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THE IMPACT OF THE ECONOMIC AND FINANCIAL WAR WITH RUSSIA ON THE FUNCTIONING OF THE WESTERN ECONOMY

Abstract: *In the current confrontation between Russia and the broadly understood West, we are not only dealing with military struggles. It can be said that military operations in Ukraine are just one element of the global confrontation. Economic and financial operations are at the forefront, which are intended to inflict losses on the opponent, forcing them to make concessions or even capitulate. The aim of the article was to draw attention to the threats that Western countries may face, directly or indirectly involved in conducting economic activities. It indicates what threats may appear in the economic and financial spheres. It turns out that some of these threats may result from deliberate counteraction by the opponent (in this case the Russian Federation), and some may arise in connection with the indefiniteness of economic wars, with phenomena in politics, economy, finance, etc. that are difficult to predict. Sometimes we are not fully able to predict what consequences prohibitive tariffs and sanctions that were to hit our opponent will have for us.*

Keywords: *economic war, sanctions, energy resources, industry, production costs, financial system*

Introduction

Economic and financial wars are an essential component of every hybrid war. The range of actions of states deciding to conduct economic and financial wars is very diverse, depending on the economic potential and financial capabilities of a given state. When preparing hybrid operations in the economic sphere, it is important to predict all possible effects of the actions taken. One of

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the tools necessary to carry out an attack on the economy of the attacked country is to prepare a “strike plan”, taking into account the economic situation of the target country, its specific situation in the spheres of production, distribution, exchange and consumption. In such a plan, it is also important to determine the level of development of the opposing state in each of the above-mentioned areas, as well as to determine the thresholds, exceeding which may have a significant impact on the functioning of both these spheres and the economy as a whole[2]. On the other hand, the “economically attacked” state should retain the ability to reveal the nature of the emerging danger in order to effectively counter the model of chaos in the economic sphere used against it. Neutralization of external and internal economic threats requires the introduction of significant adjustments in the state's macroeconomic policy. Development of specific industrial sectors of the economy, development of the military-industrial complex and balanced financial policy. Predicting possible actions of the aggressor country and the effects of processes initiated using the economic warfare model is of paramount importance for defense against a possible attack and weakening or complete destruction of the economy. Economic and financial wars against economically weaker opponents do not require such complicated procedures. In many cases, economic sanctions, blocking the accounts of individual politicians, enterprises, and sometimes economic blockade of the opposing country are sufficient. Of course, various types of sanctions are more effective when we include our allies in them, and also deprive the opponent of the possibility of economic maneuver and sources of financing. We can see such solutions in the actions of the United States towards Russia, which has included most of its allies in this war. Russia is trying to respond, but its economic countermeasures are limited. This does not mean that we can ignore the threats that may affect the West, on the occasion of such actions.

Russia's Economic Game with the West

Russia's military invasion of Ukraine has provoked a hybrid reaction from the West. A number of diplomatic, informational, technological, and primarily economic and financial actions have been taken against Moscow, the aim of which is to limit the country's ability to conduct combat operations against Ukraine. Tens of thousands of economic sanctions, export and import restrictions have been introduced on Russian companies, enterprises, banks, and research institutes, including primarily the Russian fuel and energy sector.

[2] K. Surdyk, *Konflikt ukraiński w rozgrywkach geopolitycznych*, Warszawa 2017, pp. 115-118.

Economic threats to the West

Although Russia is suffering huge losses from the ongoing economic war, it also unfortunately carries the risk of serious macroeconomic consequences for the West. These include: slowing economic growth, even higher inflation and possibly even stagflation, rising unemployment and falling consumer confidence, etc. The prolonged conflict is likely to lead to downward revisions to sales forecasts. The effects of the ongoing war against Ukraine and its geopolitical repercussions – continued sanctions, trade bans with Russia, supply disruptions, higher military spending – mean that the crisis in Ukraine could have as big or even a longer-term impact on the global and European economy as the COVID-19 crisis and its aftermath[3]. "The world economy was already struggling with numerous challenges before the war (in Ukraine - author's note), such as lockdowns during the pandemic, climate change, energy problems. The migration crisis was smoldering. Now, as a result of Russia's aggression against Ukraine, there are problems with millions of refugees from Ukraine, problems with food, including grain supplies, energy crisis and high inflation"[4]. In addition, the war in Ukraine also brought a food and energy crisis, which are also inflationary factors.

First, energy. Energy prices have been volatile since mid-2021. In the Versailles Declaration of March 2022, the leaders of the 27 EU member states agreed to end the EU's dependence on Russian fossil fuel imports as soon as possible. On 30-31 May 2022, the European Council decided that by the end of 2022, the EU would stop importing almost 90% of its oil from Russia, with a temporary derogation only for oil delivered via pipelines[5]. Russia previously supplied Europe with around 140 billion cubic meters of pipeline gas, but in 2022 it supplied only 76 billion cubic meters, half as much. Europe has managed to cope with this problem, albeit with heavy losses. In 2023, Russia supplied around 25 billion cubic meters of gas, including gas transported via the Turkish Stream and transit through Ukraine. Of course, even in such conditions, Europe is coping; no one freezes in winter. However, Europe is paying high bills for becoming independent from Russian gas. These include,

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[3] W. Kukuła, *Skutki wojny na Ukrainie – długoterminowe ryzyka dla globalnej motoryzacji*, <https://magazyn.cartrack.pl/wojna-na-ukrainie-konsekwencje-dla-motoryzacji/> (20.10.2022).

[4] V. Movchan, Research Director at the Institute of Economic Analysis and Policy Consulting in Kijev, statement during the debate on „Krynica Forum '22 – Wzrost i Odbudowa", <https://www.rp.pl/wydarzenia-gospodarcze/artykul/37296281-wplyw-wojny-w-ukrainie-na-gospodarke> (25.10.2022).

[5] *Rynkowe skutki rosyjskiej inwazji na Ukrainę: reakcja UE,* <https://www.consilium.europa.eu/pl/policies/eu-response-ukraine-invasion/impact-of-russia-s-invasion-of-ukraine-on-the-markets-eu-response/> (25.10.2022).

among others: a one-third drop in income in industry, billions of euros spent on keeping gas prices for households under control, record inflation, which the ECB is fighting with interest rate hikes, a slowdown in the European economy and the threat of recession in the entire eurozone. Germany alone spent 18 billion euros at the end of July 2022 on measures to limit electricity and gas price increases. In December of that year, 22.7 billion euros were allocated for consumer benefits for energy supplies. The entire package of support measures is estimated at 200 billion euros. Even the economy of wealthy Germany cannot withstand such expenditure. At the end of August 2023, German Chancellor Olaf Scholz admitted to Bloomberg that Germany lacks the funds to subsidize electricity prices in the long term. According to forecasts by leading experts from the Institute of German Economics and the international consulting company Frontier Economics, published on the website of the authoritative analytical center Dezernat Zukunft, the current high energy prices can seriously threaten the economic situation in Germany. The study shows that if the German authorities fail to develop effective measures to reduce energy costs for industry and business, the German economy may lose up to 1.7 million jobs by 2030. This will inevitably lead to a decrease in the republic's gross domestic product by 1.7-4.5%. At the same time, even after the implementation of large-scale programs to switch to such a promising type of fuel as “green” hydrogen, electricity prices in Germany, according to experts, will exceed the world average by 30-65%[6]. A study conducted by the leading German Chamber of Industry and Commerce confirmed the concerns of the business community in Germany. 52% of companies negatively assess the impact of the energy transition on their activities due to rising costs and the likelihood of energy shortages. Analysts say that without a return to cheap Russian gas supplies, fuel and electricity prices in Germany are likely to remain extremely high, which would seriously harm the country's economic competitiveness. Hence, there are voices in Berlin about the need to repair the blown-up Nord Stream 1 and 2 gas pipelines[7].

Secondly, industry. In recent years, Europe has been deindustrialized. Industrial production fell by 20% in 2022 and by 10% in the first half of the comparable period in 2023, although it would seem that gas prices in 2023 are much more convenient (not $1,000-3,000 per thousand cubic meters, but only $400-500). This means that the European industry has reduced its production by almost a third. A number of industries in Europe have been closed, mainly energy-intensive chemical plants for the production of mineral fertilizers, and

[6] K. Surdyk, *UE i NATO wobec zagrożeń hybrydowych*, [in:] *Rzeczpospolita Polska w NATO i UE*, ed. Z. Nowak, Warszawa 2024, pp. 261-292.

[7] M. Kretschmer, From an interview with the Prime Minister of a German federal state Saksonia, Michael Kretschmer for “Wirtschaftswoche”, 25-26.08.2023.

part of their production has been moved from Europe to the USA. In the United States, compared to Europe, there is a better investment climate and more favorable conditions for further work. As Bild writes (issue of August 21, 2023), as a result of restrictions on the import of Russian gas for the chemical industry, gas prices in Germany have increased by 40%, and the cost of producing mineral fertilizers by 150%. In this situation, "gas-intensive fertilizer production" turned out to be "unprofitable", and the supply of "Russian fertilizers to the EU", according to the industry, "increased fivefold over the year". Some experts believe that Russia treats the food crisis as a weapon. Previously, this was said about energy sources, and no one took food problems into account, especially at the EU level. Meanwhile, it was clear that Russia was preparing for war, as it stopped exporting fertilizers and developed its production capacities in the agri-food sector. In the meantime, Russia was developing this sector of the economy, becoming an exporter of food. Ukraine is also an exporter of food, and the war of these countries immediately affected the food situation in other countries[8].

Thirdly, finances. The Ukrainian conflict has also created certain threats to the finances of the European Union. Although in the sphere of finances, it is primarily the United States and Europe that are the attacking parties. In the geopolitical game with Russia, the West has used a financial weapon that is very painful for this country. It has blocked its currency reserves, mainly in dollars, but also reserves in euros, British pounds and yen. Russia's ability to make payments in these currencies has also been seriously limited, by disconnecting major Russian banks from the international SWIFT financial transaction system. In principle, after such radical steps, one could calmly watch the collapse of Russian finances, if not for the fact that very disturbing movements have begun in the global financial system, which may indicate that such actions by the West may be a "double-edged sword". It is expected that the war and the humanitarian crisis in Ukraine, the sanctions imposed on Russia and the risk of the conflict expanding - these are factors that will have a significant and multi-directional impact on the central banks and the entire banking sector of the European Union countries. Although the risks of banks in individual EU countries differ, we can identify a wide range of closely related threats[9]. These include: financial sanctions, legal and image risks, macroeconomic, market and credit risks related to high market uncertainty, as

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[8] J. Kwieciński, V-ce President Pekao Bank, statement during the debate on „Krynica Forum '22 – Wzrost i Odbudowa", <https://www.rp.pl/wydarzenia-gospodarcze/artykul/37296281-wplyw-wojny-w-ukrainie-na-gospodarke> (25.10.2022).

[9] *Konsekwencje wojny w Ukrainie dla europejskiego sektora bankowego. Wpływ na banki centralne i cały sektor bankowy państw Unii Europejskiej*, <https://kpmg.com/pl/pl/home/insights/2022/04/artykul-konsekwencje-wojny-w-ukrainie-dla-europejskiego-sektora-bankowego.html> (22.04.2022).

well as the need for some banks to update their strategies and business models, especially in Eastern Europe. The coming months will be critical for understanding how events will unfold. Banks must ensure that they take appropriate preventive measures. It is difficult to predict how the crisis will evolve and what its ultimate impact on the Western economy and its banking sector will be. However, experts recommend that European banks in particular take the necessary steps to ensure resilience to various scenarios of economic development. In Poland, the war in Ukraine has caused a deterioration in the macroeconomic environment due to the impact of both supply and demand factors. Although the shock related to the crisis in Ukraine is not able to shake the foundations of the Polish banking sector, it may amplify existing tensions or weaknesses in the banking system. In particular, the greatest threat to the stability of the banking sector is the occurrence of many shocks in a relatively short horizon, generating losses in the banking system or negatively affecting the long-term ability of banks to generate profits.

A certain threat to the entire Western financial system, the Bretton-Woods system, based on the dollar, is the desire of Russia, but also China and other countries affected by Western sanctions, such as Iran or Venezuela, to conduct financial settlements bypassing Western currencies, and above all the main, world settlement currency, the US dollar. These countries are trying to convince their allies to settle in national currencies, and they themselves are starting to experiment with digital currencies, and even attempt to create a common currency, e.g. a common currency of the BRICS countries. The BRICS countries, led by Russia, are also examining the possibility of creating their own settlement system in foreign trade. Such a solution may be very profitable for these countries economically, but dangerous for Western countries from a political point of view, because it will make the BRICS countries independent of the will of Western politicians. It is to be an "independent settlement payment system based on the digital principles of blockchain". This settlement system was first discussed during the meeting of the finance ministers and central bank governors of the BRICS countries in Sao Paulo, Brazil, in 2024. A decision was made to prepare a report that will include a list of initiatives and recommendations in the field of financial settlements of the organization, including consideration of the possibility of creating a common settlement and payment platform BRICS Bridge. It is also worth noting that within the framework of financial cooperation in BRICS, special emphasis is placed on increasing the share of national currencies in mutual settlements and creating an independent, equally accessible financial infrastructure[10].

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[10] *Finance ministers discuss BRICS Bridge digital currency payments*, February 28, 2024, <https://www.ledgerinsights.com/brics-bridge-digital-currency-payments/> (28.02.2024).

Needless to say, such initiatives, in which Russia actively participates, help to bypass the sanctions imposed on it and mitigate the effects of the economic war waged against this country.

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