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What War in Ukraine means for Global Trade

UK, US and EU Perspectives

Whilst it is of no surprise that Russia's invasion of Ukraine currently dominates global news cycles, no recent conflict has ever impacted the global financial and business agenda so significantly as this current war. New international economic sanctions levied against Russia (and Belarus) on an unprecedented scale caught many multinationals by surprise. Russia's invasion of Ukraine has forced US, EU and UK leaders to fundamentally rethink post-WW2 international security doctrines with direct consequences for businesses and globalisation.

Despite the recent years of volatile diplomatic, financial, and international trade relations between the EU, US, and UK, these core G7 members have ostensibly formed their own pro-sanction bloc against Russia. This aims to raise economic costs for the Kremlin and isolate the country from global financial markets. The targets of these economic sanctions have included the Central Bank of Russia, the Russian National Wealth Fund, and the Ministry of Finance of the Russian Federation to ensure that a considerable percentage of Russia's $630 billion in foreign exchange reserves remains frozen. Furthermore, sanctions have prohibited seven of the largest banks in Russia[1] from participating in the SWIFT messaging network, effectively denying them access to international markets and further alienating Russia from the global financial system. A significant number of multinational companies with interests in Russia (Belarus and Ukraine) have now abandoned their operations despite decades of investment in the region[2].

The systemic consequences of recent developments will last years, likely decades. The emergence of new international alliances and their resultant geopolitical divisions, coupled with anti-Putin sanctions, Europe's energy supply pressures, and additional worldwide agricultural supply chain disruption, signals the end of 'globalisation as we know it'. That can only mean further storms are forming on the horizon for the international business community.

[1] Otkritie FC Bank, Novikombank, Promsvyazbank, Rossiya Bank, Sovcombank, Vnesheconombank (VEB.RF), and VTB Bank.
[2] The New York Times, Here Are Some of the Companies That Have Pledged to Stop Business in Russia, The New York Times, Article updated on April 20, 2022

Friendships renewed?

On the bright side, however, the current crisis has accelerated a reset in diplomatic and trade relations between the EU, US, and UK. Renewed consensus and cooperation are back on the political menu.

For example, cooperation between the EU and US has been deepening since 2021 with the start of the Trade and Technology Council and the end of long-lasting tariffs in response to disputes on Airbus-Boeing and steel and aluminium. Even on long-standing business issues such as data sharing, the EU and US have signed an "agreement in principle" for a new "Privacy Shield" pact[3].

The EU and UK have shown a largely united front against Russia and Brexit tensions have been put on the backburner for the time being.

Completing the picture, the UK and US have initiated their own dialogue on the 'Future of Atlantic Trade'[4], Although at an earlier stage, retaliatory tariffs have similarly been lifted and both sides' political leadership have committed to exploring closer trade ties.

[3] European Commission Press Release, European Commission and United States Joint Statement on Trans-Atlantic Data Privacy Framework, European Commission, March 25, 2022

[4] James Manning and Brian Papp, The UK & US 'Future of Atlantic Trade' Dialogues – A New Dawn for Trade in the Special Relationship?, FTI Consulting, April 1, 2022

Case study: when global agricultural powerhouses go to war

Russia's invasion of Ukraine is radically disrupting international food supply chains. There are expected to be dramatic consequences on trade flows with significant upward price pressure placed on global agricultural commodities including staple crops, as well as critical food production inputs such as fertilizers. Together, Ukraine and Russia are leaders in the global food and agribusiness, responsible for close to a third of the world's wheat exports, 19% of the world's corn supplies, and 80% of the world's sunflower oil exports. According to the Center for Strategic & International Studies, twenty-six countries from around the world have previously sourced at least half of their annual wheat imports from Russia and Ukraine alone[5].

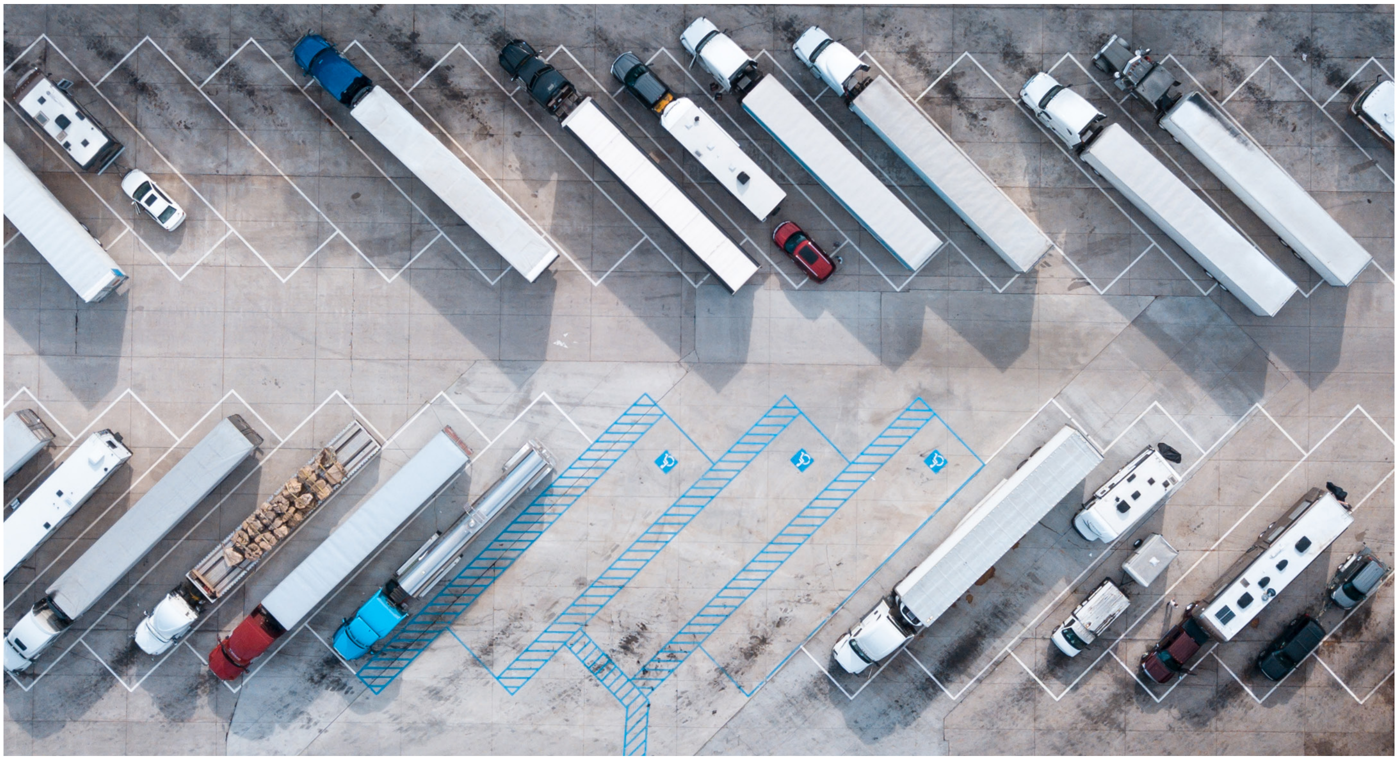
Rising global agricultural commodity prices could not have come at a worse time, given their essential importance. The rising prices will serve to exacerbate the existing macroeconomic headwinds, such as inflation and fuel prices. Global agricultural trade will see declining agricultural production in certain jurisdictions, supply constraints for staple crops, and interruptions, such as shortages and shipping disruptions, to global food supply chains.

In addition, the EU, US and UK, now face record-high energy prices as they wean themselves off Russian energy dependency to avoid financing Russia's war. This will cause added economic pain and further inflationary pressures on households, likely reducing discretionary consumer spending and slowing some of the re-heating of unlocked economies. These impacts are unlikely to be felt immediately, but as already-sourced inputs are exhausted in the supply chain, costs will likely be passed onto retailers and consumers. As such, there is a real risk that once the real costs and implications of sanctions start to be felt around the world, the widespread unity that the invasion has sparked may very well start to fragment.

Of course, the consequences of this dramatic disruption to food supplies will be felt most acutely and more immediately beyond the West. On April 8, the Food and Agriculture Organization of the United Nations announced that "World food commodity prices made a significant leap in March to reach their highest levels ever, as war in the Black Sea region spread shocks through markets for staple grains and vegetable oils...."[6] Particularly for major importers of food in the developing world, disruption to supplies risks sparking domestic instability. For companies operating in such markets, the everyday risks to doing business will grow.

[5] Caitlin Welsh, The Russia-Ukraine War and Global Food Security: A Seven-Week Assessment, and the Way Forward for Policymakers, Center for Strategic & International Studies, April 15, 2022

[6] FAO, Food Price Index posts significant leap in March, FAO, April 8, 2022



What it means for companies

The authors of this piece advise that:

Companies within the food, agricultural, or consumer discretionary sectors should prepare for future macroeconomic uncertainty.

As our Case Study suggests, Russia's war in Ukraine will have a direct impact on these sectors as rising food and agricultural commodity prices will affect household and per capita consumption in key markets across the globe.

Businesses should diversify supply chains and call for markets to remain open

Policymakers will be tempted to adopt protectionist and nationalist trade policies, including to promote resilience through growing and producing more at home or by reshoring critical industries wherever possible. However, erecting trade barriers to shield domestic industry will only raise prices for firms, their employees and consumers. Businesses need to recognise the changing geopolitical landscape and prepare accordingly. But any realignment needs to be balanced and proportional. Industry should ensure resilience through diversification, especially among allies and oppose overly restrictive protectionist policies.

Industry should seek to use newly-invigorated trade talks to encourage policymakers to reduce barriers to trade, including tariffs, export restrictions, and customs red tape.

With various bilateral trade talks between the US, EU and UK back on the table in some form, businesses should proactively engage on the basis of their trade interests and push for liberalisation. This could be via formal free trade agreement negotiations, potentially with other countries or trade blocs, or less-structured, ad hoc, bilateral dialogues.

Ultimately, companies with a presence in the UK, US, and EU need a comprehensive international trade strategy that is prepared for geopolitical and economic shocks, as well as being well positioned for opportunities that will arise given the multiple ongoing dialogues between the three G7 economic powers.

It is important to note for businesses that currently the UK, US, and EU have rather different views on trade. The UK, having rolled over most EU trade arrangements struck when it was an EU member, is now eager to sign new trade agreements (for example with India) and expand its international reach whenever possible.

As a rule, the EU and the US see limited gains from Free Trade Agreements (FTAs) in the future. Both are more focused on bilateral or plurilateral arrangements which will set future standards, especially in technology. This is exemplified by the recently created EU-US Trade and Technology Council[7] and the newly announced EU-India Trade and Technology Council[8].

Recent geopolitical developments, including COVID and increasing tensions with China, have strengthened Europe's more protectionist south led by France, which increasingly dictates EU policy since the UK has exited the EU. As an example of this newly gained trade confidence Paris has applied the brakes to traditional tariff-led trade discussions and focused on upgrading the EU's trade defence tools. However, on the back of the war and with the end of the French Presidency of the EU in July, the bloc could return to currently frozen FTA negotiations to diversify its supply chains and reduce some of its problematic dependencies.

From the US side, however, the Biden Administration is more clearly veering away from the framework put forward under traditional FTAs and seeking to engage trading partners and allies through new bilateral and multilateral frameworks built on putting workers at the centre of trade policy.

Over the coming months, there are also a number of key milestones with possible trade implications to track. Notably, the second round of the EU-US Trade and Technology Council May 15-16 in France, the US mid-term elections and the French National Assembly elections in June. The UK's new trade negotiations also continue, with the third round of negotiations on an FTA with India taking place in April and deals with Mexico and the Gulf Cooperation Council to be launched later in the year. On the global stage, the next WTO Ministerial Conference (MC12) on the June 12-15 will be especially important to follow and take into account considering the current geopolitical context.

[7] European Commission Press Release, EU-US launch Trade and Technology Council to lead values-based global digital transformation, European Commission, June 15, 2021

[8] European Commission Press Release, EU-India: Joint press release on launching the Trade and Technology Council, European Commission, April 25, 2022

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