflict in Ukraine had the potential to drive a wedge between NATO and two key constituent states. If the Russian invasion of Ukraine had succeeded in magnifying divisions within NATO, it could have made any meaningful response from any member state less likely, and accelerated the centrifugal forces at work within the alliance. While gaining Ukrainian territory unchallenged by NATO would have been a win for the Kremlin, weakening the alliance and foreclosing the possibility of Ukrainian ascension would have achieved key strategic imperatives.

### **Taiwan Strait: Playing a tough hand in Chinese poker**

The global security regime is underwritten by American power, the use of which is often avoided by the credible threat of force embedded in American security guarantees. The tension in the Taiwan Strait is outside the scope of this paper, but the fact of it is very pertinent.

Even if it was warranted and the United States desired to do so, it is doubtful that Washington could make a credible commitment to defend both Taiwan and Ukraine at the same time. Resources are stretched too thin, and simultaneous conflict in both theaters would accelerate the trend of Sino-Russian rapprochement. The two countries nearly fought a hot war in the second half of the last century, and their mutual antagonism was a significant strategic advantage to the West during the Cold War. An anti-U.S. Beijing-Moscow alliance would represent the emergence of a grave threat to American power and the current global order. In a simultaneous test of wills in East Asia and Eastern Europe, it is possible that America would need to

negotiate masterfully, or else choose one theater in which to draw a line in the sand. The recent announcement by Russia and China of a "no limits" partnership (directed against the U.S.) underscores the necessity and challenge of America playing its cards in a way that safeguards American and allied interests while driving a wedge between Beijing and Moscow.

Putin was tempted toward action in Ukraine because he knew that the long-developing U.S. "pivot to Asia" commands increasing attention and resources. He saw the U.S. acknowledging China as the greater geopolitical rival. The more keenly the U.S. senses risk in East Asia, Putin calculated, the less credible are U.S. commitments in Eastern Europe.

### **What to make of it?**

Upon the dissolution of the USSR in 1991, Ukraine inherited up to 3,000 nuclear weapons, the third largest stockpile in the world. By 1996, Ukraine returned its nuclear weapons to Russia, the accepted legal successor state to the USSR, in exchange for guarantees of its sovereignty and territorial integrity by the nuclear powers, particularly the United States and Russia.

Russia argues that its 2014 seizure of Crimea was instead a separatist action by Crimeans, and that Russia has no obligation to compel Ukrainians to remain part of Ukraine. Russia's invasion of Ukraine sweeps aside such convenient fictions and now forces the U.S. to assess the very real costs associated with all possible next steps.

### **There is no avoiding a decision and shouldering its attendant costs.**

Russia's decision to invade hinged on Moscow's perceived cost of aggression. Unfortunately, as we have seen, Russia believed that it had much to gain from belligerence in Ukraine, and possibly little to fear. To adapt the old bullsh quip, "if you liked the price of invading Ukraine in 2014, you're going to love it today."

To the Kremlin, action against Ukraine seems to offer the possibility of restoring national prestige and security through expanded borders; gaining a diminished Ukraine as a satellite; driving a wedge between NATO allies, weakening the alliance while checking its growth; and undermining the global security order and the value of U.S. security guarantees. This would grant Moscow more influence in the near-abroad and a freer hand globally, while enhancing Putin's prestige at home.

However, Moscow's favorable assessment of risk-reward is proving a serious miscalculation, with grave consequences for everyone.

Many conflicts escalate due to misapprehension of opponents' intentions, redlines, and resolve. Sometimes conditions on the ground escape the control of diplomats. Mistaken judgments or inertia have triggered modern conflicts from WWI to the first Gulf War.

As Ukraine's government and people continue to exceed expectations in the defense of their nation, U.S. and European resolve is strengthening. Consider that every possible gain by Russia is a loss to

Europe and the United States. For the West, the invasion of Ukraine could see a hostile actor extend its borders deeper into friendly territory; convert a former friend into a foe; weaken NATO, a bedrock component of the global order; and raise the prospect of further conflict, both in Europe and beyond.

Separately, the greatest constraint on U.S. options in Eastern Europe may be a U.S. assessment that it is necessary to retain greater freedom of action in East Asia – cold comfort, indeed.

**Whatever the appropriate attitude toward the crisis in Eastern Europe, it is not complacency.**

There are numerous yet dwindling paths forward available to Russia, Ukraine, and the West. Peace might still be restored. Conflicts can be contained. But there is a very real risk of events developing such that the U.S. and Europe will be forced to choose from a menu of only heavy costs. Statesmen will understand that over time some of the less robust options are pricier than they appear, if they jeopardize independence (a concern for Ukraine), the internal legitimacy of the regime (Russia), or the global security order (the West). This means that escalatory options are relatively more compelling than some observers may appreciate. It also means that once events reach a certain point, even if a wider open conflict is avoided today, tomorrow's risks are heightened.

Again, my purpose is not to prognosticate or to argue for any specific course of action. For investors, a singular future cannot exist – only many possible futures, which collapse into a singular past. It is necessary, however, to recognize the risks present in Eastern Europe and to observe that many possible outcomes entail significant consequences for supply chains, energy markets and commodities, international trade, sovereign issuers, and risk appetites. My hope is that this letter provides a useful starting point for considering what may unfold, and how attendant risks and opportunities may impact portfolios.

**About the author**



**Jordan Loh** is a Senior Vice President of Institutional Sales for Carillon Tower Advisers. He joined Carillon's affiliate Eagle Asset Management in 2010 and has 13 years of investment industry experience in equity capital markets and asset management. Loh earned a Bachelor of Arts in economics from the University of Florida.

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