



Looking beyond sanctions? Prospects for economic interaction between the EU and Russia

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EU and Russia still important partners in spite of political crisis

Participants from both sides agreed that Russia and the EU remained important economic partners – regardless of the prolonged political crisis and mutual sanctions.

Russia expected gas demand on the European market to be high at least until 2035. From an EU perspective, too, Russia maintained its importance as an energy supplier and a significant market. Energy relations had not (yet) been seriously affected by the sanctions. Indeed, in 2017 Gazprom had been able to consolidate and expand its position as the main supplier of natural gas to the EU. This was possible thanks to its increasingly competitive behaviour, but also due to the gradual withdrawal of Norway and other previously important suppliers.

This overall positive assessment became more nuanced during the discussion. It was pointed out that, whilst the sanctions had little effect on the aggregate economic relationship between Russia and the EU, trade relations with individual EU Member States were affected to varying degrees. EU speakers argued that this increased the risk of political divisions inside the EU. Moreover, some Russian speakers warned that EU financial and sectoral sanctions would have significant impact in areas such as technology transfer and R&D in the future. One participant predicted that Russia risked incurring serious delays in the development of offshore Arctic oil fields, which would lead to a decrease in oil production and shortfalls in deliveries in the years to come.

There was concern among participants that mutual sanctions will cause the

sides to drift further apart as business communities adjust to new realities. In Russia specifically, one EU speaker explained, sanctions had been used deliberately to shield the agricultural sector from international competition.

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and called for more exchange between Russian and EU economists to come to a joint understanding of those effects.

Russia-China intensified relations: part of a natural process of "catching up"

EU and Russian speakers saw Russia's intensified relations with China and Asia not only in the context of deteriorating relations with the West, but also as part of a “natural process of catching up” with broader international trends. They also expressed doubts, however, regarding the actual potential of economic and trade relations with China. Prompted by EU and US sanctions, Russia had started to obtain more technologies and machinery from China – with mixed results regarding standards and quality.

From a Russian perspective, one speaker explained, China was perceived as a monopoly consumer with a very unclear future. Beijing, on the other hand, considered Russia merely as a supplier of energy resources while Russia bore all the risks of the energy relationship.

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Economic sovereignty and import substitution: swimming on land in a globalised world?

Participants agreed that the future of EU-Russia economic relations depended on the development of economic policies and openness to the outside world on both sides. Russian speakers were somewhat divided about the official discourse in Russia. One speaker referred to the Economic Security Strategy, which was approved by President Putin in the summer of 2017. While introducing the term economic sovereignty, most of the challenges outlined in the document had been known for a long time, such as de-industrialization, insufficient competitiveness, excessive red tape and economic disparities within and across Russia's regions. Russian participants disagreed on the concept of import substitution. Some claimed it had waned in significance, while others acknowledged efforts undertaken, especially in the areas of high technology and R&D, to become more independent from Western imports. One speaker argued that the transition to import substitution in 2014 had been based on political considerations rather than on economic necessities.

EU participants questioned the validity of concepts such as economic sovereignty or import substitution in a globalized world and compared them to attempts to “swim on land”. One speaker conceded that economic sovereignty was an option for large and internationally competitive economies – but impossible to achieve for smaller and more dependent ones.

The EU's attitude towards economic interdependence and globalisation

EU participants stressed that not only political elites but also societies in the EU displayed a positive attitude towards economic interdependence and free trade. This attitude could be traced back to the Union's origins as a customs union in the 1950s. Unlike other customs unions, it was pointed out, EU Member States relied to a much larger degree on intra-EU trade than on trade with third countries. A high degree of interdependence among EU economies had prepared them for opening up to global trade – with the exception of sensitive areas such as the agricultural sector. The EU, one EU speaker underlined, was probably

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EU participants also discussed societal resistance to globalization and free trade, a phenomenon which has increasingly emerged in EU Member States in recent years. One speaker argued that protests, for instance against the Transatlantic Trade and Investment Partnership, were motivated less by a general rejection of globalization than by concerns that modern free trade agreements could deprive governments of their ability to act autonomously in important areas of public policy. Populist and nationalist movements merely exploited these sentiments without, however, addressing their root causes.

Economic modernisation and diversification in Russia

Participants agreed that the modernization and diversification of the Russian economy would serve both Russian and the EU interests. When discussing why in the 26 years of its post-Soviet history Russia had been unable to modernize its economy, Russian speakers pointed to the drastic consequences of the liberal reforms undertaken in the early 1990s, which had had a lasting negative effect on attitudes towards reforms both in society at large and among the elite. One Russian participant called on the EU not to forget that it, too, needed to instigate reforms to overcome some of its structural problems. EU participants objected that there was an ongoing process in the EU of reflecting about and acting on reforms. Moreover, the economic situation in the EU was considerably more favourable today than a few years back. The EU's core economies continued to be very competitive, while the weaker and crisis-ridden economies had implemented reforms successfully over the past years and were on the road to recovery.

EU speakers stressed that the EU had a vested interest in a sustainable and diversified Russian economy.

This would not only make Russia a more attractive economic partner, but would also have a stabilizing effect on the whole region, including on the EU, in economic, political and security terms. Participants discussed EU support for Russian small and medium-sized enterprises (SME) as one way of fostering diversification. However, one speaker pointed out that as

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SMEs had no strategic importance in the Russian economy, the EU should also consider encouraging investment in certain strategic sectors, despite the predominance of large, partly state-owned companies in them. One EU speaker pointed to the discrepancy between current trends in Russian policy-making and the EU's transformational agenda. This discrepancy limited policy choices for both the EU and Russia. Other EU participants expressed doubts about the EU's capacity to efficiently support economic reforms in a country like Russia.

More interaction between the EU and the EEU?

Russian participants described the development of Russia's economic policy in its neighbourhood as characterized by inertia for much of the post-Soviet period. The creation of the Eurasian Economic Union (EEU) was the first positive sign of a more proactive Russian policy. As one Russian participant put it, Moscow was able to come up with a project like the EEU only when the EU and the US became a real challenge in the neighbourhood. Russian speakers stressed the progress the EEU has achieved so far, both in terms of enlargement and deepening integration. Special attention was given to emerging contractual relations with third countries, for instance a free trade agreement with Vietnam (2016) and, more recently, a preferential trade agreement with China (2017). The latter, even though much more modest in scale than a free trade agreement, was seen as a major achievement that would pave the way for deeper cooperation in the future. On a more sceptical note, one Russian speaker observed that the EEU's contribution to Russian growth was rather small and unlikely to grow in the future.

Russian speakers were very critical about the role played by the EU in the common neighbourhood. Unsurprisingly, the key bone of contention in this part of the discussion was Ukraine. Russian participants claimed that Brussels' refusal to grant Russia access to the DCFTA negotiations with Kyiv was the main cause of the current crisis. In the words of one speaker, the EU had told Russia "our business with Ukraine is not your business; but in fact the substance of the [DCFTA] negotiations was our business, and now it is the business of the whole world". Nonetheless they stressed that both Russia and the EU should continue to explore opportunities for cooperation between the EU and the EEU and listed a number of potential areas where such cooperation

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EU participants were divided about the extent to which cooperation with the EEU was possible. They pointed to the persisting weakness of Eurasian integration, and to the limited mandate of the European Commission in its dealings with the EEU. They also stressed that the Russian side did not sufficiently appreciate contacts already existing at the technical level. Other EU speakers called for the EU to take a more open approach towards the EEU. They argued that the failure of the trilateral negotiations between the EU, Ukraine and Russia did not imply that there was no potential for such talks in the future. Here the EEU could even play a positive role if its non-Russian member states became more involved. Lengthy periods of implementation of the DCFTAs with Ukraine, Moldova and Georgia could allow more time to explore areas with more flexibility regarding EU standards. Many products from those countries would ultimately not reach EU markets. The EU could, therefore, consider their exemption from the application of DCFTA standards, which could facilitate trade with Russia. The EU could also consider elevating contacts with the EEU from a technical to a more formal level. EU participants stressed that the Comprehensive and Enhanced Partnership Agreement (CEPA) between the EU and Armenia demonstrated both the EU's willingness to take a more flexible approach towards its eastern neighbours, and its ability to devise solutions that allowed them to pursue their interests with the EU and Russia.

How far until a tipping point?

The discussions during the meeting proved that the EU and Russia maintain substantive economic relations. They also demonstrated, however, that after four years of crisis interdependence is shrinking. Speakers did not rule out that there may come a tipping point beyond which rebuilding the relationship – both economically and politically – would not be possible. Participants from both sides expressed a strong desire to explore opportunities for economic cooperation beyond sanctions.

'Discussions demonstrated that after four years of crisis interdependence is shrinking'

However, whether or not Russia and the EU would be able to capitalize on such opportunities depended, as one speaker put it, on what was domestically feasible on both sides.

EU-Russia Experts Network on Foreign Policy (EUREN)

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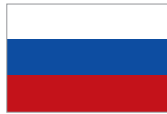
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Not all core group members were present.
The Chronicles do not necessarily reflect the opinion of the core group.

About EU-Russia Experts Network

The **EU-Russia Experts Network on Foreign Policy (EUREN)** was initiated by the EU Delegation to Russia at the beginning of 2016 as a new form of interaction between EU and Russian foreign policy experts, analysts and think tanks.

EUREN brings together experts, analysts and foreign policy think tanks from Russia and EU member states to discuss topical foreign policy issues with the aim of coming up with concrete recommendations. The network meets on a quarterly basis inviting approximately 30 experts for one or two full days of discussions on a given topic. The meetings take place at the venues of the participating think tanks, both in Russia and different EU capitals.

About this edition

This edition of the **EUREN Chronicles** is the result of a two-day meeting discussion that took place on the premises of the **Russian International Affairs Council (RIAC)**, Moscow, 8-9 February 2018.



Public Diplomacy EU and Russia offers a platform for dialogue between Russian and EU selected audiences on a number of bilateral and global issues. Personal ties built over the years are an indispensable element of our relations with Russia, particularly with an eye to the future of the next generations.

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