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The Economic Consequences of Political Factors: Energy, Finance, and Policies

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Abstract: It has been more than one year since the outbreak of the Russia-Ukraine conflict. In addition to the intense military actions on the surface, the confrontation between the parties in the economic field is equally intense. Taking the Russia-Ukraine conflict as an example, this paper is dedicated to illustrating the political impact from an economic perspective, to provide lessons for the optimization of political and economic decisions of the countries concerned. This paper contains two main aspects. The first is the impact of the Russia-Ukraine conflict on the energy market, financial market, etc. The second is to explore the impact of sanctions and counter-sanctions from both sides on Russia and the global economy. This article provides new insights into the impact of political factors on the economy by exploring the impact of the political event of the Russia-Ukraine conflict on the global economic and financial markets and even the international political and economic landscape. The paper concludes by suggesting that both sides in the conflict should remain calm and rational to avoid further escalation and deterioration of the situation.

Keywords: Russia-Ukraine conflict, finance, energy, political economy

1. Introduction

Political economy is devoted to the search for political explanations of development, especially economic development, emphasizing the economic behavior of political processes and the political behavior of economic processes [1, 2]. War is a continuation of politics [3], and politics is a concentration of economics. Therefore, there is an inextricable relationship between politics and economy, and between development and security. The Russia-Ukraine conflict is a complex issue with intertwined political and economic factors, which needs to be studied deeper from the perspective of political economy.

The research in this paper includes the following: First, the economic and financial impact of the Russia-Ukraine conflict, focusing on the impact of the Russia-Ukraine conflict on energy markets, financial markets, etc. The second is the game analysis of sanctions and counter-sanctions, which focuses on the impact of sanctions on Russia and the global economy, and assesses the global impact of Russia's actions through an analysis of the series of countermeasures it has taken. This study uses a combination of literature research and case studies on the Russia-Ukraine conflict and is dedicated to exploring the political explanations for the economic outcomes to provide lessons for the optimization of political and economic decision-making in the countries concerned.

The main contribution of this paper is to use the theories and methods of political economy to explore in depth the impact and influence of the extreme political events of the Russia-Ukraine conflict on the global economic and financial markets and even the international political and economic landscape, to make a preliminary attempt to expand the topic of political economy research and to provide new insights about the influence of political factors on the economy.

The structure of this paper will be divided into five parts. In addition to the introduction and conclusion, the second part will focus on the analysis of the changes in global energy markets since the Russian-Ukrainian conflict through a comparison of historical and current conditions. The third part will focus on the impact and influence of the Russia-Ukraine conflict on Russian financial markets and global capital flows. The fourth part will focus on the game of sanctions and counter-sanctions, mainly exploring the impact of sanctions on Russia and the global economy, and assessing the impact of Russia's actions on the global economy through an analysis of the series of countermeasures it has taken.

2. Changes in the Energy Market

Russia is the world's leading energy producer and the largest energy exporter, with a significant position and influence in the global energy market. European countries are highly dependent on imported energy, especially on Russian gas, oil, and coal. Since the outbreak of the war, the United States, the United Kingdom, the European Union, and the G-7 have imposed a series of sanctions on Russia, including energy, and Russia has responded with counter-sanctions. These sanctions and counter-sanctions have caused turmoil in the energy markets over the past year and have led, for example, to direct disruption of Russia's energy cooperation with the EU-led Western countries. The continuously deepening Russia-Ukraine conflict has produced a series of serious negative effects, and a series of energy crises [4] and economic and financial crises have been spawned by the security crisis. These crises have had a lasting and profound impact on the theme of the era of peace and development, and have seriously disrupted the internal and external economic linkages of countries, especially developing countries. Among them, the energy market has borne the brunt of the impact, with increased risks to energy supply, increased volatility in energy prices (Figure 1), and dramatic changes in the structure of energy trade on a global scale, and the global energy market has begun to enter a period of complex games and deep adjustments.

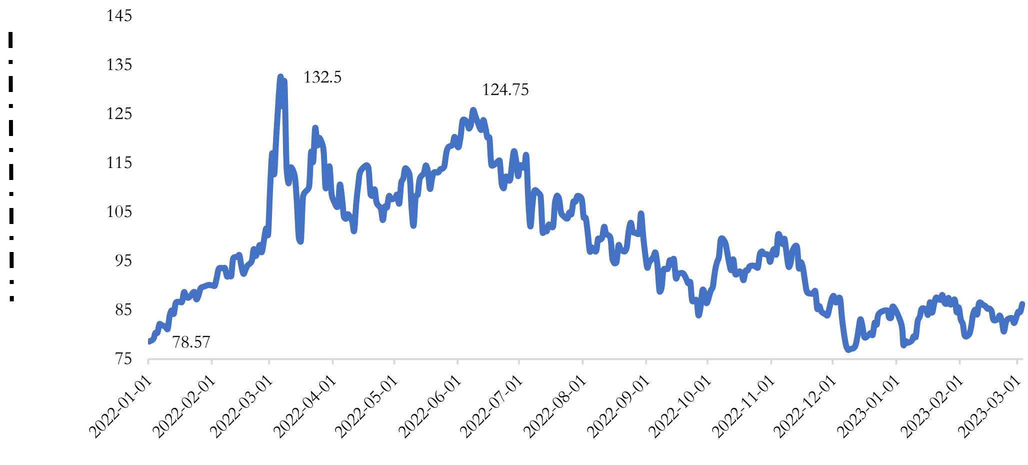

Figure 1: International Crude Oil Market Spot Price Trend.
Data source: Investing
Photo credit: Original

Of course, for different regions and countries, the impact of the Russia-Ukraine war on their energy markets is variable. Taking the crude oil market as an example, the current global crude oil consumption is mainly concentrated in Asia-Pacific, North America, and Europe, which account for 38.1%, 23.7%, and 14.4% of the global crude oil consumption market, respectively. In terms of further breakdown, the US, China, and the EU consume 19.9%, 16.4%, and 11.1% of crude oil respectively, showing a typical "three-legged stool", followed by India and Saudi Arabia with 5.2% and 3.8% of crude oil consumption respectively. This section is intended to be analyzed from the perspective of Europe, the United States, and other countries.

2.1. Europe

From the outbreak of the Russia-Ukraine conflict to date, the EU has implemented several rounds of sanctions packages against Russia, with measures related to Russian crude oil and oil exports dominating the sanctions package [5]. To date, the EU-Russia crude oil trade has seen a large change, with the EU's dependence on Russian crude oil imports decreasing from about 27% to about 16% currently, marked by the outbreak of the Russia-Ukraine conflict in February 2022. Further data show that EU imports of Russian crude oil were around 2.5 million bpd in January-February 2022, falling to around 1.4 million bpd in October, a reduction of around 1.1 million bpd. The cut was better supplemented by increased imports to the Middle East (+600,000 b/d), Africa (+400,000 b/d), Norway (+200,000 b/d), and South America (+200,000 b/d, Brazil and Guyana) [6]. Many people expected at the beginning of the sanctions that the EU would not survive the winter without Russian crude oil, but it seems clear that this judgment was overstated. This does not mean, of course, that Europe is not paying the price. Europe's energy needs have been supplemented by markets outside of Russia, but at the heavy cost of higher prices. Europe's primary energy consumption structure, the proportion of oil and natural gas up to 59%, while Europe's domestic oil and gas dependence degree of foreign more than 90%, in the energy security game in a disadvantageous position. Taking natural gas prices as an example, they have reached unprecedented levels in Europe since the outbreak of the conflict, rising about 14 times from the third quarter of 2019, before the new crown epidemic, to the third quarter of 2022. As a result of the spike in energy prices, European aluminum smelters, and zinc smelters began to cut production significantly, with capacity declines of more than 800,000 tons and 500,000 tons, respectively.

2.2. United States

Since around 2010, with the maturation of shale oil extraction technology and the partial lifting of the ban on extraction, U.S. crude oil production has moved rapidly upward and achieved energy self-sufficiency in 2017, driving the share of North American production back up from 17% to 27%. By BP caliber, the U.S. had become the world's top oil producer in 2014. At the same time, due to the highly market-oriented U.S. shale oil production, a pattern of competition between OPEC+ and U.S. shale oil has been formed, and the pricing power of OPEC+ has been weakened, limiting the volatility range of international oil prices to a certain extent. In addition, it is worth mentioning that U.S. crude oil exports to the EU have not increased significantly since the outbreak of the Russia-Ukraine conflict, which is inconsistent with many people's analysis that the U.S. has taken a share of Russia's energy, especially crude oil, the market in the EU. Of course, this does not mean that U.S. crude oil exports to the EU will not increase. According to forecasts by the three major international crude oil agencies, there is a high probability that the market gap for Russia's crude oil production in 2023, which is 1.5-2 million barrels per day lower than before the conflict, will be filled by an increase of around 1-1.5 million barrels per day from the US and 500,000 barrels per day from other non-OPEC+

producers. Not surprisingly, the US will likely be the potentially largest beneficiary in the event of structural changes in the global energy market as a result of the Russia-Ukraine conflict.

2.3. Other Countries

Russia is a major player in the global energy market, so the Russia-Ukraine war could have implications for other countries as well. For example, developing countries such as China and India import large amounts of oil and natural gas from Russia, so if Russian energy supplies are disrupted or restricted, these countries could face energy shortages and price increases. An examination of the general trends in the evolution of global crude oil consumption patterns over the past six decades reveals that, in terms of geographic location, the center of gravity of global crude oil consumption has gradually shifted from Europe and the United States to the Asia-Pacific region. In the eastward shift to the Asia-Pacific region, Japan was the dominant player until the mid-1970s, while China has been the dominant player since the 1980s. China's contribution accounts for about half of the increase in the share of consumption of non-OECD members, roughly equal to that of the other BRICs. Since the outbreak of the conflict, Russia's exports of crude oil and crude oil products to the West have fallen sharply, but exports to India, Turkey, and China have increased significantly, showing a typical east-to-west pattern. Comparing January-February and September-October 2022, it can be observed that Russian crude oil exports to India, Turkey, and China have increased significantly, reaching increments of 1 million bpd, 300,000 bpd and more than 200,000 bpd, respectively.

3. Financial Markets

The Russia-Ukraine military conflict that erupted on February 24 became a Black Swan event that exceeded most investors' expectations and had a broad and lasting impact on global financial markets. Overall, the Russian-Ukrainian war had a broad and lasting impact on Russian financial markets, capital flows and foreign exchange markets.

3.1. Russian Financial Market

First, the Russian-Ukrainian war led to instability in the Russian financial markets. The impact of the war and other factors led to a sharp decline in the exchange rate of the Russian ruble, causing investors' confidence in the Russian market to be undermined. In addition, the Russian economy and financial markets have been greatly affected by a series of economic sanctions adopted by the international community against Russia. These sanctions led to reduced liquidity in the Russian market, difficulties for investors to trade, and volatility and uncertainty in the market [7]. The Russian stock market fell sharply at the beginning of the conflict. on February 24, 2022, the dollar-denominated Russian RTS index fell by 39.44% in a single day, and as of February 28, 2023, the Russian RTS index fell by 38.35% in the interval from 1,534.82 points on February 10, 2022, before the outbreak of the conflict, with the maximum drop once more than 60% (Figure 2).

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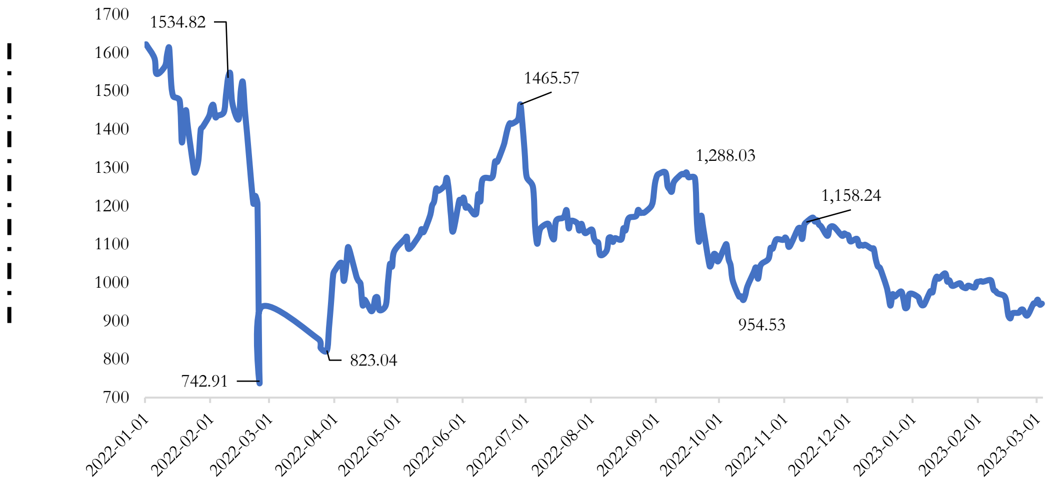

Figure 2: Russian stock market price trends.
Data source: Investing
Photo credit: Original

3.2. Capital Outflows

The outbreak of the Russia-Ukraine conflict has caused global financial markets to shake and commodity prices to fluctuate, coupled with the impact of the Federal Reserve's interest rate hike. Russia, which is deep in the center of the conflict, is beginning to face the dilemma of rising inflation and capital outflows. According to statistics released by the Central Bank of Russia, in the first quarter of 2022, capital outflows from Russia amounted to $64.2 billion, while the capital outflow figures for January-February 2022 were only $12.8 billion. This shows that in March, after the outbreak of the Russian-Ukrainian conflict, $51.4 billion flowed out of the country. This size already exceeds Russia's capital outflows of $50.3 billion for the whole of 2020 and 70% of the capital outflows of $72.6 billion in 2021. This trend is likely to continue as the conflict continues. This will have a further impact on the performance and stability of Russian financial markets.

The scale of capital outflows from Russia in March was still greatly restricted scale of outflows due to a series of measures implemented by the Central Bank of Russia since around the beginning of March, including the suspension of stock market transactions, a strict ban on the purchase of foreign currency by companies and individuals, a ban on the transfer of money from companies and individuals to foreign accounts, and a strict ban on the sale of stocks and Russian assets by foreign investors. According to Interfax experts' estimates, international companies that evacuated Russia still have more than $200 billion in fixed assets and liquid assets such as stocks and debentures in Russia that could not be realized out of the country due to Russian government control measures [8].

3.3. Foreign Exchange Market

The foreign exchange market is one of the largest and most active markets in the global financial markets and is an important basis for international trade and investment. While the Russia-Ukraine conflict has had an impact on financial markets in Russia and globally, it has also inevitably had an impact on the foreign exchange market [9]. Looking first at the exchange rate fluctuations in Russia, tensions have arisen in the Russian foreign exchange market due to the international sanctions against Russia. As a result, the Russian government has had to take several measures to protect its foreign exchange reserves, which has further increased uncertainty and volatility in the foreign exchange

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market [10]. The conflict led to increased volatility in Russia's exchange rate, with the dollar-ruble exchange rate at one point rising from around 70 to around 120 in January 2022, and although the Russian ruble later strengthened back to pre-war levels, volatility increased sharply throughout, with a large impact on Russia's economic and financial stability (Figure 3).

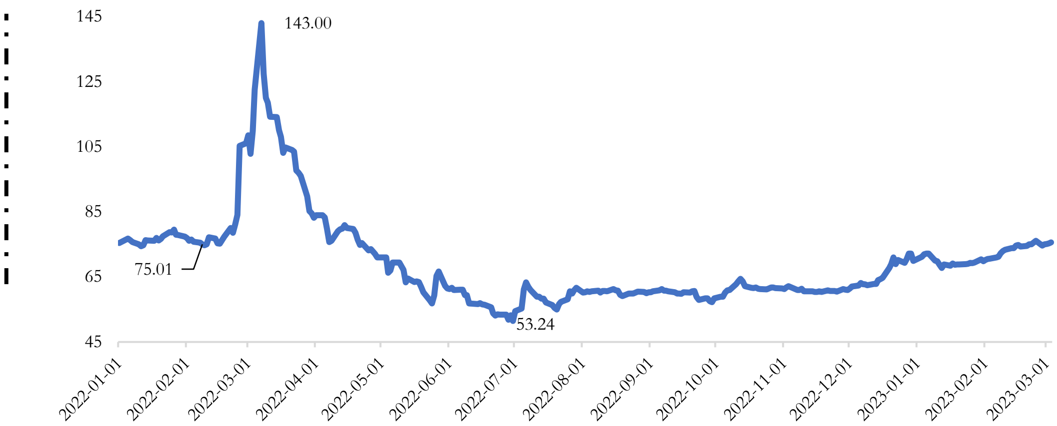

Figure 3: Russian exchange rate (USD to RUB).
Data source: Investing
Photo credit: Original

Looking next at exchange rate fluctuations in the euro area, the euro exchange rate accelerated its decline after the outbreak of the Russia-Ukraine conflict, and the euro started a new round of depreciation against the U.S. dollar. the euro-dollar exchange rate fell to its lowest point in nearly 20 years in September 2022 (Figure 4). At the same time, the dollar index strengthened all the way to its highest point since May 2020. The weakness of the euro against the dollar is not only a sign that Europe's economic recovery is weaker than that of the United States, but also a reflection of the Russian-Ukrainian conflict that has brought more uncertainty to the European economy.

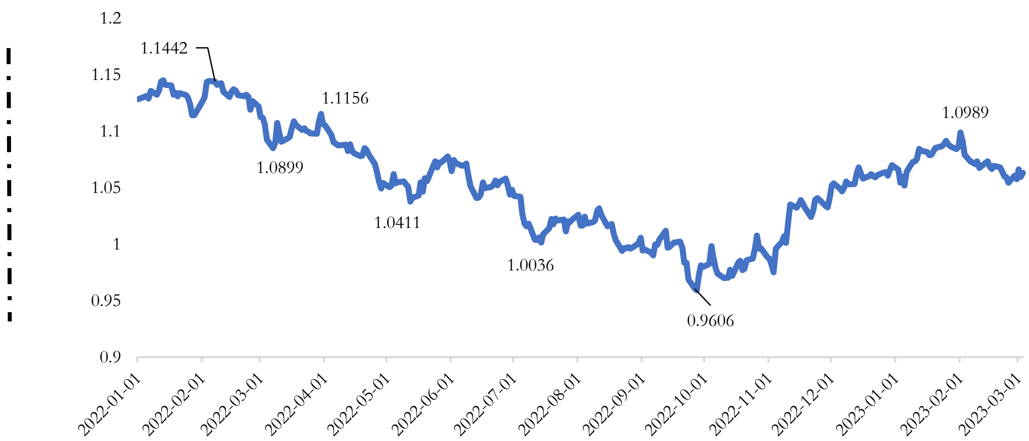

Figure 4: Eurozone exchange rate (EURUSD) movements.
Data source: Investing
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4. Economic Sanctions and Countermeasures

4.1. US, EU Member States, etc. Sanctions Against Russia

On the surface, the sanctions are intended to make it difficult for Russia to finance the war in Ukraine and to make those responsible for the Russo-Ukrainian war (e.g., the Russian political elite) bear the corresponding economic and political consequences. In terms of potential objectives, the EU needs sanctions to reduce the geopolitical pressure caused by the Russian-Ukrainian war, while the US can use them to capture a certain degree of the European energy market. Since the outbreak of the Russia-Ukraine conflict, the United States, the European Union, and others have successively imposed several rounds of sanctions on Russia, which mainly include the following.

Financial Sanctions: This is one of the most significant sanctions, including the prohibition of Western financial institutions from providing financing support to Russia, providing financing and credit facilities to Russian companies and individuals, and limiting Russia's access to financing in international financial markets. These sanctions have seriously affected Russia's economic development and financial revenues.

Trade sanctions: These include a ban on the export of military technology to Russia and restrictions on exports of energy and high-tech products to Russia. These measures have created a degree of repression and restrictions on Russia's energy exports and military industry.

Individual sanctions: Sanctions, including asset freezes and bans on entry, were imposed on Russian government officials and business people suspected of involvement in the territorial dispute in Ukraine.

Military Sanctions: These include an arms embargo on Russia and technological restrictions on the Russian military, which have limited Russian military modernization and upgrades.

Overall, the above sanctions have had a profound impact on Russia's economic and social life, but they have also caused a degree of economic damage and political pressure on the countries imposing the sanctions themselves [11]. In addition, as Russia is one of the world's largest energy exporters, these sanctions have also had a large impact and influence on global energy markets (Table 1).

Table 1: Sanctions against Russian oil in Europe and the US since the Russia-Ukraine conflict.

Time	Sanctions Content
February 26, 2022	The US announced that several major Russian banks were kicked out of the SWIFT international settlement system, but energy transactions were whitelisted.
March 7, 2022	The U.S. banned imports of Russian oil, gas and other products.
June 6, 2022	The EU Parliament formally adopted a sanctions package against Russia's energy sources, with a ban on imports of crude oil coming into effect on December 5; the ban on imports of petroleum products will come into effect on February 5, 2023.
Dec. 2, 2022	The provision of transportation and services for Russian oil (such as insurance, brokerage, and financial services) are subject to price caps.

4.2. Russia's Countermeasures

In response to a series of sanctions introduced by the U.S. and European countries, Russia has also taken a number of countermeasures. In general, Russia's countermeasures against the West are focused on the economic sphere, especially on the import and export of commodities, and include,

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inter alia. Given that Western sanctions are focused on the financial and energy sectors, Russia aims to mitigate the impact of sanctions on energy export markets and other aspects of social stability and smooth economic development through these measures.

Counter-sanctions against countries where the U.S. and Europe have introduced sanctions against Russia: The Russian government has imposed a series of economic counter-sanctions against the U.S., the EU, Canada, Australia, and other countries, including a ban on the import of some food and agricultural products, as well as tax measures such as VAT on goods from these countries.

Raising gas prices: Russia has a stronger voice in the gas market and can exert pressure on Western countries by controlling gas prices. Back in 2014, Russia removed preferential gas prices from Ukraine and increased gas prices by 40%. In addition, Russia plans to strengthen its gas cooperation with countries such as China to reduce its dependence on the European market.

Adopting financial countermeasures: Russia has taken a number of financial countermeasures, including reducing its bond investments in the U.S. and the EU and shifting to investments in Asian markets, while expanding its domestic bond market.

5. Conclusion

Overall, the impact of the Russia-Ukraine conflict on the global economy and finance is broad and lasting, including both negative impacts on both sides of the conflict, as well as on global energy markets and global trade and investment. First, the conflict has already led to economic weakness and currency devaluation on both sides of Russia and Ukraine and has negatively impacted domestic and international trade on both sides, which in turn could trigger regional inflation and political instability. Second, global energy markets have also been affected. Russia is one of the world's largest exporters of natural gas, and Ukraine is one of the main transit countries for gas pipelines. As a result, tensions in the region could lead to disruptions in natural gas supplies, with significant implications for global energy markets. Third, tensions over regional conflicts could have a negative impact on global trade and investment, which could lead to a slowdown in international capital flows and slower economic growth.

In conclusion, the future development of the Russia-Ukraine conflict is complex and uncertain, as it involves multiple factors and interests. First, the current tensions in the conflict are likely to continue for some time, which could lead to more clashes and violence, especially in the border areas. The parties may try to reach some kind of compromise in the regional conflict, but this will require joint efforts and compromise by all parties. Second, Russia may continue to use economic sanctions and other means to exert pressure to ensure that its interests in the Ukraine conflict are safeguarded. This could lead other countries to take a tougher stance against Russia, including sanctions and other forms of confrontation. Third, the Russian-Ukrainian conflict could affect the security and interests of other countries. For example, Russia may strengthen its threat to Europe and NATO, particularly in the Baltic region. In addition, the conflict could also increase tensions in the Middle East, particularly in places such as Syria and Iran. Fourth, over time, Ukraine may fall more to the West to reduce its dependence on Russia. This could lead to a further deterioration of relations with Russia, but it could also strengthen cooperation and relations with Western countries such as Europe and the United States.

Development and security are closely related, and the two have a positive feedback of mutual promotion. Development is the guarantee of security, and security is the premise of development. Every country should take people's interests and national security as the fundamental starting point, effectively integrate the relationship between development and security, respect the sovereignty of all countries, abandon the Cold War mentality, and the reasonable security interests and concerns of all countries should be taken seriously and properly resolved, seeking a win-win development situation. Therefore, both parties to the conflict should remain calm and rational, and resolve their

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differences and problems through dialogue and consultation to avoid further escalation and deterioration of the situation. The United States and NATO member countries should also take measures to reduce tensions in the region to prevent further negative impacts on the global economy and finance.

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