

BUSINESSEUROPE



# Taking European and Russian Relations Forward



December 2012

[WWW.BUSINESSEUROPE.EU](http://WWW.BUSINESSEUROPE.EU)

# WHO

## ARE WE?



BUSINESSEUROPE's members are 41 central industrial and employers' federations from 35 countries, working together to achieve growth and competitiveness in Europe.

Its mission is to strengthen the competitiveness of the European economy in order to increase prosperity and opportunities for all Europeans.

## OUTLINE

CALL FOR ACTION .....	<b>4</b>
INTRODUCTION .....	<b>5</b>
1 CRITICAL ASSESSMENT OF EU-RUSSIA TRADE AND ECONOMIC RELATIONS .....	<b>6</b>
2 ACCESSION TO THE WTO .....	<b>10</b>
3 BUSINESS CLIMATE .....	<b>11</b>
4 INDUSTRY .....	<b>16</b>
5 ENERGY .....	<b>19</b>
6 PEOPLE-TO-PEOPLE EXCHANGES .....	<b>21</b>
CONCLUSION .....	<b>22</b>



Jürgen R. Thumann  
President of BUSINESSEUROPE

On 22 August 2012 Russia joined the WTO and a new page was turned for EU-Russia relations. WTO membership provides Russia with a framework for structural reforms that will help improve the business climate and increase bilateral trade and investments. But it also creates opportunities for a step change in our bilateral partnership.

*BUSINESSEUROPE believes that this is  
a rare opportunity to deepen our  
economic cooperation.*

Our new Russia Strategy sets out the definitive pathway for a new EU-Russia growth partnership based on an ambitious EU-Russia Agreement covering people-to-people exchanges and cooperation in the fields of industry and energy.

We hope all companies in Europe, and in Russia, will join us to make this happen.

A handwritten signature in black ink that reads "Jürgen Thumann". The signature is written in a cursive, flowing style.

# CALL FOR ACTION

**The following key policy objectives should be prioritised:**

- 1** Strict implementation of Russia's WTO Accession Protocol. **BUSINESSEUROPE** will keep a list of main barriers to trade and investment to better inform companies and facilitate solution at the political level.
- 2** Acceleration of the negotiations for a new, ambitious EU-Russia agreement and launch of a separate agreement on investment with WTO+ provisions, if investment provisions are not included in the new agreement.
- 3** Launch of studies to explore the possibilities and scope of negotiations on a FTA with Russia or the Customs Union in the forthcoming years.
- 4** Further reciprocal facilitation of the EU-Russia visa regime, by transition to a multiannual regime without invitation requirements as a next step towards visa-free travel between the EU and Russia.
- 5** Improvement of the efficiency of Russia's energy supply networks and promotion of investment in energy and other infrastructure.
- 6** Continuation of the negotiations for Russia to become a full member of the OECD in the next two years.

# INTRODUCTION



The trade and economic ties between the EU and Russia are long-standing and expanding, and the two partners consider their relationship a strategic one. Russia is the 3rd largest trading partner of the EU with 45% of Russia's imports, 55% of its exports and 75% of its foreign direct investment (FDI) originate from the EU.

Apart from the Partnership and Cooperation Agreement (PCA) which provides the general political framework of the EU-Russia relations, numerous other initiatives and fora exist to promote EU-Russia cooperation. To name a few, the Partnership for Modernisation and the EU-Russia Common Spaces at the political level, or the Industrialists' Round Table (IRT) and the Northern Dimension Business Council, and cooperation between BUSINESSEUROPE and the Russian Union of Industrialists and Entrepreneurs (RSPP) at the business level.

Overall, business recognises that there is good will from both partners to further enhance their relationship. Significant challenges have nevertheless resulted in delays in the delivery of concrete results. It is indicative, for instance, that it took 18 years of negotiations for Russia to become member of the WTO and negotiations on the New EU-Russia Agreement to replace the PCA have already taken several years since the automatic extension of the initial period of the PCA in 2008.

The purpose of this strategy paper is to assess and make recommendations for taking forward the European and Russian bilateral relationship.

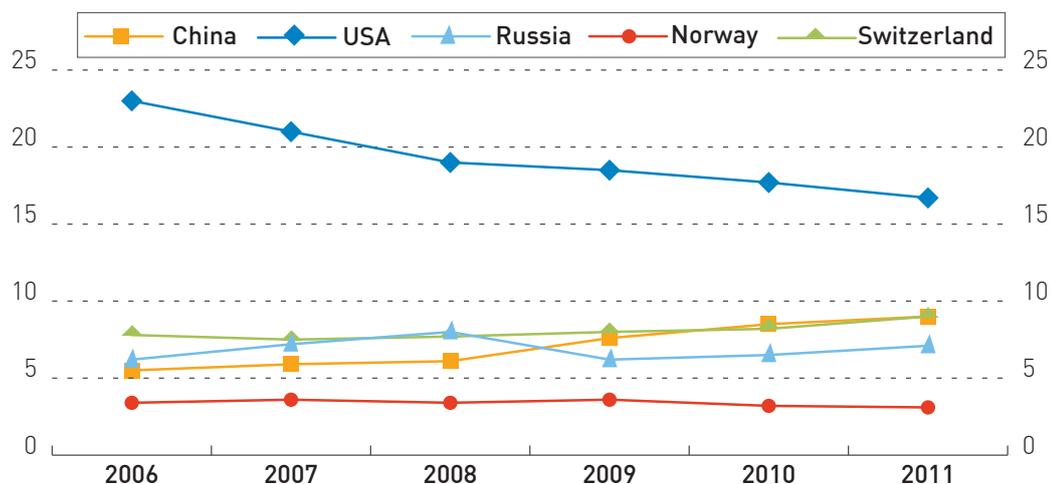


## Trade relations – some facts and figures



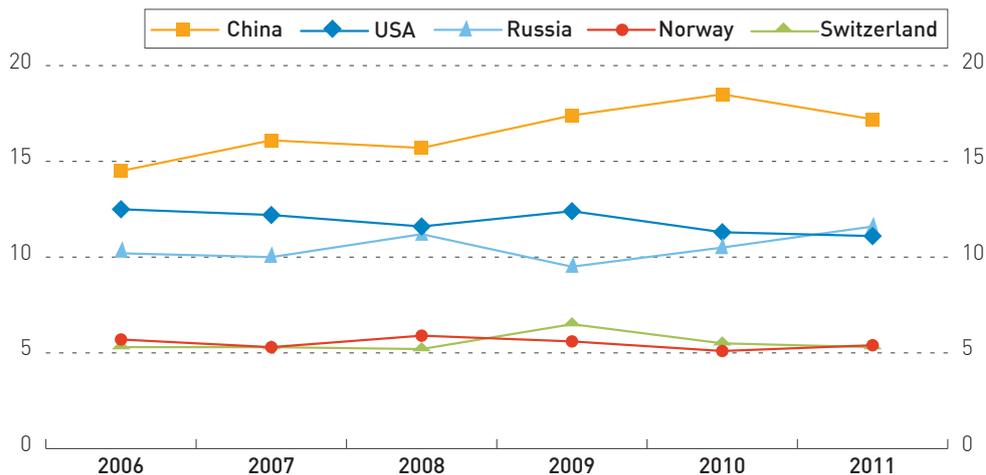
Despite the drastic drop in 2009 the overall trend of the EU-Russia bilateral trade has been positive and increasing since 2006, while Russia's GDP per capita (2011) was €9,508, close to Spain's (€9,900). In 2011, both imports and exports surpassed the pre-crisis levels. As figures below indicate, 7% of all EU exports in 2011, representing 108bn euro, were destined to Russia, while 11.8% of all EU imports for the same year, which correspond to €199 billion, came from Russia.

Chart 1 Share of EU Exports 2006-2011 (per cent)



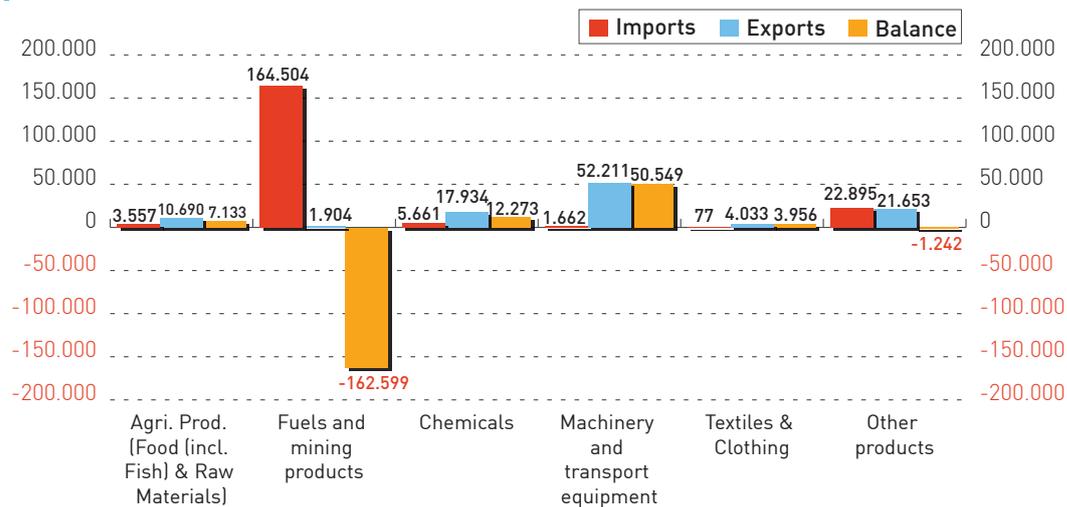
Source: Eurostat

**Chart 2 Share of EU imports 2006-2011**



Source: Eurostat

**Chart 3 Outlines the main categories of products traded between the EU and Russia (2011) in millions of euros**



Source: DG Trade

As indicated by the figures, energy and minerals play a dominant role in the EU imports from Russia. The second sector is chemicals.

EU exports are mainly machinery, chemicals and other industrial products.



## The political framework



- The EU and Russia are associated with a Partnership and Cooperation Agreement (PCA) which was signed in 1994. The PCA, which came into force in 1997, constitutes the basis for the development of further and closer relationships between the two partners, especially in the fields of trade and economic cooperation. Other areas of cooperation include culture, the prevention of illegal activities and illegal immigration.
  
- In the framework of the PCA, the EU and Russia agreed in May 2003, during the Summit of Saint Petersburg, to create the following four Common Spaces:
  - 1. Common Economic Space**

Trade and economic issues as well as energy and environmental issues are dealt with the form of regulatory and policy dialogues.
  
  - 2. Common Space of Freedom, Security and Justice**

Illegal migration, organised crime and other cross-border issues of security nature are covered. Furthermore, cooperation in the field of Justice is promoted and based on a commitment to democracy and human rights.
  
  - 3. Common Space of External Security**

It includes crisis management and cooperation with EU operations (for instance, between the EU NAVFOR Atalanta and the Russian naval mission in the Gulf of Aden).
  
  - 4. Common Space of Research and Education**

It covers EU-Russia cooperation in the fields of science and technology to promote innovation, the cooperation among universities, academic mobility and modernisation.

- Negotiations for a new bilateral EU-Russia agreement, which will eventually replace the existing PCA, were launched in 2008. Although the process has been moving at a slow pace, the accession of Russia to the WTO and the prospects that stem from it could accelerate the negotiations for a bilateral EU-Russia Agreement. Nevertheless, the two partners need to overcome fundamental differences and address significant challenges. For instance, negotiations with regard to a trade and investment chapter are lagging behind. An ambitious WTO+ Agreement should be promoted, which would cover market access and investment protection provisions.

European businesses see a comprehensive Agreement between the EU and Russia as the most effective way to underline the strategic nature of EU-Russia relations. A clear and non-discriminatory framework for investors would not only promote bilateral trade but also contribute in the creation of growth and jobs. The political leadership should grasp the momentum that is currently presented by Russia's accession to the WTO and its future accession to the OECD. It is an opportunity not to be missed.

- The Partnership for Modernisation was launched during the 25th EU-Russia Summit in Rostov-on-Don, on 31 May-1 June 2010. The Partnership comprises of technical sectoral dialogues, groups of cooperation as well as a number of concrete projects. It constitutes a 'positive agenda' for EU-Russia relations overall and it is seen as a vehicle that could help Russia diversify its economy and overcome its over reliance on the export of raw materials.

Over the past months, the process of the Partnership for Modernisation has been experiencing a slow down, mainly due to the Parliamentary and Presidential elections that took place in Russia (in December 2011 and March 2012 respectively). It seems that the process is once again accelerating and the two sides are ready to explore the prospects for further scientific and technological cooperation, for example in the field of space (EU programme Horizon 2020).

- Eurasian/Customs Union between Russia, Kazakhstan and Belarus: BUSINESSEUROPE welcomes the process of regional integration. Restrictions however exist. Certain challenges are presented in the process of the New EU-Russia Agreement, as Russia promotes the idea that the EU negotiates with all three members of the Eurasian Union. In the June 2012 Summit in Saint Petersburg the EU and Russia agreed to continue their discussion to find a solution in the framework provided by the latter's Accession Protocol to the WTO.



On 22 August 2012 Russia officially became a Member of the WTO. BUSINESSEUROPE welcomes this development, which for many years has been the number one priority of the EU trade policy towards Russia.

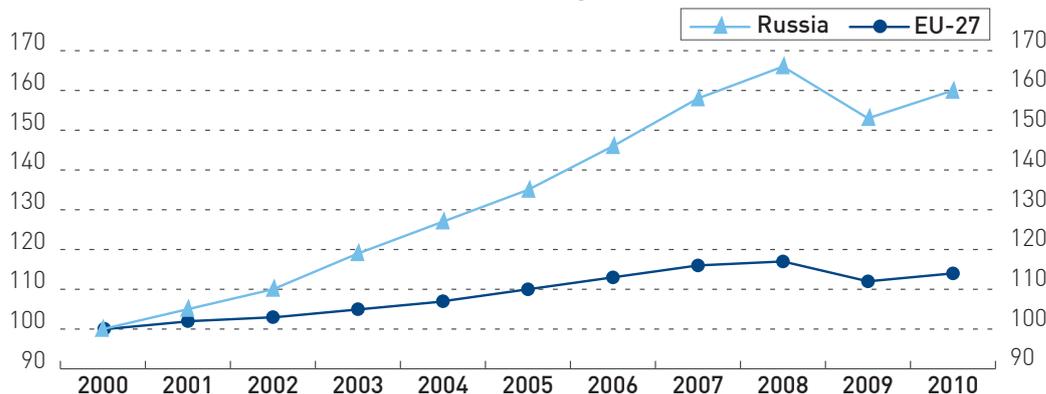
How Russia's accession to the WTO can enhance bilateral relations:

- It brings in the multilateral trading system the only big country – a member of the BRICS – that was not so far a member to the WTO. From now on, Russia will be obliged to implement on equal terms the multilateral trading rules that apply for all WTO Members.
- It can open the Russian market. In its Accession Protocol, Russia has signed up for considerable commitments (including in tariffs, services, legislation for transparency and predictability) that will bring more certainty in Russia's trade relations.
- It can make Russia accountable to its trading partners. Russia will be obliged to publish all new laws and regulations and notify members on measures the country intends to adopt. Furthermore, the WTO dispute settlement system may be also used. Russia will be able to launch cases against a WTO Member, as well as a WTO Member may start a procedure against Russia.
- It can give new impetus to the diversification of Russia's economy. The participation in the WTO can be an enabler for Russia to adopt the appropriate regulatory and structural reforms that could promote innovation, for instance in the fields of Intellectual Property Rights (IPR). This could also open more possibilities for Russia to join international value chains.
- EU-Russia bilateral trade can improve. There is a clear correlation between a country's accession to the WTO and the attraction of investments. This was for example observed in the cases of China, Saudi Arabia and Vietnam.

Implementation is key. European business calls for the European Commission to closely monitor the implementation process of the WTO Accession Protocol in Russia and provide technical and legal assistance where needed. All measures that contradict Russia's Accession Protocol and could potentially harm trade should be concentrated in a database to inform companies, activate the political leadership and help tackle the problems.

In the past years Russia has been experiencing comparatively high GDP growth, as the graph below indicates.

**Chart 4 Gross Domestic Product (GDP): indexed development 2000-2010 (2000=100) (national currencies, constant prices)**



Source: Eurostat (EU-27), OECD (Russia)

The country also has a low public debt and the third largest stock of foreign currency reserves, 40% of which are in euro. These constitute positive perspectives for the future. With regard to the structure of Russia's economy, industry has a relatively high share of the country's economic output at 27.5%, while services account for 68% and agriculture for 4.7% (source: OECD).

### STRATEGY 2020

In 2008, the then President Dmitry Medvedev, presented the Strategy 2020. It comprises a series of reforms for the modernisation of Russia's economy and concentrates around the following objectives:

- undertaking a process of privatisation,
- increasing spending on education and infrastructure,
- improving the environment for investments.

The Strategy 2020 sets an ambitious agenda, however not many concrete, tangible results can be identified so far. The progress of the reforms has been relatively slow, the accession to the WTO, however, is expected to revive the process.



## DOING BUSINESS IN RUSSIA

Russia is considered a market economy, and constitutes the number one destination for FDI in the region of Central and Eastern Europe (Ernst & Young, 2012). The table below shows the concentration of FDI projects in Russia per sector. Activities in manufacturing and sales and marketing concentrate 84% of the FDI.

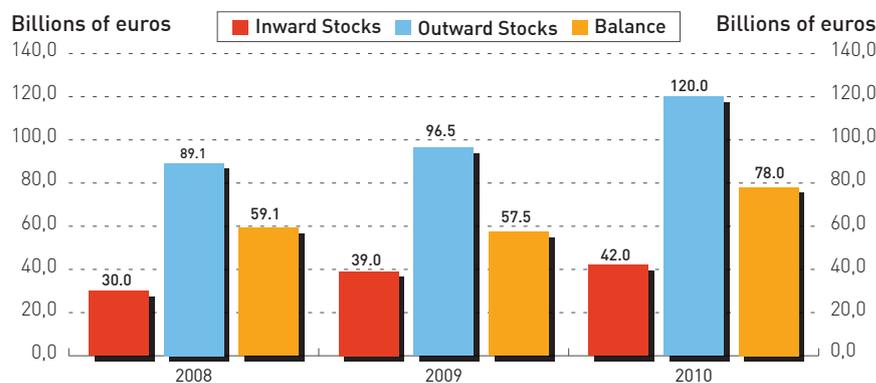
**Table 1: FDI projects by activity**

Rank	Activity	FDI projects (2007-11)	Share of total (2007-11)
1	Manufacturing	402	51%
2	Sales and Marketing	259	33%
3	Logistics	46	6%
4	R&D	25	3%
5	Testing and servicing	20	2%
6	Headquarters	12	2%
7	Education and training	8	1%
8	IDC	4	1%
9	Shared services center	4	1%
10	Contact center	1	0%
	Total	781	100%

Source: Ernst & Young's European Investment Monitor 2012

The following chart presents the total EU stocks of FDI with Russia, both inward and outward. In 2010, €120 billion were invested by EU Member States in Russia, while Russia's investments in the EU reached €42 billion.

**Chart 5 EU27 Stocks of FDI with Russia**



Source: Eurostat (NewCronos)

More specifically, the table below shows the FDI inflows in Russia in rankings based on 2011 figures. Amongst EU Member States, Cyprus<sup>1</sup>, the Netherlands, Luxemburg and Germany concentrate the majority of FDI inflows.

**Table 2: Inflows of direct investment into Russia, stock at year's end, US\$ billion (rankings based on 2011 figures)**

	Total	2009	2010	2011
		<b>378.8</b>	<b>489.3</b>	<b>455.9</b>
1	Cyprus	129.9	179.2	128.8
2	Netherlands	33.6	40.0	59.7
3	British Virgin Islands	36.6	51.0	56.4
4	Bermuda	27.2	49.8	32.5
5	The Bahamas	18.7	24.6	27.1
6	Luxembourg	14.4	19.7	20.3
7	Germany	15.3	23.1	18.7
8	Sweden	11.7	18.1	16.1
9	France	9.0	11.5	15.4
10	Ireland	0.2	3.8	8.9
11	Jersey	0.3	0.4	8.7
12	Austria	7.4	7.8	8.3
13	United Kingdom	6.5	7.8	6.3
14	Switzerland	5.7	6.5	6.3
15	Gibraltar	10.2	5.8	5.9
16	Finland	5.5	6.6	5.4
17	United States	13.9	5.4	3.4
18	St. Kitts and Nevis	0.1	0.2	2.8
19	Belgium	1.9	2.6	2.2
20	Japan	1.2	2.0	2.0
21	China	1.3	2.0	1.4
22	Italy	1.1	1.3	1.2
23	Denmark	0.9	1.4	1.1
24	South Korea	1.2	1.9	1.0
	Others	25.1	16.8	15.9

Source: Central Bank of Russia

<sup>1</sup> It is assumed that most of this investment is actually repatriated Russian capital.



The country however presents certain particularities. Stability and predictability are key factors in attracting foreign investments. Nevertheless, these conditions are undermined by the long standing problems of corruption as well as low administrative capacity and bureaucracy in Russia. The OECD Anti-Bribery Convention (Russia became member on 17 April 2012) should boost structural reforms that would help Russia effectively address these problems.

Legal and administrative burdens also exist in Russia. Laws and regulations that are not favourable for the establishment of investors as well as put limitations to the production processes may be displayed. For instance, changes in definitions of products or labelling requirements (brewery industry) or the introduction of additional qualification criteria and assessment processes (telecommunication infrastructure equipment) are telling examples of measures that may have a negative impact to foreign investments.

The table below shows the evolution of selected governance indicators for the period 2000-2010.

**Table 3: Russia: World Bank Governance Indicators, 2000-2010 (percentile rank, 0-100)**

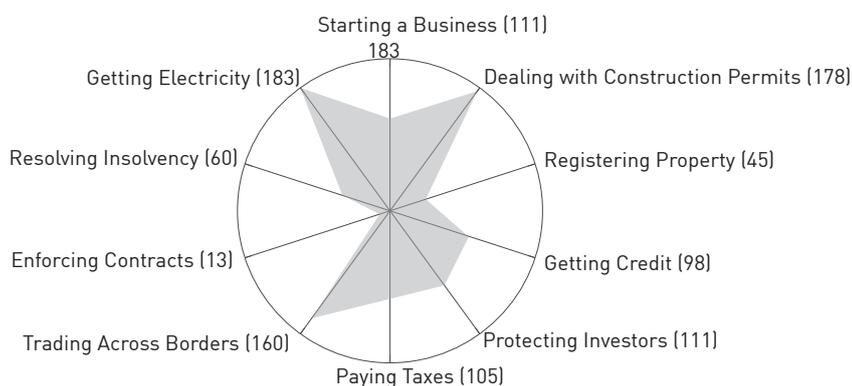
	2000	2005	2010
Voice and accountability	33.7	27.9	20.9
Political stability	13.9	13.9	18.4
Government effectiveness	26.3	38	41.6
Regulatory quality	29.9	50	38.3
Rule of law	16.3	19.6	26.1
Control of corruption	15.6	23.9	12.9

Source: World Bank, Governance Indicators (2012)

Europe and Russia should invigorate their dialogue in order to achieve regulatory harmonisation. This rapprochement will improve market access and increase investment opportunities.

According to the Doing Business Report of the World Bank and the IFC (2012), Russia ranks in the 120th position on the ease of doing business. Using different indicators, the figure below measures the ease of doing business in Russia:

**Chart 6 Ranking of the Russian Federation on different factors of doing business (out of 183 countries)**



Source: Doing Business database, World Bank/IFC

Starting a business in Russia on average, requires 30 days while 9 different procedures need to be completed. As the chart below indicates, overall, the situation has been improved.

**Table 4: The ease of starting a business in Russian Federation over time by Doing Business report year**

Indicator	DB 2004	DB 2005	DB 2006	DB 2007	DB 2008	DB 2009	DB 2010	DB 2011	DB 2012
Rank	..	..	..	..	..	..	..	106	111
Procedures (number)	14	11	10	9	9	9	9	9	9
Time (days)	44	36	31	30	30	30	30	30	30

Source: Doing Business database, World Bank/IFC

Note: .. = not applicable (the economy was not included in Doing Business for that year).

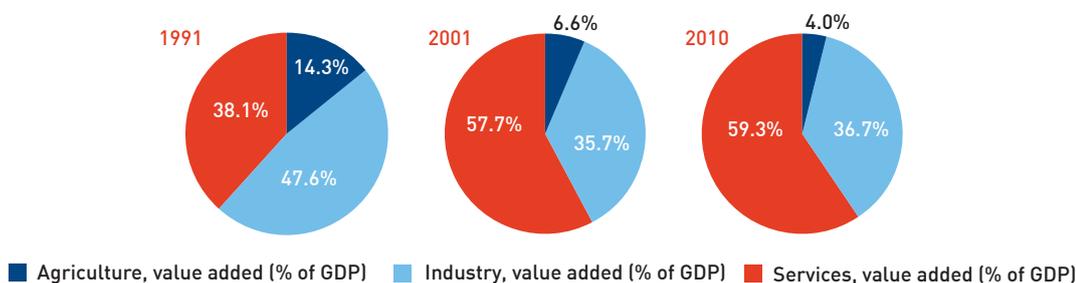
DB2012 rankings reflect changes to the methodology.



Russia has a long industrial tradition and industry represents 27.5% of Russia’s economic output, including the sectors of energy and raw materials (OECD, 2012).

The figure below shows the change over time in the contribution of sectors of agriculture, industry and services in Russia’s GDP. With regard to industry, manufacturing takes up 16% of GDP, to which the automotive sector contributes almost 5% and the chemicals sector around 3.5%.

**Chart 7 GDP by sector**



Source: World Bank (World Development Indicators)

The potential of Russia’s economy is overall good. There is a need however to modernise and diversify the industrial tissue. There are two possible ways to achieve this:

- Russia to modernise its economy by “leap-frogging”, for example Moscow to become a financial centre.
- “Evolutionary way”, by developing a secondary industry, for instance in the food, chemicals, or sophisticated metals sectors.

Russia's accession to the WTO on one hand, and the Partnership for Modernisation on the other, paved the way for the structural reforms that Russia needs to undertake in order to achieve this.

## The role of the Regions

Many Russian regions have great potential for economic growth. They are rich in natural resources and have a long industrial tradition, especially in the manufacturing and energy sectors. However, a technological leap forward should be made in order for Russian regions to catch-up with regions in the EU and elsewhere.

There is significant divergence between regions with regard to attraction of investments. The top three regions with regard to the attraction of FDI are:

- 1 Moscow (Federal City) – 30% of FDI
- 2 St. Petersburg (Federal City) – 12% of FDI
- 3 Kaluga (Region) – 5% of FDI

*Source: Ernst & Young, 2012*

Nizhny Novgorod and the city of Kazan also rank well in terms of FDI shares.

Well educated and skilled workforce, active local authorities that are receptive to business needs, as well as a friendly tax environment constitute the main advantages that the top FDI destinations present.

On the opposite side, there are regions in Russia that attract less than 1% of FDI, for instance Khabarovsk, Rostov or Irkutsk. Concentration and over-specialisation, for instance over reliance on the export of raw materials and energy, as well as a business climate that is not favourable to new investments, are the main factors that do not allow the potential of these regions to be tapped.

Overall, the diversification of Russia's economy and the improvement of infrastructure should help improve the quality of products, enhance the competitiveness of Russian industry.



## A four-axis strategy for Russian regions:

### 1 INSTITUTIONS

The modernisation of local institutions is critical for economic growth. The adoption of legislation that facilitates the localisation of foreign companies will lead to the development of the regional economic potential. Such measures could be: cut of red tape, high-level municipal engineering, offering tax incentives, removing technology transfer barriers and properly implementing effective Intellectual Property Rights (IPR) protection. A constant dialogue should also be established between local authorities and stakeholders, in order for regional strengths and weaknesses to be identified.

### 2 INFRASTRUCTURE

Amelioration of the existing rail and road networks in Russia – both inter and intra-regional, but also cross-border connections between the Russian regions and the European regions – as well as the construction of new, including airport hubs and telecommunication networks, would improve connectivity and reduce the time that the supply of raw materials and products take to reach their final destination. Services will also be facilitated.

### 3 HUMAN RESOURCES

Skilled, highly competitive human resources are considered an asset for companies in all sectors and a real challenge for European investors in Russia. Development of human capital in Russian regions will greatly help achieve high levels of competitiveness and production efficiency. To this end, collaboration with experienced European companies and organisations is the key in bringing the desirable results. Training centres, organisation of seminars and exchange of staff could all be part of such cooperation between Russian and European counterparts.

### 4 UNIVERSITY-INDUSTRY LINKAGES

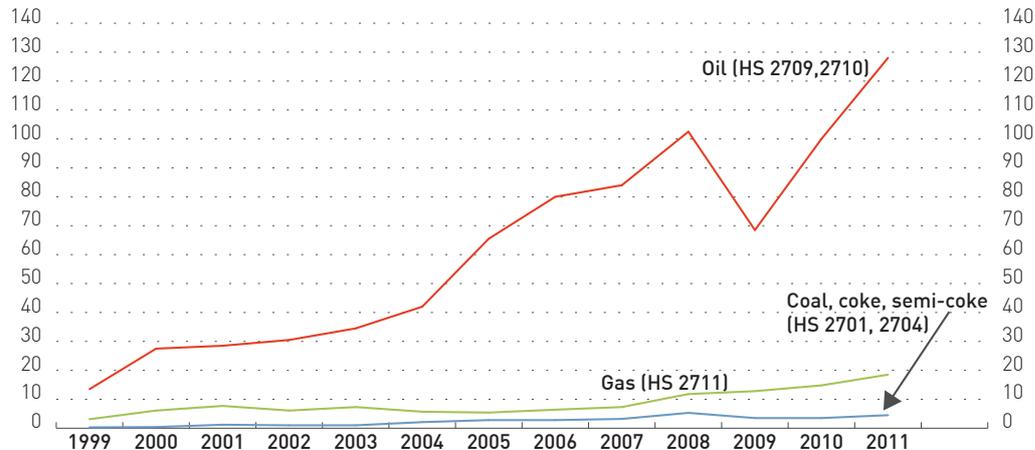
Creating networks between the industry and universities will foster Research and Development (R&D) and Innovation in regional economy. Taking advantage of new technologies and media, the establishment of R&D centers will evoke the development of new, innovative products. This will in turn improve the competitiveness of the Russian companies and give them significant market access opportunities.

The four elements or economic development strategies presented above will help Russian regions not only attract investments, but also keep these in the region. Thus, regional systems of innovation will be created, which will in turn foster the development of industrial clusters.

Energy plays an important role in Russia's economy, representing the main source of exports. The EU is no exception. In 2010, the EU energy imports from Russia represented 74% of the total EU imports from Russia. Oil imports amounted to 63%, gas imports reached 9%, while coal imports represented 2%. Electricity worth €693 million was imported from Russia in 2010 as well.

The figure below shows the evolution of EU energy imports from Russia for the years 1999 to 2011. The mass of EU imports are in oil, with gas and coal following. Furthermore the relative growth of imports of solid fuels is considerable with Germany, Poland and Finland being the main importers, although their overall share of EU energy imports remains low.

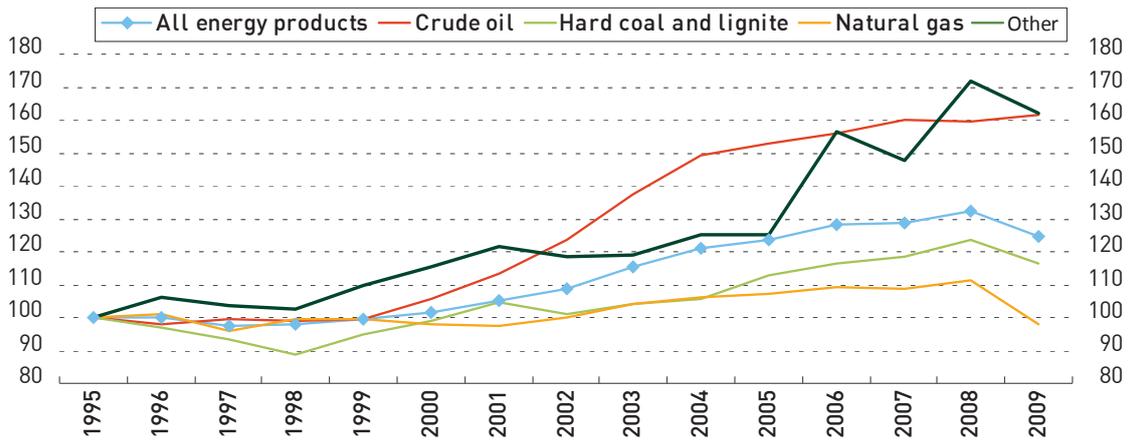
**Chart 8 Main energy imports from Russia, billions of euros**



Source: Eurostat

As the next figure shows, energy production in Russia has experienced a positive trend since 1999. We notice that while the production of oil has increased significantly. A sharp decline has been experienced following the outburst of the financial crisis (2008). Interestingly however, the nuclear and renewable energy production – under the category “other” – has increased as well.

**Chart 9 Primary energy production in Russia - indexed series (1995=100)**



Source: Russian Federal State Statistics Service

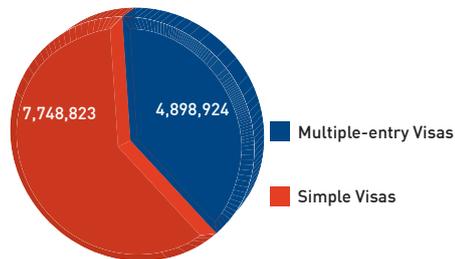
Russia is one of the main providers of energy in the world. Nevertheless, this ability may be compromised in the future because of lack of efficiency in energy supply. It is imperative that Russia improves its energy infrastructure (extraction infrastructure, refinery infrastructure, modernisation of the gas pipelines network) in order to facilitate exports.

Furthermore, the issue of pricing of energy products is of particular importance to Russia's trading partners. For instance, the prices that apply to domestic consumption for gas are significantly lower than those applied for the gas that is being exported.

In 2007, the EU and Russia signed a bilateral agreement on the facilitation of the issuance of visas to the citizens of the European Union and the Russian Federation. The Agreement describes the rules and procedures that apply in the issuance of visas, including the multiple entry visa requirements. Currently, a limited number of categories may apply for this type of visas.

In 2011, 12,647,747 visas in total were issued by the EU. The chart below indicates the shares of multiple and simple visas.

**Chart 10 Number of visas issued by the EU (2011)**



Source: DG Home

Although business and scientific travellers are covered by the multiple entry regime, European business would like to see further liberalisation in the EU-Russia visa regime. Lifting unnecessary administrative burden on a reciprocal basis will increase business and academic mobility between the two partners. These exchanges will in turn contribute to the improvement of skills, increase of the competitiveness and the adoption of innovative practices by both Russia and the EU.

# CONCLUSION



This strategy paper attempts to give an overall assessment of the trade and economic relations between Europe and Russia. While recognizing the existing barriers and challenges, it focuses on the issues which could best promote bilateral relations in the future.

The conclusion of an ambitious EU-Russia agreement will not only improve the regulatory framework, and thus increasing investments in manufacturing and services, it will also pave the way for closer links between our societies through for example the establishment of a visa-free travel regime.

Most importantly, this report shows that progress in bilateral relations is closely tied to the timely implementation of Russia's multilateral commitments in the WTO. WTO accession and closer bilateral ties with the EU can provide Russia with a huge opportunity to modernise its economy, improve governance and attract new investments.

## Further information



For more information, please contact the  
**International Relations Department:**

**Adrian van den Hoven, Director and  
Sofia Bournou, Adviser**

Tel +32 (0)2 237 65 29

E-mail [s.bournou@businessseurope.eu](mailto:s.bournou@businessseurope.eu)

POLICY BRIEFING

BUSINESSEUROPE

6 January 2012

**EU-RUSSIA RELATIONS  
AND PARTNERSHIP FOR MODERNISATION**

### KEY MESSAGES

- 1 Europe and Russia are key trade and investment partners, but Russia's business environment can be challenging for European exporters and investors.
- 2 Russia's WTO accession and the early conclusion of the New EU-Russia Agreement will boost bilateral trade and investment.
- 3 The Russia, Belarus and Kazakhstan Customs Union should be transparent and rules-based and should emulate EU technical regulations.
- 4 The EU-Russia Partnership for Modernisation can boost EU-Russia relations.

The policy briefing "EU-Russia relations and partnership for modernisation" can be downloaded on our website  
[www.businessseurope.eu](http://www.businessseurope.eu).



# BUSINESSEUROPE



MEMBERS ARE 41 LEADING  
NATIONAL BUSINESS FEDERATIONS  
IN 35 EUROPEAN COUNTRIES



BUSINESSEUROPE AV. DE CORTENBERGH, 168 / BE-1000 BRUSSELS  
TEL + 32 (0) 2 237 65 11 / E-MAIL: MAIN@BUSINESSEUROPE.EU  
[WWW.BUSINESSEUROPE.EU](http://WWW.BUSINESSEUROPE.EU)