

RF – EU: scenarios for the future

During recent Great Recession (2008-2013) Russia proves its importance as a reliable economic partner for EU. During just four crisis years export from EU to Russia completely doubled. Russia's FDI to EU countries grew up by 86% during same period of time. In my perception, Russia supported EU output during the crisis time and played much more positive role in than say South European countries. Despite of 6% decline of Euro share on global foreign exchange market where its fell by 15% (to 33%) in April 2013 from (39%) in April 2010, and strong doubts couple years ago about sustainability of Eurozone, we kept stable share of Euro in our foreign exchange reserves.

Last year our trade turnover outperform the pre-crisis indicators. The 5 major Russia's trade partners are China, Netherlands, Germany, Italy, Ukraine.

Here is our forecast for GDP, based on demographic outlook and labor productivity growth assessments. What is important here: 1) US going to outperform EU, according comparisons both in PPP and current exchange rate. 2) China, despite its future leadership in PPP terms since 2020, will be lower according its future GDP than US and EU in current exchange comparison.

Russia during crisis period lost its leadership as a prime gas supplier to EU. We are not overdramatizing that situation. There are visible oversupplies on this market, but we still keep rather strong market position. As producers and consumers we are in a different part of the market equilibrium with EU. So if for EU the mantra is diversification of supply, for us - diversification of demand. After Fukushima, Japanese market became the most premium one. There are growing LNG supply to Tokyo from Sakhalin, some new projects

under consideration as well as ongoing active penetration on Chinese and in nearest future – on South Korean markets.

The geopolitical environment in hydrocarbon markets is changing. Five biggest oil producers comprise Iran and China now. These countries are key stakeholders. But at the same time, China and USA are high volume oil importers. But the trends in these two countries are oppositely directed. **Chinese dependence on import, will rise, whereas USA are moving in the direction of energy independence.** It's already 3 years since USA has been outperforming Russia in gas production. Though the country still remains high volume gas importer (from Canada), in 3-5 years the United States has a good chance to become a net gas supplier. Moreover, shale oil and oil sands intensive exploitation may lead USA to energy independence in 10-15 years.

To make the long story shorter we at IMEMO normally considered four key areas of cooperation: 1-4. Due to the high unpredictability of the future cooperation with EU let me suggest both optimistic and pessimistic scenario options for each area.

Commodity trade

In my perception, development of the common EU- Eurasian economic area could be a game changer, could help overcome the problem of the EU's decreasing share in the global economy. Unfortunately, a rapid process of negotiations around free trade agreement is impossible. Firstly, Russia needs several years for adaptation to WTO's norms. Secondly, Russian partners in Customs Union (Belarus and Kazakhstan) should also integrate in the modern international trade system. However, I do not foresee any other productive alternative for such a process. For example, it is very dangerous to put "Ukraine dilemma" in agenda of EU-Russian trade relations. It is an economic exaggeration and political mistake that Ukraine should make a choice between EU and Russia. However, such a strategy is very popular by politicians both in the EU, Russia

and Ukraine. The only result will be trade wars and new non-tariff barriers across Wider Europe.

Before that, not to waste we may continue now elaboration and implementation along the line of WTO's set of norms for trade barriers diminishing. Such as: one custom principle, one window for paper submission, mutual recognition of phytosanitary documents, gradual unification of technical regulation and anti-dumping investigation.

Investments in technologies

In the field of manufacturing there are also two options. Of course on the Russia side there still a huge home work for domestic business climate improvement.

Despite intensive FDI flows in both directions, we cannot see real investment cooperation between Russian and the EU. Both European and Russian TNCs prefer market-seeking and resource-seeking FDI. Sometimes, they meet investment protectionism because current political and economic interests of partners are not the same. Such tendencies can continue for a long time. Nevertheless, there are many opportunities to elaborate a productive EU-Russian cooperation in the field of FDI by development of various global value chains. European and Russian TNCs can reach synergy in their expansion in Central Asia, China, Africa or Latin America. Of course, in many cases such opportunities can be exploited only after modernization of Russian industrial plants. Reindustrialisation – urgently needed in Russia. Some lessons could be borrowed cooperation between Russian Space Agency and NASA.

This is the map of foreign expansion of 20 Russian non-financial corporations. The prime area is EU, CIS countries on the 2 place, with more than 30% in Ukraine and than – Northern America. Despite, that China is our trade partner number 1, as for many

other countries, there are rather small investment activity of Russian companies.

For example, our investments in France 16 times bigger than in China. And French investments in Russia is 4,6 times more than in China. In my perception, this demonstrates that Russia-France business confidence is bigger than between those two countries and China.

Energy cooperation

Key challenges for energy cooperation

- **Different goals for the common energy market**
 - Russia**
 - **Maximizing profits**
 - **Preservation of its market share**
 - European Union**
 - **Energy liberalization**
 - **Diversification of energy supply**
 - **Competition on the basis of common European rules**

Result: ongoing debates on the EU's Third energy package, which stipulates the separation of companies' generation and sale operations from their transmission networks. Russia is seeking exempt status of the European parts in Nord Stream and South Stream. Third energy package is also an obstacle for Russian participation in privatization of European energy companies.

- **Extreme politicization of energy issues by both sides**
 - **Russia's outmode claim to be an energy superpower is still often (incorrectly) seen as hegemonic aspiration, especially in CEE countries.**
 - **Consequences of Russian-Ukraine gas conflicts which provoked debates on Russia's reliability as natural gas supplier**
 - **EU's using political pressure to angle for fuel price cuts.**

Example: in September 2012 “Gazprom” accused the European Union of levying political pressure against the company in a bid to force down prices. This statement came after the EU launched a probe into the company's alleged violation of antitrust laws.

➤ Protectionist measures in several European countries, afraid of Russian presence in their energy sector

- Surgutneftegas trying to buy MOL in Hungary
- Gazprom trying to buy “Centrica” in the UK
- current privatization of DEPA in Greece etc.

- The lack of legal basis

Existing documents, signed by both sides (Roadmap on the common economic space, Partnership for modernization, EU/Russia Roadmap for Energy Cooperation until 2050), provide only a loose regulatory framework for further cooperation.

Energy cooperation: new opportunities

Due to the complexity of current energy issues between Russia EU, the focus should be shifted to the concrete spheres of cooperation, which have a high, yet unrealized potential:

➤ Energy efficiency cooperation

- Russia has huge energy-saving potential and can take advantage of European technologies, solutions and experience.

- Energy efficiency is not as sensitive and politicized issue between Russia and the EU, as gas.

- Russia is trying to quickly develop an up-to-date legal basis for energy saving and energy efficiency increase.

- At the same time it lacks long-term financial capital implementation of energy efficiency projects and is interested in FDI in this field.

- There are several success stories of European companies' involvement in that kind of programs (“Fortum”)

➤ Cooperation on renewable

Though currently underdeveloped it has a great potential in several spheres:

- the support and promotion of renewable energy resources in the Russian Federation with the help of EU technology and best practice;
 - exchange on financial and other support mechanisms;
 - Development of synergies between renewable energy resources and traditional fuels as back-up capacity, notably natural gas
- Cooperation in exploration and development of remote oil and gas fields (with participation of European investments), such as Eastern Siberia, Arctic region, Russian Far East, application of new European extracting technologies
 - Attracting investments in small-scale LNG-projects (for example, the projecting LNG-Plant Pechora), located close to the European market.

Humanitarian contacts

International relations do not always consist of relations between countries and their groups. In epoch of globalization contacts between people can influence international relations significantly. However, so named humanitarian contacts usually suffer from barriers of previous epochs. The best example in EU-Russian relations is connected with the relict of “cold war” – visa regime. It is impossible to develop productive cooperation within Bologna process or 7th Framework Program when students and scientists regularly receive only 3-days or 7-days Shengen visas. Of course, we can find many reasons for the growth of xenophobia in the EU. However, the crisis of multiculturalism was produced predominantly in brains, not in life. It is impossible to develop efficient economic and political relations with strategic partners like Russia and at the same time to elaborate new barriers between EU and Russian citizens.