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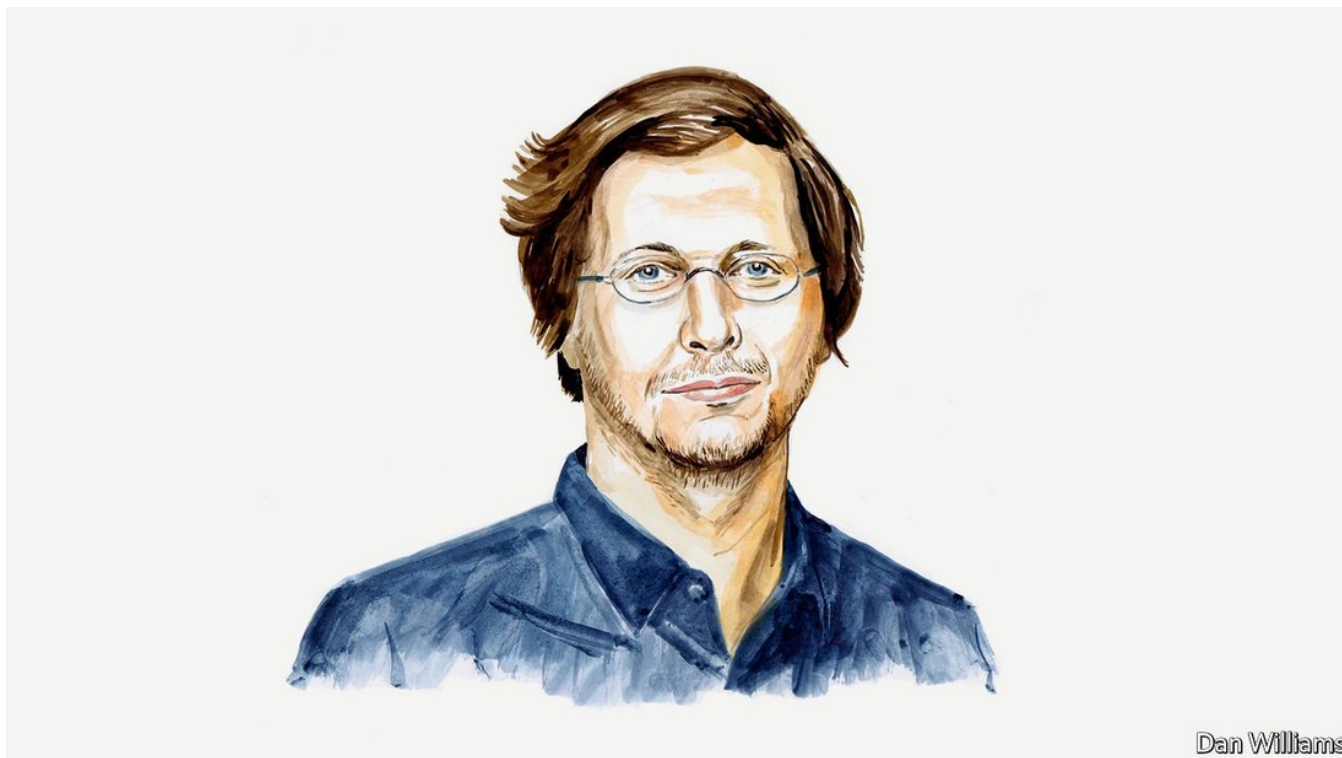
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By Invitation | Russia and Ukraine

Moritz Schularick argues that Germany should immediately cut off Russian gas

The economist and academic says the country can survive more easily than
some people think



May 14th 2022

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WHEN GERMAN diplomats in Brussels recently tried to convince their Hungarian counterparts to sign up to the European Commission's plan for an embargo on Russian oil, they heard arguments that must have sounded familiar. Until recently, Germany also rejected such calls as unrealistic and economically disruptive. "*Geht nicht*" ("Can't do") was the mantra from the chancellor's office.

But on April 26th Robert Habeck, Germany's economy minister, declared that the country could stop all Russian oil imports "within a few days". What happened? The problem turned out to be less intractable than many had assumed. Mr Habeck's team had secured alternative supplies of crude for two east German refineries that process Russian oil.

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Germany has been too cautious on nearly everything about the Russian attack on Ukraine. It was slow to recognise the imminence of the invasion and slow to fall in line during the debate about excluding Russian banks from SWIFT, an international payment network. It was late in supplying weapons to Ukraine when it mattered most, during the initial Russian attack. And it was slow on oil, until Mr Habeck's U-turn.

A similar shift may follow when Germany confronts a yet more important

decision: what to do about Russian gas. Over the past two decades, Russia won over substantial parts of the German political and business elite with the promise of cheap gas as the basis for the competitiveness of German industry. Close ties to and dependence on Vladimir Putin's Russia were dismissed by alluding to the success of German "*Ostpolitik*" since the 1970s. Now as then, economic integration would reduce the risk of confrontation and eventually lead to political rapprochement. In the process, dependence on Russian gas imports increased until they were meeting 55% of Germany's needs in 2021. That share has dropped to less than 40% this year. Gas is now Russia's second-biggest source of export revenues.

For now, Germany remains staunchly opposed to imposing an immediate gas embargo. Government talk of "mass poverty" raised the spectre of a major economic downturn should the country lose Russian supplies. In a tight corporatist embrace, industry and unions supported the government's "can't do" attitude.

But here, too, the wind is changing. It is increasingly clear that the German economy could weather the shock of an immediate cut-off of Russian gas. Even the government's most pessimistic scenarios are not far worse than the original 3% drop in output that an international team of researchers (of which I was part) estimated in March. These costs are substantial, not unlike those during the covid-19 pandemic, but would be manageable—especially since Germany has ample fiscal space to compensate workers in energy-intensive industries, such as chemicals and glass production, over the winter. Not pushing for a faster cut-off from Russian gas is a political choice, not an economic one. Yet for now, Berlin sticks to its 2024 target of becoming independent from Russia.

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Whether such costs are worth it is for elected politicians to decide. But economics has something to say on the potential trade-offs. To start with, doing nothing also carries considerable costs—not least to Ukrainians in bomb shelters. The flow of gas money allows Mr Putin to press ahead with his war. The longer it lasts, the worse the downgrades to European growth.

It is difficult to quantify what contribution a full energy embargo would make to ending the war. The sanctions imposed on Iranian oil and gas exports in the past decade have crippled Iran's economy. In Russia's case, the effect on the state budget would be particularly big. About 40% of Russian government revenues are linked to commodity exports. Although Mr Putin could fix a budgetary hole by printing money, the ensuing inflation could weaken his control over the country and limit his ability to grease allies' palms.

Yet whatever the exact cost of a gas embargo, it would be far greater for Russia than for Germany. As an open economy Germany, unlike Russia, has access to an insurance mechanism to cushion the effects: trade. Take the example of energy-intensive glass production, a sector that features prominently in the German debate (although it accounts for only about 0.1% of GDP). An interruption of gas supplies in the winter would be bad for German producers. But German consumers of glass could still buy products from other countries—just as they can with energy. The German trade balance would deteriorate, but openness to trade gives the country the ability to import energy indirectly at various points in the value chain. Some particularly energy-intensive industries could face more permanent challenges to maintain domestic production without cheap Russian gas. But this fate is in the cards anyway over the next decade, as the green transformation of the German economy picks up speed.

By contrast, Russia's gas pipelines mainly go west to Europe. Rerouting gas to Asia is impossible in the short run, especially if sanctions also cover the shipping sector and maritime insurance. Russian liquefied natural gas capacity is limited, as is storage. All of this means the gas must keep flowing. Otherwise Russia will have to burn off the excess gas, or seal the fields. Within a short time, Germany, not Russia, would have the upper hand.

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The main risk for Germany is not turning off the Russian gas taps prematurely, but to delay doing so. The summer months offer a chance to pivot away from Russian gas. If German industry is not forced to begin the adjustment soon, Mr Putin will be in an even stronger position come winter. It is time to break with the habit of “geht nicht”, and for the country to step up.

Moritz Schularick is a professor of economics at Sciences Po in Paris and the University of Bonn.

This article appeared in the By Invitation section of the print edition under the headline "Moritz Schularick argues that Germany should immediately cut off Russian gas"

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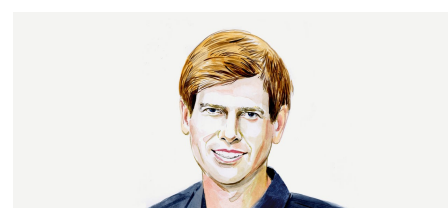
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