

A European sanctions compensation fund?

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The EU has now finally agreed to impose ‘third-level sanctions’ against Russia. As usual, it has been a long and difficult process to arrive at this point. A key problem all along has been that sanctions serve a common purpose, but the costs of implementing them are borne by individual member states. Moreover, the costs are very concrete and visible, as jobs in certain enterprises with exports to Russia seem to be at stake. A common fund to provide compensation for the economic costs of sanctions would provide a highly visible token of solidarity and should be an integral part of the common foreign policy stance that is now emerging towards Russia, albeit slowly and painfully. It is thus not surprising that many member states were more concerned with the potential cost of the sanctions on their own economy than the overall foreign policy goal of sending a clear signal to Russia that its disregard of international norms would have consequences.

The process of creating such a fund would also provide an excellent occasion on which to reflect on the nature of the cost of sanctions for the EU.

From the point of view of an economist, a key consideration is that losing export sales does not represent a cost per se. For example, if a company that produces a generic consumer good like food or even cars sells less in Russia, one should not count the reduction in sales as a loss. For generic goods that have a global market, a loss of sales in one market can be compensated for by higher sales in another. This implies that reports purporting that the cost of sanctions would be high because exports to Russia amounted to so many billions and represented tens of thousands of jobs are highly misleading. Moreover, a large part of Russian imports from the EU consists of these generic consumer goods, which in any event are not affected by sanctions.

An economic loss arises only if a firm produces some specialised products that can be sold only in Russia, and if the labour and capital that had been employed to produce these goods were also specialised and could not be used to produce something else. This applies in particular to Germany whose famous ‘Mittelstand’ often does produce highly specialised products, but which also prides itself on its flexibility and adaptability.

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It would not be difficult to develop objective criteria to determine access to this proposed Fund. A firm could be eligible for compensation if it operated in the sectors covered by sanctions and if the product in question had special characteristics that meant that sales could not be re-directed elsewhere. A quantitative test of eligibility could be that sales to Russia over the last years had amounted to over one-fourth of total sales and that they had diminished by more than a certain percentage this year.

Compensation would take the form of retraining programmes for personnel and possibly a re-financing of credits that had been obtained to finance specialised machinery.

There are two sectors in which no compensation is needed: energy and finance.

Energy: The threats made by some Russian politicians that Europe would have to pay a higher price for its energy imports from Russia are hollow. Russia cannot ask European importers to pay a higher price for oil because Europe can then turn to the global oil market. For gas it would also be impossible for Gazprom to increase the price it charges its European customers without breaking existing contracts and, in any event, Europe is the only customer for a large part of Russian gas exports which in the short run have to go through the existing pipelines. Only the makers of highly specialised equipment, perhaps for exploration under Siberian conditions, might have a case of compensation.

Finance: Here the case for compensation is even weaker. Providing the kind of medium- to long-term financing that is now subject to sanctions constitutes only an infinitesimal fraction of the business of European banks. Moreover, as the political system in Russia becomes ever-more oppressive and arbitrary, rich Russians will be even more inclined to establish a safe base abroad for their wealth and their families. The political freedom and rule of law provided by financial centres, such as London, will thus become even more attractive.

Some years ago, the EU created a 'Globalisation Fund' whose purpose was to cushion those sectors hardest hit by increasing imports. This fund had been given only €500 million, a rather modest sum compared to the overall annual EU budget of around €100 billion. But its creation had sent an important political signal that the EU stood ready to compensate those who lose out from a common policy. A similar signal is needed today and the sum needed would probably again be rather small compared to the overall EU budget.