

THE EU AND RUSSIA

Strategic partners or squabbling neighbours?

Katinka Barysch





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ABOUT THE AUTHOR

Katinka Barysch is chief economist at the Centre for European Reform, where she also runs the CER Russia Programme. She previously worked as Russia editor at the Economist Intelligence Unit. Her CER publications include ‘Germany, the sick man of Europe?’, December 2003; ‘A pact for stability and growth’, October 2003; ‘Britain and the euro’, June 2003; ‘Does enlargement matter for the EU economy?’, March 2003; ‘The euro and prices’, March 2003; ‘Russia and the WTO’, December 2002 (with Pascal Lamy, Maxim Medvedkov and others); ‘Who’s ready for EU enlargement?’, November 2002 (with Heather Grabbe); and ‘New designs for Europe’, October 2002 (as co-author).



AUTHOR’S ACKNOWLEDGEMENTS

I would like to thank the many officials and policy-makers in Brussels, Moscow and other European capitals who have helped me with this pamphlet but would like to remain anonymous. My colleagues at the CER, in particular Charles Grant, have provided invaluable input and commented on earlier drafts, as have Sir Rodric Braithwaite, Lutz Guellner, Bobo Lo, Hiski Haukkala and Marius Vahl. I am grateful to BP for their financial support of the CER’s Russia programme. All remaining errors are the author’s own.



Contents

About the author

Author’s acknowledgements

1	Introduction	1
2	Why the EU and Russia don’t get on	7
3	Trade and the WTO	15
4	Towards a common economic space?	25
5	The EU-Russia energy dialogue	31
6	External security and the common neighbourhood	37
7	Internal security, freedom and justice	45
8	The role of leaders, bureaucrats and institutions	51
9	Outlook, recommendations and some wishful thinking	61

1 Introduction

Mikhail Gorbachev talked about a common European house in the late 1980s. But today Russia and the EU often resemble quarrelling neighbours rather than considerate cohabitants. Over the last decade their relationship has developed in fits and starts. It has moved from somewhat naïve optimism towards grudging co-operation. Both sides have long known the vast potential of their bilateral relationship; today they also understand the pitfalls.

Relations with Russia will stay near the top of the EU's agenda. Russia is the EU's largest neighbour. It is the only other serious power on the European landmass. Russia is, and will remain, one of the Union's key energy suppliers. Its economy could become a booming market for EU businesses. Russia and the EU share an unstable and unsettled neighbourhood. They are both struggling to redefine their positions *vis-à-vis* the US and rising powers such as China.

Russia and the EU describe their bilateral relationship as a 'strategic partnership'. Yet neither side has done much strategic thinking on where their relationship is heading. Moscow and Brussels rarely behave like friends or partners. Mistrust and mutual frustration mar their dealings. There is a widening gap between acrimonious negotiations on technical details and the heady rhetoric of the six-monthly EU-Russia summits. Disagreements over small issues, such as transit rights for Kaliningrad or steel export quotas, are regularly allowed to disrupt the entire relationship.

Tensions in EU-Russia relations peaked in early 2004. The EU criticised authoritarian tendencies in Putin's Russia, following a round of free but unfair parliamentary and presidential elections. It asked Russia to speed up economic reform and to co-operate more in protecting the environment and fighting smugglers and criminals.

Russia, on the other hand, complained that the EU demanded too much. It blamed the EU for the lack of progress in its WTO accession. It fretted about the implications of eastward enlargement, which has brought a larger and more powerful EU closer to Russia's doorstep. It has repeatedly asked the EU to scrap its tough visa requirements and let Russia have a say in its foreign and security policies.

In the spring of 2004 Russia and the EU vented their pent-up frustrations during an ill-tempered squabble over the Partnership and Co-operation Agreement (PCA), the treaty that has formed the basis for bilateral relations since 1997. In February, Russia presented the EU with a list of 14 demands related to enlargement, such as the continuation of trade preferences and the protection of Russian minorities in the Baltic states. Russia threatened that it would not sign an extension of the PCA to the new member-states unless the EU heeded its requests. The EU retorted that Russia had no right to do so, and issued thinly veiled warnings of trade sanctions. The PCA dispute died down in April, with Russia agreeing to extend the agreement and the EU promising to take into account Russia's 'legitimate concerns' over enlargement. One month later, the EU and Russia reached a bilateral deal on Russia's WTO accession, following six years of acrimonious negotiations. Nevertheless, Russia is unlikely to join the trade organisation before 2006 at the earliest.

Bilateral agreements on enlargement and the WTO have eased tensions in EU-Russia relations, for now. Yet it remains puzzling that relations are so difficult. A cursory glance reveals a multitude of common interests and objectives. The EU is Russia's most important business partner, accounting for more than half of Russia's external trade and most of its foreign investment. Two-thirds of Russia's oil and gas exports – the country's main source of foreign currency – goes to the EU. The EU relies on Russian oil and gas for around one-quarter of its energy consumption. Both sides want their common neighbourhood to be stable and prosperous. Both have put the fight against international terrorism and weapons

proliferation at the top of their security agendas. Both Russia and the EU see themselves as partners of the US, but they worry about America's global hegemony. Both would like to protect the role of international organisations such as the UN and uphold the rule of international law.

Table 1: Russia and the EU: basic figures, 2003

	EU-25	Russia
Population, million	455	145
Area, 1,000 km ²	3,929	17,075
GDP, € billion	9,700	383
GDP per head, €	19,500	2,650
Exports, € billion	2,650	120
Imports, € billion	2,610	67

Sources: Economist Intelligence Unit, Eurostat and Goskomstat

Yet many Russians are dismissive of the EU and prefer the US as an international partner. America, they say, is a country we can do business with. The Europeans are weak, divided and do not understand Russia's needs. "What irritates Russians about the EU is its weakness," said Sergei Karaganov from Russia's Council on Foreign and Defence Policy during a Berlin seminar in February 2004. "Today the EU is based on the principles of bureaucracy, collectivism and political correctness," he continued, "and these principles do not suit us". Karaganov wants Russia to ignore the Europeans until they have got their act together, and instead focus on the US as the only suitable strategic partner. Karaganov's views are extreme, but most Russians would agree with him that relations with the US are more important for Russia than those with the EU.

Such comparisons are short-sighted and unfair. EU-Russia relations are difficult exactly because they are multi-faceted and complex. Since there is so much at stake, there is much scope for disagreement. Relations with the US are focused on strategic and military issues, for example non-proliferation and the problem of 'rogue' states such as Iran and North Korea. The US is much less important as a trading partner, taking only 7 per cent of Russian exports. It does not share a direct border with Russia. It buys only tiny amounts of Russian energy, although some Americans talk about Russian oil replacing shipments from the unstable Middle East in the future. In short, US-Russian relations are more straightforward. Russia likes to focus on geo-strategic issues rather than economics – as would any country that sits on the world's second largest stockpile of nuclear weapons but ranks 16th on a list of the world's top economies. And it finds the American approach to foreign policy-making – leadership-driven, interest-based and hard-nosed – much easier to deal with than the EU's foreign policy-making through compromises and committees.

President Putin knows that it would be unwise to choose between the US and the EU. His country needs good relations with both. But while Russia's relations with the US are evolving in a global political context, its dealings with the EU have a more regional focus. Good relations with the US are the key to Russia's shaky self-confidence. Those with the EU are crucial for the country's internal development, which is increasingly influenced by trade and technical co-operation with the EU. This pamphlet will argue that the intrusive nature of EU policies is the biggest obstacle – but perhaps also the biggest opportunity – in EU-Russia relations.

The EU's initial instinct was to treat Russia like any other East European transition country. So it offered closer ties on the condition that Russia reformed its economy and strengthened its democracy. But, as Chapter 2 explains, Russia is not Poland writ large. Profound differences in outlook and approach have spoiled, and will continue to spoil, EU-Russia relations. The Europeans say

Russia can only be a good partner if it opens its economy, protects private property and upholds democratic and human rights – in short, if it becomes more like the EU. Russians say the EU can only be a good partner if it stops trying to interfere in Russia's internal affairs and overcomes its own internal divisions and inconsistencies. The following chapters trace the impact of these differences through the key areas of EU-Russia relations, such as trade, energy, and internal and external security. Chapter 8 shows how badly designed institutions and unco-ordinated decision-making on both sides, as well as differences between EU member-states, are making matters worse. The final chapter warns that EU-Russia relations may well worsen in the short term, as a result of the EU's eastward enlargement and rising nationalism within Russia. The pamphlet concludes with a number of suggestions on what the EU and Russia should do to improve their bilateral relationship.

2 Why the EU and Russia don't get on

What the EU wants from Russia

The EU wants a Russia that is stable, wealthy and reliable as a neighbour, energy supplier and political partner on the world stage. Russians have similar aspirations. But although the two sides' ultimate interests and visions may coincide, their short- to medium-term objectives are very different. The EU's main goal is to nudge Russia along the path of economic reform and democratisation. The EU is not being altruistic; it fears that trouble within Russia could quickly turn into a security threat for the whole continent, not only because the 'wrong' people might take over in the Kremlin, but also because a poor, chaotic Russia could be a major source of organised crime, terrorism, weapons smuggling, illegal migration and environmental hazards.

To achieve this objective, the EU has resorted to its tried and tested methods of integration and association. It offers a closer relationship but attaches heavy conditionality. In the case of the Central and East European countries, this method resulted in one of the most successful instances of 'regime change' ever undertaken. Countries such as Latvia, Hungary and Poland went from post-communist upheaval to orderly EU membership within a decade and a half.

Russia's case is different, however. The overriding wish to join the EU as quickly as possible served as a powerful 'anchor' for reforms in the East European candidate countries. The EU has not offered Russia membership, nor will Russia be interested in this prospect in the foreseeable future. Russia sees itself as an independent player, a regional great power with global aspirations. Unlike the Central

and East European countries, Russia has political clout that is out of proportion with its economic might. Russia's economy is small by global standards, equivalent to only 4 per cent of EU GDP (about the same as the ten new EU members taken together). As a former superpower with one of the world's largest armies and a formidable (if rusty) nuclear arsenal, it likes to throw its weight around. Countries such as Hungary and Slovenia hope to gain international clout by being part of a big and powerful club. Russia likes clubs where it can mingle with other great powers, such as the UN Security Council or the G8. But it does not want to be constrained by rules. As Ivan Ivanov, a former deputy economics minister, put it at a Geneva conference in January 2002: "Russia is a world calibre power, belongs to both Europe and Asia and thus prefers to have free hands in its foreign and economic policy along all azimuths."

There are other reasons why Russia's transition from Soviet central planning turned out to be more difficult than that of the Central and East European countries. Russia has never experienced a sustained period of democracy and market economics. Setbacks, muddle and delay have stymied its post-communist reform process. Huge oil and gas reserves have helped economic recovery, but also fostered cronyism and corruption on a scale unseen in other transition economies. The sheer size of the country makes it harder for the government to implement reforms, introduce competition and move people from remote villages and declining industrial regions to booming cities.

While reforms in Russia proceeded at a snail's pace, westerners oscillated between dizzy optimism and utter despair about Russia. But now the West is moving to a more sober assessment of Russia's prospects. Russia will need decades to build a competitive market economy, and its political development will not be smooth. The reform challenges are much larger than they were in Central and Eastern Europe, not least because the process lacks an external anchor. The EU has been hugely successful in influencing countries that are queuing for membership. It has been much less adept in

dealing with countries that are not on the list of candidates. And its dealings with Russia are particularly difficult, for several reasons:

- ★ As a big political player but middling economic power, Russia likes to stress high-level political ties over economic ones. The EU, often described as an economic giant but a political dwarf, is the exact reverse.
- ★ Russians have very different ideas about the role of law. The EU is the epitome of a rules-based community. Its single market, competition policy or fiscal rules, to name but a few, cannot function without assiduous adherence to, and enforcement of, the law. Russia's confusing and contradictory laws remain a breeding ground for petty bribes, recent improvements notwithstanding. Overworked and often corrupt judges cannot be relied upon to protect rights and enforce obligations. The recent arrest of several high-profile businessmen, including Yukos boss Mikhail Khodorkovsky, shows that in Russia the law of power is still stronger than the power of law.
- ★ The EU likes to uphold the idea that all countries are equal. Most Russians believe that their country is unique. They argue that Russia needs to do things the Russian way, not the European or the western way. Such perceptions serve as a powerful impediment to Russia accepting EU conditionality. In addition, Russia's new-found self-confidence and a resurgence of nationalism are making the country ever more sensitive to outside interference.
- ★ Large parts of Russia's policy establishment remain wedded to old-fashioned concepts such as spheres of influence, zero-sum games and strict reciprocity. Many EU policy-makers and most Brussels bureaucrats believe in 'post-modern' ideas of statecraft, such as mutual interests, shared sovereignty and win-win solutions.

Paper trail of a turbulent relationship

1997 – Partnership and Co-operation Agreement (PCA): Russia and the EU signed the PCA in 1994, but it did not enter into force until December 1997.¹ Unlike the Europe Agreements between the EU and the Central and East European countries, the PCA does not include the prospect of EU membership. But it reflects early optimism that Russia would follow a similar path of liberal reform and seek to join the 'European mainstream'. The PCA states that Russia should align its laws and trading standards with those of the EU to allow for deeper integration and, eventually, a free-trade area with no mutual trade barriers. The PCA also establishes a regular political dialogue and sets up the

¹ All EU documents are available on http://europa.eu.int/comm/external_relations/russia/intro/index.htm.

institutional machinery for co-operation and consultation between the EU and Russia. Russia agreed to a provisional extension of the PCA to the new member-states shortly before May 1st 2004, the official enlargement date. The PCA expires in 2007.

1999 – Common Strategy: As part of their nascent Common Foreign and Security Policy (CFSP), the member-states agreed on a number of common strategies towards neighbouring countries, of which Russia's was the first. The strategy lays out broad and bold objectives, including the consolidation of Russia's democracy and its integration into a European economic and social area. Against the backdrop of the 1998 rouble crisis and the ever more erratic leadership of former President Boris Yeltsin, the common strategy's objectives already looked unrealistic when adopted by the EU. The document now plays little role in guiding EU policy towards Russia. When the common strategy expired in mid-2003, the EU extended it for another year, but a full update is unlikely.

1999 – Russia's medium-term strategy towards the EU: Russia's irritable response to the common strategy reflected the Kremlin's anti-western turn after NATO's Kosovo campaign in 1999, as well as Moscow's distaste for being the 'object' of any EU strategy or policy. According to Russia's own strategy, the main objective of EU-Russia co-operation is to balance US power and improve Russian access to EU markets and money. Nevertheless, many observers saw the medium-term strategy as positive: "The EU and Russia may have been talking

past each other, but at least they were doing so in the same room."² Despite Putin's more pro-western and pragmatic foreign policy, Russia has no plans for updating its strategy before it runs out in 2010.

² David Gowan, 'How the EU can help Russia', CER, January 2001.

2001 – EU Country Strategy Paper: This Commission document provides the framework for the EU's multi-billion euro assistance to Russia up to 2006 (see box on TACIS on page 58). It reflects renewed optimism in the wake of Putin's reassessment of Russian foreign policy and the launch of long-overdue economic reforms. The EU's main objective remains "to foster respect of democratic principles and human rights, as well as transition towards a market economy".

2004 – Communication from the Commission: The immediate trigger for this stock-taking exercise was the embarrassing EU-Russia summit in November 2003, when Silvio Berlusconi discarded EU positions to defend Putin's human rights record (see Chapter 8). But the Commission paper also reflects a gradual and growing disillusionment with EU-Russia relations, referring to "increasing strain" and "insufficient overall progress". It calls on the EU to stick to commonly agreed positions and to get tough in negotiations with Russia. At the same time, it reminds Russia that its dealings with the EU should be based on "shared values".

What Russia wants from the EU

President Putin and his government will continue to resist any outside attempts to shape Russia's domestic development. What he wants from the EU is not policy advice, or even financial assistance. He sees relations with the EU as a way of strengthening the domestic economy through trade and, to a lesser extent, investment. A stronger and more stable economy is the precondition for restoring Russia to its former great power status in the world. In short, Putin does not seek good relations with the West for their own sake. He sees the West, and the EU in particular, as a "modernisation resource".³

³ Dmitri Trenin, 'Russia and the West: what you see is what you get', *The World Today*, RIIA, April 2004.

Foreign policy during the Yeltsin years was characterised by bluff and bluster. When Putin took over the presidency at the start of 2000, he started from a much more realistic reassessment of Russia's position. The outcome of this reassessment was sobering. Russia's economy was weak and unstable, and its total output dwarfed by that of the Netherlands. Over 40 per cent of all Russians were living in poverty. Life expectancy had fallen to rates usually found in third world countries. The population was shrinking at an alarming pace. The once proud Soviet army was in disarray, and the entire Russian GDP could not match the US defence budget.

Putin soon realised that Russia had to regain its internal strength before it could once more become a big player on the global stage. He therefore launched an ambitious programme of economic and judicial reforms. He re-consolidated power in the Kremlin and cut regional governors and business oligarchs down to size. But in his quest for control, he also systematically eliminated all potential sources of political opposition. By the time of his re-election in March 2004, Putin had gained almost complete control over the government, both houses of parliament, the largest political parties and the mass media. Press freedom is severely curtailed, and a new draft law may prohibit public demonstrations. Civil society organisations complain about frequent visits from the FSB (formerly known as the KGB).

⁴ Andrew Jack, 'Inside Putin's Russia', *Granta*, March 2004. The Russian army continues to trample on human rights in Chechnya, and the Kremlin appears unwilling to hold the perpetrators to account.⁴

Few Russians seem bothered by this. After the tumultuous Yeltsin years, they associate democracy and capitalism with chaos and corruption. They value stability above all else. Opinion polls show that less than one-quarter of Russians regard Putin's regime as democratic, yet more than 70 per cent voted for the architect of 'managed democracy' in the last presidential election in March 2004.

Values or interests?

Despite the autocratic tendencies that are evident within the Russian system, the EU remains convinced that relations with Russia should be based on 'shared values'. Many European officials, parliamentarians and policy-makers still insist that the EU should try to guide Russia back to the path that leads towards liberal democracy. After all, they say, Russia itself signed up to respecting human rights and political freedoms when it joined the Council of Europe. They also point out that the emphasis on values is what makes the EU's foreign policy different from America's 'might makes right' approach. "If we take values out of the Common Foreign and Security Policy (CFSP), there is nothing left", says one high-ranking official from the European Commission.

Yet many Russians find routine reminders of 'shared values' irrelevant or, more often, irritating. They think the EU wants to encroach on their sovereignty by telling them how to run their country. They suspect that the EU is implicitly linking 'real' issues such as trade preferences and visa rules to Russia's performance on human rights. They cannot understand why the EU – in contrast to the US – does not see the campaign in Chechnya as part of a global struggle against international terrorism. As one western expert on Russian foreign policy puts it: "Russians see the Europeans as limp-wristed moral fairies. The Americans may be bastards, but they are tough bastards, and the Russians respect that."

A growing number of experts and policy-makers argue that the EU should move away from its emphasis on 'shared values' and take a more hard-nosed approach towards Russia. They advocate a Russia policy that would be based mainly on joint interests and day-to-day co-operation. Rather than starting out with a blueprint for future relations and an elaborate institutional framework, the EU should seek to work with Russia in well-defined areas, such as trade, energy, the environment or the fight against organised crime. Integration in one area, such as trade, could create the need for more co-operation in a related field, such as the prosecution of

smugglers or the alignment of industrial standards. According to this way of thinking, when the EU and Russia have built up a habit of working together – and the trust that comes with it – they will be more willing to agree upon institutions and treaties that safeguard and cement their co-operation.

At present, EU-Russia relations are a mix of both approaches. The EU insists that its relationship with Russia is values-based, forward-looking and strategic in character. At the same time, it concentrates on achieving tangible progress in well-defined areas of co-operation. As this pamphlet shows, the EU and Russia are already working together in many areas, and they have ambitious plans for more. At their summit in St Petersburg in 2002, the EU and Russia decided to intensify co-operation in all areas, with a view to creating four ‘common spaces’, namely for economics; internal security and justice; external security; and research, education and culture. However, the EU and Russia cannot agree on how to fill these common spaces. Some Russians joke that the defining characteristic of space is emptiness. The EU worked out ‘action plans’ for all four spaces before the May 2004 EU-Russia summit. But although the plans mainly drew together existing projects under new headings, Russia did not formally endorse them. The following chapters examine the difficulties of EU-Russia co-operation, in areas where – in theory – they have clear mutual interests. Chapter 8 returns to the broader question of why the two sides fail to exploit the full potential of their relationship.

3 Trade and the WTO

An unbalanced relationship

Trade is clearly a growth area in EU-Russia relations. The value of bilateral trade has more than doubled since 1995, to €85 billion in 2003. However, the headline figures reveal little about the true content of the EU-Russia trade relationship. As one economist puts it: “The two key words characterising Russia’s trade with Western Europe are energy and asymmetry.”⁵

⁵ Carl B. Hamilton, *Russia’s European economic integration: escapism and realities*, CEPR discussion paper 3840, March 2003.

The asymmetry is twofold. The EU is clearly Russia’s single most important trading partner, accounting for more than half of total trade after enlargement. But the same does not hold true the other way round. Only 3 per cent of the EU-15’s exports went to Russia in 2003, and 5 per cent of its imports came from there. For most big EU companies Russia is a market of only secondary importance. The composition of trade flows is similarly skewed. Russia mainly sells oil, gas and other raw materials to the EU but very few manufactured goods. The EU, on the other hand, exports mainly machinery to Russia, as well as cars, consumer goods and food products.

Russia wants better access to the EU’s €10 trillion internal market, especially for its non-energy exporters. The government worries about the economy’s growing dependence on energy exports. According to the World Bank, the oil and gas sector now accounts for one-quarter of Russia’s GDP, more than half of its export earnings, some 30 per cent of federal budget revenue and the bulk of investment spending. This dependence leaves the Russian economy at the mercy of volatile international commodities markets. High oil prices since 2000 have fuelled Russia’s economic recovery,

leading to GDP growth rates of 5-10 per cent a year and sustained surpluses in the state budget and the external accounts. But a prolonged oil price slump could quickly send the Russian economy back into recession and instability.

Table 2: Trade between Russia and the EU-15 (€ billion)

	1996	1997	1998	1999	2000	2001	2002	2003
EU exports to Russia	19.1	15.5	21.1	14.8	19.8	27.8	30.3	33.0
EU imports from Russia	23.4	27	23.2	26	45.3	47.4	47.5	51.6
Trade balance	-4.3	-11.5	-2.1	-11.2	-25.5	-19.6	-17.2	-18.1

Source: European Commission

Russia claims that ‘protectionist’ western trade policies make it unnecessarily difficult to diversify its economy away from oil and gas. The only areas where Russia’s outdated industrial sector can compete internationally are metals, military goods, basic chemicals and some labour-intensive products such as shoes or clothing. These, however, are exactly the areas that the developed market economies – the US as much as the EU – consider to be ‘sensitive’. In 2004 the EU had 11 anti-dumping actions in place against Russian goods. It also restricts Russian exports of steel and farm products through strict quotas, and it retains the right to limit textile imports.

The EU rejects allegations of protectionism. It says that it only uses anti-dumping procedures to keep out Russian goods that are priced ‘unfairly’. It points out that Russia itself has erected high barriers against some EU products, including cars, alcohol and meat. The EU

insists that its overall trade policy is aimed at deeper economic integration with Russia. Although Russia is not yet a member of the WTO, the EU has granted it ‘most-favoured nation’ status (MFN, which means that the lowest available EU tariff is extended to Russian goods) through the PCA. The PCA also opens the perspective of a ‘free-trade agreement’, that is the abolition of most customs duties, between Russia and the EU – although there has been little progress in this direction. Both sides agree that Russia should join the WTO before they talk about further liberalisation.

Table 3: Composition of EU-Russia trade, 2003 (€ billion)

	EU exports to Russia	EU imports from Russia
Machinery	11.5	0.4
Transport equipment	3.9	0.2
Chemicals	4.4	2.1
Farm products	3.4	1.9
Energy	0.2	29.3
Textiles and clothing	1.7	0.2

Source: European Commission

The impact of enlargement

Russia’s main concern about EU enlargement is its impact on trade. Maxim Medvedkov, Russia’s chief negotiator in the WTO talks, warned that the extension of the EU common tariff to the

new member-states would cause his country losses of €300 million a year. However, Russian officials struggled to give concrete examples of how enlargement would damage Russian exports. They were able to cite higher tariffs on Russian aluminium exports that would be applied by the new member-states, and the extension of EU quotas to the new members. But by the time enlargement took place, on May 1st 2004, they admitted that it made little difference to Russian trade.

Most Russian exports to the new members consist of oil and gas (up to 90 per cent in the case of some of them), and these will continue to be tariff-free. EU tariffs on most industrial goods are lower than those that the East European countries applied before accession. In line with the PCA, the new members have also granted Russia most-favoured nation status – before accession, only Hungary did so.

⁶ See Carl B Hamilton, 'Russia's European economic integration: escapism and realities', CEPR discussion paper 3840, March 2003.

Russia is right to fear the spread of the EU's protectionist farm policies – especially now that Russia is once again becoming a major grain exporter. Russia also worries about EU anti-dumping actions. With accession, the Central and East European countries have started to apply the same anti-dumping duties to Russian products as the EU does. Since only a small number of products are affected, this is unlikely to cause much damage to Russian exporters.⁶ However, Russians also fear that the new members may influence future EU trade policy in a way that harms Russian exporters. Since countries such as Poland or Slovakia compete with Russian exporters of steel and chemicals, they could ask the EU to impose more anti-dumping duties in the future, or tighten Russian export quotas. But will they do so? The new members are rapidly upgrading their economies from heavy industries to high-tech manufactured goods, for which Russia will be a lucrative market. They will therefore want to maintain good and open trade relations with Russia.

Table 4: Potential impact of enlargement on Russian exporters

Positive	Negative
Russian businesses can sell into a deeply integrated market of almost half a billion consumers	Russian exports to the new members have to comply with tough EU product standards
Average manufacturing tariffs of new members fall	Trade in farm products falls under strict CAP rules
New members grant Russia MFN status and remove all quantitative restrictions on Russian imports	New members could lobby for EU anti-dumping action against Russian steel and chemicals
Customs and transit procedures are unified and simplified	Tougher visa requirements apply to businesspeople travelling to new member-states
Enlargement will boost European growth and create new business opportunities for Russian exporters	Russian exporters will face more competition in the enlarged EU market

Ways out of the WTO deadlock

Once Russia has joined the WTO, its producers will be better protected against anti-dumping duties and other trade barriers, whether applied by the EU states or other WTO members. Russia first applied to join the WTO in 1993. But it was only when Vladimir Putin took over the presidency that accession became a

priority. In 2001 and 2002, Russia made much headway in the accession talks. It agreed tariffs and market access conditions for most products and re-wrote dozens of laws in line with WTO requirements. One major obstacle to WTO membership was removed in May 2002, when the EU re-classified Russia as a market economy for trade policy purposes. This upgrade will allow Russia to join the WTO on the same terms as other developed economies.

⁷ Nikolay Kaveshnikov, 'Three stories about strategic partnership between Russia and the European Union', paper presented at EU-Russia conference in St Petersburg, September 2002.

It has also shifted the burden of proof in anti-dumping cases from Russian companies to the EU. Nevertheless, many Russians were cynical about the upgrade. They regarded it as a politically motivated U-turn and argued that subsequent amendments to EU trade rules watered down the hoped-for benefits.⁷

In late 2002, the negotiations on Russia's WTO membership ran out of steam. The Russian authorities put the blame squarely on the EU. "We permanently hear assurances and EU statements in support of this process, but unfortunately in practice time and again we are facing what we consider excessively strict requirements that actually

⁸ Quoted by Prime-Tass and available on <http://www.wto.ru>.

block Russia's accession to the WTO", said Putin at a meeting with EU and Russian businesses in December 2003.⁸

EU officials insisted that the speed of accession depended mainly on Russia itself. "Any new WTO member", wrote Pascal Lamy, the EU's trade commissioner, in 2002 "enjoys the legal rights and has to take on the obligations that have previously been negotiated

⁹ Pascal Lamy, Maxim Medvedkov, Robert Cottrell et al., 'Russia and the WTO', CER, December 2002.

by the existing members. This usually requires the acceding country to carry out extensive legal and structural reforms, which turns WTO accession into a difficult and sometimes politically-charged process."⁹

Russia must not forget, Lamy added, that WTO membership is primarily in its own self-interest. Russia would gain better access

to EU markets. Membership would spur economic reforms, improve transparency and create greater legal certainty – all of which would make Russia a more comfortable place for investors. Russia would get access to the WTO's dispute settlement system, which would leave it better placed to challenge anti-dumping and other actions against its exports. Last but not least, Russia would get a seat at the table where global trade policy is made.

To reap these benefits, the EU asked Russia to improve access to its markets for goods such as cars and aeroplanes; open up its services sector and let in foreign banks, insurers and telecoms providers on equal terms; phase out the discriminatory fees that EU airlines have to pay for flying over Siberia; limit agricultural subsidies; phase out export tariffs; clean up the notoriously corrupt customs administration; enforce trade-related legal rules; and clamp down on producers of pirate CDs and fake designer goods.

The most intractable dispute, however, concerned energy prices. The EU claimed that Russia's very low domestic energy prices – gas prices are one-quarter of world-market levels – gave an 'unfair' advantage to Russian producers, in particular in energy-intensive sectors such as metals and fertilisers. Russia protested that local energy costs were not part of the WTO's remit and should not hold up the accession talks. The EU countered that there are no 'standard terms' of WTO accession, and that latecomers would just have to accept the demands of those that are already in the club.

Initially, the EU had asked Russia to raise its domestic gas prices to what EU companies and consumers have to pay (although there are big differences in gas price levels among the EU member-states). Russia replied that high European prices were the result of inefficient, fragmented markets, high transport costs and the strong euro. Low Russian prices, on the other hand, stemmed from the country's 'natural advantage' of sitting on one-third of the world's gas reserves. Fine, said the EU, but the claim that prices were 'naturally' lower could only be tested if Russia liberalised the energy

sector and let market forces, rather than state regulators, set prices. In the early days of his presidency, Putin talked about breaking up Gazprom, Russia's giant gas monopoly, and liberalising the local gas market. But he has since changed his mind and shelved plans for thorough gas sector reform. Faced with Russian intransigence, the EU reformulated its gas-price position once again, asking Russia to at least raise gas prices to a level that covers production and investment costs. However, given that Gazprom's operations are so opaque and inefficient, it proved difficult to estimate which price level covers costs. Some analysts even claimed that if Russia liberalised its gas market, gas prices would fall.

The EU's demands on energy prices were hard to justify from the start. By 2004 they had lost all credibility. Not surprisingly, the deal that the two sides struck at their May 2004 summit involved only minimal Russian concessions in this area. Russia promised to gradually raise gas prices for industrial users from around \$28 per 1,000 cubic metres in 2004 to \$49-57 per 1,000 cubic metres in 2010 – an increase that was in any case foreseen in the country's national energy strategy. Russia also resisted EU demands for further gas market liberalisation. It did agree to give EU gas companies limited access to its pipeline network – but insisted that Gazprom keep its monopoly of pipelines. In what looked like a concession to the EU, President Putin reiterated Russia's commitment to ratify the Kyoto protocol, although he did not make any firm promises (see Chapter 5).

In other areas too, Russia did rather well out of its bilateral deal with the EU on WTO accession. For example, it secured a 7-year transition period for lowering tariffs on imported cars, and retained the right to give its farmers generous state support. But like all other WTO members, it had to agree to maximum tariffs on manufactured goods, services and farm products at rather low levels. Russia also agreed to open its markets for banking, telecoms and other services, although the details of this agreement will not be published for as long as negotiations with other WTO members

continue. Although the EU deal was a milestone on Russia's path into the WTO, it still needs to reach similar bilateral agreements with the other big WTO members. The US, for example, has made tough demands on Russia to liberalise its services sector, protect intellectual property rights and open its highly protected aircraft market. Russia hopes to conclude all bilateral deals at the end of 2004 or in early 2005. These deals will then be tied into an accession package that could allow the country to join the trade club in 2006 or 2007.

4 Towards a common economic space?

Despite slow progress in the WTO talks, the EU has sought to reassure Russia that it remains committed to economic co-operation and integration that stretches beyond WTO accession. It has therefore kept alive the idea of building a common economic space (CES) between the EU and Russia. The term first appeared in the EU's Common Strategy of 1999.¹⁰ The basic idea would be to give Russia improved access to the EU's single market, provided that Russia brings its standards and regulations in line with the *acquis communautaire* (the EU's accumulated rulebook).

¹⁰ *The original idea was for a Common European Economic Space (CEES), to achieve trade and economic integration. The St Petersburg summit in 2002 added energy and environmental issues and renamed it the Common Economic Space (CES).*

In 2001 the two sides set up a high-level group to look into the possibility of a CES and also asked a team of economists to thrash out the details.¹¹ However, when the high-level group reported to the Rome EU-Russia summit in November 2003, it had still not come up with a workable road map for economic integration. It listed some guiding principles but stated that it was too early to set concrete targets. The EU and Russia are now working on an 'action plan' for the CES to be presented at their November 2004 summit.

¹¹ *Russian-European Centre for Economic Policy, 'Common Economic Space: Prospects of Russia-EU relations', TACIS 2002.*

Both sides agree that Russia's WTO accession is the essential first step for the CES. First, many of the preparations that Russia has to undergo for WTO membership, such as upgrading customs procedures and providing better protection for investments and intellectual property, are also prerequisites for deeper integration

with the EU. Second, Russia simply does not have enough skilled trade specialists to negotiate a WTO deal and the CES at the same time (see also Chapter 8). And third, since the CES would be a regional trade agreement, it could conflict with the WTO's non-discrimination clauses, potentially making Russia liable for compensation claims from third countries.

Nevertheless, the EU hopes to interest Russia in approximating its rules to EU rules more closely than the WTO requires. This looks somewhat unlikely. Many economists, both from Russia and the EU, are sceptical about the whole idea of the CES. They say that the gap between the EU's well developed and densely regulated market and Russia's shaky, oil-dependent transition economy is so wide as to make the CES meaningless as a framework for concrete policy measures.

Some economists doubt that the CES would bring substantial economic benefits for Russia.¹² Others think that only a small part of the *acquis* – notably the free movement of goods, services, capital and

¹² Pekka Sutela, 'Russia and Europe, some economic aspects', *Carnegie Moscow Centre*, 2003.

¹³ Vladimir Mau and Vadim Novikov, 'Otnosheiya Rossii i ES: Prostranstvo Vybora ili Vybor Prostranstva?' *Voprosy ekonomiki* 6, 2002.

people – would be good for Russian development. Other EU rules, such as those on environmental and social standards, could harm Russia's growth prospects. Most of the *acquis* would be either irrelevant or have little impact.¹³

The European Commission has reassured Russia that a CES would not require it to take over the whole *acquis*. But the EU's newcomers from Central and Eastern Europe may take a tougher

line. They fear that Russia will 'cherry pick' those parts of the *acquis* that it likes but reject those that are difficult, restrictive or expensive. Such a selective approach, they fear, could give Russia an unfair advantage. The accession countries also know from first-hand experience how difficult it is to adopt, implement and enforce large numbers of EU rules in a short period of time. Many, and not only in Central and Eastern Europe, fear that Russia's inefficient and

notoriously corrupt bureaucracy would not be up to the job. The European Commission would be in a poor position to supervise the actual implementation of the *acquis*, as it has done in the accession countries. If the EU did not trust Russian health and safety inspectors, it would refuse to let in Russian products, which would defeat the purpose of any negotiated market opening.

¹⁴ Tim Gould, 'The European Economic Area as a model for the wider Europe', *background paper for the EFTA parliamentary meeting*, June 2003.

Some observers also find the CES concept problematic from a political point of view. The CES would require Russia to play according to rules which it would not be able to influence.

The basic idea is similar to that underlying the European Economic Area (EEA).¹⁴ The EEA gives non-EU members such as Norway and Iceland full access to the EU single market. In return, these countries implement the *acquis* in all relevant areas. Although the EU consults EEA countries in the law-making process, it does not give them a say when it decides on new rules. This asymmetry has led many former EEA members to apply for EU membership, including Sweden, Finland and Austria.

Given that Russians are more prickly about sovereignty than say, Norwegians, they would find it difficult to accept anything resembling the EEA model. What is more, current plans for the CES would not even allow Russia the consultative role that the EEA countries enjoy. Russia has already made it clear that it dislikes the idea of having to adapt to EU rules unilaterally. Instead, Russians call for a more 'balanced' approach to legal approximation. "Convergence cannot be a one-sided process", says Elena Danilova, who is in charge of the CES project in Russia's economics ministry. But the EU remains adamant that non-members cannot be part of EU internal decision-making. And it finds any suggestion that EU rules should move closer to Russian standards simply abhorrent.

Badly drafted and contradictory laws remain a huge burden on businesses in Russia. An EU-style competition and anti-subsidy

policy could help to arrest the ever-growing concentration of economic assets in a few hands. But Russia does not at present see the CES as an opportunity. On the contrary, many of its officials suspect that the EU is using the CES concept to make unrealistic demands on Russia – or else to shut Russian goods out of the internal market.

The voice of business

Political leaders in Russia have shown only limited interest in driving economic integration with the EU forward. But Russian companies and foreign businesses operating in Russia like the idea of more trade integration. They also like the idea of the CES, because it means that the business environment in Russia would become more similar to that of the EU. But while there are occasional EU-Russia business roundtables, these are insufficient for companies to make their voice heard in EU-Russia negotiations. The dearth of business involvement in EU-Russia relations is not only a problem for trade and the CES. It also looms large in the EU-Russia energy dialogue, where companies rather than governments or Brussels bureaucrats are the main players (see next chapter). Igor Yurgens, deputy director of the Russian Union of Industrialists and Entrepreneurs (RSPP), says that Russian business clubs would like closer links with their EU counterparts. UNICE, the EU's main business federation, says it too wants closer links. Yet neither the RSPP nor UNICE has taken the initiative or appears willing to spend money on setting up a framework for co-operation.

In September 2003, Russia agreed with Belarus, Kazakhstan and Ukraine to create a 'single economic space', a plan that looks conspicuously similar to the CES. The EU now worries that if both plans proceed in parallel, it might end up sharing a single market with some unreformed and badly managed former Soviet economies. These worries are likely to be misplaced: over the last decade, Russia has signed half a dozen agreements on free trade and regional

economic integration with its neighbours in the Commonwealth of Independent States (CIS) – without any tangible results. But Russia's launch of the single economic space does show its lack of enthusiasm for aligning its economy more closely with that of the EU.

5 The EU-Russia energy dialogue

Since plans for the CES have yielded few results, some EU officials have suggested looking elsewhere for a general framework for EU-Russia relations. Chris Patten and Pascal Lamy, external relations and trade commissioners respectively, have suggested using the EU-Russia energy dialogue as “a blueprint for wider relations”.¹⁵

¹⁵ Chris Patten and Pascal Lamy, ‘Economic space and beyond: EU enlargement will help build closer economic ties between Russia and the rest of Europe’, Financial Times, 5th December 2001.

In the energy field, more than in almost any other area, the EU and Russia have very clear mutual interests. The EU is the final destination for two-thirds of Russia’s oil and gas exports. Before enlargement, the EU relied on Russia for about 20 per cent of its gas and 17 per cent of its oil. These shares have since risen, because some of the new members get 90 per cent or more of their energy from Russia. In the medium term, the EU expects its own energy resources to diminish, while consumption will further shift from oil and coal to natural gas. Both trends will increase the EU’s reliance on Russian supplies (see below).

To acknowledge the importance of this mutual dependency, the two sides launched a bilateral ‘energy dialogue’ in 2000, with the aim “to raise all issues of common interest relating to the [energy] sector, including the introduction of co-operation on energy saving, rationalisation of production and transportation infrastructures, European investment possibilities, and relations between producer and consumer countries”.¹⁶ The dialogue involves regular meetings of experts, as well as high-level political discussions during the bi-annual EU-Russia summits.

¹⁶ Communiqué of the EU-Russia summit in Paris, October 2000, http://europa.eu.int/comm/external_relations/russia/summit_30_10_00/statement_en.htm.

However, progress since 2000 has been mixed. There have been some notable successes, for example the establishment of an energy technology centre in Moscow in November 2002, plans for an EU-funded investment guarantee scheme, and the start of several pilot projects for energy savings. But on many of the more important issues – pipelines, gas supply contracts, electricity sector restructuring or nuclear fuel supplies – the two sides continue to disagree.

As explained above, the EU had initially asked Russia to liberalise its internal gas market as a precondition for WTO accession. But under the deal struck in May 2004, the EU accepted that Gazprom would not be broken up and that it would keep its monopoly on gas pipelines. Nevertheless, the EU fears an increasing mismatch between its own efforts to liberalise its energy markets and the supply of Russian gas through a monopolist, namely Gazprom. EU countries have committed themselves to liberalising their energy markets for industrial users by July 2004 and for households by July 2007. However, Russia supplies its EU customers under long-term supply contracts, some of which contain ‘territorial restriction clauses’: even if one EU country receives more gas than it needs, it is not allowed to sell it on to its neighbours. These clauses are in breach of EU single market rules. They allow Gazprom to sell gas to different EU countries at different prices, and they prevent European countries from developing a functioning EU-wide gas market. While Gazprom has agreed to remove the territorial restriction clause that applies to Italy, there has been no such agreement for Germany and Austria.

Problems also plague the EU-Russia dialogue on electricity. Russia is increasingly keen on linking its own electricity grid to that of the enlarged European Union. This would enable UES, the electricity monopoly, not only to sell surplus electricity to EU consumers, but also to make up for temporary shortages in its own market by importing power from the EU. The EU says that in order to sell into the European market, Russia must apply EU-level standards of

competition, nuclear safety and environmental protection – which of course it does not – and that it must get rid of the ‘unfair’ subsidy that UES receives in the form of cheap Russian gas from Gazprom. For now, the two sides have asked an expert panel to find out how much EU and Russian rules and policies diverge in these areas.

The dialogue on oil is less politically charged, partly because Russia has already privatised and liberalised its oil industry. Here, discussions focus mainly on how to attract EU investors to the Russian oil sector. The EU has long pushed Russia to establish a workable framework for production sharing agreements (PSAs). These are commonly used in emerging market economies to make the legal and tax environment safe for large-scale investments in natural resources. The Russian government has been dragging its feet, however, and in 2003 cancelled all ongoing PSA negotiations while making it more difficult to conclude new ones. The government claims that BP’s decision in 2003 to commit more than \$6 billion to its Russian ventures is proof that PSAs are not needed. But apart from BP’s investment and a couple of giant offshore ventures financed mainly by Shell and Exxon Mobil, there has been remarkably little foreign investment in the Russian energy sector.¹⁷ The absence of a functioning PSA framework is only one reason for the dearth of foreign involvement; potential foreign investors are deterred by uncertainty over property rights, while among Russians there is widespread hostility to the idea of selling the country’s riches to foreigners.

¹⁷ According to Russia’s own energy strategy, the oil sector requires \$12 billion in investment each year until 2020, to renew the capital stock and sustain economic growth. Similar sums are required for gas and electricity.

Another obstacle to private investment, not only in oil but also in the gas sector, is the state’s firm grip on pipelines. Transneft, the state-owned oil pipeline monopolist, has failed to invest enough in new export pipelines to keep up with rapidly rising oil output. Russia’s oil majors are complaining that lack of pipeline capacity is impeding their plans for expansion and investment. Several Russian oil companies are also sitting on considerable gas reserves. But few

exploit them commercially because domestic gas prices are too low and Gazprom will not give them access to its export pipelines. The Russian government also refuses to let gas producers in Uzbekistan and Turkmenistan use its pipelines for transit. And it does not allow private oil companies or foreign investors to build new pipelines on Russian territory. In April 2004 the government did promise to give private companies better access to the state-controlled gas pipeline network, but it has not given details or taken any practical steps.

¹⁸ Roland Goetz, 'Russlands Energiesicherheit und die Energieversorgung Europas', SWP Studie, Berlin 2004.

From the EU's perspective, the lack of investment and openness in the Russian energy sector is worrying. The EU predicts that by 2020 it will need to buy an additional 300 billion cubic metres of Russian gas a year, to meet growing domestic demand. But Russia's own energy strategy foresees additional sales to the enlarged EU of only 30 billion cubic metres a year by 2020, while it projects increasing amounts of gas going to the fast-growing Chinese market and the US.¹⁸ The EU therefore has a large stake in the development of the Russian energy market. The two sides have identified a number of projects of 'common interest', such as the development of the giant offshore Shtokman gas field in the Barents Sea, and a new gas pipeline under the Baltic Sea. But so long as the Russian state retains a firm grip on the sector there is unlikely to be a great deal of fresh investment from EU companies.

¹⁹ The Kyoto protocol would enter into force if the major greenhouse gas producers – accounting for 55 per cent of 1990 worldwide carbon emissions – ratified it.

While talks on market opening and pipelines have made little progress, other issues have moved to the top of the bilateral energy agenda, namely the Kyoto protocol and quotas for nuclear fuel imports. The EU is the main supporter of the Kyoto protocol on climate change and has started implementing its provisions, although the treaty has not yet entered into force. With the US refusing to accept the treaty, it cannot enter into force without Russian ratification.¹⁹ In economic terms, Russia would probably gain from Kyoto, for it

could sell off unused pollution rights. However, some experts think those gains would be small unless the US joins the new market for emission rights trading. The Russian administration appears split on the issue of ratification. Russia promised to ratify the protocol in 2002 but it has since been dragging its feet. Different parts of the administration have given conflicting signals, with presidential advisor Andrei Illarionov announcing in 2003 that Russia would not ratify the treaty. In what looked like a package deal related to WTO accession, President Putin announced in May 2004 that Russia would "try to speed up ratification". Although journalists were quick to interpret Putin's statement as another Russian U-turn, it does not in fact amount to a clear commitment.

Environmental hazards

Frequent oil spills and leakages into the drinking water are only one of the many environmental problems that plague Russia. The EU worries greatly about pollution, toxic waste and dilapidated nuclear facilities in Russia. Some 15 per cent of Russia's territory is so polluted as to be unfit for human habitation, and almost one-third of the population suffers from pollution at levels far above internationally accepted standards.²⁰ Russia sits on 1.8 billion tonnes of toxic waste, and still accumulates more than 100 million extra tonnes each year. Russian industry gobbles up three to four times more energy per unit of output than its western equivalent. Half of Russia's 30 nuclear reactors are more than two decades old. Hundreds of reactors are rotting in decommissioned nuclear submarines. For Russia, economic growth is the top priority, while environmental protection and clean-up a secondary issue. It took five years of negotiations before Russia signed an agreement that allows western donors to help secure Russia's nuclear facilities. And Russia's refusal so far to ratify the Kyoto protocol on climate change indicates how difficult it will be to engage Russia in more serious co-operation on environmental matters.

²⁰ Foreign and Commonwealth Office Eastern Research Group, 'Environmental Problems in the Russian Federation', October 2000.

Russia is also concerned about its lucrative contracts for selling nuclear material to Central and Eastern Europe and storing that region's nuclear waste. Almost all power stations in the new member-states are Soviet-built and run on Russian nuclear fuels. As a result, Russia has a near monopoly in supplying the new member-states with enriched uranium. This could clash with a decision that the EU member-states took in 1994 that Russia should not have more than 20 per cent of the EU's uranium market. In November 2003, the EU member-states finally gave the Commission a mandate to negotiate with Russia on this issue.

There are several possible reasons why progress under the energy dialogue has been slow. First, the dialogue has become intertwined with other EU-Russia negotiations, in particular the WTO accession talks and Russia's refusal to ratify the Kyoto protocol. Second, the EU-Russia energy dialogue involves a host of participants that do not always see eye to eye. The Russian government and the EU may agree on the importance of bilateral co-operation. But the key players in this field are private or state-controlled companies that often have their own agendas. Third, the energy dialogue is not only, or even primarily, about country-to-country sales of oil and gas. It reaches deep into national economic policies, and in particular presses the Russians on energy market liberalisation. It is yet another example of how mutually beneficial co-operation is perceived as intrusive by the Russian side.

6 External security and the common neighbourhood

Russia and the ESDP

While the EU and Russia have made only mixed progress on trade and energy, co-operation in security and defence has been even more difficult. For most of the 1990s, Russia did not regard the EU as a credible actor in foreign and security policy. Given the embryonic state of the EU's Common Foreign and Security Policy (CFSP), this was not surprising. Through their political dialogue the EU and Russia have thrashed out a number of common positions, for example on the Middle East peace process. But Russia's attitude towards the EU as an actor in foreign and security policy only started to change when the Union took its first concrete steps towards a European Security and Defence Policy (ESDP), following a Franco-British summit in 1998. NATO's Kosovo campaign in 1999 – which led to the Russians suspending their relations with NATO – accelerated the Russian reassessment of ²¹ *Dov Lynch, 'Russia faces Europe', EU-ISS, May 2003.* European security policy. Russia hoped that the ESDP would reduce NATO's dominance in European defence.²¹

In 2000, the French EU presidency launched a political and security dialogue with Russia. Since then, and especially after September 11th 2001, meetings, commissions and agreements in the political and security area have proliferated. A Russian officer now works with the EU military staff in Brussels. Every month, the Russian ambassador to the EU meets representatives from the Union's Political and Security Committee. EU and Russian experts are engaged in talks about proliferation, disarmament, terrorism and technical co-operation, for example in the use of Russia's

long-haul military aircraft and EU satellite technology. In a highly symbolical move, Russia sent a small handful of officers to take part in the ESDP's first autonomous mission, the EU police mission in Bosnia and Herzegovina, at the start of 2003.

Nevertheless, the political and security dialogue has remained weak

²² *The ESDP has made considerable progress since the autumn of 2003. See Everts, Freedman, Grant, Heisbourg, Keohane, O'Hanlon, 'A European way of war', CER, May 2004.* on substance – which is probably why the two sides re-launched it at their November 2003 summit. The EU has had considerable difficulties getting its defence policy off the ground. The ESDP has been bogged down by internal disagreements, ranging from the Greek-Turkish row over EU access to NATO assets to the more recent disagreements over an EU military headquarters.²²

The Russian military is not an easy partner for the EU to work with. In the Russian security and defence establishment, there is deep-seated mistrust of any military co-operation with the West. And even if the EU and Russia could agree on joint missions, the sheer disarray of Russia's armed forces would render such co-operation difficult in practice. Russia's political leadership, meanwhile, has always been somewhat ambiguous about what it wants from security co-operation with the EU. It appears to have moved from its negative objective, that of reducing the importance of NATO, to the positive ambition of having a stable and reliable partner in the search for security in the wider Europe. But Russia is still trying to exert some control over the development of EU defence. In particular, Russia insists that the EU should not act without a UN mandate – which would leave Russia with an effective veto over all EU military missions. It wants the EU to clearly define the geographical reach of its ESDP – as a means of ensuring that EU troops do not turn up on Russia's doorstep in the Caucasus. And it wants to be involved at the various stages of ESDP decision-making.

The EU has rejected such demands. Its main objective is to get the ESDP off the ground and add a military dimension to the EU's

foreign policy. The EU is happy to involve Russia in military planning and in operations, if and when that is necessary and desirable. But it will not give Russia a regular and institutionalised say in a policy area that remains in a state of flux. In particular, the EU has consistently dismissed Russian calls for an EU-Russia Council that would mirror the NATO-Russia Council.

Russia's initial enthusiasm for the ESDP has clearly diminished since 2001, partly because of disagreements about the form and scope of co-operation, and partly because the EU has made little progress driving the ESDP project forward. "Words, nothing but words," is how Yury Baluevsky, Russia's deputy chief of staff, summed up EU-Russia security co-operation during a DGAP seminar in Berlin in February 2004.

The deep intra-EU splits over the Iraq war have confirmed many Russians' view that the EU will not become a serious actor on the international stage any time soon. Although Iraq has also brought a chill to US-Russian relations, many Russians still think that the US is the only viable partner for Russia in the security sphere. They clearly prefer the Americans' emphasis on *realpolitik* to the EU's focus on 'soft power'. To follow Robert Kagan's dichotomy: Russians would rather live on Mars with the Americans than follow the Europeans to Venus. In reality, however, Russia – as its leaders are well aware – cannot afford to make a choice between the two. Hence Putin's attempt to improve relations with the US while at the same time keeping Berlin and Paris sweet in the aftermath of the Iraq war.

In the long run, Russia and the EU are likely to discover more common ground in security questions. Both sides, for example, are becoming more interested in fighting the proliferation of weapons of mass destruction. And both sides believe that their future security challenges lie not in their common neighbourhood but elsewhere. Russia knows that its western border, now shared with the EU, will be its most secure one in the coming decades. Meanwhile, instability along the country's southern flank could

increase, be it through ethnic strife in the Caucasus, Islamic fundamentalism in Central Asia or expansionist tendencies in China. Similarly, the EU sees its main security challenges not in the east, but rather in the south, particularly in North Africa and the wider Middle East. Improved EU-Russia security co-operation would allow both sides to concentrate on those areas where they think the greatest threats lie.

The fight against terrorism

The EU and Russia could also find much common ground in the fight against international terrorism. Both the EU and Russia give high priority to this issue in their security strategies. After September 11th, the two sides held several meetings on counter-terrorist strategies and agreed to share intelligence. However, the problem of Chechnya looms large in this area. The Russian authorities have classified the Chechen rebels as international terrorists, and insist that the Chechen military campaign is just as legitimate as the West's action against al-Qaeda or Saddam Hussein. They point to numerous recent attacks that have been attributed to Chechen groups, most notably the Moscow theatre siege of October 2002 and the assassination of the pro-Kremlin Chechen president, Akhmad Kadyrov, in May 2004.

The EU has repeatedly called on the Russian government to restrain its troops in Chechnya, safeguard human rights and seek a 'political solution' through talks with the more moderate Chechen factions. Western criticism of Russia's Chechnya campaign died down after September 11th, but the EU has recently become somewhat more vocal. In particular, the EU – and the other international observers – accused Russia of rigging the 2003 Chechen elections, which returned Kadyrov to power. Russia, meanwhile, has accused EU countries, in particular the UK, of double standards in the fight against terrorism, especially after a London court granted political asylum to Chechen leader Akhmed Zakayev in late 2003.

The common neighbourhood

The enlarged EU and Russia share a common neighbourhood (or 'overlapping near abroad', as Brussels officials like to call it) that is characterised by widespread poverty, political instability and several intractable local conflicts. Politicians in the EU fear that unless these problems are addressed the common neighbourhood will become an even worse breeding ground for organised crime and political extremism. The EU has offered Russia co-operation in seeking solutions for secessionist conflicts in Moldova and in the Caucasus. Security experts have long called for joint EU-Russia peace initiatives and peace-support missions in the region.²³

²³ Dov Lynch, 'Russia faces Europe', *EU-ISS*, May 2003. Michael Emerson, 'The Wider Europe Matrix', *CEPS*, January 2004.

The Putin administration has so far refused to discuss any possible joint initiatives with the EU.

²⁴ Dmitri Trenin, 'Putin's neo-imperial ambitions', *Taipei Times*, February 24th 2004.

Russia regards the post-Soviet countries along its western and southern border as its exclusive sphere of influence and it has recently tightened its grip on its smaller neighbours.²⁴ Moscow helps to prop up secessionist regimes in parts of Georgia and Moldova. And it keeps troops and military hardware in both countries, in contravention of international agreements. Many observers think that Russian troops are themselves involved in the smuggling of drugs, weapons and women, as well as the customs rackets that prop up the economies of secessionist regions such as Transdniestria or Abkhazia (in Moldova and Georgia, respectively).

The EU plays a very limited role in the Caucasus and Central Asia, much smaller than that of the US. Russia has grudgingly accepted US military and political involvement in Georgia and some of the Central Asian states – it had little choice and Putin does not fight foreign policy battles he cannot win. But Russia is clearly not interested in the EU taking on any mediating or peacekeeping role in its 'near abroad'. "The Europeans don't even know what they want in this part of the world," says one Russian security expert with some disdain. More importantly, while the Europeans are hoping for

a lasting settlement of the region's conflicts, some Russians prefer a degree of 'controlled instability': it provides Russia with extra leverage over fragile governments and secessionist movements.

Russia may refuse to discuss Georgia and Moldova with the EU, but Russians clearly worry about the EU's growing interest in their common neighbourhood. Following the May 2004 round of eastward enlargement, several former Soviet countries are themselves pondering the idea of EU membership. The EU has its own reasons for discouraging these countries from applying for membership. Many in the EU fear that the recent round of enlargement will undermine EU policies and weaken decision-making procedures. They wonder whether an ever-larger Union will strain solidarity and trust between the member-states. They are concerned that Turkish accession could change the EU beyond recognition. Some want to close the door altogether once the current candidates have joined the Union.

Common neighbours

Moldova: The country is split between communist-run Moldova and the self-proclaimed Transnistrian republic, dominated by ethnic Russians, which survives largely on the proceeds of organised crime. The situation is stable but not sustainable: the split has turned Moldova into Europe's poorest country, large numbers of young people have emigrated, and both parts of the country are heading towards authoritarianism. The OSCE has proposed a federation under international tutelage, but Russia came up with its own plan in 2003. The EU has said it wants to play a larger role but has not been very proactive. Moldova's president, Vladimir Voronin, wants closer ties with the EU but he also wants Russia's backing ahead of the 2005 election. Russia has traditionally supported the Smirnov regime in Transnistria and has several thousand troops there – despite promising to pull out by 2002 under a 1999 OSCE agreement.

Belarus: Since 1994 President Alexander Lukashenka has kept a firm grip on the country and clamped down on any sign of political opposition. Although there

has been little reform and modernisation, the economy is doing quite well compared with other CIS countries. The EU severed ties in 1997 and does not have an official plan for a post-Lukashenka period. Putin's government has moved away from earlier schemes to forge an economic and political union with Belarus, but still exerts tremendous influence, not least because the Belarusian economy is entirely dependent on cheap Russian energy.

Ukraine: Ukraine has a population of almost 50 million and a fast-growing economy (GDP has risen by one-quarter since 2000, albeit from a low level). Since the early 1990s, successive Ukrainian governments have flirted with the West while at the same time keeping close ties to Russia. Russian influence is on the rise, not least because Russian companies have bought up chunks of the local economy. Ukraine wants the EU to keep the door open for eventual membership and has also set its sights on joining NATO. But the EU has discouraged an application and warned President Leonid Kuchma that his poor record on democracy and human rights stands in the way of closer ties. Ukraine may yet apply for EU membership after the next elections in October 2004.

Faced with the prospect of Ukraine, Moldova and possibly even Georgia wanting to become candidates, the EU had to draw up a strategy for dealing with its new neighbours. In May 2004 the Commission proposed a 'new neighbourhood policy', offering its neighbours in Eastern Europe (with the exception of Belarus), the Mediterranean and the Middle East the prospect of a close association that falls short of membership but offers 'everything but institutions'.²⁵ The Commission has recommended including Armenia, Azerbaijan and Georgia in the new neighbourhood policy, although EU governments will have the last word on this. Russia's place is ambiguous. Russia was initially more than a little miffed about being included in the new policy. "We are not a new neighbour," grumbled one Russian minister, "and not just

²⁵ European Commission, 'European neighbourhood policy – strategy paper', May 2004. http://europa.eu.int/comm/world/enp/pdf/strategy/Strategy_Paper_EN.pdf.

any neighbour either”. Russia resented being lumped with countries such as Morocco and Moldova. And it was confused about how the proposed form of association – which looks similar to the idea of a common economic space (see Chapter 4) – would mesh with the existing EU-Russia relationship.

EU officials quickly made it clear that Russia, as the Union’s largest neighbour and main energy supplier, would retain its special status. They also explained that the CES, should it ever get off the ground, would function differently from the ‘everything but institutions’ offer extended to other East European and North African countries. “To the new neighbours we apply conditionality,” explains a Brussels official, “but from Russia we seek reciprocity”. That implies that the EU does not expect to have the same kind of leverage over Russia as it may have over, say Moldova.

Russia’s bigger problem for the medium to longterm is how far and how fast the EU will extend its influence into the common neighbourhood. Many observers expect a growing rivalry between the EU and Russia over Ukraine, Moldova, Belarus (once it has got rid of the authoritarian Lukashenka regime) and possibly the Caucasus countries. For the Russians, this poses a dilemma. The more pressure they apply on neighbouring countries, the more these countries will look towards the EU as a political safe haven. To use a metaphor of Michael Emerson from the Centre for European Policy Studies: When the Russian bear growls, the EU – described by Emerson as a vegetarian elephant – dangles a carrot.²⁶ The carrot may not be as big as many of the CIS countries would wish, and it

²⁶ Michael Emerson, *The Elephant and the Bear: The European Union, Russia and their Near Abroads*, CEPS 2001.

does not include EU accession. But the EU’s approach of offering market access could tempt these countries to orientate themselves more towards the West and away from Russia.

7 Internal security, freedom and justice

Visas and co-operation in justice and home affairs

The EU frowns upon Russia’s more assertive policies towards its neighbours. But when EU politicians and officials say they are worried about Russia as a security threat, they are usually referring to organised crime, money laundering and environmental hazards, as well as the trafficking of drugs, people and weapons, rather than potential military aggression. The EU therefore hopes to make quick progress in building what it calls the ‘common space for freedom, security and justice’ with Russia. But in this ambition, too, the two sides have very different priorities. The EU is mainly interested in helping Russia to fight crime and illegal migration and to secure their common border. Russia, on the other hand, wants visa-free access to EU countries and special transit rights for its Kaliningrad exclave.

For ordinary people in the EU and Russia, border checks and visa requirements are the most visible aspect of the EU-Russia relationship. While both sides have pledged greater openness, they have in fact moved in the opposite direction. Russia’s visa system for EU citizens has become more costly and complicated over recent years. Tourists can now expect to pay well over €100 for a Russian visa. A multiple-entry visa for business travellers often costs €300 or more – and is increasingly hard to get. Applicants struggling through Russia’s three-stage visa process often encounter delays and complications at every stage.

Russians wishing to visit the EU are equally frustrated. The EU’s Schengen agreement (which eliminates internal passport checks)

²⁷ *Some non-EU members, notably Norway and Iceland, have joined the Schengen agreement, but the UK and Ireland have remained outside.*

should allow Russians to apply for one visa for the whole Schengen area.²⁷ Yet the various EU countries still apply vastly different rules and procedures to the issuance of Schengen visas. Russian tourists, business travellers and students have to submit a plethora of documentation with their applications, such as personal invitations (sometimes stamped by the mayor of the town in which the inviting person lives), aeroplane tickets or bank statements. Those people living outside Moscow have to make two time-consuming and expensive journeys to the capital to join the long queues outside the consulates of EU member countries. Russians now also need to apply for visas if they want to travel to Poland and the other new member-states, countries that they could previously visit visa-free. Although the new member-states will not join the Schengen area for some years, they had to adopt the EU's visa requirements ahead of enlargement. Vladimir Chizhov, Russia's deputy foreign minister in charge of EU relations, sums up the anger of his fellow countrymen: "Schengen has become a dirty word in Russia."

Despite mounting frustration on both sides, Russia and the EU have made no progress on visa facilitation. Russia wants the EU to make a political commitment to eventual visa-free travel. The EU has accepted visa-free travel as a political goal for the (very) long term. But it says that the two sides have to start by loosening existing rules and making the application process easier and cheaper. The EU wants Russia to fulfil several conditions before making its own rules more flexible. First, Russia should sign a re-admission treaty, which would oblige the country to take back any illegal immigrants who have entered the EU from Russian territory. Russia has been dragging its feet on this issue, arguing that it may end up with large number of illegal immigrants from third countries, such as China or Afghanistan, who have been trying to slip into the EU via its territory. Russia has not managed to get its own neighbours to sign re-admission treaties that would oblige them to take back these immigrants.

Second, the EU wants Russia to co-operate more in fighting crime, smuggling and corruption. But the EU has had difficulty persuading the Russian government to co-operate, and in particular the staunchly conservative interior ministry. Russians also think that EU fears about Russia as a source of crime are exaggerated. They claim, for example, that 75 per cent of those arrested for suspected drug smuggling at the Russian-Finnish border are Finns and only five per cent are Russians.²⁸ In recent years, Russia has nevertheless become more co-operative. The Russian parliament passed an anti-money laundering law in late 2001. In 2003 the Russian interior ministry signed an information-sharing agreement with Europol. And Russian interior and justice ministers have repeatedly attended the EU's council for justice and home affairs. Both sides also agree that the fight against organised crime is closely related to the fight against terrorism. However, political differences still stand in the way of more fruitful co-operation in that area (see Chapter 6).

²⁸ *Report on the 2nd annual meeting of the Committee 'Russia in the United Europe', Helsinki, May 2003.*

The EU's conditional approach to reform of its visa regime suffered a setback in 2004, when Germany unilaterally loosened its rules for Russian businessmen and students. France, Italy and some of the new members are now negotiating similar bilateral deals. These deals have undermined the Commission's 'package' approach. But they have also put pressure on the EU to come up with a joint position and speed up visa facilitation, and that presents an opportunity for a much more open and sensible visa policy towards Russia.

Kaliningrad

The Russian exclave of Kaliningrad creates a number of specific problems for EU-Russia relations. Sandwiched between Poland and Lithuania, Kaliningrad is a part of the Russian Federation that is now entirely surrounded by EU territory. Its 950,000 inhabitants used to be able to travel freely to the Russian mainland and through

Lithuania and Poland without having to wait for a visa. Enlargement changed all that. Russians were outraged at the thought of having to ask Lithuanian officials whether they could travel between two parts of their own country. Yet the EU refused to grant Kaliningraders a blanket exemption from its visa requirements, especially in view of the exclave's reputation as a hotspot of organised crime, smuggling and contagious diseases.

²⁹ *Joint statement on transit between the Kaliningrad region and the rest of the Russian Federation*, EU-Russia summit, November 2002, http://europa.eu.int/comm/external_relations/russia/summit_11_02/js_kalin.htm.

After a protracted and sometimes cantankerous battle, the EU and Russia reached a grudging compromise on transit travel in November 2002.²⁹ Since July 2003, Russians travelling between Kaliningrad and Russia proper can obtain a 'facilitated transit document' (FTD). The FTD is basically a visa that is issued much more quickly and free of charge. An even simpler system applies to rail transport (facilitated rail transit document, or FRTD). The EU has also promised to look into the option of allowing visa-free travel on a high-speed train through Lithuania. However, the two sides have not yet agreed on details such as how fast the train has to travel to make sure that passengers cannot jump out and disappear into the Baltic forest.

³⁰ *Evgeny Vinokurov, 'Kaliningrad's borders and transit to mainland Russia: practicalities and bottlenecks'*, CEPS, February 2004.

After some early hiccups, the new system for railway transit appears to be working well. But Russians still have to join long queues to get an FTD. The Lithuanian authorities issued more than 120,000 FRTDs in the second half of 2003, but only 2,000 FTDs.³⁰ Travellers may encounter further problems in 2005, when they will need international passports, as opposed to their Russian identity cards, to obtain an FTD. Moreover, the new facilitated system applies only to transit, which does not help Kaliningraders who want to visit neighbouring Lithuania or Poland. They need to follow normal Schengen rules. This matters because cross-border trade and business have been crucial to propping up Kaliningrad's shaky local economy. Transit accounted for fewer than

one-fifth of the 8.7 million crossings reported at Kaliningrad's border in 2001.

The transit of people is not the only challenge that Kaliningrad brings to the enlarged EU. Other tricky issues need to be resolved, including energy supplies, goods transit, military deployments, environmental pollution and fishing rights. Kaliningrad's economy is far from self-sufficient, so each year some 25 million tonnes of goods are shipped between the exclave and the Russian mainland. In the wake of enlargement, the EU and Russia have argued over transit fees, customs checks and freight insurance. Russia wants the EU to guarantee that transit fees will not rise in the future, but the EU says that Russia gains anyway as the new EU rules are simpler and cheaper than those Lithuania used to apply.

Russians may resent having to apply EU law to the transit of passengers and goods transit between two parts of their territory. But what they really worry about is the exclave's long-term future. So does the EU. But while the EU sees Kaliningrad in terms of 'soft' security concerns, such as organised crime and illegal migration, the Kremlin regards it as a geo-strategic problem. It wants territorial integrity and unchallenged sovereignty.

The EU wants a wealthy and well-governed Kaliningrad to blend in nicely with the increasingly prosperous Baltic neighbourhood. The EU offers money and western advice for internal reforms, as well as regional co-operation under its 'Northern Dimension' initiative. The Kremlin's position is more ambiguous. Kaliningrad could be a showcase for a more liberal and economically advanced Russia. But Moscow also fears that a rich and stable Kaliningrad may seek to sever ties with the more backward Russian mainland and move closer to its EU neighbours. Already, many Kaliningraders define themselves as 'EuroRussians', and they prefer to travel to Poland, Lithuania and on to Western Europe, rather than visit the Russian mainland.³¹ Moreover, some in Moscow fear that other Russian regions might

³¹ *'Between two worlds'*, *The Economist*, June 27th 2002.

want to follow Kaliningrad's example, if it prospers through closer integration with EU neighbours.

The diverging visions of Russia and the EU may well clash at some point in the future. They are already impeding EU attempts to support Kaliningrad's local economy. Some €25 million in EU aid allocated to Kaliningrad remains unspent because the EU and Russia disagree about policy priorities. Once they have sorted out the nitty-gritty of transit rights and fishing quotas, the EU and Russia will have to start a more strategic dialogue on the future of Kaliningrad.

The Northern Dimension

The Northern Dimension, a regional co-operation programme, developed from a vague idea into concrete action plans during the late 1990s. The aim is to get various actors – not only or even primarily national governments, but also regional or local governments, NGOs and businesses – from the Nordic and Baltic countries, and north-western Russia, to work together. The actors involved report some small but important successes in economic, social and environmental co-operation. But the Northern Dimension programme has also encountered numerous obstacles. Finland is the main driving force within the EU, but the larger EU countries that usually lead in EU foreign policy have shown little interest. The southern EU states are overtly suspicious because they think that the Northern Dimension will divert scarce resources from other neighbouring regions, in particular the Middle East and North Africa, which top their own foreign policy agenda. The Russian government – while officially committed to the programme – does not like the fact that it requires a degree of autonomy for local governments so that they can work together without involving their capitals.

8 The role of leaders, bureaucrats and institutions

The EU and Russia share many interests, as the previous chapters describe. Yet they find it difficult to get on. In many respects, their differences are real and profound, as Chapter 2 argues. But poor communication, badly designed institutions and flawed decision-making on both sides are making the bilateral relationship unnecessarily complicated. There is certainly no institutional cure for all the ills in EU-Russia relations. But it is worth looking at how policy-making processes and common institutions affect the relationship, and at what could be done to make it easier for the two sides to deal with each other.

The institutional framework for bilateral relations

The current institutional structure for EU-Russia relations is neither simple nor particularly effective. It involves six-monthly summits, annual ministerial meetings and a plethora of dialogues, working groups, commissions and committees. As David ³²David Gowan, Gowan, former deputy ambassador to Moscow has observed: "Problems are often passed up and down the chain of this structure without being resolved."³² *January 2001.*

The six-monthly summits have become more useful since Putin took over in the Kremlin. As one Brussels official puts it: "Of the three parties attending [Russian president, Commission president and the leader of the country that holds the rotating EU presidency], Putin is usually the best prepared." Yet the summit meetings are too tightly scripted to allow for real discussions. The same applied to the annual meetings of the so-called co-operation council, which was co-chaired by the Russian foreign minister and his counterpart from the EU

presidency. Much of the institutional infrastructure for technical co-operation, such as the expert committees foreseen under the PCA, is either defunct or functioning badly. Russia and the EU accuse each other's negotiators of being insufficiently flexible. Russian officials tend to have limited negotiating mandates, which means that they have to consult their minister (or even the Kremlin) before they can agree on even a minor compromise. The hands of EU representatives are similarly tied because their mandates rest on complicated compromises between the EU member-states.

Both Russia and the EU agreed that the system was rigid and overly bureaucratic, so they decided on some changes at their May 2003 summit. In particular, they agreed to transform the co-operation council into a 'permanent partnership council' (PPC), in which ministers – not only foreign ministers, but also say, transport ministers, trade ministers or farm ministers, depending on the issue at hand – could meet as frequently as required. However, not a single PPC was convened in the year after the summit, while Russia and the EU bickered about the composition of the new body. The EU insisted that the Russian minister in question should meet a 'troika' from the EU, namely the minister from the country that currently holds the rotating EU presidency, alongside representatives from the European Commission and the Council of Ministers. Russia, on the other hand, wanted a 25+1 approach, under which the Russian minister would meet all his or her EU counterparts at once.

Many EU officials have become tired of Russian demands for 'a seat at the table' where EU decisions are made. "The EU is not ready to have a 26th member-state without obligations," warns Richard Wright, who heads the European Commission delegation in Moscow. EU policies, insists the Commission, are made by EU institutions and the member-states. Third countries can consult, co-ordinate and co-operate, but they have no place in EU internal decision-making. EU officials also insist that the troika format is written into the PCA, which Russia has signed up to. Last but not least, they think that meetings at 25+1 would be too unwieldy for real negotiations and compromise. "25+1

fits with Russia's preference for symbolism over substance," says one EU official, "but it won't allow us to make progress".

Russian policy-makers think the EU's position is narrow-minded. They say that a broad-based and fast-changing relationship needs more flexible institutional arrangements. If a 25+1 format (or 26+1, assuming that the Commission would also be present) is too unwieldy, why not assemble only interested parties around the table? "If we want to talk to the EU about fisheries, the Austrians may wish to stay away. If we want to talk about human rights, we want Latvia and Estonia [countries in which the treatment of ethnic Russians is an issue] to sit at the table, not just the Irish presidency," explains Deputy Minister Chizhov. Russian officials also point out that the EU has already broken its own rule and allowed for 25+1 meetings, for example in transport and also in justice and home affairs.

In April 2004, the EU and Russia reached a compromise, which allowed the first meeting of the permanent partnership council to go ahead. Russia agreed that its foreign minister should meet the troika of EU foreign ministers, while the EU accepted, at least in principle, that future meetings could be open to other member-states as well.

Divide and rule, or the role of the member-states

Many EU officials warn that the 25+1 format could allow Russia to exploit divisions between the European Commission and the member-states, as well as among the member-states themselves. These fears are justified. Russian officials moan that the EU's multi-layered structure of governance is simply too complex to understand and to deal with. But they seem to understand the EU well enough to turn its internal contradictions and complexities to Russia's advantage, through skilful 'divide and rule' tactics.

Given the traditionalist views that dominate Russian foreign policy-making, it is perhaps not surprising that the Kremlin has sought 'special relations' with the EU's larger countries, in particular

Germany, but also the UK and more recently France and Italy. Moscow has often sought to harness these bilateral ties to get a better deal than it could expect from 'Brussels'. And the large member-states have been only too happy to play along.

For example, when the Kremlin became frustrated with EU-Russia security co-operation, it sought to strengthen military ties with France and the UK in 2003. When the Commission made wide-ranging demands in the energy sphere, Putin forged closer energy relations with individual EU countries. Thus in 2003 Russia and the UK agreed on a bilateral energy dialogue, on top of the EU-Russia dialogue. On Kaliningrad, Putin found a great deal of understanding from the French President, Jacques Chirac, as well as Spanish and Italian leaders. In the area of trade, Putin sought help from Germany in late 2003, and Chancellor Gerhard Schröder promised to speed up Russia's entry into the WTO – despite the fact that it is the Commission rather than individual member-states that is responsible for external trade negotiations. At the November 2003 Russia-EU summit, Putin did not even have to ask for help when journalists grilled him on Chechnya and the arrest of oil magnate Mikhail Khodorkovsky. Silvio Berlusconi, Italian prime minister and EU president at the time, declared himself to be Putin's "defence lawyer" and announced that "the truth is that there are often distortions in the press, in Italy as abroad. It's the same thing as far as Chechnya and the Yukos story is concerned."

EU governments have often been more sympathetic than the European Commission to Russian requests. They highlight business links rather than trade disputes. They rarely criticise Russia's poor record on democratic procedures and the protection of human rights. They have largely banished Chechnya from their bilateral agendas with Russia. They are happy to leave the difficult bits of the EU-Russia relationship to the Commission and other EU institutions, while reassuring Putin that it is ultimately the capitals rather than Brussels that call the shots in foreign policy.

Russia will not take the EU and its institutions seriously as long as the member-states seem to ignore agreed policy positions or long-established competences. The EU-Russia relationship is too important to be undermined by differences among member-states, or between the member-states and the Commission. The national capitals should regard the EU-Russia relationship as a testing ground for their nascent common foreign and security policy. Their attitudes and interests differ somewhat when it comes to Russia, but less than in many other areas of foreign policy. It should be possible for the EU to speak with one voice when it talks to Russia.

A more streamlined policy *vis-à-vis* Russia is all the more important now that the Central and East European countries have joined the EU. Some of the new members still harbour deep-seated suspicions about Russia, drawing on memories of Soviet dominance. Relations between Russia and the Baltic states remain tricky, with Russia often accusing Latvia and, to a lesser extent, Estonia, of 'mistreating' their sizeable Russian-speaking minorities. Many Balts, on the other hand, regard Russia as an unreconstructed bully that is trying to keep a stranglehold on Baltic oil and transport facilities. But many of the new members see Russia as an important trading partner that is also influential in the borderlands between the EU and Russia; they therefore have a strong interest in good EU-Russia relations. The new member-states also know and understand Russia better than most of the current EU members. They will therefore want to play an active part in formulating EU policy towards Russia.

Many in the EU thought that Berlusconi's behaviour during November 2003 EU-Russia summit would embarrass national governments enough to make them change their policies. "Berlusconi has done us all a favour," said one European ambassador in Moscow. "He has shown that national capitals cannot go on like this." The Commission sprung into action and produced a document that called on the member-states to pursue

a tougher and more consistent line with regard to Russia.³³ The

³³ 'Communication of the European Commission to the Council and the European Parliament on relations with Russia', February 9th 2004, http://europa.eu.int/comm/external_relations/russia/russia_docs/com04_106_en.pdf.

³⁴ 'Council conclusions on relations with Russia', February 23rd 2004.

(unpublished) annex to the document listed the EU's official position on all key areas of the bilateral relationship. All EU foreign ministers endorsed the document, promising "increased coherence across all areas of [EU-Russia] co-operation".³⁴ But soon afterwards both Chirac and Schröder were back in Moscow, soothing Putin about enlargement and promising more co-operation between Russia and national governments.

A lack of co-operation among the EU governments is not the only problem. There are also too many differences between the Council – represented currently by the High Representative for foreign policy, Javier Solana – and the commissioner for external relations, currently Chris Patten. Similarly, the Commission's attempts to streamline its own policies towards Russia have not been a great success. Different Commission departments (known as directorates-general or DGs) have long pursued their own Russia policies, for example on trade, energy, the environment or human rights. In 2003 the Commission revived an inter-service committee to impose more discipline, but some of the directorates-general are still reluctant for DG external relations to play the co-ordinating role assigned to it. Perhaps the EU needs to task a high-ranking official with co-ordinating its Russia policy. Some EU diplomats think that the new European Commission should have a special commissioner for EU-Russia relations. Alternatively, the EU could set up a new Russia office that would stand above the different DGs. If the EU ever has the new 'foreign minister' that is promised by the draft constitutional treaty, such an office could work directly under the minister. The new EU foreign minister would combine the roles of Javier Solana and Chris Patten, which would help to make the foreign policies of the Commission and the Council more consistent.

Even more importantly, the draft constitution proposes abolishing the EU's rotating presidency.³⁵ The practice of shifting the presidency from one country to another every six months has led to a lack of continuity in dealing with Russia. Successive presidencies have sought to leave their mark on EU-Russia relations, for example through announcing ever more ambitious targets, setting up a new high-level group or launching another dialogue. Usually another country takes over the presidency before these initiatives get off the ground. The result is a relationship that is littered with moribund committees and a complex array of documents, targets, treaties and dialogues.

³⁵ *EU member-states failed to agree on the EU constitutional treaty at their December 2003 summit. Even if member-states reach a compromise at their June 2004 summit, the fate of the treaty will remain uncertain since several countries, including the UK, are planning referenda before ratification.*

The draft constitution would replace the rotating presidency with a new full-time president of the European Council, who would probably be a former prime minister. Such a figure could bring greater consistency to EU-Russia relations, and make sure that initiatives were followed up. He or she would also hopefully have enough stature not only to talk to the Russian president on behalf of the EU, but also to remind the member-states not to stray too far from pre-agreed positions.

Russia needs more EU specialists

If the EU improved its institutions, and the member-states followed a more consistent line in dealing with Russia, Russians would have fewer reasons to blame the Union's internal complexities for problems in the relationship. More streamlined policy-making from the EU would also increase pressure on the Russians to sort out their own administrative structure. The situation has improved since 2000, when Putin appointed Deputy Prime Minister Viktor Khristenko to oversee the EU-related work of more than 30 ministries and federal agencies. Khristenko's inter-ministerial commission on EU relations meets regularly and attempts to make ministers and high-ranking officials tow a common line, albeit with varying degrees of success.

EU aid for Russia – TACIS

The EU has supported Russia's reform process through its TACIS aid programme since 1991. Between 1991 and the end of 2001, Russia received €2.4 billion in TACIS grants, and the EU has pledged another €500 million or so until 2006. Many observers have criticised TACIS aid for being slow, unfocused and wasteful. A 1999 evaluation report found TACIS spending to be of limited impact, with much of the money going to western consultants. A 2001 revamp put the Russian economics ministry in charge of handling the funds, and most TACIS money now goes towards supporting the government's economic reform programme and helping socially vulnerable groups. But despite repeated attempts to refocus TACIS money, the programming documents for the 2002-06 period still include a veritable shopping list of objectives, including support for institutional, legal and administrative reform, the private sector and economic development, and addressing the social consequences of transition, in addition to projects related to nuclear safety, the environment, the information society and justice and home affairs. With an average project size of €1-3 million, TACIS is unlikely to have much impact on Russia's overall reform progress.

The EU already spends much less on Russia than in the mid-1990s, and the Commission has suggested reducing TACIS money further during the next EU budget period in 2007-13. As the sums involved get smaller, targeting will become even more important. The EU should refocus TACIS on a small number of key areas, namely support for (a) judicial reforms and the protection of property rights; (b) civil society organisations; and (c) training bureaucrats in EU issues and generally spreading information about the EU.

³⁶ *The permanent secretariat of the Khristenko commission is a department of the foreign ministry.*

In practice, the Russian foreign ministry remains in charge of co-ordinating EU-Russia relations.³⁶ The ministry has departments dedicated to individual EU countries but few people dealing with EU-Russia relations per se. Moreover, the

ministry is in a poor position to provide vision and direction for Russia's EU policy. It can and does, however, act as a "braking mechanism".³⁷ It has the right to block negotiations in say, trade or energy, and it often does so to create 'linkages' with other issues, for example visas. Many people in Moscow believe that the foreign ministry has become a drag on EU-Russia relations.

³⁷ *A term used by Gorbachev to describe the obstructing role of Soviet bureaucracy in the nascent reform process, see Bobo Lo, 'Vladimir Putin and the Evolution of Russian Foreign Policy', RIIA, 2003.*

Some commentators have suggested that Russia's new prime minister, Mikhail Fradkov, should take charge of Russia's EU policies. He enjoys the trust of the president and, having headed Russia's EU mission in Brussels, knows more about the EU than most other Russian politicians. However, while the prime minister's expertise will be welcome, Fradkov does not have a strong and independent power base and may not be the best person to handle such a key area of Russian foreign policy. As explained in Chapter 2, the Kremlin is in charge of Russia's foreign policy and it is increasingly shaping relations with the EU. In March 2004, for example, Putin appointed one of his closest aides, Sergei Yastrzhembsky, as special advisor for EU-Russia relations. If the Kremlin was to take over from the foreign ministry as the main driver and co-ordinator of EU-Russia relations, it would have to hire more EU specialists.

However, the Kremlin may find it difficult to do so because the number of Russian officials with a good understanding of EU institutions and policies is severely limited. Many specialists have recently moved from the Moscow ministries to Brussels, where Russia is seeking to double the size of its diplomatic corps. Meanwhile, Russia's facilities for training and educating EU specialists are woefully inadequate. At the moment, only the Moscow State University of International Relations (run by the foreign ministry and known as MGIMO) offers courses in European integration, and in EU law and policies. MGIMO has teamed up with the Institute of Europe, part of the Russian Academy of Sciences, and

the two together are planning to roll out EU courses in other Russian universities and to publish Russia's first textbook on European integration. But money is short and for the time being only about 70

³⁸ *The European college in Bruges will start training a small number of Russian officials in EU matters in 2004.*

Russians – out of a population of 145 million – receive some formal training in EU matters each year.³⁸ No wonder that Deputy Foreign Minister Chizhov sums up Russia's approach to training EU specialists as “learning by doing”.

9 Outlook, recommendations and some wishful thinking

Why do Russia and the EU find it so difficult to get on, despite their significant overlapping interests and common objectives? One explanation may be that the two are simply too different to become genuine partners. “Russia is a sovereign state, with a unified political, economic and military system, an elected leadership dedicated to the advancement of the state's interests and institutions for co-ordinating means to desired ends. The EU is nothing of that sort. The European Union is a unique, not to say strange, political actor, with divided and clashing institutions, unclear sovereignty, a weak sense of common interest and few institutions in the political arena yet able to achieve its declared ends.”³⁹

³⁹ *Dov Lynch, ‘Russia faces Europe’, EU Institute for Security Studies, May 2003.*

Not surprisingly, actors so different tend to have different ways of going about things. The EU's approach is often characterised by the desire to ‘mould’ Russia in its own image. It thinks that the kind of European values that underlie its own history of integration should also inform its relationship with Russia. But the EU also projects its rules and policies to further its interests. It hopes that by influencing Russian domestic policies it can help to stabilise the country – and thus contribute to the stability of the whole of Europe. The EU also thinks that economic co-operation and integration require Russia to play by its rules.

In Russia's eyes, the EU's approach is too intrusive. Putin sees its dealings with the EU primarily as a means to an end – the objective of making Russia strong again, internally and externally. Many of the things that the EU is asking Russia to do would contribute to this objective, for example liberalising the energy sector or reforming the

legal system to improve the conditions for economic development and growth. But Russians still resent the EU's demands, in particular if these are coupled with complaints about civil liberties or the military campaign in Chechnya.

At present, mutual disillusionment appears to be the main feature of EU-Russia relations. Perhaps this was inevitable. When they started to develop their relationship, the EU and Russia knew little and expected much of each other. The official documents at the heart of EU-Russia relations – the EU's common strategy and Russia's medium-term strategy – reveal this curious mix of high

⁴⁰ Hiski Haukkala, 'What went right with the EU's Common Strategy on Russia?' In Arkady Moshes (ed.), 'Rethinking the respective strategies of Russia and the European Union', Carnegie Moscow Centre and Finnish Institute of International Affairs, 2003.

hopes, ignorance and lingering scepticism. The years since 2000 have been characterised by a more sober mood. Russia and the EU now understand each other much better. They know what they like and dislike about each other. The very process of co-operation, and the PCA in particular, served as a catalyst for this mutual disillusionment.⁴⁰

Disillusionment does not have to be entirely bad. It provides an opportunity for a thorough re-assessment and a new start. The EU is set to update its common strategy by the middle of 2004, or else think about something that could replace it. The update could be a good opportunity to re-launch its relationship with Russia on the basis of a more realistic assessment of mutual interests. Many observers have also called on the EU to imbue its relationship with Russia with more strategic vision. This is desirable, but also difficult as long as two key components of the relationship are in a state of flux, namely EU foreign policy and Russia's internal transformation. For now, the EU would be best served if it continued to strengthen co-operation in areas of clear mutual interest, such as trade, energy, visas and border management. And it should seek to reach common positions with Russia on more contentious issues, such as the common neighbourhood and the fight against terrorism. Geography and the multitude of common

interests leave Russia and the EU little choice but to continue working for a better relationship in the long run.

In some respects, conditions for improved relations are better now than they have been for a while. Putin is firmly in power for a second term, and he remains determined to maintain a broadly co-operative relationship with the West. Domestic political and economic stability will also guarantee a degree of consistency in foreign policy. The EU-Russia WTO deal of May 2004 has not only increased Russia's chances of entering the trade club, but could also pave the way for progress in other areas. President Putin has already indicated that Russia may finally move towards ratification of the Kyoto protocol. The WTO could also unlock negotiations in other areas, including visas, energy relations and the planned 'common spaces'.

However, there are reasons to believe that EU-Russia relations could worsen in the short to medium term. First, autocratic trends within Russia will complicate EU-Russia relations. Even if the EU stops insisting on building its relationship with Russia on 'shared values', it is unlikely to have cordial relations with a government that disregards human rights and civil liberties. Second, the slow-down of economic reform within Russia – in particular in the energy sector – will impede progress in EU-Russia economic integration. Third, a number of contentious issues are moving up the agenda at a time when the atmosphere in bilateral relations is already chilly, including the common neighbourhood and the visa problem. Russia is unlikely to soften its negotiating stance as long as economic growth and political stability provide a sense of strength and purpose unseen since Soviet days. If bilateral relations deteriorated further, the EU could become an easy target for growing nationalist sentiment in Russia. Already, polls show rising hostility towards the EU. In February 2004, 20 per cent of Russians thought Russia was not welcome in Europe and that the EU would never treat it as an equal. Fourth, suspicion of and antagonism towards Russia still run deep in some of the new

member-states. Some of them have long felt vulnerable to Russian bullying tactics. They may use their newly acquired veto on EU foreign and security policy to 'get tough' on Russia. "It's payback time", warned Toomas Ilves, Estonia's ex-foreign minister at a conference in 2003. The EU is unlikely to allow historical grievances to hijack its Russia policy, but progress could be tricky, at least during a transition period. Fifth, the EU's new neighbourhood policy offers Ukraine and other CIS countries the prospect of integration, provided they adopt EU norms and policies. Russia, which still regards the CIS as its strategic backyard, is unsure what to make of this. Russian politicians are warning of growing competition in the 'near abroad'. Things could come to a head if Ukraine defies veiled warnings from both sides and applies for EU membership after the next election in October 2004.

⁴¹ Graeme P. Herd, 'Russia and the EU', in Julie Smith and Charles Jenkins (eds), *Through the paper curtain*, RIIA, 2003.

Although there may be further tensions in EU-Russia relations, there is unlikely to be a crisis. The two sides are simply too important to each other. But there is a real risk that the EU and Russia could fail to resolve their differences and to exploit the potential of their relationship. The result would be some kind of 'enforced partnership'.⁴¹ Trade would become even more imbalanced, leaving a shaky Russian economy ever more dependent on oil and gas sales. There would be little foreign policy co-ordination. Russia and the EU would risk a standoff over the common neighbourhood. The EU would tighten its border checks and visa requirements. Animosity rather than co-operation would be the key ingredient in mutual relations. Clearly, both Russia and the EU will want to do their utmost to avoid such a scenario.

Recommendations: What the EU should do:

★ Focus on interests not values

Most Russians think that the EU's insistence on 'shared values' is intrusive, arrogant and ultimately counter-productive. As long as oil prices remain high and Putin is in charge of the Kremlin, the EU has very little influence over Russia's internal developments. Russia would feel a lot more comfortable with an EU that clearly defined its interests and bargained hard to get them. This does not mean that the EU should close its eyes to autocratic tendencies in Russia or atrocities in Chechnya. But rather than pretending that Russia shares its values and aspirations, the EU should openly acknowledge that there are profound differences.

★ Sing from the same hymn sheet

Russia cannot and will not take the EU seriously if the Commission, the Council and various member-states continue to pursue different policies and objectives. The member-states should agree on a number of realistic policy objectives for Russia and stick to them. This would require more discipline in Europe's capitals, but the rewards would be a much more credible CFSP and a smoother relationship with Russia. The next Commission president needs to figure out how to improve co-ordination between different parts of the Brussels bureaucracy, whether through a dedicated Russia commissioner or a Russia office reporting to the proposed EU 'foreign minister'.

★ Allow for flexible institutions

If the member-states became serious about sticking to pre-agreed positions, the EU would be less vulnerable to divide-and-rule tactics. And it could more easily respond to Russian demands for more flexible forms of co-operation. Endless

debates about the format of bilateral meetings are a waste of time and scarce resources on both sides. Russia itself will probably find that meetings with all the EU member-states (and the Commission) are a recipe for grandstanding and gridlock. But the EU's insistence that a 25+1 formula is out of the question "because the PCA says so" sounds simply stubborn to Russian ears – especially since much of the EU-Russia relationship is already conducted outside the PCA framework. If Russia craves the symbolism of meeting all EU members at the same time, the EU should offer it the occasional meeting at 26. Real work will continue to be done in smaller fora.

★ Ease visa requirements

It is in the EU's own interest to encourage more Russians to visit the EU, especially at a time when young Russians are becoming more nationalistic and suspicious of the West. The EU should stop insisting on strict reciprocity and move swiftly to streamline and ease Schengen visa requirements. It should build up a database of previous visits, so that business people, academics and representatives of civil society organisations no longer have to prove their identity and intention for each new visit. And it should open more consulates outside Moscow and St Petersburg to make it easier for Russians living in the regions to obtain a visa.

★ Support training and education on European issues

If the EU and Russia are to focus on common interests, Russia needs to be able to work more closely with EU officials on technical issues. But the dearth of well-trained EU specialists makes this unduly difficult. The EU should think about what it could do to help train more EU specialists in Russia. The EU should offer Russia a student exchange that is as extensive as its own Erasmus programme. It could set up a College of

Europe in Moscow, to supplement the ones in Warsaw and Bruges. Courses on European integration that involved an exchange-year abroad and foreign language tuition would be hugely popular with Russian students.

What Russia should do:

★ Acknowledge shared interests and reap mutual gains

Zero-sum thinking still dominates Russia's approach to the EU. The Union's enlargement is a case in point. As one Russian policy maker put it: "The EU is enlarging but the European continent is not getting bigger", implying that if enlargement is good for the EU it has to be bad for Russia. Russia's zero-sum approach clashes with the notion of mutual gains that is at the heart of European integration. Russia's approach is outdated and will impede it from reaping the potential benefits of co-operation with the EU. Russia should also scrap its habit of entering all EU negotiations with unrealistic requests, such as visa-free travel or influence over EU defence policies. The Russian tactic has been to make maximalist demands at the start of a negotiation, in hope of gaining minor concessions later on.

★ Take the political dialogue seriously and don't let things boil over

Vladimir Putin is the first Russian president to take the EU seriously and engage with it constructively. Yet Russia often lets problems fester, before trying to gain political capital from an impending 'crisis', as it has done on enlargement and the PCA, and also on Kaliningrad. If Russia wants to be a reliable partner for the EU, it must make better use of the existing bilateral dialogues, and also take working groups more seriously.

★ Streamline your policy machinery

The foreign ministry is the key player in the day-to-day management of EU-Russia relations. But most Moscow observers think its overall co-ordinating role has become a brake on EU-Russia relations. Policy formulation takes place in the Kremlin. There is a case for beefing up the Kremlin's resources on the EU, and eventually shifting the policy co-ordination role from the foreign ministry to the Kremlin.

★ Abolish visa requirements for all EU citizens

Russia, even more than the EU, would benefit from scrapping demands of strict reciprocity in visa negotiations. A move towards 'unilateral visa disarmament' would be hugely welcome by (potential) western investors and could give a big boost to Russia's underdeveloped tourism industry.⁴² Even a less radical step, such as easing visa requirements rather than

⁴² Robert Skidelsky and Pavel Erochkin, 'Unilateral visa disarmament', *The Moscow Times*, May 28th 2003. abolishing them, would vastly increase the pressure on the EU to shake up its own onerous visa regulations.

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THE EU AND RUSSIA

Strategic partners or squabbling neighbours?

Katinka Barysch

The EU and Russia share a multitude of interests and objectives. The EU is Russia's biggest export market, while Russia is a crucial supplier of energy to the Union. However, as Katinka Barysch explains, the two sides often squabble. The EU asks Russia to become more liberal, open and democratic, but Russians find the EU policy arrogant and intrusive. The Union's recent enlargement has made the relationship more tense. The pamphlet concludes with a series of recommendations to both the EU and Russia on how they can build a more constructive partnership.

Katinka Barysch is chief economist at the Centre for European Reform and also runs the CER Russia programme.



ISBN 1 901 229 56 4 ★ £10/€16