

How to open the Gordian knot between the EU and Russia?

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1. Trade and transportation

Russia's foreign trade has tripled during the past 10 years. Even if a part of the trade growth is due to an increase in the prices of natural resources, volume growth has also taken place. Increasing volumes lead to more transportation, which in turn stresses the importance of functioning borders and safe transport routes. As the European Union represents more than half of Russia's foreign trade, the EU-Russia borders face this increased pressure.

We have, each moment around the clock, truck lines exceeding tens of kilometres, if all the customs points between the EU and Russia are taken into account. A common goal should be that no truck is forced to wait more than four hours in the line before its customs formalities begin. Technical solutions are available. For instance, the electronic customs declaration could be applied in all the customs points between the EU and Russia. The electronic declaration should also be extended to Russia's borders with non-EU countries, or otherwise, the competitive position of the EU-based companies deteriorates in the Russian market. With the widespread application of the electronic customs declaration, the Russian State would get rid of double invoicing and gain billions of Euros, foreign firms would save valuable time, and ultimately Russian consumers would get cheaper import goods. Besides, the number of the Russian authorities at the borders could be reduced by minimum of one third, which would ease the labour situation, at least, in St. Petersburg and the Leningrad region surrounding it.

The Baltic Sea has become the largest export route of Russian oil. The oil shipments via the Baltic Sea at the moment already exceed those of the Black Sea and the deliveries via the Druzhba pipeline. In 2007, approximately 140 million tonnes of oil is estimated to be shipped through ports around the Gulf of Finland. By the middle of the next decade, the

amount is estimated to go over 250 million tonnes. Such a dramatic increase in oil shipments between the East and the West, hectic north-south traffic between Helsinki and Tallinn, and the long winter with a thick ice coverage has transformed the Gulf of Finland into a cradle for the next major oil hazard; possibly polluting the shores of the EU and Russia. Although vessel monitoring and the information system helps us in preventing a collision between ships, this is not enough, since single hull tankers are the major threat in the shallow and narrow fairways in the proximity of the City of St. Petersburg.

In addition to oil, natural gas has heated the discussion between some EU countries and Russia. As the Nord Stream pipeline seems to divide the Union, I propose that this gas pipe should be re-directed so that it would go via the Baltic States and Poland to Germany. The re-direction of the pipeline would be a fundamental gesture of goodwill from the Russian side, and this gesture would definitely support continent-wide integration in Europe. Even if the relations of the Baltic States and Poland with Russia are not at their best at the moment, these states are members of the EU, and hence, they should be regarded as reliable transit countries. Moreover, the land-based pipeline is obviously less risky operationally, environmentally more friendly, and financially less expensive. However, should the land-based pipe prove to be more costly, these four transit countries should compensate for the financial gap. Furthermore, these transit countries should not charge extra transit fees, since the use of the Nord Stream pipeline does not cause any extra administrative transit cost to its owners.

Even if Russia's share in the external trade of the European Union is not more than 8 %, the Union is dependent on hydrocarbon imports from Russia. Two thirds of the Union's Russian imports consist of mineral fuels, lubricants and related materials. In fact, Russia accounts for 43 % of the EU's imports of gas and 33 % of oil (European Commission).

Some EU countries are clearly more dependent on Russian trade and imports of fossil fuels than others. Generally speaking, the former socialist countries, the Baltic States in particular, are the most dependent on Russia. Paradoxically, a correlation between high economic dependence and poor relations with Russia seems to exist. Finland is an exception to this general rule. Finland has the highest Russian trade per capita within the EU and has

relatively functioning relations with Russia despite the fact that Finland has also had painful historic moments with Russia (Table 1.)

Table 1. The EU-Russia economic relations

	Russia's share of the country's		Trade with Russia per capita	Russia's share of the country's	
	Exports 2006	Imports 2006	€, 2006	Oil imports 2005	Natural gas imports 2005
Austria	2 %	2 %	568	28 %	70 %
Belgium	1 %	2 %	715	42 %	5 %
Bulgaria	2 %	3 %	76	89 %	100 %
Cyprus	2 %	1 %	78	0 %	n.a.
Czech Republic	2 %	6 %	559	71 %	76 %
Denmark	2 %	1 %	387	0 %	n.a.
Estonia	8 %	13 %	1 481	n.a.	100 %
Finland	10 %	14 %	2 638	81 %	100 %
France	1 %	2 %	225	11 %	20 %
Germany	3 %	4 %	633	34 %	42 %
Greece	2 %	7 %	350	32 %	84 %
Hungary	3 %	8 %	668	99 %	73 %
Ireland	0 %	0 %	84	n.a.	n.a.
Italy	2 %	4 %	361	21 %	32 %
Latvia	11 %	8 %	564	n.a.	100 %
Lithuania	13 %	24 %	1 526	100 %	100 %
Luxembourg	1 %	1 %	524	n.a.	n.a.
Malta	0 %	0 %	10	n.a.	n.a.
Netherlands	1 %	5 %	1 381	27 %	0 %
Poland	4 %	10 %	352	98 %	66 %
Portugal	0 %	1 %	72	0 %	n.a.
Romania	1 %	8 %	163	56 %	100 %
Slovakia	2 %	11 %	849	100 %	100 %
Slovenia	4 %	2 %	572	0 %	60 %
Spain	1 %	3 %	200	14 %	n.a.
Sweden	2 %	4 %	634	36 %	n.a.
United Kingdom	1 %	2 %	183	10 %	n.a.

Source: Compiled and calculated by the author from the data of Eurostat 2007: Various Statistics, <http://epp.eurostat.ec.europa.eu>

The Finnish experience shows that one should try to step away from the shadows of history and to search for constructive ways to go forward instead of searching for differences in opinions, systems or values. The EU and Russia are different enough to learn from each other but similar enough to collaborate with each other. The Finnish pragmatic approach on how to conduct relations with Russia might also be useful to some other EU countries. Even if Finland's bilateral ties with Russia are the most intensive among the EU countries, bilateral relations should never challenge the common approach of the Union towards Russia.

2. Movement of capital

Russia's ex-president Putin stated during the recent EU-Russia summit in Portugal that Russian investments in the EU total less than three billion Euros (The Moscow Times, 2007). I doubt the aforementioned amount, when I keep in mind that the United Nations suggests that Russia's total outward foreign direct investment (FDI) stock, by the end of 2006, was over 100 billion Euros. Additionally, my earlier studies indicate that the EU is one of the major destinations for Russian outward FDI.

The question here is not statistical but political, since Russia seems to imply that the EU restricts her investments in the Single Market, which is not the case – at least not yet. All foreign privately run companies are openly welcomed to the EU regardless of their country of origin as long as they do not create a monopoly inside the European market, they cannot be regarded as tools of any country's foreign policy and they obey the rules.

Instead of being afraid that the EU starts to exercise protectionism in order to slow down the expansion of Gazprom in the Single Market, I am more concerned that the Russian investment environment takes a more restrictive turn towards foreign firms. I am not only concerned about the possible Law on Strategic Sectors or the Mineral Resource Act, but I am even more worried about the future development of the so-called national champions policy, which in my understanding accumulates unpredictability in the Russian investment environment, because foreign investors cannot predict what will be the sectors where the champions will be created with the help of the Russian State. Here, one should not assume that state support would be only financial in nature. The non-transparent national champions policy

is more damaging to the Russian investment climate than is the restrictive legislation towards foreign firms (Liuhto, 2007).

I would like to stress that both the EU and Russia should keep their investment milieu as liberal as possible, and even more importantly, as predictable as possible, since that same predictability is one of the key determinants driving investments both domestically and internationally. Furthermore, I would like to underline the importance of competitiveness in attracting foreign investments and modernising economic structures. However, one cannot achieve improved competitiveness without intensive competition, and therefore, a national champion policy fostering oligopolisation and legislation restricting foreign competition does not help Russia become more competitive.

Reciprocity is generally a good principle of how to treat neighbours regardless of their size or political power. Now, the EU and Russia are on the ultimate edge of a new era of reciprocity, which I would term as the reciprocity of restrictions. Russia will obviously restrict the operations of foreign firms in defence-related industries, and probably thereafter, in some natural resource sectors. Correspondingly, the EU plans to restrict the operations of foreign state run companies in energy sectors in order to avoid the overwhelming concentration of production, transit and distribution of energy into the hands of any single company.

In order to avoid the vicious circle of restrictions, one should create an independent expert team of policy-makers, businessmen and academics to analyse how to create a free and predictable investment environment in the EU-Russia context. The EU-Russia Industrialists' Roundtable, accompanied by leading policy-makers and researchers could be a convenient way to form an objective research team, which could biannually produce a report on the EU-Russia investment climate and the main barriers hindering its further development.

At the end of the day, one should not forget that foreign investments are not only the cheapest way to obtain capital, modern technology and advanced management techniques, but the foreign enterprises per se are valuable since their business contacts build additional bridges between the EU and Russia, and hence, support European integration continent-wide. Due to differing opinions at the political level, all the additional actors are needed in keeping

the dialogue constructive. I cannot say if there are some parties outside the EU and Russia, which would benefit from our poor relations, but I am sure that there are only few marginal groups inside the Union and Russia, which would gain from an investment and trade war between us.

3. Movement of people

Unnecessary technicalities preventing the free movement of people should be identified and abolished, when the explicitly specified conditions are met. The external travelling of the Russian citizens living in Kaliningrad could be solved, for instance, by establishing a conditional visa free zone between the EU and Kaliningrad for a period of 10 years. If this zone proves to be mutually acceptable, the visa free regime could be made permanent after this tentative period, and the EU and Russia could consider the extension of the zone to the Russian mainland.

Here, one should not forget the integrating power of people-to-people contacts. Whilst I have stated so, I regret that the grass root level contacts between the EU and Russia are clearly below their potential. The EU-Russia Centre in Brussels indicates that only 18 % of Russians have visited a non-CIS state at least once in their lifetime. Most likely, the proportion of EU citizens having visited Russia is even lower (EU-Russia Centre, 2007).

If the decision-makers at the top cannot decide upon a common path for the EU and Russia, let the grass roots strengthen the ties between the Union and Russia. When we speak about the free movement of people, we should not forget that already in the foreseeable future the EU faces a labour shortage unless the EU member states liberate their immigration policies. The Russian labour force would definitely adjust to EU conditions and cultures easier than those immigrants arriving from far-away countries.

Several million ethnically Russians already presently live within the EU, particularly in Germany, Spain, the UK, and the Baltic States. Though it is difficult to comprehend the accusations that the ethnically Russian minority is discriminated against in the Baltic States, such allegations are so serious that they should not be neglected. In order to objectively clarify the situation, an independent group of specialists – representing the parties concerned and third countries – should fully analyse the case.

All in all, common research efforts are necessary to pinpoint aching areas in EU-Russia relations. I support the idea of Russia to open and fund an institution in Brussels to monitor the rights of the ethnic minorities, immigrants and media in the EU as long as the analyses are conducted jointly (von Twickel, 2007). This idea should be applied in a reciprocal way, in other words, common research efforts should take place in the EU-funded research centres in Russia as well. Independent research teams consisting of scientists from both sides and perhaps from third countries could provide fresh ideas on how to improve mutual relations.

To conclude, contemporary EU-Russia relations are seriously constrained by a number of fundamental issues. In order to open the Gordian knot which has arisen between the EU and Russia, the parties should focus on collaboration, through which both parties can obtain tangible results already in the short and medium term. I do not ignore the significance of grand visions, but if the major leap cannot be implemented under the present conditions, we should focus on smaller steps, since these small victories could help us to prepare soil where the grand ideas can flourish. Therefore, I suggest that both the EU and Russia should agree on a list of operational targets, which can be fulfilled by the middle of the next decade, instead of aiming at a rhetoric strategic partnership. These small steps allow us to avoid the ancient opening mechanism of the Gordian knot.

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