



LONDON POLITICA

# Too Hot to Handle?: EU Inflation and the Energy Crisis

Special report on the macroeconomic challenges  
and energy crisis facing the EU

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# Executive Summary

*Jonathan Topaz*

This public report breaks down the current macroeconomic situation faced by the European Union in the summer of 2022 and analyses its implications for the future. It was authored by a team of eight analysts, each of whom focused on different aspects of the crisis, be they economic, political, social, or security-related.

The report is designed to provide a holistic view of the situation by explaining current developments and trends before analysing how they will affect the bloc going forward (as well as what factors could change this outlook). However, readers are encouraged to browse, explore, and select according to personal interest, as chapters were written with a view to being accessible and digestible on a standalone basis as well.

With inflation hitting record highs and broad concerns that fuel supplies would be insufficient to heat homes in the winter, let alone power heavy industry, the EU is arguably in a worse position than other developed economies. The sources of its inflation are external and largely outside its control, while any remaining remedies, like interest hikes, risk backfiring and causing more damage. Still worse is that, whereas previously crises emerged from Europe's periphery, this time it is Germany, the powerhouse of the EU economy, that is at the centre of Europe's plight, owing to its longstanding reliance on Russian fuel. This makes cooperation across the bloc more crucial than ever, as failure will inevitably affect everyone.

Though the EU's proponents have ascribed numerous identities to the bloc, including shared values, a cultural heritage, political integration, and legal union, it is the economic benefits of free trade and movement which underpin its existence and remain least challenged by its diverse set of member states. If EU states fail to see the economic rewards of European integration, pro-EU leaders will struggle to justify continued membership in the face of Eurosceptic populist politicians and disaffected electorates, putting the EU's very survival at stake.

The report tackles five broad dimensions of the EU energy crisis:

**First**, 'The problem' - What is the nature of the high inflation affecting Europe and its causes?

**Second**, 'The response' - What has the EU done, on a collective and individual member-state level, to tackle the situation and ease hardship?



**Third**, ‘The implications’ - What does the evolving macroeconomic situation mean for the EU going forward? What are the key risks in the short and medium term?

**Fourth**, ‘The windfalls’ - What factors could mitigate the worst effects of the crisis and help the EU navigate it successfully?

**Fifth**, ‘The opportunities’ - What are the potential benefits to be reaped by the EU in the medium-to-long term of overcoming the crisis?

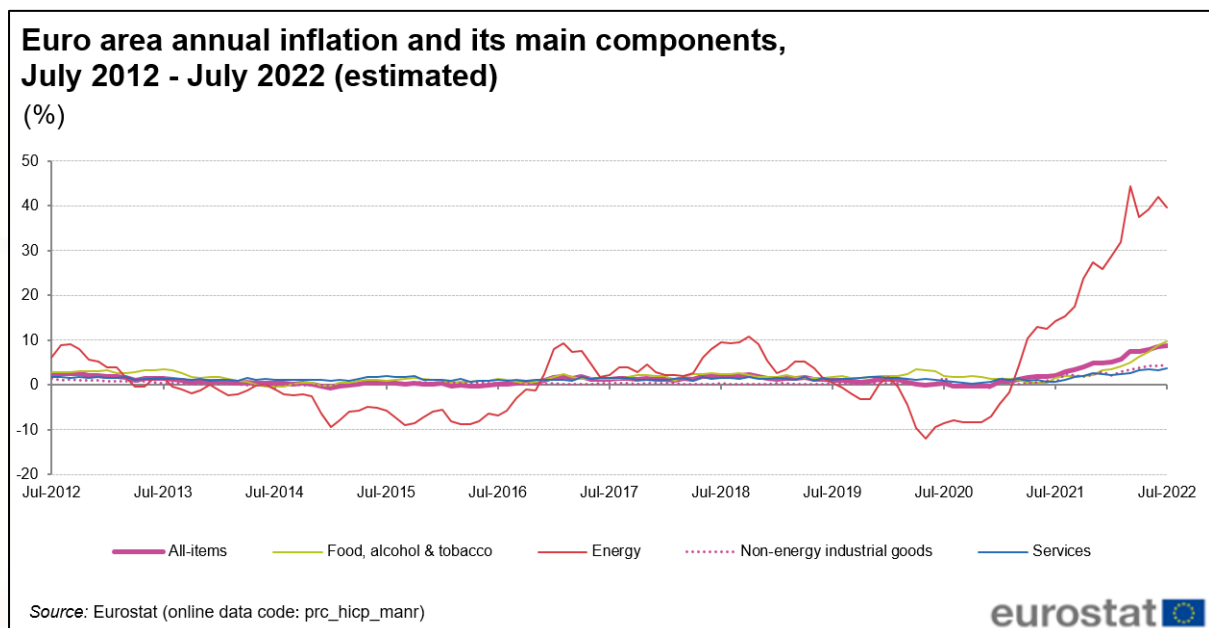


# Section 1: The Problem- Inflation

## 1.1 EU Inflation Statistics and Forecasts

*Antonio Visani*

In the EU, prices have been rising for twelve consecutive months. Headline inflation in the Euro area [peaked](#) at 8.9% in July 2022. In the first quarter of 2022, it hit 6.1%, from 4.6% in the last quarter of 2021. This is the highest rate since the establishment of the euro currency in 1999 and doubles its previous peak in 2008 [figure below]. Core inflation - which does not take into account the more volatile energy and food prices - [rose](#) to 4%. In non-euro EU countries, inflation was even higher. From 4.9% in the last quarter of 2021, it [increased](#) to 6.6% in the first quarter of 2022. The main component of this increase in Eurostat's Harmonised Index of Consumer Prices (HICP) is energy prices, which surged by 39.7% from a year earlier. Indeed, already in February, Brent oil price surpassed 100 USD per barrel, up from 65 USD a year earlier. Natural gas prices [peaked](#) in July at 370 EUR/MWh, a six-fold increase from last year. In the eurozone, meanwhile, food prices [rose](#) 8.9% in July. However, it is worth noting that not all inflation is caused by imported goods. Indeed, in 2021, the GDP deflator, which only includes domestically produced goods and services, rose by 2%. With regards to country-level differences, the states [hardest-hit](#) were those neighbouring Russia. The Baltic countries' inflation fluctuated around 21% and Poland's [around](#) 15.5%. Germany, Italy, and France were closer to the EU average, with 8.5, 8.4 and 10.8% respectively. The following paragraphs will analyse the factors behind this rise in EU inflation.



[Figure 1](#): Euro area annual inflation and its main components, July 2012 - July 2022



The first factor behind the current inflation rate is COVID-19. Indeed, even before the Ukraine War broke out, the EU was already experiencing inflationary pressures. In December 2019, Covid-19 was first detected in China, and in a matter of weeks, it quickly spread to the rest of the world. To contain the spread of the virus, governments implemented lockdowns, factory closures, and social distancing rules. At the same time, the severe recession in the spring of 2020 led producers to shut down production and conduct layoffs. This created a negative supply-side shock that took a heavy toll on global supply chains. Consequently, EU trade [fell](#) in 2020: exports decreased by 9.4% in a year, while imports by 11.6%. At the same time, European countries' real GDP [decreased](#) by 6.1%, more than during the 2008 financial crisis. When economies reopened, demand for goods and services rose sharply, boosted by governments' fiscal measures in response to the pandemic, and supply could not keep pace. This [mismatch](#) between supply - still constrained by supply chain disruptions - and a surging demand was reflected by an increase in prices. For example, inflation shifted from 0.3% in December 2020 to 5.3% in December 2021. To date, China's strict zero-COVID policy has led to lockdowns in Shanghai and other major cities, thus causing further labour shortages and slowing operations in Chinese ports and airports. Thus, pandemic-related supply disruptions are far from over.

Secondly, the Ukraine War destroyed any hope that inflationary pressures in Europe could ease off. On the contrary, its effects led the prices to surge even more. In this regard, the major influence the conflict had was through Ukraine and Russia's role in the global economy as suppliers of natural resources [see fig. 2]. Disruptions caused by the war, the Russia's export ban on its own raw materials and sanctions imposed by the US and its allies - among them EU countries - disrupted trade, thus creating major supply shocks. At the same time, with parts of the Sea of Azov and the Black Sea [inaccessible](#) and rail and airspace over Ukraine and Russia closed, trade costs have soared. This had a negative impact on the price of several critical goods. First, the war disrupted trade in [agricultural goods](#) as Russia and Ukraine exported about 30% of the global amount of wheat, 25% of barley and 15% of maize. Together, they also accounted for half of the world's exports of vegetable oils. This explains the high inflation for food products. Second, EU energy imports from Russia are falling sharply. Indeed, in May, European leaders agreed to [ban](#) 90% of Russian crude oil by the end of 2022, and Moscow is halting gas exports to an increasing number of European countries. Given that Europe [imports](#) one-third of its oil and 40% of its gas from Russia, this led to an energy crisis that boosted oil and gas prices. In addition to negative supply-side shocks, the war also caused an increase in demand. Indeed, by May 2022, more than 5 million Ukrainian refugees have entered the EU. This has led to a [surge](#) in demand for goods in European countries, which widened the mismatch between supply and demand, thus strengthening inflationary pressures.

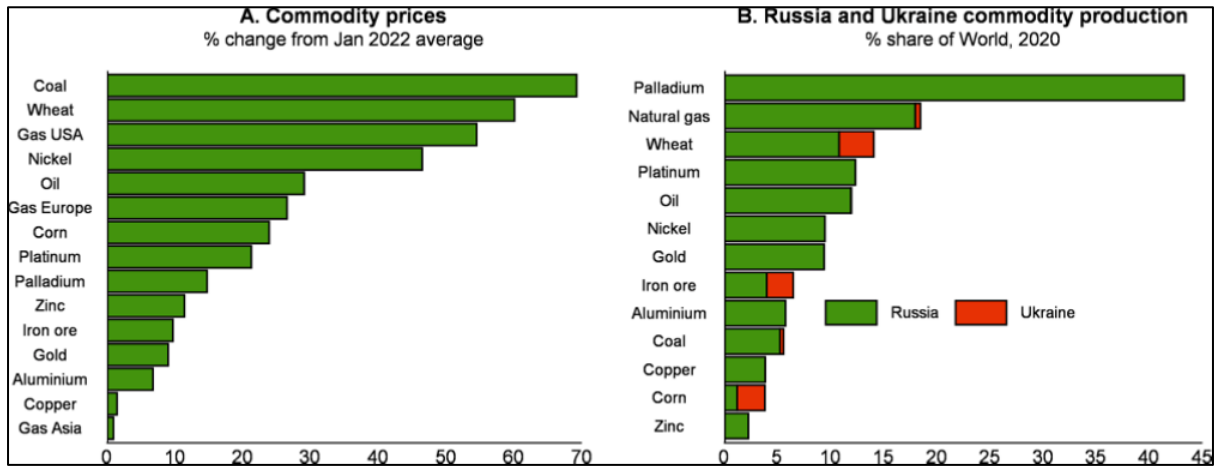
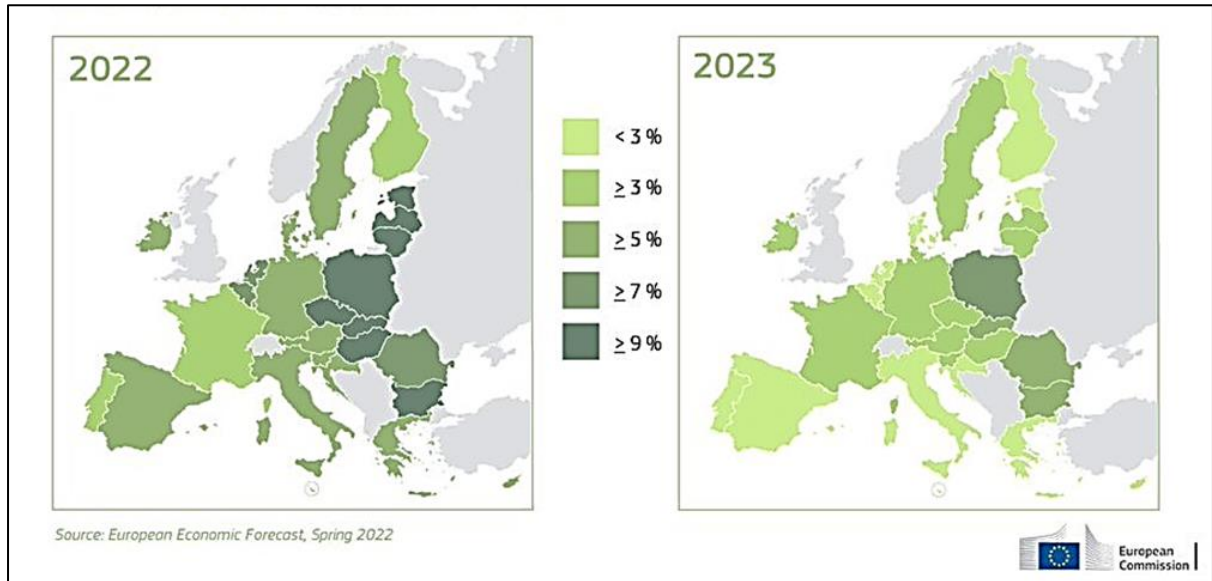


Figure 2: The role of Russia and Ukraine as suppliers of natural resources

With regards to inflation forecasts, the European Commission [expects](#) EU headline inflation to reach 8.3% in the summer of 2022, more than four times the European Central Bank’s (ECB) 2% target. This is attributed to aforementioned higher commodity prices and supply chain disruptions. In 2023, inflation is projected to decline to 2.7% [see fig. 3]. On the other hand, the Organisation for Economic Co-operation and Development (OECD), in its June 2022 Economic Outlook, [forecasts](#) that inflation will reach 3.9% at the end of 2023, more than 1 percentage point higher than what the European Commission has forecasted. This difference owes to two central aspects, which will determine the price level in the medium term. The first is whether the external price shocks that the EU has endured - the pandemic and the Ukraine War - will become entrenched or not. What should be watched closely in this regard is core inflation, which excludes volatile goods like food and energy. If the price of goods that are usually not volatile increases, it might take longer for inflation in the EU to fall. In May, core inflation [was](#) at 3.8%, up from 3.5% in April, which supports the forecast that inflation may not be only a temporary or otherwise transitory situation. Secondly, inflation expectations play a major role in the persistence of the phenomenon. Indeed, if workers expect prices to surge in the future, they demand higher wages. This, perhaps counter-productively, feeds into higher inflation, with a dangerous mechanism called “wage-price spiral”. Even if, in the first quarter of 2022, wages [rose](#) by 2.8%, wage growth and expectations remain quite well-anchored. Indeed, as the ECB chief economist, Philip Lane, [noted](#), a wage increase by 3% is consistent with reaching the ECB objective of 2% inflation in the medium term.



**Figure 3:** Projected inflation rate in the EU, 2022 – 2023

However, there are risks that may lead to higher inflation rates in the next months than those forecasted above. First, the adverse effects of the war could be greater than expected. If all energy exports from Russia ceased completely, the impact on EU price levels would be much higher and long-lasting. Indeed, with global demand for natural gas outstripping supply, it would be impossible for Europe to replace forgone Russian imports in a short time. On the other hand, shifting to renewable energies is a long-term process. As European economies would need to source additional supply on world markets, energy prices would increase rapidly. The OECD expects that, in such a scenario, gas prices would rise by 50%, while oil prices would rise by 10%. Rising energy prices, in turn, significantly increase manufacturing costs and transport costs, driving cost-push inflation, with spillover effects that could last for at least one year. Second, another wave of a new COVID-19 strain could force governments to re-impose lockdowns, which would reduce labour shortages and cause new supply chain disruptions. Global supply would decrease, thus pushing up prices. These two factors could make the inflationary pressures last longer than current forecasts expect. Beyond all this uncertainty, therefore, it could be concluded that high inflation in the European Union is here to stay.



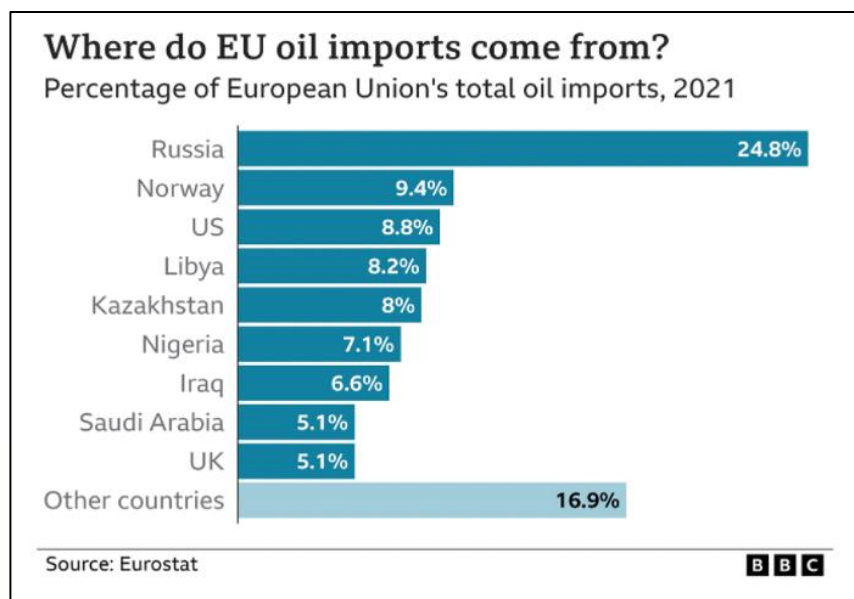


## 1.2 Energy Inflation and the Russian Oil Ban

*Iben Vagle*

When inflationary pressures began to rise in early 2021, pandemic-related supply shortages were deemed the root cause. More than a year later, inflation is still accelerating, but now it is overwhelmingly the war in Ukraine which rallies energy markets and threatens supplies, causing energy bills to spike.

The Ukraine conflict has forced (most) Western countries to move away from Russian energy supplies. The EU receives [27% of its imported oil](#) and [40% of its gas](#) from Russia, in exchange for some [400 billion euros](#) (341 billion GBP) yearly. As a result, the EU has, by May 2022, spent [35 billion euros](#) on Russian energy since the war began and merely 1 billion euros on aid to Ukraine.



[Figure 4](#): Sources of EU oil imports, 2021

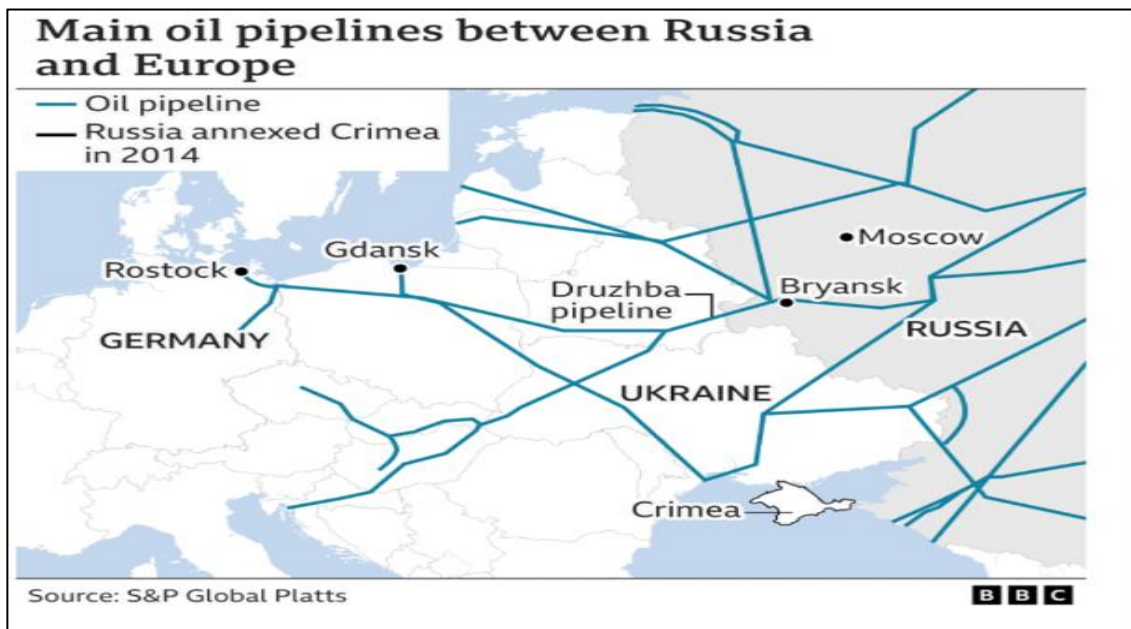
### *The Sixth Sanctions Package*

The most recent round of measures saw EU leaders agree to an immediate ban on oil imports from Russia transported into the bloc by sea. Sea imports constitute [two-thirds](#) of Russian oil supply to the EU. However, following opposition from Hungary, the compromise includes a temporary exception for pipeline oil. Voluntary pledges by Germany and Poland to shun pipeline oil imports by the end of 2022 will increase the ban's scope to [90% of imports](#) from Russia.



### *The EU's sixth sanction package - key provisions*

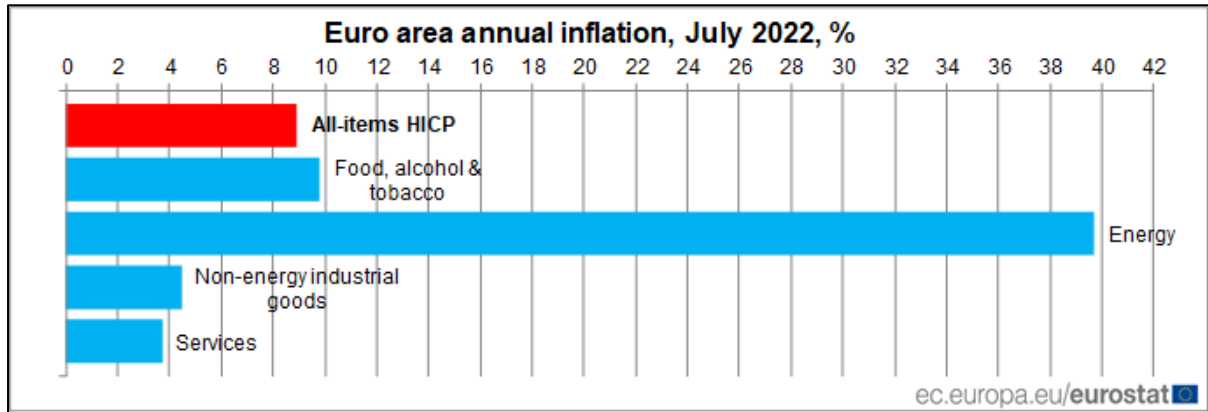
- Russian seaborne oil to be banned the end of 2022, with a temporary exemption for pipeline oil
- Pledges by Poland and Germany to halt pipeline imports to extend the ban to 90% of Russian imports
- Russia's largest bank, Sberbank, to be cut off from the SWIFT payment system
- Three additional Russian state-owned broadcasters banned
- More restrictions on "individuals responsible for war crimes in Ukraine"



*Figure 5: Major oil pipelines connecting Russia and Europe*

The EU has [referred](#) to its latest sanction scheme as a “landmark decision to cripple Putin’s war machine”. Nevertheless, it will take several months for the sanctions to take full effect and even then Russia will have [alternatives](#), including exports to China and India.

The repercussions of Russia’s invasion of Ukraine and persisting supply chain shortages, further aggravated by lockdowns in China, have resulted in inflationary pressures far beyond the European Central Bank’s target of 2%.



[Figure 6](#): Euro area annual inflation, July 2022

Euro area [inflation](#) rose from 8.6% year on year in June to 8.9% in July. Energy prices surged to 39.7% year on year in July, and remain a significant driver for the headline rate. The increase in non-energy goods prices also encompasses a significant indirect effect on energy prices.

Oil prices are further under pressure as European Union leaders agreed on a plan to thwart more than two-thirds of Russian oil imports. In May, Brent crude [reached](#) at two-month peak, rising above \$123 a barrel. Petrol prices [hit](#) a new high in June of 186.59p a litre, and the average price of diesel in the UK [increased](#) to 182.58p a litre. The rising costs are adversely pressuring consumer markets, making it increasingly expensive to drive and heat homes.

Starting in the fourth quarter of this year and continuing through 2023, base effects for energy prices and the eventual resolution of supply chain dislocations should result in lower inflation rates. However, beyond the short term, multiple factors, including costly (but necessary) green transition policies, more expansive fiscal policies, and reduced workforce participation rates due to ageing demographics, are due to raise underpinning trend inflation in the Eurozone for years to come.

According to Berenberg, inflation is [expected](#) to remain stable in year on year terms through the third quarter of 2022, only to begin cooling in the fourth quarter. Some government actions to protect consumers from rising costs, for instance Germany's three-month gasoline tax relief from June 1st, will initially help to prevent a substantial increase in headline inflation. However, when these policies are rolled-out, they will themselves contribute to inflation.



## 1.3 Food Inflation

Alice Presotto

The Eurozone is suffering the [highest inflation](#) since the creation of the Euro in 1999. After energy, ‘food, alcohol and tobacco’ accounts for the second most important factor of this high inflation rate in the EU [see fig. 6), increasing 7.5% year-over-year in July.

	Weights (%)	Annual rate							Monthly rate
		2022	May 21	Dec 21	Jan 22	Feb 22	Mar 22	Apr 22	May 22
<b>All-items HICP</b>	1000.0	2.0	5.0	5.1	5.9	7.4	7.4	<b>8.1e</b>	0.8e
All-items excluding:									
> energy	890.7	0.9	2.8	2.5	3.1	3.4	4.1	<b>4.6e</b>	0.7e
> energy, unprocessed food	841.2	0.9	2.7	2.4	2.9	3.2	3.9	<b>4.4e</b>	0.7e
> energy, food, alcohol & tobacco	681.8	1.0	2.6	2.3	2.7	3.0	3.5	<b>3.8e</b>	0.5e
Food, alcohol & tobacco	208.9	0.5	3.2	3.5	4.2	5.0	6.3	<b>7.5e</b>	1.3e
> processed food, alcohol & tobacco	159.4	0.7	2.8	3.0	3.5	4.1	5.4	<b>7.0e</b>	1.6e
> unprocessed food	49.5	0.0	4.7	5.2	6.2	7.8	9.2	<b>9.1e</b>	0.5e
Energy	109.3	13.1	25.9	28.8	32.0	44.3	37.5	<b>39.2e</b>	2.0e
Non-energy industrial goods	265.2	0.7	2.9	2.1	3.1	3.4	3.8	<b>4.2e</b>	0.6e
Services	416.7	1.1	2.4	2.3	2.5	2.7	3.3	<b>3.5e</b>	0.4e

e estimate

*Figure 7: Euro annual inflation and its components in%, July 2022*

The drivers behind the food inflation are largely on the supply side. The globalisation and resulting interconnectedness of supply chains has made them more vulnerable to unexpected shocks such as the global pandemic and the Russia-Ukraine war.

At present, we are still seeing the effects of Covid-19 on global food supply chains. The case of China’s zero-Covid policy and protracted lockdowns are exacerbating serious [shortages](#) of fertiliser, labour and seeds and therefore heavily impacting EU imports of products like soy. Yet even in countries where restrictions have been lifted, food production remains below pre-pandemic levels. Two years of restrictions reduced the global demand of goods, hurting those reliant on supply chains while local producers have been privileged. These restrictions have also encouraged the accumulation of savings, which are now being released into the market and are bolstering demand for goods, including food. However, market adjustments will not be achieved overnight as production takes time to adapt to demand and employers look to re-employ staff. As disruptions and adjustments in the supply chains continue, transport costs such as global shipping costs and their inflationary effects are [pushing up](#) food prices further.



Another impact on food supply availability has been [weather volatility](#). In Latin America, Brazil, as the world's largest grower of coffee, experienced a frost which killed off young coffee trees. Flooding in China's key pork region inundated farms and raised the threat of animal disease, while heat and drought crushed crops on the U.S.-Canada border. As for Europe, torrential rains sparked the risk of fungal diseases for grains and stalled tractors in flooded fields. These recent environmental effects such as droughts, floods and fires are contributing to the spike of the food commodities.

What has caused more recent and high-level impacts on exacerbating global food shortages is the Russia-Ukraine war. One-quarter of global exports of wheat [came](#) from Russia and Ukraine before the war started. Since the war began, 90% of all Ukrainian wheat exports have been [halted](#), due to closures of all Ukrainian ports on the Black Sea, while the remaining has passed through rail corridors in Poland. Russian wheat exports have not been affected. While the EU [relies](#) on Ukraine for cereals (52 % of EU maize imports) as well vegetable/rapeseed oils (23 % and 72 % of EU imports respectively), dependency of EU countries from Russian and Ukrainian wheat is not as strong as in non-EU countries such as [India](#).

Despite the EU not being dependent on Russia or Ukraine for wheat, the war has triggered a [spike](#) in wheat prices given the decreased availability of the product coming from Ukraine or from countries such as [India](#) which have banned their own exports in order to provide food to their people. Bans are also [happening](#) with other products: Indonesia banned palm oil exports; Argentina banned beef exports; and Turkey, Kyrgyzstan and Kazakhstan have banned a variety of grain products. Due to these restrictions being placed and affecting the supply side of production, prices will continue to rise globally.

Limited production is one direct cause of the food inflation. However, there are indirect causes with great impact on food prices, such as the rising prices of energy, fertilizer, and animal feed. For each of these items, the EU is not [self-sufficient](#). With the Russian, Ukrainian or Belarusian origins of these items and the EU's dependency, costs for producers increase and are affecting in turn the cost of food. This dynamic reduces the purchasing power of consumers, as well as the income of producers, while damaging certainties of supply.



## Section 2: The Solutions- EU Policy Alternatives

### 2.1 ECB Rate Hikes

*Alice Presotto*

As a consequence of the surging of prices of energy and food, projections of inflation for 2022 in the European Union have been considerably [revised](#) up to 8.3%. The 8.9% [inflation](#) in July, far above the target of 2% over the [medium term](#), has raised alarm in the ECB, and fuelled its program of monetary tightening.

After years of maintaining low borrowing costs of the Euro, the ECB implemented its first interest rate [rise](#) since 2011. At 50 basis points (0.5%), this was even more aggressive than markets expected. The ECB's initial plans for gradual approach of consecutive 25 basis point hikes, aiming to prevent investor panic and a bond market selloff, were hastened against its will when inflation prints came in hotter than expected.

Along with raising interest rates, the ECB decided to [end](#) net asset purchases under the Asset Purchase Programme (APP) as of 1 July. The [last](#) €20bn-a-month asset purchases could have been halted already in May, but the ECB has opted to wait longer. This decision could have stemmed from the necessity to provide reliability for investors, without taking sudden policy turns that could surprise them. On the other hand, a failure to act in a timely manner to stop the bond purchase could cause even further increase of consumption levels and therefore increase in prices and inflation. While ending bond buys is necessary to counteract inflation by dampening demand, this will represent a halt in the attempt to stimulate growth by [keeping](#) the long-term interest rates low.

Despite ending the APP, the ECB has decided to continue [reinvesting](#) the proceeds of maturing bonds under the APP for as long as is necessary. While this allows favourable liquidity conditions and prevents countries' balance sheet from shrinking, it is also very difficult to justify given the current economic trends. However, the decision taken on this matter by the Governing Council is consistent with previous ECB decisions on the [evolution](#) of the outstanding asset portfolio over the medium term. This provides the ECB with reliability, while being an attempt to stabilize the market despite rising interest rates. Despite compressing the growth outlook of the eurozone by raising interest rates, ECB President Lagarde looked positively at the growth projections, not expecting a recession because entire sections of the economy were [recovering](#) with such pace. Additionally, these measures were taken with the intention of seeing their benefits in the medium term, as inflation is a lagging indicator and changes to its pace do not happen overnight. They could provide a sense of stability for the Eurozone, anchoring market expectations by reaffirming the ECB's commitment to the 2% inflation target.





Compared to the United States' central bank, the Federal Reserve, the ECB has acted with some delays. Following its sharp 50 basis points hike in May, the Fed has ventured further to raise its funds rate by an additional two 75 basis points hikes in June and July, its fastest ever hiking cycle. Now operating a 2.25-2.5% target rate, the Fed is also unwinding its highly inflated balance sheets, now [selling](#) bonds at \$47.5bn per month, a rate set to rise to \$95bn starting in September.

This difference in timing and scale of the rise in interest rates is likely due to the very nature of the cause of inflation, and not due to delays or an effort to catch up. [According](#) to Ms. Lagarde, EU inflation is primarily 'imported' inflation, caused by rising prices of goods from abroad like food and energy, whereas in the US inflation can be attributed to overheating demand. Hence, if the primary cause of inflation is the spike in demand, it makes more sense for the Fed to act quickly and strongly to contain it.

However, both on the European side and on the American one, there are nuances and contrasting views on the nature of inflation, and therefore on the most appropriate policy approach to be taken by central banks. Lagarde notes EU inflation goes beyond just imported inflation caused by energy and exogenous bottlenecks. The inflation is encompassing almost every sector, including non-energy industrial goods and services, calling for dynamics not attributable to the rise in energy prices, such as wage rises, to be considered. In the US, as David Glymon [argued](#) in the Financial Times, inflation is mainly supply-driven, citing prices of eggs and chicken. The economic stimulus has not led to a boost in demand for these two items, while there is an evident struggle in keeping up the production in the industry. Therefore, the impact of the measures to tackle inflation taken by the Federal Reserve can only be partial, first because they aim to reduce consumption, while the cause of inflation is largely supply-drive and not demand-driven, and second, because interest hikes' demand reduction takes roughly three quarters (or nine months) to take effect within the economy, and therefore might result too late.

The ECB, perhaps even more than the Fed, is finding itself between a rock and a hard place. Inflation, whatever its causes may be, erodes consumer and business confidence in the economy and the currency, while precipitating a cost-of-living crisis and ballooning personal debt. By overdoing monetary tightening, however, the ECB and the Fed risk dragging their respective economies into a painful recession.



## 2.2 EU National Government Response

*Jonathan Topaz*

Monetary measures, in the form of interest rate hikes and quantitative tightening, constitute the core of EU efforts to combat inflation. However, the time-lag of up to a year before their desired effects has prompted national governments to act in an attempt to mitigate the worst effects on consumers through fiscal policy measures such as price controls, subsidies, and even handouts to those most in need.

Hungary, for example, has recently [extended](#) price caps on food items like wheat, sugar, chicken, as well as on petrol, till October. Germany, meanwhile, has attempted to combat inflation by [introducing](#) a steeply-discounted €9 monthly public transport tickets for the summer, which, according to [estimates](#) from Berenberg, may temporarily reduce inflation by 0.4% YoY.

These measures, as well as slashing excise taxes on gasoline, can help protect the most vulnerable consumers. Their sustainability, however, is up for question. Artificially cheap Hungarian fuel [sparked](#) an inflow of ‘gasoline tourists’ from Slovakia until price caps were narrowed exclusively for cars with Hungarian license plates, a move fiercely [opposed](#) by the EU for going against common market principles. Germany’s railroads, meanwhile, buckled under the pressure of crowds capitalising on the scheme to go on holiday and visit major cities, leading to severe disruptions and near-constant delays. Already in June, Deutsche Bahn [requested](#) that passengers avoid bringing bicycles on trains due to lack of room.

More generally, such fiscal measures as subsidies and tax cuts stretch public budgets by decreasing tax revenues and raising spending, which can worsen the already tenuous debt position of [some](#) EU governments. Price caps, in turn, squeeze companies’ earnings by preventing them from passing on rising costs to consumers, which can lead to layoffs and erode business confidence at a time when many are already predicting a severe EU recession.

Outside the EU, some governments have opted for ‘inflation relief’ handouts to top-up disposable incomes. These include the UK government’s £15 billion handouts in May, or California’s plan to distribute up to \$1,050 to 23 million residents, amounting to some \$17 billion. These have been highly controversial, as injecting more money into the economy intensifies the process of consumers bidding up the prices of goods, contributing to the very inflation which these measures purport to solve. Moreover, for EU governments, any such handouts would have to come directly from limited public budgets, contrary to the stimulus checks implemented by the US during the coronavirus pandemic, which were financed by





theoretically unlimited public borrowing underwritten by the Federal Reserve. This is because the euro's money supply is exclusively in the hands of the ECB, which has recently turned against quantitative easing as a sustainable and equitable way to finance public spending.

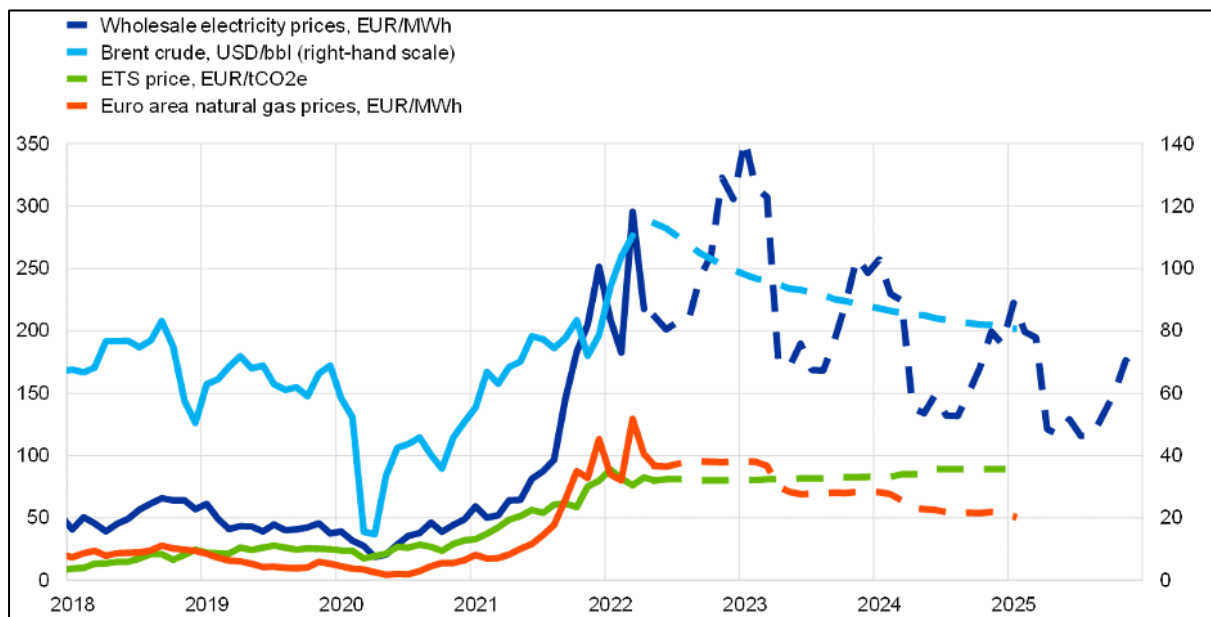
In sum, fiscal responses to inflation require governments to spend when conventional economic theory advises exactly the opposite - a painful but badly needed fiscal contraction. Opinion is gradually converging on the idea that any 'inflation relief' must be limited in size and targeted only at those most in need.



## 2.3 Alternative Energy Sources

*Sharif Fatourehchi*

European energy markets, especially oil and gas, had been experiencing an upward price trend in the post-pandemic economy. Around February 2021, Brent crude oil had already recovered from the 75% price [drop](#) it suffered between February and April 2020. Gas prices followed a similar trajectory, now reaching higher than pre-pandemic price levels [see fig. 8].



**Figure 8:** Pandemic-related energy price volatilities, 2018-2026 (forecast)

These price increases and volatilities were a product of complex demand and supply side factors. The drop was largely a consequence of a [slowdown](#) in economic activity brought about by pandemic-related restrictions. However, the subsequent recovery and further rise are due to a combination of factors including risk, supply and economic activity. With Europe experiencing a colder-than-usual winter in 2020, as well as low winds during the summer, the demand for gas rose and placed pressure on its price.

Almost a year later, energy inflation was accelerated by Russia's invasion of Ukraine and subsequent sanctions packages that reduced the supply of Russian oil and gas, causing a crisis for those dependent on Russian energy. The European Union saw 45% of its gas [imports](#) in 2021 come from Russia, totalling 40% of its annual gas consumption. This is in addition to 27% of its imported oil [originating](#) from Russia. Within the sanction packages announced in reaction to Russia's invasion is the [ban](#) on all Russian seaborne crude oil and petroleum products, as well as [pledges](#) from Poland and Germany to wind down the import of pipeline oil.



These actions from the EU will require large-scale adjustments to the union's energy infrastructure, production, and trade. There exists short- and long-term policy developments required to facilitate the transition away from Russian energy; scaling-up advancements in renewable energy will not be sufficient in meeting the EU's immediate energy demands. Therefore, short-term adjustments will be necessary apace with advancements in renewable energy production.

### ***Short-term***

Short-term alternatives are predominantly a matter of finding alternative sources of fossil fuels, be it increases in gas production, backsliding to coal for electricity production, or importing liquefied natural gas (LNG) from non-Russian sources. The International Energy Agency (IEA) provided a [10-point plan](#) to the EU for the reduction of reliance on Russian energy supplies; the plan included a few short-term recommendations that included the aforementioned urgency for finding alternative energy sources, as well as introducing a minimum requirement for gas storage in order to increase the gas system's resilience come next winter.

Germany, to lower its reliance on Russian oil and gas, initially considered [postponing](#) its nuclear power plant closure in order to ease the pressure, though it was decided that the risk and costs of life-time extension outweighed the short term benefits. However, [measures](#) to use the burning of coal to supply electricity as an alternative source to gas are being taken by the EU's largest economy. Germany is not alone in this, Austria and Netherlands are also reverting to coal by removing restrictions on coal-powered plants, as [announced](#) by their respective ministries.

Italian energy giant, Eni, has [signed](#) a deal with Algerian state-owned Sonatrach to boost gas imports from Algeria and invest in further gas exploration that could see supplies increasing to not only Italy but other parts of the EU as well. Along the same lines, The EU has [signed](#) a deal with Israel and Egypt to boost gas exports. Israel is currently exporting gas to Egypt where it is liquified and shipped to the EU. With infrastructural improvements, that capacity can grow and further aid in the transition away from Russian energy. The U.S. has also greatly contributed to providing the EU with energy, [sending](#) 74% of their LNG exports to Europe over the first four months of 2022, a large increase on the 2021 annual average.

Vis-à-vis regional production, Equinor has [announced](#) that, working with Norwegian authorities, it will maintain its high gas production throughout the summer by virtue of increased production permits. The Oseberg field is due to increase gas exports by around 1 billion cubic meters up to the 30<sup>th</sup> of September. The Heidrun field is also set to increase exports by 0.4 billion cubic meters by the end of 2020. The 1.4 billion cubic meters increase in production could [meet](#) the annual gas demands of 1.4 million households.



## ***Long-term***

Although the above-mentioned policies and actions alleviate the immediate pressure on European energy markets, they are not in tune with the urgent obligation facing all nations of transitioning away from fossil fuels and toward renewable energy. Aiming to achieve net greenhouse gas emission reduction goals does not pair well with backsliding into coal. Additionally, the current infrastructure is not optimised for LNG and pipeline gas and oil imports from desired non-Russian sources. Therefore, the long-term, sustainable key to the EU's desired independence from Russian energy is accelerating the green energy transition and investing in the technological infrastructure required to phase out Russian fossil fuels. The EU has already [communicated](#), through the REPowerEU package, their intended strategy; it includes saving energy, diversifying energy sources, and boosting green energy with proposed funding of €210 billion until 2027.

### Energy Saving

Saving energy includes demand side as well as regulatory action in favour of greater energy efficiency in both residential and industrial activities. Increasing the [Energy Efficiency Target](#) to 13% from its current level of 9% would positively strengthen the bloc's ability to supply energy in the winter. The EU Save Energy Communication also [sets out](#) methods of reducing oil and gas usage by 5% through outreach to citizens and industries; informing them of practices to reduce consumption will assist in successfully meeting that reduction. Fiscal policy tools, such as tax reductions or government subsidies, can also encourage shifts to greater energy-efficient machinery and appliances.

### Diversification of Sources

Diversification of energy sources is already underway for short-term relief, but there are also longer-term partnerships signed to secure energy supplies in the future. An example of such is Germany's energy partnership with Qatar; the signed partnership allows for an increase in trade with a focus on LNG and hydrogen. The CEO of QatarEnergy [stated](#) that Qatar could potentially supply "20-25% of Germany's total gas consumption" in 2024. With LNG trade expected to increase alongside further [increases](#) in global liquefaction, pushed by the United States and Australia, these partnerships could open doors for greater diversity in energy sources. Italy's Eni's [agreement](#) with Algerian Sonatrach also has the potential to yield long-term dividends if planned investments in gas exploration are fruitful. However, LNG imports require terminals with sufficient capacity to accommodate; although the EU has an overall import capacity that is enough to meet 40% of total gas demands, there is a [lack of access](#) to those facilities in South Eastern Europe, Central and Eastern Europe and the Baltic. Further investment in that area is therefore required to allow for reliance on LNG in the long run.



## Green Energy

Boosting green energy and transitioning to renewable sources has been on the EU's agenda for many years now, though it will play an exclusively critical role in establishing the bloc's energy independence from Russia. There are proposals to change the bloc's 2030 [targets](#) for renewables from 40% to 45%. The commission has set out measures to be taken in order to achieve the goals and accelerate the transition in their REPowerEU package. Included in the [measures](#) is [the EU Solar Strategy](#), ramping up domestic renewable hydrogen production and import by setting a target of 10 million tonnes by 2030; a [Biomethane Action Plan](#) to increase production to 35 billion cubic meters by 2030, and utilizing emission trading revenues to push for a green transition in industry. These ambitions and targets would aim to [increase](#) the EU's prospective 2030 renewable energy generation capacities by 169 gigawatts, an estimated 16% increase. It is important to note that these are all 'proposed' actions and are now with the European Parliament and the Council. Meanwhile, countries are taking individual action to increase the usage of clean energy, such as Germany and their plans for hydrogen trading. Otto Waterlander, Chief Commercial Officer at TES, [spoke](#) about their plan to build a clean energy hub at The Wilhelmshaven and establish it as the hub for international hydrogen trading. The TES Chief claimed that the scale of the project allows for the potential replacement of the Nordstream 1 or 2 pipeline in terms of energy supply.

The combination of short- and long-term measures, if implemented appropriately and effectively, could alleviate the pressure on European energy markets as well as build a more risk-free future vis-a-vis energy provision. Although the short-term measures may be an immediate step backwards when considering climate change objectives, the goal to increase clean energy consumption and production, in the long run, has now been given an extra motivating factor: energy independence.



## Section 3: Implications- Key Macro Risks

### 3.1 Renewed Debt Crisis

*Jonathan Topaz*

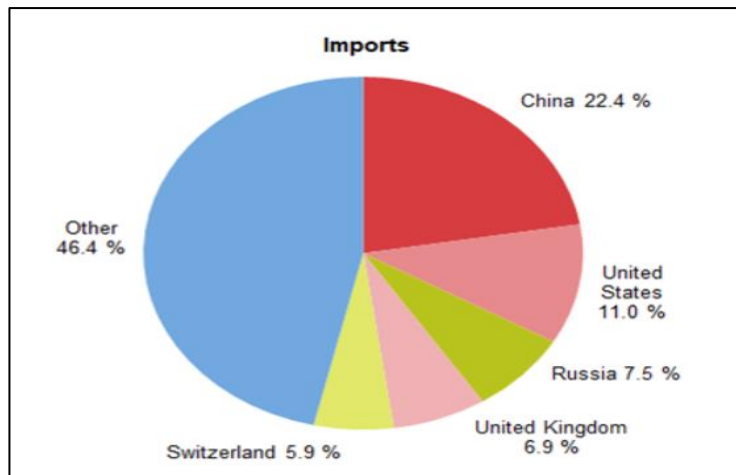
Tightening EU monetary conditions and the bloc's worsening economic outlook due to the ongoing energy crisis have raised serious questions about the ability of EU countries to meet current debt obligations and refinance on favourable terms. Such concerns have so far taken the form of bond market fragmentation, a phenomenon which sees widening differences in the yields of bonds issued by different EU countries. These differences in borrowing costs reflect investors' perception that some countries are more likely to default on their debt, and therefore should reward investors with higher rates for the risk they undertake by buying their bonds. In July, spreads (differences) between Germany's and Italy's 10-year bond yields [surpassed](#) 2%, over double this time last year. The selloff in Italian bonds (bond prices and yields are inversely related, so as prices fall, yields rise) was exacerbated by recent political instability, as Prime Minister and ex-ECB Chief Mario Draghi [resigned](#) on 21 July as head of the national unity government following conflict with coalition partners.

The high indebtedness of some EU countries, like Italy, Greece, Spain, and Portugal relative to others, like Germany, carries two major implications. Firstly, the ECB is severely limited in its ability to follow international peers such as the US Fed on rate hikes to counter inflation. For over a decade, the bloc has relied on negative interest rates (and thus cheap borrowing) for continued economic growth in the face of structural issues like an aging population. Closing the credit taps now could have widespread unintended consequences in plunging the EU into a recession that would call the union's very existence into question. Higher interest rates cause investors to transfer capital from bonds to savings accounts, which are traditionally considered to be even lower in risk, thus raising bond yields and effectively making it harder and more expensive for governments (and companies) to borrow. Thus, governments facing impending maturity dates (on which they must return the principal sum borrowed to bond holders) will have to borrow cash on unfavourable terms, stacking high (and perhaps unsustainable) interest expenses in the future.

Here, the shadow is cast squarely on Italy, which, [according](#) to the Financial Times, must repay about €200bn in debt this year and €305bn more in the next. Thus, while Greece may be more indebted, with an average weighted maturity of 18 years to Italy's 7, it effectively has more than double Italy's time to repay its debt. Acutely aware of these figures, the ECB has pursued a slower and more conservative course of interest hikes. Despite surprising investors by making its first hike in 11 years that of 50 basis-points, this only brings its deposit rate to 0% - neutral territory - compared to the Fed's 2.5%. While not only potentially falling short of what is needed to stem inflation, low rates have triggered money



flows away from the euro and into the dollar, [bringing](#) the two currencies to parity (1:1) for the first time since 2001. A historically weak euro makes imports from the US, its second largest import partner [accounting](#) for 11% of goods, more expensive, causing imported inflation.



[Figure 9](#): Share of EU goods imports by source in%, 2021

In a similar vein, the ECB is caught between a rock and a hard place when it comes to curbing its bond buying. Since 2001, the central bank began purchasing primarily government bonds of various EU countries in order to keep interest rates artificially low, finance budget deficits, and incentivise borrowing. However, an inflationary economic environment traditionally calls for winding down such purchases and even unwinding balance sheets by selling bonds on the open market or refraining from reinvesting after bonds mature. The EU has [discontinued](#) its main two bond purchasing programmes, the Pandemic emergency purchase programme (PEPP) and Asset Purchase Programme (APP) in March and July respectively. Nevertheless, it will have to continue bond purchases of higher yield bonds (such as Italy's) to prevent fragmentation. Pierre Wunsch, head of Belgium's central bank and ECB governing council member, [argued](#) for being "as unlimited as possible," in the case of "unwarranted fragmentation", echoing then-ECB chief Mario Draghi's commitment to doing "whatever it takes" back in 2012. This will include strategically reinvesting cash from maturing bonds in bonds whose yield is deemed excessively high. Analysts, however, have expressed doubt that this would be enough to thwart fragmentation, and investors are likely to test any unlimited commitment as they sell any debt they consider unsafe or unattractive given rising interest rates. In addition, some northern EU countries like Germany and the Netherlands have [called](#) for bond purchases to be conditioned on disciplined public budgets, which southern neighbours oppose, so any anti-fragmentation tool will be both legally and politically controversial.



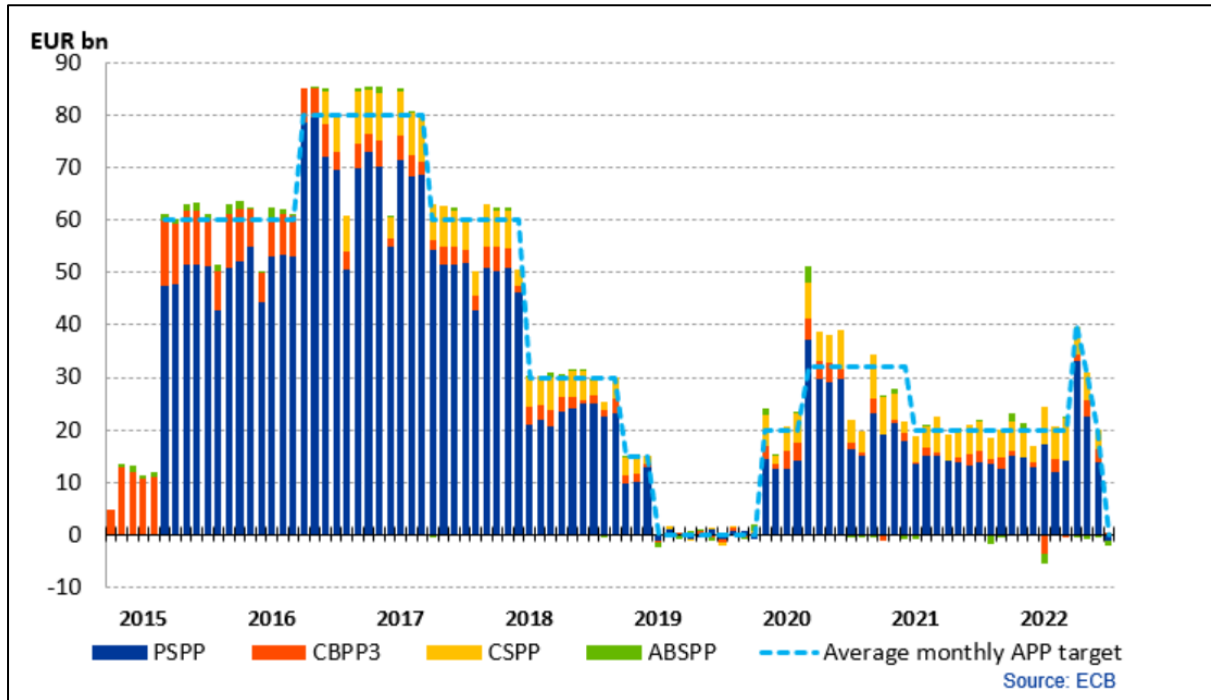
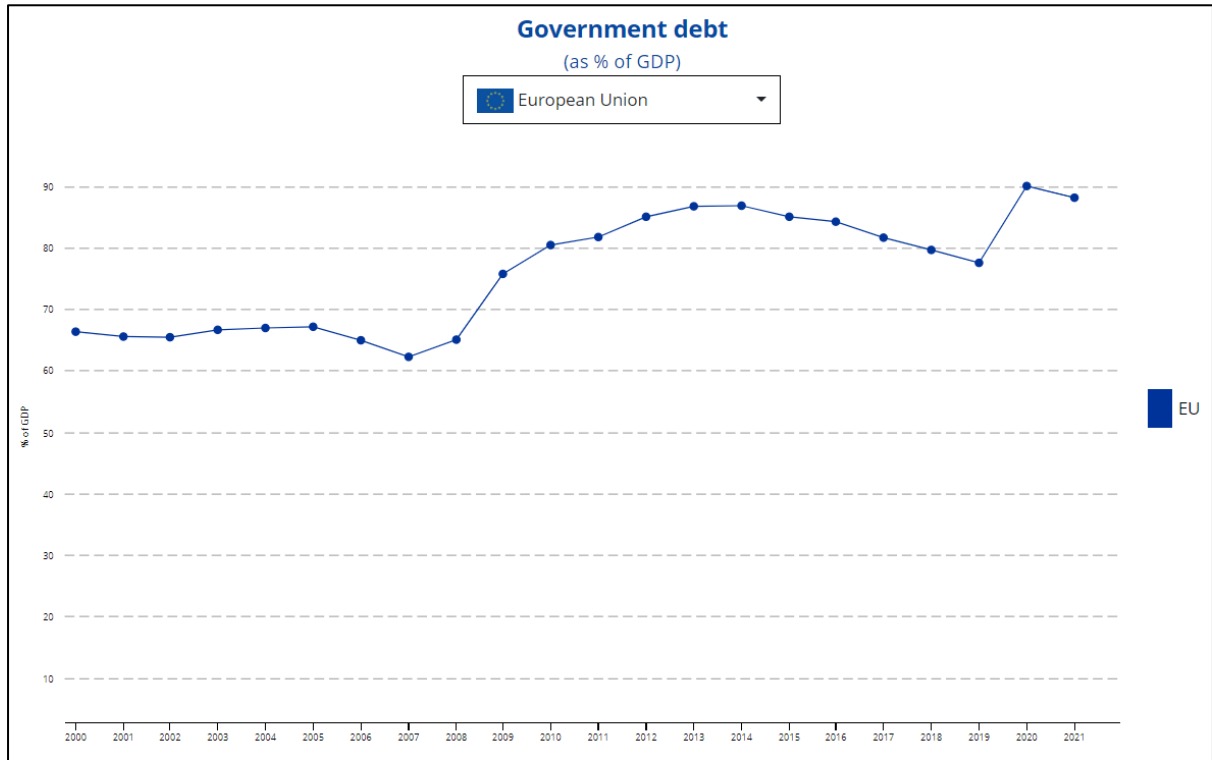


Figure 10: Purchases under the ECB's Asset Purchasing Programme in EUR billion, 2015-2022

It is unsurprising that these headlines have caused memories of the 2009-2012 European debt crisis to resurface. Especially so when the EU's government debt-to-GDP ratio has actually [increased](#) from 65% in 2008 to 88% in 2021. However, it is unlikely that events will play out similarly, as the EU has drawn lessons and experience from the Greek debt crisis and has more actively monitored the situation in an attempt to prevent a repeat.





[Figure 11](#): EU government debt as percentage of GDP, 2000-2021

In sum, rapid inflation will continue to force the EU to reach some difficult decisions which would put its borrowers in an uncomfortable position. Some countries, like Italy, are sure to be more affected than others, but two decades of EU integration guarantee that the shockwaves will be felt by all. The situation demonstrates once again the limitations of monetary policy when not combined with fiscal union. In other words, the inability of EU institutions to regulate the public spending and national budgets of EU states leaves it with very limited options when it comes to setting interest rates. Shifting gears is only so useful without access to the gas pedal.



## 3.2 Europe's Cost-of-Living-Crisis

*James Towndrow*

As Europe confronts the harsh realities of the cost-of-living crisis, total inflation in the eurozone [reached](#) 8.9% in July 2022, more than four times the European Central Bank's 2% target. A third of the EU's twenty-seven member states have now [experienced](#) double digit inflation. Exacerbated by soaring energy prices, food inflation reached historical [highs](#) at 9.8% last month among the seventeen countries sharing the Euro, representing an [all-time high](#) since the single currency was launched in 1999. Price pressures within the eurozone - particularly within the food and energy sectors - have increased significantly since Russia invaded Ukraine. [Energy](#) accounted for more than half of the overall inflation rise in the eurozone to record levels. Spain, Portugal, Greece, Poland, and the Baltics were among those countries exposed to double digit inflation in the year to date.

Europe's problem is widespread and compounding the financial impact of the pandemic, from which most countries were only just beginning to recover. [Inflation](#) is running as high as 10.4% in Belgium and 11.6% in the Netherlands. Meanwhile France's [annual budget deficit](#) increased to 6.5% last year, more than twice the EU's 3% limit. Southern Europe is among the worst hit, where living standards have suffered for some time. In Spain, Italy, Portugal and Greece living standards had taken some time to catch up in the aftermath of the eurozone crisis, only to be [hit](#) again by the pandemic and now the cost-of-living crisis.

Linked to Russia's invasion of Ukraine, rising energy costs have played a major role in the current crisis. Owing partly to their greater reliance on Russia compared to the rest of Europe, the Baltic States have been [badly impacted](#). Inflation is [well above](#) the bloc's average, reaching 21% in Latvia, 20.8% in Lithuania and 22.7% in Estonia, partly reflecting their proximity to Russia.

Whilst the cost-of-living crisis itself is worrying, the wider political impacts throughout Europe pose yet more concerns, not least in terms of the greater appeal being lent to populist movements. Europe's present cost-of-living problem represents one of a number of crises that have exacerbated [national differences](#) and interests within EU countries. This often becomes framed as a battle between the ordinary masses and the privileged elite, in which populism takes on a ['host' ideology](#) through either a left or right wing stance. National self-interest creates political overlaps in the stances of populist politicians, including the need for self-reliant, protectionist economies. The greater appeal of such movements was ultimately reflected in the strong performance of [Jean-Luc Mélenchon](#) in the French parliamentary elections, or [Marine Le Pen's](#) run against Emmanuel Macron in the presidential race.



In spring, both Spain and Italy [witnessed protests](#) over increased fuel and energy prices. Spain's hard-right Vox party is also [gaining support](#), securing a place in regional government in the north-western area of Castilla y Leon, whilst managing to become the third largest party in the national parliament.

Meanwhile Italy faces populist waves of its own. Brothers of Italy, the largest party of the populist right, is enjoying [strong support](#). Italy's inflation rose to its highest level in over two decades, reaching 8.4% in July. On July 21st, ex-ECB chief and head of the national unity government Prime Minister Mario Draghi [resigned](#) after disputes with right-wing coalition partners Five Star Movement and Matteo Salvini's League. [Polls](#) suggest the right wing coalition, with Brothers of Italy at its head, will win a solid majority with 60% of the vote.

The cost of living was a significant issue in the French election and is considered a factor for the lowest turnout in a Presidential race for fifty years. The first round saw [increased support for populist candidates](#), with Le Pen gaining 23% of the vote, whilst Melancon (23%) and Zemmour (7%) also attracted support. Marine Le Pen and her far-right National Rally party also claimed 89 seats in the [French National Assembly](#), and have [drawn success](#) on issues like the cost-of-living crisis, alongside her party's traditional themes such as law and immigration. The party also has a history of sourcing some of its campaign activities with [Russian money](#), whilst Le Pen herself has previously highlighted her relationship with Vladimir Putin.

Poland with its Prime Minister Mateusz Morawiecki and Hungary's Viktor Orban have also presented the EU with problems for some time. Both states are facing infringement procedures for [failing to uphold EU values](#), which include issues relating to rule of law, the judiciary, and [Article 2 violations](#) of the EU treaty. The EU is set to withhold funds from its general budget, whilst €40 billion of Covid recovery funds are also being [withheld](#). Both countries form an important part of the EU's "[eastern flank](#)", making them important to Europe and NATO in presenting a united diplomatic and political front against Moscow.

The cost-of-living crisis and inflation within Europe raise the issue of "[stagflation](#)": the combination of inflation and economic slowdown associated with the 1970s, which governments and central banks find hard to cure. [Populism](#) represents the face of systemic changes within international politics which are putting national interests and the liberal international order at odds with one another. Part of the EU's global attraction includes its [commitment](#) to democracy and the rule of law. Political unity forms a large part of the bloc's ability to act in the realm of foreign policy, which has been fundamental in responding to the war in Ukraine. The EU therefore faces a challenging road ahead, as the cost-of-living crisis provides [political traction](#) for populists, undermining the bloc's capacity to present a united diplomatic and political front amid Putin's war of aggression in Ukraine.



### 3.3 Migration Crisis

*Emma Dondero*

The EU is currently facing a record-breaking influx of refugees stemming from the Ukraine crisis, with [over 5.5 million](#) Ukrainian refugees moving west since February 2022. In stark contrast to previous migration policy, the EU immediately responded with a temporary protection mechanism that enabled the free flow of Ukrainian refugees into EU territory, as well as €17 billion to support member states hosting refugees. This protection mechanism, [which had never before been triggered in EU history](#), affords Ukrainian refugees the right to work in the EU labor market, go to school, and access local housing. On a grassroots level, videos swarmed social media of locals in [Germany, Poland, and Denmark visiting train stations](#) and border towns to welcome refugees into their personal homes as they get temporarily settled in a new country.

These protections are “temporary” and many Ukrainian refugees are staying in neighboring countries with the hope they can soon return. But the reality is that, on average, only 30% of refugees return home 5 years after a crisis in their home country. The protections, allowances, and societal changes will have to continue into the long-term, and member states with a high level of burden will need to adapt to account for resource scarcity and heavy job market competition. The three biggest cities in Poland (Warsaw, Krakow, and Gdansk) [grew](#) in population by 15-34% in the few months following the crisis, indicating a significant need for a sizable adjustment, and Ireland is already experiencing a [“pinch point”](#) when it comes to Ukrainian refugee accommodations. While so far xenophobia or cultural tensions have not been a flashpoint, Poland recorded [44,000 hate crimes](#) against Ukrainians in 2017 alone, demonstrating a history of ethnic tension that could re-surface in the (likely) event of economic difficulties. The case of [Turkey](#) is a good example of such a situation; 72% of Turkish citizens approved of supporting Syrian refugees in 2016, while 80% approved of deportation in the economic downturn that followed. The rise in populist, far-right, anti-migrant rhetoric in the years prior to the pandemic similarly does not help the issue, as far-right politicians still have [pull and influence](#) within the EU. Coincidentally, the three EU governments with far-right politicians in power are also the three neighboring countries of Ukraine that have received the most migrants since February 2022.

This picture does not yet account for non-Ukrainian migration indirectly spurred by the war and non-Ukraine-related migration. Migration had dropped significantly in 2020 and 2021 due to the COVID-19 pandemic and subsequent restrictions, and the EU can expect this number to [rise again](#) in 2022. In the coming months, experts have estimated that at least 150,000 migrants from the Global South are expected to embark on a journey towards Europe, spurred by Ukrainian-war induced food insecurity. Egypt, Tunisia, and Lebanon are [heavily dependent](#) on Ukrainian food staples, with Egypt alone receiving 80% of its grain imports from Ukraine.



As food insecurity looms, available Ukrainian wheat products are locked in a [politicised battle of morals](#) as the EU and the US have threatened struggling countries who may choose to buy large quantities of discounted grain stolen by Russia from Ukraine, in order to head off famine in their own countries (and a more aggravated migration crisis).

Prior to the war, EU policy suggests that non-European migrants coming from the Middle East and Africa were not a priority; according to Eurostat, the EU [hosts](#) only 0.6% of the world's global refugee population. The last few years have seen several member states, including Lithuania, Hungary, and Poland, [publicly call for](#) or begin constructing for border fences. In 2021, the EU gave \$224m to Greece towards the construction of migrant camps in which asylum seekers could be locked if their claims are denied. The union also provides funds to external border countries, like [Libya](#), to patrol, collect, and imprison migrants attempting to cross the Mediterranean in an attempt to avoid violation of international humanitarian law that stipulates no country is allowed to repatriate a migrant if their life is considered to be in danger in their home country. Despite this law, [Greece](#) directly deports migrants back before they reach land.

After the 2021 Belarussian migration crisis, whereby Belarus allowed thousands of mostly Afghan and Iraqi migrants to pass through into the EU, the EU tripled the annual budget to \$226m for border protection in Latvia, Lithuania, and Poland. At the end of 2021, before the Ukraine war, experts predicted the situation growing more tense and the EU ramping up their already strong efforts to prevent migration, with one expert [saying](#): “2022 has more dark notes... It is going into more containment, more fences, more criminalisation of actors providing solidarity, so the reality is even more dark for refugees”.

While the migrant situation with non-European migrants intensifies, there is potential for conflict with Ukrainian, European-born migrants. In contrast to their Ukrainian refugee politics, Poland has continued to prevent non-Ukrainian refugees from entering, and Denmark is likely to follow the UK in [deporting](#) non-Ukrainian asylum seekers from their respective countries. As mentioned previously, the scope of the Ukrainian refugee crisis is immense, and the annual hosting cost this year is [expected to reach](#) \$30 billion. With the impending food security problems, housing shortages, North-South refugee treatment disparity, and sheer numbers of incoming migrants, the EU will have its hands full in coping with both the economic, social, and political costs of the upcoming migrant changes.



### 3.4 Member State Invasion

*Emma Dondero*

In a May meeting on European defence planning, European Union foreign policy chief Josep Borell [cited](#) the EU's "Lisbon Treaty", stating that all EU member states "are obliged to [assist] with all its means" should any member of the bloc undergo an armed attack and request help. While Russia's invasion of Ukraine is highly informed by the nature of their past historical relationship, the question still looms as to whether the war will spread to an EU member state, pulling the entirety of the union into a larger European conflict. Though unlikely, Finland has a shared contentious history with Russia that could put it at risk, and the marked changes in its foreign policy approach to Russia since the start of the war certainly support this line of thinking. To a lesser extent, Poland also is also facing a degree of risk due to its insistence on providing arms to Ukraine from the very beginning of the war, as well as its past history of invasion by the USSR.

In the early 1800s, Finland was [annexed](#) into the Russian Empire, eventually declaring its independence over a century later amidst the chaos of Russia's Bolshevik Revolution. After a period of tense relations, the USSR invaded Finland in 1934, resulting in heavy human casualties on both sides and the ceding of one-tenth of Finland's territory to Russia. Up until the current day, Finland has historically followed a policy of appeasement whereby Finland agreed to act as a [neutral buffer zone](#) between Russia and Western Europe, promising to not join NATO and allowing Russia to exercise its influence broadly within the country. Following Russia's 2014 annexation of Crimea, however, Finland began departing from this policy of "Finlandization" and began building up its military capabilities. Since the concept's inception during the Cold War, Finland's [biggest departure to date](#) took place this May, when Finland and Sweden (who often coordinate security moves) announced that they would formally apply for NATO membership. Russia immediately referred to this move as a "mistake" and warned of "consequences", which so far has taken the shape of [banning exports](#) of gas and electricity to Finland.

While the bulk of Russia's military capabilities are currently occupied in Ukraine, the extent of Russia's reaction depends on how exactly the two countries' NATO membership pans out. Despite earlier proclaiming his intentions to approve any membership bids, President Erdogan of Turkey has voiced [grievances](#) with the two countries that could lead to its rejection of their membership bids. Given that new members need unanimous approval from existing ones, Turkey's rejection would determine the bids' fate (and therefore, head off any potential conflict). If the countries are eventually accepted into NATO, Russia's reaction could then depend on how exactly Finland [integrates itself](#) into Europe's NATO infrastructure. Norway is a good example of a Nordic NATO member, also bordering Russia, that has managed to remain "neutral" between the West and Russia by [refusing](#) to allow any NATO bases, stationing of





nuclear weapons, or deployment of troops in peacetime on its soil. In sum, the extent of a Russian response to Finland's decision to join NATO will remain to be seen until, and if, Finland is accepted into NATO, which usually takes [8 months to a year](#) at the least.

Also in a potential line of fire is Poland, which has had its own history of conflict with Russia and which has been a [vehement supporter](#) of Ukraine and Ukrainian refugees since the start of the war. Poland has reported that they have sent [\\$1.6 billion worth of arms](#) to Ukraine, making them the second largest provider after the United States. In response, a popular presenter on Russian state TV threatened [military action](#) against Poland. While these words are meant for a Russian audience, they add fuel to a fire that has surrounded Poland since the start of the Ukraine crisis. In a pre-war [survey](#) conducted in Finland, France, Germany, Italy, Poland, Romania, and Sweden, Polish citizens consistently proved most willing to support Ukraine in the event of an invasion regardless of the consequences, and were also most convinced the invasion poses the largest existential threat to their country. Since the beginning of the crisis and up to the current day, top Polish politicians (including the [deputy foreign minister](#)) have also expressed [concerns](#) they would be the next victim of Russian aggression. However, Poland has been a NATO member since the 1990s and has a certain level of protection not yet afforded to Finland or Ukraine. Although Poland is currently facing Russian sanctions, it's unclear as to whether there will be any military retaliation as Poland continues to directly support Ukraine with weaponry.

Lastly, while these security risks are dormant for the time being, the reality of the situation in Ukraine as well as the EU's perception of their defense risk has already resulted in efforts to strengthen the EU's (and individual member countries') defense capabilities and readiness. In [March](#), heads of state agreed to set up new deployment units and to take over strategic capabilities that previously had been seen as fit to outsource to the US. [Germany](#) has committed to fulfilling its longstanding NATO requirement of a 2% GDP spend on defence. Denmark has voted similarly to meet the 2% spending threshold, as well as to participate in [EU joint military operations](#) for the first time in 30 years. The European Commission has also voted to allocate [almost €1 billion to the European Defence Fund](#) and €2 billion to funding defence innovation within the EU. While the EU and Russia have so far limited their responses to each other in the form of economic sanctions and diplomatic exchanges, and while outright military conflict between the two parties does not seem likely in the near future, EU heads of state have taken steps in regards to defence that prove they themselves can not yet rule out the possibility of further conflict.



## Section 4: Possible Windfalls

### 4.1 Success in Replacing Russian Energy

*James Towndrow*

#### *Alternatives to Russian oil*

Having reached an [agreement](#) to ban seaborne imports of Russian oil by the end of 2022 – which account for around [two-thirds](#) of imports – the EU is now faced with looking to alternative suppliers. The delay before the ban takes effect gives Europe some time to source short-term alternatives. However, EU refineries consume around 1.23 million barrels of Russian oil a day, accounting for [26% of total supply](#). The EU has [invested](#) €12 billion in pipelines and LNG terminals to improve access to gas and oil from alternative suppliers.

Russia's Urals crude is [bought](#) by refiners across Europe which include Germany, Italy, the Netherlands, Poland, Finland, Lithuania, Greece, Romania, Turkey, and Bulgaria. OPEC has finally [announced](#) that a production increase of 648,000 barrels per day (b/d) will come into effect this summer, bringing forward the increase already planned for September. The increase amounts to around 60% more than originally planned for this summer. Saudi Arabia and the United Arab Emirates are expected to [provide the bulk](#) of this accelerated production increase, as Riyadh has indicated it is now willing to make up for shortfalls in Russian exports.

The search for alternatives to Russian oil has led European refiners to search further afield in the short-term. [West African crude](#), for example, was up 17% compared to the 2018-2021 average in April. An estimated 600,000 b/d arrived in northwest Europe from the region in May, with Nigeria, Angola and Cameroon providing the bulk of this. Meanwhile supply from North Africa to Europe has risen 30% since March. Supply from Egypt's Sidi Kerir port (likely to be Saudi Crude) was estimated to have [doubled](#) in May to 400,000 b/d compared to March.

The United States has also [stepped up exports](#), with crude supply to Europe in May up 15% compared to March. The Biden Administration appears to have offered minor relief of sanctions to Venezuela. Italian company Eni S.p.A and Spain's Repson SA are set to begin shipping Venezuelan oil to Europe; the two companies have joint ventures with Venezuelan state oil company PDVSA and could count the crude cargoes toward unpaid debts. A key condition of the agreement was that the oil had to [go to Europe](#), as the White House hopes to cut Europe's energy dependence on Russia. Although the quantities to be shipped are small, the White House showing signs of softening its stance towards Venezuela could provide a boost to Europe amid its efforts to source alternatives to Russian oil moving forwards.





There is hope that the medium to long term will present Europe with more alternatives as additional supply is [expected](#) to become available from Norway, the UK, and North America. Volumes are also expected from Azerbaijan and Kazakhstan. There is also hope for supply from Africa, although [concerns](#) remain over the long-term viability of this, as internal demand will possibly exceed supply capacity.

From a long-term perspective the United Arab Emirates is exploring upsizing its current expansion programme. This includes the possibility of [expanding](#) its production capacity to six million barrels per day by 2030, one million b/d (or 20%) more than previously planned. There are suggestions this could be completed 2-3 years earlier in what would be a major supply boost to address the current lack of spare global capacity outside Russia. Ultimately, the UAE (1.1mb/d) and Saudi Arabia (2.0 mb/d) [hold](#) most of the world's current spare capacity and are therefore likely to be crucial to Europe's future oil supply.

### *Alternatives to Russian natural gas*

The EU-wide energy saving scheme designed to [cut demand](#) in homes by a total of 18 billion cubed metres (bcm) should facilitate the wider transition from Russian natural gas, accompanied by a 20 bcm cut in demand for the power sector taking the total to 38 bcm. Taking steps to significantly reduce demand would facilitate the EU's efforts to find alternatives. However, it appears the European Commission will move the [EU Green Deal](#) to the forefront of its efforts to end reliance on Russian gas in the medium to long term.

Although currently operating near full capacity, Norway could provide an [increase](#) of around 8 bcm year-on-year if present export rates are maintained, helping to prop-up Europe's internal gas production, which appears likely to [decline](#). Further afield, Algeria's pipeline links to Europe mean it is well placed to step in. In April, a [new agreement](#) was signed with Italy to increase natural gas imports by around 40%. Although Algeria has [only a few](#) bcm of extra supply, the deal provides a relief to Italy, which had been [reliant](#) on Russia for 40% of its natural gas imports.

Poland, Bulgaria, and Slovakia have all had to adopt contingency plans in their efforts to find alternatives to Russia. Poland has managed to [source supply](#) from Norway via the Baltic through links to a 10 bcm pipeline and should benefit from a new LNG terminal to bring additional supply from the US and the Middle East. More gas links are expected to open for Poland [throughout the year](#), including a link with Lithuania supplying up to 2.5 bcm and a link with Slovakia with capacity up to 5-6 bcm. Meanwhile, [Bulgaria](#) has secured its own alternative gas supply from the Trans-Balkan pipeline in Romania. It has also secured LNG supply via the Revithoussa terminal in Greece and a new [inter-connector pipeline](#) via Greece to facilitate gas from Azerbaijan from the summer of 2022. [Slovakia](#) is exploring LNG supplies



from the US, Qatar, Australia, and Egypt, and is taking LNG deliveries from US tankers via the Croatian island of Krk.

As the EU looks further afield, Israel offers hope for greater cooperation after discovering large offshore gas reserves in recent years. Ursula von der Leyen said preparations were underway for two “major” infrastructure projects designed to [increase energy links](#) with the EU. This includes a gas and hydrogen pipeline in the eastern Mediterranean, as well as an underwater power cable linking Israel to Cyprus and Greece.

Almost half (50 bcm) of the EU’s efforts to replace Russian imports is aimed to be achieved through [upscaling reliance](#) on LNG. In the first two months of 2022, LNG imports into the EU were around 10 bcm [higher](#) than 2021 and new facilities are also being proposed in Germany, Italy, Greece, and the Netherlands. As part of the EU’s efforts to ramp up LNG imports, the US, Qatar, Egypt, and Algeria have all [signed deals](#) to export LNG to various parts of Europe.

As Russia provides it with the most natural gas, Germany in particular faces a challenge in sourcing alternatives. Qatar could prove to be a [major provider](#) in the future, as its LNG production is set to increase 60% by the middle of this decade, although there would be significant challenges to overcome as a significant proportion of the supply has been sold on long-term contracts. Meanwhile, West Africa also provides some room for optimism as gas projects look set to be revamped. One of Nigeria’s major LNG exporters – Nigeria LNG – is just 72% mobilised, suggesting room for [future supply](#) capacity.

Overall, Europe’s efforts to replace Russian energy will be [extremely challenging](#). With gas in particular, the European Commission’s seven steps proposed as part of its REPowerEU strategy to cut reliance on Russian gas appears heavily reliant on LNG supply growth being realised and demand falling in Asia, whilst the proposed energy savings within the EU are somewhat reliant on a mild winter. The idea that Europe’s current energy crisis has incentivised long-term investment in green energy provides room for optimism in the future. However, the EU faces a difficult path in the short to medium term as it is faced with the need to sacrifice climate and democratic principles amid its efforts to find alternatives to Russian fossil fuels.



## 4.2 Effects on Energy Supplies of a Mild 2022-2023 Winter

*Antonio Visani*

The Ukraine War brought serious disruption to the EU's energy market. Indeed, the heavy reliance on Russian liquefied (LNG) and non-liquefied natural gas has turned out to be a vulnerability for Europe. While EU countries try to decrease their use of Russian gas, they have to find enough alternative energy supplies to keep the lights on and their houses warm before it gets cold again. A mild 2022-2023 winter could considerably help them succeed in their effort.

Currently, the EU [imports](#) 45% of its natural gas from Russia. If supplies were to be completely cut off, it would have to replace 790 terra-watt hours (TWh) in the next year. This calls for supply-side adjustments from European states. In March, Italy signed an [agreement](#) with Algeria to increase the supply of gas through a pipeline in the Mediterranean Sea. As a result of the agreement, by 2024, the volume of imported gas from Algeria will peak at 9 billion cubic metres a year. At the same time, Germany has strengthened its energy partnership with Qatar, boosting its imports of LNG arriving by ship. Consequently, in April LNG supplies to EU countries surged to a record of 10.6 billion cubic metres. However, completely [supplanting](#) the 155 billion cubic metres of Russian gas will be difficult. Indeed, most of the agreements and new investments aimed at increasing the EU's energy supply will yield appreciable results only after 2024. The reason for this is that, globally, demand for gas [outstrips](#) supply. With world demand expected to reach 436 million tonnes in 2022, a supply of just 410 million tonnes is not enough. While, in the long term, producers will increase their production to meet the spike in demand, in the short term, the EU's goal of diversifying its gas supplies appears arduous. In other words, as Mr Fatih Birol, executive director of the International Energy Agency, [noted](#), the risk of demand-side adjustments -and especially rationing of gas- cannot be excluded.

Nevertheless, this scenario would look less dire in case of a mild winter in Europe. Indeed, this would allow citizens to consume less energy for their heating systems, which would considerably reduce the amount of gas required by EU countries. In particular, warmer temperatures would [decrease](#) demand for gas by 28%. As the figure below shows, there is a [strong correlation](#) between the average daily gas demand and the average daily heating degree days in European countries, taking 15.5 degree Celsius as a baseline temperature. This is because fluctuations in demand are largely driven by temperature differences, as the demand curve for natural gas is highly inelastic, i.e. it is resistant to a rise in prices. The analysis presented here is confirmed by last year's events. According to an analysis published by [Bruegel](#), the fact that, last winter, exceptionally cold temperatures did not materialise -with the average temperature in Germany being 1.6 degrees Celsius higher than in the previous decade- was a major factor in keeping a positive EU gas balance. This year, the importance of moderate



weather conditions will be even higher since gas reserves in storage facilities are running exceptionally low. Indeed, by April 2022, [reserves](#) were only 33% full, 10% less than in preceding years. Normally, they contribute to absorbing demand spikes in case of cold temperatures, thus reducing the need to import additional gas during the winter heating season. However, this year, the rise in demand caused by the lifting of COVID-19 restrictions and the supply disruptions due to the Ukraine War led to a surge in gas prices in the spring and summer of 2022, thus disincentivising states to replenish their reserves in their storage facilities. Moreover, European gas production has [decreased](#) in the last few years, because of the closing of gas fields such as that in Groningen, the Netherlands. Those gas fields were used for “swing production”, i.e., boosting supply during winter to meet higher energy demand. As a result, a warm 2022-2023 winter is likely to be pivotal in preventing the need for the EU to increase its energy imports, at a moment in which countries are struggling to reduce them.



[Figure 12](#): EU temperature VS gas demand, winter months,2021

However, the European Union cannot just sit and hope for moderate weather while its storage reserves deplete. In May, the European Parliament and the Council of the EU adopted a [regulation](#) requiring member states to fill their gas reserves to 80% by November 2022, rising to 90% from December 2023 onward. While this measure is a step forward, it is not a definitive solution. A new [analysis](#) of the Institute of Energy Economics at the University of Cologne found that, even in case of reserves 80% full, Europe would have a 488-TWh energy gap by the end of the 2022-2023 winter, amounting to 17% of the winter demand. To tackle the issue, last March the European Community issued the 300-billion-euro [RePowerEU](#) plan, aimed at reducing Europe’s overdependence on fossil fuels. This includes boosting rooftop solar panels and heat pumps, speeding up the roll-out of renewable projects, decarbonising



the manufacturing sector by switching to electrification and renewable hydrogen and doubling the EU's production of biomethane. Even if shifting to renewable energy is the ultimate, long-term solution, it will hardly offer an answer to European countries' energy needs for next winter. Indeed, the goals of RePowerEU are planned to be achieved only by 2027-2030. As a result, a mild 2022-2023 winter is still the best solution European leaders can hope for.



### 4.3 Quick End to Russia-Ukraine War and Removal of Sanctions

*Valeri Zhu*

Since the beginning of the war in Ukraine in late February, the formulation and implementation of [sanctions](#) against Russia have constituted a critical toolkit for the West to both deter further aggression and add negotiation leverage for future peace settlements. However, it is important to understand that sanctions remain an issue of divergence, if not explicit disagreements, in terms of how different Western states, policymakers, and private-sector entities perceive the limits, side effects, and timeline of sanctions.

The likelihood of a peace settlement, which might either prolong or expedite the ending of the conflict, is an important indicator for the analysis of sanctions. Even in Washington, both policymakers and analysts are divided between essentially [two stances](#). The first, [suggested](#) by commentators like Dr Henry Kissinger, aims to use sanctions to draw Russia to the negotiating table and expedite a diplomatic settlement. Thus, the main goal is to begin diplomatic negotiations immediately, with the possibility for Ukraine to [cede territory](#) to Russia. The opposing view holds that sanctions should punish Russian aggression, rather than be eroded by compromises.

In these two cases, the functionality of sanctions may overlap but their duration and severity will drastically vary. In the former case, Russia could use the lifting of these sanctions as one of its demands, especially for the issues of food and energy supplies, to seek desirable objectives in Ukraine, which the West will have to inevitably consider. However, in the latter case, the sanctions will be more definitively enforced independent from their roles in potential negotiation as a [“price for aggression.”](#)

Consequently, two distinct scenarios will need to be taken into consideration. The first would see sanctions evolve with the diplomatic progress of negotiations and contribute to bringing about a certain form of settlement. Thus, the sanctions might be adjusted or lightened should Russia raise them as a part of its demands. In the second case, the sanctions will be long-lasting and will be more resistant to the effects of potential compromises at the negotiation table. In this scenario, both the [global economy](#) and the Russian economy will have to adapt to the long-term impacts of sanctions, which will continuously [sink in](#) for the foreseeable future.

It is also important to note that the end of the conflict will not be synonymous with the termination of the sanctions. Currently, [the G7](#) has already made clear that its sanctions will cause “significant” long-term damage to Russia’s economy. So far, the measures have included [limiting trade](#), banning transactions with Russia’s central bank, barring access to the international payments system SWIFT, and [cutting off access](#) to currency reserves.



However, the impact on global food and energy supplies is considered a particular challenge that requires differentiation from other sanction-related policies given its urgency and wide implications. While the financial sanctions may be enforced rather swiftly, many countries will be unable to locate alternative suppliers of energy [in the short term](#), and will be forced to remain reliant on Russia for at least a substantial portion of their supplies. Such concerns are reflected in the fact that while EU countries search for new suppliers, [several sectors](#), including gas, remain largely untouched by governments for a fear that such moves will damage their own economies more than Russia's.

The prediction of an impending closure to the conflict is extremely difficult given the stances held by both Ukraine and Russia. The more likely outcome would be what Joseph Nye refers to as a “frozen conflict,” in which both parties fail to achieve meaningful breakthroughs or gain overwhelming leverage for negotiations. In this case, the activeness of warfare will continuously decline and eventually reach a contained state of “strategic equilibrium.” However, such a scenario poses long-term implications and uncertainties that could linger for years to come - a “frozen conflict” provides fewer motivations and immediate leverages for diplomatic negotiations and could serve as the embryo for future conflicts as its dormant state by no means implies the termination of war. The possibility that such a scenario may not only become the outcome, but also become consolidated into a future status quo, should be taken into account.





## Section 5: Implications- Key Opportunities

### 5.1 Lowered Energy Dependence on Russia

*Sharif Fatourehchi and James Towndrow*

#### *Energy policy*

Lowering reliance on Russian fossil fuels removes a significant geopolitical weakness of the EU which has long-since influenced the bloc's overall security strategy. It can provide a major boost to the bloc's internal political security in the long term, whilst offering significant scope for both extending and enhancing its external outreach.

Reducing the role of fossil fuels in Europe's energy mix will dent the Kremlin's ability to exert economic and political pressure on Europe, whilst shielding member states from the [inherent volatility](#) of fossil fuel prices, for which they are now paying the price. Europe also has the opportunity to break up the [informal networks of influence](#) linked to Russia's energy supply that the Kremlin has cultivated throughout Europe. Major refineries in Germany are owned by Rosneft, whilst Lukoil also has a notable presence across Europe, with refineries in Bulgaria, Romania, the Netherlands, and Italy. Lowered dependence on Russia will cut off the Kremlin's economic and political influence throughout Europe.

Russia's war against Ukraine has [exacerbated](#) supply chain bottlenecks stemming back to the pandemic, while increasing energy prices across the EU. Both contribute to the rising cost of living, whilst soaring oil and gas prices [disproportionately](#) affect poorer households. This will only serve to enhance the appeal of populist leaders within Europe. Lowering reliance on Russian energy – and with this Europe's exposure to its associated risks in the future - therefore presents the EU with a major opportunity to enhance internal political security in the long term.

The fallout from the war in Ukraine and the transition away from Russian energy leaves Europe with the opportunity to reconsider both its energy policy and how it manages strategic relationships. The EU Energy Platform aims to [pool](#) demand for purchasing gas, LNG, and hydrogen, ultimately helping to boost purchasing power and the EU's external outreach. An EU energy policy based on [regional integration](#) among member states would leave the bloc better placed to manage external relations when negotiating supply, whilst making the EU a more attractive market to potential suppliers and increasing its leverage in negotiations. It would also become much more difficult for suppliers to [exploit internal divisions](#) in the same way that Russia has, thus boosting the bloc's internal political stability.





As the EU turns away from Russian energy, this could prove particularly relevant as Brussels seeks to renew or elevate existing strategic partnerships, particularly when it comes to the Middle East and, more specifically, OPEC. The recent decision to [accelerate](#) production increases underlines the importance of managing relationships with suppliers, particularly as the Middle East looks set to take on even greater importance. The EU's ability to foster relations with Middle Eastern states, whilst better coordinating internal policy and making itself a more attractive market, could prove useful during the transition to more sustainable energy, where the Middle East can become a major player. Low-carbon hydrogen, for example, could provide the [opportunity](#) for a mutually beneficial relationship. Facilitating this with better internal coordination will ultimately help the bloc to maintain a more stable energy policy as Russian fossil fuels are phased out.

### ***Opportunities for Europe's green ambitions***

The aim of phasing out of Russian fossil fuels presents both obstacles and opportunities vis-à-vis green energy transition as well. Some of the [short-term measures](#) taken by countries such as Germany, Austria, and the Netherlands are steps in the wrong direction when considering the EU's larger climate goals. The ministries of the respective countries have announced the easing of restrictions on [coal-powered plants](#) to alleviate the pressure on current energy markets. The blacksliding towards more fossil fuels could have great implications for current emissions and the trajectory of the EU's transition. A similar issue can be seen with Italian energy giants, Eni, [investing](#) in further gas exploration in Algeria through a partnership with Algeria's Sonatrach. Further investment in gas field exploration and infrastructure, similar to the aforementioned, may threaten the EU's transition towards clean energy. It is largely a matter of prioritising short-term relief over long-term ambitions.

However, it is important to note that the transition to renewable energy in itself is taken by the EU as an opportunity to phase out Russian fossil fuels. The key to long-term, sustainable energy independence are renewables; the EU aims to utilise that and accelerate the transition through measures detailed out in the proposed [REPowerEU](#) package. Facilitated by €210 billion of funding until 2027, the plan rests on 3 main pillars, one of them being a boost in green energy. The [EU's Solar Strategy](#) and a [Biomethane Action Plan](#) are two examples of proposed measures to accelerate the transition. Alongside Brussels's proposed plans, European companies, such as Germany's TES, are aiming towards greater facilitation of renewables as well. For example, TES is working towards building a [clean energy hub](#) and establishing it as the hub for international hydrogen trading.

Although short-term policies may obstruct EU economies from moving to clean energy, the long-term key to independence from Russian energy still lies in renewables. There may be investments in non-renewable or carbon-based energy sources that would have been redundant



had Russia not invaded Ukraine, though the transition away from fossil fuels has now been given another time-sensitive motivating factor apart from climate change: energy independence.



## 5.2 Enhanced Security and Foreign Policy

*James Towndrow*

The present crisis highlights the need for Europe to adopt a more authoritative and unified stance towards its security and foreign policy, which has for years been hindered by the need for stable relations with Moscow. Now, a [containment-like approach](#) has been suggested within Europe's eastern neighbourhood, as Russia's invasion of Ukraine has provided added impetus for supporting democracy in those countries threatened by Russian revanchism.

The EU has shown itself capable in [aspects of crisis management](#) as it attempts to coordinate the transition away from Russian energy. However, the current situation demonstrates the [blurring of border lines](#) with regard to internal and external policy, and that Europe's energy is intrinsically linked to both foreign and security policy. The [EU Strategic Compass](#) advocates a stronger and more capable EU being beneficial to both global and transatlantic security, whilst becoming more complimentary to NATO. Cutting energy links to Russia therefore presents the EU with the chance to conduct a fundamental review of its inner structures, with a view to enhancing policy coordination to the benefit of member states, leaving the bloc better placed to deal with future challenges and more fit for a [world in which geopolitics hold](#) increasingly greater sway.

The seismic shift within Berlin as it confronts the geopolitical costs associated with energy dependence on Moscow is set to provide Europe with a major opportunity to reinvigorate its security policy. [Long-held stances](#) within German politics are being dropped: the Social Democrats have abandoned their Ostpolitik position, the Greens their opposition to defence spending, and the liberal Free Democratic Party its opposition to public debt. Until recently, Russia's apparent reliability as an energy supplier diverted attention in Berlin from its less than reliable role as an international security actor.

The current energy crisis has [demonstrated](#) in clear view the inherent risks associated with reliance on one particular (unreliable) state. As Germany, like others within the EU, tilts away from Russian energy, it will be [less exposed](#) to the instability and unreliability which has long-since been overlooked in the relationship with Russia. The geopolitical tools at the Kremlin's disposal - which include the [weaponisation of gas flows](#) to parts of Europe - will become less formidable. With the scrapping of Nord Stream II, a key pillar of Germany's relationship with Russia was dismantled also. Berlin is now presented with the [opportunity](#) to become a more reliable and productive partner, to the benefit of its EU neighbours.

Germany's move to diversify will now provide more options to both Berlin and the EU in terms of strategic autonomy. More [attention](#) may now be given to the concerns and



protecting the independence of Eastern European neighbours located between Germany and Russia. Offering candidate status to both Ukraine and Moldova is a step in the right direction. Candidate status (and with it the prospect of membership) provides a [major incentive](#) for structural and institutional change, at a time when the EU can capitalise on its appeal as an advocate of democratic principles, freedoms, and most importantly on being a better partner than Russia in Europe.

The EU has started to take action in this regard, through the establishment of a [rapid reaction force](#) of up to 5,000 troops to be deployed during a crisis. Germany appears willing to provide the core of the EU's new rapid reaction force, due to become operational by 2025 and replacing the existing EU battlegroups. The plans emphasise not only the fundamental shift occurring within German foreign policy, after Chancellor Olaf Scholz [promised](#) to invest €100 billion in the country's depleted armed forces, but also a wider recognition of the EU's importance as a defence and security actor.

Germany undoubtedly has a major role to play as the EU seeks to transform its security strategy. NATO has [increased](#) its forces on high alert more than seven-fold to 300,000. Germany's €100 billion investment is an [initial step](#) and it will be some time before the full benefits are felt within Europe. The United States – among others – has been calling on Germany to make a greater commitment to NATO for some time. Although Scholz has been criticised since its announcement, Germany's [Zeitenwende](#) - if enacted - could prove hugely beneficial to European security, after Russia's invasion of Ukraine has shattered many of the illusions associated with the post-Cold War era.

One of the key issues associated with Germany's historic energy policy was not being entirely ['trusted'](#) by central Europeans; Poland and the Baltic states were among the most vocal critics, along with the United States. As it breaks free from the policy constraints associated with relying on Russia's fossil fuels, Germany – and therefore the EU – can develop new policies designed to [deter outside](#) aggression, as opposed to retroactively punishing it.



### 5.3 Increased Confidence in the EU

*Jonathan Topaz*

Though the dangers are many, there are also benefits to be reaped from successfully navigating this upcoming macroeconomic crisis. Most fundamentally, this would strengthen confidence in the bloc by its constituent states and their respective electorates. Not only has the EU survived crises before, but it has also usually emerged stronger on the other side.

During the EU debt crisis of 2009-2012, then-ECB President Mario Draghi's [resolve](#) to do “whatever it takes” to save the euro, combined with Germany's albeit reluctant agreement to bear the weight of Greece's bailouts, demonstrated a resilience and determination for self-preservation that the EU's detractors thought it lacked.

In the mid-2010s, the EU survived various ‘exit’ fears, by Greece, the Netherlands, Italy, and France, largely unscathed, as eurosceptic populist politicians such as Geert Wilders and Marine Le Pen failed to gain power in national elections. Brexit, the only successful withdrawal from the EU to date, has in many ways increased the bloc's cohesion and *raison d'être*. EU states witnessed the resulting recurrent public crises in post-Brexit United Kingdom, as motorists [queued](#) for hours amid supply chain problems and panic buying in September 2021, or when EU authorities [decided](#) to limit exports of the Belgian-produced Covid-19 AstraZeneca vaccine, against the protest of the UK government. This, combined with a strong desire by remaining EU countries to revindicate the bloc and prove Brexit was a wrong move, has gone some way in revitalising the bloc and its popularity.

Finally, though the EU's initial response to the pandemic was muddled as each country scrambled to secure PPE and tests, its vaccination programme largely succeeded in achieving equity among members and preserving freedom of movement through a universal, standardised [EU Digital Covid Certificate](#).

In this context, the energy inflation crisis is another obstacle the EU will have to overcome, whatever the damage caused, or lessons learned.



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