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Friedman Institute Issue Brief:

UNFERTILE GROUND: FERTILISER SANCTIONS UNDERMINE EU AGRICULTURE

Key Points

- The Milton Friedman Institute strongly opposes new European sanctions on imports of Russian fertilizers. The measures represent harmful state interventionism that will distort markets.

- The new sanctions on fertilisers will be introduced as additional measures on natural gas and ammonia – two key ingredients in fertilizer production – are being considered, risking a re-run of the fertilizer price spike of 2022.

- Most importantly, they will penalize European farmers, consumers and businesses, risking economic self-harm without effectively resolving the conflict in Ukraine.

- There are protectionist forces that are seeking a stronger sanctions policy, but it is not clear that these forces are interested in the welfare of the EU's farmers or citizens.

- Open trade has brought more than 50 years of prosperity to the world. At this time of trade uncertainty, the world needs more free trade, not less.

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Introduction

In a January letter to Kaja Kallas, the EU's High Representative for Foreign Affairs and Security Policy, the governments of Finland and Sweden proposed a "complete ban on the import of Russian fertilizers into the EU" as part of the EU's 20th Russian sanctions package. These sanctions could be enacted as soon as February.

Russia is a major supplier of fertilizers to markets across the globe. Europe relies on Russia for over a quarter of all its fertilizer imports. These figures are similar in Africa (20%) and the United States (18%).

The impact of these sanctions will be severe, if enacted. Prices for fertiliser will rise. Farmers will reduce output and lose profitability and global competitiveness. European consumers will face more inflation and greater imports of food.

Moreover, it will be the larger agricultural states – principally France and Italy – that will feel greater pain.

In combination with additional, new sanctions on energy (natural gas) and ammonia imports, the moves are likely to dramatically increase the cost of fertilizer and food.

New Restrictions Mean Immediate Price Rises

New restrictions on Russian fertilizers will have a deep negative effect on the European economy. Fertilizers account for a significant share of expenses for Europe's farmers. A tightened supply from the world's leading supplier would mean higher prices for consumers, lower profits for farmers and a threat to entire sectors such as food production.

In 2022, the EU initially targeted potash (potassium fertilizer) and certain Russian individuals, as well as restricting transit of Russian fertilizers through EU territory. This immediately strained global fertilizer supply.

Fertilizer sanctions would likely increase Europe's short-run cost of fertilizer by up to 80%. Like other protectionist measures, such as tariffs, a complete ban would rapidly change the entire market.

When sanctions were first introduced, fertilizer prices spiked sharply. In three months the benchmark price for potash (muriate of potash, MOP) jumped 53%.

Additional Threats on Gas and Ammonia

The EU's 20th Sanctions Package also proposes a further curtailing of Russian energy imports (through the banning of the use of seaborne transport services) and caps or quotas on imports of ammonia.

In combination, these will have a significant impact on the production of nitrogen-based fertilisers in Europe. Natural gas is an essential input for the creation of ammonia, itself the key component of nitrogen fertilisers.

Curtailing these key ingredients in tandem will drive the cost of fertilisers up. Over the past 12 months ammonia prices have spiked sharply, and recent gas price rises are placing further upward pressure on prices.

Impacts on European Farmers Will Be Severe

Farmers are not equipped to absorb these price shocks.

Fertilizer generally make up around 6% of farmers' costs. Sanctions nearly tripled fertilizer prices, which added an additional 12% to farm production costs. A large portion of this cost increase was ultimately passed down the chain.

The effects were so significant that the EU adjusted its approach by the end of 2022. It allowed EU member states to facilitate shipments and unfreezing Russian assets. This partially eased the sanctions.

Currently, the average French farmer planting non-durum wheat to harvest spends close to 14% of their budget on fertilizers. This is 1% above the share of fertilizers in input costs for 2025. Commentators estimate that an additional 0.5% price rise will push production beyond the break even point.

Price Inflation Will Immediately Harm Consumers

When agricultural production costs increase, the impact tends to spread across the entire supply chain. Grains, vegetables, and processed foods become more expensive as higher input costs are passed on, while meat and dairy prices may rise indirectly due to higher feed costs.

The IMF estimates a 10% rise in fertilizer prices yields about a 7% increase in cereal prices in the following quarter.

Fertilizer prices are already 20% higher than in 2024 as a result of global conflict and trade restrictions. Additional fertilizer sanctions will translate into price increases spreading along the value chain—from cereals to dairy products—hitting families and consumers. Cereal prices could increase by as much as 13% and headline inflation could increase by roughly 1.5%.

In 2022, bread inflation in the EU surged to 18% year-on-year by August, far outpacing general CPI inflation. Bread prices, which had been rising in line with CPI at 3% annually, have recently spiked due to skyrocketing grain costs and input prices.

EU Will Lose Agricultural Competitiveness

One of the largest risks to European farming is loss of competitiveness from poor fertilizer availability.

Higher prices mean farmers will reduce fertilizer use; cutbacks risk lowering crop yields and quality in the short run, as less nutrient availability can constrain plant growth. EU officials have warned that fertilizer shortages and reduced application "can have short-term effects on yield", potentially meaning less agricultural output and "lower agricultural yields mean less food."

This will be compounded by the major trade agreements that the EU has just concluded, including those with Indonesia, Mercosur and India. Brussels is negotiating further agreements with Thailand and the Philippines. Both Mercosur and Thailand are incredibly efficient export-oriented producers.

Additional policies being introduced and implemented by Brussels, particularly as part of the Green Deal, which are further eroding competitiveness.

Lack of competitiveness manifests itself as higher production costs per unit of output for EU farmers. By late 2022, EU prices for certain products far outpaced world prices.

EU white sugar prices spiked 50% above prior-year levels due to costlier beet cultivation and processing, far more than global sugar price rises. This led to a 34% jump in sugar imports and a 31% plunge in EU sugar exports. The result here is a potential loss of exports – and therefore export revenue – combined with greater levels of food importation.

In addition, the combination of LNG-ammonia sanctions poses another risk. In 2022, the spike in gas prices resulted in drastic losses for ammonia manufacturers, resulting in the loss of ammonia production capacity across Europe. This placed additional upward pressure on the price of nitrogen-based fertilisers. The risk here is that this will be repeated. Although gas prices have been low in recent months, there is no guarantee this will remain the case.

The Sanctions Will Have Limited Geopolitical Effectiveness

There is little empirical evidence that protectionist trade measures deliver successful geopolitical results. Protectionist policies are successful at limiting the free market and disrupting natural market mechanisms, but they are far less effective at delivering wartime outcomes.

The more wide-ranging a trade embargo is, the greater the time and cost of any adjustments in the country *imposing* the sanctions. Importers will need to: seek replacement supplies; bear the higher cost of commodities; reconfigure supply routes and infrastructure.

Achieving the balance between inflicting economic damage on the sanctions target without imposing significant economic harm on one's own economy appears to be art rather than science. Here are three examples:

- Trade sanctions were first imposed against the government of South Africa in the late 1970s. However, their initial impact was limited in that South Africa was a significant producer of energy commodities (i.e. coal) as well as gold. It has been argued that the goods sanctions had limited impact, but that divestment played a more significant role.
- Severe sanctions were imposed against Iraq following its occupation of Kuwait in 1990s. There was significant damage to the Iraq economy; however, this prompted an effective 'doubling down' on the political position taken by Iraq, culminating in a full-scale military invasion of Iraq by allied forces. This would indicate that although sanctions may succeed in terms of their economic outcomes, they may not ultimately achieve the desired political outcome.

- Sanctions were undertaken against Iran for its continued development of nuclear capabilities by the European Union and the United States. The sanctions had two components. First, an embargo on Iranian oil; second, expulsion of Iran from the SWIFT (Society for Worldwide Interbank Financial Telecommunication) and from using its services. This made financial transactions and bilateral trade particularly difficult for all Iranian entities and their trading partners. Observers noted from this particular example that the impact of sanctions has a limited time window. The sanctions will have significant impact in the first two years of implementation, but economies and economic actors eventually adjust to new conditions and can shift a polity further away from a desired political goal, by encouraging nationalistic and 'strongman' behaviour.

Italy and France Will Feel Great Pain

The proposal for the sanctions has come from Northern European members Sweden and Finland. With smaller agricultural sectors, Northern European countries are less exposed to agricultural input costs and are unlikely to experience the same consequences as agriculture-dependent European counterparts and developing countries. In other words, Sweden and Finland will not feel the same economic pain. The Commission's Sweden CAP Strategic Plan summary states that the primary sector accounts for less than 1% of Sweden's total GDP. For Finland, the Commission puts agriculture, forestry and fishing at 2.8% of total GDP. The countries have agriculture employment shares of 1.3% (Sweden) and 3.2% (Finland). Agricultural employment in Italy and France is closer to 3.6%. Already, Italy and France have objected to the price rises on imported fertilisers being imposed via the Carbon Border Adjustment Mechanism. To press ahead is therefore likely to undermine a unanimous position on the response to the conflict – which is precisely what Moscow wants.

A Protectionist Play from Norway

Further, it has become apparent that there are forces outside the EU that are seeking to capitalize on Russian sanctions – despite their cost to EU economies.

Norway is home to Yara International, one of the largest fertilizer companies in the world that competes directly with Russian fertilizer companies globally. The Norwegian Government is a significant shareholder in Yara, with a shareholding of greater than 40%.

The company's CEO has been forthright in arguing that the EU has not taken enough action against Russian fertilizer manufacturers, and directly lobbied for the imposition of greater sanctions.

The company has also stated that it would withdraw European investments if fertilisers are not included as part of the European CBAM, which would effectively mean that the EU market for fertilizer would remain more open.

The question here is whether companies such as Yara have the interests of European farmers and the broader EU economy at heart. Or are they simply seeking for profit from Russian sanctions?

Conclusion

From our perspective these sanctions interfere with free trade and ignore real consequences. At a time of trade uncertainty, the world needs more open trade, not less. Immediately, however, the concern of European policymakers is that these interventions will result in a clear rerun of 2022, during which Europe lost production capacity.

Instead of pursuing protectionist policies that punish the European economy, the EU should actively engage in the peace process launched by the United States promoting diplomacy and multilateral negotiations for a peaceful resolution of the conflict. This can indeed be done without undermining the priority protection of its own citizens and food security, nor by sacrificing economic freedom. This is the position that the European center-right should be adopting.

Only by avoiding the historic failures of state interventionism and the useless sanctions already tested in the past can we safeguard the free market and competitiveness, contain inflation, and support the growth of the eurozone.