HOW SANCTIONS ON RUSSIA IMPACT THE ECONOMY OF THE EUROPEAN UNION

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Abstract:
Although new sanctions have been imposed, to varying degrees, on Russia since the debut of the Crimean crisis, few experts are taking the chance of publishing an assessment of the impact these sanctions will have on Russia or the European Union. On one hand, the complexity of the variables involved makes it extremely difficult to predict the outcome of said sanctions; on the other hand, an accurate assessment would make an invaluable tool in the hands of decision makers, no matter if their decisions are made with regards to foreign policy, public policy or the daily business of private companies. This article sets out to examine the context, some of the variables involved and some of the forecasts that have been put forward by various experts, while trying to provide a simplified model for assessing the impact of sanctions enacted by the EU on its own economy.

Key words: Russia, European Union, Ukraine, Sanctions, Foreign Policy

1. Introduction

The fall of the Soviet Union in late 1991 meant a step forward to achieving convergence between the European states and their common policies. While communism was collapsing, the European states agreed on signing the Treaty of Maastricht, creating a framework for a strengthened European Union. The nature of the European Union and Russian Federation after 1991 has been characterized by the geostrategic developments in their relative influence and by the expansion of this new political construct into what was known before as the “communist,” “Eastern” or “soviet
bloc.” Nowadays, the EU has Russia as a neighbour, so the cooperation and collaboration between the two of them is inevitable (Van Elsuwege 2012).

2. Russia and the European Union

The framework of this relationship between Russia and the European Union was created in 1994, by signing the Partnership and Cooperation Agreement (PCA). This treaty is focused on economic relations, international trade and investments. Article 106 stipulates that the agreement is renewed every year, until one party decides to denounce it by giving the other side a six-month notice before the expiration date (EEAS 2015).

The biggest complaint was the lack of equality of this partnership and the creation of an asymmetrical relationship in which Russia is the only one to comply with the European legislation, norms and values. Also, the phrase from the Treaty’s preamble, referring to the Russian economy as being “in transition” could no longer be considered appropriate since the recognition of the market economy status and the accession of Russia as a member of the World Trade Organization (WTO 2012). Given these problems, from 1999, Russia has insisted on “the joint elaboration and conclusion of a new framework agreement in Strategic Partnership and Co-operation in the 21st century” (EULAW 2007).

The enlargement of the European Union towards the East has provided the opportunity to re-evaluate the strategic and legal framework of the economic relation with Russia. At the St. Petersburg Summit of 2003, the European and Russian decision-makers agreed to create the Common Economic Space - CES - a step toward a more open and integrated market between Russia and EU. The purpose of CES is to build the necessary means for a more diversified trade, by creating the investment opportunities, based on economic integration, elimination of tariff barriers, modern trade facilities, regulatory convergence and the development of infrastructure (EEAS 2015). The regulatory convergence is meant to allow the economic agents to cooperate under a common set of rules in many fields throughout an enlarged market of 600 million consumers from the EU and Russia. The Roadmap on the Common Economic Space, agreed upon in 2005, sets out the overall objectives and fields of cooperation between EU and Russia for the short and medium term. The Roadmap also sets out dialogues on additional issues: Industrial and Enterprise Policy Dialogue, Energy Dialogue, Competition Dialogue, Macroeconomic and Financial Services Dialogue, Trade facilitation and customs.

At the 2008 Khanty-Mansiysk Summit, negotiations were launched for a new EU-Russia agreement that would provide a more complex framework for the strategic partnership, reflecting the evolved cooperation and include legally binding commitments in political, security, economical, research, education, trade, investment and energy areas (EU Commission 2009).
3. Russia and Germany

The beginning of the 21st century made Russia one of Germany’s main trade partners. Their cooperation provides imports and exports on both sides, foreign direct investments, financial resources and all types of services like new technology or know-how transfer (Gotz 2007).

Russia represents the 7th source of Germany’s imports and the 11th market for the exports of goods and services. Looking at the 2000-2012 period, it is easy to evaluate the ascending trend in imports and exports. In 2000 the value of the exports from Russia to Germany amounted to $9.2 billion.; in 2010 the exports rose to $25.6 billion; and in 2012 - $34.9 billion. The same trend could be observed regarding the value of the imports - from $3.8 billion in 2000 to $38.3 billion in 2012 (GKS 2015).

Germany - Russia trade decreased by 5.4% in 2013, including Russian exports - $37 billion, and imports to Germany - $37.9 billion (GKS 2015). The major reason for the decrease of the trade performance in 2013 is the strong reduction in imports and exports from Russia, which took place in March, October and December 2013 due to the difficult political context.

In the structure of Germany-Russia imports, one of the most important elements is the energy industry production, which reaches 86.7% and forms the cumulative deficit. Moving on, the other main industry groups include: industries for investment goods - first place in terms of exports (about 55%); industry of materials (raw and semi-processed) - 2nd place in terms of exports (23.7%) and 11% from imports and industries of consumer goods which represent 18.1% of exports (GKS 2015).

Collaboration and cooperation between Germany and Russia has been developing not only in terms of foreign trade, but also in the field of direct foreign investments. In recent years, Germany has strengthened its role as the main foreign investor in Russia. At the end of 2012, all of Germany’s investments in Russia amounted to $25 billion, while, at the end of 2013, they stood at $21.3 billion. These investments can be divided into FDI, worth $ 13.5 billion, and other financial investments worth $13.5 billion (Khoroshun 2014).

In 2012, over 6,000 German companies were registered in Russia. They traded billions of dollars and maintain a staff of about 270,000 people. In Germany, it is estimated that about 350,000 jobs depend on doing business with Russia. Top business leaders trading with Russia are Volkswagen, Siemens, BASF, Metro and Henkel (IIEA 2014).

In recent years, we can observe new trends in terms of this bilateral partnership between Germany and Russia. First, it seems that Russia is becoming more attractive for further development of new technologies. Trade and economic cooperation between Germany and Russia aims to build and ensure prosperity, and an ascending trend of key indicators in the post-crisis period.
Table 1: Russian Federation - Germany trade (mln US $)

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<td>Exports</td>
<td>9232</td>
<td>19736</td>
<td>33165</td>
<td>18710</td>
<td>25662</td>
<td>34158</td>
<td>34995</td>
<td>37028</td>
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<tr>
<td>Imports</td>
<td>3898</td>
<td>13272</td>
<td>34115</td>
<td>21229</td>
<td>26699</td>
<td>37683</td>
<td>38305</td>
<td>37916</td>
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4. Russia and France

Russia’s 5th largest trading partner in the European Union is France, according to 2012 statistics. Also, trade with France represents a percentage of 2.9 % of Russia’s trade, and a rate of 5.9 % of EU total trade. As was the case with Germany, in 2013, foreign trade between Russia and France fell by 4% compared to the same period of 2012, accounting up to $ 22 billion, including exports ($ 9 billion) and imports ($ 13 billion) (GKS).

Looking at the French imports from Russia, according to 2012 statistics, the main category of goods supplied is represented by mineral products (along with fuel and energy products), amounting up to 89.3% of total imports. Consequently, the main import commodities from Russia to France are petroleum, coal, natural gas and oil (OEC 2015).

Moving on to French exports, the range of products is mainly dominated by machinery, equipment and vehicles - amounting to 54.2 % of total exports, food products and agricultural materials - 11%. The main export commodities include: equipment for aviation, medicinal products, cosmetics and perfumes, French food products like wine, cheese or meat, cars and equipment etc. (GKS 2015)

Traditionally, France is known as one of the main European investors in the Russian market. In 2012, France was one of the top 10 investors in the Russian market.

Table 2: Russian Federation – France trade (mln US $)

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<tr>
<td>Exports to France</td>
<td>1903</td>
<td>6111</td>
<td>12201</td>
<td>8726</td>
<td>12420</td>
<td>14859</td>
<td>10527</td>
<td>9203</td>
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<tr>
<td>Imports from France</td>
<td>1187</td>
<td>3673</td>
<td>10015</td>
<td>8431</td>
<td>10043</td>
<td>13276</td>
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Sanctions

Sanctions against Russia

Russia’s embroilment in the Ukrainian crisis and its experiment in redrawing borders did not go unnoticed by the international community, who imposed a series of sanctions to showcase its denunciation of such behaviour. This section of the paper discusses these sanctions and their efficiency as an instrument of deterrence.

As far as the UN is concerned, their chosen method of expressing discontent towards Russia’s actions has been through the means of the General Assembly Resolution 68 / 262, adopted on March 27, 2014, entitled “Territorial Integrity of Ukraine”, which declared the Crimean referendum null and void and reaffirmed Ukraine’s unity and territorial integrity. The resolution passed with 100 votes in favour, 11 against and 53 abstentions. While it has symbolic value and proves that the international community does not approve of the violation of Ukraine’s borders and internal affairs, it remains an empty and powerless avenue of protest, since resolutions passed by the General Assembly are not legally-binding. One such resolution, if it came from the Security Council, would have had far more weight, but attempts in this direction have been fruitless, since Russia is a permanent member and benefits from veto right (UN News Centre 2014).

However, other sanctions imposed by individual states and / or international organisations have been more practical in nature. Hereinafter, we shall attempt to draw a timetable of the sanctions against Russia issued by these international actors:

- **March 6, 2014**: The United States issue a ban on travel to the U.S. and freeze the U.S. assets of those threatening the security of Ukraine. The State Department prepares visa restrictions on a number of officials and individuals (Reuters and The Associated Press 2014).

- **March 17, 2014**: The EU imposes travel restrictions and asset freezes on 21 individuals held responsible for the crisis, including the Speaker of the Crimean Parliament and several Russian MPs (OJEU 2014). The scope of these penalties is the highest Russia has ever been issued since the fall of the Soviet Union in 1991 (Katakey, 2014). The U.S. expands the list of sanctions against Russian and Ukrainian officials (RT, 2014). Canada also imposes economic sanctions against Ukrainian and Russian officials involved in the crisis (PMOCSH, 2014).

- **March 18, 2014**: Japan suspends talks with Russia on matters concerning visa norms, investments, military issues and space exploration (Shankar 2014).

- **March 19, 2014**: Australia imposes travel bans and financial sanctions on 12 Russian and Ukrainian individuals (Hurst 2014).

- **March 20, 2014**: The United States expand the list of sanctions again, to include 20 members of Putin’s clique and Bank Rossiya, because of its support for officials involved in the Crimea (JNM Journal 2014). The EU also expands the list of individuals targeted by sanctions up to 33. The G8 forum, over which Russia was supposed to preside, is suspended indefinitely (CBC...
News 2014). Moldova joins the EU in sanctions with travel bans and asset freezes on Ukrainian officials accused of human rights violations (Teleradio Moldova 2014).

- **April 11, 2014:** Montenegro, Iceland, Albania, Norway and Ukraine adopt the same restrictions regarding travel bans and asset freezes as those enforced by the Council of the European Union on March 17 (EU 2014).

- **April 28, 2014:** The U.S. usher in a new wave of penalties, freezing the assets of 7 Russian individuals and 17 companies associated with President Vladimir Putin, including Putin’s close adviser Igor Sechin, and banning business transactions with them. The EU includes 15 further individuals on its sanctions list (DeYoung, Birnbaum, 2014).

- **July 17, 2014:** American sanctions target Russia’s main oil producer Rosneft, gas producer Novatek and banks Gazprombank and Vneshekonombank, closing medium- and long-term dollar funding (Reuters 2014).

- **July 24, 2014:** Canada adds further sanctions on Russian arms, financial and energy companies thought to assist Ukrainian rebels, as well as providing a list of 8 targeted Ukrainian individuals (CBC News 2014).

- **July 25, 2014:** The EU includes another 15 persons and 18 entities to its list of restrictions (OJEU 2014).

- **July 30, 2014:** The EU’s list expands by another 8 individuals and 3 entities (OJEU 2014).

- **July 31, 2014:** New EU sanctions against the Russian financial, energy and defence sector; new individuals and entities added to the asset freezing list (OJEU 2014). These measures are meant to curtail the ability of Russian banks to raise money on Western markets and to limit the transfer of military or oil equipment to any Russian entity. EU nationals and companies are prohibited from buying or selling financial instruments issued by several major Russian banks (Sberbank, VTB Bank, Gazprombank, VEB, Rosselkhozbank) or their representatives (Lewis, Santa, 2014).

- **August 5, 2014:** New sanctions issued by Japan include freezing the Japanese assets of 2 organizations and 40 individuals embroiled in the Ukrainian crisis, as well as restricting imports from Crimea (Fackler 2014).

- **August 12, 2014:** Norway decides to support the EU embargo on the import and export of arms and oil technology from and to Russia (Offshore Energy Today 2014).

- **August 14, 2014:** Switzerland tightens military embargo on Russian and Ukraine to include drones, simulators and small arms. Previously, Switzerland had suspended the training of Russian military specialists on its territory and supported 5 of the 6 versions of the EU sanction list (87 individuals and 20 companies) (Tass 2014). Furthermore, Ukraine levels sanctions against 172 individuals and 65 entities involved in the crisis (Radio Free Europe / Radio Liberty 2014).
August 27, 2014: In an attempt to prevent Russia from using Switzerland to circumvent sanctions, the Swiss government decides to prohibit 5 Russian banks from issuing new long-term financial instruments, as well as banning business arrangements with 11 Russian and Ukrainian persons and organizations and expanding the military embargo (Maclucas 2014).

September 12, 2014: The U.S. levels new sanctions against Sberbank, Russia’s largest bank, and Rostec, a state corporation that specialises in the industrial and defence sectors: these entities are now restricted in accessing the American debt markets. American companies are also barred from trading with 5 Russian energy firms that conduct deepwater, Arctic offshore and shale projects: Gazprom, Gazprom Neft, Lukoil, Surgutneftegas and Rosneft. The purpose of these measures is to deprive Russian corporations of expertise coming from companies such as Exxon Mobil Corp and BP Plc (Mohammed, Trott, 2014).


December 18, 2014: The EU details further measures to be taken in regards to Crimea, i.e. sanctions on investment, services and trade with Crimea and Sevastopol: EU entities are banned from purchasing real estate in Crimea or from financing Crimean corporations, in an attempt to upset tourism and oil / gas exploration in the Black Sea region (RT, 2014).

December 19, 2014: The U.S. steps up the embargo on Crimea and levels new sanctions on Eastern Ukrainian separatist leaders: trade and new investments in the Crimea are forbidden, while individuals or companies offering aid to the new leadership are prevented from entering the U.S. and their American assets frozen (Baker 2014).

February 9, 2015: The Foreign Affairs Council issues an asset freeze and a travel ban on 19 individuals and 9 entities involved in the Ukrainian crisis, but delayed the implementation of these measure until February 16, due to the diplomatic debates in Minsk (Council of the EU 2015).

Sanctions by Russia

Needless to say that Russia did not sit idly when flooded with so many restrictive measures by the international community and attempted to retaliate with her own set of sanctions.

March 20, 2014: As retaliation for the American sanctions of March 17, Russia bans several U.S. officials from entering the country, such as John Boehner, the Speaker of the House of Representatives, Senator John McCain and two advisers to President Barack Obama (RT 2014).

March 24, 2014: 13 Canadian officials (including members of government and of parliament) are prohibited from entering Russian soil.
August 6, 2014: Agricultural produce from countries that have issued sanctions against Russia are banned for the duration of one year: vegetables, fruit, meat and dairy products (RT 2014).


Inverse Effects
As the sanctions war unfolded, the most visible outcome was the loss of revenue generated by restricted imports. For example, Russia’s ban on imports of food products from the EU meant that as much as 10% of revenue in this sector would have been lost for the EU. Restricting this ban to exclude soft drinks and alcohol decreased this loss to less than 5%, which roughly translates to $6 billion. $1 billion of this loss is incurred by Lithuania alone.

EU companies with activities in Russia are also due to lose some of their earnings from those activities as a result of bans being enforced, but also as a result of the degrading overall state of the Russian economy and the depreciation of the rouble. This, in turn, entails job losses on both the EU and the Russian side.

Moving on to indirect effects, the decrease in activity by EU companies in Russia, generated by the fact that those activities were forbidden or simply by the fact that investors decided to cancel or postpone their investment decisions, means that there are significant capital outflows on the Russian side and corresponding inflows in EU banks. This is not to say that capital flows are all unidirectional, money is also returning to Russian banks, but the net balance weighs heavily in favour of EU banks. This means that levels of liquidity have surged in some parts of the EU at a time when all this cash is most welcome.

The capital flight from Russia, stock market crashes and foreign exchange reserve depletion have all contributed to an even worse recession and rising inflation. Add falling oil prices to this mix and we can glimpse Russia spiralling towards economic collapse and default. The same factors, which paint a grim image for the Russian economy, add up to a far less problematic net result for the EU. Some might even call it a positive outcome. What Russia is losing from oil alone translates to a significant gain for some EU countries from the cost of importing that oil from Russia: $31 billion for the Netherlands, $30 billion for Germany, $21 billion for Italy and $19 billion for Poland (Giumelli 2014).

That is roughly $100 billion per year from savings on oil alone, which makes most other losses pale by comparison.

5. Conclusions
It’s difficult to argue that sanctions are ever likely to generate profits. We’re usually far more concerned with ensuring that the sanctions harm those being
sanctioned to a much greater extent than they do those initiating the sanctions. We also know that the effect of sanctions is limited in time due to the tendency of those affected to adapt and find ways around them. In this particular instance, however, depending on the measurement tools employed we might find the current set of sanctions to have a long lasting effect on the Russian economy and, even, go as far as saying that the effects of sanctions on the EU economy are positive.

While the economic impact of EU foreign policy towards Russia on the EU GDP can be deemed positive, the impact of these policies on the economies of individual countries is another matter entirely. If there is to be real cohesion between EU member states on matters of foreign policy we should expect members to be cohesive in bearing the costs of those policies as well.

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