

# Russia and the EU: Cooperation or Protectionism?

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**R**ussia is the third largest trade partner of the EU (after the US and China), accounting for almost 9% of its external trade turnover. The EU is even more important trade partner of Russia: more than half of Russian trade is conducted with EU member countries. What concerns foreign direct investment (FDI) incoming to Russia, some 75% of its accumulated stock is owned by the EU based firms.

The trade and investment relations which have already reached a meaningful level would be further strengthened if both partners concluded a free trade agreement. In the last few years CASE – Center for Social and Economic Research has prepared the two subsequent feasibility studies of the potential FTA agreement between the EU and Russia commissioned by the European Commission – Directorate General for Trade. Both of them demonstrated that further trade and investment liberalisation (beyond the Most Favoured Nation clause as

determined by the Partnership and Cooperation Agreement) will be beneficial for both sides, especially if parties opt for the so-called deep FTA, i.e. agreement which will not only eliminate import tariffs (not so high, especially on the EU side) but also involve substantial reduction of non-tariff barriers, further liberalisation of trade in services and FDI regime, as well as a great deal of regulatory approximation between Russia and EU.

Due to asymmetry in economic potential (total GDP of EU is 11 times larger than that of Russia if current exchange rates are used and 6.7 times higher if estimation is done in PPP terms) the benefits of hypothetical FTA are larger for Russia than for EU. However, all EU economies will benefit from such a deal, especially those of Finland, Ireland, Netherlands, Denmark, Estonia, Slovakia, Slovenia and Sweden.

The benefits for the Russian economy would come not only from the increased

trade flows but from regulatory regime more compatible with that of the EU, improvement in business and investment climate, and modernisation facilitated by larger flows of FDI. However, the way from the current status quo to the deep FTA both concluded and implemented seems to be long, complicated and uncertain.

First of all, Russia has not completed its accession to the WTO yet (actually this is the largest economy remaining outside this important global organisation) and WTO membership is considered as a precondition to start FTA negotiation by the European Commission not only in respect to Russia but also in respect to all other trade partners. This position has an important merit as the FTA commitments are to be built on the legal and institutional foundations of the world trade system codified in various WTO agreements and protocols. In 2004 Russia concluded bilateral market access negotiation with the EU and signed the WTO-accession-related protocol with the

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EU. The EU side has the right to expect that this protocol will be ultimately confirmed in Russia's accession agreement with the WTO.

However, it is worth to remember that EU made some exceptions in the past, negotiating trade and association agreements or stabilisation and association agreements with the EU candidates, in parallel to or even ahead of their WTO accession negotiations.

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Russia started its WTO accession process in 1993, i.e. sixteen years ago, but it seemed to lose its political momentum in the last few years. Although on December 1, 2008, Russia had finally completed bilateral negotiations on terms and conditions of market access for goods and services with all the members of the WTO Working Group the multilateral negotiations on systemic issues were not finished yet. Making things worse, in June 2009, the prime ministers of Belarus, Kazakhstan and Russia announced publicly that they were willing to accede to WTO as a customs union. Taking this declaration seriously, it would mean either starting a WTO accession process from nil or at least its further considerable delay.

Various ad hoc decisions taken by the Government of Russia, very often under pressure of the specific industrial interest groups, do not help the WTO accession either. The examples include introducing export tariffs for exported Russian timber or additional import tariffs for car, both considered by the EU side as departure from Russia's previous commitments. The zigzags in Russia's trade policy seem to reflect a lack of consensus inside Russian authorities and the business elite as well as complicated political economy and politics of the WTO accession process.

Even assuming optimistically that the WTO accession will be completed soon one may doubt whether the same kind of problems will not be repeated during negotiating an FTA. Potentially, some EU industries (for example, metallurgy) may also fear of increased competition coming from Russia. The additional obstacle can come from the fact that FTA will be, most likely, the part of a larger political deal, i.e. the new treaty between Russia and EU, succeeding the PCA. Under such scenario, trade negotiations may become easily a hostage of political agenda on both sides, including a number of sensitive issues in bilateral relations between Russia and individual EU member states (in fact, this happened already at the start of negotiation which was delayed by almost two years).

One such sensitive issue relates to supply of energy resources from Russia to Europe. Without any doubt the importance of cooperation in an energy sector is going beyond the purely trade and economic considerations. Several EU economies depend heavily on import of Russian natural gas and oil and any disruption in delivery (like that in January 2008 caused by the Russian-Ukrainian gas conflict) makes their

economies and societies highly vulnerable. Two further problems in this sphere relate to the Energy Charter Treaty, an EU-backed multilateral agreement on energy investment and transit rules which Russia signed in 1994 but never ratified and monopolistic structure of Gazprom incompatible with the blueprints of EU energy market liberalisation.

Looking further ahead, the biggest questions relates to future Russia's ability to generate sufficient volumes of oil and gas export to Europe, taking into consideration both poor investment climate in Russia's energy sector and uncertain level of energy prices. This is probably a more serious problem than the geography of new oil and gas pipelines, the issue which has always raised the biggest excitement and controversy. The bottom line is that it must be something to be transported through these pipelines.

The global financial crisis and resulting economic downturn hit heavily both EU and Russia. Previous investors' optimism disappeared, risk perception increased, commodity prices went down, capital inflows were replaced by capital outflows. In each country there is a natural temptation to resort to protectionist measures but ultimately they will always bring more harm than good to those who initiate them. It makes more sense to choose the alternative strategy: more trade, more investment and more business predictability as the way to help economy to recover. More trade means also usually more confidence in political relations.



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