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AFTER THE CHANGE OF TIMES: LESS RUSSIA IN GERMAN FOREIGN TRADE?¹

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Times of change in relations with Russia

With the start of the Russian war of aggression against Ukraine on February 24, 2022, Germany, as one of Russia's most important trading partners, had to fundamentally rethink its political and economic relations with Russia. However, the change of times proclaimed by the German chancellor not only meant a redefinition of the military threat situation and the accompanying strengthening of external security, but also the overcoming of economic dependencies. There was no longer any question of a special role for German-Russian economic relations; the break with Russia at the economic level also appeared inevitable. More than a year after the proclamation of this turning point, the question therefore arises whether words have been followed by deeds in the development of German-Russian foreign trade. Has Germany succeeded in substantially reducing its economic ties with Russia?

Russia's declining importance as a trading partner

The times of change proclaimed by the German government in February 2022 is very clearly reflected in German-Russian trade relations after a year of Russia's war against Ukraine. However, the relations changed earlier: German trade with Russia has already been in decline since the occupation of Crimea and the imposition of sanctions by the EU and counter-sanctions by Russia in 2014. Although the EU sanctions at the time were limited, they were a clear indication for companies of the increased political risks in Russian trade. Based on this catalog of sanctions, EU sanctions were gradually expanded in 2022 in response to the Russian aggression to reduce economic dependencies and limit Russia's economic ability to wage war.

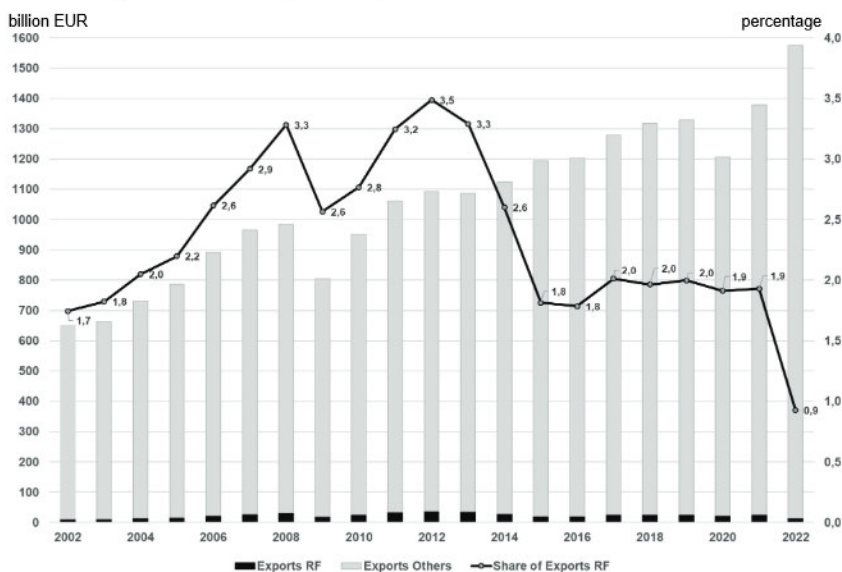
The analysis presented shows this prehistory of the change of times as well as the inevitable break in the first year of the war: Until the Crimea crisis, exports to Russia had grown disproportionately, with Russia's share of German exports rising to 3.5 percent (Figure 1). This momentum of business with Russia was broken after 2014, there was a "Crimea effect", which was reflected in a decline of Russian exports to a 2 percent plateau. The sanctions and counter-sanctions at the time and the resulting deterioration in the business climate thus had an early impact. In this respect, there was less at stake in German exports to Russia in 2022 than had been the case eight years earlier. Unlike for the Baltic states and Finland, Russia had never been one of Germany's main export partners. Thus, the collapse in Russia's exports in 2022 meant only a small "drop" for the German economy. The deep slump in 2022, with the value of exports

¹ The full article is available on the CD enclosed with this publication.

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falling by 45 percent and the share of Russia’s exports shrinking to 0.9 percent, was not felt by the German economy as a whole. This is because, despite the times of change, total German exports rose to a new record level.

Figure 1:
The development of German goods exports to Russia 2002–2022^a

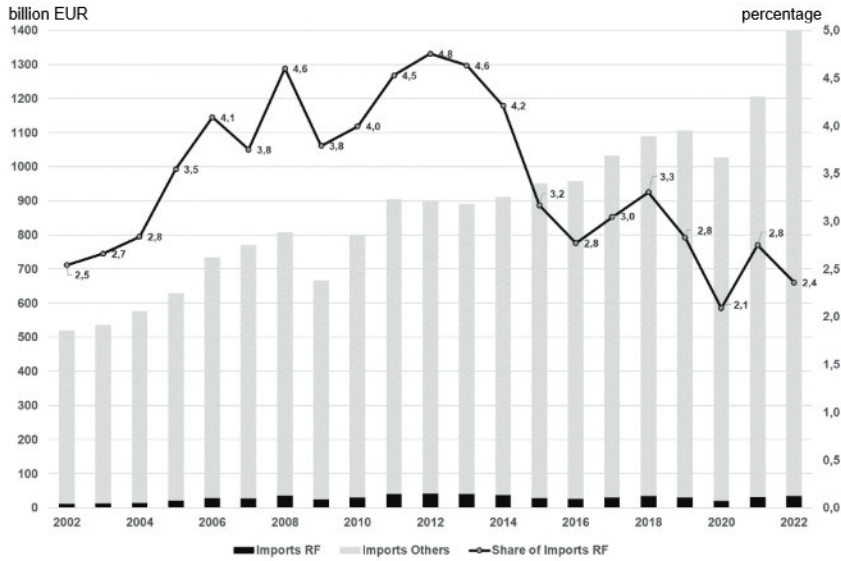


^aLeft axis: exports in billion EUR; right axis: shares of exports to Russia as a percentage of total German exports.

Source: Statistisches Bundesamt (2023a, b); own illustration and calculations.

On the import side, Germany’s and the other EU countries’ trade with Russia also experienced a visible loss of importance in the wake of Russia’s aggression against Ukraine, but this was not as pronounced as for exports. It is true that in the wake of the Crimea crisis, Russia’s share of German imports had fallen from a peak of around 5 percent in 2012 to a range of around 3 percent in subsequent years (Figure 2). Russia was thus not among Germany’s top 10 import partners. In 2022, the year of the war, Russia’s import share declined to 2.4 percent, but the import value actually increased by 6.5 percent — relatively strong forces of inertia were obviously at work on the import side. This applies in the same way to the majority of other EU member states: For 10 member states, the shares of imports from Russia actually increased when comparing 2022 and 2021. These did not include the three Baltic states and Finland, where these shares shrank very significantly — nevertheless their import shares remained comparatively high in the 7 percent range.

Figure 2:
The development of German goods imports from Russia 2002–2022^a



^aLeft axis: imports in billion EUR; right axis: shares of imports from Russia as a percentage of total German imports.

Source: Statistisches Bundesamt (2023a, b); own illustration and calculations.

Hardly any dependencies due to exports to Russia at the industry level

Although the increasing loss of importance of exports to Russia was not reflected in the overall development of German exports, dependencies were greater for individual product groups and the sectors and companies behind them. However, this did not apply to the heavyweights of German exports — road vehicles and mechanical engineering — which had already reduced their business with Russia before the 2022 war year and then cut back further. For example, the Russia shares of “road vehicles” and “electrical machines” were well below the already low overall export share of 0.9 percent. At the end of 2022, there was no substantial dependence on Russian exports in any major sector — not even in the pharmaceuticals industry, despite its counter-trend growth in exports of medicinal products.

Although the loss of business in Russia is certainly painful in individual cases, it is only at company level that this can threaten the existence of a company if there is little regional diversification and a lack of flexibility. However, by the end of 2023 at the latest, the last dependencies should be overcome, even at company level — sanctions and entrepreneurial risk considerations should accelerate this process.

Overcoming dependence on Russia for raw materials

While the German economy had cut back on exports to Russia at an early stage and there were no substantial dependencies, the picture on the import side was different until the outbreak of war. Here, there was an extremely strong concentration on raw materials and raw material-intensive products until 2022. German imports from Russia in 2022 were still dominated by “crude oil and petroleum products” and natural gas, as well as nonferrous metals and “coal and coke”. Crude oil and petroleum products alone accounted for almost half of Germany’s imports to Russia. Although imported volumes fell significantly in 2022, the value of imports did not decline in the same way due to massive price increases. It actually rose for the majority of main product groups — the value of imports from Russia was therefore 6.5 percent higher on average in comparison with the previous year.

Nevertheless, Germany’s dependence on Russian raw materials declined in the war year 2022: In the top 10 import groups, the shares of imports from Russia at the respective total imports of these groups fell almost without exception — the higher import share for fertilizers was the exception. The front-runner in a “ranking of dependence on Russia” in 2022 was again the import of “coal and coke,” where almost 25 percent of imports came from Russia. But this share here fell by 18 percentage points. For the other two heavyweights, “petroleum and petroleum products” and “gas,” Russia’s shares declined by about 5 and 15 percentage points, respectively, yet their shares of imports from Russia, at 19 and 9 percent, remained well above the average of 2.4 percent. This was also true for two other important import groups, fertilizers and nonferrous metals, which also had above-average Russia shares. However, it must be pointed out that this dependency must be viewed in a differentiated manner. For example, it is relatively easy to find other supplier countries on the world market for raw materials such as crude oil and coal, but this is more difficult for pipeline-bound natural gas. At the beginning of the crisis year 2022, Germany was dependent on Russian gas, which was not so easy to overcome.

The special problem of natural gas

Germany’s great dependence on Russian natural gas until the war year 2022 can be seen as its “Achilles heel” in trade with Russia. Because it is tied to pipelines, natural gas supplies could hardly be substituted in the short term, unlike petroleum or coal. This is because Germany has not used the time it has had since the occupation of Crimea in 2014 to become more independent of Russian natural gas. Warnings of political blackmail by the Russian “energy partner” were ignored, and instead the role of cheap Russian natural gas as a transitional energy on the path to decarbonization of the German economy was strengthened.

The actual extent of this dependence cannot be clearly determined. The survey of Russian natural gas imports was complicated by the fact that foreign trade statistics do not clearly record imports of Russian pipeline natural gas for end use in Germany — transit trade or purchases via third countries remain in a “grey zone”. However, using international and German energy statistics, it can be shown that the Russian import share

grew from 35 to 55 percent between 2012 and 2020. The Crimean crisis did not result in a reduction in dependence on Russia — the opposite was true. The construction of LNG terminals was abandoned and direct supply routes from Russia were expanded (“Nord-Stream 2”). Moreover, other raw materials were also increasingly sourced from Russia.

It was the Russian invasion of Ukraine that forced a rethink in Germany: In a few months, independence from Russia as a raw materials supplier was pushed ahead in a rush at high cost and with restrictions on the supply situation. This abrupt turnaround is not so much reflected in import values for petroleum and gas, but rather in import volumes, which fell by 70 percent for gas alone. Russia was able to benefit from higher world market prices until the end of 2022, but by the beginning of 2023 Germany had become independent of Russian natural gas. To an increasing extent, the markets have offered supply alternatives not only for crude oil and coal, but also for natural gas, which can now increasingly be procured in the form of LNG from a growing number of supplier countries. Although the high prices of 2022 resulting from tight supply on commodity markets led to high switching costs in Germany, rising prices have also led to an increase in supply, which has had a dampening effect on prices during 2023. Thus, supply bottlenecks for natural gas have been overcome, but the late turnaround in this market has proved very costly.

Possible learning effects

Since the occupation of Crimea by Russia, German business had reduced its involvement in Russian markets and avoided dependencies. The warning signals were understood by most companies. The persistence of commodity imports from Russia, especially natural gas, can be explained by short-sighted German policies and temptingly low prices. However, it turned out to be advantageous for the German economy that there was hardly any industrial division of labor with Russia. Russia did not play a significant role in the global value chains of German industry. Otherwise, the costs of gaining independence from Russia would have been much higher. Crises such as the Russian war of aggression or the Corona pandemic should, nevertheless, prompt German and European industries to examine their global value chains for crisis resilience. For the globally interconnected German economy in particular, a possible learning effect would be to subject international supply chains to regular stress tests and, depending on the risk situation, to diversify them more regionally. The same applies to the sales markets, where larger concentrations should be avoided.