Disrupted Trade Relations Between the EU and Russia: The Potential Economic Consequences for the EU and Switzerland

Foreign trade between the EU and Russia has fallen dramatically. Sanctions and counter-sanctions, imposed as a reaction to the political tensions over the Ukraine conflict, in combination with low raw material prices and the weak rubel triggered an economic crisis in Russia. WIFO conducted a study to assess the potential economic consequences of the current trade conflict between Russia and the EU on EU countries (plus Switzerland).

The export ban on the products directly covered by these sanctions and counter-sanctions is likely to cause only limited economic damages for economies within the EU. The share of these products in total EU exports to Russia is (with some exceptions) rather low; furthermore some contracts are still in force and are thus exempted from the sanctions. Commissioned by LENA, the "Leading European Newspaper Alliance", and based on the most recent data, WIFO updated its study from December 2014 on the economic impacts of the EU-Russia trade conflict. The sizeable macroeconomic effects of the trade loss, amounting to € 34 billion in value added in the short run and € 92 billion in the longer run, are much more a result of a general worsening of trade relations between the EU plus Switzerland and Russia. The decline of exports over the last quarter of 2014 and the first quarter of 2015 by € 30 billion (equivalent to a decline of almost 25 percent compared to the previous year) and an estimated decrease in tourism expenditures by some € 3.5 billion (–29 percent as compared to the winter season 2013-14) have multiple causes: In addition to the sanctions and counter-sanctions, diplomatic disruptions, boycotts by Russian trading partners as well as indirect effects caused by the high level of economic integration of European countries are contributing to the reduction in trade activities. Furthermore, the Russian economy is suffering from a recession that has deepened ever since it started in 2013. As these effects are hard to disentangle, the estimation of economic losses covers multiple factors where sanctions play a major role.

Using a multi-country model covering, among others, 27 EU countries, Switzerland and Russia, the observed decline in exports and tourism expenditures of € 44 billion was estimated to have an impact on the economies of the EU 27 plus Switzerland of € 34 billion in value added in the short run, with employment effects of almost 0.9 million people. Switching to a longer term view (additionally taking into account an income induced reduction in household consumption), the economic effects increase up to 2.2 million jobs (around 1 percent of total employment) and € 92 billion (0.8 percent of total value added), respectively.

Table 1: Simulation results by country: employment and real value added impacts due to a decline in tourism demand and exports
Fourth quarter 2014 to first quarter 2015

	Tourism and exports							
	Short term				Long term			
	Employment		Value added		Employment		Value added	
	In 1,000	Percentage shares	Million €	Percentage shares	In 1,000	Percentage shares	Million €	Percentage shares
EU 27	*– 870*	*0.39*	*– 33,485*	*0.29*	*– 2,205*	*0.99*	*– 89,580*	*0.77*
Austria	– 15	0.35	– 990	0.35	– 40	0.95	– 2,505	0.88
Belgium	– 15	0.33	– 1,010	0.30	– 30	0.66	– 2,345	0.69
Bulgaria	– 20	0.58	– 155	0.45	– 65	1.90	– 410	1.20
Cyprus	– 5	1.40	– 205	1.36	– 15	4.21	– 490	3.25
Czech Republic	– 45	0.88	– 1,015	0.76	– 90	1.76	– 2,045	1.53
Germany	– 145	0.35	– 9,475	0.39	– 395	0.94	– 23,385	0.95
Denmark	– 10	0.36	– 580	0.27	– 20	0.72	– 1,390	0.65
Estonia	– 40	6.52	– 800	4.91	– 100	16.30	– 2,155	13.24
Spain	– 60	0.35	– 2,525	0.27	– 190	1.10	– 7,815	0.84
Finland	– 15	0.60	– 1,200	0.72	– 35	1.41	– 2,405	1.45
France	– 40	0.15	– 2,460	0.13	– 120	0.45	– 7,925	0.43
UK	– 20	0.07	– 1,570	0.09	– 95	0.32	– 6,175	0.37
Greece	– 15	0.38	– 590	0.37	– 55	1.41	– 2,135	1.33
Hungary	– 15	0.37	– 390	0.47	– 45	1.10	– 935	1.14
Ireland	– 5	0.27	– 305	0.21	– 10	0.53	– 835	0.57
Italy	– 75	0.31	– 3,820	0.27	– 200	0.83	– 10,930	0.78
Lithuania	– 85	6.58	– 1,010	3.24	– 140	10.84	– 1,985	6.37
Luxembourg	0	0.00	– 55	0.14	0	0.00	– 150	0.37
Latvia	– 10	1.13	– 175	0.84	– 25	2.81	– 390	1.87
Malta	0	0.00	0	0.00	0	0.00	0	0.00
Netherlands	– 25	0.29	– 1,450	0.27	– 60	0.70	– 3,630	0.67
Poland	– 135	0.87	– 1,945	0.56	– 300	1.94	– 4,930	1.42
Portugal	– 5	0.11	– 170	0.12	– 25	0.55	– 655	0.45
Romania	– 20	0.22	– 235	0.19	– 80	0.87	– 890	0.71
Sweden	– 10	0.21	– 815	0.22	– 25	0.53	– 1,870	0.51
Slovenia	– 5	0.54	– 150	0.49	– 10	1.09	– 355	1.16
Slovakia	– 15	0.68	– 380	0.58	– 30	1.37	– 840	1.28
Switzerland	– 10	0.21	– 805	0.16	– 40	0.83	– 2,755	0.55
EU 27 + Switzerland	*– 880*	*0.39*	*– 34,290*	*0.28*	*– 2,235*	*0.99*	*– 92,340*	*0.76*

Source: WIFO calculations. Short-term and long-term effects do not refer primarily to a time period, but rather a sphere of influence in the model simulations. Short term: includes direct and indirect effects as well as effects on investment; long term: additionally accounts for income effects.

The simulations, however, do not take into account trade diversion effects of companies to partly compensate for losses on the Russian market by expanding their presence elsewhere in the world. Therefore, these negative income and employment effects will very likely not materialise up to the full extent as estimated. On the other side, negative growth effects from ceased common investment projects in the future and the decrease of foreign direct investments are not considered, likewise.

Not surprisingly, geographical closeness highly correlates with the relative size of the effects at the national level, with the Baltic countries, Finland and the Eastern European countries being hit above the EU average of 0.3 percent of GDP in the short and 0.8 percent in the long run. The impacts for Germany, due to the size of the economy and the strong export performance – it accounts for almost 30 percent of total EU 27 exports to Russia – are in absolute terms the largest across the EU countries and lie above the average impact with respect to value added.

The sectoral composition of the effects differs somewhat between the short-term scenario, where exporting industries and their suppliers as well as industries specialised on the production of investment goods dominate, and the long term scenario where the effects are spread out to industries that are more dependent on final household demand.

Agriculture and manufacturers of food products, the metal product industry, the manufacturing of machinery, equipment and motor vehicles, plus manufacturing related services (wholesale, business services) are the most affected industries in the short run. In the longer run, construction, wholesale trade and business services are still among those with higher impacts; in addition, retail trade is now more strongly affected since a lower income of households will reduce their consumption expenditures.

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For further information please contact on Friday, 3 July 2015, before 3 pm
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Further detailed results are presented in the WIFO study: Elisabeth Christen, Oliver Fritz and Gerhard Streicher, Effects of the EU-Russia Economic Sanctions on Value Added and Employment in the European Union and Switzerland (commissioned by LENA – Leading European Newspaper Alliance, June 2015, 24 pages, 40 €, download version 32 €: http://www.wifo.ac.at/wwa/pubid/58219)