

To the participants of the international conference Russia's
opening to the world economy and establishment
of the common European economic space

Dear colleagues,

Please accept my greetings and wishes of success on behalf of the Government of the Russian Federation. The subject of this conference is important not only because the concept of a common European economic space has so far been formulated very broadly and has yet to be given real content.

The prospects of EU-Russia relations are being widely discussed on the political level, in the business, academic and expert communities. I am confident that the conference will help to identify the areas and forms of cooperation which could contribute to harmonization of the Russian and European legislations, to consistent and reasonable approximation of rules and standards, and thereby to Russia's openness to European investors and partners.

Sectoral issues are, of course, at the top of the current agenda of negotiations between Russia and the European Union. Barriers, created by both parties to establishment of a common European economic space as regards specific sectors of the economy, need to be identified and implications of establishment of a common market for specific goods and services should be forecast. Hence the continuing dialogue between Russia and the European Union is to largely not only a dialogue of politicians but also that of experts. In this context the role of such events as your conference can hardly be overestimated.

In conclusion, allow me to express my gratitude to the Academy of the National Economy under the Government of the Russian Federation, the Working Centre for Economic Reform of the Government of the Russian

Federation, and the Russian-European Centre for Economic Policy, as well as hope that that the conference will be very productive.

Victor Khristenko,
Deputy Chairman of the RF Government

Development of a concept of a common European economic space between Russia and EU

Establishment of a common European economic space (CEES) is undoubtedly very important both from the perspective of promotion of Russia's integration into the world economy and that of determination of medium-term and long-term prospects of further cooperation between Russia and the European Union, with EU enlargement and Russia's forthcoming accession to the WTO taken into account.

It is fair to say that the idea of development of a common European economic space has resulted from the entire course of Russia's cooperation with the EU, has long been ripening and finally materialized in the form of the agreement of the Russia-EU Moscow summit of May 17, 2001, on setting up a Joint High-Level Working Group to develop a concept of a common European economic space.

The following summit (Brussels, October 3, 2001) approved a mandate of the High Level Group (HLG) co-chaired by Victor Khristenko, Deputy Chairman of the Government of the Russian Federation, the Chairman of the Government Commission on Cooperation with the EU, and Christopher Patten, External Relations Commissioner.

The main task of the group is to study prospects for closer economic cooperation and harmonization of legislation, and to design tools and mechanisms for achieving common goals. An agreement was reached that fulfillment of the mandate will be reviewed, with the mandate itself possibly revised by a EU-Russia summit no later than October 2003.

The Group's effort to develop a concept of a common European economic space was highly appreciated by the latest EU-Russia summit (Moscow, May 29, 2002) which approved its report incorporating a working plan for establishment of the CEES with regard to some pilot key areas. Specifically, at the first stage opportunities will be studied for legislation harmonization in such areas as standards, technical regulation and conformity assessment, tariff regulation, government procurement, competition, and establishment of a CEES in relation to some services sectors (financial services, accounting and auditing, transport, commercial space launches, and telecommunications),

industries (ferrous and non-ferrous metallurgy, aircraft and automotive industries), and agriculture (meat and meat products, grain).

Thus, identification of opportunities for harmonization of legislation and regulatory systems will be complemented by finding opportunities for stepping up economic exchanges, development of trade and promotion of investment in some areas of production and the services sector.

Independent experts were involved in development of the CEES on both sides. Reports prepared will be discussed by agencies concerned, based on which practical recommendations on development of a concept of the CEES will be formulated.

Of course, establishment of the CEES “from the bottom upwards” cannot substitute for development of its strategy and concept. In this connection, I would like to emphasize that we are only at the outset of a long process without precedent in history. Therefore, in addition to official organizations, it is important to involve in these activities the business community, academic institutions, research centres and non-governmental organizations. Dialogue with key actors in society is all the more important, since the issue in question is the strategy of Russia’s relations with the EU. The concept of a CEES will undoubtedly have an all-European dimension. This concept should look beyond the current stage of EU enlargement.

In this connection it would be appropriate to mention interesting results produced by the Russian-European Centre for Economic Policy. The White Paper on the issues of Russia’s openness and establishment of a common European economic space is undoubtedly an important academic contribution to development of approaches to those issues, providing a lot of food for thought.

As the authors point out rightly, “establishment a Common European Economic Space is sustainable growth for all the inhabitants of Europe. Between them, Russia and the EU have all the ingredients of success at a time when globalisation and knowledge are the main levers of development.”

We hope that we will be able to seize this historic opportunity and achieve success.

In developing the CEES concept, the experience of European integration involving the EU should be taken into account, specifically, the experience of operation of the European Economic Area between the EU member states and the EFTA.

It is based on implementation of the principle four freedoms (movement of goods, services, capital, and people), as well as competition and close cooperation in other areas, such as environment protection, research, education and social policy.

The idea of possible connection of the CEES concept with the Barcelona process of developing EU cooperation with the Mediterranean countries is very interesting.

In developing the CEES concept it is necessary to take into account the Treaty on Customs Union and Common Economic Space signed by Russia, Belorussia, Kazakhstan, Kirghizstan and Tadjikistan, the Treaty on Establishing the Eurasian Economic Community involving the same countries that has come into force already, and the process of establishment of common economic area as part of establishing the Russia-Belorussia union state.

The concept of the CEES may be of practical interest to the European non-EU member countries, which seek closer cooperation with the EU.

Andrey Denisov,
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Key recommendations of RECEP White Book

1 – The Common European Economic Space (CEES) between Russia and the European Union has first to be considered as a *co-development path* that will define, step by step, its actual content. The final aims of this space are : to implement the four fundamental freedoms for goods, services, capital and persons ; to achieve an intensive exchange of know-how and capital through FDI ; and to support strong modernisation policies.

2 – This co-development path is of *mutual interest*. For Russia it offers a way to diversify an economic system based mainly on exploitation of natural resources and permanently exposed to Dutch disease, and to organise a diversified competitive economy based on relevant investments. For the Economic Union, Russia is a major foreign trade partner in absolute terms and presents opportunities for capitalisation of EU strengths through increased complementarities. Both parties will gain increased prosperity, stability and security from creation of the CEES.

3 – This co-development path is a way for Russia to find a *virtuous growth cycle* that could become sustainable. It is dependent on adequate positive interactions between development of trade liberalisation (the small scale of Russian domestic market makes the EU market vital for modernisation of the Russian economy), investment and know-how flows and institutional adjustments. Lack of parallelism between these three essential pillars would induce inefficient reorganisation and could even generate tensions.

4 – The EU *acquis communautaire* should be viewed as a lever for growth and modernisation for Russia, at all stages of the process. The *acquis* can offer Russia many solutions for construction of modern market institutions, but it is important to distinguish between parts of the *acquis*, which are logically related to the need for growth in a market environment, and parts of the *acquis*, which have more to do with EU enlargement processes. Priority should of course be given to the former, whatever the global agenda of the CEES. As shown by the White Book, the most relevant measures are those

likely to improve the investment climate and lead to a business-friendly environment, particularly for SMEs.

5 – Dynamic strategies underlying implementation of the CEES must consider new features of the world economic environment. Growth relies on new productive paradigms, such as the knowledge economy and environmental values. Orientation towards the knowledge economy is very consistent with Russia's human capital endowment. This means that themes such as intellectual property rights, environment-friendly production or SME development have to be at the top of the agenda.

6 – Econometric simulations showed that the best concept for the Common European Economic Space between Russia and the EU is one that combines effects of trade liberalisation with productivity effects of internal adjustment thanks to strong FDI flows. The economic efficiency for Russia of such a CEES concept is manifest, since it will lead to the highest GDP increase, strong expansion of imports and exports, a higher share of manufactured goods in exports, and improved welfare in Russia.

7 – Macroeconomic modelling proved that exists a strong potential for trade through the CEES. Gravity measurement showed that mutual trade between the EU and Russia could be multiplied by several times. Realisation of this potential is not basically detrimental to trade between Russia and other CIS countries, although Russia-CIS trade is now higher than is economically justifiable.

8 – Institutional adjustments are necessary for the Russian economy to be competitive and sustainable, whatever type of integration is considered. Better adjustment between capital and investment and better implementation of property rights are of major importance for the Russian economy. The CEES must be viewed as a way to support such a process. It has been shown that convergence towards market-friendly institutions, which exist in the EU, could alone produce an 80 % increase in trade between Russia and the EU.

9 – In its movement towards WTO accession, Russia has made the important choice of "large openness" as opposed to "small openness". The nature of Russia's negotiations on bound tariff rates, which will be progressively reduced, suggests that Russia will benefit from a 6-8 year "window" in order to implement needed adjustments. This is not a long time. EU support is

essential for Russian accession to the WTO, and active partnership within the CEES for modernisation of Russia's production is a condition for making this accession a success.

10 – World standards in productivity, competitiveness, product quality, customer care and service will be increasingly important for Russian firms, whatever their size and market. Russia will only be able to compete successfully in the world economy based on major brownfield or greenfield investment for restructuring. It also needs creation of a proper banking and financial system, which can mobilise savings to finance long-term immobilisation of capital. Thanks to FDI activity CEE countries restructured their manufacturing industry very quickly and successfully to become competitive even on EU markets. However the FDI-driven restructuring model of Hungary or the Czech Republic is only partly relevant for Russia, where privatisation conditions and need for capital are quite different. Adequate restructuring schemes have to be found for Russia, combining domestic investment, FDI activity in Russia and even acquisitions in the EU or elsewhere by Russian companies. The CEES is a privileged space for intensive capital and know-how flows between the EU and Russia, and for launching competitive EU-Russia sectoral and company partnerships in agriculture, industry, transport, tourism, banking and finance.

11 – Strong complementarities between Russia and the EU in commodities do not have to mean lock-in of Russia as a raw material provider for the EU. On the contrary, it opens opportunities to improve performance of the whole Russian economy within the CEES framework. The aluminium sector is a good example of this : EU experience could help Russia extract more gains from use of secondary (recycled) aluminium and to develop high value-added finished goods.

12 – Another promising field for EU-Russia co-operation within the CEES relates to the threat of higher costs and reduced competitiveness in the Russian gas industry because of the planned opening of costly new extraction fields¹. It is expected that Russian gas exports to the EU will almost double by 2008 to over 200 bn m³. Experts consider that at least 100 bn m³ could be gained in Russia by energy-saving measures in industry and housing. This matches the planned export increase to the EU. The EU has the experience

¹ D. Finon, C. Locatelli " The liberalisation of the European gas market and its consequences for Russia" RECEP-IEPE policy paper, Moscow- Grenoble, 2002, 15 p.