DISCUSSION PAPER

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Strengthening the impact of EU sanctions against Russian aggression in Ukraine

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Executive summary

As Russia's largest trade and economic partner, the European Union (EU) has significant leverage to expand the current sanctions regime. Yet, at the same time, EU countries remain heavily reliant on Russia for their energy, certain raw materials, and agricultural fertilisers. This reduces the EU's economic resilience and exposes it to supply chain disruptions. Much more should be done to turn the tide on this dependency.

The EU has so far adopted eight sanction packages against Russia as a consequence of its war of aggression in Ukraine. However, the effectiveness of the EU and Western sanctions could and should be further improved. Closing loopholes and reinforcing and widening sanctions must be prioritised by the EU and its allies to strengthen the impact of sanctions and to stop the war as soon as possible. To achieve this, the following steps should be taken: increase the scope of sanctions to cut Russian export revenues; expand and align export restrictions among the coalition countries; prevent circumvention; encourage further company-level self-sanctions, and prolong the renewal periods for economic sanctions.

Along with restricting Russia's export revenues, sanctions can also serve other important purposes. These include reducing EU dependency on a single supplier as well as providing opportunities for integrating Ukrainian producers into EU supply chains and replacing Russian products with Ukrainian ones.

1. The scope for harsher sanctions against Russia

Following Russia's full-scale invasion of Ukraine on 24 February 2022, the EU and other coalition countries (US, G7 and other allies) adopted an unprecedented number of wide-ranging, coordinated sanctions. These targeted Russian companies, individuals, financial institutions and trade flows of goods and services. They also included export controls on Russia. Their goal is to increase the economic costs for the Kremlin, deprive its military complex of key technologies and weaken its ability to wage war on Ukraine. Russia is now the world's most sanctioned country, surpassing Iran, Syria, and even North Korea.[1]

Until Russia's full-scale invasion of Ukraine, the EU and Russia remained closely interdependent, despite EU sanctions imposed following the illegal annexation of Crimea and the Russian-provoked war in the Donbas. EU countries remained particularly heavily reliant on Russia for their energy, certain raw materials and agricultural fertilisers (but even so, Russia represented only 5.8% of the EU's total trade in goods).[2] In 2021, the EU imported more than 40% of its total gas consumption, 27% of its oil imports and 46% of its coal imports, from Russia.[3] Other EU imports that are highly reliant on Russia include nickel mattes – 95% as of 2021 (used for the production of stainless steels and alloying elements); direct reduced iron – 65%; nuclear fuel elements and cartridges – 62%. About 60% of imported fertilisers such as ammonia, phosphate and potash come from Russia and Belarus.[4]

In 2021, the EU imported more than 40% of its total gas consumption, 27% of oil imports and 46% of its coal imports from Russia.

High dependence on these Russian imports reduces the EU's economic resilience, amplifying the need for diversification. Countries but also industries that are more dependent on and integrated with the Russian economy are subject to higher costs and supply chain risks and disruptions.

Germany was particularly dependent on Russian energy imports, which accounted for 55% of its gas supply, 35% of its oil and 45% of its coal in 2021. High dependence and vulnerability in fertiliser trade are acute for EU food production and food security.[5]

As it turned out, the traditional argument about the EU-Russia trade interdependence and having mutual interests failed to stop Russia from weaponising energy supplies, hurting both sides and provoking a severe EU energy crisis. However, as Russia's largest trade partner, the EU has significant leverage to expand sanctions against Russian trade and economy. The EU accounted for $282 billion or about 36% of Russia's trade[6] in 2021, while all coalition countries (G7, EU, and their allies) made up about 54% of Russia's total trade in goods.[7] In 2021, EU-Russian trade was more than two times greater than that of its second-largest partner, China ($140 billion). Europe is a major destination for Russian fossil fuel, accounting for about 50% of crude-oil exports[8] and 75% of its natural-gas exports in 2021.

Russia's general economic and budget performance and the medium-term ability to fund the war in Ukraine is largely dependent on its revenues from the export of fossil fuels.

Indeed, Russia's general economic and budget performance and the medium-term ability to fund the war in Ukraine is largely dependent on its revenues from the export of fossil fuels[9] - Russia earned $117 billion from energy sales to the EU in 2021. Besides, the EU is one of the major exporters of high-tech and innovative goods to Russia, as well as the main source of foreign investments. Russian military and aviation industries, as well as resource/energy extraction businesses are particularly dependent on EU and Western technologies, components (advanced chips, sensors), and advanced services.[10]

2. What has been done so far?

The coalition countries have imposed a series of sanctions on exports and imports of goods and services to and from Russia, including bans, export control and licensing requirements, and import-blocking tariffs.

The coalition countries revoked Russia's 'most favoured nation' status (MFN) under the security exemptions of the World Trade Organization (WTO) Agreement.[11] This deprives the Kremlin of major WTO trade preferences – non-discrimination and predictability – and enables WTO members to impose tariff and non-tariff restrictions on Russian imports.

So far, the EU has adopted eight sanctions packages[12] against Russia's war of aggression in Ukraine. The first two packages were introduced swiftly in response to Russia's recognition of Ukraine's self-proclaimed separatist entities and a full-scale invasion of Ukraine on 24 February 2022.[13] Since then, the EU members have been remarkably united in their sanctioning of Russia.

The EU members have been remarkably united in their sanctioning of Russia for its military aggression against Ukraine.

The latest package was adopted on 6 October in response to Russia's continued escalation and illegal annexation of Ukrainian territory based on sham referenda.[14] It extends export bans to additional aviation items, electronic components, specific chemical substances, and certain services. Moreover, this package aims to cut off Russian revenues. New restrictions are imposed on a wide range of Russian goods worth €7 billion,[15] including semi-finished steel products, wood pulp and paper, certain machinery and appliances, intermediate chemicals, plastics, and cigarettes.

The new measures extend the scope of the previous seven packages, which have introduced a series of bans on EU exports to Russia, including cutting-edge technology, certain machinery and transport, specific goods and services for oil exploration, energy, aviation, space industries, and dual-use goods. In addition, the EU has restricted imports of Russian oil and oil products (although not yet in effect), coal, gold, certain steel and iron products, wood, cement, and certain fertilisers. The trade-related sanctions also include the closure of EU ports to Russian vessels, as well as a ban on Russian road transport operators.

Existing sanctions imposed by the EU and other coalition partners have been more restrictive towards Russian imports than exports. The oil embargo imposed by the EU and Norway will, for instance, only become fully effective from December 2022-February 2023. According to estimates by the Kyiv School of Economics,[16] as of 21 July 2022, the coalition applied sanctions to about 25% of total Russian imports but only 8% of its exports.[17] The EU oil embargo will help to increase the volume of sanctioned Russian export revenues significantly – to 29%. With the new restrictions included in the eighth package, about 30% of total Russian export revenues will be sanctioned. Yet, non-sanctioned Russian imports and exports will remain significant – and more can still be done.

3. Impact of sanctions on the Russian economy and trade

Although the real impact of sanctions will only materialise following the full implementation of the EU oil embargo, the initial impact on Russia's economy and trade is already visible. The economy declined by 4% year over year (y/y) in the second quarter (Q2) of 2022,[18] after a 3.5% y/y rise in Q1 of 2022. Export-oriented and import-dependent industries have been hit the hardest by trade restrictions[19] (e.g., motor vehicle production). Russian budget revenues have started to decline under the pressure of lower energy production and sanctions,[20] resulting in a sharp shrinking of Russia's budget surplus in August 2022.

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The biggest impact of sanctions can be seen in Russian imports. According to the Russian Central Bank, imports of goods and services contracted by 22.4% y/y or about $21 billion in Q2 2022 vs +12.1% y/y in Q1 2022.[21] Export control sanctions imposed by major manufacturing centres such as the EU, US, UK, and Japan resulted in sharp declines in imports to Russia of advanced technologies, equipment and components used in manufacturing industries. These products cannot be easily or fully replaced. The withdrawal of many foreign companies from the Russian market has also negatively impacted Russia's import and foreign direct investment (FDI) flows.[22]

Yet, high export revenues have allowed the Russian economy to stabilise after the initial sanctions, and exports grew in value terms by 19.7% y/y (+ $25 billion) in Q2 2022. However, there was a clear slowdown, when compared to a 58.8% y/y growth in Q1 2022.[23] This growth was driven by record energy and commodity prices on oil, gas, coal, fertilisers, non-ferrous metals, while physical volumes of major Russian exports contracted.[24] Increasing Russian export revenues combined with shrinking import and strict capital control supported the increase of Russia's current account surplus and the stabilisation of the rouble and the economy from the initial shock of sanctions. However, Russian export revenues are likely to significantly drop upon the implementation of the EU oil embargo, combined with EU cut-offs from Russian gas. This will put pressure on Russia's balance of payment by the end of 2023.[25] Further rounds of sanctions on Russian exports may further accelerate this trend.

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As sanctions are not global, Russia sought to shift its export flows to non-sanctioning markets, such as China, India, Turkey, and the United Arab Emirates (UAE), offering them substantial discounts (e.g., since April, Russia's Urals crude oil has been trading with a $23-$35 per barrel discount compared to the global benchmark Brent oil[26]). Consequently, imports (mostly oil and gas) from Russia to these countries significantly increased in Q2 2022; Turkey's imports surged by 120% y/y, China's by 37%, and India's by 364%. However, the capacity of such countries to further absorb Russian exports is rather limited. Such re-routing is costly due to logistical barriers, lacking infrastructure and entry costs, and it is time-consuming. Furthermore, while Moscow seeks to redirect import flows to non-sanctioning countries, the trade and transaction costs for Russian companies have risen significantly. Russia's economic dependence on China has increased substantially, often due to a lack of suitable alternatives for critical products from the coalition countries. At the same time, supplies from key non-sanctioning countries to Russia increased at a lower scale, amid concerns of secondary sanctions from the coalition allies. Exports from Turkey increased by 21% y/y in Q2, but only by 2.1% from China, according to official statistics.[27] However, during the last months their exports to Russia have accelerated.[28]

In the long term, EU and global supply chains are expected to permanently reconfigure towards reduced reliance on Russian products.[29] In addition, FDI withdrawal and trade reorientation will reduce the scope for technology transfer to Russia from advanced economies, which will widen the technological gap between them. Restricted access to advanced technologies will hamper the total factor productivity growth of the Russian economy (a measure of the efficiency of economic production), undermining Russia's economic growth prospects.[30]

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EU-Russia trade relations are also undergoing significant changes. While EU exports to Russia severely contracted due to export sanctions, Russia's imports to the EU surged in value terms. Based on UN Comtrade data, EU exports to Russia contracted sharply during Q2 2022 – by 54% y/y (-$14.5 billion), with the largest cuts of sanctioned goods being aircraft/spacecraft vehicles (-100%), motor vehicles (-92%), and electrical machinery and equipment (-78%). Yet, EU imports from Russia increased in value terms – up by 34% y/y (+$13.7 billion) in Q2 2022. This increase was primarily driven by expensive Russian energy supplies (+55% or +$15 billion), despite the EU significantly reducing its energy consumption in physical volumes. Energy earnings significantly surpassed drops of Russia's non-energy imports to the EU (-10.6% y/y, -$1.3 billion), including sanctioned imports. At the same time, some non-energy imports from Russia increased in Q2, e.g., diamonds (+31%), nickel (+33%), aluminium (+28%).

4. Factors limiting the immediate impact and effectiveness of sanctions

Several factors have postponed the immediate and tangible impact of the adopted sanctions on the Russian economy and have limited their effectiveness.

First, there are wind-down periods and exemptions. Generally, the EU's bans on supplies to and from Russia applied immediately to new contracts. However, supplies under existing contracts were not suspended during wind-down periods. For example, exports of equipment, technology and services for the Russian oil exploration industry under contracts concluded before 16 March 2022 could be executed until 17 September 2022 (subject to a notification requirement).[31] The EU coal and oil embargos on Russia were also adopted with the following wind-down periods in mind: coal until August 2022, crude oil until December 2022, and certain refined petroleum products until February 2023. The moment these wind-down periods and temporary exemptions end, the impact of sanctions will become more evident. Besides, EU bans also envisage a series of exemptions (allowing supplies for humanitarian or personal use, for example), creating loopholes in the sanctions regime that can be abused.

Second, there is the limited coverage of embargoes. While the EU banned imports of certain finished steel and iron products, such as rolled metal and pipes, restrictions were not applied to cast iron and semi-finished steel products. The import of cast iron and semi-finished steel products to the EU market even increased in physical terms after Russia's invasion when compared to 2021. Some semi-finished steel products were included in the EU's eighth package on 6 October. However, the ban still does not cover all iron and steel imports from Russia (e.g., cast iron, ferroalloys, direct reduced iron). Moreover, some new sanctions have been postponed to 2023-2024. For example, imports of slabs have been permitted up to a quota of more than 3.7 million tons per year until 2024.[32] The ban on steel products processed in third countries using steel originating from Russia will be in effect as of 30 September 2023.[33]

Third, there is the circumvention of EU bans on exporting to or importing from Russia to the EU. Almost all sanctions include a ban on circumvention, as it erodes their effectiveness. However, Russia actively looks for new routes to import and export to the EU and the West via friendly third countries, including Belarus, Armenia, Central Asian countries, among others.

Russian logistics companies,[34] circumvent bans on Russian imports using the following measures:

- **importing via a third country**: sanctioned goods are imported into a third country, cleared by customs and then resold to Russia.
- **direct re-export**: sanctioned goods are purchased by a third country, brought to its territory, to the customs warehouse, then resold to Russian companies.
- **indirect re-export or resale enroute**: sanctioned goods are purchased by a third country. They are resold to Russian companies during their transit in the territory of the EU, and then imported into Russia.
- **false transit**: sanctioned goods are brought into Russia with documents for further transit to a third country. Goods enter the customs warehouse in Russia and then are resold to Russian companies.

In addition, Russian military manufacturers use different schemes to evade sanctions for dual-use items (goods, software and technology that can be used for both civilian and military applications). They import indirectly by establishing intermediate companies in third countries, using a false description, or importing individual components.

To circumvent the EU bans on imports from Russia, sanctioned Russian products (such as iron, steel, crude oil and coal) are mixed, refined, or processed in third countries (e.g., Kazakhstan, UAE, Turkey) to conceal their country of origin before being exported to the EU or other coalition partners. For example, Russian crude oil can be mixed with crudes of other origins, like Kazakhstan, but as the Russian share is smaller, the blend is claimed to be Kazakh. In addition, crude cocktails are often mixed when transferring oil between ships at sea to hide its origin.[35]

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Fourth, there is insufficient coordination of export restrictions (export controls, export bans) among the coalition partners, which undermines their effectiveness. Recent studies on the effectiveness of restrictions on exports to Russia reveal that out of all the sanctioned product categories, only about 50% of products have been sanctioned by both the EU and the US (about 31% only by the EU, and some 19% just by the US).[36]

Fifth, Russia is attempting to reorient its trade and investment relations to countries outside the sanctions coalition to decrease the negative impact of sanctions. Third countries can also increase their imports of Russian products for domestic consumption while redirecting domestic products for export to EU member states and other coalition countries. In addition, record energy and commodity prices have so far negated much of the sanctions' effects on Russian revenues. As mentioned before, in 2022 Russian export revenues have been increasing even though physical volumes of major Russian exports contracted as compared to the previous year.[37]

5. Room for increasing the sanctions' impact

The EU and Western sanctions placed on Russia could and should be expanded further to increase their impact. This can be achieved through the following measures:

EXTENDING THE SCOPE OF SANCTIONS ON RUSSIAN EXPORT REVENUES

The impact of sanctions can be increased by further expanding their scope, as a large part of Russian trade flows remains unsanctioned. When all eight sanctions packages will be fully implemented, including the oil embargo, more than 60% of all imports from Russia to the EU in value terms of 2021 will be sanctioned (Russia's oil revenues reached $84 billion in 2021 or about 50% of total Russia's revenues from the EU in 2021). In addition, there is still the potential to increase the scope of sanctions on Russia's energy and non-energy exports to the EU, for example by extending them to natural gas (amounting to $22 billion in 2021), diamonds ($2.1 billion in 2021), cast iron, ferroalloys, direct reduced iron[38] ($1.3 billion in 2021).[39]

Russia is receiving record revenues from energy exports due to skyrocketing gas prices in Europe.[40] Russia started to significantly reduce its gas supplies to Europe in 2021,[41] months before its invasion of Ukraine, provoking energy price hikes. Because of the weaponisation of gas, the EU can no longer rely on any Russian supplies of critical imports. In response, the EU approved the REPowerEU Plan which aims to end the dependence on Russian fossil fuels before 2030.[42] However, taking into account Russia's escalation of hostile actions against Ukraine and the EU, this goal could and should potentially be achieved much sooner.[43] As a result, part of the gas exported to Europe is projected not to be redirected to new markets. It will instead stay in the ground, leading to a considerable reduction of Russian energy exports in terms of volume and revenue.[44]

Russia is no longer the major supplier of gas to Europe. In 2022, as some EU countries stopped buying Russian gas while Gazprom halted gas supplies, Russian gas flows to the EU decreased sharply. As of 5 October 2022, Russia supplied only 7.5% of the EU's gas imports, vs 40% in 2021.[45] In late August, it shut down Nord Stream 1 entirely.[46] The recent damage to the Nord Stream 1 and 2 gas pipelines in the Baltic Sea, suspected to be a deliberate act of sabotage,[47] will further accelerate the EU's diversion from Russian gas. To diversify its suppliers, the EU has increased gas imports, including Liquefied Natural Gas (LNG) and pipeline imports from other suppliers, including Norway, Algeria, Azerbaijan, and the US. The Greece-Bulgaria gas interconnector has also been launched. It aims to facilitate non-Russian gas flows and help reduce southeast Europe's dependence on Russian gas.[48]

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Furthermore, the import of Russian diamonds into the EU is still possible, as they were not included in the list of import bans on Russian products in the eighth sanctions package. Only Alrosa, Russia's largest diamond mining firm, was sanctioned. About 85% of all diamonds imported from Russia ($1.8 billion out of $2.1 billion in 2021) are destined for Belgium. EU purchases of Russian diamonds even increased in Q2 2022 by 31% y/y.[49] Yet, Belgium's dependence on Russian raw diamonds is not that critical, as Russian diamonds make up only 25% of Belgium's total diamond imports. They could be replaced by imports from other countries. The US and UK have already banned purchases of Russia's diamonds.

EXPANDING AND ALIGNING EXPORT RESTRICTIONS AMONG THE COALITION COUNTRIES

There is also potential to increase the impact of export restrictions by i) further expanding them, ii) better targeting products, and iii) achieving stronger coordination among a broad coalition of countries. A large part of Russian imports remains unsanctioned.[50] Sanctions could be extended further to ramp up the pressure on the aggressor. Better targeting means focusing on imports to Russia that are relatively difficult for Moscow to replace, such as products for which Russia has a low domestic production capacity, while the sanctioning countries have a dominant market position.[51] Products whose imports are relatively difficult for Russia to replace domestically include spare parts for vehicles, parts of motor vehicle bodies, taps, valves, appliances, automatic controlling equipment, and machinery for temperature change.[52] In this respect, coordinating and aligning sanctions regimes among the coalition partners (including vis-à-vis the application of secondary sanctions) makes it harder for Russia to redirect its trade to other markets and substitute such critical imports.

ENCOURAGING MORE COMPANY-LEVEL SELF-SANCTIONS

International companies from various sectors often go far beyond country-level sanctions, and voluntarily impose 'self-sanctions', even in unsanctioned sectors and product categories. These sanctions may have a much larger impact on Russian trade and investment flows than country-level sanctions. Self-sanctions of foreign companies operating in the Russian market usually include reducing or curtailing current operations in the country, holding off new investments or fully withdrawing companies' investments from Russia. According to the Kyiv School of Economics database on self-sanctions, as of 2 October 2022, 114 foreign companies had already completed their withdrawal from Russia; 1119 companies have curtailed Russian operations; 501 companies have reduced current operations and held off on new investments while 1,154 companies continue their operations in Russia.[53]

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Besides, European and international companies may choose to impose self-sanctions in the form of suspending Russian brands and refusing to enter into new supply deals with Russian entities, thus gradually cutting off Russian products from their supply chains. For example, several large aluminium users such as Novelis, a division of Hindalco Industries, and Norsk Hydro's extrusions unit have already said they will not purchase Russian material.[54] Russia's recent escalation of its aggression against Ukraine is set to amplify European and international condemnation and increase the political and public pressure on European companies to review their relations with Russia. Increasing the visibility of the responses of international companies related to their operations in or with Russia can intensify public pressure and serve as an effective catalyst for companies' trade and investment withdrawal from Russia. In this regard, it is getting increasingly important to collect and maintain public databases (such as Yale's database) of companies' self-sanctions, regularly monitoring and tracking companies' self-sanctions, listing and watchdogging companies being under enforcement action for their involvement in sanctions evasion, as well as widely reporting and circulating this information among media organisations and national governments. Following Russia's escalation, more public pressure is expected from EU and Ukrainian civil society organisations in the form of organising corporate and economic boycotts of international companies that continue their operations in Russia.

PREVENTING SANCTIONS CIRCUMVENTION

Preventing sanctions circumvention is essential for the effectiveness and credibility of the sanctions regime. The following steps are crucial in this respect: exclude loopholes by expanding the scope of sanctions, especially related to the Russian military sector; undertake strong enforcement actions against Russian-controlled companies evading sanctions, as well as countries and foreign companies that facilitate evasion (secondary sanctions); and more coordinated efforts by the EU and sanctions' coalition countries in monitoring and enforcing imposed sanctions. In addition, restricting imports of sanctioned Russian products that have been further processed in third countries can also be effective in some sectors. This measure was introduced in the EU's eighth sanctions package for Russian steel products for a one-year period.[55]

PROLONGING THE RENEWAL PERIODS FOR ECONOMIC SANCTIONS

The current EU six-month sanctions renewal system is rather unhelpful, as it may encourage some member states to call for sanctions to be lifted, thereby undermining EU unity. For example, Hungarian Prime Minister Victor Órban has expressed his intention to block the next six-month extension of the sanctions.[56] To secure EU unity and foreign policy credibility it may be worth considering prolonging the renewal periods for economic sanctions until Russian troops leave Ukraine. The EU has maintained sanctions regimes against other countries with longer renewal periods. For example, the sanctions imposed on Iran for human rights abuses are extended by the EU on an annual basis.[57] The framework for targeted sanctions to address the situation in Lebanon is also renewed by the Council on a yearly basis.[58]

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6. Facilitating Ukraine's integration into the EU supply chains and the internal market

Russia's economic and energy aggression against the EU is expected to have long-term implications for EU policies and EU companies' investment decisions. To prevent similar attacks and shocks in the future, EU leaders and businesses should prioritise strengthening supply chain resilience and further reduce the EU's dependency on aggressor countries for critical imports: energy, raw materials, and fertilisers. Amid the current sanctions regime and self-sanctions, EU-based companies are looking for alternative markets to substitute Russian products from their supply chains and diversify their suppliers.

As a result, sanctions can provide new opportunities for Ukrainian producers to replace Russian products (such as iron ore, iron and steel, agricultural and food products, electricity, plastics, chemicals, textiles and others) in the EU market and to become more integrated into EU supply chains. This will support the recovery of Ukraine's export sector and help sustain foreign currency revenues during the war and beyond. While Ukraine's export ability during the war is restricted and dependent on resolving security, logistic and power outage challenges, existing possibilities should be exploited.

What is more, replacing Russian products with Ukrainian ones and integrating Ukraine into EU supply chains will also contribute to advancing Ukraine's EU candidate status further. The functioning free trade agreement with the EU (DCFTA), the significant level of Ukraine's regulatory approximation with the EU under the EU-Ukraine Association Agreement, and geographical proximity to the EU allow for shorter and safer supply chains with the EU in the long-run.

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Prior to Russia's missile strike on Ukraine's heat generation and electrical substations on 10 October 2022,[59] Ukraine had signalled its willingness to help the EU overcome Europe's energy crisis by supplying nuclear energy. Electricity trading between Ukraine and the EU started on 30 June 2022, following the successful synchronisation of the Continental Europe power system and the Ukraine/Moldova power system on 16 March 2022. The trading capacity with Ukraine was increased to 300 MW during the day, keeping the trade capacity at 250 MW during the night as of 5 September 2022 (on the interconnections Ukraine-Romania and Ukraine-Slovakia),[60] and it is expected to be further increased. According to Ukrainian officials, the country's electricity exports to the EU could reach more than 1,500 MW of electricity (export capacity per day), thus replacing about five billion cubic meters (bcm) of natural gas.[61] However, Russia's attack on Ukraine's energy infrastructure forced Ukraine to stop exporting its electricity to the EU to stabilise its grid.[62]

Fig. 1

EU IMPORTS OF IRON AND STEEL PRODUCTS FROM RUSSIA AND UKRAINE IN 2021,(PER MILLION TONS)

Iron and steel products	EU imports from Russia	EU imports from Ukraine	Ukraine exports to world	EU imports from world
Iron ore **(HS2601)**	10.5	16.5	45.1	93.6
Cast iron **(HS7201)**	0.7	0.9	3.2	2.4
Semi-finished products of iron or non-alloy steel **(HS7207)**	4.2	2.8	6.8	8.3
Semi-finished products of iron or non-alloy steel w/o slabs **(HS7207 w/o 720712)**	0.5	0.7	3.8	1.9

Source: UN Comtrade

Extending the scope of the iron and steel embargo can provide new opportunities for Ukrainian producers. Until now, the EU was highly dependent on Russian cast iron, semi-finished iron, and steel products. Russia's share in EU imports of direct reduced iron (DRI) was 65%; semi-finished iron and steel products amounted to 51%, while cast iron was 29% in 2021. As the EU's iron and steel embargo was only partial, EU imports of unsanctioned steel and iron products from Russia continued and totalled $2.2 billion in Q2 2022. In particular, based on UN Comtrade data, EU imports of cast iron from Russia grew by 2.5 times y/y in physical terms in Q2 2022, with direct reduced iron by 17%. In this respect, extending the iron and steel embargo will further increase the scope of sanctioned Russian supplies to the EU (total EU imports of iron and steel from Russia reached $9.2 billion in 2021). It is also expected to help reduce EU reliance on one supplier.

At the same time, extending the scope of the iron and steel embargo can support the growth of relevant Ukrainian iron and steel supplies to the EU, as Ukrainian products can potentially help to fully or partially replace most Russian products in EU value chains. Among those Russian products that are not yet covered by the iron and steel embargo, Ukrainian metal producers have the necessary production capacity and resources to replace Russian supplies of iron ore, cast iron, semi-finished iron and steel products, excluding slabs– see Figure 1. Ukraine's total exports of these products well exceeded Russian supplies to the EU in 2021. Ukraine used to export a significant number of slabs before Russia's invasion (3 million tons in total). However, due to the war, the domestic production facilities of Ukraine's main slab producer Azovstal, which is based in Mariupol, have been destroyed. According to Ukrainian producers, about 30% of Ukraine's iron and steel production capacities have been lost.[63]

The Russian invasion has been particularly devastating for Ukraine's iron and steel industry due to Russia's blockade of Ukrainian seaports, and the destruction of the country's production capacity, which has led to drastic drops in iron and steel exports from Ukraine to the EU and global markets. Expanding the iron and steel embargo will prevent Russian steelmakers from taking advantage of this situation. To restore Ukraine's exports, it is essential to resolve the current security and logistical challenges for shipping abroad, as Ukrainian seaports were a major export route for iron and steel. This could be achieved by increasing the capacity for shipments by rail to ports in Poland and Romania or negotiating an agreement to allow vessels carrying non-agricultural goods to transit the Black Sea.[64] In addition, the termination or further suspension of all safeguards and antidumping measures on iron and steel products from Ukraine for more than one year will provide more certainty for Ukrainian producers in terms of market access to their major destination market.

Conclusion

While the sanctions have undoubtedly had an impact on the Russian economy – and will have a bigger impact in the medium term – the Kremlin is far from crumbling. To enhance the impact of sanctions, the EU and its allies must prioritise closing loopholes and reinforcing and expanding the current sanctions regime. Russia's violent actions against Ukraine have led to devastating economic and infrastructure damages in Ukraine and caused the tragic loss of thousands of lives. The scope of sanctions should reflect the extent and consequences of Russia's actions, as well as the EU's willingness to prepare for and defend itself against possible hostile actions or new economic attacks from Russia. As the war escalates, new and more severe sanctions should be imposed by the EU and Western governments.

To enhance the impact of sanctions, the EU and its allies must prioritise closing loopholes and reinforcing and expanding the current sanctions regime.

In addition, sanctions' effectiveness in limiting the aggressor's capacity to continue the war should be constantly monitored and analysed. The strong enforcement of sanctions and closing loopholes should be the absolute priority. As sanctions entail costs to both sides, maintaining EU unity and commitments may become a great challenge, especially considering the growing disinformation pressure from Russia. Yet, staying united on sanctions and providing support to Ukraine is of crucial importance for sustaining the credibility of EU policies, creating the right conditions for a quicker end to the war and securing long-term peace in Europe. The responsibility for maintaining EU unity will lie with European national governments, which should clearly explain and communicate the goals and results of the sanctions policy to their citizens. Moreover, EU unity should not come at the expense of reducing the ambitions of the sanctions policy, as any concessions will only lead to a prolongation of the war.

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