



INSTITUTE FOR STRATEGIC AND INTERNATIONAL STUDIES

# **Dialogues for Sustainable Development Russia and the European Union**

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## **Synthesis**

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## **1. STRATEGIC PARTNERSHIPS BETWEEN THE EU AND CHINA, BRAZIL AND INDIA**

### **Mark Entin**

This Project was designed to enhance the efficiency of bilateral cooperation between the EU and its main strategic partners. The EU is the largest commercial partner of the Russian Federation and Russia is the EU's third biggest trade partner, with Russian supplies of oil and gas making up a large percentage of Russia's exports to Europe. For both parties, it is quite relevant to improve economic cooperation, which has a huge potential underused. This misused cooperation might be related to the lack of coordination between the respective development strategies of both parties and also misunderstandings regarding economic fundamentals.

The main purpose of this workshop is to introduce the development strategies of both the EU and Russia and make a first comparison approach so that at a later stage we might provide some recommendations on how to better build and structure the strategic partnership between the EU and the Russian Federation.

In order to understand better this Project, we found important to have some feedback about the previous workshops held with China, Brazil and India. In deed, Russia has great interest in the so called BRICs. Our political establishment has the aspiration of using the experience of these emergent economies to restore Russia's prestige in the world. More particularly, we would like to know what the BRICs mean to the EU.

### **Maria João Rodrigues**

The idea of this Project was based in the EU experience of designing and implementing a long term development strategy for growth, competitiveness and employment, which was adopted in the year 2000. In 2006 it became quite obvious that such strategy that aims to combine economic growth with social cohesion and environmental aspects cannot be successful unless our main international partners go more or less in the same direction.

With the convergence focus in mind, we started a dialogue with our major international partners. The choice of these partners is related to the main priorities of the external action of the EU:

- The commitment with the multilateral system: the EU believes that most of the international problems should be addressed within the framework of multilateral institutions;
- The special concern with our neighbouring countries;
- The intensive development cooperation with developing countries;
- The support of regional integration in other parts of the world;
- The support of the relationship with our strategic partners under which falls our Project.

Taking the timeframe as criteria, the EU strategic partners are: USA, Russia, Canada, Japan, India, China and more recently Brazil. The EU wants to intensify relations with these key players by going beyond the traditional diplomatic approach, focused mainly

on trade and security issues. With this international dialogue, the EU wants to exchange experiences regarding development strategies, covering all relevant dimensions.

### **Main outcomes of the workshops with China, Brazil and India**

I was positively surprised by confronting a lot of common ground between the EU and these countries. Like in the EU, all these countries have a tradition in strategic planning as a regular exercise to: identify challenges, define long term priorities, turn these priorities into operational plans with implications for different sector policies and establish, in different degrees, political negotiations with parliaments and/or civil society. We can also argue that the implementation process is rather complex in all these countries because, like in the EU, it is done at national, regional and local levels and involves a very strong coordination effort amongst different ministries.

As examples of strategic planning, we may refer in the case of Brazil to the project “Brazil Three Times” and the recent Lula’s “Growth Accelerating Plan<sup>1</sup>”. China is keeping the mechanism of the five year plan, which is translated into sector policies implemented by the provinces. India also keeps the tradition of the five year plan and the EU has strategic plans for a timeframe of three years.

Other similarities I can point out refer to the main challenges these countries are dealing with, which are related to sustainable growth, job’s creation, reducing social inequalities and improving environment. It is very interesting to notice that all countries are emphasising knowledge (and the associated trio: education, research and innovation) as the main source for economic growth and social development.

Another common point we could identify is the proactive approach of these countries to globalisation. All of them try in the one hand, to capture the opportunities and maximise the benefits and on the other hand, to minimise the costs and avoid the threats. The central goal is to respond to globalisation by implementing a long term strategy for sustainable development, combining economic growth with social and environmental dimensions.

The last common feature is related to governance infrastructures. We are talking about countries with continental size and all of them have multilevel governance structures to define and implement the development strategies.

Regarding the main differences, we may refer that China and India are putting a strong emphasis on poverty reduction while in Brazil the problem is formulated in terms of reducing social inequalities. In the EU the concern with the environment (greening the economy), including climate change, is much clearer when compared with China, Brazil or India. This also applies to the aim of transforming the EU into a knowledge intensive economy.

An exclusive problem of the EU is the process of deepening the EU integration and deal with its multifaceted implications like completing the internal market and reinforcing the economic and monetary union.

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<sup>1</sup> “*Brasil Três Tempos*” and “*Plano de Aceleração do Crescimento*” in the original language.

A core problem for China and India is the relationship between the external markets with the internal market. In China, the economic growth pattern has been mainly based on exports, but now it's clear the need for growth based in the internal market. It happens the same in India but on the other way round i.e., they have started with internal market based growth and now are trying to increase exports. In Brazil this relation is much more balanced, but unlike China and India they have a huge problem with internal security, which in some situations, may jeopardise any development efforts.

Other differences may be found in what concerns structural policies such as the industrial policy. In China, the choice of sectors to be supported are much more prescriptive than in Brazil and India, although in these two countries, there is also an industrial policy based on choices. In the case of the EU during the 1990s, the concept of industrial policy was not used in the Community's lexicon. During Prodi's mandate, the concept was introduced in a horizontal approach more related to innovation, i.e., the industrial policy should not be protectionist and should promote new competitive advantages without choosing particular sectors.

The major differences rely on the social area. In the EU, we have a very sophisticated and developed social model whereas in China, only now they are trying to build a social protection system. In Brazil, there is a segmented situation where part of the population enjoys a social protection scheme and another large part of the population, mainly from the informal sector, has no social security at all.

Despite all differences that result from different stages of development and political choices, there is a lot of common ground between the EU and China, Brazil and India in the general strategy direction and therefore, we can achieve much more convergence than we could think at the beginning.

We hope that this convergence process may be helpful to find out possible solutions to the crisis, which is a good argument to justify further structural change and more ambitious development strategies.

## **2. ECONOMIC DEVELOPMENT STRATEGIES, INNOVATION AND THE FINANCIAL CRISIS**

### **Ruslan Grinberg**

The global financial crisis has affected greatly and surprisingly the Russian economy. Some months ago, we believed that the crisis' impact wouldn't have this magnitude but now it became quite obvious the great influence international trends have over the Russian economy. One important lesson we can withdraw from the financial crisis is that our economy is perhaps excessively open. In fact, our stock market depends about  $\frac{3}{4}$  on foreign actors and is therefore too vulnerable to the volatility of the international markets. We also thought that ordinary people wouldn't be affected seriously because less than 1% of the general population holds shares, however it turned out differently.

After the very serious collapse of the stock market followed by the credit crunch, there is a growing lack of confidence in the banking system. People tend to think that this is a liquidity crisis, but in my opinion the problem relies on the lack of trust in the financial

market. The rescue measures taken by Russia together with other countries were mainly addressing the liquidity problem. Actually, the overall volume of injections will amount five trillion rubbles, which is quite impressive, but still the situation is rather uncertain.

We are hopeful that the new American administration will contribute to stabilise the dynamics of the financial markets.

### **About the Russian economy**

There are two serious problems in the Russian economy. The first one is the excessive imbalance in the income distribution. The rapid average economic growth over the last height years does not reflect the real situation because the gap between the income growth of the reach and the income growth of the middle class had become larger.

While in the Soviet times we used to have a non-market social oriented economy, nowadays we have a non-social market economy, which is a crucial problem in Russia. Although the President and the Prime-minister have emphasised this problem, my impression is that very little has been done and I think that the country's social strategy is not social at all. My hope is that in the future the economic growth may contribute to narrow the present and growing gap between the reach and the poor.

A second problem very critical to Russia is the privatisation of the country's economic structure, which over the last height years has being done in a very simple and primitive way. Gorbachev's Perestroika introduced several political and economic reforms to avoid the lagging behind of Russia as compared to the rest of the world, regarding technological development and innovation. However, twenty years after the reforms we may conclude that little progress has been realised, despite the great achievements in the institutionalization of the market and the fast acceptance by the Russian people of the market way of life. In my perspective, the way the simplification of the Russian economy has occurred, and which involved neglecting government's assistance, was too naïve and caused a lot of inertia in the present times.

The authorities' rhetoric over the last years has been giving ground for inducing private investment, reducing the tax burden, opening markets and favouring an independent judicial system. The government should guarantee the property rights, overcome corruption and provide strong impetus to entrepreneurship. However, over the last fifteen years, the government's main task has been reducing the inflation rate, which amounts nowadays to 13-14% average. This is a very serious problem for the population purchasing power, especially for the middle class.

The Russian economy is presently witnessing a strange paradox: on one side we have been moving into the liberalisation of the economic development but one the other side, state owned corporations are being created and this process goes currently hand in hand with the international trend of nationalising bank's assets.

Another internal problem we are facing is the lack of democratic control over state owned corporations because we have a very weak democratic competitiveness and the construction process of the civil society is still very fragile. We are now having a discussion if we should first modernise and reinforce institutions and then develop proactive government's policies or if we should do it simultaneously, as I think.

In what concerns the relation between Russia and the EU, I believe that in the context of shifting the world's economic power to the East, we have no alternative but cooperate and deepen our strategic partnership. Although we have different schools of thought, which are changing in a day to day basis, both Russia and the EU have much to gain by fostering this relation. Furthermore, with the new President in the US, a new window of opportunity has opened and we should consider the world at large and cooperate more effectively.

### **Maria João Rodrigues**

I entirely agree that a new window of opportunity has come into place at world level and in this context, the cooperation and open dialogue between the EU and Russia might be particularly relevant.

Before approaching the EU development strategies I would like to make some comments on the unprecedented crisis we are presently facing and which will bring many new problems. In the EU four main priorities were already identified to respond to this crisis:

- To control the financial meltdown: urgent measures undertaken to control the credit crunch;
- To improve the regulation of the financial system in order to avoid crisis with this scope and implications in the future;
- To respond to the recession that will follow;
- To improve international cooperation with our strategic partners in order to identify a long term response to the crisis. We believe the way out to this crisis requires not only a new architecture of the international financial system but also general adjustments on international consumption and production patterns.

I also would like to make a comment about economic and social models. We are aware about the complex transition process in Russia from a socialist economy to a market economy. In the EU we use the concept of social market economy, which means basically that we combine a market economy with a very strong social dimension. More recently we are also trying to incorporate the environmental dimension and that's why we use the concept of sustainable development. This model requires a special combination between market, state and institutions.

Regarding the recent measures undertaken to face the crisis, it's important to make a distinction. In the EU tradition, companies are, with very few exceptions, private owned. The fact that governments are currently buying bank's shares should be seen as an exceptional and temporary measure to assure bank's liquidity and avoid the credit crunch. Overall, the EU economic model is based on private initiative but in exceptional situations, governments may intervene to guarantee stability.

As regards to the EU social model, the public sector plays a very important role, particularly in the education, health and pension systems. The tax system is mainly used with the purpose of income redistribution. Finally, the labour market is not totally liberal as it combines the market rules with some regulation to protect workers – the so called flexicurity model.



These are the fundamentals of the EU social market economy and it is important to underline these aspects not only when approaching the EU development strategies, but also when discussing possible solutions for this crisis. Furthermore, it would be interesting to compare the EU model with the American model. In a very simplistic way, and considering the crisis context, I would say that the American model seems to be more vulnerable than the European because several basic society mechanisms depend largely on credit. If there is a credit crunch, most of the crucial features of the American society become under threat: lending for investment to create jobs, giving credit to support consumption, accessing education and health services and even the pension system, which is mainly based on private schemes. Another reason that reinforces this “vulnerability” of the American model is the levels of public deficit and public debt. In any case, it is too early to say who will come out first of this crisis.

### **Antonio de Lecea**

The European Commission (EC) started these dialogues with our strategic partners, not to entail negotiations but to share experiences and views on the main challenges posed by the international context and on how we approach structural reforms for the short and mid term in order to address these common challenges. With these dialogues, we also intend to involve the academic community, outstanding experts and other relevant stakeholders in our institutional frameworks.

### **Financial sector developments**

The causes for the turmoil in the financial sector that turned into a financial crisis, which will spread for the real economy (companies and consumers) are multiple. The trigger was the housing bubble in the US along with the subprime lending but the causes are much more profound and aren't confined to the US only. For example, focusing on the macroeconomic dimension, several errors were incurred. Due to the lack of a monetary policy and to an inadequate exchange rate policy, the US kept for a long time an excess of liquidity in the financial market. China kept artificially exchange rates to promote the growth model oriented towards exports and build up reserves that were then channelled into the American market providing more liquidity to the system. This excess of liquidity has facilitated the access to credit and pushed investors in the search for business with higher revenues. This together with the securitisation and other financial innovations, not all very clear, contributed certainly for the crisis. Other causes were the underestimation of the risk exposure, lack of suitable regulation in the financial markets and the poor supervision over the financial sector.

At the beginning we thought the financial crisis would remain only within the US. In our opinion the EU economy was better prepared to face recessions than in the past due to structural reforms that resulted in more flexible labour markets, more competitive enterprises and balanced public budgets in general. The EU banking system seemed to be sounder because it was supposed to use more prudent business models. It turned out differently and the crisis is having a severe impact over the EU economy: stock markets are falling, banks are decreasing borrowing levels (deleveraging) and there is no confidence in and within the financial system. Very soon, the financial crisis will spread its effects over the real economy because companies and consumers will no longer find credit to finance its activities.

In this context, it became clear that the market wouldn't recover itself and some countries from both sides of the Atlantic decided to intervene in the financial system

and take measures to safeguard the financial stability and diminishing the recession effects.

### **EU response to the financial crisis**

Amongst other measures, some EU Member States had taken the following actions:

- Establishing a political commitment to protect depositors;
- Setting up guarantees for intra-banks funding through debt issuance;
- Injection of liquidity into the system via the purchase of assets, including toxic assets;
- Recapitalisation of banks.

The EC has accelerated also its work to address some of the problems of the financial markets and facilitate EU Member States action:

- Adjustments on bank's capital requirements;
- Deposit guarantee schemes;
- Proposal on credit rating agencies, which were completely unregulated;
- Modifications on accounting rules to avoid procycality;
- Executive remuneration;
- Supporting the frame for coordinated action within the financial system to avoid market distortions and preserve stability.

The awareness on the need for joint action led the European Council and the Economic and Financial Affairs Council to agree on a number of principles. For example, interventions should be timely and temporary, in particular those to provide liquidity to the system. Once the financial markets stabilise, these measures should be withdrawn. Another principle agreed was the commitment to safeguard the interest of taxpayers who shouldn't pay for the wrong decisions taken within the financial sector.

The spillovers of this crisis demonstrated clearly that it's not enough to take measures only in the EU and in the US. It is also necessary to coordinate measures with other key international players and that's why the EU prefers dealing with this issue in a multilateral framework.

### **Pierre Dalsaux**

The core of my presentation relies on what lessons can we learn from the current financial crises and which measures can we undertake to avoid such crises in the future. It is articulated around three main points:

- Causes of the financial crisis;
- Reaction to the crisis within the EU and its Member States;
- How can we improve the financial and other systems to make sure that in the future we don't face similar crisis.

### **Causes of the financial crisis**

The main responsibility for this crisis lies basically in the financial actors themselves – banks, insurance companies, credit rating agencies, etc. – essentially because they were trading unreliable financial instruments, which functioning was less than clear. This

makes us wonder on how risk management and corporate governance was being applied in the bank system.

Another important factor is that most of the financial markets were based in the principal of self-regulation. Therefore, the lack of regulation was certainly another cause for the present crisis. Clearly, the subprime lending crisis is linked to the fact that everybody could receive a mortgage without any element of protection.

Another cause is the lack of adequate supervision of the financial markets at national level and the lack of coordination amongst supervisory systems of different countries.

### **Reaction to the crisis within the EU and its Member States**

Most of the countries reacted in a very protectionist and individualistic manner. In the initial phase, they tried to solve the problem of the banking sector at national level and there was no relevant willingness to cooperate. This was true at international level and particularly within the 27 Community Member States, which reflected a lack of trust and communication at the EU level.

In a more positive analysis I would say that this scenario was probably true during the worst peak of the crisis, but very quickly most countries understood that reactions have to be more coordinated to find common solutions both at international and at the EU level. We are now having several in-depth discussions within the Member States and also with foreign counterparts like Russia and the US.

This is very obvious, but one significant lesson from this financial crisis is that we leave in a global world where the “butterfly effect” has significant implications.

### **Possible solutions for the financial crisis**

The first question that we have to reflect upon is about the corporate governance mechanism that was being applied within the financial sector. The issue of corporate governance in the financial sector is difficult and brings a lot of debate around the need for more regulation and internal controls. For example, we need to find mechanisms to guarantee a stronger involvement of the directors, and particularly the shareholders, in the management’s more important decisions. The role of shareholders needs therefore to be approached. Another issue that we should reflect upon is related to the remuneration structure in the financial system not only at director’s level but also at trader’s level, which are mainly paid based on short-term profit.

It is also very important that we look at the way the financial markets are functioning in a more coordinated matter. Actually, most of the financial products at the basis of the crisis were being traded between banks and other financial institutions in a sort of a bilateral market, without any kind of regulation or transparency.

We also need to think about the levels of capital requirements within the bank system, that is, how much capital banks need to hold to ensure that capital reserves are appropriate to risk exposure and to safeguard their solvency and overall economic stability.

Accounting has been also at the core of the debate. Presently the notion of accounting is based on the concept of fair value, which is used as an estimation of the market value of

an asset (or liability). There is now a clear discussion if we should stick to this concept or if we should move into another kind of notion.

The most difficult issue under discussion is the suitable level of regulation in the financial sector. Until now, the principal of self-regulation has been privileged with the arguments of flexibility and efficiency. This financial crisis demonstrated that self-regulation doesn't work well enough and that we need to reflect deeply on the adequate levels of regulation in order to assure the effectiveness of the financial markets. The regulation issue also triggers the question of appropriate levels of sanctions.

Finally, we need to reflect on the way international organisations like the IMF are supervising the stability of the financial markets and on the way this supervision is being organised at national levels both in terms of quantity and quality. It is also clear that supervision requires more coordinated cooperation at international level.

### **Oleg Fomichev**

The main priorities of the social and economic development strategy for the Russian Federation up to 2020 are:

- To orient Russia's development towards innovation;
- To privilege investment on human capital by expanding the state budget expenditure on education and health services.

It is expected that the implementation of innovation-based policies will have a positive impact in the performance of the main macroeconomic indicators that can be then transformed into bigger state budget expenditure on the social sphere. This is the logic for the long term innovation-based development strategy for Russia

The foundations of the Russian past economic growth model were the industrial sector based on raw materials, other non-competitive sectors like housing construction and the domestic consumption. This model is exhausted and regardless the consequences of the global financial crisis, Russia needs to guarantee the transition into a different economic development model anyway.

### **Streamlining and modernising the social sector**

The choice of which public health model to adopt is very critical. In Russia we believe that we should focus on developing a competitive model of health insurance combining service providers from the public sector and from the private sector.

We need to address urgently the male mortality at working age due to accidents and traumas, which is quite high in Russia and has a very negative impact on the labour market.

We are also planning to implement measures to reduce the levels of pollution, particularly in the industrial cities. We might say that our present environmental policy is not a very successful one and this will be a tremendous challenge for our long term development strategy.

Regarding the public education policy, we want to introduce developments on life-long learning and post diploma studies, which is something new in our approach. We also

want to support enterprises that wish to provide training and learning initiatives to their staff and provide co-funding opportunities to member regions of the Russian Federation to support their educational programmes. Finally, we are planning to establish twenty education and research centres with international quality standards. The rating of the Russian universities demonstrated that we are lagging behind quite significantly and we want to invert this trend.

### **Modernising other sectors**

We consider the expansion of the national transport network through several mechanisms of private and public partnerships as an important regional development factor. Therefore, Russia wants to expand considerably the budget expenditure in the transport sector, especially the high-speed transportation as occurred in the EU in order to decrease regional imbalances.

As regards to industrial specific policies, I would like to highlight the enormous efforts in developing the aircraft and shipbuilding industry. Relevant measures were taken to support the intensive restructuring process in these sectors and we intend to continue this in the future.

One of the goals concerning the financial sector is transforming Russia into an international financial centre at regional level and developing the ruble as a regional reserve currency for international settlements, firstly in the Eurasia region. Other goals for the financial system are the improvement of regulation and the functioning of the stock markets.

Regarding the innovation policies, the aim is basically to stimulate the application of technological innovations in enterprises. Although a huge investment has been done in this area, there is a significant gap between the levels of research and the application of its results in the real economy. In our long term strategy we are planning to reduce this gap and stimulate the use and implementation of the main technological developments in the production sector.

We also want to develop science and technology clusters and special economic zones, like science cities, in order to foster corporate development and help enterprises managing its intellectual capital. We intend to work jointly with universities, research centres and enterprises to form a technological platform that would make possible a shared vision on innovation development and on how this can be applied in the Russian economy.

### **Sergey Seliverstov**

The implementation of the national innovation-based development strategy to respond to the internal and external challenges should be in place by the year 2020. We have chosen this year because our forecasting has demonstrated that the raw material-based model will be completely exhausted by the year 2014, 2017 the latest.

The rapid economic growth of the recent years, averaging 7% annually, allowed the Russian economy to improve significantly the reserve funds. We believe this accumulation of financial resources will help to mitigate the financial crisis impact and the transition for the new development model, which will enhance the living standards and the social dimension.

Russia wants to work closely with its international partners and particularly with the EU concerning the innovation-based development models. We are paying great importance to the EU project in creating a unified space for research, innovation, science and technology (European Research Area – ERA). In this field, Russia is really doing an effort to bring its position closer to the EU.

### **Maria João Rodrigues**

I am impressed by the level of convergence that we may find between Russia and the EU regarding the long term planning process, not only on the topic of central strategic priorities, but also on the rationale behind it.

Like in Russia, the EU also realised the need for a new development model to deal with fundamental dilemmas:

- Competitiveness vs. jobs creation – this trade-off can be overcome by focusing on innovation, not only in processes, but also in products and services;
- Faster economic growth vs. keeping social cohesion – this can be achieved by keeping a balance between the export led growth and the internal market led growth;
- Macroeconomic stability vs. growth – these two goals can be combined by redirecting public expenditure to central investment priorities regarding education, innovation and research;
- Economic policies vs. social policies – this traditional trade-off can be overcome with the argument that social policies are an important productive factor because they increase labour force productivity.

These are some of the main dilemmas that were under a very hard discussion process in the EU and which formed the basis to define our long term development strategy – the Lisbon Strategy. However, experience taught us that the implementation process of this strategy is very difficult and it brings a lot of tension, mostly in the short term.

The EU experience regarding the implementation of the Lisbon Strategy might be very relevant to Russia because you are facing presently the big challenge of implementing a very ambitious long term strategy. The breakthrough of the Lisbon Strategy was in the year 2000. Since then, several problems were posed to the implementation process: we had to translate this strategy into all available instruments; we had to increase coherence amongst all relevant sector policies in order to assure consistency with the strategy; we had to adjust the EU budget and find the right incentives to address the strategy; we had to revise our Stability and Growth Pact; we had to create new financial instruments through the European Investment Bank; we had to change the EU governance structures within a new Treaty that awaits for full ratification. For every each step we needed to build coalition within the political framework. This has been and will continue to be a long and rather difficult process.

Now we are facing a new problem which is the financial and economic crisis and the core discussion is currently based on how we can make this crisis an opportunity to better implement the strategy.

One important lesson from the EU experience in speeding up the transition into a knowledge-based economy is that we need to have two very strong policies: the innovation policy, which involves a lot of horizontal coordination and the human capital policy. In 2006, the innovation policy of the EU gained a new status when a comprehensive agenda for innovation was adopted in the framework of the Lisbon Agenda. Some of the differences introduced were that innovation was not just about processes and technology but also about products and services, organisation and management. Furthermore, innovation and cluster policies need to combine demand side instruments with supply side instruments<sup>2</sup>. Finally, we need to give special attention to the human capital and develop ambitious education and training policies in order to prepare people for creativity, self-initiative and new competences.

### **Luc Soete**

The current financial crisis is likely to have a positive short term impact on the private research and development (R&D) investments:

- The negative impact on corporate profitability leads companies to focus on the most innovative production segments at the expense of lower value added segments;
- Within the R&D portfolio, focus will be on most promising development areas at the expense of longer term and more risky projects;
- Furthermore, in order to address the crisis, companies tend to hold scientists and engineers and remove flexible and temporary work force.

Therefore paradoxically, it is likely that R&D activities increase in the short term and Europe might become nearer to the Barcelona target (3% R&D of the GDP).

On the long term, it's possible that we will see in the EU business community a renewed focus on R&D outsourcing in countries with a strong science base in order to further reduce R&D costs. We can expect that a strong outsourcing will happen in direction to Russia, for example in the airspace and aircraft industries, like had happened already with China and India.

I also believe that we will witness a stronger outsourcing to the public sector and an increasing role of the public authorities in the R&D activities. More precisely, if governments are prepared to invest millions to save the bank sector, why wouldn't they be willing to do the same in R&D infrastructure, for example? It is very likely that in the long term the balance between the private and public sectors will shift significantly in what concerns the R&D activities.

### **Knowledge keynesianism**

The current state-led financial rescue operations with respect to national banks in order to restore the trust and confidence in the financial system opens up questions about using more actively national savings for local knowledge investments. This financial nationalism is basically an anchor instrument for the localisation of international knowledge and offers opportunities for much stronger emphasis on local knowledge investments and innovation.

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<sup>2</sup> We may refer the *Lead Markets Initiative*, which aims at fostering the emergence of markets with high economic and societal value.

In short, there is currently a need for renewed attention on the *glocal* challenges of the knowledge economy and on smart specialisation. From a worldwide perspective, one could argue that knowledge is globally linked but locally embedded.

### **Regional growth**

The regional disparities in the EU and Russia are an important development challenge for both parties and a scope for mutual learning. Although the problems of regional disparities to be addressed by Russian and European policy makers are similar, policy responses are substantially different. While EU policies with respect to development are concerned with convergence and cohesion and to equality of social and economic conditions for all European citizens, Russia's main priority is unlocking the resource-based development trajectory, fostering regional competitiveness and promoting economic growth, even if it implies a temporary increase in regional disparities or polarised development. According to the polarisation principle, the concentration of resources should provide preconditions for the rise of entrepreneurial and innovation activity at the poles and spur rapid economic growth that can be exported to other regions at a later stage.

The differences in the strategies for regional development emphasise the potential for learning from each other's experiences.

## **3. SOCIAL DEVELOPMENT**

### **Dmitry Sorokin**

One of the major goals of the development strategy for the Russian Federation up to 2020 is to address the social policy and the human capital development. For the first time in 15 years, the social sphere in this country was considered a priority. However, it's no secret that the Institute of Economics in the Russian Academy of Sciences has a critical approach to the social policy which is pursued in Russia today, including the one declared in the strategy up to 2020. Our critical approach is based not only in the research and analyses of the actual situation but also on the government practices. We don't question the goals and tasks of the social policy, but the fact is that the country's social dynamics is running in the opposite direction.

Some years ago, President Putin declared he was ashamed with the poverty in the country. Ten years ago, 29% of the Russian population lived bellow the poverty line. Now the figure is 12,3% and the development strategy defines 5% as the target to be achieved by the year 2020.

However, it is necessary to clarify that the method we used to measure the poverty line, based in a standard subsistence basket has changed in the meantime. If we use the same method applied for example in the EU, we would have today the same 29% of the population living bellow the poverty line, which means that poverty didn't decline at all. Furthermore, the low income population (above the poverty line, but bellow the average level) amounts to 45%. Taking into account that the average income is rather low, i.e., 15.000 rubbles per month, then the poverty problem in Russia is really critical. Although Russia's top management is aware of the problem and understands it, very little has been done to change the situation.



Along with the poverty problem, we face big unemployment rates within the poor classes and also ethnical/integration problems, particularly in Moscow, which receives each year a high number of migrants.

The social differentiation has increase greatly in Russia, particularly in the last ten years where the economy achieved high growth rates. The gap between the average income of the poor and the rich is widening since then. This triggers the question on what basis this growth is taking place and at what cost. Our experts on social differentiation argue that Russian won't be able to solve this problem until we keep a flat tax scale.

### **Janine Goetschy**

My presentation will focus on the EU social systems, its main difficulties and the reforms underway due to globalisation and demographic problems.

Social Europe comprises two policy levels: the EU or Community level which consists of a set of general rules and principles, directives, collective agreements, corporation processes, etc. and the national level that embraces a variety of 27 national systems. Social Europe covers three policy domains: employment and social protection policies and industrial relations.

The major features of the European social model are:

- Organised social partners – trade and labour unions;
- Dynamic collective bargaining structures;
- Labour laws;
- Employee representative structures in the companies;
- Social protection systems that encompass pensions, health care, family and children allowances, lodging, social inclusion, disability, etc.;
- Public services like transports;
- Education and training systems.

The EU has relatively low employment rates. The Lisbon Strategy tried to address this problem and set up several targets for 2010 and policies to increase the employment rates in the EU, particularly among women and elderly people. We are far from reaching the targets, but there have been improvements. The EU also has high unemployment rates amongst specific groups like migrants, low skilled people and long term unemployed. For these groups, we need to set up specific policy tools and measures.

The EU employment strategy, which has been reinforced by the Lisbon Agenda, is essentially a coordination policy among the 27 Member States around common goals and based on the following concepts:

- Activation – the approach should focus on preventive/active measures rather than curative/benefit measures in order to activate unemployed and increase employability;
- Flexicurity – combining flexibility in the labour markets with increased security;
- Gender – facilitating the conciliation of work with family life, particularly among women.

The social protection systems in the EU cover several policies (pensions, health care, family and children allowances, lodging, social inclusion, disability, employment benefits, etc.) and some are paid by the tax systems while others are supported by a contribution structure based on the employers and employees of the labour market.

The EU also has some of the problems that Russia is facing. For example, 16% of the population is at risk of poverty, i.e. earn 60% or less of the EU average income. Nearly 10% of adults live in jobless households and in-work poverty reaches 8%.

One of the major problems the EU is facing is how to finance in the future its social protection systems taking into account the present demography trends. Pensions and health care that count for  $\frac{3}{4}$  of the total expenditure tend to increase in the future but the EU is confronted with increasing life expectancy and low fertility rates. We forecast that in the year 2060 there will be only two working age people for each pensioner. This demographic pressure has forced the EU Member States to undertake several reforms in order to assure the future of their social models.

At the EU level it's worthwhile to mention the three processes of "open method of coordination" in the areas of pensions, health care and social inclusion/fighting poverty developed within the framework of the Lisbon Strategy. This EU policy in the field of social protection has been relatively successful, particularly in the area of social inclusion, and it has a multi-dimensional approach to poverty, i.e., being poor is more than just not having enough money to live. It is also about not having access to good schools and hospitals, living in bad housing conditions or in regions without public services like transports, etc. In the EU, social benefits (excluding pensions) reduce the risk of poverty by 38%, which is fairly efficient.

Despite all problems and the needs for reform, the idea is to modernise and keep the EU social model alive for as long as possible.

#### **4. THE LISBON STRATEGY AND ENVIRONMENTAL DEVELOPMENT**

##### **Ian Begg**

The Lisbon Strategy is above all about policy coordination across the Member States because the EU government structures have actually a rather weak power. In this sense, we have to think of what role coordination plays in economic governance. Within the EU context, there are some policy competences that were given to the supranational level like the monetary and trade policies. However, most of economic and social policies remain under the competence of Member States. In this unique structure of the EU system, coordination is there as an attempt to steer Member States policies in a common direction.

Coordination is important to minimise spillover effects, cross-boarder impacts and free-riding. Sometimes it is better to coordinate things at a higher level because it's easier to get some economies of scale or economies of scope. This is particularly true for the environmental area because the environmental problems cross borders and are essentially global, not national.

Equally important to understand the Lisbon Strategy is that coordination is about learning and policy transfer, rather than discipline or constrain governments. The innovation in the Lisbon Strategy is that we want to transfer policy ideas from one country to another, enabling each other to learn about best practices and how to do things in an appropriate manner. The rationale behind coordination is improving policy rather than constrain policy through discipline.

To do this, we invented the Open Method of Coordination which has a number of features:

- Setting up targets;
- Using indicators to monitor progress;
- Using benchmarking techniques to assess how well we are doing;
- Peer review whereby countries scrutinise each other through an organised process.

Regarding the evolution of the EU processes we may say that we started with disciplining forms of coordination like the broad economic guidelines focusing on the macro level and on the Stability and Growth Pact which was a way of constraining deficits countries were able to have. In 1997, the EU adopted the employment strategy model that was followed by the Lisbon Strategy launched in 2000 and relaunched in 2005 because the judgement was that things were not working properly. This process was nourished with other coordination strategies: sustainable development which puts together social issues, environment and competitiveness; social protection and social inclusion that brought together social processes into one single approach; and finally the energy policy for Europe.

Another key element in this process is the use of Action Plans as policy methodology whereby the EU level decides upon a number of broad targets and asks Member States to put forward action plans to achieve these targets.

### **The 2005 Lisbon Strategy relaunch**

The emphasis shifted from growth, jobs and social cohesion to growth and jobs. Social cohesion along with environment were mentioned but with smaller emphasis. The second change was the new partnership approach which comprises the national level where the Member States were obliged to present a comprehensive National Reform Programme based on 24 integrated guidelines and the EU level with the definition of the Community Lisbon Programme that brought into the picture the use of directives or hard law to complement the soft coordination method. Another difference is that originally the Lisbon Strategy was a target for 2010 and now has changed into two/three year cycle.

Annually the Commission along with an Economic Policy Committee and an Employment Committee scrutinise what the Member States are doing regarding the strategy and from this assessment result some conclusions and recommendations for performance improvements.

### **The new policy context**

At some point, we have to recognise the facts that have been put to us by the Intergovernmental Panel on Climate Change and realise that the levels of carbon

emissions are no longer sustainable. There has been a gradual understanding of this in the economic policy making circles and it is now an imperative to change into a new economic paradigm based on low carbon. This will probably dominate our thinking in the near future, including further developments on the Lisbon Strategy. To me this means that we have to emphasise not so much on the rate of growth, like in the past, but on the quality of growth. Apparently this might look a contradiction but I believe it's possible to envisage forms of growth that have much lower carbon intensity, but still enable high level growth rates.

We need to rethink this in regulatory terms because regulation has a strong impact on the degree to which carbon is emitted in the economy. We have been witnessing the regulation impact on the financial stability because of the crisis, but this also applies to the environmental dimension. The business community already gave signs for the need of a regulatory framework in order to engage proper investment strategies for the future. Regulatory certainty is critical to achieving a low carbon transition.

### **Broad aims post 2010**

The first major aim for post 2010 is reconciling the different processes (Lisbon Strategy, Sustainable Development, Energy Policy for Europe, Social Inclusion) and reforming the EU budget. One of the big debates undergoing in the EU is if we should bring together all these different processes to increase policy coherence or should we keep them separate as until now. Furthermore can the EU budget, which was dominated for many years by the common agriculture policy and the social cohesion policy, do more to promote the low carbon economy and the growth agenda.

The second aim refers to the balance of power between the Member States and the EU level. Over the last ten years, it's the Member States that in fact hold the power in most areas and have engaged a much more intergovernmental approach. This model might not be very appropriate for the environmental area, where it is necessary a redefinition of the supranational role.

The third major aim is engendering political ownership, i.e., how do we translate this into something that makes sense to the normal citizen. The Lisbon Strategy failed to reach down the decision making and the citizens were left out of the process. Citizens in general support a transition to a low carbon economy and want a clean environment and yet how do they feed back to the decision makers through these processes.

### **A low carbon approach**

The transition to a low carbon economy poses a number of trade-offs. The first one is that carbon emissions is a global problem but many developing countries are concerned with economic growth, which requires higher levels of energy consumption and don't see carbon emissions and climate change as a priorities.

There is also a social policy challenge because dealing with excessive carbon emissions is ultimately a problem of raising the price of carbon and then fuel and electricity becomes more expensive. This creates a new form of poverty, the fuel poverty, with all social consequences involved.

Another relevant point is who shares the burdens on emissions cut. Historically, Europe, the US and Russia caused the problem but for the future it's the developing world,

particularly China, who will aggravate it and yet, they see development first and carbon emissions later.

The enormous engineering and political challenge of shifting to a low carbon approach is also inter-generational. The idea of sustainable development is meeting the needs of the present without compromising needs of future generations. If we care about future generations and resource sustainability then, strategically we need to invent a new approach to investment, where every investment decision must respect a low carbon agenda.

The effective way forward entails going beyond simple competitiveness and recognising that green investment also can be competitive.

Summarising, my smart growth approach emphasise that it's possible to have a low carbon strategy that achieves high growth levels and economic aims but at the same time allows decoupling the negative externalities of the excessive carbon use.

### **Vladimir Zakharov**

The official position is that Russia is concerned about environment and climate change, but in fact we are not taking very proactive measures in this area. If development would take place tomorrow, a large part of the population in Russia would be happy to welcome some degree of pollution.

It is a great thing that the business community in this country, including the Russian Federation of Entrepreneurs and Industrialists, assumed that it's not possible to develop sustainable investments without taking into account the environmental implications and they are aware that very soon, investment decisions will be confronted with limitations and restrictions in this area.

There are some regions in Russia where the environmental policy is very strong mainly because of the active role played by NGOs and civil society. In Moscow, for example, the government encourages the use of "environment safe" vehicles, but in general we do have a lack of understanding about the environmental issues at political level.

Another challenge that is being discussed currently by the civil society is the possible use of environmental indicators, normally used to assess sustainable development, to complement the economic indicators. The public sector doesn't use them yet, however thanks to the civil society involvement in a number of Russian regions, these indicators have been elaborated and they demonstrate the quality of the GDP growth rate. I believe that the most straightforward indicator is the Energy Efficiency that is rather low in Russia.

## **5. GOVERNANCE, POLITICAL AND INTERNATIONAL CONTEXT**

### **Mario Telò**

Within the experience of this Project – Dialogues for Sustainable Development – dealing with the external dimension of the Lisbon Strategy is also part of a dialogue on the political future of multilateralism. My main challenge is to prove you that we can

discuss about the international political framework without mentioning the Georgia crisis, NATO and other security issues.

**The framework of Russia-EU cooperation: a multilevel unexploited potential**

I think that one of the challenges is to improve the combination between bilateral and multilateral dimensions. Regarding the global multilateral dimension, the framework has been established by the United Nations (UN) and the Security Council of the UN. What has been new during the last 15 years is the rapprochement of Russia to the Western countries (G8 and NATO-Russia cooperation). I also would like to stress that Russia's signature of the Kyoto protocol was a precondition for entering into force.

Regarding the pan-European dimension, the framework relies on the dynamics that started in 1973 with the Conference on Security and Cooperation in Europe, to serve as a multilateral forum for dialogue and negotiation between East and West, until the institutionalisation of the Organisation for Security and Cooperation in Europe (OSCE) in 1994, which deals with three security dimensions: politico-military; economic and environmental; and democracy and human rights. Equally important within the pan-European dimension is the Council of Europe (with the Russia membership and the Russian presidency in 2007), which seeks to protect human rights, pluralist democracy and the rule of law; and to promote awareness and encourage the development of Europe's cultural identity and diversity.

I also would like to withdraw your attention about the increasing relevance of the regional dimension for economic cooperation and peace keeping based on the relations between the EU and the Commonwealth of Independent Countries (CIS), on the Black Sea cooperation and on the Shanghai Cooperation Organisation (SCO) and the EU central Asian policy.

Regarding the bilateral dimension, the main features of the Russia-EU strategic partnership are as follows:

- There are strong economic ties and mutual interdependence since 1991, particularly in the areas of trade, energy market and technical cooperation;
- We have been discussing the Partnership and Cooperation Agreement (PCA) for a long time. In June 2008 the Russia-EU Summit launched negotiations for a new Russia-EU Agreement to replace the current PCA which entered into force on December 1997;
- Russia-EU Common Spaces which the overall objective is the creation of an open and integrated market between the EU and Russia. It is based on four policy areas (economic issues and environment; freedom, security and justice; external security; and research and education, including cultural aspects) and several sector dialogues;
- Seven cross border cooperation programmes for 2007-2013.

For the EU, after 50 years of Cold War and strong divisions, it's extremely important the place of Russia in the changing international order, particularly within the framework of pan-European and global governance after 1991. To what extent it's possible to move steadily towards a new multilateralism setting. In my opinion this is central for the open challenge of building a new common security system in Europe.

It is clear that the unipolar momentum, dominated by the US, is over and global governance is being challenged by new and rising powers. The essential question for the Russia-EU dialogue and cooperation is if it's more realistic to achieve a multipolar balance of power or an asymmetrical multipolar world.

Moreover, there are still a lot of uncertainties from which depend the evolution of the multilateralism framework. The EU has not achieved yet its final institutional setting and expects the ratification of the Lisbon Treaty that will allow it to act more consistently in the international arena. The implications of the new multilateral game remain unclear in a range of key policy areas like environment, energy-supplies, energy security, regional security, etc. The risk of neo-mercantilist global framework is emerging because of the financial and economic crisis. The question remains therefore open: are we going towards a zero sum game or a win-win situation. The outcomes depend also on Russia and the EU policy choices and responses.

By taking stock of the current international change, Russia and the EU could be interested in building a new multilevel<sup>3</sup> multilateral global governance based on the following main challenges:

- The declining of the unipolar agenda;
- The risk of global fragmentation and proliferation of preferential trade agreements (PTA);
- The revival of a multipolar power balanced agenda.

What kind of new multilateral and bilateral cooperation could Russia and the EU jointly foster? I would recommend the following:

- Structuring a more focused Russia-EU dialogue, including internal reform agendas (knowledge society, growth, social cohesion, research, education and sustainable development) and linking the internal agenda to external policies regarding common global challenges;
- Going beyond mere instrumental multilateralism by diffusing reciprocity, sharing ownership and enhancing mutual trust;
- Building a bottom-up relationship based on a more proactive role of the civil society and on trans-national cross border networks.

Summarising, there is a huge unexploited potential for strengthening our bilateral and multilateral ties, with the perspective of setting an inclusive agenda to “multilateralise multipolarism”, enhancing convergence and building a knowledge society in Russia and the EU, combining economic, social, environmental and university cooperation.

### **Mark Entin**

I would like to finalise with some broad conclusions and complement the political and international context discussion with some remarks about Russia's position concerning international cooperation with the EU.

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<sup>3</sup> Including the national, regional, inter-regional and global dimensions.

The current dominant vision in Russia is that the transition into an innovation-based strategy for development can only be achieved by strengthening governmental institutions, civil society and business community. This point of view is reflected in the official government papers and in the social and economic development strategy for the Russian Federation up to 2020, which reflects the main needs of the Russian society.

The Russian society needs a more efficient-oriented public sector, with improved services and management systems. In order to make sure that this new public sector can be shaped it's necessary to comply with the institutional and legal mechanisms like respect for human rights, private property and rule of law. Furthermore, it is necessary to improve the traditional system of federal relations and strengthen local self-governance. It is envisaged a more rational distribution of powers between different authority levels and this decentralisation process will increase municipal governance, which will be far more involved in the decision-making and management procedures. In this regard, a forthcoming change is the increased representation of regions in the State Council, which was formed to harness the potential of regional leaders and considers issues of particular importance to the state, such as the development of governmental institutions, economic and social reforms and other subjects affecting the public as a whole.

The comparison of the development strategies of the EU and Russia revealed to be very useful and showed a significant level of similarities, including several common challenges.

For both strategies, the social dimension is extremely important although there is a huge distance concerning the development stage of the respective social models and its implementation mechanisms. The European social model(s) is one of the most advanced in the world while in Russia we are giving the first steps to bringing social policies into the agenda's spotlight. However, we are both confronted with problems of the same nature: fighting poverty and social inequalities, overcoming the gap between the wealthy and the poor and modernising social security systems, particularly pensions and health care.

The main difference between the development strategies of the EU and Russia relies on the environmental dimension. While in the EU greening the economy and the environment's protection are becoming government's key priorities, in the Russian development strategy up to 2020 the environmental component is hardly visible. Although civil society is engaged to make sure that environment's protection and fighting climate change becomes part of the government's policies, several environmental challenges are completely left out of the strategy or merely slightly approached.

Regarding the international dimension, the challenge relies on the ability to building Russia's bilateral, regional and global connections within a changing multilateral global system. In this respect, strengthening economic and political ties with the EU is very important and we need to make sure that the interaction between both parties becomes more effective and dynamic.

The current PCA represents only the first step in setting up beneficial cooperation and partnership between the EU and Russia. To be put into practice, it needs to be



reinforced by a stronger political will and by focusing more on what brings both parties together rather on what keeps them apart.

Although the PCA has facilitated a smooth transition from confrontation to partnership and collaboration, it neither captures the changes that have affected both Russia and the EU over the last ten years nor provides the adequate legal framework needed to move further and stimulate better results. The existing cooperation structure, the random nature of events taking place and the low levels of manageability and predictability of the partnership no longer suits the Russia-EU relations. Therefore, there is a common understanding about the need for a new agreement and an enormous room for improvements. The question is rather what kind of an agreement the EU and Russia require to considerably change the character of their strategic partnership.

This Project has proved to be very relevant and with rather practical and clear targets. It allowed an open and frank dialogue about unease and even controversial issues and provided abundant food for thought that definitely will contribute to enhance and explore the full potential of the strategic partnership between Russia and the EU.