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Sustaining Trade Under Cloudy Prospects

Ukraine War Impact: Changing the Economic Order

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SYNOPSIS

Russia's invasion of Ukraine has been generating adverse economic shocks on a massive scale, hampering global economic growth and recovery after the pandemic. Rising prices in food and energy and disruptions in the global supply chain triggered by the war will have a severe and long-lasting impact on the global economy.

COMMENTARY

THE GLOBAL economy is undergoing shocks once again. After two years of fighting the pandemic, many countries have begun to ease or lift COVID-19 restrictions with the hope of stimulating the economy and normalising global supply chains. However, Russia's ongoing invasion of Ukraine in late February has brought significant levels of uncertainty and anxiety to the global market. The impact of the shocks from the Russia-Ukraine War has been confirmed by several international organisations.

The World Trade Organisation (WTO) has downgraded its trade forecast from 4.7% to 3% this year and 3.4% in the following year, warning about the risk of reducing supplies and higher prices of essential goods (e.g., food, energy, fertiliser). The Organisation for Economic Cooperation and Development (OECD) most recently reported that the war would reduce global economic growth by more than one percentage point but increase global inflation at least by more than 2.5 percentage points. The United Nations called the ongoing war in Ukraine "an immediate humanitarian crisis," warning about worldwide economic damage from the war.

Economic Consequences of the Ukraine War

Russia and Ukraine account for less than 3% and 2% of the global economy, respectively. Their competitive advantages in certain critical sectors, however, have made the two countries leading suppliers of raw materials in the global supply chain. As “the breadbasket of Europe or the World,” Russia and Ukraine are among the top five exporters of important grains and represent 12% of total calories traded globally.

The two countries together supply 34% of wheat and 27% of barley, and Ukraine alone makes up half of the sunflower production in the global market. In the energy market, Russia accounts for 30% of oil imports and 40% of natural gas consumption of the European Union (EU) member countries while supplying 11% of the global oil and 19% of natural gas.

Many parts of the world are already feeling negative economic shocks from the war in Ukraine in the form of shortages and price hikes across various sectors. Earlier this month, the UN’s Food and Agriculture Organisation (FAO) announced that its price index for global food commodities rose to a record high of 159.3 points in two decades.

This is due to the loss of major exports from the two countries, such as staple grains and vegetable oils. The intensification of the war and a slim chance of reaching a peace deal have driven up oil and gas prices that were already under upward pressure from the post-pandemic rebound.

Rising prices of food commodities are expected to hit hard poorer countries, imposing a threat to global food security. Shortage of raw materials and rise in energy prices are again disrupting the global supply chain and putting a damper on economic recovery from the pandemic-spiked recession. The war in Ukraine also sparked concerns over the global semiconductor shortage due to high demands and supply chain disruptions during the pandemic.

A critical gas by which the specialised lasers carve silicon into chips reached a low level, as just two companies in Ukraine produce about 45-54% of the global total neon output. The chip shortages are expected to cause production cuts in the auto, computer, smartphone, and electronic industries.

Unified Sanctions but with Limitations

The United States and Western powers began to hit Moscow with several batches of sanctions that aimed to disconnect Russia from Western markets almost completely.

The wide-ranging actions include: cutting Russian banks from SWIFT, the international payment platform; freezing assets of Russian banks, oligarchs, political elites, and their families; banning transactions with Russia’s state-owned enterprises and banks and investment in Russia; and export restrictions and controls. The scope of sanctions has been continuously expanded by the US and G7 countries over Russia’s alleged war crimes and execution of civilians in Ukraine, especially in Bucha.

There is no doubt that full-blown sanctions would significantly damage Russia’s economy and make Russia fall behind in its competition with the West, as current sanctions on Russia come from at least 37 countries that account for 55% of the world’s Gross Domestic Product (GDP).

Nevertheless, researchers suggest that economic sanctions, although causing severe hardships to Russian citizens, will neither stop Russia's aggressive behaviours nor destabilise Putin's regime. Economic sanctions are deemed ineffective in changing the military behaviours of targeted countries, especially when they are imposed on personal autocracies that rely substantially on petroleum exports.

The fluctuation of the Russian ruble over the past weeks indicate the complicated dynamics of Western sanctions. The ruble plummeted to a record low right after the issue of Western sanctions that aim to put pressure on the Russian government with currency drops and economic instability.

In early April, however, the ruble has almost bounced back to the pre-war level. This is not only because the Russian central bank imposed a set of artificial measures but also because Russia's economy still benefits from rising prices of oil and gas and stable trade relations, specifically with China and India. Several EU countries, such as Germany, Italy, and Austria, rely heavily on Russian natural gas, despite Putin's recent proposal that unfriendly countries should make gas payments in rubles.

Geopolitics and the Global Economy

The progress of the war in Ukraine and its impact on global and regional economies reflect the changing landscape of the international economic order. While the tension between Russia and Western allies has been escalating, Finland and Sweden are leaning towards joining the North Atlantic Treaty Organisation (NATO) amid Putin's threat of retaliation.

On the other hand, China has been sending out pro-Russia signals with official neutrality despite the US's warning that China will face "secondary sanctions" if Beijing supports Russia in the war.

In this time of uncertainty, it will be critically important to reaffirm commitment to multilateralism and enhance government capacity to cushion external shocks. The Ukraine war could eventually divide the world politically and economically, creating trade blocs based on geopolitical forces.

However, as the WTO Director-General Ngozi Okonjo-Iweala has recently said, such rival blocs excluding poorer countries will not lead to prosperity or peace. The apparent decoupling between Eastern and Western blocs would cause a reduction in global welfare and substantial losses to low-income countries that gain significantly from trade, primarily via knowledge and technology spillovers.

Here, the WTO's role in sustaining the multilateral trading system cannot be emphasised enough. It is the WTO's multilateral enforcement that has developing countries build capacity for growth and development without being subject to power disparity.

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