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Ukraine, Russia and the European Union: Economic Consequences of the Conflict

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Ukraine

- external vulnerability
- budget austerity on the agenda
- Western financial package and EU integration steps
- economic impact of secession of Crimea and potentially other Russian-speaking provinces

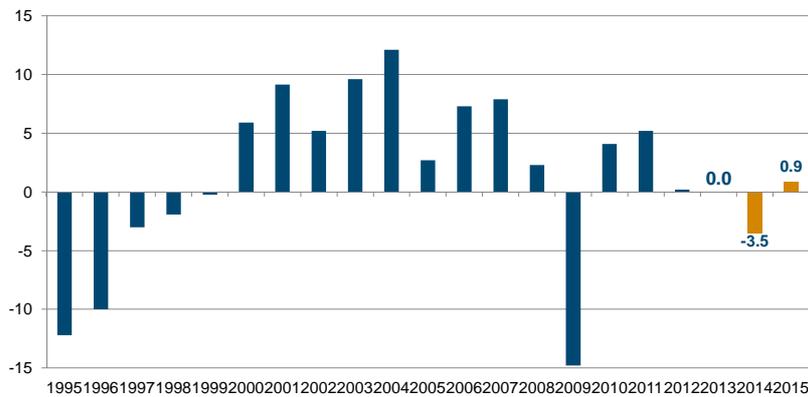
Ukraine: Key indicators (2013)

Population (million)	45
GDP (EUR billion)	136
GDP growth (%)	0.0
GDP at constant prices, 1990=100	69.3
GDP per capita (EUR, PPP)	6700
Unemployment rate (%)	7.5
Budget deficit (% GDP)	-4.4
Public debt (% GDP)	40.5
Exports (EUR billion)	48.9
Imports (EUR billion)	63.6
Current account (% GDP)	-8.9
Gross external debt (% GDP)	75.7
FDI stock per capita (EUR)	1200
Doing Business ranking	112 (out of 189)

Source: wiiw Database, The World Bank, national statistics.

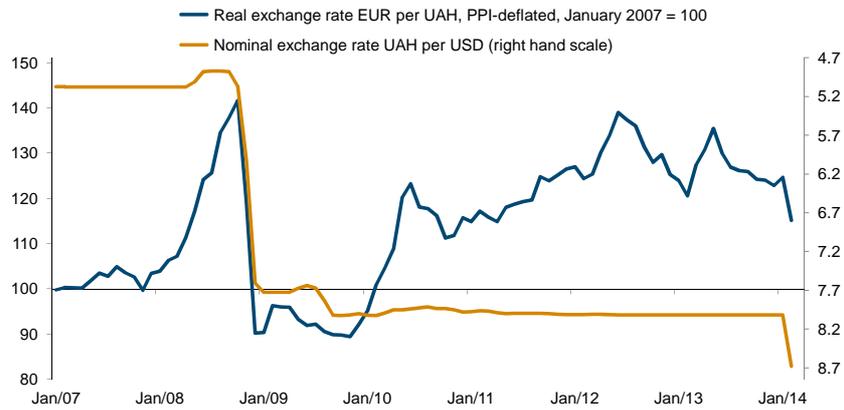
Volatile economic performance

real GDP growth in %



Source: wiiw Annual Database incorporating national statistics.

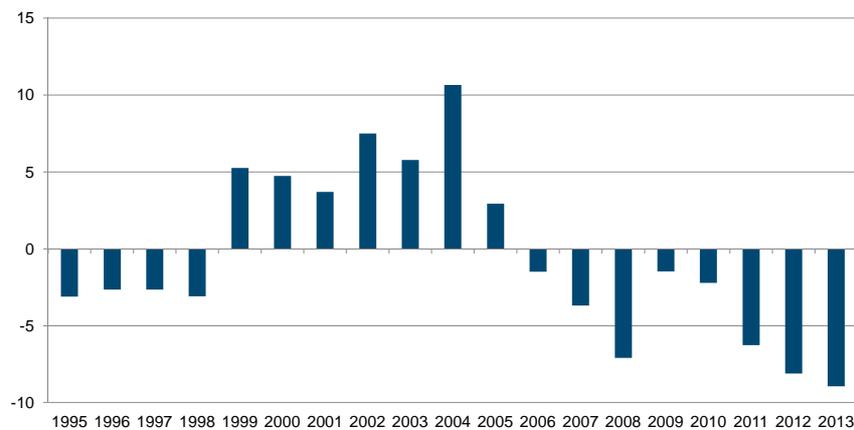
Exchange rate over-valuation ...



*Values more than 100 indicate real appreciation against January 2007.
Source: wiiw Monthly Database incorporating national statistics.

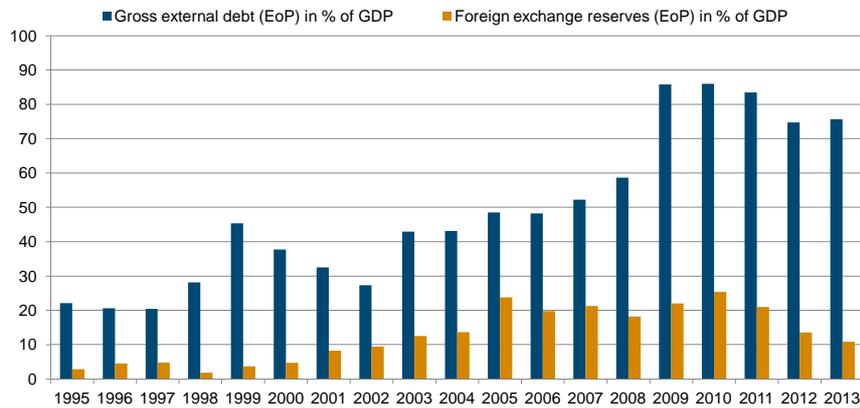
... results in mounting external deficits

current account balance in % of GDP



Source: wiiw Annual Database incorporating national statistics.

Continued external fragility ...



Source: wiiw Annual Database incorporating national statistics.

... prompts budget austerity

- Large external financing needs: USD 35 billion in 2014-2015
- Russian credits agreed in December 2013 have stalled (only USD 3 billion disbursed)
- Ongoing negotiations over an IMF 'rescue package'
- But: IMF requires budget consolidation
- Public expenditures to be cut by up to 17% (6 p.p. of GDP)
- Energy tariff hikes for households
- Pensions of working pensioners to be cut by 50%, etc.
- Likely consequences: deeper recession and rising social tensions

Western financial package for Ukraine

- IMF loan (**USD 15 billion?**)
 - Balance-of-payments support
- European Union: **EUR 3.2 billion** over 2014-2020
 - EUR 1.6 billion loans (MFA, i.e. also BoP support)
 - EUR 1.6 billion grants for institutional reforms (democracy, human rights, justice, public finances, ...)
- EBRD and EIB: up to **EUR 8 billion** in loans
 - specific projects (e.g. pipelines, ...)
- World Bank: **USD 3 billion**
- US government: **USD 1 billion** in 'loan guarantees'

Source: European Commission, Memo, Brussels 5th March 2014.

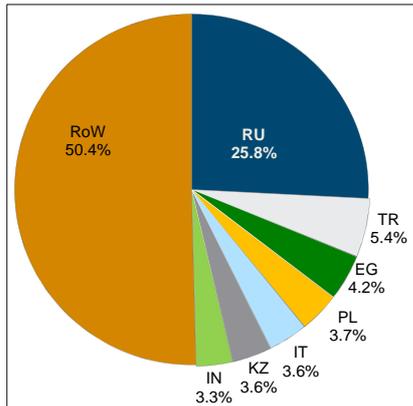
EU integration steps

- Offering EU membership perspective? (S. Füle)
- Political part of EU-Ukraine Association Agreement signed on 21 March 2014
- Deep and Comprehensive Free Trade Agreement (DCFTA) to be re-negotiated
 - May harm in particular Eastern Ukraine (also because of Russia's counter-measures)
 - High costs of 'acquis' adoption: probably unrealistic
- But: EU has unilaterally opened its market for Ukrainian exporters

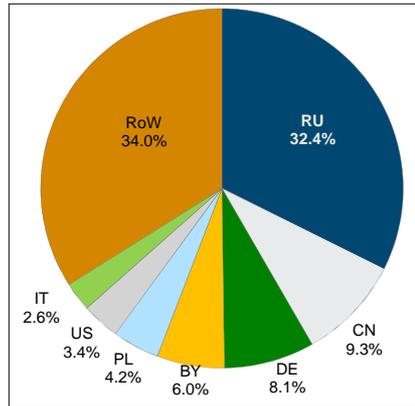
Ukraine's main trading partners

2012, in % of total

UA exports (EUR 53.5 billion)



UA imports (EUR 65.9 billion)

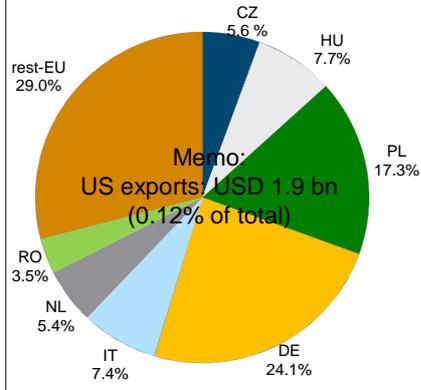


Source: wiiw Annual Database, national statistics.

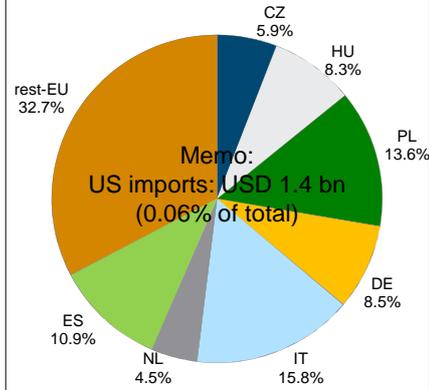
Ukraine's main trading partners in the EU, 2012

in % of total EU trade with Ukraine

EU exports: EUR 23.8 billion
(0.5% of total EU exports)

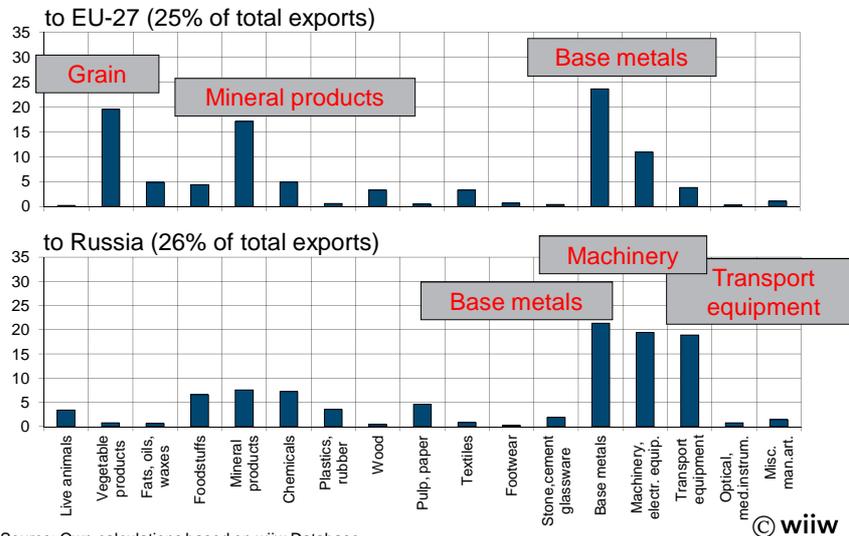


EU imports: EUR 14.6 billion
(0.3% of total EU imports)



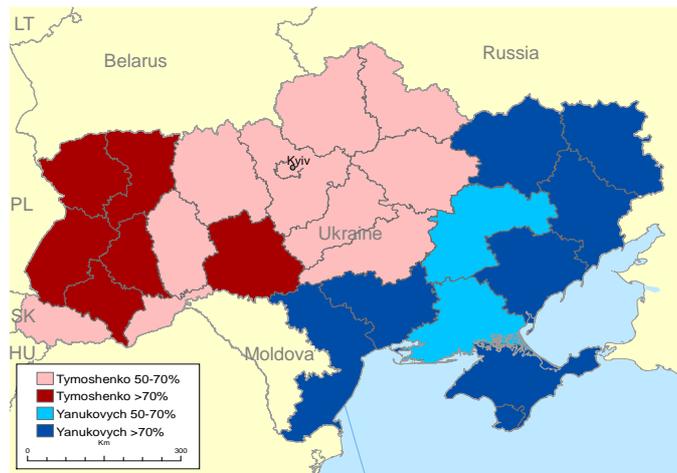
Source: wiiw, Eurostat Comext.

Structure of Ukraine's exports, 2012, in %

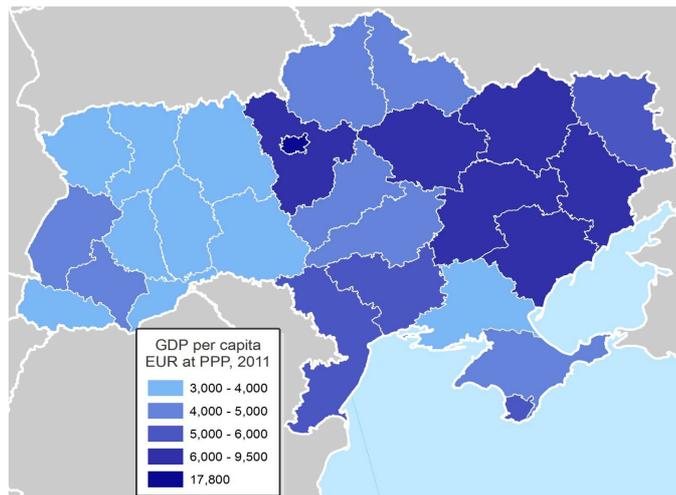


Eastern Ukraine voted for Yanukovich in 2010

Overall results: Viktor Yanukovich **49.0%**; Yulia Tymoshenko **45.5%**



And the East is generally wealthier



Economic consequences of Crimea joining Russia

- Substantial gains for Crimea (2.4 million people)
 - Crimea under-performing even by Ukrainian standards
 - Russia 3 times richer than Ukraine » big economic attraction
 - transfers of a much larger magnitude
 - investments will accelerate (tourism, infrastructure, ...)
- Ukraine's losses relatively modest
 - Crimea accounts for only 4% of Ukraine's GDP and 2% of exports (goods & services)
 - but for 6% of gas and 16% of oil deposits, though production is expensive

Impact of a potential secession of **all** Russian-speaking provinces would be much bigger

- Home to much of the country's industry and main export earners: metals, chemicals, machinery
- Break-up would result in a direct loss of 50% of GDP and exports for rest-Ukraine
- Economic role of Kyiv (17% of GDP) would be greatly reduced
- Still, break-up not the most likely scenario at the moment (despite unrest)
 - Crimea is the only region where ethnic Russians are the majority
 - Would require strong Russian (including military) involvement
- More likely: federalisation/de-centralisation of Ukraine

Russia

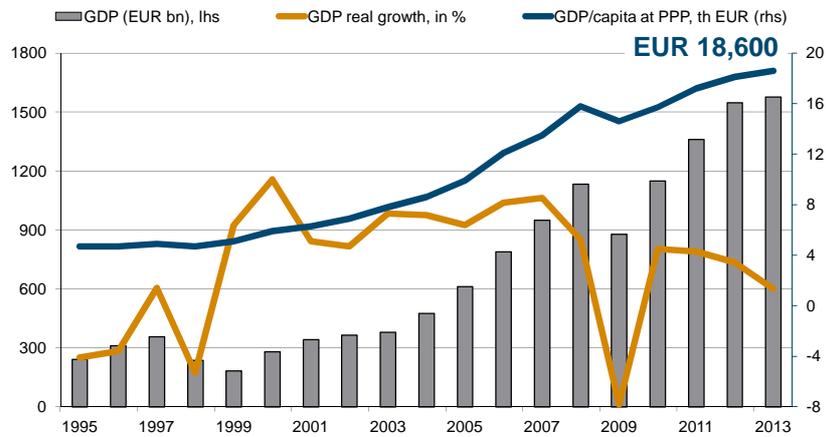
- Western sanctions unlikely to hurt directly
- Russia will retaliate
- investment and GDP growth will still suffer
- greater medium-term reform pressures?
- Eurasian integration derailed?
- Serious medium- and long-term repercussions

Russia: Key indicators (2013)

Population (million)	143
GDP (EUR billion)	1578
GDP growth (%)	1.3
GDP at constant prices, 1990=100	117.7
GDP per capita (EUR, PPP)	18600
Unemployment rate (%)	5.5
Budget deficit (% GDP)	-1.3
Public debt (% GDP)	10.5
Exports (EUR billion)	392.6
Imports (EUR billion)	259.2
Current account (% GDP)	1.6
Gross external debt (% GDP)	33.8
FDI stock per capita (EUR)	2600
Doing Business ranking	92 (out of 189)

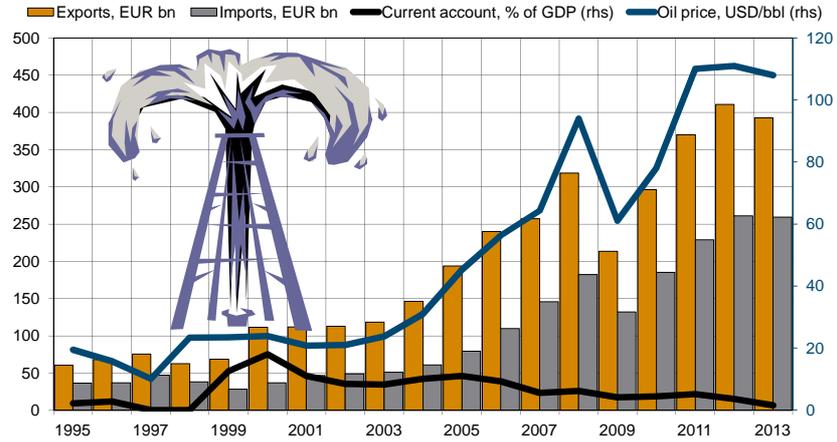
Source: wiiw Database, The World Bank, national statistics.

Russian GDP growth 1995-2013



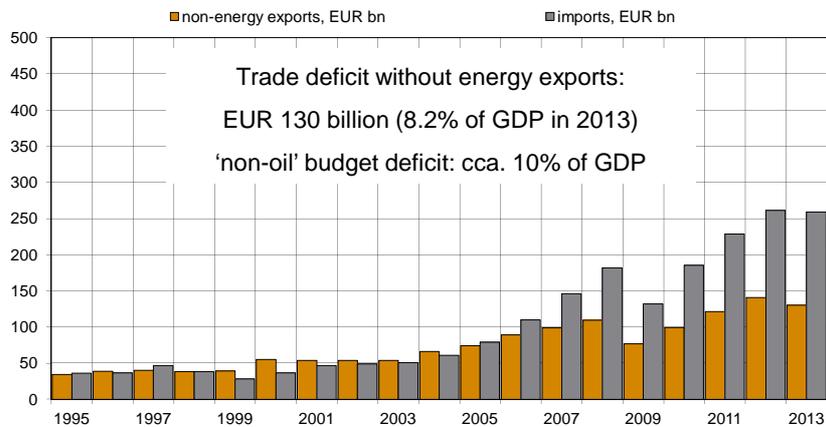
Source: wiiw Annual Database, national statistics, own estimates.

External sector: surplus thanks to energy



Source: wiiw Annual Database, national statistics, own estimates.

External sector: deficit without energy

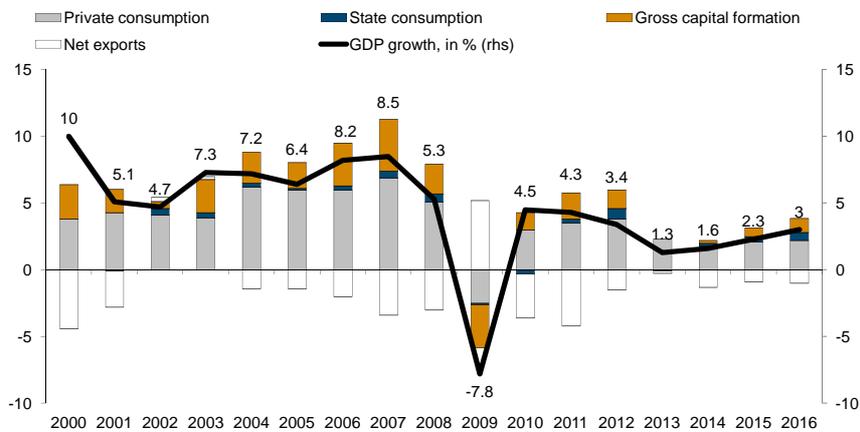


Source: wiiw Annual Database, national statistics, own estimates.

New (and old) challenges: GDP growth stutters – Russia is stuck in transition !

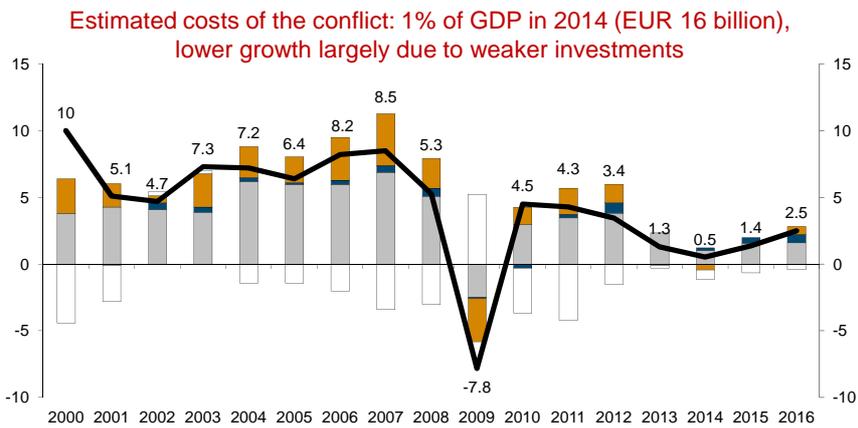
- Energy exports and growth sustainability
 - Increased pressures on energy supply diversification in the EU
 - Impact of current sanctions just indirect
 - But investment (climate) already suffers, mostly FDI
- Diversification and modernisation of the economy
 - Growing reform pressures?
 - Yet modernisation difficult without more FDI!
- Stability of the ruling elite
 - Putin's ratings grow, Russia's ratings fall
 - Yet this may rapidly change ...
- Integration on the post-Soviet space derailed/fails?
 - Crimea's example not helpful for the Eurasia project
 - New design/reset of neighbourhood policies?

Drivers of GDP growth: original (optimistic) scenario: contributions of main components to GDP growth, in pp



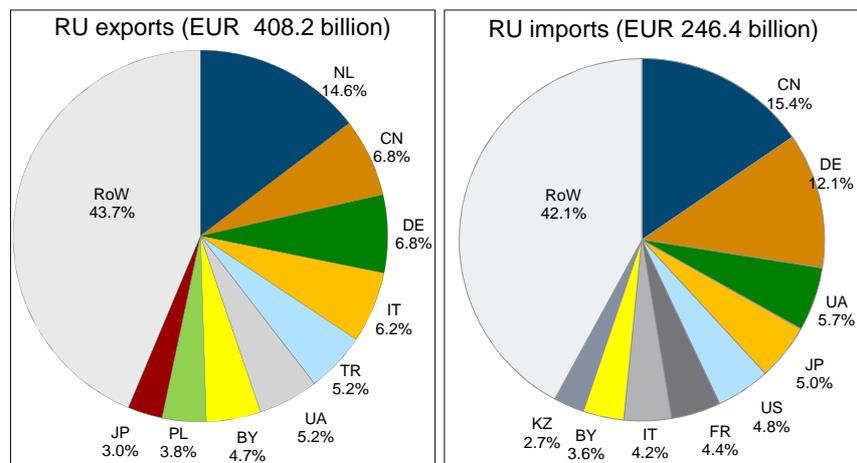
Source: wiiw Annual Database, national statistics, own estimates.

Drivers of GDP growth: current (realistic) scenario, contributions of main components to GDP growth, in pp



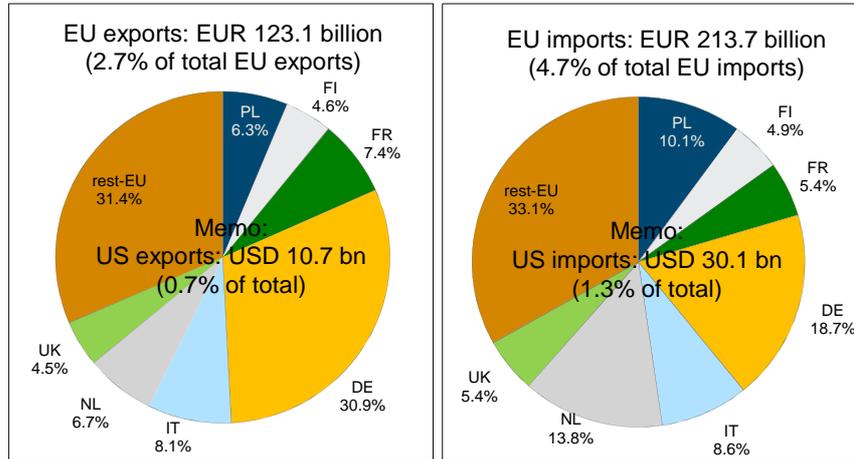
Source: wiiw Annual Database, national statistics, own estimates.

Russia's main trading partners, 2012, in % of total



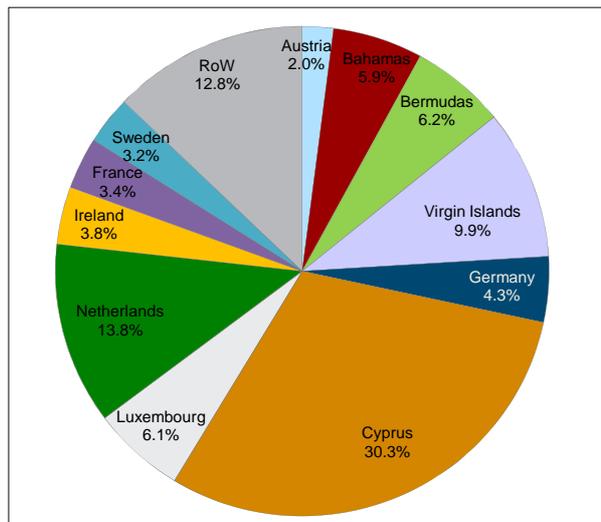
Source: wiiw Annual Database, national statistics.

Russia's main trading partners in the EU, 2012
in % of total EU trade with Russia



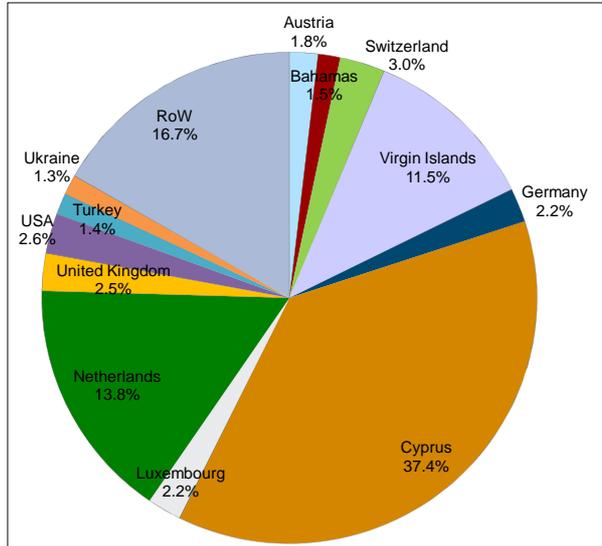
Source: wiiw Annual Database, EU Comext.

Russian inward FDI stocks: USD 496.4 billion, end-2012



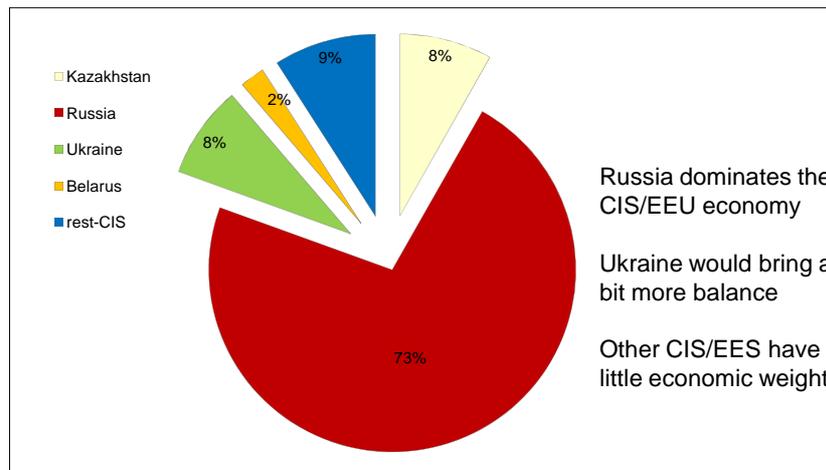
Sources: wiiw FDI Database incorporating national statistics (CBR); own estimates.

Russian outward FDI stocks: USD 406.3 billion, end-2012



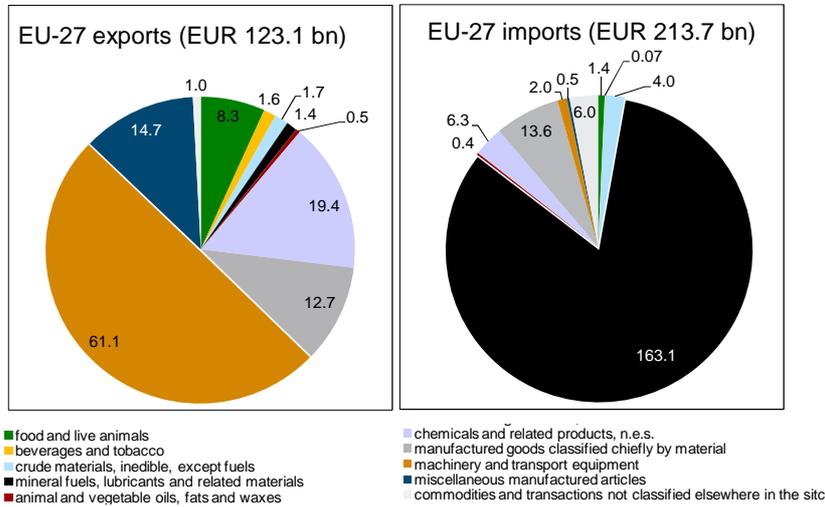
Sources: wiiw Database incorporating national statistics (CBR); own estimates.

GDP in the CIS/EEU, year 2012, in % of total



Sources: wiiw Database incorporating national and CISSTAT statistics; own estimates.

EU trade with Russia by SITC commodities, EUR billion



What is the real content of the EU-UA AA/DCFTA?

- Political part of AA signed on 21 March 2014 in Brussels
- Original DCFTA contains 15 Chapters, 14 annexes and 3 protocols (altogether 906 pages text, English version published in November 2012)
- Majority of customs duties (99.1% by Ukraine and 98.1% by the EU) will be removed as soon the Agreement enters into force
- Transition periods for automotive sector in Ukraine for 15 years and for some agriculture products in the EU for up to 10 years
- WTO rules will be generally applied to non-tariff barriers
- Ukraine will progressively adapt its technical regulations and standards to those of the EU (takeover of the EU acquis is costly)
- Public procurement exceptions provided for the defence sectors

What is the real content of the EU-UA AA/DCFTA?

- Specific provisions on trade-related energy issues such as
 - rules on pricing,
 - prohibition of dual pricing and transport interruption to third countries,
 - rules on non-discriminatory access to the exploration and production of hydrocarbons
- DCFTA deals also with rules of origin and defines the 'economic nationality' of products needed to determine the duties applicable to traded goods
- DCFTA 'shall not preclude the maintenance or establishment of customs unions, free trade areas or arrangements for frontier traffic except insofar as they conflict trade arrangements provided for in this agreement (Article 39)

Ukraine, Russia and the European Union

- Thorny way out of the crisis
- Sanctions and/or negotiations
- Re-design of neighbourhood policies
- Medium- and long-term effects likely substantial!
- New Iron Curtain?
- Do not forget Ukraine!

Conclusions and policy implications (I)

- EU accession perspective is crucial as a reform anchor
- Money is useful, but no panacea !
- DCFTA negotiations should focus only selectively on costly harmonisations (not full 'acquis takeover' without accession prospects)
- DCFTA is currently incompatible with Eurasian Customs Union
- Yet there is no "either – or" choice for Ukraine: both EU and CU integrations needed
- Hence: unilateral steps without Russia's inclusion/cooperation too risky and prone to conflicts
- Russia is expected to retaliate; the spiral of sanctions may endanger Ukraine's territorial integrity beyond Crimea
- Still, the violation of territorial integrity cannot be accepted

Conclusions and policy implications (II)

- Stability of entire Eastern Neighbourhood may be adversely affected as well (Moldova, Georgia, Armenia, etc)
- EU-Russia negotiations should not be about Ukraine or other EaP countries but must involve these countries in the process
- Instead of sanctions, the EU should foster visa liberalisation procedures and other confidence-building measures with the whole Eastern Neighbourhood
- Instead of erecting new walls and barriers: a closer integration of the enlarged EU, Russia and the EaP countries – from 'Lisbon to Vladivostok' – would boost badly needed stability, trade, investments and growth in Europe;
- Do not forget medium and long-term effects !
- Do not forget Ukraine which stays in-between !

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Thanks for your attention !!!