Wolters Kluwer

War and Globalization: Invasion of Ukraine brings surging energy and food prices around the world

SPECIAL REPORT | The Ukraine Crisis

Russia's invasion of Ukraine was shocking for multiple reasons, including the fact that such a brazen act of cross-border aggression struck many as anachronistic. But the extent to which it is shaking up the world's economy is very much a sign of our modern, globalized times. This is particularly evident when it comes to energy and other commodities.

We often fret about price increases, yet we rarely probe their underlying causes. Select shortages of consumer goods during the COVID-19 pandemic changed this, suddenly making discussions about global supply chains more relevant to all of us. Now, the war in Ukraine is forcing us to reflect on the origins of the commodities that touch on virtually every aspect of our lives, including how we travel, how we warm our homes, and what food we eat.

The disruptions to energy and food supplies sparked by the conflict and resulting sanctions will leave few consumers and companies untouched. High inflation is already a concern, and the risk of price gouging looms. Radical measures such as price controls may no longer be taboo. Leaders scrambling to minimize the damages have several options, but panaceas are elusive.

SAPPING RUSSIA OF ITS ENERGY: BANNING OIL AND GAS IMPORTS

With energy exports a crucial source of income for Russia, calls for embargoes were inevitable for a global community looking for effective pressure points.

UNITES STATES MOVES SWIFTLY

The U.S.'s reaction was quick and aggressive. In early March, President Biden signed an Executive Order banning the import of Russian crude oil and certain petroleum products, liquefied natural gas, and coal products into the United States. Products that merely transit or depart from Russia are not affected. The ban also provides a 45-day grace period for previously purchased deliveries, but immediately bars new investments in the Russian energy sector. (The House overwhelmingly passed a bill with similar provisions soon thereafter.)

Though they are bold in tone, the moves have been deemed as primarily symbolic. Russian oil and gas imports play relatively limited roles in the United States. Exact estimates vary, but Russian oil amounts to about 8% of oil imports. Even before the new ban, sanctions already in place had prompted U.S. oil companies to seek alternative sources of crude oil. Yet the ban's unambiguous message and potential ripple effects may still pack considerable punch, as underscored by the growing number of pledges made by various players to cut all ties with Russian energy businesses.

Enforcing the ban will ultimately implicate myriad actors and rules, but specific units of the Treasury Department and Commerce Department will likely play important roles. The Treasury Department's Office of Foreign Assets Control (OFAC) is responsible for enforcing U.S. economic sanctions programs, while the Commerce Department's Bureau of Industry and Security oversees import and export restrictions. Both agencies have the authority to impose significant fines and can refer cases to other agencies for enforcement actions, both civil and criminal.

OFAC has already issued some guidance relating to the ban. The Department of Homeland Security's Customs and Border Protection is also involved, and has issued guidance regarding the required documentation for cargo arriving at U.S. ports of entry from Russia.

UNITED KINGDOM

The United Kingdom announced that it will phase out imports of Russian oil by the end of 2022, and has vowed to explore ways to end its use of Russian natural gas. Like the United States, the United Kingdom meets about 8% of its oil demand with supplies from Russia. Natural gas from the country makes up even less of its supply – under 4%.

EUROPEAN UNION

The European Union is heavily dependent on Russian energy supplies. Levels vary from country to country, but the European

Commission estimates that Russia provides over 40% of the EU's gas imports, around 25% of its oil imports, and 45% of its coal imports. As a result of this dependence, the bloc's reaction has been more muted and focuses on weaning itself from Russian oil and gas in the long run. Specifically, the EU's plan aims to reduce its demand for Russian imports by two-thirds this year, and to reach energy independence from the country before the end of the decade.

The so-called "RePowerEU" plan announced by the European Commission – the EU's executive arm – includes requiring increased gas storage by October of each year and diversifying supply. Diversifying supply involves finding more liquefied natural gas (LNG) partnerships, increased biogas production, speeding up the use of renewable hydrogen, and fostering more traditional renewables such as solar.

Meanwhile, the most recent package of the bloc's sanctions on Russia – which previously purposely avoided covering energy – includes a ban on new investments in the Russian energy sector.

HUNTING FOR ALTERNATIVES

Finding alternative sources of energy for Europe involves no easy options. Ultimately, moving towards independence will likely involve embracing an awkward mix of the old and new. Solutions will also vary greatly from country to country. Undoubtedly, energy efficiency will be an overarching theme.

Before Russia's invasion of Ukraine, both natural gas and nuclear energy had been touted as reasonable interim options for EU countries seeking to phase out fossil fuels like oil and coal. Support for nuclear energy, however, varies tremendously throughout the bloc. France has been its strongest promoter, while Germany has already planned to shut down its nuclear plants by the end of this year. Both viewpoints are supported by other EU countries.

It remains to be seen how the conflict in Ukraine will affect the balance. Recurring reports of possible damage to nuclear power plants scattered across the embattled country serve as unsettling reminders of possible risks. Yet leaders across Europe, including Germany, are already calling for a re-think of current phase-out plans. Similarly, letting go of coal more slowly than envisioned is no longer off the table.

LNG also looms large as a part of the overall picture. Though less damaging to the environment than coal or oil, its ecological footprint is a topic of considerable debate. In addition, there are several practical hurdles. Germany, for example, faces a lack of appropriate terminals to move deliveries of LNG into local pipeline systems.

Meanwhile, calls to intensify investments in developing renewable energy sources, such as solar and wind power, have also grown. Renewables pose their own issues. The amount of sun and wind fluctuates, and storing power derived from such sources remains problematic. Still, these "freedom energies," as Germany's finance minister has dubbed them, now clearly have fresh wind at their back.

FOOD SECURITY

Many observers had at least some inkling of Russia's important role in meeting global oil and gas demand. Its role, together with Ukraine, as the 'world's bread basket' likely caught many off guard, however.

The two countries' vast agricultural lands produce crops exported to an array of countries in the Middle East, Africa, Asia, and Europe. These exports make up considerable shares of the global wheat, corn, and sunflower product supplies. Russia is also a major exporter of nutrients used in fertilizers, and fertilizers were expensive even before sanctions were imposed due to rising natural gas prices.

The West's direct exposure is relatively limited, but governments may quietly be contemplating reducing their own exports to ensure domestic supply. Moreover, food shortages and price spikes in even distant regions may very well trigger political upheaval that would ultimately be felt around the globe.

The timing is especially delicate. With Ukrainian farmers joining their country's defense forces, the spring planting season is at risk. Even if they are successfully planted, crops need to be cultivated, harvested, and transported to consumers – but Ukraine's Black Sea ports are practically closed and various factors, particularly sanctions, limit Russian exports.

PRICES, PRICES, PRICES

The risk of spiraling costs for a wide range of goods is real. Sectors that rely heavily on energy, such as transportation and manufacturing, will be especially hard hit. Global players may feel the squeeze first. Companies in a wide range of other sectors will ultimately be affected, even if those companies are more localized and do not have a transnational reach.

Raising prices will be unavoidable, and some may be tempted to do so dramatically. President Biden explicitly enunciated this

risk when issuing his Executive Order when he urged domestic oil companies not to engage in "profiteering or price gouging."

PREVENTING PRICE GOUGING

To what extent warnings about price gouging, and relevant prohibitions, can protect American consumers remains to be seen. Price gouging occurs when sellers exploit sharp demand surges by charging prices that exceed the typical market price. Natural disasters often trigger such practices, but the COVID-19 pandemic is a more analogous example, given its broad effects and uncertain duration.

The pandemic triggered somewhat unusual involvement with pricing at the federal level, with the Department of Justice turning to a law from 1950 – the Defense Production Act – to counter the accumulation of scarce materials for purposes of price gouging.

Price gouging is more typically, and more directly, regulated at the state level. The states have embraced varying approaches to this issue. In official states of emergency, anti-price gouging laws can provide important protection to consumers. Yet even during states of emergency they may be less than effective if the prices a seller is charging can be plausibly justified by prevailing market conditions. The conditions that justify an emergency declaration will affect sellers, by making it more difficult for them to obtain necessary products. Ultimately, there is a fine line between exploiting a situation and simply charging prices that create sufficient incentive to provide products that are suddenly immensely difficult to obtain.

PRICE CONTROLS: DRASTIC TIMES, DRASTIC MEASURES?

Price controls occur when the government sets rules on how much companies can legally charge their customers. These controls can be specific to certain industries or producers, or may be imposed more broadly. Proponents of price controls underline the need to protect consumers. Critics of price controls contend that price caps exacerbate the problem they are meant to address by failing to reduce consumption, resulting in shortages, and also undermining both new and long-term investments.

Price controls are rare in the U.S., but not unheard of. In addition to being applied during both world wars and the Korean war, they were also adopted by the Nixon administration during the economic instability of the 1970s. Initially, all prices – and all wages – were frozen. Eventually, prices were allowed to rise if approved by a government commission. Longer-term price controls were imposed on both oil and gas, and the controls stayed in place, in varying forms, throughout the remainder of the decade.

In certain sectors, such as utilities, price controls already exist. Utility companies come in private, public, or cooperative forms. Traditionally viewed as natural monopolies, they are regulated and run by both state and federal agencies. Both the Federal Energy Regulatory Commission and state public service commissions can have a say on the prices charged for utility services. Yet not all firms are subject to such control, and even those that need regulatory approval to raise rates are often allowed to recoup higher operating costs through customers.

TOUGH CHOICES AHEAD

It is too early to tell whether price controls for select goods are on the horizon. For now, in the U.S., less direct efforts, such as controlling inflation through interest rates, remain the focus. Securing alternative sources of energy is another clear priority, including from countries with their own murky records on rights. Strategic reserves will also need to be tapped.

Both in the United States and in Europe, the current flurry of activity by leaders shows that several options are available. Unfortunately, what unites them is that none are easy to embrace. ■