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ISSUE BRIEF

IMPACT OF RUSSIAN INVASION OF UKRAINE ON THE EUROPEAN ECONOMY

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September 27, 2022

(Views expressed in the brief are those of the author, and do not represent those of ISSI)

On February 24th, 2022, Russia invaded Ukraine. It has been six months since and the economic indicators of Europe, Asia and even the rest of the world have plummeted. The global economy, especially the economy of Europe, has faced trade disruptions, reduced remittances, weakening of investor confidence, rising commodity prices especially of oil and gas. Countries around the globe have experienced these economic burdens, the ones most affected are those in close proximity of Russia and Ukraine.

Large economies of Europe such as Germany, France, UK, Italy, and Spain have faced the aftermath of sanctions on Russian oil and gas. According to statistics provided by the European Union, Russia's largest trade partner was the EU; the total trade between them amounted to approximately €257.5 billion.[1] Since the invasion of Ukraine, the European Union has halted trade with Russia and imposed several wide-ranging sanctions on Russia.

This brief will specifically focus on how Europe has been impacted by these sanctions.

1 "Russia". 2022. *European Commission*. https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/russia_en#:~:text=In%202021%2C%20the%20total%20trade,(1.78%20bn%2C%201.1%25)

Shortage of oil and gas

Despite several years of efforts by climate change experts and environmentalists, the switch from non-renewable sources of energy such as hydrocarbon fuels to renewable sources of energy has been slow. Russia provided gas and oil to almost every country in Europe; Russian energy consists of "47% of natural gas and 25% of oil imports to Europe".[2] The Nord Stream 1 pipeline between Germany and Russia provided approximately 5000 million cubic meters of gas on a monthly basis.[3]

Due to global warming, all of Europe has experienced a scorching summer which will be followed by an even harsher winter. Gas is the major source of heating in Europe, due to which the supply of gas will become a matter of life and death.

Disruptions in the Global Value Chain

While Russia and Ukraine account for only 3% of global exports, the ongoing conflict has resulted in disruptions in the global value chains. Trade routes that move through Russia and Ukraine have been interrupted. According to the World Bank, the sanctions and ongoing war have resulted in a shortfall of wheat. Countries such as Armenia, Georgia, Kazakhstan, and Türkiye import approximately 75% of their wheat from Russia and Ukraine.[4] The sanctions on Russia and the inability of Ukraine to safely export its grains has led to global food insecurity. This will be mitigated to some extent by the Russia-Ukraine grain agreement signed on 22nd July, which will "allow exports of grain and other agricultural products to resume from selected Ukraine Black Sea ports after months of Russian blockade".[5] The trade routes from and to Europe have suffered the most.

2 Office of Chief Economist. 2022. "War In The Region". Europe And Central Asia Economic Update. World Bank.

3 Kumar, Nikhil. 2022. "Germany Depends on Russian Gas. Will It Still Stand with Ukraine Through A Brutal Winter?". *Grid*. https://www.grid.news/story/global/2022/08/23/germany-depends-on-russian-gas-will-it-still-stand-with-ukraine-through-a-brutal-winter/.

4 Office of Chief Economist. 2022. "War In The Region". Europe And Central Asia Economic Update. World Bank.

5 Glauber, Joseph, and David Laborde. 2022. "The Russia-Ukraine Grain Agreement: What Is At Stake?". *Ifpri.Org*. https://www.ifpri.org/blog/russia-ukraine-grain-agreement-what-stake#:~:text=On%20July%2022%2C%20Ukraine%20and,after%20months%20of%20Russian%20blockade.

Rising Commodity Prices all over Europe

The strain on the global value chain coupled with increased shipping and insurance costs in varying industries such as food, automobiles, construction, pharmaceuticals, and transport, has led to rising commodity prices all over the world.[6]However other regions have been able to cope with these rising prices because they have had access to sanction-free equity and uninterrupted trade routes. European countries have faced these impacts ten-fold because of its proximity to Russia and Ukraine.

The increased burden of refugees flowing into neighboring countries of Ukraine have further stressed European resources. This puts an upward pressure on the already increasing commodity prices across the continent which was still undergoing the process of economic recovery due to the setbacks it suffered during the COVID 19 pandemic.

Reduced investor confidence and decreased remittances to European countries

Russia was removed from the SWIFT banking system in March 2022. According to the BBC, this was meant to block out Russia from “the international financial system and harm its ability to operate globally”.[7] Although this has had the desired outcome for Russia, it has negatively impacted European countries. Many European countries and energy firms have bilateral investments with Russia. They face a potential loss of investment. According to the World Bank the estimated cost of disinvestment can be up to $25 billion.[8]Countries such as France, Italy, Norway, Finland, Austria, UK, Netherlands and Germany have major stakes in Russian oil fields or are financially tied to Nord stream 2.

The top source and destination of Russian Foreign Direct Investment (FDI) includes Eurasian countries particularly Armenia, Belarus, Moldova and the Kyrgyz Republic. According to the

6 World Bank. 2022. “The Impact Of The War In Ukraine On Global Trade And Investment”. Trade, Investment And Competitiveness, Equitable Growth, Finance And Institutions Insight. https://documents1.worldbank.org/curated/en/099750104252216595/pdf/IDU0008eed66007300452c0beb208e8903183c39.pdf.

7 “Ukraine Conflict: What Is Swift And Why Is Banning Russia So Significant?”. 2022. *BBC News*. https://www.bbc.com/news/business-60521822.

8 World Bank. 2022. “The Impact Of The War In Ukraine On Global Trade And Investment”. Trade, Investment And Competitiveness, Equitable Growth, Finance And Institutions Insight. https://documents1.worldbank.org/curated/en/099750104252216595/pdf/IDU0008eed66007300452c0beb208e8903183c39.pdf.

IMF Coordinated Direct Investment Survey (CDIS) database 2020, most of Russia's FDI stock is concentrated in Europe and Central Asia.[9]

The World Bank estimates that remittances from Russia account for approximately "30 percent of Gross Domestic Product in some Central Asian countries such as the Kyrgyz Republic and Tajikistan".[10] Furthermore, countries such as Georgia, Montenegro and Türkiye which are reliant on tourism are likely to be deprived of Ukrainian and Russian tourists which account for more than 10% of arrivals in about half of European and Central Asian economies.

Conclusion

Sanctions on Russia have shown to be a double-edged sword. On one hand, they have negatively impacted Russia and its ability to maintain its economy during this conflict while on the other hand, it has led to massive shortages of gas, oil and even wheat in Europe. These impacts, although not unforeseen, have created an undesired situation for the European Union and the UK. The Russian invasion of Ukraine and the subsequent sanctions have also highlighted the dependency of European countries on Russian oil and gas. European countries have announced several initiatives to switch towards renewable energy sources, however these initiatives have been followed by little action. Higher rates of inflation caused by high oil and gas prices has become one of the biggest challenges for European countries. According to Black Rock, one of the world's largest investment companies, "the EU countries will spend more than 9% of their GDP on energy" in 2022.[11] Consequently, the living standards of Europeans have declined. This has also given rise to debates about whether it is important to protect values such as democracy or reduce fuel prices and cost of living.

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9 World Bank. 2022. "The Impact Of The War In Ukraine On Global Trade And Investment". Trade, Investment And Competitiveness, Equitable Growth, Finance And Institutions Insight. https://documents1.worldbank.org/curated/en/099750104252216595/pdf/IDU0008eed66007300452c0beb208e8903183c39.pdf.

10 World Bank. 2022. "The Impact Of The War In Ukraine On Global Trade And Investment". Trade, Investment And Competitiveness, Equitable Growth, Finance And Institutions Insight. https://documents1.worldbank.org/curated/en/099750104252216595/pdf/IDU0008eed66007300452c0beb208e8903183c39.pdf.

11 Prohorovs, Anatolijs. 2022. "Russia'S War In Ukraine: Consequences For European Countries' Businesses And Economies". *Journal Of Risk And Financial Management* 15 (7): 295. doi:10.3390/jrfm15070295.