

Illustration featuring a view of Kiev, Ukraine's capital city by Matias Galarza. Pixabay License.



# ECONOMICS

# OF WAR

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“In the 21st century, the aftereffects of war would be felt far beyond the region where it takes place. In fact... far beyond the boundaries of any countries that participate in it.”

The case of Ukraine which faced the unprovoked full-scale Russian invasion on February 24 in 2022 proves this most accurately. The consequences of this war (probably the most horrifying since World War II) have already touched the future not only Ukraine and the Russian Federation but the rest of the planet. For sure, these aftereffects would be quite different, for instance, in the European Union (the EU) and the Middle East. But hardly any area of the world will stay unaffected.

During the period of independence starting in 1991, Ukraine struggled its way out of the post-Soviet political, ideological, economic, and cultural heritage. And we should admit it wasn't a direct path. In fact, very often the movement of a new Ukrainian democracy towards the high league of developed countries was sideways or even backwards.

Why did that happen? Let's look at some reasons that came into play.

First, the unwillingness of the new Ukrainian political elites to reform deeply on the model of the well-recognized western democracies and economies. Doing so, said elites would lose absolute power within the country, and with it the possibility to enrich themselves, their families and their partners over the years.

Second, the permanent revisions of the Ukrainian legislation to satisfy mainly the financial needs of the ruling elites. This, as international economists know, is, probably, the most terrible nightmare for foreign investors who stay away from markets where their money could not be protected by a transparent and stable law.

Third, total corruption from top to bottom, the scale of which can shock an average citizen in any corruption-free country. Just imagine that members of your parliament lobbying for specific-interest laws are getting additional "gratitude" in envelopes for each and every decision in favor. Or that you should pay a surgeon and the involved hospital staff secretly in cash to save the life of somebody from your family.

Fourth, the revanchism of pro-Russian political forces and parties which openly or covertly hampered the process of Ukraine's integration into the club of developed countries. The resistance of a wide society to such Russian-oriented forces led to two Maidan Uprisings that resulted in the peaceful Orange Revolution (2004) and the bloody Revolution of Dignity (2014).

Despite these and some other substantial impediments, Ukraine managed to move, though slowly, but still forward toward its European dream. At last, after years of negotiations the Association Ukraine signed the Association Agreement with the EU in 2014. The latter meant establishing of a Deep and Comprehensive Free Trade Area (DCFTA) between Ukraine and the EU. Coming into force on 1 September 2017, the Association Agreement helped promote deeper political ties, stronger economic links and respect for common values. The positive economic effects of such promotion were not long in coming. Today the EU is Ukraine's largest trading partner, accounting for 39.5% of its trade in 2021. Total trade between Ukraine and the EU reached almost €52,4 billion in 2021, almost doubling since the entry into force of the DCFTA.

In recent years Ukraine also tried to get its place within global manufacturing and supply chains and become a country with new leading economic sectors. Keep in mind that our heavy industry was hit badly after the Russian Federation's military and political support of the non-government-controlled areas of the Donetsk and Luhansk oblasts and illegal annexation of Crimea in 2014. Therefore, Ukraine was forced to make a bid for agricultural production. Animal and vegetable fats and oils as well as cereals added greatly to our export potential. In 2021 agricultural products totaled \$27.8 billion, accounting for 41% of the country's \$68 billion in overall exports. Suffice to say, Ukraine is the world's biggest exporter of sunflower seed oil over the last decade, exporting about 45-55% of the global supply.

Information and communication technology (ICT) services also fueled Ukraine's economy lately. According to the World Bank (WB), ICT service ex-

ports of the country amounted \$7.11 billion in 2021 have grown by almost 40% compared to 2020.

All that, along with other incremental structural and economic reforms, led to an all-time record in terms of the Ukrainian Gross Domestic Product (GDP) worth \$200.1 billion in 2021, 19% up compared to the previous year. Another noteworthy achievement average pay which also broke the record increasing to \$550. That was the best result over the years of independence since 1991.

Unsurprisingly, this ascending economic trend that emerged, even in times of the COVID-19 pandemic, provided means for the fundamental renovation of the country. Here we can't but mention the national "Great Construction" project that was announced in the fall 2019. This extremely ambitious joint project of a new President and the Government of Ukraine was designed to upgrade and/or build from scratch a modern transport and social infrastructure. It was expected the full execution of the project would lead to the construction of thousands kilometers of highways, hundreds of new schools, kindergartens, stadiums and hospital admissions as well as to the creation of at least 150,000 new jobs throughout the country. In addition, it would lead to a cumulative increase in GDP over the next 5 years by 4,4%.

However, as it turned out, the aggressor from the East pushed its own agenda regarding Ukraine's plans...

Pro-EU Euromaidan in Kiev, 27 November 2013, by Evgeny Feldman, Wikimedia Commons; CC-BY-SA 3.0



War monument on Freedom Hill,  
Kiev, Ukraine.  
By Mickey Estes.  
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Every war is about plans that have been radically disturbed. Instead of further development the full-scale Russian invasion has brought an ordeal to my country last seen in the mid of the 20th century. The result is thousands of deaths, total devastation of cities as well as numerous and unbelievable war crimes by modern fascists including raping of kids, bombardment of maternity clinics, mass execution of civilians just for fun, and more..

Along with huge civilian losses, this war has led to a drastic economic crisis in Ukraine. It is not even possible to provide an in-depth analysis of all the socioeconomic consequences Ukraine is suffering, mainly, because the warfare is not over yet. Besides, in times of war there is an obvious lack of accurate data relating to different spheres of economic development of the country as a whole. Instead, I will focus briefly on some basic macroeconomic indicators of present-day Ukraine.

For one, lots of firms, companies and enterprises, especially from regions that suffered from the Russian invasion the most, were forced to shut down entirely. Those who survived face various challenges trying to find new ways to operate with or without relocation throughout the country. One of recent researches indicates that only 22% of all businesses retained the production capabilities they possessed before the full-scale aggression of this war in February 2022. Surely, this autumn demonstrated that businesses are slowly coming again to life, but the overall negative impact of the war on Ukrainian economy remains dramatic. For instance, during the first six months of 2022 the country's export shrank by 24%!

The first months of the horrific war generated predictions that the country's GDP would sink by over 45% in 2022. In October, our Ministry of Economy grew more optimistic raising the predicted failure to 30%. This happened largely because of establishing of the UN grain corridor from Ukrainian sea ports, and, thus, the partial revival of agricultural export.

## AN AGGRESSOR'S VICTIM



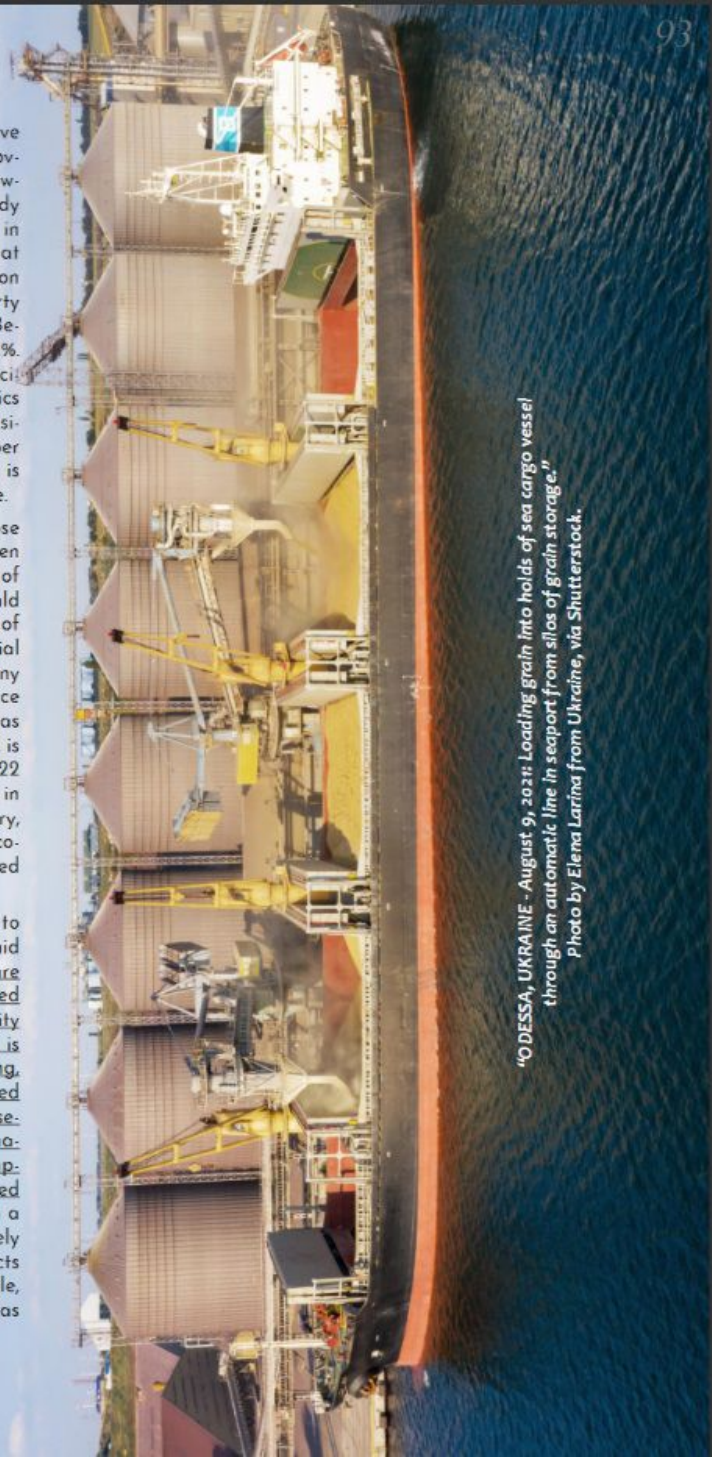
That said, one should bear in mind that the loss of one third of the whole economy during such a short period of time is a real shock for any country, a developing, post-independent Ukraine in particular. The war-driven economic crisis in Ukraine has already caused acceleration of consumer inflation to almost 22% as well as officially devalued hryvnia (Ukraine's national currency) by 25% against US dollar. Unofficial exchange rate on the black market is even worse.

And to top it all, Forbes estimated at the end of the summer 2022 that the war has caused \$108 billion in damage to Ukraine's infrastructure. Here, please, recall all those ambitious renovation plans for the country I described earlier. Russia has not only eliminated them all but destroyed and heavily damaged even the existing infrastructure. Actually, the aggressor fiercely continues doing that as I writing these lines.

All mentioned above have led to a total and fast moving impoverishment. Nowadays Ukraine has already faced a tenfold increase in poverty which means that 25% of the whole population would be living in poverty by the end of this year. Before the war it was only 2%. Know that today an associate professor in economics from the Ukrainian university can hardly earn \$250 per month. Unfortunately, this is not even the worst example.

In fact, the number of those living in poverty could even exceed 50% by the end of 2023. I suppose, this would depend on the duration of the war, its intensity, spatial coverage and, without any doubt, financial assistance from abroad. The latter, as the Kiel Institute estimates, is really huge. In August 2022 the aid reached \$84 billion in the way of meeting military, humanitarian, social and economic needs of the invaded country.

You may be shocked to learn that not all foreign aid is unconditional. There are certainly no-strings-attached grants but in the majority of cases, aid to Ukraine is actually by way of lending, a fact that remains hushed over. And that's another serious issue for us as the national debt will rise to approximately 106% compared to about 50% in 2021. Such a debt trap can only negatively influence Ukraine's prospects for years to come. Meanwhile, the debt will keep building as long as the war stretches.



"ODESSA, UKRAINE - August 9, 2021: Loading grain into holds of sea cargo vessel through an automatic line in seaport from silos of grain storck."

Photo by Elena Larina from Ukraine, via Shutterstock.



*"Ukrainian Night,"*  
oil on canvas, 1999,  
by Sergey Zagraevsky;  
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*"The consequences of the explosion of the hotel Ukraine by a Russian missile."*  
Photo by Sarymsakov Andrey,  
via Shutterstock

Since invading Ukraine in February 2022 Russia was imposed an unprecedented range of sanctions by the United States and mostly European allies which, it had probably never been seen before. These include but are not limited to:

- » immobilization of about \$300 billion worth of Russian Central Bank assets;
- » export controls to restrict Russia's access to advanced technology from the Western countries;
- » loss by sanctioned Russian oligarchs of their long-held assets outside Russia (e.g. luxury real estate, superyachts, football clubs, etc.);
- » collapse of the Russian financial sector that has lost close ties with reliable foreign partners;
- » other critical constraints on Russia's real economy (for instance, over 1000 world famous companies have curtailed their business in Russia firing hundreds of thousands of employees).

According to the U.S. Government, reports about 1,500 new and 750 amended sanctions listings alone against Russia on its website, levied since the war began. All of them have severed Russia's access to key technologies and industrial inputs that erode its military capability, in particular, to produce and stockpile weapons.

And the erosion does take place! Today, 8 months after the invasion, Russia is forced to turn to less technologically advanced countries such as Iran and North Korea for military

## A TERRORIST STANDS TO PAY

assistance. Being unable to import semiconductors and other key components, this terrorist country is now cannibalizing existing civil airplanes to get parts it can no longer buy abroad.

Finally, bearing in mind lost investment, export controls, and numerous economic as well as financial constraints, one may anticipate that Russia's growth and development will be irretrievably hampered in both the immediate and long runs.

In the short run, however, the economic situation for Russia is not so critical. The International Monetary Fund expects the terrorist's economy will contract by only 3% in 2022. This will happen basically due to extremely high energy prices on the international market caused by the war and the fact that not all the sanctions have gone into effect yet. For example, the price cap from the European Union for crude oil or petroleum products originating from Russia will happen in the upcoming December-February.

In the meantime, Russia is frantically looking for the new markets for its basic export products, though with a large discount for buyers or to satisfy various import needs. Since invading Ukraine, Russian trade has boomed with India (+310%), Turkey (198%), Brazil (106%), and China (64%). Could that be an equal substitution for Russia that has almost lost all of the Western market and its consumers/providers? For sure, no! I'm more than sure, we'll see grave economic effects on Russia quite distinctly this year.

*"Russia, Pervouralsk, Sverdlovsk region, 13.07.2017: Thousands of families live in emergency and dilapidated housing in Russia."*

*Photo by Rananasta from Russia, via Shutterstock.*



One may be deeply mistaken to suggest that the victim and the aggressor are the only sides that this war's consequences will run across. The world as a whole - without meaning to - "reaps the fruits" of the Russian invasion.

The World Bank has disclosed that economic implications of this war are truly global. They have already led to a considerable volatility on the international markets (firstly, energy and food), disruptions to global supply chains and logistics networks, shift of foreign direct investment (FDI) from risky destinations as well as stagnation of specific economic sectors (e.g. tourism) in some countries. All that in 2022 will reduce the world trade by 1%, thus also lowering the global GDP by just under 1%. This year, if the war continues, its global aftereffects could be much more sensitive.

## THE WORLD REELS FROM IT

In general these figures may seem not so critical, but they appear quite challenging in terms of separate regions and particular countries. For instance, instead of expected modest growth of 1.6% in Eurozone in 2023, Organization for Economic Co-operation and Development (OECD) now corrects its forecast to just 0.3%, if natural-gas prices rise by 50% over the rest of the year. German economy, as a leading one in Europe, is supposed to be contracted to 0.7% from previously expected 1.7%.

In other words, the European Union, because of a surge in energy prices that egged on widespread inflation, is slowly but steadily going into recession. Something similar is going to happen with the USA. The OECD also reconsidered its forecast for this country's growth in 2023 to 0.5% from 1.2%. In case inflation doesn't fall as rapidly as the Federal Reserve

hopes, even a steeper downturn is possible. China as well, as the second major economy of the world, will accelerate in 2023 much slowly if compared to previous years or even decades.

Readers who are not much of economists, may be thinking: why this war causes global energy crisis, inflation and other related economic issues? Well, because Russia is one of the world's biggest energy suppliers. Globally, 14% of crude oil and 9% of natural gas originate from this country. After the invasion the exports from Russian Federation are reducing. As a result, international energy markets feel shortages of corresponding Russian products. In return, lack of supply means inflation - higher prices for these very products as well as for all other commodities produced with energy usage. Simple math!

The Russian aggression against Ukraine has led to unpredictability in the global food

supply. The main reason for that is the following. In recent years Ukraine and Russia combined accounted for 25% of the world's wheat exports and 14% of corn shipments. Other agricultural production is also important for both countries, Ukraine in particular (see above). It's also worth mentioning that before the war Ukraine alone was able to produce enough food to feed 400 million people per year. But when it had started Russia began the blockade of Ukrainian food exports by sea and, surprisingly for itself, losing its agricultural exports potential because of unprecedented Western sanctions. The outcome for the planet? Again shortages, rise of prices and food insecurity throughout the globe. This time developing countries in Africa, Asia and Latin America are expected to bear the brunt with tens of millions of their citizens to suffer from hunger.

This war has another important dimension - a demographic one. One can't ignore the fact that in 2022 the planet witnessed the greatest migration crisis since World War II. More than one-third of Ukraine's total population (42 million) is considered to be externally or internally displaced with approximately 8 million people to leave their homeland for neighboring and distant European countries. One may argue, saying migration is not about economy and I will definitely oppose. We just can't close our eyes on the situation when labor markets of such countries as Poland and Germany have received 1,5 and 1 million potential workers respectively. Therefore, I'm afraid, in the medium and long run Ukrainians will shape not domestic but foreign economic development. Plain statistics: about 11% of those who escaped to Europe aren't going to come back even when the war is over. Nearly the same number of people - 10% - still hesitate. The economic impact of such a human loss for Ukraine's future is difficult to overestimate.

To cut a long story short, I must admit that consequences of this war are not necessarily negative. In fact, there are or can be some advantages for all the parties involved. For instance, the European Union will finally terminate its critical dependence on Russian natural resources and much quicker turn to renewable energy. Besides, war lessons will force the EU to pay more attention to its security in the future. The United States will overcome lots of economic challenges by promoting production in defense sector. The Middle East will conquer new markets getting rid of the fading Russian competitor. And so on, and so forth!

But my heart is obviously praying for Ukraine, my motherland. I really hope, it will survive, triumph over the terrorist state and join the free democratic world as a strong and reliable economic partner - a decent member of the EU and NATO. Surely, such dreams can come true only with the considerable assistance from the developed countries. Once the war is over, Ukraine will definitely need its own "Marshall Plan". Today we are paying for it, global freedom and planet's prospects in blood...

