CEPS COMMENTARY

Thinking ahead for Europe

The Economic Impact of Sanctions against Russia: Much ado about very little

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23 October 2015

The EU's foreign policy instruments are limited to 'soft power'. This is the main reason why the EU's reaction to Russia's annexation of Crimea and its subsequent military intervention in Eastern Ukraine consisted primarily of the imposition of economic sanctions.

In principle these sanctions were wide-ranging, including asset freezes, travel restrictions, the suspension of development loans from the EBRD, limited access to primary and secondary capital markets in the EU (for targeted Russian financial institutions, energy and defence companies), export and import bans on trade in arms, an export ban on dual-use goods and reduced access to sensitive technologies and services linked to oil production.[1] The sanctions that have attracted the most attention have been the bans on trade in certain goods, introduced in July and September 2014.

In response to these EU measures, Russia announced 'counter-sanctions', prohibiting the import of certain perishable goods (meat, fish and vegetables) from countries adhering to the EU sanctions.

The decision process leading to the sanctions has been very difficult for the EU, with some member states claiming that they have been particularly hard hit because exports to Russia are important to their economies.

We show, however, that the economic cost in terms of lost exports, and thus potentially jobs, has been negligible.

Those claiming that the sanctions imposed a high cost on their economies can point to the fact that exports to Russia have in many cases fallen by 50%, and sometimes more. *Prima facie*, it thus appears that the sanctions (plus the Russian counter-sanctions) have had a strong negative impact on trade (and thus potentially on jobs in the countries trading most intensively with Russia).

However, this first impression of a high cost from sanctions is completely misleading. Overall Russian imports have halved because the oil price has fallen by over 50%, pushing the Russian economy into a deep recession (see Figure 1). The real question is thus whether EU exports to Russia have fallen by more than they would have in the absence of the sanctions given the recession in Russia.

[1] http://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/

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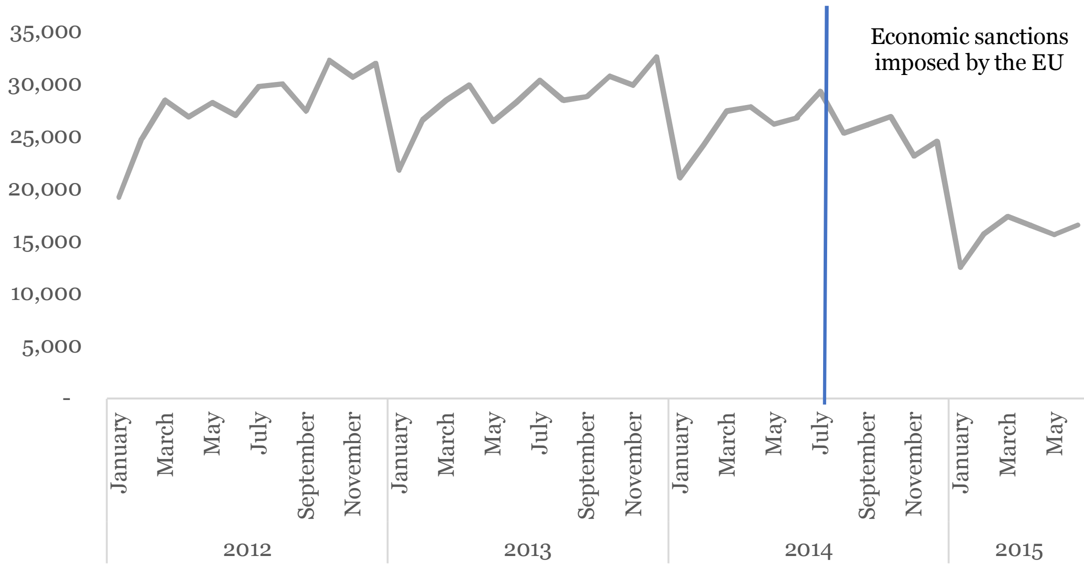
Figure 1. Russian imports of goods, January 2012-May 2015 ($ mil)



Source: Central Bank of Russia database (2015).

There exists a simple way to disentangle the impact of the recession from the effects of EU sanctions (plus counter-sanctions) on (bilateral merchandise) trade: one has to look only at the share of the EU (and other countries that imposed sanctions, like the US or Japan) in Russian imports. If these shares have not changed significantly, sanctions cannot have played a major role in undermining trade flows between the EU and Russia. The common factors (oil prices, recession in Russia, etc.) affected all exporters to Russia.

Figure 2 shows the trend in these shares, i.e. of Russian goods imported from the EU-28, the US and Japan, compared to total Russian imports.

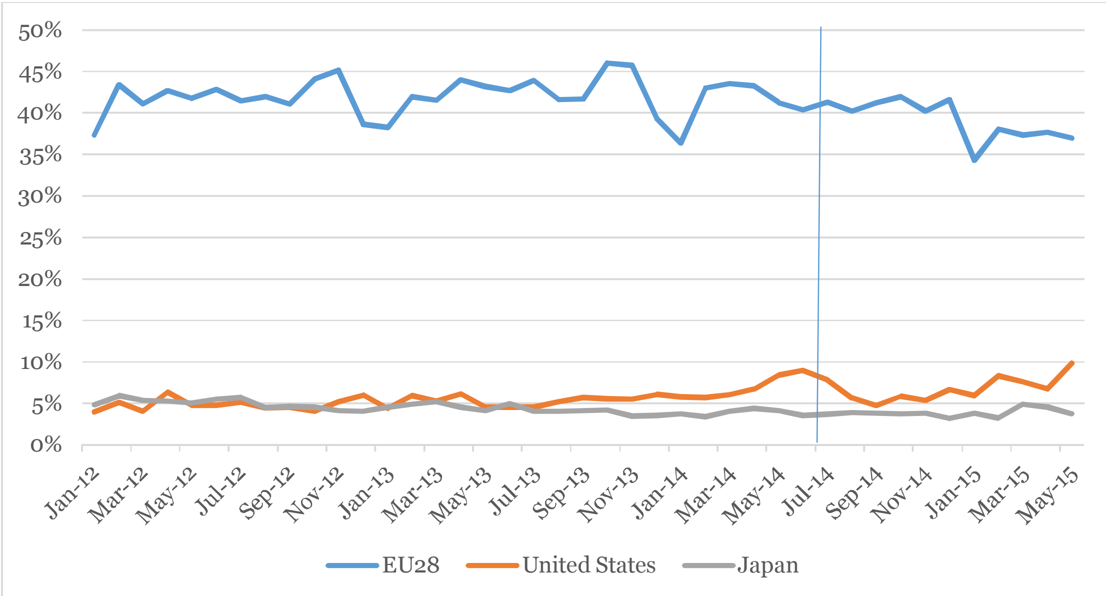
If the sanctions had had a strong impact on trade, one should find that the share of the EU in overall Russian imports has declined after the sanctions were imposed. However, we find that the EU's share in Russian imports has been fairly stable (slightly above 40% of the overall Russian goods imports) until the end of 2014, and then it declined somewhat, down to 37% in May 2015. This decline of about 3 percentage points is equal to a fall in exports (from the EU to Russia) of less than $500 million on a monthly basis.

The share of the US (in Russian imports) has actually increased after the sanctions, reaching 10% in May 2015, while Japan is quite stable at around 4% for the whole period under analysis. The data for the US present an intriguing puzzle in that the US has been among the most vociferous champions of sanctions against Russia, but this stance does not seem to have affected US exports.

For Japan there is no evidence that the sanctions have had any measurable impact on trade.

The small loss in market share for the EU seems to be mirrored by an increase in a number of smaller exporters. But major exporting nations that did not participate in the sanctions, such as China or South Korea, have also lost market shares. There is thus no evidence that the sanctions led to a broad-based shift in trade patterns.

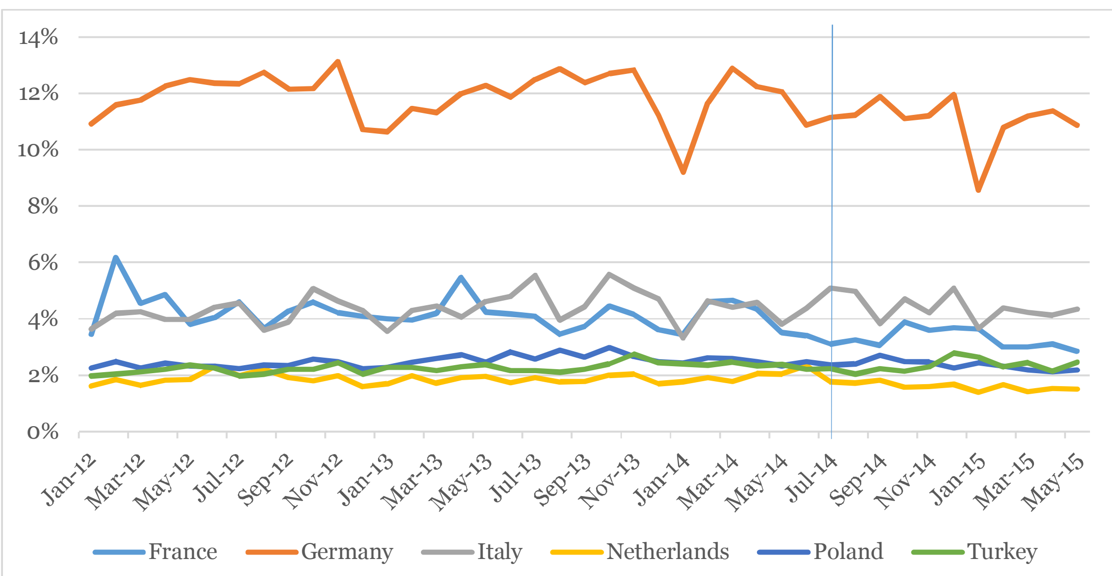
Figure 2. Russian imports of goods by partner countries, Jan 2012-May 2-15 (% of total)



Source: IMF Directions of Trade Statistics (2015).

This is also confirmed by looking at country-specific trade flows. Indeed, in Figure 3, we observe that the share of Russian imports from the top five EU member states (Germany, France, Italy, Poland and the Netherlands) and Turkey has not changed significantly since the imposition of the sanctions.

Figure 2. Russian imports of goods by selected EU partners and Turkey, Jan 2012-May 2015 (% of total)

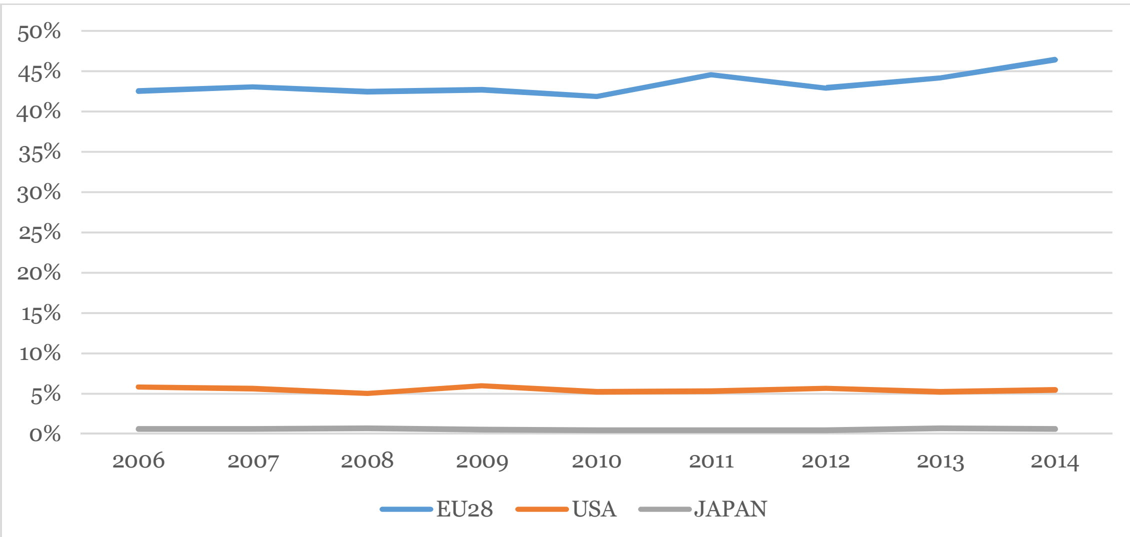


Source: IMF Directions of Trade Statistics (2015).

A recent study published by the Austrian Institute of Economic Research (WIFO)[2] also finds that the sanctions and counter-sanctions had a limited impact, although it has been widely cited in a different sense, as discussed below. The WIFO study argues that a potential sizable trade loss could be the result of worsening relations between the two economies, but that it not directly linked to the economic sanctions.

The WIFO study also raised some concerns over the spill-over of the sanctions and the generally more strained relations between the EU and Russia on trade in services, especially tourism. The data do not bear this out, however, as shown in Figure 4. On the contrary, the share of the EU in Russian imports of services has actually increased (slightly) over the last few months. There is thus absolutely no evidence that political tensions have had any negative impact on trade in services.

Figure 3. Annual Russian imports of services by partner countries, 2006-14 (% of total)



Source: Central Bank of Russia database (2015).

We have looked only at the reduction in trade flows between the EU and Russia. The consequences for valued added and employment are more difficult to gauge. 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. An economic loss arises only if a firm produces some specialised good that does not have a market anywhere else with specialised capital, which cannot be used in the production of some other goods or services. Gros (2014)[3] argues that this is unlikely to be the case in the large majority of the goods or services exported from the EU to Russia. This argument should apply in particular to the agri-food sector, which was the one sector singled out by Russian counter-sanctions.

All in all it seems that the EU's sanctions against Russia had a very limited impact on the EU economy. These sanctions must therefore be considered more as a political signal, than an important economic weapon.

[2] E. Christensen, O. Fritz and G. Streicher (2015), "Effects of the EU-Russia Economic Sanctions on Value Added and Employment in the European Union and Switzerland", WIFO Study, Austrian Institute of Economic Research, Vienna, July.

[3] D. Gros (2014), "A European sanctions compensation fund?", CEPS Commentary, CEPS, Brussels, 12 August.