

EU-Russia Economic Relations: Looking Ten Years Ahead

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The EU-Russia relations experienced several waves of relative successes and failures over the last 23 years. Signing a Partnership Agreement in 1994 (functional since 1997 until 2007, when it has not been prolonged) was an evident success. The years 2003 and 2004 happened to be a particular period of growing interest and optimism in economic cooperation and even integration of the European Union and Russia. However, in the following years, this issue receded into the background.

The current crisis over Ukraine has most serious implications for the EU-Russia relations, reducing them to something immeasurably smaller than two parties should enjoy. It is clear that a person suggesting economic integration between the EU and Russia (or, as a matter of fact, the emerging Eurasian Economic Union) risks being perceived as a madman now. Think, however, of a much longer perspective – say, a ten-year period. When the crisis subsides, the time will come to resurrect earnest talks on economic rapprochement.

Objectively, there is a solid foundation for being mutually interested in deeper economic integration, this time between the EU and the emerging Eurasian Economic Union (EEU). It is based on the territorial proximity; mutual energy dependency; colossal (from the EEU point of view) trade flows; the potential of

investment flows, coupled with the transfer of technologies; issues of soft and hard security; common neighbourhoods; the unresolved issues of trans-border energy and transport infrastructure and so on. After all, even the issue of Ukrainian sustainable development can be ultimately resolved only in the triangle EU-Ukraine-Russia. Neither side – West, Russia, and multilaterals – will be able to carry the financial burden alone.

A few words on the regional integration bloc where Russia has taken a natural leading role. The Customs Union (CU) of Belarus, Kazakhstan and Russia was created in 2010. It has been followed in 2012 by a comprehensive series of agreements establishing the Single Economic Space (SES) and aiming at a full-fledged single market. The member states intend to move forward the Eurasian Economic Union by 2015 (its closest analogue in terms of scope would be the European Union by 1992). The successful establishment of the CU, SES, and, finally, the EEU will call for a new perspective on the relations with the European Union. One of the biggest challenges for the EEU will be to finally move forward in its economic relations with the EU.

This is a mutual challenge as the EU, for its part, still has to recognize a new reality associated not only with problems but also with multiple opportunities. It is clear that Eastern Partnership approach – essentially a multiplication of virtually identical DCFTA agreements with the EU smaller Eastern neighbors – does not work particularly well. The EU, most importantly, has to recognize that its standard Eastern Partnership approach is not applicable to its eastern neighbor; a prospective regional economic bloc with five member states, ca. 180 million population and \$2.4 trillion GDP (these numbers include Armenia and Kyrgyzstan, which plan to accede the EEU soon).

Deep economic integration with the EU is extremely important to the emerging Eurasian Economic Union. First, the EU is the largest trade partner of both Russia and Kazakhstan. E.g., EU accounts for over half of Russia's commodity turnover, while Russia is, in turn, the EU's third largest

trade partner. Secondly, the EU may play an important role in resolving the EEU member states' modernization problems. The key instrument here is large-scale capital flow coupled with the transfer of technologies. Thirdly, the emerging Eurasian Union is currently initiating a number of free-trade agreements with smaller partners, from Israel to Vietnam. In this context, deeper economic integration with the EU is the main long-term challenge. Fourthly, Ukrainian problems may eventually be resolved only through deep economic cooperation between the EU and Russia, making this cooperation paramount for developing a stable common neighborhood.

However, Russia, Kazakhstan and its partners are not simply interested in a free-trade agreement, but in a deep and comprehensive agreement with the EU. The reason is straightforward: current EU-CU trade structure (commodities to EU, investment and consumer goods to CU) would make it such an easy ride for the European Union. Losses in the conditions of trade must be compensated by gains in other domains.

The prototypes of potential EU-Eurasian Economic Union integration are manifold. They include a deep and comprehensive free trade agreement (DCFTA) as well as a comprehensive economic and trade agreement (CETA). The latter is exemplified by the recent agreement between the EU and Canada. There are also prototypes of the Transatlantic Trade and Investment Partnership (TTIP) and Transpacific Partnership (TPP), currently under negotiation. We discuss the problem of choice elsewhere.¹ A point to be taken is the following: a prospective EU-EEU agreement should be both wide-ranging and deep to be, as a matter of fact, feasible. The obvious problems entailed by trade concessions should be compensated by advantages in other areas.

- DCFTA (Eastern Neighborhood)
- CETA (comprehensive economic and trade agreement) EU-Canada;
- TTIP EU-US
- A set of vertical agreements (EU-Switzerland)

Presidents of Russia and Kazakhstan have already voiced support for the idea of a deeper economic integration with the European Union. Vladimir Putin suggested putting a free trade zone with the EU back on the agenda during the EU–Russia Summit on January 28th, 2014. On February 5th, 2014, this proposal received explicit support from Nursultan Nazarbayev.

The scope of the prospective deal might include dozen of domains and policy areas. Let us list a few of them:

1. Trade in goods
2. Partial elimination (or, alternatively, streamlining) of non-tariff barriers
3. Third Energy Package.
4. Ukrainian gas transport system.
5. Rules of e-commerce.
6. Trade in services
7. Access to financial markets
8. Free movement of capital
9. Regulatory convergence
10. Intellectual property rights
11. Bilateral recognition of professional education certificates
12. Establishing a visa-free regime (including a package of readmission agreements)
13. A bilateral regime for Kaliningrad
14. Policies towards common neighbourhoods
15. Large-scale educational exchanges (such as Erasmus Mundus)
16. Development of cross-border transport infrastructure (automobile and railway corridors)
17. Establishment of the common electric power market
18. Competition rules
19. Mediation and settlement mechanisms

The negotiations are most likely to be difficult and prolonged. There are a lot of hugely complicated issues, e.g., the one of regulatory convergence.² Let us take a common electric power market (CPM) as a vivid example. The emerging Eurasian cross-continental dimension is critically associated with infrastructure, its daunting bottlenecks and a huge development potential. Relevant infrastructure sectors encompass railways, automobile corridors, electric power networks, and land-based fiber-optic links, to

name most important ones.³ Have a look at the map of potential regional and sub-regional common electric power markets (CPMs) across Eurasia (figure 1; prospective CPMs are drawn by dotted lines). Many of them entice policy-makers and investors by its strong economic and technological rationale, since common power markets tend to provide lower prices and stabilize energy systems by combining various types of energy generations. The greatest prize of all would be a CPM uniting the EU and EEU electric power grids. This is a concrete initiative entailing very concrete and quantifiable economic benefits.

Russia and the EU often demonstrate a deep misunderstanding of the essence of each other's integration processes and aspirations. On the whole, Europe tends to perceive Russia-led integration initiatives as products of 'Russian imperialism.' However, the post-Soviet integration project has a vital economic dimension which is expected to produce considerable benefits for the member states. It seems to be difficult for Europeans to understand the extreme depth of cooperation ties that have been inherited from the Soviet Union, and the vital importance of these ties for the modernisation of the economies of Russia, Ukraine, Kazakhstan and Belarus. There has hardly been a

precedent for a similar breakdown in the modern world, except, possibly, the breakdown of Austria-Hungary. It is not difficult to model mentally, though. Just make an effort. Imagine a breakdown of the current European Union (not only the currency zone but the entire single market, including free movement of goods, services, labour and capital). Now imagine all the incentives for Europe's re-integration in this case. And now triple the result, because the Soviet economy was much more intertwined than the economy of today's European Union is.

There are two major problematic areas between the European Union and the emerging Eurasian Economic Union. The first one is the absence of positive dynamics on the issues of trade, capital flows, energy, education, and security. The second one is competition for the western and southern flanks of Russia, which is also the eastern neighborhood of the EU. Countries such as Ukraine are in the focus of rivalry. With somewhat less intensity, the same rivalry applies to Georgia, Armenia and Azerbaijan.

Overcoming the current crisis will be a daunting task. However, in the longer term, EU-Russia relations deserve a break-through. It is time to think about deep changes in conceptual approaches on both sides. It simply makes sense economically and strategically.

Figure 1. Existing and potential regional and sub-regional electric energy markets in Northern and Central Eurasia



Source: Vinokurov E., Libman A. (2012) *Eurasian Integration: Challenges of Transcontinental Regionalism*. Basingstoke: Palgrave Macmillan, p. 133-143.

¹ EDB Centre for Integration Studies (2014) *Quantifying Deeper Economic Integration between the European Union and the emerging Eurasian Economic Union*. Report no. 23, April. EDB: St. Petersburg.

² See, e.g., Messertin P., Emerson M. et al. (2011) *An Appraisal of the EU's Trade Policy Towards its Eastern Neighbours: the Case of Georgia*. CEPS: Brussels.

³ Vinokurov E. (2014) *Emerging Eurasian Continental Integration: Trade, Investments, and Infrastructure*. *Global Journal of Emerging Market Economies*. Vol. 6(1): 69-93.