

SOME ECONOMIC CONSEQUENCES OF THE WAR IN UKRAINE

By Jack Rammus

Major existing and planned natural gas pipelines supplying Russian gas to Europe. Photograph Source: Samuel Bailey (sam.bailus@gmail.com) – [CC BY 3.0](#)

It may be premature somewhat to consider economic consequences of the Ukraine war with the Russian invasion still less than a week old. However, certain outlines of where things are going are nonetheless possible. With that caveat, the following represent some early considerations of the likely—in some cases already occurring—economic consequences of the war for Russia, European Union, and the USA.

Economic Consequences for Russia

The immediate effect on the Russian economy in the initial days was a sharp fall in its stock and financial asset markets. Investors began cashing out and running for the sidelines to wait out subsequent developments. But not too much should be made of that. Financial asset price deflation is just paper value and doesn't impact the Russian consumer or its general economy all that much.

A large collapse of financial markets is typically accompanied by a fall in the value of a country's currency and Russia's Ruble was no exception. It too fell. A currency collapse means a country must pay more for imports of goods. However, existing import contracts don't change in price. Thus there's a delay for new contracts to reflect a price hike only when the prior contracts have ended. So there's a delay in the inflation effect caused by a fall in the country's currency. That may not stop retailers from raising prices, however, in the interim in anticipation of the rise in import costs due to Russia's currency fall. In short, some inflation is an immediate effect with more coming later.

To offset the inflation effect, Russia could impose some price controls to limit the impact on consumers in essential consumer goods. Similarly, the central bank can take steps to put a floor under the collapse of the currency. A government can even step in and purchase certain strategic stocks to mitigate a stock market contraction if it wants. Japan has been buying stocks for years to prop up its financial markets. It appears Russia's central bank has taken steps to stabilize the Ruble. No actions as yet have occurred to control prices or prop up the stock markets, however.

More medium and longer term is what are the effects of increased sanctions by the USA and NATO EU countries on Russia's economy?

Sanctions on Russian Goods Flows (Exports & Imports)

There are sanctions on goods and services flows, sanctions on individuals, and sanctions targeting banking and money capital investment flows, and on international payments.

Traditionally US sanctions have focused on cutting off goods (products) flows into and from Russia. That is, imports from the rest of the world economy into Russia (inflow) as well as exports from Russia (outflows) from Russia to the rest of the world economy.

A reduction of imports into Russia would result in a reduced supply of the particular product in Russia and therefore a rise in its price—i.e. more inflation. A reduction of exports from Russia can mean a fall in production in Russia and therefore layoffs in those industries affected. The negative impact on production and employment, however, occurs only with a significant time lag. The impact on imports depends on how much of an inventory the country, Russia, has accumulated prior to the sanction. So sanctions impact on goods flows typically take weeks and months, as does in turn any consequent effect on either inflation and unemployment. In the meantime there are numerous ‘work arounds’ Russia could implement in order to ensure the flow of key goods via alternative channels of trade. Russia could continue to purchase or sell through a third country, most notably China perhaps.

In the longer run a reduction of Russian exports due to sanctions over time results in Russia earning less in foreign currencies (especially dollars). Cutting off Russian oil and gas sales would deny Russia its major source of earning foreign currency which is needed for trade for other goods and services. Cutting Russia off from obtaining dollars from oil-gas sales would be especially significant, since 85% of all global oil transactions are done in the global trading and reserve currency—i.e. the US dollar!

That cut off would seriously disrupt global oil supplies as well as crude oil prices. Russia is the second largest producer of oil in the world, generating more than 10 million barrels per day. (The USA is the first due to its fracking technology, producing 11m per day normally). Cutting off Russian oil sales reduces the global supply of crude by around 15%. A 15% reduction of supply results in massive roiling of oil markets and likely historic increases in the price of oil. Gasoline prices at the pump in the US could rise a \$1 a gallon or more. While the US is the largest producer of oil, it also purchases oil from other countries—notably Canada, Mexico, and even some from Russia. Why is that, if it’s the largest producer? Because US oil companies export a lot of refined US oil products to the rest of the world while it also imports crude. It is unknown what the impact of a 15% reduction in global oil supplies would have on US oil prices or oil prices globally. Major market restructuring and shifts would have to occur. It may not go smoothly. Disruptions could be chaotic. That is why the US and EU have been reluctant to target Russian oil and gas deliveries to Europe. This brings up two areas also potentially affected by sanctions on Russia: the effect of the suspension of the Russia-German Nordstream 2 gas pipeline and the possible consequences of the US/NATO/EU decision to deny Russia access to the SWIFT international payments system. Let’s examine the possible effects of both, on Russia as well as rest of the world.

Nordstream 2 Natural Gas Pipeline

Much is made in the media about the Russia-Germany Nordstream 2 natural gas pipeline. To listen to US media, Biden has permanently shut off its gas flow. But how can one shut down what has not even been opened up yet? There is no gas

flow via Nord2 yet. Moreover, Germany's chancellor, Olaf Sholtz, has merely indicated Nord2 won't be opened soon. It has been suspended. Not shut down. Meanwhile, Germany depends on more than 50% of its natural gas from Russia. That is not going to change soon, since it gets that 50% from 7 pipelines that flow through Ukraine to southeast Europe and from there to Germany. Additional gas pipelines flow from Russia through Turkey into Europe. There is no talk by the USA or Europe about shutting down those pipelines. So Russia will continue to earn significant foreign currency from gas sales to Europe. In fact, it may earn even more gas revenue since gas prices are spiking and the volume sold will be at a higher price.

Sanctions are thus irrelevant so far as Nord2 is concerned, since they don't exist. There's only the 'shutdown' of the gas pipeline, Nord2, that doesn't yet even provide gas.

A lot is said about the USA and other countries (Qatar, Azerbaijan, etc.) providing Germany and Europe natural gas in lieu of Nord2. But that's irrelevant in the short run. Germany lacks port facilities to accept US liquid natural gas (LNGs). And it will take five years to build those facilities. In addition, it will take Qatar and other sources two years just to expand its production facilities in order to generate the extra gas to sell to Germany.

It should be noted as well that all of the current inflow of Russian natural gas to Europe comes from the existing seven gas pipelines flowing through Ukraine into East Europe and from there to Germany and the west. Several more pipelines flow through Turkey to Europe. It's unclear if US sanctions are intended to cut this gas flow as well. Reportedly all of Europe gets 40% of its gas from these pipelines currently. To cut that off means a likely collapse of EU industries.

The US has been trying for years to get Europe to buy US natural gas in lieu of Russian. US gas is multiple times more expensive due to transport costs and the need to convert it into liquid form (LNG) and then back again to gas form when offloaded again at European ports. When the US introduced widespread fracking under Obama it raised the production of US natural gas (and oil) significantly. Exporting that oil and gas serves to prevent a supply glut in the USA that would reduce prices in the US. So getting Europe to buy US gas raises US energy corporations' profits: it achieves more sales revenue from Europe and it gets to keep prices high in the US as well. It's been difficult to convince the Germans up to now to buy much more expensive US gas. The war in Ukraine is the answer to this US dilemma. It may now get Europe to shift to US gas even though the cost is so much higher. (Some estimate five times as high).

SWIFT International Payments System

The international payments system refers to how countries and their businesses selling of goods and services are paid for. The payments for purchases and sales—i.e. the money flow—occurs through the network of connected global banks, of which the US banks are the biggest players since most of the payments are in the global trading currency, the US dollar.

SWIFT is the means by which the US banks and government can 'look into' global inter-bank transactions to identify which country or business might be

violating US official sanctions. US big banks are at the center of SWIFT and can determine the violators on behalf of the US government. But SWIFT is headquartered in Belgium and the US would have to get the EU on board to deny Russian banks access to SWIFT to sell its oil or any export. Initially the EU—and especially Germany and Italy, was not at all amenable to doing that. So SWIFT has been initially exempted from Biden's US announcement of recent sanctions. On the other hand, political forces in the US and especially in Ukraine and East Europe NATO began immediately to push hard to implement SWIFT sanctions on Russia. Biden and the US have been pushing hard to get the rest of the EU/NATO countries (especially Italy and Germany) on board.

The US has apparently succeeded in doing so. As this writer predicted at the outset of the Russian invasion, US/NATO would include denial of SWIFT to Russia as one of its sanctions. This is a qualitative new step—and a risky one—in the history of sanctions on Russia. It can backfire causing serious economic impact on US, EU and global oil markets and thus consequent sharp rise in oil related inflation globally and via oil prices into the economies in general price inflation. Already rising everywhere due to the structural impacts on supply chains by Covid and the recent recessions, inflation could accelerate even higher in Europe and US and rest of the global economy. That price acceleration might bring the tentative, weak recovery of the US, EU and global economy to a halt. Nonetheless, it appears that including denial of SWIFT to Russia with the goal of shutting down its oil and gas revenues is on the agenda and likely within days. The political war hawks pushing more confrontation with Russia in Ukraine have thus won the day so far as SWIFT is concerned. Russia's responses to this move can be expected.

There are ways Russia could do an 'end run' around SWIFT. It could simply use the China Yuan currency in its transactions. Or it could join with China and others to establish a parallel international payments system bypassing SWIFT. That possibility was raised and piloted as far back as 2012 when the USA imposed sanctions on Iran's sale of its oil. China's alternative payments system is called CIPS, 'Cross Border Interbank Payment System'. Russia has also been piloting its own payments system, called STFM, System for Transfer of Financial Messages. The two could be integrated and expanded into something even greater.

There's yet another 'work around' SWIFT possible: Russia could join China using digital currency. China is already well on its way to a digital currency, having already introduced it in China.

Whether SWIFT sanctions are introduced soon (likely) or not, it is clear that US control of the SWIFT system—through the US dollar and dominance of US banks globally—is a key instrument of US financial imperialism. It is as important as US control of other global economic institutions, like the IMF, World Bank, and the US dollar as global trading and reserve currency.

Many US Corporations Exempted from Russian Sanctions

Thus far Biden has not imposed sanctions directly on Russian oil and gas because its impact on global oil supplies and prices would be significant. (Denial of SWIFT would of course mean indirectly a major sanction). But at the behest of

US and EU oil companies Biden specifically exempted oil and gas from sanctions. Initially SWIFT was excluded as well. But that's not the entire list of exemptions. Biden in day 2 of the invasion announced Aluminum exports from Russia are exempt, after he met with US auto, Boeing, and canning industry CEOs who it seems are dependent on Russian raw aluminum imports to the US. At least 10% of raw aluminum comes to the US from Russia. Europe is even more dependent on Russian aluminum imports. So the corporate lobbyists have gotten themselves exempted from Russian sanctions as well. It can be expected other critical metal based commodities imports from Russia will lobby and quietly get exemptions from sanctions as well.

Russian Banking Sanctions

Biden initially announced sanctions on Russian banks, but left big holes in those initial sanctions exempting Russia's two biggest banks, Sber bank and VTB bank. These two were central to the processing of SWIFT on the Russian side. Clearly, big US oil corporations did not want to roil the global markets. Pressure on Biden, however, rose to expand the sanctions. VTB was added to the list. Sberbank apparently still is not although that may have, or soon will, changed. Banking sanctions not only mean interrupting the flow of payments revenue from sale of exports from Russia, whether oil and other resource commodities and productions. Banking sanctions are designed to prevent Russian banks and investors' access to financial markets in the west.

Russian corporate and government bonds are often initiated for sale in the west, mostly it appears in London financial markets. Banking sanctions are designed to cut this off. Banking sanctions mean Russian companies' ability to sell debt (bonds, etc.) in western markets may also be cut off. So may raising of investment capital in the west for Russian start up companies. Russian government debt (i.e. sovereign bonds) sales through foreign banks would be cut off as well, according to the new sanctions. But Russia's central bank could step in here and absorb (buy) both the corporate and government debt as a 'buyer of last resort' in the crisis—just as the US central bank, the Fed, and other central banks in the west do in emergency situations.

It's reported that Russia in recent years accumulated up to \$680 billion in an emergency cash hoard in anticipation of getting out from under US and western dependence on the US dollar and banking system. That cash hoard, in liquid currencies and gold, is available to offset western sanctions on its banking & financial system. It could also be used to subsidize Russian investor-Oligarchs' interim losses from the US sanctions levied on individual wealthy businessmen. It should also be noted in turn, however, that US sanctions tactic cut both ways: Russia can in turn freeze foreign investors' assets in Russian banks. And there's a lot of western investors' deposits held in Russia's big five banks that serve Russia's giant oil and gas producing industries.

Summing up Russian Sanctions

To sum up the recently announced Biden sanctions: they won't likely prove very effective—except perhaps if the access to the SWIFT payments system is quickly implemented. Sanctions on Russian exports and imports do not have an immediate effect and there are third source 'work arounds' that western

companies (and even governments) would be willing to 'look the other way' in order to ensure the supply of critical Russian commodities sales. The same applies to sanctions on the Russian banks and global money capital flows. There will be some disruptions longer term, but no major short term impact on Russia's economy. Goods and money capital flows sanctions all have potential 'work arounds'.

Financial experts and investors know this. That's why, when US and EU financial markets initially fell by 800 points when Russia invaded the first day, the financial markets quickly bounced back quickly when Biden announced initial sanctions that same day. Global investors know the Biden sanctions are full of perforations. And if slipping out one or more of the holes is not possible, Russia has a big back door through which it can exchange money and goods with the rest of the world. It's called China.

Russia will therefore experience in the short run significant volatility in its financial markets and its currency. It will experience inflation—as will all economies worldwide as supply disruptions of commodities (oil, gas, metals, even grains and other food) results in higher prices worldwide. It may even experience some initial production slow down, and thus unemployment, as goods markets and therefore demand are disrupted globally. But it won't suffer a major economic crisis due to the war in Ukraine. And should that worst scenario occur, it has its cash hoard of reportedly more than \$680 billion.

The major wild card in the US sanctions is the SWIFT system. If it is denied to Russia, it will have to create work arounds that will be somewhat more difficult—either using the China Yuan and other currencies or even joining China in significantly expanding the use of digital currencies in foreign trade transactions.

European Economic Impact

Like Russia, the EU will experience significant financial market and currency volatility in the short run. Both declined sharply first day of the invasion and then recovered.

Europe is far more energy insufficient compared to the USA which is the world's largest producer of oil and natural gas. The EU will therefore experience more significant price inflation driven by the chronic and steady rise in the global price of oil and gas. Global oil prices are projected to rise from around current \$100/barrel levels for benchmark Brent (northsea) crude at the time of the invasion, rising to at least \$120-25/barrel. As noted previously, natural gas prices will rise as well in the shorter run. And should in the longer run the EU have to purchase natural gas from the Mideast or USA in the form of LNG, prices will be much higher.

Europe's economic recovery from Covid is also more tentative compared to the US economy's. As its central bank plans to raise interest rates as inflation rises, it's more likely those rate increases will dampen the recovery of the real economy more quickly than would a similar rate hike by the US central bank on the US economy. Wage increases have also been slower to recover in the EU compared to the US recently. Rising energy and commodity prices will discourage household consumption more and sooner in the case of the EU as well. Food

prices may also rise as the EU obtains some agricultural goods from the Ukraine. In short, the inflation and greater EU real economy's sensitivity to central bank interest rates will slow its economic recovery further. Added to the slowdown may be the new Covid Omicron2 variant that appears even more infectious than the earlier Omicron and currently is spreading rapidly in parts of the EU and will exacerbate the trends toward economic slowdown and recovery due to the war effect via inflation and interest rate policy.

Europe will also feel the effects relatively more of Russian reciprocal response to Russian banks' asset freezes, Russian debt access, and export-import sanctions on Russia. Europe's economy is integrated with Russia's not just in energy, but in a long list of industrial and consumer products.

Yet another negative effect in the longer run is that the US will likely demand that the EU shoulder a still greater share of its total defense burden and expenditures. Diversion of tax revenues from social spending programs to defense will result in a net real disposable income decline for many European households. Like inflation, that too will impact consumer spending and slow economic recovery and growth. EU government debt and corporate debt will likely rise in the longer run due to slower growth and inflation.

In short, the EU stands to experience significant negative real affects to its economy as a result of the Ukraine war. In the shorter run more asset and currency volatility, but in the longer term higher chronic inflation, declines in real wage incomes, loss of markets in Russia, and consequent slower economic recovery and growth. Central bank monetary policy response stability are also not promising. Will the European Central Bank raise interest rates to try to slow inflation? When it's economy is simultaneously experiencing war related developments that are already slowing its recovery and economy?

The USA Economic Impact

Like the EU the USA was already experiencing significant consumer price inflation before the war's occurrence. In fact, higher chronic inflation than Europe. While the USA is more energy independent than the EU, it will nevertheless have to deal with still higher inflation due to the global energy shock in oil markets. Oil companies raise prices not because of legitimate supply or demand causes, but because as monopolies in their respective home economies they simply can. That has already been going on in the US economy before the Ukraine war. Recent US consumer inflation has been driven by oil prices. Nearly half of its latest 7.5% annual inflation rate has been oil price related.

US financial markets in the short run have also fallen sharply but recovered just as quickly—as in Europe and to a lesser extent in Russia. The US currency, the dollar, has been less volatile than the Euro and even less so than the Ruble. US financial markets may soon, however, experience a second major negative impact from its central bank, the Fed, rise in interest rates in March. That rate hike will likely be larger than any Europe may take. So the higher inflation, combined with higher rate hike, plus the Ukraine war may constitute a combination of negative economic events that cause a second more volatile fluctuation in US financial asset markets.

The combined rate hikes, inflation, and war perception—should the latter continue and deteriorate—will also slow the US economy recovery, as it will Europe's.

A relatively greater effect on the US economy, compared to the EU's, will be a further surge in US defense/war spending in the wake of the Ukraine war. With Pentagon spending this year already at \$778 billion (and more than \$1 trillion for all sources of US defense spending), tens of billions more in military spending can be expected as a result of the Ukraine war. That spending will surge in what remains of the current fiscal year, but continue thereafter as well in subsequent annual defense budgets for next and following years. That will exacerbate still further US deficits and national debt and, with higher interest rates, cause a higher cost of debt servicing that impacts later budget deficits as well. Rising deficits and debt—in the wake of already record deficits and debt due to Covid related policies, 2020-21, may lead to political pressures to cut social spending programs once again—i.e. austerity fiscal policies.

Chronic rising inflation, social program spending cuts, and rising central bank interest rates will together slow an already tentative economic recovery. If all these are severe in scope and magnitude, it may very well result in a double dip recession sometime late 2022 or early 2023.

In short, the US economy will feel the contributing negative effects of the Ukraine war in terms of inflation, disposable household incomes, and unstable central bank monetary policies. In some ways the effects of the war will be less than the effects felt in Europe; in other ways perhaps more severe.

Long Run Consequences for Global Capitalism

The global capitalist economy today is highly integrated: In the flow of real goods and services; in money capital flows between financial markets; in currency relative exchange rates; and in banking systems and interest rates—to name but the most obvious. The Ukraine war's economic consequences will impact all the three economies—Russia's, Europe's and America's. The impacts may be relatively different qualitatively and quantitatively. But actions taken against one have their inevitable economic reverberations on all.

Inflation due to escalating oil and commodity price inflation will negatively impact all. Central bank policy responses will be weaker across the board. Slower economic growth will result as goods and services flows are interrupted and global supply chain problems continue and perhaps even worsen. The war and US-EU economic and political policy responses will likely accelerate fundamental structural changes in relations between countries and global economic institutions.

It remains to be seen whether these economies, and the global capitalist economy itself, can absorb the stresses of the war and its fallout—so soon after the devastating impact of the Covid global crisis. Meanwhile, the other two systemic challenges will likely not disappear either: the worsening global health crisis of constantly mutating viruses and the deteriorating climate.

While nations continue to fight each other in wars hot and cold the War of Nature against Man—in the form of chronic diseases and global warming—will also continue. As nations fight the former, the latter will likely not be attended to. And if so, the scenario for mid-century will not be pleasant.

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