Economic repercussions of Russia’s war on Ukraine – Weekly Digest

This paper provides a summary of recent economic, financial and budgetary decisions and developments following President Vladimir Putin’s decision of 24 February to start a military attack against Ukraine. It includes recent information relating to the EU sanctions regime, recent economic estimates, and policies supporting economic and financial resilience, including the coordination of national economic and fiscal measures. It also highlights policy recommendations made in the public domain to mitigate any adverse economic, financial and social effects and to support economic recovery in the EU and the Euro Area.

For a list of previous Weekly Digest on the economic repercussions of Russia’s war on Ukraine see here.

1) EU energy responses - latest developments

Commission proposals for emergency intervention measures

The European Commission unveiled on 14 September a proposal for an EU Council Regulation, based on article 122 of the Treaty, providing for three main solidarity emergency measures to mitigate the impact of high electricity prices on households and businesses, while preserving the benefits of the internal market and the level playing field.

In detail, the Commission’s Regulation contains the following proposals:

1/ A cap for all Member States on the revenues of electricity generators with a cost below the wholesale market price (‘sub-marginal generators’) at 180 euros/MWh.

According to the Commission’s estimates, such a cap would allow Member States to collect up to EUR 117 billion on an annual basis. The exact amount of revenues per Member State will depend on several factors such as the energy mix, the national design of support schemes for renewable energy, the level of electricity prices, etc.

The sources of electricity concerned would include wind energy, solar energy (solar thermal and solar photovoltaic), geothermal energy, hydroelectricity without water retention, solid or gaseous biomass fuels (excluding biomethane), waste, nuclear energy. However, this instrument would not concern technologies with a break-even point above the level of the cap, such as gas and coal power plants.

According to the factsheet published alongside the Commission’s proposals, revenues above the cap will be collected by the Member States and channelled back to all who are exposed to high electricity prices, households, businesses and the industry at large. Moreover, the proposed Regulation also foresees the possibility to share surplus revenues between Member States trading electricity, whereby the producing state can share part of the collected revenues for the benefit of end-consumers in the importing state.
2/ Introduction of a "temporary solidarity contribution" to redistribute part of the windfall profits of certain fossil fuel companies

This contribution would apply to excess profits generated by oil, gas, coal and refining companies.

It would be levied by Member States on 2022 profits exceeding the average profits of the previous three years by more than 20%, at a rate of at least 33%, and would allow Member States to raise around EUR 25 billion in additional public revenue, the Commission estimates.

Member States would be responsible not only for collecting the solidarity contribution, but also for redistributing the revenue collected to households and businesses and for investment in renewable energy, energy efficiency and other decarbonisation technologies.

3/ Setting electricity demand reduction targets

The Commission also proposes to set two electricity demand reduction targets:

- The first, binding, would require Member States to reduce their gross electricity consumption by at least 5% during certain peak hours, covering at least 10% of the hours in each month when prices are expected to be highest.

  The Commission estimates that this obligation would result in the selection of an average of 3 to 4 hours per day, normally corresponding to peak loads. However, it would be up to Member States to identify the peak demand hours in their own markets.

  The Commission estimates that this measure could reduce gas consumption by around 1.2 billion cubic metres over 4 months, representing an EU-wide reduction of around 4% in the amount of gas used to generate electricity over the winter period.

- The second, indicative, target would require Member States to put in place measures (information and communication campaigns, tenders, financial incentives, etc.) to reduce their overall electricity consumption by at least 10% by 31 March 2023.

Other initiatives proposed by the Commission

In addition to these emergency measures, the President of the European Commission announced in her 2022 State of the Union Address that the Commission wants to set up a European Hydrogen Bank to bridge the investment gap and connect future supply and demand. Planned for 2023, this bank will help build the future hydrogen market by guaranteeing the purchase of hydrogen through an investment budget of EUR 3 billion from the 'Innovation Fund'.

Finally, the President of the European Commission also announced to continue working on the revision of the EU's internal electricity market rules, with a view to presenting a legislative proposal in early 2023, with a view to decoupling electricity prices from "the dominant influence of gas", adding further that "The current electricity market design - based on merit order - is not doing justice to consumers anymore."

In the context of the energy crisis, the Commission has also set up several work streams on measures related to the financial system, in particular measures that address liquidity stress caused by margin calls (e.g. by broadening the list of eligible collateral), that improve the level of information on prices and volumes of gas imports into the EU (e.g. by introducing a complementary transactions-based price benchmark for gas imports), and that allow energy exchanges to interrupt trading in case of significant

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1 As regards liquidity stress caused by margin calls, also see the previous briefing.
price movements (e.g. by investigating the effectiveness of the current safeguard mechanisms – so-called circuit breakers – on trading venues).

The Commission established a task force with Norway to discuss a gas price reduction.

The Commission has also indicated in the hearing of Commissioner Vestager on 8 September its intention to further adapt the EU State aid Temporary Crisis Framework (the first amendment was made on 21 July 2022).

On 30 September, EU energy ministers will aim to reach a political agreement on a proposal for a Council regulation on an emergency intervention to address high energy prices. In advance of this meeting, the Commission may still provide further elements in a form of a Communication. An informal meeting of heads of state or government in, Prague on 7 October 2022 will also discuss the EU energy responses.

Some related charts and figures

In an effort to increase EU security of energy supply, Member States agreed on 26 July to voluntarily reduce their gas demand by at least 15% (compared to their average consumption in the past five years, between 1 August 2022 and 31 March 2023), with measures of their own choice. One may note that (see Figure 1) many Member States, but not all, managed to reduce their consumption of gas already during spring 2022; in parallel, Member States managed to build up reserves: In September 2022, the average gas storage filling level among Member States exceeded 80%; the agreed minimum EU target for the end of 2022 is 85% (gas quantities that are stored were deducted from the calculated consumption in Figure 1).

**Figure 1:** Natural gas consumption, excluding storage, across EU in the first half of 2022 compared to the first half of 2021

As part of the latest temporary emergency measures (see above), the Commission has proposed to Member States to put in place measures (information and communication campaigns, tenders, financial incentives, etc.) to reduce their overall electricity consumption by at least 10% by 31 March 2023. During spring 2022, the electricity consumption in the Member States remained close to the same level as in 2021 (see Figure 2 below).
Supportive measures to deal with the high energy crisis are, nevertheless, framed by calls for sustainable public finances and the need to coordinate fiscal support measures to households and companies.

The ECOFIN latest fiscal guidance (as part of the 2022 Country Specific Recommendations), recommends an overall neutral policy stance, taking into account continued temporary and targeted support to most vulnerable households and firms. The Eurogroup made a similar plea in July, calling for nationally financed measures to be temporary and increasingly adjusted towards targeting the most vulnerable, preserve incentives for the energy transition and include income, rather than price, measures.

However, a Bruegel database shows (see Figure 3) that the amounts spent nationally to mitigate the impacts of the energy crisis vary considerably, not only in absolute terms, but also relative to the Member States’ GDP. The collected information covers funding allocated by selected EU countries to shield households and firms from the rising energy prices and their consequences on the cost of living in the period September 2021 to September 2022. One may note that the highest support as a percentage of GDP was in Croatia, Greece and Italy.
Single Market Emergency Instrument (SMEI)

Following up on its Updated Industrial Strategy Communication of May 2021, on 19 September the Commission put forward a proposal setting up the Single Market Emergency Instrument (SMEI). The new crisis management tool aims at protecting the freedom of movement of goods, services and persons in the Single Market, reinforcing transparency and information sharing, and facilitating coordination in times of crisis. The Commission further adds that the SMEI will allow to “equip the EU with the resilience tools needed to sustain the competitiveness of the EU industry” and allow “for a structured monitoring of supply chain disruptions and for the adoption of possible response measures such as strategic reserves”. The legislative package is composed of three texts:

- a Proposal for a Regulation establishing the SMEI (the proposal establishes a governance structure centered around Council decisions, and defines a set of tools that can be used to tackle crisis, notably, joint procurement procedures or, in very extreme cases, the power to order companies to prioritise orders or supplies);
- a Proposal for a Regulation addressing measures to facilitate the supply and availability of crisis-relevant goods in the context of a Single Market emergency; and

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2 The new framework applies horizontally to all potential threats to the Single Market but leaves out financial services, medicinal products, medical devices or other medical counter-measures and food safety products due to the existence of a dedicated crisis-relevant framework in these areas. Existing crisis management instruments are, for instance, the integrated political crisis response mechanism, the Union Civil Protection Mechanism and its Emergency Response Coordination Centre, the Single Market Enforcement Task-Force, or the Health Emergency Preparedness and Response Authority. Additional pending Commission proposals (notably the European Chips Act, the Directive on the resilience of critical entities, or the Data Act) are not covered by this mechanism, as they also foresee specific crisis management frameworks.
- a Proposal for a Directive introducing emergency procedures for the conformity assessment, adoption of common specifications and market surveillance in the context of SMEI. The proposals will be discussed by the Council and the Parliament.

**Box: Latest policy responses in Germany**

In a national move to safeguard energy supplies, Germany’s government has appointed the country’s federal energy regulator, the Bundesnetzagentur (BNA), as fiduciary of Rosneft Deutschland. That intervention, which in particular brings three oil refineries under the BNA’s control, became necessary as – due to the sanctions – Rosneft was no longer considered a reliable business partner by other contract partners. Fiduciary management means that the original owner no longer has authority to issue instructions, and that the fiduciary is tasked to ensure that business continues in an orderly manner. Rosneft accounts for about 12 per cent of Germany’s oil refining capacity, making it one of the largest oil processing companies in the country, according to the related press statement of the Federal Ministry for Economic Affairs and Climate Action.

In the same context, the German government announced on 21 September their decision to nationalise Uniper, taking 99% of the shares of a company that once was Europe’s biggest importer of Russian gas. The shares are bought from the current majority owner, the Finnish Fortum Oyj group, for EUR 480 million (at a 65% discount to their nominal value); the government intends to recapitalise Uniper with a EUR 8 billion capital injection, and it will also provide a EUR 7.5 billion credit line that replaces the one previously granted by the Finnish mother company.

After Russia cut its gas supplies, Uniper was forced to buy more expensive gas on the spot market in order to meet its supply contracts, but the fact that it could not pass on the price increases to its clients brought the company close to insolvency. That situation already required a government intervention in July (see previous briefing), which initially aimed to acquire only a 30% stake.
2) Ukraine’s reconstruction and financing needs

Ukraine’s external financing needs have grown rapidly since the Russian invasion; besides the tremendous damage to roads, bridges, factories, houses, hospitals and other physical infrastructure, the country has also lost its access to the international financial markets. Furthermore, the day-to-day management of a country in a war situation requires very significant budgetary resources.

On 18 May, the European Commission set out plans for the EU’s immediate response to address Ukraine’s financing gap (see below), as well as the longer-term reconstruction framework. The reconstruction effort should be led by the Ukrainian authorities in close partnership with the European Union and other key partners, such as G7 and G20 partners, and other third countries, as well as international financial institutions and international organisations.

The Ukrainian government estimated its overall - including long-term - financing needs (in the National Recovery Plan presented on 4-5 July 2022) at USD 750 billion in total. This plan sets out a medium-term framework comprising three stages of recovery. The first stage would be an immediate implementation plan starting with emergency humanitarian help, such as restoration of water supplies and bridges; the second a medium-term framework from 2023 to 2025 to bring back life to destroyed communities through reconstruction of schools, hospitals and housing, and finally a long-term modernisation vision from 2026 to 2032 for a Ukrainian green digital economy.

In a joint Rapid Damage and Needs Assessment (RDNA)3 released on 9 September 2022, the Government of Ukraine, the European Commission, and the World Bank, in cooperation with other partners, estimate that the current cost (as of 1 June 2022) of reconstruction and recovery in Ukraine amounts to USD 349 billion. This figure is expected to grow in the coming months as the war continues. RDNA results are preliminary, and damage and needs should be considered as minima.

The RDNA covers the impacts of the war sustained between 24 February and 1 June, 2022, and found that physical damage from the war reached over USD97 billion. It was particularly high in the housing, transport, commerce and industry sectors. The report found that recovery and reconstruction needs across social, productive, and infrastructure sectors total USD349 billion, which is more than 1.6 times the 2021 GDP of Ukraine. Over the next 36 months the RDNA assesses that USD105 billion is needed to address urgent needs such as restoring education and health systems and infrastructure, preparing for the upcoming winter through restoration of heating and energy to homes, support to agriculture, and repair of vital transport routes. The safe management of debris and explosives, including landmines, also pose a substantial cost.

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3 The RDNA is a standard instrument the World Bank uses in a war situation to present a first comprehensive evaluation of war impacts across twenty different sectors. It also lays out the financing needs for a resilient, inclusive, and sustainable recovery and reconstruction and provides a roadmap for planning.
The German Marshall Fund also published on 7 September a comprehensive document, which aimed at designing the recovery of Ukraine in the spirit of the 1947 Marshall Plan. The German Marshall Fund refers to preliminary estimates about the cost of rebuilding the damaged Ukrainian infrastructure, pricing that at more than USD 100 billion. It makes a plea for a sequenced approach, with a gradual ramping up of activity to be adopted during the recovery process, and includes four stages: relief, reconstruction, modernisation, and accession to the EU. Besides setting out a roadmap for Ukraine’s financing and investment needs some proposals are made on how to effectively steer and manage operations, as laid out in the below chart.
**EU macro-financial assistance**

The EU, alongside the international community, is making its best efforts to help Ukraine to address its most acute and soaring financial needs, including for meeting its short-term Balance-of-Payments and budgetary needs. Budgetary needs alone amount to EUR 5bn every month. Ukraine seeks to finance this through resources obtained from the IMF and bilateral donors, and primarily the EU and the US.

Until May 2022, the EU mobilised around €4.1 billion to support Ukraine’s overall economic, social and financial resilience in the form of macro-financial assistance, budget support, emergency assistance, crisis response and humanitarian aid.

The European Council endorsed on 23-24 June 2022 an exceptional Macro Financial Assistance (MFA) package of up to €9 billion to Ukraine as proposed by the Commission on 18 May. The exceptional MFA aims to provide immediate financial support in a situation of acute funding needs and to ensure the continued functioning of the most critical functions of the Ukrainian state. The Commission is extending the loan to the government in Kyiv on highly favorable terms.

The Commission disbursed the first €1 billion of this MFA package in early August. On 15 September 2022, MEPs gave the green light to a €5 billion macro-financial loan; the Council formally adopted the act on 20 September. This is the second and largest tranche of a €9 billion EU support package, of which €1 billion has already been disbursed. The remaining up to €3 billion will be provided as soon as possible.

This new package complements the support already provided by the EU, including a €1.2 billion emergency MFA loan paid out in the first half of the year (see below).

As for all previous MFA loans, the Commission will borrow the funds on international capital markets and transfer the proceeds on the same terms to Ukraine. The exceptional MFA loans agreed in June will be backed by guarantees provided by Member States which will complement the provisioning available from the EU budget. Between the EU budgetary provisions and the Member State guarantees, the loans will be fully secured for 70% of their value.

**Table 1: EU Macro Financial Assistance to Ukraine**

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>EU legal act</th>
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<tbody>
<tr>
<td>April 2014 (MFA II)</td>
<td>EUR 1 billion (loan facility; 15 years)</td>
<td>COUNCIL DECISION of 14 April 2014</td>
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<tr>
<td>April 2015 (MFA III)</td>
<td>EUR 1.8 billion (loan facility; 15 years)</td>
<td>EP/Council Decision (EU) 2015/601</td>
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<tr>
<td>May 2020 (COVID-related MFA)</td>
<td>EUR 1.2 billion (loan facility; 15 years)</td>
<td>EP/Council DECISION (EU) 2020/701</td>
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<td>February 2022 (emergency MFA)</td>
<td>EUR 1.2 billion (loan facility; 15 years)</td>
<td>EP/Council DECISION (EU) 2022/313</td>
</tr>
<tr>
<td>July 2022 (new exceptional MFA)</td>
<td>EUR 1 billion (loan facility; 25 years)</td>
<td>EP/Council Decision (EU) 2022/1201</td>
</tr>
<tr>
<td>September 2022 (additional exceptional MFA)</td>
<td>EUR 5 billion (loan facility; 25 years)</td>
<td>EP/Council Decision (EU) 2022/1628</td>
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ANNEX: Public monitors on the economic and other effects of the war in Ukraine

Centre for Research on Energy and Clean Air (CREA):
CREA has compiled a detailed dataset of pipeline and seaborne trade in Russian fossil fuels in order to shed light on who purchases Russia’s oil, gas and coal, and how the volume and value of imports have changed since the start of the invasion. CREA also leads a project that tracks detailed ship movements and pipeline flows, its Russia Fossil Tracker brings to light details of energy exports from Russia to other countries after the invasion of Ukraine.

Kiel Institute for the Word Economy:
The Ukraine Support Tracker:
The Ukraine Support Tracker lists and quantifies military, financial and humanitarian aid promised by governments to Ukraine since January 24, 2022 (the day some NATO countries put their troops on alter). It focuses on support by 31 Western governments, specifically by the G7 and European Union member countries. The database is intended to support a facts-based discussion about support to Ukraine.

Peterson Institute for International Economics (PIIE):
Russia’s war on Ukraine: A sanctions timeline.

An International Working Group on Russian Sanctions by Stanford University:
A working group of independent, international experts aim to recommend new economic and other measures to pressure Russian President Vladimir Putin to end his invasion of Ukraine as soon as possible and restore Ukraine’s territorial integrity within its internationally recognized borders.

Think Tank - Bruegel:
A dataset covering national fiscal policies to shield consumers from rising energy prices. It includes figures showing the funding allocated in the period September 2021 to September 2022 by selected EU countries to shield households and firms from the rising energy prices and their consequences on the cost of living.