

Russia and the EU

Speech by Peter Mandelson at the EU-Russia Centre

Brussels, 17 October 2007

In April I gave a speech like this in Bologna, on the same subject of the EU-Russia relationship. I argued then that relations between the EU and Russia were probably as difficult as they have been for a decade or more.

At the time I was rebuffed by some for my pessimism – or, more accurately, the concern that was interpreted as pessimism. But I think that my original analysis was right – I think if anything it has been reinforced by the last six months. And I think that any honest observer would accept that we are in a period that will test the EU-Russia relationship very seriously. Those of us on both sides who believe in the long term strategic and political importance of the relationship - who have absolutely no doubt that Russia and the EU cannot afford to see this often strained partnership deteriorate or weaken - have to be concerned.

Fundamentally, on the EU and Russia, I am not a pessimist – I certainly try not to be. But, to date, we have only a relatively brief modern experience of managing a relationship, as opposed to conducting a Cold War. Inevitably, Russia and the EU have very different perceptions of the period since 1989, as well as a lot of residual distrust, and I think that for this reason there is still a very great extent to which we do not understand each other as well as we need to. But there is also beyond that a much deeper hinterland of common European history and culture, and many on both sides who wish to see the EU and Russia grow closer together once again.

There is no reason to believe that this cannot happen. But good reason to fear that it will not if the political relationship is mishandled. The next year is likely to put strain on the EU-Russia relationship at precisely the points where it is most sensitive.

The transfer of Presidential power in 2008 will be closely watched and read in Europe and elsewhere as a bell-wether of the direction of Russia's politics and the development of its democracy. So will developments in the relationships between Russia and its near neighbours.

There are also diplomatic challenges. The EU will want to find agreement with Russia on the future of Kosovo. President Putin's visit to Tehran yesterday further reinforced the need for the EU and Russia to deal with Iran's nuclear programme within the UN framework as a collective security problem.

But what is really striking about the EU-Russia relationship is that political and strategic questions like these still share the same political stage with disputes over timber export taxes and the food export ban that is holding up the negotiation of the new EU-Russia bilateral treaty. Regardless of who is right or wrong, issues like these should not be allowed to dominate our relationship.

Yet because we have not put the fundamentals in place - because, if you like, the relationship doesn't have clear tracks to run on - the political machinery of the EU-Russia relationship repeatedly snarls up on the details, and the heavy emotional charges of history they carry on both sides. The relationship becomes all about short term political tactics, and not enough about long term objectives.

I want to focus today on how we can put some of the economic fundamentals in place, above all by integrating the EU and Russian economies better and getting Russia into the WTO. Because, of course, this area is closely tied to my work as Trade Commissioner, but also because closer economic integration is arguably the most effective way to anchor our changing societies and economies in habitual and mutually beneficial cooperation. And in doing so to counteract the inevitable political pressures threatening to pull them apart.

Closer economic integration

The economies of Russia and the EU look a bit like two cities joined only by a narrow road – and a gas pipeline. For two such large and economically complementary neighbours there is a striking lack of economic integration. If you remove energy from the mix, Russia's exports to the EU are about the same as those of Morocco or Argentina.

Russia is not really capitalising on the fact that it is so close to the huge European market, with strong human resources and a strong scientific and industrial tradition. In part because it lacks the stimulus of greater trade, the Russian economy is under-diversified and its SME sector is underdeveloped.

In the other direction, opportunities for EU trade and investment in Russia are limited by an uncertain business and political climate and barriers to imports. Current FDI rates are good and EU markets are pretty bullish on Russia, but for more risk adverse investors and traders outside of the energy sector there is still too little legal confidence and security. And, as I have said before, we look in Russia for the entrenchment of a political and social system based solidly on the rule of law.

This is why I have always supported Russia's long-standing desire to conclude negotiations on accession to the WTO. WTO membership is not a cure-all for Russia's international economic challenges, but it is an inevitable first step, an essential springboard to closer economic integration with the EU and the global economy – and the growth and prosperity this will bring. It is the basic confidence builder for an economy looking to attract investment and trade. It is also the necessary first step towards an EU-Russia Free Trade Agreement and the basis for the kind of trade and investment opening we want to achieve through the negotiation of the new Partnership Agreement. The WTO is not a strait-jacket we are trying to force Russia into; it is an opportunity that Russia is seeking.

I know that there are some in Russia who believe that current inflows of foreign investment and the oil and gas cushion mean that Russia has no need of further economic integration into the global economy or with the EU. That a protected economy means a more secure economy. In my view, this cannot be right. More than four fifths of Russia's exports are still hydrocarbons, raw materials and semi-manufactures – which means that more than a third of Russia's GDP is tied to commodities with volatile international prices. High energy prices are not the economic icing on the cake in Russia, they are the cake itself. Without the high prices, the cake shrinks. That's why Russia needs a more diverse economic platform on which to keep building its income growth.

The bottom line is that whatever the costs of WTO membership in accepting to live by international trade rules and reducing the arbitrary discretion of the state in trade – and that is unfortunately a real question at least for some in Moscow - the gains from stability, economic diversification and growing trade and investment outweigh them many times over.

President Putin has repeatedly said that he is committed to WTO membership as the next step in Russia's global economic engagement, and as a ratchet for much of his own reform programme. The departing trade minister German Gref – to whom I would like to pay tribute -

saw it as integral to the Russian reform agenda. So does the new Minister Elvira Nabiullina, with whom I shall be speaking to later today.

The great majority of conditions for WTO accession for Russia have been negotiated. The EU has not added any new ones. Both the objective and the timetable are clear. We have arrived at a point where only political will in Moscow can close the remaining distance. I hope Russia will capitalise on the time remaining to this administration to resolve the final issues, rather than pushing the issue onto the desk of its successor. Indeed, we should strive to resolve the remaining issues between us ahead of next week's EU-Russia Summit in Mafra.

Energy politics

Energy is closely linked to this economic integration process. It is the biggest single issue in our economic relationship. Because of the structure of the energy sector in Russia, and the lack of a bilateral legal framework for energy trade and investment between us, there is a widespread concern that energy trade has been politicised and become less predictable.

Energy dependence on Russia is an inescapable part of the EU's short and probably longer term future – we have to accept that. But we also need to recognise that Russia has been a reliable supplier for many decades. Nevertheless, it is a simple reality that a quarter of the EU's gas needs are supplied by one foreign company. So the EU is understandably looking for stability, legal predictability and security as well as energy.

If the EU wants security of supply it is fair to say that, given the huge costs of developing new fields and transport, Russia is equally entitled to security of demand from its biggest market.

There has to be a meeting of interests here. I accept that we have different views of how energy markets should ideally work. The EU wants – broadly speaking - competitive markets with strong rules, genuine rights of transit and the separation of energy production from distribution. Russia prefers state ownership, exclusive rights, vertical integration and limited transit rights. Russia would probably prefer asset swaps as a way of integrating the EU and Russian markets, while the EU is oriented towards a genuinely integrated and transparent cross border market. It is time we stopped attributing deep value judgements to these two views, and got on with agreeing how they can interact and be brought together. The EU's decision to allow foreign control of transmission pipelines only by companies whose governments have signed agreements with the EU is not intended to keep those companies out. It is a way of promoting balanced opening with third countries while guaranteeing the security and integrity of the network.

It seems to me that an agreement that allows Russian investment downstream and European investment upstream, anchored in a broader economic integration agreement between the EU and Russia, would take a lot of the politics out of energy trade, without in any way denying Russia's legitimate right as a state to take the maximum benefit from her oil and gas.

Better political management

Running alongside this economic integration agenda is the inevitable necessity to improve and strengthen political ties between the EU and Russia. The European Commission is one of the EU's most important interlocutors with Russia and the body that deals with the inevitable periodic irritants but we could build a much denser network of political contacts.

Obviously the EU also needs to make sure that this network of contacts is delivering a coherent and consistent message. Enlargement has complicated the relationship on both sides: there is no denying that fact. The EU is in any case a very complex animal in the way

it manages its external relationships. These things complicate our joint Russia policy, but they do not excuse us from having one. The EU complains that Russia plays divide and rule between individual member states. But Russia can hardly be blamed for such behaviour when some in Europe appear to invite it, and fail to deliver a unified message. Russia is one of the examples of where the EU needs to apply stronger shared continental weight.

We should think, going forward, about the mechanism for this. One option may be the creation under the new Partnership and Cooperation Agreement of something akin to the Strategic Economic Dialogue created by the US and China; a regular top down structure focussed on addressing the detail of a range of economic priorities in trade, investment and energy. Such a body could service our summit meetings and allow these to focus on the larger picture and the overall relationship.

Conclusion

The only way to prevent any one of the issues I've touched on today dominating our relationship is to make that relationship bigger than any individual issue. I believe the foundation for this can only be in deeper economic interaction and integration. Our urgent challenge is to get fundamentals like WTO membership in place so that we have the necessary ballast to handle a frank and constructive relationship on our shared neighbourhood and collective future without being capsized by each little trade or political storm.

George Kennan used to argue that the only way to live with Russia was to "let the Russians be Russian". I can see the appeal of that in Moscow. But it does seem to me that this is not really enough. The shared European continent, and the forces of globalisation, will continue to push us together. Our goal should be a relationship that does not deny our differences, but that tries to address them constructively, and work around them where necessary. We need to bring as many as possible of our peoples into contact with each other - through our cooperation programmes, through our trade and through our politics.

The EU's search for accommodation and partnership with our largest neighbour is not amenable to quick fixes or simple answers. Each room of the edifice will need to be built with great care and dedication. But the whole building will only stand if it has solid economic foundations.