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COMMENTARY

Long-term business implications of Russia's war in Ukraine

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Abstract

Following its invasion of Ukraine, Russia's macroeconomic stability will worsen; foreign trade and Russia-bound investment will dry up; and human capital will become scarce. Russia will not fully compensate these losses with increased economic engagement with China, with particular deficiencies likely in high-tech areas for Russia. Import substitution is also unlikely to allow Russia to innovate its way out of economic isolation or escape the resource curse. As Kremlin-connected elites further dominate the impoverished economy, crony state capitalism and kleptocracy will rise. The global repercussions of Russia's war will include commodity shocks and the attendant supply chain disruptions and inflationary pressures. In terms of FDI, the global industries in energy, auto, and consumer goods will be particularly affected. The loss of the Russian market will be less critical to sales revenues. Structurally, Russia's forced decoupling from the global economy may lead to the fragmentation of global financial infrastructure and the formation of economically contained blocks.

Keywords Geopolitics · Russian war · Sanctions · De-globalization · Business climate

Russia's 2022 invasion of Ukraine triggered historically unprecedented sanctions against state-affiliated individuals, companies, and financial institutions (including Russia's Central Bank). Formal sanctions imposed by governments were compounded by informal pressure on private companies to leave the Russian market, leading to a corporate exodus by multinationals.

Taken together, these measures have kneecapped the world's 11th largest economy in three major ways. First, Russia's macroeconomic stability is under assault—with inflation climbing, the value of the ruble precarious, and the default on Russia's

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foreign debt possible. Second, trade and foreign investment activity in Russia have collapsed. Third, disconnecting major Russian banks from the SWIFT global payment network has cemented the country's economic isolation.

This article specifies the long-term repercussions of the war in Ukraine for Russian firms and, separately, for the global business landscape in terms of the affected industries and the overall economic realignments following the geopolitical upheaval.

Business implications for Russia

The long-term global competitiveness of Russian business will decline drastically, due to (a) reduced technology transfers, (b) supply chain disruptions, and (c) 'brain drain'.

In terms of technology, the US-led effort to restrict high-tech exports to Russia—particularly in microelectronics, telecommunications, as well as aerospace and naval equipment—has been joined by key global producers. Historically, Russia's high-tech imports (worth $19 billion annually) have mostly come from the EU (45%), the US (21%), and China (11%).[1] By losing its NATO-aligned suppliers, Russia will have to increasingly rely on China for its high-tech needs. It is unlikely, however, that China will fill Russia's needs across the spectrum. In particular, the production of semiconductors—crucial for sustaining a modern economy via computer systems, smartphones, medical and military equipment, as well as batteries and electric vehicles—is dominated by the US and Asian nations such as Taiwan, Korea, and Japan, all of whom have signaled their cooperation with the US sanctioning efforts.[2]

The supply chain disruptions felt by Russian businesses as a result of the high-tech blockade will be worsened by payment difficulties. The latter result from both the external sanctions (e.g., disconnecting Russian banks from SWIFT) and Russia's internal capital controls (introduced to shore up the value of the ruble). Russia's Central Bank signaled that alternative arrangements will be made for the processing of cross-national payments, yet these are unlikely to fully resolve the problems. Overall, Russian companies will see their foreign supplies disrupted even for goods that are not directly sanctioned.

Finally, at least 200,000 Russian workers—above all the younger and better educated tech labor—have left the country since the invasion. This brain drain, combined with supply chain disruptions and technology shortages, will seriously reduce Russia's global competitiveness.

Still, there will be a (very slim) silver lining to this downward spiral. As the new economic Iron Curtain descends, Russian domestic producers will find a market without international competitors. While the Russian consumers' purchasing power will have shrunk, domestic businesses will have a captive audience for their goods

[1] https://www.bruegel.org/2022/03/the-decoupling-of-russia-high-tech-goods-and-components/

[2] https://www.forbes.com/sites/arielcohen/2022/02/28/western-sanctions-aim-to-cut-off-russia-from-critical-high-tech-goods/?sh=205f485e6d8b

and services. From e-commerce to streaming services to cars, the Russian economy may see a revival of domestic production and innovation over the long run. While the Russian government has time and again vowed—and failed—to diversify the economy away from energy exports, the country's current isolation may forcibly cure it from the 'resource curse'.

History offers little hope for such a renaissance of the Russian economy based on import substitution, however. The closest parallel here is Iran, another heavily sanctioned economy reliant on energy exports and led by a West-hostile government. Amidst waves of sanctions since the 1980s, Iran has seen the rise of domestic producers across all sectors of the economy. However, their products tend to be low-quality knockoffs rather than innovative solutions.

Iran's case offers another warning for Russian firms—namely, the increasing statization of the economy by a militarized and corrupt regime. In Russia's state capitalism, private entrepreneurs have dominated middle- and small-size businesses, while state corporations, i.e., the entrenched cronies of Vladimir Putin, have controlled the 'commanding heights' in strategic sectors (Markus, 2017). While Russia has always been a competitive kleptocracy under Putin (Markus, 2015), today's shrinking of the economic pie means that Putin must find new ways to 'feed' his cronies. Putin's oligarchs, particularly those connected to the military and the FSB (and hence critical to Putin's hold on power), are likely to absorb new sectors of the Russian economy, crowding out state-independent entrepreneurs (Markus, 2022).

Implications for global business

Russia's war and Western sanctions will have broad implications for the global business landscape as well. As a producer of 11% of global oil and home to 25% of the world's natural gas reserves, Russia will continue to impact energy markets. The increasing boycotts of Russian energy will inflict losses on companies such as BP and Shell, drive up prices, and fuel global inflation—while also speeding up structural shifts toward renewable energy and liquified natural gas technology, particularly in Europe.

The commodity shock extends beyond oil and gas. Russia is a top producer of precious metals such as palladium (needed for catalytic converters) and the world's third biggest steel exporter, for example. Russia is also a leading exporter of fertilizer (particularly of nitrogen, phosphorus, and potassium kinds), with many developing countries in Africa, Latin America, and Asia relying on Russia for affordable harvests. The disruption of these trade flows, combined with the implosion of Ukraine's agricultural exports (especially grains and vegetable oils), is threatening the global food markets.

Separately, the restriction of Russian air space (in retaliation for Western countries' ban on Russian airlines) for 38 countries—including all of the EU, the UK, and Canada—will inflate airlines' costs as they must navigate around Russia's huge Eurasian landmass.

Meanwhile, Western FDI providers with greatest exposure to Russia (outside of the energy firms) include auto and consumer goods industries. Companies such

as Volvo, Daimler Benz, Volkswagen, Renault, Nissan, Volkswagen, as well as Carlsberg and Danone have experienced major (and often self-imposed) disruptions to their Russian production facilities. More gravely still, the Russian government has threatened the nationalization of assets abandoned by Western multinationals in the country.

At the same time, the revenue exposure of global players to Russia is relatively modest since Russian consumers constitute a relatively small share of the global market. Among the most exposed are Philip Morris International (8% of global revenue from Russia), McDonald's (4.5%), and PepsiCo (4.3%).

Finally, at a deeper structural level, Russia's war, Western sanctions, and the ongoing geopolitical turmoil may trigger a long-term fracturing of the global financial system that would affect global businesses for decades to come. The economic devastation unleashed on Russia has sent a powerful signal to other regimes that may run afoul of the West which controls the global financial infrastructure. The signal is: create alternative infrastructure asap. We may see a fragmentation of payment networks, a proliferation of state-issued digital currencies, "sovereign internet" (as Russia termed its largely failed effort), etc. China's advances to-date on all these fronts may be accelerated in the future by Russia's war. The global geopolitical realignment and the early signs of a China-Russia anti-Western partnership imply that businesses need to prepare for an emergence of Cold War blocks amplified by infrastructural decoupling. The challenge for business is how to span the blocks effectively and act as a bridge-builder in the eyes of the stakeholders.

Conclusion

Overall, Putin's decision to invade Ukraine will likely downgrade the competitiveness of the Russian economy for years to come. While the country's ostracism may subside after the end of the war, the stigma of Putin's regime will be long-lasting. Foreign investment and trade with Russia are unlikely to bounce back to their previous levels, and Russia's 'brain drain' will continue as long as the Kremlin suffocates the domestic politics and the economy. Geopolitically as well as economically, Russia will increasingly rely on China—yet this unbalanced partnership is unlikely to lead Russia out of its economic doldrums. The global repercussions of Russia's war will be particularly felt in commodity markets including not only oil and gas but also a variety of critical precious metals. Finally, Western sanctions on Russia may unintendedly accelerate de-globalization by forcing preemptive decoupling by regimes that are non-aligned with or hostile to the West.

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