

# Deep freeze? East-West relations and the Arctic

Conference note

16 October 2015

Helsinki

On October 16<sup>th</sup>, AIG, the East Office of Finnish Industries and the Centre for European Reform, organised a one-day event in Helsinki's Hotel Kämp to discuss political and economic developments in the Arctic. The objective of the event was to assess how the collapse of the oil price and tensions between the West and Russia affect the politics and economics in the Arctic region.

The speakers included Olli Rehn (minister of economic affairs, Finland), Esko Aho (East Office of Finnish Industries, and former prime minister of Finland), Paavo Lipponen (former prime minister of Finland), Baroness Pauline Neville-Jones (Britain's House of Lords), Thomas Grove (Russia correspondent, *Wall Street Journal*), Andrei Kortunov (Russian International Affairs Council), Juha Jokela (Finnish Institute of International Affairs), Timo Koivurova (Arctic Centre), Jette Nordam (Danish Ambassador to Finland), Dieter Helm (University of Oxford), Kathleen Stephansen (chief economist, AIG) and Anna Belova (Graduate School of Business, Moscow). Since the event was off-the-record (aside from the keynote address) what follows is a summary of the discussions without attribution to the speakers.



### Arctic boom or bust?

There was a divide between those that emphasise the potential of large-scale economic activities in the Arctic and those that are more bearish. Optimists said that the Arctic can become Europe's largest area of investment. Planned investment in the Barents Sea region alone amounts to roughly €140 billion euro. They say that the Arctic could be a good news story for the EU. Since the EU is import-dependent on raw materials, exploiting the High North's ample resources seems straight-forward.

Others argued that the Arctic may be an attractive proposition for governments – land leases and drilling rights can amount to hundreds of billions of euros in government revenue – but international investment will not flock to the region. There are major challenges to Arctic oil and gas exploration. Arctic drilling is expensive and technically challenging, and shale oil offers a competitive alternative. The global economy is going through structural changes and emerging markets are shifting from commodities- and manufacturing-led growth to domestic consumption-led growth. Climate regulation is also making the exploitation of Arctic resources less attractive. Japan's 2011 tsunami signalled the end of the commodities 'supercycle' (a prolonged period of high commodity prices), while China has now reached the end of its debt 'supercycle'. It suggests a future



with lower global growth and lower commodity prices. So, Arctic oil may well stay in the ground. Arctic trade routes may also not boom: currently 51 per cent of China's trade is within the Asian region, and China's 'One Belt One Road' initiative has more momentum behind it than development of the Northern Sea Route.

But it is risky to assume that low oil prices will be the 'new normal'; current oversupply in the oil market will not last and underinvestment may cause prices to recover. After all, in 2013 most analysts believed oil prices would remain high.

### **An Arctic security dilemma**

One key question is, can the Arctic remain immune to geopolitical tensions elsewhere, such as in Ukraine or Syria? In contrast to the Cold War – when East and West could co-operate on Arctic issues – today, a 'race' to control shipping lanes or Arctic resources could increase the risk of conflict.

Russia's increasingly assertive foreign policy, including in the Arctic, is cause for concern. Russian military developments are worrying: two-thirds of the Russian navy is now based in the Arctic and Russia has invested in new Arctic land forces. Russian planes fly through EU airspace with greater intensity and frequency than before, including in the Arctic. Moscow has also set up a strategic command centre, streamlining military decision making in its north. Perhaps this is the result of its economic interests – 20 per cent of Russia's GDP comes from the Arctic, and 25 per cent of its exports originate there – but Moscow's public rhetoric is also increasingly belligerent about the Arctic.



While none of the panellists believed that there is an imminent security threat in the Arctic, Europe should expect Russia to be less co-operative than before. Though Moscow may not be militarising the Arctic, it is increasing its military presence there, and Russia is not transparent about its intentions. This raises the possibility of an Arctic security dilemma: because Russian intentions are not clear, its actions can be misperceived, creating a cycle of escalation.

Some panellists suggested that Russia may be developing the capabilities to unilaterally enforce its claims over the North Pole and the Northern Sea Route. Another panellist said that Russia could take deliberate steps to increase tensions in the Arctic in response to Western sanctions. (The EU and the US, amongst others, have placed sanctions on offshore oil projects in Russia's Arctic). Connected to this is Russia's desire to

remain the dominant country in the Arctic – Russia’s coastline amounts to 50 per cent of the Arctic littoral. It wants to avoid third countries from playing a meaningful role there. Sergey Shoygu, the Russian defence minister, has complained that “non-arctic states [like China] are increasing their presence in the Arctic”.

### Calmer waters

Other panellists were less worried. The Arctic is a region of long-term, relatively slow-moving, developments, and so they wondered what Moscow would have to gain by escalating tensions. They said that the Arctic is not on the cusp of major changes: the trade routes are currently uneconomical (there is too much ice and the weather is unpredictable); major mineral exploration is as of yet not probable; and the infrastructure to do both is currently missing. To make the various Arctic passages more useful, more deepwater ports, fuelling stations, icebreakers and search and rescue capabilities are needed. Besides, all coastal states signed the 2008 Ilulissat declaration in which they declared to resolve conflicts peacefully. Also, the bulk of Arctic resources lie in undisputed waters.



Even the Danish-Russian overlapping claim on the North Pole need not be controversial. In November 2014, Denmark submitted its claim to the Commission on the Limitations of the Continental Shelf (CLCS). But its claim is only number 76 on the waiting list of the CLCS. The first discussions are not expected before 2020, while a resolution of the claim will not occur before 2027 or 2030. The issue is likely to remain frozen given the few

valuable resources in the deep Arctic, low oil prices, and the lengthy process to resolve the competing claims.

Issues related to Arctic navigation may also not be a cause for concern. The EU surely has an interest in the free passage across the Northern Sea Route, as does China and other third countries. These routes mainly pass through the high seas. But some of the Arctic trade routes pass through internal waters, which could be taxed, policed or closed. This concerns parts of Russia’s Northern Sea Route, and parts of Canada’s North-Western passage. But since the frequency of Arctic shipping is very low, for now this is mostly a theoretical issue. Less than 70 ships passed through the Northern Sea Route in 2014, while more than 17,000 ships transited the Suez Canal that year. As such, speakers questioned the profitability of trans-Arctic shipping: in the long term, bulk shipping might

be economic, but container shipping is not likely to be. One speaker made the point that if third parties, like the EU, want to ensure free passage they should offer something in return; for instance, assistance with the necessary infrastructure development along the Arctic routes.

In short, if the economic prospects of Arctic exploration and navigation were very promising, an Arctic race could lead to increased geopolitical tensions, threatening the basis for sustainable economic activities there. As it happens, low oil prices and technological challenges have raised doubts about the region's economic opportunities. But, as long as relations between Russia and Europe remain troubled, Arctic tensions cannot be ruled out.

### **Europe's role**

A majority of the speakers believed that the EU has a stronger role to play in Arctic affairs (while some want to 'keep the Arctic for the Arctic states'). There is a case to be made for stronger EU involvement: the Schengen border and the single market reach to Arctic; EU fishing policies extend to the Arctic; the EU's Horizon 2020 programme and the EU's Northern Dimension policy with Russia, Norway and Iceland relate to the Arctic. In the Arctic Council (an intergovernmental forum which includes the eight states that lie – partially – within the Arctic circle), the EU wants to have permanent observer status; though its current status was described as "quasi-permanent".

The Finnish minister of economic affairs, Olli Rehn, said that the EU should unlock the Arctic by funding a transport link from Kirkenes to Rovaniemi, and – perhaps in the longer term – a tunnel under the Gulf of Finland from Helsinki to Estonia. Rehn said that the EU should play a stronger role in the Arctic, because two of its member-states, Sweden and Finland, are Arctic states. Arctic issues are too important for the EU not to play a substantial role: the safety of navigation, the promise of the Arctic's oil and mineral wealth, and competing territorial claims all command the EU's attention.

Different speakers called on the EU to help avoid negative spillover from the Ukraine crisis. Despite the seemingly adverse economics, the EU should recognise opportunities in the Arctic, particularly as a means to re-engage with Russia. Europe has an interest in trying to get clarity on Russia's Arctic intentions. To do so, the EU needs an agenda to discuss Arctic issues with Russia. Finally, Finland should use its chairmanship of the Arctic Council in 2017-18 as an opportunity to build bridges between East and West.

(Pictures of the event can be found here: <http://www.cer.org.uk/events/conference-deep-freeze-east-west-relations-and-arctic>)